

Drivers of Economic Growth in Malawi

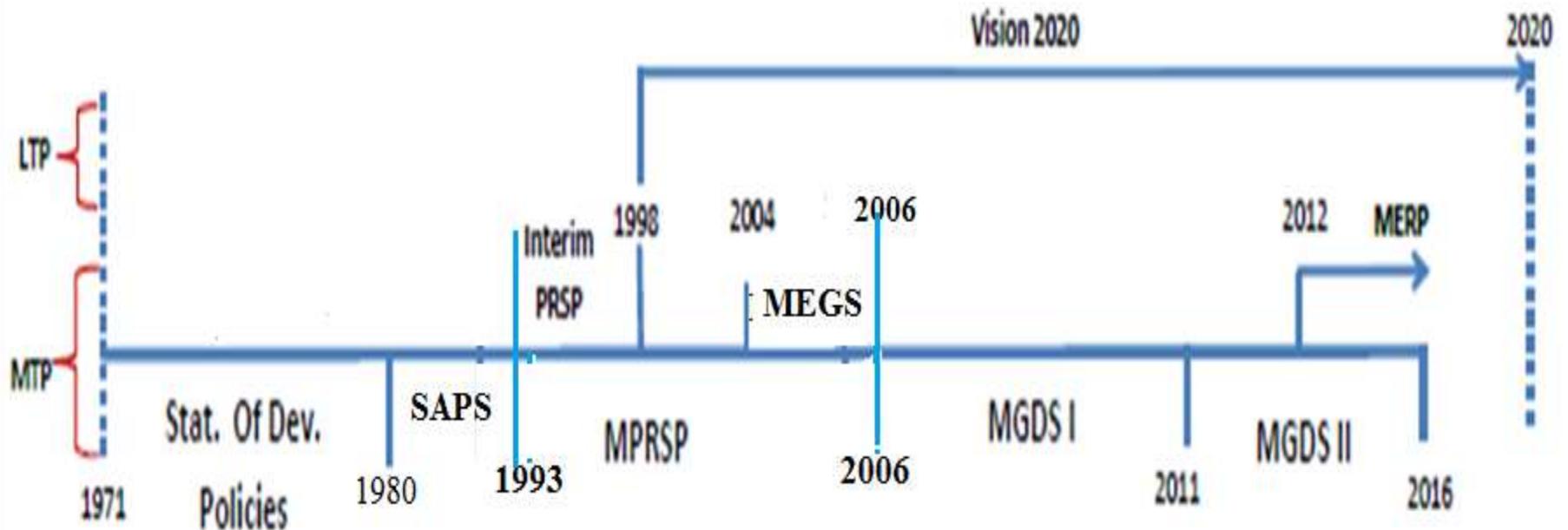
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Outline of presentation

1. Economic development planning in Malawi
2. Theories of economic growth
3. Phases in growth of Malawi economy
4. Sources of growth in Malawi
5. Constraints to growth
6. Lessons for the way forward
7. Going forward
8. Main Sources: MCEM 2009, NES2012, Drivers of Change Study 2004, Ngwira 1994

Development Policies



LTP: Long Term Perspective; **MTP:** Medium Term Plan; **SAPS:** Structural Adjustment Programmes

Vision 2020: Growth at 11%, become middle income country

- Strategic Issues
 - Good governance
 - Sustainable economic growth and development
 - Vibrant culture
 - Economic Infrastructure
 - Social sector development
 - Science and technology led development
 - Fair and equitable distribution of wealth and income
 - Food security and nutrition
 - Sustainable natural resource and environmental management

Economic Recovery program

- Pulled out of the MGDS II as a prioritization of those activities that can put the economy on fast path of recovery, and build a foundation for continued growth in the medium term.
- Five priorities: Commercial agriculture; tourism; mining, energy, transport and ICT
- Changing bad laws; repairing relationships with donors and correcting monetary policies

Economic Growth Theory

- **Classical:** All the theories of growth are based on the Ricardian theory of exchange whether domestic or external. Main implications of Classical theory is that a country's growth rate has a natural steady state, even if you increase capital you come back to this level in the long run because capital has diminishing returns;
- **Neoclassical:** To go beyond the steady state you need technological change
- **Endogenous growth theory** :tries to explain what causes difference in growth rate of countries and points to technology, development of labor skills as explanatory factors
 - Variations of these theories are many
- **Common threads:** The quantity and quality of factors of production drive growth: labor, capital and technology;
- Most growth theories did not explicitly deal with the institutional and policy issues needed for growth to take place. Ricardo used his writings to persuade change of government policy, particularly the repeal of corn laws and encourage trade

Export led Growth

- Is a trade and economic policy aiming to speed up the economic development of a country by exporting goods for which it has competitive advantages
- The core strategies are floating the exchange rate(except for China) and strong government support for exporting sectors/industries
- Lessons from experiences of other countries
 - Declining ToT for commodities; some initial conditions may not exist; strategy should be supported by diversification to mitigate impacts of global price changes and global recessions; capacity of government to select winning sectors/companies

Five phases of economic growth

Phase 1. 1964- 79 - rapid economic growth but was based on a (highly dualistic) development policy that was unsustainable in the long run, based on preferential land and credit policies. Estates grew at 17% and smallholder sector at 3%; rural incomes supplemented by WENELA remittances. Smallholder offered prices well below export parity; exchange rate fixed most of the time

Phase 2. 1979-89: Terms of Trade collapsed by 25%, high fuel prices, war in Mozambique, blocking routes to ports. Collapse in commodity prices, reduced WENELA remittances

Five phases of economic growth- cont'd

Phase 3: 1989-2003;

- Coinciding with Muluzi 's presidency, implemented some liberalization policies; for example change in legislation making it possible for smallholders to participate in export crops esp. burley tobacco did not avert a decline in real per capita incomes; produced an even worse performance, frequent crises and a steep decline in most development indicators.
- Large fiscal deficits and exchange rate liberalization led to price instability; inflation reached 83%, droughts of 1992,1994, and Mozambican refugees all had their negative impacts.
- At the end of this period in 2004, Malawi was at the edge of an abyss
- Other concerns: the density of the rural population, patterns of land-use, environmental degradation and the absence of productivity-enhancing measures in smallholder agriculture, were issues of particularly grave concern.

