AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE
DE DÉVELOPPEMENT

Country Focus Report 2025

Malawi



Making Malawi's Capital Work Better for its Development

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African Development Bank Group
Avenue Joseph Anoma
01 BP 1387 Abidjan 01
Côte d'Ivoire
www.afdb.org

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LIST OF ACRONYMS AND ABBREVIATIONS

AEO	African Economic Outlook
AfCFTA	African Continental Free Trade Agreement
AfDB	African Development Bank Group
ATMM	Agriculture, Tourism, Mining and Manufacturing Strategy
BTI	Bertelsmann Transformation Inde
CFR	Country Focus Report
DFIs	Development Financial Institutions
DRM	Domestic resource mobilization
DSA	Debt Sustainability Assessment
ECCE	Country Economists Department
ECMR	Macroeconomics Policy, Forecasting and Research
ECNR	African Natural Resources Center
ECST	Department of Statistics
ECVP	Economics Vice Presidency
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GHG	Green House Gas emissions
HCI	Human Capital Index
IFF	Illicit Financial Flows
IMF	International Monetary Fund
KYC	Know-your-customer
MITC	Malawi Investment and Trade Center
MSE	Malawi Stock Exchange
MSMEs	Micro, Small and Medium Sized Enterprises
ODA	Official Development Assistance
PPPs	Public Private Partnerships
PV	Present Value
RDGS	Southern Africa Regional Development, Integration and Business Delivery Office
SEZs	Special Economic Zones
SMEs	Small, and medium enterprises
SOEs	State-owned Enterprises
UHC	Universal Health Coverage
USD	United States Dollar
VAT	Value-Added Tax
WTO	World Trade Organization



GENERAL INTRODUCTION

Malawi is a landlocked country in southeastern Africa, characterized by a diverse topography of highlands, the Great Rift Valley, and the expansive Lake Malawi. The country's natural beauty is accentuated by several national parks, home to a rich array of wildlife, including the Big Five. Lake Malawi alone hosts over 700 species of fish—many with ornamental value—and is known for its crystal-clear waters, which attract diving and boating enthusiasts. With a land area of 118,484 km^2 and an estimated population of 21.2 million, Malawi has a population density of approximately 236 people per km^2. Its vegetation is dominated by Miombo woodlands, covering around 90% of the country's natural forest area.

Since gaining independence from Britain in 1964, Malawi has pursued an open trade strategy rooted in the exploitation of its natural and human capital. However, limited investment in created capital—such as infrastructure, technology, and industrial capacity—has resulted in persistently low productivity, keeping the country in the low-income category. A combination of external shocks and policy missteps has exacerbated macroeconomic instability and led to a state of debt distress, undermining the country's attractiveness to investors.

The Country Focus Report (CFR) is an annual publication aligned with the African Development Bank's African Economic Outlook (AEO), offering country-specific analysis that mirrors the continental-level themes and diagnostics. The theme for the 2025 AEO, *Making Africa's Capital Work Better for Africa's Development,* is also the focus of this year's Malawi CFR. This report provides a concise, policy-relevant analysis tailored to Malawi's context, offering evidence-based policy options aimed at national decision-makers.

Expanding on the 2023 CFR, which primarily focused on natural capital, the 2025 edition broadens its scope to encompass all forms of capital—financial, human, created, and natural. The report is grounded in a data-driven analysis that supports the formulation of practical and effective policy recommendations to harness Malawi's capital for sustainable development.

MACROECONOMIC PERFORMANCE AND OUTLOOK

1



Key Messages

- Malawi's growth has slowed down, averaging 2% over 2020-2024. Real GDP growth in 2024 was estimated at 1.8% and marginally lower than the 1.9% in 2023.
- The financial sector in Malawi is dominated by the banking sector, with over 60% of the total assets.
- Major risks to the growth and macroeconomic stability outlook include tepid recovery, high inflation, food insecurity, vulnerabilities in the banking sector and a protracted delay in resolving the debt crisis and climate shocks.

1.1 Introduction

This chapter presents Malawi's recent growth and macroeconomic economic performance and provides updated growth projections over the period 2025-2026, including the main downside risks and upside triggers to the outlook. It assesses the public debt situation, and financial flows. The Chapter provides policy options to foster high and resilient growth, supporting macroeconomic stability, economic transformation and how to deal with shocks. The Chapter also provides a link Malawi's current domestic resource mobilization efforts and its development finance gap and how that impacts human capital development.

1.2 Growth Performance

Malawi's growth has slowed down, averaging 2% over 2020-2024. Real GDP growth in 2024 was estimated at 1.8% and marginally lower than the 1.9% in 2023. On the demand-side, falling real incomes due to elevated inflation, high cost of credit, and foreign currency shortages reduced corporate and consumer demand. On the supply-side, agriculture, wholesale and retail trade, manufacturing, and accommodation and food services underperformed, with agriculture and wholesale and retail contracting by 0.2% and 1.6% over that of 2023. Weather shocks negatively impacted agricultural output, with maize output 14 percentage points lower than in 2023. Although lower than previously projected, the resilience of the utilities, construction, mining and quarrying, health, and financial and insurance sectors' growth helped the economy achieve the growth recorded. While the macroeconomic environment remained challenging, the resurgence in mining and tourism has the potential to enhance foreign currency earnings.

1.3 Other Recent Macroeconomic and Social Developments

1.3.1 Monetary Policy, Inflation, Exchange Rate

Inflation has remained elevated despite the tightening of monetary policy. Inflation in Malawi is mainly driven by the domestic food supply situation, global commodity price fluctuations and global logistical disruptions and weather-related shocks such as cyclones. The Reserve Bank of Malawi tightened monetary policy to contain inflation, raising the policy rate from 22% in June 2023 to 26% in April 2024. Improved maize supplies following the support of the donor community have contributed to the recent declines in inflation from a peak of 34.3 in September to 27% in November 2024, but this was reversed in December 2024 when inflation rose to 28.1%.

