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The political economy determinants of economic growth in Malawi

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Abstract

Since independence Malawi has failed to translate initial periods of economic growth (growth acceleration regimes) into sustained long-term growth (growth maintenance). This paper assesses why this has been the case and what feedback loops have existed between growth, the political settlement and institutions. This is done by assessing Malawi's: (1) deals space – are business-government deals credible and open to many, or not credible and closed? (2) rent space – where do political elites source money for their political objectives? (3) product space – to what extent does Malawi's product base organically spur economic growth? Malawi's long-term growth problem is that the rent space for the political elite remains too heavily tied to the 'powerbroker' business elite that have a low propensity to invest and support exported-oriented reforms. There is relatively little alignment of political rents to 'magicians' (value adders and job creators), rentiers (except mining and cotton) and workhorses (the poor). Developmental interest is increasing, though this comes about in dribs and drabs when politicians want growth, so that support is stop-and-go and lacks the continuity necessary to overcome major structural challenges to structural transformation and growth maintenance. This suggests that the nature of growth going forward will be volatile, with a number of booms and crises in short-term growth. While long-term growth is likely to remain positive, driven by improvements in technology, the financial sector, energy and regional integration, it is unlikely to be strong enough in the next eight years to support the welfare requirements of the burgeoning population so as to allow Malawi to maintain high long-term growth. Altering this route would probably involve the disintegration of Malawi's deeply embedded patronage and clientelist political settlement through the emergence of a developmental dominant party or the easing of political pressures currently caused by a five-year democratic term in which the largest voter group is rural, subsistence farmers, who are too far removed from the government's policy-making process.

Keywords:

Malawi, deals space, rent space, product space, growth regimes, political settlement, clientelism, elites

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1. Introduction

Endogenous economic growth literature is increasingly taking an interest in the role of institutions. Recent literature has attempted to understand why in certain political contexts, growth-enhancing institutions emerge while growth-impeding institutions persist in many developing countries for long periods of time (Acemoglu and Robinson 2012; Khan 2010).

There remains an inadequate understanding of the political dynamics of economic growth. Three unanswered questions are: (a) why do some countries successfully initiate episodes of rapid growth while others suffer extended stagnation? (b) why do some countries *sustain* growth episodes over many decades, while other growth episodes end in reversion to stagnation or collapse? and (c) what characterises feedback loops between growth and institutions?

This is a case study on Malawi and is part of a wider research project run by Effective States for Inclusive Development (ESID) that aims to contribute to the literature on the political determinants of economic growth. The objective is to help understand the political drivers of within-country growth, while applying the conceptual framework developed by Sen (2012) and Pritchett and Werker (2012). It is a qualitative assessment of the political factors that explain past and current growth processes in Malawi. It analyses the role played by the product space, the structure of rents around the product space, and the incentives of political and business elites in Malawi’s growth regimes and structural transformation process since 1954. The paper is centred around an assessment of Malawi’s four growth regimes registered between 1954 and 2013.

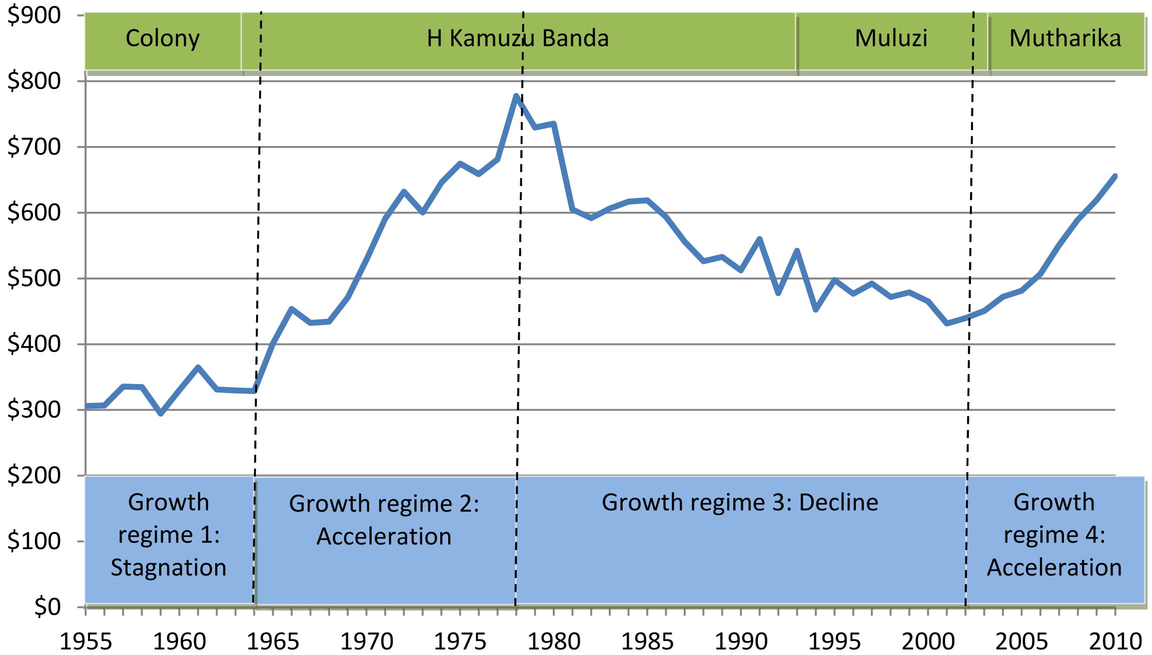
In Section 2 Malawi’s economic and political history is presented, including its structural transformation story. Section 3 provides a brief methodological note. Section 4 presents a description of the evolution of Malawi’s rent space and Section 5 presents a description of how it currently stands: Pritchett-Werker’s (2012) market rent matrix of elite interests is applied to Malawi’s product space to characterise the structure of rent around the product space. Section 6 concludes by summarising Malawi’s structural transformation history and characterising Malawi’s feedback loops relative to its ability to deliver a growth maintenance regime following a growth acceleration regime. A rationalising of Malawi’s failure to structurally transform since the 1970s is provided from the context of the market rent space. A potential future outlook for Malawi is provided.

2. Political settlements, growth and structural transformation

Malawi’s economic growth since 1954 may be characterised by four distinct phases: (a) stagnation between 1954 and 1964; (b) growth acceleration between 1965 and 1978; (c) decline of GDP per capita between 1979 and 2002; and (d) growth acceleration between 2003 and 2013. The growth of real GDP per capita in dollar terms from 1954 to 2010 is plotted in Figure 1 below. There are three structural breaks in Malawi's growth path between 1954 and 2013 (Kar *et al.,* 2013). These occurred in 1964, 1978 and 2002 and are indicated in Figure 1 below, together with its political regimes.

Real GDP per capita peaked in 1977 at $778, at the end of a growth acceleration regime that started in 1964. Thereafter real GDP per capita slumped to $431 in 2001 at the end of a long period of decline that lasted 23 years. A second period of growth acceleration commenced in 2003, though at $656, real GDP per capita in 2010 remained below the peak achieved in 1977.

Figure 1: History of Malawi's political regimes and GDP per capita (1955-2010), US dollar prices, and breaks filtered from four possible Bai-Perron breaks



Source: Penn World Tables 7.1 – PPP converted GDP per capita (chain series), at 2005 constant prices.

2.1 Growth regime 1: 1954–1964

The stagnant growth regime between 1954 and 1964 reflected the final years of British colonial rule. Between 1883 and 1953 Malawi was a British Protectorate, initially under the name of British Central Africa Protectorate, and later Nyasaland Protectorate. Between 1953 and 1963 it was adjoined to the Rhodesias, forming the Central African Federation. Malawi became self-governing in 1963 and fully independent in 1964.

The British pound was used as currency during this pre-independence period (Pauw, Dorosh and Mazunda, 2013). Malawi had no reserve bank and no independent monetary policy. The pound was not suitable for the Malawian economy. It was extensively overvalued, given Malawi's trading position and its limited capacity to export.

Fiscal policy was also ill-suited to Malawi. Between 1953 and 1963 the British protectorate of Nyasaland was federated into the Federation of Rhodesia and Nyasaland – with most fiscal expenditure concentrated in South Rhodesia, modern-day Zimbabwe. As such, both the productive sectors and the welfare system, such as education and healthcare, were relatively underdeveloped. Infrastructure investment in railways and roads had also dried up, following the investments made in the first half of the century. The period of stagnation at this time came about despite relatively low population growth at the time that averaged 2 percent per year.

The Malawi Congress Party (MCP) assumed power after easily winning the 1961 elections for a new legislative council. It emerged from the Nyasaland African Congress that led the independence struggle from 1944. Its leader, Hastings Kamuzu Banda, became Prime Minister in 1963 and President in 1966, after Malawi adopted a new constitution that created a republic and a one-party state. Malawi assumed a dominant party system that lasted until 1994, when multi-party democracy was introduced.

2.2 Growth regime 2: 1965–1978

In 1964 Malawi entered a growth acceleration regime that lasted until 1978. During this period the annual average real growth rate exceeded 5 percent and over the whole period GDP per capita more than doubled (Booth *et al.*, 2006).

Malawi became independent in 1964 and a new constitution was introduced in 1966. H. Kamuzu Banda suppressed opposition movements and either detained their leaders or drove them into exile. The MCP established a paramilitary wing to maintain authoritarian control together with a secret police. Thousands of dissenting Malawians were imprisoned. The party monopolised the mass media and introduced censorship to prevent the expression of dissenting views (Meredith, 2006).

In his initial 15 years in power, H. Kamuzu Banda balanced a developmental approach with a patronage system based on clientelism to reward followers. He promoted development through a long-term vision, while at the same time building his own personal empire. He assumed a dualistic development policy that balanced active government interventions with targeted private sector leaders in strategic sectors. He did not opt for free markets and an open door policy on private sector investment. According to experts interviewed for this paper, he instead selectively identified strategic partners to enforce growth in specific sectors. His thinking was for such partners to attract investment by being sectoral pace-setters in technology, innovation and quality control. Such companies included Lonhro (formerly owned by the Tiny Roland family) in sugar, the Conforzi family in tea, David Whitehead in textiles and Limbe Leaf in tobacco. This came at a time when the production of commodities such as tobacco became more cost-effective in developing rather than developed countries. Investment in tobacco was well coordinated, with constraints on land, extension services, market linkages, research and transport all being addressed through public and private sector players in the sector.

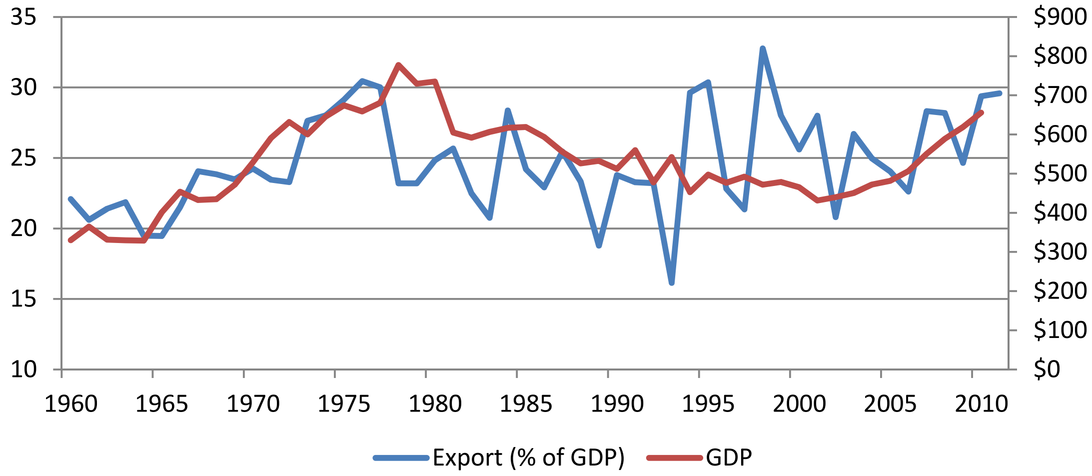
The government promoted agricultural development by advocating for estate farming models. Its policies supported large-scale agriculture, awarding preferential access to land, investment and credit. It established a monopoly state marketing board – the Agricultural Development and Marketing Corporation (ADMARC) – that channelled profits into the estate sector and subsidised investments in industry. It supported smallholder production and food consumption through subsidies. This growth regime was largely a product of estate-based growth, such that during this period the production of estates grew at an average annual rate of 17 percent, while smallholder production grew at 3 percent (Ngwira, 2012). The government supported this development policy through a fixed exchange rate regime that undervalued the Malawi Kwacha. This supported higher rates of savings (Simwaka *et al.*, 2012).