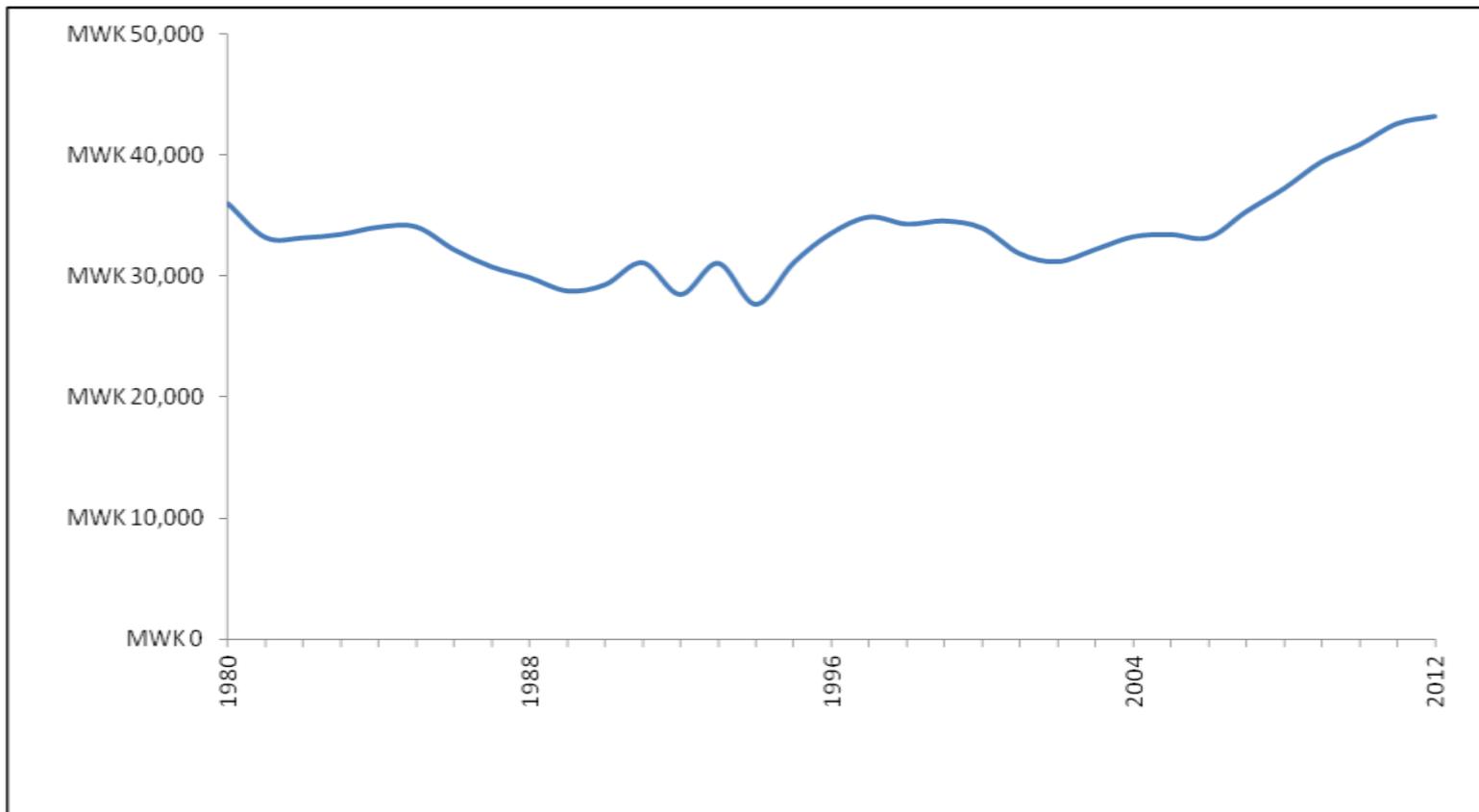
Five phases of economic growth - cont'd

Phase 4. 2004 – 2009 Coincided with Bingu's first term. Stabilization enhanced growth, and per capita income returned to its 1979 levels.

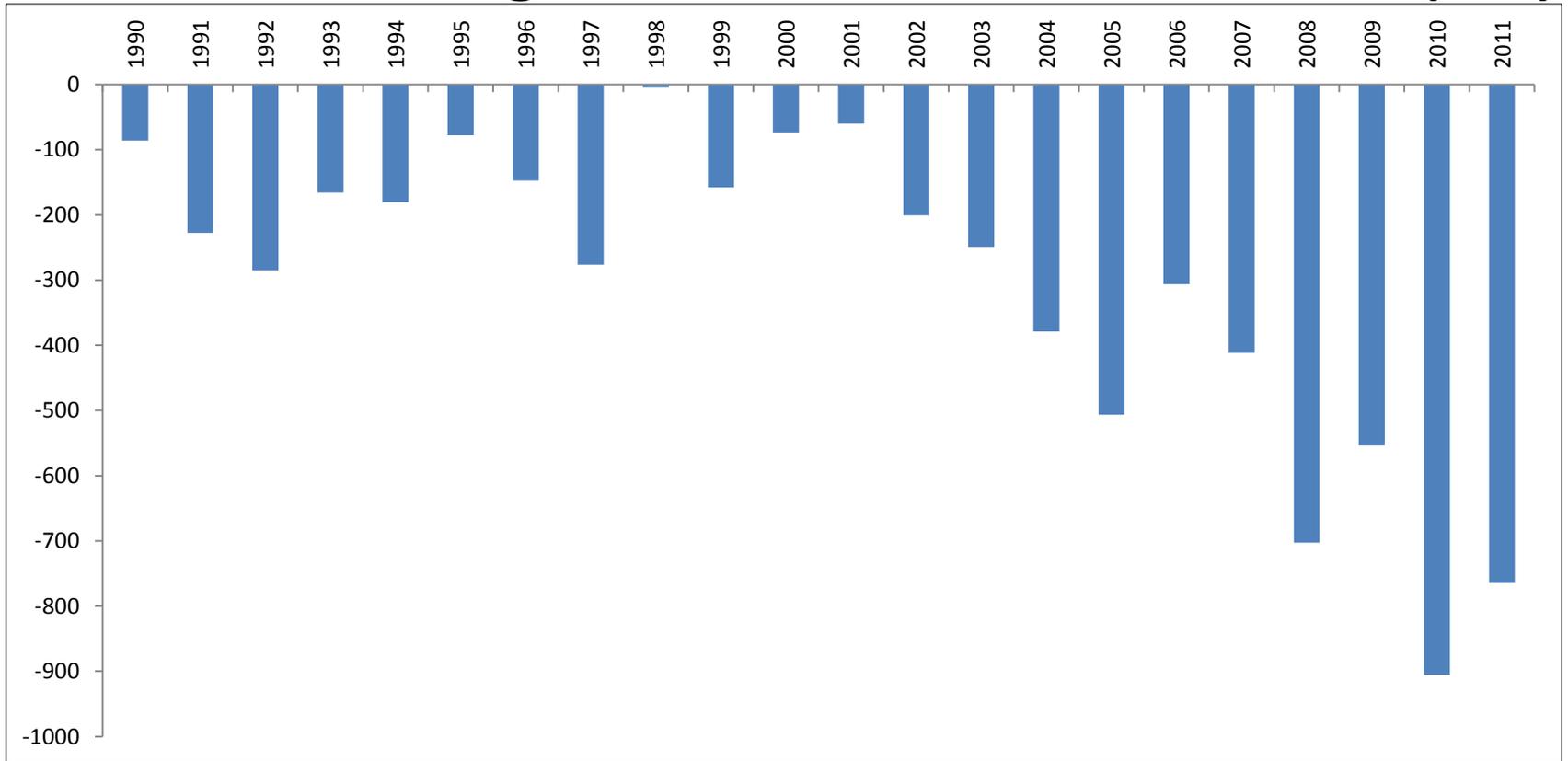
Phase 5. 2010-2011 Coincided with Bingu's second term when governance issues led to a serious deterioration of the economy and human rights condition and plummeting growth from the highs of 9% to now 1.4%.

Phase 6??

