Malawi: Mid-Year Budget Review Brief (Financial Year 2017/18)

20 February 2018

Key messages and Recommendations

- Public spending on social sectors supporting the survival, development and protection of children is under pressure because revenues and grants have underperformed by K113.9 billion, implying a 19 percent short fall. This has led to a downward revision of the total budget for 2017-18 by about MWK 10 billion from MWK 1.323 trillion to MWK 1.313 trillion.

- Whilst development budgets for education and health remained the same, the very low annual development budget for the Ministry of Gender, Children, Disability and Social Welfare has been drastically cut, with no provision for development expenditure in the second half of the year.

- Unless the Government closely monitors implementation of the national budget in the second half of the year, there is still a risk that remaining social sector development budgets may not be fully spent. Furthermore, slippages in recurrent expenditures by some MDAs may lead to budget overruns and ultimately increase borrowing (as occurred in the first half of the year).

- While on paper the government committed to have a developmental budget at the beginning of the 2017-18 financial year, the expenditure trends seem to suggest that the 2017-18 budget may turn out to be consumptive if development budgets are not implemented as planned.

- Revised allocations to the end of financial year 2017-18 show high standard deviation in percentage changes to individual votes. This implies that the burden of under-performance of revenues and grants weighs more heavily on some ministries, departments and agencies (MDAs) than others.

- Given limited fiscal space, the focus of Government should be on improving efficiency and effectiveness of public expenditures, including bolstering efforts to reduce wastages and leakages throughout the expenditure chain, including in procurement and frontline service delivery.

- The Malawi Revenue Authority (MRA) should investigate other underlying reasons for underperformance of tax revenue, besides power outages, and further strengthen its efficiency and effectiveness in tax revenue collection.

I. Introduction

This brief provides highlights of the Mid-Year Budget Review (MYBR) for the financial year 2017-18, presented to Parliament by the Minister of Finance, Economic Planning & Development, Hon. Goodall Gondwe on 16 February 2018. Although the MYBR is not a legal requirement, it is an internationally recommended public finance management practice. The brief also analyses the extent to which the MYBR will lead to improved spending on sectors and programs that benefit children. Every section includes a few key takeaway messages.
2. Macroeconomic context

The Malawi economy, which grew modestly by 2.48 percent in 2016, has remained relatively stable over the past six months. In the past year, inflation decreased from 18.2 percent in January 2017 to 7.1 percent in December 2017. Even though the 2017-18 budget had initially projected that inflation would remain in single digits, new forecasts point to a likely increase by 4 to 6 percentage points in 2018. Already, market prices for maize have gone up. Notwithstanding this, the Malawi Kwacha has remained relatively stable at around 720 against the US dollar for the first half of the year.

As outlined in the speech by the Minister of Finance, the main objective of the 2017-18 national budget is to consolidate and sustain macroeconomic stability, building on gains made in the past two years. The IMF estimates that in 2018, economic growth will be in the range of 3 to 5 percent, followed by an increase to 6-7 percent over the medium term. To achieve macroeconomic stability, the Government realizes the need to spend within its means, keep its debt stock sustainable and budget deficit low, maintain a stable exchange rate regime and sustain a robust monetary policy regime.

The economic rebound is however most likely to be affected by dry spells and armyworm which may lead to reduced economic output, food insecurity and increased cost of living. Other challenges such as an outbreak of cholera are also crowding out funding initially intended to strengthen the health system. The country is also faced with recurring energy and water crises which have already affected private sector productivity and consequently government revenue generation. In the past six months, the country faced a serious shortage of electricity which, although the exact magnitude is not known, has had a negative impact on the economy. It is however regrettable that the energy problem has not been comprehensively addressed in the MYBR. For instance, the major electricity generation projects have not been assigned any allocation in the MYBR.\(^1\)

Key Takeaways

- The 2018-19 budget should seek to purposefully address energy and water challenges.
- A medium term expenditure framework should be established for the third Malawi Growth and Development Strategy (MGDS III) which ensures balance in investments amongst all sectors.

Source: Reserve Bank of Malawi
Source: Word Bank Data

\(^1\) http://www.imf.org/en/News/Articles/2018/02/14/pr1851-imf-staff-reaches-staff-level-agreement-on-malawi?cid=em-COM-123-36626

\(^2\) Project No. 10 under Annex IV A and Project No. 1 UNDER Annex IV B.
3. Public Revenue Performance and Financing

The Government has entered the second half of 2017-18 with virtually no fiscal space to increase spending in both social and economic sectors. In the first half of the year, total revenue and grants underperformed by about 19 percent, effectively generating significant fiscal pressure on the Government. The Government had projected that revenues and grants in the first half of the financial year would total K587 billion, but only K474 billion was collected. Government revenue alone was projected to be K478.02 billion but the mid-year turnout was K434 billion, meaning an underperformance by 9.1 percent (K43.635 billion).

