2019/20 National Budget Brief

How Does the Malawi National Budget Respond to the Needs of Children?

MALAWI

Key messages and recommendations

1 The revenue projections for FY2019/20 are optimistic, given the past trends and economic growth trajectory. If revenue projections are not attained, the Government may resort to deficit financing further increasing the already heavy debt burden.

→ **Recommendation:** In future, the Government is encouraged to be realistic with its projections and assumptions on revenue generation.

2 Surging debt has become an issue of concern for the Government, with public debt charges expected to sour from MK224 billion in FY2018/19 to MK244 billion in FY2019/20, consuming 17% of domestic revenue.

→ **Recommendation:** The ongoing discussions on debt restructuring is a step in the right direction, which should be supported, and concluded on time by the Government.

3 Despite fiscal space constraints, the Government has protected allocations to social sectors notably health, education and social protection.

→ **Recommendation:** Moving forward, the challenge for the Government is to ensure budgets are implemented as planned and efficiency of spending enhanced to avoid downward revisions at mid-year.

4 Total transfers to local authorities (LAs), net of PE, amounts to 2.9% of net revenue in FY2019/20, which is below the Government's Intergovernmental Fiscal Transfer Formula (IGFTF) commitment of 2002 to allocate 5% of net revenues to the development of LAs.

→ **Recommendation:** The Government should review the overall size of ceilings to LAs and the IGFTF in order to foster equitable allocations to LAs.

5 Non-tax revenue continues to be subdued, with majority of parastatal dividends being remitted below targets in the previous two years.

→ **Recommendation:** The Government should increase the oversight of parastatals and examine and strengthen the efficiency as well as transparency in domestic resource mobilization.

6 There are considerable variances between approved and revised expenditures for some social sector votes, especially for capital projects, which is suggestive of project management, procurement and absorption capacity challenges.

→ **Recommendation:** The Government should investigate and address any possible inefficiencies, absorption capacity challenges, and red-tape in procurement and management of capital projects.

1. INTRODUCTION

This budget brief is one of several which explores the extent to which national budgets respond to developmental needs of children in Malawi. The brief analyzes the size and composition of the approved fiscal year (FY) 2019/20 budget allocations to sectors concerned with children. It also offers insight into the efficiency, effectiveness, equity, and adequacy of past spending.

The analysis in this brief is drawn from a review of several budget documents. These include; Financial Statements, Annual Economic Reports, Public Debt Reports, Appropriation Bills, Detailed Budget Estimates, and Program Based Budgets (PBBs). The analysis has also made use of data from the World Bank, International Monetary Fund (IMF), Reserve Bank of Malawi (RBM) and the International Budget Partnership (IBP). Reports by various stakeholders including Ministries, Departments and Agencies (MDAs) and donors also contributed to the analysis.

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2. MACROECONOMIC CONTEXT

The FY2019/20 National Budget was crafted at the back of contested May 2019 tripartite elections. The current budget hinges on five key macro-economic issues that the Government seeks to address namely: economic growth, job creation, economic empowerment, sustainable debt management, and infrastructure development.

The Government projects economic growth rate of 5.1% for 2019/20. Nevertheless, uncertainties remain as Malawi's growth is reliant on external factors such as global growth and continued demand for tobacco farming which has dwindled in recent years. Economic growth continues to be affected by climate related shocks such as droughts and floods.

The Government has succeeded in stabilizing inflation and the exchange rate. Inflation for 2019 averaged 9.2%[1], slightly higher than the projected 8.0%[2] but in line with the levels of 2018. Non-food inflation and the relative stability of the Malawi Kwacha vis-à-vis the major currencies contributed to subdue the hikes in food inflation. At an average 5.4%, non-food inflation for 2019 is the lowest recorded since 1991[3]. Inflation for 2020 is projected to average 6.1%. The exchange rate of Malawi Kwacha to US Dollar has remained relatively stable at around MK735.

1 Reserve Bank of Malawi, Inflation Rates (January-November), January 2020
2 Ministry of Finance, Economic Planning and Development, Annual Economic Report 2019
3 Ministry of Finance, Economic Planning and Development, Annual Economic Reports 2015 - 2019

On account of good rainfall, real growth in the agriculture, forestry, and fishing sector is projected to increase from 0.9% in 2018 to 3.9% in 2019 and further up to 5.1% in 2020. The economy of Malawi continues to largely rely on rain fed agriculture, whose contribution to GDP is expected to reach 27.1% in 2019, compared to 55.7% for services and 8.9% for manufacturing industry. Reliance on rain fed agriculture however, makes the economy susceptible to internal and exogenous shocks caused by fluctuating weather conditions. Maize production increased by 20% from 2.8 million metric tons in 2017/18 growing season to 3.4 million metric tons in the 2018/19 growing season. The proportion of families that rely on farming which are food insecure also dropped from 16.8% in 2017/18 to 14% in 2018/19 growing season. However, tobacco production, Malawi's major cash crop and source of foreign exchange, decreased by 6% in 2018/19 due to the poor market prices of the previous growing season that discouraged farmers from growing.

