

# **AERC Working Paper No. 2**

## **EXPLAINING AFRICAN ECONOMIC GROWTH PERFORMANCE: A CASE STUDY OF MALAWI**

by

Chinyamata Chipeta

and

Mjedo Mkandawire

Southern African Institute for Economic Research

Zomba, Malawi

**Prepared as a component of the AERC Collaborative Research Project,  
Explaining Africa's Growth Performance**

**For**

**AFRICAN ECONOMIC RESEARCH CONSORTIUM**

**PO Box 62882, Nairobi, Kenya**

**January 2004**

### **1. INTRODUCTION**

In 1960 Malawi had an estimated real gross domestic product (GDP) of MK397.1 million or, in per capita terms, MK116.10. How the country's national income grew between 1960 and 1999 is summarized by half-decade in Table 1. During the first half-decade, real GDP on average grew at 4.6% per annum. During the three succeeding decades, real GDP grew more rapidly, at an average annual rate close to or above 6.0%. With the exception of the 1995–1999 half-decade, subsequently Malawi achieved lower rates of economic growth averaging one-third during 1980–1984, about one-half during 1985–1989 and one-tenth during 1990–1994 of the average rate achieved between 1965 and 1979 (Table 1). The high average

rate of growth during 1995-1999 was due to high rates of growth in 1995 and 1996 associated with recovery from a large negative rate of economic growth in 1994 caused by a serious drought.

In per capita terms, real GDP on average grew at a rate close to 2.0% during the first decade. During the three succeeding half-decades, real per capita GDP grew at an average annual rate above 2.0% and reached MK173.70 in 1979. This record is remarkable in comparison with the achievements of the colonial period and the less satisfactory performance of its neighbours, especially Mozambique, Zambia and Tanzania, and with the country's own performance between 1980 and 1994 (Table 1).

**Table 1: Malawi half-decadal rates of growth of real gross domestic product (GDP) and real per capita GDP**

Half-decade	Average annual rate of growth of real GDP %	Average annual rate of growth of real per capita GDP %
1960-64	4.6	1.9
1965-69	5.8	2.2
1970-74	6.4	3.1
1975-79	5.8	3.2
1980-84	2.1	-1.3
1985-89	2.6	-0.6
1990-94	0.6	-1.4
1995-99	7.4	5.4

Source: Malawi Government, *Economic Report* (various issues) and International Monetary Fund, *International Financial Statistics Yearbook 1990*.

The structure of the economy in 1960 was typical of a very low-income country. Agriculture accounted for about 45% of GDP, whereas manufacturing accounted for 4.5%, industry as a whole for 8.8% and services for 24% (Malawi Government, 1965). Over 90% of the country's labour force was engaged in agriculture. By 1979, some structural transformation had occurred, as the share of agriculture in GDP declined to about 32%, while the shares of manufacturing, industry as a whole and services increased to about 12%, 20% and 45%, respectively. The share of agriculture in the total labour force was below 90%. Since then, there has been virtual stagnation in the shares of agriculture, industry and services in GDP. The share of manufacturing has increased, but only slightly.

## 2. MACRO AND SECTORAL DEVELOPMENTS

Why did real GDP grow at a modest rate between 1960 and 1964? Why did real GDP grow more rapidly from 1965 to 1979? What was behind the marked slowdown during 1980-1984, the expansion between 1985 and 1989, the sharp deceleration between 1990 and 1994, and the subsequent rise between 1995 and 1999? Why did structural change occur between 1960 and 1979? Why has there been no transformation since 1979? This study will attempt to explain this growth performance of Malawi between 1960 and 1999. The explanation will focus on structural and policy factors, including governance, markets and private agents, and determine the relative importance of these factors in explaining the growth performance of the country.

### 2.1 Growth Accounting

In order to account for changes in the growth performance of Malawi over time and explain differences with other countries, we shall first draw upon the Collins-Bosworth growth accounting framework (Collins and Bosworth, 1996). This framework is available for 21 sub-Saharan countries (including Malawi), 67 other developing countries and a number of developed countries. It is based on the familiar Cobb-Douglas production function where physical capital K and effective labour h.L are the inputs. The production function itself is expressed as

$$Y = AK^{.35} (h.L)^{.65} \quad (1)$$

or, in per worker terms,

$$y = Ak^{.35} h^{.65} \quad (2)$$

Where  $y \square Y/L$  and  $k \square K/L$ .

The unobserved variable A is an index of total factor productivity, its contribution to growth being calculated as a residual. The elasticity of output with respect to capital is 0.35 and with respect to labour is 0.65. These elasticities are broadly consistent with international experience.

The labour input is measured by the population of labour force age. Ideally, this should be measured by the actual labour force. For lack of suitable data, however, this was not used. The labour quality index, h, had to be calculated. Consistent with international experience on wage premiums, Collins and Bosworth (1996) assumed that other things being equal, each year of educational attainment raises labour's marginal product by 7%. Since the marginal product for uneducated labour is also positive, this approach is believed to limit the variation in measured human capital formation in comparison with an approach based only on average years of schooling. For this reason, human capital accumulation plays a relatively small role in explaining international growth differences in these data. The capital input is measured by the stock of capital. The stock of capital in any one year is taken to be equal to the sum of past investments, depreciated at a rate of 0.4. Initial capital stock data were estimated for the year 1950 by Nehru and Dharehwar (1993) who provided country-by-country estimates. Investment rates are taken from national accounts data.

Growth decomposition for Malawi for the period 1960–1997 is shown in Table 2 by half-decade. All the variables in these tables are measured in% and are from the 1996 Collins and Bosworth study. Growth in real GDP per worker is decomposed into the three components shown on the right-hand side. The contribution of physical capital per worker is estimated as 0.35x (growth of physical capital per worker), and that of education per worker as 0.65x (growth in labour quality index). The residual is the difference between growth in real GDP per worker and the sum of the contributions of physical capital and education per worker.

The data in Table 2 show that over the entire period 1960–1997, physical capital per worker contributed more to the growth of real GDP per worker in Malawi than either education per worker or the residual (total factor productivity or TFP). In this regard, Malawi did not differ from the general pattern in the world economy (Table 2). Over a similar time period, Malawi did better than sub-Saharan Africa and Latin America in terms of growth in real GDP per worker, and contribution of physical capital per worker, but not in terms of the contribution of education per worker. With respect to the residual, Malawi did better only than sub-Saharan Africa. In these same respects, Malawi did worse than the remaining regions of the world (Table 2).

Although the contribution of physical capital per worker to growth was larger than that of other factors, this was so only up to the 1975–1979 period. Thereafter, it decelerated and on average ultimately became negative from the 1985–1989 period (Table 2). These trends in the contribution of capital per worker reflected trends in investment rates, which were relatively low during 1960–1964. This period coincided with the transition from colonial rule to independence in 1964 and from the Federation of Rhodesia to break up of the federation in 1963. The uncertainty associated with the political and economic transition may have discouraged investment. The rate of investment peaked during 1975–1979, but thereafter declined (Table 3). The initial rise in the rate of investment made possible an increase in the amount of capital per worker; whereas the subsequent decline in the rate of investment has probably decreased the amount of capital per worker.

**Table 2: Growth accounting decomposition %**

Period	Growth in real GDP per worker	Contribution of:		
		Physical capital per worker	Education per worker	Residual

1960–64	0.28	1.54	0.03	-1.29
1965–69	5.06	3.12	0.18	1.76
1970–74	4.17	3.55	0.26	0.36
1975–79	3.49	2.49	0.09	0.90
1980–84	-1.28	0.05	0.18	-1.51
1985–89	-0.50	-0.59	0.22	-0.13
1990–97	-1.80	-0.55	0.13	-1.38
Total	1.35	1.37	0.16	-0.18
<u>1960–97</u>				
SSA	0.41	0.61	0.23	-0.42
LAC	0.91	0.67	0.35	-0.11
SA	2.33	1.17	0.30	0.86
EAP	3.86	2.20	0.50	1.15
MENA	2.82	1.50	0.41	0.91
INDU	2.70	1.29	0.33	1.08
All countries	1.82	1.08	0.34	0.40

SSA stands for Sub-Saharan Africa  
LAC stands for Latin America and Caribbean  
SA stands for South Asia  
EAP stands for East Asia and Pacific  
MENA stands for Middle East and North Africa  
INDU stands for Industrialised Countries.  
Source: Ndulu and O'Connell (2000).

The fall in the rate of investment is worrisome for a number of other reasons. First, although high investment rates do not necessarily result in high rates of economic growth, a critical minimum rate of investment is essential for sustainable economic development. Second, because of the low efficiency of investment, the volume of investment required to generate an additional unit of income is high. The low efficiency of investment is reflected in rising incremental capital–output ratios (ICORs). The average ICOR seems to have increased from 2.5 in 1962 to 3.5 in 1987 (in a number of years between 1962 and 1987 this coefficient was far above 3.5). This implies that to achieve an acceptable rate of economic growth, a higher rate of investment must be attained. Third, the high rates of inflation to which the country is subjected have increased the cost of investment. This too suggests that a higher rate of investment is desirable. Planners, however, are content with a low rate of investment.

**Table 3: Investment rates<sup>1</sup> in Malawi 1960–1964 to 1990 - 97%**

Period	Private investment rate	Public investment rate	Total investment rate
1960–64	–	–	9.78
1965–69	–	–	15.88
1970–74	15.31	8.49	23.80
1975–79	14.39	16.28	30.67
1980–84	9.05	10.84	19.89
1985–89	8.90	8.39	17.29
1990–97	9.06	9.14	18.20

<sup>1</sup>Gross domestic investment as a%age of GDP.

Source: Malawi Government, *Economic Report* (various issues).

The growth of savings has also passed through distinct phases since 1960. During the 1960s (the first phase), national savings were negligible in Malawi and virtually all capital expenditure was financed by foreign savings. Between 1967 and 1969, for example, gross national savings financed only 8% of total investment (World Bank, 1985). The 1970s ushered in a new period when national savings grew fairly rapidly. As national savings increased, the share of foreign financing in total investment fell from 92% in 1967 to 50% in 1979 (Malawi Government, 1983). During the 1980s (the third phase), this trend reversed.

These trends in savings rate probably parallel those that have occurred in the sub-Saharan African region as a whole. According to the 1987 *World Development Report*, saving in sub-Saharan Africa as a percentage of GDP was 23.0% in 1980. By 1983, it had declined to 13.6%, and was estimated at 13.8% in 1986 (World Bank, 1987).

Unlike the contribution of capital per worker, the contribution of education per worker was positive throughout the study period. As stated above, the contribution of education per worker to the growth of real GDP per worker in Malawi did not exceed the average contribution of this variable in sub-Saharan Africa as a whole or in any of the other regions of the world. The explanation for this might be the lower average years of schooling in Malawi compared with other countries in Africa and abroad (Table 4).

On the whole, the contribution of education to growth in Malawi is relatively weak. That this is so has been corroborated by the observation that although open unemployment in Malawi is low, the majority of the people who are occupied are actually under-employed, suggesting that educational capital is not highly socially productive at the margin (UNDP/ILO, 1999). These findings are seemingly puzzling given (a) the central role attributed to human capital investment in the theoretical literature on growth, (b) microeconomic evidence on the substantial private returns to education in African countries, and (c) the widespread view that human capital played a central role in the growth experience of East Asia. What is the problem?

It has been suggested in the literature that the very weak performance of education in cross-country growth regression is due to a measurement error in the education attainment data (Krueger and Lindahl, 1998). It has been demonstrated that downward bias in the coefficient on the change in the educational attainment can be very severe when educational attainment is measured with an error. This bias is especially large when short time periods are used and variables correlated with “true” education attainment are included in the equation, since these effects lower the signal-to-noise ratio in the educational accumulation variable. The regressions on which this study is based are subject to these problems, partly because the authors used short (five-year) periods and partly because the regressions included a variety of variables that are correlated with educational attainment, including initial income, life expectancy at birth and dependency rates. When the measurement error is taken into account, the change in educational attainment should have the expected positive and statistically significant effect on growth.

It has also been found out that when initial average educational attainment is used and its coefficient is allowed to vary across countries, the pooling restriction fails decisively (Krueger and Lindahl, 1998). This may help to explain the weak performance of this variable when the pooling restriction is maintained. When educational attainment is entered quadratically, its net impact on growth appears to be positive for low-income (e.g., many African) countries and negative for high-income countries.

The data shown in Table 2 indicate that the social return to educational investment in Malawi was relatively low during the 1960–1997 period, but that it rose during the period 1960 to 1974 and it either declined or remained static during subsequent periods. There are several reasons for these and other observations on the social return to educational investment.

First, from the beginning in the nineteenth century, Malawi’s educational system has tended to produce school leavers and graduates who are best suited for employment in the civil service or the parastatal sector where social productivity is lower than in the private sector. That the latter requires prospective employees to have suitable experience means that the private sector considers formal education to be largely irrelevant to its needs. For these reasons, there are relatively more educated people employed in the public sector than in the private sector.

The initial rise in the contribution of education per worker up to 1974 and the subsequent decline are due to four factors. The first is a technology related explanation according to which the social return to education was initially low because each worker did not have much capital to work with. The increase in the rate of investment raised the amount of capital per worker, which led to an improvement in labour productivity. By this reasoning, the subsequent decline in the contribution to growth of education per worker is attributable to a decrease in the rate of investment and consequently in the amount of capital per worker.

The second factor is that the return to education rose up to 1974 because new technologies were becoming available, especially in agriculture, industry and transport and because the economy was

undergoing rapid structural change. Subsequently, there have been fewer new technologies adopted and certainly there has been little structural transformation of the economy, a topic that we shall return to later.

The third factor is that the quality of education initially rose as more teachers were trained and, in real terms, adequate resources were allocated to public schools and colleges. In addition, relative price stability during the initial period meant that the real value of earnings and other benefits did not fall much. In other words, teachers had adequate incentives to work hard and to remain in the teaching profession. The number and quality of passes were high. During the second half of the period in question here, the reverse has been true. In addition, the country has had to use unqualified teachers.

And the fourth factor is that during the first period (1960 to 1979), recruitment, remuneration and promotions in the public sector were mainly based on merit, that is, qualifications and experience. The presence of expatriate officers helped the public sector to retain this tradition even in the face of pressure from politicians. The localization of most of the expatriate positions during the subsequent period created room for basing recruitment, remuneration and promotions on nepotism, ethnicity, regionalism, politics and other factors, which have contributed to a marked decline in productivity.

A negative residual is another striking feature of Malawi's growth experience during 1960–1997. This residual has had a variety of sources. Among the ones that have been addressed in the literature and which apply to Malawi is the impact of tax and tax-like policies in generating an inefficient composition of aggregate investment. Such a distortion produces a negative residual by undermining the quality of the capital stock (see, for example, Adam and O'Connell, 1999). The same effect can be produced by a general bias against private sector accumulation unless offset by an unusually high marginal product of public capital (Mkandawire and Soludo, 1999). A negative residual can also be produced by slow movement of factors of production out of agriculture, given the assumption of differences in sectoral marginal productivities.

Another group of literature has emphasized geography as an additional factor in African growth. African geography either undermines the health status of workers or imposes high transaction costs that discourage market integration. Some of these effects operate on the residual rather than the growth rate. For example, a change in average health status can have major effects on the productivity residual (see, for example, Sachs and Warner, 1997, and Bloom and Sachs, 1998). But the biggest health challenge in Malawi has nothing to do with the hot African climate. This challenge is HIV/AIDS. In 1999 the adult HIV prevalence rate in the country was 16.1%. On this basis, the country ranked eighth in the Southern African Development Community (SADC). In terms of the proportion of people in high risk groups infected by HIV, however, Malawi had an infection rate of 86% and ranked first along with Zimbabwe; among women attending urban antenatal clinics in 1996, Malawi had an HIV infection rate of 21.9%, the third highest in the SADC (SAPES, UNDP and SADC, 2000). According to one study, by the year 2010, Malawi's GDP could be as much as 10% smaller than it would have been in the absence of the AIDS epidemic and per capita GDP will be up to 3% smaller.

**Table 4: Initial average years of schooling**

Malawi		Other countries 1994	
1960–64	1.9	China	5.3
1965–69	2.0	East Asia	7.2
1970–74	1.88	South Asia	3.4
1975–79	2.5	Africa	3.5
1980–84	2.65	Middle East	4.9
1985–89	2.81	Latin America	5.5
1990–97	2.7	Industrialized Countries	9.8

Source: Collins and Bosworth (1996); Barrow and Lee (1993).

In addition to the factors explained above, Malawi has experienced a variety of other influences. These include falling capacity utilisation; high rates of depreciation of physical capital; water and

electricity interruptions; climatic shocks (droughts or excessive rains) that undermined total factor productivity in agriculture, particularly during 1980–1984 and 1990–1994; rising transport costs; transport route disruptions; changes in the terms of trade; and, at shorter frequencies, fluctuations in aggregate demand that affect output through capacity utilization and the degree of underemployment. The impact of most of these factors on the rate of economic growth is not known exactly. The one factor whose impact has been estimated is transport route disruptions. It is believed that this has led to a loss of one percentage point in the rate of economic growth.

## **2.2 Income Distribution, Poverty and Growth**

There are no time series data to show that poverty in Malawi was on a falling or rising trend during the 1960–1999 period. Estimates for the poverty line and poverty head counts are available for fewer than five years and only from 1989 for that matter, with the latest being 1998. And the available estimates of the poverty line are not even comparable because each of them was based on a different method, on the basis of which the proportion of the population under the poverty line was estimated at 60% in 1990 and at an incomparable 65.3% in 1998. The majority of the poor live in rural areas where 66.5% of the rural population were under the poverty line in 1998 compared with 54.9% for the urban population.

However, data exist to show trends in some major poverty-related variables for a good part of the four decades. For example, real monthly average earnings in the agriculture sector, where sectoral average wages are the lowest, fell cumulatively by 59% over 14 years from 1980 to a 1994 level of a miserable K7, compared with an average of K18 for all sectors in that year; implying a much larger average real monthly wage for non-agriculture sectors taken together. The large income differential in disfavour of those working in the agriculture sector, the largest employing sector (about half of the total formal sector employment in the 1980s and 1990s), is therefore obvious from these relative average real wages. In addition to high rates of inflation, the erosion of real wages was over the years worsened by the wage restraint policy of the government, which was amenable to exploitation by employers in the absence of active trade unionism during the single party rule up to May 1994.

Within the agriculture sector, we also know that real per capita money incomes earned from marketed crop output by the largest group, namely peasants (who comprise over 80% of the country's population), must have been on a falling trend as evidenced by a combination of three major factors: first, a worsening trend in the domestic commodity terms of trade faced by peasants by about 13 percentage points in the 1970s, 11 percentage points in 1980s, and further worsening in some years of the early 1990s (M.L.C. Mkandawire, 1999); second, the average arable hectares of land per peasant household also declined; third, peasant crop yields per hectare also fell. Some relief for some peasant households have for a long time arisen from net cash transfers from their relatives who are in wage employment or are in business.

Available evidence therefore points to two major unfavourable developments: one, the level of poverty in Malawi cannot have decreased over the years, particularly in the agriculture sector among peasants, tenants and employees on estates. Two, inequality in the distribution of income has remained glaringly large since 1960, on a national level (largely attributable to the huge rural–urban differential), also among the urban population, as well as within the agriculture sector between the peasants, tenants and estate employees on one hand and estate owners on the other. It is not surprising therefore that the Gini ratio for the country as a whole deteriorated from 0.45 in 1968 to 0.65 in 1995; among peasants it was less pronounced at 0.57 in 1995. The huge income inequality in disfavour of peasants arose from policies favouring estate agriculture. The rural–urban income inequality would have been much larger were it not for the wages restraint policy.

It appears that economic growth was negatively affected by the three interrelated factors discussed above: one, the falling trend in real money incomes (from an initial 1960 position, which was already low) of the majority of consumers (peasants, tenants and employees on estates, as well as several low wage earners in non-agriculture sectors); two, the persistence of abject poverty among the majority of the population; three, the large and worsening inequalities of income distribution in disfavour of the majority of consumers. These three factors depressed growth in demand for consumer goods and (particularly smallholder agricultural) capital goods produced locally by manufacturing and service industry sectors. Consequently the growth of such sectors is likely to have been less than would have been the case. With

their depressed growth, the industrial sectors' capacity to create wage employment and to pay better wages was constrained, with the latter having been exacerbated by the wages restraint policy. All this also constrained growth in consumer demand, which in turn contributed to constraining economic growth.

### 2.3 Sectoral Growth Performance

A key feature of modern economic development is structural transformation or change in the relative importance of different sectors. Structural transformation is usually associated with a shift from a predominantly agricultural economy to one dominated by industrial and service sectors. Lewis (1954), Fei and Ranis (1964), and others have analysed this phenomenon in relation to reallocation of labour from agriculture to industry.

What are the causes of changes in the structure of economies? Two fundamental causes are (a) rising per capita income and consequent changes in consumer demand, and (b) varied increases in productivity in different sectors of the economy owing to specialization and division of labour associated with scientific and technological advances. Studies of consumer expenditure patterns have demonstrated that as an economy grows, expenditure on food as a proportion of total expenditure falls. This dictum is consistent with Engel's law, which states that given tastes and preferences, the proportion of income spent on food diminishes as incomes increase. This phenomenon is explained in terms of higher income elasticity of demand for food at low levels of income than at high levels of income. But there is also the empirical fact that the rate of growth of population, which is another determinant of demand for food, is lower in rich countries than in poor countries.

Studies of consumer expenditure have also demonstrated that elasticities of demand for manufactured goods and services are higher than those of agricultural products. This implies that as national income grows, an increasing amount of income is spent on non-agricultural goods and services, thereby stimulating the growth of non-agricultural and service sectors. But the growth of these sectors is also due to increased productivity achieved through industrial application of scientific advances with associated changes in division of labour and industrial structure. Increasing division of labour in all economic activity brings with it the opportunity of using machinery whose power, speed and precision raise productivity. Specialization not only makes possible the introduction of capital equipment, it also facilitates improvements in organization and the use of more productive technologies.

Two common measures of changes in economic structure are (a) the proportion of national income produced in each sector, and (b) the proportion of the labour force engaged in each sector. The data shown in tables 5 and 6 indicate that Malawi's high rate of economic growth between 1960 and 1979 was accompanied by rapid structural change, with agriculture decreasing its share in GDP from 36.37% during 1965–1969 to 31.89% during 1975–1979 and its share in the labour force from 93.20% during 1960–1964 to 88.66% during 1975–1979. Correspondingly, the share of industry in GDP increased from 18.56% to 19.87% (with the share of manufacturing alone standing at 12.06%), while that of services rose from 44.87% to 48.23% between the two time periods. Considering that agriculture accounted for 45%, industry for 8.8%, manufacturing for 4.5% and services for 24.1% of GDP in 1960 (Malawi Government, 1965), these changes were quite significant.

