## 1.0 Introduction

The COVID-19 pandemic has struck amid a promising economic growth outlook for Malawi at the start of 2020 characterized by reducing interest rates, low headline inflation rate and a stable exchange rate. However, with the pandemic causing local, regional and global supply disruptions as well as a deterioration in consumer and business confidence levels which have in turn reduced aggregate demand; the reality now is that these stable macroeconomic foundations are under threat and the economy stands to suffer from the potential negative spillover effects. The Ministry of Finance, Economic Planning & Development has since revised its 2020 economic growth projections from 6.0 percent to 1.9 percent while the International Monetary Fund's projection is at 1.0 percent all pointing to slowing down in economic activities.

These projections have been made under the assumption that the pandemic will fade in the second half of the year 2020 and that containment efforts like lockdowns will have been lifted by then. The expectation is that once normal economic activity returns through resumption of global value chains and trade links; Malawi's economy will experience a substantial growth of 4.5 percent in 2021 as per the Ministry of Finance's projections.

Therefore, during this period ***(year 2020)*** when reduced economic activity and increased pressure on public health resources is expected for Malawi; the need for fiscal policy intervention has been elevated to an unprecedented level and rightly so because of the following reasons:

- Firstly, our health system is very weak as such this has created the need to boost health resources in the country and thus the expenditure outlay needed in the sector has increased.
- Secondly, holding all other things constant, the general decline in economic transactions has had acute effects on aggregate demand in the economy because the key determinants of aggregate demand such as demand for private consumption, demand for new capital goods (private investments) as well as net demand for domestic goods and services by foreigners have sharply declined.
- Thirdly, this has then created the need for the Government to increase public investment ***(increased government expenditure)*** while at the same time provide tax incentives like tax graces or waivers ***(reduced government revenue)*** in order to offset this downward pressure on aggregate demand.

The fiscal response however is likely to be constrained due to a low fiscal space and ultimately this weak fiscal position is expected to deteriorate further with the crisis, which will aggravate high borrowing needs. On the other hand, the external debt service relief that was provided by the IMF to Malawi could not have come at a better time and will go a long way at freeing up financial resources that can be used in policy response.

The analysis below tries to look at how Malawi can build a more robust fiscal response to the economic effects of COVID-19 while at the same achieving a stable economic recovery that is characterized by the following:

- Public domestic debt levels that are sustainable to avoid public debt distress.
- Stronger fiscal management that avoids financial resource leakages.
- Targeted expenditure on priority areas like the health sector and agriculture sector.
- Social support services through provision of income support to local people and businesses.

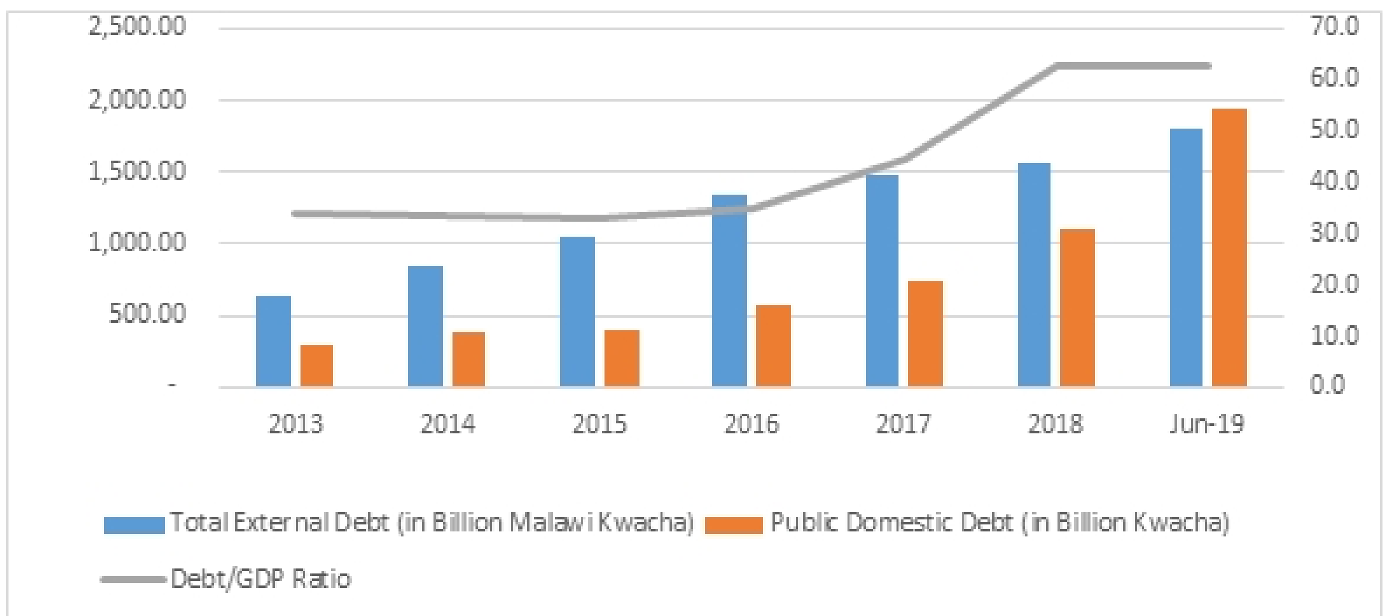
**2.0 Fiscal financing, public debt stock & target areas**