The export base for the economy remains very narrow, impacting negatively on the country's trade balance. The trade deficit widened by 44% from MK869 billion in 2016 to MK 1.2 trillion in 2017, before narrowing by 6% between 2017 and 2018. It is expected that the trade deficit will further reduce in 2019 owing to projected 30.9% increase in sugar production and 20% increase in pulse exports[4]. Negative trade balances alongside slow infrastructure creation, less developed financial markets, and low but also less diversified investments have for long stand in the way of economic growth.

Several challenges such as energy and infrastructure deficits, and corruption continue to stand in the way of national development. In 2018/19 the Anti-Corruption Bureau (ACB) received and processed 800 corruption complaints and of these only 120 were investigated, of which 100 were completed. The ACB managed to prosecute 68 cases of which only 12 were completed. Half of the completed 12 cases ensued to conviction[5]. On average, it takes about 230 days to complete an investigation in Malawi, a figure which is much higher than the average for sub-Saharan African region[6]. It is estimated that only 16 out of every 100 Malawians who observe corrupt practices end up reporting. Malawi scored 31% on the Corruption Perception Index in 2017, with 0 being highly corrupt and 100 very clean.

Increasing external and internal debt levels and charges connected to debt servicing are gradually putting a strain on Malawi's budget. The current debt stock, at 62.8%, is a constraint to additional borrowing and debt servicing costs equaled 21.9% of domestic revenue in FY2018/19. Although the budget deficit for Fiscal Year (FY) 2019/20 is expected to be significantly lower than during FY2018/19, at 2.5% of GDP against 6.08%, this is mostly linked to very optimistic revenue assumptions that if unmet would generate further financing needs. In terms of sustainability of the debt, the Joint World Bank-IMF Debt Sustainability Analysis (DSA) conducted in 2019 determined that Malawi is at moderate risk of external debt distress, but at high overall risk of debt distress due to high public domestic debt.

KEY TAKEAWAYS

- A paradigm shift from over dependence on rain fed agriculture to dependence on irrigation farming is required to avoid risks associated with climate shocks that affect agriculture output, which is the backbone of the Malawi economy.

- Stronger fiscal consolidation is required to lessen the risk of escalating debt. Going forward, concessional financing that prioritizes projects with high returns would be beneficial for the country.

4 Ibid.
5 Ministry of Finance (2019), 2019/20 Draft Program Based Budget, page 419.
6 UNODC, SADC, EU, SAFAC and SAHRIT (2018), Corruption and Anti-Corruption in Southern Africa, Gaborone, Botswana

3. SOCIO-ECONOMIC CONTEXT

Malawi continues to face human development challenges, notwithstanding some noteworthy progress made in recent years. Malawi's Human Development Index (HDI) score for 2018 is 0.485 as compared to 0.482 in 2017, ranking the country number 172 out of 188 countries. The Human Capital Index (HCI) for 2018 is 0.416, ranking the country number 125 out of 157 countries[7]. Ultra-poverty reduced from 24.5% in 2010/11 to 20.1% in 2016/17, particularly in rural areas (from 28.1% to 23.8%)[8]. Inequalities as measured by the Gini Coefficient reduced from 45.5% in 2010 to 44.7% in 2016. Nonetheless, national monetary poverty rate marginally worsened from 50.7% in 2010 to 51.5% in 2016.

Notable progress has been achieved in child health, nutrition, early childhood development (ECD) and primary education outcomes. Data from the UN Inter-Agency Group for Child Mortality Estimation show that under five (U5) mortality declined from 75.4 deaths per 1,000 livebirths in 2012, to 59.2 in 2015 and 49.7 in 2018. This is lower than most peer countries in the SADC region.

7 https://www.worldbank.org/en/data/interactive/2018/10/18/human-capital-index-and-components-2019
8 National Statistical Office (2018), IHS4 Report

Stunting went down from 47% to 37% during the same period which is just 4% higher than 33% target for 2020 in MGDS III. Notwithstanding these improvements, with Malawi's high rate of population growth, the absolute number of stunted under-five children has increased from 1.26 million in 2004 to 1.31 million in 2015/16. Enrolment in Early Childhood Education (ECE) has increased by 13 percentage points from 34% in 2010 to 47% in 2017, way above most African countries. Unfortunately, net enrollment rate for primary school dropped from 98% (97 for boys, 99 for girls) in 2016 to 88% (87 for boys, 89 for girls) in 2017[9]. Child poverty declined from 63% in 2010/11 to 60.5% in 2016/17.

A demographic boom in Malawi is likely to affect social service delivery but can also create massive opportunities for growth, if harnessed. On average, one woman bears about five children in her life time. Nearly half (48%) of the Malawian population is under the age of 15, with 51% under the age of 18, and 60% below the age of 24. The national population has grown at an average rate of 2.9% since 2008.[10] By 2030, Malawi's child population is projected to increase to about 15 million from approximately 9.6 million in 2018. This demographic boom will require improvements in investments in human capital development especially in the areas of health, nutrition and education.

