MALAWI

2017

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- **Economic growth in 2016 remained sluggish at 2.7% due largely to the El Niño induced drought, but is projected to improve to 4.0% in 2017 and further accelerate to 5% in 2018.**
- **Malawi was amongst countries in the Southern African Region worst affected by the drought, with 36% of the population requiring food relief. It is crucial for Malawi to build resilience to weather-related shocks to attain food security and to achieve sustainable development.**
- **Coherent national policy efforts to promote and nurture entrepreneurship are necessary to create enabling conditions for industrialisation. This will require multi-pronged efforts to improve the business environment, develop skills, and strengthen provision of business development services to Micro, Small and Medium Scale Entreprises (MSMEs).**

Overview

In 2016, Malawi's economy continued to face challenges emanating from adverse weather conditions. The drought reduced output of maize, the main staple crop, by 14%, necessitating maize imports to meet the supply gap, at significant cost.

The drought also had a negative impact on power supply, constraining economic activities in sectors such as manufacturing, which experienced low capacity utilisation. The economic challenges were exacerbated by poor tobacco earnings, a rapidly depreciating kwacha, high inflation and high interest rates dampening consumer and business confidence.

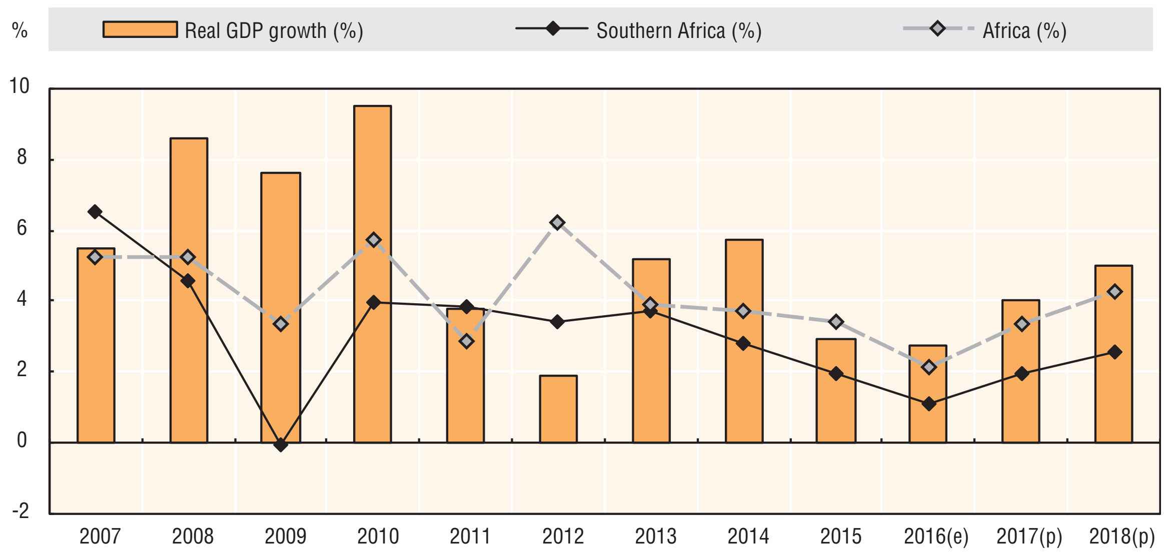
Average annual headline inflation in 2016 stood at 22.6%, slightly lower than the 2015 figure of 21.0%, with rising food inflation as the main driver. The monetary policy stance in 2016 remained tight with a view to containing inflation. Inflation is projected to fall to 16% by the end of 2017 and decelerate further to 9.7% in 2018 assuming normalisation of food supply, improved fiscal discipline and stabilisation of the kwacha. Nonetheless, upside risks to inflation remain elevated in view of the expected increase in international oil prices and persistent domestic borrowing pressures. The Reserve Bank of Malawi (RMB) is, therefore, likely to maintain a cautious approach and allow the policy rate to decline only when inflationary expectations are reduced.

Fiscal policy management in FY 2015/16 was challenged by revenue shortfalls, non-availability of donor budget support, spending pressures from domestic debt servicing costs and the high costs of fertiliser subsidies. Despite fiscal policy tightening, net domestic borrowing increased beyond the budget by 1% of GDP due to the need to respond to the food crisis through additional financing. Fiscal consolidation efforts were deepened in the context of FY 2016/17 budget through reforms to the Farm Input Subsidy Programme (FISP) and restrained public sector wage growth.

Real GDP growth is projected to rebound to 4.0% in 2017 and accelerate to 5% in 2018, driven by agriculture and services. The risks to the economic outlook, though, remain significant. These include inflation, weak tobacco prices and uncertainty over external donor inflows.

Entrepreneurship development needs more support in Malawi, given existing talent and potential. The growth of micro-, small- and medium-size entreprises (MSMEs) could be enhanced through better business support services, improving access to finance and creating stronger linkages to markets. A coherent and co-ordinated approach to entrepreneurial development to spur industrialisation is needed.