1.3.2 The Financial Sector

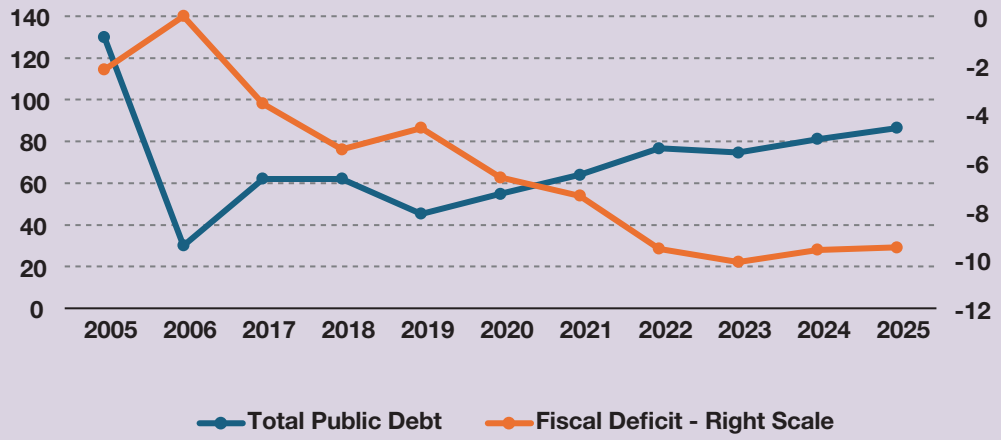
Malawi's financial sector is primarily dominated by the banking industry, which accounts for over 60% of total financial assets. In 2024, the sector contributed approximately 7.1% to GDP. Despite a challenging macroeconomic environment characterized by high interest rates and inflation, the sector remained stable. Profitability was buoyed by arbitrage opportunities in foreign currency transactions, with growth in earnings ranging from 41% to 120% compared to 2023. However, financial stability faces emerging risks, notably the rising ratio of non-performing loans, which increased from 6.1% in 2023 to 8.3% in 2024. Additionally, the concentration of lending in agriculture and government securities heightens exposure to sectoral and fiscal vulnerabilities.

1.3.3 Fiscal Policy and Public Debt

The government committed to fiscal restraints under the IMF Extended Credit Facility programme, but the fiscal deficit, at 9.6% of GDP in 2024, is higher than 8.2% projected level although lower than the 10.1% in 2023. The fiscal deficits are mainly due to higher-than-budgeted expenditure and underperformance of revenue. Given the high fiscal deficits, Malawi's external and overall public debt is assessed as "in distress" (IMF DSA, 2022). Public debt rose from 81.1% in early 2024 to 86.4% of GDP by year end – more than 5 percentage points' increase and well above the 50% sustainability threshold. The Present Value (PV) of

debt-to-exports, debt service-to-exports, and debt service-to-revenue ratios are above the threshold over the medium term under the baseline scenario. The PV of the debt-to-exports ratio threshold is 140%. Debt pressures emanate from poor fiscal performance, the falling value of the Malawi Kwacha and rising interest rates. Debt restructuring negotiations with bilateral creditors are ongoing. Malawi reached an agreement with China in July 2024 that resulted in the extension of the repayment period by 78 months.

Figure 1: Trends in fiscal balance and total public debt in Malawi (% of GDP)



Source: Author, based on AfDB data

1.3.4 External Position – External Financial Flows

Malawi has long faced structural imbalances, with imports consistently exceeding export earnings by more than threefold. Despite this, the country has made progress in attracting foreign direct investment (FDI), which increased from USD 129 million in 2021 to USD 203 million in 2023. However, remittance inflows declined from USD 264 million in 2022 to USD 179.7 million in 2023 due to an unattractive exchange rate and a smaller number of those sending remittances. ODA rose from USD227.4 million in 2021 to USD705.7 million in 2023 of which 92% was from international organizations. The USA was the largest bilateral financing partner. Mismatches in foreign currency inflows and outflows resulted in the current account balance widening from 17.5% of GDP in 2023 to 18.5% in 2024. Acute foreign currency shortages caused a widening gap between the official exchange rate and bureau de change rates - exceeding 11% - and a disparity of about 100% in the parallel market. As a result, official foreign reserves have remained critically low, covering less than one month of imports.

1.3.5 Social Developments

Approximately 72% of the population in Malawi was below the USD2.15 international poverty line in 2023, implying an even higher proportion of the poor given falling per capita incomes in 2024. Low growth and high dependence on a climate-vulnerable agriculture sector that supports 80% of the population has made the situation more difficult given the increasing frequency of natural disasters and internal and external risks. Youth unemployment stood at 23.0% for those aged 15 to 34 years. As for women, the unemployment rate was 5.9% compared to a national average of 5.0% in 2023. Life expectancy at birth rose from 39.9 years in 2000 to 54.7 years in 2021.

Box 1. Domestic Resource Mobilization Efforts and Development Finance Gap

Since 2023 Malawi has been implementing public finance management reforms aimed at containing expenditure and enhancing revenue mobilization. While domestic revenue has risen from 14.7% of GDP in 2022 to 18.1% of GDP in 2024, expenditures have risen from 26.8% of GDP in 2022 to 32% of GDP in 2024. The financing gap has therefore been rising as expenditures rose faster than revenues. While external financing amounted to 26.3% of the total revenue in 2024, this figure has fallen to 25.7% in 2025, implying a widening domestic financing gap.

Table 1: Key Macroeconomic and Social Indicators

	2020	2021	2022	2023	2024(e)	2025(p)	2026(p)
Real GDP Growth	0.8	4.6	0.9	1.9	1.8	3.0	3.8
Real GDP Growth per Capita	-1.9	1.9	-1.7	-0.7	-0.8	0.4	1.2
Inflation	8.6	9.3	20.8	28.7	32.3	23.8	15.8
Overall Fiscal Balance, Including Grants (% GDP)	-6.6	-7.4	-8.9	-10.1	-8.8	-9.3	-8.6
Current Account (% GDP)	-13.9	-15.8	-18.1	-17.5	-18.5	-17.9	-16.9

Source: Data from Domestic authorities; estimates (e) and prediction (p) based on AfDB Statistics Department, authors' calculations.
April 2025

1.4 Macroeconomic Outlook and Risks

1.4.1 Outlook

The economic outlook is positive, with real GDP growth projected to improve to 3.0% and 3.8% in 2025 and 2026, respectively. Inflation is projected to fall to 23.8% and 15.8% in 2025 and 2026, respectively. The fiscal balance is projected at 9.3% of GDP in 2025 and will further decrease to 8.6% in 2026. The recovery in real GDP growth and consumer demand is likely to increase the import demand, but the current account deficit is projected to narrow to 17.9% of GDP in 2025 and further to 16.9% in 2026, supported by higher export receipts.

