

Report No. 132785

Malawi
Systematic Country Diagnostic:
*Breaking the Cycle of Low Growth and Slow Poverty
Reduction*

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Malawi Country Team
Africa Region



ABBREVIATION AND ACRONYMS

ADMARC	Agricultural Development and Marketing Corporation
ANS	Adjusted Net Savings
APES	Agricultural Production Estimates System
BVIS	Bwanje Valley Irrigation Scheme
CDSSs	Community Day Secondary Schools
CBCCs	community-based child care centers
CPI	Comparability of Consumer Price Index
CCT	Conditional cash transfers
CEM	Country Economic Memorandum
DRM	Disaster Risk Management
ECD	Early Childhood Development
EASSy	East Africa Submarine System
IFPRI	Food Policy Research Institute
FPE	Free Primary Education
GPI	Gender parity indexes
GEI	Global Entrepreneurship Index
GDP	Gross Domestic Product
GER	Gross enrollment rate
GNI	Gross national income
IPPs	Independent Power Producers
IFMIS	Integrated Financial Management Information System
IHPS	Integrated Household Panel Survey
IHS	Integrated Household Survey
IRR	internal rate of return
IMP	Investment Plan
ECD	Mainstream Early Childhood Development
MACRA	Malawi Communications Regulatory Authority
MHRC	Malawi Human Rights Commission
SCTP	Malawi's Social Cash Transfer Program
GNS	Malawi's gross national savings
MOAIWD	Ministry of Agriculture, Irrigation and Water Development
MPC	Monetary Policy Committee
MICS	Multiple Indicator Cluster Survey
NDRM	National Disaster Risk Management
NES	National Export Strategy
NFRA	National Food Reserve Agency
NSO	National Statistics Office
NDC	Nationally Determined Contribution
NNS	Net national savings
NRR	Non-resource-rich
ODA	Official Development Assistance
OCL	Open Connect Limited
O&M	Operating and maintenance
OPRC	Output and Performance Based Road Maintenance contracting
PFM	Public Financial Management
PSR	Public Sector Reform
MNSSP	Reforms on social protection

RMNCAH	Reproductive, Maternal, Neonatal, Child, and Adolescent Health
RBM	Reserve Bank of Malawi
RBF	results-based financing
SCTP	Social Cash Transfer Program (SCTP)
SAPP	Southern Africa Power Pool (SAPP)
SADC	Southern African Development Community (SADC)
SACMEQ	Southern and Eastern Africa Consortium for Monitoring Educational Quality
SSA	Sub-Saharan Africa (SSA)
SLM	sustainable land management (SLM)
SCD	Systematic Country Diagnostic (SCD)
TVET	Technical, and Vocational Education and Training (TVET)
TNM	Telekom Networks Malawi (TNM)
TEV	total economic valuation (TEV)
TFP	total factor productivity (TFP)
TFR	total fertility rate (TFR)
TB	tuberculosis (TB)
UBR	Unified Beneficiary Registry (UBR)
WBG	World Bank Group (WBG)
WDI	World Development Indicators (WDI)

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EXECUTIVE SUMMARY

Against a history of very low overall poverty reduction, slow and volatile growth and vulnerability to shocks, in recent years Malawi has made notable gains in macroeconomic stability, reduction in ultra-poverty rates and progress on key demographic indicators. This Systematic Country Diagnostic (SCD) identifies the key challenges and opportunities Malawi faces, and presents priority policy interventions for the country to sustain and build on recent gains towards eliminating extreme poverty and boosting shared prosperity. It argues that Malawi must break out of recurrent cycles of weak governance and institutions to ensure macroeconomic stability and sound and efficient policy implementation, while diversifying the economy, improving human capital, and implementing resilience strategies.

Malawi's densely-populated, agriculture-based economy has recently seen progress in demographic patterns

Malawi is a landlocked economy in Sub-Saharan Africa (SSA) and amongst the poorest countries in the world. Malawi's per capita GNI is just US\$320 in 2017 and around 70 percent of the population live below the international poverty line of US\$1.90 per day (WDI, 2018). The economy is dominated by the agricultural sector, which drives livelihoods for two thirds of the population, yet accounts for only a third of gross domestic product (GDP).

An already dense population of 17 million, expected to double by 2038, puts pressure on farm size and productivity as well as environmental sustainability. High population growth has posed challenges for poverty reduction, but Malawi has seen recent success in reducing the total fertility rate (TFR). This follows a ten-year campaign promoting the use of modern contraception, which raised the share of married women using modern contraception to 58 percent, more than double the regional average (Schneidman et al. 2018). This progress in demographic indicators could support efforts to reduce poverty.

Vulnerable to external and internal shocks and a political economy trap, growth has been weak and volatile, slowing poverty reduction

Malawi's growth patterns initially mimicked those at the overall SSA level, but it has fallen behind since 1980. Malawi's per capita GDP grew relatively rapidly at 3.7 percent per year on average during the first 15 years after independence, outperforming the rest of SSA. However, it shrunk much faster than the rest of SSA during 1980-1994, when the rest of Africa also suffered a decline in living standards. Most concerning is how Malawi's real per capita GDP grew at an average of around 1.5 percent between 1995 and 2015, falling below the 2.7 percent average in non-resource-rich SSA economies.

Despite decades of development efforts and significant foreign aid, Malawi's weak and volatile economic growth performance has persisted. Malawi's low growth performance relative to its peers is particularly striking given that Malawi has been politically stable and conflict-free, and it has suffered no more weather-related or other external shocks than its neighbors.

Exogenous, climate-induced shocks are a major source of vulnerability, exacerbating macroeconomic instability, and making it harder for Malawi to break the cycle of vulnerability. Malawi's high dependence on rainfed agriculture contributes to volatile agriculture performance as extended dry spells lead to the failure of major staple crops such as maize, which then contributes to rural poverty. Vulnerability to weather shocks is only likely to worsen with the effects of climate change (World Bank 2016b).

Weak governance and institutions contribute to Malawi's poor development performance. Malawi's stagnation is in large part driven by a stable but low-level equilibrium, in which a small group of elites compete for power and political survival through rent seeking. The competitive-clientelist political settlement creates strong incentives for policies that can be seen to address short-term popular needs (such

as agriculture subsidies, market and price distortions), while undermining the ability to credibly commit to fiscal discipline and long term reforms needed to spur productive structural transformation.

The confluence of political and economic incentives has led to the promotion of domestically oriented sectors such as government services, farm inputs, and construction that generate high rents, but limited growth opportunities. This has stunted private sector growth in more complex and export-oriented industries that could build the foundation for more sustainable growth and employment generation (Said & Singini 2014).

Malawi’s vulnerability to external and internal shocks has been reinforced by weak governance and institutions, contributing to cycles of economic crisis, corruption scandals and food insecurity. Malawi’s heavy dependence on aid adds a further dimension to these cycles, as donors have suspended budget support in response to poor economic mismanagement and corruption scandals three times in the last two decades, most recently the 2013 “cashgate” scandal.¹ While crises are often followed by periods of reform and fiscal discipline, these have not been sufficiently institutionalized to prevent relapse.

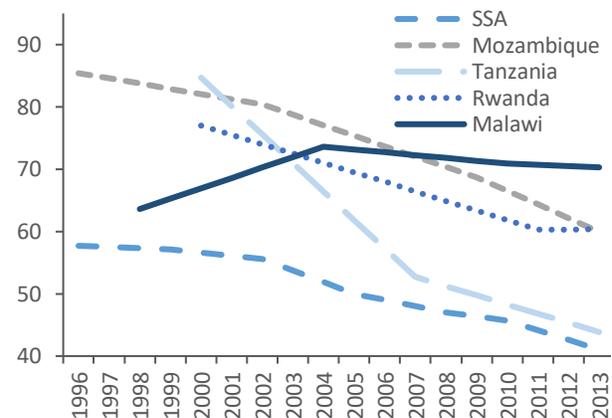
These factors have contributed to a relatively slow economic transformation, especially considering Malawi’s rapidly growing population. Since the mid-1990s the share of agriculture has gradually declined to about 30 percent of GDP, while services have expanded to more than half of GDP. Employment in agriculture still dominates, but its share of total employment has gradually fallen from about 87 percent in the 1970s to around 65 percent in the 2000s, as employment has shifted towards low productivity services (World Bank 2016f). Employment growth has therefore resulted from ‘push factors’ out of agriculture, such as increasing population and degradation of soils, rather than ‘pull’ factors toward services.

Macroeconomic instability, recurrent natural shocks, and limited transformation have made it difficult to achieve meaningful reductions in poverty. Malawi’s pace of poverty reduction has been slower than the SSA average and slower than the decline in neighboring countries, which had higher poverty rates than Malawi in the early 2000s, but recorded significantly lower rates by 2013. Approximately half—50.7 percent—of the population lived in moderate poverty in 2010, which increased slightly by 2016/17 to 51.5 percent.

However, Malawi has registered some progress in promoting shared prosperity and reducing ultra-poverty in recent years.² Despite macroeconomic instability between 2012 and 2016, the proportion of ultra-poor shows a significant reduction, from 24.5 to 20.1 percent between 2010/11 and 2016/17, which contributed to a decrease in inequality. Poverty is predominantly rural, with nearly 95 percent of the poor living in rural areas, where 57 percent of the population is poor, compared to only 17 percent in urban areas. Besides stagnation in monetary poverty, child stunting is still high, at around 37 percent in 2015, and has actually increased amongst the bottom 40 percent (NSO and ICF, 2017).

Figure E.1: Poverty has reduced slower in Malawi than in neighboring countries

Poverty headcount rate (percentage) measured at US\$



Source: Authors’ calculation based on Povcalnet data. Note: Poverty for 2013 were projected with National Accounts data

¹ In September 2013, revelations came to light of misappropriation of public funds through fraudulent transactions carried out in the Government’s Integrated Financial Management Information System (IFMIS).

² “Moderate poverty” is based on a poverty line approximately 60 percent higher than the benchmark used for the “ultra-poverty” measure. “Ultra-poverty” is the government’s term used for “extreme poverty.”

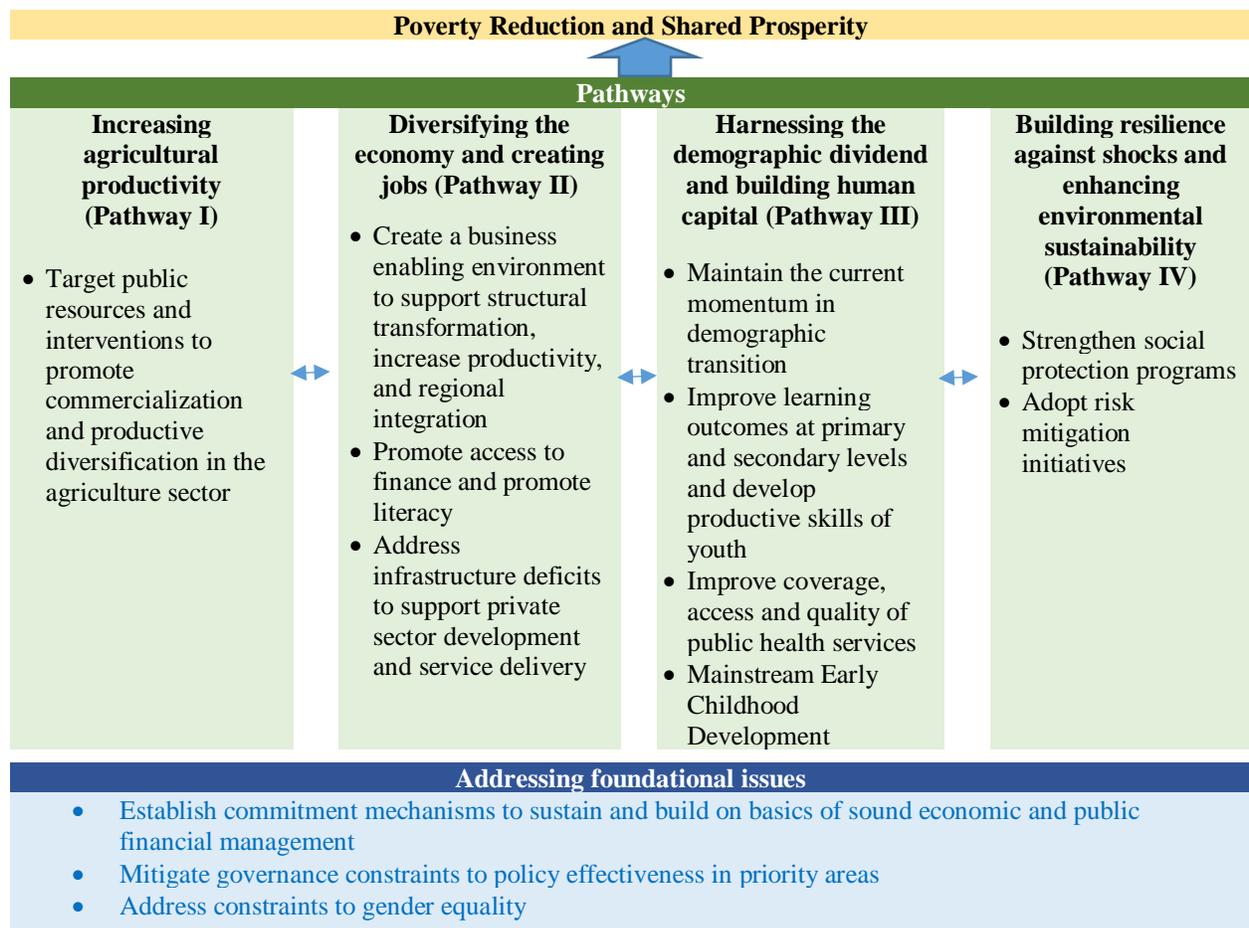
Recent macro-economic stability presents an opportunity for Malawi to break out of the cycles of crisis

Malawi has enjoyed relative macro-economic stability since 2017, presenting an opportunity to break out of its repeated cycles of crisis. Following two years of depressed economic activity due to floods and a drought, real GDP growth picked up to 4 percent in 2017 and is projected at 3.7 percent in 2018. Moreover, after six years of double-digit inflation rates, headline inflation has receded to single digit levels, and the Kwacha has been stable against the U.S. dollar. This relative stability, combined with recent progress on demographic indicators and reducing ultra-poverty, presents an opportunity for Malawi to move forward along pathways to sustainably reduce extreme poverty and boost shared prosperity.

Pathways to Achieving the Twin Goals

The SCD identifies two foundational issues to address, and four pathways for Malawi to break out of its pattern of weak and volatile growth, and instead make further progress towards reducing extreme poverty and boosting shared prosperity. Addressing the foundational issues and following the pathways should not be seen as separate activities, but have significant synergy and complementarity between them.

Priority policy interventions to progress along the pathways and addressing the foundational issues have been identified based on criteria and extensive consultations with stakeholders. Criteria include: maximizing impact on the twin goals, balancing the time horizon of impacts, complementarity across pathways, available evidence, and ensuring feasibility. From this process, the SCD identifies three priority policy interventions for addressing foundational issues and ten specific priority policy interventions to progress along the pathways toward poverty reduction, inclusive growth and sustainability.



Foundational Issue I: Weak governance underlies macroeconomic instability and poor policy implementation

While external shocks have contributed to Malawi’s repeated episodes of macroeconomic instability, poor economic policies and management have played an even larger role. Recurring issues in Malawi’s economic management during episodes of instability include weak fiscal management, through budgetary indiscipline and weak expenditure control, soft budget constraints, and weak budget planning, with overly optimistic assumptions leading to frequent overruns. Government’s response to shocks is reactive and short term, with ad hoc expenditure cuts and arrears, and relying on donors, rather than making hard fiscal adjustments.

Weak institutions underlie fiscal slippages and wider policy implementation gaps. Malawi is frequently characterized as having sound policy and legal frameworks, but evidence points to considerable gaps in implementation. Informal rules of the game responding to political economy imperatives continue to shape behavior and function. The 2013 “cashgate” scandal revealed that significant investment in public financial management (PFM) reforms had little impact on actual behavior, with endemic levels of corruption. Moreover, decentralization, intended to strengthen accountability for citizen-oriented services and diffuse overly centralized power, has been undermined by partial implementation and competition over control of resources, negatively affecting basic health, water, and education services.

Yet Malawi has been able to deliver on reforms when incentives are so aligned. This was the case from 2004 to 2009, when prudent fiscal policy and a new fertilizer subsidy contributed to a period of growth. Reform traction is also seen in the aftermath of crisis, often as a condition of donor support and sometimes in response to civic protest. The challenge has been sustaining reform by institutionalizing commitment mechanisms that continue to constrain authorities in the face of inevitable pressures and political exigencies. Malawi’s relatively open civic space provides opportunities for collective action, but limited transparency and appeal to identity, combined with a predominantly rural and under educated population, has so far limited the impact of citizen engagement.

- *Priority policy intervention 1: Establish commitment mechanisms to sustain and build on the basics of sound economic and public financial management*

The government has taken steps to reinstate foundational elements of macro stability and PFM since “cashgate,” but it needs to deepen these reforms and take steps to minimize the chance of reversal, in order to restore confidence and create an enabling environment for more effective development performance. Malawi must develop incentives to strengthen fiscal management by adhering to rule-based, transparent and predictable systems for budget planning and execution. Further measures include careful prioritization and control of expenditures, increased use of fiscal and borrowing rules, and assuring central bank independence. Commitment mechanisms should include clarifying accountability relationships, credible sanctions for non-compliance, and strengthening the enabling environment for public accountability by increasing transparency, publicity and pathways for broader public interests to engage in policy-making and implementation.

- *Priority policy intervention 2: Mitigate governance constraints to policy effectiveness in priority areas*

Serious progress on overcoming binding constraints to the pathways requires mitigating the effects of Malawi’s political economy trap. Incremental progress will require targeted measures that focus on drivers of behavior to solve specific coordination challenges rather than on comprehensive best practice reforms. This could include, for example, to steer the behavior of farmers and the private sector toward more productive and efficient practices, or to induce cooperation of teachers against absenteeism. These measures are identified in the specific priorities below. Investment is also needed to increase the interests represented in the policy arena by strengthening the collective action capacity of, for example, farmers

groups, private sector associations more representative of small and micro enterprises, and civil society networks.

Foundational Issue II: Gender inequality

Gender inequality has a profound impact on a wide array of activities in Malawi, affecting agricultural productivity, opportunities in the non-farm sector, the demographic transition, and households' resilience against shocks. Reducing gender inequality will allow for quicker progress along the pathways and help improve the socio-economic status of people in Malawi.

Female headed households tend to be poorer and have less endowments (assets and access to infrastructure and basic services) than male headed households. Poverty headcount rates of female headed households are around 5 percentage points higher, and fewer own telephones and transportation means than male headed households (World Bank 2016b). They also tend to own smaller cropland and have less access to electricity and improved water and sanitation.

Women tend to be less productive than men in agriculture and the non-farm sector. Agricultural productivity on female-managed plots has been estimated to be 25 percent lower than on male-managed plots (Kilic et al., 2013). Additionally, women-owned businesses are less formal, less profitable, and smaller than those owned by men (Campos et al., 2015 & World Bank 2016b).

Women in Malawi have limited access to higher education, experience early marriage and child bearing, and have poor health. Malawi has one of the highest rates of adolescent fertility in the world, with 135 births per 1,000 women ages 15-19 (WDI, 2018). Early marriage is widespread and women comprise 60 percent of those living with HIV. Lack of access to improved water and sanitation facilities also affects female school attendance, given that adolescent girls disproportionately collect water.

- *Priority policy intervention: Address constraints to gender equality*

This calls for improving girls' participation in secondary education and employment opportunities to increase returns from women's economic activities and accelerate the demographic transition. This can be done through conditional cash transfers (CCT) to positively impact girls' school attendance, early marriage/childbearing, and exposure to HIV (Baird et al 2010; 2011; 2012). For girls who are unlikely to return to school or trying to transition to work, interventions should target multiple constraints simultaneously with vocational training focused on self-employment, life skills, and linking young women to credit. Additionally, interventions should support female-headed households' access to farm labor. Improving women's access to endowments can be supported by including female headed households as part of selection criteria for provisions of subsidies and other social protection programs.

Pathway I: Increasing agricultural productivity

The agriculture sector constitutes the backbone of the Malawian economy and its performance has more direct and bigger implications for economic growth and poverty reduction, especially in rural areas, than any other sector. About 87 percent of Malawian households are engaged in agricultural activities, which rises to 94 percent in rural areas (NSO, 2012). However, agricultural sector growth, often affected by large scale weather shocks, has been volatile and frequently surpassed by population growth.

Agricultural productivity remains relatively low for the region, due to limited adoption of modern technologies, exacerbated by heavy dependence on rain-fed agriculture, low soil fertility, weak links to markets, and poor research and extension services. The reliance on rain-fed agriculture is highly risk prone, particularly to price and weather shocks. Moreover, some 94 percent of smallholders focus on maize production, with only 26 percent producing the second most popular crop, groundnuts (World Bank 2016b). This lack of diversification and crop rotation depletes soil quality, further lowering yields. To date, growth in the sector has mainly been driven by increasing land under cultivation and labor. However, given one of

the highest population densities in Africa and shrinking farm sizes—with a median plot size of 0.8 hectares—the gains from continuing such practices are approaching their limit.

Although 94 percent of farmers produce maize, only 14 percent sell it. These thin markets and low density of economic activity in rural areas, as well as poor road connectivity to markets, motivate farmers to continually produce maize solely for their household needs, as they are unsure whether they can purchase or sell the crop in the market (Dorward et al., 2009).

Inefficient patterns of public expenditure have contributed to the persistence of low productivity in the sector. Substantial funding to heavily subsidize maize fertilizers has not been well-targeted. The Government's focus on maize undermines efforts to increase productivity and diversify the sector towards other crops, which could also allow for improved soil conservation and higher yields. It further crowds out complementary public investments to introduce and diffuse new technologies, develop irrigation, improve soil water management, develop climate smart agriculture, and strengthen markets, all of which have significant potential to enhance the performance of the sector.

Additionally, maize price volatility is in part associated with government interventions, including ill-timed procurement or stock releases, mixed signals on price controls or procurements, and uncertainties on the imposition or lifting of export bans. Interventions by parastatals such as Agricultural Development and Marketing Corporation (ADMARC) often distort markets, negatively impacting smallholders, while often necessitating government bailouts. The ad hoc imposition of export bans has further undermined commercial investment in the sector.

- *Priority policy intervention: Target public resources and interventions to promote commercialization and productive diversification in the agriculture sector*

Continuing reforms to FISP will build resilience and free up scarce resources for productive investment and social safety nets. This will include better targeting productive farmers, keeping a low, fixed government subsidy, and increasing private sector participation in the program.

Additionally, strengthening agricultural commercialization is critical for income growth and poverty reduction. Resources should target market enhancing information systems, agricultural research, and communication and transport infrastructure (including a more extensive feeder road network). Expanding participation in markets will help reduce the risks of transaction failure and reduce transaction costs. Regulatory reforms should be accelerated to facilitate commercial activity in agricultural value chains. Additionally, agricultural extension services should support the formation of farmer groups and cooperatives, train farmers on profitable crop production and marketing, and ensure mutually beneficial contract farming arrangements.

Government interventions and institutions should be reformed to reduce distortions in the sector. The government should avoid the ad hoc imposition of export restrictions to encourage investment in the agricultural sector. It should therefore lay out and follow clear and transparent procedures for applying regulatory requirements for exports and imports. Moreover, it should increase the use of alternative measures to address short term food insecurity. Additionally, reforming ADMARC would reduce distortions in agricultural markets and reduce its fiscal burden. ADMARC's market interventions should follow transparent rules and set price intervention bands, which would encourage the participation of private traders and strengthen the market position of Malawian farmers.

Diversifying the agriculture sector beyond maize is important for increasing resilience and transformation. Intercropping, crop rotation, irrigation, and incorporating organic fertilizers would replenish soil fertility and complement the chemical fertilizer to diversify and increase agricultural output.

Improved irrigation and water management can help mitigate the impact of droughts and prevent destruction through floods. However, irrigated farming calls for significant technical and market analysis,

capital, strong management capacity, and increased commercialization of higher value crops. Additionally, promoting drought resistant seed varieties and integrated pest management is key to increase resilience.

Pathway II: Diversifying the economy and creating jobs

Malawi has experienced limited structural transformation and a slow pace of job creation. Along with increasing agricultural productivity, the expansion of non-farm activities and diversification of incomes is one key to increase economic development and ensure productive employment opportunities for Malawi's growing population.

Although urbanization has been an important catalyst for growth and poverty reduction in many countries in sub-Saharan Africa, urbanization has been relatively slow in Malawi, stagnating at around 15 percent since 1999 (WDI 2018). For example, although starting at a similar rate in 1999, Rwanda has since increased to 29 percent. Even small increases in urbanization and urban investment could enhance Malawi's long-term economic prospects by accelerating growth and bringing more meaningful structure change.

Structural change has been more prominent in Malawi's rural areas, where the labor force has started to move from the agricultural sector to the non-farm sector. This contributes to poverty reduction, while also supporting agricultural productivity (World Bank 2016f). Nevertheless, the opportunities for the non-farm sector are volatile and the life-span of non-farm businesses is very short.

Malawi's ability to achieve robust and sustainable growth will depend to a large extent on developing a thriving private sector. However, the business structure is characterized by a "missing middle," signaling a difficult business environment that constrains growth opportunities for small-sized companies and favors those with long-established networks, and a policy framework that is biased toward larger firms.

A challenging business environment has undermined efforts to develop the private sector and its potential for employment. In addition to a historically unstable macro-economic environment increasing inflation and general risk, access to finance is cited by businesses as a top constraint. Low and unreliable access to energy and water supply have been key constraints to private sector development. Moreover, the high cost of domestic and regional trade, with particularly limited access in rural areas, has constrained MSME growth and value addition in the agriculture sector. Additionally, corruption, as well as weak human capital—particularly in rural areas—has reduced the potential for MSME development.

- *Priority policy intervention 1: Create a business enabling environment to support structural transformation, increased productivity, and regional integration*

Efforts should be made to foster a structural transformation towards more productive sectors. Promoting rural small-scale industries and value addition to agricultural products, particularly for sectors in which Malawi can be regionally competitive such as oilseed and sugar products, would help create a more diversified rural economy. Policies should promote innovative means of financing for value-added investments. This should be combined with information sharing, better linkages to potential buyers, skills development, business advisory services, and the continuous improvement of rural infrastructure.

Additionally, increased urbanization can accelerate economic growth and structural change. Strong linkages between rural and urban economies should be reinforced through production, consumption, and migration channels. Increased investment in urban areas financed by own resources, particularly property taxes, can support urban transport and sewer systems.

Malawi could benefit from policies to increase exports and regional trade to increase and diversify incomes. Strong regional economies and demand for niche products could present an opportunity for farmers and entrepreneurs, including for products such as oilseeds. Malawi should further develop its logistics services sector and improve trade procedures, increase coordination across agencies, and reduce border inspections. Non-tariff barriers should be reduced, particularly the imposition of export bans.

Much greater efforts are needed to make existing regulations—including tax and licensing requirements—simpler, more accessible, and easier to implement. The government should implement reforms that directly improve the investment climate, ensure adequate consultation on policy changes, build in mechanisms that prevent ad hoc policy shifts, and address inconsistencies between the practices of different regulatory bodies. Additionally, it should empower institutions such as the Malawi Investment and Trade Centre that can actively work to attract higher-quality, longer term investment, and facilitate the creation of more and better-quality jobs.

- *Priority policy intervention 2: Promote access to finance and financial literacy*

Access to finance is cited as a top constraint to business. Increased macro-economic stability and improving the business environment through simplified regulations and addressing infrastructure constraints, particularly in rural areas, would reduce the cost of doing business, lower risk and inflation, and allow for lower interest rates. Additionally, measures to improve financial literacy and to develop financial products tailored to the needs of small businesses should be promoted. With new mobile subscribers increasing by 12 percent annually since 2014, the expansion of mobile money can support access to finance, particularly into rural areas. Finally, Malawi should make use of its recent developments in warehouse receipts systems, to help to expand lending in the agriculture sector and for further value addition.

- *Priority policy intervention 3: Address infrastructure deficits to support private sector development and service delivery*

Increasing access to electricity is essential for enabling economic growth and enhancing the well-being of Malawians. The Government should improve and expand its transmission and distribution network and create an enabling environment for off-grid market development. Extra financial resources should be mobilized based on a good-practice, bankable financing plan. Additionally, extensive technical assistance is needed to strengthen sector institutions.

Malawi needs to urgently diversify and expand its energy sources. Malawi should tap into the Southern Africa Power Pool (SAPP) regional grid to help meet the generation gap and ensure supply especially considering low hydrology. At the same time, the performance of ESCOM should be improved, including by implementing cost reflective tariffs, which could help contain demand growth, support revenue needs and investment, and help attract private investment through Independent Power Producers. Finally, given the importance of the Shire River to Malawi's energy security³, increased adoption of natural resource management practices is needed to sustain and protect energy security.

Malawi should improve the transport system to lower the cost of domestic and international trade. It should expand the rural transport network through reliable, all-weather, and safe rural roads, complemented by a network of carefully planned rural logistics platforms, to support agricultural marketing. Output and Performance Based Road Maintenance contracting practices would maximize the private sector's role in transport investments. Malawi should also improve road safety, with one of the highest global rates of fatal accidents primarily affecting the poor. The Nacala rail corridor offers an opportunity to disrupt the current transport equilibrium, but complementary investments and policy reforms will be needed.

Additionally, addressing the deficits in access and quality of water and sanitation services in both rural and urban areas should be a high priority. This will require deeper efforts to improve governance of water utilities as well as finding ways to encourage private investment to increase installed capacity.

³ About 98 percent of current electricity generation is from “run-of-river” hydropower plants on the Shire River. More hydro power plants are planned on the Shire (Mpatamanga)

Pathway III: Harnessing the demographic dividend and building human capital

Malawi has made significant progress in human development outcomes in the last two decades. The recent success in significantly reducing the total fertility rate (TFR) could enable Malawi to harness a demographic dividend in the near future. However, this would require Malawi to accelerate further its investment in human capital: improving health status, educational attainment, and skill formation of working age populations.

The quality of education, health, and water and sanitation services remains of real concern, and improvements are often skewed towards the wealthy. Critical shortages in human resources (70 percent vacancy rates), medicines and medical supplies, and poor/inadequate infrastructure afflict the health sector. Also, learning outcomes are poor, partly due to significant numbers of untrained teachers in primary and secondary schools. The 62 percent adult literacy rate is lower than both the SSA and LDC averages of 65 and 63 percent, respectively (WDI, 2018). Malawi has made significant progress in improving access to water supply (increasing from 42 to 87 percent between 1990 and 2015), but progress on sanitation has been slower (from 29 to 40 percent between 1990 and 2015). Malawi is currently ranked number five of the top 10 countries globally with the highest proportion of population at risk of frequent water shortages.

- *Priority policy intervention 1: Maintain the current momentum in demographic transition*

To maintain the pace of TFR reduction, Malawi should scale up services to satisfy the remaining unmet demand for high quality, affordable family planning/reproductive health services. Efforts should target adolescent girls, particularly those in rural areas who face multiple constraints and have seen virtually no progress in childbearing patterns over the past twenty-five years. High-level political support and mobilizing traditional community and civil society leaders will be critical to overcome religious or socio-cultural barriers to contraception. Child survival rates through enhanced maternal and child health and nutrition interventions should continue to be improved.

- *Priority policy intervention 2: Improve learning outcomes at primary and secondary levels and develop productive skills for youth*

Support should be provided for children, particularly girls, in poor and underserved areas to help them complete and attain quality foundational skills at the primary and secondary levels. Key to this will be to adopt cost-effective and equitable strategies in the delivery and management of key inputs (teachers, teaching materials, infrastructure, school finances). Additionally, effective strategies for enhanced content and pedagogical capacity of teachers are needed. Moreover, innovative strategies, including financial incentives, are necessary to support girls to complete primary and secondary education. Accountability and transparency in school management should increase. In addition, job relevant skills for out of school youths should be provided through formal and informal systems with the private sector, while scientific and technical skills should be built at the secondary and tertiary education levels.

- *Priority policy intervention 3: Improve coverage, access and quality of public health services*

To address shortages in human resources, improvement in the recruitment, distribution and retention of health workers is required, and scaling up mentorship programs and results-based financing approaches. It is also important to improve the supply of medicines, medical supplies, and vaccines to address shortages, while further ensuring availability and functionality of medical infrastructure. Improving governance and health financing by enhancing efficiency in resource allocation and use, strengthening PFM, and increasing government financing are all important. Efforts to address the large communicable disease burden of HIV, TB, and Malaria should continue. There is also a need to increase access to reliable water services and safely managed sanitation as preventive measures.

Interventions to improve Reproductive, Maternal, Neonatal, Child, and Adolescent Health (RMNCAH) and Nutrition services are needed. To do so, linkages should be strengthened between primary health facilities and communities, particularly in rural areas. Effective supervision is needed in primary health facilities and communities to improve quality of care.

- *Priority policy intervention 4: Mainstream Early Childhood Development (ECD)*

Support for adolescent mothers should be prioritized in ECD services to counter the high incidence of poor outcomes in children born to these mothers. A multi-sectoral approach is required to prevent teenage pregnancies as well as improve health outcomes in children born to young mothers. There is an urgent need to establish and strengthen Malawi's ECD policy environment, implementation, and monitoring. Additionally, integrated and cost effective ECD for improved school readiness is needed. There is a need for strengthened early childhood education and implementing innovative low-cost interventions.

Pathway IV: Building resilience against shocks and enhancing environmental sustainability

Malawians, especially the poorest 60 percent, are highly vulnerable to shocks. Most recently, droughts and flood in 2015 and 2016 further contributed to the stagnation of moderate poverty.

Social safety net programs can provide households resilience against shocks but increasing and reforming the funding mix is necessary to increase effectiveness. Current expenditure on safety net programs (around 0.6 percent of GDP), is low in terms of needs, and falls short of the 1.5% regional average. Cash transfers have great potential to enhance resilience and longer-term human development. Malawi's Social Cash Transfer Program (SCTP) has had a relatively strong impact, while, on the other hand, the more extensive MASAF Public Works Program continues to face implementation challenges (see e.g., Ralston et al. and McCarthy et al. 2017).

More broadly, Disaster Risk Management (DRM) provides a comprehensive approach for reducing disaster losses and impacts. Various Government policies present aspirations to ensure that disaster losses and impacts are sustainably reduced, breaking the cycle of food insecurity, and building the country's resilience to disaster risks. However, implementation is hampered by policy implementation challenges.

Risk mitigation can help reduce the impact of economic downturns and natural disasters, but historically has been neglected. Risk of droughts or floods can be mitigated by improving water management, building irrigation, using improved seeds, or diversifying into cash crops or non-farm employment.

Efforts to address land degradation through sustainable land management (SLM) practices offers opportunities for inclusive poverty reduction. SLM investments in Malawi are estimated to generate a 32% internal rate of return (IRR) with agroforestry, woodlots, on-farm soil conservation and natural forest rehabilitation offering substantial opportunities (LTS et al 2013). Furthermore, the benefits of SLM are highly inclusive, accruing mainly to smallholder farmers, followed by electricity consumers benefitting from reduced power outages associated with improved watershed protection and erosion control.

- *Priority policy intervention 1: Strengthen social protection programs*

To improve households' ability to address shocks and exit from poverty, the following reforms need to be adopted. First, government needs to establish and meet domestic spending targets for basic safety net interventions, which are currently almost exclusively donor financed. Second, it needs to refine its program mix by strengthening the core safety net with increased focus on cash transfers, and careful review of public works. Third, ongoing efforts to improve the targeting of the ultra-poor should be sustained. Fourth, safety nets should be strengthened to promote resilience and respond to shocks.

- *Priority policy intervention 2: Adopt risk mitigation initiatives*

Increasing climate risks can be countered by investments in agricultural development but also by a range of sustainable natural resource management interventions – such as scaling-up sustainable land management practices, measures to protect forests and woodlands and to improve the management of water resources. At the macroeconomic level, prudent fiscal and monetary policies can reduce the risk of macroeconomic crisis.

INTRODUCTION

1. The Systematic Country Diagnostic (SCD) for Malawi provides the analytical foundation for country-level actions and investments to foster progress towards the World Bank Group (WBG) Twin Goals as well as the country's national goals. The main purpose of the SCD is to identify the key challenges and opportunities that Malawi faces as it works towards eliminating extreme poverty and boosting shared prosperity in a sustainable manner. The systematic and evidence-based analysis from the SCD will serve to inform a new Country Partnership Framework and help the WBG, Government and external partners to prioritize and align their strategies towards achieving the twin goals.

2. Over past decades, Malawi's development progress has been negatively affected by shocks, both climate-related shocks, and domestic political and governance shocks, which have collectively contributed to a slow pace of poverty reduction. Very little progress has been made in reducing poverty in rural areas, where most Malawians live. Weak governance and entrenched political clientelism have been obstacles to policy reform and the development of the country. This SCD takes a holistic approach to identify the drivers of previous poor growth performances, drawing on the history of Malawi, and proposes a set of priority areas to promote durable and inclusive growth.

3. The SCD relied on existing literature, new analysis, and consultations to identify priorities for Malawi. The SCD is designed to be an evidence driven exercise that draws together diverse findings into a comprehensive country diagnostic. As part of the process, the team reviewed scores of documents, including survey findings, reports, project documents and journal papers, prepared by the World Bank other bilateral and multilateral donors, think tanks, civil society organizations, non-governmental organizations, and academia, covering both quantitative and qualitative evidence. A key contribution was the 2017 Country Economic Memorandum (CEM) and the various background papers supporting the CEM. The team also drew on previously unreleased poverty data from the 2016/17 IHS4. Moreover, the SCD applies the framework of the World Development Report 2017, Governance and the Law, to go beyond identifying technical constraints and policy solutions to analyze the underlying causes of poverty reduction and growth performance and factors that have impeded policy effectiveness. The SCD process also involved stakeholder consultations with government, civil society, private sector, and citizens of Malawi to incorporate their perspectives. Throughout the process the SCD team worked closely with World Bank sector experts to better understand complex relationships within or between sectors. Those areas in which the team still found the evidence base incomplete have been identified as priority areas for future research and are discussed in the Knowledge Gaps section.

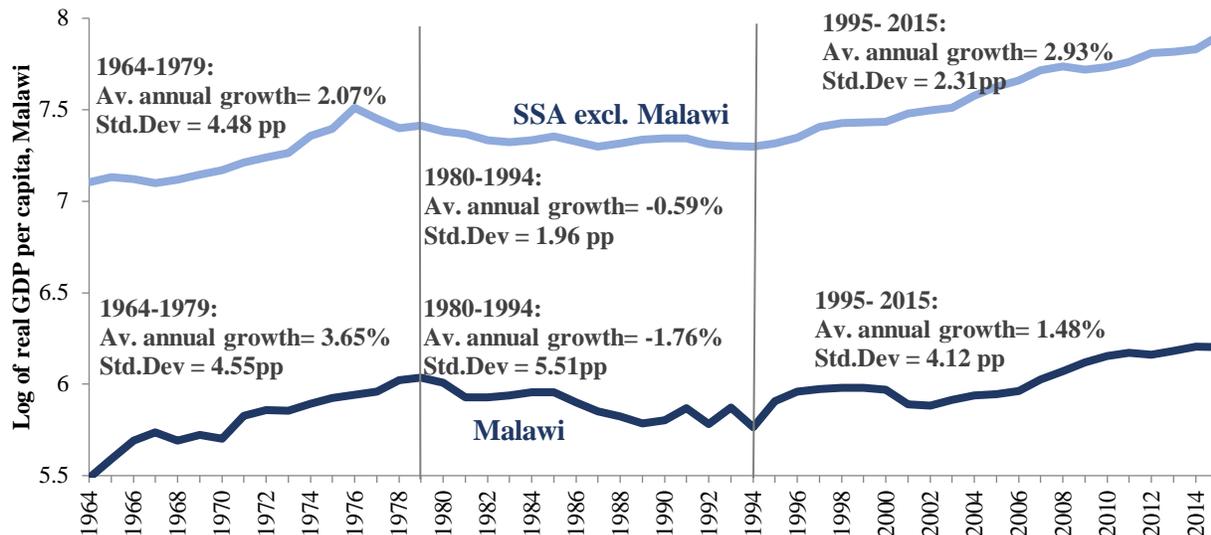
4. The SCD is divided into six parts. The first part gives an overview of the country context, while the second part traces out the trends in economic growth. The third part analyses poverty and shared prosperity in Malawi and their main drivers. The fourth part provides the main diagnostics, identifying the key constraints and pathways for Malawi to achieve the twin goals. The fifth part outlines the preliminary hypotheses for achieving the twin goals, while part six indicates knowledge gaps and areas for further research.

1. MALAWI COUNTRY CONTEXT

A. An agriculture-dominated economy that is subject to multiple shocks

5. **Malawi is a landlocked economy in sub-Saharan Africa and among the world’s poorest, with a per capita GNI of just US\$320 in 2017 (WDI, 2018).** Economic growth in Malawi has been historically more volatile and lower than the rest of SSA (see Figure 1.1). Such an erratic growth performance has been attributed to both external shocks, such as severe climate shocks and, often domestically generated policy-induced, macroeconomic instability. Poverty levels have remained among the highest in the region, although there has been improvement in terms of non-monetary wellbeing.

Figure 1. 1: Malawi has had lower average annual growth and higher volatility than the rest of SSA
Real GDP per capita, Malawi versus SSA 1964-2015



Source: World Bank/MoFEPD staff estimates based on WDI 2016; Real GDP per capita is in constant 2010 US\$

6. **The agricultural sector dominates the economy, accounting for almost 30 percent of GDP, around three-quarters of total exports and 64 percent of the labor force.** Over 80 percent of households depend on the sector for at least some of their income. Other major sectors of the economy are highly dependent on agricultural performance, including manufacturing and wholesale and retail trade. Since the agricultural sector serves as a primary source of food supply, incomes, employment, foreign exchange and government revenue, risks affecting the sector have a far-reaching impact on the overall economy.

7. **Over the past decades, Malawi has been struck by several large-scale weather shocks that have resulted in plunges in crop production, spikes in food prices and food insecurity, especially in rural areas.** Climate shocks and erratic rainfall patterns seem to have increased in both their frequency and intensity over the past years. On average, droughts and floods reduce total GDP by about 1.7 percent per year (GFDRR, 2009). Recent climate shocks include flooding in the Southern Region in 2015 resulting in the destruction of 4 percent of Malawi’s arable land, and the El-Niño-induced drought of 2016 which pushed 40 percent of the population into food insecurity (MVAC, 2016). As food constitutes around half of the national consumer price basket, and nearly two-thirds in rural areas, high food prices have had a particularly negative impact on household welfare. The poor are particularly affected, as food inflation continues to erode their incomes throughout the country, with those in rural areas being predominantly net food buyers (World Bank, 2016a).