H. Kamuzu Banda also created a company called Press Holdings that dominated a number of sectors: retail, wholesale, tobacco estates, oil distribution, property, banking, insurance, ranching, pharmaceuticals and transport. At its peak it accounted for one-third of Malawi’s GDP and employed 10 percent of the wage-earning work force (Meredith, 2006). H. Kamuzu Banda had probably hoped that other investors and local entrepreneurs would emerge to fill gaps in the economy once Asians were kicked out of rural areas. When they did not, Press did. He also hoped that estates would pass on skills and technology to smallholders, but there was no mechanism for this to occur. As a result, what emerged was a symbiotic relationship between Press Corporation and ADMARC, the former in agriculture and production and the latter in marketing. Smallholder farmers were largely excluded from this economic set-up.

Malawi also established strong economic ties with South Africa, under which South Africa invested in Malawi’s infrastructure, including the construction of a new city centre in Lilongwe.

The government's centralised approach to development policy allowed Malawi to exploit its existing support structures at the time, such as its rail and road network. Malawi exported 95 percent of its products through the Mozambican ports of Nacala and Beira (Lea and Hanmer, 2009). Real domestic revenue from exports created growth by stimulating non-tradeable services and, to an extent, import-substituting industrialisation in sectors such as textiles. From 1964 to the late 1970s, the increase in exports corresponded to the growth in GDP per capita (Figure 2 below).

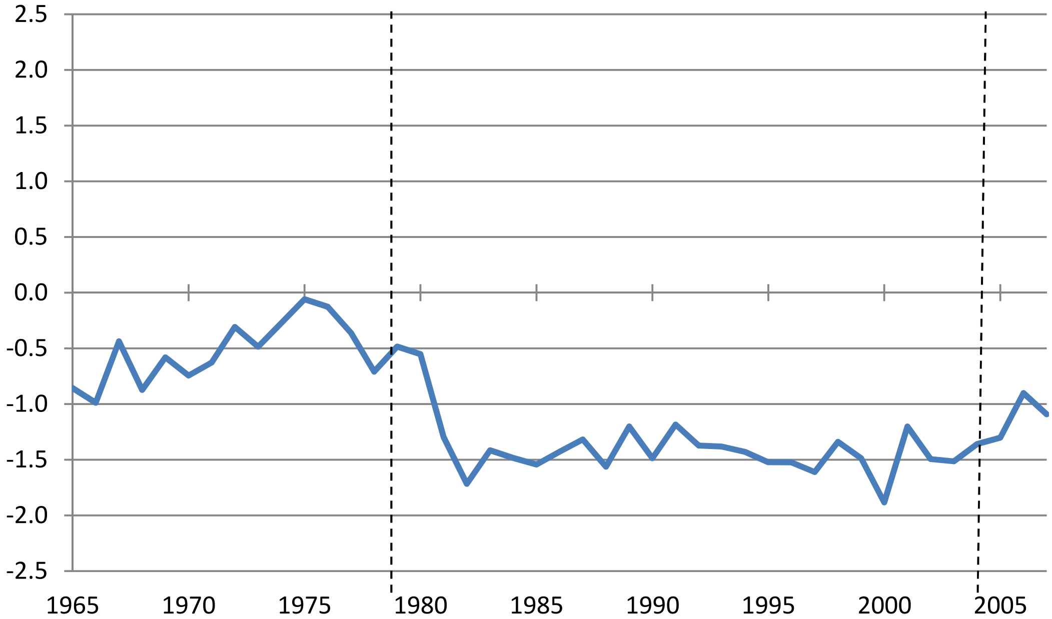
Figure 2: Percentage of exports and GDP per capita, US dollar prices



Source: Penn World Tables – PPP converted GDP per capita (chain series), at 2005 constant prices and World Bank World Development Indicators.

The development policy pursued by H. Kamuzu Banda in the 1960s and 1970s drove Malawi's score on the Economic Complexity Index to rise from -0.99 in 1966 to a peak of 0.06 in 1975 (Figure 3 below). This index is a measure of the extent to which a country exports products that inherently support investment in other more complex products, because of a similar cost base. The improvement in the Economic Complexity Index during this period was also supported by the emergence of new sectors such as sugar cane – two major estates were established in the 1960s – and beverages – Carlsberg opened its first brewery outside of Denmark in Malawi in 1968.

Figure 3: Economic Complexity Index, Malawi



Source: The Observatory of Economic Complexity. The dotted lines represent Malawi's growth breaks. Note: The graph charts the degree of complexity of Malawi's export basket over time, where 2.5 represents the maximum level of complexity and -2.5 the minimum.

2.3 Growth regime 3: 1979–2002

Malawi's third growth regime is one of decline. This growth regime is complemented with a decline in Malawi's Economic Complexity Index to -1.72 in 1982 and to an all-time low of -1.88 in 2000 (Figure 3 above).[1]

Following the 1973 oil price shock, commodity prices fell in the late 1970s. Commodity price volatility in the late 1970s led to the collapse of Malawi's terms-of-trade that declined by 43 percent from 1980 to 2002. As world demand declined, credit became more expensive internationally. This hit Malawi's tobacco sector hard and estate bankruptcies followed, which induced a domestic banking liquidity crisis (Cammack, Kelsall and Booth, 2010). Similarly, South African demand for migrant labour declined, reducing Malawian remittance incomes. In 1977 civil war broke out in neighbouring Mozambique and lasted until 1992. Renamo damaged the Beira railway line in 1979, and the war also blocked the port of Nacala. This led to a significant increase in transport costs, as exports were diverted to Tanzania and South Africa, via Zambia and Zimbabwe. The Mozambican Civil War resulted in an influx of over one million refugees into Malawi, equivalent to 10 percent of Malawi's population. This gave Malawi one of the highest refugee ratios in the world (Lea and

[1] The decline in the index in the late 1970s and 1980s was also a result of a decline in the complexity at a global level of products that Malawi exported – such as tobacco and legumes – because the rise in global commodity prices shifted the production of such crops from developed economies to less developed economies.

Hanmer, 2009) and placed a large strain on public expenditure, land and food security.

The start of lender-promoted structural adjustment (e.g. through the partial decontrol of prices of some commodities in 1983), a severe drought in 1979-80, bad weather conditions in 1981, food shortages and the closure of the most cost-effective rail route to a sea port also contributed to this growth regime. The government maintained a fixed exchange rate regime, but resorted to constant devaluations and fiscal deficits on the back of its efforts to fund welfare expenditure. The cumulative effect of all these factors manifested itself in an inflation rate of 83 percent in 1995, after it had been maintained at around 10 percent in the 1960s and 1970s (Naferankhande and Ndhlovu, 2006).

The political economy played a key part in the decline of GDP per capita between 1979 and 2002. In the late 1970s and through the 1980s the government's policy became less coherent, because as the economy declined due to external shocks, structural problems and policy weaknesses, the regime could no longer buy off clients, such that a group who wanted change emerged. This group included people who stopped benefiting from the regime, including Bakili Muluzi, who led a group called MCP Team B that advocated with donors for liberalisation. H. Kamuzu Banda, who had been declared life President in 1971, lost his developmental approach as pressure gradually mounted for increased political freedom. In the 1978 assembly elections he allowed for some constituencies to have more than one contestant.[2] He required all potential candidates to belong to the MCP and to pledge their allegiance to him. He excluded many by requiring them to pass a tough English exam. In the elections one of Banda's supporters in the government lost his seat. He was reinstated a few weeks later. An aid embargo was introduced as development partners called for a multi-party democracy following the fall of the Berlin Wall.

Banda was in his 80s in the early 1980s, the decade in which succession politics and intrigue emerged, with John Tembo, Banda's deputy, strengthening his position. Many viewed him as the real power holder in the 1980s and early 1990s, with Banda as a figurehead (Cammack, Kelsall and Booth, 2010). Supported by Tembo, Banda charged several Ministers and politicians who turned against him with treason and regularly reshuffled his ministers in order to prevent the emergence of a political rival and to demonstrate his authority. In 1981 a prominent exile, Orton Chirwa, was abducted in Zambia and returned to Malawi to be given a death sentence. Following international protests the sentence was commuted to life imprisonment. In 1983, allegedly on orders from Banda, three Ministers and a Member of Parliament who were advocating internal reforms were killed by the police in a staged traffic accident.

> 'The nature of clientelist politics sits at the centre of these murders with policy differences quickly personalised and the need for Banda and his deputy John

[2] http://africanelections.tripod.com/mw.html

> Tembo to maintain close control of power and to crush opponents before they rose too far' (Cammack, Kelsall and Booth, 2010).

The growth regime during this period is ultimately characterised by three underlying structural constraints that had developed gradually over time since the 1960s, but which emerged on the back of these external shocks, on the gradual liberalisation of the economy and on ageing Banda's loss of focus on economic policy in the 1980s, which meant that the country lost economic policy direction (Cammack, Kelsall and Booth 2010).[3] These were weak and deteriorating state capacity, the exclusion of the majority of the population from the high value economy due to the estate based nature of agriculture and the limited number of private sector players in the economy.[4] These exposed the fundamental weakness in Banda's development strategy in the 1960s and 1970s, in which he picked one business winner in each sector and did not invest sufficiently in state capacity.

The first serious challenge to the rule of Banda and Tembo came in 1992 and it came from the Catholic Church. A pastoral letter written by all eight Catholic bishops in Malawi was read out in March 1992 in every Catholic Church in the country. In the letter the bishops publicly condemned Banda, giving him a scathing indictment of poverty, corruption, inequality, censorship and political repression. It referred to overcrowding of schools, inadequate healthcare, lack of freedom and the lack of a fair justice system. Following the publication of this letter, demonstrations were sparked across the country and many development partners suspended aid for six months, citing Malawi's poor human rights record.

The outcome was a referendum held in 1993 on the continuation of the one-party state. The majority voted for multi-party democracy, paving the way for multi-party elections in 1994. Banda's MCP was defeated by the United Democratic Front (UDF) which won 46 percent of the votes, ahead of MCP's 34 percent. Its leader, Bakili Muluzi, was a former Minister and secretary general of the MCP under Banda. The UDF incorporated senior members of the MCP that were sidelined by John Tembo in the 1980s and 1990s.

Between 1994 and 2004, Malawi had three major political parties. Muluzi won the 1994 election with 47 percent. In 1999 the UDF won with 52 percent, while the MCP recorded 45 percent of the vote. In 2001 the UDF held 96 seats in the National Assembly, the MCP held 61 and the Alliance for Democracy held 30.

Muluzi's politics of favouring his religious and ethnic cohorts in the southern region in order to build the patronage structure necessary to win multi-party elections led to an increase in the mismanagement of state resources. Politically connected business elites, such as Kalaria, benefited from insider knowledge and illegal deals. Although

[3] Some observers and visitors claimed in the 1980s that he did not appear astute enough to his government all of the time and that he seemed uninterested in the details of development policy (Pryor, 1990).
[4] Please refer to Appendix for a description of these three structural weaknesses.

