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.

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.**

![Graph showing Malawi Government Expenditure vs Total Revenue Collection and Overall tax performance.](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 (public 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
Figure 3 shows that since 2010 growth of gross capital formation has been inconsistent characterized by two huge troughs in 2011 and 2016. This can be attributed to poor planning and execution of the development budget as evidenced by the increase and decrease in development expenditure over the period under review while recurrent expenditure has been consistently increasing throughout the same period.

Furthermore, figure 3 shows that over the same period growth of Foreign Direct Investment inflows has been negligible at best with the only significant growth experienced in 2011 when it grew at 10.1 percent of GDP but almost immediately in the following year 2012 growth shrunk to -0.1 percent of GDP. Foreign investors have not been too keen to invest in our economy among others: due to lack of quality public investment in road infrastructure necessary to enhance market linkages as well as lack of investment in electricity which is inadequate and unreliable.

With the economic effects of COVID-19 being felt globally we must expect FDI inflows to shrink further as foreign investors will be focusing more on boosting growth in their own economies. Therefore, Government must take the lead in promoting domestic investment by investing in areas that could trigger domestic private investment.

2.2 Choosing target areas

In making decisions on how much and whether to scale up quality public investment (through increased public borrowing), the Government must make full considerations of fiscal costs vs. benefits by paying careful attention to domestic absorption capacity. Holding all things constant, currently both private consumption and private investment are experiencing downward pressure due to low consumer and business confidence levels as well as the increased uncertainty about future income which is in turn causing precautionary saving. Therefore, the fiscal response should target sectors which have large positive externalities, sustained domestic demand and also those which could crowd in private sector investment.

For instance, the agriculture sector should be one of the sectors the response should target. The Government should invest in the Green Belt Authority (GBA) projects to build resilience for the sector to weather shocks as well as revitalize idle estates for production of essential food crops to cushion 2021 food stocks. In the very short term, Government should also support irrigation farming to utilize waters that are still prevalent in many parts of the country and Government should partner with private sector companies in this endeavor. Resilience of the agriculture sector will have positive effects on the economy due to significant contributions to employment as well as its linkage with other sectors in terms of supply of raw materials; while food security will influence the economy by strengthening human capital through improved nutrition. Furthermore, the Government should also invest in health infrastructure and emergency services to improve quality of public health, enhance resilience, and help mitigate risks from future epidemics.

Figure 4: Trend of Malawi Government expenditure in the Agriculture & Health sectors

Figure 4 shows that Government expenditure in these two sectors has consistently been on the rise in the last couple of years however to mitigate the impact of COVID-19 the expenditure outlay in these sectors has to increase even more.

In addition, on top of the K2 billion announced and earmarked for lending to Small Scale Enterprise businesses the Government must also look to provide special lines of credit that can be accessed by larger businesses as a way of revitalizing the economy. The Government must prioritize firms that belong to the sectors that contribute significantly to the country's GDP in order to maximize impact as well as firms in hardest hit sectors like the accommodation and food service (tourism) whose total output is expected to contract by -9.9 percent in 2020 as per the Ministry of Finance's statistics.

Figure 5: Shows the top 3 sectors that contribute the most to Malawi's GDP vs. Annual GDP Growth
recommendations very seriously as they contain real issues that could help stimulate
Furthermore, the channels of communication between the private sector and the Government
businesses.
formulating the policy response Government must therefore take private sector
must remain wide open to ensure a coordinated effort that takes input from both sides. In
channel financial resources to sectors with a potential for high returns.
domestic currency deposits have freed up financial resources which private sector companies
could borrow. However, we still urge the government to provide special lines of credit that can
be accessed by larger firms as a way of revitalizing the economy. The Government must
regards to the reduction of the Lombard rate and the Liquidity Reserve Requirement on
We are aware that the monetary policy interventions that the RBM has instituted particularly in
strengthen oversight and tighten controls in use of financial resources.
Over the past few years Government revenue collection has regularly performed below set
acknowledges that the speed with which normal business activity can return depends on how
fiscal restraint especially for recurrent expenditure, improve execution of development budget,
the close of 2019. However, due to the unprecedented nature and size of the shock that
quickly the country can neutralize the threat of the pandemic and thus fighting the pandemic
COVID-19 has posed to our economy; it is inevitable that the Government will have to engage
targets while expenditure has consistently been above budget and this has plunged the country
in more borrowing in order to mobilize resources to counter the pandemic. MCCCI
should indeed be a priority for the Government. Therefore, the Government is urged to practice
into more domestic debt with RBM statistics quoting public domestic debt at MK 1.4 trillion at
4.0 Conclusion
program beneficiaries know what to do when they do not receive their expected payments.
distribution of financial support that is meant to help struggling businesses and individuals.
funds over a set amount within a specified number of days after funds are released and/or used.
opportunities for corruption and abuse of funds. Given the unprecedented nature of the crisis
Even though all these interventions are necessary it is important to note that they also present
and the need for cooperation across agencies and levels of Government; oversight mechanisms
Government must adopt the following measures:

3.0 Fiscal leakages and corruption
Kammwamba Coal Fired Power Generation Plant, Mozambique-Malawi Regional
Plant. Private sector companies have been failing to produce goods at maximum capacity due
anything the impact of COVID -19 has taught us the importance of digital technology in an
diesel powered generators which is an additional cost of production. Moving forward in the
aforementioned projects to support more reliable power supply will promote economic growth
important determining factor to cost of production and ultimately production capacity.
that will promote economic diversification and improve financial inclusion levels in the country. If
by moving forward and implementing in the medium term at least one of the following projects:
Government must commit to addressing the long standing problem of electricity in the country
country's GDP but also those that have economic linkages with these sectors. The agriculture,
safeguard jobs for the local citizenly. Other sectors like transport and storage services that
and also employ a huge portion of the labour force as such they should be targeted to
provide logistical support to these three sectors and the rest of the other sectors should also be
supported to keep the business transmission channels running in the economy.
The fiscal response should look to lender support to sectors that contribute significantly to the
manufacturing and wholesale & retail sectors are the top 3 contributors to the country's GDP
Source: Data from RBM, Ministry of Finance & World Bank

**Figure:** GDP Annual Growth, Agriculture, Manufacturing and Wholesale & Retail sectors from 2010 to 2019.