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Economic Performance Assessment: Malawi

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Economic Performance Assessment: Malawi

Sponsored by the Economic Growth office of USAID's Bureau of Economic Growth, Agriculture and Trade (EGAT), and implemented by Nathan Associates Inc. under Contract No. PCE-I-00-00-00013-00, Task Order 004, the Country Analytical Support (CAS) Project, 2005-2006, is developing a standard methodology for producing analytical reports that will provide USAID missions and regional bureaus with a clear and concise analysis of economic growth performance for particular host countries. The aim is to help USAID officials gain a clear picture of the host economy, as an input into the identification of possible strategic priorities for Economic Growth program interventions. Under the CAS Project, Nathan Associates will also respond to mission requests for in-depth sector studies to examine more thoroughly particular issues identified by the data analysis in the country reports. The CTO for this project is Yoon Lee. USAID missions and bureaus may seek assistance and funding for these activities by contacting Rita Aggarwal, USAID/EGAT/EG Activity Manager for the CAS project, at raggarwal@usaid.gov.

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This Economic Performance Assessment for Malawi is one in a series of papers that will provide USAID missions and regional bureaus with a concise analysis of selected indicators relating to economic growth prospects for particular host countries. The assessment uses international benchmarking to identify major constraints, trends, and opportunities for strengthening transformational growth and poverty reduction. *Primary performance indicators* are examined to establish how the country is performing in a particular area. Where performance is weak, *secondary indicators* are examined to diagnose the source of the problem.

The data analysis for Malawi reveals serious problems in numerous areas, and few signs of healthy performance. Overall, Malawi urgently needs to follow through on recent efforts to strengthen macroeconomic management, as a starting point, and to take serious steps toward further improvement of the enabling environment for private sector development. This will entail deeper reforms, control of corruption, infrastructure investment, and better health and education programs, within the limits set by very scarce resources.

Highlights are summarized in the table on the next page, followed by a scorecard, which lists the primary indicators for which Malawi's performance is very weak or very strong relative to the benchmark standards.

IMF Program Status. Because of problems with macroeconomic management in recent years, Malawi has not qualified for a Poverty Reduction and Growth Facility from the IMF. Instead, the country has been under a Staff Monitored Program. In July, 2004, the new government requested IMF assistance to put their economic fiscal and monetary policies back on a sustainable path. According to a recent IMF press release (March 3, 2005), the Government of Malawi has made good progress in "demonstrating its commitment to sound macroeconomic policies." Discussions are underway to reestablish a PRGF arrangement.

Economic Growth	Overall growth performance has been poor, signaling fundamental problems with the enabling environment for private sector development.
Poverty	Poverty remains severe and pervasive. The latest data is from 1998. It shows that 65% of the people were living in poverty. There is no evidence that this has changed materially.
Gender	The gender differential in adult literacy is extremely high, though great progress has been made in raising female school enrollment.
Fiscal and Monetary Policy	Macroeconomic performance has been fraught with excessive spending, unsustainable budget deficits, and inflationary growth of the money supply. *Thus, a cornerstone for rapid growth has not been in place*. Recent steps to improve macroeconomic policy must be sustained.
Business Environment	Though institutional indicators for Malawi are comparable to benchmark values, there is a huge need to tackle corruption and ample room to reduce institutional impediments to doing business.
Financial Sector	The financial sector is extremely underdeveloped and inefficient in mobilizing and intermediating saving.
External sector	Malawi is a relatively open economy, but it is not reaping the benefits. Exports are highly concentrated in a few primary products, and export growth is very weak. The country is attracting very little Foreign Direct Investment. The current account deficit is extremely high, and foreign exchange reserves are dangerously depleted.
Economic infrastructure	Basic infrastructure needed to support growth is comparable to benchmark countries, but very deficient in absolute terms.
Health	Maternal mortality is extremely high, and life expectancy has declined to one of the world's lowest levels due to HIV/AIDS. Poor health of the population and labor force is both a result of poverty, and a cause of poor growth.
Education	The government scores well in improving primary enrollment rates. The quality of education is difficult to judge from available international indicators, but it is clearly a major problem.
Employment and Workforce	The labor force is growing rapidly, creating an urgent need for jobs and income opportunities. Legal constraints to employment are relatively low, but job creation will be stuck in low gear without more investment.
Agriculture	Growth in agriculture has been moderately good. Given the critical importance of this sector to the economy, much stronger performance is needed to make visible inroads against poverty. In the medium to long run, transformational growth and poverty reduction will depend on thriving non-agricultural activities, more so than improvements in agriculture itself.

MALAWI PERFORMANCE SCORECARD

	Actual Value	Benchmark Value	Latest Year of Data
INDICATORS SHOWING POOR PERFORMANCE			
Growth Performance			
Per capita GDP, $PPP	643	1,698	2004
Per capita GDP, current US$	165	533	2004
Real GDP Growth, % change (five-year average)	1.4	4.6[a]	2003
Poverty and Inequality			
Population living on less than $1 PPP per day, %	42.0	26.1	1997
Poverty headcount, by national poverty line, %	65.3	38.0	1997
Gender			
Ratio of male to female adult literacy rate	1.6	1.5[b]	2002
Fiscal and Monetary Policy			
Government expenditure, % GDP	42.4	17.1	2003
Growth in the money supply, % change	29.3	20.5[a]	2003
Inflation Rate, %	19.9	9.4[a]	2004
Overall govt. budget balance, including grants, %GDP(five-year average)	-7.5	0.5	2004
Business Environment			
Corruption Perception Index	2..8	3.0[b]	2004
Financial Sector			
Domestic credit to private sector, % GDP	7.8	11.8	2003
Interest rate spread, lending rate minus deposit rate	23.8	14.1[a]	2003
Money supply, % GDP	19.4	25.6	2003
Real interest rate, %	39.3	12.3	2003
Stock market capitalization rate, % GDP	9.2	47.2	2001
External Sector			
Current account balance, % GDP	-10.6	-6.9	2002
Foreign direct investment, % GDP	0.3	4.1	2002
Gross international reserves, months of imports	2.4	3.0[b]	2002
Growth in exports of goods and services, (5-year average)	1.5	3.9	2003
Remittance receipts, % exports	0.2	11.6	2002
Economic Infrastructure			
Internet users per 1000 people	3.4	10.3	2003
Telephone density, fixed & mobile subscribers per 1000	15.2	32.6	2002
Health			
HIV Prevalence, %	14.2	6.6	2003
Life expectancy at birth, years	37.5	47.0	2002
Maternal mortality rate, deaths per 1000	18.0	9.3	2002

	Actual Value	Benchmark Value	Latest Year of Data
INDICATORS SHOWING GOOD PERFORMANCE			
Fiscal and Monetary Policy			
Government revenue, % GDP	22.8	15.4	2003
Education			
Net primary enrollment ratio, %	81.0	46.9	2001
Employment and Workforce			
Rigidity of employment index (0 – 100)	21.0	57.3	2002

Note: The benchmark standard is the average for low-income sub-Saharan Africa, except as follows: [a] Estimated value from benchmark regression analysis; [b] Performance determination based on absolute criteria.

1. Introduction

This paper is one of a series of Economic Performance Assessments (EPAs) prepared on behalf of the EGAT Bureau to provide USAID missions and regional bureaus with a concise analysis of selected economic growth (EG) performance indicators for particular host countries. The aim is to help USAID missions gain a clear picture of the host economy, as an input into the identification of possible strategic priorities for EG program interventions. The review uses international comparisons ("benchmarking") to highlight major constraints, trends, and opportunities in areas such as macroeconomic management, trade policy, financial markets, the legal and regulatory environment, agricultural development, and others enumerated below. The analysis draws on the latest data from USAID's internal Economic and Social Database (ESDB)[1] and from readily accessible public information sources.

The approach used here is analogous to examining an automobile dashboard to see which gauges are signaling problems. A blinking light sometimes has obvious implications—such as the need to fill the fuel tank when the indicator shows that the tank is low. In other cases, it is necessary to have a mechanic probe more deeply to assess the source of the trouble and discern the best course of action.[2] The EPA, similarly, is based on an examination of key economic and social indicators. For some of the issues where indicator lights are blinking, a detailed study may be needed to investigate the problems more fully and identify appropriate programmatic interventions.

ANALYTICAL FRAMEWORK

The analysis is organized around two interrelated and mutually supportive goals: transformational growth and poverty reduction.[3] Rapid and broad-based growth is the most powerful instrument for poverty reduction. At the same time, measures to invest in human capital, reduce poverty, and lessen inequality help to underpin rapid and sustainable growth. These interactions create the potential for a virtuous cycle of economic transformation and human development.

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[1] The ESDB is accessible through the USAID intranet. It is compiled and maintained by the Development Information Service (DIS), under PPC/CDIE.

[2] Sometimes, too, the problem is faulty wiring to the indicator—analogous here to faulty data.

[3] In USAID's White Paper on *U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century* (January 2004), transformational growth is a central strategic objective, both for its innate importance as a development goal, and because growth is the most powerful engine for poverty reduction.

Transformational growth requires a high level of investment and rising productivity. This is achieved by establishing a strong ***enabling environment for private sector development***, involving multiple elements: macroeconomic stability; a sound legal and regulatory system, including secure contract and property rights; effective control of corruption; a sound and efficient financial system; openness to trade and investment; sustainable debt management; investment in education, health, and workforce skills; infrastructure development; and sustainable use of natural resources.

The impact of growth on poverty depends on policies and programs that create opportunities and build capabilities for the poor. We call this the ***pro-poor growth environment***.[4] Here, too, many elements are involved, including effective education and health systems; a strong commitment to fighting HIV/AIDS; policies facilitating job creation; agricultural development (in countries where the poor depend predominantly on farming); dismantling barriers to micro and small enterprise development; and progress toward gender equity.

CRITERIA FOR SELECTING INDICATORS

The scope of the paper is constrained by the availability of suitable indicators. Indicators have been chosen to balance the need for broad coverage and diagnostic value, on the one hand, and the need of brevity and clarity, on the other. The analysis covers 15 EG-related topics, and just over 100 variables. For the sake of brevity, the write-up highlights issues for which the "dashboard lights" appear to be signaling serious problems, which suggest possible strategic priorities for USAID intervention. An accompanying Data Supplement provides a full list of indicators, along with the complete Malawi data set, including data for the benchmark comparisons, and technical notes for every indicator.

For each topic, the analysis begins with a screening of *primary performance indicators*. These "level I" indicators are selected to answer the question: Is the country performing well or not in this area? The set of primary indicators also includes descriptive variables such as per capita income, the poverty head count, and the age dependency rate.

In areas of weak performance, the analysis proceeds to review a limited set of *diagnostic supporting indicators*. These "level II" indicators provide more details about the problem or shed light on *why* the primary indicators may be weak. For example, if economic growth is poor, one can examine data on investment and productivity as diagnostic indicators. If a country performs poorly on educational achievement, as measured by the youth literacy rate, one can examine determinants such as expenditure on primary education, and the pupil-teacher ratio.[5]

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[4] A comprehensive poverty reduction strategy also requires programs to reduce the *vulnerability* of the poor to natural and economic shocks. This aspect is not covered in the template since the focus is on economic growth programs. Also, it is difficult to find meaningful and readily available indicators of vulnerability to use in the template

[5] Deeper analysis of the topic using more detailed data (level III) is beyond the scope of papers in this series.

