MALAWI: Studies on Past Industrial Trade Reforms Experience and Economic Implications

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1. Introduction

1.1. Economic and trade environment

1.1. Main features of the economy

Malawi is a landlocked country covering an area of 118,500 square kilometres, of which 24,420 square kilometres consists of water. It borders Mozambique, the United Republic of Tanzania and Zambia. Even though Malawi does not share a common border with Zimbabwe, the two countries have strong economic and social ties dating back to the British colonial period. Zimbabwe is an important transit route for Malawi's exports and imports to and from its major trading partner, South Africa.

Malawi's main port for international trade with Europe and the United States is Durban in South Africa; goods are transported by land, to and from Durban, through Mozambique and Zimbabwe. Prior to the war of independence in Mozambique, Malawi's main international trading ports were Nacala and Beira in Mozambique to which it was connected by rail. Efforts to revive the old and cheaper route have been very slow.

The country's population is estimated at 11 million (Box 1), and, overall, it is quite young: 44 per cent of the population is in the 0–14 years age group and 52 per cent in the15–64 years age group. Between 1997 and 2003 the population grew at an average annual rate of 2.1 per cent.

Box 1. Main features of the Malawi economy

Population (2003):11 million

Population growth (1997 – 2003): 2.1%

1983 1993 20022003

GDP (current $ billion) 1.22.11.91.7

Gross domestic investment/GDP22.815.212.58.1

Gross national savings/GDP ..0.2-7.3-7.0

Structure of economy (% of GDP)

Agriculture value added42.348.936.537.6

Industry 21.424.114.814.6

Services 36.327.048.747.8

Literacy rate total (% ≥15 yrs)61.8

Literacy rate female (% ≥15 yrs)48.7

Source: World Bank, *World Development Indicators* (various years)

Malawi is one of the world's poorest countries, with an estimated GDP of $1.75 billion and a per capita GDP of $163. Adult literacy is estimated at 61.8 per cent, of which female literacy lags behind at 48.7 per cent. The country has a predominantly agrarian economy and is dependent on subsistence farming, with 75 per cent of the population living in the rural areas. Since 1980, the urban population has been growing at an average annual rate of 5.2 per cent, thereby increasing the urban population from 9 per cent of the total population in 1980 to 15 per cent in 2003.

The aggregate real GDP growth is strongly influenced by climatic conditions. Thus, severe droughts in 1992 and 1994 led to decline in real GDP (at factor cost) of 7.9 per cent and 11.6 per cent,

respectively, while favourable harvests in 1995 and 1996 were largely responsible for real GDP growth averaging 9.25 per cent in those years.

Developments at sectoral level reflect the pattern of aggregate GDP growth. The share of agriculture in GDP fell from a peak of 49 per cent in 1993 to 37.6 per cent in 2003. Likewise, the share of industry has been declining, from a high of 31.5 per cent in 1992 to 14.6 per cent in 2003. The services sector is now the main contributor to GDP, with a share of 47.8 per cent in 2003.

Malawi's savings and investment rates have been among the lowest in the region. The low gross national investment and negative gross national savings as a percentage of GDP reflect the poor state of the economy. Gross investment was 8.1 per cent of GDP in 2003, which was 4.4 percentage points lower than the previous year. Gross national savings were -7 per cent of GDP in 2003, a slight improvement over 2002 when they were -7.3 per cent.

1.1 Economic developments

Malawi's growth performance has generally been weak. Between 1981 and 1990, GDP (in constant 1995 $) grew at an average annual rate of 2.2 per cent (Table 1). Subsequently, there was an improvement in GDP growth, mainly as a result of stronger growth in the first half of the 1990s. During the period 1990–2002, the GDP grew at an average annual rate of 3.2 per cent, but has slowed down since. In 2001, it grew by 1.7 per cent before shrinking by 1.5 percent in 2002. The slow growth of GDP was mainly due to economic mismanagement and the poor performance of the agriculture sector. It resulted in the deterioration of per capita GDP from $169 in 2000 to $163 in 2001, (representing negative growth of -0.4 per cent), and in 2002, it fell even further, by -3.5 per cent, to $157.

Table 1. Changes in GDP and per capita GDP, 1981–2002

	1981-1990	1990-2002	2001	2002
GDP percentage growth (constant 1995 $)	2.2	3.2	1.7	-1.5
GDP per capita growth (constant 1995 $)	-1.0	1.31	-0.4	-3.5

Source: IMF, International Financial Statistics.

Developments at the sectoral level reflect the pattern of aggregate GDP growth. The average annual growth rate of agriculture was 3.9 per cent over the period 1999–2003 (Table 2), having deteriorated drastically from 53 per cent of GDP in 1993 to -29.25 per cent in 1994. Changes in weather conditions have traditionally had a greater impact on the agricultural output of smallholder farmers because of their very limited access to irrigation facilities.

During the period 1999–2003, the manufacturing sector performed poorly. It declined at an average annual rate of 5.5 per cent over the period 2000–2002, before increasing by 1.1 per cent in 2003. Data in the electricity and water sectors indicate swings in performance over the period 1999–2003, with grow thin one year followed by a decline the following year.

Table 2. Annual percentage change of GDP by economic activity (at constant 1994 factor cost), 1999–2003

	1999	2000	2001	2002	2003
Agriculture	10.1	5.3	-6.0	2.7	7.3
Smallholders	13.4	1.6	-4.8	-0.4	13.3
Estates	-1.9	21.0	-10.3	14.2	-12.1
Mining and quarrying	3.4	10.8	7.5	-38.7	23.5
Manufacturing	1.8	-3.0	-6.6	-6.9	1.1
Electricity and water	-0.4	10.2	-7.0	5.8	0.9
Construction	15.5	-2.2	-4.7	14.1	4.0
Distribution	-1.8	-0.3	1.1	1.6	2.3
Transport and communications	4.8	-4.2	-0.6	13.4	2.2
Financial and professional services	-0.3	2.0	-3.0	6.4	6.0
Ownership of dwellings	2.1	2.6	2.8	2.8	2.8
Private community services	0.7	2.7	2.9	2.9	2.9
Government services	-1.8	-9.9	0.8	-0.5	1.4
GDP at constant 1994 factor cost	3.5	0.8	-3.2	1.0	4.5

Source: Central Statistical Office

Real GDP growth in the construction and transportation, and communications sectors showed negative growth in 2000, but recovered in 2002 and 2003.

