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IMPLICATIONS FOR STRATEGY- MAKERS

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Constraints to Service Sector Development in Malawi

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INTRODUCTION

1. Structure of the Economy

The Malawi economy remains agro-based with the agriculture sector accounting for over 38.6 percent of GDP, employing about 84.5 percent of the labour force and accounting for 82.5 percent of foreign exchange earnings. Agriculture is characterized by a dual structure consisting of commercial estates that grow cash crops and a large smallholder sub-sector that is mainly engaged in mixed subsistence farming. Maize, the staple food, accounts for 80 percent of cultivated land in the smallholder sub-sector. The main agriculture export crop is tobacco, followed by tea, sugar and coffee.

The manufacturing sector is small at 11.0 percent of GDP and is declining. Manufacturing comprises mainly of agro-processing activities, including tobacco, tea and sugar. Distribution and services represent about 22.0 percent each over 1998-2002 period.

Export Mix-Diversity and Performance

Over recent years, Malawi has consistently run a large and unsustainable deficit on the current account in the order of US$200 – 500 million per year. Then dollar deficit has essentially been financed by balance of payment support from international donors.

Malawi's exports are heavily dependent on a narrow range of primary commodities with tobacco accounting for nearly 70 percent of the export earnings. This leaves Malawi highly vulnerable to demand stocks in the tobacco sector. Demand for tobacco has been declining in traditional markets due to anti-smoking lobbies in Europe and the US. However, this is more than offset by growth in demand in Asian developing countries.

In recent years, Malawi has seen modest growth in the non-traditional exports of textiles and garments, although the overall position is still not diversified. However, with the phasing out of import quotas applied to producers such as China and India under the WTO Agreement on Textiles and Clothing (ATC) on 1 January 2005, uncertainty surrounds the prospects of Malawi's garment exports to the US under the provisions of the African Growth and Opportunity Act (AGOA). Tea and sugar are the other major commodities that account for sizeable shares of Malawi's exports; however, these two commodities are also facing challenges in the developed country export markets.

2 Constraints to Service Sector Development Overview:

In view of the constraints mentioned above in respect to export development in Malawi, coupled with the high transport costs, the services sector offers Malawi some room for export diversification. However, the sector has its own challenges.

The services sector accounts for around 60 percent and 30 percent of global production and employment respectively and increasingly the sector is becoming the dominant driver of growth in developed economies. One quarter of world trade is services trade and its growth rate is 14 percent per annum exceeding growth in trade in goods. Increasingly developing countries are benefiting from the growth in business outsourcing and exporting such commercial services direct to developed countries.

In theory, Malawi stands to benefit significantly from increased trade in services as the disadvantages that landlocked-ness and high transport costs have on trade in goods are not serious impediments to trade in services.

The GATS provides a legal framework for liberalisation of trade in services under the WTO and the international trade in services is operated under four modes of supply namely:

- Cross border supply;
- Consumption abroad;
- Commercial presence; and,

- Movement of natural persons.

Recent service performance in Malawi

In 2002 Malawi's services exports totalled USD 49.4 million (approximately 10 percent of total exports), while service imports amounted to USD 221.9 million, implying a considerable deficit (World Development Indicators 2005). The majority of Malawi's services exports were in the tourism sector (67 percent of services exports).

Clearly Malawi is underperforming in the trade of services, although a recent modest success story has been the expansion of NICO General Insurance into Tanzania and Uganda. There has also been considerable criticism by donor agencies and developed country health organisations of the so-called "brain drain" of Malawian medical professionals (doctors and nurses) to developed countries, particularly the UK. This process, it is claimed, has undermined the provision of healthcare in Malawi. However, from a trade perspective this process can be seen as a demonstration of a clear comparative advantage in Malawi in the training of medical professional staff.

Formalisation of this process would be a significant step in improving Malawi's services export performance. The major challenge is to reconcile the public cost of training staff with the private benefit of income earned abroad. If this market failure could be satisfactorily addressed, then there is great potential to expand the export of skilled medical staff, while at the same time maintaining the incentives for a sufficient number of medical staff to remain in the Malawian health system.

3 Constraints to increased trade in services

Cross border supply

As with the export of goods, Malawian enterprises face a number of competitive disadvantages that limit their ability to supply export markets. While services exporters are less encumbered by the high cost of transport (although expensive air passenger services are still a constraint), the usual constraints of high interest rates and difficult access to credit, the poor quality, unreliability and high cost of utilities all apply. The poor state of Malawi's telecommunications infrastructure, the very high cost of international telephone calls and Internet connections in particular are a major barrier to improved performance in services exports. Unless the cost of international communications can be reduced, it is highly unlikely that the country will be able to take advantage of its skilled English-speaking labour force to export services in the same way that India, Bangladesh and the Philippines have done so.

Consumption abroad

Essentially, consumption abroad concerns the tourism industry. Malawi has struggled to attract a meaningful share of world tourism, an industry which is growing at a high rate. International arrivals have been stagnant at a low base for several years. Malawi is the only country in SADC, which does not have direct flights to Europe, and the country has seen the withdrawal of British Airways, Air France and KLM during the last ten years. A major complaint prior to withdrawal by these airlines was the high cost of landing fees and local charges. Without direct flights to Europe, it is unlikely that Malawi will be able to attract a significant number of profitable premium market tourists. However, the basic infrastructure for tourists in Malawi is reasonable and roads connecting Lilongwe International Airport to the major tourism sites of Lake Malawi and key national parks are of acceptable standard. Travel to the more distant sites is more difficult. In general, costs are comparatively high.

Commercial presence

As noted above, the expansion of NICO to Tanzania and Uganda demonstrates improved performance by Malawi's services sector in terms of foreign commercial presence. However, NICO appears to be the exception rather than the rule. The reality is that the private sector in Malawi (with the exception of a handful of sectors) is struggling to survive. Unless the domestic private sector operating environment can be improved, firms are unlikely to be in a position to expand abroad.

Movement of natural persons

Historically, the movement of natural persons was a major source of export revenue to Malawi during the period when the country sent mineworkers to South Africa. In spite of the decline in this industry, Malawi possesses a significant overseas population, particularly in the UK. Globally, international remittances now exceed ODA flows and amount to some 70 percent of World FDI flows. However, most of this total is unrecorded. As mentioned above, Malawi has the potential to become a significant exporter of skilled medical personnel if the current market failures in the sector are addressed.

If the domestic banking system became more receptive to allowing Malawian’s based abroad to hold foreign currency accounts, without any requirement to pay taxes or convert foreign currency into Malawi Kwacha, then there would be enormous potential to take advantage of Malawian’s earnings abroad. Such a step would significantly boost the availability of forex in the domestic banking system.