

## Malawi Economic Brief: May 2005

### Malawi: Key Development Facts

- Malawi is one of the ten poorest countries in the world with an income per person of around \$160 per year: 170 times less than the average Scot's income.
- Although Malawi's population (c.12m) is more than twice the size of Scotland's, and its land area is around 50% larger, its economy is only a little over 1% of the size of Scotland's (\$1.8bn vs. \$139bn in 2003). Falkirk's economy alone is around twice the size of Malawi's.
- Malawi suffers from one of the worst HIV/AIDS epidemics in the world with around one million people infected – more than the total number in Europe and North America combined – and around half a million orphans: roughly the same number as the entire population of Edinburgh.
- Life expectancy at birth has fallen from around 45 years in 1990 to around 37 years today: around half of the life expectancy of the average Scot.
- Malawi's government can only afford to spend on average \$12 (around £6) per person each year on healthcare. (Source: Statement by Health Minister Ntaba, Feb 05).
- Children under the age of five are 27 times more likely to die than those in Scotland.
- Malawi is the country with the fewest doctors per person (Source: Guinness World Records). USAid cite this ratio at: 117,647:1 for 2002: one doctor serving a population equivalent to that of Ayr and Livingston combined.
- Malawi's population is growing rapidly: more than half the population is less than 15 years old.
- In Malawi there is one qualified teacher for every 95 pupils, compared to one for every 14.9 pupils in Scotland (Source: National Statistics On Line 2002/03).



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## **Malawi Economic Brief**

**Geography:** Malawi is a relatively small, landlocked country in southern Africa at the southern end of the East African Rift Valley. It shares borders with Mozambique, Tanzania and Zambia and occupies an area of 118,480 Km<sup>2</sup> – around 50% larger than Scotland – although a fifth of this is accounted for by Lake Nyasa. The climate is sub-tropical, with a rainy season lasting from November to May and a dry season from May to November.

**Population:** The population, projected to reach 12.9m in 2005 (UN Population Division), is fast growing and young: nearly half the population is under 15 years of age, less than 3% over 65 years. Rapid population growth is creating land pressures in a country that is critically dependent on agriculture. The population is predominantly Christian (55% Protestant; 20% Catholic) but Islam represents a sizeable minority accounting for 20%. The official languages are English and Chichewa.

**History:** The Republic of Malawi, formerly known as Nyasaland, gained independence from the UK in 1964, after 73 years of British rule. The Prime Minister at the time, Hastings Kamuzu Banda, was elected President for life in 1971 and established authoritarian, one-party rule. His reign ended in 1994, when he was defeated by Mr Bakili Muluzi and his United Democratic Front (UDF) in the country's first multiparty elections. Muluzi and his UDF party were re-elected in June 1999 but presided over a period of poor economic performance, including a severe drought in 2002.

**Politics:** The current President Bingu wa Mutharika was elected in May 2004, after President Muluzi failed to amend the constitution to enable him to stand for a third term in office. The President is head of government and state and presides over a 46-member cabinet. The legislature is unicameral, with the 193 members elected for five-year terms. Various political parties comprise both the ruling coalition government and the opposition. Parliament has not met since summer 2004 and it is not clear when it will reconvene.

**Poverty:** In actual prices, Malawi's GDP was only \$1.8bn in 2003 – little more than one per cent of that of Scotland, notwithstanding that its population is more than twice as large as Scotland's. Around 60% of the population live below the poverty line. The average income is only \$160 per year: the average Scot's income is over 170 times greater. The situation appears slightly better if purchasing-power parities (PPP) figures are used, which take the cheaper cost of living in Malawi into account when comparing national income levels. On PPP terms, GDP is over \$7bn and income per capita around \$600 per year. However, on either measure, Malawi remains desperately poor, one of the ten poorest countries in the world, despite the efforts of government and civil society. Malawi is classified a heavily indebted poor country (HIPC), rendering it eligible for conditional debt relief [See Box 1].

**Why is Malawi so poor?** Malawi's poverty is a result of a variety of factors: under-developed institutions; poor physical infrastructure – such as transport links – reflecting low savings and investment; corruption<sup>1</sup>; low human capital investment - reflecting limited educational provision; undiversified exports; difficult climatic conditions; an adverse geographical position – restricting access to international markets; and relatively few natural

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<sup>1</sup>Malawi ranks 87 out of 145 countries for the extent of corruption (as measured by Transparency International's Corruption Perception Index 2004) alongside India and Russia.

resources. Recent work carried out for DFID also highlighted the significance of population density for Malawi's poor economic performance. Compared to other countries in the region, each household has a relatively small plot of land to grow food and hence they are unable to use techniques such as crop rotation. Over time this has reduced the quality of the soil and the size of the harvest. In recent years, Malawi's poverty has been exacerbated by real income losses resulting from adverse terms of trade as the prices of its exports (e.g. tobacco) have fallen, while prices for key imports (e.g. oil) have risen. As a result of all of these factors – often reinforcing one another, Malawi's economic growth has remained erratic and well below the 6% annual growth rate that the World Bank estimates is necessary to make serious inroads into poverty reduction.