Malawi has performed poorly in international trade: between 1990 and 2002, imports of goods increased by an average of 10.7 per cent per annum while exports increased by only 5.3 per cent, with the highest growth (21.4 per cent) recorded in 2002 (Table 3). In 2001, exports increased by 6.1 per cent, but declined by 1.3 per cent the following year. This gap between growth in exports and imports led to a widening of the trade deficit, from $15 million in 1992 to $150.8 million in 2002, although in 1998 it registered a surplus.

Table 3. International trade (%)

	1981–1990	1990–2002	2001	2002
Growth in exports of goods	5.5	5.3	6.1	-1.3
Growth in imports of goods	1.5	10.7	2.2	21.4
Growth in exports of services	4.8	6.9	27.3	13.2
Growth in imports of services	5.4	2.4	2.6	29.5

Source: IMF, International Financial Statistics

Services exports grew at an average annual rate of 6.9 per cent between 1990 and 2002 and have grown further in recent years: 27.3 per cent in 2001 and 13.2 per cent in 2002 (Table 3). Growth in imports of services has been slower than exports: between 1990 and 2002, imports grew by 2.4 per cent, which was almost half the growth experienced during the period 1980–1996.

Inflation, as measured by the consumer price index, remained very high over the period 1990–2002, with an average 12-month inflation rate of 29 per cent (Table 4). While it has moderated in recent years, it still remains very high. In 2002 inflation was 14.7 per cent. High inflation levels averaging 40 per cent per annum were experienced between 1994 and 1999. Theprice increases were due to poor fiscal management, which resulted in money and quasi-money increasing by an average annual rate of 32 per cent during the period 1990–2002.

Table 4. Inflation and interest rates

	1981–1990	1990–2002	2001	2002
Inflation	16.3	29	22.7	14.7
Bank rates	12.5	33.8	46.8	40
Lending rates	21.5	38.1	56.2	50.2

Source: IMF, International Financial Statistics.

Overall monetary developments may be divided into two distinct phases. The first phase (1990-1994) reflected a significant relaxation of domestic credit policy, which led to a rapid expansion of broad money and a sharp acceleration of inflation. In particular, the growth of broad money was fuelled by a rapid expansion of the net domestic assets of the banking system. During the second phase (1995–1997), the growth of broad money declined significantly to about 39 per cent by March 1996 and further to 19 per cent by March 1997.

The tightening of monetary policy which occurred after 1994/95 was facilitated by considerably lower fiscal deficits as well as significant measures implemented by the Reserve Bank of Malawi. In 1995, the Government's automatic access to ways and means advances at the Reserve Bank was stopped, and the discount rate of the Reserve Bank was raised from 40 per cent to 50 per cent. Further tightening occurred in early 1996, with the inclusion of government deposits in the commercial banks' base of liquidity reserve requirement.

In response to the tightening of monetary policy, the inflation rate fell sharply, from 75 per cent at the end 1995 to less than 7 per cent at the end 1996. As a consequence, interest rates also declined.

Following a short recovery in 1993, Malawi's financial situation deteriorated significantly in early 1994. This was due to increasing problems in controlling expenditure ahead of its first multiparty elections in 30 years; in addition, administrative problems in revenue collection led to a large overall fiscal deficit mainly financed by the banking system. The resulting acceleration of inflation was further fuelled by strong upward pressures on food prices induced by a severe drought and the pass-through effect of a major adjustment of the exchange rate following the introduction of a market-based exchange rate system.

Against this background, in early 1995, Malawi embarked on an adjustment programme designed to restore financial stability and set the basis for sustainable economic growth. A fiscal adjustment over the period 1994–1997 resulted in the reduction of the overall deficit (excluding grants) by 20 percentage points. This was a consequence of significant measures undertaken to curtail expenditure and to improve the administration and collection of taxes. The fiscal adjustment permitted the adoption of a tight monetary policy that helped reduce the inflation rate from its peak of 98 per cent in July 1995 to less than 7 per cent in 1996.

In the context of re-establishing the basis for sustained growth, the authorities embarked on an ambitious programme of structural reform. In the agricultural sector, reforms were aimed at providing smallholder farmers access to cash crops and to liberalizing the marketing of agricultural output, including terminating the monopsony position of the marketing parastatals as the sole purchaser of smallholder crops. Additionally, the marketing of inputs was liberalized, encouraging the participation of private traders in this activity and increasing the supply of inputs to farmers. However, this achieved the opposite effect, as small-scale, rural subsistence farmers were faced with the burden of travelling long distances to sell their produce. Also, subsistence farmers could not afford the high price of fertilizer, and this resulted in lower yields.

Structural reforms designed to liberalize the economy and facilitate the growth of private enterprise were also implemented in several other areas. In the external sector, the exchange and trade systems were reformed with the introduction of a market- based exchange rate system in February 1994 and a formal, foreign exchange inter-bank market in September 1996. All restrictions on external current account transactions were removed, and in December 1995, Malawi accepted the obligations under Article VIII of the IMF's Articles of Agreement. The external trading environment was significantly liberalized with a phased reduction of the temporary export levy and import duties, and a decrease of the weighted average tariff rate from 18 per cent in 1994 to about 15 per cent in 1996.

The introduction of a value added tax (VAT) and other taxes, aimed at covering the shortfall in revenue due to reduced tariffs, exposed domestic industries to stiff competition from imports and did not benefit consumers since the final purchase price either remained the same or increased. It was clear that the objective of the policies, advocated mainly by the IMF, were intended to provide better access to imports. The policies also did not take into account job losses. Against this background, in early 1995, Malawi embarked on an adjustment programme designed to re-establish financial stability and set the basis for sustainable economic growth.

