



COUNTRY PRIVATE SECTOR DIAGNOSTIC

# CREATING MARKETS IN MALAWI

The Road to Recovery: Turning Crisis into Economic Opportunity

*Executive Summary*

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## Priority recommendations to support private sector development

**CROSS-CUTTING**  
(GOVERNANCE,  
INVESTMENT  
CLIMATE, ACCESS  
TO FINANCE)**Strengthen macrofiscal fundamentals and foundations for growth.**

- Strengthen public financial and investment management through more realistic budget planning, stronger prioritization, and stricter fiscal discipline, in part to limit the need for domestic borrowing, avoid incurring arrears, reduce interest rates, and maintain available credit for the private sector.
- Transpose into national law the newly ratified New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to increase private sector confidence in investment dispute resolution in Malawi.
- Promote the use of collateral registry systems and the National Switch among financial institutions to facilitate longer-term and more affordable financing to private sector borrowers.

**ENERGY****Increase access to reliable power.**

- Improve the management and performance of ESCOM and continue the phased increase in the national electricity tariffs to allow cost recovery, which will help the national utility become financially sustainable and thus a more reliable contractual partner with current and potential IPPs.
- Ensure adequate resource allocation to support the development and implementation of energy projects—most notably the Mpatamanga Hydropower Project—and the approval, tendering, contracting, construction, and completion of new solar and wind IPP projects.

**CONNECTIVITY**  
(TRANSPORT  
& LOGISTICS;  
DIGITAL INFRA-  
STRUCTURE &  
SERVICES)**Improve access to markets.**

- Leverage engagement in the Nacala Corridor Development Trilateral Committee and African Continental Free Trade Agreement negotiations to eliminate nontariff barriers to trade, harmonizing rules and regulations that will reduce the time and cost of trade for Malawi's traders.
- Reduce the cost of mobile phone ownership and mobile broadband data services by rationalizing trade, tax, and levy policies, and promote infrastructure sharing to encourage wider mobile penetration and broadband access to low-income and rural residents.

**AGRIBUSINESS****Promote commercial agriculture.**

- Create standard operating procedures for conducting reviews of trade restrictive measures under the COGA, including quarterly updates of the Food Balance Sheet and wider public-private consultations to mitigate the risk of new market distortions.
- Approve and gazette backlogged legislation—the Seed Bill and National Fertilizer Bill—and provide operational guidelines to support timely implementation.
- Improve resource allocation for productive investments in the agriculture sector, including by reviewing and adjusting the Affordable Inputs Program to improve the efficiency of distribution, target farmers most likely to benefit from the subsidy, and ensure fiscal sustainability.

# EXECUTIVE SUMMARY

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Malawi is at a turning point in its political, social, and economic trajectory. Lazarus Chakwera was sworn in as Malawi's sixth president in June 2020. This marked a historic moment: the first time in Africa that an opposition candidate won a presidential election following initial results being overturned. After widespread unrest prior to the election, Malawians, especially the youth, have been demanding greater accountability, an end to corruption, and tangible progress on eradicating persistent poverty levels that exceed 70 percent of the population. The average gross national income (GNI) of a Malawian is the third lowest in the world, just US\$380 as of 2019. The Chakwera administration will need to find a way to unify the country's fractured political landscape and deliver on development promises.

**On top of these challenges, the new administration must also navigate the ongoing and evolving economic shocks of the COVID-19 pandemic.** Gross domestic product (GDP) growth expectations for 2020 have been lowered from 4.8 percent to 0.8 percent. Recent efforts to build fiscal and institutional resilience have helped but need to be strengthened. The pandemic's fallout has weakened the country's macroeconomic foundations, and the overall risk of debt distress is now high. Meanwhile, human capital gains are at risk. Poverty reduction is expected to stagnate, and overall poverty could potentially worsen. The pandemic will likely exacerbate existing inequalities in economic opportunities for women. Women-owned firms, for example, are primarily concentrated in informal agriculture and services, sectors that lack basic social protections to buffer against economic distress. Female farmers, for example, generally have lower access to productive inputs, information, and liquidity than male farmers—so in times of crisis, their farm productivity and food security can be hit harder.

**For decades, Malawi has failed to deliver the inclusive growth necessary to lift more of its people out of poverty.** Most remain trapped in subsistence farming. This is in part due to farmers' dependence on a single rainy season, vulnerability to weather-related shocks, lack of crop diversification due to policies that incentivize maize production, low soil fertility, high postharvest losses, and weak links to markets. People not working in agriculture are mostly employed in unproductive micro, small, and medium enterprises (MSMEs). Nearly 9 out of 10 jobs are informal.<sup>1</sup> Three-quarters of Malawi's firms consist of only the proprietor, with only 3.6 percent of all nonfarm enterprises having four employees or more.

**Prior to the pandemic, employment numbers showed signs of modest structural transformation out of agriculture and into services jobs, but this trend has been reversed by the pandemic's economic fallout.** Even in previous years, there were serious concerns that this shift was more of a "push" out of agriculture than a "pull" into new, productive economic opportunities. With the pandemic and the fall in economic activity making it harder for urban residents to find jobs, many have chosen to return to rural areas to farm as a matter of survival.

**The COVID-19 crisis has demonstrated just how critical farming—and the broader agribusiness sector—is to Malawian livelihoods and the wider economy.** Over 80 percent of households depend on agriculture for at least some of their income. A more prosperous future for all Malawians will require a more sustainable, resilient agrifood system. Today, most farming households are extremely vulnerable to climatic shocks. The Notre Dame Global Adaptation Initiative ranks Malawi 165th out of 181 countries in terms of both vulnerability to the impacts of climate change and overall readiness to adapt to it.<sup>2</sup> Bouts of severe drought and flooding are increasingly frequent, often leading to significant economic losses. These losses are likely to worsen unless urgent action is taken to strengthen economic, social, and climate resilience.

