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# Fiscal Decentralisation in Malawi Situational Analysis

## Final Report

Improving local services
through financing of
Local Government Authorites

NATIONAL LOCAL GOVERNMENT FINANCE COMMITTEE
NLGFC

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# Acknowledgements

This assignment was undertaken by the Overseas Development Institute (ODI) under the guidance of the National Local Government Finance Committee (NLGFC), with funding and support from UNICEF Malawi.

The consultancy team from ODI included Dr Per Tidemand, Emmanuel Ssewankambo, Tom Hart, Antoine Lacroix, Nick Hall, Tuntu Mwalyambire, Bright Sibale, Hadrod Mkwandire, Dr Asiyati Chiweza and Professor Roy Kelly.

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Needless to say, despite all the support received, the team is responsible for any mistakes or omissions in this draft report. The conclusions and recommendations in this report are subject to Government and development partner review for their actions through the intended Fiscal Decentralisation Strategy that is planned for by NLGFC.

# 1. Introduction

## 1.1 Background

The Government of Malawi through National Local Government Finance Committee (NLGFC), with support from UNICEF and other Development Partners (DPs), is seeking to strengthen fiscal decentralization. ODI has been contracted to support this initiative.

One of the deliverables is the stocktake of how the fiscal decentralisation system in Malawi currently is operating and its strengths and weaknesses.

The stocktake is intended to inform the development of a comprehensive Fiscal Decentralization Strategy (FDS) through a reform discussion note. The FDS is expected to cover all pillars of fiscal decentralisation including but not limited to:

- expenditure assignments (how responsibilities/ functions for service delivery are shared between levels of government as a basis for sharing of revenue sources)
- financing assignments including own source revenues (OSR), ceded revenue, Intergovernmental Fiscal Transfers (IGFTs) and borrowing; and
- institutional arrangements for both the management of fiscal decentralisation reform as well as routine government functions for local government authority (LGA) financing and related M&E arrangements.

The National Local Government Finance Committee (NLGFC) has prepared a **FDS Concept Note** (January 2021) that makes proposal for:

- the broad scope of reforms – later to be described in detail in the Fiscal Decentralization Strategy;
- the required analyses to inform the development of the strategy;
- the institutional arrangements for oversight, guidance and implementation of the Fiscal Decentralization Strategy; and
- recommendations for how to complete the development of a comprehensive and practical Fiscal Decentralization Strategy.

The FDS Concept Note has been guiding the scope and approach for this stocktake.

The overall objective of the Stocktake is to provide a comprehensive overview of current arrangements for LGA financing as a basis for development of Fiscal Decentralisation Strategy (FDS) through a reform discussion note.

Fiscal resources for LGAs in Malawi can be categorised as follows:

1. Own source revenues generated by LGAs.
2. Fiscal transfers to LGAs from central government through the normal IGFT system for devolved functions: these are clearly indicated in the national budget as LGAs votes. These transfers are managed and monitored by NLGFC; this includes both development funding as well as other recurrent transactions (ORT).
3. Fiscal transfers earmarked for Personal Emoluments (PE) transferred by Ministry of Finance (MoF) direct to LGA employee bank accounts following submission of paysheets by LGAs. Since 2017/18 the larger PE budget was decentralised for various sector staff (mainly teachers and health worker) as the budget vote shifted from respective sector ministries to LGAs). However, the PE budget has not been entirely devolved as decisions on budget allocation and various human resources management (HRM) practices are still partially centralised.
4. Non-devolved fiscal support for local service delivery – for instance, for medical drugs, agricultural inputs and several other development and capital expenditures managed by central government ministries, departments, and agencies (MDAs) on behalf of LGAs (where fiscal transfers are not made to LGAs but procurement undertaken centrally in one form or the other – this can be done with significant LGA involvement as in the case of drugs).
5. Development Partner support for local service delivery provided as fiscal support to LGAs as on-budget support but with different degrees of integration into the IGFT system: typically provided through sector ministries' votes outside the official Government fiscal transfer system, but with varying degree of compliance with IGFT rules (e.g. the Performance Based Grant under the Governance to Enable Service Delivery (GESD) intends to be part of the IGFT system).

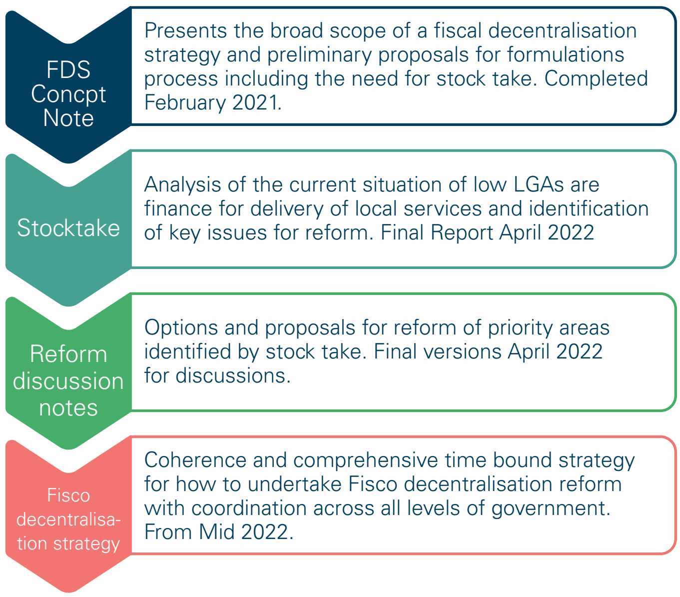
In addition to these fiscal resources, LGAs are also receiving support from DPs and NGOs that are not on-budget. Such resources have not been systematically mapped through this exercise as they, are unlikely to form part of a government fiscal decentralization strategy.

The two first categories of fiscal resources are monitored by NLGFC and analysed in its annual reports as these funds are fully integrated in the LGA budgets and finance devolved functions. This includes some PE expenses (of traditionally devolved staff), ORT expenses and capital expenditures.

## 1.2 Pathway Towards a Fiscal Decentralization Strategy

The work is undertaken under the auspices of NLGFC with funding from UNICEF for the initial stages of the assignment, whereas NLGFC has secured financing from GESD / World Bank for the final stage of development Fiscal Decentralization Strategy. The different stages and overall work schedule are illustrated in the figure below.

**Figure 1: Steps towards development of a Fiscal Decentralization Strategy**



## 1.3 Approach and Methodology

The team has:

1. Reviewed previous studies and relevant government policies and strategies,
2. Undertaken a very comprehensive analysis of available LGA finance data – and developed a comprehensive database that has been used for analysis of numerous trends (the development of the real value of various elements of the grants) and fiscal inequity issues. For the sake of brevity only a small subset of the analyses is included in the main report. Details of database analyses are found in annex 1.3.
3. Undertaken interviews with key ministries and central government stakeholders (see list of people met in Annex)
4. Undertaken fieldwork in selected LGAs (see people met in Annex). The sample included:
    - Two rural LGA from each region (with variation of size and socio-economic aspects)
    - One City Council, and
    - One Municipal Council and
    - One Town Council (as they have rather particular issues with expenditure assignments etc.)

The data collection exercise – in particular the qualitative aspects of stakeholder consultations - has been challenged by COVID-19 restrictions and remote work by several key consultants. Nevertheless, the team managed to undertake on-site LGA data collection as well as one full week of stakeholder consultations and a workshop in November for discussion of initial findings and recommendations.

In addition to this Situational Analysis, the team has also prepared Reform Discussion Notes with recommended proposals or options for reform of the most important aspects of Fiscal Decentralization. The structure of these notes are summarised in chapter 6 of this report.

# 2. Expenditure Assignments

## 2.1 Introduction

Governments strive to ensure that public services are delivered to the citizenry in an efficient, equitable, accountable and cost-effective manner. This involves the assignment of the delivery of services and allocation of resources to the appropriate levels of government. The mandate of delivering some of the services is devolved to Local Government Authorities (LGAs). The implementation of the National Decentralisation Policy in Malawi was meant to strengthen local governments capacity to deliver social and economic services more efficiently and consolidate democracy through the following: devolving administration and political authority to the district level; integrating governmental agencies at the district and local levels into one administrative unit through the process of institutional integration; manpower absorption; composite budgeting and provision of funds for the decentralised services; diverting the centre of implementation responsibilities and transfers these to the districts. Hence, the aim of fiscal decentralisation is to ensure that LGAs have access to adequate and predictable resources to deliver the mandated services. Therefore, before discussing the services assigned to the sub-national entities (expenditure assignments), it is essential to ensure that a credible and responsive Local Government (LG) system is in place. This section describes and assesses Malawi's Local Government system and the LGA expenditure assignments, specifically discussing the following parameters:

- The Local Government System
- The De-jure and De-facto devolved Services
- The functions stakeholders perform regarding a sample of the devolved services
- The existence of costed service delivery standards/ norms
- Summary of key issues on expenditure assignment

## 2.2 The Local Government System

The 1994 Constitution Section 146 and the LG Act 1998 section 4 and First Schedule classifies LGAs into District, Municipal and City Councils. Currently (FY 2021/22) there are 35 LGAs/Councils in Malawi of which 28 are District Councils; 4 are City Councils[1] and 3 are Municipal Councils[2].

Section 147(1–2) of the Constitution of the Republic of Malawi states that local government authorities shall consist of (a) local government officers (political structure) who shall be elected by free, secret and equal suffrage by the registered voters in the area over which that local government authority is to have jurisdiction; and (b), an administrative personnel (administrative structure), subordinate to local government officers (the political wing), to execute and administer the lawful resolutions and policies of those officers (Tambulasi, 2009: 11).

The political structure (the council) is the highest decision-making and oversight body of the local government. Section 3 of the LG Act defines the composition of the council. It consists of elected ward councillors, traditional chiefs of the rank Sub-Traditional Authority (STA) and above, Members of Parliament (MPs) whose constituencies are in the local government area and five non-voting members selected by the elected members to serve as representatives of special interests in the local government area.

Administratively, the District Council is headed by the District Commissioner (DC) who is the Controlling Officer, appointed by Ministry of Local Government (MoLG). The City and Municipal Councils are headed by the Chief Executive Officer (CEO) also appointed by MoLG. The Districts have the Directorates of: (i) Administration; (ii) Planning and Development; (iii) Public Works; (iv) Health and Social services; (v) Agriculture and Natural Resources; (vi) Education; and (vii) Finance. The City and Municipal Councils can customize the administrative structure to the respective needs, since they are able to pay staff salaries from locally generated revenues.

1 Lilongwe, Blantyre, Mzuzu, and Zomba.

2 Kasungu, Luchenza and Mangochi

## 2.3 The De-jure and De-facto Devolved Services

Expenditure assignment refers to the determination of the services for which local governments are responsible, and the level of discretion they should have in deciding on their expenditure budgets. This section describes the extent to which expenditure assignments for LGAs as described in Decentralisation Policy 1998 (de-jure) have actually been devolved to LGAs as at 2021 (de-facto)[3].

For **Basic Education**[4], out of the services that were supposed to be devolved and financed by LGAs (Nursery and kindergarten, Primary Schools; and Distance Education Centres), it is only Primary Education that is currently being financed by LGAs. Distance education has not been devolved to the LGAs and is still with the MoE and Nursery and kindergarten functions were transferred to the Ministry of Gender, Children and Social Welfare

For **Primary Health Care**[5] all the services that were supposed to be devolved and financed by LGAs (health centres, community hospitals, and dispensaries; maternity clinics and health posts; control of communicable diseases; as well as health education and environmental sanitation) have actually been devolved to districts[6]. In addition, the sector has devolved secondary health care (district hospital).

For **water supply & sanitation** all the services that were supposed to be devolved to LGAs (provision and maintenance of water supplies including: boreholes; piped water projects; protected wells; gravity fed piped water schemes; rehabilitation of small community dams; protection of catchments for small community dams) have actually been devolved to districts. However, for Urban centres, provision of water is by independent Water Boards.

3 Knowing that the devolved sectors/services are many notwithstanding, this chapter focuses on the provision of basic education; primary health care; water supply and sanitation and agriculture extension

4 Includes Complementary Basic Education and Primary Education.

5 Includes preventive and curative services

6 Note that urban LGs are not providing health services

For **agriculture extension**, all the agriculture extension related activities in all agriculture departments (livestock extension; control of livestock diseases; land husbandry; crop husbandry; food and nutrition; as well as construction/rehabilitation of small dams) have been devolved to districts.

## 2.4 Functions Performed by Stakeholders for a Sample of Devolved Services

To implement each of the devolved services, broad guidance has been provided regarding the functions that have to be performed by the Ministries and those that have to be devolved to LGAs. The Decentralisation Policy (1998) empowers the LGAs to assume all the planning, budgeting, implementation functions of the devolved services while central ministries retain responsibility over policy formulation, policy enforcement, inspectorate, establishment and dissemination of standards, training, curriculum development and international representation. The LGAs are also responsible for the management of service delivery including: financing the construction of basic infrastructure for service delivery; ensuring the functionality of LGAs, service delivery units and human resources; financing the operations of service delivery; as well as monitoring and inspection of service delivery units. For a sample of devolved services (education, agriculture, health and water), this section analyses the extent to which both central and local government perform the prescribed functions. Although the functional division of responsibilities between central government and LGAs appear to be clear in the formal legislation and policy (de-jure), in practice the actual situation on the ground is quite different with some functions that were meant for the LGAs being done by the central government as the following sub-sections illustrate:

**a. Developing and disseminating standards and guidelines to the LGAs and service delivery units**

The Ministries are responsible and developed Guidelines for the Management of Functions Devolved to LGAs: Ministry of Education (2008 and updated in 2014); Ministry of Health (2005); Ministry of Water Development (2002); and Ministry of Agriculture (2002). The guidelines were meant to be a quick orientation for all stakeholders involved in carrying out functions at the district level. Our analysis shows that although the Ministries developed guidelines, they do not properly disseminate them to the potential users (LGAs and service delivery units). In addition, the MDAs have neither developed nor issued grant, budget and implementation guidelines that among others: provide: i) the expected service delivery levels for the devolved services[7] (ii) basic information about the grants/transfer to LGAs (e.g., objectives/purpose, allocation formula); (iii) how the grants should be used (eligible and ineligible activities); (iv) budgeting, implementation and reporting procedures. Monitoring compliance to sector devolution guidelines and standards is at best ad hoc as there is no well-defined and harmonized framework for monitoring devolution process and its results. A key contributory factor which the sector ministries reported is that the Ministry of Local Government did not provide the requisite continuous support, guidance and coordination during the devolution processes.

**b. Planning and Financing of Capital Expenditure Responsibilities**

Contrary to Decentralisation Policy expectations, the stock take found that planning, budgeting, procurement of contracts, and implementation of LGA infrastructure projects is mostly done at central level through a variety of donor-initiated projects and infrastructure management units: In the education sector, the Education Infrastructure Management Unit (EIMU) which falls under the Policy and Planning Directorate, handles infrastructure projects (classrooms, washrooms, etc..) in LGAs. In the health sector, the District Hospital Rehabilitation Fund used for maintenance and rehabilitation of district hospitals was transferred to NLGFC starting FY 2021/22 but is still appropriated under NLGFC instead of LGAs. In addition, MoH is set to operationalize Health Centre Improvement Grants (HCIGs). Initially, MoH had planned to roll them out in 10 LGAs but this may be reduced to 4 due to Foreign and Commonwealth Development Office (FCDO) budget cuts. FCDO is financing this initiative and it will be implemented through UNICEFs Health Systems Strengthening Support programme. It is planned that after two years, MOF will take over providing such

7 See details in section 1.5

grants through LGA budget allocations. MOH reported that it is still handling construction of District and community hospitals because the amounts involved are substantial and LGAs might not be able to handle processes involved to ensure Value for Money (VFM). In the agriculture sector, MoA controls and implements all development part 2 and part 1 investments. In the 2021/22 budget, there is an allocation for livestock related infrastructure (dip tanks) – development 2 and this will be handled centrally. In general, the PIU at HQ coordinates infrastructure projects to be constructed in DADOs. Similarly, in water, large-scale water projects, are financed by donors through projects initiated and controlled by the central government. The foregoing notwithstanding, LGAs: (i) finance water infrastructure, mainly boreholes using the Water Fund to District and Urban LGAs[8]; and (ii) finance the construction of other service delivery infrastructure across the sectors using the existing discretionary development grants notably the DDF/IDF, CDF and PBG.

**c. Financing of operational expenditure responsibilities of devolved services**

Financing the operational expenditure responsibilities of devolved services is mainly devolved to LGAs. However, this differs between districts and urban LGAs; as well as between the different sectors within a LGA. Whereas financing the operations of service delivery at the District level across the four sectors is mainly through ORT (which is determined on an ad-hoc/ historical basis and is not related to the nature and volume of the devolved functions), financing service operations in Urban LGAs is mainly provided through own LGR. Among the four sectors ORT in urban LGAs is only provided to Education[9]. Unlike other sectors, for Education, financing of operations is also done through the School Improvement Grant (SIG) which is only sent to District LGAs. The education sector also allows parents to contribute to the operations of the schools by paying small sums charged by schools which does not apply to the other sectors. The foregoing notwithstanding, the respective sectors also have a budget that is used to procure essential supplies centrally. For example, the health sector has a drugs budget and MoEST procures textbooks. For water, minimal ORT in rural LGAs is provided for operation and maintenance of boreholes and, shallow wells. Operation expenditures for other large-scale water projects, are financed by donors through projects controlled by the central government. The same applies in agriculture, where financing of many operational expenditure responsibilities in LGAs is done through stand-alone projects supported by various donors and being controlled and implemented by Ministry of Agriculture. The net effect of these practices is that it becomes difficult to track the volume of resources going to LGAs. It also compromises accountability relationships where the confused responsibilities can lead to LGAs being held accountable for centrally initiated projects

**d. The functionality of LGAs and service delivery units' human resources**

Recruitment, deployment and transfer of staff is done by LASCOM in consultation with LGAs, the respective MDA and DHRMD. For example, in the Health Sector, when staff belonging to central hospitals want to be transferred to districts, they write to the LGA where they want to be transferred enquiring availability of a vacant equivalent posts. If the LGA answers in the affirmative, they then write to DHRMD requesting a transfer – DHRMD later pass on information to MoH HR. Each month, MoH HR prepares a template with all names requesting transfers which is submitted to LASCOM who make necessary additions and other changes to their records (LASCOM also forwards this information to DHRMD). MoH HR also makes necessary deletions to their payroll (and provides same information to DHRMD). Similarly, LGA staff who want to move to central hospitals write to the relevant hospital. If the post is available, they write to DHRMD. Their LGA deletes them from payroll and submits the same to DHRMD. LASCOM is also informed and make necessary deletions and write to MoH HR to add particular individuals on their payroll (DHRMD is also informed). Salary payments are done by the LGAs since November 2017 when HR devolution started. However, in the Health Sector, the MoH pays staff recruited by DPs on behalf of the Malawi government for two years until when they are absorbed onto the Government payroll. Supervision and disciplining of staff is done by LGAs as the starting point: Sanctioning and other disciplinary

8 This Fund originated as a Borehole Fund. Its name was later changed to Water Fund. In the urban LGAs, it is also used for water tanks in schools, construction and rehabilitation of boreholes and water kiosks in peri-urban areas despite the fact that the law does not allow boreholes to be drilled in urban areas.

9 Other ORT provided to urban LGAs is: GRF; Environment and Youth and Sports

procedures for staff are also now being handled by appointment and disciplinary committees in LGAs and LASCOM if need be. Since the recruitment of staff has not been devolved and is still being done centrally, it creates dual accountabilities making it difficult for LGAs to control staff mobility and ensure that there are sufficient staff in hard-to-reach areas.

**e. Monitoring and inspection of the management of service delivery by the LGAs.**

The respective MDAs are responsible for monitoring and inspection of service delivery at the LGA level: In MoES, the Directorate of Quality Assurance (previously DIAS) is responsible for monitoring and inspection. MOE Finance Directorate also reported to be making ad hoc monitoring of budget execution in LGAs. This was necessitated by numerous instances of inter-sectoral borrowing in various LGAs, where DEM office resources were used in other sectors. As a result, LGAs do not adequately report on the use of the ORT funds. In the MoH, the Directorate of Quality Assurance supported by Zone Offices is responsible for monitoring and inspection. MoH headquarters produces district planning guidelines as well as providing oversight in the preparation and monitoring implementation of LGA health sector District Implementation Plans (DIPs). MoH also conducts quarterly zonal performance reviews through which LGA performance is assessed. Zonal Health teams also visit District health offices all the time. Exit meetings are organized with the District Health Management Team (DHMT) to present findings. Each zonal office also prepares a quarterly report to the MOH headquarters. In MAIWD - Agriculture Development Division - ADD offices (across the country) which are part of HQ, are responsible for policy, standards and regulation backstopping in DADOs. They collect M&E data which HQ consolidates. ADDs are supposed to do quarterly monitoring/inspection visits to each DADO which falls under them. However, ADD Monitoring/inspection are not done routinely due to resource (monetary, transport and personnel) challenges. Most of the regulation and inspection visits conducted are done by the Seed Supplies Unit (SSU) – part of the crops directorate. The crops directorate also does inspection visits annually as part of the yearly countrywide crop yield estimation process. Otherwise, the other directorates (e.g. livestock and extension services) do regulation and inspection visits when resources permit.

**f. Monitoring and inspection of service delivery**

The District and Urban LGAs are responsible for inspecting service delivery. For primary education, inspection is conducted by the Directorate of Education and Youth (DEY); school Inspectors and Primary Education Advisors (PEAs) at each TDC (teach development centre with network of typically 10 schools. In Health, District health Offices are also supposed to make at least one supervision visit to each health centre each quarter. In Agriculture, DADOs inspecting EPA: DADOs are supposed to visit each EPA at least once each quarter for monitoring and supervisory purposes. These visits are supposed to include interface meetings/site visits with ASPs. Resource challenges mean that these are not done as scheduled. "Mobility is a serious challenge in most DADOs. For instance in Chitipa District you need good vehicles to monitor budget implementation". There are HR challenges too – some DADO sections are not manned (e.g. no AEDO, no veterinary extension officers). This affects conduct of monitoring, regulation and inspection visits. In water. At village level, monitoring by the community and its water/health committee is supposed to be done monthly. This information is passed on to the water monitoring assistants on a monthly basis who compile it for the district. At district level, the information is consolidated and then sent to the regional level for analysis and feedback. From regional level, reporting both narrative and as data files, will be done quarterly to the national level.

## 2.5 Costed LGA Service Delivery Standards

A Service Delivery Standard is the measure of the quantity and/or quality of an essential service that should be delivered by the LGA to the citizens. Usually, the central government establishes minimum service levels that lower tiers of government are obliged to provide. In Malawi some sectors such as Education and Agriculture have clearly defined service delivery standards. For example, in Education the major standards that LGAs track and document in the socio-economic profiles include the following: a) availability of teaching and learning materials-Pupil-textbook ratio (1:1); b) Pupil Classroom Ratio (60 learners per classroom) - the average number of pupils/ students per classroom in primary education in a given school year; c)Pupil Teacher Ratio (60:1)- the proportion of the number of filled authorized positions for teachers at a certain level in a given year to the enrolment at the same level in the same year and d) toilet per users ratio ( 1:25 for boys, 1:15 for girls).

For agriculture extension services, the key indicator that LGAs track is the ratio of Agricultural Extension and Development Officer (AEDO) to farmers

However, the service delivery standards are not costed to get a sense of the minimum cost implications for providing the mandated LGA services; and there are no minimum and measurable levels of services that LGAs are obligated to provide in terms of quantity, quality and time. Consequently, resource allocation for the devolved services is adhoc and  does not enable the LGAs to deliver to the level of the defined standards. The overall statistics for 2019/2020 show that the education sector still faces huge challenges in meeting its service delivery standards e.g. availability of teachers, classrooms, toilets and teaching and learning materials (Ministry of Education, 2020).  The LGA socioeconomic profiles illustrate this problem.

| | Gov. Standard | Mangochi | Lilongwe | Mwanza |
|---|---|---|---|---|
| **Teacher-pupil ratio** | 1:60 | 1:118 | 76:1 | 1:63 |
| **Pupil classroom ratio** | 60:1 | 151:1 | 149:1 | 114:1 |
| **Pupil/ latrine ration** | 25:1 for boys and 15:1 for girls | 106:1 | 100:1 | 70:1 |
| **Pupil/text book ratio** | 1:1 | | 3:1 | 11:1 |
| **Pupil desk ratio** | 2:1 | 15:1 | 10:1 | 6:1 |

**Source:** Various LGA Socioeconomic profiles

The ratios on infrastructure, staff and teaching and learning matters are very high, a clear indication of a critical shortage of teachers, desks, toilets and textbooks. Shortage of classrooms force school authorities to conduct classes in temporary classrooms/shelters. In addition, most schools have dilapidated structures such as toilets and classrooms. Similarly, for agriculture extension services, the key indicator that LGAs track is the ratio of Agricultural Extension and Development Officer (AEDO) to farmers. The national standard is 1:750. Data from a sample of districts show a very high farmer to staff ratio e.g. Mangochi 1:3200; Mwanza: 1: 1542; Lilongwe: 1: 1436 and Mzimba 1: 1198. This has led to poor service delivery because it is extremely difficult for the available extension workers to adequately reach all farmers. There is a need to introduce policies that guarantee desired minimum levels of provision for certain services at the local level.

## 2.6 Summary of Key Issues for Reform

A stable and meaningful decentralization requires an unambiguous and well-defined institutional framework in the assignment of expenditure responsibilities among the different levels of government together with the sufficient budgetary autonomy to carry out the assigned responsibilities at each level of government. There is a stable local government system characterised by: (i) legitimate Councils that have the potential to oversee the operation of the LGA administration and account to the citizens; and (ii) administrative structures that can implement council decisions.

A number of services that were planned to be devolved to LGAs under the Decentralisation Policy have actually been devolved. These include primary education; primary health care, water supply and agriculture extension. However, there are several services planned to be financed by LGAs that have not been devolved notably nursery and kindergarten as well as distance education centres. There are also services that were not intended to be devolved that have been actually devolved notably secondary health care.

There are several stipulated functions that are performed by the ministers to support the implementation of the devolved expenditure assignments. For example, development of Guidelines for the Management of

Functions Devolved to LGA and monitoring and inspection of service delivery at the LGA level. However, the ministries did not properly disseminate the guidelines to the potential users and did not develop nor issue grant, budget and implementation guidelines. MoLG did not provide continuous support, guidance and coordination during the devolution processes.

There are a number of functions that could be devolved to LGAs that are still financed and performed by the Ministries. These include: construction of infrastructure for local service delivery; recruitment, deployment and transfer of staff which is done by LASCOM and procurement of essential supplies (e.g. drugs and text books)

The foregoing notwithstanding, there are several functions that are being performed by LGAs. These include: construction of water infrastructure and service delivery infrastructure across the sectors using the existing discretionary development grants; salary payments; supervision and disciplining of staff; financing the operations for service delivery[10]; and inspection of service delivery.

Finally, Service Delivery Standards across the sectors that are measurable in terms of quantity, quality and time; costed and disseminated are not in place.

10 However, financing the operations for service delivery differ between: districts and urban LGAs; as well as between the different sectors within a LGA

# 3. LGA Own Source Revenue

## 3.1 Introduction - Legal and policy context

The 1998 Local Government Act briefly outlines in Section 44 and the Third Schedule: "locally generated revenue to include but not be limited to: (i) property rates, (ii) ground rent (iii) fees and licenses (iv) commercial undertakings and (v) service charges". No further details of revenue sources are provided in the Act (or in the 1998 Decentralization Policy that simply states the same). As further explained below, the LG Act provides guidance on several aspects of the property tax but is otherwise silent on other revenues (such as business licenses that also are regulated by the Minister responsible for Trade). Part VII of the LG Act (section 61 to section 107) provides guidance on valuation and rating, with the following highlights:

- The part of the Act applies to "areas…which the Minister shall designate by notice in the Gazette as "rate able areas" (section 61)
- In those areas not designated as rateable areas, the LGA may levy a fixed sum upon owners of buildings which can be differentiated by building use and/or a fixed sum per unit of land or fixed sum per unit of superficial area.
- For those rateable areas, all land within the local government boundary…with all improvements shall be assessable property (section 63)
- The LGA shall make a valuation roll (at least every five years) of all assessable property (section 65),
- Update the valuation roll to capture newly discovered or previously omitted properties (supplementary roll) as necessary every 12 month (section 66),
- The valuation shall specify the value of the land and property separately (section 68) and reflect market value (section 68-2),
- The valuation shall be undertaken by a valuer registered under the Land Economy Surveyors, Valuers, Estate Agents and Auctioneers Act - (section 67),
- Taxpayers can object to the valuation (section 76) which shall be heard by a Valuation Tribunal (section 78),
- Exemptions are described in various parts (mainly sections 83-86) of the Act and includes vacant public land, land and improvements used for public religious worship, educational facilities, or sport facilities. Central Government shall pay 50% of the assessed rate (section 85).

The LG Act of 1998 strengthened LGA OSR in some respects as (i) licenses were assigned to LGAs as a source of revenue (section 44) and property ratings were in principle extended to all LGAs – including rural LGAs (section 63).

Since 1998, there has been no major amendment of the LG Act, nor any other major policy shift regarding OSR assignment to LGAs which has provided a quite stable policy environment (for instance compared to Tanzania and Uganda that have changed revenue assignment on numerous occasions – in Tanzania almost every year since 2004).

A small amendment of the LG Act in 2010 (Act no 17 of 2010) mainly clarified the composition of the LGA Council and didn't change OSR assignments. Another (proposed) amendment in 2017 sought to make some adjustments to management of property taxes (mainly regarding tax tribunals and appeals as well as more detailed guidance for the establishment of rate able areas). However, there was no major adjustments of the approach to valuation or OSR assignments suggested in the final draft legislation, and it was apparently never passed[11].

## 3.2 Overall Trends of Own Source Revenue

As illustrated in Figure 3, OSR collections (both actual and budgeted) have increased very substantially over the last decade: actual collections (in nominal terms) from approximately MK1.7 billion to MK14.4 billion. However, the growth of OSR has not been able to fully keep pace with overall economic development as reflected in GDP growth over the same period.

In general, LGAs have substantially overestimated planned OSR collections (reflected in the gap between outcome and budget data in the figure below) and in 2019/20, the gap between budget and actual collections has widened.

It should be noted that the NLGFC data on OSR outcomes is based on IFMIS records from LGAs that apply accrual accounting principles – thus for instance, once large urban LGAs send invoices for property taxes through the system this is immediately recorded as "income" and not (yet) effectively addressed in subsequent updated. Thus, for some LGAs OSR outcomes is overestimated, and interpretation of details of fluctuations etc. should be made with care.

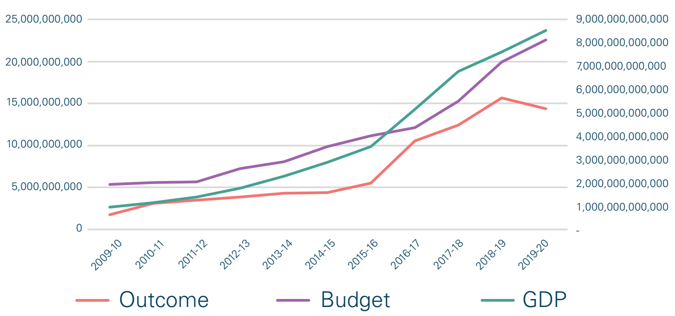
Figure 3 below shows OSR adjusted for population growth and inflation.

