Malawi Economic Growth Strategy

Volume I:
Summary

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ACRONYMS

ADMARC	Agricultural Development and Marketing Corporation
AGOA	Africa Growth Opportunities Act
BRP	Business Residence Permit
CEM	Country Economic Memorandum
COMESA	Common Market for Eastern and Southern Africa
DANIDA	Danish International Development Agency
DEMATT	Development of Malawian Entrepreneurs Trust
DFID	Department for International Development (UK)
DTI	Diagnostic Trade Integration (Study)
DWS	David Whitehead and Sons
EBA	Everything But Arms
EC	European Commission
ECAMA	Economics Association of Malawi
EIB	European Investment Bank
EPZ	Export Processing Zone
ESCOM	Electricity Supply Company of Malawi
EU	European Union
FAO	Food and Agriculture Organisation
FOB	Free on Board
FTA	Free Trade Area
GDP	Gross Domestic Product
GoM	Government of Malawi
GRAMIL	Grain and Milling Co.
GTMA	Garments and Textile Association of Malawi
IMF	International Monetary Fund
ITC	Information, Technology and Communication
JICA	Japan International Co-operation Agency
LDC	Least Developed Country
MASAF	Malawi Social Action Fund
MASIP	Malawi Social Investment Programme
MBCAH	Malawi Business Coalition against HIV/AIDS
MBS	Malawi Bureau of Standards
MCCCI	Malawi Confederation of Chambers of Commerce and Industry
MDC	Malawi Development Corporation
MEDI	Malawi Entrepreneurship Development Institution
MEPC	Malawi Export Promotion Council
MEPD	Ministry of Economic Planning and Development
MFI	Micro-finance Institutions
MIPA	Malawi Investment Promotion Agency
MIRTDC	Malawi Industrial Research Technology Development Centre
MMTZ	Malawi Mozambique Tanzania Zambia
MoAi	Ministry of Agriculture, Irrigation and Food Security
MoCI	Ministry of Commerce and Industry
MoF	Ministry of Finance
MPRSP	Malawi Poverty Reduction Strategy Paper

MRA	Malawi Revenue Authority
MRFC	Malawi Rural Finance Company
MSE	Micro and Small Enterprises
MTL	Malawi Telecommunications Ltd
MTPW	Ministry of Tourism, Parks and Wildlife
NAC	National Aids Commission
NAG	National Action Group
NASFAM	National Smallholder Farmers Association of Malawi
NGO	Non-Governmental Organisations
NRA	National Roads Authority
NSO	National Statistical Office
ODA	Overseas Development Assistance
PAYE	Pay As You Earn
PSIP	Public Sector Investment Programme
RBM	Reserve Bank of Malawi
SACU	Southern African Customs Union
SADC	Southern African Development Community
SEDOM	Small-scale Enterprise Development Organisation of Malawi
SFFRFM	Smallholder Farmer Fertilizer Revolving Fund of Malawi
SHIMPA	Shire Highlands Milk Producers Association
STA	Smallholder Tea Authority
STABEX	Stabilisation System for Export Earnings
STC	Smallholder Tea Company
SUCOMA	Sugar Corporation of Malawi
TAM	Tea Association of Malawi
TAMA	Tobacco Association of Malawi
TCC	Tobacco Control Commission
TEP	Temporary Employment Permit
TEVETA	Technical Entrepreneurial and Vocational Education Training Authority
UNDP	United Nation Development Programme
UNIDO	United Nations Industrial Development Organisation
USAID	United States Agency for International Development
WTO	World Trade Organisation

PREFACE

This Malawi Economic Growth Strategy reflects a joint realisation by Government and the private sector that the economy has been registering negative growth and that something had to be done in order to reverse the trend. The rationale for growth and diversification for Malawi is compelling because rapid broad-based growth is necessary to reduce poverty. Rapid broad-based growth will expand the sectoral sources of growth, deepen and sustain the gains to be made from smallholder agriculture, and make the economy less susceptible to external shocks like weather, changes in terms of trade, political developments in the region, and fluctuations in external aid flows. However, existence of low per capita income and high inequality implies that high future economic growth should be complemented by equity policies.

The Malawi Economic Growth Strategy has been based on a realistic assessment of the resources available. It focuses on strategies and actions that do not require substantial additional spending by Government and instead can be achieved through refocusing of existing resources and by developing a more conducive set of policies that will stimulate private sector investment and trade in the immediate future. However, in the medium term, donor organisations will have a key role to play in creating a conducive environment for economic growth by supporting policy reforms and providing resources to support government during the transitional period.

The development of the Malawi Economic Growth Strategy was led by the Ministry of Economic Planning and Development (MEPD) with a Task Force drawn from key institutions within Government, the University, private sector and other key stakeholders. MEPD and the Task Force were supported in the process by the National Action Group (NAG) Secretariat. MEPD, the Task Force and NAG Secretariat would like to acknowledge the considerable inputs received from stakeholders in the public and the private sectors in preparing this Malawi Economic Growth Strategy. There have been many consultations with individuals and organisations to ensure that the different issues constraining economic growth are reflected and that appropriate proposals are formulated to address them.

We acknowledge the considerable work of Task Force members in providing information and drafting key sections of this document and also the role of Dr Zaki Chalira, who as the Director General of National Economic Council and the Department of Economic Planning and Development, provided his guidance for the large part of the process. We also thank Francis M'buka from the World Bank and Mr R. M. Jiah, Ministry of Tourism, Parks and Wildlife. We are also indebted to the financial support provided by the United Nations Development Programme (UNDP) in the development of the Malawi Economic Growth Strategy. Finally we thank all of those who have commented on and contributed to the various drafts of this Malawi Economic Growth Strategy.

ABOUT THIS REPORT

In April 2002, the Government of Malawi launched the Malawi Poverty Reduction Strategy Paper (MPRSP) that aims at meaningfully reducing poverty by empowering the poor. The MPRSP is built around four strategic pillars, the first of which emphasises the promotion of sustainable pro-poor growth. However, many stakeholders, including the private sector, have observed that policies to fulfil this strategic objective are insufficient to achieve a sustained annual economic growth of at least 6 per cent required to reduce poverty by half by the year 2015, primarily because they did not encompass all sectors of the economy.

