

Rebalancing Fiscal Policy for Economic Stabilization and Growth

Introducing the
Malawi Public Finance Review



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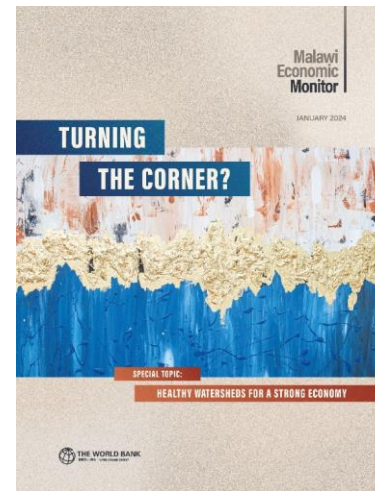
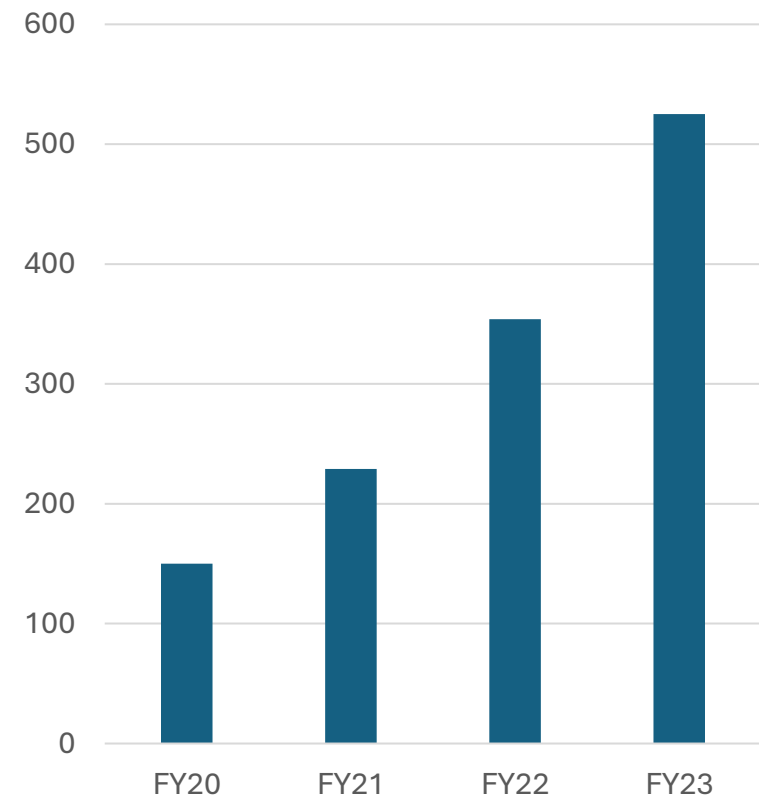
What does the World Bank do in Malawi?

The World Bank Group is a global partnership of five institutions focused on creating a world free of poverty on a livable planet.

Malawi joined the World Bank in 1965 and is one of 189 member countries.

Our focus is on financing Malawi's priority development projects (including budget support), analytics and knowledge development, and catalysing collective action.

In response to recent economic challenges, World Bank investment in Malawi has increased significantly (in million USD)



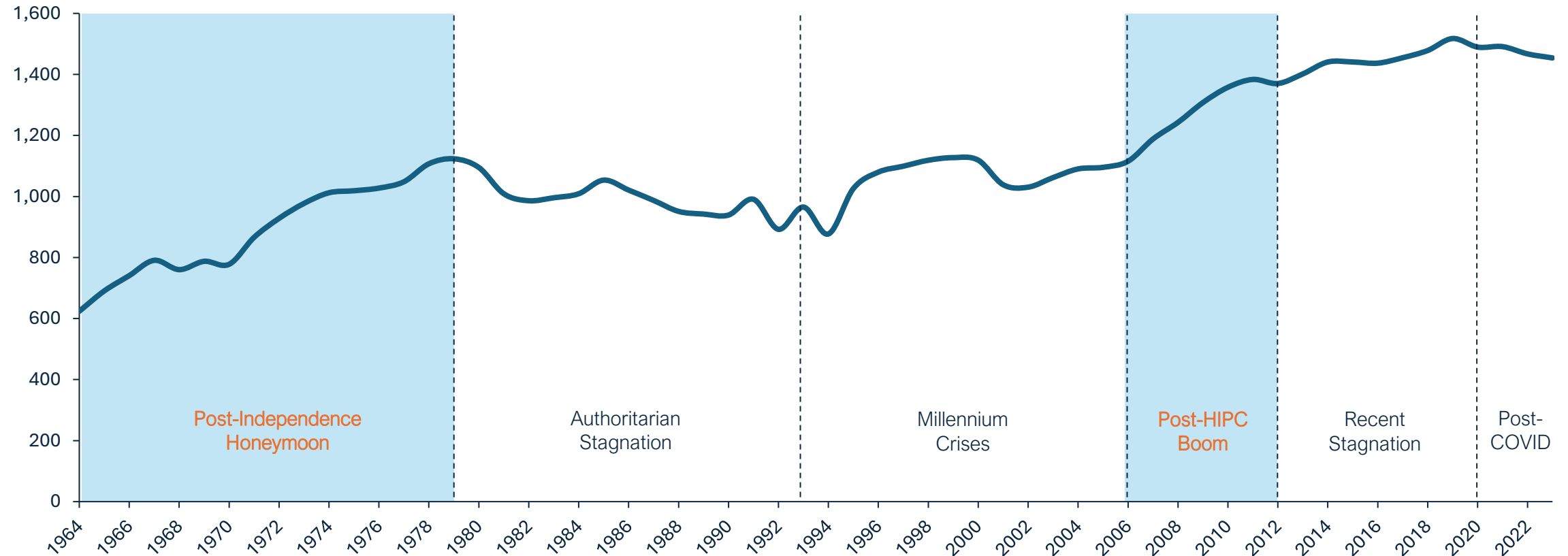
Overview of Presentation

1. Rising fiscal imbalances and Malawi's development aspirations
2. What caused Malawi's fiscal crisis?
3. The new "Malawi Public Finance Review": what is it and what is it trying to accomplish?

The elusive quest for sustained, long-term growth

Despite periods of acceleration, Malawi's economic growth has not been transformational

