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Malawi: Lessons Learnt from First Reforms Lead to New Approach

by
Chauncy Simwaka*

Malawi provides valuable experience on the advantages of a holistic approach when attempting reforms, and on how to manage longer reform programmes. Since 1995, the budget process has been based on the principles of the Medium-term Expenditure Framework. This article presents the findings of a comprehensive review of the MTEF in 1999/2000 which examined its strengths and weaknesses, the possible causes and the proposed reforms required. MTEF Phase II is targeted at strengthening the management and co-ordination of the budget process, ensuring that there is political leadership of the budget process, improving policy and budget scrutiny processes, and strengthening financial accountability systems. The article also draws on a review of the education sector for a line ministry perspective on whether and how budgetary reforms assist in improving service delivery.

* Chauncy Simwaka is the Deputy Budget Director in the Ministry of Finance, Malawi.

1. Introduction

This article presents a synopsis of a programme for public expenditure management (PEM) reform in Malawi, focusing on the consolidation and revitalisation of the Medium-term Expenditure Framework (MTEF) and the introduction of Public Expenditure Reviews (PERs).

The aim of the second MTEF phase is to provide a co-ordinated framework for donor assistance to PEM and a framework for co-ordination within government, by linking together all the previously *ad hoc* and marginal reform processes into a coherent whole. The reform programme is also an essential complement to the Malawi Poverty Reduction Strategy Paper (MPRSP). Together, the MPRSP and the MTEF/budget form the core of the Malawi government's planning, budgeting and monitoring framework.[1]

Improved public expenditure management is crucial to Malawi's poverty reduction efforts for at least three reasons. First, improved PEM is a prerequisite for stronger fiscal discipline and therefore macroeconomic stability. Without macroeconomic stability, poverty reduction will be impossible, as high interest rates impede investment and growth, and inflation erodes the real incomes of the poor. Second, improved PEM is essential if the objectives of the MPRSP are to be met, since it is clearly stated in the MPRSP that the budget is a principal vehicle for its implementation. Thus, improved PEM will ensure that public resources are allocated to priority areas and will produce value for money.[2] Third, the MPRSP is expected to bring a shift by donors away from donor-driven project-based support towards programme or general budgetary support with reduced conditionalities, more regular inflows and improved government ownership. However, this shift will not occur unless significant improvements are made to the budget process using an MTEF approach, so that the donors are assured that their financial support will be utilised on priority activities as stated in the MPRSP.

In Malawi, the MTEF is being implemented at a time when government is adopting other reforms across the public sector. In addition to the overall programme for the reform of the public sector, there are specific initiatives, such as sector investment programmes (SIPs) and sector-wide approaches (SWAPs), which are directly related to the MTEF. In the past, such initiatives have been seen as separate donor-driven "add-on" activities requiring only temporary and minimal changes to "business as usual". This programme is intended, in part, to address these problems by defining a Malawi-owned coherent reform package that will transform the PEM system.

2. Background

2.1. Evolution of the MTEF in Malawi

The central tool for PEM is the budget process, which since 1995 has been based on the principles of the Medium-term Expenditure Framework (MTEF). The MTEF was introduced in order to correct some of the problems of the existing budget process in Malawi. These problems were highlighted in the 1990 Public Expenditure Review and the 1995 Budget Management Review conducted by the World Bank. The first central problem was the failure to link policy making and planning to the recurrent budget. Although the development budget (through the public sector investment programme) was generally well prepared by planners and based on overall government policy and planning,[3] the recurrent budget was not planned and was generally prepared on an incremental basis. The second central problem was that the budget system was focused on the short term rather than the medium to long term. Not only were budgets prepared for one year, the recurrent and development budgets were subject to separate analysis. This led to a strong upward bias in development expenditure (reinforced by donor pressure) and a shortfall in recurrent expenditure needed to maintain the development projects.

To address these problems, the MTEF was intended to introduce strategic, medium-term budgeting, bringing together the policy-making, planning and budgeting roles of government into a rolling three-year horizon. The focus was on the reallocation of expenditure to priority activities. As such, the role of the budget under the MTEF was to change from a centralised inventory of inputs adjusted on an incremental basis to an output-focused approach based on costings of priority activities and projections of available resources. In order to ensure consistency and comprehensiveness, the MTEF reforms were also intended to lead to the integration of the recurrent and development budgets.

The MTEF was introduced on a phased basis, starting in 1995/96 with five key ministries (Agriculture and Irrigation; Education, Sports and Culture; Health and Population; Works and Supplies; and Police – together accounting for 40% of the recurrent budget), expanding to 12 ministries in 1996/97 and covering all ministries and departments by 1997/98. The initial phases of the MTEF emphasised prioritisation through the production of logical frameworks. Although the emphasis was on the budgetary processes of the line ministries, the Ministry of Finance (MOF) managed the MTEF from the start.

2.2. Situation analysis

Progress has been made, including some shift of resources to priority sectors and the preparation of detailed activity-based budgets in selected sectors. By 1999, however, it became clear that the MTEF had not transformed the budget into an effective allocative and management tool. Sector policies remained unaffordable and resources were spread too thinly across many activities, substantial off-budget expenditures were taking place, and there were significant divergences between priority expenditures, as expressed in approved budgets, and actual expenditures. As a result, the MTEF failed to achieve aggregate fiscal discipline,[4] adequate direction of resources to strategic priorities, or value for money in service delivery.