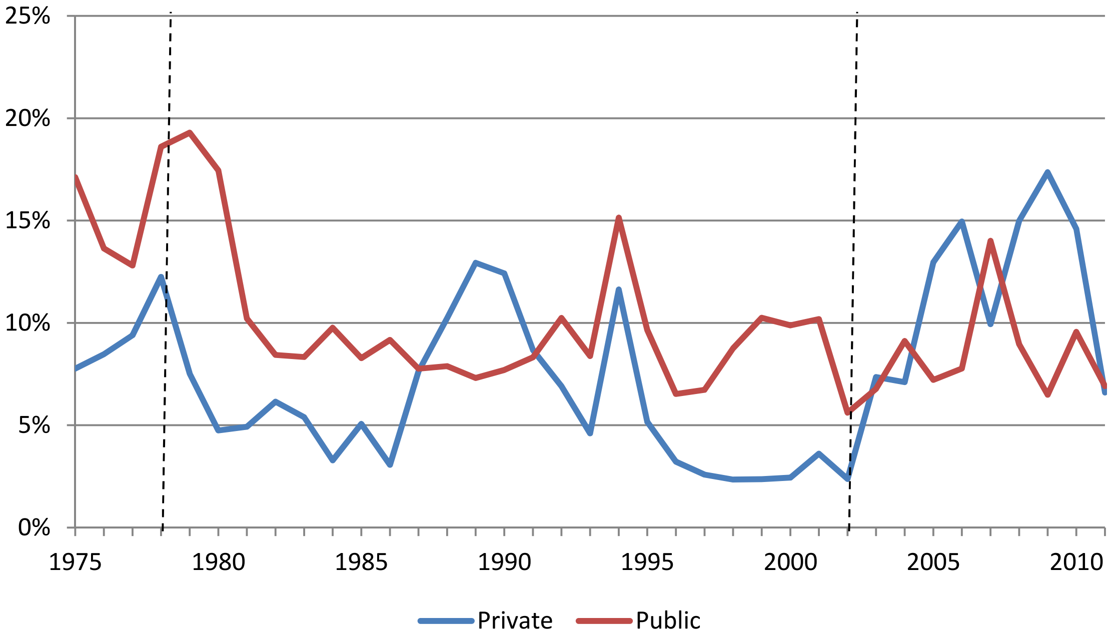
initially Muluzi followed donor advice and relied on advisors who prioritised development, within a few years he had surrounded himself with politicians who had an interest in short-term gains and aimed to use state resources, aid and the development process to stay in power and get rich (Cammack, 2011). Muluzi oversaw the sale of the strategic grain store, partly to political cronies, who benefited from the famine that followed. He was also accused of siphoning off $11m of revenue from this sale to his personal accounts. Muluzi's approach to politics undermined attempts to lay down a solid foundation for economic growth in the first decade of multi-party democracy.

The unlawful grab of Press Holdings (Van Donge, 2002) and various politically inspired changes to the constitution were part of a long string of rule-of-law infractions that contributed to civil strife in 1999, a third-term bid attempt and the eventual election of Mutharika as the third President in 2004. While in 1994 aid hit 39 percent of GDP (OECD, 2013), by 2003 it was cut to 14 percent of GDP and the IMF withdrew when Muluzi's high-level corruption practices and his efforts to secure an unconstitutional third-term in power became evident.

The already weak and demoralised civil service continued to weaken, due to less centralised corruption, political appointments and poor wages (Cammack, 2004). The weakness of the civil service contributed to difficulty in implementing development and poverty-alleviation policies, such as universal primary education, infrastructural development and food security. The spread of HIV/AIDS and fiscal ill-discipline reduced capacity even further. The Special Crops Act was repealed, allowing smallholder farmers to export crops (Diagne and Zeller, 2001). This led to a large shift in smallholder production from nearly nothing in 1990 to around 70 percent of total production of export crops in 2009 (Lea and Hanmer, 2009). Yet market systems were not developed, so smallholder farmer productivity remained low. In addition, debt undermined spending on services (Cammack, 2004). Public services and infrastructure worsened, the inability to deal with poor rains and drought increased, corruption-with-impunity increased and anti-corruption institutions were handicapped by the regime. These undermined foreign investment, manufacturing, job creation and food security. Private investment slowed in the late 1990s as the lending rate increased from 17 percent in 1980 to 56 percent in 2001 (Figure 4 below).

Donors recognised the problems of the Muluzi regime but did not cut aid between 1994 and 2001 in their support of a new democracy in Africa. When they did cut aid in 2002 and 2003 they did so because of Muluzi's attempt to remain President for a third term. However aid was then reinstated to avoid an imminent collapse of the economy (Cammack, 2004).

Figure 4: Investment as a share of GDP, Malawi



Source: World Bank, World Development Indicators and Reserve Bank of Malawi. Measured as the ratio of gross fixed capital formation to GDP.

2.4 Growth regime 4: 2003-2013

Malawi entered a growth acceleration regime from 2003 to 2013. This period benefited from a move to more orderly deals. In 2004 the election's main contestants were MCP and UDF. Following Muluzi's unsuccessful attempt to amend the constitution to run for a third term in office, Bingu wa Mutharika was handpicked by Muluzi to run as the UDF's presidential candidate. Mutharika won the election, but not a majority of seats in Parliament. Wanting to be his own man, in February 2005 Mutharika left the UDF and formed his own Democratic Progressive Party (DPP). A number of ministers and politicians from the UDF transitioned to the new party – epitomising the clientelist nature of Malawi's political system.

He brought in a former IMF economist as Minister of Finance, who set the right macroeconomic policies and opened up to the private sector by strengthening a public-private dialogue mechanism called the National Action Group, which had been waning since its launch in 1999. The group developed the Malawi Economic Growth Strategy in 2004 and 2005, with wide backing from the private sector and government (Chingaipe and Leftwich, 2007).

The change in government served as a conducive basis for growth factors to kick in from 2004. First was the return of development partners following Muluzi's failure to run for a third term. If Highly-Indebted Poor Country debt relief is added to official development assistance, total aid inflows equalled 93 percent of GDP in 2006 and 50 percent in 2007, according to the OECD's aid database (Said *et al*, 2011). While debt relief may appear to be endogenous, given the election of a new President who says and does the right things, this factor is actually exogenous: the continued support for Muluzi's regime, despite a move to disorderly deals in the face of the risk of economic meltdown and the global movement for unconditional debt relief, suggests it is external. In addition, it is not certain that Malawi ever reached the HIPC point, but was nonetheless given debt relief.

Second, good rains in Mutharika's first term, something Muluzi did not enjoy in his two terms, and a boom in the tobacco sector and other cash crops also contributed to the growth acceleration.

Third, the introduction of a large fertiliser and seed subsidy programme and the gains made in the health sector, particularly in HIV/AIDS, supported the acceleration. The introduction of the Farm Inputs Subsidy Programme – and the luck of good rains – prevented famines that had plagued Malawi right up to 2005 (Figure 5 below) and allowed Malawi to create a maize surplus for the first time in almost two decades (Chinsinga, 2012).

Fourth, a key factor behind the growth acceleration from 2006 onward was the fixing of the exchange rate above market equilibrium, resulting in a sharp increase in a moderation of inflation and a boom in consumption, mostly of imported goods. This is evidenced by the rapid increase in Malawi's trade deficit, that rose from 7 percent in 2001 to 21 percent in 2010, and the rise in construction and automobiles on the roads. This policy worked until Mutharika ran out of forex in 2011.

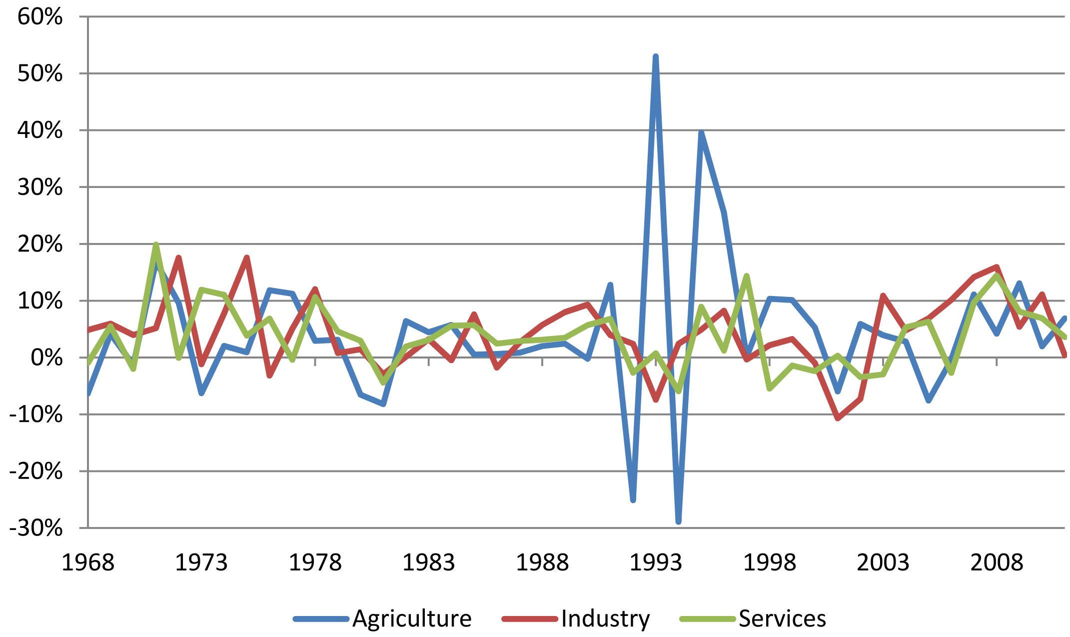
Fifth, Malawi's terms of trade improved in line with rising commodity prices during this period.

Yet the underlying enabler of this growth regime was Mutharika's ability to deliver a more orderly deals environment. He did this by engaging with the private sector, achieving macroeconomic stability and fiscal discipline and centralising rent-seeking activity in his office rather than Muluzi's free-for-all approach to rent-seeking activity.

Things changed in the latter part of this regime. Mutharika won the 2009 election by a landslide, mostly because of his economic successes, and became increasingly concerned with succession. He favoured his brother Peter as presidential candidate in 2014 and sidelined his vice-president, Joyce Banda. According to the constitution, the President could not remove her from the role of vice-president. She formed her own party – the Peoples' Party – and prior to Bingu wa Mutharika's death it had only two Members of Parliament.

The combination of an overvalued fixed exchange rate, a structural trade deficit, in which Malawi imported double what it exported in 2010, and the cutting of aid following a reversal of Mutharika's development stance to one based on succession politics, led to a foreign exchange crisis in 2011. This brought about a deceleration in growth to 1.8 percent that year from 9.0 percent in 2008.

Figure 5: GDP growth rates by major sector, based on constant local currency



Source: World Bank Development Indicators.

Mutharika died in April 2012. Constitutionally the vice-president was to assume the Presidency until the next elections in 2014. However, Peter Mutharika and his supporters in Cabinet attempted to convince the courts to swear him in as President before his brother's death was officially announced. The attempted *coup d'état* was only prevented on the back of delays secured by the Ministry of Justice and through the intervention of the army – which backed a constitutional exchange of power. The decision of the Minister of Justice and the head of the army was probably based on the economic crisis of 2010 and 2011 that was associated with Mutharika and his inner circle. This suggests a positive feedback loop: lack of growth (i.e. foreign exchange crisis) led to a change in government and a shifting of political elite to the ruling party.

Joyce Banda – who had been in politics since the 1990s, first with the UDF and then with the DPP – became Malawi's fourth President, and its third since multi-party democracy was introduced in 1994. A large number of party members abandoned the DPP and joined Joyce Banda's Peoples' Party, in line with the concept of 'chameleon politics' (Englund, 2002). In November 2013 the secretary general of the MCP joined Joyce Banda's Peoples Party and became Minister of Good Governance. For a while Atupele Muluzi, the son of the former President, who heads the UDF, and the head of the rump AFORD party, also became Ministers.

Joyce Banda lost the 2014 elections to Mutharika's brother Peter, who became Malawi's fifth president. Her electoral strategy failed largely because of a 2013 corruption scandal that implicated her and that went public (for which the internet and the media were critical), the rise in maize prices in 2013 and the fact that the bureaucracy remained allied to Peter Mutharika, which probably gave him a strong handle on the electoral process. Losing parties turned to the courts, alleging vote rigging. The Electoral Commission became convinced of the need for a recount of votes following anomalies in the first official count. But while the law allowed the Commission to recount, it did not provide for a time extension for the publication of results. The court announced this with one hour and 30 minutes left before results had to be published, leaving no room for a recount and an official victory for Peter Mutharika. Mutharika won with 36 percent of the vote, ahead of the MCP candidate with 27 percent. Joyce Banda got 20 percent. Mutharika won in the south, MCP in the central region and Joyce Banda in the north.

2.5 Conclusion

Malawi's political settlement is competitive clientelist. Party leaders manage a system of patronage and compete with each other for their clientelist base. Parties are weak and morph one into another, while a small class of political elite change parties to stay in power. Parties are made up of factions of patron-client relationships and this explains the tendency for them to splinter. Banda's government indicated that when it came into power by accident in 2012, the civil service was led by people ready to support a transition of power from Bingu wa Mutharika to his brother Peter. In addition, Mutharika's main business associate was ostracised by previous government to the extent that he had threatened to leave Malawi.