1.1. Cost of adjustment

To control the increase in prices, the Reserve Bank of Malawi increased its lending rate. During the period 1990–2002, its lending rate averaged 33.8 per cent compared to 12.5 per cent during the period 1981–1990. However, the rate has gone even higher in recent years: as high as 50.2 percent in 2002 before declining to 46.8 per cent in 2001 and 40 per cent in 2002. The commercial banks in turn increased their lending rates from an average of 21.5 per cent during the period 1981–1990 to 38.1 per cent during the period 1990–2002. Their lending rates reached a high of 56.3 per cent in 2001 before falling to 50.5 per cent in 2002. Such high lending rates had a negative impact on the manufacturing sector. Manufacturers were reluctant to borrow since their returns were actually far less than the rate at which they could borrow from the commercial banks. As a result the manufacturing sector experienced a decline in growth by 3 per cent in 2000 and by a 6.9 per cent in 2002.

Inflationary pressures, which led to an increase in interest rates, were also reflected in interest payments, from 3 per cent of GDP in 1992/93 to about 6.75 per cent in 1995/96. The subsequent decline in inflation in the second half of 1996, led to lower interest rates, which alongside a repayment of government debt equivalent to 2 per cent of GDP, reduced interest payments to about 5.5 per cent of GDP in 1996/97.

On the currency side, after the large depreciation of the Malawi kwacha in 1994, the currency remained broadly stable in nominal effective terms until July 1998. Given the relatively high inflation rate, this implied a substantial real appreciation, creating problems for the balance of payments despite a rise in tobacco prices. In August 1998, the kwacha started to depreciate and by the end of that year it had fallen by nearly 40 per cent in nominal effective terms, offsetting the previous rise in the real exchange rate. The kwacha experienced a period of relative stability vis-à-vis the US dollar, which led to a substantial rise in the real effective exchange rate until April 2000. This was followed by a nominal deprecation of nearly 40 per cent, through end-October 2000.

The bulk of Malawi's domestic investment has been financed by foreign investment which averaged about 10 per cent of GDP during the 1990s. Large budget deficits (mainly due to increases in general administration expenses) have diverted private savings from investment, thereby hindering growth and contributing to large deficits in the external current account and, to a significant extent, a build-up of the external debt. The lack of sustained fiscal adjustment worsened competitiveness by raising interest rates in a period when a boost to competitiveness was required to offseta worsening of the terms of trade.

Private savings rates decreased during the 1990s, despite some progress with structural reforms. Net national savings fell from a peak of 13.2 per cent in 1988 to -9.1 per cent in 2001. Private savings need to grow since the current level of foreign investment cannot be sustained indefinitely. The current low rate of private savings reflects in part an overall economic environment that has not been conducive to private economic activity. Economic prospects and returns from savings would be greatly enhanced by achieving sustained, stable macroeconomic conditions.

2. The role of trade in Malawi's economy

2.1. International trade

Malawi's overall international trading environment during the pre-liberalization period was positive. The balance of payments recorded surpluses in 1987 and 1988 (Table 5). The current-account deficit narrowed from $260 million 1980 to $87 million in 1988. The bulk of the deficit was due to imports in the services sector which increased from $178.6 million in 1980 to $197.9 million in 1988. Transportation accounted for the largest share of the increase, implying a rise in foreign payments on transport services. As a landlocked country, Malawi depends mainly on land transport for international trade in goods.The reduction in the deficit was due to increased inflows of current transfers from $82.6 million in 1980 to $169.3 million in 1988.

Table 5: Balance of payments during the pre-liberalization period ($ million)

	1980	1986	1987	1988
Current account	-259.9	-85.3	-60.8	-87.0
Foreign direct investment	9.5	n.a.	0.1	n.a.
Capital account	152	45.8	59.5	68.9
Overall balance	-22.0	-0.6	45.4	60.2

Source: IMF, International Finance Statistics

The capital account surplus narrowed from $152 million in 1980 to a low of $45.8 million in 1986 before increasing to $60 million in 1987, and to a three year high of $68.9 million in 1988.

2.2. Composition of trade

Malawi's exports are highly concentrated. Primary commodities constitute the bulk of merchandise exports, of which nearly 90 percent are agricultural commodities. Tobacco accounts for about 53 per cent of total exports followed by tea and sugar, which account for about 8 per cent each. Malawi has a niche place in the international tobacco market. It is the second largest producer and exporter of burley tobacco, behind the United States, but it does not compete directly with the United States as it produces a different variety. Similarly, Malawi does not compete with varieties produced by large producers such as Brazil and India. Manufacturing exports account for about 10 per cent of total exports. These include mainly textiles and clothing and, to a lesser extent, furniture and processed food products.

Malawi's exports declined from an average of $258.9 million a year between 1980 and 1985 to US$238.4 million in 1986 before increasing to $272.46 million in 1987 and to $278.7 million in 1988 (Table 6). The bulk of the exports were from beverages and tobacco,[1] (which averaged 53 per cent of total exports during the period 1980–1988) followed by food and live animals. The share of manufacturing exports gradually declined, from 4.9 per cent in 1980 to 3 per cent in 1988.

[1] This refers only to tobacco, but the classification includes beverages as well.