According to the IMF policy response tracker, currently the Malawi Government’s fiscal response plan includes: a US$20 million (0.25 percent of GDP) expenditure outlay on health care and targeted social assistance programs; tax waivers on imports of essential goods to manage and contain the pandemic as well as an Emergency Cash Transfer Program of about $50 million (0.6 percent of GDP), that is mostly going to be financed by development partners to support small businesses in major urban areas and will run between May to November 2020. Financing the response mechanisms particularly for Government funded programs is likely going to be very challenging and this is due to among others: the lack of fiscal space as evidenced by the fiscal deficits that have persisted so far throughout the 2019/20 fiscal year as indicated in the Reserve Bank of Malawi March 2020 Monthly Economic Review and the high overall risk of public debt distress with RBM statistics quoting the Debt/ GDP ratio for Malawi at 62 percent at the close of 2019.

Even though the Debt/GDP ratio for Malawi is already high; the weak fiscal position that the economy finds itself in makes Government borrowing the only available alternative to quickly finance the fiscal response. However, as (Bi, Shen and Yang 2016) note, high public debt levels are usually associated with lower multiplier effects of discretionary fiscal policies; this then

presents the need for the Government to manage the fiscal response in a way that maximizes impact on the economy while at the same time keeping an eye on debt sustainability to avoid public debt distress.