Outcomes: Real GDP/PC not impressive

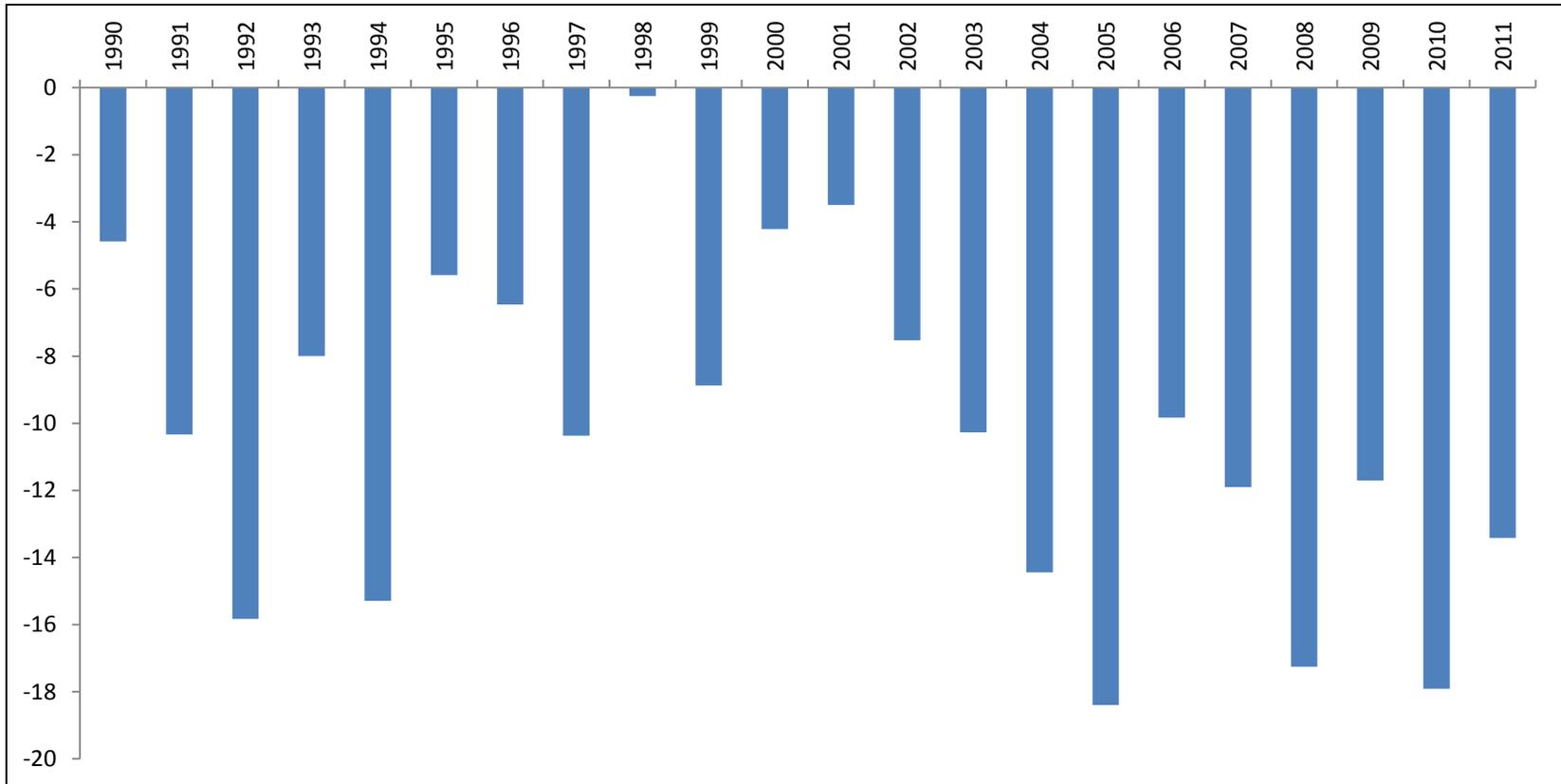


Outcomes: Negative Current Account Balance (\$M)



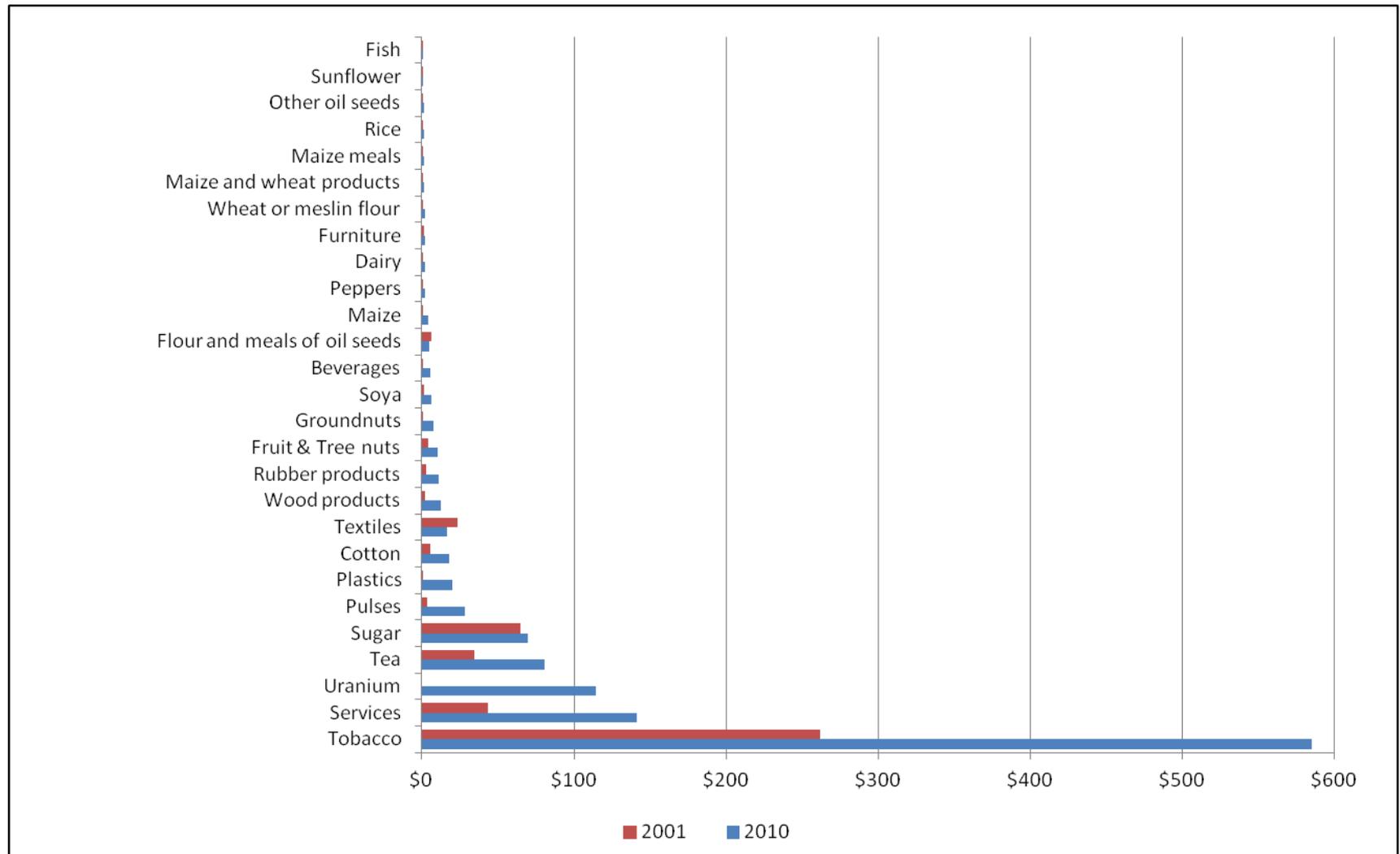
Outcomes:

Negative Current account balance(% of GDP)



