

Malawi Economic Monitor

JUNE 2021

Investing in Digital Transformation



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MALAWI ECONOMIC MONITOR

June 2021

Investing in Digital Transformation

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The World Bank team welcomes feedback on the structure and content of the Malawi Economic Monitor. Please send comments to Patrick Hettinger (phtettinger@worldbank.org) or Yalenga Nyirenda (ynyirenda@worldbank.org).

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OVERVIEW

The impact of COVID-19 is slowing growth, offsetting a strong harvest

Malawi was affected by a severe second wave of COVID-19 cases starting in the last weeks of 2020. As a result, the Government declared a second 'State of National Disaster' and announced increased social distancing measures. Case numbers peaked in January and gradually subsided through April, when restrictions were relaxed. Malawi received its first consignment of vaccination doses from COVAX in March, but uptake has been low, with around 400,000 doses administered to about 2 percent of the population as of mid-June.

Growth in 2020 was strongly affected by the pandemic, falling to an estimated 0.8 percent, down from pre-pandemic projections of 4.8 percent. The pandemic's impact on the services and industry sectors was partially offset by a strong agricultural harvest. Services and industry slumped amid the ongoing disruptions caused by the pandemic to global value chains and trade and logistics, decreases in tourism and remittances, and dampened demand due to social distancing measures. The accommodation and food services subsectors were the most affected, while information and communication services, and utilities performed well.

Agricultural production estimates for 2021 are strong, but the pandemic will still weigh on economic activity. Maize production is expected to increase to 4.5 million tons, a 17 percent increase over 2020's bumper harvest. Business sentiment is showing some improvement in early 2021 but is still below pre-pandemic levels. Some 46 percent of firms surveyed in February 2021 by the Malawi Confederation of Chambers of Commerce and Industry (MCCCI) expect a positive performance for the year. This is an improvement from 31 percent in 2020 but remains short of pre-pandemic levels.

Exports and remittances dropped sharply in 2020. Tobacco faced an annual revenue drop of 21 percent y-o-y in 2020, while tea and sugar also saw a decline in production. Imports declined in 2020 due to lockdown measures in South Africa, increased border restrictions, and lower demand. Remittances also fell by 20 percent. The current account deficit is estimated to have widened to 12.0 percent of GDP in 2020. Remittances have stabilized from November and in the first months of 2021.

Inflation decelerated through much of 2020 but has started picking up since December. The annual y-o-y headline inflation rate decelerated to 7.1 percent in October before gradually picking up to 8.9 percent in May 2021. Food inflation decelerated until January but picked up in recent months due to base effects despite maize prices remaining low. Non-food inflation started picking up in December 2020 following increases in fuel prices, as well as the gradual 8.7 percent depreciation of the kwacha since July 2020.

Fiscal pressures from the pandemic and expenditure on the AIP are expected to contribute to a fiscal deficit of 8.7 percent of GDP for FY2021. Revenue is expected to perform slightly below targets due to underperformance in parastatal dividends and departmental receipts. Personal income taxes underperformed following the more-than-doubling of the zero tax threshold, but are projected to be more than offset by strong corporate tax performance. The Government is projecting expenditure to meet the increased revised target of 24.6 percent of GDP, which would be the highest level in recent years, elevated by high levels of expenditure on wages, interest payments, and fertilizer subsidies. Development spending has also been strong, driven by disbursement of project grants and loans to finance COVID-19 response programs, and irrigation and water projects. The deficit was largely financed by domestic borrowing, at 5.9 percent of GDP.

The FY2022 deficit is budgeted to expand from 8.7 to 9.4 percent of GDP and there are risks that it could go even higher. Tax revenues are optimistically budgeted to pick up significantly from 11.9 to 13.6 percent of GDP, which would represent the highest intake in recent years as a share of GDP. If unrealized, this could lead to an even larger deficit or the further accumulation of arrears. Expenditure,

already at high levels, is increasing further, driven by a surge in domestically-financed development spending and a modest increase in an already high level of recurrent expenditure. The second year of the universal inputs subsidy program, the Affordable Inputs Program (AIP), will weigh heavily on the budget at 7 percent of total expenditures. Risks of the program over-spending are substantial if imported fertilizer costs increase due to market pressures or currency depreciation.

Rising domestic debt previously pushed Malawi into high overall risk of debt distress and is budgeted to continue rising sharply, which will increasingly reduce fiscal space. The Government continues to finance fiscal deficits through domestic borrowing, reaching 5.9 percent of GDP and a budgeted 7.8 percent in FY2021 and FY2022, respectively. As such, domestic debt could exceed 30 percent of GDP by the end of FY2021. The external debt-to-GDP ratio may also increase from its current level of 21 percent due to financing needs for COVID-19 response, as well as depreciation of the exchange rate. Additional off-budget domestic borrowing of 13 percent of GDP is planned for the medium term, which will call for rigorous cost-benefit analysis of projects to assess if they justify high borrowing costs over 20 percent. In addition, the Government is expected to clear arrears amounting to 3 percent of GDP.

Macroeconomic imbalances will hamper growth in the medium term

Malawi's economic growth is projected to pick up to 2.8 percent in 2021. Favorable weather and the AIP have led to a one-time jump in the maize harvest. Combined with a modest increase in tobacco production, this should result in strong agricultural production for the year. However, sluggish vaccine availability and uptake will continue to necessitate social distancing policies and perpetuate risks of new waves of infection, which will weigh on growth in the services and industry sectors.

Looking toward 2022 and beyond, continued universal fertilizer subsidies are unlikely to lead to another boost to maize production, and they will not help diversify growth. Instead, the risks of the AIP will heighten with time, as it depletes fiscal space and diverts resources from badly-needed investment in economic diversification. As maize production is still vulnerable to weather shocks, the risks of losing the considerable expenditure on AIP with a drought will increase by the year. This combines with the main export of tobacco projected to decline in the medium term. While mining could support growth, development of the sector should be informed by realistic expectations in terms of job creation, and resources would need to be carefully managed. Yet mobile money has expanded with the pandemic and supporting the expansion of ICT services could provide a new avenue for diversification, as well as an efficient channel for the delivery of safety nets.

Sustained economic recovery is also at risk from macroeconomic imbalances and continued Government expenditure toward consumption at the expense of much-needed investment. Increasing domestic debt levels raise interest rates, reducing fiscal space for investment and increasing the costs for private sector investment. After several years of 'super-stability,' while the depreciating exchange rate should gradually help to reduce a significant trade imbalance and increase export competitiveness, it will also increase imported inflation and external borrowing levels.

The fiscal deficit may remain elevated in the medium term, which will further increase the domestic debt burden. Revenues are being affected by the pandemic's impact on growth as well as personal income tax reductions. Grants from bilateral partners may also be affected as countries refocus their resources to support their own economies. Meanwhile, pressures to continue spending for pandemic response are expected to continue. With continued domestic borrowing combined with exchange rate depreciation increasing external debt in local currency terms, public debt and interest expenses are likely to increase.

The current account deficit will remain elevated into the medium term. Lifting the maize export ban is an encouraging step that will support exports in 2021; a sustainable increase in exports will

require a consistent, transparent and predictable increase in trade openness which can help increase investment in the medium term. On the other hand, the implementation of the recently-gazetted export mandate regulations for a number of agricultural commodities could increase the cost and administrative burden of exporting, thereby potentially increasing informal exports. Nonetheless, tobacco and cash crop production should support exports in 2021, though increasing international oil prices may increase the fuel import bill. Exchange rate depreciation should help improve the trade balance in the medium term. Remittances are likely to increase as the global economy gradually recovers.

Bold reforms are needed to increase and diversify growth while reducing domestic borrowing

The new Government is at a critical juncture. It needs to increase growth to 5 percent and above to increase incomes and employment, as well as to reduce an increasing domestic debt burden. Strengthening growth and resilience also requires diversifying the economy away from rain-fed maize and tobacco production. Yet it must also rein in fiscal expenditure to avoid further increasing domestic debt and crowding out private investment. It will have to balance this with continued efforts to contain the COVID-19 pandemic, expanding vaccination, and building resilience against future shocks. Addressing these issues calls for actions in four key areas:

1) Continuing with COVID-19 containment is critical to reduce vulnerability to future waves:

Malawi should continue with current efforts to contain the COVID-19 pandemic in order to reduce vulnerability to future waves. This would include expanding testing, strengthening contact tracing, containing outbreaks among high-risk populations, ensuring access to essential care for COVID-19 such as medical oxygen, and maintaining other pandemic control measures such as universal face mask mandates. The Government should also accelerate deployment of the COVID-19 vaccine, with attention to generating demand, addressing hesitancy, and maintaining equity in access.

2) To create a foundation for macro stability and growth, the Government needs to reduce high fiscal deficits and domestic debt:

Lower deficits will reduce domestic financing needs and create a foundation for growth and stability. Malawi needs a sustainable fiscal policy so that it can reduce debt service costs. Fiscal consolidation in the medium term will be needed. Recurrent expenditure should be paid for as much as possible by domestic revenues instead of domestic borrowing. This will require prioritizing expenditure in a sustainable medium-term fiscal framework, based on realistic revenue and grant assumptions. Malawi has critical spending needs across a range of sectors, and this will require focusing expenditure where it can achieve the most impact. The Government needs to make hard choices about expenditure priorities, including ensuring that subsidies for agricultural production are sustainable and containing an increasing wage bill. Domestically-financed development expenditure—including that funded off-budget—should undergo a rigorous cost-benefit analysis to ensure it is justified by high borrowing costs. Strengthening revenue mobilization should be balanced with promoting the business environment to enable growth.

Reducing the fiscal risks posed by state-owned enterprises (SOEs) and a pipeline of Public-Private Partnerships (PPPs) is critical for fiscal sustainability and to strengthen service delivery. Weak oversight of SOEs and PPPs increases their fiscal risk while also reducing their effectiveness and service delivery. The Government should strengthen efforts to enhance compliance with timely SOE financial reporting and audits to improve information flow and risk management. Analyzing aggregate

and parastatal-level fiscal risks, and scrutinizing the fiscal risks of PPPs will also be key. It should also promote the competitive selection of SOE management and hold them accountable for results.

Strengthening Public Finance Management (PFM) systems will help use limited public resources more efficiently. This calls for stronger budget credibility, combined with implementing commitment controls to avoid arrears. Rolling out the Integrated Financial Management Information System (IFMIS) to all Ministries, Departments and Agencies (MDAs) prior to full quality checks on its functionality may increase PFM risks and would need to be carefully managed to ensure a return on the Government's investment in the system and to maintain the integrity of public resources. The Government continuing a phased rollout with quality assurance and stabilization of the system would help ensure that critical issues and lessons from the first phase of implementation are addressed, which will be key to the success of second phase. In addition, transparent and competitive procurement can strengthen value for money of limited fiscal resources. Independent audits of public resources help identify weaknesses in PFM systems and should continue, and the Government should ensure adequate follow-up on addressing identified gaps.

3) The Government should focus on diversification and growth in order to increase incomes and revenues:

Promoting diversification and commercialization in the agriculture sector is the first pillar of Malawi 2063 (MW2063) and will be key to increasing incomes and strengthening resilience. Malawi needs to rebalance spending in the agriculture sector away from fiscally unsustainable maize input subsidies and toward investment to promote diversification and growth. This includes supporting more sustainable farming practices and irrigation. Subsidy programs need to be affordable, more cost-efficient, and should reduce fiscal risks. In addition, commercializing agriculture requires predictable and transparent trade policies. As such, a sound implementation and monitoring framework of trade measures under the Control of Goods Act would help safeguard food security and balance this with increasing export potential, as well as development of various value chains. As part of this, the rules for the implementation of export mandate regulations should be assessed in consultation with the private sector to avoid creating additional market distortions. A reliable, transparent trade policy would, in turn, stimulate investment and commercialization, which could increase production, food security, and exports in the medium term. The Agricultural Development and Marketing Corporation's (ADMARC's) market interventions also need to be transparent, timely, and predictable.

Policies to increase diversification outside of agriculture, including through digital transformation, will be critical to enhance productivity and job creation. Expanding reliable access to electricity will be critical to increase value addition and support economic diversification. This calls for continued progress on energy investment projects and stronger governance at key sector utilities. In addition, the Government should review and revise tax policies and administration and business regulations in order to increase transparency, reduce ad hoc changes, and to support value addition. Moreover, the Government can harness growth in the mobile and Information Communication Technology (ICT) sectors by reviewing the tax regime, levies, and tariffs to enable greater customer access; and fostering competition in the broadband infrastructure development market. Finally, reducing Government domestic borrowing will ease pressures on interest rates, enabling broader access to finance for Small and Medium-Sized Enterprises (SMEs). It may also need to extend the ongoing moratorium on repayment of loans on a case-by-case basis.

4) There is a need to invest in mechanisms to increase resilience to shocks:

Poverty reduction measures have historically been focused on fertilizer subsidies and maize distribution following shocks, but targeted social protection systems are a more efficient use of limited public resources. Investing in shock-responsive social protection systems can help prepare for future crises. This calls for consolidating Malawi's social protection systems through tweaking

existing cash transfer, public works, livelihoods support, and economic inclusion programs to have a comprehensive resilience building platform for the poorest populations. This also entails strengthening inter-operability of Malawi's electronic identification cards and the Universal Beneficiary Registry, improving delivery systems and digital payments, so that such programs can reach the vulnerable more quickly, efficiently, and transparently. Additionally, to increase resilience and reduce fiscal risks, it is essential to implement policies related to environment management, climate change, and disaster risk management (DRM), and to strengthen climate and information services.

INVESTING IN DIGITAL TRANSFORMATION

Malawi's growth trajectory has lagged the region for decades. Despite a modest shift from farm to non-farm rural livelihoods, economic transformation, through diversification, commercialization and urbanization has not kept up with rapid population growth. Meanwhile recent shocks – including the COVID-19 pandemic – continue to be major obstacles to growth and poverty reduction.

Strengthening the digital economy will enable Malawi to diversify and also achieve its development objectives. Given the importance of the digital economy to increasing productivity and efficiency, its potential benefits are amplified in the context of the COVID-19 crisis. Malawi can leverage digital technologies to ensure that public services, businesses, and individuals are able to withstand social distancing, ensure business continuity, and prevent service interruptions. Widespread access to broadband and ICT services can offer a powerful platform to remove barriers of distance, lower cost in the delivery of public services, and improve human development thereby contributing to economic growth and reduced poverty.

The Government of Malawi has set ambitious development objectives that identify the digital economy as a central pillar for reducing poverty and accelerating growth. Malawi launched the National ICT Master Plan in 2014 to operationalize the 2013 National ICT Policy. In 2019, it adopted a national broadband strategy and a cyber security strategy. However, despite adopting ICT-related national policies, plans, and strategies, Malawi has not yet built a robust digital economy ecosystem.

Most recently, the Government rolled out a five-year Digital Economy Strategy which sets new targets for different aspects of the digital economy. As outlined in the Digital Economy Strategy 2021-2026, the Government aims to create a strong digital ecosystem that can enable critical sectors, such as agriculture, and health to function more efficiently, while supporting a growing ICT sector that provides goods and services which spur economic growth and create employment opportunities. The strategy is also a critical step toward achieving Malawi's revised long-term development plan – Malawi 2063.

To achieve the objectives in the Digital Economy Strategy 2021-2026, the Government must develop a robust digital ecosystem. Under the Digital Economy for Africa (DE4A) initiative, the Government has partnered with the World Bank to conduct an assessment of Malawi's digital economy. DE4A leverages an integrated and foundations-based diagnostic framework to examine the present level of digital economy development across Africa based on five (5) core foundations of the digital economy: Digital Infrastructure; Digital Platforms and Services; Digital Financial Services and payment systems; Digital Skills; and Digital Entrepreneurship.¹ Recommendations developed based on the findings of the Malawi DE4A Diagnostic aim to help the Government of Malawi create an enabling environment that supports an inclusive digital economy.

Malawi's digital infrastructure is relatively well developed, although often inaccessible to many. Malawi has made progress in expanding digital infrastructure coverage: 30.8 percent of the population

¹ Additional information on the Digital Economy for Africa Initiative is available at <https://www.worldbank.org/en/programs/all-africa-digital-transformation>.

lives within 10kms and nearly all of the population lives within 50km of fiber nodes; 88 percent of people have access to either 3G or 4G signals. The potential economic impact of Malawi's continued digital infrastructure development is considerable. Studies estimate that an additional 10 percent increase in mobile broadband penetration in Malawi could lead to US\$ 189 million in additional GDP and US\$ 33 million in additional tax revenues per year. Yet low levels of electrification, high Internet prices, high cost of smart devices, and lack of digital skills have prevented Malawi from realizing the full potential of its digital infrastructure. Connectivity remains unpredictable and expensive for many, contributing to persistent gender and rural-urban divides in the access to and use of digital technology.

The Government of Malawi has laid the essential foundation for public digital platforms. The 'whole of government' digital transformation strategy is geared toward strengthening the Government's ability to deliver public services through institutional strengthening, capacity building and leveraging integrated public digital systems and platforms. Despite infrastructure challenges, the Government has made many innovative breakthroughs in its platforms – most notably in the issuance of electronic identification (ID) cards. In partnership with development partners, Malawi launched a nationwide smart biometric identity for its citizens - the National Registration and Identification System (NRIS). With over 9.1 million adult citizens possessing new biometric identification cards, Malawi is ready to leverage the NRIS infrastructure to accelerate financial inclusion.

Digital financial services are slowly expanding in the Malawi financial sector. Banks offer a wide range of banking products and services, and technological developments are pushing them toward strategic partnerships with mobile network operators. Two mobile network operators (MNOs) – TNM and Airtel – have successfully reached remote unbanked parts of the country, facilitating domestic and cross-border transfers through mobile money wallets. However, despite technological advances, and a recent uptake in mobile money accounts, cash remains the predominant payment method. Greater enforcement of telecommunications and financial sector regulations is needed to promote competition, protect consumer benefits, and stimulate market demand.

Although the Government committed to integrating ICTs in the education systems at all levels and developing a large pool of skilled ICT personnel, Malawi's supply of digital skills is low. In 2020, Malawi was ranked 127 out of 134 countries by the Portulans Institute's Network Readiness Index. Notably, Malawi was ranked 125 under the index's "people pillar," which measures the usage and skills of digital technologies by individuals, businesses and governments in the digital economy. Employers in the private sector struggle with a small pool of youth who have the requisite basic digital skills for their business needs, and report having to retrain them in both digital skills and soft skills. New digital skills programs—led by NGOs, private sector companies, and development partners—seek to address this need, with many targeting the most underserved and marginalized communities in Malawi. However, the country still has a long way to go in building a digital-savvy workforce that will allow it to effectively utilize digital technology and the digital economy to drive economic growth, job creation, and competitiveness.

As a result of the insufficient supply of digitally skilled labor, many individuals and businesses are unable to leverage digital public platforms and digital financial services or launch digital startups. Traditional firms tend to use only the most basic digital technologies. For digital businesses, especially startups, access to finance at ideation, seed, and growth stages is very limited and commercial banks are not viable sources of early-stage financing. Malawian startups could also benefit from linkages to more developed regional ecosystems, such as Kenya and South Africa, which host a number of business support structures and early-stage financiers. Supporting Fintech startups through a specialized regulatory 'Sandbox', along with financial support, can facilitate development of local solutions for payments, transfers, and access to e-credit. Additionally, to capitalize on the active community of young entrepreneurs who are innovating Malawi's nascent digital entrepreneurship ecosystem, the Government must address the underlying constraints in ICT and financial access and affordability for youth, women, and rural communities.

Malawi has an opportunity to kickstart digital transformation by enabling the growth of a robust digital economy ecosystem. The Government can adopt actions under three themes: (1) Improving the enabling environment for the digital economy; (2) Driving digital transformation and demand through the public sector; and (3) Strengthening competencies for digital skills and entrepreneurship. Given the fiscal constraints, leveraging private sector investment will be critical to successful implementation.

First, the Government should adopt forward-looking policies and practices that improve the enabling environment for the digital economy. The Government should define a comprehensive, industry-wide approach toward the deployment of digital infrastructure upgrades. The intensive development of national fiber infrastructure by competing operators has led to an overbuilding of shareable infrastructure. Coordination can possibly include 'dig once' mandates and 'rights of way' streamlining processes to avoid duplication and ease prices. In relation to this, the Government should leverage digital infrastructure investments to roll out digital financial services in underserved areas. This would include efforts to develop key power, broadband, and financial infrastructure that provide the foundation for expanding financial services to the rural population. Finally, the Government should also restructure distortionary sector-specific taxation for ICT services. High ICT sector-specific taxes slow urgent investment into digital infrastructure and services and increase the cost to businesses and consumers. The net effect is to lower affordability of both devices and services, leading to lower consumption.

Second, there is an opportunity to drive digital transformation and demand through new public-private partnerships. A coordinated public-private innovation venture fund can provide a vehicle to mobilize private investment for new digital startups and provide equity capital for established digital firms. The Innov Invest Fund in Morocco provides a potential model to adopt. With the emergence of innovation hubs in Lilongwe and Blantyre, the government can develop links with regional and global incubators and accelerators. In addition, the Government can scale-up existing operations that promote use of digital technologies, such as those supported through the World Bank's *Digital Malawi Project*, with an emphasis on increasing ICT and digital device access and affordability for women and people in rural areas.

Finally, the Government should strengthen competencies for digital skills and entrepreneurship. It is essential that the Government improve the quality of basic education to equip Malawians with the literacy and numeracy skills that are foundational to digital and financial literacy. This requires the provision of qualitative learning material, better trained and incentivized teachers, a reduction of the student-teacher ratio, as well as conducive classroom environments to enable learning. Moreover, the Government should also upgrade Technical, Entrepreneurial and Vocational Education and Training (TEVET) institutions to offer foundational and intermediate digital skills to trainees. This will require significant investment in providing infrastructure to the existing training institutions as well as the establishment of new centers in the mid- to long-term. It will also require training and retraining of trainers in ICT competences. Stronger linkages are needed between the Government, academia, and private sector to co-curate ICT curricula. Cross-sector partnerships will help trainees develop technical and soft skills that are relevant to local and international markets.

