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Abstract

This paper discusses the dynamics of public and private investment in Malawi from 1964 to 2011. The evolution of the two components of investment in Malawi is a product of the market intervention and market-based policies. Initially, as a result of the centralized economic management system, public investment expanded rapidly – thereby crowding out private investment growth from 1964 to 1980. The market-based reforms that have been implemented in Malawi since the 1980s, have promoted private investment-economic leadership, limiting public investment to basic infrastructural provision. Although private investment has grown to occupy a position of dominance in all economic activities in Malawi, it still faces some challenges. Some of the challenges facing private investment in Malawi include: poor transport infrastructure, unreliable power supply, low diffusion in the use of modern information technology, and a generally weak generation and transmission of research, science and technological outputs. From the policy stand point, these findings call upon the Malawian government to address the private sector growth constraints while limiting public investment growth to the private sector's complementary economic activities.

Keywords: public investment, private investment, privatization, Malawi.
JEL Classification: E22, E62, H54.

Introduction

There is a general consensus in economics literature that both public and private investment is essential for economic growth. On the one hand, public investment spending on basic infrastructure, such as in transport, communication, water systems, health and education promotes economic growth indirectly through increasing private sector productivity (Ashcauer, 1989a, 1989b; and Munnell, 1990). Infrastructural public investment spending attracts private capital formation. For example, private firms can easily set up operations in the presence of a healthy and educated workforce, to take advantage of the possible increases in labor productivity. On the other hand, there is a growing body of literature that supports private investment leadership as the engine for high and sustained economic growth rates (Khan and Reinhart, 1990; Luis, 1996; Phetsavong and Ichihashi, 2012). The economy can benefit from high efficiency and productivity if private firms compete amongst themselves in economic activities – complemented by public investment by their adoption of various strategies, such as investment in technology. Thus, the crucial roles played by both public and private investment in the growth process of an economy cannot be overestimated.

Some of the policies that have shaped public and private investment in Malawi have evolved, since its independence in 1964. Persuaded by the basic infrastructural hypothesis, the new Malawian government initially expanded public investment, even in economic activities where the private sector had a higher marginal efficiency. The financial losses of the State enterprises and the resultant negative economic growth rates that followed forced the Malawian government to consider adopting the private sector leadership in economic activities, limiting the State to playing its complementary role in core infrastructural provision. This new economic system has enabled Malawi to achieve high and sustainable economic growth rates.

However, despite the indispensable roles played by public and private investment in the economic growth process of Malawi, research on the dynamism of the two components of investment is scanty (Mataya and Veeman, 1996; Van Donge, 2002; Whitworth, 2005). This paper aims to put under the spotlight, the evolution of the Malawian public and private investment – by highlighting the reforms, trends and challenges facing these two components of investment from 1964 to 2011.

The rest of the paper is organized as follows. Section 1 discusses the policies, the trends and the challenges facing public sector investment in Malawi; and section 2 focuses on the dynamics of private sector investment, also highlighting the reforms which have transformed the sector, its trends and challenges. This is then followed by the last section that provides some concluding remarks.

1. Public investment in Malawi

The evolution of public investment in Malawi can be traced from its political independence in 1964. For the first 15 years after independence, the Malawian government pursued strong market-intervention policies. The objective was to accelerate growth rates whose benefits were envisaged to trickle down to the poor majority, who had been marginalized during the colonial rule. This resulted in a massive expansion of public investment spending that accounted for about two thirds of the gross investment during that period (Pryor, 1990).

Public investment spending was carried out through the established corporate triumvirates in different portfolios: Malawi Development Corporation (MDC), the Agricultural Development and Marketing Corporation (ADMARC), and the quasi-privately owned Press Holding Ltd. The MDC was created as a holding company to establish State-owned enterprises (SOEs) in various sectors, such as in finance, transport, agriculture, manufacturing, tourism and manufacturing. The main role of the MDC was to provide funding to long-term projects undertaken through the acquisition of shares from foreign enterprises, or to completely new investments in different sectors of the Malawian economy.