8. **While climate shocks continue to affect the entire region, a number of factors aggravate their effects in Malawi.** In terms of a headcount ratio, Malawi’s poverty rate is significantly higher than that of

neighboring countries. In addition, Malawi has the highest poverty gap ratio, indicating that a large share of the population is barely able to cover their food needs, even in normal years. The situation is exacerbated by Malawi's high population density, with 238 people/km² of agricultural land, compared to the average level of 53 people/km² in neighboring countries (World Bank, 2017b). Agriculture remains focused on the cultivation of a small number of crops, with 49 percent of agricultural land being utilized for the cultivation of maize. It is estimated that only 0.5 percent of crop plots are under irrigation, rendering production levels and smallholder incomes particularly vulnerable to changing rainfall patterns and associated price swings.

B. A landlocked situation and weak export base creates a competitive disadvantage in trade

9. As a landlocked country with limited natural resources, Malawi faces higher costs and suffers from a number of competitive disadvantages in trade. This has resulted in the country experiencing large structural deficits on the current account balance throughout its history. Malawi is distant from major ports, with freight having to cross neighboring countries. Despite the fact that international transport rates, measured as per ton/km, are roughly comparable to those along other corridors in the region, the total costs of bringing goods to the nearest port remain higher than along the most competitive corridors due to the long distances. Furthermore, domestic transport prices remain especially high relative to international prices, despite short distances within Malawi (Gondwe and Kirk, 2014). The transport costs between farm and market centers remain 10 to 20 times higher than comparable costs in Mozambique (World Bank, 2015a) mainly due to poor feeder roads, low volume of trade between rural locations and market centers and low level of competition among service providers (Lall et al., 2009). This leads to imports consistently outpacing exports, as Malawi depends on a weak and undiversified export base, mainly consisting of primary commodities, such as tobacco, tea and sugar.

C. The rate of population growth is high and poses a major challenge for poverty reduction

10. Rapid population growth and a large youth cohort in Malawi pose challenges for poverty reduction. In the last decade, Malawi has maintained an average annual population growth rate of about 3 percent—above the average of 2.7 percent for low-income countries in SSA—adding to its population a little under half a million people each year, on average. If current trends persist, the country's population is expected to double in approximately two decades, from 17.2 million in 2015 to 34.4 million in 2038 (UNDESA, 2015). Sustained high fertility rates at 5 births per woman combined with declining mortality rates, particularly in children, explain these demographic dynamics. The country's total and adolescent fertility rates are among the highest in the world ranking 15th and 7th respectively in 2014. However, the latest Demographic Health Survey 2015/16 showed significant improvements in demographic transition – for example, the total fertility rate declined to 4.4.

11. The increasing demands of the growing population are exerting pressure on Malawi's limited arable land and natural resources. In a country that was ranked the 10th most densely populated in SSA in 2014, population growth is contributing to the depletion of natural resources, is reducing productive capacity and increasing exposure to the effects of climate change. Malawi has lost 19 percent of its forest cover over the last 25 years according to FAO estimates, resulting in the lowest hectareage of forest cover *per capita* among neighboring countries. Groundwater levels have dropped significantly and erosion presents a growing challenge. Agricultural yields and farm/smallholder income have been reduced by the loss of soil fertility as a result of land degradation. Prudent management and restoration of soils will be critical to ensure the sustainability of agricultural production in the country.

D. Malawi's political economy trap: recurring cycles of crisis

12. In addition to the above structural factors, the political economy context is important to setting the stage for Malawi's performance regarding the twin goals. The World Development Report (WDR, 2017) highlights how governance is the process through which state and non-state actors make

decisions on the design and implementation of policies. That process is shaped by the relative power and particular interests of actors in the ‘policy arena’, which in turn shapes the ability of the government to commit to developmental policies and to induce collective action in support of their implementation.⁴ The policy arena is shaped by Malawi’s unique combination of structural conditions, historical legacies and the evolution of its political settlement,⁵ and is characterized by an elite bargain that allows competition among a small elite, while providing stable benefits to them; fragmentation along identity lines; high donor dependence, and a limited social contract based on food security and maize in particular. These characteristics have contributed to a stable, but low-level equilibrium, trapping the country in a cycle of crises, followed by reactive responses rather than deeper commitment to reform needed to break out of the cycle (Banik and Blessings 2016, Cammack 2017, Koch 2015).

13. Malawi’s policy arena is shaped in part by legacies of past political and economic strategies that bet on a limited set of private sector partners to deliver growth and rents. Malawi experienced strong growth in its first post-independence decade, largely due to select state-driven investment in agricultural estates that cultivated export crops. The wealth this generated supported the consolidation of a powerful, yet developmental one-party state under the highly personalized reign of Hastings Kamuzu Banda. By the late 1970s, however, it was clear that the vast majority of the population remained subsistence smallholders, unable to participate in the high value economy. Yet, due to political imperatives, these structural flaws were never properly addressed (Said and Singini 2014). Compounded by external shocks – the oil crisis, decline in commodity prices, Mozambique’s civil war – Malawi adopted structural adjustment policies which severely limited the rents that held together Banda’s patronage network. As the economy declined, political competition and popular grievance emerged, leading to a loss in policy focus as political survival took center stage. The next fifteen years saw an increase in suppression, deterioration in bureaucratic effectiveness and in the quality of policy making. Ultimately internal pressure led by church groups and trade unions, together with external pressure from donors led to democratic regime change.

14. Multi-party elections were adopted through a referendum in 1993, introducing a period of democracy, which has nonetheless been called a ‘transition without transformation.’ (Chirwa 2001). As previously, the President has retained vast powers, with weak checks and balances: Parliament is largely dependent on the executive, civil society is weak, and there is a very limited private sector. Although the number of political parties has multiplied from seven in 1994 to over forty today, they are mostly led by members of a small elite and revolve around strong individuals rather than substantive programs. In what has been called ‘chameleon politics’, three of the four elected presidents broke off from the ruling party to form their own, bringing along a host of loyalists. While this has been challenged as unconstitutional, the practice of crossing the floor has prevailed, enabling personal, rather than issue based coalitions. While political competition is real, the overall political settlement is stable, allowing elites to benefit often at the expense of a policy environment conducive to broad based development (Cammack 2017).

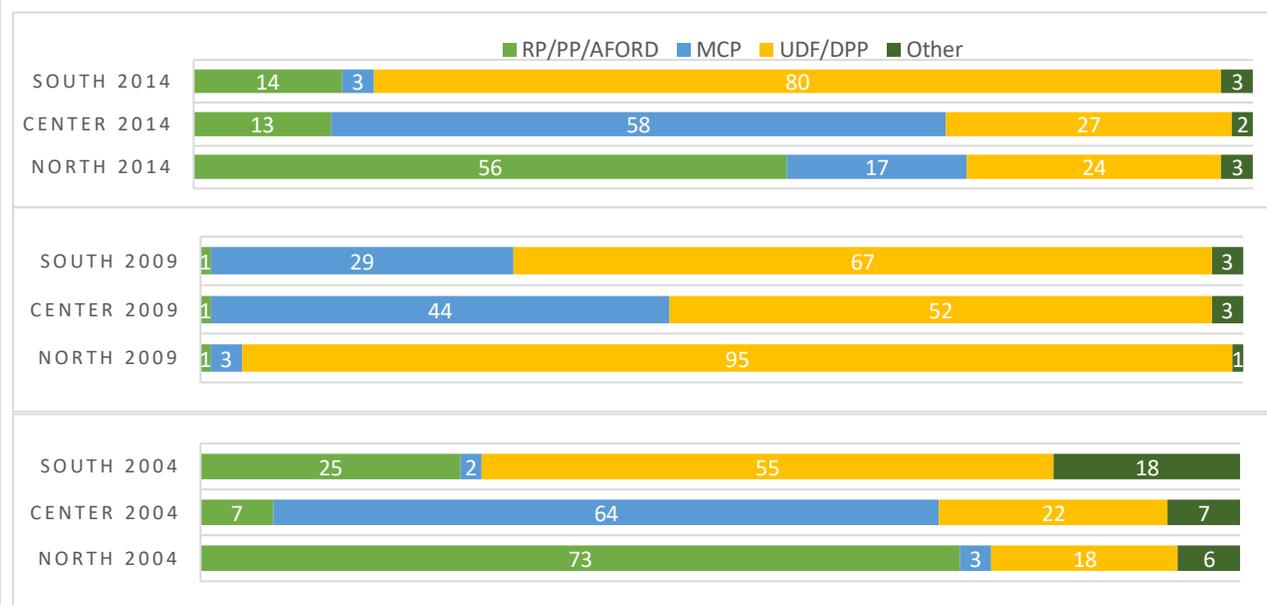
15. The need for political loyalty has led to increased appeal to identity politics through co-ethnics, regionalism and cooptation of traditional chiefs (Cammack 2017). Tribal cultural associations have been used as political machines to bring out the vote and reward loyalists, leading to widely reported accusations of nepotism and ethnic-based appointments (Zeze 2015). For the most part, voting has largely followed regional patterns, indicating the extent of identity-based politics. The exception in 2009, in which Bingu wa Mutharika won a clear majority in all three regions, is in part due to incumbency bias, but also the impressive development record of his first term, indicating that under the right conditions identity politics may be overcome by development performance (Figure 1.2).

⁴ The policy arena is the de facto setting in which policy decisions are made. It can be formal or informal and may vary depending on the particular issue at stake. WDR 2017.

⁵ A political settlement, or ‘elite bargain’, is an (often tacit) agreement among elites on the rules of the game for the distribution of power and resources. ‘Elite bargains are dynamic, constantly adapting to changes in the relative power, incentives, and preferences of elite actors.’ (WDR 2017 (chapter 7); see also Khan 2010).

Figure 1. 2: Regionalization of electoral politics

Presidential elections in 2004 and 2014 have largely followed regional patterns; 2009 saw the reelection of incumbent DPP candidate Bingu wa Mutharika by a landslide



Based on National Elections Commission data

16. The politics of succession in this system of competitive clientelism has drawn politicians to shore up support and resources through rent seeking and the delivery of short term private goods at the expense of investment in long term development strategies. Whereas in the first two post-independence decades Banda’s centralized patrimonial system built around control of productive resources allowed for investment in a capable bureaucracy where ‘patronage followed policy’, the current fragmented politics where the public sector is the key source of rents leads to a logic of ‘policy following patronage’ (Cammack et al 2018). This perpetuates a political logic in which corruption is tolerated as a means of rewarding loyalists, and rents are captured to promote political aims rather than to reinvest in poverty reduction and inclusive growth (Cammack, Kelsall and Booth 2010).

17. Policies concerning maize—the country’s food staple—are at the heart of this political economy. Periodic suffering from food shortage and the dominant role of agriculture in the economy has put the availability of maize at the center of the social contract between the state and the people (Chinsinga 2012). While state interventions in agriculture date back to the 1971 creation of the marketing parastatal ADMARC, since the late 1990s the government has introduced a series of initiatives to guarantee food security, primarily through targeted inputs, subsidies and price stabilization interventions. It has become apparent, however, that the system has been readily manipulated for populist political purposes while providing significant opportunities for patronage via non-transparent targeting, pricing and procurement (Chinsinga and Poulton 2014). At the same time, yields have not met targets, maize price volatility remains high and the focus on maize has prevented much needed crop diversification. As the main agriculture program (FISP accounted for 75 percent of the budget for agriculture or 3 percent of GDP in FY2014/15 (World Bank 2017b)), it has come at the expense of critical measures to promote productivity such as irrigation and extension services. While more recently the government has made sustained progress in limiting the negative effects of FISP, the emotive issue of maize security underlies policies that are reactive rather than proactive and riddled with opportunities for rent seeking.

18. These dynamics have led to poor policy choices that have exacerbated the effects of weather and global economy related shocks, and resulted in unstable aid flows, leading to recurring cycles of crisis. Malawi’s insufficient fiscal and policy discipline, as well as numerous corruption scandals, have led to repeated cycles of the suspension of donor budget support, notably in 2001, 2010 and 2013 (figure 1.3).

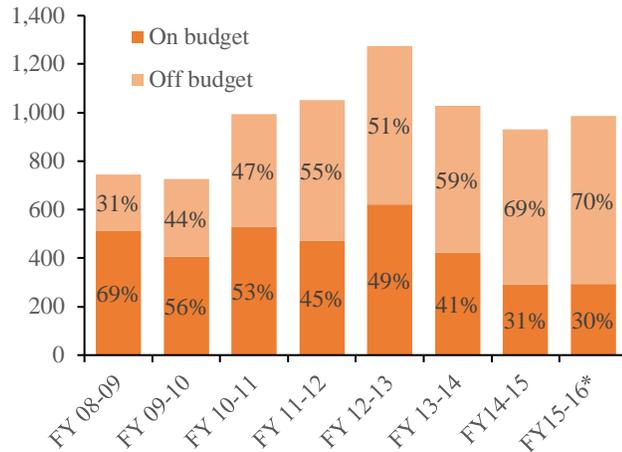
Malawi is heavily dependent on donor aid, averaging at over US\$ 1 billion per annum, between 2010 and 2015 (WDI, 2017), which equates to about US\$60 per capita each year in official development assistance (ODA), compared to around US\$50 in SSA as a whole. The most recent withdrawal of (on-budget) 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. These crises in turn are met by a wave of reforms aimed in part at restoring aid flows.

But these reforms are then diluted and even derailed by entrenched interests or political exigencies, leading to the suspension of donor budget support once again and the consequent destabilization of the Malawian economy. Donor behavior has been seen as contributing to these dysfunctional dynamics by demanding reforms that can be met by superficial changes, reinforcing tendencies of ‘isomorphic mimicry’ (Bridges 2016; Koch 2015). This phenomenon of ‘partial reform syndrome’: whereby aid is reinstated at the promise of reform, which often proves to be temporary or superficial – with a focus on form over function has been well documented in Malawi (Bridges and Woolcock 2017).

19. Breaking out of these recurrent cycles requires strong commitment from the highest levels to implement rule based systems and an overall culture change. Where reform efforts have had traction, elite incentives have been aligned due to either being in a vulnerable political position and therefore the need to shore up support through performance, as was the case in the first term of Bingu wa Mutharika, who held a minority government, or because of the need to address a threatening economic crisis, and reinstate donor aid (Folscher et al 2012). At these junctures the government has demonstrated the ability to establish discipline and implement sound policy, at least temporarily. Avoiding relapse by fostering more effective institutions will require GoM and donors to work in tandem to strengthen commitment capacity to rule-based systems over time and to shift incentives from immediate political expediency to more steady functional performance on an ongoing basis.

Figure 1.3: The share of ODA on budget has declined sharply

Annual ODA inflows to Malawi in US\$, on and off budget, selected years



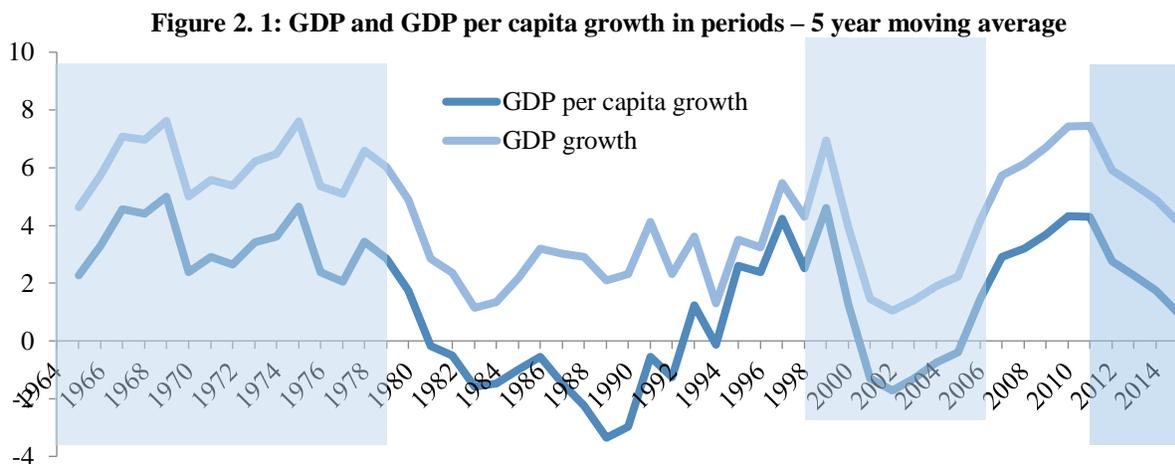
Source: World Bank staff based on data from MoFEPD

*Staff estimate

2. TRENDS AND PATTERNS IN GROWTH

A. Growth performance has been slow with a noticeable divergence from regional peers

20. Malawi's economic performance has been poor since independence despite peace and political stability. Growth has generally been low and volatile, with only two periods of high and relatively stable growth in 1964-1979 and 2003-2010 (Figure 2.1). The economy has largely been driven by developments in agriculture. In the period following independence from British colonial rule in 1964, Government policies were geared towards supporting large-scale estate farming. This led to a growth that was largely uneven, with smallholder production lagging far behind estate production. As a result, despite impressive Growth Domestic Product (GDP) growth and per capita income figures in the period 1964-1979, the economy failed to diversify beyond agriculture and agro-based manufacturing. From 1980-1994, growth spiraled downwards, following a spate of external and internal shocks and the inability of the economy to weather these events. This was made worse by rising population growth, a thin economic base outside estate farming, fiscal indiscipline and poorly implemented and sequenced liberalization initiatives. The introduction of multiparty rule in 1994 did little to support growth, which remained low and volatile with only one period of relatively higher and stable growth between 2003 and 2010.



Source: World Bank staff based on World Development Indicators (WDI) data

21. Malawi's GDP growth has failed to keep pace with similar developing economies. Despite decades of development efforts supported by significant amounts of foreign aid, Malawi has experienced weak and volatile economic growth over a sustained period, falling behind its peers. Malawi's real GDP per capita grew at an average of 1.5 percent between 1995 and 2015, falling below the 2.7 percent average in non-resource-rich (NRR) Sub-Saharan Africa (SSA) economies. Malawi's growth remains an outlier even compared to its geographically and demographically similar peers that were at a similar stage of development in 1990. Real GDP per capita growth has also been more volatile than the regional average since the country's independence (World Bank 2017b).

B. A stagnant capital stock is the proximate reason behind Malawi's inability to grow faster

22. Growth volatility reflects the evolution of the different factors of production and total factor productivity (TFP). A standard growth decomposition, in which GDP growth is attributed to underlying increases in human capital, physical capital or TFP allows an initial inspection (Table 2.1, World Bank 2017b). Labor contribution has remained positive and relatively significant over time. The exercise examined five sub-periods: 1964-1979, 1980-1994, 1995-2002, 2003-2010 and 2011-2015. The first sub-period corresponds to estate driven export agriculture. The second was characterized by fiscal indiscipline and deteriorating terms of trade following the oil price shock and Mozambique's civil war. The third sub-period represents the most volatile period amidst macroeconomic instability and adverse climatic shocks.

The fourth sub-period reflects a resumption in growth due to adoption of appropriate policies. The fifth sub-period saw a stagnation of growth owing to fiscal indiscipline and exogenous climate induced shocks.

Table 2.1: Labor and TFP growth have become relatively more significant sources of GDP growth for Malawi
Decomposition of real GDP growth by component, selected periods

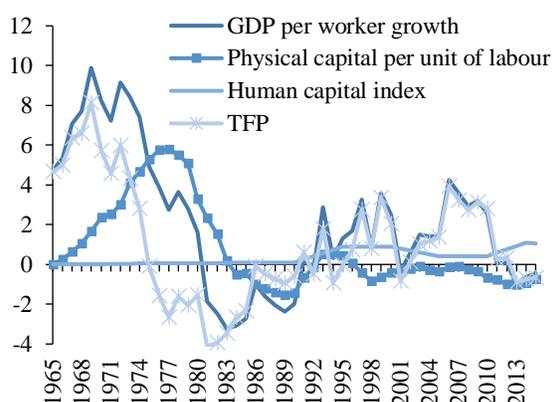
	1964-1979	1980-1994	1995-2002	2003-2010	2011-2015
GDP growth	8.79%	0.90%	2.85%	6.25%	3.82%
<i>Contribution of</i>					
(1) Total factor productivity	2.68%	-1.46%	2.14%	2.59%	1.55%
(2) Physical capital	4.62%	0.69%	0.07%	1.09%	0.24%
(3) Labor	1.49%	1.68%	0.63%	2.57%	2.03%

Source: World Bank staff calculations based on PWT 9.0 data for 1964-2014; for 2015, real GDP growth from WDI, employment growth from ILO.

23. A large share of GDP growth can be ascribed to total factor productivity (TFP) growth. During the 2003-2010 strong growth period, TFP was the most significant contributor to GDP growth, followed closely by labor. Even after considering the growth in human capital (due to increased schooling achievements in Malawi's labor force, particularly since the 1990s), high periods of growth have also been high periods of TFP growth.⁶ In fact, TFP growth tracks GDP per capita growth quite closely (Figure 2.2).

Figure 2.2: TFP growth has quite closely tracked growth in real per capita GDP

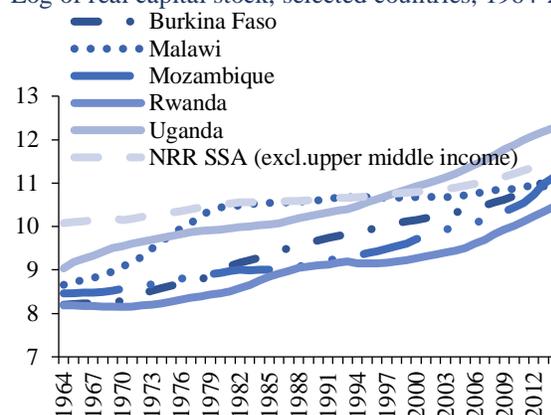
1964-2015, five-year moving average



Source: World Bank/MoFEED staff estimates based on PWT 9.0 data for 1964-2014; for 2015, real GDP growth from WDI, employment growth from ILO.

Figure 2.3: Malawi's capital stock has stagnated compared to its peers

Log of real capital stock, selected countries, 1964-2014



Source: World Bank/MoFEED staff estimates based on PWT 9.0 data.

24. In contrast, the contribution of physical capital to economic growth has been quite small since 1980, with the rate of capital accumulation falling far behind labor growth. While the contribution of physical capital to economic growth was significant during the high growth period of 1964-1979, its contribution has fallen dramatically since then (Table 2.1). In fact, when taking into account population growth by looking at the contribution of physical capital per worker, it appears that physical capital per worker has contributed negatively to economic growth in Malawi since 1980 (table 2.2). This shows that the rate of capital accumulation has lagged far behind labor growth, resulting in thinning of the capital base of the economy. The inability to grow the capital stock has been somewhat specific to Malawi compared to its SSA peers (Figure 2.3), so the reasons behind it are also likely to be specific to Malawi.

⁶ To account for increasing schooling and returns to education, the human capital index was included in the decomposition analysis using the augmented production function approach. Having removed the human capital effect, TFP became a better measure of productivity growth.

Table 2. 2: The contribution of physical capital per worker to economic growth has been negative since 1980
Decomposition of real GDP growth per worker by component, selected periods

	1964-1979	1980-1994	1995-2002	2003-2010	2011-2015
GDP per worker growth	6.29%	-1.92%	1.78%	1.92%	0.40%
<i>Contribution of</i>					
(1) Total factor productivity	2.68%	-1.46%	2.14%	2.59%	1.55%
(2) Physical capital per unit of labor	3.60%	-0.46%	-0.36%	-0.67%	-1.15%

Source: World Bank/MoFEPD staff estimates based on PWT 9.0 data for 1964-2014; for 2015, real GDP growth from WDI, employment growth from ILO.

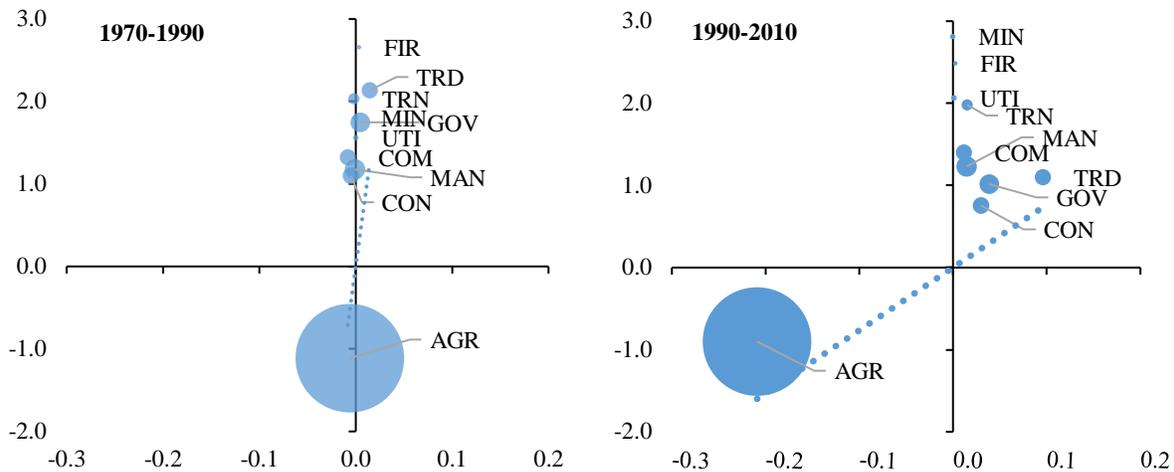
25. The stagnation in capital accumulation over such a long period is mostly attributed to macroeconomic volatility. The alarming negative contribution of physical capital per worker to growth since 1980 implies that total investment in capital remains lower than the cumulative rate of return of such investment. There are two non-exclusive mechanisms that could explain this overall negative contribution. Firstly, the cost of capital is higher than the internal rate of return of the built investment. Secondly, a large share of investments is made towards investments projects with limited productive returns. High inflation rates lower the real rate of return of investment and exacerbates macroeconomic instability which in turn leads to a rise in premiums. The limited ability of the government to raise taxes further adds to the cost of finance by constraining it to primarily rely on domestic borrowing to finance its budget operations thereby crowding out private sector investment. Complementing the high cost of finance, it appears that a large part of investments in the economy has been in unproductive infrastructure projects, which initially result in a boom, as long as construction is ongoing, followed by a bust, when forecasted benefits fail to materialize. Such projects end up becoming a drag on the economy and add to macroeconomic instability when they are debt-financed (Kandoole, Stylianou and von Carnap 2016).

C. Limited structural transformation towards services, although agriculture still dominates

26. The speed of transformation appears to be relatively slow, especially in the context of Malawi's rapidly growing population. Transition to multi-party democracy coincided with an observed shift from agriculture to services. The share of agriculture has since gradually declined to about 30 percent of GDP, while services have expanded to more than half of economic output. Unlike other economies, expansion in industry has not been a major driver of transformation although the period 2004-2010 experienced an 11 percent growth in the sector compared to 7 percent and 1 percent in services and agriculture, respectively.

Figure 2. 4: Malawi experienced some structural transformation from agriculture to services, but with only limited gains in productivity

Correlation between changes in sectoral productivity and employment shares, selected periods of time



Source: Enache, Ghani, and O'Connell (2016).

Note: AGR is agriculture; CON is construction; CSV is public and community services; FIR is financial and business services; GOV is government services; MAN is manufacturing; MIN is mining; TRD is trade services; TRN is transport and communications; and UTL is utilities. The size of the bubble indicates the share of employment in the sector at the beginning of the period.

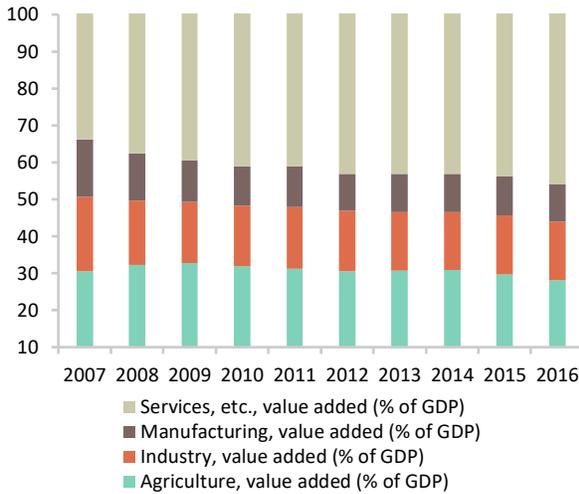
27. Positive yet limited structural transformation appears to be happening in Malawi. Yet labor is shifting towards sectors whose productivity is declining over time. While agriculture is still the dominant source of employment, its share of total employment has gradually fallen. Wholesale and retail trade generated the most jobs for the greater part of the past three decades, followed by government services and construction. These have also been among the least productive sectors, with negative growth in terms of sectoral value added per worker, although their productivity remains higher than that of agriculture. This also links to the growth decomposition findings that Malawi has experienced limited capital investment towards sectors with lower productivity, such as construction and real estate. Employment growth has therefore been the result of ‘push factors’ out of agriculture, such as increasing population and degradation of soils, rather than ‘pull’ factors toward services.

D. Growth has been driven by services on the supply side and consumption on the demand side

28. The most dynamic sectors for over the past decade were construction; and the service sub-sectors⁷ (wholesale and retail trade, real estate, information and communication and financial services). Growth in agriculture was limited although it contributes the most to GDP growth. Differences across sectors reflect changes in supply and demand. For example, the fertilizer subsidy implied a supply shift in the production function of maize and other crops whilst the expansion of mining and quarrying was mostly the result of an increase in external demand for minerals. The multiplier effect of government expenditure and aid is visible in the dynamism of the service subsectors and construction.

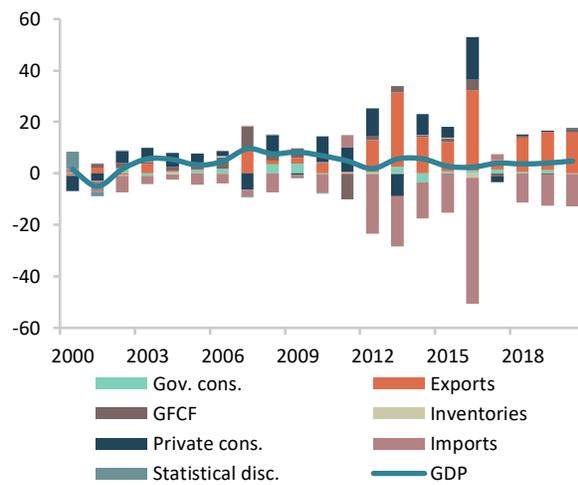
⁷ For example, the expansion of information and communications was the result of the mobile phone technology against the background of a sharp increase in domestic demand (the number of households with mobile increased from 3.0 percent in 2005 to 47.5 percent in 2017). Innovations in the financial sector include higher penetration of village banks as the largest source of loans (did not exist in 2005 but have grown to 38.1 percent in 2017) whilst loans from commercial bank have remained low as access to finance continues to be prohibitive (from 2.0 percent in 2005 rising to 11.9 in 2011 and dropping to 3.3 percent in 2017). Growth in manufacturing has mostly been in agro-processing whilst real estate development has complemented the construction industry.

Figure 2. 5: Supply side contribution to GDP growth Percentage of GDP



Source: World Bank MFMod

Figure 2. 6: Demand side contribution to GDP growth Percentage of GDP

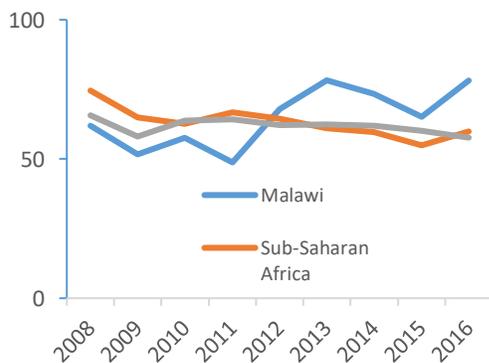


Source: World Bank MFMod

29. Decomposition of the rate of growth by component of aggregate demand revealed that consumption -household and government - and exports were the most dynamic components. As discussed above, the contribution of investment to growth has been limited reflecting high macroeconomic volatility. The government’s high appetite for borrowing also crowds out private sector investment.

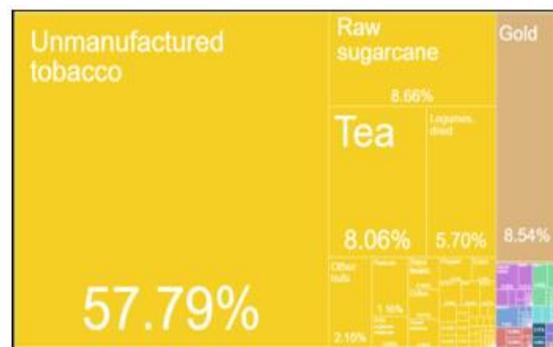
30. Malawi continues exporting primarily agriculture commodity products which are vulnerable to external shocks, particularly for tobacco, which is facing progressively lower global demand. Malawi has increased trade since 2011, outperforming the Sub-Saharan average, after the exchange rate was floated (Figure 10). However, the country has not been able to significantly expand its export base and terms of trade have been on a declining long-term trend (Mwanza, 2013). The top five products – unmanufactured tobacco, raw sugarcane, gold, tea, and dried legumes – account for 89 percent of goods exports (Figure 11). This concentration signals the need for value addition and investment in export diversification and integration. Malawi maintains a comparative advantage in the vegetables and food products sectors. Vegetables accounted for 17 percent of Malawi’s exports in 2015 after growing by an average of 8 percent between 2008 and 2015. Food products, which accounted for 60 percent of Malawi’s goods exports in 2015, on the other hand, experienced negative growth rates over the same period.

Figure 2. 7: Trade openness (as imports and exports of goods & services relative to GDP), 2008-2016



Source: World Development Indicators

Figure 2. 8: Goods export composition (shares), 2016



Source: UN Comtrade access through WITS

E. Cautious optimism as economy is characterized by repeated external and policy induced shocks

31. Following two years of depressed economic activity, real GDP growth picked up to 4 percent in 2017 but is expected to moderate to 3.7 percent in 2018. With a rebound in agricultural production, the prospects for growth were generally positive. However, performance in the industrial and services sectors was much weaker than anticipated. Industry was adversely impacted by structural challenges related to erratic energy and water supply, which had a particularly negative impact on manufacturing. Within services, the performance of the wholesale and retail trade and distribution sub-sectors declined as a result of subdued domestic demand. In 2018, the growth rate is projected to moderate due to an estimated decline in agricultural production on account of erratic rains and Fall Army Worms infestation. The performance of industry and services is also projected to remain weak as structural challenges remain.

32. After six years of double digit rates, year on year headline inflation has receded towards single digit levels. Inflationary pressure subdued in the latter half of 2017, with the year-on-year headline rate falling to 7.1 percent in December. The decline was largely due to a fall in food inflation, from a high of 20 percent in December 2016 to as low as 4.3 percent in December 2017. An interesting reversal in the factors driving inflation was noted, with non-food inflation remaining sticky and slowing down only marginally, from a peak of 15.4 percent in December 2016 to 10 percent a year later. Inflationary pressure has remained subdued recording a year on year headline inflation rate of 7.8 percent in February 2018.

33. Responding to the significant decline in the headline inflation rate, the RBM has continued to cautiously ease monetary policy. Since November 2016, the RBM has reduced the policy rate by an overall 11 percentage points, with a reduction by 8 percentage points in 2017 alone. While the reduced policy rate has led to a decline in lending rates, the decrease has not been enough to significantly stimulate long-term borrowing for investment. Commercial banks have continued to impose a risk premium on lending, resulting in only moderate adjustments to base lending rates. On average, commercial banks' minimum lending rates have declined from about 34 percent in January 2017 to around 25 percent in January 2018, with the maximum lending rates declining from 42 percent to 32 percent over the same period. Despite the revision in lending rates, they remain prohibitive for long-term financing.

Figure 2. 9: Volatility in the economy is reflected in a relatively high and unstable rate of inflation...
Percentage change in annual consumer prices

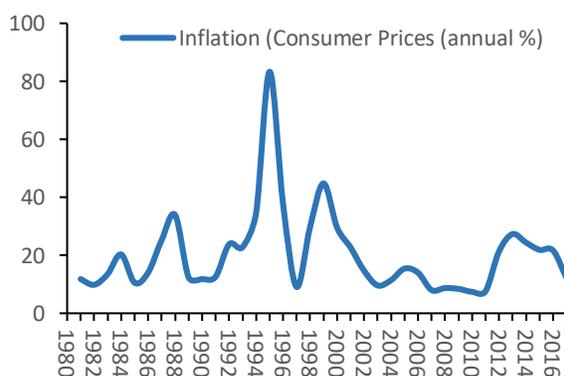


Figure 2. 10: ...high and unstable interest rates...
Real interest rates, percentage

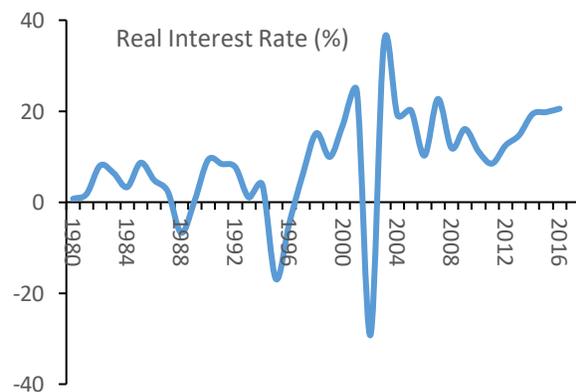
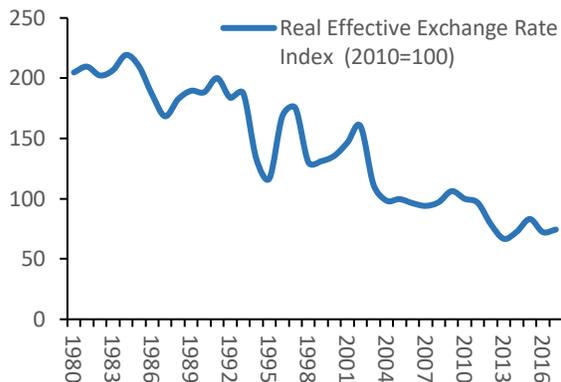
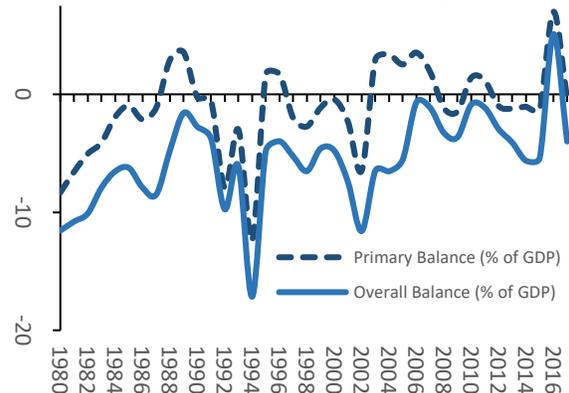


Figure 2. 11: ...a declining exchange rate
Real effective exchange rate, index



Source: World Bank staff based on WDI, NSO, RBM and MoFEPD data.

Figure 2. 12: ...and persistently large fiscal deficits
Primary and overall balance, percentage of GDP



34. Maintaining steady levels of foreign exchange reserves has also enabled the authorities to tame typical seasonal variations of the exchange rate. Traditionally, the Kwacha appreciates in the early months of the year, prior to and during the tobacco sales season, and depreciates towards the end of year as reserves are drawn down to finance significant expenditures on imports, such as fertilizer for FISP. The RBM has continued to implement measures to absorb excess liquidity in the banking system, which has contributed to the stability of the Kwacha. Since August 2016 the Kwacha has traded at an average of MWK 730 to US\$1, with foreign reserves reaching 3.4 months import cover in January 2018.

35. In FY 2016/17 the fiscal gap was contained at 4.8 percent of GDP, after several years of deficits of about 6 percent of GDP, mainly due to strong revenue performance and controlled spending. By the end of the fiscal year, the deficit had declined from 6.1 percent of GDP in FY 2015/16 to 4.8 percent of GDP in FY 2016/17, even lower than the revised target of 5.2 percent of GDP envisaged at mid-year. Despite a looming food crisis, Government was also able to somewhat contain spending within the approved ceiling.

36. The fiscal outlook is threatened by the risk of the Government's difficulties in curtailing expenditures during economic slowdowns and in the face of unrealized revenues. Although weather related shocks have been implicit in fiscal imbalances, several episodes of instability have resulted from bad fiscal management even in the absence of external shocks. The revised mid-year budget projects the fiscal deficit to widen to 7.1 percent of GDP in FY 2017/18. This has been driven by significantly lower than expected revenues and expenditure overruns largely due to the securitization of arrears and the realization of a contingent liability (2.3 percent of GDP). This has been compounded with mounting spending pressure in the run up to the general elections in 2019.

37. Malawi's external outlook seems promising but threatened by risks related to vulnerability to the external environment. The current account deficit is projected to narrow to 9.2 percent of GDP in 2018 from 11.3 percent in 2017. A significant shift towards tobacco production is expected due to higher prices obtained in 2017, the collapse of the pigeon peas market, and generally lower prices for most other commodities in 2017, especially maize. Malawi's export performance is, therefore, expected to improve. The import bill is also projected to increase modestly due to additional fuel imports for emergency diesel power generators that were commissioned by the Government in January 2018. However, demand for other imports is estimated to continue to be subdued.

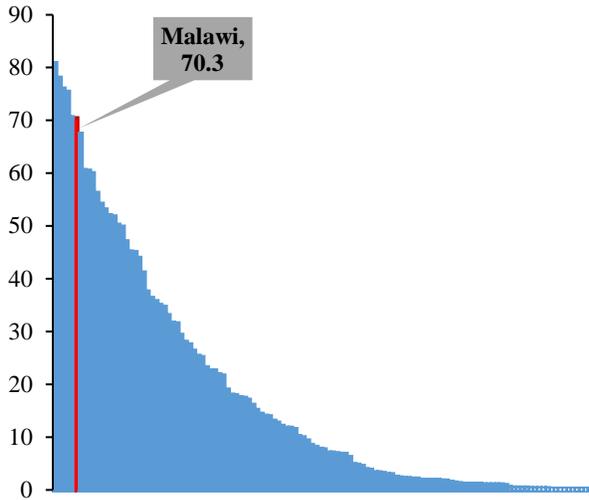
3. POVERTY AND SHARED PROSPERITY: PATTERNS AND CAUSES

A. Ultra-poverty has started to show a reduction, but other poverty measures have stagnated

38. Malawi is the sixth poorest country in the world and its pace of poverty reduction has been very slow. According to the World Bank’s projections, around 70 percent of the population in Malawi live below \$1.90 per day per capita (2011 Purchasing Power Parity).⁸ This is the sixth highest poverty headcount rate in the world, after Central African Republic, Madagascar, Democratic Republic of Congo, Burundi and South Sudan (see Figure 3.1). If the middle-class poverty line (\$3.10 per day per capita) is used, nearly 90 percent of the population is living in poverty. These metrics indicate that Malawi’s pace of poverty reduction has been slower than the sub-Saharan (SSA) average and slower than the decline seen in neighboring countries such as Mozambique, Tanzania and Rwanda. These countries all had higher poverty rates than Malawi in the early 2000s but recorded significantly lower rates in 2013 (see Figure 3.2).

