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# GLOBALIZATION AND SUSTAINABLE HUMAN DEVELOPMENT: PROGRESS AND CHALLENGES FOR MALAWI

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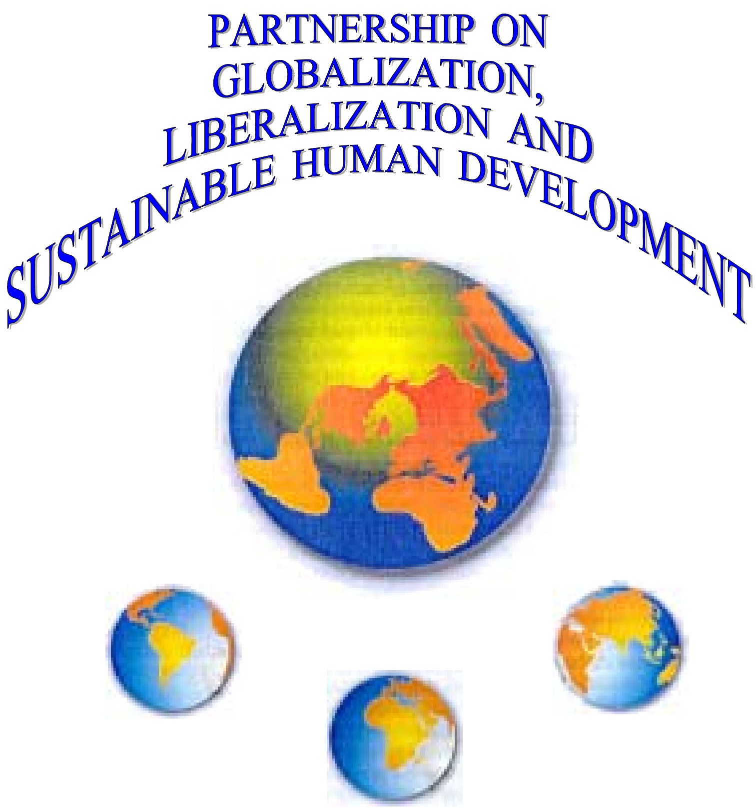


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# EXECUTIVE SUMMARY

1. This case study of Malawi examines the relationship between globalization and sustainable human development before drawing appropriate policy lessons and recommendations. In this connection, the study evaluates structural reform and liberalization policies that Malawi has adopted for opening up the economy, as well as recent macroeconomic and sectoral performance. The study also assesses the extent of Malawi=s integration into the world economy through trade, investment and financial flows. The integration of Malawi into global structures is not new. It began with colonialism just before the turn of this century. After independence, this relationship continued under various voluntary arrangements, such as the Lomé Convention. More recently, liberalization of the external sector under structural adjustment programmes became the major means of integrating the Malawian economy into the global economy. Other mechanisms of integration are bilateral trade agreements, regional arrangements and multilateral agreements under the World Trade Organization (WTO).

2. Malawi is one of the first developing countries to have adopted a Structural Adjustment Programme supported by the Bretton Woods institutions. Under this programme, agricultural and manufacturing sectors as well as trade and capital flows were liberalized.

## 1. Domestic Liberalization

3. In agriculture, the principal objectives of SAPs were to ensure appropriate price policy and adequate incentives, expand the role of the private sector in the marketing of small holder crops, increase efficiency and improve incomes of small holders, increase efficiency of land use and protect the environment. The main policy measures implemented were rationalization of small holder producer prices; removal of fertilizer subsidies; promoting private competition in marketing inputs and outputs; controlling of inflation to shift the rural-urban terms of trade in favour of agriculture; and exchange rate liberalization to remove the implicit tax on agricultural exports. However, despite these measures the performance of the food sector under SAPs has been unsatisfactory with no increase in yields of most food crops. This has increased the risks of food insecurity and necessitated food imports, which use up scarce foreign exchange. The yields of the main cash crops grown by small holder farmers have not increased either.

4. In manufacturing, SAPs aimed at encouraging efficient import substitution and improving the policy environment for the sector. In order to attain these objectives, prices of a large number of manufactured products to which controls applied were decontrolled. Other policy measures included the elimination of authority to grant exclusive product rights, revision of the duty drawback system, establishment of the Malawi Investment Promotion Agency (MIPA), simplification of the process for registration and incorporation of companies, and establishment of Export Processing Zones (EPZs). These policy measures have not led to a marked expansion in manufacturing activity in the country. This has been due to lack of competition, with most industries dominated by monopolies and oligopolies; excessive regulation of the economy; and remaining price controls on a number of products.

5. The net benefit of privatization to the economy is not yet clear. Some positive evidence is emerging, particularly in enterprises where the controlling interest has been sold to an established private-sector operator. However, the extent to which the objective of reducing monopoly is being achieved is debatable, especially in cases where large enterprises being privatized are not split into and sold as small independent units. Also, participation by many indigenous people in privatized enterprises remains limited due to low average levels of income of the majority of Malawians. Further, privatization worsens the plight of those who are retrenched and do not find alternative employment.

6. Liberalization of the formal financial sector has led to an increase in the number of bank and non-bank financial institutions and freed interest rate determination and credit allocation from control. However, there has been an insignificant increase in competition, in new products and in the quality of financial services. In relation to GDP, neither the level of deposits nor the level of credit has increased. Export financing and mortgage and savings banking services remain inadequate. Key policy issues include how to increase the number of market players, especially, but not only, in savings and mortgage banking; to establish a specialized export finance company; and to increase lending to SMEs.

7. Measured as a percentage of GDP, budget deficits used to be tolerably small up to the mid-1970s but have subsequently been uncomfortably high as expenditure growth exceeded revenue growth. Two major adverse effects have emerged: Firstly, except in a few recent years sizeable proportions of the deficit have been financed by inflationary borrowing from the Central Bank. Secondly, deficit financing from domestic banks and non bank financial institutions have been crowding out private sector investment in productive activities. To address the problem, reforms have been undertaken on both revenue and expenditure sides. A combination of tax administration reforms and actual tax reforms has, however, not been able to generate adequate revenue to even fully cover recurrent expenditures only. Major weakness of the tax system have been numerous exemptions, tax evasion, and the existence of the untaxed large and growing second economy/informal sector. Reforms have been undertaken to restrain/cut down expenditure and introduce priorities in resource allocation, between and within sectors but meaningful success is yet to be seen.

## 2. External Sector Liberalization

*Liberalization of Foreign Trade*

8. Policy measures for promoting foreign trade were implemented throughout the entire reform period, 1981 to 1999. In the early phase of the reform process, SAPs set out to diversify the export base and promote exports. In order to achieve these objectives, the authorities used the exchange rate as a policy instrument to keep the economy competitive for an effective export promotion strategy.

9. Trade liberalization measures included freeing of 65 per cent of imports from prior approval for foreign exchange allocation by the Reserve Bank; elimination of restrictions on payments for current payments and transfers and reduction of the scope for export licensing, and reduction of import duties. However, despite these measures, Malawi has had little success in diversifying its exports away from agricultural to non-traditional products. It has had limited success in increasing exports and imports in real terms and relative to GDP.

*Liberalization of the Foreign Exchange Market*

10. The major measures for liberalizing the foreign exchange market included the removal or liberalization of limits on payments abroad and granting rights to allocate foreign exchange for all payments to authorized dealer banks. An export retention scheme was also introduced under which an exporter could retain up to 90 per cent (later reduced to 60 percent) of earnings in foreign currency accounts. The deposits kept in these accounts can be used as the owners wished. The removal or liberalization of limits on payments abroad has facilitated payments for imports of goods and services and tended to increase demand for foreign exchange whereas he introduction of the export retention scheme has encouraged exports and tended to increase foreign exchange earnings.

11. An important step was the establishment in 1994 of an independently floating exchange rate regime under which commercial banks sell and buy foreign exchange at freely determined exchange rates. Foreign exchange bureaus can engage in spot foreign exchange transactions at negotiated rates. The floating of the Malawi kwacha and the consequent increase in the exchange rate has resulted in a narrowing of the gap between the official exchange rate and the parallel exchange rate.

*Liberalization of the Foreign Capital Account*

12. Certain aspects of the capital accounts in Malawi were liberalized before SAPS. These are the inward transfers of non-debt creating capital and the repatriation of the same provided that the original investment was made with funds from abroad. In effect, this means that there was no rest restriction of foreign direct investment. Inflows of portfolio investment have all along been quite free. But, the absence of a local stock exchange until 1996 meant that inflows on account of portfolio

investment were limited. At present, inflows of portfolio investment are somewhat constrained by the requirements that all portfolio investment and divestment must be channeled through authorized dealer banks. A single portfolio investor is not permitted to hold more than 10 percent of a listed company's listed issued capital, or 49 percent in aggregate; and, that where as no prior investment approval is needed, the remittance of sales proceeds requires adequate evidence to be presented to authorized dealer banks. Inward foreign investment into government securities is welcome. There are no indications of restrictions on this type of investment. For national residents, there are restrictions on purchases of foreign government securities, on foreign direct investment, on portfolio investment abroad and on contraction of loans abroad.

## 3. Global Integration of the Economy

13. Malawi is one of the early starters in liberalization. It has made significant effort to implement the standard prescriptions of structural adjustment and stabilization policies. It has maintained one of the most stable (relatively) political environments in Africa. Both the flows of multilateral and bilateral aid have been modest but steady. Despite all these, however, Malawi has not succeeded in integrating into the world economy. All the trade and investment indicators suggest (despite liberalizing the economy and implementing most of the required policy changes) that Malawi is being marginalized rather than being integrated into the world economy.

### *Obstacles to Globalization*

14. What are some of the possible trade and investment-related obstacles to globalization in Malawi? It is not intended to present an exhaustive list. The following are among the most important issues that need to be addressed, both at the policy and implementation level.

- *Low export base*: the prospect for an improved export performance will be limited without a serious effort to diversify the export base by aiming at high value-added export products.

- *Lack of competitive environment*: In Malawi, the industrial sector is only dominated by a few firms. Such a structure hides inefficiency and limits the ability to compete both locally and globally. Though firms operating in such an environment are likely to enjoy scale economies, they are also likely to focus on static rather than dynamic gains. Firms operating under monopoly are likely to focus on temporary gains that they enjoy due to their monopoly power. But this may limit future growth of industry in question if for instance R and D is not undertaken by the monopolistic firm. Further, innovation and product quality (due to the need for product differentiation) are likely to flourish under a more competitive environment. Therefore, a well-articulated competition policy would go a long way in addressing this problem.

- *Credibility in conducting macroeconomic policy*: investment flows require a reasonably predictable macroeconomic environment. Credibility and reputation issues seem to play an important role as is indicated by the competitiveness index for Malawi and observed in the movements of the exchange rate.

- *Weak financial sector*: the financial sector in Malawi is weak and is dominated by two main commercial banks. The small size and lack of competitive environment are not conducive for financing investment. Further, due to these factors it is likely that the financial sector will be vulnerable to external and internal shocks.

## 4. Small and Medium Enterprises (SMEs) and Globalization

15. The net effect so far of the process of globalization and liberalization on SMEs (including micro-enterprises) is not clear, especially with respect to access to international markets for goods, technology and finance. On the one hand, liberalization has contributed to an expansion of SMEs engaged in trading small holder crops as well as imported goods (new and second hand) including farm inputs. On the other hand, the process has adversely affected SMEs (and large enterprises) which produce goods that compete with cheap imports, which are consequently flooding the country.

16. Due to a number of constraints, the environment in the country is not particularly attractive for FDI inflows into SMEs and large enterprises compared to most of the countries in the Southern African sub region. Meaningful positive impact of the process of globalization and liberalization on SME export competitiveness may be felt only after the reduction/removal of the constraints they face, some of which are common to large enterprises. The major constraints include: lack of skills in export marketing; information on products wanted by consumers; limited access to appropriate technology; pre- and post-shipment export finance; low productivity of SMEs and fragmentation among them; high transport costs and high production, and distribution costs due to heavy reliance on imported inputs, costs of which are high because of surtax paid on them, in addition to import duty.

## 5. Socioeconomic Impact of Globalization

17. Although a low income-country, Malawi made rapid strides before reforms. Real GDP, for instance, rose at an average annual rate of around 6 per cent. High rates of economic growth were driven by high rates of investment and rapid expansion in exports. Fiscal discipline, economic stability and favourable terms of trade facilitated development. In principle, globalization and liberalization should lead to an acceleration in growth and productivity through an improvement in resource allocation. In practice, the opposite has occurred in Malawi, as productivity has declined in many sectors of the economy.

18. Liberalization has led to high prices of goods and services, including food prices, which have consequently been considerably exposed to international trends. Due to land and other constraints, the majority of small holders are unable to meet their subsistence requirements and have to rely on the market to cover their food deficits. High food prices have therefore eroded real incomes of the poor who consume mainly food.

19. The high inflationary environment has therefore made the poor poorer. The situation has been aggravated by the very unequal distribution of incomes in Malawi, particularly in urban areas. The hardest hits by inflation in urban areas have been earners of relatively fixed incomes including pensioners, as well as the unemployed.

20. The impact of poverty reduction strategies has so far been disappointing. The current strategy of promoting the production of cash/export crops (particularly burley tobacco) by small holders should, however, not be at the expense of raising food production and food security. Due to cultural forces, female-headed households are more vulnerable to factors which perpetuate/worsen poverty, and therefore require special attention.

21. Among the poor (and even others), informal income-generating activities have become an increasingly popular survival strategy, particularly trading/vending, in which entry and exist is relatively easy. However, operators of such activities face such constraints as lack of access to institutional credit.

22. Retrenchments have taken place in the private sector as firms have endeavoured to restructure/rationalize in the face of growing competition induced by liberalization. In the public sector, retrenchment has arisen from restructuring of the civil service and privatization of state-owned enterprises. All this has contributed to a slow down in the growth rate of paid employment.

## 6. Impact of Globalization on Sustainable Human Development

23. The rate of gross domestic investment in Malawi is lower than what it was before structural adjustment programmes. The current rate of natural resource extraction is potentially unsustainable and the long-term outlook for development is not bright. To what extent these problems are due to globalization is not known.

24. Rising unemployment, underemployment and poverty have characterized the period of structural adjustment. These phenomena have led to serious natural resource degradation. Land degradation, soil erosion, forestry depletion and water pollution and availability are worse now than they were twenty years ago. In turn, natural resource degradation has severely limited the ability of the economy to sustain current income levels into the future. Therefore, it is necessary, to address the factors causing environmental degradation. The policy measures will have to deal, *inter alia*,

with unsatisfactory land husbandry practices. Other measures include empowerment of local communities to manage their own natural resources and enforcement of natural resource exploitation fees.

25. There is also greater macroeconomic instability now than before SAPs. Externally, the current account and foreign debt are worse now than twenty years ago. Foreign reserves are better but the exchange rate is unstable. Internally, the budget deficit is higher. So are unemployment, underemployment, inflation and interest rates.

26. What is the impact of low macroeconomic sustainability on globalization? With an open economy and a market determined exchange rate, internal disequilibrium causes external disequilibrium. Budget deficits and deficit financing spark inflation, which leads to exchange rate depreciation. The redistributional effects, force more people below the poverty datum line. Inflation also reduces savings and investment. At the same time the domestic financing of the budget deficit pushes up interest rate which reduces investment. The higher level of interest rate payments by government makes it difficult to reduce the budget deficit, while the level of domestic debt burden complicates government financing.

27. Trade and investment indicators suggest that Malawi is being marginalized rather than integrated into the world economy. The export financing facility established during the third SAP was inadequate and periodic adjustments of the exchange rate have proved ineffective. Trade liberalization measures have had more success. The ratio of imports to GDP has increased although exports to GDP have not. Expansion of exports is hampered by the lack of supporting trade development measures, non-tariff barriers imposed by trading partners, and inadequate capacity for promoting exports. Foreign capital inflows are discouraged, among other factors, by unsatisfactory infrastructure, crime, inflation, corruption, and macroeconomic instability.

## 7. Policy Options and Recommendations

28. Economic reforms have not led to either an increase in the long-term rate of economic growth, or a reduction in the incidence of poverty or a marked improvement in the distribution of income. Literacy rate has increased but the steep decline in the quality of education, especially at primary and secondary school levels, and in the health status of the nation, imply that human capital formation has declined. In short, human development is not sustainable due to a reduction in human capital, in environmental capital and due to growing macroeconomic instability.

29. The sequencing of SAPs has not been optimal. Capital markets were liberalized first, not last. During the era of SAPs, goods markets were liberalized first, followed by foreign trade, formal financial markets and factor markets. Sustained macroeconomic stability has not been attained. The ideal order should have been macroeconomic stability, financial markets, factor markets, goods markets, foreign trade and capital markets.

30. Policy reforms in small holder agriculture have not been deep or consistent enough to address problems of inadequate net returns. Dependance on rains which frequently fail, on maize and tobacco. Similarly, policy reforms in manufacturing have not been deep enough to create efficient import substitution or encourage innovation.

## 8. Policy Recommendations

### A. Macroeconomic Management and Competitiveness

*Sequencing the Process of Global Integration*

31. Economic stability should be attained first before putting emphasis on the development of financial markets, factor markets, goods markets, foreign trade and capital markets. Before everything, however, institutions should be reformed.

*Achieving Macroeconomic Stability*

32. Macroeconomic stability (sustainable balance of payments, low interests rates and inflation) should be a top priority since it is an essential prerequisite for both growth and poverty alleviation. This will call for prudent macroeconomic management, and capable and competent civil service.

*Improving Policy Consistency*

33. Greater policy consistency is required between growth objectives and poverty reduction, between growth and economic stability and between macroeconomic and microeconomic objectives. This requires closer co-ordination of Fund and World Bank activities in the country. It also requires better co-ordination of the work of lead ministries and agencies.

*Enhancing International Competitiveness*

34. This requires measures on a broad front to reduce input and transaction costs, to improve productivity through, *inter alia*, the use of information technology which enables access to market and technological information, to restore economic stability and to expand credit and pre- and post-shipment financing facilities to the private sector.

*Attracting Foreign Investment*

35. Macroeconomic stability, security and good infrastructure are essential preconditions for attracting FDI. Remaining restrictions on capital inflows may also have to be gradually removed.

*Promoting Regional Trade*

36. As tariff barriers are already quite low, Malawi needs to reduce non-tariff barriers in order to expand inter regional trade. Complementary tiers between production structures of Malawi, South Africa and Zimbabwe within SADC need to be exploited further by diversifying the export base.

*Reducing Debt Burden*

37. Malawi is one of the most indebted countries in Africa. Huge debt-service payments reduce its capacity to invest in such essential activities as infrastructure. It is therefore important to reduce its debt burden through debt relief. However, Malawi will have to deepen its reforms to qualify for debt cancellation under enhanced HIPC.

## B. Institutional Capacity Building

*Good Governance*

38. Good governance, efficient management of the economy and proper implementation of policies and programmes are dependent not only on political commitment, but also efficient and dedicated civil service, and an adequate reward and monitoring system. Reform of the civil service deserves a high priority, as does the improvement of security, which is an essential prerequisite for attracting foreign investors.

*Developing Human Resources*

39. A well-educated and healthy population is essential for Malawi to improve its competitiveness in the global economy. Hence every effort must be made to improve the quality of education and health services. In the public sector, there is a need to train staff in techniques of formulating, implementing and evaluating SAPs, stabilization programmes and development programmes; and to adopt manpower utilization policies that would help retain staff once trained. In the private sector, there is a need for training small producers in international marketing and quality control. There is also a need to provide technical and financial assistance to organizations responsible for promoting exports, investment and industrialization

*Support for Poverty Reduction Programmes*

40. A number of initiatives are underway to alleviate poverty particularly in the rural areas, but their performance has been poor due to the lack of adequate resources and organization. National initiatives need reinforcement through international support in such areas as micro credit, strengthening the capacity of institutions supporting small and medium enterprises, and international marketing of manufactured products.

## C. Other Recommendations

41. In order to curtail the reduction in environmental capital, there is a need to reduce pressure on the land through further diversification of the economy away from agriculture; encourage the cultivation of suitable crops on environmentally fragile land; popularize agro-forestry practices, and so on.

42. Secondly, capital flight seems to be a serious problem. It was not possible to discuss it for lack of data. But it would be useful to systematically investigate the magnitude of capital flight from Malawi, and its causes, channels and consequences.

43. Thirdly, a survey of international competitiveness of SMEs should be undertaken and products with potential for exports identified.

# 1. INTRODUCTION

44. The purpose of this case study of Malawi is to examine the relationship between globalization and sustainable human development as well as to draw appropriate policy lessons and recommendations. In this connection, the study will evaluate structural reform and liberalization policies that Malawi has adopted for opening up the economy and recent macroeconomic and sectoral performance. The study will also assess the extent of integration of the Malawian economy into the world economy in terms of trade, investment and financial flows. We shall begin our analysis by conceptualising "globalization", "liberalization" and "sustainable human development".

## Globalization

45. As an economic process, globalization is the rapid integration of national economies through trade, capital and financial flows. Historically, this process is known to have taken place during the nineteenth and early twentieth century, and between 1950 and the early 1970s. In the mid-1980s, a new episode of globalization started, driven by increasing liberalization of international trade, free capital and financial flows and rapid change in transport and communications technology. This episode is characterised by the intensification of international trade in goods and services, capital flows (foreign direct investment or FDI and short-term flows), role of multinational enterprises (MNEs), reorganisation of production networks on an international scale, and the adoption of new technology, including information technology, all of which are interrelated.

46. For countries for which data are available, the share of exports in GDP increased from 11.2 per cent in 1973 to 16.0 per cent in 1996 (ILO, 1999). This intensification in international trade has been accompanied by a change in the structure of that trade. Improved opportunities for storage, processing and communication of data are facilitating trade in services. As a result, exports of services are rising faster than exports of goods. Another structural change is a rising share of manufactured goods in the exports of developing countries.

47. Responding to the re-organisation of production networks on an international scale, the growth of multinational enterprises MNEs, advances in communications technology and financial liberalization by developing countries, FDI flows world wide have increased considerably during the last 15 years. The share of these flows in total GDP was below 1.5 per cent up to 1986, but has fluctuated around 2 per cent in the 1990s (ILO, 1999). Short-term capital flows have increased more rapidly and their volume is much higher than the volume of goods and services traded. For example, the daily global turnover in foreign exchange markets in 1998 was at least 78 times the daily volume of exports of goods and services, up from 56 times in 1989 (ILO, 1999).

48. The integration of national economies in various spheres has made them more interdependent. For developing countries, dependence on rich nations has always been a fact of economic life. The recent surge in globalization has increased that dependence. The developed world itself is becoming more economically dependent on the developing world for its export markets (Todaro, 1997). Then there is interdependence through the use of the same ecosystem. One general view of globalization is that it is in fact inevitable. Yet, there is scepticism about its possible benefits.

