The Case of Malawi

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Introduction

The *Accelerated Development Report* [World Bank 1981] demonstrates quite clearly that the region's economies were in serious trouble by 1979. Excluding Nigeria, GDP per head fell during the 1970s by half a per cent a year in real terms; food production grew much more slowly than population so that food imports increased rapidly; current account deficits increased from $1.5 bn to $8 bn a year despite extremely painful cutbacks in imports; and the cost of servicing foreign debt doubled as a proportion of foreign exchange earnings.

Crucially, the Report's puts most of the blame for African countries' economic problems on the policies of their governments, rather than on their economic inheritance from the colonial period, or on the adverse external economic conditions that they have had to face. As Philip Daniel has also noted, three main 'domestic policy inadequacies' are listed in the Report. These are: trade and exchange rate policies which over-protect industry; over-extended public sectors; prices, taxes and exchange rates which are biased against agriculture and in favour of industry.

Although generalisations of the type found in the Report rapidly lose their interest when one begins to study the problems of a particular country, the power and influence of the World Bank, including its new role in making structural adjustment loans, do make it necessary to examine whether the Report is right or wrong in its analysis, at the country level. Malawi makes an interesting case because it seems, at first glance, to have avoided at least some of the policies which are supposed to have been the prime cause of the present crisis. Yet although Malawi's economy grew quite fast in the 1970s, and may not be in such a severe economic crisis as some of the other countries in the region, the economy does nevertheless face serious short and long-term problems.

Malawi's Recent Economic Policies and Performance

From 1970 to 1979 real GDP in Malawi grew at an average of 7 per cent a year. This growth was based on agricultural exports, so that the country cannot be accused of neglecting the agricultural sector, taken as a whole. Manufacturing industry mainly produces consumer goods with relatively little protection, and using relatively labour intensive methods (manufacturing employment has risen at about the same rate as manufacturing value added), so that farmers have not been forced to buy expensive inputs from an overprotected local manufacturing sector. Average real earnings of employees fell steadily through the 1970s from K308 a year in 1970 to K194 a year in 1979, at 1969 prices. This fall probably overstates the fall in the real income of most employees, as the average is pulled down by relatively rapid increases in the number of low-paid workers. Nevertheless, the overall wage trend greatly reduced the likelihood of the Malawian Kwacha being overvalued.

Nor is there much evidence that the public sector is too big, as it consists mainly of the usual utilities such as electricity, water and railways. Agricultural marketing of smallholder crops for export is, however, in the public sector, being exclusively handled by ADMARC (the Agricultural Development and Marketing Corporation). This body also markets smallholder crops for the domestic market in unofficial competition with private markets. Thanks mainly to the large profits made by ADMARC itself, the public sector as a whole was profitable until 1978 and made only a small loss in 1979. Considerable debate surrounds ADMARC's pricing policies, as will be discussed below. Nevertheless it undoubtedly provides a fairly efficient service in the sense that marketing costs have not risen as a proportion of turnover, except insofar as can be explained by the increased cost of oil and therefore transport, and an increasing proportion of maize in total tonnage handled.

Concerning the prices that have been offered to farmers, the real value of ADMARC's prices to smallholders has fallen annually since 1973, and prices for the export crops of tobacco, groundnuts and cotton were significantly below export parity until the fall in export prices from 1979 to 1981. The estate sector, in contrast, was able to sell direct to export markets. Furthermore, a large part of the finance for expansion of the estate sector came from ADMARC, which invested more than half of its profits in the 1970s in this way. As a result, all of the growth in agricultural exports, and therefore in total exports, came from the estate sector. Purchases by ADMARC from the smallholder sector actually declined by half a per cent a year from 1964 to 1980, even though there was quite a large implicit subsidy on maize and rice [Kydd and Christiansen 1981:83].

On the whole, then, with distinct reservations as to how policy has operated *within* the agricultural sector, it could be said that, until 1979, Malawi's policies had conformed quite closely to what the Report is now recommending. It could also be said that these policies had been quite successful in generating economic growth, based on growing agricultural exports and accompanied by growth in formal sector employment.

