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Choosing Creditors: The Politics of Government Borrowing in Malawi

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Like many countries in sub-Saharan Africa, Malawi finds itself in debt distress. Over a decade ago, in the wake of a government corruption scandal, aid donors withdrew their support. The land-locked Southern African country filled the resulting financing gap with debt. The COVID-19 pandemic, a cholera outbreak, and natural disasters – including droughts and tropical cyclones – further stretched the government's fiscal needs, plunging the country into a deeper borrowing hole.

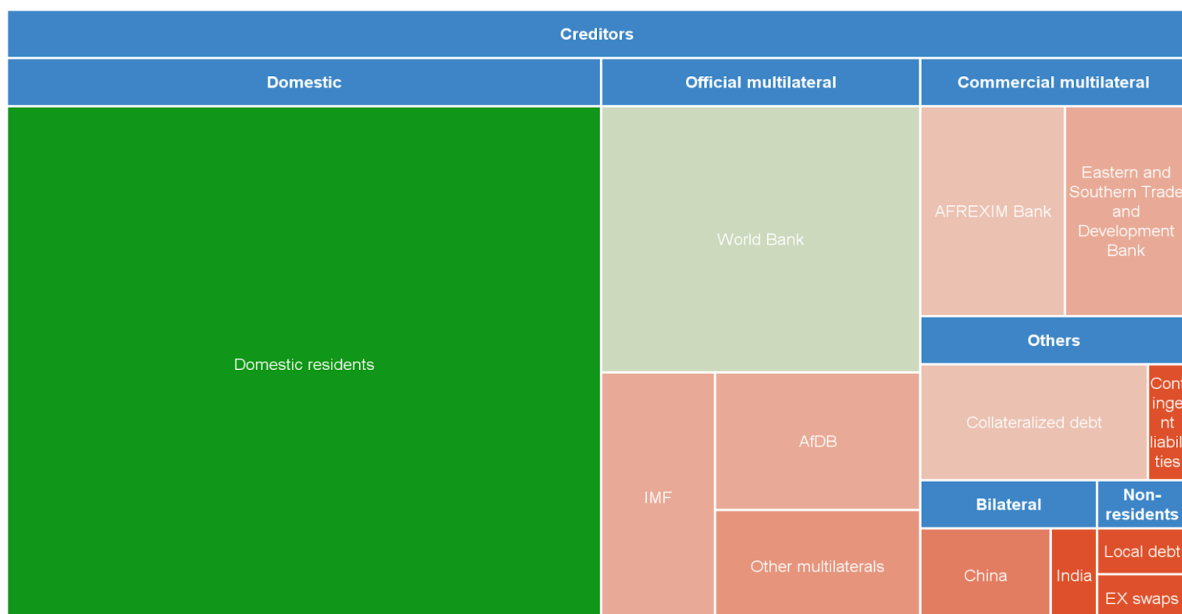
In 2022, Malawi's total debt stock stood at 76 percent of the country's GDP. At the end of 2023, it had increased to 85 percent of GDP (Ministry of Finance 2024: 10). Even worse, much of the country's external debt was denominated in foreign currency. As the government devalued the local currency (the kwacha) in response to market pressures – by over 20 percent in 2022 and over 40 percent in 2023— the country's debt position worsened further. By 2023, debt service accounted for nearly half of government revenue.

Malawi is due for a general election by September 2025. In a bid to eliminate the substantial debt burden, President Lazarus Chakwera, has called on the international community to cancel Malawi's debts. But absent debt cancellations by external creditors, the government may have to deal with restructuring its domestic and external debt. The opposition, led by former President Peter Mutharika, has already made the current crisis a centerpiece of their campaign, vowing to "rescue" the country from its economic distress.

How did Malawi get here? Politics matters not only in the context of a coming election, but also for government borrowing more generally. This brief examines the political determinants of the ways in which and extent to which Malawi has taken on debt. It also discusses efforts to enhance transparency around government borrowing, and the government's concerns over debt-related protests.

Background: From where did Malawi borrow? Figure 1 displays the composition of Malawi's existing debt stock, using data provided by the International Monetary Fund. Total debt stock stood at 76 percent of GDP in 2022. Just over half (54 percent) of this debt stock is domestic. Of Malawi's significant stock of external debt, much is owed to official multilateral creditors, including the World Bank, the International Monetary Fund, and the African Development Bank.