In the agricultural sector, the State-established ADMARC had the sole mandate to market agricultural produce. The ADMARC, as a marketing board, had a number of functions to perform that included: implementing pricing policy, distributing inputs; exporting produce; ensuring food security, and also as development-cum-investment corporations. The objectives behind the establishment of ADMARC included: (a) shielding the producers from export-market instability; (b) earning a profit from profitable export crops (cotton, groundnuts and tobacco); (c) subsidising inputs and food producers; and (d) investing in other sectors of the economy in partnership with key-development institutions and equity participation (Kaluwa et al., 1992).

ADMARC performed a number of marketing activities to the smallholder crop growers. It was the main market for the bulk of the smallholders' non-perishable crop output, although legally its monopoly was restricted to the purchase of tobacco and cotton, which were the main cash crops of the smallholders. In practice, ADMARC was the market for a wide range of smallholder crops – including maize. It also became involved in the transportation, storing, cleaning, grading, milling and shelling of the crops, and in arrangements for their domestic and export sales. Its sales to the domestic market were mainly made to the agro-based industries (such as grain millers and textile manufacturers) and to individual consumers, including the smallholders who had shortfalls in their subsistence requirements before the next harvest, in the case of food crops. The tobacco bought from smallholders was then sold on the auction floors (as with estate tobacco growers). The exception was oriental tobacco, which was exported directly under private treaty (Chipeta and Mkandawire, 2004).

Unfortunately, the marketing of smallholder crops was not competitive. Since the sales to ADMARC were at officially set prices for the prescribed qualities or grades for the entire market, the interplay of market forces was ruled out. The parastatal, however, made huge profits, which were then reinvested in other sectors. The profits were as a result of the wide difference between the selling price and the generally low producer prices paid to the smallholders (Ng'oma, 2010).

In addition to the MDC and ADMARC, Press Holding Ltd. (Press) was formed in 1969. Although privately owned, Press Holding Ltd.'s activities were similar to those of the MDC and ADMARC. The activities of these companies resulted in the building up of a range of public and quasi-public bodies that invested in, managed or supported a broad spectrum of economic activities in agriculture, industry, commerce and finance. Together, they dominated all economic activities and virtually displaced the private sector (Ng'oma, 2010).

The corporate triumvirate was the only group of local companies that for a long time were allowed to partner foreign firms in the formation of management contracts and shareholdings. The objective of joint ventures between local and foreign capital was to reduce remittances to foreign countries; and this was also taken as another route of economic nationalization. By 1974, the State's interventionist policies resulted in the establishment of 320 new factories (GoM, 1974). By 1977, Press Holdings Ltd. and its subsidiaries had a gross turnover of about 33% of GDP, while the parastatal sector was contributing 25% of GDP (Lwanda, 1993).

In terms of the composition of the State investment during the pre-reform period, 1964 to 1980, the focus was to develop the domestic infrastructure, mainly transport and communication, and to finance smallholder agriculture-related delivery systems. Table 1 shows the sectoral shares of development expenditure in Malawi from 1974 to 1981.