GDP per capita in 2017 constant US\$ purchasing power parity

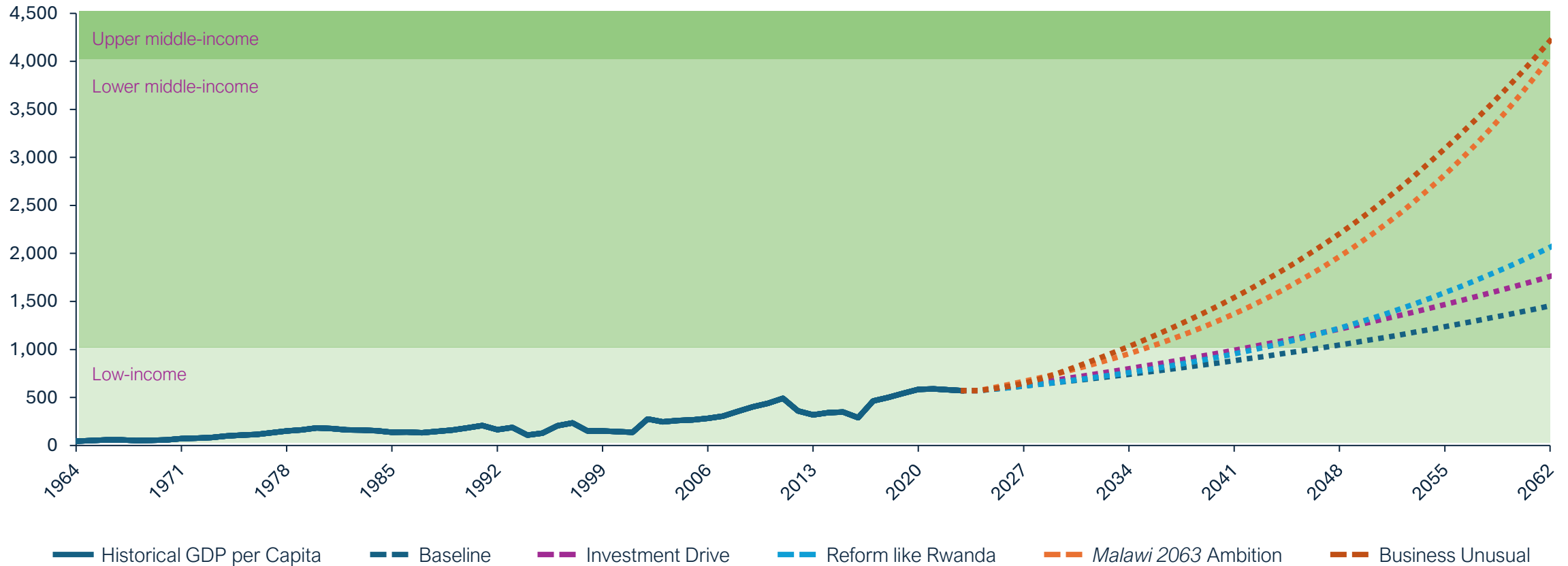


Source: World Bank World Development Indicators (1990 – 2021), staff calculations based on World Bank Macro-Poverty Outlook (10/2023), and staff calculations based on Maddison Project Database 2020 (1964 – 1989).

What does this mean for the *Malawi 2063* goals?

The Long-Term Growth Model illustrates scenarios of Malawi's potential future

Real 2018 US\$ per capita

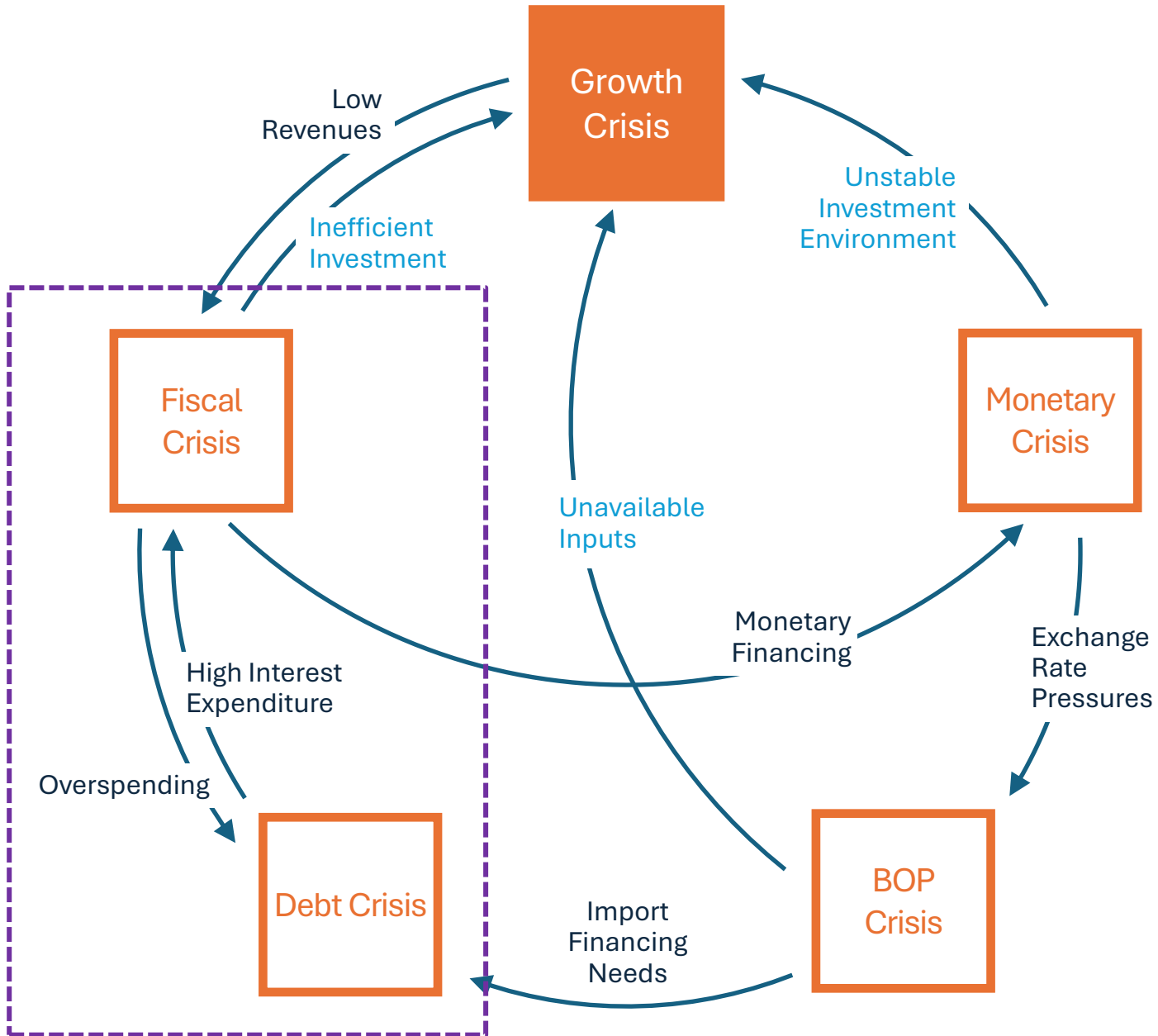


Source: World Bank analysis using the LTGM.

Macroeconomic stabilization is central to driving growth

Malawi's macroeconomic challenges are interconnected. Resolving the fiscal crisis is critical to support Malawi's medium and long-term growth.

Sound fiscal management can enhance Malawi's resilience to external shocks, ensuring macroeconomic stability.