BOX 1: KEY SOCIAL INDICATORS

Under-five (U5) mortality rate **50 deaths per 1,000 live births**	Multiple forms of violence against children **25%**
Infant mortality rate **42 deaths per 1,000 live births**	Stunting rate **37.1%**
Primary net enrollment rate **88%**	Underweight rate **11.7%**
	Human development index **0.47**
Secondary net enrollment rate **16%**	Human Capital Index **0.41**
Youth literacy rate **76%**	Inequality (Gini Coefficient) **0.45**
Enrolment in early childhood education **47%**	National poverty **51.5%**
Transition from primary to Secondary school **38.4%**	Ultra poverty **20.1%**

KEY TAKEAWAY

- Remarkable strides in child health, nutrition, early childhood development, and primary education can only be sustained by continued investment in human capital sectors.

9 Education Management Information System (EMIS) (2017)
10 National Statistical Office of Malawi (2018), 2018 Malawi Population and Housing Census Report, Zomba Malawi

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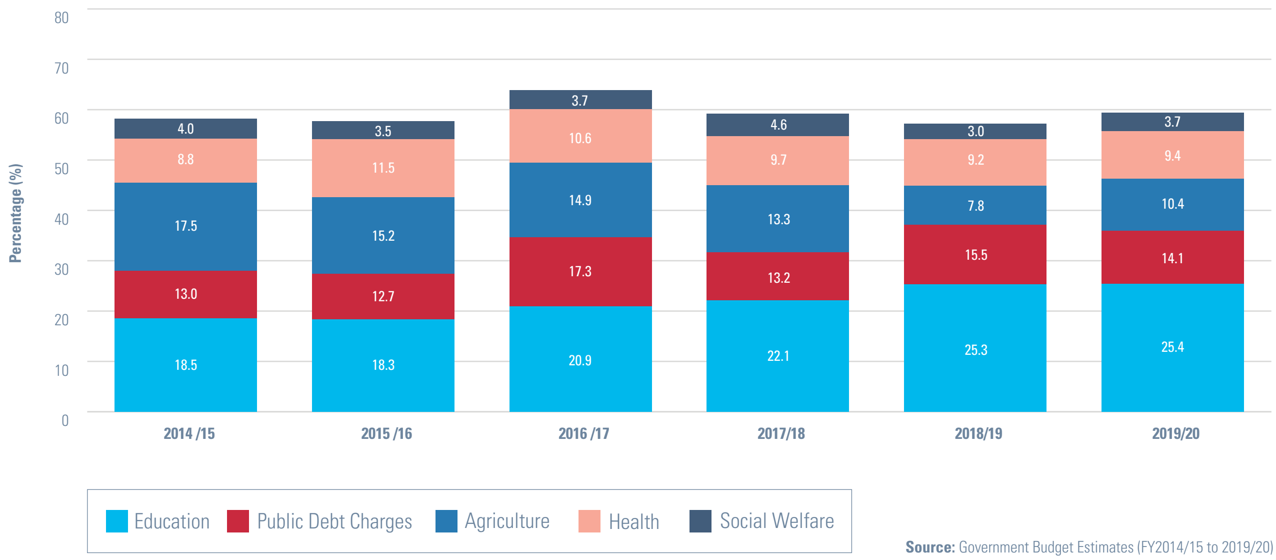
4. AGGREGATE SOCIAL SECTOR SPENDING TRENDS

The Government cautious fiscal policy geared towards reducing the deficit still left room for an overall budget increase in nominal and real terms. The national budget has increased by 21.1% in nominal terms and 9.1% in real terms from the revised MK1.43 trillion in 2018/19 to MK1.73 trillion in 2019/20. As a percentage of GDP, the national budget stands at 32.8% which is up from 26.8% in the previous financial year.

The Government continues to prioritize social services[11], which received 38.4% of the national budget in FY2019/20. The share of social sector expenditure has generally been protected over the years, averaging 38%. The education sector remains the top spending priority, receiving 25%[12] of the FY2019/20 budget as shown in Figure 1. Public debt charges constitute the second largest share of national budget at 14.1%, while the agricultural sector ranks third, receiving of 10.4% in FY2019/20. The health sector received the fourth largest share of the FY2019/20 budget of 9.4%.

11 Education, health, water, sanitation and hygiene (WASH) and social welfare programs (social protection, child protection, ECD and disability).
12 The education figure includes Aid in Appropriation (the revenue assigned to and collected by public institutions which they are permitted by the Treasury to appropriate against expenditure approved by Parliament) for subvented education institutions. If aid in appropriation is excluded, the share of education spending stands at 18.5%.

FIGURE 1 Trends in Allocations to Key Sectors as Shares of National Budgets



Source: Government Budget Estimates (FY2014/15 to 2019/20)

KEY TAKEAWAYS

- The Government has prioritized social sector spending over the years, a trend which should be sustained to help improve the social well-being of its citizens.
- Increasing public debt charges could potentially crowd out spending on social sectors.