To close this gap, therefore, Cabinet directed that the Ministry of Economic Planning and Development (MEPD)[1] should coordinate the formulation of the Malawi Economic Growth Strategy. This initiative was fused with a parallel private sector recovery initiative spearheaded by National Action Group (NAG)[2].

MEPD set up a Task Force to formulate this Malawi Economic Growth Strategy in close co-operation with the private sector. The main objective of the Strategy is to generate high and sustainable broad-based economic growth of at least 6 per cent per annum over the long-term. The approach is to stimulate economic growth through promotion of trade[3] and investment. The Malawi Economic Growth Strategy has been developed through a consultative process involving both the public and private sectors under the Task Force led by MEPD. The Strategy highlights the main constraints on economic growth, trade and investment and identifies corrective measures.

The end result is the report, *Malawi Economic Growth Strategy*. It is published in three volumes. Volume I is the summary of the whole strategy. Volume II is the full Strategy, outlining the detailed analyses of the macroeconomic situation, trade strategy, proposed investment incentives, the current performance of the core and priority -sectors. Volume III provides the Action Plans of each working group.

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[1] Successor to the National Economic Council, under which this initiative was begun.
[2] A high level forum for Chief Executives of leading businesses and Representatives of businesses, Government 'Economic' Ministers and Donors that support the Private Sector.
[3] Trade refers to export-oriented and import-substitution trade.

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CHAPTER ONE: OVERVIEW OF THE ECONOMY

The Malawi economy remains agro-based. The agriculture sector accounts for over 38.6 per cent of GDP, employs about 84.5 per cent of the labour force, and accounts for 82.5 per cent of foreign exchange earnings. Agriculture is characterised by a dual structure consisting of commercial estates that grow cash crops and a large smallholder sub-sector engaged in mixed subsistence farming. Maize, the staple food, accounts for 80 per cent of cultivated land in the smallholder sub-sector. The main agricultural export crop is tobacco, followed by tea, sugar and coffee. The manufacturing sector is small at 11.0 per cent of GDP and declining. Manufacturing comprises mainly agro-processing activities, including of tobacco, tea and sugar. Distribution and services represent about 22.0 per cent each over the 1998-2002 period.

During 2000-2002, fiscal policy became more expansionary: The deficit including grants rose further to 7.1 per cent of GDP in the 2002/03 fiscal year. The money supply increased by 25.2 per cent in 2002 largely because of excessive Government domestic borrowing. Domestic debt accumulated to the unsustainable level of about K45 billion. Domestic interest payments rose sharply to 24.7 per cent of Government revenue and 4.5 per cent of GDP compared to 13.2 per cent and 2.1 per cent in 1998, respectively. Interest rates remained high at above 40 per cent while gross investment fell substantially to 10.9 per cent of GDP from 13.9 per cent in 2001. Real GDP growth recovered slightly by 1.8 per cent while inflation decelerated substantially to 14.8 per cent from 27.5 per cent in 2001.

This, combined with the drop in the capital account balance, led to the deterioration of the overall balance of payments after debt relief from a surplus of 4.4 per cent of GDP in 2001 to a deficit of 5.5 per cent of GDP in 2002 and gross official foreign reserves from the equivalence of 3.2 months of imports in 2001 to 2.6 months of imports in 2002 and prompted the Kwacha to depreciate by 6.2 per cent to K76.7 to US$1 in 2002.

In the medium-term (2004–2008), economic growth will continue to be driven by the agriculture sector. With increased investment in infrastructure, improved credit and marketing, agricultural production is expected to increase substantially. This, in turn, is expected to stimulate economic activity in the manufacturing, transport and distribution sectors. Therefore, the structure of the economy in terms of sectoral shares to GDP is projected to remain the same in the medium term.

Overall growth for the agriculture sector is estimated at 7.8 per cent per annum over the entire period. The crops are projected to increase annually as follows: seed cotton by 13.8 per cent; tobacco by 6.8 per cent; tea by 2.6 per cent; and sugar by 3.7 per cent. The manufacturing sectors are expected to increase by 5.0 per cent per annum, agro-processing by 6.8 per cent, and textiles and garments by 13.8 per cent. The mining sector is expected to increase by an average growth rate of 9.4 per cent and tourism 9.6 per cent.

Real GDP growth is projected to increase from 4.9 per cent in 2004 to 7.2 per cent in 2008 (Table 1.1). The source of growth remains the agriculture sector whose share of GDP rises to 42.1 per cent by 2008, especially the smallholder sub-sector, which increases from 32.6 per cent of GDP in 2003 to 34.9 per cent in 2008. As regards the high economic growth potential sub-sectors of mining, tourism and agro-processing, their respective shares of GDP will remain small despite growing at between 7.0-10 per cent per year over the 2003-08 period. The major reason is that these sectors are currently low at 1.5 per cent of GDP such that it will take a long time at high growth to reach significant levels of GDP.

In order to achieve the projected growth rates,

1. Gross fixed capital formation should increase by an average annual rate of 7.2 per cent from K19.0 billion in 2005 to K41.5 billion in 2008. This means an almost double increase in the share of GDP from 7.8 per cent in 2004 to 13.1 per cent in 2008;

2. Domestic savings will have to rise from K-4.1 billion to K28.8 billion over the same period. As a share of GDP, it will reach only 9.1 per cent by 2008;

3. National savings must rise from K2.5 billion to K37.0 billion. This is an increase from 1.1 per cent to 11.7 per cent of GDP; and

4. While foreign savings will slow down, they will remain high during the period.

Projected Selected Macroeconomic Indicators, 1995- 2008
(Annual percentage changes, unless otherwise stated)