The Fiscal Policy Accelerator

Some fiscal acceleration is needed to reach development goals

- Developmental fiscal policy was a key ingredient of every sustained economic growth episode

Exceptional circumstances may warrant additional fiscal acceleration

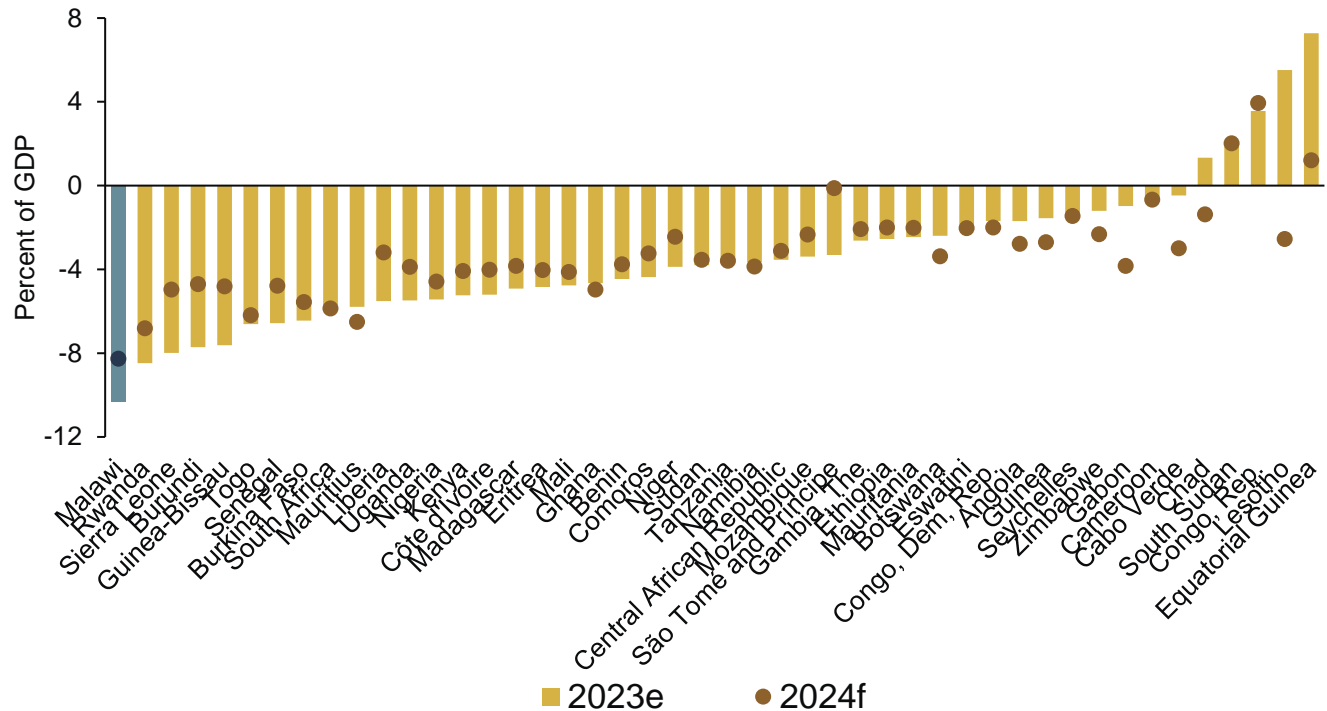
- Faced with the COVID shock, most governments rapidly expanded expenditure
- But to support development, fiscal acceleration needs to support the right policies and programs (more expenditure does not always lead to more growth – e.g. AIP scale-up)

Fiscal acceleration has a tipping point

- Most episodes of sudden macroeconomic collapse were driven by irresponsible fiscal policy – e.g. Lebanon, Zimbabwe

The state of fiscal acceleration

Malawi is again on the path to have one of the highest fiscal deficits in Sub-Saharan Africa



- Malawi is on track to have the highest fiscal deficit in Africa for the second time in a row in 2024.
- FY2023/24 expenditure and fiscal deficit outturn was higher than both approved and mid-year budgets driven by slippages across expenditure lines and by RBM recapitalization.
- The approved FY2024/25 budget shows a lower deficit, but relies on significantly improved revenue performance and expenditure discipline.

Source: World Bank (2024)

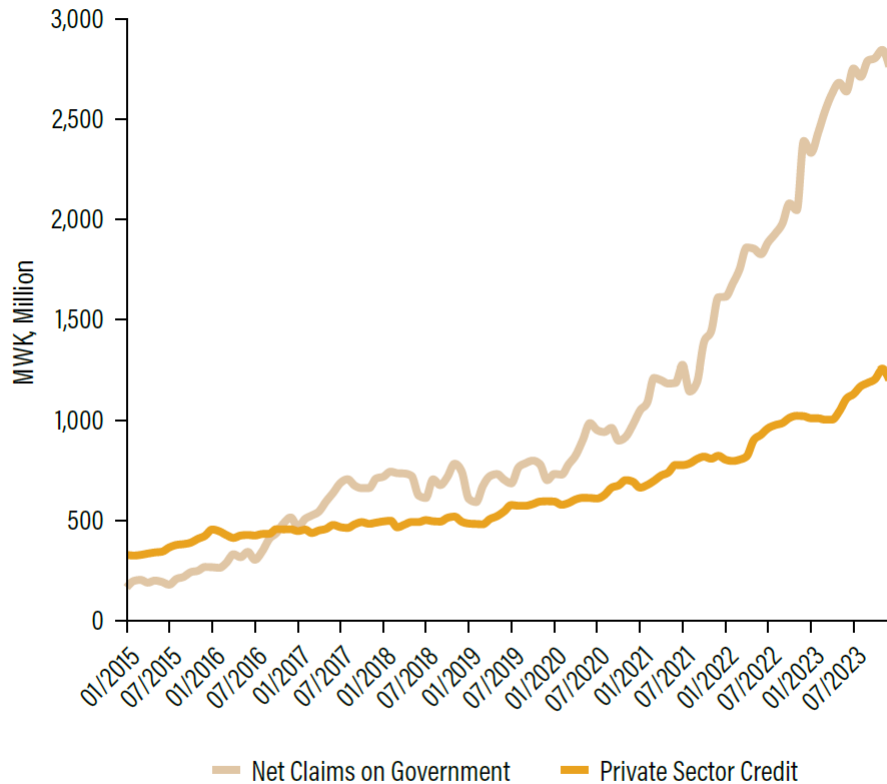
Note: Deficit estimates adjusted from fiscal year to calendar year for comparability across countries. These have been updated for Malawi to include the FY2024/25 approved budget. e indicates estimate, f indicates forecast.

What does this mean for the “real” economy?

Government borrowing is crowding out private sector credit...

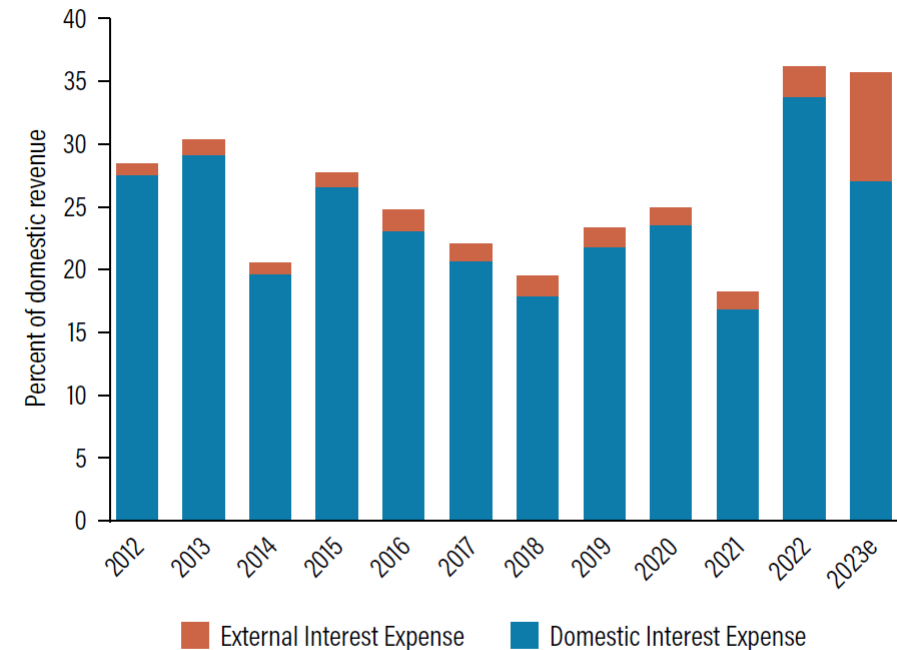
... leaving Government with ever less revenue to use for productive investment

Lending to Government and private sector credit, in MWK million



Source: WB with data from RBM.

