Is Malawi's Fiscal Crisis Over? A Donor Perspective

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Introduction

In August 2004 I presented a paper titled '*Malawi's Fiscal Crisis – a Donor Perspective*' which looked at the fiscal situation inherited by the new government. The paper pointed out that the previous government's failure to control expenditure had led to the accumulation since 2001 of a dangerously large domestic debt and the loss of government control over its Budget. As a result, Malawi faced a fiscal crisis with disturbing implications for macro-economic stability, investment, financing of public services and poverty reduction. The crisis could only be overcome with substantial financial support from the international community. However, the Malawi Government's international reputation for economic mismanagement was so bad that it would be difficult persuading donors to assist.

Three years later the crisis appears to have been largely overcome, as illustrated by Malawi reaching HIPC Completion Point in August 2006. To illustrate the changes in fiscal management which have persuaded the IMF, DFID and other donors to resume and increase their support to Malawi, I have updated the previous paper (and a November 2005 update) to cover the period up to FY 2007/08. The paper goes on to consider the prospects for using the increased resources available to the Malawi Government (GoM) as a result of improved economic management to increase growth and poverty reduction.

As before, the analysis is based mainly on Table 1 and charts derived from it. Table 1, which now covers the period 2000/01 to 2007/08, has three sections:

1. revenue and expenditure data in *nominal Malawi Kwacha*. Figures up to 2005/06 are from the IMF PRGF Third Review of February 2007, but originate in the Ministry of Finance. 2006/07 and 2007/08 figures are from the GoM Financial Statement for FY2007/08.
2. the same figures expressed as *percentages of Total GoM Domestic Expenditure* (ie excluding donor funded projects, Part I of the Development Budget)
3. the same figures expressed as *percentages of Gross Domestic Product* (GDP), ie Malawi's annual income

The nominal figures are essential input to the table, but are of little value when comparing changes over time. This is because inflation reduces the value of the Kwacha over time; comparing, say, 2000 and 2007 expenditure in nominal terms is 'comparing apples and oranges'. Analysis of trends in shares of total expenditure and of GDP is much more useful because the effect of inflation is neutralized. Such figures can also be compared with other countries.

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In March 2007 the National Statistics Office launched a new National Accounts series for the years 2002, 2003 and 2004. These use an improved methodology based on the UN 1993 System of National Accounts. As a result, GDP for the three years has been revised upwards by an average of 37.5%. While the revised figures are more accurate they have not been incorporated here. This is because the paper looks at *changes over time* in GoM economic performance over the period 2000/01 to 2007/08. For such time series analysis it is important to have *consistent* data for the whole period, not just for three years.

Various key trends in Table 1 are illustrated in four charts:

- Figure 1 shows total government expenditure as a share of GDP, along with government revenue and external grants. The Fiscal Deficit is the difference between expenditure on the one hand and the sum of revenue and grants on the other. While the coverage of external grants has varied over time, the deficit figures are accurate.
- Figure 2 shows the Net Domestic Debt Stock and the government interest bill (domestic and foreign), as shares of GDP.
- Figure 3 shows domestic expenditure broken down in percentage terms into various categories – explained below.
- Figure 4 is the same as Figure 3, but presented as shares of GDP.

Recap, 2001 – 2004

In order to see how things have changed since 2004, it is important first to recap developments in the preceding period – as described in the earlier papers. These are illustrated in Table 1 and Figures 1 to 4. The fundamental cause of the fiscal crisis was the previous government's inability to control expenditure and to live within its means. Every year from 1994 expenditure exceeded that approved by Parliament (and agreed with the IMF) in the Budget – and by increasing margins over time. Budget outturns bore little resemblance to approved estimates and the budget process lost credibility.[2] While fiscal discipline improved sufficiently to persuade the IMF to approve Malawi's first Poverty Reduction & Growth Facility (PRGF) in December 2000 – supported by budget support commitments from the Common Approach to Budget Support (CABS) group of donors[3] - this improvement was not sustained. Continued over-expenditure soon caused Malawi to go 'off track' with the PRGF in November 2001.

Donors were not prepared to continue 'pouring good money after bad' in support of fiscally irresponsible government. Most CABS budget support was conditional upon GoM remaining on track with the IMF and so was suspended when the PRGF went off track. This represented 23% of budgeted revenue in

[2] Moreover, an examination of those areas in which unbudgeted expenditure took place reveals a consistent pattern of over-expenditure on activities which are of little benefit to the poor, eg travel, state residences, foreign affairs, defence, National Intelligence Bureau and Special Activities.

[3] At the time CABS comprised the UK, the European Union, Norway and Sweden.

2001/02. Instead of reducing expenditure to offset the lost revenue, GoM continued spending almost as though nothing had happened. This inevitably led to an increase in the fiscal deficit (ie government revenue minus expenditure). Table 1 and Figure 1 show that the deficit increased from –5.8% of GDP in 2000/01 to -7.9% in 2001/02. The deficit increased still further in 2002/03 to a massive –11.6% of GDP, as a result of the maize operation (costing 3.8% of GDP) following the poor harvest in 2002.

Following an apparent improvement in fiscal management in 2003, Malawi got back 'on track' with the IMF PRGF in October 2003 and CABS donors resumed disbursements of budget support. However, this was almost immediately followed by a relaxation in expenditure control in the run-up to the May 2004 elections, resulting in a 2003/04 deficit of –7.8% and the abandonment of the PRGF.

The fiscal deficits for the three years 2001/02 to 2003/04, which amounted to some 27% of GDP, were largely financed by short-term borrowing from the domestic banking system – mainly in the form of Treasury Bills[4]. The substitution of domestic borrowing for donor grants and soft loans was disastrous for Malawi – both Government and the private sector. Government expenditure on interest obviously increased directly as a result of its increased borrowing. However, it increased much more than proportionately to the debt stock. If government suddenly increases its' borrowing from local banks interest rates will go up – because there are only limited funds available. As a result, *real* (ie after inflation) interest rates ranged between 20 – 35% for most of the period November 2001 to October 2003 – among the highest rates in the world[5].

Increased interest rates do not just hurt government. Hardly any private firms can afford to borrow at 30% real interest. As a result, private investment was depressed; government 'crowded out' the private sector. Direct investment in Malawi dropped from US$59 million in 1999 to US$6 million in 2002[6]. This has obvious implications for growth, employment and poverty reduction.

The combination of the increased *stock* of debt and the jump in interest *rates* meant that Government's domestic interest bill shot up from MK3.4 billion (3.0% of GDP) in 2000/01 to MK17.3 billion (9.1%) in 2003/04. This is illustrated in Figure 2.

Table 1 and Figure 4 show that there was a substantial step increase in GoM *domestic expenditure* (ie excluding donor funded projects) from 24.7% of GDP in 2000/01 to 33.2% in 2003/04. With domestic revenue at about 23% of GDP, this could not be sustained without substantial outside support. Most of the increase (from 25.9% to 32.4% of GDP) occurred in 2002/03, mainly

[4] Table 1 shows that the net domestic debt stock increased by 16.8% of GDP between June 2001 and June 2004.
[5] IMF '*Selected Issues & Statistical Appendix'*, October 2004, page 22. Nominal Treasury Bill yields are illustrated in Table 5, discussed below.
[6] Economist Intelligence Unit, *Malawi Country Report*, January 2004, page 28.

attributable to that year's maize operation. However, instead of reverting to normal in 2003/04, the full impact of the increased interest bill was felt that year. Most of the increase in domestic expenditure was due to fiscal mismanagement since 2001, therefore, and its impact on the interest bill.

In addition to its impact on *total* expenditure, Figures 3 and 4 illustrate the damaging impact of government borrowing on the *composition* of public expenditure, in particular on what is termed here 'discretionary' expenditure. By discretionary expenditure I mean *that part of the Budget over which the Ministry of Finance can exercise a reasonable degree of control*, ie that part which can in principle be allocated in accordance with policy priorities. The concept is perhaps best understood by looking at '*non*-discretionary' expenditure. There is no universally agreed definition of non-discretionary expenditure. However, I would argue that the Malawi Government has virtually no control in the short term over the following:

1) Interest (domestic and foreign)
These payments are 'statutory', ie they must be paid by law.

2) Pensions and Gratuities
These payments are also 'statutory'.

3) Transfers to Malawi Revenue Authority (MRA) and National Roads Authority (NRA)
The legislation establishing MRA and NRA provides for them to be financed from a fixed percentage of tax collected and the fuel levy respectively. Government has no option but to pay these funds over, therefore.