In order to properly assess the status of the MTEF, government conducted a comprehensive review of the MTEF in 1999/2000, which has informed the design of the MTEF Phase II reform programme. The review concluded that the budget was not operating as an authoritative and credible fiscal management tool. The review went on to evaluate the strengths and weaknesses of the MTEF process to date, considered the causes of these, and proposed the reforms required.

At the outset of the MTEF Review it was determined that it would not be sufficient to focus only on the planning and MTEF/budget formulation processes. The early indications were that critical weaknesses elsewhere were undermining the implementation of the MTEF. Therefore, the scope of the MTEF Review was the full PEM cycle. As a first step, the MTEF Review took a view on the current functioning of each stage in the cycle, based on the findings of the Institutional Analysis of the 2000 Public Expenditure Review. At the time of the MTEF Review (March 2000), the assessment was expressed as follows:

- **Planning** is undermined by technical and institutional deficiencies in resource forecasting, which have made it impossible to generate a reliable medium-term framework. This has been compounded by weaknesses in policy formulation.
- **Budget preparation** has, as a result, been hampered by an absence of timely and authoritative expenditure ceilings and by the continued attempt to pursue sectoral policies, which are in aggregate unaffordable. The end result has been a persistent mismatch between expenditure plans and actual budgets, with many activities being under-funded as a consequence.
- **Budget execution** has been based on the cash budget system, with inevitable divergences between actual monthly releases and approved budgets. These divergences have been aggravated by pressures to finance new, unbudgeted activities and by lax controls over expenditure commitments.

- **Accounts reconciliation** within line ministries and **accounts consolidation** within the Accountant General's office have been several months late,[5] seriously compromising **within-year budget monitoring**. This has been partly compensated for by the monthly monitoring of expenditure returns – although without the possibility of verifying returns against payment vouchers and accounting records, there is clearly a question mark over accuracy.
- **Reporting and audit** processes are supported by adequate legislation and regulations but are undermined by capacity and resource constraints. In addition, the absence of disciplinary actions, follow-up investigations and prosecutions dramatically weakens the effectiveness of audit in enforcing accountability.
- **Policy review**, in the sense of a formal annual evaluation of policy outcomes with results fed into the definition of expenditure plans and output targets, simply does not happen.[6] There are many individual policy reviews – indeed, too many – but most of these are donor-driven and are rarely linked back to the budget process.

This listing of the key weaknesses at each stage of the budget process illustrates why MTEF Phase I was unable to have any significant impact on the quality of budgetary outcomes. It was a partial intervention, supported only by modest resources and not concerted efforts. As such, it was unable to have a real impact on the complex, interlinked problems that existed throughout the budget process.

There were enormous divergences between the approved budget and outturns, due to the issues discussed below:

- Weak revenue projections and unpredictable revenue flows, both from domestic and from donor sources, were common. There were inadequate risk management strategies to ameliorate these factors. In principle, since the cash budget system aimed at countering the risk of aggregate fiscal overruns, it did not comprehensively recognise mechanisms to counter the negative effects of revenue uncertainty on the distribution of resources and MTEF implementation. This undermined the MTEF by shifting focus from strategic budgeting to *ad hoc* and short-term decision making.
- Weak budget execution institutions in the spending ministries further limit the ability of government to implement the MTEF. There is insufficient technical capacity to control and report on expenditures, both internally and to the MOF. Controls over expenditure (*i.e.* robust systems of commitment approval, verification of delivery and payment approvals) are weak.
- Financial reporting is not done on a timely basis throughout the system, thereby impairing the ability of controlling officers, whether in the spending ministries or the MOF, to react timeously and use financial reporting as a means to control expenditure.

- The practice of undertaking new, unbudgeted (off-budget) expenditures during the spending year continues. In an environment of less than budgeted resources, unplanned activities routinely divert scarce resources from planned priorities, leaving them even more severely under-funded.
- Due to weaknesses in both the budget planning and execution systems, actual expenditure deviates severely from planned expenditure. This means that the MTEF/budget has very little credibility, and therefore is unsuccessful as a planning and control tool.
- The technical linkages between budget planning and budget execution are weak, allowing the link between strategic budgeting and funded activities to break down.
- The institutional arrangements of the budget planning process (*i.e.* the roles and responsibilities, rules, processes and sequencing of processes, and the information that is requested and used) do not support stronger linkages between policies, budgets and actual expenditure.
- It is unclear where, when and by whom bottom-up demands for spending are reconciled with the top-down resource constraints, during both budget planning and budget execution. Hard budget ceiling rules are neither clear, nor consistently rolled out and enforced. This leaves funding decisions uncontested and undermines accountability for the decisions.
- In an attempt to address issues impinging on smooth implementation of the cash budget system, several mechanisms have been developed that have assisted government to more effectively control the aggregate level of spending and, to a limited degree, keep better track of the uses of available funds.
- Most recently, the MOF has put in place an improved system for tracking priority poverty expenditures. The system speeds up the monthly process of collating expenditure reports and enables the MOF to respond sooner when required.
- While there have been delays, the Integrated Financial Management Information System (IFMIS) is being developed and will lead to further improvements.