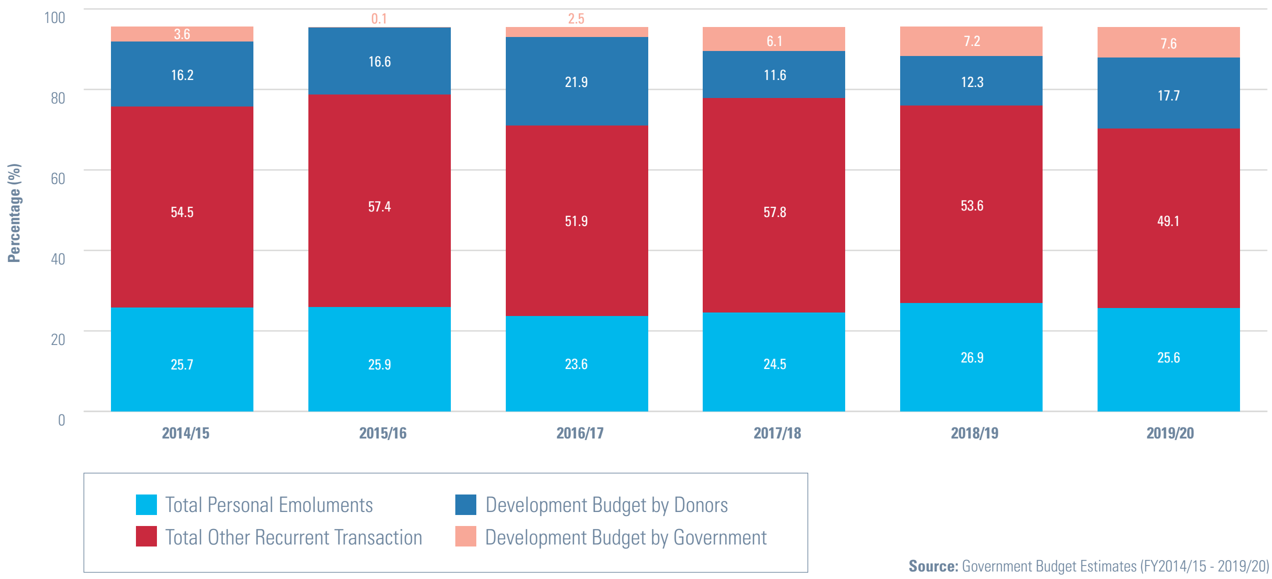
The education sector remains the top spending priority, receiving 25% of the FY2019/20 budget.

5. COMPOSITION OF GOVERNMENT ALLOCATION

A large proportion of the Government budget is for recurrent expenses, with a significant share going to personnel emoluments (PE). In the current fiscal year, MK443.4 billion (25.6% of National Budget) has been allocated to wages and salaries (14.4% increase from previous fiscal year), of which MK215.1 billion will be transferred to the Local Councils. Over the past five years, wages and salaries have on average constituted 25.1% of national budgets and have absorbed 29.4% of total revenues. As a share of GDP, the budget for wages and salaries has marginally increased by one percentage points from 7.4% in FY2018/19 to 8.4% in FY2019/20. Total recurrent expenditure is estimated at MK1.29 trillion, which is 24.6% of GDP, 74.7% of the national budget, and will absorb 82.1% of total revenues.

A total of MK437.9 billion has been allocated for development projects, which is equivalent to 8.3% of GDP, 25.3% of national budget and 27.8% of the total revenues. Donor financing continues to be the main financing source for the development budgets, although in recent years the Government contribution to the development budget increased in line with the commitment to fund at least 25% of the total development budgets. This is shown in the stacked columns of Figure 2, detailing the composition of Government budgets by economic classification. Most of the increase is linked to the co-financing of major donor-funded projects. In terms of recipients of the development budgets, a few MDAs are absorbing significant shares of development budgets, namely the Ministry of Agriculture with 63.7%, and the Ministry of Education with 40.7%.

FIGURE 2 Composition of Government Budget by Economic Classification (2014/15 – 2019/20)



Source: Government Budget Estimates (FY2014/15 - 2019/20)

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KEY TAKEAWAY

- The development budget continues to be heavily funded by donors, also in the social sectors. The Government's trend of increasing its development budget by co-funding donor projects should be encouraged and sustained to ensure the development budget becomes less and less donor dependent.

6. BUDGET CREDIBILITY AND EXECUTION

There are significant budget credibility challenges for most sectors, considering huge variances between approved and revised budget estimates. The Ministry of Education vote for FY2018/19, for example, was revised downwards by 15.9%, the Ministry of Health's was revised downwards by 9.7% and the Ministry of Gender's was revised downwards by a remarkable 56.2%. The deviation of revised expenditure plans from approved has been recurring and significant over the past five years, largely due to the over optimistic assumptions on revenue collection and the vulnerability of the economy to external shocks like floods and drought.

Overall budget execution was within target, with marginal deviation from the revised budget of FY2018/19, following a trend holding since FY2014/15. The deviation between outturn and revised estimates of expenditures were generally within 5% over the period. Even though the Government spent 0.8% above revised estimate in FY2018/19, on average national budgets have been underspent by 3.4% since FY2014/15. Generally, development budgets were largely underspent whereas recurrent budgets predominantly experienced budget overruns.

