



MALAWI

ECONOMIC DEVELOPMENT DOCUMENT

July 2017

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ECONOMIC DEVELOPMENT DOCUMENT FOR THE REPUBLIC OF MALAWI

ASSESSMENT LETTER FOR THE IMF

Approved by Bella Bird (Country Director)
May 29, 2017

I. COUNTRY CONTEXT

1. **Malawi is a small open economy in Sub-Saharan Africa with a per capita GNI of just US\$320 in 2016, one of the lowest in the world.** Per capita income has grown at an average of little more than 1.5 percent between 1995 and 2014, below the average of 2.8 percent for non-resource-rich African economies. Malawi remains an outlier even compared to its peers that are geographically and demographically similar and were at a similar stage of development in 1995.
2. **While not strictly a fragile state, Malawi displays many of the characteristics of fragile and conflict affected countries, particularly in terms of the way that its governance institutions function.** The economy is dominated by the agricultural sector, which accounts for about a third of GDP, and drives livelihoods for two thirds of the population.
3. **Over past decades, the country's development progress has been negatively affected by shocks leaving the country in a cycle of vulnerability.** Both climate-related external shocks, and domestic political and governance shocks, have collectively contributed to economic stagnation and a low pace of poverty reduction.

II. POVERTY AND VULNERABILITY

4. **In the last ten years, Malawi has seen some progress in non-monetary indicators of human development, however there have been persistent challenges with respect to progress in reducing poverty in monetary terms.** As a result of the progress accomplished in some health and education aspects, and due to large flows of ODA, Malawi partially or fully achieved 4 of 8 of the Millennium Development Goals (MDGs), the set of 2015 targets to address poverty in its many dimensions.
5. **Gains in access to primary education have been steady and positive.** Between 2004 and 2013, primary school completion rates rose by 17 percentage points to reach 75 percent. The proportion of households with school-aged children attending school also has increased steadily since 2004, reaching 63 percent in 2013.
6. **In addition, child malnutrition has trended downwards, as has under-five mortality.** According to the Malawi Demographic Health Surveys (DHS) between 2004 and 2015, the prevalence of stunting among children under five (a measure of long-term nutritional deprivation in children) fell from 53 percent to 37 percent. Data from the DHS also reveals that the under-five mortality rate declined from 133 deaths per 1,000 live births in 2004 to 64 deaths per 1,000 live births in 2015. A downward trend also was observed in the prevalence, incidence, and deaths associated with HIV/AIDS, malaria, and tuberculosis, particularly since 2000.

7. **Notwithstanding the improvements in non-income dimensions of poverty, monetary poverty in Malawi remains pervasive and largely stagnant, especially in rural areas.** In 2010, using a basic needs basket that cost 37,000 kwachas per person per year, 50 percent of the population were classified as poor. Approximately 25 percent lived in extreme poverty, defined as the inability to satisfy food needs. Between 2004 and 2010, poverty in rural areas (where most Malawians live) increased slightly from 56 percent to 57 percent. Extreme poverty increased at a greater rate from 24 percent to 28 percent. The average consumption of the poor moved farther below the poverty line as well. Using the international poverty line of US\$1.90 per person per day (at 2011 international prices), Malawi's poverty rate in 2010 remained high—71 percent—a small increase from 64 percent in 1997.

8. **More recently, poverty likely has increased further, given the large-scale floods of 2015 and the major drought of 2016, which also had a major impact on growth.** No comparable living standards measurement survey has been completed since the Third Integrated Household Survey (IHS3) of 2010/11 (the 2016/17 Fourth Integrated Household Survey is currently in the field), but other sources of data allow for projections of poverty. A World Bank macro-poverty forecast exercise has projected that poverty in Malawi measured by the population living below the international poverty line has not changed between 2010 and 2016 (70.9 percent in 2010 to 69.6 percent in 2016). However, considering that a significant number of the non-poor in rural areas are highly vulnerable to weather shocks, the poverty rate is—if anything—expected to increase due to the impact of recent floods and drought.

9. fallen only marginally from 70.9 percent in 2010 to 69.6 percent in 2016. Using a panel survey to the IHS3, when only household characteristics (number of members, location, and sociodemographic profile) were used to predict the likelihood of falling into poverty, 22 percent of households were expected to become poor in 2013. This proportion almost doubled to 42 percent when expected shocks, particularly rainfall shocks, also were considered.

10. **Food insecurity in Malawi remains widespread, especially among the rural poor.** In 2013, a large 81 percent of poor rural households consumed fewer than 2,100 kilocalories per capita per day (kcal/person/day), considered the benchmark a person needs to lead a healthy life. Not surprisingly, in 2013, 65 percent of all households (and 84 percent of rural households) reported experiencing food insecurity for at least 1 month per year—a 15 percentage point increase since 2010.

III. MALAWI'S DEVELOPMENT PLAN

11. **The Malawi Growth and Development Strategy (MGDS) is the country's overarching medium term development tool** designed to lead the country towards attainment of the MDGs and the nation's long term aspirations as spelt out in its Vision 2020. The first MGDS (MGDS I) was in operation from 2006-2011. It built on consolidated lessons from the Malawi Economic Growth Strategy of 2004 and drew its focus areas from the country's first medium-term development strategy, the Malawi Poverty Reduction Strategy that was in operation from 2002-2005. The second MGDS (MGDS II) aimed to guide Malawi's development and growth path during 2012– 2016.

12. **Both the MGDS I and II shared the same objective of reducing poverty through sustainable economic growth and infrastructure development.** However, the key priority areas of the MGDS have been changed over the years to reflect lessons learnt from previous development strategies. Weaknesses in the planning and implementation of MGDS I, necessitated rethinking of its successor, MGDS II, to give emphasis to the need to diversify the economy, improve governance and promote human capital development.