In contrast, the slower rate of economic growth between 1980 and 1997 is responsible for virtual stagnation in the share of agriculture, industry (except manufacturing where it rose slightly) and services in GDP (tables 5 and 6). However, the share of agriculture in the labour force decreased further, albeit at a smaller rate than during 1960–1979. On balance, during the second half of the study period, Malawi failed to effect structural change associated with economic growth.

Following World Bank publications in the early 1980s, the literature on African economic development blamed policy biases for constraining structural change. It was argued, in particular, that over taxation of the agricultural sector by governments had limited its structural transformation and hence its ultimate contribution to long-run development. More recent literature has argued that governance, civil strife and geography produced a bias against manufacturing sector in Africa (Collier and Gunning, 1999). This study will test these assumptions. On our part we hypothesize that lack of structural transformation in Malawi after 1979 is due to stagnation in real per capita income and the consequent lack of changes in consumer demand, and lack of improvement in total factor productivity.



A critical question is whether the pattern of sectoral transformation in Malawi departs in systematic ways from what would be expected given the country's overall growth record. To answer this question, we show in tables 5 and 6 not only actual sectoral shares in GDP and the labour force, but also fitted shares that indicate what these shares should be on the basis of the country's income and population. Given income and population, the actual share of the agricultural sector in Malawi is smaller than it should be, as is that of the service sector, but the actual share of the labour force in agriculture is higher. In contrast, the actual shares of industry and manufacturing are greater than what they ought to be on account of the country's income and population. Consistent with these findings, the labour productivity differential in favour of non-agricultural activities has been greater than it ought to be (Table 6). In respect of industry, manufacturing and service sectors, Malawi's sectoral patterns are similar to those of sub-Saharan African cross-country norms. As regards agriculture, Malawi's pattern differs from that of sub-Saharan Africa in that the actual share of agriculture in GDP in the latter is slightly higher, not smaller, than the fitted share.

The sectoral patterns explained here, along with slow growth in per capita income, suggest an economic environment that has not been suited to the challenge of rapid population growth. Structural change appears to have favoured industry compared with agriculture, but the elasticity of employment in industry is weak. Much of this is due to the capital-intensive nature of utilities, mining and construction.

**Table 5: Malawi actual and predicted sectoral variables, %**

Period	Agriculture's share in GDP			Industry's share in GDP			Service's, etc., share in GDP		
	Actual share	Fitted share	Residual	Actual share	Fitted share	Residual	Actual share	Fitted share	Residual
1960-64	—	48.89	—	—	5.88	—	—	45.22	—
1965-69	36.57	46.19	-9.62	18.56	7.30	11.26	44.87	46.51	-1.64
1970-74	34.53	43.84	-9.31	19.17	8.45	10.73	46.30	47.71	-1.42
1975-79	31.89	39.90	-8.01	19.87	11.08	8.79	48.23	49.01	-0.78
1980-84	29.78	37.27	-7.49	19.61	12.66	6.95	50.61	50.08	0.54
1985-89	28.56	37.60	-9.04	19.11	11.54	7.57	52.33	50.85	1.48
1990-97	29.67	36.59	-6.91	19.84	11.70	8.14	50.49	51.72	-1.23
Total	31.83	41.47	-8.40	19.36	9.80	8.91	48.81	48.73	-0.51

Source: Ndulu, B.J. and O'Connell, S.O., *Background Information on Economic Growth*, April, 2000.

**Table 6: Malawi Actual and Predicted Sectoral Shares, %**

Period	Manufacturing's share in GDP			Agriculture's share of the labour force			Ratio of ALP <sup>1</sup> in non-agriculture to ALP in agriculture		
	Actual share, my 95	Fitted share	Residual	Actual share, alsh	Fitted share	Residual	Actual ratio, alpd	Fitted Ratio	Residual
1960-64	—	0.80	—	93.20	64.56	28.64	—	—	—
1965-69	—	1.36	—	92.15	62.02	30.13	19.76	4.44	—
1970-74	—	1.88	—	90.71	59.40	31.31	18.60	4.31	15.45
1975-79	12.06	3.11	8.95	88.66	56.24	32.42	16.83	4.07	14.53
1980-84	12.37	4.05	8.32	87.15	53.08	34.06	16.00	4.12	12.71
1985-89	12.39	3.89	8.51	86.84	50.68	36.17	16.52	3.86	12.14
1990-97	14.35	4.34	10.00	—	47.79	—	—	2.99	13.52
Total	12.79	2.77	8.95	89.79	56.25	32.12	17.54	2.36	13.67

<sup>1</sup>ALP is ratio of value added in constant 1995 prices to sectoral employment.

Source: Ndulu and O'Connell (2000).

## 2.4 Cross-Country Regression Evidence

The cross-country regression exercise makes use of the augmented Solow model. In the original Solow model growth in output per worker depends on initial output per worker, the initial level of technology, the rate of technological progress, the savings rate, the growth rate of the workforce, the depreciation rate, the share of capital in output and the rate of convergence. This model predicts that a high rate of saving will affect growth of output per worker positively, whereas high labour force growth (adjusted for the rate of technological progress and the rate of depreciation) will have a negative effect on growth of output per worker. In the augmented version of the Solow model, investment in human capital is an additional determinant of growth in output per worker. The dependent variable in the augmented Solow model used here is the difference of real GDP per capita in the initial and final year of the period (e.g., 1970 and 1974). The explanatory variables are (a) real GDP per capita in the initial year of the half-decade (e.g., 1980); (b) the national savings rate, proxied by the ratio of investment to GDP, both at constant international prices; (c) a variable measuring replacement investment requirements and dominated in practice by population growth; and (d) a measure of saving for human capital accumulation. For purposes of (d), educational attainment is believed to be more appropriate than enrolment rates (Hoeffler, 1999). Hence, use is made of initial average years of schooling achieved by population aged 15 or above.

The estimation of the model used the recently developed system GMM (SYS-GMM) estimator. This estimation technique avoids biases stemming from endogeneity of explanatory variables and unobserved country specific effects associated with ordinary least squares or within group's estimation. The parameters derived from this exercise have been used to predict growth and to decompose it into contributions made by initial income, investment (proxy for savings), education, replacement requirements and a residual (Table 7). According to the estimates shown in Table 7, growth for Malawi is over predicted. The growth deviation is fully explained by the observed right-hand variables. Moreover, Malawi lies below (sometimes far below) the regression line throughout. Thus, the regression model provides a kind of "negative" guidance. Apart from initial income, replacement investment, which is mainly population growth and time dummies, the other standard determinants do not operate in the typical way. This suggests that there may be other factors that are slow moving and not well proxied by investment rate and initial educational attainment.

Actual growth, predicted growth and the residual are all larger during the half-decades starting in 1960–1964 and ending in 1975–1979 than during succeeding half-decades. Furthermore, the contributions of initial income, investment rate, initial educational attainment and replacement investment to the actual deviation from the sample mean all follow similar time patterns. However, the actual deviation of growth from the sample mean is on the average lower during the half-decades up to 1975–1979 than it is in succeeding half-decades.

**Table 7: Malawi fits and residuals from SYS-GMM estimation of augmented Solow model**

Period	Actual growth	Predicted growth	Residual	Actual deviation of growth from sample mean	Estimated contribution of:					
					Initial Income	Investment rate	Initial educational attainment	Replacement investment term	Time dummies	Residual
1960–64	1.62	3.32	-1.70	-0.32	5.61	-4.22	-0.13	-0.46	0.60	
1965–69	1.32	5.39	-4.08	-0.62	5.37	-1.74				-4.10
1970–74	2.91	5.84	-2.92	0.98	5.17	0.06	-0.13	-1.12	-0.06	-2.94
1975–79	1.69	5.65	-3.96	-0.24	4.73	0.11	-0.06	-1.29	0.26	-3.98
1980–84	-1.34	1.51	-2.85	-3.28	4.47	-2.08	-0.05	-1.30	-1.44	-2.87
1985–89	0.04	1.32	-1.29	-1.90	4.67	-3.81	-0.04	-1.52	0.10	-1.31
1990–97	1.36	2.62	-1.25	-0.57	4.67	-3.70	-0.04	-0.82	0.60	-1.27
Total	1.09	3.66	-2.58	-0.85	4.95	-2.20	-0.08	-1.02	0.10	-2.60

Source: Ndulu and O'Connell (2000).

**Table 8: Malawi fits and residuals from pooled conditional model**

Period	Fits and residuals			Actual and predicted growth deviation				Breakdown of policy contribution variables		
	Actual growth	Fitted growth	Residual	Actual growth deviation from sample mean	Contribution to predicted growth deviation of			Inflation (<500 %)	Black market premium (<500 %)	Non-productive government spending/GDP
					Base variables	Political instability	Policy			
1960–64	0.03			-2.17			-0.70	0.06	0.10	-0.86
	5.03	1.31	3.72	2.83	-0.53	0.20	-0.60	0.06	0.07	-0.72
1965–69	3.44	2.44	1.00	1.25	-0.15	0.20	-0.41	0.03	-0.04	-0.40
	2.67	0.16	2.51	0.47	-1.56	0.20	-0.89	0.04	-0.43	-0.49
1970–74	-1.62	-1.16	-0.45	-3.82	-1.53	0.13	-1.25	0.01	-0.36	-0.89
	-1.18			-3.38	-0.91	0.20		-0.01	-0.04	
1975–79	1.78			-0.42	-1.25	0.20		-0.06	-0.10	
1980–84										
1985–89										
1990–97										
Total	1.45	0.69	1.69	-0.75	-0.99	0.19	-0.77	0.02	-0.11	-0.67

Source: Ndulu, and O'Connell (2000).

Table 8 shows the results of a full regression incorporating a set of policy (inflation rate, black market premium and ratio of non-productive government less defence and education expenditure to GDP a la Barro/Lee) variables, base (initial income, initial life expectancy, age dependency ratio, growth in potential labour force participation, terms of trade shock, trading partner growth and landlockedness) variables, and institutional (political instability index) variables. The fitted growth underestimates actual growth. The actual growth deviation from the sample mean is not fully accounted for by the explanatory variables on the right-hand side. The base and the non-productive government expenditure/GDP variables have a negative contribution to the predicted growth deviation. So too the policy variables, especially during later half-decades. The political instability index has a positive contribution, a reflection of the role of political stability in the economy.

According to the estimates in this table, Malawi is on average fairly well characterized by the regression equation, but has large residuals during 1965–1969 and 1975–1979. Both half-decades had their expected share of bad weather (average proportion of dry years being 0.204 per half-decade). Often, Malawi also suffered from mixed weather conditions when there was bad weather in some part(s) of the country and good weather elsewhere, where bad weather may mean excessive rains.

The large positive residual during 1965–69 reflects a marked expansion in export receipts, as a result of an increase in both export volumes and prices. In 1966 alone, the year when sugar exports commenced, export earnings increased by 65%. As a result, there was no problem with the balance of payments. In 1967, the balance of payments improved on 1966 and remained healthy throughout the half-decade. Another contributory factor was an expansion in both private and fixed capital formation. It must be noted that it was during this half-decade that Malawi started constructing the Nkula Falls Hydroelectric Project, the Nacala Railway, the New Capital City in Lilongwe and upgrading the Blantyre-Lilongwe Road.

The 1975–1979 half-decade was also associated with a favourable balance of payments position. During this half-decade, the level of fixed capital formation was higher than during 1965–1969 as Malawi embarked on new major development projects, including the new Lilongwe International Airport, sections of the Lakeshore Road and the National Rural Development Programme.

## 2.5 Illustration

Next we use the regression evidence to calculate the policy requirements for high growth performance. We start by asking the simple question: What would it take to raise the growth rate in Malawi to East Asian levels? Alternatively, what would be the contribution to growth of achieving East Asian levels of policy variables?

Growth of real GDP per worker averaged -1.80% during 1990–1997 in Malawi. During the same time period, the growth of real GDP per worker in East Asia averaged 4.94%. In other words, the growth of real GDP per worker in Malawi must rise by 6.74 percentage points to reach East Asian levels. This has far-reaching implications for physical and human capital formation and for total factor productivity.

The contribution of physical capital per worker to the growth of real GDP per worker averaged -0.55% in Malawi against 2.29% in East Asia. This implies that the contribution of physical capital in Malawi would have to rise by 2.84 percentage points to reach East Asian levels. The rate of investment would correspondingly have to rise from about 20% now to about 40%, and that of domestic saving would have to rise from the current low rate of around 5% to about 27%, leaving a resource gap of 13%. These changes would no doubt have to be gradual. Even then, raising domestic saving and investment rates would be a major challenge for the economy of Malawi.

The contribution of education per worker to the growth of real GDP per worker averaged 0.13% during 1990–1997 in Malawi, against 0.39% in East Asia. Hence, in order to attain East Asian rates of economic growth, the contribution of education per worker would have to rise by 0.26 percentage points in Malawi, implying that the average years of schooling in Malawi would have to increase from 2.7 years to East Asia's level of 7.2 years or by 4.5 years.

Total factor productivity during 1990–1997 averaged -1.38% in Malawi against 2.26% in East Asia, implying that an increase of 3.64 percentage points is required in Malawi to reach East Asian levels. In the immediate future, this is not feasible. Therefore, it should serve as a long-term goal.

The policies that can contribute to high growth performance in Malawi can be divided into two groups. The first comprises policies that can play a positive role in both capital accumulation and productivity gains. These include stable macroeconomic policies. Average fiscal deficits must be kept low, thus limiting the need for inflationary finance. The public sector savings must be relatively high; inflation rates must be moderate; real interest rates must be quite stable and positive; and the black market exchange rate must be very small. The first group also includes policies to promote education. Government must continue promoting broad-based educational increases at primary and secondary levels with the assistance of interested church, private and community organizations. Development at post-secondary school level must focus on acquisition and strengthening of managerial and technical skills. The second group of policies focuses on trade policy. The Malawian economy has opened up and must remain so; and trade policy is export oriented. Nevertheless, it may be necessary to adopt selective interventions to promote promising export industries.

## 2.6 Conclusion

On the basis of the growth accounting decomposition for 1960–1997 for Malawi, the contribution of physical capital per worker and total factor productivity to the growth of GDP per worker was greater than that of education per worker. Also, the contribution of physical capital per worker followed a distinct pattern, but that of education per worker did not. The former rose rapidly during 1960–1969; rose further, then fell during 1975–1979; decreased further and became negative during 1980–1989, and remained negative during 1990–1997. The contribution of the residual also rose rapidly during 1965–1969, declined but remained low during 1970–1979, became negative during 1980–1989 and remained negative during 1990–1997. Correspondingly, the growth of real GDP per worker rose rapidly during 1965–1969, decreased but remained high during 1970–1979, was negative during 1980–1989, and became progressively negative during 1990–1997. Prima facie, it is tempting to use all four periods for analytical purposes. However, since the differences between 1960–1969 and 1970–1979 on the one hand, and between 1980–1989 and 1990–1997, on the other hand, are not substantial, this study will use two broad periods, 1960–1979 and 1980–1997. The former corresponds to pre-SAP (structural adjustment) era and the latter to the SAP era.

Rapid growth in value added during 1960–1979 and slow growth in the same during 1980–1999

occurred across many sectors. The data in Table 9 are merely illustrative of the changes that occurred in agriculture and manufacturing. Until 1965–1969, the growth rate of smallholder agriculture value added exceeded the growth rate of estate agriculture value added. However, between 1970–1974 and 1990–1994, the growth rate of value added in estate agriculture exceeded that of smallholder agriculture. But, during 1995–1999, the growth rate of smallholder agriculture value added once again exceeded the growth rate of estate agriculture value added.

According to the data in Table 9, the dichotomy in growth rates between 1960–1979 and 1980–1999 is more apparent in the manufacturing sector than in the agricultural sector. The same dichotomy is confirmed by indexes of manufacturing output (Table 10).

The period (1960–1979) of growth in real GDP per worker was associated with structural change in the economy as the shares of manufacturing, industry and services increased in GDP, while the share of agriculture declined. In contrast, no structural change occurred during the period (1980–1997) of decline in real GDP per worker.

**Table 9: Malawi growth rates of value added in agriculture and manufacturing 1965 to 1999 %**

Period	Agriculture			Manufacturing
	Smallholder	Estate	Total	
1965–69	15.46	9.88	20.48	..
1970–74	5.53	16.42	6.60	20.46
1975–79	3.32	12.70	4.34	16.74
1980–84	0.48	6.38	6.42	2.36
1985–89	0.28	4.80	1.28	3.64
1990–94	4.96	9.44	2.24	2.06
1995–99	20.74	7.50	15.92	1.10

Source: Malawi Government, *Economic Report* (Various Issues).

The overall intertemporal account of growth is also broadly consistent with the stylized facts as laid out in the regression analyses. In the SYS-GMM estimation of the augmented Solow model, for example, actual growth, predicted growth, residual and actual deviation of growth from the sample mean are all more favourable during 1960–1979 than during 1980–1997. So too the estimated contribution to the actual deviation of growth from the sample mean of initial income, investment rate, replacement investment and time dummies. Similarly, in the pooled conditional growth model, actual growth, fitted growth, residual and actual growth deviation from the sample mean are all more favourable during 1960–1979 than during 1980–1997. As are baseline and policy variables.

**Table 10: Malawi indexes of manufacturing output 1970–1999**

1970 = 100.0		1984 = 100.0		1984 = 100.0	
1970	100.0				
1971	110.6	1981	98.9	1991	138.6
1972	122.0	1982	93.1	1992	137.0
1973	147.4	1983	103.4	1993	129.2
1974	156.0	1984	100.0	1994	122.9
1975	180.0	1985	103.2	1995	124.5
1976	178.3	1986	105.7	1996	128.9
1977	199.1	1987	100.5	1997	127.8
1978	219.9	1988	106.9	1998	123.8
1979	220.7	1989	115.8	1999	112.2
1980	223.9	1990	131.8		

Source: National Statistical Office, *Malawi Statistical Yearbook* (Various Issues).

The aggregate approach used to explain changes in the growth of real GDP per worker emphasizes the role of physical capital accumulation, human capital formation, technological change, base variables, political instability and policy variables. While these factors are important in the particular case of

Malawi, it is useful to take into account two other factors. One is the replacement of short routes to the sea by longer land routes from 1984. The other is the declining amount of land per worker.

Taking land into account, the growth of output may be explained with the use of a neoclassical production function of the form:

$$Y = f(R, L, K) \quad (3)$$

where Y represents output, R represents land and other physical resources, L represents labour and K represents capital. This function identifies the determinants of growth as R, L and K. For a long time, economists believed that Y depended on the quantities of R, L and K used in the economy. This belief was seriously questioned from the 1950s. After examining research on agricultural growth using this production function, Schultz (1956) concluded that the link between conventional inputs (land, labour and capital) and output was weak. He identified two inputs that were neglected in the neoclassical production function: activities that improve the quality of people as productive agents, and activities that raise the level of the productive arts (technology). In reviewing analyses of growth in the United States, Northwestern Europe and Japan, Hagen (1980) concluded that land, labour and capital only explained from 19 to 37% of the increase in national income. According to his estimates, some 35% of the increase in national income was due to advances in knowledge and its application. Increases in the educational level of the labour force were also found to contribute significantly to increases in national income. The two non-conventional factors of production can be summed up as (a) the quality of labour as influenced particularly by education, and (b) the quality of capital due to technological change. Raising the quality of labour and capital requires investment in education and in research and development.

While it is important to consider quantitative measures of policy variables in explaining growth performance, the aggregate approach ignores the fact that various aspects of political economy may also influence growth. These aspects include major policy developments; policy choices in relation to interest group interactions and the incentives created by patterns of political competition; and the impact of politics on investment.

Furthermore, the aggregate approach ignores the microeconomic foundation of the observed macroeconomic performance, in particular the microeconomic variables that are relevant for economic performance. Economic agents (households and firms) and markets are believed to be among key microeconomic variables. What are the factors that appear usually to explain the growth performance of these private agents? What are their incentives and constraints? As media of exchange between these agents, markets are key institutions in the growth process. It is known, for example, that the reduction of transaction costs through institution building is the source of modern economic growth.

The early literature on economic growth emphasized low savings and hence shortage of capital as the main constraint to economic growth (Harrod, 1939; Domar, 1946). According to this literature, the rate of economic growth can be increased by increasing the rate of investment or reducing the incremental capital output ratio. Later, it was pointed out that a high savings rate and hence a high investment rate did not necessarily lead to a high rate of economic growth if there was a foreign exchange constraint. This view was behind the development of the two-gap model.

In a recent study that was motivated by the empirical evidence that Africa's poor growth performance is unexplained after considering basic growth fundamentals and policy stances among other things, Elbadawi and Ndulu identified two constraints to long-term growth in the continent. The first is vastly underdeveloped infrastructure. The significance of this factor in explaining the poor growth of Africa was confirmed through review of empirical studies and empirical analysis conducted by the two authors themselves. The second was the small size of African national markets (Elbadawi and Ndulu, 1996).

### **3. THE 1960–1979 PERIOD**

As stated above, the Malawi economy exhibited above-average growth during 1960-79, particularly after independence in 1964. What accounted for this good growth performance were a number of favourable

factors on both demand and supply sides. We shall concentrate on the major factors here. On the demand side, there was a marked increase in foreign demand for Malawi's principal agricultural exports of tobacco, tea and sugar. In the case of tobacco, this increase in demand was partly due to the international sanctions against tobacco from Zimbabwe (then Rhodesia) owing to the unilateral declaration of independence by white settlers there. International prices of these commodities rose as a result of the increase in demand for them. Because import prices did not rise as rapidly, the terms of trade improved. The value of the country's exports is said to have increased at an average annual rate of 19.5% between 1967 and 1977 (UNDP/ILO, 1999).

In the domestic market, there was a marked increase in demand for industrial products. This increase in demand was due to expansion in real disposable income, particularly among the majority smallholder farmers. Crop sales by these farmers to the state marketing corporation rose. A low average rate of inflation during this period permitted an increase in real disposable income and an increase in consumer demand of 4.3% per annum (World Bank, 1988).

This rise in consumer demand was overshadowed by a more rapid increase in the rate of investment, which occurred in both public and private sectors of the economy (Table 3). Public investment went into the construction of new tarmac roads, hydroelectric and water works, a new Capital City, a new international airport and public buildings, and the rehabilitation and construction of railways. Private sector investment went into factories, commercial buildings, plant, equipment and machinery, and new agricultural estates.

On the supply side, the main factors in the real sector of the economy were rapid expansion in estate agricultural production, especially production of tobacco and sugar, and a broadening of the industrial base, partly because of the establishment of import-substitution manufacturing enterprises. Other key factors were a rapid increase in domestic savings on account of expansion in income; a rapid rise in foreign exchange receipts on account of expansion in exports and foreign aid and capital inflows; and a fall in transaction costs caused by rehabilitation and construction of railways and internal roads.