There are, however, considerable negative variances between revised estimates and actual outturns with regards to development spending since FY2014/15. Development expenditure was below its revised estimate for FY2018/19 by 8.6% and on average by 16.6% since FY2014/15. Conversely, ORT budgets were fully utilized and, in most cases, overspent. In addition, there are observable expenditure overruns on wages and salaries and on debt interest charges over this period. Overruns are particularly high for both domestic and foreign debt interest charges as illustrated in Table 1. For FY2018/19 alone, total interest payment on debt witnessed a budget overrun by a remarkable 23.5%. This was on account of the outturn of domestic borrowing which exceeded planned domestic borrowing by nearly 25%.

Budget execution rates vary across sectors and programs. For FY2018/19 for instance, allocations to goods and services in the agriculture sector were overspent by 0.9%, whereas the health allocation was underspent by 4.5% in the same period. Allocation for goods and services was nearly spent according to plans for the education and health sectors while there was under expenditure by 4% for the agriculture sector in FY2017/18. Within the agriculture sector, for example, the Farm Input Subsidy Program was underspent by 12.8% in FY2018/19, with maize purchases being underspent by 6.4%. The general impression is that variances and spending dynamics within sectors may need further examination.

KEY TAKEAWAYS

- The Government needs to prioritize development projects with the highest impact, only making commitments to projects that can be funded with available resources to help improve the credibility of development projects.

- Interest on debt payments and wages and salaries have been consistently above budgeted levels, which requires the Government to exercise fiscal restraint and improve on its fiscal projections. The Government should investigate the underlying reasons behind the expenditure overruns on wages and salaries and on debt interest charges.

TABLE 1 Variance Analysis of Actual Outturns Vs Revised Estimates for Selected Expenditure Items[13]

Expenditure Item	2014 /15	2015 /16	2016 /17	2017/18	2018/19	Average
Total Expenditure	-5.11	-2.32	-1.13	-9.43	0.79	-3.44
Development Expenditure	-21.42	-23.38	9.57	-38.98	-8.58	-16.56
Recurrent Budget	0.84	4.26	-4.16	1.05	3.36	1.07
Personnel Emoluments	-1.32	1.75	0.09	0.01	-1.56	-0.21
Other Recurrent Transaction	1.89	5.43	-5.97	1.49	6.03	1.77
Total Interest on Debt	8.39	14.12	-6.06	1.34	23.49	8.26
Domestic Interest on Debt	18.28	14.38	-5.58	1.40	24.75	10.65
Foreign Interest on Debt	-51.28	11.58	-12.25	0.49	8.85	-8.52

Source: Government Budget Estimates (FY2014/15 - 2019/20)

13 This was computed by dividing the deviation (the difference) of current allocation from previous allocation, by previous allocation figure, expressed as a percentage (multiplied by 100).

The general impression is that variances and spending dynamics within sectors may need further examination.

7. DECENTRALIZATION AND SUB-NATIONAL SPENDING

In FY2019/20, MK256.5 billion is budgeted for local authorities (LAs). Out of this amount, MK215 billion (83%) is for personal emoluments with 3% (MK8.5 billion) for local development expenditure as shown in Figure 3. As a percentage of the national budget, total transfers to local authorities are about 14.8%, with ORT taking about 1.9% of total budget. Total transfers for ORT and development budget (MK41.3 billion) to LAs amounts to 2.9% of domestic revenue (MK1.42 trillion), down from 4% in FY2018/19. This implies that the share is increasingly diverging from the 2002 Intergovernmental Fiscal Transfer Formula (IGFTF) commitment by the Government to allocate 5% of domestic revenue for development (ORT+Capital budget) of LAs as shown in Figure 4. Out of MK32.9 billion to be transferred for ORT in 2019/20, education is allocated MK9.87 billion, and health will get MK8.9 billion. The apportionment to the health sector is net of MK15.3 billion for the drug budgets of the district hospitals allocated under the National Local Government Finance Committee (NLGFC).

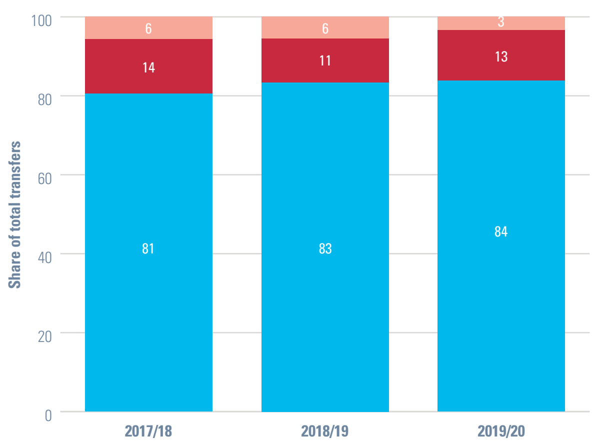
About 18 sectors have been devolved, but not all devolved functions have been accompanied by resources. For instance, the ECD budget under MoGCDSW is still not devolved, despite the majority of ECD services being offered at the local level. In addition, total transfers to LAs significantly fall short of cost estimates in district development plans (DDPs). The Local Government Act which provides the legal framework for implementation of the decentralization policy was adopted in 1998 but devolution of sector ORT budgets was not made effective until 2005/06, and development budget devolution later followed in FY2015/16.