Figure 3.1: Malawi is the sixth poorest country in the world

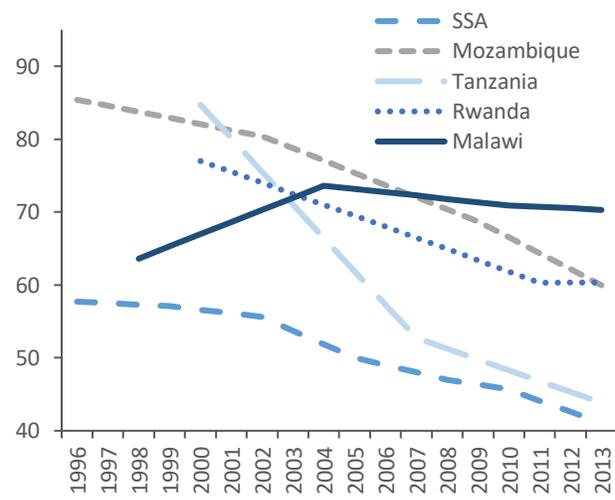
Poverty headcount rates (percentage) measured at \$1.90/day/capita (2011 PPP) in 2013, ranked countries of world



Source: Authors’ calculation based on data from PovcalNet (August 1, 2017 version). Note unless a country had household survey data in 2013, poverty headcounts are projected with data from National Accounts

Figure 3.2: Malawi’s pace of poverty reduction has been very slow in comparison to its neighboring countries

Poverty headcount rate (percentage) measured at US\$ 1.90/day/ capita in 2011 PPP terms



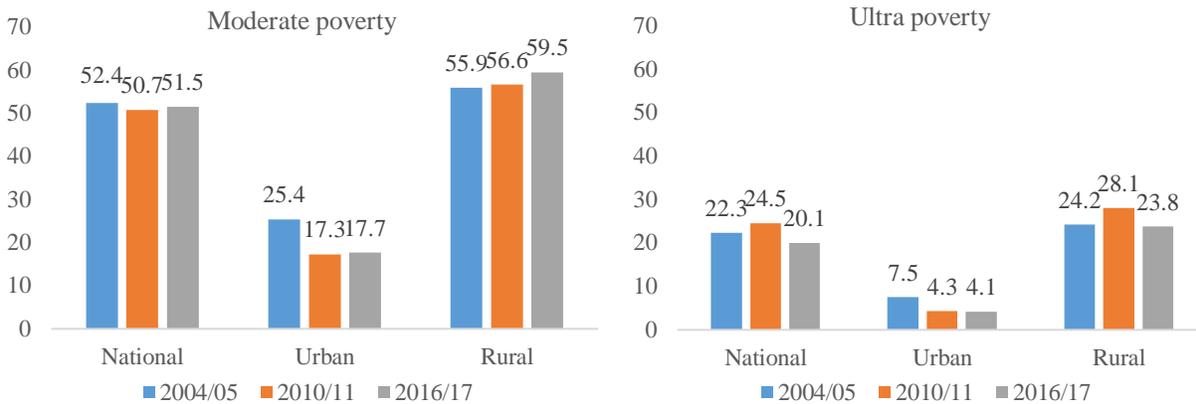
Source: Authors’ calculation based on PovcalNet data (August 1, 2017 version). Note: Poverty headcount rates for 2013 were projected using data from the National Accounts. Details are available in PovcalNet

39. Latest national estimates of official poverty show that moderate poverty rates have stagnated at high levels, while ultra-poverty rates have declined significantly. The National Statistics Office of Malawi publishes two official poverty measures – moderate and ultra-poverty. These measures are released every six years following the completion of the Integrated Household Survey (IHS). Both measures use household expenditure per capita as a welfare measure. The moderate poverty measure is based on a poverty line approximately 60 percent higher than the benchmark used for the ultra-poverty measure. According to these measures, a quarter of the population still lives in ultra-poverty and approximately half the population

⁸ In this report, four measures of poverty will be discussed. 1. International poverty measure – a proportion of population below \$1.90 (2011 PPPs) per day per capita. This measure is estimated by the World Bank for international comparisons. 2. Official moderate poverty – a proportion of population below 4518 MWK (April 2016 prices). This measure is estimated by the National Statistics Office of Malawi. 3. Official ultra-poverty – a proportion of population below 2803 MWK (April 2016 prices). This measure is also the National Statistics Office of Malawi. 4. Chronic poverty – A proportion of population who were moderately poor in both 2010 and 2013. This measure is estimated using Integrated Panel Survey.

have persistently lived in moderate poverty since 2004. The proportion of the population living in moderate poverty has seen no improvement since 2010, however the proportion of ultra-poor shows a significant reduction – by more than 4 percentage points. Across both poverty measures, approximately 95 percent of the country’s poor reside in rural areas. With the poor predominately living in rural areas, national poverty rates follow rural poverty trends – stagnation in the moderate poverty rate but a reduction in the ultra-poverty rate since 2010.

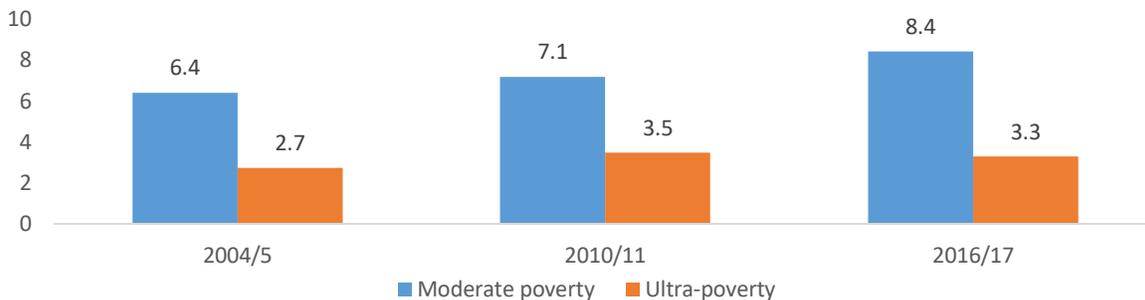
Figure 3. 3: Poverty headcount rates (%)



Source: World Bank (2016b) and World Bank (2018)

40. The number of ultra-poor has stopped increasing for the first time since 2004/05 while the number of moderate poor continued to increase. Malawi’s population has been increasing at an annual rate of roughly 3 percent since 2004. With rapid population growth but no improvement in the moderate poverty rate, the absolute number of those living in moderate poverty has correspondingly increased by more than 30 percent since 2004-05. In line with the reduction in the proportion of those living in ultra-poverty since 2010, the absolute number of ultra-poor, has stopped increasing.

Figure 3. 4: But, the number of the moderate poor has risen over time



Source: Authors' calculation based on IHS population projection and poverty rate.

B. Who are the poor?

41. Most of the poor live in rural areas and poor households tend to have higher dependency ratios, lower educational achievement, less diversified sources of income, and less access to assets and services compared to non-poor households. Poverty in Malawi is predominantly rural. Nearly 95 percent of the poor live in rural areas where 57 percent of the population is poor, compared to 17 percent in urban areas. Poor households typically have a larger number of household members, particularly children and the elderly. Poor households have lower primary and secondary school completion rates than non-poor households and higher rates of stunted growth among children (46 percent) compared to the richest quintile

(24 percent) (NSO and ICF International, 2016). In addition, poor households rely primarily on farm activities, usually with lower returns than other types of work.

42. Almost one quarter of the population are chronically poor and most of them reside in rural areas. Data from Integrated Household Panel Survey (IHPS), which are panel surveys conducted in the non-lean seasons of 2010 and 2013 using a subsample of IHS, give greater insights into the characteristics of poverty. According to IHPS data, 60 percent of all poor in Malawi were chronically poor, i.e., remained poor between both surveys in both 2010 and 2013. Of the 2.6 million people who are classified as chronically poor, 2.4 million live in rural areas. Those who are chronically poor were also significantly poorer to begin with than those who were able to escape poverty. The initial average consumption of those who remained poor between 2010 and 2013 was 35 percent below the poverty line, as compared to the initial average consumption of those who escaped poverty which was at 28 percent below the poverty line.

43. The main drivers of poverty reduction in rural areas have been diversification into productive activities in the non-farm sector and increased crop income. Analysis using IHPS data shows that those who exited from poverty between 2010 and 2013 were more likely to have diversified into the non-farm sector and were able to increase crop income compared to those who stayed in poverty (World Bank, 2016b).

44. For urban areas, a key driver for poverty reduction is non-farm wage employment. Between 2010 and 2013, due to heightened macroeconomic instability however, many non-farm wage workers moved to non-farm sector self-employment or experienced a significant wage cut.

45. Malawian women remain disadvantaged in both economic and political arenas. Female-headed households constitute a quarter of poor households and are relatively more deprived than male-headed households in terms of access to public services, access to finance, improved housing conditions, and asset ownership. Less access to and control over productive resources has direct implications on women's productivity.

C. There have been modest improvements in reducing the non-income dimensions of poverty

46. In the last decade, the proportion of people who are multi-dimensionally poor saw a modest decline due to gains in education and health. The share of the population that faced deprivation in the areas of education, health, and holding of assets fell from 71 percent in 2004 to 61 percent in 2010⁹. Both urban and rural areas saw reductions in multi-dimensional poverty, with more notable progress in rural areas (World Bank, 2016b). The 1994 Free Primary Education (FPE) policy eliminated tuition fees for primary education which resulted in a surge in gross enrollment—from 104 percent in 1994 to 152 percent in 1995. Gross enrollment in primary education has since stayed above 120 percent (WDI, 2017). Primary school completion rates that were as low as 41 percent in 1994, have risen for both male and female children to reach 79 percent in 2014. Progress in health has been made through reductions in child undernutrition, as stunting among children under five years of age has been reduced from 47 percent in 2010 to 37 percent in 2015, and under-five mortality, which has more than halved to 64 deaths per 1,000 live births in 2015 from 133 in 2004 (NSO and ICF International, 2016). Since 2000, the prevalence, incidence, and deaths associated with HIV/AIDS, malaria, and tuberculosis have also declined.

47. Strong public investment in the health and education sectors partially explain the gains. Total health expenditure (public, external and private) has grown faster on average than population growth and has more than doubled, in per capita real terms, in the past decade. Malawi is also one of six countries in

⁹ The following indicators are considered for the three dimensions: (i) primary school completion and primary school attendance (ii) under-five mortality, stunting, underweight and wasting (iii) access to electricity, improved sanitation, safe drinking water, flooring, cooking fuel, and ownership of assets.

the African Union that met and surpassed its health-spending target of allocating at least 15 percent of their national budget to public health (UNAIDS, 2013)¹⁰. It also allocated 11 percent of GDP to its health sector in 2014, far above the SSA average of 5.5 percent (WDI, 2017)¹¹. Similarly, the education sector has accounted for a large share of Malawi's total Government expenditure, closely following agriculture in the most recent budget (2015/16) at over 12 percent of total expenditure (World Bank, 2016d).

D. Progress in promoting shared prosperity since 2010

48. For Malawi, although the goal of promoting shared prosperity coincides largely with the goal of ending extreme poverty, the distribution of growth remains an important issue. The goal of promoting shared prosperity aims to improve the welfare of the bottom 40 percent of population and reduce inequality. In Malawi, the first aim coincides largely with the goal of ending extreme poverty since more than 70 percent of the population lives below \$1.90 per day per capita (2011 PPP). But the second aim of reducing inequality still deserves attention given that Malawi's economic growth has not been inclusive – between 2003 and 2010 when GDP per capita growth was relatively high, even for regional standards, poverty persisted, inequality worsened and rural extreme poverty increased.

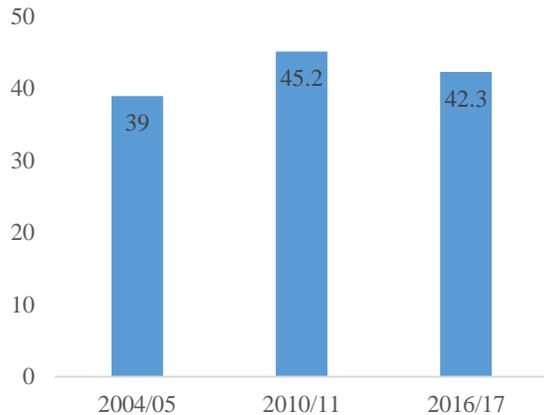
49. Progress in non-monetary dimensions of welfare have not always reached the poor in Malawi. Average accomplishments in health and education outcomes as well as improvements in access to services have not always reached the poor. When they have, richer households benefitted more from them compared to the poorer segments of the population. Access to critical public services—electricity, running water, and non-solid cooking fuels—was virtually non-existent for households in the bottom 40 percent according to the latest household surveys. Richer segments of the population experienced, from an already higher base, greater gains in primary completion than the bottom 40 percent between 2004 and 2010 (World Bank, 2016b). In addition, the nutritional status of children living in wealthier households was markedly better than that of children living in poorer households. Trends in child nutritional status also revealed a growing disparity between wealthier and poorer households between 2010 and 2013, where the top 10 percent experienced reductions in stunting, underweight and wasting, whereas the bottom 40 percent experienced increases in all three indicators. Stunting is not only the human tragedy, but also has serious implications for educational achievements and labor productivity.

50. Malawi's inequality remains high but has started to decline since 2010. Malawi's consumption Gini index increased nationally between 2004 and 2010. This increasing disparity can also be highlighted with a comparison of the growth rates of household expenditure per capita between the poorest 40 percent and the whole population. However, the trend of rising inequality has reversed since 2010. Since 2010, Malawi's consumption Gini has started to decline (see Figure 3.5). During this time, the bottom 40 percent of the population enjoyed a higher growth rate of household expenditure per capita than the whole population, with a shared prosperity premium of 2.3 percent (see Figure 3.6).

¹⁰ This includes donor funds channeled through the budget.

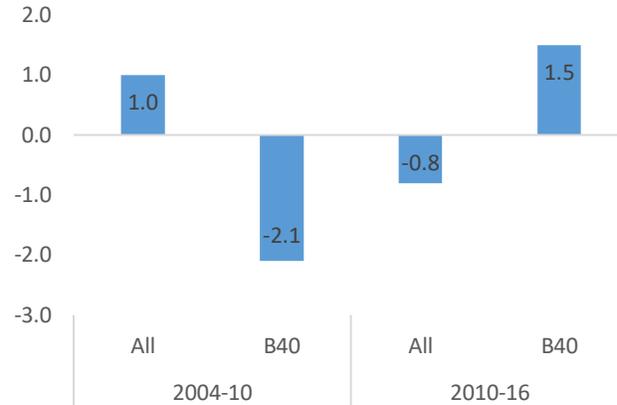
¹¹ Nevertheless, due to Malawi's low level of GDP, this translates into a relatively low per capita health expenditure of US\$ 29 and the 9th lowest in SSA (WDI, 2017).

Figure 3. 5: Inequality has started to decline since 2010
Consumption Gini (%)



Source: World Bank (2016b)

Figure 3. 6: The bottom 40 percent have seen faster income growth since 2010
Per capita expenditure growth rates (%) for all population (All) and the bottom 40 percent (B40)

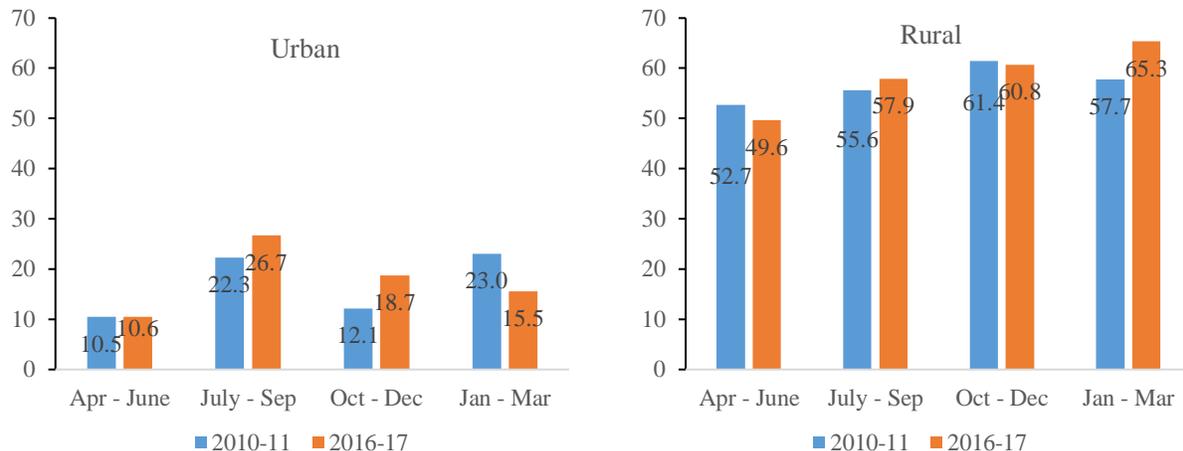


Source: World Bank (2016b)

E. Vulnerability to shocks and seasonality

51. Both urban and rural households' ability to cope with seasonality is limited. Quarterly estimates of poverty show large fluctuations of poverty rates by quarter. The first quarter – April to June – includes harvests of maize and thus is expected to be the richest quarter in a year. For rural areas, this is indeed the case. In 2010-11, the poverty rate of the first quarter was 53 percent and rose to 61 percent in the third quarter and started to decline afterwards. In 2016-17, the poverty rate of the first quarter was 50 percent and continued to increase by 15 percentage points by the final quarter (January to March). Urban areas also show large fluctuations in poverty rates across quarters in both rounds of IHS, especially immediately after the harvest season was over. In 2010-11, the urban poverty rate increased by 12 percentage points in the second quarter while it increased by 16 percentage points in 2016-17.

Figure 3. 7: Both rural and urban (moderate) poverty incidences are subject to significant seasonality
Poverty headcount rates (%) in rural areas by season

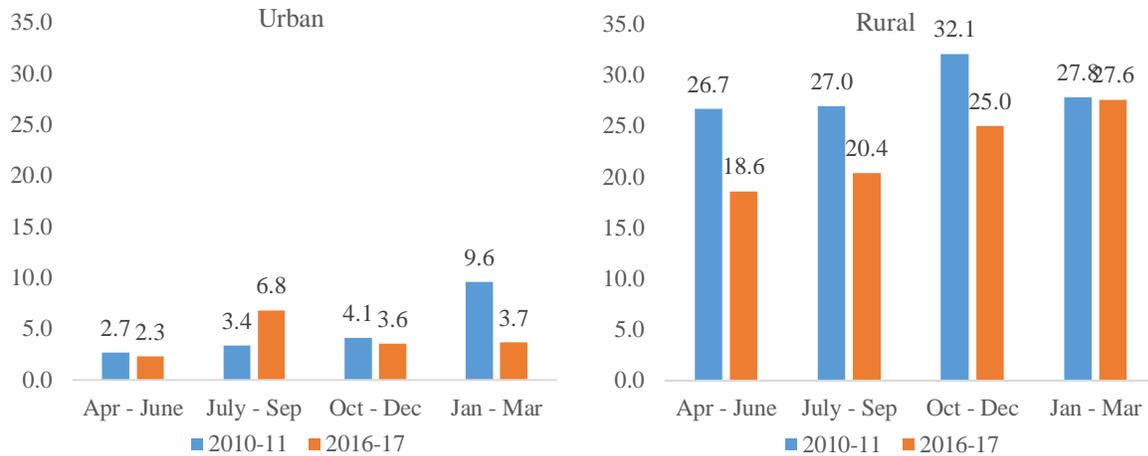


Source: Authors' estimation using IHS3 and IHS4

52. However, the level of rural ultra-poverty in 2016-17 and its fluctuation are significantly less than in 2010-11. Figure 3.8 indicates how, despite recent floods and droughts, rural ultra-poverty declined in all quarters in 2016-17. Like moderate poverty, ultra-poverty in rural areas continued to rise until the fourth quarter, but it fluctuated less, as shown by the decline in the standard deviation from 45 percent to

42 percent. For urban areas, both the level and fluctuation of ultra-poverty did not change much although the seasonal patterns are slightly different.

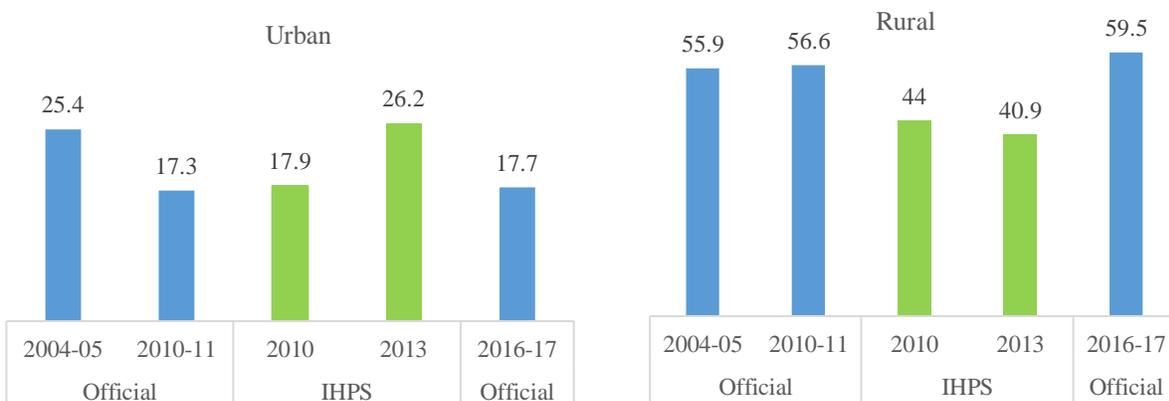
Figure 3. 8: Ultra-poverty also fluctuated but less than moderate poverty
Poverty headcount rates (%) in rural areas by season



Source: Authors' estimation using IHS3 and IHS4

53. Poverty appears to fluctuate between the official survey years. Since official poverty data are available only every six years, it is difficult to see how poverty rates may be fluctuating. To fill this data gap, the results of IHPS are used in conjunction. The poverty estimates of IHPS are not fully comparable to official poverty estimates, but we can see a poverty trend from the estimates since they are comparable within IHPS. Figure 3.9 shows sizable deterioration in urban poverty and significant improvement in rural poverty between 2010 and 2013. In 2016-17, however, both urban and rural poverty rates returned to the same level as in 2010-11 suggesting the trends between 2010 and 2013 were reversed. This analysis indicates that poverty is likely fluctuating across years like its seasonal variation.

Figure 3. 9: Poverty trends including the results of IHPS



Source: Authors' estimation using IHS3, IHS4 and IHPS.

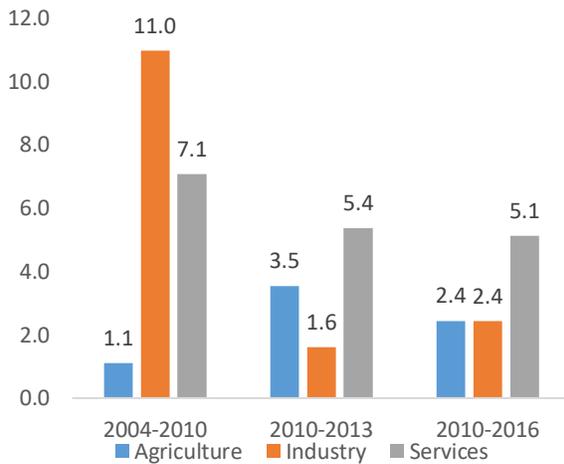
54. Rural poverty in Malawi appears responsive to agricultural sector growth. Why did rural poverty increase between 2004-05 and 2010-11 despite the fact that GDP per capita grew at 2.4 percent annually during this period? This seeming inconsistency can be understood if we take a closer look at sectoral GDP growth rates. Despite the expansion of the whole economy, agricultural GDP was growing at just 1.1 percent, which implies it was decreasing in per capita terms since population was growing at 3 percent. Since nearly 90 percent of rural households work in agriculture, it is not surprising that rural

poverty increased when agricultural GDP was not growing in per capita terms. Indeed, in the following three years, as agricultural GDP growth rose to 3.5 percent outpacing population growth, rural poverty declined significantly according to IHPS data (see Figure 3.10).

55. Urban poverty appears responsive to growth in non-farm sectors, especially in the manufacturing and industry sectors. Between IHS2 and IHS3 in 2004-05 and 2010-11 respectively, the growth rates of these sectors were much higher than population growth. In particular, growth in the manufacturing sector was 13.2 percent and 11 percent in the industry sector as a whole (see Figure 3.10). However, in the following three years, the growth of these sectors, particularly the manufacturing sector, slowed down substantially. This explains the fluctuations in urban poverty since 2004 (see Figure 3.9).

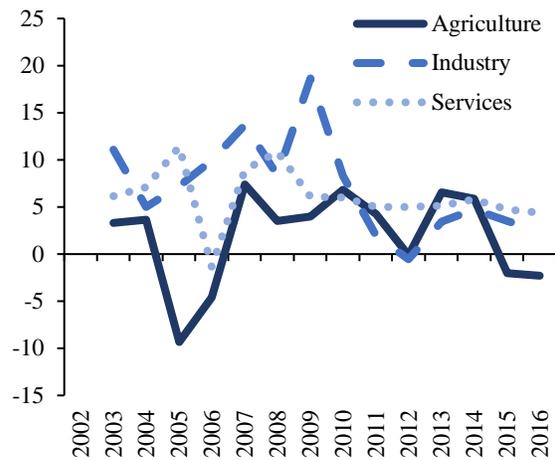
56. Large fluctuations in sectoral growth rates suggest both rural and urban populations are likely experiencing frequent surges of poverty. Even with the IHPS, poverty data are available only every three to five years and we cannot see how frequently poverty rates are fluctuating. But, given the large fluctuation of sectoral growth rates (see Figure 3.11), both urban and rural populations are likely experiencing frequent surges in poverty. For example, the agricultural sector grew at an annual rate of 1.1 percent between 2004 and 2010 on average, but the sector recorded a massive contraction – a growth rate of -9.3 percent in 2005. Given that rural households have limited ability to smooth consumption, many in rural areas likely fell into poverty in that year.

Figure 3. 10: Drivers of rural and urban poverty appear very different
Average annual sectoral growth rates (percentage) for 2004-10 and 2010-13



Source: World Bank Staff estimates

Figure 3. 11: Volatile and slowing growth are a concern
Sectoral growth rates (yearly, percentage) between 2002 and 2017



4. CONSTRAINTS AND PATHWAYS TO ACHIEVING THE TWIN GOALS

57. Malawi’s growth has been volatile and uneven and poverty (measured by both international and national poverty lines) has remained stagnant at over 50 percent of the population while inequality has remained high. Following the introductory sections on the country context and trends in poverty and shared prosperity, this section presents the main constraints and opportunities which, together, form pathways to achieve the twin goals, in particular, the constraints to growth and inclusiveness and the risks to sustainability.

58. The SCD identifies foundational issues and potential pathways for Malawi to break its cycle of low growth and slow poverty reduction. Their selection has been informed by analysis in this report as well as consultation with government, development partners, and civil society.

- ***Foundational issue 1: Weak governance underlies macroeconomic instability and poor policy implementation:*** Repeated episodes of macroeconomic instability have undermined long-run growth and poverty reduction in Malawi. This has been largely due to weak institutions with limited commitment capacity contributing to fiscal slippages and wider policy implementation gaps. Strengthening governance for improved macroeconomic stability and policy implementation will call for establishing commitment mechanisms to sustain and build on the basics of sound economic and public financial management.
- ***Foundational issue 2: Gender inequality:*** Gender inequality is a foundational issue because it has a profound impact on all pathways and a wide array of activities in Malawi. Gender inequality affects agricultural productivity, opportunities in the non-farm sector, the demographic transition, and even households’ resilience against shocks. Reducing gender inequality therefore will allow for quicker progress along the pathways and have an impact on improving the socio-economic status of people in Malawi including growth, poverty reduction, and sustainability.
- ***Pathway 1: Increasing agricultural productivity:*** Agriculture constitutes the backbone of the Malawian economy and the sector’s performance has the most direct and biggest implication for economic growth and poverty reduction, especially in rural areas, than any other sector. However, to increase low productivity in the sector, the Government should target public resources and interventions to promote commercialization and productive diversification.
- ***Pathway 2: Diversifying the economy and creating jobs:*** In order to ensure productive employment opportunities for Malawi’s growing population, Malawi needs to accelerate job creation and develop a thriving private sector. Malawi therefore needs to address constraints to its challenging business environment and promote structural change.
- ***Pathway 3: Harnessing the demographic dividend and building human capital:*** Malawi has made progress in human development outcomes in the last two decades. The country’s recent success in significantly reducing the total fertility rate (TFR) could enable Malawi to harness demographic dividends in the near future. However, to realize a demographic dividend and support the development of a sustainable growing economy, would require Malawi to accelerate its investment in human capital further – better health status, educational attainment, and skill formation of working age populations as well as investments in future generations now.
- ***Pathway 4: Building resilience against shocks and enhancing environmental sustainability:*** Finally, Malawi is highly vulnerable to weather and environmental shocks. The development of sustainable practices and risk mitigation systems is needed to reduce the impact of future shocks.

59. These pathways are not mutually exclusive and present complementarities with each other. This section begins with the foundational issues of governance and macro-fiscal instability, followed by gender inequalities, which underlie the sector constraints which are subsequently presented¹². This section will therefore lay a foundation for the identification of feasible priority reforms.

¹² See Annex 4 for a summary of constraints identified by sector.

Foundational issue I: Weak governance underlies macroeconomic instability and poor policy implementation

Malawi has enjoyed political stability, including a peaceful transition from an authoritarian regime to multi-party democracy in 1994, but this has yet to translate into strong and accountable institutions. The competitive-clientelist political settlement is characterized by unstable coalitions, the appeal to regional and ethnic identity, and the use of rents and public resources to buy loyalty and remain in power. The result has been a deteriorating public service; short term and populist policies instead of long term investments; and the eruption of periodic large scale public corruption scandals. This impacts on all development sectors by generating policy inconsistency and incoherence that undermines credible commitment needed for macro fiscal management as well as for firms and individuals to make productive investments. Reforms tend to gain traction in the wake of crises where the restoration of donor support is paramount, or where political consolidation requires performance legitimacy. These actions demonstrate that Malawi is certainly capable of sound policy implementation but these need to be aligned to longer-term goals and the government must strengthen its commitment to basic rule-based systems that reduce the space for relapse into poor management for purposes of political exigency.

60. Malawi's economic performance may be exogenous in the short run but is endogenous to governance, institutions, and policies over the long run. Reducing fiscal deficits and volatility can help boost private sector confidence and lower interest rates, encouraging investment which can in turn lead to job creation. With weak institutions and limited policy buffers, however, the adverse consequences of negative shocks tend to cumulate, so low growth becomes entrenched. In addition, in such circumstances, corruption shocks like 'cashgate', and the cycles of donor withdrawal, followed by reform efforts that lapse all too quickly further reinforce a non-optimal cycle where progress is followed by stagnation. Pathways to development therefore require macroeconomic stabilization as well as strengthening governance and institutions.

Recurring macroeconomic instability

61. Malawi's history since independence has been characterized by repeated episodes of macroeconomic instability with implications for the country's long-run growth and poverty reduction. These episodes have involved a combination of macroeconomic policy variables and outcomes traditionally associated with instability: growth collapses, high fiscal deficits, high inflation, low international reserves, currency depreciation, and large fiscal deficits (Figures 12-15). It appears certain that due to frequent bouts of macroeconomic instability, Malawi's long-run growth has fallen behind its peers in SSA. Their long-run growth since the mid-1990s is partly explained by their stable macroeconomic situations. Overall macroeconomic instability could also be an important factor behind the persistently high incidence of poverty in Malawi. Apart from the indirect effect through slower growth, instability directly hurts the poor. Empirical evidence suggests that lower inflation is associated with greater improvements in the welfare of the poor (Easterly and Fischer, 2001). Moreover, as argued by the World Development Report 2000-01, macroeconomic crises tend to be associated with increases in income poverty and inequality, and such increases in poverty may not be reversed once the crises end.

62. The review of historical evidence identifies some recurring issues in Malawi's economic management around episodes of instability, namely weak fiscal management, lack of fiscal space, and inappropriate policy interventions in agricultural markets, especially maize markets (World Bank 2017b).¹³

¹³ Government interventions in the maize market have had a destabilizing effect in many instances in the past. This is discussed further in a section on pathway 1.

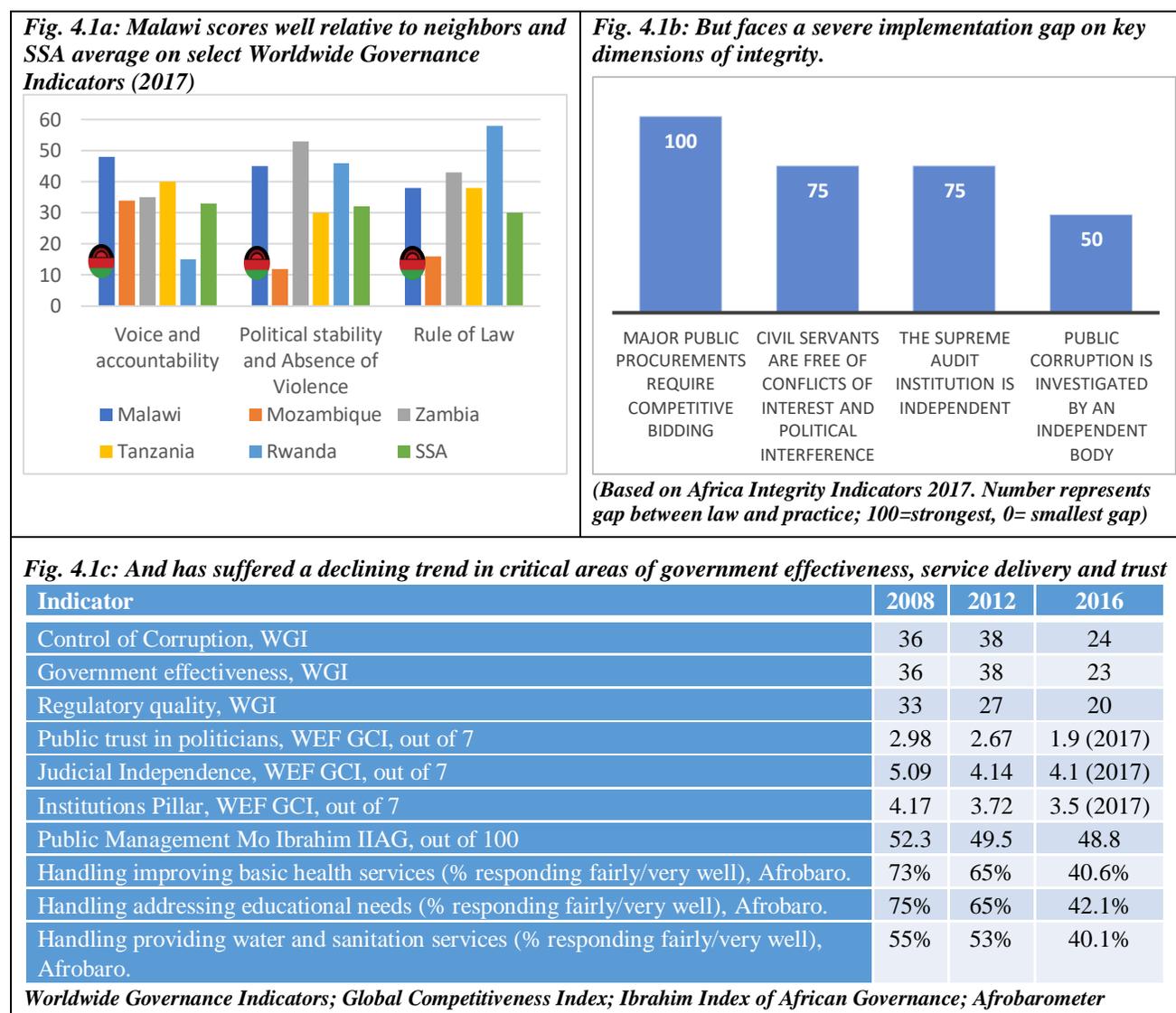
Of the three, weak fiscal management has been at the heart of most episodes of macroeconomic instability. Several aspects of weak fiscal management in Malawi deserve attention. These include:

- **Weak medium-term budget planning.** Large recruitments that are at times unbudgeted have derailed several budgets in the past. Similarly, regular public wage increases are postponed then made in an unplanned and lumpy fashion, thereby disrupting fiscal plans. Estimates of revenues and grants have also been repeatedly overly optimistic and based on unrealistic growth assumptions.
- **Budgetary indiscipline and weak expenditure control.** Pre-election budget overruns have been routine. In addition, unproductive recurrent expenditures such as on travel, representation, and payroll irregularities tend to build up repeatedly then need to be corrected periodically. Recurring off-budget commitments and arrears have needed to be normalized on multiple occasions. The inability to reduce corruption and the fraudulent use of public resources has been a major challenge.
- **Slow fiscal response to shocks.** In most instances, response to weather shocks has been drawn out and slow. Generally, the government approach is to muddle through such situations. As mentioned earlier, the government responds to these crises mostly by adopting ad hoc expenditure cuts, postponing expenditures, and running arrears without making hard fiscal adjustments, thus sowing the seeds for future crisis. At times, it is also an issue of incentives, with the government being in a game-like situation with donors and attempting to maximize the grants it can receive in times of crisis. While donors often ramp up grants in times of weather-related crises, these often take time to be mobilized, thereby delaying adjustment.
- **Soft budget constraint.** Historically, the Reserve Bank of Malawi (RBM) has generally financed excess government deficits whenever the need has arisen. This monetary accommodation of demand for fiscal resources takes the pressure off of the executive to stay within the prudent budgetary limits.

Governance constraints

63. Thanks to political stability and its peaceful transition to multi-party democracy in 1994, Malawi is a relatively strong performer on governance indicators related to stability, voice and rule of law (Figure 4.1a). However, Africa Integrity Indicators show the vast gap between a variety of laws on the books and actual practice (Figure 4.1b). Moreover, indicators of government effectiveness, control of corruption, regulatory quality, service delivery and trust have been declining over the past decade (Figure 4.1). This is especially marked in the wake of the “cashgate” scandal, in which US\$ 50 million in public funds were stolen through illegal access to the national payment system (see Box 4), precipitating a drop in Transparency International’s Global Corruption Perception index from 37 in 2012 to 31 in 2017, and 69 percent of Malawians surveyed believing that corruption is increasing and the government is doing badly in fighting it, according to the Global Corruption Barometer 2015. Malawi is on a downward trend according to the Global Competitiveness Index, ranking 132 out of 137 in the 2017-2018 edition, with 19.7 percent of businesses surveyed citing corruption as the most problematic factor for doing business.

64. Weak enforcement of laws and regulations and a focus on form versus function characterizes Malawian public sector performance (Bridges and Woolcock, 2017). Motivated in large part by donor expectations, there is a desire among policy makers to create the outward semblance of a modernized system of economic governance, but without unblocking the underlying political and institutional barriers to change. On the surface, laws and policies are generally sound, but with absent commitment mechanisms and incentives they are not effective in shaping behavior. As a consequence, there is a wide implementation gap, where there exists a divergence between the quality of rules and policies on paper and the quality and extent of their implementation in practice. This is not only due to a lack of implementation capacity, but also due to distorted incentives for those who adopt and implement the laws.

Figure 4. 1: Governance Indicators for Malawi and selected comparators


Limited public sector efficiency and effectiveness

65. The Government’s flagship public sector reform strategy launched in 2015, *Making Malawi Work*, acknowledges the sharp deterioration of the quality of the public service, once considered among the best performing in the region. Among the deficiencies cited are politicization of the recruitment process, favoritism and nepotism, unfair allocation of training and benefits, inability to progress absent connections, and an atmosphere of impunity for wrongdoing, leading to a demoralized and underperforming service.¹⁴ Quality assurance, controls and career management have largely been displaced from professional bureaucrats to external ‘patronage’ appointments. Civil servants widely report that their career depends on their loyalty, with incentives to keep their head down rather than strive for performance (Cammack et al 2018). In turn, weak public service performance is evident in its inability to provide adequate and quality public services; to effectively implement policies, programs and projects for the achievement of intermediate outputs and outcomes; to create a conducive environment for other sectors to

¹⁴ Making Malawi Work, Public Service Reforms Commission, Final Report, February 2015.

contribute to growth and consequently to facilitate significant improvements in economic and social development (Kathyola 2014).

66. Wage bill pressures have kept salaries low, with high inflation rates leaving civil servants with even lower earnings in real terms, contributing to a poor public service performance trap (Soreide et al 2012). A rapid growth in the public service wage bill since multi-party democracy has led to a significant decline in real earnings in light of inflation, fiscal constraints and pressure to contain the wage bill. For example, medical officers in 2012 were earning 56% of their 2003 salary (Kathyola 2014). Low salaries underpin the pervasive ‘per diem culture’ in which extra allowances, travel and trainings are sought as a means of augmenting income for civil servants under pressure to support family and home villages – sometimes by means of syndicates organized for the sole purpose of generating and allocating discretionary resources (Tambulasi 2010; Soreide et al 2012; Cammack et al 2018). As Government has successfully contained the wage bill to 6.5 percent of GDP in recent years, this has led to very high vacancy rates as recruitments for approved positions are frozen. In June 2016, the average vacancy rate across the public service was 21 percent, with the Ministry of Health vacancy rate as high as 46 percent (Cammack et al 2018).

67. Fiscal constraints, coupled with poor budgeting and planning processes have also resulted in inefficient allocation of resources between wage and non-wage items, further undermining public service performance. The rapid increase in the size of the public service has crowded out spending on non-wage expenditures essential for service delivery. This reflects a broader disjuncture between budgeting and planning, in the absence of a process of setting strategic priorities within actual budget limitations. Ministry budgets reflect low ratios of non-wage running costs compared to wage costs in sectors such as health and education, demonstrating failure to make strategic choices to optimize actual resources for performance. This is compounded by reliance on donor funding for operational costs and capital investment, and the need to revise expectations in light of periodic donor withdrawal from on-budget funding. While a Medium-Term Expenditure Framework is used, it has yet to serve the function of integrated planning and budgeting (AFRITAC report).¹⁵ There is a need to take a fresh look at existing national, sector and entity strategic planning processes to ensure they better support annual budgeting, sustainable payroll management, and a more productive Public Service.

68. The ‘malaise’ affecting the civil service is broadly recognized and lamented, yet several major reform efforts have had little success in turning things around. Evaluations of these efforts, which have included a variety of New Public Management reforms, including performance management, performance contracting, wage reforms and decentralization, have a common refrain. While the form of Malawi’s public sector institutions have evolved, and often match international best practices, the underlying function of the state has seen little change. Informal practices and rules of the game responding to political economy imperatives continue to shape behavior and function (Tambulasi 2010; Anders 2010; Bridges and Woolcock 2017). As demonstrated by the high-quality bureaucracy in the 1970s and 80s, Malawi can generate the system and capacity it needs to perform. But technical solutions will have at best incremental impact with incentives at the highest level to invest in a strong meritocratic bureaucracy, still absent.

