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UNISA ECONOMIC RESEARCH WORKING PAPER SERIES

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Accepted: *Interdisciplinary Journal of Economics and Business Law*

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Working Paper 23/2022

December 2022

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THE DYNAMICS OF PUBLIC DEBT IN MALAWI: A REVIEW

Talknice Saungweme[1] & Nicholas M. Odhiambo

Abstract

This study provides an exploratory review of Malawi's government debt, how it has impeded development and suggests potential solutions. The study examines the size, composition, and structure of Malawi's public debt stock from 1970 to 2020 by analysing the sources of government debt, emphasizing the institutional changes and legislative frameworks put in place to support responsible public spending and debt management. The study was aided by the analysis of data on public debt, both domestic and foreign, from a number of organisations, including the World Bank, the International Monetary Fund, and the Government of Malawi. The review discovered three main time periods of debt patterns in Malawi: 1970–2006, 2007–2012, and 2013–2020. One of the challenges faced by Malawi is the higher-than-expected primary deficits, which are primarily covered by expensive domestic debt taken out at higher interest rates. This is because the country's economy and income base have not expanded quickly enough to meet the rising government spending needs, such as those associated with covid-19 and the high cost of public employment. The study suggests that fiscal consolidation be further strengthened to guarantee that government debt remains within sustainable limits and does not crowd out the private sector. This will strengthen the currently in place debt management mechanisms.

Keywords: Public debt Malawi; government debt; debt management; sustainability

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1. Introduction

For decades now, debt has been an increasing problem across all income groups of sub-Saharan African (SSA) countries, and the coronavirus pandemic and climate change issues have only intensified the problem. The debt dynamics in SSA countries, that is, the size, structure, and composition, have been influenced by many factors, including the rapid growth of public spending (particularly a surge in infrastructure projects and social welfare), rapid growth in population size, non-concessional loans from multilateral financial institutions, increased borrowing from domestic and international financial markets, deterioration in terms of trade, and global shocks, such as oil crises and disease outbreaks. Increased debt stocks have been accompanied by rising debt servicing costs, but countries have not always broadened their capacity to pay for these obligations, aggravating both the regional debt situation and economic instability (World Bank, 2022a, United Nations Children's Fund, 2021). In a bid to grow economies and reduce poverty levels in the SSA region, several debt remission initiatives were undertaken by creditors, including debt cancellation, rescheduling, and debt service suspension. Malawi was no exception.

Malawi is among the poorest countries in the world, whose GDP per capita was US$163 and US$626 in 1999 and 2020, respectively, signifying that the majority of the population lives below the poverty line (World Bank, 2022a; International Monetary Fund/IMF, 2002). A set of five-year plans called the Malawi Growth and Development Strategy (MGDS) directs the country's development. The current MGDS III, termed Building a Productive, Competitive, and Resilient Nation, will last through 2022. A good harvest is expected to contribute to real GDP growth in 2021, increasing from 0.9% in 2020 to 2.2% (World Bank, 2022a). However, future fuel, fertilizer, and food price increases are predicted to cause inflation to rise to 9% in 2021 from 8.6% in 2020 (IMF, 2021).

In the past, poor fiscal management and economic strategies in Malawi have facilitated recurrent and widening fiscal deficits, which have been mostly financed by expensive domestic borrowing and led to a rise in public debt. In recent years, debt susceptibilities have sharply increased. According to the IMF's 2021 debt sustainability analysis, Malawi's foreign and total public debt are unsustainable and pose a significant risk of default (IMF, 2022; 2018; Reinhart *et al.*, 2003).

As suggested by the IMF (2018), the World Bank (2010) and Reinhart *et al.* (2003), debt thresholds exist and vary significantly depending on the country's income. Malawi falls under the low-income group and is characterised by weak debt carrying capacity (World Bank, 2022b; IMF, 2021; 2018). Public debt carrying capacity and the ability to tolerate debt by low-income countries, Malawi included, are negatively affected by less developed domestic financial markets; a low degree of trade openness, poor quality of institutions, low economic growth rates, and low remittances (IMF, 2018; World Bank, 2010; Reinhart *et al*., 2003). Debt levels in low-income countries such as Malawi may have a detrimental impact on those countries' capability to generate domestic revenue, their ability to service their debts through poor export volumes and values, and their potential to expand their economies through the inflationary channel (Reinhart *et al.,* 2003). Table 1 shows the resulting debt thresholds in IMF's (2018) debt sustainability framework for low-income countries.

Table 1. Public Debt Sustainability Thresholds for Low-Income Countries

Debt carrying capacity	PV of PPG foreign public debt		PPG foreign public debt service		PV of total public debt
Weak	30% of GDP	140% of exports	10% of exports	14% of revenue	35% of GDP
Medium	40% of GDP	180% of exports	15% of exports	18% of revenue	50% of GDP
Strong	55% of GDP	240% of exports	21% of exports	23% of revenue	70% of GDP

PPG = public and publicly guaranteed; PV = present value
Source: IMF (2018)

The present value of total government debt has drastically increased, rising from 38.8% of GDP in 2013 to 54.8% of GDP in 2020 due to underperformance in revenues (economic growth slowed from 5.4% in 2019 to 0.8% in 2020), coronavirus (covid-19) related expenditures, expanding domestic funding and non-concessional borrowing from regional development and private banks, as well as from individual countries such as China and India (World Bank, 2022a; IMF, 2021). This most recent increase in total public debt levels exceeded the 35% threshold, increasing the country's susceptibility to debt distress (see Table 1). Even though the fourth wave of the covid-19 pandemic has less severe economic effects than the first three, the disease has had a substantial detrimental influence on the Malawian economy (World Bank, 2022c). Due to the constrained fiscal space, the government has been forced to borrow money

from local markets, which has stifled both private sector investment and social spending (IMF, 2021).