Analysed in this manner, it is evident that OSR growth has been far more limited than judged by analysis of nominal figures. The data indicates that throughout the period, the actual revenues have been fluctuating around MK750 percapita, without following any clear trend. Budgeted OSR has declined from about MK1800 to MK3200 per capita.

In other words; OSR collections from LGAs have increased nominally but have not been able to keep pace with inflation and population growth.

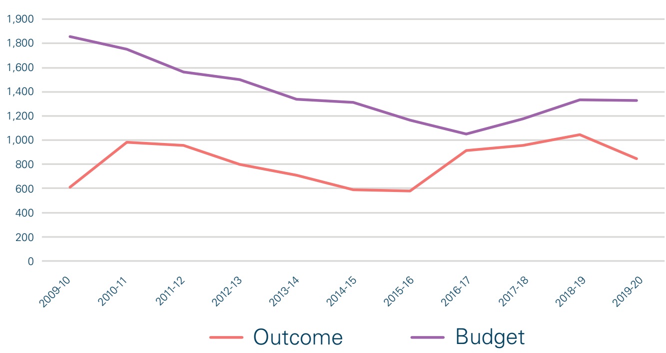
11 The 2017 LGA amendment was not passed (?) but a full copy of the Act with indication of Presidential assent is found at the website: https://malawilaws.com/malawi-bulletin-2017-acts (Act no 6 of 2017)

**Figure 2: Nominal Own Source Revenue and GDP 2009/10 – 2019/20**




**Source:** NLGC compiled data (2021) on LGAs own Source revenue.: GDP data from the World Bank (current LCU) (https://data.worldbank.org/indicator/NY.GDP.MKTP.CN?locations=MW **Note:** GDP axis is on the right, and Fiscal data is on the left.

**Figure 3: Own Source Revenue Real Per Capita 2009/10 – 2019/20 (MK/capita)**



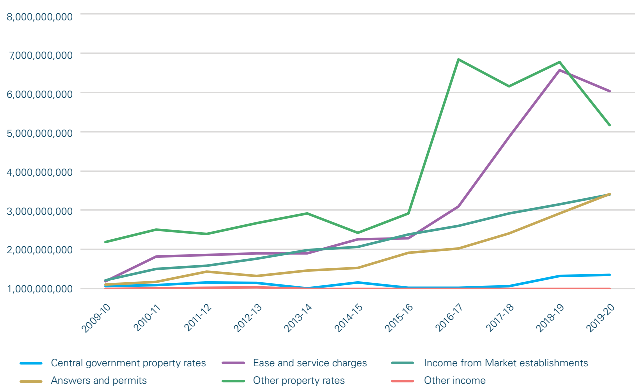
## 3.3 Composition of Own Source Revenue

As shown in Figure 4 below:

- The three most important sources of revenue are (i) fees and licenses (ii) property rates and (iii) income from markets,
- all sources of revenues have grown steadily in nominal terms (except central government property taxes).
- Property rates used to be the most important source of revenue until around 2018 where fees and charges have surged. This revenue is mainly explained by significant recent revenue from income derived from sale of plots in urbanizing LGAs – and thus not a sustainable source of revenue.

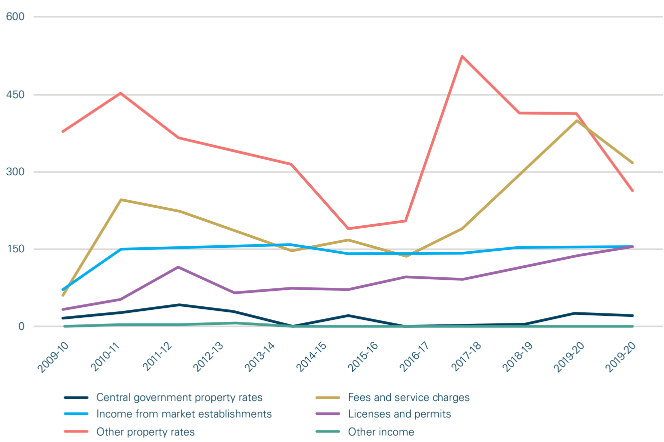
Figure 5 below illustrates the development of revenue composition as real per capita over the decade. Analysed in this manner, it can be concluded that virtually all sources of revenues have declined in terms of real per capita revenue, except for Fees and Service Charges that increased drastically in 2018 (in relation to sale of land plots within LGAs and thus not a sustainable source of revenue).

**Figure 4: Actual Own Source Revenue Composition 2009/10 – 2019/20 (MK nominal)**




**Source:** NLGFC compiled data (2021) on LGAs own Source revenue. (Nominal data).

**Figure 5: Own Source Revenue Composition 2009/10 – 2019/20 (MK real per capita)**




**Source:** NLGFC Reports – actual revenues

## 3.4 Variation across LGAs

Figures 6 and 7 below illustrates the variation on own source revenue collection across LGAs. The patterns are very clear:

- Own source revenue is primarily collected from the four big cities (with OSR ranging from approx. MK1.5 billion to MK5.0 billion), although Lilongwe District Council in nominal terms also have substantive OSR (nominally above MK2 billion) while all other LGAs are far behind in OSR collections.
- The four big cities also have by far the largest per capita OSR collection:
  - The average actual OSR collected by the four big cities in 2019-20 was MK4,060 per capita.
  - The per capita collections ranged from MK2,154 in Lilongwe city to more than MK5,622 in Blantyre City and MK13,131 in Zomba City[12],
  - The total OSR collected by those four cities in FY 2019-20 corresponded to 63% of the total OSR collected by all LGAs.

12 As discussed elsewhere: the data on actual collections have some challenges as it is based on actual invoiced rather than effectively collected -and e.g. Zomba City invoiced substantially in the most recent year.

- The two municipal councils and Mangochi Town collected 3.4% of the total OSR of the LGAs. In per capita terms, they collected MK3,760. (note: some population data missing)
- The rural LGAs have far smaller OSR collections:
    - On average their OSR collections were 302 MK/capita in 2019-20.
    - The 28 districts (with most of the population) collected only 33.7% of the total LGA OSR.
    - Within rural LGAs there is also very significant OSR variation ranging from 50 MK/capita (Kasungu District) to around 1,317 MK/capita for Lilongwe District.
- The cities rely mainly on property taxation as well as fees/licenses whereas rural LGAs rely relatively more on market fees.

**Figure 6: Own Source Revenue by LGA and type of revenue 2019/20 (MK nominal)**

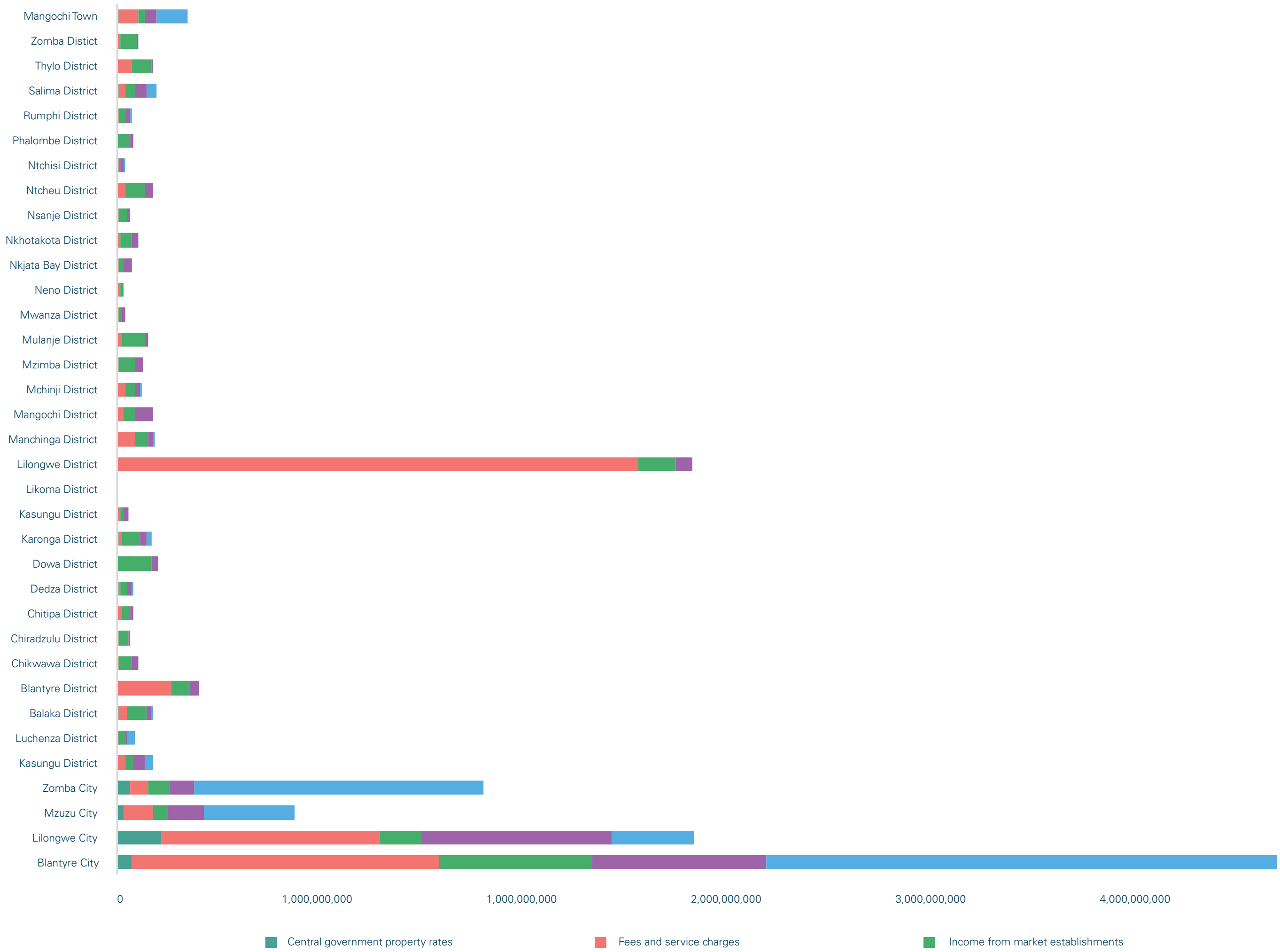
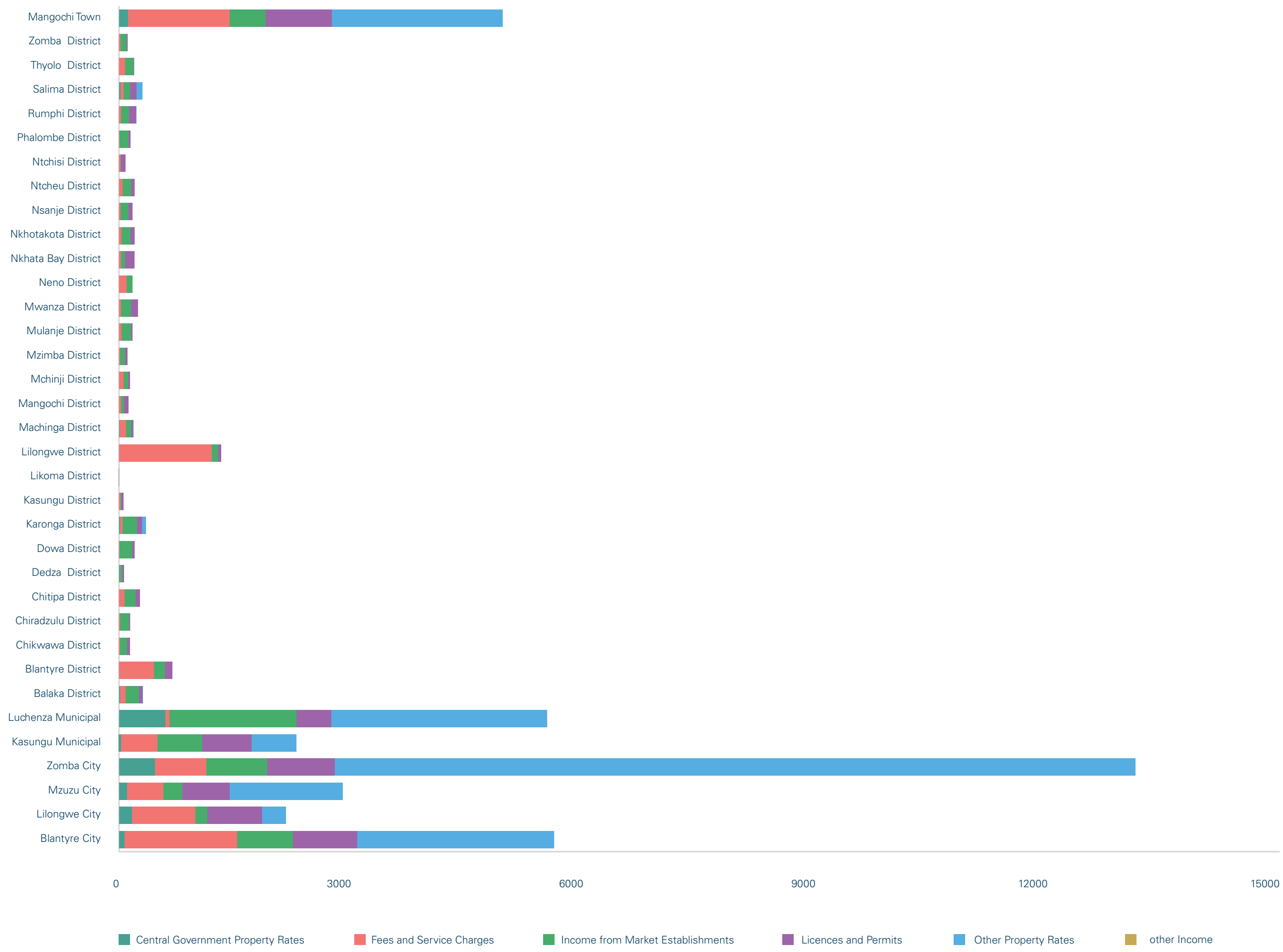


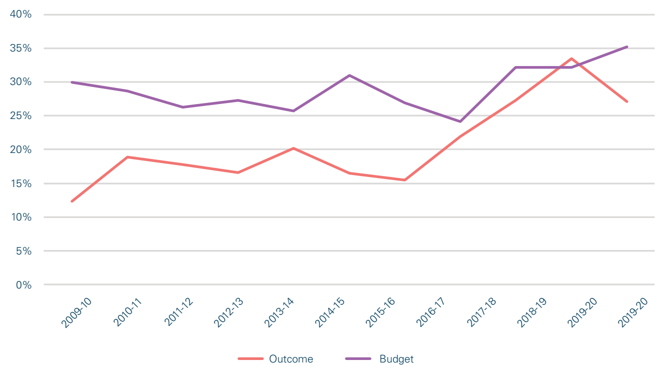
**Figure 7: Own Source Revenue by LGA and type of revenue 2019/20 (MK per capita)**




## 3.5 OSR Share of Total LGA Revenues

As shown in Figure 8 below, across the period, OSR share of LGAs' actual budget has fluctuated but generally increased from approximately 15% to 25% over the period. This is very much a result of the real (inflation and population adjusted values) decline of transfers discussed in next chapters rather than an indication of OSR growth and thus an indication of overall dwindling of fiscal resources in LGAs.

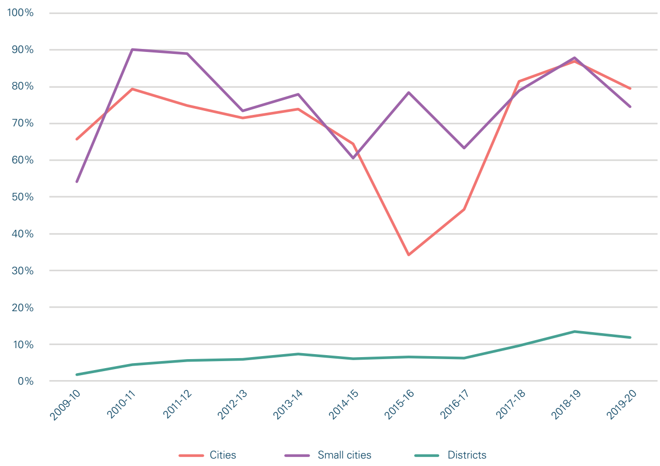
**Figure 8: Share of total budget financed by OSR (all LGAs) 2009/10 to 2019/20**



As illustrated in Figure 9 below, there are huge differences in the importance of OSR across types of LGAs – urban LGAs have financed 70-80% of the budgets from OSR, whereas rural LGAs have financed 5-10% of their budgets from OSR.

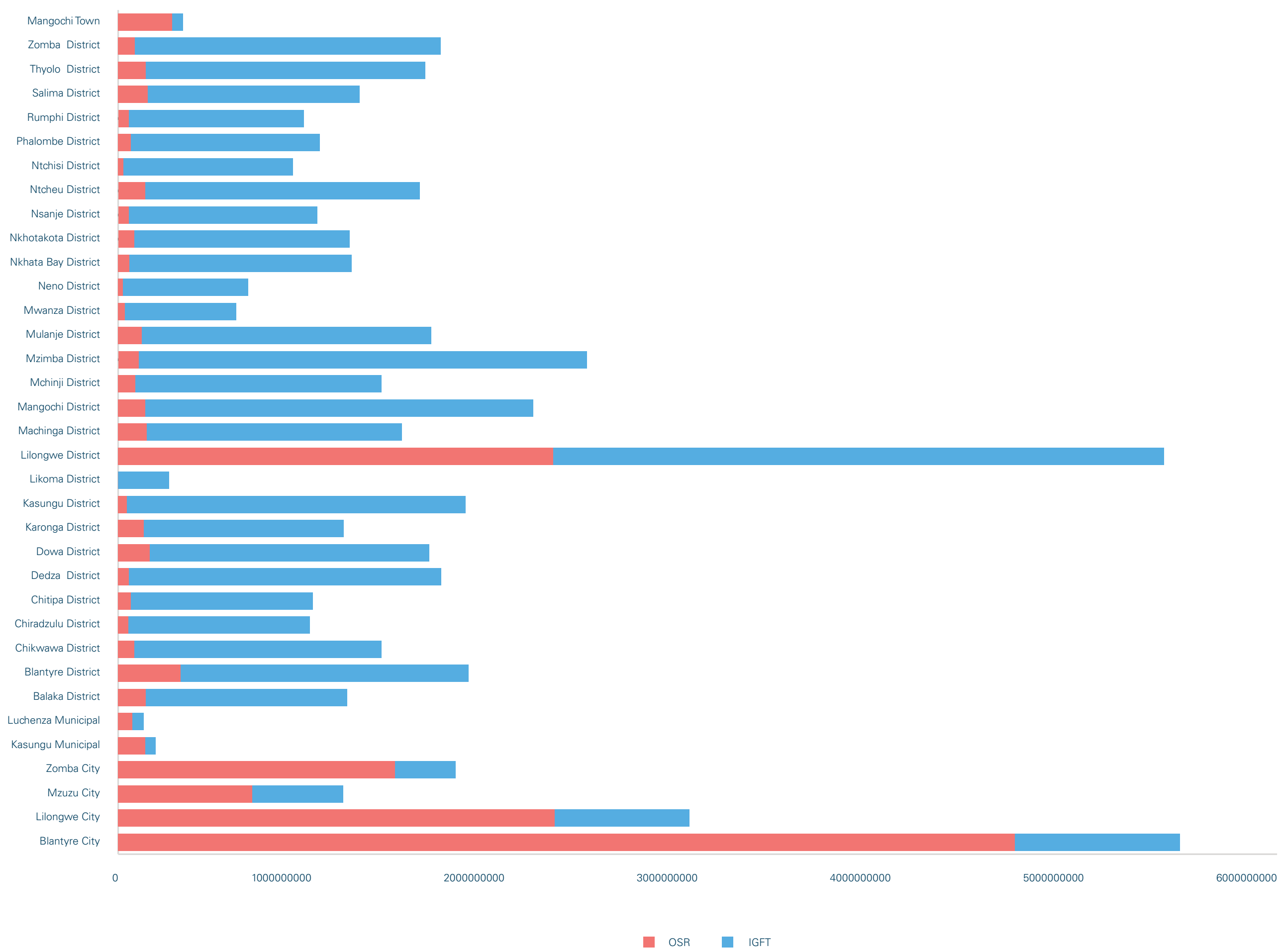
Rural LGAs mainly spend OSR on recurrent expenditure for local administrative staff, councillors' allowance – whereas urban LGAs in addition also spend their OSR on actual delivery of urban services, some contributions to social sectors (like employment of some health workers etc.) and development expenditures.

**Figure 9: OSR Share of Budget (by category of LGs) 2009/10 to 2019/20**




There is an inverse relationship between IGFT transfers and OSR – in general the LGAs with least OSR receive higher levels of IGFT – although that to a large extent reflects the expenditure assignments of rural LGAs that are more expansive than urban LGAs. As Figure 10 illustrates, one notable outlier is Lilongwe Rural District that both generates significant OSR and receives high levels of IGFT.

**Figure 10: Actual OSR and IGFT per capita in 2019/20**



## 3.6 LGA OSR Management Practices

While a separate systematic assessment of LGA OSR collection procedures or other management practices and capacities was not undertaken, a recent study[13] noted several challenges with regards to LGAs OSR management which MoLG developed with USAID support an action plan to address.

Other studies like World Bank 2017[14] also suggested that improvement of OSR management practices could lead to potentially significant improvements – in particular with regards to the urban LGAs and suggested that especially property tax revenues had a significant untapped potential while pointing to successful reform efforts in Blantyre and Mzuzu.

## 3.7 Conclusions and Key Issues for Reform Discussion Notes

1. Need for LGA specific revenue enhancement plans to ensure local optimisation of existing revenue sources.
2. Improvement of Property taxes: The relevance and feasibility of possible expansion of rateable areas and improvements for assessment and collection methodologies (and corresponding legislation)
    a. Explore opportunities for alternative and cheaper valuation methods – e.g., to allow other valuers (that are not registered under the land economy board) to undertake valuation.
    b. Clarification of guidelines on procedures that rural LGAs should follow in order to start collecting property rates (the clause that indicates that the Minister is responsible for declaring an area rateable is too general and does not provide the steps to be undertaken to get there);
    c. Explore how mass valuation can be taken on board (The current approach is too costly and difficult to be implemented outside areas with few high value properties)
3. Business taxation improvement and possible inclusion of the informal sector (ref 2021/22 budget speech) possible through LGA taxation?
4. Viability of rural LGAs OSR – and potential for cost effective improvements of rural LGA OSR management through ICT and improved management.

13 The study was undertaken with LGAP/USAID support (around 2020) "on improving Local revenues in District Councils in Malawi).

14 World Bank. 2017. Malawi Economic Monitor: Harnessing the Urban Economy. World Bank, Lilongwe, Malawi. https://openknowledge.worldbank.org/handle/10986/26763

# 4. Intergovernmental Fiscal Transfer System (IGFTS)

## 4.1 Policy and Overview of Fiscal Transfers

The Malawi Constitution states (article 151) that "Government shall be under a duty to ensure that there is adequate provision of resources necessary for the proper exercise of Local Government functions". The Decentralization Policy of 1998 provides some additional guidance on the Intergovernmental Fiscal Transfer System (IGFTS). Section 10 provides a brief statement on "financing the new Local Government System":

***For District Assemblies to translate the power and competence given to them by this policy into development phenomena a sound local government financing mechanism is required. They will have two main revenue sources: (a) locally generated revenues (traditional); and (b) central government transfers.***

With regards to central government transfers, section 10.4 of the Policy states:

Government will make available to District Assemblies at least 5% of national revenues, excluding grants, to be used for the development of districts. The distribution of these grants will be done by the Local Government Finance Committee in accordance with a formula approved by Parliament.

In practice, it has proved difficult to operationalise and monitor the policy regarding sharing of net national revenue (NNR): as there has been no consensus on how exactly to calculate net national revenue or value of LGA transfers for development[15]. In practice the share of all ORT and development transfers combined are approximately 4.5% of national revenue, whereas all development transfers combined constitute only 1.8% of national revenue, and the GRF only 0.3 of national revenue (see details in Annex 4.1).

The distribution of fiscal transfers across LGAs in accordance with a formula has, as discussed in sections below, also been challenging and in practice only applied to a small subset of transfers, such as the recently introduced Performance Based Grant (PBG) and selected elements of education transfers (capitation grants), etc.

LGAs receive in addition to the reimbursement of salaries for staff (discussed in chapter 5) two main types of fiscal transfers:

- ORT transfers composed of 18 sector specific (of which health, education and agriculture constitute 38%, 34% and 5% respectively – and other sector grants each less than 1%), and the General Resource Fund (GRF – 9.6% of all ORT transfers). In total 19 different ORT transfers[16].

15 Issues that have been debated include: in addition to donor funds, should all statutory payments be deducted from national revenue? And the transfers thus be calculated only as share of" Net National Revenue?) With regards to fiscal transfers for development – should this also include all sector transfers and ORT or focus entirely on GRF?), See Annex 4.1.

16 For detailed description of all the ORT transfers please see Annex 4.3.

- 5 different development transfers: the non-earmarked DDF (for rural LGAs) and IDF (for urban LGAs), earmarked funding for City Roads and water sector – in addition LGAs also receive Constituency Development Funds that are subjected to MP's planning priorities.

## 4.2 Historical Trends - Fiscal Adequacy of the Grants

IGFTs (ORT and development combined) have in nominal terms increased substantially over the last decade. As shown in Figure 11 below: both budget and outcome data has tripled over the period from approximately MK13 billion MK to MK50 billion (outcome data). The IGFT share of GDP has declined significantly to around 1% of GDP.

However, as Figure 12 below shows, the IGFT data adjusted for inflation and population growth indicates a significant decline from approximately MK4000 to MK2500 over the period from 2009/10-2021/22.

Figure 13 below explores the overall trends in balance between ORT and Development funding within the IGFTs: the share of development funding has increased and that of ORT in this manner has been further squeezed.

**Figure 11: IGFT (left axis) and GDP figures (right axis) for the period 2009-2022 Nominal (MK)**

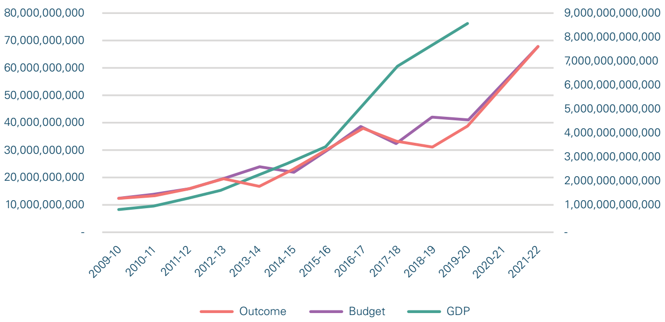



**Figure 12:IGFT for the period 2009-2022: MK real per capita**

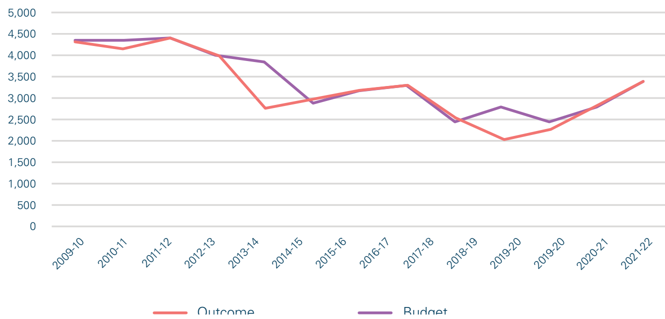
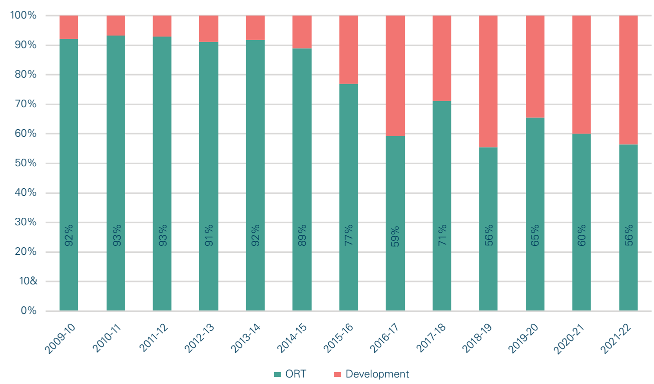


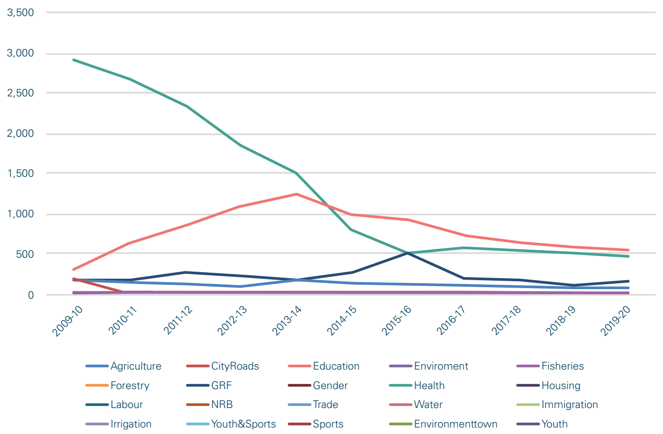

**Figure 13: Share of development and ORT transfers of total IGFT**



## 4.3 ORT Transfer Trends

As illustrated below, the real value (adjusted for inflation and population growth) of ORT transfers has declined substantially.

**Figure 14:ORT IGFT by sector 2009/10 – 2019/20: MK per capita (real value)**




- The real value of ORT transfers has overall declined substantially – mainly driven by the drastic decline of health transfers that have reduced from almost MK3,000 MWK/c to about 500 MK/c. This major decline is foremost explained by the fact that drugs are no longer financed through the LGA budgets. However, it can be noted that the real value of health transfers has continued to decrease also after this change.
- Education ORT increased substantially the first four years but has in real terms declined since 2014/15. It is today the largest ORT transfer of about 544 MWK/c.
- GRF increased slightly with a peak in 2015/16 and has since then declined in real terms and is today around 159 MWK/c

A closer look at most recent (real per capita outcome) data (Table 1 below) shows:

- Three relatively large grants:
  - Education that in recent years has declined from about 723 MWK/capita to 544 MWK/c, this is the single largest ORT grant and amounts to approximately 0.68 USD/capita.
  - Health that has declined from approx. 575 to 477 MWK/c
- GRF that declined from 198 to 159 MWK/c
- Fifteen (15) very small transfers that all have declined about 25% and now range between 8 and 11 MWK/capita. This is only approximate 0.01 USD/capita and clearly insufficient for any meaningful service delivery by any of these sectors.