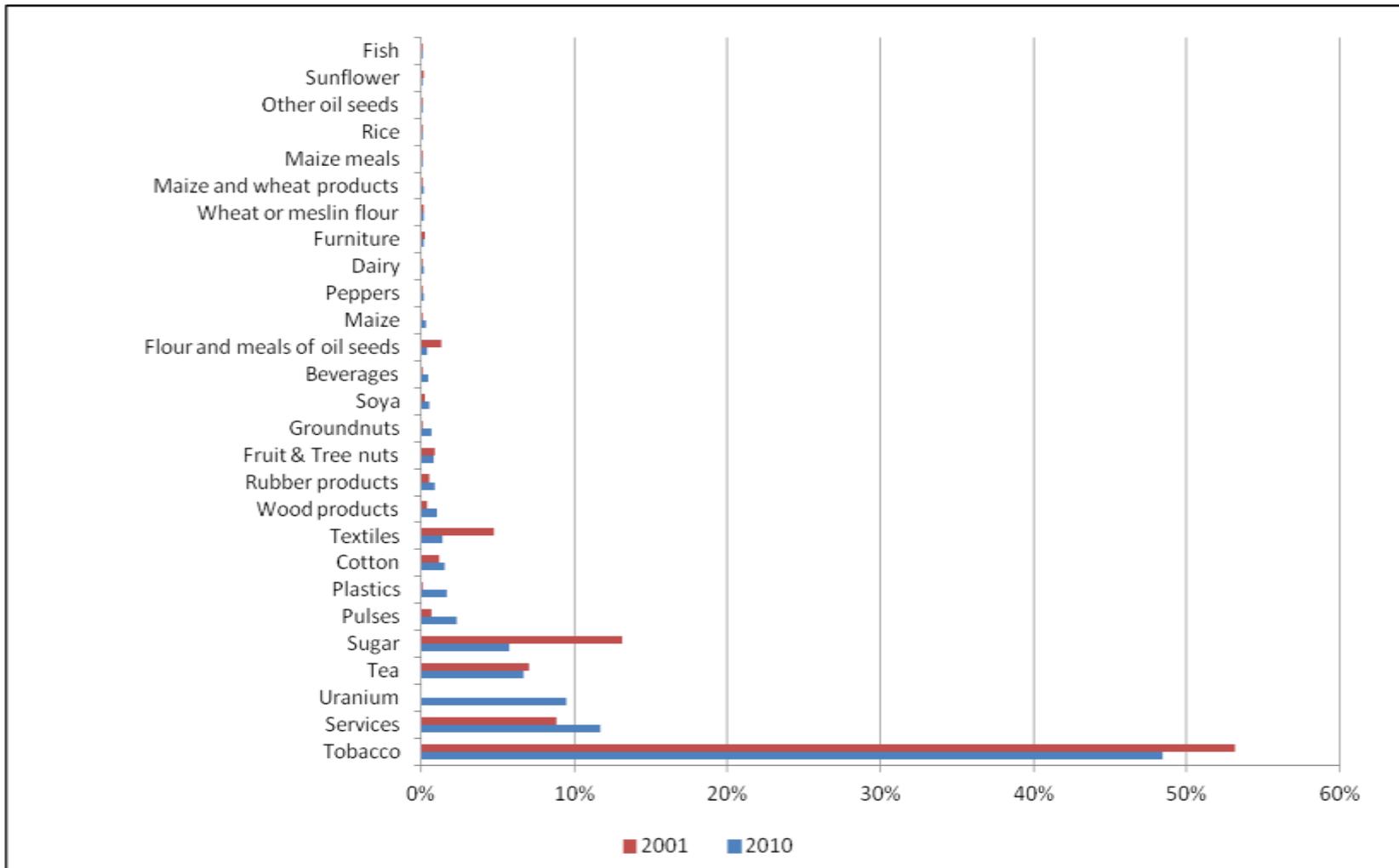
Outcomes:

Dependency on one Export (\$ m)

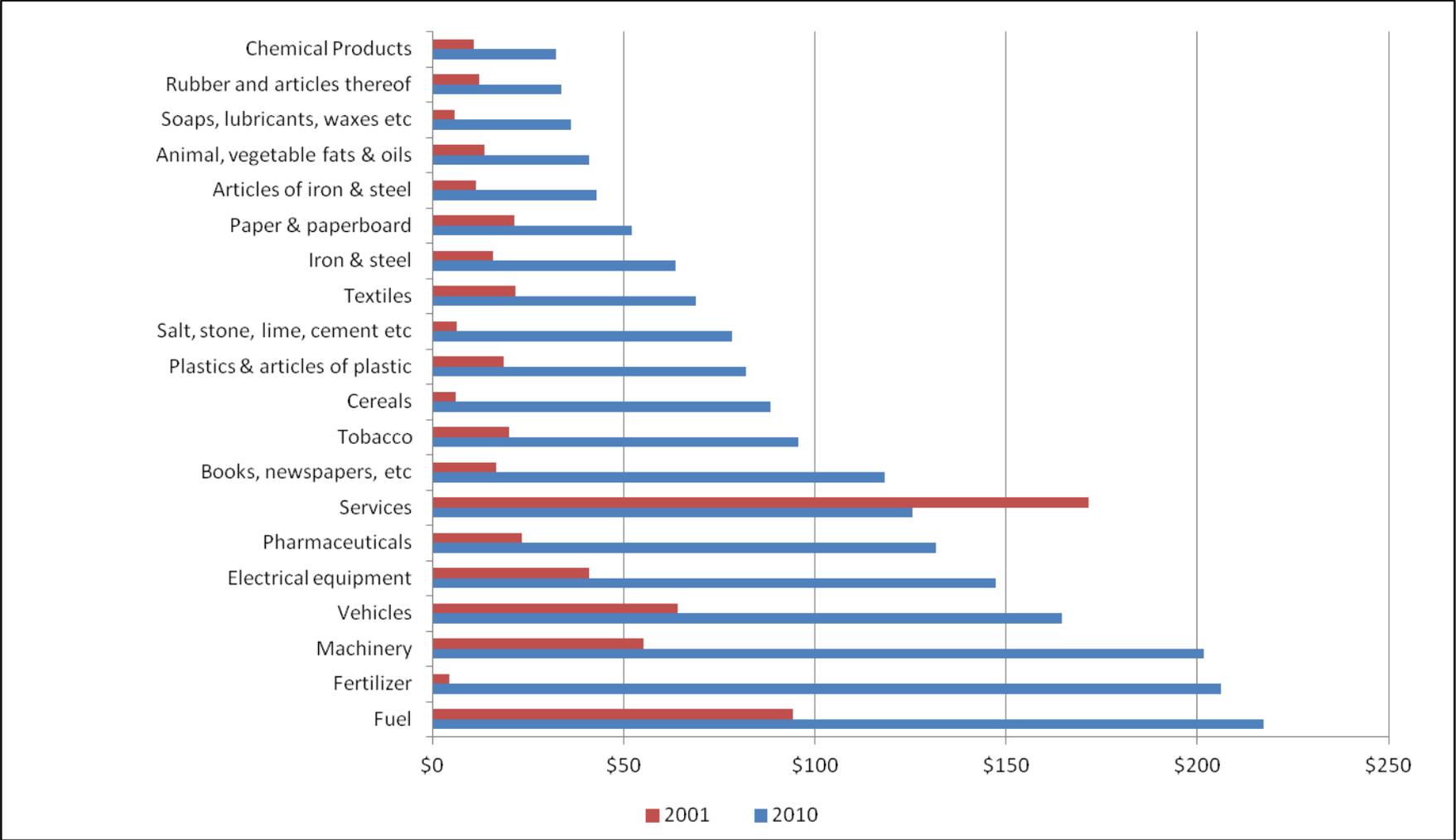


Outcomes:

Dependency on one export (% of Total Exports)