**Now more than ever, Malawi needs new drivers of growth to jumpstart an economic recovery and help meet the jobs challenge of a rapidly growing, youthful population.** The population is growing at roughly 3 percent a year, meaning that the already densely populated country will likely double its citizenry within a generation. Three-quarters of Malawians are younger than 35—over 40 percent are under age 14. An estimated 400,000 Malawians are entering the job force each year, and the economy is not growing at a pace to provide decent work.<sup>3</sup> Even for those who do find work, most are underemployed.<sup>4</sup> The latest government household survey (2020) found that 9 out of 10 respondents were engaged in at least some income-generating activity over the survey's preceding 12-month period. But most of these activities were in temporary, informal farming and fishing work. In urban areas, where farming is more limited, roughly one-quarter of all residents reported being unable to find work in the past 12 months. Only 1 in 10 Malawians over age 15 has a wage- or salary-paying job. Even those with a tertiary education struggle to find formal employment, with less than two-thirds finding a waged job. These numbers have only worsened since the onset of the pandemic. Estimates through August 2020 suggested 12 percent of the employed population lost jobs, with those in services and industries in urban areas most heavily affected.<sup>5</sup>

**Creating more and better jobs for Malawians requires the infrastructure, enabling environment, and good governance to foster economic transformation.** The new administration has put job creation at the center of its development agenda. Continuing a campaign promise, the president has pledged to create one million new jobs by June 2021. This is an ambitious target, and one that will be difficult to meet—especially considering the effect the pandemic has had on external market conditions and the government's fiscal space. The country already faces the challenge of being landlocked, with underdeveloped infrastructure to connect to regional and global markets, and a relatively small and poor domestic market. Economic activity is split between its two commercial hubs—the cities of Lilongwe and Blantyre—and with one of the least urbanized societies in the region, the country lacks the agglomeration effects that typically attract private investment.

**Yet there is significant private investment potential in Malawi, with a few lead firms already actively transforming key areas of the economy.** In the years prior to COVID-19, a small number of relatively large deals suggested that Malawi was becoming a more attractive location to invest—a promising sign for hopes of an infusion in productivity-enhancing technology, know-how, and capital goods. These deals include Ethiopia's investment in Malawi's national airline, China's continued interest in the real estate sector, and a joint venture with European partners to manufacture green building materials. The government also signed a major public-private partnership (PPP) with an Israeli firm to develop one of the region's largest



greenhouses for horticulture production. In the energy sector, a Swiss company won the country's first-ever competitive tender for a power purchase agreement (PPA) in 2019. This is now one of many PPAs approved and in the pipeline. All these deals suggest Malawi has the conditions in place to attract investment once markets recover from the COVID-19 crisis.

**Major investments in ongoing energy and regional connectivity projects will transform Malawi's economic landscape in the next few years.** No investment may be more important for the future of Malawi than the planned Mpatamanga Hydropower project. Just 18 percent of the population had access to electricity as of 2018, among the lowest rates in Africa. For the private sector, unreliable and unaffordable electricity has been a consistent constraint on growth. Mpatamanga would add 350 megawatts of energy to the country's current installed capacity of 482 megawatts—a legitimate game changer. The project is a flagship initiative to market test new policies and demonstrate that the government is creating opportunities for private sector participation in the market. Meanwhile, billions of dollars in public and private investment have gone into rehabilitating and building new rail, road, and port infrastructure along the Nacala Corridor, which runs from the Mozambican port city for which it is named across southern Malawi, north of Blantyre, and back into the Mozambican hinterland to the west. This has improved services and introduced more competition into the transport and logistics market, giving Malawi's importers and exporters another viable route to global markets. A World Bank Group–led US\$380 million investment approved in May 2021 will continue to improve performance along the Nacala Corridor and others, which will help bring down production and transport costs across the entire Malawi market.

*For Malawi to seize these opportunities and create new markets, the government will need to tackle long-standing governance and policy implementation weaknesses.*

**Weak governance underlies the country's persistent macroeconomic instability—a major concern for potential investors.** Limited domestic resource mobilization and poor public financial management have often left the government reliant on domestic borrowing and donor financing to meet expenditure overruns. The government has accumulated significant domestic debt to meet large fiscal deficits, and further borrowing from the domestic market would limit available finance for the private sector. The government stated the stock of total public debt stood at 54 percent of GDP as of the end of December 2020, a significantly lower number than the 69.1 percent of GDP the IMF had reported just three months prior.<sup>6</sup> Yet, the overall risk of debt distress remains high.

**At a time when the government may need to increase borrowing to support COVID-19 responses, maintaining fiscal discipline will be a tremendous challenge.** Improvements over the last few years were already at risk of weakening before COVID-19, and responding to the virus has now elevated those risks. According to authorities, statutory expenditures account for 91 percent of the budget, implying less than 10 percent of domestic revenue is discretionary. Thus far, the government has been adjusting programming and working with donors to receive budget support. In the medium-term, government will need to demonstrate a strong commitment to careful prioritization and control of expenditures and ensuring COVID-19 relief is used for sustainable and resilience-building measures.

