Trade, Investment and Regional Economic Integration:

Southern African Countries

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I. TANZANIA

A. Country Position on Regional Integration

Although Tanzania has huge trade deficit with SADC countries, particulalry with RSA (Republic of South Africa), government officials I met consider favorably about regional economic integration. Specifically, they mentioned that Tanzania has not exploited the opportunity for increased trade offered by COMESA and that it is now stands to gain. In addition, SADC provides an opportunity for more equitable negotiation for its member countires vis-a-vis RSA. RSA, with its strong economic and political power, forces its trading partners of SADC members come to its own (RSA's) terms in bilateral negotiations, sometimes it is intimidating. RSA's trade policy is protectionist and has to come out of cacoon. However, it will take time for RSA to adjust to a new trade regime. Tanzania stressed the need to harmonize investment environment (i.e., minimize the differences in investment regulations) and privatization, development of sustainable industrial development strategy, reform in financial sector, reduction in market distortion, improved governance, improved legal and property rights, and infrastructure. the development strategy should be made by partnership approach and consultation with private sector should be institutionalized.

Tanzania is the coordinating country for Industry and Trade within SADC. As the coordinator, it is managing three projects: i) new strategy for industry and protocol; ii) Development of trade strategy and negotiation of trade protocol; and iii) support services. The last SADC industrial policy, developed in 1989 is out of date and the new one is planned to be prepared by the end 1997. The SADC coordinator plans to prepare a draft of protocol for industry after the SADC industrial policy and strategy paper is completed. However, the terms of reference of the paper is still in preliminary draft and expected to be finalized by mid-June 1996. The SADC coordiantor does not seem to have clear idea of when the industrial strategy will be adopted and the protocol will be develped and negotiated. The coordinator did not show capability to do the right job, nor a strong commitment or seriousness. Technical assistance by donors may expedite the progess but it does not seem to be anxious to ge assistance. "Industrial Development Policy" for Tanzania was prepared in April 1996. The paper simply provides a list of items desired but lacks strategies and actions required to achieve the wishes or strategies.

Negotiation for trade protocol is still going on and is expected to be signed by August 1996. The coordinator is working on trade directory but has not made muchprogress. In the area of support service, the coordinator serves as SADC trade and industry information center and focuses its effort on small scale industries. In addition, it coordinates a study on "Rules of Origin of Commodities" funded by European donors.

The SADC coordinator thinks SADC has a better chance to make smooth progress and COMESA because the latter community includes countries with serious internal civil/political problems: Burundi, Rwanda, Somalia and Sudan. With these countries, COMESA will find it very difficult to do serious business and make progress. He said that SADC provides more hope than COMESAand that it's better to expand SADC by including Kenya and Uganda and eliminate COMESA, rather than pursue both tracks. According to him, Malawi will hold next COMESA meeting but it (Malawi) does not have experience in doing such a job and therefore may not do a good job. (As will be written in Malawi section, we learned that the Malawian offfice in the Ministry of Commerce and Industry) coordinating COMESA is highly qualified and well versed. This observation led us to a conclusions that the SADC coordinator is not credible, and lacks capability and commitment to his job.

B. Macroeconomic and Sectoral Policy Environment

The Governemnt of Tanzania has initiated major reform programs since mid-1980s to liberalize virtually all apects of the economy. The principal areas of reforms include: liberalization of agricultural markets; abolition of restrictions on trade, exchange rates, industrial policies, private investments and interest rates; and parastatal reforms. Though the pervasive restrictive regime has been dismantled, progress on implementing structural reforms has been slow and macroeconomic instability and inflationary pressure remain serious due to the over-extended public expenditure program and finacial system is extremely weak.

<u>Price and Market Reforms:</u>

A number of price and market reforms has been made in recent years including liberalization of producer prices in agriculture, elimination of marketing and transportation of food grains, liberalization of marketing of traditional and nontraditional exports, and phse out of input subsidies. However, discriminatory regulations and practices which give advantages to the public sector and to the state-sponsored cooperatives still remain.

<u>Exchange Reform:</u>

The huge exchange rate distortion in Tanzania has been almost eliminated by mid-1992 and official exchange rate controls were abolished later. An auction system of exchange was introduced in 1993 and in June 1994, the auction sytem was replaced by an interbank market for foreign exchange, a further rationalization of the exchange system. The official rate is now based on the interbank rate.

<u>Trade and Industrial Policy Reforms:</u>

Restrictive trade and industrial policies has been liberalized. Quatitative import restrictions were replaced with a system of open general license. The tariff system was rationalized: 20 tariff rates (before 1988) has been reduced to 4 rates by 1990 and the maximum tariff rates of 200% (before 1988) has been reduced to 50% by July 1994. The sales tax structure of 26 rates (before 1988) with a maximum rate of 300% was reduced to 7 rates, and then to only two advalorem rates of 25% and 30% in 1995.