	Average 1995-2001	2002	2003	2004	2005	2006	2007	2008
GDP at 1994 factor cost	4.4	1.8	4.4	4.9	5.7	6.4	6.8	7.2
Real Exports of Goods and Non-factor Services	5.5	-0.9	1.4	9.2	5.5	6.5	7.5	8.0
Real Imports of Goods and Non-factor Services	3.5	28.3	-0.6	-0.9	0.5	1.5	2.0	2.0
Real Gross Fixed Capital Formation	-3.2	-19.7	0.7	4.1	14.4	19.1	23.8	24.0
Gross Savings as Share of GDP*	13.7	10.1	9.1	8.6	9.3	10.4	12.1	14.0
of which:	2.9	-	-	-	-			
Domestic Savings as Share of GDP		7.1	6.6	4.7	1.8	1.3	5.0	9.1
National Savings as Share of GDP**	7.6	-	-	-				
		2.6	2.6	1.6	1.1	4.1	7.7	11.7
Foreign Savings as Share of GDP	6.1							
		12.7	11.6	10.3	8.2	6.3	4.3	2.3
Gross Investment as Share of GDP	13.7	10.1	9.1	8.6	9.3	10.4	12.1	14.0
Inflation	37.4	14.8	10.0	8.0	6.0	6.0	6.0	6.0

Notes:
**Gross Savings is sum of national savings and foreign savings.*
***National Savings is domestic savings plus net factor income plus net private transfers plus net government transfers.*
Source: Ministry Economic Planning and Development.

Annual and Projected Gross Domestic Product at 1994 factor cost, 1994- 2008 (Per cent)

	Average 1995-2001	2002	2003	2004	2005	2006	2007	2008

Agriculture	11.9	2.4	6.8	7.0	8.6	8.1	7.7	6.7
Small-scale	14.4	-0.4	13.3	5.7	9.4	8.7	7.9	6.6
Maize	11.4	-6.6	19.0	5.0	5.0	5.0	5.0	5.0
Cassava	22.6	-12.2	5.0	5.0	5.0	5.0	5.0	5.0
Seed Cotton	32.6	4.9	2.8	5.0	10.0	15.0	20.0	10.0
Other*	14.8	7.2	14.1	6.1	12.5	11.0	9.5	7.5
Large-scale	5.5	13.9	-16.5	13.3	5.1	5.6	6.9	7.3
Tobacco	8.6	14.0	-18.7	15.2	5.5	6.0	7.5	8.0
Tea	1.2	6.6	2.1	2.5	2.3	2.5	2.5	3.0
Sugar	1.0	20.9	-3.8	1.2	3.7	3.7	3.7	3.7
Other**	-5.9	16.7	-6.2	5.8	2.8	2.8	2.8	2.8
Mining and Quarrying	49.7	-38.8	23.5	9.9	7.5	8.0	10.0	12.0
Manufacturing	-1.1	-0.2	1.2	2.5	3.7	4.9	6.0	5.4
Agro-processing	1.8	-26.0	3.1	3.2	7.6	7.1	6.7	5.7
Textiles and Garments	-1.2	45.6	6.0	6.4	10.0	15.0	20.0	10.0
Other	-2.0	11.1	-0.1	1.7	1.3	2.5	3.5	4.5
Electricity and Water	2.5	5.8	4.6	7.0	3.5	4.0	4.5	5.0
Construction	4.6	14.2	9.7	7.5	3.5	4.5	5.5	6.5
Distribution	1.5	1.6	2.3	3.4	4.5	6.6	7.6	9.7
Tourism	14.4	9.8	10.8	3.2	5.0	8.5	10.0	15.0
Wholesale and Retail	1.4	1.4	2.1	3.4	4.5	6.5	7.5	9.5
Transport and Communication	2.6	14.5	2.2	3.3	3.5	4.0	5.5	6.5
Financial and Professional Services	8.1	6.3	6.0	4.9	5.0	7.0	8.5	10.0
Ownership of Dwellings	2.3	2.8	2.8	2.7	2.8	2.8	2.8	2.8
Private Social and Community Services	4.1	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Producers of Government Services	-1.3	-0.6	1.4	2.4	1.5	2.0	2.5	2.5
Unallocable Finance Charges	4.2	15.2	6.1	5.0	5.0	5.5	7.5	3.0
GDP at Factor Cost	4.4	1.8	4.4	4.9	5.7	6.4	6.8	7.2

*Note: *All other crops, i.e pulses, sweet potatoes, millet, wheat, sorghum, small-scale fishing, etc.*
***Coffee, timber, commercial fish catch.*
Source: Ministry of Economic Planning and Development.

CHAPTER TWO: CROSSCUTTING CONSTRAINTS

There are many crosscutting constraints on private sector growth identified from consultative process involving private sector and other key stakeholders that would need to be addressed first. These are the macro-environmental[4] issues that constrain firms from achieving higher sales and profits through investment and trading activities.

There are some positive enabling factors that can support growth:

- A good climatic condition for the growing of many crops.
- Potential for irrigation.
- Relatively low labour costs.
- Existence of rule of law and political will.
- Contract farming arrangement between smallholder farmers, buyers, and processors exists for a number of crops including tobacco, tea, sugar, and cotton.
- Membership of regional and international trade bodies including SADC and COMESA that gives Malawi potential to increase market access for exports and deal with unfair trade activities and disputes with other countries.

The constraints fall into several broad areas:

1. Poor macroeconomic conditions (manifested through high inflation, high interest rates, and wide fluctuations in the exchange rates).
2. Inefficient tax and incentive system (the tax system is geared towards revenue collection rather than on supporting economic growth, while the incentive system is complex, non-transparent, non-automatic and discretionary).
3. Poor infrastructure (including transport infrastructure: poor access to ports, limited air links and freight capacity, limited rail capacity).
4. Poor private and public sectors dialogue and cooperation.
5. Low human resource base and skills (current resource base is relatively weak and is characterised by low skill, limited vocational and technical skills and low productivity);
6. Costly regulatory environment.
7. Unfavourable trade agreements and weak negotiating capacity.
8. High insecurity, which adds significant costs, increased insurance costs and unrecoverable losses that deter investment.
9. Delays in allocation and administration of land for establishment of new industries.
10. High cost and unreliable supply of utilities (water, electricity, telecommunications).