**One of the most critical areas in need of improved governance and public financial management is the performance of Malawi's most important state-owned enterprises (SOEs).** There are currently 67 commercially operating SOEs in Malawi, many of which play justifiable roles in the market and which have helped expand economic activity and services into rural areas. But in some key areas of the economy—like agriculture and energy—SOEs have been performing poorly. Most SOEs also have limited autonomy and operate with little transparency, opening the door for political interference and mismanagement. This situation is problematic, particularly in markets where SOEs compete with the private sector while receiving regulatory, financial, or de facto advantages over their competitors that may include soft budget constraints, preferential access to land, and tax concessions on acquisitions. The previous government had pledged to improve SOE performance by partnering with strategic private investors in some of these sectors and by redefining SOE mandates to level the playing field for private actors. But progress has been slow. The country's Competition and Fair Trading Commission is well placed to start tackling some of these challenges but will need to be empowered to do so. Existing rules for public financial management should be strengthened and more strictly adhered to.

**The fundamental conditions to support market-based competition are not in place, particularly in the agriculture and energy sectors.** The parastatal Agricultural Development and Marketing Corporation (ADMARC) has been historically characterized by poor corporate governance, financial mismanagement, and distortion of markets. A government bailout in 2018 cost roughly 1 percent of GDP.<sup>7</sup> In the energy sector, the Electricity Supply Corporation of Malawi Limited (ESCOM) is equally known for allegations of corporate and financial mismanagement. The parastatal's lack of transparency and financial instability have made it unreliable in the eyes of independent power producers (IPPs) that might be willing to invest in the country but would need to rely on ESCOM as an off-taker. Past governments have largely failed to address the weaknesses in these institutions, promising reforms but failing to fully implement them. The new administration replaced the boards on all parastatals in September 2020 and will need to continue to work with these boards to improve the management, performance, and transparency of the institutions.

**Failure to implement reforms has been a blight on the country—whether stemming from a lack of capacity or simply from a lack of political will.** Past governments have put in place many elements of a modern legal and policy framework to enable a rules-based system of economic governance. However, decisions still tend to be deal based and characterized by political patronage, a lack of transparency, and considerable uncertainty. Consistent misapplication of official policy and legal frameworks has colored the business environment with the perception of corruption. Pledging to crack down on corruption, the new administration launched several high-profile investigations in its first few months in power, but much more will need to be done to increase transparency and accountability across the whole of government.

*Improving macroeconomic fundamentals and governance will need to be complemented by further efforts to improve the enabling environment if Malawi is to spur private sector development.*

## Infrastructure

**The government is eager to attract more private finance into infrastructure projects, but it will need to carry out significant reforms to create bankable investment opportunities.** Malawi needs tremendous amounts of investment to fill its infrastructure gaps. In the 20-year period through 2017, total public investment averaged just over 4 percent of GDP per year. Estimates suggest the country needs that much investment in the energy, water, and sanitation sectors alone. The government simply does not have the ability to finance all these needs, even less so with rising COVID-19 expenditures.

**The private sector could play a larger role in infrastructure projects, through PPPs and other innovative market solutions—but most proposed projects are not yet commercially viable.** Projects often cited as opportunities by the government have failed to attract the private sector's interest. Some projects are too small to attract foreign direct investment (FDI) or too large for domestic firms to deliver. Others are not viable in Malawi's small market, where affordability for the target consumer must be carefully considered. Across the board, underlying issues need to be addressed, including better data collection, better identification of blended finance opportunities and de-risking solutions, and more transparent and competitive public investment management processes.

**Investor protection is a key area for policy makers' attention, both in contract enforcement and insolvency regimes.** Resolving commercial disputes in Malawi takes almost two years because of the poor quality of judicial processes and frequent arbitrary injunctions. In a big step toward reducing risks for investors in the event of a dispute, Malawi ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in early 2021. Transposing the convention into national law will guarantee that awards granted in international arbitration would be enforceable by the country's local courts. This is critical for attracting investors into large, complex projects, such as the Mpatamanga Hydropower Project.

## Finance

**Malawi's domestic MSMEs struggle to grow in part because owners and management often lack awareness of the benefits of financial services, and those that are aware often cannot access finance at reasonable interest rates with sufficiently long tenors.** Limited access to finance and few options for financial intermediation are a constraint in most countries in the region, but especially so in Malawi. An estimated 90 percent of loans are channeled to just a handful of large corporate borrowers. Relying on short-term deposits, Malawi's banks are risk averse, especially when lending to MSMEs. Most banks offer only short tenors—typically no more than 12 months—carrying high-risk premiums and requiring collateral that most MSMEs lack. Credit infrastructure, supported by the revised Credit Reference Bureau Act, is not yet fully used by banks and their clients. Greater uptake could reduce the cost of borrowing by employing more accurate credit risk assessments, especially for MSMEs that typically lack the means to signal their creditworthiness and the channels to provide transparent information about their activities. The Malawi Agricultural and Industry Investment Corporation, a public-private entity, was set up to help facilitate long-term financing, including risk capital and guarantees, but it has also struggled to find well-prepared investment proposals.



## Land

**Gaining access to land and securing uncontested rights to the use of land are also major challenges for private sector development.** Eighty percent of land in Malawi is customary land and has historically been informally managed.<sup>8</sup> The government enacted a package of land reforms in 2016 that marked a significant breakthrough. The Customary Land Act, part of the package, enabled smallholder farmers to convert their customary land rights to private land rights, granting them a registered title and establishing tenure security. But implementation has been slow and challenging. For most smallholder farmers, the perceived risk of losing one's land remains. Land tenure security is desperately needed to encourage investments in climate-smart agricultural technologies and practices that can help farmers become more productive, more profitable, and more resilient to climate-related shocks.