Export Incentives:

To remove impediments to exports, the following measures have been undertaken:

- -- remove surrender requirements on 100% of foreign exchange receipts from both traditional and non-traditional exports;
- -- elimination of licensing and registration requirements for exports;
- -- reduction of the number of items subject to permit;
- -- elimination of restrictions on the current account regarding internationalpayments and transfers; and
- -- permit for private sector to participate in traditional exports.

Financial Sector Reforms:

Prior to 1993, the banking system of Tanzania consisted entirely of insolvent and inefficient gorenment owned banks. The largest, the National Bank of Commerce (NBC), accounted for roughly 90% of commercial bank deposits and the Cooperative and Rural Development Bank (CRDB) accounted for roughly 5%. The remainder of the commercial banking sector consisted of the Tanzania Housing Bank and the People's Bank of Zanzibar (PBZ). In an effort to strengthen the banking sector, the government enacted the Banking and Financial Institutions Act for private banking and liberalized interest rates and allowed banks to set lending rates below an announced maximum.

these effort, however, were only partially successful. Two private foreign owned banks began operations in 1993 and another five banks have been licensed. However, new banks have targeted relatively few niche customers and have ben reluctant to expand beyond Dar es Salaam. Competition in the secotr, therefore, is still very limited.

Monetary Policy and Inflation:

The inflation rate is high and above the program target, particularly in 1994: 23.2% in 1993, 36.0% in 1994 and 28.0% in 1995. The high inflation rate is mainly due to high government budget deficit and high money growth. the inflation is also suceptible to the abolition of price controls, and the drought in 1994.

C. International Trade

As shown in table 1, Tanzana's total exports has increased by US$ 358.7 million in 1991 to US$ 682.9 million, by more than 90%. Both traditional and non-traditional exports has grown by about same rate: 93.8% and 86.2%, respectively. However, non-traditional exports increased by 63.5% between 1993-1995, compared to traditional exports by 49.7% during the same period. This is an indication that Tanzania's exports are diversified slowly in response to policy liberalization in recent years.

Table 1: Tanzania Exports by Commodity
(in US$ millions)

Commodity	1991	1992	1993	1994	1995
Traditional					
Coffee	77.3	59.5	96.1	115.4	142.6
Cotton	63.3	97.6	78.4	105.1	120.2
Tea	21.7	22.4	38.0	39.5	23.4
Tobacco	16.7	27.2	17.1	20.6	27.1
Raw Cashewnuts	16.7	23.5	23.3	51.2	64.0
Sisal	2.2	1.3	3.3	5.1	6.3
Sub Tot	**197.9**	**231.5**	**256.2**	**336.8**	**383.6**
Non-traditional					
Petro Prod.	7.3	10.6	9.1	5.5	11.0
Minerals	41.6	40.8	69.0	30.0	44.9
Manufact gds	70.3	64.2	52.0	77.0	109.3
Other exports	41.6	49.9	53.0	70.0	134.3
Sub Tot	**160.8**	**165.6**	**183.1**	**182.5**	**299.4**
Total Exprt	**358.7**	**397.1**	**439.3**	**519.4**	**682.9**

Source: Economic Bulletin, Bank of Tanzania, December 1995, Vol XXIV, No. 4.

As shown in table 2, the latest export figures by country of destination is 1990. Tanzania's exports are concentrated in European countries and exports to African countires are limited. Kenya is the largest export market for Tanzania's exports, with roughly TZS 2.4 billion in 1990. Other African markets are rletively small.

Table 2: Tanzania's Exports by Country of Destination (TZS million)

Countries	1988	1989	1990
United Kingdom	3,432	6,267	8,578
Germany	4,798	7,422	10,044
Netherlands	1,974	2,993	4,353
United States	869	1,638	5,495
Japan	1,595	2,440	3,140
Sub Total	**9,448**	**15,119**	**31,610**
Kenya	1,102	2,088	2,368
Zambia	393	244	388
Burundi	176	408	238
Somalia	648	538	968
Mozambique	9	209	170
Uganda	341	560	780
Sub Total	**2,669**	**4,047**	**4,912**
Others	19,836	33,611	28,049
Total	**27,041**	**52,777**	**64,571**

Source: Economic Bulletin, Bank of Tanzania, December 1995, Vol XXIV, No. 4.

As the case of exports, Tanzania's import sources are highly concentrated on European countries. Imports from African countries are limited. Of the African exporters to Tanzania, Kenya is the largest source, with TZS 3.5 billion in 1990, followed by Zambia, with TZS 1.0 billion. Trade deficit with Kenya is TZS 1.1 billion in 1990.

Table 3: Tanzania's Imports by Country of Origin (TZS million)

Countries	1988	1989	1990
United Kingdom	1,468	23,912	34,104
Germany	11,791	14,651	20,059
Netherlands	NA	5,905	8,719
Italy	8,240	13,342	13,391
United States	1,198	2,141	3,112
Japan	8,546	14,244	15,426
Sub Total	**44,502**	**74,195**	**94,811**
Kenya	3,681	4,140	3,533
Zambia	945	1,197	1,010
Burundi	13	42	8
Somalia	1	15	99
Mozambique	56	79	73
Uganda	14	24	167
Sub Total	**4,710**	**5,497**	**4,890**
Others	38,771	67,013	99,559
Total Imports	**87,983**	**146,705**	**199,260**

Source: Economic Bulletin, Bank of Tanzania, December 1995, Vol XXIV, No. 4.