There is a general neopatrimonial logic that transcends changes in government and that continues to drive the behaviour of the ruling elite (Cammack, 2011), so that there is little to differentiate parties in terms of ideology or approach. This is not to say that the same areas, people or groups benefit, because when the leadership changes, while some clients remain, others do change. The only lines of difference are regional or ethnic roots, and the ideology (or lack of) of the leader. All parties are built around their leader – at present there are more than 30 registered parties, based on the premise that if one wants to be political one forms one's own party – such that the system is largely the same and may be becoming more entrenched, irrespective of the proliferation of new parties. The system of patronage essentially remains such that awkward coalitions are formed to ensure re-election.

As argued by Cammack:

> we cannot assume that the old political culture has disappeared just because the electorate has apparently voted for economic growth rather than regionalism or historical loyalties. Patronage, clientelism, opportunistic 'chameleon' politics will not disappear overnight. Nor will the centralising tendency of the executive, or the relative weakness of the judiciary and parliament, the media and constitutional bodies. The rule of law may again be undermined. Political parties are no less owned by their patrons now than before. The public sphere is still narrow and the public interest is still largely under-debated and unarticulated. Government is still largely non-transparent and not overly participatory (Cammack, 2004).

Joyce Banda’s administration showed few signs of changing this culture. While it introduced a number of key reforms made necessary following a foreign exchange crisis caused by Bingu wa Mutharika’s lack of focus on developing the economy, and claimed that it wanted to move away from regionalism and ethnics in politics, it was primarily oriented toward the 2014 election. Its ideology was not very different from that of H. Kamuzu Banda and Bingu wa Mutharika: it was based on trying to support strategic business partners (e.g. in dairy), strengthening the patronage system, using government finances to fund political campaigning and not investing in state capacity. The establishment of various Presidential Initiatives was testament to this.

In conclusion, while Malawi structurally transformed from peasant subsistence agriculture to tobacco-led, estate-based export agriculture in the 1960s and 70s, Malawi’s structural transformation story since then has been one of failure. Malawi remains highly dependent on the export of tobacco (see the graph in the Appendix). In 1995 tobacco accounted for 68 percent of all goods exports, rising from 41 percent in 1965. Its share of goods exports remained at 58 percent in 2010. The economic dependence on tobacco and tea contributed to Malawi’s lack of structural transformation over the past five decades because these sectors had little incentive to innovate and expand into new sectors, due to the relatively high cost of developing new products compared to their existing business model (Government of Malawi, 2012). In addition, Malawi’s competitive clientelist political settlement also appears to have contributed to the lack of structural transformation since the 1970s. This is further explored in Sections 4 and 5, through a detailed analysis of the rent space.

3. Methodology

The aim of this paper is to apply the Effective States for Inclusive Development framework to Malawi (Sen, 2012). This framework is focused on a characterisation of the deals space as presented in Table 1 below (Pritchett and Werker, 2012), using the market rent matrix (rent space) of Pritchett and Werker (2012) that is presented in Section 5 and the product space (Hausmann and Klinger, 2006 and Hausmann, Hwang and Rodrik, 2006).

The research methodology was composed of five steps. The first step was a literature review on Malawian history, politics and economy. The second step was a data collection exercise on the Malawian economy. The third step was composed of semi-structured in-depth interviews. A total of 34 interviews were conducted in Blantyre, Zomba and Lilongwe, with business managers, political scientists, researchers, civil society and government officials, in order to obtain a detailed insight into the relationship between businesses, government and growth in different sectors and in the wider economy. Given the sensitive nature of the topic, most interviews were given in confidence, and for that reason names of informants have been withheld. Most of the persons with whom an interview was requested granted

Table 1: A typology of the deals environment – the deals space

	Open (deals depend on *actions* of agents (including influence activities) but not identities)	**Closed (deals are available only to specific individuals/ organisations – deals depend on identities)**
Ordered (deals done stay done, predictable)	"Retail" corruption (e.g. driver's licences in Delhi)	"Cronyism" (e.g. Indonesia under Suharto, Russia under Putin, China, Korea (1960s))
Disordered (unpredictable what deals are available, deals have uncertain time horizon)	"Informal" sector in many countries	"Fragile" states

Source: Pritchett and Werker, 2012.

an interview, although some interviewees possibly withheld certain information. The deals space was mapped using these first three steps. The fourth step was the mapping of the market rent matrix presented in Section 5 below. This was based on the previous steps, while using the Malawi National Export Strategy as a basis. This strategy was based on an application of the product space model to Malawi (Hausmann and Klinger, 2006).

The final step was a corroborative exercise, in which preliminary findings were reviewed and critiqued by experts in the field, particularly political scientists interviewed in the third step.

4: Evolution of the Malawian deals space

On achieving independence in 1964, H. Kamuzu Banda's vision was to develop Malawi through strategic foreign business and aid partners in each sector of the economy. His closest supporter was apartheid South Africa, which supported Banda through the construction of a new capital, Lilongwe. Selected investors in tobacco, tea, sugar, textiles and other industries enjoyed privileged access to the President, who, guided by their expertise, used the public sector to deliver the factors necessary for investment and growth.

Banda used patronage to promote loyalty, and clients were dependent on his largesse (Harrigan, 2001). His form of clientelism fit with his conservative, capitalist, support-the-strong development policy, in that he provided benefits like land, credit and training to favourites, based on his unfulfilled expectation that this would create a middle class that would develop the nation (Cammack, 2004).
The main thrust of Banda's development policy was to generate capital for reinvestment through the agricultural and manufacturing sectors. Access to these

rent-earning opportunities provided Banda with a useful fund of political patronage (Frankenburger et al, 2003). At independence the agricultural sector was divided into a small 'estate' sector and a much larger smallholder sector. Banda's policy was to make possible conversion of customary land to leasehold farms for commercially oriented smallholders, which were subsequently classified as 'estates' and licensed to grow tobacco. In this way, a few privileged Malawians were granted customary land and so joined the largely expatriate estate (tea, tobacco and coffee) sector, then responsible for most of the country's exports (Stambuli, 2002).

> Building on colonial development thinking, Banda thus fostered the creation of an elite class of Malawians that he thought would spearhead agricultural development and national growth while excluding those individuals deemed to be less productive (Cammack, Kelsall and Booth, 2010).

ADMARC 'taxed' smallholders through its pricing policies and used that income to promote estate farming for export (Mhone, 1992), while some customary land was transferred to estates (Stambuli, 2002).

His strong control on government and his developmental approach are reflective of a closed but ordered deals space. This led to the period of growth acceleration between 1964 and 1978.

Yet the lack of openness and the nature of Banda's patronage system meant that growth in the first part of Banda's rule created a negative feedback loop on the rent space. The majority of the population (80 percent) was unable to participate in the high value economy and by the late 1970s unable to benefit from the wealth it generated, such that their demands for food security, healthcare, education and public services could not be satisfied by the nature of growth seen under this regime. This strengthened the push for liberalisation and structural adjustment by development partners and after, which in turn placed Banda's patronage and rent-capturing structure under threat. Malawi experienced a negative feedback loop, whereby the lack of sustainability in the nature of growth achieved before 1979 – which failed to deliver a sizeable middle class – and the succession politics that it led to contributed towards deteriorating institutions that prevented Malawi from addressing a number of structural constraints, leading to a decline in GDP per capita in the 1980s (Cammack, Kelsall and Booth, 2010).

> Economic restructuring under the tutelage of the IMF and World Bank disrupted in significant ways the system for channelling rents that had worked, with limitations, under Banda [the second growth regime]. The policy of reforming the estate sector to reduce subsidies and make it more competitive, together with the shift against import-substitution industrialisation, heralded a major change in the types of rent-creation and distribution that could be encouraged (Cammack, Kelsall and Booth, 2010).

Therefore the lack of sustainability of the second growth regime – which led to worsening macro-economic and debt indicators – provided a window for development partners to undo Banda's rent system. The negative feedback loop came about because, as the economy and markets opened up, the position of elites came under threat. This led to the emergence of succession politics, in which Tembo dominated initially, but was later undone by Muluzi and others within the MCP. Succession politics contributed to a deterioration of institutional capacity, a lack of development policy and hence a return to disordered deals in the second half of Banda's 30-year term as President. Since the private productive sector lacked the capacity to compete in sectors beyond tobacco and tea, fiscal revenues and public sector wages declined. The civil service lost its ability to address market and coordination failures and to supply welfare services to the burgeoning population.

The period between the start of structural adjustment in the early 1980s and the 1994 election can thus be characterised as a gradual deterioration of the institutional space, from orderly informal deals in a closed environment (for example, the transfer of Press Corporation and National Bank to private hands was by invitation) to disorderly informal deals.

The disorderly nature of the rent space continued in the 1990s, although deals became more open – particularly for medium- and large-scale private traders. The rent space also opened up for smallholder farmers, though their rents were negligible. The increasingly disorderly nature of deals under Muluzi is characterised through a number of factors.

First, Muluzi's background as a trading businessman who emerged from the Malawi Confederation of Chambers of Commerce and Industry (MCCCI) supporting free-for-all policies, meant that traders – his clients and patrons – took advantage of the open rent space. The people in and around UDF were essentially traders who made their rents by importing consumables, such as fertilisers and various consumer goods previously not available in Malawi.

Second, the UDF dismantled Press Corporation in an illegal manner and divested it for political reasons, as it was the basis of support for its rival, the MCP. Development partners liked this, as they saw Press Corporation as dominating industry and wanted to open up for all industrialists to grow. In doing this, they missed the fact that the indigenous class lacked the right type of industrialists to fill the Press Corporation gap.

Third, the disorderly nature of the deals space in Muluzi's time is also characterised by the shelving of plans by the UDF to set up its own company, because it was not sure that it could control the funds earned by the company (Cammack, Kelsall and Booth, 2010).

Fourth were weak macroeconomic policies and a lack of government strategic direction and coordination.

Fifth was a surge in corruption surrounding government contracts – for example, when development partners gave aid to build bore holes, friends of UDF were contracted for such work (Cammack, Kelsall and Booth, 2010). Contracts were also abused and service delivery was poor. Many government contracts were given to companies who did not fulfil the requirements to deliver on those deals. One case was the awarding of building contracts to various contractors by the Ministry of Education for school infrastructure (much of which was not built) worth approximately $2 million; some of the money was apparently used to fund the 1999 elections. Similarly, Muluzi was accused of exporting Malawi's maize reserves in 2001 for personal gain, shortly before the onset of a drought which resulted in a famine in 2001.

Cammack *et al.* (2010) quote the example of Petroda, a petrol distributor:

> Petroda, a petrol company owned by a Tanzanian, wanted to open stations in Malawi, including in parts of the country where other stations had not been built. He was awarded a contract to build stations – some in prime locations – and to import petrol. In return, one informant claimed, 'Petroda helped the party so much'…Also it is well known that after Petroda came upon the scene, all government vehicles were required to buy their petrol from Petroda stations instead of BP or Oilcom.

Many politicians were running scams and had clients. Quite possibly they were allowed to do this by Muluzi, who gave them the space they need to collect rents in return for their loyalty. This was different to H. Kamuzu Banda's approach, which was to centralise control of rents, and throw any subordinate (except Tembo) in jail.

The disorderly nature of the rent space meant that there was minimal new investment because rent-seeking efforts were based on scams and not on complementing traditional rent-generating sectors (tobacco, tea and sugar) with new growth sectors, leading to stagnation in the product space.

Muluzi's macroeconomic abuses and a move to alter the constitution in 2002 to allow Muluzi to stand for a third term led to donors cutting aid. After they realised that aid conditionalities were not working, they resumed aid. Muluzi also, reputedly, relied on Middle East funding and business associates, such as Kalaria, to support his election campaign. When his third-term bid was blocked in the National Assembly, Muluzi appointed Mutharika as the UDF presidential candidate, which upset many long-term UDF leaders.

In Mutharika's first term, the deals space seemed more orderly and, to a certain extent, more open. He centralised rent-seeking activities at the top of government such that contracts, some of which were undoubtedly given out through corrupt practices, were better supervised and controlled. Rampant corruption and the creation of rents for patronage purposes were reduced (Cammack *et al*., 2010). It appeared that companies were expected to perform against their contracts, unlike in

Muluzi's time. In return, some special relationships were born, so that later these companies would bankroll the President. Mutharika awarded most large road and rehabilitation contracts to Mota-Engil, a Portuguese company, which performed well on their contracts, but also reputedly bankrolled the President and his clique. They replaced Group 5 as the main winner of similar contracts in Muluzi's time. Mutharika also had a stake in one of the main beneficiaries of government contracts – Mulli Brothers. He appointed one of the family to a senior role in the Ministry of Health, where he ensured that health contracts for drugs were won by the company – despite this firm initially not knowing anything about the supply of drugs. Similarly, Peter Mutharika, the President's brother and the then Minister of Justice, was awarded a licence to cut and sell timber in the Chikangawa forest, from which local sawyers were being evicted by the army. Reportedly, the area had been 'sold' to the minister, 'who has a contract, together with Mulli Brothers, to supply timber to China', while former licence holders were barred (Cammack *et al.,* 2010).