Unlike the 2016-17 financial year, when the Malawi Revenue Authority (MRA) exceeded its mid-year target, tax revenue has underperformed by approximately 8 percent in the first half of the current financial year. Tax revenue was projected at K438.3 billion but K402 billion was collected, resulting in a shortfall of K35 billion. Nearly all key categories of tax revenue performed below their targets. Value added tax, for example, had a shortfall of 5 percent (K7.3 billion), import duty underperformed by K6.7 billion (15.4 percent), PAYE by 12.1 percent, withholding tax by 16.1 percent and excise duty by 9 percent. Weak performance of the private sector, largely due to electricity problems, has been cited by the Government as one of the main reasons for the underperformance of tax revenue. However, there is need for more scrutiny of the factors behind this trend; the same energy conditions prevailed in 2016-17 when tax collection over-performed.

As was the case in 2016-17, non-tax revenue continues to underperform, an issue that should concern the Malawi Revenue Authority. Non-tax revenue fell short of its target by 20 percent. Whilst Government had targeted K39 billion, only K31 billion was collected. Out of the K10 billion projected as non-tax revenue in the form of parastatal dividends for the first half 2017-18, the Government only collected slightly below K3 billion. One of the reasons for this is non-performing parastatals, which only met 28 percent of the target.

Only 37 percent of projected K109 billion grants were received in the first half of financial year 2017-18. The Minister of Finance has attributed this to the non-disbursement of K55 billion expected from the European Union. The Minister however explained that the grant was hastily included in the budget before conditionalities for disbursement were met. There has been a general reduction of on-budget support over recent years, with a decline of at least 10 percent since 2015. In the second half
of the year the Government however expects K177 billion in grants to be disbursed. Included in this figure is K60 billion expected from the World Bank in the form of a concessionary loan.

**Both domestic and foreign borrowing exceeded initial projections.** The increase in borrowing was necessitated by underperformance of revenues and grants as well as an unplanned bailout of ADMARC to the tune of K45 billion as well as non-disbursement of K55 billion in grants, expected from the EU. Together, this increased budget deficit to K197 billion against a projected value of K104 billion. In response to the deficit, domestic borrowing for the first half of the year increased by 132 percent to K78 billion from the projected K33 billion. Foreign debt increased from a projected K78 billion to K118 billion.

**The Government continue to borrow but at a diminishing rate.** Net domestic borrowing amounted to 0.9 percent of GDP in 2016-17.

**Key Takeaways**

- Whilst it is true that power outages have had significant impact on private sector performance, this cannot be the only reason for such widespread non-performance of various tax revenue sources. The Malawi Revenue Authority should investigate early this trend and also improve its own efficiency and effectiveness in tax revenue collection.
- Non-performance of parastatals and some government departments, including border controllers, is a recurring problem which the Government should pay attention to.
- The Government should only include firmly committed grants in its annual budget to reduce risk of underperformance of grants.
- Although the debt situation is within sustainable levels the Government should tightly control expenditures by ministries and parastatals to avoid fiscal slippages which may force government to borrow.

**4. Mid-Year Budget Performance**

**Total mid-year expenditure was lower than projected, which may be a reflection of cash flow problems and/or delays in procurement of services, especially for development projects.** The Government had projected half-year spending to be K692 billion for the first half of the year, with K519 billion being recurrent expenditure and K170 billion development expenditure. The actual mid-year expenditure and net lending was K671 billion, which is 3.1 percent below the target.

**In the first half of the year, development budgets for several MDAs were underspent.** In total, development spending underperformed by K32.9 billion, with K19.2 billion emanating from domestically financed spending and K13.5 billion arising from foreign financed development spending. Donor-funded development expenditure (Part I) amounted to K97.6 billion against a planned expenditure of K111.3 billion for the first half of the year. Locally-funded development expenditure (Part II) amounted to K40.6 billion against a target of K59.8 billion.