49. Globalization has created new opportunities for economic progress by broadening the scope for international division of labour and increasing the mobility of factors of production. International transport and communications costs have declined due to technical progress. These changes have turned a large number of non-tradeable goods and services into tradeables and promoted the process of internationalization of production of goods and services. Furthermore, the decline in the cost of international communications and advances in information technology have created immense possibilities for international financial flows.

50. However, globalization also poses immense risks, mainly, but not only, for developing countries. The opportunities that it offers developing countries for progress are offset by risks of marginalization, economic insecurity and instability, as well as physical insecurity and crime. In particular, low-income countries and disadvantaged social groups have become more vulnerable to economic exclusion and impoverishment. At the same time, inequality among and within nations has increased. The risk of integration, especially into world capital markets without prudence and requisite capacities, is demonstrated by the recent economic crisis in East Asia. With a high degree of international economic integration, financial crisis, inflation and recession can easily spread from one region to another, adversely affecting economic development in their wake.

51. Thus, globalization poses new challenges for national development strategies and policies. In theory, developing countries can choose to withdraw, relying, perhaps, on collective self-reliance. But in practice this is unlikely to be a feasible option since most developing countries are opening up their economies. There seems to be a certain inevitability about the process of globalization which these countries cannot really influence at least individually. Thus, the challenge will be how to improve the competitiveness of their economies so as to maximize the benefits from and minimize the risks of globalization.

**Liberalization**

52. Most developing economies frequently face the problem that the amount of resources they would like to use are greater than the amount that they have themselves. Assuming that we have an economy with a public sector and a private sector, the excess expenditure or deficit can occur in either of these two sectors, or in both. Since some domestic demand is normally satisfied through imports of goods and services, the excess expenditure will also be reflected in a deficit on the balance of payments. The country's expenditure exceeds its receipts of foreign exchange.

53. A country may live beyond its current income or means for a while, using up its savings and foreign exchange reserves to finance excess internal and external demand. But once domestic savings and foreign exchange reserves decline to low levels or get exhausted, it cannot continue living beyond its current income without borrowing and hence incurring debt. Borrowing to finance excess demand has at least two drawbacks. First, all debt gives rise to future debt service obligations. In the case of foreign debt, debt service payments use up scarce foreign exchange resources. Secondly, domestic debt can undermine price stability if it is incurred through money creation. Since a country cannot live beyond its current means indefinitely, it must sooner or later adjust the level and/or composition of aggregate demand and/or supply in order to reduce or eliminate internal and external financial imbalances (deficits) in its economy. Short-term adjustment is called stabilisation. It is usually through the implementation of neo- Keynesian fiscal (revenue increasing and expenditure reducing) policies and monetary (credit restraining) measures. In the past, before the advent of structural adjustment programme, a country implementing a stabilisation programme could even use such non-price or non-market-based policies as ceilings on domestic credit expansion, restraint on foreign borrowing, restriction on imports and on allocation of foreign exchange.

54. In many developing countries, stabilisation programmes either failed to restore financial balances or, if they succeeded, the restoration of financial balances was temporary. On account of structural and other factors, financial imbalances would occur again. For these countries, the IMF thought that adjustment should aim at removing structural constraints within the framework of a longer-term programme, particularly with a view to increasing aggregate supply.

55. According to neo-classical economics, which underpins World Bank and International Monetary Fund thinking, deficits in developing countries are caused by market imperfections (caused by private or official interference) that prevent supply from rising in response to an increase in demand and price in both internal and external markets. Supply will respond only if market imperfections are removed. This logic is the foundation of market-oriented stabilisation and structural adjustment programmes.

56. The ideal type of a structural adjustment programme recommended by the World Bank is one where all forms of selective intervention in the market are removed and free market driven allocation of resources is restored, exposing activities to domestic and international competition. Above all, reform of the incentive system by "getting prices right" is crucial to all other adjustment measures. In this connection, the liberal economics school believes that this should be applied to all economies regardless of their level of development, since by definition all markets are efficient or at least more efficient than governments. Furthermore, reforms should be carried out quickly and across the board since there is no justification for continuing to select activities for more gradual liberalisation (World Bank, 1994). Full implementation should lead to sustainable human development, a topic that we turn to next.

## Sustainable Human Development

57. Human development is defined in relation to three basic components of standard of living; per capita income, education and health. Essentially, it refers to an improvement in these three elements. Human development is said to be sustainable if the present generation can earn its living without compromising the ability of future generations to do the same. The livelihood of future generations can be compromised in at least three different ways.

58. The first is if economic growth or a rise in per capita GDP in the short run is achieved by reducing environmental capital. To the extent that the reduction in environmental capital would reduce the future rate of economic growth, such economic growth is said to be environmentally unsustainable. Because national income measures do not account for environmental degradation, they do not reveal the fact that economic growth is environmentally unsustainable in the long run. The effect of environmental damage on the rate of economic growth can vary from country to country, depending on the nature of economic growth itself and on environmental institutions in a particular country.

59. The second is if economic growth is achieved by undermining human capital. Extreme concern for environmental protection, for example, might neglect the need for poor people to survive through intense use of the environment. In this situation, environmental protection at the expense of survival is seen as morally wrong and not viable. Therefore, a balance must be struck between environmental sustainability and human sustainability.

60. And the third is if a set of economic policies which avoid serious macroeconomic disequilibrium are absent. The presence of such economic policies is necessary for the proper functioning of the economy, for raising per capita income and for increasing social development. For a comprehensive set of definitions of sustainability (see Pezzy, 1992).

61. The World Bank (1997b) has come up with two alternative GDP growth scenarios for the period 1997 to 2006, corresponding to a base case of 4 per cent annual growth rate and a high case of 6 per cent growth rate. A third scenario of a low 3 per cent average annual growth rate is entirely possible in case there is a low rate of growth in the agricultural sector which happened in the past. The base case corresponds to the "macro-economically sustainable growth rate", in other words, it is the maximum rate at which the economy can grow without overheating. The high case corresponds to the "poverty-reducing growth rate" or the minimum rate at which per capita GDP growth would permit reduction in poverty. The "environmentally sustainable growth rate" or the maximum rate at which GDP per capita could grow without degrading the environment has not been determined. If it is lower than the other growth rates, then environmental sustainability is the binding constraint.

# 2. REFORMS OF DOMESTIC SECTORS

62. This chapter considers agricultural, manufacturing, privatization, formal financial sector and budget reforms. The consensus view that optimal reform of the real sectors or the goods markets should succeed financial and factor market liberalization was not followed in Malawi. Instead, the reform of the real sectors started earlier in 1981. But, as was the case with other reform programmes, in varying degrees these reforms spanned the entire SAP period.

**Agriculture**

63. Concerning the agricultural sector, the principal objectives of SAPs were to ensure appropriate price policy (Structural Adjustment Loan I or SAL I), adequate incentives (Structural Adjustment Loan II or SAL II), and expand the role of private sector in marketing small holder crops (Structural Adjustment Loan III or SAL III). Besides this, SAPs should increase efficiency and improve incomes of small holders, increase efficiency of land use, protect the environment (Agricultural Sector Adjustment Credit or ASAC) and complete removal of remaining pricing and marketing constraints on small holder agriculture (Fiscal Restructuring and Deregulation Programme or FRDP). The main policy measures implemented were rationalization of and annual increases in smallholder producer prices; removal of fertilizer subsidies; reducing the role of the Agricultural Development and Marketing Corporation (ADMARC) in favour of private competition in marketing inputs and outputs; and allowing smallholder farmers to grow burley tobacco. Supporting macroeconomic policies stressed the control of inflation so as to shift the rural-urban terms of trade in favour of agriculture and the role of exchange-rate liberalization to remove the implicit tax on agricultural exports.

64. The performance of the food sector under SAPs has been unsatisfactory with no increase in yields of most food crops. This has increased the risks of food insecurity and necessitated food imports, which use up scarce foreign exchange. At the local level, the distribution of food imports is constrained by poor transport infrastructure and logistics. Hence, in addition to economic reforms, two interventions are required: policies that would increase productivity in the food sector, and direct intervention to lower transport and marketing costs (*African Development Bank*, 1995).

65. The yields of the main cash crops grown by smallholder farmers have not increased either. For example, the average yield of fire-cured tobacco, which was 389 kg per hectare between 1970 and 1980, declined to 337 kg per hectare between 1981 and 1994. The corresponding average yields for sun-air cured tobacco were 364 kg and 287 kg per hectare, respectively. The removal of restrictions on the cultivation of burley tobacco by smallholders has led to a marked increase in production in the smallholder sub-sector. However, total production of burley tobacco has declined owing to a reduction in production on estates caused by higher input costs and rising insecurity in rural areas.

66. Thus, growth of the smallholder agricultural sector under SAPs has generally been stagnant. While the performance of smallholder agriculture cannot be attributed solely to SAPs (other factors included weather and the terms of trade), the fact that smallholder agriculture has not done well under SAPs suggests that SAP policies failed to arrest the impact of other factors on the sector. SAPs have addressed price constraint, but not such non-price constraints as infrastructure and risk. Nor have they adequately addressed such problems as inadequate producer incentives, unfavourable internal terms of trade and inadequate credit and extension services. Improvements are required in rural infrastructure, feeder roads, extension services and credit and producer prices.

**Manufacturing**

67 In the manufacturing sector, SAPs aimed at encouraging efficient import-substitution (SAL I and SAL II) and improving the policy environment for the sector (Industry and Trade Policy Adjustment Credit or ITPAC). In order to attain these objectives, under SAL II, prices of 41 per cent of manufactured products to which controls were applicable were decontrolled. Under SAL III, the prices of the remaining items were decontrolled, except those of petrol, low-grade beef, fertilizers, sugar and motor vehicle spare parts. Later, beef, sugar and fertilizer prices were decontrolled. At present only petrol and motor vehicle spare parts are subject to price controls. Other policy measures for reforming the manufacturing sector needs to include:

- reducing the scope of industrial licensing requirements,
- eliminating the authority to grant exclusive product rights,
- revising the duty drawback system,
- establishing the Malawi Investment Promotion Agency (MIPA),
- simplifying the process for registration and incorporation of companies,
- eliminating the industrial licensing process for investments, except for a short list, and
- establishing of Export Processing Zones (EPZs).

68. These policy measures have not led to a marked expansion in manufacturing activity in the country. Between 1981 and 1996, manufacturing value-added increased at an average annual rate of 3.9 per cent, while during the pre-SAP period (1971-80), it grew at a much higher average annual rate of 13.6 per cent. As a result, the manufacturing sector has not increased its share in GDP since 1980, which remains at about 14 per cent. Nor has it increased its share in total formal sector employment since that year which is also stagnant at about 14 per cent. Measured by the index of production, total manufactured output is lower now than it was in 1991, as is that of the sub-sectors of export goods, e.g. intermediate goods and consumer goods (except food and beverages). The unsatisfactory rate of growth in the manufacturing industry is due to

- foreign competition,
- unreliable utilities,
- high cost of imported inputs induced by devaluation,
- foreign exchange shortages,
- inadequate internal road networks,

- an unstable economic environment,
- decreasing rates of investment, and
- inadequate delivery of credit to small and medium-scale enterprises (see Chapter 5).

69. Greater efficiency in import substitution has not been achieved either. This is due to the lack of competition as most industries are dominated by monopolies and oligopolies; excessive regulation of the economy; and price controls which were retained on some products after the authorities had started to dismantle price controls. A number of firms have stopped local manufacture of their product lines due to the high cost of production. These include BAT (Malawi) Ltd., Capital Oil Refining Industries, Brown and Clapperton Ltd., Condolidated Textiles Ltd., and Chiperoni Blanket Company. Lever Brothers (Malawi) Ltd. In addition, several other firms, including Universal Industries, are finding it difficult to face foreign competition.

**Privatization**

70. There are four objectives under the government's policy to reduce the size of the public enterprise sector through privatization (*Privatization Policy, Act and Regulations Booklet*). These are to:

- foster increased efficiency in the economy,
- increase competition and reduce monopoly in the economy,
- promote participation by the Malawian public in enterprises, and
- raise revenue for the government.

71. A proper assessment of the extent to which all of these objectives are being met is beyond the scope of this report. With respect to the objective of raising efficiency in the economy, some positive evidence is emerging, particularly in enterprises where the controlling interest has been sold to an established private-sector operator (Privatization Commission, *Annual Report 1998*, p. 8). To what extent monopoly is being reduced is not clear, particularly in cases where large enterprises undergoing privatization are not split into and sold as small independent units.

72. As in any poor country, the objective of promoting participation by many indigenous people in the privatized enterprises is easier said than achieved. This is due to very low average levels of income of the majority of Malawians. This major problem is being addressed only partially by setting up special loan facilities to enable Malawians to purchase shares in enterprises, which are being privatized, with some shares being offered at a discount.

73. Another major problem is the new life of the retrenched workers as a result of the privatization of some enterprises. In the early period of privatization, the retrenched staff, many of whom have not found alternative wage employment, were not offered preparatory facilities like training and loans to enable them to engage in alternative income-generating activities (Chilowa and Chirwa, 1997). In this

connection, the Privatization Commission has engaged a consultant to provide counselling services to those affected by retrenchment. In addition, its intention is to put in place social safety nets for minimizing social costs arising from privatization.

**Formal Financial Sector**

74. Reforms in the domestic financial system targeted the formal financial sector only. For this reason, we shall begin by focusing on this particular sector. For purposes of this study, the formal financial sector refers to all institutions that are involved in mobilizing and/or lending financial resources, are licensed and which are subject to control by the legal and monetary authorities. In the context of Malawi, this sector consists of a central bank, commercial banks, a discount house and other non-bank financial institutions (NBFIs).

75. Compared to Mozambique or Tanzania, financial repression in Malawi was modest. The Government did not directly or fully own the banks. Interest rates were controlled. But these were only mildly negative (Table 2.2). Commercial bank credit expansion was also controlled, but not that of other financial institutions, whereas there were few directed and subsidized flows.

76. The liberalization of Malawi's financial sector under SAPs has facilitated entry by foreign financial institutions into the domestic financial sector. In this regard, the issue that we would like to investigate is whether this aspect of globalization has made Malawi's financial sector more competitive, leading to competitive interest rates, more output of financial services, new financial products and better financial services. The second, but related, issue is whether indigenous financial institutions can withstand competition from foreign-based entrants, continue in business at home and even open branches abroad. To the extent that globalization is associated with free movement of portfolio and short-term capital ("hot money") which can speedily be withdrawn, it can affect the stability of the financial sector and of the whole economy. This chapter will investigate how Malawi can benefit from these capital flows and by what means she can minimize the risks of capital flight.

77. Financial liberalization and globalization have generally not led to an increase in the competitiveness of Malawi's financial sector. Interest rate spreads have increased in the sub-sectors of commercial banking, mortgage banking and savings banking (Table 2.4), and they are high in the discount market. This implies that there is insufficient competition for deposits and loans and that borrowers and depositors are not offered competitive interest rates. The entry of more players into the various financial sub-sectors is highly desirable, as it would help to reduce the market power of existing institutions. On equity grounds, the licensing authorities should not discriminate against Malawian applicants in favour of foreign banks. Being a reputable foreign bank does not necessarily mean that it will help to improve the efficiency of Malawi's financial sector, whether that applicant is coming as a strategic partner, as a joint investor in a new institution or on its own.

78. Recent entrants have largely introduced new loan products into the formal financial sector. These include factoring and insurance premium financing by leasing finance companies, discounting bills by the Continental Discount House and structural finance by Loita Investment Bank, on the lending side. Diversification by older banks has not so much been in the form of new loan products. Rather, it has entailed increase in lending to such sectors as manufacturing and house holds which were not favoured before reforms. On the savings side, both new and old banks have not done much to introduce new savings instruments. In fact, some of the banks have withdrawn longer-term deposit instruments and raised minimum deposit balance requirements.

79. Historically, Malawi's banks developed as specialized institutions that focus on a few core activities in which they have developed expertise and from which they enjoy economies of scope. In other words, they are not universal bankers. (This is not to deny the wide range of services provided by commercial banks. But, strictly speaking, even this is not universal banking). This alone would encourage banks to resist suggestions that they should diversify. If banks in Malawi were to diversify their products, they would need to invest in extra facilities and recruit/train extra manpower. Besides, they could face managerial and other diseconomies. For these reasons, it may be worthwhile to rely on new market players for diversifying financial products.

80. As far as quality of services is concerned, there has been improvement in the speed with which deposit and withdrawal services are discharged at both banks and NBFIs. This has occurred largely through computerization, introduction of automatic withdrawal facilities and elimination of small accounts. Through computerization, banks can now be more easily accessed from offices, thus saving valuable time. But there has been little or no improvement in the quality of those services that are not amenable to computerization, such as processing loans (despite decentralization of part of this function to branches) and the sale of travellers cheques.

81. In terms of quantity of deposits and credit, overall these have not increased in relation to changes in the level of economic activity in the country (Table 2.3). At corporate banks and the only mortgage bank, they have due to the offer of competitive deposit interest rates. But this has been offset by a sharp decline in the ratio of deposits to GDP and of credit to GDP at commercial banks. On the deposit side, financialized savings have been discouraged by high rates of inflation, which have partly contributed to negative real interest rates (Table 2.2). They are also constrained by low rates of growth of profits (and other incomes) and budget deficits. Reduction in the rate of inflation, restoration of high rates of economic growth and elimination of budget deficits would facilitate an increase in financialized savings. On the credit side, the demand for bank credit has been adversely affected by an unfavourable economic environment of high budget deficits, large government demands for bank credit, high rates of inflation, high nominal rates of interest and a depreciating currency, all of which must be contained. Private-sector demand for bank credit has also been adversely affected by unreliable power and water supplies, an unsatisfactory state of the internal road network, unreliable telecommunications system, a rising rate of crime and high transport costs, all of which need more effective attention.

82. The relatively low level of private-sector demand for bank credit has, furthermore, been blamed on the conditions that banks impose on borrowers. The amount of security that banks demand depends on their perception of risk. Where the level of risk is low, less is demanded by way of security, but where it is high, the amount of security demanded tends to be high as well. What may be objectionable is not the amount of security, but the type of security since borrowers may not be able to offer certain types. In this regard, there is a need for banks to exercise flexibility, to demand forms of security that suit different borrowers and to devise other ways of securing credit.

83. No existing bank has suffered under the weight of competition from new institutions. The entry of two small foreign-based firms into commercial banking has not provided strong competition to existing commercial banks, which have remained market leaders. In future, if bigger and aggressive foreign-based banking corporations enter the industry, it will be very necessary for the existing banks to improve their efficiency. In other sub-sectors, the recent entry of a foreign-based investment bank has created competition for the existing investment bank whereas the establishment of a (foreign-owned) discount house will complement the activities of existing players in the money market.

84. The existing stock of foreign-owned short-term and portfolio capital is small. Hence its withdrawal would not adversely affect the stability of Malawi's financial sector and that of the economy as a whole. In future, these inflows may increase and become significant. If this happens, it will be essential to avoid or contain developments that may make the economy vulnerable to currency or bank crises. These factors include high rates of inflation, real exchange rate appreciation, wide balance of payments current account deficits, rapidly growing domestic credit and inflated share or asset prices. A rapidly rising ratio of broad money to international reserves is also a signal of vulnerability to pressures in currency markets as are share price declines, deterioration in the terms of trade and a rise in world interest rates.

85. Formal financial-sector reforms have not paid much attention to the need to strengthen the micro-finance sector. They have paid attention only to the Malawi Rural Finance Company and the Small holder Agricultural Credit Administration before it, but not to several other micro-finance institutions. Other important missing links include export finance; the informal financial sector; the primary capital market required to promote companies and issue new shares; and the integration of informal, micro-finance and formal financial sectors to enhance deposit mobilization and credit allocation.

## Government Budget

86. The internal macroeconomic financial imbalance, as indicated by government budget deficits, has been an intractable problem for a long time now. The deficits (excluding grants), which generally used to be tolerably small (below 5% of GDP) up to the mid-1970s, have since the second half of the 1970s generally been uncomfortably high, averaging over 10% of GDP up to the late 1990s (Table 2.5). The deficits have been arising from higher growth in expenditures than in revenues, and shortfalls in receipt of foreign aid, which finances 45 per cent of the whole budget.

87. There have been two major macroeconomic effects of the large budget deficits. First, in addition to foreign loans and grants, a good part of the deficit has (from the 1980s onwards) been financed by borrowing from the financial system, particularly the central bank, which is one of the major causes of the high inflation. The last few years have seen no domestic financing of the deficit. In these years the deficits (after grants) have been wholly financed by foreign loans. Second, deficit financing from domestic financial institutions, which also lend to the private sector, have been crowding out the private sector with consequent adverse effects on investment in productive activities.

88. Given the problems associated with deficit financing through local as well as foreign borrowing, a viable long-term solution lies in increasing tax revenue. Several tax reforms have been carried out, particularly after the 1983-84 fiscal year, to improve tax performance through changes in rates of existing taxes and through broadening the tax base by increasing the number of items and activities to which existing taxes apply and by introducing new taxes. In addition to raising revenue, other objectives of the tax reform are to provide fiscal incentives for private-sector investment and to ensure equity. The reforms have also aimed at strengthening tax administration and collection.

89. However, the combination of administrative reforms and tax reforms has so far not been able to generate adequate revenue to meet even the recurrent expenses. And the tax revenue/GDP ratio has fallen short of expectations (Table 2.5). One major weakness of the Malawi tax system is the numerous exemptions on both direct and indirect taxes, resulting in substantial loss of revenue; initiatives are now underway to cut down on exemptions. Tax evasion is another problem, which is partly induced by some high tax rates. A related problem is the existence in the country of a large and still growing second/informal economy whose activities are not taxed (Chipeta, 1998). In the past, the pursuit of the short-term fiscal stabilization objective by maximizing revenue collection has been at the expense of constraining long-term development of the very tax payers.

90. A number of fiscal reforms aimed at restraining/cutting down expenditures and prioritising sectoral allocation of funds, have also been carried out. For example, under the World Bank's 1995-96 Fiscal Restructuring and Deregulation Programme (FRDP) of the SAP, one of the measures introduced was the cash budget system. Under the FRDP, over 20,000 civil servants were retrenched in 1995-96, comprising workers in non-established positions in non-priority areas. Another 3,194 were retrenched in 1997. Retrenchment will have helped to restrain the growth for several years in the proportion of the budget allocated to wages at the expense of capital and recurrent items, although the adverse effects on the retrenched are obvious. In the same year, the number of principal secretaries was cut down by 12, and by mid-1999 the number of ministries was 23, having been reduced from 26 (Malawi Government, *Economic Report 1999*, p.69).