**Addressing inefficient land allocation is also a major opportunity to attract investment.** While most of Malawi's farmers work on small plots, the country also has large tracts of land in mostly private estates. Due to inefficiencies in publicly managing these estates, approximately 70 percent of titles have expired.<sup>9</sup> An estimated 20 percent of all estate land is unused or underused, equivalent to roughly half a million hectares of arable land. The government points to private and leasehold land lying idle for years as a top concern. The new administration has called for a review of the 2016 land laws and their implementation. Fully implementing these reforms in a culturally sensitive, fair, and transparent manner will help improve titling, create certainty in land transactions, and increase investor confidence.

## Skills

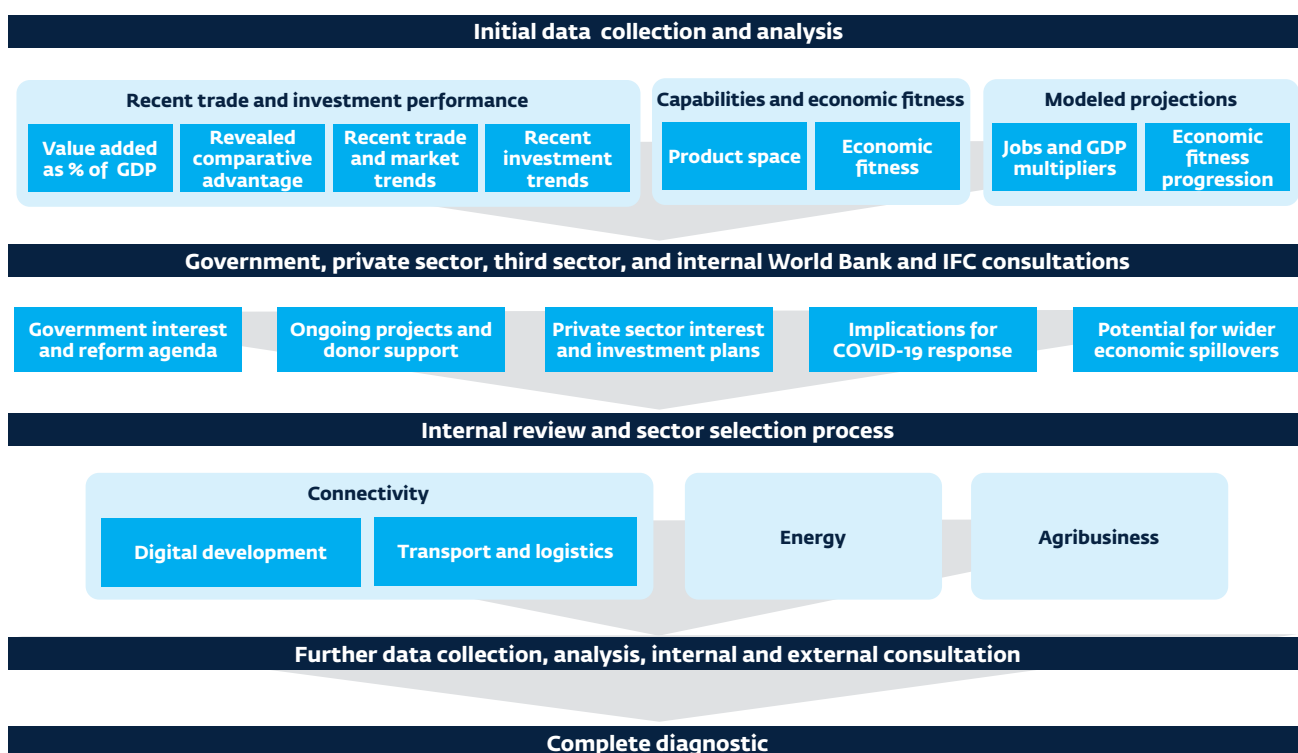
**Malawi would benefit from new approaches to building knowledge and skills among its labor force.** Most of Malawi's medium and large firms focus on low-complexity activities, requiring only modest skills. They rely on low-cost labor to arbitrage the higher costs of doing business in Malawi. Building the knowledge base for more complex industries will take many years, but empowering today's entrepreneurs, farmers, and youth with basic digital skills could provide more near-term opportunities to enhance productivity and create job opportunities in the market. Tackling gender inequalities, especially the extremely high attrition rate for girls in school, will be especially important for creating a larger, more skilled labor force and more inclusive jobs.

**Malawi's labor force may be mostly low skilled, but it is also young and entrepreneurial.** More than 40 percent of Malawi's MSMEs are owned by entrepreneurs under the age of 35. Roughly one-third of these are start-ups, having only been in business for three to five years. Roughly 6 in 10 were started by women. New opportunities are emerging, empowered by wider digital connectivity and the use of Facebook, WhatsApp, and other mobile-based apps. E-commerce is increasingly trusted and growing—despite tremendous challenges—across rural and urban communities and, surprisingly, across age groups, education levels, and genders. Supporting these entrepreneurs, by expanding digital connectivity and increasing digital literacy, could have an outsize impact on the economic empowerment of Malawi's women and youth.

