

Chapter 1

INTRODUCTION

1.1 Introduction

Poverty in Malawi remains widespread. According to the 2004 Malawi Integrated Household Survey, 52 percent of the total population is poor, with 22 percent of the total population living in extreme poverty. The poverty situation in Malawi is exacerbated by the country's little capacity to reduce or mitigate the effects of different types of risks faced by households due to both micro and macro factors. At the household (or micro) level, poverty levels remain unbearably high, formal insurance hardly exists, credit markets are usually imperfect and can only reach a minority of the population, and social safety nets are inadequate. At the macro (or national) level, social protection (generally defined as public measures to provide income security for individuals) is hampered by inadequate government resources, and the economy's dependence on rain-fed agriculture. The agricultural sector remains the backbone of the economy, contributing about 90 percent of export earnings, 45 percent of the gross domestic product (GDP) and supporting about 90 percent of the population (World Bank, 2004).

The poor in Malawi are subjected to different types of risks, most of which threaten their livelihoods and their own existence. Risks are important determinants of poverty due to their effect on households' livelihoods. The majority of the poor are subsistence farmers, depending on rain-fed agriculture. As such, droughts and floods are among the greatest risks that continue to impact negatively on their welfare due to the substantial losses of income, consumption and wealth when these shocks occur. It is obvious that the extent to which these shocks affect households' welfare depend on the households' *ex-ante* risk reduction strategies, as well as their *ex-post* coping strategies. It is therefore logical that an assessment of the dynamics of poverty in Malawi should incorporate a thorough understanding of risks and shocks that households face, and the mechanisms used to cope with such shocks, both *ex-ante* and *ex-post*.

A deeper understanding of the linkages between risk, vulnerability and poverty would provide an empirical basis for social policy, thereby strengthening both the analytical and operational content of the Malawi poverty reduction programmes. The risk and vulnerability analysis are key to understand the dynamics leading to, and perpetuating, poverty. The current study would therefore provide a dynamic approach on what can be done to help the current poor rise out of poverty and to reduce the likelihood of the vulnerable from falling into poverty in Malawi. It endeavours to identify not only the determinants of household vulnerability, but also the determinants of different risk management strategies that are employed by households in the presence of shocks. Further, the study will also attempt to validate the existence of consumption smoothing behaviour as an insurance mechanism among the rural population, as advocated in the literature (see Dercon and Krishnan (2000), Skoufias (2002) and Harrower and Hoddinott (2002)).

1.2 Problem Statement

The Government of Malawi, with the support of the international community, has been undertaking poverty assessments, which were incorporated in the Malawi Poverty Reduction Strategy Paper (MPRSP) of 2002, and the recent Malawi Growth and Development Strategy (MGDS) for 2006-2011. However, such poverty analyses only focus on the levels and the distribution of welfare in a specific (static) context and provide a profile of the characteristics of the poor. They are less disposed toward informing about the underlying processes that contributed to the observed levels of poverty or to clarify the reasons for poverty persistence (Hoogeveen *et al.*, 2003). In order to fully understand the dynamics of poverty, there is need to incorporate factors that explain the dynamics of wealth and poverty. One such factor is risk, which needs to be incorporated in the analytical mix to adequately understand the dynamics by which households move in and out of poverty or remain chronically poor.

Furthermore, poverty reduction programmes in Malawi are not sufficient to reduce levels of poverty, (thereby contributing towards achieving the Millennium Development Goals (MDGs)), because they are only based on *ex-post* measures of poverty. The country's

poverty programmes are based on national poverty assessments, which provide detailed profiles of the poor and document the incidence of poverty in various segments of the population. However, the fact that today's poor may or may not be tomorrow's poor implies that policies to effectively address poverty must be forward looking (*ex-ante*). In such forward-looking anti-poverty interventions what really matters is the *vulnerability* of households to poverty, i.e. the *ex-ante* risk that a household will, if currently non-poor, fall below the poverty line, or if currently poor, remain in poverty.

The analysis of risk and vulnerability in Malawi is the entry point of the study. Vulnerability begins with a notion of risk, and the study, therefore, focuses on the role of risk in the dynamics of poverty and the strategies households use to address the exposure to various sources of risk, taking into account the informal and formal mechanisms of risk reduction, risk mitigation and the coping strategies available to households. This risk and vulnerability analysis will illuminate the link between risk and poverty and attach more meaning to the notion of vulnerability in the Malawian context.

1.3 Research Objectives

The general objective of the study is to undertake an operational risk and vulnerability analysis at household level in Malawi. Specifically, the study has the following objectives:

1. To identify the determinants of household vulnerability in rural Malawi;
2. To analyze households' coping mechanisms for different shocks and identify the determinants of these mechanisms;
3. To test for the existence of household consumption smoothing as an insurance mechanism against idiosyncratic shocks.

1.4 Research Questions

In line with the above objectives, the central research question is 'what is the role of risk in influencing households' vulnerability to poverty in rural Malawi?' This would be answered by considering the following sub-questions?

1. *How vulnerable are rural households in Malawi?*

2. *What are the sources of vulnerability?*

The objective is to identify key risks and shocks (both idiosyncratic and covariate), their severity, and their impact on households in Malawi.

3. *How do households cope with risk and vulnerability?*

The study will analyse major *risk prevention strategies* (*ex-ante* risk management), *risk mitigation strategies* (*ex-ante* risk management), and *risk coping strategies* (*ex-post* risk management) employed by households in Malawi. The study will further seek to understand the determinants of these different risk management strategies.

4. *How effective are household coping mechanisms in smoothing household consumption? Is there any evidence of consumption smoothing among the households in rural Malawi?*

This would be addressed by running a fixed-effect model to control for any unobserved characteristics in the two-period panel dataset used in the study.

1.5 Thesis Outline

The thesis proceeds as follows: after this introduction, chapter 2 provides a review of the literature on the main issues that are addressed in this study- vulnerability to poverty, risk management strategies, and consumption smoothing. Chapter 3 presents the theoretical and conceptual framework that is guiding the study, which is followed by a brief introduction to the Malawi economy in chapter 4. It will also include a section on sources of data that were used in the study, including the sampling techniques employed. Chapter 5 presents the poverty profiles in Malawi that were undertaken using the Malawi Second Integrated Household Survey (IHS2) data. The same chapter will also outline the livelihood profiles of the districts from which primary data were collected, after which the determinants of household vulnerability will be dealt with (chapter 6). Chapter 7 provides an exposition of the determinants of different risk management strategies, both *ex-ante* and *ex-post*, that rural residents use in the face of different shocks. It will be followed by a chapter on consumption smoothing. This chapter particularly considers

whether there is any evidence in the data that consumption smoothing was taking place in the sampled areas. Chapter 9 will conclude the whole discussion and offer some policy implications arising from the results of the study.