Table 6. Exports during the pre-liberalization period (US$ '000)

	1980–1985	1986	1987	1988
Food and live animals	105,259	86,594	79,277	75,446
Beverages and tobacco	127,336	129,663	169,068	178,418
Crude materials, inedible, except for	12,127			
Mineral fuels, lubricants and related		11,647	8,979	11,151
Animal and vegetable oils and fats	73			
Chemicals	399	59	11	3
Manufactured goods classified chiefly by material	1,209	152	235	200
		1,474	622	846
Machinery and transport equipment	9,908			
Miscellaneous manufactured articles	89	7487	12,420	8,339
Commod. & transacts. not class. Acc	1,956	7		6
Total exports		1,052	47	3,952
	506		1,475	
	258,864	241		374
		238,375	333	**278,734**
			272,459	

Source: IMF, International Finance Statistics

During the pre-liberalization period (1980–1988) the value of imports declined gradually between 1980 and 1987, from $440.2 million to $297.27 million, before increasing to $408.8 million in 1988. This was the result of stringent exchange control restrictions. The import basket was dominated by machinery and transport equipment followed by manufactured goods and chemicals. The value of imports of machinery and transport equipment fell from $148.3 million in 1980 to $84.7 million in 1987 before recovering in 1988 to $121.6 million. The lower imports of machinery, which is key to production, was due to a shortage of foreign exchange, and not to a lack of demand. Imports of manufactured goods slowed down from $101.7 million in 1980 to a record low of $51.3 million in 1986 before recovering in 1988 to $84.3 million.

Exports of manufactured goods grew faster than imports. The trade deficit in manufactured goods narrowed from $88.6 million in 1980 to $43.3 million in 1987 before increasing to $76 million in 1988.

Malawi's main export markets during the pre-liberalization period were Germany, which accounted for 16 percent of Malawi's exports, the United Kingdom (15 per cent and the United States (11.5 per cent). Exports to Germany and the United Kingdom were mainly sugar (which had preferential market under the Lomé Agreement) and tea. Tobacco was mainly exported to the United States. South Africa and Zimbabwe were destinations for mainly manufactured exports, accounting for 7 per cent and 3 per cent, respectively, of Malawi's exports.

Malawi's main source of imports was South Africa, which accounted for 28 per cent of its total imports, followed by the United Kingdom (21 per cent), Zimbabwe (9 per cent) and Germany (6 per cent). South Africa and the United Kingdom were the main suppliers of capital equipment, while the relatively more developed economies in the region, South Africa and Zimbabwe, supplied most of Malawi's manufactured goods and agricultural inputs.

Table 7. Imports during the pre-liberalization period (US$ '000)

	1980–1985	1986	1987	1988
Food and live animals	19,312	11,460	17,842	31,016
Beverages and tobacco	2,537	1,173	533	699
Crude materials, inedible, except fuels	7,821	4,999	4,902	9,115
Mineral fuels, lubricants and related materials				
Animal and vegetable oils and fats	53,246	35,688	43,918	49,774
Chemicals	5,344	4,410	4,313	5,112
Manufactured goods classified chiefly by material	58,566	53969	68,347	86,719
Machinery and transport equipment	73,150	51,311	55,723	84,279
Miscellaneous manufactured articles	87,985	79,326	84,670	121,648
Commod. & transacts. not class. Acc	20,491	14,524	14,569	
Total imports				17,974
	942	1,241	2450	
	329,424	**258,100**	**297268**	2,468
				408,804

Source: IMF, International Finance Statistics

During the period 1980–1988, Malawi was a net importer of services. The services trade deficit widened from $146.78 million in 1980 to $159.4 million in 1988. As mentioned earlier, the main payments were for transport services which increased from $130 million in 1980 to $147.7 million in 1988. As a landlocked country, Malawi's dependsmainly on an expensive road transport system from the port of Durban (in South Africa) through South Africa, Zimbabwe, Mozambique and the United Republic of Tanzania (Dar es Salaam), even though it is considered inefficient. Exporters and importers have relied largely on South African transporters.

3. Trade liberalization and economic impacts

3.1 Trade liberalization

3.1.1. Trade Policy Reform

Beginning in 1988, and continuing through most of the 1990s, the Government implemented a series of measures aimed at liberalizing the trade regime. Much of this was done under the World Bank/IMF structural adjustment programmes. The trade reform programme, which started in the latter half of the 1980s and was deepened in the mid-1990s, consisted of two distinct approaches:

(i) Reducing the restrictiveness and complexity of the trade regime in the context of the World Bank and IMF structural adjustment programmes; and,

(ii) Improving market access through bilateral and regional agreements.[2]

(iii) Objectives and instruments available

Throughout most of the 1980s, Malawi maintained a restrictive and complex trade and exchange rate regime that was based on the discretionary allocation of foreign exchange for imports, pervasive non-tariff barriers, a large number and wide dispersion of tariff bands, high tariff protection against imports, restrictive licensing requirements on imports and exports, and surrender requirements on export proceeds.

[2] Even though Malawi acceded to the WTO in 1994 its membership did not provide new market access opportunities because it already benefits from the Cotonou Agreement and the Everything-but-Arms (EBA) initiative of the EU and the Africa Growth and Opportunity Act (AGOA) of the United States.

The reforms introduced since the late 1980s have substantially liberalized trade. Priorities under Malawi's trade reform programme were to streamline import procedures by eliminating licences and their bureaucratic requirements, simplifying the import regime by amalgamating tariffs, reducing dispersion by cutting the number of tariff bands, reducing protection by progressively cutting tariff rates and equalizing domestic taxes between imports and domestic goods, and increasing transparency by reducing the use of discretion.

The export regime was also liberalized by reducing export surrender requirements and export levies, even though the process proceeded more slowly than that of the import regime.

3.1.2. Measures affecting imports

Imports were subjected to cumbersome, lengthy, and costly procedures including the obtaining of an import licence (subject to a fee of 5 per cent of value) and foreign exchange approval from the Reserve Bank of Malawi through a commercial bank. The application process alone normally took about a month, with further administrative delays on arrival of the goods. Allocation of foreign exchange was subject to substantial discretion. Guidelines used by the Reserve Bank of Malawi reflected perceived national priorities within the limitations of the foreign exchange budget. The import tariff system was prohibitive and complex. Imports attracted a maximum tax rate of 75 per cent, an import levy of 10 per cent and surtax rates of 0–35 per cent for non luxury items and 55–100 percent for luxury goods. Government imports were exempt from customs tariffs.

Imports may still be subject to four types of duties: the customs tariff, excise duties (on some products), surtaxes, and anti-dumping duties. The domestic surtax and excise duties are applied to imports and domestically produced goods in a non-discriminatory manner.