Creating an improved environment for strategic, medium-term results-oriented budgeting in the current context will involve a number of elements. This should begin with marshalling political will to implement both the MTEF and an improved PEM. The result must be the adoption of hard budget ceilings, with adequate controls and penalties to enforce compliance. In order to simultaneously maintain a strategic focus, there must be improved human and systems capacity in the MOF and in line departments to develop realistic forecasts, with respect to both revenue projections and programme costing, with greater involvement of ministries and external stakeholders, and established links to other planning initiatives. Full transparency throughout the budget process, with respect to plans and outcomes, will increase accountability at the technical and political levels. Predictability of the policy framework and consistency in policy decisions, and predictability of cash flows, part of which remains the responsibility of donors, will be essential for government to maintain compliance with the hard budget constraints.

2.3. Desirable characteristics of the MTEF

The main thrust of the MTEF Review was to consider what the PEM cycle was actually delivering, compared to the characteristics that a well-functioning PEM system would normally exhibit. In arriving at the characteristics, the MTEF Review drew on Malawi's own experience as well as experience from elsewhere. The desirable characteristics are as follows:

- political leadership and commitment to the MTEF/budget;
- effective management, co-ordination and development of the MTEF/budget cycle, principally by the MOF;
- predictability in the funding of services;
- ensuring that policies and budgets are focused on the delivery of affordable and prioritised outcomes and outputs;
- comprehensiveness in the coverage of the MTEF/budget; and
- accountability for the use of public resources, incorporating effective management, control and accounting for expenditures.

While it is convenient to consider each of these characteristics in turn, it is evident that some weaknesses in different characteristics have common causes, or that problems regarding one characteristic have cross-cutting impacts on others.

2.3.1. Political leadership and commitment to the MTEF/budget

Ministers and parliamentarians have not taken advantage of the budget as a management tool to achieve Malawi's development goals, despite the fact that the budget is essentially a political process. This arises for several reasons. The extent to which Parliament is able to fulfil its role of "watchdog" over government is limited, partly due to lack of knowledge and poor presentation of information. At present, the National Assembly has little substantive engagement in the process of determining the budget, and little results from the deliberations of the Public Accounts Committee on the Auditor General's Report.

In addition, Cabinet committees with responsibility for issues regarding the budget have not been systematically engaged in budget formulation and budget monitoring.

Finally, the line ministry managers often do not consider the budget to be a binding constraint on the total level of expenditure and the allocation of expenditures, largely because resources are occasionally made available outside the formal budget process, and because of the lack of proper accountability for the use of funds.

2.3.2. Effective management, co-ordination and development of the MTEF/budget cycle

The first phase of the MTEF suffered from inadequate management and co-ordination. The institutional rules and procedures for planning and managing the MTEF/budget across government were not effectively applied, the MOF did not operate as a cohesive team to provide leadership and guidance, and the management and co-ordination arrangements within line ministries were poorly defined.

The effective functioning of the MOF is the central issue, both in terms of its internal operation and its relationships with other central agencies and line ministries. In part, the problem relates to a lack of teamwork across the ministry.

The MOF encompasses the Budget Division, the Economic Affairs Division, the Debt and Aid Management Division, and the Accountant General's Department, which operates separately from the rest.

2.3.3. Predictability in the funding of services

The flow of funds to service providers has not consistently met the monthly cash release requirements agreed with the line ministries. This is a result of three main factors: first, fluctuations in revenue receipts, which determine aggregate expenditure through the cash budget system that Malawi operates; second, releases within the year for expenditures that are not included in the budget; and, third, intermittent inflow or/and withholding of budgeted resources by donors. As a consequence, the approved annual budget allocations and the projections for the subsequent two years are not considered to provide reliable indications of the level of resources that will be made available to a ministry or spending unit.

Lack of predictability in funding is a critical factor in undermining the efficiency and effectiveness of service delivery. It does not allow managers to plan. Spending agencies do not know what they will receive until the bi-weekly release is made by the Budget Division. From the beginning of the 2001/02 financial year, the Budget Division has provided spending agencies with an estimate of the allocation they are to receive for the coming quarter; however, communication between the Budget Division and line ministries remains a problem.

2.3.4. Focusing policies and budgets on the delivery of affordable and prioritised outcomes and outputs

The MTEF Review concluded that policy development was weak and not clearly focused on affordable outputs and outcomes. As a consequence, inconsistency between budgets and policies persist, and expenditure is not focused on the outcomes desired by government.

The main causes were identified as a lack of clear resource limits to guide sector policy development, a policy process that is not systematically linked to the budget process, lack of clarity in policy-making responsibilities, lack of standard costs for budget preparation, and lack of transparency and accessibility in the presentation of the MTEF/budget documents.

2.3.5. Comprehensiveness of budget coverage

Two main issues exist regarding the comprehensiveness of budget coverage. The first is the existence of off-budget expenditures, often funded by donors. In some cases, no information is available to the MOF regarding donor activities. The second is the lack of co-ordination regarding the planning and financing of the recurrent and development budgets. There is still a tendency within government (often reinforced by donor practices) to treat development projects as separate from recurrent expenditure, and to focus more on the planning and monitoring of development projects than on the recurrent budget.[7] As a consequence, government expenditures are not derived from a single set of policies, accountability does not embrace all activities and programmes equally, and the financial implications of some programmes are not properly captured in the selection and budget processes.