**Figure 1: Trend of Malawi's Public Debt/GDP percentage vs External debt and Public domestic debt.**



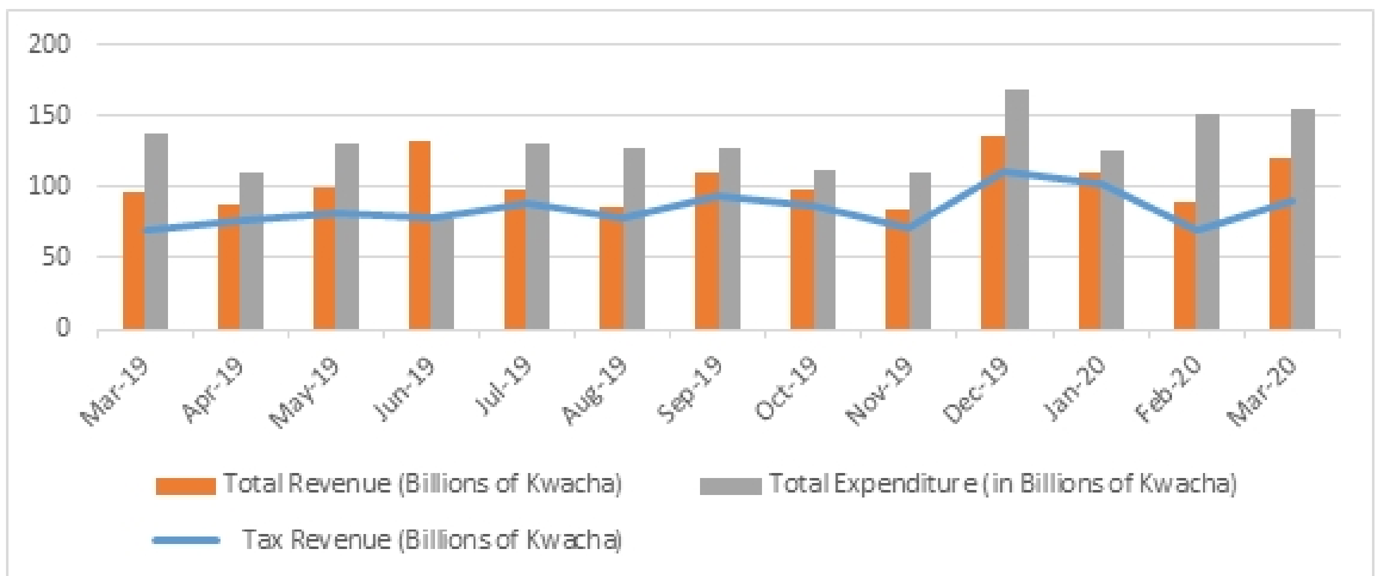

Source: Data from RBM & World Bank

Figure 1 shows that the Public Debt/ GDP ratio has increased rapidly in the last couple of years mainly due to the rapid increase in public domestic debt. World Bank statistics indicate that from 2012 to June 2019 external debt increased from 26.5 percent of GDP to 30.2 percent of GDP while during the same period public domestic debt increased from 13.8 percent of GDP to 32.6

percent of GDP surpassing external debt in the process with the total debt stock standing at

62.8 percent of GDP. As at June 2019, Word Bank estimates show that public domestic debt was at MK1.9 trillion while external debt was at MK1.8 trillion. Furthermore, at the close of 2019 RBM statistics show that the Debt/ GDP ratio was down to 62 percent mainly due to the decrease in public domestic debt that was at MK1.4 trillion.

**Figure 2: Malawi Government Expenditure vs Total Revenue Collection and Overall tax performance.**




Source: Data from RBM

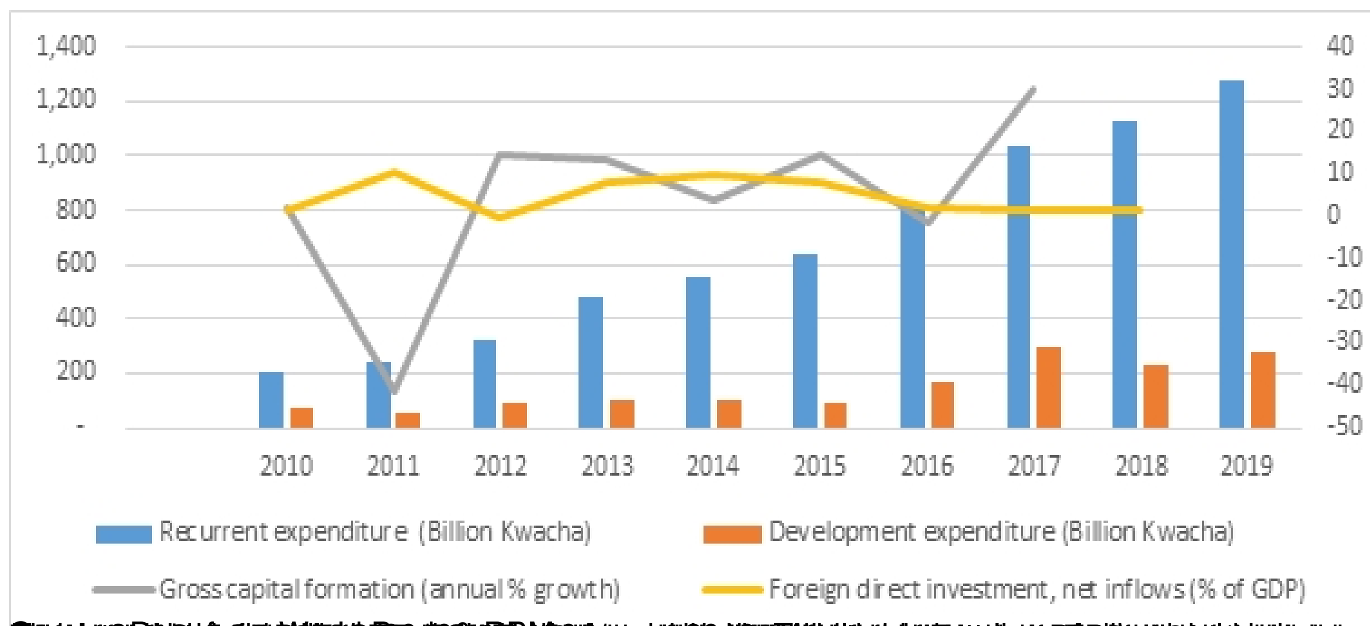
Figure 2 shows that fiscal deficits have persisted throughout the 2019/20 fiscal year most likely due to failure of achieving revenue targets. During the same period the trend of tax performance has not been too volatile with significant drops in revenue collection experienced in November 2019 and February 2020. However, the tax waivers and tax graces that Government has put into place are going to lead to a drop in revenue collection and this will increase the fiscal pressure even more.