Particular indicators have been selected on the basis of several criteria. Each indicator must be accessible through USAID's Economic and Social Database or convenient internet sources. The indicators must be available for a large number of countries, including most USAID client states. Each one must be sufficiently timely to support an assessment of country performance that is suitable for strategic planning purposes. Data quality is another paramount consideration. For example, subjective survey responses are used only when actual measurements are not available. Aside from a few descriptive variables, the indicators must also be useful for diagnostic purposes. Preference is given to measures that are widely used, such as Millennium Development Goal indicators, or evaluation data used by the Millennium Challenge Corporation. Finally, redundancy is minimized. If two indicators provide similar information, one is selected, with preference to variables that are simplest to understand. For example, both the Gini coefficient and the share of income accruing to the poorest 20% of households can be used to gauge income inequality. We use the income share because it is simpler, and more sensitive to changes.

BENCHMARKING METHODOLOGY

Comparative benchmarking is the main tool used to evaluate each indicator. The analysis draws on several criteria, rather than a single mechanical rule. The starting point is a comparison of performance in Malawi relative to the average for countries in the same income group and region —in this case, low-income countries in sub-Saharan Africa (hereafter "LIC-Africa").[6] For added perspective, three other comparisons are examined: (1) the global average for this income group; (2) respective values for two comparator countries selected by the Malawi mission (Uganda and Mozambique); and (3) the average for the five best and five worst performing countries globally. Most comparisons are framed in terms of values for the latest year of data from available sources; in cases where year-to-year fluctuations are large, five-year averages are used. Five-year trends are also taken into account if they shed light on the performance assessment.[7]

For selected variables, a second source of benchmark values uses statistical regression analysis to establish an expected value for the indicator, controlling for income and regional effects.[8] This approach has three advantages. First, the benchmark is customized to Malawi's specific level of income. Second, the comparison does not depend on the exact choice of reference group. Third, the methodology allows one to quantify the margin of error and establish a "normal band" for a

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[6] Income groups as defined by the World Bank for 2004. For this study, the average is defined in terms of the mean; future studies will use the median instead, because the values are not distorted by outliers.

[7] The five-year trends are computed by fitting a log-linear regression line through the data points. The alternative of computing average growth from the end points produces aberrant results when one or both of those points diverges from the underlying trend.

[8] This is a cross-sectional OLS regression using data for all developing countries. For any indicator, Y, the regression equation takes the form: Y (or ln Y, as relevant) = a + b * ln PCI + c * Region + error – where PCI is per capita income in PPP$, and Region is a set of 0-1 dummy variables indicating the region in which each country is located. Once estimates are obtained for the parameters a, b and c, the predicted value for Malawi is computed by plugging in Malawi-specific values for PCI and Region. Where applicable, the regression also controls for population size and petroleum exports (as a percentage of GDP).

country with Malawi's characteristics. An observed value falling outside this band on the side of poor performance signals a serious problem.[9]

Finally, where relevant, Malawi's performance is weighed against absolute standards. For example, Malawi's inflation rate averaged 20% over the past five years. Regardless of the regional comparisons or regression results, this is a sign of serious economic mismanagement.

The results of this exercise must be interpreted with caution. No analysis of this sort can provide mechanical or definitive answers to questions about strategic priorities. For some topics, such as macroeconomic policy, it is easy to find fairly clear diagnostic indicators. For others, such as the quality of economic infrastructure, international statistics tell a very incomplete story. The aim is to identify signs of serious economic growth problems based on a systematic review of a variety of indicators, subject to the limits of data availability and quality, and thereby provide analytical insight into possible priorities for USAID interventions. On-the-ground knowledge and further in-depth studies are required to supplement this broad-strokes analysis.

The remainder of this report discusses the most important results of the diagnostic analysis. The review is presented in three sections: Overview of the Economy; Private Sector Enabling Environment; and Pro-Poor Growth Environment. Table 1-1 summarizes the topic coverage.

Table 1
Topic Coverage

Overview of the Economy	Private Sector Enabling Environment	Pro-Poor Policy Environment
• Growth Performance • Poverty and Inequality • Economic Structure • Demographic and Environmental Conditions • Gender	• Fiscal and Monetary Policy • Business Environment • Financial sector • External sector • Economic Infrastructure • Science and Technology	• Health • Education • Employment and Workforce • Agriculture

[9] This report uses a margin of error of 0.66 times the standard error of estimate (adjusted for heteroskedasticity, where appropriate). With this value, 25% of the observations should fall outside the normal range on the side of poor performance (and 25% on the side of good performance). Some regressions produce a very large standard error, giving a "normal band" that is too wide to provide a discerning test of good or bad performance.

2. Overview of the Economy

This section reviews basic information on Malawi's macroeconomic performance, economic structure, demographic and environmental conditions, poverty and inequality, and indicators of gender equity.[10] Some of the indicators are descriptive rather than analytical, and are included to provide context for the performance analysis.

GROWTH PERFORMANCE

With an estimated per capita GDP of just $165 in 2004 (or $643 in terms of purchasing power parity), Malawi remains one of the poorest countries in the world. The need for rapid and sustained economic growth is acute. Yet over the past five years, growth has averaged just 1.2 percent per year, never exceeding 4.0 percent. This is well below average for LIC-Africa and far less than the standard achieved by Uganda and Mozambique (Figure 2-1). In absolute terms, growth is far too low to deliver improved standards of living or adequate income opportunities for a population that is growing by 2.1 percent per year. Visible signs of progress towards prosperity require sustained and broad-based growth of no less than 5 percent.

The proximate cause of low growth is no mystery: both investment and productivity growth are very weak. Gross fixed investment, at 9.5 percent of GDP, is alarmingly low by any standard (Figure 2-2). Looking at the private sector, alone, gross fixed investment has been nearly zero according to IMF estimates. In addition, there has been virtually zero growth in productivity of the labor force. (Figure 2-3) Capital productivity is likewise poor: the incremental capital-output ratio shows that nearly $10 of gross investment has been undertaken per dollar of extra output—twice the average for LIC-Africa, and more than triple the capital requirement for output growth in Uganda. (Figure 2-4).

Poor growth performance is the central economic challenge facing the government and the donor community. Major factors contributing to low investment, low productivity, and low growth are examined in section 3, on the enabling environment, and discussions in section 4 on human capital development. One vital question that must be asked, though the issue is beyond the scope of this paper, is whether the political foundation exists in Malawi for achieving rapid growth. Is there the political will for sound economic policies and institutions? Is there an effective constituency for effective pro-growth policies? How can these be strengthened?

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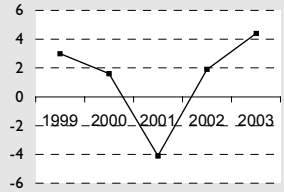
[10] The Data Supplement provides a full tabulation of the data for Malawi and the international benchmarks, including indicators not discussed in the text technical notes for each indicator.

Figure 2-1

Real GDP growth, percent

11p3

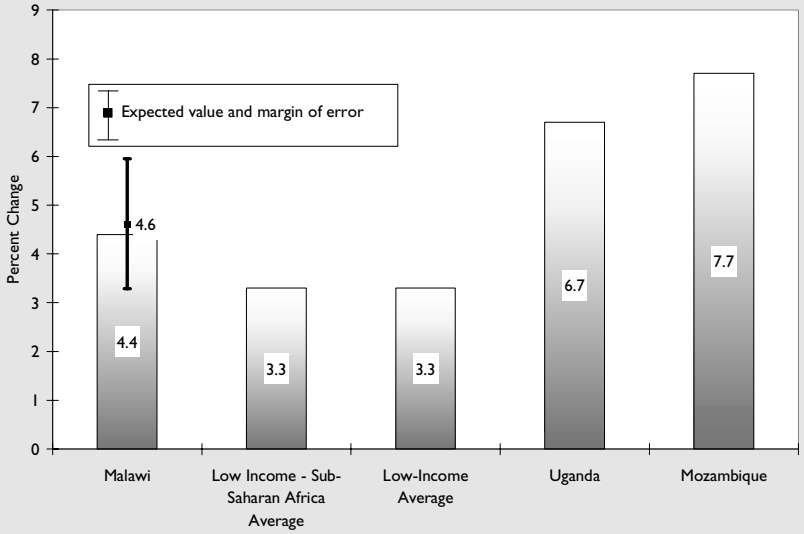
Time series



Year	Value
1999	3.0
2000	1.6
2001	-4.1
2002	1.9
2003	4.4
Summary for 1999 – 2003	
Five year average	1.4
Trend growth rate	N/A

Top-five average: 14.
Bottom-five average: -12.5.

Comparisons to other countries, most recent year



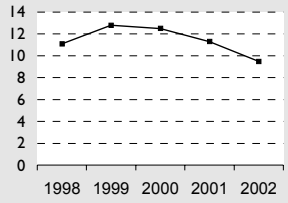
Source: Latest Malawi data from IMF Article IV Review available at www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators (NY.GDP.MKTP.KD.ZG) for benchmark and Malawi older time-series data;

Figure 2-2

Gross fixed investment in GDP, percent

11s3

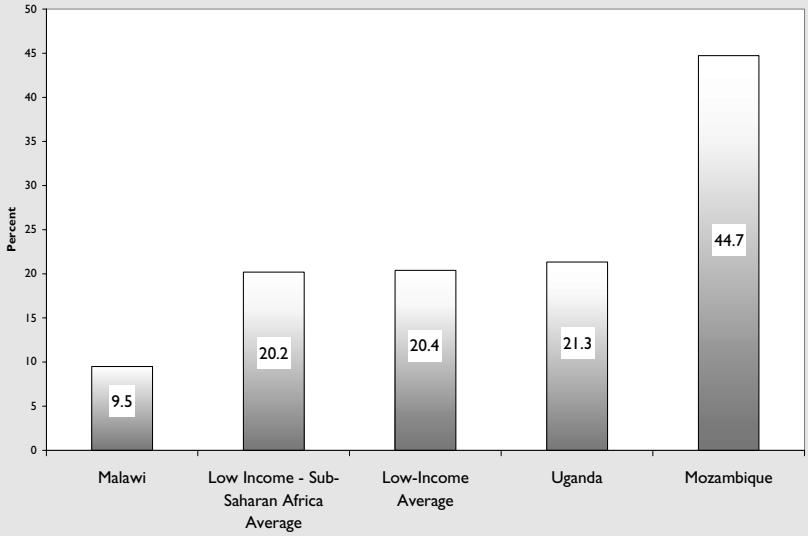
Time series



Year	Value
1998	11.1
1999	12.8
2000	12.5
2001	11.3
2002	9.5
Summary for 1998 - 2002	
Five year average	11.4
Trend growth rate	-4.2

Top-five average: 46.6.
Bottom-five average: 6.9.

Comparisons to other countries, 2002



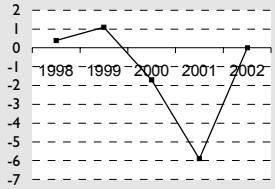
Source: IMF Article IV Consultation Report for latest Malawi data; benchmark and older time-series Malawi data from the World Development Indicators. (NE.GDI.FTOT.ZS)

Figure 2-3

Growth of labor productivity, percent change

11s1

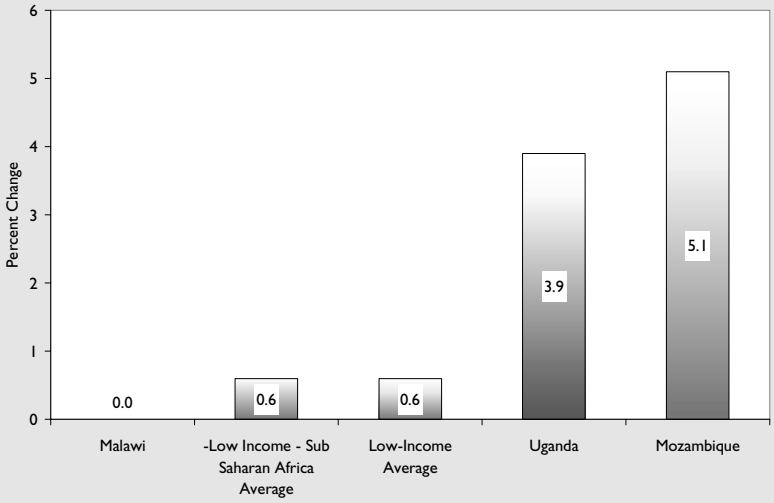
Time series



Year	Value
1998	0.4
1999	1.1
2000	-1.7
2001	-5.9
2002	0
Summary for 1998 - 2002	
Five year average	-1.2
Trend growth rate	N/A

Top-five average: 11.4.
Bottom-five average: -14.8.