The current study aims to critically investigate the country's debt dynamics in light of Malawi's constantly rising debt levels and its shifting debt composition and structure. The study highlights the country's debt reforms, structure, trends, and challenges between 1970 and 2021. The remaining paper is set out as follows: Malawi's public finance and debt reforms are covered in Section 2. The sources and dynamics of Malawi's government debt are examined in Section 3. Malawi's public debt management problems and solutions are covered in Section 4, and the paper is wrapped up in Section 5 by outlining major conclusions and policy suggestions.

2. Public Sector Finance and Debt Management Reforms in Malawi

The political landscape of Malawi profoundly influenced public finance and debt management reforms. Since the beginning of the 1980s, Malawi has tried a number of structural adjustment programs, including the public sector finance management reform (PFM), but the results have been mixed in terms of debt reduction, poverty alleviation, and economic growth. Notwithstanding a number of initiatives by the International Monetary Fund, World Bank, and other donors to improve the budget process, public expenditures continued to outgrow revenues over the period up until 2005 (World Bank, 2022b; 2001). For instance, during the fiscal year 2003/04, 2019/20, and 2020/21, primary fiscal deficits were 3.6%, 4,7%, and 7.7% of GDP, respectively (World Bank, 2022a). The inability of the PFM to achieve the desired outcomes could be attributed to improper execution strategies or wrong public finance and debt management policies. Execution pitfalls include the absence of a political will, lack of knowledge and expertise on the part of the civil servants, the complexity and sequencing of reforms; and finally, the lack of technical support from the creditor community that had initiated and backed many of the reforms (Stambuli, 2002, World Bank, 2001).

Public sector finance and debt management reforms that were implemented by the Government of Malawi (GoM) included, among others, the Civil Service Pay and Employment Reform, Medium Term Expenditure Framework, Public Sector Investment Programme, Integrated Financial Management Information System, Cash Budget System, Public Debt Management measures and arrangements, Public Procurement Act, Internal Audit Unit, the establishment of the Malawi Revenue Authority, Decentralisation Implementation Plan, and Malawi Poverty

Reduction Strategy (World Bank, 2003, GoM, 2003). Table 2 provides a summary of some of the reforms in Malawi.

Table 2. A summary of Public Sector Finance and Debt Management Reforms in Malawi

Reform	Properties
Civil Service Pay and Employment Reform	▪ Political changes in the country were intertwined with reforms to the civil service. ▪ The performance of the public service of Malawi has been declining over time, despite being one of the best performing organisations in the 1970s and the early 1980s (Durevall and Erlandsson, 2005). ▪ The 1980s saw significant changes to the civil service incentive structure, which largely accounted for the changes to the remuneration system (World Bank, 1990). ▪ During the 1990s, and early 2000s, when the economy of Malawi was on a downward trajectory, with worsening fiscal deficits (wages and salaries made up 7% of GDP, while central government spending was 28% of GDP in 1995), control of the civil service wage bill and rationalisation became indispensable (Durevall and Erlandsson, 2005). ▪ Currently, the main legal frameworks for managing the public service include the Constitution of the Republic of Malawi of 1994, and a number of other legal instruments, such as the Public Service Act (Cap. 1:03) of 1994, the Public Finance Management Act (Cap. 37:02) of 2003, the Public Procurement and Disposal of Assets of 2016, the Public Audit Act (Cap. 37:01) of 2003 and the Local Government Act (Cap. 022:01) of 1998, the Employment Act of 2000 and the Labour Relations Act of 1996, Corrupt Practices Act (2004), among others (GoM, 2018). ▪ These policies were implemented to encourage budgetary restraint and nurture efficient and effective public service administration in order to achieve the country's economic development goals.

The Medium-Term Expenditure Framework (MTEF) & Cash Budget System	▪ The MTEF was first introduced in the 1980s, but it was a failure since it did not account for actual income trends, recurrent costs related to development expenditures, and spending prioritisation (World Bank, 1989). ▪ The failure was attributed to a lack of technical expertise and transparency in the public civil service. ▪ The MTEF was reintroduced in 1995 as the ideal framework for restructuring budgets and planning strategic expenditures. ▪ The MTEF of 1995 was a successor to the Programme budgeting of 1985 and the Public Expenditure Review of 1993. ▪ The MTEF encouraged fiscal prudence (deficits were kept to 2.3% of GDP between 2000 and 2013**),** a reduction of foreign public debt, and promoted consistent donor inflows (World Bank, 2013). ▪ The cash budget system, implemented in 1996 with the intention of reducing the risk of overall budgetary overruns, served as the foundation for the execution of the MTEF's improved budgeting procedures. ▪ The Public Expenditure Review, which suggests measures to increase public expenditure efficiency, eventually supplanted the MTEF in 2013 (World Bank, 2013).
Integrated Financial Management Information System (IFMIS)	▪ The financial management system was made more efficient and transparent by the computer-based information system known as IFMIS. ▪ The GoM used the IFMIS to give government managers timely and accurate financial information through a standardised integrated financial management reporting system (World Bank, 2003). ▪ The basic IFMS sub-systems include accounting, budgeting, cash and debt management, related core treasury systems, revenue collection, procurement and asset management, human resource and payroll systems, pension and social security systems, and asset management.