13. **Implementation of MGDS II saw major challenges, with very limited progress towards the attainment of the strategy’s targets and goals.** Major governance shocks, including a policy-induced recession in 2012 accompanied by fuel and foreign exchange shortages, followed by the “cashgate” corruption scandal of 2013 where a large amount of resources were stolen from government accounts, not only undermined growth but also dented Malawi’s international reputation. Since 2013, Malawi has struggled to restore macroeconomic stability, as fiscal imbalances and weaknesses in public finance management, compounded by a shift of a significant share of donor aid to off-budget mechanisms, have resulted in a vicious cycle of rising debt, high inflation, high interest rates and poor business confidence.

14. **Malawi’s Economic Development Document presents an interim picture of the country’s medium-term development plan, as the successor strategy—likely to be called MGDS III—is prepared.** Disappointing results with respect to implementation of MGDS II have triggered a qualified rethink in Malawi’s development planning process. There is a growing recognition that Malawi needs a more realistic development plan, in terms of both the underlying assumptions and resource availability, as well as with fewer priorities and a greater emphasis on implementation. Climate change has also become a major new factor in this process. The recent formation of a quasi-independent National Development and Planning Commission will also help to improve the independence of the planning process in Malawi.

IV. KEY POLICY PRIORITIES FOR POVERTY REDUCTION

15. **As articulated in the Economic Development Document, the overarching policy objective of the Government of Malawi is to improve national economic development and reduce poverty among the Malawian population.** Five priority areas have been identified through a consultative process, including: agriculture and climate change management; education and skills development; energy and industrial development; transport and ICT infrastructure development; and health and population management. These priorities correspond well to Malawi’s underlying development challenges of reducing poverty and various forms of inequality, boosting agricultural performance, and achieving structural transformation coupled with demographic transition—while necessitating an additional focus on macroeconomic stability. The following paragraphs set out a summary assessment of the key associated challenges as Malawi seeks to achieve sustainable reductions in the level of poverty.

16. **Achieving robust agricultural growth.** Agriculture constitutes the backbone of the Malawian economy and agricultural performance has more significant implications for economic growth and poverty reduction, especially in rural areas, than any other sector. However, agricultural sector growth has been volatile and frequently surpassed by population growth. To date, agricultural growth has been achieved through factor accumulation—primarily through inputs such as land cultivated and labor. However, given one of the highest population densities in Africa and shrinking farm sizes, the gains from continuing such practices are approaching their limit. In addition, most farmers in Malawi rely on rain-fed agriculture, which is highly risk prone, particularly to price and weather shocks, and suffers from low productivity. And many of Malawi’s agricultural institutions and past policy choices have served to exacerbate price volatility and undermine incentives for investment in commercial agriculture. ***Boosting agricultural productivity will require the reallocation of resources to provide more comprehensive and targeted support to the rural poor, including efforts through introducing climate-smart agriculture, investing in irrigation and water management, and transitioning subsistence agriculture to more diversified, commercial agriculture.***

17. **Managing rising climate risks.** The impact of flooding and drought in Malawi has intensified over recent years and is likely to worsen with climate change. In the past four decades, droughts have become more frequent, widespread, and intense. As a result of the most recent drought in 2015/16, around 40 percent of the population experienced food insecurity. This calls for further interventions to ***increase resilience to***

climate related shocks focused on modernizing institutions and policies, expanding social safety nets and investing in resilient infrastructure.

18. **Facilitating structural transformation.** Although urbanization has been an important catalyst for growth and poverty reduction in many countries in sub-Saharan Africa, Malawi has seen a very slow pace of urbanization in recent years. Within rural areas, the labor force has started to move from the agricultural sector to the non-farm sector, contributing to poverty reduction. But, the opportunities for the non-farm sector are volatile and the life-span of the non-farm businesses is very short. Furthermore, the business environment for the non-farm sector is challenging in that access to finance, access to markets, and access to electricity are all highly restricted in rural areas and the human capital of the rural labor force remains low. *Stimulating growth in the non-farm sector will require investment in education and skills, complementary investments in critical infrastructure (such as power, connectivity and access to finance) and smarter policies to facilitate faster, but sustainable, urbanization.*

19. **Strengthening macroeconomic stability and the improving the allocation of scarce public resources.** Macroeconomic instability, driven mostly by fiscal slippages and governance failures, has been a persistent challenge for Malawi, undermining growth and investment. High inflation hits the poor disproportionately by reducing their purchasing power and ability to maintain food security. It also contributes to high costs of finance and exchange rate instability, making it harder for businesses to invest and create jobs. Furthermore, to bring fiscal deficits and debt under control the government has frequently needed to undertake measures to reduce public spending and increase revenue collections, which can have adverse impacts on the poor. Making this challenge worse, is the fact that evidence increasingly points to very little impact on growth or poverty from Malawi's major public expenditure programs such as the FISP (Farm Input Subsidy Program). *Stronger macroeconomic and fiscal management is a necessary prerequisite for sustainable growth, job creation and poverty reduction in Malawi. Improving the effectiveness of key public expenditure programs will also be necessary to maximize the impact on the poor of the country's finite resource envelope.*

20. **Addressing social inequality, especially gender inequality.** Female headed households face unfavorable conditions in both agricultural production and the non-farm sector businesses compared with male headed households. In the agricultural sector, women tend to have smaller land lots, deploy fewer inputs, benefit from less extension and investment, resulting in significantly lower productivity (by 28 percent on average) compared to their male counterparts. Also, in the nonfarm sector, they tend to have less access to finance, capital and new technology. *Closing the gender gap will improve agricultural productivity and growth opportunities, and investing in girls' education is a pathway to both higher long-term growth and a lower fertility rate.*

21. **Addressing population growth.** Malawi's fertility rate has remained persistently high and the country's population is expected to double in approximately two decades. For a country that is already one of the most densely populated in Africa, existing levels of population growth will put enormous pressure on limited land resources, service delivery, and make poverty reduction that much harder. Furthermore, the high fertility rate lowers productivity because it impairs women's ability to engage in more productive farming or nonfarm work. *Addressing rapid population growth and building productive human capacity requires increased investments in the education and skills of the youth so that Malawi can benefit from a demographic dividend.*

V. CONCLUSIONS

22. **Exogenous climate induced shocks have become a major source of volatility in Malawi, exacerbating macroeconomic instability, and making it harder for the country to "break the cycle"**

of vulnerability. Extensive reliance on basic farming methods and reliance on rain-fed agriculture, together with a growing population, has made food security a recurrent challenge as well as adding to pressures on land use, soil fertility and forest resources. In recent years Malawi has suffered from weather shocks at an increasing frequency. Weak public financial management has tended to transmit recurring shocks into fiscal indiscipline, in turn exacerbating macroeconomic instability. Malawi is thus confronted with twin pressures arising from vulnerability to climate shocks and weak fiscal management, both of which contribute to macroeconomic instability.