Figure 1. **Real GDP growth**



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Table 1. **Macroeconomic indicators**

	2015	2016(e)	2017(p)	2018(p)
Real GDP growth	2.9	2.7	4.0	5.0
Real GDP per capital growth	-0.2	-0.4	0.9	1.9
CPI inflation	21.0	22.6	16.0	9.7
Budget balance % GDP	-6.5	-6.1	-5.6	-3.4
Current account % GDP	-8.2	-13.9	-10.7	-10.3

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Recent developments and prospects

In 2016, Malawi's economy continued to be weighed down by weather-related shocks, in particular the El Niño drought which affected the entire Southern African Region. The El Niño induced drought had a negative impact on agricultural production and Malawi's hydro power generation capacity. Power generation was reduced by 30% due to low levels in the Shire River, necessitating load shedding. The insuffiency of power supply is also the result of under investment in power generation and transmission. To address power shortages, Malawi has embarked on plans to expand hydro generation capacity and improve the transmission and distribution system. The government is encouraging private investment in the energy sector to develop its potential. Malawi's economic growth prospects in 2016 were also negatively affected by weak business confidence and low consumer demand, arising from high inflation, tight bank-lending conditions, as well as the depreciation of the kwacha. Economic challenges were exacerbated by the poor 2016 tobacco season, which saw earnings drop by 30% from USD 335 million to USD 233 million. The drastic fall in tobacco earnings was caused by low tobacco prices owing to weak demand and the high rejection rate at the auction floors. The cumulative average price of burley tobacco dropped from USD 1.75/kg in 2015 to USD 1.54/kg in 2016. The downward trend in tobacco earnings is likely to continue as the global tobacco demand continues to fall, underscoring the urgency of economic diversification.

Agriculture, which accounts for 28% of GDP, contracted by an estimated 2%, on the back of a 1.6% decline in 2015 following floods in some parts of the country coupled with dry spells. The final crop estimates for the 2015/16 growing season show that production of maize, the main staple crop, decreased by 14% from 2.8 million metric tonnes in the 2014/15 cropping season to 2.4 million tonnes. The resultant maize supply-consumption gap of 740 000 metric tonnes left approximately 6.5 million people in need of food relief during the 2016/17 crop season, prompting the government to declare a national disaster in April 2016. Other major crops also performed poorly, either due to drought conditions or low commodity prices occasioned by weak global demand. Besides maize, the other food crops that registered reduced output include wheat, sorghum and cassava, the exception being potatoes. In terms of cash crops, production of tea, the second largest export crop, decreased by 23% while cotton and sugar production fell by 54% and 21% respectively. The government is aware of the significant potential to transform the Malawian agricultural sector through investment in irrigation systems and value added activities. It has developed a new national agricultural policy and is working on incentives to diversify and improve the sustainability of the sector while also improving food security and nutrition. As a goal, the government seeks to commercialise agriculture and promote a shift from subsistence-based to market-based agriculture that includes the creation of agro-processing industries, which have significant economic benefits.

The other sectors of the economy grew at a relatively subdued pace, reflecting effects of reduced agricultural output and incomes, weak aggregate demand, persistent power shortages and macroeconomic instability. The manufacturing sector, which accounts for 9% of GDP, grew at an estimated 2%, down from 3.2% in 2015 while growth in the wholesale and retail sector, with a share of 16% of GDP, decreased sharply from 4.2% to only 2%. Growth performance in the services sectors, accounting for 40% of GDP, was largely mixed. While growth of information and communication declined from 8.4% to 4%, due to reduced disposable incomes, financial and insurance services remained robust with a growth rate of 5.5%. Mining and quarrying grew by only 1.6% as uranium mining and exports continued to be suspended because of low global prices. The prospects for early resumption in uranium mining and exports are not promising, which means that future growth in the mining industry will largely depend on the outcome of ongoing mineral exploration activities and the coming on stream of new mining projects, in particular the Kanyika Niobium Nickel Mine.

Malawi's overall GDP grew at only 2.7% in 2016, down from 2.9% in 2015. With a population growth rate of 3%, this translated into a 0.3% decline in per capita income growth. In 2017, real GDP growth is expected to improve to 4.0% and subsquently reach 5% in 2018. The basis for economic recovery will be favourable weather conditions, achievement of macroeconomic stability and easing of supply side constraints, including power shortages. There are already signs that the agricultural harvest during the 2016/17 crop season will be better following improved rain fall. Agriculture sector growth is set to rebound to 4%. Recovery of agricultural output and incomes would have positive spill over effects in manufacturing, transport and logistics, wholesale and retail trade and services. Real GDP growth will be further bolstered by public infrastructure projects, especially in transport and energy sectors.

The downside risks to the medium-term economic outlook, however, remain significant. Erratic weather conditions could hurt growth by reducing agricultural production and incomes. Other short-term risks include macroeconomic instability, lower commodity prices and uncertainty in external donor flows. Pressures on the fiscal side could undermine growth by increasing government borrowing, which would, in turn, raise interest rates and crowd out private sector credit, reducing business confidence further.

To mitigate these multiple risks, Malawi will need to: i) expand investment in climate-smart agriculture, particularly irrigation and water conservation; ii) address energy sector bottlenecks; and iii) sustain macroeconomic, structural and governance reforms. There will also be a need to consolidate on-going Public Financial Management systems (PFM) reforms, which by restoring confidence in the budget process would help improve prospects for the restoration of external budget support. This would in turn contribute to macroeconomic stability by easing budget financing pressures. Successful completion of the eighth and ninth Extended Credit Facility (ECF) Reviews by the IMF and negotiation of a new programme would also help boost confidence in the economy.