4) Salaries and Wages
While wages are not statutory, and governments can reduce the number of their employees, in practice there is virtually no scope to cut wage expenditure in the short term. Retrenchment of public servants has a substantial short term cost in the form of retrenchment packages.

Other items treated here as non-discretionary are the costs of *elections*, repayment of *arrears*, *emergency food* imports in food deficit years and (since 2004/05) donor funding of *Health other recurrent transactions (ORT)* under the Health sector wide approach (SWAp).

A good case could be made for counting a number of other budget categories as non-discretionary. For example, since 2000/01 the Government has designated certain budget lines as *Pro-Poor Expenditure*, which are protected in real terms and from within year budget cuts. University staff salaries, which are separate from the GoM wage bill, could also be included.

However, there is no need for precision here. The trend in Figures 3 and 4 is clear. The 'discretionary balance' (as defined here) in Figure 3 dropped from 52.4% of total domestic expenditure in 2000/01 to 36.9% in 2003/04. Despite the fact that total domestic expenditure increased from 24.7% of GDP in

2000/01 to 33.2% in 2003/04, the discretionary balance shrunk from 13% of GDP to 12.2% over the same period.

In other words, in 2003/04 Government had, at best, some degree of control over just a third of its budget – and it was shrinking fast. It was simply not possible for the Ministry of Finance to *manage* government expenditure in any meaningful sense with such a small discretionary balance. This clearly constituted a fiscal crisis.

The origins of the crisis can be clearly seen in Figures 3 and 4. The crowding out of discretionary expenditure began with the 2002/03 maize operation[7], which represented 11.7% of domestic expenditure that year. However, much the most important factor was increased domestic interest costs which accounted for a massive 27.4% of total domestic expenditure (9.1% of GDP)[8] in 2003/04.

As noted above, the fundamental problem was the government's inability to control expenditure. Figures on arrears released subsequently reveal that the situation was even worse than described here. The Auditor General estimated that as at 30 June 2004 the government had accumulated arrears of Kwacha 10.9 billion. This represents expenditure made (equivalent to 5.8% of GDP) and goods and services received by government, which had not been paid for. In other words, Table 1 and Figures 1 and 4 *underestimate* public expenditure by this amount[9]. Responsibility for paying these arrears fell to the new government.

Perhaps the easiest way of appreciating the crisis inherited by the new government is by looking at the direction of the trends in Figures 1 to 4 over the period **up to June 2004**:

- Figure 1 shows a rapid growth in total expenditure to unprecedented levels and **large fiscal deficits**.
- Figure 2 shows a dramatic **growth** in the **domestic debt stock** and the **GoM domestic interest bill**.
- Figure 3 shows the reduction in **discretionary expenditure to just 36.9%** of total domestic expenditure in 2003/04 – and this is probably an overestimate.
- Figure 4 shows a rapid growth in: (a) **domestic expenditure** in general and (b) **interest** in particular to unprecedented levels.

You do not need to be an economist to recognise that continuation of the above trends would have been disastrous for the government and the economy. It is unclear whether the crisis should be attributed to ignorance of

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[7] Maize purchases in 2002/03 and 2005/06 account for the two 'humps' in 'non-discretionary' expenditure in Figures 3 and 4.
[8] Interest – including interest on foreign debt – averaged 3.4% of GDP in Sub-Saharan Africa (excluding South Africa and Nigeria) in 2002. '*African Development Indicators: 2004'*, World Bank, page 190. The equivalent figure for Malawi in 2003/04 was 10.6% of GDP.
[9] Arrears cannot be included because it is not known *when* they were incurred. Had they all been incurred in 2003/04 the fiscal deficit would have increased to a massive 13.6% of GDP.

the basics of economic management or to plain irresponsibility. What is clear is that Malawi is much poorer as a result and that things could not continue the same way following the election.

The 2004 paper concluded that the crisis could only be overcome with substantial financial support from the international community. However, Malawi's international reputation was so low as a result of its economic mismanagement that international organizations were reluctant to entrust the government with their money. Malawi had earned a reputation as a country that fails to honour its commitments. The paper emphasized therefore the critical importance of restoring the country's reputation. The most effective way of achieving this would be to agree and strictly adhere to a new programme with the IMF. Central to this would have to be strict expenditure control and fiscal discipline combined with strengthened public financial management. How has the new government performed?

Fiscal and Macro-economic Performance, 2004/05 – 2006/07

In this section we look at fiscal performance since 2004/05 and at how the new government responded to the crisis it had inherited. It should be emphasized that the 2006/07 out-turn figures in Table 1 are *provisional* and will not be finalized for some months. However, they are not expected to change very significantly.

The single most noteworthy policy change is that, following at least ten years in which expenditure exceeded the approved budget, the Malawi Government has stayed within the budget approved by Parliament for each of the last three years. Given the extremely difficult fiscal situation it inherited (described above), this represents a substantial achievement. As a result, domestic expenditure stabilized at about 33% of GDP (Figure 4) and the fiscal deficit declined from –7.8% in 2003/04 to a projected –2.8% of GDP in 2006/07 (Figure 1).

This dramatic turnaround since 2004/05 demonstrates that, even in very difficult circumstances, if there is sufficient political determination to maintain fiscal discipline it can be achieved. After the 2004 election, the President and Minister of Finance declared that the Government intended living within the approved Budget – and Government actions matched their words. This shows that the persistent over-expenditure of previous years was a product of *political choice* rather than technical weakness.

While political will was critical, two other developments contributed to the improved fiscal performance. Firstly, as illustrated in Figure 1, *revenue* performance continued to improve. As pointed out previously, the '*increase in the tax / GDP ratio in recent years has been one of the most positive features of Government economic performance……*. Table 1 shows that the revenue ratio has continued to increase, reaching a projected 25.0% of GDP (old series) in 2006/07. With few significant new revenue raising measures, the increase appears to be largely attributable to improved performance by the Malawi Revenue Authority.

Turning to *expenditure*, much the most important single development has been the reduction in *domestic interest*. As noted above, the 2003/04 domestic interest bill of MK 17.3 billion represented a massive 27.4% of government expenditure and 9.1% of GDP (Table 1). Domestic interest has decreased steadily every year since with projected figures for 2006/07 of MK 14.3 billion, 13.1% and 4.4% of GDP respectively. The interest reduction of 4.7% of GDP accounts for virtually the entire (5%) improvement in the fiscal deficit since 2003/04, therefore. This is illustrated in Figures 2, 3 and 4.

It is instructive to examine in detail how the turnaround started in the crucial first year, **2004/05**, with the help of Figure 5. As noted above, the interest bill is determined by two factors, the debt *stock* and the interest *rate*. The process began in mid 2004 with two distinct (mutually reinforcing) developments. Of particular importance in 'kick starting' the turnaround was the reduction in bank rate from 35% to 25% in June 2004, which was closely reflected in the Treasury Bill yield (blue line in Figure 5). Although the benefit was not felt until existing Treasury Bills were rolled over at the new rate, this cut the domestic interest bill by 28% (0.9% of GDP) within a few months.[10]

Secondly, the new government rapidly agreed a Staff Monitored Program (SMP) with the IMF and started implementing it. Following the collapse of the first PRGF in April 2004, the IMF stopped lending to Malawi (and CABS suspended budget support). The SMP – to which no funds were attached - was drawn up to enable the new government to establish a track record of responsible fiscal management during FY 2004/05, as a precursor to a new PRGF (and the resumption of budget support). With the help of increasing tax revenue (2.6% of GDP more than 2003/04) and reduced interest costs, the SMP / Budget was able to provide for modest repayment of GoM debt without imposing significant expenditure cuts. The effect is vividly illustrated in Figure 5 (green bars); following a continuous increase since 2001, credit to government started declining immediately after the 2004/05 Budget was approved by Parliament in September 2004.

The reduction in the GoM domestic interest bill from 9.1% of GDP in 2003/04 to 7.4% in 2004/05 was attributable, therefore, to the combined effect of the June 2004 cut in bank rate and the stabilization of the domestic debt stock resulting from improved fiscal discipline.