Over one third of local authorities suffered reductions in per capita allocations in FY2019/20 as shown in Figure 5. The reductions come at a time when the transfer formula has long not been reviewed, with only the health formula currently being work in progress. Out of 32 LAs, 13 had their per capita allocations reduced, representing 40.6% casualties. The reduction in per capita allocations range from 67% to 0.9%.

KEY TAKEAWAYS

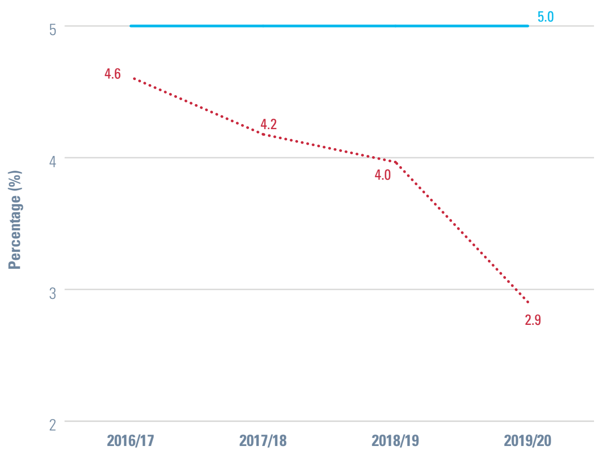
- The Government needs to review the overall and sectoral formulae, to address regional disparities.
- The size of ceilings for ORT to Local Authorities should be reviewed upwards in line with IGFTF to meet the growing demand for service delivery.

FIGURE 3 Trends in the Composition of Transfers to LAs by Economic Classification



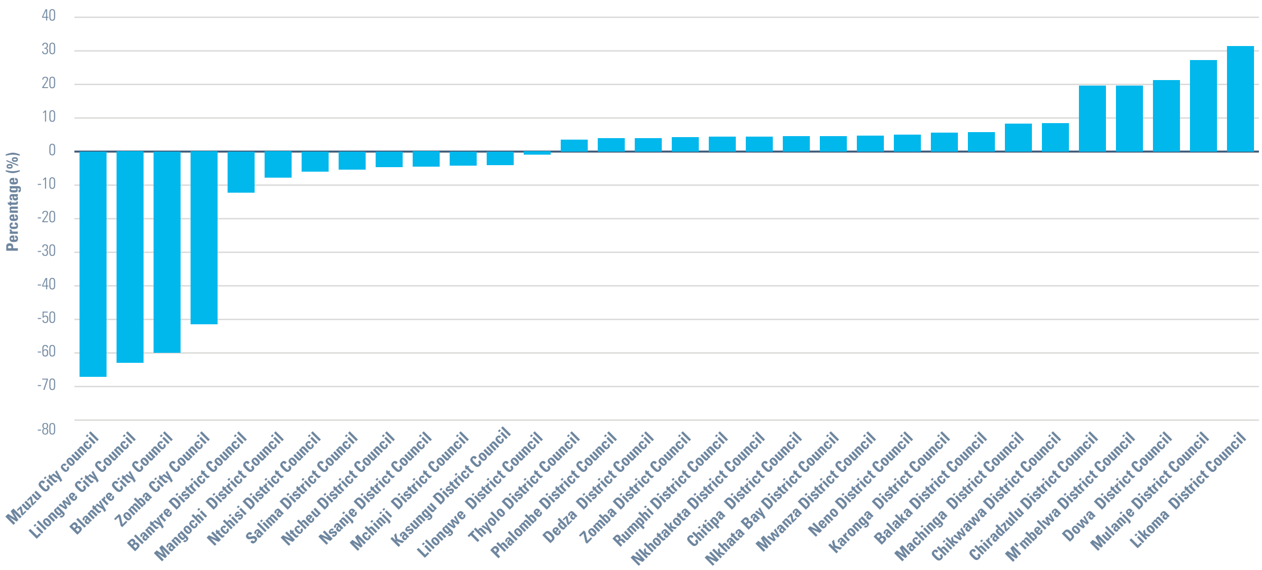
Source: Government Budget Estimates (FY2016/17 to 2019/20)

FIGURE 4 ORT and Capital Transfers to LAs vs. IGFTF 2002 Committment (5%)



Source: Government Budget Estimates (FY2016/17 to 2019/20)

FIGURE 5 Changes in Per Capita Transfers to LAs (FY2018/19 - FY2019/20)



Source: Government Budget Estimates (2019/20) Ministry of Finance

8. BUDGET FINANCING

In the current year, revenues and grants are expected to increase by a remarkable 40.5% in nominal terms[14]. The growth in revenues and grants for FY2019/20 is equivalent to twice the growth rate in total expenditure of 20.1%. Projected revenues and grants stand at 29.9% of GDP up from 21% of GDP in FY2018/19, and are expected to cover 91% of total expenditures, which is considerably higher than the 78% coverage of FY2018/19. With these estimates, the Government project the fiscal deficit to narrow from 6.5% of GDP in 2018/29 to just 2.5% in 2019/20. However, these estimates appear to be overly-optimistic considering that outturns of revenues and grants have consistently fallen below target for the past five years.