Malawi's applied tariffs have been reduced from an average of 30.7 per cent in 1994 to 13.1 per cent in 2001 (Table 8). The manufacturing sector is the most protected followed by agriculture. The applied average MFN tariff rates on manufactured goods and agricultural products are 13.7 per cent and 12.2 per cent respectively.

Malawi's tariff structure continues to be characterized by the phenomenon of cascading tariff escalation. The lowest tariff rate (5 per cent) is applied to "necessities", consisting predominantly of capital goods and other inputs; the middle rate (15 per cent) is applied to intermediate goods; and the highest rate (25 per cent) is applied to "non-essential" goods, consisting mainly of consumer goods.

Malawi applies the highest tariffs on tobacco products, wearing apparel and dressing and dyeing of fur, tanning and dressing of leather, luggage, hand bags, saddles, harnesses and footwear (Table 8). High tariffs are also applied on wood and wood products, textiles, food products and beverages and, rubber and plastic products. Higher tariffs are also applied on four other products that Malawi need not protect: manufacture of office, accounting and computing machinery; motor vehicles, trailers and semi-trailers; manufacture of radio, television, and communications equipment and apparatus; and, manufacture of medical, precision and optical instruments, watches and clocks. Higher tariffs are applied to these products because of the need to protect a few smaller local producers who are able to lobby government for protection.

Table 8: Malawi's average applied tariff levels

Product category	1994	1998	2001
Tobacco products	44.3	10.0	25.0
Wearing apparel; dressing and dyeing of fur			
Tanning and dressing of leather; manufacture of luggage, handbags, saddles, harnesses and footwear	44.8	39.9	25.0
Furniture; manufacturing n.e.c.			
Wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	43.7	36.4	24.8
Textiles			
Office, accounting and computing equipment machinery	44.1	38.3	23.5
Motor vehicles, trailers and semi-trailers			
Radio, television, and communications equipment and apparatus			
Food products and beverages			
Rubber and plastic products	31.9	25.2	19.7
Other non-metallic mineral products			
Fabricated metal products, except machinery and equipment	47.1	28.5	19.3
Medical, precision and optical instruments, watches and clocks			
	42.8	35.9	18.2
	32.9	24.8	18.0
	37.6	39.8	17.6
	34.5	24.1	17.6
	34.6	21.0	15.3
	28.5	19.1	14.3
	31.0	19.7	14.1
	31.2	23.3	13.8
Total average	**30.7**	**20**	**13.1**

Source: NACE.

3.1.3. Major constraints inhibiting exports

During the 1980s, exports were restricted to ensure an adequate supply of goods for the domestic market. A large number of goods, including maize, beans, groundnuts, and petroleum, could not be exported at all. Many other exports were subject to licensing. Specific duties were levied on exports of hides and skins, and tobacco, and foreign exchange earnings were required to be surrendered to the Reserve Bank of Malawi.

The export regime has been liberalized substantially since 1988. There are no general licensing requirements for exports and no export tariffs. Only four commodities require an export licence (implements of war other than arms and ammunitions; petroleum products; wild animals, trophies, and products of such animals; and maize and maize meal). Nevertheless, exports of tobacco, tea and sugar remain subject to a surrender requirement of 40 per cent of foreign exchange receipts. Tobacco production has been liberalized, but exports are permitted only through a single auction house.

Malawi's external trade arrangements have changed with the provision of preferential market access to the United States through the African Growth and Opportunity Act (AGOA) and to the EU through the Everything-but-Arms (EBA) initiative. An important question is whether these initiatives provide meaningful additional market access for Malawi, and, therefore whether they can contribute to stimulating exports and growth and reducing poverty. The preferential market access provided by AGOA had a small positive impact on apparel exports. For agricultural commodities of interest to Malawi, AGOA does not provide additional market access. Tariffs remain high (35 per cent) on tobacco imported for cigarettes, such as Malawi's burley tobacco, and relatively low on tobacco imported for other than cigarettes (5.6 per cent). For many of the other agricultural commodities, such

as sugar, raw cotton, coffee, black tea and certain kinds of peanuts, they are either governed by a tariff-rate quota or are not eligible under the general United States agricultural policy.

Since Malawi already receives highly preferential access to the EU market under the Cotonou Agreement, the impact of the EU's EBA on enhancing market access will be negligible except for sugar. Under the EBA, all duties on sugar will be eliminated by 2009. In the interim, the EU will continue to offer a tariff-free quota that is to increase by nearly 15 per cent per annum. Given the substantial price advantage that the quota provides to sugar producers in beneficiary countries, there is considerable potential for an expansion of sugar exports to the EU.

After the expiration of the Cotonou preferences in 2007, Malawi is likely to continue enjoying preferential access to the EU market under the EBA, but it will face increased competition from other LDCs that previously did not have preferential market access to the EU.

The average tariff imposed on Malawi's exports increased from 5.03 per cent in 1988 to 11.9 per cent in 2003. However, the main obstacles are transport costs and supply- side constraints. The country's production output has been declining since the mid-1990s. The ability to export is constrained by high transportation costs, which make Malawi's products uncompetitive in export markets. Commodity exports entail high volumes and therefore high shipping costs, while they fetch low prices in the export market compared to manufactured products, such as wristwatches, that require lower transportation costs and fetch very high prices.

Table 9: Average applied tariff levels on Malawi's exports

Product category	1990	1998	2003
Forestry, logging and related service activities	5.3	2.2	25.0
Manufacture of wearing apparel; dressing and dyeing of fur			
Tanning and dressing of leather; manufacture of luggage, handbags, saddles, harnesses and footwear	24.45	28.37	19.45
Other transport equipment			
Coke, refined petroleum products and nuclear fuel	10.41	33.96	19.14
Paper and paper products			
Rubber and plastic products	1.52	18.23	19.0
Textiles			
Wood and of products of wood and cork, except furniture; articles of straw and plaiting materials	6.03	44.57	18.93
Motor vehicles, trailers and semi-trailers	21.28		18.6
Food products and beverages		36.67	18.34
Other non-metallic mineral products		19.36	17.63
Total average			
		22.15	
	14.98		
			14.49
	23.7		
	16.03	18.67	13.86
	7.6	18.11	13.1
	10.58		12.42
		21.23	
			11.89
		16.02	
		18.16	

Source: UN, COMTRADE

3.1.4. Implementation process

Malawi's trade reform process consisted for four elements: elimination of non-tariff barriers; consolidation of the tariff structure; reduction of tariff protection; and liberalizing of the export regime (see Box 2). Key reforms took place between 1988 and 1998. Since embarking on trade liberalization, Malawi has substantially rationalized its tariff structure by lowering and amalgamating duty rates, thus reducing dispersion.