Figure 1: Composition of Malawi's creditors (by end of period debt stock)



Data from IMF staff report (2022, 103).

Also significant for Malawi's external debt are commercial multilateral creditors, including pan-African international financial institutions: the African Export-Import Bank (Afreximbank), which is the largest trade finance bank in Africa, and the Eastern and Southern African Trade and Development Bank (TDB). According to the Ministry of Finance's 2022/2023 Annual Debt Report, Afreximbank became Malawi's second largest creditor in 2022/2023, holding 6 percent of total debt stock. TDB, a sub-regional development bank, holds 5 percent of total debt stock. Official bilateral creditors such as China and India also play a role, although their presence is more limited than in countries such as Sri Lanka and Zambia.

Together, collateralized (6 percent) and contingent debt (1 percent) debt make up seven percent of total debt stock. Some of the contingent liabilities are sovereign guarantees issued to commercial banks in Malawi as well as regional development banks. For example, for the 2022/23 fiscal year, the government had issued a US$50 million sovereign guarantee to the Arab Bank for Economic Development in Africa on behalf of the National Oil Company of Malawi. Unlike contingent liabilities, most of Malawi's collateralized transactions are never reported. According to the IMF, it was not until debt restructuring

negotiations that some of the creditors of these collateralized debts were revealed—though the extent of collateralization still remains unclear.[1]

Borrowing choices: It's all about politics

Governments make choices not only about how much to borrow, but also from which creditors to borrow. In the early 2010s, many governments – even those with high levels of sovereign risk – found themselves with expanded access to credit from a range of sources. These include domestic debt, multilateral creditors, traditional as well as new bilateral creditors, collateralized finance, and private bond issues. Macroeconomic conditions and fiscal need influence borrowing outcomes; But governments' borrowing choices also reflect political considerations and political institutions.

Malawi had long depended more on foreign aid (grants) than on sovereign debt (loans). In September 2013, "Cashgate" captured both domestic and international media attention. It involved a low-level government official hiding funds more than three hundred times his monthly salary, an assassination attempt on the National Budget Director, and the theft of millions of public funds from the national payment system—nearly 1 percent of Malawi's annual GDP. These incidents exposed the mismanagement of public funds and rampant corruption in a largely donor-dependent country.

Following these Cashgate revelations, major donors began to retreat. Bilateral donor support came to a halt. According to the Ministry of Finance, multilateral donors, like the World Bank and the AfDB, joined other development partners in dramatically reducing direct budgetary support—estimated at 4.5% of GDP (AfDB 2018: 2).

This was not the first time Malawi found itself cut off from significant foreign aid. Donors previously suspended financial assistance to Malawi in 1995, 2001 and 2002, and 2011 (Fagernäs and Schurich 2004; Wroe 2012). However, the Cashgate-linked suspension was followed by a series of crises— droughts, floods and other climatic shocks, as well as a global pandemic and a domestic health emergency, all of which exacerbated the country's financial needs.

No Checks, Big Balances: The Role of Parliament

Countries vary markedly in the degree to which their legislatures are involved in the ratification of loan agreements. In Zambia, the government does not need to disclose the purpose of the loans it agrees to (Soko, 2022: 12). In Ghana, parliamentary approval is required for all government debt transactions, but loan agreements involving state-owned

[1] For example, collateralized debt to Afreximbank continued to be serviced at the same time as debt to TDB went into arrears.

corporations are exempt from such requirements (IMF 2015: 32). Some legislatures, such as those in Mauritius, do not require parliamentary approval before a loan is signed (Soko 2022: 10-11). Others, like Mauritania, have constitutional provisions requiring parliamentary approval for each borrowing transaction. Additionally, in some countries, government ministries and government-linked entities are able to borrow externally, with limited government oversight.

Policymakers, practitioners, and scholars alike agree that these institutional practices have consequences for debt management. Parliamentary oversight allows for broader deliberation and input on borrowing choices. Where such oversight is robust, it should enhance accountability, debt transparency, risk management and public scrutiny—all of which can improve long-term debt sustainability. On the other hand, a lack of effective parliamentary checks can allow for creative accounting and misreporting by government ministries as well as unsustainable borrowing. Especially when numerous government entities are able to borrow abroad, the public and political opposition parties may have little, if any, idea of the real magnitude of government indebtedness (Brautigam 2022).