Table 2. **GDP by sector (percentage of GDP at current prices)**

	2011	2014
Agriculture, forestry, fishing and hunting	31.2	28.3
of which fishing	1.6	1.2
Mining and quarrying	1.1	1.2
of which oil	...	...
Manufacturing	10.9	7.8
Electricity, gas and water	1.5	1.6
Construction	3.2	3.4
Wholesale and retail trade; Repair of vehicles; Household goods; Restaurants and hotels	19.9	20.3
of which hotels and restaurants	1.9	1.9
Transport, storage and communication	6.5	6.9
Finance, real estate and business services	13.5	17.6
Public administration and defence	3.4	2.6
Other services	8.7	10.3
Gross domestic product at basic prices / factor cost	**100.0**	**100.0**

Source: Data from domestic authorities.

Macroeconomic policy

Fiscal policy

The execution of the FY 2015/16 fiscal plan proved challenging as the amount of domestic revenues and grants fell short of the budget while expenditure on fertiliser subsidies, goods and services and interest on the domestic debt was higher than budget estimates. In FY 2015/16, domestic revenues under performed by 1% of GDP, reflecting the impact of the slowdown in the economy and lower imports on tax collection efforts. The resultant fiscal pressures were exarcebated by the need for the government to respond to the food crisis. Due to revenue shortfalls, expenditures were further restrained, with domestically funded development expenditures reduced from 1.4% of GDP to 0.7%. As a result of fiscal consolidation during the year, the actual fiscal deficit to GDP ratio in FY 2015/16 amounted to 6.1%, significantly lower than the 6.5% of the previous year.

Despite the improved fiscal stance, the actual level of net domestic borrowing exceeded the budgeted level by 1% of GDP because of the shortfall in external financing and the need for additional financing to cope with the humanitarian crisis, the severity of which was initially underestimated. The fiscal plan for FY 2016/17, which was formulated against the backdrop of the food crisis, focused on boosting revenue mobilisation, addressing the food crisis, protecting critical social sector spending and restraining growth in the wage bill. As part of fiscal adjustments, the budgetary allocation for goods and services and fertiliser subsidies was reduced in order to create fiscal space for food security intervention and food crisis mitigation. At the mid-term review of the FY 2016/17 budget, in February 2017, further expenditure cuts were made to compensate for shortfalls in the planned volume of external grants. With fiscal adjustment, the fiscal deficit for FY 2016/17 is projected at 5.6% of GDP, an improvement on the previous year's outturn. The net domestic financing requirement is projected to remain within the budget target, the equivalent of 1.4% of GDP. It is important for the government to continue on the fiscal consolidation path to foster macroeconomic stability and build an adequate fiscal buffer to absorb the impact of future revenue shocks on the budget. In particular, there will be a need for further improvement in expenditure prioritisation and to increasingly focus on expenditure efficiency while boosting domestic revenue mobilisation.

Table 3. **Public finances (percentage of GDP at current prices)**

	2007/08	2012/13	2013/14	2014/15	2015/16(e)	2016/17(p)	2017/18(p)
Total revenue and grants	**24.1**	**27.5**	**22.8**	**21.4**	**22.5**	**23.1**	**23.3**
Tax revenue	14.1	15.9	17.4	16.3	16.6	18.0	18.4
Grants	8.7	10.0	3.1	2.7	3.9	3.0	2.8
Total expenditure and net lending (a)	**26.2**	**28.5**	**28.9**	**27.9**	**28.6**	**28.7**	**26.8**
Current expenditure	16.9	22.6	24.5	22.6	21.9	22.3	20.3
Excluding interest	15.1	20.7	20.3	18.6	18.7	19.1	17.4
Wages and salaries	4.4	5.5	6.1	6.8	6.3	5.7	5.5
Interest	1.8	1.9	4.3	4.0	3.3	3.1	2.9
Capital expenditure	9.3	5.9	4.4	5.3	6.7	6.5	6.4
Primary balance	**-0.4**	**0.9**	**-1.8**	**-2.5**	**-2.8**	**-2.5**	**-0.5**
Overall balance	**-2.2**	**-1**	**-6.1**	**-6.5**	**-6.1**	**-5.6**	**-3.4**

Note: a. Only major items are reported.
Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Monetary policy

In 2016, Malawi continued to record high inflation, driven largely by rising food prices due to maize supply shortages, which persisted from 2015. The depreciation of the kwacha contributed to the inflationary pressures. Between December 2015 and December 2016, the kwacha depreciated by 13%, from MK 636:USD 1 to MK 725:USD 1. The kwacha's depreciation continued even during the tobacco season when typically the exchange rate appreciates as foreign exchange inflows increase. The kwacha depreciation was driven by a strong US dollar and accentuated by speculation in the foreign exchange market.

The annual rate of inflation in 2016 averaged 22.6%, slightly lower than the figure of 21.0% recorded in 2015. Since mid-2016, inflation has been declining with non-food inflation decelerating at a faster rate than food inflation in response to the tight monetary policy stance adopted by the RBM. The prevailing policy rate of 27% was adjusted downwards to 24% in November 2016 to take into account the improved inflation outlook. The liquidity reserve requirements ratio was maintained at 7.5%.