69. Similarly, despite the adoption of good laws for accountability and PFM, implementation gaps are wide, and corruption and patronage remain endemic. The 2013 “cashgate” crisis was a stark reminder that fundamental and deep-rooted governance problems have remained largely impervious to technical reform efforts. In response, the government has committed to rebuilding trust and has made inroads with some incremental reforms, including strengthening budget control by enforcing monthly fiscal reporting, publishing budget execution, establishing a Cash Management Unit to better align spending with

¹⁵ See also Rakner et al. 2004. “The budget as theatre – the formal and informal institutional makings of the budget process in Malawi”, which remains relevant.

available resources, increasing the coverage of transactions under IFMIS, and clearing arrears in reconciliation of government accounts (Box 4.1). The use of public procurement as a vehicle for rent seeking and corruption is what underlay both “cashgate”, and the 2016 “maizegate” scandal.¹⁶ In response, a new Public Procurement and Disposal of Assets Law was enacted in August 2017, establishing a new independent authority responsible for the regulation, monitoring and oversight of public procurement and disposal of assets. While the National Audit Office, the Anti-Corruption Bureau and the Judiciary have made notable progress in uncovering and prosecuting corruption cases arising from these and other instances, these institutions suffer from lack of resources, under-funding, and reported political interference (Koch 2015). There is broad realization that much more needs to be done to regain the confidence of the citizenry as well as international donors.

Box 4. 1: Efforts to restore integrity in Malawi’s Public Financial Management system after “cashgate”

The September 2013 discovery of a massive theft of public resources by a group of individuals, from both the Government and the private sector, exposed significant underlying weaknesses in Malawi’s Public Financial Management (PFM) systems. Dubbed the “cashgate” scandal, some US\$ 50 million in public funds were stolen through illegal access to the national payment system. The repercussions included a major public outcry, the arrest (and subsequent trials and imprisonments) of a number of Government officials, and the dissolution of the Cabinet. Prior to the scandal, budget support had been provided by six development partners under a common approach. This budget support was suspended and there were sharp reductions in Official Development Assistance (ODA) channeled through national systems. As a consequence, Malawi’s fiscal situation deteriorated rapidly, with a significant negative impact on private sector confidence and on Malawi’s international reputation.

The newly elected Government in 2014 committed itself to rebuilding trust in public institutions and to correcting macroeconomic imbalances as a means for Malawi to achieve sustainable and inclusive growth. As a means of achieving this, “home grown” PFM and Public Sector Reform (PSR) plans have been launched with high level political support. Nonetheless, fiscal adjustment has proved challenging, particularly in the context of two years of consecutive weather shocks that have dampened growth and created additional fiscal burdens on already strained public resources. Similarly, the majority of aid flows have been shifted to implementation mechanisms outside of Government systems.

Measures to restore basic PFM systems have taken longer than expected to materialize, with progress slower than hoped. This partly reflects the fact that the “cashgate” scandal and its aftermath exposed a financial management and accountability framework that was in fact much weaker than had been previously recognized. A large gap between the form of Malawi’s public sector institutions, many of which compare favorably with international norms and standards, and their actual function has become apparent, with many of these institutions characterized by the complete breakdown of basic reporting and control frameworks (Bridges and Woolcock, 2017).

However, after a slow start, a back to basics approach is beginning to restore confidence. Bolstered by the provision of significant technical assistance, and as a response to acute expenditure pressures resulting from external shocks, the Government has rebuilt the framework under which Controlling Officers operate under the supervision of the Secretary to the Treasury and are accountable for day-to-day transactions. This has helped to re-establish centralized monitoring and controls of expenditures and commitments. Similarly, the Government has cleared the backlog in its financial reporting obligations, producing five years of financial statements within a single year, with these financial statements now current for the first time in a decade. More than 10,000 public servants have submitted detailed declarations of their assets. A payroll audit has resulted in significant improvements to an error-strewn wage bill.

¹⁶ According to audit reports on cashgate, much of the lost funds were due to public procurement of goods and services from a limited number of companies – including some created just for purposes of particular transactions - that did not deliver and/or overinflated their prices.

Information security has been strengthened, with system access regularly subjected to penetration testing as part of efforts to close the loopholes that allowed “Cashgate” to happen. The existing Integrated Financial Management Information System (IFMIS) has been reinforced, with a successor system currently in the process of procurement.

Weak accountability and responsiveness

70. Decentralization was launched in 1998 as part of the transition to democracy, with the aim of diffusing overly centralized power and bringing services closer to citizens through elected local councils. There are twenty-eight rural councils and 7 municipal councils, with responsibility for 17 functions, including primary schools, health facilities, agriculture extension services, provision and maintenance of basic water supplies, and local roads. As has been the case in many African countries, the promise of decentralization has been undermined by a slow, fragmented and incoherent assignment of functions and resources to local authorities and by a tendency to re-centralize power (O’Neill and Cammack 2014). With very weak capacity, financial accountability and incentives to perform, local government has struggled to deliver services and respond to citizen needs. Inter-governmental fiscal transfers to local councils have consistently fallen short of the benchmark set in the decentralization law of 5 percent of net revenues. Lack of capacity and financial mismanagement at the district level is cited as justification for holding back resources, creating a vicious cycle. Line ministries continue to hold resources and Members of Parliament use Constituency Development Funds largely as handouts.

71. In 2014, following a hiatus of ten years, local council elections were held, and the government has given renewed attention to decentralization by increasing intergovernmental transfers and initiating the devolution of human resources beginning with the payroll. Evidence of the benefits of increased decentralization is emerging: payroll devolution has resulted in timely payments of salaries and elimination of many ‘ghost’ workers from the rosters; sectoral staff at the local level report that access to local development funds increases their ability to respond to immediate citizen needs; and, albeit on a small scale, increased information loops have yielded increased accountability. However, maximizing these and other benefits to yield tangible improvements in responsiveness to citizens will require more effective agreements between line ministries and subnational authorities on the assignment of functional responsibilities and allocation of resources, and incentivizing service delivery performance.

72. While Malawi has enjoyed relatively open and free civic space, neither the enabling environment nor citizen collective action capacity has been strong enough to change incentives in the policy arena. According to Africa Integrity Indicators 2017 and World Justice Project Rule of Law Index 2017, Malawi scores lower than its sub-region on access to information and openness, due to insufficient operationalization of the Access to Information Act and the limited availability of public information on legislative processes, financial records of state owned enterprises and political party financing. Operationalizing the Act will require amending inconsistent legislation, establishing positions for information holders in respective MDAs and empowering the Malawi Human Rights Commission (MHRC) to oversee the process. Malawi committed to the Open Governance Partnership, but again implementation has lagged.

73. Civil society, the church, the judiciary and media have all played critical roles at key points to prevent or demand response to abuse of power. The Church, for example, was a principal force in the fight for multi-party democracy. Civic protest, faith-based groups and the judiciary were critical in maintaining constitutional order during Muluzi’s bid for a third presidential term, and during the transition following Bingu wa Mutharika’s death. The media has been an important vehicle for exposing corruption scandals and keeping pressure on a response. Broader collective action capacity has remained weak in light of the predominantly poor and under educated rural population, identity-based fragmentation, manipulation

of traditional authorities, and perhaps the legacy of authoritarian rule (Chinsinga 2012; Cammack 2017). While achieving significant immediate goals, pressures of contestation have not been sufficient to change political incentives away from patronage and clientelism toward accountability and performance. However, increased access to internet and urbanization are contributing to greater awareness among the public, with prospects for increasing demand and pressure for responsiveness.

Limited facilitation of private sector development

74. A consequence of a very powerful central executive with weak checks and balances is a lack of depth and policy feedback loops. The regulatory environment for domestic businesses is slow, costly and inconsistent. Malawi has some of the least business-friendly regulations, having ranked 141st out of 189 economies on the Doing Business index in 2016. Laudably, it jumped up to 110th place in 2017 primarily due to an improvement in the country's credit reporting system. The other indicators score low. Poorly designed and implemented policies related to macroeconomics, trade, regulation and administrative procedures at border crossings, damage business potential. In addition, poor investment and trade facilitation services, such as inefficient permit and licensing systems, inhibit private sector growth. Particularly regarding trade, a number of recent research works (World Bank 2014; Hoppe and Newfarmer 2014) show evidence that policies in these areas make it difficult for Malawian firms to gain access to low cost imported inputs and take advantage of export opportunities. Various surveys indicate how the most problematic factors for doing business relate directly to the role of the public sector, particularly electricity, corruption, access to finance, tax rates, poor infrastructure, and inefficient bureaucracy.¹⁷

75. Malawi's commitment to private sector development is weakened by the role of business interests in political survival. Malawi's weak performance in creating a regulatory environment conducive to private sector growth can be explained in part by the alignment of political rents and business interests. As compellingly laid out by Said and Singini (2014), the political patronage system has involved picking strategic private sector partners to deliver rents, undercutting the need to develop state capacity and systems to address market coordination failures. Historically, these have been in sectors with low economic complexity, leading to a lack of spillovers and innovation. Over the last decade, the focus has been on domestically oriented sectors that generate high rents, but limited growth opportunities, such as government services, farm inputs, construction and transport services. This has diverted attention away from more complex industries more conducive to long term growth, such as manufacturing and other export oriented sectors, while leading to favoritism and limiting competition for the private sector actors integrated in the patronage network (Said and Singini 2014; Koch 2015; Chingaipe 2010).

76. Shifting incentives toward state facilitation of private sector-led growth may be precipitated by increased regional integration and technological advancement. The former may strengthen opportunities for economic diversification and export oriented policies; the latter may improve information for policy oversight and market linkages while lessening the dependency of firms on government connections (Said and Singini 2014). Increasing the collective voice of a broader set of private actors – in particular agro-processing and manufacturing -- in the policy space, through more representative public private dialogue and increased participation in the regulatory and policy making process will be important to fostering enabling conditions for growth.

Foundational issue II: Gender inequality

Gender inequality in Malawi is observed in many different aspects of life in Malawi. Agricultural productivity of female headed households is significantly lower than that of male headed households. Also,

¹⁷ See World Economic Forum "Executive Opinion Survey 2017," Malawi Confederation of Chambers of Commerce and Industry "2017 Business Climate Report," and World Bank Enterprise Survey Malawi 2014.

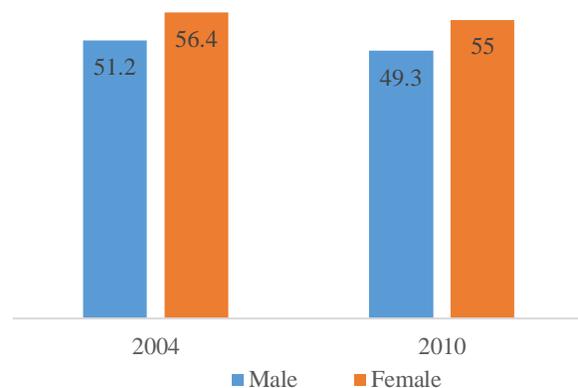
female headed households face significantly lower wages and profits in the non-farm sector. Their access to education has improved significantly at the primary education level, but there remains large gender disparity in secondary and tertiary education. Reducing gender inequality will not only accelerate the pace of poverty reduction by increasing productivity of both agriculture and non-farm sectors, but will also accelerate the demographic transition and health status of household members.

77. This report treats gender inequality as a foundational issue because it has a profound impact on a wide array of activities in Malawi. Gender inequality affects agricultural productivity, opportunities in the non-farm sector, the demographic transition, and even households’ resilience against shocks. Reducing gender inequality will have an impact on improving the socio-economic status of people in Malawi through growth, poverty reduction, and sustainability.

78. Female headed households tend to be poorer and have less endowments – less ownership of assets and access to infrastructure – than male headed households (figure 4.2). Poverty headcount rates of female headed households are around 5 percentage points higher than those of male headed households for both 2004 and 2010 (World Bank 2016b). Less female headed households own a TV, telephone, transportation means (bicycle and others), or reside in properties with improved floors than male headed households. Also, female headed households tend to own smaller crop lands and have less access to electricity and improved sanitation.

79. Women tend to be less productive than men in agriculture and the non-farm sector because of their limited endowments. In rural Malawi, agricultural productivity on female-managed plots has been estimated to be 25 percent lower than on male-managed plots due to limited endowments of female headed households (Kilic et al., 2015).¹⁸ Analysis shows closing the gender gap in agricultural productivity could reduce the poverty rate by an estimated 2.2 percent, lifting 238,000 people out of poverty each year (UN Women et al., 2015). In addition, businesses owned by women appear to be less formal, less profitable, and smaller than those owned by men (Campos et al., 2015 and World Bank, 2016b).

Figure 4. 2: Comparison of poverty headcount rates (%) by gender of household head



Education and health outcomes

80. Due to a host of interconnected factors underpinned by social norms, adolescent girls are pushed into a vicious cycle of school drop-out, early marriage and child bearing, poor health, and reduced economic opportunities. In 2010, out of every 100 girls who begin Standard 1, only about three will enter into secondary education. Of those three, only one will enter university (2010 Malawi Demographic and Health Survey). Malawi has one of the highest rates of adolescent fertility in the world, with 135 births per 1,000 women ages 15-19 (WDI, 2017). Furthermore, early marriage is widespread, with 28 percent of adolescent girls surveyed in the 2013-14 Multiple Indicator Cluster Survey (MICS) reporting that they were currently or previously married. Early marriage and childbearing in Malawi is associated with lower education and household wealth and lower decision-making power once girls become adults. It may also be connected to the high maternal mortality rate.

¹⁸ Palacios-Lopez and Lopez (2015) show that agricultural labor productivity is, on average, 44 percent lower on female-managed plots, and while 34 percent of this gap is explained by differences in labor market access and 29 percent is explained by differences in credit access.

81. Health constraints disproportionately impact women. Women make up 60 percent of those living with HIV, with obvious negative impacts on their ability to work, and are more likely to have to provide care to sick household members (because of norms regarding women's caring role but also because data from the show that female-headed households are more likely to have a member sick with AIDS or TB¹⁹). Significantly reducing their time for income generating activities.

82. Malawi has achieved gender parity in primary school enrolment and completion, however women generally fare worse than their male counterparts with regards to access to higher education and educational achievement. Over the years, Malawi has narrowed gender disparity in secondary and tertiary school enrolment. This improvement nevertheless left Malawi with a Gender Parity Index of 0.91 for secondary school and 0.64 for tertiary school in 2014. Girls do not perform as well as boys as indicated by the latest SACMEQ data, and female literacy rates (59 percent) remain significantly lower than male rates (73 percent) (WDI, 2017). Furthermore, the proportion of female-headed households with at least one member of their household having completed primary or secondary school is lower than that of their male counterparts (World Bank, 2016b).

83. Inequality in access to education at higher levels contributes to the female disadvantage in productivity. While more females than males excel in the secondary school examination (46 percent males and 58 percent for females in 2015) there is only 1 female for every 10 males with tertiary education, which indicates that significant barriers exist which limit opportunities for females to pursue and attain higher education in Malawi. This is worsened by the fact that at present Malawi has no gender driven policy to reduce the gender gap in tertiary education. There is very strong evidence of a gender gap in agricultural productivity in Malawi and that this gap is caused by women's lower access to endowments, especially their lower participation in cash crop cultivation and lower use of household adult male labor and labor-saving equipment²⁰.

Women's rights and political representation

84. Malawian women encounter discrimination due to discriminatory customary practices. While the Constitution recognizes equal rights for men and women²¹, enforces equal parental responsibility for husbands and wives²², prohibits polygamy²³ and the Deceased Estates Act voted in 2011 gave spouses and children the right to inherit the marital estate in case of the death of a husband, its implementation is still limited due to gender norms and cultural barriers, leading to women's inability to own, dispose of, and inherit property, which, in turn, creates economic dependence on men, trapping women in widow inheritance, polygyny and abusive relations where they are less empowered to protect themselves from HIV infection or seek treatment.^{24,25}

85. Female representation in key political positions has stagnated at very low levels. Since 2014, the number of female ministers has averaged at three in a Cabinet of twenty. Similarly, the number of female parliamentarians declined from 22.2 percent in 2009 to 16.7 percent in the 2014 general elections.

¹⁹ Integrated Household Panel Survey

²⁰ Kilic et al, (2015) Caught in a productivity trap: a distributional perspective on gender differences in Malawian agriculture. World Development, 70, 416-463.

²¹ The Constitution (Sections 20 and 41)

²² Marriage, Divorce and Family Relations Bill

²³ Penal Code for common law marriages and the Marriage, Divorce and Family Relations Act of 2015.

²⁴ Regional differences should be noted. Under matrilineal customs, which are found in the central and southern regions, women often have more land rights and are less vulnerable upon a husband's death (Slavchevska et al. 2016).

²⁵ The Customary Land Act intends to strengthen women's representation in decision making on land issues by ensuring equal representation in customary land tribunals and enabling women and minors to register as proprietors of land in their own right

This representation is lower than both, the global average (20.6 percent) and the average for countries with the same income levels (21.5 percent). The percentage of ward councilors is even lower at 56 women out of 457 (12.25 percent). Literature shows that women's representation in the community leadership alleviate the negative effects of heterogeneity, increase collective action capacity to provide public goods; and in turn boost community-level agricultural productivity and welfare (McCarthy and Kilic, 2015).²⁶

Pathway I: Increasing agricultural productivity

Agriculture remains the mainstay of Malawi's economy and provides livelihood for nearly 90 percent of poor households. The agriculture sector dominates around three-quarters of total exports and accounts for 65 percent of total employment in the country, and nearly 90 percent of poor households are engaged in some kind of agricultural activity. Yet, despite a large part of the population being engaged in agriculture, the sector only represents about 30 percent of GDP, as most people remain locked in low-productivity, subsistence agriculture. Agriculture has strong inter- and intra-linkages to other major sectors of the economy and thus serves as a primary source of food supply, incomes, employment, foreign exchange and government revenue. Therefore, improving agriculture performance is critical in reducing extreme poverty and promoting shared prosperity. To do this will call for strengthening agricultural markets, diversifying production, and adopting measures to increase resilience to climate change.

86. Agricultural production remains at the center of most economic production in Malawi and is key for achieving development outcomes and reducing poverty. As discussed in Benson & Edelman 2016, the sector contributes about one-third of Malawi's GDP. While this contribution has dropped from one-half of economic output 50 years ago, Malawi's economy remains amongst the world's 15 national economies most dependent on agriculture. About 87 percent of Malawian households are engaged in agricultural activities, which rises to 94 percent in rural areas (NSO, 2012). An estimated 67 percent of income nationally is from agricultural activities (World 2016b).

87. However, agricultural productivity remains relatively low for the region, due to limited adoption of modern technologies, exacerbated by heavy dependence on rain-fed agriculture, weak links to markets, and poor research and extension services. Smallholders focusing on subsistence maize production without crop rotation depletes soil quality, further lowering yields. Thin markets and low density of economic activity in rural areas, as well as poor road connectivity to markets, motivate farmers to continually produce maize solely for their household needs, as they are unsure whether they can purchase or sell the crop in the market (Dorward et al., 2009). Yields are significantly below potential for smallholder production given Malawi's agro-ecological environment (Benson & Edelman 2016).

88. Malawi's food system relies heavily on self-sufficient maize-focused agricultural production, with its per capita maize consumption the second-highest globally, some 13 percent higher than the next ranked countries (FAO 2016). An estimated 65 percent of maize consumption in rural areas is from own production (Mussa 2015). Combined with high population growth, subsistence-oriented low-input crop production itself is not a sustainable solution for feeding all Malawians (Benson & Edelman 2016).

89. Rural population densities are considerably higher in Malawi than in neighboring countries, contributing to small average farm sizes which mostly utilize family labor. Farm sizes average around 0.8 ha per household (World Bank 2016b). Additionally, a much higher share of agricultural land is under temporary and permanent crops than in other countries. While in neighboring countries, land not suited for cropping is generally used for livestock production, the limited availability of such land in Malawi has

²⁶ Besides improving women's political representation, it is also important to improve wives' bargaining power within households and cooperation between spouses would exert larger positive impacts on total household income and consumption expenditures per capita, as well as the share of household consumption devoted to public goods (McCarthy and Kilic 2017).

reduced the availability of livestock (Benson & Edelman 2016). Most producers are smallholder farmers, using predominantly family labor.

Constraints to growth

Limited Diversification and Commercialization

90. The overall level of crop diversification remains low, despite some recent signs of diversification. Almost all farming households (94 percent) are engaged in the production of maize. A smaller share produces groundnuts (26 percent), pigeon peas (24 percent), and tobacco (14 percent) (see table 4.1). The share of maize in cropping areas has gradually decreased since the early 1980s from 75 to 50 percent, as the share of land cultivating non-maize crops doubled following liberalization policies. There recently have been some signs of crop diversification into legumes and nuts, with legumes facing less distorted markets and contributing to soil fertility. Commercial estate farming is mostly limited to the export crops of sugar, tea, and coffee. Tobacco production historically has cycled between estate- and smallholder-dominated production, largely depending on shifting regulatory preferences. However, with tobacco sub-sector liberalization since the mid-1990s, estate production of tobacco has declined to 9 percent as of 2015 (Benson & Edelman 2016).

91. Agricultural—and especially maize—markets in Malawi are particularly thin and weak. As shown in table 3, tobacco and rice are the only crops grown primarily for sale, with 96 percent and 58 percent of producers, respectively, reporting to also sell them. The percentages are much lower for groundnuts (36 percent) and pigeon peas (26 percent), and lowest for maize (14 percent).

Table 4. 1: Only small shares of agricultural crops are actually sold in Malawi
Percentage of farming households

Crop	Produce	Of those producing, who reported any sales	Of those selling, mean portion of harvest sold
Maize	93.6	13.9	35.1
<i>Local varieties</i>	52.5	10.9	32.1
<i>Hybrid, recycled hybrids, or improved open-pollinated varieties</i>	52.8	16.8	37.1
Groundnuts	25.9	36.1	45.4
Pigeon peas	20.7	26.5	53.9
Beans	8.6	20.7	48.0
Rice	4.7	58.3	49.3
Tobacco	14.4	95.5	86.8

Source: Benson and Edelman (2016).

92. Uncertain, thin, and risky markets, combined with poor road access and the low density of economic activity in rural areas, perpetuates a cycle in which farmers focus on the production of maize solely for their household needs. Farmers are hesitant to engage in trade as they face high transaction costs, particularly for transportation, and high risk of transaction failure since traders may not be available when the produce (from maize or potentially higher-value crops) is to be sold. Similarly, traders cannot be sure whether there will be enough suppliers in a given market to justify the high costs of getting there. As a result, few maize farmers can profit from seasonally high demand for their produce, and trade is less effective in reducing price differentials both within the country and over time. Farming households therefore reduce risk by devoting their land to producing maize for their household's own consumption (Dorward et al. 2009). This in turn means that farmers remain cash-poor, which constrains their ability to

purchase inputs or other productivity-enhancing technologies, which is exacerbated by limited access to finance (Benson & Edelman 2016).

93. In turn, maize production and prices remain highly volatile. Despite a relatively favorable agro-ecological environment and large government subsidies, maize price volatility in Malawi is the highest in the region (with the exception of Harare). Price increases between May and February average around 60 percent, inviting hoarding and speculative behavior even by relatively well-off individuals otherwise not engaged in trading activities. Weather and other external shocks have a significant influence on maize production, but their impact on prices could be better managed and largely mitigated (World Bank, 2017b).

94. The low level of crop diversification exposes smallholders to significant market risk. This is particularly the case for the main cash crop, tobacco. Decreasing demand and prices globally has led to reduced demand for Malawi's tobacco crop, averaging about 1 percent each year. Although strengthening quality controls could help improve Malawi's world market position in the short term, it appears doubtful that tobacco can continue as a major source of income in the long term (World Bank, 2017b).

Limited use of inputs and farming techniques

95. Agricultural credit is difficult to obtain on affordable terms, thereby limiting abilities to invest in inputs and to sell during the lean season. Despite high production and market risks associated with farming in Malawi, some financial institutions in Malawi will make loans to the agriculture sector. However, interest rates in the recent past (over 25 percent until 2017) would call for unrealistic returns on production. Only 22 percent of households in 2013 applied for credit, and of the households who applied for credit, only 27 percent were successful (World Bank 2016b). Credit given in kind, to be reimbursed at the end of the season, does however play a role in contract farming or outgrower schemes for tobacco or other cash crops (Benson & Edelman 2016). The passage of the Warehouse Receipts Act of 2017 could help open up an opportunity for farmers and traders to use stored commodities as collateral for lending, which could help smooth market supply and prices over the year.

96. Malawi falls far behind other countries in its use of mechanization and animal traction, partially reflecting land constraints and abundant labor. Less than 1 percent of households in Malawi own some type of equipment. The second lowest comparator country is Nigeria with 9.4 percent, followed by Uganda with 13.4 percent, while this is more than 70 percent of households in Ethiopia and Niger (Table 4.2). Machine-use in agriculture makes economic sense when compensating for labor constraints in land-abundant farming systems (Hayami and Ruttan 1971). However, Malawi, more so than virtually all other countries in Africa, is land-constrained and labor abundant. There is no evidence that smallholder use of imported machines will be more cost effective than the use of family labor, particularly if well-trained. As such, mechanization is unlikely to be profitable for smallholders on a broad scale. However, for emerging medium-scale farmers or small estates growing crops with clear economies of scale, such as groundnut and soya bean, there will be greater scope for developing local tractor hire arrangements (Benson & Edelman 2016). Moreover, limited use of animal traction represents another weakness in Malawi. Only 2.4 percent of households use animal traction, the lowest proportion by far amongst comparator countries – the second lowest is 19.9 percent in Nigeria. This also reflects the limited land availability for livestock pasture.

Table 4. 2: International comparison of input uses

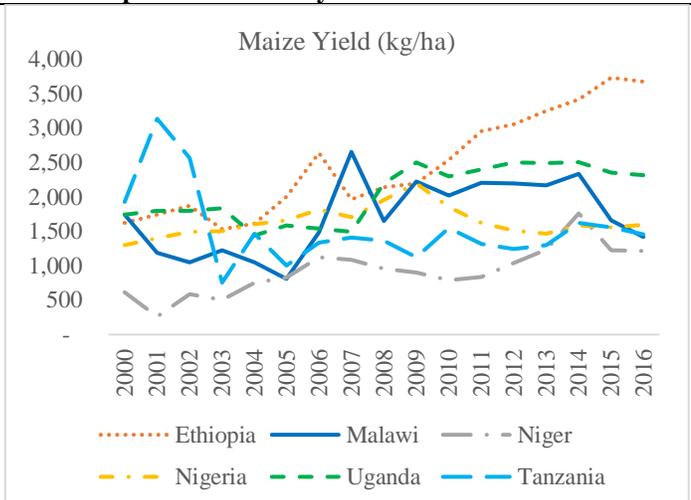
	Use of inorganic fertilizer		Use of Improved seed varieties		Under irrigation		animal traction and mechanization		
	% of hhs	mean nutrients (kg/ha)	% of hhs	% of area	% of hhs	% of crop land	% of hh w/ traction animals	% of hh owns a tractor	% of hh owns any equipment
Malawi	77.3	56.3	56.2	40.5	0.4	0.2	2.4	<0.1	0.8
Ethiopia	55.5	25.2	23.7	33.7	8.7	1.3	79.8	NA	73.6
Niger	17	1.7	NA	NA	6.9	1.4	37.8	0.3	77.5
Nigeria	41.4	64.3	NA	NA	4.1	2.5	19.9	1.6	9.4
Tanzania	16.9	7.7	NA	NA	3.6	1.8	22.5	2.2	16.4
Uganda	3.2	0.7	NA	NA	3.9	3.5	30.4	0.2	13.6

Source: Sheahan and Barrett (2014) using comparable LSMS-ISA data

97. Malawi is an outlier in the use of inorganic fertilizers yet maize yields are not far above other countries. Nearly 80 percent of households in Malawi use inorganic fertilizer. Ethiopia comes in a distant second in inorganic fertilizer use, where 56 percent of households use inorganic fertilizers, while in Uganda, only 3.2 percent of households use inorganic fertilizer. This high rate in Malawi is supported by the FISP program heavily subsidizing fertilizer to over half of the population. As for the level of mean nutrients used, where mean nutrient usage refers to mean applications of nitrogen, phosphorous, and potassium, Malawi and Nigeria record the highest levels. Malawi also records high levels of improved seed usage – 56 percent of households use improved seeds for 40 percent of total crop land. Although maize yields in Malawi increased substantially from 2005 levels, they have stalled since 2009, and are not significantly different from countries with limited fertilizer use. According to FAOSTAT, average maize yield in Malawi has been around 2000 kg/ha between 2011 and 2016 (See the right panel of Table 4.3). Annual figures show that the biggest gain occurred between 2005 and 2007 when the Farm Input Subsidy Program (FISP) was introduced. Since then, yield growth has broadly stalled, and fallen sharply during droughts or floods.

Table 4. 3: International comparison of maize yield

	Average yield 2000-10 (kg/ha)	Average yield 2011-16 (kg/ha)	Growth rates (%)
Malawi	1,553	1,996	28.5
Ethiopia	1,989	3,349	68.4
Niger	764	1,220	59.6
Nigeria	1,680	1,556	-7.4
Tanzania	1,604	1,416	-11.7
Uganda	1,839	2,428	32.0



Source: FAOSTAT (March 2018).

98. Combining inputs (inorganic fertilizer and improved seeds) together with extension advice is necessary to achieve substantial increases in yields yet extension services are limited. Average yields on plots on which both inorganic fertilizer and improved seeds were used was at least 60% higher than the

average yields on plots on which none of the inputs had been used in 2013 (World Bank 2016b). Despite the positive impact that the combined use of inorganic fertilizer, improved seed and extension services had on yields, less than 25 percent of agricultural households use these complementary inputs in 2013. Extension services have limited reach, and, when available, are often engaged in supporting FISP implementation. Public expenditure on agricultural extension is estimated at only 1.7 percent of total expenditure for food and agriculture. One extension agent is estimated to cover between 1,800 and 2,500 farmers in Malawi, which compares unfavorably with Ethiopia (480), China (620), and Kenya (950), where the agriculture sectors are much more dynamic (Ragasa, Mazunda, and Kadzamira 2015). Extension workers are often largely registering farmers into FISP and distributing fertilizer coupons, instead of providing agronomic advice. This further dilutes the impact of already limited extension services, and likely reduced the productivity benefits of FISP (Snapp et al. 2014, World Bank 2017).

99. Despite the contribution FISP has made to improving maize yields, the cost-effectiveness of fertilizer use and of substantial fertilizer subsidies is questionable, while the impact of improved yields on poverty reduction is low. For poor farmers, low yields almost eliminate the cost-effectiveness of using fertilizer even when subsidies halve the price. The average maize yield for a poor farmer is 36 percent lower than the yield for a non-poor farmer (World Bank 2016b). This yield difference between poor and non-poor farmers is substantially larger than other crops such as ground nuts (8 percent) and pigeon pea (29 percent). For poor farmers, even with 50 percent subsidies on the price of fertilizer, maize production when fertilizer is used as an input is not profitable. Furthermore, increasing maize yield has limited impact on household expenditure and poverty reduction. Raising maize yields by 1 percent only increases household expenditure per capita by 0.13 percent (World Bank, 2016b). Moreover, increasing maize yield has limited impact on poverty reduction: a 50 percent increase in the maize yield can reduce the moderate poverty rate only 7 percentage points. This limited impact is due to the high cost of inputs, especially fertilizer and improved seed, to raise the maize yield.

100. Land pressures resulting from high population growth, combined with limited diversification and crop rotation, have contributed to the gradual depletion of nutrients in Malawi's soils. Land fertility is a key determinant of productivity. Addressing the deterioration of organic matter, increased acidity, and reduced soil fertility is necessary to increase productivity. On average, productivity on plots of good or fair soil quality was estimated to be approximately 15.4 percent higher than productivity on plots of poor soil quality (World Bank 2016b). Historically, most smallholders in Malawi practiced a crop-fallow system which would allow soil nutrients to be replenished. However, high population growth and increasing rural population densities over the past century have gradually precluded the use of this method. Few farmers practice crop rotations of alternating maize with grain legumes which could sustain soil fertility better than monocrop maize, while the repeated growing of maize has, in fact, mined out plant nutrients in the soils, particularly nitrogen. Additionally, the use of manure is not broadly possible due to the relatively low numbers of livestock, with most land that could be used for livestock already used for crops (Benson & Edelman 2016). Without changed practices, ever increasing volumes of chemical fertilizer will be required to prevent a further reduction of Malawi's already low yields.

101. Agricultural production in Malawi is predominantly rain-fed. The proportion of cultivated land that uses irrigation is very low. Although estimates vary considerably—from 0.2 to 4 percent—it is clear that lack of irrigated land is a key challenge for Malawi's agricultural production (Sheahan and Barrett (2014), Government of Malawi, 2015). Most staple food crops not profitable enough to cover the operating and maintenance costs of irrigation infrastructure, given current price levels, at least when grown on a small scale. As a result, the sector is particularly vulnerable to unreliable rainfall and weather shocks, such as floods and drought.

102. Droughts have recently increased in frequency, but few measures have been undertaken to mitigate this risk. Dry spells are often related to the El Niño weather phenomenon which brings drought conditions across Southern Africa. Such global weather patterns are often foreseeable long before their

consequences materialize. Malawi could therefore benefit from a forward-looking perspective towards food security. This could include direct measures to address the next shortage, such as building-up and managing food reserves, as well as maintaining sufficient fiscal space. Additionally, although more drought-tolerant crop varieties are often available, their usage is low due to various factors including limited knowledge, access to finance, and harvest seasons that overlap with other crops.

103. Other environmental risks, including pests and diseases, also affect agricultural production. Conservative estimates suggest that Malawi lost an average of 4 percent of its annual agricultural production's value between 1980 and 2012 due to droughts, floods, pests, diseases, and other factors (Giertz et al., 2015). This figure does not include post-harvest losses and it masks the catastrophic household-level impacts in affected areas during specific years (World Bank 2017b). In the 2017/18 agriculture season, an estimated 20% of Malawi's total crop loss was due to pests, particularly fall army worm, which the government is now working to address through integrated pest management. Flooding conditions also further reduce weak market access due to damaged and flooded roads.

104. While 59 percent of farmers in Malawi are women, they have smaller land lots and are less productive (by 28 percent on average) compared to their male counterparts. If their productivity increased to that of men, it has been estimated that this would add an additional US\$ 100 million per year to the value of the country's agricultural production, and would result in around 240,000 people rising out of poverty in Malawi (UN Women et al 2015). Structural factors in the agricultural sector explain the majority of the gender gap, including access to male labor, gender-divided production systems, and access to inputs.

Unsupportive Market Interventions

105. Inefficient patterns of public expenditure and unpredictable government interventions have contributed to the persistence of low productivity in the sector. The current policy framework whereby agriculture is viewed as a means to food security through self-sufficiency has justified the substantial funding to heavily subsidize fertilizers for maize through various schemes (currently FISP) since at least 1952. Although FISP has consistently accounted for more than 50 percent of total agricultural expenditure in Malawi, it has not been well-targeted or led to significant gains in productivity. The stated aim of FISP was to make inorganic fertilizer available to small-holder, resource-poor farmers, but in 2013, only 33 percent in the poorest quintile obtained fertilizer through the subsidy scheme (World Bank, 2016b). While FISP supported increased maize yields in the first years of the program (FY2005/06), yields have stalled since 2010 due to weather conditions and less efficient implementation. The program regularly delivers inputs late to farmers, sharply reducing its impact. As a result, the proportion of the population below the food poverty line did not decrease during FISP implementation, instead increasing from 22.4 percent in 2004/05 to 24.5 percent in 2010/11.

106. The Government's focus on maize undermines efforts to increase productivity and diversify the sector, which could also allow for improved soil conservation and higher yields. The disproportionately high expenditure on FISP crowds out complementary public investments to introduce and diffuse new technologies, develop irrigation and strengthen markets, all of which have significant potential to enhance the performance of the sector. FISP has become increasingly difficult to sustain. Increasing population density, combined with government-subsidized mono-agriculture, worsen soil quality, thereby calling for ever-increasing levels of fertilizer. Moreover, a depreciating exchange rate makes the importation of fertilizer more expensive each year, while rent seeking has undermined program efficiency. Recognizing the fiscal burden of FISP, in the past two years, the government has taken steps to reduce the scope of FISP, to introduce a fixed value coupon system, and to expand private sector participation in fertilizer procurement and distribution. These steps have reduced the program cost from 3 percent of GDP in FY2014/15 to one percent in FY2016/17.

107. Maize price volatility is in part associated with government interventions. Ill-timed procurement or stock releases, mixed signals on price controls or procurements, uncertainties on the imposition or lifting of export bans, and unreliable production estimates have been found to add to uncertainty in already imperfect markets (Benson and Edelman, 2016). Interventions by ADMARC and the National Food Reserve Agency (NFRA) often distort markets. ADMARC is the biggest buyer and seller in the market, but often buys months after harvest from traders at higher prices, thereby pushing up prices. This is instead of buying from farmers at harvest time when they could support demand and prices paid directly to smallholder farmers. Sales at subsidized prices later in the season often do not cover costs, necessitating government bailouts, most recently amounting to about one percent of GDP in FY2017/18 (Giertz et al 2015).

108. The imposition of export bans has further undermined investment in the sector. While often imposed due to concerns of food shortages and to maintain low food prices, bans have been left in place for indeterminate periods which often drag into better harvest years. While maize export bans result in a temporary increase in the availability of maize, the policy is self-defeating in the long run as it reduces incentives to produce maize, thereby constraining supply in the long term, and increasing prices and threatening food security. Furthermore, unpredictable Government interventions and volatile prices are major deterrents to commercial farmers increasing investments in maize production. Increased commercial production of maize would result in prices becoming less seasonal and more predictable, benefiting producers, consumers, and processors alike.

109. Moreover, public expenditure is focused on dealing with the after effects of shocks rather than on mitigating them in advance. Giertz et al. (2015), found that, over the period 2008-2012, public expenditure on coping mechanisms after a production shock were approximately double the total investments on risk mitigation. This included expenditures on irrigation development, extension services, and agricultural research which could help avert or reduce production shocks.

Opportunities

110. To improve the agricultural sector's contribution to poverty reduction, a more balanced, cost-effective, and climate-resilient approach is needed. As shown above, Malawi's heavy reliance on the use of fertilizer and improved seed has had a limited impact on poverty reduction. Increasing productivity and resilience to climate change can be achieved by enhancing farmers' knowledge of agricultural production and input uses; measures to improve soil fertility; increased use of drought-resistant varieties; crop rotation; irrigation and water development; exploiting the land reform agenda; and addressing gender bias. Commercialization of the agricultural sector away from subsistence farming and strengthening markets is also critical. This includes diversification and producing more cash crops (outside of tobacco and maize); improving farmers' knowledge and skills in agri-business in terms of pricing, storage, and business negotiation; reducing inefficient public expenditure; and limiting unpredictable market interventions by the government.

111. Commercialization of the agricultural sector and better marketing is critical for income growth and poverty reduction among farmers. For example, the time of sale makes a huge difference in the profitability of maize production. As shown in Table 4.4, in three of the last four agricultural cycles (2013/14 to 2016/17), maize prices in lean season (January to March) were significantly higher than those in harvest season (May to July).

Table 4. 4: Price difference between the lean and harvest seasons

	2013/14	2014/15	2015/16	2016/17
Harvest (May - July) (kwacha/kg)	90	80	111	213
Lean (January - March) (kwacha/kg)	129	96	238	206
price growth rate	43%	20%	114%	-3%

Source: Authors' calculation using Agricultural Marketing Information System (AMIS) and mobile Vulnerability Analysis and Mapping (mVAM) data

112. Nevertheless, for smallholders to take advantage of this opportunity, they need to overcome liquidity constraints and improve capacity to store crops. Many farmers, who have limited capacity to smooth income and are often facing low cash liquidity and pressing financial needs at harvest time, will struggle to strategically plan the sale of their crops across harvest and lean seasons. Furthermore, such cash-constrained poor farmers have limited means of storing maize until the lean season, and tend to avoid public storage space due to the risk of theft preferring instead to store their maize on their own or their relatives' properties. The passage of the Warehouse Receipts Act of 2017 should help facilitate the development of a warehouse receipts system, which can promote progress in this area. Improving access to finance and facilitating access to better and more reliable storage spaces can increase and help smooth farmer incomes.

113. Education and access to information is key, particularly for women. Smallholders' limited market knowledge and capacity greatly compromises their ability to profit from transactions with assembly traders or other private sector buyers. Although assembly traders visit many villages including those in very remote areas and, on average, offer farmers fair maize prices which leave traders with limited profit margins, there is also large intra-village variation in maize prices. Some farmers are able to negotiate nearly 100 percent of the retail maize price and others only a fraction (Sitko and Jayne, 2014). This price variation signals smallholders' low levels of education, limited market knowledge, information, and negotiation skills. Moreover, assembly traders come to villages at harvest time, not in the lean season.

114. Crop-diversification into legumes and nuts, which is happening in Malawi, is also key. The share of maize in cropping areas has gradually decreased since the early 1980s from 75 to 50 percent, as the share of land used to cultivate non-maize crops has doubled. Additional benefits of legume cultivation are the benefits for farmers of a better functioning market - the legumes market is not as distorted compared to the maize market, while legume production also adds to soil fertility. Diversification and commercialization need to be further incentivized through appropriate policies.

115. Diversification would also positively impact nutritional outcomes. Investing in nutrition supports human capital development, which is particularly relevant for Malawi given its high population growth, prevailing poverty levels, and the fact that it is the poor who are most likely to be stunted. Malawi should invest in interventions to increase, especially among the rural poor, knowledge of improved diets, and to induce behavioral change towards consumption of a diversified diet, as well as investments towards increasing food availability, food safety and diversified food products.

116. Diversifying into non-farm sectors can also increase the productivity of the agricultural sector significantly. Given the pressures of increasing population on a limited land base, attracting an increasing share of the population towards non-farm economic sectors will be key to improving productivity in the agriculture sector, which will be discussed in the next pathway.

117. Recent land reforms have the potential to improve the productivity of maize, access to finance, and promote structural transformation. The recently enacted land bills, once implemented, are likely to result in greater security in land tenure, which would in turn encourage investment in land and greater access to credit as land becomes viable collateral. The fear of land being taken away is estimated to reduce output by 5 percent. For women, the productivity losses are estimated at 12 percent (Deininger et al., 2017). Furthermore, the documentation of land ownership provides a basis for efficiency-enhancing

transactions in rental markets, which can support positive structural transformation and the growth of the rural non-farm economy, and facilitates leasing of farming lands to more efficient farmers, which can create scale economies and make mechanization profitable.

118. Also, expansion of irrigation systems has a potential to increase the productivity of the agricultural sector as well as the resilience of agricultural production (see Box 4.2).

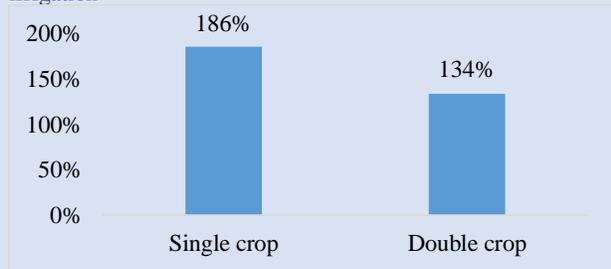
Box 4. 2: Irrigation productivity and resilience of the agricultural sector

Given the impact of recent weather shocks on agricultural production in Malawi, the government is increasingly focusing on investment in irrigation as one part of its efforts to boost climate resilience. Currently, 96 percent of cropland in the country is rainfed and highly vulnerable to extraordinary weather conditions like droughts and floods. According to the National Irrigation Master Plan and Investment Plan (IMP), the Government of Malawi plans to double the irrigated cropland by 2035 with the implementation cost of US\$ 2.4 billion (in 2014 prices). However, irrigated farming is not an easy solution, requiring significant technical analysis, capital, social and market analysis, and effective market linkages.

