# Cotton - Textile - Apparel

# Value Chain Report Malawi

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## Executive Summary

Since the late 1980s, cotton production has declined in Malawi. This was a result of many factors including the structure of the industry, the dominance of the public sector in the purchasing of cotton, decreasing productivity and latterly declining world prices. The shrinking of the domestic textile industry since the late 1990's has resulted in further reduced domestic demand for cotton lint. Until about two years ago, international demand for Malawi cotton lint has also declined significantly, because of quality problems. However, since the problem was properly identified, the Ginners have taken measures and the problems seem to have been solved.

The revival of the local textile industry could further increase the flow of Malawi cotton from growers and ginners upstream. However, even without a recovery of the Malawi textile industry there are ample market opportunities for the sale of increased volumes of cotton lint within the region. The current growth of the spinning market in neighboring countries, especially South Africa, offers the cotton sub-sector enough potential with the recent investment of two international ginning companies supporting this view.

As an outlet for cotton lint, South Africa is of paramount importance for Malawi, having the biggest textile and garment industry in the region. Most of the cotton lint for this industry has traditionally been imported from Zimbabwe so Malawi might benefit from lower production in Zimbabwe in the short to medium term. However, Malawi has the structural disadvantage of higher transport cost into South Africa, whilst competitor countries such as Mozambique and Zambia are closer to South Africa. Therefore, Malawi needs to focus on how to achieve continuous reductions in the cost of production and higher productivity over time. This focuses attention on agricultural research and extension systems plus co-coordinating the supply channel for credit and inputs in a way that makes cotton profitable for both farmers and commercial firms over the medium to long run. It is very unlikely that a low-input, low-yield approach to cotton production will allow the industry to flourish.

The Textile industry has been in long-term decline. David Whitehead and Sons (DWS) is currently subject to a privatization exercise that may see it back in production. In principal there is a potential role for this mill to play in the supply of fabrics to the domestic and regional garment industry, especially post 2004, but in reality this will be difficult without significant capital improvements and textile expertise from an experienced investor, who can understand the global world in which it must compete.

The savings from developing a local textiles industry are high when one considers that fabric wastage represents 30% of the weight of imported textiles and transport is a major cost item. Malawi's medium and long-term advantage will be in the production of garments made from locally woven cotton cloth as opposed to imported synthetic fabrics. This would allow Malawi to maintain and use the advantages of AGOA, SADC, COMESA and Everything But Arms. However, investors must be found for the textile industry and as Malawi is a relatively unattractive destination for international investment, this might be difficult.

For the Garment end of the value chain, there was rapid growth in the 1990's followed by major dis-investment after January 2000 due to the effective collapse of the agreement with South Africa. The garment industry is now beginning to increase its exports and recover some of the ground lost. Main export destinations are South Africa and USA, mostly under SADC agreement and AGOA.

Currently, negotiations are running in order to increase the SADC quota. If these negotiations succeed, garment companies can increase production quickly as capacity is already available. AGOA might influence the balance in the negotiations. To benefit fully from AGOA and grow quickly, garment producers must import fabric from within the region, products that are often cheaper to produce at the source than within SACU. Moreover, if AGOA enables the South African textile and garment industries to reverse their downward trend, the resistance against imports from within SADC will diminish. This should motivate South African exporters targeting Europe and the USA to advocate for liberalized regional trade for textile and garment products.

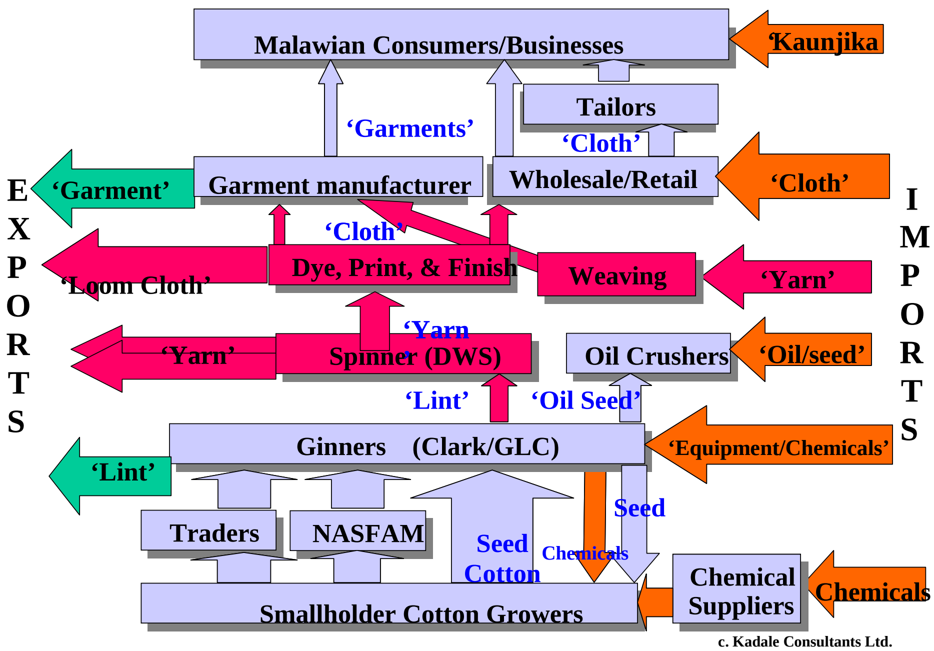
AGOA still offers potential for the Malawi garment industry, however, only three companies are exporting under AGOA, although other companies are now also certified.

The ACP/EU Cotonou agreement still needs to be addressed by the Malawian textile industry. Although Malawi get duty and quota-free access for exports of yarn, fabric and clothing to the European Union market, this opportunity has so far not yet been exploited.

## 1.0 Introduction

Evaluating the cotton, textiles and garments value chain shows that the levels of integrated up and down the chain are limited in Malawi. Figure 1 illustrates the simplified components of and "integrated" value chain.

*Figure 1: Cotton/Textiles/Garment Value Chain*




*Note: Boxes and flows in red are not operating as at July 2003 (Spinning, Weaving & Dye/Print/Finish).*

Until the 1990's, there was an integrated cotton textiles and garment chain in Malawi with intra-sector linkages. However, changing trading circumstances during the 1990's and the decline and then collapse of the only remaining textile company David Whitehead and Sons (DWS) mean that the chain has effectively been broken into three separate entities: Cotton, Textiles and Garments, with Textiles no longer functioning.

Cotton has traditionally been an important cash crop in Malawi. The crop is grown on approximately 30,000 ha and supports up to 90,000 farm families, primarily smallholders. Its declining profitability, in the face of sharply reduced international prices, has led to smallholders tending to substitute other cash crops for cotton over the last 15 years with 2002 seed cotton production at approximately 20% of peak production, attained in 1986. However, recent investment by two international ginning companies and a recovery in world market prices for cotton this year will have a positive effect on cotton growing in the 2003/4 season. Moreover, the regional demand for cotton lint is likely to increase as a result of international trade agreements in the textiles and garment sub-sector. Therefore, as will be explained in this document, the cotton sub-sector in Malawi appears to have a brighter future, although various problems still need to be overcome.

With respect to textiles, there was only one operating spinning and weaving mill in Malawi, which is in receivership as at July 2003, though it appears likely that the sale to Jimtex Mapeto will go through shortly. The shrinking of the domestic textile industry since the late 1990's has resulted in further reduced domestic demand for cotton lint with the vast majority of cotton lint being exported. This study will clarify why it is of paramount importance for the country to revitalize spinning and weaving and to attract other investors in the textile sector.

The garment industry moved from a predominantly domestic market industry in the 1970s and 1980s to an export orientated industry in the 1990s through to 2003. In the early 1990s there were over thirty garment factories in Malawi, currently, there are only six left mainly as a result of unfavorable trade agreements or the failure to implement those that are favorable. The garment firms have been the main users of the Export Processing Zone (EPZ) status, but this has failed to attract any recent garment or textile investors into the country.

Trade agreements, such as African Growth Opportunities Act (AGOA), Community of East and Southern Africa (COMESA) free trade area and the Malawi Mozambique, Tanzania and Zambia (MMTZ)/Southern African Customs Union (SACU) Agreement offer opportunities for both the cotton and garment sector. These will be discussed in this report as well as the constraints, which need to be tackled to take advantage of these agreements. The Regional Trade Center (RATES) might assist in this development by designing a targeted program to increase regional competitiveness. To ensure effectiveness, the activities undertaken by RATES should be in line with the Growth Strategy of Malawi where Government of Malawi (GoM), donors and private sector have described detailed action plans to address the issues and constraints in the various sub-sectors.