In **2005/06** these developments were reinforced by a third crucial factor – the resumption of *budget support* from the international community. As noted above, by the time its first PRGF was abandoned in April 2004 the Malawi Government had lost virtually all credibility with the international community. As a result, budget and balance of payments support to Malawi – ie the types of aid which presuppose a degree of trust in government economic competence and honesty – had virtually dried up. Yet there was clearly no

[10] Interestingly, the reduction had no effect on GoM's ability to roll over maturing Treasury Bills. This indicates that a 25% return was still better than returns on alternative investments in Malawi and that bank rate may have been higher than necessary.

way out of the fiscal crisis without such support. Two elements were crucial in regaining international support. Firstly, the new policy of zero tolerance of corruption suggested an increased commitment to poverty reduction. Secondly, the establishment of fiscal discipline and the successful implementation of the 2004/05 Budget and the IMF Staff Monitored Program greatly increased confidence in the Government's economic competence.

This confidence was manifested in the approval by the IMF Board in August 2005 of a new three year PRGF for Malawi (and reconfirmed a year later by HIPC Completion Point – see below). For similar reasons, members of the CABS group of donors agreed during 2004/05 to resume budget support to Malawi – although large scale support only started in 2005/06.

The combination of increasing external support and falling interest meant there was much less pressure on the 2005/06 budget; with stable domestic revenue, GoM was able to both increase domestic expenditure by 2.4% of GDP (necessitated by the food shortage that year) and still cut the fiscal deficit. The decline in credit to government which began in September 2004 continued until September 2005 (Figure 5), when GoM started importing maize in response to the food crisis. The downward trend resumed in May 2006[11].

The impact of the resumption of budget support by CABS can be seen in Table 1. Programme / Budget Support grants increased from MK 5.1 billion (2.2% of GDP) in 2004/05 to MK 13.9 billion (5.1% of GDP, provisional) in 2005/06. Increased donor support accounted for much of the reduction in the fiscal deficit from –5.4% to –0.9% (provisional) of GDP. It should be noted that roughly half of the increase was due to a US$ 30 million World Bank grant in response to the previous year's food crisis.

After deducting the Bank humanitarian grant, CABS budget support totalled US$ 83.4 million or MK 10.7 billion (4% of GDP) in 2005/06. This should be compared not with *total* GoM expenditure, but with *discretionary* resources. Table 1 shows a '*discretionary balance (excluding wages)*' of MK 34.1 billion in 2005/06. Given that, as noted above, this is probably an over-estimate budget support represented about a third of GoM discretionary resources. [12]

The net domestic debt stock increased slightly in 2005/06 from MK 53.9 billion in June 2005 to MK 54.8 billion a year later (Table 1). However, these are *nominal* figures. When inflation is taken into account (15.3% in 2005/06), this represents a significant *real* reduction. Figure 5 shows that after 18 months of stability Treasury Bill yields began to fall in early 2006, reflecting lower GoM borrowing (ie less 'crowding out'), improved macro stability and expectations of lower inflation. As a result, domestic interest decreased from MK 16.7

[11] Credit to government started increasing again in January 2007 because of overruns on the 2006/07 fertiliser subsidy programme.

[12] It is worth emphasizing that the resumption of budget support was a direct result of the improved fiscal performance in 2004/05 and the increased confidence of the international community in the Government's ability to manage the economy.

billion (22.3% of expenditure, 7.4% of GDP) in 2004/05 to MK 15.0 billion (15.4% and 5.5%) in 2005/06.

What we are seeing here is the mirror image of the mushrooming of debt and interest that took place between 2000/01 and 2003/04[13], where interest grew much more than proportionately to the growth in the debt stock. As GoM stopped new borrowing from (and started modest repayment to) the domestic banking system, this helped reduce interest rates in two ways. Firstly, it reduced GoM's demand for borrowing relative to that of the private sector (see Figure 5). Secondly, by reducing inflationary pressure it allowed RBM to reduce bank rate without fuelling inflation. As bank rate falls so do Treasury Bill yields and GoM's interest bill. This in turn enables GoM to use some of the interest savings to retire more debt, which permits further rate cuts - and so on; GoM is in a 'virtuous circle' of declining rates, expenditure and debt stock.

With continued fiscal discipline and a modest boost from HIPC Completion Point, domestic interest continued to fall in **2006/07**[14]: to MK 14.3 billion (nominal); 13.1% of total expenditure; and 4.4% of GDP. The draft **2007/08** Budget projects further decreases to MK 12.0 billion, 9.9% of expenditure and 3.2% of GDP.

Although the debt stock increased by 11% in *nominal* terms between June 2004 and June 2007, with inflation averaging 13% over the period, this represents a significant reduction in *real* terms. The combined effect of: (a) a modest nominal increase in the debt stock; (b) inflation; and (c) the acceleration in GDP growth over the period is a substantial reduction in the domestic debt / GDP ratio from 24.8% to 16.0%. A further reduction to 13.7% is projected for June 2008, which can be considered a sustainable level. It seems safe to conclude, therefore, that the 2004 debt and fiscal crisis is now over.

HIPC Completion Point

The announcement that Malawi had reached HIPC Completion Point in August 2006 gave rise to unrealistic expectations in some quarters of extra resources that would be available to GoM as a result. Two points need emphasizing. Firstly, the HIPC initiative only applies to *foreign* debt. However, as can be clearly seen in Table 1 and Figure 2, Malawi's debt problem has been largely one of *domestic* debt. While the stock of foreign debt prior to Completion Point – at US$ 2.97 billion in nominal terms or 145% of GDP[15] - dwarfed domestic debt (20% of GDP), most was borrowed from the IMF, World Bank and African Development Bank on highly concessional terms. The interest rate on IDA loans, for example, is just 0.75%. By contrast, as shown in Figure 5, GoM was paying 35% interest on Treasury Bills prior to the June 2004 cut in bank rate. It was interest on domestic debt that was

[13] Note the symmetry in Figure 2.
[14] Also, bank rate was further reduced to 20% in November 2006.
[15] In NPV terms, the total external debt stock was US$ 1.19 billion or 57% of GDP.

causing real fiscal damage; domestic interest was 9.1% of GDP in 2003/04 compared to foreign interest of 1.5%.

Secondly, Malawi had been receiving ‘interim’ debt relief since reaching HIPC Decision Point in December 2000. This was worth an average of US$ 55 million pa between 2000 and 2006. Attaining Completion Point meant that interim debt relief was made permanent and that all debt to the above institutions up to 2020 was written off. While the debt relief following Completion Point is notionally worth an average of about US$ 110 million pa (covering both interest and loan repayment) between 2006/07 and 2025, the *additional* resources available to GoM are much less for two reasons. Firstly, as noted, $55 million pa was being received prior to Completion Point. Secondly, under the Multilateral Debt Relief Initiative, the traditional annual allocations from IDA and African Development Fund will be reduced by the amount of debt relief to be provided in that year. After allowing for this, the ‘net’ additional resources available to GoM - compared to the 2005/06 budget – are of the order of just US$ 25 million pa.

In other words, while HIPC has increased the resources available to GoM, their value is much less than: (a) the savings in domestic interest that GoM has achieved through improved fiscal discipline; and (b) budget support. Arguably, the main benefit to Malawi of reaching Completion Point is the signal it sends to the international community and private sector that competent macro-economic management has been restored.

Summary to Date

Table 2 highlights recent fiscal trends from Table 1 by looking at values of key fiscal variables for the three years 2000/01, 2003/04 and 2006/07.

Table 2: Summary of Fiscal Trends, 2000/01 to 2006/07: % of GDP

	2000/01	**2003/04**	**2006/07**
Revenue	18.4	22.5	25.0
Total Domestic Expenditure	24.7	33.2	33.4
Interest (total)	4.6	10.6	4.9
Non-interest Expenditure	20.1	22.6	28.5
Domestic Debt Stock	8.0	24.8	16.0
Fiscal Deficit	-5.8	-7.8	-2.8
GDP, Kwacha billion (nominal)	*113.3*	*189.6*	*327.3*

Above we summarised developments up to June 2004 visually by looking at Figures 1 to 4. It is instructive to revisit the charts to see how things have changed **since July 2004**:

- Figure 1 shows a rapid growth in total expenditure to unprecedented levels and large fiscal deficits up to June 2004, followed by **much slower growth in total expenditure**[16] and **greatly reduced deficits.**
- Figure 2 shows a dramatic growth in the domestic debt stock and the GoM interest bill up to June 2004, followed by a **substantial reduction (halving) in both the debt stock** and **interest**.
- Figure 3 shows a sharp reduction in discretionary expenditure to 36.9% of total domestic expenditure in 2003/04, with **little change for two years** before **rebounding to 44.9% in 2006/07.** (Note that the fertilizer subsidy is shown separately from other discretionary expenditure.)
- Figure 4 shows a rapid growth in: (a) domestic expenditure in general and (b) domestic interest in particular to unprecedented levels up to June 2004. Subsequently, **domestic expenditure has stabilized** while **interest has been significantly reduced**.