Comparisons to other countries, 2002



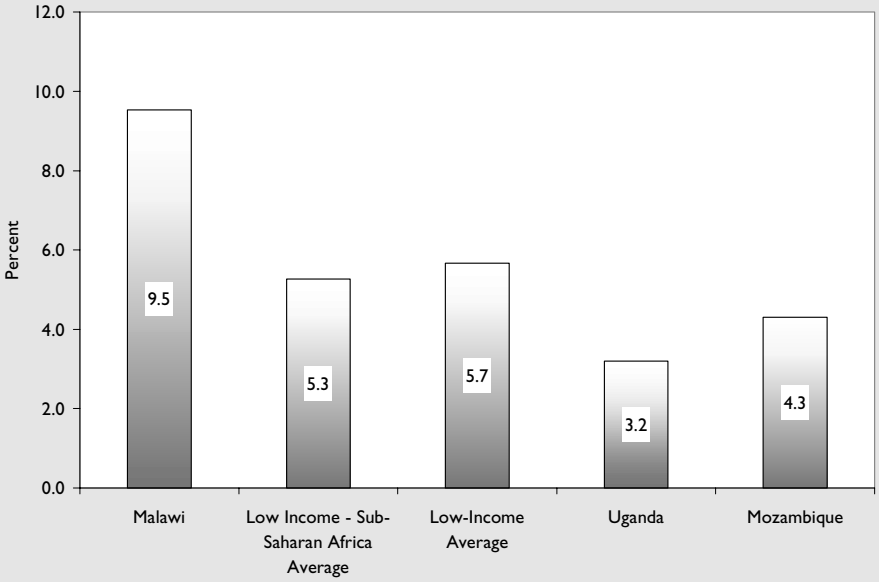
Source: World Development Indicators. Estimated by calculating annual percentage change of the ratio of GDP (constant 1995 US$) (NY.GDP.MKTP.KD) to the total population ages 15-64, (SP.POP.1564.TO).

Figure 2-4

Investment Productivity – Incremental capital-output ratio, percent

11s2

Comparisons to other countries, 2002

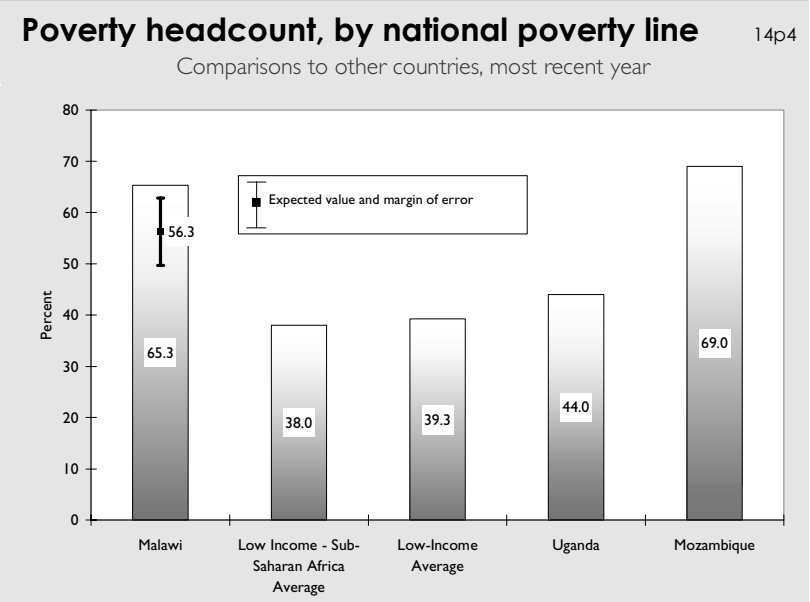


Source: Malawi data computed from IMF Article IV Consultation Report; international benchmark data computed from the World Development Indicators. It is the ratio of the five-year average of the share of fixed investment (NE.GDI.FTOT.ZS) and the five-year average of GDP growth (NY.GDP.MKTP.KD.ZG).

POVERTY AND INEQUALITY

As the income data suggest, poverty in Malawi is severe. The latest hard data on poverty are derived from a national household survey in 1997, which showed that 65 percent of the people live below the national poverty line. An estimated 41 percent struggle to survive on less than $1 per day measured in terms of international purchasing power parity—the international standard for absolute poverty. These poverty rates are much higher than average for LIC-Africa. (Figure 2-5) Given Malawi's poor growth performance in recent years, it is unlikely that the situation has improved materially since 1997. The UNDP's Human Poverty Index provides a broader gauge of poverty, taking into account access to basic education and safe water, as well as income poverty. For 2004, this index shows 47% of the population living in a condition of deprivation—slightly above the average for LIC-Africa (Figure 2-6). Another sign of deep poverty is the adult illiteracy rate of 62 percent.

Figure 2-5

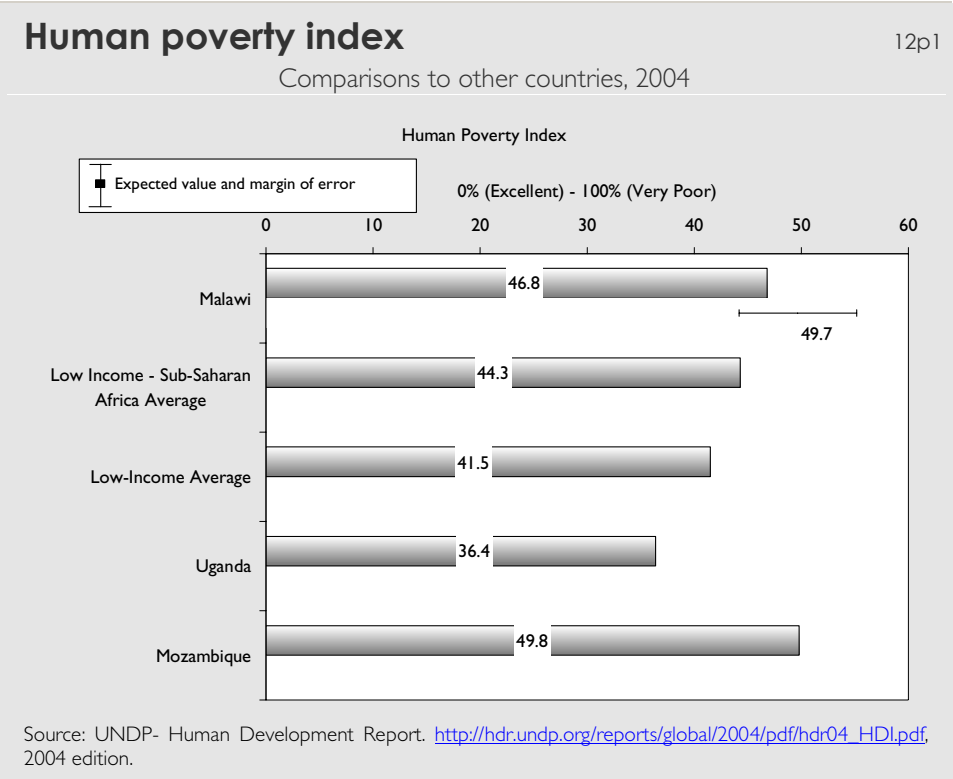


Source: World Development Indicators, (SI.POV.NAHC), original data from national surveys.

Inequality of income is also a serious problem. With reference again to the 1997 household survey, just 4.9 percent of total household income accrued to the poorest 20 percent. This is only slightly below the main benchmarks, yet Uganda has shown that rapid growth can be combined with a much larger income share for the poor (8.8 percent) through a strategy that boosts earnings for small farmers.

The Malawi government has taken steps to address the poverty problem by completing a Poverty Reduction Strategy Paper in 2002. In line with World Bank and IMF guidelines, the PRSP is meant to serve as a tool for coordinating donor interventions to promote pro-poor growth, as well as forming the basis for the government's own development program. The PRSP is based on four pillars: sustainable pro-poor growth, emphasizing micro-finance and rural infrastructure; human capital development through education and health; safety nets to improve the quality of life for the most vulnerable; and good governance through more effective, transparent, and accountable public institutions. The strategy also highlights four cross-cutting issues: HIV/AIDS, gender, environment, and science and technology.

Figure 2-6



Source: UNDP- Human Development Report. http://hdr.undp.org/reports/global/2004/pdf/hdr04_HDI.pdf, 2004 edition.

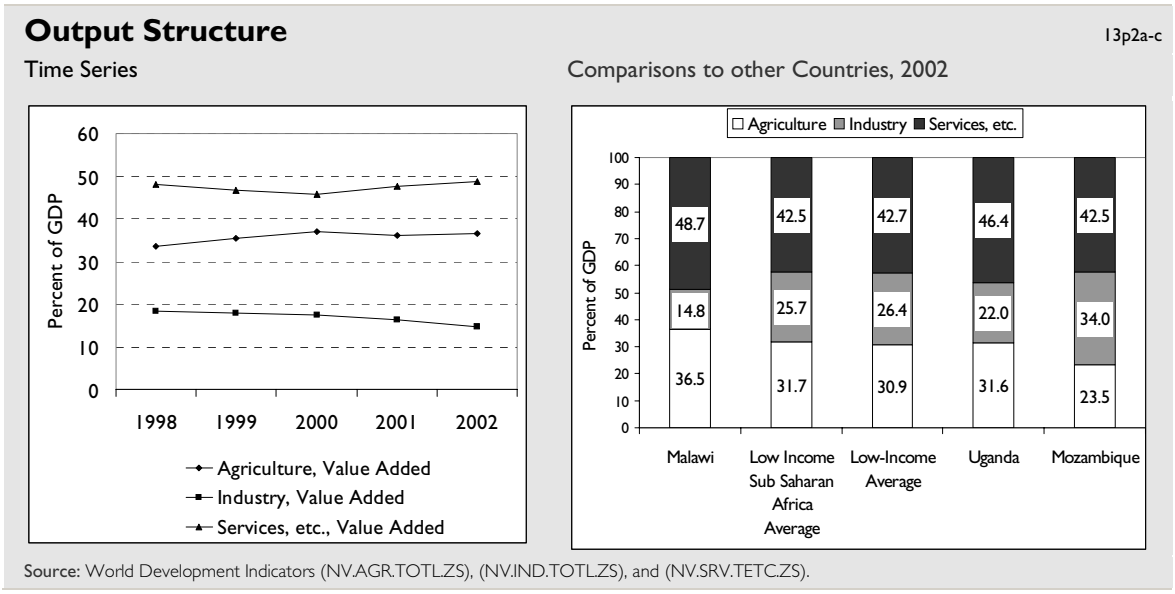
ECONOMIC STRUCTURE

The broad structure of output in Malawi shows no tendency toward transformation over the past five years. Value added in agriculture continues to account for 36 % of GDP. The share in industry actually declined in relative importance, to 15 % of GDP in 2002; this is very low relative to all international benchmarks (Figure 2-7). In the labor force, an estimated 90 percent of the workers depend on agriculture as a major source of income. With 90 percent of the labor force producing just 36 percent of value added, one can see that productivity in agriculture is far lower than the average for the economy overall, which itself is exceedingly low (as shown by GDP per capita). All of these statistics show that Malawi's economic development is stalled in a poverty trap. They also suggest that programs to raise productivity in agriculture may have first-order effects on overall growth. At the same time, interventions to accelerate the creation of off-farm earning opportunities are essential for transformational development in the medium to long term.