The scope of the study focuses on Cotton Lint, Yarn, Fabric (woven and knit fabric) and Garment. The main objective of this report was to give insight into these sectors by describing their functioning and the established trade structures**.** Specifically the objectives were:

- To identify producers and producer associations and showing their production capacities in volume
- To determine Malawi's production of cotton lint, cotton yarn, fabric and garment
- To determine transaction costs associated with the transformation of cotton from raw cotton (seed cotton) to cotton lint, yarn and fabric
- To analyze the flow of cotton lint, cotton yarn, fabric and garment
- To analyze the import of cotton lint, cotton yarn, fabric and garment
- To determine production related constraints along the cotton-garment value chain showing the effects of these on Malawi's ability to export and possible solutions to overcome these problems
- To determine marketing challenges for cotton lint, cotton yarn, fabric and garment
- To determine trade policies and regulations and other constraints impeding export/import of cotton lint, cotton yarn, fabric and garment
- To identify opportunities for enhancing regional and extra regional trade of cotton lint, cotton yarn, fabric and garment and strategies which could be employed to exploit these opportunities
- To identify institutional constraints along the cotton-yarn value chain and propose strategies to resolve these constraints
- To identify existing initiatives geared towards development of cotton and textile trade

## 2.0 An assessment of production capacity

### 2.1 The Cotton Industry

#### 2.1.1 Cotton production

Cotton has traditionally been an important smallholder cash crop in Malawi, especially in the lakeshore districts and in other low-lying areas. The crop is often cultivated together with maize and drought-tolerant small grains. Different sources give different figures with respect to area under cultivation, yield and production. It is nevertheless a common feature that production has decreased considerably in the last 15 years. The most reliable estimates from the Ginners gives 2001/02 raw cotton production at less than 20,000 tones with average yields also lower than in the mid-1990s, at 500-700 kg/ha.

Not only is production down, but so is quality according to the industry. Malawi used to have the reputation for producing a well-graded middle-level quality of cotton. However, the crop has deteriorated in several respects including mixing of different grades, limited grading by farmers and polypropylene contamination, though the latter now seems to be reducing.

Another issue in Malawi is the low Ginning-Out-Turn (GOT) which is very important for the ginners, and consequently for the growers as the higher the GOT, the higher the value of the cotton-seed. In Malawi, the GOT is reported at between 33-35%. In comparison, in most neighboring countries, the GOT is above 40% due to the variety of cotton grown. If the GOT can be increased to 40%, then this would represent an additional 20-25% more cotton lint available for sale based on the same hectarage and production.

The decline in the production and quality is due to a combination of reasons. First, the high input requirement for cotton growing such as pesticides and herbicides, combined with the limited resources of smallholders and the lack of micro-credit available. A second factor relates to the general decline of the official extension service and the resultant decline in cotton husbandry, including pest management. A third factor has been weak price incentives with both the decline in international prices and the inefficiencies in marketing arrangements within Malawi being translated into substantially lower prices for farmers in recent years. Finally there has been poor organization of producer organizations in the past, limiting farmer access to credit and their abilities to achieve economies through joint purchases of inputs and/or transport of seed cotton to buyers. The later has allowed the proliferation of small scale traders that have often exploited the limited options for sale available to smallholders for their own short term gain.

Both ginning companies and farmer groups are trying to tackle the problems of farmers regarding extension work and cash flow shortages. The two ginning companies are now making greater efforts to support the farmers by providing technical support and credit facilities. However, there is clearly a limit to how much commercial companies can assist the growers and this is undermined if the ginners cannot be sure that the seed cotton grown can be purchased by the firm that provided the input (‘free riding’).

### 2.1.2 Cotton producers

Smallholders grow cotton and it supports up to 90,000 farm families[1]. There have been experiments with larger commercial farms cultivating cotton, yet its declining profitability in the face of sharply reduced international prices over the past five years and individual firm inefficiencies has led most of these larger growers to move away from cotton. For the same reason, smallholders have also tended to substitute other cash crops for cotton over the last 15 years, but this is difficult as many small farmers grow cotton out of tradition and lack of an alternative cash crop that can grown in low lying dry areas, particularly the Shire Valley. The major cotton growing areas are:

- The Lower Shire Valley accounting for up to 50% of national production;
- The Southern region upland areas around Balaka accounting for 30% of production;
- The Lakeshore area around Salima accounting for the remaining 20%.

### 2.1.3 Cotton trading

Virtually all the cotton crop is sold within Malawi to the two ginning companies, Great Lakes Cotton Company (GLCC) and Clark Cotton Malawi (CCM).[2] The table below illustrates the significant decline in cotton growing, and the knock-on effect for conversion by the ginners. The latest projections for the 2003 marketing year are that the crop will not exceed the level of 2001/2.

*Table Production of Seed Cotton, and conversion to Lint and Cotton Seed 1997 - 2002*

| **Product** | **1997/98** | **1998/99** | **1999/2000** | **2000/01** | **2001/02** |
|---|---|---|---|---|---|
| | **Tonnes** | **Tonnes** | **Tonnes** | **Tonnes** | **Tonnes** |
| **Seed Cotton** | 28,455 | 18,470 | 13,818 | 24,633 | 15,999 |
| **Cotton Lint*** | 9,390 | 6,095 | 4,559 | 8,129 | 5,280 |
| **Cotton Seed**** | 18,780 | 12,190 | 9,120 | 16,258 | 10,559 |
| **Waste** | 285 | 185 | 138 | 246 | 160 |

*Source GLCC and ADMARC*

*Note Seed cotton is the cotton’ that is harvested. Cotton Seed is the seed used for planting or crushing.*
** Cotton lint estimated production at 33% of raw cotton purchases*
*** Seed Cotton estimated production at 66% of raw cotton purchases*
**** Waste estimated production at 1% of raw cotton purchases*

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[1] *Estimates of the number of families is very difficult to obtain reliably. This data is based on MoAI estimates.*
[2] *A joint venture of Clark Cotton South Africa (51%) and ADMARC (49%)*

There are three main methods by which seed cotton is sold to Ginners through traders, Farmers Organizations and direct to Ginners.

*Sales through traders*

Estimates for the relative sales through the three different routes suggest that many smallholders sell to private traders. This can be explained by geographical problems, as production of cotton is relatively widely spread but the buying points of Ginners are often too far away particularly as many of the old bush markets have closed for economy reasons. As traders take care of transport, this is then an easier alternative for the individual smallholder. Traders also pay cash, which is often urgently needed in the immediate post harvest period to meet outstanding loans and other cash expenditures. This can occur before the price is announced by the ginners[3], so the farmers have no idea what they could get from the ginners and the traders price low to avoid the risk of loss. There are examples given of traders offering basic commodities such as salt in exchange for the crop or taking the crop and then not paying. The general behaviour of traders has acted to discourage growers.

*Sales through farmer organisations*

Sales through Farmer Organizations like Balaka Smallholder Farmers Association (BASFA), affiliated to and supported by the National Smallholder Farmers Association of Malawi (NASFAM), are increasing. BASFA currently has a membership of 3,000 smallholder cotton producers in the Balaka area producing about 1,350 MT of Grade A seed-cotton. In 2002 BASFA purchased over 550 MT and delivered this to the Ginners but purchases by BASFA are limited by the availability of cash. BASFA also delivers other services such as training, organising inputs and transportation. There is scope to further increase the numbers of members of BASFA and other farmer organisations as the benefits on price, training, inputs and pooled transport become clearer to others.

*Sales direct to ginners*

Selling seed cotton directly to the Ginners is possible for smallholders who are located near to the four Ginneries in Salima, Balaka and Shire Valley (2) or to the Ginners' own buying points. In the last season, GLCC operated two additional buying points, whilst CCM took a different approach by utilising the ADMARC facilities in the cotton growing areas (over 60). By selling directly, farmers get a better price, but usually have to organise transport and meet its cost, though ginners will collect larger volumes. Operating buying points is also a big expense for the ginners, but appears to be necessary to encourage more growing and to secure a share of the crop. It is understood that both Ginners have increased the number of buying points for the 2003 Marketing year.