The main forces leading to the change that ended this period were:

- A deceleration in the rate of public investment (Table 3), following the completion or near completion of major development projects, such as the Lakeshore road, the new capital city, the new international airport and other public buildings.
- A decrease in the rate of private investment (Table 3), in conjunction with the decline in the rate of public investment, but partly due to lack of profitable projects and inadequate internal savings.
- A sharp increase in transaction costs following the severing of the short railway routes to the sea through Mozambique from the late 1970s and the closure of these routes from 1983/84. These transport-related problems contributed to deterioration in the terms of trade.
- A decline in private consumption in real terms. According to reliable sources, private consumption per capita fell at an average annual rate of 0.6% between 1980 and 1997.
- A slowdown in the expansion of the estate agricultural sector in terms of output growth (Table 9).
- A sharp worsening in the terms of trade and a serious drought that affected the 1979/80 crop growing season.
- A sharp fall in the number of Malawians employed on South African gold and coal mines owned by members of the Chamber of Mines.

### **3.1 The Political Economy**

#### ***The 1960–1964 Period of Multi-Partyism***

This was a period of transition from British colonial rule to independence. Through 1960, a British Governor was in charge, and there was a legislative council in which a handful of Africans were included.

Meanwhile, the country, then called Nyasaland, belonged to the then Federation of Rhodesia and Nyasaland (FRN) comprising the three countries of Nyasaland, Southern Rhodesia (now Zimbabwe) and Northern Rhodesia (now Zambia). The Federation was formed in 1953 and was dissolved in December 1963. A few political parties existed and now there were two strong ones, a party mainly for whites and the Malawi Congress Party (MCP) for the indigenous people. MCP had in September 1959 succeeded the Nyasaland African Congress (NAC), which was founded in 1944.

In the August 1961 elections, MCP, under the leadership of Dr. H. Kamuzu Banda, emerged with a landslide victory. In January 1963, the country attained full self-government. On 6 July 1964, the British protectorate of Nyasaland became the independent state of Malawi. Other than the March 1959 bloody conflict between the nationalists and the colonialists in which some tens of the former were shot dead, there was no violent conflict during the 1960–1964 period. However, one major event that took place in September 1964 marked a major turning point in the course of Malawi's political history. The event was what is widely referred to as the "famous cabinet crisis".

The crisis was precipitated by a group of quite capable and progressive senior cabinet ministers who resented Kamuzu Banda's leadership style and tried to persuade him to pursue stronger anti-colonial policies including speedy Africanization. They failed. Consequently, six of them were dismissed or resigned from the cabinet in September 1964 and later fled into exile mainly in neighbouring countries, particularly Tanzania and Zimbabwe; they were eventually followed by some other dissidents. The conflict was to persist for three decades between the former ministers who went into exile and the opposition parties they formed and operated abroad on one hand and Kamuzu Banda and his ruling party on the other. On some occasions, the conflict resulted in violent injuries and even deaths of some of those in exile who were relentlessly persecuted by the Banda regime. Before he fled into exile, senior minister Henry Masauko Chipembere, one of the strongest opponents of Dr. Kamuzu Banda, started an open war in some part of southern Malawi but his force was quickly repulsed when attempting to advance to the then capital, Zomba.

The country became a de facto one-party state when the MCP won all the seats in parliament in the elections held three months before the independence date of 6 July 1964. The one-party system was later institutionalized by an amendment to the constitution.

The effects on the economy arising from the conflicts triggered off by the 1964 cabinet crisis and the ensuing undemocratic ways of managing many of the affairs of the state were to be felt over several decades.

**Periods of Particular International Agreements.** The country was hardly involved in major agreements with major international financial organizations in the 1960–1964 period. This, inter alia, was partly due to what has been stated below with respect to major policies.

**Dates of Major Policy Pronouncements.** The 1960–1964 period was to a large extent marked by a continuation of policies inherited from the colonial period. For example, no independent monetary policy could be pursued because the country had not yet established its own central bank and continued to be served by a branch of the central bank of the Federation of Rhodesia and Nyasaland. For the same reason no independent effective exchange rate policy could be pursued. As noted earlier, the Federation was dissolved in December 1963.

**Government Policy Choices.** As noted above, the period was largely marked by a continuation of policies inherited from the colonial administration. Nonetheless, some policy choices had to be made. A notable choice related to the development of the agriculture sector, the backbone of the country's economy. The choice was that of giving priority to the development of peasant agriculture in the 1962–1965 National Development Plan so as to raise the incomes of the masses. Thus government expenditure on the agriculture sector in the 1961–1968 period was mainly directed at smallholder projects and fewer resources were allocated to the estate subsector (J. Kydd, 1985). This policy choice was to be reversed from the late 1960s, however, to the detriment of peasants over the succeeding decades.

### ***The 1964–1979 Part of the Single Party Rule***



On 6 July 1966, Malawi became a republic, with Dr Kamuzu Banda as the first President. And in 1971 Banda became Life President as a result of an amendment to the constitution. Executive power was vested in the Life President and legislative power in the unicameral national assembly.

After the 1964 cabinet crisis, the existence of an autonomous social organization that did not support the ruling Malawi Congress Party (MCP) eventually became impossible. All Malawians resident in the country, willy nilly, had to be members of the MCP. Opposed by a major segment of the Malawi intelligentsia, Banda reacted by giving greater responsibilities to expatriates and by drawing popular support upon less well-educated sections of the population (McCracken, 1986). The cabinet crisis marked the beginning of the reversal of the development of genuine participatory democracy and the start of political intolerance, which became increasingly oppressive during the 30 years of the single-party regime that ended in May 1994. The regime became so intolerant of dissent that Malawians who dared to criticize it, or were suspected of doing so, were ruthlessly punished through detention, invariably without trial, and some of them died. Eventually Malawians, literate and illiterate, had to, for their own safety, learn not to express their dissenting views in public

Banda's intolerance of criticism applied even to those within the ruling party. He ruthlessly suppressed even the least sign of disloyalty on the part of members of the governing elite, including his closest associates. In the process, a small ruling clique emerged that handed down policies and decrees. Thus the ministers were left with nominal powers (Mhone, 1992) and the national assembly was reduced to "sycophantic impotence" (McCracken, 1986). Frequent reshuffling of ministers and other officials in key positions helped to keep the incumbents feeling insecure, not too comfortable and not over confident, thereby preventing the emergence of any rival to Banda. Intolerance even extended to religious bodies; they too had to be seen to identify themselves with the only political party. Even the chiefs were not spared if perceived to be disloyal to the party, and a few were deposed. This treatment of chiefs damaged the very nerve centres of the traditional civil society in the rural areas. In the process, party officials became even more powerful than traditional chiefs/leaders in most cases. The Malawi Congress Party became synonymous with the government.

In those political circumstances, therefore, press freedom and freedom of speech were luxuries that people in Malawi could not afford. Firm controls were kept not only on the local press and radio facilities but also on information given to foreign journalists. Probably the best political freedom of expression one had in Malawi was to praise/hero-worship Banda, an art that party functionaries and parliamentarians apparently strove to perfect.

Regaining the African pride, dignity and confidence lost during the oppressive colonial rule once against faced some hurdle after independence; and this was paradoxically in the form of Dr. Kamuzu Banda's attitude towards his fellow African. This was best evidenced by his refusal to allow any African to teach at the Kamuzu Academy, an expensive grammar/high school he established in his home district of Kasungu. Ironically, many of the students from Kamuzu Academy who fail to secure scholarships for study at universities overseas are admitted into the University of Malawi where they are taught by the same well-qualified Africans whom Banda considered not good enough for the grammar school. In this connection, it is of interest to note that during all the three decades of his rule, Dr. Banda (who had lived abroad including in the United States of America and Britain for about 40 years up to July 1958 when he returned home) never addressed any meeting in his native language, Chichewa, or any other language of Malawi; he always spoke in English through an interpreter.

Within the single-party system, however, politicians still competed for some party positions; also as parliamentary candidates in general elections whose names were, however, first approved by Banda. He also had powers, which he used, to nominate some members of parliament. Thus for three decades, the only secure position in public life was that of the Life President Dr. Banda who faced no competition (Level 3 on the Executive Scale, Humphreys 2000).

The background discussed in the above paragraphs is important for the reader to fully appreciate the difficult undemocratic conditions in which politicians, economic technocrats, other public servants and the rest of society lived for thirty years. And the implications for the making of public policy choices is reflected in the discussion.

**Periods of Particular International Agreements.** Periods of particular international agreements with

major donors and international financial bodies are several and in many cases overlapping. We therefore only state periods of agreements that seem to have made a difference, positively or negatively, to the economy. Some agreements related to sectoral issues and others to broader macroeconomic issues.

The Integrated Rural Development Project (IRDP) strategy ran from 1968 to 1978. This was agreed with the World Bank. The strategy was implemented in four selected parts of the country up to the late 1970s. Under this strategy, all requisite farm inputs and services (extension, credit, marketing, land development, roads, communications) were provided in an integrated and simultaneous manner. Implemented as part of an effort to promote small-scale agriculture, the strategy, however, failed to raise productivity of peasants in the four selected areas and proved expensive. It was realized by 1978 that a large proportion of peasants had been by-passed by this strategy, which had therefore contributed to rising inequality in the distribution of income among peasant households.

**Dates of Major Policy Pronouncements.** The dates in question are many. We therefore focus only on dates of a selection of main changes/shifts in key policy areas and introduction of a few major policies, sectoral and macro, which are of major importance in the analytical sections. The dates refer to when the policies were either pronounced or, of more analytical significance, when the policies were first put into effect, even if they may not have been formerly announced publicly. They include:

- ***Agriculture sector***
  - Late 1960s: The policy shifted to giving priority to the estate agriculture subsector instead of the smallholder subsector, which had been given priority in the early years of independence.
- ***Trade***
  - 1969: Internal trade policy saw the phased removal of Asian and European traders from rural areas to urban areas; this was completed in 1978.
- ***Exchange rate policy***
  - 1967: The Malawi pound was, for the first time, devalued by 14.3%. This was in response to the 14.3% devaluation of the pound sterling, to which the Malawi pound had been pegged at par since it was established in 1963.
  - 1971 February: A new currency called Malawi kwacha (MK) was introduced and pegged to the pound sterling at MK2.0 = £1.0.
  - 1973 November 19: The Malawi kwacha was pegged to a trade-weighted basket comprising the pound sterling and the US dollar.
  - 1975 June 9: The kwacha was pegged to the Special Drawing Right (SDR) of the IMF at MK1.0541 = SDR 1.0 initially.
- ***Financial sector***
  - 1973: Commercial banks were instructed to raise the proportion of their lending to Malawians to 50%, thereby forcing them to restrain their lending to non-Malawians (M.L.C. Mkandawire 1999, p.99).

**Government Policy Choices.** Here we focus on some critical policy choices at both the macro and the sectoral level. At the sectoral level we have included agriculture because it is the leading sector in the Malawi economy, and trade because it is critical to the development of the economy in the globalizing environment.

***Some agriculture sector policy choices.*** The critical policy choice made during the period under discussion was that from the late 1960s government agricultural policy began to shift priority back to the estate subsector as had been the case under the colonial administration. The choice was made in the wake of wide year-to-year fluctuations of output in the smallholder subsector including the output of maize and tobacco. This raised doubts about the ability of the smallholder subsector, which had been given priority in the 1962–1965 National Development Plan, to spearhead economic growth and generate enough revenue for government investments. The policy choice was made with the hope that the estate subsector had the potential for a more reliable source of economic growth and government revenue. Thus the Malawian elite comprising leading politicians, public servants and others were strongly encouraged, even

by Dr. Banda himself, to establish tobacco estates to expand output of a major export crop and provide the training ground for future commercial farmers (R.M. Mkandawire, 1992).

The Malawian elite were encouraged to grow burley tobacco, which requires less capital than the flue-cured tobacco that the white farmers were mainly growing. In fact, the issuing of burley tobacco growing licences and production quotas became an important part of the political patronage system in the country during the one-party rule. The Malawian elite were given, under leasehold tenure, generally large amounts of land alienated from customary land, which is where peasants are entitled to cultivate. The land rent was nominal. In addition, commercial banks were instructed by the government to support the new estate tobacco growers with medium-term loans for estate development and with seasonal overdrafts; bank support was generally almost 100% of the financial requirements of an estate owner because owner capital injection was nominal as the newcomers had no capital.

Policy emphasis on estate tobacco was justified by some external developments. One, there was a boom in world prices of flue-cured tobacco and burley tobacco varieties from 1973/74. Two, growth of the Malawi tobacco subsector benefited from international sanctions against (Southern) Rhodesia's Unilateral Declaration of Independence (UDI) by settler whites until that country, now called Zimbabwe, came under black majority rule in 1980 (M.L.C. Mkandawire 1999: 47).

Sugar estates were also established, the first one in 1965 and the second in 1979, operated by a large multinational. Like expatriate owned tobacco estates, tea estates were already being operated from the colonial period by foreign owned companies.

In short, tobacco, tea and sugar estates have over the years benefited substantially from the economy as a whole through access to large tracts of arable land at low rents, access to cheap labour backed by the government policy of low wages and, for tobacco estates in particular, access to large amounts of domestic bank credit.

The policy shift in favour of the estate subsector benefited the economy particularly in terms of exports, especially tobacco, which became the major export. But the policy contributed to the worsening of the economic position of peasants.

The interest group whose preferences were met by the policy choice comprised, as discussed above, large-scale commercial farmers. Since the interest group also included public policy makers (including President Banda himself) and implementers of the very policy choice under discussion, coupled with the fact that implementation of the chosen policy became increasingly impregnated with political patronage, the rest of the members of the group, existing and potential, did not have to lobby for their preferences. They had a free ride.

***Some trade policy choices.*** In the case of exports, the policy choice from the late 1960s was to boost the growth of exports of estate crops by giving several forms of support to their growers as discussed above. Support in the form of substantial bank credit was also extended to merchants involved in buying and exporting such crops. Thus the interest group that benefited from the policy choice, and continues to benefit, comprised not only estate crop growers but merchant houses as well, most if not all of them being owned by expatriates.

A major policy initiative was launched in 1969. "To meet the nationalist aspirations of African businessmen, particularly in commerce, presidential directives were decreed in 1969, which gradually eradicated trading activities of Asians and Europeans in the countryside; initially from the market centres to the trading centres and to the district centres by 1970, and cities by 1978. By 1979, all Asian and European non-farm sector activities had ceased in the countryside" (Chipeta, 1992). And many Asians had left the country by 1979. The initiative was welcomed by Malawian traders, existing and potential. However, it is evident that they have not adequately filled the vacuum left in rural areas by European and particularly Asian traders. Consequently, distribution of manufactured goods has been adversely affected in several rural areas over the years. This has also tended to raise transaction costs of many rural dwellers, who consequently have had to travel longer distances to urban shopping centres.

***Some fiscal policy choices.*** Politics has been a major factor in the distribution of government budgetary resources. And we will illustrate this with respect to regions. Dr. Banda's one-party rule practised a discriminatory policy of regional development in favour of the centre where he came from. This was a

key element of Banda's divide-and-rule strategy; the other element was persecution of northerners and southerners to some extent (Chirwa, 1998), although national unity was rhetorically preached on the political platform. Regionalistic sentiments have been quite pronounced since the colonial period, particularly between northerners on one hand and the rest on the other; which should be understood against a background of a number of historical factors, the major one being differences in literacy levels.

Historically, the level of literacy has been higher in the north than in the centre and the south of the country. Early missionaries established schools in all the regions. Job opportunities, however, were more available in the south where meaningful business enterprises were first established by the Europeans, mainly tea and tobacco estates where many jobs did not require good formal education. This may have distracted many with the potential to continue with formal education. Mainly as a result of this, for several years, northerners occupied proportionately more jobs requiring education in the civil service and elsewhere relative to their smaller population compared with people in the south and centre. This was resented by those from the south and centre. The imbalance has been considerably reversed in the post-colonial period, but signs of resentment still linger.

Northerners, too, have had feelings of resentment, but for different reasons. Also during the colonial rule little economic development took place in the north, which was referred to as the "Dead North". Development was concentrated in the south and to some extent in the centre, a regional imbalance that in the case of the north was not corrected by the Banda regime. To add salt to the wound of northerners who were already persecuted particularly in the public sector, most schoolteachers belonging to the north who were teaching in the south and centre were as recently as 1989, for no convincing reasons, forced to go and teach in the north, involving unnecessary use of budgetary resources in transferring teachers in large numbers. The move was relaxed with the coming of multi-party rule in 1994.

## 3.2 Markets

### *Agricultural Product Markets*

The following sections concentrate, first, on markets for the products of large-scale commercial farms and, second, on markets for smallholder crops.

**Estate Crops.** By 1960, the major crops grown on large-scale commercial farms (estates) were tobacco and tea. Sugar cane became another from the mid 1960s. Estate tobacco was grown in a few districts; since the late 1960s and particularly the 1970s, it has spread to many more districts. Tea was and continues to be grown only in two districts in the south of the country. Estate sugar cane is also grown in only two districts, one in the south, another in the centre. Tobacco estates by 1960 were almost wholly owned by Europeans, a situation that began to change from the late 1960s and particularly the early 1970s, so that by 1979 the majority of tobacco estates were owned by indigenous Malawians. Tea estates were and continue to be operated mainly by European owned firms. The only two sugar estates were and continue to be owned and run by a multinational.

During the period under review, estate crops were sold, and continue to be sold, under competitive market forces. Estate tobacco leaf was sold directly to international buyers/merchants through the local auction floors; the first floor was opened in 1938 in Limbe, Blantyre, in the southern region of the country and the second was opened in 1979 in the capital city, Lilongwe, in the central region. Tea was sold directly to foreign buyers through the local auction in Limbe, Blantyre, through the London auction and under private contracts. Sugar was sold abroad largely under quota agreements with the EEC and the USA. Negligible proportions of tobacco and tea were consumed locally, but a much larger proportion of sugar was consumed locally. While prices of most estate agricultural products have always been freely determined by market forces, there was one major exception: The local price of sugar was controlled by the government throughout the period under review.

Reliable market information on estate agricultural products has been readily available for a long time. A major source of such information is the organizations that look after the interests of the growers, merchants and processors, and auction floors. For tobacco, they include the Tobacco Association of Malawi, Tobacco Control Commission and Auction Holdings Limited. For tea, they include the Tea Association of Malawi and Tea Brokers Central Africa. The secretariats of most of these organizations

issue newsletters and other periodicals containing market and other related information for use by their members and other users. Other sources of information include periodicals from developed countries where the products are mainly exported, especially where international market centres are located such as London.

During the period under review transport was, among estate crop producers, more of a problem for estate tobacco growers located far away from tobacco auction floors, which therefore had to meet higher transaction costs. This was particularly the case for tobacco growers in the central and northern regions of the country before the auction floors were opened there. In the southern region, transport infrastructure was more developed to serve the needs of export commodities, in terms of both internal roads and the rail line; with the latter connecting landlocked Malawi with the Mozambique seaports of Beira and Nacala; the rail route to Nacala was opened during the period under review and the rail route to Beira was opened in the colonial period.

Malawi has always been one of several countries that produce tobacco, tea and sugar. The competition Malawi exporters face on international markets is therefore obvious. Domestic transactions, however, need to be qualified. In the case of sugar there was, and still is, only one producer/supplier, whose domestic selling price was, as stated above, government controlled during the period under review. In the case of tobacco, the growers, who add up to several hundreds, do not export but sell to a handful of tobacco buyers/merchants at the local auction floors who process the leaf and export it. There have sometimes been allegations of collusion on prices among the buyers, to the detriment of growers; the buyers are much more knowledgeable about the world tobacco market than most growers. In the case of estate burley tobacco, the growing of which is based on the tenant scheme, the prices (whose ceiling was set by government) paid by estate owners to tenants was, and still is, much lower than the prices fetched by estate owners on tobacco auction floors; estate owners are in turn much more knowledgeable about the tobacco market than their tenants, who are resource constrained and powerless.

It seems therefore that where the crop grower is not the exporter (as for tobacco of all varieties) and where the grower is not the seller on the local auction floors (as for tenants on burley tobacco estates), the market is less integrated (in terms of flow of information and price levels) and less efficient with respect to resource allocation than where the grower is also the exporter, as is the case with the bulk of tea and sugar exports.

Most of the characteristics of the markets for estate agricultural commodities for the period under review were inherited from the colonial period. They hindered the performance of private agents in varying ways. As indicated above, notable hindrances included the relatively high transaction costs incurred by estate tobacco growers located far away from auction floors; prices fetched by tobacco growers on the auction floors sometimes being unattractive because of the alleged collusion among foreign buyers; and unfairly low prices paid to tenants on burley tobacco estates.

Some institutional changes took place during the review period. A major one was the shift in the composition of firms operating tobacco estates, from nearly all of them being European owned at the beginning of the period to the majority of them being owned by indigenous Malawians by the end of the period because of a sharp increase in their numbers. Another major development was the introduction of the country's second tobacco auction floor, this time in the central region.

**Smallholder Crops.** A wide range of crops were already being grown by smallholder farmers by the early 1960s. And during the review period the main ones comprised food crops, including maize (the staple food), cassava, rice, potatoes, beans and other pulses, groundnuts, sorghum, vegetables, tomatoes, and the major non-food cash crops, namely smallholder tobacco and cotton. While many of the crops were and continue to be grown in most parts of the country, some were concentrated in a few parts with suitable soils and climatic conditions. The crops continued to be grown by smallholders on customary (traditionally) held land as opposed to leasehold and freehold land where estate crops continued to be grown. During the review period, customary land became progressively scarce owing to its conversion into leasehold land for estate tobacco growing and rapid population growth. Consequently, the proportion of smallholder households with adequate land to always grow marketable crop surpluses over their subsistence food requirements progressively decreased to a minority.

Smallholders had two outlets for selling their commodities, private and official. Private outlets

consisted of selling food crop harvests, perishables and non-perishables, either directly to consumers at small produce markets in rural areas mainly on roadsides and urban produce markets in the case of smallholders located within the vicinity of urban areas; or to middlemen/small-scale traders. Private traders, however, played a significant role only with respect to some crops including rice (Malawi Government, Statement of Development Policies 1987–1996). Exporting of agricultural commodities by private traders was heavily regulated through licensing, especially food crops, more so in years of national scarcity caused by droughts when exporting of major food crops was usually banned.