Impact on Growth and Poverty

The story so far shows that GoM has done a good job of tackling the 2004 fiscal crisis and in establishing macro-economic stability. However, macro stability is not an end in itself. It is important primarily as a precondition for sustainable growth and poverty reduction. What has been the impact of the above developments on growth and poverty? I highlighted above the damage caused by the fiscal crisis through two forms of 'crowding out'. Firstly, GoM borrowing from the domestic banking system increased interest costs and crowded out borrowing by the private sector; this discouraged private investment. Secondly, the increasing GoM interest bill crowded out other public expenditure including expenditure benefiting the poor. We now look at how progress since 2004 has reversed such crowding out, beginning with private borrowing.

Figure 5 shows that credit to the private sector from the banking system increased from MK 10.5 billion (US$ 96.3 million) in June 2004 to MK 27.7 billion (US$ 198.7 million) in April 2007[17]. Much of the increase will be explained by trends in the other two lines in Figure 5: the reduction in credit to government meant there was relatively more credit *available* for others, while the reduction in bank rate (reflected in Treasury Bill yields) lowered the *cost* of borrowing.

There are no reliable statistics on private investment in Malawi, so it is not possible to prove that the increase in private sector credit indicates increased investment. However, together with the increase in trading volumes on the Malawi Stock Exchange, this represents compelling 'circumstantial evidence' that private investment is rebounding in response to improved economic management.

'Crowding in' Public Expenditure

[16] The apparent increase in total expenditure is misleading. It reflects increased **coverage** of **donor** project aid in the budget. Table 1 and Figure 4 show that domestic expenditure has been fairly stable in the range 33% - 35% of GDP since 2003/04.
[17] *Monetary Survey*, Reserve Bank of Malawi.

As we have seen, increased external funding in the form of budget support and debt relief has been crucial in helping GoM achieve its macroeconomic objectives since 2004. With traditional project aid donors just focused on the sectors where they were active. However, with budget support donors are helping finance *all* GoM expenditure (or strictly 'marginal' discretionary expenditure). CABS donors are concerned with the entire budget, therefore. The main reason donors provide budget support and debt relief is to increase (discretionary) resources available to governments for expenditure on poverty reduction. However, given the imperative to establish macro-economic stability in Malawi and agree a new IMF programme following the 2004 elections, CABS donors recognised that the short term priority was to establish fiscal discipline and reduce the fiscal deficit. Increased pro-poor expenditure could only be afforded **after** macro stability was established and domestic debt reduced.

The overall conclusion from the above is that GoM macro-economic management since 2004 has been largely successful. We have now had three years of macroeconomic stability; a new PRGF and HIPC Completion Point have been achieved; and domestic debt has been brought under control. Table 1 shows that, after discounting the emergency maize purchases in 2005/06, total GoM domestic expenditure has been stable at about 33% of GDP since 2003/04. Within that total, interest has dropped from 10.6% of GDP in 2003/04 (9.1% domestic, 1.5% foreign) to 4.9% (4.4% domestic) in 2006/07. So without increasing total expenditure as a share of GDP, GoM now has substantial discretionary resources at its disposal as a result of interest savings alone.

Table 1 shows that, following a two year 'investment' in establishing macro stability during which there was little change in discretionary resources, there was a step increase in 2006/07. The '*discretionary balance (excluding wages)*' increased from 35.0% of total expenditure and 12.4% of GDP in 2005/06 to 44.9% and 15.0% respectively in 2006/07. A further increase to 50.3% and 16.3% is budgeted for 2007/08. In other words, for the first time in many years, GoM has significant resources at its disposal - representing the 'reward' for improved macro-economic management. The key issue now is how these extra resources are utilised.

With macro-economic stability now established, donors' main concern is that increased discretionary resources - which their budget support helped bring about - are efficiently **allocated** through the budget towards poverty reducing activities. In other words, the focus of attention is switching from **macro** to **micro**-economics. Establishing macro-economic stability can be difficult politically, but is *technically* easy. It really only requires two individuals, the Finance Minister backed by the President, to insist on maintaining strict fiscal discipline. When this is the case the job of the finance ministry becomes straightforward. Once budget lines are fully spent no more cheques are issued: the deficit, borrowing and inflation all fall automatically.

By contrast, micro-economic management and budgeting is much more difficult. To allocate scarce resources efficiently between competing demands (ie the budgeting function) on the basis of policy priorities and sound technical and economic analysis requires far more people and skills, as well as suitable institutional arrangements. This is a particular challenge in Malawi for several reasons. Firstly, as noted above, until recently there have been few discretionary resources to allocate. Secondly, there has been little demand for technical analysis as allocation decisions were largely politically driven. As a result, economic and budgeting skills within GoM have been lost. Thirdly, the two ministries responsible for allocating resources – Finance (Budget Division) and Economic Planning & Development (MEPD) – are seriously understaffed. Fourthly, the division of responsibility between Finance and MEPD has aggravated the staff shortage. Finally, and arguably most importantly, Malawi has one of the most complicated budget systems in Africa; a recent IMF review has recommended a major overhaul and simplification.

Clearly, it is unrealistic to expect GoM to produce efficient, poverty focused budgets as quickly as it was able to establish macro stability. With this in mind, the rest of the paper looks at the main features of recent trends in GoM expenditure and future plans as reflected in the 2007/08 draft Budget. It starts by reviewing the broad trends since 2003/04 before looking at the details.

How have increased resources been used?

Table 1 shows that roughly half of the interest savings have been allocated to a single item, the **fertiliser** (and seed) **subsidy** which was introduced in 2004/05. The 2006/07 cost of over MK 8 billion represented 8.3% of domestic expenditure and 2.8% of GDP (Figures 3 and 4). The subsidy made 140,000 tons and 170,000 tons of fertiliser available to close to two million farmers in 2005/06 and 2006/07 respectively at less than a third of its market price, leading to estimated[18] increases of 17% and 30% in fertilizer application. It has been estimated that, after allowing for the contribution of above average rainfall in 2006/07, increased fertiliser use was responsible for additional maize production in 2007 of the order of 600,000 - 700,000 tons - a 25% increase. This has had a direct impact on poverty. The 2007 Welfare Monitoring Survey shows that the improved harvest in 2006 resulted in a decline in the proportion of people living below the national poverty line from 50% to 45% between 2005 and 2006. While some aspects of implementation have been questioned, overall the subsidy programme appears to have been successful in both increasing agricultural production and reducing poverty.

Between them, improved fiscal management since 2004 and increased maize harvests in 2006 and 2007 explain most of the recovery in economic growth – 7.9% in 2006 (new GDP series) and a forecast 7.4% in 2007. They also account for the drop in inflation to below 8% in May 2007 for the first time in over a decade. Food has a weighting of 58% in the Consumer price Index

[18] Dorward et al (2007), '*Evaluation of the 2006/07 Agricultural Input Subsidy Programme: Interim Report*'.

basket, so the 75% reduction in maize prices between March 2006 and March 2007 has had a substantial impact on inflation.

After the fertiliser subsidy, the main beneficiary has been the **wage bill**, together with Pensions and Gratuities, which increased from a combined 7.4% of GDP in 2003/04 to 8.8% in 2006/07. A further substantial increase to 9.6% of GDP is proposed in the 2007/08 draft budget. A 2003 external review of public service wages demonstrated that, apart from people on performance contracts, wages were far too low to attract, retain and motivate competent public servants. Along with reforms to the wage structure since 2004, the increase is a necessary condition for improved public service performance.

To see how key individual ministries have benefited from increased domestic resources we can look at Table 3[19]. This compares the budget outturn for 2003/04 with the draft 2007/08 budget estimates for selected ministries. The figures are presented in Kwacha and US Dollars and show the changes over the period in Dollars per capita terms. Total domestic discretionary expenditure increases by $18.60 per capita. As noted, much the largest beneficiary is **Agriculture** ($7.50) because of the fertiliser subsidy. The next largest increase is **Health**, where GoM funding has increased by $2.36 per capita. This underestimates the increase in health expenditure in recent years because donor funding of ORT under the Health SWAp, which is channelled through the GoM budget, has been excluded here (since the funds are earmarked and therefore 'non-discretionary') [20].