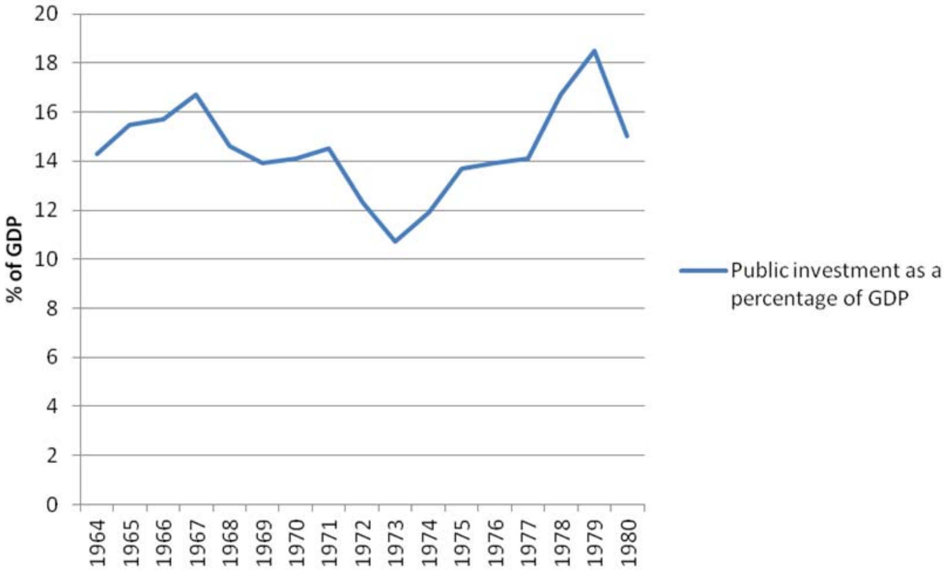
Table 1. Sectoral shares of development expenditure

Sector	1974-79	1979-80	1980-81
Agriculture	19.4	15.7	15.9
Social services	6.3	6.2	8.4
Transport and communication	50.0	34.6	36.9
Government building	9.4	21.2	16.4
Water	2.4	5.6	16.4
Power	5.5	7.6	7.4
Finance, commerce and industry	1.1	1.5	0.3
Other	5.9	7.6	3.8

Source: Economic Planning Division (various issues).

As shown in Table 1, from 1974 to 1979, the transport and communication sector had the highest share of 50%. This sector maintained the highest share for the years 1979 and 1980, although it decreased from 50% to 34.6% before it again increased to 36.9% for the years 1980 and 1981. The highest share of State investment expenditure to transport and communication was necessitated by the need to construct roads, which linked the smallholder farmers to the markets. These had previously been inaccessible due to the absence of adequate road networks during the colonial period. Government buildings, however, absorbed an increased share of the GDP during the late 1970s. This was mainly due to construction work in Lilongwe, the new capital city, after its relocation from Zomba, and the building of State houses (Kaluwa et al., 1992).

The consolidated growth of the public sector investment through the corporate conglomerate: MDC, ADMARC and Press Holding Ltd., as well as the direct investment expenditure by the line ministries is shown in Figure 1, which gives the trends in public investment in Malawi during the period of 1964-1980.



Source: World Development Indicators (2000), Nehru and Dhareshware (1993) and own calculations.

Fig. 1. Trends in public investment from 1964 to 1980

As can be seen from Figure 1, public investment increased from 14.3% of GDP at independence through to 16% of GDP in 1967. The infrastructure hypotheses can partly explain this growth trend in public investment. For example, during the 1960s, public investment on health and education exceeded 5% of GDP (Msosa, 1998). From 1967, there was generally a declining trend in public investment, which bottomed in 1973. The first oil shock of the early 1970s explains this reduction in public investment. From 1973, it again assumed the upward trend, which was interrupted by the second world oil shock of 1978. Generally, public investment expenditure – for the first 15 years after independence – was on the upward trend.

The growth trend of public investment in Malawi for the first 15 years after independence, however, reversed with the onset of the economic crisis of the period 1979 to 1983. The second 1978 world oil shock and the resultant parastatal crisis of the early 1980s gave rise to negative economic growth rates from 1979 to 1983 (WDI, 2000). In response to this, the Malawian government adopted several policies that shaped public investment. These policies were implemented in three major sequential categories: (1) The first phase of privatization; (2) the second phase of privatization; and (3) the Malawi economic growth strategy.