Domestic revenues (tax and non-tax revenues) is projected to increase by 37% from revised estimate of MK1.037 trillion in FY2018/19 budget to MK1.425 trillion. As a percentage of total revenues and grants the share of domestic revenue is also expected to increase by 6% from 84% to 90%, and to cover 82.3% of total expenditure. However, over the last five years, domestic revenue underperformed by an average of 2.1% and grew by only 9.6% in FY2018/19.

Tax revenue alone, which is the major source of finance for the Government, is projected to grow by 39.9% (MK390.6 billion) to MK1.36 trillion. The growth rate in tax revenue is a remarkable increase from revised estimates of MK978.7 billion in 2018/2019 to MK 1.369 trillion. Relative to GDP, tax revenue is at 26% up from 18% last year. Actual tax to GDP ratio averaged 18% between FY2014/15 and FY2018/19. Malawi's average tax to GDP ratio (16%) was lower than the SADC average for the period 2014-2017[15] as shown in Figure 6.

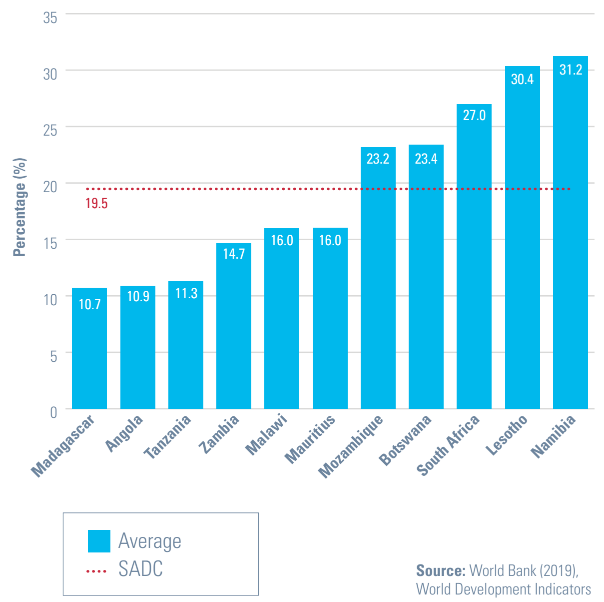
Non-tax revenues[16] are projected to decline by 3.6% from revised estimates of MK57.9 billion in 2018/2019 to MK55.8 billion in the current financial year as shown in Figure 7. Notably, a reduction in parastatal dividends by 45.8% is the main driver behind the decline. Non-tax revenue now contributes only 3.9% of total domestic revenue and covers just 3.2% of total expenditures. With an exception of FY2014/15 and FY2017/18, non-tax revenue has largely underperformed.

14 In 2019/20, the Government introduced measures to enhance revenues, such as carbon tax on motor vehicles, increase in withholding tax on rental incomes from 15 to 20%, reduction in export allowance for non-processed traditional exports from 25 to 20%.

15 Tax to GDP ratios from the World Bank differ from those reported by the Ministry of Finance.

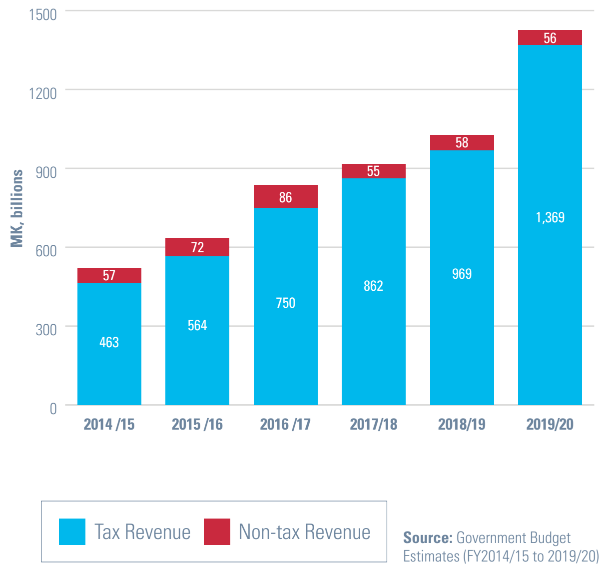
16 Comprise of Departmental Receipts, Receipts from parastatals, Storage Levy, and Road Tax

FIGURE 6 Average Tax to GDP Ratio of SADC Countries (2014 – 2017)



Source: World Bank (2019), World Development Indicators

FIGURE 7 Trends in Domestic Revenue (FY2014/15 – FY2019/20)