In the review period the official outlet was dominant. Smallholders sold the bulk of their non-perishable marketed crop output to the Agricultural Development and Marketing Corporation (ADMARC, earlier on called Farmers Marketing Board-FMB), a parastatal charged with the responsibility of marketing smallholder crops. Legally, ADMARC's monopsony was restricted to the purchase of smallholder tobacco and cotton, the main cash crops of smallholders. In practice, however, the parastatal went on to purchase a wide range (over 15) of smallholder crops including maize. It also became involved in transporting, storing, cleaning, grading, milling and shelling of the crops and in arranging for their domestic and export sale. Domestic sales were made to agro-based industries (such as grain millers and textile manufacturers) as well as directly to consumers in the case of major food crops, including smallholders who ran out of their subsistence requirements before the next harvest. As for the varieties of tobacco ADMARC bought from smallholders, it sold on the local auction floors (just like estate tobacco growers), except one variety, oriental tobacco, which the corporation sold directly abroad under private treaty. In addition, ADMARC was also involved in procuring and supplying to smallholders farm inputs such as fertilizer, pesticides, seeds and tools.

Official producer prices of smallholder crops were fixed by the government and ADMARC as guaranteed minimum prices and announced before the planting season. The prices were uniform across the country and across the season; the one exception was in the case of tobacco: if ADMARC earned significantly higher prices on the local auctions than expected, an additional payment was made to smallholder tobacco growers later in the marketing season. Smallholder producer prices were raised in many years but by smaller percentages than was later to be the case after liberalization. Over-valuation of the country's currency arising from the fixed exchange rate regime, among other factors, constrained ADMARC's capacity to raise smallholder producer prices.

Market information available to smallholders was mainly in the form of the pre-planting official announcement of producer prices and the corresponding type, quality/grade of a crop; this information was also obtainable at hundreds of ADMARC markets operated throughout the country. No information was compiled on the private channels of marketing smallholder crops.

Smallholders transported their commodities to ADMARC markets on foot, on bicycles, and – in much fewer cases – on ox-drawn carts and other means. The same applied to the transporting of their commodities to other markets. In some cases they could freight their products as accompanied luggage on buses, or (usually illegally) on lorries and pickups particularly when going to faraway produce markets in urban areas. While a problem to smallholders generally, transport was much more of a problem to smallholders living and cultivating in remote rural areas with poor or hardly any access roads.

In the circumstances, the domestic markets for smallholder crops were hardly competitive. Their sales to ADMARC were at officially set prices for the prescribed qualities/grades. In the case of their sales through private outlets, smallholders could hardly compete because of lack of market information and the transport constraint. Mobile private traders are likely to have been in a stronger bargaining position compared with smallholders because they will have collected some information on other smallholder suppliers. It is clear from the foregoing discussion that the markets for smallholder crops were fragmented: Apart from the information on producer prices released before planting, there was considerable lack of up-to-date and reliable market information for use by either sellers or buyers, particularly with respect to private trading activities. The uniform producer prices paid by ADMARC, as already noted, were determined officially and not by market forces.

It is also clear that most of the characteristics of smallholder crop markets arose from government policies and regulations. The effects of the market characteristics on the performance of the official and private economic agents was mixed. In terms of profitability, ADMARC performed well, as was evidenced by the huge profits the parastatal was making through large differentials between its selling

prices and the low produce prices paid to smallholders. On the other hand, the performance of smallholders was considerably constrained by being heavily taxed through the low producer prices, which were officially set, hardly with due consideration of the smallholders' cost of living. In addition smallholders had to pay poll tax. The performance of private traders was considerably constrained as well. Their participation in the marketing of most smallholder crops was limited, and even non-existent in the case of smallholder tobacco and cotton since the two crops were only bought by ADMARC.

### ***Financial Markets***

Issues touched on here include the institutions operating in the market, and characteristics of the financial such as competition and fragmentation. The section also looks at the money market, the capital market and some of the impact of the characteristics of the financial markets.

**Formal Financial Credit Market.** During the period under review, the characteristics of the formal financial credit market arose out of historical factors, behavioural traits of financial institutions and financial repression. Financial repression was characterized by direct controls on interest rates and bank credit; also entry into the financial market appears not to have been encouraged by the country's own central bank (Reserve Bank of Malawi), which was formed in 1965.

**Institutions.** Lack of official encouragement of new entrants into the market was illustrated by the fact that during the whole period of 1964 to 1979, only one new commercial bank was established, in 1970, called Commercial Bank of Malawi (CBM). Thus, in this period there were only two commercial banks; the other one, the National Bank of Malawi (NBM), arose from the amalgamation of two old expatriate banks (Barclays and Standard) in 1971. Only three new non-bank financial institutions (NBFIs) were established: two development finance institutions (DFIs), in 1964 and 1972, and one trade finance institution in 1976. This raised to only eight players in the market (excluding insurance companies), i.e., two commercial banks dominating the market and six NBFIs, three of which were old ones.

None of the new NBFIs was licensed to accept deposits, illustrating the fact that monetary policy gave little attention to the critical issue of mobilization of domestic financial savings for economic development. They relied wholly on equity and loan finance, the bulk of which was from abroad, thereby perpetuating the foreign aid dependence syndrome among such NBFIs. All of the three old NBFIs were deposit acceptors: Post Office Saving Bank (POSB), New Building Society (NBS) and Mercantile Credit (MC).

Another illustration of little official encouragement of new entrants into the formal financial market was the fact that no agricultural credit bank was formed in spite of the agricultural sector being the backbone of the economy. As a result, the role of an agribank was largely played by the only two commercial banks. Also missing was a discount house in the underdeveloped money market and a stock exchange in the underdeveloped capital market.

As for shareholding, some of the financial institutions were wholly owned locally while others had local and external shareholders. Post-colonial government participation in critical financial institutions, mainly through the major parastatals, led to considerable inter-locking of state shareholding, particularly in commercial banks.

**Competition.** Openness and competition of the formal financial market were constrained by some of the characteristics mentioned above. Namely, little encouragement of new entrants into the market, resulting in having only a few players in the market; also, overlapping of state shareholding. Another constraint was overexposure of commercial banks to the estate tobacco subsector, a national priority subsector of export production to which the banks were instructed to direct a considerable proportion of their credit, particularly from the mid 1970s. This left the banks with not much resource capacity, particularly human, for administering credit to other sectors. Even within the estate tobacco subsector, inter-bank competition was for sometime weakened by an arrangement that required one of them to concentrate on assisting growers of flue-cured tobacco and the other bank growers of burley tobacco, the two tobacco varieties produced on estates. The arrangement eventually was not followed as the growing of burley overtook flue-cured and became increasingly dominant.

A further constraint to competition was the banks' and NBFIs' own conservative perception of lack of

good lending opportunities in the economy. This was evidenced by their unwillingness to venture into areas of lending hardly tested and known to them, including non-traditional export activities, smallholder farmers, and non-agricultural small and medium enterprises (SMEs), none of which had access to adequate credit. With such a conservative perception, there was little incentive for them to attract deposits that they felt they could not invest gainfully.

Competition between the commercial banks segment and the NBFIs segment of the financial market was also constrained by the fact that for historical reasons the former specialized in short-term lending (largely to serve the needs of foreign trade and large enterprises), with little medium- and long-term lending, while the latter specialized in medium- to long-term loans with little short-term lending. Within the NBFIs segment, competition was to some extent also hampered by the limited resource base of non-deposit accepting NBFIs. NBFIs in general were engaged in rather narrower specialized ranges of services than commercial banks. Further, the lending mandate of the POSB was restricted to the government through holding local registered stocks and treasury bills. To some extent location of branches and agencies may also have influenced competition. For example, commercial banks were well placed in urban areas whilst the POSB was dominant in the rural areas in terms of mobilizing deposits from small rural savers.

Competition, particularly among commercial banks, was also hampered by the very official/central bank controls and regulations, some of which have already been mentioned, i.e., controls on credit and interest rates. Also, the central bank was involved in setting rates of fees charged by banks on their various non-lending services.

**Fragmentation.** In the review period, there were weak linkages/fragmentation in the formal financial market as reflected in inadequate flow of resources among its institutions. There were weak linkages within and between the commercial bank segment and the NBFIs segment of the market. A number of factors were behind the fragmentation.

First was the specialization of the commercial bank segment and the NBFIs segment on their lending side as noted above. Specialization is not inherently undesirable; after all, it promotes efficiency through quality and quantity of the service provided. What was undesirable was that institutions in each segment tended not to explore business opportunities beyond their traditional confines.

Second, development finance institutions mainly relied on foreign sources of capital funds even when some other domestic institutions had excess loanable funds. Also, commercial banks, before being localized, relied heavily on their head offices overseas when in need of additional funds; after localization they continued to seek assistance, on a reduced scale, from international banks including their former head offices, which were now called associate banks.

Third, the money and capital markets were too underdeveloped to facilitate efficient flow of funds amongst institutions. Their underdeveloped level was basically due to lack of market participants and appropriate financial instruments.

**Money Market.** A number of specific factors were responsible for the shallow money market. One, even after being localized, commercial banks seldom borrowed from the central bank as lender of last resort; and when they did so it was in small amounts. There were three reasons for this: their long-standing reliance on overseas banks; the fact that commercial banks usually held liquid assets in excess of their statutory minimum requirements; and the interest rate structure that reduced commercial banks incentive to borrow from the central bank because the bank rate at which commercial banks could borrow from the central bank was higher than the interest rates paid to depositors by commercial banks on savings deposits and some of the term deposits.

Two, the POSB with its large deposit resources could not place its funds at commercial banks and other NBFIs since its use of funds mandate was restricted to holding government securities.

Three, there was a narrow range and low volume of commercial paper (bills of exchange etc) because sellers and buyers of major cash crops (agriculture being the mainstay of the economy) had easy access to overdraft facilities, so that payments to creditors were prompt; and they had developed intimate knowledge and trust of one another, which also applied to the relationship between major exporters and their traditional buyers abroad. Also, in addition to interest charges, commission and stamp duty were



levied on borrowing through bills of exchange, which made it a costlier method of raising funds than through an overdraft. Thus, apart from the overdraft, the major money market instrument was the government treasury bill.

Four, NBFIs were little involved in short-term credit instruments, and five, there was no discount house to facilitate money market operations.

**Capital Market.** Specific reasons for the underdeveloped capital market included the following:

- Lack of tradeable financial instruments of medium- and long-term maturity other than government local registered stocks.
- The problem of maturity transformation of the largely short-term deposit liabilities of commercial banks (some of them being unstable deposits) into medium- and long-term instruments of lending. Being risk averse, banks find it hard to take on risks associated with long-term lending. In practice, however, commercial banks are to some extent already lending long against relatively short deposits: their fluctuating non-seasonal yearly overdraft facilities provided to non-agricultural large corporate perpetual borrowers are usually not repaid fully but rolled over on the renewal anniversary; this goes on for several years, thereby in practice turning administratively short-term into medium- and long-term credit.
- For fear of dilution of their ownership, existing owners of some enterprises were likely to be reluctant to accept new shareholders, especially in the case of most SMEs, which are family owned.
- There was no local stock exchange.
- There was a legal constraint to dealings in shares of private companies.
- There were not many individuals who could deal in securities owing to generally low income levels and lack of knowledge about sophisticated financial instruments amongst people in the country.

**Some Consequences of Market Characteristics for Its Agents.** The banks became overexposed to the estate tobacco subsector through the official policy of directed credit as noted above. And this subsector generated significant proportions of non-performing debts. Two major adverse consequences were that the banks' capacity to attend to other (even more profitable) sectors of the economy, particularly outside their traditional areas of lending, was considerably constrained and their profitability levels were substantially depressed. The human resource capacity constraint in general facing the banks as well as NBFIs, and particularly their conservative perception of lack of good lending opportunities outside their traditional areas of lending, resulted in excess liquidity on their books. This was a paradoxical phenomenon in an economy where a large part of aggregate demand for credit was not satisfied.

### 3.3 Microeconomics

This part of the study explains the environment faced by key economic agents, their response to it and the consequences of those responses for economic growth. The relevant thematic paper focused on rural households and the manufacturing sector (Collier and Gunning, 1999). Our preference is basically for the same types of economic agents, but for the fact that rural agents will include smallholder and estate sector agricultural households. Throughout the study period (1960–1999), agriculture was the dominant sector of the economy of Malawi. For example, in 1964, agriculture, mainly smallholder agriculture, accounted for 45% of GDP, 90% of domestic exports and 90% of the resident labour force. Manufacturing contributed 4.5% and distribution contributed 10% to GDP in the same year. In 1997, agriculture still accounted for about 90% of exports, but its share was down to 37% of GDP and 70% of the labour force. Most of the agricultural exports are now generated in the estate sector. However, the smallholder agricultural sector remains the major contributor to GDP, food security and informal employment. Altogether, changes in rural incomes have a profound effect on demand for domestic industrial products. The share of manufacturing and distribution in GDP had gone up to 14 and 24%, respectively, by 1997. This study will focus on the manufacturing sector because of its long-term role in transforming the economy. Currently, manufacturing is the second largest source of employment after agriculture and the third largest contributor to GDP after agriculture and distribution.

### ***Agricultural Households***

Agricultural households face a physical and policy environment that is in many ways daunting. The total land area of the country is rather limited and measures only 94,276 square kilometres. On high-altitude plateaux, soils are infertile and strongly leached. With high rainfall and cool climates, these areas are suitable for tree crops and forestry, but not for arable farming. Similarly, high-altitude hill areas and the Rift Valley escarpment have thin, stony soils. Areas with higher agricultural potential are confined to medium-altitude plains, which have clay or loamy soils and normally receive adequate rains. These plains contain the largest agricultural land in Malawi. But their soils as well as the stony soils of the high-altitude areas are not suitable for irrigation using micronutrient fertilizers. Such farming technology is suitable for the Rift Valley floor with its alluvial soils, but the extent of this area is quite limited.

Malawi experiences three seasons in the year: a hot and wet season, followed by a cool and dry season, then a hot and dry spell. Normally, the hot and wet season extends from November to April, but in many years rains end in March and can commence as late as January. This uncertainty over the duration of the rainy season, along with frequent droughts, increases the risk of rain-fed agriculture.

Together with manufacturing firms, agricultural households face high rates of morbidity and mortality. In 1994, there were 49,410 malaria cases per 100,000 people; in 1998, there were 205 tuberculosis cases per 100,000 people; and the HIV/AIDS prevalence rate among adults is now about 16% or over 800,000 people, to name but a few examples. This level of morbidity translates into a high death rate and a low life expectancy rate of less than 40 years. It is partly responsible for low productivity on both smallholder farms and estates; for absenteeism on estates; for an increase in expenditure on treatment and funerals by estates; and for an increase in the time devoted to the care of patients and orphans and in the time spent on funerals by smallholder farmers, all of which divert resources away from agricultural production.

Against this background, smallholder farmers find it risky to concentrate on cash cropping, which may fail. Hence, they practice both subsistence and cash crop farming. They also find it risky to concentrate on a single cash or subsistence crop, so they are involved in growing several subsistence and cash crops. In the absence of concentration on one or a few crops, they miss gains from specialization. With a larger amount of resources, most estates can mitigate the effects of late rains or drought by irrigating their crops from dams, rivers or other water bodies. Hence, they can afford to specialize on one or a few crops, but not so the majority of smallholder farmers.

In response to the risky physical environment, smallholder farmers employ a number of mechanisms to share risk, including cooperative arrangements for production, for savings and credit, and for the use of other resources. They attempt to reduce would-be fluctuations in consumption by smoothening it through cooperation. They also smoothen consumption by keeping their wealth in the form of assets that they can readily transform into foodstuffs. Inevitably, this implies that most of their wealth is kept in the form of liquid assets, e.g., cash.

During the colonial period Africans grew the bulk of the food crops (maize, millet, sorghum, groundnuts, rice, potatoes, beans, vegetables, fruits, etc.) for consumption and for sale. Although they dominated exports, they were allowed to grow only cotton, coffee, oriental tobacco and dark fired-cured tobacco as cash crops. They were not permitted to grow burley tobacco, flue-cured tobacco, tung or tea, which were grown on European-owned estates. This severely limited economic opportunities available to them. In addition to crop restrictions, there were quota restrictions on the production of tobacco.

After political independence in 1964, the government started removing these restrictions. From the second half of the 1960s, Africans were allowed to grow tea and sugarcane through smallholder outgrower schemes. But these schemes have not done much to alter the colonial pattern of distribution of opportunities. Africans were also allowed to grow flue-cured and burley tobacco on estates. But this too did not spread opportunities widely enough. This had to wait until smallholder farmers were allowed to grow burley tobacco from the early 1990s.

Estate agriculture enjoyed many privileges. It had easy access to subsidized credit, to cheap customary land, and to local and foreign markets. It paid low prices to tobacco tenants and low wages to agricultural workers. In contrast, with a growing population, smallholder farmers faced declining acreage per household. They lacked adequate credit, infrastructure and agricultural extension services. Meanwhile, increasing dependency on the production of tobacco and failure to diversify increased the vulnerability of

the estate sector to weather conditions and a fall in tobacco prices. The neglect of smallholder agriculture, in terms of declining productivity and incomes, was responsible for the underdevelopment of off-farm small-scale and medium-scale activities in both urban and rural areas.

The volume of estate agricultural exports grew at 13% per annum over the period 1973 to 1983. In contrast, the volume of smallholder agricultural exports stagnated over the same time period, despite huge public investments in smallholder agriculture. Estate agricultural exports were heavily concentrated in tobacco, tea and sugar. While it was possible to expand tobacco output further, growth was constrained by inadequate managerial manpower, lack of credit and fuel wood scarcity (which affected flue-cured tobacco). Growth of tea was hampered by lack of suitable land and unfavourable prices on the world market. Uncertainties about prices and export quotas affected the expansion of sugar production. Hence, if the estate sector was to maintain its share in total exports, increased diversification into other crops was essential.

Smallholder agricultural development was under strain, as well. Frequent droughts, plant pests (e.g., the mealy bug), the declining land/person ratio and falling productivity cut into living standards and growth prospects. The consequences were serious, not only for the incomes of agricultural producers, who included most of the women and the poor, but also for supplies of food and raw materials for industry, for employment, savings, government revenues, and for the demand for goods and services produced outside agriculture. However, the sectoral plan, which had few policy changes, lacked appropriate strategies.

Population growth put intense pressure on agricultural land, and the structure of land holding became more dualistic, with several large but many more very small farms. The country achieved substantial growth in high-value agricultural exports (especially tobacco, tea and sugar) until 1983, but largely from estates; smallholder production grew little or not at all in per capita terms (Kydd and Christiansen, 1981). Thus no success was achieved in reconciling growth and equity objectives. The success of the estate sector reflected a macroeconomic policy environment that broadly favoured commercial agriculture and allowed the country to adjust better to severe external shocks. These shocks included substantial terms of trade losses on agricultural exports. The country avoided extreme over-valuation of its currency, and thus implicit taxation of agriculture, and its budgetary deficits and inflation rates were relatively smaller and stable. While the shares of government expenditure in GDP were comparatively smaller, relatively large shares of government expenditure were devoted to agriculture and infrastructure (Lele, 1989).

### ***Manufacturing Firms***

In Malawi, manufacturing enterprises are classified into micro, small, medium and large scale. This classification of manufacturing enterprises is based on three criteria (capital investment, employment and turnover) for demarcating size and the use of four size groups (micro, small, medium and large) as shown in Table 11. Owing to these complications, a manufacturing enterprise may not qualify as purely micro, small, medium or large under all the three criteria. If an enterprise satisfies two of the criteria, then it is classified as micro, small, medium or large, as the case may be. If, in contrast, it satisfies one criterion as micro, one as small and another as medium, then the middle classification (small) is binding. But, there is an element of arbitrariness in this to the extent that the three criteria are given equal weight.

The number of employees as a criterion has been used in a many past studies and even in official statistical publications. However, the exact number of employees for micro- and small-scale enterprises is contentious, even though recent studies have tended to follow the official view that 5–20 employees correspond to small-scale enterprises, 1–4 employees to micro enterprises.

The size distribution of manufacturing enterprises in Malawi is typical of countries at an early stage of development. In 1987, for example, the National Statistical Office had in its register 405 firms in the manufacturing sector. Some 88 or 21.73% of these firms were micro enterprises; 107 or 26.42% were small scale; 106 or 26.17% were medium-scale and 104 or 25.68% were large-scale enterprises. By 1998, the percentage of micro enterprises had increased to 32.27%, while the rest had declined (for small-scale to 25.47%, for medium-scale to 22.00% and for large scale to 20.26%). Hence, the sector is increasingly becoming dominated by comparatively small enterprises.

In terms of industrial classification, manufacturing industries are divided into those that produce goods for the domestic market, which are further divided into consumer goods industries and intermediate goods industries, and those that produce goods for the export market. The bulk of manufactured output for

the domestic market stems from four subsectors: food, beverages, textiles and clothing, and leather goods. Products for construction and building (cement, brick and tiles) form the bulk of the intermediate goods produced in the country.

With a population of under 10 million and a real per capita GDP of MK1,224 in 1997, Malawi's domestic market is too small to profitably support more than one or two large firms in many subsectors. As a result, there is a high degree of market imperfection. Using the Herfindahl–Hirschman index of concentration for three years, 1981 to 1983, a World Bank study found that the market structure in manufacturing is characterized by a high degree of concentration, with oligopolistic firms accounting for 68% of the total number of firms and monopolies accounting for 4% in 1983. Oligopolies accounted for 86% of total sales and monopolies for 3%. Competitive firms were 28% of all manufacturing firms, but their contribution to total sales was only 11%. The liberalization of imports since 1983 has meant that all domestic firms are now subjected to more competition. On its part, government has recently enacted a law to encourage competition and fair-trading practices, but its effective implementation is yet to be seen.

**Table 11: Malawi, official classification of enterprises**

Criterion	Micro	Small	Medium	Large
Capital <sup>1</sup> investment	Up to MK5,000	Up to MK200,000	Up to MK500,000	Above MK500,000
Employment	1-4	5-20	21-100	Above 100
Turnover	Up to K12,000	Up to MK400,000	Up to MK1 million	Above MK1 million

<sup>1</sup>Including land and buildings.

Source: Ministry of Commerce and Industry.

On the basis of ownership, manufacturing firms are classified into private local, private foreign and parastatal. The World Bank study found parastatals to be the most protected and inefficient. Using effective protection, which measures the effects of a tariff system on an industry's value added, the rate of effective protection for the parastatals group was estimated to be 278%, as against 146% for the private local and 93% for the private foreign. Long-run domestic resource cost ratios, which measure the sum of dollars spent on labour for each dollar of foreign exchange that is saved through import substitution (or exports), were 2.16 for parastatals, 1.24 for private local and 0.87 for private foreign firms. Under the ongoing privatization programme, the number of public enterprises and, hence, inefficient firms is declining.