The Malawian government adopted the first phase of privatization of SOEs (1984-1994) under the auspices of the World Bank and the International Monetary Fund structural adjustment programs (Adam et al., 1992; Adam, 1994). The objectives of the privatization policy were to: (1) increase the efficiency of the SOEs, and to thereby make them profitable entities; (2) to reduce further public investment expenditure; and (3) to significantly reduce the portfolios of SOEs through the sales to the private sector (Chirwa, 2005).

Initially, during the first phase of privatization, between 1983 and 1987, there was the rationalization and restructuring of the SOEs. This involved commercialization of the SOE's sector. The parastatal reform strategies included a review of corporate objectives, the introduction of performance-related incentives, increasing the autonomy of management in the recruitment and firing of employees (Malawi Government, 1987). These reforms were implemented with the objective of improving the efficiency and effectiveness of parastatal institutions and their contributions to GDP (Chirwa, 2001).

Moreover, during the first phase of privatization, the two State-holding corporations, ADMARC and MDC swapped their assets. This was necessitated by the fact that ADMARC, MDC and a quasi-private corporation, Press Corporation, had interlocking ownership in several investments, so that the poor performance in major subsidiaries affected all the three institutions (Harrigan, 1991).

The Press Corporation was restructured, and the rationalization of investment portfolios of ADMARC and MDC through assets swaps in 1984 was concluded with the assistance of the World Bank and the International Monetary Fund as a short-term solution to the State-owned enterprise crisis (Adam et al., 1992). The rationalization of State-holding corporations resulted in ADMARC holding investment portfolios in agriculture-oriented activities, in the MDC focusing on industrial and service sectors, and in Press Corporation having a heterogeneous portfolio. Besides the asset swaps and the market liberalization undertaken between the period of 1984 and 1994, the government implemented the sale of subsidiaries of MDC and ADMARC.

In the manufacturing sector, nine enterprises were privatized, and two were liquidated out of a total of thirty-two SOEs. Among the nine enterprises privatized, two were sold to existing shareholders, who had pre-emptive rights; and the other two were new foreign investors. New foreign investors also participated in the sale of the three manufacturing enterprises in the food-processing industry in 1991. However, the government still retained more than twenty per cent of the ownership (Adam et al., 1992; Chirwa, 2000).

The first phase of the privatization program greatly reduced further public investment spending, although the stock of the SOEs did not significantly decrease as was anticipated. In 1994, the government undertook to implement a much broader scope of privatization than the first phase. The second phase of privatization was undertaken under the fiscal deregulation and restructuring framework, as part of the structural adjustment programs. With sponsorship from the World Bank and the International Monetary Fund, the government drafted the policy framework for privatization, which became a policy statement after endorsement by cabinet at the end of 1995. This culminated in the passing of the Public Enterprise (Privatization) Act by parliament in March 1996 (Chirwa, 2001).

Under the national privatization program, more than one hundred SOEs were planned for divestiture. Some eight enterprises in manufacturing were privatized between 1993 and 1998 through private placement and sale to existing shareholders with pre-emptive rights (Chirwa, 2000). Foreign multinational firms had all the investments with pre-emptive rights. Through the Malawian stock exchange (MSE), the public offering of equity sales was only used for the privatization of one enterprise in the manufacturing sector (Privatization Commission, 1997). Thirty-six public enterprises were privatized by 1999; and by 2004, the figure had reached sixty-two. This represented a more aggressive privatization program than the one undertaken during the first phase.

The second phase of privatization of SOEs was concluded by the end of 1998, although up to the early 2000, there were still sales of the few remaining assets. The guiding principle during the sale was to eliminate government involvement in economic activities that were in competition with the private sector, and where the latter had a higher marginal efficiency and productivity. This resulted in the dispossession of government stake in several firms in each sector of the economy. The government was left with portfolios in natural utilities sectors, such as in power generation/distribution and water. The end of the second phase of privatization ushered in a new economic policy in 2004: the Malawi Economic Growth Strategy. This economic strategy had a cocktail of action plans that were to affect public investment from 2004 to 2011. With the persuasion that public investment in roads, education, health and other public infrastructure could increase the productivity in the private sector; the government resuscitated the Public Sector Investment Framework (PSIF), as part of the efforts to promote higher economic growth rates.