As a result of monetary policy tightening, lending rates in 2016 remained elevated, with base lending rates averaging 36%. With these high interest rates, the private sector was seriously constrained from borrowing. Yields on treasury bill (TB) rates in 2016 averaged 28%, which provided investors positive returns in real terms, an incentive to hold kwacha denominated financial assets. In 2016, growth in private sector credit shrunk by 2% in real terms. Broad money supply growth in the second half of 2016 declined to 18% from 27.4 % between January and June 2016. Fiscal consolidation contributed to the easing of demand pressures

The inflation outlook has, however, improved. Average inflation in 2017 is projected to decline to 16% and then reach 9.7% in 2018. The increase in food availability resulting from joint government and donor humanitarian efforts has led to an easing in food prices from the second half of 2016. While international oil prices are set to pick up in 2017 and 2018, sustained improvement in the food situation and the positive effect of sound macroeconomic policies are expected to offset pressures arising from higher fuel and utility prices.

Since food is a key driver of Malawi's inflation, efforts to improve agriculture productivity and build resilience to the effects of climate change will be particularly critical in bringing down inflation on a sustainable basis.

Economic co-operation, regional integration and trade

Malawi, which belongs to two regional economic communities – the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) – has continued to progress in its regional economic co-operation and regional integration efforts. Malawi has to date ratified more than 75% of SADC and COMESA protocols; the most recent one being the protocol on gradual eradication and eventual elimination of visas. Tariffs on imports originating from SADC have been largely eliminated in line with Malawi's commitments under the regional trade protocols. Malawi is committed to deepening trade integration and is amongst the 24 countries that signed a trade agreement that includes the East African Community (EAC) along with SADC and COMESA, the SADC-EAC-COMESA Tripartite Free Trade Areas, representing a potential market of 300 million people. As part of its regional economic co-operation efforts, Malawi is implementing several regional infrastructure projects jointly with its neighbours, including transport corridors, notably the Nacala Transport Corridor (with Zambia and Mozambique) and the Northern Transport Corridor (with Tanzania).

Malawi has not exploited existing market access opportunities largely due to the narrow export base, supply side constraints and weak competitiveness. Consequently, Malawi has continued to register large trade and current account imbalances.

Malawi's current account deficit deteriorated sharply, from 8.2% of GDP in 2015 to 13.9% in 2016. The deterioration was driven by the decline in exports, particularly tobacco, tea and sugar, and the surge in imports. The necessity for maize importation to fill the gap contributed to the widening trade and current account imbalance.

Export diversification and reduced reliance on imports of consumer goods is crucial for Malawi to achieve sustainable current account balances. In 2016, the government adopted the National Industrial Policy and the National Trade Policy, and launched the Buy Malawi Strategy. These policy initiatives, which are complementary to existing National Export Strategy, seek to support the private sector in furthering economic development, generating employment and reducing poverty, as well as improving the viability of Malawi's external sector by bolstering exports and reducing the import bill. There are also efforts underway to enhance trade facilitation. The National Trade Portal was launched in 2016, while the Malawi Revenue Authority signed a Memorandum of Understanding with COMESA establishing the Regional Cargo Transit System.

Table 4. **Current account (percentage of GDP at current prices)**

	2008	2013	2014	2015	2016(e)	2017(p)	2018(p)
Trade balance	-16.3	-11.9	-8.2	-7.8	-6.6	-6.5	-6.6
Exports of goods (f.o.b.)	17.9	23.3	25.3	22.5	25.2	22.1	20.7
Imports of goods (f.o.b.)	34.2	35.2	33.6	30.3	31.8	28.7	27.3
Services	-2.1	-2.4	-2.6	-2.7	-3.6	-2.6	-2.3
Factor income	-2.8	-4.8	-5.0	-5.1	-6.2	-3.8	-3.4
Current transfers	8.2	10.5	7.3	7.5	2.4	2.3	2.0
Current account balance	**-13.0**	**-8.7**	**-8.5**	**-8.2**	**-13.9**	**-10.7**	**-10.3**