1. ECONOMIC DEVELOPMENTS

1.1 Global and Regional Context

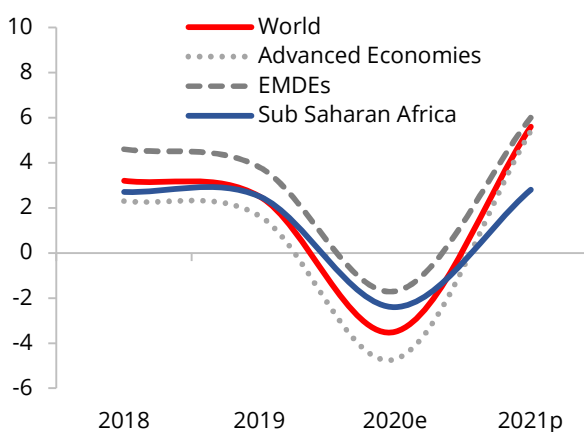
Sub-Saharan Africa entered its first recession in over two decades

1. The initial rebound in global economic activity in mid-2020 slowed in the second half of the year and has since varied across regions. While activity and trade in goods showed improvement, the services sector remained in a slump, particularly international tourism. The global economy is estimated to have contracted by 3.5 percent in 2020. Among advanced economies, the euro area fell back into recession in the end of 2020 amid high infection rates, extended restrictions, and a slower vaccine rollout. Recovery in the United States picked up speed in early 2021 thanks to a rapid vaccine rollout and supportive fiscal stimulus. Among emerging markets and developing economies (EMDEs), China boasted strong growth toward the end of 2020 supported by infrastructure spending. However, other EMDEs exhibited slower recoveries or deepening contractions due to disruptions from the pandemic.

2. In Sub-Saharan Africa (SSA), economic activity contracted less than in advanced economies and EMDEs, but will recover more slowly. This reflects a slower spread of the virus, lower mortality rates, robust agricultural growth, and a recovery in commodity prices. The overall economic contraction in SSA amounted to 2.4 percent in 2020. Despite faring relatively better than others, this represents the region's first recession in over two decades, driven by contractions in industry and services on the supply side, and private consumption and investment on the demand side. While the second half of 2020 brought some rebounds in economic activity amid the easing of lockdown restrictions, a tempering of the slowdown in private consumption, an increase in exports, and stabilization of investments, progress faltered in the end of 2020. A second wave of infections made more dangerous by new and more contagious variants forced Governments to reimpose restrictions suppressing the recovery. As a result, growth in SSA is projected to recover at a modest pace of 2.8 percent in 2021, while per capita output will not return to pre-crisis levels until after 2022.

Figure 1: SSA contracted less than other regions, but will recover more slowly

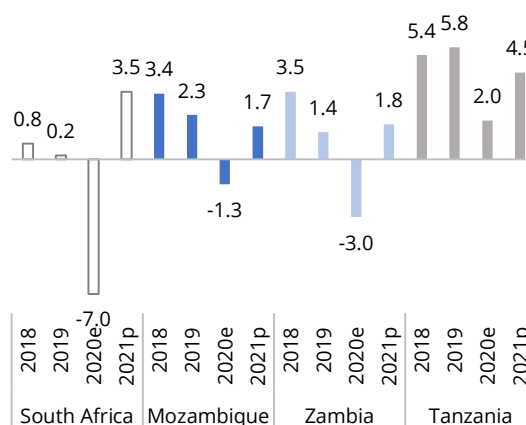
Real GDP growth, percent



Source: Global Economic Prospects

Figure 2: The downturns in economic activity among Malawi's neighbors have been varied

Real GDP growth, percent



Source: Global Economic Prospects

3. Among Malawi's neighbors, consequences of the pandemic have been varied (Figure 2).²

South Africa underwent a severe contraction in activity in 2020 owing to lockdown measures, as well as higher cases and deaths than the regional average. The country experienced its sharpest contraction in Q2 2020, while a rebound in the second half of the year in the mining sector and increased agricultural output staved off even lower output for the full year. Reimposed lockdowns in early 2021 have weighed down on consumer spending, manufacturing, and the mining sector. Moreover, the scarring effects of the crisis, rising inequality, frequent electricity shortages, and product and labor market rigidities will encumber recovery to a projected 3.5 percent in 2021. Economic recovery in Mozambique has been tempered by terrorist attacks and the ongoing impacts of the pandemic on the service and mining sectors. Economic growth for the country is projected to reach 1.7 percent in 2021. In Zambia, the recession deepened in the second half of the year as a debt crisis exacerbated the consequences of the pandemic on the economy. The decline in business confidence also intensified due to currency weaknesses and challenges to operations from lockdowns resulting in a 3.0 percent contraction in GDP for 2020. Despite higher global copper prices, GDP growth is projected to reach just 1.8 percent in 2021. In Tanzania, where COVID-19 restrictions have been removed, the economy has continued to grow driven by construction and agriculture and is projected to rebound to 4.5 percent in 2021.

4. Most commodity prices rebounded in the second half of 2020, though oil prices recovered more slowly due to the prolonged impact of the pandemic (Figure 3).³

Crude oil prices averaged US\$ 41 per barrel in 2020, a 34 percent decline from 2019. Oil demand decreased by 9 percent in 2020 representing the largest one-year drop on record. This was partially offset by sizable production cuts among major oil exporters. Since then, oil prices averaged US\$ 61/barrel over the first five months of 2021, a 49 percent increase over the 2020 average. Over the same period, base metal prices also rebounded by 37 percent. This trend is poised to continue amid resurgent industrial activity in China and advanced economies, as well as increased demand resulting from the US fiscal stimulus. Agricultural prices have continued their upward march since a trough in April 2020 due to a combination of supply shortfalls and increased demand for edible oils and meals. Soybeans and maize have also been among the crops with the highest price increases, jumping by 47 percent and 57 percent in 2021 as of end-May over their 2020 averages (UNICEF, 2021). These increases will exert upward pressure on inflation bringing levels closer to long-run averages (United Nations, 2021a).

5. Vaccine procurement has remained scant in low-income developing countries (Figure 4).

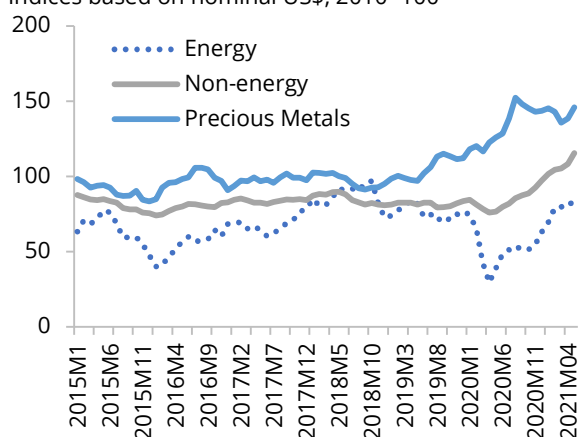
In SSA, vaccination campaigns have made limited progress. Most countries in the region are highly dependent on COVAX, the vaccine facility supported by the United Nations, Coalitions for Epidemic Preparedness Innovations, and the World Health Organization. According to the first interim distribution list published in February 2021, 145 countries would receive enough doses to immunize 3.3 percent of their population by mid-2021. At the end of May, with 1.4 bn vaccine doses administered globally, less than 24 million, under two percent, have reached Africa.

² For further reading on the impact of COVID-19 on the region, please see the latest edition of the World Bank's Africa's Pulse series (Zeufack et al., 2021)

³ Additional discussion on commodity price developments is available in the World Bank's Commodity Markets Outlook (World Bank, 2021a)

Figure 3: Oil prices have recovered more slowly than other commodity prices

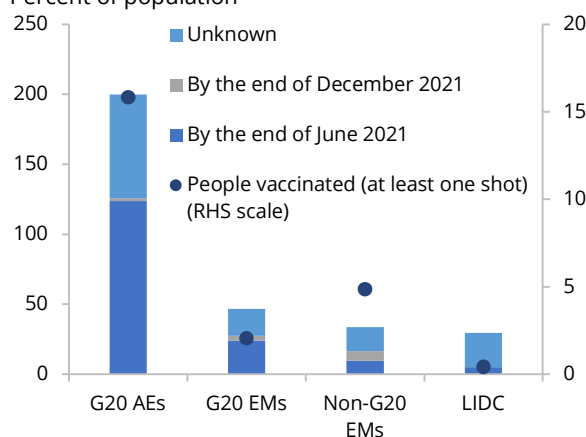
Indices based on nominal US\$, 2010=100



Source: World Bank Commodity Markets Outlook

Figure 4: Vaccination procurement is much lower outside advanced economies

Percent of population



Source: IMF (2021a) via Duke Global Health Innovation Center, Johns Hopkins University COVID-19 statistics, and national government reports in Our World in Data (Ritchie et al., 2020).

Note: AE = Advanced economies, EM = Emerging markets, LIDC = Low-income developing countries

1.2 Recent Economic Developments

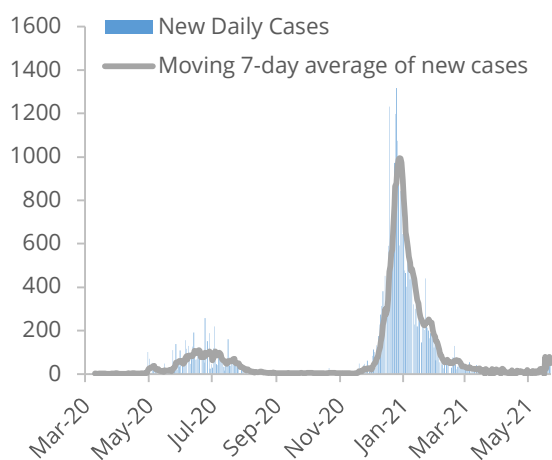
The economic impact of the pandemic has been mitigated by a strong harvest

6. Public health risks from the pandemic worsened sharply in Malawi toward the end of 2020, with a severe second wave of COVID-19 cases starting in mid-December (Figure 5). January 2021 brought a surge of 17,380 new cases, with two cabinet ministers among the fatalities. In response, the Government declared a second ‘State of National Disaster’ and announced lockdown measures, including the closure of schools, a night-time curfew, the wearing of masks, routine disinfection of public buildings, and restrictions on gatherings. The surge in cases had mostly dissipated by March and by the third week of June, the cumulative case count stood at 34,832 with 1,168 deaths. The Government began to loosen restrictions in late April, as case numbers continued to decline. However, cases have started to pick up again in mid-June. Ongoing Government efforts to curb the pandemic and its consequences include the development of an enhanced COVID-19 preparedness response plan to complement the National Vaccine Deployment Plan, which intends to cover 20 percent of the population in its first phase. There are also plans for the expansion of social protection benefits to cover around 35 percent of the urban population, with additional cash-transfers for those affected by COVID-19 in rural areas. Malawi has received vaccine doses from COVAX, the African Union, and the Government of India (United Nations, 2021 b). As of mid-June, the number of doses administered has reached around 400,000, or about 2 percent of the population, targeting all individuals aged 18 and above.

7. Growth in Malawi fell to an estimated 0.8 percent in 2020, a sharp drop from pre-pandemic projections of 4.8 percent. With population growth around 3.0 percent, this represents a 2.2 percent contraction in per capita GDP. The services sector contracted due to disruptions to in-person services from the pandemic (Figure 6). Accommodation and food services, wholesale and retail trade, and transport suffered from social distancing measures and reduced demand, as did professional services related to education, given the closure of schooling facilities. The contribution of the tourism industry to GDP halved from 10.4 percent in 2019 to 5.5 percent in 2020, according to

estimates by the World Travel and Tourism Council (2021). Total traffic at the Kamuzu and Chileka airports decreased by 86 percent for domestic traffic, and 71 percent for international traffic y-o-y in 2020 (World Bank, 2021b). Growth of industry was also weak, amid disruptions to global value chains and logistics. Foreign currency shortages further hampered the purchase of intermediary inputs. The overall economic impact of the pandemic was mitigated by a strong harvest.

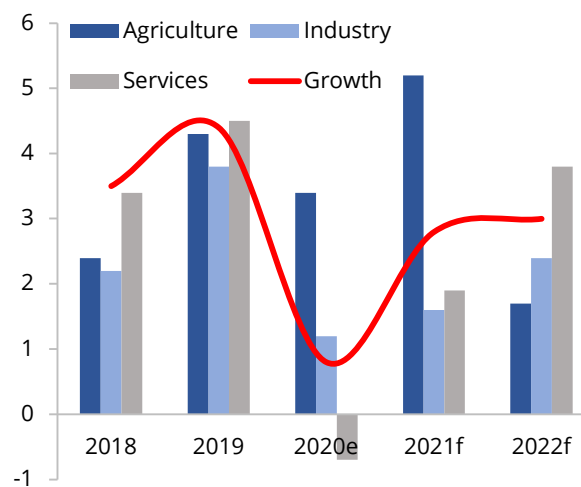
Figure 5: A second wave of COVID cases largely dissipated by March, but cases started increasing again in June



Source: National government reports via Our World in Data

Figure 6: The pandemic has hurt growth especially in services and industry

Real GDP growth, percent



Source: World Bank Staff Calculations

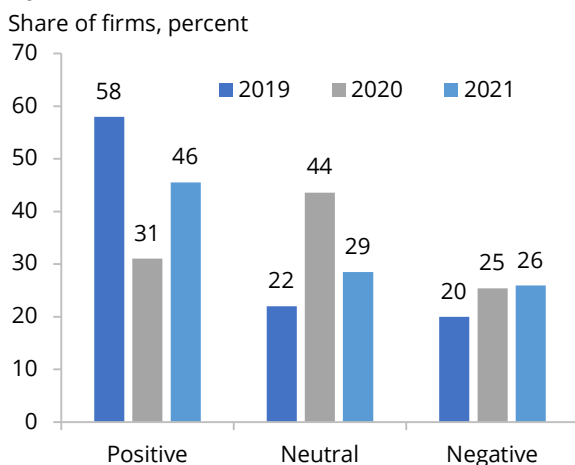
8. Agricultural production estimates for 2021 suggest another strong year of growth. Maize production is expected to increase for the third year in a row, to 4.5 million tons, a 17 percent increase over 2020's bumper harvest (Figure 8). This jump has been driven by favorable weather conditions combined with the Affordable Inputs Program (AIP), which has expanded fertilizer subsidies to all rural farming households, although at considerable fiscal cost.

9. The first months of 2021 have shown an improvement in business sentiment. Among firms surveyed by the Malawi Confederation of Chambers of Commerce and Industry (MCCCI) in February 2021, 46 percent had a positive view of performance for 2021 (Figure 7). This marks a notable improvement from just 31 percent in 2020, though it remains short of a return to pre-pandemic levels. Estimates of capacity utilization present a similar trend where the share of firms operating at above 75 percent capacity jumped from 21 percent to 40 percent from 2020 to 2021. The share of firms reporting rates below 50 percent dropped from 24 percent to 18 percent over the same period. Positive expectations are motivated by prospects of greater consumer spending powered by a good harvest, improved strategies to cope with the pandemic, and a boost in online transactions allowing businesses to expand their customer base. This was supported by the expanded use of financial services through mobile phones through the pandemic (see special topic). Political stability also offered an opportunity to improve the regulatory environment. Nonetheless, a quarter of businesses still hold a negative view on performance for 2021, citing continued disruptions from the pandemic and dwindling working capital forcing closures.

10. Various structural constraints continue to weigh on growth in Malawi. The banking system remains shallow, inefficient, and limited in reach, leaving many micro, small, and medium-sized enterprises (MSMEs) without adequate access to finance. Deficits in connectivity infrastructure, particularly in electricity, water, and telecommunications, hinder competitiveness and constrain diversification. These deficits are exacerbated by poor SOE performance in the sectors, which slows maintenance and investment. Expensive road transportation exacerbates Malawi's competitive

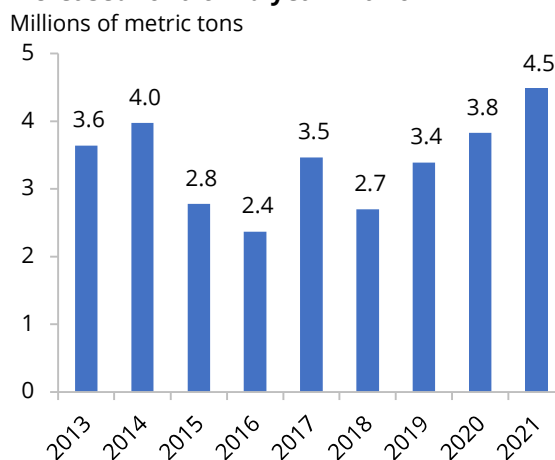
disadvantage as a landlocked country. Distortive state intervention through SOEs continues to crowd out the private sector. In addition, an increase in the minimum wage, implemented from January 2021, has weighed on formal sector activity, increasing costs during a period with already weak demand.

Figure 7: Business sentiment has improved in 2021



Source: World Bank Staff Calculations based on MCCI business surveys

Figure 8: Maize production in 2021 has increased for a third year in a row



Source: Agriculture Production Estimation Surveys
Note: 2021 based on APES Round 2

Exports and remittances fell sharply in 2020

11. Malawi experienced a sharp drop in exports in 2020.⁴ Lower global demand, trade restrictions, and disruptions to production reduced exports by 15 percent in 2020 compared to 2019. Tobacco, Malawi's key export, faced an annual revenue drop of 21 percent y-o-y in 2020, driven by higher production costs and disruptions due to COVID-19 and lockdown measures. These challenges add to existing pressures on the industry from anti-smoking campaigns and a shift toward non-Malawian grown blends. Tea and sugar revenues declined in 2020 by 5 percent and 8 percent y-o-y, respectively, due to both the consequences of the pandemic, as well as disruptions to production from electricity outages that interrupt irrigation, and higher costs due to reliance on expensive generators. At end-February 2021, Illovo, Malawi's largest sugar producer, posted a net profit of MK 6.1 billion, an almost threefold jump over MK 2.1 billion for the corresponding period a year earlier. However, they also noted lower than expected export sales due to restrictions posed by the pandemic (Illovo, 2021).

12. Tobacco auction sales have increased in the first half of 2021. Following 2020's particularly weak performance, tobacco auction sales over the first eight weeks of the 2021 season showed a 30 percent increase in revenue over the same period last year (Tobacco Commission, 2021). The rise was driven mostly by a 20 percent increase in volume supported by prices that were 9 percent higher than last year. In addition, tea auction sales have increased by 10 percent in the first four months of 2021 over the same period last year (RBM, 2021a).

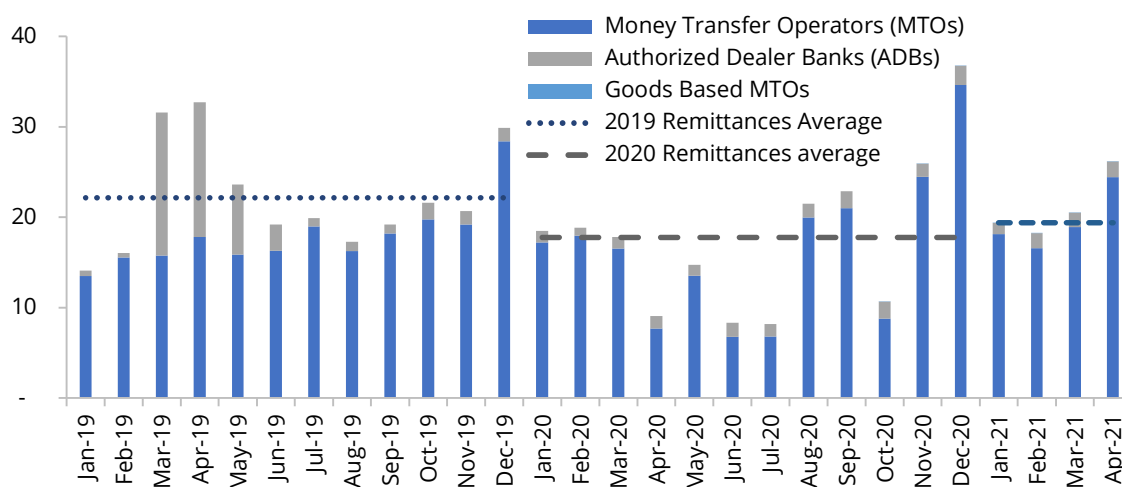
13. The slump in economic activity in 2020 also exerted downward pressure on imports, which fell by 6 percent. This reflected the lockdown measures in South Africa, increased border restrictions, and lower demand. However, the value of Malawi's two largest imports, fuel and fertilizer, increased in 2020. The rise in the volume of fuel imports offset lower global oil prices resulting in an import bill of US\$ 208 million, a 10 percent increase y-o-y (RBM, 2021b). Fertilizer imports also increased by 9 percent amounting to US\$ 229 million (RBM, 2021b).

⁴ Trade values are based on US\$ denominated figures presented in Reserve Bank of Malawi (2021a) via the National Statistical Office and Malawi Revenue Authority.

14. A reduction in international remittances contributed to a worsening external sector balance in 2020. Remittances to Malawi declined by 20 percent y-o-y in 2020 to 2.6 percent of GDP (Figure 9). This contrasts with the regional trend where excluding Nigeria, remittance inflows to SSA proved resilient increasing by 2.3 percent for the year (Ratha et al., 2021). While this difference can be partially explained by the patterns of migration and lockdowns, another factor is that SSA ranks as the most expensive region in the world for transferring remittances. Transaction costs on a transfer from South Africa to Malawi amounted to 16 percent as of 2020 Q4, far above the already high regional average of 8.2 percent. However, remittances to Malawi recovered and showed some stabilization from November through April 2021. The current account deficit is estimated to have expanded from 11.5 percent to 12.0 percent of GDP in 2020, which was largely financed by development assistance, while foreign direct investment remained stagnant.