1.4.2 Risks

Major risks to the growth and macroeconomic stability outlook include a tepid recovery, high inflation, food insecurity, vulnerabilities in the banking sector and a protracted delay in resolving the debt crisis and climate shocks. Increased geopolitical tensions, the global trade wars and reduced external financing all contribute to a potentially gloomy picture for Malawi (Box 2). Moreover, the elections scheduled for September 2025 pose significant fiscal risks and other policy missteps. The government needs to moderate its expansionary fiscal policy to support tight monetary policy efforts from the central bank.

Box 2. Impact of Aid Cuts and US Tariff Impositions

Foreign grants were expected to contribute 25.7% of total revenue in Financial Year (FY) 2024/25, but actual disbursements had fallen short by 61.8% of the target. This has been compounded the suspension of USD 350 million annual funding from the United States Agency for International Development (USAID), the cancellation of the USD 350 million five-year Millennium Challenge Corporation support and the imposition of an 18% tariff on exports from Malawi to the USA. Given these new developments, the Bank's growth projections have been reduced from 4% in 2025 and 4.2% in 2026 to 3% and 3.8%, respectively. While the first-round trade effects of the tariffs are limited due to the small share of Malawi's exports to the USA (<4%), the aid cuts will have a big effect given that 87% of aid is allocated to capital projects, directly affecting infrastructure development and economic growth. The second-round trade effects emanate from reduced global growth, especially that of South Africa, the EU and the UK, which will reduce Malawi's export demand. In the medium-to-long-term, both the aid cuts and tariff imposition will have employment, productivity and competitiveness and growth effects that will exacerbate macro-fiscal instability.

1.5 Policy Options to Accelerate Malawi Economic Development

The government's current efforts to boost agricultural productivity through mega farms and mechanization initiatives are commendable. However, it is essential to ensure that all completed water infrastructure investments are fully utilized to maximize returns. A critical enabler of these efforts will be the creation of a conducive business environment that attracts both domestic and foreign private capital. Achieving this will require sustained macroeconomic stability and streamlined regulatory processes. Greater coordination between fiscal and monetary policy is vital to stabilize inflation and create conditions for lowering the policy interest rate, thereby improving private sector access to credit. This, in turn, necessitates a reduction in government borrowing from the domestic credit market. Additionally, under the Agriculture, Tourism, Manufacturing, and Mining (ATMM) strategy, it will be important to ensure that the necessary skills are available either by developing them locally or by revising the temporary residence policy to attract skilled foreign labour where needed. Emerging risks, including aid cuts and heightened protectionism, require the government to reduce dependence on aid, diversify the economy and export markets, including fully adapting to the continental trade market. Moreover, putting in place a structured diaspora labour market and mobilizing remittances through formal channels must be accompanied by appropriate exchange rate policies.



BOOSTING DOMESTIC CAPITAL MOBILIZATION AND EFFICIENT UTILIZATION

2



Key Messages

- Malawi is going through a very slow pace of structural transformation despite its abundant natural capital.
- Financing needs to fast track structural change were estimated at USD 4.5 billion to fund investments in education, energy, productivity, and infrastructure until 2030 or about USD 0.79 billion annually until 2063, resulting in a gap of about USD 3.59 billion or USD 0.63 billion annually.
- Natural capital contributes about 52% to Malawi's economy, thereby significantly impacting the wealth and livelihoods of the population.

2.1 Introduction

This Chapter highlights the financing constraint of Malawi in terms of domestic resource mobilization, expenditure efficiency and debt sustainability. Apart from assessing the fiscal resources and the operations of the domestic capital market, this chapter also identifies key forms of capital - natural capital, human capital, and business capital available to Malawi and traces their usage, efficiencies and gaps. The key objective is to determine how Malawi can mobilize and valorise these resources more efficiently to facilitate future growth, structural transformation, and sustainable development.

2.2 Fiscal Resource Mobilization

2.2.1 Malawi's Financing Needs

As presented in the CFR 2024, Malawi's annual needs to fast track structural change were estimated at USD 4.5 billion to finance investments in education, energy, productivity, and infrastructure until 2030 or about USD 0.79 billion annually until 2063, resulting in a gap of about USD 3.59 billion or USD 0.63 billion annually. Malawi's financing needs are driven by persistently high fiscal deficits, rising debt service obligations, and the need to meet the ambitions of Malawi Vision 2063. In recent years, these deficits have been financed through domestic borrowing and concessional external financing.

2.2.2 Tax Revenue

Tax revenue constitutes about 91% of domestic revenue, comprising value-added tax (VAT) at 25%, tax sales of goods and services (13%), income tax (43%) and trade taxes (10%). Tax revenue amounted to 12.8% of GDP in 2022 and increased to 18.0% of GDP in 2024 and outperformed sub-Saharan countries by about 3%. Malawi's tax performance is affected by informality, a narrow tax base, VAT exemptions, lower compliance and enforcement levels and dependence on grants that make about 20% of total revenue.

2.2.3 Non-Tax Revenues

Only 4% of total domestic revenue or 2.0% of GDP is non-tax revenue compared to an average of 6.2% of GDP for sub-Saharan Africa in 2024. Profits from state-owned enterprises (SOEs) form the dominant non-tax revenue category, bringing in 68% of the total, followed by sales of goods and services at 29%. The poor performance of the non-tax revenue is largely due to the underperformance of SOEs and pilferage of penalties and fines. Digitalization in the collection of fines and penalties is gaining momentum, with high expectations for growth in 2025.

2.2.4 Mobilizing Domestic Fiscal Resources and Expenditure Efficiency

Overall, domestic revenue has increased from 12.5% of GDP in 2022 to 18.0% in 2024. However, despite this positive trend, expenditure has continued to outpace revenue growth, leading to widening fiscal deficits. Significant drains on public finances include transfers to underperforming SOEs and implicit fuel subsidies. These expenditures place considerable pressure on the country's already limited revenue base. In response, the government is implementing reforms aimed at enhancing domestic revenue mobilization. Key measures include strengthening tax administration and broadening the tax base to improve fiscal sustainability. There is an urgent need to address macro-fiscal imbalances, strengthen public institutions, and enhance public sector efficiency. Moreover, the strategic mobilization and alignment of domestic resources with Vision 2063 priorities will be essential to promote resilient and inclusive growth.