Fifteen strategies to address those constraints have been recommended for improving prospects for growth. (*See Volume Two for more detail.*)

1. Restore and sustain macroeconomic stability.
2. Increase availability of long-term capital.

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[4] Refers to crosscutting issues like infrastructure, macroeconomic and social situation including HIV/AIDS pandemic and general policy framework.

3. Improve the tax and incentive system and administration.
4. Improve the cost efficiency of regulatory environment.
5. Increase budgetary resources to public institutions and agencies that support the private sector, reduce the bureaucracy and stop policy reversals.
6. Improve GoM trade negotiating capacity through training and full consultation and involvement of the private sector (*see also Trade Strategy*).
7. Improve the security situation in the country.
8. Improve infrastructure.
9. Improve the cost effectiveness and reliability of supply of utilities.
10. Improve the dialogue between Government and the private sector.
11. Improve the human resource base.
12. Improve corporate governance.
13. Increase business management training opportunities.
14. Introduce vocational and technical and business management courses at primary and secondary schools.
15. Improve the process for allocating and administering land for establishment of new industries.

CHAPTER THREE: FRAMEWORK

The Malawi Economic Growth Strategy has been built upon lessons from the economic development experiences of other countries. A central development issue is the interaction between Government and markets. Competitive markets are the best way found to effectively organise production and distribution of goods and services. But markets cannot operate in vacuum. They require a legal and regulatory framework that only Governments can provide.

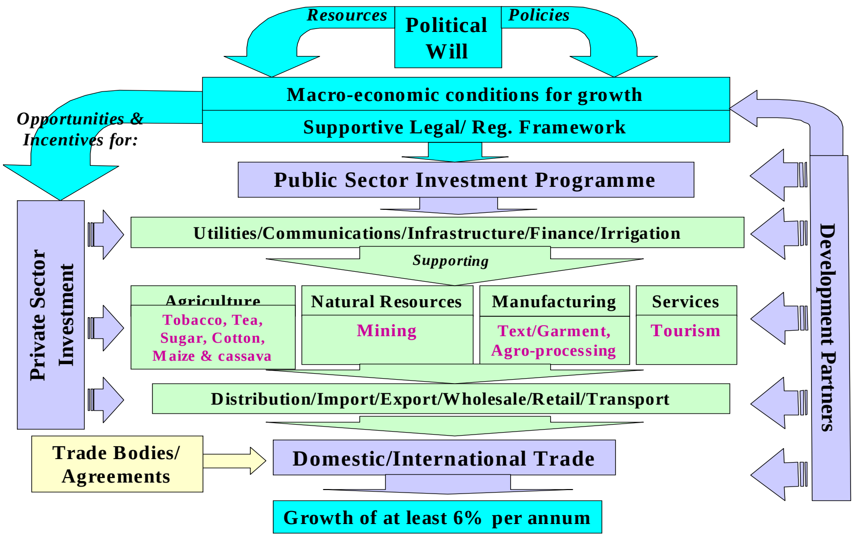
High economic stability has been associated with:

- Stable political system and political will to support economic growth.
- Macroeconomic policies that promote sustainable economic stability.
- Policies promoting outward orientation and competition.
- A domestic supply of internationally competitive goods and services for domestic consumption and exports.
- A favourable external environment.
- A clearly defined role of Government.
- A favourable climate for private enterprise.
- Quality and supportive institutions.
- Skilled human resources.

The Malawi Economic Growth Strategy is built upon all the above principles and aims at achieving high economic growth through the stimulation of trade and investment and the restoration of macroeconomic stability. It also recognises the need to stimulate domestic supply in the core sectors and five high growth potential sectors to meaningfully benefit from domestic and international trade. Figure 3.1 depicts the framework underpinning the Malawi Economic Growth Strategy.

This Malawi Economic Growth Strategy recognises that GoM resources are limited. It, therefore, seeks to deliver higher growth rates by stimulating investment in high growth sectors. Generally, an improved business climate would result in an increased revenue base for Government with which it can meet additional expenditure requirements. Due to current fiscal gaps, Malawi requires budgetary support by development cooperating partners to finance a large portion of its development programmes. The Malawi Economic Growth Strategy also relies on mobilising the resources within the private sector at micro, small, medium and large-scale levels. The Malawi Economic Growth Strategy will seek, as a central theme, to improve the business climate in Malawi so as to unlock and attract new investment and trade.

Figure 3.1: The Framework for the Malawi Economic Growth Strategy



Source: MEPD/Task Force

CHAPTER FOUR: TRADE STRATEGY

Trade is a fundamental and powerful catalyst for economic growth. Although the exact correlation between trade and economic growth is not definitively understood, no country has developed successfully without increasing domestic and international trade and stimulating long-term capital inflows.

Malawi is a member of COMESA, SADC, ACP/EU Cotonou, and the World Trade Organisation as well as a beneficiary of the AGOA and Everything But Arms (EBA) agreement. Bilateral agreements exist with South Africa, Zimbabwe and Botswana, with further agreements currently under consideration with Zambia, Tanzania and Mozambique. These alongside other initiatives such as the Growth Triangle and spatial development initiatives offer considerable opportunities for increasing trade and investment in the region and stimulating growth in Malawi.

According to the needs assessment undertaken in 1998, the main trade-related constraints were identified as follows:

- As a land-locked country, lead times and transport costs are high; the domestic market is small.
- Inappropriate technology.
- Limited access to trade and investment finance; inadequate trade missions.[5]
- Poor economic infrastructure, including roads, rail, airports, ports, utilities and telecommunications, which undermines both domestic and international trade.
- Lack of a clear trade strategy and supporting policies.
- High customs tariffs on manufactured imports.[6]
- High level of informal cross border trade.

The Strategy to stimulate growth in the trade includes the following measures:

1. Review and improve trade policy.
2. Provision of supportive trade infrastructure.
3. Expand export markets and diversify product base.
4. Maintain and strengthen preferential non-reciprocal agreements.
5. Negotiate new preferential arrangements.
6. Create a competitive domestic market by developing and implementing competition, consumer protection and trade remedies policy with supporting legislation/regulation for each.

[5] Malawi has trade attachés in only South Africa and Zimbabwe, though there are proposals for including other countries.
[6] This may be solved in part through the SADC FTA in the final years of its phase in (possibly in 2008).

