A strategy for economic growth: improved macro-economic conditions and private sector development

After having followed sound economic policies from 1995 to 1997, in more recent years the overall performance of Malawi's economy has not been conducive to trade and investment: expenditure control has weakened, agricultural prospects have become mixed, the deficit has increased, interest rates have gone up. As a result of the poor economic management of the country, the private sector has collapsed. However, in the past year, the joint commitment of government and private sector to diversification from tobacco is a positive signal for business growth in the future.

Malawi is predominantly a rural economy, relying on favourable climatic conditions for its agricultural production. Agriculture supports 90 per cent of the population, contributing 45 per cent of the Gross Domestic Product (GDP) and over 90 per cent of export earnings. Even though in the past two decades the structure of the economy has not varied substantially, some major changes have occurred since the early 1990s.

During the one-party system the overall production structure of Malawi consisted of two distinct sectors: the export-oriented large-scale sector, which produced mostly tobacco, and the smallholder sector, which produced mostly subsistence maize. When it took over, the UDF government adopted a different development strategy by placing smallholder agriculture as the engine of growth. A decade later, the results of this reform are significant. The country's food basket has changed, with a remarkable growth in the production of cassava and sweet potatoes over maize. In the tobacco sector, the number of smallholders has grown tremendously, but at the same time it is increasingly realised that Malawi cannot rely only on tobacco in its efforts to reduce poverty.

A comprehensive economic growth strategy

Overall, the economic performance of the Malawi economy in recent years has been very weak. It has been characterised by low or negative GNP growth rates, currency devaluation, high inflation, a large budget deficit, and high interest rates, which have impacted negatively on the fight against poverty. In response, the Malawi Poverty Reduction Strategy Paper (MPRSP), launched by government in April 2002, provided a pro-poor economic growth strategy to directly tackle poverty. "One of the main pillars of the MPRSP is the stimulation of the private sector. In Malawi there is too much government and too little private capital. But this will change soon. New jobs will be created and as soon as the private sector becomes more dominant a new work habit based on systems of rewards and penalties will be installed in Malawi. Companies that are not profitable will no longer be in the market", says Minister of Commerce and Industry Samuel John Mpasu.

Meanwhile, a comprehensive business plan to stimulate private sector growth was put forward by the National Action Group (NAG). Matthew Chikaonda, economist and chief executive of Press Corporation Limited, one of the largest employers in Malawi, explains the goals of the NAG: "It is a gathering of key players in the private sector who meet to decide what to do to unlock the potential for growth in Malawi. For each sector there is now a lead player, who works in conjunction with the government to see what the constraints and opportunities are for that specific sector. Several public sector entities are also active in this process: the Ministries of Commerce and Industry, Economic Planning and Development, Finance, and also the Central Bank."

Malawi has also an ongoing Poverty Reduction and Growth Facility (PRGF) programme with the International

Cotton production has seen a major decline since the 1980s as the arrangements serving the industry began to break down; low prices have meant that there is less incentive to grow cotton. But the recent investment by two international cotton ginners has given fresh impetus to the sector.

Monetary Fund (IMF). The PRGF is the IMF's concessional facility for low-income countries, based on country-owned poverty reduction strategies to ensure that PRGF-supported programmes are consistent with a comprehensive framework to foster economic growth and reduce poverty. In 2001, disbursements were suspended due to lack of progress on achieving the macroeconomic stabilisation targets, but following an IMF mission to Malawi in July 2003, disbursements resumed in October 2003. "Malawi has made substantial progress in meeting the targets set under a track-record programme. It has agreed to commit itself to undertake certain actions, including strict control in public spending and the repayment of government domestic debt. Returning to macro-economic stability and implementing structural reforms is key to accelerate growth", said Girma Begashaw, IMF resident representative.

Following the approval of Malawi's PRFG arrangement review, four European donors providing budgetary support under the Common Approach to Budget Support (CABS) pledged to resume their €45 million aid package. However, the CABS, which is made up of the European Union, Britain, Norway, and Sweden, in a common statement declared that "should government fail to meet the requirements, there will no alternative but to re-evaluate budget poverty programmes."

Constraints for business growth

Working together, the private sector and the government have launched a comprehensive Economic Growth Strategy (EGS) whose objectives are: to create an overall macro-economic environment conducive to broad-based growth of at least six per cent, to be maintained in the long term; to ensure wide participation in and sharing of the benefits from higher economic growth. Several constraints affecting the business sector have been identified in the EGS. The major ones relate to the poor macro-economic conditions of the country. "The business environment is simply not conducive for doing business. Many firms have shut down; others still operate but only because they need to recover their initial costs. The poor management of the economy is the result of a lack of vision of our leaders: too many people just look at the short term," says Mr Chancellor Kaferapanjira, chief executive of the Malawi Confederation of Chambers of Commerce and Industry (MCCCI).

The primary cause of slow growth in the private sector is the large budget deficit and the consequent need for government to borrow from local banks. This has resulted in an increase in the real interest rates, which are over 40 per cent. Inflation rates, though having declined substantially as of the beginning of 2003, remain unstable and higher than anticipated; the exchange rate is volatile and unpredictable. Furthermore, the level of savings is too low, essentially for three reasons. "First, people do not earn a lot of money, so they have very little to save from; second, due to inflation and the devaluation of the currency, people tend to consume because the value of the money tomorrow is not the same as today; third, because of the extended family idea typical of our society, people who earn some money tend to support their relatives who are struggling," explains Mr Thomson Frank Mpinganjira, managing director of First Discount House Limited, one of the major financial institutions in Malawi.

Tea represents about nine per cent of Malawi's exports by value. Even though there has been a gradual improvement in production and productivity over recent years, world prices have been very low for the past three to four years, impacting negatively on the profitability of the whole sector.