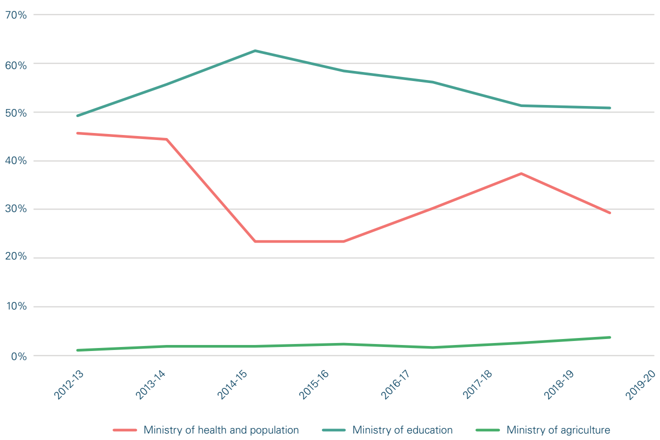
**Table 1: ORT Transfers real per capita 2016-2020.**

| | FY 2016-17 | FY 2017-18 | FY 2018-19 | FY 2019-20 |
|---|---|---|---|---|
| Education | 723 | 646 | 587 | 544 |
| Health | 575 | 539 | 516 | 477 |
| GRF | 198 | 176 | 105 | 159 |
| Agriculture | 116 | 99 | 73 | 87 |
| Gender | 30 | 28 | 8 | 11 |
| Labour | 15 | 14 | 8 | 11 |
| Irrigation | 15 | 14 | 8 | 11 |
| Immigration | 15 | 14 | 8 | 11 |
| Community Development | - | - | - | 11 |
| NRB | 11 | 14 | 8 | 11 |
| Water | 11 | 13 | 8 | 10 |
| Environment | 11 | 10 | 6 | 8 |
| Fisheries | 11 | 11 | 6 | 8 |
| Trade | 11 | 11 | 6 | 8 |
| Forestry | 11 | 11 | 6 | 8 |
| Youth | - | 11 | 6 | 8 |
| Housing | 11 | 11 | 6 | 8 |
| Sports | 23 | 10 | 6 | 8 |

The above (table 1 and figure 14) illustrates that over a decade there has been a drastic decline in the real per capita value of virtually all ORT grants. For the last four years alone, the real value of the fiscal transfers has declined with approximately 25%.

Figure 15 below illustrates trends of the three sectors (education, health, and agriculture) with relative the most devolution of recurrent funding (ORT). In spite of the majority of services – and staff - being devolved to LGAs, then the share of sector ORT funding to LGAs is only about 50%, 30% and 4% respectively for these sectors, thus suggesting scope for further devolution of the sector ORT budgets.

**Figure 15: Recurrent IGFT as % of national ORT for MoH, MoE, and MoA**




**Source:** Actual Budget data.

## 4.4 Development Grants Trends

Fiscal transfers for development in LGAs are composed of five different grants: (i) one non-sector specific transfer for rural local governments (the District Development Fund – DDF), and (ii) another non-sector specific transfer for urban local governments (the Infrastructure Development Fund – IDF). In addition, LGAs are provided with (iii) earmarked development funding for construction of boreholes (Borehole Fund), and (iv) road funding in the cities (Construction of City Roads). Finally, some local development funding is provided through (v) the Constituency Development Fund (CDF) that is supposed to finance local development priorities identified by the MPs[17]. The CDF is in this manner not fully integrated into the normal LGAs planning cycle.

All these grants are voted as LGA allocations in the national budget and monitored by the NLGFC. In addition, sectors are centrally managing and funding devolved functions e.g., classrooms through their Ministerial votes – further discussion of such type of funding by MDAs and DPs are provided in section 4.5 and 4.6 respectively.

Development transfers have been dominated by:

- City roads earmarked for the four City Councils
- Constituency Development Funds

Only lately – from around 2015/16 has LGAs through Government budget been provided with a discretionary development grant: the District Development Fund (DDF) for the rural LGA and the Infrastructure Development Fund (IDF) for the urban LGAs, but they have remained small compared to CDF (by a factor 2).

17 Note that although the CDF is funding development activities then CDF is still registered in the national budget books under the list of ORT transfers to LGAs.

For 2020/21 and 2021/22, Government has continued the relative emphasis on city roads and expanded the overall allocations significantly[18]:

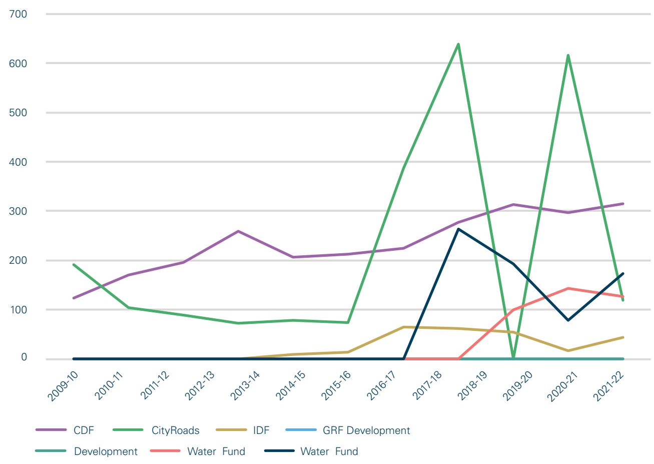
FY: 2020/21: Total LGA Development budget: MK13.6 billion of which MK7.0 billion for upgrading of city roads and MK6.6 billion for other rural projects.

FY 2021/22 (9 months) MK30 billion of which MK23 billion is for City Roads, MK2.8 billion for DDF, MK2.3 billion for water and MK0.6 billion for (urban) IDF. In addition, the Government allocated MK7.7 billion for CDF and in addition between MK4.1 and MK8.9 billion per city for road maintenance[19].

18 Financial Statements for FY 2021/21 and 2021/22 on https://www.finance.gov.mw/index.php/our-documents/budget-statements

19 Ministry of Finance Budget Statement page 38-39 for FY 2021/22 – the Budget describes these transfers although do not include them in the overview table for LGA transfers

**Figure 16: Development Transfers FY 2009/10 to 2019/20 – real per capita**




**Source:** NLGFC LGA Annual Disbursement Reports available on their website: https://www.nlgfc.gov.mw/index.php/the-star/documents/category/6-historical-disbursements-in-las

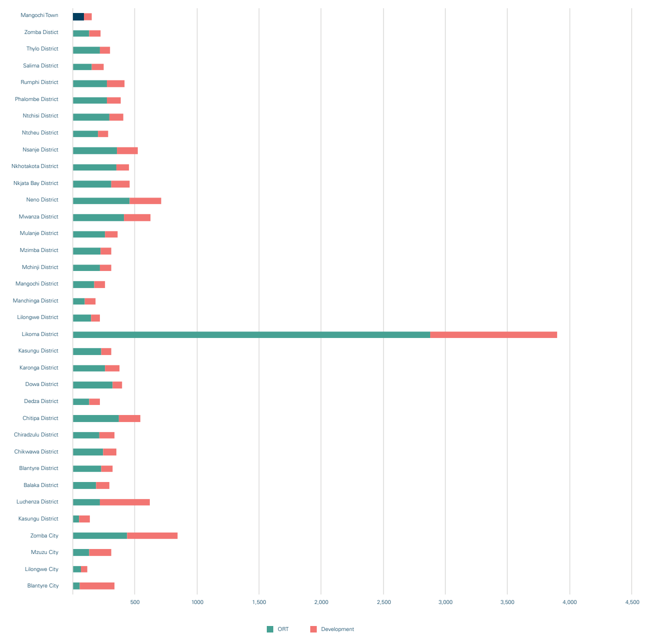
## 4.5 Horizontal allocations patterns – Equity of the Grants

Details of allocation patterns for ORT and development transfers are found in annexes 4.3 and 4.4. However, in general it can be observed that fiscal transfers are NOT allocated according to an objective formula. ORT transfers are to a large extent allocated according to past historical allocations and existing facilities and staff deployed to LGAs. Development transfers are to a larger extent subject to discretionary decisions in particular the allocation for City Roads. Urban LGAs generally receive far less ORT transfers than rural because of their lesser role in management of social sector services (health and education in particular) on the other hand they receive larger development funding (almost entirely for city roads).

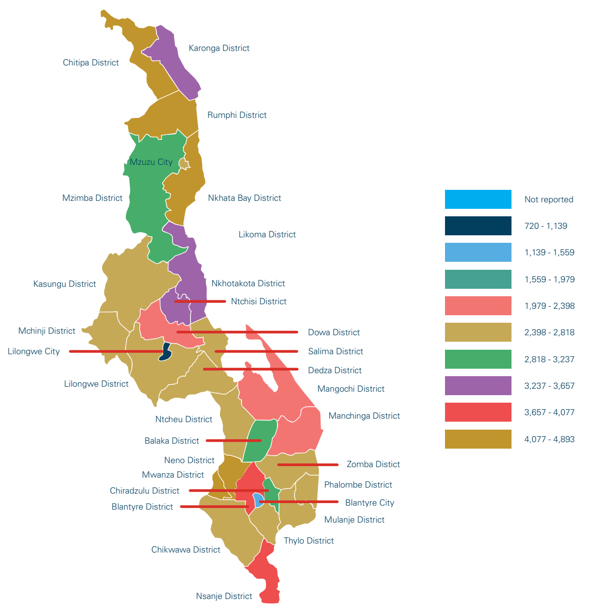
The broad patterns of total IGFT (ORT and Development) nominal and per capita allocation are presented in Figure 17 below. In general, and as expected, in nominal terms, the larger and more populous LGAs receive more funding than the smaller as they must serve larger populations. However, in per capita terms, there is very significant variation across LGAs. Some cases, like the small island LGA: Likoma District can be explained by its unique challenges in delivery of services to a very small population on an island. Other variation is more difficult to explain – e.g., why the rural LGAs such as Neno and Mwanza are receiving more than 100% extra per capita compared to Machinga and Mangochi.

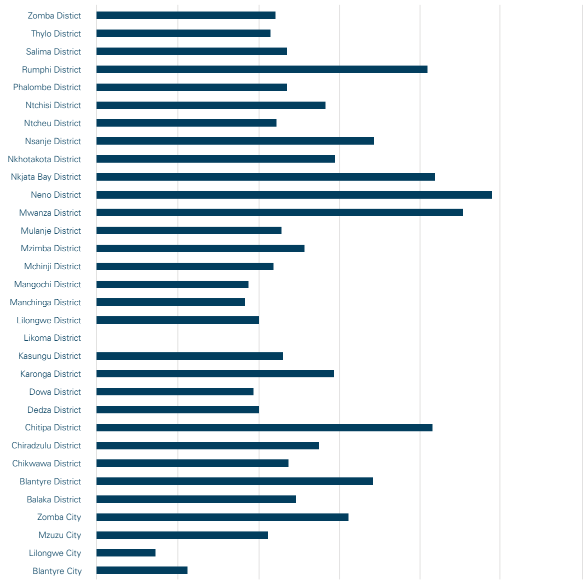
## Figure 17: IGFT Horizontal Allocation Patterns

| ORT and Development TransferFY2020/21 – nominal budget | ORT and Development Transfer FY2020/21 – per capita budget |
|---|---|


All transfers per capita allocation mapped (excluding the Likoma outlier) actual allocations 2019/20




Details on sector specific fiscal transfers are provided in annexes and can furthermore be explored in the dashboards of our LGA fiscal database.

## 4.6 DP/MDA Funding and Reform Initiatives for IGFT

Several MDAs, including ministries responsible for education, health, agriculture and local governments, are financing activities at LGA level that in principle are devolved functions under the mandate of LGAs. Some of these funds that currently are held by MDAs can and should be transferred to LGAs through the IGFT system. These funds includes both elements of the GoM recurrent and development budget as well as DP funded activities as summarised further below and discussed in more details in respective annexes (4.5 and 4.6)

Annex 4.5 and 4.6 examine whether spending which is currently carried out at central level could be decentralised to local councils by being included in the IGFT system.
Annex 4.5 examines government of Malawi-financed expenditure in the agriculture, education, health and water sectors. General local government functions under the Ministry of Local Government are also examined. It finds that the centrally-held budgets for district drugs, and the around 10% of the education development Part 2 budget, and around 70-75% of the health and local government Part 2 budget are on district functions and should arguably be decentralised. If this is to be taken forward, consideration will need to be given as to whether there is a case for additional sector-specific development transfers, joining the existing water development grant, or whether development transfers should be streamlined around a single development grant for rural (DDF) and urban (IDF) local governments.

Annex 4.6 examines on-budget development partner-financed expenditure in these sectors, both at the central and local levels. At central level, development part 1 financing spending that could be considered for devolution either provides financing for primary schools and health facilities, often through performance-based grants, or is financing investment in service delivery infrastructure (for education, health and water). However, it may not be straightforward to transfer these funds to local governments because of a variety of fiduciary and other issues. Some local governments are also reporting significant amounts of development partner financing in their financial statements. However, these contain little further detail, and the large variation in amounts reported plus the fact that not every district is reporting suggests that there is not a standard approach for how to include DP funding in accounts. A first step would be to regularise and improve LGA recording of development partner support in budgets and financial statements. Once this is done it could be examined whether any of these funds should also be recorded in the national budget, as a transfer to LGAs.

Each of the main sectors (education and health sectors, and to lesser extent agriculture and water as discussed in annexes 7.1. to 7.3.) pursue aspects of reform for improved service delivery that are of relevance to reforms of the IGFT system. In addition, the Government is reforming the discretionary part of the development grant system (DDF) through the Governance to Enable Service Delivery (GESD) Project (for details see annex 4.4).

As discussed further in these annexes:

- The Government has under GESD established a reform of development funding to LGAs, whereby funds are provided along a basic formula but adjusted annually in accordance with performance. This Performance Based Grant (PBG) is a discretionary grant to (initially only all the 28 rural) LGAs and can be used by LGAs in accordance to local needs across sectors. The established PBG presents a model for future further devolution of development funding to LGAs.
- Of all the sectors analysed, education sector has progressed most in terms of programming for more equitable and adequate sector funding through the IGFT system. However, all sectors have unique challenges and opportunities for reform of the IGFT that need to be considered when developing the Fiscal Decentralization Strategy.
- While many DP funds for LGA service delivery are reflected in the accounts of individual LGAs, then they are not reflected as IGFTs in the national budget, and it is difficult to determine how they contribute to equity of fiscal allocations.

## 4.7 Summary of Key Issues for Reform Discussion

- **IGFTs are intended to fill the gap between the own revenue sources assigned to LGAs and the costs of provision of devolved services** – however, the size of fiscal transfers are inadequate:
  - the real value of IGFT has declined over the last decade. In particular, ORT transfers have declined in real value: adjusted for population growth and inflation LGAs receive today approximately 25% less of what they received four years ago.
  - There are significant local infrastructure and service delivery gaps within the LGAs, and it's beyond the fiscal capacity of LGAs to substantially address all of these. The purposes of the specific grants are vaguely formulated, and, in this manner, it is difficult to hold the LGAs accountable for delivery of the related services and impossible to determine the exact funding needs.
  - The GRF for instance should allow LGAs to perform basic administrative and policy functions – but the low level of funding has led some LGA to accumulate debt as they cannot finance all the required expenses.
  - The National Decentralization Policy stipulated that no less than 5% of National Net Revenue should be set aside for LGAs development. While the precise approach for monitoring this policy has been debated[20], then, using conservative estimates, GRF only constitutes about 0.5% of NNR and the combined value of all development funds to LGAs only once in recent years have been above 3% of NNR.
- **The devolved functions of LGAs are to a significant degree financed outside of the IGFT system** as (i) some GoM funding for devolved functions (both capital and ORT) are managed by various MDAs rather than the LGAs and (ii) several DP supported projects for LGA service delivery are classified as MDA votes.
- **The majority of IGFTs are in the form of conditional / earmarked grants to LGAs,** only the GRF and DDF/IDF transfers are to a degree unconditional / non earmarked. If all transfers are highly earmarked, it is difficult for LGAs to respond to local needs and priorities and LGA budgets will reflect only national budget priorities. The CDF is unconditional but subject to planning priorities of the MPs. Unless addressed, this will undermine the overall rationale of the entire decentralisation process: that LGAs should be accountable to their local citizens and ensure that budget allocations are made in response to local needs and priorities. Currently the GRF is effectively spent mainly for ORT of administrative functions and councillors' allowances, leaving only the DDF/IDP (and CDF) as a discretionary source of finance subject to local planning and budget prioritisation.
- **The allocations of fiscal transfers across LGAs are highly inequitable.** Some LGAs will in spite of similar profiles receive significantly less than others: for ORT mainly for historical reasons as many transfers are based on the number of facilities and staff within the LGA, whereas inequities in development is more ad-hoc. The degree of per capita inequities varies across the various fiscal transfers: typically, the smallest transfers are distributed with the highest degree of per capita inequities. In general, the allocations of transfers are not made in accordance with objective formulas (as otherwise indicated in the Decentralisation Policy). Both NLGFC and several sectors have developed proposals for allocation of fiscal transfers according to various formula, but most of these initiatives have not been implemented in practice. It is recommended to initiate a process for practical introduction of formula-based allocations (discussed further in reform discussion notes) based on:
  - Clarification of grant objectives,
  - Consultations on need-based formula for each of the grants (to the extent that they have different objectives it is necessary with different formulas),
  - Gradual introduction of formulas over a medium-term perspective where LGAs are held harmless (i.e. no LGAs should be allocated less in nominal terms as result of formula based allocations).

20 For instance: what elements of LGA transfers should be included in the calculation (only GRF? Or all development funds? Or all transfers including also PE transfers?). The definition of national Net revenue is also debatable: should debt payments, pension payments and all other statutory payments be deducted from gross national revenue before the % share is determined? For detailed analysis see the Situational Report.

# 5. LGA Fiscal Transfers – PE

## 5.1 Introduction

LGAs need adequate, competent, and motivated staff to properly handle the increased financial resources for improved service delivery. In Malawi LGAs, there are broadly two categories of staff:

- Staff recruited by LASCOM[21], posted in LGAs and paid using PE transferred from Central Government: These are staff from Grade K and above that include: District secretariat staff, primary school teachers, health workers, extension workers as well as health workers and teachers posted in urban councils but paid under the district.
- Staff directly employed and paid by the LGAs using the Local Government Revenues (LGRs) or General Resource Fund (GRF). These are staff in Cities which include those in the secretariat, additional teachers and health workers as well as staff in districts from Grades L and below.

This chapter discusses the situation regarding the fiscal transfer system by PE which constitutes the highest component of fiscal transfers focussing on:

- Consistence of staff on LGA payroll and staff in actual positions.
- Distribution of PE and staff across Districts; and
- Payroll management

21 Note that most of the existing staff were recruited by Central Government and transferred across LGAs until 2017 when they started to be recruited by LASCOM.

## 5.2 Consistence of staff on payroll & staff in post

Sometimes, staff on LGA payroll differ from staff in post. There are cases where: (i) staff are seconded to the center but remain on LGA payroll; (ii) staff transferred are not deleted from their previous payroll, particularly when there is no vacant positions in the district where they are going; and (iii) HR does not take action to delete the staff from payroll.

As a result, some District Councils have ended up with more staff than warranted by the authorised Establishment. In some instances, this has resulted into some District Councils having employees that are being paid by another District Council and even some urban LGA staff appearing on the district payroll. This is attributed to the fact that some of the employees are posted to Councils where there are no vacancies and/or to non-existent posts contrary to Section 5(2) of the Malawi Public Services Act (1994).

There are cases where LASCOM has contributed to some of these challenges. For example, there are instances where posting instructions within a District Council and other directives come from Local Government Service Commission (LASCOM). This contravenes LASCOM mandate which is to recruit, promote and handle disciplinary cases of employees in District Councils. This has resulted in the LASCOM taking over the responsibilities of the Controlling Officers in posting employees to different stations whereas its mandate is confined to recruitment, promotion and handling of disciplinary cases of employees only.

## 5.3 Distribution of PE and staff across Districts

The number of staff per District vary greatly. The number of staff vary from 196 and 1,548 in Likoma and Mwanza Districts respectively to 10,379 and 17,755 in Mzimba and Lilongwe Districts respectively.

Assuming similar levels of labour productivity and efficiency, the variances in the number of staff per District is not necessarily a problem if it is based on the level of service expected to be provided as among others measured by the population being served. The need for more travel time to cover larger geographical areas in rural districts notwithstanding, an analysis of the number of staff per District per 1000 people again shows great variances. Rumphi and Nsanje District have 15 and 14 staff per 1000 people respectively as compared to Blantyre and Lilongwe with 6 staff per 1000 people respectively.

PE allocation per capita also varies greatly and PE allocation per staff is unequal. This may be because the proportions of staff per category differ by district council, hence differences in pay scale.

The inequitable distribution of PE and staff across Districts is mainly because: (i) some LGAs are not proactive enough to request for additional budget lines for vacant positions[22]; (ii) MDAs do not support the LGAs; and (iii) there are cases where the Districts and service delivery facilities which are attractive as a place of work (with amenities, proximity to urban areas) are better staffed a manifestation that staff are deployed to the LGAs and service delivery facilities they prefer instead of where they are most needed. The political economy network mapping for example revealed that teachers leverage informal networks and political patronage to resist placement in remote schools, while administrative officials are unable to stand up to these formal and informal pressures, in part because of a lack of reliable databases and objective criteria for the allocation of teachers[23]

22 Districts need to request a budget line for a position to fill. This budget line will be controlled by treasury which will make sure that the position is vacant. If the district do not request for the budget line the vacant position will never be created

23 Salman Asim et al Policy Research Working Paper 8253, Moving Teachers to Malawi's Remote Communities, A Data-Driven Approach to Teacher Deployment

## 5.4 Payroll Management

The PE data on HRMIS is incomplete and does not provide historical trends. A recent personnel audit has also found that poor management of records and weak internal controls have adversely affected the integrity and accuracy of the HRMIS database leading to incomplete data relating to Human Resource Management. It also acknowledges that the HRMIS needs to be redesigned and upgraded.

Lack of quality data does not facilitate objective allocation of staff and PE which maintains inequities and affect service delivery. There were also claims by LGAs that procedures for LGAs processing of payroll are complex as some of the rights were retained at the centre[24] which is expensive. However, it was noted that this is being done to ensure fiduciary safeguards.

## 5.5 Summary of Key Issues for Reform

1. Sometimes, staff on LGA payroll differ from staff in post: There are cases where: (i) staff are seconded to the center but remain on LGA payroll; (ii) staff transferred are not deleted from their previous payroll, particularly when there is no vacant positions in the district where they are going; (iii) HR does not take action to delete the staff from payroll.
2. PE and staff are inequitably distributed across and within Districts: This is mainly because: (i) some LGAs are not proactive enough to request for additional budget lines for vacant positions; (ii) MDAs do not support the LGAs; and (iii) there are cases where the Districts and service delivery facilities which are attractive as a place of work (with amenities, proximity to urban areas) are better staffed, a manifestation that staff are deployed to the LGAs and service delivery facilities they prefer instead of where they are most needed.

24 For example adding and deleting employees from the payroll requiring the LGAs to go to Lilongwe every month to effect changes on the payroll

**3.** Payroll management: The PE data on HRMIS is incomplete and does not provide historical trends. A recent personnel audit has also found that poor management of records and weak internal controls have adversely affected the integrity and accuracy of the HRMIS database leading to incomplete data relating to Human Resource Management. It also acknowledges that the HRMIS needs to be redesigned and upgraded. Lack of quality data does not facilitate objective allocation of staff and PE which maintains inequities and affect service delivery. There were also claims by LGAs that procedures for LGAs processing of payroll are complex and expensive as some of the rights were retained at the centre. However, it was noted that this is being done to ensure fiduciary safeguards.

# 6. LGA Debt and Borrowing

## 6.1 Legal and Policy Framework

The Local Government Act allows councils to obtain overdrafts and loans from local financial institutions such as banks. Overdrafts may be used to address short-term regular expenditure needs. On the other hand, loans are intended to assist councils make long-term investments. Council approval is required before an overdraft can be obtained. However, for a council to obtain a long-term loan, it must have the approval from the Minister of Finance in line with the Public Finance Management Act[25].

According to the World Bank Urbanization Review, the Development Fund for Local Authorities (DFLA) is the only institution in Malawi that lends investment finance to local governments. DFLA was established (as a Trust Fund) in 1993 with a start-up capital of about US$ 8.5 million, as part of the World Bank funded Local Government Development Project (LGDP)[26].

## 6.2 DFLA Performance

According to the World Bank Urbanization Review, the DFLA, as intended, has provided grant and loan finance for local government investments: since 1993, DFLA has lent or granted funds to 31 local governments for a range of investments (construction of roads, market facilities, and other infrastructure, purchase of vehicles, etc.). Most DFLA grants/loans were approved in the period between 1994 and 1998; after the late 1990s DFLA activities appear to have ground to a standstill, because of capital depletion – itself due to poor rates of repayment, debt cancellation, attrition through the conversion of loans to grants (which became an ever-larger proportion of DFLA funding), and management costs. Since 2010, DFLA has re-commenced operations on a very modest basis of a greatly diminished capital of about US$ 1.4 million and is seeking to replenish its revolving fund. Although it is still – in legalistic terms – a functioning institution, DFLA is effectively non-operational and no longer a significant source of investment finance for local governments, few of which are even aware of the Fund's continued existence[27].

The World Bank's ICR (2001) for LGDP noted that: "The financing mechanism (DFLA) set up by the project was a failure" (p. 17). While the DFLA, as a form of revolving fund, was expected to reconstitute itself through LG repayments, this did not happen " … due to the chronic failure of local authorities to service their debt obligations". The ICR further notes that: "The DFLA apparently never incorporated any systems to assess the creditworthiness of the local authorities to which it "lent". In practice, the costs of new sub-projects financed under the LGDP would automatically appear as "loans" to the local authorities with no ex ante analysis, discussion, or agreements". Although infrastructure investments were completed (behind schedule), the DFLA was evaluated as being un-sustainable.

25 Ministry of Local Government and Rural Development 2013: Guidebook on The Local Government System in Malawi (Revised October, 2013).

26 Word Bank 2016: Republic of Malawi, Malawi Urbanization Review: Leveraging Urbanization for National Growth and Development, Report No: AUS10133, April 15, 2016. Note the Local Authorities Loans Fund Act no 39 of 1971 is apparently the original legal basis for the Fund and has not been changed.

27 Ibid, page 46.

In the FY 2020/21 development budget the government set aside 800 million MWK for recapitalization of DFLA and the Fund is thus still operational.

Annex 6 provides more details on the performance of the loan's portfolio in recent years. In general, it appears from available information from DFLA that only one LGAs per year is provided with a loan and typically for a small capital project like market construction likely to contribute to OSR generation. According to availed data from DFLA, the most recent loan was provided to Blantyre City for their property valuations.

During the study our team sought to assess annual reports from DFLA, but these were not availed and are apparently not made public.

The DFLA is a relatively small organization with a board of directors chaired by the Secretary for Local Government. MALGA is also represented on that board. The day - to - day business is steered by a Secretariat which is very lean (CEO, Director of Operations who also doubles as Credit/Loans Director, Director of Finance and Assistant Accountant). However, this lean Secretariat is understandable considering their current loan portfolio.

The average annual loan issued over the last seven years is 158 million MWK or 190,000 USD per year. In per capita terms this translates into 0.01 USD/capita and is thus a relative insignificant part of total LGA revenue. However, as the loans generally is allocated to only one LGA each year then the fund could potentially support innovative investments although this probably would require additional technical expertise within DFLA – potentially for linking access to wider financing or PPP arrangements. Note that the mandate for approval of LGA bank borrowing lies with the Ministry of Finance (as per the provisions of the Local Government Act) and that further reform of LGA borrowing would require coordinated approach by the involved ministries and DFLA.

## 6.3 LGA Indebtedness and GoM Bailout Plans

LGAs have accumulated various debt to suppliers, service providers and even for own staff salaries[28]. In June 2021 it was reported that "The Malawi Local Government Association (MALGA) expressed excitement with the decision by the Central Government to sanction audit of debts in the councils, a process that will pave the way for a bailout package for the councils". It was further noted that "cumulatively, the councils owe various suppliers and service providers in excess of K14 billion, which they have failed to settle due to inadequate funding"[29].

Review of the most recent LGA financial statements of (2019/20) indicates that:

- LGAs generally have a total positive net balance (total assets / liabilities) because of the accrual accounting principles whereby properties, land and buildings are included in the overall balance.
- A narrower comparison of current assets and liabilities reveal that most LGAs still have positive balances in particular Blantyre City Council with a net balance of 7.8 billion, but also significant surpluses in some rural LGAs (ref figure below). Such assessments of net positive balances are of course on the assumption that LGAs debtors are capable and willing to pay their debts (that for instance include substantive owed property taxes or similar revenues).
- However, several LGAs have substantive negative balance sheets – this includes Mzuzu City Council, Nkhata Bay District, Machinga and Karonga District LGAs (see details in annex 6).

28 https://www.zodiakmalawi.com/nw/national-news/66-news-in-southern-region/3434-nsanje-district-council-employees-not-paid-for-3-months

29 Malawi Nyasa Times 19 June 2021 https://www.nyasatimes.com/malga-excited-with-govts-positive-response-to-calls-for-bailout-for-councils/

# 6.4 Key Issues to Consider in FDS

- LGA indebtedness must be considered in a fair and sustainable manner:
    - to ensure that the indebtedness does not incur again – it must be assured that chronic imbalances between revenues and expenditures for selected LGAs are addressed.
    - that LGAs with poor management performance are not rewarded.
- Long-term borrowing for capital outlays is a sound element of LGA financing, however
    - Is the current set up of DFLA appropriate?
    - Are alternative credit facilities possible to explore…e.g. in connection with specific PPP arrangements etc?

# 7. Institutional Arrangements

## 7.1 Introduction

Fiscal decentralisation cannot work without effective LGA systems, strong state functions, strong and robust monitoring of LGAs, and a strong mechanism of coordinating the fiscal decentralisation policy, fostering dialogue among the various actors, coordinating the management of grant and revenue systems, and facilitating coordination of grant allocation criteria and other modalities. Strong state functions include developing guidelines, supporting implementation and providing oversight to ensure adherence by LGAs to financial management and service delivery standards.

To guarantee the efficient delivery of public services there is need to have structures and processes at both the national and LGA levels that among others ensure that the funds transferred to LGAs: are used for the intended purposes; achieve value for money when spent; and are properly recorded and fully accounted for. At the national level there is need to have institutions and processes for the development of the policies and systems, supporting and inspecting the LGAs to ensure that LGAs adhere to the set guidelines and improve the delivery of services. Similarly, there is need to have LGAs that can allocate and use resources to promote services for their constituents.

This chapter assesses the key national and local level institutional arrangements (processes and structures) that are meant to implement, coordinate and monitor the overall fiscal decentralization in Malawi.