	▪ The success of the IFMS in Malawi was due to ongoing technical help and guidance from the World Bank and other donors (World Bank, 2003).
Public debt Management	▪ The Reserve Bank of Malawi (RBM) Act of 1989, the Public Finance Management Act of 2003, and the 1995 Constitution of Malawi all contain provisions that grant the government the authority to borrow. The RBM Act carries out the following tasks: (i) it gives the Reserve Bank the authority to issue and manage domestic debt on the government's behalf; (ii) it allows the extension of an overdraft facility to the government up to a statutory limit of 20% of the government's projected annual revenue; and (iii) it carries out monetary policy operations with the ultimate objective of achieving price and financial stability. ▪ The Debt and Aid Management Division (DAD) was set up in 1997 in the Ministry of Finance. ▪ DAD is the primary government representative in charge of overseeing the foreign aid and public debt portfolios. ▪ The establishment of DAD eliminated the fragmented approach to debt management by consolidating all the debt and aid management duties previously carried out by various government departments and agencies, including the Accountant General, Ministry of Economic Planning and Development, Ministry of Finance, Ministry of Foreign Affairs, and Reserve Bank of Malawi. ▪ The GoM also established the Debt Management Technical Committee (DMTC), which meets once a month. ▪ The DMTC serves as a consultant to enhance public debt management through continuously reviewing and recommending debt policies. ▪ Another initiative is the sub-committee on Short Term Borrowing Requirements (SBR), to which the Debt and Aid Management Division (DAD) is the Secretariat.

	▪ The SBR convenes weekly to discuss the week's liquidity and potential financing needs and overall effect on debt (GoM, 2020). ▪ More so, are the Cash Management Committee meetings, which have led to improved cash flow forecasts (GoM, 2020). ▪ Foreign public debt reforms were much focused on the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) initiatives. ▪ Malawi reached the decision point in December 2000 and the completion point in 2006, which led to the government receiving sizeable debt relief packages, including sizable debt cancellation and a rescheduled debt service schedule. ▪ Under these debt relief initiatives, the IMF and World Bank compelled the country to adopt market-driven policies and conduct portfolio assessments and debt sustainability analysis. These include (i) privatisation of public enterprises; (ii) the elimination of agricultural subsidies; (iii) the selling of grain reserves to cut government deficits; (iv) predictions of the macro-variables and financial needs; and (v) an analysis of the finance needs in several macro-risk scenarios (IMF, 2005; 2001, 2000). ▪ To effectively manage its domestic debt component, the GoM implemented the Medium-Term Debt Management Strategy to reduce the re-financing and re-fixing risks of the domestic public debt stock (GoM, 2020).

3. Public Debt Structure, Composition and Trends in Malawi

A number of economic, financial, and political forces have influenced Malawi's public debt dynamics since the 1960s. These factors include the balance of payments problems caused by the first and second rounds of the oil crises. Rising debt stocks and growing gaps in external liquidity were also caused by deflation, which began in the late 1970s and exacerbated in the 1980s (Stambuli, 2002). This decline in export commodity prices was particularly bad for raw tea and tobacco (Stambuli, 2002). Furthermore, a high real interest rate burden during the period 1973-1985 made it more difficult for the country to satisfy its financial obligations both domestically and internationally (World Bank, 2022a). For instance, the average interest rate on foreign loans increased from 1.9% in 1976 to 8.8% in 1981 (World Bank, 2022a). Domestic economic policies, such as the country's import substitution policy established in the 1970s, contributed significantly to the debt issue because the majority of resources were not allocated to high-yielding productive activities (Stambuli, 2002).

Malawi received sizeable loans from western banks, governments, and institutions in the 1970s, adding to the country's rapidly escalating stock of foreign public debt (World Bank, 2022a). Additionally, the entry of over a million refugees from Mozambique's civil war, which lasted from 1977 to 1992, and a severe drought in 1992 contributed to the country's economic troubles and debt accumulation. Table 3 shows Malawi's sovereign debt indicators during 1970-2022.

Table 3: Malawi Debt Indicators (1970-2020)

	Debt indicator		
	Debt Stock (US$ millions	Debt service/export (%)	Debt/GDP ratio
1970	121.1	9.1	41.7
1975	307.7	10.1	50.2
1980	684.6	23.7	55.3
1985	987.7	39.6	87.3
1990	1686.6	30.4	89.7
1995	2688.7	27.7	167.3
2000	2048.3	7.5	163.8
2005	1271.6	2.8	158.6
2010	1074.9	4.1	36.3
2015	3196.2	7.3	38.4
2016	3356.9	7.9	41.6
2017	4112.1	8.2	43.9
2018	4855.2	8.4	47.8
2019	5376.7	8.7	50.3
2020	6,491.6	6.9	54.8

Source: Author compilation using data from Ministry of Finance annual debt reports and IMF country reports (various years)

Table 3 shows that total debt stocks have gone up from 1970 to 1995. Some of the debt problems were caused by energy crises, capital flight, public sector expansion, the interest rate factor, and a sudden downturn in export fortunes as commodity prices ebbed in the late 1970s until the 1980s (Overseas Development Institute, 2004; Kydd, 1988). Malawi's total long-term debt in 1995 was US$2339.1 million, while its short-term debt was US$349.5 million (Overseas Development Institute, 2004). Like most other low-income countries, Malawi owes more debt to official creditors than to private creditors (IMF, 2001). However, in Malawi's case, the contrast is even more accentuated. Private creditors account for only $14 million out of the long-term debt of US$2339.1 million, with the bulk of Malawi's long-term debt owed to multilateral creditors; that is, the World Bank, through its own direct lending, and through its International Development Association (IDA) facility, and the African Development Bank (World Bank, 2022a; IMF, 2021; 2001).