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Debt policy

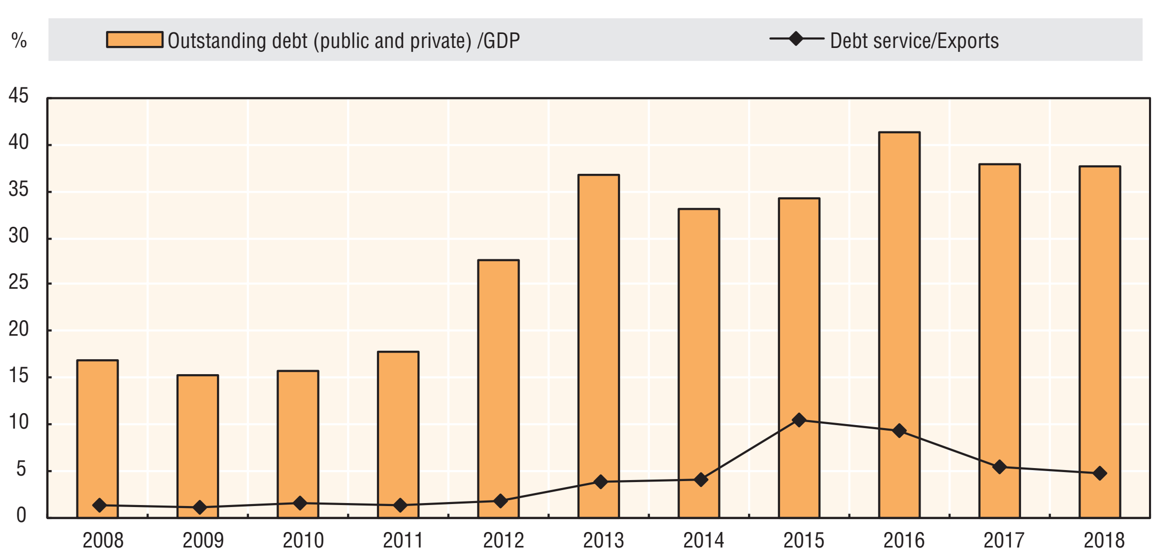
Malawi's total public debt has increased rapidly in recent years. The most recent debt data show that the value of Malawi's external debt stock increased to USD 1.78 billion (37% of GDP) as at end 2015, up from USD 1.45 billion in 2013 (30.8% of the rebased GDP). The size of Malawi's external debt stock is approaching the debt levels prior to the Highly Indebted Poor Countries (HIPC) levels. The build up in the foreign debt stock has been driven by growth in public investment financing needs, especially for infrastructure, part of which is being met through borrowings from non-traditional donors, notably India and China. The overwhelming share (75%) of foreign borrowing is still mostly from multilateral institutions, on concessional terms. The most recent Debt Sustainability Analysis by the IMF reveals that Malawi's external debt remains sustainable, with a moderate risk of debt distress. However, risks have heightened due to unfavourable external conditions.

The value of the domestic debt stock more than doubled from MK 207 billion in 2012 (13.8% of GDP) to MK 538 billion (16.8% of GDP) in 2016. The surge in the domestic debt has largely been driven by net domestic financing requirements to meet shortfalls in external financing, securitisation of accumulated payment arrears and restructuring of the maturing portion of the local debt. The high cost of servicing the domestic debt has aggravated the debt burden. The government's fiscal consolidation efforts will be critical in ensuring debt sustainability.

Malawi's policy, legal and institutional framework for debt management is sound. A new debt management policy has been developed, which demands that debt service obligations be met adequately and at the lowest possible cost and reasonable risk. The debt management function is carried out by the Debt and Aid Division within the Ministry of Finance. The debt data recording is adequate and the data regularly updated.

Malawi's debt management capacity and oversight, however, needs further strengthening. The government has taken steps to this end. The Debt Management Committee (DMC) has been fully operationalised to provide high-level oversight over debt management. The aim is to ensure concessionality of external borrowings, and that the balance between cost and the risk of borrowing is properly assessed. The government's annual borrowing plan is being carefully scrutinised to ensure compliance with non-concessional borrowing limits under the IMF ECF Programme. Another measure includes the restructuring of maturities of government debt to reduce the rollover costs.

Figure 2. **Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)**



Source: IMF (WEO & Article IV).

Economic and political governance

Private sector

The Malawi private sector would benefit from an enabling business environment, including improved access to finance, stable power and water supplies, lower interest rates, fewer and less complicated regulations and procedures (i.e. less “red tape”) and macroeconomic stability. Towards this end, the government has intensified policy efforts to improve the business climate and to foster private sector-led growth. The key economic laws that were pending enactment have been passed by parliament. These include the Business Registration Act, the Insolvency Act and the Personal Registry Act. The One Stop Services Centre (OSSC) at the Malawi Investment and Trade Center (MITC) has been operationalised to facilitate investment, both local and foreign, by simplifying business set up processes in areas of business registration, taxation, customs, land acquistion, immigration and work permits.

Furthermore, the Malawi Business Registration System (MBRS) was launched in 2016 to allow online registration of businesses. The MBRS has already reduced the time taken to register a business from 39 days to 5 hours, improving the ease and cost of doing business significantly. Malawi has also simplified the process of starting up businesses by streamlining company name search processes and eliminating the requirement for company premise inspection before the issuance of a business permit.

The recent reforms are starting to have a positive influence on Malawi’s performance in Doing Business (DB) as evidenced in the World Bank Ease of Doing Business report. Malawi’s ranking for 2017 improved by 8 places from 141 the previous year to 133. The specific DB areas where Malawi achieved improvements are in “getting electricity” and “getting credit”; the latter follows the 2016 launch of the collateral registry of personal property system.

Nevertheless, considerable efforts are needed to sustain the improvements so that Malawi’s private sector can thrive and the country can attract more foreign direct investment (FDI). Currently, the volume of FDI is amongst the lowest in the region. The government needs, in particular, to urgently address power shortages, lower the cost of doing business and ensure greater predictability in policy implementation and enforcement of regulations. Furthermore, macroeconomic stability should be restored to bring interest rates down.

Financial sector

There are currently 11 banks in existence, with 2 major banks accounting for nearly 50.4% and 53.3% of total bank assets and deposits, respectively. Financial sector deepening has been taking place in Malawi gradually, but the sector is still shallow. Private sector credit, as a share of GDP, is estimated at about 11.7% (end 2015), lower than the average for sub-Saharan Africa of 17%.

At 33%, lending rates are abnormally high. This is partly the result of tight monetary policy, limited competition and the high cost of providing banking services due to high inflation.