This situation is further complicated by a breakdown in the clear distinction between the recurrent and development budgets. Rather than capturing all recurrent costs and all investment costs, respectively, the two budgets tend to capture programme costs and project costs, respectively. As many donor projects now contain a significant (often majority) proportion of expenditure that is recurrent in nature, and many government programmes contain expenditures that are investment in nature, the distinction breaks down.

2.3.6. Accountability for the use of public funds

The MTEF Review found accountability to be critically important for the proper functioning of the MTEF. The core problem identified by the review was that financial discipline is weak and good performance is not encouraged. This has led to significant weaknesses in financial management, including: *i)* accumulation of unpaid bills and extra-budgetary expenditures, which undermines fiscal discipline; *ii)* retention of funds for service delivery by ministry headquarters, which diverts funds from priorities expressed in the budget; and *iii)* unauthorised virement and unsound financial management and procurement practices, which reduce value for money.

The root causes are:

- lack of transparency about expenditures made, outputs achieved, compliance with rules, and procurement, due to inadequacies in the availability and dissemination of information;
- inadequate monitoring of outputs and service delivery;
- non-enforcement of rules and procedures;
- low morale in the public service; and
- lack of incentives for controlling officers who perform well.

Without improvements in accountability, improvements in the formulation of the MTEF and annual budgets will have little impact, as they will continue to lack the authority required to make them effective.

2.3.7. Progress since the MTEF Review

Since the MTEF Review, steps have been taken that suggest some improvement in specific areas. Many of the recommendations arising from the review have guided the budget preparation process, and the budget for 2000/01 marked the start of the new direction. In addition, the planning and monitoring sections of the Budget Division have been reorganised, and important improvements have been made to the funding system and the banking and commitment control functions. These advances provide a gathering of momentum that will be continued through the comprehensive MTEF Phase II programme, which demonstrates government's commitment to the improvement of PEM using an MTEF approach.

3. The reform programme

3.1. Programme design

The reform programme is based on solutions to the problems already outlined. It is built around the following six outputs, which reflect the six desirable characteristics identified above:

- strengthening management and co-ordination of the MTEF/budget process, especially through the MOF;
- improving the information base for political leadership of the MTEF/budget;
- improving the predictability of funding of services, especially though macroeconomic management processes;
- strengthening the policy and budget scrutiny process to emphasise outputs, effective poverty reduction, affordability and value for money;

- improving the comprehensiveness of budget coverage; and
- strengthening accountability for the use of public funds, including strengthened expenditure control and monitoring.

Although several activities that are included in this reform programme are ongoing, the majority of the activities will be implemented during the main implementation period of the programme (and of the MPRSP), which runs for three years with an allowance that further reforms will continue beyond this time frame.

A summary of the anticipated activities is provided below. It should be noted, however, that the activities and their timing may change significantly as the project develops and as progress towards the stated output and purpose targets is assessed.

3.1.1. Strengthened management and co-ordination of the MTEF/budget process

The role of the MOF is key to the success of Phase II. Improved management and co-ordination within the MOF and interaction with implementing agencies is crucial. In order to ensure effective management and co-ordination, a strengthening programme for the MOF will be designed and implemented as an immediate objective. This strengthening programme will apply to the whole ministry, including all departments and divisions for extensive consultations and capacity reviews. At a minimum, the implementation phase will involve seminars for senior management and training for all departments and divisions.

Efforts will also be made to develop and operationalise a revised budget calendar, so that the budget process is fully predictable and institutionalised. This issue has been identified as one of the critical success factors for MTEF Phase II, and a considerable emphasis has been placed on establishing a revised MTEF/budget calendar within which responsibilities and rules are clearly spelt out, and which becomes the backbone of the budget process. This will be supported by stakeholder sensitisation workshops on the budget calendar and the role of MTEF Phase II.

3.1.2. Political leadership of the budget process

MTEF Phase II aims to improve the presentation of the MTEF/budget, to make it more intelligible to parliamentarians and ministers. This will be facilitated by the introduction a new Budget Preparation System (BPS) to replace the current input-based system. The new BPS will be based on a user-friendly software package to be customised to ensure output focus and consistency with IFMIS. It will be introduced across government through extensive training and support services, together with the appropriate computer hardware, where necessary. This new system will have advantages in accuracy, activity focus and speed of budget preparation, clearer budget presentation, and budget monitoring.

These activities will be complemented by efforts to improve understanding of public finance issues by MPs, Cabinet and the media. In particular, this will focus on the role and importance of the MTEF/budget and its links to macroeconomic stability and poverty reduction. Basic information on the MTEF/budget will also be disseminated directly to the general public through leaflets and radio programmes.

Finally, fiscal transparency will be improved by ensuring that quarterly expenditure reports are submitted to Parliament, Cabinet and the media.

3.1.3. Predictability of funding

MTEF Phase II will aim to create an MTEF/budget process that guarantees quarterly allocations, and delivers them on time. In addition, it will aim to set credible and reliable three-year ceilings for the joint budgeting of recurrent and development activities. This will be achieved through a phased improvement of the macroeconomic forecasting model, especially as regards fiscal projections.