CHAPTER FIVE: THE AGRICULTURE SECTOR

Agriculture is the largest sector of the economy. It contributes about 40 per cent of GDP and more than 80 per cent to total export earnings and employs over 80 per cent of total rural population. Agriculture is subdivided into the smallholder and large-scale/estate sub-sectors. The smallholder sub-sector grows mainly food crops, maize being the main one. The large-scale sub-sector cultivates mostly cash crops, including tobacco, tea and sugar.

Tobacco is the main export crop accounting for 60 per cent of total export earnings, followed by tea and sugar that contribute nearly 10 per cent each. Agriculture also provides raw materials for the manufacturing sector, which is mainly based on agro-processing activities. The rest of this chapter will analyse the agricultural policy to develop the sector. Tobacco, tea, and sugar are referred to as core sectors in this report, while cotton and agro-processing are referred to as high growth potential sectors. These are addressed in other chapters.

The Ministry of Agriculture, Irrigation and Food Security recently developed its sectoral strategy from which this Growth Strategy draws some key issues. The anticipated rapid growth in the other priority sectors, particularly the increasing importance of the agro-processing industries, will require complementary growth in agricultural output for reliable and sufficient supply of inputs and raw materials. The overall goals of the strategy are to:

1. Forge more economic linkages in commodity value-chains, vertically and horizontally.
2. Diversify agriculture production over time through increased production of key crops and related agro-processing.
3. Increase smallholder productivity and resulting incomes.

The growth of the agricultural sector will be driven by private initiatives and greater commercialisation of smallholder agriculture through linkages. While the public sector will continue to provide some facilities, the contribution of the private sector will have to be enhanced, given limited resources available to Government.

Priority will be given to the re-orientation of the smallholder sub-sector towards greater commercialisation and international competitiveness. The commercial approach to agriculture will require better integration with larger businesses, particularly those that are export oriented.

The inadequacy of essential farm infrastructure, such as access roads to rural areas, power supply, drainage, irrigation, storage, and grading facilities, discourages farmers from producing marketable surpluses of crops and livestock. The MoAI strategy will support these aims and be integrated with this Strategy.

Irrigation is a key component of the development of most crops. Given limited resources, there is a need to be realistic about irrigation's potential in Malawi and to recognise that irrigation development is not a panacea. Irrigation will probably only be viable for high value export crops or for horticultural development close to an urban market. It is also critical that irrigation development should be driven by the private sector as businesses are best placed to determine whether the benefits from irrigation development justify the high cost of investment to be made.

The broad policy objectives for irrigation development include the following:

1. Create an enabling environment for irrigated agriculture by facilitating and encouraging the private sector to invest in irrigation through appropriate investment incentives.
2. Optimise Government investment in irrigation development by applying the principles of cost recovery and sharing with targeted beneficiary sub-sectors.
3. Enhance human capacity to facilitate effective research in irrigation technology and the marketing of irrigated produce.
4. Improve access to finance for small-scale irrigation equipment such as treadle pumps and use private sector distribution to make them available.

MoAI plans to create a conducive environment for irrigation development where the private sector plays the leading role. MoAI's active role would be limited to providing education, advice on irrigation development aspects, and information on the suitability of different land for irrigation development. The private sector has to some extent expanded investment in irrigation in response to the removal of duties on imported irrigation equipment. However, duty remains on imported spare parts and the process of importing equipment is time-consuming and the maximum demand tariff costly.

Malawi made considerable progress towards deregulation and liberalization of agricultural input markets. Currently there are no restrictions on pricing and marketing of inputs and the private sector accounts for a large proportion of the input market. However, the seed and fertilizer markets are served by a limited number of enterprises and prices are high.

In view of the opening up of the economy to trade, there is an urgent need for agriculture to implement programmes and policies that are outward-looking and export-oriented rather than import-substituting. Agriculture will therefore need to concentrate more on the production of commodities in which Malawi has competitiveness and export growth potential. Malawi's major exports have been tobacco, sugar and tea and these are still the dominant export crops.[7] Despite current problems, Malawi will continue producing and exporting them into the foreseeable future.

There is need for Malawi to develop the production of other export commodities which have potential for rapid growth, such as cotton, cassava, pigeon peas, groundnuts, beans, rice, dairy products, and soya.

Comment [JG1]: I added this one.

Cassava has been prioritised for commercial processing into ethanol and starch for industrial use. However, further work is needed to qualify and quantify the opportunities, which the Ministry is currently working on. A detailed analysis of the cassava sub-sector using the value-chain approach is recommended. Chapters 6-9 analyse the performance, constraints and strategies of sectors of tobacco, tea, sugar and cotton. Chapter 11 looks at the agro-processing potential for other agricultural crops including cassava.

CHAPTER SIX: TOBACCO

Around 375,000 smallholders depend on tobacco for cash incomes, which means that tobacco's success has a major impact on rural incomes and livelihoods. The biggest challenges facing the tobacco industry revolve around productivity, the cost of inputs and profitability, access to credit,

[7] Groundnuts and Cotton also used to be significant exports but are much smaller now.

effectiveness of extensions services, the marketing system, tobacco prices at the floors and at the world market and environmental sustainability of production and curing. Threats to the industry come from the anti-smoking lobby, regional competition, cross-border trade, genetically modified tobacco, access to finance, child labour, HIV/AIDS, and gender issues.

The strategic plan calls for efforts to take advantage of the short to medium production gaps in the region and increase production of Northern Dark Fired, Burley and Flue Cured to meet market requirements. In addition, address constraints in the industry and increase production by engaging smallholder farmers. The priorities of the tobacco industry include: clear tobacco policy and Tobacco Act; taxation review including withholding tax; review of factors that influence informal cross-border trade; and encouragement of exportation of processed tobacco.