## 7.2 National Level Institutional Arrangements

The regulatory framework that governs the Local Authority financial management function is made up of the following: (a) The Constitution (b) Public Finance Management Act (PFMA), 2003 (c) Public Audit Act (PAA), 2003 as amended (d) Public Procurement and Disposal of Assets Act (PPDA), 2017 and (e) Local Government Act (LGA), 1999. This legislative framework identifies several key institutions with roles to play regarding the management of fiscal decentralisation. These include: the NLGFC, MoF, MoLG, Sector Ministries, and Auditor General and Parliament. Table 2 below provides a summary of their roles

**Table 2: Functions of National Institutions Regarding Fiscal Decentralization**

| Institution | Core Functions |
|---|---|
| NLGFC[30] | **Budgeting**<br>• Receive all estimates of revenue and all projected budgets of all LGAs;<br>• Prepare a consolidated budget for all LGAs;<br>• Consider submissions of supplementary estimates/reallocations from LGAs; and<br>• Make application to the Minister for supplementary funds for LGAs where necessary.<br><br>**Accounting and financial management**<br>• Examine and supervise accounts of LGAs;<br>• Receive final accounts from LGAs and forward a copy to the Auditor General;<br>• Receive a copy from the Auditor General of the report of the LGAs audited accounts; and<br>• To have power to disallow any item of expenditure and to surcharge.<br><br>**Fiscal allocation and transfers**<br>• Make recommendations relating to the distributions of funds allocated to LGAs; and<br>• Revenue mobilization. |
| Ministry of Finance | • Overall economic and fiscal policies – allocation of LGA and (partially decentralized) sector financing in GoM budget and determination of overall size of grant pool for LGAs.<br>• The Budget Division manages the allocation of national resources sustainably. This is achieved through the management of the government national budget and the resource allocation to public sector institutions.<br>• Accountant General – setting national accounting standards – oversee and develop IFMIS implementation.<br>• Internal audit standards, guidelines and capacity building. |
| Ministry of Local Government | • Coordination of LGA policy related issues.<br>• Leading decentralization policy developments – including issues related to e.g., LGA own source revenues.<br>• Oversight and coordination of district level training and capacity building activities<br>• Coordination of the annual LAPA exercise |
| Sector Ministries | • Policy setting and standards – including for devolved services.<br>• Capacity building and supervision of local sector service delivery in LGAs.<br>• Advice on sector allocation formula.<br>• De-facto decision making on distribution of sector resources - not flowing through LGA votes - across LGAs. |
| Parliament | • Approval of LGA Budgets and key finance policies such as allocation formulae. Oversight of national and LGA budget implementation |
| Auditor General | • Audit of all public institutions including LGAs. |

How well do the listed institutions perform their functions in as far as fiscal decentralisation is concerned?

30 For the NLGFC, the core functions are outlined in the constitution.

### a. Ministry of Local Government (MoLG)

The Ministry has a strategic role to play as coordinator and facilitator of the implementation of the decentralisation policy by various stakeholders at the national, council, and community levels. It also ensures that the Local Government System is operating effectively by providing technical guidance and support to the local councils. However, the MoLG has paid a disproportionate attention towards the coordination of decentralisation policy in general and sectoral devolution with scanty attention towards fiscal decentralisation and financing arrangements of the devolved services. As of June 2017, 17 sectors had developed their devolution plans as well as management guidelines – most of which are now outdated (see discussion in chapter on expenditure assignments). However, review of the Second National Decentralisation Programme revealed the ministry's limited focus on its coordination, performance and standards enforcement functions largely due to the existence of high vacancy rates at professional and technical levels. To date these coordination and enforcement challenges have persisted. The MoLG has not played an active role to ensure that what sector ministries promised to devolve is actually devolved. Part of the problem is that the MoLG itself does not have the moral ground to deal with sectoral resistance to devolution because it has not devolved its functions to the LGAs as well.

### b. NLGFC

NLGFC derives its mandate from the Constitution. Since the onset of decentralisation, the committee has been able to do the following: established ORT grants for the vast majority of devolved functions and developed systems for improved LGA PFM. However, without subsidiary legislation, the reporting lines for the Committee are not spelt out clearly and hence in practice reports to the Ministry of Finance on financial matters and Ministry of Local Government on administrative matters affecting LGAs. This duo reporting is confusing and makes the Committee ineffective. In practice the Committee does not work proactively to engage Treasury and coordinate the allocation of resources. In its strategic plan, the NLGFC itself acknowledges a variety of constraints which it faces such as; lack of internal coordination of reporting requirements from LGAs; inadequate feedback mechanism for responding to LGAs monthly reports, inadequate technical support to LGAs on various functional areas. Currently there are no updated guidelines that are based on to determine the amount for the various grants to be transferred to LGs. The transfers to the LGs are allocated by the NLGFC using ad hoc means. Ideally transfer of funds to the LGs should be rule / formula based.[31]

### c. Sector ministries

Some sector ministries such as Health, Education, Water, Agriculture etc have developed devolution plans and guidelines concerning the services that have to be delivered by the LGAs. Many of the guidelines provide an indication of the functional responsibilities that have to be performed at the LGA level and those that have to be performed by line ministries. However, in practice the sectoral ministries have not fully implemented the devolution plans. The 2014 review of decentralisation noted that while the guidelines were thorough in their coverage, they left some room for ministries to resist the devolution of their functions since they were given the leeway to determine what to devolve and what to retain as their core functions (Kutengule, et.al 2015). The sector ministries have exercised discretion on what devolved responsibilities to transfer to LGAs and which ones to retain. As a result, all the sector ministries have not devolved assets associated with the devolved functions and have still retained control over development expenditure budgets and are still implementing micro-projects in LGAs.

### d. Ministry of Finance

As part of its roles of managing the government national budget and the resource allocation to public sector institutions, the Ministry of Finance provides indicative ceilings for transfers to LGAs and issues the budget preparation guidelines. However, within the Ministry of Finance, there is no clear responsibility for monitoring and analysing the total level of resources allocated to LGAs, and its sectoral and functional composition. Therefore, MoF does not effectively analyse whether resource allocation to LGAs is in line with the Government's broader policy commitments and objectives. The Budget division does not measure/report the overall level of

31 USAID (2019). Malawi's Fiscal Decentralization Architecture, Progress Made, Current Status and Strengthening Alignment of LGAP's PFM Interventions. Research Report for the Local Government Accountability Project (LGAP): Lilongwe.

decentralisation (ORT plus development) during the budget consolidation process.

**e. Parliament**

Along with central agencies, there is also an important role for parliament, as approvers of the annual budget and the creation of new local governments. This involves ensuring that allocations are equitable across local governments. Having a more holistic institutional oversight of total allocations is particularly important for fragmented intergovernmental fiscal transfer systems like that of Malawi. However, political interests of Members of Parliament prevent them from taking a strategic view and objective discussion of fiscal decentralisation in an open manner. A Political Economy Analysis of Decentralisation and Local Government Reforms[32] found that MPs are more interested in ensuring their electoral visibility against the local councillors. Thus, because of this the MPs tend not to promote needs based equitable allocation of development resources through the DDF. They favour more funding modalities that promote constituency allocations where they have overriding control such as CDF and Borehole Fund.

**f. Inter-ministerial Coordination challenges**

Coordination should be horizontal (between various ministries) as well as vertical, between central and local governments. There are a number of fiscal decentralisation issues that require coordination across MDAs. Some can be addressed at the technical level and others require policy guidance. At the technical level, the issues that need to be discussed and/or coordinated to ensure consistence across MDAs include: objectives and allocation formulae for the respective grants; as well as budget, implementation and reporting arrangements for the respective grants. The issues that require cross-sectoral debate and guidance at the strategic level include: the degree to which LGA should be granted autonomy in budget allocations and/or adhere to nationally determined policy prioritizations; and integration of DP funding into grant structures and the reporting structures. There are inadequate formalized/systematic coordination mechanisms that provides space to discuss cross-sectoral issues related to fiscal decentralisation.

32 USAID (2017). Political Economy of Decentralisation and Local Government Reforms in Malawi. Research Report for the Local Government Accountability Project (LGAP): Lilongwe

Previous studies[33] have shown that there is no clear administrative and political oversight and demand over the implementation of decentralisation policy from Parliament as well the OPC Reforms Unit. Decentralisation is not clearly linked to the Public Sector Reforms being championed by OPC. The OPC reforms unit engages with Councils directly on the Councils preferred areas of reform and how best they can move ahead. However, it does not deal with the broader issues surrounding the implementation of the decentralisation policy, fiscal decentralisation and the bottlenecks affecting the process. Thus, there are questions like: who consistently takes to task the lead MOLG, MoF and NLGFC over the policy implementation process and results?

Current coordinating mechanisms, mainly the Sector Working Group is more of technical information sharing mechanism between government, NGOs and development partners & it has very little leverage for driving/pushing fiscal decentralisation. The participation of members is not consistent. The Road Map consultations study of 2018 noted that there are other sectoral decentralisation focal points e.g., from education and health that had never attended the TWG meetings and do not recall to have received any formal invitation. As a result, there has been very weak inter-ministerial consensus, understanding, and coordination in terms of the history, direction of the decentralisation reform and what to do to achieve full devolution.

## 7.3 LGA Level Institutional Arrangements

At the LGA level, there is a political and administrative structures with roles to play regarding the management of fiscal decentralisation. There is Council, which is the highest decision-making and oversight body of the LGA. The LGA administrative structure headed by District Commissioner (DC) for Districts and Chief Executive Officer (CEO) for urban councils who are the Controlling Officers.

33 USAID (2018). Decentralisation Road Map Full findings & Road Map Report Research Report for the Local Government Accountability Project (LGAP), Lilongwe: USAID.

It has for some time been observed that LGAs lack skills, competences, and incentives to undertake their functions for management of resources for delivery of local services- these weaknesses included poor planning, budgeting, procurement, accounting, reporting and internal auditing[34]. To counter this, the Government has with the assistance of the World Bank through the GESD project established a system of annual performance assessments (the LAPA) and corresponding annual capacity building interventions to LGAs. This system is very comprehensive and well resourced. The LAPA system not only links capacity building with LAPA results (and in this manner systematically target the most needy LGAs and thematic areas of performance accordance to comprehensive annual assessments), but also provide fiscal incentives to LGAs to enhance their performance (through the annual adjustments of PBG allocations).

On this background it is not recommended to include local PFM capacity issues in the FDS as these are better catered for through the already established LAPA and PBG modality.

## 7.4 Summary of Key Issues on Institutional Arrangements

The most critical institutional issues to be addressed under the FDS relates to the way national level institutions undertake their functions – while LGA institutional weaknesses are addressed through the current LAPA / PBG arrangements.

34 See GESD Project document and the National Synthesis Final Report, Local Authority Performance Assessment for the year 2019/2020, Baseline Report for Governance to Enable Service Delivery Project, NOVO HABITUS CONSULTING Limited – May 2021.

Whereases the key institutions mandated to perform roles regarding the management of fiscal decentralisation at the national level including: the MoLG, NLGFC, MoF, Sector Ministries, Auditor General and Parliament are in place, they either lack or have weak units/focal point to manage fiscal decentralisation.

The structures and mechanisms which brings together the NLGFC and representation from among others MoF, MoLG and all MDAs making transfers to LGs for cross-sectoral discussion and coordination related to fiscal decentralisation are at best weak.

A number of processes relevant for the management of fiscal decentralization are inadequate. MDAs do not explicitly elaborate policy commitments/priorities to be implemented by the LGAs to be used as a basis for allocation and alignment of resources with the priorities. Current MDA budget submissions only make justification for the funds to be spent by the national agency, and do not include the transfers in that sector. There are no systematic budget hearings where submissions containing transfers are scrutinised and no systematic mechanism for NLGFC and sectors to negotiate any proposed increases.

***The reform discussion note on institutional arrangements presents recommendations for how to improve the above.***

# 8. Summary Conclusions and Next Steps

## 8.1 Summary Conclusions

The current system of LGA financing in Malawi has in a regional perspective several strengths including:

- A sound overall legal structure for the LGAs that enable local political oversight over cross sectoral development planning in LGAs,
- Democratic elections of local councils
- Relative stable number of LGA units
- Broad policy direction and establishment of structures like NLGFC to guide and monitor reform,
- Several elements of good LGA finance practices including property taxation as core LGA source of revenue and IGFT structure with elements of discretionary development funding,
- Elements of DP supported IGFT reforms including the GESD supported PBG and sector specifics reforms in support of greater equity and adequacy of funding for local service delivery.
- The introduction of PBG and related LAPA that provides for a comprehensive system to address LGA level capacity constraints through (i) comprehensive annual capacity assessments (ii) fiscal incentives for LGA to improve performance and (iii) capacity building interventions that on an annual basis target the most needy LGA capacity issues.

However, LGA financing in Malawi has also several challenges. The most important are:

- Unclarity in the assignment of expenditure responsibilities across all sectors,
- The above includes a number of issues that are specific to the role of urban LGAs and corresponding financing arrangements,
- Limited own source revenue generation by LGAs,
- Intergovernmental Fiscal Transfer System that is characterised by
- Very many small fiscal transfers insufficient for service delivery,
- Pattern of decline of the value of the transfers,
- Lack of objective allocation criteria for most transfers
- A high level of earmarking of most resources,
- Institutional weaknesses – mainly at the national level for management of IGFT reform and LGA financing generally.

## 8.2 Next Steps

The NLGFC is planning to take reforms of LGA financing forward in the form of a comprehensive fiscal decentralisation strategy (FDS). To facilitate the development of the strategy, the team has in addition to this situational analysis also produced the following Reform Discussion Notes that presents recommendations and options for reform for issues identified in this report in need for consideration when the FDS is completed:

1. Expenditure Assignments – Recommendations and options for Reform
2. Urban LGA Financing Options and Recommendations (as several issues for the urban LGAs are unique and not previously addressed explicitly in policy)
3. Mobilizing Local Own Source Revenues
4. Intergovernmental Fiscal Transfers for Improved Local Governance and Service Delivery
5. PE and LGA Staffing - Recommendations and options for Reform
6. LGA Debt and Borrowing
7. Institutional Arrangements for Management of Fiscal Decentralisation

# Annexes

## 1.1 References and other documents consulted

### References in the text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Financial data:
- 2020 financial statements for each of 35 LGAs
- GDP data, World Development Indicators

## 1.2 People Met

| Organisation | Interviewee | Position |
|---|---|---|
| **NLGFC** | Alifeyo Banda | ED |
| | Kondwani Santhe | DOF |
| | Charles Chunga | GESD team leader |
| | Patricia Banda | Senior Budget Analyst |
| | Yohane Nyanja | Budget Analyst |
| | Jonathan Banda | Budget Analyst |
| | MacMillan Bonomali | Budget Analyst |
| | Andrew Banda | Financial Analyst |
| | Duncan Macheso | Financial Analyst |
| | Miriam Awadi | Financial Analyst |
| | | |
| **MOLG** | Douglas Mweta | Deputy Director LGS |
| | Charles Kalemba | PS (since left) |
| | Lukes Kalilombe | Director of Planning |
| | Edna Makhole | HR Director |
| | | |
| **Ministry of Finance** | Levi Chirwa | Deputy Director Budget |
| | Loyce Chilimsungwi | Deputy Director Budget |
| | | |
| **Accountant General** | Masumbu | IFMIS |
| | Fwasani Ziba | Chief Accountant |
| | | |
| **Ministry of Education** | Grace Milner | Director of Basic Education |
| | Cecily Kampanje | HR Director |
| | Edwin Kanyoma | Deputy Director, Planning |
| | Roland Sakala | Senior Planning Officer |
| | James Chamadeya | Planning Officer |
| | Precious Mtontha | Director of Finance |
| **Ministry of Health** | Thoko Sambakunsi | Retired Central West Zone Supervisor (M&E) |
| | Patrick Bokho | HR Officer |
| | Rabson Chomba | Chief Accountant |
| | Bryson Kangwam'minga | Internal Auditor |
| | | |
| **Ministry of Agriculture** | Assed Mgoba | Accountant, Lilongwe ADD |
| | Friday Likwinji | Director of Finance |
| | Rhodes Mzonde | Director of Policy and Planning |

| Organisation | Interviewee | Position |
|---|---|---|
| **Ministry of Gender** | Ron Phiri | Director of Gender |
| | McKnight Kalanda | Director of Child Affairs |
| | Dina Gumulira | Director Social Welfare |
| | Bridget Chinguo | Director of Community Development |
| | Jayne Nkhono | Chief Economist |
| | Clothilda Sawasawa | HR Director |
| | Mercy Zimpita | Deputy Director Nutrition and HIV/AIDS |
| | | |
| **Water Sector** | Emma Mbalame | Director, Water Supplies |
| | Various | Interviews done in 2019 for PER |
| | | |
| **MALGA** | Hadrod Mkandawire | Acting ED |
| | | |
| **National Audit Office** | Mponda | Assistant Auditor General, Regulatory Compliance |
| | | |
| **Central Internal Audit Unit** | Atusaye Kayuni | Controller of Internal Audit |
| | | |
| **OPC** | George Chande | Director of Policy |
| | | |
| **Lilongwe District** | Willard Chirwa | DPD |
| | - | DC |
| | Paul Chunga | DEHO |
| | Rabson Kawalala | Chief Education Officer |
| | Mr Denis Nkhwazi | Accounts Officer |
| | Charles Mhone | DOF |
| | | |
| **Ntchisi** | Lumbani Munthali | DEHO |
| | Magomelo | DAENR |
| | Lusizi Nhlane | DC |
| | Elizabeth Banda | DOA |
| | Daveson Matola | DOF |
| | | |
| **Mmbelwa** | Ted Bandawe | DHSS |
| | Steven Chima | DOA |
| | | |
| **Rumphi** | Dr Nyirenda | DHSS |
| | Thomas Mwafongo | DOA |
| | Faison Zidana | Chief Accountant |

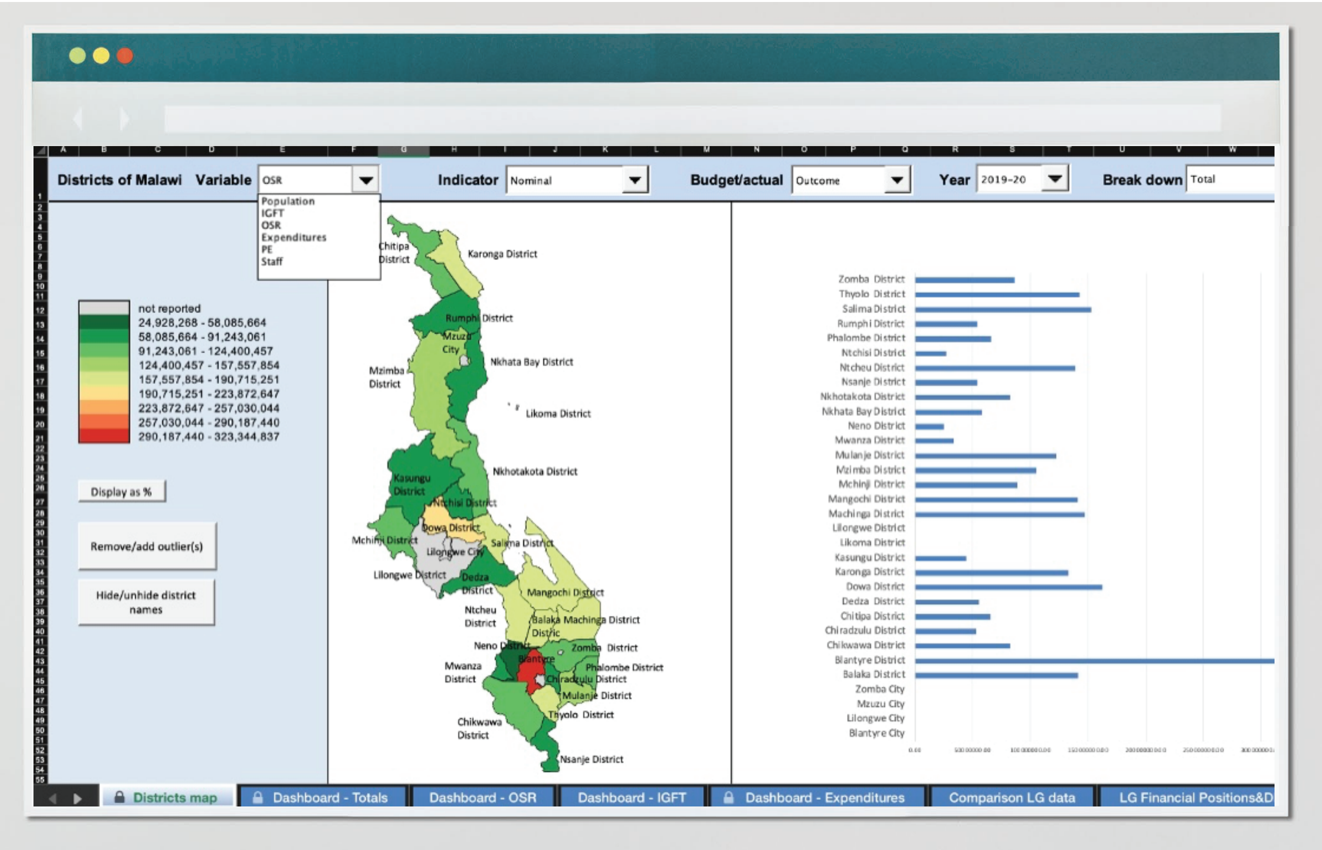
| Organisation | Interviewee | Position |
|---|---|---|
| **Neno** | Rohine Mlombwa | CAO |
| | Chikumbutso Chabuka | HRMO |
| | Robson Manda | Assistant Accountant |
| | Whyton Chitete | Senior Accountant |
| | Charles Willow | CDA |
| | Rabton Dyeratu | CDO |
| | Grace Momba | DHSS |
| | Rueben Menyere | DEM |
| | | |
| **Blantyre City Council** | Dr A Chanza | CEO |
| | Kanjunjunju | DHSS |
| | Afrey Nyengo | HRD |
| | Mshali | DOF |
| **Luchenza Municipal Council** | John Maneya | DPD |
| | Selina Chimphamba | CEO |
| | Pilo Mponda | EHO |
| | King Milosi | Accountant |
| | | |
| **Mangochi District Council** | Enford Kanyimbo | DAENR |
| | Dominic Mwandira | DOA |
| | Ahmed Sadi | DOF |
| | Dougal Mwaungulu | Acting DOF |
| | | |
| **Mangochi Town Council** | Robert Lusinje | Chief Accountant |
| | M. A. M. Mwenemurupa | Acting DPD |

## 1.3 LGA Fiscal Data Base and Mapping / Dashboard Tool

The team has put significant effort into the development of a comprehensive LGA fiscal data base that allow stakeholder for exploring data in ways most relevant to their purpose. The data base is also intended for future use by NLGFC (or interested researchers) and is based on:

- LGA finance data from NLGFC 2009-2020 – revenue and expenditure data – also publicly available at https://www.nlgfc.gov.mw/
- LGA Final Annual Financial Statements as submitted for audit – for FY 2019/20
- National Budget data up to and including FY 2021/22 – publicly available at https://www.finance.gov.mw/
- PE allocation data.
- Population and inflation data
- Sector service delivery (education and health)
- Creation of dashboards for analysis and potential future NLGFC tool

**Figure 18:Overview of the LGA Database and Dashboards**




The key findings and analysis of this report are presented in a summary form in this main report. Further detailed analysis is included as annexes, whereas the most detailed analyses are found in the database and associated dashboard presentations. The LGA database and its dashboard analyses have been handed over to NLGFC – this may enable also more detailed sector engagement in reform.

## 2.1 List of LGAs in Malawi: Type and Population

| LG Code | LG Name | Region | Type | 2018 Census Population |
|---|---|---|---|---|
| **602** | Lilongwe City | Central | City | 989,318 |
| **804** | Kasungu Municipal | Central | Municipality | 58,653 |
| **906** | Dedza District | Central | District | 830,512 |
| **907** | Dowa District | Central | District | 772,569 |
| **909** | Kasungu District | Central | District | 784,300 |
| **911** | Lilongwe District | Central | District | 1,637,583 |
| **914** | Mchinji District | Central | District | 602,305 |
| **920** | Nkhotakota District | Central | District | 393,077 |
| **922** | Ntcheu District | Central | District | 659,608 |
| **923** | Ntchisi District | Central | District | 317,069 |
| **926** | Salima District | Central | District | 478,346 |
| **603** | Mzuzu City | Northern | City | 221,272 |
| **905** | Chitipa District | Northern | District | 234,927 |
| **908** | Karonga District | Northern | District | 365,028 |
| **910** | Likoma District | Northern | District | 14,527 |
| **915** | Mzimba District | Northern | District | 940,184 |
| **919** | Nkhata Bay District | Northern | District | 284,681 |
| **925** | Rumphi District | Northern | District | 229,161 |
| **601** | Blantyre City | Southern | City | 800,264 |
| **604** | Zomba City | Southern | City | 105,013 |
| **805** | Luchenza Municipal | Southern | Municipality | 12,600 |
| **806** | Luchenza Municipal | Southern | Municipality | 12,600 |
| **807** | Mangochi Town | Southern | Town | 53,498 |
| **901** | Balaka District | Southern | District | 438,379 |
| **902** | Blantyre District | Southern | District | 451,220 |
| **903** | Chikwawa District | Southern | District | 564,684 |
| **904** | Chiradzulu District | Southern | District | 356,875 |
| **912** | Machinga District | Southern | District | 735,438 |
| **913** | Mangochi District | Southern | District | 1,095,113 |
| **916** | Mulanje District | Southern | District | 684,107 |
| **917** | Mwanza District | Southern | District | 130,949 |
| **918** | Neno District | Southern | District | 138,291 |
| **921** | Nsanje District | Southern | District | 299,168 |
| **924** | Phalombe District | Southern | District | 429,450 |
| **927** | Thyolo District | Southern | District | 708,856 |
| **928** | Zomba District | Southern | District | 746,724 |
| **Total** | | | | **17,576,349** |

# 4.1 Analysis of IGFT as Share of National Revenue

The decentralization policy stipulated that "Government will make available at least 5% of national revenue, excluding grants (thus primarily tax revenue) should be used for the development of districts (sic...thus not explicitly considering the urban LGAs)

The Policy doesn't specify whether the fiscal transfers are only for development funding- and if yes should include all sector grants or only discretionary funds (like the GRF).

In the reports from NLGFC in its early years after establishment, the annual reports included analysis of GRF share of National Net revenue, where also some statutory expenditures (like pension payments, debt payments) were excluded, however in recent years there has been no such publication of the ratio.

The two tables below analyse trends of share of IGFTs of national revenue.

### Table I: NNR calculated as Total Revenues (excluding grants) minus Statutory Expenditures

| | FY 13/14 | FY 14/15 | FY15/16 | FY16/17 | FY17/18 | FY 18/19 | FY 19/20 | FY 20/21 |
|---|---|---|---|---|---|---|---|---|
| **Net National Revenue** | 284,669,212,360 | 330,959,868,471 | 424,475,130,279 | 552,979,350,449 | 610,466,021,360 | 671,758,000,000 | 693,962,000,000 | 634,388,000,000 |
| **Total (ORT and Dev) Transfers** | 16,944,270,620 | 22,360,614,136 | 30,213,610,100 | 37,682,876,123 | 33,045,780,634 | 31,118,359,481 | 38,678,012,807 | 53,250,000,000 |
| **of which GRF** | 761,618,921 | 2,168,728,313 | 4,906,125,847 | 2,476,468,242 | 2,470,277,069 | 1,701,369,250 | 2,925,506,979 | 3,059,000,000 |
| **Development Transfers** | 1,114,398,862 | 2,713,442,278 | 7,995,140,259 | 15,287,058,528 | 10,114,413,713 | 8,678,300,959 | 12,090,556,809 | 21,283,000,000 |
| | | | | | | | | |
| **Transfers / NNR** | 6.20% | 6.70% | 7.80% | 5.20% | 5.40% | 4.63% | 5.57% | 8.39% |
| **of which GRF / NRF** | 0.27% | 0.66% | 1.16% | 0.45% | 0.40% | 0.25% | 0.42% | 0.48% |
| **PE for LGAs / NNR** | | | | | | | | |
| **Development Transfers / NNR** | 0.37% | 0.55% | 1.37% | 1.35% | 1.66% | 1.29% | 1.74% | 3.35% |

### Table II: NNR calculated as Total Revenues (excluding grants)

| | FY 13/14 | FY 14/15 | FY15/16 | FY16/17 | FY17/18 | FY 18/19 | FY 19/20 | FY 20/21 |
|---|---|---|---|---|---|---|---|---|
| **Net National Revenue** | 441,146,000,000 | 550,584,000,000 | 634,311,000,000 | 840,463,000,000 | 978,773,000,000 | 1,005,615,000,000 | 1,098,607,000,000 | 1,169,795,000,000 |
| **Total (ORT and Dev) Transfers** | 16,944,270,620 | 22,360,614,136 | 30,213,610,100 | 37,682,876,123 | 33,045,780,634 | 31,118,359,481 | 38,678,012,807 | 53,250,000,000 |
| **of which GRF** | 761,618,921 | 2,168,728,313 | 4,906,125,847 | 2,476,468,242 | 2,470,277,069 | 1,701,369,250 | 2,925,506,979 | 3,059,000,000 |
| **Development Transfers** | 1,114,398,862 | 2,713,442,278 | 7,995,140,259 | 15,287,058,528 | 10,114,413,713 | 8,678,300,959 | 12,090,556,809 | 21,283,000,000 |
| | | | | | | | | |
| **Transfers / NNR** | 3.84% | 4.06% | 4.76% | 4.48% | 3.38% | 3.09% | 3.52% | 4.55% |
| **of which GRF / NRF** | 0.17% | 0.39% | 0.77% | 0.29% | 0.25% | 0.17% | 0.27% | 0.26% |
| **PE for LGAs / NNR** | | | | | | | | |
| **Development Transfers / NNR** | 0.25% | 0.49% | 1.26% | 1.82% | 1.03% | 0.86% | 1.10% | 1.82% |

## 4.2 Ceded Revenue

Ceded Revenue was stipulated in the 1998 Decentralization Policy as an additional source of funding for LGAs but has in practice not been implemented. The Policy suggested several potential sources of central government revenue to be collected by central government but shared among LGAs according to an agreed formula. In this manner, the proposed ceded revenue would constitute part of the overall IGFT system, but be rule based (constitute a share of a particular government stream of revenues) in a similar way as the Decentralization policy position regarding sharing of National Net Revenue.

### 1. Malawi Policy on Ceded Revenue

The Decentralisation Policy (1998) provides in chapter 10 some guidance on fiscal decentralisation and states that LGAs will be provided with two main sources of revenue:

- locally generated revenues (traditional); and
- central government transfers.

However, in Section 10.3 the Policy also specifies ceded revenue as a distinct form of revenue:

*Government will cede to District Assemblies some of its nontax revenue. However, Government will continue to collect the ceded revenue which will later be redistributed to District Assemblies using a formula to be approved by the Cabinet.*

Non-Tax Revenue to be ceded will include the following:

- Toll fees
- Gambling and casino fees
- Fuel levy/fee (Road maintenance levy)
- Motor vehicle registration fees
- Industrial registration fees.

Ceded revenue is also stated as one of the three main categories of revenues in the LG Act (Third Schedule, and Section 44); the other two main categories being "locally generated revenue" (own source revenue) and fiscal transfers/grants. However, the Act itself nor any other legislation provide further clarification on how it should be managed.

### 2. Government Study on Ceded Revenue 2006

The Government of Malawi commissioned a study in 2006[35] that further explored how the policy on ceded revenue could be operationalised.

#### The Study made the following key observations:

While there is a provision to cede the above non-tax revenues to Assemblies, it is not clear from the Local Government Act, 1998 and the National Decentralisation Policy whether these should be fully or partially ceded to the Assemblies. Currently the procedures for ceding these non-tax revenues are not transparent and Local Governments are not made aware of the total revenues collected by Central Government that ought to be ceded to Assemblies.

#### Gambling and Casino Fees

In as much as the decentralization policy provides for ceding of the gambling and Casinos fees to Local Authorities such is not the case at present because there is no requirement in the Gaming Act to pay part of the proceeds to Central Government. In the absence of such provision, Central Government has no access to gambling and casino fees and hence cannot cede the same to Assemblies.

In order to ensure that gambling and casino fees are paid over to Central Government, there is need to amend the Gaming Act so that surplus fees (as shown by the audited accounts) are paid over to Central Government. This will in turn enable Central Government to cede the same to the Local Assemblies. Consequently, there will be need to harmonise the Gaming Policy and Act on the one hand with the Decentralisation Policy and Local Government Act on the other in order to allow the cession of revenue to local governments.