The PSIF was to prioritize investment by the public sector in the high economic growth potential sectors that were identified by the Malawi Economic Growth Strategy (2004), thereby ensuring that government priorities were harmonized. The mandate of PSIF was to comprehensively list and coordinate the implementation of all new and ongoing high priority social and economic-development programs and projects in the economy. To achieve this, support was required from the Ministries of: Finance, Commerce and Industry, and

Agriculture Irrigation and Food Security. The Ministry of Finance was to come up with a tax policy that would be efficient in promoting private investment and economic growth. The Ministry of Commerce and Industry was identified as the core government ministry in terms of the private sector development. The success of the Malawian Economic Growth Strategy (2004) depended on the support in implementation from the Ministry of Commerce and Industry.

Since, the agricultural sector was the greatest contributor to GDP by 2004, close co-operation with the Ministry of Agriculture, Irrigation and Food security was also strategic in achieving the high economic growth rates pronounced in the Malawi Economic Growth Strategy (2004). Specialist services were required in the main crops that have high potential to stimulate economic growth, like tobacco, tea, sugar, cotton, maize and cassava for onward transmission to private farmers.

2. Private investment in Malawi

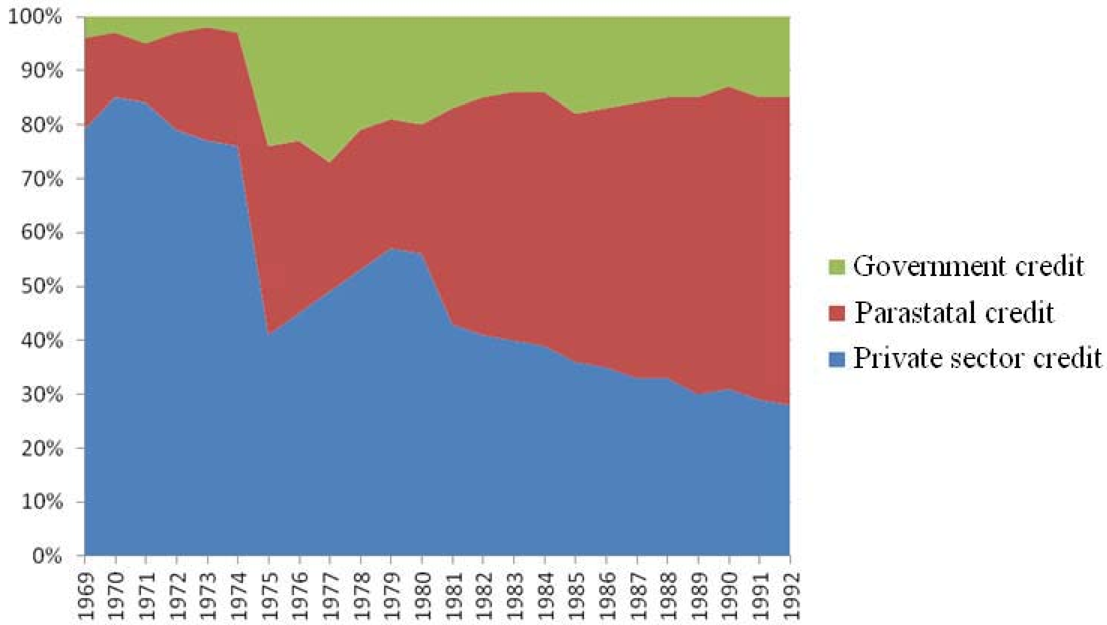
Growth of investment by the private sector for the first 15 years after independence in Malawi was choked by the expanding dominance of the State in economic activities. The State crowded out private investment in the allocation of the domestic bank credit, as well as through the enactment of Acts and regulations that made it virtually impossible to set up private investments.