2.3. Malawi's Natural Capital

2.3.1 Overview of Malawi's Natural Capital

Malawi is endowed with abundant natural resources, encompassing agriculture, mineral deposits, forests, wildlife, and renewable energy potential. However, environmental degradation, land mismanagement, and

weak governance limit their contribution to GDP (agriculture - 30.4%; minerals - (1%, uranium, rare earth elements, bauxite, coal, gemstones, and industrial minerals). Renewable energy accounts for 90.4% (hydropower - 72%; solar - 18.4%) of the total energy mix. The forest cover has declined from 34.1% of land in 1990 to 34.0% (2024). The potential in carbon trading is not fully utilised, earning only USD 9.5 million in 2024.

Table 2: Decomposition of Natural Capital

Nominal Wealth Shares	1995	2005	2014	2015	2016	2017	2018	2019	2020
Produced capital	0.04	0.01	0.01	0.02	0.02	0.02	0.02	0.02	0.02
Human capital	0.34	0.42	0.28	0.31	0.28	0.29	0.36	0.35	0.38
Renewable Natural Capital	0.62	0.57	0.71	0.67	0.70	0.69	0.62	0.63	0.60
Non-renewable Natural capital	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

2.3.2 Economic Contribution of Malawi's Natural Capital

Natural capital contributes about 52% to Malawi's economy, thereby significantly impacting the wealth and livelihoods of the population. Natural capital and the services derived thereof are double the average for other low-income countries. The economy relies on the agricultural sector, which contributes about 30% to Malawi's GDP and over 60% to total employment. Despite its importance, land degradation and poor resource management practices pose a huge risk to both economic growth and climate resilience. Equally at risk are the country's forests due to unsustainable charcoal production.

2.3.3 Estimates and Dynamics of Natural Capital

Based on AEO 2023, unlike other low-income countries, Malawi experienced a 36% growth in its natural capital, yet per capita natural wealth has been decreasing. A major factor in this trend is high population growth and a lower rate of discoveries of new non-renewable assets. A spike in the growth of the created capital index between 2004 and 2010 (from 90 in 2004 to 128 in 2010) was not sustained, reducing the capacity of the country to increase per capita wealth for its population.

2.3.4 Challenges in Leveraging Malawi's Natural Capital

Malawi is at the early stages of creating a system of natural capital accounting but has started introducing biodiversity financing within its budget to ensure resources are allocated for the management and protection of the country's biodiversity. As part of this process, efforts to develop a natural capital accounting tool are underway. Using genetic sequencing, there are efforts to establish the true monetary value of unique species such as tabalaba root and mbuna fish and leverage the potential USD 600 million in carbon markets annually. So far, projects like cleaner cooking technologies and forestry initiatives have resulted in carbon credits being auctioned on digital exchanges.

2.4 Business Capital

2.4.1 Setting the Stage

Business capital refers to the financial, physical, and intellectual assets that enterprises leverage to drive economic activity, investment, and production. This includes micro, small, and medium enterprises (MSMEs), large corporations, start-ups, industrial capital, and financial capital sources supporting businesses. Malawi is estimated to have over 1.6 million MSMEs, the majority being microenterprises (74%), with operations in

agriculture, manufacturing, ICT, and financial services. MSMEs employ about 80% of the total labour force and contribute about 40% to GDP.

2.4.2 Indicators of Business Capital

Following a decline between 2003 and 2007, Malawi's business capital rebounded sharply in 2008, recording a 62% increase. Despite this growth, business capital remains a small component of national wealth—accounting for only 2% compared to 15% for Sub-Saharan Africa in 2020. This limited contribution reflects the dominance of micro and small enterprises engaged primarily in hawking and low-capital activities, which require minimal investment. Additionally, growth in business capital has decelerated significantly, from 23% in 2017 to just 5% in 2020, amid mounting macroeconomic instability. Malawi currently has approximately 76 MSMEs per 1,000 people.

2.4.3 Challenges and Opportunities for Enhancing Business Capital in the Malawi

In the past five years Malawi's business environment has been challenging due to high inflation, large fiscal and current account deficits, high costs of credit, shortages of foreign currency and vulnerability to climate change and other external shocks. Moreover, many MSMEs find the business start-up costs, access to credit and meeting tax requirements prohibitive. However, Malawi offers investment potential in sectors like mining, tourism, and agriculture, with opportunities for public-private partnerships in infrastructure. As a result, the stock market has experienced rapid growth, with market capitalization growing more than 3.4 times compared to South Africa's 30% rise and the Malawi All Share Index rising 4 times between 2020 and 2024. However, only 16 firms are registered on the Malawi Stock Exchange, indicating a very shallow market. Malawi's private sector credit to GDP is low, at 1.8% compared to South Africa's 67.6% or 12.8% for Zambia.

2.5 Malawi's Human Capital

2.5.1 Current State of Human Capital in Malawi

Malawi's Human Capital Index (HCI) score improved from 0.36 in 2010 to 0.41 in 2020, yet the country still ranks 125th out of 157 countries. Human capital accounted for 38% of Malawi's total wealth in 2020—a 10 percentage point increase since 1995—though still below the Sub-Saharan Africa average of 50%. Life expectancy declined from 64.1 years in 2019 to 57.4 years in 2024 (Table 3), reversing previous gains. Despite this, Malawi outperforms many low-income and Sub-Saharan African countries in early childhood survival, years of schooling, and primary school completion. The maternal mortality rate stands at 381 deaths per 100,000 live births, lower than the regional average of 454. Youth literacy is improving, rising to 76% in 2021 from 73% in 2015. However, youth unemployment remains a concern at 19% in 2020—above the regional average. The country's human capital development continues to be hindered by limited access to quality education and healthcare, entrenched poverty, weak institutional capacity, and constrained fiscal resources.

Table 3: Key Indicators of Education, Health, and Workforce in Malawi

	1992	2000	2004	2010	2015	2024
Infant mortality rate per 1000 births	135.00	104.00	76.00	66.00	42.00	35.00
Unemployment rate (%)	6.85	6.64	6.60	6.55	6.74	6.70
Adult literacy (%)	44.00	64.00	69.94	61.31	62.14	75.50
Youth Literacy (%)			72.14		72.94	75.06
Life expectancy, years	43.41	44.52	50.45	56.38	61.38	57.41

2.5.2 Major Barriers to Human Capital Development in Malawi

Barriers to human capital development in Malawi include low access to quality education and health services. For education, inadequate infrastructure, teacher shortages, and high school expenses, underdeveloped curricula, and shortages of institutions that offer technical and vocational training limit opportunities for developing practical skills. Regarding health, malnutrition and undernutrition are still commonplace, and this is compounded by limited healthcare access due to shortages of essential medicines and skilled personnel and high poverty rates, at 72% in 2024, making affordability of basic services challenging.