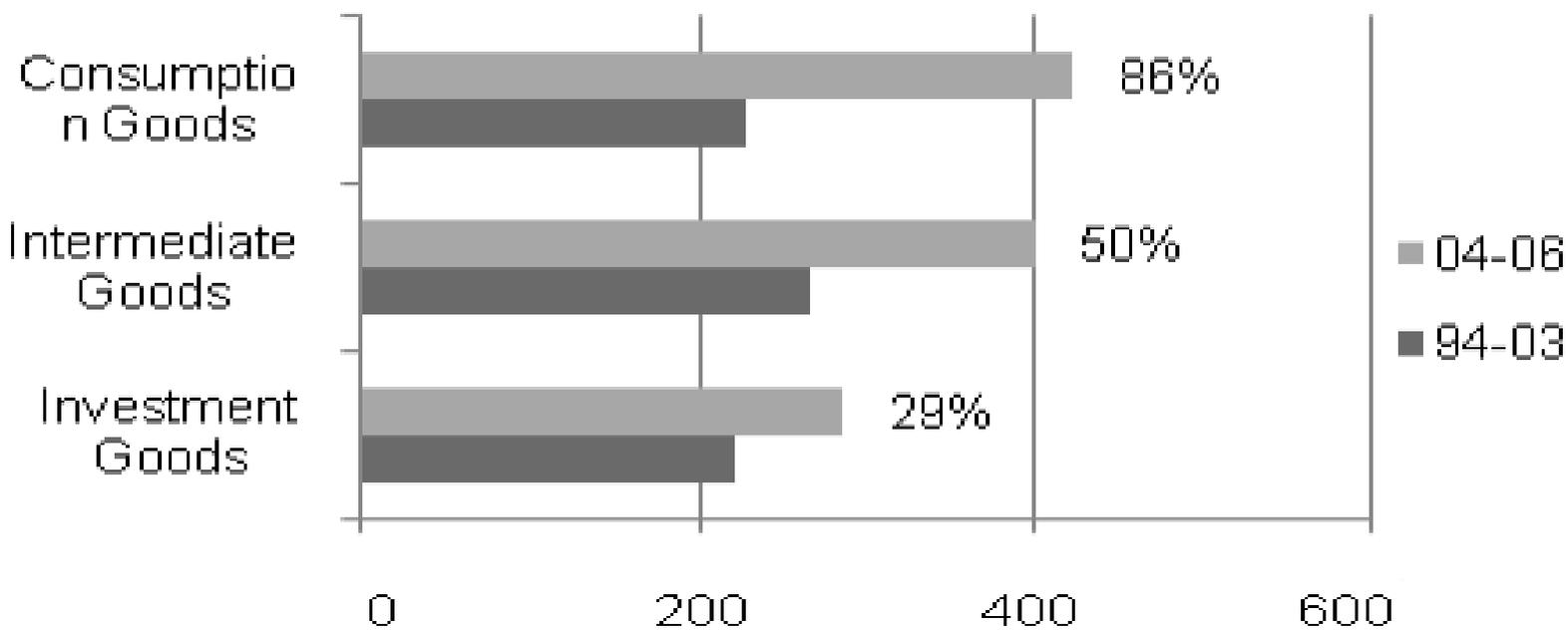


Outcomes: Growing imports



Growing imports that are skewed to consumption

Import composition (real USD 2005)



GDP and Sources of growth - 1

	Average 1989-2003	Average 2004-2009	Average 2010-2011
GDP (US\$ million)	1943	3459	5377
Exports, fob (US\$ million)	470	869	1417
Imports fob (US\$ million)	726	1599	2321
Trade ratios (% of GDP)			
Exports (fob)	24.7%	26.2%	29.8%
Imports (fob)	38.5%	46.4%	43.4%
Trade balance	-13.8%	-20.2%	-13.6%
Agriculture	5.0%	2.6%	1.1%
Mainlining, quarrying	0.1%	5.3%	18.5%
Manufacturing	1.1%	4.1%	1.0%
Electricity, water	2.7%	1.6%	3.4%
Constriction	0.7%	0.4%	16.0%
Distribution	1.0%	5.0%	1.8%
Transport, communication	0.9%	3.6%	5.1%
Financial professional	1.9%	2.0%	4.0%
Government Services	0.5%	1.1%	5.2%
Growth in GDP (factor costs)	4.1%	7.1%	5.5%

Pillars, Sources and Drivers of growth

- Nomenclature is important.
- ‘Pillars’ is used in this presentation in the same way it is used in the MGDS.
- Several ‘Sources of growth’ could be in one Pillar, e.g. Agriculture and manufacturing are both in the sustainable economic growth Pillar
- ‘Drivers’ are factors other than sectors, sources, or pillars that propel growth or change. These may be transmission mechanisms of economic forces or social and political factors, or policies that determine the direction and pace of change/growth

GDP and Sources of Growth - 2

GDP and sources of growth

	95	96	97	98	99	00	01	02	03	04	05	06	07
National Account (\$US m)													
GDP (\$US m)	1,925	3,149	3,669	2,451	2,447	2,402	2,365	2,665	2,425	2,625	2,755	2,917	3,324
Exports, fob (\$US m)	444	510	539	539	447	402	427	414	433	499	509	543	706
Imports, fob (\$US m)	508	588	697	497	573	460	471	595	684	810	1,006	1,055	1,182
Trade ratios (as percentage of GDP)													
Exports (fob)	23.1	16.2	14.7	22.0	18.3	16.7	18.0	15.5	17.9	19.0	18.5	18.6	21.2
Imports (fob)	26.4	18.7	19.0	20.3	23.4	19.2	19.9	22.3	28.2	30.9	36.5	36.2	35.6
Trade balance	-3.3	-2.5	-4.3	1.7	-5.1	-2.4	-1.9	-6.8	-10.3	-11.8	-18.0	-17.6	-14.3
Growth in GDP (factor cost)													
Growth in GDP (factor cost)	13.8	10.0	6.6	3.0	1.6	0.8	-3.9	1.9	3.9	5.1	2.2	8.6	9.2
Agriculture	9.8	7.8	0.0	5.3	1.6	2.0	-2.4	1.0	2.3	1.1	-3.5	4.3	3.5
Mining, quarrying	0.0	1.5	-0.4	0.1	0.0	0.1	0.1	-0.6	0.2	0.5	0.8	-0.5	0.0
Manufacturing	0.9	-0.1	0.1	0.2	0.2	-0.4	-1.8	0.0	0.4	0.8	0.9	0.7	1.0
Electricity, water	0.0	0.0	0.1	0.1	0.0	0.1	-0.1	0.1	0.0	0.1	0.1	0.1	0.1
Construction	0.1	0.2	0.1	0.0	0.3	0.0	-0.1	0.3	0.3	0.3	0.4	0.4	0.9
Distribution	0.6	-0.2	3.7	-1.6	-0.4	-0.1	0.2	0.3	-0.2	1.4	2.8	1.8	1.3
Transport, communications	0.9	-0.4	0.4	0.0	0.2	-0.2	0.1	0.6	0.4	0.4	0.5	0.4	1.3
Financial, professional	0.7	1.3	2.5	-0.7	0.0	0.2	-0.2	0.5	0.5	0.8	0.7	1.7	1.1
Ownership of dwellings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Government services	1.0	-0.3	0.2	-0.5	-0.2	-1.0	0.1	0.0	0.2	0.2	0.1	0.3	0.6

Source: NSO 1994 series of accounts. GDP is from 2002 series back-adjusted using the 1994 series rates of growth.

Historical drivers of growth- 1

(MCEM Study)

- A) Exports are important drivers of growth and hence the Exchange rate
 - Growth is primarily driven by the multiplier from real domestic export income
 - The real exchange rate determines the strength of the multiplier effect from exports, by translating US dollar export revenues into local purchasing power. The real exchange rate has remained overvalued for long and acted as a strong disincentive to invest in the tradeable sector or in import-substituting industrialization. It is important for Malawi to adopt more flexibility in the management of its currency. Improvements in the real exchange rate since 1980 have raised real export incomes and have been strongly beneficial to growth