35 Ministry of Local Government and Rural Development 2006: Study for the Development of a System for Ceded Revenue Collection & Distribution and Administration of User Charges" submitted October 2006 by O&M Associates.

### Toll Fees

Under the current legislation, the National Decentralization Policy and the Local Government Act provides for toll fees as one of the non-tax revenues that should be ceded to District Assemblies. However, toll fees are currently viewed as a non-starter in Malawi predominantly due to lack of alternative roads to the main roads which could be accessed by road users if application of toll fees is to be relevant.

### Industrial Registration Fees

The Ministry of Trade and Private Sector Development originally administered the industrial registration function. The licensing for manufacturing concerns has largely been discontinued under the government's liberalization programme. As such there are no revenues from industrial registration fees that could be ceded to the Local Assemblies.

### Motor Vehicle Registration Fees

Motor vehicle registration fees are collected by the Road Traffic Directorate on behalf of Central Government. These are deposited into Government of Malawi number one account and are later supposed to be redistributed to the local assemblies. In the past, these were collected from three centres namely Blantyre, Lilongwe, and Mzuzu. The RTD has currently added Zomba as the fourth centre in its bid to widen its coverage and increase its revenue base.

The RTD has observed that these Centres are not adequate as revenue collecting points and hence has affected the amount of fees collected nationally. In line with the decentralization process, Section 182 of the Road Traffic Act empowers the Local Assemblies to make by-laws within their jurisdiction to enable them generate revenues. The RTD intends to devolve functions relating to Motor Vehicle fees, Operating permit and authorization fees, and Driver testing and certification fees to the Local Assemblies. In this regard the local Assemblies will be the collecting points on behalf of Central Government. However, the Road Traffic Directorate will devolve these functions to the Local Assemblies in phases depending on the capability of individual assemblies. Furthermore, the registration of taxis within the jurisdiction of the Local Assemblies will be the responsibility of the local assemblies and hence the fees will form part of the Assembly's own revenues. The Local Assemblies will determine the fees to be charged as provided under Section 182.

However, there is no capacity in the Local Assemblies to handle the earmarked functions to be devolved to the Local Assemblies in terms of the following:

- Lack of computerised vehicle registration system and supporting infrastructure (hardware) in the Local Assemblies.
- The non-availability of facilities in the Local Assemblies to accommodate taxi service providers would make the administration of the 'Operator Registration & Authorization Fees' difficult.

### Fuel Levy

The fuel levy is a charge in tambala per litre of total receipts by Petroleum Importers Limited (PIL) on petroleum products which is passed on to National Roads Authority. Currently the rehabilitation and maintenance of roads in the districts is undertaken by National Roads Authority through engagement of contractors, technical supervision and paying the contractor using proceeds from the fuel levy. In this context, Assemblies do not view this arrangement as ceding fuel levy to them since contracting, supervision and settlement of invoices is done by NRA. Assemblies are of the opinion that the funds from NRA for maintenance and rehabilitation of roads in the districts should be managed by the Assemblies themselves.

On the other hand, the NRA feels that with limited capacity in the Assemblies, Assemblies are not better placed to manage these funds as the funds will be diverted to other uses within the Assemblies in view of the limited financial resources.

Out of the five earmarked non-tax revenues, Central Government only collects fuel levy and motor vehicle registration fees. The other three sources are either non-existent (phased out) or not passed on to Central Government thereby making it difficult for Central Government to cede what it has not collected. This means that local assemblies have access/derive direct benefit only from the fuel levy much as it is administered by NRA.

### Differences in Ceded Revenue Definition

In addition to the controversy on the proportion of earmarked non-tax revenues to be ceded to Local Assemblies, there appears to be a different understanding between Central Government and Local Government regarding the definition of ceded revenue and what constitutes ceded revenues.

The Ministry of Finance views the whole process of transferring financial resources from the Centre to Local Governments as ceding revenues. Therefore, Central Government has not drawn a distinction between ceded revenues and central government transfers since it is argued that both emanate from the same resource envelope available to Central Government.

However, the Decentralisation Policy specifically identifies locally generated revenues and central government transfers as the two main sources of revenues for local assemblies. According to the Policy, Central Government Transfers comprise ceded revenues and government grants. This distinction is supported by the Third Schedule of the Local Government Act, 1998. Government Grants in accordance with the Policy constitutes 5% of national revenues, excluding grants for the development of districts.

In accordance with the Decentralisation Policy and the Local Government Act, 1998, Central Government should view Central Government Transfers to constitute ceded revenues and government grants. In this respect, Central Government should put in place a transparent mechanism of ensuring that earmarked non-tax revenues are ring-fenced for onward transfer to the local assemblies separate from government grants.

### Study Conclusion and Recommendations

The study rightly took a broad view of LGA financing and included considerations of how ceded revenue would fit into the larger picture of financing based on LGAs OSR and Fiscal Transfers. Several options for reform are discussed – the preferred option (option 3 pages 47-49) is to abandon the intention of the specific ceded revenues but focus on how to "redefine central government transfers as shared revenues based on agreed percentages". Various specific taxes are discussed for sharing – with relative emphasis on VAT. It is rightly considered inappropriate to base the allocations of revenue based on the origin of VAT collections as this would favour the most economic advanced LGAs than also have other sources of OSR. In summary they argue in favour of a complete overhaul of the decentralisation fiscal decentralisation policy statements by abandoning the ceded revenues and reconsidering the statements regarding 5% national revenue (for GRF according to their report).

If this Option is adopted, ceded revenue system and the General Resource Fund based on 5% of net national revenue shall be phased out and hence no longer regarded as part of a system of intergovernmental fiscal transfer between Central Government and Local Governments. There will therefore be need to amend the Local Government Act, 1998 and the Decentralisation Policy in order to reflect 'Revenue Sharing System' as part of a system of Intergovernmental Fiscal Transfers.

Considering that Central Government is currently failing to meet its obligation of transferring 5% of net national revenues as General Resource Fund, there is need to review the percentage split for sharing these revenues between Central Government and Local Governments. The percentage split should take into account the resource envelope available to Central Government and the responsibilities assigned to Local Governments through the devolved functions, as well as hidden costs in local governments' budgets such as operation and maintenance costs of existing assets. (O&M Consultant op.cit.2006, page 50).

## 3. Overall Conclusion and Issues for the Reform Discussion Notes

The Decentralisation Policy essentially considers ceded revenue as part of the IGFT system. However, the debate on ceded revenue has also often included alternative interpretations, with emphasis on revenue sharing of specific revenue according to the location of revenue sources. This would favour the more economically endowed LGAs and not bring the same governance benefits as normal own source revenue (where local taxpayers are to decide on both tax rates and service delivery standards).

The overall team recommendation for further work on ceded revenue would be to focus primarily on sharing revenue from funding sources where the objective of the grant can be linked to the source: such as e.g., sharing road funds for LGA road works, more specifically consider sharing of fuel levy between central government and LGAs would enable LGAs to fulfil their mandatory road works responsibilities. The formula should consider the relative importance of the centralised and decentralised road network as well as the relative share of the road network of each LGA.

## 4.3 Details on ORT IGFT

In the most current budget (FY2021/22) 20 different grants are listed as ORT transfers. Figure 19 provides and overview the relative importance of each of these transfers.

**Figure 19: Overview of existing fiscal transfers for ORT and their relative importance**

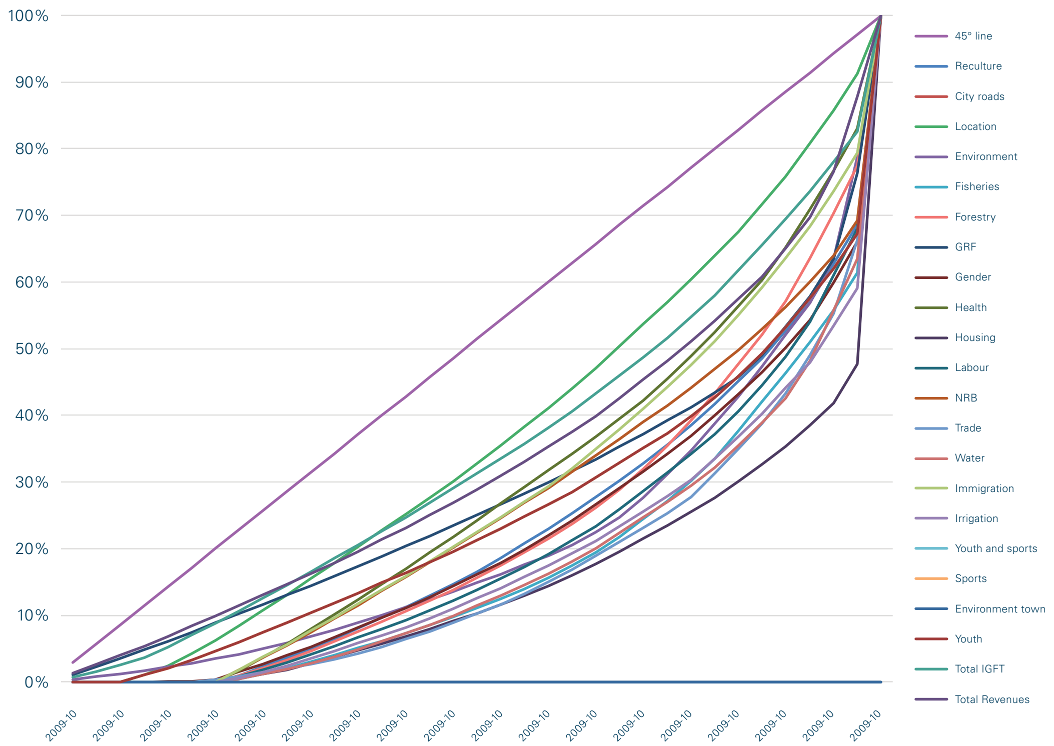
| Sector | Start date | Objects of expenditure | 2020/21 Outturn (millions MWK) | Share of total ORT Percentage |
|---|---|---|---|---|
| **Education** | 2005 | Education Methods Advisory Services (Education Standards), and Management and Administration of schools and education services. | 10,803 | 33.8 % |
| **Health** | 2005 | Primary health care, District hospitals, Rural hospitals, Health Center Facility, Clinics, Public health inspection, and Health technical support + Covid response. | 12,265 | 38.4% |
| **Agriculture** | 2005 | Farmer group mobilization and training, In-service staff training, Message development, District-level inspection and monitoring functions, and District-level coordination of agricultural services. | 1,739 | 5.4% |
| **General Resource Fund** | 2005 | For councils to manage their daily operations, pay councillors honoraria (20%), conduct council meetings | 3,059 | 9.6% |
| **Water** | 2013 | Management of water resources, Provision of technical services including: Borehole siting, supervision of drilling, tendering, etc; Rehabilitation of small dams; The protection of catchment areas, Water supply and sanitation, Maintenance of rural water piped systems, boreholes and community based management of water resources | 223 | 0.7% |
| **Housing** | 2006 | Provision of office and housing accommodation, Provision of rural housing, Provision of housing plots, Enforcing building standards and regulations, and Provision of valuation Services. | 187 | 0.6% |
| **Trade** | 2006 | Business Licensing, registration of garages and garage related businesses | 187 | 0.6% |
| **Youth** | 2013 | Youth Economic Empowerment, Youth participation and leadership, Youth Health | 187 | 0.6% |
| **Gender** | 2006 | Economic empowerment of vulnerable groups, provision of social welfare services | 250 | 0.8% |

| Sector | Start date | Objects of expenditure | 2020/21 Outturn (millions MWK) | Share of total ORT Percentage |
|---|---|---|---|---|
| **Community Development** | 2006 | Provision of community development services | 250 | 0.8% |
| **Labour** | 2013 | Employment and labour relations, health and occupational safety and workers compensation | 250 | 0.8% |
| **Sports** | 2013 | Talent identification, mass participation in sports | 178 | 0.6% |
| **Forestry** | 2013 | Forestry extension services, | 187 | 0.6% |
| **Environment** | 2013 | Environmental extension services. | 189 | 0.6% |
| **Fisheries** | 2013 | Management of fisheries at district level | 187 | 0.6% |
| **Irrigation** | 2013 | Provision of technical support in small scale irrigation | 250 | 0.8% |
| **Immigration** | 2013 | Vetting of passports applications | 250 | 0.8% |
| **OPC- NRB** | 2013 | Management of vital statistics of births and certificates | 247 | 0.8% |
| **Disaster Risk Management** | 2015 | Disaster Risk Management | 1,079 | 3.4% |
| **Constituency Development Funds (CDF)** | 2005 | For all MPs to implement micro-projects at community level | 7,720 | n.a |
| **Total Proper ORT – excl. CDF** | | | **31,967** | **100%** |

The Lorentz curve below illustrates the degree of variation away from a total equal allocation for each of the sector ORT transfers. Education is the grant that is most equally distributed, whereas the smallest grants like trade, housing and gender are the most unequal.

### Figure 20: Lorenz curve for each source of transfer MK per capita 2019/20

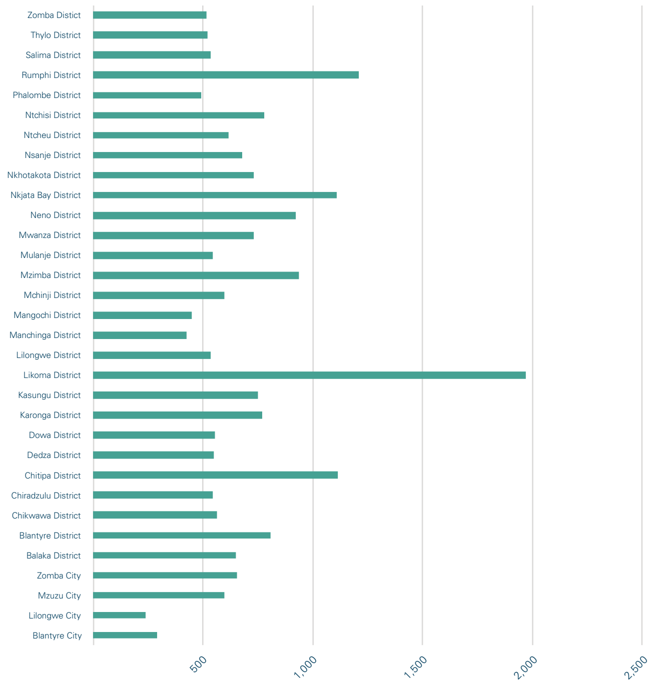
| Grant | Concentration index |
|---|---|
| Agriculture | 56% |
| Education | 28% |
| Environment | 57% |
| Fisheries | 65% |
| Forestry | 55% |
| GRF | 45% |
| Gender | 57% |
| Health | 44% |
| Housing | 70% |
| Labour | 60% |
| NRB | 49% |
| Trade | 66% |
| Water | 65% |
| Immigration | 46% |
| Irrigation | 64% |
| Sports | 51% |
| Youth | 51% |
| IGFT | 32% |



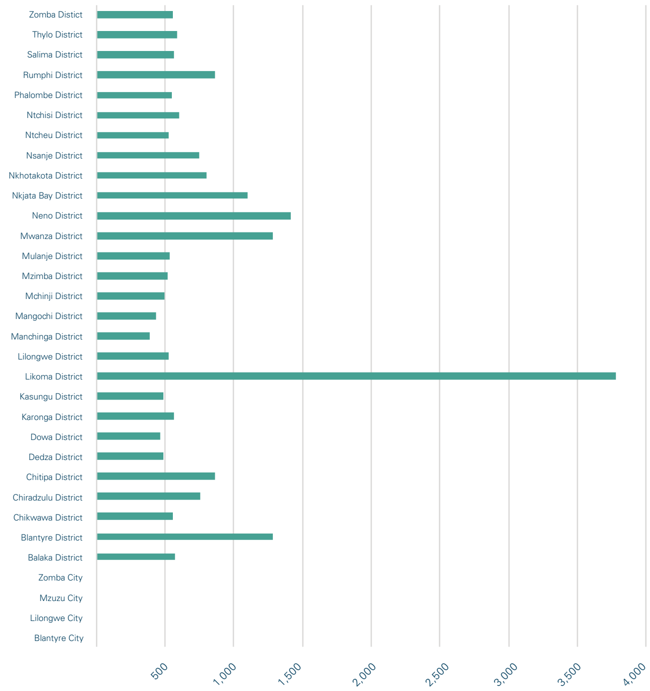

As Figures 20, 21 and 22 show, the fiscal allocations to LGAs for ORT follow similar patterns across sectors with significant variation in per capita allocations. For the very small grants – like gender (see below) there is a very close correlation between total population size of LGAs and the per capita allocations as the grants in realty are allocated largely as equal shares among LGAs.

For larger sectors like education and health, then this pattern is not equally pronounced. Some of the variations are easy to explain like the low allocations to urban LGAs that have large number of private schools, or high allocations to remote LGAs with small populations (like Likoma). However, there is also significant variation across rural LGAs where some of these receive more than twice as much as others.

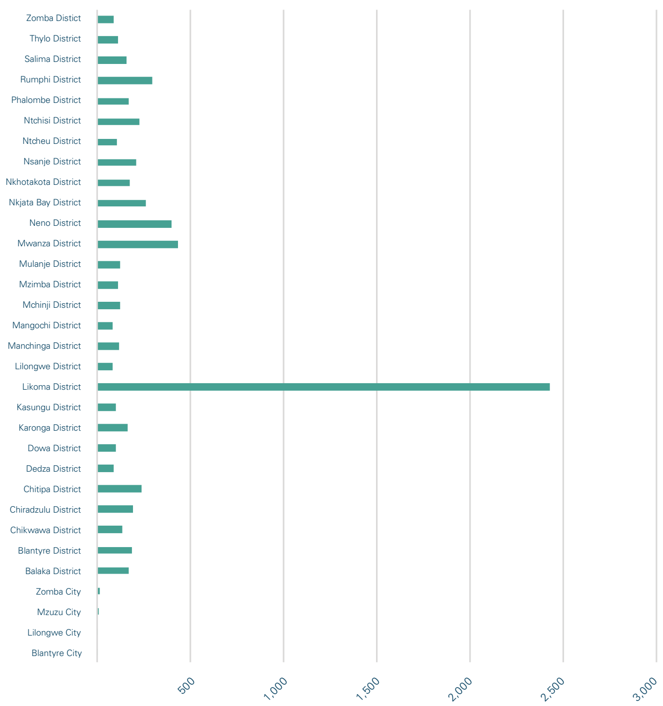
## Figure 21: Education per capita grant allocations-actual FY 2019/20




## Figure 22: Health per capita grant allocations-actual FY 2019/20




## Figure 23: Gender per capita grant allocations-actual FY 2019/20



## 4.4 Details on Development IGFT

Types and trends of development transfers (adequacy)
As illustrated in Figure 25, fiscal transfers for development in LGAs are composed of five different grants: (i) one non-sector specific transfer for rural local governments (the District Development Fund – DDF, as further explained in Box 1), and (ii) another non-sector specific transfer for urban local governments (the Infrastructure Development Fund – IDF). In addition, LGAs are provided with (iii) earmarked development funding for construction of boreholes, and (iv) road funding in the cities. Finally, some local development funding is provided through (v) the Constituency Development Fund (CDF) that is supposed to finance local development priorities identified by the MPs. The CDF is in this manner not fully integrated into the normal LGAs planning cycle.

All these grants are voted as LGA allocation in the national budget and reported by the NLGFC. In addition, sectors are funding devolved functions (e.g., classrooms through their Ministerial votes as discussed in the next chapter). The DDF forms the basis for the Government reform of the development transfer system discussed further below.

**Box 1:The Government District Development Funding (DDF) Modality**

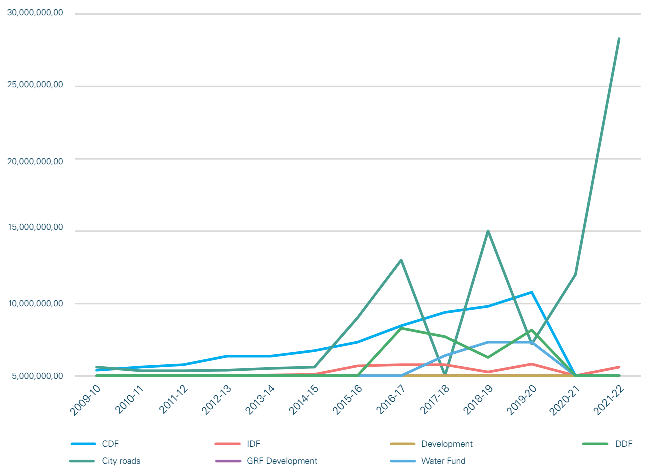
The current "DDF" was introduced in 2015/16 FY by the Government of Malawi as Development Budget for the rural LGAs. Some quarters started calling it DDF and later NLGFC generally adapted the name, however the terminology is not applied without some ambiguities as there are in a way two types of DDF. The original DDF was a designated fund for Donor financed development projects for Councils. Councils still have a special bank account for this, and some DP funded projects still make use of the account. The discretionary development transfers were from 2015 termed "GRF Development" but later DDF.

Initially funding for DDF was being done on a monthly basis but from 2018-19 financial year, transfers are on quarterly basis.

The MLGRD -Planning Department has issued a brief set of guidelines "for the Utilization of the Development Budget" (MLGRD 2015) which essentially constitutes guidelines for the DDF. This guideline stipulates that:

- Projects should be extracted from the District Development Plans (DDP's) especially the Annual Investment Plans (AIP's)
- Development Budget does not finance recurrent expenditures. In this regard projects such as painting of buildings, maintenance of vehicles, procurement of spare parts, Payment of honorarium for instance do not qualify for such transactions.
- An allocation of 5% on monthly basis should be used for administrative costs such as supervision of projects and monitoring visits.
- Funds allocated should be used for payment of contractors for certain projects and other overhead costs.
- Funds should be used on projects which are infrastructure in nature, visible on the ground, can demonstrate tangible results in terms of impacts. These for instance may include, Construction of School blocks, Health Centres, Irrigation Schemes etc.
- No development funds shall be used to finance recurrent expenditures.
- Members of Parliament (MP) and Ward Councillors (WC) should not directly be involved in the transactions of any funds in implementing these projects.
- Development funds should only be administered by the District Commissioner (DC) referred herein as Controlling Officer.
- Councils should designate an Accounts Desk Officer to account for the development funds.

**Figure 24: Development Transfers FY 2009/10 to 2021/22 – nominal MWK**




**Source:** NLGFC LGA Annual Disbursement Reports available on their website: https://www.nlgfc.gov.mw/index.php/the-star/documents/category/6-historical-disbursements-in-las

Development transfers have been dominated by

- City roads earmarked for the four city Councils
- Constituency Development Funds

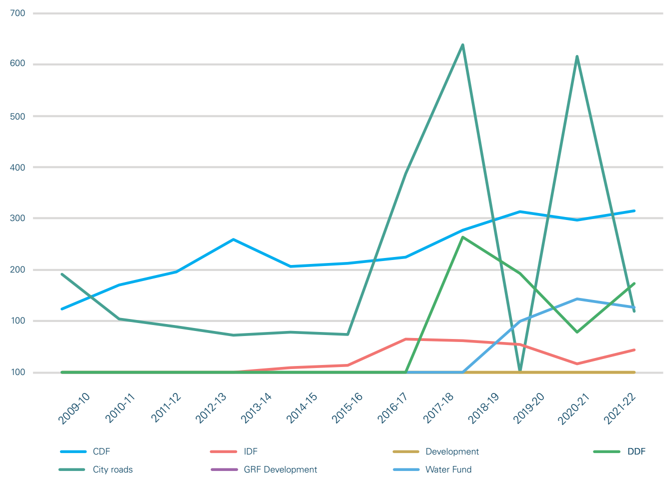
Only lately – from around 2015 has LGAs through Government budget been provided with a discretionary development grant: the DDF for the rural LGA and the IDP for the urban LGAs, but they have remained small compared to CDF (by a factor of 2).

For the two most recent FYs Government has continued the relative emphasis on city roads and expanded the overall allocations significantly[36]:

FY: 2020/21: Total LGA Development budget: MK13.6 billion of which MK7.0 billion for upgrading of city roads and MK6.6 billion for other rural projects.

FY 2021/22 (9 months) MK30 billion of which MK23 billion for City Roads, MK2.8 billion for DDF, MK2.3 billion for water and MK0.6 billion for (urban) Infrastructure Development Fund (IDF). In addition, the Government allocated MK7.7 billion for CDF and in addition between MK4.1and MK8.9 billion per city for road maintenance – although these latter figures are not found in the overview table for LGA transfers[37].

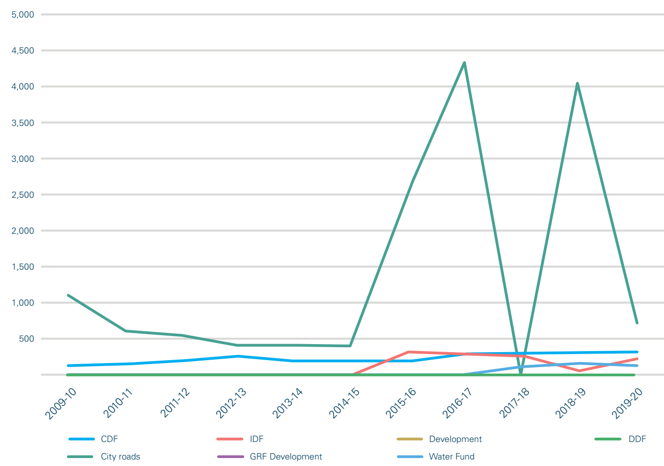
**Figure 25: Development Transfers FY 2009/10 to 2019/20 – real per capita**




### Urban – Rural Variation

Urban development funding is highly dominated by the city roads allocations – that in several years has been very substantial but is not very regular or predictable by LGAs.

**Figure 26: Blantyre City - Development IGFT by sector 2009/10 – 2019/20 (MWK)- real per capita**




Rural LGAs depend largely on the much smaller discretionary DDF and CDF for development funding (discussed below).

36 Financial Statements for FY 2021/21 and 2021/22 on https://www.finance.gov.mw/index.php/our-documents/budget-statements?start=20

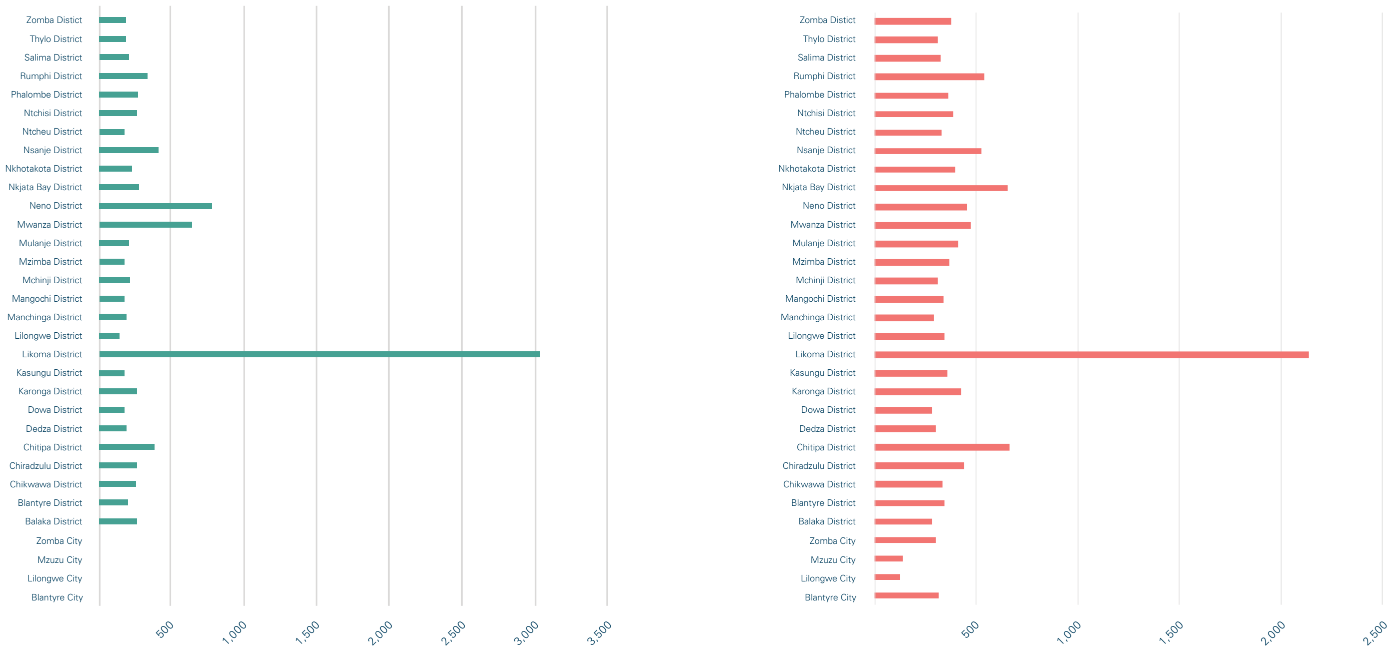
37 Ministry of Finance Budget Statement page 38-39 for FY 2021/22.

### Equity issues

Rural LGAs are primarily receiving development funding through the discretionary DDF (and CDF) as well as some funding earmarked the water sector.

The small Likoma District is receiving most when analysed in per capita terms, which is understandable as a population-based allocation would have resulted in a such a small allocation that no single meaning project could be implemented. However, there is also significant variation per capita allocations across the larger LGAs as illustrated in figure 27 below. The DDF ranges largely between 200 – 400 MWK/capita (0.25 – 0.50 USD/capita) and the CDF ranges between 300 and 600 MWK/capita (0.37 – 0.74 USD/capita) while the water fund ranges mainly between 100 and 200 MWK/capita.

**Figure 27: DDF and CDF actual per capital FY 2019/12**




Further detailed analysis of past allocation patterns for the DDF in relation to poverty indicators has revealed that there was no justifiable explanation for the variation (poor LGAs would often receive less than richer LGAs)[38].

The Government of Malawi has since the introduction of the new Performance-Based Grant system (see section below) committed itself to allocation of DDF funding through an agreed formula (same as for PBG discussed below).

### Government reforms for improved development funding (GESD)

The Government of Malawi has with World Bank support launched a project to reform and improve the system for development IGFTs: the Governance to Enable Service Delivery (GESD) Project (USD100 million). The project became effective December 2020 with the objective to strengthen Local Government Authorities' institutional performance, responsiveness to citizens and management of resources for service delivery.

38 DEGE Consult 2019: GESD Design Report for PBG and World Bank 2020: Public Malawi Subnational Public Expenditure Review.

The Project includes the following key components:

1. Performance-Based Financing for Service Delivery component which will substantially enhance predictable development financing for LGAs in a manner that incentivizes sustained improvements in efficiency, equity and accountability in the execution by LGAs of their service delivery responsibilities. This includes a Performance-Based Grant (PBG) available to the twenty-eight District LGAs, provided they meet eligibility conditions, and a Local Authority Performance Assessment (LAPA) subcomponent which will determine the eligibility for the PBG and the amount of the performance element.
2. Strengthening Intergovernmental Accountability Systems component which is expected to support two central government functions that are critical to strengthening intergovernmental accountability relations:
   - Strengthened Service Delivery Financing Through Fiscal Decentralization subcomponent which is expected to strengthen mutual accountability of central government and local governments around service delivery financing by strengthening transparency and implementation of the existing Intergovernmental Fiscal Transfers (IGFTS), and by supporting development of a fiscal decentralization strategy, including own source revenue, to guide renovation of the IGFTS.
   - Strengthened Accountability of Local Authorities Through External Audit subcomponent will support the National Audit Office (NAO) to conduct timely financial audits of local government financial statements.
3. Local Authority Performance Improvement Support component which is expected to support enhanced local government capabilities.

