

## Ministry of Trade and Private Sector Development

### SECTOR ASSESSMENT PAPER – TRADE AND PRIVATE SECTOR DEVELOPMENT

This paper has been prepared by the Ministry of Trade and Private Sector Development in support of the Malawi Joint Country Program Review between the Government of Malawi and five donors (DFID, EC, GTZ, Norway and the World Bank).

The aim of the review is to take stock of Malawi's developmental needs, existing policies and support programmes with a view to ensuring that assistance is in line with the new Malawi Growth and Development strategy, and that as far as possible future donor assistance is harmonised in order to reduce the transactions costs and administrative burden of receiving aid, and to raise the effectiveness of donor support in line with the objectives of the 2005 Paris High-Level Forum Declaration on Aid Effectiveness.

#### 1.0 Taking stock of trade and private sector development in Malawi

##### 1.1 The environment for doing business

As in many developing countries, the legal operating environment for private sector enterprises in Malawi is not conducive enough. Firms are subjected to multiple lengthy processes in terms of regulations and requirements in carrying out their every-day business activities. In addition, the burden of taxation falls heavily on a relatively narrow formal private sector.

Inappropriate regulation creates obstacles to the process of market development by raising the costs of business entry and growth. In particular, regulation and inadequate institutions for property rights and the rule of law create barriers to transition from the subsistence and very small scale economy to the modern more productive sector. Many entrepreneurs in Malawi remain trapped in the informal private sector due to the high costs of formalisation. Such firms therefore are not able to grow and benefit from economies of scale or access the additional benefits of formalisation such as bank finance and business development services.

The costs of starting a business in Malawi (both financial and in time), are not actually especially high compared to the average for Sub-Saharan Africa, as can be seen in Table 1 below. In terms of the number of procedures required to establish a business and the time taken, Malawi compares favourably with OECD countries. Similarly the zero minimum capital requirement ought to act as an incentive to small scale entrepreneurship. However the cost, as a percentage of per capita income, is high.

**Table 1: Starting a business, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Number of procedures	10	11	6
Time (days)	35	63	25
Cost (% of income per capita)	139.6	215.3	6.5
Minimum capital (% of income per capita)	0.0	297.2	28.9

Source: WB/IFC Doing Business database (2005)

Similarly, the steps, time and costs of complying with licensing and permit requirements for ongoing operations while comparing reasonably well with the

region, highlight the additional challenges that the private sector faces in Malawi compared with developed countries.

**Table 2: Dealing with licences, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Number of procedures	23	20	14
Time (days)	205	251	150
Cost (% of income per capita)	244.7	1,597.3	68.0

Source: WB/IFC Doing Business database (2005)

In terms of hiring and firing workers, Malawi again compares favourably with both other African economies and with OECD countries on all indicators except with respect to firing costs. Table 3 shows how in Malawi the cost of firing a worker is equal to 90 weeks of wages, compared to an average of 59.5 weeks in Sub-Saharan African and 40 weeks in OECD countries. The high cost of laying off workers is likely to act as a significant disincentive to the creation of jobs in the private sector as firms fear the costs of expanding their labour-force too rapidly.

**Table 3: Hiring and firing workers, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Difficulty of hiring index	22	48.1	29.5
Rigidity of hours index	20	63.2	50.0
Difficulty of firing index	20	47.8	27.3
Rigidity of employment index	21	53.1	35.7
Firing costs (weeks of wages)	90	53.4	32.6

Source: WB/IFC Doing Business database (2005)

With respect to registering property, the process in Malawi compares reasonably well to other countries (Table 4) although the time taken (118 days) is still very long.

**Table 4: Registering property, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Number of procedures	6	6	4
Time (days)	118	117	33
Cost (% of property per capita)	3.4	12.7	4.7

Source: WB/IFC Doing Business database (2005)

It is a widely held belief in Malawi that the legal system fails to provide the kind of service that the private sector needs to enforce contracts and settle civil disputes. Unsurprisingly the data in Table 5 shows that while the number of procedures and the time required to enforce a contract is no worse than in other countries, the cost is much higher in Malawi, 136.5 percent of the debt, compared to an average of 41.6 percent in Sub-Saharan Africa and just 10.9 percent in OECD countries. When the cost of settling a dispute with a debtor is actually significantly higher than the value of the debt, then it is unsurprising that few companies choose to pursue settlement through the legal system. This situation is a major contributor to the high level of default on trade credit and non-payment of bills in Malawi.