By mid-1999, Malawi's liberalization programme had produced one of the most liberal and transparent regimes in Africa. Non-tariff barriers had been largely eliminated, except for restrictions relating to health and security reasons. Only 13 commodities (about 5 per cent of Malawi's total imports) require an import licence. The maximum tariff rate was reduced to 25 per cent, and average tariffs declined to below 16 per cent. There are now only three effective non-zero tariff bands. However, because of bilateral agreements and preferences given on a reciprocal basis to other members of the Common Market for Eastern and Southern Africa (COMESA)[3] and the Southern Africa Development Community (SADC),[4] a large proportion of trade is subject to lower effective tariffs. COMESA has focused on the acceleration of regional integration through trade facilitation and the elimination of non-tariff barriers and intraregional tariffs. A timetable was set for the progressive reduction of tariffs, with the target of free intraregional trade by October 31, 2000. However, only nine countries (Malawi, Djibouti, Egypt, Kenya, Madagascar, Mauritius, Sudan, Zambia and Zimbabwe) met the October 31, 2000 target. COMESA also planned to adopt a common external tariff by 2004 with three tariff bands of 5, 15 and 30 per cent. Malawi already surpasses this liberalization objective.

SADC began implementation of a free trade area in September 2000. It will take about 12 years for the agreement to become fully effective. As a least developed member, Malawi will start reducing tariffs against South African goods only in 2005. Currently about 40 per cent of Malawi's imports come from South Africa.

Nothing much is happening on the multilateral front. Malawi officially became a member of the WTO in April 1995, assuming the commitments of a developing country under the Uruguay Round. All of its tariff lines in agriculture were bound, but only 3.9 per cent of its industrial products. Agricultural and industrial goods were bound at 125 per cent and 47 per cent respectively. Malawi did not offer to reduce ceiling bindings, although this was required by the agreement. As these tariff bindings are far in excess of current tariff rates, they have little relevance. The commitments relating to domestic agricultural policies and export subsidies also have little relevance for Malawi's domestic agricultural policies. Malawi does not subsidize agriculture owing to fiscal constraints.

Currently, imports into areas declared as export promotion zones (EPZs) are exempt from all tariffs and income taxes for a specified number of years. All companies engaged exclusively in manufacture for export may apply for EPZ status. Exporters are allowed to maintain foreign currency deposit accounts.

[3] COMESA currently has 19 members: Angola, Burundi, Comoros, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, the Democratic Republic of the Congo, Zambia and Zimbabwe.

[4] SADC has 13 members: Angola, Botswana, the Democratic Republic of the Congo, South Africa, Swaziland, the United Republic of Tanzania, Zambia and Zimbabwe. Madagascar has applied to join.

Box 2. Malawi's key trade reforms (1988–1998)

Eliminating non-tariff barriers (1988–1997)

- February 1988 –Exchange controls on about 25 per cent of imports of non-petroleum raw materials and spare parts were eliminated. However, petroleum imports remained unrestricted.
- August 1988 –Liberalization of foreign exchange controls was extended to an additional 50 per cent of non-petroleum imports, including raw materials, industrial spare parts, and intermediate goods (including most goods related to commercial transport and some consumer goods).
- January 1991–Introduction of a narrow and temporary negative list that freed all other items from the requirement for prior foreign exchange approval. The negative list covered, among others, alcoholic beverages, precious metals, motor vehicles and electrical goods.
- February 1994 – The negative list for imported commodities was abolished. However, following a shortage of petroleum imports, the government reinstated a State import monopoly through the Petroleum Control Commission.
- June 1997 – All licensing requirements on imports and exports were abolished, except for items related to health, security and the environment.

Consolidating the Tariff Structure (1988-1996)

- 1988 – Customs duties and import levies were combined into one tariff schedule, followed by a broadening of the tax base.
- 1992–1993 – The differential in the surtax levied on imports and domestic goods was eliminated in combination with an upward adjustment of import duty rates.
- 1996 –The number of tariff bands was reduced.

Reducing tariff protection (1988 – 1997)

- 1988 – Maximum tariffs on non-government imports were reduced from 70 per cent to 45 per cent of the c.i.f. value, with a weighted average of about 21 per cent. Some tax rates were later abolished. Government imports were exempt from customs tariffs.
- April 1996 –The maximum tariff rate was reduced from 45 per cent to 40 per cent, resulting in a weighted average import tariff rate of about 15 per cent. Nonetheless, the tariff structure contained 10 bands (including for zero-rated items) ranging from 0 to 40 per cent. The import bands were 0, 5, 7.5, 10, 15, 20, 25, 30, 35, and 40 percent. However, only a few items were levied at the 5, 7.5, 15, 20, and 25 per cent rates.
- April 1997 – The import duty rate on raw materials used in manufacturing was eliminated and the maximum rate (on finished products) was further reduced from 40 per cent to 35 per cent. The temporary export levy on tobacco, tea and sugar, which was introduced in April 1995, was lowered from 10 per cent to 4 per cent in April 1997. However, the export levy was extended to coffee under the 1997/98 budget.
- June 1997 – All licensing requirements on imports and exports were eliminated, except for items related to health, security and the environment, completing the removal of non-tariff barriers.
- 1999 - Maximum tariff rate was reduced to 25 percent.