[3] *This is a function of uncertainty over the direction of world market prices for cotton and risk of exchange rate fluctuations, hence the reduced risk to the ginner by announcing a price as late as possible.*

### 2.1.4 Major Players - Cotton processing

As mentioned above, there are only two Ginners in Malawi, both of which are subsidiaries of international cotton companies, Clark Cotton Malawi (CCM) and Great Lakes Cotton Company (GLCC).

CCM controls approximately half of the national ginning capacity, owning two plants, one in Salima and the other in the Shire Valley. CCM has commenced operations in the 2002/3 growing season and is planning to offer a very intensive system of support to smallholders. This would include formation of clubs and access to an inputs package with close monitoring of the progress of the clubs at critical times to ensure that inputs are applied at the right time and that pests are identified early. There will also be a limited amount of credit available to farmers that will be closely monitored and those that repay will be able to access credit again.

GLCC, the other ginner, also owns two plants, one in Balaka and one in the Lower Shire Valley. It introduced a Pilot Credit Scheme in the last growing season in co-operation with selected local Farmer Unions, which assist and advise the participating farmers. This has worked better in some areas than others and GLCC will be modifying its approach and building steadily. GLCC in association with Chemicals and Marketing has also supported around 60 demonstration plots, from which smallholders can see the benefits of appropriate seeds and the application of modern growing practices, including the use of chemicals and pesticides.

All four ginneries are in reasonably good technological condition. However, the current concern is that all four are seriously under-utilized, with probably only about 25% of total ginning capacity being used. This situation is indicative of the limited profitability of the industry at present. On the other hand, the under capacity of the ginneries means there is still an enormous capacity to be fulfilled by the growers, without the ginners having to make significant capital expenditures.

### 2.1.5 Cotton seed and Cotton lint

Once the seed cotton has been ginned, the ginners are left with cotton lint and cotton seed.

Cotton seed

A proportion of the cotton seed (up to 10%) is kept back for the ginners to supply farmers with seed for the following year. This is sold at a highly subsidised price of MK 2.5 to MK 4/kg ($45/tonne) against its realisable commercial value for oil pressing at US $120-130 /tonne. The ginners provide seed at this price to encourage farmers and in recognition that the farmers will be short of ready cash at the time when they need to purchase.

However, this then creates problems of freeloading by either ginners or traders, with questionable real impact on the take up of seed.[4]

Most of the rest of the cotton seed is exported to South Africa with little local cotton seed used by the two to three active seed crushing companies in Malawi[5]. Ginners prefer exporting the cotton seed because of the more attractive export price (and hard currency) and because they have contract obligations. The percentage of cotton seed sold to the local market for crushing varies every year (on the price) but is around 10%.

Ironically, the oil crushing businesses are importing some cotton seed from Mozambique or Zambia or are using cheaper groundnut seed and sunflower seed instead.

**Cotton lint**

Historically, a much higher proportion of the cotton lint was sold to DWS[6] based in Blantyre with the balance of the crop exported as lint within and outside of the region. The financial problems that have dogged DWS have resulted in the steady decline in production of textiles and domestic demand for cotton lint to less than 1,000 tones p.a.. As a result, almost all the cotton lint is now exported with South Africa as the major destination with around 60-80% of exports, with most of the other exports going to South Asia.

Table 2 shows a sharp decrease of cotton lint production after 1997. According to the Ginners and as stated in Table 1, the production of cotton lint in 2001 and 2002 was 8,129 MT and 5,280 MT respectively. The latest projections for the 2003 marketing year are that the crop will not exceed the level of 2002. Although the figures of Table 2 are inconsistent with those from Table 1, the trend represented is fairly the same.

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*Table 2: Production of Cotton Lint, 1996-2000*

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| | **HS Code** | **Units** | **1996** | **1997** | **1998** | **1999** | **2000** |
|---|---|---|---|---|---|---|---|
| Cotton Lint | 52.01 | Tones | 19,900 | 20,947 | 7,054 | 6,278 | 6,592 |

*Source Malawi Confederation of Chamber of Commerce and Industry (MCCCI)*

[4] *It is unclear how much influence the price of seed at these low levels has on the decision by a farmer to grow cotton or not.*
[5] *Though more firms could do this activity.*
[6] *A subsidiary of ADMARC.*

### 2.2 The Textiles Industry

#### 2.2.1 Textile Production

As mentioned in the previous section, DWS is the country's sole textile mill and has experienced severe financial problems. An anomaly exists in Malawi where none of the local textiles are used by the garment industry as all the fabric for the Cut, Make, Trim (CMT) garment firms is imported. This is because DWS was unable to provide the necessary variety and quality at the right time. However, with the changing requirements of the trade regimes for a two tariff heading conversion that encompasses the use of local fabric, for strategic reasons, Malawi has to develop its textile industry based on a revitalized DWS and/or attracting new entrants.[7] All the trade agreements have increasing future requirements on exporter nations to use either national and/or regional textiles. Therefore, there may be difficulties in satisfying this requirement if Malawi is not able to produce at least 25% of the textiles for its garment Industry.

Except for DWS, there is one other company in Malawi that can knit textiles but this is no longer producing as importing fabric proved to be more cost effective.

Table 3 shows that production of Yarn and Fabric peaked in 1997 but decreased after that year. Although not included in the table, the production figures for 2001 and 2002 are expected to be even lower as a result of the negative development of DWS.

*Table 3: Production figures of Yarn and Fabric, 1996-2000*

| | HS Code | Units | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|
| Cotton Yarn | 52.05 | Tones | 13,682 | 15,202 | 12,366 | 9,965 | n.a. |
| Cotton Fabric | 52.08 | Tones | 5,396 | 5,680 | 3,291 | 2,929 | 3,075 |
| Polyester/cotton yarn | 54.0 and 55.0 | Tones | 5,261 | 5,538 | 773 | 688 | 723 |

*Source Malawi Confederation of Chamber of Commerce and Industry (MCCCI)*

#### 2.2.2 Major Players - Textile Manufacturers

DWS comprised a large vertically organized production complex for spinning, weaving, dyeing, and several other specialized finishing processes. Until the early 1990's the company utilized Malawi cotton and with high tariff protection enjoyed financial success. However, its fortunes waned when severe dumping and smuggling of finished textile goods and garments drastically disrupted its domestic market. Following the sale of the Lonhro stake to GoM which was combined with ADMARC's existing stake, DWS as a public enterprise has incurred substantial losses, with the current accumulated deficit now

[7] *There is no industry logic that requires an integrated textile firm, though this may simplify dealings. It may be possible to attract a number of smaller operators in each of the stages of textile production.*

in excess of K.1 billion (US$ 30 million) and as a result DWS has been in receivership since 2002. Production has fallen from a peak output of over 30 million meters per annum in the early 1980's, to the hundred thousands of meters in 2002/3. In the 1990s, much of this production was exported for finishing thereby creating a break in the textile and garment value-chain even before production effectively ceased. Also most of the equipment is at least 15 years old, making productivity low, compromising quality and increasing costs. Several sections cannot currently operate for need of spare parts.

In 2003, DWS an agreement for sale was reached by the Privatization Commission to Mapeto Wholesalers & Jimtex Consortium at a price of MK 73 million (approximately US$785,000). However, the management of DWS protested this sale, arguing that the price was too low and did not reflect the book asset value. A high level intervention stopped the sale of the company and set up a Review Commission to examine how the sale was conducted and to find a way forward. The Commission is released its report at the beginning of August 2003 and essentially cleared the continuation of the sale. The terms of the sale of DWS included a commitment that the buyer should invest US$11.2 to bring the company back to production and that the buyer should increase jobs from 400 to 4,000 in 5 years, though this may not have been fixed in the contract of sale as a condition.

Knitwear Industries, was also a textile producer of knitted/weaved fabrics as well as a garment manufacturer. Its facilities included knitting, dyeing and printing, but over the last few years, the company found that it was not profitable to buy local yarn from DWS so it imported it. Subsequently this also became uneconomical and it now imports textiles and concentrates on garment production.

## 2.3 The Garment Industry

### 2.3.1 Garment production

The garment industry moved from a predominantly domestic market industry in the 1970's and 1980's to primarily an export orientated industry in the 1990's. This transition was due to the smuggling and imports of second hand clothing into Malawi combined with a favorable bi-lateral agreement with South Africa that allowed preferential access for Malawi based companies. As a result, by the late 1990s there were over thirty garment industries in Malawi.