Formal risk management processes will also be developed to ensure that exogenous shocks, including non-availability of donor funds, do not undermine predictability. Further, the forecasting and accounting of non-tax revenues will be improved. Finally, the administration and communication of funding between the MOF and the line ministries will be improved after consultation with the line ministries.

The negative impact of non-predictable funding on the quality of service delivery makes this a high priority in MTEF Phase II.

3.1.4. Strengthening policy and budget scrutiny processes

These issues are central to the effective working of the MTEF/budget, and will be a major part of MTEF Phase II. The MPRSP forms the key link between policy processes and the MTEF/budget, by translating consensus-driven policy into an affordable action plan. The MPRSP will be reviewed annually to monitor progress and make necessary alterations. Further, the links between the MPRSP and the MTEF/budget will be strengthened. In particular, the Ministry of Economic Planning and Development will develop poverty-related budget contestation criteria linked to the Key Poverty Indicators (KPI), which it will use to appraise investment plans submitted by ministries.

The MOF will also conduct annual Public Expenditure Reviews (PERs, see Section 4 below) in conjunction with line ministries. Each PER will cover a number of cross-cutting issues (*e.g.* decentralisation and non-tax revenues) and a number of sectors.

This output will involve strengthening budget scrutiny capacity within the MOF, and budget preparation capacity within line ministries. The MOF will provide timely expenditure ceilings and budget preparation briefings for line ministries. Training will be provided in activity-based budgeting and outputs, and budget submissions will be critically reviewed in line with the MPRSP, MTEF and cross-cutting principles. A process for agreeing on and monitoring performance indicators for line ministries linked to MTEF/budget preparation will also be introduced, with the appropriate training.

Finally, an MTEF/budget manual will be developed, taking into account the activities of the reform programme and the views of stakeholders. This manual will be supported by extensive training designed to ensure institutional rather than merely personal capacities.

3.1.5. More comprehensive budget coverage

As an early priority, MTEF Phase II will aim to improve the flow of information from donors, and within the MOF, in order to achieve some immediate improvements in aid management. As a starting point, a development activity database will be established to record all existing and planned development activities of government and its development partners, both domestic and international. These activities will be assessed to check for duplications and consistency with the MPRSP. This database will then inform the preparation of the development budget as part of the MTEF/budget process.

Further, an improved tracking system for donor projects will be introduced in a phased manner across all ministries. Finally, the MOF will review and redefine an aid and debt policy, to ensure that donor inflows are directed towards government's priorities, that the financial implications of donor inflows are taken into account, and that the flow of donor budgetary support is smoothened.

3.1.6. Strengthening financial accountability systems

Achievement of early gains in accountability is one of the critical success factors identified for MTEF Phase II and is amongst the highest priorities for the first phase of the programme. The early gains include strengthening the legal framework for financial accountability through revised and separate Finance, Audit and Procurement Acts. These Acts provide for the passing by Parliament of supplementary budgets before spending by ministries; and for the early introduction of Performance Accountability Compacts with linkages between annual performance and salary/renewal of contracts made clear. Controlling officers currently have authority to discipline their staff by means of interdiction under the Public Service Regulations. Both of these initiatives include stronger sanctions against poor financial performance.

Budget monitoring systems, focused on finalising the introduction of IFMIS, will be strengthened. Once implemented, IFMIS has inherent controls to match expenditure to budget and flag where budgets/commitments have been exceeded. In the context of the MPRSP, an effective budget monitoring system focusing on pro-poor activities and outputs will be introduced to complement IFMIS. Additional efforts will be made to improve the quality of expenditure returns, by improving reconciliation of accounts and designing and implementing a systematic and rigorous process of monitoring budget execution.

Recent improvements in treasury and cash management and commitment control will be consolidated, and processes of bank reconciliation and financial record keeping in line ministries will be revised, in conjunction with the strengthening of internal audit systems based on the establishment of an internal audit unit in the Office of the President and Cabinet (OPC).

3.1.7. Other reform elements

Many of the reform initiatives contained in this programme are dependent on complementary reforms, particularly to the public service and accountability framework. Further, the programme will be implemented in the context of decentralisation.

Government adopted the Decentralisation Policy in order to consolidate democracy and allow people to take an active role in issues of governance and development. The policy aims at mobilising the local community to participate in socio-economic development and the promotion of accountability and good governance. Accordingly, the decentralisation process has been designed to be implemented in two phases. The first phase was scheduled for 2002/03 to 2004/05, with the second phase from then until 2010. During the process, central government will devolve the planning and implementation of agreed activities to local authorities. The activities will be devolved together with the required material, financial and human resources.

The MTEF recognises the decentralisation policy and process. The first phase of the MTEF emphasised prioritisation at sectoral level through the production of logical frameworks. Capacity-building at central and line ministry levels, especially in the area of training around the concept of an MTEF and its implementation, was widely covered during the first phase. The second phase, which aims at revitalisation and consolidation, will build on the existing capacity at central level. MTEF Phase II will consolidate and interface with various financial management and public sector reforms that are under implementation. Introduction of the MTEF to the local authorities will be a milestone of MTEF Phase II. The current planning and budgeting system of district assemblies will need to be reoriented during MTEF Phase II to easily interface with the national (central government) system.