23. **However, the recent food security crisis has added urgency to difficult and politically challenging reforms** that the Government of Malawi is undertaking to reduce distortions in, and improve the performance of, the agricultural sector; and to rebuild basic public financial management and accountability systems. These measures represent a first, but critical, step towards the building of a more resilient economy. Coupled with an anticipated scale-up of development finance, including under IDA 18, there is a potential pathway open to Malawi as the country attempts to begin making meaningful progress to address the severe and chronic poverty that has characterized the country for the last two decades.

24. **The Economic Development Document presents an appropriate outline of the challenges that Malawi faces with respect to achieving sustainable economic growth and poverty reduction.** The document rightly acknowledges the challenges of past inconsistency of economic policies, the impact of both domestic (governance related) and external (climate related) shocks, and the need to carefully prioritize finite resources towards a more limited set of priority areas.

25. **Yet, as with past plans, the central challenge that Malawi faces is with respect to the actual implementation of stated policy objectives.** This calls for an emphasis on the functional strengthening of the country's public sector institutions so that Malawi is really able to "break the cycle" of vulnerability, better absorb the impact of future shocks and maximize the impact of available domestic and foreign resources. Moreover, while meaningful steps have been taken to reduce the risk of a "cashgate" type event from reoccurring, gaps in oversight do remain—particularly with regard to public procurement—that will require continued efforts to strengthen governance and accountability frameworks.



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FOREWORD

Malawi faces various economic challenges including: low productivity; narrow and raw export base with high reliance on few commodities; lack of alternative energy sources; and poor transport network and ICT facilities. This, in addition to natural disasters that hit the country in 2015 and 2016, affected implementation of the Malawi Growth Development Strategy (MGDS) II- the medium-term development strategy guiding development policies from 2012 to 2016. This affected the achievement of the goals proposed in the strategy document. A review of MGDS revealed that most of the targets that were achieved were linked to Millennium Development Goals. The review identified 9 gaps that need to be addressed in successor development strategies.

In order to address these gaps, there is need to identify game changers which will accelerate the pace of economic growth and development. This will call for a properly sequenced development plan that addresses the most binding constraints first. The Economic Development Document (EDD), whose goal is to highlight the development areas that Malawi will emphasise over the planning period in order to promote economic performance and attain the GDP growth rates of over 7.2 percent, is a reflection of the intervention areas for the national development strategy in the next five years.

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1.0 National Economic Development in Malawi

1.1 Background

Since independence in 1964, Malawi has developed and implemented various development strategies to improve the socio-economic landscape of the country. Soon after independence, the Government of Malawi executed 10-year development policies (DEVPOLS) up to the early 1990s. In the course of executing these plans the Government, with assistance from the World Bank, introduced and implemented the Structural Adjustment Programmes (SAPs) in early 1980s in order to strengthen economic growth initiatives. In the late 1990s, the country adopted the Poverty Alleviation Programmes (PAPs) as first generation of the poverty reduction strategies. Around the same period, the Government developed the Vision 2020 which was launched in 2000 from which medium term strategies have been drawn. The Malawi Poverty Reduction Strategy Paper (MPRSP) was developed to guide medium-term development programmes from 2002 to 2005. This was followed by the Malawi Growth and Development Strategy (MGDS) which ran from 2006 to 2011 and MGDS II which was implemented between 2011 and 2016.

Despite well-designed development strategies, slow implementation has limited the achievement of sustainable economic growth and development. Reasons for this outcome include inadequate financial resources, natural disasters and unstable macroeconomic environment characterised by high inflation and interest rates. These have negatively affected the country's ability to sustain high levels of economic growth of 7.2 percent envisaged to be the level that would meaningfully reduce poverty within the implementation period of the MGDS II. Per capita income, for example, stood at US\$494 in 2015 (World Development Indicator, WB) which is still far from the US\$1000 envisioned in the year 2020.

MGDS II, the overarching medium-term development strategy that guided development programs between 2012 and 2016, aimed at reducing poverty through sustainable economic growth and infrastructure development. The strategy recognized that in order for all Malawians to benefit equitably from economic growth, concerted efforts to promote human and social development need to be complemented with efforts to improve labour productivity and structural transformation leading to economic diversification.

The strategy had six thematic areas namely: sustainable economic growth; social support and disaster risk management; social development; infrastructure development; governance; and gender and capacity development. MGDS II singled out nine Key Priority Areas (KPAs) which were designed to sustain and accelerate economic growth based on available resources so as to reduce poverty and bring about prosperity in the medium term while accelerating attainment of the Millennium Development Goals (MDGs). These KPAs were: Agriculture and Food Security; Transport Infrastructure and Nsanje World Inland Port; Energy, Industrial Development, Mining and Tourism; Education, Science and Technology; Public Health, Sanitation, Malaria and HIV and AIDS Management; Integrated Rural Development; Green Belt Irrigation and Water Development; Child Development, Youth Development and Empowerment; and Climate Change, Natural Resources and Environmental Management.