Malawi's exports of garment under codes HS 61 and HS 62 grew rapidly from US $1.8 million in 1990 to US $63 million in 1999 once the new firms began to take advantage of the trade agreement. However, in 1998, the agreement came under attack from within South Africa, by local manufacturers and trade unions. By January 2000 trade with South Africa under the bilateral virtually ceased over night with nine companies closing at that time.

Since then, new trade agreements, discussed later in this report, have become active but these have not resulted in new investment in Malawi's Garment industry. Most of the remaining companies are struggling to survive and are not investing to a sufficient extent. The exceptions to this are the larger international groups, whose parents companies provide them with markets for their production as well as access to supplies of raw materials at competitive prices, supply new equipment when required and provide access to affordable financing. These companies also do not have any problems in marketing as this function in often centralized outside Malawi. For companies who are of Malawian origin there are constraints in doing full fledge marketing. This is costly and the volumes produced are not enough to invest in marketing. They mostly depend on CMT or CM operation and cannot invest in raw material, designs and development as the cost of finance is too high.

According to the GTMA, garment production increased in 1995 until 1998. From 1999 to 2001 there was huge drop in production. In late 2002 and 2003 there was a slight increase in production. Table 4 confirms this trend with peak production in 1998.

*Table 4 Production of Garment, 1996-2000*

| | **HS Code** | **Units** | **1996** | **1997** | **1998** | **1999** | **2000** |
|---|---|---|---|---|---|---|---|
| Poly/cotton fabric: Men and Women fabric | 61.01-17 | '000 Units | 8,381 | 12,081 | 17,622 | 15,166 | 11,368 |
| Poly/cotton fabric: Men and Women fabric | 62.01-17 | '000 Units | 5,810 | 8,374 | 9,172 | 9,590 | 9,324 |
| *Total* | | | *14,191* | *20,455* | *26,794* | *24,756* | *20,692* |

*Source MCCCI*

The garment firms face relatively high production costs in Malawi particularly the high cost of borrowing, poor and expensive financial services and the high cost of freight into and out of the country.

Currently, the real interest rate in Malawi is above 35 percent (nominal around 45), which means that there is no borrowing for investment and the cost of short-term working capital is prohibitive. Letters of Credit cost 0.5% of invoice value and pre-shipment finance even when supported by irrevocable letters of credit is unavailable. Transportation is a major cost element for the industry as material is brought in, turned into garments and then exported minus the trimmings. The cost per kilometre between Durban and Blantyre is one of the highest in the world at over $ 3,000/40 foot container compounded by the long lead times to import and export (c.7-10 days). All export go through Durban for international destinations owning to the certainty of booking space, compared to Beira and Nacala, which are nearer and cheaper, but unreliable. As many of the shipments are destined for the USA, for which there is no leeway for delay, then Durban is the only realistic route to market.

Although these two are the main issues, there are many other constraints discussed below.

### 2.3.2 Major Players – Garment Industry

The garment industry is relatively small, consisting of the following main companies:
- Crown Fashion,
- Giant Clothing
- Knitwear Industries
- Chirimba Garment
- Crossbow Clothing
- Haps Investment Co Ltd./Vanguard Garment Company

Apart from these six companies, there are other smaller garment manufacturers in Malawi. These other manufacturers range from individual tailors operating from home or the street to small tailoring firms employing 2 -10 workers, concerned only with the relatively small domestic market.

Three of the garment companies are locally owned and three are owned by South African or Taiwanese companies, which handle sales and marketing out of the South Africa and Taiwan respectively. In 2002, these six garment companies employed some 7,600 people and were producing at a rate of 1.93 million garments per month with annualized sales of US $67.3 million (Source: Mhoni, J.D.C., 2002). Garment production in Malawi is generally focused on low value garments suitable for mass market and discount stores.

*Table 5 Textile and Garment Industry Overview, 2002*

| Company Name | Year Established | Monthly Production '000 pieces | No of Employees | Yearly Export '000 US$ | Main Export Market | Owner |
|---|---|---|---|---|---|---|
| Crossbow Clothing | 1984 | 400 | 350 | 750 | RSA | Local |
| Giant Clothing | 1999 | 140 | 480 | 6,000 | RSA | South Africa |
| Knitwear Industries | 1981 | 250 | 68 | Nil | Local | Local |
| Haps Investment | 1995 | 780 | 2,300 | 34,800 | RSA/USA | Taiwan |
| Crown Fashion | 1975 | 200 | 1,500 | 3,750 | RSA/USA | Local |
| Chirimba Garments | 1994 | 660 | 2930 | 22,000 | RSA/USA | Taiwan |

*Source Mhoni, J.D.C. National Consultant International Trade Centre*

**Garment and Textile Manufacturers Association of Malawi - GTMA**

GTMA is an association of garment and textile manufacturing firms established in 1996 to provide a forum for addressing a variety of issues, opportunities and problems facing producers in the sector. Currently, the Association has 7 members, the six garment companies and DWS, but is heavily reliant on one very active individual.

## 2.4 Capacity: Installed versus utilized

*Table 6 Installed versus utilized capacity*

| | Installed | Utilized |
|---|---|---|
| Ginning Companies | 100,000 MT | 20% |
| Spinners | 6,000 MT | 0-1% |
| Garment Industries | 40 million pieces | 40% |

*Source Own Research*

The Ginners only use approximately 20% of their capacity. An increase in cotton production can be processed easily as the production facilities are being heavenly under-utilized with ginning only occurring from late May until August. For the other months, the production facilities are not being used.

The total spinning capacity in Malawi is more than 6,000 MT per year for turning lint into yarn. However, the production equipment is partly run down and investment is necessary before the capacity can be fully utilized again. The current production is virtually zero.

According to estimates during 2003, the garment industry capacity registered under AGOA and EPZ units was over 40 million garments per year, but only about 40% of the capacity is currently being utilized. If the constraints hitting the sub-sector can be overcome, this production level can be increased easily. The range of products for both domestic and export market cover Trousers, Shirts, Industrial work wear, Ladies & Girl dresses, Knitted and woven garments etc. Most production facilities include cutting, sewing, finishing and packing. In addition to the 40 million capacity, there are about 2000 industrial sewing machines with unregistered and closed down clothing manufacturing firms. If the economy of Malawi becomes more investor friendly, these could be adding about 20 million garments annually to the above-mentioned figure (GTMA, 2003).

### 2.5 Transaction costs

The value change can be summarized as follows:

800 kgs raw cotton
=
1 bale of cotton lint
=
175 kgs quality yarn
=
700 sq. meter fabric
=
38 dozen t-shirts for men

*Source K.K. Desai, Chairman Garment and Textile Manufacturers Association*

Table 7 gives an idea about the transaction costs associated with the transformation of cotton from seed-cotton to cotton lint and yarn. Note that all calculations depend on kwacha:$ exchange rate that varies from time of inputs to price paid.

As shown in the table, prices paid to smallholders for seed cotton are higher this season. Ginners make losses selling the cotton-seed for planting back to the smallholders and the seed cotton to the oil crushing industry. They must be able to offset this against the profit made on cotton lint. With respect to yarn there is little price information as this is only used internally within DWS for their own production, which is currently minimal. However, based on information of the GTMA, an estimation of prices is given in the table.

For fabrics there is no standard product therefore making computation of added value meaningless. The same is true for garments for which the individual cost of production and selling would be needed as items are by definition not standard. Value addition at each stage can be improved by way of design, style and labels e.g. a branded t-shirt will sell for US$ 10 against the same quality unbranded selling at US$2.50. For this reason, fabrics and garments are not included in this table.