*This Country Private Sector Diagnostic examines opportunities and constraints in four sectors where targeted reforms could increase private investment, contribute to growth, and support job creation.*

Recognizing the potential for Malawi’s private sector landscape to change dramatically in the coming years, this report looks at four sectors where changes are already taking place and progress could be accelerated through further investment and more enabling policies. It begins by looking at the potential role of the private sector in the energy market, turns to broader issues of digital and physical connectivity, and concludes with an assessment of opportunities and constraints in agribusiness. This Country Private Sector Diagnostic (CPSD) does not include an exhaustive deep dive into all sectors of the economy but highlights these areas—energy, connectivity, and agribusiness—which are tightly interconnected and together are crucial for Malawi to meet the challenge of creating jobs and revitalizing economic transformation. Several criteria informed the selection of these sectors, which were further validated through extensive internal and external consultations (figure ES.1). Criteria included analysis of recent performance—including trends in trade, investment, and productivity indicators—and modeling of the country’s current capabilities and economic fitness, including the potential of each sector to act as a jobs and GDP multiplier. Consultations provided additional insight into market dynamics, private sector interests and investment plans, and the potential for near-term action under the new administration. Finally, additional consideration was given to the sectors’ role in the response to COVID-19, in economic recovery, and in laying the foundations for private sector development in the medium term.

**FIGURE ES.1: SECTOR SELECTION PROCESS AND CRITERIA**



Source: World Bank Group.  
 Note: GDP = gross domestic product.

## SECTOR ASSESSMENTS

### Energy

Malawi's energy sector is one of the most important areas where reforms of SOEs could create more viable opportunities for private sector participation. ESCOM and its related institutions should be at the center of the new administration's efforts to improve the performance of SOEs. Prior reform efforts were met with little interest by the leadership within these institutions, and mismanagement and corruption allegations have remained commonplace. The top priority should be to make ESCOM financially sustainable. For this to happen, national electricity tariffs need to be adjusted to become cost reflective. The Malawi Energy Regulatory Authority (MERA) approved a 31.8 percent increase in tariffs in 2018, to be phased in by 2022. This was less than what ESCOM had initially requested but an important step forward. A first increase of 20 percent was carried out, followed by a further increase of 10.6 percent effective March 30, 2021.

**Higher tariffs will increase costs for the private sector in the near term, but the increases are necessary to allow for cost recovery and create commercially viable investment opportunities that will expand access to electricity.** Implementing the National Electrification Strategy and National Energy Policy, following least-cost energy development pathways, are imperative for future economic development. Improving the management and efficiency of the sector's SOEs, and shoring up ESCOM's financial position, are critical first steps. The more cost-reflective tariff will help these utilities meet revenue requirements for operations and maintenance while also helping to attract investment from IPPs. With an estimated funding gap of US\$1.8 billion in generation, transmission and distribution, and off-grid services, there could be strong interest from private firms if ESCOM becomes a more reliable off-taker.<sup>10</sup>

**Ensuring that the Mpatamanga Hydropower Project becomes a reality should also be a top priority of the government.** The project is one of the most ambitious in the entire region and would transform the country's economy. Partially funded by the World Bank, with IFC as codeveloper, the project will obtain remaining funding through government resources, commercial loans, and private equity. A competitive tendering process to determine a strategic sponsor is ongoing. Successful closure of this highly visible deal would send a powerful signal to the market and could catalyze wider investment and PPP opportunities.

**In the more immediate future, connection to the Southern Africa Power Pool (SAPP) through the Zambia-Malawi and Mozambique-Malawi interconnectors will be a major milestone for the development of the sector.** Completing the connections will give Malawi access to a reliable and cost-efficient supply of electricity. The ability to import energy will also allow the government to better manage the sector and mitigate risks, such as a prolonged drought sapping energy from its hydropower stations. Access to the SAPP will also reduce the need for ESCOM to contract costly and polluting diesel generation sets to stabilize power supply and meet gaps in demand. The government will need to continue to strengthen cooperation with Mozambican and Zambian counterparts to ensure that the completion of the projects are not delayed by COVID-19-related complications and that future participation in the SAPP achieves objectives.

**Streamlining the regulatory environment to make it easier for private firms to develop off-grid energy systems and sign PPAs with the government could also generate significant market interest.** Nine million Malawians live more than 5 kilometers (km) away from a national grid connection. Off-grid and minigrid renewable energy systems are a viable alternative to building out transmission and distribution infrastructure, and they are increasingly cost competitive. Solar minigrids are cost competitive with diesel-burning generator systems in all districts. Analysis suggests they could provide basic energy needs to 37 percent of the population, if institutional support and favorable regulatory policies were in place.<sup>11</sup> These systems could eliminate the need for expensive diesel-burning generators while providing additional socioeconomic gains, such as providing cheaper and more reliable power to health clinics and schools. The government can support these investments by better leveraging available international climate financing and exploring innovative solutions to de-risk commercially viable projects, including through blended concessional financing.

### Transport and Logistics

**Investment in transport and logistics infrastructure and services will be essential to reduce the cost of trade and boost the competitiveness of Malawi's private sector.** Trade disruptions at the border and reduced market access during the COVID-19 crisis have been a stark reminder of the need for Malawi to deepen cooperation with neighbors and smooth regional integration. As a small, isolated market, Malawi's economy needs to continue to expand beyond its borders to access new markets and meet its development objectives. Malawi is a member of the Common Market for Eastern and Southern Africa (COMESA) and the Southern Africa Development Community (SADC), as well as a party to the Tripartite Free Trade Area agreement between COMESA, SADC, and the East African Community (EAC)—but the collective implementation of commitments to foster regional integration through these regional economic communities (RECs) has been slow and mostly incomplete. Preferential market access advantages have often been offset by nontariff measures that have restricted market access and plagued transport and logistics services.