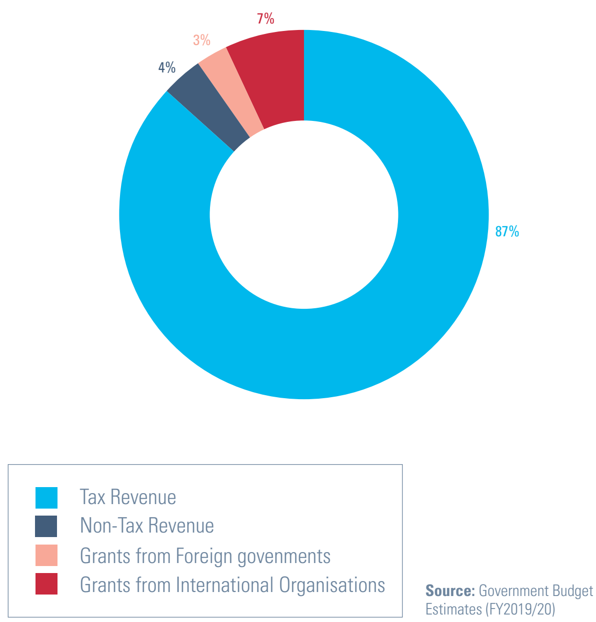


Source: Government Budget Estimates (FY2014/15 to 2019/20)

On-budget support by donors is expected to constitute 10.5% of total revenue as shown in Figure 8, and 8.7% of total expenditure. Grants are projected to increase by 10% (MK13 billion), from revised estimates of MK137 billion in the FY2018/2019 budget, on account of a surge in capital grants which have leaped by 60.5%. However, preliminary outturn for FY2018/19 budget indicates that some of the committed grants were not disbursed, most notably MK60 billion from the World Bank. Some key sectors for children remain heavily dependent to donor resources. In the health sector for instance, 85% (MK20.9 billion) of the 2019/20 development budget is expected to come from donors, with the remainder (MK3.7 billion) expected to come from Government. Donors are funding 93% (MK34 billion) of on-budget social protection programs.

Considering that Malawi is amongst the least developed countries in the world, in the short-to medium term, donor support, whether pooled or discrete, will continue to be important. There is therefore need to ramp up support from donors in order to increase investments in critical social sectors. The Government can also leverage other international financial resources such as the Global Partnership for Education Fund, the Global Financing Facility (GFF) for Reproductive, Maternal, Newborn, Child and Adolescent Health (RMNCAH) or the Green Climate Fund.

FIGURE 8 Composition of Government Revenue (2019/20)



Source: Government Budget Estimates (FY2019/20)

Some key sectors for children remain heavily dependent to donor resources. In the health sector for instance, 85% (MK20.9 billion) of the 2019/20 development budget is expected to come from donors.

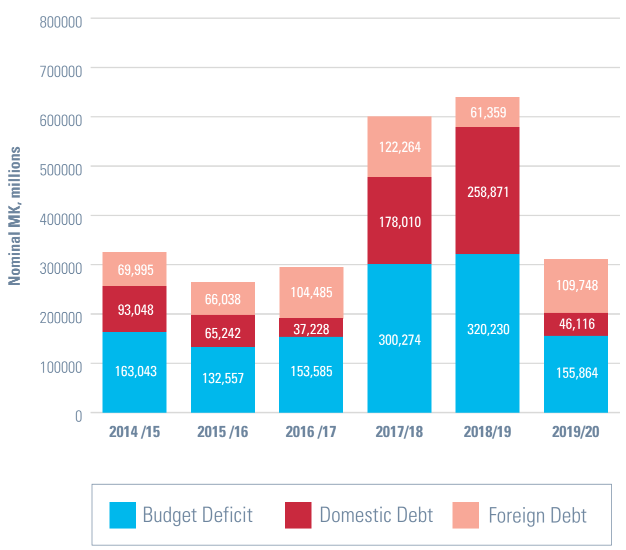
Due to limited domestic revenue, Government resorted to borrowing, with public domestic debt surpassing external debt in recent years. As of June 2019, the total value of public debt stood at 62.8% of GDP[17], its highest level over the past decade. Cumulative external debt increased from 26.5% of GDP in 2012 to 30.2% in 2019. Over the same period, domestic debt surged from 13.8% to 32.6% of GDP. In terms of composition of the deficit financing in FY2019/20, foreign borrowing has increased by 78.9% from FY2018/19 and domestic borrowing reduced by 82.2% from FY2018/19. The spike in domestic debt poses significant risk to Malawi's debt sustainability[18]. In line with these worries, the Government planned to reduce Government borrowing to reduce by 51.3% to MK155.9 billion in FY2019/20 from MK 320.2 billion in FY2018/19, after two years of continued increase. However, achieving these targets will largely depend on revenue outturns and expenditure decisions that the Government implements during the fiscal year.

17 World Bank (2019). Malawi Economic Monitor December 2019.
18 According to the "Guidance note on the Bank-Fund Debt Sustainability Framework for Low Income Countries", public borrowing is deemed to be sustainable when it has not gone beyond 50% of GDP with domestic borrowing not more than 20% of GDP and external borrowing not exceeding 30% of GDP.

KEY TAKEAWAYS

- The overly-optimistic revenue projections may pose a risk to budget implementation and could lead to a higher deficit due to increased domestic borrowing.
- Stronger fiscal discipline is required to avoid excessive debt accumulation and expand fiscal space.

FIGURE 9 Trends in Annual Debt Structure and Deficit



Source: Government Budget Estimates (2019/20)

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