Access to financial services in Malawi is very low, highlighting the need to promote financial inclusion. The low access to credit is attributed to a lack of credit information availability, high interest rates and the inability of small borrowers to provide collateral. In 2016, the Personal Property Security Registry system became functional. This was designed as a collateral registry based on the 2013 Personal Property Security Act. The Registry enables small businesses to pledge mobile assets as collateral and includes a database that allows financial institutions to access financial background information of prospective clients.

Malawi’s financial system continued to be well capitalised and liquid, with financial institutions earning adequate returns on their equity and assets. According to the RBM’s *Financial Stability Report* of December 2016, the banking sector maintained both core and total capital ratios above the minimum requirements, with the exception of two banks. However, the quality of loan portfolio has deteriorated as evidenced by the increase in the share of non performing loans (NPL) in gross loans from 11.6% in September 2015 to 14.7% in September 2016. The rise in the level of NPL has resulted from high interest rates and slow growth, which have constrained borrowers' loan repayment capacity. High credit concentration has also contributed to heightening of the credit risk, necessitating higher loan loss provisions.

The RBM continues to undertake measures to safeguard financial sector stability. New prudential directives have been issued to banks on loan classification and loss provisioning. The measures also include a report on compliance with credit concentration regulations. The RBM has also adopted and is implementing a legal framework for the prompt resolution of problem banks.

Natural resource management and environment

Malawi's vulnerability to climate challenges manifested in a humanitarian crisis in 2016 with estimates of over 6.5 million people left food insecure. A second consecutive year of drought recorded a decline of 14.7% over the 30% recorded in 2015 in the production of maize. Other extreme weather events, for example, flooding in some districts in the north, heightened worries over the impact of climate change, leading Malawi to sign the Paris Agreement on Climate Change. However, public concern over the environmental impacts of resource depletion, and weak regulatory control of pollution and unsustainable resource extraction have yet to be translated into action. Nonetheless, the government is supporting sustainable management of the environment and natural resource base through the approval of various policies and regulatory frameworks on irrigation, agriculture, forestry, fisheries, aquaculture, trade and industry. The government has also created a National Resilience Plan to address the causes of climate change and minimise the effects of climate change on food insecurity as well as working towards a renewable energy strategy.

A revised environmental management bill has been presented to parliament, which proposes a semi-autonomous Environmental Management Authority for implementation and enforcement when the bill becomes an act. There are also new proposals for environmental management improvements through adopting a "payment for ecosystem services" (PES) mechanism and polluter pays principle strategies. A cabinet paper that proposes the banning of the use of burnt bricks to promote forestry conservation is also being considered.

The National Resilience Plan has been instrumental in linking all relevant sectors to address environmentand natural resources (ENR) complemented by a series of advocacy sessions with parliamentary committees on increasing national budget allocations. A budget coding system has been designed to enable expenditure tracking for ENR and disaster risk management related public expenditure to better inform budget allocation.

Political context

Malawi is a peaceful and stable country. The most important recent development was the passage of the much awaited Access to Information bill by the parliament, which will usher in greater transparency and accountability in governance. A national identity system was launched by the National Registration Bureau (NRB) to address a long-standing challenge of the absence of a universal identity document for the citizens; it is seen as a potential "game changer" for good governance across multiple sectors. A new Board of Commissioners of the Malawi Electoral Commission (MEC) was appointed in June 2016, which achieved gender parity with 50% of the eight members being women.

Social context and human development

Building human resources

Food, especially maize prices in 2016, increased 58% over 2015 prices due to the continued severe drought, adversely affecting food and nutrition security. The rise in food inflation resulted in an increase of 52% in the monthly cost of the basket of basic needs between May 2015 and May 2016. Further, the number of new admissions to supplementary feeding programmes increased by 126% over a 12-month period from June 2015. However, the death rate of severely malnourished children receiving nutrition treatments decreased from 2.2% to 1.3% from June 2015 to June 2016.

The food crisis seems to have had an adverse impact on individuals undergoing anti-retroviral therapy (ART) and/or TB treatment. There was a sharp increase in the number of people – from approximately 180 000 in the first quarter of 2015 to approximately 240 000 by the third quarter of 2016 – that have either stopped or defaulted on their treatment mostly because of lack of food. However, the number of people tested for HIV increased substantially in the first quarter of 2016 while the rate of new infections remained consistent at 9.1% from the third quarter of 2012 to the first quarter of 2016.

While the budgetary allocation over the last five years for the health sector in Malawi has remained constant at 10%, below the 15% required by the Abuja Declaration, the per capita health allocation has decreased from USD 21 in 2013 to USD 9 in 2015. The HIV National Strategic Plan is facing serious financing gaps, which could hinder further progress on achieving the UN Sustainable Development Goal (SDG) 3 (ensuring healthy lives and promoting the well-being for all at all ages) in Malawi.

The food crisis also affected school attendance among children leading to increased drop out rates and the adoption of negative coping strategies, such as begging or engaging in child labour. An increase in child marriages has also been reported. These developments threaten to unravel some of the development gains made in school enrolments in Malawi. With 63% of children in Malawi deprived of education, health, nutrition, water, sanitation and shelter, the implementation and achievement of SDGs 2 (zero hunger) 3 (noted above), 4 (quality education) and 6 (clean water and sanitation) is a serious concern and calls for an integrated and multidimensional approach to address issues of health, education and child poverty.