Liberalizing the export regime

- February 1994 –The export surrender requirement was abolished, except for tea, sugar and tobacco; at present 40 per cent of proceeds are still subject to surrender requirements.
- April 1995 – A 10 per cent temporary export levy on tobacco and sugar was reduced to 8 per cent.
- 1997 –Temporary export levy on tobacco and sugar was further reduced 4 per cent and concurrently extended to include coffee.
- 1997 –The corporate tax on firms in export processing zones was eliminated.
- 1998 – The export levy was eliminated.

3.2. Economic impact of trade liberalization

There have been some significant changes in the pattern of trade since liberalization and the removal of legal and institutional impediments. These in turn have reflected changes in relative profitability. However, some distortions remain in the incentives structure, partly because of the cascaded tariff structure and persistent structural impediments, and partly because of different and overlapping regional trade arrangements. The direction of trade has also changed substantially, with South Africa now the dominant partner. Previously, the main trading partners were the UK and Germany.

3.2.1. Exports

The trade openness index shows some positive changes, with the ratio of exports to GDP increasing from 20.8 per cent in 1983 to 27.5 per cent in 2003; the imports to GDP ratio also rose from 28.3 per cent to 40.6 per cent over the same period. However, while new export products have emerged, tobacco remains the single most important export commodity, accounting for over 60 per cent of total exports. This is followed by tea and sugar with 8 per cent and 6.5 per cent respectively. Non-traditional exports, which are predominantly within agriculture, registered strong growth in the 1990s, albeit from a small base, increasing their share in the total export basket from 6.7 per cent in 1990 to 12.7 per cent in 1997– 2003. In particular, exports of cotton products increased rapidly, together with exports of flowers and special vegetables to Europe, reflecting production by the EPZs.

Tobacco continues to be Malawi's main export product. In 1996, it accounted for 63 per cent of total exports (compared with 72 per cent in 1992) and for 73 per cent of traditional exports. Malawi's traditional exports grew by 9 per cent a year over the period 1993-1996 due to growth in tobacco exports. Boosted by the sharp depreciation of the Kwacha in 1994 and the structural reforms implemented since 1995, the growth of non-traditional exports, mainly in the clothing industry, averaged 37 per cent a year during the period 1995–1996. Nevertheless, their share in total exports remains small.

Malawi's total exports increased significantly, from $278.8 million in 1988 to $436.9 million in 2001. Exports of tobacco, which increased from $178.4 million in 1988 to $259.6 million 2001, were largely responsible for the overall increase. However, exports of manufactured goods fell sharply from $8 million in 1988 to $4 million in 2001. This is a reflection of the negative impact of liberalization on local manufacturers, who failed to compete with imports in the domestic market and did not have enough capacity to produce for exports. Consequently, most of them were forced to close down.

Table 10. Exports following liberalization (US$ '000)

Product category	1988	1999	2000	2001
Food and live animals	75,446	102,046	98,492	118,837
Beverages and tobacco	178,418	286,451	229,166	259,653
Crude materials, inedible, except fuels	11,151	10,592	13,807	12,933
Mineral fuels, lubricants and related materials	3	1,203	687	595
Animal and vegetable oils and fats	200	60	1	30
Chemicals	846	1,485	2,523	2,503
Manufact goods classified chiefly by material	8,339	13,849	5,150	4,176
Machinery and transport equipment	6	1,707	3,581	2,743
Miscellaneous manufactured articles	3,952	21,016	15,196	35,267
Commod. & transacts. not class. According to kind	374	0	2	176
Total exports	**278,734**	**438,410**	**368,604**	**436,914**

Source: IMF, International Finance Statistic.

The pattern of trade has changed more markedly, with a substantial increase in the share of trade with South Africa. Exports to industrialized countries, while still accounting for the largest recorded share, declined from 76.6 per cent of total exports in 1990 to 60 per cent in 1997-2003. Exports to South Africa more than doubled in relative importance, rising from 6.9 per cent of total exports in 1990 to an average of 21.4 per cent during the period 2000–2003 (Table 11). This reflects, in part, the non-reciprocal bilateral agreement which allows Malawi's export goods duty-free entry into South Africa.

Table 11. Direction of exports, following liberalization, 2000–2003

	($ million)				(% of total)			
Country	**2000**	**2001**	**2002**	**2003**	**2000**	**2001**	**2002**	**2003**
South Africa	85.9	94.8	102.9	130.3	20.3	20.0	22.1	23.3
United States	53.8	76.5	69.5	75.3	12.7	16.2	14.9	13.5
Germany	29.3	55.9	56.6	62.7	6.9	11.8	12.1	11.2
Japan	46.5	32.7	23.9	25.5	11.0	6.9	5.1	4.6
Netherlands	28.6	27.0	22.1	23.4	6.8	5.7	4.7	4.2
United Kingdom	15.3	19.6	17.3	17.5	3.6	4.1	3.7	3.1
Zambia	2.2	3.1	3.3	8.6	0.5	0.6	0.7	1.5
France	8.8	11.3	8.9	7.6	2.1	2.4	1.9	1.4
Zimbabwe	6.0	2.6	2.9	3.6	1.4	0.6	0.6	0.6
Mozambique	0.5	2.9	2.6	3.3	0.1	0.6	0.6	0.6
Tanzania, United Rep. of	1.7	1.9	1.3	1.7	0.4	0.4	0.3	0.3
Other Industrial	61.2	51.2	47.1	85.6	14.4	10.8	10.1	15.3
Other	84	94	107.8	113.7	19.8	19.9	23.2	20.4
Total	**423.8**	**473.5**	**466.2**	**558.8**	**100**	**100**	**100**	**100**

Source: IMF, Direction of Trade Statistics

Despite Malawi's bilateral trade agreement with Zimbabwe, trade between the two countries remains relatively small. Among the industrialized countries, Germany and the United States are the leading export markets, reflecting the concentration of tobacco exports to the United States market. Germany and the United Kingdom are important importers of sugar from Malawi.[5]

It is evident from Malawi's direction of exports that its membership in COMESA has not resulted in a shift in its trade towards the COMESA market. This casts doubts on the benefits of this grouping to Malawian exporters. However, the expansion of trade with South Africa and other SADC countries could justify the need to consolidate its membership in SADC.