Interest expense, as percent of domestic revenue



Source: WB with data from MoFEA.

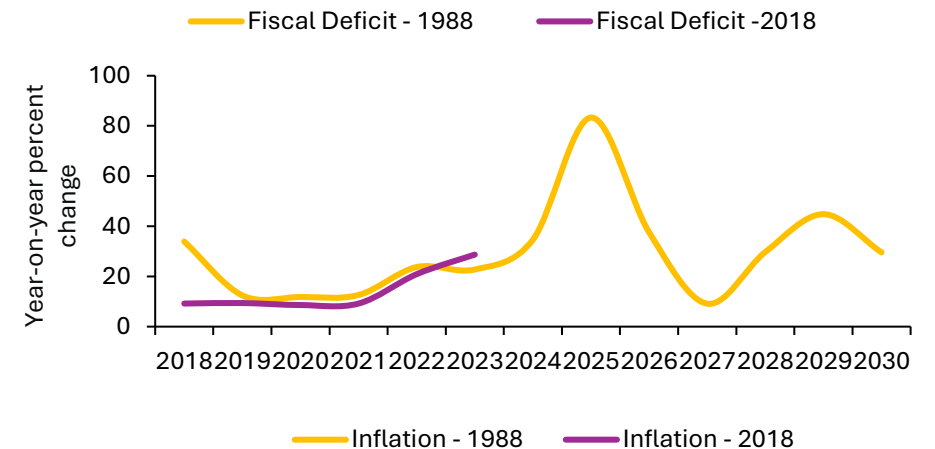
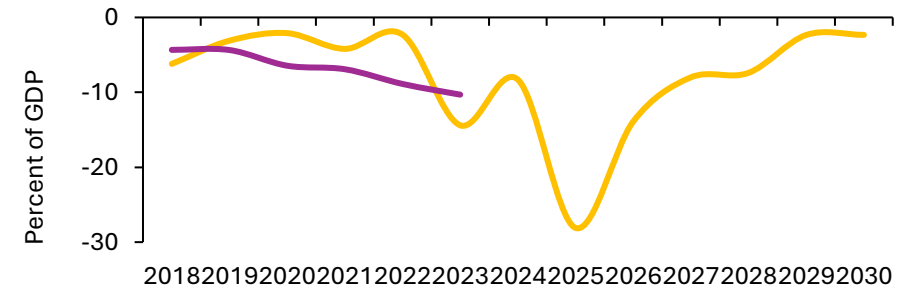
Note: e indicates estimates.

Recent macroeconomic dynamics echo those of early 1990s

Lessons from the early 1990s underscore the risks of failing to address macroeconomic imbalances.

A key lesson from this period is the importance of prioritizing fiscal discipline and addressing macroeconomic imbalances proactively.

Recent macroeconomic trends echo those of early 1990s



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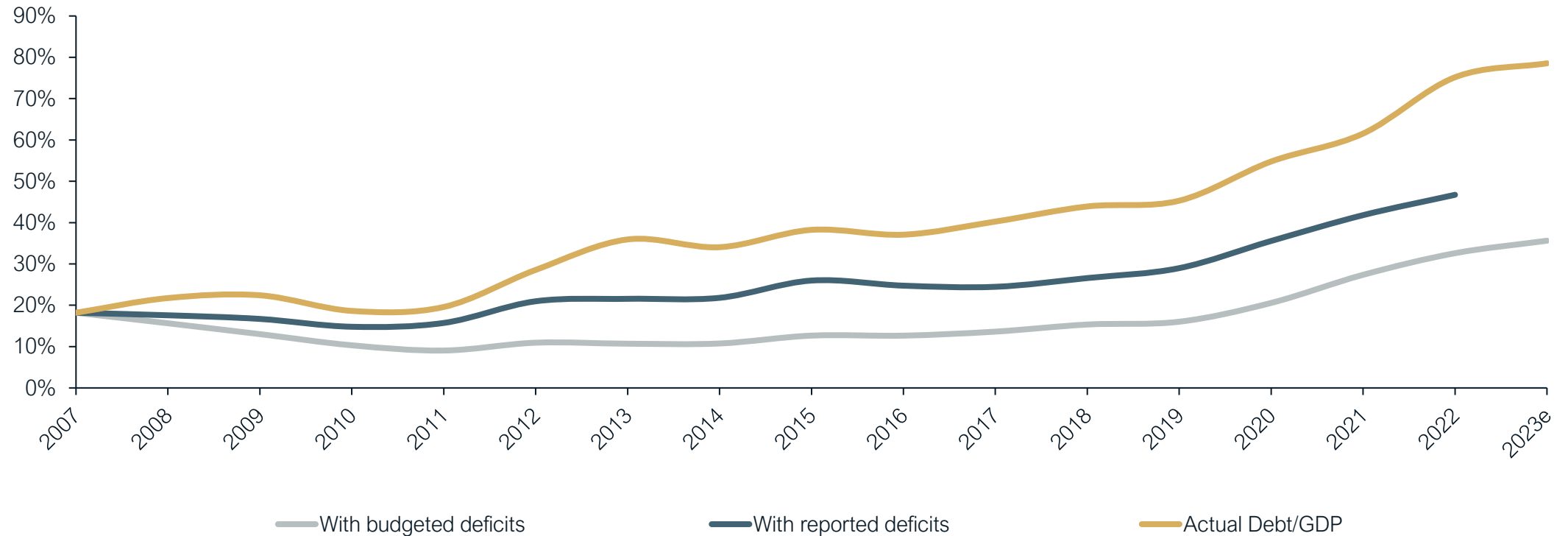
Causes of Malawi's fiscal crisis

- 1. Consistent overspending resulting in unsustainable debt accumulation**

If budgets were adhered to, Malawi's public debt stock would be 50% less

Where does debt come from?