Poverty reduction, social protection and labour

Poverty remains persistent in Malawi with half of the population living below the poverty line and nearly a quarter living in extreme poverty. Even though the country progressed in non-monetary dimensions of poverty (e.g. access to education, health, water and electricity), income poverty has remained unchanged and may even have been exacerbated by the extreme weather events that the country has experienced. The World Bank estimates that the impact of drought on the poorest 40% will be enormous as their consumption will decline by 11.8% as compared to 1.7% across SADC. This will result in worsening consumption inequality, which in 2011 was already declining (before the effects of the 2016 drought) with a rate of 0.452 in 2011 as compared to 0.390 in 2004. The majority of Malawi's poor live in rural areas where extreme poverty is rife and resilience low. One of the mechanisms for effective reduction in poverty and inequality is adequate coverage and targeting of the poorest through the National Social Support Programme. However, the reach of safety net programmes has been limited both in terms of budgetary outlays and the targeted beneficiaries; only 10% of the poor were reached with an allocation of 2.99% of GDP in 2014/15. The school feeding programmes and the public works programmes, however, had more coverage but still less than a quarter of the poor populace was covered. The social cash transfer programme supported 151 317 households and a total of 670 482 individuals in the same period. Given the low rates of coverage, ineffective targeting of beneficiaries and persistent leakages, the World Bank has recommended a major reform in the social assistance programme to effect poverty reduction.

Another factor that has stymied poverty reduction is persistent macroeconomic instability, with the country posting growth rates of less than 3% consecutively in 2015 and 2016. High rates of inflation, averaging 20%, exacerbated by decreased food production, has led to a large fiscal deficit resulting in lower resources dedicated to poverty alleviation efforts. This is cited as one of the major factors in the underperformance of the Malawi Growth and Development Strategy (MGDS) II. Moreover, social assistance programmes are mainly driven and funded by donors, which is not sustainable. Social assistance programmes have not affected Malawi's youth, which comprises nearly 60% of the total population with an unemployment rate of 23%, with more females (28.3%) than males (16.9%) unemployed. Youth unemployment is higher by 12 percentage points in urban areas as compared to rural areas, constrained by low skills, inadequate education and lack of job opportunities. It is also noted that 65.6% of young males and 51.8% of young females dropped out of school because of poverty. Various empowerment initiatives, as well as the National Youth Policy, have not been effective due to fragmentation and absence of linking entrepreneurship training with business advisory services and access to finance. As Malawi drafts its National Development Strategy (2017-2022), a more integrated approach to youth empowerment and poverty reduction is warranted.

Gender equality

SDG 5 (gender equality and women's empowerment) emphasises the achievement of gender equality and elimination of all forms of discrimination against women and girls. This is an issue of particular concern for Malawi, which did not achieve its gender-related Millennium Development Goals (MDGs). Despite representing a higher share of the labour force, the employment rate for women at 74.3% is less than that for men at 85.7%. Women in unpaid work constitute 93% as compared to 79% of men. Moreover, the gender wage gap at 39% is also high. Further, only 3% of women are registered owners of commercial land and 14% of firms have women in top management positions. Likewise, women represent only 17% of parliament, a figure far below the 50% African Union (AU) target. Malawi also has the fifth highest incidence of sexual violence in sub-Saharan Africa and gender inequality, especially in secondary education, is also high as there are only four women to every ten men with secondary school education.

The passage of the 2016 Land Bill strengthens access to land and security of tenure, including by providing women with the opportunity to register land in their own name and by ensuring that women are represented equally on land committees. Further the Gender Equality Act was used successfully to punish an offender resorting to harmful cultural practices such as sexual cleansing ceremonies with girls and widows.

Thematic analysis: Entrepreneurship and industrialisation in Malawi

Malawi's industrial development is guided by its new industrial policy, which sets the country on a path of structural transformation through industrialisation. The industrial sector in Malawi comprises manufacturing, mining and quarrying, construction and infrastructure. The National Industrial Policy (NIP), adopted in 2016, is broadly aligned to SDGs 8 (decent work and economic growth) and 9 (industry, innovation and infrastructure) and the SADC and COMESA Industrialisation Strategies. The NIP aims to address the drivers of growth – namely, land availability, taxes, labour force productivity, energy supply, availability of raw materials, transport cost and skills development – in a comprehensive and integrated manner.

Malawi's economy is predominantly agricultural contributing 28% to the GDP. Industry's value added to GDP has declined from 17% in 2005 to 15% in 2015. Manufacturing constitutes a much smaller proportion of the economy, contributing approximately 9% to the GDP. Agro-processing contributes approximately 50% of value added in the manufacturing sector. The share of manufacturing peaked in 1992 at 20% but has been in a downward spiral since then owing to a complex mix of macroeconomic and other factors that have hindered diversification and led to greater import dependence. The industrial structure is characterised by a few large companies at one end and micro and small enterprises at the other. Very few micro-and small-size enterprises graduate or develop into medium-size enterprises. In Malawi, the informal economy is predominant as 89% of the working population works in informal occupations, with 91% of informal occupation in rural areas.