Figure 9: Remittances declined in 2020 but have stabilized since the last quarter of 2020

US\$ million



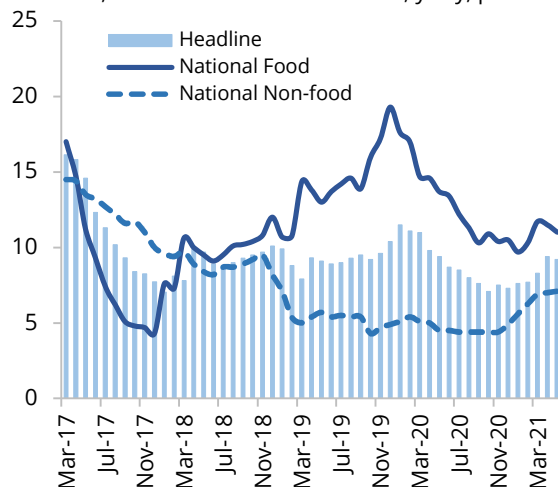
Source: Reserve Bank of Malawi

Inflation has started picking up driven by fuel price adjustments

15. After decelerating for a year due to lower food prices, inflation has started to pick up in recent months due to an increase in both food and non-food inflation. The annual y-o-y headline inflation rate decelerated to 7.1 percent in October 2020 before gradually picking up to 8.9 percent in May 2021 (Figure 10). The deceleration was supported by lower food and global oil prices. Inflation has picked up in recent months due to a depreciating exchange rate which has affected non-food inflation. Food inflation had decelerated until January 2021 but picked up in recent months, largely due to base effects (with 2020 maize prices declining). Maize prices have been substantially lower than the previous season and have declined since the beginning of 2021 as traders offloaded stock and with ADMARC delaying maize purchases (Figure 11). By May 2021, maize prices had declined to K130 per kilogram. Non-food inflation had remained at 4.4 percent since July 2020 but started picking up in December 2020, reaching 7.1 percent in May 2021 largely on account of a recent upward adjustment in fuel prices. The price of petrol and diesel were adjusted upwards by 7.7 and 8.7 percent, respectively, in December 2020 and again in March 2021 due to increased international prices, as well as the depreciation of the kwacha (see Figure 18). Across categories of non-food inflation, transportation, housing, water and electricity contributed to the rise in May 2021.

Figure 10: Food and non-food inflation have increased since recent lows

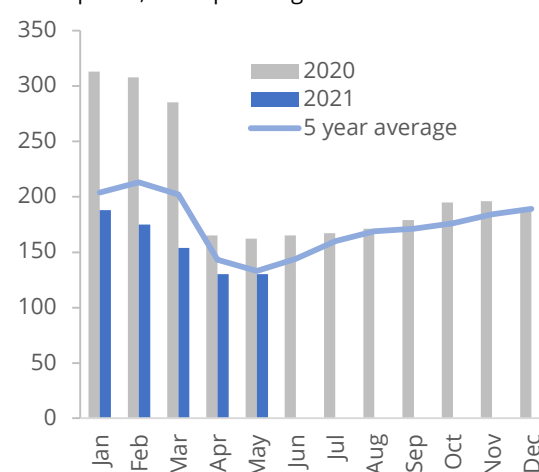
Headline, food and non-food Inflation, y-o-y, percent



Source: World Bank staff calculations based on National Statistical Office (NSO) data

Figure 11: Maize prices are lower this season

Maize prices, MWK per kilogram



Source: World Bank staff calculations based on data from World Food Programme

The FY2021 fiscal deficit is expected to reach 8.7 percent of GDP

16. Fiscal pressures from the pandemic and expenditure on the AIP are expected to contribute to a fiscal deficit of 8.7 percent of GDP for FY2021, marginally higher than the revised target of 8.6 percent of GDP. The Government is expecting to spend as revised at mid-year, at 24.6 percent of GDP. However, revenue is expected to slightly underperform targets, due to weak performance of other revenues. Domestic financing will reach 5.9 percent of GDP, the highest in recent years.

17. Revenue is expected to reach 15.9 percent of GDP, lower than the revised target due to underperformance in other revenue. Taxes on income and capital gains are expected to reach 5.8 percent of GDP, surpassing the revised target of 5.6 percent. The implementation of the widened zero-bracket for PAYE is expected to lead personal income tax performance to fall 5.8 percent less than the revised target. PAYE collection was 5 percent higher than FY2021 before the zero tax threshold was adjusted (from MWK 45,000 to MWK 100,000), but has fallen 14 percent below FY2021 since the adjustment. However, this is expected to be offset by corporate taxes exceeding their revised targets. Goods and services, as well as trade taxes are projected to meet their revised targets of 5.2 and 0.9 percent of GDP, respectively. Other revenue is expected to fall to 0.4 percent of GDP, below the revised target of 0.7 percent, due to a significant underperformance in parastatal dividends and departmental receipts. Disbursement of COVID-19 resources is expected to improve performance of grants which are likely to reach the revised target of 3.6 percent of GDP.

18. The Government is projecting expenditure to meet the increased revised target of 24.6 percent of GDP, which would be the highest level in recent years. Recurrent expenditure is expected to reach 18.1 percent of GDP, similar to the revised target, elevated by high levels of expenditure on wages, interest payments, and fertilizer subsidies. Recruitment of additional health personnel to aid in the response to the pandemic will likely push wages and salaries beyond the mid-year revised target of 5.7 percent of GDP to reach 5.9 percent. On the other hand, despite the rise in domestic debt, the Government expects that interest expense will be less than the revised target of 4.0 percent of GDP at 3.8 percent, with domestic financing lower than budgeted. Government also spent 0.1 percent of GDP lower than originally budgeted on the AIP, due to the elimination of non-existing households and duplications which reduced beneficiaries from 4.2 to 3.7 million. As such, AIP

expenditure was only MWK 142 billion versus the originally budgeted MWK 160 billion. Overruns are expected in other expenses due to the additional funds government disbursed for pandemic response.

Table 1: Fiscal Accounts

Percent of GDP

Percentage of GDP	17/18	18/19	19/20	20/21	21/22*		
	Appr	Rev	Proj	Proj	Proj		
Revenue	14.6	14.7	14.5	15.1	16.1	15.9	16.6
Domestic Revenue	13.6	13.2	13.1	12.4	12.5	12.3	14.4
Taxes	12.8	12.8	12.3	11.8	11.8	11.9	13.6
Taxes on Income, Profits and Capital Gains	6.1	6.0	5.8	5.6	5.6	5.8	6.5
Taxes on Goods and Services	5.5	5.7	5.5	5.2	5.2	5.2	6.1
Taxes on International Trade and Transactions	1.1	1.1	1.0	1.0	0.9	0.9	1.1
Other Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Revenue	0.8	0.5	0.8	0.7	0.7	0.4	0.7
Property Income	0.3	0.1	0.3	0.3	0.4	0.1	0.3
Sale of Goods and Services	0.5	0.4	0.5	0.4	0.3	0.3	0.3
Fines, Penalties and Forfeits	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Grants	1.0	1.4	1.5	2.7	3.6	3.6	2.2
From Foreign Governments	0.6	-	-	0.4	0.4	0.4	0.8
From International Organizations	0.4	1.4	1.5	2.3	3.1	3.1	1.5
Expenditure	19.0	19.1	20.9	23.1	24.6	24.6	26.0
Expense	15.7	15.6	16.6	17.7	18.1	18.1	18.5
Compensation of Employees	4.8	5.2	5.5	5.7	5.7	5.9	5.9
Goods and Services	4.5	3.4	4.0	3.3	3.7	3.7	3.4
Generic goods and services	2.3	2.1	2.5	2.0	2.4	2.4	2.1
Maize purchases	1.0	0.1	0.1	0.1	0.1	0.1	0.2
Expenditure for arrears	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Interest	2.8	2.9	3.0	4.0	4.0	3.8	3.9
To non-residents	0.2	0.2	0.2	0.1	0.1	0.1	0.2
To residents other than general government	2.6	2.7	2.8	3.8	3.8	3.7	3.7
Grants	2.0	2.7	2.7	1.9	1.9	1.9	2.1
Social Benefits	1.5	1.4	1.4	2.8	2.6	2.6	2.9
Fertilizer payments	0.4	0.4	0.3	1.4	1.3	1.3	1.6
Other Expenses	0.1	0.1	0.1	0.1	0.2	0.3	0.3
Acquisition of Non-Financial Assets (Development expenditure)	3.3	3.5	4.2	5.4	6.5	6.5	7.5
Foreign financed	2.2	2.2	2.4	4.3	5.4	5.4	4.6
Domestically financed	1.1	1.4	1.8	1.1	1.1	1.1	2.9
Overall balance including grants	(4.4)	(4.5)	(6.3)	(8.0)	(8.6)	(8.7)	(9.4)
Primary Balance	(1.6)	(1.6)	(3.3)	(4.0)	(4.6)	(4.9)	(5.5)
Domestic Primary Balance	(0.4)	(0.8)	(2.3)	(2.4)	(2.8)	(3.1)	(3.1)
Net Incurrence of Liabilities	4.7	4.5	5.7	8.0	8.6	8.7	9.4
Foreign borrowing (net)	1.8	0.8	0.8	2.4	2.6	2.8	1.8
Program Borrowing	1.0	0.1	0.0	0.2	0.2	0.5	-
Project Loans	1.2	1.0	1.2	2.6	2.8	2.8	2.4
Amortization	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)	(0.5)	(0.6)
Domestic borrowing (net)	3.0	3.8	4.9	5.6	6.0	5.9	7.6

* FY2022 figures as a percent of GDP represent a 9 month fiscal year, to enable comparison with previous FYs.

Note: Figures are a share of rebased GDP figures.

19. Development expenditure is expected to reach the revised target of 6.5 percent of GDP.

The bulk of this is foreign-financed development expenditure, which is expected to reach 5.4 percent of GDP, driven by disbursement of project grants and loans to finance COVID-19 response programs including social protection, and earmarked projects in the irrigation and water sectors. Domestically-financed development expenditure is expected to reach its revised target of 1.1 percent of GDP.

20. The fiscal deficit continues to be largely financed by domestic borrowing. Disbursements of loans for COVID-19 response are expected to lead to an increase in foreign financing to reach 2.8 percent of GDP, surpassing the revised target of 2.6 percent of GDP. Nonetheless, as per the recent trend, domestic borrowing continues to be the main channel for financing the fiscal deficit. In FY2021, government is expected to borrow 5.9 percent of GDP domestically to finance the fiscal deficit.

The FY2022 budget will expand the fiscal deficit further

21. The Government presented its proposed FY2022 budget on May 28th, 2021. This fiscal year will only be 9 months, from July 2021 to March 2022, so that the subsequent fiscal year (FY2023) can be adjusted to run from April to March. As such, while many kwacha values are lower than the previous fiscal year, this is largely accounted for by the fact that the budget represents only 9 months, or 75 percent, of a full fiscal year. This analysis adjusts figures as a share of GDP accordingly to enable comparison with previous fiscal years.⁵

22. The FY2022 budget deficit is budgeted to expand from 8.7 to 9.4 percent of GDP, and there are risks that it could go higher. Tax revenue projections are optimistically budgeted to pick up significantly, which, if unrealized, could lead to an even larger deficit or the further accumulation of arrears. Expenditure, already at high levels, is increasing further, driven by a surge in domestically-financed development spending and a modest increase in an already high level of recurrent expenditure. Domestic debt is expected to expand even further, with around 81 percent of the deficit financed by domestic borrowing. Additional off-budget borrowing of 13 percent of GDP is also planned for the medium term through a 15-year development bond.

23. Tax revenue is budgeted to increase from 11.9 to 13.6 percent of GDP due to optimistic tax revenue projections, which could lead to revenue shortfalls and a wider budget deficit. Total revenue and grants for FY2022 are budgeted at 16.6 percent of GDP, up from the expected 15.9 percent in FY2021. Tax revenues are budgeted to increase considerably, from 11.9 to 13.6 percent of GDP. This would represent the highest intake in recent years as a share of GDP in aggregate and across various tax lines. Personal income taxes are budgeted to increase from 3.4 to 4.0 percent of GDP, and corporate taxes from 2.3 to 2.5 percent. Meanwhile, goods and services taxes are budgeted to surge upwards from 5.2 to 6.1 percent of GDP. Only taxes on international trade show a more modest increase, from 0.9 to 1.1 percent of GDP. Other revenue is also expected to increase, from 0.4 to 0.7 percent of GDP. These budgeted increases are combined with numerous tax measures, many of which will reduce the tax intake, and could make achieving these figures even more difficult (see Box 1). A year after doubling the zero tax threshold, the Government has again reduced income taxes on the lowest tax-paying wage-earners. Those earning from MWK 100,000 to MWK 1 million per month will see a tax reduction from 30 to 25 percent.

⁵ Figures as a share of GDP have been revised to account for the shortened 9-month fiscal year and to facilitate comparison with previous fiscal years. As such, this MEM analysis applies 9 month kwacha figures as a share of 9 month GDP figures (on the other hand, the budget document's cited deficit of 7.0 percent of GDP applies a 9 month deficit figure to a 12 month GDP figure, which does not make it comparable with previous fiscal years). However, an adjustment is not made for revenues or expenditures which are not evenly distributed throughout the year, such as the AIP. In addition, the newly rebased GDP figures are used, which are around 40 percent higher than previous figures.

Box 1: The Government announced various tax measures for FY2022

The Government has introduced a wide range of tax measures in the FY2022 budget aimed to protect small businesses and boost aggregate demand, though tax revenues will likely be adversely impacted as the fiscal picture worsens. Many of these measures address inefficiencies and raise appropriate thresholds to reduce compliance costs, or promote local value-addition or import substitution, which could broadly support private sector growth. However, some measures are likely to support wealthier groups and are regressive, or benefit larger firms with higher capacity. Additionally, some measures unnecessarily add to the complexity of tax administration and could lead to abuse. A selection of the new measures is discussed below:

- *Pay As You Earn (PAYE)*: One year after doubling the zero tax threshold from MWK 45,000 to MWK 100,000, which had a clear impact on the tax revenues, the Government has reduced taxes on wage earners between MWK 100,000 and MWK 1 million per month, from 30 to 25 percent. In addition, it has introduced a new income tax bracket of 40 percent for earners above MWK 6 million per month. While this does make the income tax more progressive, the net impact on tax collection is unclear.
- Introducing a duty-free week for imports not exceeding US\$ 3,000, once a year. This is intended to boost the growth of small businesses and to reinvigorate the economy, though without more specific targeting, larger businesses and the wealthy will benefit as well.
- The Government raised some thresholds, including the VAT registration threshold from MWK 10 million to MWK 25 million, and increased the Common Market for Eastern and Southern Africa (COMESA) Simplified Trade Regime threshold from US\$ 2,000 to US\$ 3,000, for which items valued up to US\$ 3,000 can be imported without import duty, but excise and value-added taxes are still payable.
- The Government introduced presumptive tax rates for small businesses with turnover less than MK12.5 million.
- Consistent with ratification of the African Continental Free Trade Area (AfCTA) treaty, duty rates for imports from countries within the AfCTA have been reduced.
- The requirement for affixing or printing of electronic tax stamps on various products including alcohol, energy drinks, and soft drinks has been introduced.
- The Government has granted duty free importation of motor vehicles by the Justices of Appeal and High Court Judges, General Officers of the Malawi Defense Force, Grade A and B under the Civil Service and Malawi Electoral Commission Commissioners in line with their condition of service.
- The Government will allow duty free importation of building materials for construction of churches or mosques.
- The Government will allow duty free importation of vessels for transportation of goods or people for the tourism industry. This measure is expected to benefit this hard-hit sector. It has also aligned the multiple entry visa charges with those in neighboring countries by reducing the charge from US\$ 150 to US\$ 80, and reduced the single entry visa charge from US\$ 75 to US\$ 50.
- The Government removed import VAT on (i) raw materials for use in manufacturing of Medicaments, Pharmaceuticals and Medical Apparatus, and (ii) raw materials for use in printing and publishing goods. It removed the 10 percent import duty on soap noodles, which is the key ingredient in soap manufacturing, and soap will not be imported duty free.
- The Government reduced excise tax on opaque beer from 30 to 10 percent, and excise tax on malt beer will be reduced from 60 to 40 percent. This is intended to make local beer production more competitive against smuggled imports.

24. The budget expects a decline in the disbursement of grants in FY2022. Grants are estimated at 2.2 percent of GDP, a decline from 3.6 percent in the FY2021 preliminary outturn. These comprise MWK 58.4 billion from foreign governments and MWK 111.9 billion from international organizations in the form of dedicated and project grants.

25. Expenditure will increase from already high levels in FY2022, largely due to a budgeted surge in domestically-financed expenditure. Total expenditure and net lending is estimated at MWK 1.99 trillion, 26 percent of GDP, an increase from 24.6 percent expected in FY2021. FY2021 and FY2022 would represent the highest level of recurrent and development expenditure in at least a decade. Recurrent expenditure is budgeted at MWK 1.42 trillion, 18.5 percent of GDP, an increase from 18.1 percent in FY2021. Most recurrent expenditure lines remain fairly stable at levels comparable to FY2021

as a share of GDP. Notably, the AIP is held constant at MWK 142 billion, although this is increasing as a share of GDP from 1.5 to 1.9 percent, due to the adjusted 9-month GDP. This will continue putting a strain on the import bill and will contribute to pressure on the exchange rate. Moreover, by guaranteeing the price farmers pay instead of providing a fixed benefit, this also exposes the Government to fiscal risk if imported fertilizer costs increase, and could lead to overspending (as occurred in the past with the Farm Input Subsidy Program (FISP)). Generic goods and services, which historically overspent, is budgeted to decrease somewhat from 2.4 to 2.1 percent of GDP. Interest payments are expected to pick up modestly, from 3.8 to 3.9 percent of GDP. The Government is also allocating MWK 12 billion for maize purchases (0.2 percent of GDP), an increase from MWK 10.3 billion in FY2021, for the National Food Reserve Agency and ADMARC to restock the Strategic Grain Reserves. It further indicates that for other maize purchases, ADMARC will be supported to borrow from commercial banks – however, in doing so, it needs to consider the commercial viability of borrowing at high interest rates and weigh the risk of a guarantee being called.

26. Development expenditure is increasing from 6.5 to 7.5 percent of GDP, due to a surge in domestically-financed development expenditure. Domestically financed development expenditure more than doubles from 1.1 to 2.9 percent of GDP, while foreign-financed drops from 5.4 to 4.6 percent of GDP. The increase in domestically-financed development expenditure raises concerns of how well these projects are being prioritized and if they justify their high financing costs. Historically, many domestically-financed development projects have not been subjected to rigorous cost-benefit analysis. A large portion of this – MWK 70.7 billion (0.9 percent of GDP) – is for 35 Road Fund Administration projects, of which 13 are new for FY2022, and another 7 are new feasibility studies and designs. This is an increase from MWK 21.8 billion for 22 projects for all 12 months of FY2021.

27. The Government further indicated that it will raise, over a period of 5 years, a 15-year development bond of MWK 1 trillion (13 percent of GDP) for 15 projects which have not been included in the budget. However, given the long maturity of the bond and the high interest rate environment where 10-year Treasury notes currently have a yield of 22.5 percent, it will add considerably to already high public debt levels, even if it is carried out off-budget. Many of the proposed projects are roads projects, yet they should undergo rigorous cost-benefit analysis as to whether they justify financing costs of over 20 percent.⁶ This follows the Government already issuing a MWK 21 billion long-term development bond as the first step in the construction of the 10,000 houses for security institutions, for which over 231 houses are under construction.

28. The Government is clearing arrears that the previous Government owed to the private sector, amounting to MWK 228 billion, or 3 percent of GDP, with some dating back as far as 2015. The Auditor General is auditing the arrears, which are being cleared through promissory notes (for those over MWK 100 million) and through the budget (for those under MWK 100 million). While the amount to be paid through the budget is unclear, through March 2021, MWK 79.8 billion had been converted to promissory notes. While boosting the private sector, this will further add to expenditure and debt pressures.

29. Arrears are a repeated problem, which together with concerns raised in recent audits of COVID-19 resources, highlight the need to address fundamental budget and public financial management (PFM) issues. The budget statement also announced the rollout of the new Integrated Financial Management Information System (IFMIS) to all MDAs on July 1, 2021. While this should represent a step forward, concerns about its state of readiness suggest that this could introduce additional PFM risks which would need to be carefully managed to ensure integrity of the system and public resources.

⁶ Various means to strengthen long term financing for infrastructure are discussed in World Bank 2020 “Mobilizing Long Term Finance for Infrastructure” and World Bank December 2020 Malawi Economic Monitor “Doing More with Less”.

An already substantial domestic debt burden is increasing

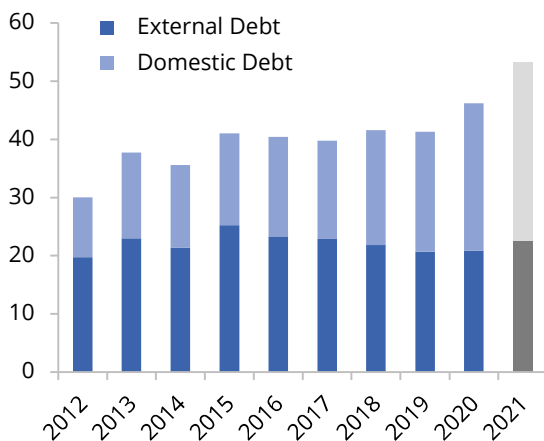
30. Most of the FY2021 and FY2022 fiscal deficits will be financed by domestic borrowing. As has been the trend, a large and increasing proportion of the fiscal deficit will be financed using high-cost domestic debt, from 67 percent of financing in FY2021 to 81 percent in FY2022. It is budgeted to increase from K555.9 billion in FY2021 to K583.5 billion in FY2022, even though it is only a 9 month fiscal year, or from 5.9 percent of GDP in FY2021 to 7.8 percent in FY2022. This is contributing to an ever-larger fiscal burden (Figure 13). Debt service comprises 31 percent of domestic revenues and is 16 percent of total expenditure in FY2021, and is budgeted at a similar level in FY2022.