DEMOGRAPHY AND ENVIRONMENT

Malawi's population is relatively small, at 11 million people. But the country is also very small geographically, and arable land is very limited, so there is already severe population pressure on the land. This pressure is intensified by population growth of 2.1 percent per year, accentuating the need for programs to foster rapid development of off-farm employment activities. The growing population also creates ever rising demand for public services, not least in education and health. The demographic problems are compounded by the high prevalence of HIV/AIDS (see health section), which has a devastating impact on the prime-age labor force, including teachers

Figure 2-7



Source: World Development Indicators (NV.AGR.TOTL.ZS), (NV.IND.TOTL.ZS), and (NV.SRV.TETC.ZS).

and health professionals. Rapid population growth also produces a very youthful age structure, with 91 dependents per 100 persons of working age. The high dependency rate is a symptom of deep poverty, but also a cause, since there are many mouths to feed for each hand to work. It is also a programmatic opportunity, in that declining rates of population growth and dependency have been significant factors supporting a rapid increase in per capita income and improved public services in Asia.

Despite the population pressure on soil resources, Malawi scores moderately well on a recently created index of Environmental Sustainability, compared to international benchmarks. The overall score combines data on 68 variables for Malawi. Looking behind the overall score, the detailed figures reveal serious problems in the areas of population stress and environmental health.

GENDER

Gender equity is central to poverty alleviation in countries like Malawi where women have been disproportionately deprived of access to education, health services, and productive opportunities outside of subsistence agriculture. Selected gender indicators show a mixed picture for Malawi. There are stark differences in adult literacy, with male literacy (76 percent) being 1.6 times higher than the rate for females (49 percent). This has major long-term effects on growth because women head many households, and maternal education is strongly related to children's health, education, and nutrition. The good news is that impressive progress is being made for the younger generation. The gross enrollment rate for all levels of schooling is just 1.08 times higher for males than females. This is much better performance (less inequality) in the school system than the average ratio of 1.27 for LIC-Africa.

In terms of life expectancy, the gender difference is minimal. The male to female ratio of 0.98 for Malawi is virtually the same as the differential for other low-income countries and LIC-Africa

countries. The big problem is that life expectancy is extremely low for both males and females (37 and 38 years, respectively), and it has been dropping steeply because of the AIDS pandemic. High mortality among young adults undoubtedly affects incentives to invest in education, job skills, and productive pursuits.

3. Private Sector Enabling Environment

This section reviews indicators for key components of the enabling environment for encouraging rapid and efficient growth of the private sector, namely fiscal and monetary policy; development of the financial sector; global integration; a strong legal, regulatory and institutional environment for doing business, including control of corruption; development of the economic infrastructure; and capacity for science and technology. Sound fiscal and monetary policies are essential for macroeconomic stability, which is a necessary (but not sufficient) condition for sustained economic growth. Financial institutions play a major role in mobilizing and allocating saving, facilitating transactions, and creating instruments for risk management. Access to the global economy is another pillar of a good enabling environment, because the external sector is a central source of potential markets, modern inputs, technology, finance, and competitive pressure for efficiency and rising productivity. A dynamic market economy also depends on basic institutional foundations including secure property rights, an effective system for enforcing contracts, and an efficient regulatory environment that does not impose undue barriers on business activities. Equally important is development of the physical infrastructure to support production and trade. Finally, developing countries need to develop the capacity to adapt and apply science and technology as a basis for attracting efficient investment, improving competitiveness, and stimulating rapid productivity growth.

FISCAL AND MONETARY POLICY

Sound macroeconomic management should be evident in low and stable inflation and a sustainable fiscal balance. In Malawi, the fiscal and monetary indicators reveal the opposite. Looking at fiscal policy, government expenditure rose sharply in recent years, reaching 42 percent of GDP in 2003 (Figure 3-1). This is extremely high by every benchmark; the average for LIC-Africa is just 17 percent. Revenue mobilization, at 23 percent of GDP, is also substantially above the benchmark average (15 percent for LIC-Africa), but the differential for expenditure is much larger. Thus, the budget deficit has been unsustainably high, triggering macroeconomic instability. Taking grant receipts into account, the deficit in 2003 was 8.5 percent of GDP, compared to an average of 0.5 percent for LIC-Africa (see Figure 3-2).

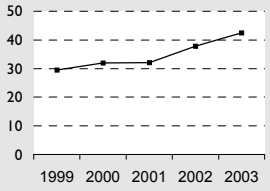
Both current and capital expenditures rose sharply during this period. Using data on a fiscal year basis from the IMF's Article IV Review for 2004, current expenditures jumped from 24.6 percent of GDP in 2001/02 to an estimated 32.0 percent in 2003/04. The main source of this enormous jump was interest on domestic debt, which rose from 3.9 to 9.5 percent of GDP. This appears to

Figure 3-1

Government expenditure, percent GDP

21p1

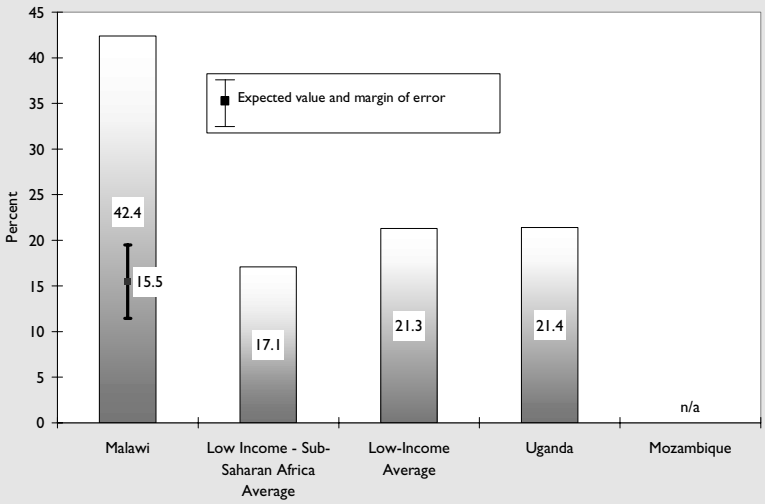
Time series



Year	Value
1999	29.5
2000	32.0
2001	32.1
2002	37.8
2003	42.4
Summary for 1999 - 2003	
Five year average	34.8
Trend growth rate	9.3

Top-five average: 48.4.
Bottom-five average: 1.3

Comparisons to other countries, most recent year



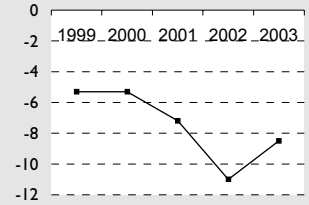
Source: Estimated using IMF Article IV Review for latest Malawi data; available through www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators for benchmarking and older Malawi time-series data (GB.XPD.TOTL.GD.ZS).

Figure 3-2

Overall government budget balance, including grants, percent GDP

21p5

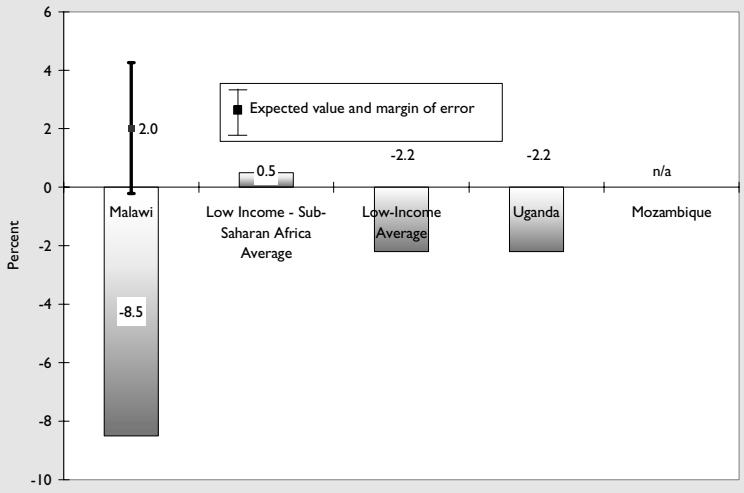
Time series



Year	Value
1999	-5.3
2000	-5.3
2001	-7.2
2002	-11.0
2003	-8.5
Summary for 1999 - 2003	
Five year average	-7.5
Trend growth rate	-18.1

Top-five average: 4.3.
Bottom-five average: -10.5.

Comparisons to other countries, most recent year



Source: IMF Article IV Review for latest Malawi data, available through www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators for benchmarking and older Malawi time-series data, (GB.BAL.OVRL.GD.ZS).

be a classic example of how borrowing to finance excessive deficits can mutate into a fiscal crisis. Interest on foreign debt, in contrast, has been relatively stable, rising from 1.2 to 1.5 percent of GDP. Government purchases of goods and services increased from 8.4 to 9.3 percent GDP—with a spike in 2002/03 due to maize purchases equaling 3.9 percent of GDP, driving up borrowing costs. Even without the spike, government purchases are very high for such a poor country. So are subsidy and transfer costs, which average around 4.5 percent of GDP, and the wage bill, at just under 7 percent of GDP. Development expenditure also soared, from 7.4 to 11.3 percent of GDP, though virtually the entire increase is attributable to inflows of foreign aid.

Government budget deficits have been the driving force behind inflationary growth of the money supply. In 2002 and 2003, broad money growth[11] averaged 27 percent per year; of this, 96 percent was attributable to the financing of government deficits by the banking system—printing money to pay the bills.[12] The rate of money growth was not out of line with the benchmark for LIC-Africa, but that is not a strong point of reference, since inflation has been very high among countries in this group (averaging 18 percent). In absolute terms, the combination of rapid growth of broad money and stagnant output, as in Malawi, predictably leads to high Inflation. Indeed, inflation in Malawi has averaged 20 percent over the past five years, and this high rate continued in 2004. See Figure 3-3.

Unsustainable fiscal deficits and high inflation are major sources of uncertainty, inducing economic agents to lose confidence in the viability of doing business in Malawi. This is a potent cause of low saving and investment, capital flight, exchange rate instability, and inefficient diversion of resources into inflation hedges. The result is lower growth, with particularly adverse effects on the poor, who are least capable of coping with rising prices and economic instability.

Since mid-2004, the Government has demonstrated new resolve to rein in excessive expenditure and bring inflation under control. This effort is a first-order requirement for stimulating economic growth. Even with strong revenue mobilization and improved public expenditure management, however, Malawi is too poor to afford vital expenditure programs without major support from the international community. In the area of fiscal and monetary management, donor interventions may focus on helping the government build capacity and strengthen the institutional framework for policy formulation and implementation, along with programs to educate the public about the importance of sensible macroeconomic policies.