Irrigation’s potential is large. In non-irrigated lands, farmers can produce maize and most other crops only in the rainy season; while in irrigated lands, they can produce crops even in the dry season. Furthermore, providing supplemental irrigation to bridge long dry spells can increase yields in the rainy season. According to the International Food Policy Research Institute (IFPRI)’s recent evaluation on the Bwanje Valley Irrigation Scheme (BVIS), farmers in irrigated lands more than doubled their agricultural incomes and could increase daily per capita caloric intake significantly (IFPRI, 2014). Farmers producing two crops could earn more income than those producing only one crop in the irrigated lands (see Figures 4.2.1 and 4.2.2). Marginalized households like youth and female headed households were also found to enjoy a significant increase in their income and calorie intake by participating in this irrigated crop production.

Figure B 4.2.1: Participants of an irrigation scheme have enjoyed large income growth

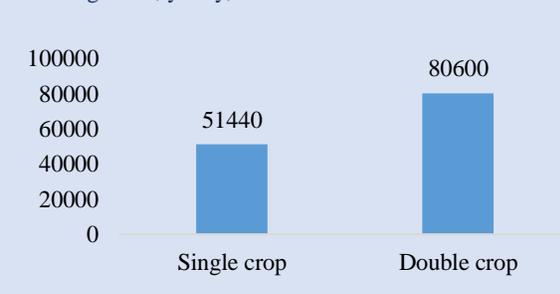
Income growth (%) by BVIS farmers growing crops under irrigation



Source: IFPRI 2014

Figure B 4.2.2: Participants with double crops increased more income

Income growth, yearly, Malawi Kwacha in 2012



Source: IFPRI 2014

Is irrigation enough? No. To make irrigation work, a more holistic approach is required. The economics of sustainable irrigated farming in Malawi is challenging. Most importantly, irrigated crops will have to be profitable to cover sizeable operating and maintenance (O&M) costs of irrigation infrastructure, costs associated with scheme management when grown in communal irrigation schemes, as well as basic production costs. In addition, O&M needs an institutional arrangement to ensure that operational costs are collected from users and irrigation facilities are properly maintained. This requires transformation of subsistence agriculture to commercial agriculture. For example, more reliably profitable crops are higher value crops with limited dry season supply, primarily vegetables for sale in urban areas. However, as these crops are perishable, it limits their potential in remote areas due to transportation costs.

Furthermore, improved water storage is necessary to maintain water flow during droughts and the dry season. The Post-Disaster Needs Assessment for the 2015/16 drought (Government of Malawi, 2016) estimates

a loss of US\$ 31.8 million in irrigated lands due to the drought. This suggests a severe drought could also reduce the water supply in irrigated lands and could cause even greater damage in irrigated lands than in rainfed lands. IFPRI’s evaluation also shows that only an estimated 200 out of 800 hectares of land irrigated by BVIS produce crops in the dry season. It is thus important to combine irrigation with other types of water management, especially improving the capacity of water storage. Finally, according to IMP, total irrigable land is estimated to be around 400,000 hectares, which is a less than a quarter of the total cropland of the country. For non-irrigable lands, other types of interventions are needed to improve agricultural productivity.

Source: Government of Malawi (2014b), IFPRI (2014), Benson & Edelman (2016), and Government of Malawi (2016)

Pathway II: Diversifying the economy and creating jobs

Improving agriculture productivity is a key development priority, but given a rapidly growing population on a limited land base, it requires that other sectors attract workers and provide attractive livelihoods. Increasing growth and employment in the private sector would further help diversify income sources and improve resilience to shocks in the agriculture sector. Moreover, Malawi’s ability to achieve robust and sustainable growth and poverty reduction will depend to a large extent on developing a thriving private sector, given that private enterprises play a key role in the economy as providers of goods and services, as importers and exporters, and as employers and taxpayers. Therefore, continued structural transformation is critical, particularly towards more productive manufacturing and services sectors, which will include the movement of households from rural to urban areas.

119. Malawi has been undergoing structural transformation from the agriculture to the non-farm sector, but the pace of job creation has been slow. While 1.1 million jobs were created between 1998 and 2013 in Malawi, the agricultural sector lost 180,000 jobs, the industry sector gained 218,000 jobs, and the service sector gained 1.06 million jobs. As a result, the share of jobs in the agricultural sector shrank from 84 percent to 64 percent between 1998 and 2013 (see Figure 4.3). However, the pace of job creation has been slow – the annual job growth rate was 1.5 percent, lower than population growth at 3 percent.

Figure 4. 2: Structural transformation between Malawi’s agriculture and non-farm sector has been slow
Percentage share of the labor force deployed by sector



Source: Malawi Urbanization Review (World Bank 2016f)

120. Urbanization has limited impact on the ongoing structural transformation. Although urbanization has been an important catalyst for growth and poverty reduction in many countries in sub-Saharan Africa, Malawi exhibits a very slow pace of urbanization as the percentage of urban population has stagnated at around 15 percent since 1999 (WDI, 2017, see Figure 4.3). The pace of urbanization is

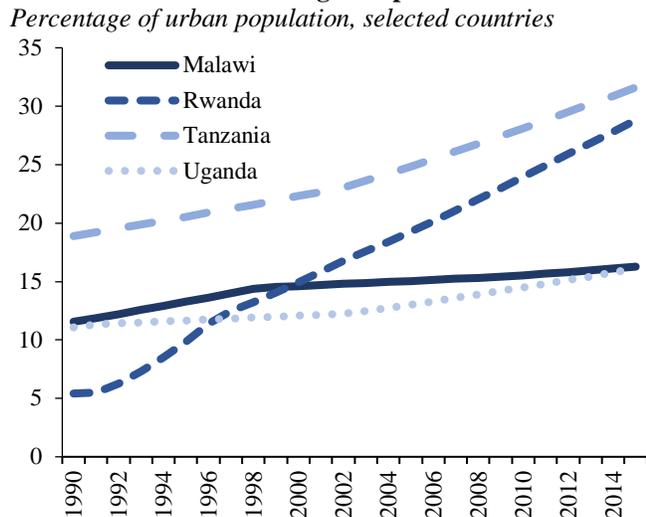
slower than other African countries, like Tanzania and Rwanda. Even small increases in the pace of urbanization and level of urban investment could enhance Malawi’s long-term economic prospects by accelerating growth and bringing more meaningful structure change.

121. Instead, a massive structural transformation has been taking place within rural areas (see Figure 4.4). Nearly 83 percent of new jobs were created in rural areas but the share of jobs in urban areas increased slightly because the growth rate of jobs in urban areas (2.4 percent) was higher than in rural areas (1.3 percent). Also, a massive structural transformation has been taking place in rural areas where the number of jobs in agriculture declined while those in industry and services increased substantially. The biggest job creation occurred in the rural service sector with an annual growth rate of 11.2 percent, followed by the rural industry sector with an annual growth rate of 7 percent.

122. The ongoing structural transformation increased productivity of the whole economy and, interestingly, agriculture, but reduced productivity of the non-farm sector, especially services. The shift of employment from a low productivity sector (agriculture) towards more productive sectors (industry and services) contributed to growth and productivity at the national level. Indeed, productivity measured by GDP per worker grew at an annual rate of 2.3 percent. Also, the structural transformation accelerated the agricultural GDP *per worker* despite the slow growth of the agricultural GDP likely by cutting redundant agricultural labor. But, the productivity of the service sector declined at an annual rate of 3.5 percent. Such a reduction in productivity occurred likely due to low human capital of former farmers and the poor “quality” of new jobs in the services sector, much of which is informal. Declining productivity of the non-farm sector is worrisome because it weakens the competitiveness of the sector.

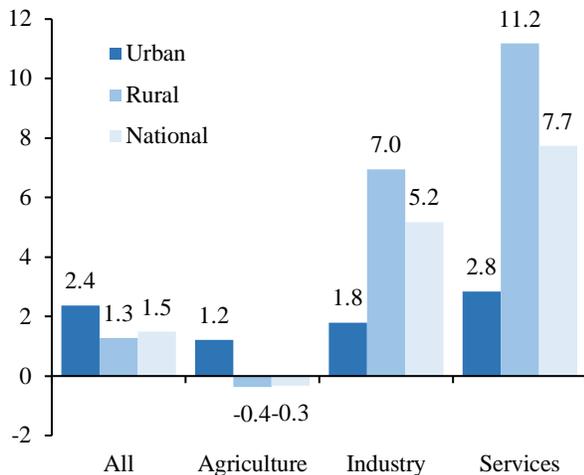
123. Despite some sectoral growth in employment, the share of manufacturing to GDP has remained stagnant and relatively small at around 10 percent. The sector mostly produces for the domestic market and manufacturing firms are operating on average at just 68 percent capacity utilization (Record et al., 2016). This suggests that, with the right policy framework, Malawi’s private sector could produce as much as a third more than current levels without needing to undertake new investment. Therefore, the manufacturing sector has great potential for economic growth as well as job creation and income diversification. On the contrary, the decrease in productivity of the services sector has been the main reason for low productivity growth between 1998 and 2013.

Figure 4. 3: Malawi’s urban population share falls well behind regional peers



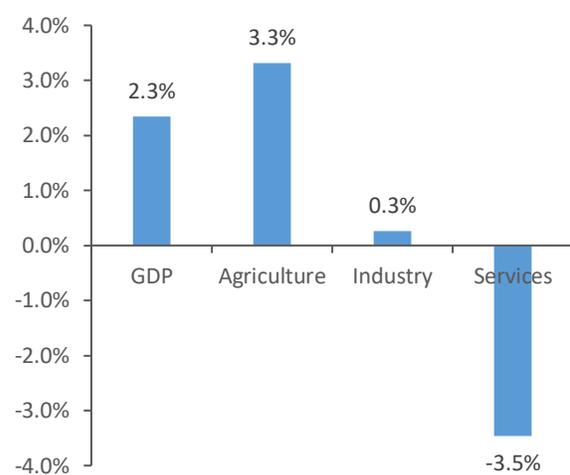
Source: WDI, 2017

Figure 4. 4: Job creation has been gradually taking place in the rural non-farm sector
Annual growth rates of employment by sector and region between 1998 and 2013, percentage



Source: Authors' calculation using data from Malawi Urbanization Review (World Bank 2016f)

Figure 4. 5: Rapid productivity growth in agriculture but declining productivity in non-farm sector
Growth rate of sectoral GDP per worker (%)



Source: Authors' calculation using data from Malawi Urbanization Review (World Bank 2016f).

Constraints to growth

Challenges for Structural Transformation

124. A higher rate of urbanization, while potentially increasing productivity, could also lead to a phenomenon known as the “urbanization of poverty,” unless a higher proportion of public resources are allocated to meet investment needs in urban areas. While many development efforts have focussed on rural areas, increasing funding towards urban development has often been construed as taking away funding from rural development. However, the urban economy can finance its own development by increasing the urban tax base, particularly through property taxes. Strong needs in urban areas include often limited coverage of secondary road networks, while feeder roads are generally in poor condition. Similarly, solid waste management in Malawi's towns and cities remains a major challenge. Malawi's urban areas have developed as collection of small and fragmented neighborhoods, lacking reliable transportation and limiting job opportunities, while preventing firms from reaping scale and agglomeration benefits. Investing in cities and building dense, connected, and efficient cities will support private sector development, increase demand for agriculture products, and increase opportunities for increased production and trade.

125. Agriculture continues to employ the vast majority of workers, and formal employment is uncommon, particularly for women. Formal employment comprises only 11 percent of total employment, with a large share of own-account workers (54 percent), mostly in the agricultural sector. Around 84 percent of men and 94 percent of women hold jobs without social protection or employment benefits, which includes own-account workers as well as a large share of paid employees. According to survey data, about one in six people has a secondary job (NSO, 2012). The unemployment rate has been estimated at 20 percent nationally, although this number is difficult to interpret in the context of most households being engaged in agriculture (von Carnap, 2016).

126. In rural areas, participation in self-employment is key for income growth, but it is still limited and is highly correlated with agricultural sector growth, instead of providing an independent safety

net against agricultural shocks. According to the Malawi Poverty Assessment (World Bank, 2016b), participation in self-employment tends to increase household consumption expenditure per capita 11 to 14 percent in rural areas. Participation in self-employment fluctuated but was no more than 30 percent, and was never more than 14 percent of income share. Self-employment currently performs like a multiplier of the rural agricultural sector rather than a means of diversification from agricultural activities. For example, the participation in self-employment declined between 2004 and 2010 when agricultural GDP growth was low (1.1 percent), while it rose between 2010 and 2013 when agricultural GDP grew fast (3.5 percent).

127. The high correlation between agriculture and self-employment in rural areas reflects how many small and medium enterprises in Malawi are selling agricultural products. Most self-employment in rural areas is through micro, small, and medium enterprises (MSMEs).²⁷ More than 80 percent of MSMEs are retailers and around half of them are selling agricultural products or other goods with almost no value addition (FinScope 2012). Also, more than 40 percent of MSMEs do their business at their home. Therefore, the success of rural MSMEs (and thus rural self-employment) are dependent heavily on local economies where agriculture is still a dominant industry.

128. To date growth has been highly volatile, short and too highly concentrated on capital-intensive sectors to create a sustained increase in employment and initiate sustained economic growth. While Malawi has displayed an impressive growth performance over the second half of the last decade, this did not start a sustainable structural transformation towards higher productivity sectors, as it has come in the wake of investment in capital-heavy industries such as mining and finance and high prices for agricultural export goods on one hand. On the other, the main driver of increased services employment has been the wholesale and retail trade sector, in which relative productivity has been declining. There has also been inadequate investments in agro-processing of products resulting in minimal to little improvements in agricultural productivity and thus in job creation particularly for the rural population. Employment generation is currently held back more by demand-side constraints. After a strong period of hiring in the early 2000s, employment growth slowed to 3.2 percent per year and fell behind regional trends during 2011-13 (von Carnap, 2016). The private sector has been significantly constrained to attain any meaningful growth let alone diversification. Whilst, the demand for workers with post-secondary education is low, reflecting the scarcity of high-value jobs.

129. Existing skills gap and challenges of job matching in the labor market. Lack of skilled labor is a barrier to private sector-led growth, whilst even with improved tertiary education levels employers have highlighted the unpreparedness of graduates once they enter the labor market. This is compounded by the absence of formal matching mechanisms in the labor market—a large share of companies does not use formal search mechanisms such as advertisement and public employment services, so most jobs outside of the civil service are found through personal connections.

130. Malawi's competitiveness is particularly constrained by deficiencies in connectivity infrastructure. Addressing this constraint for a landlocked economy is key because much of the country's trade transits through neighboring countries. Road transport is the main mode of transportation, which is comparatively more expensive than other modes of transport such as rail and water. The overall quality of the road network, particularly at the secondary and tertiary level, and to some rural areas, is poor.

131. An underdeveloped logistics services sector, poorly performing trade corridors, and poor trade facilitation also constrain regional integration. Its low level of alignment with the recent WTO Trade Facilitation Agreement (TFA) highlights the need to significantly improve its border clearance performance, particularly for perishable food. Trade is slowed by cumbersome trade procedures, lack of

²⁷ The characteristics of informal employment (NFSE) shown in Malawi Poverty Assessment (World Bank 2016) are very similar to MSMEs in FinScope (2012) in terms of location of enterprises, registration, and owners' age distribution. Therefore, we use the characteristics of MSMEs from FinScope as part of NFSE's characteristics.

trade automation across numerous agencies; a high rate of border inspections including a lack of inter-agency coordination and the lack of use of risk management. Malawi's logistics sector is underdeveloped with many large, often well-connected, firms vertically integrated partly due to lack of demand. The private sector's low level of involvement in the trade reform process is also a cause for concern.

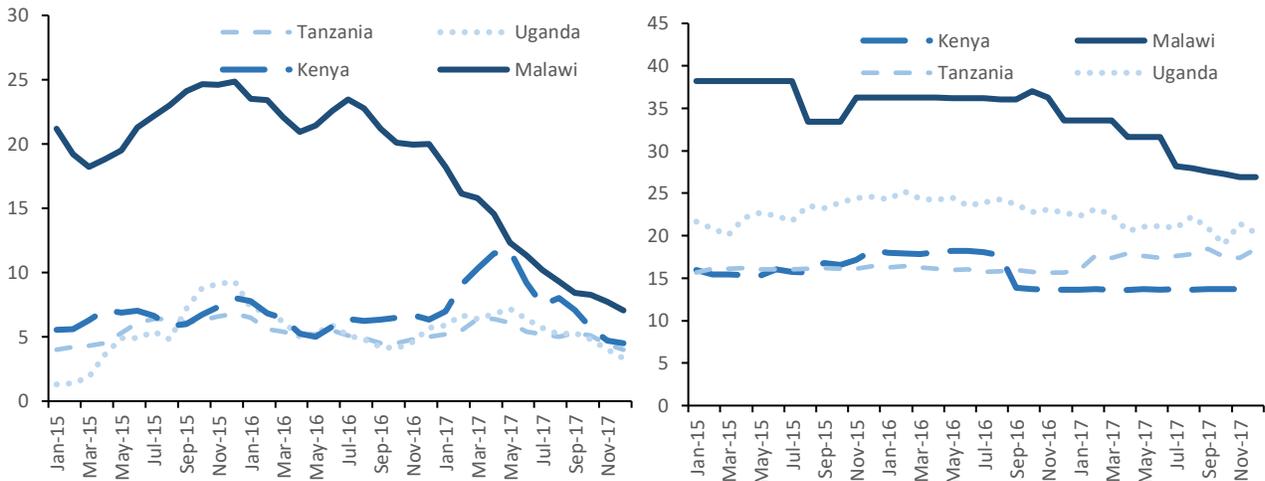
A Challenging Business Environment

132. Malawi's private sector is predominantly small and dominated by informal small-scale enterprises. The FinScope MSME Survey 2012 highlights the importance of MSMEs, which employ over one million people. Small-scale enterprises are primarily informal and mostly operating in services sector such as restaurants, and particularly in retail activities such as vending. There is a small number of large scale enterprises often engaged in agriculture or agro-processing activities, and manufacturing of products such as soap, cooking oil, confectioneries and food products. The absence of middle-sized firms²⁸ points to the difficulties in the business environment characterized by macroeconomic instability, corruption (including on land acquisition), inconsistent policies, and access to good markets. This signals a difficult business environment that constrains growth opportunities for small-sized companies and favors those with long-established networks and policy framework that is biased toward larger firms. This is partly due to the enduring legacy of heavy state intervention, which further exacerbates the limited entry and success rate of new companies that would contribute to the diversification of exports and of the economy (Hoppe and Newfarmer, 2014). In addition, the regulatory deficiencies around private sector activity similarly favor established firms with broad networks which allow them to mitigate various risks. This underscores the potential inherent in structural transformation toward a more diversified economy beyond agriculture, as the few formally operating manufacturing firms are generally profitable.

133. Macroeconomic stability is a prerequisite for growth, and lowering inflation and interest rates (Kibuuka & Vicente 2016). Since mid-2012, exchange rate depreciation contributed to high inflation, averaging over 20 percent, to drive up economic uncertainty. This coupled with banks raising their lending rates as high as 30 percent stifles access to finance particularly for small to medium enterprises (see Figure 4.6). As for the informal sector, interest rates can reach as high as 60 percent which is equally prohibitive and restricts investment. Interest and inflation rates only began falling over the past two years. Lower lending rates would lead to increased access to finance and stimulate investment. The nature of the banking sector also has a role to play, as it is very concentrated and highly exposed to the public sector, while it offers limited products and operates at high costs.

²⁸ Malawi's economy is dominated by a very small number of large firms: in 2012, the five largest business enterprises accounted for 62 percent of total exports, while the 20 largest business enterprises accounted for 81 percent. At the other end of the spectrum is a vast number of household and micro enterprises engaged in sales and small-scale manufacturing. In aggregate terms, the vast majority of exporters are small, with more than 65 percent of firms exporting goods at a value of less than USD 50,000 per year (World Bank 2017b)

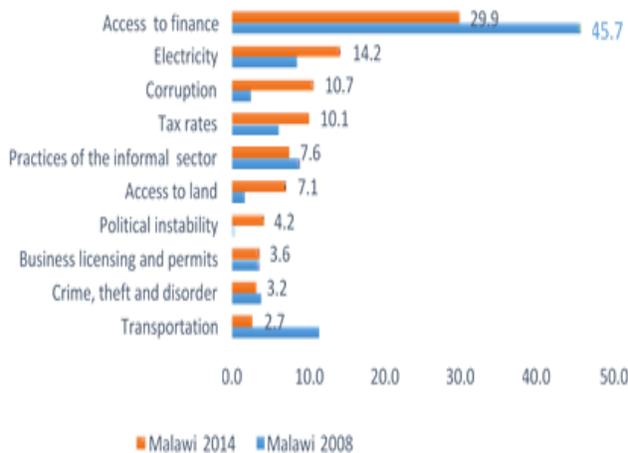
Figure 4. 6: Macroeconomic instability has led to persistently high inflation rates until 2017, and consequently high lending rates compared to the region



Source: World Bank staff calculations based on country data

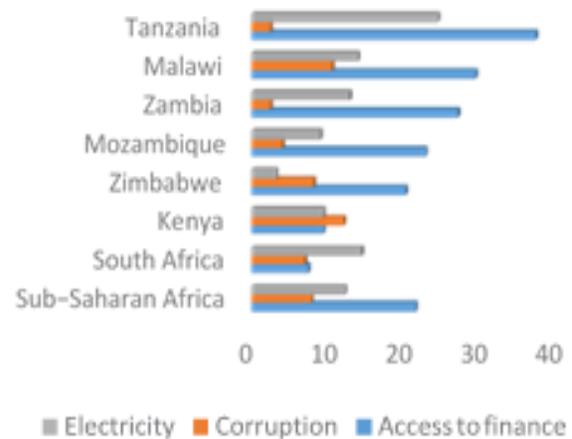
134. An overall challenging business environment has undermined efforts to develop the private sector and its accompanying potential for employment (figure 4.7). Malawi fares poorly on the competitiveness indicators and rankings. According to the Doing Business 2018 Report, Malawi ranks 110th of 189 countries, mostly outside the top 100 economies across indicators. The Global Competitiveness Index (GCI) placed Malawi at 135 out of 140 countries in 2015/16. The most frequently cited obstacles to private sector growth and performance are access to finance, unreliable electricity, and corruption. In addition, Malawi does not fare well in comparison to her neighbors. Many indicators do not meet the sub-Saharan regional average—the percentages of firms that reported access to finance and electricity as biggest obstacle in Malawi is higher than the regional average (Figure 4.8).

Figure 4. 7: Top obstacles to doing business in Malawi in 2014 and 2018



Source: WB 2016 Investment Climate Assessment

Figure 4. 8: Regional comparison of major obstacles to doing business in the region



Source: WB 2016 Investment Climate Assessment

135. Similar to other countries in the region, access to finance was the most commonly cited concern in both the 2008 and the 2014 World Bank Enterprise Surveys. This declined from about 46 percent in 2008 to 30 percent in the 2014, however, in both surveys, there is a large gap between access to finance and the subsequent constraint. High interest rates, collateral requirements, and complex application Malawi: Systematic Country Diagnostic

procedures were cited as the main reasons for not taking up a loan. While 79 percent of large firms (more than 100 employees) had taken on credit in the year before the Enterprise Survey, only 63 percent of firms with 10–49 employees and 33 percent of firms with less than 5 employees had done so. Commercial banks offer only a narrow range of financial instruments, and do not offer long term financing schemes. Smaller firms mostly source their working capital from within their business, or owners use private assets as collateral when taking up credit. Limited wealth and capital form a further constraint for the rural poor.

136. Malawi’s financial sector is small and shallow. While showing signs of improvement, financial inclusion remains a challenge. While there is growth innovation in transactional products/services such as e-money and mobile banking, as well as steady growth in the number of ATMs and POSs, usage of these to support business growth is low. Financial illiteracy is high. Village loan systems continue to be popular especially in the rural areas, together with a growing non-bank microfinance industry. Financial literacy programs are needed to encourage people, especially in rural areas, to benefit fully from these innovations. Subscriber base for MNO-led payment schemes is expanding. However, the active agent ratio and the rural spread of agents remains relatively low.

137. Corruption is also cited as a major obstacle to doing business. One in five interactions with the public sector are reported to have involved bribes, with the highest incidence for construction permits, import licenses, and electricity connections—all three areas that are likely to be key factors for successful business entry (Figure 4.7). This further constrains the potential for foreign direct investment.

138. Labor related constraints such as education of workers or labor costs are not identified as a major concern by firms. Only 11.9 percent of firms in Malawi identify education of the workforce as a major constraint, compared to 40.8 percent in Tanzania. Similarly, labor regulations concern only 4.6 percent of firms in Malawi versus 31.7 percent in Tanzania. These numbers reflect the relatively high capital intensity of Malawian firms, as few are engaged in labor-intensive sectors. Limited returns to education for self-employment, and firms not stating it as a binding constraint should not lead to the conclusion that employment and education policies are of lesser importance. To the contrary, a major concern is whether Malawi’s economy will be able to provide employment to the growing population with the current sectoral orientation, which also reflects low standards of education.

139. Although they have played an important role in poverty reduction, MSMEs engaged in rural non-farm self-employment (NFSE) face heightened constraints than the rest of the private sector. Self-employment is characterized by informality, lack of access to finance, limited capital/assets, and unskilled workers with low educational attainment. Women-owned businesses are less formal, profitable, and smaller than those owned by men. Moreover, the self-employed are further vulnerable to various types of shocks including natural disasters, climatic shocks, sickness and theft. Around three quarters of those who participate in rural NFSEs did not complete primary education and most of them are self-taught and did not receive any formal skill training (World Bank 2016b). The Malawi Poverty Assessment found the key constraints to rural self-employment as: 1) remoteness from roads and markets; and 2) limited wealth and access to finance to start a business or self-employment activity (World Bank 2016b). Education has a limited impact on participation in and returns from self-employment (NFSE), but this is likely due to the fact that most MSMEs are retailers who sell agricultural products or other goods without almost any value addition. According to the FinScope survey, almost 60 percent of MSMEs are financially excluded and 44 percent of MSMEs identify lack of access to finance as a key constraint for their business. Additionally, 98 percent of MSMEs are not formally registered.

Challenging and Deficient Infrastructure

Energy and water

140. Low and unreliable access to energy is a major constraint to development in the formal sector, with the situation seeming to have worsened since 2008. Firms of all sizes in the formal sector identified this as the second-biggest constraint to doing business in Malawi. Energy access is only ten percent. On average, firms reported losing 5.1 percent of their annual sales due to electricity outages, with 40.9 percent of firms owning a generator as a backup. These utility problems affect larger-sized enterprises the most, especially in the manufacturing sector. Operating backup generating facilities can triple the marginal cost of electricity supply, undermining competitiveness, and in fact are only feasible in areas of business where margins can absorb such incremental costs. The erratic electricity supply not only increases operational costs as firms substitute into more costly energy alternatives but also lowers productivity, and ultimately sales, incomes and deters existing and new growth prospects.

141. Lack of investment in new generating capacity has resulted in a widening gap between Malawi's demand for energy and installed capacity. The total installed generating capacity of 365 MW (of which 98 percent is from hydropower sources along the Shire River) falls well short of estimated demand at around 440 MW. Climate variability and drought have had a significant impact on hydropower supply availability, leading to prolonged load shedding. At the same time, improving the overall performance of ESCOM to ensure cost reflective tariffs would enable the utility to meet its revenue requirements and investment programs.

142. Water supply is also a constraint to business, with Malawian enterprises experiencing a high frequency of water disruptions, particularly in Blantyre. In 2014 firms reported experiencing on average of 5.3 days of insufficient water in a typical month, which is highest amongst comparable countries in the region, and more than double the regional average for countries in sub-Saharan Africa (1.8 days in a typical month) (Record et al 2016).

Transport

143. The high cost of domestic and international trade further constrains private sector development and poverty reduction in Malawi. Malawi has historically served as one of the more famous examples of a landlocked and small economy that suffers from high trade costs (Ksoll and Kunaka, 2016). Transport costs are seen to constrain Malawi's economy in two ways: (i) they increase the price of imported products such as fuel, fertilizer and raw materials; and (ii) they reduce the competitiveness of Malawi's exports. Road transport remains the major mode of transport in Malawi handling more than 70% of the internal freight traffic and 99% of passenger traffic. Road connections are also imperative for tourism development; given that the tourism sector across Africa is projected to grow at an average of 4.3% per year and Malawi has a strong potential.

144. A number of studies have attributed these high costs to the long distances to seaports for overseas trade, the large gap between import and export volumes, an overreliance on road transport, competition on some trade routes (especially those through Mozambique), and delays in clearing cargo at border crossing points and at ports in neighboring Mozambique and Tanzania. Transport costs are further exacerbated by other domestic constraints, such as higher fuel prices than elsewhere in the region (except Zimbabwe), expensive spare parts and equipment, prohibitive cost of finance, elite connections of key firms, and supply chain constraints, which render Malawi uncompetitive in larger transport contracts. Given low income levels and a relatively modest population size, Malawi's domestic market provides limited opportunities—particularly in sectors where economies of scale are only possible if international markets are accessible.

145. Rural transport costs are even higher than international costs, further impeding the development of economic activities and poverty reduction in rural areas, especially given the low value of unprocessed agricultural produce. This is largely attributed to thin and seasonal fluctuations in demand, the availability of transport services, and the condition of rural roads. The National Rural Accessibility Index (RAI) is estimated at 23.1% in Malawi, leaving about 11.3 million rural residents unconnected to roads in good or fair condition. While the RAI is relatively high around large cities, such as Blantyre, Lilongwe and Karonga, it is quite low in some of the hilly or hinterland districts, such as Ntchisi (9.8%), Mwanza (16.7%) and Neno (14.5%). The high cost of internal freight transport has a major impact on agricultural commercialization given the low value of much unprocessed agricultural produce. The poorest households tend to live in the most remote locations with little or no access to markets for their agricultural produce, making it harder for them to escape poverty. However, reducing rural transport prices requires more than just addressing infrastructure, it requires appropriate logistics solutions which are currently lacking (Malawi National Transport Masterplan, 2017).

146. The lack of climate resilient infrastructure, including flood resistant infrastructure and inadequate design standards, presents a major challenge. Damages to transport sector significantly affect agricultural exports, which are highly reliant on a properly functioning transport network. A total of US\$ 62.4 million of damages and losses to road infrastructure were accounted after the January 2015 rainy season, the second largest cost of estimated damages after housing.

Information Communication and Technology (ICT)

147. Malawi significantly lags behind its peers in the development of its market for telecommunications and other digital services, which prevents it from achieving wider digital dividends. The country is ranked 168 out of 175 countries in the International Telecommunication Union's (ITU) 2016 Global ICT Development Index²⁹. Mobile penetration remains low, with subscriptions standing at 39 percent of the population at end 2017³⁰, compared with over 80% across East and Southern Africa. Mobile internet connections are growing at a 25% annualized rate, but have only reached 12%, compared with 32% for the East and Southern Africa region. Development of and access to digital public services is likewise extremely low. Malawi has fallen from 133 in 2004 to 166 of 193 countries in the 2016 United Nations (UN) e-government index³¹, which measures provision of online services, telecommunication connectivity, and human capacity. The uptake of digital technologies by private firms is also low, with Malawi scoring just 0.07 on the business component of the World Bank's 2015 digital adoption index³², lower than its scores for either citizen (0.17) or government (0.29) use of ICTs.

148. Access and advancement of digital technologies and services in Malawi are constrained by a lack of affordability, availability, quality of broadband connectivity and digital devices, coupled with low human and institutional capacity and low income levels. Mobile voice tariffs are among the four least affordable in the world, costing as much as 48.9 percent of gross national income (GNI) per capita. The retail price of an entry-level mobile broadband package (500 MB per month of data) is equivalent to 24.4 percent of GNI per capita, while a fixed connection exceeds 111 percent.³³ In a recent national survey, affordability was cited by 55 percent of respondents as the main barrier to Internet access, while 31 percent reported a lack of knowledge of basic Internet use as the main constraint.³⁴ Backbone and access network infrastructure is lacking or deficient in most rural areas and secondary cities, limiting the opportunity to

²⁹ International Telecommunications Union, 2016. <http://www.itu.int/net4/ITU-D/idi/2016/>

³⁰ GSMA Intelligence, 2018.

³¹ United Nations, 2016. *UN e-Government Survey 2016*. <https://publicadministration.un.org/egovkb/en-us/reports/un-e-government-survey-2016>

³² World Bank 2015. <http://wbfiles.worldbank.org/documents/dec/digital-adoption-index.html>

³³ As calculated by World Bank, based on ITU and GNI per capita data

³⁴ Source: Malawi Communications Regulatory Authority (MACRA)

deliver high-quality ICT services, even for those willing to pay a premium price. The Government does not have the needed connectivity, infrastructure, and capacity to deliver high-quality public services digitally.

149. Various factors contribute to these constraints, including a lack of competition in critical telecom market segments, insufficient infrastructure investment, and high costs for international bandwidth. An effective duopoly has persisted in mobile communications between Airtel and Telekom Networks Malawi (TNM) for the past fifteen years, despite the award of several additional licenses. The resulting lack of investment and competitive pressure on prices and quality has severely affected ordinary consumers—the vast majority of whom access both voice and broadband services through mobile phones. In the fixed broadband market, Open Connect Limited (OCL) owns the most extensive and, in many areas, the only fixed network infrastructure. Until recently, OCL also held a monopoly on international connectivity through access to the East Africa Submarine System (EASSy) submarine cable, although this has improved through the market entry of SimbaNet Malawi and investments from other entities.

150. High levels of taxation and lack of regulatory authority are also impeding investment, affordability, and demand for services. Taxation and regulatory levies account for a large and increasing proportion of operating costs and retail prices. Previous attempts to cap retail prices by Malawi Communications Regulatory Authority (MACRA) have been stymied due to lack of clear legal authority, and there have been no enforceable regulatory mechanisms for network interconnection, number portability, and infrastructure sharing between service providers. This has discouraged new market entrants and reduced competition despite formal liberalization in the sector.

Opportunities

151. As a landlocked country, Malawi has significant trading relations with its neighboring countries and countries outside the region. Although regional trade data has limitations, South Africa remains the top import source for Malawi globally in 2017, and the second biggest export destination (see Table A3.2 in Annex 3). Traditional agricultural exports continue to dominate exports, namely tobacco (some 60 percent of exports in 2017), tea (8 percent), and sugar (four percent). Groundnuts, soya beans, dried legumes (pigeon peas) were also exported in some amounts. Oilcake exports—the third largest export with a 7 percent share—presents some evidence of oilseed processing, and were exported to Tanzania and other regional markets. Some 37 percent of tobacco was exported to Belgium in 2017, with significant shares also going to Egypt, Germany and China. About 60 percent of tea was exported to South Africa and the UK. Sugar was exported to the U.K., U.S., and Italy. Macadamia nuts emerged as the 8th largest export at about US\$15 million in 2017, largely exported to the Netherlands, South Africa, and U.S.

152. Regional integration can support economic diversification and more inclusive growth. Increased integration will allow Malawi to benefit from its geographical access to fast-growing neighboring economies. However, to improve the prospects for regional integration, Malawi needs to undertake policy reforms and address numerous structural and institutional constraints to reduce trade costs. This is even more critical for Malawi, which relies on low value agricultural exports.

153. Non-tariff barriers, particularly the imposition of export bans, need to be addressed to increase the potential for regional trade. These include the risk of government intervention, differences and complexity in rules of origin, quality and product standards, and commitment and compliance to protocols. Most recently, amidst food security concerns, the Government re-imposed a maize export ban in January 2018. Historically, trade in food staples has long been discouraged by national policies that place a high priority on food self-sufficiency. In 2008, Malawi banned all exports of maize, and other SADC and COMESA countries have also intervened in these markets, in ways that are not structured and rules-based. Consequently, one of the biggest impediments to large-scale investment in regional trading capability

remains the unpredictable behavior of governments in imposing export bans whenever they fear shortages in their own markets. The ex-ante risk of government intervention has limited investment in commercial agriculture, and slowed the development of the nascent commodity exchanges that Malawi has put in place for the sub-regional and for its domestic markets: Agricultural Commodity Exchange (ACE), and Malawi Agricultural Commodity Exchange (MACE) (World Bank, 2017b).

154. Malawi National Export Strategy (NES, 2013 to 2018) identifies products in which Malawi is potentially competitive.³⁵ The NES presents opportunities for Malawi to move from the export of raw and semi-raw commodities to higher value goods and services,³⁶ thereby creating jobs and wealth. Products are identified according to three clusters namely: a) Oil Seed Products -- particularly sunflower, groundnuts, soya and cotton – and their value-added products such as soap, cooking oil, lubricants, paints, cosmetics, soya meals, peanut butter; b) sugar and its value-added products such as confectionery products, ethanol, fertilizer, animal feed; and c) manufactures such as beverages, agro-processing (dairy, maize and wheat products), plastics and packaging and assembly.

155. Other products that were not identified in the NES such as macadamia nuts have emerged as export products. This suggests that there are other products that Malawi has a competitive advantage in that need to be further explored and developed. This is an exercise that is important in the context of developing a successor strategy to the NES. Other potential areas of growth through export include rice and processed foods. Some of these are being exported to places such as Zimbabwe and Tete in Mozambique, but could find their way to regional and global markets.

156. Recent efforts have been made to improve regional rail, energy and information communication technology (ICT) infrastructure. The recent \$4 billion investment in the Nacala railway line creates opportunities for Malawi's businesses to export their products through the Nacala port in Mozambique. However, to date, the corridor is still used mostly for imports, while exports comprise only one-quarter of freight. While Malawi has usage rights to 5 million metric tons per year, it has only utilized an average of 250,000 metric tons. Additionally, to address erratic energy supply, the Government has also resumed negotiations on a regional electricity interconnector with Mozambique whilst the IPP framework has been finalized and one PPA has been signed for the construction of a 41 MW hydro power plant. Going forward, identifying alternative sources of renewable energy remains paramount. Finally, initiatives to improve ICT have also included expansion of the national fibre backbone through Tanzania, in addition to Mozambique, with plans to extend access to users across the country.

157. Renewable energy sources and particularly solar power have great potential. Solar radiation in Malawi is among the highest in the world. A recent solar modelling report found that Global Horizontal Irradiance in Malawi is very ideal for solar photovoltaic systems (Suri et al., 2015). These can be used both for off-grid systems where there is no access, and also for on-grid connection. In recent years, greater penetration of household level solar has been observed which has the potential to make an impact for those able to afford this technology in the context of high costs for connections to grid-based systems and high unreliability of grid power. Development of wind energy could also be important in this respect.

158. Malawi's ICT sector has recently improved regulation while connectivity cost has dramatically decreased. Legislation approved in 2016 has modernized the governance framework for the ICT sector, particularly strengthening the regulatory role of MACRA. The market entry of SimbaNet has led to the price of international connectivity falling precipitously from US\$3,000 per Mbit/s per month in 2011 to just US\$135 or less today, removing one of the largest components of service providers' operating

³⁵ Hausmann and Klinger, 'Structural Transformation and Patterns of Comparative Advantage in the Product Space', Harvard CID Working Paper No. 128, 2006 and Hausmann, Hwang and Rodrik, 'What You Export Matters', Harvard University, 2006

³⁶ Through developing the productive base and export capacity

costs. Interest also appears to be growing among both existing market players and potential new entrants to make significant network infrastructure investments and launch new service offerings, particularly in urban centers.

159. It is critical that this positive momentum is reinforced and accelerated in order to transform Malawi's digital development trajectory and to ensure that digital dividends are reaped and shared widely. By investing in ICTs, Malawi can enhance its international competitiveness and position itself as an attractive destination for foreign investment and digital innovation in a variety of sectors, including tourism and agriculture. A significant scale up in private sector infrastructure investment should be encouraged, especially in rural and underserved areas. Competition needs to be strengthened through progressive, forward looking government policy and light touch regulation of the ICT sector. Affordability may need to take precedence over short term revenue maximization. Finally, digital skills need to be nurtured to equip citizens, especially youth, to build the digital society, government and economy of tomorrow.

160. Going forward the priority is to address the aforementioned challenges and create opportunities for a digitally-enabled economy, society and government, with the ultimate aim to promote economic and social opportunity, increase access to services and improve quality of life. There is a need to leverage digital technology to improve service delivery at the sector level once there is adequate connectivity, skills and service delivery infrastructure/capacity. The potential is particularly great in agriculture (online market platforms, access to extension services), financial inclusion (mobile money, savings, insurance – this would largely be private sector driven if regulation is progressive and connectivity is cheap and widespread), health (telemedicine, health messaging, remote diagnostics, supply chain management, etc.), and education.

161. Lastly, Malawi's lower labour unit costs and higher labour productivity compared to its neighbouring countries could make it competitive in attracting investment into labour-intensive manufacturing industries (World Bank 2016g). If it addresses its other business environment issues constraining foreign direct investment (FDI) and manufacturing growth, this could position the country to attract investment and support employment growth. According to the Malawi Trade and Investment Center (MITC), while not discriminatory to foreign investors, investments in Malawi require multiple time consuming bureaucratic processes, which may include obtaining a business license, a tax registration number, and a land use permit. There is no government policy to screen FDI, however, it needs to be registered with the MITC. Malawi's landlocked geography, cumbersome trade facilitation, and the inadequate infrastructure are critical obstacles to foreign direct investment. As such, FDI over the past decade has been very limited, with only a few greenfield projects announced in sectors including communications, financial services, real estate, food and tobacco, metals, and coal, oil, and natural gas.

Pathway III: Harnessing the demographic dividend & building human capital

Malawi has made great progress in human development outcomes in the last two decades. The performance in reproductive health and family planning has already surpassed regional averages. In the field of education, Government demonstrated its commitment to improve primary school education, resulting in continued improvements in primary school enrollments and gender parity, although there is much room for improvements in the quality of education and access to higher education. But, the recent achievements in Malawi—especially rapid reduction in total fertility rates—suggest that the improvements in human development could boost economic growth and poverty reduction through demographic dividends. Reduction of total fertility rates will increase the share of working age population, which will increase the growth of GDP per capita and the pace of poverty reduction. Implications of a demographic dividend could

be huge – according to Schneidman et al. (2018)’s projections, the growth rate of GDP per capita can increase five-fold. However, to harness a potential demographic dividend, Malawi needs to accelerate its investment in human capital further. This would call for improving health status, education, and skill formation of working age populations as well as invest in future generations.