However, Malawi's policy within the agricultural sector was far from being consistent with the Report's priorities. Smallholders have not been given priority. Via ADMARC they have been taxed to the benefit of investment in estates. Real grower prices have not been raised but have fallen in every year since 1973. Admittedly given relative efficiency of marketing throughout, dramatic real transport cost increases and the surrender of ADMARC's whole surplus (initially near 30 per cent of its turnover), it is now hard to see how they could be. ADMARC has been a dependable buyer; in the right place, on time with cash. But it has been a monopoly buyer for export crops. Further, it has paid pan-territorial prices — raising maize production in previously non-cash areas, but thereby also raising average transport costs. Consumer goods have — at least until 1981 — been fairly readily available in rural areas. Cautious, profit and export oriented, and relatively successful in generating output growth in the 1970s Malawi's agricultural policy demonstrably was; centred on smallholders and on real price increase incentives it was not.

The Recent Crisis

Malawi's barter terms of trade held up quite well until 1977, when they were moderately better than in the late 1960s and only 7.5 per cent below their 1972 peak.

Malawi's terms of trade fell sharply in 1978, 1979 and 1980 and showed no improvement in 1981, remaining stagnant at 32 per cent below their 1975-77 average.

Import prices rose 54 per cent in two years and export prices, which had more or less kept pace with import prices in 1974 and 1975, did not rise at all in 1979 and 1980. So severe was this loss of international purchasing power that Malawi's current account deficit rose from an average of K68 mn in 1975-77 to an average of K169 mn in 1978-81, *in spite of* 67 per cent growth in the value of exports in the three years to 1981.

Table 1

Malawi's barter terms of trade 1967-80

(1970 = 100)

1967	87	1972	93	1977	94
1968	90	1973	90	1978	84
1969	93	1974	84	1979	67
1970	100	1975	81	1980	57
1971	102	1976	79	1981	57

Source: Reserve Bank of Malawi, *Financial and Economic Review*, no 3, 1981; *Economic Report*, 1982.

Note: these calculations exclude sugar exports whose price to Malawi was high in 1981, so that the decline in the terms of trade shown in the table is overstated; however, the price obtained by Malawi for sugar exports fell disastrously in 1982.

Malawi had to borrow, therefore, an additional K100 mn a year in the four years from 1978 to 1981, which was more than twice the average level of foreign exchange reserves during the period 1974-77. Previously Malawi had been able to finance most of its current account deficits with relatively cheap long term money, so that growth in external debt had been kept within manageable limits. External public debt outstanding grew from K120 mn in 1970 to K423 mn in 1979, but the 1979 figure was actually a smaller proportion of GNP (at 33 per cent) than the 1970 figure (39 per cent). Because there was some rise in the proportion of shorter term commercial borrowing, the burden of debt service rose, but only slightly, as a percentage of GNP (1.8 per cent to 2.1 per cent) and as a percentage of exports of goods and services (from 7 per cent to 9.4 per cent).

By 1982 the debt service situation had deteriorated sharply. The debt service forecast for 1982 is K84 mn, which would give a debt service ratio of 29 per cent on the basis of the official export forecast for 1982 (in the 1982 *Economic Report*), which now seems rather optimistic. Moreover, these figures do not include short term debt, which has increased rapidly since 1979: the net foreign asset position of the banking system went from a negative figure of K9 mn in 1978 to a negative figure of K112 mn in 1981. Although this short term debt has been rolled over successfully so far, the interest burden adds to the country's problems, and is vulnerable to increases in international interest rates. This sudden and rapid worsening of the debt service position, from 9 per cent to 29 per cent of exports in only three years, was caused by:

- the need to borrow on much harsher terms, because soft loans could not expand by nearly enough to finance the greatly increased current account deficit;
- the sharp increase in both nominal and real interest rates on commercial-type debt.

Thus external debt slightly more than doubled between 1978 and 1981, but debt service increased by a multiple of £10. The damaging increase in 'real' interest rates is shown in Table 2.

The calculation of 'real' rates of interest implies that the rate of inflation used in the calculation applies to the income of the borrower, who thus is able to make interest and capital payments out of increased earnings in devalued monetary units. If, however, the borrower's income does not rise with the general level of inflation then the real cost of borrowing is higher than implied by the simple calculation of Table 2. Put slightly differently, a country in Malawi's position facing declining terms of trade, must somehow increase export volume (and borrowing) not just to pay the higher cost of imports, but also to pay higher interest on external debt. This item is not included in the conventional terms of trade calculation.