From the Malawian government's point of view, this was necessary in order to indigenize the economy and in the absence of adequate indigenous private capital, the State's comprehensive ownership of the means of production and the centralization of the economy – and the management thereof – was taken as the substitute. Licensing regulations, which were enacted in 1968 as part of the legislation on the control of goods and services, severely affected private investment growth, especially in pricing and distribution. In some sectors, entry to various business activities was restricted, especially to imports, commercial agriculture and the formation of joint ventures with foreign capital. These avenues were exclusive to the corporate triumvirate (MDC, ADMARC and Press Holdings Ltd.). The business regulations applied to the private sector came in the form of different Acts, such as Business Regulation, Price Controls and Enforcement, and the Business Forfeiture and Security Property (Ng'oma, 2010).

The Business Licensing Act of 1970 empowered the Minister of Trade and Industry with absolute discretionary power to refuse or cancel business licenses. Regarding commercial agriculture, especially in the production of burley tobacco, the Minister of Agriculture was responsible for the licensing. Within the licensing requirements, however, government 'quota' allocation committees periodically decided the maximum import values that the firms were allowed, as well as the maximum quantities of specific types of tobacco that any grower could produce (Ng'oma, 2010). The Control of Goods Act (1968) was instituted by the Malawi government as a price-control mechanism. This resulted in the formation of a Pricing Monitoring and Control Committee (PMCC) in the Ministry of Trade and Industry with the mandate to implement the price-control regime. At district level, subsidiary committees were formed, which were chaired by the District Commissioners (DCs). Their mandate was to check on prices and monitor that traders were displaying the prices of their merchandise. Depending on the extent of competition facing the firm, the PMCC reviewed prices and introduced a mark-up of between 12 and 18 per cent. Firms would need permission from the ministry to effect price changes for those commodities specifically mentioned in the law (Ng'oma, 2010). This price control regime effectively undermined the growth of the private enterprises, especially in the context of the oil crisis of 1973, which resulted in an inflationary trend. Most private enterprises could not grow, or were forced to close operations, since they were not allowed by law to pass on to consumers any increase in production costs – in the form of product price increases caused by exogenous shocks, such as oil price increases. Also, through the Forfeiture Act of 1966, the security of property rights for private assets was endangered. Through the Act, the State could confiscate the private property of those who had broken the business law.

Such practices, as selling above the government's prescribed price and violations of foreign currency quotas not only resulted in the cancellation of business licenses, the freezing of bank accounts and deportations, but also the forfeiture of the personal property of the person involved (Ng'oma, 2010).

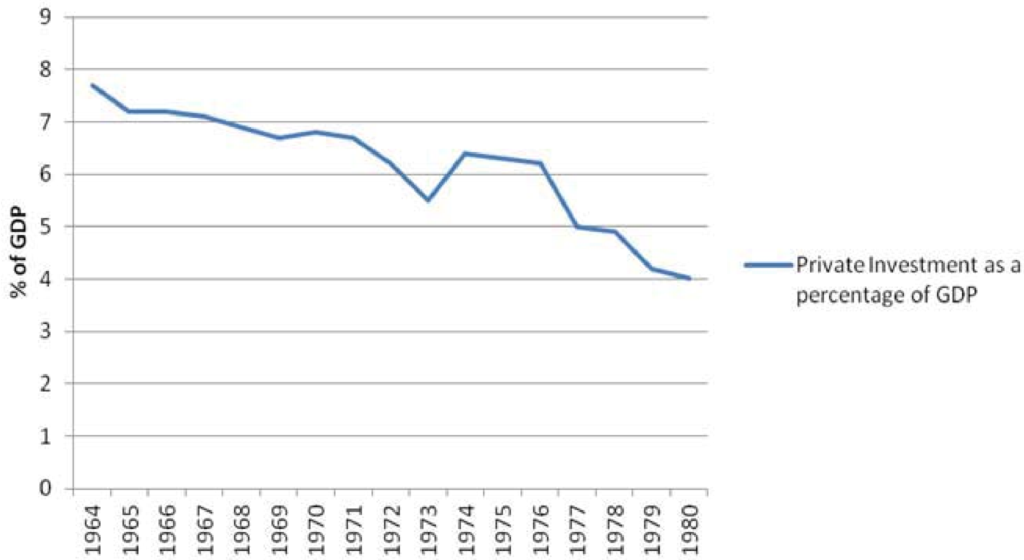
In the allocation of the domestic bank credit, the State also displaced the expansion of the private sector. This was because of the majority control of the financial sector that the State had during the pre-reform period, and even thereafter. As may be seen in Figure 2, there was a growing trend in the consumption of domestic bank credit by the government and the parastatals from the period 1969 to 1992.