Mutharika also followed H. Kamuzu Banda's lead in identifying strategic partners to possibly bankroll him for election campaigns. These were reputedly the Chinese government,[5] the Australian firm Paladin (which was given a concession to mine uranium through a contract deemed unfavourable to Malawi), Mulli Brothers and Mota-Engil – which won most road construction and rehabilitation projects and which are also building a new railway line funded by mining company Vale, joining Tete in Mozambique to the Nacala railway.

Despite such rent-seeking practices at the top, this centralising approach strengthened the orderly nature of the rent space because there was a long-term relationship and consistency of suppliers. They also produced results, compared to many of the deals in Muluzi's period that did not. The lack of growth during Muluzi's time – growth declined from between 2000 and 2002 and Malawi continued to be plagued by food insecurity and poor social services – gave a platform for Mutharika to distance himself from Muluzi. It gave him the capacity to strengthen his patronage base by delivering growth, while at the same time expanding his personal wealth through rent-seeking activities. In this manner, Mutharika was able to consolidate corruption at the centre of government, also because initially political elites in Mutharika's camp remained fearful of Parliament and the opposition (Cammack *et al*., 2010). This equation drove political elites at the top of government to be committed to economic growth and hence to ordered deals. This alignment was possible because the previous regime had failed to deliver growth, suggesting a positive feedback loop from the lack of growth recorded under Muluzi to improved institutions. This spurred investment and growth, which peaked at 9 percent in 2009.

While the rent space initially remained open, as it was under Muluzi, in time it started to close, entrenching itself more and more around Mutharika's strategic business partners. In 2006 Mutharika adopted a new development and growth strategy, the

[5] Mutharika's DPP was initially supported by the DPP in Taiwan (where the Malawian DPP got its name from) but then switched its diplomatic recognition to Beijing.

Malawi Growth and Development Strategy (MGDS), at the expense of the Malawi Economic Growth Strategy (MEGS). While officially the MGDS was a merger of the Malawi Economic Growth Strategy and the social protection-oriented Poverty Reduction Strategy Paper, the focus on growth was lost. The MGDS sought to accommodate everyone – including agencies like the United Nations Development Programme which was concerned that the MEGS threatened Malawi's performance against the Millennium Development Goals (Chingaipe and Leftwich, 2007) – such that it lacked focus and proper prioritisation. This lack of focus contributed to the demise of the National Action Group in 2007.

After winning the 2009 election by a landslide on the back of his Farm Input Subsidy Programme and the return to growth, Mutharika's stance became predatory as the focus of his second term shifted away from growth to succession. He also adopted a less liberal economic policy that undermined growth. He had no reason to fear parliament and the opposition, as he did in his first term, and his own economic thinking (he claimed a PhD in economics) emerged more clearly (Cammack *et al*., 2010). Although it would later come to haunt him, at that point he felt that he did not need to balance growth with the efforts to develop his patronage base. Autocratic tendencies that surfaced in a muted fashion between 2004 and 2009, controlled by a desire to outperform Muluzi, emerged more forcefully, having secured growth and a positive response by the electorate. The British High Commissioner was expelled in 2011 for alleging this, which in turn prompted donors to cut aid that year.

Mutharika's became less supportive of the private sector as his Presidency progressed, particularly in his second term. He deliberately prevented the successor to the National Action Group – the Public Private Dialogue Forum, based at the main business association – from meeting and being effective. In doing so, he shut down the official feedback mechanism for the private sector. He maintained an overvalued fixed exchange rate to finance his farm input programme and to support the strong importer lobby created by Muluzi. This undermined Malawi's development agenda. He maintained this policy despite the emergence of a large black market and extensive foreign exchange shortages as the trade deficit jumped to 21 percent of GDP in 2010 from 7 percent in 2001. Companies talk about the business environment being worse during Mutharika's second term than in the 1980s. They claim that while foreign exchange was limited in the 1980s and occasionally sanctioned, companies could nonetheless tender for it. Under Mutharika, foreign exchange became impossible to access legally. It was only under his Presidency that banks started paying 30-day future contracts on foreign exchange that were settled the next day. The black market for foreign exchange flourished, favouring rent-seekers and undermining Malawi's burgeoning manufacturing and agro-processing sector.

Mutharika also entered into conflict with the tobacco sector over the prices they were willing to pay producers, the country's main foreign exchange earner, arriving to a point where he expelled two managing directors of major tobacco companies. Some tobacco companies left, deeming Malawi too risky. He also sought more populist policies which undermined development, such as price controls in major crops like tobacco and cotton.

The private sector interviewed for this paper claims that, while under H. Kamuzu Banda there was no information made available to investors who were not part of the President's strategic partner plan, under Muluzi information became available in spite of his efforts to control it. In Mutharika's first term, information was made available, but this worsened significantly in his second term. One company talks about how he started to present false and distorted information: the interviewee recalls how Mutharika once invited businesses to State House and tried to convince them that development partners had a conspiracy against Malawi. The private sector said that the rent space closed up: while under Muluzi, businesses could access information through the banking sector and the stock exchange, which in turn led to a certain improvement in accountability, Mutharika targeted the flow of such information, for example by accusing international companies of transfer pricing. While this practice did occur, false cases were also created and specific companies were targeted.

Mutharika's importer-based patronage system meant that he was reluctant to free the exchange rate. This resulted in a foreign exchange crisis in 2010 and 2011, which led to a disorderly rent space. Together with Mutharika's efforts to move to closed deals, this caused real annual economic growth to decline from a peak of 9 percent in 2009 to 1.9 percent in 2012, as Malawi experienced chronic shortages of fuel, fertiliser, medicine and other imported inputs and consumables.

As during H. Kamuzu Banda's latter years, the growth that Mutharika secured in his first phase led to a negative feedback loop: economic growth and food security between 2004 and 2009 led to an easy election victory that gave Mutharika the comfort he needed to focus on succession and on further building his patronage and wealth. At his death in 2012, his estate was worth $152 million, up from a declared $1 million in 2004 (Nyasa Times, 24 Jun 2013). He held $35 million in an account in South Africa and $4 million in an account in New Jersey, among others.

The initial days of Joyce Banda's Presidency, which started in early April 2012, saw a reversal of distortionary policies, such as the freeing up of the exchange rate and the return of budget support aid which was cut in 2011. This represented a move to a more orderly rent space, and was driven by a reaction to the acute foreign exchange crisis Malawi experienced in 2010 and 2011. Joyce Banda adopted an Economic Recovery Plan to give the perception of economic direction, and reinstated an IMF extended credit facility. Likewise she adopted a Malawi National Export Strategy that was developed by the Ministry of Industry and Trade. She established the Malawi Investment and Trade Centre with a private sector board to serve as a one-stop shop for investors, something that Muluzi and Mutharika had ignored. Her government took important steps to strengthen state capacity, such as supporting the operationalisation of the Competition and Fair Trading Commission, promoting discussions on land reform, improving business registration processes and supporting the previously ignored Malawi Bureau of Standards. It also maintained a floating exchange rate, despite pressures from some elements of the business community.

Yet with elections looming in 2014, her focus was on social protection and securing her patronage base – as evidenced by her One Cow One Family programme that handed out free cows and goats to smallholder farmers (Diaspora Messenger, 26 July 2013) and her Presidential Initiative on Hunger and Poverty Reduction that gave out free seed and fertiliser to farmers. She perceived the government she inherited to be one oriented to supporting Peter Mutharika, and believed she could make little use of the government bureaucracy to meet her objectives. She therefore set up parallel Presidential Initiatives on key areas such as maternal heath, doing business reforms and hunger reduction. This was also done so that she could demonstrate that her government was the reason for any positive outcomes. She gradually replaced the senior civil service and opened dialogue with the private sector, although in a haphazard, unstructured manner. This led to limited focus in addressing structural constraints and sent conflicting messages to the productive economy – for example, through claiming that export bans would not be re-introduced and then introducing an export ban on soya.

Yet at the informal level of the deals space, Joyce Banda either failed to gain control of the bureaucracy – or failed to reign in the consequences of its or her rent-seeking efforts. In September 2013 a large corruption and public looting scandal – 'Cashgate' – erupted, following the near-fatal shooting of the Director of Budget. By November 46 people were arrested after being found in possession of public funds ($168,000 in one instance) without supporting documents. Joyce Banda's first Minister of Justice was arrested. It was alleged that $50 million was awarded to companies without a formal contract with the government in 2013 alone. Malawi returned $3 million to the Global Health Fund – this money could have put 21,400 Malawians on health treatment for a year – because the fund was not managed properly. In November 2013 two officers in the Office of the President and Cabinet were arrested for allegedly making a $2.5 million dollar payment without a contract to a company owned by a member of Joyce Banda's party (Daily Times, 6 November 2013). By November, the total value of the pilfering and false contracting was estimated at $155 million, or 4 percent of GDP (The Telegraph, 18 November 2013). Budget support was cut again (Nyasa Times, 11 November 2013). Public looting, through loopholes in the Integrated Financial Management System installed during Mutharika's time, has been going on since Mutharika's and Muluzi's time.

Joyce Banda claimed that she was exposing long-standing practices, but her critics claimed that she was at the helm of the crisis driven by her efforts to secure government finances to fund her political campaign (Nyasa Times, 13 December 2013). In June 2014 the leader of the MCP, Lazarus Chakwera, said that:

> no President can stamp out corruption completely without first cutting his own arm, and this means exposing and prosecuting corrupt politicians in his own

party as well as corrupt banks and business interests with strong links to and a long history of dealings with Government (Nyasa Times, 19 June 2014).

Either way, the perception of rent earners (private sector and donors) of increased corruption and looting was such to undermine their investment and aid plans. The fundamental problem was her inability to provide an ordered deals environment despite the increased openness of the deals environment. Whether this was driven by an inability to control the bureaucracy or by a failure to extract government finances without creating a media crisis (as done by Mutharika in his early days), the outcome was a move towards a disordered deals environment. In November 2013 donors suspended budget support – worth $150 million every three months or 41 percent of the government budget – until confidence in the government budget system could be restored. This undermined formal government efforts, through its formal strategies, such as the Malawi National Export Strategy 2013-2018, to support more complex sectors in the product space.

Her inability to improve the deals space was determined by the onset of elections in May 2014 that drove her priorities to be about securing patronage among her voting base. Having restored growth in 2013 following the foreign exchange crisis of 2010-11 and weak growth in 2012 by liberalising the exchange rate and securing the return of aid flows, as demanded by the electorate, Joyce Banda's priorities shifted towards shoring up her political patronage base. She probably opted to play her predecessors' game of accessing government funds, in addition to entertaining private donations from the Indian business community.[6] Her priority was developing her political party's resource base and handing out free maize, cows and seed to smallholder farmers. Her cabinet was selected for its patronage base, rather than its technical capacity. This suggests another negative feedback loop of growth, similar to that experienced after Mutharika's first term.

The political determinant of the nature of this loop is the as yet underdeveloped electorate and the deeply entrenched patronage system that is reinforced by competitive clientelism and a five-year election cycle. However, through increased internet access and urbanisation, the public is more aware now than it was under the previous three Presidents and this contributed to Joyce Banda's electoral defeat of 2014.

5: The Malawian rent and product space today

This section maps Malawi's elite interests to the market rent matrix, as set out in Table 2 below by Pritchett and Werker (2012), and the product space. We call this the rent space and it reflects the nature and type of deals sealed between business and political elite. The product space merely reflects the basket of products and services produced in Malawi and could be thought of in this context as the source of rents. The rent space relates to how rents are then distributed between owners of the

[6] According to experts interviewed for this paper, the Indian business community liked her because she allowed them to avoid paying taxes such as VAT.

product space (mainly business elite) and owners of government policy (political elite).