Box 3. Successful Reforms and Investments in Education

The National Education Investment Plan 2020-2030 committed to catalyzing an education and skills revolution that promotes science, technology, research and innovation to build knowledge, human capital, capabilities and skills. Current reforms focus on expanding access to education, improving quality and relevance, and enhancing governance and management of the education sector, with emphasis on affordability, inclusion and equity. Moreover, a holistic approach that aims to ensure integration of the education system from early childhood development to the tertiary level has been developed to ensure sustainable educational development.

2.5.3 Investing in Education and Skills Development

The education budget, while mainly financed by donors (86%), represents a smaller share of the total allocation and has been declining from 17% in 2020/2021 to 14.8% in 2024/2025. Moreover, planned investments in education infrastructure have consistently underperformed. Despite private schools being an alternative to overcrowded and under-resourced public schools, their sustainability, affordability, and equity is questionable. Therefore, Malawi should invest more resources into critical subjects such as science, technology, engineering and mathematics that would allow the country to develop essential skills needed for industrialization, as well as in Technical and Vocational Education and Training (Box 3).

2.5.4 Health as a Pillar of Human Capital Development

Nutrition affects the development of healthy individuals and addressing stunting and malnutrition is an integral component of human capital development. The health sector budget for 2024/2025 grew by 14% in real terms, but the on-budget per capita expenditure of USD16 is low to strengthen health systems. Malawi has 7 hospital beds per 10,000 people against a recommended 25 beds, yet it faces a high disease burden compounded by increasing non-communicable diseases. Malawi has about 0.12 healthcare worker per 1,000 people and a Universal Health Coverage (UHC) index of 69.68%, indicating the need to invest more in health systems and infrastructure.

2.6 Financial Capital

2.6.1 Domestic Capital and Financial Markets

The Malawi Stock Exchange forms an important part of the capital market. It allows foreign portfolio investment, with government securities constituting the secondary market. The MSE has 16 listed companies and total equity market capitalization of USD 3.63 billion and a

debt market value of USD 2.12 billion. The banking sector has eight commercial banks with 116 branches, 498 auto-teller machines, and 8494 banking agents, but its financial intermediation role remains limited given the limited number of financial instruments on offer. Banking sector assets grew by 163% between 2019 and 2023. By end-2024, the insurance market was worth USD 123.5 million and focuses largely on life and general insurance. NICO insurance dominates the insurance sector with more than 50% of the total assets. The pension market had total assets of USD903.2 million in 2023, having grown from USD314.7 million in 2019. The capital market development plan 2021-2025 aimed to grow the issuer and investor base, invest in market infrastructure, raising intermediation standards and efficiency, and the quality of regulation and consumer protection to ensure stability.

2.6.2 The State of Financial Development in Malawi

Between 2000 and 2021, Malawi lagged all Southern African countries in financial development, ranking 176th out of 183 countries globally. The country's Financial Development Index peaked at just 0.095 in 2021, with its lowest score of 0.07 recorded in 2017. While the depth of financial institutions has gradually increased, access to financial services has declined, and financial market development has remained stagnant—essentially flatlining at zero. Over the long term, the efficiency of Malawi's financial sector is on a downward trajectory, although recent signs of recovery have emerged since 2020, largely driven by innovation and the digitalization of financial services.

Despite ongoing reforms aimed at revitalizing capital markets and promoting inclusive financial development, the allocation of financial resources remains heavily skewed towards the public sector. Efforts to grow capital markets have not translated into greater market depth. The introduction of new instruments—such as SME, green, and social bonds—could help mobilize long-term investment as they cater to the specific needs of the small firms. Supporting fintechs requires policymakers and regulators to comprehend the fintech landscape and create an enabling environment for their growth and thus enhance competition. Increasing credit access and expanding credit guarantee schemes, while leveraging technology to enhance market efficiency, are also critical steps.

The development of pension funds and greater insurance penetration are constrained by a high degree of informality in the economy and a lack of long-term savings and investment products. Addressing these structural limitations is essential to building a robust and inclusive financial system capable of supporting sustainable economic growth.

2.6.3 Mobilizing Financial Resources for Malawi's Development

The banking sector comprises eight banks, four domestic and privately-owned with assets at 63.4% in 2023 compared to 56.2% in 2022: four foreign owned with 36.6% of total assets. Four banks are listed on the Malawi Stock Exchange (MSE). Two banks - National Bank of Malawi and Standard Bank - account for 51% of banking deposits. Malawi's banking sector is adequately capitalized, profitable and liquid, but non-performing loans have increased to levels above the 5.0% prudential threshold. Credit is concentrated in agriculture, services and manufacturing, accounting for 77.4% of total credit. Total assets have been growing at more than 20% annually but remain small. Other banking sector players are microfinance banks, savings and credit cooperatives, development finance institutions, and mobile-based digital operators. The MSE, pension funds and insurance companies are key to capital mobilization, but participation is low. The MSE market capitalization is growing but the limited participation of the corporate sector limits its role in financing economic transformation. The government's 10-year bond is a leading indicator for interest rates in the bond market.

2.6.4 Offshore-Linked Financial Resources for Malawi's Development

Funds sourced outside the country, mainly through foreign-owned banks or international financial institutions, ODA, and diaspora remittances are classified as offshore financing. There are no restrictions on foreign investment, but prior approvals from the central bank are required for transactions such as international loans and profit remittances. Shortages of foreign currency have become a major challenge for foreign capital, profits, loan and lease repayments remittances. Given that the Malawi Kwacha is not pegged to any foreign currency and the debt distress situation, foreign capital inflows are limited. Trade finance is a large part of offshore financing in Malawi. Significant foreign development financing is provided through development finance institutions and international organizations. Examples of such financing include the USD100 million trade finance facility from the African Export-Import Bank to the National Bank of Malawi and USD15 million to FDH Bank Malawi, a de-risking World Bank Investment Project Financing instrument for the importation of essential commodities, credit lines for on-lending to the agriculture and MSE sectors from the European Investment Bank and the African Development Bank.