31. Continued financing of high and growing fiscal deficits using high-cost domestic debt has contributed to an increase in public debt levels. Recurrent expenditure consistently exceeds domestic revenues, requiring domestic borrowing at high costs to fund low-return expenditure. By the third quarter of FY2021, domestic debt cost totaled MWK 2.52 trillion (27 percent of GDP). With almost 6 percent of GDP expected to be borrowed from the domestic market during the fiscal year, domestic debt will likely go beyond 30 percent of GDP by the end of FY2021 (Figure 12). Whereas external debt had been on a downward trajectory, borrowing to finance the gap in COVID-19 response as well as depreciation of the exchange rate are contributing to a recent rise in external debt in local currency terms. External debt totaled 21 percent of GDP by mid-year and is expected to reach 23 percent of GDP by end of FY2021. Cumulatively, public debt is expected to exceed 52 percent of GDP in FY2021.

32. The September 2020 joint World Bank/International Monetary Fund debt sustainability analysis (DSA) assessed that Malawi is at high risk of overall debt distress due to high levels of domestic debt which are contracted at high interest rates. It is at a moderate risk of external debt distress with limited space to absorb shocks, a deterioration from the previous DSA. Despite a high level of external debt, the debt servicing burden from external debt is lower, considering that 84 percent is held with multilaterals with low, concessional interest rates. On the other hand, the burden is higher on the domestic front given high interest rates (Figure 13). The debt situation has worsened further since the last DSA, highlighting the need for the Government to regularly update its debt management strategy, in order to adjust for changing market dynamics and to strengthen debt management. Full reporting of public sector and SOE debt and guarantees is needed in order to increase oversight and mitigate fiscal risks.

Figure 12: Domestic debt is rising at a higher rate than external

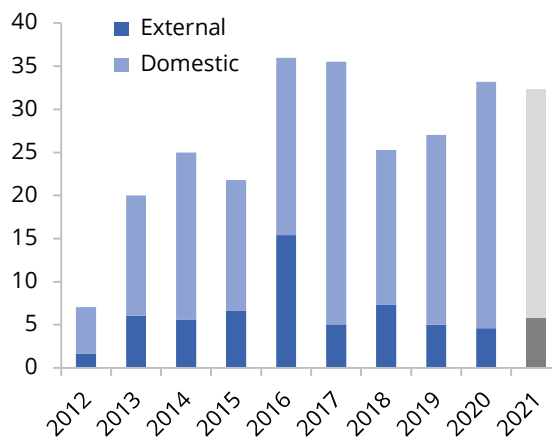
Percent of GDP



Source: World Bank staff calculations using MoF data

Figure 13: Debt servicing costs are also higher for domestic debt

Percent of revenue and grants



Source: World Bank staff calculations using MoF data

Box 2: The Impact of COVID-19 on Public Debt in Sub-Saharan Africa

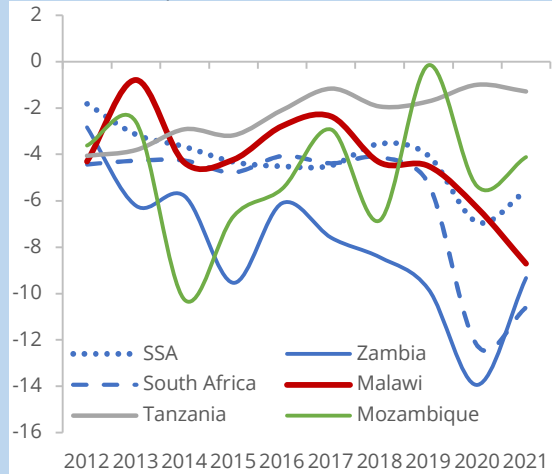
The COVID-19 pandemic has driven rapid increases in public debt in SSA. Following early episodes of debt relief under the Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative in 1996 and 2005 respectively, public debt in SSA stood at about 35 percent of GDP in the early 2010s (Kose et al., 2021). As many countries took advantage of increased fiscal space in human- and physical-capital enhancing investments, public debt in the region rose to about 55 percent of GDP by the mid-2010s. Since then, public debt broadly stabilized until before the pandemic, and was expected to decline in 2020, as several countries in the region were planning fiscal consolidation (IMF, 2020a and World Bank, 2021c).

As the pandemic struck, sharp reductions in output combined with higher pandemic-related spending expanded fiscal deficits and exerted pressure on public debt. These effects were felt unevenly, with countries most affected including South Africa, Zambia, and Malawi, although with various underlying causes (Figure 14, IMF, 2021b). South Africa underwent one of the starkest contractions in economic activity in the face of a sharp rise in infections and a consequent stringent lockdown. In Zambia, a slump in global commodity prices depressed mining proceeds and a debt crisis shook the economy even before the pandemic. Malawi witnessed a sharp expansion of the deficit due to optimistic revenue assumptions, high recurrent expenditure overruns, growing domestic interest payments, and repayment of unbudgeted arrears. Some countries fared better, like Tanzania which maintained a healthier fiscal balance and lower public debt throughout the crisis. The net effect across the region was an increase in median deficits from 3 percent to 5.4 percent of GDP (Zeufack et al., 2021). As a result, median public debt increased by 6.5 percent in 2020, bringing the stock of public debt to 63.2 percent at end-2020 (Figure 15).

Looking forward, the prospects for public debt vary across countries in SSA. Debt is likely to increase further as governments aim to finance post-pandemic economic recovery. Depending on how quickly economic activity resumes, countries will enjoy stronger revenue collection and pandemic-related expenditures will decline. Oil and mineral exporters in the region will benefit from higher commodity prices, but non-resource-intensive countries are expected to recover more slowly. Nonetheless, even under a relatively benign scenario where vaccination is successful and international interest rates do not increase substantially, there is considerable uncertainty about the speed and scale of recovery.

Figure 14: Fiscal balances have deteriorated, particularly since the pandemic

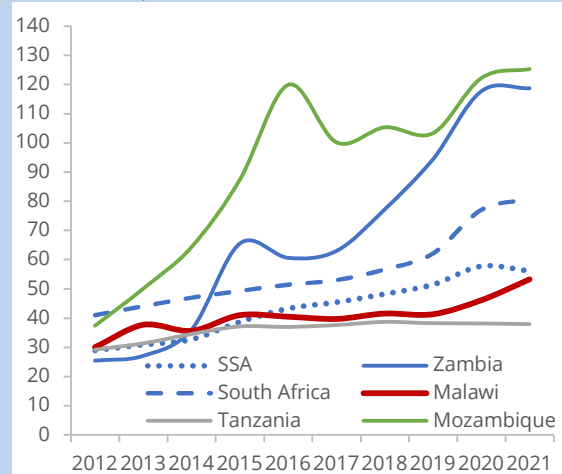
Fiscal balance, percent of GDP



Source: World Economic Outlook

Figure 15: Public debt has jumped in the last two years across SSA

Public debt, percent of GDP



Source: World Economic Outlook

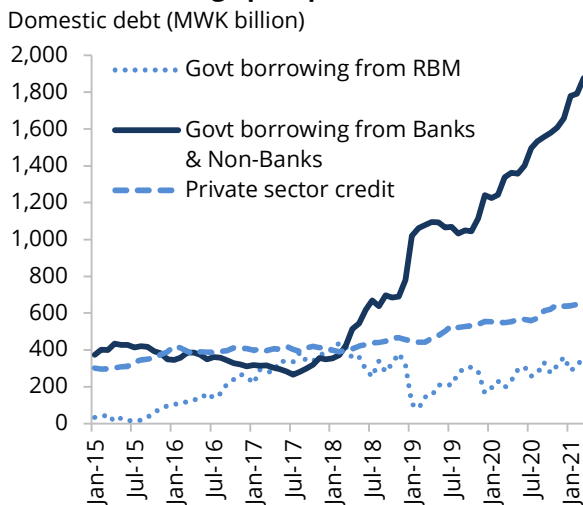
In the short-term, efforts to inject liquidity and broaden fiscal space through debt relief can alleviate debt burdens of countries in SSA. Broadening the scope of debt covered by debt service relief initiatives (like the Common Framework for Debt Treatments and the Debt Service Suspension Initiative) can give countries additional breathing space and enable governments to allocate additional resources toward supporting vulnerable populations impacted by the crisis. Engaging the private sector in such debt relief initiatives can provide further support given their increased share in the creditor base. However, such initiatives primarily serve as short-term palliatives. In the past, excessive debt has been resolved through some combination of a set of standard approaches relating to economic growth, fiscal austerity, and privatization, and less standard

approaches involving financial repression, debt relief, and wealth taxes. These approaches entail difficult trade-offs and are not possible in every country.

Longer-term solutions to rising public debt require efforts to strengthen policy frameworks that enhance debt sustainability (IMF, 2020b). This is true for all countries, but especially so for those in SSA with worse initial conditions. Sound debt management systems and transparency reduce borrowing costs and ensure that today's debt can be repaid tomorrow. Good governance is needed to ensure that borrowed funds are used in ways that enhance productivity and potential output. While temporary regulatory easing can serve to provide firms with much-needed liquidity in the crisis period, proactive financial sector regulation and supervision can help policymakers better identify and respond to emerging risks and mobilize domestic savings. Moreover, robust macroeconomic policies in terms of monetary, exchange rate, and fiscal policy frameworks can support economies' resilience and growth in the midst of global economic volatility.

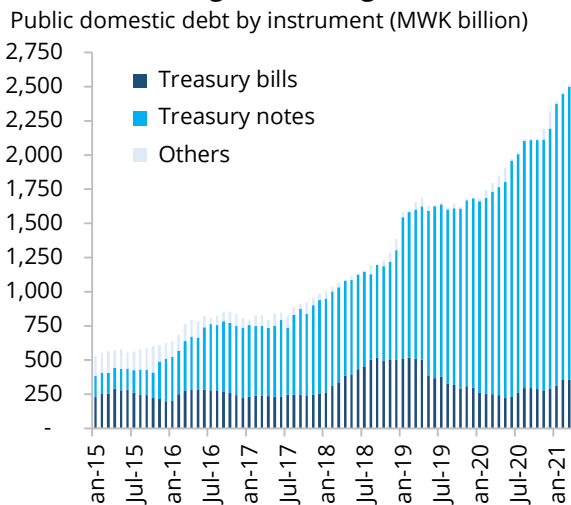
33. Public domestic debt continues to surge past private sector credit. Government borrowing from banks and non-banks has far outpaced private sector borrowing since early 2018 (Figure 16). The Government needs to contain growth of domestic debt or risk crowding out resources needed for private sector investment for economic recovery and diversification. Domestic borrowing continues to shift toward longer term instruments. Since mid-2019, over 80 percent of domestic debt has been held in longer-term treasury notes (Figure 15). High interest rates associated with treasury notes will continue increasing the fiscal burden from domestic debt.

Figure 16: Public domestic borrowing continues to surge past private sector credit



Source: World Bank staff calculations based on RBM data

Figure 17: Public domestic debt continues to shift toward longer-maturing instruments



Source: World Bank staff calculations based on RBM data

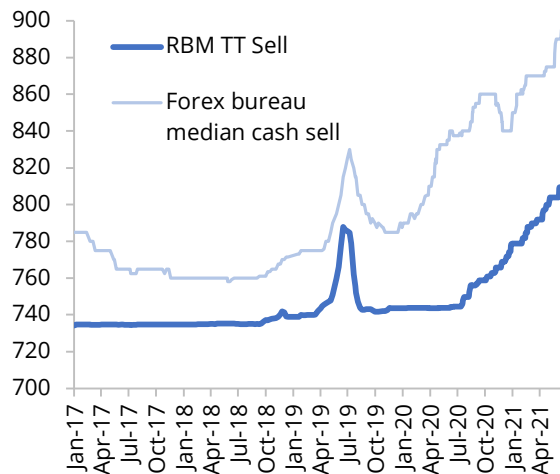
Flexibility of the kwacha has increased, with reserves declining

34. The Malawi kwacha has continued a controlled depreciation against the US dollar (US\$).

Following several years of “super-stability” against the US dollar, from July 2020 to mid-June, the Reserve Bank of Malawi (RBM) kwacha rate has gradually depreciated by 8.7 percent (Figure 18). At the same time, the spread with foreign exchange bureau (FXB) cash rates remains elevated but has declined somewhat. The private sector continues to report queues for foreign exchange, indicating some continued room for balancing foreign exchange supply with demand. Official foreign exchange reserves have been affected by low inflows during the pandemic, with the RBM only intervening with foreign exchange sales. As such, its official gross reserves have declined over the year, to US\$ 414.4 million as of end-May, around 1.8 months of import cover (Figure 19). While the depreciating exchange rate will increase imported inflation and the levels of foreign borrowing in kwacha, it should also gradually help to reduce a significant trade imbalance and increase export competitiveness.

Figure 18: The MWK has depreciated against the US\$...

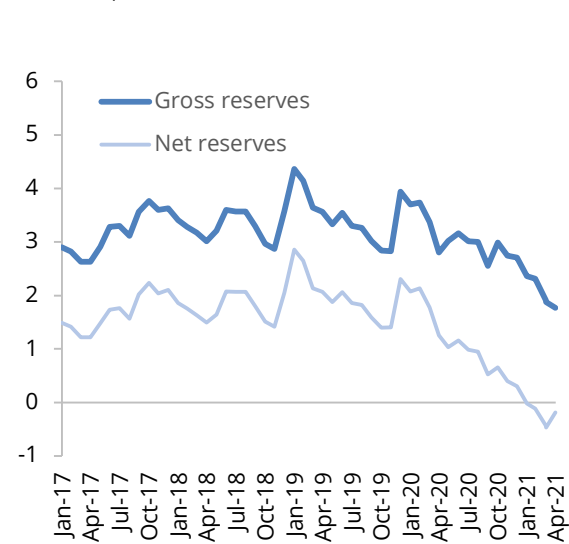
RBM telegraphic transfer (TT) and forex bureau (FXB) cash MWK/ US\$ rates and spreads through June 18



Source: World Bank staff calculations based on RBM data

Figure 19: ...while reserves have declined

Months import cover



Source: World Bank staff calculations based on RBM data

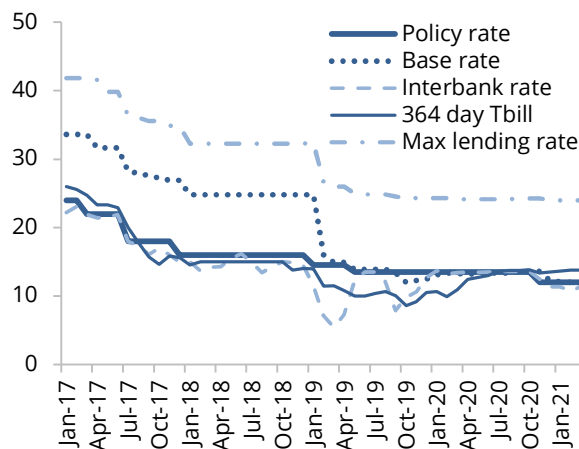
Note: Net reserves from April onward are estimated by assuming a constant level of liabilities from March

The Monetary Policy Rate was maintained in January

35. After the Monetary Policy Committee (MPC) reduced its key policy rate in November 2020, it maintained the rate in January 2021 (Figure 20). The MPC noted the need to let the impact of the November 2020 rate reduction transmit through the economy, while containing impending inflationary pressures, and still providing space for economic recovery. After a significant increase in yields on T-bills and T-notes in the first half of 2020, since then rates have increased only marginally (Figure 21). The increase was driven by a surge in the Government's domestic borrowing, particularly in longer term T-notes in the first eight months of 2020 (Figure 16 17). Liquidity conditions have remained tight, with inter-bank rates closely tracking the monetary policy rate.

Figure 20: The policy rate has been maintained since November 2020

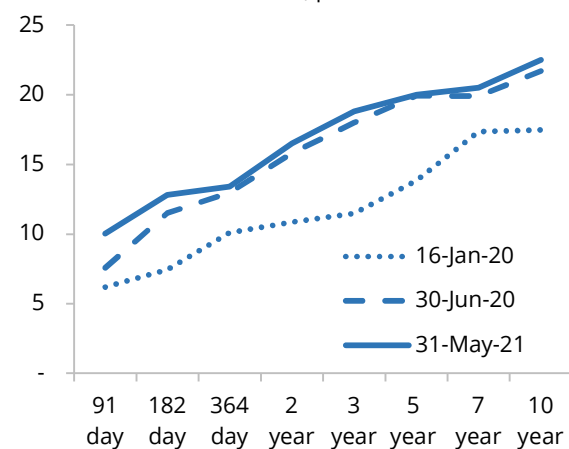
Percent



Source: World Bank staff calculations based on RBM data

Figure 21: Government borrowing yields have increased only slightly since mid-2020

T-bill & T-Note interest rates, percent

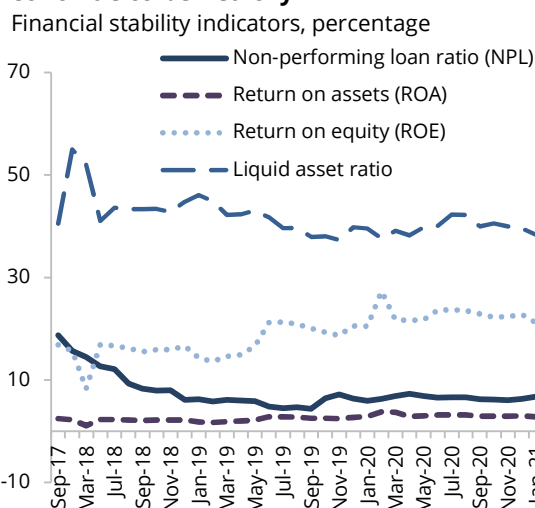


Source: World Bank staff calculations based on RBM data

The banking sector has remained resilient through the pandemic

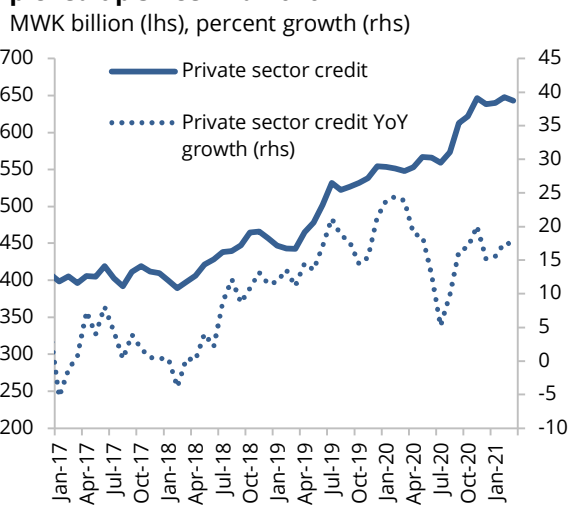
36. Malawi's commercial banks have registered profits and maintained healthy capital and liquidity positions. As of March 2021, the banking sector's return on equity stood at 24.5 percent, an increase from 21.8 percent in March 2020 (see Figure 22). Return on assets stood at 3.3 percent, a modest decline from 3.1 percent a year earlier. The liquidity coverage ratio was at 38.9 percent, and the tier 1 capital ratio was at 20.0 percent. The private sector faced a number of challenges in the year due to COVID-19, and non-performing loans (NPLs) reduced over 2020 to 6.1 percent in November, before gradually deteriorating to reach 8.3 percent in March 2021.

Figure 22: Financial soundness indicators continue to be healthy



Source: World Bank calculations based on RBM figures

Figure 23: Private sector credit growth has picked up since mid-2020



Source: World Bank calculations based on RBM figures

37. A moratorium on payment of bank interest, principal on loans and the fees levied by mobile network operators (MNOs) was extended to June 2021, following the expiry of an earlier measure in response to COVID-19 in December 2020. As a result, borrowers would continue to negotiate with their respective banks on the restructuring of loans. About 1,900 loans for a total value of MWK 13.4 billion (US\$17.5 million or about 2 percent of private sector credit) were granted a repayment holiday as part of the RBM's temporary measures to support firms affected by the pandemic. It is possible that a portion of these borrowers could struggle to repay their loans or loans could become non-performing once the moratorium deadline ends, potentially raising the NPL ratio.

38. Lending to the private sector remained robust, apart from a decrease around July, despite the impact of the pandemic on economic activities. Overall growth (y-o-y) largely rebounded by the fourth quarter of 2020 and remained strong in the first quarter of 2021 (Figure 23). The community, social and personal services sector had the largest share of loans,⁷ followed by wholesale and retail trading; agriculture forestry, fishing and hunting sector; and manufacturing sector.

39. Banks remain vulnerable to a number of risks. The single borrower exposure concentration risk remains a challenge, partly due to waivers by the RBM on single exposure limits, especially for goods which are deemed sensitive for the economy such as fuel. Liquidity risk is evident with banks using short-term liabilities (mostly deposits) to invest in longer term assets, putting them at risk should there be high demand to withdraw short-term liabilities. Malawi's bank resolution framework and financial sector stability framework need strengthening to ensure the sector is resilient and prepared to deal with such shocks.

⁷ The share of community, social and personal services loans increased largely due to reclassification of "unsectored" loans to this sector.

1.3 Medium Term Economic Outlook

40. The global economy has strengthened and is projected to grow at 5.6 percent in 2021.

The approval of several vaccines, initiation of vaccination, and stronger economic performance at the end of 2020 have all contributed to this optimism. In addition, the easing of restrictions, adaptation to lockdowns, and expansionary policy responses, like those adopted in the United States and Japan, have further improved the prospects for global recovery.

41. Recovery across SSA is likely to be uneven and slow. Higher commodity prices will support recovery in resource-intensive countries. Among non-resource-intensive countries, rebounds in private consumption and investment will support recovery. However, limited policy space and a sluggish vaccine rollout will weigh on recovery in the region. Countries reliant on tourism will face challenging recoveries given the slow normalization of cross-border travel. Non-pandemic related sources of risk also threaten recovery. Political instability may arise as there are 13 countries holding elections in 2021 and others facing elevated security concerns. A withdrawal of international policy support or a reversal of capital flows could also further limit countries' fiscal space and add pressure to debt sustainability and currency depreciation.