Table 5: Tanzania's Trade with COMESA Countries

(TZS million)

Countries		1988	1989	1990
Burundi	Exports	176	408	238
	Imports	22	42	8
	Trd Bal	154	366	230
Comoros	Exports	0	89	151
	Imports	0	0	0
	Trd Bal	0	89	151
Djibouti	Exports	0	5	23
	Imports	0	0	0
	Trd Bal	0	5	23
Ethiopia	Exports	5	1	57
	Imports	67	3	16
	Trd Bal	-62	-2	-41
Kenya	Exports	1,102	2,088	2,368
	Imports	3,853	4,140	3,533
	Trd Bal	-2,751	-2,052	-1,165
Rwanda	Exports	21	70	95
	Imports	3	15	8
	Trd Bal	18	55	87
Somalia	Exports	24	63	212
	Imports	1	15	99
	Trd Bal	23	48	113
Uganda	Exports	341	560	780
	Imports	24	24	167
	Trd Bal	317	536	613
Lesotho	Exports	0	0	0
	Imports	2	1	1
	Trd Bal	-2	-1	-1
Malawi	Exports	194	484	169
	Imports	129	23	125
	Trd Bal	65	461	44
Mauritius	Exports	51	97	88
	Imports	13	3	1
	Trd Bal	38	94	87
Swaziland	Exports	2	1	0
	Imports	120	229	496
	Trd Bal	-118	-228	-496
Zambia	Exports	393	244	388
	Imports	963	1,197	1,010
	Trd Bal	-570	-953	-622
Zimbabwe	Exports	151	210	670
	Imports	447	577	910
	Trd Bal	-296	-367	-240
Total	Exports	2,460	4,320	5,239
	Imports	5,644	6,269	6,378
	Trd Bal	-3,184	-1,949	-1,139

Source: Economic Bulletin, Bank of Tanzania, December 1995, Vol XXIV, No. 4.

Table 5 shows Tanzania's trade with some of the COMESA and SADC countries. Unfortunately, 1990 is the latest year trade data by country are available. Tanzania experienced large trade deficit with the fourteen countries combined together: TZS 1.9 billion in 1989 and TZS 1.1 billion in 1990. These figures are equivalent to 45.1% and 21.7% of total exports in 1989 and 1990, respectively. Though Tanzania has trade surplus with eight countries in 1990, the amount is relatively small. Of the countries included in the table, Kenya is the largest trading partner, followed by Zambia and Zimbabwe.

The following statements are from an interview with a Principal Trade Officer, Ministry of Trade and Industry. Since these statements were made off-head, some of them may not be correct. Specifically, they are not consistent with Table 5 which shows data upto 1990. Accordingly, these statement may be interpreted as a general impression.

-- Tanzanian trade with Zambia is reasonably well balanced. Kenya and Zimbabwe have relatively good industrial base and advanced technology and they export manufactured goods to Tanzania. Tanzanian Trade with Kenya is in favor of Kenya with 5:1 deficit ratio. Tanzania exports raw materials and livestock to Kenya and imports consumeable goods. Trade with RSA is highly skewed in favor of RSA.

-- With the border closure by Kenya and Uganda in 1977, there was large increase in unofficial trade but since late 1980s, official trade increased and unofficial trade reversed. Border trade is now at a minimum level. With the revival of East African Community in November 1995, a large increase in official trade is noticed. Roughly 50% of Tanzania's trade goes to Europe, particularly England, Germany, and Italy.

One of the official in the Bank of Tanzania mentioned that USAID import support condition requiring 60% of financing (40% may be imported from any free world countries) be used for imports from the U.S. is so strict that Government of Tanzania (GOT) cannot withdraw money from the import support program. The fund balance is now as high as $28 million. The GOT's inability to import from the U.S. is due to the lack of strong trade relationship between the two countries, which in trun reflects the following factors: difficulty of getting spare parts, non-tariff barriers (specification), U.S. electrical parts which are not conistent with those of Tanzania, non-metric system and high gas consumption of U.S. automobiles.

D. Trade Incentives and Constraints

In order to increase both domestic and foreign direct investment, the government introduced Invetment Code and establihed

Investment Promotion Center (IPC) which provides one-stop window for investors, duty drawback system and joined MIGA (Multilateral Investment Guarantee Association) and ICSD (International Center for Settlement on disputes). Under the one-stop window, the entire process from the business application to the final approval is handled by the Center. It takes about 60 days to complete the process, though it varies depending on the nature and size of the project.