4. The use of public expenditure reviews (PERs)

Government carried out a PER for the 2000 fiscal year together with the World Bank. On a macro level, the PER analysed overall trends in expenditure, the institutional framework for expenditure management (particularly the budget process) and the development budget. On a sectoral level, the PER was carried out for the four key sectors of education, health, agriculture and roads. For each sector, past trends in intrasectoral expenditure were analysed, and recommendations were made for future allocations on the basis of past trends, benefit incidence analysis and prioritisation through reassessment of the role and resources of government. Thus, the PER was designed to complement existing and ongoing work on improving the quality of public expenditure, and to provide input into the Poverty Reduction Strategy and strengthen the MTEF process.

4.1. *Objectives of the PER*

The primary objective of the PER is to guide government in making more efficient use of its scarce resources, in order to foster more rapid and equitable growth and wealth creation, and improve the effectiveness of public policies, notably on service delivery. Therefore, the role of the PER is to assess and improve the quality and content of public expenditure.

Specifically, the PER is aimed at supporting government in addressing the challenges encountered in public expenditure, by exploring options to tackle them in order to root out causes of inefficiency. Some of the areas of concern are civil service rationalisation and a review of government's operations and its use of public resources, in order to identify policy reforms that can support faster growth and more efficient delivery of services to the public, thereby contributing to the reduction of poverty. From the macroeconomic perspective, proper expenditure management and prioritisation, by helping to maintain fiscal stability, are critical for economic growth and poverty reduction. High fiscal deficits can hurt growth and employment by raising the interest rate and inflation, creating exchange rate instability, and crowding out critical public and private investment.

4.2. *Methodology and content*

As mentioned above, the PER was a joint exercise of the Malawi government and the World Bank. The macroeconomic chapters were drafted by teams drawn from the MOF and the National Economic Council (now the Ministry of Economic Planning and Development) and then revised to accommodate the World Bank comments. Teams from the relevant ministries drafted sectoral chapters (Education, Health, Agriculture and Roads) with assistance from the World Bank.

The PER was conducted through detailed consultations with various stakeholders, down to the lowest-level cost centre to appreciate the problems encountered in the course of service delivery.

4.3. PER findings

The PER format assists government to make immediate decisions in view of longer-term trends, and helps bring more rationality into budget management processes. The findings point out long-term trends in budget policy and pertinent issues in budget planning and implementation that require attention. In this way, the PER helped shift the focus from the immediate problems of ongoing budget allocation on an annual basis to an analysis of longer-term issues.

4.3.1. Typical macroeconomic findings

The macroeconomic and budget management findings set out the fiscal policy and budget reform challenges. The PER found that over the years of structural adjustment programme implementation, the country's economic performance was dismal. The unstable macroeconomic environment and low (or even negative) growth were attributed to multiple factors, including external shocks, inconsistent implementation of reforms, poor fiscal discipline and a severe drought. Economic instability also resulted from poor expenditure management, which led to high fiscal deficits, forcing government to borrow large amounts on the domestic market, thereby crowding out the private sector and putting pressure on inflation and the interest and exchange rates.

However, changes in distribution of spending were positive from a pro-poor perspective, with spending in the social sectors growing from 6.16% of GDP in 1993/94 to 9.24% in 1998/99. General administration expenditure fell in the same period, but spending on the economic sector (in such vital areas as agriculture and tourism) also declined, raising the challenge of generating even further savings on the civil service in order to invest more in the economic sector.

4.3.2. Typical budget management findings

The PER pointed out that many of the problems in the budget process were caused by lack of co-ordination at all levels. For example, the roles of key players were not clearly defined and information about new budget system initiatives and sectoral expenditure ceilings was not clearly communicated to line ministries. It was recommended that co-ordination problems within ministries be resolved through the use of Budget Co-ordination Committees, and those between government and donors through the use of sector-wide approaches (SWAPs). The PER also made useful findings on the first MTEF reform programme, most significantly that there was a lack of ownership, on account of poor understanding and the perception that it was a donor-driven process. Thus, while ministry budgets were supposed to be prepared through activity-based budgeting (ABB), the budgets in most ministries were not consolidated (*i.e.* were meaningless) as the line-item budget was still perceived to be the important resource-negotiation tool.

4.3.3. Findings on the development budget

The development budget accounts for an increasing share of total government expenditure, reaching 25.3% in 1998/99. The majority of the development budget (66% in 1999/2000) is spent on the key sectors of education, health, agriculture, water and roads. Wages and salaries (13%) and operations and maintenance (23%) together account for 36% of development expenditure, while building accounts for 27% (averages 1995/96-1998/99).

Donor resources make up over 80% of development expenditures. Of this, grants account for around 28% (1997/98-1998/99 average) and loans 72%. This means that around 58% of development expenditure is financed through loans, which raises concerns about the sustainability of development projects and future budgetary pressures through interest payments.