In the 1990s, creditor governments, through the IMF and World Bank, launched the Heavily Indebted Poor Countries (HIPC) initiative with the promise of reducing debts. Malawi entered the HIPC initiative in 1996 and reached the decision point in 2000 (IMF, 2000). In December 2000, the IMF approved a three-year Poverty Reduction and Growth Facilities arrangement,

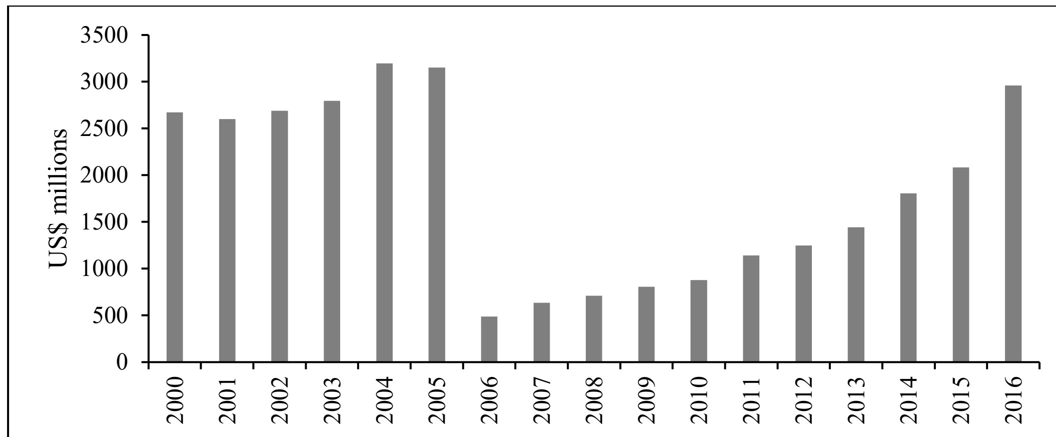
and the total debt service relief from all of Malawi's creditors was then worth around US$1482 million (IMF, 2000). After enhanced HIPC in 2005 and MDRI debt relief in 2006, Malawi's foreign debt decreased from US$3.2 billion at the end of 2005 to US$487 million at the end of 2006 (IMF, 2006). As indicated in Table 2, all of Malawi's debt burden ratios fell below the HIPC limits as a result of the reduction. Public debt sharply increased during the post-HIPC era, going from US$1074.9 million in 2010 to US$6491.6 million in 2020 (World Bank, 2022a). In this post-HIPC era, the debt/GDP ratios breached the standard optimal level of 35% of GDP.

The debt service/export ratio, which increased from 2.5% in 2005 to 8.7% in 2019, shows that the foreign debt repayment burden has also increased dramatically. The fall to 6.7% in 2020 is primarily due to revenue constraints rather than an improvement in repayment capacity (IMF, 2021). The country's inability to sustain foreign debt is adequately explained by its unpragmatic government policy, including nonadherence to prudent public spending and borrowing principles, small domestic tax base, low foreign exchange reserves, bad history of debt service, the escalating level of debt, and history of macroeconomic instability (see World Bank, 2022a; IMF, 2021; 2006; 2001; 1999).

Since Malawi has experienced some form of disinvestment and repatriation of profits or interest, public spending should crowd in rather than crowd out private investment. This implies that public spending can enable and incentivise private investment, guiding it into high-returning areas. Something like this happened in Japan, South Korea, Singapore, and the People's Republic of China (See Quah, 2018).

Figure 1 shows the evolution of foreign public debt during the pre-and-post-HIPC periods.

Figure 1: Foreign Public Debt Trends in Malawi (2000-2016)



Source: Author compilation using Africa Statistical Yearbook 2019, IMF Country reports (various years)

At the end of 1999, Malawi's stock of foreign public debt was projected to be $2608 million. This was after the country received HIPC assistance for US$643 million in 1999, but before the implementation of conventional debt relief initiatives (IMF, 2000). With additional debt relief provided by the Paris Club, African Development Bank, Japan, and other bilateral creditors, the IDA and IMF each authorised debt reduction in 2001 totalling US$331 million and US$30 million, respectively (IMF, 2000) (see Figure 1). Following strict economic, financial and debt measures from the Bretton Woods organisations, as well as improved fiscal and debt management efforts, the foreign debt stock grew moderately during the years 2000 to 2005. The average general government gross debt decreased throughout this time from US$3.2 billion in 2000 to US$487 million in 2005 (IMF, 2006). In the main, Figure 1 illustrates how the growth in the stock of foreign public debt during the post-HIPC period represents a continuance of robust foreign borrowing that started up again in 2007. The rising debt burden has increased the risk of debt distress in Malawi in recent years and going into the immediate future.

Multilateral creditors continued to make up the most significant portion of Malawi's foreign debt (84%), which as of the end of December 2020, totalled US$3214.78 million, while 16% of all foreign debt was held by bilateral creditors (IMF, 2022). The World Bank is ranked first among Malawi's top five foreign creditors, followed by the IMF, the African Development Fund (ADF), the People's Republic of China, and India.

The rise in foreign indebtedness beginning 2020 was partly due to loan disbursements made to cushion the country from the adverse impact of the covid-19 pandemic – this is in spite of emergency covid-19 assistance in 2020 and Special Drawing Rights allocation in 2021 (IMF, 2021). Specifically, the IMF paid out US$661.96 million through the Rapid Credit Facility (GoM, 2021). Additionally, the ADF contributed US$24.48 million in direct financial support. IDA distributed US$120.28 million across several projects (GoM, 2021). Similarly, EXIM Bank of China and India reported sizeable disbursements under the recently contracted loan, National Fibre Backbone Phase II, to finance the energy, roads, infrastructure, water, and agricultural sectors (GoM, 2021).