Success in implementation of these depended on several assumptions that were outlined in the strategy document: the ability of the country to sustain and accelerate real gross domestic product (GDP) growth rates, with a view to reduce poverty in substantial ways; prudence in management of fiscal and monetary policies; sustaining political stability; conducive macroeconomic environment; increased diversification and value addition of export commodities to drive exports in an effective manner; effective aid management and further improvements in domestic debt management; adequate resources and capacity to implement MGDS II activities; entrenchment and institutionalization of good governance practices with a view to avoiding wastage of scarce resources; designing effective social protection interventions to mitigate negative effects of growth and development; and continued political will (commitment) to carry forward the national development agenda.

Due to macroeconomic challenges and other bottlenecks that the country faced during the implementation period of the MGDS II, most of the assumptions made were not realised. Growth averaged 4.1 percent between 2011 and 2015 which is far below the expected average of 7.2 percent; the country adopted a flexible foreign exchange regime which was accompanied with a massive devaluation of 52 percent of the Malawian Kwacha, and thereafter the instability of the local currency; withdrawal of donor budget support due to the cash gate scandal; floods and drought in 2015 and 2016 which led to massive food shortage in the country. These are some of the major challenges that impeded achievement of the goals of the MGDS II.

Withstanding these challenges, some remarkable progress was registered in attaining some of the goals under the Millennium Development Goals (MDGs). In this regard, Malawi managed to increase the ratio of girl-boy in primary and secondary education; created an enabling legal environment for the promotion of gender equality and women empowerment through the enactment of laws related to inheritance, gender equality, marriage and trafficking; reduced the gender disparity in access to tertiary education with a marked increase in proportion of girls entering public universities; reduced HIV prevalence, universal access to ART; and increased access to safe water.

However, the country still has to do more in accelerating public sector reforms and public financial management with a view to enhancing accountability in the public sector, and having a stronger focus on delivery of development results to the majority of the population; creating an enabling private sector development to facilitate improvement of Malawi's doing business environment and global competitiveness ranking; implementing and enforcing measures to arrest unsustainable population growth; and taking forceful measures to implement a national food and nutrition security strategy, and incorporating food safety and standards which aligned to the SADC Food and Nutrition Security Strategy.

In order to address these gaps and reverse the situation, Malawi needs to identify game changers which will accelerate the pace of economic growth and development. This process may entail deviation and abandonment of traditional approaches to more radical and result-oriented approaches to planning and implementation of the economic policies. It will call for a properly sequenced development plan that addresses the most binding constraints first.

1.2 Macroeconomic Overview

Due to inconsistent implementation of policies and persistent shocks to the economy, economic growth has been fluctuating over time. While economic growth was negative in the years 2001 of -5.0 percent (WDI) partly due to poor agricultural performance as a result of bad weather, the economy registered positive growth rates, reaching a peak of 9.6 percent in 2007. Economic activity remained relatively moderate with an average of 4.1 percent between 2011 and 2015, except in 2012 when growth slowed to as low as 1.9 percent.

Agriculture is the main determinant of economic performance contributing around 30.0 percent to GDP. It also drives growth in the other sectors, particularly manufacturing. In the years when economic growth has been above the expected average of over 7.2 percent (2007-2009), agriculture significantly contributed to it, in part, the farm input subsidy programme (FISP) coupled with favourable weather conditions. Poor performance in the agriculture also negatively affects performance of other sectors and the overall growth of the economy.

Average annual inflation has been fluctuating over the years reaching a peak of 27.3 percent in 2013, the highest inflation rate since 2000. This is a high variation from the average inflation rate of 5.9 percent that was expected for the five years within the implementation of MGDS II. Interest rates have also risen significantly in line with the inflation rate with lending rates ranging from 18 percent in 2011 to 33.6 percent in December 2016. Consequently, the economy has lost some of the gains it made. Nonetheless, GDP per capita has been increasing at an average of 2.6 percent in the last ten years up to US\$494 reported in 2015. Foreign exchange reserves have remained low mainly due to low and undiversified export base that has failed to generate adequate reserves. Although the reserves have been improving in some months, they have mostly been below the minimum level of three months of import cover.

The performance of the economy is a reflection of low productivity as well as weak value addition in sectors such as agriculture, mining, tourism, fisheries and transport. While development policies have focused on strategies to increase production and productivity, implemented has always faced some challenges. During the implementation of the MGDS II, the cashgate scandal also contributed to the poor performance as development partners withdrew budget support which affected implementation of key development initiatives. In the absence of alternative sources of financing, the Government resorted to borrowing domestically which also increased domestic arrears.

1.3. Socio-Economic Profile

Malawi is one of the poorest countries in the world with 50.7 percent of the population living below the poverty line and 25 percent living in extreme poverty. Efforts to reduce poverty have failed to yield the desired results due in part to a rapid population growth that erodes the marginal gains from economic growth. According to the third Integrated Household Survey (IHS3), over a period of six years there was a slight decline in the poverty rate from 52.4 percent in 2005 to 50.7 percent in 2011 and has remained steady thereafter. It also observed that the majority of the rural people are poor. Out of the total rural population, 57.0 percent is poor compared to 17.0 percent of the urban population.

Over this period, income distribution also worsened as the disparity between the rich and poor widened with the Gini coefficient increasing from 0.39 in 2005 to 0.45 in 2014. Geographically, the Southern Region has the largest Gini-coefficient which reflects highest income inequalities in the country. In terms of gender, female-headed households (57.0 percent of the total households) are poorer than their male-headed counterparts (43.0 percent).

Several factors have led to the ineffectiveness of policy interventions aimed at improving the living standards of the people. The majority of Malawians are vulnerable to social and economic shocks which exacerbates poverty. According to the World Bank (2006), there are four major shocks that make households vulnerable to poverty. These include: (i) over-reliance on rain-fed agricultural production systems which are prone to climatic shocks; (ii) animal and plant diseases which lead to major crop and livestock losses; (iii) volatility of prices of maize, fertilizer, and tobacco; and (iv) HIV/AIDS, Malaria, tuberculosis and anaemia which are prevalent in Malawi and these put monetary burden on most households. These factors together with increased frequency and intensity of climate related disasters influence levels of vulnerability among Malawians.