91. Under the IMF's Enhanced Structural Adjustment Facility (ESAF), one of the measures adopted was the Medium Term Expenditure Framework (MTEF) approach to budgeting, starting with a few ministries in 1996-97 and eventually covering all ministries. MTEF's main focus is on the restructuring of expenditure both between and within sectors so that sufficient resources are directed towards higher priority sectors/activities while cutting back on those of lower priority or eliminating them altogether.

92. One may be tempted to conclude that some progress is being made in restraining expenditure judging from the decrease in the total expenditure/GDP ratio in recent years (Table 2.5). However, lot remains to be done, and there are a number of areas where expenditure can be scaled down. For example, the numbers of ministries and ministers (including their deputies) and of Malawian Embassies abroad (currently 17) may still be large. Transport and other costs of continuing to locate some government functions in Blantyre and Zomba instead of bringing them to one place in Lilongwe is also an unnecessary drain on the budget.

93. A lot also remains to be done in prioritizing the allocation of budgetary funds. For example, in several fiscal years there have been increases in the shares of the total budget allocated to priority sectors of education, health, agriculture and transport. However, intra-sectoral allocation is inefficient as is evidenced by the situation on the ground hospitals, and schools facilities are very poor. Does this suggest, *inter alia*, that intra-sectoral allocation of funds is disproportionately in favour of higher levels in the ministries?

**Table 2.1 Malawi: Macroeconomic Indicators Pre-Liberalization and Post-Liberalization Periods**

| Indicators | Pre-Liberalization Period | | Post – Liberalization Period | | |
|---|---|---|---|---|---|
| | 1971-75 | 1976-80 | 1981-86 | 1987-92 | 1993-98 |
| Rate of Growth of Real GDP (Per Cent Per Annum) | 7.0 | 5.1 | 1.9 | 2.4 | 4.6 |
| Rate of Growth of Formal Sector Employment (Per Cent Per Annum) | 8.7 | 5.4 | 3.9 | 5.9 | 1.01 |
| Gross Domestic Savings/GDP (Per Cent) | 10.9 | 15.0 | 13.3 | 8.2 | 4.1 |
| Gross Domestic Investment/ GDP (Per Cent) | 23.9 | 28.4 | 17.6 | 19.0 | 13.7 |
| Commercial Bank Lending Rate (Per Cent) | 8.5 | 11.0 | 14.3 | 18.7 | 35.2 |
| Rate of Inflation (Per Cent) | 9.5 | 9.5 | 12.9 | 20.1 | 36.2 |
| Current Account Deficit of the Balance of Payments/ GDP (Per Cent) | 10.6 | 15.6 | 8.6 | 10.2 | 12.0 |
| Broad Money/GDP (Per Cent) | 16.2 | 17.4 | 18.5 | 17.7 | 15.9 |
| Exchange Rate (Malawi Kwacha Per US Dollar) | 0.84 | 0.84 | 1.35 | 2.77 | 18.25 |
| Budget Deficit Excluding Grants as Percentage of GDP | 2.5 | 12.1 | 9.3 | 7.8 | 13.5 |
| Budget Deficit Including Grants as Percentage of GDP | 1.6 | 8.9 | 8.8 | 4.2 | 6.2 |

1 1993-95

Sources: Malawi Government, *Economic Report* (various issues); Reserve Bank of Malawi, *Financial and Economic Review* (various issues) and World Bank; and *World Development Report* (various issues).

## Table 2.2 Malawi: Real interest rates[*]

| Period | Bank rate | Treasury Bills (91 days) | Commercial banks | | | New Building society | | |
|---|---|---|---|---|---|---|---|---|
| | | | Savings deposits | Time deposits[1] | Bank overdraft minimum rate | Savings deposits | Fixed deposits[2] | Minimum mortgage rate[3] |
| 1971-75 | -2.04 | -3.31 | -4.77 | -3.24 | -0.64 | -4.77 | -2.02 | -1.25 |
| 1976-80 | -1.31 | -2.48 | -2.59 | -0.76 | 1.62 | -2.59 | 0.16 | 0.16 |
| 1981-85 | -2.48 | -2.18 | -2.72 | -0.67 | 0.89 | -2.72 | 0.30 | 2.02 |
| 1986-90 | -6.03 | -4.36 | -6.19 | -4.26 | -1.91 | -6.51 | -4.03 | -4.29 |
| 1991-95 | -4.95 | -8.50 | -6.65 | 1.24 | -3.95 | -7.54 | -6.08 | -7.19 |
| 1996-98 | 5.25 | -0.15 | -6.02 | -4.27 | 4.69 | -3.85 | -20.92 | -0.75 |

[*]Calculated as 100 [(i + 1)/(1 + p)-1] where i is the nominal rate of interest and p is the inflation rate as measured by the GDP deflator. These rates apply to both rural and urban areas.

[1]Twelve months and over.
[2]Thirty-six months and over.
[3]Minimum mortgage rate for owner occupation.

Source: Reserve Bank of Malawi, *Financial and Economic Review* (various issues).

**Table 2.3 Malawi: Measures of Financial Deepening: End of Year Deposits[1] and Gross Domestic Credit Balances[2] of Commercial Banks as Percentage of Gross Domestic Product (GDP) at Current Market Prices**

| Period | Deposits/GDP | Gross Domestic Credit Balances/GDP |
|---|---|---|
| 1971-75 | 16.2 | 13.4 |
| 1976-80 | 17.4 | 21.5 |
| 1981-85 | 18.5 | 21.0 |
| 1986-90 | 17.7 | 13.1 |
| 1991-97 | 15.9 | 12.4 |

[1]Demand, time and savings deposits of private residents, parastatals and non-residents at commercial banks.
[2]Claims of commercial banks on central government, parastatals and domestic private sector.

Source: Reserve Bank of Malawi, *Financial and Economic Review* (various issues).

**Table 2.4 Malawi: Nominal interest rates, 1971-1998**

| Period | Bank rate | Treasury bills (91 days) | Commercial banks | | | New Building society | | |
|---|---|---|---|---|---|---|---|---|
| | | | Savings deposits | Time [1] | Bank overdraft minimum rate | Savings deposits | Fixed deposits [2] | Minimum mortgage rates[3] |
| 1971-75 | 6.00 | 5.59 | 4.40 | 5.50 | 8.50 | 4.40 | 7.00 | 8.00 |
| 1976-80 | 7.800 | 6.85 | 6.40 | 8.40 | 11.00 | 6.40 | 9.40 | 9.40 |
| 1981-85 | 10.20 | 10.55 | 9.95 | 12.25 | 14.00 | 9.95 | 13.35 | 12.95 |
| 1986-90 | 12.20 | 13.70 | 11.60 | 14.63 | 17.20 | 11.60 | 14.85 | 14.35 |
| 1991-95 | 26.60 | 21.33 | 21.20 | 17.94 | 24.80 | 15.40 | 20.85 | 21.0 |
| 1996-98 | 31.50 | 24.55 | 20.00 | 12.38 | 31.00 | 15.17 | 13.00 | 24.17 |

[1]Twelve months and over.

[2]Thirty-six months and over.

[3]Minimum mortgage rate for owner occupation.
Source: Reserve Bank of Malawi, *Financial and Economic Review* (various issues).

## Table 2.5 Malawi: Selected Indicators of Government Budget

| | Annual Averages[a] | | | | |
|---|---|---|---|---|---|
| | Pre-Liberalisation | | Post-Liberalisation | | |
| | 1970/71 | 1975/76 | 1980/81 | 1986/87 | 1992/93 |
| | - | - | - | - | - |
| | 1974/75 | 1979/80 | 1985/86 | 1991/92 | 1997/98 |
| Budget deficit (excluding grants) as % of GDP | 2.5 | 12.1 | 9.3 | 7.8 | 13.5 |
| Total (Recurrent & Development)Expenditure as % of GDP | 26.8 | 34.9 | 34.0 | 29.0 | 26.9 |
| Tax Revenue as % of GDP | 11.3 | 14.0 | 17.3 | 17.6 | 15.4 |
| Gross Advances[b] from Reserve Bank of Malawi as % of Total Gross Domestic Financing of the Budget Deficit [c] | | 10.7 | 62.9 | 56.3 | 37.6[d] |
| | | | | | |

a Fiscal year: April to March, up to 1996/97. Changed to July to June with effect from 1998/99. The transition year 1997/98 covered 15 months from April 1997 to June 1998.

b Including Reserve Bank credit to government from foreign funds.

c Figures based on calendar years, in some of which there was no financing of the budget deficit.

d Excluding 1997 and 1998.

Sources: Chipeta C., *Tax Reforms and Revenue Productivity in Malawi*. Paper presented at a National Economic Conference, organised by the Department of Economics, Chancellor College, University of Malawi, 22 - 23 October 1998, Tables 1 and 2; Malawi Government, *Economic Report* (various issues); Reserve Bank of Malawi, *Financial and Economic Review*, quarterly (various issues), statistical Annex Table 3.1.2; Table 2.1 above.

# 3. EXTERNAL SECTOR REFORMS

## Liberalization of Foreign Trade

94. The liberalization of foreign trade followed the liberalization of goods markets. From that standpoint, the sequencing was optimal. But, instead of following financial market liberalization and factor market liberalization, it was executed at the same time as these other programmes. Policy measures for promoting foreign trade were implemented throughout the entire reform period (1981-99). In the early phase of the reform process, for example, both Structural Adjustment Loans I and II (SAL I and SAL II) set out to diversify the export base. In addition, SAL II included promotion of exports among its main objectives. In order to achieve these objectives, the authorities carried out periodic adjustments of the exchange rate (Table 3.1) even after floatation to keep it competitive. They also prepared an export promotion strategy and established an export-financing facility under SAL III.

95. Trade liberalization measures were first implemented under ITPAC, which covered the fiscal years 1988 to 1990. Among the major objectives of ITPAC were, liberalization of imports to promote efficiency and export expansion. The main policy measures included freeing 65 per cent of imports from prior approval for foreign exchange allocation by the Reserve Bank; elimination of restrictions on payments for current transactions and transfers (acceptance of IMF Article VIII Status in 1995) and reduction of the scope for export licensing. The reduction of import duties from 1990 onwards was another major measure which resulted in a decline in the weighted average tariff rate from 21 per cent in 1989 to 19 per cent in 1994 and about 15 per cent in 1998.

96. As indicated in the following chapter on the *Extent of Globalization*, Malawi has had little success in diversifying its exports away from agricultural to manufactured products. Among agricultural products, the share of tobacco in total domestic exports was planned to fall below 50 per cent during SAPs. Instead, it rose from 47.4 per cent during 1980-83 to 64.0 per cent in 1988. Since then, it increased to 70.4 per cent in 1994 before declining to 63.1 per cent in 1997. Over the same period, the share of tea fell significantly, as has the share of sugar, groundnuts, and rice. The share of coffee and pulses has increased. Currency, devaluation and depreciation, which have usually occurred at the start or during the tobacco-buying season (Table 3.1), have encouraged tobacco rather than the production of other crops. The absence of currency devaluation or depreciation during the period of importing inputs has meant that tobacco inputs have been acquired at lower import prices. Seasonally, timed currency adjustments have not favoured the manufacturing industry, which import inputs, and export the output all the time. Another explanation is that in the 1980s, Malawi continued with the development orientation of the 1970s, which favoured estate tobacco production over other activities.

97. During the pre-SAP period up to 1980, exports grew rapidly (Table 3.2) due to favourable demand and prices. The rate of growth of exports during the early phase of SAPs (1981-85) declined by 28 per cent due to a worsening in the country's terms of trade. There was further deterioration in the terms of trade in 1986. Trade liberalization seems to have reversed the declining trend in the rate of growth of exports. But over the entire post-SAP period, the rate of expansion was lower than during the entire pre-SAP period.

98. The policy of currency devaluation and depreciation, so central to balance of payments corrective measures, has encountered difficulties as devaluation-induced inflation has eroded the very relative price advantage which currency adjustment was designed to achieve. In the case of Malawi, the elasticity of domestic inflation with respect to currency devaluation was recently estimated at 1.00, and with respect to foreign import prices at 0.57. The high import content of production and consumption accounts for this. Apart from the erosion of the relative price advantage of currency adjustment, the small increase in the domestic price of exports following a currency adjustment (the so-called pass-through) does not offer much incentive. The value of the pass-through for Malawi was estimated at only 0.14 (*African Development Bank*, 1995).

99. Other key coefficients are not favourable either. Price and income elasticity of demand for Malawi's exports were estimated at only -0.18 and 0.4, respectively, meaning that price and income changes will bring about a less than proportionate change in demand. Price elasticity of export supply was estimated at 1.08. This unitary elasticity of export supply implies that price and quantity exported change by the same proportion, leaving revenue unchanged. Even if devaluation has a positive impact on the volume of exports in the short run, such a remedy is inappropriate as a long-term solution. This could tend to concentrate more on expanding the exports of a few existing agricultural products, which gave rise to the structural weakness of the balance of payments in the first place.

100. The view is that it is inappropriate to make price manipulation the prime driving force in the reform process. On the supply side, price factors explain only a small proportion of the change in export supply; and, on the demand side, they explain only a small proportion of the growth of export market shares in international trade. Emphasis must be placed on non-price factors. For the supply of exports, these factors are, institutions, infrastructure, inputs, information and innovations (Streeten, 1987). To increase demand for exports, emphasis must be given to sales and marketing, including marketing arrangements; the export-excellence of the product, including packaging, quality, preservation and delivery time for agricultural exports; ease of maintenance, reliability, delivery-time and after-sale services for manufactured goods.

101. It is well known that Malawi is facing serious supply constraints and that, as a result, her exports are not competitive. This is principally due to

- high costs of imported inputs caused by currency devaluation,
- payment of import duties, and surtax on most of these inputs, and
- delays in refund of taxes paid, and high costs of freight estimated at 30 to 40 per cent of the value of imports; as well as high costs of domestically produced raw materials which have risen due to high production costs.

102. Other factors contributing to the high cost of production are an unsatisfactory state of the internal road network, frequent cuts in power and water supply, inefficient telecommunications services and a high rate of crime which necessitates large expenditure on security.

103. In its efforts to facilitate export expansion, Malawi is also facing constraints. On attaining independence in 1964, the country became a Contracting Party to GATT in its own right. In doing so, Malawi committed itself to trade liberalization, creation of discipline in the world trading order and to strengthening of the multilateral trading system. However, due to lack of financial resources and expertise, the country rarely takes part in trade negotiating rounds and other fora.

**Multilateral, Regional and Bilateral Trade Agreements**

104. As a former colony of a member state of the EU, Malawi enjoys non-reciprocal preferential access to the EU market. Since 1975, trade and aid relations with the EU have been governed by four successive Lomé Conventions. Despite duty and quota-free access for most of her exports to the EU and the trade-related provisions of the Convention, the performance of Malawi's trade with the EU has not been satisfactory. The absolute level of exports to the EU has increased less rapidly than that of some of her neighbours, while the share of exports going to the EU in total exports has declined. The problems with the Lomé Convention are that the preferential margin of the tariff over non-ACP exporters is often nil and the value of the preference is low because of the low response of primary product exports to price changes. Malawi has not been able to diversify her exports towards products with a high preferential margin. Other problems are limited awareness of the existence of Lomé preferences, complicated procedures that apply to the access provisions and restrictive rules of origin. In addition, the extension in recent years of some near-equivalent preferences to non-ACP developing countries, and multilateral trade liberalization, have reduced the importance of Lomé preferences.

105. The implementation of the SA-EU Free Trade Agreement, which has entered into force, will have the following negative effects on the economy of Malawi. Some local producers may lose their SA market shares due to intensified competition from EU producers. Other local producers may be forced to shut down due to this competition; and EU producers may gain access to the SA market on better terms than those offered to Malawian firms. All this suggests that Malawi's trade with South Africa will not be fully liberalized.

106. Malawi also maintains bilateral trade agreements with Botswana, South Africa and Zimbabwe. The trade agreement with South Africa covers a specific list of goods. In view of differences in the levels of development between Malawi and South Africa, the trade agreement between them is non-reciprocal in favour of Malawi. In contrast, the trade agreement with Zimbabwe covers all goods and is reciprocal, despite differences in levels of industrialization between the two countries. This provision and the use of non-tariff barriers by Zimbabwe against goods from Malawi have led to an increase in the trade imbalance in favour of Zimbabwe. There is no provision for dispute settlement, and it appears that this agreement was not carefully negotiated.

107. At the regional level, Malawi is facilitating its trade through the Common Market for Eastern and Southern Africa (COMESA), formerly the Preferential Trade Area for Eastern and Southern Africa (PTA); and through the Southern African Development Community (SADC), formerly the Southern African Development Co-ordination Conference (SADCC). The trade liberalization measures of the Preferential Trade Area (PTA) included a gradual reduction of all tariffs imposed on a range of selected commodities, known as the common list, over a ten-year period. This was to be followed by eventual elimination of tariff and non-tariff barriers among member states and the evolution of a common external tariff. Later, the common list was abolished; thus subsequently tariff cuts extended to all goods. The execution of this programme should have had far-reaching consequences for intra-regional trade. Unfortunately, the rate of progress on tariff reduction fell far behind schedule. Some member countries were given exemptions; and the actual reductions, by a handful of countries, were modest. Only four member states carried the tariff reduction programme far enough. Under COMESA, the tariff reduction programme has made more progress (Malawi has cut her tariffs by 70 per cent) towards establishing a free trade area in the year 2000. But this is not enough. Trade will continue to be constrained by non-tariff barriers.

108. SADCC was more cautious in promoting intra-regional trade. While recognizing that several member states already had multilateral and bilateral trade arrangements, it believed that, even within these parameters, there was room for an increase in trade among them. To achieve this, SADCC encouraged multiyear purchase agreements and other bilateral trade deals among member countries. The successor organization, SADC, has yet to implement measures to facilitate intra-regional trade. A trade protocol providing for a free trade area was signed in 1996. While the required two-thirds majority of the membership has ratified it, it has not yet entered into force. Trade liberalization under the protocol will start with free trade, while most of the member countries are already integrating through bilateral trade agreements and at a higher level, through the Southern African Customs Union (SACU) and COMESA. The present protocol is basically of no interest to SADC Member countries that are also members of SACU or COMESA, but between those that are members of SACU but not COMESA and those that are members of COMESA. At any rate, the protocol free trade will be limited by the provisions relating to rules of origin, local content, choice by member countries of eligible

products, and the existence of those non-tariff barriers. Besides this, communication problems, border procedures, lack of information, import licences, surcharges, subsidies, transport problems, foreign exchange shortage, customs procedures, export licensing, and so on, are not covered by the trade protocol.

109. A number of studies have concluded that, in a *static* context, trade creation in the SADC will be small. The trade creation effects of dismantling high tariff and non-tariff barriers will be an offset by the high level of extra-regional trade of Member States. The low barriers to trade of non-members, long distances between Member States and the limited degree of complementarity of the production structures of the economies of Member States (Chipeta, 1995). A more recent study has come up with a similar conclusion regarding static effects of regional integration (Mandaza, Holmes and Evans, 1997). But it points out that SADC will reap benefits from such *dynamic* effects as scale economies in production and marketing and cross-border competition affecting technology transfers. It also points out that freer trade will necessitate promoting the rest of the framework, including reduction in non-tariff barriers, bodies to make rules about all aspects of policy, tribunals to interpret rules and agencies to enforce them. Given the need to develop and enforce common policies, to be effective deeper integration will necessarily require more complex institutions. Yet another recent study emphasizes the importance of complementary developments in the industrial sector and in infrastructure (Mayer and Thomas, 1997).

110. During the late 1980s, intra-regional trade increased in the SADCC. The upward trend in intra-regional trade has continued throughout the 1990s. Member countries that have increased the share of their regional trade in total trade include Angola, Mozambique, Malawi, Tanzania, Zambia and Zimbabwe. If one takes into account the level of informal cross-border trade, the extent of intra-regional trade would be higher.

**Liberalization of the Foreign Exchange Market**

111. Before the liberalization of the foreign exchange market in the early 1990s, Malawi operated a strict system of exchange control that was first instituted during the colonial era. Under this system, all citizens were compelled to hand over to the exchange control authorities (the central bank) through authorized dealer banks their entire earnings of foreign currencies. Anyone requiring foreign currencies for the purpose of making payments abroad had to apply to the exchange control authorities for permission to buy foreign currencies at the fixed official exchange rate. Exchange control was intended to protect scarce foreign exchange reserves, and enable the authorities to follow a system of priorities with certain imports given priority over others. Payments for consumer, capital and intermediate goods sourced abroad were normally permitted. But, foreign exchange allocation for these payments was rationed. Most of the other current payments and transfers, the allocable payments were fixed. Administrative allocation of foreign exchange was inefficient to the extent that the amount allowed was not related to economic need.

112. The major measures for liberalizing the foreign exchange market were implemented in 1994. These included the removal or liberalization of limits on payments abroad and the granting of the rights to allocate foreign exchange for all payments to authorized dealer banks. An export retention scheme was also introduced by which an exporter could retain up to 90 per cent (later reduced to 60 per cent) of earnings in foreign currency accounts. The deposits kept in these accounts could be used as the owners wished.

113. The removal of restrictions on exports, and the introduction of the export retention scheme have encouraged exports resulting in an increase in foreign exchange. The liberalization of payments for imports means, however, that the demand for foreign exchange has also increased. In the light of the consequent pressure on limited foreign exchange resources, the question is whether Malawi should reintroduce some form of exchange control, where imports of inputs are prioritized over imports of consumer goods, allowances for travel is restricted, and dealings in foreign exchange are once again restricted to authorized dealer banks.

114. An important step taken in 1994 was the establishment of an independently floating exchange rate regime under which the exchange rate was supposed to be determined by the demand for, and supply of, foreign exchange. Under this exchange rate regime, commercial banks could sell and buy foreign exchange at freely determined exchange rates. Foreign exchange bureau's, the first of which were licensed in 1994, could also buy and sell foreign exchange.

115. The floating of the Malawi kwacha, and consequent increase in the exchange rate has resulted in a narrowing of the gap between the official exchange rate and the parallel exchange rate. In theory, the official exchange rate is supposed to be determined independently by the forces of demand and supply. In practice, however, the authorities manipulate its movements. The other drawbacks of the present foreign exchange rate regime include the need for foreign exchange to cushion fluctuations in the exchange rate, which is potentially volatile. For these reasons, it may be worthwhile to review the appropriateness of the current exchange rate regime.