Between 1960 and the mid 1980s maximum price controls were in force. These prices could not be adjusted upward automatically in line with increases in costs, as the industries concerned had to obtain government approval first. Sometimes approval was denied or, when it was granted, the price adjustment was not adequate. Some industries reacted by reducing supply, which resulted in rationing, e.g., of sugar and cooking oil. Unable to generate enough revenue, the firms experienced cash flow problems, while their profitability and internal savings were adversely affected, leading to lower levels of investment. Because the political elite had no direct business interests in manufacturing, the Chamber of Commerce and Industry failed to convince government to abolish maximum price controls.

Development of manufacturing industries in Malawi started during the later part of the colonial period (1891–1964) when a few light industries were set up by private enterprises to produce consumer goods. A few intermediate goods industries were also set up during this period to produce cement, bricks and tiles. The attainment of political independence in 1964 gave industrialization a push as Malawi began to consciously promote manufacturing industries to diversify sources of income, exports and employment in a country that had hitherto been dependent on the production of primary products. Although limited by low per capita income, the domestic market offered some opportunity for import substitution industrialization through which it was hoped that foreign exchange would be saved. In manufacturing areas where private enterprises were either unable or unwilling to set up industries, public enterprises were set up to fill the gap, mainly under the aegis of the Malawi Development Corporation (MDC).

From the mid 1960s, the policy framework for industrial development was contained in the 1966 Industrial Development Act, which set out the conditions under which industrial firms could be licensed

and the incentives for stimulating them. The emphasis on a minimum efficient scale in the act meant that large firms were favoured at the expense of small-scale firms. Also favouring large-scale firms were generous investment and depreciation allowances, which were given to them to reduce their tax liability. The provisions relating to tariff and exclusive protection bred monopolies and infant industries that could not survive if protection were lifted. On balance, however, the act is believed to have provided appropriate sector policies for industrial development.

In general, the economic environment was favourable to manufacturing firms. Improvements in infrastructure occurred on many fronts: a marked expansion in electricity generating capacity and in urban water supplies, construction of the Nacala Railway to the Mozambican coast and extension of the domestic railway, and improvement to the country's main road network, among other developments. The economy itself experienced relative stability; the rate of inflation averaged less than 10%; financial policies resulted in interest rates that were low and not volatile; and the pegging of the currency consecutively to the pound sterling, the US dollar and the pound sterling, then to the Special Drawing Right (SDR) gave the exchange rate a measure of relative stability.

In response to the generally favourable economic environment, there was a marked increase in gross capital formation in manufacturing during the period. Among large-scale firms, for example, gross capital formation increased in real terms from an average annual amount of K102.45 million during 1965–1969 to K182.40 million during 1970–1974 and K282.34 million during 1975–1979, according to data provided by the National Statistical Office. During 1970–1974, inventory investment was 68.56% of gross capital formation, implying that there was less investment in equipment and machinery. But the situation changed during 1975–1979, with inventory investment accounting for only 23.02% of total manufacturing investment. Available evidence also indicates that at first investment in manufacturing was largely financed from foreign saving because domestic savings were negligible (World Bank, 1985). The early 1970s witnessed large gains in private sector savings. Consequently, the share of domestic financing in manufacturing investment increased (Malawi Government, 1983).

The growth of manufactured output during the 1970s averaged 5.6% per annum. As a percentage of GDP, the manufacturing sector increased its share from 7% at independence to 13% in 1980. Employment in the manufacturing sector, in turn, increased by an impressive 6.8% per year. These developments were very closely related to the performance of the economy as a whole, with GDP growing at an average annual rate of 6.3%.

## **4. THE 1980–99 PERIOD**

These were years of profound change for Malawi – a declining economy, policy reform at many levels, growing political unease and, finally, the passing of the leadership mantle from the Life President to a successor.

### **4.1 Political Economy**

From the standpoint of political economy, this period can be divided into two, the years of continuing single-party rule from 1980 until 1994, and the period of multi-partyism since 1994.

#### ***The 1980–1994 Part of the Period of Single Party Rule***

Ruthless oppression of any form of political dissent in the country and persecution of dissidents abroad increasingly intensified under the authoritarian rule of Kamuzu Banda.

Much earlier on, in October 1967, violent conflict had taken place when a small band of armed exiles led by Yatuta Chisiza briefly dared to enter Malawi and challenge Banda. They were quickly crushed and some of them were shot dead including Chisiza. Another exile, Dr. Attati Mpakati was assassinated in Harare while on a visit to Zimbabwe in March 1983. Another exile, Mkwapatira Muhango, together with nine members of his family, was killed in a bomb attack in Lusaka, Zambia, in October 1989. In May 1983 three cabinet ministers (one of whom was the Secretary General of the ruling party) and one member of parliament died under mysterious circumstances – strongly believed by many to have been due

to their opposition to a prominent member of the ruling clique favoured by Banda to succeed him.

**Periods of Particular International Agreements.** The National Rural Development Programme (NRDP), agreed with the World Bank, was an improved version of the failed IRDP strategy. Developed in 1977 and launched in 1978, aimed at eventually covering all peasants. The programme was designed to improve the provision of a reduced number of farm inputs and services (extension, credit and marketing) to peasants at a lower cost than the earlier strategy. It continues to be administered through eight Agricultural Development Divisions (ADDs). The impact of the NRDP strategy on peasant's productivity has so far fallen short of expectation, however, nor has it yet promoted crop diversification (Statement of Development Policies 1971–80, 1987–96: 27; UN in Malawi and Malawi Government, 1993; Kalua et al., 1992: 5). The failure to improve the performance of peasant agriculture has been in spite of massive government investment in activities aimed at it. And this has been due to various constraints faced by peasants. Structural adjustment programmes (SAPs) agreed with the World Bank began in June 1981 and continue to date. The various issues of SAPs are discussed in several places of this study. Similarly, a series of standby arrangements agreed with the IMF beginning in 1979 relate to economic stabilisation programmes. The issues involved are also discussed in many places of this study. Official foreign debt relief agreements with the Paris Club of creditors covering several relatively short periods (compared with World Bank SAPs and the series of IMF standby arrangements) ran from 1982 to 1999, except the five years of 1990–1995 when there was no debt relief.

**Dates of Major Policy Pronouncements.** Many policy pronouncements, some reversing earlier policy stances were made during the period under consideration in the areas of agriculture, manufacturing, trade and foreign exchange. Among these were the following:

- ***Agriculture sector***
  - 1981 onwards: There was a trend of raising smallholder crop prices by much higher percentages than before.
  - 1990: The transfer of land from customary tenure to estates was halted.
  - Early 1990s: Peasants were for the first time legally allowed to grow burley tobacco on customary land, a cash crop that was until then reserved for estates.
- ***Manufacturing sector***
  - 1984 onwards: Decontrol of prices of locally manufactured products.
- ***Foreign trade***
  - 1988: Changes to the export protocols included reduction of the scope for export licensing
  - 1994: Introduction of an export retention scheme
  - 1988–1994: Import changes ranged from relaxation of import controls
  - 1994: Relaxation of exchange controls
- ***Exchange rate.***
  - 24 April 1982: The first of a series of devaluations of the kwacha. Since then Malawi has implemented an active exchange rate policy. Before this, there was no deliberate adjustment of the exchange rate other than simply shifting the pegs essentially to prevent its depreciation and appreciation against major currencies and this was regardless of the country's demand and supply of foreign exchange (Mwalwanda, 1985).
  - 17 January 1984: The kwacha was pegged to a weighted basket of seven currencies: the US Dollar, pound sterling, Deutschemark, South African rand, Japanese yen, French franc and Dutch guilder.
  - 7 February 1994: The kwacha was floated, a policy that is still applicable.
- ***Monetary policy.*** The early 1990s saw a shift from direct to indirect monetary policy instruments:
  - 1990: Liberalization of interest rates.
  - 1990/91: Opening the financial market to new entrants.
  - 1992: Elimination of direct bank credit controls.

**Government Policy Choices.** Policy choices during the period ranged over agriculture, manufacturing, trade and finance. The authoritarian role of the state remained strong, although there were signs that some policy stances were beginning to be tempered in some respects by the structural adjustment programmes

and other agreements with donors.

***Some agriculture sector policy choices.*** The major interest group that lost directly because of the policy shift in favour of the estate subsector comprised small-scale farmers. And their loss has been greatest in terms of the growing scarcity of arable customary land; the average size of landholding by peasant households decreased from 1.6 hectares in 1968/69 to 1.1 ha in 1987/88 owing to rapid population growth and customary land alienation by estate tobacco growers.

The peasants could not dare advocate for a reversal of the policy shift in favour of the estate agriculture subsector. This was mainly because of the lack of democratic freedom of association and speech, which was their major constraint during the one-party rule. In the circumstances, peasants were expected to do what they were told, even if they knew that it was not correct (Schwartz et al., 1994). Thus when peasants were interviewed, individually or as spokespersons for their farmers clubs, for radio programmes or the press, expectedly they first of all spent a good part of the time showering exaggerated praises on Dr. Banda for the so called unrivalled, single-handed saviour role he was playing in developing rural communities to a level, Banda himself fondly described, of “beyond recognition”. They only secondarily complained of some problems faced by their rural communities in the later part of the interview, always doing so in a carefully guarded manner to avoid being misinterpreted as critical of the regime personified by Dr. Banda. Their very exaggerated praises tended to pale their complaints into insignificance.

Even if they were given a chance to express their views on the growing scarcity of arable customary land and other problems, peasants were, and continue to be, confronted by several other constraints. One is that peasants are too many and too widely scattered to formally organize themselves as an interest group in an effective manner on a broad scale covering large geographical space. This is exacerbated by the transport and communication problem in terms of inadequate and poor infrastructure and services, particularly in remote rural areas; this makes it difficult for them to communicate with one another, meet and organize themselves promptly and effectively, and to communicate with policy makers and implementers, many of whom are in urban areas (M.L.C. Mkandawire, 2001: 11).

Furthermore, the illiteracy rate is still high among peasants, although peasants with no formal education can express concerns on some issues, e.g., the not abstract issues of scarcity of arable land, low producer prices and high prices of farm inputs. Of course, most issues can be more effectively articulated, orally and in writing, by literate peasants. The peasants’ poverty is itself a major constraint, putting them in a vicious circle. Because they are poor in resources, including finance and literacy skills, the peasants are in a relatively weak position to mobilize and organize themselves into efficient and sustainable broad based interest groups that can articulately advocate for their preferences.

Technocrats played a key role initially in identifying the weakness of the smallholder subsector, on the basis of which doubts were raised about the subsector’s ability to spearhead economic growth. In retrospect, however, they blundered since they failed to foresee the adverse consequences for the smallholder subsector that were to arise from the policy shift in favour of the estate subsector, especially with respect to the issue of the supply of arable land.

A recent major policy choice made in the early 19902, in favour of smallholder farmers this time, was to suspend further conversion of customary land to estate land. The intention has been that in future, parts of unutilized estate leasehold land would be redistributed to smallholders and/or sub-leased to tenants on estates, the implementation of which is yet to be carried out. This is a SAP-induced policy choice that would considerably benefit land-constrained smallholders.

Yet another major policy choice made in the early 1990s was to legally allow smallholders to grow burley tobacco on customary land from. This choice was initiated by the World Bank as part of the structural adjustment programme, and USAID also gave considerable support. At a meeting of the World Bank, the donor community, the government and the private sector in 1989, “it was concluded that a lack of a viable cash crop was keeping the rural people poor; it was proposed that burley tobacco, a crop that is labour intensive, requires limited land and is well within the smallholder farmers’ technical capabilities, could enable smallholders to participate in the cash crop economy” ( Schwartz et al., 1994: 3). That this policy choice was externally induced was evidenced by the fact that estate tobacco growers (comprising several senior politicians, government ministers, senior civil servants, and other public servants and private sector people) as an interest group initially opposed the policy reform initiative. They eventually

gave in to external pressure. In the government circles the policy reform was initially supported only by mid-level civil servants/technocrats in the Ministry of Agriculture who had no vested interest in tobacco growing and had genuine concern to see improvement in the welfare of the smallholders (Schwartz et al., 1994).

Indeed, more and more smallholders became involved in growing burley tobacco. They benefited, initially without any of their effort to lobby. Later on they participated in the policy design, most significantly in determining options for marketing their burley tobacco leaf as discussed in the part on markets. This policy reform has some potential adverse consequences, however: To the extent that this non-food cash/export crop attracts some of the smallholder farmers' labour, scarce land and capital resources away from food crop production, there is some potential danger of making the country progressively less able to feed itself and therefore force it into the undesirable position of spending scarce foreign exchange on importing even staple food grain, the bulk of which is grown by smallholders, aside from food shortages caused by droughts in some years. Consequently, the net gain in foreign exchange would be reduced (M.L.C. Mkandawire, 1999: 60–1).

**Foreign trade.** Also as part of the ongoing effort to promote export growth, a policy choice was made in 1988 to reduce the scope for export licensing. This met the preferences of new entrants into the export business as well as existing exporters who wanted to broaden their range of exports. Another major policy choice, made in 1994, was the introduction of an export retention scheme. While this has met the preference of exporters, particularly those who rely heavily on imported inputs, it sometimes has disadvantaged importers and other users of foreign exchange when it has been in short supply, while exporters are retaining unused balances on their foreign currency denominated accounts. These policies were more of SAP-induced than a result of lobbying by the interest group of exporters. While the policies have to some extent helped to promote exports, a lot more remains to be done.

**Exchange rate.** Prescribed by the IMF, a series of devaluations of the currency since April 1982 and its eventual floatation in February 1994 have been major policy choices aimed at promoting exports. While devaluations were meeting the preference of all exporters, especially those not heavily dependent on imported inputs, the timing of most devaluations was deliberately at the beginning of the tobacco marketing season, which was therefore immediately benefiting the interest group consisting of the powerful estate tobacco growers and the tobacco merchants.

**Some financial policy choices.** Financial repression went on up to the late 1980s. In spite of quantitative controls on bank credit, however, borrowers in sectors accorded priority by the government benefited through directed credit as a policy choice. The major beneficiaries were estate tobacco growers, to whom the extension of bank credit extension, as indicated above, became an important part of the political patronage system during the one-party rule. Further, between 1980 and 1989, estate tobacco growers borrowed from banks at a preferential interest rate. As already noted, this interest group did not have to lobby for these and other policy choices because policy makers also belonged to it.

Financial sector reform since the late 1980s has, inter alia, involved the shift from the use of direct monetary policy instruments (mainly comprising quantitative controls on bank credit and administered interest rates) to indirect instruments. Thus in the absence of the use of the instrument of “directed credit”, less viable/unviable borrowers in the priority subsector of estate tobacco growing began to lose out from the early 1990s. Coupled with a reduction in political pressure on banks made possible through donor intervention, banks could not continue to extend credit that was hardly viable.

### ***The Multi-party Period from 1994 Onward***

Beneath the political stability that the Banda regime had put in place, feelings of bitterness were silently simmering among the majority of Malawians. Bitterness against the ruthless political oppression; bitterness against the fact that after years of independence and being exhorted by Banda to work hard in their gardens and other activities, most of them had, and have, not come out of abject poverty. The regime had failed to deliver the goods to the masses. That type of political stability could therefore not be sustained forever. Thus when external donors began to exert pressure on the government by calling for



transparency and accountability, respect for human rights, and other principles of good governance as conditionalities for aid, the situation in the country was silently already ripe for political change.

The readiness for change was vividly demonstrated by how the prospect for change was overwhelmingly embraced when the opportunity arose in 1992. Internally the pro-democracy movement was sparked off by the Roman Catholic Bishops through their pastoral open letter titled "Living in Our Faith", which was issued in March 1992; the bishops criticized the Banda regime for abuse of human rights, denying the people their right to live "as dignified sons and daughters of God". Once again the age old power of religion to change the course of history resurfaced. Nonetheless, Banda and his Malawi Congress Party desperately fought to silence the dissenting voice. The pastoral letter was banned and people were ordered to surrender it to the police; the seven bishops who co-authored it were placed under house arrest although only for a few days. An extraordinary MCP convention summarily resolved to let the bishops "go missing", meaning that they should be killed (Mwanza, 1997). Fortunately that did not take place.

A month after the pastoral letter, Banda was further challenged to introduce democratic reforms by Chakufwa Chihana, a trade unionist; Chihana was returning to Malawi from Zambia where he had gone to attend a meeting, largely of political exiles and other Malawians living abroad, on the political future of Malawi. As expected, Chihana was detained for several months. But the message was clear, namely that the hitherto unassailable "Lion of Malawi" could now be challenged. Meanwhile political pressure groups emerged. A national referendum was held in June 1993 in which Malawians resoundingly voted in favour of the multi-party system of government. After the referendum, the pressure groups became political parties and were joined in the fight for political pluralism by other new parties including those that had operated in exile after the 1964 cabinet crisis. Presidential and general elections were held in May 1994. Banda lost the presidency and his MCP party got the second largest number of seats in parliament. Bakili Muluzi won the presidency and his United Democratic Front (UDF) party got the largest number of seats, while Chakufwa Chihana's Alliance for Democracy (AFORD) party was in third position. Other parties did not win any seats; this outcome was repeated in the 1999 elections in which UDF again won the largest number of seats, MCP came second and AFORD third. Muluzi was re-elected President for a second term of five years, which is the maximum as provided for in the constitution. In both general elections, voting was clearly on a regional basis, largely influenced by the region where the presidential candidate came from.

The elections of both 1994 and 1999 were conducted without violent conflicts. However, the pre-referendum period was not bloodless. After the Bishop's pastoral letter and Chihana's challenge to Banda to introduce democratic reforms, industrial unrest broke out in May 1992 in the southern city of Blantyre; it escalated into violent anti-government riots that spread to the capital, Lilongwe, and resulted in about 38 deaths.

How has the multi-party regime fared since 1994? We will address this question on the basis of principles of good governance, which appear to be increasingly considered as being universally applicable: the rule of law with an independent judiciary; a system of open political competition, allowing for alteration; effective participation of various actors in decision making; public accountability and transparency; and respect for human rights including freedom of association, a free press and other media (Van Hoek and Bossuyt 1993).

The rule of law appears to have been reasonably upheld. However, law enforcement agents have in some cases appeared to be reluctant to bring to book offenders from the ruling party. The judiciary has demonstrated a large degree of independence, with decisions in some major cases having not been in favour of the government, for example.

Also reasonably upheld has been the principle of respect for human rights. Many autonomous social organizations have been formed dealing with a variety of issues. Trade unionism has regained its strength after having been made impotent during the one-party rule. Chiefs have regained their traditional respected status. Press freedom has not been hindered and some attempts to muzzle it have not been successful. Many newspapers and other periodicals have been launched. The major exception has been the use of radio facilities at the Malawi Broadcasting Corporation (MBC), the only public broadcasting house, a parastatal subvented by the government; the ruling party has tended to dominate its use in terms of coverage of political events at the expense of other political parties. So too has been the case with

Television Malawi (the only TV station), a parastatal that started to operate in 1999. In addition to MBC, which has the nation-wide coverage, there are five or more independent radio stations, all opened between 1993 and 1999, but they all have limited coverage.

The principle of having a system of open political competition has to a large extent been upheld. Several political parties contested in the 1994 and 1999 presidential and parliamentary general elections. While new parties have been freely launched, a number of them have ceased and others have joined the ruling party, which is strongest in terms of financial resources. Some problems have been encountered with respect to the upholding of this principle, however: There have been accusations and counter-accusations of electoral fraud and intimidation, and some violent confrontations between supporters of major parties have been reported in some constituencies during election campaigns or other times; in some cases some people have been injured. Further, open political competition has been diluted by voting largely on regional lines, and by the alleged buying of some opposition politicians by the ruling UDF party.

Effective participation of various actors in the decision making process has met considerable obstacles. Much of the blame has been put on the ruling party, which has become increasingly intolerant of criticisms/suggestions from the opposition. Some of the blame has been put on the opposition for not doing enough to, inter alia, give constructive suggestions and responses to the ruling party. The manner of debate in parliament has reflected lack of mutual respect between the opposition side (MCP and AFORD) and the government side (UDF); the public has expressed concern about this, as well as concern about the use of courts by political parties to resolve a number of conflicts between them. Concern has also been expressed by the electorate in some constituencies that after being voted into parliament, their MPs hardly hold meetings and consult with them on problems faced by their areas. Further, local government elected councils (district councils, municipal and city councils), which had been inherited from the one-party regime, were dissolved after the multi-party general and presidential elections in May 1994; local government elections in the multi-party period were belatedly held in November 2000. In the long interim period, the electorate were denied their democratic right to participate in the affairs of their wards through their representatives.

With respect to the principle of public accountability and transparency, there have evidently been major shortfalls. Corruption has grown considerably in public offices and it is breeding inefficiency; it may be encouraged down the line if, among other factors, some of the offending senior public servants are not brought to book, which was particularly the case in the early years of the period under discussion when only lower level public servants were arrested. Recently, however, there have been cases of bringing to court some senior public servants, including a couple of cabinet ministers alleged to have been involved in corrupt practices. Institutions to promote accountability and transparency have been put in place, namely the Anti-Corruption Bureau to ensure accountability of resource management by public servants and the Office of the Ombudsman to whom citizens can appeal if they believe that their rights have not been respected.

**Periods of Particular International Agreements.** There has been hardly any new major period of international agreement since 1994 other than a continuation of those listed under the 1964–1994 period.

**Dates of Major Policy Pronouncements.** As explained in a similar subheading under the 1964–1979 period, the dates in question are many and we therefore have to be selective. The dates here refer to when the policies were either pronounced or, which is of more analytical significance, when the policies were first put into effect. These include the following:

- ***Agriculture sector***
  - 1994 October: Introduction of the Malawi Rural Finance Company (MRFC), a culmination of a policy decision to have a financial institution that focuses on lending to peasants
- ***Trade***
  - 1996: Introduction of Export Processing Zones (EPZs)
- ***Fiscal policy***
  - 1995/96: Retrenchment of 20,000 employees of the government
  - 1996: The beginning of reorientation of public spending to pro-poor areas

- **Privatization**
  - 1996: The beginning of privatization of several state owned enterprises
- **Financial sector**
  - 1995: Introduction of a stock exchange
  - 1998: Introduction of a discount house

**Government Policy Choices.** Often informed by the structural adjustment programme and other conditionalities of donor assistance, the policy measures during this period had wide-ranging effects in agriculture, trade and fiscal policy, as well as privatization of some state resources.

**Agriculture sector.** In the absence of an agricultural bank, the establishment of the World Bank funded Malawi Rural Finance Company (MRFC) in October 1994 to focus on lending to peasants was a commendable policy choice. This was the culmination of many years of advocacy for such an institution by a number of stakeholders, foreign and domestic, including technocrats in the public and private sectors, as well as farmers. The main beneficiary interest group comprises small-scale farmers. Non-agricultural borrowers in the subsector of small and medium-scale enterprises (SMEs) also have access to some credit facilities at MRFC. MRFC is making an impact, but its coverage of the target groups is limited by inadequate resources at its disposal.