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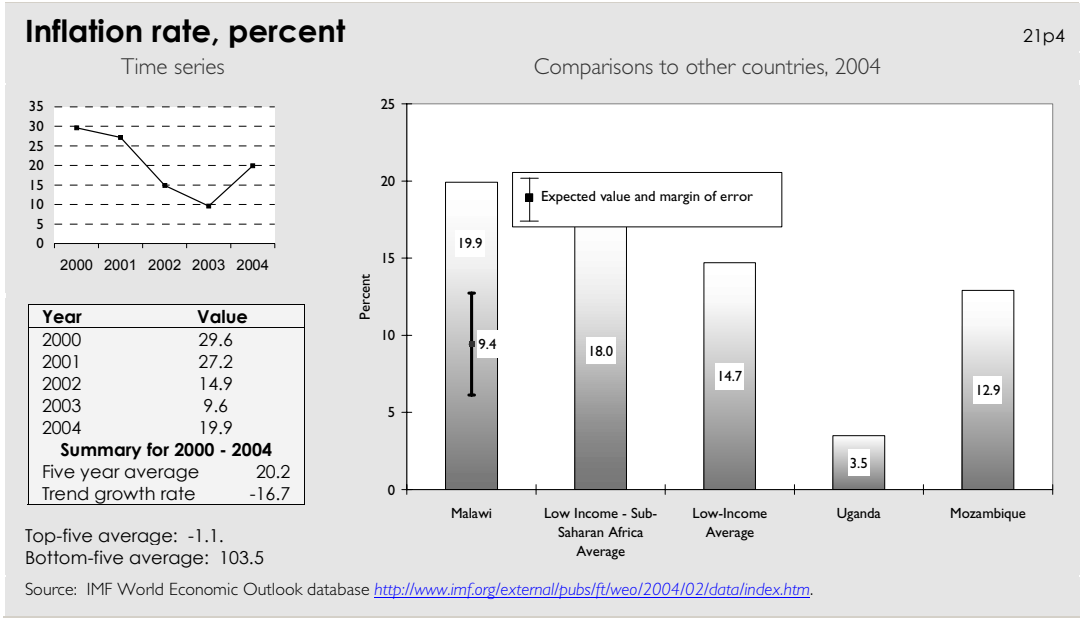
[11] Narrow money includes the stock of currency in circulation plus current account deposits in the banking system. Broad money includes these elements plus the stock of "quasi-money," in the form of time and saving deposits.

[12] Source: Calculations for this study based on monetary survey data from the IMF Article IV Review, November, 2004.

Figure 3-3



BUSINESS ENVIRONMENT

Institutional barriers to doing business, including corruption in government, are critical determinants of private sector development and prospects for sustainable economic growth. Compared to peer benchmarks, Malawi's performance is reasonably good in this area, suggesting that legal and institutional barriers are not a severe constraint on growth. Yet the benchmarks represent conditions in very poor countries. In absolute terms, there is a huge need to tackle corruption, and great room to improve on other impediments to doing business.

Malawi is on par with other LIC-African countries in terms of a composite index of "Doing Business" indicators[13] (Figure 3-4). For the World Bank's Rule of Law index—an eligibility criterion for the Millennium Challenge Account—Malawi's score of -0.3 on a scale of -2.5 to +2.5 is better than the average for LIC-Africa (-0.9), and even better than Uganda and Mozambique (-0.8 and -0.7), the regional stars. Malawi's score on Transparency International's Corruption Perceptions Index (2.8 out of 10) likewise is better than the LIC-Africa average, and comparable to scores for Uganda and Mozambique (Figure 3-5). Nonetheless, any score below 3 indicates rampant corruption that poses severe difficulties for business development. Furthermore, the five-year trend suggests that corruption in Malawi has been getting worse. This is a critical area of concern for donors. According to an IMF report,[14] the Government has recently has taken steps to implement a new zero-tolerance policy for corruption. It would be very good news for growth prospects in Malawi if this proves to a serious commitment.

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[13] See the Technical Notes for details. The composite index has been constructed for this report based on guidance from USAID/EGAT.

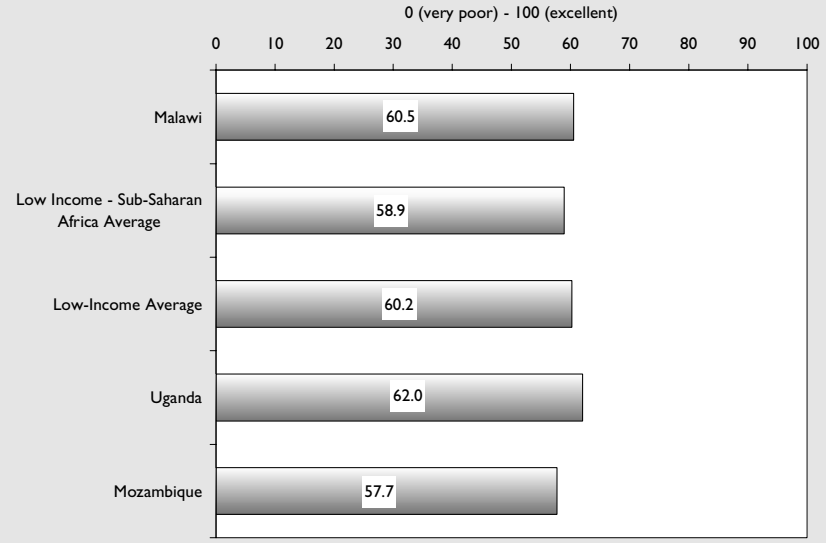
[14] IMF Press Release No. 05/50, March 3, 2005.

Figure 3-4

Doing business composite index

22p2

Comparisons to other countries, most recent year



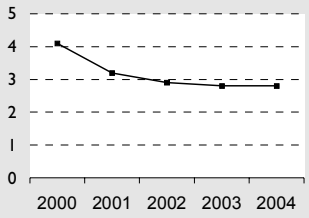
Source: World Bank, Doing Business. http://rru.worldbank.org/DoingBusiness/. The index is estimated by scaling all the "Doing business" indicators from 0 (lowest in the world) to 100 (highest) and then taking a simple average of all the scaled indicators.

Figure 3-5

Corruption perception index

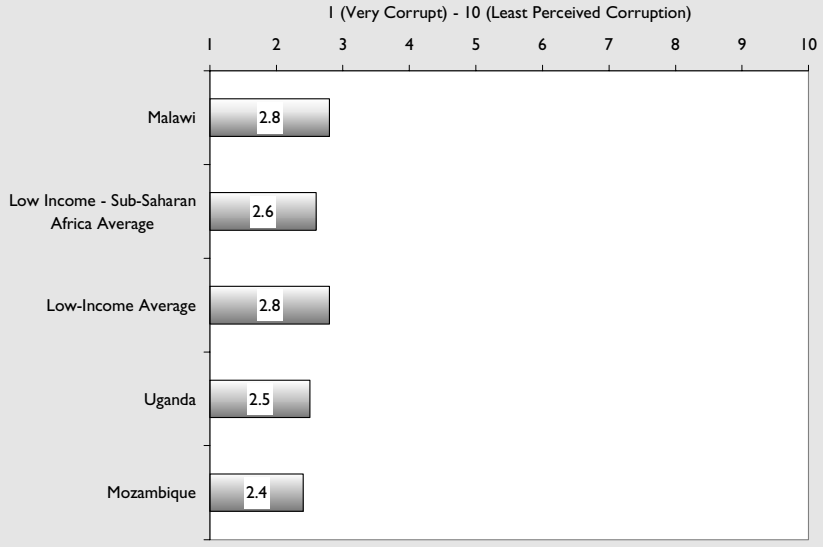
22p1

Time series



Year	Value
2000	4.1
2001	3.2
2002	2.9
2003	2.8
2004	2.8
Summary for 2000 - 2004	
Five year average	3.2
Trend growth rate	-8.6

Comparisons to other countries, most recent year



Top-five average: 9.5.
Bottom-five average: 1.6.

Source: Transparency International

Without going into detail, our supporting indicators for the business environment reinforce these inferences (see the data supplement accompanying this report). Relative to peer comparisons, only one indicator stands out: the time to register property in Malawi (118 days) compares badly to Uganda and Mozambique (48 and 33 days, respectively). Even on this point, however, Malawi's score is better than the average for LIC-Africa (126.8 days).

FINANCIAL SECTOR

A sound, efficient, and competitive financial sector is a fundamental mechanism for mobilizing saving, allocating financial resources, fostering entrepreneurship, and improving risk management. A simple indicator of financial development is the degree of monetization, measured by the ratio of broad money (currency plus bank deposits) to GDP. The monetization ratio averages 26 percent for LIC-Africa, which is very low by standards in other regions. In Malawi, the ratio has hovered around 14 percent, indicating that the banking system touches only a very small segment of the economy. The amount of bank credit to the private sector in Malawi is also miniscule: just 5 percent of GDP in 2003, down from 8 percent in 2000. These figures compare to an average of 12 percent for LIC-Africa. To put this in perspective, bank credit to the private sector averages 156 percent of GDP in the top five countries globally. In short, the banking system is severely underdeveloped.

For those businesses that do obtain bank credit, the cost is very high. The real interest rate on bank loans has been rising in recent years, reaching 28 percent in 2002. The spread between lending and deposit rates has persistently been around 20 percent. Both statistics are well above the respective international benchmarks (see Figures 3-6 and 3-7). The punitive cost of borrowing is related to the government's large demand for credit to finance the budget deficit, which crowds out financing for the private sector. Other possible factors include inefficient bank operations, a high rate of non-performing loans, or a highly concentrated financial system that allows banks to charge what the market will bear. The important point, for present purposes, is that the underdeveloped financial system is a choke-point for growth. The system does little to mobilize saving or allocate resources to efficient investment. If anything, the high cost of credit actively discourages investment. Financial sector development could therefore be an important strategic priority for USAID. A more detailed study would be required, however, to determine the best opportunities and appropriate avenues for intervention.

EXTERNAL SECTOR

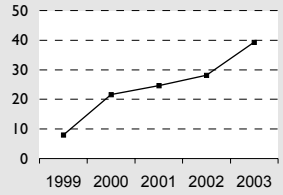
Fundamental changes in international commerce and finance, such as lower transport costs, advances in telecommunications technology, and the decline in policy barriers have fueled a rapid increase in global integration over the past 25 years. The international flow of goods and services, capital, technology, ideas, and people offers great opportunities for Malawi to boost growth and reduce poverty by stimulating productivity and efficiency, providing access to new markets and ideas, and expanding the range of consumer choice. Globalization also creates new challenges in the need for institutions, policies, and regulations to take full advantage of international markets; cost-effective approaches to cope with the adjustment costs; and systems for monitoring and mitigating associated risks.

Figure 3-6

Real interest rate, percent

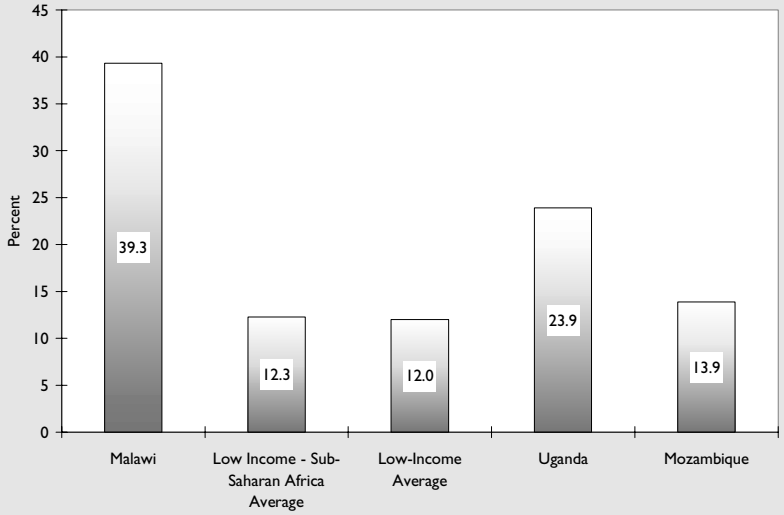
24s4

Time series



Year	Value
1999	8.0
2000	21.6
2001	24.7
2002	28.1
2003	39.3
Summary for 1999 - 2003	
Five year average	24.4
Trend growth rate	41.1

Comparisons to other countries, most recent year



Top-five average: -11.5.
Bottom-five average: 46.7.