Other findings were:

- In general, actual development expenditure was far less than budgeted expenditure, on account of capacity problems associated with government (delays in counterpart funding, and inaccurate work plans, for example) and donors (linked to the multiple and varied conditions for the release of funds). Remedies for these problems were improving expenditure prioritisation and implementation and building the capacity of the Debt and Aid Management Division of the MOF to track aid inflows and ensure that conditionalities are met.
- The development budget does not cover all projects implemented by government. In order to gain control over public expenditure, it was seen as critical that all government-managed projects be included in the development budget.
- Better estimates of the recurrent implications of project spending need to be made.

4.3.4. Typical sectoral findings

The sectoral analysis provided a detailed review of trends in intra-sectoral funding and expenditure for the four key sectors of education, health, agriculture and roads. The first step in this analysis was the identification of priority activities that are core to the performance of the sector and that are largely public goods or services. This was complemented by a benefit incidence analysis that provided an examination of the effectiveness of expenditure. The cost of priority activities was calculated in order to assess the extent to which they are affordable given a particular resource envelope. Consequently, strategies to close the resulting funding gap were identified, such as cost-recovery and efficiency-enhancing measures. The following paragraphs briefly discuss the main findings and recommendations for education, as an illustration of the scope and usefulness of PERs.

4.3.5. Education sector review

Outcomes in the education sector

The PER found that primary school enrolment had risen by more than 50% over the period, largely due to the abolition of school fees in 1994. However, there were very high rates of dropout and repetition, especially in low standards and for girls. The survival rate to Standard 8 was about 30%. The majority of students who sat the primary school leaving certificate passed, but the transition rate to secondary education was only about 65%.

Secondary school enrolment had trebled over the period, with the largest absolute increase in community day secondary school (CDSS) students, who made up about 55% of enrolment. Nevertheless, access to secondary education is still limited: the gross enrolment ratio is less than 30%. There were several inequalities present in the system. First, access was heavily skewed in favour of children from high-income families. Second, girls were under-represented and accounted for about 40% of enrolment. Third, there was a huge disparity in the Malawi School Certificate Examination (MSCE) pass rate between conventional and community schools, and the trend had worsened considerably over the period. In 1999, the CDSS pass rate was 4%.

Enrolment at university level had increased very little over the period and was below 4 000 students. Female students occupied less than 30% of places and were particularly under-represented in science disciplines. Enrolment was almost completely skewed in favour of high-income families.

Financing of education

By the time of the PER, the government had made education a high priority, increasing its share of the national recurrent budget from 22% in 1993/94 to 28% by 1999/2000. Within this allocation, there had been a clear shift in favour of primary education. In terms of development expenditure, up to 1998/99, government loans mainly financed primary school construction; however, in the following two years there was a move into the construction of day secondary schools. Bilateral donor grants were substantial in the education sector, more than matching the loan funds, and were focused on primary school construction.

Primary school students were receiving a vastly lower public resource allocation, on a per student basis, than their counterparts at higher levels. Over the period, the matter had worsened, with a university student receiving over 200 times the amount of a primary student. These ratios were considerably higher than regional norms.

Between 1990 and 1998, the distribution of both public and primary secondary education expenditures had become more pro-poor. Nevertheless, at secondary level the distribution was still extremely inequitable – over half of secondary public education expenditure accrued to the richest 40% of households, and boys benefited more than girls.

The definition of "free primary education" varied among different communities. Although no fees were charged, some parents contributed directly to general-purpose funds, provided labour in kind for construction projects, and supplemented government provision of learning materials. At secondary and university level, fees were extremely low in real terms and collection rates were less than 50%. Approximately 5% of public secondary costs were recovered from fees, and at the University of Malawi the rate was 1%.

At primary level, salary expenditure was severely crowding out other quality inputs, which accounted for less than 20% of total expenditure. The amount spent on teaching and learning materials was less than 50% of the recommended USD 5 per pupil. However, there appeared to be little scope for reducing the salary bill: pupil-teacher ratios were high and salary levels were low in real terms. In short, more resources were needed.

The distribution of primary teachers across divisions, between urban and rural areas, and between standards, was extremely inefficient. Female teachers were concentrated in urban areas, which was a particular worry for the educational attainment of rural girls. In terms of effectiveness, roughly half of the primary system's resources were being spent on dropouts and repeaters. The average duration of study for a dropout was much less than the four years thought to be necessary to achieve functional literacy.

In conventional secondary schools, boarding costs and "other" non-salary expenditures were crowding out quality inputs. As in the primary system, teachers were not deployed efficiently across divisions, and pupil-teacher ratios were much lower in conventional secondary schools than in CDSSs. Over the period, cost-effectiveness in the conventional secondary system had fallen dramatically. While enrolment had nearly doubled, the number of graduates remained almost static. In tertiary education, there were vast differences in student-lecturer ratios, and in public expenditure per student in the six primary teacher training colleges. There appeared to be scope for redistributing resources between colleges to improve efficiency.