In Malawi, multiple entities beyond the central government have borrowing capacity. These include Malawi's Central Bank, the Reserve Bank of Malawi (RBM), as well as state-owned enterprises and state and local governments. Debts owed by these entities are also not readily available, and their exclusion in Malawi's debt sustainability analysis could mean the true extent of Malawi's current debt hole is unknown.

While Malawi's parliament must approve public borrowing, there is no legal requirement to disclose the loan purpose. According to the Open Government Partnership, Malawi's international loan authorisation bills are treated like emergency bills. These bills can appear on the agenda without adequate notice to members of parliament; without disclosure of loan details; and without involvement of the parliamentary Budget and Finance committee. This has left Malawi's parliament to play a "rubber-stamping" role rather than an oversight one. The executive branch has had considerable (and unchecked) control over borrowing decisions—which can quickly lead a country into debt distress. This seemed to be the case with Malawi, where the government began to borrow in large amounts, especially from the domestic market.

Borrowing privileges and a turn to domestic debt

Following Cashgate, the government shifted to domestic borrowing in the absence of international sources of finance. According to the Ministry of Finance, unbudgeted domestic borrowing reached MK121 billion and increased by 180% (reaching MK340 billion) as early as May 2014 in the immediate aftermath of the scandal. The upward trend in domestic borrowing continued long after Cashgate as domestic debt accounted for 40.8 percent of Malawi's GDP by 2022. Much of Malawi's current domestic debt stock is held by

the Reserve Bank of Malawi (RBM) and the non-bank financial sector (pension funds and insurance funds). The banking sector is also highly concentrated and heavily invested in government debt.

Recent research by Betz and Pond (2023) on government regulations in domestic financial markets suggests that political factors help explain why domestic institutions and residents hold so much government debt. Some governments leverage on their dual role as borrowers and regulators to incentivise domestic actors to hold their debt. Through regulation, governments can create borrowing privileges which increase their access to domestic capital.

As Betz and Pond (2023) demonstrate, government reliance on such borrowing privileges is evident across many developing countries. In Uruguay, for example, private pension funds are required to hold a portion of their total assets (ranging from 30% to 60%) in government securities. Mexico's government requires buyers of foreign securities or foreign currency-denominated securities to receive official authorization (IMF 2007: 783). Since domestic government securities and securities issued in foreign currency by the government are exempt from this extra hurdle, there is an incentive to purchase Mexico's government debt rather than foreign stocks and bonds.

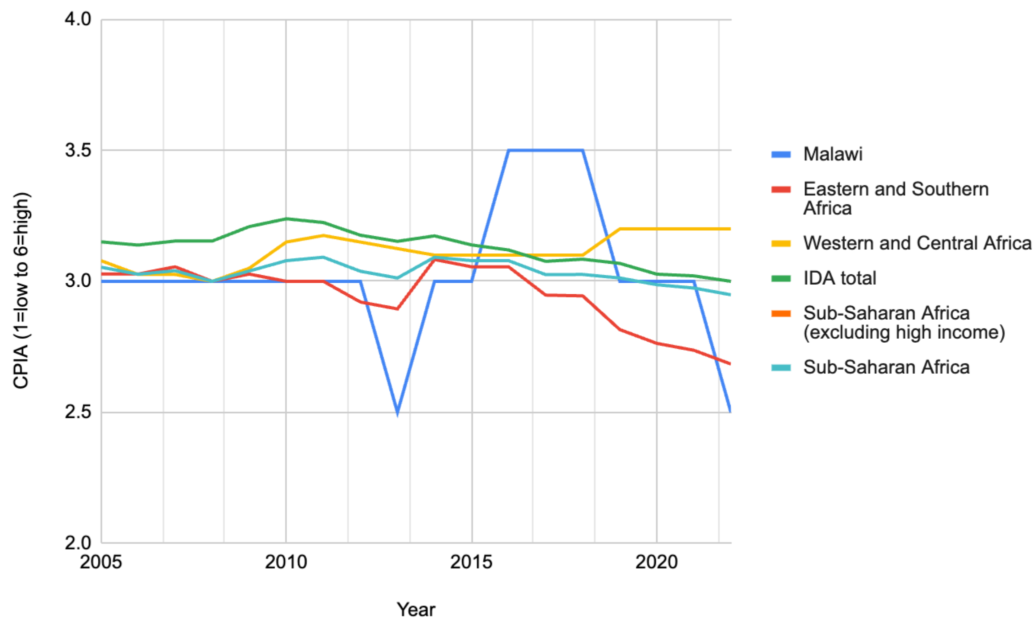
Malawi's government has its own set of regulatory inducements for holding government debt. Its Pension Act, in effect from June 2011, prevents pension funds or umbrella funds from investing assets abroad with limited exceptions based on provisions in the country's Exchange Control Act. The Pension Act was arguably a political move intended to rescue the government from funding shortfalls in the wake of an earlier suspension of donor support in March 2011 (Wroe 2012). According to the government's own 2011 year-end review of its public debt portfolio, the Pension Act positively impacted pension funds' investments in government debt.