**Prior to the pandemic, the cost of exporting goods from Malawi had been falling and had become comparable to regional benchmarks for efficient transport services.** Despite improvements, the cost of importing was nearly double that of exporting, largely due to the imbalance of trade. For costs to be further reduced, a combination of constraints must be addressed:

- **Border delays and fees**—Structural constraints, such as distance to ports and seasonal peaks in trade, are exacerbated by regulatory inefficiencies that lead to unnecessary delays. Malawi has been lagging its peers in the implementation of digital solutions to streamline and automate trade processes and customs clearance. Trade facilitation, including harmonizing regulations and processes with neighbors, is critical for improving efficiency at the border and reducing delays.
- **Lack of backhaul loads**—Because Malawi is a net importer, most trucks deliver goods without necessarily finding a load of freight to carry on their return—known as empty backhauls. Since truckers cannot make money on their return, importers tend to have to pay a premium. Within the country, low volumes of trade between rural locations and market centers have a similar effect. This is further compounded by the poor condition of feeder roads in rural areas, which causes frequent damage

to vehicles and results in higher charges to cover the cost of vehicle repair and maintenance. Increasingly affordable and mainstream technologies are powering a new wave of digital logistics solutions, platforms, and optimization services to overcome these challenges.

- **High fuel costs**—Fuel prices account for up to 50 percent of operating costs for transport firms.<sup>12</sup> Multiple levies and surcharges are imposed on the price of fuel by government agencies to fund various programs, but these have not been managed in a fully transparent manner. More analysis is needed on the potential trade-offs of reform, but a rationalization of the levies and duties on fuel could help reduce transport costs.
- **Inadequate infrastructure investment**—An underdeveloped, and often damaged, road network is another cause for high transport costs. Inaccessibility and unpredictable delays force transporters to build this extra time into their prices. Beyond the need for investment in expansion and in all-season roads, much of the problem is due to a lack of proper and periodic road maintenance. Like elsewhere in the region, oversight of road construction projects is weak, and the road construction industry is well known for collusive rent-sharing relationships. Modernizing contracting and procurement practices could revolutionize the system by increasing transparency, bringing down costs, and helping reduce fiscal constraints.

**The revitalization and modernization of the Nacala Corridor will significantly reduce trade and transport costs.** Several projects along the corridor are now coming online, most notably the multibillion-dollar investment by the Brazilian mining company Vale in rehabilitating and expanding the rail network connecting its mine in the west of Mozambique to the port city of Nacala, cutting across southern Malawi in the process. Rail usage had started to increase prior to the pandemic. If rail services become more reliable and operations more efficient, including at the port, the Nacala Corridor could become much more competitive with Malawi's other routes to market. Shifting from a reliance on road transport to more use of rail could be a cheaper, more efficient means of transport for Malawi's top exports—tobacco, tea, and sugar—as well as its major bulk imports of fertilizer, fuel, containerized consumer goods, and food products. The government should continue to work with development partners to support the rail concessionaire in Malawi, Central East African Railways Ltd. (CEAR), to enhance the efficiency of services across the network.

**Improvements in transport and logistics will also be driven by the implementation of commitments under the World Trade Organization (WTO) Trade Facilitation Agreement (TFA) and, in time, the African Continental Free Trade Agreement (AfCFTA).** Malawi ratified the AfCFTA in January 2021, but just how quickly continentwide negotiations lead to actual implementation of reforms is highly uncertain, especially while countries continue to battle the pandemic. Progress on the WTO TFA, on the other hand, will likely be more tangible in the coming years. The government ratified the WTO TFA in 2017 and has since requested assistance from the international community to meet its obligations and align with international best practices. Specific requests for assistance have been made to improve processes and procedures for advance rulings, authorized operator programs, and corridor management systems that will make it easier for private firms to trade. Progress has already been made to fully operationalize the ASYCUDA World computerized system for administering customs processes. The planned development of a national single window for trade would be a major step forward. The single window will integrate e-payments, preclearance of cargo, and other procedures. Meanwhile, investments in the physical infrastructure for one-stop border posts will also help reduce standing times and the associated costs of delays.



These developments should spur further regional integration, reducing the costs of imports while creating wider market opportunities for export-led growth. This effort will likely help consumers and export-oriented industries using imported inputs, but it will create challenges for firms focused on the domestic market that may have previously benefited from less competition. Addressing these trade-offs will require cooperating with regional peers to ensure a level playing field and sensible trade policy. Hopes are high that the AfCFTA can succeed where other RECs have not, becoming a much stronger driver of regional integration.

## Digital Development

COVID-19 has highlighted the importance of digital connectivity, which has enabled the government to deliver critical public services, such as emergency social safety net cash transfers and important health alerts, to its citizens. The question now is this: How can the government build on the crisis response to further drive digital development and increase digital connectivity to markets? Plugging into the digital economy has the potential to dramatically reduce some of Malawi's inherent disadvantages as a landlocked country. But Malawi's internet use and mobile penetration are among the lowest in Africa. Despite 88 percent of the population living in areas covered by mobile broadband networks, only 41 percent of the population has a mobile phone, and less than one-fifth of Malawians use mobile internet services. Moreover, there is a 19 percent mobile ownership gender gap in Malawi.<sup>13</sup> Given that women have been disproportionately affected by the pandemic<sup>14</sup>, actions to expand digital inclusion could help women access online markets, jobs, and educational opportunities during this crisis. These opportunities would put them in a better position to overcome the economic impacts of the pandemic, while at the same time creating economic opportunities as the country eventually moves toward recovery and growth.