*Table 7 Value change along the Cotton Chain at 2003 prices, Grade A cotton*

| Transaction Point | Buying price US $/MT | Selling Price US $/MT | Value Added % |
|---|---|---|---|
| Farmer | Growing Cost: $204* | Seed Cotton: $215-280 | +5 to 37 % |
| Traders | Seed Cotton: $215-269 | Seed Cotton: $236-300 | +10 to 40% |
| Association (BASFA) | Seed Cotton: $269 | Seed Cotton: $280 | + 4% |
| Ginners | Seed Cotton: $215-300 | Cotton Seed for crushing: $140 | - 35 to 115% |
| | | Cotton Lint ex factory: $850-900 | +183 to 319% |
| | | Cotton Seed for planting: $65 | -230 to 360% |
| Spinners | Cotton Lint: $ 850-900 | Yarn: $2100 | +133 to 147% |

*Source  Own Research*
** Depends on amount and effective use of labour (paid or family) and chemical inputs and the impact on yield.*

## 2.6 Production related constraints

### 2.6.1 Seed Cotton production

According to the Ginners, they have considerable potential sales for cotton lint at prevailing market prices, but are constrained by the relatively low production levels. Therefore to increase the trade of cotton lint, the production of seed cotton needs to be addressed first.  The cotton stakeholders have highlighted the following major constraints in the production of seed cotton:

1. Low quality seed varieties and the usage of unsuitable seed varieties as a result of mixing seed between areas results in low yields and low returns to growers, making the crop unattractive at the current world market prices.  Moreover, the uptake of pre-treated seeds (= coated with insecticides before planting) is very slow in Malawi.
2. Low usage of inputs due to cost and poor availability that results in lower productivity due to pest and weed losses.  Most inputs are imported and the kwacha price increases with devaluation.  Prices have increased more than the cotton price in recent seasons
3. Lack of credit available to farmers, partly due to failure to repay previous loans leading to effective withdrawal of credit and credit providers from many areas. Farmers find it difficult to preserve the cash they need for inputs after the harvest due to social and economic demands on it.
4. Lack of farmer organization for buying inputs and marketing cotton.  This also makes it harder for farmers to receive technical support and training
5. Poor husbandry by farmers with limited knowledge of basic issues like spacing, number of seeds to plant, pest identification etc.
6. Limited effectiveness of government extension work, which is not reaching the vast majority of cotton farmers and even if it does the officers are not cotton specialists.
7. Weak world prices for cotton which are beyond the control of the industry directly but impact on the relative attractiveness of growing cotton
8. Activities of traders and the reduction in the number of buying points resulted in smallholders getting worse terms and being exploited. This is also a function of the late announcement of the season’s price by the Ginners that gives room for the traders to offer cash prices well below the market price. The fewer the buying points the more scope there is for traders.

As a result of the above-mentioned problems, the production of seed cotton is low. Therefore, the Ginners only use their capacity for around 20%, making the operational cost very high.  Both ginning companies, often in co-operation with farmer organizations and chemical companies, try to deal with some of these issues such as extension work, the activities of traders and the quality/suitability of seed. The latter is currently actively addressed by a consortium of interested parties as they applied for a grant to establish a seed treatment plant in Malawi. In Section 5 this initiative will be discussed further.

### 2.6.2 Cotton lint production

During the Ginning, the following problems do occur:

1. Low Ginning Out-Turn, in Malawi reported between 33 and 35%, resulting in lower returns for the Ginners.
2. High polypropylene contamination. This has reduced the attractiveness of Malawi's cotton lint in the international market. There has been an improvement in Malawi's record recently, but it is still a potential problem.

Ginners are aware of these problems and try to tackle them mainly through educational programs and strong vigilance at the intake of seed cotton. However, this is adding to the cost of production and reducing the returns to growers and Ginners.

### 2.6.3 Garment Production

Within the garment industry, the following production constraints have been mentioned:

1. Production inefficiencies, delays and product defects (especially in textiles) have in the past limited the use of locally produced cloth for quality and price reasons.
2. Poor finishing of fabrics, mainly the result of insufficient investment to maintain and upgrade equipment has constrained the textile industry from providing appropriate products
3. Relatively low levels of productivity with a high ratio of managers/supervisors to workers required.
4. High cost of electricity, as the industry tends to be charged at peak usage rates, the so called 'Maximum Demand tariff'.
5. Theft In House – Problems with theft result in high security costs
6. Inefficiencies in the operation and support for EPZ companies resulting in lost entitlements, inefficiencies and added costs on producers.

These problems are very serious and have a negative effect on production quality and price of garment.

## 3.0 Trade flow

### 3.1 Import

Table 8 shows that the import of cotton lint is sporadic and minimal. As the only spinner in Malawi has decreased production and local supply of cotton lint is available, this seems to be a logical figure. However the import of fabrics has especially increased in 2001, which probably reflects the limited local supply of fabrics.

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| **Cotton lint, not Carded HS 52.01 (MT)** | **8** | **573** | **1** | **-** | **238** |
| - South Africa | 7 | 570 | - | - | 24 |
| - Others | 1 | 3 | 1 | - | 214 |
| **Cotton lint, Carded HS 52.03 (MT)** | **-** | **67** | **44** | **-** | **1** |
| - South Africa | - | 43 | 3 | - | 1 |
| - Zimbabwe | - | 24 | 41 | - | - |
| **Cotton yarn HS 52.05 (MT)** | **-** | **-** | **53** | **-** | **83** |
| **Woven fabric HS 52.09 (000 m2)** | **649** | **2,500** | **2,187** | **3,610** | **9,485** |
| - Pakistan | 4 | 1,008 | 49 | 1,726 | 3,235 |
| - India | 277 | 87 | 341 | 136 | 111 |
| - Taiwan | - | 602 | 1,101 | 1,173 | 3,849 |
| - Hong Kong | 253 | 509 | 274 | 209 | 343 |
| - Others | 115 | 294 | 422 | 366 | 1,947 |
| **Woven fabric HS 52.10 (000 m2)** | **1,481** | **293** | **123** | **25** | **3,043** |
| - Pakistan | 1,292 | 134 | - | - | 507 |
| - Taiwan | - | - | - | - | 2,349 |
| - Others | 189 | 159 | 123 | 25 | 187 |
| **Woven fabric HS 52.11 (000 m2)** | **200** | **13** | **1** | **11** | **281** |
| **Woven fabric HS 52.12 (000 m2)** | **5,795** | **3,293** | **195** | **26** | **140** |
| - South Africa | 392 | 547 | 24 | 18 | 128 |
| - Pakistan | 3,417 | 2,151 | 98 | - | - |
| - Taiwan | 1,800 | - | 69 | - | - |
| - Others | 186 | 595 | 4 | 8 | 12 |

*Table 8, Import volume of Cotton and Textiles, 1997-2001, including major Countries of Origin*

*Source Malawi Government, Annual External Trade Report, 1997-2001*

Table 9 shows the major types of garment imports. In the last five years, underpants for both men and women have become the major import garment product. However, the table shows that all quantities are fairly low. To make an overall total of garment imports was not possible as many items were quantified in pairs and kilograms.

*Table 9 Major Types of Garment Imports in 000 units, 1997-2001*

| | **1997** | **1998** | **1999** | **2000** | **2001** |
|---|---|---|---|---|---|
| | | | | | |
| Underpants/briefs for men/boys of cotton | - | - | 12 | 18 | 28 |
| Underpants/briefs for men/boys of man-made fibers | - | - | - | 61 | 27 |
| Underpants/ briefs for men/boys of other textiles | 30 | 2 | 15 | 6 | 31 |
| Women/girls briefs of man-made fiber | - | - | 4 | 304 | 61 |
| T-shirts of cotton | 16 | 9 | 51 | 107 | 44 |
| T-shirts of other textiles | 22 | 11 | 62 | 68 | 95 |
| Shirt for men/boys of cotton | 12 | 18 | 16 | 18 | 19 |
| Shirts for men/boys of other textiles | 31 | 1 | 70 | 38 | 32 |
| Other garments of textiles | 18 | 25 | 104 | 21 | 66 |
| Trousers/short for men/ boys of cotton | 35 | 6 | 22 | 68 | 46 |
| Trousers/short for men/ boys of other textiles | 21 | 3 | 37 | 36 | 48 |
| Dresses for girls/ women of other textiles | 14 | 3 | 43 | 26 | 26 |
| Dresses of other textiles, knitted | 2 | - | 7 | 3 | 32 |
| Trousers/short for girls/women of other textiles | 16 | 2 | 4 | 7 | 11 |
| Women/girls coats of man-made fibre | - | - | - | - | 47 |
| Baby garment of cotton | 9 | - | - | 54 | 10 |
| Baby garment of other textiles | 10 | 1 | 5 | 75 | 32 |
| Garment clothing accessories | 14 | 2 | 2 | 185 | 18 |
| Shawls scarves etc of synthetic fibre | 140 | 94 | 272 | 32,170 kg | 94,929 kg |
| Shawls scarves etc of other textiles | 38 | 3 | 49 | 45 | 77 |

*Source Malawi Government, Annual External Trade Report, 1997-2001*

### 3.2 Exports

The Annual External Trade Report of the Malawi Government shows that with respect to cotton lint, Malawi only exports cotton lint that is “not carded or combed”. South Africa has become the major country of destination for this product. Please note that the figure of 1999, export of 599,518 MT of cotton lint, cannot be right as the total production is only 6,000 MT. As expected, the export of fabrics has decreased fast.