The PBG is intended to finance key development priorities of the LGAs. As it is a discretionary grant subject to local prioritisation it is not possible to predict how the grant will be spent. LGAs can spend funds within an agreed investment menu (Table 6) . During project design it was estimated that during the overall life of GESD across all 28 Local Authorities, the PBG (total 70 million USD) could fund a substantive number of new health centres, primary school classrooms, teacher houses, public latrines and very gravity fed piped water supplies.

**Table 3: PBG Eligible Investments**

| Sector | Eligible investments include: |
|---|---|
| **Education** | New Primary Schools, Teacher Development Centers, classroom construction and rehabilitation, furniture (desks, chairs), teachers housing |
| **Health** | Rehabilitation and construction of health units, medical equipment, furniture, beds |
| **Water and Sanitation** | Gravity fed water supply, shallow wells, springs, public latrines, sewerage and waste dumps. |
| **Agriculture and Environment** | Agricultural demonstration projects. Community nurseries inputs (watering cans, seeds, tools, tubes). Communal headworks, mechanical and solar/power for small scale irrigation |
| **Transport** | Construction, rehabilitation and grading of undesignated roads, bridges, community roads, culverts, footbridges, including associated drainage |
| **Public service** | Bus shelters, village markets, police posts |

The PBG is divided across LGAs based on a basic formula (Table 4 below)– and adjusted annually in accordance with the LGAs' performance in the annual assessment system.

**Table 4: Factors and weights for the basic need based PBG allocation formula**

| Factor | Weight | Rationale |
|---|---|---|
| **Population** | 40% | A significant portion of the grant allocated according to population as the service delivery responsibilities / cost of services of a LGA is closely related to the population it is to serve. |
| **Poverty** | 40% | Ensure that differential levels of endowment across LGAs are acknowledged, consistent with government policy commitments to equity of outcomes (30% poverty head count and 10% ultra- poor persons). |
| **Land Area** | 10% | The relative cost of services on a unit and recurrent basis are approximate to LGAs land areas |
| **Equal (fixed) Share** | 10% | Very small LGAs need a minimum allocation to make meaningful investments. |

Preliminary analysis of LGA budgeting for the PBG and DDF grant allocation for the current fiscal year indicates that education and health are relative prioritised compared to other local investments (such as local roads, markets, waste management, agriculture or water sectors).

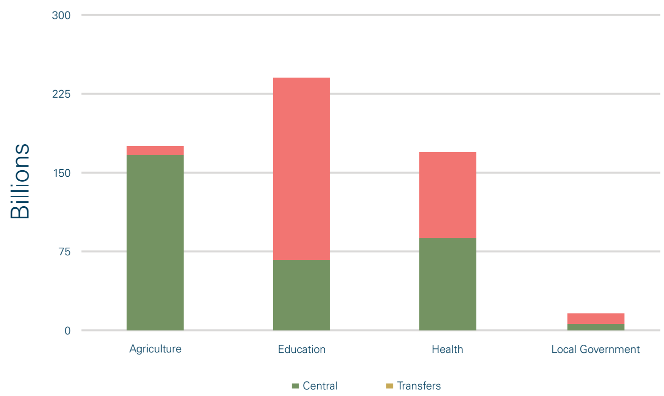
It should be noted, that even though the PBG is intended to spearhead reform of the IGFT system, then the budget allocations to the LGAs are not (yet) registered under the respective LGA votes in the national budget.

## 4.5 MDA Funding of LGA Functions – Eligible for Devolution

The overall balance of funding between central and local levels in the agriculture, education and health sectors is shown in Figure 28 below (water is not included as it was not possible to estimate recurrent central government water spend as this is contained within the Ministry of Forestry and Natural Resources budget). This demonstrates the magnitude of centrally managed resources which can be examined to see if they should be shifted to the local level.

We first examine recurrent spending by across the agriculture, education, health sectors, followed by examined development part 2 spending across these sectors, water and general local government.

**Figure 28: Estimated distribution of spending between levels of government, 2020/21**




**Note:** Data is based on revised budgets for the Ministries of Agriculture, Education and Health, and on ORT transfers to local councils. For central ministries, figures include PE, ORT and Development Part 2. Development Part 1 is excluded. PE transfers by sector is not available, so amounts are estimated by looking at the decrease in central PE budgets between 2016/17 and 2017/18 when PE budgets were devolved, and then rescaled in accordance with the growth of the central PE budget between 2017/18 and 2020/21 for each sector.

**Source:** FY 2021/22 Draft Financial Statement, except PE spending estimated by authors.

## Agriculture

Agriculture spending is predominantly at the central level, with this accounting for 95% funding. This is driven by ORT spending at the centre on the Affordable Input Programme which makes up over 80% of total sector spending. In the 2020/21 budget, out of total Ministry of Agriculture ORT budget of K158 billion, K142 billion is for the Affordably Input Programme. As this is a national programme, these funds are unlikely to be a suitable candidate for decentralisation.

Our estimates of local PE spending in agriculture suggest that PE spending is roughly similar between national, at just under K8 billion under the Ministry of Agriculture, and around K7 billion at the local level. Beyond this, there is around K6.7 billion of spending, compared to the ORT transfer to local authorities of K1.7 billion.

Half of the recurrent budget is allocated to 13 research stations and 8 regional ADD offices, which are arguably not suitable for decentralisation as these are national support functions. A detailed study of the PE spending and the remaining recurrent spending that is not on research or regional offices would be needed to judge if any of this expenditure should be decentralised.

**Figure 29: Summary of Agriculture Budget, 2020/21, excluding AIP**

| Department | Recurrent budget | % of total |
|---|---|---|
| HQ | 1,188,072,617 | 8% |
| 4 other HQ depts | 1,898,973,105 | 13% |
| 8 Regional ADD Offices | 3,625,070,611 | 25% |
| 13 Research Stations | 3,672,338,777 | 25% |
| Crops Development HQs excluding subsidies and inputs | 3,004,742,775 | 20% |
| Irrigation Services | 1,331,562,725 | 9% |
| **Total** | **14,720,760,610** | **100%** |

**Source:** Calculated from Draft Estimates of Expenditure on Recurrent and Capital Budget for the Financial Year 2021/2022. Excludes allocations to subsidies and inputs.

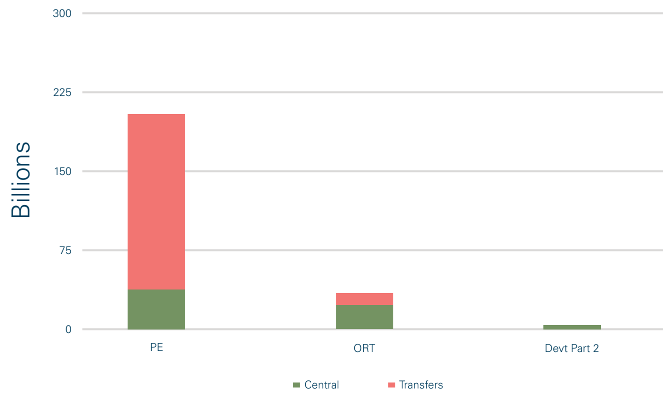
## Education

In education, just over a quarter of spending is at central level, and just under three-quarters at local level. This is driven by the allocation of PE spending, of which around 80% is at the local level, and the fact that PE spending makes up around 84% of total sector spending.

The main drivers of Ministry of Education recurrent spending is salaries and grants for secondary schools, which account for roughly two-thirds of its spending. The other third is split, broadly speaking, between teacher training colleges and HQ. None of this expenditure appears to be on areas that should be devolved.

What is striking, however, is that the ratio between PE and ORT spending is less than 2:1 at central level, it is 15:1 at local government level. The reason for these appears to be the policy decision to have a much lower ORT allocation for primary than for secondary education.

**Figure 30: Estimated distribution of education spending between levels of government, 2020/21**



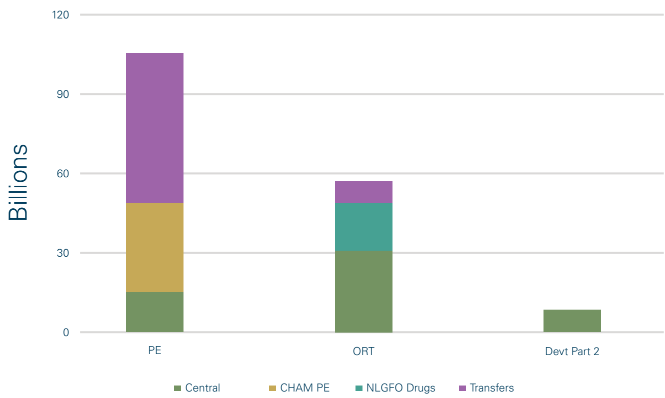

**Notes:** Sector PE transfers are estimates. Source: 2020/21 Midyear Revised Estimates in Draft 2021/22 Financial Statement

### Health

In contrast to the other two sectors, spending in the health sector is split roughly fifty-fifty between central and local levels. This is true for both PE, and for ORT spending once the allocation for drugs in district facilities that is budgeted under NLGFC is taken into account.

Just under 40% of total health spending is allocated to transfers. However, in each of PE, ORT and development spending, there are areas where central government is spending on primary and secondary health functions that have been decentralised. In total around another 25% of sector spending is centrally-managed spending on these functions.

**Figure 31: Estimated distribution of health spending by levels of government, 2020/21**




**Notes:** Sector PE transfers are estimates.
Source: 2020/21 Midyear Revised Estimates in Draft 2021/22 Financial Statement

This represents a laudable objective of the Ministry of Health to prioritise primary healthcare across the country, where it is most likely to reach the broad population, rather than concentrating resources on the small number of tertiary central hospitals. However, it does raise questions about which, if any, of these areas might be suitably devolved to local authorities to manage.

On PE, the central Ministry of Health budgets for the salaries of Christian Health Association (CHAM) facilities which provide primary and secondary services under local authority supervision. This is arguably the least appropriate for decentralisation as the ORT costs of CHAM are currently met by donor-funded 'service level agreements' which provide funds centrally to CHAM facilities, rather than through local governments.

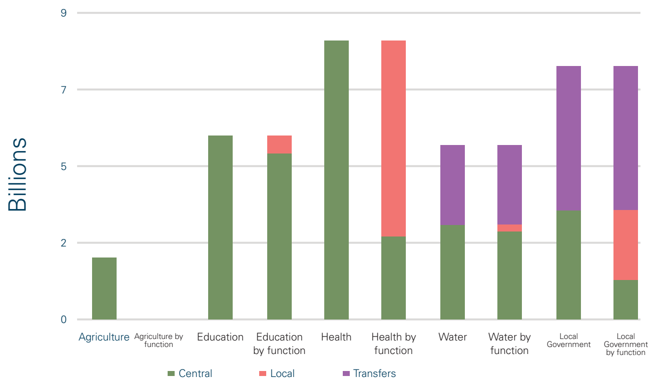
On ORT, NLGFC holds the budget for district-level drugs. These funds are paid directly to the Central Medical Stores Trust (CMST). Districts can then make orders against their allocations for drugs. These funds were originally part of the ORT transfer to districts, but was removed from it due to perceptions that districts were not effectively utilising the health ORT transfer, diverting it to other uses, and were building up arrears to CMST. It may now be considered whether local government PFM performance has sufficiently improved to again decentralise management of this funding to districts. This may also have the advantage of being accompanied by measures to allow districts to procure some proportion of their drug supply from other providers in cases where CMST runs out of stock.

### Development Part 2 spending

Development Part 2 spending at central level only accounts for a small amount of the overall domestically-financed spending is these sectors, making up only 1% of domestically-financed spending under the Ministry of Agriculture, 8% under Education and 9% under Health in 2020/21.

The balance between development spending directly by central government and LGA development spending financed by transfers across agriculture, education, and health sectors, and local government institutions is shown in the figure below. The figure also shows the estimated proportions of central development spending which is on local functions. Note that all development spending in the agriculture sector is currently carried out the central government. We do not seek to estimate if any of this expenditure should be devolved as to do this would require each project to be examined in more detail by sector experts to see if any activities cover local, rather than central functions. Additionally, to the extent that the projects are co-financing for development partner projects (e.g. co-financing for the World Bank Shire Valley Transformation Project accounted for 56% of the 2020/21 budget), these will not be suitable for devolution.

**Figure 32: Estimated distribution of development part 2 spending between levels of government, 2020/21**




**Notes:** 1. Distribution by function are author's estimates based on project descriptions. 2. Transfers included under Local Government are DDF and IDF, but not for City Roads or Water Structures.

**Source:** 2020/21 Midyear Revised Estimates in Draft 2021/22 Financial Statement

The figure highlights that there are large proportions of infrastructure investments by the central government for devolved service delivery responsibilities by the Ministry of Health and Ministry of Local Government. Under the Ministry of Health 2020/21 development Part 2 budget, 70% of the allocations are for construction or rehabilitation of community and district hospitals which are under the management of local councils. As such these funds should arguably be decentralised to local management. There are not currently sector-specific development grants, but there may be a case for introducing these to allow such funds to be decentralised.

Similarly, around 70% of the 2020/21 development part 2 budget under the Ministry of Local Government and NLGFC is for functions that are clearly local government responsibilities. These projects include:

- Construction of administrative buildings including Mzuzu civic office, Mzimba, Ntcheu and Thyolo DC offices, stadiums in district headquarters and chiefs houses
- Construction of rural roads
- Construction and rehabilitation of urban and rural markets
- Development of rural growth centres

Only two projects clearly belong at central level: the recapitalisation of the Development Fund for Local Authorities, and counterpart funding for the More Employment and Income to Rural Areas Program.

It is clearly undesirable if the main agencies tasked with overseeing decentralisation are unwilling to fully embrace it. It is hard to think of good reasons why the projects listed above should be allocated and implemented by central, rather than local, government. Once the projects which have already been contracted have been completed, ideally these funds should be combined into the DDF and IDF so local governments are able to allocate them to their priority development projects.

By contrast, little, if any of Education's capital spending looks obviously like it should be decentralised spending. In Education, out of the K5.4 billion development Part 2 budget, only one project totalling K500 million, or just under 10% of the total, is for construction of primary schools, which should arguably be devolved to local councils. In 2021/22, the budget allocation for this is increased to K1 billion. This would equate to an average grant to local councils of just under K36 million. As with health, there is a case for introducing a sector-specific capital grant to allow these funds to be channelled to local governments.

The water sector is unique in already having a sector-specific development grant. This is similar in size to central development spending. Nearly all of this central spending is on urban water programmes. Although the decentralisation policy makes no differentiation between urban and rural local government functions, in practice whilst rural water projects are a district function, urban water is provided by the three regional water boards, Blantyre and Lilongwe water boards. As such development spending supporting the water boards should remain centralised while this function is still centralised.

**Conclusions and recommendations**

The Ministries of Health and Local Government are spending significant sums on decentralised functions. While this may be defensible where bulk procurement is justified on technical or efficiency grounds (i.e. if it is significantly cheaper for central government to procure and then provide goods or infrastructure in kind to local governments), this does not seem to be the case in the areas highlighted above.

This analysis points out the following areas where proposals for decentralisation of funding should be examined in detail:

- ORT allocation for district drugs held by NLGFC.
- Development part 2 budgets for decentralised functions held by the Ministries of Education, Health and Local Government. This will need to consider whether there is a case for sector-specific development transfers, joining the existing water development grant, or whether development transfers should be streamlined around a single development grant for rural (DDF) and urban (IDF) local governments.

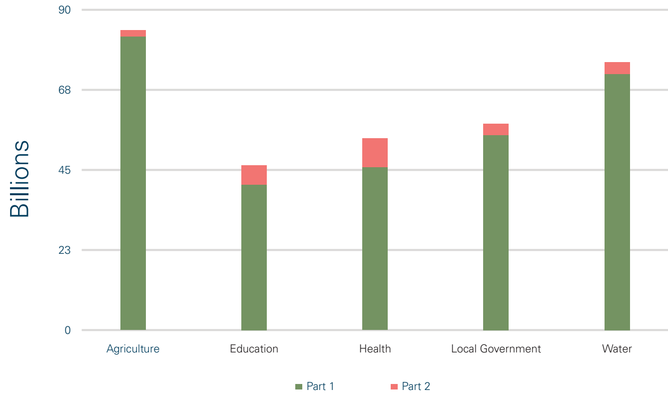
## 4.6 DP Funding of LGA Functions – eligible for devolution

This section examines on budget development partner funding at the central and local levels.

**Central Development Part 1 Spending eligible for devolution**

The development budget in the agriculture, education, health, water and general local government sectors is predominantly development partner-financed, as shown in figure 33 below. Thus, even if relatively small proportions of this spending is for decentralised functions, it could have significant implications for the level of development financing that should be handled at local level.

**Figure 33: 2020/21 Development budget by source of financing**

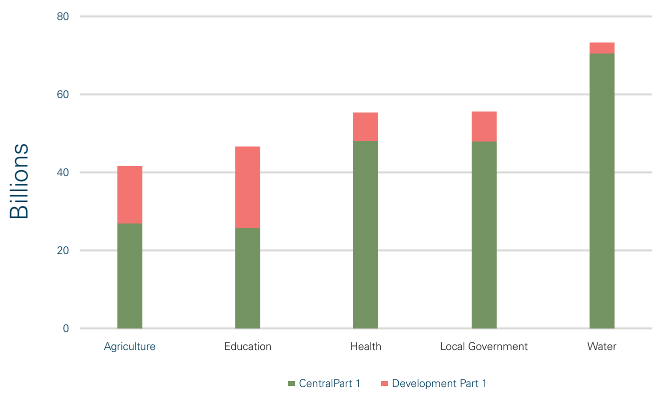



**Source:** 2020/21 Midyear Revised Estimates in Draft 2021/22 Financial Statement

We assessed whether each of the development Part 1 projects listed in the 2021/22 draft financing statement was likely to be funding mostly central or local functions and classified it accordingly. Doing this is not straight-forward as a single project may finance multiple functions, some of which are central functions, and some of which are local functions. As such, these classifications are necessarily a matter of judgement (which could be contested in some cases) and so this analysis should be taken as preliminary, with the aim of starting a discussion, not being the final word. To the extent that donor projects also finance central functions, these figures will be over-estimates, and exact splits would need to be confirmed through analysis of project documents. As with Agriculture Part 2, we did not seek to estimate if any Part 1 expenditure was on local functions as this will again require each project to be examined in more detail by sector experts to see if any activities cover local, rather than central functions.

In education, around a third of Part 1 projects are for primary education, rising to two-thirds in 2021/22 as several major secondary or teacher training projects end of decline in value. This is shown in figure 39 below.

**Figure 39: Estimated distribution of development part 1 spending between central and local functions of government, 2020/21**




**Notes:** 1. Distribution by function are author's estimates based on project descriptions.

**Source:** 2020/21 Midyear Revised Estimates in Draft 2021/22 Financial Statement

The major project we are assuming is funding decentralised functions is the Education Services Joint Fund/Malawi Education Sector Improvement Project (MESIP). This project is focused on improving the equity and quality of primary education service delivery. Two components are unambiguously central-level functions (development of strategic policy frameworks and project management and sector coordination). Two components are a local government function: performance-based school improvement grants and improving sanitary facilities in schools are a local function. The last component on improving learning outcomes, accountability, and cost-effectiveness at school level has activities that are a mixture of local and national functions (e.g. national government may develop policy frameworks and provide training, local governments may roll this out to schools): school leadership training, school data collection and usage, and community involvement in schools. To the extent that some of MESIP is financing central functions, the figure above shows an over-estimate of the extent of development part 1 financing on local functions.

In health, conservatively, half to two-thirds of Part 1 health funding is for primary health services. The main project we are assuming is primarily financing devolved functions is the Health Sector Joint Fund (HSJF). This finances activities including financing Service Level Agreements (SLAs) with Christian Health Association of Malawi health facilities, procurement and distribution of medical commodities, and upgrading of health facilities and health worker housing. However, only for the last activity would it be possible in principle to distribute funds to local authorities to manage as SLAs are currently centrally administered, and medical commodities need to be centrally bulk purchased. From 2021/22, the HSJF is joined by the Multi-Sectoral Nutrition Programme-Reduce Stunting in Malawi, Provision for Basic Health Care Services and Results Based Financing for Maternal and Newborn Health II projects. The latter provides financing for health facilities through performance-based grants.

Under the Ministry of Local Government and NLGFC, less than 20% of the 2020/21 Development Part 1 budget is for local functions. This is because the largest project is the Malawi Social Support for Resilient Livelihoods, the largest component of which finances social cash transfers, which are centrally administered. The decentralised portion is for the Governance to Enable Service Delivery programme, which will scale up over time as it finances performance-based grants for districts.

In the water sector, only around 12% of the water Part 1 budget is for rural water, but this amounts to nearly four times the value of the water development transfer. The rural water-focused projects are the Sustainable Rural Water and Sanitation project and the Climate Adaptation for Sustainable Water project. Other Development Part 1 water projects are all focused on urban water, and so are implemented through the various urban water boards, which are financed centrally.

The implications of this analysis are not as clear as for government-financed spending. In general, development part 1 spending that could be considered for devolution either provides financing for primary schools and health facilities, often through performance-based grants, or is financing investment in service delivery infrastructure (for education, health and water). However, it may not be straightforward to transfer these funds to local governments because of a variety of fiduciary and other issues. Even if grant and loan flows are on budget, they may not fully flow through government systems, even if government has decision-making role. For example, the HSJF uses a third-party fiscal agent to implement its activities.

There are likely to be different implications for different types of "on budget" support. If funding is fully "on treasury" then this raises the question what parts of the project could be channeled to LGAs as a donor-financed conditional development transfer? The Governance to Enable Service Delivery is pioneering development partner-financed transfers to districts. Other sectors may be able to build on this and introduce development partner-financed conditional transfers, or allow donor co-financing of existing conditional transfers.

If funds are not "on treasury" so that government has some decision-making power in project, but e.g. funds are ultimately spent by a third-party agent, or funds have specific fiduciary arrangements outside the Treasury Single Account, then implications are not so clear. The first step may be to explore what arrangements development partners would need to see in place before funds can be handled by LGAs? Again, as the Governance to Enable Service Delivery proceeds, it may be able to provide a model for other sectors on how to move forwards with this.

### Development partner funding that is already devolved

As well as development partner funding that is on budget at central level as part of the Development Part 1 budget, LGAs report on donor funded development in the final (audited) financial statements. The amounts reported for 2019/20 are shown in the table below. Not all LGAs are reporting development partner financing, and only five reported amounts consistently across their approved budget, revised budget and actual outturns.

### Table 5:Donor Funding Reported in LGA Final Statements FY 2019/20

| LG Code | LG Name | Approved | Revised | Actual |
|---|---|---|---|---|
| 807 | Mangochi Town | - | - | - |
| 913 | Mangochi District | 9,248,841,209 | 6,498,505,748 | - |
| 914 | Mchinji District | - | - | 1,959,467,193 |
| 917 | Mwanza District | 433,445,274 | 433,356,275 | 321,877,604 |
| 603 | Mzuzu City | - | - | - |
| 918 | Neno District | - | - | - |
| 919 | Nkhata Bay District | - | - | - |
| 920 | Nkhotakota District | 1,326,584,238 | 1,326,584,238 | 1,326,584,238 |
| 922 | Ntcheu District | - | - | 245,785,924 |
| 924 | Phalombe District | - | - | - |
| 925 | Rumphi District | 843,193,389 | 843,193,389 | 837,121,212 |
| 926 | Salima District | - | - | 1,804,370,028 |
| 928 | Zomba District | - | 3,565,144,017 | 1,505,374,178 |
| 901 | Balaka District | 445,955,370 | - | 445,955,370 |
| 601 | Blantyre City | 300,000,000 | 380,838,981 | 80,013,881 |
| 902 | Blantyre District | - | - | 1,003,762,000 |
| 903 | Chikwawa District | - | - | 1,427,955,648 |
| 904 | Chiradzulu District | - | - | 2,382,663,870 |
| 905 | Chitipa District | - | - | 911,395,027 |
| 912 | Machinga District | - | - | - |
| 906 | Dedza District | 2,377,371,691 | - | 2,377,371,691 |
| 908 | Karonga District | - | - | 837,902,305 |
| 910 | Likoma District | 43,077,365 | 43,077,365 | 43,077,365 |

**Source:** Audited Financial Statement FY 2019/20 – obtained from NLGFC.

The level of funding reported is significant. For instance, Dedza District report DP funding at approx. MWK 2.4 billion in 2019/20. This compares to IGFTs for ORT and development totalling around MWK 1.6 billion in the same year (PE was MWK 10.2 billion). Mangochi District reports MWK 6.5 billion of development partner funding, compared to MWK 2.0 billion of ORT and development funding through IGFTs (PE was MWK 13.8 billion).

The reports do not contain data on the nature of these donor funded projects, and whether these amounts were received as cash or districts are recording the monetary value of in kind support. Moreover, that large variation in amounts plus the fact that not every district is reporting suggests that there is not a standard approach for how to include DP funding in accounts.

The first step would thus be to regularise and improve LGA recording of development partner support in budgets and financial statements. This should make clear whether the support is in cash, with expenditures managed by the LGA, or whether in kind support is being recorded. Where development partners are providing in cash, this raises the question of whether these funds should also be recorded in the national budget, as a transfer to LGAs.

# 5. Human Resource Management Procedures at the LGA

An overview of HRM procedures at the LGA level which have implications on LG staffing levels, the PE allocations and hence LGA performance are provided in the table below[39].

**Table 6: Overview of Human Resource Management Procedures at the LGA**

| Issue | HRM de-facto processes |
|---|---|
| **Determining the Staff Establishment** | LGAs have not had a functional review since 2014 to among others customize the Staff Establishments with a wide range of devolved functions.<br>As a result, there is always a discrepancy between establishment and payroll (the payroll often has more people than the positions on the Staff Establishment) |
| **Staff recruitment** | Starting from Grade K, DCs requests for authorization from DHRMD to recruit.<br>After getting authorization, LASCOM advertises, shortlists, conducts interview and recruits staff working at the LGA level (e.g. secretariat staff, primary school teachers, health workers, Extension Workers) with assistance from technocrats of the respective MDAs.<br>There are however exceptional cases for some MDAs recruit staff. For example, during the COVID-19 pandemic MoEST directly recruited some teachers. |
| **Staff Deployment and transfers across LGs** | For transfers: LGA – identifies a gap and writes to DHRM for clearance;<br>DHRMD – passes on information to concerned MDAs<br>The concerned MDA prepares names of people requesting a transfer and submit to LASCOM<br>LASCOM – effects the transfer and make changes in the records<br>Postings between LGAs is done by LASCOM in liaison with the responsible line Ministry |
| **Process of allocating PE across LGAs** | PE is allocated based on salary/wage bill of staff in post.<br>Staff posted in urban LGAs (teachers and health workers) have their PE allocated through their respective Districts |
| **Staff payment: management of staff payroll and payment modalities** | PE budget and payroll management/ processing was devolved to LGAs in late 2017 but not to Cities (the cities pay the staff they directly recruit from LGRs and the teachers and health workers posted in the cities are paid through the respective districts)<br>Salaries are paid directly into staff bank accounts<br>However, some of the rights were retained by DHRMD e.g. adding and deleting employees from the payroll requiring the LGAs to go to Lilongwe every month to effect changes on the payroll which is expensive. |
| **Staff Performance Management** | Sanctioning and other disciplinary procedures are initially handled by LGAs but are referred to LASCOM for determination.<br>After HR devolution, staff performance appraisals are seldom done as the LGAs were not trained, there are no incentives and sanctions based on performance. |

39 The procedures do not cover: (i) direct employees who are recruited and paid by the LGAs; and (ii) intra LGA staff issues (e.g. deployment)

# 6. LGA Debt and borrowing

### 1. Legal and Policy Framework

The Local Government Act allows councils to obtain overdrafts and loans from local financial institutions such as banks. Overdrafts may be used to address short-term regular expenditure needs. On the other hand, loans are intended to assist councils make long-term investments. Council approval is required before an overdraft can be obtained. However, for a council to obtain a long-term loan, it must have the approval from the Minister of Finance in line with the Public Finance Management Act[40].

According to the World Bank Urbanization Review, the Development Fund for Local Authorities (DFLA) is the only institution in Malawi that lends investment finance to local governments. DFLA was established (as a Trust Fund) in 1993 with a start-up capital of about US$ 8.5 million, as part of the World Bank funded Local Government Development Project (LGDP)[41].

(Note the Local Authorities Loans Fund Act no 39 of 1971 is apparently the original legal basis for the Fund and has not been changed?).

### 2. DFLA Performance

According to the World Bank Urbanization Review, the DFLA, as intended, has provided grant and loan finance for local government investments: since 1993, DFLA has lent or granted funds to 31 local governments for a range of investments (construction of roads, market facilities, and other infrastructure, purchase of vehicles, etc.). Most DFLA grants/loans were approved in the period between 1994 and 1998; after the late 1990s DFLA activities appear to have ground to a standstill, because of capital depletion – itself due to poor rates of repayment, debt cancellation, attrition through the conversion of loans to grants (which became an ever-larger proportion of DFLA funding), and management costs. Since 2010, DFLA has re-commenced operations on a very modest basis of a greatly diminished capital of about US$ 1.4 million and is seeking to replenish its revolving fund. Although it is still – in legalistic terms – a functioning institution, DFLA is effectively non-operational and no longer a significant source of investment finance for local governments, few of which are even aware of the Fund's continued existence[42].

The World Bank's ICR (2001) for LGDP noted that: "The financing mechanism (DFLA) set up by the project was a failure" (p. 17). While the DFLA, as a form of revolving fund, was expected to reconstitute itself through LG repayments, this did not happen " … due to the chronic failure of local authorities to service their debt obligations". The ICR further notes that: "The DFLA apparently never incorporated any systems to assess the creditworthiness of the local authorities to which it "lent". In practice, the costs of new sub-projects financed under the LGDP would automatically appear as "loans" to the local authorities with no ex ante analysis, discussion, or agreements". Although infrastructure investments were completed (behind schedule), the DFLA was evaluated as being un-sustainable.

In the FY 2020/21 development budget the government set aside 800 million MWK for recapitalization of DFLA and the Fund is thus still operational.

40 Ministry of Local Government and Rural Development 2013: Guidebook on The Local Government System in Malawi (Revised October, 2013).

41 Word Bank 2016: Republic of Malawi, Malawi Urbanization Review: Leveraging Urbanization for National Growth and Development, Report No: AUS10133, April 15, 2016

42 Ibid, page 46.

The table below provides an overview of the performance of the loan's portfolio in recent years.

### Table 7: DFLA Loan Portfolio Performance 2014-19

| Year | Loans | Purpose | Year | Repayment Rate |
|---|---|---|---|---|
| 2014 | 25,300,000 | Construction of market sheds | 2014 | 85% |
| 2016 | 25,626,105 | Construction of market | 2016 | 97% |
| 2016 | 24,570,452 | Restaurant and butchery | 2016 | 62% |
| 2017 | 36,710,352 | Procurement of refuse truck | 2017 | 71% |
| 2018 | 243,572,273 | Procurement of machinery | 2018 | 78% |
| 2019 | 690,000,000 | QVR (property evaluations) | 2019 | 100% |
| **Total** | **1,103,584,182** | | | **81%** |

**Source:** DFLA communication October 2021

During the study our team sought to assess annual reports from DFLA, but these were not availed and are apparently not made public.