162. Malawi’s population growth rate is high, presenting a major challenge for poverty reduction.

Malawi’s population growth rate is estimated at 2.9 percent in 2016, higher than the regional average of 2.7 percent and the global average of 1.2 percent (World Development Indicators 2018). Both poverty reduction and promoting shared prosperity are measured by household expenditure per capita, which is closely linked to GDP per capita. This means that to achieve the same pace of poverty reduction, a country with a high population growth rate requires a higher rate of GDP growth than a country with low population growth. For example, Malawi’s average GDP growth rate was 3.8 percent per annum between 2010 and 2016, but, due to its average population growth rate of around 3 percent during this period, the average GDP per capita growth rate was just 0.8 percent. If Malawi had the same population growth rate of South Africa—just 1.3 percent—its average GDP per capita growth rate would have tripled to 2.5 percent.

163. In addition, Malawi’s high dependency ratio poses another challenge to poverty reduction.

The dependency ratio measures the number of dependents (aged 0 – 14 and over 65) to the total working age population (aged 15 – 64). In Malawi, the dependency ratio is estimated at 95 in 2015, higher than the sub-Saharan Africa average (86) (Schneidman et al. 2018). The dependency ratio is positively associated with poverty and negatively with household expenditure per capita. In addition, a household with a high dependency ratio faced a higher probability of falling into poverty between 2010 and 2013.

Table 4. 5: Trends of key demographic indicators since 2000

	2000	2005	2010	2015	SSA* (2015)
Infant Mortality rate (per 1000 live births)	104	76	66	42	56
Under-5 mortality rate (per 1,000 live births)	189	133	112	63	83
Maternal mortality ratio (per 100,000 live births)	1123	984	675	439	547
Life expectancy at birth (years)	44	48	57	64	59
Annual population growth rate (percent)	2.8	2.7	3	3.1	2.7
Contraceptive prevalence rate (modern method, %)	26	28	42	58	22
Total fertility rate (per woman)***	6.3	6	5.7	4.4	4.9
Dependency ratio (percent)	99	99	98	95	86
Population growth rate (percent)**	3	2.8	3	2.9	2.8

Source: Schneidman et al. 2018.

*Note: NA refers to "not available". * SSA refers to "sub-Saharan Average". ** Population growth rates are from World Development Indicators 2018. *** Data may not reflect the exact year indicated.*

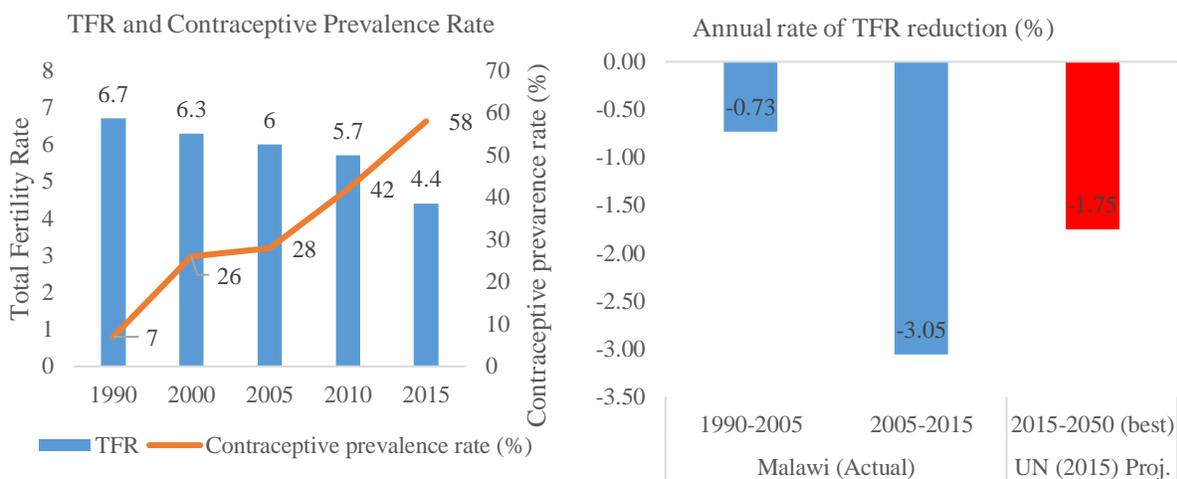
164. Since 2000, Malawi has made remarkable progress in many key demographic indicators, especially in the most recent five-year period (2010 – 2015).

By 2010, Malawi had already made good progress in some key demographic indicators. For example, infant and under-5 mortality rates as well as the maternal mortality ratio declined significantly between 2000 and 2010. Life expectancy and the use of modern contraception also increased significantly during the same period. On the other hand, Malawi’s progress in the dependency ratio and total fertility rate (TFR) was minimal and Malawi still lagged behind regional averages in all of the selected indicators. Since 2010 however, Malawi has made a further leap in progress and now surpasses regional averages for all the indicators listed in Table except for the dependency ratio and the population growth rate.

165. Recent reduction in total fertility rates masks socio-economic and geographic disparities. Fertility levels vary by place of residence, wealth, and education level. Rural women have 1.7 more children than their urban counterparts, reflecting the continuing importance of children for subsistence labor and as old age security, with rural girls also married young to ease the family’s financial burden (Schneidman, et.al. 2018). Fertility rates also vary considerably across education levels. Girls with no education can expect to have more children (5.5) than those with secondary or higher education (2.3). This underscores the importance of ensuring Malawian girls complete secondary school (Schneidman, et.al. 2018).

166. Malawi is still a pre-dividend country but could become an early-dividend country before 2025 if the pace of reduction in TFR between 2005 and 2015 is maintained.³⁷ A pre-dividend country is a country with a high fertility rate and a declining mortality rate. The high fertility rate with declining mortality tends to increase population growth and dependency ratio, both of which constrain growth in GDP per capita. Once a country becomes an early-dividend country where its TFR declines below four and the share of the working age population rises, it will experience the first demographic dividend – rapid economic growth boosted through the increase in the number of income earners relative to dependents. In Malawi, the share of the working age population started to increase from 2010, with the upward trend becoming more pronounced from 2015. According to the UN (2015)’s projection, Malawi is expected to have TFR of 4 slightly after 2030. However, this projection might be conservative. The UN (2015) projects Malawi’s TFR to decline at an annual rate of 1.8 percent between 2015 and 2050, but Malawi’s pace of the reduction in TFR was accelerated from 0.7 percent (1990-2005) to 3.1 percent (2005-2015) as the use of modern contraception increased. If Malawi’s TFR continues to decline at an annual rate of 3.1 percent, Malawi will become an early dividend country before 2025. Also, no country with more than 55 percent of contraceptive prevalence rate had TFR more than 4. This reinforces the view that the UN (2015) projection is conservative and Malawi can become an early dividend country before 2025.

Figure 4. 9: The pace of the reduction in TFR is accelerating and exceeding United Nation (2015) best-case scenario projections.



Source: Schneidman et al. (2018)

167. The impact of a continued rapid reduction in TFR on real GDP per capita growth could be substantial. According to Schneidman et al. (2018)’s simulations, if the TFR projection under the UN (2015) best case scenario is realized, Malawi’s real GDP per capita could grow at an unprecedented pace – an annual average rate of 4.2 percent – between 2015 and 2050. Malawi’s performance currently exceeds

³⁷ TFR estimates are drawn from DHS series.

the UN (2015) best case scenario, which could allow for GDP per capita growth rising faster than these estimates and a faster associated rate of poverty reduction.

Constraints to growth

Challenges in the health sector

168. Incidence of disease and mortality rates in Malawi remain high. Concerns regarding HIV/AIDS and tuberculosis (TB), child stunting and maternal mortality remain as pertinent today as they did a decade ago. In 2016, Malawi had the 10th highest incidence of HIV/AIDS infection in the world³⁸, with a reported 2.29 incidences per 1,000 uninfected population. An estimated 10 percent (1.1 million people) of the population is living with HIV/AIDS. Out of these only 66 percent were receiving lifesaving ART treatment³⁹. Malawi is also among the top 30 countries in the world in terms of burden of TB with 363 reported TB cases per 100,000 population (WHO 2018). Lastly, it is also estimated that at least 37.1 percent of children under the age of five are stunted.

169. Malawi has made significant investments in health and high impact interventions against the major causes of disease and death, however per capita expenditure is low and directed towards higher levels of care. Government health expenditure is the third highest expenditure category after agriculture and education, however, per capita expenditure remains below regional averages (Fig 4.13). Health expenditure is also heavily weighted towards priority areas. In 2014/15 for instance, about 61 percent of the total health budget was spent on three diseases (HIV/AIDS, malaria, and reproductive health) that account for 58 percent of the national burden of disease. Malawi's free health policy has kept out of pocket health expenditure among the lowest in a group of comparators⁴⁰. Even with free healthcare, 27% of total health expenditure comes from the private sector, and from this, 53.4% is total out of pocket spending (Mchenga et al 2017). This is a significant amount and highlights the inadequacy of service provision in public health services.

170. Over reliance on aid and the large share of personal emoluments in the health budget compromise quality of care. The bulk of health sector spending goes towards personal emoluments (64 percent in FY2016/17 and 50 percent in FY2017/18) as opposed to the provision of health services and capital spending (Fig 4.12). In addition, health expenditure is skewed towards provision of higher levels of care—tertiary and secondary levels—rather than the primary health care level where most health problems originate (MoH, 2016). The sector is also highly donor reliant with 63 percent of the sector budget being donor funded. This reduces the government's flexibility in resource allocation and reprioritization of services in the face of changing needs.

171. There are significant limitations in public services coverage, access and quality of services. Critical shortages in human resources (70 percent vacancy rates), medicines and medical supplies, and poor/inadequate infrastructure afflict the health sector. In 2010, there was an estimated 2 doctors for every 100,000 people and 38 nurses and midwives for every 100,000 people⁴¹. This is far below the recommendation by WHO of 230 core health workers per 100,000 people. Inadequate compliance to rules and systems governing the management of public funds (Carlson et al. 2014⁴²) has contributed to several cases of corruption and mismanagement of funds in the health sector (e.g., the 2013 cash gate scandal), and pilferage of medicines.⁴³ The combined impact of inadequate funding for existing health needs, a free health

³⁸ data.unicef.org/regionalclassifications

³⁹ *ibid*

⁴⁰ Angola, DRC, Ghana, Kenya, Lesotho, Malawi, Mozambique, Uganda, Tanzania, Zambia, and Zimbabwe

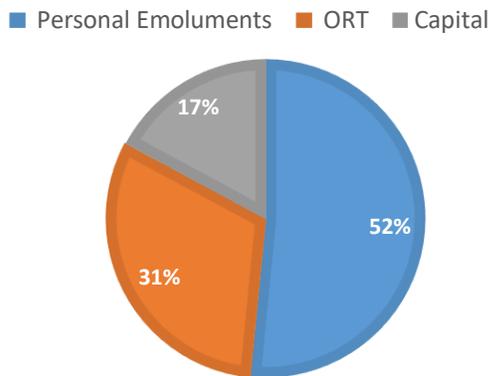
⁴¹ <http://www.afro.who.int/sites/default/files/2017-05/Malawi-ccsbrief-en.pdf>

⁴² Carlson C., Chirwa W.C., Hall N., and Cammack D. (2014). Study of Health Sector Efficiency in Malawi. Lilongwe: MoH

⁴³ Ministry of Health (MoH) (2016). Malawi National Health Accounts Report for Fiscal Years 2012/13, 2013/14 and 2014/15.

care policy and rising population, exerts pressure on supply of services leading to congestion and the inability to deliver on its Essential Health Package. However, given that health already receives a relative high share of the government budget, additional resources for the sector are unlikely to be available except via sustained economic growth and improvements in overall revenue generation; hence improvements in efficiency and equity – including gender equity – of outlays would be necessary.

Figure 4. 10: Personal emoluments represents the majority of the health expenditure budget, 2016/17
Expenditure as percentage of total



Source: World Bank Staff calculations MoFEP&D data

Challenges in water and sanitation

172. Access to water and sanitation has improved but not for all. While there have been some gains in those recording access to improved water sources from 42 percent in 1990 to 87.1 percent in 2015, progress in access to sanitation has lagged far behind (rising from 29 percent in 1990 to just 40 percent in 2015)⁴⁴. At present only 3.1 percent of the population has access to a flush toilet while 85.6 percent are said to rely on pit latrines (IHS4, 2018). It is estimated that Malawi losses about 1.1 percent of its annual GDP due to poor health outcomes attributed to, among other things, low access to safely managed sanitation services⁴⁵.

173. The reliable supply of clean water remains a challenge, even in cities, posing significant health risks. High population growth, dwindling water resources, insufficient infrastructure development and ageing infrastructure have resulted in large supply constraints leading to unreliable water supply. This forces people to use unsafe water sources. Water resources are highly variable between seasons and from year to year. The country's water storage capacity is one of the lowest in the region putting Malawi at risk of becoming water scarce. Lilongwe, the most populace city, in particular, faces a unique water challenge with the Water Board producing 90,000 m³/day against a peak demand of 130,000 m³/day. Globally, Malawi ranks 5 out of 10 countries⁴⁶, with the highest proportion of the population at risk of frequent water shortages⁴⁷. The consequences of which include a high occurrence of water borne diseases, such as cholera, among the population.

⁴⁴ NSO, 2018, IHS4

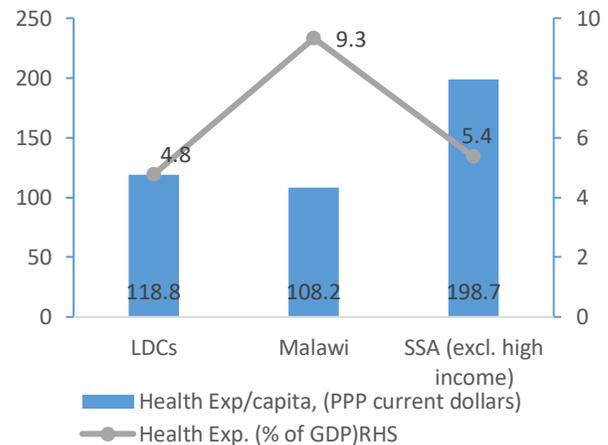
⁴⁵ Water & Sanitation Program (2012). Economic impacts of poor sanitation in Africa. Water & Sanitation Program, World Bank

⁴⁶ In the category of countries with a population of more than one million

⁴⁷ Sadoff C.W., Hall, J.W., Grey, D., Aerts, J.C.J.H., Aitkadi, M., Brown, C., Cox, A., Dadson, S., Garrick, D., Kelman, J., McCorrick, P., Ringler, C., Rosegrant, M., Whittington, D. and Wiberg, D. (2015). Securing Water, Sustaining Growth: Report of the GWP/OECD Task Force on Water Security and Sustainable Growth, University of Oxford, UK, 180pp

Figure 4. 11: Per capita health expenditure is low against selected comparators

Current Expenditure (PPP international \$) and as % of GDP. 2015



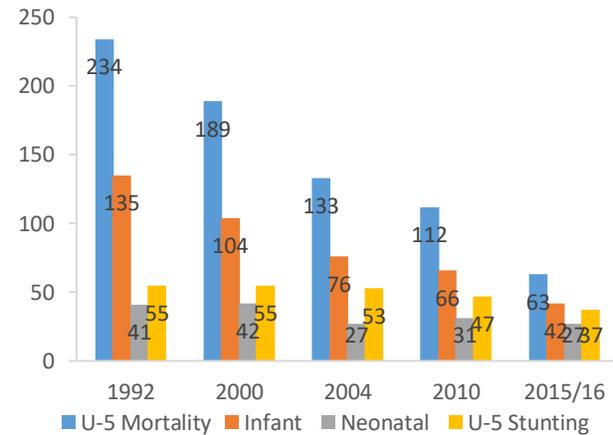
Challenges in Early Childhood Development (ECD)

174. Malawi has disturbing trends in ECD especially among children born to poor, uneducated, underage and/or poor mothers. There has been a decline in under-five stunting, neonatal, infant and under-five mortality rates over the years however the rates remain high especially among vulnerable sub-groups (Fig. 4.12). In addition, despite a fall in the percentage of under-fives who were stunted, from 55 percent to 37 percent between 2000-2015, the absolute number of stunted children has remained roughly the same⁴⁸. Most children who are malnourished are located in rural areas and are from the poorest quintiles (Fig. 4.13). An estimated 48 percent of these children have mothers with no education, while 38 and 30 percent have mothers with primary and secondary school education, respectively (Fig. 4.14) (NSO and ICF 2016)

175. In addition, children born to adolescent mothers have a higher risk of mortality, poor nutrition, and onset of illness than children of older mothers. Adolescent mothers are less likely to take preventive measures to ensure better health of their children⁴⁹. The odds of under-five mortality are approximately 70 percent higher for infants born to adolescent mothers than for infants born to older mothers. Similar elevated odds exist for deaths of children (under 5 years) by mother’s age. Mother’s education level had a strong impact on children’s receptive vocabulary scores. If the mother held primary school education, their children’s scores increased by 1.2 point. This increased to a 3.2 point increase if the mother had secondary education⁵⁰.

Figure 4. 12: Mortality & Under-5 stunting in decline

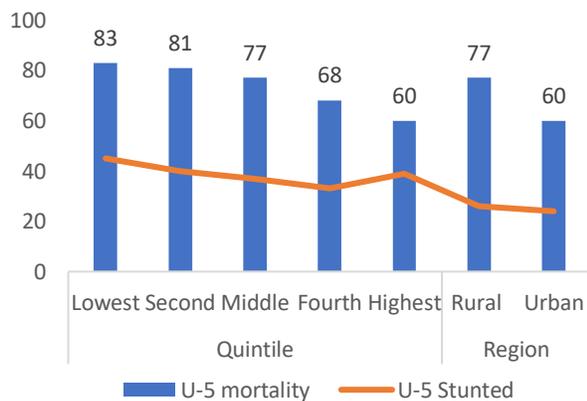
Under-5 Stunting, Neonatal, infant and Under-5 mortality rate



Source: World Bank Staff calculations based on DHS data

Figure 4. 13: Under-five health outcomes worse in rural areas and among the poorest quintiles

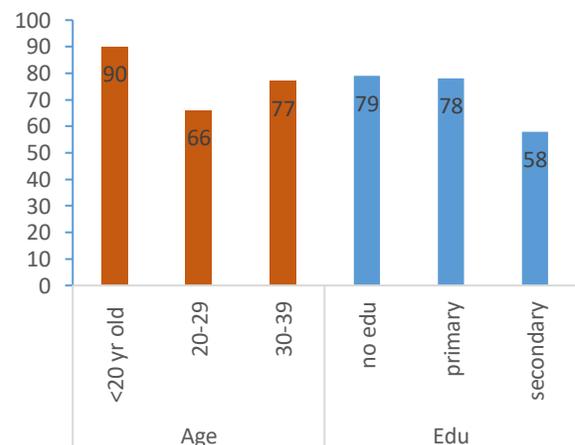
By Income quintile and residency status



Source: World Bank Staff calculations based on DHS data

Figure 4. 14: Mortality by mothers’ characteristics

Under-5 mortality rate



Source: World Bank staff calculations based on DHS data

⁴⁸ Using WDI population figures for 1-4 years olds we estimate 1.4 million children were stunted in 2000 and 1.06 million in 2015/16.

⁴⁹ Bakilana, A, Moucheraud, C, McConnell, C, & Hasan, R. (2016). Early Childhood Development. World Bank, Washington, DC

⁵⁰ ibid

176. Poor services and policy implementation limit impact of Early Childhood Development (ECD) interventions in Malawi. The National Policy on Early Childhood Development (2006) and a range of other instruments guide ECD in Malawi. The country provides free pre-primary education for 3 to 5 year olds at community run childcare centers, as well as a range of essential health services available at public hospitals and health facilities. To this effect, there is a nationwide network of government facilitated community-owned and community-based ECD programs. It is estimated that over 1 million mostly orphans or vulnerable children benefit from these services⁵¹. Nevertheless, ECD initiatives are under-resourced in terms of financing and availability of human resources, particularly for activities at the community level. It is estimated that only 53 percent of community-based child care centers (CBCCs) listed in the government registry were operational during unannounced visits⁵² due to a range of factors including lack of funding and volunteers to run the centers. Malawi can harness easy gains through ECD programs as they are demonstrated to improve cognitive development, school performance and progress in later life⁵³.

Challenges in the education sector

177. Malawi is not able to provide quality education for all, despite the free primary education policy introduced in 1994. The number of primary school pupils has risen (see Fig. 4.17), owing in part to this policy and the significant reduction in the under-five mortality rate (Fig. 4.15). Nevertheless, dropout rates in primary schools are high with only 55 percent of pupils making it to the final grade.⁵⁴ Approximately 25 percent of standard 1 pupils, and 20 percent of students in standard 2, are required to repeat these grades. This contributes to a situation in which only 19 percent of students progress to the final grade (standard 8) without repeating a year.⁵⁵ A significant proportion of enrolled students remain chronically absent and many drop out of the system altogether. As a result, national education outcomes are poor with an adult literacy rate of only 62 percent, lower than both the SSA and LDC averages of 65 and 63 percent, respectively (WDI, 2018).

178. Increasing repetition and dropout rates over the years have compromised efficiency of the education system in Malawi. While the official primary school cycle is only 8 years, producing a primary education graduate in the Malawi system was estimated at 23 years in 2006/7 compared to 20 years in 1999/00. This is in contrast to 6 years for producing a secondary education graduate in 2006/7 compared to the official 4 years of secondary education.⁵⁶ The last Southern and Eastern Africa Consortium for Monitoring Educational Quality (SACMEQ, 2007) survey conducted at Grade 6 level was carried out in 2007 and reported low levels of primary mathematics and reading attainment in Malawi. SACMEQ estimated that less than 50 percent of students acquired at least the SACMEQ basic numeracy competency level by the end of primary school. Lack of more recent data limits the understanding of how this has fared over time but there are some indications that this outcome may have worsened. At present, the average rate of repetition in the first six grades is in excess of 20 percent, significantly higher than the African average of 15 percent. The rate of grade repetition has also increased slightly over the past decade, in spite of government efforts to mandate automatic promotions for selected classes.⁵⁷

⁵¹ https://www.unicef.org/malawi/development_3961.html

⁵² Neuman, M., C. McConnell, and K. Foster. (2014) "From Early Childhood Development Policy to Sustainability: The Fragility of Community-Based Childcare Services in Malawi." *Int. Journal of Early Childhood* 46 (1): 81–99.

⁵³ Walker SP, Wachs TD, Gardner JM, Lozoff B, Wasserman GA, Pollitt E, Carter J, Internat'l Child Development Steering Group.

⁵⁴ World Bank. 2015. Malawi Economic Monitor, October 2015: Adjusting in Turbulent Times. World Bank, Washington, DC

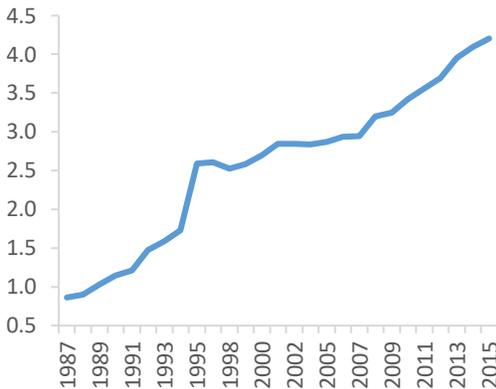
⁵⁵ *ibid*

⁵⁶ The World Bank. 2010. The education system in Malawi. World Bank Working Paper No. 182.

⁵⁷ World Bank. 2015. Malawi Economic Monitor, October 2015: Adjusting in Turbulent Times. World Bank, Washington, DC

Figure 4. 15: Number of primary school pupils has increased since 1994

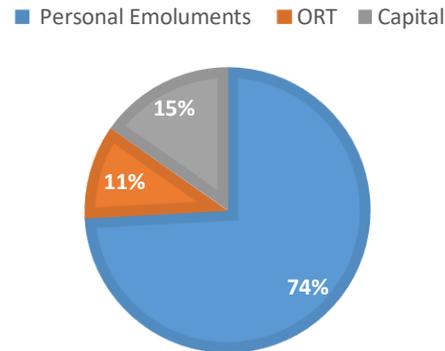
In millions



Source: World Bank (2017d)

Figure 4. 16: PE dominate sector budget leaving little for teaching resources and sector capitalization.

Percentage of total



Source: World Bank (2017d)

179. There is massive wastage at end of primary education, significantly contributing to the low transition to secondary education. Overall, access levels to secondary education are still very low compared to regional counterparts, with few opportunities for the poor. In 2017, existing public and private secondary schools could only absorb 53 percent of the 2016 primary education graduates who qualified to enroll in secondary schools. This is worsened by a very low net enrolment rate of 14 percent in secondary schools. Evidence from a regional study indicates that the excluded are the extremely poor, girls and rural based learners (Bashir, et.al., 2018⁵⁸). There is a strong association between per capita GDP and secondary education gross enrolment for the SADC countries cementing the importance of increasing investments in promoting secondary school education for sustained economic growth⁵⁹.

180. Malawi has a low skill base. The country ranks 130 out of 137 countries in the 2017 Global Entrepreneurship Index (GEI), indicating the country’s need to develop its entrepreneurial and innovation skill base. In 2017, of the population aged 15 and above, about 14 percent had never attended school, 70 percent did not have any qualification at all, while 11 percent had some primary level qualification and only 3 percent had a tertiary qualification (NSO 2017). The gross enrollment rate (GER) for secondary education stands at 15 percent with large variations across income quintiles as of 2011. Moreover, the GER for tertiary education was 0.4 percent, characterized by low gender parity indexes (GPI) of 0.34 in universities and 0.53 in public Technical, and Vocational Education and Training (TVET) institutions.

181. Teaching capacity is a growing concern for Malawi’s education sector. Only 75.6 percent of teachers in primary schools and 57 percent of teachers in secondary school are professionally trained. Due to high enrolment rates in lower grades, there are high primary student-teacher ratios (69:1 in 2015 (PqTR of 81:1) (EMIS)), and high pupil-to-classroom ratios (130:1 in 2014) and an estimated 27,000 classrooms are needed. The student-teacher ratio has been as high as 81:1 in 2009 through a combined increase in student enrolment and pupil retention and a reduction in the number of teachers. Fiscal constraints hamper government efforts to improve learning conditions, in particular the recruitment of new teachers. Of the 10,400 qualified teachers that graduated in 2014, only about 2,800 have been recruited – and only for three months thus constraining progress on the pupil qualified PTR (currently 81:1 in 2015 (PTR 69:1)). Cumulatively a total of 19,400 teachers that have graduated remain to be hired in 2016.

⁵⁸ Bashir, Sajitha; Lockheed, Marlaine; Ninan, Elizabeth; Tan, Jee-Peng. 2018. Facing Forward: Schooling for Learning in Africa. Washington, DC: World Bank

⁵⁹ World Bank, 2017, Investing In Early Years for Growth and Productivity Project. Malawi

Table 4. 6: Allocations to the education sector (2011-2017)

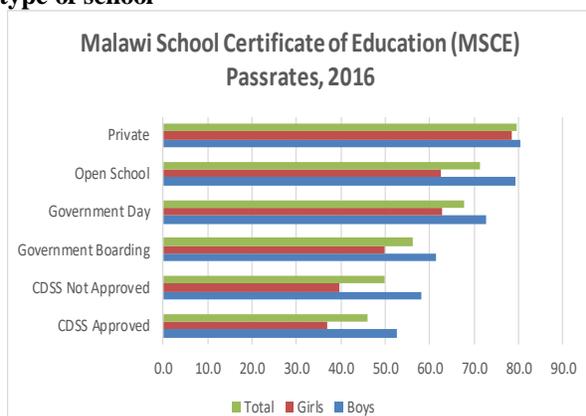
Financial Year	2011	2012	2013	2014	2015	2016	2017
Total Recurrent Education (MK billions)	43,750	49,890	73,430	93,400	112,790	157,869	174,690
Total Voted Recurrent Expenditure (excl. Statutory Expenditures)	182,580	194,790	321,460	386,220	495,750	582,522	666,255
% of Recurrent Expenditure (excl. Statutory expenditures) spent on education	24%	26%	23%	24%	23%	27%	26%

Source: Adapted From GoM, The 2016/17 Education Sector Performance Report, MoSET

182. While the education budget has increased in nominal terms over the years, the sector remains critically resource deficient. Budget allocation to the education sector remains a priority after agriculture. Sixty-one percent of the sector’s allocation goes towards basic education, while secondary and tertiary education represent 15 and 20 percent of the sector budget respectively. However, just like the health budget, the bulk of this allocation is spent on personal emoluments (Fig 4.7)⁶⁰ leaving little fiscal space for the procurement of teaching and learning materials as well as construction of school infrastructure. It is estimated that on average, a single textbook is shared by 4 to 12 students, with the most acute shortages experienced by pupils in grades 5 and 6⁶¹. While the recommended classroom size in Malawi is sixty (60) learners per public primary school, the classes with the least pupils average 77 while classes in Machinga and Lilongwe average 160-165 pupils per classroom⁶². It is also estimated that a third of all standard 3’s and 4’s are taught outdoors⁶³.

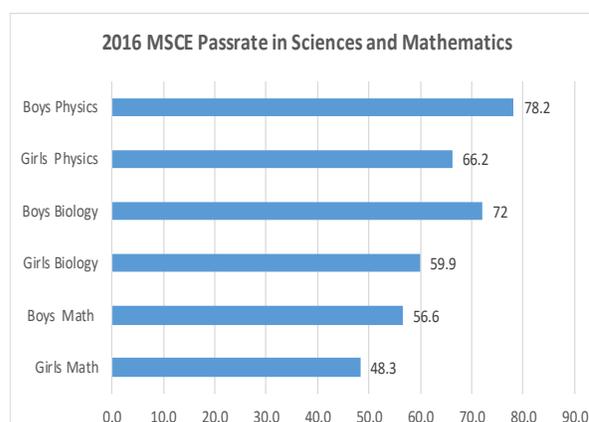
183. Despite increasing Government expenditure on education, equitable access to education remains a challenge. Public expenditure on education averages 6.9 percent of GDP, higher than the sub-Saharan average of 4.3 percent in 2014. There are, however, wide differentials in unit expenditures per student by district, region and type of government school⁶⁴. Learning outcomes are lowest in the Community Day Secondary Schools (CDSSs) which enroll the highest share of secondary education students in Malawi (Figure 4.17). The gender gap in pass rates is also wider in the CDSSs than conventional public schools. Pass rates are low for maths and science subjects especially biology, with lower performance for girls than boys (Figure 4.18). Rural learning outcomes are also significantly weaker.

Figure 4. 17: MSCE pass rates vary significantly by type of school



Source: World Bank (2017d)

Figure 4. 18: MSCE pass rates in sciences and math



Source: World Bank (2017d)

⁶⁰ The increase in PE overtime is however resulting from inflationary adjustments with only 18 percent attributed to recruitment of new teachers (World Bank 2015, *ibid*).

⁶¹ *Ibid*, quoting Education Management Information System (EMIS) data

⁶² GoM, The 2016/17 Education Sector Performance Report, MoSET

⁶³ *ibid*

⁶⁴ World Bank (2017) Investing in Secondary Education – Issues Paper, November, 2017

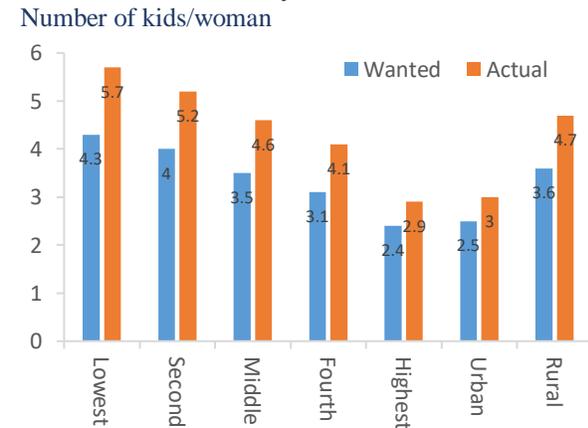
184. Teacher distribution in Malawi is highly uneven between schools and across grades within schools, further limiting equitable access to education. In particular, the ratio is highest in the lowest grades of primary schools and in remote areas where teachers usually abscond due to lack of basic amenities. In addition, poor linkages between teacher performance, remuneration and promotion is frequently cited as a demoralizing factor by the teaching workforce. This manifests in high levels of teacher absenteeism, further compounded by the remoteness of a substantial proportion of schools. Further, weaknesses in governance and accountability have resulted in the limited transmission of expenditure into educational outcomes.

185. Disparities in allocation of female teachers is a stumbling block for promoting female education. In 2015, the female-to-male ratio of the teaching force was 0.93 females for every male teacher. However, the national average masks huge disparities in female teacher allocations across districts and between schools within each district. The female-to-male ratio ranges from 12.7 females to one male in urban areas to as low as 0.24 females to one male in remote areas. Approximately 15 percent of schools in Malawi have no female teachers at all.

Opportunities

186. For average projected real GDP per capita growth rates associated with the demographic dividend to materialize, three conditions will need to be satisfied. First, drivers of this ongoing demographic transition need to be sustained and expanded. Malawi's great progress in TFR reduction can be attributed to its rapid expansion of modern contraception use. Figure 4.9 shows the use of modern contraception has been rising since 1990 but its impact on fertility reduction had been limited until 2010, after which TFR finally started to decline rapidly. It is important to maintain the expansion of the use of modern contraception. In addition, Malawi Poverty Assessment (World Bank 2016b) and Schneidman et al. (2018) show that reducing early marriages and childbearing and expanding access to secondary education for girls have a big impact on TFR reduction. Also, addressing the high unmet need for contraceptives is critical for reducing TFR further. Despite the recent increase in modern contraception uses, Malawi still has high rates of unsatisfied demand (29 percent for the lowest and 23 percent for the highest income quintile⁶⁵) for modern family planning services which is demonstrated by the large difference between wanted and realized fertility (Fig 4.19). It is estimated that if all Malawian women with an unmet need for modern contraception were to receive services, unintended births would drop by 87 percent, maternal mortality by more than two-fifths.

Figure 4. 19: A significant discrepancy remains in wanted vs actual fertility



Source: NSO, (2017) DHS

187. Second, investments in health and education need to increase. As the number of children per household falls, public and household-level spending per child can increase. Since there will be fewer children to demand services, spending on education, healthcare, and Early Childhood Development interventions can be increased with the same resource envelope. Greater investments in the human capital

⁶⁵ NSO and ICF. 2017. Malawi Demographic and Health Survey 2015-16. Zomba, Malawi, and Rockville, Maryland, USA. NSO and ICF.

of children will lead to direct improvements in human development outcomes. The productivity of these children will experience permanent improvements, leading to higher incomes over the life-cycle and larger contributions to aggregate economic growth (Becker 1960; Kalemli-Ozcan, Ryder, and Weil 2000; Schultz 2007). However, this is not an automatic process. As the economy grows, skills and knowledge required by new cohorts will also change. Continued efforts to identify the type of education and skills that are needed and the ability to offer practical and effective education and training will be necessary.

188. Third, an economic environment has to be fostered so that the youth bulge can find well-paying jobs, rather than be forced into low-productivity work. If jobs are not available for the youth bulge, increasing the ratio of working-age population to the number of dependents will not help to increase real GDP per capita nor reduce poverty. In this sense, this pathway to reduce poverty and promote shared prosperity is strongly complementary to the pathways of improving productivity of agricultural production and transforming the non-farm sector. If all three steps are successful and well timed, a substantial economic dividend can result as the large youth cohort moves into highly productive jobs, boosting household and national income while supporting a smaller share of young dependents.

189. The marginal economic benefits of fertility reductions can be increased. The above growth projection is made under the conservative assumption that the skill-share of the labor force remains constant into the future. Skilled and unskilled labor supply grow at the same rate as the working age population, making the skill composition of the labor-force (proportion of skilled/unskilled labor force) constant throughout the simulation period. If Malawi manages to increase the stock of human capital, growth associated with the demographic transition will be even greater as the additional working age population becomes more effective and participates more in production. As recent evidence from South Africa suggests, rapid improvements in educational attainment and employment ratios can help countries take greater advantage of high or growing working-age populations (World Bank 2015b).

Pathway IV: Building resilience against shocks and enhancing environmental sustainability

Extreme weather and other types of climate risks have been rising in Malawi in recent years. High volatility in poverty incidence within a year shows that Malawi's population, especially the poorest 60 percent, are highly vulnerable to shocks and can fall into poverty due to small shocks, even if they have successfully exited poverty before. The latest poverty estimates also show droughts and flood in 2015 and 2016 contributed to stagnating poverty rates since 2010/11, negating relatively good performance in the first half of this period. This rather discouraging news is offset by one positive finding – ultra-poverty has declined in absolute numbers for the first time since 2004/5. More importantly, this success appears associated with the recent expansion of social protection programs, especially the Social Cash Transfer (SCT) program. Malawi is dealing with rising climate risks and other types of shocks while current growth patterns are causing massive depletion of natural capital. Malawi needs to change its growth patterns if sustainable growth is to be achieved.

190. Climate change will contribute to continued variability in temperature and rainfall. Even with high levels of uncertainty associated with climate modelling, all major climate change models suggest that in the coming decades: (i) temperatures will rise, causing higher evaporation and consequent water stress; and (ii) rainfall variability will increase. There is less confidence around exact future patterns of extreme weather, but there is a higher likelihood of dry spells and intense rainfall events (associated with floods).

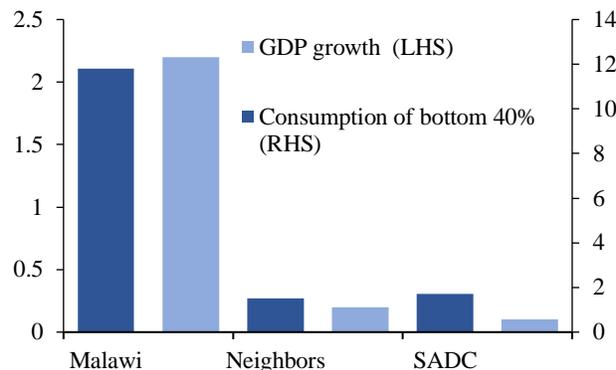
191. In recent years, droughts and floods have become more frequent, widespread, and intense in Malawi. Since 2000, at least four major droughts (2005, 2012, 2015, and 2016) have occurred. In 2005,

due to drought, agricultural GDP contracted nearly 10 percent. Results from a computable general equilibrium assessment indicate that in 2016, drought is estimated to have caused a reduction in GDP growth of around 2.2 percentage points, making Malawi one of the worst impacted among affected countries in the Southern African Development Community (SADC) (World Bank, 2016c). Furthermore, the floods witnessed in 2015 led to an estimated 30 percent reduction in maize production and caused an estimated US\$50 million in damages to road infrastructure (Government of Malawi, 2015).

192. The impact of the 2016 drought on the poorest 40 percent of the population was greatest in Malawi. Results from a computable general equilibrium assessment indicate that the average annual level of consumption of the bottom 40 percent may have declined by 11.8 percent in Malawi, compared to an average decline of 1.7 percent across the SADC in 2016 (see Figure 4.20). As a result of the drought, annual maize production is also projected to have declined year-on-year by 14.7 percent, which follows a decline of 30.2 percent in the previous year. As a consequence of the gap between supply and demand, Malawi recorded a significant rise in the price of maize - 152 percent in nominal terms in the 12-month period prior to March 2016. This huge price increase affected not only the rural poor but also the urban poor.

Figure 4. 20: Malawi’s GDP was reduced significantly by the drought, with the poor hit hardest...

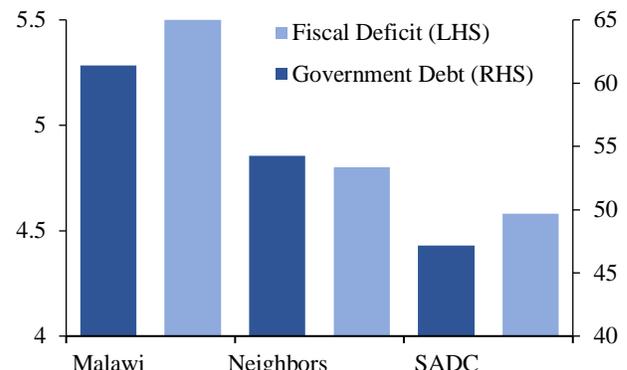
Negative impact on GDP growth and consumption of the bottom 40 percent, annual percentage change in 2016, selected countries



Source: World Bank staff estimates based on LINKAGE model

Figure 4. 21: ...with limited fiscal space for Government to respond

Size of fiscal deficit for most recent year (2015) and stock of public debt, percentage of GDP, selected countries



Source: World Bank staff calculations

Constraints to growth

Impact of Shocks

193. Climate change affects major infrastructure and is projected to slightly reduce the growth rate of GDP. Severe flooding in particular causes considerable damage to infrastructure, including roads, bridges, schools and health facilities. Costs for repair and restoration of infrastructure place an added burden on over-stretched public expenditure budgets. For example, the 2015 floods highlighted the vulnerabilities of the transport sector with serious damage caused to the infrastructure. For the transport sector, the total disaster effects of damages and losses were approximately USD 60 million while the cost of recovery was almost USD 130 million – the highest among all the sectors. Based on a broad analysis using median climate scenarios directly related to temperature and precipitation changes through to 2050 it has been estimated that, without adaptation measures applied to the planning, construction and maintenance of road infrastructure, Malawi is facing a potential total annual average cost of USD 165 million.

194. Beyond its economic impact, climate change is likely to compound existing health risks in Malawi. The country's Second National Communication⁶⁶ assessed the link between weather and incidence

⁶⁶Malawi's Second National Communication, Ministry of Natural Resources, Energy and Environment, 2011

of malaria, cholera, diarrhea, and undernutrition and concluded that climate change is likely to increase exposure to these conditions. Undernutrition is one of the most important health and welfare problems facing Malawi. There is a significant relationship between climate change and undernutrition – with climate change described as a "hunger risk multiplier". Climate change exacerbates existing rates of undernutrition through three causal pathways: (i) impacts on household access to sufficient, safe and adequate food; (ii) impacts on care and feeding practices; and (iii) impacts on environmental health and access to health services. For example, declines or greater variability in crop yields could have significant negative implications for nutrition and stunting, and even when calorie consumption is adequate, micronutrient deficiencies can prevail. The link between climate change and diarrhea, cholera and malaria is high too. There is a strong relationship between temperature and diarrhea, with increases in this food-borne disease caused by higher temperatures. Diarrhea outbreaks are also associated with the aftermath of floods, due to contamination of water supplies. For these reasons, although deaths from diarrhea are projected to decline to about 3,100 by 2050, the proportion of these deaths attributable to climate change will rise to approximately 14.9%. Cholera epidemics have been occasionally reported in Malawi, with the 2001-2002 epidemic associated with over 33,000 infected and over 1,000 deaths. These epidemics occurred more often in dry years when the population is forced to rely on contaminated water, although it can also be exacerbated by floods, when these lead to contamination of water sources. Lastly, Malaria is increasingly being reported in high altitude plateaus and hilly areas that were malaria-free four to five decades ago. This is notably due to changes in rainfall patterns and increase in temperature, although socio-economic determinants also account for spatial variations in malaria risk⁶⁷.