2.6.5 Innovative Finance

New and unconventional financing instruments for socioeconomic development include blended finance, results-based financing, social and green bonds, and public-private partnerships. So far, Malawi has utilised results-based financing from the World Bank to strengthen fiscal governance, implemented the Malawi Innovation Challenge Fund that uses mobile applications targeting MSMEs, exemplified by the Fin Mobile initiative, and accessed climate financing through the Climate Investment Fund and the Green Climate Fund to fund energy projects. In addition, the African Development Bank has provided financing for sovereign insurance against natural hazards such as drought and cyclones, which has allowed Malawi to receive payouts of more than USD23 million in the last three years. Malawi also has comprehensive policy guidelines and legislation for public private partnerships as provided in the Public Private Partnership (PPP) Policy of 2011, and the PPP Act of 2011. The implementation of the PPP framework has not been very successful, due to a weak macroeconomic investment climate for private investors characterized by high inflation rates, credit costs and fiscal deficits, which have led to over-reliance on external finance and aid.

2.7 Policy Recommendations

Malawi has potential for increasing domestic capital mobilization, but its full potential is not being utilized. To maximize domestic capital mobilization, Malawi needs to enhance policies that ensure maximization of the tax and non-tax revenue mobilization by strengthening tax compliance and enforcement, expand value-adding activities in agriculture and mining, and implement natural capital accounting system to capture the full value of its natural resources and leverage additional debt financing. Furthermore, reducingSME financing costs, streamlining business regulations (Box 4), promoting financial literacy, developing capital and financial markets to their full potential for financial intermediation, and encouraging institutional investor participation are essential steps toward mobilizing domestic resources effectively. The tourism and mining sectors hold potential that can be tapped to enhance revenue flow as well. Given the size of Lake Malawi, undertaking policies that promote growth of aquatic sectors and ecotourism could unlock substantial resources. To be able to do this Malawi will need to align its education and health sector reforms to ensure maximum benefits from human capital development that is consistent with industry demands and diversify financing instruments and enhance capital market participation. Moreover, Malawi needs to enhance the effectiveness and efficiency of its investments by channelling debt resources into highly productive areas to ensure enhanced repayment capacity.

Box 4. Improving the Business Environment and Enhancing Integration of the Financial Sector

Simplifying business registration processes, tax filling procedures, and enhancing the social contract can increase revenue collection through enhanced formalization of the economy. The informal sector contributes an estimated 40% to GDP yet does not pay some of the taxes as those paid by formal businesses. Moreover, Malawi needs to enhance its financial sector integration into regional systems as this remains very limited and therefore reduces its ability to tap into regional financial markets.

HARNESSING MALAWI'S CAPITAL POTENTIAL AND RESOURCES FOR DEVELOPMENT

3



Key Messages

- Malawi is making some progress in enhancing domestic resource mobilization, but the utilization of the resources to ensure sustainable financing for development has been suboptimal.
- Improving the ease of doing business is key to leveraging private sector participation in development financing. This includes addressing debt distress and ensuring macroeconomic stability.
- Building institutional and human capacity at all government levels in a devolved governance system will enhance service delivery, resource mobilization and management.

3.1 Introduction

Chapter 3 explores how Malawi's institutional quality, governance, and the rule of law influence its ability to mobilize domestic capital and promote sustainable development. Malawi's capital base is critical for economic development and the utilization of its natural, human, business and financial capital will determine the speed and sustainability of economic structural transformation. However, weaknesses in its institutions and governance hinder efforts to harness the full potential of its capital effectively.

3.2 Institutional Arrangement for the Management and Utilization of the Various Forms of Capital

Malawi has established several institutional, regulatory, and legal frameworks to manage and utilize its capital more effectively. Recognizing the limitations of public financing for development - particularly in infrastructure - the government has taken steps to promote private sector participation in resource mobilization for sustainable development. One such initiative is the Public Private Partnerships (PPP) Act of 2011, overseen by the Ministry of Finance and Economic Affairs and implemented through the Public Private Partnership Commission (PPPC). The government also implements a five-year Public Sector Investment Program (PSIP), informed by inputs from line ministries and aligned annually with the national budget and Vision 2063 priorities.

To support broader financial sector reforms, Malawi is implementing its third Financial Sector Development Strategy (FSDS). The FSDS aims to build a more resilient, competitive, and dynamic financial system capable of supporting economic growth, enhancing the strength of domestic financial institutions, and addressing the needs of businesses and the general population. Its objectives include reducing high domestic borrowing, deepening capital markets, expanding the use of innovative financial instruments, improving banks' intermediation role, strengthening know-your-customer (KYC) practices, and boosting financial literacy. While some progress has been made, persistent challenges - particularly macroeconomic instability and high public borrowing - continue to undermine these efforts. Learning from regional peers and addressing inefficiencies could significantly improve the effectiveness of Malawi's capital management institutions.
Despite these frameworks, Malawi remains vulnerable to illicit financial flows (IFFs). In 2022, IFFs were estimated at approximately USD 58 million per year - equivalent to nearly 6% of government revenue - driven largely by tax evasion and avoidance by multinational corporations, as well as corruption. Increasing information sharing under the African Beneficial Ownership Transparency Network initiative may help counter IFFs. As Malawi's mining sector grows in importance, further institutional strengthening is urgently required to improve oversight and governance in the extractives sector.

Malawi's legal arsenal against financial crimes includes the Financial Crimes Act of 2017, amended in 2023, which criminalizes money laundering and terrorist financing. The Act led to the creation of the Financial Intelligence Unit, mandated to monitor suspicious financial activity and facilitate asset forfeiture. The Act also enabled the establishment of the Asset Forfeiture Unit, which is responsible for recovering the proceeds of financial crime, while the Financial Reporting Centre shares intelligence with relevant enforcement agencies. The launch of the National Anti-Money Laundering, Combating the Financing of Terrorism and Proliferation of Weapons of Mass Destruction Policy in July 2024 further underscores Malawi's commitment to financial integrity.

Nonetheless, new vulnerabilities - such as cybercrime and unregulated cryptocurrency activity - pose growing threats to financial stability. Addressing these issues will require new technical capacities and regulatory reforms. In the short term, Malawi could benefit from knowledge sharing and technical assistance from regional peers that have developed more advanced financial regulatory systems.