The DFLA is a relatively small organization with a board of directors chaired by the Secretary for Local Government. MALGA is also represented on that board. The day - to - day business is steered by a Secretariat which is very lean (CEO, Director of Operations who also doubles as Credit/Loans Director, Director of Finance and Assistant Accountant). However, this lean Secretariat is understandable considering their current loan portfolio.

The average annual loan issued over the last seven years is 158 million MWK or 190,000 USD per year. In per capita terms this translates into 0.01 USD/capita and is thus a relative insignificant part of total LGA revenue. However, as the loans generally is allocated to only one LGA each year then the fund could potentially support innovative investments although this probably would require additional technical expertise within DFLA – potentially for linking access to wider financing or PPP arrangements. Note that the mandate for approval of LGA bank borrowing lies with the Ministry of Finance (as per the provisions of the Local Government Act) and that further reform of LGA borrowing would require coordinated approach by the involved ministries and DFLA.

### 3. LGA Indebtedness and GoM Bailout Plans

LGAs have accumulated various debt to suppliers, service providers and even for own staff salaries[43]. In June 2021 it was reported that "The Malawi Local Government Association (MALGA) expressed excitement with the decision by the Central Government to sanction audit of debts in the councils, a process that will pave the way for a bailout package for the councils". It was further noted that "cumulatively, the councils owe various suppliers and service providers in excess of K14 billion, which they have failed to settle due to inadequate funding"[44].

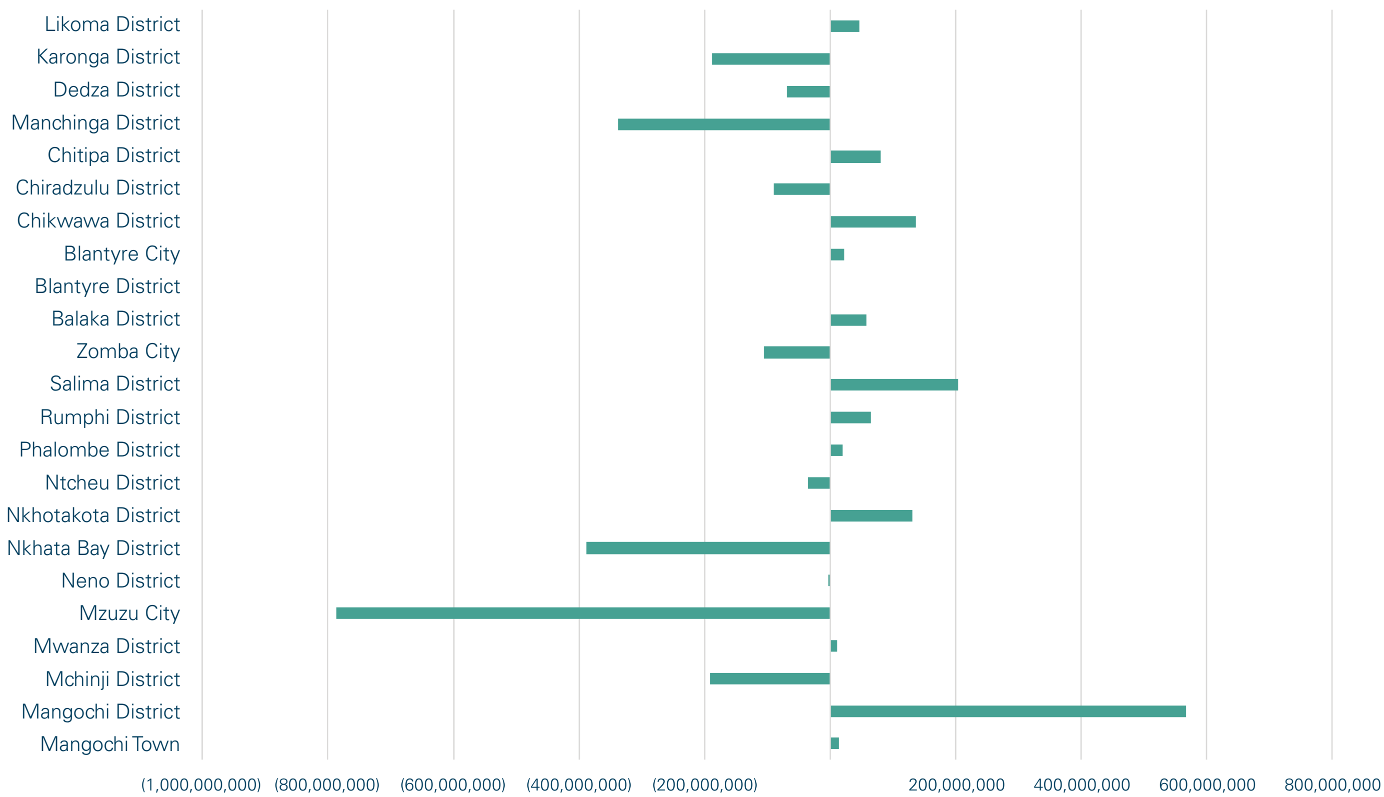
Review of the most recent LGA financial statements of (2019/20) indicates that:

- LGAs generally have a total positive net balance (total assets / liabilities) because of the accrual accounting principles whereby properties, land and buildings are included in the overall balance,
- A narrower comparison of current assets and liabilities reveal that most LGAs still have positive balances in particular Blantyre City Council with a net balance of 7.8 billion, but also significant surpluses in some rural LGAs (ref figure below). Such assessments of net positive balances are of course on the assumption that LGAs debtors are capable and willing to pay their debts (that for instance include substantive owed property taxes or similar revenues).
- However, several LGAs have substantive negative balance sheets (see figures XX below) – this includes Mzuzu City Council, Nkhata Bay District, Machinga and Karonga District LGAs (see details of figure below).

43 https://www.zodiakmalawi.com/nw/national-news/66-news-in-southern-region/3434-nsanje-district-council-employees-not-paid-for-3-months

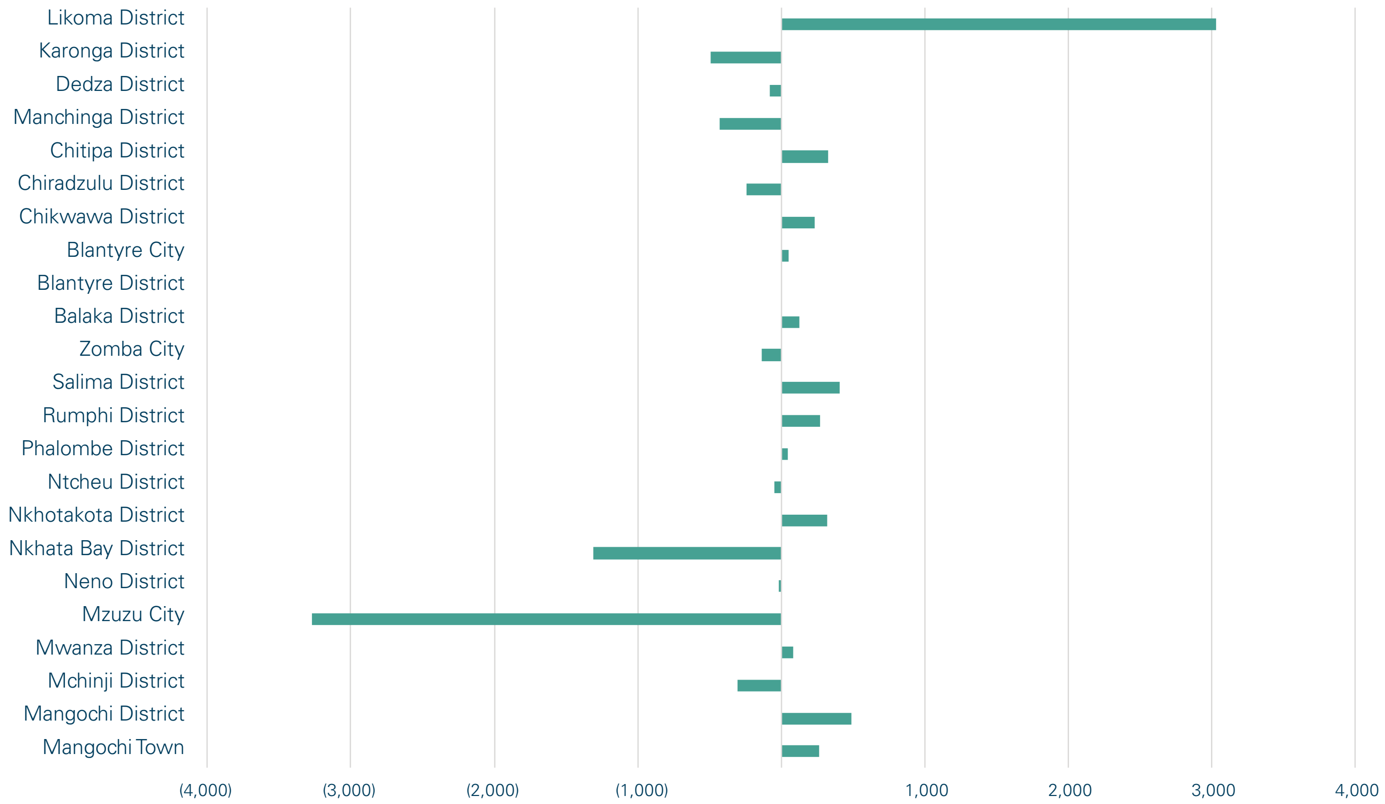
44 Malawi Nyasa Times 19 June 2021 https://www.nyasatimes.com/malga-excited-with-govts-positive-response-to-calls-for-bailout-for-councils/

**Figure 35: Net Assets Liabilities of LGAs in Malawi FY 2019/20**




**Source:** Financial Statements of LGAs FY 2019/20. Note Blantyre City is not included in this graph as its net assets are so significant that the variation of among other LGAs will be difficult to distinguish graphically.

**Figure 36: Per Capita Net Assets Liabilities of LGAs in Malawi FY 2019/20**




**Source:** Financial Statements of LGAs FY 2019/20. Note Blantyre City is not included in this graph as its net assets are so significant that the variation of among other LGAs will be difficult to distinguish graphically.

## 4. Key Issues to Consider in FDS

- LGA indebtedness must be considered in a fair and sustainable manner:
  - to ensure that the indebtedness does not incur again – it must be assured that chronic imbalances between revenues and expenditures for selected LGAs are addressed,
  - that LGAs with poor management performance are not rewarded
- Long-term borrowing for capital outlays is a sound element of LGA financing, however
  - Is the current set up of DFLA appropriate?
  - Are alternative credit facilities possible to explore …e.g. in connection with specific PPP arrangements etc?

# 7. Sector service delivery and LGA Financing Reforms

This Annex explores sector specific LGA financing issues and the linkages between different elements of LGA funding and sector service delivery.

For each sector we highlight briefly:

- Sector service delivery patterns and key challenges,
- Where data allows it, we compare sector service delivery performance by LGA with corresponding levels of LGA fiscal transfers,
- Government and donor strategies for addressing service delivery challenges – with emphasis on those elements of strategy that relates to LGA financing arrangements,
- Implications for LGA financing reforms.

## 7.1 Education Sector

### Service Delivery Performances[45]

Education outcomes in Malawi are poor despite consistent public investment. Education and Skills Development are among the five Key Priority Areas within the Malawi Growth and Development Strategy III, 2017- 2022, and since 2015, public expenditure on education has increased from 4 percent of GDP to 5.1 percent in 2019, representing 21 percent of public expenditure[46]. Malawi spends more on education than most low-income countries (UNICEF 2021).

45 Two key documents inform this sub-chapter: World Bank 2021: The project Information Document for Malawi Education Reform Program (MERP) (P174329) – July 2021 and UNICEF Malawi 2019/20 Education Budget Brief.

46 Government budget 2020/21 allocates 21.6 percent of total budget to Education (Statement by Minister of Finance to Malawi Parliament, 11th September 2020)

### Box 2: Key Challenges for Primary Education in Malawi[47]

Malawi's primary education system has achieved remarkable progress in increasing access to school, with Gross Enrolment Rates above 100 percent at primary level for more than a decade, but faces continued pressure to provide quality learning in the face of growing intake of students. Chronic rates of high repetition and dropout among students, particularly in lower grades, represent a significant source of inefficiency. More than three percent of students drop out in Standard 1, with dropout rates rising to almost five percent in upper grades (and to almost seven percent for girls). Fewer than two-thirds of students entering Standard 1 survive to Standard 5, and this rate has declined in the last five years. Those who do survive to upper primary learn very little. In learning assessments conducted as part of the Malawi Longitudinal Schools Survey (MLSS), implemented by the World Bank in partnership with the Ministry of Education (MoE), students struggled to complete simple tasks such as adding two- and three-digit numbers or identifying a missing letter in a sequence. Only 22 percent of tested students could comprehend a short passage in Chichewa, suggesting a high degree of learning poverty.16 These poor outcomes continue in upper primary. Moreover, with 1.3 million children entering the school system every year, the large and fast growing young population places tremendous pressure on limited resources available for education service delivery. The number of school-age population at primary level is expected to rise from 4.8 million to 6.5 million by 2030. Without smart, strategic investments in schools the education component of Malawi's Human capital Index (HCI) is likely to decline over time.

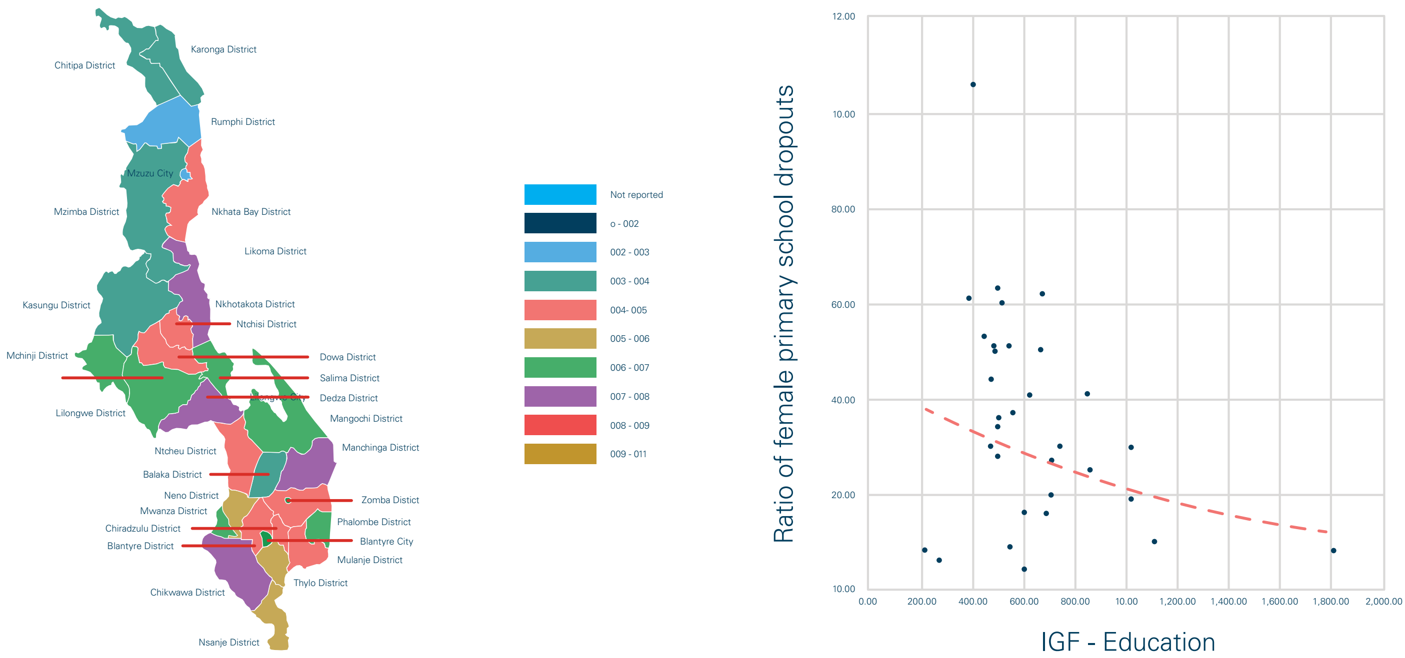
There is a need for urgent attention to binding constraints to learning at lower primary level, particularly large class sizes. Malawi's primary schools are an extreme case of a 'traffic-jam' problem, with extremely large class sizes and low learning in Standards 1 and 2. High fertility rates have driven a rapid rate of enrollment expansion in recent years. Without adequate supply of classrooms and teachers, this results in extremely large class sizes, typically above 100 students in Standards 1-2. In such conditions, schools act more as daycare than places for learning. Students and teachers alike respond to these poor conditions with high absenteeism rates: in a typical school, 29 percent of enrolled students are absent on a typical day. These poor conditions make it difficult to achieve progress on reducing the high rates of repetition and dropout and raising learning outcomes. Even when controlling for teaching practices and a wide range of other characteristics, students in schools where the Standard 4 class size is above 60 achieve several weeks' less learning on average. There is a need to ensure equitable learning opportunities especially for girls. Though Malawi has achieved gender parity in enrolment in primary school girls are falling behind boys in terms of test scores and primary school completion.

47 World Bank 2021 op.cit.

**LGA Inequities of Finance and Education Sector Service Delivery**

Education sector performance varies across LGAs. Our team has explored the relationship between education sector service performances and the education sector IGFT (ORT). The figure below explores relationship between IGFT allocations and dropout rates. The LGA Database established under the study also explores other types of sector performance indicators and their relationship with IGFTs – for details see the database.

**Figure 37: Female Dropout Rates[48] across LGAs and relationship with IGFT**




48 Source: EMIS data and NLGFC finance statistics. Consult team's calculations.

Overall, there is a strong relationship between the most the district level education indicators and their per capita education transfers. However, this relationship can also be explained by the underlying characteristics of the districts, such as the population size. Smaller districts tend to fare better across all the indicator considered, and smaller districts tend to also receive significantly more education conditional transfer in per capita terms (correlation of -0.54). However, rural districts like Rumphi, Chitipa, Nkhata Bay, or Mzimba district, receiving substantially more in per capita terms and outperforming the other rural district would suggest some form of relationship between education transfers and education performance. Mangochi Districts perform generally poorly in education sector service delivery and also receives less than average IGFT per capita. However, as discussed further below Mangochi District (like other poor rural LGAs) also benefits from several DP supported projects not captured by the above IGFT statistics.

### Education Sector Strategies and LGA Finance

The ongoing Malawi Education Sector Improvement Project (MESIP).

The Government's National Education Sector Plan (NESP) 2008-2017, and related Education Sector Implementation Plan II (ESIP-II) 2013-2018, were supported by the Malawi Education Sector Improvement Project (MESIP, P154185), financed by the GPE. Under MESIP, significant gains have been achieved in school learning environments, teaching practices and outcomes through interventions including:

1. Provision of additional grants disbursed directly to schools to reduce delays;
2. School Leadership Program training for headteachers, deputy headteachers, and Primary Education Advisers (PEAs, sub-district officials); and substantial improvements in the targeting of newly allocated teachers to schools.
3. A new, low-cost approach to classroom construction led by communities, a new standardized design is being developed for low-cost classrooms by the Education Infrastructure Management Unit (EIMU) within MoE, which is intended to allow the construction of safe and high-quality low-cost classrooms by communities for approximately US$7,000.

Each MESIP intervention is targeted to around 15 percent of public primary schools. In most cases, the targeted schools are all within eight disadvantaged districts: Mzimba South, Kasungu, Lilongwe Rural West, Dedza, Mangochi, Machinga, Chikwawa and Thyolo.

#### Box 3: Selected Targeting of performance based finance for School Improvement Plans

The strategies and guidelines are being used in the management of the 800 schools. The Guidelines were Developed based on what transpired on the stakeholders meeting and are translated and edited into 3 languages. 400 schools were trained. The output of the trainings was the formulation of costed School Improvement Plans (SIP) and action plans. These plans were done with the involvement of relevant stakeholders in the school communities that were oriented on MESIP. The SIP and Action plan were first approved by District Education Managers (DEMs) after which the school base grants were distributed to all the 800 targeted schools basing on the approved funding formulae. A total of MK3, 559,731,734.00 (USD4, 959,512) has been disbursed to the 800 targeted schools. The SIP and action plans approved by the DEMS are financed by the base grants for the management of the schools. The school base grants vary as they are calculated based on school enrolment but on average each school receives MK 1,200,000.

Since the inception of the project, 400 targeted schools have been assessed for the award of PBG twice. In Year 1 of project implementation, performance for grades 1 and 2 was assessed. In Year 2 performance for grades 1, 2 and3, was assessed. The incentive to schools is based on the increase in promotion rates in the selected grades above the baseline. A total of MK 190,555,920 (USD257,500) has been disbursed to the qualifying schools out of the 400 targeted schools.

Performance Based Funding is one of the Project's strategies to incentivize schools to implement strategies that will help improve promotion at the school level. Schools are allocated a grant over and above the Base grant for various levels of improvement on promotion rates above the baseline. This is meant to encourage competition among schools to improve internal efficiency manifested by improved promotion rates. The third round of the PBF grants has been calculated.

In the third round of PBF a total of US$ 214,590 out of US$472,615 allocated was shared among 325 schools, out of the 400 schools target. While in round two a total of 154,980 USD was shared among 317 schools out of the 200 schools target. Out of the 325 schools that received PBF in the third round, 166 are on PBF treatment and 159 out of 200 are on PBF plus training treatment.

**Source:** Malawi Education Sector Improvement Project (MESIP) Quarterly Report for period ending December 2019.

The new National Education Sector Investment Plan (2020-30) and the proposed Malawi Education Reform Program (MERP) (P174329).

The new National Education Sector Investment Plan includes a mixture of medium-term mitigation actions to address severe challenges and long-term reforms. The proposed project will support the new National Education Sector Investment Plan (NESIP) 2020-2030 and accompanying five-year costed implementation plan - the Education Sector Implementation Plan (ESIP) III (2020-2025), currently under development.

The proposed Malawi Education Reform Program (MERP) seeks to expand nationally the elements of education sector financing for LGAs and schools previously piloted under MESIP. It includes the following components of specific relevance to decentralized funding for education:

Component 1. Expanding and Reforming Primary School Improvement Grants (US$44.00 million, of which US$12.50 million subject to PBCs). This component supports the expansion and reform of PSIG, which is the primary source of discretionary finance to schools, to provide additional and more needs-based support to schools, with timely and predictable delivery of finance, building on the successful pilot under MESIP. The component will expand the standard per- student allocation of PSIG; expand the enrollment-related component to provide more equitable per-student funding; and support and incentivize reforms to the flow of funds for PSIG to enable timely and full delivery of finance to schools. PSIGs will be invested by schools in line with the PSIG Guidelines, which were recently updated to include additional activities piloted under MESIP; and additionally PSIGs will also support schools' development of emergency response plans where they do not yet exist, focused specifically on droughts and flooding, disasters to which Malawi is specifically prone.

Financing of US$10 million will close the existing shortfall in PSIG allocations, ensuring that all schools receive their allocation; and allow the average per-student PSIG to increase from US$1.75 to US$2.25, increasing the capacity of schools to implement the mainstreamed MESIP strategies as well as the original PSIG guidelines. The component finance includes government financing of US$24 million, which reflects current expenditure on PSIG, which will be subject to the revised formula and form part of the MERP expenditure framework. Of the US$20 million in total IDA and GPE financing for the component, US$2.5 million will be subject to a PBC to incentivize the introduction of the revised formula and reforms to the flow of funds to ensure timely payment of PSIG to schools (PBC 1); US$5 million will be subject to a PBC rewarding the timely release of adequate finance by Treasury for annual PSIG (PBC 2); and US$5 million will be subject to a PBC rewarding the timely delivery of PSIG to a target percentage of schools each year (PBC 3). PBCs 1, 2 and 3 form part of the Variable Part of MERP, with PBCs 2 and 3 forming part of the GPE Variable Part.

Component 2. Improved Learning Environments in Lower Primary to Support Learning Recovery After COVID- 19 (US$131.45 million, of which US$11.50 million subject to PBCs). This component will provide finance targeted to schools with exceptional need ("MERP School Improvement Grants", or "MERP SIG"), to support construction of low-cost classrooms and latrines, and hiring of auxiliary teachers, to address severely large class sizes in lower primary and as a result support improved learning and prevention of COVID-19. The component will also support the introduction of Hardship Support for teachers posted in remote schools. MERP SIG will be targeted to approximately 3,500 schools (around 60 percent of public primary schools) which face severe shortages of classrooms and teachers in lower primary. The eligibility of schools for additional MERP SIG will be established based on EMIS data. In total, the component will support construction of around 10,900 classrooms and appointment of 3,500 auxiliary teachers.

Sub-component 2.3. Hardship Schools Support: In order to address the large disparities in staffing between schools in remote areas and those close to trading centers, the component provides support to a revised Hardship Schools Support scheme to reward teachers who accept postings in the most remote schools. MoE will also refine and re-circulate tools to guide district-level officials in allocation of teachers to the schools with the highest PqTRs, and conduct capacitation activities to ensure correct utilization of the tools. A total of US$38.3 million, including government financing of US$28.2 million, will be allocated to Hardship Schools Support. The Government finance includes the existing rural allowance scheme, which will be reduced in scope to release finance for the new Hardship Schools Support scheme. The Hardship Schools Support forms part of the Variable Part of MERP and is financed subject to two PBCs. PBC 4, which is financed by IDA, provides incentives for the establishment of the scheme and provision of updated guidance to districts. In order to reward the implementation of the scheme, and improvement in both inter- and intra-school allocations of teachers, PBC 5, which is part of the GPE Variable Part, provides annual incentives for increases in the share of schools with PqTRs in Standards 1-2 within an acceptable range.

**Key Education Sector Issues to Consider in FDS**

In summary, the education sector is planning (or already undertaking) activities to ensure several elements of IGFT reform for the education sector:

- Adequacy of fiscal Transfers
    - Enhancement of ORT by increasing the PSIG - and allow the average per-student PSIG to increase from US$1.75 to US$2.25 (and hardship school support)
    - Enhancement of PE through hiring of 3,500 auxiliary teachers
    - Enhancement of development funding for construction of 10,900 classrooms

- Equity of fiscal transfers
    - The DP support for school grants will be rolled out to all schools and the combined GoM and DP funding for PSIG will use one combined formula to ensure equity of allocations.
    - The formula for PSIG will be updated with more emphasis on enrollment in order to ensure more equitable per-student funding
    - The allocation of teachers across schools will be more equitable as further incentives are provided for teachers who accept postings in remote schools.

- Effectiveness and efficiency of grant allocations
    - Rewards (to MOF only?) for timely allocation of grants (PSIG only?)
    - Incentives (for MOE/MOF) to establish reformed hardship allowance scheme that will target truly marginalized schools.
    - The direct allocation of PSIG to schools is assumed more effective/efficient (to be discussed)

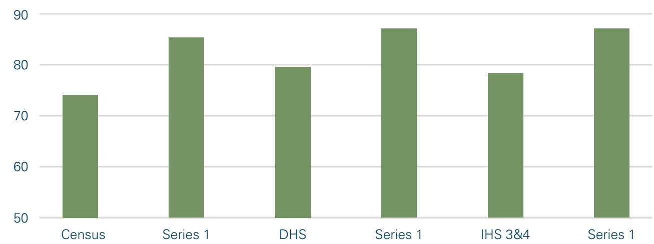
- Key sector issues to consider for the Reform Discussion Notes:
- School Improvement grant
    - Will reformed PSIG that flow directly to schools be reflected in LG Vote structure?
    - What will be the Role of the LGA in management of reformed PSIG (compared to now)
    - How can Procedures for management of the performance assessment under PSIG be made cost-effective, fair, transparent and sustainable (any linkages with LAPA?)
- Can interrelationship between Education and NLGFC / LGA for budget process be improved (with dedicated desk officers etc?)
- Given the general decrease of ORT transfers – also for education over the years --- how is that reflected in service delivery – do the LGAs not need other areas of increase than school grants? (to enable LGA supervision etc)
- Construction of classrooms:
- Is currently to be funded by two different (World Bank supported) modalities: PBG under GESD – and the sector specific funding arrangements. How to learn about best practices for future reform?
- How will the ministry engage in GESD to ensure best practices and sector relevant monitoring?

## 7.2 Water and sanitation (W&S) Sector

**W&S Sector Service Delivery Performances**

Access to improved water sources is gradually increasing. The most frequently used measure of water sector service delivery is 'access to improved water sources'. Figure below shows that access to improved water source increased from three separate and somewhat different sources of data: From 74.2% to 85.4% over the Census period (2008-2018), from 79.7% to 87.2% over the Demographic and Health Survey (DHS) period (2010/11 to 2015/16) and, using Integrated Household Survey (HIS) data, from 78.7% through 87.1% to 88.3% between 2011, 2016 and 2020 respectively.

**Figure 38: Access to improved drinking water source (2008–2018)**

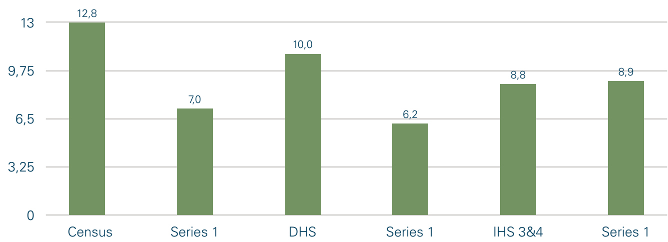



The 2020 IHS results per LGA show that city LGAs have access levels ranging from 90.9% (BT City) up to 94.0% (both Lilongwe and Mzuzu Cities) while district LGAs range from 66.4% (Neno) up to 95.6% (Phalombe).

Service delivery functions are performed by the district LGAs and the water boards, with the water boards focused on urban areas. Operation and maintenance functions for rural water systems are performed by water users associations (WUAs). Operational costs of both water boards and WUAs are intended to be financed by users, with Government responsible for overall service delivery.

Sanitation performance improvement has slowed down. The most frequently used indicator of sanitation progress is the proportion of households that still have no toilet facilities, ie open defecation rates (OD) are used. OD rates reduced from 12.8% to 7% over the census period (2008-2018) and from 10.8% to 6.2% over the DHS period (2010/11 to 2015/16). IHS data revealed no change in OD figures, with the OD rate (no toilets) steady at 8.8%, 8.9% and 8.9% in 2011, 2016 and 2020, respectively. This points to some serious concerns surrounding sustainability in the sector. The vast majority of latrines in Malawi are simple pit latrines and are vulnerable to collapse.

**Figure 39: Proportion of the population defecating in the open**




The 2016 IHS results per LGA show that city LGAs have OD rates ranging from 1.67% (Mzuzu City) down to 0.6% (Zomba City) while district LGAs range from 19.3% (Nsanje) down to 3.1% (Mangochi).

**LGA Inequities of Finance and W&S Sector Service Delivery**

Government funding of the W&S sector is low. Operational costs of both water boards and WUAs are intended to be financed by users (i.e. households and non-domestic users), with Government responsible for overall service delivery. Total expenditure on the W&S sector was K135 billion in 2018/19 and comprised a) what is spent by households at 41% of the total, b) the non-household spending by water boards at 27%, c) donors at 28%, and d) government expenditure accounting for the balance of 4%.