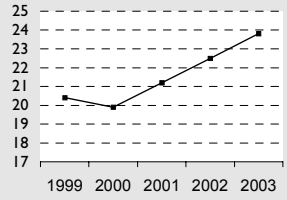
Source: World Development Indicators (FR.INR.RINR)

Figure 3-7

Interest rate spread, lending minus deposit rate, percent

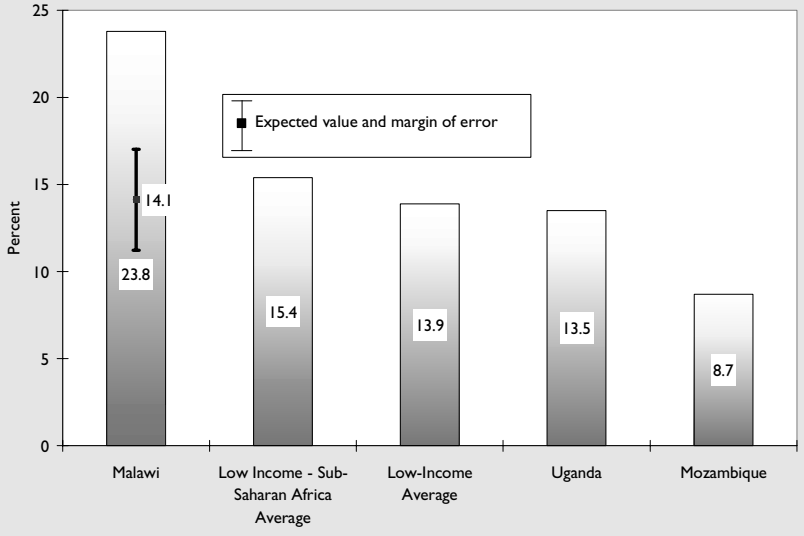
23p2

Time series



Year	Value
1999	20.4
2000	19.9
2001	21.2
2002	22.5
2003	23.8
Summary for 1999 – 2003	
Five year average	21.5
Trend growth rate	4.4

Comparisons to other countries, most recent year



Lowest-five average: 1.7.
Highest-five average: 32.1.

Source: World Development Indicators (FR.INR.LNDP).

Malawi is a relatively open economy, but the data reveal serious problems in the external sector. These include low export growth, highly concentrated export earnings, high dependency on foreign aid, very low recorded remittances from nationals outside the country, a precarious current account balance, extremely low inflows of foreign investment, and dangerously low levels of foreign exchange reserves.

Trade and the Current Account

The most common indicator of openness to trade is the ratio of exports plus imports (goods and services) to GDP. The ratio for Malawi, 68 percent, is fully in line with the international benchmarks (Figure 3-8). But export earnings have been virtually stagnant, averaging just 1.5 percent growth over the past five years (in US dollar value) (Figure 3-9). Moreover, export growth has been extremely erratic from year to year, due to high dependency on a few primary products: tobacco, sugar, and tea, which account for 80 percent of total earnings. There is an acute need for export diversification.

Looking behind the weak export performance, the Heritage Foundation gives Malawi a score of 3 (out of 5) for its composite trade policy index; the average for LIC-Africa is 4.1, suggesting that Malawi lags behind other countries in the region in liberalizing trade. Another trade disadvantage stems from an appreciation of 15 percent in the real exchange rate from 1995 to 2002; the average for LIC-Africa is a depreciation of 7 percent. Thus, Malawian goods have become less competitive because of the relative change in currency values. In addition, the terms of trade for Malawi declined by 15 percent in 2002 and 2003.[15] These factors contribute to the lack of dynamic trade performance. Considering other indicators, however, the core problem appears to be the weak enabling environment, in general, for stimulating investment and private sector development.

Imports of goods and services have far exceeded export earnings. This gap might be offset partially through worker remittances, but Malawi is not effectively tapping this source of funds. In 2002 recorded remittances were just 0.2 percent of exports, versus an average of 11.6 percent for LIC-Africa. With millions of Malawians working abroad, it should be possible to capture remittances much more effectively with secure and accessible cash transfer systems—not to mention better economic policies to encourage Malawians to invest at home.

The overall current account deficit has been extremely large. Excluding official transfers (grants), the deficit was 24.5 percent of GDP in 2002 and 17.8 percent in 2003. Taking grants into account, the deficit still averaged over 10 percent of GDP for these two years, creating an unsustainable financing requirement (Figure 3-10).

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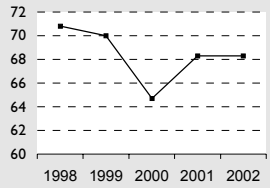
[15] IMF Article IV Review for Malawi, Statistical Annex, December 2004, Table 16.

Figure 3-8

Trade, percent GDP

24p10

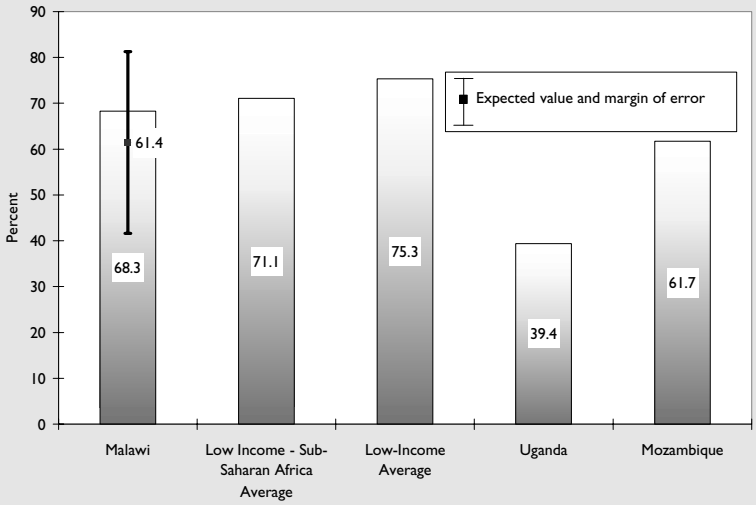
Time series



Year	Value
1998	70.8
1999	70.0
2000	64.7
2001	68.3
2002	68.3
Summary for 1998 - 2002	
Five year average	68.4
Trend growth rate	-1

Top-five average: 258.8.
Bottom-five average: 23.4.

Comparisons to other countries, most recent year



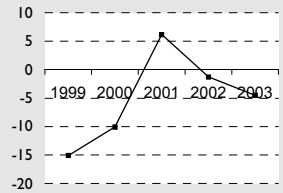
Source: IMF Article IV Review for latest Malawi data, available through www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators for benchmarking and older Malawi time-series data (NE.TRD.GNFS.ZS).

Figure 3-9

Exports growth of goods and services, percent change

24p4

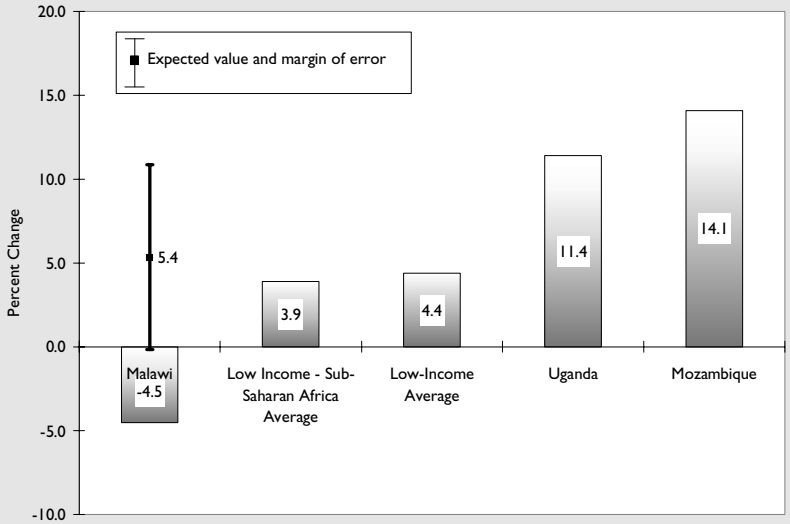
Time series



Year	Value
1999	-15.1
2000	-10.1
2001	6.2
2002	-1.3
2003	-4.5
Summary for 1998 - 2002	
Five year average	1.5
Trend growth rate	N/A

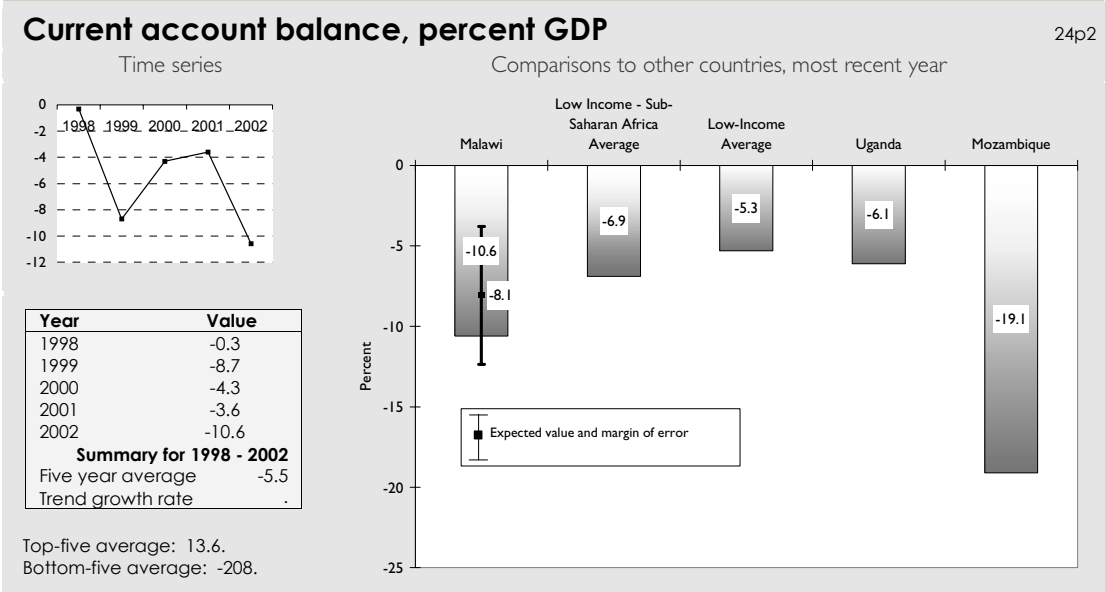
Top-five average: 27.5.
Bottom-five average: -21.4.

Comparisons to other countries, most recent year



Source: IMF Article IV Review for latest Malawi data, found at www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators for benchmarking and older Malawi time-series data (NE.EXP.GNFS.KD.ZG).

Figure 3-10



Source: IMF Article IV Review for latest Malawi data, www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators for benchmarking and older Malawi data (BN.CAB.XOKA.GD.ZS).

Financing

Malawi's current account deficit represents a huge resource gap that must be financed. Foreign aid remains the main source of financing. The net flow of aid (grants and soft loans) averaged 25 percent of GDP between 1998 and 2001, falling to 20 percent in 2002. This is a very high level of aid dependency. In relative terms, it exceeds the average of 17 percent for LIC-Africa, yet it is slightly below the statistical expected value for Malawi's level of income.