42. While advanced economies are poised to recover thanks to extraordinary fiscal stimulus, countries in SSA have faced severe second waves and some incipient third waves in the midst of depleted fiscal reserves and monetary buffers.

Similarly, most countries in SSA will struggle to receive and administer enough vaccine doses to cover their populations, which risks weighing on growth in the region for a longer period. Policymakers may find themselves in a position trying to contain an outbreak, while simultaneously trying to boost and rebuild the economy. The extent to which SSA can recover ground lost during the crisis will depend on their ability to create fiscal space, spend effectively, and attract external funding to support the pandemic response, vaccinations, and economic recovery.

43. Considerable uncertainty remains in the global economy. On the upside, the rapid manufacturing of vaccines, their distribution, and the effectiveness of therapies, would help countries overcome the pandemic faster. In turn, this would have positive impacts on firms and households, raising consumption, investment, employment, and boosting demand. However, renewed surges of the virus and new variants, reinstated lockdowns, and obstacles to vaccine deployment, ranging from logistical challenges to vaccine hesitancy and limited fiscal space, could slow this recovery, particularly in SSA. In addition, inadequate policy responses, continued bankruptcies, and deteriorating financial stability could exacerbate economic distress.

44. Malawi's economic growth is projected to rebound slightly to 2.8 percent in 2021.

Favorable weather and the impact of the AIP have contributed to a one-time jump in the maize harvest up to 4.5 million tons. Tobacco production is projected to increase slightly after last year's weak harvest, by 7 percent y-o-y to 122 million kilograms, and auction sales have been strong in the first eight weeks. Combined, this should result in strong agricultural production for the year.

45. Looking toward 2022 and beyond, continuing the AIP in its current form is unlikely to lead to another boost to maize production and it will not help diversify growth.

Instead, the risks of the program will heighten with time, as it depletes fiscal space and diverts resources from badly-needed investment to encourage diversification and commercialization (such as in irrigation and research and development) as well as in economic diversification out of agriculture. As maize production is still vulnerable to weather shocks, the risks of losing the considerable expenditure on AIP with a drought will increase by the year. This combines with the main export of tobacco projected to decline in the medium and longer term, calling for increased investment in diversifying Malawi's economy. While mining could support growth, development of the sector should be informed by realistic expectations in terms of job creation, and resources would need to be carefully managed.

Mobile money has expanded with the pandemic and supporting the expansion of digital services could provide a new avenue for diversification (see special topic).

46. Limited vaccine availability and uptake will continue to necessitate social distancing policies and perpetuate risks of a new wave of cases, thereby weighing on growth in the services and industry sectors in 2021. Limited uptake of vaccines and vaccine hesitancy could significantly increase the risk of new waves of cases and thereby impact future growth. International tourism is also unlikely to rebound in the short term, further weighing on growth.

47. Sustained economic recovery is also at risk from rising macroeconomic imbalances and continued government borrowing to support consumption at the expense of much-needed investment. Increasing domestic debt levels raise interest rates, increasing the costs for private sector investment. After several years of 'super-stability,' while the depreciating exchange rate should gradually help to reduce a significant trade imbalance and increase export competitiveness, it will also increase imported inflation and external borrowing levels.

48. Inflation expectations are mixed. Food inflation is likely to remain subdued in 2021 due to the strong harvest but will continue to be at risk in future years in the event of unfavorable weather. Demand for maize in the region could also increase food price pressures. In addition, exchange rate depreciation will continue to exert pressure on non-food inflation.

49. The fiscal deficit may remain elevated in the medium term. Revenue performance has been affected by the pandemic's impact on growth as well as personal income tax reductions and will continue to be subdued in the medium term with limited growth. A clear Government focus on diversification and growth is needed to expand revenues. Performance of grants from bilateral partners could also be affected as countries refocus their resources to support their own economies. Meanwhile, spending pressures for pandemic response are expected to continue, as well as increased interest expense and spending arrears. Additional fiscal risks could also materialize from SOEs, weak PFM systems, and the input subsidy.

50. Public debt is expected to increase in the medium term. The Government may continue borrowing on the domestic market to cater for financing shortfalls, which will likely push domestic debt upwards. In addition, exchange rate depreciation will increase external debt in local currency terms. With increased borrowing there is a risk of increasing interest rates and crowding out private sector investment. This highlights the need for fiscal consolidation to reduce domestic interest rates, as well as implementing policies that increase growth and investment, which will also help reduce the debt burden.

51. The current account deficit is projected to remain elevated in the medium term. Lifting the maize export ban is an encouraging step that will support exports, but a sustainable increase in exports will only come in the medium and longer term, where—if investors experience a consistent transparent and predictable increase in trade openness—they may increase investment in the agriculture sector, thereby increasing commercialization, incomes, and also food security. On the other hand, the implementation of the recently-gazetted export mandate regulations for a number of agricultural primary and value-added could increase the cost and administrative burden of exporting, thereby potentially increasing informal exports. Nonetheless, a modest uptick in tobacco production in 2021 and a projected increase in global tea prices should support exports in 2021. Increasing international oil prices may increase the fuel import bill, yet exchange rate depreciation should also help improve the trade balance in the medium term. Remittances are likely to rise closer to pre-pandemic levels as the global economy gradually recovers. However, in the medium term and longer term, limited diversification beyond rainfed subsistence agriculture and declining global demand for tobacco will contribute to a sustained current account deficit.

Bold reforms are needed to increase and diversify growth while reducing domestic borrowing

52. The new Government is at a critical juncture. It needs to increase growth to 5 percent and above to increase incomes and employment, as well as to boost tax revenues in order to reduce an increasing domestic debt burden. Strengthening growth and resilience also requires diversifying the economy away from rain-fed maize and tobacco production. Yet it must also rein in fiscal expenditure, to avoid further increasing domestic debt and crowding out private investment. It will have to balance this with continued efforts to contain the COVID-19 pandemic, expanding vaccination, and protecting the poor against future shocks. Addressing these issues calls for actions in four key areas:

1) Continuing with COVID-19 containment is critical to reduce vulnerability to future waves:

- **Malawi should continue with current efforts to contain the COVID-19 pandemic in order to reduce vulnerability to future waves.** This would include: expanding testing, particularly at service delivery points and ports of entry; strengthening contact tracing across the districts; containing outbreaks among high-risk populations (such as healthcare workers and those at risk of severe disease); ensuring access to essential care for COVID-19 such as medical oxygen; and maintaining other pandemic control measures such as universal face mask mandates and hygiene measures, as well as limiting large gatherings. The Government should also accelerate deployment of the COVID-19 vaccine, with attention to generating demand, addressing hesitancy and maintaining equity in access. Maintaining essential health services while doing this will help avoid a worsening of broader health outcomes.

2) To create a foundation for macro stability and growth, the Government needs to reduce high fiscal deficits and domestic debt:

- **Lower deficits will reduce domestic financing needs and create a foundation for growth and stability.** High fiscal deficits funded by high-cost domestic borrowing pose a considerable risk to fiscal sustainability, with domestic debt service comprising an increasing share of revenues. Malawi needs a sustainable fiscal policy so that it can reduce debt service costs. Fiscal consolidation in the medium term will be needed. Instead of borrowing from domestic sources for recurrent expenditure, this should be covered as much as possible by domestic revenues. This will require prioritizing expenditure in a sustainable medium-term fiscal framework, based on realistic revenue and grant assumptions. Malawi has critical spending needs across a range of sectors, and this will require focusing expenditure where it can achieve the most impact. This will require hard choices about expenditure priorities, including ensuring that subsidies for agricultural production are sustainable and containing an increasing wage and pension bill. The Government should ensure to closely scrutinize domestically-financed development expenditure through rigorous cost-benefit analysis in order to ensure the returns from projects are justified by high borrowing costs. This will increase fiscal space for public investment and enable lower interest rates to support private investment. Efforts to increase revenue mobilization should be balanced with promoting the business environment to enable growth.
- **Reducing the fiscal risks posed by SOEs and a pipeline of PPPs is critical for fiscal sustainability and to strengthen service delivery.** Weak oversight of SOEs and PPPs increases their fiscal risk while also reducing their effectiveness and service delivery. The Government has made strides to improve the oversight of SOEs and should strengthen efforts to enhance compliance with timely financial reporting and audits. This will improve information flow and allow for effective risk management. It can then analyze aggregate and parastatal-level fiscal risks and expand the coverage of SOEs in this analysis. In doing so, it should also include scrutiny of the fiscal

risks of PPPs.⁸ It should promote the competitive selection of SOE management, hold it accountable for results, and conduct independent forensic audits on parastatals that have had issues with their performance and integrity.

- **Strengthening PFM systems will help use limited public resources more efficiently.** Financial management practices need to be strengthened to make the best use of limited fiscal funds. This calls for stronger budget credibility, combined with implementing commitment controls so that controlling officers do not commit resources outside the financial management system and contribute to arrears. Rolling out the IFMIS to all MDAs prior to full quality checks on its functionality may increase PFM risks and would need to be carefully managed to ensure a return on the Government's investment in the system and to maintain the integrity of public resources. The Government continuing a phased rollout with quality assurance and stabilization of the system would help ensure that critical issues and lessons from the first phase of implementation are addressed, which will be key to the success of second phase. In addition, ensuring transparent and competitive procurement can strengthen value for money of limited fiscal resources. Moreover, independent audits of public resources help identify weaknesses in PFM systems and should continue, and the Government should ensure adequate follow-up on addressing identified gaps.⁹

3) The Government should focus on diversification and growth in order to increase incomes and revenues:

- **Promoting diversification and commercialization in the agriculture sector is the first pillar of Malawi 2063 and will be key to increasing incomes and strengthening resilience.** Malawi has enjoyed three consecutive years of good harvests which have helped offset the impact of the COVID-19 crisis. However, its continued reliance on rainfed subsistence agriculture increases its vulnerability to weather shocks. As such, it needs to rebalance spending in the agriculture sector away from fiscally unsustainable maize input subsidies and toward investment to promote diversification and growth. This includes supporting more sustainable farming practices and climate-smart agriculture technologies including irrigation, as well as nutrition-sensitive crops such as legumes and biofortified maize varieties. Subsidy programs need to be affordable, to avoid worsening domestic debt levels and crowding out private sector investment. They can be more cost-efficient by fixing the subsidy amount and strongly engaging the private sector in the distribution.¹⁰ In addition, commercializing agriculture requires predictable and transparent trade policies for agricultural products. As such, a sound implementation and monitoring framework of trade measures under the Control of Goods Act would help safeguard food security and balance this with increasing export potential, as well as development of various value chains. As part of this, the rules for the implementation of the export mandate regulations should be assessed in consultation with the private sector to avoid creating additional market distortions. A reliable, transparent trade policy would, in turn, stimulate investment and commercialization in order to increase production, food security, and exports in the medium term. ADMARC's market interventions also need to be transparent, timely, and predictable, in order to avoid causing distortions. Promoting the new seed and fertilizer policies can also increase regional seed trade and improve productivity.
- **Policies to increase diversification outside of agriculture, including through digital transformation, will be critical to enhance productivity and job creation.** Expanding access and improving reliability of the electricity supply will be critical to increase value addition and

⁸ For more discussion on fiscal risks, SOEs, and PPPs, see World Bank Malawi Public Expenditure Review 2019: Putting Fiscal Policy on a Sustainable Path; as well as World Bank Malawi Economic Monitor, December 2020: Doing More with Less.

⁹ The Government has made notable progress, for example, in terms of preparing consolidated audit reports of SOEs and the audit of COVID-19 resources, which are helping strengthen public oversight, yet timeliness and coverage needs to increase.

¹⁰ For more discussion on policy options related to the AIP, see World Bank Malawi Economic Monitor, December 2020: Doing More with Less.

support economic diversification. As such, this calls for continued progress on critical investment projects in energy generation, transmission, and distribution. This will need to be complemented with stronger governance at key utilities in the sector, including through competitive, merit-based recruitment.¹¹ In addition, the Government can make deliberate efforts to review and revise tax policies and administration and business regulations in order to increase transparency, reduce ad hoc changes, and to support value addition, particularly in key growth-enabling sectors such as manufacturing and ICT. Moreover, the Government can harness growth in the mobile and ICT sector, where COVID-19 measures have contributed to the growth in mobile and e-transactions and services. The ICT sector broadly could be supported by reviewing the tax regime, levies, and tariffs to enable greater customer access; and fostering competition in the broadband infrastructure development market, including a review of the Malawi Communications Regulatory Authority's (MACRA's) regulations to reduce market distortions (see special topic). Finally, limited access to credit is a key constraint to business. Reducing Government domestic borrowing will also ease pressures on interest rates, enabling broader access to finance for SMEs. In addition, the ongoing moratorium on repayment of loans may need to be extended on a case-by-case basis, or allow for restructuring of repayments.

4) There is a need to invest in mechanisms to increase resilience to shocks:

- **Poverty reduction measures have historically been focused on fertilizer subsidies and maize distribution following shocks, but targeted social protection systems are a more efficient use of limited public resources.** Investing in shock-responsive social protection systems can help ensure preparedness for future crises. Targeted social protection systems are a more efficient use of limited fiscal resources to support the poor than blanket input subsidy programs.¹² To expand this would call for consolidating Malawi's social protection systems through upgrading existing cash transfer, public works, livelihoods support, and economic inclusion programs to have a comprehensive resilience building program for the poorest populations. This also entails improving delivery systems including investments into an adaptive Unified Beneficiary Registry (UBR) for rapid and objective intake and registration of beneficiaries. It also includes expanding digital payments of safety net benefits to ensure rapid and secure payments, so that such programs can reach the vulnerable more quickly, efficiently, and transparently, with flexibility to rapidly scale-up in times of crises. In addition, it is essential to strengthen policies related to environmental management, climate change, and Disaster Risk Management (DRM), and to continue to strengthen climate and information services. Improving DRM will also reduce Malawi's vulnerability to weather shocks and limit fiscal risks.

¹¹ See "Doing More with Less," Malawi Economic Monitor, December 2020.

¹² For more discussion of the efficiency, equity, and effectiveness of various social protection programs, see World Bank Malawi Public Expenditure Review 2020: Strengthening Expenditure for Human Capital.

2. INVESTING IN DIGITAL TRANSFORMATION

Malawi's growth trajectory has lagged the region for decades. Despite a modest shift from farm to non-farm rural livelihoods, economic transformation, through diversification, commercialization and urbanization has not kept up with rapid population growth. Meanwhile recent shocks—including the COVID-19 pandemic—continue to be major obstacles to growth and poverty reduction. Malawi's economic growth fell to an estimated 0.8 percent in 2020, down from previous projections of 4.8 percent, as the services and industry sectors slumped amid the disruptions caused by the pandemic to global value chains, trade, logistics, tourism, and remittances.

Malawi should develop the digital economy to not only diversify but also strengthen economic growth, job creation, and innovation. Digital technologies have the potential to transform all aspects of the economy, by lowering the cost of economic and social transactions for firms, individuals, and the public sector. Digital investments boost economic growth, expanded job opportunities, and improved service delivery. Rather than focusing solely on the information and communication technology (ICT) sector, the digital economy refers to a modern economy enabled by digital technologies. The African Union launched the Digital Transformation Strategy for Africa (2020-2030), with the objective to “harness digital technologies and innovation to transform African societies and economies to promote Africa's integration, generate inclusive economic growth, stimulate job creation, break the digital divide, and eradicate poverty for the continent's socio-economic development and ensure Africa's ownership of modern tools of digital management” (African Union, 2020).

Given the importance of the digital economy to increasing productivity and efficiency, its potential benefits are amplified in the context of the COVID-19 crisis. Malawi will need to rely on digital technologies to ensure that public services, businesses, and individuals are able to withstand current and future pandemic preventative measures, ensure business continuity, and prevent service interruptions. Widespread access to information and communication technology (ICT) services can offer a powerful platform to remove barriers of distance, lower cost in the delivery of public services, and improve human development, contributing to economic growth and reduced poverty.

Malawi can capitalize on the digital economy to boost productivity and achieve robust sustained and inclusive economic growth. By leveraging ICT and tech-entrepreneurship, and improving digital skills, Malawi's private sector can contribute substantively to economic growth, nurture innovation, catalyze job creation, and attain better access to markets and information. Similarly, full integration of the government's systems and platforms will support improved safety net targeting and delivery of public services and foster transparency for better fiscal management and management of future crises. Given significant fiscal constraints, leveraging private sector investment is critical. The Government must prioritize reforming the tax regime in the ICT sector, fostering competition in the broadband infrastructure development market, and incentivizing private sector investment in the digital entrepreneurship ecosystem.

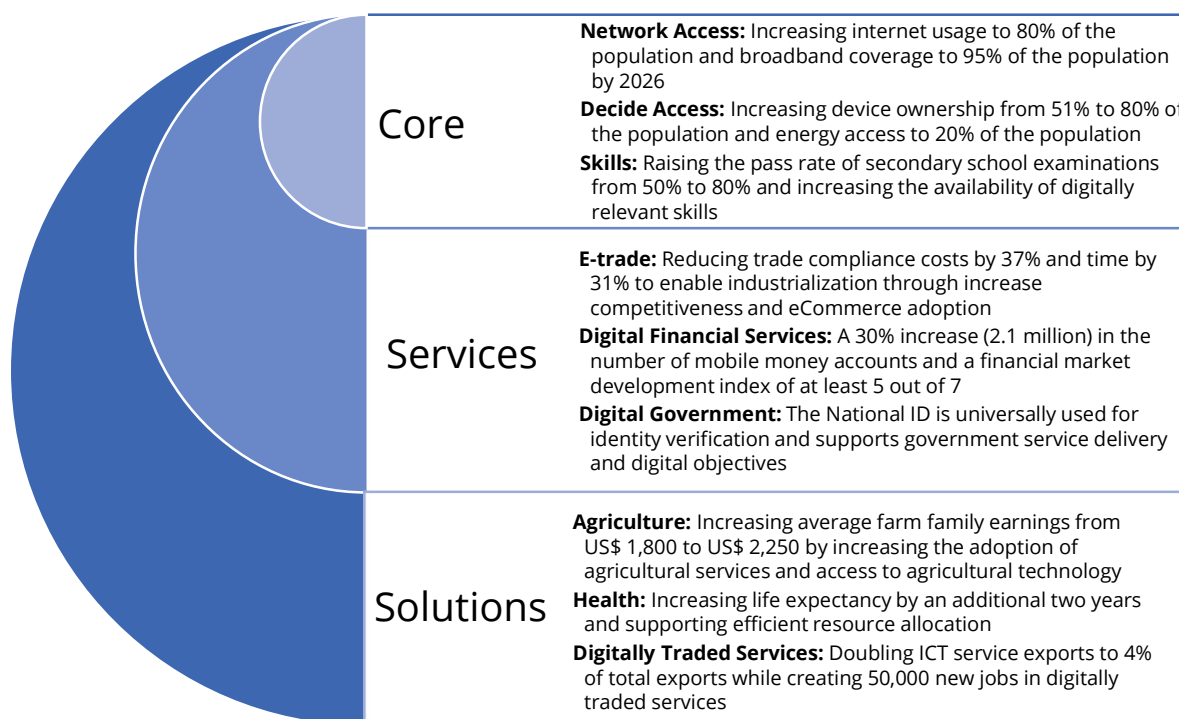
The state of Malawi's digital economy

53. Over the past decade, Malawi has emphasized the need to digitize its economy. Malawi launched the National ICT Master Plan in 2014 to operationalize the 2013 National ICT Policy. In 2019, Malawi adopted the national broadband strategy and a cyber security strategy. The COVID-19 pandemic has accelerated this priority, as the government continues to rely on digital technologies to ensure that public services, businesses, and individuals are able to withstand social distancing, ensure business continuity, and prevent service interruptions.

54. Most recently, the Government rolled out a five-year Digital Economy Strategy which sets new targets for different aspects of the digital economy (Figure 24). As outlined in the Digital Economy Strategy 2021-2026, the Government aims to create a strong digital ecosystem that can

enable critical sectors, such as agriculture and health, while supporting a growing ICT sector that provides goods and services which ignite rapid economic growth and create employment opportunities. The strategy is also a critical step toward achieving Malawi's revised long-term development plan – Malawi 2063 (MW2063). This vision seeks to establish Malawi as an industrialized upper middle-income country with wealthy and self-reliant citizens by the year 2063.

Figure 24: Malawi's 2026 Digital Economy Strategy – Target Outcomes



Source: Government of Malawi (2021)

55. To achieve the objectives outlined in the Digital Economy Strategy 2021-2026, the Government must develop a robust digital ecosystem. It is critical for Malawi to expand connectivity infrastructure, while raising the foundational and digital literacy, so that the majority of the population can access and productively use new technologies. Entrepreneurs and private sector firms can leverage these foundations to develop an innovative ecosystem that offers a range of digital financial, health, social, and business services. At the same time, public service platforms must be integrated and made accessible, providing two-way channels for Government agencies to improve accountability, communication, and service delivery to citizens. Expanding Malawi's digital foundations will create ripple effects across critical economic sectors, including agriculture (Box 3).

56. The Government has partnered with the World Bank to conduct an assessment of Malawi's digital economy as part of the Digital Economy for Africa (DE4A) initiative. The DE4A initiative supports the digital transformation strategy for Africa prepared by the African Union (African Union, 2020). DE4A leverages an integrated and foundations-based diagnostic framework to examine the present level of digital economy development across Africa based on five (5) core foundations of the digital economy: Digital Infrastructure; Digital Platforms and Services; Digital Financial Services and payment systems; Digital Skills; and Digital Entrepreneurship.¹³ The next section presents findings from the assessment and provides guidance for accelerating the growth of an inclusive, innovative digital ecosystem.

¹³ The Digital Economy for Africa (DE4A) Initiative, <https://www.worldbank.org/en/programs/all-africa-digital-transformation>.