Part of the reason more Malawians are not using digital services is that mobile data service is simply too expensive for the average citizen. In a positive sign of public-private cooperation, the Malawi Communications Regulatory Authority (MACRA) announced an agreement with Uganda's two mobile network operators (MNOs) to reduce the cost of internet data bundles by as much as 30 percent, effective April 2021. Prior to this, the cost per gigabyte of a basic package of mobile broadband data ranks in the top 10 most expensive in the world, equivalent to 22.8 percent of the average Malawian's gross monthly income.<sup>15</sup> The international benchmark is less than 2 percent.<sup>16</sup> Policy makers have decried a lack of competition in the mobile market and nontransparent pricing by the MNOs as reasons for the lack of affordability, but high costs are also due to the tax regime. There is a 17.5 percent value added tax (VAT) on mobile phones and services, 16.5 percent on internet services including mobile data, and a 10 percent excise duty on short message service (SMS) and mobile data services, plus regulatory fees and Universal Service Fund levies.<sup>17</sup> Creating affordable access to the internet has helped telecommunications (telecom) markets boom in countries like Kenya, where more than 85 percent of the population now uses at least 3G broadband services. Reviewing Malawi's policy framework for the sector, including the tax regime and foundations to promote competition, is essential to finding ways to continue to lower costs and to encourage higher usage of digital technologies by firms and consumers.

**More innovation in digital services and investment in digital infrastructure are needed to lower costs for consumers and grow the market.** The de facto duopoly in Malawi's mobile market has persisted for the past 15 years, despite the award of several additional licenses. In the fixed broadband market, a spin-off of the incumbent owns the most extensive and, in many areas the only, fixed network infrastructure. The incumbent and its spin-off had also held a monopoly on international connectivity to the East Africa Submarine System (EASSy) until recent regulatory reforms allowed for the market entry of new players, including ESCOM. ESCOM's investment in a national fiber backbone could play a major role in expanding internet access, improving service delivery, and developing Malawi's digital economy. Strengthening frameworks for infrastructure sharing and interconnection across the sector could facilitate the entry of new service providers to inject competition into the market.

**Malawi's underserved market presents a huge opportunity to expand digital financial services, particularly as mobile money services have become more popular during the COVID-19 crisis.** Malawi has been heavily reliant on cash for financial transactions, with a relatively slow take-up of mobile money and digital financial services. This can be partly explained by a lack of interoperability between service providers. The government has made progress in connecting banking and financial institutions and its two MNOs to the shared National Switch facility. But not all lenders have been connected to the network, including important intermediaries for MSMEs, such as microfinance institutions and financial cooperatives. If government reforms and new policy frameworks can help bring down the cost of owning a mobile phone and using mobile data, the market could quickly follow in the footsteps of other leaders in mobile money, like Kenya.

### **Agribusiness**

**Strong growth in agribusiness will be needed to facilitate the economic recovery from the COVID-19 crisis.** Malawi has done well to become a major producer and exporter of high-demand commodities like tobacco, tea, and sugar. But these successes belie the tremendous poverty and vulnerability among farming households. Decades of interventions to boost productivity and diversification through government programs targeting smallholder farmers have largely failed to improve food security or create a more resilient, commercial agribusiness sector. Production remains reliant on rainfall, with concerns over basic food security keeping most farmers from diversifying away from maize production.

**With the pandemic expected to reduce international investment flows, Malawi will need its incumbent lead firms to drive investment.** Many have already been investing in diversification of tree crops, legumes, and groundnuts and the development of improved seed varieties. The most active in doing so are the tobacco firms—and, to a lesser extent, the tea and sugar companies. These firms are already demonstrating returns on investment in diversified crops, climate-smart agricultural practices, and new technologies. As large buyers and leaders in contract farming, they have tens of thousands of farmers in their supplier networks and the market power to drive behavior change throughout their supply chains. The government will need to support and help scale these initiatives by amplifying demonstration effects while also strengthening legal frameworks for contract farming that protect both buyer and seller.

**The government can also help facilitate improved productivity and diversification by more effectively channeling public resources into the sector.** The central pillar of agricultural development in Malawi had long been the Farm Input Subsidy Program (FISP), which, in its early years, helped increase productivity but later failed to substantially improve food security or drive diversification and commercialization. The new administration cancelled the FISP, creating a similar but much larger Affordable Input Program (AIP) to take its place. While the FISP had supported 900,000 smallholder farmers with coupons to subsidize the cost of fertilizer and various seeds, the AIP will scale up to cover 3.7 million smallholder farmers. The objectives remain the same: to increase farmer productivity, thereby improving food security and creating marketable surplus.

**The rollout of the AIP and beneficial weather conditions have helped produce bumper harvests, but the longer-term effectiveness and financial implications of the AIP will need to be closely monitored.** The budget allocation for the AIP is four times that of the FISP in its final year, absorbing nearly half of the overall agricultural budget. This crowds out productive investments in the sector that could promote commercialization and more sustainable farming practices. By widening incentives for maize production, the AIP also departs from years of effort to promote intercropping and diversification into other, more lucrative commercial crops, such as legumes. Reliance on a single crop weakens resilience to production and price shocks—unfortunately all-too-common occurrences for Malawi’s farmers.

**The government could also reduce fiscal burdens and reduce distortions in agricultural markets by following through on outstanding reforms to ADMARC.** As is, ADMARC acts as both a major purchaser and seller of agricultural goods and services, often making it the largest customer of most farmers and private sector input suppliers. To remove conflicts of interest and increase efficiency, the previous government had announced it would split the parastatal’s functions into ADMARC Social and ADMARC Commercial. The new government has also pledged to improve the performance of ADMARC and would like to see the institution strengthen its role in the market. What this may mean for plans to unbundle ADMARC’s functions or how it plans to continue to operate in the market is unclear. ADMARC’s programs and interventions—and those of the government’s other institutions active in the market, such as the National Food Reserve Agency—should follow transparent rules that strengthen the market position of Malawian farmers, not weaken it.

