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Sustainability of external debt on Malawi's import cover – Considerations for Malawi's Vision 2063

By

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Abstract

Malawi is currently relying on external debt to cushion its forex reserves and support country's import cover. This is unsustainable in medium to long-term and World Bank has already expressed concerns on this matter. Malawi's debt stress levels are currently at high levels but the country is expected to borrow heavily from external sources to support bankable and flagship projects running from 2021 through 2030 under MIP-1 which is a ten-year medium strategy of Malawi's Vision 2063. There is need to find reasonable export strategies to boost export proceeds but at the same time reduce massive illegal externalisation of forex to give MIP-1 a better chance of success.

Type of Paper: Conceptual Paper

Key words: External; Debt; Malawi; Forex

1.0 Introduction

Malawi is dogged by perennial forex shortage which is blamed on trade imbalance as the country is known to be a predominantly importing economy. The National Export Strategy II (2021:14) summarised:

[Malawi is a net importer and suffers chronic trade imbalance to the scale of an import to export ratio of more than 3:1 in 2019.

… Total imports for 2019 - USD2,941,148,000].

2.0 How does Malawi manage to pay for imports?

Kumwembe (2022) posed the same question and then stipulated that development partners remain key in supporting the country's forex situation with grants expected to be USD320 million in the 2022/2023 fiscal year representing 2.8 percent of the GDP. World Bank (2018:6) provided a better picture of Malawi's overdependence on aid as follows:

[Malawi is heavily dependent on donor aid, averaging at over US$ 1 billion per annum, between 2010 and 2015 (WDI, 2017), which equates to about US$60 per capita each year in official development assistance (ODA), compared to around US$50 in SSA as a whole. The most recent withdrawal of (on-budget) donor support, following the 2013 public finance management scandal known as "cashgate", put heavy strains on government finances as the budget deficit rose from almost 2 to 6 percent of GDP (Government of Malawi, 2014a). The lack of predictable

and stable aid flows has also further undermined the commitment capacity of the government, and the ability to effectively prioritize and execute budgets.]

World Bank (2022) shows that Malawi has not improved on its heavy reliance on external financing as presented below:

[Historically, Malawi has financed its trade deficit primarily with transfers from abroad and through debt (…). Between 2017 and 2021, Malawi needed US$9.4 billion to finance its trade deficit and US$1.3 billion to fund its negative primary income. During the same period, it received US$2.8 billion in current transfers (secondary income), which helped finance consumption expenditure. Only 14 percent of these transfers were received by the Government, while 29 percent represents remittances, and the rest represents other transfers to non-government enterprises such as NGOs. In addition, Malawi attracted US$4.4 billion in transfers for capital expenditure. Most current transfers (86 percent) and capital transfers (77 percent) went to private enterprises rather than the Government. The remaining US$2.9 billion was largely financed through public sector debt and a decrease in reserve assets.

Financing volatile imports with transfers and debt is risky, especially now given Malawi's low level of reserve assets.]

World Bank (2022:28) provides a gloomy picture of Malawi's debt which receives little attention in the local press and amongst elite Malawian economists:

[Malawi's debt has become unsustainable. The November 2021 IMF – World Bank DSA indicates that Malawi's external and public debt are both at high risk of debt distress and that debt is unsustainable (IMF and World Bank, 2021). The stock of public and public-guaranteed debt increased to 59 percent of GDP8 in 2021, up from 55 percent in 2020. This was driven by increased uptake of both domestic and external debt (…). Financing of government fiscal deficits using high-cost domestic borrowing continues to drive domestic debt on an upward trajectory (…). Consequently, this has also been driving domestic debt service upward, increasing the fiscal burden from payments on both interest and principal. The change in definition of external debt from a currency to a residency basis and the conversion of RBM short-term reserve liabilities to medium-term external debt have seen total external debt increase to 32.9 percent of GDP in 2020 — the highest level since debt relief under the Highly- Indebted Poor Countries Initiative in 2006. RBM uptake of medium-term debt on non-concessional terms has also increased the debt-servicing burden from external debt.