While excessive foreign public debt can be crippling, it is equally vital to recognise that prudent public spending has frequently been economically advantageous, even when it has been financed by debt. In the context of Malawi, the low growth rates highlight the concern of whether public spending has been utilised to 'seed' higher returning industries that would reduce the country's dependence on agriculture.

Table 4 shows Malawi's aggregated and foreign public debt sustainability analysis between 2019 and 2021.

Table 4: Foreign Public Debt Sustainability Analysis for Malawi (2019-21)

Indicator	Threshold	2019	2020	2021
PV of debt (% of GDP)	**35%**	19%	21%	24%
PV of foreign debt (% of GDP)	**30%**	19.6%	20.3%	21.9%
PV of Debt (% of exports)	**140%**	88%	99%	109%
PV of external Debt (% of exports)	**180%**	148.9%	152.2%	156.2%
Debt service (% of exports)	**10%**	5%	5%	6%
Debt service (% of revenue)	**14%**	6%	6%	7%

Source: GoM (2022); IMF (2018)

According to the IMF's assessment of debt sustainability for 2021, both the aggregated and foreign public debt are assessed to be unsustainable under present policies, and that Malawi's government debt is in the high-risk category as demonstrated by the majority of debt indicators reaching the threshold limits (IMF, 2021). Although debt service measures have been maintained within the established sustainability boundaries, the rising maturity of previously contracted short-term loans and a shift from medium to low debt carrying capacity have worsened the repayment burden (GoZ, 2022). In addition, chances of a future debt default are quite likely given the significant financing requirements over the next few

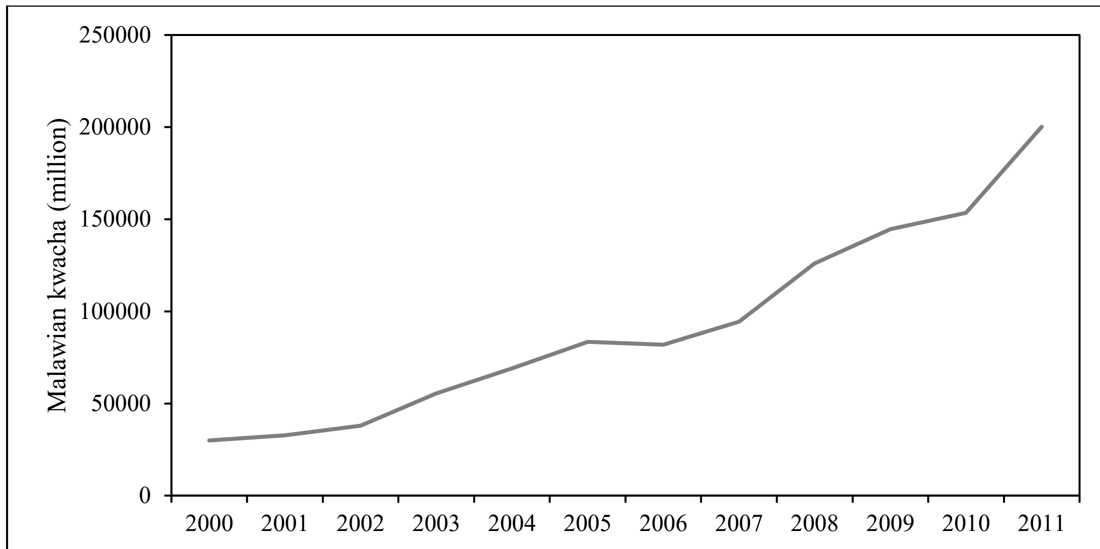
years, low levels of foreign reserves, and weak yearly economic growth rates (World Bank, 2022a; IMF, 2021).

It goes without saying that the factors that have contributed to Malawi's significant rise in debt levels over the past ten years should be of concern and have significant implications on how attention should be divided between the possibility of better-directed government spending and the severity of the debt. Weak economic policies, corruption, and poor governance were mostly to blame for the severity of the debt in Malawi. As an example, Malawi and Singapore became politically independent in 1963 and 1965, respectively. In 1960, Singapore's per capita annual GDP was US$428, a mere 40% greater than that of Malawi in 1965 (World Bank, 2022a). Singapore's GDP per capita went from US$428 in 1960 to US$72,765 in 2021, a 170-fold increase (World Bank, 2022a). Singapore shared certain characteristics with Malawi, including being a fishing community with few other natural resources (such as arable land), a lack of high-quality education, and proximity to other countries with limited economic advantages (Quah, 2018).

In contrast to Malawi, Singapore's self-styled reforms, however, addressed issues that were comparable or worse. Singapore's success can be attributed to the pragmatic leadership of the late Lee Kuan Yew and his successors, an efficient public bureaucracy, effective corruption control, reliance on the "best and brightest" citizens through investments in education and competitive remuneration, and learning from other world successful economies (Quah, 2018). In this way, Malawi can record strong growth rates and attain budgetary and debt sustainability without even enacting austerity measures.

Domestic public debt, which has been quickly expanding over the years, added to the growth in the stock of foreign public debt. Despite having issued debt securities since the 1980s, the pace picked up in 2001 (see Figure 2). Domestic public debt increased dramatically during the review period as a result of a number of factors, including fiscal irresponsibility, lax spending control by the government, particularly poor forecasting of the wage and interest bills, failure to accurately predict donor budget support, a lack of shock-absorption mechanisms, and losses from parastatals that led to a heavy reliance on the fiscus (African Forum and Network on Debt and Development/AFRODAD, 2011).