**Predictable and transparent trade policies for agricultural products would also help encourage investment in commercial agribusiness and export-oriented business models.** The updated Control of Goods Act (COGA) was operationalized in July 2020 to add clarity to trade regulations. The COGA requires that certain thresholds be met to legally justify any import or export controls and for the government to carry out data-driven reviews prior to implementing, changing, or removing any such measures. The COGA was eagerly welcomed by the private sector, in part because it would require a review of the maize export ban that had been in place since 2017, despite evidence the ban was ineffective in supporting food security or farmers’ livelihoods.<sup>18</sup> The review resulted in the ban’s being lifted in March 2021. However, the government stopped issuing export licenses just one month later, reintroducing uncertainty in the market and calling into question whether the COGA was being implemented in the spirit of the law. Such uncertainty in the past had been a major deterrent to investment in agricultural production and exports. Dialogue with the private sector is a requirement under the revised act and, if carried out in good faith, should provide more transparency and reduce uncertainty when such decisions are made.

## Recommendations

**Malawi is facing formidable challenges: one of the poorest countries in the world, tasked with combating the COVID-19 pandemic while fortifying the foundations for inclusive, sustainable development.** The country has thus far avoided major loss of life during the pandemic, and the situation was improving across the country at the time of writing. The government will need to act decisively and efficiently to mitigate the adverse effects of the pandemic on health, human capital, and the economy. Health and safety precautions, coordination with regional neighbors in critical areas such as trade and trade facilitation, and support for businesses and workers must continue to meet the challenge.

**The campaign against corruption and moves to improve governance and accountability should help strengthen the necessary pillars for a postpandemic recovery.** In this CPSD, we identify promising opportunities to build on these foundations and take action in areas that can attract more private investment to realize growth and fulfill the commitment to create 1 million new jobs. Some of the country's most pressing challenges, especially macrofiscal discipline and transparency, will require efforts to instill confidence among investors. The government will need to continue creating a more predictable policy environment, fostering greater regional cooperation and market integration, and finding innovative solutions to fill infrastructure gaps and support market development. More consistent and productive public-private dialogue will be needed to foster collaboration among government, the private sector, and development partners.

**In this CPSD, we seek to support the government's development objectives and World Bank Group engagement in Malawi by providing an updated synthesis of private sector investment and growth opportunities along with recommended actions to help seize these opportunities.** Naturally, these are only a subset of opportunities and needed actions, with an eye toward the interests of the private sector, that the government can consider as it charts a course for economic recovery. The full report elaborates on the analytical underpinnings for these recommendations and provides details on additional, complementary actions to facilitate the jobs and economic transformation agenda. Progress in any one of these areas is likely to have significant spillover effects, particularly when considering the interrelated systems of the sectors featured in this diagnostic. Some reforms and their sequencing may also entail trade-offs, which would need to be carefully explored and quantified with further analysis, especially in light of the current pandemic crisis. Table ES.1 summarizes 10 priority areas where policy makers can take action to support private sector growth and investment and create space for the private sector to play a greater role in meeting Malawi's development challenges.

**TABLE ES.1 PRIORITY RECOMMENDATIONS TO SUPPORT PRIVATE SECTOR DEVELOPMENT**

### Strengthen macrofiscal fundamentals and foundations for growth.

- Strengthen public financial and investment management through more realistic budget planning, stronger prioritization, and stricter fiscal discipline, in part to limit the need for domestic borrowing, avoid incurring arrears, reduce interest rates, and maintain available credit for the private sector.
- Transpose into national law the newly ratified New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to increase private sector confidence in investment dispute resolution in Malawi.
- Promote the use of collateral registry systems and the National Switch among financial institutions to facilitate longer-term and more affordable financing to private sector borrowers.



### Increase access to reliable power.

- Improve the management and performance of ESCOM and continue the phased increase in the national electricity tariffs to allow cost recovery, which will help the national utility become financially sustainable and thus a more reliable contractual partner with current and potential IPPs.
- Ensure adequate resource allocation to support the development and implementation of energy projects—most notably the Mpatamanga Hydropower Project—and the approval, tendering, contracting, construction, and completion of new solar and wind IPP projects.



### Improve access to markets.

- Leverage engagement in the Nacala Corridor Development Trilateral Committee and African Continental Free Trade Agreement negotiations to eliminate nontariff barriers to trade, harmonizing rules and regulations that will reduce the time and cost of trade for Malawi's traders.
- Reduce the cost of mobile phone ownership and mobile broadband data services by rationalizing trade, tax, and levy policies, and promote infrastructure sharing to encourage wider mobile penetration and broadband access to low-income and rural residents.



### Promote commercial agriculture.

- Create standard operating procedures for conducting reviews of trade restrictive measures under the COGA, including quarterly updates of the Food Balance Sheet and wider public-private consultations to mitigate the risk of new market distortions.
- Approve and gazette backlogged legislation—the Seed Bill and National Fertilizer Bill—and provide operational guidelines to support timely implementation.
- Improve resource allocation for productive investments in the agriculture sector, including by reviewing and adjusting the Affordable Inputs Program to improve the efficiency of distribution, target farmers most likely to benefit from the subsidy, and ensure fiscal sustainability.

Note: COGA = Control of Goods Act; ESCOM = Electricity Supply Corporation of Malawi; IPP = independent power producer.



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