Between 2011 and 2020, there was also a significant increase in pension members—over 500%, according to RBM principal examiner responsible for pension regulations, Peter Kambalame. This could also explain why the government's recourse to domestic financing after Cashgate and the onset of the COVID-19 pandemic saw pension funds' holdings of government debt increase. Between 2021/2022 and 2022/2023, there was an 82 percent increase in the contribution of pension funds as domestic debt holders—from MK146.66 billion to MK 268.02 billion. These funds became the fifth largest holders of government domestic debt, behind commercial banks, RBM, insurance companies, and the foreign sector.

Corruption, fiscal transparency, and the return of the multilaterals

Governments also tend to have varying preferences regarding economic transparency. Some –often well-performing democracies – choose to share more information about the state of the economy. Others prefer to obfuscate their economic outcomes and fiscal strategies. Recent research links these fundamental preferences over transparency with governments' choices among financing instruments. Governments that prefer greater opacity tend to prioritise financing sources that involve less public disclosure of debt commitments, like those from commercial banks or bilateral official creditors —even if these are more expensive.

Figure 2: CPIA Quality of budgetary and financial management rating



Source: World Bank data

While we cannot be certain about Malawi's government's underlying preferences over fiscal transparency, it is reasonable to assume that a government that is performing poorly would prefer to disclose less to external funders as well as its own citizens. According to the World Bank's internal staff-led Country Policy and Institutional Assessment (CPIA), one of Malawi's worst-performing clusters at the time of the 2013 Cashgate scandal was its quality of budgetary and financial management (Figure 2). The CPIA assessment includes three distinct dimensions: (1) a comprehensive and credible budget linked to policy priorities; (2) effective financial management systems; and (3) timely and accurate accounting, auditing, and reporting.

In the initial aftermath of the crisis, Malawi turned inward to meet its financing needs. However, the government also began to carry out major reforms to its public financial management systems. Then-President Joyce Banda reshuffled the cabinet and appointed a team to carry out an audit (Mapondera and Smith 2013). The United Kingdom sponsored an additional audit, which showed that the Cashgate scandal may have dated back to 2009 (Chiwala 2018). In late 2013, Malawi also became a member of the Open Government Partnership, in part to highlight its commitment to addressing the debt problem through transparency (Lipenga 2023). In 2014, the new President, Peter Mutharika, made further pledges to rebuild the integrity of public financial management systems; he established a Public Service Reform Commission to address weaknesses in public sector delivery and accountability (Office of the President and Cabinet 2018: 6-7).

As the data in Figure 2 illustrate, Malawi began to perform better than many of its sub-Saharan counterparts in terms of budgetary management. Official multilateral creditors, like the World Bank, the IMF, and the AfDB resumed lending in 2016 (AfDB 2019: iv). The effectiveness of the reform efforts, however, seemed to be short lived. Malawi began to revert to Cashgate-era outcomes from 2018, performing relatively poorly in terms of transparency and accountability. In one notable example, Malawi misreported its foreign exchange reserves to secure funds from the IMF under its 2018 Extended Credit Facility (ECF) arrangement. This ultimately led to the dismissal of the RBM governor in 2020 and a special audit of the RBM's assets (IMF 2022).