Table 2: Market rent matrix of elite interests

Rents / Market orientation	High	Low
Export	Rentiers	Magicians
Domestic	Powerbrokers	Workhorses

Source: Pritchett and Werker (2012).

Rents in the product space in Malawi have not changed much since independence, although there is a slight growth in the rents secured by magicians and workhorses. Table 3 below presents a mapping of sectors in Malawi against the market rent matrix.

Table 3: Mapping of Malawi's main sectors against the market rent matrix, 2012

Rentiers	**Magicians**
- Tobacco (54% of exports), 5 main buyers - Mining (12% of exports)**note that this is in decline, given the 2014 closure of Paladin's mine* - Tea (6% of exports), 4 main producers - Tourism (3% of exports), 2 main players - Coffee (1% of exports), a few players - Cotton (2% of exports), 14 ginners	- Beverages (juices), 1 new company, social enterprise - Some manufacturing - Some small tobacco buyers - Some 5,000 smallholder tea producers - Numerous small tourism players - Some exporters of groundnuts, rice, pigeon peas, etc. (e.g. National Association of Smallholder Farmers of Malawi) and by some companies that are mainly domestic oriented, but which also export
Powerbrokers	**Workhorses**

- Certain manufacturing (8% of GDP)
  - Farm inputs (seed, fertiliser) (based on links to government, dependent on government procurement)
  - Beverages (beer, spirits), 1 main company
  - Dairy (4 main companies)
  - Packaging and plastics (5 main companies)
  - Wheat and maize processing (3 main companies)
- Sugar (4% of exports), 1 main processor
	- Millions of maize smallholder farmer households, 80% of population
	- Some 250,000 smallholder tobacco farmers
	- Some small manufacturers of various products, e.g. beverages, assembly, food processing, plastics, pharmaceuticals
	- Numerous informal retailers and distributors, close to 800,000
	- Some smaller foreign banks that have entered Malawi in past 10 years
	- Some small oil seed processors and

- Oil seeds (8% of exports), 5 major players - Electricity (1% of GDP), 1 state company - Construction (5% of GDP) - Financial services (7% of GDP, 12 commercial banks but 3 largest banks own approximately 65% of total bank assets and largest banks have profit margins above 50%) - Telecommunications (4% of GDP) - Large retailers (supermarkets) (14% of GDP) - Transport and storage services (4% of GDP) - Large professional service providers - Fish product, 1 large company - Government services (health, education, justice, water, immigration, etc.). The government budget equated to 34% of GDP in 2013, backed by official development assistance worth 20% of GDP. Approximately 120,000 civil servants. - Poultry industry (3 main producers) - Meat industry (3 main producers) - Forestry (few players) - Fuel importation (3 main players) - Vehicle importation (3 main players)	farmers (inc. groundnut, soya, legumes) - Sugar small smallholder farmers - Thousands of smallholder farmers growing crops like rice, beans, potatoes, cassava, pigeon peas, etc. Some work in associations such as 100,000-member National Association of Smallholder Farmers of Malawi - Some smaller seed and fertiliser importers/producers - Business and professional service providers - Numerous smallholder fishermen - Thousands of smallholder energy providers (charcoal) - Some 1,000 smallholder sugar producers

Note: Export data is for 2012, sourced from Trademap (http://www.trademap.org/). GDP data is for 2010 sourced from the Reserve Bank of Malawi.

The nature of the deals space faced by each group is as follows:

- **Rentiers:** rents are largely centred on agriculture estate concessions, secured under H. Kamuzu Banda, and mining concessions secured since 1999. There have been no new agricultural concessions recently, limiting scope for deals. Estates need deals in farm security, electricity access and transportation to export markets. In tobacco the deal space is also characterised by the linkage between smallholder farmers and the auction floors, allowing transport and other service providers to extract rents. Mining rents and deals are also centred on major concessions. Rents are mainly earned from accessing global commodity markets (e.g. tobacco, tea, coffee, uranium). Mining deals are more informal than formal, due to a weak institutional framework for the sector. Agricultural rentiers have become more formal since H. Kamuzu Banda's time, as there have been no new agricultural land concessions in recent years and the Government has been weary of estate agriculture since multi-party democracy.

- **Magicians:** deals are required for business and export licensing, access to seed, extension services, tax, electricity connection, water access, etc. They are more formal than informal. Rents are primarily gained from accessing competitive export markets.
- **Powerbrokers:** deals are centred on securing government contracts (e.g. construction, fertiliser imports, financial services through funding government bonds), on limiting competition and new entrants (e.g. transport, dairy, financial services), securing preferential access to inputs (e.g. poultry), securing preferential licenses (e.g. forestry), extracting income from government (e.g. civil service and politicians via allowances). Deals are much more informal than formal. Rents are gained primarily from taxpayers and aid (fertilisers, construction, financial services) and secondly from the domestic market (e.g. telecommunications, poultry, sugar). Rents are relatively large.
- **Workhorses:** deals are characterised by maize and legume fertiliser subsidy, the maize market, various domestic crop markets accessing transportation services and extension services, accessing seed, securing business permits and evading tax. There is a mixture of formal and informal deals. Rents are very low rents and this group covers the majority of the population.

With the exception of mining and cotton, which are rentier sectors, the political elite are largely tied to powerbrokers, making this the most important group from a political rent perspective.

Mining is linked to the most senior political elite, while the government and politicians have a significant interest in cotton, for both populist and business reasons, through the powerful ginneries. The political elite have limited ties to other rentier sectors like tea, tobacco,[7] tourism and coffee, as these are predominantly managed by large foreign companies with foreign ownership. Companies in sectors such as tobacco and tea are large enough to have direct ministerial, and sometimes presidential, access on an informal basis when issues arise with government bureaucrats that threaten their business, such as fraudulent labour cases or delayed licences. However, political interest in such sectors is generally not based on personal patronage, but on national or party priorities, such as foreign exchange generation, donor conditionalities or populist measures such as minimum prices.

The main linkages between the political and business elite are described in Table 4 below. This table also indicates the location of these sectors in the product space. An example of how the political elite benefit from general agriculture and maize production at the informal level is through using their access to government-donor information to support their business interests. A company interviewed for this paper

[7] While there are tens of thousands of Malawian smallholder tobacco farmers, the tobacco is mostly bought and exported by a handful of international tobacco companies.

Table 4: Sectors with political elite economic interest, their attraction to the political elite and their location in the product space

Sectors with political elite interest	Political elite interest	Location in the product space
Government services (Powerbroker)	Access to rents from law and regulatory enforcement and provision of government services	Various. Potentially enabling services and regulations that could assist in evolution of Malawi's product space. But limited capacity to address market failures means such services are not sufficiently conducive to structural transformation and increased economic complexity in the product space.
Farm inputs (Powerbroker)	Farm inputs generate one of the strongest political-business elite relationships. This is because the largest market is the government-run Farm Input Subsidy Programme, which accounts for 50% of the market. Political elite interest in such contracts is large, such that a local fertiliser manufacturer complained this year that it was excluded from the tendering process despite being cheaper than linked-in fertiliser importers, who, it claims, have secured most of this year's contracts. Politicians also target such companies to help them secure their patronage base in their constituencies.	Economic complexity depends on the specific crops supported and the extent to which those crops are economically complex. Maize is the main crop, but while many downstream products can be secured from maize, Malawi's culture and lack of capacity to address market failures – such as poor sector coordination and asymmetric information – limit this crop to singular usage (household consumption). It is therefore not currently conducive to structural transformation.
Construction (Powerbroker)	Mota-Engil is the primary beneficiary of government contracts and this	Key enabling sector, mostly focused on houses and office buildings.

	company had a strong link with the previous government. It also has a reputation for extensive corruption at various levels of government. Politicians tend to be involved in construction company ownership. Government infrastructure contracts are also targeted by politicians to prioritise contracts in vote-generating areas. The road budget is notorious for such activity. Chinese companies are a key beneficiary of Chinese grants and soft loans for large, white elephant projects.	Relatively good quality of national trunk roads has supported more complex sectors in the product space. But current major construction projects include white elephants such as an inland river port that is inoperable, a 40,000-seat stadium and a huge hotel and conference centre.
Transport and storage (Powerbroker)	Dominated by a strong trucking lobby with significant business interests of politicians. Many politicians and their families own trucking businesses, include Joyce Banda's son. Trucking firms tend to run oligopolies on rural routes. Efforts to increase competition within road transport and through other modes, particularly rail, have met sufficient resistance by truckers, backed by vested politicians, to be thwarted since the 1990s. Storage has historically been dominated by ADMARC, a state company set up by H. Kamuzu Banda. Mutharika's main business partner (Mulli Brothers)	Key enabling sector, particularly for linking rural agriculture to manufacturers (agro-processing). But since political elites do not gain much rent from agro-processing, transport services have generally failed to serve as a genuine enabler of structural transformation. In addition, truckers (who in the past included Presidents H. Kamuzu Banda and Bakili Muluzi) have benefited and continue to benefit from a dependence on imports and aid (e.g. World Food Programme). Several politicans own trucks and, prior to Vale, this has prevented the development of Malawi's

	sought to invest here, but has since been ostracised by Joyce Banda. Tobacco industry's auction company – which is subject to political elite interests – is keen to exploit the storage market.	railways.
Poultry (Powerbroker)	One company in particular, Central Poultry – which is the largest supplier of chickens – has been successfully lobbying the government to maintain bans on the export of soya, which it uses as chicken feed, to the detriment of other soya customers and soya producers.	Low economic complexity.
Meat industry (mainly beef) (Powerbroker)	The meat industry has recently become linked to the political elite. This relationship is epitomised by the President's One Cow One Family project, which was instigated by the meat industry.	Low economic complexity. Malawi struggles to compete with regional neighbours that have vast amounts of pasture. Also, the tradition of grazing cattle and not keeping them in pens is not widespread country-wide, nor is use of cattle for ploughs. So incentives to own cattle are weak except in the North, where cattle are also culturally significant.
Fuel importation (Powerbroker)	Agents for companies have typically had close relationships with the political elite, and appear to secure petrol station licences very easily.	Key input into numerous sectors with both high and low economic complexity
Financial services (Powerbroker)	The main banks are either government owned (Malawi Savings Bank) or owned by Press	Key enablers for all sectors, including those with both high and low economic complexity. But

	Corporation (National Bank), which has had a turbulent relationship with politicians since its restructuring. On the micro-finance side, the government is a big player, running agencies such as the Malawi Rural Finance Company and the Malawi Agriculture and Rural Development Fund. These have proved to be ineffective service providers and have been used as vehicles to transfer funds to secure political patronage. New smaller banks that have been introduced since 1990s offer kickbacks to politicians for allowing them to open.	abnormal profits in the sector, the lack of a coherent government growth strategy and political elite distortions mean this sector struggles to support sectors with high economic complexity.
General agriculture (Powerbroker)	A number of politicians run or are invested in small or medium-sized farms. The main interest is in maize, tobacco, cassava, legumes and soya. They benefit from insider government information, such as upcoming export bans and minimum prices.	Economic complexity varies based on crop/livestock. Soya has relatively high complexity but is a relatively new value chain.
Mining (Rentier)	Highest level of politicians (presidents and close allies) have access and interest, due to capacity for rents from licences and country-level bargaining, e.g. with China.	Low economic complexity, particularly since main product is uranium, for which there are no downstream products in demand in Malawi or the region. As of 2014 this mine is temporarily closed. New mining prospects are in rare earths and coal.
Cotton (Rentier)	Interest in ginneries, which generate rent from	Low to medium economic complexity. Malawi's

	exported lint. Also political interest, as it is a drought-resilient crop in the poorest, most populated and driest parts of the country.	textile industry is unable to compete in an open market. Though there is scope to support the Oil Seed Products cluster, which scores at mid-level complexity.

cited an example in 2013 where a donor published a large tender to buy maize the next day which drove up the price. Politicians and bureaucrats with access to this information prior to publication informed their business interests and friends to buy maize the day before the tender, knowing that the next day the price of maize would rise. The interviewee claims that many business decisions in agricultural commodity trading are based on such insider information.

