Chapter 5 - Macroeconomic and Expenditure Framework

5.1 Introduction

Macroeconomic stability[42] and efficient utilisation of public resources are essential conditions for economic growth and poverty reduction. Macroeconomic stability requires prudence in fiscal management and tight monetary policies. This demands that Government spends within its means, and therefore that expenditure requirements are balanced with resources available in a stable macroeconomic environment. This chapter outlines the macroeconomic and expenditure framework within which the MPRS will operate. It is crucial to the implementation of the strategy as it balances the expenditure requirements based on costing of the poverty reducing activities outlined in Chapter 4 with resources available.

5.2 Macro-economic Framework

5.2.1 Economic Growth and Poverty Reduction

Economic growth is a necessary but not sufficient condition for sustainable poverty reduction, as without growth, there will be no rise in incomes, and no additional resources available for Government to spend on poverty reducing activities. However, for growth to be effective in reducing poverty, it must involve and benefit the poor (pro-poor, or "quality" growth).

In the past, both the quantity and quality of growth in Malawi have been poor. The quantity of growth has been erratic and low on average. The distribution of growth has been highly skewed towards the wealthy. This is clearly demonstrated by a World Bank study in 1998, which demonstrated that assuming past patterns and distributions of growth, the economy would have to grow at 5.3 percent a year just to maintain constant levels of poverty. This compares unfavourably to the average of 4.5 percent growth in the period 1994-2000. However, the study also shows that changes in the distribution of growth would have a far greater impact on poverty reduction. The challenge for Malawi is therefore to improve both the quantity and quality of growth.

[42] Macroeconomic stability involves low and stable inflation, low interest rates and a stable exchange rate

5.2.2 Macroeconomic Stability and Poverty

As described in Chapter 3, although there have been periods of relative stability, the economy has generally been characterised by high inflation rates, an unstable nominal exchange rate, and high interest rates. This was caused by poor fiscal and monetary policies, adverse weather conditions and other external factors. For Malawi to attain macroeconomic stability, Government will adopt policies which will improve public expenditure management and reduce government borrowing; control money supply and inflation; maintain a stable and competitive exchange rate; and improve the trade regime and investment environment.

5.2.2.1 Fiscal Imbalances and Poverty

High fiscal deficits have necessitated excessive Government borrowing, which in turn has led to high interest rates and the crowding-out of the private sector. In addition, excessive borrowing has resulted into increased interest payments thus reducing the net resource envelope available to fund government activities, of which some are crucial to poverty reduction. Excessive Government borrowing from the Reserve Bank of Malawi (RBM) has contributed significantly to macroeconomic instability. There have been times when government borrowing from the RBM has exceeded the stipulated limits, leading to increases in interest rates and inflationary effects.

A number of measures to improve fiscal discipline are outlined under Public Expenditure Management in Pillar 4 of the strategy outlined in Chapter 4. In particular this involves improving the budget implementation by creating hard budget constraints, through strengthening political oversight of the budget, improving financial management and expenditure control mechanisms (including stronger sanctions against those that break financial management regulations), and the strengthening of resource forecasting.

In addition to these reforms focussed on controlling Government expenditure, a number of activities will be undertaken. Firstly, efforts will be made to increase the independence of the Reserve Bank of Malawi from government. This will be achieved through a review of the Reserve Bank Act, including revising the appointment procedures for the Governor and Deputy Governor, and the current stipulated agreement on borrowing from the RBM. Also, there is need for stronger monitoring and enforcement procedures against overspending in parastatals. This will be achieved through the Public Enterprise Reform and Monitoring Unit (PERMU) and relevant Parliamentary committees, to be governed by a single, all encompassing Act covering parastatals. Government will also revise the legal framework governing the roles of the Secretary to the Treasury and the Budget Director, to ensure a degree of autonomy in the execution of the Budget. Finally, the powers of the Public Appointments Committee will be strengthened in order to ensure transparency in appointments of senior officials in government and parastatals.

5.2.2.2 Monetary Imbalances and Poverty

The ultimate objective of monetary policy is the pursuit of low and non-volatile inflation. This is premised on the fact that high rates of inflation discourage saving and investment, and thereby damage an economy's potential for economic growth. Inflation is also a regressive and arbitrary tax that places a heavy burden on the poor as it erodes their purchasing power. Volatile inflation also introduces uncertainty in the business environment and thereby adversely affecting growth prospects and poverty.