In 2015, the country's population was estimated at 16.3 million and increasing at 3.1 percent per annum. The employment rate for Malawi is at 79.6 percent and about 64.1 percent of employed persons are in agriculture, forestry and fisheries. Due to limited opportunities, a rapid population growth rate has put pressure on natural resources. It also increases the demand for the provision of public services, thus placing pressure on the budget.

1.4 Development Challenges

Table 1 below summarises the development challenges facing Malawi that need to be addressed to achieve sustainable development.

Table 1: Factors affecting economic growth and development in Malawi

	Challenge	Cause
1	Low productivity	lack of complementary investments in agriculture and limited access to information, inefficient patterns and composition of public expenditure in agriculture
2	Narrow and raw export base, high reliance on tobacco, sugar, tea and few others	Slow implementation of or lack of diversification programme
3	Poor doing business environment	Despite recent improvements more still

		needs to be done on starting a business; access to electricity; registering property; getting credit; protecting investors; high taxes; trading across borders; and enforcing contracts and resolving insolvency
4	Land degradation and natural resource depletion	High population growth, limited access to electricity, and lack of energy alternatives
5	Lack of alternative sources of energy	Inadequate investment, inadequate policy environment
6	Inadequate ICT facilities	Inadequate investment
7	Inadequate access road network	Inadequate investment

1.5 The objective of the Economic Development Document

The Economic Development Document (EDD) is a reflection of the intervention areas for the national development strategy in the next five years which has been developed in line with the IMF's new policy on Poverty Reduction Strategy (PRS) documentation. The major goal of the EDD is to highlight the development areas that Malawi will emphasise over the planning period in order to promote economic performance and attain the GDP growth rates of over 7.2 percent¹ as stipulated in the Malawi Growth and Development Strategy II. To this effect, the EDD highlights priorities that Malawi will focus on in the medium term in order to accelerate socio-economic development and reduce poverty.

1.6 Key Priority Areas of the National Development Plan – The MGDS III

The current EDD which reflects the priorities to be contained in the MGDS III, therefore, focuses on sectors that have been determined to spur economic growth and development for Malawi for the period 2017 to 2022. Largely, this will hinge on addressing the identified challenges that the economy is facing with particular focus on ensuring that the economy is resilient to shocks such as climate change and other economic shocks. Furthermore, the EDD focuses on the sectors which will form a platform for inclusive growth.

¹ 6 percent growth is taken as a minimum target if the country is to reduce poverty considering the current poverty levels and the level of population growth.

Malawi acknowledges the commitment it has made to implement the Sustainable Development Goals (SDGs) and other international and regional development frameworks. In this regard, the EDD and the MGDS III will ensure that all the frameworks and instruments that would facilitate the achievement of the national, regional and global development goals are taken on board. Of particular importance is the principle of leaving no one behind which emphasises the need to undertake national planning comprehensively to ensure inclusivity in the growth process.

Malawi recognises that in order to develop, there is need to invest in strategic sectors of the economy. Therefore, while the country faces a number of development challenges, sectors have been prioritised on the basis of their expected impact on other sectors of the economy and economic growth. In view of this, the next development strategy (MGDS III) has identified five key priority areas (KPAs). These priority areas are (i) agriculture and climate change management; (ii) education and skills development; (iii) energy and industrial development; (iv) transport and ICT infrastructure development; and (v) health and population management.

1.6.1 Agriculture and Climate Change Management

Malawi remains an agro-based economy and it will be so for the next few years. The sector is characterised by rain fed subsistence farming, smallholder farming and traditional ways of farming, which leave a lot of people vulnerable to food shortages in times of shocks such as price fluctuation and weather variations. The strategy will focus on mechanised large scale commercial farming complemented with agro-processing, value addition and manufacturing.

In order to mitigate the impact of climate change that has negatively affected agricultural productivity in recent years, the strategy will focus on the promotion of adaptive technologies and strategies and/or mitigation programmes. In addition, environmental management and conservation and climate-smart agriculture technologies will be promoted.

Sector Policies and Instruments for Implementation

Through pooling of resources in the Agriculture Sector Wide Approach (ASWAp) by development partners and using domestically mobilised resources, the government will focus on commercialisation, mechanisation, water harvesting and development, and large scale irrigation targeting medium to large scale farmers.

In line with the National Agriculture Policy (NAP)'s goal, the Strategy will aim to achieve sustainable agricultural transformation that will result in a significant increase in the contribution of the sector to the national economy. The NAP is expected to have positive effects in the following areas: (I) agricultural production and productivity; (ii) diversification of agricultural production and market surpluses; (iii) use of irrigation in crop production; (iv) mechanisation of farming and agro-processing activities; and (v) agro-processing and value addition of agricultural products.

1.6.2 Education and Skills Development

Education and skills development have direct linkages to other sectors of the economy such as manufacturing. Improving education standards will result in improved productivity, reduced poverty and other social benefits. The strategy will therefore focus on improving learning outcomes across different levels whilst promoting education of girls.

Considering that the population of Malawi is largely youthful and that the majority of the youths are unemployed, education and skills development will be key in addressing the challenges that the youth are facing thereby enabling the country to benefit from the demographic dividend. This will also positively affect the other sectors through the availability of skilled labour.

Sector Policies and Instruments for Implementation

In order to improve the relevance of education in Malawi, quality will be improved to meet the needs of the industry. In this regard, the education policies will focus on Early Childhood Development (ECD) and Early Childhood Education (ECE), primary and secondary education, special needs education and improving access to tertiary education.

Considering that there is high rate of unemployment, the education policies will also focus on skills development for the youth. Technical colleges and vocational training will be emphasised to take care of the youth leaving secondary school who are not admitted into universities. In view of that, skilled labour will be readily available for increased production and productivity.