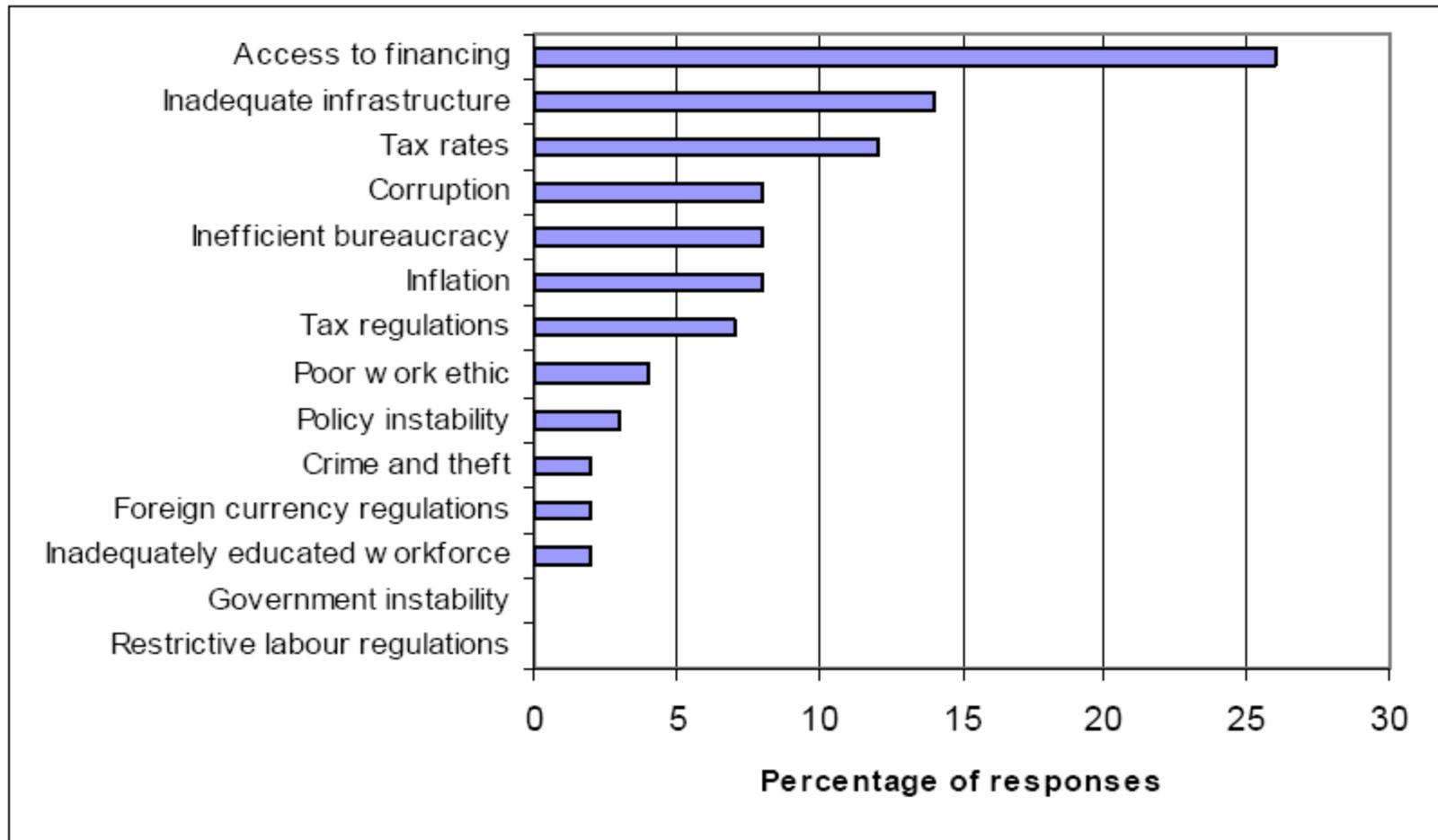
Historical drivers of growth -2

- B) Growth transmission has run from agriculture to non-tradeables and only minimally to domestic manufacturing. This is despite strong demand for consumer imports.
- C) Macroeconomic stability: between 1995 and 2003 instability suppressed investment through high inflation and cost of credit which prevented growth transmission, and this will be repeated now.

Historical drivers of growth -3

- **4). AID:** to the extent that public expenditure have driven growth, Aid has contributed. But the contribution has been as effective as the use of the pooled funds to which Aid contributed;
- The principal agent problem inherent in Aid relationships has generated an on/off pattern of policy-based lending and program Aid that is unsatisfactory. The use of conditionalities to promote complex reforms in this type of context almost always generates nominal compliance followed by non-implementation or worse.
- Sometimes reforms have failed both because the government was not really committed to them and because their design was not well grounded in the country reality..

Principle Factors Affecting the Business-Enabling Environment in Malawi



Source: World Economic Forum, Executive Opinion Survey 2004

Summary of factors impacting growth

- Droughts
- Exchange rate overvaluation
- Lack of export diversification
- Fuel prices; Terms of Trade
- Transport logistics and inefficient trade value chains
- Finance
- Education
- Energy shortages
- Leadership
 - Policy reversals, no commitment to rule based regulation based on evidence and market intelligence; performance of civil service
 - Culture and neo-patrimonialism in politics
 - Are second terms bad for growth?

Leadership is the silent dummy of the growth equation

- Like other countries of the region, Malawi has had a hybrid, 'neopatrimonial' state, where there is a framework of formal law and administration but the state has in the past been informally captured by patronage networks.
- Neopatrimonialism of the African variant has some distinguishing features, such as the 'big man syndrome'.
- ***The distribution of the spoils of office have taken precedence over the formal functions of the state, severely limiting the ability of public officials to make policies in the general interest.***

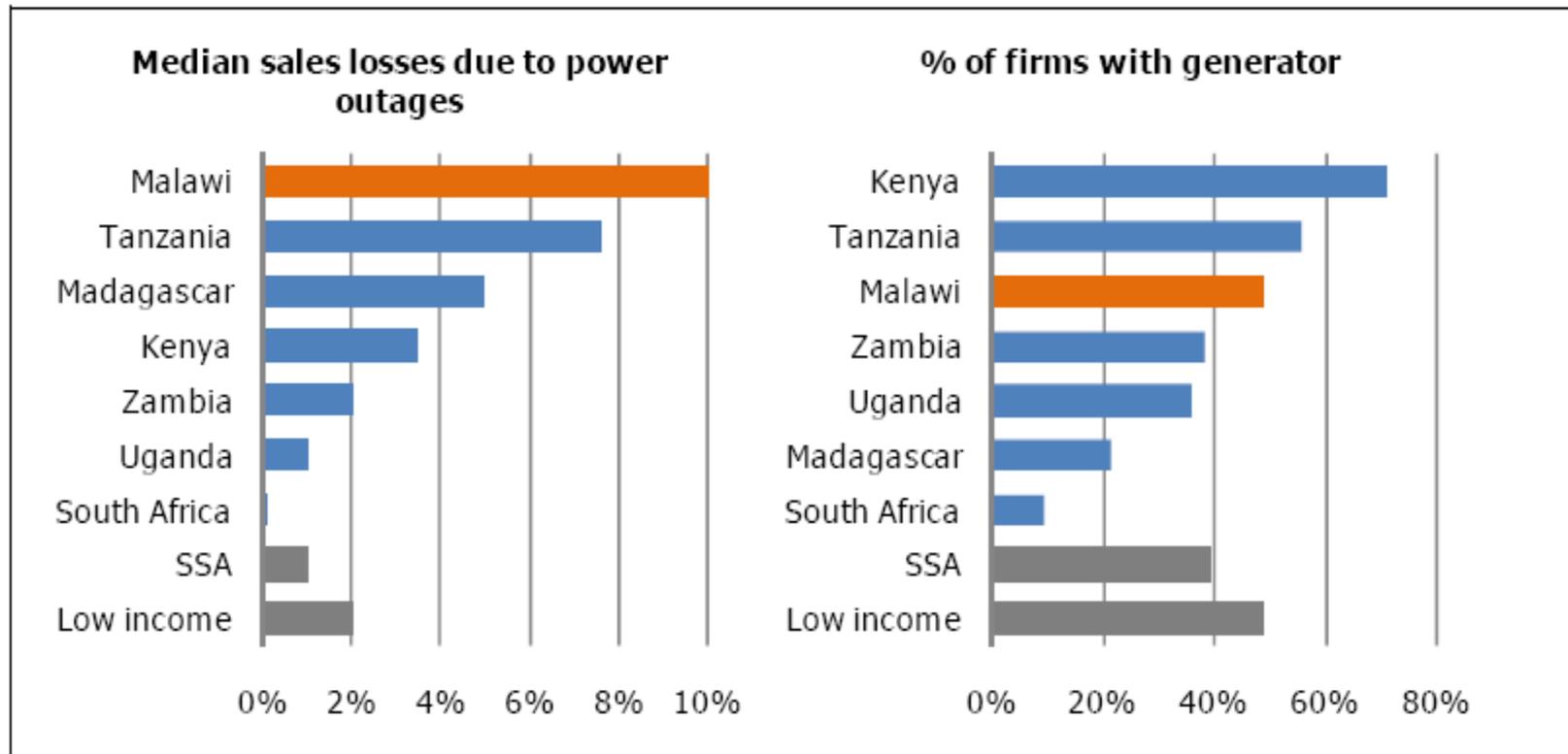
Neo-patrimonialism negatively influences investor climate

- Malawi badly needs a recovery of economic growth. However, the environment for long-term private investment – local or international – is badly affected by the political system.
- The pursuit of ‘money power’ by politicians has damaged the macro-economy and encouraged the sort of business ventures that are only profitable when competition is restricted.
- Local capitalists prefer quick-turnover operations in the service sector, and foreign investors stay out.
- Ethnic biases may also have discouraged some investors.