The worsening debt position would be relatively manageable if Malawi's exports were to continue growing and its terms of trade to cease falling. But the main sources of growth of exports in the 1970s appear to have been extinguished as a result of the current economic crisis. As already noted, more than half of ADMARC's profits in the 1970s were invested in estate agriculture, providing an important part of the finance for the growth of exports from the estate sector. This source of finance for investment in estate agriculture dried up completely in 1979. Trading profits for ADMARC of K34 mn and K40 mn in 1976-77 and 1977-78 respectively became only K5.5 mn a year later and were eliminated in 1979-80 and 1980-81. Overall, ADMARC ran losses in those latter years, as losses on the supply of fertiliser and other inputs, plus other expenses, exceeded dividends and interest on its investments.

A second important source of finance for estate agriculture was commercial bank lending. From 1970 to 1980, commercial bank lending to the agricultural sector rose from K2 mn to K93 mn, and from 10 per cent to 54 per cent of bank advances, so that advances to the agricultural sector accounted for more than 60 per cent of the increase in bank lending over the period. As part of a series of macroeconomic measures introduced in August 1979, to ease the balance of payments situation, the government implemented a credit squeeze. Total lending was virtually unchanged in 1980, and lending to the agricultural sector rose by K11 mn only by means of a fall in lending to other sectors, notably the distribution sector. It is doubtful whether this could be repeated. In any case many estates were in financial trouble from 1980 because of a combination of adverse price changes and excessive reliance on loan finance. There were a number of bankruptcies. More positively, there was an effort by the banks to supply technical assistance. In such circumstances, some of the more recent increases in lending must have been to cover losses rather than to finance expansion.

Table 2

Real interest rates 1975-81
(percentages)

	eurodollar deposit rates *highest month*	*lowest month*	*industrial country inflation*	*range of interest rates*
1975	8.6	6.1	10.8	−2.2 to −4.7
1976	6.2	5.4	7.8	−1.6 to −2.4
1977	7.1	5.1	8.4	−1.3 to −3.3
1978	11.6	7.3	7.2	+4.4 to +0.1
1979	15.0	10.5	9.2	+5.8 to +1.3
1980	19.9	9.8	11.9	+8.0 to −2.1
1981	18.8	12.0	9.9	+8.9 to +2.1

Source: IMF *International Financial Statistics.*

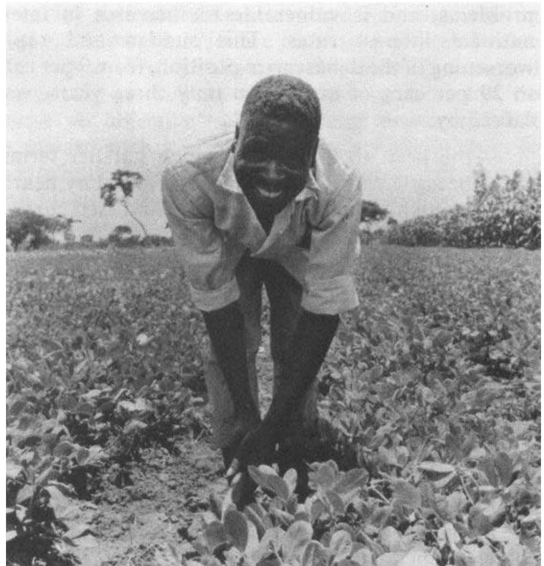
The third source of estate investment — retained earnings — has also dried up. On an accounting basis losses predominate and many estates even have negative current cash flows.

Inevitably, there was a large drop in agricultural as in other private sector investment. Public sector investment also fell, though not as drastically.

In 1980, private sector fixed investment was lower in real terms than it had been in 1973. In 1981 it was so low, at K33 mn, that it was substantially below the level needed to maintain the capital stock.