### **Box 1: Heavily Indebted Poor Country (HIPC) Initiative**

In 1999 the Heavily Indebted Poor Countries' (HIPC) Initiative was launched by the World Bank and the International Monetary Fund (IMF), to provide debt relief to poor countries committed to eradicating poverty. By October 2004, 27 HIPC countries had qualified with 15 at Completion Point and the other 12 at an Interim Point.

Malawi has foreign debt of \$2.9 billion, of which \$1603 million is owed to the World Bank, \$322 million to the African Development Bank, and \$88 million to the IMF. In 2000, under the enhanced HIPC Initiative, the World Bank and the IMF agreed to support a debt-reduction package for Malawi. Total HIPC assistance was estimated at \$1 billion in nominal terms.

Due to the poor fiscal management of the previous government, Completion Point has not yet been achieved, delaying full debt relief. Despite these interruptions in the HIPC Initiative, some relief has been issued. Since December 2000 Malawi has received interim debt relief on its foreign debt and hence benefited from lower interest payments on foreign debt. In terms of Malawi's bilateral debt to the UK Government, £4m has already been written off; only £300,000 remains outstanding.

Since the election of the new president in 2004, the government has shown itself to be committed to improving macro-economic management (containing spending; borrowing and keeping inflation down) and on the basis of an encouraging three-months track record, it is hoped that Malawi will soon reach Completion Point at which time its debt should be reduced to sustainable levels.

**Human Development Index:** On wider development indicators, Malawi also performs very poorly, ranked 165 out of 177 countries according to the UN's human development index (2004) - a composite measure which takes health, longevity, education and standard of living into account. Life expectancy has fallen dramatically over the past decade with the onset of HIV/AIDS (see Box 2): from 45 years in 1990 to around 37 years currently. The epidemic has also resulted in a massive increase in the number of orphans: to around half a million currently, similar to the entire population of Edinburgh. Furthermore, the World Bank estimates that, with more than one million infected, Malawi has more people living with HIV/AIDS than the whole of North America and Western Europe combined. According to the World Bank's latest country assistance strategy, Malawi is unlikely to reach any of the Millennium Development Goals by 2015 with the exception of primary school enrolment (although note that enrolment is not the same as attendance: the last World Bank country assistance strategy reported that only one in three children complete five years in education).

## Box 2: HIV/AIDS

In the fight against poverty nothing can be more essential than combating Malawi's increasingly vicious HIV/AIDS epidemic. According to the Malawian Health Minister, the country is losing about 10 people to AIDS every hour; 240 people every day. In a recent report by the Malawian health ministry, annual spending per capita on health must increase from \$12 currently to at least \$36 if HIV/AIDS infections are to be reduced. The report also identified that about 90% of Malawi's physicians' posts and 35% of nursing jobs are vacant due to death and the so-called "brain drain" to better paid jobs overseas.

### *Estimated number of adults and children living with HIV/AIDS, end of 2003*

Adult (15-49) HIV prevalence rate	14.2%
Adults and children living with HIV	900 000
Adults (15-49) living with HIV	810 000
Children (0-15) living with HIV	83 000
Woman (15-49) living with HIV	460 000
AIDS deaths (adults and children)	84 000
Current living AIDS orphans (<17)	500 000

Source: 2004 report on the global AIDS epidemic, UNAIDS.

Since Mutharika's government came into power Malawi has seen an improvement in its response to the HIV/AIDS epidemic. Not only has the government increased its efforts to combat the epidemic, but in doing so, improved donor confidence, leading to an increase in much needed financial support. However much remains to be done. Although the increase in the number of anti-retroviral recipients to 9,500 in 2004 is impressive, it is a small number in comparison with the total number of those who benefit from treatment.

**Inequality:** Even the minimal average income figures mask the plight of Malawi's poorest as society is highly unequal, by income and by gender, affecting access to land, education and other assets. The Gini coefficient – which measures income inequality – is particularly high (0.62) – meaning that Malawi suffers from one of the worst income disparities in the world. Gender inequality is reflected in the disproportionate work burden that falls on girls and women, who undertake most of the home and farm work.

**Agriculture:** Malawi's economy is critically dependent on agriculture, which accounts for over 90% of exports and 40% of GDP. 85% of the population live in rural areas and of that the majority are subsistence farmers. Industrial development is limited. Tobacco is the principal export (accounting for around 60% of export earnings), making Malawi vulnerable to weak tobacco prices. Tea, sugar, coffee and cotton are also important. Maize – the staple diet and domestic crop – is largely produced by small, quasi-subsistence peasant holdings which occupy much of the farmland. Maize production has been inadequate in recent years creating the need for maize imports. Food security does not exist, even during good harvests. In addition to pressures from rapid population growth, agricultural development has been hampered by recurring droughts, poor resource management and environmental degradation (deforestation, land degradation, water pollution etc).