Predicted and actual debt levels as a share of GDP

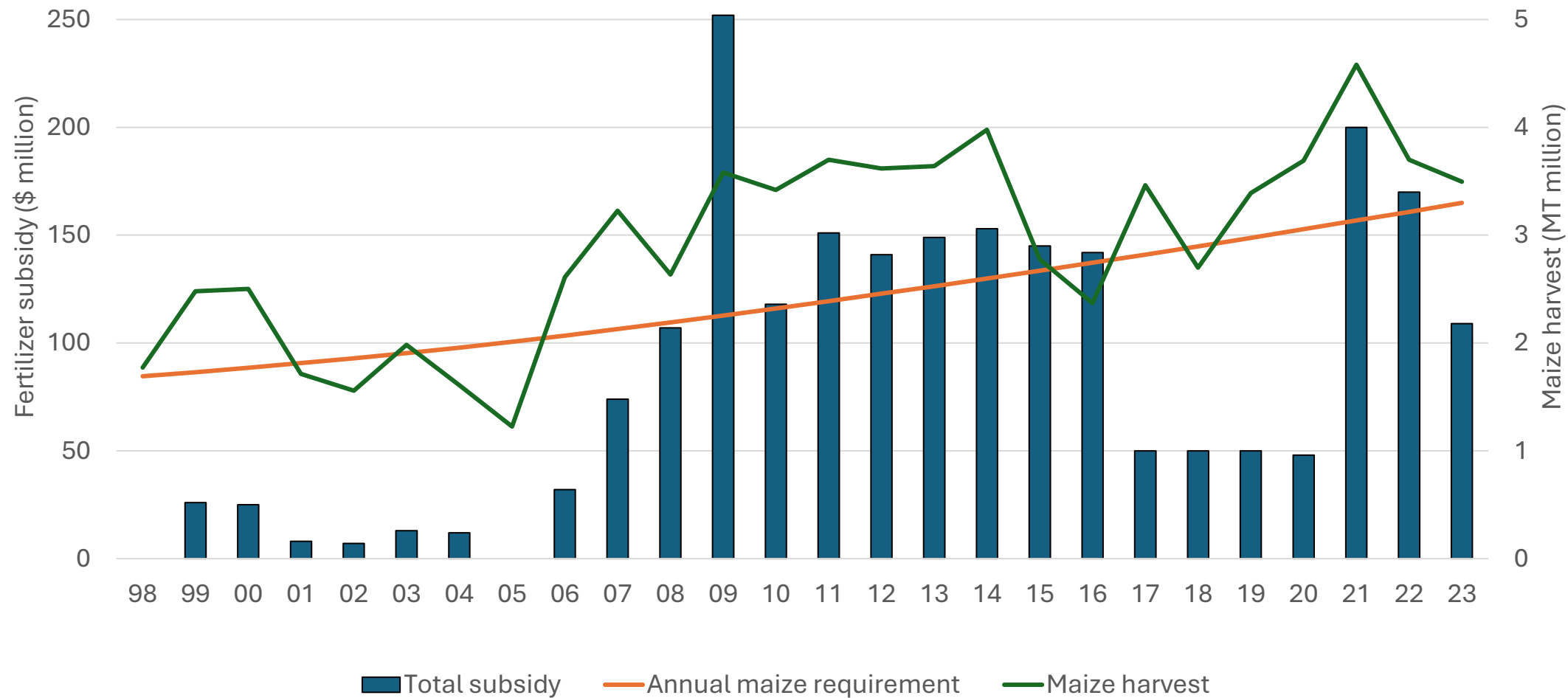


Source: World Bank staff calculation based on MoFEA data.

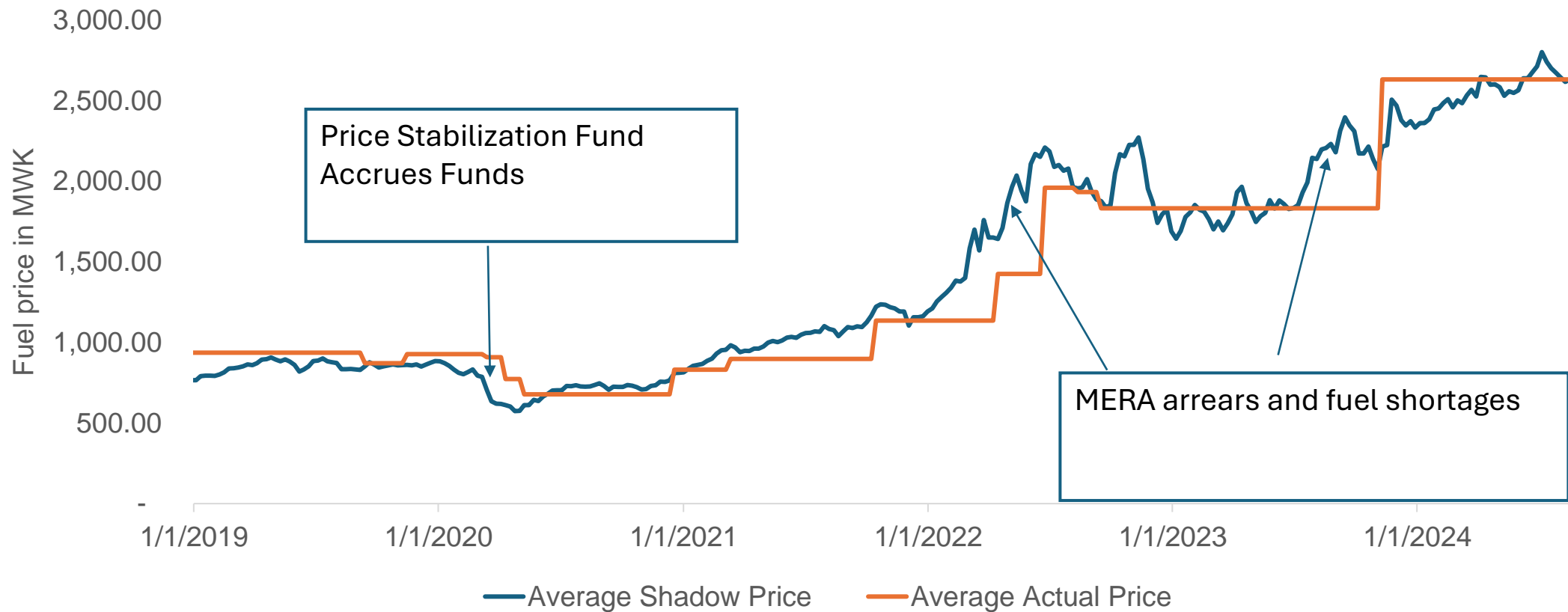
Causes of Malawi's fiscal crisis

1. Consistent overspending resulting in unsustainable debt accumulation
2. **Spending has often been poorly targeted and inefficient**

Expenditure on fertilizer subsidies has had only a weak relationship with maize production