Source: International Bank for Reconstruction and Development (1994).

Fig. 2. Allocation of domestic credit from 1969 to 1992

The State's and parastatals' share of domestic bank credit rose from about 21% in 1969 to about 45% in 1980, and then to 73% in 1992. The growing share in the domestic resource allocation of the State investment spending crowded out the resources that could otherwise have been made available to the private sector investment expansion. The resultant effect of private sector business regulations and its displacement in domestic resource allocation, among others factors that determined its growth, were to reduce its growth from 1964 to 1980. As may be seen in Figure 3, private investment exhibited a general negative growth trend from a high of 7.7% in 1964 to a low of 4.0% of GDP in 1980.



Source: World Development Indicators (2000).

Fig. 3. Trends in private investment from 1964 to 1980

As was with public investment, the growth trends of private investment after 1980 were greatly shaped by the first and second phase of privatization and the economic policies implemented during the economic-recovery phase (2004-2011). As part of the market reforms during the first phase, the liberalization of the markets resulted in the participation of the private sector in markets that were the preserve of the SOEs. The domestic trade was liberalized, especially with respect to agriculture and the financial system. Through the Agricultural Act of 1987, the marketing of smallholder agricultural produce was opened to private traders and export markets. In 1990, the marketing of the agricultural inputs, which had previously been done by ADMARC, was liberalized, thus allowing private players (Chirwa, 2005). Private traders were allowed to compete with ADMARC in the marketing of smallholder crops. In the early years of liberalization, smallholder cash crops, such as tobacco and cotton were excluded. Private traders' participation in the marketing of smallholder crops subsequently rose. This was evidenced by a decrease in the market share of ADMARC, which used to purchase the bulk of smallholder crops. For instance, ADMARC's market share by the early 1990s had dropped to as low as 20% for tobacco, and to between 45% and 50% for cotton (ADMARC was the only buyer of smallholder tobacco and cotton before liberalization), 5% for groundnuts, and 35% for rice. Private traders would have displaced more of ADMARC's market share were it not for the constraints they faced in the areas of financing, crop procurement, storage, grading, marketing and transport (especially with respect to remote rural areas, from which ADMARC had withdrawn). As a result, their capacity to offer attractive producer prices to smallholders was impaired. Such incapacity was not conducive to the growth in smallholder agricultural output and incomes (Chilowa and Chirwa, 1997). In the manufacturing sector, entry was liberalized in 1991 after completion of the phased decontrol of prices (Chirwa, 2005).