**Whilst the Government spent less than the targeted development budget, recurrent expenditure registered a 2.1 percent over-expenditure from its projected figure.** Recurrent expenditures amounted to K530.8 billion against a target of K519.5 billion, implying an over-expenditure of K11.3 billion. This was mainly due to over-expenditures on maize purchases and wages and salaries.\(^3\) The

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\(^3\) Total expenditure on maize purchases in the first half of the financial year was K69.9 billion against the budgeted amount of K35.0 billion, representing an over expenditure of K34.9 billion. A large component of this over expenditure was channelled towards repayment of the maize purchase loans whose government guarantee issued to ADMARC was called upon.
personal emoluments part of the recurrent budget was overspent by about K1 billion because of the unbudgeted recruitments and staff upgrades at the Malawi Police Service and Malawi Defence Forces, costing the Government nearly K5.7 billion, altogether. While on paper the government committed to have a developmental budget at the beginning of the 2017-18 financial year, the expenditure trends seem to suggest that the 2017/18 budget may turn out to be consumptive if development budgets are not spent as planned. It is already worrying that locally funded development budget has been revised downwards. Figure 5 below shows overall budget performance, by economic classification.

![Figure 5: Summary budget performance](image)

![Figure 6: Sector performance](image)

Budget utilization rate and fiscal slippages are not uniform across sectors and ministries. Mainly because of unplanned maize purchases, the agriculture sector overspent by nearly 202 percent. The education sector exceeded its mid-year expenditure target by 11.92 percent. The health sector however spent more or less as expected, registering under-expenditure of only 1.17 percent. There are however dynamics within sectors that may need further examination. Within the agriculture sector, the Farm Input Subsidy Program underspent by 61 percent and expenditure for maize purchases increased by nearly 100 percent. Only 35 percent of the planned expenditures on drugs for district hospitals and clinics, and 70 percent for national hospitals were spent. It is important to find out why this trend prevailed considering the criticality of drugs in health service delivery.

Budget outturns for other recurrent transactions (ORT) and development budgets for key social sector ministries (Health, Education and Social Welfare) were mostly below projected figures. However, personnel emoluments (PE) for Ministries of Health and Education were overspent. Ministry of Education spent K10.1 billion against a target of K9.9 billion, as Ministry of Health also overspent its PE budget by nearly K1 billion. The PE budget for the Ministry of Gender, Children, Disability and Social Welfare was however underspent by K142 million, with the Ministry of Civic Education, Culture and Community Affairs also underspending its PE budget by 125 million. The MYBR does not provide information on why these budgets were under spent. The total recurrent expenditure for the Ministry of Gender, Children, Disability and Social Welfare (K1.96 billion at midyear) was underspent by nearly K400 million, implying a 15.31 percent shortfall. The total recurrent expenditure for the Ministry of Education Science and Technology at midyear was K18.6 billion against a target of K19.6 billion. However only 62 percent (K26 billion) of the projected K36.56 billion for the entire
ministry was spent. It is mainly the development budget which was underspent by 55 percent from a projection of K16.9 billion which explain this huge under-expenditure. The projected half-year budget for the Ministry of Health was underutilized by slightly over 3 percent, with actual outturn at K41.3 billion against a projection of K42.8 billion. Although locally funded development budget was underutilized, by almost 50 percent, the entire development budget (foreign funding) of K12.8 billion was exhausted.

The MYBR is silent on the performance of District Councils regarding ongoing fiscal decentralization, especially the devolution of payroll. In financial year 2017-18, a total of K132 billion for personnel emoluments will be transferred to District Councils. From this amount, it is estimated that K6.5 billion will go to agriculture, K92.3 billion to education and the remaining K32.2 billion to health.

Key Takeaways

- In the second half of the year, close monitoring is required of recurrent expenditures by all MDAs and parastatals to avoid fiscal slippages that may result in budget overruns (and increased borrowing).
- Sector-specific public expenditure reviews would help to better understand recurring expenditure patterns of both recurrent and development budgets.
- Government should continuously generate and utilize robust food security and vulnerability data and forecasts to inform planning and budgeting to minimise unplanned expenditures.
- The Ministry of Finance is requested to include a short annex on budget performance by individual districts in future MYBRs to monitor fiscal performance at sub-national level.

5. Projections to the end of Fiscal Year 2017-18

The total government budget has been reduced by nearly 10 percent from K1.323 trillion to K1.313 trillion. Effectively, this has reduced per capita government spending in both real and nominal terms. In nominal terms, per capita expenditure declined by 0.7 percent. The challenge now for MDAs is to ensure value for all allocated resources and to ensure that spending targets for the second half of the year are met.