Policy reversals confuse economic agents

- There have been many policy reversals in the past e.g. Exchange rate:
- Feb 94-Nov 94 Floating
- Dec 94-June 97: Fixed
- July 97-July 2003 Flexible
- Aug03-Feb05 Fixed
- Mar05-Jun05 Flexible
- July05-Dec05 Fixed
- Jan06-Nov07 Flexible
- Dec07-April12 Fixed with occasional devaluation
- May 2012: Devaluation and floating

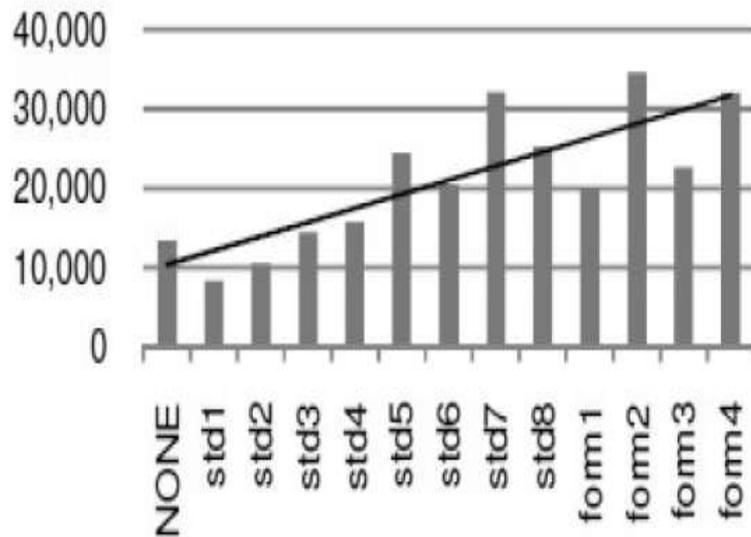
Sales losses due to power outages



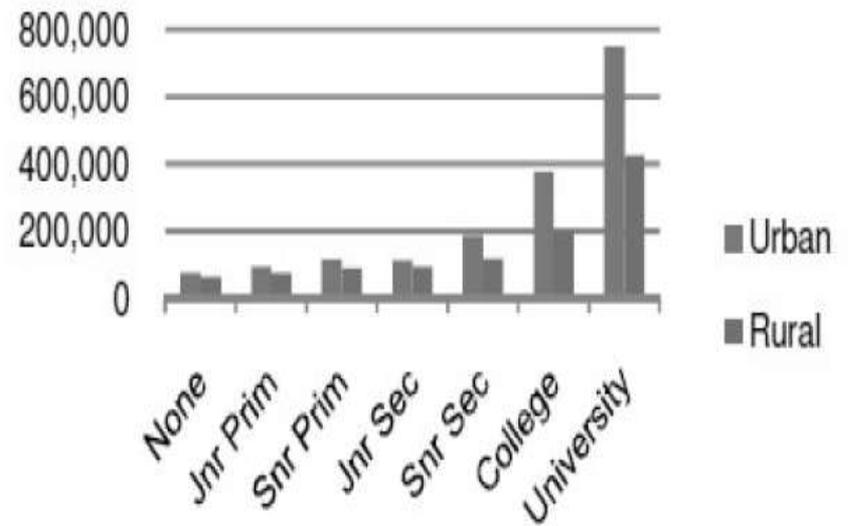
Source: Malawi Investment Climate Assessment, 2006

Is growth constrained by Education?

Average sales of tobacco

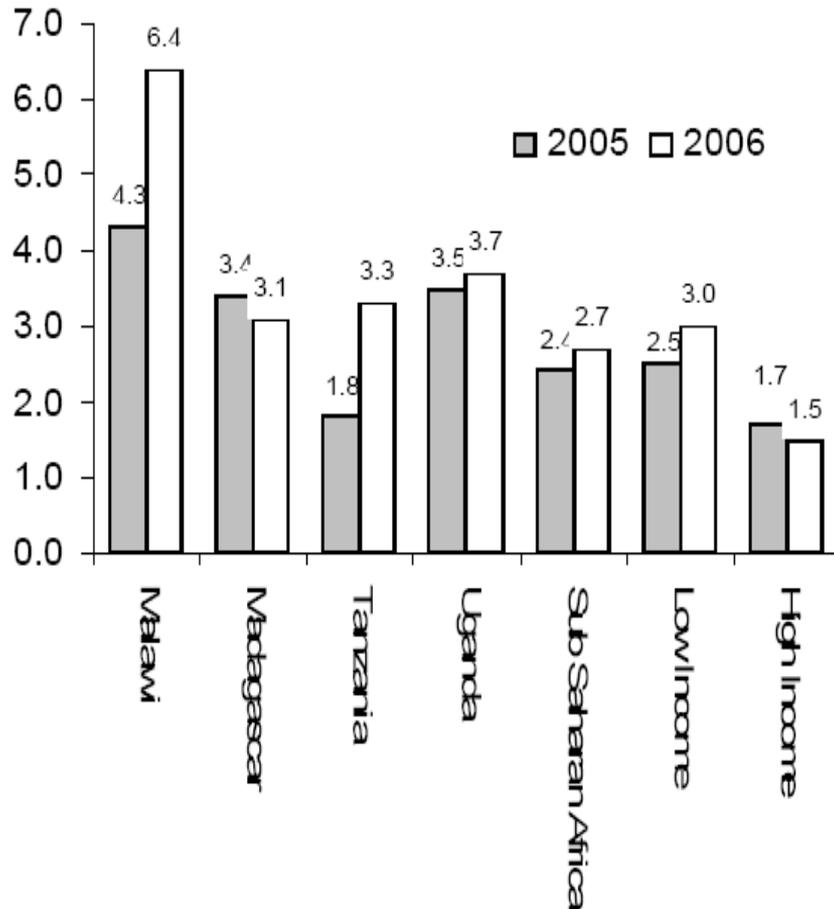


HH Expenditure by education level



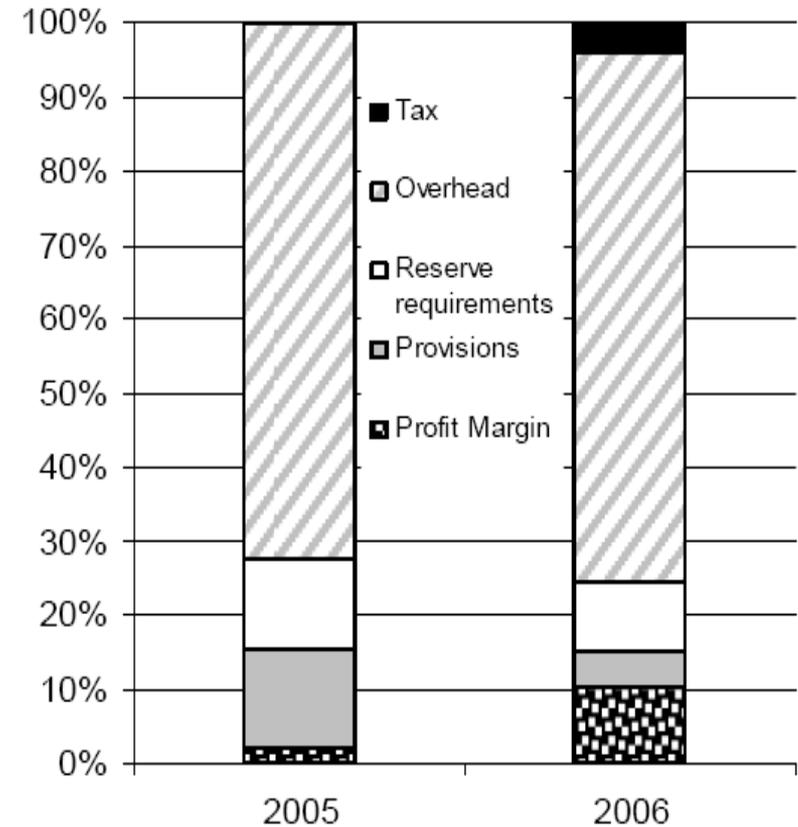
Structural Issues in the Financial Sector