Tariff rate was significantly reduced and it now ranges only 5%-35%, with the low rate applied to captal goods and equipment (5%) and the high rate applied to consumable goods (35%). The Government offers tax holidays for up to 5 years for new investments (only) by either foreigner or domestic investor. The tax holidays cover corporate income tax (45%) and withholding tax on dividends. Labor Union is not strong and the minimum wage of TSh 17,500 per month (roughly $30) is so low that it is not binding even in the rural areas. Employers can hire and fire workers without much constraints.

Though there has been much improvement in overall policy environment and business incentives, investment in Tanzania has not increased significantly, probably due to poor infrastructure, high interest rate (50%) and high inflation (25%), and the difficulty of getting credit. High rent and high costs for doing business in Tanzania is a discouragement for investment in this country. Land belongs to the State and negotiation of land lease with the State may take two years. There is a proposal for land reform but no one knows how long it will take to have it materialized. There is no export tax but corporate income tax and excise tax are considered to be high and people tend to cheat to escape paying the taxes.

One businessman mentioned that average capacity unilization of plants is only 20% and there is an urgent need for revitalization of industry. In textile industry, for example, there is strong competition from outside dumping, particularly from East Asia. Though there is tariff on imports to protect domestic producers from dumping, the importers avoid paying tariff by bribing customs officers. To reverse this situation, tariff rates need to be reduced and eliminate tax loopholes.

Investment code is good in book only, if it is good at all. Whatever written in the code is not implemented. The code is described in broad terms and lacks details, which provides room for descretionary administration and conflicting interpretation, which in trun allows room for corruption and bribery. Follwing is a list of examples:

-- While the Investment Code provides tax holidays for up to 5 years, determination on aplication is made by discreet administrative decison.

-- Corruption, particularly in mid/working level of government is a serious problem for investors. According to some businessmen, (illegal) commission for approving new investment may range from 10% to 30% of the total investment. Though high level policy makers try to reduce the corruption, the bureaucrats at mid/working level don't cooperate. Given pervasive corruption and difficulty of doing business in Tanzania, businessmen would like to have Export Processing Zones (EPZ) established quickly. In fact, opening an EPZ in Zanzibar is discussed but it has not been established yet because of the lack of commitment by the Government.

-- Investment Promotion Center (IPC) mentioned that it takes up to a maximum of 60 days for an investor get investment approval, since IPC coordiantes the approval process among different ministries. However, it took about six months for a Korean garment company, Goo Ryong, Inc., to get the approval. According to an IRIS staff who visited Dar es Salaam under EAGER project and casually talked to a small Asian businessman (probably a sole proprietor), it took 9 months for him to get approval. Some businessmen mentioned that it is not uncommon that government officials take business applications to home and if he is out of office (on leave or on TDY), the applications will not be processed until the official returns to office. There is lack of cooperation and consistency among different ministries and the one-stop window of IPC does not work. In fact, investors have to carry applications around various ministries. Revision of investment codes to incorporate the opinions of businessmen is being considered.

-- While the investment code allows easy hiring and firing of employees by business, employees have easy ways to avoid lay-off or firing. When an employee takes employment disputes to Office of Labor (which does not cost to the empolyee), the Labor Office takes side with employees and it is practically impossible to fire or lay-off an employee.

-- Customs service at Zanziba port of entry charges 5% of tariff only on consumerble goods, whereas they charge 40% at the port of Dar es Salaam. Accordingly, there is large smuggling into Dar es Salaam from Zanzibar port. This problems is caused by the lack of cooperation of the Zanzibar government.

-- One of the reasons why domestic textile producers cannot compete with imports is due to the high income tax and excise tax which together amount to 50% and domestic producers cannot compete with importers who avoid paying tariff by bribing customs officials.

-- Duty Drawback System does not work and many businessmen do not count on it. The money collected as import duty from exporters are not set aside and are put together in a general account with other import duties. A small amount of budget for duty drawback payments is allocated by the Ministry of Finance, but the amount is so small that it runs out quickly and most exporters don't get benefit from this system.

-- Lack of export financing is the most serious problem for exporters. With high interest costs, exporters find it difficult to be competitive in international market. Export Credit Guarantee Scheme by Bank of Tanzania does not work well, due to lack of manpower to screen beneficiary. National Bank of Commerce deals with the application for Export Credit by exporters but the Scheme itself is handled by the BOT and there is not much coordiantion between the two banks.

-- Presidential Export Award: Three exceptional export performers are selected each year by the Office of the President and recognized, but there is no financial award. It is similar to the Korean version of Presidential award for those who exported more than $100 million in 1960s.

-- Tanzania's incentives are directed toward large companies and there is not much incentives for small scale enterprises (SSE). The Chamber is lobbying for the SSEs. Though there is incentive schemes for large companies in paper, these schemes are not implemented because of non-functioning government bureaucracies.