Box 3: How Digital Technologies Will Impact Malawi's Agriculture Sector

Digital technologies can help to boost agricultural productivity. In Malawi, to cope with the lack of extension workers and mobility challenges, the Ministry of Agriculture has started to use digital tools such as ESOKO, an agricultural profiling and messaging service that collects and sends out market data using simple text messaging. Under the Second Agriculture Sector Wide Approach Support Project, the Ministry has reached over 60,000 farmers with text messages on crops, livestock, nutrition, and even gender and HIV. The Department of Extension services is expanding the use of available platforms and envisaging the development of new tools in the near future. Apart from digital extension services, Malawian farmers can profit from many other tools to improve their crops, raise productivity, and increase the return on their investments. The use of drones for input application and data collection is a good example of a tool that has gained popularity in recent years among large farmers and corporations and may be scaled up to all farming sectors.

A robust digital ecosystem can improve access to markets. In Malawi, the Agricultural Commodity Exchange (ACE) is offering online services such as prices that are sent to farmers via cell phones. Digital technologies can be used in e-commerce and help to put in place digital marketplaces where sellers and buyers match their needs and do business. Digital platforms can lower marketing costs and facilitate trade in agriculture inputs and outputs.

Digital innovations can improve financial inclusion for farmers. Farmers can also profit from digital payments, digital banking, access to credit, insurance, and other financial services. FinTech can help in modernizing and deepening rural finance.

Investments in digital platforms can improve data analytics and drive evidence-driven policy decisions. The Ministry of Agriculture is using digital technologies to establish the first-ever web-based National Agricultural Management Information System (NAMIS), under the Second Agriculture Sector Wide Approach Support Project. NAMIS is an example of a tool that helps to collect and store agricultural data to inform decision making processes. It is deemed strategic to monitor and enhance agricultural productivity by improving the efficiency and quality of data collection, facilitating analysis and decision making, and monitoring and evaluating the interventions that are part of the National Agricultural Investment Plan. This is just the beginning and policy makers and the sectoral actors can profit from numerous other modern data collection and processing tools with mobile applications.

Malawi has not realized the full potential of its digital broadband infrastructure

57. Fast, high-quality and affordable broadband Internet is the foundation of the digital economy, and key to enhancing productivity, facilitating information exchange, and improving service delivery. While potential impacts vary by country, studies estimate that a 10 percent increase in mobile broadband penetration can lead to a minimum of 0.8 percent additional GDP growth (Endquist et al., 2018; Koutroumpis, 2018; ITU, 2020). Estimates for the Africa region are even higher, with projections of up to 2.46 percent of additional GDP growth per 10 percent higher broadband penetration (ITU, 2020).

58. Malawi's digital infrastructure value chain can be examined in four segments: first, middle, last and invisible miles. The Internet enters a country (first mile), passes through that country (middle mile), to reach the end user (last mile) wirelessly or via fiber and copper connections. The invisible mile includes the policy and regulatory factors that impact the performance of the first, middle and last mile. Malawi receives its Internet capacity through six international fiber links to Mozambique, Zambia, and Tanzania. Total used international bandwidth lags neighboring countries despite sufficient international links.

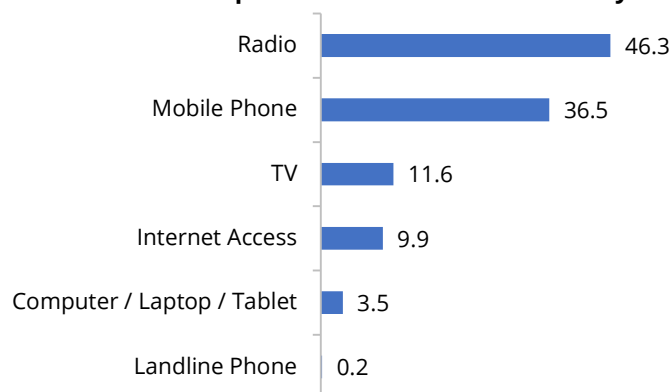
59. The foundations of Malawi's digital infrastructure are relatively well developed. Some 30.8 percent of the population lives within 10km of fiber nodes, with nearly all of the population living within 50km (CTO, 2019). This coverage extends to public institutions, as 68 percent of public institutions have direct Internet access on their premises (NSO, 2019a). Around 78 percent of Malawi's

population has 3G coverage, and 88 percent of people within Malawi have access to either a 3G or 4G signal (Research ICT Solutions, 2021; ITU, 2020). The potential economic impact of Malawi's continued digital infrastructure development is considerable. An additional 10 percent in mobile broadband penetration in Malawi could lead to US\$ 189 million in additional GDP and US\$ 33 million in additional tax revenues per year (ITU, 2020).

60. Despite these advances, low electricity coverage, amongst other things, has contributed to low access and use of ICT devices in Malawi. Currently, only 11 percent of the population has access to electricity at home, local production falls short of estimated peak local demand, and for many, electricity is unaffordable (Government of Malawi, 2021). Approximately 11.2 percent of households in Malawi used electricity for lighting and only 1.2 percent used electricity for cooking (NSO, 2019b).

61. High Internet prices, high cost of smart devices, and lack of digital skills have also prevented Malawi from realizing the full potential of its digital infrastructure. In 2017, it was estimated that only 13 percent of Malawians use the Internet (ITU, 2018). In relation to its most immediate neighbors, Malawi compared favorably to Zambia (14.3 percent) and Mozambique (10 percent), but still significantly lagged behind Tanzania (25 percent). According to the 2019 National Survey on ICT Access and Usage, 14.6 percent of individuals in Malawi use the Internet (MACRA, 2020). Ownership of ICT devices remains low, as 36.5 percent of households own a mobile phone, 9.9 percent of households have Internet access, and only 3.5 percent of households own a computer, laptop, or tablet (Figure 25). Over 90 percent of households reported being unable to afford to own a mobile phone, and 96.6 percent of households report being unable to afford to own a computer, laptop, or tablet. Household respondents also cited lack of electricity access as a main reason not owning ICT devices.

Figure 25: Access and Ownership of ICT Services and Devices by Household



Source: MACRA, 2020.

62. Individual use and access to ICT services varies by demographic factors. Roughly 72.3 percent of Malawians in urban areas own a mobile phone, and 65.0 percent report using a mobile phone. In comparison, only 37.3 percent of individuals living in rural areas own a mobile phone. However, 60.5 percent of those in rural areas report using a mobile phone, indicating that they have access to a mobile device through friends, family, or work (MACRA, 2020). Though 40.7 percent of individuals in urban areas use the Internet, this number falls to 9.3 percent for individuals in rural areas.

63. There remains a persistent gender gap in ICT access and usage. A higher proportion of men indicated that they owned a mobile phone (44.9 percent), compared to 37.7 percent of women. Similarly, 68 percent of men use a mobile phone, compared to just 56.2 percent of women. Internet use was also higher among men at 15.4 percent relative to 12.4 percent among women. Interventions to increase ICT access must seek to close these gender and geographic digital divides.

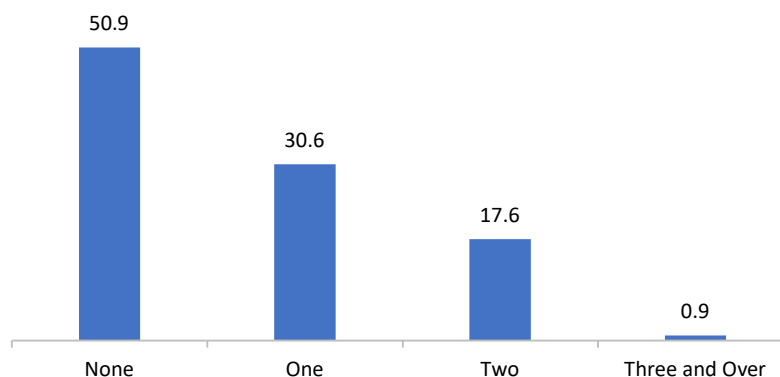
64. The lack of competition in the mobile retail market and mobile money services has led to significant market concentration and sub-optimal competitive outcomes. The mobile retail market is characterized by a duopoly with Airtel Malawi Limited and Telekom Networks Malawi PLC (TNM) serving as national network providers. In a market with more supply-side participants, one might expect to see more price fluctuations over an extended period as rival operators jockey for greater market share. However, there is little evidence of price competition between the two major operators.

65. Fixed broadband penetration is demonstrably low in Malawi despite a significant number of licensed Internet Service Providers (ISPs). There are approximately 12,000 subscriptions, representing only 0.06 percent penetration. Concentration of fixed broadband networks remain mainly in urban areas with mobile broadband (3G/4G) being the predominant option in rural settlements. While the African average for fixed broadband penetration is low (0.5 percent), Malawi nevertheless performs well below this average. Fast last mile connectivity should be possible; however, costly and duplicative backbone investments and an unfavorable taxation regime for ICT services lead to high prices for connectivity. Considering Malawi’s relatively low population density and high proportion of the population living in rural areas, fixed broadband will continue to be concentrated in urban markets.

66. Mobile broadband is the main avenue for Internet access in Malawi. Although there are several fixed broadband ISPs in the market, mobile access through 3G and 4G services remains the greatest hope for getting Malawians online. Despite continued growth, smartphone penetration is low owing to numerous demand-side factors pertaining to affordability and the cost of devices. On the supply side, mobile broadband signal coverage—estimated at 78 percent for 3G and 85 percent for 4G connections—demonstrates the strides made by private sector operators to enhance access (Research ICT Solutions, 2020).

67. Mobile subscription penetration and usage remain low. Mobile cellular subscriptions are estimated at 39 per 100 inhabitants, far below Africa’s regional average of 82 percent (ITU, 2020). Because the mobile market has just two players, multi-SIM use—which tends to significantly increase penetration rates in most African countries—is also prevalent in Malawi. Apart from owning a mobile phone, some individuals only own SIM cards which they use by borrowing mobile handsets from family members or friends. A 2019 MACRA survey found that 30.6 percent of individuals owned one active SIM card, and over 18 percent owned two or more SIM cards (Figure 26).

Figure 26: Share of Individuals Owning an Active SIM Card



Source: MACRA, 2020.

68. Mobile broadband prices are expensive in Malawi in absolute and relative terms, significantly hampering the uptake of ICT services. Mobile broadband prices in Malawi are relatively expensive, constituting a significant fraction of monthly income. In Malawi, a mobile data plan of 300 MB per month (10 MB per day) costs US\$ 1.70, which is 5.4 percent of Gross National Income (GNI) per capita per month. The cost of a 20GB plan exceeds monthly GNI per capita, making it prohibitively

expensive for most Malawians. While mobile broadband remains costly in most African countries, Malawi's rates remain comparatively more expensive than other countries in the region (Table 2). In Africa, 20 countries were cheaper than Malawi for 300 MB per month prepaid data use in Q1 2021, 33 for 1GB per month and 61 for 20GB per month (Table 3). Malawi is at the bottom end of affordability rating when expressing prices in terms of GNI per capita per month. It ranked 46 for 300 MB per month, 49 for 1GB, and 50 for 20GB.

Table 2: Malawi's Broadband Affordability Country Comparators (Q1 2021)

	300 MB		20GB	
	US\$	Percent of GNI per capita per month	US\$	Percent of GNI per capita per month
Malawi	1.70	5.4	39.56	124.9
Tanzania	1.29	1.4	6.47	7.2
Mozambique	1.22	3.1	13.58	33.9
Zambia	1.18	1.0	15.42	12.8
Uganda	1.08	1.7	12.97	20
Rwanda	1.02	1.5	10.16	14.9
Botswana	5.37	0.8	35.83	5.6

Source: Research ICT Solutions – ICT Evidence Portal.

Table 3: Malawi's Broadband Affordability Regional Rank (Q1 2021)

Monthly usage	US\$	African Rank	Percent of GNI per capita per month	African Rank
300 MB	1.65	21	5	46
1GB	4.50	34	14	49
20GB	38.61	52	122	50

Source: MTN Investor Relations, Airtel Malawi AFS, TNM AFS, MACRA.

69. When considering mobile data usage, Malawi trails behind its regional neighbors. Active data subscribers of mobile operators as a percentage of total subscribers is approximately 30 percent. Airtel and TNM report that data subscribers are roughly a third of total subscribers (Table 3). Critically, the number of smartphones on the TNM network as a percentage of data users is extremely low compared with other countries in the region (Table 4). This limits Airtel's and TNM's ability to sell mobile broadband data, despite Malawi's extensive 4G coverage.

Table 4: Key Indicators for 2019 Financial year

	Subscribers 1,000	Active data subscribers	Smartphones % of active data users	Data revenue as % of voice revenues	Revenues in US\$ million	ARPU US\$ Q4 2019
Airtel Malawi	4,030	1,299	32%	35%	126	2.86
TNM Malawi	3,531	1,050	30%	32%	119	2.75
MTN Ghana	19,777	8,144	41%	98%	957	4.35
MTN eSwatini	937	461	49%	109%	26	7.31
MTN South Africa	28,890	14,134	49%	132%	3,147	7.36
MTN Zambia	6,989	2,343	34%	100%	197	2.14
MTN Uganda	12,642	3,402	27%	80%	464	3.22
MTN Rwanda	5,203	1,300	25%	89%	138	2.11
Notes	US\$ values converted based on average exchange rates for 2019					

Source: MTN Investor Relations, Airtel Malawi AFS, TNM AFS, MACRA.

70. Mobile Internet access and usage is low and varies by residential location. Smartphone penetration is even lower than for feature or basic phones, since smartphones are more expensive and their batteries need to be charged more frequently. Among the individuals that own a mobile phone, only 29.5 percent own a phone that can browse the Internet (MACRA, 2020). Just over 50 percent

of individuals in urban areas had a phone capable of browsing the Internet, compared to just 21.3 percent of individuals in rural areas.

71. High data prices and a digital skills shortage limit the ability of individuals, businesses, and public agencies to capitalize on the benefits of digital transformation (FinMark Trust, 2020).

Given Malawi's low electrification and low levels of ICT asset ownership, any initiative to increase mobile or fixed broadband usage must address both supply- and demand-side barriers. For example, the World Bank's *Digital Malawi Program Phase I: Digital Foundations Project* supports high speed connectivity and access to online academic content for higher education institutions through the Malawi Research and Education Network (MAREN) (Box 4).

Box 4: The Malawi Research and Education Network (MAREN)

The US\$ 72.4 million Digital Malawi Program Phase 1: Digital Foundations is supporting high speed connectivity and access to online academic content for higher education institutions through the Malawi Research and Education Network (MAREN). MAREN is a member of the UbuntuNet Alliance, a collective of research and education networks (RENs) in East and Southern Africa. As part of UbuntuNet's Africa Connect 3 project, MAREN has access to very low-cost international connectivity, academic content, and training opportunities.¹⁴

MAREN has procured total international capacity of 1,800Mbps from UbuntuNet, of which 622 Mbps is being provided through Zambia and 1,200 Mbps is being provided through Mozambique. The MAREN data network became operational toward the end of 2020 and they are currently at the rate of US\$ 85/Mbps/month. This makes MAREN the lowest cost Internet service provider of non-shared bandwidth in Malawi. MAREN has contracted open connected limited (OCL), a fiber network provider) to provide connectivity to 61 higher education sites in Malawi. To date, 21 sites have been connected resulting in 34,061 additional students accessing Internet services out of which 14,085 are women and 19,976 are men.

MAREN has also been supporting schools that have been affected by the COVID-19 pandemic. Because of their limited network and server infrastructure, Malawi's public higher education institutions were unable to successfully migrate to online teaching and learning. MAREN is supporting this transition by procuring three servers to construct a 10Gbps fiber loop interconnecting the Malawi Internet Exchange Point (MIXP) at the College of Medicine and the MAREN Point of Presence (POP) at the Malawi Liverpool Welcome Trust office. The link to MIXP will help facilitate access to academic content hosted locally by MAREN.

72. Critically, sector-specific taxes pose an obstacle to wider broadband adoption and accelerated economic growth. Malawi's mobile operators face a significant tax burden, which includes taxes and duties levied specifically against the ICT sector. The Malawi Revenue Authority (MRA) imposes a 10 percent excise duty on airtime usage. The Malawi Communications Regulatory Authority (MACRA) imposes an additional incoming internal call termination levy of U.S. 8 cents per minute. Best practice principles state that excise duties are meant to discourage undesirable behavior or consumption, rather than services that generate economic growth such as broadband access (GSMA, 2016).¹⁵ These duties and levies that only target the ICT sector are not aligned with best practice principles, distort investment, and slow economic growth which could be induced by the ICT sector.

¹⁴ The Africa Connect 3 project is supported by the European Union. For AfricaConnect 2, the membership fee was €280k Euros, and leveraged bandwidth and other services worth €1.12m from the European Union. A similar leveraged funding structure is expected for Africa Connect 3. For more information, go to <https://www.africaconnect2.net/Pages/Home.aspx>.

¹⁵ There are five best-practice features for an efficient tax system: (1) broad-based; (2) take into account externalities; (3) simple and enforceable; (4) Incentives for competition and investment should be unaffected; and (5) progressive not regressive. The excise duty on airtime and the international incoming call termination levy violate four out of five best practice principles.

Malawi has launched many innovative digital public platforms, including an electronic identification system

73. Digital platforms facilitate digital services, including digital transactions, and exchange of information, goods and services; thus, digital platforms help serve people, businesses, and government agencies in all aspects of life, including healthcare, education, and commerce.

Malawi has developed a 'whole of Government' digital government transformation strategy aligned to the national priorities and the country vision enumerated in the third Malawi Growth and Development Strategy (MGDS III 2017-2022), Malawi Vision 2020 and United Nations Sustainable Development Goals (SDGs). The strategy is premised toward strengthening the Government's ability to deliver public services through institutional strengthening, capacity building and leveraging integrated public digital systems and platforms.

74. Despite infrastructure challenges, the Government has made many innovative breakthroughs – most notably the issuance of electronic identification (ID) cards.

In partnership with development partners, Malawi launched a nationwide smart biometric identity for its citizens – the National Registration and Identification System (NRIS) (Box 5). Having successfully rolled out the system in 2017 with over 9.1 million adult citizens (16 years and above) registered and possessing new biometric identification cards, Malawi is ready to leverage the NRIS infrastructure to further accelerate financial inclusion. In the wake of the COVID-19 pandemic, the digital ID will provide a critical platform in the development of systems to respond to the crisis in a rapid and scalable manner.

Box 5: Malawi National Registration and Identification System (NRIS)

The Malawi National Registration and Identification System (NRIS) is a nationwide smart biometric identity for Malawian citizens. The project contributes to the Government's efforts to guarantee the fundamental right to identity, entitlement and enjoyment of full citizenship in Malawi. Over 9 million Malawian citizens registered for a National ID, and more than 9 million cards have been issued and distributed. This transformational rollout has been co-led by the Malawian Government's National Registration Bureau and the United Nations Development Program (UNDP), and funded by the Government of Malawi, UK Aid, European Union, Irish Aid, Norwegian Embassy, USAID and UNDP. This registration initiative has set a specific target to provide every person with a legal identity, including birth registration by 2030.

The Government is in the process of integrating the national identity register with other functional identity registers in order to provide citizens with relevant services. These include a Malawi business registration database, health registries, Malawi Revenue Authority (MRA), immigration and passport control, traffic management, and the Universal Beneficiary Register (UBR) which combines Malawi's various social protection programs into a single registry database.

75. Malawi is accelerating public service transparency and accountability through digital public platforms.

The Ministry of Finance is implementing a new enhanced Integrated Financial Management Information System (IFMIS), which, once it undergoes quality assurance and testing, could help strengthen controls on Government PFM processes. Once it is fully tested and operational, the new system could help strengthen Government revenue collection and payments platforms, foster interoperability with more than 11 service delivery public and private sector platforms including an interface with the Reserve Bank of Malawi (RBM) to facilitate migration from the current vendor cheque payments to fully Electronic Funds Transfer (EFT) payments.

76. The Government has been supporting the private sector and other actors to develop quasi-public-private digital platforms with support from the World Bank.

These innovations include a health management information system, social protection management information integrating e-wallet and smart e-ID to support mobile payments. In the water and agriculture sectors, various digital platforms innovations, including Decision Support Systems (DSS), are helping to mitigate water wastage, e-water billing and revenue management, weather forecasts, and other strategic

planning and operations decisions. In land management, the Government has successfully supported digitization of land cadastral mapping and attendant land transactions across major cities, which will expand to targeting land in rural areas. Digital platforms are also being leveraged to improve the equity and quality of primary education service delivery in early grade levels, with an emphasis on improved accountability and functioning at the school level.

77. The Government's rollout of digital public platforms has encountered several challenges. Agencies struggle to secure the required technical expertise, financial resources, and institutional authority to effectively launch and maintain platforms. Challenges of last mile connectivity delay adoption of e-Government applications by officers in district/regional offices. To compound the situation, electric power supply and Internet connectivity are intermittent and unreliable outside large cities.

Mobile money is a critical driver of digital financial services in Malawi

78. Digital financial services (DFS) provide individuals and firms with convenient and affordable channels to pay, save and borrow. DFS comprise a broad range of financial products and services, such as payments, transfers, savings, credit, insurance, securities, financial planning, and account statements, that are delivered via digital/electronic technology, online channels or via a mobile phone while building digital credit histories of those seeking financing. By using DFS, governments can increase efficiency and accountability in various payment streams, including for the disbursement of social transfers, collection of taxes and other revenues. To ensure safety and soundness, the DFS ecosystem must be anchored on a forward-looking and proportionate legal and regulatory framework (e.g., to allow market entry and innovation), robust financial infrastructures (e.g., national payment systems and credit reporting systems), and development and deployment of low-cost delivery channels (e.g., agents, point-of-sale devices, automated teller machines, mobile phones).

79. Despite significant progress in the modernization of Malawi's national payment system, financial intermediation remains low. Malawi's financial market infrastructure supports interbank transfers, automated clearing house for processing checks and electronic funds transfers, integration of microfinance institutions into the payment system, and other systems. However, cash and cheques are still predominantly used as payment instruments. In 2017, approximately 75 percent of the cash in the Malawian economy was estimated to be outside the banking system, leaving only 25 percent in the formal banking system (Reserve Bank of Malawi, 2017).