There is limited political involvement in the telecommunications sector, since this fast-moving market is dominated by a foreign market leader and a local company mostly owned by Press Corporation, which is trying to keep up with its main competitor.[8] Likewise, there are limited political elite connections with sectors such as sugar[9] and beverages, which are both dominated by a foreign company. Both these companies (Illovo and Carlsberg) are, however, politically influential. Illovo is the largest tax payer in the country and has engaged a former Director of Trade to be its avenue to government; and Carlsberg has established a dual CEO role, with one CEO focused on operations and the other on government lobbying. Agro-processing and other forms of manufacturing (e.g. plastics, pharmaceuticals, packaging, assembly) are generally dominated by the Malawian-Indian community that, since being evicted from rural areas in the 1970s, has generally tried to keep government and politicians at arm's length. Such companies have limited relations with the political elite and rely on the MCCCI to represent them on issues such as tax, and energy and water supply.

Nevertheless, being such a small country, prominent businessmen in most sectors have some sort of relationship with the political elite, both formally and informally. A number of companies also feel they cannot rely on the MCCCI to represent their political interests. Out of 29 largely private sector respondents to a survey conducted for this paper, 18 said that it is very important for them to interact with policy makers on an individual basis, while eight said that it is important. However, the key interaction appears to be with bureaucrats, and not with politicians. Most companies, 22 out of 27, claim it is important to maintain a personal relationship with high-ranking bureaucrats, while only 10 out of 26 claim it is important to maintain a personal relationship with high-ranking politicians. This is because the key government

[8] This was different at its start in 1995, when politicians had cornered the mobile and internet markets for rents and distorted growth in both sectors.
[9] The sugar market was dominated by Muluzi in the 1990s and his UDF cronies for rents. It changed under Bingu wa Mutharika. Nowadays there are rents gained by politicians in the local growing areas.

decision makers for the majority of formal, not trading companies are principal secretaries, the Reserve Bank Governor and the Commissioner of Tax Revenue. A large number of such companies are based in sectors that have relatively higher economic complexity in the product space, such as manufacturers of food products, dairy, beverages, plastics, packaging and assembly. Such companies are less reliant on government contracts or natural resources than they are on foreign exchange availability, an efficient tax system, the cost of transport to markets, the cost of finance and access to energy. The government has largely proved that it cannot be relied upon to enforce formal and informal agreements here – unless the implementation of the agreement is solely dependent on the actions of senior politicians. An interviewee for this paper cited an example of lack of reliability in tax agreements with the telecommunications sector. In 2012 the government introduced a 3 percent increase on corporate tax for the mobile phone industry, which essentially comprises two companies. In subsequent negotiations an agreement was reached to reverse this increase, on the basis that it discriminated against one sector and two companies. However the government did not follow through, despite the agreement.

Personal interactions with politicians are more important for companies reliant on natural resources, such as land, water or minerals, or on government contracts, such as farm input suppliers, medicine suppliers and construction companies. Typically such companies are located in the lower complexity sections of the product space.

What this suggests is that the political elite's rent space is mostly linked to sectors within the product space that are generally less conducive to long-term growth because they have a lower level of economic complexity, such as sectors dependent on government welfare spending, mining and import trading. Political elites are also tied to construction, which is a key enabling sector for development. However, the developmental impact of this sector depends on what is being built: white elephant stadiums and hotels *versus* energy and transport infrastructure, for example. The political elite also has access to rents around land and water, but since such resources are subject to the village chief system, power sits with thousands of village chiefs, rather than with the political elite at the centre of government. The political settlement is one that cannot wrest power from the chiefs; as such, rents in this market are small because of the limited capacity for the private sector to invest in them.

Many key sectors for the development of the product space are characterised by a disconnect between political and business elite rents. Today the political elite have minimal access to rents in manufacturing, sugar, oil seeds and tourism.[10] As such, bottlenecks faced by these sectors are not typical political priorities. This may explain why, as emerged from the interviews for this paper, the structural constraints faced in

[10] While tourism is thought of as the home for cashgate in 2013, this was the Ministry of Tourism rather than the tourism sector. Sugar was controlled by Muluzi in the mid-1990s, but is now internationally run.

the 1990s have largely gone unaddressed since multi-party democracy – with the exception of reform periods led by Mutharika and Joyce Banda in their first terms.

This characterisation of the rent space relative to the product space is not conducive to long-term growth. This outcome is reinforced by the low complexity of Malawi's main exports and rent earners since the 1960s.

6: Summary and outlook

This paper assessed Malawi's deals space, rent space and product space and the role they have played in Malawi's growth regimes since independence. This section summarises, brings out the main implications and suggests a possible outlook for Malawi's future.

6.1 Why has Malawi failed to structurally transform since the 1970s?

Since the 1970s, Malawi has failed to structurally transform. The reasons for this are threefold. First, rent-earning sectors have historically been either low in economic complexity, leading to a lack of spillovers and innovation (e.g. tobacco and tea), or have been oriented towards welfare (e.g. maize) or personal wealth and patronage (construction, infrastructure), rather than towards economic growth.

Second, rent-seeking activities of the political elite have largely been in sectors in which dominant business players are powerbrokers (Pritchett and Werker, 2012): they are domestically-oriented sectors that generate high rents. Such sectors include government services, farm inputs, construction, transport services, poultry and financial services. Such political interests have proved important in preventing structural transformation. Political interests in government services, financial services and farm inputs have meant that such services and inputs are tailored to political clients and voters, rather than to economic agents who have the potential to drive economic growth. Political rents in transport services have contributed to sustaining high transport costs by preventing investment in railway infrastructure and by maintaining dominant market positions in rural transportation. Similarly, there has been and is a lack of political interest in complex industries such as manufacturing.

Third, political elites have had limited interest in developing state capacity. This is a result of the patronage system introduced first by H. Kamuzu Banda and then reinforced by Bingu wa Mutharika. Their strategy of picking strategic private sector partners in each sector to deliver the degree of growth they need to maintain political patronage allowed them to side-step the daunting task of building state capacity and developmental structures. This was important to protect their ultimate goal of personal wealth generation, and left Malawi with an inability to permanently address market failures through functional government intervention. One major government failure was an inability to address market coordination failures such that sectors with higher economic complexity than tobacco and tea could thrive in a way that would deliver structural transformation.

6.2 Outlook for the near term: can Malawi enter a growth maintenance regime?

Looking forward, there are three factors that could translate the growth acceleration regime of 2003-13 into a growth maintenance regime in the next ten years. These are: the product space; state capacity; and the deals and rent spaces.

Although there is a slight positive trend in the product space, with more complex sectors and markets developing, such as plastics, packaging, dairy and soya, these sectors remain in their infancy compared to tobacco, tea and raw sugar. Mining was the new entrant in the past ten years, and so far, this has been the main contributor to the relatively small decline in the dependency of export revenues on tobacco, tea and raw sugar. However, mining, led primarily by uranium, has a low level of economic complexity and is a rentier sector, while its contribution to GDP declined in 2014 following the temporary closure of Malawi's only large mine.[11] The main change in the product space has been in the services sector – with sectors such as telecommunications and finance growing significantly. In addition, the gradual progression of regional integration, which is fuelling foreign direct investment in agriculture and agro-processing in the region, is starting to have some tangible, albeit small positive effects on the product space.

Yet when measured against Malawi's capacity to enter a growth maintenance regime, the growth of sectors such as finance, telecommunications, manufacturing and agriculture has not yet translated into a significant increase in the complexity of goods produced and exported. There is an increasing likelihood that while these sectors will continue to grow over the next ten to 20 years, Malawi's product space will remain too underdeveloped to ensure, by itself, that the 2003-13 growth acceleration regime is translated into a growth maintenance regime in the next ten years.

The second factor is state capacity. As assessed by Cammack in 2011, state capacity and government systems have continued to deteriorate since the 1970s, because there is a lack of motivation and interest to develop these. State capacity in Malawi is not sufficient to support long-term growth maintenance and due to limited resources, state capacity in Malawi is ultimately dependent on the extent to which the product space or the deals and rent space drive political elites to want to develop it.

Therefore for Malawi to enter a growth maintenance regime[12] this coming decade, it would need to rely on the deals and rent space. With none of the major political parties being issues-based, Malawi's competitive clientelist political settlement based on a system of patronage inherited from H. Kamuzu Banda's time, remains strong, with no signs of weakening. Chameleon politicians (Englund, 2002) regularly jump ship in line with the shift of power. This political settlement leads to an outcome

[11] Production at the Kayelekera uranium mine is not expected to resume until 2016.

[12] A growth acceleration regime is a period of at least eight years of significant average growth that follows a period of at least eight years of decline, deceleration or stagnation. A growth maintenance regime is a regime in which significant growth is achieved on average over at least an eight-year period, directly following a growth acceleration regime.

whereby re-election and succession politics and patronage-seeking tend to take the upper hand over growth policies. This was the case with Muluzi between 1994 and 2004, and also Mutharika between 2009 and 2012, who was unable to adequately balance growth efforts with personal wealth and patronage generation efforts between 2004 and 2009. It was also the case with Joyce Banda, who in her two years in power was predominantly focused on succession politics in a bid to win the 2014 election.

This political settlement is delivering two types of feedback loops between growth and the rent space. On the one hand are negative feedback loops, in which positive growth leads to a worsening of the rent space through more disorderly deals – such as H. Kamuzu Banda's second 15 years relative to his first 15 years; Muluzi's and Mutharika's second term relative to their first terms; and Joyce Banda's second year relative to her first year. On the other hand, periods of negative growth (or significant slowdowns in growth) register positive feedback loops on the rent space. Negative growth leads to a reaction in the electorate because it manifests itself in famine or shortages of key supplies. This drives new governments to deliver growth – such as H. Kamuzu Banda in 1964 following stagnation prior to independence, Mutharika in 2004 following the failures of Muluzi, and Joyce Banda in 2012 following the foreign exchange crisis and decline in growth in Mutharika's second term.

Political rents by the main parties are largely extracted from high rent sectors such as mining, construction contracts, transport services and government procurement of farm inputs, medicines and fuel. Business-politician deals typically hold despite a change of government. Mota-Engil, Vale and Paladin serve as the best examples of this continuity, as does the continued strength of the transport services lobby and the farm input lobby. Similarly, the Indian business lobby supports all parties in exchange for tax support. As the product space develops, this trend is likely to be strengthened.

The continuity of business to political elite relations is true of companies that are able to enter into deals with government while keeping it at arm's length, such that they are not viewed as too politically close to the President. Companies that have got too close, such as Kalaria and Mulli Brothers, suffered with a change of government, such that the majority of business elites like to keep political elites close, but at arm's length, in order to ensure a continuity of deals.

While this continuity gives scope for investment, the problem is that the rent space for the political elite remains too heavily tied to the powerbroker business elite that have a low propensity to invest. There is relatively little alignment of political rents to magicians, rentiers (except mining and cotton) and workhorses. Powerbrokers have relatively little incentive to support export-oriented policies and increased competition, leading to little political interest to drive through economic diversification strategies. Such interest is increasing, though this comes about at times when politicians want growth – and often this comes about in drips and drabs following a period of weak growth or a foreign exchange crisis. Support is stop-and-go and lacks the continuity necessary to overcome major structural challenges to structural transformation and growth maintenance. This suggests that the nature of growth going forward will be volatile: a number of booms and crises in short-term growth backed up by a gradual underlying positive long-term trend. While long-term growth is likely to remain positive, driven by improvements in technology (telecommunications, agricultural technology), financial sector development, investment in energy and the slight but strengthening pull of regional integration, it is unlikely to be strong enough in the next eight years to support the increased demands for welfare improvements (food security, healthcare, education, public services) so as to allow Malawi to enter a growth maintenance regime. Historically, the large welfare requirements have reduced the already limited government capacity to support long-term policies needed to develop the productive economy.

A growth stagnation regime is therefore most likely in the next eight years. For this not to occur in the next eight years or more, it would require a developmental leader with a minimum ten-year term, who is not sufficiently distracted by successor politics and personal wealth generation in the second term. Malawi's political settlement suggests that it is difficult though possible for this to occur because it is hard to identify political incentives that would lead to a developmental second five-year term.

6.3 Outlook for the long term

Increased regional integration, globalisation, technology, advancements in telecommunications and financial services, and some positive, albeit small developments in the product space suggest that there may be the possibility for the product space to become an important driver of growth in the long term (at least ten to 20 years). The gradual strengthening of the product space might lead to a situation in the 2020s in which the rents generated in these sectors would lead to a much better alignment of incentives between the growth-oriented business elite (magicians) and the political elite. This process will be increasingly strengthened by regional integration, technological advancement, telecommunications and financial sector deepening and the gradual maturing of development partners to better understand their role in improving the developmental incentives of the political and business elite. This assessment would suggest the possibility for another growth acceleration regime in the 2020s – with increased probability for a transition of this regime into a growth maintenance regime in the 2030s, following a period of likely GDP per capita growth stagnation between 2013 and 2020.