1.6.3 Energy and Industrial Development

Long and persistent load shedding has negatively affected industrial development in Malawi. There is need for reliable power supply to support a growing economy. Generation of electricity and provision of alternative sources of energy is critical to transform the country into a productive, competitive and resilient economy. Energy is needed at different levels including households, industrial production and provision of social services such as education and health. MCC has invested \$350 million in transmission/distribution networks and planned electricity generation projects will generate as much as 470 MW by 2020. Government also has energy projects which are in the pipeline and they include: the Songwe River Basin project (2018), a regional project, splitting 300MW equally between Malawi and Tanzania which involves irrigation, power, and potable water; the Millennium Challenge Corporation project (\$350 million invested over 4 years) ending in September 2018. Project covers installing distribution/ transmission; Kholombidzo Hydroelectric (feasibility study done), adding 100MW in 2020; Mozambique, Malawi interconnector possibly by 2018, adding 50-100MW; Zambia-Malawi interconnector, adding 50-100MW; Tedzani Falls (Japanese funded), adding 20MW.

The Government recognises that reliable energy is needed if industries are to improve production. Furthermore, reliable energy would attract investors to ply their business in Malawi. Energy development is one of the most important aspects in improving the environment for private sector development which would also promote private sector investment in the country.

Private Sector Development is recognized as the engine of economic growth in Malawi. As such, industrial development has been highlighted as a priority area. The trade, industry and private sector development strategy will help in achieving that. The strategy aims to build Malawi's

productive base and its export capacity in a manner that empowers the poor, farmers, youth, women and other vulnerable groups.

Sector Policies and Instruments for Implementation

The Government will implement the energy policy whose goal is to increase access to affordable, reliable, sustainable, efficient and modern energy for all Malawians. It will, among other things, enhance electricity generation and distribution to all those who need it for domestic and industrial use. In order to improve access to energy, the Government will continue to undertake rural electrification through establishment of Rural Electrification Agency as a semi-autonomous legal entity to manage rural electrification activities, the Rural Electrification Fund and renewable energy activities. The Government will promote the use of solar and other renewable energy sources in rural areas to reduce deforestation across the country.

The National Industrial Policy is also important in the implementation of MGDS III since it will help increase the proportion of manufacturing in GDP through enhancing productivity of the sector. This will be supported by education and skills development interventions such as the introduction of the community colleges to capacitate the youth in the rural areas.

The National Export Strategy (NES) will also help promote local industries and local production to increase export and trade. The NES focuses on three product clusters namely oil seed products, sugarcane products and manufactures. These products have the potential of complementing tobacco and driving exports through value addition in a manner that exports can outpace the growth of imports.

1.6.4 Transport and ICT Infrastructure

The cost of doing business in Malawi is high largely due to high transport costs resulting from poor roads and the absence of alternative transport modes. Upon development of the road network and other transport facilities, Malawi will become a cheap destination for business, making Malawi competitive and attractive to investors. The feeder roads are crucial if the provision of social services including schools, health facilities and markets is to improve. In addition, the Nacala railway, which was instrumental in moving humanitarian relief supplies during the period the country was hit by calamities, will ease the movement of goods and people.

Good ICT infrastructure is also important in improving communication and broadcasting services. In this era of technology, development of ICT infrastructure is paramount in promoting trade and investment. ICT is also playing a catalytic role in the provision of social services such as health and education. In this regard, the government will work towards improving the ICT infrastructure in order to create a conducive environment for private sector development.

Sector Policies and Instruments for Implementation

A key policy area that will help in realising the aspirations of Malawians is the national transport policy whose goal is to ensure the development of a coordinated and efficient transport infrastructure that will foster a safe and competitive operation of viable, affordable, equitable

and sustainable transport services. The implementation of the policy will produce the following expected outcomes: reduced travel time and transport costs for persons and goods; enhanced access to inputs; improved access to local and international product markets; and improved access to social and public services for the urban and rural population. The national strategy will, however, concentrate on construction and rehabilitation of roads and railway transport infrastructure so that mobility of goods and passengers is made easy.

Information and Communication Technology is a new and emerging sector in Malawi due to its pivotal nature in accelerating economic growth and as an enabler for poverty reduction and wealth creation. The following are some of the strategies that will be implemented in order to achieve the goals: Creating a conducive environment to attract investment in ICT infrastructure and services; developing a reliable, fast, adaptive and robust national ICT infrastructure that feeds into international networks; Intensifying ICT education and training in all sectors; Improving ICT access by all communities; and developing monitoring and evaluation tools and techniques for the sector.

1.6.5 Health and Population Management

A healthy population is key to increased productivity and sustainable economic growth and there is a strong correlation between health status of the population and the level of development of a country. Poor health is costly to the economy and is associated with under-development. In Malawi, access to quality health care is low among the rural poor. Improving the health of the people, therefore, will accelerate economic growth and development of the country. The benefits will accrue from the savings that the government will realise from the reduced health care spending as well as improved productivity of the citizens.

The country continues to experience rapid population growth which negatively affects provision of various services such as health and education. In addition, high population growth exerts pressure on the existing infrastructure including housing, roads as well as environment. At an annual growth rate of 2.8%, the Malawi population has almost doubled in the past two decades having grown from 9.9 million in 1998 to 17.3 million in 2017. Based on this growth rate, the population is projected to reach 45 million by 2050. This is very high growth and clearly not sustainable. In the next five years, therefore, the Government will continue promoting policies that will help to control rapid population growth.

Sector Policies and Instruments for Implementation

The goals of the health sector will be achieved through strengthening the delivery of community health services; community participation; the prevention, management and control of Essential Health Package (EHP) conditions which are high impact and cost effective interventions; establishing staffing norms for all levels of the health care facilities; and advocating systematic assessments of the health impact of rapidly changing environments, including in the areas of technology, working practices, sources of energy, commercial production and urbanization.

2.0. Implementation of the MGDS III

The MGDS III will be implemented using various policies, programmes and flagship projects². The Government will ensure that existing policies are aligned to the new national development strategy by embarking on a comprehensive review of relevant policies which will also bring harmony among these policies. It is expected that government will encourage formulation and effective implementation of new policies where it is felt that the existing policies are no longer relevant to induce the required change in a given sector.