**Liberalization of the Foreign Capital Account**

116. It is generally believed that the capital account should be liberalized last. In Malawi, certain aspects of the capital accounts were liberalized before SAPs, however. These were inward transfers of non-debt creating capital and its repatriation, provided that the original investment was made with funds from abroad. In effect, this means that there has been no restriction on inflows of foreign direct investment. Portfolio investment flows have all along been quite free. but were limited in the absence of a local stock exchange until 1996. At present, these flows are somewhat constrained by the following requirements: all portfolio investment and divestment must be channelled through authorized dealer banks; a single portfolio investor is not permitted to hold more than 10 per cent of a listed

company's listed issued capital, or 49 per cent in the aggregate; and, whereas no prior investment approval is needed, the remittance of sales proceeds requires adequate evidence to be presented to authorized dealer banks. Inward foreign investment into government securities is welcome. There are no indications of restrictions on this type of investment. For national residents, there are restrictions on purchases of foreign government securities, foreign direct investment, portfolio investment abroad, and on contraction of loans abroad. The magnitudes of foreign capital inflows and their impact on the local economy are explained in the next chapter.

**Balance of Payments**

117. The deteriorating overall balance of payments position, which started in the second half of the 1970s, worsened in the six years to 1986, five of which registered deficits and one a surplus as measured by changes in net foreign assets of the banking system. After decreasing in 1976-80, foreign reserves import cover decreased further to an average of only 1.5 months in the 1981-86 period, well below the safe levels of 3 months and above registered up to the mid 1970s (Table 3.3). However, during the six years to 1992, the position improved as there were four surplus years and only two deficit years, a pattern, which was repeated, in the next six years to 1998. The foreign reserves import cover also improved to 2.4 months in the 1987-92 period and further to safe levels of 3 months and above for almost the entire period of 1993-98 and averaged almost 4 months. The target for end 1999 is forty two months (Malawi Government, *Budget Statement* 1999-2000, para 11).

118. An improvement in the foreign exchange position during the twelve-year period to 1998, however, was not due to an improvement in balance of payments fundamentals. The export base continued to be not diversified, and there was no improvement in the growth of exports. Droughts occurred in some years. The commodity terms of trade continued to be generally depressed, a condition which had started in the 1970s. An additional major external shock now was the diversion of external trade cargo from short rail routes to long road routes to seaports from the early 1980s, which raised the cost of freight and insurance from 15 per cent to 40 per cent of the value of imports. In addition, some of the foreign loans contracted in the 1960s and 1970s became due and considerably raised the debt service ratio from the tolerable levels of the first 15 years of independence to over 20 per cent for a good part of the 18 years to 1998. Further, between 1992 and 1993 non-humanitarian aid to Malawi was suspended.

119. Rather, the general improvement in the foreign exchange position in the 1987-92 period and particularly in the 1993-98 period, arose from a combination of balance of payments financial support form the IMF, the World Bank and bilateral donors and stabilization policy measures. Some of the policy measures were applied even long before the start of the stabilization and SAP measures.

120. A major measure was exchange control applied more vigorously from the 1980s, until the control was removed. A related measure was import licensing. The other was bank credit control. All these, mostly direct measures contributed in varying degrees to the improvement of the foreign exchange position through restraining demand for imports. A major, indirect, policy measure has since April 1982 been a series of devaluations of the Kwacha and its eventual floatation on 7$^{th}$ February 1994; whether it is assisting in bringing about a viable balance of payments position is debatable. The balance of payments position has since 1982 been also benefiting from debt rescheduling and conversion of some loans into grants. The country's economic fundamentals, however, continue to be so weak that in their present state they cannot bring about a viable balance of payments position without external support.

**The Exchange Rate**

121. One of the objectives/conditions of macroeconomic stability is stable, and competitive exchange rates. The exchange rate of the Malawi currency was stable all along up to March 1982. Only negligible adjustments occurred when there was a shift in the peg from the Pound Sterling to a basket comprising the Pound Sterling and the US dollar (November 1973), then to the SDR (June 1975) and lastly to a basket of seven currencies (January 1984). Shifting the pegs was done essentially to prevent the Kwacha from depreciation and appreciation against major currencies. Meanwhile the rather inflexible pegging resulted in the progressive overvaluation of the Kwacha, thereby rendering it increasingly uncompetitive. There has also been temporary stability of the exchange rate in between devaluations and even after floatation of the Kwacha in February 1994, but volatility of the exchange rate is of considerable concern.

122. Temporary stability is being achieved in the floating exchange rate regime, due to foreign financial assistance largely in the form of balance of payment support. The policy question therefore is whether the floating regime would be sustainable in the absence of such support in the long run, given the narrow, undiversified and unstable export base (see Chapter 4). Also of concern is whether adequate institutional arrangements exist in the country to promote strong competition under which financial markets can effectively determine exchange rates.

**Table 3.1 Malawi: Schedule of Exchange Rate Adjustments During the Reform Period**

| Date | Exchange Rate Action |
|---|---|
| April 24, 1982 | The Malawi Kwacha devalued against the SDR to which it was pegged by 15 per cent. |
| September 17, 1983 | The Malawi Kwacha devalued against the SDR by 12 per cent. |
| January 17, 1984 | The peg to the SDR discontinued and the Malawi Kwacha linked to a new basket of seven currencies comprising the US$, Sterling, Deutschemark, Yen, Rand, French Franc and the Dutch Guilder, resulting in a small depreciation of the currency. |
| April 2, 1985 | The Malawi Kwacha devalued by 15 per cent against the new basket. |
| August 16, 1986 | The Malawi Kwacha goes through a 10 per cent devaluation against the new basket. |
| February 7, 1987 | The Malawi Kwacha devalued once more by 20 per cent against the new basket. |
| January 16, 1988 | The Malawi Kwacha devalued yet again by 15 per cent against the new basket. |
| March 24, 1990 | The Malawi Kwacha devalued by 7 per cent against the basket of currencies to which it was pegged. |
| March 24 and June 12, 1992 | The Malawi Kwacha devalued by 15 and 22 per cent, respectively, against the same basket of currencies. |
| February 7, 1994 | The Malawi Kwacha delinked from its currency basket and floated. Since then depreciations and devaluations have led to an 890.1 per cent slide against the US Dollar in nominal terms. |

Source: Reserve Bank of Malawi, *Financial and Economic Review* (various).

**Table 3.2 Malawi: Growth of Real Exports and Imports**

| Period | Average Annual Percentage Change In Real Exports | Average Annual Percentage Change In Real Imports |
|---|---|---|
| 1971-75 | 9.3 | 14.0 |
| 1976-80 | 4.9 | 1.9 |
| 1981-85 | 2.5 | -3.5 |
| 1986-90 | 5.7 | 5.9 |
| 1991-97 | 5.1 | 5.1 |

Source: Calculated from data available in Reserve Bank of Malawi, *Financial and Economic Review* (various issues).

## Table 3.3: Malawi: Selected Indicators of Balance of Payments

| | Annual Averages (unless stated otherwise) | | | | | |
|---|---|---|---|---|---|---|
| | Pre-liberalisation period | | | Post-Liberalisation period | | |
| | 1966 - 1970 | 1971 - 1975 | 1976 - 1980 | 1981 - 1986 | 1987 - 1992 | 1993 - 1998 |
| Number of years in which there was overall b.o.p.: | | | | | | |
| Suplus[a] | 2 | 4 | 2 | 1 | 4 | 4 |
| Deficit[a.] | 2 | 1 | 3 | 5 | 2 | 2 |
| Neither surplus nor deficit | 1 | | | | | |
| Gross foreign reserves[b] in months of imports of goods and services | 3.7 | 4.1 | 2.5. | 1.5 | 2.4 | 3.9 |
| Foreign debt service ratio, in percent | 7.0[c] | 12.6[d] | 15.4[e] | 28.4[f] | 27.4 | 19.3 |
| Current account deficit/GDP ratio, in percent | 13.6 | 10.6 | 15.6 | 8.6 | 10.2 | 12.0 |
| | | | | | | |

Notes a). Change in net foreign assets of the Reserve Bank of Malawi plus commercial banks: Surplus = increase. Deficit = decrease.

b). From 1993 gross foreign assets held by the commercial banks have been added to those held by the Reserve Bank of Malawi. Foreign reserves/assets are as at end of year

c). Only 1970

d). Average of 1973 and 74

e). Average of 1978 and 80

f). Excluding 1984

Sources: Reserve Bank of Malawi, Financial and Economic Review, Quarterly (various issues).

Reserve Bank of Malawi, Monthly Economic Review, November (1998).

Chipeta C. Debt in the SADCC Region: A: Case Study of Malawi, a paper for a Conference of Non-Governmental Organisations on the Critical Issues of ADebt in the SADCC Region@, held in Brussels, Belgium, September (1989), Table 1.

Table 2.1 in Section 2 above

COMESA, Review Study of the Implementation of the COMESA Monetary Harmonization Programme, Volume 1, Main Report, October (1995) Annex Table 10.

# 4. THE EXTENT OF GLOBAL INTEGRATION

123. This chapter indicates the extent to which the Malawi economy, particularly the trade sector, is integrated with the global economy following the policy reforms discussed above. The extent of its globalization by using various openness indicators is examined.

**External Trade: Trends, Composition and Linkages**

124. The average shares of total trade (to GDP), in general, and exports in particular have not changed significantly over the years. Moreover, as indicated in Table 4.1, there seems to be no marked difference between the pre- and post-reform averages of the main trade aggregates. For instance, exports have averaged between 20 and 25 per cent of GDP while imports have ranged between 25 and 33 per cent of GDP since the 1960s. The share of trade in GDP is, however, significant and comparable to similar economies (averaging about 55 per cent of GDP between 1964 and 1997). Further, examining the trend on a year-to-year basis, though both exports and imports show an upward trend, the change does not seem strong enough to be attributed to significant policy regime shifts. Figure 4.1 illustrates the movements of exports and imports between 1964 and 1997. The striking features of the movements of exports and imports are the volatility of both aggregates and the constant trade deficit (except 1985 and 1987) over the last three decades.

125. Similarly, both exports and imports grew at an average annual rate of about 9 per cent between 1950 and 1995. Table 4.2 indicates that both exports and imports were growing faster in the 1960s and 1970s than in the 1980s and 1990s (except for two years in the 1990s). This is particularly true of exports, as is also the case for the average for Sub-Saharan Africa where most countries have been liberalizing their economies since the 1980s (albeit at different degrees and speed). But the growth of exports and imports does not seem to positively correlated with the shift in the policy regime.

126. An alternative indicator of openness is *the ratio of tariff revenue to imports*. Again on average, as indicated in Table 4.1, tariff revenue as a percentage of imports was higher after reforms compared to the pre-reform period. Tariff revenue-to-import ratio averaged around 18 per cent in the 1970s but increased to about 33 per cent in the 1980s and 1990s. Within the SADC region, Malawi's tariff rate is one of the lowest; it is in line with that of the other member countries.

127. The composition of both exports and imports remains undiversified. The export sector is dominated by tobacco (accounting for more than 50 per cent of total exports), while industrial goods dominate the import sector, accounting for more than 30 per cent of the total since the mid-1970s. As Table 4.3 shows, the bulk of Malawi's exports (more than 85 per cent) are agricultural items, while manufactured goods dominate its imports (accounting for more than 70 per cent of the total). The two

most important import items are machinery and transport equipment. This composition has not changed over the years. In other words, the relative share of commodities in both exports and imports has, by and large, been stable since the mid-1970s, indicating that efforts to diversify exports have either not taken place or have not proved successful. The only exception seems the relative increase of tobacco and a decrease in groundnuts in the share of exports in more recent years.

128. A similar picture emerges when one examines the number of goods exported, and diversification and concentration indices of exports. As indicated in Table 4.4, both the figure of goods exported and the diversification index remained the same in 1994 and 1980, with a slight increase in 1995. The concentration index increased in 1992 and 1994 compared to 1980. According to 1994 estimates, Malawi has one of the most highly concentrated export sectors among the SADC member countries.

129. In addition to being highly concentrated, Malawi′s share of exports in total world trade is very small. For instance, for all commodities its share of world exports was only 0.01 per cent in 1994. Even the share of its dominant export (tobacco) was only 5.6 per cent of the world total. The relatively high concentration and the small size of the sector relative to world trade suggest that Malawi cannot influence world prices even in commodities that dominate its export sector. This makes the Malawi export sector even more vulnerable to terms-of-trade shocks that are likely to follow its global integration in the future.

130. Table 4.5 illustrates Malawi's terms of trade and the movement of price and quantity of exports and imports. Malawi's terms of trade have been on the whole unfavourable; they have been lower since the 1980s compared to the 1970s. And they started to further deteriorate in the 1990s.

131. Malawi's main trading partners are mainly developed countries. More than 70 per cent of its exports go to and its imports come from industrial (mainly European) countries. In contrast, its trade with African countries is limited; it declined in more recent years compared to 1970. In fact, it would have been even smaller were it not for its trade with South Africa, which accounts for more than half of the African total. This is despite the adoption and partial implementation of the SADC protocol, which, *inter alia*, calls for liberalized trade among its members. In general, both the composition and direction of trade has not changed significantly over the last three decades (see Table 4.6). This observation is consistent with the concentration and diversification ratios discussed earlier.

## Employment and Earnings Indicator

132. To further examine the extent to which the Malawi economy is integrated (or has the potential to integrate), we computed the distribution of employment and earnings between what are relatively modern and traditional sectors. The classification between what are categorized here as modern and traditional is rather arbitrary. For brevity, however, employment and earnings in mining, manufacturing, communication and finance are classified as modern sectors, while agriculture, construction, wholesale and related activities are classified as traditional. If this classification captures the dynamic nature of a modern sector, it implies that the higher the share of employment and earnings in the modern sector, the more likely it is that the country will reap the benefits of globalization.

133. The share of the modern sector in both employment and earnings has steadily increased relative to its share in the mid-1970s (Table 4.7). Similarly, the role of the private sector relative to the public sector has also slightly increased during the same period. However, given the scope of privatization undertaken during the period, it seems that the ability of the private sector to expand employment has been limited.

134. Although employment in tradeable and non-tradeable sectors and goods may in general be more relevant for the study on globalization, this is likely to be inapplicable in the case of countries like Malawi, where the more relevant basis for classification is the technological content (basis for modernity) of what is actually traded rather than what is potentially tradable. Accordingly, modern-traditional dichotomy may be justified on the following grounds. First, Malawi's exports are unprocessed (primary) products (e.g. tobacco and ground nuts).These products are agriculture-based and are commonly referred to as traditional. Secondly, if one takes the use of modern machinery and equipment in the production process as the basis for an industry (sector) to be considered relatively more modern, then in countries like Malawi such means of production are not used to produce the goods that are exported. Modern equipment is likely to be found in sectors like manufacturing, mining and communication activities. Third, if one looks at the skill level required to produce the goods actually exported, the least skilled are engaged in the production of these primary commodities. The most skilled are likely to be found in other sectors (that is, in sectors that do not produce exportables). Indeed, the human capital constraint will most probably hinder Malawi's export diversification.

135. Clearly all the above outlined trade-related indicators of globalization suggest that there is no marked difference in terms of Malawi's degree of integration during the post-reform period compared to the pre-reform period. The question is how should the stability of the above aggregates be interpreted? Does the impact of globalization occur after a long time lag? Or is the Malawi economy being marginalized rather than integrated into the world economy? It is clear that the economy is

integrating very slowly, at best or being marginalized at worst. This is because the economy is not actively focusing on its comparative advantage, which would enable it to compete globally as intended by liberalization. But the old question surfaces again - namely, is it possible for an economy like that of Malawi to compete globally before the structure of production, and quality standards, have reached a certain stage of maturity? And how long does it take and what policy measures are the more appropriate to achieve this standard? As noted earlier the, Malawi economy is basically agricultural with no appreciable dynamic sector such as manufacturing, that could immediately gain from liberalized trade. Table 4.8 illustrates the structure and recent growth of the manufacturing sector in Malawi in which agro-processing is the dominant sub-sector accounting for about 50 per cent of total manufacturing (a share which has been increasing in more recent years). The manufacturing sector could not be considered dynamic in the sense that its value added is low. It needs to be diversified towards higher value-added manufactured goods in order to improve Malawi's comparative advantage. It is also worth noting that the overall growth rate of the manufacturing sector (comparing roughly five-year averages between 1980 to 1996) decreased in the 1990s compared to the 1980s. It is difficult to attribute this to the effects of liberalization, but the latter definitely has not helped industrial growth.

136. In general, the reform policies have not yet (if at all) made an impact on the integration process of the Malawi economy. It is not yet clear whether this is due to slow implementation of policies, the long time lag required before such policies can transform the economy, or rigid production structures incapable of competing in the global market. It is more likely to be a combination of all the above factors.

137. The policy implications are that, first, countries like Malawi are likely to need a transition period during which they identify production and market niches that favour their respective comparative advantages in the context of the emerging world division of labour. Once this is achieved they could accordingly fine-tune their commercial practices. Secondly, during such a transition period, they might avoid being marginalized if their integration process is made easier through well-articulated preferential trade policies and bilateral and multilateral assistance to augment their capacity to integrate into the world economy. Such an effort is likely to limit both the potential of marginalization at a country level, and within the country, in different sectors.

**Trends in Investment Flows**

138. Another commonly used indicator of globalization is the extent of investment flows. This includes both physical and portfolio investments. In the case of Malawi, both portfolio investment and the flow of foreign direct investment are insignificant. There are many reasons why private investment in general, and foreign direct investment in particular have not increased significantly over the years. They range from the poor infrastructure of the country to inappropriate Government policies and general inefficiencies. A recent World Bank survey (1997) of private business cites poor infrastructure,

crime and theft, inflation and corruption as major obstacles to private business. The same survey also cites tax regulation and policy instability among moderate obstacles. Even though significant policy changes have been undertaken in liberalizing the financial sector, the private sector still plays a minor role in promoting investment. Although the share of the private sector in total investment on average increased, it has not overtaken the public sector investment share (see Table 4.9). In fact, on average it shrank in the 1980s and 1990s compared to the previous two decades, following the pattern of total investment. A recent World Bank projection (Table 4.10) for the early years of the next century indicates that there will be a significant improvement in private investment, while public investment is expected to slightly decline. Consequently, increase in total investment will still remain marginal unless the high-case scenario materializes.

139. Cross-border investment, which takes the form of foreign direct investment, portfolio investment and loans, is on the increase. The main flow of cross-border investment is from South Africa. There have also been flows of cross-border investment from other countries such as from Zimbabwe in the financial sectors of Malawi, Tanzania in the dairy industry; Zambia in the financial sector of Malawi; from Malawi in the retail trade, and insurance industry of Zambia, to name a few. These flows have been facilitated by the liberalization of national economy, which includes capital inflows, privatization of public enterprises, and the establishment of stock exchanges in recipient countries. There are a number of barriers that need to be addressed if the level of cross-border investment is to rise substantially in the future. These barriers include restrictions on investment abroad by residents in some countries; restrictions on the contraction abroad of loans by residents of certain countries; formal inconvertibility of regional currencies outside the Common Monetary Area; exchange rate instability; shortage of capital; and shortage of foreign exchange. Cancellation of foreign debt may help reduce the foreign exchange constraint.

140. The stock of foreign direct investment in Malawi is small in magnitude but has been steadily increasing. As a whole it seems to be comparable to the average for African countries (see Table 4.11). From a low of $100 million in 1980, the stock of FDI reached $284 million by 1997 and it averaged around 10 per cent of GDP.

141. Similarly, the flow of FDI indicates an upward trend even though it has been volatile. The volatility was particularly high in the early 1990s as shown in Fig. 4.2. The insignificant inflow of FDI is probably to be expected given the poor infrastructure of the country and its low favourable ratings by potential investors., Malawi's competitive position is the lowest among SADC countries (Table 4.12). Similarly, both the improvement and optimism indices and the opportunity to trade index also put Malawi among the least-favoured countries in the region.

142. The above assessment of potential investors clearly reflects the present unfavourable economic environment for investment flows, at least relative to similar countries in the region. The problem such countries face in attracting FDI goes beyond the existence (or absence) of pure economic returns. Perceptions and overall socio-political uncertainty play an important role in determining the direction of FDI flows. To put it differently, the premium required to compensate for the actual or perceived risks of investing in such economies is likely to be high.

143. According to the World Bank Development Finance Country Report (1997), portfolio equity flows to Malawi have been nil for the last two decades. This is mainly due to the financial repression which characterized Malawi's financial sector before the introduction of the reforms, and its slow development during the post-reform period. The equity market is in its infancy with only a few domestic companies that recently emerged to finance investment through equity capital. It is unlikely to attract any appreciable equity capital any time soon, despite its fast growth at a global level.

**Degree of Indebtedness**

144. The purpose of this sub-section is to briefly highlight Malawi's extent of indebtedness. Debt being one of the sources to finance investment, this will highlight the linkages to international finance in general, and to what extent resource gaps needed to finance investment are filled with external resources in particular, Malawi is one of the most highly indebted countries in Africa. Since 1994 its outstanding long-term debt exceeded its GNP (Table 4.13). The percentage of debt service payments to export earnings is also significant. This situation suggests the following implications. First, Malawi has been borrowing not only for investment but also for other expenditures since investment only accounts for a small proportion of GNP. Second, with such huge debt service payments, Malawi's ability to increase its expenditure on investment in infrastructure for instance, to become globally competitive will be limited. Third, such a huge debt burden will likely discourage flows of foreign direct investment via what is referred to as the 'debt over- hang'. All these factors suggest that Malawi's ability to fully integrate into the global economy and meaningfully compete will be adversely affected until the debt burden issue is resolved.

**Table 4.1: Malawi: Selected Trade Indicators (Annual Average)**

| Aggregate | 1964/70 | 1971/75 | 1976/80 | 1981/85 | 1986/90 | 1991/97 |
|---|---|---|---|---|---|---|
| Exports to GDP ratio- (%) | 21 | 25.5 | 25.9 | 24.3 | 23.2 | 23.8 |
| Imports to GDP ratio- (%) | 30.2 | 32.7 | 33.7 | 25.7 | 28.3 | 33.5 |
| Trade/GDP ratio- (%) | 51.2 | 58.1 | 59.6 | 50 | 51.6 | 57.3 |
| Tariff/Import ratio- (%) | ... | 16 | 21 | 38 | 35 | 28 |
| Terms of Trade | 87.69 | 90.17 | 86.61 | 113.73 | 95.85 | 101.5 |

Source: Reserve Bank of Malawi, *Financial and Economic Review* (1998).