<u>Success Story of Goo Ryong, Ltd.</u>

Goo Ryong is one of the Korean multinational medium size coprporation in textile industry. For this company, it took roughly 6 months to get business approval in Dar es Salaam. It started operation about 8 months ago. Currently, it employes about 1000 Tanzanians. About one third of them work 11 hours a day, six days a week. For over time work, they get overtime pays. Average salary is about $45 a month. Their products (Y shirts) are entirely exported to the U.S. The interviewee mentioned that the recovery period of their capital invetment is taking longer than in other countries, which suggests that investment environment in Tanzania is not favorable. The difficulty is that the rules and regulations are not implemented as they are written, and lacks transparency and consistency. If another foreign company tries to invest in Tanzania, they may have to go through similar difficulties. Credit for exporters are not available. Though they would like to use domestic products for their intermediate inputs (cloth), their quality is not good and, if quality is acceptable, their price is higher than imported product.

Is this a story of success or failure? This is one of the few low-skill labor-intensive investment by forieng companies.
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Notes on Data

The Board of External Trade prepared a preliminary draft table which shows exports by country for three years (91-93). It needs to be cross-checked for consistency (export from country **A** to country **B** should be equal to imports of **B** from **A**, after the adjusting for cif values) and will be ready by Mid-June 1996. As of now, they cannot release it to outsiders.

Tariff data is not available but it may be available in Malawi.

"DIRECTORY OF IMPORT REGIMES" BY UNCTAD, 1994, UNCTAD/DMS/2/REV.1 is available in both hard copy and CD RAM but it does not have data for 91-93 for most countries and is not really useful.

II. MALAWI

A. Country Position on Regional Trade

Malawi considers trade liberalization and regional economic integration is very important and takes pride of its being ahead of other countries in terms of liberalization progress. On the other hand, it is frustrated with the slow progress by other countries. The negotiation on trade protocol under SADC being slow, Malawi is interested in making bilateral agreements which can be achieved quickly. Malawi has free trade agreement with Zimbabwe and Botswana. With Zambia and Mozambique, Malawi proposed similar free trade agreement but these countries drag their feet and have not yet responded positively. In 1990 (before the new government), Malawi signed one-way trade agreement with RSA (Republic of South Africa), namely, there will be no tariff on Malawi's export to RSA, whereas Malawi's imports from RSA will have to pay tariff. This agreement have to be nulified under SADC agreement because any preference offered to a country has to be applied to all member countries. Since RSA wants gradual liberalization, other countries tend to follow suit. For example, at the begining of the SADC negotiation, most countries preferred 100% (immediate) liberalizattion, but now they prefer 70% liberalization.

In terms of SADC trade protocol, removal of non-tariff barriers and preshipment inspect are key concerns for Malawi which has already eliminated non-tariff barriers and are suffering from preshipment inspection by other countries (Tanzania and RSA).

Malawians consider Zambia and SACU are market econmies, but RSA is protectionist economy. Since RSA's economic cooperation is in words only, Malawians would like to see USAID play important roles in putting the SADC system in place quickly.

COMESA: Malawi consier tariff reduction under COMESA is also slow because of two fundamental problems in the negotiation. First, every country is supposed to reduce tariff by 70% from the level at the start of the negotiation. Since countries started negotiation at different tariff levels, their tariff levels will not be same, after every members reduced by 70%. It is an unfair game for countries with low tariff levels. Second, all members should have reduced by 80% by 1996, and by 100% by 2000. At that time, all members will be on equal foot. However, implementation is slower than agreed upon and uneven among countries. So far, only five countries out of twenty two achieved 70% reduction: Malawi, Mauritius, Zimbabwe, Burundi and Sudan. The COMESA agreements should now be in the third phase, but it is still in the first phase. The slow progress on the implementation is basically ascribable to two factors: loss of tariff revenue and protection of infant industries. With the lack of reciprocity, the multilateral negotiations are becoming bilaterized.

There are also problems in the area of non-tariff protection. For example, progress on implementation of liberalization of foreign exchange (FEX) and licensing varies among countries and, due to lack of budget, COMESA Secretariat cannot verify member's implementation. During an interview with COMESA coordinator, it was noted that Zimbabwe threatened, at the Zimbabwe's International Trade Fair, that it will increase its tariff rate to protect its industry and to correct unfair competition.

Most people I met in Malawi do not see economic jestification for having two separate institutions: SADC and COMESA. They perceive it as a political and historical issue. However, they think it is impossible to merge the two institutes. Their view is to have the two institutes focus on their special areas and try to complement each other through close coordination of their programs: COMESA on trade, SADC on investment and infrastructure. However, there is not much communication between the two coordination offices of SADC and COMESA within a country (Malawi, Tanzania), because these offices are located in different ministries. COMESA is coordinated by an office in by Ministry of Commerce and Industry and SADC by an office in the Ministry of Economic Planning and Development. To achieve maximum coordination, the two coordinating offices have to be in the same ministry. This institutional problem is same for Tanzania. Putting them in the same ministry, however, is politically not acceptable. Indeed, COMESA Secretariat proposed this idea but was not adopted by member countries.