Quasi-fiscal activities further exacerbate fiscal imbalances



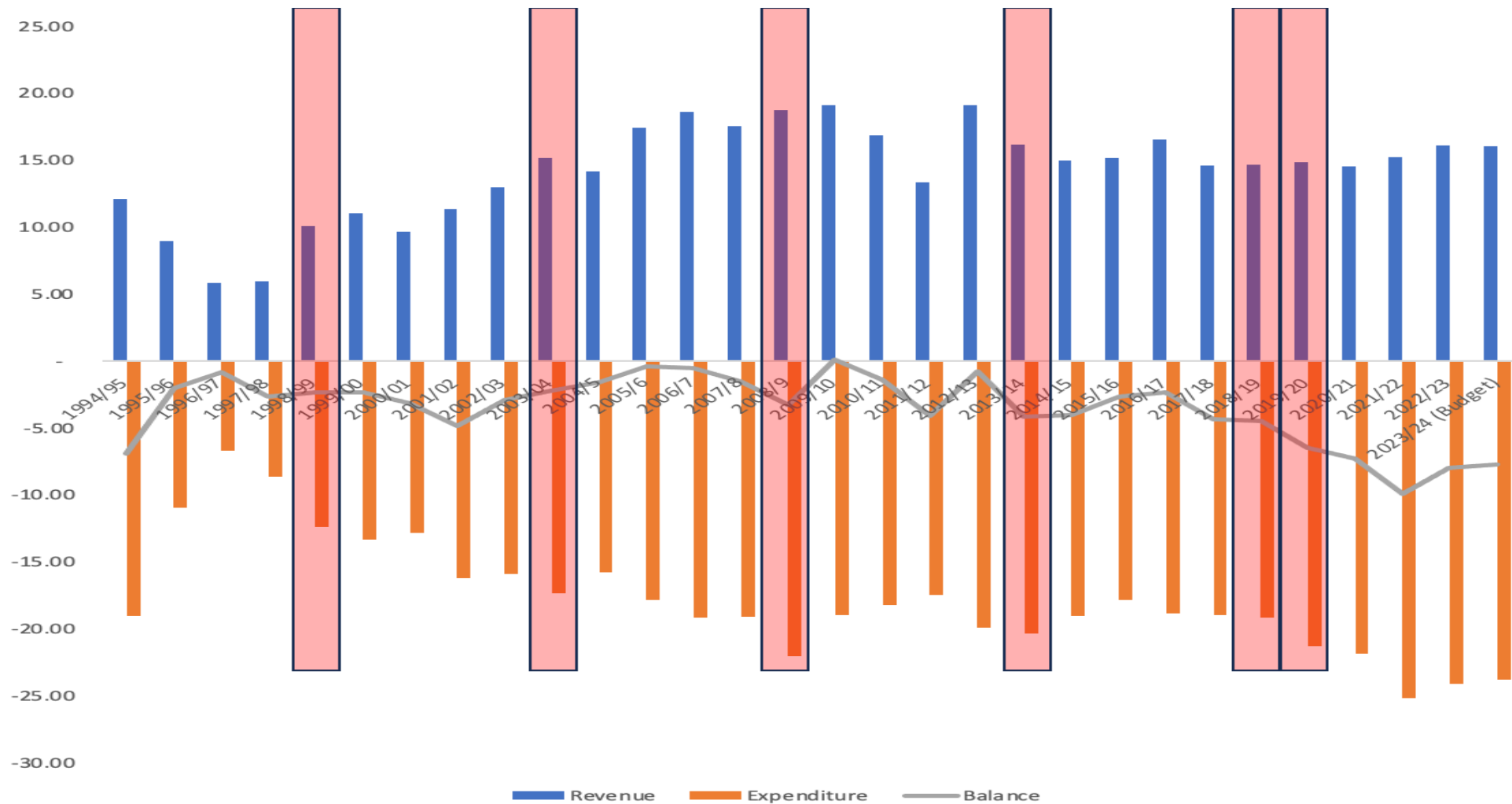
Causes of Malawi's fiscal crisis

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3. **A small revenue base, numerous exemptions, high costs of tax collection and declining grants**

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3. A small revenue base, numerous exemptions, high costs of tax collection and declining grants
4. **This is exacerbated by external shocks and electoral pressures**

Deficits in election years have been 78% higher than the average during the four previous non-election years



Causes of Malawi's fiscal crisis

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Remedying this will require comprehensively reforming fiscal policy and governance.

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New “Malawi Public Finance Review” – Aims and Contribution

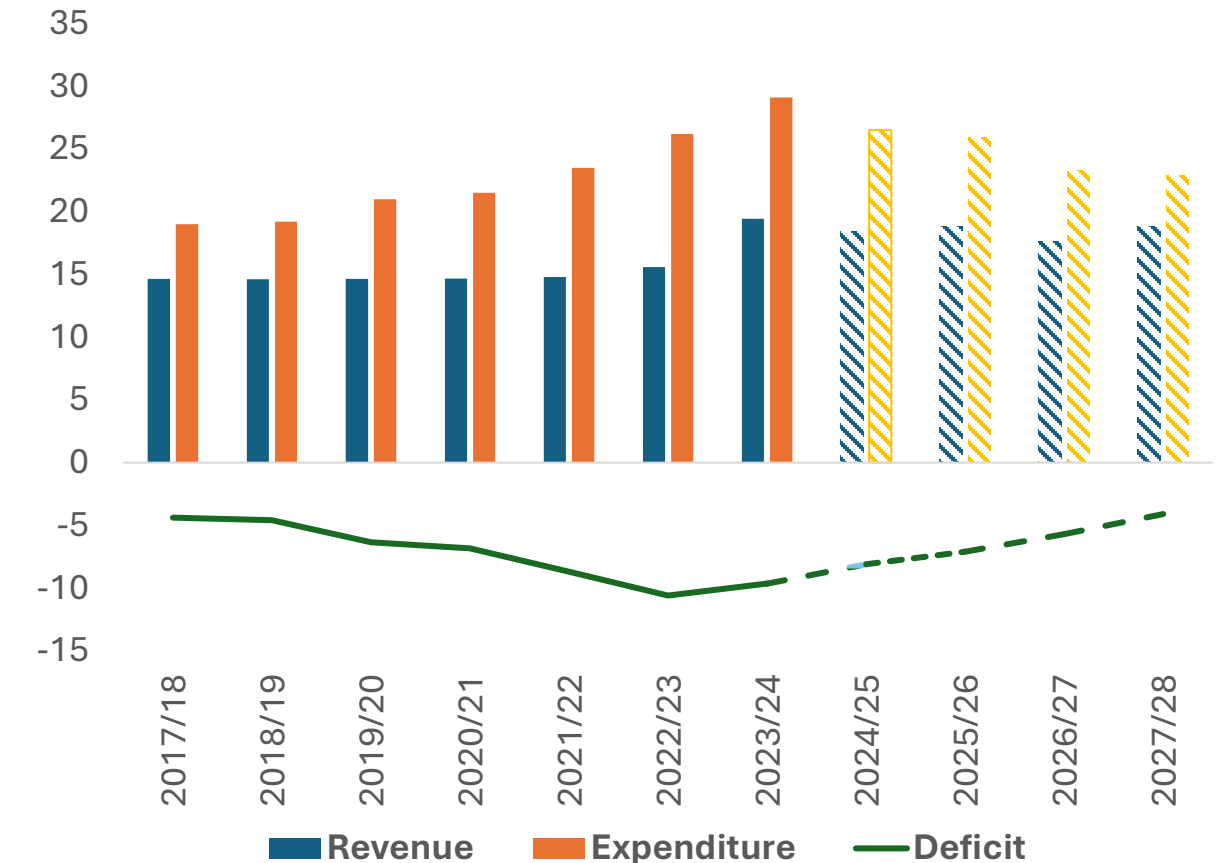
- Expansion of Public Expenditure Reviews to also include focus on domestic revenue mobilisation.
- 2 key aims:
 1. Help Malawian authorities identify and address critical fiscal policy challenges.
 2. Enhance effectiveness of development financing to achieve Malawi’s development goals.

The PFR should serve as comprehensive resource to reform public finances for current and future Government.

- Priority deep-dive issues include mining, local government financing and SOE performance.
- Collaboration with academic institutions, CSOs, and the private sector is not only welcome but desired – especially with the ECAMA community.