Education policy recommendations

The policy recommendations that came out of the education sector review were as follows:

- Realistic cost-sharing schemes should be introduced at secondary and university level, to free up resources for quality improvements at primary level.
- Improving access at secondary and tertiary level should be an important objective. The introduction of local area recruitment would allow a phased process of de-boarding to begin at secondary level and an expansion of day schooling. Promoting a more judicious use of physical facilities, through double-shifting at secondary level, and through weekend and holiday time use at the university, would enable greater access at a lower unit cost. Private sector provision should be encouraged through a partnership arrangement, which would enable the government to ensure quality standards. Finally, to ensure that the poor are not disadvantaged, a targeted bursary scheme should be implemented at secondary level, and the student loan scheme revamped at university level.
- More trained teachers are needed. A high-volume programme of initial teacher training needs to continue in the medium term. At secondary level, a fast-track method of training untrained teachers, who currently staff the CDSSs, is urgently needed.
- Adequate provision needs to be made in the recurrent budget for teaching and learning materials for primary schools and for school inspection and advisory visits. This should include support for the zonal in-service teacher education programme.

Cost-saving and cost-effectiveness measures include:

- Raising pupil-teacher ratios in conventional secondary schools. Both double-shifting physical facilities (but using the same teachers in both shifts) and ensuring that newly trained secondary teachers are able to teach at least two subjects could achieve this.
- At the university, the student to administrator/lecturer ratios need to be dramatically reduced. The exam system should be rationalised by reducing the number of subjects and papers offered.
- Putting in place measures to improve the quality of education, and continuing to sensitise the community on the need for regular attendance, form the core of the recommendations to reduce dropout and repetition rates. Other means of improving the efficiency of expenditures are to reduce the resource inequities across standards and regions and between different types of school.
- Improvements in the government budget system are needed to ensure that the recommended resource shifts actually take place. This includes the development of a sector-wide expenditure and output monitoring process.

Furthermore, secondary school fees should be retained at school level, and not remitted to the central treasury, in order to improve collection rates, accountability and effectiveness.

5. Conclusion

Malawi has been undertaking major reforms to its public expenditure management systems for a number of years. Since the early 1990s, two main reform waves can be distinguished. In the MTEF Phase I project, reforms were focused on the planning phase of the budget process, and were implemented largely in a bottom-up manner, with more concerted efforts to improve forward policy prioritisation and financial planning at the sector level than to improve the centrally driven, comprehensive framework within which the planning was taking place.

While there were some benefits from these reforms – for example, a more transparent linkage between sector policy and budgets, and improved capacity at line ministry level to link policies and budgets – their full impact was somewhat undermined by unpredictable funding during budget execution (on account of revenue shortfalls and in-year allocation to new activities), resulting in non-funding of the detailed sector requirements. Weak institutions and capacity at the centre, for the provision of suitable resource frameworks and assessing the more detailed sector plans, also undermined the first-phase reform mechanisms. Sector detailed development of activity-based budgets and efforts to prioritise happened in a vacuum, and largely amounted to empty annual compliance with procedural requirements – with only limited effect on spending outcomes – rather than robust engagement with problems.

The second phase of reforms has paid far greater attention to strengthening complementary systems, to sector policy prioritisation and budget planning systems, such as improved macroeconomic and revenue forecasting capacity, improved cash management and in-year transparency systems, improved capacity at the centre for budget management (including the development of a considered budget process that provides timely hard budget constraints) and improved institutions for economic governance, including mechanisms for political involvement, transparency and accountability.

The Malawi case study highlights the need to consider individual technical reforms in a specific phase of the budget, within the larger context of budget management, and the degree to which reforms are likely to succeed only if they are useful to participants in the budget process (if they count in determining what happens eventually), and if attention is paid to the overall incentive framework within which budget management and the reforms take place.

One of the shortcomings of MTEF Phase I can be said to relate to the MTEF reforms being implemented on a sector-by-sector basis and as parallel systems to the ongoing pre-reform system of budget allocations from the centre. This prevented proper consolidation of the bottom-up activity costings, even at ministry level (and therefore fell short of inducing prioritisation within sectors), as senior management perceived the annual budget process to be more important. While the development of detailed expenditure strategies can happen on a sector-by-sector basis, the Malawi case study illustrates that such sector-specific development needs to happen within a co-ordinated framework for budget management that is resource constrained, provides medium-term predictability and awards prioritisation.

The case study stresses the need for strong capacity at the centre (in the Ministry of Finance) to forecast revenues, to involve the political level, to assess budget formulation against cross-cutting issues and to co-ordinate the process.

Notes

1. This framework covers both the recurrent and development budgets, with the intention of moving from improved co-ordination and integration to eventual merging of the two.
2. This reform programme is itself based on the PEM sections of the MPRSP.
3. However, the strengths of the PSIP were fading by 1995, as the development budget increasingly became a collection of projects with both investment and recurrent elements, rather than purely investment in nature.
4. In terms of adhering to aggregate fiscal policy targets.
5. The revision of the Chart of Accounts to introduce Programme and Sub-programme classifications has apparently increased the time required for accounts consolidation and reconciliation. These delays may therefore not have been so significant in 1995 and 1996.
6. The completion of the 2000 Public Expenditure Review and the introduction of the MPRSP represented an important step to correct this deficiency. Malawi is intending to make PERs an annual process linked to the PRSP review process.
7. At a national level, the selection and monitoring of the development budget has declined in recent years as a result of the PSIP being transferred from the National Economic Council to the MOF. However, the PSIP has now been given to the Ministry of Economic Planning and Development, where screening, monitoring and evaluation projects will be conducted using poverty budget contestation criteria linked to MPRSP Key Poverty Indicators (KPIs, see Section 3.1.4).