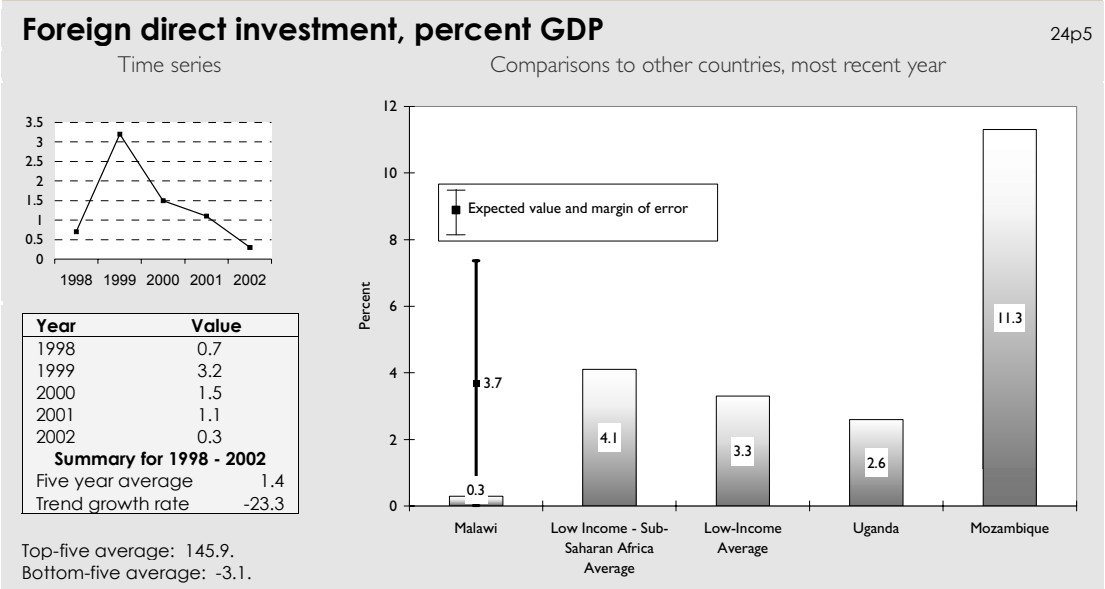
Private capital flows are another major source of external financing in most countries. For Malawi, the amounts are small in absolute terms, and much lower than the benchmark standards. FDI, in particular, averaged just 1.4 percent of GDP from 1998 to 2002, barely a third the average for LIC-Africa (Figure 3-11).

To the extent that aid and private capital flows fall short of the financing requirement, the deficit must be covered by reducing foreign exchange reserves. In 2003, gross international reserves in Malawi declined to a level that covers just 1.8 months of imports, compared to a comfortable 4 months of import cover in 2000. This is the clearest sign that the external sector is on the verge of a crisis. USAID, of course, is not in the business of solving short-run macroeconomic crises, but the situation reveals a compelling need for better long-run policies to foster export growth, attract remittances,

Debt

The data suggest that external debt is not a major problem for Malawi. World Bank figures show that debt service payments have declined in recent years to less than 8 percent of export earnings. Also, the present value of future debt payments is below 50 percent of GDP. Both figures are well below the threshold to signal a serious debt problem.

Figure 3-11



Source: IMF Article IV Review for latest Malawi data, www.imf.org/external/np/sec/aiv/index.htm; World Development Indicators for benchmarking and older Malawi time-series data (BX.KLT.DINV.DT.GD.ZS).

ECONOMIC INFRASTRUCTURE

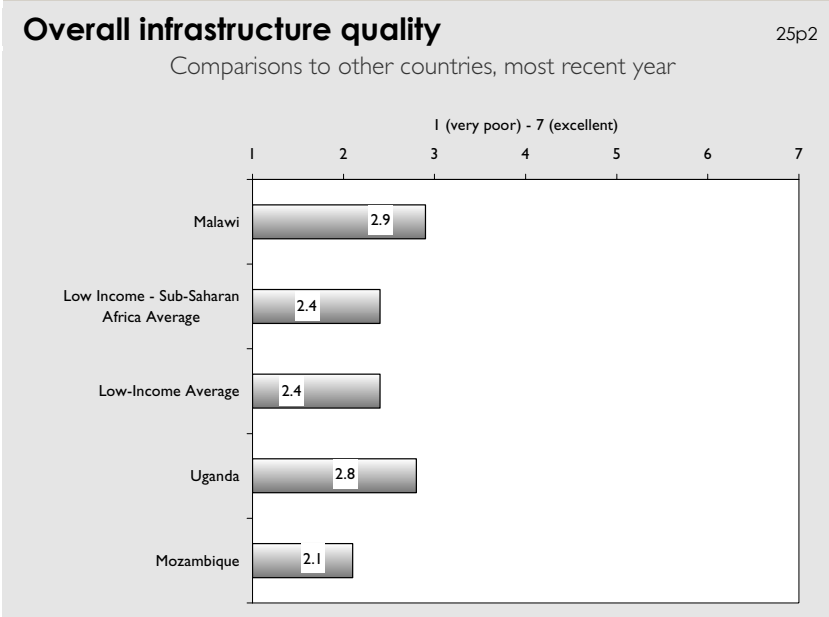
A country's physical infrastructure—for transportation, communications, power, and information technology—is the backbone for improving competitiveness and expanding productive capacity. Key indicators show a mixed picture about infrastructure development in Malawi, in support of business development.[16]

The broadest indicator of infrastructure *quality* for business development is an index of executive perceptions compiled by the World Economic Forum (WEF). Malawi's score of 2.9 (out of 7) is better than the median for LIC-Africa and the score for Mozambique, and comparable to the score for Uganda (See Figure 3-12). The perception of infrastructure adequacy, by regional standards, carries through WEF survey results for rail development (with a score of 2.1), port facilities (2.3) —obviously dry ports, in this case—and air transportation, all of which are particularly important given Malawi's landlocked position. However, Malawi score on the quality of electricity supply (2.1) is well below the benchmark standards. Problems with electricity supply create yet another competitive disadvantage for local businesses.

For communications infrastructure, two indicators tell a story of serious underdevelopment. Telephone density I Malawi is 15 lines per 1000 people (including mobile phones), and the number of internet users per 1000 people is 3.4. Both figures are extremely low compared to the LIC-Africa averages of 32 phone lines and 10.3 internet users per 1000 people, though they are

[16] This section relies on perception indicators to assess infrastructure quality and adequacy. Objective measures of infrastructure *quantity* often have little diagnostic value. For example, a low value for kilometers of paved roads does not imply that there is a problem to be fixed, since unpaved all-weather roads may be more efficient than paving secondary and tertiary roads in poor countries.

Figure 3-12



Source: Global Competitiveness Report 2004-2005, World Economic Forum. The indicator can be found in the Data Tables, Section V. General Infrastructure; 5.01.

consistent with the expected value for an African country with Malawi's low level of income. With communication technology being a vital link for international transactions, the poor state of this infrastructure is a serious barrier to trade and investment. The good news is that both of these indicators are rising rapidly in Malawi, albeit from rock-bottom levels.

Given the critical importance of infrastructure for economic growth, and the weak conditions in Malawi, this may be an important area for USAID intervention, particularly through sustainable approaches such as improvements in capital budgeting, better planning for recurrent costs, and greater involvement of the private sector.

SCIENCE AND TECHNOLOGY

Science and technology are central elements of a dynamic business environment, and technical knowledge is a driving force for rising productivity and competitiveness. Even for low-income countries, transformational development increasingly depends on acquiring and adapting technology from the global economy, and applying it in ways that are appropriate to their level of development. A lack of capacity to access and utilize technology prevents an economy from leveraging the benefits of globalization. Unfortunately, few international indicators of science and technology are available for judging performance in low-income developing countries. Hence, one must draw inferences from a very limited data set, as proxies for other missing information.[17]

The primary indicator of indigenous science and technology capability is the number of patents filed in Malawi each year by residents of the country. Malawi has averaged just 3 such patents per

[17] For many low-income countries, there is not even timely data on the number of college-age students enrolled in science and technology programs.

year over the past five years. This is comparable to the average of 2 for LIC-Africa, but that is only because performance is extremely poor for the entire group. Another useful technology indicator is the number of internet users per 1000 people; as discussed in the previous section, Malawi remains far behind other low-income countries in Africa by this measure, though internet use is growing quickly. No data are available for Malawi on R&D expenditure.

4. Pro-Poor Growth Environment

Rapid growth is the most powerful and dependable instrument for poverty reduction. Yet the link between growth and poverty reduction is not mechanical. In some countries, the structure of development fosters income growth for poor households that is faster than overall per capita income growth, while in other settings growth benefits the non-poor far more than the poor. A pro-poor growth environment stems from policies and institutions that improve opportunities and capabilities for the poor, while reducing their vulnerabilities. These characteristics are associated with improvements in primary health and education, the creation of jobs and income opportunities, the development of skills, micro-finance, agricultural development (for countries like Malawi with large population of rural poor), and gender equality.[18] This section focuses on four of these issues that contribute to pro-poor growth: health; education; employment and the workforce; and agricultural development.

HEALTH

The provision of basic health service is a major form of human capital investment, and a significant determinant of economic growth and poverty reduction. Although health programs do not fall under the EGAT bureau, an understanding of the health status of the population can influence the design of EG programs.

The broadest indicator of health status is life expectancy. In Malawi life expectancy has dropped precipitously in recent years to 37.5 years, one of the lowest levels in the world. This is due primarily to the impact of the HIV/AIDS epidemic, on top of already high rates of infant and child mortality (Figure 4-1). Reversing this trend is crucial since the prevalence of poor health and premature death affects all aspects of the economy, including labor productivity, saving rates, the delivery of public services, the education of future generations, and overall growth, and poverty. Data show that HIV prevalence among adults has decreased slightly from 16 percent in 1999 to 14.2 in 2003, but this change may reflect a change in the accuracy of the measurement, or the impact of deaths from HIV/AIDS rather than an actual improvement in the situation. In any case, the HIV/AID epidemic in Malawi is clearly one of the most severe in Africa. This dire situation needs to be taken into account in any economic growth strategy.

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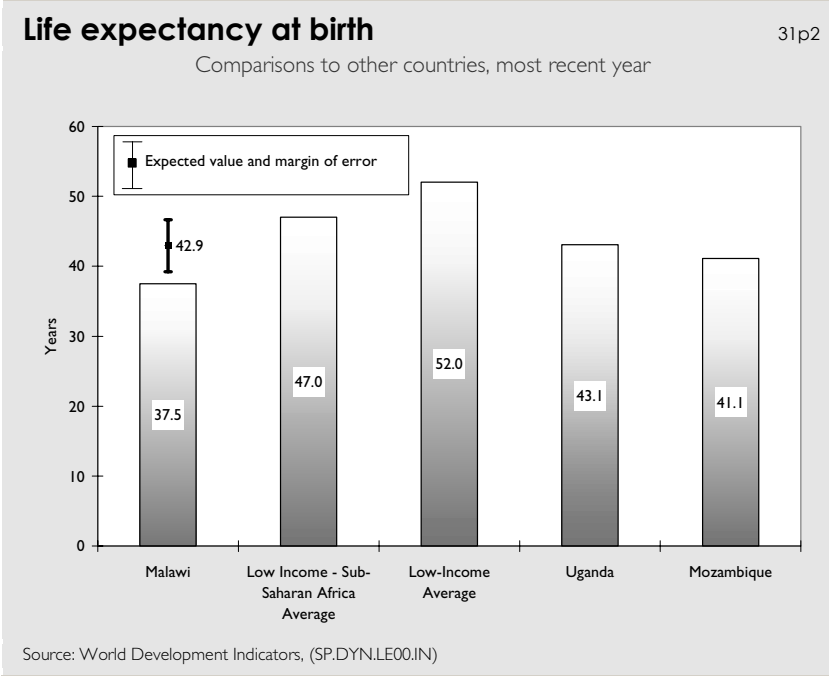
[18] For purposes of economic growth programming, the template does not cover emergency relief.

Figure 4-1



Malawi's maternal mortality rate (MMR), at 18 deaths per 1000 live births, is also among the highest in the world, confirming the severity of the national health crisis and the human cost of deep poverty (Figure 4-2).The high MMR occurs despite more than half of all births being attended by trained health personnel. This is a higher rate of birth care than in most low-income African countries. Clearly, though, inadequate access to, quality of, or knowledge about health care is causing the death of many women in child birth.