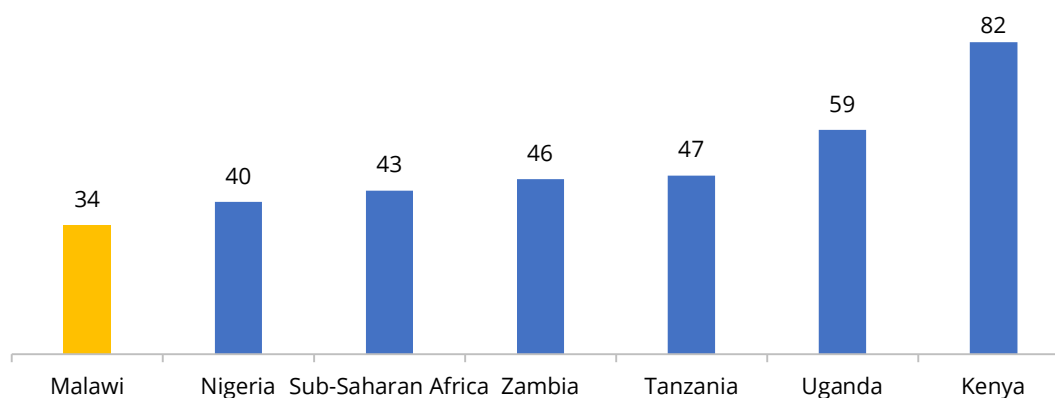
80. Digital financial services are slowly entering Malawi's financial sector, with some banks and non-banks adopting technology to offer digital financial products. Traditional banks are offering digital banking and making efforts to expand their reach through various channels that include the traditional automated teller machines (ATMs); point of sale (POS) terminals, mobile phones, branches and agent networks. The entry of non-bank players into the payments space has also changed the payments landscape. Airtel and TNM have emerged as significant players in the retail payments space, by partnering with banks to extend their services and leveraging the agent networks to reach remote communities. Remittance service providers at domestic and cross-border level have also entered the DFS space, albeit on a small scale.

81. Financial inclusion in Malawi has significantly increased in recent years. According to the 2017 Global Findex, the percentage of Malawians with a transactional account increased from 18 percent in 2014 to 34 percent in 2017 (World Bank, 2018).¹⁶ However, Malawi lagged behind the Sub-Saharan Africa regional average of 43 percent and comparator countries like Kenya (82 percent), Nigeria (40 percent), Tanzania (47 percent), Uganda (59 percent) and Zambia (46 percent) (Figure 27).¹⁷

¹⁶ A transactional account is an account at a bank or another type of financial institution or mobile money service.

¹⁷ All data points are taken from the 2017 Global Findex Database unless otherwise stated.

Figure 27: Individuals with a Transaction Account in 2017 (percent age 15+)



Source: World Bank (2018)

82. Mobile money has emerged as a catalyst for the rise of DFS in Malawi. The number of mobile money accounts in Malawi rose from fewer than 1,000 accounts to 1.8 million active accounts between 2012 and 2017. The proportion of Malawians having a mobile money account increased from 4 percent in 2014 to 20 percent in 2017 (World Bank, 2018). The usage of digital channels to make payments has also increased, with approximately 28 percent of adults making or receiving a digital payment in the last 12 months in 2017, compared to just 11 percent in 2014. Remittances are primarily sent or received through a mobile phone. The 2017 Global Findex shows that 31 percent sent or received domestic remittances in the past year, primarily through a mobile phone.

83. This upward trend has accelerated during the COVID-19 pandemic. The RBM reported a significant increase in overall performance of retail DFS transactions as of the end of 2020 (Table 5). Mobile money services subscribers numbered 7.6 million, and mobile banking subscriptions reached 1.0 million. Mobile payments increased in volume by 18.5 percent and in value by 15.2 percent between the period of Jul-Sep 2020 and Oct-Dec 2020 (RBM, 2020b). For transactions initiated through mobile phones—with the exception of cash-in and cash-out transactions (CICO services) that are mainly done through agents—airtime top-up is the transaction with the highest volume, while business-to-business transactions have the highest share on value of payments. There has also been significant impact on Person-to-Person transactions (P2P), with an increase of close to 40 percent in volume and more than 32 percent in value in September 2020.

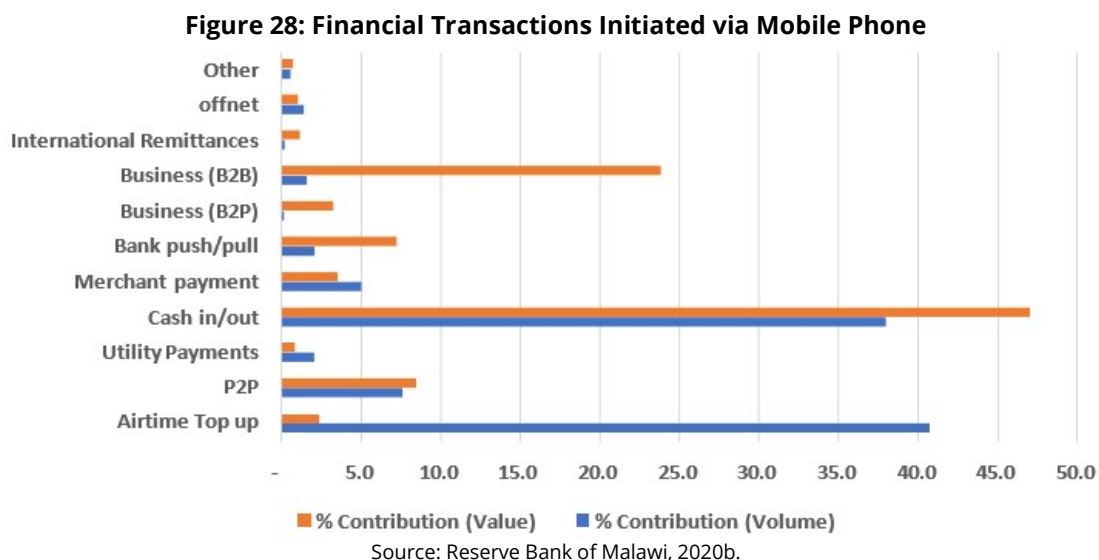
Table 5: Transaction Flows Across Various Payment Systems Channels

	Jul-Sep 2020		Oct-Dec 2020		Percentage Change	
	Volume	Value (K Billion)	Volume	Value (K Billion)	Volume	Value
RTGS	65,722	12,903.5	76,422	14,328.5	16.3	10.3
ACH	1,801,601	1249.8	1,754,520	1402.0	(2.6)	12.2
EFT	1,526,526	659.2	1,467,443	772.9	(3.9)	17.2
Cheques	275,075	590.6	287,077	629.3	4.4	6.6
ATM	4,001	0.2	3,500	0.2	(12.5)	-----
Internet Banking	696,797	1075.9	714,317	1060.9	2.5	(1.4)
Mobile Payments	129,149,965	862.4	148,186,556	994	18.5	15.2
POS	506,412	16.2	582,569	20.9	15.0	29.0

Source: Reserve Bank of Malawi (2020b)

84. Mobile money agents facilitating cash-in and cash-out (CICO) services are a relevant component of the non-bank mobile payments ecosystem. This is reflected not only by their share of transactions but also in the growth of number of mobile payments agents servicing non-bank

entities. CICO services contributed to over 45 percent of transactions initiated via mobile phone (Figure 28).



85. Although there has been an increasing reliance on digital payments, access and use of DFS remains low. In 2019, roughly 31.6 Malawians reported using at least one form of digital financial services (MACRA, 2020). There are also demographics gaps in DFS access and use, as 33.0 percent of men and 27.7 percent of women report using digital financial services. The geographic gap is even larger, with only 25.4 percent of individuals in rural areas using digital financial services, compared to 62.5 percent of individuals in urban areas.

86. Banks, fintech, and non-bank institutions have the opportunity to boost DFS by continuing to invest in mobile money. Banks offer a wide range of banking products and services, and technological developments are pushing them toward strategic partnerships with mobile network operators. TNM and Airtel have successfully reached remote unbanked parts of the country, facilitating domestic and cross-border transfers through mobile money wallets. Approximately 77.5 percent of mobile money agents are located in urban and semi-urban areas, with only 22.5 percent located in rural areas (Reserve Bank of Malawi, 2020b). However, Mukuru's recent acquisition of Zoona (a fintech with over 600 booths) is expected to boost the agent network coverage, and further extend financial products and services to underserved areas of Malawi.

Malawi still has a long way to go in building a digitally-skilled workforce

87. Digital skills are a critical pillar for developing a vibrant digital economy. Individuals, businesses and governments must develop the relevant competencies to make gains from local and global economies. Without digital skills, countries cannot leverage the other foundation pillars of the digital economy ecosystem (i.e. the use of Digital Platforms, Digital Financial Services, Digital Entrepreneurship and Digital Infrastructure). The importance of digital skills is further underscored by the COVID-19 pandemic, which resulted in a rise in transactions and accessing of public services via digital platforms.

88. Malawi has developed several policies and plans outlining strategies for digital skills development within academic institutions, technical and vocational institutions as well as public sector agencies. In its national ICT policies, the Government of Malawi committed to integrate ICTs in the education systems at all levels and develop a large pool of highly skilled ICT personnel (Government of Malawi, 2006). The policies strongly emphasized the use of ICTs in all levels of education, and outlined strategies to reach underserved communities, promote local content and

applications, and to use them as catalysts in Malawi's bid to build a robust digital economy. The Government has recently developed the Malawi Digital Economy Strategy 2021-2026 which outlines its Digital Economy objectives for Skills and Education (Government of Malawi, 2021). These objectives include: an 80 percent pass rate in secondary school exams; Malawians having the practical skills needed to produce and consume digital products and services; and having wider access to Education. The strategy also provides brief action points, timelines, potential financing sources and responsible parties.

89. Malawi's digital skills ecosystem is fledgling and is characterized by significant illiteracy and digital skills gaps. Literacy and numeracy are critical prerequisites to the development of a digitally-savvy workforce. Almost 3.5 million Malawians aged 15 and above are considered illiterate.¹⁸ Roughly two-thirds of Malawi's labor force have not completed primary education, while 25 percent of those that completed their primary education have not progressed to secondary school.¹⁹ There is also a significant gender gap in education. Of the 29 percent of girls who complete Standards 1-8, only 35.8 percent transitioned from primary school to secondary school in 2017 (USAID, 2019). Even fewer girls who enter secondary education access higher education. Many Malawians—45 percent of whom are youth living in rural areas—have limited employment opportunities due to limited basic and advanced digital literacy skills.

90. Implementing plans for digital skills development has remained challenging at every tier of Malawi's education system. There remains no policy for teaching ICTs to primary school students. In public secondary schools, Computer Science is primarily taught in a theoretical manner due to an insufficient number of available computers, poor power supply, and insufficient teachers with adequate ICT training. Most students encounter ICT subjects for the first time in tertiary institutions. This exposure remains limited, as do opportunities to pursue advanced degrees in Information Technology. A survey of all 58 universities and colleges in Malawi found that approximately 30 institutions offer ICT-related courses, while a handful have no websites (World Bank, 2021).

91. Public education expenditure is not targeted toward ICT education, which requires significant investment in equipment and connectivity. Malawi's expenditure on education has been increasing at a modest rate over the past six years, and currently stands at 18.5 percent of the Government's total FY2019/20 budget. However, there remain persistent disparities, especially in secondary school education where roughly 74 percent of budgetary allocation are for personnel emoluments rather than much needed ICT infrastructure for schools (UNICEF, 2019). Without comprehensive investments in the digital ecosystem, the realization of the Government's digital skills and education goals will fall short of expectations.

92. Malawi's Digital Economy Strategy 2021-2026 outlines steps for updating the national school curriculum. According to the Malawi EMIS 2019 ICT-trained teachers constitute only 0.7 percent of the total teaching force and 1.1 percent of the qualified teachers. The Digital Economy Strategy 2021-2026 includes plans to 'revise teacher training curriculum to include blended learning, device usage for education and LMS' as a means for students to achieve 'high quality skills' and an 80 percent pass rate in secondary schools (Government of Malawi, 2021). It further highlights that teacher training has been 'analog' and has thus resulted in an insufficient supply of teachers with ICT skills and qualifications.

93. Taking a market approach, it is difficult to quantify and categorize the demand and supply of digital skills. Due to insufficient data, information on digital skills demand and supply is mainly drawn from proxy data and qualitative information, such as interviews with stakeholders. In 2020, Malawi ranked 127 out of 134 countries in the Network Readiness Index, which measures the

¹⁸ UNESCO (2020). *Education and Literacy – Malawi*, <http://uis.unesco.org/en/country/mw?theme=education-and-literacy> [Accessed: March 26, 2021].

¹⁹ World Development Indicators (2011). *School enrollment – Malawi*, <https://data.worldbank.org/indicator/SE.ENR.TERT.FM.ZS?end=2011&locations=MW&start=2008> [Accessed: March 23, 2021].

propensity for countries to exploit the opportunities offered by ICTs (Figure 29). Malawi ranked 125 under the index's people pillar, which measures the usage and skills of digital technologies by individuals, businesses and governments in the digital economy, highlighting an insufficient supply of digitally skilled labor (Portulans Institute, 2020). According to the World Economic Forum's 2019 Global Competitiveness Report, Malawi ranks 137 out of 141 countries for digital skills among active population and 109 out of 141 for ease of finding skilled employees (WEF, 2019).

Figure 29: Network Readiness Index – Malawi Ranking

	Rank (out of 134)	Score
Network Readiness Index	127	25.23
A. Technology pillar	130	11.64
1st sub-pillar: Access	128	17.47
2nd sub-pillar: Content	130	5.49
3rd sub-pillar: Future Technologies	127	11.96
B. People pillar	125	19.55
1st sub-pillar: Individuals	130	14.11
2nd sub-pillar: Businesses	119	23.99
3rd sub-pillar: Governments	122	20.54
C. Governance pillar	122	34.90
1st sub-pillar: Trust	114	21.33
2nd sub-pillar: Regulation	104	51.62
3rd sub-pillar: Inclusion	127	31.75
D. Impact pillar	118	34.83
1st sub-pillar: Economy	124	9.95
2nd sub-pillar: Quality of Life	120	42.27
3rd sub-pillar: SDG Contribution	106	52.27

Source: Portulans Institute (2020)

94. Malawi still has a long way to go in building a digital-savvy workforce that will allow it to effectively utilize digital technology and the digital economy to drive economic growth, job creation, and competitiveness. Employers in the private sector struggle with a small pool of youth who have the requisite basic digital skills for their business needs, and report having to retrain them in both digital skills and soft skills. Exceptional ICT graduates are motivated to seek jobs in external markets where opportunities and remuneration are significantly higher. Employers also highlight a mismatch between content and training provided in education institutions and what is required in industries.

95. New digital skills programs led by NGOs, private sector companies, and development partners seek to address this need, with many targeting the most underserved and marginalized communities in Malawi, particularly girls and women (Box 6). For example, The Centre for Youth Development is a Malawi-based NGO which implements a range of ICT programs, including the installation of ICT labs in 44 schools, with the plan to install 4,000 computers in 200 schools within three years. However, over 80 percent of schools are unable to join the program due to lack of electricity and lack of funding for a computer lab (Tantakasem, 2019). Similarly, many digital programs and hubs offer training targeted at incubating startups, and focus less on offering digital skills training. Without reliable and affordable underlying infrastructure, it remains a challenge for both the Government and for development partners providing digital skills training to schools and other training institutions.

Box 6: Digital Skills for Girls and Women

The gender gap in educational achievements has significant implications for Malawi's digital literacy and skills development for women and girls. Malawi has a Gender Parity Index of 0.91 for secondary schools and 0.64 for tertiary schools. In 2016, for every girl enrolled in secondary school, 1.7 males were enrolled in higher education. The absence of a clear policy to bring about gender parity in education and labor force participation risks furthering the gender digital divide.

The limited number of women in science, technology engineering and mathematics (STEM) education – as well as the limited resources available for them to venture into entrepreneurship – also hinders women's participation in the digital entrepreneurship ecosystem. Social, economic, and institutional barriers to access ICTs, education, and employment restrict the ability of women and girls to start and grow digital businesses.

The following programs work with women and girls to equip them with digital skills, and support their success in digital employment and entrepreneurship:

- **USAID's Secondary Education Expansion for Development (SEED)** activity invests in school construction nationwide, bringing secondary schools closer to where the most vulnerable girls live. Priority is given to areas with high HIV burden as well as long distances to secondary schools. Higher education initiatives also bring learning closer to where students live by enhancing and expanding open distance learning (ODL) centers to provide short-term courses that reflect current and future market needs, including digital skills training.
- **Dzuka Africa StartUp Hub** provides on-the-job training and incubation for emerging entrepreneurs in Blantyre, Malawi, focusing on business training, provision of co-working spaces and access to working tools or equipment. The program focuses on empowering youth and women, and offers: internship programs; entrepreneurship programs; social entrepreneurship programs; and mentorship programs.
- **The Turing Trust ICT project** aims to provide digital skills to 9,000 Malawian girls, marginalized by gender, disability and geography and the necessary teacher training to create a sustainable pathway for digital education.
- **The Digital Malawi project** has launched a US\$ 2 million innovation grants program to support youth, especially women and girls in Malawi, to develop digital skills so they can leverage the digital economy for job creation and innovation. Six hubs - mHub, Mzuzu Entrepreneurs, Dzuka Africa, Growth Africa, Takeno Lab, and Ntha Foundation – have been awarded grants. Together, they aim to train 2,945 youth, with 50 percent being women.

Malawi's growing digital entrepreneurship ecosystem is being led by young innovators

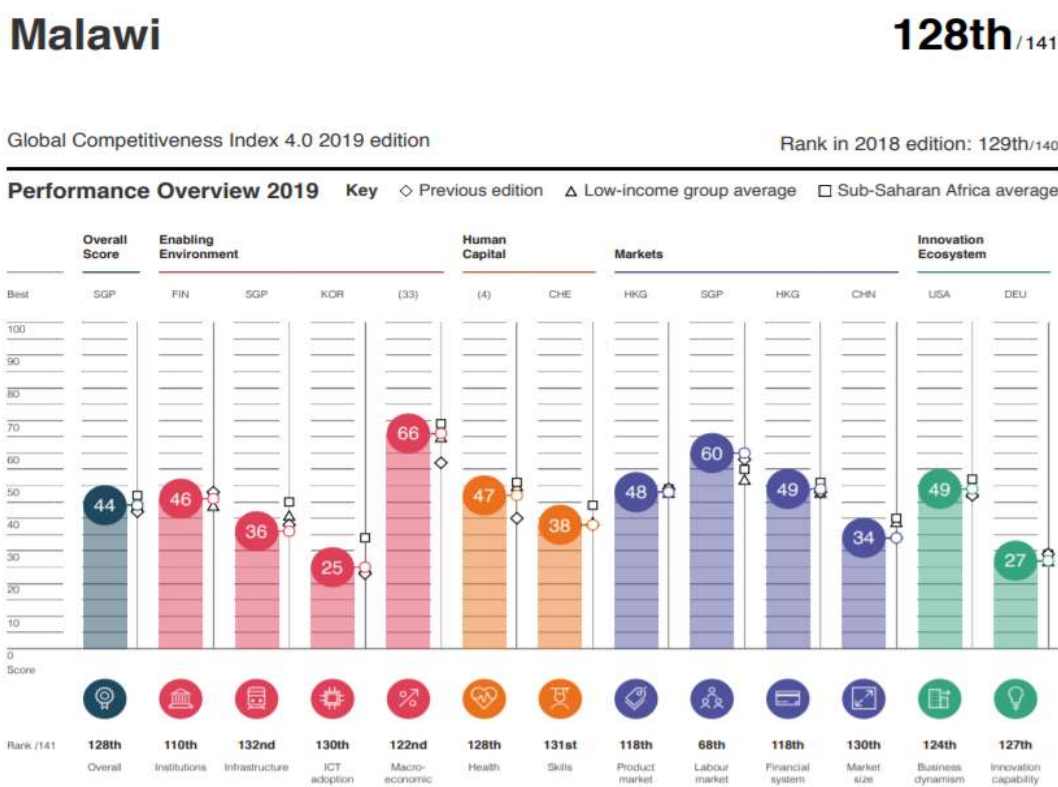
96. Firms in Malawi can reap significant rewards from the adoption of even basic digital technologies. Total factor productivity of firms in developing countries is found to rise by 1.6 percent with email adoption and by 2.2 percent with website adoption (Cusolito, Lederman and Peña, 2020). Moreover, technology adoption is key in enhancing productivity in traditional firms, especially in agriculture. In Kenya, farmers reported that the use of mobile phones to obtain pricing information via a dedicated application, M-Farm, led to improved planning and higher incomes (Baumüller, 2015). Cross-border trade also benefits from digitization, through the integration of digital technologies into logistics management, cross-border movement and now more recently into enhancing health and safety controls at the borders.

97. The policy environment for digital businesses in Malawi is evolving and there are significant gaps that need to be addressed. Malawi's Growth and Development Strategy III clearly recognizes the cross-cutting role of ICT in supporting the economic development of the country (Government of Malawi, 2018). The strategy emphasizes the links between ICT development and private sector driven growth in Malawi. Increased access to ICT services, improved ICT infrastructure and a better skilled workforce are seen as contributing factors for Malawi's further development as a 'productive, competitive, and resilient nation.' However, for digital businesses, especially startups, the

high cost of Internet connections and tariffs can prove prohibitive. Some entrepreneurship hubs establish agreements with MNOs that allow for access to cheaper Internet. This highlights the need for a review of taxes and levies in the ICT sector, as well as new policies to incentivize the provision of digital infrastructure services (for e.g., introducing a Government subsidy that is similar to the provision of serviced land for economic zones).