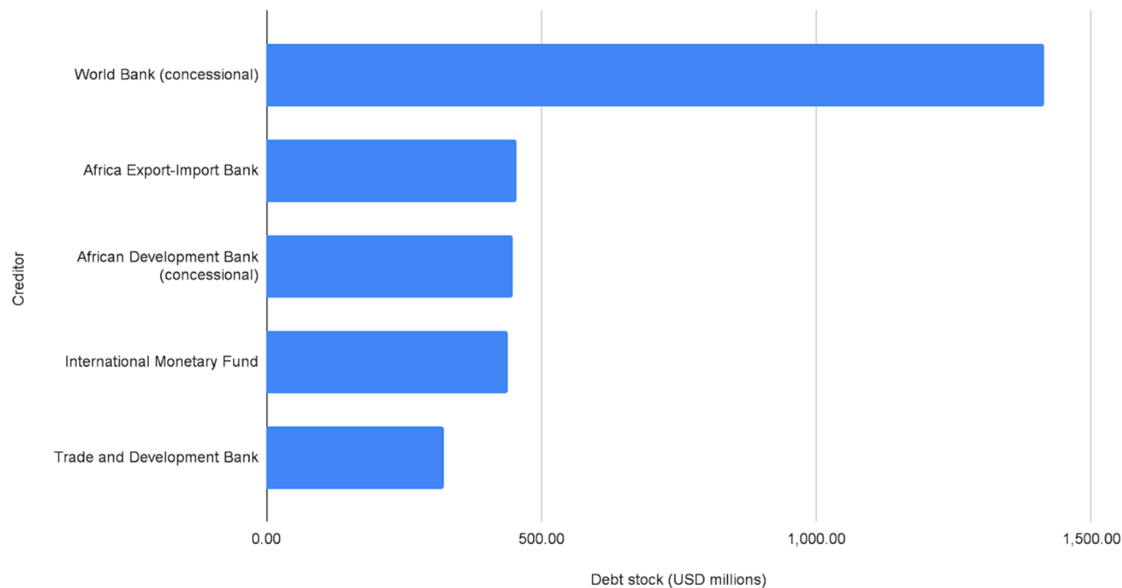
This deterioration seemed to compel development partners to continue to target their funding to mostly "vertical, off-budget projects," often through international non-governmental organisations (World Bank 2022: 11). However, in the wake of a series of climatic, health, and economic crises and the current government's renewed commitment to address macro-economic problems, some multilateral creditors have responded with non-project-based financing.

In December 2023, the World Bank approved a US$137 million budget support package to Malawi—marking the first time since 2017 that the World Bank will be giving such direct budget support to the country. The AfDB followed in May 2024 with a $22.7 million budget support grant. According to Malawi's Minister of Finance, Simplex Chithyola Banda, the resumption of budget support operations was "induced" by the country's current ECF arrangement with the IMF, approved in November 2023. This development is not surprising given empirical evidence suggesting that IMF-supported programs tend to unlock other financial flows (Stubbs, Kentikelenis, and King 2016; Bal Gündüz and Crystallin 2018).

At 68 percent, the IMF as well as other multilateral creditors currently account for the largest proportion of Malawi's external debt—reaching $4 billion in 2022. Given current trends, multilateral creditors are likely to account for 90 percent of Malawi's external debt in 2025. Since debt to the World Bank and the AfDB is considered senior and (given its concessional nature) not subject to restructuring, Malawi has few restructuring options

should it return to debt distress (Zucker-Marques 2023). For now, however, Malawi could restructure its current debt with another set of multilateral creditors: the borrower-led, sub-regional pan-African international financial institutions.

Figure 3: Malawi's top 5 external creditors (2023)



Source: Annual Public Debt Report, Malawi

Other multilateral creditors: no "hassle" factor, and a trade finance lifeline

Among Malawi's five largest external creditors, two are borrow-led sub-regional banks (Figure 3). The first is Afreximbank, a Cairo-based institution created to provide trade finance to African countries (Afreximbank 2004). The second, the TDB, is a sub-regional multilateral development bank that provides both trade and project finance to its member states (Humphrey 2019). As borrower-led banks, both are majority-owned and controlled by African countries that are concurrently recipients and donors. Loan processing is simpler than it is at larger multilateral banks.

With regional members (borrowers) having a high level of decision-making power, political scientists and international development specialists suggest that these borrower-led banks are also far more empowered to support borrowing countries in ways that would be more difficult in the donor-led multilateral development banks.

Most of the debt with Afreximbank and TDB was incurred between 2017 and 2019. In 2017 alone, TDB trade finance loan approvals to Malawi increased significantly, accounting for 18% of the bank's total approvals. In 2019, Malawi signed a US$1 billion deal with

Afreximbank, which saw the latter fund major infrastructure projects, including an airport, a hotel, and industrial parks.