Table 10 shows that the export of garments declined to 8,853,000 units in 2000 but recovered some ground in 2001, mainly as a result of increased exports to the USA. From 1997 until 2001, South Africa has by far been the major export destination of garments. The table reflects clearly the low point in the garment industry after the effective collapse of the South Africa bilateral in 2000 and the slow recovery in 2001.

*Table 10 Export volume of cotton and textiles, 1997-2001, including major countries of destination*
*Source Malawi Government, Annual External Trade Report, 1997-2001*

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| **Cotton lint HS 52.01 (MT)** | **9,029** | **4,703** | **599,518** | **8,523** | **5,443** |
| - South Africa | 5,350 | 1,212 | 20 | 2,929 | 4,861 |
| - UK | - | 2,464 | 599,498 | 4,426 | 562 |
| - Zimbabwe | 2,055 | 987 | - | - | - |
| - Tanzania | 53 | - | - | - | - |
| - Zambia | 1,571 | - | - | - | - |
| - Others | - | 40 | - | 1,168 | 20 |
| **Cotton lint HS 52.03 (MT)** | **0** | **0** | **0** | **0** | **0** |
| **Cotton yarn HS 52.05 (MT)** | **55** | **11** | **0** | **N.A.** | **N.A.** |
| - Botswana | 55 | - | - | - | - |
| - South Africa | - | 11 | - | - | - |
| **Woven fabric HS 52.09 (000 m2)** | **1,480** | **1,041** | **474** | **434** | **570** |
| - South Africa | 595 | 787 | 347 | 424 | 520 |
| - UK | 885 | 254 | 127 | - | - |
| - Others | - | - | - | 10 | 50 |
| **Woven fabric HS 52.10 (000 m2)** | **15** | **10** | **21** | **1** | **0** |
| - South Africa | 15 | 10 | 21 | 1 | - |
| **Woven fabric HS 52.11 (000 m2)** | **37** | **27** | **0** | **23** | **7** |
| - South Africa | 37 | 27 | - | - | - |
| - Mozambique | | | | 23 | 7 |
| **Woven fabric HS 52.12 (000 m2)** | **0** | **0** | **0** | **0** | **0** |
| **Garment HS 61 (000 units)** | **11,493** | **13,270** | **10,295** | **4,839** | **4,086** |
| - South Africa | 11,284 | 11,869 | 10,139 | 4,105 | 3,902 |
| - Zambia | 58 | - | 64 | - | 1 |
| - Zimbabwe | 116 | 85 | 89 | 39 | 1 |
| - Others | 35 | - | 3 | 695 | 182 |
| **Garment HS 62 (000 units)** | **6,945** | **5,439** | **5,820** | **4,014** | **9,692** |
| - South Africa | 6,711 | 5,386 | 5,358 | 2,378 | 5,816 |
| - Mozambique | 2 | 1 | 4 | 6 | 5 |
| - Zimbabwe | 34 | 22 | 4 | 84 | - |
| - Zambia | - | - | 19 | - | - |
| - USA | 198 | 26 | 435 | 1,268 | 3,862 |
| - Others | - | 4 | - | 278 | 9 |

T-shirts, shirts and singlets for men of other textiles are the major garments sold for export, according to Table 11. The export of trousers and breeches for men is increasing.

*Table 11 Major types of garment exports in 000 units, 1997-2001*

| | **1997** | **1998** | **1999** | **2000** | **2001** |
|---|---|---|---|---|---|
| | | | | | |
| Mens/boys shirts of other textiles | 956 | 1,314 | 1,472 | 466 | 433 |
| T-shirt/singlets of other textiles for men | 839 | 1,856 | 1,849 | 831 | 1,431 |
| T-shirt/singlets of cotton | 592 | 499 | 758 | 1,475 | 585 |
| Night shirt/pyjama for men/boys of cotton | 3,722 | 1,982 | 1360 | 130 | - |
| Brief/panties knitted for girls of cotton | 4,580 | 4,080 | 1,803 | - | - |
| Track-suits of other textiles | 77 | 250 | 355 | 531 | 767 |
| Others | 727 | 3,289 | 2,698 | 1,406 | 870 |
| **Total HS 61** | **11,493** | **13,270** | **10,295** | **4,839** | **4,086** |
| | | | | | |
| Trousers/breeches for men/boys of cotton | 524 | 513 | 603 | 307 | 679 |
| Trousers/breeches for men/boys of synthetic fibres | 5 | 2 | 111 | 23 | 1,733 |
| Trousers/breeches for men/boys of other textiles | 761 | 888 | 492 | 305 | 1,832 |
| Shirt for men/boys of other textiles | 3,339 | 2,143 | 3,105 | 2,276 | 3,770 |
| Others | 2,316 | 1,893 | 1,509 | 1,103 | 1,678 |
| **Total HS 62** | **6,945** | **5,439** | **5,820** | **4,014** | **9,692** |
| **Total HS 61 and 62** | **18,438** | **18,709** | **16,115** | **8,853** | **13,778** |

*Source Malawi Government, Annual External Trade Report, 1997-2001*

Comparing the import and the export data of cotton and textiles, it is very obvious that except for fabrics, Malawi is an export-oriented cotton and garment producer. The import quantities of cotton lint and garments are fairly low and incidental. The exports of those products have been recuperating slowly the last few years, but according to the respondents, have currently been stabilized.

According to the GMTA, a total of 26.2 million pieces by the garment sector were produced for exports in 2002 indicating a further significant recovery of exports. Furthermore, the association gives the following information with respect to export of textiles.

*Table 12 Export of Twine, Yarns and Textiles 1997- 2001 by volume and weight*

| | 1997/1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|
| Non regional Fabric Exports (000 metres) | 2,432 | 922 | 109 | 5 |
| Regional Fabric Export (000 metres) | 2,230 | 1,204 | 837 | 302 |
| Total Fabric Exports (000 metres) | 4,662 | 2,126 | 946 | 307 |
| Twines & Yarns (1000 kgs) | 368 | 198 | 107 | 43 |

*Source Garments and Textile Manufacturers Association of Malawi - GTMA*

This indicates the effective collapse of the domestic textile industry by 2002.

### 3.3 Trade Agreements

#### 3.3.1 MMTZ/SACU Agreement

In July 2000, the South African Customs Union (SACU) offered a quota of 8,565,000 garments to Malawi under the special MMTZ/SACU Agreement, for export to SACU. The quota system will revert to the double transformation requirement in December 2005, a condition that the MMTZ countries will not be able to meet without buying nearly all the cloth from SACU. This provides a potential threat on the horizon for the garment industry, but an opportunity for textiles. The new agreement of quota obviated the problem of value-added percentages (except for printed greige fabric) and the new accord is generous to the textile industry but imposes a small fixed quota that will severely restrain the growth of Malawi's clothing industry. This is the wrong way round for Malawi, which currently has no functioning textile industry with DWS in receivership. Therefore, there is a critical need to renegotiate the level of the quotas. All garment companies except Knitwear Industries are exporting under this agreement. The capacity of these existing garment manufactures in Malawi to manufacture for the South African market is far in excess of the available quotas. This means that there is no available quota to attract any other investment for the South African Market and that the existing firms are operating below their installed capacity.

Though partial, SACU's concessions for imports of garments do stimulate production in the MMTZ countries. However, being temporary, those concessions provide a risky basis for building an industry. The eventual re-imposition of the double transformation rule is a threat to the sub-sector's existence if implemented before these countries' garment industries become efficient enough to sell much of their output in the American and European markets and before they have a sufficiently robust local textile industry able to supply much of the fabric. The best option would be if SACU could be persuaded to reduce the investors' risk by guaranteeing that concessions will continue until the main SADC protocol abolishes all tariffs on yarn, fabric and clothing within the region.