The priority areas will be anchored on flagship projects that have been carefully identified to address the key development challenges that the country is facing. These projects have been designed in such a way that they play a catalytic role for the growth of other related sectors such that investments in one priority area are expected to spur growth in other sectors. This is a stark departure from the previous development strategies where the Public Sector Investment Programme (PSIP) consisted of too many projects which lacked adequate financing. It is therefore, expected that by focusing on limited projects, the PSIP will be adequately resourced so that the flagship projects generate the desired changes in the targeted sectors.

While the PSIP will focus on the flagship projects in each of the five priority areas, the other sectors that are not appearing as priority areas will continue receiving support from the government. This will ensure that a conducive environment is created for the effective implementation of the priority areas. For example, continued support to governance institutions will ensure that resources allocated to the priority areas are properly accounted for. It is also recognised that by addressing the key development challenges. In this regard, the government will continue supporting the non-priority sectors while recognising that investments in the priority sectors generate benefits for the other sectors.

Being the national blue print, the MGDS III will guide implementation of development activities among different stakeholders including the government Ministries, Departments and Agencies (MDAs); Civil Society Organisations (CSOs); the private sector; the academia; research institutions; development partners and the general public. The Government will continue using Sector Working Groups (SWGs)³ as means of implementing the National Development Strategy as well as fulfilling and domesticating international commitments and ensuring aid effectiveness. With membership spanning across different stakeholders, SWGs will continue to be a relevant mechanism for implementing the MGDS III.

² Flagship projects are research and development projects that are strategically and scientifically defined and are of substantial size with regard to their scientific and financial volume, the number of project partners and the running time (FFG, 2013).

³ In 2008, government instituted 16 Sector Working Groups (SWGs) as a coordination mechanism for planning, implementation and review of sector activities.

3.0 Community Resilience and Disaster Risk Management

Changing climate has made disasters frequent in Malawi and other surrounding countries. Disaster risk management policy, whose main goal is to sustainably reduce disaster losses in lives and socio-economic and environmental assets of individuals, communities and the nation, will be critical. The National Disaster Risk Management Policy will be instrumental in addressing challenges faced due to losses and damages that are caused by disasters. The policy will ensure that disaster risk reduction strategies are mainstreamed in sector policies, plans, and budgets at all levels; resilience of communities to disasters is increased and improved preparedness is attained for effective response to, and recovery from disasters.

A comprehensive system for disaster risk identification, assessment and monitoring will be established and made functional. In addition, a people-centred early warning system will be established by ensuring that newly established and existing early warning systems are comprehensive, effective, people-centred and integrated.

The culture of safety and adoption of resilience-enhancing interventions will be promoted through interdisciplinary and policy-oriented research on appropriate disaster risk management technologies and approaches. The redress of underlying risks will be undertaken through promotion of sustainable and long-term community-based disaster risk reduction measures; the good land use planning; construction of resilient infrastructure; and the strengthening of preparedness capacity for effective response and recovery.

4.0 Fiscal and Debt Framework

The fiscal framework, within which the Malawi Economic Development Document will be implemented due to declining resource envelope against growing expenditure, demands that priority setting is effectively done. The suspension of budget support in 2013 and the reduction of dedicated grants to several sectors have created pressure on the budget which has resulted in the reduction of some expenditure. For example, the Government's contribution to the development budget has fallen to around 1 percent of GDP due to the decline in budget support and disbursements of dedicated and project grants. This has resulted in widening fiscal imbalance which has seen a continual trend towards reduced development expenditure to offset overruns in recurrent spending. Table 1 shows a summary of the Central Government Budgetary Operations.

Table 2: Central Government Budgetary Operations (Percent of GDP)

	2012/13	2013/14	2014/15	2015/16
Revenue	27.5	22.8	21.5	21.4
Total Domestic Revenue	17.3	19.7	18.7	17.7
Tax Revenue	15.7	17.3	16.3	15.9
Nontax Revenue	1.6	2.4	2.4	1.8
Grants	10.2	3.1	2.8	3.7
Budget Support	4.5	0.3	0	0.5
Dedicated Grants	3.7	1	1.1	1.8
Project Grants	2	1.8	1.7	1.4
Total Expenditure and Net Lending	28.4	28.9	27.9	28.4
Current Expenditure	22.4	24.4	22.5	23.6
Wages and salaries	5.7	6.2	6.9	6.4
Interest Payments	1.9	4.4	4.0	3.8
Domestic	1.7	4.2	3.8	3.4
Foreign	0.2	0.2	0.3	0.3
Goods and Services	8.4	7.9	5.5	5.7
Generic Goods and Services	3.5	2.9	2.7	2.4
Other Goods and Services	4.9	5.0	2.8	3.3
Subsidies and Transfers o/w Fertilizer and seed subsidy	5.7	5.6	4.9	4.9
Arrears	3	2.7	1.9	1.8
Development Expenditure	0.7	0.4	1.2	2.5
Domestic	1.8	0.9	1.0	0.6
Foreign	4.2	3.6	4.4	4.1
Overall Balance	-0.9	-6.1	-6.5	-6.7
Total Financing	1.8	6.1	6.5	6.4
Foreign financing (net)	1.9	2.0	2.5	1.9
Borrowing	2.2	2.4	2.9	2.4
Budget Support	0.0	0.6	0.0	0.0
Project loans	2.2	1.8	2.2	1.9
Other External loans	0.0	0.0	0.7	0.5
Amortisation	-0.3	-0.4	-0.4	-0.5
Net Domestic Financing	-0.1	4.2	3.3	1.7
Discrepancy	-0.9	-0.1	0.0	0.3