Increased funding of Agriculture and Health is of direct benefit to the poor. However, the other major sector of concern to the poor, **Education**, has benefited much less from the increase in discretionary resources. Recurrent resources to primary and secondary education have increased by a modest $1.04 per capita (although Education's share of the 2007/08 salary increase will increase this to nearer $2). By contrast, recurrent funding of the Universities alone has increased by $1.50. Given the small university population and that most students come from better off households, this is of questionable benefit to the poor.

Particularly welcome to donors is the $1.27 per capita increase in funding for 'accountability institutions' (National Audit Office, Parliament, Anti Corruption Bureau, MEC, Law Commission, Ombudsman, Human Rights Commission, Legal Aid).

Development vs Recurrent Expenditure

The other main expenditure category to benefit from interest savings has been GoM Part II funding of the Development Budget. GoM policy since 2004 has been to increase the share of development relative to recurrent

[19] Table 3 was prepared by my colleague Bernabe Sanchez.
[20] Table 1 indicates that additional ORT funding under the Health SWAp, which started in 2004/05, is expected to reach 2.1% of GDP in 2007/08. This does not reflect reallocation of interest savings because earmarked funds were provided by SWAp donors specifically for this purpose.

expenditure in the budget. Table 1 suggests that this was accomplished between 2003/04 and 2006/07 largely through increased donor funded (Part I) development expenditure, which increased from 9.3% to 13.3% of GDP. However, this is misleading; it reflects improved *coverage* of project aid in budget documents rather than increased expenditure. On the other hand, there was a significant increase in GoM *Part II* funding in 2006/07. The Part II share of total expenditure increased from 5.3% (1.8% of GDP) in 2003/04 to 8.6% (2.9% of GDP) in 2006/07. A similar share is proposed for 2007/08, with the Road Fund Administration again receiving much the largest allocation (30%).

The distribution of GoM expenditure between Recurrent and Capital / Development activities is of particular interest to donors. There appears to be a consensus in Parliament and Malawi society generally that extra resources should be mainly allocated to increased capital expenditure. This is seen as consistent with the Malawi Growth & Development Strategy (MGDS), with its emphasis on the need for growth in order to reduce poverty. Although the logic is rarely spelt out in detail, the thinking appears to go as follows:

1. in order to reduce poverty Malawi needs faster economic growth
2. to accelerate growth more investment is needed, particularly in infrastructure
3. since GoM funded investment projects appear in the Development Budget, its size should increase relative to Recurrent.

While the first point is uncontentious, the other strands of the argument require closer examination before the conclusion can be regarded as proven.

MGDS emphasises that growth must be led by the private sector. GoM's role must be to create the conditions for increased *private* investment, therefore. This does not necessarily imply significantly increased public expenditure. Improvements in legislation and reductions in red tape can be as effective as new infrastructure.

Malawi has, in fact, invested significant amounts in infrastructure since Independence. However, this has not had the expected impact on growth. There are two main explanations. Firstly, with the benefit of hindsight, a number of *bad or unfortunate investment choices* were made. Chilumba Port and the Mchinji – Lilongwe rail link, for example, were major investments which are operating at a fraction of their capacity. While Malawi has one of the best trunk road networks in Africa, it is also one of the emptiest. Many roads are used by only a handful of vehicles. Had they been built to lower standards the resources saved could have been used elsewhere.

Secondly, even where sound investments have been undertaken, many of the potential benefits have been lost for *lack of maintenance*. Blantyre water supply and the ESCOM power system are obvious examples. Road maintenance funding is just a third of what is needed to maintain the current network – and is falling in real terms.

The fundamental point is that the pace of economic growth depends not just on the quantity, but also the *quality*, of expenditure - whether capital or recurrent. Conceptually, the quality of expenditure is measured by its economic rate of return, or the ratio of benefits to costs, though this is often difficult to measure. Expenditures with high rates of return will increase growth. However, it is not the case that **any** investment will contribute to growth. Investment in projects with low (or negative) rates of return will slow growth down. Public resources will be scarce for the foreseeable future, so undertaking Project A means taking funds away from Project B or recurrent expenditure. To achieve accelerated growth GoM needs to ensure that all public investment proposals are subject to sound technical and economic analysis and that only projects with good economic returns are prioritised. There is little evidence of such analysis being conducted within GoM. Instead projects appear to be largely politically driven.

There appears to be a widely held view in Malawi that recurrent expenditure contributes little to growth. The implication is that the economic returns to recurrent expenditure are lower than for capital. While there are many examples of inefficient recurrent expenditure in recent years, the same is true for capital expenditure. International experience shows that the returns to recurrent expenditure frequently exceed those on new investment. A hospital building without nurses or drugs or a school without teachers or textbooks will have negative rates of return. By contrast, recurrent funding for staff salaries, drugs, etc, by enabling the facilities to operate properly, is likely to have very high returns. Proper recurrent funding and maintenance of existing assets nearly always has better economic returns than new investments. This is particularly well documented in the case of roads. Returns to road maintenance invariably exceed those on upgrading roads. Yet, while GoM is embarking on a major road upgrading programme, road maintenance funding is currently just a third of what is needed to maintain the *existing* network according to the Transport Ministry's recent Road Sector Programme,

Malawi is full of public infrastructure that is not fully utilised for lack of recurrent resources and maintenance. The Ministry of Health's Programme of Work shows that over 90% of the resources required over the period 2004/05 to 2009/10 are for recurrent purposes. It is a widely held view among donors that deficiencies in basic public services in Malawi are due in large measure to grossly inadequate *recurrent* funding (both wages and ORT) and maintenance. It is not clear that this view is shared by Malawian politicians, who appear preoccupied with building new infrastructure even though existing assets are not being properly utilised and maintained.

To sum up, it is dangerous to simply **assume** that increased capital expenditure will increase growth, especially given Malawi's track record. Only investments with good economic prospects will contribute to growth – and then only if sufficient recurrent funds are provided once they are completed. **All** expenditure proposals – capital and recurrent – need to be thoroughly and critically reviewed before funds are allocated in the budget. However, the capacity to carry out this function is very weak. Arguably, the single highest priority investment should be to build up the human and institutional capacity in the Ministry of Finance to ensure that increased resources are allocated on the basis of sound evidence and analysis.

Conclusions

The main conclusion of this paper is that the Government has successfully overcome the 2004 fiscal crisis. While the MRA has also made an important contribution, this has been achieved essentially through a single policy measure – the adoption of strict fiscal discipline. Having agreed a budget framework with the IMF and Parliament, by adhering to approved budgets GoM has been able to bring down domestic debt and the interest bill. This, in turn, has reassured donors that it is safe to resume budget support and that Malawi deserves debt relief. The end result is that macro-economic stability has been restored and GoM has substantially more resources available to combat poverty.

The key economic issue now is how GoM uses the extra resources. Initial signs are encouraging. The main beneficiary to date has been the fertiliser subsidy, which has contributed to significantly increased agricultural production and, in turn, to poverty reduction. The increase in the wage bill is also vital for improved public service delivery, as long as it is accompanied by strengthened public service management. Both increases were relatively 'easy' decisions for GoM to make since there is a consensus that they represent both good economics and good politics.

The substantial increase in discretionary resources means that GoM is in the unfamiliar position of being able to provide additional funds to virtually all votes in the 2007/08 draft Budget without having to make cuts. However, future budget allocations are likely to be more difficult. Despite growing resources from both domestic sources and donors, the reality is that Malawi will be well short of the level of resources needed to meet the Millennium Development Goals. This makes it vital that all resources are allocated as efficiently as possible. The recent Public Expenditure Review highlights several examples of wasteful expenditure. However, with very weak planning and budgeting systems, there is little technical capacity within GoM to assess efficiency. This carries the danger that budget allocations will be driven mainly by political concerns, such as the desire to increase capital expenditure for its own sake.

While GoM is to be congratulated on recent progress in economic management, establishing macro-economic stability was the easy bit! Translating the benefits into real poverty reduction will require a long term political commitment to allocate resources on the basis of sound evidence and analysis and the building of technical capacity in central government to undertake such analysis.