**Table 5: Enforcing contracts, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Number of procedures	16	35	19
Time (days)	277	434	232
Cost (% of debt)	136.5	41.6	10.9

Source: WB/IFC Doing Business database (2005)

For growth in the private sector to take place, it is important that capital is able to flow freely within an economy and be transformed from non-productive and unprofitable investment into productive and profitable activities. The time required to close a business in Malawi is not high compared to other countries, however the cost is very high (30 percent of the estate) and recovery rate of just 12.3 cents in the dollar indicates that the process of transforming capital does not work efficiently.

**Table 6: Closing a business, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Time (years)	2.6	3.6	1.5
Cost (% of estate)	30	20	7.6
Recovery rate (cents in the dollar)	12.3	16.1	73.5

Source: WB/IFC Doing Business database (2005)

Table 7 demonstrates that entrepreneurs on average spend 782 hours per year dealing with the Malawi Revenue Authority, this represents almost 100 working days and imposes a significant cost on the private sector in terms of time forgone.

**Table 7: Paying taxes, 2005**

	Malawi	Sub-Saharan Africa average	OECD average
Payments (number)	33	41	16
Time (hours)	782	394	192
Total tax payable (% of gross profit)	56.5	58.1	46.1

Source: WB/IFC Doing Business database (2005)

## 1.2 Demand side constraints

Malawi is a small country with only limited domestic demand. Hence international trade is always going to be a key driver of growth in the private sector. While there are constraints and distortions limiting demand internationally (notably agricultural subsidies, technical barriers to trade and sanitary and phytosanitary requirements in developed country markets), the evidence would suggest, given Malawi's comparatively poor trade performance compared to other commodity dependent developing countries, that a lack of demand in the markets in which Malawi participates is not the primary constraint to export expansion. In fact Malawi enjoys moderate current account surpluses with the United States and European Union, but has massive deficits with nearer neighbours, most notably South Africa, Mozambique and Zimbabwe. Malawi's highly liberalised economy means that the private sector faces intense price competition, even in the domestic market.

## 1.3 Supply side constraints

As a landlocked country, Malawi faces additional challenges that need to be overcome in sending its products to international markets. This is an added, but not insurmountable obstacle. Malawi's comparatively high domestic transportation costs imply that the high cost of transport frequently cited by export pessimists is not entirely due to the distance from Malawi to major ports. Malawi's inability to fully capitalise on trade opportunities such as AGOA, together with collapsing share of the domestic market in certain key products (e.g. textiles) implies that the binding constraints to private sector development lay on the supply side of the economy.

The supply side constraints to the development of not only the private sector in Malawi, but the wider economy in general are well-known and include high transport

costs, the high cost and poor quality of utilities (electricity, water and telecommunications), weak skills base and the heavy tax burden on the narrow formal private sector.

However, a stable macroeconomic environment is almost certainly a prerequisite for entrepreneurs to invest and carry out business with any confidence. Just about the most importance consideration for entrepreneurs in any business environment, is the interest rate. Closely followed behind is the rate of inflation, and for companies involved in international trade, the exchange rate.

High interest rates and inflation, together with a volatile exchange rate mean that otherwise profitable investment opportunities are not taken. High risk and/or non sustainable projects tend to be the only types of investment activities that yield a positive net present value. Both savings and investment is discouraged in such a climate.

## 2.0 Existing donor programmes in the sector

Trade and private sector development is not a sector in the same way that health, education or agriculture can be described as sectors and provided with support measures. Trade and private sector development is a cross-cutting issue and reforms aimed at improving the investment climate in Malawi touch on issues right across the national economy. As such, while there are a number of donor programmes that have primary objectives linked to trade and PSD (see Table 8 below), many other programmes in other sectors are closely related to improving the way in which the private sector operates and trades.

**Table 8: Donor support to trade and private sector development**

Donor	Project title	Implementing agency	Project purpose	Time period	Amount of resources
CIDA	Project on Economic Governance		More inclusive national decision-making processes -Encourage constructive public dialogue on public expenditure. -Facilitate private sector issues into the budget	October 2004 – March 2006.	To be determined by the need.
Commo n Fund for Commodities	Commercialisation of Hides and Skins by Improving Collection and Quality in Small-Holder Farming Systems	MTPSD / Eastern and Southern Africa Leather Industries Association	To demonstrate the economic value of hides and skins through improved production, recovery, storage, preservation and marketing of hides and skins to improve the returns of primary producers.	2004-2006	USD 2,550,000 (Malawi component is USD 352,754)
DFID	Malawi Trade and Poverty Programme Phase 2 (MTPP2)	Second phase managed by Project Manager (consultant) based in MTPSD	Enhance capacity in appropriate Malawi institutions to formulate, negotiation and implement trade policies that are sustainable, inclusive and pro-poor.	December 2004 – December 2005 (Now extended until March 2006)	Total over one year: £200,000
DFID	CUMO	Concern Universal	Develop viable financial services for poor rural households that can be scaled up sustainably in Malawi	January 2002 – December 2006	£2,453,217
DFID /	Support to	Procurement	Improve dialogue about the	Two years	Procuremen