There are some immediate priorities to be addressed by the tobacco industry and the Government through MoAI. These include:

1. A clear policy and operating guidelines on contract farming, developed in conjunction with the industry and communicated to all stakeholders.
2. A review of duties and surtax on Action Holdings Limited (AHL) to prevent a further deterioration in farmers' prices.
3. Remove withholding tax of 7 per cent imposed on farmers' tobacco income below the threshold of K36,000 per year.
4. Consult with the industry on taxation and other related issues.
5. Commercial banks should publicise the effective exchange rate for buying growers' tobacco proceeds from the auction floors on a daily basis and the accepted conversion periods to reduce the delay in payment of farmers.
6. Amend the Tobacco Act in accordance with the recommendation made by the End of Season Tobacco Seminars.
7. Improve auction prices by reducing monopsony amongst buyers at the auction floors and reducing illegal exportation.
8. Explore alternatives to extending credit to farmers.

The tobacco industry is already well organised and would be able to manage implementation of issues in co-operation with Government bodies and MOAI. There is clearly a need for better dialogue between industry and Government to avoid some of the misunderstandings that have occurred. There could be considerable benefit in using the value-chain approach to bring together all the public and private sector stakeholders around a shared understanding of the industry, its constraints, and way forward. A group of industry stakeholders has developed an implementation plan for the above strategy (*see Volume III*).

CHAPTER SEVEN: TEA

The biggest challenges facing the tea industry revolve around issues of:

- Productivity.
- Rain-fed production.

- The cost of inputs and profitability.
- Low yielding tea technologies.
- Access to credit.
- Closure of the STABEX scheme
- Effectiveness of extensions services
- The marketing system.
- Tea prices at the floors and in the world market.
- Exchange rate instability.
- High interest rates.
- Electricity tariff system.
- Taxation including extended surtax.
- Demand for tea in the world market.
- The land policy.

The strategic plan for the tea industry calls for:

Reducing production costs.
Reviewing the negative effects of certain taxes on the industry.
Encouraging investment in high yielding varieties.
Revitalising the smallholder to improve rural incomes.
Addressing constraints, including investment.

CHAPTER EIGHT: SUGAR

The biggest challenges facing the sugar industry revolve around issues of productivity, rain-fed production, the cost of inputs and profitability, lack of skilled personnel, access to credit, effectiveness of extensions services, the marketing system, sugar prices at world market, exchange rate instability, electricity tariff system, demand for sugar in the world market and the land policy.

The strategic plan calls for: closer liaison between MoCI and SUCOMA in the negotiation of trade agreements and protocols that directly or indirectly affect sugar; development of smallholder growers; improve productivity of Dwangwa sugar scheme; protect the domestic market against unfair competition; and review the electricity tariff pricing system and regulations on own generation.

CHAPTER NINE: COTTON

The biggest challenges facing the cotton industry revolve around issues of:

- Productivity.
- Rain-fed production.
- The high cost of inputs and profitability.
- Low yielding cotton technologies.
- Access to credit.
- Effectiveness of extensions services.
- The marketing system.
- Low cotton prices at world market.
- Exchange rate instability.
- Electricity tariff system.
- Demand for cotton in the world market.
- The land policy.

The strategic plan calls for:

1. Reducing cost of production and increasing productivity through high yielding technologies.
2. Increasing the coverage of extension services.
3. Improving availability of inputs for the cotton industry.
4. Improving the marketing of cotton.
5. Encouraging investment in textile industries to stimulate the demand for cotton.
6. Encouraging the establishment of the Cotton Council to improve the organisation of cotton farmers.
7. Reviewing the tax system in relation to the cotton industry.

CHAPTER TEN: MINING

Mining and quarrying accounts for 1.6 per cent of GDP and has been identified as having the highest growth potential. Exploration licences as well as mining licences have already been issued based on known deposits. Government needs to support small-scale mining (including gemstone, stone aggregates, sand, lime production, and salt).

The major constraints affecting the mining sector can be divided into those affecting small-scale mining and those affecting medium-scale and large-scale mining.

The constraints for small-scale mining include:

- Low productivity due to inappropriate equipment.
- Low value-added because of lack of equipment.
- Poor access to credit by small-scale miners.
- Lack of skilled small-scale miners.
- Poor linkages between suppliers and buyers.
- Safety issues.
- Inadequate technical support, which leads to poor practices and environmental damage.
- Limited access to legitimate market outlets.
- Smuggling of gemstones.

The constraints for the medium-scale to large-scale mining include:

- Lack of a Minerals Policy and Minerals Act.
- Inadequate incentives.
- Inadequate economic infrastructure to support the industry.
- Risk of irreversible environmental damage.

The strategic plan will focus on:

1. Defining investment incentives in the industry, including tax incentives.
2. Reviewing the policies on infrastructure upgrading.
3. Improving technical support to the industry through training and by increasing budgetary allocation to the Department of Mines and Geological Surveys.
4. Embarking on skills development in response to the needs of the industry;.
5. Ensuring that government provides the necessary support services.
6. Drafting a minerals policy by specifying ownership of mineral resources, environmental issues, and health and safety standards.

CHAPTER ELEVEN: THE MANUFACTURING SECTOR

The manufacturing sector is facing a steady but relentless decline, having fallen from 17 per cent of GDP in 1994 to 11.6 per cent of GDP in 2001, with further decline predicted. It is facing a major crisis, with further disinvestments on the horizon unless policies and practices towards manufacturing are dramatically turned around in the very near future.

Based on 1998 data, manufacturing is dominated by beverages (29 per cent), food/agro-processing (23 per cent) and pharmaceuticals/soap (11 per cent). This dominance is likely to have increased as the main closures have been in other sub-sectors. Manufacturing is also highly concentrated with 77 per cent of 52 industries analysed considered to be monopolistic (concentration indices of between 0.5 and 1.0). Also, manufacturing is generally highly import-dependent.

The input/output orientation of manufacturing implies that domestic economic integration is weak. There are also poor inter-industry (activity) linkages within manufacturing and between manufacturing and other sectors. The linkages between manufacturing and the primary sector are limited by the narrow product range and underdevelopment of agriculture and mining. The whole manufacturing sector therefore faces vulnerability in the short-term as agro-based food processing and exports depend heavily on the performance of domestic agriculture for its inputs. Over 90 per cent of firms rely on domestic demand, making performance heavily sensitive and closely tied to the domestic business cycle. The latter is weather-bound on the supply side and sensitive to macroeconomic management on the demand side.