What this assessment of the deals space, rent space and product space means is that Malawi will likely remain a regional laggard and its development will be slowly 'pulled' by regional integration and the global economy (e.g. through firms invested in neighbouring countries investing in magician sectors in Malawi to alter its product space) and technology (e.g. through improved information systems for policy oversight and market linkages). There is an alternative, yet much more difficult, route for Malawi to enter a growth maintenance regime in the short term. This would involve the disintegration of Malawi's deeply-embedded patronage and clientelist political settlement, for example through the emergence of a developmental dominant party or through the easing of political pressures currently caused by a five-year democratic term in which the largest voter group is rural, subsistence farmers who are too far removed from the government's policy-making process.

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Annex 1 – Additional detail on Malawi's economic history

Between 1978 and 2002 Malawi's real GDP per capita declined. While a number of external shocks played a part, the fundamental structural weaknesses of Hastings Banda's development model that drove this decline were threefold.

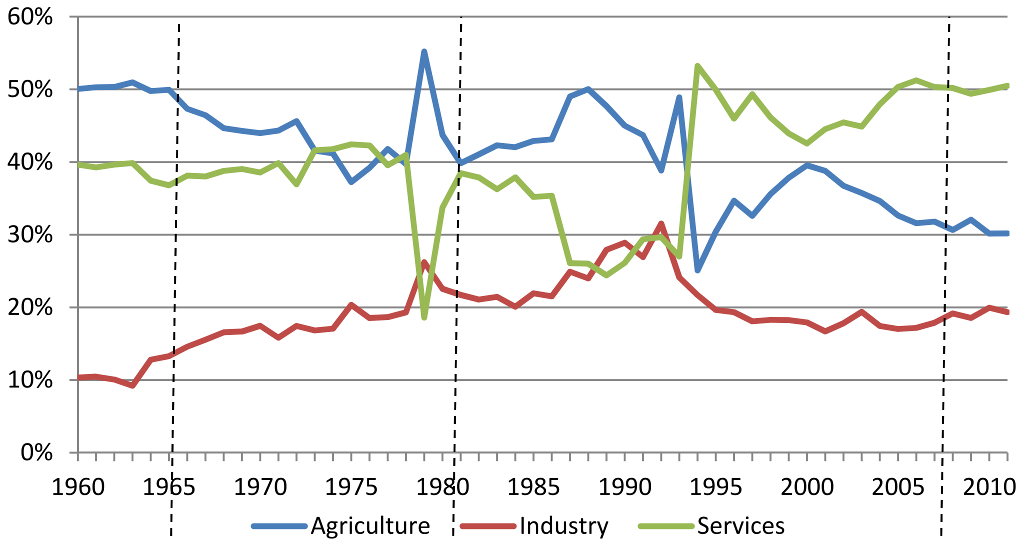
First, limited state capacity led to fiscal indiscipline and the poor sequencing of price and market liberalisation. H. Kamuzu Banda mixed state, party and personal finances with impunity (Cammack, 2004), resulting in a misuse of state resources (e.g. in the construction of Kamuzu Academy) and in the fiscal restructuring of the state and of the debt-ridden Press Holdings in the early 1980s as part of the conditions set out by lenders. There was a lack of knowledge and capacity – by the 1980s expatriate civil servants had been largely replaced with less experienced Malawian staff, who had an inability to cope with external shocks (Cammack, 2004) as the leader's centralised ideology gave way to more open markets. Professionalism, morale and competence in the civil service deteriorated from the mid-1980s as wages fell and political loyalty rather than merit became the basis for assigning key jobs. Inefficiencies in government-run entities such as ADMARC emerged. ADMARC recorded large financial losses (Lea and Hanmer, 2009).

Second, estate-based growth proved unsustainable in the long run because it was based on preferential land and credit policies (Ngwira, 2012) and because it excluded the majority of the population: smallholder farmers and their families. ADMARC's trading surplus on smallholder tobacco, cotton and groundnuts was channelled into investments in estates, leaving minimal investment in the smallholder sector. These policies squeezed land, labour and profit out of the smallholder sector, which accounted for the vast majority of the population. In 1995 Malawi's Gini Coefficient rose to 0.62, the third highest in the world after Brazil and Namibia (Booth *et al,* 2006*)*. The factors that supported estate-led growth in the 1960s and 1970s, such as high product prices, a strong producer lobby, efficient value chain of estate marketing, good transport infrastructure and cheap credit, all reversed between 1979 and 1989. As smallholder and civil society lobbies strengthened, their limited productive capacity emerged. By then large land pressures led to a point where diversification and production for export were beyond the capacity of smallholder farmers (Stambuli, 2002), such that by the late 1980s food security was problematic, particularly in refugee-afflicted border areas (Cammack, Kelsall and Booth, 2010).

Third, private sector players in the services, manufacturing and mineral sectors (Booth *et al.,* 2006) were few and far between, due to Banda's policy of picking one strategic private sector player in key sectors. Malawi's private sector was largely focused on estate agriculture and was involved in the export of agricultural commodities, with little domestic value addition. As such there was limited productive capacity to exploit liberalised markets.

Limited private sector capacity and a lack of public sector support meant that the private sector (except for those in the tea, tobacco and sugar sectors) was unable to fill the production and market-linkage space vacated by Press Corporation and ADMARC. What the liberalised economy initially did by allowing the participation of the poor and smallholder farmers in the economy was drive the growth of Malawi's informal trading sector, based primarily on the importation of consumer goods. This led to an increase in the share of the services sector in the economy (Figure A1 below). Productive agriculture and manufacturing slumped as smallholders lacked sufficient capacity to participate in liberalised markets, while manufacturing proved too weak to survive without government backing. As such the period of de-industrialisation that started in the early 1980s accelerated in the late 1990s with the advent of multi-party democracy. The lack of strategic partners to drive the economy meant there were no strategic investors. Most industries prevalent during H. Kamuzu Banda's regime closed or significantly scaled down.

Figure A1: Structure of Malawi's GDP by major sector



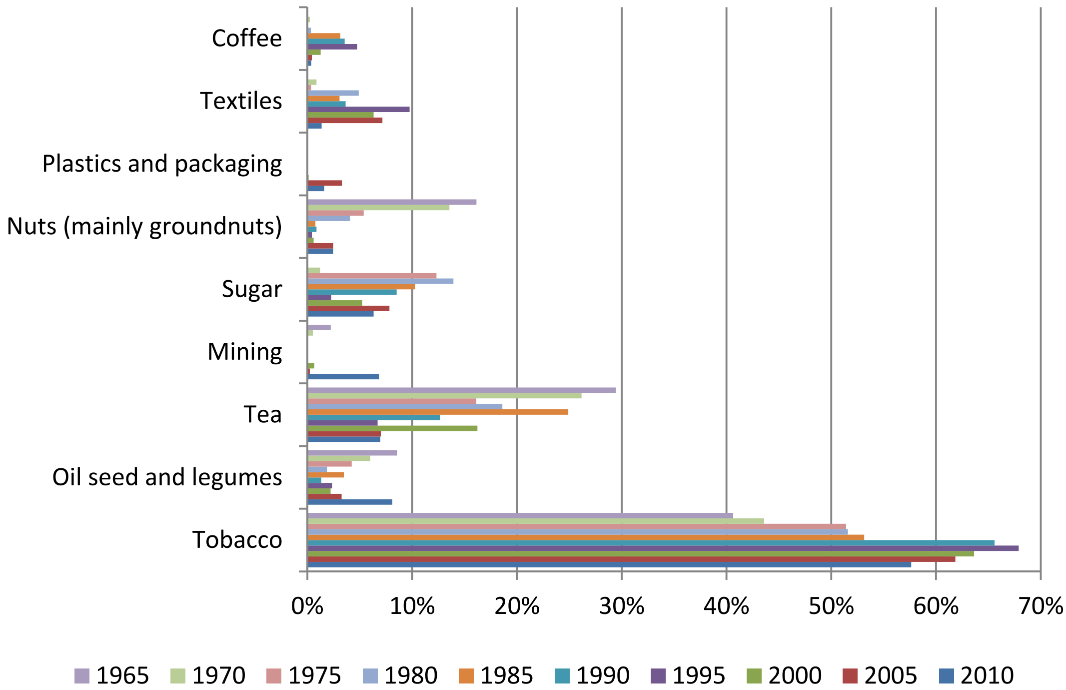
Source: World Bank, *World Development Indicators*.

The liberalisation of the exchange rate in 1994 initially led to price instability, as it was not accompanied by fiscal discipline. Higher import prices immediately fed through into inflation. In addition, excessive government borrowing financed by domestic treasury bills resulted in real interest rates exceeding 20 percent between 2000 and 2004. In 2001 real interest rates were above 24 percent; up from 0.75 percent in 1980 (Lea and Hamner, 2009).

Malawi's main foreign exchange earners have been tobacco, tea and raw sugar (Figure A2 below). These commodities have low levels of economic complexity (Figure A3 below) and therefore do not naturally assist in delivering structural transformation, at least not unless supported by strong institutions. The increasing dependence on tobacco up to 1995 came on the back of stagnation in the tea sector, whose share of exports declined from 29 percent in 1965 to 7 percent in 2010.

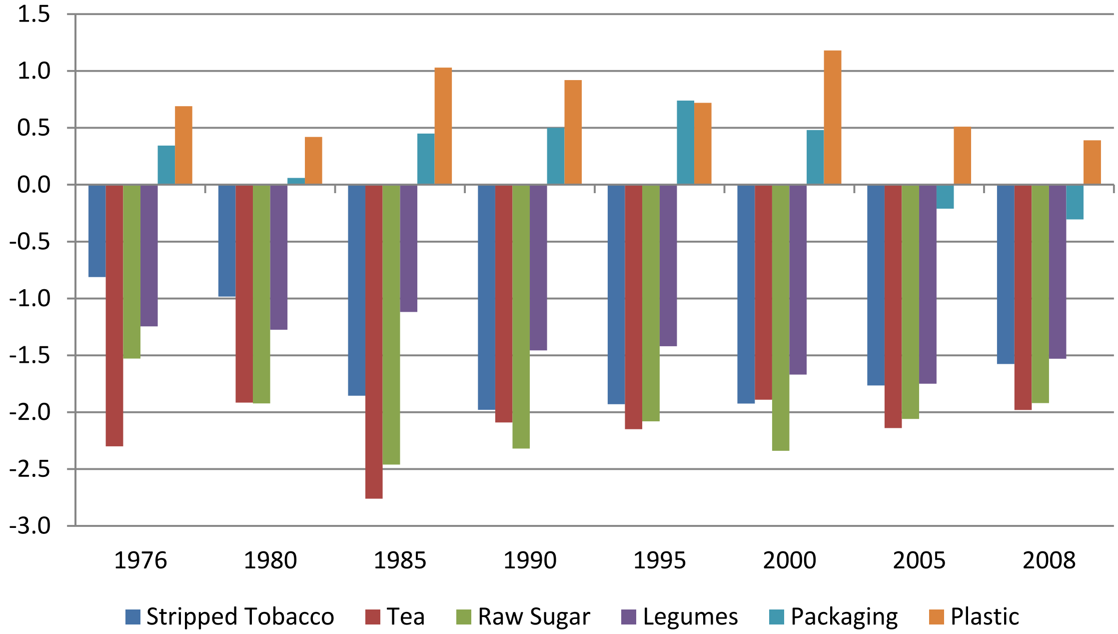
Although Malawi's economic history is one of lack of structural transformation, over the past decade certain changes in the structure of the economy have started to take place. Uranium production started in 2009, allowing mining to account for 7 percent of goods exports in 2010. A number of other mines, including for rare earths and coal, are expected to start operating in the next decade. Similarly the private sector in manufacturing is gradually growing – particularly in the agro-processing of crops such as oil seeds, legumes, maize and wheat, and also in dairy, plastics and packaging.

Figure A2: Malawi's main goods exports, as a share of total goods exports



Source: The Observatory of Economic Complexity (http://atlas.media.mit.edu/).

Figure A3: Economic complexity of main exports



Source: The Observatory of Economic Complexity (http://atlas.media.mit.edu/). A score above 1 indicates a high level of complexity and a score below -1 a low level of complexity.

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