Table 1 MALAWI: RECENT FISCAL TRENDS & 2007/08 DRAFT ESTIMATES

	Actual (Kwacha billion)					provisional	projected	budget
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**
Total Revenue & Grants	31.3	31.4	42.7	65.8	84.9	117.1	143.9	162.9
Revenue	20.9	22.9	32.0	42.8	56.8	67.3	81.7	98.0
Tax revenue	19.3	20.4	27.3	36.9	49.8	59.9	74.5	86.0
Non-tax revenue	1.6	2.5	4.8	5.9	7.0	7.4	7.2	12.0
Grants	10.4	8.6	10.7	23.1	28.1	49.8	62.2	64.9
Programme/ Budget Support	6.2	2.5	1.2	6.6	5.1	13.9	8.7	11.1
Project	3.6	3.5	4.6	6.5	11.0	11.1	23.9	30.4
Dedicated Grants			0.2	4.2	6.9	17.2	18.8	23.3
HIPC Debt Relief	0.6	1.7	3.6	5.3	5.1	7.6	2.7	
MDRI Debt relief from IMF							8.1	
Japanese Debt Relief		0.8	1.1	0.5				
Total Expenditure (& net lending)	37.8	42.5	61.3	80.5	97.2	119.7	153.1	172.8
Donor funded Development Expenditure, Part I	9.8	7.8	9.5	17.7	22.6	22.3	43.7	52.0
Total Domestic Expenditure	28.0	34.7	51.8	62.9	74.7	97.4	109.4	120.9
of which:								
Interest (domestic)	*3.4*	*5.2*	*8.9*	*17.3*	*16.7*	*15.0*	*14.3*	*12.0*
Interest (foreign)	*1.8*	*1.6*	*2.1*	*2.8*	*3.0*	*3.2*	*1.6*	*0.7*
Wages	*6.0*	*9.2*	*10.9*	*12.3*	*17.1*	*20.2*	*24.0*	*30.4*
Pensions & Gratuities	*1.3*	*1.4*	*1.4*	*1.6*	*2.1*	*3.2*	*4.8*	*5.5*
Transfers to MRA & NRA	*0.9*	*1.8*	*1.9*	*2.3*	*2.9*	*3.3*	*1.8*	*2.2*
Maize (& pulses / oil) Purchase			*6.1*		*2.4*	*10.4*	*2.1*	
Elections			*0.0*	*2.0*	*0.1*	*0.1*	*0.1*	*1.1*
Arrears Repayment				*1.3*	*1.5*	*2.8*	*5.4*	*0.5*
Health SWAp ORT					*1.0*	*5.1*	*6.1*	*7.8*
Non-Discretionary Expenditure (incl.wages)	13.3	19.2	31.3	39.7	46.6	63.3	60.2	60.1
Discretionary Balance (excluding wages)	14.7	15.5	20.5	23.2	28.0	34.1	49.2	60.7
Discretionary Balance (including wages)	20.6	24.7	31.4	35.5	45.1	54.3	73.2	91.1
Overall Fiscal Balance (including grants)	-6.6	-10.5	-18.6	-14.7	-12.3	-2.6	-9.2	-9.9
Net Domestic Debt Stock*	9.1	25.8	32.7	47.1	53.9	54.8	52.4	51.1
Nominal GDP	113.3	133.7	160.1	189.6	226.5	275.4	327.3	373.2
Grouping for Summary Table								
Total Interest	5.2	6.8	11.0	20.0	19.6	18.2	15.9	12.7
Non-discretionary (excl. debt)	2.2	3.2	9.4	7.3	10.0	24.9	20.3	17.0
Fertiliser & Seed Subsidy					4.3	6.9	9.1	11.5
Wages	*6.0*	*9.2*	*10.9*	*12.3*	*17.1*	*20.2*	*24.0*	*30.4*
Discretionary Balance (excluding wages & subsidy)	14.7	15.5	20.5	23.2	23.7	27.2	40.1	49.2
Development Budget:								
Part I (donor)	9.8	7.8	9.5	17.7	22.6	22.3	43.7	52.0
Part II (GoM)	1.7	2.1	2.3	3.3	2.4	3.9	9.4	10.6
Total Development	11.5	9.9	11.8	21.0	25.0	26.3	53.1	62.5
Development / Total Expenditure	30.5%	23.2%	19.2%	26.1%	25.7%	21.9%	34.7%	36.2%

	As % of Total Domestic Expenditure					provisional	projected	budget
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**
Total Revenue & Grants	111.8%	90.6%	82.4%	104.7%	113.8%	120.2%	131.5%	134.8%
Revenue	74.6%	65.9%	61.8%	68.0%	76.1%	69.1%	74.7%	81.1%
Tax revenue	68.9%	58.8%	52.6%	58.7%	66.7%	61.5%	68.1%	71.2%
Non-tax revenue	5.7%	7.1%	9.2%	9.3%	9.4%	7.6%	6.6%	9.9%
Grants	37.1%	24.7%	20.6%	36.7%	37.7%	51.1%	56.8%	53.7%
Programme/ Budget Support	22.1%	7.3%	2.4%	10.5%	6.8%	14.3%	7.9%	9.2%
Project	12.9%	10.0%	8.9%	10.4%	14.8%	11.4%	21.8%	25.2%
Dedicated Grants	0.0%	0.0%	0.4%	6.7%	9.3%	17.7%	17.2%	19.3%
HIPC Debt Relief	2.1%	5.0%	6.9%	8.4%	6.8%	7.8%	2.5%	
MDRI Debt relief from IMF							7.4%	
Japanese Debt Relief		2.4%	2.1%	0.8%				
Total Expenditure (& net lending)								
Donor funded Development Expenditure, Part I								
Total Domestic Expenditure	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
of which:								
Interest (domestic)	12.1%	*15.1%*	*17.1%*	*27.4%*	*22.3%*	*15.4%*	*13.1%*	*9.9%*
Interest (foreign)	6.4%	*4.5%*	*4.1%*	*4.4%*	*4.0%*	*3.3%*	*1.4%*	*0.6%*
Wages	21.3%	*26.5%*	*21.1%*	*19.6%*	*22.8%*	*20.7%*	*22.0%*	*25.2%*
Pensions & Gratuities	4.5%	*4.0%*	*2.8%*	*2.6%*	*2.8%*	*3.3%*	*4.4%*	*4.6%*
Transfers to MRA & NRA	3.2%	*5.2%*	*3.7%*	*3.7%*	*3.9%*	*3.4%*	*1.6%*	*1.8%*
Maize (& pulses / oil) Purchase			*11.7%*		*3.3%*	*10.7%*	*1.9%*	
Elections			*0.0%*	*3.2%*	*0.1%*	*0.1%*	*0.1%*	*0.9%*
Arrears Repayment				*2.1%*	*2.0%*	*2.9%*	*5.0%*	*0.4%*
Health SWAp ORT					*1.3%*	*5.2%*	*5.6%*	*6.4%*
Non-Discretionary Expenditure (incl.wages)	47.6%	55.3%	60.5%	63.1%	62.5%	65.0%	55.1%	49.7%
Discretionary Balance (excluding wages)	52.4%	44.7%	39.5%	36.9%	37.5%	35.0%	44.9%	50.3%
Discretionary Balance (including wages)	73.7%	71.2%	60.6%	56.5%	60.4%	55.8%	66.9%	75.4%
Overall Fiscal Balance (including grants)								
Net Domestic Debt Stock*								
Nominal GDP								
Grouping for Summary Table								
Total Interest	18.6%	19.7%	21.2%	31.9%	26.3%	18.7%	14.5%	10.5%
Non-discretionary (excl. debt)	7.8%	9.2%	18.2%	11.6%	13.4%	25.5%	18.6%	14.1%
Fertiliser & Seed Subsidy					5.8%	7.1%	8.3%	9.5%
Wages	21.3%	*26.5%*	*21.1%*	*19.6%*	*22.8%*	*20.7%*	*22.0%*	*25.2%*
Discretionary Balance (excluding wages & subsidy)	*52.4%*	*44.7%*	*39.5%*	*36.9%*	*31.7%*	*27.9%*	*36.7%*	*40.7%*
Development Budget:								
Part I (donor)								
Part II (GoM)	*6.2%*	*5.9%*	*4.4%*	*5.3%*	*3.2%*	*4.0%*	*8.6%*	*8.7%*
Total Development								