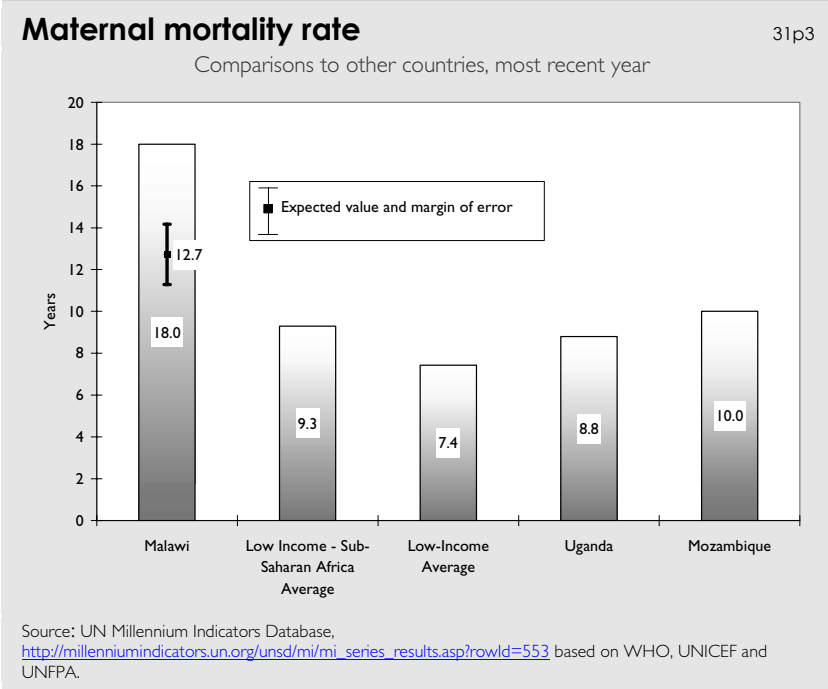
The Malawi government has been taking steps to improve conditions in the health sector. In line with the PRSP guidelines, public expenditure on health care has risen from 2.7 percent of GDP in 2001 to an estimated 4.7 percent in 2004. In addition, Malawi is at or above the LIC-Africa norm on important health indicators such as access to improved water and sanitation, and child immunization.

EDUCATION

The government of Malawi has taken the goal of eliminating poverty through education seriously by introducing free primary education in the last decade. As a result, 81 percent of primary school age children are now enrolled in school, well above the average for LIC-Africa, and youth literacy has risen slowly but steadily to reach 73 percent in 2002, virtually matching the corresponding peer-group average.

Although great gains have been made in access to primary education for poorer-socio-economic groups, this does not automatically translate into a higher percentage of students completing primary school. According to the latest data, for 2000, 54 percent of the students persist to grade five, a very low performance indicator. Dropout rates remain especially high for girls in rural areas. The increase in primary enrolment may also be compromising the all-important quality

Figure 4-2



Source: UN Millennium Indicators Database, http://millenniumindicators.un.org/unsd/mi/mi_series_results.asp?rowId=553 based on WHO, UNICEF and UNFPA.

dimension. This is most evident in the primary school pupil-teacher ratio, which reached 63:1 in 1999 (latest data point), virtually the highest ratio in the world.

The data therefore suggest that the key problem in the education sector is quality. Appropriate measures may include teacher training, to improve the teacher- pupil ratio, better financing of teaching and learning materials, improved curriculum, and innovative incentives to keep children in school, particularly girls.

EMPLOYMENT AND WORKFORCE

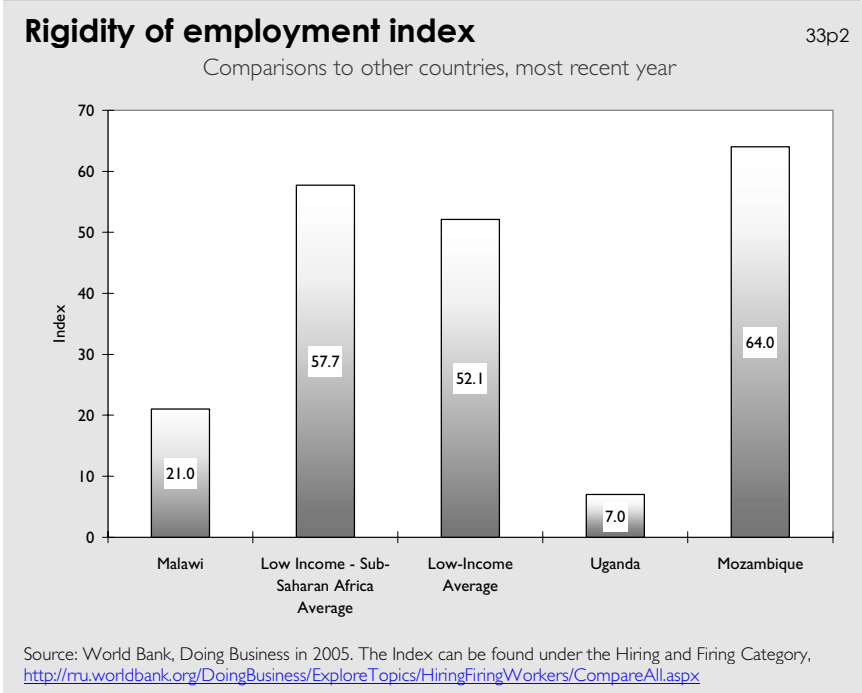
Malawi faces an acute need to create productive jobs and income generating opportunities for the growing population. Reflecting Malawi's very youthful demographic structure, the labor force is estimated to be growing by 2 percent per year. Although this is below the average of 2.6 percent per year for LIC-Africa—most likely due to the ravages of HIV/AIDS—the economy needs to absorb roughly 100,000 new workers each year.

The labor force participation rate in Malawi is extremely high, with an estimated 93 workers per 100 people of working age (15-64). The average of 88 for LIC-Africa is also very high, compared to 77 for low-income countries globally. In part, the high values are a consequence of deep and severe poverty, because very poor people can ill afford the luxury of remaining outside the labor force. But the figure also hints at a very serious labor market problem in Malawi and other low-income countries in Africa: the use of children as workers. While accurate data are not available, ILO estimates that 31.5 percent of children from ages 10 to 14 were working as child laborers in 2000. Moreover, the ILO regards conditions in Malawi to involve the "Worst Form" of child labor, due to the potential harm to health and safety. The tobacco industry is the largest offender, with other small-scale agricultural enterprises close behind. This problem may be a high priority

for attention by USAID and other funding agencies, when planning education programs or strategies to stimulate agricultural production.

On the bright side, Malawi's labor laws and regulations are relatively favorable for job creation. The World Bank's index of Rigidity of Employment measures the difficulty in hiring and firing workers on a scale of 0 to 100 (with higher values indicating greater rigidity). The score of 21 for Malawi in 2004 is far better than the average of 58 for LIC-Africa (Figure 4-3). Uganda's score of 7 shows that there is still considerable scope for improvement in Malawi. Even so, the regulatory environment is not the most serious constraint on job creation. The main issue is the inability of the country to attract investment of any sort, due to problems in other areas discussed above.

Figure 4-3



Source: World Bank, Doing Business in 2005. The Index can be found under the Hiring and Firing Category, http://rru.worldbank.org/DoingBusiness/ExploreTopics/HiringFiringWorkers/CompareAll.aspx

AGRICULTURE

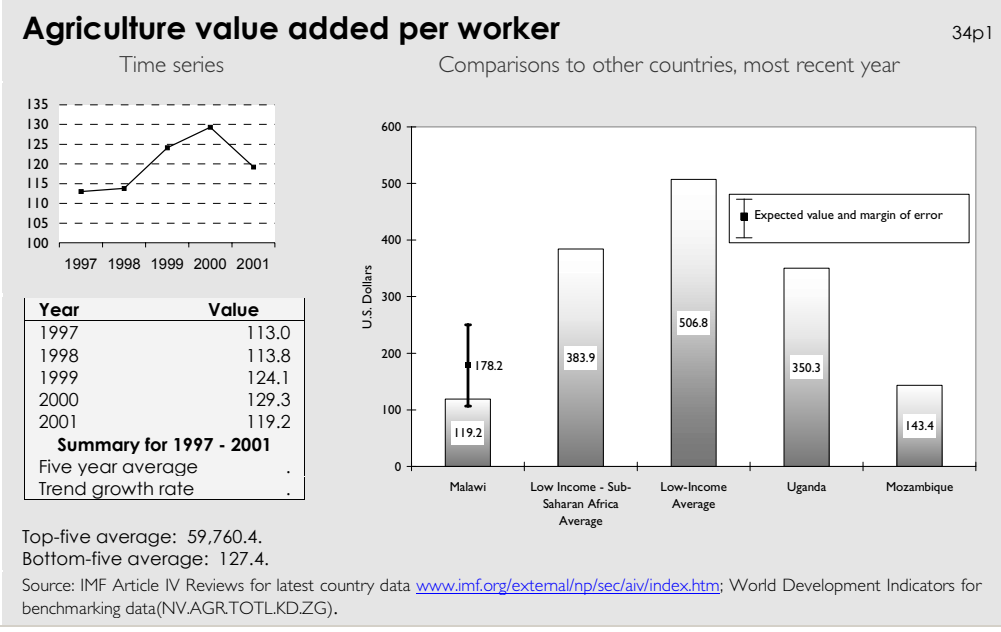
The basic picture in this sector is one of moderately good performance, but with large year to year fluctuations, and high labor intensity due to severe population pressure on the land and an extreme absence of off-farm jobs. Agriculture accounts for more than one-third of GDP, and 80% of export earnings. An estimated 90 % of the population lives in rural areas; nearly all of these people depend on agriculture for their livelihood, primarily through very small-scale subsistence production. Hence, conditions in agriculture have a large bearing on overall growth and poverty.

Agricultural output has been highly erratic from year to year, showing the impact of rainfall variations, as well as changes in the availability of inputs such as fertilizer (through the Starter Pack program, for example). Even so, the underlying trend has been reasonably favorable. The sector has grown by nearly 4 percent per year over the past five years. This is far better than the

LIC-Africa average of 0.7 percent, though below recent growth rates in Uganda (5 percent) and Mozambique (7 percent). Another positive factor is that growth has been somewhat faster among smallholders than in the estate sector. Overall crop production has risen by 50 percent since 1990, compared to an average of only 38 percent for other low-income African countries. Cereal yield has been rising by 3.3 percent per year, and the average of 1,045 kilograms per hectare is very similar to the benchmark standard of 1,087 for LIC-Africa.

Value added per worker in agriculture, at $119.2 (in constant 1995 prices) is less than one-third the average of $384 for low-income countries in sub-Saharan Africa the region (Figure 4-4). This factor alone goes a long way to explaining the high rate of poverty in Malawi. Since overall yields are comparable to the regional norms, the productivity indicator shows that agricultural production in Malawi is exceedingly labor-intensive—resulting from very high population pressure on limited arable land,. Other factors such as lack of access to agricultural equipment, fertilizer, and quality seeds may also be driving low productivity, but suitable indicators are not available for this study. In any case, poor subsistence farmers in Malawi lack funds to obtain modern inputs, and the financial system is not filling the gap (as indicated by the financial sector data reviewed earlier). Policy constraints do not appear to be a major problem. According to the World Economic Forum, Malawi receives a score of 3.8 (out of 7, with 7 being best) on a survey question regarding the burden of policy costs in agriculture. This is comparable to the benchmark standard for LIC-Africa, and also for low-income countries globally. Still, in absolute terms the score is fairly low, indicating considerable room for policy reform.

Figure 4-4



On balance, agricultural development is a critical determinant of economic growth and poverty reduction in Malawi. In the medium to long run, however, the major problem is to transform the economy by stimulating investment and creating jobs outside of agriculture.