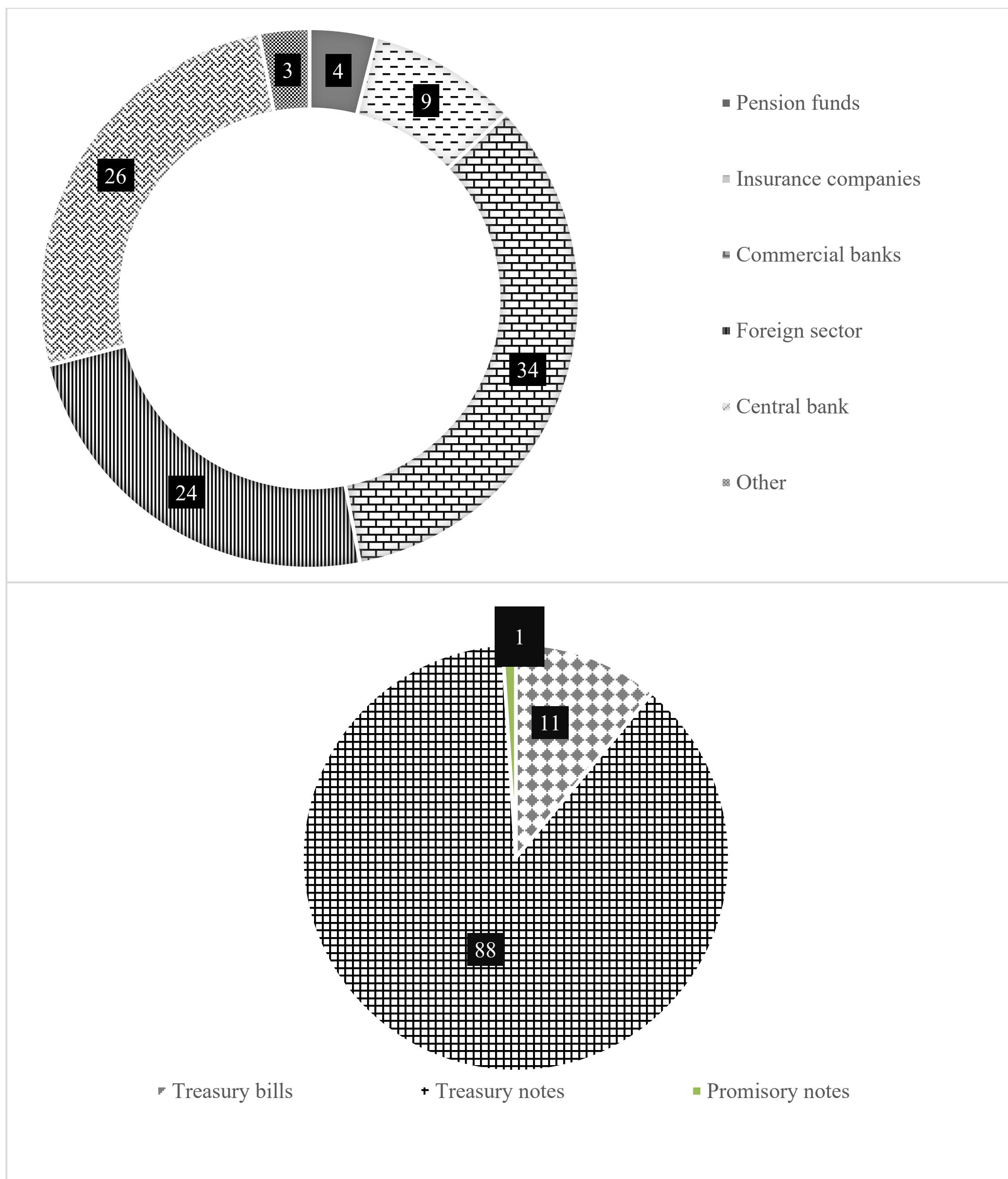
Figure 2: Trend of Domestic Public Debt between 2003 and 2011



Source: Author compilation using AFRODAD data

Malawi's domestic debt is issued as marketable securities, such as treasury bills (with short maturities), treasury bonds, and treasury notes (with medium to long maturities, 2–25 years), as well as nonmarketable instruments, such as central bank bills and arrears to suppliers and employees, and automatic overdraft facility to the government, also known as a “ways and means advance" facility. Total domestic public debt stood at MK2.72 trillion as of December 2020 (GoZ, 2021). The stock of domestic public debt is depicted in Figure 3 by holder and instrument.

Figure 3: Domestic Public Debt Stock by Instrument and Holder in 2020



Source: Author compilation using data from the GoM (2021)

Figure 3 clearly shows that Malawi's domestic debt has evolved from primarily short-term to medium and long-term, with treasury notes making up 88% of the total domestic public debt. Commercial banks and the central bank, which hold MK970.25 billion and MK632.43 billion, respectively, continue to be the largest holders of domestic debt, accounting for 60% of the market in 2021 (GoM, 2021). Due to the fact that commercial banks in Malawi carry sovereign debt, this has a negative impact on both private sector lending and bank balance

sheets and jeopardizes the solvency and stability of the financial system. Additionally, because widespread bank failures are exceedingly disastrous to the economy, in times of crisis, the government is compelled to bail out banks in order to stop them from failing, which is costly. A significant portion of Malawi's domestic debt, 24% of the total, is gradually being held by the foreign sector. As a result of foreign acquisitions of government securities, there will be a net income outflow to foreigners. Hence, foreign purchases of government securities lower the deficit's expenses on the entire economy. Insurance companies and pension funds continue to have a small but growing role in Malawi, with holdings of 9% and 4% in 2020, respectively.