They also noted that there should be more cooperations between the Secretariats of COMESA and SADC. They are planning a joint meeting in July or August, 1996. Though the agenda for the meeting is not clearly defined yet, two key issues will be discussed:

-- rationalization of two activities to avoid duplication, with COMESA focusing on tariff, SADC on industry and infrastructure; and

-- hwo to handle a situation when the tariff rate negotiated under SADC is different from that under COMESA.

Malawi is the coordinating country for Forestry, Fishery and Wild Life, handled by an office in the Ministry of Natural Resources. Food, Agriculture and Natural sector regional policy paper was prepared by Malawian consultant, Dr. Naomi Ngwira and was presented to member countries and is waiting comments form them. No copy is available now.

The SADC coordination office has two staff only and lacks manpower and technical capability. At the time of our visit with the office, the chief coordinating officer went to RSA to attend the Economic Summit Meeting between government sector and private sector people of SADC countries.

B. Macroeconomic and Sectoral Policy Environment

Trade liberalization is in the final stage of the second phase. There is no control on interest rate and exchange rate and the current account of foreign exchange is fully open. Accordingly, dividend paymnets, profits, interest payments, debt service and etc. are all free. Only capital market is controlled to prevent Malawians from investing in foreign countries. They cannot incurr debt from foreign capital markets without registration with the Reserve Bank of Malawi. (Of the SADC countries, Zambia only liberalized capital account as well as current account. In this sense, Zambia is ahead of Malawi.)

Foreign exchange can be purchased with documents within the indicative limits, but, with reasonable justification, they can purchase beyond the limits. Foreign exchange rate is determined by the supply and demand conditions of the exchange market. Though the exchange transactions are handled by six authorized banks, two banks (National Bank of Malawi and Commercial Bank of Malawi) play major roles. There are four major exporters and they, with monopoly power as a group, can control FEX market. Against this monopoly power, there are many small exporters who try to keep the large exporters from manipulating the market.

Exporters are allowed to retain 40% of their export earnings but parastatal exporters are not permitted to do that.

The Reserve Bank does not control interest rate and the discount rate of the central bank is based on the treasury bill rate which is determined in the auction market. As the case of exchange market, two large commercial banks (National Bank and Commercial Bank) play major roles in the determinataion of interest rates. For example, if Reserve Bank decreases discount rate, the two private banks exercise counter balancing power by increasing cash reserves.

The monetary and exchange rate policy of the central bank is fully market oriented, but because of the institutional weakness that the two private banks can exercise monopoly power, the financial market may not be not stable.

Malawi is ahead of other members of SADC and COMESA in terms of trade liberalization:

-- imports are fully liberailzed except for 19 items requiring licensing for security and health considerations;

-- exports are also free except for holding maize exports for food security consideration and seven otheir items.

-- the export tax on tobacco and tea is 8%.

Tariff ranges 10-40%: raw materials (10), intermediate goods (20), consumable goods (40), textiles (35).
Under SADC agreement, tariff is 20% for all goods except for zero percent on basic goods like maize and rice. For domestic textile products, there is 20% sales tax.

Financial System

The financial system of Malawi is small and not yet well developed, but operates with very few distortions. It consists of formal and informal market segments. The formal market comprises the central bank, two large private banks, the National Bank of Malawi and the Commercial Bank of Malawi, and four recently opened private banks. The informal credit market, which includes money lenders, traders, estate owners, friends and relatives, provides a significant share of the micro-, small- and medium-enterprise sector's capital. The informal sector is reported to provide two-thirds of the total value of loans.

Exchange control is the major constraint on the growth of stock market (only Zambia allows free movement of capital). Other factors include: lack of standardization of accounting system among countries, poor investment climate, low level of saving, tax system penalizing portfolio investment.

Investment and Development Bank (IDB) provides medium-term finance through equity participation and loans. It provides loans to all vialble projects (commercially attractive) regardless of size of the firm. This Bank, profit oriented, charges interest at commercial bank rate. There are not many applicants because of the lack of financially viable project, which is ascribable to the high interest rate (46-48%). Though the nominal interest rate is high, the real rate is negative, with inflation is running at more than 60% in late May 1996. Treasury bill rate is above 50%. Bank customers are predominantly medium-size firms. It does not offer a credit guarantee scheme. To provide credit to black Malawians, it (IDB) created a special fund, but it is not utilized widely because there are not many black Malawians who can come with required collateral for the loans.

C. Institutions and Incentives for Trade and Investment

In addition to the macroeconomic and sectoral reforms, the government established institutions to promote trade and investment and specific incentives to compensate for the unfavorablbe business environment.

Malawi Export Promotion Council (MEPC)

Established in 1971, MEPC carries out the following functions:

- collect information on products available for export and disseminate it in other countries;
- collect information on foreign markets and disseminate it to domestic producers;
- provide technical assistance to the exporting community in areas such as export procedure, financing, marketing and export packaging;
- organize trade fairs and exhibits, and etc.

In addition, it has been doing research on non-traditional exports such as mushroom, gem stone, and spices, and helped the start of cut flower business.

MEPC coordiante its activities with MIPA through joint meeting, trade fairs. They try to be complementary each other. MEPC provides market information to MIPA.