**Table 4.2: Malawi: Malawi's Annual Average Growth Rates of Exports and Imports (%)**

| Year | Exports | Imports | Year | Exports | Imports |
|---|---|---|---|---|---|
| 1950/1996 | 8.7 (7.9) | 8.6 (7.8) | 1990/1995 | -4.0 (0.4) | -6.5 (3.5) |
| 1950/1960 | 4.5 (4.8) | 7.3 (5.9) | 1990/1991 | 13.2 (-5.5) | 21.0 (1.1) |
| 1960/1970 | 9.9 (7.3) | 11.1 (5.7) | 1991/1992 | -18.9 (2.2) | 2.1 (6.8) |
| 1970/1980 | 16.7 (19.9) | 16.4 (20.1) | 1992/1993 | -16.4 (-8.8) | -24.0 (-0.9) |
| 1980/1990 | 2.0 (-1.3) | 3.2 (-2.8) | 1993/1994 | 1.6 (3.1) | -10.1 (-3.8) |
| 1980/1985 | -1.6 (-7.6) | -8.2 (-9.8) | 1994/1995 | 24.6 (17.9) | -3.3 (22.3) |
| 1985/1990 | 8.4 (6.8) | 18.2 (6.2) | 1995/1996 | 18.8 (28.0) | 31.4 (0.3) |

Source: UNCTAD: *Handbook of International Trade and Development Statistics*, 1996/97.
Note:Numbers in brackets are for Sub-Saharan Africa.

**Table 4.3: Commodity Composition of Exports and Imports (Annual Average) (%)**

| | 1975/80 | 1981/85 | 1986/90 | 1991/97 |
|---|---|---|---|---|
| **Exports (by commodity** | | | | |
| Tobacco | 51.4 | 50.1 | 62.7 | 68.6 |
| Tea | 18.7 | 19.9 | 12.3 | 8.9 |
| Groundnuts | 5.7 | 1.8 | 1.2 | 0.2 |
| Cotton | 1.3 | 0.9 | 0.8 | 1.7 |
| Sugar | 11.9 | 12.6 | 8.9 | 6.5 |
| Other exports | 11.1 | 14.7 | 13.6 | 14.2 |
| **Imports (by end use)** | | | | |
| Consumer goods | 12.5 | 13.0 | 11.1 | N/A |
| Equipment | 15.7 | 12.0 | 15.8 | N/A |
| Transport | 13.5 | 10.6 | 12.7 | N/A |
| Construction | 8.4 | 5.9 | 5.5 | N/A |
| Industry | 34.2 | 40.7 | 39.5 | N/A |
| Final and Intermediate | 15.3 | 17.5 | 14 | N/A |
| Miscellaneous | 0.36 | 0.3 | 1.3 | N/A |

Source: Reserve Bank of Malawi, *Financial and Economic Review* (1998).

### Table 4.4 Malawi: Export Concentration and Diversification Indices

| Indicator | 1980 | 1992 | 1994 | 1995 |
|---|---|---|---|---|
| No. of Commodities Exported | 47 | 35 | 47 | 56 |
| Diversification index | 0.926 | 0.923 | 0.921 | 0.899 |
| Concentration index | 0.490 | 0.704 | 0.696 | 0.680 |

Source: UNCTAD: *Handbook of International Trade and Development Statistics, 1994, 1995.*

### Table 4.5 Malawi: Tentative Terms of Trade Estimates (1980 = 100)

| **Year** | **Exports** | | | **Imports** | | | **Terms of Trade** | **Purchasing Power of Exports** |
|---|---|---|---|---|---|---|---|---|
| | **Value** | **Unit value** | Quantum | **Value** | **Unit value** | **Quantum** | | |
| 1970 | 21 | 41 | 52 | 20 | 30 | 65 | 136 | 70 |
| 1975 | 49 | 76 | 64 | 57 | 58 | 98 | 130 | 84 |
| 1985 | 87 | 94 | 93 | 67 | 91 | 74 | 104 | 96 |
| 1990 | 147 | 132 | 111 | 130 | 119 | 109 | 111 | 123 |
| 1994 | 107 | 107 | 100 | 134 | 123 | 109 | 87 | 87 |
| 1996 | 158 | 114 | 139 | 170 | 122 | 139 | 93 | 129 |

Source: UNCTAD: *Handbook of International Trade and Development Statistics*, 1995

**Definitions:**

1. Value index = current value of exports (fob) or of imports (cif) converted to dollars and expressed as a percentage of the average for the base year (1980).
2. Unit value index = the ratio of the export (or import) value index to the corresponding unit value index.
3. TOT = the so called Anet-barter@ terms of trade, defined as the ratio of the export unit value index to the import unit value index.
4. Purchasing power of exports = the value index of exports deflated by the import unit value index.

## Table 4.6 Malawi: Export and Import Structure by main regions of Origin and Category

| | Exports | | | | Imports | | | |
|---|---|---|---|---|---|---|---|---|
| **Region/Country** | **1970** | **1980** | **1990** | **1995** | **1970** | **1980** | **1990** | **1995** |
| **World ($m)** | 48 | 269 | 402 | 521 | 86 | 440 | 580 | 500 |
| **Developed Countries** | 76.6 | 63.8 | 88.1 | 84.3 | 63.5 | 87.5 | 85.1 | 73.5 |
| **%** | | | | | | | | |
| Europe | 66.5 | 57.7 | 53.0 | 53.3 | 37.1 | 37.4 | 42.6 | 32.8 |
| USA | 3.6 | 18.0 | 12.1 | 13.7 | 5.9 | 4.8 | 2.6 | 3.4 |
| Japan | 0.5 | 2.0 | 13.5 | 5.2 | 5.3 | 7.0 | 7.5 | 5.0 |
| Other | 6.0 | 6.0 | 9.5 | 12.1 | 15.1 | 38.3 | 32.3 | 32.4 |
| **Developing Countries** | 20.5 | 15.9 | 11.4 | 11.9 | 36.2 | 12.5 | 14.2 | 26.0 |
| OPEC | 0.4 | 0.6 | 0.2 | ... | 4.5 | 0.8 | ... | 1.0 |
| America | 0.1 | ... | 1.2 | 1.4 | ... | 0.2 | 0.8 | 0.9 |
| Africa | 19.0 | 14.0 | 6.9 | 0.6 | 27.3 | 6.5 | 6.8 | 13.4 |
| West Asia | ... | ... | ... | 2.0 | 4.5 | 2.3 | 0.1 | 0.6 |
| Other | 0.6 | 1.8 | 2.7 | 33.1 | 4.4 | 3.5 | 6.5 | 11.2 |
| **Category of Exports** | | | | | | | | |
| Total Value ($m) | 49 | 269.5 | 402.2 | 421 | 86 | 440 | 580 | 500 |
| All food items | 88.2 | 90.9 | 92.9 | 90.4 | 18.1 | 7.5 | 8.7 | 13.9 |
| Agric. Raw Material | 7.7 | 2.4 | 1.9 | 2.1 | 1.1 | 1.0 | 0.8 | 0.6 |
| Fuels | 0.1 | ... | ... | 0.1 | 5.5 | 15.3 | 10.7 | 11.1 |
| Ores and Metals | 0.4 | ... | ... | 0.1 | 1.1 | 1.4 | 1.5 | 0.9 |
| Manuf. Goods | 3.2 | 6.4 | 5.1 | 7.3 | 71.7 | 74.5 | 77.8 | 73.4 |
| Others | 0.5 | 0.3 | 0.1 | ... | 2.5 | 0.2 | 0.5 | 0.1 |
| **Commodity Groups** | | | | | | | | |
| Cereal | 1.4 | 1.5 | 0.4 | 0.9 | 9.0 | 2.9 | 3.7 | 8.4 |
| Fertilizers | ... | ... | ... | 0.1 | 1.0 | 4.2 | 8.8 | 7.5 |
| Crude petroleum | ... | ... | ... | ... | ... | 0.1 | ... | ... |
| Petroleum products | ... | ... | ... | 0.1 | 5.1 | 14.3 | 10.3 | 10.6 |
| Medical and pharm. | 0.1 | 0.2 | ... | ... | 2.2 | 1.9 | 1.7 | 7.9 |
| Textile, fibres & cloth. | 7.7 | 7.0 | 3.6 | 6.7 | 11.0 | 5.3 | 5.4 | 6.0 |
| Metal & metal manuf. | 0.3 | 0.1 | 0.1 | 0.2 | 8.9 | 10.6 | 6.9 | 6.5 |
| Machinery | 0.5 | 0.2 | 0.1 | ... | 16.6 | 19.1 | 18.2 | 14.8 |
| Transport equip. | ... | ... | 1.0 | 0.1 | 13.5 | 14.6 | 17.2 | 13.3 |

Source: UNCTAD: *Handbook of International Trade and Development Statistics, 1996/97.*

### Table 4.7: Malawi: Employment and Earnings by Sector (annual average)

| Sector | 1976/80 | 1981/85 | 1986/90 | 1991/95 |
|---|---|---|---|---|
| Employment In: | | | | |
| Modern | 29.7 | 30.8 | 32.2 | 31.3 |
| Traditional | 70.6 | 69.3 | 67.8 | 68.9 |
| Private | 78.1 | 78.4 | 79.2 | 0 |
| Public | 21.9 | 21.6 | 20.8 | 0 |
| Earnings In: | | | | |
| Modern | 48.5 | 50.4 | 55.2 | 53.9 |
| Traditional | 52 | 48.9 | 44.6 | 44.5 |
| Private | 72.8 | 74 | 76.8 | 0 |
| Public | 27.2 | 26 | 23.2 | 0 |

Source: Reserve Bank of Malawi, *Financial and Economic Review (1998).*

### Table 4.8 Malawi: Structure and Growth of the Manufacturing Sector

| Sub-sector | 1980 | 1990 | 1996 |
|---|---|---|---|
| Agro-processing | 44.5 | 48.5 | 56.1 |
| Textiles, clothing, leather | 11.1 | 8.8 | 4.3 |
| Wood products, publishing | 10.0 | 8.4 | 7.6 |
| Chemicals, plastics, rubber | 16.2 | 19.1 | 19.4 |
| Non-metallic mineral products | 6.6 | 5.6 | 5.6 |
| Metal products, machinery | 9.4 | 6.9 | 3.7 |
| Other manufactures | 2.0 | 2.7 | 3.3 |
| Total | 100.0 | 100.0 | 100.0 |
| Annual Average Growth Rates- % | 3.0 | 5.2 | 1.5 |

Source: The World Bank, *Accelerating Malawi's Growth: Long-term Prospects and Transitional Problems, September, 1997*

**Table 4.9 Malawi: Private and Public Investment (% of GDP)**

| Year | Private | Public | Total |
|---|---|---|---|
| 1965 | 4.2 | 9.7 | 13.9 |
| 1970 | 7.5 | 12.7 | 20.2 |
| 1975 | 7.8 | 17.1 | 24.9 |
| 1980 | 4.8 | 17.5 | 22.3 |
| 1985 | 5.1 | 8.3 | 13.4 |
| 1990 | 8.5 | 8.0 | 16.5 |
| 1991 | 8.8 | 8.1 | 16.9 |
| 1992 | 6.7 | 9.4 | 16.1 |
| 1993 | 2.6 | 7.4 | 10.0 |
| 1994 | 11.6 | 15.1 | 26.7 |
| 1995 | 5.6 | 9.4 | 15.0 |
| 1996 | 5.8 | 5.1 | 10.9 |
| 1997 | 5.2 | 6.2 | 11.4 |
| 1965-1969 | 7.1 | 8.9 | 16.0 |
| 1970-1979 | 8.9 | 13.8 | 22.7 |
| 1980-1989 | 5.6 | 9.4 | 15.0 |
| 1990-1997 | 6.9 | 8.6 | 15.5 |

Source: IMF, *International Financial Statistics* (various years).

**Table 4.10: Malawi: Projections in Public and Private Investment (% of GDP)**

| | Private Investment | | Public Investment | |
|---|---|---|---|---|
| Year | Moderate | High | Moderate | High |
| 2001 | 14.1 | 15.3 | 5.9 | 6.8 |
| 2006 | 14.3 | 17.2 | 5.9 | 6.8 |
| 1997-2006 | 13.8 | 15.4 | 5.8 | 6.6 |

Source: World Bank,Accelerating Malawi's Growth: Long-term Prospects and Transitional Problems, September, 1997

**Table 4.11: Malawi: Inward FDI Stock**

| Year | Value $million | % of GDP | % of GDP (for Sub-Saharan Africa) |
|---|---|---|---|
| 1980 | 100 | 8.1 | 4.0 |
| 1985 | 143 | 12.6 | 7.8 |
| 1990 | 215 | 11.6 | 13.5 |
| 1996 | 267 | 18.2 | 21.8 |
| 1997 | 284 | 11.4 | ... |

Source: UNCTAD, *World Investment Report,* 1998.

**Table 4.12 Malawi: Competitiveness Index**

| Country | Competitiveness | Improvement (1992-1997) | Optimism (1997-1999) | Trading Opportunity |
|---|---|---|---|---|
| Malawi | -0.43 | 10.39 | 12.60 | 4.33 |
| Mauritius | 0.87 | 13.0 | 11.27 | 6.02 |
| Botswana | 0.54 | 9.6 | 8.99 | 4.57 |
| Namibia | 0.43 | 10.02 | 6.99 | 5.19 |
| South Africa | 0.34 | 9.22 | 3.61 | 5.38 |
| Zambia | -0.09 | 13.35 | 15.06 | 4.13 |
| Tanzania | -0.24 | 20.03 | 20.55 | 4.8 |
| Mozambique | -0.32 | 19.44 | 23.13 | 3.85 |
| Zimbabwe | -0.4 | 18.37 | 9.55 | 4.8 |
| Maximum score | 1 | 30 | 30 | 7 |

Source: World Economic Forum, *The Africa Competitiveness Report* (1998).

**Table 4.13Malawi: Long-term Debt: Debt Outstanding and Debt Service**

| Year | Debt Outstanding | | Debt Service | |
|---|---|---|---|---|
| | Amount ($m) | % of GNP | Amount ($m) | % of Exports |
| 1975 | 279 | 44.9 | 20 | 9.5 |
| 1980 | 746 | 65.6 | 69 | 22 |
| 1985 | 1021 | 94.6 | ... | 40 |
| 1990 | 1487 | 82 | 111 | 25 |
| 1991 | 1619 | 76 | 102 | 19 |
| 1992 | 1661 | 91 | 93 | 21 |
| 1993 | 1826 | 92 | 73 | 21 |
| 1994 | 2127 | 172 | 69 | 18 |
| 1995 | 2242 | 156 | ... | ... |
| 1996 | 2312 | 105 | ... | ... |
| 1997 | 2287 | 104 | 89 | 12.4 |
| 1998 | 2507 | ... | ... | |

Source: UNCTAD, *Handbook of International Trade and Development Statistics.*

**Figure 4.1: Share of exports and imports in GDP (%)**

**Figure 4.2: Flows of Foreign Direct Investment**

# 5. SMALL AND MEDIUM ENTERPRISES AND GLOBALIZATION

## Expansion of SMEs

145. In Malawi, the number of SMEs including micro-enterprises have been growing: at an estimated average annual growth rates of about 16 per cent in urban areas and 10.5 per cent in rural areas (UNDP/ILO1999, p.47). Many SMEs have been established in response to business opportunities, some are the result of government's promotional efforts and there are still others, mostly informal (unregistered) micro-enterprises have grown as a survival strategy in response to adverse effects of reforms.

146. Liberalization of foreign trade and the foreign exchange market have given business opportunities to SMEs engaged in pure trading, but the positive impact on those engaged in actual production does not appear to be clear. Some old and new SMEs are now engaged in import trading of goods mainly sourced from neighbouring countries (particularly from South Africa and Zimbabwe) whose industries have a competitive edge over Malawi. Others are engaged in selling second-hand clothing (and footwear) sourced from developed countries. The second-hand goods are sold at very low prices relative to new goods, which has provided some relief especially to poor households in rural and urban areas (a situation somewhat similar to that in Zimbabwe). Furthermore, liberalization of the marketing of smallholder crops and farm inputs has enabled many new and old SMEs to engage in the business of buying and selling farm inputs and particularly crop produce. All these trading opportunities have contributed to the birth of new SMEs and expansion of some existing ones. On the other hand, the flooding into Malawi of imported consumer goods, which are generally cheaper than similar goods produced locally by some SMEs (and large firms), has adversely affected SMEs output and employment.

## SME Competitiveness

147. At present, not much is exported by SMEs and exporting tends to be a one-off activity due in part to supply constraints in producing large quantitites. (Chipeta, 1994, pp. 16, 20). However, Malawi's trade with neighbouring countries handled by SMEs in recent years appears to be large. A study on informal cross-border trade estimated that between April 1995 and March 1996, informal agricultural exports to neighbouring countries amounted to US$2.4 million (K103.2 million), industrial exports amounted to US$11.3 million, giving total informal exports of US$13.7 million. Compared with officially recorded data for 1994, unrecorded informal trade (exports plus imports) with neighbouring countries from April 1995 to March 1996 was larger (*The Nation*, 5 August 1999 p. 7).

148. Opportunities for expanding exports to regional and international markets do exist. According to the Malawi Export Promotion Council (MEPC), Zambia, Tanzania, Zimbabwe and South Africa in the Southern African sub region offer Malawi better export opportunities than other countries. MEPC's market surveys in the sub region, supplemented by buyer/seller meetings, and participation in trade fairs have shown considerable demand potential for Malawi′s products in these markets. Some these are, textiles, blankets, netting products, PVC pipes and fittings, buses, agricultural hand tools, art crafts, cane furniture, rubber, confectionery products, sugar, peri-peri sauce, spices, rice, beans and other pulses. Some of these products are/can be produced/exported by SMEs. Furthermore, Malawi has the natural endowment to produce most horticultural products in demand abroad even beyond Southern Africa, for example, mangoes, passion fruit, pineapples, asparagus, paprika and vanilla. There is also the potential to develop some forest-based products such as medicinal herbs, bees wax and honey. Opportunity also exists for Malawi to export live goats, particularly to Saudi Arabia where over 3 million of them are slaughtered annually during Muslim festivities (Thindwa 1996, pp. 13, 17). However, above opportunities can be exploited only when various constraints faced by SMEs are overcome.

**SME Constraints**

149. SMEs face both supply and demand constraints, some of which are shared with large enterprises. On the supply side, some major constraints include: lack of skills in export marketing, export procedures and related aspects; inadequacy or absence of credit facilities in general export finance, particularly in lack of appropriate technologies to produce goods of high quality; low productivity of production units, very small size of individual SMEs which limits their capacity to meet large export orders on a regular basis. On the demand side, a major constraint is: the lack of information in the export markets of Southern Africa, and elsewhere about the products Malawi can supply; likewise among exporters in general and SMEs in particular, there is lack of market information on the products consumers want, where, how much, when and on international price trends and other aspects of market behaviour (Thindwa 1996, pp16-19). Even if SMEs manage to get export orders, several additional constraints which raise transaction costs: high transport costs right from within the country and *en route* to the export destination, especially overseas markets outside the Southern African region. As a result it is not easy to offer internationally competitive export prices that at the same time ensure the viability of an enterprise. Compared to many other countries in the region, transport costs constitute a larger proportion of Malawi's foreign trade due to heavy reliance on road routes, which are at present in very poor condition. Added to this are the unreliable telephone and mail services, and unreliable power and water supply. All these adversely affect the speed and efficiency of doing business and therefore competitiveness. Many of the exportables, usually in raw form, need to have more value added to them in order to, *inter alia*, raise their value/weight ratio and cushion the high freight costs.

150. Lack of pre- and post-shipment export finance is another constraint. In the past government introduced one-off special export finance facilities with assistance from foreign donors and involvement of the Reserve Bank of Malawi, but their impact has fallen short of expectations because of stringent lending conditions. Further, export finance has hardly been forthcoming from commercial banks and non-bank lending institutions. This problem can be addressed by requiring one or two SME-support institutions to focus on export finance. An Export Development Finance Scheme was established to provide finance to SMEs with confirmed export orders; the funds were disbursed through Indebank, National Bank of Malawi, Commercial Bank of Malawi and Finance Corporation of Malawi. However, the impact of such financing facilities on SMEs has been limited due, *inter alia,* to stringent lending conditions.

151. Procurement of raw materials is also a problem as was shown by a 1995 Industrial Raw Materials Survey. Importing of materials and capital goods is expensive and particularly difficult owing to SMEs' failure to obtain scarce foreign exchange. Consequently SMEs are often forced to purchase these imported inputs from established large importers at highly inflated prices. Production and distribution costs are high due to heavy reliance on imported industrial inputs, costs of, which are high because of the surtax paid by most industries. This puts the Malawian exporter, small and large, in a non-competitive position in relation to many countries in the sub region (Zimbabwe) where this is not a common practice (MCCI 1998, 1999).

152. At present SMEs face an acute problem of limited access to appropriate technologies to enable them to produce goods of high quality for the export market. This arises from a number of factors such as inability to access information on available technologies, inability to select and assimilate technologies due to lack of management and labour skills and inadequate finance for technological modernization and productivity growth. Quality control and management are also poor, currently compounded by a decline in work ethic in the country. All these are reflected in low-quality products and poor packaging and labelling (MCCI, 1998).

153. The supply constraints discussed above may be overcome by establishing small producers cooperatives and production centres with common facilities, which would enable SMEs to pool resources and wield more bargaining power (Thindwa 1996, p.23). This would, *inter alia*, enable them to meet large export orders directly, or through subcontracting with large firms, which is at present not practised in Malawi even in the case of SMEs producing for the domestic market. In principle, experiences from other countries show that such subcontracting can offer to SMEs learning experience and training as well as modern marketing expertise and technology to enable them to enter export markets successfully.

154. While capital and foreign exchange for SMEs is scarce and expensive, the supply of unskilled and semi-skilled labour is abundant, which suggests an appropriate strategy at this stage would be to promote SME exports produced with labour-intensive techniques. It also seems sensible for SME exporters to concentrate on the Southern African sub regional market, since freight and business travel costs of trading within the sub region are generally lower and competition less keen. As chapter II noted scope exists for greater trade within the region.

**Institutional Support Facilities for SME Exports**

155. There are some ongoing initiatives to address the various constraints noted above. A leading institution in this connection is the Malawi Export Promotion Council (MEPC), a parastatal which promotes Malawi products in international markets through research, analysis, awareness, exposure, export training and other market support programmes. MEPC promotes SME export activities in several ways, some of which are: the provision of advice and information on prospective buyers, and various other aspects of trade through direct contact, as well as through its publications; conducting workshops on marketing techniques, export procedures, costing and pricing and arranging the participation of some SMEs in trade fairs abroad. It has a trade documentation centre/library which compiled a *Directory of Micro, Small and Medium Enterprises Products in Malawi* in collaboration with the Development of Malawian Enterprises Trust (DEMAT), which reduces the information gap between SME producers and buyers (MEPC 1999, p.3). In 1999 MEPC organized local buyer/seller meetings, which have also served as a training ground for SMEs participation in similar meetings in foreign markets. MEPC's activities themselves, however, face institutional constraints. Inadequate finance is the most critical problem, which, for example, is reflected in inadequate computer facilities. This is an area where international co-operation can be fruitful.