4. Problems with Public Debt Management and Possible Fixes

Malawi has experienced higher-than-expected primary deficits, which are primarily covered by expensive domestic debt taken out at high interest rates. This is because the country's economy and revenue base have not expanded quickly enough to keep up with the country's rising expenditure needs, such as those related to covid-19 and the high cost of public employment. The government also had significant arrears to suppliers, which it was able to pay off in 2021 (GoM, 2021). As a result, debt distress risks and debt servicing costs have soared. In addition, Malawi, like many African countries, has had to deal with rising interest costs as a result of the depreciation of its currency, which has led to a deterioration in debt levels.

Given the foregoing, the government is urged to resolve the disparity between revenue and expenditure by using fiscal restraint in its central government budgetary activities. To avoid becoming overly dependent on the agriculture sector, which is vulnerable to outside and natural shocks, the country should continue its drive to reform and diversify the economy. When development projects, particularly those funded by donors, result in budget overruns, efforts should be made to strengthen budget credibility by addressing any potential inefficiencies, problems with absorption capacity, and red tape in the procurement and management of development projects, as well as by making the most of the available development finance.

According to this study, Malawi has institutionalised frameworks and laws that regulate the management of both domestic and foreign public debt, including loan contraction, debt analysis, debt recording, and debt payments. These include the Ministry of Finance's Debt and Aid Management Division (DAD), the Reserve Bank of Malawi's Research and Statistics and Financial Market Operations divisions, as well as numerous committees like the Debt

Management Technical Committee, the Cash Management Committee, the Reserve Bank of Malawi (RBM) Act, and the Public Finance Management Act. Despite having such strong structures in place, the country continued to practice fiscal irresponsibility, and in certain years, the government misused the overdraft facility by borrowing more than the statutory limit of 20% of its projected yearly revenue (IMF, 2015). Additionally, the government should improve its oversight role on contingent liabilities that arise from explicit guarantees issued to state-owned enterprises and establish a blanket ceiling on domestic borrowing. Both the national debt strategy and the country's constitution should reflect this. For instance, the stock of issued guarantees in 2020 totalled MK159 billion, or more than 2.5% of GDP (GoM, 2020). Additionally, certain guaranteed sums, such as those to the Agricultural Development and Marketing Corporation (ADMARC) and the Malawi Enterprise Development Fund Limited, were not fully drawn (GoM, 2020).

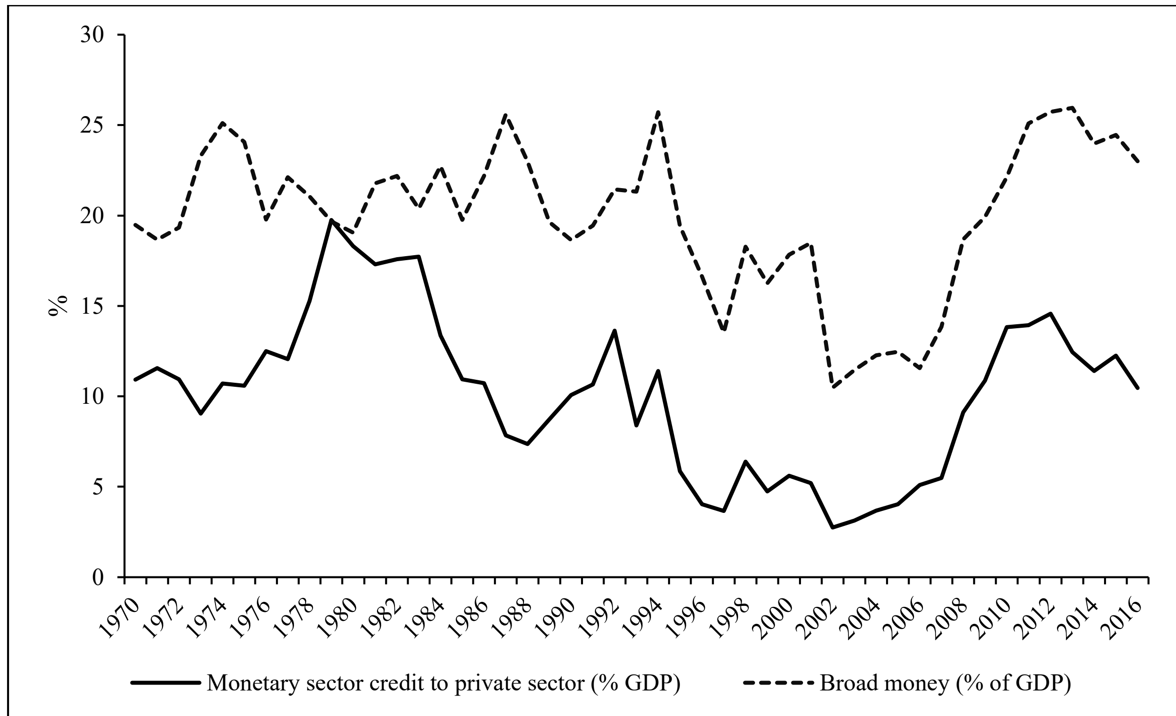
On the basis of the development of the debt indicators, mechanisms should be put in place to monitor the impact of additional borrowing on overall domestic public debt sustainability and to provide a quick fiscal correction. Political influence should be avoided so that the public finance and debt committees mentioned earlier can continue to function effectively and give guidance on government financing modalities and debt management. To ensure accountability and prudent borrowing, the oversight role of the parliament should also be expanded.