The council has staff of 40, including 10 professionals. Its operating expenditure has been funded by the government and the program budget has been supported by external donors, which has decreased their contribution by two-thirds: from Kw 9 million to Kw 6 million per year. As a result, export promotion activities are reduced. The operating budget has dcreased from Kw 6 million to Kw 3 million. There are no Malawian companies which could provide some money for the council's activities.

Malawi Investment Promotion Agency (MIPA):

MIPA was established by the Investment Promotion Act of 1991, started its operation in April 1993, to assist investors, both local and international, whether domestic or export market oriented, and investors, large and small.

MIPA takes active role in promoting both domestic and foreign investment now. During 1992-94, there was a major change in political enviornment: from one party to multi-party system. This process brought political instability and economic slump and set back of investment promotion. With the restoration of political stability and market oriented economic policies, the government is committed to bring down inflation and budget deficit. With improved policy environment, MIPA is now ready to go out for investment and massive public relations work. In a targeted approach, the Agency plans to focus on key business people, particularly on business involved in low-skill and labor intensive sectors.

The Malawi Chamber of Commerce and Industry

The Chamber's primary role is to defend and promote the interests of the business community of Malawi. Its membership is open to any businesses of all sizes in any sector of economic activity. To defend and promote the interest of the business community, the Chamber works closely with the government and its various institutions including the Export Promotion Council.

Export Incetives in Malawi include Export Processing Zones (EPZ), Manufacturing Under Bond (MUB), and Duty Drawback System.

Duty Drawback System: Fund for this system is about Kw 100 million per year. Though the fund is small, it is enough to cover all the requests for refund. This may be due to small amount of reported imports of materials and intermidiate goods for export.

Export Processing Zone: It just started its operation three months ago. It is not a zone in its literal sense but a regime, and could be a single factory.

Industrial Rebate for Manufacturing ranges 50-100% of tariff.
EPZ: Companies engaged exclusively in manufacturing for export can apply EPZ status and receive special incentives, including:
-- a reduced tax rate (15% instead of 35%);
-- no withholding tax on dividends;
-- no duty on capital equipment and raw materials;
-- no excise taxes on purchases of raw metrials and packaging materials made in Malawi;
-- no VAT, and
-- a transport allowance of 25% of international transport costs.

MUB: MUB offers many of the same inducements as EPZ for companies who will be exporting but not exclusively. A notable difference is that MUB requires the usual tax rate (35%) but offers a 12% export tax allowance.

D. International Trade

As shhown in the following table, Malawi's exports are highly concentrated in three agricultural products: Tobacco, tea and sugar.

Malawi's exports (in MK million)

	1993	1994	1995
Tobacco	938	2241	2504
Tea	157	261	380
Sugar	69	224	342
Coffee	35	128	NA
Cotton	9	15	58

Note: Data for 1995 covers nine months from Jan-Sept.
Exchanged rate in May 1996: 14.5/US$

Malawi's trade with SADC countries and with the rest of the world is highly skewed. Malawi's exports are concentrated on European market, with roughly two thirds of its total exports. Malawi's total exports to SADC countries is less than one fourth of total imports from these countries. It has trade deficit with all SADC countries, except for two countries with very samll amount of surplus: Angola (US$ 46,000 in 1994), and Tanzania (US$ 432,000 in 1994). In terms of exports, the largest trading partner is RSA with roughly US$ 19.6 million, followed by Zimbzbwe (US$3.2 million) and swaziland and Mozambiques (US$ 2.2 million each). Malawi's largest SADC source of imports is RSA, US$ 77.4 million, or 65.4 ercent of total imports. The second largest SADC source is Zimbabwe (US$ 28.7 million), followed by Zambia (US$ 4.8 million).

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Insert Malawi Trade Table: destination of exports

E. Business Environment and Constraints

Though Malawi made significant liberalization in macroeconomic, trade and investment policy fronts, the overall business environment does not seem to be favorable:

In January 1996, the government announced to introduce addtional taxes in an effort to reduce budget deficit:
10% excise duty on textiles; a 10% increase in surtax on hotels and restaurants, bringing it to 20%; and a 20% surtax on Southern Bottlers for distributing Carlsberg beer. These taxes add up to costs of business.

At the begining of Febrauary, 1996, RSA announced that it would impose compulsory cash deposits of 125% on all road shipments passing through the country, following the discovery that some clearing agents have been declaring imports as destined for third countries as a means of evading customs duties. The deposits will be refunded after a 30 days if proff is provided that the goods concerned have left RSA. Nevertheless, this policy would likely hit businesses in Malawi very hard, given their heavy dependence on getting imports through Durban.

Interaction between government and business community does not seem to be adequate. Though dialogue between the government and private sector increased recently, the government still makes decision on important policies without consultation with private sector. The lack of consultation was perceived more serious at mid/working levels of the government.

Though businessmen see some investment opportunities exist, they are discouraged because of the high interest cost. Investment incentives such as tax holidays are not considered to be adequate because of other taxes such as high surtax (10%).