Long-run efficiency is associated with a number of related features of domestic manufacturing and its environment including: excess capacity problems, the quality of utilities, agricultural productivity/demand problems; obsolete technologies; low skills/productivity levels; weak finance capital market; increased import competition and an uncertain economic environment.

The investment and operating environment in Malawi needs to significantly improvement to achieve a comparative advantage in manufacturing. Most immediately is the need for sound fiscal management and industrial support infrastructure to ensure lower real interest rates, competitive foreign exchange rates and reasonably priced reliable utilities. The non-market operational environment such as rule-of-law and security as well as issues of corruption and transparency are also crucial for an internationally competitive incentive environment. The longer-term requires development and strategic orientation of key upstream markets such as a diversified and more developed raw materials base, a more developed and competitive finance capital market and skills development of employees.

One of the most important issues to be addressed is the formulation of a more attractive set of incentives for manufacturing investment. Past prioritisation of manufacturing and current incentives have failed to stem the decline of manufacturing, let alone stimulate its growth.

Malawi needs to stimulate both export-oriented and import-substituting domestic manufacturing as well as to improve the general climate for manufacturing. Agro-processing and textiles/garments are the two main growth sub-sectors within manufacturing.

CHAPTER TWELVE: TEXTILES AND GARMENTS

Textiles and Garments have been identified as a high growth potential sector. This sector has backward linkages to the cotton sub-sector (though these are virtually non-existent at present). The textiles industry has been in long-term decline, with only two firms operating.

For the garments end of the value-chain, there was rapid growth in the 1990s followed by major disinvestments after January 2000 due to the effective collapse of the agreement with South Africa through application of non-tariff barriers. The sub-sector is beginning to increase its exports and recover some of the ground lost. Garment firms have been the main users of Export Processing Zones (EPZ), but this has failed to attract any new garment or textile investors.

The future for the textiles and garments industry depends on the development of a vibrant cotton growing and processing industry.

The major constraints of the textile and garment industry are as follows:

- Severe underdevelopment of the textile industry.
- Production inefficiencies and product defects.
- Limited access to credit.
- Lack of pre-shipment finance.
- High cost of borrowing.
- Low labour productivity levels.
- Inadequate capacity to enforce the various rules of origin
- Overly restrictive rules on EPZs.
- Removal of surtax exemptions for firms in EPZ.

The Textiles and Garments Strategy calls for:

1. Encouraging spinners, weavers, knitters and dyers to invest in the industry, including a revitalisation of DWS as a spinner and weaver.
2. Improving availability of credit including export financing.
3. Improving economic and social infrastructure as well as reliability of transport services.
4. Improving human capital productivity.
5. Supporting companies in EPZs as well as expanding the scope of EPZ.

CHAPTER THIRTEEN: AGRO-PROCESSING

Agro-processing is one of the targeted high growth sectors. Already, it contributes over 10 per cent of the value added by the manufacturing sector. A significant proportion of agro-processing relates to production of beverages, tobacco, tea and sugar. The areas of proposed potential are processing fruits and vegetables, rice, macadamia/tree nuts, and cassava. For example, products from cassava would include glue, animal feeds, ethanol, starch, and other food products.

The main problems that affect the agro-processing industry in Malawi include:

- Cost and availability of capital for investment.
- Inadequate supply of affordable raw materials.
- Inappropriate technology.
- Poor marketing and distribution system.
- Inadequate incentives.

The main strategies and actions for the agro-processing and food-processing sector include:

1. Ensuring the availability of affordable capital for investment.
2. Establishing specific investment incentives for agro-processing.
3. Improving marketing and distribution by providing information and better accessibility.
4. Improving productivity in the smallholder sub-sector.
5. Organising farmers into cooperatives.
6. Developing technologies that can be made available at low cost.

Specific agro-processing areas outlined in Volume 2 are canning/preserving fruits and vegetables; rice processing; cassava processing; and other.

The strategy for cassava will focus on developing and disseminating appropriate cassava technologies and attracting private investment in cassava processing, particularly for industrial starch from cassava. The objectives proposed for a full-scale cassava development programme include:

1. Developing high yielding mosaic- and mealy bug-resistant cassava varieties.
2. Developing ecologically sustainable methods of controlling pests and diseases.
3. Improving crop management practices that are within the means of resource-poor farmers.
4. Training of extension staff and farmers.

CHAPTER FOURTEEN: TOURISM

Worldwide, tourism is recognised as a high growth economic sector. Accoridng to immigration data, tourism has had an average growth rate of 6.3 percent between 1975 and 2001. With proper attention to the constraints, strategies, and action plans set out in the Malawi Economic Growth Strategy, this could be as high as 8 percent over the next five years.

The tourism strategy of the Malawi Economic Growth Strategy should be aligned with the Ministry of Tourism, Parks and Wildlife *Strategic Tourism Development Plan, Final Report 2002*. This five-year plan seeks to reposition Malawi as an eco-tourism destination, as well as to improve the tourism product and to enhance the attractiveness of the country to investors.

The main problems affecting the tourism industry include high cost of air fares, poor domestic infrastructure, low numbers of wild animals, perceptions about health risks, poor marketing, negative publicity, high hotel tariffs, poor incentives for investors, poor macro-economic situation, and poor quality of services.

Seventeen strategies have been outlined in Volume 2 of this report, to address the constraints facing the Tourism sector. Briefly, these are:

1. Improve international access and reduce the cost of airfares.
2. Improve the state of internal infrastructure.
3. Improve the attractiveness of national parks by increasing the numbers of wild animals.
4. Strengthen protection of wild animals against poaching.
5. Reduce the perception of health risks.
6. Rationalise the pricing system for hotel accommodation and services.
7. Improve the development of eco-lodges along the Lakeshore.
8. Increase destination marketing.
9. Improve the quality of service offered.
10. Reduce negative publicity.
11. Strengthen coordination in the industry.
12. Review and improve legal framework and investment incentives for tourism promotion.
13. Create a Malawi Tourism Investment Fund.
14. Improve domestic infrastructure.
15. Improve macroeconomic situation.
16. Improve marketing of investment opportunities.
17. Improve the statistical base for decision-making.