Concerning public sector investment, there may be some reason for believing that the situation is not quite as bad as suggested by these figures. A number of large infrastructural investments, whose contribution to growth of output is bound to be very small in the medium term in relation to their cost, have recently been completed: the new international airport at Lilongwe, the tarred road to the North, the building of the new capital city, the extension of the railway to Lilongwe and on to the Zambian border at Mchinji (still some 400 miles from the Zambian railway network). This may be part of the reason why the Incremental Capital Output Ratio (ICOR) rose during the 1970s, and could partly justify the official forecast, in the *Economic Report 1982*, that the ICOR will fall from 4.9 in 1983 to 2.8 in 1985, and even lower in 1986 and 1987.

Nevertheless, that same forecast expected estate agricultural production to grow by 50 per cent from 1982 to 1987, and exports to grow by nearly 150 per cent over the same period. Even if the economy had just got through a period of heavy infrastructural investment with relatively little impact on output, much of that same investment would require current expenditure by the government, for example the new airport, and Air Malawi (which ran up large losses in 1977-80). Meanwhile the government itself was not only running a much increased overall deficit and had moved into recurrent deficit, but was unable to reduce the deficit despite strenuous efforts to do so. In 1981-82 the overall deficit was budgeted to fall to K80 mn from K116 mn the previous year, but in fact rose slightly to K120 mn.



Lilongwe Land Dev.

Most Malawians are small peasant farmers but government policy has discriminated in favour of estate production which has now reached an impasse. (Malawian peasant weeding groundnuts)

Table 3

Changes in gross fixed investment 1977-81
(percentages)

Current prices	*1977*	*1978*	*1979*	*1980*	*1981*
public investment	+29	+60	+ 4	+20	-26
private investment	+ 1	+82	+ 2	-37	-55
Total	+17	+68	+ 3	- 2	-34
In constant prices (using GDP deflator)	*1977*	*1978*	*1979*	*1980*	*1981*
public investment	+19	+54	-11	+ 2	-39
private investment	- 6	+76	-12	-46	-63
Total	+ 8	+62	-12	-17	-45

Source: Reserve Bank of Malawi *Annual Report 1980; Economic Report 1982* (not wholly comparable with other source, but basic picture consistent in both).

So the government was in no position to provide the finance for increased agricultural exports, either directly, or indirectly (for example, by raising ADMARC's prices to smallholders for export crops and covering the resulting ADMARC deficits). Nor could the commercial banks resume their earlier growth in lending to agriculture while the balance of payments remained so heavily in deficit, and while credit restraint remained a condition of IMF lending and the World Bank's structural adjustment loan. In fact, in 1982 the government was again attempting to cut back on its own spending; and the Reserve Bank was continuing to rely on credit restraint plus a 15 per cent devaluation in April 1982, rather than import or exchange controls, to restrain the level of imports.

Conclusion

In the short run, Malawi survived the collapse of its terms of trade comparatively well. Growth never fell below zero (although it did fall below the population growth rate). The authorities did not have to resort to controls, so that imports were still obtainable for production, and indeed for consumption. The black market rate of exchange, from the evidence of a court case, involving the (as it happens) legal sale of travellers cheques, appeared to be only 10 to 15 per cent higher than the official rate. But the future was heavily mortgaged: debt service was an increasingly heavy burden, and investment spending fell drastically.

The situation would not be so serious if export growth could be maintained. But the three main sources of finance for export growth in the 1970s, ADMARC's surpluses, estate profits and bank credit, were no longer available. Moreover, Malawi's present situation, precarious as it is, depends on having had declining real wages, and on even more rapidly declining real income in smallholder agriculture (since otherwise people would not have moved into estate employment in such large numbers, even with the enforced decline in the numbers going to work in South Africa). There must be some limit to the reduction in real wages that can be enforced, and that in turn limits the options available for generating future export growth.

In one sense the World Bank has been consistent: Malawi obtained a Structural Adjustment Loan from the Bank. But it would seem that this is more a recognition that Malawi needs balance of payments support because of the serious impact of external events, than finance for some form of 'structural adjustment'. Certainly no significant structural adjustment measures have been announced, and it is not particularly easy to see what they might be. Meanwhile, Malawi is having to cut back on the already rather meagre levels of public spending, compared to other countries in the region, on such areas as health and education, in order to 'justify' the present levels of borrowing. If this was the reward for the 'right' policies, competently administered, then surely the Bank was wrong in playing down the impact of external events.

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