156. Most SME support institutions suffer from weak institutional capacity in terms of human, financial and material resources. Co-ordination of efforts for promoting SMEs is also poor among government ministries and departments as well as other SME support institutions. Due to lack of co-ordination, some laws have been introduced which constrain the development of SMEs. For example, trust deeds of some SME support institutions have not permitted them to lend to enterprises in which non-Malawians are partners, thus preventing the transfer of expertise and technology from non-Malawians. It is argued that this legal restriction protects the unsuspecting small local entrepreneurs from some unscrupulous foreign investors. But there is a cost in terms of foreign investment foregone. The Ministry of Commerce and Industry is the lead institution and must be recognized as such.

# 6. SOCIO-ECONOMIC IMPACT OF GLOBALIZATION

157. In this chapter we focus on the impact of liberalization/globalization on productivity and growth, poverty and employment.

## Productivity and Growth

158. Considering the economy as a whole, productivity in terms of value added per worker was lower in 1995 than in 1980. Among individual sectors, value added per worker was lower in manufacturing, construction, distribution, transport and communications, and in financial and professional services. But it was higher in estate agriculture, utilities, and in community, social and personal services.

159. Malawi experienced lower average rate of growth of real GDP during the SAP period (1981-98) than during the pre-SAP period (1971-80). The rate of growth of real GDP was also lower than the average target rate of 4.3 per cent during the 1981-86 sub-period (see Table 2.1). Continuation of the inappropriate development orientation of the previous decade was partly responsible for this outcome. Other contributory factors included: increasing control and regulation of the economy, exogenous shocks such as the adverse terms of trade and rising transport costs, a decline in the rate of gross domestic investment (see Table 2.1) and a decline in the rate of growth of exports.

160. During 1988-91, the annual rate of growth of real GDP averaged 5 per cent compared to the annual rate of growth of exports of 3.5 per cent. Favourable weather conditions, economic stability, an increase in public-sector savings and private investment, all contributed to this good performance. But this growth upswing was replaced by a serious setback during 1992-94 when the average rate of economic growth once again fell below the target rate of 4.5 per cent. This setback was caused by two droughts, a substantial decline in the terms of trade and a suspension of non-humanitarian aid for 18 months. Following good weather, restoration of non-humanitarian, an improvement in the terms of trade and the return of economic stability, the rate of economic growth shot up during 1995-97 but only to slip back since then.

161. Thus, liberalization and globalization alone cannot be blamed for the decline in economic growth especially as we noted in Chapter 4 that Malawi is a weak integrator into the global economy.

## Inflation and Poverty

162. Globalization and liberalization can impact on poverty and income through increases in domestic food prices relative to world prices after liberalization, increases in inflation rates which hurt the poor severely and through a fall in real wages. Small holder farmers produce the bulk food in Malawi. Small holder producer prices were eventually liberalized, thereby leading them to converge to international prices. Due to the various constraints faced by smallholders, largely attributable to inappropriate agricultural policies, the annual rate of growth of food production in the country has been slowing down between 1990 and 1993. In view of the rapid growth of population, the volume of food production per capita has actually dropped persistently over the same period (World Bank, 1996). In recent years, food production has also been adversely affected by droughts and floods, and the successive removal of fertilizer subsidies under SAPs, which further pushes up food prices.

167. Low-income groups suffer from food price increases since they spend the bulk of their incomes on food. This is particularly true in rural areas. In the composite national consumer price index (CPI) of all income groups, food costs are given a weight of 55.5 per cent (see Table 6.1). The food costs increased staggeringly during the 1990s. No doubt, increase in smallholder producer prices of food crops is of benefit to smallholders producing marketable surplus. But such smallholders with adequate land (1.5 hectares and above) was only about 24 per cent of all smallholder households in 1987-88. The proportion must have fallen further by now due to the intensifying pressure on arable land arising from rapid population growth. This means that the high increases in food prices have been impacting negatively on the wellbeing of over 75 per cent of smallholder households who have to rely, in varying degrees, on the market to cover shortfalls of food production on their inadequate land area. But even the real incomes of smallholders who produce surplus food for sale and cash crops were eroded up to the late 1980s, as is indicated by the deterioration in their commodity terms of trade index (Mkandawire 1999).

168. Over the years, the rate of inflation has considerably exceeded the rates of increase in nominal wages as well as revenues of smallholder farmers. Consequently real wage earnings have been falling. For example, between 1980 and 1994, real monthly average earnings of paid employees in all formal sectors fell cumulatively by 59 per cent. The fall was also 59 per cent for employees in the agricultural sector where average wages are the lowest, which reduced this sector's real average monthly earnings in 1994 to a miserable l7K compared to an average of about K18 for all sectors (Chipeta 1997, Table 3). Real minimum wages per day in Blantyre fell cumulatively by about 48 per cent in the ten years up to 1980 and by 27 per cent from 1982 to a level of K0.48 in 1992. During the same period, they fell by 19 per cent in rural areas to K0.38 per day. (World Bank, *1993*, cited in UNDP/ILO, 1997, p. 17). The erosion of real wages was worsened by the wage restraint policy which was exploited by employers in the absence of any active trade unionism during the one-party rule.

169. Owing to declining productivity and high rates of inflation noted above, real earnings of most people in paid or self-employed are lower now than they were before SAPs. In 1993, for example, the average wage could only buy less than half the amount of goods and services that it could buy in 1980.Two years later, in 1995, it could only buy less than one-quarter of the amount of goods and services that it could purchase in 1980. This trend has continued since 1995, with dire consequences for the standard of living of the workers and their families and for their morale, ability and willingness to work. Many supplement their incomes by engaging in informal sector activities and in subsistence farming, thus further putting pressure on land and other natural resources.

170. Poverty is an old problem but the highly inflationary environment of the post-reform period has made the poor in the country even poorer. New forms of urban poverty may have also grown as a result of civil servant retrenchments. The World Bank (1997 p. 18) estimated that in 1993, 43 per cent of the small holder population lived below a national basic needs poverty line corresponding to an annual per income of K151 (equivalent to US$34 at the 1993 exchange rate). An aggravating factor is that Malawi has one of the most unequal distribution of incomes in the world, with the Gini ratio having deteriorated from 0.45 in 1968 to 0.62 in 1995 when it was 0.57 among smallholders (World Bank,1997b, p. 17).

171. Major social indicators of poverty are also unfavourable: infant mortality rate is at 131 per 1000 live births for the mid 1990s, and life expectancy is low. Water and sanitary facilities are poor, with only 37 per cent of the population having access to safe water for drinking. Although it has improved from the 1964 level of 10 per cent, literacy rate is still low, which was estimated at 39 per cent in 1987 for the total population aged five years and above, with the rate for men at 48 per cent, and for women much lower at 29 per cent. Primary school enrolment ratio rose from 40 per cent in 1965 to over 50 per cent in 1985, and shot up to 83 per cent in 1995 due to the introduction of free primary education in that year (*Malawi Social Indicators Survey* 1995), but facilities in schools are poor and the quality of education low.

**Impact on Women**

172. As women are already in a relatively weaker position than men due to strong cultural factors, female-headed households are more vulnerable to the intensifying pressure on arable land, high inflation rates and other unfavourable economic developments including those arising from liberalization (leaving aside its favourable effects). In rural areas, 30 per cent of smallholder households are female-headed and they represent about 42 per cent of the core poor; these are smallholders cultivating less than 0.5 hectares and representing 26 per cent of the farming households. The female-headed households in rural areas can be sub-divided into: those divorced and/or widowed, those whose husbands are working elsewhere in Malawi, and those whose husbands are working as migrants in neighbouring countries (the number of migrant workers has, however, decreased considerably these days). The first two groups are among the poorest households. Many in the third group receive some additional income transferred by their husbands working abroad.

173. However, it should be noted that rural and urban women in general, play a crucial role in the

economy, doing about 70 per cent of the smallholder agricultural work. This is in addition to their other responsibilities such as child bearing and rearing, fuel and water collection and other domestic chores which reduce the amount of time available for farming and other income-generating activities (Kalemba, 1997).

**Employment**

174. Another factor accounting for poverty is the worsening employment and underemployment situation throughout the 1990s with the rapid growth of the labour force. At existing growth rates Malawi's population was expected to rise from an estimated 7.6 million in 1987 to approximately 10.2 million in 1995 and 12.0 million by the year 2000. These general population trends have had a strong influence on the growth of the labour force (i.e. population of between 15-64 years) which was projected to increase from 3.7 million in 1987 to 5.0 million in 1996 or by an average of 145,000 persons a year.

175. The effect of liberalization has been felt through civil service retrenchments. Retrenchments can occur in the private sector. Retrenchment of workers can occur in the private sector following liberalization and globalization, which increase international competition and thus force firms to rationalise/restructure in order to lower costs and improve efficiency through better resource allocation. They can also occur in the public sector following the implementation of SAPs, which lead to a reduction in public expenditures. However, in principle, employment can also rise because of the positive effects of economic reforms. What has been Malawi's experience?

176. Over 20,000 civil servants were retrenched in 1995-96, and over 3000 in 1997. While retrenchment helped restrain budget, it worsened the employment situation. According to the *Statement of Development Policies 1987-1996*, public-sector employment was not expected to increase by more than 2,000 a year, the main sources of growth being primary education and health services. Private sector wage employment might increase by between 15,000 and 35,000 a year, while non-agricultural informal sector, employment could rise by between 7,000 and 15,000 per year. That left between 95,000 and 120,000 new labour force entrants who could not be absorbed in any of the sectors mentioned above. To this must be added the number of workers who were retrenched due to restructuring, 25,000 in the civil service and over 6,000 in the private and parastatal sectors since 1993.

177. In the post-reform period cumulative growth of total employment slowed down considerably to only 23 per cent in the ten years to 1989 and 28 per cent in the six years up to 1995. The slowdown was again attributable mainly to the agricultural sector. As the estate sub sector could, expectedly not continue to grow at a rapid rate forever. With the general slowdown of the economy, the growth of employment in several other sectors also slowed down. The manufacturing sector registered growth

by only 41 per cent in the ten years up to 1989, and 45 per cent in the six years up to 1995. Specific major factors hitting manufacturing and other firms have been periodic bouts of severe foreign exchange shortages, increased cost of import inputs resulting from devaluations of the Kwacha, compounded by high indirect taxes, as well as the import of cheap consumer goods following liberalization. Consequently many firms have had to operate below capacity and some have had to even close down, thus resulting in loss of employment. Major reasons given by some private-sector firms which have retrenched workers include financial hardships, decline in demand, rationalization, restructuring, and problems related to strikes in the multi-party era. Retrenchment is also taking place in the official sector as a result of SAP policies of restructuring the civil service and privatization of state owned enterprises. All this naturally creates job insecurity among workers. The share of the private sector in total employment expanded significantly upto 1979. However, it generally hovered below 80 per cent in the 1980s and began to expand again in the first half of the 1990s to an average of 83 per cent (Table 6.2).

178. Wage employment in the formal sector is, however, no more that 15 per cent of the total labour force, which is estimated to have been growing annually at 3 per cent, well in excess of the average growth rate of the demand for labour. The majority (80 per cent) of the labour force are self-employed in smallholder household agriculture and in informal non-agricultural activities where there are varying levels of underemployment (UNDP/ILO, ibid). At present, the unemployment rate in the country is not yet clear (*Malawi Government*, 1999, p. 58).

**Female Employment**

179. In the pre-reform period, female employment in the formal sector proportionately grew much faster than total employment. As a result, the share of females increased by 3 percentage points, and rose by another 3 percentage points between 1979 and 1984 to a level of 14 per cent. However, in the reform period, the share contracted during the early part of the second half of the 1980s, and recovered to 14 per cent in 1989-90. The very low share of females should be viewed against much lower average literacy rate compared to males, and (which is the cause of the former) the strong cultural forces which impinge on their position in society. Data is not available to show whether or not the proportion of female employees being retrenched is higher or lower than of males. Apart from wage employment, females are engaged in intensive work on various family activities, which make a significant contribution to their households.

## Table 6.1 Consumer Price Indices

Indices of Blantyre Retail Prices
(Excluding rent)
(1970 = 100)

| | Low income index | | | High income index | | |
|---|---|---|---|---|---|---|
| Year | All items | Foodstuffs | Non-food items | All items | Foodstuffs | Non-food items |
| 1970 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1975 | 157.0 | 171.8 | 143.8 | 167.5 | 153.2 | 171.8 |
| 1980 | 243.9 | 269.9 | 220.0 | 352.2 | 245.5 | 384.6 |

**COMPOSITE NATIONAL CONSUMER PRICE INDICES**[1]

(1980 = 100 UP TO 1989. 1990 = 100 UP TO LATEST)

| | All items | Food Costs | Beverages and tobacco | Clothing and Footwear | Housing | Household operation | Transportation | Miscellaneous |
|---|---|---|---|---|---|---|---|---|
| | Overall Weight | | | | | | | |
| | 1000 | (555) | (27) | (117) | (96) | (84) | (65) | (56) |
| 1980 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1981 | 110.3 | 112.7 | 109.5 | 108.6 | 109.3 | 106.3 | 110.2 | 110.0 |
| 1982 | 120.1 | 120.5 | 119.3 | 118.1 | 118.9 | 118.3 | 121.3 | 123.2 |
| 1983 | 136.2 | 140.3 | 131.4 | 133.6 | 136.7 | 136.1 | 131.5 | 136.0 |
| 1984 | 151.2 | 154.4 | 139.8 | 156.4 | 155.7 | 149.6 | 136.5 | 146.0 |
| 1985 | 173.8 | 177.0 | 160.6 | 178.3 | 177.0 | 173.8 | 176.1 | 158.0 |
| 1986 | 199.5 | 206.9 | 180.7 | 194.5 | 194.3 | 190.7 | 219.1 | 172.0 |
| 1987 | 252.9 | 259.2 | 229.9 | 225.5 | 239.5 | 234.9 | 307.2 | 213.7 |
| 1988 | 332.2 | 344.5 | 303.4 | 304.9 | 322.4 | 287.4 | 400.5 | 272.4 |
| 1989 | 384.5 | 394.6 | 326.6 | 364.8 | 383.7 | 306.2 | 489.4 | 296.1 |
| 1990 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1991 | 108.2 | 108.4 | 106.5 | 104.8 | 114.1 | 104.4 | 112.1 | 105.9 |
| 1992 | 133.4 | 138.9 | 137.4 | 114.4 | 136.7 | 131.7 | 130.5 | 116.7 |
| 1993 | 163.8 | 175.6 | 180.1 | 126.2 | 159.0 | 158.4 | 149.1 | 149.9 |
| 1994 | 220.5 | 242.9 | 259.8 | 149.3 | 191.7 | 219.3 | 197.3 | 206.3 |
| 1995 | 404.2 | 468.6 | 463.6 | 231.9 | 326.4 | 385.2 | 336.5 | 337.1 |
| 1996 | 556.2 | 680.7 | 598.0 | 278.0 | 429.6 | 444.9 | 439.6 | 402.8 |
| 1997 | 607.1 | 736.8 | 701.2 | 296.6 | 480.9 | 504.2 | 486.6 | 435.1 |
| 1998 | 788.0 | 941.2 | 1178.3 | 333.7 | 607.2 | 751.3 | 671.4 | 530.9 |

1 The indices are weighted averages of the Composite Consumer Urban and Rural Price Indices for all income groups.

Source: Malawi Government, National Statistical Office, *Monthly Statistical Bulletin* (various issues).

**Table 6.2 Malawi: Employment Trends by Sex and Private Sector**

| | '000 | '000 | | % of | % of Private |
|---|---|---|---|---|---|
| Year | Total | Male | Female | Female | Sector |
| 1970 | 159 | 146 | 13 | 8 | 69.2 |
| 1974 | 227 | 203 | 24 | 11 | 70.7 |
| 1979 | 357 | 318 | 39 | 11 | 80.1 |
| 1984 | 384 | 329 | 55 | 14 | 79.2 |
| 1986 | 417 | 366 | 51 | 12 | 80.3 |
| 1987 | 412 | 361 | 51 | 12 | 77.7 |
| 1888 | 432 | 374 | 58 | 13 | 79.6 |
| 1989 | 440 | 378 | 62 | 14 | 80.0 |
| 1990 | 473 | 406 | 67 | 14 | 78.4 |
| 1991 | 559 | | | | 82.5 |
| 1992 | 546 | | | | 82.6 |
| 1993 | 583 | | | | 83.7 |
| 1994 | 563 | | | | 83.4 |
| 1995 | 564 | | | | 83.3 |
| | | | | | |

**Source**: Malawi Government, National Statistical Office, *Statistical Yearbook 1995*, *Monthly Statistical Bulletin* (various issues).

# 7. IMPACT OF GLOBALIZATION ON SUSTAINABLE DEVELOPMENT

180. The impact of globalization and liberalization on growth and productivity, poverty, women, non-income aspects of poverty and employment is analyzed in the last chapter. In this chapter, the impact of globalization and liberalization on environmental and human sustainability is examined. As indicated below, Malawi is facing serious environmental problems. The extent to which these problems are due to globalization (mainly via cash cropping) is not known exactly, as globalization is only one of the many contributory factors. The other factors include population pressure and illiteracy.

181. Before analyzing the impact of globalization and liberalization, the extent of environmental degradation needs to be examined. In view of the fact that environmental sustainability is closely linked to exploitation of natural resources in Malawi, focus should be on agriculture, forestry, and water. There has been significant environmental degradation over the past two decades in Malawi, which has coincided with the implementation of structural adjustment programmes.

## Extent of Environmental Degradation

182. Malawi has a total land area of about 9.4 million hectares. Out of this total, 4.6 million hectares, representing 49 per cent, were under cultivation in 1992. However, at the unimproved level of land management among small holder farmers, only 31 per cent of the total land area is suitable for cultivation. Hence, 18 per cent of the cultivation was taking place on marginal or environmentally fragile land like steep slopes, riverbanks and valleys. This situation is believed to have become worse since then. The extension of cultivation to marginal areas, unsatisfactory land use practices, lack of appropriate conservation measures, deforestation and overgrazing have led to a loss of agricultural land productivity, mainly through soil erosion and declining soil fertility.

183. In 1992, the World Bank estimated that soil erosion in Malawi ranged from 13 metric tonnes per hectare per year to 29 metric tonnes per hectare per year. This averages to 20 metric tonnes per hectare per year, contributing to mean yield loss of between 4 and 11 per cent per year equivalent to annual income losses per hectare of between MK10 and MK29. In aggregate terms, Malawi is on average losing a total of about 160 million tonnes of soil per year. The cost associated with soil erosion was estimated at MK1,155 million per year which corresponded to 8.1 per cent of the country's GDP in 1994. The figures do not go beyond 1994. All the same, this development is unsustainable and has serious implications for long-term land productivity.

184. About 37 per cent of the total land area (3.5 million hectares) is classified as forests. This is composed of 0.73 million hectares of forest reserves, 1.09 million hectares of national parks and wildlife reserves and 1.7 million hectares customary land forests. It has been estimated that aggregate consumption of fuel wood exceeds the level of sustainable yields by as much as 30 per cent. There is continuous loss of forest resources, especially on customary land due to clearing of forests in excess of natural forest regeneration and afforestation activities. The rate of deforestation has been estimated at 1.4 per cent per year due to dependence on agriculture, dependence on fuel wood, high rate of population growth and excessive selling of wood to generate income. Deforestation results in depletion of surface water resources and in problems of siltation/sedimentation, reduced base flows and recurring drought conditions.

185. Regarding water resource degradation, Malawi is facing three serious problems. Firstly, chemical contamination of stream water in urban areas were due to improper disposal of domestic and industrial wastes; and pollution by agro-chemicals through water run off due to absence of proper biological and physical conservation measures on farms in rural areas. Secondly, the poor bacteriological quality throughout the year of major rivers due to inadequate sanitation facilities, and the presence of other sources of organic pollution. As a result of this, it is estimated that 50 per cent of all illnesses in Malawi are caused by water borne diseases. Thirdly, depletion of surface water resources caused by deforestation leads to watershed loss, siltation/sedimentation, reduced base flows and recurring drought conditions.

## Effects of Globalization on the Environment

186. Globalization affects the environment through various sectors in Malawi; such as manufacturing, mining, tourism, transport and agriculture. The linkage between globalization on the one hand, and each of manufacturing, mining, transport and tourism on the other hand, is small because these sectors are relatively insignificant. However, the linkage between globalization and agriculture is large because the latter is the source of the livelihood of most of the people. This linkage creates pressures on land resources and this pressure is reflected in the production and consumption patterns of smallholder and large-scale (estate) farmers.

187. The environment is affected by globalization in a number of ways. The main channel through which this is done is a shift towards the production of tradeables, especially exports. The shift towards export crop production by smallholder farmers can cause more soil erosion, land degradation and forest depletion than food crops. In this case, the effects of liberalization will be adverse. The production of manufactured goods for export can have a similar effect not only on natural resources but also on air, causing pollution and hence adversely affecting the urban environment. In addition, liberalization can exacerbate environmental degradation by indirectly contributing to a bigger incidence of poverty through higher prices of foodstuffs and other goods. Liberalization can worsen the pattern of income distribution through changes in relative prices and in income distribution. The poor can exert pressure on natural resources as a survival strategy, while the rich can indulge in unregulated resource exploitation, leading to degradation.

188. Since 1981, agriculture has undergone a number of structural changes, which affected environmental sustainability in one way or another. As pointed out above, exports have grown less rapidly during the post-1981 reform period than before. Until the early 1990s tobacco increased its share in total domestic exports, implying increased production of this crop returns from which largely accrued to the rich estate owners. The increasing production of tobacco in turn implies rising deforestation as wood is used in drying burley tobacco and in curing flue-cured tobacco. The complete liberalization of burley tobacco growing in the early 1990s has reversed this trend. Between 175,000 and 200,000 smallholder households now grow burley tobacco. Whereas production on smallholder farms has increased, that on estates has fallen for the reasons noted above. The pressure on forest resources from the production of burley tobacco has thus diminished. So too the pressure from flue-cured tobacco because its production has declined on account of high input costs.

189. While there has been a relative and absolute decline in the production of tobacco, the production of other principal export crops, tea, sugar and coffee, has been stagnant. In contrast, the production of cotton and non-traditional crops such as paprika, chillies, other spices, soya beans, essential oils and minor industrial crops has increased. The expansion in the production of these crops has created new pressures on land and other natural resources.