Industrialisation has been hampered by limited investment in physical infrastructure and human capital development, which in turn has hindered the country's competitiveness and growth. Other constraints to further industrialisation include paucity of necessary skills; lack of innovation and technology; limited access to finance and markets; high costs of doing business; low investment in strategic sectors, such as agro-processing; weak institutions and low implementation capacity; and barriers to MSME participation in manufacturing. For example, MSME products are generally of low quality as there is no knowledge of product and quality standards. Further, high levels of corruption, low FDI inflows (8% of GDP in 2015) and a weak infrastructure impede entrepreneurship and private sector growth.

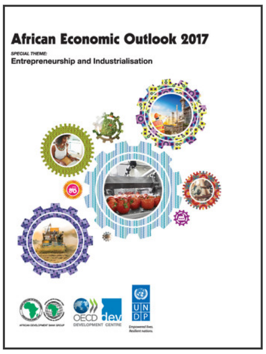
The NIP adopts a three-pronged approach to address these constraints: i) prioritisation of public and private sector resources in focus sectors for structural transformation; ii) robust upskilling of people and upgrading of productive technology; and iii) strengthened policy making and implementation. The focus is on sectors with export potential that are also important domestically. These include agricultural sector products, such as oil seeds and sugar cane; manufacturing in the agricultural sector, including agro-processing of crops such as maize, wheat, rice, cassava and pigeon peas; plus manufacturing of beverages, plastics and packaging and assembly. The NIP also targets the textiles and clothing, leather and pharmaceutical sectors for import substitution. While the industrial policy does not make a specific reference to entrepreneurship, it is closely linked to and builds upon the National Export strategy, the Buy Malawi strategy, the Education policy and the Micro, Small and Medium Enterprises (MSME) policy, which target entrepreneurship specifically. The NIP also outlines interventions in technical vocational skills development and improving access to credit and finance to enhance the contribution of MSMEs to manufacturing.

The MSME sector is a significant contributor to the economy as there are nearly a million MSMEs and the sector employs over a million people and generates an income of MK 326 billion. Despite this, the sector is small, as 59% are micro entrepreneurs, largely informal, and only 41% of businesses generate employment. Most of these enterprises (85%) are in rural areas and are engaged mainly in agriculture retail. There are more male-headed MSMEs (54%) as compared to female-headed MSMEs (46%), most of whom are individual entrepreneurs. On average, the MSME owners are young (31 years) and are in business by default, as they could not find other assured employment. Entrepreneurs, comprising mainly women and youth, are engaged in assembly, leather works, tailoring, motor mechanics, construction, arts and crafts and carpentry, among other unskilled and semi-skilled activities. These activities have a low capital base and low quality production; hence, they are not sustainable which is why entrepreneurship is secondary to public or private employment.

Malawi needs a stronger culture of entrepreneurship. This could be addressed through appropriate curriculum in the education system and by supporting a business environment that encourages job creators (entrepreneurialism) rather than job seekers. Further, the private sector is sustained by government procurement and private sector development, industry and trade is still not prioritised by donors (accounting for only 1.27% of official development assistance [ODA] in 2014/15), even though it is a promising approach to promoting entrepreneurial culture. The government's forthcoming MSME policy prioritises entrepreneurship development through improved business development services. It proposes to build and strengthen entrepreneurial culture through a series of interventions targeting education and training for developing skills of entrepreneurs, while also promoting mentoring and counselling and establishing business incubators and effective business development services. This will be complemented by other initiatives to ease access to finance and markets, as well as the development of appropriate infrastructure in both rural and urban areas. Particular attention will be paid to youth and women entrepreneurs. To remove the binding constraints to entrepreneurship, the government proposes to promote value chain development and encourage innovation by establishing enterprise challenge funds and supporting business-to-business linkages. An example is the Competitiveness and Job Creation Project, supported by the AfDB, that promotes business linkages for small-scale entrepreneurs. Another example is the UN Development Programme (UNDP), KfW Development Bank, the UK Department for International Development (DfID) and the International Fund for Agricultural Development (IFAD) supported Malawi Innovation Challenge Fund (MICF), which promotes innovation and inclusive business models. Another successful venture is Malawi's new technology hub, mHub, an incubator for technology startups focusing on youth entrepreneurs by imparting training, skills development and mentorship.

Regulatory reforms are also improving the business environment. For example, the automation of a business registration system, the creation of a collateral registry and a credit information system (as mentioned previously) will help to create an enabling business environment which will also benefit small entrepreneurs.

The government's policy articulation is operationalised by entities such as the Small and Medium Enterprises Development Institute (SMEDI), the Technological Development Institute, the Malawi Bureau of Standards (MBS) and the Malawi Investment and Trade Centre (MITC). The industrial policy, national export strategy, trade policy and the MSME policies are implemented under the leadership of the Ministry of Industry, Trade and Tourism. Further, the Trade Industry and Private Sector Development Sector Wide Approach (TIPSWAp), the Public Private Dialogue Forum and Trade Policy Technical Group are effective multi-sectoral fora to engage the private sector and other stakeholders on entrepreneurship.



From:

African Economic Outlook 2017

Entrepreneurship and Industrialisation

Access the complete publication at:

https://doi.org/10.1787/aeo-2017-en

Please cite this chapter as:

African Development Bank/OECD/United Nations Development Programme (2017), “Malawi”, in *African Economic Outlook 2017: Entrepreneurship and Industrialisation*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/aeo-2017-42-en