The composition of external debt shifted toward non-concessional debt from regional development banks, while commercial banks remain the highest holder of domestic debt. The share of external debt held by multilaterals on concessional terms at end-2020 has been revised downward to 58.9 percent, from 80 percent reported in the September 2020 IMF – World Bank report (IMF and World Bank, 2020). Regional development banks held 29.5 percent of the external debt in 2020, while the remaining 11.5 percent was held by official bilateral lenders. High interest rates associated with debt from regional development banks have resulted in an increased

external debt-servicing burden. Uptake of domestic debt by the RBM has increased, but bank and non-bank private financial institutions remain the largest holders of domestic debt, and were owed 75 percent of the total domestic debt stock as of December 2021.].

Government of Malawi (2021b:4) provides possible explanation in increase in external debt as follows:

[During the first six months of 2020/21FY, the increased external debt stock is mainly attributed to loan disbursements made to cushion the economy from the effects of COVID-19 pandemic. Notably, the IMF disbursed US$101.96 million under the Rapid Credit Facility. In addition, the ADF provided US$24.48 million as direct budget support. IDA disbursed US$120.28 million under various projects. Likewise, EXIM Bank of China registered significant disbursement under the newly contracted loan –National Fibre Backbone Phase II.].

Government of Malawi has increased external debt in the 2022/2023 fiscal year with USD60 million from World Bank to rehabilitate the damaged Kapichira Hydro Power Station due to Cyclone Ana in January 2022 knocking off over 100 megawatts from the national power grid.

3.0 Malawi's import cover

The current forex monthly cover for Malawi is USD 250 million as revised from USD209 million since July 2021 – Mzale (2021). The annual forex cover is thus USD3 billion which is adequate to cover for import of goods

only leaving out imported services, interest payments on external debts and principal repayments. Remittances from abroad, external debt and transfers to non-governmental organizations have been the primary source for financing the foreign bills but what is not certain is the reliability of the outstanding forex figures at any given period of time considering the fact majority of imports and exports are done on credit basis. It is therefore more likely that the current monthly import cover of USD250 million might be on the lower side as evidenced by scarcity of forex because it is wiped out in the high street banks and indeed abundant in the thriving black market where the exchange rates are quite high.

Relying on the external debt to prop up import cover is a poor financial management policy as short-term expenditures are being financed by long-term financing and liquidity problems are likely to ensue if the credit rating on Malawi's debt is downgraded further.

4.0 Vision 2063 and Malawi's Import Cover

Government of Malawi operationalised The Vision 2063 through First Year 10 –Year Implementation Plan known as MIP-1 running from 2021 through 2030. Government of Malawi (2021a:40) annotated:

[On economic governance, the country is targeting to have a stable macroeconomic environment with a minimum of 6 months of import cover by 2030, from around 3 months in

2020.].

Critical review of the MIP1 does not clearly stipulate how the import cover would be doubled by 2030. There are however several strategies and interventions related to the subject matter as follows:

a) Develop a National Import Substitution Strategy (NISS) between 2022 and 2024 to be spearheaded by ministry responsible for trade.
b) Enhance exports so as to reduce trade deficit from projected USD2.297 billion in 2022 to USD0.400 billion in 2030. This in part to be achieved through mining activities of uranium, niobium, gold and gemstones to support the inclusive wealth creation and self-reliance agenda. It is envisaged that share of mining to GDP will increase from 0.8 percent in 2020 to 10 percent in 2030 which will be achieved by establishing mining parastatals, mining regulatory authority and structured markets for strategic minerals.

There will be need for commitment and political will to be able to realise both the import substitution strategies and export enhancement drive.

5.0 Vision 2063 and external debt

Government of Malawi (2021a:xiv) annotates:

[Financing of MIP-1

The Government will strive to finance its development programmes primarily by itself by initially tapping on innovative financing sources, both internal and external. Combining both traditional and non-traditional sources of financing, the focus will be on securing financing towards catalytic investments which will help the country to generate its own domestic revenue. Such sources include external grants, sustainable domestic and international debt, PPPs and other regional and international financing mechanisms.

… During the implementation of MIP-1, Government's preference for development aid is grants and concessional loans, with the latter only contracted for projects with high rates of return and huge multiplier effects as part of accelerating our development agenda.]