190. There was a shift in the relative importance of different food crops as well. Maize has always been the main staple food crop and remains so to this day. Until the early 1990s, adoption rates for hybrid maize were high because of subsidies for fertilizer, seed and credit. Following the removal of fertilizer subsidies, the absence of free input programmes, and the alignment of maize prices between import and export parity, hybrid maize became less profitable since 1996-97. These factors contributed to an increase in the production of other food crops, notably, rice, groundnuts, sweet potatoes, beans and cassava. The introduction of a free input programme in 1998-99 may have reversed this trend.

**Human Sustainability**

191. Like other developing countries of Southern Africa, Malawi went through a development and employment crisis during the 1980s and 1990s. The rapid economic progress of the 1970s with recorded average annual GDP growth of well above 5 per cent dropped to 2.6 per cent in the period 1980-87 as the country experienced mounting economic and financial problems giving rise to growing open unemployment and underemployment. The indications are that the employment situation throughout the 1990s has been more difficult as the labour force has continued to grow rapidly. At existing growth rates Malawi's population was expected to rise from an estimated 7.6 million in 1987 to approximately 10.2 million in 1995 and 12.0 million by the year 2000. These general population trends have had a strong influence on the growth of the labour force (i.e. population of between 15-64 years) which was projected to increase from 3.7 million in 1987 to 5.0 million in 1996 or by an average of 145,000 persons a year.

192. Lack of rapid growth in wage employment in the sectors mentioned above implied that a larger proportion of new labour entrants was absorbed in smallholder agriculture or in unemployment. In turn, this has had a number of serious ramifications. Absorption in smallholder agriculture has resulted in further diminishing returns and degradation of the environment. This has occurred because, with rising population, new entrants into this sub-sector have tilled or grazed poorer and higher risk land, cut wood for sale or sub-divided land into still smaller pieces. The rise in unemployment has increased the incidence of poverty which has put further pressure on natural resources as the unemployed have tried to eke out a living. As noted above, for most of the people real earnings are lower now than they were before SAPs.

193. A change in the status of burley tobacco, from being a predominantly estate crop to a predominantly small holder crop indicates that the small holder farmers that cultivate this export crop are now vulnerable to fluctuations in the price of this product, the dynamics of trade preferences, and of course to adverse weather conditions. Those that grow chillies, paprika, soya beans and other non-traditional export crops have, similarly, become vulnerable to fluctuations in the international prices of these crops. Because reforms appear to favour these tradeable cash crops, smallholder and large-scale farmers who grow these crops benefit. The poorer smallholder farmers without much land concentrate on growing food crops. But they too are vulnerable to the effects of liberalizing of prices and marketing of the crops which they grow.

194. The effects of these developments on the environment are not known exactly. While some farmers have entered cash cropping on new land and may have encroached on marginal land, others have merely converted land on which they were previously growing food crops. But the use of either new land or old land can lead to degradation if the cultivation of these cash crops requires the use of fertilizer and other chemicals.

195. The number of poor people living in rural areas is in absolute terms greater than the number of poor people that lives in urban areas. Proportionately, the rural areas have fewer poor people than urban areas. The structural change in smallholder agriculture towards cultivating cash crops combined with population increase has led to reduced access of the poor to productive land and other assets. Other groups of the rural poor include rural wage earners and tenant farmers, which are both dependent on the natural resource base.

196. The health status of the population has generally come under strain. Whereas the infant mortality rate declined from 169 per thousand in 1980 to 132 per thousand in 1995, the child mortality rate declined from 299 per thousand in 1980 to 240 per thousand in 1992, and life expectancy at birth decreased from 44 in 1980 to 40 in 1997. At present it is below that number. This trend is due to rising morbidity and mortality in the general population, caused by infectious diseases. Particularly worrying developments are the high HIV seroprevalence and the large number of deaths due to HIV/AIDS related diseases.

197. The worsening health status has resulted in a decline in the amount of time allocated to work, a rise in absenteeism, low income, low savings and investment and high health costs. HIV/AIDS alone is said to be adversely affecting GDP by one half of a per cent per year. Real increases in the health budget have not achieved much to arrest the trend. The recently completed National Health Plan aims at rationalising policies, plans, resources and practices with a view to raising the health status of all Malawians.

198. The educational attainment of the population has also come under strain. This has occurred despite an improvement in access to educational facilities at all levels. Particularly at the primary school level, where enrolment has increased from less than 50 per cent of the children aged 6-13 in the early 1990s, to nearly 85 per cent at present, and where the gender gap has more or less been closed. The educational system has become so ineffective and inefficient, that the quality of education has been compromised at all levels. For example, only 40 per cent of the pupils who start Standard One complete Standard Four. By the time they reach Standard Eight, 62.6 per cent have repeated at least once, and only 23 per cent of the pupils who enrol in Standard One continue to successfully complete Standard Eight. As another example, the pass rate at the Malawi School Certificate of Education Examinations has been declining steadily in recent years, reaching a low of 13 per cent in 1999.

199. Although the literacy rate has increased, this is of little consequence in the face of the overall decline in the quality of education. Low educational attainment has contributed to a decrease in productivity in the economy, high fertility rates and a worsening in the nutrition and health status of the population. Besides this, the lack of technical and business education, and low quality of education implies that the youth are ill prepared for paid and self-employment.

# 8. POLICY OPTIONS AND RECOMMENDATIONS

200. To summarize the conclusion of this study, the impact of economic reforms on the economy, in general, and on sustainable human development, in particular, an evaluation of the policy reforms in different spheres, should be examined, paying special attention to their depth and coherence. Measures should be taken for improving the policy reforms, sequencing the process of global integration, enhancing international competitiveness, promoting greater consistency between policies, the development and utilization of human resources, and strengthening the institutional capacity for the implementation of policy reforms.

**Impact of Policy Reforms on Sustainable Human Development**

201. The impact of economic reforms on sustainable human development has generally been unfavourable. As noted above, the long-term rate of growth of GDP has been lower during the reform period than during the pre-reform period. The lower rate of long-term economic growth implies that the incidence of poverty has increased. Compared to the pre-reform period, inequality in the distribution of income has worsened, and it remains one of the highest in the world.

202. Due to the abolition of fees recently, primary and secondary school enrolment has increased. This has been accompanied by a marked increase in budgetary allocation to these sectors of education, which has resulted in the literacy rate having risen sharply, although the quality of education at all levels has fallen. There has also been a marked increase in budgetary allocation to health. However, the health status of the nation continues to decline due to the HIV/AIDS pandemic.

203. On the whole, human development in Malawi is not sustainable for a number of reasons. The first is that economic growth in the short run is achieved by reducing environmental capital. To the extent that the reduction in environmental capital tends to reduce the future rate of economic growth, long-term economic growth is not sustainable. This fact is not revealed in national income measures because such measures do not take into account environmental degradation which they should.

204. The second is that economic growth is undermining human capital. One aspect of this is that the rate of economic growth is not high enough to prevent the number of poor people from rising. Since poor people are not able to invest enough in the education and health of their families, the growth of human capital, upon which future economic growth depends, is seriously compromised. Another aspect is that in the face of high rates of inflation and declining productivity, low rates of economic growth have failed to prevent real incomes of workers from falling. This has led to a reduction in their standard of living and in their morale, ability and willingness to work. Related to this aspect is the fact that the fall in real earnings has led to an exodus of high-level or skilled manpower from Malawi to other countries and within Malawi from the public sector to private and NGO sectors.

205. The third reason for the unsustainability of human development is growing macroeconomic disequilibrium. Externally, the current account and foreign debt are worse now than twenty years ago. Foreign reserves are better. The exchange rate is unstable. Internally, the budget deficit is higher than twenty years ago. As are unemployment, underemployment, inflation and nominal interest rates. What is the impact of low macroeconomic sustainability? With an open economy and a market determined exchange rate, internal disequilibrium causes external disequilibrium. Budget deficits, in part caused by delays in disbursement of anticipated foreign aid, and deficit financing spark inflation, which leads to exchange rate depreciation. With high import dependence of domestic production and consumption, this leads to more inflation. The redistribution effects of this drives more people below the poverty datum line. Inflation also reduces savings and investment. At the same time, the domestic financing of the budget deficit pushes up interest rates, which reduce borrowing and investment. The higher level of interest rate payments by government makes it difficult to reduce the budget deficit, while the level of domestic debt burden complicates government financing.

## Policy Options

### *General Considerations*

206. The review of SAPs has revealed that the formulation of structural adjustment policies is undertaken in the context of a methodology that yield answers to policy problems, distinguishing clearly between policy objectives and policy instruments. The methodology relies on models of the economy, which are supposed to reflect both the structure and behaviour of key agents. Most SAP policies aim at improving economic efficiency through the liberalization of markets, changes in the structure of the economy or through institutional reforms. Wherever possible, policy objectives are translated into concrete goals or measurable targets. In order to achieve these policy targets, use is made of intervention techniques known as policy instruments. While in order to put policy instruments into effect, government implements policy measures.

207. A review of Malawi's SAP policies has led us to the conclusion that policy-making has satisfied at least one requisite technical criterion, that is, in each programme there must be as many policy instruments as there are policy targets at the very least. In mathematical terms, there must, in other words, be as many equations as there are unknowns for a unique solution to be found. While this criterion is a must for mathematical models to yield unique solutions, in practice, it is neither a necessary nor a sufficient condition. It is not a necessary condition because some policy targets may be realized automatically or as a by-product of the realisation of other targets. And it is not a sufficient condition because some policy targets may be out of reach under any circumstances, and other policy targets, while attainable, may be incompatible with each other.

208. In some respects, SAP policy formulation has not satisfied two other technical criteria. One of these is that policy objectives or targets must be compatible or consistent. If policy objectives or targets are inconsistent, it is difficult to achieve them with given policy instruments. We shall illustrate this point by pointing out a few examples. First, the objective to reduce poverty is inconsistent with a target rate of growth of GDP of 4.5 per cent. Secondly, the objective pursued under SAL I to III to strengthen government's planning, monitoring and policy-making capacity is not quite consistent with the objectives to promote and diversify exports, encourage efficient import substitution and improve the performance of development institutions. The reason being that the latter objectives need ed strengthening of capacity in formulating, implementing, monitoring and evaluating SAPs, whereas what happened under the former, which was unnecessary, is that capacity was strengthened in the same old fields of macro and sectoral planning, public debt monitoring and management, formulation of a medium-term strategy, and in project identification, monitoring and evaluation. In other words, the former objective emphasized the acquisition of skills, which were not critical for the success of SAPs.

209. The other criterion, which has not been fully satisfied is that policies must be co-ordinated in order to maximize the values of the policy targets. The need for co-ordination arises from the fact that all policy instruments affect all policy targets, positively or negatively. Co-ordination can ensure minimization of negative impacts, while maximizing their positive impacts. Again, a few examples will do. First, decontrol of prices, which aimed at improving efficiency, has been price destabilizing because mechanisms for regulating market power under imperfect competition were not in place. Secondly, liberalization of prices and markets under SAPs, formulated by the World Bank, has not had maximum impact because it was not coordinated with the complementary development of the real sectors of the economy which was done by government under the Public Sector Investment Programme (PSIP).

210. Apart from technical defects, SAPs have also suffered from delays in implementation. Three examples readily come to mind: delays in the reduction and eventual elimination of fertilizer subsidies; delays in divesture of ADMARC's investments that are unrelated to its marketing function; and delays in reforming the civil service. We would not like to doubt government commitment to economic reforms and insinuate that its main aim is to obtain resources for the budget and balance of payments and to obtain approval for debt relief. Delays have reflected genuine concern about the adverse impact of some of the reforms, especially on vulnerable groups.

*Trade, Investment and Finance*

211. The trade and investment indicators suggest that Malawi is in the process of being marginalized rather than integrated into the world economy. This is happening despite having liberalized the foreign sector and implemented relevant economic policies. How deep and appropriate were policy reforms in the areas of trade, investment and finance? How coherent were these policies?

212. The export promotion strategy adopted under SAL III does not seem to have diversified exports or raised the ratio of exports to GDP. The export financing facility established under the same SAP was also inadequate as evidenced by the unsatisfied demand for export finance in the country. The establishment of a specialized export financing institution may be a better way of dealing with this problem. Periodic adjustments in the exchange rate have failed to sustain its competitiveness in the medium-term and long-term because of subsequent increases in domestic prices triggered by the very exchange rate adjustments. This casts doubt on the appropriateness of currency devaluation as a policy tool for expanding and diversifying exports.

213. Trade liberalization measures - freeing imports from the Reserve Bank's approval for foreign exchange allocation, elimination of restrictions on payments for current payments and transfers, reduction in the scope for export licensing and in import duties - have had more success. Following the implementation of these measures, the rate of growth of both exports and imports has increased. However, whereas imports as percentage of GDP have increased, exports as percentage of GDP have not. The problem may not be with the above measures, which are fairly deep, but with weak trade development, trade facilitation and trade promotion policies.

214. A narrow export base, largely of a few agricultural products, and uncompetitiveness of exports are hallmarks of Malawi's trade predicament. The challenge is how to improve competitiveness of exports in the light of declining productivity, high cost of importing inputs and exporting products, high internal transport costs, unreliable utilities and communications and a high rate of theft and other crimes.

215. As a result of unilateral reduction in tariff barriers carried out by several countries under SAPs and reduction of the same through bilateral trade agreements and COMESA, Malawi's exports face fewer tariff barriers in the region. Outside of this region, the Lomé Convention, GSP and WTO are all facilitating Malawi's access to the world market. The problem, however, is that non-tariff barriers (NTBs) are more important than tariff barriers, at least with respect to regional trade. Yet more emphasis is placed on reducing tariff barriers. SADC has identified quotas (most already removed under SAPs), surcharges on imports, customs procedures and export subsidies as core NTBs, which must be eliminated. This list contains NTBs on which action can be taken as soon as possible. It is essential that agreement on eliminating them should be reached before the Trade Protocol comes into force. But it does exclude other important NTBs, which also require urgent attention. These include transport and communication problems, lack of market information, border procedures, domestic content requirements, levies, other border charges, customs charges, trade finance, import/export licensing requirements, and lack of dispute settlement mechanisms. Then there are other NTBs, which are instituted from time to time in particular countries. Malawi should be on the alert and deal with these through multilateral channels.

216. In international trade negotiations, Malawi's participation is handicapped by the lack of technical (especially legal) personnel. Lack of funds means that attendance at international trade fora is not assured. Like trade facilitation, trade promotion is also constrained by the lack of adequate technical personnel and other resources at the Malawi Export Promotion Council (MEPC) and at diplomatic missions abroad. Yet it is essential that both MEPC and diplomatic missions should effectively disseminate trade information and that MEPC should assist in improving the marketing of Malawi's products.

217. The sequencing of foreign trade liberalization was not entirely optimal. To the extent that it followed the liberalization of the goods market, it was optimal. But to the extent that it did not follow financial market and factor market liberalization, it was not.

218. Inflows of foreign direct investment, portfolio investment and short-term capital have not increased significantly over the years. Despite liberalization, restrictions remain on inflows of portfolio capital relating to shareholding by an individual and the channel through which such investment must be made. Both of these restrictions must be reviewed. There are virtually no restrictions on inflows of foreign direct investment and of short-term capital. Inadequacy of capital inflows is therefore due to other factors that are also discouraging domestic investment, such as unsatisfactory infrastructure, crime, inflation, corruption, tax regulation and policy instability.

219. Like the sequencing of trade liberalization, the sequencing of the capital account was not optimal. Instead of the whole capital account being liberalized last, certain aspects of this account were liberalized even before SAPs. These are the inward transfers of non-debt creating capital and the repatriation of the same, and inflows of portfolio investment.

220. In the domestic financial sector, liberalization has increased the number of bank and non-bank financial institutions and freed interest rate determination and credit allocation from official control. However, there has been an insignificant increase in competition, in new products and in the quality of financial services. In relation to GDP, neither deposits nor credit have increased. Export financing and mortgage and savings banking services remain inadequate. Key policy issues include how to increase the number of players, especially, but not only, in savings and mortgage banking; to establish a specialized export finance company; to increase lending to SMEs, and to foster more interaction among various financial institutions and sectors.

*Real Domestic Sectors*

221. Policy reforms in smallholder agriculture have been neither deep nor consistent. Smallholder producer prices have been adjusted annually, but the incentive effect of this has been offset by high rates of inflation. The process of reducing fertilizer subsidies has been protracted, sometimes halted, and only recently have subsidies been completely removed. The Agricultural Development and Marketing Corporation is still playing a significant role in the marketing of smallholder agricultural inputs and output. Rural-urban terms of trade have not shifted in favour of agriculture due to high rates of inflation. The reduction in the implicit tax on agriculture has not been sustained because currency depreciation has bred inflation, which has caused subsequent appreciation of the real effective exchange rate. Smallholder agriculture has also been handicapped by an inadequate and underdeveloped road network, which has constrained access to markets and increased internal transport costs.

222. The basic problem with smallholder agriculture can be summed up as inadequate returns mainly caused by high transport costs and high margins of official and non-official middlemen who market both inputs and output. Under these circumstances, the development of smallholder agriculture requires extending and improving the maintenance of the road network to connect different rural areas and rural and urban areas, controlling the cost of motorized transport inputs and increasing/strengthening direct access of farmers to markets. Improvement in internal terms of trade through a reduction in the rate of inflation would also help to restore incentives. So would a reduction in the implicit tax on agriculture that would occur by avoiding overvaluation of the real effective exchange rate. If smallholder farmers perceive that returns are adequate, they will innovate, take up credit and seek advise from extension officers. But demand should be matched by improved delivery of inputs, research and credit, combined with appropriate price policies and dissemination of agro-forestry techniques to increase smallholder agricultural productivity.

223. One major weakness of Malawi's agriculture is that it occurs almost completely on rain-fed land. There is comparatively less use of irrigation. Yet for the unfavourable land-man ratio to induce intensive land use, better land infrastructure, including irrigation, is essential. The need to increase the amount of agriculture under irrigation is as urgent as ever.

224. Another is dependance on maize as the staple food crop. In terms of land and other input requirements, the cost of production is high. Besides, the volume of output fluctuates with changes in weather. During drought, output can fall significantly, undermining food security in the process. A key policy question is whether maize should continue to be promoted or whether consumer tastes should be changed in favour of alternative staple food crops that are drought-resistant and less sensitive to the amount of precipitation.

225. With reference to the manufacturing sector, the objective to promote efficient import substitution was not achieved, as we have pointed out already. Most of the price controls which were retained and which bred inefficiency have now been removed. The other cause of inefficiency is dominance of the sector by monopolies and oligopolies. This is difficult to avoid in view of the small size of the domestic market. The question is whether abuse of market power can be controlled. A law on competition has been legislated, but it is not yet operational. It is important that arrangements for operationalizing this law should be completed as soon as possible, even though it does not address international competitiveness.

226. Since efficient import substitution was not achieved, several manufacturing industries are failing to compete with imported products after removal of price controls and import liberalization. Restructuring and export-orientation have assisted some industries to restore their competitiveness, sometimes after receiving special assistance. There are others that may benefit from similar initiation. A survey to determine which industries can benefit should be carried out. The same survey should identify activities with difficult learning processes that may need protection and those infant industries that may require assistance.

227. Industrial development depends on the use of new or improved technologies by enterprises. This is not easy as access to technology requires effort, there are learning costs to contend with and technology must be adapted. Often technology information is lacking. Sometimes an enterprise cannot access technology unless investment is coordinated and undertaken across several activities. All this implies that wide ranges of technological support services are required. The Malawi Bureau of Standards and the Malawi Industrial Research and Technology Development Centre are the main organizations in this field at present. Their outreach is constrained by limited capacity. Yet technological development is important for improving the export competitiveness of all enterprises, including SMEs.

228. The sequencing of the reform of the agricultural and manufacturing sectors, which are essentially goods markets, was not optimal. The reform of the manufacturing sector, which should have followed that of the agricultural sector was done first. Both sectors should have been reformed after the reform of the financial sector and the factor market. Instead, only the agricultural sector was reformed after the reform of the financial sector. The manufacturing sector was reformed at the same time as the financial sector. While the factor market was not reformed until both the manufacturing and agricultural sectors had been reformed.

229. Both the agricultural and manufacturing sectors have few linkages with other sectors of the

economy. The major market for non-food cash crops is foreign. Fertilizers and other chemical inputs are also sourced from abroad. Most of the manufactured output is sold in the domestic market, but the bulk of capital goods, intermediate products and raw materials used in manufacturing is purchased abroad. Inadequate backward and forward linkages are severely limiting multiplier and accelerator effects and overall development of the economy.

230. The strains and stresses in the agricultural and manufacturing sectors contrast sharply with the rapid growth in the service sectors, namely, distribution, tourism, restaurants and social services. These sectors owe their growth to trade liberalization, removal of restrictions on domestic economic activity, deterioration of services provided by the government and downward adjustments in the exchange rate, among other factors. With the exception of tourism these sectors do not produce tradable goods. But because they provide alternative sources of income and employment opportunities they should be exploited further through quantitative and qualitative improvements.

## Policy Recommendations

### *Macroeoconomic Management and Competitiveness*

#### *Sequencing the Process of Global Integration*

231. Once macroeconomic stability has been attained, the consensus view is that domestic financial markets should be liberalized first, followed by liberalization of factor (including labour) markets, goods markets, foreign trade and capital markets, in that order of precedence. Financial markets should be liberalized first so that, through relaxation of interest rate and credit controls, they can mobilize more resources required for efficient allocation in the goods markets and foreign trade sectors which will demand more credit after their own liberalization. Secondly, the liberalization of factor markets will also benefit to the extent that retrenched workers will find it easier to obtain credit for starting small-scale or medium-scale business enterprises. Thirdly, by leading to an increase in interest rates, financial market liberalization should help to prevent foreign capital flight which would occur in the absence of incentives to remain in the country.

232. The liberalization of factor markets before goods markets and foreign trade is premised on the need to increase mobility of factors of production which is expected to promote efficient allocation of resources once those other sectors are liberalized. Between goods markets and foreign trade, it is recommended that the former should be liberalized first so that the gains will not be captured by foreign exporters, importers and investors (Toye, 1999).

233. With respect to core areas, the sequencing of Malawi's structural adjustment programmes (SAPs) has not been optimal. Capital markets were actually liberalized before the beginning of the SAPs. During the era of SAPs itself, goods markets were liberalized first, followed by foreign trade, financial markets and factor markets in that order of precedence. This ordering has not been ideal and may have adversely affected the welfare gains from the SAPs. However, to the extent that measures in most areas were implemented simultaneously, the adverse impact of inadvertent sequencing of core areas was mitigated. It must be noted, in any case, that the welfare gains from SAPs can be more adversely affected by other factors, such as inappropriate policies and unfavourable exogenous developments, than by sub-optimal sequencing.