By offering South Africa a large export market, AGOA may also change the balance in the negotiations with SACU. To benefit fully from AGOA and grow quickly, garment producers in SACU must import yarn and fabric from within the region, products that due to labor and transport cost differentials are often cheaper to produce at source, close to the cotton than within SACU. Moreover, if AGOA permits the South African textile and garment industries to reverse their downward trend, the South African Labor unions' resistance against imports from within SADC may diminish. This should motivate South African exporter targeting Europe and America to advocate for liberalized regional trade for textile and garment products.

### 3.3.2 AGOA

The purpose of this Act is to promote trade and investment between the United States and the Sub-Saharan African (SSA) countries, targeted mainly at garment manufacturers in those countries. AGOA permits export of clothing manufactured in qualifying SSA countries to be imported into the USA free of quota limitations and free of all the normal import duties. The effective timescale of the Act is from October 1st 2000 until September 30th 2008. Malawi qualified on 17th August 2001.

So far, according to the garment companies, there has been no additional growth that is directly attributed to the AGOA. Their exports have simply been diverted from SADC to AGOA. All textile and garment companies are accredited to export under AGOA but currently only three companies actually export: HAPS Investment, Chirimba Garment and Crown Fashion.

*Table 13 Value of Exports from Malawi Under AGOA in US $s:*

| | **Sept-Dec 2001** | **Jan- Dec 2002** | **Jan- Feb 2003** |
|---|---|---|---|
| Total | 8,388,496 | 14,169,663 | 4,599,577 |

*Source Customs, MRA*

The total value of the goods exported to the USA under AGOA up to February 2003 is US $ 27.2 million.

One of the potential threats of the AGOA agreement for Malawi is the "snapback clause" whereby the President can suspend any category of goods and without notice or warning if American jobs seemed to be threatened. The USA market has recently suffered a strong drop in retail sales, which has put some strain on US based clothing producers. Should this situation worsen, the snapback clause could be used to effectively export unemployment to Malawi. This makes Malawi's garment industry very vulnerable.

Further to this, there will be a shortage of textiles in the AGOA approved countries. South Africa cannot produce sufficient textiles to supply its own industry let alone the rest of East and Southern Africa and there are few new textiles manufacturers arriving in the region to take up the slack. Because AGOA only allows Malawi to use fabric from non-AGOA approved countries up till December 2004, then there is potential major problem on the horizon that needs resolving. This will probably require some effective negotiation and the revitalization of the textile industry.

#### 3.3.3 COMESA free trade area

As a member of COMESA, Malawi has duty-free relations with eight African nations. Since the COMESA free trade area and the region covered by SADC Trade Protocol overlap, Malawi may ship goods between itself and Zambia, Zimbabwe and Mauritius under either agreement. Outside of SACU, the largest volume of trade in textiles and garment has been with those three SADC countries, which are also member of the COMESA. Under COMESA, the tariffs are zero and the rules of origin are less restrictive than SADC's to make it a more attractive agreement.

#### 3.3.4 ACP/EU Cotonou

Under ACP/EU Cotonou, Malawi also gets duty and quota-free access for exports of yarn, fabric and clothing to the European Union market.

#### 3.3.5 USA Multi Fibre Agreement

The Multi Fibre Agreement (MFA) will fall away in December 2005. This will allow the East Asia, Pakistan and India free access to the USA market at Most Favored Nation rates. Thus Malawi would only have a 25 to 30% advantage with which to compete with the rest of the world, which is probably not sufficient given the costs of production and transport. The removal of the MFA in 2005 is a huge threat to the Malawian textile and garment sector.

### 3.4 Import and export licensing

None of the products in the cotton, textiles and garment sector are subject to import licensing.

However, to export under the AGOA and MMTZ/SACU agreement, a license is required through the Malawi Revenue Authority (MRA). MRA informs the Ministry of Commerce and Industry (MCI), which chairs the AGOA Taskforce. All members of the Taskforce come for inspection at the premises of the applicant and check the process of manufacturing, the machinery, the conditions of the premises and the labor force. These must be in good conditions to ensure compliance with US manufacturing standards. Specific areas needing attention include working conditions, ventilation, overcrowding, fire exits and evacuation plans and general housekeeping. Once registered, the company has to inform the MRA whenever the goods are loaded. A custom inspector will check the origin. After this, the invoice for the consignment must be submitted to Customs Dept. of MRA to stamp with the AGOA visa. According to the MRA, there are no fees involved for registering or for stamping.

The procedure for registration for the MMTZ/SACU agreement also goes through MRA. After application, the officers of custom go to inspect the premises and if satisfied with their findings, they will issue the official registration.

### 3.5 Documentation

According to the regulations, customs officials require the following documents for exporting goods out of Malawi:

- Exchange Control – CD 1 Form – is an exchange control document, which must be completed for all shipments that exceed MK 2,000. Copies are sent to the MCI and the Reserve Bank of Malawi (RBM). RBM will check with the exporter at the end of the stated period to ascertain if such payment has actually been received.
- Declaration Form – All exports must be cleared through Customs by submission of a Bill of Entry, Form 12.
- Commercial Invoice – The commercial invoice is completed to enable the importer to clear his goods in his country. It contains the name of the exporter, weight, value and description of goods.
- Certificate of Origin – establishes in the importing country the origin of the goods to ensure whether they are entitled to preferential duties or not. The Certificate of Origin is issued by MCI at a cost of MK 1,200.
- Certificate of Health for Cotton Lint and Cotton Seed. The phyto-sanitary certificate assures that the materials being exported are free from diseases and pests.
- Bill of Lading – Only required when goods are shipped by sea
- DA 59 Certificate – Export to the Republic of South Africa must be accompanied by DA 59 Certificate, in addition to a certificate of origin. These can be obtained at a fee from the Malawi Confederation of Chambers of Commerce and Industry (MCCCI).
- GSP Form A – This document is issued for export of goods to developed countries that are offering preferential treatment to developing countries under the Generalized System of Preferences. It is used in Malawi for export to industrialized countries outside the EU and obtainable from the MCCCI.

Respondents mentioned a lot of problems and delays with respect to the clearance of products by Customs (MRA).

### 3.6 Tariffs

*Table 14 Import Tariffs*

| | Preferential* | Non-Pref. | COMESA** | SADC*** | VAT | Excise |
|---|---|---|---|---|---|---|
| | | | | | | |
| Cotton Lint | 10 | 10 | 0 | 25 | 20 | - |
| Cotton Seed | 0 | 5 | 0 | 0 | Exempt | - |
| Yarn | 5 | 10 | 0 | 0 | 20 | - |
| Cloth | 25 | 30 | 5/6 | 25 | 20 | 20 |
| Garments | 25 | 30 | 5 | 25 | 20 | 10 |
| Second-hand clothes | 25 | 30 | 14 | 25 | 20 | 10 |

*Source Malawi Revenue Authority, Customs Department*
** Includes WTO-, EU- and Common Wealth members*
*** Only 9 members of COMESA enjoy a free trade area. Rates mentioned in the above table are applicable for trade between other members, who do not enjoy this free trade area.*
**** On some goods, rates have not yet been agreed*
*Note Importers can choose the most favourable rate whenever a country is party to two trade agreements.*

All the exporting garment companies are registered under the Export Processing Zone (EPZ) status. This entitles them to duty and excise free imports and concessions on corporation tax. Although this sounds favorable, the rules on EPZs in Malawi are somewhat restrictive on what can be included duty free.

Another problem has risen since November 2002 when surtax was implemented in Malawi on most items. Removal of the surtax exemption for EPZ companies means that all surtaxable supplies from Malawian suppliers are now more expensive. Ironically, the EPZ companies can import the same goods without duty or surtax, putting many Malawian suppliers at a competitive disadvantage and increasing the costs for the EPZ companies as not all the domestic supplies can be replaced. This effectively makes Malawi’s exports less competitive and it’s EPZ less attractive.

### 3.7 Standards

The Malawi Bureau of Standards (MBS) tried to introduce standards and quality measures in the early 1990’s. However, so far the MBS only comes in on the request of the exporter or when it has detected something wrong. MBS use international standards, or standards given by the importer or exporter. MBS might be involved more in the near future, as the industry tries to improve the quality process and competitiveness. Both the US and EU markets require strict observance of quality and standard regulation, which MBS may be able to help certify.