	As % of GDP					provisional	projected	budget
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**
Total Revenue & Grants	27.6%	23.5%	26.7%	34.7%	37.5%	42.5%	44.0%	43.7%
Revenue	18.4%	17.1%	20.0%	22.5%	25.1%	24.4%	25.0%	26.3%
Tax revenue	17.0%	15.2%	17.0%	19.5%	22.0%	21.7%	22.8%	23.0%
Non-tax revenue	1.4%	1.8%	3.0%	3.1%	3.1%	2.7%	2.2%	3.2%
Grants	9.2%	6.4%	6.7%	12.2%	12.4%	18.1%	19.0%	17.4%
Programme/ Budget Support	5.5%	1.9%	0.8%	3.5%	2.2%	5.1%	2.6%	3.0%
Project	3.2%	2.6%	2.9%	3.4%	4.9%	4.0%	7.3%	8.2%
Dedicated Grants	0.0%	0.0%	0.1%	2.2%	3.1%	6.3%	5.7%	6.3%
HIPC Debt Relief			2.2%	2.8%	2.2%	2.7%	0.8%	
MDRI Debt relief from IMF							2.5%	
Japanese Debt Relief		0.6%	0.7%	0.3%				
Total Expenditure (& net lending)	33.4%	31.8%	38.3%	42.5%	42.9%	43.5%	46.8%	46.3%
Donor funded Development Expenditure, Part I	8.6%	5.8%	5.9%	9.3%	10.0%	8.1%	13.3%	13.9%
Total Domestic Expenditure	24.7%	25.9%	32.4%	33.2%	33.0%	35.4%	33.4%	32.4%
of which:								
Interest (domestic)	*3.0%*	*3.9%*	*5.5%*	*9.1%*	*7.4%*	*5.5%*	*4.4%*	*3.2%*
Interest (foreign)	*1.6%*	*1.2%*	*1.3%*	*1.5%*	*1.3%*	*1.2%*	*0.5%*	*0.2%*
Wages	*5.3%*	*6.9%*	*6.8%*	*6.5%*	*7.5%*	*7.3%*	*7.3%*	*8.1%*
Pensions & Gratuities	*1.1%*	*1.0%*	*0.9%*	*0.9%*	*0.9%*	*1.2%*	*1.5%*	*1.5%*
Transfers to MRA & NRA	*0.8%*	*1.3%*	*1.2%*	*1.2%*	*1.3%*	*1.2%*	*0.6%*	*0.6%*
Maize (& pulses / oil) Purchase			*3.8%*		*1.1%*	*3.8%*	*0.6%*	
Elections			*0.0%*	*1.1%*	*0.0%*	*0.0%*	*0.0%*	*0.3%*
Arrears Repayment				*0.7%*	*0.6%*	*1.0%*	*1.7%*	*0.1%*
Health SWAp ORT					*0.4%*	*1.8%*	*1.9%*	*2.1%*
Non-Discretionary Expenditure (incl.wages)	11.8%	14.4%	19.6%	20.9%	20.6%	23.0%	18.4%	16.1%
Discretionary Balance (excluding wages)	13.0%	11.6%	12.8%	12.2%	12.4%	12.4%	15.0%	16.3%
Discretionary Balance (including wages)	18.2%	18.5%	19.6%	18.7%	19.9%	19.7%	22.4%	24.4%
Overall Fiscal Balance (including grants)	-5.8%	-7.9%	-11.6%	-7.8%	-5.4%	-0.9%	-2.8%	-2.7%
Net Domestic Debt Stock*	8.0%	19.3%	20.4%	24.8%	23.8%	19.9%	16.0%	13.7%
Nominal GDP								
	5.8%	7.9%	11.6%	7.8%	5.4%	0.9%	2.8%	2.7%
Grouping for Summary Table								
Total Interest	4.6%	5.1%	6.9%	10.6%	8.7%	6.6%	4.9%	3.4%
Non-discretionary (excl. debt)	1.9%	2.4%	5.9%	3.8%	4.4%	9.0%	6.2%	4.6%
Fertiliser & Seed Subsidy					1.9%	2.5%	2.8%	3.1%
Wages	*5.3%*	*6.9%*	*6.8%*	*6.5%*	*7.5%*	*7.3%*	*7.3%*	*8.1%*
Discretionary Balance (excluding wages & subsidy)	13.0%	11.6%	12.8%	12.2%	10.5%	9.9%	12.3%	13.2%
Development Budget:								
Part I (donor)	8.6%	5.8%	5.9%	9.3%	10.0%	8.1%	13.3%	13.9%
Part II (GoM)	1.5%	1.5%	1.4%	1.8%	1.1%	1.4%	2.9%	2.8%
Total Development	10.2%	7.4%	7.4%	11.1%	11.0%	9.5%	16.2%	16.8%

Source: IMF, PRGF Third Review, February 2007, p30
Financial Statement 2007/08, Budget Document No. 3, Table 1

* Balance at 30 June. Excludes MK 3.364 bn securitised arrears & MK 0.937 bn promissory notes for RBM re-capitalisation from January 2007

Table 3: Changes in Budget Allocations for Selected Items, 2003/04 vs 2007/08 Budget

Item	2003/04 (revised) MKmillion	2007/08 (proposed) MK million	2003/04 (revised) $million	2007/08 (proposed) $million	change $ per capita
Interest	20,024	12,684	194	89	8.84
Education (recurrent)	7,380	12,791	72	90	1.04
Health (recurrent)1	4,480	11,028	43	78	2.36
Agriculture (recurrent)	1,495	16,358	15	115	7.50
Accountability (recurrent)2	942	3,779	9	27	1.27
SSAJ (recurrent)3	1,712	3,613	17	25	0.58
Universities (recurrent)	2,229	6,111	22	43	1.50
Foreign Affairs (recurrent)	1,508	2,705	15	19	0.26
Malawi Defence Force (recurrent)	1,426	3,586	14	25	0.79
Salary increase		4,875		34	2.58
Total recurrent (domestically funded)	**59,126**	**102,604**	**574**	**723**	**8.40**
Domestic development spend	**3,281**	**10,565**	**32**	**74**	**3.05**
Total domestic expenditure	**62,407**	**113,169**	**606**	**797**	**11.45**
Domestic discretionary expenditure 4	40,805	94,985	396	669	18.60

1 Excluding Health SWAP Pool contribution
2 As per PAF indicator
3 Police and Prisons only
4 Domestic expenditure excluding donor earmarked contributions to recurrent budget, interest payments and pensions & gratuities