Although domestic revenues have improved in the past 3 financial years from 17.3 percent of GDP in 2012/13 to 17.7 percent of GDP in 2015/16, the economy experienced a significant reduction in on-budget Official Development Assistance (ODA) from 10.2 percent of GDP in 2012/13 to 3.7 percent of GDP in 2015/16. ODA is significantly being transmitted through off-budget support which is being provided at a slower pace as a result of low absorptive capacities at project level (MEM, 2016). In line with decreasing resources, expenditure and net lending marginally decreased to 28.4 percent of GDP in 2015/16 from 28.5 percent of GDP in 2012/13. Current expenditure increased by 1.2 percentage points from 22.4 percent of GDP in 2012/13, development expenditure decreased from 6.0 percent of GDP to 4.7 percent of GDP. Development expenditure, on the other hand, registered significant decrease due to cuts that were made to offset deficit in recurrent expenditure. Domestically financed development expenditure was the hardest hit, declining by 1.2 percentage point from 1.8 percent of GDP in 2012/13 while foreign financed development expenditure decreased by 0.5 percent of GDP. The discovery of huge government payment arrears to the private sector of about K157.0 billion (about 5.5 percent of GDP) in 2014 increased the demands on the already small resource envelope.

In line with the disproportionately large decrease in resources compared to expenditure, public debt has grown but it has remained within sustainable thresholds. Public debt has risen from 28 percent in 2011 to 54 percent at end-2016. While Malawi is classified as at moderate risk of debt distress it faces significant vulnerabilities due to the sharp increase in domestic debt which is creating fiscal stress through the growing interest burden. According to the Joint Debt Sustainability Analysis report of June 2016 by the International Monetary Fund and the World Bank, Malawi's public debt is sustainable but faces a moderate risk of distress. Therefore, foreign borrowing will be restricted to concessional loans that meet internationally agreed thresholds to ensure continued sustainability of the public debt and will be used to fund development programmes. In addition, domestic borrowing will be reduced by retiring maturing debt instead of securitization as the current trend has been.

Therefore, the medium term expenditure framework will seek to rationalise expenditure to ensure that more resources are allocated to capital formation and social sectors while ensuring sustainability of the public finances. The fiscal policy will ensure that development expenditure increases substantially to about 25.0 percent of the total budget in medium to long term in order to promote economic growth and development in the country. In addition, external borrowing will largely be used for development programmes other than financing consumption.

Going forward, a package of bold fiscal rules will be developed to constitute fiscal policies in the medium to long term. Among others, the following are specific areas which will need concerted efforts to ensure that the budget is consistent with growth aspirations and macroeconomic stability.

- a. Reduction in the share of interest payments by reducing domestic debt stock;
- b. Slowing growth in wage bill by slowing unplanned recruitment, payroll irregularities and restructuring the public service;
- c. Review the current policies such as FISP, Decent Housing and Accommodation Subsidy Programme (DHASP) and social cash transfers among other social protection

- interventions. These reduce discretionary resources that could otherwise be channelled towards productive areas; and
- d. Review and strengthen alignment of the budget to national development strategies.

5.0 Spending Framework

With the shrinkage of foreign aid channelled through the budget, the priority areas will mainly be implemented using domestic resources and foreign concessional borrowing. It is expected that with the administrative and policy reforms that are taking place in revenue administration, tax and non-tax revenue collection is expected to rise to about 20.0 percent of GDP by 2019/20 financial year. Grants are expected to stabilise around 3 percent of GDP for the five year period that this document will be implemented. However, reforms in project implementation to increase the rate of absorption may increase this ratio. On the other hand, foreign borrowing is expected to rise to 2.5 percent of GDP to finance specific projects within the priority areas.

On the expenditure side, it is envisaged that the Government will increase the share of domestic resources that goes to the development budget to around 25 percent of total budget to promote economic growth in the country.

6.0 Launch Date and Timeframe for Implementation

The MGDS III is expected to be finalised and launched by the end of June 2017 and will be the guiding national development strategy from July 2017 to June 2022. The draft document will be ready by end of May 2017 and it will be presented to a Committee of Principal Secretaries which will discuss the document and provide policy advice before it is submitted to Cabinet for approval. The National Planning Commission, upon approval, has been given the mandate to spearhead implementation of MGDS III.

7.0 The Consultation Process of the Successor Strategy

The development of the strategy was consultative and participatory. The consultations involved District Executive Committees, Area Development Committees (ADCs), MDAs, development partners, Members of Parliament, representatives for political parties, the academia, the media, the private sector, special interest groups⁴, Civil Society Organisations (CSO) and Faith Based Organisations (FBOs).

The consultation process largely requested suggestions on interventions that the next strategy should focus on in the next five years, the role that the stakeholders would play when implementing the strategy as well as the role of the Government in ensuring that the strategy is effectively implemented. In addition, stakeholders were asked to suggest ways of improving the strategy implementation considering that previous policies/plans were not implemented as expected.

8.0 Conclusion

Despite development and implementation of a number of policies including DEVPOLs, SAPs and the MGDs, socio-economic development has hardly been attained and poverty has remained a big concern in Malawi. This is attributed to a number of factors such as inadequate implementation of some policies/plans in place, agricultural land degradation; low production and productivity, poor access to markets, high transport costs and negative effects of climate change. It is against this background that the Government has to develop this EDD and the next national development strategy in order to improve national economic development and reduce poverty among the Malawian population.

During the five years, the economy is expected to grow by a rate of at least 6.0 percent annually. Five priority areas have been identified through national consultations. These KPAs are addressing the challenges that have been identified to affect sustainable growth. The KPAs are: agriculture and climate change management; education and skills development; energy and industrial development; transport and ICT infrastructure development; and health and population management. The Government and other stakeholders in the country are committed to implementing these in full through provision of necessary and adequate resources. The emphasis will be on development policies which are expected to spur economic growth and development in the country. Hence, the Government will concentrate on domestic resource mobilisation to make sure that the priority areas are adequately funded.

⁴ Interest groups included the marginalised groups such as women, girls, people with disability, the elderly and people living with HIV and AIDS.