Government of Malawi (2021:162) projected possible arrangement to facilitate fiscal guarantees towards bankable projects requiring huge investments that can be financed through external loans between 2021 and 2030 to the tune of MWK206.810 billion (about USD276 million based on the exchange rate of MWK749.53 used in the projections). The flagship projects were estimated at MWK5.139 trillion (USD6.856 billion based on exchange rate of MWK749.53) for a period of between 2021 and 2030. Most of the materials would have to be imported and would significantly drain country's already depleted reserves and therefore external debt would be the most viable means of financing those projects. With the twenty

five percent devaluation of the Malawi Kwacha in May 2022, the projected costs of the flag ship projects in the local currency are significantly off track and unless Malawi can generate substantial forex reserves through increased exports and or significant reduction of the massive illegal forex externalisation, both the bankable and flagship projects under the MIP-1 of the Vision 2063 will be reduced to ideas on paper with little to show on the ground. Alternatively, the development projects (both bankable and flagships) can be implemented with massive external debt either as sovereign or private with significant distortion of the country's economy with costs of projects outweighing any possible benefits.

6.0 Vision 2063 and Public Finance Management Act

Public Finance Management Act 2022 repealed the Public Finance Management Act 2003. The Debt Retirement Fund was listed in MIP-1 as part of Reduced National Debt Strategies. This does not however appear to be case with the Public Finance Management Act 2022 as it is simply a tool to collect funds committed for debt repayment.

Section 72 of the PFMA 2022 talks about Annual Borrowing Plan which is meant to guide planned borrowing operations for the year, borrowing instruments to be used and the indicative timing of the borrowings. This is a good start point but it is desirable that borrowing

must be tied to the fiscal budget through estimates of resources which Government can realise over a given period of time like the case in the United States of America where there is a debt limit which can be increased or decreased through appropriate Act of Parliament. Vision 2063 should influence the provision of debt limit in the Public Financial Management Act (PFMA) so as to prevent Government of Malawi from excessive borrowing both in external and domestic debt which otherwise can lead to unbearable tax rates on its citizenry.

Section 74(e) of PFMA 2022 stipulates that in the case of external debt, Parliament must consult Reserve Bank of Malawi in accordance with Section 42 of the Reserve Bank of Malawi Act. This is to do with terms and conditions relating to interest, fees and maturity. Section 75 and Part II of Third Schedule deals with matters related to raising loans in foreign currency. The foreign currency loans have enormous exchange risks which can greatly affect the Government of Malawi's financial resources especially whenever devaluation and depreciation of the Malawi Kwacha against major trading currencies is concerned. It might be prudent to create an Escrow at Reserve Bank of Malawi so that at least 5 percent of all the export proceeds and remittances coming to Malawi should be reserved for payment of interest and principal repayments wherever applicable. Government of Malawi (2021:189) projected a reduction in the Debt to GDP Ratio

from 61 percent in 2019 to 56 percent in 2030. The massive devaluation of the Malawi Kwacha which is significantly far from the projected MWK749.53/USD in 2022 to actual rate of MWK1,200.00/USD might mean that the Debt to GDP Ratio might not be achievable unless new ways of boosting country's GDP are pursued amidst hostile international economic catastrophes attributable to war in Ukraine, food shortage due to weather related phenomena and rising oil prices.

7.0 Conclusion and recommendations

External debt appears to be much easier to procure than rolling out projects to generate export products. Malawi's economy is thus being plagued with unsustainable levels of external debt and might default soon or later if no proper fiscal policies are put in place. There is need to enhance monitoring and evaluation mechanisms for external debt financed project to ensure that the intended outcomes are achieved because there are some external debts whose projects failed to take off despite draw down of the substantial chunk of the foreign currency loans.

Vision 2063 through its medium term strategy dubbed MIP-1 appears to be projected on very ambitious and unattainable targets considering the pressure of the earmarked developmental projects on the country's meagre forex reserves. It is not too late to go back to the drawing board to determine how bankable and flagship

projects can be financed through specific export proceeds ring fenced/locked up for particular project under legislation instrument for fiscal and financial management compliance.

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