To achieve stable inflation, authorities will continue to target the growth in reserve money in order to reduce the growth of money supply. The management of reserve money will involve Open Market Operations (OMO)[43], adjusting the Liquidity Reserve Requirement (LRR)[44], and exchange rate operations[45].

High interest rates have an adverse effect on economy particularly on the poor. Changes in interest rates affect real demand in an economy that in turn affects output and prices. High interest rates act as a disincentive to investment and therefore retard economic growth. High rates also reduce the affordability of credit, especially for the poor.

As a result the second objective of monetary policy is to reduce interest rates by improving the efficiency of the financial system. This will be achieved through the review of the regulatory and institutional frameworks and encouragement of new financial institutions and instruments to increase competition.

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[43] Sales and purchases of securities (Treasury and Reserve Bank of Malawi Bills),
[44] A statutory requirement that banks maintain a minimum percentage of their deposits in cash at the Reserve Bank. Adjusting the LRR is a means of realising and withdrawing reserves from the banking system
[45] The purchase or sale of foreign exchange by the Reserve Bank of Malawi.

5.2.2.3 External Sector Imbalances and Poverty

An exchange rate can have an adverse effect on the poor. A depreciating exchange rate erodes incomes and purchasing power of the poor through inflationary effects. Thus Government will strive to attain a stable Malawi Kwacha that is competitive with other foreign currencies, and will avoid the appreciation of the Real Effective Exchange Rate (REER)[46]. The strategic polices which will assist in containing exchange rate pressures include: sound fiscal and monetary polices, low and stable inflation, increased competition in the foreign exchange market and lastly improved market information. These strategies can be achieved through encouraging the development of an interbank foreign exchange market, broadening the participation of the private sector in exchange rate management and a review of the regulatory framework which promotes the growth in non-traditional exports.

The country's deteriorating balance of payments position has been the major cause of exchange rate instability. This has emanated from the unfavourable terms of trade and shortfall in donor inflows. The country has in the past heavily relied on traditional exports like tobacco that have not generated the desired level of foreign exchange. There should therefore be a deliberate policy to encourage the diversification of exports.

5.2.3 Resource Envelope and Macroeconomic Projections

The gross resource envelope envisaged for the MPRSP during the fiscal year 2002/03 will be K44.9 billion. This is based on several assumptions, as shown in Table 5.1 below. For the 2003/04 and 2004/05 fiscal years, the projected resource envelopes are K48.5 billion and K55.6 billion respectively (see Table 5.2 below). The declining trend in the inflation rate is premised on the envisaged tight fiscal and monetary polices.

Table 5.1 – Macroeconomic assumptions for resource envelope

Indicator	2001	2002	2003	2004
GDP growth (%)	2.7	3	4.5	5.2
Inflation (%)	27.6	11.5	5	4.4
Exchange rate	70	71	74	78
% of donor pledges honoured	90	90	90	90

[46]The Real Effective Exchange Rate is a measure of a country's competitiveness, calculated from the nominal exchange rate adjusted by the inflation differential between the foreign and domestic prices

These projected resource envelopes are deliberately based on realistic assumptions. These do not mean that the Malawian economy should not aim for higher levels of growth. Instead, they are realistic estimates based on past experience and technical knowledge. If the MPRSP is fully implemented and there are no negative external shocks, growth and revenues may be higher than projected. In that case, the additional activities that currently fall outside the resource envelope will be implemented.

Table 5.2:Gross Resource Envelope

		MPRS projection	
Million kwacha	**2002/3**	**2003/4**	**2004/5**
Domestic Revenue	28,545	32,471	36,917
of which non-tax revenue	2,857	3,137	3,443
Grants and Loans	14,277	15,158	18,157
Domestic Financing	- 1,399	- 3,245	- 4,597
HIPC	3,513	4,144	5,139
Gross resource envelope	44,936	48,528	55,617

The resource envelope (total resources available) is derived from projections of total domestic taxation and non-tax revenue, in addition to conservative estimates of donor inflows. At present, the latter are based on aggregate donor pledges. In order to make the projections more realistic, Government will undertake a survey to ensure that the resource envelope is comprehensively derived so that it can accurately be compared to the costings. In particular, Government will undertake a survey of existing donor and NGO programmes and projects. As the 2000 PER clearly demonstrated, a large proportion of these programmes and projects do not currently appear in the Budget and are not factored into the projection of the resource envelope.

Where ongoing projects involve activities identical or similar to MPRS activities, the financial resources funding the MPRS activities within those projects will be counted as part of the resource envelope. However, projects and parts of projects that do not involve activities contained in the MPRS will be noted and the associated resources excluded from the MPRS resource envelope. Government will continue to welcome the implementation of the project until any review phase or the end of the project life-span. However, any new projects and any mid-term project reviews will be required to take into account the MPRS so that ultimately all programmes and projects involve only MPRS activities.