### 3.8 Phyto-sanitary measures and Certificate of Origin

For exports of cotton lint and cotton seed, the Ginneries need to obtain a Phyto-sanitary Certificate and a Certificate of Origin. The procedure for acquiring these certificates is not complicated. However, Ginners complain about the costly and time-consuming activity with respect to obtaining the documents, especially the phyto-sanitary certificate. Some countries, for example South Africa, require a phyto-sanitary certificate for every truck, instead of every contract. This results in additional cost for the exporter and considerable hassle. At customs, the Ginners find that some officials have a non-supportive attitude, which results in delayed departure of the trucks.

### 3.9 Constraints faced in export/import of cotton lint and garment

Policies and regulations:

1. Weak lobby within government to negotiate for favorable quota and terms in the various trade agreements.

2. Delays in clearing imports by the Malawi Revenue Authority (MRA) causing excess inventories, production inefficiencies and shipment delays leading to higher costs and loss of orders that cannot be fulfilled.

3. Overly restrictive rules on Export Processing Zones (EPZs). If individual firms were found to be exploiting the rules, they could loose the concession or even their EPZ status. EPZ rules are also overly restrictive in allowing only purchases of items directly relating to production, instead of all items necessary for the operation of the EPZ business. For example office equipment and furniture are not included.

Marketing:

4. Cost of Bank financing and charges in Malawi. Letters of Credit cost 0.5% of invoice value in Malawi and only 0.25% in South Africa. Many exporters are simply contracting services internationally rather than use Malawi's banks, which cannot offer the right service at the right price for relatively basic exporter's needs. Moreover, the real interest rats are very high (over 35%+), which means that there is no investment capital available locally and the cost of short-term working capital is prohibitive

5. Unavailability of pre-shipment finance even when supported by irrevocable Letters of Credit banks will not accept them resulting in lost orders

6. Costly and inefficient communication services which affect exporters disproportionately through extra cost and wasted time

7. Theft In Transit – containers are being opened and goods partially stolen in transit. This has huge impacts on the exports as shortages means cancellation of entire orders and canceling of contracts especially in the USA. The problem appears to be at the Malawi end of the shipment process and is well organized.

8. High marketing costs – Companies of total Malawian origin cannot invest in marketing as the volumes produced are not high enough and costs of investing are too high as a result of high interest rates.

Institutional limitations:

9. Absence of pro-active industrial development banks to vigorously assist the industry to grow has limited the availability of credit to the industry

10. MRA Capacity - MRA lacks the staff and equipment to enforce adequately the various rules of origin. This enforcement sometimes requires joint Malawi-South African or Malawi-American customs teams to verify factories' production and documentation, which often takes a long time. MRA also needs to give better service to EPZ manufacturers to clear goods for export within agreed times.

11. Garment and Textile Manufacturers Association needs to be strengthened as it is heavenly reliant on one very active individual. Capacity needs to be built with more robust consultation processes.

Other:

12. Underdevelopment of the textile industry that limits the range and quality of locally produced fabrics available for garment producers and will constrain Malawi's ability to meet local content rules in the near future.

Although all above problems are crucial, stakeholders in the sector are especially concerned about the weak lobby of Malawi to negotiate favorable terms in the various trade agreements and the upcoming problem of how to fulfill the demand of locally produced fabrics necessary for the various trade agreements. The delays in customs as a result of bureaucracy are a continuing struggle and result in missing delivery deadlines.

## 4.0 Opportunities for enhancement of cotton and textile trade

Once the constraints as mentioned in paragraph 2.6.1 have been (partly) addressed and production of seed cotton within Malawi will increase, the ginners will be able to increase their exports. As shown in Table 6, the capacity of the Ginners is by far not fully exploited and they can process approximately 80,000 MT more. No additional investment is needed to use this capacity. As a result of the current growth of the regional spinning industry, especially in South Africa, demand for Malawian cotton is set to continue growing, which will provide the industry with great opportunities and security for the years ahead. This increased demand for cotton lint is driven by the opportunities presented by the AGOA initiative via supplying South Africa's textile and garment industry which is seizing the opportunity. However, Ginners need to ensure that the quality of the lint produced is compatible to avoid decline in demand as happened a few years ago.

The revitalization of DWS or any investment of another spinner in Malawi will have an extra effect of boosting local consumption of cotton lint, estimated at potentially 6-10,000 tones. The cotton sector as a whole, look forward to this positive development, but in the meantime they can be satisfied that they are not dependant upon this progress in order to develop its potential.

On the contrary, the future for garments depends partly on the development of a vibrant textile industry. This will allow the development of an integrated chain, reducing the cost of importation and transportation considerably. Without this re-integration between the textile and garment sub-sectors, the remains of the garment industry in Malawi is threatened for both cost and market access reasons. There is no requirement for an integrated spinner and weaver as each can be a separate operation, but some operating textile industry is a strategic necessity for Malawi if it is retain its garment industry. Current trade agreements (such as AGOA) only allow Malawi to use fabric from non-AGOA countries until December 2004. After this date, minimum local content rules apply. The underdevelopment of the textile industry will constrain Malawi's ability to meet these rules in the near future.

Apart from this threatening outlook, the garment industry is waiting for positive developments in the investment climate of Malawi. During the last five years, no significant new investments have been made by local or international companies in Malawi due to unfavourable conditions such as high interest rates, high cost of operations, poor market access/trade agreements and custom delays. Banks are also not very willing to assist due to poor performances in this sector in the last few years. As long as these problems will not be addressed, it is highly unlikely that any garment company will invest in Malawi, even though having a very huge AGOA market. Malawi is far behind countries like Lesotho and Swaziland who had less capacity than Malawi in the early 90s. An investment friendly situation and a stable economy in these countries have attracted and still are attracting large investment from the Far East. Relocation from the Far East to these countries is on the increase every year, but not to Malawi due to the various constraints as described in paragraph 3.8.

## 5.0 Existing initiatives in cotton and textiles sector

**National Action Group/Government of Malawi – Growth Strategy for Malawi**

Cotton and Textiles/Garments have both been included in the Growth Strategy for Malawi as focal sub-sectors. The constraints highlighted above have been partly generated by the stakeholders and draw from that document as representing the agenda for action. Outline strategies for action have been developed and more detailed action plans are being drawn up by the stakeholders in each sub-sector to address these constraints and issues.

Given the focus being put on the Growth Strategy process by GoM, Donors and Private Sector, any activity of RATES needs to be fully integrated with this process to ensure its effectiveness. The Growth Strategy is now encompassing the World Bank's Integrated Framework to promote domestic and international Trade.

**Business Linkages Challenge Fund (BLCF)**

The BLCF is a cost-sharing grant scheme that gives grants to enterprises to develop commercially sustainable business linkages that bring benefits to the poor. Funding comes from the UK Government's Department for International Development (DFID) and the project is managed by Deloitte and Touche.

A consortium of 7 organizations in Malawi, headed by Great Lakes Cotton Company, has applied for a grant of approximately £300,000 UK Pounds for assistance at the introduction of pre-treated seed in Malawi. The other consortium partners include Clark Cotton Malawi, Chemical and Marketing, Syngenta, NASFAM and the Ministry of Agriculture and Irrigation.

The project objective is to upgrade the production volume and quality of the Malawian cotton sector by installment of a seed treatment plant and implementation of a professional system of information dissemination. Through the rapid introduction of pre-treated seeds to smallholders the yield, volumes and quality of produce will be improved, thereby increasing the profitability of growing cotton for the smallholders. As a result of this project, the export of cotton lint is expected to increase considerably as well.

Currently, the Fund is reviewing the Full Application Form (second round) after approval of the Concept Note (first round). In August 2003, the final outcome will be expected.

**National Cotton Sector Strategy and Action Plan**

The Ministry of Agriculture and Irrigation has developed a National Cotton Strategy and Action Plan in order to outline the policies, strategies and actions to be undertaken by stakeholders in the cotton sector between 2003 and 2008 in an effort to create "a national strategy with cotton being one of the key commodities in the agricultural sector".

This plan is geared at addressing a number of challenges that continue to affect the performance of the cotton industry.  During the implementation of its action plan MoAI seeks to achieve various objectives.  An increase in export of cotton products is one of those.

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**Annex 1: Addresses of the Major Players**

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Organization: BASFA
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Organization: Great Lakes Cotton Company
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Organization: Clark Cotton Malawi
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Organization: Garment and Textiles Association Malawi
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Organization: David Whitehead and Sons
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Organization: Knitwear Industries
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|---|---|
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|---|---|
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|---|---|
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|---|---|
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