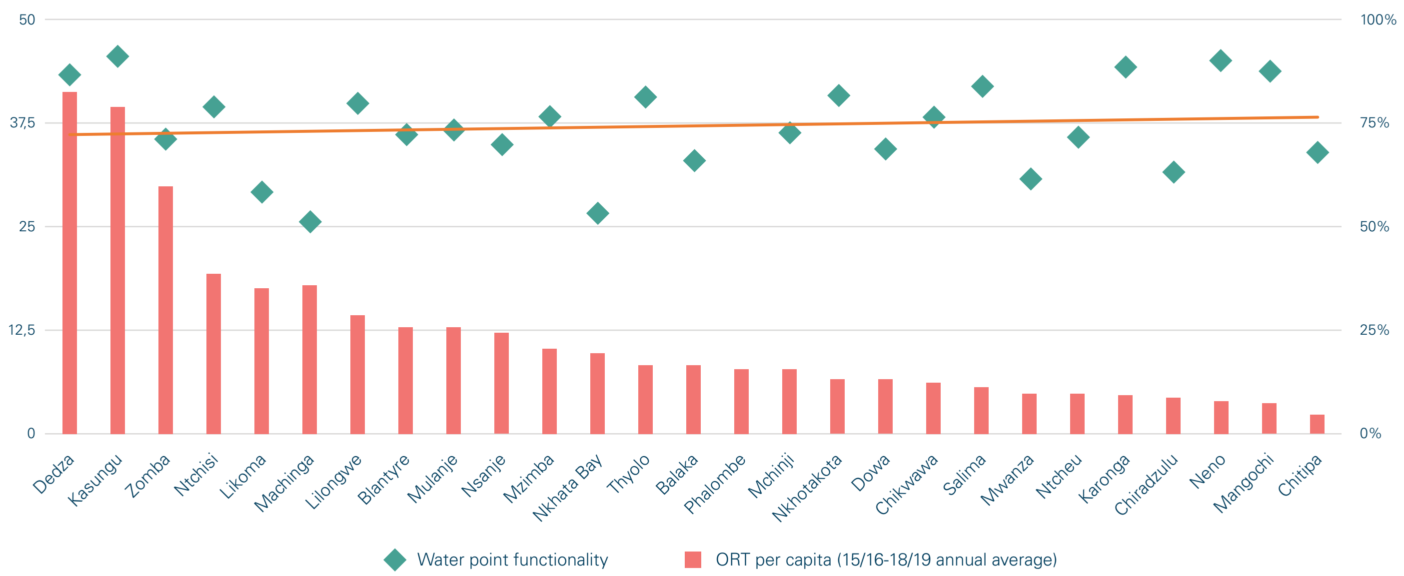
GoM budget allocations to WASH as a proportion of GDP is low. Despite limited fiscal space, the Government of Malawi (GoM) has increased budget allocations to WASH (including hygiene) since 2017/18, mainly due to the introduction of the Borehole Fund. However, GoM budget allocations to WASH as a proportion of GDP is low compared to that of other countries in the region. Available data show that the Malawi Government's allocation of resources to WASH is 0.081% of GDP, which is only 55%, 52%, 43%, and 27% of that allocated by Kenya, Zambia, Ghana and Mali, respectively; the per capita allocation is less than one-fifth of those countries.

The 4% spent by government in 2018/19 (K5.5 billion) includes the following elements spent at LGA level:

| | 14/15 | 15/16 | 16/17 | 17/18 | 18/19 | Five-year proportions |
|---|---|---|---|---|---|---|
| **Districts** | | | | | | |
| PE | 153 | 148 | 147 | 157 | 177 | 9.0% |
| ORT | 81 | 96 | 96 | 108 | 69 | 5.1% |
| Dev | 83 | 305 | 486 | 1,778 | 1,551 | 48.1% |
| **Cities** | | | | | | |
| Dev | - | - | - | - | 13 | 0.1% |
| **MoAIWD** | | | | | | |
| PE | 38 | 42 | 41 | 59 | 62 | 2.8% |
| ORT | 16 | 17 | 19 | 30 | 31 | 1.3% |
| Dev (Part II) | 798 | 440 | 413 | 893 | 365 | 33.3% |
| Emergency | 22 | - | - | - | - | 0.3% |
| **Total GoM** | | | | | | |
| **Total Water** | **1,191** | **1,048** | **1,202** | **3,026** | **2,269** | **100%** |

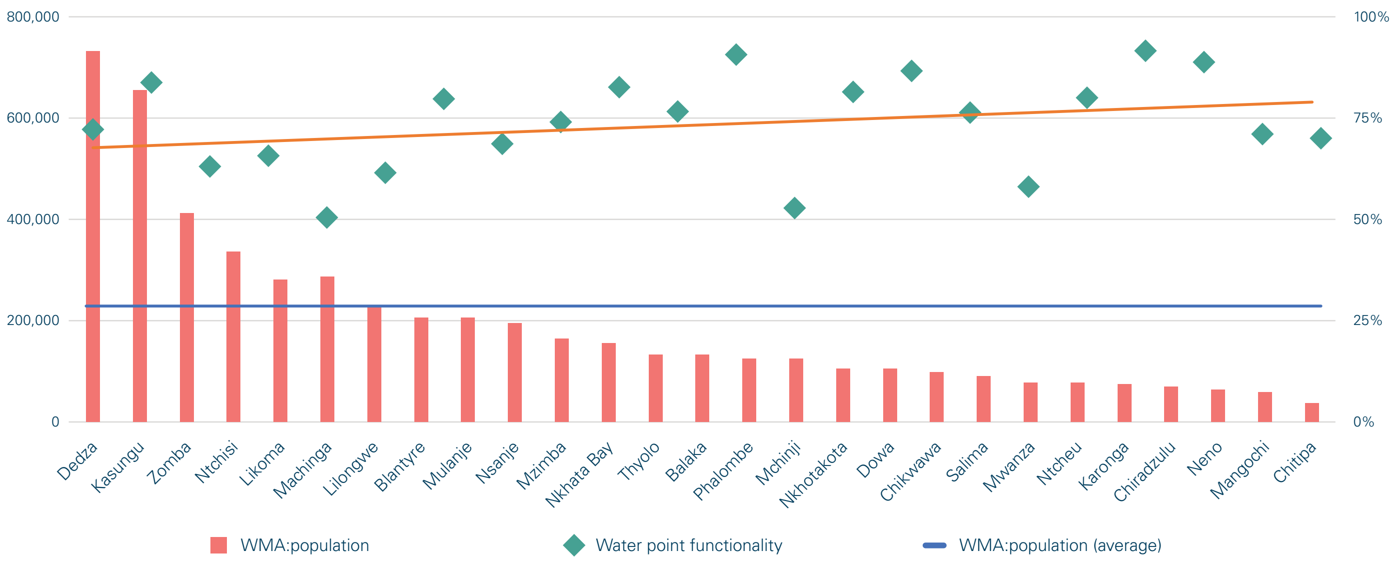
**There is no significant correlation Government ORT funds and water point functionality at the local level.** Of the K5.5 billion of Government expenditure only the ORT amount targeted for use by the Water officers in the 28 district LGAs was only K116 million. Districts use part of these small ORT funds to support operations and maintenance of water points. However, a correlation analysis of per capita ORT funds and water point functionality show no clear relationship between the two variables. This could mean that the current size of ORT allocations is too low to affect the outcome, or are ineffectively spent. The annual average district ORT budget for water is about MWK 4 million (~US$5,000). During a public expenditure review, district Water Management Assistants (WMAs) frequently reported that ORT did not reach frontline staff for maintenance activities. The average annual ORT allocation per capita 2015/16 to 2018/19 was just MKW 20 per person per year.

**Figure 40: ORT per capita* and water point functionality**



Adequate staffing is an essential component of effective service delivery, and a recognised challenge in the rural water sub-sector. The number of WMAs per person in the district averages 1:230,966, suggesting that each WMA on average is responsible for monitoring the services of a quarter of a million people. This level of staffing varies widely between districts and is correlated with the water point functionality rates in the district. On average, functionality rates are higher in districts where there are more WMAs per population served (see chart), though there is considerable variation.

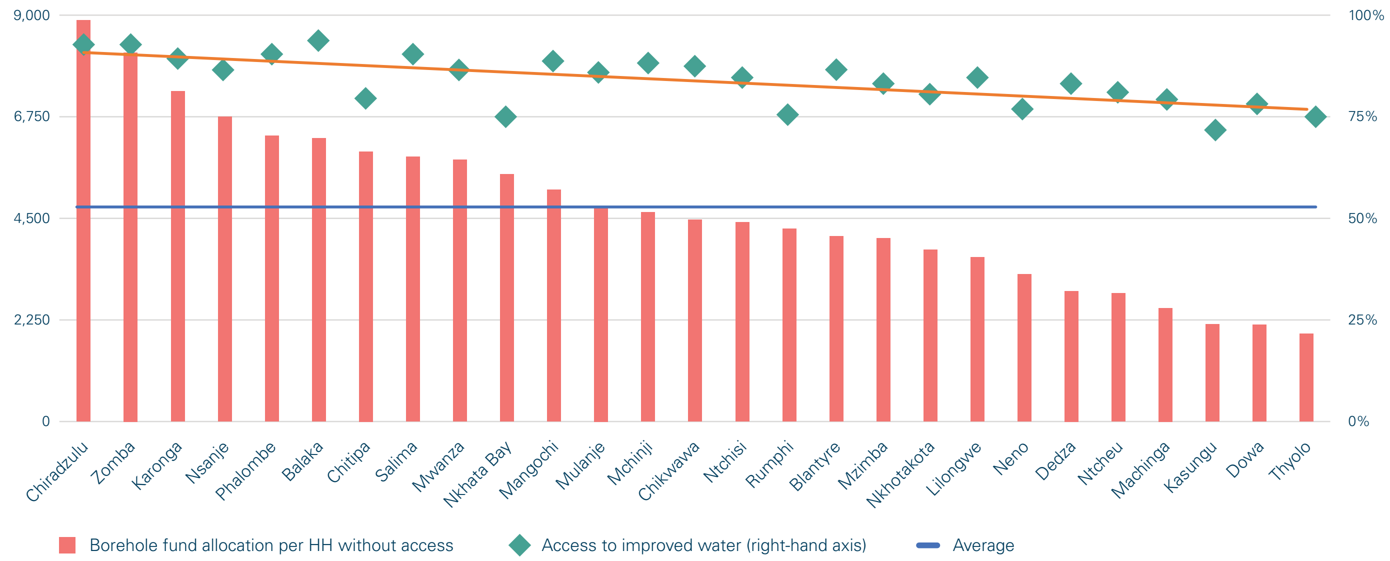
**Figure 41: Ratio of WMAs to population in districts**




The introduction of the Borehole Fund from 2017-18 has enhanced that aspect of development expenditure at the district level, but interventions may not always be effective. There is evidence that Borehole Fund spending is highly politicised. District-level staff interviewed highlighted that spending decisions under the Borehole Fund and the CDF are made by the constituency's MP. Some District Water Development Officers (DWDOs) report that this can cause issues when it comes to siting and installing boreholes, as the sites chosen by the MP may not be suitable. It is also common for borehole installations to be done by private contractors at the direction of the MP, as opposed to through the DWDO. The limited involvement of the DWDO in installing water points is a source of concern as it raises questions surrounding value for money and quality assurance, and issues related to the future O&M. The quality of the initial installation of water points has been shown to be a key determinant of the future functionality. Arguably, not involving the DWDO in supervising the construction and siting of boreholes constructed under the Borehole Fund increases the likelihood of poor targeting limiting the effectiveness of Government expenditure.

Although the Borehole Fund is a major area of WASH expenditure at district level, its targeting is not according to district water needs. This is highlighted in the next chart. A targeted allocation criterion for the Borehole Fund would favour districts with low levels of access to water. However, the current distribution shows substantial variations with some districts with the lowest levels of access receiving lower per capita Borehole Funds than other better performing districts.

### Figure 42: Per capita Borehole fund allocations vis-a-vis access to improved water sources by district




Where donors and NGOs focus their programmes has a strong influence on who is reached with services. Once a donor or NGO has selected a district to work in the decision regarding where to work is determined with the DCT. District staff report that the allocation of NGOs to TAs is designed to minimise overlaps and duplication of efforts. A broader equity consideration relates to the process by which donors decide which sectors to fund, and through which channels. The analysis of donor expenditure and projects has shown a tendency for recent donor funding to be primarily channelled to urban areas and through the water boards. The new large WASH projects of the AfDB and World Bank have tended to focus on urban areas. While the PER does not seek to question the validity or necessity of these investments it remains the case that the limited donor funding is concentrated in urban areas: there is comparatively little funding for developing services in the WASH-disadvantaged rural areas.

**Overall sector financing**

Malawi remains reliant on external sources of financing to drive investments in the WASH sector. The ratio of Malawi's external funding to financing from domestic resources is 8.8, much higher than Kenya's 2.9 and Zambia's 2.0, and higher still than Mali's and Ghana's. This is despite Malawi's comparatively low funding from external sources measured in per capita terms. Malawi receives $3.2 per capita external funding for WASH, compared to Kenya's $6.2 and Zambia's $4.2.

DP support at district level (donors and NGOs) is fragmented: There are at least 71 different partner organisations funding the Water sector at the local level. Of these 71, 10 feature in six or more districts. These partners include (number of districts in parenthesis): World Vision (18), UNICEF (14), Southern Region Water Board (10), CADECOM (9), Central Region Water Board (9), United Purpose (8), Water Aid (7), Red Cross (6), ONS

### Key W&S Sector Issues to Consider in FDS

The overall low level of ORT for the water sector is hampering effectiveness of district water teams. Obviously, an increase in ORT is needed, however Treasury has not responded to this need. In any event, the needs of each district may depend on the level of DP support in that district. Some districts without a good water partner like World Vision may need extra ORT.

Sector Specific Key issues for Reform:

- Increase sector specific ORT for water sector or consider through increased GRF?
- Increase sector specific development funding – or rely primarily on the PBG as modality as it allows LGAs to a greater extent to allocate resources in accordance with local priorities.

## 7.3 Health sector service delivery and financing

**Health Sector Service Delivery Performances**

Malawi has made significant progress in improving health indicators, although these remain high by global standards. Malawi was one of the few countries in sub-Saharan Africa which met the MDG 4 target of reducing under-5 mortality by two-thirds between 1990 and 2015. It is argued this is because it was among the first in sub-Saharan Africa to adopt evidence-based policies and implement programmes at scale to prevent unnecessary child deaths (Kanyuka et al., 2016). Under-5 mortality has continued to decline since 2015 from 54 deaths per 1,000 livebirths in 2015 to 42 in 2019, a lower rate than all its neighbours (Tanzania, Zimbabwe, Zambia and Mozambique).

There remain disparities in health outcomes between urban and rural areas. Deaths in Under-5s are 61 and 77 deaths per 1,000 live births respectively and stunting in Under-5s in the lowest wealth quintile, at 46%, is almost double the prevalence in children in the highest wealth quintile. However, inequalities in access to RMNCH services between the lowest and highest wealth quintiles, as measured by the composite coverage index, is the third smallest among the 81 countries that account for 95% of maternal and 90% of all child deaths (Boerma et al., 2018)Countdown to 2030 aims to support the monitoring and measurement of women's, children's, and adolescents' health in the 81 countries that account for 95% of maternal and 90% of all child deaths worldwide. To achieve the Sustainable Development Goals by 2030, the rate of decline in prevalence of maternal and child mortality, stillbirths, and stunting among children younger than 5 years of age needs to accelerate considerably compared with progress since 2000. Such accelerations are only possible with a rapid scale-up of effective interventions to all population groups within countries (particularly in countries with the highest mortality and in those affected by conflict.

**Box 4: Key Challenges for Health in Malawi**

The primary healthcare system in Malawi faces many challenges, several of which are due to financial constraints. A key challenge is shortage of essential medical products due to inadequate funding, weak supply chain management and irrational use of medicines, leakage and pilferage. Other challenges include high vacancy rates for healthworkers and inadequate medical equipment and infrastructure.

The Health Sector Strategic Plan II also identified the lack of gatekeeping as a major issues and estimated that around 70% of the services central hospitals provide are either primary or secondary. It can be assumed that there are similar problems at district and community hospitals.

The sector is also very dependent on donor financing and parallel reporting systems weakness the government led- monitoring and evaluation system.

**Source:** Ministry of Health (2017) Health Sector Strategic Plan II.

**Key Health Sector Strategies and LGA Finance Related Interventions**

Health is one of the five Key Priority Areas within the Malawi Growth and Development Strategy III, 2017-2022. Health has consistently been one of the top priority sectors for budget allocations, and in 2020/21 was allocated 9.3% of the budget, the third largest sector behind education (18%) and agriculture (16%), and the fourth area of priority counting debt service (17%) (UNICEF, 2020).

Malawi spends a greater proportion of its budget on health than most peer countries, 9.8% in 2018. Of low income African countries, only Madagascar spent more on health in 2018 (10.5%) and most of the other African countries spending more are high income or upper middle-income countries (Botswana, South Africa, Namibia, Syechelles, Mauritius) with only three small lower middle-income countries spending more (Lesotho, Sao Tome & Principle, Cabo Vede; WHO Global Health Expenditures Database, 2020). Low per capita spending on health ($10 in 2018) is thus primarily a matter of Malawi's income level, rather than the degree of prioritisation in the budget.

A perennial challenge is coordinating development partner financing for the sector. In the 2017/18 financial year, 75% of overall healthcare came from external partners (Ministry of Health, 2018), and since 2013/14 it has never been less than two-thirds of the sector total.

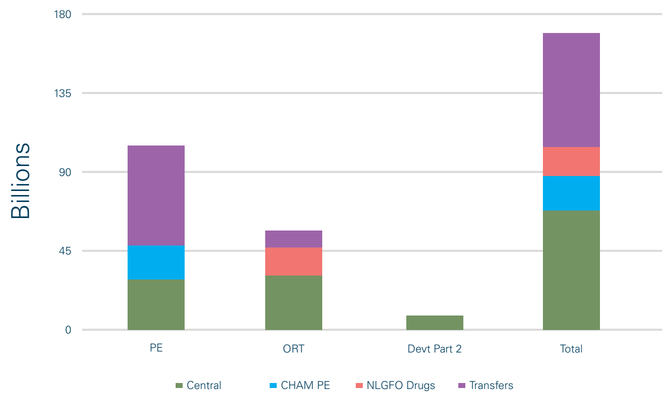
The Ministry of Health has a strong commitment to prioritising resources and focusing on the most cost-effective interventions. As part of the preparation of the 2017-2022 Health Sector Strategic Plan II (HSSP II), the Ministry revised its Essential Health Package (EHP) – the set of prioritised publicly financed health services to be delivered by the health system – to better focus it on the most cost-effective interventions. This has resulted in the estimated cost of the revised HSSP II EHP being closer to the available level of resources. Despite the HSSP II EHP being 31% cheaper than its predecessor - $247 million instead of $362 million per year – it is forecast to avert 92% as many DALYs (Ministry of Health, 2017). The revised EHP is thus better value for money than its predecessor and represents "significant progress towards a package that is more realistic and less aspirational." (Ochalek et al., 2018).

The functional assignment for health delivery between levels of government is also broadly clear. Central government is responsible for policy, and for tertiary services (four central hospitals). Districts are responsible for primary services (village and outreach clinics, health centres and community hospitals) and secondary services (district hospitals).

One caveat to this is that the functional assignments for health to urban local governments is not clear. Currently the seven urban local governments (3 cities, 2 municipalities and 1 town) do not receive conditional grants for health. It may thus be assumed that the surrounding district is thus effectively providing health services within the urban jurisdiction. For the cities where central hospitals are located, many of the health services provided will effectively be by the centre. For the municipalities and towns, it will be the surrounding district. It should also be noted that at least some of the cities (e.g. Blantyre City Council) also run a handful of health centres from their own revenues.

Government funding in the health sector broadly follows this set of functional responsibilities. In FY 2020/21 spending was split roughly 52% at spent at the centre, and 48% spent at the district level, comprising PE and ORT grants to local governments, and in the district drug budget which is held by the NLGFC.

**Figure 43: Health Sector Funding by level of government, 2020/21**




**Source**: FY2021/22 Draft Financial Statement
**Notes:** Except for PE grant, all data is midyear revised estimates for 2020/21. PE Grant figures are rough estimates. ORT Transfers excludes the additional allocation for Covid response.

However, the simple split between central expenditure and transfers to local governments underplays the extent to which the overall health sector allocation is focused on primary and secondary care. Firstly, the budget for the purchase of drugs for local government health facilities is held under the NLGFC's budget since 2016/17 due to delays in districts reimbursing the Central Medical Stores Trust (CMST) and concerns resources were being shifted away from medicines to other uses. Central government transfers the budget to CMST quarterly and districts make orders against this funding. The drug budget is allocated across districts in the same way as the general ORT transfer. The Ministry of Health, however, may now be willing to allow the drugs budget to be recombined with the ORT transfer.

Second, a quarter of the Ministry of Health's recurrent budget is for salaries of Christian Health Association of Malawi (CHAM) facilities, which are equivalent to health centres and district hospitals. Around a third of health services in Malawi are provided through these facilities

(Ministry of Health, 2017). Whilst these are technically supervised by the District Health Office, they receive funding for their payroll directly from the Ministry of Health and receive funding for their operations through fee-for-service contracts which are funded by development partners. Thirdly, around 70% of the development part 2 budget is allocated to the construction or rehabilitation of district and community hospitals.

Taking all of these together, around 64% of the 2020/21 sector budget is allocated for LGA-level functions. Just under 40% of sector financing is allocated to transfers. Another quarter of sector expenditure is on LGA-level functions, but with budgets held by central-level institutions (for CHAM payroll, district drugs, and district facility capital spending). Of the remaining 36% of the sector budget, this is split between 22% for central hospitals and 14% for Ministry of Health HQs (including allocations to the five Zonal Health Support Offices, the Department of Nutrition HIV and AIDS, the Health Service Commission and Malawi Against Physical Disabilities). These proportions of the allocations have been fairly stable over time. In the 2018/19 draft estimates, 69% of the budget was allocated to providing primary and secondary services at the district level.

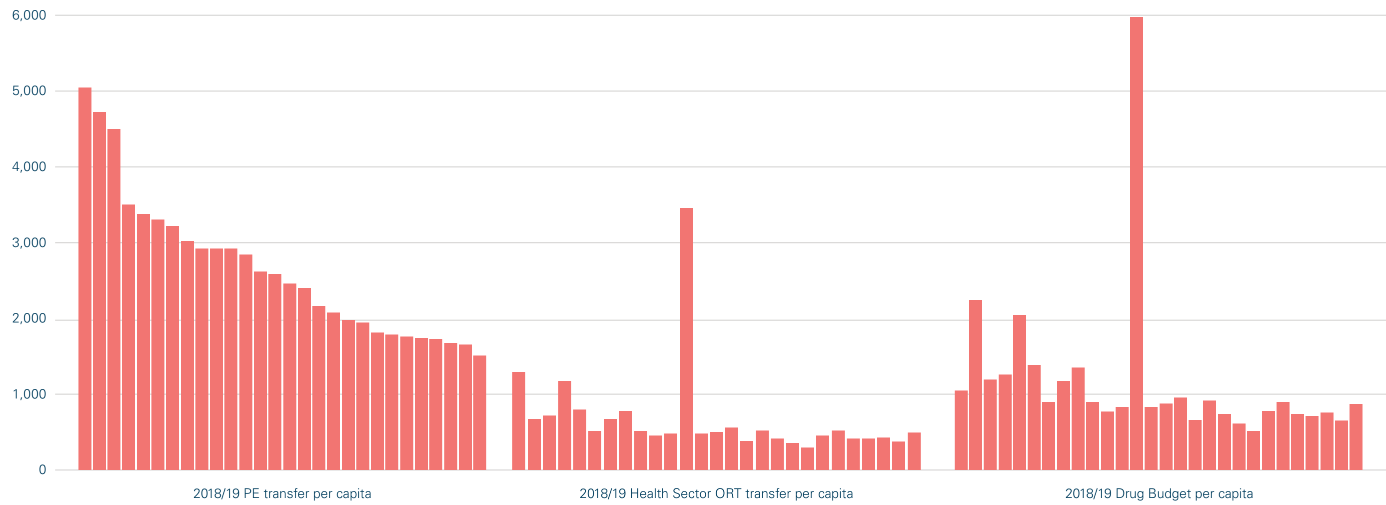
**LGA financial allocations and health sector service delivery**

Resources for health not clearly allocated across local governments by transparent needs-based formula. While the PE has been decentralised, this has not lead to changes in allocation processes. On ORT, whilst a new formula for allocating the health ORT transfer across local governments was introduced in 2009,[49] this was never fully implemented. At the time of introduction of the new formula, the transfer was allocated based 50% on the new formula, and 50% on the historical allocation. The intention was that the full formula would be phased in over time as the ORT transfer grew. However, this never occurred and increments have simply been added to the 2009 allocation since then (i.e. the allocations for each district are simply the previous year's allocation with the same increment added for all districts). The same has occurred for the drug budget.

This means that substantial inequities in per capita transfers remains, as shown in the figure below. The district with the highest PE resources per capita (Nkatabay) receives more than three times the amount the district that receives the least (Phalombe). Excluding Likoma which is an outlier in its ORT and drugs budget allocations, the district with the highest ORT and drugs allocations (Neno) receives more than four times the resources of the district with the least (Lilongwe).

49 This formula was based on five weighted factors; outpatient utilisation rate (15%), stunting percentage below -3 standard deviations (50%), bed capacity (15%), land area (5%) and infant mortality (15%). See Mcguire et al. (2018) for further discussion.

**Figure 44: Distribution of transfers per capita under the current formula**




**Source:** PE, ORT and drugs budget allocations from Mcguire et al. 2018. Population data for 2018 from 2018 Malawi Population and Housing Census.
**Notes:** As health transfers are not made to urban councils, their population has been combined with that of their surround district.

The variation in PE and recurrent allocations also leads to large differences in the proportion of resources taken up by salaries in each district. In Likoma it is only 22%, and 51% in Mwanza, the next lowest district. By contrast, in Nkatabay, salaries account for over 70% of total resources.

The Ministry of Health has undertaken analytical work to develop a new formula that would better match transfers to the resources each district needs to ensure equitable delivery of the EHP across Malawi based on estimated costs of delivering the EHP to the specific demographic mix and disease burden in each district (McGuire et al., 2020; Twea et al., 2020). In effect the aim of this resource allocation is to give each district an equal opportunity to deliver the same level of services to its population. Instead of a standard increment being allocated to all districts, this would be allocated in line with their resource needs to deliver the EHP.

However, it has not yet been implemented, and would only cover ORT transfers, and not the PE allocations, which would remain skewed. However, it would have the disparities in PE allocations across district more transparent, by showing the difference between PE allocations that have evolved on a historical basis, and a more needs-based allocation of ORT resources.

### Key health sector issues to consider in FDS

#### Health functions of urban local governments

Urban local governments do not currently receive grants for health, and in effect their health functions are carried out either by central government (through the central hospitals) or via the surrounding districts.

This poses an accountability issue as districts are delivering services in areas that are not represented by councillors as they are covered by urban councils. So how are urban councillors representing that area meant to hold a neighbouring district accountable for service delivery performance?

Against this, there are arguments that further dividing up health budgets between more local government health departments could be inefficient in a small, resource-poor country such as Malawi. Creating seven additional local government health departments (for the four cities, two municipalities and one town council) would be a 25% increase in their number, and could lead to concerns health budgets are becoming unduly fragmented. Whilst this argument may have validity for the smaller municipal and town councils, it is harder to see for the four city councils. Looking at LGAs by population, Lilongwe and Blantyre Cities are the 3rd and 6th largest LGAs. Mzuzu and Zomba Cities are smaller, but still comparable in size to smaller districts. Mzuzu City, with a population of 221k, would only be larger than two other districts excluding Likoma (Neno and Mwanza) and has a population half of the median. Zomba City, with a population of 105k, has a smaller population than any districts (excluding Likoma), and only a quarter of the median. Kasungu Municipality and Mangochi Town have populations of 59,617 and 54,377 respectively. Luchenza Municipality has a population of only 12,807, smaller than Likoma (which itself has a population of only 11% of the next smallest district).

These competing arguments need to be further studied and considered as to whether urban and rural local governments should have different functions and whether neighbouring local governments can deliver services within others jurisdictions. It also raises questions as to whether a strict single-tier system of governance is appropriate. Just considering population sizes suggests there may be a case for treating municipal and town councils, which are much smaller, differently from the cities and districts. Lastly, it should also be considered whether the health sector has specific complexities which justify a different treatment to other sectors.

### Design of fiscal transfers

The discussion above raises three issues: 1) should the drugs budget be reintegrated into the health ORT transfer; 2) how can a revised health ORT formula be introduced; and 3) should current Ministry of Health development part 2 spending be converted into a fiscal transfer?

#### Reintegration of the drugs budget into fiscal transfers

The drugs budget was separated out from the rest of the ORT transfer due to local councils building up arrears to the Central Medical Stores Trust (CMST), and concerns funds were being diverted to other uses. If it is considered that district financial management capacity has improved, this budget may now be able to be recombined with the health ORT transfer.

This also raises a number of questions about how this would be utilised: given the current insufficiency of the drugs budget which is utilised in full prior to the end of the year, would districts allocate more funding to drugs once the drugs budget and ORT budget was combined? What other expenditures would or could be cut back? Given that the CMST can itself run short of supplies, should districts be able to purchase (a portion of) commodities from sources other than CMST, in line with the practices of CHAM facilities?

### Implementation of a revised IGFT formula

The Ministry of Health has developed proposals to revise the formula that governs the ORT transfer and drugs budget to bring this more into line with a needs-based allocation across districts. However, this has not yet been implemented. There appear to be two challenges. The first challenge is how to phase the new formula in. The key issue is making a trade-off between how far 'loser' districts that receive a lower proportion of resources are protected and how quickly the new formula is phased in. For example, 'losing' districts could be fully protected in nominal terms so they would not see a fall in their budgeted amounts, with any increase in the nominal transfers going to districts gaining under the new formula. The Ministry of Finance projects inflation to be 7.8 percent and 8.6 percent in 2021 and 2022, respectively (Ministry of Finance, 2021). If transfers increase in line with inflation, this increase could be allocated in a way consistent with moving allocations towards the new formula. The second challenge is that responsibility for final approval and implementation of the new formula appears unclear. Whilst MoH has prepared the new formula, the precise responsibilities for implementing it between MoH and NLGFC do not seem clear.

### Development Part 2

As stated above, the majority of the development part 2 budget is allocated for construction or rehabilitation of community and district hospitals. Whilst one project (rehabilitation of 7 District Hospitals) has been moved to NLGFC budget in 2021/22, there does not seem to be a clear understanding of the overall policy direction. During the preparation of this report, we have heard different explanations of what this might be. First, we have heard claims that MoH has sought devolution of this, but did not convinced MoF to undertake this. Second, we have heard that MoH argues that districts should be responsible for construction of health centres, this implies that community and district hospital capital projects should remain with the central MoH.

These views need to be reconciled so that a clear position on responsibility for financing and implementing capital spending on district-level facilities can be communicated to districts. This will also affect the type of support districts will need on capital investment planning and implementation, for example from MoH zonal offices.

**Facility financing**

A further issue is that district facilities do not currently manage any resources directly, receiving goods and services in kind from districts. Health centre improvement grants have been piloted, and may be rolled out further with donor support. The arrangements for these grants should take into account the lessons from both the government and donor financed parts of the school improvement grant.

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