For problems with nontraditional exporters, lack of credit is most critical. The Export Guarantee Scheme is not easily accessible to exporters because it is handled by the Reserve Bank and the potential users don't deal with Reserve Bank. Banks require large amount of collateral and most exporters don't have such assets.

Garments imported from Far East Asian countries (Thailand, India, Malaysia, etc) at low prices, particularly the second hand clothes, cause big problems for domestic producers and domestic textile companies are closed.
Corruption is a big issue and the government passed anti-corruption law and established Office of Anti-corruption, but is not in operation yet.

Tax is too high for Malawian companies to be competitive with foreign companies. Corporate income tax is 35%, plus 3% of drought tax, plus surtax of 10-25% on service sector like hotels and restaurants. The drought tax is temporary and should be imposed during major droughts only. However, once the tax was introduced, it is imposed even after the drought is over.

MIPA is established as one-stop window for investors. However, it is not implemented as it is intended because of the lack of coordination among differrent ministries. Lease of land takes three years and cause major problem for investors.

The Export Incentive Package legislated by the government is not working. Business community interprets the package as intention of the government which does not have budget to implement the package such as duty drawback and allowance for sales tax. Duty drawback payments are made at the end of the year as income tax reduction.

It was noted at the Controller's Office of Customs and Excise that customs clearance takes only four or five hours, which is unbelievable. However, business community complained that customs clearance takes too long and domestic producers for export can not meet the (time) deadline required by foreing buyers.

Many businessmen complained that there is no reciprocity in bilateral trade agreements and Malawian companies suffer from unfair games. It is easy to import finished products into Malawi, while there are many restirctions (non-tariff) on exports from Malawi to Zambia, Zimbabwe ans RSA.

Malawi observes agreement and regulations whereas other countries don't. Zimbabwe provides 18% of export incentives on final products. Malawian domestic producers pay higher VAT tax. Cooperation between countries should be two way.

For imports from RSA, it pays 10-20% of tariff, plus 20% of sur tax. With free trade agreement with Zimbabwe, imports from Zimbabwe pays only one percent of tariff, plus 20% of surtax.

Networking regional indigenous companies and foreign companies is weak and few foreign investment mission has visited in Malawi. Some domestic companies (NALI, for example) would like to have joint venture with foreign company but don't have information. It has not heard of African Enterprise Development Fund, but would like to get benefit from this fund.

A group of American as well as Asian trade missions visited Malawi last year but there is no interest expressed by them, apparently, due to unfavorable investment environment.

MIPA does not seem to have the capability to implement its duties well. For example, some Malawian companies went to U.S. without much preparation and didn't make much success. Business community mentioned that MIPA should identify some U.S companies interested in investment in Malawi and match them with domestic firms. In this regard, they mentioned that match making idea was proposed by the World Bank by some staff but it was blocked by other staff because it was considered as subsidizing profit making companies.

A lot of Bureaucracy hampers investment in the region: example, an Asian intrastructure project was required to prepare 21 copies of documents of thousands pages. Who would be happy to invest in this country?

Infrastructure including roads, telecom and electricity, particularly, railroads are not well linked, and movement of goods are mainly monopolized by RSA. Malawian companies are at disadvantage vis-a-vis those of neighboring countries in terms of the poor infrastructure. For imports through Durban, they have pay high road levy, goods are stolen while they are inspected. They have to go through a lot of hassle at the border of Zimbabwe, truck drivers are detained, birbery is epidemic. There is no transparancy and consistency. Rules and regulations by other states are changed overnight without warnings. SADC has not helped at all. Malawi needs to protect its domestic producers.

Lots of informal cross border trade from Mozambique to Malawi, and a lot of sugar from Malawi to Mozambique, causing loss of tariff revenue for the government.

Due to dumping, direct and indirect subsidies (and their economies of scale) by Asians, domestic producers can't compete with imports from Far Asia. WTO should verify Asian countries.

Investment Promotion Act is in paper only and not implemented. Liberalization shoudl be implemented gradually, in a controlled way. Why there is turf trade negotiation going on between the U.S. and Japan? Isn't this an indication that even developed countries liberalize gradually to protect teir own industry? Why donors push the weak (countries) hard but not the strong ones? Malawi is being pushed to liberalized, not voluntarily reforming it. As a result, Malawi is becoming consumers, not producers. The World Bank destroys African economies and make it an economic colony, in the name of liberalization.

On the macroeconomic front, high inflation and high interest rate discourage investment. The governemnt lives on borrowed fund, increassing its debt and debt service.

With the ILO efforts to establish a strong union in Malawi, a textile company from RSA, which is interested in investment in Malawi, is ready to pull out. Also, a huge rice mill planned by a foreign company is on hold.

Sundry Notes on Information

1. COMESA Secretariate prepared a Report on its second conference. Should be available from SADC in Gaborone.

2. There is a publication (in 1995?) on (analytical) Report on COMESA and SADC by UNCTAD

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