5.3 Expenditure Framework

The expenditure framework consists of three main elements. Firstly, statutory and statehood expenditures. Secondly, the costing of the MPRS activities outlined in Chapter 4. Where possible, this costing has been done on the basis of targets and unit costs, so that planned expenditure reflects a realistic estimate of the resources needed to meet national objectives. These first two elements are combined to compare total costings to gross resource availability. Thirdly, the expenditure framework presents certain large-scale infrastructure development projects. These projects involve large investment by the private sector and/or external donors and are not included in the MPRS costings and are will not be in the Budget. Although they are not a priority for poverty reduction, their funding is important for the development of the nation.

5.3.1 Statutory and Statehood Expenditure

Before the costing of MPRS activities can be compared to the resource envelope, two types of activities must be considered. Firstly, projected expenditures on statutory activities must be allocated a share of the resource envelope. These statutory activities are by definition ones that have to be funded and cannot be scaled down, and include items such as interest payments, debt repayments and pensions and gratuities.

Secondly, a share of the resource envelope must be allocated to statehood activities. These activities do not directly reduce poverty, but are essential in any country as the basic activities that enable the functioning of state by promoting and protecting national integrity, security and leadership. Examples include ensuring external security, supporting the President, conducting national public events and gathering and disseminating information to the nation. As with any other set of activities and resource allocation, the use of these resources must be as efficient and effective as possible, and there must be transparency and accountability. Equally importantly, these activities must have a hard Budget constraint – expenditure must not exceed the resource allocation in the Budget, which will be guided by the allocation outlined in this Chapter. Any additional expenditure on these activities translates into reduced allocations to the MPRS activities. The MPRS is in part intended to clearly demonstrate these trade-offs, for example by demonstrating the impact that additional unplanned statehood expenditure has in terms of reduced expenditure on health and education activities.

Table 5.3 below presents a summary of statutory and statehood expenditures. Statutory expenditures will require around K11.5 billion in 2002/3 (accounting for 23.5 percent of total costings), decreasing to K11.2 billion in 2003/04, before increasing to K12.2 billion in 2004/05 (20.9 percent). Statehood activities have been allocated K3.2 billion in 2002/03 (6.5 percent of total costings), increasing to K3.5 billion in 2004/05 (6.0 percent).

Table 5.3 Statutory and Statehood Expenditure

	2002-3	2003-4	2004-5
Million kwacha			
Total costings Statutory	48,859.9 11,483.3	51,591.8 11,186.1	58,085.8 12,157.9
Of which Public Debt Charges	9.468.6	9,017.1	9,817.7
Statehood	3,191.0	3,332.0	3,463.0
As percent total costings			
Statutory	23.5%	21.7%	20.9%
Statehood	6.5%	6.5%	6.0%

5.3.2 MPRS Costings

The MPRS gives a costed and prioritised description of the set of activities that are seen as those that will reduce poverty in Malawi. These activities were designed in large part through a bottom-up approach – the needs of the poor were defined first and strategies designed to help them reduce their poverty. These activities were then costed, where possible on the basis of unit costs applied to relevant targets[47]. These targets and costs were adjusted to ensure realism, especially as regards implementation capacity[48]. Once all activities were costed, the total cost of the MPRS activities was derived. The next stage was to reprioritise, rephase and rescale the activities so that the total costings were in line with the total resources available. A summary of the resulting costings are shown in Tables 5.4 and 5.6, and a more detailed break-down by objective is produced in annex 2[49].

These summaries of costings are not Budgetary allocations[50], but an indication of how much certain groups of activities will cost. The costs are derived bottom-up rather than top-down. The total numbers for each Pillar were derived from costing the constituent activities and then rephasing where possible as a result of capacity and resource constraints, rather than starting

[47] For example, in education the total teacher wage bill was derived by multiplying the required number of teachers in a particular year by the cost of paying each teacher in that year.
[48] For example, although it may be desirable to have a pupil:teacher ratio of 50, this is not possible given the capacity of teacher training institutions and the supply of educated potential recruits.
[49] The break-down of costings by strategy and activity is also available as a separate data source.
[50] Except in the case of Statehood Expenditures, which were not separately costed.

with a total allocation and splitting it between activities or ministries. Further, the costings refer to activities rather than to institutions. In the MPRS, the activities are the focus – the responsible institutions are secondary.