3.3 Governance Challenges in the Management and Utilization of the Various Forms of Capital for Resource Mobilization

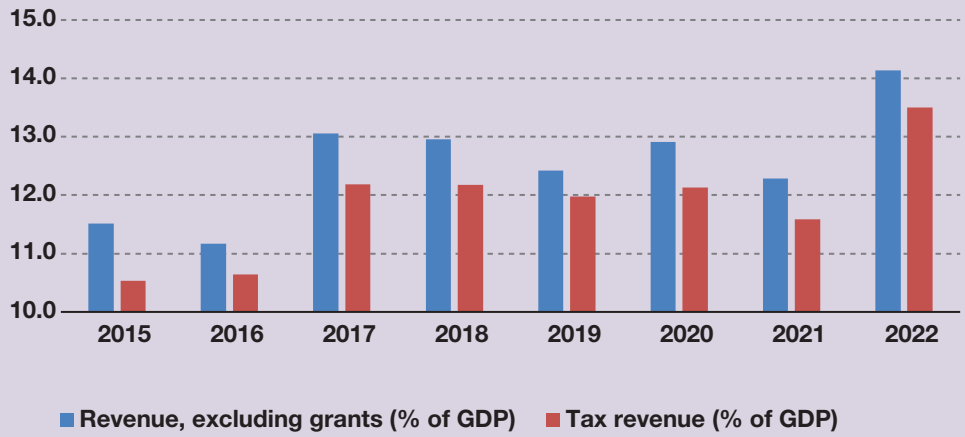
Malawi ranks 50th out of 137 countries under the Bertelsmann Transformation Index (BTI) in 2024 and 19th out of 54 African countries under the Ibrahim Index of African Governance (IIAG), with a score of 55.2 out of 100, which is an improvement of 1.2 points since 2014. While Malawi's performance surpasses both the continental average of 49.3 and the Southern Africa regional average of 54.6, the rate of improvement is slow to meet the expectations of the country's citizens.

The National Decentralization Policy, approved in October 1998 and revised in 2024, was developed within the context of the provisions of the National Constitution, 1994 and Local Government Act of 1998 and its revisions. The decentralization process provides for devolution of administrative and fiscal responsibilities as part of the democratic process and national development and service delivery efforts. Malawi is divided into three regions (Northern, Central, and Southern) and comprises 28 districts that are overseen by district councils, city councils, municipal councils, and town councils. Local level responsibilities include the management and protection of natural resources and the environment, as well as financial resources, as provided under the Public Financial Management Act of 2023, and coordination and implementation of government programs. Notably, the devolution of government enables greater participation by interest groups, civil society, communities and other stakeholders as part of democratic institutions and within the context of the existing legal provisions.

Devolution has had its own challenges, including inadequate revenue and development funding. Local governments experience tax evasion, embezzlement of public funds, inequities arising from resource distribution and inadequate controls. In particular, the Integrated Financial Management Information Systems have not been fully rolled out to local governments, and the required infrastructure is not readily available. Continued PFM reforms are therefore needed to make public financial management more effective, efficient, transparent and participatory resulting in improved accountability and better service delivery.

Institutional quality is central to a country's capacity to mobilize its national capital and apply it for the development of the nation for the benefit of its citizens. By mobilizing and efficiently allocating domestic resources, countries accelerate their economic development. As the government invests in public goods and services, particularly infrastructure, it creates an environment that attracts private investment for the overall development of the country. Malawi is making efforts to build its institutions with the support of international development partners to enhance its capacity to mobilize resources that are critical for long-term economic transformation. Mobilizing domestic resources, such as natural capital, financial, human and business assets, enable Malawi to finance its development and thus reduce dependence on foreign aid, which remains unpredictable and inadequate. Overall, the highest tax-to-GDP ratio for Malawi since 2005 was 13.2% in 2017, with the lowest being 9.0% in 2005. Since 2015, revenue performance has been mixed (Figure 2).

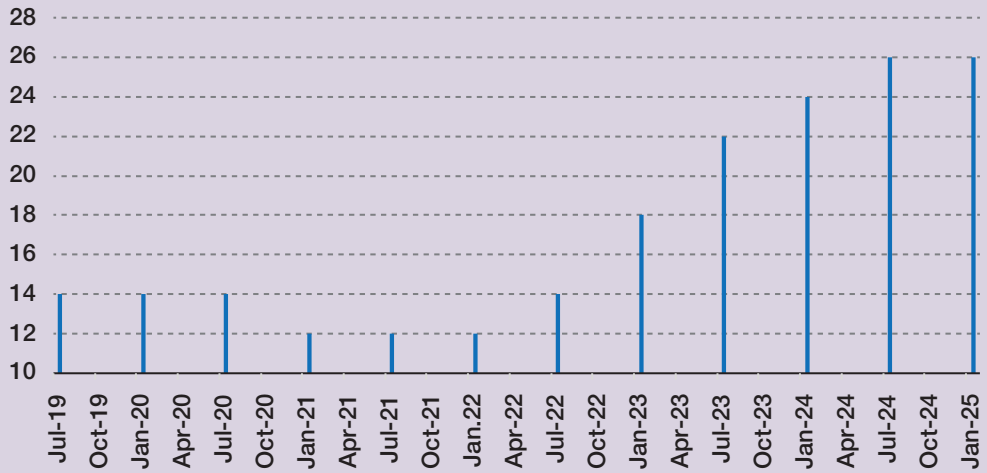
Figure 2: Revenue Trends (% of GDP)



Source: Author, based on AfDB data

Considering domestic resource mobilization, Malawi's capacity to mobilize and apply the revenues has shown a recurring pattern, where meeting revenue targets has largely been elusive while expenditures exceed targets resulting in widening fiscal deficits and unsustainable debt (Figure 1). Financing of the fiscal deficits has also crowded out the private sector, which faces increasing costs of capital both on the domestic and international markets (Figure 3).

Figure 3: Policy Rate (%)



Source: Author, based on AfDB data

Regarding public financial management, several challenges exist, including corruption, weak internal controls, and inadequate funding, which hinder effective service delivery and sustainable development. Macroeconomic instability and external shocks complicate the situation, thereby impacting fiscal and debt positions, with implications for resource flows that are critical for the development and transformation of the economy.

3.4. The Rule of Law, the Management and Utilization of the Various Forms of Capital

Malawi has made notable progress in upholding the rule of law as enshrined in its Constitution, particularly in strengthening the legal framework and reforming the criminal justice system. The legislative process broadly aligns with international and constitutional standards. The judiciary, tasked with interpreting and enforcing the law, has demonstrated its commitment to independence and impartiality, most notably in the 2019 election dispute ruling. Reforms in the criminal justice system include training police officers on human rights and public order management. However, persistent challenges remain, particularly in access to justice, judicial independence, poverty, and corruption.