**Trade.** The policy decision in 1996 to begin to introduce EPZs was part of the ongoing effort to promote exports under the structural adjustment programme. The need for EPZs had been raised in the private and public sectors in the past. While the EPZ facility is of potential benefit to a wide range of exporters, those who have so far seized the opportunity largely comprise export manufacturers of textiles and clothing. The benefits of EPZs to the economy are obvious.

**Fiscal policy.** As part of the broad policy of restraining/cutting down expenditure to reduce the uncomfortably large budget deficits, a choice was made to retrench some civil servants numbering 20,000 in 1995/96 and 3,194 in 1997. They comprised workers in non-established positions in non-priority areas. The policy choice was part of the fiscal reforms under SAPs. It was obviously against the preference of the retrenched employees to continue working.

Also as part of the fiscal reforms, a policy decision was made to reorient public spending to pro-poor areas as part of the poverty reduction programme. A major project under the programme has been the Malawi Social Action Fund (MASAF), which was started in July 1996 as a successor to a fund of the social dimension of adjustment (SDA) project. Funded by the World Bank, MASAF is a quick disbursing fund for projects that are demand driven and promotes community participation to ensure capacity building at community level (Ministry of Economic Planning and Development, 1996 and 1997). MASAF is indeed meeting the preferences of the targeted interest group – the poor (plus other low-income households) who are involved in their own community sub projects such as construction of school blocks and health centres. Another of the SAP-induced policy choices, its introduction benefited considerably from years of discussion in government since the late 1980s about the pressing need to reduce poverty in the country. MASAF's modus operandi has also benefited a lot from the approach of self-help projects in which communities, mainly of low-income households, were involved in earlier years. The ruling party has sometimes been criticized for misusing MASAF funds as a political weapon against the opposition (Chakufwa Chihana, 1998). Generally, however, even the major opposition parties have spoken well of the MASAF project. The project might have been more effective than it actually has been if the degree of community cooperation, self-help spirit and hard work ethic were not weakened by multi-partyism.

**Privatization.** One of the objectives of this SAP-induced policy choice of privatization is to promote participation by the Malawian public in state owned enterprises that are being privatized. This objective is easier said than achieved because the majority of the interest group of indigenous people earn low average levels of income. This problem is being addressed in part by setting up special loan facilities to enable Malawians to purchase shares in enterprises that are being privatized, with some shares being offered at a discount. Consequently the programme is mainly benefiting a few individual and institutional investors

who are financially strong, and this interest group also includes the non-indigenous.

Another objective of privatization is to raise revenue for the government, which is being achieved. However, employees retrenched as a result of privatization constitute the losing interest group. What happens to their new life is a major problem. Many of them do not find alternative wage employment, which is aggravated by not being offered preparatory facilities like training and loans to enable them to engage in alternative income generating activities (Chilowa and Chirwa, 1997).

A further objective of privatization is to reduce monopoly and increase competition in the economy; 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. The fourth objective is to foster increased efficiency in the economy, the achievement of which is also not clear. In short the net benefit of privatization to the economy is debatable.

**Reversals of Policy and Other Decisions.** In recent years there have been a number of government decisions that have later been reversed. Some decisions have been in the form of awarding contracts to suppliers of goods or services reportedly without following established tendering procedures. Such cases have, for example, related to school notebooks, production of national identity cards, pre-shipment inspection services, all involving firms abroad. Other decisions have been in the form of changing the type, source and procurement agent of a kind of vehicle suitable for certain units of the government. Further, the government recently imported several Mercedes Benz cars for use by ministers; they were reportedly one of the latest models. This was being done amid government rhetoric of its drive to cut down expenditure. Following heavy criticism from the public, including donors, the government decided not to allocate the limousines to the ministers but to sell them to the public. Allegations of corruption have been attached to some of the decisions that have later been reversed.

Such reversals of decisions, coupled with the fact that wrong original decisions were also made, tend to reduce government's credibility among the public in general as well as existing and potential investors in particular. Occurrence of several decision reversals has tended to make some public sector technocrats deliberately delay acting on certain decisions made by their superiors in case they may also be reversed, thus slowing down work speed in such cases.

## 4.2 Markets

### 4.2.1 *Agricultural Product Markets*

As in the discussions for the earlier periods, our focus here is on markets for estate crops, which are mainly for export, and those for smallholder crops, which are mainly for local consumption.

**Estate Crops.** Compared with the 1964–1979 period, many features of the markets for estate agricultural crops did not change in the 1980–1999 period. For example, the composition of the major estate crops did not change, which was also true of where they were grown, the composition of the growers (i.e., between foreigners and indigenous Malawians) and the major channels of marketing. We will therefore focus only on features/characteristics that changed and on new ones.

As for tea, the proportion sold at the local auctions was rising over the years, while that sold on the London auctions was decreasing and reached zero in 1997. A third tobacco auction floor was opened, this time in the city of Mzuzu to cater for the northern part of the country.

The review period experienced wider changes compared with the earlier period in prices of estate crops (and other goods) owing to the devaluation of the Malawi kwacha from April 1982 and its eventual floatation in February 1994, thus rendering more uncertainty to budgeting. Domestic prices of sugar were decontrolled. Tobacco growers in some years complained of very low prices realized on the local auction floors, which they alleged to result from collusion among tobacco buyers. And they at times called for government intervention. Low prices at times were due to low quality, which since the mid 1990s was exacerbated by the introduction of the intermediate tobacco buyers (ITBs) scheme because many ITBs were not experienced in handling the leaf.

The availability of market information during the period under review was considerably facilitated by advances in information technology.

Malawi's costs of freighting exports and imports have been quite high since the early 1980s. Malawi's shortest rail routes to the seaports of Beira (640km by rail from Blantyre, Malawi's commercial city) and Nacala (815km by rail from Blantyre) were closed in the early 1980s due to the civil war in Mozambique. Consequently Malawi's cargo has had to be re-routed through much longer road routes mainly to/from the South African seaport of Durban (2,600–3,806km away depending on the route taken) and partly via the Tanzanian seaport of Dar –es Salaam (3,030km by road). This raised the proportion of freight and insurance elements to about 40% of the total c.i.f. value. For example, by 1997, transport costs accounted for about 47% of the retail price of fertilizer imports, based on delivery to Kasungu, a district in the northern part of the central region. Although peace in Mozambique was restored several years ago, Malawi's cargo going through Nacala and Beira seaports is still far below the potential. This is due to unreliability of the rail and road links through Mozambique and higher external shipping costs from that country's ports (World Bank, 1997: 48–9).

By the mid 1990s, Malawi had perhaps the highest internal transport costs in the region, according to the World Bank (1997: 48). For example, ADMARC's contract price per ton/km was equivalent to US 10.5 cents compared with reported charges of US 3.0 cents in Zimbabwe and US 4.0 cents in South Africa. During a good part of the 1990s the roads in Malawi generally deteriorated and became considerably pot-holed, a condition that has just begun to improve. This was due to lack of maintenance and failure to enforce weight restrictions. Also, the low weight capacity of some critical bridges has forced circuitous and expensive re-routing. The resultant wear-and-tear of vehicles has led to high operating costs to transport providers, who have had to pass the costs on through the national supply chain. Also adding to the high internal transport costs have been: lack of competition owing to entry restrictions on foreign transport; lack of credit facilities to enable Malawian transporters to import trucks, tyres and spare parts directly; and high indirect taxes on tyres and spares.

Theft of cargo has also been a problem on main routes, particularly for exporters whose product is freighted in bulk and is undifferentiated and unidentifiable, as is especially the case for agricultural exports.

Delays in despatching and receiving goods owing to the poor condition of many internal roads and bridges, long transit routes to/from seaports, and some cargo losses through theft en route have been forcing firms, including those involved in agricultural commodities, to operate expensively with higher rates of working capital (Zandoli, 2000: 15). A surtax of 20% on transport services was recently introduced. This, among other effects, has also tended to raise the cost of freighting goods including agricultural commodities. The policy measure appears to have been introduced without proper analysis of the consequent pervasive adverse effects on the whole economy. The high transport costs have been making Malawi's exports less competitive.

**Smallholder Crops.** From the 1980s the markets for smallholder crops have been considerably influenced by SAP-induced liberalization, which has essentially involved the removal of controls on prices and the opening up of markets. The objectives have been: to correct relative prices of products as determined by market forces of demand and supply; to improve incentives for the production and supply of tradeable goods; and to give an opportunity to compete in the markets to economic agents who were denied this. The expected results have been better resource allocation by economic agents as they respond to correct market signals, thereby stimulating production.

For the first time smallholders were legally allowed to grow burley tobacco on customary land from the early 1990s as explained earlier. This was a reform programme initiated by donors. Initially smallholders were reluctant to participate in the programme because ADMARC was identified as the sole buyer of the burley crop they were going to legally produce. Based on their past experience with respect to sales of other types of tobacco legally grown on customary land for decades, smallholders did not trust that ADMARC would give them honest prices for their burley tobacco; smallholders of a certain area explicitly stated that they did not want to sell to ADMARC but directly to the auction floors. Their fears were proved correct during the pilot stage of the programme in the 1990/91 season when ADMARC indeed underpaid them. As a result, many peasants decided to drop out of the programme. In due course the government allowed smallholders to also sell their burley tobacco directly at the auction floors in addition to selling to ADMARC. With the assistance of the Ministry of Agriculture staff, registered

smallholder tobacco growers had to form clubs for the purpose of controlling the number of units that would sell at the auction floor. Later on, registered smallholder burley tobacco growers were also allowed to sell to estates holding burley tobacco growing/selling quotas.

A fourth marketing channel for smallholders was opened in the 1994/95 season when they could also sell to intermediate tobacco buyers (ITBs) under an ITB scheme that had just been introduced for burley tobacco and other smallholder tobacco varieties as part of the market liberalization programme. With these selling channels as alternatives to ADMARC, some of which they had lobbied for, smallholders' interest in the reform programme of encouraging them to grow burley tobacco was rekindled.

The burley tobacco reform programme, for the first time, gave smallholders the opportunity to actively participate in their own development. Their participation in the requisite policy design improved with time through meetings with extension and other staff of the Ministry of Agriculture and with donor staff. Their participation was most significant in determining market options (Schwartz et al., 1994).

As part of the market reform process, ADMARC underwent restructuring/divestiture, which, *inter alia*, involved the closure from the 1980s of hundreds of its unviable markets in remote rural areas with poor roads. Private traders were allowed to compete with ADMARC in the marketing of smallholder crops (in the early years of liberalization smallholder cash crops, namely tobacco and cotton, were excluded). And private traders' participation in the marketing of smallholder crops has indeed been rising. This is evidenced by a decrease in the market share of ADMARC, which used to purchase the bulk of smallholder crops and by 1999 had dropped to as low as 20% for tobacco, between 45% and 50% for cotton (ADMARC was the only buyer of smallholder tobacco and cotton before liberalization), 5% for groundnuts, and 35% for rice. Private traders would have eaten more into ADMARC's market share were it not for the constraints they face in the areas of financing, crop procurement and transport (especially with respect to remote rural areas from which ADMARC has withdrawn), storage, grading, and marketing. As a result, their capacity to offer attractive producer prices to smallholders is impaired (Chilowa and Chirwa, 1997), which is not conducive to growth in smallholder agricultural output and incomes.

During the reform period, the frequent raising of nominal crop prices paid by ADMARC to smallholders has generally been by higher percentages than before reforms. This has been facilitated by devaluations of the kwacha.

Emphasis was initially on export crops but later on a more balanced approach in raising prices was adopted to avoid discouraging food production. Nonetheless the producer prices have always been generally much lower than those at which ADMARC in turn sells the products locally and particularly on the export market.

In the review period, lack of market information on smallholder crops continued to be a considerable problem. More so with respect to crop marketing by private traders. In recent years a schedule of crop prices at selected local produce markets has been published in popular newspapers from time to time. But circulation of newspapers in rural areas is negligible. The problem of transport has been discussed under the subsection on Estate Crops. In the circumstances, smallholders could hardly compete on most crops, except with respect to tobacco, which they were now able to sell as clubs on the competitive auction floors, apart from other alternative marketing channels for their tobacco as discussed above. With market liberalization, there was competition between ADMARC and private traders and among private traders. However, the degree of competition was hampered by lack of market information, the problem of transport and other constraints facing private traders as noted earlier. Thus there was still a good measure of fragmentation of markets for smallholder crops.

In the period under review, changes in market institutions were mainly in the form of the springing up of more and more private traders (including intermediate tobacco buyers) to compete with ADMARC. Recently the Government has set up the National Food Reserve Agency (NFRA), another parastatal, to manage the strategic grain reserves in order to ensure food security, a function previously discharged by ADMARC. NFRA will import all government maize where necessary. Meanwhile, with pressure from the Bretton Woods Institutions, moves have been underway to commercialise ADMARC. Its eventual privatization is debatable, however. The move would assume that NFRA would discharge the function more efficiently than ADMARC. But how? How will duplication of effort be completely avoided between the two? As a parastatal, will NRFA eventually not suffer from the same management inefficiencies that

most other parastatals have experienced for decades? Why therefore substitute one parastatal with another?

#### **4.2.2 Financial Markets**

The discussion of financial markets during this period looks at the institutions and characteristics of the formal financial credit market, as well as the functioning of the informal market.

**Formal Financial Credit Market.** Financial repression persisted into the 1980s until implementation of financial sector reforms was started at the end of the decade. Liberalization of interest rates began in May 1990. Opening of the financial market began to be given more encouragement from 1990/91, and in 1992 direct bank credit controls were eliminated.

**Institutions.** While financial repression persisted, four new NBFIs were nonetheless formed in the 1980s. During the 1990s, three new commercial banks and at least six new NBFIs were established, which included the first discount house in the country. Also, several forex bureaux were opened. A stock exchange was also formed for the first time. These numbers of the NBFIs exclude insurance companies. The majority of the new NBFIs formed in the 1980–1999 period were aimed at assisting SMEs and a couple of them were aimed at smallholder farmers. Of the ten or so notable NBFIs formed during the 1980–1999 period, only about five were accepting deposits.

By the end of the 1990s, altogether there were five commercial banks and over fifteen notable NBFIs, excluding insurance companies and forex bureaux. Some of the NBFIs were NGOs, and would strictly speaking be called semi-financial institutions because of being also involved in the provision of business training and advisory services, in some cases even more than their financial intermediation activities. About nine of all the NBFIs were accepting deposits. Growth of non-deposit accepting NBFIs tended to be slower than those accepting deposits. Inter-locking state shareholding in the old banks and a couple of the critical old development finance institutions continued; initiatives to address the issue were started later in the period.

**Competition.** Competition in the formal financial market continued to be weak in the 1980–1999 period, but appears to have been less weak than in the 1960–1979 period owing to the reduction and elimination of some of the constraints discussed under that period, including the following: First, the number of competitors (banks and NBFIs) increased, particularly in the 1990s. Second, banks' overexposure to the estate tobacco growing subsector proportionately decreased because of the adoption of a more prudent approach to lending to this subsector from the 1980s, as well as a reduction in political interference in banks' credit administration especially later in the 1990s after the end of the one party rule under which credit to this agricultural subsector had been an important element of political patronage. Third was the shift from direct controls on bank credit, interest rates and other service charges to the use of indirect instruments of monetary policy.

**Fragmentation.** The problem of fragmentation of the formal financial market continued into the 1980–1999 period. This was clearly reflected in excess liquidity among banks, some deposit-accepting NBFIs and major insurance companies; the bulk of their excess liquidity was held in government securities (in the absence of meaningful alternative tradeable securities), excess deposits at the central bank in the case of commercial banks, and excess deposits at commercial banks in the case of insurance companies; the excess deposits referred to being those over and above the levels required to meet the normal requirements of the depositors. For example, the combined liquidity ratio of commercial banks was as high as 64% in the first quarter of 1997 and 43% in the first quarter of 1999. The major factor behind the high levels of excess liquidity was the long-standing conservative perception by banks and some NBFIs of lack of good lending opportunities beyond their traditional lending areas.

As one of the factors behind fragmentation, the factor of different transaction costs faced by financial institutions appears to have been particularly applicable in the case of weak links between the donor-funded semi-financial institutions on one hand and other NBFIs and banks on the other, with transaction costs being much higher in the case of the former than the latter. Related to this was that the controlled

low interest rates for lending by some donor-funded semi-financial institutions could (in case of need for additional loanable funds) prohibit them from borrowing at higher interest rates from the uncontrolled deposit-accepting NBFIs and banks following interest rate liberalization. Establishment of such semi-financial institutions started in the 1980s.

While fragmentation continued into the 1980–1999 period, nevertheless there were indications of some decrease, made possible by a reduction and elimination of some of the constraints discussed under the 1960–1979 period, including the following: One, the mandate of the POSB, whose name had now changed to Malawi Savings Bank (MSB), was broadened to include placing its funds at other financial institutions, thereby contributing to the strengthening of the money market. Two, the introduction of the discount house in 1998 was a boost to the money market. Three, the establishment of the stock exchange in 1995 was also a boost to the capital market; however, the growth of the stock exchange faced a number of constraints including taxation of dividends.

***Some consequences of market characteristics for its agents.*** Banks exposure to the estate tobacco subsector (not an attractive source of their income) decreased as noted above. This contributed to a recovery in the levels of their profitability.

A number of NBFIs, some of them semi-financial institutions, were established to assist SMEs and a couple of them to assist smallholder farmers. However, many more small-scale operators did not access credit at the new lending institutions. And unfortunately, many of the lending institutions were driven into difficulties because of poor loan recovery, worsened by problems associated with politicization of their credit facilities, as well as constraints brought about by inadequate resource capacity, financial and human.

**Informal Financial Credit Market.** Owing to lack of historical information on it, the informal financial market is discussed only under the 1980–1999 period because some studies were carried out in the late 1980s and early 1990s.

According to a study in the late 1980s by Chipeta and Mkandawire (1991), the informal financial market appeared to play an important role in alleviating economic hardships among low-income groups in rural and urban areas (smallholder farmers, labourers, messengers and the like) among whom informal finance was most popular. That role was played through enabling these groups gain access to financial resources, which they partly invested in productive activities and partly spent on consumption. And the magnitude of that role is better appreciated in the light of the finding of the same study that the informal financial sector was more or less as large as the formal plus semi-formal financial sector in terms of the volume of credit disbursed. In 1988 the annualized total credit of K104.5 million extended by the informal financial sector was almost equal to the annual increase in total credit extended by the formal and semi-formal sector, which averaged K104.7 million in the three years to 1989.

The informal financial credit sector is heterogeneous, comprising entities that can be simply classified broadly into individuals, associations, business firms, government and NGOs (Chipeta, 1990). The typical entities in the late 1980s included savings and credit associations (SCAs), cooperative savings associations (CSAs), community funds (CFs), and the typical moneylenders. The common characteristic of the entities with respect to their informal credit (and deposit) transactions is that they are not directly subjected to registration, licensing and other legal requirements, and they do not fall under the direct influence of monetary policy. Thus officially they are not recognized.

One of the causes of the origins of informal credit activities was beneficiaries' lack of access to credit facilities at formal financial institutions, both banks and NBFIs. Furthermore, people's need for financial assistance considerably increased in view of high inflation and other economic hardships created mainly by currency devaluations, other policies and non-policy events from the early 1980s. Another cause was that even when formal credit was accessible, the procedures (paper work, decision making processes, etc.) were generally time consuming and cumbersome; consequently borrowers met higher transaction costs than in the informal credit market where collateral security requirements (if any) and lending procedures were generally simple and quick, usually without even bothering about how a loan was to be used. A further cause consisted of autonomous culturally related factors, which for generations led to the habits of borrowing and lending that in the distant past involved commodities (barter) and eventually evolved into



more of cash transactions in the wake of an increase in monetization of subsistence output and barter transactions.

According to the study by Chipeta and Mkandawire, most of the funds were available to beneficiaries not at exorbitant interest rates. This was so because a significant proportion of the loans did not bear interest, so that although loans from some of the informal lending agents (e.g., typical moneylenders) carried high nominal interest rates, the weighted average interest rate for lending by the informal financial sector as a whole was low; e.g., in 1989 it was estimated at 7.8% per annum, while the prime lending rate at commercial banks was 18%. Most of the informal lending agents provided loans at very low or zero interest as a way of promoting good public relations, solidarity, friendship and the like. This was contrary to the common belief that interest rates in the informal financial sector were higher than in the formal financial sector.

The major constraint that faced informal lenders was that loanable funds were considerably inadequate to meet the demand for credit by their clients. Their major weakness was that they did not provide medium- and long-term credit. This may have been partly due to their preference for short-term loans. Part of it may have been due to the short maturity of the liabilities of some of the informal lenders, as was reflected in the volatility in the levels of savings at SCAs and CFs, which to some extent was attributable to lack of safe deposit facilities.

Compared with the formal financial market, there was more fragmentation (lack of, or weak links) within the informal financial market. There appeared to be hardly any flow of resources between the market institutions. There also appeared to be little access among them to information about each other and about their clients. This was due to a number of factors including: the degree of secrecy surrounding their transactions, especially those of typical moneylenders; lack of publicity about the market institutions; and lack of official recognition of the market institutions so that they could hardly transact with banks openly in the name of informal lenders. For these same reasons, the informal financial market could not have been meaningfully competitive. And for associations (SCAs, CSAs and CFs), their major objective was to meet the financial needs of their members and therefore competing with another informal financial institution was not an issue.

Fragmentation between the informal and formal financial sectors was more pronounced on the lending side than on the deposit liabilities side of the banks. In other words, indications were that the flow of resources from the informal financial sector to banks was more than the reverse flow.

### **4.3 Microeconomic Policy and General Economic Environment**

The factors which brought the period of rapid economic growth to an end were also responsible for sluggish growth during the succeeding 1980-99 period. But, the unsatisfactory growth performance during 1980-99 also reflected an unfavourable policy and general economic environment, which we review first before discussing economic agents, namely manufacturing firms and agricultural households.

#### ***Budget Deficits, Money Supply and Inflation***

The overall budget deficit as a percentage of GDP was higher during the SAP period than during the pre-SAP period. Since a significant part of the deficit was financed through borrowing from the banking system, broad money supply grew faster during the SAP than before. Consequently, the rate of inflation was also higher during the SAP period than during the pre-SAP period (Table 12). By leading to an increase in the prices of imported consumer, capital and intermediate goods, currency devaluations have also contributed to high rates of inflation in Malawi, as has the re-routing of imports through much longer routes from seaports since the early 1980s. The other causes have been shortages of foodstuffs and agricultural raw materials caused by droughts or floods and taxes on imported and domestically produced goods.

Structuralists explain inflation in terms of the relative inelasticity of supply of foodstuffs, as a result of which food supply tends to lag behind demand generated by increases in incomes in the non-agricultural sector. While imports of foodstuffs may relieve domestic shortages, there is a foreign exchange constraint that prevents the importation of adequate quantities of foodstuffs to prevent prices from rising, and the imported foodstuffs may be at higher prices than local supplies. Should this happen, workers will demand an increase in their wages, which, if granted, will result in a further increase in

demand and a further rise in food prices.