98. Compared to regional neighbors, Malawi's digital entrepreneurship ecosystem is nascent. Malawi ranks 133 out of 137 countries on the Global Entrepreneurship Index (Global Entrepreneurship and Development Institute, 2018). Malawi also ranks low on the World Economic Forum's Global Competitiveness Index (GCI) (Figure 30). The GCI serves as an economic compass for a country's productivity based on 12 pillars, including ICT adoption, skills, business dynamism, and innovation capability. Out of 141 countries, Malawi currently ranks 128. According to this index, Malawi ranks 130 for ICT adoption; 131 for skills; 124 for business dynamism, and 127 for innovation capacity.

Figure 30: World Economic Forum's Global Competitiveness Index - Malawi



Source: WEF (2019)

99. Traditional firms tend to use only the most basic digital technologies. Although figures have likely increased since the time of a 2014 study, at the time fewer than 45 percent of firms in Malawi reported having their own website, although nearly 80 percent used email to interact with clients (World Bank, 2014). There was also a significant gender gap—only 24 percent of women-led firms had their own websites and 56 percent used email, compared to nearly 49 percent of male-led firms with websites and 83 percent that use email (World Bank, 2014).

100. For digital businesses, especially startups, access to finance is very limited in a high-cost environment. Donors are currently the main funders for digital startups and their priorities inform the challenges which startups seek to address. One benefit of donor-driven funding is a focus on pressing social and humanitarian challenges, such as public health. However, the potential danger is that the digital sector will focus primarily or even exclusively on catering to donors and business

competitions—giving rise to a culture of ‘prizepreneurship’ versus sustainable growth entrepreneurship.

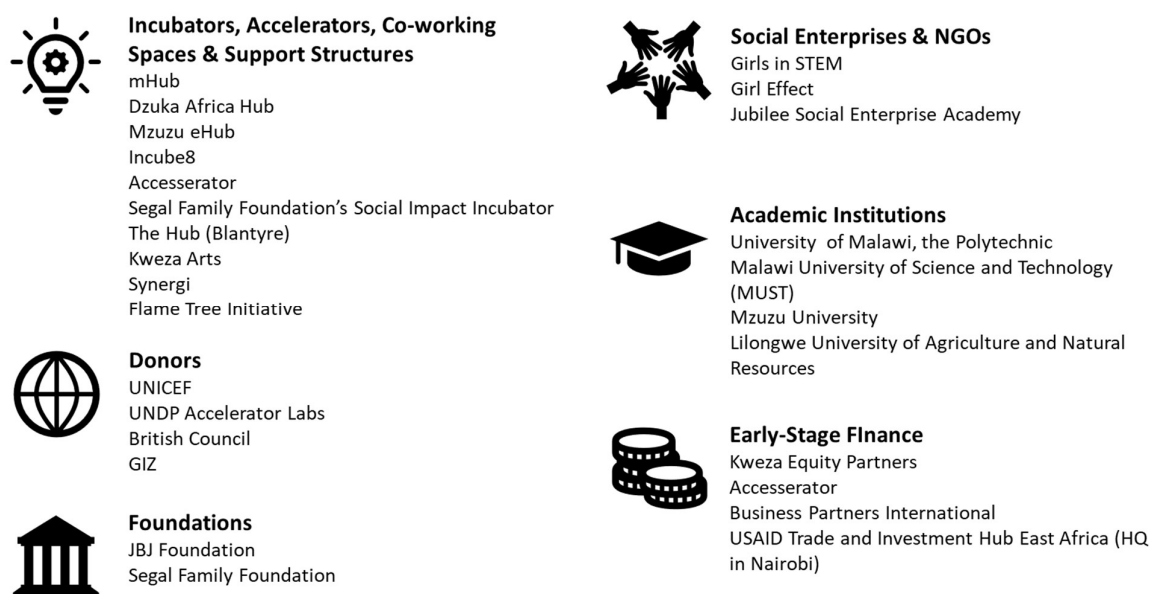
101. Access to finance at ideation, seed, and growth stages is limited and commercial banks are not viable sources of early-stage financing. Select investors, such as Accesserator (an impact investment firm registered in the Netherlands and Malawi) and Kweza Equity Partners are present in the market. Some Malawian firms have successfully raised funding from other African investors, i.e. based outside of the country. As in many other markets, digital startups are financed through a combination of personal savings and funds from family and friends, but the high-risk nature of startups means that these sources of funding may not be sustainable even for the initial time needed to develop a minimum viable product (MVP). Additionally, Malawi lacks angel investors and angel investor networks which also provide MVP and seed financing. To address the access to finance challenges of small and medium enterprises (SMEs) the government, through the World Bank-financed *Financial Inclusion and Entrepreneurship Scaling (FinES)* project, will be facilitating commercial credit to SMEs, as well as patient capital and longer-term loans to viable tech startups channeled through the Malawi Agriculture and Industry Investment Corporation (MAIIC).

102. More mature digital businesses in Malawi are not well linked with the national and regional digital entrepreneurship ecosystem and startups. Established digital businesses are mainly large platform-based and data-driven firms that have passed the initial startup stage, having acquired suppliers, contractors, and consumers rapidly. Malawian startups could also benefit from linkages to more developed regional ecosystems, such as Kenya and South Africa, which host a number of business support structures and early-stage financiers.

103. Malawi has limited e-commerce as the focus tends to be on business to consumer (B2C) though there is a greater opportunity in developing business to business (B2B) models. According to the UNCTAD e-Trade assessment, Malawi ranks 140 out of 152 countries on the 2019 e-commerce B2C (business to consumer) index (UNCTAD, 2019). According to the World Bank’s Global Findex database, only 2 percent of the population has used the Internet for online purchases (for women this is only 1 percent), which accounts for 15 percent of Internet users. As use of mobile phones expands, there is a significant market opportunity to further develop e-commerce.

104. An initial mapping of business support providers in Malawi identified 10 incubators, accelerators, co-working spaces and support structures (Figure 31). Generally, entrepreneurship hubs in Lilongwe and Blantyre are key service providers for micro, small and medium-sized enterprises (MSMEs), including digital startups. There is little distinction between incubation and acceleration services, and a limited number of providers specialize in supporting digital businesses. The mHub in Lilongwe is the first dedicated technology-focused hub in the country. The expansion of the Dzuka Africa Startup Hub from Blantyre into Limbe indicates that tech hubs are finding smaller locations to be viable areas for their operations.

Figure 31: Mapping of Business Support Providers in Malawi



Source: World Bank (forthcoming)

105. The Government can capitalize on its growing youth population, which includes an active community of young entrepreneurs who are innovating in Malawi's nascent digital entrepreneurship ecosystem in Lilongwe and Blantyre. This includes embedding entrepreneurial programming at the primary and secondary level, leveraging existing organizations, including NGOs that target youth. In addition, the FINES project includes a focus on building firm capabilities that would improve capacity and knowledge of entrepreneurs, especially youth and women, on how to leverage technology in business. FINES will facilitate the building of firms' capabilities, with measures to enhance the quality of business support provided by private and public Business Services Development (BDS) providers. The project will provide training to entrepreneurs and firms, using a three-stage approach. This training will encompass the development of psychological and technical skills, followed by measures to connect trainees with market opportunities. Concessional loans will also be provided to firms which will be selected among those who complete the entire training and graduate from the program to incentivize participation in the entire program.

106. Digital businesses have the potential to be critical elements of the COVID-19 response and recovery. Malawi hosts a dedicated humanitarian drone corridor, enabling new drone-based business pilots. In the context of the COVID-19 crisis, this corridor can create digital entrepreneurship opportunities. To capitalize on this potential, the Government must address the underlying infrastructure constraints in access and affordability. These digital businesses can serve as a critical element of Malawi's COVID-19 response and recovery strategy (Box 7).

Box 7: COVID-19 and Digital Business in Malawi

The COVID-19 pandemic is having a deep impact on Malawi's private sector and economic growth. Economic growth fell to 0.8 percent in 2020 from the 4.8 percent that was projected in September 2019 (World Bank, 2020c). Supply chain disruptions have led to trade delays. Services and industrial sectors are particularly vulnerable: for manufacturers, the slowdown in imports has led to shortages of inputs and consumer spending has also fallen. This contributed to a reduction in employment and incomes.

Digital startups bring new innovations to market that can allow traditional businesses to adapt, and help established businesses to scale up digital solutions in the health, education, and logistics sectors. Agriculture, which remains the largest sector in Malawi, would benefit from commercial technologies that can boost productivity through applications that share market information, provide technical advice, or match with buyers. Interruptions in supply chains and logistics can be better managed using data-based decision-making tools and inventory management solutions.

Similarly, existing commercial digital solutions can be scaled up. Malawi has made strides in digital healthcare solutions including equipping some members of the national network of health surveillance assistants (HSAs) with digital tools for data collection. These tools can be effectively harnessed for contact tracing; increased real-time analysis capabilities through machine learning can be leveraged to predict potential outbreaks and allocate resources more efficiently. Dissemination of public health information through models such as the Airtel 321 service (GSMA, 2017) is already ongoing and has the potential to be adapted for the COVID-19 response.

MSMEs in Malawi tend to be young and concentrated in the retail sector, making them especially vulnerable to the impact of COVID-19. For SMEs in the retail and trade sector, leveraging digital platforms offers a viable avenue to continue business activities while limiting in-person interactions. Increased investment in health and safety protocols with digital monitoring of production facilities offers manufacturing firms a pathway to maintaining operations. For younger firms, interruptions in cash flows are likely to have a greater impact as they may not have the cash reserves to weather the COVID-19 crisis. In this context, expansion of digital credit and digital financial services may offer an avenue for support.

107. Linkages with the real sector, particularly agriculture and agribusiness, offer a significant market opportunity for digital businesses. Technology adoption is a key aspect of boosting productivity in the economy, where Malawi lags. There is a need for stronger linkages between traditional firms and digital businesses to allow the latter to develop demand-driven solutions. A focus on business-to-business (B2B) models would serve to provide digital businesses with a larger market as traditional businesses are likely to have higher spending power and require digital solutions on an ongoing basis. For established digital businesses, with proven solutions, this path is perhaps more viable.

108. A key aspect of introducing and scaling up use of digital technologies in businesses would be to invest in upskilling and training on digital capabilities to enable and empower workers to use these technologies effectively. Women and girls, particularly in rural communities, also need greater support to overcome constraints in access to digital technologies which in turn limit their ability to start and grow digital businesses. Supporting Fintech startups through a specialized regulatory 'Sandbox', along with financial support, can facilitate development of local solutions for payments, transfers, and access to e-credit. A robust data protection and privacy framework would be needed for businesses to effectively and safely use digital technologies.

Taking action to kickstart Malawi's digital transformation

109. The Government has set ambitious development objectives, identifying the digital economy as a central pillar to reduce poverty and accelerate growth. Yet, while Malawi has made progress in expanding digital infrastructure coverage, connectivity remains unpredictable and expensive for many. Greater enforcement of telecommunications and financial sector regulations is needed to promote competition, protect consumer benefits, and stimulate market demand. The supply

of digital skills is low, affecting the ability of individuals and businesses to leverage digital public platforms and digital financial services. There is also a persistent rural-urban digital divide, as well as a gender divide in access and use of digital technology.

110. A holistic approach to developing the digital economy is necessary to maximize Malawi's chance for attaining its digital potential. Rather than implementing multiple, fragmented interventions, a coordinated, complementary, high-level approach is needed for building an inclusive digital economy. Most of these areas require amendments in the Insolvency Regime and Companies Act. To address challenges across the digital economy foundations and advance toward an inclusive digital economy in Malawi in the wake of the COVID-19 crisis, the Government can adopt actions under three themes: (1) Improving the enabling environment for the digital economy; (2) Driving digital transformation and demand through public-private partnerships; and (3) Strengthening competencies for digital skills and entrepreneurship. Given fiscal constraints, leveraging private sector investment is critical. Private investors stand to be incentivized through strong and transparent public-private partnerships, well-designed development projects, improved protection of minority investors, and recourse to out-of-court settlements (including becoming an official signatory to the New York Convention on Arbitrage).

1) Improving the enabling environment for the digital economy

111. The Government should define a comprehensive, industry-wide approach toward the deployment of infrastructure upgrades. The intensive development of national fiber infrastructure by competing operators is leading to duplication of shareable infrastructure. Because fiber infrastructure continues to be built along the same routes, rather than expanding into new areas, these infrastructure investments have not led to broader access. Coordination can possibly include 'dig once' mandates and 'rights of way' streamlining processes. This would avoid the duplication associated with significant capital expenditure and further ease the pressure on prices. The Government can also conduct a detailed fiber backhaul audit to establish the need for additional fiber routes. Eliminating the need for duplicative infrastructure would help to reduce unit costs for operators, eventually leading to lowered retail rates, and helping to achieve the twin aims of commercial viability and enhanced affordability of ICT services for the general public.

112. In relation to this, the Government should leverage digital infrastructure investments to roll out digital financial services in rural areas. Subsistence and commercial farmers – who constitute a majority of the working population – require agricultural inputs that can be financed through credit and savings. This creates opportunities for expanding finance to farmers and digital credit and savings to the greater part of the population. However, exploitation of these opportunities is likely to be hindered by inadequate electricity and mobile network coverage in rural communities. Efforts to develop key power, broadband, and financial infrastructure will provide the foundation for rolling out financial services to the rural population.

113. The Government should also restructure sector-specific taxation for ICT services. Malawi has 88 percent broadband population coverage and an extensive national backbone infrastructure, yet very low usage of broadband Internet. High ICT sector-specific taxes slow down urgent investment into digital infrastructure and services and increase the cost to consumers and businesses. The net effect is to lower affordability of both devices and services, leading to lower consumption.

2) Driving digital transformation and demand through public-private partnerships

114. Malawi's Government should strengthen the legal and operational framework for digital platforms and financial services. The e-Government Strategy and agenda needs to be enforced through appropriate legal mandates and regulations. Relevant enabling legislations (Acts and

Regulations) are required in the areas not limited to technology transfer, data protection, data sharing among government agencies and capacity building. The e-Government Strategy and agenda needs to be enforced in Malawi through appropriate institutional mandate. The Government may consider elevation of the e-Government Department under the Ministry of ICT to an Authority tasked with: (i) rationalizing and streamlining the management of all Government of Malawi digital economy initiatives to foster harmonization and standardization across the Government; and (ii) promoting ICT literacy, capacity, innovation and enterprise in line with the Government ICT Master Plan and e-Government Strategy.

115. The Government should also coordinate joint public and private sector efforts to enhance the digital entrepreneurship ecosystem. A coordinated public-private innovation venture fund can provide a vehicle to mobilize private investment for more risky digital startups and equity capital for established digital firms. For startups, it may be useful to leverage risk finance where public investments can mobilize private resources. Large local firms may finance growth and expansion expenditures using private equity and venture capital. Lessons can be drawn from Morocco, where the Government launched the Innov Invest Fund in 2017, with support from the World Bank and the European Union. Implemented by the Morocco Guarantee and SME Finance Group (CCG), the Innov Invest Fund invests in innovative SMEs and startups, including digital businesses, who are underserved by the local commercial banking sector. This public-private sector approach to investing in firms with higher risk profiles aimed to provide critical financing that is currently limited in the local ecosystem, while attracting other early-stage financiers (such as angel investors, and international VC funds). This model is in the process of being replicated in Jordan and South Africa.

116. The Government can also scale-up existing operations that promote use of digital technologies, with an emphasis on increasing ICT and digital device access and affordability for women and in rural areas. The ICT gap assessment found that 2 million Malawians remain unconnected. To grow an inclusive digital entrepreneurship ecosystem, it is critical to address access and affordability barriers for women, people with disabilities, and rural communities. Working with service providers to subsidize smartphone costs, provide discounted data packages, and offer basic Internet services at schools and community centers can help address these barriers to access. The World Bank's *Digital Malawi* project is supporting rural broadband connectivity through a reverse auction, least cost subsidy model where 10 sites will be connected. The private-public partnership connectivity transaction under *Digital Malawi* is also providing connectivity to 500 public institutions in Malawi for a period of 10 years across towns, cities and rural areas. The universal service fund implementation plan prepared for MACRA has proposed the provision of subsidized digital devices to promote adoption and usage of broadband. Communications campaigns coordinated with mobile operators and other stakeholders can help to address restrictive social norms around the usage of mobile phones for girls and women.

3) Strengthening competencies for digital skills and entrepreneurship

117. It is essential that the Government improve the quality of basic education to equip Malawians with the literacy and numeracy skills that are foundational to digital and financial literacy. This requires the provision of qualitative learning material, better trained and incentivized teachers, a reduction of the student teacher ratio, as well as conducive classroom environments to enable learning. Malawi should also do more to increase the number of students, particularly female, who progress from primary to secondary schools and from secondary schools to tertiary institutions. This will require deep and consistent engagement with parents and communities to address needs and to educate communities on the importance of education in the long-term.

118. The Government should also upgrade Technical, Entrepreneurial and Vocational Education and Training (TEVET) institutions to offer foundational and intermediate digital skills

to trainees. This will require significant investment in providing infrastructure to the existing training institutions leveraging FINES and donor programs, as well as the establishment of new centers in the mid- to long-term through public-private initiatives. It will also require training and retraining of trainers in ICT competences. The World Bank's Skills for A Vibrant Economy (SAVE) Project has a provision for offering digital skills in TEVETs, which should be exploited to the extent possible. The Government can offer tax benefits to incentivize private sector investment in TEVETs, including the creation of internship and other employment programs, to expedite having a digitally skilled workforce to strengthen its digital economy.

119. As the Government invests in educational institutions, leaders should build stronger linkages between the Government, academia, industry and the private sector to co-curate ICT curricula. In Nigeria, the Government is taking a similar approach with Edo Basic Education Sector and Skills Transformation operation (EdoBESST). EdoBESST aims to improve the teaching and learning processes in basic education and expand access to quality digital skills and entrepreneurship development programs for youth in Edo State. Under EdoBESST, the Government is entering into MOUs with private sector partners such as Amazon, Pluralsight, Cyan academy, Coven Works, and EdoBits ICT Academy to jointly develop the curricula and deliver digital skills programs to ensure linkages with jobs and entrepreneurship opportunities. Malawi can follow a similar approach to develop cross-sector partnerships to help trainees develop technical and soft skills that are relevant to local and international markets. Cross-sector partnerships will help trainees develop technical and soft skills that are relevant to local and international markets. By reducing the mismatch of demand and supply of digital skills, these market-driven curricula can reduce the incidence of unemployment and boost the productivity of the economy.

120. Critically, the Government must develop and implement a holistic approach toward supporting digital businesses in Malawi. With the emergence of hubs in Lilongwe and Blantyre, the anchors for activity are developing more specialized support programs. There is a need to develop and strengthen links with international service providers, including regional and global incubators and accelerators. The GSMA Ecosystem Accelerator and Google Launchpad Accelerator Africa provide equity-free funding, technical support, mentoring, and training to seed-stage startups in Africa. There are also successful accelerators and incubators based in Nigeria, Ghana, South Africa, Tunisia, and Egypt which provide catalytic financing to digital startups, such as MAN Impact Accelerator, FB Start Accelerator, and Flat6Labs. Partnerships with these incubators and accelerators will provide an opportunity for digital businesses in Malawi to access global networks that could enable their success. Government agencies should also provide sustained support to local innovation hubs, incentivizing the creation of local content that is relevant to marginalized communities.

Table 6: Macroeconomic Indicators

	2017	2018	2019	2020	2021	2022
				Est.	Proj.	Proj.
National Accounts and Prices						
GDP at constant market prices (% change)	4.0	4.4	5.4	0.8	2.8	3.0
Agriculture	5.0	0.3	5.9	3.4	5.2	1.7
Industry	2.2	7.2	7.7	1.2	1.6	2.4
Services	4.0	4.5	5.5	-0.7	1.9	3.8
Consumer prices (annual average)	11.5	9.2	9.4	8.6	8.8	7.6
Central Government (FY % of GDP)						
Revenue and grants	16.8	14.6	14.7	14.5	15.9	16.6
Domestic revenue (tax and other revenue)	14.3	13.6	13.2	13.1	12.3	14.4
Grants	2.5	1.0	1.4	1.5	3.6	2.2
Expenditure and net lending	19.1	19.0	19.1	20.9	24.6	26.0
Overall balance (excluding grants)	-4.8	-5.4	-5.9	-7.8	-12.3	-11.6
Overall balance (including grants)	-2.4	-4.4	-4.5	-6.3	-8.7	-9.4
Foreign financing	1.8	1.8	0.8	0.8	2.8	1.8
Domestic financing	0.6	3.0	3.8	4.9	5.9	7.6
Amortization (zero coupon bonds)	-1.2	-1.4	-1.0	-0.1	--	--
Money and Credit						
Money and quasi money (% change)	19.7	11.4	8.1	9.5	10.9	13.7
Credit to the private sector (% change)	0.4	11.5	21.3	15	11.7	14
External Sector (US\$ millions)						
Exports (goods and services)	841	1,112	1,314	1,118	1,327	1,339
Imports (goods and services)	2,565	2,924	3,262	3,050	3,015	3,008
Gross official reserves	757.4	750.1	815	574		
(months of imports)	3.6	3.6	3.9	2.8		
Current account (percent of GDP)	-16.7	-11.3	-11.5	-12.0	-11.3	-10.9
Exchange rate (MWK per US\$ average)	730.3	732.3	745.5	749.5	-	-
Debt Stock						
External debt (public sector, % of GDP)	22.9	21.8	20.7	20.9	22.5	22.2
Domestic public debt (percentage of GDP)	16.9	19.8	20.7	25.3	30.7	33.9
Total public debt (percentage of GDP)	39.8	41.6	41.3	46.2	53.3	56.1
Poverty						
Poverty rate (US\$ 1.9 in 2011 PPP terms)	68.6	68.1	67.4	68.1	68.1	67.9
Poverty rate (US\$ 3.2 in 2011 PPP terms)	88.7	88.5	88.1	88.5	88.5	88.5

Source: World Bank staff calculations based on MFMod, MoF, RBM, and IMF data

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