To finance the budget until end of financial year, domestic revenue is projected at K953.1 billion from K980.2 billion representing a 2.8 percent decrease. Of the total K953.1 billion, taxes will account for K873.7 billion (reduced by K27 billion from the approved budget) while non-tax revenue will total K79.4 billion.

Social sector ministries have not been prioritized in the MYBR, mainly as a result of constrained fiscal space, although some votes were revised upwards. A review of budget revisions to each vote has shown that social sector ministries are not amongst the top ten MDAs whose allocations were revised upwards. The budget for Ministry of Education barely changed as the Ministry of Health budget slightly increased by 2.8 percent. Unfortunately, as is often the case, the budget for Ministry of Gender was cut by nearly 12 percent and the budget for the Ministry of Civic Education, Culture and Community Development was reduced by nearly 15 percent. Within the Ministry of Gender, the capital budget was affected the most. The already very small capital budget was cut out completely, with no provision development expenditure in the second half of the year. Development budgets for ministries of health and education remained the same.
Despite fiscal constraints, the Government has plans to embark on several infrastructure projects, especially road construction, in the second half of the year. Out of the 15 projects that must be completed in the current financial year, six are road construction projects which take away nearly half (48.86 percent) of the development budget. Social sector related projects (hospitals, schools, etc) are taking up 33.48 percent of planned capital budget. Out of the 26 projects that should be started and implemented to a visibility stage by June 2018, over half (15) are also road construction projects taking approximately 45 percent of planned costs.

Total borrowing is expected to be lower than projected figures in the approved budget. However, domestic debt is forecast to slightly increase from K27 billion to K30 billion. At the same time, foreign debt is expected to decline from K167 billion to K152 billion.

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<th>Table 1: Votes with highest upward revisions</th>
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<td>Top Ten Highest Votes</td>
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<td>Unforeseen Expenditure</td>
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<td>Ministry of Agriculture, Irrigation and Water Development</td>
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<td>Malawi Police Service</td>
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Source: Unicef calculations, based on MYBR

**Key Takeaways**

- In deciding which capital projects should be prioritized and pended, the Government should first consider projects that have already started, and to focus on a few rather than spreading itself thinly.
- Crucial social sector spending should be safeguarded in the face of fiscal constraints, especially health, education and child welfare. For several years, the Ministry of Gender, Children, Disability and Social Welfare has suffered deeper and more frequent cuts than many other MDAs.
6. Policy and public finance management issues to consider

- **Improving Efficiency and Effectiveness of expenditures.** The Government has rightly identified macro-economic stability, including containment of government expenditures, as a key goal. But this is only one side of the story. The other side, given limited fiscal space, is that the Government should strengthen measures to improve efficiency and effectiveness of public expenditures. This entails tackling wastages and leakages throughout the spending chain, including in procurement and frontline service delivery.

- **Revenue Forecasting and Performance of Malawi Revenue Authority.** Domestic revenue is the most sustainable source of financing for public service delivery, including implementation of children’s rights. The Government is therefore encouraged to strengthen the role of Ministry of Finance and MRA in revenue forecasting and collection.

- **Budget Transparency.** The MYBR was presented two weeks after the global results of the Open Budget Survey were released. Malawi’s score of 26 out of 100 on the 2017 Open Budget Index (OBI) is substantially lower than its score in 2015 (65 percent). In the same index, the legislature, which scored 55/100, was deemed to be providing adequate legislative oversight on public budgeting. Considering the low OBI score, the Government should ensure that key budget documents – including the approved budget estimates and MYBR – are made publicly available online. The Government should also strengthen institutional, legal and administrative measures for fiscal transparency and accountability at various governance levels. Transparency is a cross cutting value that should be considered in all public expenditure sub-systems such as cash management, procurement, payments, asset management, reporting and accountability. Furthermore, the government should consider strengthening public participation in the budget process.

- **Consistency in recruitment policy and personal emoluments.** The government is encouraged to plan and budget for the hiring and recruitment of all civil servants, including in subvented organizations, to keep the wage bill under control and avoid unplanned government expenditures.

- **Disaster and risk management.** The Government of Malawi should comprehensively cost and budget for disaster and risk reduction, considering that droughts and other environmental shocks have become frequent and widespread, based on robust evidence and analysis. The National Resilience Plan is a good starting point.

- **Performance of parastatals.** The performance of parastatals and subvented organizations, including matters of revenue generation, is an issue that requires the attention of Government. If not carefully addressed, parastatals may end up draining much needed public resources without corresponding return.

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