Malawi was not immune to debt challenges despite experiencing rapid economic growth rates of 4.7% on average between 2001 and 2020 (World Bank, 2022a). In order to keep promoting long-term investments, the government should preserve low share of short-term securities while continuing with macroeconomic stability measures to improve the climate in the financial sector. Further, the country should diversify its debt portfolio by issuing a range of debt instruments with varied maturity periods in order to mitigate potential liquidity and solvency problems related to debt maturity. Furthermore, since domestic economic, fiscal, and financial administrations alone cannot restore debt sustainability, significant support from the international community is required in the form of non-debt financing methods, including debt relief, rescheduling and budget support.

The limited scope of Malawi's financial system continues to have a negative effect on the country's monetary base, level of foreign exchange reserves, and, ultimately, the structure and

composition of its debt. Figure 4 depicts the financial sector development in Malawi from 1970 to 2016, as measured by monetary sector credit to the private sector (% of GDP) and broad money (% of GDP).

Figure 4: Financial Sector Development in Malawi (1970-2016)



Source: Author compilation using World bank (2022a) data

Figure 4 indicates that the historical average of monetary sector credit to the private sector as a proportion of GDP is 10.1%, and the 2020 figure was 10.4%. This is below the SSA average of 30%, South Africa's 112%, and the USA's 217% (World Bank, 2022a). The rise in domestic credit as a percentage of GDP, which started in 2002 and accelerated in 2008, points to significant increases in the portfolio of loans, government asset holdings, and the number of other financial institutions. The ratio's decline after 2012 is concerning, though. Therefore, it is necessary to promote the growth of the financial sector through thoughtful policies that will draw more participants and increase the diversification of financial institutions and assets. The government should encourage the issuance of credit by offering incentives to organisations that are eager to extend credit to the private sector. Developing the domestic financial market improves the country's capacity to absorb new debt, meeting government financial needs locally while reducing the likelihood of monetarisation of debt, and also helps to maintain low

interest rates. Therefore, it is critical that accurate projections of excess reserves are made to avoid depriving the market of much-needed liquidity that should be used for financial deepening and the development of a secondary market, which in turn will make the implementation of monetary policy more efficient and effective (AFRODAD, 2011). It is also crucial to create a transparent and efficient interbank foreign currency market, improve the recording, monitoring, and reporting of reserve assets and liabilities, and create a plan for managing foreign exchange reserves (IMF, 2021).

5. Conclusion

This study examined Malawi's public debt evolution from 1970 to 2020. The size, structure, and composition of public debt analyses were examined via the prisms of economic development, fiscal and monetary policy stabilisation, financial sector development, debt sustainability, and legal and institutional frameworks and reforms. The debt trends in Malawi can be divided into three distinct time periods: 1970–2006, 2007–2012, and 2013–2020. Rising debt stocks in the first period were primarily caused by non-concessionary foreign borrowings, rising primary deficits arising from poor performance of raw tobacco and tea exports, and budgetary irresponsibility. At the height of its debt burden in the late 1990s to 2006, the country qualified for debt relief from its long-standing multilateral and bilateral creditors, as well as the Paris Club, in the form of debt cancellation and rescheduling. As a result, foreign public debt stocks drastically decreased, and overall debt indicators dropped to levels that could be sustained. Throughout the time frame, positive economic growth rates averaged 4.7% (World Bank, 2022a).

The country's debt, both domestic and foreign, increased significantly during the second phase (2007–2012), despite debt indicators being still below predetermined threshold levels. The rise in domestic debt resulted from the new issuance of both treasury bills and notes, with the latter constituting a higher proportion of total domestic debt. Lastly, the period from 2013 to 2020 is characterised by an ongoing increase in both domestic and foreign debt. The persistent rise in debt during this period caused the country **to** fall into the high debt distress category. Additionally, the shifting balance of debt toward more expensive bilateral and private debt contributes to the rise in yearly debt payback expenses. The analysis also showed that Malawi's growing domestic and foreign debt vulnerabilities were made worse by the covid-19 pandemic, posing future default risk.

This study has also shown that the country implemented some significant reforms that were aimed at managing public debt effectively. These include the Ministry of Finance's Debt and Aid Management Division (DAD), the Reserve Bank of Malawi's Research and Statistics and Financial Market Operations divisions, as well as numerous committees like the Debt Management Technical Committee, the Cash Management Committee, the Reserve Bank of Malawi (RBM) Act, and the Public Finance Management Act. According to the current study, Malawi's debt-related issues are multifaceted and stem from its internal fiscal and financial misalignments. In addition, the country's aggregate debt is also driven by international and regional economic, financial, and natural causes.

To continue strengthening the already existing debt management arrangements, the study recommends that fiscal consolidation be enhanced to ensure that government does not crowd out the private sector and therefore allow for credit expansion to the private sector. As a result, more work needs to be done to improve public sector governance, strengthen policy effectiveness, diversify the economy to avoid becoming overly dependent on the agricultural sector, increase oversight of the central bank's management of foreign exchange reserves, and enhance transparency and forecasting methods. The study also suggests that credit should be extended to the private sector in order to grow the domestic financial sector. To do this, organisations that are ready to grant credit to the private sector should be given incentives to do so. Finally, the study warns that Malawi’s foreign and overall public debt, like in many other SSA countries, is unsustainable and poses a significant future financial risk to the country.

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