The structural characteristics of the fiscal system are important as well. The tax system has low inflation elasticity so that when the general level of prices rises, the real value of tax revenue falls. This is because taxes are fixed in money terms or adjust slowly to inflation. In addition, the long collection lags mean that taxes are worth less by the time they are collected. Expenditures, on the other hand, tend to be fixed in real terms so that when prices rise, the money value of expenditures is raised proportionately. The consequence is that when prices begin to rise, the fiscal deficit tends to widen in real terms. In Malawi, the fiscal deficit can also rise because of delays in disbursements of foreign aid.

On the effects of inflation in Malawi, such evidence as exists is consistent with what is known about its effects in other developing countries. While moderate (say, single-digit) inflation has few measurable consequences, the more rapid the inflation, the more serious its effects. First, rapid inflation discourages and distorts investment. Studies show that when there is a rapid inflationary trend, prices also tend to become unstable around the trend. The resulting uncertainty encourages short-term speculation, such as stockpiling of imported goods and agricultural products. Speculators anticipate future price increases and withhold stocks until prices have risen, leading to scarcities and further price increases. Second, high and unpredictable inflation has a negative impact on long-term private investment because investors face greater uncertainties and will, therefore, be reluctant to commit themselves to long-term projects. Moreover, the composition of investment tends to be distorted by rapid inflation. Not all prices rise by the same percentage and the resulting changes in relative prices distort their information content and reduce the social efficiency of investment.

Rapid inflation also adversely affects the financial system and, through this, again discourages investment and economic efficiency. With rapid inflation, real interest rates (approximated by nominal rates minus the actual rate of inflation) remain negative, despite the removal of controls on nominal interest rates. Negative real interest rates discourage the mobilization of savings through the banks. However, it is unclear how large this effect is in Malawian conditions, partly because of the limited availability to savers of reasonably liquid alternative assets. Empirical studies for Malawi have shown that higher real interest rates do not cause a significant increase in private sector saving. In extreme cases, inflation, which is a type of tax on money holdings, can so erode the value of money that people become increasingly reluctant to use the national currency, let alone to save, preferring to use foreign currencies, or to retreat into pre-modern modes of barter and subsistence. The economic efficiency costs of such survival strategies can be very large.

**Table 12: Malawi Selected pre-SAP and SAP period macroeconomic indicators**

Indicators	Pre-SAP period (1971–80)	SAP period (1981– 98)
Budget deficit excluding grants as percentage of GDP	7.3	10.2
Budget deficit including grants as percentage of GDP	5.3	6.4
Broad money/GDP (percent)	16.8	17.3
Rate of inflation (percent)	9.5	23.1
Commercial bank prime lending rate (percent)	9.8	22.7
Current account deficit of balance of payments/GDP (percent)	13.1	10.3
Exchange rate (Malawi kwacha per US dollar)	0.8	7.5

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

### **Interest Rates**

Interest rates represent the opportunity cost or price of capital. But there is more to the actual level of interest rates, which tend to be influenced also by relative scarcity of capital, cost of administering capital, default risk, and imperfections in the structure of the financial markets. These factors change gradually. The increase in interest rates in Malawi during the SAP period (Table 12) is therefore not significantly a by-product of these factors. It is the result of three phenomena. One is the high demand of government for credit, reflected in large sales of treasury bills and an increase in the treasury bill rate. The rise in the treasury bill rate is exerting an upward pressure on other interest rates. The second is the restrictive stance

of monetary policy. As the bank rate is raised, other interest rates are supposed to rise as well to dampen demand for credit. The third is the high rate of inflation. In the face of a high rate of inflation, if nominal rates are not adjusted upwards, they become negative in real terms and so tend to discourage financial savings and encourage borrowing for not-so-productive activities (thus breeding inefficient allocation of resources).

### **Liberalization of Foreign Trade**

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 to 1999. In the early phase of the reform process, for example, 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 even after floatation to keep it competitive. They also prepared an export promotion strategy and established an export financing facility under SAL III.

Trade liberalization measures were first implemented under Industry and Trade Policy Adjustment Credit (ITPAC), which covered the fiscal years 1988 to 1990. Among the major objectives of ITPAC were export expansion and liberalization of imports to promote efficiency. The main policy measures were freeing 65% of imports from Reserve Bank's prior approval for foreign exchange allocation, completed after ITPAC in 1991; elimination of restrictions on payments for current items 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 was another major measure. As a result of the implementation of this measure, the weighted average tariff rate declined from 21% in 1989 to 19% in 1994 and about 15% in 1998.

Have these trade promotion and liberalization measures led to diversification of the export base? Have they led to an increase in exports and imports? Malawi has hardly succeeded in diversifying its exports away from agricultural to manufactured products. In 1980, agricultural products accounted for 88.6% of domestic exports. The share of agricultural products in total domestic exports increased to 93.5% in 1985, before declining slightly to 93.2% in 1990 and 86.6% in 1995. This outcome has partly to do with inability to expand production of many manufactures, the reasons for which are explained below. Following recent increases in the exports of horticultural products, textiles and garments, the share of other (non-traditional) products has increased.

Among agricultural products, the share of tobacco in total domestic exports was planned to fall below 50% during SAPs. Instead, it rose from 47.4% during 1980–1983 to 64.0% in 1988. Since then, it increased to 70.4% in 1994 before declining to 63.1% in 1997. Over the same period, the share of tea has fallen significantly as has the share of sugar, groundnuts, and rice. Coffee and pulses have increased their shares. Currency devaluations and depreciations, which have usually occurred at the start of or during the tobacco-buying season, have encouraged tobacco rather than the production of other crops. The absence of currency devaluations or depreciations 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 manufacturing industries that import inputs and export their output all the time. Another explanation is that in the 1980s Malawi continued with the development stance of the 1970s, which favoured estate tobacco production over other activities.

During the pre-SAP period up to 1980, exports grew rapidly owing to favourable demand and prices. The rate of growth of exports during the early phase of SAPs (1981–1985) declined owing to a worsening in the country's terms of trade by 28%. 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 SAP period the rate of expansion was lower than during the entire pre-SAP period. The average export/GDP ratio rose from 20.4% between 1971 and 1975 to 22.5% between 1976 and 1980. It then declined to 21.1% over 1986–1990 before rising to 22.4% between 1991 and 1997. Hence, there is no evidence of a strong upward trend.

The average rate of growth of imports was high during 1971–1975 owing to rapid economic growth

and rising receipts of foreign exchange. During 1976–1980 the average rate of growth of imports declined because of the lower rate of economic growth and emerging foreign exchange constraints. From 1981 to 1985, the average rate of growth of imports was actually negative owing to intensification of the earlier problems and increasing restrictions on import trade. Liberalization of trade has led to rapid expansion of imports, more so during 1986–1990. As percentage of GDP, imports between 1971–1975 and 1976–1980 increased, then declined to 26.0% between 1981 and 1985, before rising again. After liberalization, the trend, though mild is definitely upward.

### ***The Balance of Payments and Exchange Rate***

The current account deficit of the balance of payments as a percentage of GDP worsened during SAPs in Malawi. Prior to the liberalization period, total exports grew at an average annual rate of 19.9% in real terms, rising from K99.5 million in 1970 to K218.3 million in 1980. As a percentage of GDP, total exports increased from 15.7% in 1970 to 20.8% in 1980. In contrast, total exports increased at a lower rate in real terms during the reform period. From 1981 to 1996, they increased at an average annual rate of only 3.3%. As percentage of GDP, they rose only marginally from 19.2% in 1981 to 22.9% in 1996. Clearly, economic liberalization has not led to a marked expansion in the volume of exports.

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 relative price advantage that 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. 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).

Other key coefficients are not favourable either. Price and income elasticities of demand for Malawi's exports were estimated at only -0.18 and 0.4, respectively, meaning that a price or income change 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, raising revenue by the same margin. Even if a devaluation might have a positive impact on the volume of exports in the short run, such a remedy is inappropriate as a long-run solution as it tends 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.

Using data on real gross domestic product and the Malawi kwacha/US dollar exchange rate for the period 1984 to 1994, the elasticity of gross domestic product with respect to the exchange rate has been estimated as 0.11. This implies that a change in the exchange rate by 1% leads to a 0.11% change in gross domestic product. In other words, GDP is inelastic with respect to the exchange rate.

### ***Transportation***

As a landlocked country, most of Malawi's import and export trade goes through other countries. Inevitably, Malawi faces higher transport costs than countries that have seaports of their own. Access to the sea is entirely by railway only through the Nacala Corridor. Access to the Beira and Dar –es Salaam corridors is through a combination of road and railway transport, which makes for high transport costs. The large devaluations of the Malawi kwacha after 1993 have led to an escalation in transport costs because of the consequent increase in the cost of fuel and transport equipment and the increased payments in local currency for transport services provided by foreign carriers. Devaluations have also led to marked increases in the cost of internal transport, although the problem here is also due to the unsatisfactory state of the roads, which has led to an increase in motor vehicle maintenance costs. The data in Table 13 show a marked increase in the cost of transporting and insuring imports between 1971 and 1995.

High transport costs are recognized as one of the factors that make Malawi's goods uncompetitive in domestic and international markets. For this reason, government would like to increase efficiency and competition and hence lower the high costs of transport. In 1994, the Malawi Railways, a parastatal, was commercialized with a view to achieving efficiency and effectiveness of its operations and to improve its ability to carry more traffic. Furthermore, Malawi Railways (1994) Limited underwent concessioning, an

agreement that was completed in 1999, and a new private company, Central East Africa Railways (CEAR), started operations in December of that year. Some signs of improved efficiency in railway operations have been reported, although full positive effects of concessioning are yet to materialize.

**Table 13: The cost of insurance and freight in relation to the free on board value of Malawi's imports 1971–1999**

Period	Cost of insurance and freight in real terms Mk mn	Cost of insurance and freight as a percentage of imports fob
1971–75	33.7	15.4
1976–80	68.2	24.8
1981–85	108.8	51.8
1986–90	121.1	64.3
1991–95	179.8	81.1
1996–99	106.1	44.4

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

With respect to road transport, until a few years ago, the main centres of economic activity were connected by fairly good bituminized and all weather roads. These roads were designed for low axle load capacity and low volumes of traffic. Increased traffic and overloading have resulted in rapid deterioration of the road network. The consequent damage to vehicles has increased operating costs, which are reflected in high prices. Limited capacity and financial resources have constrained the ability of government to carry out maintenance. With donor funding and revenue from a special fuel levy, the financial constraint has eased, while the use of contractors means that limited capacity within government is no longer the binding constraint.

#### **Utilities**

In order to improve telecommunications, which are essential for domestic and international trade, cellular phones were introduced a few years ago and the Government Department of Posts and Telecommunications was converted into a statutory body. However, these developments have done little to improve the efficiency of telecommunications. There are frequent breakdowns, especially of ordinary telephones, making it difficult to communicate within Malawi and with the outside world. The need to break up the monopoly of the statutory body and so promote competition as a means of increasing efficiency is urgent. In the Internet end of the sector there are a few operators. To keep competitors away, license fees are kept very high. These must be brought down to encourage entry by more competitors into the industry.

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 failure 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. Government would like to see private sector participation in the provision of electricity as a way of increasing efficiency.

Urban water supplies are somewhat 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 decentralized 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 they will be able to meet the growing demand for water.

#### **Security**

The era of multi-party democracy from 1994 has experienced a sharp increase in crime, including fraud, forgery, theft, armed robbery and corruption. As a result, neither property nor life is secure in the countryside or in towns. It is believed that the high crime rate is discouraging investment and business activity.

Crime represents deviant behaviour. Therefore, its causes are basically sociological, having to do with

failure in upbringing. But the environment, such as economic hardship, town life and exposure to violent films, is also important. Urbanization has in fact increased rapidly in the recent past, as has economic hardship and exposure to foreign life styles. Multi-party democracy has been misconstrued to mean freedom to do whatever one likes, while past and current civil wars in the region have made small firearms readily available.

Then there have been government failures associated with the political transition. One was the abolition of the youth movement that supported the small police force, which has created a vacuum. A second was the legal requirement that a suspect should be charged within 48 hours, failing which he or she should be set free; and Third was the limited capacity of the courts to handle cases, which has led to the freeing of some criminals from police custody. All of these developments have increased the freedom of people to perpetrate crimes.

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 have had a limited impact also. Malawi simply needs to accord top priority to improving security, allocate more resources to the police and the judiciary, and ease the economic hardship suffered by the people.

Corruption exists in all walks of life, in the public sector as well as in the private sector, and the country ranks high among corrupt countries in Africa. The period since 1994 has seen an increase in the incidence of corruption. The reasons for this trend are similar to the ones that have led to an escalation in the number of crimes. The government has reacted by establishing an Anti-Corruption Bureau. Working within a limited budget with limited numbers of staff and facilities and subject to political interference, this bureau has not been effective in prosecuting offenders and hence in curbing the wave of corruption. The authorities need to be more serious about reducing this disease.

### ***Foreign Exchange Reserves***

The sources of Malawi's foreign exchange receipts are exports of goods and services, foreign aid, and loans and transfers. These receipts are not always adequate in relation to demand as it happened in 1987 and in 1992/93. When this occurs the manufacturing sector is adversely affected because of inability to import sufficient inputs and because of the adverse effect of foreign exchange shortage on the general level of economic activity which influences demand for manufactured products.

Since 1994, the level of gross official foreign exchange reserves has been the equivalent of at least three months imports and therefore generally adequate. However, perhaps persuaded by uncertainties regarding the receipt of foreign aid, the authorities have acted as if the country is heading for a crisis and resorted to currency devaluation. This has served to create the perception among investors that the country does not have enough foreign exchange reserves when in fact it has.

### ***Manufacturing Firms***

In response to the changed economic environment, the average half-decadal rate of investment in manufacturing declined in real terms from K282.34 million during 1975–1979 to K227.60 million during 1980–1984 and K183.08 million during 1985–1989. Although the half-decadal rate of investment subsequently increased and reached K230.54 million during 1990–1994, it never reached the peak level attained during 1975–1979 and was even much lower in real terms. During 1995–1999 it actually fell again to K219.28 million. A notable development was a steep decline in the share of inventory investment in the total to 2.82% during 1980–1984. This was short-lived, however, as inventory investment climbed to 35.44% during the 1985–1989 period and remained high during subsequent time periods. The relatively large inventory investment reflects the uncertainties manufacturing firms face because of transport and foreign exchange constraints. This high level of inventory investment competes with fixed investment for scarce resources and is probably responsible for their inability to diversify the product range. Manufacturing firms are also spending more money on security and electric generators than before. But the quantitative magnitude of this is not known.

The unfavourable policy and general economic environment has had the effect of raising transaction costs. Manufacturing firms face rising imported input costs because of exchange rate depreciation and

rising domestic input costs owing to the high rate of inflation and inefficiency in the provision of electricity, water and telecommunications. They must also contend with rising interest costs and rising transport costs stemming from the high cost of external and internal transport. The unfavourable policy and general economic environment have also exposed domestic manufacturing firms to stiff foreign competition. In reaction to rising transaction costs and foreign competition, many manufacturing firms have either stopped normal operations, or scaled down their operations, or turned to trading in the goods they formerly made themselves.

Did manufacturing sector reforms improve the efficiency of manufacturing firms? The view that optimal reform of real sectors should succeed financial and factor market liberalization was not followed. Instead, the reforms of the manufacturing sector started earlier. But, as was the case with other reform programmes, in varying degrees these reforms spanned the entire SAP period.

Reforms in the manufacturing sector 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% of manufactured products to which controls applied 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 petroleum products are subject to price controls. Other policy measures for reforming the manufacturing sector included reduction of the scope of industrial licensing requirements, 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, elimination of the industrial licensing process for investments except for a short list, and establishment of export processing zones (EPZs).

These policy measures have not yielded 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%, while in the 1971–1980 pre-SAP period, it grew at a much higher average annual rate of 13.6%. As a result, since 1980 the manufacturing sector has not increased its share in GDP, which remains at about 14%. Nor has it increased its share in total formal sector employment since that date, which is also stagnant at about 14%. Measured by the index of production, total manufactured output is lower now than it was in 1991, as is that of the subsectors of export goods, intermediate goods and consumer goods (except food and beverages).

Greater efficiency in import substitution has not been achieved either. This has been due to lack of competition, with most industries dominated by monopolies and oligopolies; regulation of the economy; and price controls, which were retained on some products after the authorities had started to dismantle price controls.

On industry, economic reforms have taken a neoliberal view that markets are efficient and government intervention in resource allocation is distorting and inefficient. Markets may prove to be inefficient, but this is believed to be less costly than government inefficiency. And, on technology, the following assumptions are made: access to technology is such that there is no need for further efforts; there are no learning costs; there is no need to make adaptations; and there is no need to create information networks or to coordinate investment decisions across activities. As a consequence, the design of industrial reforms does not take into account capabilities, institutions and markets; the need for technological upgrading, and the importance of providing opportunities for competitive activities to develop.

The technological capability analysis of industrialization suggests that industrial development is influenced by how well firms manage technological development. In this regard, protection is necessary to induce entry into activities with difficult learning processes. The newly industrialized economies of East and Southeast Asia used a variety of state interventions to promote industrial development. These included active industrial policies and sound macroeconomic management. Domestic resources were channelled to selected infant industries, with the encouragement to export upon approaching competitiveness. A wide range of technological support services was provided by the state. The adoption of interventions to protect the learning process so as to facilitate industrial deepening was a key feature of policies there (African Development Bank, 1995).

Manufacturing firms are feeling the effects of high levels of morbidity and mortality particularly now because of the prevalence of HIV/AIDS among urban workers. Morbidity is partly responsible for a high level of absenteeism and low productivity and for an increase in time and cost of hospital care. And mortality is responsible for a high level of funeral expenses. It is illegal for firms to dismiss workers on health grounds, so the best they can do is to intensify HIV/AIDS education for their employees.

### ***Agricultural Households***

The unfavourable policy and general economic environment has also adversely affected the agricultural sector, where gross capital formation has declined. On the basis of data on estates reported in the Annual Economic Survey, in real terms gross capital formation in these enterprises fell from an annual average of K40.3 million during 1975–1979 to K12.2 million during 1980–1984, K10.1 million during 1985–1989 and to K8.8 million during 1990–1994. Furthermore, like manufacturing firms, agricultural enterprises face rising imported input costs, rising domestic input costs, rising interest costs and high transport costs. Many tobacco estates have either ceased producing or scaled down operations, especially in the flue-cured tobacco subsector.

With a limited amount of irrigation, agriculture continues to suffer from an erratic rainfall pattern. Since 1985/86, for example, there have been three seasons of drought conditions (less than 800mm per annum) and six seasons of above normal rainfall (over 1,000mm per annum). During the same time period, the highest rainfall was experienced in 1988/89 with a national average of 1,233mm and the lowest in 1993/94 with a national average rainfall of 729mm. Changes in the amount of rainfall and other weather conditions cause fluctuations in the yields of both smallholder and estate crops.

In the early 1980s, the government carried out a number of reforms affecting the smallholder agricultural sector. The consensus view that optimal reform of the real sector or the goods markets should succeed financial and factor market liberalization was not followed in this case. Instead, the reform of the agricultural sector started earlier. But, as was the case with other reform programmes, in varying degrees reforms spanned the entire SAP period.

Among the principal objectives of SAPs in agriculture were to ensure appropriate price policy (structural adjustment loan I or SAL I) and adequate incentives (SAL II), expand the role of the private sector in the marketing of smallholder crops (SAL III), and increase efficiency and improve incomes of smallholders. Reforms also intended to increase efficiency of land use and protect the environment (Agricultural Sector Adjustment Credit or ASAC) and completely remove remaining pricing and marketing constraints on smallholder agriculture (Fiscal Restructuring and Deregulation Programme or FRDP). The main policy measures implemented were rationalization of and annual increases in smallholder producer prices and removal of fertilizer subsidies. Others aimed at reducing the role of 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, along with exchange rate liberalization to remove the implicit tax on agricultural exports.

The performance of smallholder agriculture cannot be attributed solely to SAPs (thus ignoring weather and the terms of trade). The fact that smallholder agriculture has not done well under SAPs suggests that SAP policies have failed to arrest the adverse impact of other factors on the sector. SAPs have not adequately addressed the problems of inadequate producer incentives, unfavourable internal terms of trade, and inadequate credit and extension services. Certainly, they have not attempted to address non-price constraints like infrastructure and risk. Under these circumstances, improving rural infrastructure and feeder roads, improving extension, increasing producer prices, and increasing credit are required.

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 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).



The yields of the main cash crops grown by smallholder farmers have not increased either. For example, between 1970 and 1980 the average yield of fire-cured tobacco was 389 kilograms per hectare. Between 1981 and 1994, it had declined to 337 kilograms per hectare. The corresponding average yields for sun-air cured tobacco were 364 kilograms and 287 kilograms per hectare, respectively. During the 1970s, output of fire-cured tobacco per grower fluctuated between 371 kilograms and 215 kilograms with no clear trend. Between 1985 and 1989, it fell from 384 kilograms to 116 kilograms in the Northern Division and from 119 kilograms to 95 kilograms in the Southern Division. The removal of restrictions on the cultivation of burley tobacco by smallholders has led to a marked increase in production in the smallholder subsector. Although production of burley tobacco on estates has declined because of higher input costs and rising insecurity in rural areas, total output of this crop has increased.

#### **4. THE CONCLUSION SYNTHESIS**

The growth experience of Malawi falls into two broad periods, the 1960–1979 period, corresponding to the pre-SAP era, and the 1980–1999 period, corresponding to the SAP era. During the former period, rapid growth occurred in all sectors, in GDP, and in GDP per worker and per capita. During the latter period, growth declined in many sectors, in GDP, and in GDP per worker and per capita.

The coun rapid growth during 1960–1979 stemmed mainly from a marked expansion in capital per worker. In turn, the expansion in capital per worker was due to a rapid increase in the rate of investment. Investment was at first financed largely by foreign resource inflows, but later largely by domestic savings. Investment rose in both the public and private sectors. Apart from buildings, public investment was concentrated in transport infrastructure and utilities. This helped to reduce transaction costs. Private investment went into fixed capital formation, mainly in the agricultural, manufacturing and distribution sectors of the economy. This led to an expansion in estate agricultural production, especially production of tobacco and sugar, as well as in manufacturing output.

The country also owed rapid growth during 1960–1979 to an increase in foreign demand for its principal export crops and hence in the prices of these crops in foreign markets; an improvement in the terms of trade during the earlier part of this period; a marked increase in domestic demand for industrial products caused by an increase in real disposable incomes; and a generally favourable level of foreign exchange.