However, there are important similarities with the Budget that will help to ensure that the MPRS is translated into the Budget. Firstly, the MPRS costing is comprehensive, so that it covers all Government and development partner activities[51]. Similarly, the resource envelope contains all sources of funding, be they domestic taxation, donor grants, loans or HIPC resources. Secondly, the MPRS matrix outlines the responsible institution(s) for each activity, so that the costing of the activities can be easily translated into institutional allocations for comparison with the Budget.

Table 5.4 MPRS Costing Summary by Pillar

	2002-3	2003-4	2004-5
Million Kwacha			
Total MPRSP	34,185.61	37,073.63	42,464.92
Pillar 1	9,137.19	8,709.43	8,821.76
Pillar 2	16,322.15	19,009.89	22,885.48
Pillar 3	1,755.95	1,985.60	2,388.69
Pillar 4	5,470.10	5,375.94	5,895.25
Cross-Cutting	1,302.07	1,714.18	2,203.54
Implementation, Monitoring and Evaluation	198.16	278.59	270.20
As % MPRSP costings			
Pillar 1	26.7%	23.5%	20.8%
Pillar 2	47.7%	51.3%	53.9%
Pillar 3	5.1%	5.4%	5.6%
Pillar 4	16.0%	14.5%	13.9%
Cross-Cutting	3.8%	4.6%	5.2%
Implementation, Monitoring and Evaluation	0.6%	0.8%	0.6%

5.3.3 Large scale Infrastructure Development

As mentioned above, a number of large-scale infrastructure development projects have been treated separately, since they are generally funded by development partners and have high, lumpy costs. Whilst these projects are not priorities for poverty reduction, they are important for the development of Malawi. They will not be financed by Government, which will concentrate its resources on the MPRS activities. However, Government will actively seek private sector investors and international development partners to fund these projects.

These projects fall under three main categories: telecommunications, electrification and roads. For all three, smaller scale and more poverty focussed activities are included in the MPRS. The main telecommunications project covered here is the expansion of rural telecommunications (expected to be largely funded by the private sector). In the electricity sector, the projects include the interconnection of electricity grid systems with Mozambique, the rehabilitation of existing transmission and distribution power systems and the expansion of main grid electricity supply capacity. Finally, in roads, the projects include the reconstruction and expansion of the core road network, including the Karonga-Chitipa road. More details of these can be found in Annex 3.

5.4 Resource Gap

In order to derive the resource gap, the gross resource envelope in Table 5.2 is compared to the costings of Statutory and Statehood activities contained in Table 5.3 and the MPRS costings contained in Table 5.4. As shown in Table 5.5, the resulting resource gap is K3.9 billion in 2002-3, K3.1 billion in 2003-4, and K2.5 billion in 2004-5.

Table 5.5 Resource Gap (Millions of Malawi Kwacha)

	2002/3	**2003/4**	**2004/5**
Gross resource envelope	44,936	48,528	55,617
Statutory & Statehood	14,674	14,518	15,621
Total MPRS costings	34,186	37,074	42,465
Resource gap	3,924	3,064	2,469

This resource gap may not require closing, since many of the activities included in the MPRS costing are already funded by donors and other development partners but are not counted as part of the resource envelope. In order to define a more accurate resource envelope, Government will undertake a survey on ongoing projects and future commitments in order to ascertain the extent to which MPRS activities are already funded. Once this exercise is completed, a further round of reprioritisation, rephasing and rescaling will be undertaken to ensure that the costings are brought into line with the resource envelope. Any remaining resource gap will be filled through resource mobilisation efforts.

Finally, Table 5.6 presents a more detailed summary of costings within each pillar, at the goal and sub-goal level (reflecting the headings and sub-headings in Chapter 4). The costings

[51] Apart from Statehood, Statutory and some largescale infrastructure development projects, which are treated explicitly elsewhere in this section.

reflect the MPRS priorities, with K7.3 billion allocated to basic education, K4.6 billion to essential healthcare, K1.6 billion to safety nets, and K2.6 billion to supporting agricultural livelihoods in 2002/03. The further details of the costing and resulting expenditure allocations can be found in annex 2 and the separate costing data source, together with a breakdown of costs into recurrent and development expenditures.