Donor	Project title	Implementing agency	Project purpose	Time period	Amount of resources
USAID	the National Action Group	underway now	business enabling environment between the public sector, private sector (including business associations) and donors	from completion of procurement	t underway now
EC	Trade Component of FIDP (Farm Income Diversification Program)	MoAIFS	Improved Institutional capacity in trade policy.	Overall project is 2004 – 2007. This component will last 2 months.	Trade component Est. € 300,000
EC	Trade Component of IDAF (Institutional Development Across the Agricultural Food Sector)	MoAIFS (MTPSD to be involved in the trade component)	To review the roles, mandates, organisational structures and capacities of the MTPSD (amongst others) in the context of future development thrusts for agri-food sector.	tbc.	tbc.
EC	Trade component of MAFSP (Multi Annual Food Security Program)	MoAIFS	Enhanced Food Security through Trade	2006 - 2008	Est. € 1,500,000
EC	Technical Cooperation Facility (TCF)	MTPSD	Financial support towards development activities of a National Export Strategy and of a Private Sector Development Strategy; support to the Competition Commission	2005 - 2006	€ 200,000
EC	National Development and Trade Policy Forum	MTPSD	Build capacity for EPA negotiations without additional financial pressure on the participating country's side – in particular to promote and support the participation of the NSA in the EPA process.	July 2006 – June 2009	Est. € 1,600,000
Norway	NASFAM Strategic Development Programme 2001-2006	National Smallholder Farmer's Association of Malawi (NASFAM)	Production, collection and marketing of specific crops and development of international markets	Three years from March 2003 to February 2006	NOK 28 mill, of which NOK 5 mill is for the micro finance facility (MUSCO)
UNDP	Integrated Framework Window I	MTPSD	Strengthening the capacity of LDCs to participate and lead effectively in all steps of the IF process	April 2003 to current	USD 38,026
UNDP	Integrated Framework Window II "Trade Advisory Services and Capacity Building for Trade	MTPSD	Capacity Building for MTPSD and other national stakeholders for trade integration	2005-2007	USD 524,000

Donor	Project title	Implementing agency	Project purpose	Time period	Amount of resources
	Integration”				
UNDP	Integrated Framework Window II “Standardisation, Quality Assurance, Accreditation and Metrology (SQAM)”	Malawi Bureau of Standards / International Trade Centre	Capacity building in SQAM with the overall aim of supporting enterprises in their endeavours to access foreign markets.	2005-2007	USD 476,000
UNDP	Joint Integrated Trade Assistance Programme (JITAP)	MTPSD (with support from ITC, UNCTAD and WTO)	Capacity Building to integrate African countries into the Multilateral Trading System	2003-2007	USD 600,000
USAID	Support to NASFAM	NASFAM	Crop diversification Farmer association development Agri-business promotion	2004-2006	USD 6,300,000
USAID	Revitalisation of Malawi dairy industry	Land O’Lakes	Revitalisation of Malawi dairy industry	2003-2006	USD 5.643,972
USAID	Support to the development of agricultural input markets	IFDC	Agricultural input (fertilizer and seed) markets development	2002-2005	USD 4,980,800
USAID	Opportunity International Bank of Malawi	Opportunity International	Access to microfinance services for Malawi’s under-served population	2003-2006	USD 2,160,918
USAID	Expansion of Agriculturally Linked Enterprises	International Institute of Tropical Agriculture (IITA)/Southern Africa Root Crops Research Network (SARRNET)	Expansion of agriculturally-linked enterprises	2004-2006	USD 957,350
USAID	Support for Agriculturally-Linked Enterprises	SALES / Chemonics	Promoting business linkages and BDS	2004-2008	USD 11,474,215
USAID	Community-based natural resource management	COMPASS/DAI	To enhance household revenue from participation in community-based natural resource management (CBNRM)	2004-2008	USD 14,553,249
USAID	Deepening the Microfinance Sector in Malawi	Chemonics	To help expand access to capital by micro, small and medium-size enterprises (MSMEs), thereby removing a critical constraint on their growth, through further development and deepening of the microfinance sector in Malawi.	2004-2007	USD 3,477,056
World Bank	Privatization and Utilities Reform Project	Privatization Commission	Support Govt efforts to enhance efficiency of the utility infrastructure sectors and improve the business	Closes December 31, 2007	USD 28,000,000

Donor	Project title	Implementing agency	Project purpose	Time period	Amount of resources
World Bank	Investment Climate Assessment	National Statistical Office/WB	environment Validate, prioritize constraints to private sector growth in Malawi	Final report due in by June 2005	USD 120 ,000

Source: Ministry of Trade and Private Sector Development (2006)

### 3.0 Alignment of existing sector policies and programmes with the Malawi Growth and Development Strategy

The Ministry of Trade and Private Sector Development welcomes the clear emphasis within the MGDS on the importance of trade and private sector development as the engine of economic growth, and therefore poverty reduction in Malawi.