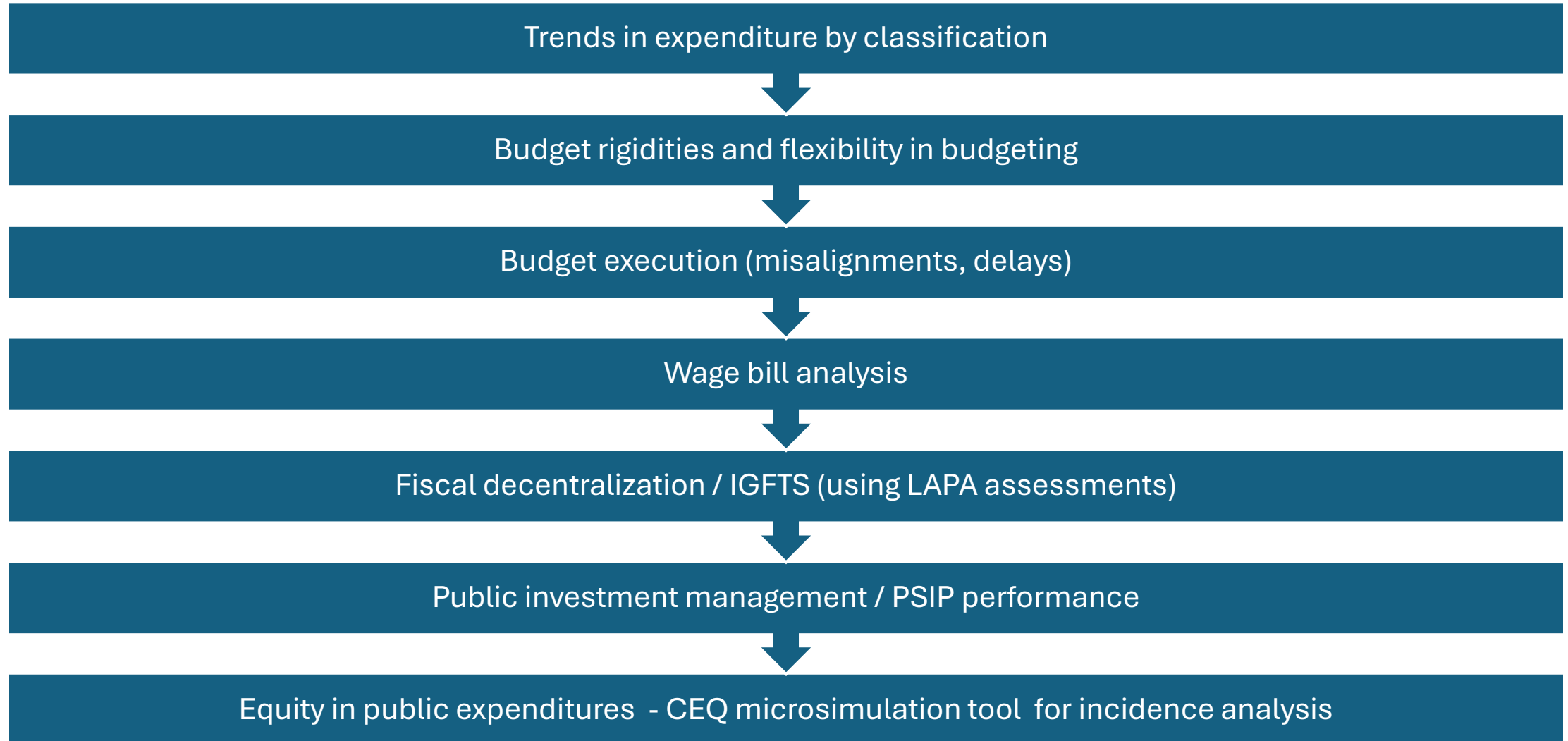
Malawi’s planned fiscal consolidation trajectory under the ECF

Revenues, expenditures and fiscal deficit as a share of GDP



What will the PFR offer?

1. Detailed public expenditure analysis



What will the PFR offer?

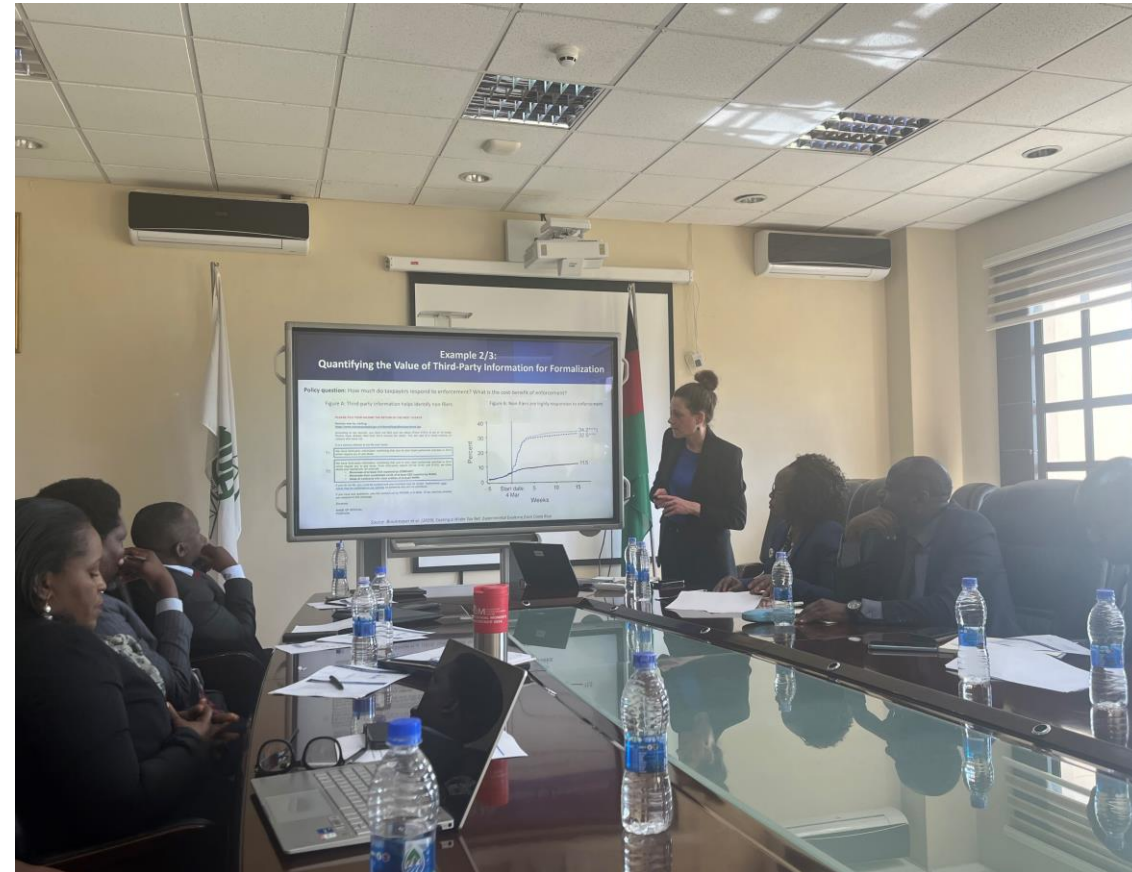
2. Using tax micro data to increase revenue collection

Ongoing collaboration with MRA using tax microdata to help achieve DRMS targets on compliance and increased revenues.

Initial priority areas for analysis

- Increasing benefits from Block Management System and Formalization
- Revenue Implications of Discontinuation of VAT Withholding Scheme

Capacity development for in-house empirical microdata analysis.



What will the PFR offer?