Besides liberalization of the markets to some extent, the Malawian government implemented various specific initiatives to assist and grow the private sector. These included: freedom to invest, industrial licensing and company formation; transfer of land, taxes and duties, external transport routes, availability of foreign exchange, access to local financing; labor practices, encouragement of small-scale and medium-scale enterprises, encouragement of export-oriented investments, investment assistance and promotion, investment protection, and access to international arbitration (Malawi Government, OPC, undated). The result of these policies was the growth of the private sector, as was evidenced by the growth in its marginal productivity. The marginal productivity of the private sector grew from a low of 4.0% of GDP in 1980, to a high of 7.4% of GDP in 1992, after the first phase of privatization. Growth in private sector investment started surpassing the public sector from 1989 onwards – at 6.7% against 5.7% of GDP (WDI, 2000). Private investment continued to grow with the adoption of the second phase of privatization in 1994. Having subscribed to the market-led growth, the government intensified the privatization of the State enterprises from 1994 to 1998.

This resulted in the increase in dominance of the private sector over the public sector in economic activities. What pertained after the second phase of privatization was the private sector-led economic model. Nevertheless, the private sector still faced some growth constraints, which were addressed by the Malawi economic-growth strategy of 2004 – during the economic recovery phase from 2004 to 2011.

The Malawi Economic Growth Strategy was adopted in 2004. It was formulated to accelerate economic-growth rates through refocusing the existing resources to the private sector, and developing policies that were geared to stimulate the private-sector investment and trade. The private sector-investment strategy focused on addressing the general weaknesses in the investment climate, in order to stimulate investment in the prioritized sectors. The Malawi Investment Promotion Agency (MIPA) that was established in 1991 under the Investment Promotion Act of 1991 was also strengthened to stimulate new investment. Through MIPA, private investors were to access general incentives, as well as export incentives that included Export Processing Zones (EPZs) (Malawi Economic Growth Strategy, 2004).

The MIPA was tasked with the responsibility of improving the poor macro-economic environment that limited new private investment, and that included: (1) financial sector reforms; (2) investment incentives; (3) a stable macro-economic environment; (4) an appropriate and functioning economic and social infrastructure; (5) capital market development; and (6) an appropriate legal and regulatory framework for domestic and foreign investment (Malawi Economic Growth Strategy, 2004). Despite having addressed some of the challenges hindering the growth of the private sector through implementing the Malawi Economic Growth Strategy (2004), there were still a number of constraints facing the sector in Malawi. These included poor transport infrastructure, irregular power supply, low diffusion in the use of modern information technology, and generally weak generation and transmission of research, science and technology outputs (GoM, 2012).

Conclusion

This paper has discussed the dynamics of public and private sector investment in Malawi from 1964 to 2011. It has highlighted the major policies, reforms and challenges that have shaped the two components of investment. Public investment grew to dominance in all economic activities for the first 15 years after independence in 1964. The State investment was implemented in all the sectors of the economy through the corporate triumvirate: Malawi Development Corporation, Agricultural Development and Marketing Corporation, and the quasi-privately owned Press Corporation Ltd. The economic crisis of the early 1980s in Malawi resulted in the government undertaking reforms that reduced the growth of public investment. The first and second phase of privatization between the years 1983 and 2000 largely eliminated public investment, limiting the State to economic activities that complemented private investment, such as in the basic infrastructure provision. The basic infrastructure hypothesis became the guiding philosophy in public investment spending from 2004 to 2011. The private investment grew from a minority share during the first 15 years after independence in 1964, to economic dominance in the period that followed. Initially, its growth was constrained by government's stringent business licensing and the public sector crowding out in domestic-resource allocation. The first and second privatization reform phases enhanced the growth of the private sector, which emphasized the private sector as the engine of economic growth. This paper has observed that although private investment has grown to be at the center of all economic activities in Malawi, it still faces a number of challenges that affect its growth. It is still negatively constrained by the poor transport infrastructure, an erratic energy supply, the weak use of information technology, and the low investment in the areas of research, science and technology in Malawi. From the policy perspectives, these findings imply that the Malawian government should consolidate on the adopted market economy through: (1) Addressing the challenges that inhibit private sector investment growth; and (2) increasing public sector investment in the private sector's complementary economic activities.

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