The average rate of economic growth during 1960–1979 should have been higher but for the small contribution to GDP growth of education per worker owing to low average years of schooling; low total factor productivity residual, reflecting climatic shocks (droughts and excessive rains) and a worsening in the terms of trade towards the end of the period; a decline in the rate of growth of value added in the smallholder agricultural sector because of insufficient incentives, controls on production and other constraints; and the implementation of policies that stifled private enterprises, such as maximum price controls and forfeiture of private business enterprises on flimsy grounds.

During the 1980–1999 period, the rate of economic growth would have been higher but for a reduction in the amount of capital per worker, reflecting a steep reduction in the rate of investment in the economy, and a negative total factor productivity residual stemming from sharp increases in transport costs. As noted earlier, higher transport costs arose because of the severing of short land routes to the sea, an increase in the cost of transport equipment and fuels, and a deterioration in the condition of internal roads. Other contributors to the lowered growth were a sharp increase in imported input costs due to currency devaluations and in local input costs due to high rates of inflation, a decline in private consumption demand in real terms, a decline in the expansion of the estate agricultural sector in terms of output growth, and frequent water and electricity supply interruptions. Terms of trade worsened, the climate delivered a number of shocks the HIV/AIDS epidemic played increasing havoc, and capacity utilization fell. The impact of tax and other policies generated an inefficient composition of investment that favours trading and other speculative activities, while the contribution of education per worker to GDP growth remained low.

Almost all of Malawi's tobacco and tea are exported; while a significant part of her output of sugar, one of the three major exports, is consumed domestically. During the two periods under review, high

transport costs, particularly over 1980–1999 period, made the country's exports less competitive. It seemed that where the crop grower was not the exporter (as for tobacco of all varieties) and where the grower was not the seller on the local auction floors (as for tenants on burley tobacco estates), the market was less integrated (in terms of flow of information and price levels) and less efficient with respect to resource allocation than where the grower was also the exporter, as was the case for the bulk of tea exports and sugar exports.

The characteristics of the markets for estate agriculture crops hindered the performance of private agents in varying ways. Notable hindrances included the relatively high transaction costs incurred by estate tobacco growers located far away from auction floors, particularly when there was only one floor, located in the south. The prices fetched by tobacco growers on the auction floors were sometimes unattractive because of alleged collusion among buyers; and prices paid to tenants on burley tobacco estates were unfairly low.

In both periods under review, the domestic markets for smallholder crops were hardly competitive. Their sales to ADMARC were at officially set prices. The major exception was tobacco, which from the early 1990s they were allowed to sell, as clubs, on the competitive auction floors, apart from other alternative marketing channels that were opened to them as part of the market reform programme. In the case of their sales of various crops to private traders, smallholders could hardly compete because of lack of market information and the transport problem. With market liberalization from the 1980s, there was competition between ADMARC and private traders and among private traders. However, the degree of competition was hampered by lack of market information, the problem of transport and other constraints facing private traders. Thus, there was a good measure of fragmentation of markets for smallholder crops reflected in lack of information flow among the economic agents and in different prices of the same quality/grade of a commodity within neighbouring localities.

The effect of the characteristics of the markets for smallholder crops on the official and private economic agents was mixed. In terms of profitability, ADMARC performed well as was evidenced by the huge profits the parastatal was making, particularly in the 1960–1979 period, through the large differentials between its selling prices and the low producer prices paid to smallholders. Because of the low producer prices, the performance of smallholders was considerably constrained. Following liberalization of the market for smallholder crops, the performance of private traders was less hindered than before, although they faced a number of other constraints.

The extent to which the market for agricultural commodities was conducive to economic growth is debatable. Estate agricultural commodities, the major exports, contributed the most to the growth of exports in both periods under review. Also, the estate agricultural subsector accounted for the bulk of the growth rate in paid employment in the 1960–1979 period and for much of the slowdown in the growth rate of paid employment in the 1980–1999 period. The rate of growth of value added in the estate agricultural subsector from the early 1970s to the mid 1990s was faster than in the smallholder agricultural subsector.

The fragmented and hardly competitive markets for smallholder crops, sold at unattractively low producer prices, comprised a major factor behind the slow growth rate in value added of the smallholder agricultural subsector; the other major factors included the growing scarcity of arable land for smallholders and their lack of access to other productive assets. As the officially regulated producer prices of smallholder crops rose proportionately less than prices of their consumer goods, the domestic commodity terms of trade faced by smallholders generally deteriorated in both periods except in some years of the 1990s (M.L.C. Mkandawire, 1999). Thus, resources were on a net basis being siphoned away from smallholders to other economic agents, thereby reducing their capacity to save and invest, and further constraining growth prospects for the smallholder subsector.

Commercial bank credit contributed considerably to the growth of estate agricultural exports, particularly tobacco, in both periods under review. However, the banks did little to assist SMEs and smallholder farmers, as was also the case with NBFIs not set up to assist such small-scale operators. Even the NBFIs that were mandated to assist small-scale operators managed to lend to only some, leaving many more of them with no access to institutional credit. In that sense, the trend increase in financial deepening registered in the 1960s, 1970s and 1980s was less meaningful because it was hardly accompanied by financial widening in the form of spreading financial liabilities and assets among many more holders in

the economy.

Measured by the ratio of total stock of gross credit extended by commercial banks, the central bank and NBFIs to GDP, financial deepening progressed from an average of nearly 15% in the 1965–1970 period to 29% in the 1970s and 42% in the 1980s; but shrank to an average of 33% in the first half of the 1990s, paradoxically in a period of financial sector reform. Also, the ratio of deposits at commercial banks and NBFIs to GDP demonstrated financial deepening, from an average of 14% in the 1965–1970 period to 20% in the 1970s and 21.8% in the 1980s, but there was some slight financial shallowing to an average of 21.5% in the first half of the 1990s.

Survey results of a 1993 study (Chipeta and Mkandawire, 1996) estimated that direct administrative cost of lending to the non-agricultural small-scale enterprises (SSE) sector by commercial banks was 1.16% of their total lending to this sector in 1991. This ratio was about the same as that of 1.19% for the large-scale enterprises (LSE) sector, suggesting that such relative costs could not be used as a basis for bank credit discrimination against small-scale enterprises in preference to large-scale enterprises. The discrimination should have been based on other factors, including a high loan default rate estimated at 16% for the SSE sector in 1991 compared with only 2% for the LSE sector, according to the same study.

Out of their dominant share of deposit resources in the market, commercial banks were not able to extend sizeable proportions of medium and long-term loans, and yet these are critical to fixed capital formation required for economic growth. Persistent excess liquidity positions at banks and some NBFIs, whilst large parts of demand for credit remained unsatisfied in the economy, were also not conducive to growth.

In short, the formal financial market did not efficiently perform its role of financial intermediation.

The volume of lending in the informal financial market was mainly constrained by inadequate loanable funds. This constraint could have been reduced significantly if there had been some meaningful flow of credit from formal financial institutions with excess liquidity to informal lenders to augment the latter's lending capacity.

The formal manufacturing sector in Malawi is dominated by micro enterprises, which employ between 1 and 4 workers, and small-scale enterprises, which employ between 5 and 20 people. There are fewer medium-scale and large-scale enterprises. Recently, the micro enterprises subsector has been growing relative to the other subsectors. The market structure exhibits a high degree of concentration, with oligopolies dominating sales. The recent liberalization of imports and the economy means, however, that industrial firms are now subject to more competition. Ownership is spread among public enterprises, which are the least efficient, private local and private foreign. With privatization, public ownership is on the decline. The number of enterprises in the informal manufacturing sector is much larger, according to various surveys.

Recently, the number of micro enterprises has been growing quite fast, followed by small-scale, medium-scale and large-scale enterprises, in that order, suggesting that larger enterprises may be facing more constraints than smaller ones. As measured by the index of production, total manufacturing output is lower now than it was in 1991, as is that of the subsectors of export goods, intermediate goods and consumer goods (except food, beverages and tobacco). The growth of manufacturing value added has followed the seasonal agricultural cycle. As a percentage of gross domestic product (GDP), the sector has not increased its share (about 14%) significantly since 1980. Nor has it increased its share (also about 14%) in total employment. The ability of manufacturing to expand is constrained by a fall in consumer demand caused by a decline in real incomes, foreign competition, escalation in the costs of production, an unstable macroeconomic environment, inadequate and unreliable utilities, a high wave of crime that is scaring away investment, a hazardous and unreliable internal road network, and uncertainty about the level of foreign reserves. Then there are chronic problems like inadequate linkages with other sectors and within manufacturing, inadequate trained and skilled manpower, the use of obsolete technology in many cases, and inadequate delivery of credit to informal, micro and small-scale enterprises engaged in manufacturing.

Apart from seeing the birth of independence, the short period of 1960–1964 was much less eventful in terms of policies than the succeeding periods. Nevertheless, the event of the famous cabinet crisis in 1964 marked a major turning point in the course of the political history of Malawi.

We have seen that most of the dates of major policy pronouncements, or when the policies were first

put into effect, fall in the period from the late 1970s/early 1980s, which marked the beginning of the long overlapping periods of Malawi's agreements with the IMF under the standby arrangements and with the World Bank under the structural adjustment programmes.

The 1964–1994 period of one-party rule was characterized by undemocratic ways of managing the affairs of the state. The masses were oppressed. Lack of freedom of expression and lack of wider participation in decision making tended to stifle creativity, initiative, and the generation of a variety of ideas and other useful/productive potentials in citizens. All this could not have been conducive to political, social and economic development of the country. In this connection, there seems to be growing conviction that there is a positive correlation between democracy and social and economic progress. Some have argued, for example, that “without democracy, sustained economic growth is impossible”. However, others have pointed out that “the relationship between democracy and development remains unclear”, the argument often made being that “China and the South East Asian tigers have hardly been noted for their commitment to democracy and yet have had impressive records of growth and poverty reduction” (Hoek and Bossuyt, 1993).

A high premium was placed on political stability, which was sustained by Banda's one party rule for three decades through an elaborate system to suppress or punish any form of dissent and reward the good guys. The system was tacitly aided by Western powers, which saw in Malawi a worthwhile political ally in subregional matters (Mhone, 1992). However, investors could not have been sure of the long-term durability of that political stability, particularly of what would happen after Banda. Meanwhile, the notorious forfeiture act was invoked from time to time. These factors could not have been insignificant among all the factors behind the stagnation in the rate of domestic private investment during Banda's rule, particularly in the 1980s and 1990s when he was at an advanced age.

Following the 1964 cabinet crisis, Malawi's relations with neighbouring countries to which former ministers had fled became unhealthy. This was not conducive to bilateral cooperation including on matters of trade.

Some major policies were made and handed down by Banda's ruling clique, particularly up to the late 1970s. Many more policy choices from the early 1980s have been donor-induced, mainly by the IMF and the World Bank. On other policies, especially before the early 1980s, economic technocrats played important roles. Up to the late 1970s, Malawi's civil service was regarded as one of the few efficiently run in less developed countries by the international development agencies (Morton, 1975, quoted in Kaluwa et al., 1992: 10). The 1980s and 1990s saw a decline in the efficiency of the civil service, however, for a number of reasons not explored here. This included a decline in the efficiency of economic technocrats in the management of the economy, in a period coinciding with considerable involvement of donors, particularly the IMF and the World Bank, in the economy. Has such involvement of external forces tended to reduce the sense of ownership of the policies and programmes among local policy makers and implementers? In this connection, the argument made by the African governors of the World Bank in 1996 is pertinent: that “aid was on balance undermining institutional capacity in Africa” (Ndulu and O'Connell, 1999, citing what is cited in Van de Walle, 1998).

Aside from the issue of the level of their efficiency, economic technocrats seem to have been wielding some measure of power. This has partly been manifested in the fact that the government budget documents they prepare, which *inter alia* contain policies and strategies, have been passed in parliament only after brief debates by politicians, without serious challenges and criticisms, during the one-party rule as well as the current multi-party regime. In turn, this has arisen from inadequate knowledge and understanding of economic issues on the part of most parliamentarians including some ministers. They therefore have had to almost wholly rely on the expertise of the technocrats.

During Kamuzu Banda's dictatorship, this was compounded by his apparent aversion for being surrounded by well-educated and critical people, particularly after the 1964 cabinet crisis. Some high level economic/financial technocrats have derived their power from being politically appointed by the President, and such power has been particularly evident in the case of some governors of Malawi's central bank. In the current multi-party era, the services of some private economic technocrats are being utilized by the opposition, particularly shadow ministers of finance, to prepare responses to the government budget presentation in parliament and other papers.

A number of policy choices in the 1964–1994 period were heavily influenced by preferences of

interest groups. And the interest groups whose preferences were met were usually those to which senior politicians and senior civil servants also belonged. In such cases, these senior people took the initiative while the rest of the members of the interest group from the public sector and the private sector hardly expended their resources on lobbying for their preferences.

There is an apparent puzzle in Malawi's story up to the late 1970s. Paradoxically, political oppression co-existed with an efficient bureaucracy, and policy choices based on political patronage contributed to high annual economic growth rates as well as other good macroeconomic measures of performance such as relatively small budget deficit/GDP ratios. The puzzle may be explained this way. Kamuzu Banda's style of dictatorship was accompanied by his persistent exhortation of the masses to work hard (a quality he himself had), although generally there were shortfalls in the actual levels of hard work attained. Amid Banda's exhortations, senior (and junior) public servants could ill afford to be marked as lazy, incompetent, corrupt and the like for fear of being retired prematurely (if lucky) or, worse still, dismissed or even imprisoned; and Dr. Banda did not hesitate to issue directives to that effect. This appears to have contributed significantly to efficiency with which Malawi's civil service operated up to the late 1970s; it was in fact regarded as one of the few efficiently run in less developed countries. During a good part of this period, Banda was still energetic. Further, unlike in some countries, resources distributed through political patronage in Malawi were largely used not for consumption but productively, mainly in the estate tobacco subsector. This type of leadership was conducive to development, and its positive effect could have been greater had it not been for Banda's own misguided political choice of not wanting to be surrounded by and to listen to well educated people/advisers with critical minds as noted above.

In addition to growth in investment and output in the estate agriculture subsector, there were other factors, domestic and foreign, as discussed above, that accounted for the high overall economic growth up to the late 1970s.

But by the early 1980s, which coincided with the beginning of SAPs, Banda's age was quite advanced (reaching 90 years in 1986) and he was progressively losing his personal grip on the leadership. Thus, other members of the small ruling clique increasingly ran the affairs of the state using Kamuzu Banda's name, ostensibly as if he was still in effective control. None of them was popular enough to succeed Banda, so that what was to happen after the Banda era was becoming more and more unclear, thus creating uncertainty among investors.

Has the multi-party regime made any difference to the affairs of the state? It has not done so on the economic front. A number of economic policies continue to be unsatisfactory as reflected in the inability to sustain high economic growth rates and the failure to create adequate employment and to distribute national income and wealth equitably, as well as failure to reduce poverty and to reduce the high rates of inflation.

On the socio-political front, the outcome is mixed. The good governance principle of the rule of law with an independent judiciary has generally been upheld, as has been the respect for human rights. The principle of having a system of open political competition has to a large extent been followed. But some problems have been encountered, including cases of violent confrontations between supporters of major political parties, voting largely on regional lines and alleged buying of some opposition politicians by the ruling party. Related to this has been the alleged use of resources by the ruling party to reward its faithful; this has, among others, included politicization of credit facilities at some institutions that lend to SMEs.

Application of the principle of effective participation of various actors in the decision making process has met considerable obstacles. Much of the blame has been put on the ruling party, which has become progressively more intolerant of criticisms particularly from the opposition. Some of the blame has been put on the opposition as well for not doing enough to, inter alia, offer constructive suggestions. The application of the principles of public accountability and transparency has encountered major shortfalls. Corruption has grown considerably even in some high public offices. There is a tendency among politicians, especially from the ruling party (while still in power), to be driven more by vested interests (material and other) than the interests of the masses and the nation as a whole.

Insecurity has risen to worryingly high levels as evidenced by frequent and sometimes violent robberies. The work ethic has generally sunk to low levels; some contributory factors appear to be the (in some cases politically motivated) practice in some quarters of not recruiting and rewarding employees on merit, the misunderstanding of the new found freedom under the young multi-party democracy, and the

unfulfilled 1994 electoral campaign promises, which created great expectations. Further, government reversal of some decisions has not augured well for its credibility. All these negative developments are not conducive to investors, existing and potential, local and foreign.

## References

Adam, C. and S. O'Connell. 1999. "Aid, taxation and development in Sub-Saharan Africa". *Economics and Politics*, 11(3), November: 225–54.

Barrow, R. and J.W. Lee. 1993. "International comparisons of educational attainment". *Journal of Monetary Economics*, 32(3), December: 363–94.

Bloom, D. and J. Sachs. 1998. "Geography, demography and economic growth in Africa". *Brookings Papers in Economic Activity*, 2, pp. 207–73.

Chihana Chakufwa. 1998. Letter as President of AFORD Party to Mr Callisto Madavo, Vice President for Africa Region, The World Bank, on the latter's visit to Malawi in May 1998, published in *The New Vision*, 9 May, Vision Publications, Lilongwe.

Chilowa, W. and E.W. Chirwa. 1997. "The impact of SAPs on social and human development in Malawi". In W. Chilowa, ed., *Bwalo: A Forum for Social Development*, Issue 1. University of Malawi, Centre for Social Research.

Chipeta, Mapopa. 1992. "Political process, civil society and the state". In Guy C.Z. Mhone, ed., *Malawi at the Cross-roads: The Post - Colonial Political Economy*. Harare: SAPES Books.

Chipeta, C. and M.L.C. Mkandawire. 1996. "Financial integration and development in Sub-Sahara Africa: The formal and semi-formal financial sectors in Malawi". Working Paper No. 89, Overseas Development Institute, London.

Chipeta, C. and M.L.C. Mkandawire. 1991. *The Informal Financial Sector and Macroeconomic Adjustment in Malawi*, Research Paper No. 4, African Economic Research Consortium, Nairobi.

Chipeta, C. 1990. "The role of the informal financial sector in economic development in Malawi". Paper presented as an inaugural lecture during the Silver Jubilee Celebrations, University of Malawi.

Collier, P. and J.W. Gunning. 1999. "The Micro-economics of African Growth", 1950–2000". A thematic paper for the AERC project, Explaining African Economic Growth Performance.

Collins, S.M. and B.P. Bosworth. 1996. "Economic growth in East Asia: Accumulation versus assimilation". *Brookings Papers in Economic Activity*, 2: 135–203.

Domar, E. 1946. "Capital expansion, rate of economic growth and employment". *Econometrica*, 14: 137–47.

Elbadawi, I.A. and B.J. Ndulu. 1996. "Long-term development and sustainable growth in Sub-Saharan Africa". In M. Lundahl and B.J. Ndulu, eds., *New Directions in Development Economics* London: Routledge.

Fei, J.C. and G. Ranis. 1964. *Development of the Labour Surplus Economy: Theory and Policy*. Homewood, Illinois: Irwin.

Hagen, E.E. 1980. *The Economics of Development*, 3rd edition. Homewood, Illinois: Dorsey.

Harrod, R.F. 1939. "An essay in dynamic theory". *Economic Journal*, 49: 14–33.

Hoeffler, A. 1999. "The augmented Solow model and the African growth debate". Background Paper. Centre for the Study of African Economies (CSAE), University of Oxford, March. Revised April 2000.

- Kaluwa Ben, Exley Silumbu, E. Ngalande Banda and Wycliffe Chilowa. 1992. *The Structural Adjustment Programme in Malawi: A Case of Successful Adjustment?* Monograph Series No. 1, Edited by B. Kaluwa. Harare: SAPES Books.
- Katjavivi, P.H. 1971. "Democracy and economic growth: Some practical experiences for parliamentarians". *African Development Review*, African Development Bank, 3(2), December.
- Krueger, A. and M. Lindahl. 1998. "Education for growth in Sweden and the world". Working Paper No. 411. Princeton Industrial Relations Section, December.
- Kydd, J.G. and R.E. Christiansen. 1981. *Trends in the Distribution of Income in Malawi since Independence*.
- Lewis, W.A. 1954. "Economic development with unlimited supplies of labour". *The Manchester School*, May, pp. 139–91.
- Malawi Government. *Statement of Development Policies 1971–1980*.
- Malawi Government. *Statement of Development Policies 1987-96*
- Malawi Government. *Economic Report 1996, 1997*.
- Malawi Government. 1965. *Nyasaland Development Plan 1962-65*. Zomba: Government Printer.
- Malawi Government. 1983. *International Conference of Partners in Economic Development Past Performance and Prospects for 1983-1987*.
- Mhone, Guy C.Z. 1992. "The Political Economy of Malawi: An overview". in Guy C.Z. Mhone, ed., *Malawi at the Cross-roads: The Post-Colonial Political Economy*. Harare: SAPES Books.
- Mkandawire, T. and C. Soludo. 1999. *Our Continent, Our Future: African Perspectives on Structural Adjustment*. Trenton, N.J.: Africa World Press.
- Mkandawire, Mjedo L.C. 1999. *Poverty and Macroeconomic Management in Malawi*. Harare: SAPES Books.
- Mkandawire, Mjedo L.C. 2001. Peasants movements against poverty in Malawi: Achievements, constraints and prospects". Paper prepared for the seminar of the Third World Forum, Dakar, Senegal, 9–12 April.
- Mkandawire, R.M. 1992. "The land question and agrarian change in Malawi". In Guy C.Z. Mhone, ed., *Malawi at the Cross-roads, The Post-Colonial Political Economy*. Harare: SAPES Books.
- Mwalwanda, C.T. 1985. "Foreign exchange management and exchange rate policy in balance of payments". Paper presented at a Seminar on Foreign Exchange held at Reserve Bank of Malawi, Lilongwe, 10–11 October.
- Mwanza, Patrick. 1997. "The church and Malawi Politics" In *The Nation*, 23 April, Nation Publications, Blantyre.
- Sachs, J. and A. Warner. 1997. "Sources of slow growth in African economies". *Journal of African Economies*, 6(3): 335–76.
- Schwartz G.M., Samu M. Samu and Stanely Khaila. 1994. *Aspects of Participation in Economic Policy Reform: The Malawi Case Study, An Analysis of Participation in the Agricultural Sector*. Agricultural Policy Research Unit of Bunda College of Agriculture, University of Malawi, Report No. 1, March.
- World Bank. 1988. *World Development Report*. New York: Oxford University Press.
- World Bank. 1987. *World Development Report*. New York: Oxford University Press.

World Bank. 1981. *Accelerated Development in Sub-Saharan Africa: An Agenda for Action*. Washington, D.C.: The World Bank.

UN in Malawi and Malawi Government. 1993. *Situation Analysis of Poverty in Malawi*.