## 2.1 How should the Government manage the fiscal space?

The first step in this is to focus on the lines for which the Government has been consistently overspending. The Government should ensure that recurrent expenditure is within budgeted levels and if there are opportunities to save resources these must be utilized. Government should identify areas that can easily be forgone to improve revenues. Government is associated with a lot of inefficiencies and misuse of resources. There is need to reduce off workplace meetings, unnecessary trips, among others; thus Government should focus more on essentials.

Furthermore, the Government must strengthen commitment controls to avoid incurring of arrears and most importantly improve planning and execution of the development budget **(publi c investment)**
as this is what will be key in implementing the fiscal stimulus. Many times when revenue collection has performed badly, it has been the trend that during mid-term budget reviews development expenditure usually takes the hit and is revised downwards while recurrent expenditure usually goes up. Such developments undermine the growth prospects for the country as public investment plays a crucial role in determining the long-run productive capacity of every economy and it is what triggers domestic private investment as well as foreign direct investment.

**Figure 3 Trend of Malawi Government expenditure vs growth of Gross Capital Formation and growth of Foreign Direct Investment Inflows**


1,400
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20
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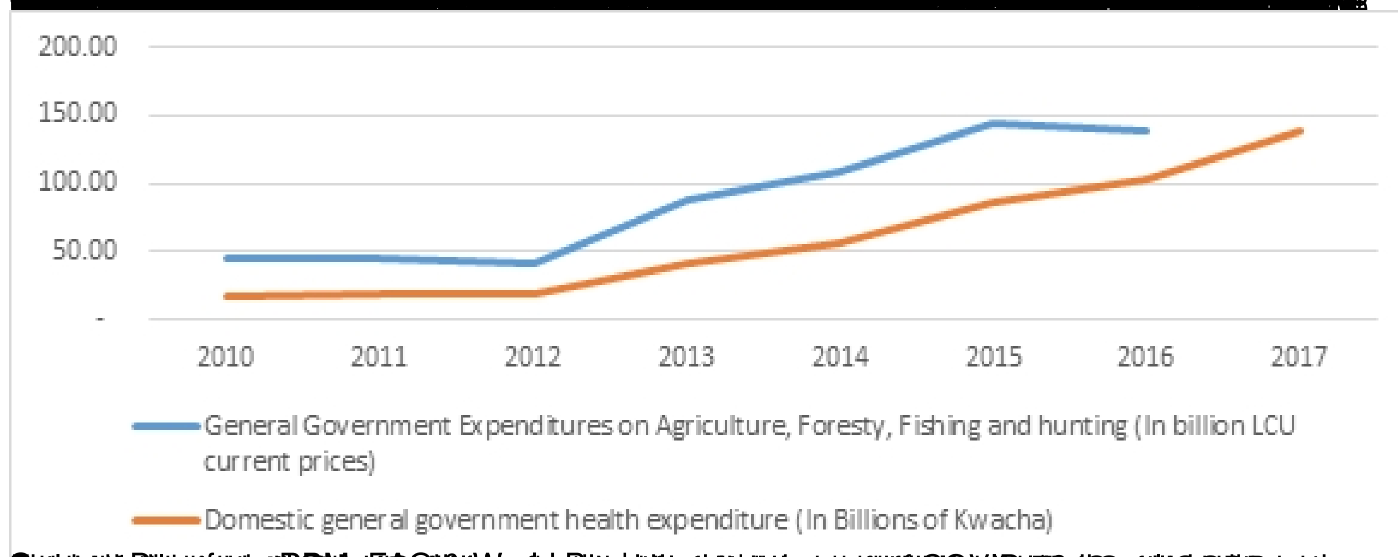
-10
-20
-30
-40
-50
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
Recurrent expenditure (Billion Kwacha)
Development expenditure (Billion Kwacha)
Gross capital formation (annual % growth)
Foreign direct investment, net inflows (% of GDP)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50.00
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2013
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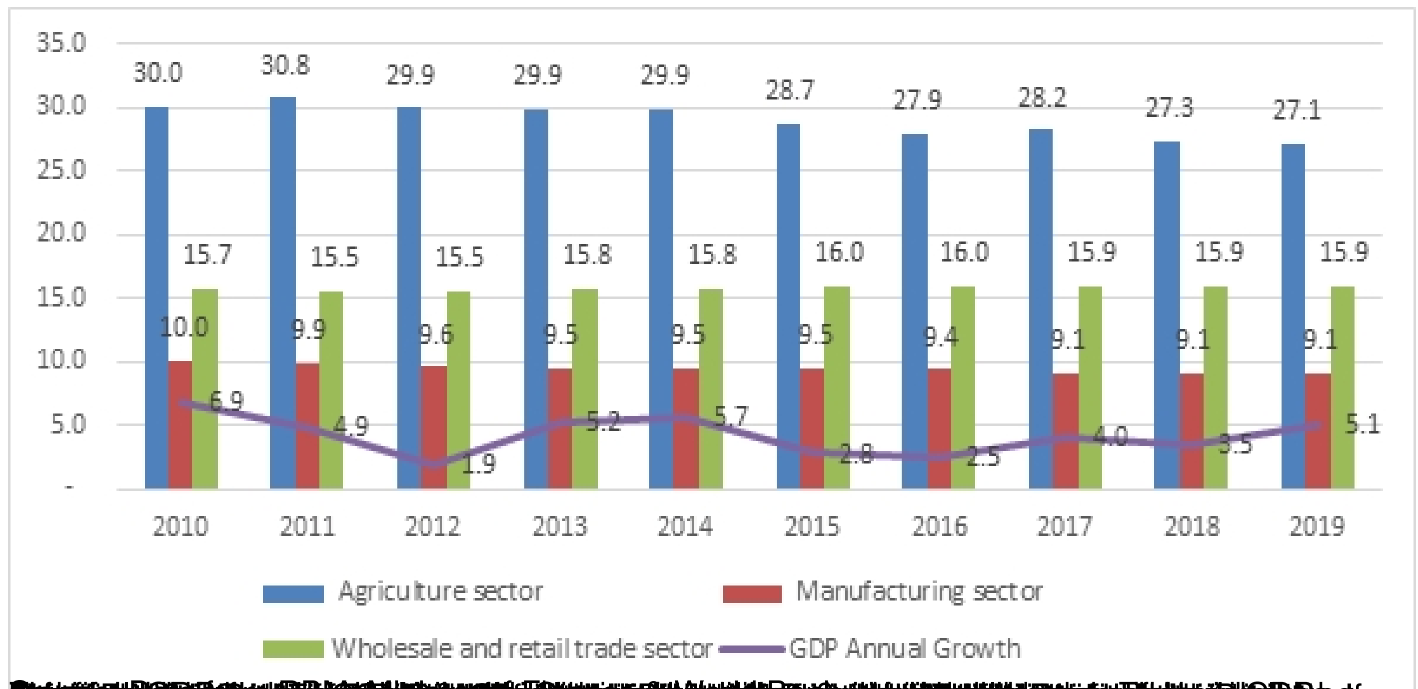
2016
2017
General Government Expenditures on Agriculture, Foresty, Fishing and hunting (In billion LCU current prices)
Domestic general government health expenditure (In Billions of Kwacha)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2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
Agriculture sector
Manufacturing sector
Wholesale and retail trade sector
GDP Annual Growth