In addition to this, as Mr Kassam Okai, former chairman of the National Economic Council (NEC) and a major figure in the business sector, points out, "Malawi faces two more non-economic constraints. First, the absence of infrastructures for the development of entrepreneurship, which is partially a consequence of the fact that the education system, being more directed towards the academic side, lacks the technical side. And then we also have the problem of HIV/AIDS, which is killing the most productive people in our society. Also, it should not be forgotten that in Malawi, being a landlocked country, freight costs are very high."

Manufacturing

In addition to further improvement in the tobacco, tea and sugar sectors, which at the moment constitute the sole foreign exchange earner in the country, the growth strategy focuses mainly on three sectors which can quickly generate growth: manufacturing, tourism, and mining.

Manufacturing has been in constant decline over the last decade, accounting in 2001 for only 11.5 per cent of GDP. Therefore, there is an urgent need to improve the incentives to encourage investment, particularly in export and employment-oriented activities. Two main sectors have been identified: agro/food processing and textiles.

Agro/food processing has potential for growth especially in processing fruit and vegetables, rice, processing Macadamia nuts, and in the production of starch from cassava. Cassava has recently been identified as a major product for agricultural diversification as it is used in the making of glue, animal feeds, ethanol, the garment industry and for incorporation into food products. "Very often in developing countries, the basics are forgotten. Where Malawi cannot compete because of freight costs, concentration should be on organic products and horticulture, high value products. Further, there is knowledge within the country to grow several species of trees and plants, which would yield high returns with their use in medical fields. These include the neem tree and *prunus africanis*. The neem tree not only prevents mosquitoes breeding in the area, but is also used for a host of medical purposes, including herbal medicines. *Prunus africanis* is used for the treatment of prostate cancer," argues Mr Okhai.

An integrated cotton-textiles-garment chain has been identified as a key component of the economic growth strategy. Mr Kantilal Karsanji Desai, chairman of the Textile and Garments Industry Association of Malawi, shows a lot of optimism about the prospective growth in the textile sector. "Malawi is an agricultural country but is not taking full advantage of its current resources. The industrialisation process could easily start from cotton. The conditions for growing and processing it are favourable: the soil is fertile, the weather is conducive, the cost of labour is cheap. But if countries in Western Europe and the US remove their subsidies we would be even more competitive". In this sense, Malawi has not yet been able to take advantage of the measures offered by international donors to low income countries: "It is true that in the textile industry we face the competition of some Asian countries which also have cheap labour. But Malawi has the advantages provided by AGOA and the Everything But Arms initiative: its products are duty free and quota free. There are other problems, such as imported technologies, high taxation, prohibitive transportation costs, but we still have a comparative advantage".

Furthermore, "there is a very lucrative sector in which to invest, thus benefiting further from AGOA: the apparel industries. We could manufacture for the entire American market. This would not only create enormous employment opportunities, but would also allow us to have some additional foreign exchange," explains Minister Mpasu.

Tourism

Tourism represents a negligible part of GDP (about 1.8 per cent in 2001). It is constrained by several factors, which affect both the number of visitors and the further development of the sector. According to Mr Kaferapanjira from MCCCI, tourism is a sector that can grow fast. "The problems faced by tourism are well known. There is a limited number of international flights coming to Malawi, prices are high, and in the past there has been a negative publicity for Southern Africa. I think we should market Malawi better. We also need to build the necessary infrastructures, such as roads, airports, hotels, and think of other complementary activities to attract tourists. There are several businesses which have expressed an interest in investing in this sector. But we need a vision: different ministries must work in conjunction. The government needs to make it a priority, to provide incentives, and build the necessary infrastructures."

Lake Malawi is still under-exploited. Last December, the government granted Malawi Development Corporation (MDC), a government parastatal set up to contribute to the development of the agricultural, industrial, and tourism sectors, the concession to develop Cape Maclear. The plan includes the construction of a chain of bungalows, water sports and hiking facilities. According to Mr Stewart Malata, general manager of the MDC, "in the past, government did not look at tourism as a priority area. But we have natural resources and historical sites and we should capitalise on that. Cape Maclear is one of the most beautiful places in Africa: the waters are crystal clear, the animal life around is very rich, there are so many different types of fish, snorkeling is marvellous. But we need an airport: there is already a landing strip in that area, but it must be upgraded. Tourists want modern facilities: let's give them something decent and attractive".

Mining

Even though no big mines operate in Malawi, mining is one of the sectors with the highest growth potential. Yet, the mining industry remains one of the under-exploited areas within the economy, contributing only 1.6 per cent of GDP. A recent study from the department of geology noted that the absence of a mining culture among Malawians is making it difficult for government to fully appreciate the benefits that the country could gain from increased mining activities. Efforts must be made at two levels: small-scale and medium/large-scale. In the short term, support is needed to help small-scale mining cope with low productivity, low value-added, and limited access to market outlets. In particular, gemstones, monazite, silica and bauxite are already being mined in several districts of Malawi. For the medium/large-scale mining, a new Mining Policy and Act is necessary: this could provide investor protection, incentives for investment, support infrastructures and guard against the risk of environmental damage.

The plan developed in the Economic Growth Strategy is very ambitious. Now, the implementation stage is very critical. A positive element is that such a strategy is based on an extensive dialogue between the private and the public sector, and that it can also count on a true partnership with international donors. "That is where the hope is at the moment for the future of Malawi," concludes Mr Chikaonda. ■ MC

Livingstonia beach.
A key strategy in the tourism sector is to develop Malawi into a competitive eco-tourism destination, aiming at attracting high yielding tourists in a way that is environmentally, socially, and economically viable.