Economic prosperity is closely linked to economic freedom, an area where Malawi performs poorly. The country ranked 133 out of 165 in the 2023 Heritage Foundation's Index of Economic Freedom. While Malawi espouses market-based economic principles, several policy decisions hinder private sector development. The protection of private property remains weak, and trade barriers continue to raise costs for consumers. For example, regulatory controls on certain goods creates investment uncertainty by complicating trade and returns on investment. Broader weaknesses in enforcing socio-economic rights and managing the judiciary - exemplified by limited resources, heavy caseloads, and eroded public trust, particularly in cases involving land disputes and financial crimes - further compound the problem. In this context, the case of Chatepa and Another v Malawi Housing Corporation is often cited as a missed opportunity to advance the enforcement of economic rights. Despite Malawi having a well-established anti-corruption framework and repeated public commitments to tackling corruption, progress has been slow. In the 2024 Corruption Perceptions Index, Malawi scored 34 out of 100 - where 0 is "highly corrupt" and 100 is "very clean" - placing it 107th out of 180 countries. This score has remained stagnant since 2022 and slightly below its 2021 score of 35. The perceived high level of corruption undermines investor confidence, deterring both domestic and foreign investment. Corruption drives up transaction costs, increases business risk, and creates an unpredictable investment environment - ultimately hampering long-term economic growth.

To address these challenges, Malawi is working to improve its investment climate. The Malawi Investment and Trade Center (MITC) is leading reforms underpinned by the new Investment and Export Promotion Act (2024) and the Special Economic Zones (SEZs) Act (2024), which aim to stimulate investment and expand exports. While Malawi is generally open to foreign investment, restrictions on land ownership and transfer continue to pose barriers. These are compounded by foreign exchange shortages, which constrain the importation of production inputs, limit profit repatriation, and impede other operational needs of investors.

Malawi stands to benefit from technical assistance provided by institutions such as the African Development Bank Group's Investment Climate Facility and the World Bank. These partners can support investment climate reforms and institutional capacity building to help the country attract greater investment and accelerate economic growth

3.5 A Pan-African Approach to Strengthening the Rule of Law, Institutions and Governance for Harnessing Malawi's Capital

Malawi's 1994 Constitution and its subsequent amendments is the supreme law of the country and provides the basis of all other laws and foreign relations. It expressly states that governing should be in accordance with the law of nations and the rule law and actively support regional and other international endeavours. The constitution adheres to four basic principles - institutional checks and balances, representative government, the rule of law, protection of fundamental rights and integrity and standards in public life. Embedded in Malawi's Constitution are elements of common law, customary law and religious law.

In accordance with the Constitution, Malawi has signed, ratified and acceded its membership in regional, continental and other international frameworks that impact the way it can deploy the several capital bases at its disposal. Thus, Malawi is a member of several African institutions such as the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and the African Union (AU), African Continental Free Trade Area (AfCFTA) and participates in COMESA-SADC-East African Community (EAC) Tripartite Free Trade Area (TFTA) processes. Malawi's membership and agreements to several international organizations and conventions, including the following international organizations: the Commonwealth of Nations, the United Nations and its specialized agencies, the International Monetary Fund, the World Bank, the Multilateral Investment Guarantee Agency (MIGA), the World Intellectual Property Organization (WIPO), the Berne Convention, the Universal Copyright Convention, the Non-Aligned Movement, G-77, and the International Criminal Court also influence its laws. Malawi also co-operates with other nations in fighting crime and sharing of intelligence within the context of Interpol and Afripol Operations. An important element that confirms Malawi's commitment to these regional and international arrangements is its domestication of the requirements of its membership within the country's laws and statutes.

Given its membership to the AU, Malawi aligns with continental strategies aimed at curbing IFFs within the context of the AU's High-Level Panel on Illicit Financial Flows. Within SADC, Malawi is implementing its obligations under the several protocols and programs, including such issues as corruption, illicit drug trafficking, control of firearms, ammunition and other materials, education & training, energy, finance and investment, fisheries and forestry, gender and development, health, transboundary, shared watercourses and mining, among others. These protocols and programs impose specific requirements that affect how Malawi mobilizes and manages it capital assets as it pursues its development objectives.

Some progress has been made in implementing SADC protocols and programs, especially in areas like gender and development and regional integration. Malawi aligned its National Gender Policy with the SADC Protocol on Gender and Development and is involved in implementing the Regional Indicative Strategic Development Plan (RISDP) and a champion for the SADC National Planning Entities Platform. Malawi is also participating in the SADC Regional Indicative Strategic Development Plan (RISDP) 2020-2030 and the Electronic Certificate of Origin (e-CoO) to enhance intra-regional trade, which influences the country's regional integration efforts and trade.

Within the context of the AU, Malawi is committed to the Maputo Protocol and the African Union's Agenda 2063. Constitutional amendments and legislative reviews were made to align with the Maputo Protocol. Malawi also submitted itself to evaluations on progress towards achieving the goals of the

Malabo Declaration and the Comprehensive African Agriculture Development Programme Biennial Review and participates in the AU Single African Air Transport Market and Education, Science and Technology. Having ratified the AfCFTA in 2021, Malawi submitted its schedule of commitments under the Protocol on Trade in Services and is participating in a pilot program aimed at testing the operational aspects of the AfCFTA agreement and fostering commercially meaningful trade.

3.6 Conclusion and Policy Recommendations

Sustaining economic recovery and macro-financial stability in Malawi requires a multilayered approach including macro-fiscal reforms, strengthening public financial management, and addressing vulnerabilities in the financial sector. Given the importance of human capital, bolstering food security, building resilience, and protecting vulnerable populations is also important. Thus, a balanced approach between protecting the economy's internal integrity and attracting foreign direct investments, and coordination between monetary policy and fiscal policy and enhanced debt sustainability are all critical to enhance debt sustainability. Moreover, key systems and institutions that facilitate investment flows, including the legal and regulatory frameworks, need strengthening.

Building public trust in government institutions reduces opportunistic and rent-seeking behaviour and enhance Malawi’s capacity to generate and effectively allocate revenue for development. The challenges that the government faces in increasing compliance with tax measures could be addressed through enhanced public trust and combating corruption, which increases the efficiency in public expenditure and effectiveness in the allocation of fiscal resources.

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