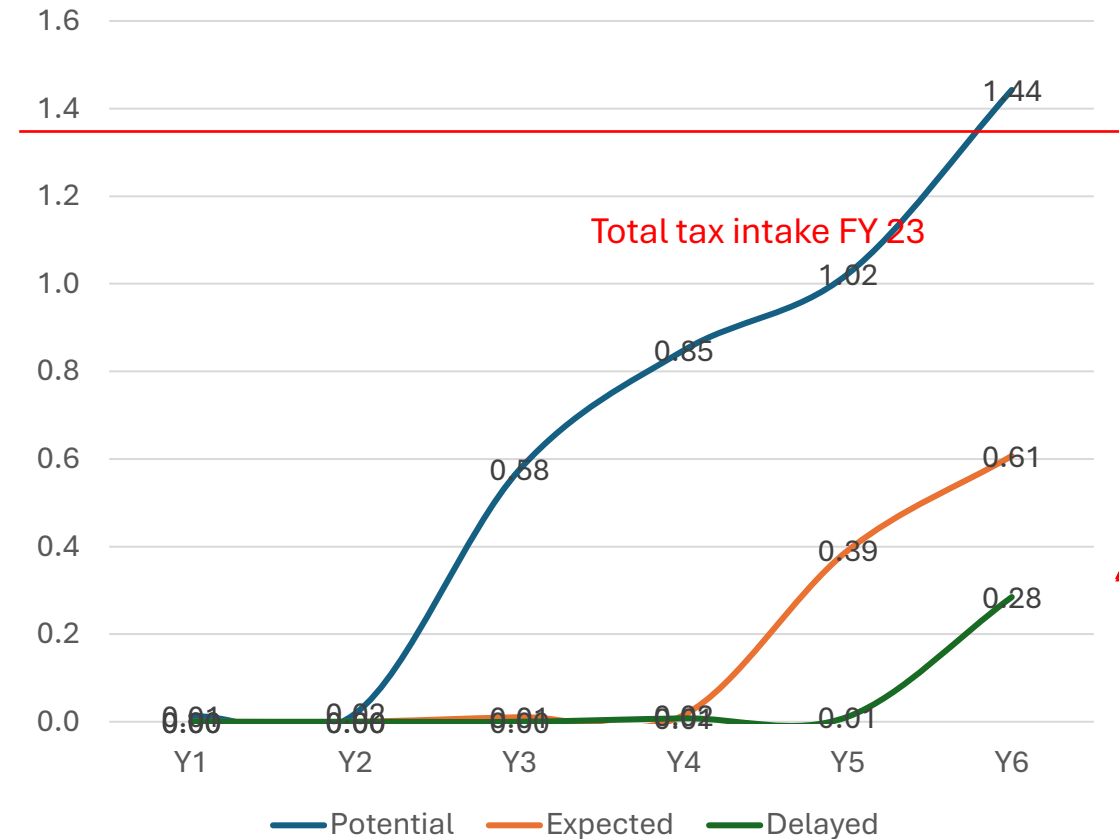
3. Making the most of the coming mining windfall

Seven major projects across the country have good chances to materialize and are concentrated in high-demand energy transition minerals.

Malawi's emerging mining sector presents opportunities for increased exports, foreign exchange generation, revenues and economic growth. This could significantly increase fiscal space over the medium term.

Key decisions are being negotiated right now, and will lock in terms for years to come.

Potential government mining revenue (in US\$ billions by scenario year)



Malawi Public Finance Review – some initial key messages

1. **Public finances are in a precarious state:** Overspending and debt accumulation needs to be controlled urgently - otherwise there is a risk of reaching tipping points.
2. **Implementation > strategies:** Implementing the many announced public financial management reforms and systems under the PFM Act 2022 is necessary for achieving fiscal sustainability.
3. **Managing the potential mining boom:** There is an urgent need to find suitable and transparent revenue management arrangements to ensure high savings and investment and manage pressures for consumption spending.
4. **Exploiting policy innovation:** Use of microdata and impact evaluation methods allows for much more granular and targeted analysis to support fiscal reforms.
5. **Political ownership is central for successful reforms:** Responsible fiscal policy is often also good politics. There is a clear (but narrow) path towards achieving medium-term fiscal targets , but this requires some difficult choices as well long-term thinking and planning, coordination, and clear communication.

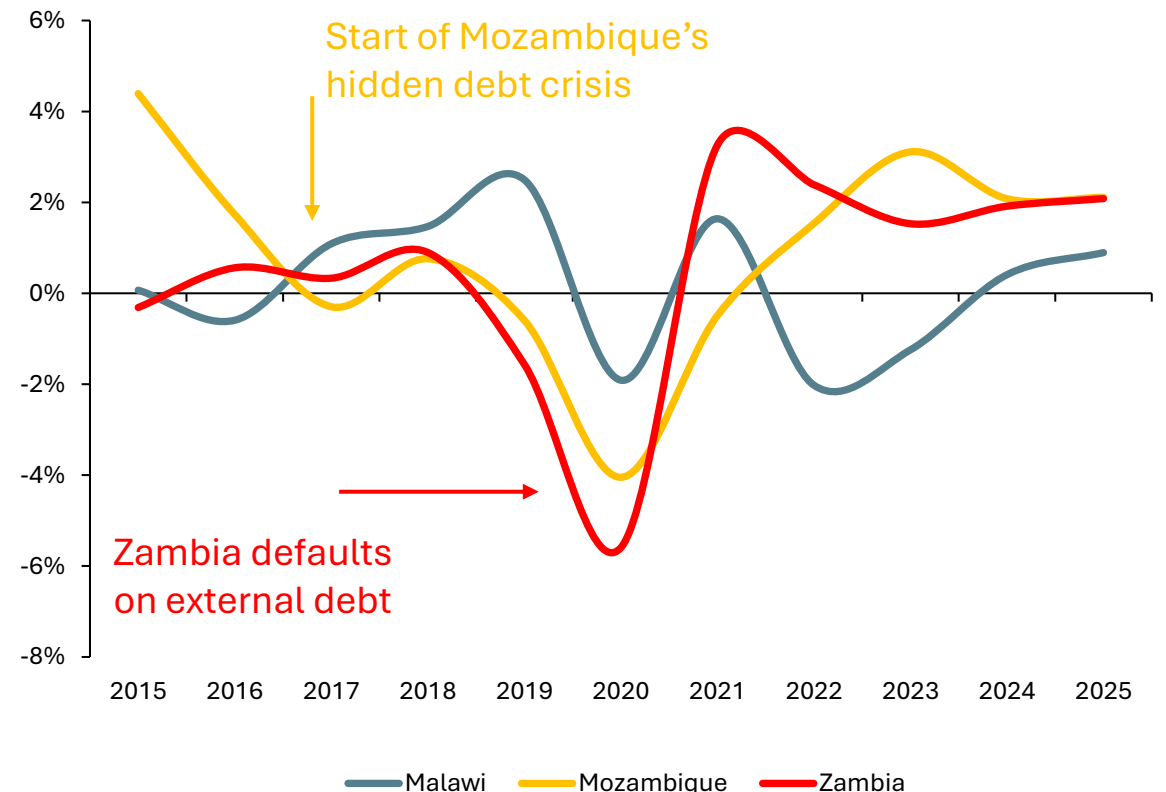
Postscript: Recent experiences in the region can show the way

Both Zambia and Mozambique have gone through deep macroeconomic crises in recent years and are seeing fruits of the recovery.

Key factors enabling adjustment :

- Sustained commitment to difficult reforms from the top;
- Focus on deficit reduction and improved debt management;
- Increasing revenues while improving services;
- Scaling up social protection to cushion impacts on poor;
- Energy sector reforms to move to cost recovery;
- Building foundations for future extractives boom;
- Business environment reforms to increase FDI and exports;

Mozambique and Zambia are recovering after severe crises
GDP growth per capita (in %)



Source: World Bank Macro Poverty Outlook (MPO) (4/2024).