**Trade:** Given its small size and undiversified economy, Malawi is necessarily dependent on trade. Trade (imports plus exports) accounts for around 60% of GDP. The trading regime is relatively liberal. South Africa and EU are the main trading partners for imports (approx 30%

each). Key export markets are the EU (35%) and US (15%). Major imports include fuel, capital and consumer goods and – disappointingly for an agricultural economy – food. Excessive dependence on imports in conjunction with weak export performance has resulted in huge current-account deficits in the order of 10% - 25% of GDP (before donor financing).

**Aid:** Given Malawi's inability to borrow on external capital markets it is heavily dependent on aid – on both international financial institutions and bilateral donors (of which the UK is the largest). Donors collectively finance around 50% of government expenditure.

**Economic Policy:** Malawi has a history of poor economic management, which has resulted in runaway inflation (e.g. 30% p.a. in Feb 2001), weak growth, spiralling fiscal deficits and volatile exchange rates. The relationship with the IMF has been difficult – leading to withdrawals of some donor funding - but has improved significantly with the new President and Government. [See Box 3] The new government has adhered to its budget, and the fiscal deficit could end up at a reasonable 4% for this financial year. They have also reinvigorated the stalled privatisation programme with the impending sale of Malawi Telecoms. With sound progress recorded under the current (unfunded) IMF Staff Monitored Programme (SMP) and the likelihood of parliamentary approval for the fiscally responsible 2005/06 budget (expected in June), a new funded IMF programme is likely to be in place by mid 2005, which will open the way for Malawi to reach its completion point under the HIPC initiative and benefit from further debt relief.

### **Box 3: IMF Poverty Reduction and Growth Facility (PRGF)**

In September 1999, the IMF established the Poverty Reduction and Growth Facility (PRGF) to make the objectives of poverty reduction and growth more central to lending operation in its poorest member countries. PRGF-supported programs are framed around comprehensive, country-owned Poverty Reduction Strategy Papers (PRSPs), which are prepared by governments with the active participation of civil society and other development partners. This is intended to ensure that PRGF-supported programs are consistent with comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty.

In December 2000, a three-year PRGF arrangement for Malawi was approved. However within a year (in November 2001) Malawi was off track with a poor performance in poverty-related expenditures and a fiscal gap significantly below target. By Autumn 2003, there were some improvements in fiscal management. The IMF completed its first review of Malawi's PRGF arrangement and approved a disbursement of US\$ 9.2 million. However by Spring 2004 the PRGF programme was again off track.

Following the election of the new Government in May 2004 the IMF prepared a Staff Monitored Programme and so far the performance of the new government has been good; for the past nine months expenditure targets have been met. Encouraged by improved expenditure management and the clampdown on corruption, the IMF is currently in discussion with the new President Mutharika over a new PRGF which would open the way to Malawi reaching its HIPC Completion Point and receiving additional debt relief.

**Monetary Policy:** The currency, the Kwacha, has suffered from a volatile exchange rate. The central bank has attempted to intervene to stabilise the currency but is constrained by very low

foreign-exchange reserves (less than two months of import cover). Interest rates remain very high. Base rates have been over 40% in recent years, but were reduced to 25% in June 2004, and remain at this rate. High real interest rates reflect the governments heavy domestic borrowing and also the under-developed and non-competitive banking sector. Such high rates have hampered private investment – a key driver of growth – in addition to exacerbating the fiscal position. Inflation in 2005 is anticipated at 15%, fuelled by high import prices (e.g. for oil and for maize – the staple food). Monetary policy is expected to remain tight in order to help bring inflation back down under control.

#### **Box 4: World Bank: County Assistance Strategy (CAS)**

In May 2003 the Malawi CAS was approved by the Bank's board. Based on the current social, economic and political situation in Malawi, the strategy presents a program aimed at helping the Government address urgent development issues. The program is organised under three pillars:

- (i) Strengthening economic management
- (ii) Establishing a platform for growth
- (iii) Improving service delivery and strengthening the safety net

All objectives organised under the three pillars of the CAS will be achieved through on-going projects funded by the bank. Currently there are twelve active projects in Malawi with a net commitment of US \$381.6 million, and an un-disbursed balance of US \$262 million (as of August, 2004). Projects include:

- *Multi-sectoral AIDS Project* which supports efforts by the government to reduce HIV transmission and mitigate the impact of the disease throughout Malawian society.
- *Malawi Social Action Fund (MASAF)*, a poverty-reduction project that supports decentralisation and community capacity building.
- *Road Maintenance Project* aimed at bringing sustainable improvements in the quality of Malawi's road infrastructure.
- *Privatisation and Utility Reform Project*, aimed at improving the quality and access to economic and physical infrastructure, namely telecoms, water, and power stations.
- *Financial Management and Accelerating Growth Project (FIMAG)*, which provides credit for structural adjustment. In 2004 the Project was approved committing US \$50m in balance of payments support over a period of 2 years.

**International Relations** (*inter alia*): Member of COMESA (Common Market for East and Southern Africa) and SADC (Southern African Development Community) and the WTO.

**President:** Bingu wa Mutharika

**Vice President:** Cassim Chilumpha

**Finance Minister:** Goodall Gondwe

**Central Bank Governor:** Victor Mbewe

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