195. Malawi's vulnerability to climate change is exacerbated by the Government's limited fiscal space. This constrains Government's ability to implement effective responses – for example through supporting effective extension services to build smallholder resilience or to invest in climate-resilient infrastructure. In order to finance budget shortfalls, the Government resorts to domestic borrowing, worsening the deteriorating debt situation due to high serving costs and short maturities. Malawi's debt levels are already among the highest in the region, and it is struggling to close a large fiscal deficit.

196. The limited coping mechanisms of rural households makes them highly vulnerable to climate shocks. As discussed in the poverty section, poverty levels fluctuate significantly across the year along with fluctuations in rural incomes. Due to limited assets and a lack of access to finance, many rural households lack the ability to smooth consumption across harvest and lean seasons. Greater variability in agricultural incomes in the face of climate shocks will present even greater challenges for rural households.

197. The poor face further risks beyond climate shocks. Malawi experienced a deep macroeconomic crisis between 2012 and 2014 which saw poverty increase in urban areas where many lost their jobs and experienced significant wage cuts. Furthermore, in the face of recent massive increases in inflation the purchasing power of households declined, resulting in an increase in poverty.

198. Malawi implements a wide range of social protection interventions, which have different needs and target groups but expenditure on safety net programs is low. These include social safety nets, labor market programs, general subsidies and social insurance. In reality, however, social protection planning is dominated by social safety net considerations – under the umbrella of the recently approved Malawi National Social Support Policy (MNSSP II). Current expenditure on safety net programs is low in terms of needs and against regional comparators. Over the past five years, expenditure on basic safety net interventions stood at around 0.6 percent of GDP, compared to an average 1.5% across the region. During this period, coverage under the larger programs saw 1.9 percent of the population covered under the Social Cash Transfer Program (SCTP), 11 percent under the School Meals Program (SMP) and 12 percent under the Malawi Social Action Fund Public Works Program (MASAF PWP). Additionally, coverage from basic

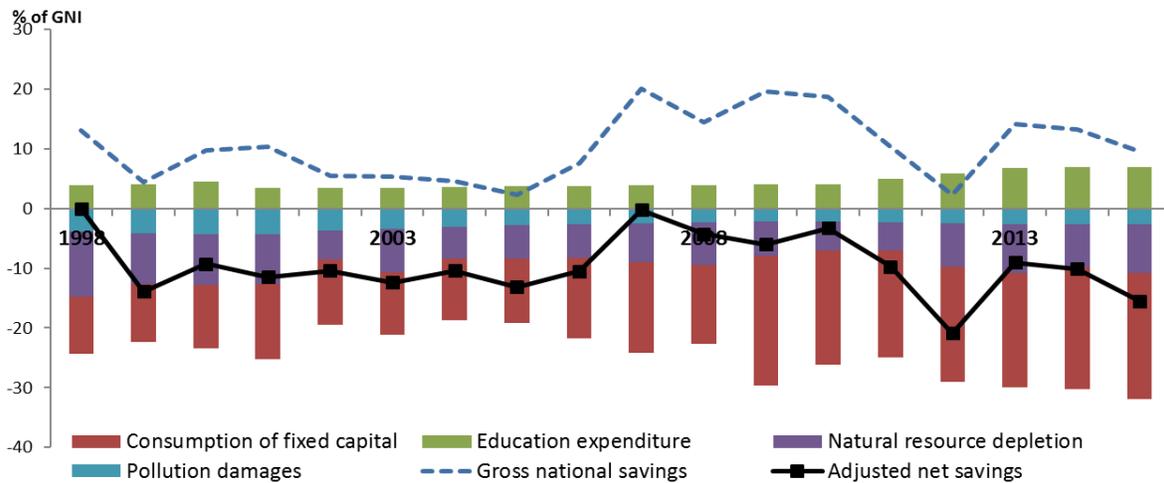
⁶⁷ Malawi's Strategic Program for Climate Resilience, Government of Malawi, 2017

safety net support has been crowded out by more costly provision of subsidies and humanitarian aid, which in 2016 covered 37 percent and 32 percent of the population respectively.

Environmental Degradation

199. Much of the increase in the country’s overall GDP has been achieved through depletion of existing capital, rather than investment in the accumulation of capital to support income generation in the long run. Figure 4.22 illustrates this point. Malawi has managed to maintain positive gross national savings since the end of the 1990s but these gross savings have been insufficient to compensate for the depreciation of physical capital, impacting net national savings. Adjusted net savings (ANS) represents the result of further adjustments of these traditional national accounts series for investment (accumulation) and disinvestment (depletion) in other capital such as human and natural capital. The figure clearly shows that ANS has been consistently negative since the end of the 1990s, indicating that assets in the economy are depleting, rather than accumulating.

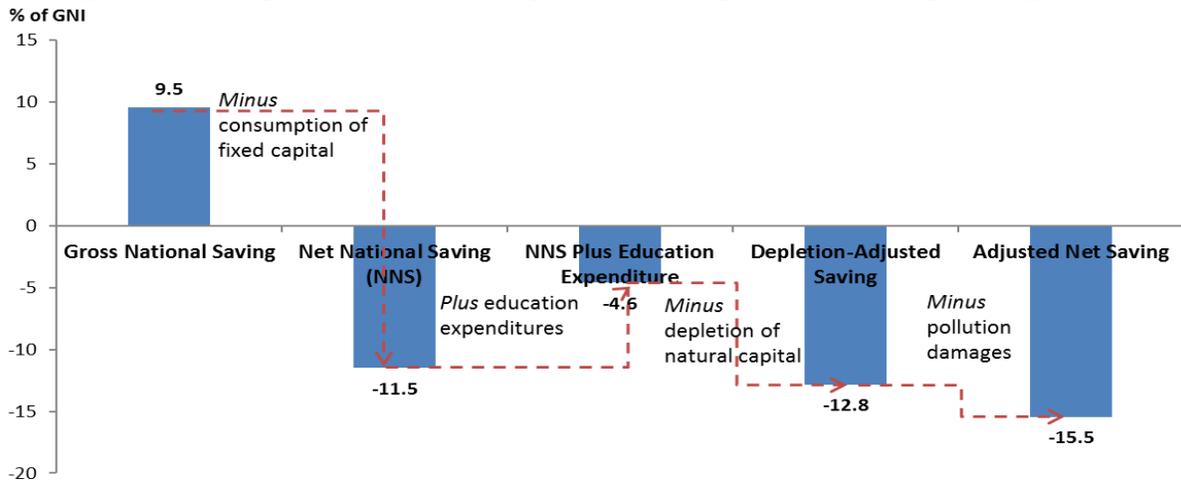
Figure 4. 22: Savings in Malawi, 1998-2015, in percentage of GNI



Source: World Bank staff calculations based on World Development Indicators 2017

200. Depletion of natural capital has been particularly acute. In 2015, Malawi saw a significant depletion of its natural capital, equivalent to 10.8 % of GNI, due to depletion of natural resources and pollution damages. In this year, Malawi's gross national savings (GNS) reached 9.5% of gross national income (GNI), while net national savings (NNS) as a percentage of GNI was minus 11.5%, with the consumption of fixed (physical) capital (21% of GNI) accounting for the difference. Under the conventional national account representation, therefore, the figure suggests that because of Malawi’s heavy consumption of fixed capital, it was unable to save income in 2015 to invest in capital formation for future consumption. The other three columns in Figure 4.23 represent the adjustment in savings figures due to changes in the quantity and quality of intangible assets (sum of human capital, natural capital and pollution). Under this representation, we can see that Malawi managed to invest, in net terms, 6.9% of GNI in the form of education expenditures to build its human capital. On the other hand, however, Malawi lost a significant amount of natural capital due to depletion of natural resources - equivalent to 8.2% of GNI - and pollution damages (2.6% of GNI). Overall, Malawi depleted its capital by the equivalent of 15.5% of its GNI in 2015, which acts to undermine long-term sustainability, wealth, and future well-being.

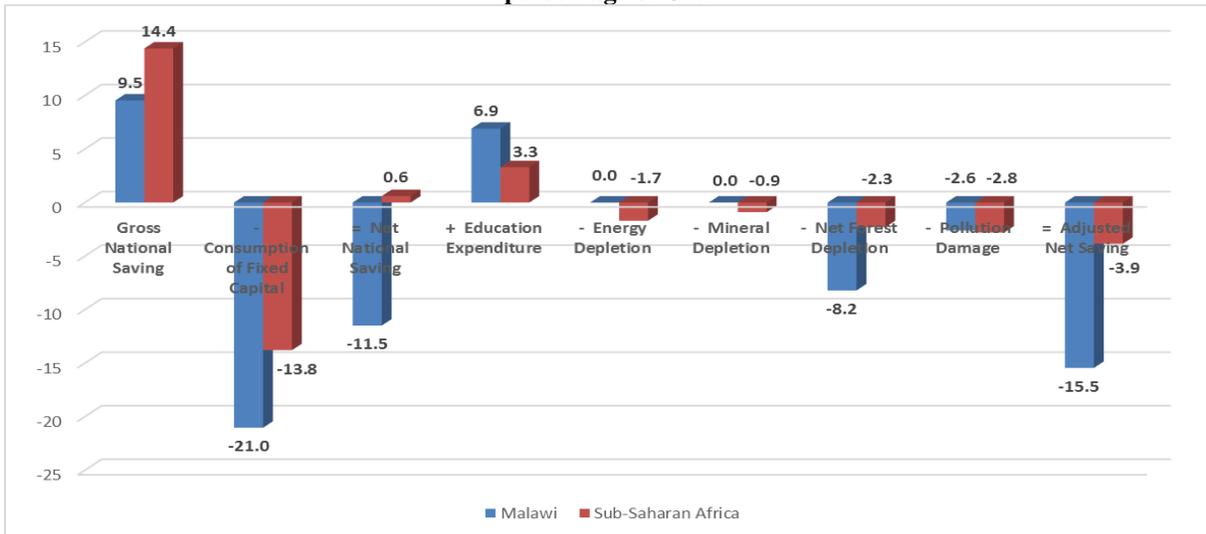
Figure 4. 23: Composition of Malawi's Adjusted Net Savings (ANS), 2015, in percentage of GNI



Source: World Development Indicators, World Bank, 2017

201. Malawi's savings levels, especially once depletion of its forests is taken into account, are far below the sub-Saharan Africa (SSA) region average. In 2015, the country's heavy depreciation of fixed capital (21% of GNI) led to a negative net national saving (NNS) (-11.5% of GNI), which is particularly high when compared against the sub-Saharan African average NNS of 0.6% of GNI. Though Malawi invested more in education compared to the SSA regional average (6.9% against 3.3% of GNI), the degradation of its natural resources - mainly driven by forest depletion, which was equivalent to 8.2% of GNI, against 2.3% of GNI for SSA - fueled consumption and brought about a negative adjusted net saving level of -15.5% of GNI, representing an 11.6-point gap with the SSA region average ANS (-3.9% of GNI). Hence, Malawi ran down its capital stocks more than the SSA region average (Figure 4.24).

Figure 4. 24: Comparison between Malawi's and Sub-Saharan Africa's Adjusted Net Savings (ANS), 2015, percentage of GNI



Source: World Development Indicators, World Bank, 2017

Land Management Practices

202. Land management practices such as forest clearance and annual burning accelerate soil erosion. The associated erosion and flooding from these activities have a severe impact on the landscape and the livelihoods of local communities.⁶⁸ The majority of smallholder farmers in Malawi practice traditional methods of cultivation. Soil and water conservation technologies are not practiced, and the adoption rate for land husbandry technology is low. It is estimated that only about 12% of cultivated land has ridges on contour. Soil erosion is reportedly affecting about 61% of the entire land area in the country. Various economic analyses exist that estimate the costs of declining soil fertility. A 2014 assessment⁶⁹ shows that ‘land degradation hotspots’ cover about 41% of land area in Malawi (Le et al. 2014). An analysis, using a total economic valuation (TEV) approach estimated that the annual costs of land degradation between 2001-2009 amounted to \$244 million. This study also estimated that each dollar spent addressing land degradation would bring about \$4.3 in return over a 30-year period.

203. Progressive and acute degradation of forests also exacerbates exposure to weather-related disasters and climate change. Between 1990 and 2010, national forest cover declined from 41% to 34% (FAO 2010). Land clearance for agricultural expansion is the leading cause of deforestation (FAO 2013), although other causes such as woodfuel harvesting in urban peripheries (e.g. around Blantyre, Lilongwe and Zomba) has led to severe woodland degradation in these areas too (Kambewa, Zulu 2010, Openshaw 2010). Over 80% of national energy consumption uses forest biomass (fuelwood and charcoal). The denudation of forests and woodlands to supply this biomass energy is having broader impacts including: erosion, reduced watershed protection often on steep slopes and biodiversity loss. There are already growing deficits between biomass supply and demand, in particular in the urban woodsheds of Lilongwe and Blantyre. This environmental degradation combined with climate change-induced stresses will increase the vulnerability of environmental systems, with knock-on adverse impacts on livelihoods and health. It has been estimated that under wetter climate conditions, an additional 16.9 million tons of soil could be eroded from forest areas, resulting in a net incremental cost of between US \$24 - 27 million by 2030 (NPV at 10% discount). Under a dry future scenario, soil water stress could increase as much as ten-fold by 2030⁷⁰.

Malawi’s 2011 Greenhouse Gas (GHG) profile

204. Malawi’s 2011 GHG profile is dominated by emissions from the land-use change and forestry (LUCF) sector, which accounted for 56% of the country’s total emissions in 2016⁷¹. Most notably, within the LUCF sector, emissions from forest land contributed 70% of the sector’s emissions.⁷² Agriculture represents the second most significant emitting sector (40%), with enteric fermentation and manure left on pasture contributing to 50% of agricultural emissions. Waste and industrial processes each contributed 2% to total emissions⁷³. As an indication of Malawi’s scope to improve emissions, although GDP has been growing faster than GHG, as of 2011, Malawi’s economy emitted approximately 3 times more GHGs relative to GDP than the world average.

205. Between 2015 and 2040, total annual GHG emissions are projected to increase from approximately 29,000 to 42,000 Gg CO₂ equivalents, a 38% rise. Although projections for emissions beyond the year 2020 are subject to a high degree of uncertainty, estimates suggest that between 14,000

⁶⁸ Perceptions of land-degradation, forest restoration and fire management: A case study from Malawi (Davies, Pollard and Mwenda, 2010).

⁶⁹ Kirui, 2016.

⁷⁰ Malawi’s Strategic Program for Climate Resilience, Government of Malawi, 2017

⁷¹ Food and Agriculture Organization of the United Nations Statistics Division (FAOSTAT), Emissions – Land use total, viewed on November 22, 2016.

⁷² Greenhouse Gas Emissions in Malawi, USAID, 2016

⁷³ World Resources Institute Climate Analysis Indicators Tool (WRI CAIT), WRI, 2016

and 16,000 Gg of CO₂ equivalent could be saved per year by 2030, if the country follows a robust low emission development path. Across this 25-year period, the largest sectoral increase is expected to occur in the energy sector, as coal-based generation by independent power producers (IPPs) becomes available and begins to meet existing energy deficits. Currently, however, due to unsustainable use of fuelwood and charcoal (97% of Malawians rely on biomass energy for cooking fuel), and poor agricultural practices resulting in a high rate of deforestation and forest degradation, Malawi is a net GHG emitter⁷⁴.

Opportunities

206. The social protection sector requires critical shifts in policy and institutional and investment commitments. These include:

- **Commitment to a national financing strategy that supports an adequate and sustainable social protection system.** At the outset, there is a critical need for the Government to establish (and meet) domestic spending targets for basic safety net interventions, which are currently almost exclusively donor financed. A starting point to this discussion is to consider re-channeling fiscal spending toward a more progressive and effective mix of social protection programs.
- **The core safety net provision must be strengthened to meet basic needs and structured to promote better long term outcomes.** There has been a significant shift towards provision of support through cash transfers, with the SCTP being scaled up to reach national level coverage by 2018. At the same time, it appears that the MASAF PWP will be scaled down. Opportunities exist to reform the MASAF PWP program to improve asset creation and skill linkages and to refine geographic coverage.
- **Efforts to scale-up safety nets which promote resilience and respond to shocks must be realized.** Given Malawi's vulnerability to shocks and the growing humanitarian presence, a better functioning safety net of last resort is required for the transitory poor. Currently, social safety nets and humanitarian aid operate distinctly from each other, despite overlapping functions. Given the predictability of unfolding crisis events, there is an opportunity to shift some of the caseload of households who repeatedly require seasonal assistance in a manner that improves the predictability and adequacy of support to these households.
- **Finally, a more systematic focus is required to improve the way in which all safety nets enhance productive potential.** This builds on available evidence which shows how current investments in Malawi are helping to improve business generation, employment and earnings.

207. Ongoing reviews of the MASAF PWP, which has the greatest coverage, suggest programs now need to be consolidated to confirm a future pathway for the program. Recent technical assessments have shown some progress towards improving the value of assets created under the program, the timing of the program across the seasonal cycle and potential linkages to other sectoral investments. At the same time, there are underlying implementation challenges which cast doubt on the viability of what has been Malawi's longest running safety net intervention. For example, McCarthy et al. (2017) show mixed results regarding the effectiveness of MASAF PWP as a response to the 2015 floods. In particular, access to MASAF PWP in 2015 was lower than in 2013, however participating in MASAF PWP did have positive impacts on food expenditures and calories per capita.

208. Malawi's Social Cash Transfer Program (SCTP) has had the strongest and most consistent positive impacts on consumption, livelihoods, earnings and human capital development of any such program implemented across Africa. Malawi's SCTP has had the most significant impact on consumption against a set of comparable sub-Saharan African cash transfer programs (see Box A3-1 and Ralston et al. 2017). Furthermore, SCTP has a potentially large impact on Pathway 3 –a range of positive

⁷⁴ Intended Nationally Determined Contribution, Government of Malawi, 2015

effects on employment, health and education outcomes have also been demonstrated. For example, the program led to an increase in household micro-entrepreneurial activity, including increased investments in productive agricultural assets; increased time spent on farm activities for adults and children; and a lower likelihood of engaging in ganyu (casual labor). Outside the home (de Hoop et al., 2017; Zezza et al., 2010; Covarrubias et al., 2012; and Boone et al., 2013) also find an improvement in school enrollment, attendance and education-related expenditure for children. Studies have also found that expenditures on temptation goods such as alcohol and tobacco did not increase in beneficiary households, despite this being a common criticism of cash transfer programs (Evans and Popova, 2014; Handa et al., 2017). The evidence therefore suggests that these social safety nets can have far reaching benefits beyond protective support.

209. The implementation of the Unified Beneficiary Registry (UBR) is a key innovation in core delivery system. The UBR is a social registry that contains information on the key socio-economic characteristics of all households. The UBR is envisioned as a universal platform for the consolidated intake, enrollment and registration of eligible beneficiaries for all social support programs. It has been applied in 11 districts in Malawi (to register the poorest 50 percent of households in 10 districts and 100 percent in one district), and is intended to be expanded into a further 14 districts. The current application should not only improve efficiency of both financial and time costs when selecting beneficiaries for each program, but also to potentially facilitate coordination between programs and to realize interlinkages. A rapid assessment of the UBR system, while pointing to areas for further improvement, highlights encouraging insights into strong institutional capacity and oversight, a well performing IT platform and good data quality in terms of low error rates as well as representation of the poorest (World Bank, forthcoming).

210. Furthermore, important steps have been taken towards strengthening the institutional environment for disaster risk management (DRM). The National Disaster Risk Management (NDRM) Policy (2015), The National Resilience Strategy (2018-2030) and the Malawi Growth Development Strategy (2017-2022) presents the aspiration of the Government of Malawi in ensuring that disaster losses and impacts are sustainably reduced, breaking the cycle of food insecurity and building the resilience of the country to disaster risks. However, implementation is hampered by a number of challenges around policy implementation, strategy and budgetary processes; insufficient institutional capacity and planning processes; slow integration of DRM-CCA into development planning at all levels and key sectors of the economy; insufficient coverage and depth of DRM actions at community level; outdated risk assessments and early warning systems; limited investment in knowledge and education; and inadequate financing.

211. Efforts to address land degradation through the introduction of SLM practices offers opportunities for inclusive poverty reduction. Modelling and analysis supported by the World Bank⁷⁵ indicated that SLM investments in Malawi could generate a 32 percent internal rate of return (IRR) with agroforestry, woodlots, on-farm soil conservation and natural forest rehabilitation offering substantial opportunities. Furthermore, the benefits of SLM are highly inclusive with benefits accruing mainly to smallholder farmers - followed by electricity consumers who gain from the reduced power outages associated with improved watershed protection and erosion control.

212. Malawi's conservation areas – including national parks, forest and wildlife reserves – play an important role in watershed protection, limiting greenhouse gas (GHG) emissions and conserving biodiversity. They also support Malawi's small but growing eco-tourism subsector. Malawi has recently entered into successful management concessions for a number of protected areas and these have delivered dramatic improvements for biodiversity conservation and the generation of tourism revenues. On the other hand, due to poor management, forest reserves have been depleted due to over-harvesting – mostly for firewood and charcoal production. These areas could still however become productive assets with investment and new management models, the latter now made possible by changes to national policies on

⁷⁵ LTS et al, *Integrated Assessment of land Use Options in Malawi–Investment Plan Financial & Economic Analysis*. June 2013. World Bank

charcoal usage. Ensuring the sustainable management of forest reserves, national parks and other conservation areas offers a cost-effective means of protecting environmental services and additionally, promotes the creation of jobs and revenues at the local level.

213. Lastly, Malawi's International Climate Change Commitments include its Nationally Determined Contribution (NDC) submission to the UNFCCC that reflects its ambition to reduce greenhouse gas emissions. This submission will see a commitment to reduce GHG - which represent 0.04% of total global emissions in 2015⁷⁶ - and improve adaptation and resilience while taking into account domestic circumstances and capabilities.⁷⁷ In addition, Malawi's Strategic Program for Climate Resilience (2017) sets out its future priorities for transformative investments to build resilience, including proposed investments in landscape and watershed management and climate resilient infrastructure.

⁷⁶ Ibid.

⁷⁷ Intended Nationally Determined Contribution, Government of Malawi, 2015

5. PRIORITIZATION OF POLICY INTERVENTIONS

214. The objective of this SCD is to identify and prioritize policy interventions so that Malawi can materialize its opportunities and transform into a more dynamic economy, with rapid poverty reduction and shared prosperity in a sustainable manner. This SCD has identified four pathways through which Malawi can enable this transformation. **First, increasing agricultural productivity is critical to raise incomes and improve livelihoods for the majority of Malawi's population that resides in rural areas.** However, one of the highest population densities in Africa has led to shrinking farm sizes, which, combined with a focus on subsistence maize production and limited crop diversification and rotation have led to deteriorating soil quality. A reliance on rain-fed agriculture increases susceptibility to weather shocks. Limited commercialization and market access perpetuates a cycle of subsistence farming. Significant public expenditure has been inefficiently targeted, while interventions have often distorted markets and contributed to the persistence of low productivity in the sector.

215. Second, diversifying the economy outside of agriculture and increasing job creation is necessary to increase incomes and productivity. However, a challenging business environment and cumbersome trade procedures often benefits larger, established firms and constrains access to regional and global markets. Limited and erratic access to electricity and water, as well as weak connectivity infrastructure, particularly to rural areas, increases the cost of doing business. Limited access to finance, with some of the highest interest rates in the region, has further constrained business expansion. Moreover, although urbanization has stirred economic growth and poverty reduction in neighboring countries, the pace of urbanization in Malawi has been very slow. Limited access to ICT constrains business opportunities and the growth potential of the country.

216. Third, maintaining the current momentum of demographic transition and investing in human capital through health and education are important to benefit from a demographic dividend. Implications of a demographic dividend could be significant. However, to materialize a demographic dividend, Malawi needs to accelerate its investment in human capital and for this, the quality of education, health, water and sanitation services needs to be improved.

217. Finally, Malawi needs to build resilience against shocks to protect the poorest population and increase environmental sustainability. Malawi is highly susceptible to environment and climate shocks, but has historically reacted to shocks instead of preparing for them in advance. The country has limited risk mitigation systems to reduce the impact of future shocks. For this, social safety net programs can provide households resilience against shocks, but increasing the allocation of public resources to safety nets and reforming the mix of programs is necessary to increase effectiveness. More broadly, Disaster Risk Management (DRM) provides a comprehensive approach for reducing disaster losses and impacts. In addition to improving coping mechanisms, risk mitigation efforts are critical for reducing the impact of economic downturns and natural disasters.

218. Growth and poverty reduction through these four pathways will rely on Malawi addressing foundational issues. Malawi has suffered from repeated episodes of macro-economic instability, which to a large extent have been due to weak governance. Limited political commitment capacity has led to fiscal slippages and policy implementation gaps, which in turn have led to exchange rate instability, high inflation, and general economic instability. Additionally, gender inequality impacts activities across sectors. This is constrained by unequal education opportunities, limited access to endowments, and continuing discrimination in customary practices.

219. Malawi faces multiple constraints in progressing on these pathways, which are summarized in Annex 4. Although constraints are identified by pathway, they can cut across multiple pathways, as in the example of transportation affecting agricultural productivity and economic diversification. The constraints

have been identified through the analysis in the previous chapters and additional analytical work, as well as through consultations.

220. Key interventions to address these constraints to progress on the pathways have been identified based on various criteria, developed according to the Bank's guidelines to produce an SCD:

- **Key amongst these are maximizing their impact on the World Bank's twin goals of reducing poverty and boosting shared prosperity.** Higher scores are given for reforms or interventions that would likely have a larger positive impact on both goals. Identified priorities all have a strong impact on achieving these goals.
- **Interventions are also balanced across the time horizon of impacts.** The prioritization effort seeks to balance short- and long-term objectives. Changing the development narrative in Malawi is a long-term process that will require both improved governance and economic reforms. The prioritization exercise has therefore focused on interventions that could alleviate bottlenecks in the five-year time horizon of the SCD but also those that can promote and foster long-term development goals.
- **The complementarity with which a constraint can help address other constraints is a key criteria.** While priorities are identified by pathway, they can often be key to advancing progress on one or more pathways. For example, improving access to finance is not only critical for diversifying the economy, but also for improving agricultural productivity by allowing farmers to borrow to access inputs, as well as for consumption smoothing.
- **Available evidence played a role in selecting priorities.** The availability of concrete evidence supported the selection of interventions, although not ignoring others that could potentially have a large impact but for which the knowledge base is incomplete. Identifying critical knowledge gaps will be important in this respect
- **Feasibility is also considered in identifying interventions.** This considers the extent to which priorities are feasible from a viewpoint of capacity of the Government and the country. Political economy and governance constraints are considered but tackled proactively using the framework proposed in the WDR 2017. Priorities thus take into account means of mitigating governance constraints by focusing on micro-foundations of functional effectiveness as well as broader levers of change in terms of contestability; elite incentives; and the ideas, preferences and beliefs of participants in the policy arena.

221. The application of these criteria as well as consultations have identified the ten key priority areas (see Table 5.1). An extensive consultation process with stakeholders and the World Bank Group country team has been carried out through various stages of the SCD process to support the identification and prioritization of constraints and priorities (see Annex 5). Specific priority areas, and their rating as per the criteria, are indicated below. Time horizon indicators are: I – Immediate, M – Midterm, and L - Long term. Other indicators are: H – High, M – Middle, L – Low, as indicated below.

Table 5.1: Summary of Priority Policy Interventions by Pathways and Foundational Issues

Pathway	Specific Priority Policy Interventions	Selection criteria				
		Twin goals	Time horizon	Complementarity	Evidence	Feasibility
Increasing agricultural productivity (Pathway I)	Target public resources and interventions to promote commercialization and productive diversification in the agriculture sector	H	I/M	H	H	M
Diversifying the economy & creating jobs (Pathway II)	Create a business enabling environment to support structural transformation, increased productivity, and regional integration	H	M	M	H	M
	Increase access to finance	H	M	M	H	M
	Address infrastructure deficits to support private sector development and service delivery	H	I/M/L	H	H	M
Harnessing the demographic dividend & building human capital (Pathway III)	Maintain the current momentum in demographic transition	H	M	H	H	M
	Improve learning outcomes at primary and secondary levels and develop productive skills of youth	H	M/L	H	H	M
	Improve the coverage, access and quality of health services	H	M	L	H	L
	Mainstream Early Childhood Development (ECD)	H	M/L	L	M	H
Building resilience against shocks & enhancing environmental sustainability (Pathway IV)	Strengthen social protection programs	H	I	H	H	H
	Adopt risk mitigation initiatives	H	I/M/L	M	H	M
Foundational Issues						
Weak governance underlies macroeconomic instability and poor policy implementation (Foundational Issue 1)	Establish commitment mechanisms to build and sustain the basics of sound economic and public financial management Mitigate governance constraints to policy effectiveness in priority areas					
Gender inequality (Foundational Issue 2)	Address key constraints to gender equality					

222. The selection of these priorities should not diminish the significance of other priorities undertaken by Government. Indeed, the identified priorities are aligned with the World Bank's twin goals, while the Government may have different criteria for selecting interventions.

Priority Policy Interventions for the Foundational Issues

Weak governance underlies macroeconomic instability and poor policy implementation (Foundational Issue 1)

1. Establish commitment mechanisms to build and sustain the basics of sound economic and public financial management

223. Strengthening and enforcing the foundations of sound and accountable public financial and economic management is essential to restore credibility and confidence, and to create an enabling environment for more effective development performance. The cashgate episode revealed that, despite

decades of investment and the appearance of a ‘good practice’ financial management and accountability framework, basic reporting and control systems did not actually function. As a condition of further budget support, the GoM has since made progress on some basic elements, including: relative exchange rate stability; single digit inflation; clearing the backlog in its financial reporting obligations, thus ensuring that the audits were up to date for the first time in a decade; establishing centralized monitoring and control of expenditures and commitments through controlling officers supervised by Secretary of the Treasury; closing loopholes in the IFMIS; and auditing payroll. The GoM now needs to consolidate these gains, deepen the functioning and quality of control systems, and develop commitment mechanisms to avoid relapse.

- **Strengthening fiscal management, in terms of both budget planning and execution, is a key step toward stability.** Malawi has sufficiently well-designed institutions for budget planning and execution. Yet all instances of economic crisis in the past have been occasions for revisiting budgetary and financial management institutions and have received strong support from development partners. However, despite almost two decades of institutional reform, it is hard to argue, for example, that expenditure slippages will not happen again or that institutions will prevent budget overruns or the RBM financing the deficit. Unless there is a strong political commitment to realistic budgeting and staying within the budget, reforms in technical design would only be “feel-good” solutions without any real impact.
- **Careful prioritization and control of expenditures is needed to create fiscal buffers to respond to future shocks without endangering macroeconomic stability.** While Malawi has large financing needs across a range of sectors, it must operate within a limited resource envelope, both in terms of domestic and foreign/development finances. Resources should therefore be invested in areas where they can achieve the greatest impact. Expenditures need to be prioritized carefully, particularly if the government is to live within its means and avoid excessive recourse to domestic borrowing. This will require difficult policy discussions around expenditure priorities but is the only way to move toward an economy in which inflation and interest rates can return to single digits, which is the most effective way to improve access to finance. Having more flexibility in the expenditure structure would also help create more fiscal space as well as more space for the private sector to grow. Ultimately, Malawi may need to reduce expenditure on a more permanent basis. Steady-state expenditure needs to be firmly linked to domestic resources rather than the size of aid. Moreover, over-expenditure on recurrent budget has been the single largest contributor to fiscal slippages to some extent off-set by cuts to the development budget. The government’s limited capacity to invest comes at a high price and limits the return on investment for the private sector.
- **Increased use of fiscal and borrowing rules, if developed and owned locally, could help establish norms around prudent limits on public expenditure.** The adoption of a set of fiscal rules could help establish a domestic consensus around an appropriate and more shock-resistant fiscal framework. This might include, for example, a cap on recurrent expenditure being linked to the amount of domestically generated resources, minimum contingency allowances in the annual budget, deficit targets over the economic cycle. However, to have an impact, such fiscal rules would need to have broad ownership across government and political parties, based on a common understanding of the costs of fiscal indiscipline to Malawi’s development. Similarly, a set of borrowing rules or a debt anchor could help establish norms, perhaps by limiting domestic borrowing to short-term consumption smoothing only.
- **Assuring central bank independence could improve macro-economic stability.** Currently, the RBM has no option but to accommodate pressures from fiscal authorities for monetizing fiscal deficits. If the Bank pursues policies to maintain low inflation and is provided the institutional independence to pursue it, it may be possible for it to resist such pressures better.

- **Consolidating and deepening gains in public financial management could be achieved by entrenching rule-based, transparent and predictable systems.** Critical basics include ensuring that funds voted by parliament are accounted for at the end of the year, audited and followed up; holding controlling officers responsible for the collection of departmental revenues, expenditure and reporting of voted funds; ensuring that plans and budgets are fiscally realistic basis, and authorized staffing levels brought into alignment with what can be afforded through the wage bill; increasing transparency and independence of public procurement. In light of increased resources flowing through decentralized systems, it is also necessary to strengthen financial accountability in local councils.
- **Investment in capacity needs to be accompanied by a focus on entrenching incentives to achieve behavior change.** Thus, training and resourcing of key accountability institutions, such as the auditor-general, parliament, accountant-general, controlling officers etc., needs to be complemented by credible sanctions for non-compliance. GoM and donors could strengthen the role of aid as an incentive through strong dialogue and a clear, sequenced plan for results-based support. As a means of binding its own hands, government could strengthen the enabling environment for public accountability by increasing transparency, publicity and pathways for broader public interests to engage on monitoring and oversight, including by reinvigorating the Open Governance initiative and implementing the Access to Information Act.

2. Mitigate governance constraints to policy effectiveness in priority areas

224. Serious progress on overcoming binding constraints to the pathways will require mitigating the effects of Malawi's political economy trap. Over the longer term, a more productive and diversified economy and stronger base of human capital should create a positive feedback loop, aligning political incentives with developmental ends (WDR 2017). In the medium term, incremental progress will require targeted measures that focus on drivers of behavior so as to solve specific coordination challenges, for example, to steer the behavior of farmers and the private sector toward more productive and efficient practices, or to induce cooperation of teachers against absenteeism, rather than on comprehensive best practice reforms. These measures are identified in the specific priorities below. In order to counter the pressures of political expedience, investment is needed to increase the interests represented in the policy arena by strengthening the collective action capacity of, for example, farmers groups, private sector associations more representative of small and micro enterprises, and civil society networks.

Gender inequality (Foundational Issue II)

1. Address key constraints to gender equality

225. Improving girls' participation in secondary education and employment opportunities can have a huge impact on both productivities of women's economic activities and acceleration of demographic dividend. Several approaches can be considered. Impact evaluation evidence from Malawi suggests that conditional cash transfers (CCT) can have significant impacts on girls' school attendance, early marriage/childbearing, and exposure to HIV (Baird et al 2010; 2011; 2012) For girls who are unlikely to return to school and for those trying to make the school-to-work transition, evidence suggests that interventions that target multiple constraints simultaneously with vocational training focused on self-employment, life skills, and linking young women to credit can have significant impacts. Interventions to support women's access to farm labor should focus on female-headed households, whose lower access to labor is driven by lower household size.

226. Improving women's access to endowments is equally important. Differences in women's performance mainly come from their limited endowments, which include asset ownership, access to subsidies and services, and access to infrastructure. To address this, it is important to include female headed

households as part of selection criteria for provisions of subsidies and other social protection programs. Indeed, this is already the case for SCTP, which include female headed households as part of selection criteria. Given that multiple evaluation studies prove SCTP has large impact on investment in agricultural equipment and other asset accumulation, this will likely help improve women's endowments. Also, FISP tends to provide more fertilizers to male headed households. Correcting this bias likely improve agricultural productivity of female headed households.

227. Women in Malawi still encounter discriminatory customary practices. While the Constitution recognizes equal rights for men and women and grants equal inheritance rights to widows and daughters⁷⁸, in customary law, these rights are severely restricted in customary law. In addition to women's limited endowments, such discrimination makes women's access to services even more difficult. Furthermore, female representation in national decision-making positions has stagnated at very low levels. Given that all interventions discussed above require the government's commitment, it is important to make explicit actions to improve women's political representation.

Priority Policy Interventions for Pathways

Pathway I: Increasing agricultural productivity

1. Target public resources and interventions to promote commercialization and productive diversification in the agriculture sector

228. Continuing reforms to FISP will help build resilience in the sector and free up scarce resources for productive investment. FISP has played a part in raising food production, but it has promoted maize production at the cost of other interventions and its efficiency could be improved. Scarce government resources could be used more efficiently to support the stated goal of increased maize production, while fiscal savings could be applied to productivity enhancing interventions. The government should continue reforms that serve to coordinate behavior of farmers and the private sector toward increased efficiency. For example, since FY2015/16 farmer contribution toward the market price has been raised from 3 percent to around 30 percent, leading to more self-selection by those farmers who can actually profit from the inputs. Similarly, impact could be further improved by expanding pilots targeting farmers who have the land and labor endowments but who cannot afford fertilizer on market terms, as well as by supporting the same beneficiaries over multiple cropping seasons. Additionally, private sector participation, which began in FY2016/17, should continue in order to improve operational efficiency and to ensure timely procurement and distribution of inputs. Alongside reforms to FISP, social safety nets need to be expanded to protect better the assets of the extreme poor, which would help separate agricultural policy from social policy.

229. Strengthening the commercialization of the agricultural sector particularly away from subsistence farming is critical for income growth and poverty reduction among farmers. To facilitate this transformation, resources should be channeled toward interventions that foster greater diversification and commercialization of the agriculture sector, boost agricultural productivity, and strengthen agricultural markets. Government policies that can induce coordination to this end include enhancing market information systems, communication and transport infrastructure, and agricultural research to create an enabling business environment for agriculture.

230. Expanding participation in markets will help reduce the risks of transaction failure and reduce transaction costs. The government should accelerate regulatory reforms to facilitate commercial activity in agricultural value chains. It should help ensure that traders are not hamstrung by regulation and

⁷⁸ Deceased Estates (Wills, Inheritance and Protection Act of 2011)

controls, instead limiting controls to those needed to ensure fair trade and responsible behavior. Increasing market competition would also reduce the returns to hoarding maize, thereby improving food security. A more extensive network of feeder roads is required to reduce transportation costs to markets.

231. Agricultural extension services can help farmers increase their profitable participation in markets. Extension services, which are currently heavily involved in FISP implementation, can instead support the formation of farmer groups and cooperatives to improve the prices received by farmers. These can benefit individual farmers to market their produce jointly with others to obtain higher unit prices. Extension services can further help farmers increase their knowledge of profitable crop production and marketing. Moreover, government can help oversee contract farming arrangements, particularly in the tobacco sector, in order to ensure the contracts are mutually beneficial.

232. Diversifying the agriculture sector beyond maize is important for increasing resilience and transformation, and will require more neutral policies and support to the sector. Many higher value crops are also more labor-intensive, thereby creating more jobs as well as incomes. Diversifying and increasing productivity through intercropping, crop rotation, and incorporation of organic fertilizers would replenish soil fertility and complement the application of chemical fertilizer to increase agricultural output. Policies could incentivize farmers to do this by limiting the duration of FISP program participation, during which farmers could use the increased yield from FISP fertilizer to invest in their farms.

233. The government should avoid the ad hoc imposition of export bans to encourage investment in the agriculture sector. In doing so, it should lay out clear and transparent procedures for regulatory requirements (including licensing requirements) for exports and imports, and outline the due process for administering these regulations. This would ensure certainty and improve predictability for market participants, and hence encourage the entry of commercial operators and investment across the agricultural spectrum, leading to increased agricultural productivity, food security and export diversification. Moreover, it should increase the use of alternative measures to address short term food insecurity, such as transparent criteria for the drawdown and management of strategic grain reserves, alongside broader measures to increase agricultural productivity.

234. Reforming ADMARC would reduce distortions in agricultural markets and reduce its fiscal burden. More transparent market behavior by ADMARC would go a long way toward deepening agricultural markets and ensuring food security. ADMARC interventions should be rules-based and transparent so that information is provided on a symmetrical basis for all actors in the maize market. A clear set of observed rules and the adoption of set price intervention bands would encourage the participation of other private traders in the market, strengthening the market position of Malawian farmers and enabling them to choose from more sources of demand. Policy makers should be cautious in allowing ADMARC to venture into profitable business activities which could be at the expense of private sector participants. Moreover, ADMARC should not be used for political purposes. Structural reforms to ADMARC itself, including increased transparency, are needed for it to operate sustainably and efficiently without relying on government bailouts.

235. Improved irrigation and water management can help mitigate the impact of droughts and prevent destruction through floods, as well as increase productivity. Investment in irrigation has been a government priority for a long time. However, irrigated farming requires significant technical analysis, capital, strong management capacity, market analysis, and effective market linkages. Moreover, irrigation is unlikely to be profitable to produce staple food crops. The production of irrigated maize would only be financially viable in poor rainfall seasons—which are difficult to predict—or if grown during the dry season following a poor rain-fed season. Instead, effective irrigation policy requires incentivizing commercialization, with smallholders growing irrigated higher value crops in better functioning markets, which then could increase their resources to buy staples. Malawi's irrigation potential lies in the plains along the shores of Lake Malawi and the Lower Shire Valley, with smaller areas in the flood plains of

rivers, where fertile soils and adequate water resources allow for the development of gravity-fed irrigated agriculture. Malawi has significant potential to unlock groundwater potential. Water harvesting and improvement of on-farm practices, potentially supplemented by small-scale irrigation structures (such as solar-powered irrigation facilities) could also mitigate the impacts of droughts and floods and increase productivity.

236. Additionally, the government should promote drought resistant varieties, ensure access to certified seeds, and expand integrated pest management to improve resilience. There are opportunities for Malawi to access various certified seeds within the region through the SADC seed harmonization initiative, once the seed policy and acts are domesticated. Additionally, integrated pest management would help offset the increasing impact of pests such as fall army worm.

Pathway II: Diversifying the economy and creating jobs

1. Create a business enabling environment to support structural transformation, increased productivity, and regional integration

237. Facilitating value addition to agricultural products would help to open up other sources of income for the rural population. Promoting the development of rural small-scale industries, particularly for sectors in which Malawi can be regionally competitive, and the professionalization of secondary activities would help create a more diversified rural economy. Policies should focus on creating an environment in which innovative means of financing, savings, and insurance can be accessed by entrepreneurs for value-added investments. This should be combined with sufficient information sharing, better linkages to potential buyers, skills development, business advisory services to MSMEs,⁷⁹ and the continuous improvement of infrastructure used by the rural economy, particularly to enable access to markets. Engagement of commercial operators in agro processing should also be encouraged through a more conducive business environment in order to develop more integrated rural value chains.

238. Promoting policies to increase exports and regional trade would help to increase and diversify incomes. Economic development in the region as well as demand for niche products could present an opportunity for both the country and individual farmers to profit from external demand. Oilseeds could be suitable for export-oriented production, thereby mitigating some of the risks associated with Malawi's dependence on tobacco for foreign exchange earnings. However, given the high transport costs to both local and regional markets, farming strategies should focus on products with a high price-to-weight ratio to make trading and exporting economical (Ksoll and Kunaka 2016). Furthermore, sustaining a stable but flexible exchange rate, as well as lower domestic inflation, would help to make Malawian exports more competitive.