Humphrey (2015; 2019) and Humphrey and Michaelowa (2013) suggest that borrower-led banks are attractive to borrowing countries because they come with fewer bureaucratic requirements. There are also fewer complications that come with the typical project-based loans of the larger multilateral development banks, including project feasibility, environmental and social impact assessments, and procurement issues. While these requirements at the larger banks are intended to encourage better project outcomes, they often cause delays in project cycles and burden national agencies by forcing governments to do things they would otherwise not do. There are certainly trade-offs being made in the choice of whether more stringent requirements are needed, but borrowers would arguably prefer the type of loans offered by the borrower-led multilateral development banks.[2]

These borrower-led financial institutions are also a convenient choice for cash-strapped African countries. Short-term trade finance for sovereign borrowers—which is not provided by the larger multilateral development banks—is particularly beneficial for net importers, including Malawi, which can use these banks as a back-end channel to tap into otherwise costly funding from foreign commercial banks. Humphrey (2019: 178-180) reports that TDB offers governments a cheaper way of financing import purchases: the bank leverages its relationship with foreign commercial banks to secure resources and subsequently on-lends those resources as loans to countries, like Malawi, at more favourable rates.

These import transactions—and the loans to fund them—are important to Malawi's government, especially with an election approaching in 2025. Access to imported strategic commodities, like staple foods, fertilisers, and fuel is a central issue, particularly for politically-important urban residents. In July 2011, for example, violent protests in response to fuel scarcity erupted across Malawi's regional capitals (Wroe, 2012). That same year, TDB provided Malawi with a US$100 million petroleum import facility and a further $US350 million in trade finance loans in 2012 to alleviate shortages.

Upcoming elections are likely to heighten the need for Malawi to request trade finance loans to import some of the strategic commodities—and for the borrower-led banks to be willing providers. Consider the run up to the 2019 presidential elections: two years before the election and amid high levels of food insecurity, Malawi's share of TDB's trade finance portfolio jumped from 7% in 2016 to 18% in 2017. In 2018, its share remained stable at 16%. This likely helped in financing food imports, including "large amounts of maize," to support over 5 million Malawians that were affected by the drought and floods that disrupted agriculture production (AfDB 2018: iv).

[2] See Kilby (2023) for a brief review of this literature.

Since 2022, Malawi has experienced recurring fuel shortages. Dwindling foreign reserves mean that the government may continue to seek financing from TDB and Afreximbank. It is likely that TDB and Afreximbank will offer this support, even as Malawi tries to restructure its outstanding debts with these institutions.

Preferred creditor status?

Beyond trade finance, these borrowed-led banks might also be key players in Malawi's efforts to overcome its current crisis, especially as the country looks towards debt restructuring—whether it is lowering interest rates, reducing the principal owed by borrowers, or lengthening the repayment period.

There has been an ongoing debate over whether borrower-led multilateral banks, like TDB and Afreximbank, should be designated as "true multilaterals" and retain preferred creditor status (PCS), which would have their debts excluded from taking losses during the restructuring process (African Legal Support Facility 2019: 28). This has been a source of contention for countries, like Malawi, Ghana, and Zambia, where Afreximbank and TDB have large exposures. In ongoing negotiations over Zambia's debt restructuring, requests by TDB and Afreximbank to be treated as preferred creditors have been redirected to the Official Creditor Committee.

Humphrey's (2023: 38) analysis of borrower-led development banks suggests that part of the uncertainty in their status is related to the IMF's delay in clarifying the preferred creditor status of their sovereign loan operations. Reports from an analysis by JPMorgan alternatively suggest that the threat to their PCS comes from the larger multilateral banks, which argue that the borrower-led banks do not provide a level of concessional financing that is sufficient to justify PCS.

In the IMF's official decomposition of Malawi's public debt by creditors (based on reports by country authorities), both TDB and Afreximbank are classified as commercial creditors and will likely take losses in any restructuring. In mid-2023, Afreximbank President, Benedict Oramah, had already assured President Lazarus Chakwera that the regional bank stands "in solidarity with Malawi's pursuit of the debt restructuring mechanism." Perhaps the banks whose loans helped get Malawi into the crisis may help in getting the country out of it.

Regardless of how the restructurings go, Malawi would need to reduce its uptake of both external and domestic debt if it wants to reach a more sustainable debt position. Limiting additional borrowing, however, is not just an economic issue; it is also a political choice for the government.