CHAPTER FIFTEEN: REFOCUSING PUBLIC SECTOR INSTITUTIONS

The public sector has an important role to play in *supporting* the development of the private sector, *regulating* its behaviour, *enforcing* policies and procedures and in *collecting* revenues. These roles require active and constructive cooperation between the private sector and the public sector. The growth strategy recognises some key institutions whose role is critical in the implementation of the growth strategy.

An institutional review of MIPA and MEPC recommended that the two institutions be merged. Government needs to make a decision as to whether the two institutions will be merged so that the new establishment can embark on capacity building in the key areas.

There are now many private sector and non-governmental organisations in Malawi that provide training in business and entrepreneurship. Malawi Entrepreneurship Development Institution (MEDI) needs to be reviewed to determine whether its function is still relevant or needs to be refocused, possibly towards the training of trainers in entrepreneurship and accreditation of entrepreneurship training. There is also some overlap of functions with other government-funded training activity undertaken by SEDOM and DEMATT.

The most significant agency that impacts on private sector development is undoubtedly the Malawi Revenue Authority (MRA). There is no question that the MRA has a legitimate function to play and that taxes due must be collected, but the method of undertaking these tasks is currently creating a further disincentive to trade and investment.

The Malawi Bureau of Standards sets and monitors the standards of products. Its capacity should be strengthened to carry out its mandate, in turn ensuring that Malawian products meet international standards.

MDC, Indefund and SEDOM were established in order to address financial intermediation gaps. Venture capital is rarely provided in adequate amounts. Government should restructure existing development finance institutions and encourage the establishment of new types of savings and financial intermediaries to mobilise domestic savings in urban areas and channel these financial resources to entrepreneurs in peri-urban and rural areas.

In order to ensure sustainable macroeconomic stability, RBM and the Ministry of Finance should coordinate their efforts to limit Government borrowing from the RBM to statutory requirements. In this regard the legal framework may need to be reviewed.

The supply of efficient, reliable, affordable and sustainable electricity, water and communications promotes private sector development and economic growth. The growth strategy should ensure that these utilities are properly regulated and available at all times.

There is a strong linkage between the Malawi Economic Growth Strategy and the Public Sector Investment Programme in that the growth strategies outline national development goals and objectives, which provide the basis for selecting projects to enter into the PSIP and ensure that government priorities are harmonised. Thus, MEPD will be a key player in the private sector investment strategy as well as the Malawi Economic Growth Strategy as a whole.

CHAPTER SIXTEEN: THE PRIVATE SECTOR INVESTMENT STRATEGY

The private sector investment strategy focuses on addressing the general weaknesses in the investment climate to stimulate investment in the prioritised sectors. Increased private sector investment creates the capacity to undertake more trade in goods and services, both domestically and internationally. This will create sustainable economic growth.

UNIDO[8] calculates that an average growth rate of 7 per cent per year would require an investment rate of 33 per cent of GDP, including domestic savings and Overseas Development Assistance. Yet between 1980-1997 the average public and private sector investment total for Malawi was only 15-15.5 per cent. Recent data from GoM suggests that current levels of investment are below this average.

Investment in manufacturing has been declining because of the poor macroeconomic environment. This will be addressed through the macro-environment strategy including: stable macroeconomic environment; investment incentives; appropriate and functioning economic and social infrastructure; financial sector reforms; capital market development; and appropriate legal and regulatory framework for domestic and foreign investment.

The major sectoral level constraints mostly concern incentives and taxation. Existing incentives are inadequate, inappropriate for the targeted high growth sectors, favour new and foreign investors over existing domestic investors, and are granted through a process which is slow, discretionary, and non-transparent. Corporate tax waivers favour new investors over existing firms in the same business, and give them artificial competitive advantages.

The major constraints at micro level mostly involve limitations of the EPZ regime and inadequacies in the labour market, attributed to insufficient investment in training, research and development, design and quality control. Six investment promotion actions have been highlighted to revive the private sector.

- Ensure that the Cabinet Committee on the Economy (CCE) actively discusses the issues of investment and exports, including integrating Export Processing Zones into a more versatile Malawi Multi-facility Industrial Zone.
- The identified industries should be packaged for promotion. In addition, government should ensure that skilled labour is available in the country in order to improve productivity in industries.
- Promote actions that create confidence among investors including the signing of investment guarantee agreements and double taxation agreements with capital-exporting and technology-exporting countries.
- Engaging Malawi's embassies and high commissions located in capital-exporting and technology-exporting countries.
- Establish a "Friends of Malawi" club among foreign investors in Malawi.
- Announce a Malawi Investment and Export Vision Implementation Period in tandem with the launch of the MMIZ.

CHAPTER SEVENTEEN: IMPLEMENTATION

A strategy is only as good as its implementation.

[8] Foreign Direct Investor Perceptions in Sub-Saharan Africa, 2002

Political will is central to the implementation, and the President is proposed to be the "Champion" supported by the Cabinet and the Cabinet Committee on the Economy.

The Ministry of Economic Planning and Development, working alongside the National Action Group, will take the leading role in co-ordinating, monitoring and evaluating the implementation activities of the Growth Strategy.

A working group for each sector highlighted in the Malawi Economic Growth Strategy has been or will be formed. These working groups have members from key stakeholder groups, representing private sector, public sector, and donors. There is also a Champion for each group, who serves as the key contact and is ultimately accountable for progress.

This is a fast moving process and it is still evolving. There is a need to retain flexibility, make changes as necessary, regularly review progress, and consider wider developments in the international and domestic macro-environment.

The critical issue is to start a process of change that delivers benefits for the various stakeholders, thereby building confidence in the process and leading to the full commitment and engagement of all stakeholders.

All the stakeholders who have been involved in the development of the Malawi Growth Strategy believe that it can be implemented and, if it is implemented, that it will deliver the growth and empowerment that is needed for the benefit of this Nation and its people.

Figure 16.1: Framework for Implementing the Growth Strategy