Figure 1: Fiscal Deficit (after grants) as % of GDP

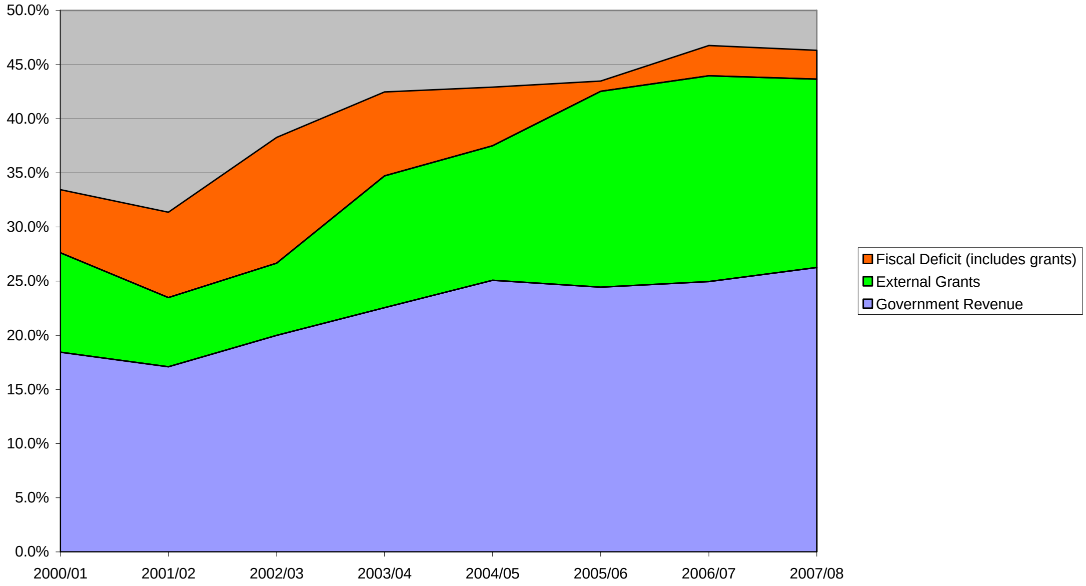


Figure 2: Domestic Debt as % of GDP

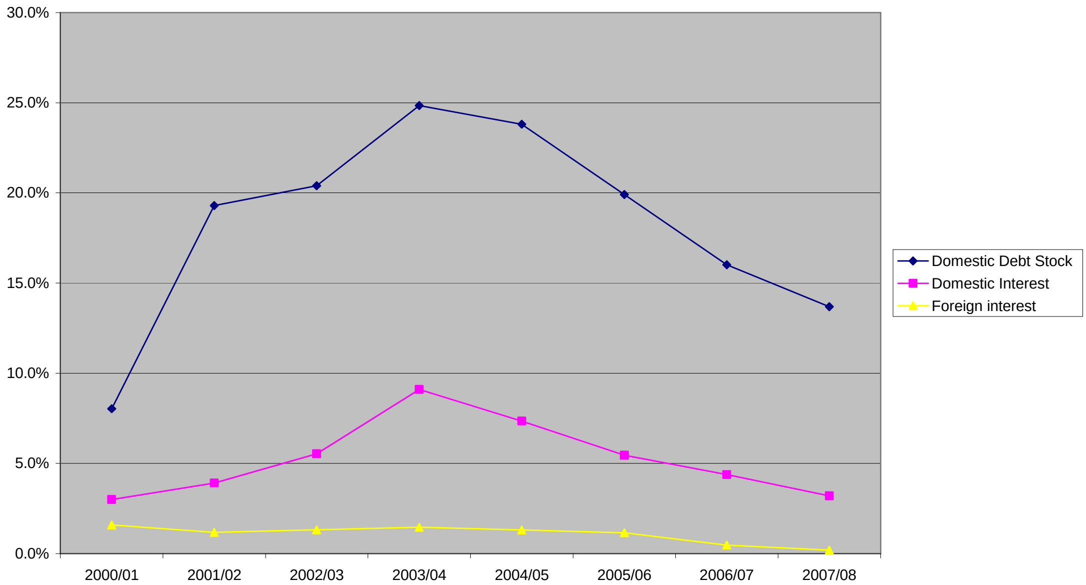


Figure 3: Breakdown of Domestic Expenditure (%)

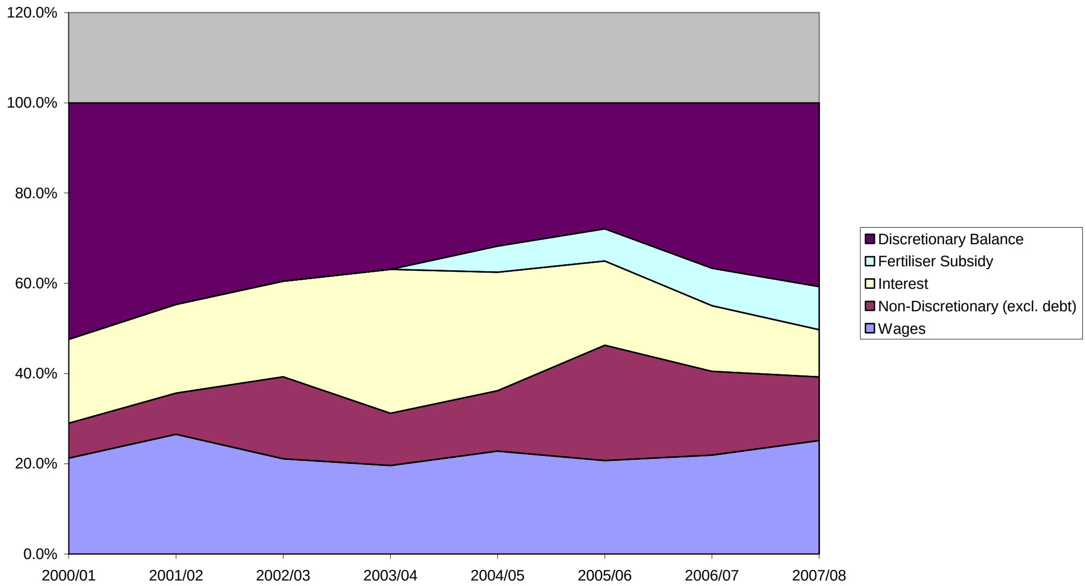


Figure 4: Breakdown of Domestic Expenditure by % of GDP

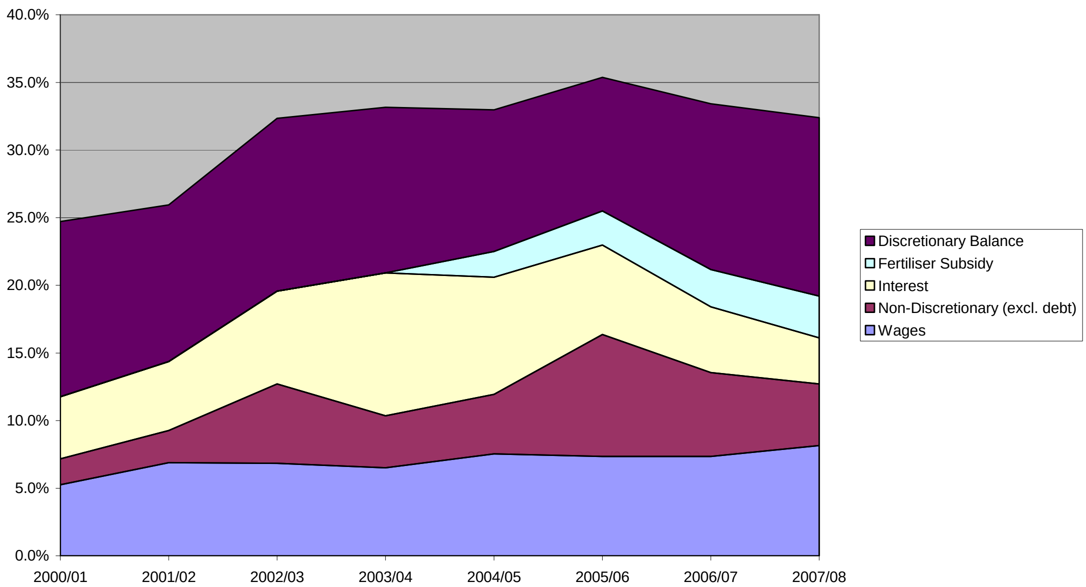
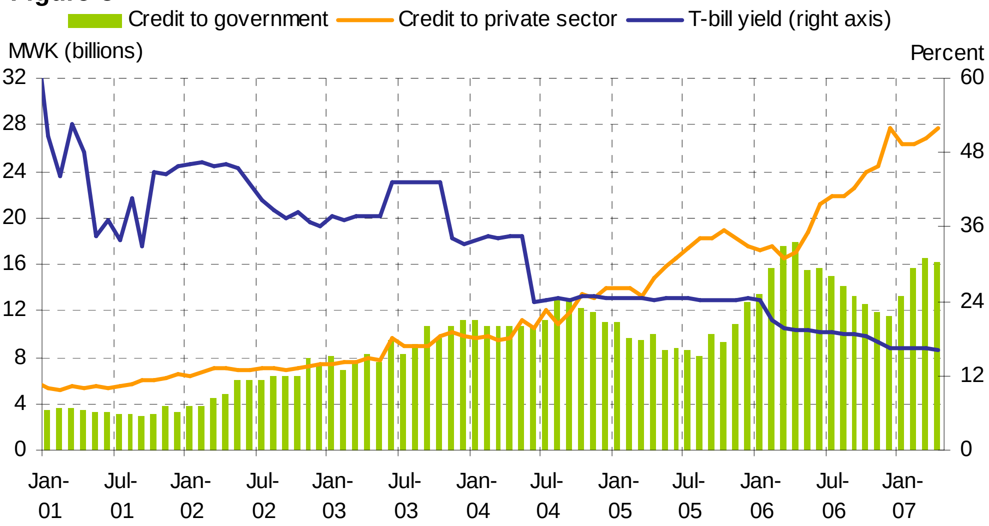


Figure 5



Credit to government
Credit to private sector
T-bill yield (right axis)
MWK (billions)
Percent
32
28
24
20
16
12
8
4
0
60
48
36
24
12
0
Jan-01
Jul-01
Jan-02
Jul-02
Jan-03
Jul-03
Jan-04
Jul-04
Jan-05
Jul-05
Jan-06
Jul-06
Jan-07