239. Increasing regional integration will call for improving the efficiency of trade procedures, increasing coordination across numerous agencies, and reducing border inspections. Non-tariff barriers should also be reduced, particularly the ad hoc imposition of export bans. Additionally, Malawi should develop its logistics services sector. These policies should be implemented alongside road network upgrades, particularly at the secondary and tertiary level, and connectivity to rural areas, to support competitiveness.

240. Urbanization can accelerate economic growth and structural change in Malawi. In doing so, it would be important to reinforce strong linkages between rural and urban economies through production, consumption, and migration channels. Increased investment in urban areas financed by own resources—

⁷⁹ For business advisory services, there is need to upscale skills such as bookkeeping, accounting and ways to run and improve businesses. There are few business advisory firms in Malawi, with limited visibility.

particularly property taxes – would help ensure public finances are not diverted from rural areas. This could help improve investment in urban roads as well as sewerage systems (World Bank, 2016f).

241. While the investment climate may have a modernized legal framework, in practice, it is characterized by a lack of transparency and considerable uncertainty. Much greater efforts are needed to make existing regulations—including tax and licensing requirements—simpler, more accessible, and easier to implement. The government should focus more on the “functions” of promoting private sector growth, instead of establishing the “form” of modernized institutions. This calls for less use of first-best institutional solutions and more context-specific approaches that result in observable improvements for businesses. In order to increase trust and promote certainty, it is important to increase efforts to ensure adequate consultation on policy changes, build in mechanisms that prevent ad hoc policy shifts, and address inconsistencies between the practices of different regulatory bodies. Particularly the case of ad hoc export bans has reduced commercial investment.

242. Due to existing challenges, investment tends to be driven by a “deals-based” business model, benefiting insiders at the expense of outside competition, with investors focusing only on short-term, quick-return activities, contributing to a “missing middle.” Instead, the government should make a concerted effort to attract higher-quality investors, foster longer term investments, and facilitate the creation of more and better-quality jobs in profitable sectors. This would require a number of policy actions with greater emphasis on full implementation of a more limited but coherent set of reforms, rather than partial implementation in many areas. Malawi should empower the Malawi Investment and Trade Centre and other institutions to facilitate investment.

243. Land is a key input into production and tenure security needs to improve. The recently enacted 10 land bills create opportunities for making land surveying more affordable to allow the poor to register and gain formal title for their parcels. Implementing the new land-related bills would improve investor confidence in the business environment, reduce the cost of documenting rights, support decentralization, improve land use planning, and protect vulnerable groups’ land rights and livelihoods.

2. Increase access to finance

244. Broader financial inclusion would facilitate the expansion of nonagricultural activities. Measures to reduce interest rates should be prioritized to ensure broader access to finance, which will call for increased macro-economic stability to reduce inflation and broader economic uncertainty. Moreover, improving the business environment through simplified regulations and addressing infrastructure constraints, particularly transport in rural areas, would reduce the cost of doing business, lower risk, and allow for lower interest rates. Additionally, the recent initiative introducing national identification numbers could be accompanied by an expansion in mobile banking as well as increased access to formal banking services. Measures to improve financial literacy and to develop financial products tailored to the needs of small businesses will also play an important role. Finally, the passage of the Warehouse Receipts Act of 2017 opens up an opportunity for farmers and traders to use stored commodities as collateral for lending. This can help to expand lending in the agriculture sector and for additional value addition.

3. Address infrastructure deficits to support private sector development and service delivery

245. Increasing access to electricity is essential for enabling economic growth and enhancing the well-being of all citizens nationwide. Improvement and expansion of Malawi’s transmission and distribution network is urgently required. At the same time, the government should create an enabling environment that supports market development for off-grid technologies (e.g. stand-alone solar) and attracts private sector participation. It is important to shift from numerous fragmented stand-alone activities for access scale-up to a programmatic approach aligning ongoing and planned electrification efforts directly with national electricity access priorities and targets under a comprehensive National Electrification

Program. The required financial resources should be mobilized based on a good-practice experience-informed bankable financing plan that is anchored by a sound least cost grid expansion and off-grid complement plan. In addition, extensive technical assistance is necessary to strengthen the viability and capacity of sector institutions implementing the comprehensive reform program.

246. Malawi needs to urgently diversify and expand its energy sources. A first step is for Malawi to quickly tap into the Southern Africa Power Pool (SAPP) regional grid. This integration would help meet the generation gap and ensure security of supply especially now in the face of low hydrology. Interconnections with Mozambique, Tanzania and Zambia are thus a priority and offer opportunities for lowering the cost of electricity supply in Malawi as well as potential opportunities in the long run to sell surplus electricity to SAPP. At the same time, efforts should be made to increase domestic generation capacity by engaging the private sector. Improving the performance of ESCOM to increase transparency, ensure cost reflective tariffs, and attracting private investment would be key reforms to support sustainability. Cost reflective tariffs could help contain demand growth, while also enabling the utility to meet its revenue requirements and investment programs and attract Independent Power Producers (IPPs).

247. Malawi should improve the transport system to lower the costs of domestic and international trade. On the domestic front, improving rural transport is critical for addressing rural poverty. Reliable, all-weather, and safe rural roads expand employment and self-employment opportunities through improving access to markets and information. Moreover, better rural roads facilitate development of human capital and well-being of the rural population through ensuring their access to social services, such as schools and health centers, especially in rainy season. A network of carefully planned rural logistics platforms should be developed around which the distribution and marketing of agricultural inputs and outputs can be organized. There is also a need to provide logistics rather than purely transport solutions to the shipment requirements of the agricultural sector. Such solutions would combine storage, road, and transport services in an optimized and comprehensive manner. On the international front, there is a need for the countries of Southern Africa to develop an integrated regional transit system. A regional approach offers many advantages over bilateral solutions but may take longer. Transport investments can maximize the role of private sector in the provision of maintenance services through Output and Performance Based Road Maintenance Contracting (OPRC) practices. They should further introduce more climate resilient approaches to road asset management to address the flooding damages and other long-term climate change vulnerabilities. Finally, they should also address improving road safety, which has become a major risk with one of the highest rates globally to of fatal accidents, and also primarily affects the poor.

248. The new Nacala rail corridor offers an opportunity for Malawi to disrupt the current transport equilibrium, but complementary investments and policy reforms are needed if the country is to fully realize the benefits from the corridor. Priority should be given to a simplified transit procedure for railways as well as investments for cargo handling facilities in strategic locations. In addition, railway and port operations need to be better synchronized. The railway could also provide additional transport capacity to alleviate pressure on high transport prices during the harvest season of major agricultural commodities.

249. Poor water supply is a major binding constraint for business, with insufficient supply and outages raising costs and undermining productivity, as well as undermining health and sanitation outcomes. Addressing the water deficit should be a high priority for government policy and investment efforts. It will require deeper efforts to improve the governance of utility suppliers as well as find ways to encourage private investment to increase installed capacity, given that the costs of filling Malawi's water infrastructure gaps are well beyond the available public-sector resources.

250. Leveraging the potential of ICT can help transform the way people, businesses, and governments communicate, transact, and access information and services. The government can encourage a significant scale up in private sector ICT infrastructure investment, especially in rural and

underserved areas through light touch regulation that strengthens competition, and by prioritizing affordability over revenue maximization in the short term. Once there is adequate connectivity, skills and service delivery infrastructure/capacity, digital technology can be leveraged to improve service delivery at the sector level. The potential is particularly great in agriculture, where online market platforms and access to extension services can enable growth in rural areas. Financial inclusion also offers opportunities through mobile money, savings, insurance. This could largely be private sector driven if regulation is progressive and connectivity is cheap and widespread. The health sector can also benefit from telemedicine, health messaging, remote diagnostics, supply chain management. Education, can also benefit from digital technology, while digital skills should also be nurtured to equip citizens, especially youth, to build the digital society, government and economy of tomorrow.

Pathway III: Harnessing the demographic dividend and building human capital

1. Maintain the current momentum in demographic transition

251. Maintaining the current momentum in demographic transition is critical for harnessing demographic dividend in the near future. To maintain this pace of TFR reduction, effort needs to be made towards scaling up services to satisfy the remaining unmet demand for high quality, affordable family planning/reproductive health services. In particular, attention needs to be given to poor and vulnerable women who are at a disadvantage because of geographic, socio-economic or cultural barriers. But, most importantly, attention needs to be accorded to adolescent girls, particularly those in rural areas who face multiple constraints and have seen virtually no progress in childbearing patterns over the past twenty-five years. High-level political support and mobilization of traditional community and civil society leaders will be critical especially for women who face opposition to contraception, either for religious or socio-cultural reasons. Child survival rates through enhanced maternal and child health and nutrition interventions should continue to be improved.

2. Improve learning outcomes at primary and secondary levels and develop productive skills of youth

252. Support for school going children, and girls in particular, in poor and underserved areas should be provided to help them complete and attain quality foundational skills at the primary and secondary levels. Appropriate policy reforms should also be pursued in this area to facilitate adoption of:

- a) Cost-effective and equitable strategies (across the rural-urban and social spectrum) in the delivery and management of key inputs (teachers, teaching materials, infrastructure, school finances);
- b) Effective strategies for enhanced content and pedagogical capacity of teachers;
- c) Innovative strategies including financial incentives to support girls complete primary and secondary education; and
- d) Accountable and transparent school management practices, including increasing accountability mechanisms through local communities.

253. In addition, job relevant skills for out of school youths should be provided through formal and informal systems with private sector involvement, and critical scientific and technical skills should be built at the secondary and tertiary education levels. Finally, opportunities to improve matching of graduates with formal employers as well as matching of lower-skilled labor with informal or short-term opportunities should be explored to reduce periods of transition and unemployment. Private sector players and investors indicate that the country requires skills for jobs in high-priority sectors. This includes engineering, natural resource extraction, agriculture, construction, health services, tourism and

hospitality. This training could be provided by existing institutions,⁸⁰ but they often face challenges of inadequate finances, equipment, and relevant curricula.

3. Improve the coverage, access and quality of health services

254. Addressing significant limitations in public services coverage, access and quality of services is necessary. Human resource policies need to provide sufficient incentives for the recruitment, distribution, and retention of health workers. The distribution of health workers should be geographically equitable and in line with the demands in each region/district. Increasing the capacity and productivity of health workers can be achieved by scaling up mentorship programs and results-based financing (RBF) approaches. Close monitoring of procurement chains is important to minimize leakage so as to improve the supply of medicines, medical supplies, and vaccines to avoid shortages of medicines. Improving governance and health financing by enhancing efficiency in resource allocation and use, strengthening public finance management, and increasing government financing are all important for improving the effectiveness of health services, especially at the primary health care level where most health problems originate. Lastly, it is important to ensure availability and functionality of medical infrastructure including transport, laboratories, and medical equipment. Also, continued efforts to address the large communicable disease burden of HIV, TB, and Malaria is key for poverty alleviation.

255. Scale-up interventions to improve Reproductive, Maternal, Neonatal, Child, and Adolescent Health (RMNCAH) and Nutrition services is needed. To do this, a RMNCAH Investment Plan should be developed and implemented which outlines a package of high-impact interventions at health facilities and at the community level. To effectively deliver RMNCAH and nutrition interventions particularly in rural and remote areas, strengthening linkages between primary health facilities and communities is necessary. This could be achieved by reinforcing community-level child health and safe motherhood action groups. To improve quality of care, effective supervision is needed within primary health facilities and communities, and to reduce the number of defaulters, electronic patient tracing management systems for HIV, TB, family planning, antenatal, and child health and nutrition services should be introduced.

4. Mainstream Early Childhood Development (ECD)

256. For Malawi to reap its full demographic dividend, it will be necessary to ensure improved health and early childhood development outcomes. Adolescent mothers should be prioritized in ECD services to counter the high incidence of poor outcomes in children born to these mothers. A multi-sectoral approach might be required to prevent teenage pregnancies as well as improve health outcomes in children born to young mothers. There is an urgent need to establish Malawi's policy environment, implementation, and monitoring and assurance of ECD policy⁸¹. Some of the laws enacted have not been implemented, and while established policies provide a solid basis for implementation there is a need to strengthen them through an overarching law specifically aimed at ECD policy and delivery. Additionally, integrated and cost effective early childhood development for improved school readiness is needed. There is a need for strengthened early childhood education programs, which require the establishment of a corresponding budget and through which innovative low-cost interventions, guided by the results from the recent impact evaluation as well as impactful experiences from elsewhere, can be implemented.

⁸⁰ Potential institutions include: the University of Agriculture and Natural Resources (Luanar), the Malawi Polytechnic (Poly), Mzuzu University (Mzuni), Chancellor College (Chanco) and Technical, Entrepreneurial and Vocational Education and Traditional Authority (Teveta)

⁸¹ World Bank. 2015a. "Malawi. ECD. Systems Approach for Better Education Results. SABER Report." Washington, D.C.

Pathway IV: Building resilience against shocks and enhancing environmental sustainability

1. Strengthen social protection programs

257. Malawi needs to continue strengthening social protection to improve households' ability to address shocks and exit from poverty. Government first needs to establish (and meet) domestic spending targets for basic safety net interventions, which are currently almost exclusively donor financed. Secondly, government needs to refine its program mix. In the immediate term, the priority is to strengthen the core safety net with increased focus on cash transfers, and careful reviews on the role of public works going forward. Third, ongoing efforts to improve the structural targeting of the ultra-poor should be sustained. This is particularly so since the number of ultra-poor started to show a reduction for the first time since 2004. Fourth, safety nets should be strengthened to promote resilience and respond to shocks.

2. Adopt risk mitigation initiatives

258. In addition to strengthening risk coping mechanisms, it is equally important to take actions to mitigate climatic and environmental risks. Increasing climate risks are already being exacerbated by severe environmental degradation and can be countered by investments in agricultural development (discussed above) but also by a range of sustainable natural resources management interventions – such as scaling-up the use of sustainable land management practices, measures to protect forests and woodlands and to improve the management of water resources. At the macroeconomic level, prudent fiscal and monetary policies can reduce the risk of macroeconomic crisis.

259. Implementing the new institutional framework for disaster risk management would help reduce disaster losses and impacts, break the cycle of food insecurity, and build the country's resilience to disaster risks. However, implementation of the Government's newly established government framework for DRM is hampered by a number of challenges around policy implementation, strategy and budgetary processes. The government should as well as development partners should increase its focus on implementing this new system.

260. The introduction of sustainable land management (SLM) practices is needed to curtail the depletion of Malawi's natural resources. Depletion of natural capital has been particularly acute in Malawi, suggesting the current growth pattern is not sustainable and can cause irreversible damage to forests, biodiversity, and other natural resources in Malawi. In 2015, Malawi saw a significant depletion of its natural capital, equivalent to 10.8 % of GNI, due to depletion of natural resources and pollution damages. Land management practices such as forest clearance and annual burning are well known to be practices which accelerate soil erosion—these practices need to be reduced. Progressive and acute degradation of forests also exacerbates exposure to weather-related disasters and climate change which could be reduced through the introduction of sustainable land management (SLM) practices. The United Nations defines SLM as “the use of land resources, including soils, water, animals and plants, for the production of goods to meet changing human needs, while simultaneously ensuring the long-term productive potential of these resources and the maintenance of their environmental functions”. It involves a holistic approach to achieving productive and healthy ecosystems by integrating social, economic, physical and biological needs and values, and it contributes to sustainable and rural development.

6. KNOWLEDGE AND DATA GAPS

261. Malawi lacks frequent updates of poverty statistics. Currently, National Statistics Office (NSO) conducts Integrated Household Survey (IHS), with which official poverty statistics are estimated, only every six years. As this SCD's analysis suggests, Malawian populations have likely been experiencing large ups and downs of poverty incidence. But due to the limited availability of data, it is not possible to see the real magnitude of volatility of poverty trends. Given that vulnerability is a key issue in Malawi, it is very important to have more frequent poverty monitoring. Reflecting this need, NSO now plans to move to a three year cycle of IHS surveys and a next IHS survey is planned to start in 2019; however, the household survey funding outlook beyond 2019/20 is not clear.

262. Convergence of poverty and other statistics between IHS and IHPS is necessary. NSO has been collecting poverty and other key socio-economic indicators from two survey series, namely IHS and IHPS. Both surveys have been designed in a comparative manner and have potentially large synergy in providing evidence to policy makers, but such synergy is limited because some statistics, especially poverty statistics, produced from these survey series are not fully comparable. There have been efforts to address this but further efforts are necessary to achieve full comparability of poverty statistics over time.

263. Comparability of Consumer Price Index (CPI) over time is an issue. To reflect the latest consumption patterns, the NSO regularly rebases the weights for CPI. However, CPI data are often not fully comparable between before and after the rebasing. It is important to establish the comparability of CPI to estimate the inflation rate and poverty trends accurately.

264. Official sources of firm level data are necessary. This SCD shows importance of the non-farm sector in Malawi's growth and poverty reduction. However, all firm level data used in this report were collected by development partners. It is of urgent need to create a new survey series of collecting firm level data, especially data on small and medium sized enterprises. Efforts should also be made to strengthen FDI data reporting, which is currently over-estimated.

265. The agricultural sector needs more data: For example, it needs farmgate price data, which is useful to properly monitor prices received by farmers and understand the effects of price regulation. The Ministry of Agriculture, Irrigation and Water Development (MOAIWD) collects monthly retail and wholesale prices of major crops from selected markets while the NSO also collects retail price data in selected 15 urban and rural domains for its Consumer Price Index. However, there is no data on farmgate prices. Farmgate price data is necessary for us to understand training margin between farmgate prices and retail prices and also the implications of grain market policies. Additionally, spatial analysis of market supply chains should be studied further, in order to help specialized products produced in some regions of Malawi get linked to regions that require them (e.g., tomatoes in Ntcheu and tangerines in Mwanza).

266. To evaluate the impact of FISP reform, it is important to collect data on fertilizer quality and seed quality/purity as well as their farm gate prices, which are not available in Malawi. This is a concern given the weaknesses in regulatory environment and capacity, the cost of the program, and the emerging empirical evidence from African settings regarding the poor quality of commercially-available inputs (see Ashour et al. 2018 on herbicides in Uganda and Kilic et al. (2017) for maize in Uganda).

267. Another area of agriculture data gap is the absence of frequent agricultural production survey. Crop production data is key for monitoring performance of the agricultural sector. The existing crop production data are collected by the MOAIWD and the NSO, but they are often inconsistent. The MOAIWD collects data on crop production and cropped area in its annual Agricultural Production Estimates System (APES). The APES data is collected by extension workers who have limited data collection expertise and possibly perverse incentive to collect objective agriculture production data (see

Benson and Edelman (2016)). The NSO collects agriculture data in the IHS and in the 2006/7 National Census of Agriculture and Livestock. The IHS data (and its panel subcomponent) provides a very useful household level information on farm productivity and the various factors associated with changes in productivity. However, the IHS is neither intended to nor capable of providing annual estimate of agriculture production and generate annual food deficit forecast. Conducting an agriculture census like the one implemented in 2006/7 could be informative, but costly. Therefore, it is highly recommended to implement an annual agriculture sample survey that provide accurate forecast of annual production and monitor the performance of agricultural production. Such a survey could be jointly implemented by the NSO and MOAIWD, which have complementary expertise on survey data collection and production forecast.

268. To understand gender gaps, collecting gender-disaggregated data is necessary. Given that women's bargaining power and role can make a huge difference in productivity and income generation capacity of households, it is important to understand individual or gender specific conditions and for this, collecting individual level, not household level, data is critical.

269. Comparisons between “female-headed” and “male-headed” households can be problematic because they represent different economic and demographic units. “Female-headed households” are for the most part defined as those without an adult male present. “Male-headed households” combines households with males and no female adults with those comprising households with both adult men and women. These definitions also vary among countries, making cross-country comparisons problematic. Instead, it is better to refine this analysis by allowing for additional categories of households based on: (i) economic type (e.g. those with a single male or single female breadwinner, with and without dependents versus dual-earner households with and without dependents), and/or (ii) demographic composition (e.g. those with a majority of males, majority of females, or equivalent number of each sex).⁸²

270. There remain large knowledge gaps on the poverty and distributional impact of climate change. McCarthy et al. (2018) and Beegle et al. (2017) study the poverty and distributional impact of recent droughts and floods and whether the social safety net performed well to reduce the damage due to the climate shocks. But, in general, research in this area is still very limited. Also, there is little knowledge base on how to build resilience to climate shocks in the energy and transportation sectors. Addressing this knowledge gap is critical for following Pathway 4.

⁸² A recently published paper provides details on this approach. *Munoz Boudet, Ana Maria; Buitrago, Paola; De La Briere, Benedicte Leroy; Newhouse, David; Rubiano Matulevich, Eliana; Scott, Kinnon; Suarez-Becerra, Pablo. 2018. Gender Differences in Poverty and Household Composition through the Life-Cycle : A Global Perspective. Policy Research Working Paper; No. 8360. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/29426> License: CC BY 3.0 IGO.”*

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Annex 1: Malawi SCD team

A. Core team

Name	Position	GP/IFC
Patrick Hettinger	Senior Economist / Co-TTL	Macroeconomics, Trade & Investment
Nobuo Yoshida	Lead Economist / Co-TTL	Poverty & Equity
Richard Record	Lead Economist / Co-TTL	Macroeconomics, Trade & Investment
Deborah Isser	Lead Governance Specialist	Governance
Katia Daude	Senior Country Officer / Co-TTL	IFC
Priscilla Kandoole	Economist	Macroeconomics, Trade & Investment
Angela Zeleza	STC/Economist	Macroeconomics, Trade & Investment
Ellie Stylianou	STC/Economist	Macroeconomics, Trade & Investment
Sunganani Kalembe	STC/Economic Researcher	Macroeconomics, Trade & Investment

B. Focal points

Name	Position	GP/IFC/CCSA/MIGA
Holger Kray	Lead Agriculture Economist	Agriculture
Valens Mwumvaneza	Senior Agriculture Economist	Agriculture
Innocent Mulindwa	Senior Education Specialist	Education
Dhruva Sahai	Senior Financial Analyst	Energy and Extractives
Ross Hughes	Senior Natural Resources Management Specialist	Environment and National Resources
Smita Wagh	Senior Financial Sector Specialist	Finance and Markets
Amara Konneh	Manager	Fragility, Conflict and Violence
Daniel Kirkwood	Gender Specialist	Gender
Shomikho Raha	Senior Public Sector Specialist	Governance
Collins Chansa	Health Specialist	Health, Nutrition and Population
Jumoke Jagun-Dokunmu	Country Manager	IFC
Madalo Minofu	Resident Representative	IFC
Luciana Harrington	Strategy Officer	IFC
Stephan Dreyhaupt	Program Manager	MIGA
Habtam Fuje	Economist	Poverty & Equity
Jane Jamieson	Senior Infrastructure Specialist	Public Private Partnerships
Colin Andrews	Senior Social Protection Specialist	Social Protection and Labor
Francis Nkoka	Senior Disaster Risk Management Specialist	Social Urban Rural Resilience
Ayaz Parvez	Senior Disaster Risk Management Specialist	Social Urban Rural Resilience
Linus Pott	Junior Professional Officer	Social Urban Rural Resilience - Land
Steven Dimitriyev	Lead Private Sector Specialist	Trade and Competitiveness
Efrem Chilima	Senior Private Sector Specialist	Trade and Competitiveness
Casey Torgusson	Senior Operations Officer	Transport and ICT - ICT
Sevara Melibaeva	Senior Transport Economist	Transport and ICT - Transport

Josses Mugabi	Senior Water & Sanitation Specialist	Water Supply and Sanitation
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Overall guidance is provided by Practice Managers Abebe Adugna (MTI) and Pierella Paci (Poverty); Program Leaders Yutaka Yoshino, Gayle Martin, and Andre Bald; Country Manager Greg Toulmin and Country Director Bella Bird.

Annex 2: Key Macroeconomic Indicators

Table A2.1: Key macroeconomic indicators

	2014	2015	2016	2017	2018 Proj.
National Accounts and Prices					
GDP at constant market prices (percentage change)	5.7	2.8	2.5	4.0	3.7
Agriculture	5.9	-2.0	-2.3	5.0	2.5
Industry	4.7	3.5	2.4	2.2	3.0
Services	5.8	4.7	4.4	4.0	4.5
Consumer prices (annual average)	23.8	21.9	21.7	11.5	10.9
Central Government (percent of GDP on a fiscal year basis)					
Revenue and grants	23.2	21.4	21.6	23.5	21.7
Domestic revenue (tax and nontax)	19.7	18.6	17.8	20.0	19.0
Grants	3.5	2.8	3.7	3.5	2.7
Expenditure and net lending	28.9	27.1	27.6	28.2	28.9
Overall balance (excluding grants)	-9.2	-8.5	-9.8	-8.2	-9.9
Overall balance (including grants)	-5.7	-5.7	-6.1	-4.8	-7.1
Foreign financing	2.0	2.5	1.9	2.5	3.2
Domestic financing	4.2	3.3	1.7	0.9	4.6
Amortization (zero coupon bonds)	0.0	0.8	2.5	1.3	-0.9
Privatization Proceeds	0.0	0.0	0.0	0.3	0.0
Money and Credit					
Money and quasi money (percentage change)	20.7	23.7	15.2	19.7	12.6
Credit to the private sector (percent change)	20.0	29.9	4.6	0.4	4.1
External Sector (US\$ millions, unless otherwise indicated)					
Exports (goods and services)	1,737	1,616	1,502	1,675	1,800
Imports (goods and services)	2,399	2,346	2,569	2,606	2,727
Gross official reserves	588	670	605	757	703
(months of imports)	3.1	3.4	2.9	3.3	3.0
Current account (percent of GDP)	-8.5	-9.2	-14.7	-11.3	-9.2
Exchange rate (MWK per US\$ average)	424.4	499.6	714.8	727.5	-
Debt Stock and Service					
External debt (public sector, percentage of GDP)	33.1	37.0	33.2	32.6	32.1
Domestic public debt (percentage of GDP)	14.9	16.8	21.2	22.6	22.2
Total public debt (percentage of GDP)	48.0	53.8	54.4	55.1	54.3
Poverty					
International Poverty rate (US\$ 1.9 in 2011 PPP terms)	69.3	69.4	69.6	69.4	69.1
Lower middle-income poverty rate (US\$ 3.2 in PPP terms)	87.4	87.5	87.3	87.7	87.6
Upper middle-income poverty rate (US\$ 5.5 in PPP terms)	95.6	95.6	95.7	95.8	95.8

Source: World Bank staff calculations based on MFMMod, MoFEPD, RBM and IMF data

Annex 3: Supplementary tables and boxes

*Table A3.1: Structural change towards services with higher relative productivity but negative productivity growth
Selected economic indicators and annual rate of change, 1998-2013*

	1998	2013
GDP (\$ million)	4,133	7,287
Agriculture	1,491	2,315
Industry	512	1,135
Services	2,130	3,837
Employment (1000s)	4,446	5,547
Agriculture	3,736	3,556
Industry	193	411
Services	517	1,581
GDP per worker (\$)	929	1,314
Agriculture	399	651
Industry	2,658	2,764
Services	4,116	2,427

Source: Malawi Urbanization Review (2016)

Table A3.2: Destination of Malawi exports and source of imports

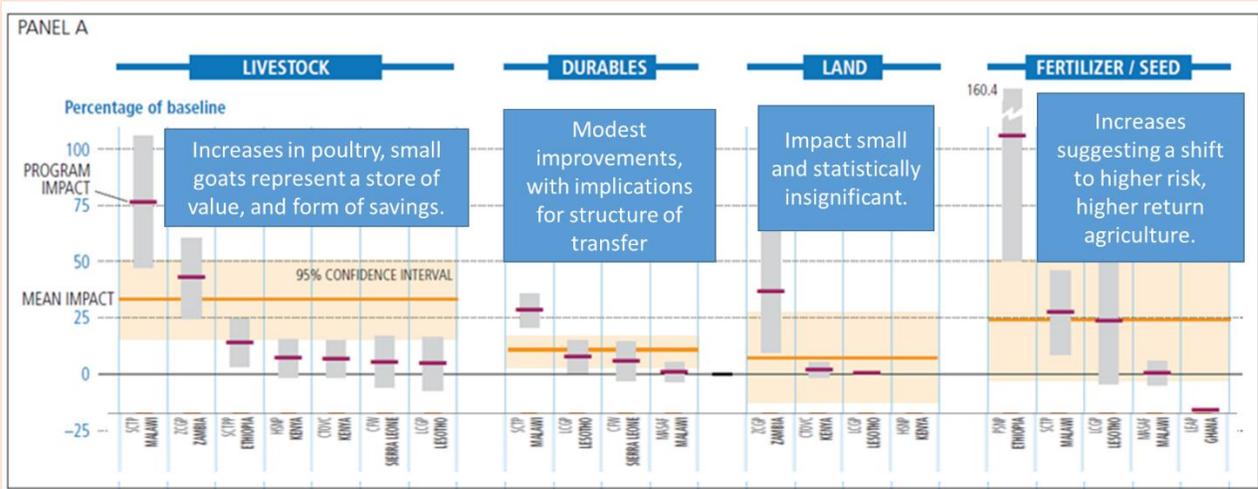
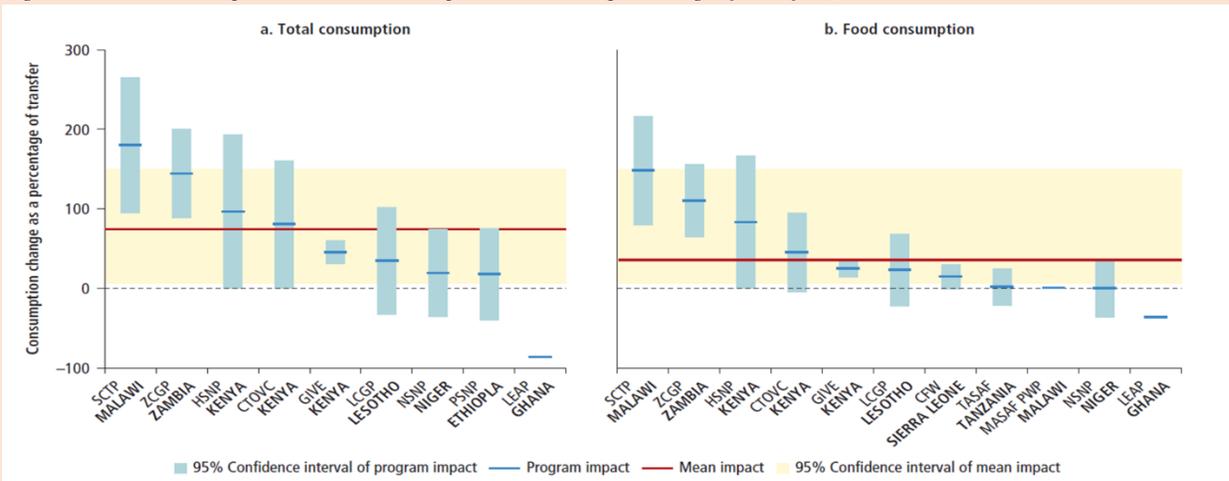
	Import Source	US\$ million	Share of total		Export destinations	US\$ millions	Share of total
	Total imports from World	2562.0			Total exports to World	889.1	
1	South Africa	454.8	18%	1	Belgium	195.2	22%
2	China	376.1	15%	2	South Africa	69.4	8%
3	India	279.7	11%	3	Tanzania	68.6	8%
4	United Arab Emirates	174.7	7%	4	Germany	50.5	6%
5	United Kingdom	135.9	5%	5	Egypt	49.3	6%
6	Kuwait	125.8	5%	6	China	41.7	5%
7	Zambia	114.1	4%	7	United Kingdom	32.9	4%
8	Japan	71.0	3%	8	United States of America	32.9	4%
9	United States of America	58.4	2%	9	Zimbabwe	28.6	3%
10	Germany	54.1	2%	10	Italy	26.2	3%
11	Tanzania	43.6	2%	11	Netherlands	23.8	3%
12	Indonesia	41.0	2%	12	Zambia	20.9	2%
13	Mozambique	39.8	2%	13	Russia	19.2	2%
14	Netherlands	39.1	2%	14	Mozambique	18.8	2%
15	Austria	35.8	1%	15	Ukraine	18.6	2%
	Share of total imports		80%		Total share of total exports		78%

Source: ITC Trade Map, Authors calculation

Box A3-1: Comparing the impact of Malawi’s Cash Transfer program against other programs in the Africa region

Ralston *et al.* (2017) reviewed 55 impact evaluations of 27 social safety net programs in 14 African countries implemented since 2005. The findings show that Malawi’s SCTP had one of the lowest baseline beneficiary consumption levels (US\$ 172) and the highest impact in terms of a range of outcomes. In terms of impact on both total consumption and food consumption, Malawi’s SCTP had the highest impact of any program across the region. SCTP beneficiaries spent an equivalent of 179 percent of the transfer amount, compared to an average of 74 percent regionally (see Figure 1). This points to the importance of community sharing and spillover effects within the program. In addition, Malawi reported some of the strongest regional outcomes in measures related to resilience (improved livestock holdings, investment in durable goods and fertilizer). Another possible sign of resilience is reduced reliance on “ganyu” i.e. low-wage and casual work, which is associated with inability to escape the poverty trap (Devereux 1997).

Figure 1: Total Consumption & Food Consumption Estimates (percentage of transfers)



Annex 4: Constraints Identified for each Pathway

Increasing agricultural productivity (Pathway 1: page 32 - 40)	Dependence rain-fed agriculture, limited irrigation
	Poor research and extension services
	Limited diversification, heavy focus on maize, no crop rotation
	Poor soil quality
	Limited economic activity in rural areas, uncertain, thin, risky markets, high price volatility
	Poor road connectivity / weak links to markets
	Substantial own-production, limited commercialization
	High rural population densities leading to small average farm sizes and limited land for livestock
	Agricultural credit difficult to obtain, liquidity constraints
	Limited adoption modern, drought & pest-resistant technologies
	Limited use of mechanization & animal traction
	Environmental shocks - droughts, floods, pests
	Limited access to and trust in public storage
	Asymmetric information on prices and limited knowledge of negotiation
	Weak land tenure and administration
Inefficient patterns of public expenditure, focussed on maize	
Unpredictable & distortionary government interventions	
Diversifying the economy and creating jobs (Pathway 2: page 41 - 52)	Slow job creation & limited formal employment
	Slow urbanization
	Limited coverage secondary roads & transportation and solid waste management constrain urbanization
	Limited value addition, particularly in rural areas
	Heavy dependence on local economies and agriculture in rural areas
	High cost domestic, rural, and international trade
	Poorly performing trade corridors and facilitation, non-tariff barriers, underdeveloped logistics services
	Regulatory deficiencies favor established firms
	Low access to finance
	Limited and unreliable electricity water access
	Corruption
	Lack of skilled labor, poor job matching in labor market
	Lack of climate resilient infrastructure
Limited ICT at high cost to Malawians	
Harnessing demographic dividend & Building Human Capital (Pathway 3: page 52 - 62)	Still high total fertility rate (TFR)
	High incidence of disease and mortality rates
	High population growth
	Still limited coverage, access and quality of health services
	Donor dependent financing
	Low learning outcomes at primary and secondary levels and develop productive skills of youth
Limited Early Childhood Development (ECD)	

	Limited access to water and sanitation
Building resilience against shocks and enhancing environmental sustainability (Pathway 4: page 62 – 69)	More frequent, wide-spread, and intense droughts and floods due to climate changes
	Increased health risk
	Limited fiscal space
	Limited coping mechanisms
	Environmental degradation
	Increasing GHG gas emission
	Weak social protection programs
	Weak MIS for social protection
	Adopt risk mitigation initiatives
	Weak implementation capacity of new DRM framework

Annex 5: Consultations during the SCD Process

Introduction

In formulating this SCD, the Bank team engaged officials from Government Ministries, Departments and Agencies; stakeholders from the private sector, civil society, and donors. In addition, internal wide Bank consultations were also undertaken with the GPs in June and November 2017, and follow ups in March and April 2018.

Objectives of the Consultation

In these consultations, the team aimed to understand the context and underpinnings of Malawi's challenges. There was also an analysis on recent developments, growth opportunities as well as appraising interventions that needed to be taken for the realization of the twin goals of ending extreme poverty by 2030 and increasing shared prosperity called for fulfilment of the following two objectives. The consultation process, had two main related objectives: (a) to obtain an explanation of what people thought was responsible for the observed outcomes, and (b) what will be the drivers of shared and inclusive growth going forward.

Approach of the Consultation

Firstly, a desk review and analytical works were taken as well as the compilation of evidence from existing reports to get a clear description of the current state of development outcomes. Secondly, the Bank team held in parallel external and internal survey form consultations. The discussions were guided by three main questions: i) What has been successful in contributing to reduced poverty and increased prosperity in Malawi?; ii) What have been the main constraints in achieving the twin goals?; and iii) What priority interventions would you suggest in order to address these constraints. The comprehensive responses to these questions supported an initial SCD concept note and set a solid basis for the development of the full SCD report.

Findings from Private Sector and CSOs consultative meetings

The findings below present a synopsis of constraint areas followed by the proposed recommended interventions to address the challenges and or promote growth as captured from key players in the private sector, and CSOs.

1. Private sector constraints and opportunities

The main constraints to private sector growth were noted as frequent occurrences of macroeconomic instability; financial constraints; lack of complementary factors⁸³; poor microeconomic policies; poor governance and high levels of corruption. The proposed solutions to these constraints include sustaining economic growth and sound macroeconomic management, removing obstacles that prevent businesses from "starting up" and "growing up", promoting good governance, investing in supporting infrastructure (e.g roads, reliable power and water supply), addressing the myriad of financial constraints, and capacity building within SMEs. The opportunities for private sector growth were also highlighted namely; Malawi's geographical position—to be seen as "land linked" not land locked. As well as, the availability of raw materials in Malawi (eg. limestone that is used in the process of cement making; fresh water that could be used for irrigation farming).

⁸³Poor Domestic Road Networks; Poor Import-Export Infrastructure, Inadequate & Unreliable Power and Lack of Human Resource

2. Climate change management challenges and recommendations

The main challenges of climate change management were seen to be embedded in overall lack of finance and inadequate technical capacity. It was noted that there is limited technical expertise and knowledge of Climate Change -- there is a lack of weather experts; climatologists; experts in resilience; and adaptation. In addition, the country does not have the facilities nor modern equipment - there is consequently no proper research to inform the relevant stakeholders on climate change and poverty. All these shortcomings have also resulted in lack of collaboration and information sharing among relevant stakeholders. The summarized recommendations include promoting investment in capacity building, human resource, equipment, disaster risk management; sensitization about the dangers of environmental degradation; provide alternative sources of income; improve collaboration among different stakeholders.

3. Water Supply Challenges and recommendations

These consultations concluded that the country's utilities have registered some success in the growth of the customer base, revenue and asset base. However, efficient service delivery is constrained largely by the following challenges: inadequate finances and huge outstanding arrears; lack of adequate and reliable power; aging system, facilities and equipment; environmental management issues (deforestation, siltation of dams); and water sources (particularly the Northern region). The consultations concluded that it is of paramount importance that utilities ensure efficiencies in the system, from improving revenue collection (eg. installation of prepaid meters); identify alternative sources of water (eg. Construction of dams, Mulanje mountain), to increasing productivity.

4. Agricultural sector challenges and opportunities

The consultations noted several challenges inhibiting the growth of the agriculture sector. These would appear to be institutional and technical in nature as follows: lack of Government commitment towards diversification (eg. coffee production-not emphasized in policy documents); lack of investment in R&D; lack of access to finance for farmers; inadequate connecting infrastructure; lack of skilled labour; unstructured markets for other crops (eg. Coffee); unreliable and inadequate power; poor application and use of agriculture farm inputs; and adverse effects of urbanization (particularly manual labor). The agriculture sector has however seen the potential and growth prospects in bee keeping and harvesting.

5. Energy supply challenges and recommendations

The consultations highlighted that the energy sector face two key and significant challenges; firstly, a constrained system—with a lack of capacity to produce and distribute, and secondly poor environmental management which affects production. This is further compounded by a high population growth that is putting upward pressure on demand for power. The consultations proposed that the rehabilitation of the system is key, as is investing in power generation and identifying alternative sources of energy, waste management and strategic planning.

Findings from Government and Development Partners consultative meetings

The findings below present a synopsis from key Government counterparts and Development Partners on prioritization of policy actions after sharing preliminary findings of SCD analyses.

i. Government consultations

The Government advised that the SCD should be harmonized with the context of Governments national strategy MGDS III and make reference to Government related documents⁸⁴. The SCD should capture successes – recent developments in macro stability (exchange rate liberalization, low price volatility) and

⁸⁴ Cited: to National Resilience Strategy on issues of disasters; Relief and Rehabilitation Act – focusing more on risk reduction

improvements as recorded by the latest Doing Business report. Although, emphasis on risks and vulnerabilities economy is still relevant. The Government recommended that the diagnosis should focus on structural transformation with regard to the agriculture sector. In particular, an analysis on the emerging informal non-farm sector. With regard to isolating specific interventions to promote growth and transform Malawi -- Government requested that the SCD analyses constraints and opportunities in transport infrastructure (rail and road); energy sector; Climate change issues; Health and Education services and Public Sector Reforms.

From the Government consultations prioritization areas for consideration of the SCD were as follows—in order of importance:

- Attaining agricultural productivity and addressing deficiencies in infrastructure
- Addressing rapid population growth
- Addressing gender inequality
- Climate change management
- Promoting good governance

ii. Development partners consultations

Development Partners expressed that the SCD should analyze what sectors can drive growth and where Malawi can be competitive (regionally). The SCD will answer important questions such as: *Is the shift from agriculture to industry the answer? Can Malawi compete in industry? How can we move away from aid dependency and ensure aid effectiveness? Why is output per worker decreasing in industry and services?* The DPs recommended that the analytical underpinnings should focus on the following: agriculture sector, markets (maize), promoting commercialization, how productivity can be improved and constraints therein; harnessing the demographic dividend (including investing in the youth); regional connectivity/integration (to improve energy supply, road, rail and water transportation; constraints to private sector growth; improving irrigation; climate change management, social protection and resilience; and domestic resource mobilisation. The SCD team were also encouraged to provide an assessment of periods of past growth and analyze why this growth has not translated into higher equality. The SCD was also seen as an important tool to provide an understanding of and recommendations towards improving the political economy given its pivotal role in the country's development. Even if growth happens, there is a risk that it will not be shared.

From the DPs consultations prioritization areas for consideration of the SCD were as follows—in order of importance:

- Promoting good governance
- Addressing rapid population growth and slow agricultural productivity growth
- Addressing the slow pace of human development
- Gender inequality, climate risk, and macroeconomic instability (were considered less important).

Conclusion

Both Government officials and development partners thought slow agricultural productivity growth, rapid population growth are key constraints for Malawi's growth and poverty reduction. Government officials thought investment for infrastructure, especially electricity, is urgent while Development Partners thought addressing weak governance is critical for growth and poverty reduction. Macroeconomic stability was seen as a low priority but this is likely to reflect the fact that Malawi has just exited from large macroeconomic instability. The results of these consultation meetings guided the overall finalization of the prioritization process.