Improving the enabling environment for the private sector (sub-theme 2), increased regional integration and trade (sub-theme 4), as well as improving the economic performance of the economy's priority sectors (sub-theme 1) are the key drivers of achieving sustainable economic growth (theme 1).

In addition, several of the sub-themes listed within the MGDS outside of the sustainable economic growth theme have a direct impact on the economic environment for private sector development, even though these sub-themes might not be explicitly labelled as being related to the private sector. The private sector needs a healthy and educated workforce (theme 3 – social development) in order to improve skills and raise productivity. Similarly, some of the largest impediments to improved competitiveness concern the high cost of transport and the high cost and unreliability of utilities (energy, water supply and telecommunications), (theme 4 – infrastructure). Finally and perhaps most importantly, the private sector needs stable macro-economic management, the full protection of property rights and fair extension of the rule of law (theme 5 – good governance) in order to prosper.

**Table 9: MGDS themes and sub-themes**

Theme	Sub-themes
1. Sustainable economic growth	1. Contribution to economic growth through the sources of growth 2. Enabling environment for private sector-led growth 3. Food security 4. Regional integration 5. Economic empowerment
2. Social protection	1. Protecting the vulnerable 2. Disaster management
3. Social development	1. Health 2. Nutrition 3. HIV/AIDS 4. Education 5. Gender
4. Infrastructure	1. Transport 2. Energy 3. Water supply and sanitation 4. Information and communications technology (including telecoms)
5. Good governance	1. Macroeconomic management 2. Public sector management 3. Decentralisation 4.: Justice, security and rule of law

Source: Ministry of Economic Planning and Development (2006)

### 4.0 Identified gaps and recommendations on future support to the sector

Trade and private sector development issues have not generally been accorded a particularly high priority in both previous Government policy under the Malawi Poverty Reduction Strategy, and recent donor support to Malawi has tended to focus more on social sector development and the improvement of social outcomes, rather than tackling the underlying causes of poverty in Malawi—namely economic under-performance.

The MGDS now places clear responsibility for achievement of social outcomes and poverty reduction on raising the rate of economic growth. The private sector has been highlighted as *the* source of economic growth and therefore, **it is important that adequate resources be made available to directly support measures that will improve the enabling environment for private sector-led economic growth** (theme 1, sub-theme 2); improve the performance of the private sector in accessing international markets (theme 1, sub-theme 4); improve the performance of Malawi's priority sectors (theme 1, sub-theme 1); and improve the entrepreneurial environment for indigenous Malawians (theme 1, sub-theme 5).

As described above, trade and private sector development is a cross-cutting issue and while many of the thematic areas listed under the MGDS are not specifically linked with trade and private sector development, it is importance that **trade and private sector development issues be mainstreamed more effectively** into the activities of programmes aimed at providing support to social protection (theme 2), social development (theme 3), infrastructure (theme 4), and governance (theme 5).

The Paris declaration includes commitments on ownership, alignment, harmonisation, and managing for results. Specifically the following recommendations can be made.

- **Ownership:** the MTPSD has the mandate of the Government of Malawi on issues related to trade and private sector development and therefore should be involved as a key stakeholder in all donor programmes related to trade and private sector development, as well as in programmes where trade and PSD are cross-cutting issues.
- **Alignment:** the MGDS clearly outlines the role of trade and private sector development as the engine of growth, and the long-run driver of poverty reduction. Donor programmes should be clearly aligned to the goals of the MGDS themes, and to the MTPSD Strategic Plan, National Export Strategy and Private Sector Development Strategy / Reform Programme (sector level policy documents which fall under the MGDS).
- **Harmonisation:** there is a clear need to reduce the transactions costs and administrative burden of receiving donor assistance (Government officials should not have to become experts in donor financial procedures in order to access funds). More predictability is needed on future donor support and pipeline projects and disbursement procedures need to be speeded up and made more flexible to suit country needs. More joint analytical work and cooperation on trade and private sector development is required (some work has already started in this area), and coordination needs to be improved (multiple taskforces and forums).
- **Managing for results:** Steps taken to improve the environment for trade and private sector development do not always result in clear outputs and results

may take time to materialise. This means that the outputs of donor projects are not always clearly quantifiable and results can be distorted by the “noise” of changes in the economic macroeconomic environment. Donor support to trade and private sector development needs to be more outcome focused and flexible in order to take these issues into account.

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