Return on average assets across countries



Source: FSAP (2008)

Decomposition of Malawi's interest margin



Source: FSAP (2008)

Determinants of Transport costs for farmers

<i>Dependent variable:</i>	ln(tobacco transport costs)			
<i>Estimation</i>	OLS, with IHS2 sampling weights			
<i>Sample</i>	all tobacco farmers in IHS dataset			
<i>ln(transport volume)</i>	0.815*** (0.029)	0.800*** (0.029)	0.812*** (0.030)	0.804*** (0.030)
<i>ln(transport distance)</i>	0.150*** (0.024)	0.139*** (0.025)	0.148*** (0.031)	0.152*** (0.033)
<i>ln(% of unpaved to nearest town)</i>		0.032** (0.013)		0.014 (0.014)
<i>ln(road traffic volume, ADT)</i>			-0.066*** (0.018)	-0.061*** (0.020)
<i>Observations</i>	970	920	825	793
<i>R-squared</i>	0.646	0.637	0.665	0.656

Note: 1 Robust Standard errors in parentheses

2.* Significant at 10%, ** significant at 5%, *** Significant at 1%

Source: CEM Vol.1 Report No. 47969-MW (2010)

Lessons for going forward:

Drivers of Change

- Policy consistency; and sticking to a long-term vision;
- Strong leadership, able to discipline and coordinate both donors and different arms of government in line with the vision;
- Proper prioritization of objectives and resource allocation;
- Improved performance of the civil service.
- A strong parliament not captured by neo-patrimonialism

Going Forward: Seeking sustainable growth

1. Focused/consistent implementation of the ERP
 - SMART Action plan and strong M&E
 - Evaluation of MGDS II shows that M&E systems are not well institutionalized
 - Policy consistency/evidence and rule based regulation
 - Increased use of policy analysis
 - Prioritizing public expenditures
 - Export led growth:
 - Quickly improve doing business indicators and also the non-traditional indicators
 - Make the ERP consistent with the NES on:
 - Targets of export receipts
 - Approach to export promotion and timelines
 - Prioritized sectors/sub-sectors

Jump start an export diversification and promotion program

a) Strong culture of exporting

Shifting mindset of everybody, particularly
politicians

morally/politically

a) Implement the NES

Objectives of the NES

- For long-term export trend to match long-term import trend
- NES broader than just exporting nuts to UK or Toor Dhal to India
- NES provides strategic focus & plan to build economy through **inclusive growth**
- Complements the Economic Recovery Plan & MGDS II
- Plan for:
 - short-term cash cows
 - medium to long-term growth clusters & target markets
 - ensures **alignment** between short-term & long-term
 - **road map** to develop productive base in medium to long-term

NES Targets exports and projected imports

	Value, US\$ million						As a share of imports						Compound Annual Growth Rate				
	2001	2010	2011*	2017	2022	2027	2001	2010	2011*	2017	2022	2027	2001-2011**	2011-2017**	2017-2022	2022-2027	
Total Imports	\$733	\$2,299	\$1,126*	\$3,248	\$4,352	\$7,679	100%	100%	100%	100%	100%	100%	13.5%	9.0%	6.0%	12.0%	
Total Exports	\$475	\$1,184	\$1,192	\$2,460	\$4,067	\$6,824	64.8%	51.5%	106%*	75.7%	93.4%	88.9%	9.3%	12.8%	10.6%	10.9%	
<i>Exports of major clusters:</i>																	
Tobacco	262	585	556	699	699	771	35.7%	25.5%	49.3%	21.5%	16.1%	10.0%	7.8%	3.0%	0.0%	2.0%	
Mining	0	114	123	246	369	493	0.0%	5.0%	10.9%	7.6%	8.5%	6.4%	n/a	12.2%	8.4%	5.9%	
Tea	35	81	81	135	206	314	4.7%	3.5%	7.2%	4.1%	4.7%	4.1%	8.8%	8.8%	8.8%	8.8%	
Services (exc. Travel)	9	61	71	169	348	716	1.2%	2.6%	6.3%	5.2%	8.0%	9.3%	23.3%	15.5%	15.5%	15.5%	
Oil Seed Products	10	41	71	227	599	995	1.4%	1.8%	6.3%	7.0%	13.8%	13.0%	21.4%	21.4%	21.4%	10.7%	
Sugar Cane Products	64	69	71	453	768	1136	8.7%	3.0%	6.3%	13.9%	17.6%	14.8%	1.1%	36.1%	11.1%	8.1%	
Tourism (Travel)	25	70	70	147	272	503	3.5%	3.1%	6.2%	4.5%	6.2%	6.5%	10.7%	13.1%	13.1%	13.1%	
Manufactures, of which	17	77	26	197	502	1376	2.3%	3.4%	2.3%	6.1%	11.5%	17.9%	4.8%	39.8%***	20.5%	22.3%	
Beverages	0.2	2	0.1	11	28	64	0.0%	0.1%	0.0%	0.3%	0.6%	0.8%	-3.9%	22.8%	20.8%	17.8%	
Agro-Processing	6	39	12	100	295	874	0.8%	1.7%	1.1%	3.1%	6.8%	11.4%	8.2%	13.2%	24.2%	24.2%	
Plastics & Packaging	2	22	4	39	74	169	0.3%	1.0%	0.3%	1.2%	1.7%	2.2%	6.9%	9.9%	13.9%	17.9%	
Assembly	9	14	10	48	104	269	1.2%	0.6%	0.9%	1.5%	2.4%	3.5%	1.4%	12.9%	16.9%	20.9%	
Other	53	85	122	186	304	520	7.3%	3.7%	10.8%	5.7%	7.0%	6.8%	8.6%	7.3%	10.3%	11.3%	

Income Approach vs Safety first approach to food security

- a) *Diversifying within agriculture – 5 tenets for increasing agriculture production and rural incomes through managing risks*
- i. Expanded program of irrigation development to manage weather risks
 - ii. Vertical coordination of agriculture sub-sectors to manage price risk (through farmer organizations and price guarantee)
 - iii. Commitment to rule based regulation based on evidence and market information to manage market risks
 - iv. Efficient input, credit and extension supply systems to manage productivity risks
 - v. Efficiently managed grain reserves and food markets to mitigate food security risk

Good Governance and a Vibrant Culture

- Contain patrimonialism, corruption, nepotism etc
- Move to performance based management of the public service
- Develop a SWAp for a vibrant culture!
 - Social mobilization:
 - sing and act the 3rd verse of the national anthem
 - Visions, and plans and required cultural changes should be taught in schools
 - Create and popularize a Bill of Responsibilities of a Malawian based on say the 3rd stanza of the national anthem
- Legislate for good governance and values (e.g. secure inheritance rights] supportive of creating a middle income class