234. The financial-sector reform programme started before Malawi had attained a sustained reduction in the budget deficit and after the reform of the real sector of the economy had begun. Hence, sequencing was not optimal. The sequencing of the liberalization of interest rates was also not optimal as it preceded the removal of barriers to entry. Liberalization of interest rates started in 1987 when commercial banks were given a say in the setting of the prime overdraft rate, although it must be noted that upward adjustment of nominal interest rates started much earlier. In 1988, NBFIs were also given power to determine their own deposit interest rates. Then, in 1990, all deposit and lending interest rates were fully liberalized, with appropriate signals for variations to be given by changes in the Bank Rate, wherever necessary. Removal of barriers to entry started in the early 1990s after the passing of a new Banking Act and a new Reserve Bank of Malawi Act in 1989. The Banking Act defined liberal conditions under which financial institutions could be set up.

235. As economic reforms have not been very successful, and because there is room for further adjustment in all areas, it is recommended that the sequencing of reforms should be optimized. This means that macroeconomic stability should be attained first before putting more emphasis on the development of financial, factor and goods markets as well as foreign trade and capital markets.

*Macroeconomic Stability*

236. Malawi's major objectives/conditions of macroeconomic stability have included a sustainable balance of payments position, stable competitive exchange rates, low positive real rates of interest, and low stable inflation rates. These objectives have not yet been achieved; yet macroeconomic stability is an essential precondition for poverty reduction, attraction of capital flows and global integration. Stable exchange rate was one of the objectives/conditions of macroeconomic stability. The improvement in the foreign exchange position during the 12-year period up to 1998, however, was not due to any balance of payments fundamentals but rather due to a combination of balance of payments financial support from the IMF, the World Bank and bilateral donors and stabilization policy measures.

Some of the policy measures were applied even long before the start of the stabilization and SAP measures. The policy question therefore is whether the floating regime would be sustainable in the absence of such support in the long run, given the narrow, undiversified and unstable export base. Also of concern is whether adequate institutional arrangements exist in the country to promote strong competition under which financial markets can effectively determine exchange rates.

237. Among other things low budget deficits can be attained by improving tax compliance and reducing tax evasion, and by improving transparency and accountability in the management of the budget. Price stability can be achieved by avoiding money creation and low and positive rates of interest can be attained by reducing the liquidity reserve ratio and by selling Treasury Bills other than through auctions. Generally, macroeconomic stability requires improvement in the management of the economy. The essential prerequisites are:

- Genuine commitment to prudent economic management on the part of all politicians and civil servants who should take it as their responsibility to restrain others.
- Manning of key ministries and posts with political and bureaucratic cadres that are trained in the relevant fields.
- Insulation of policy making from pressure from special interest groups.
- Development of an honest, highly motivated and capable public service - sustained by merit-based recruitment and promotion, competitive real earnings and other rewards to those who do well.
- Adequate representation of all ministries and other relevant public-sector institutions in economic policy decision-making bodies.
- Establishment of joint councils, one for each sector of the economy, for overall consultation and exchange of information and views. Membership on these councils should represent government, estate agriculture, smallholder agriculture, the business community, labour, consumers, the church, etc.
- Legal and other steps to ensure that only independent commission are responsible for recruitment and promotion in the public sector. The Constitution should not give discretion to politicians to decide whom they can appoint.
- Implementation of flexible and swift responses to economic instability and other economic problems.
- Willingness to change economic strategies and policies that are not helpful to the majority of the people of the country.
- Improvement in the allocation of human, financial and other resources in the public sector.
- Stern punishment to those who break the Finance and Audit Act, financial orders and instructions.
- Adherence to the principle that the Executive Branch cannot impose taxation or vary the budget without the authority of the Parliament.
- Frequent assessments of the impact of government expenditure.

238. In March 2000, the new Minister of Finance presented a 10-Point Plan designed to improve control over public expenditure. Measures included in the Plan are a restatement of the ones being implemented under the Fiscal Restructuring and Deregulation Programme. Hence there is nothing new in the Plan.

*Promoting Greater Policy Consistency*

239. As we have pointed out above, a rate of growth of real GDP of 6 per cent per annum is required to reduce the incidence of poverty in Malawi. This means that the target rate of growth of GDP should exceed the existing figure of 4.5 per cent. A higher rate of economic growth will also be consistent with more rapid creation of employment and a faster increase in per capita income and in the standard of living.

240. In attempting to increase the planned rate of economic growth, Malawi will face the following constraints which should be reduced:

- capital constraint by adopting appropriate measures to increase the rate of domestic savings;
- foreign exchange constraint by attracting more foreign capital inflows;
- skilled manpower constraint by training and retaining more trained manpower;
- government budget constraint by improving productivity of the tax system and introducing VAT and other taxes; and
- environmental constraint by adopting environmentally friendly technologies and effective implementation of plans for protecting the environment.

241. A higher rate of economic growth need not be inconsistent with price stability, low and stable interest rates and a stable but competitive exchange rate. In order to achieve consistency between a high rate of economic growth and macroeconomic stability, there is a need for greater fiscal discipline. In this regard, centralising all decisions on expenditure in the Ministry of Finance might help.

242. Greater consistency is also required between the quest for food security and a high rate of economic growth. The latter requires that the country should be reasonably food secure to minimise the need to divert resources to food import expenditure away from other development pursuits. At present, this is not the case, in part because of dependence on maize which is not drought resistant and which is costly to produce. The long term outlook for food security is not favourable either, unless a programme to popularise food crops that are drought-resistant and less dependent on chemical fertilizers is mounted and succeeds.

243. Consistency between macroeconomic and microeconomic policies requires co-ordinated formulation and implementation of structural adjustment policies, stabilisation policies, the public sector investment programme and Vision 2020. At present, two leading external institutions are involved. The World Bank takes a leading role in respect of SAPs. The International Monetary Fund takes a leading role in respect of stabilisation policies. The roles of these two institutions are not perfectly synchronised. As a result, long-term development objectives are compromised. What a developing country like Malawi needs is not an IMF but a World Bank that will pursue stabilization objectives without compromising long-term development.

244. Internally, the situation is not better. The National Economic Council is responsible for formulating the public sector investment programme and Vision 2020. The Ministry of Finance plays a leading role in structural adjustment programmes and the Reserve Bank in stabilization programmes. Outside these institutions there are other ministries and committees involved in economic policy making. Co-ordination among all these institutions is less than perfect. We recommend that a single institution should have overall responsibility for the various programmes to facilitate promotion of greater Such an institutional arrangement should facilitate promotion of greater consistency between macro and micro policies, and between policy reforms in trade, investment and finance. Before a decision is taken, a national forum should be convened to review the mandates of the various structures, and to propose an alternative single arrangement on the basis of a background paper.

**Enhancing International Competitiveness and Investment Climate**

245. As noted in Chapter 5 and elsewhere in this study, Malawi exporters, particularly the SMEs, are not competitive abroad because of several constraints such as high transport costs, low productivity and high costs of inputs. International competitiveness can be promoted by removing these constraints

*Reducing Transport Costs*

246. High transport costs are recognized as one of the major factors that make Malawi's goods uncompetitive in domestic and international markets. For this reason, it is necessary to increase efficiency and competition and hence lower the high costs of transport. In this connection, there is a need to renew the taxation of imported motor vehicles and fuel; improve management of importation of fuel into the country; encourage the use of least cost modes or combination of modes of transport; improve the maintenance of roads; upgrade earth roads to gravel standard; and to construct more roads in rural areas.

*Improving Utilities and Communications*

247. In order to improve telecommunications, which are essential for domestic and international trade, it is necessary to break up the monopoly of the statutory body and so promote competition as a means of increasing efficiency. The internet end of the sector is also monopolised, not by a statutory body, but by a private company. To keep competitors away, licence fees are kept very high. These must be brought down to encourage entry by competitors into the industry.

248. There is operational inefficiency in electricity generation and distribution as well, resulting in frequent blackouts. Silting is the cause of failure in electricity generation, while inadequate maintenance of the system is the cause of failures in distribution. On the demand side, most enterprises face high installation costs. This is one of the reasons why there is inadequate access to electricity. Private participation in the provision of electricity might be one way of increasing efficiency. For example, electricity distribution could be privatised while the existing state/owned enterprise retains responsibility for its generation.

249. Urban water supply is inadequate for industries that require vast amounts of water. Like electricity supplies, water supplies tend to be unreliable as well. Conscious of the adverse effects of these problems, government has decentralised the tapping and distribution of water by establishing commercially oriented regional water boards. It is too early to assess the impact of these boards, but it is hoped that eventually they will be able to meet the growing demand for water.

*Improving Industrial Facilities*

250. The establishment of Maone Industrial Park is the most notable recent development. Otherwise, industrial facilities in the form of industrial parks and estates and factory shells are inadequate. And so are warehousing and cold storage facilities at international airports for the export of horticultural products. Private sector collaboration in providing these facilities might be one effective way of increasing capacity. Industrial estates need to be set up in many parts of the country. In cities with land shortage, city boundaries can be extended outwards to accommodate such estates. At industrial estates for SMEs, common facilities should include, computers and other IT facilities to promote access of SMEs to market information. Old SMEs should graduate out of the estates to give room to new ones.

251. High cost of inputs can be controlled by reducing taxation of all imported inputs, replacing existing taxation with VAT and other types of taxes, controlling domestic inflation which is pushing up prices of domestically produced inputs; and by addressing problems of transport, utilities, communications and security, along the lines put down above.

252. Productivity can be raised by increasing capacity utilization; improving motivation, organisation and supervision of labour; instituting payment by result or by hours worked; improving welfare of workers both at places of work and at home; and merit-based recruitment, promotion and reward of workers in all sectors of the economy.

253. Increased credit to the private sector can be ensured through increasing competition in the financial sector by licensing more banks and NBFIs; establishing a specialized export financing company; improving the capacity of microfinance institutions to deliver loans; and promoting credit risk-sharing schemes (e.g. loan insurance schemes) to be run by private firms.

*Surveying Export Competitiveness of SMEs*

254. A survey should be carried out to investigate export competitiveness of Malawi's SMEs and to identify products with export potential. This study has suggested a number of products with such potential (see Chapter 5), namely, horticultural products and forest-based products such as medicinal herbs. Their export potential needs to be studied in detail.

**Attracting Foreign Investment**

255. We noted above that Malawi has not been attracting much capital inflows despite liberalization. Yet such inflows can benefit enterprises, both large and small, through funds, modern technology and management practices. With the introduction of SADC Protocol on Finance and Investment, such liberalization within the region should become much easier. But an essential precondition for attracting FDI is to ensure macroeconomic stability by controlling high inflation. As indicated in the competitiveness index and observed in the movements of the exchange rate, credibility of policies and incentives play an important role. Therefore, remaining restrictions on capital inflows noted above need to be reviewed.

256. Furthermore, liberalization of FDI in least developed countries like Malawi needs to be *selective* as it can hinder the development of domestic enterprises. Indiscriminatory inflows can adversely affect learning and growth by local firms especially small ones in competing activities in the product market. Secondly, FDI can also have adverse effect in the financial markets by reducing access or raising costs for local SMEs. The former can be overcome by active fostering of learning by domestic firms through government action. It can also be fostered through appropriate linkages between foreign and domestic enterprises. Strong linkages between foreign enterprises and local suppliers, subcontractors and institutions need to be encouraged. It is therefore necessary to create a more competitive and dynamic financial sector in order to mobilize both domestic and international resources to finance investment.

## Promoting Regional Trade

257. We noted above that Malawi suffers from an undiversified production structure and a low export base. Without a serious effort to diversify the export base by aiming at high value-added export products, the prospect for an improved export performance is limited. We also noted that tariff rates in Malawi are one of the lowest in the region. This suggests that further trade liberalization through lowering of tariffs is unlikely to stimulate exports very much. Instead efforts need to be devoted to reducing non-tariff barriers in order to expand exports within the Southern African region. For a least-developed country like Malawi greater regional integration is a stepping stone to broader integration into the global economy. It is generally argued that intra-regional trade is limited because of similar production structures. There are some complementarities between production structures of Malawi and those of the neighbouring countries, particularly South Africa and Zimbabwe within SADC. We believe that greater scope for expanding exports exists through a strategic diversification of the export base.

258. Malawi promotes its trade through participation at local and international trade fairs; through trade attachés at its embassies and high commissions and through buyer/seller meetings. Through these channels, the Malawi Export Promotion Council (MEPC) and diplomatic missions provide requisite information to potential buyers. However, the effectiveness of these institutions is undermined by a decline in funding in real terms, inadequate professional staff and inadequate commercial orientation in diplomatic missions. There is an urgent need to increase funding for trade promotion at both MEPC and diplomatic missions and to improve the commercial orientation of the latter.

## Reducing Debt Burden

259. We noted above that Malawi is one of the most indebted countries in Africa. This implies that huge debt-service payments reduce Malawi's capacity to invest in such essential activities as infrastructure building without which the country cannot hope to achieve either global competitiveness or attractive foreign capital flows. A reduction in the debt-service burden and debt relief will go a long way in helping to achieve greater competitiveness, higher investment, and quicker growth and poverty reduction.

260. Malawi has a serious external debt problem. Apart from the absolute size of the external debt, which has been noted above, debt service as percentage of exports of goods and services has rarely been less than 20 per cent since 1980. It was 24.5 per cent in 1981, 49.0 per cent in 1987 and 25.9 per cent in 1995, for example. In terms of domestic resources, external debt service payments absorb about a quarter of the government's recurrent budget. In the past, Malawi rescheduled debt service payments on a few occasions under the Paris and London Clubs. But because Malawi serviced its external debt

regularly, it was not eligible under the heavily indebted poor country (HIPC) initiative. There are several criteria to qualify under the enhanced HIPC: debt-to-export ratio of 150 per cent; debt to fiscal revenue target of 250 per cent; export-to-GDP ratio of 30 per cent, and revenue-to-GDP ratio of 15 per cent. In the light of these criteria, Malawi is now eligible. Its debt to export ratio in 1997 was over 328 per cent; export-to-GDP ratio 33 per cent in 1998, and government revenue to GDP ratio over 17 per cent in 1997, but it will have to manage the economy far more prudently than before to qualify. There are stringent policy performance requirements besides the above criteria, which need to be fulfilled by the countries to qualify under HIPC. For example, a country would need to demonstrate that it is implementing a comprehensive and participatory poverty reduction strategy. As we note below so far the results of poverty reduction initiatives have been disappointing.

### ***Institutional Capacity Building***

*Good Governance*

261. Under maccroeconomic stability above, we have already raised issues of governance which are essential prerequisties for achieving efficient economic management and implementation. One of the objectives of liberalization was to strengthen a number of key institutions in the public and quasi-public sectors for improving capabilities in macroeconomic management (in economic policy making, planning and monitoring). Another goal in the 1990s was to restructure the civil service so as to improve efficiency and control the growth of civil service wages and salaries. These goals have not yet been achieved. Efficiency/productivity, work ethic and commitment of the civil service has declined. Further, as salaries and wages have not kept pace with inflation, temptations may have become high for senior as well as junior civil servants to engage in private income-generating activities.

262. Shortfalls in macroeconomic management are due in part to insufficient technical expertise for policy formulation, as well as underutilisation of the available expertise. Policy implementation is even more inefficient, even in the case of some of the well-thought out policies. Government needs to improve the effectiveness of structures responsible for policy work, including review of policy recommendations from workshops and studies for possible implementation. Also there is not much consultation between the economic policymaking organs and various interest groups in civil society.

263. The government is aware of the above shortfalls and is in the process of remedying at least some of them. The functional review of all ministries is supposed to be completed in the near future, after which it is expected that the government will have a streamlined civil service with the requisite capacity for effectiveness and efficiency (*Budget Statement* 1999, para 56). Intentions are that promotions and increments in wages and salaries should be based on performance, using a new monitoring system; this may also help in addressing corruption. Hopefully in the process the economic

management machinery will also be sufficiently reformed and its efficiency improved. For example, already a new Debt and Aid Management Division has been set up in the Ministry of Finance to strengthen its capacity for debt policy analysis and aid management (*Budget Statement* 1999, para 58).

264. The security situation in the country also needs to be improved. Using donor funding and local resources, the government has increased the police force, the number of vehicles for patrolling and other facilities. But these changes have not improved the security situation, as they have been marginal. Provision of private security services and establishment of neighbourhood watches had a limited impact. Malawi needs to accord top priority to improving security, allocate more resources to the police and the judiciary, ease the economic hardship suffered by the people, and allow village and ward authorities to take responsibility for preventing crime.

*Developing Human Resources*

265. A well-educated and healthy work force is required for Malawi to increase productivity and hence its competitiveness in the world economy. Therefore, every effort should be made to improve the quality of education and health services. In this connection, there is an urgent need to improve service delivery systems, the allocation and management of human and other resources, and the content of school curriculum to include technical and business-related subjects. To this end we recommend that a new Education Act should be enacted.

266. Malawi is short of high-level manpower in many sectors of the economy, especially in the public sector as we noted above. The use of expatriates is a useful stop gap measure. However, the country must increase training of its own manpower for the longer term. But, more importantly, it must adopt manpower utilization policies that will enable it to retain trained manpower in the country. In particular there will be a need to train its staff in techniques of formulating, implementing and evaluating SAPs and stabilization programmes. Because of the high rate of turnover of staff, there will also be a need to continually train staff in the techniques of formulating medium-term and long-term development programmes.

267. Both the Ministry of Commerce and Industry and the Malawi Export Promotion Council are constrained by limited capacity in export promotion. Technical and financial assistance is required to help reduce the capacity constraints of these organizations. Institutions that support the development of manufacturing industries and SMEs such as the Malawi Bureau of Standards, the Malawi Industrial Research and Technology Development Centre and the Malawi Investment Promotion Agency are similarly constrained by limited capacity. Here too technical and financial assistance from bilateral and multilateral donors would help in alleviating the constraints faced by these organizations.

268. In the field of trade promotion, international co-operation should be increased to reinforce national efforts in strengthening SME development institutions and their capabilities in providing training in international marketing and product quality control. In this connection, a survey to investigate export competitiveness of SMEs and to identify products with export potential should be carried out.

**Support for Poverty Reduction Programmes**

269. A number of initiatives are underway to address poverty, including the raising of incomes of smallholders in general. Poverty Reduction Programmes include: the Malawi Social Action Fund (aimed at supporting communities in building infrastructure), Small and Medium Enterprise Fund (to provide credit) and the Poverty Alleviation Trust Fund (for local communities) (Malawi Government, *Economic Report 1998,* pp.90-94). But the results have so far been disappointing in relation to the magnitude of the problem, which has become worse since liberalization. These programmes lack focus, priorities, and targeting. The limited resources made available have been spread too thin. Poverty alleviation initiatives, which promote micro and small enterprises are not well co-ordinated since a number of institutions are dealing with them. Micro credit operations, which are largely funded by donors, have been criticized in the past for being politicized which together with institutional constraints facing lenders have weakened the efficacy of the programme. Furthermore, any positive effects of poverty reduction programmes are being offset by the inflationary effects of some macroeconomic policies of stabilization and liberalization, particularly frequent currency devaluations. Therefore, macro management of the economy is a precondition for poverty reduction.

270. One government initiative raises a policy dilemma in this context. As part of liberalization, smallholders have been encouraged to grow lucrative burley tobacco. To the extent that this cash/export crop attracts some of the small holders′ labour, scarce land and capital resources away from food crop production, it can raise the danger of Malawi increasingly becoming a net food importer, thereby reducing or nullifying the net gain in foreign exchange from increased exports of the burley tobacco.

271. National initiatives in poverty reduction need to be reinforced through international support and action in such areas as micro credit, strengthening capacity of SME institutions, and training in food security, international marketing of SME products. Finally, the proposed Commonwealth Assistance mentioned in the *Malawi Government Economic Report 1998* (p.92) has not yet come through. The initiatives proposed for donor support, include: micro credit, micro-enterprises, food and agricultural production, technology for rural households, strengthening of policy formulation at the macro and micro levels and promotion of Government-NGO partnership. All these are worthy of support. We emphasize the importance of macroeconomic policy formulation for better macro management of the economy.

### Other Recommendations

272. Among other factors, human development is not sustainable in Malawi due to the degradation of natural resources, which is adversely affecting productivity in agriculture and other primary sectors, resulting in loss of income. Therefore, it is essential that environment-friendly and cost-effective technologies should be popularised among farmers. Other measures required are improvement in the management of natural resources by local communities, and the enforcement of natural resource exploitation fees and diversification of the agriculture-dependent economy.

## 9. CONCLUSION

273. Malawi is one of the early starters in liberalization; it has made significant effort to implement the standard prescriptions of structural adjustment and stabilization programmes. In fact, Malawi is unique in that it has implemented these programmes over a longer period than most other developing countries. It has maintained one of the most stable (relatively) political environments in Africa; both the flows of multilateral and bilateral aid have been modest but steady. Despite all these, however, Malawi has not succeeded in integrating into the world economy. All the trade and investment indicators suggest that (despite liberalizing the economy and implementing most of the required policy changes) Malawi′s economy is in the process of being marginalized.

274. Malawi suffers from a general lack of competitive environment. A few firms dominate the industrial sector. Such a structure hides inefficiency and may limit the ability to compete both locally and globally. Though firms operating in such an environment are likely to have scale economies, they are also likely to focus on static rather than dynamic gains. Firms operating under monopoly are likely to focus on temporary gains that they enjoy due to their monopoly power. But this may limit future growth of industry in question if for instance, R and D is not undertaken by the monopolistic firm. Further, innovation and product quality (due to the need for product differentiation) are likely to flourish under a more competitive environment. Therefore, a well-articulated competition policy would go a long way in addressing this problem. Such a policy needs to create an environment in which new and small innovative firms could easily enter the market. Specific measures may range from less bureaucratic investment policies to an elaborate system of anti-trust laws. Furthermore, measures are also needed to restrict monopoly power of new firms and focus on products and services that have both local and global potential market.

275. If the Malawi economy is to integrate smoothly into the world economy and minimize the adverse effects of globalization, market forces alone may not accomplish the task. Non-interventionist but selective involvement of the Government might be essential. In addition to putting appropriate policies and an efficient bureaucracy in place, there is probably a significant role for the Government to play in such economies. For instance, providing expertise in identifying viable export sectors, identifying and supporting dynamic sectors (sectors with backward and forward linkages), promoting trade and investment at regional and international levels, and implementing some affordable and well-designed safety nets for the vulnerable sectors of society. All these issues could be addressed in a well thought out growth strategy that complements, and not substitutes, the operations of the market.

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