Table 5.6 Detailed Costings by Goal and Sub-Goal (Millions of Malawi Kwacha)

	2002-3	2003-4	2004-5
Pillar 1 - Sustainable Pro-Poor Growth	9,137.19	8,709.43	8,821.76
Goal 1.1 - Sources of pro-poor growth	4,264.90	4,263.37	4,246.33
Sub goal 1.1.1 - Increasing agricultural incomes	2,715.28	2,740.47	2,722.16
Sub-Goal 1.1.2 - Natural Resources	726.20	799.45	841.92
Sub-Goal 1.1.3 - Develop MSMEs	364.75	311.30	299.90
Sub-Goal 1.1.4 - Manufacturing and Agro-Processing	183.01	273.00	299.00
Sub-Goal 1.1.5 – Tourism	235.51	113.00	63.00
Sub-Goal 1.1.6 - Small Scale Mining	40.15	26.15	20.35
Goal 1.2 - Creating an Enabling Environment for Growth	4,872.29	4,446.06	4,575.43
Sub-Goal 1.2.1 - Macroeconomic Stability	-	-	-
Sub-Goal 1.2.2 - Credit and Micro-Finance	124.00	60.00	60.00
Sub-Goal 1.2.3 - Rural Infrastructure	3,496.25	2,980.45	3,166.29
Sub-Goal 1.2.4 - Other Enabling Infrastructure	410.52	314.09	372.47
Sub-Goal 1.2.5 - Domestic and external trade	189.69	379.93	191.95
Sub-Goal 1.2.6 – Taxation	651.83	711.60	784.72
	-	-	-
Pillar 2: Human Capital Development	16,322.15	19,009.89	22,885.48
Goal 2.1 Improving quality and access to education	10,354.84	12,502.68	15,556.68
Sub-goal 2.1.1 - Basic education	7,216.04	8,746.05	10,492.89
Sub-Goal 2.1.2 - Secondary School education	2,298.89	2,909.16	4,185.68
Sub-Goal 2.1.3 - Higher Education	678.67	678.67	678.67
Sub-Goal 2.1.4 - MANEB	131.00	131.00	131.00
Sub-Goal 2.1.5 - MIE	30.24	37.81	68.45
Goal 2.2 Better Technical, Vocational and Entrepreneurial Education and Training	532.40	530.12	591.39
Goal 2.3 Improved Health Status	5,321.55	5,837.03	6,562.41
Sub-Goal 2.3.1 - Preventative Healthcare	-	-	-
Sub-Goal 2.3.2 - Essential Healthcare	4,937.48	5,430.00	6,132.00
Sub-Goal 2.3.3 - Tertiary Healthcare	384.07	407.03	430.41
Goal 2.4 - To prevent and control Protein, Energy, Malnutrition and micronutrient deficiencies	113.36	140.06	175.00
	-	-	-
Pillar 3 - Improving the Quality of Life for the Most Vulnerable	1,755.95	1,985.60	2,388.69
Goal 3.1 - Safety Nets	1,599.98	1,815.33	2,202.69
Sub-Goal 3.1.1 - Productivity Enhancing Interventions	997.75	1,118.41	1,271.73
Sub-Goal 3.1.2 - Welfare Support Interventions	602.23	696.92	930.96
Goal 3.2 - Improving disaster management	155.98	170.27	186.00
	-	-	-
Pillar 4 - Governance	5,470.10	5,375.94	5,895.25
Goal 4.1 - Political Will and Mindset	2.00	5.00	8.00
Goal 4.2 - Improved safety, security and access to justice	3,324.62	3,684.56	4,193.81

Goal 4.3 - Ensuring responsive and effective public institutions	2,143.47	1,686.37	1,693.44
Sub-goal 4.3.1 - Improved Public Expenditure Management	428.75	353.61	320.98
Sub-Goal 4.3.2 - Public Service Reform	173.26	164.80	175.82
Sub-Goal 4.3.3 - Corruption and Fraud	111.21	118.46	126.51
Sub-Goal 4.3.4 - Decentralisation	811.18	420.69	425.49
Sub-Goal 4.3.5 - Democratisation	495.93	509.43	524.28
Sub-Goal 4.3.6 - Human Rights	123.15	119.38	120.36
	-	-	-
5 - Cross cutting	1,302.07	1,714.18	2,203.54
Goal 5.1 Ensure national response to the HIV/AIDS pandemic	289.75	320.45	346.23
Goal 5.2 Reduce gender inequalities	72.62	78.92	65.11
Goal 5.3 Ensure environmental sustainability	294.00	334.00	372.00
Goal 5.4 - Create a Science and Technology driven economy	645.70	980.80	1,420.20
	-	-	-
Monitoring and Evaluation of MPRS	198.16	278.59	270.20
Goal: Ensure implementation of the MPRS	198.16	278.59	270.20