The pursuit of liberal trade policies has reduced the anti-export bias in the trade regime and improved the domestic environment for export expansion. Despite these improvements, however, production and export performance have not been strong. In the 1990s Malawi's exports grew by approximately 1.8 per cent per annum, which is less than the average export growth of sub-Saharan Africa of 3.4 per cent per annum.

3.2.2. Imports

In the aftermath of the 1992 drought, Malawi's import capacity was severely constrained by a lack of foreign exchange. Accordingly, changes in imports reflected the changes in disbursements of balance-of-payments assistance, and commodity and project inflows. Non-maize imports declined by 10 percent between 1993 and by 4.25 per cent in 1995.

[5] Malawi has preferential access to the EU market under the Cotonou Sugar Protocol.

Malawi's import basket is highly concentrated, being dominated by machinery and transport equipment, manufactured goods and mineral fuels. Total imports increased from $408.8 million in 1988 to $561 million in 2001 (Table 12). Only imports of mineral fuels increased significantly, from $50 million in 1988 to $94 million in 2001.

Table 12. Imports following liberalization, 1998–2001 ($ '000)

Product category	1988	1999	2000	2001
Food and live animals	31,016	47,689	30,274	30,561
Beverages and tobacco	699	9,078	12,516	21,358
Crude materials, inedible, except fuels	9,115	17,758	13,008	11,845
Mineral fuels, lubricants and related materials	49,774	75,082	83,140	94,047
Animal and vegetable oils and fats	5,112	16,025	12,339	12,911
Chemicals	86,719	87,165	68,802	73,915
Manufact. goods classified chiefly by material.	84,279	107,944	95,947	109,887
Machinery and transport equipment	121,648	222,431	172,656	161,866
Miscellaneous manufactured articles	17,974	60,839	54,554	44,845
Commod. & transacts. not class. According to kind	2,468	1,377	726	363
Total Imports	**408,804**	**645,388**	**543,962**	**561,597**

Source: IMF, International Finance Statistics

South Africa remains the main source of Malawi's imports (Table 13). It has increased its market share from 45.8 per cent in 2000 to nearly 54 per cent in 2003 (Table 12). The other sources of imports in the region are Tanzania and Zambia (Zimbabwe's share has fallen). Outside the region, Malawi imports mainly from Japan, the United States, the United Kingdom, Germany and France in that order of importance.

Table 13. Direction of imports, 2000–2003

	($ million)				(% of total)			
Country	2000	2001	2002	2003	2000	2001	2002	2003
South Africa	260.2	252.3	273.8	331.9	45.8	56.4	50.1	53.7
Tanzania	12.1	6.5	19.5	23.7	2.1	1.4	3.6	3.8
Zambia	62.8	10.6	13.1	22.3	11.0	2.4	2.4	3.6
Japan	12.7	13.0	16.9	21.2	2.2	2.9	3.1	3.4
United States	14.4	16.3	33.0	18.4	2.5	3.6	6.0	3.0
United Kingdom	18.1	13.0	22.1	18.3	3.2	2.9	4.0	3.0
Mozambique	12.1	12.9	11.4	13.8	2.1	2.9	2.1	2.2
Zimbabwe	52.4	9.6	10.4	12.6	9.2	2.1	1.9	2.0
Germany	13.0	17.3	14.4	11.0	2.3	3.9	2.6	1.8
France	5.1	6.1	11.2	9.8	0.9	1.4	2.1	1.6
Netherlands	7.4	3.8	3.5	3.1	1.3	0.9	0.6	0.5
Other industrial	21.5	21.0	41.0	29.1	3.8	4.7	7.5	4.7
Other	76.2	65.1	76.0	102.6	13.6	14.5	14.0	16.7
Total	**568.0**	**447.5**	**546.3**	**617.8**	**100.0**	**100.0**	**100.0**	**100.0**

Source: IMF, Direction of Trade Statistics

3.2.3. Production

Table 14. Production, 1989–1998

Product category	1989–1991	1992/93	1994/95	1996	1997	1998
Food products	171,961	194,788	30,715	43,473	43,499	26,090
Beverages	77,405	17,141	72,807	89,658	120,384	78,046
Tobacco	23,703	16,602	9,384	16,707	19,464	11,515
Textiles	57,321	86,402	24,886	18,539	23,309	13,459
Wearing apparel	13,309	20,124	5,593	10,497	9,876	5,745
Leather products	-	-	513	537	486	284
Footwear	-	-	3,929	4,453	4,187	2,437
Wood products	9,628	8,799	8,849	10,132	11,019	6,755
Paper and products	35,596	39,302	26,394	27,704	30,527	24,954
Industrial chemicals	28,460	34,908	24,195	32,466	38,001	21,813
Other chemicals	43,778	34,581	50,827	64,389	69,526	48,464
Rubber products	15,940	18,640	6,763	10,641	9,833	5,394
Plastic products	-	-	10,155	13,287	13,847	8,052
Other non-metallic mineral prod	15,163	12,082	10,124	9,735	13,479	16,210
Fabricated metal products	28,658	30,170	13,371	12,607	16,827	18,521
Machinery, except electrical	14,879	14,056	10,485	10,550	10,624	6,121
Total manufacturing	**535,802**	**627,593**	**308,988**	**375,374**	**434,889**	**293,861**

Source: UN COMTRADE

Total manufacturing production shrank from an annual average of $535.8 million during the period 1989–1991 to $293.9 million in 1998. Food production was the hardest hit. The value of production increased at the start of liberalization, from $67.2 million in 1998 to a high of $218.4 million in 1992. However, since then food production consistently declined and reached a low of $26.1 million in 1998. Production of textiles dropped to their lowest levels in 1998. The levels of production had been declining since 1994 from a high of $93 million in 1993 to $13.5 million in 1998. This resulted in the eventual closing down of the David Whitehead and Sons textile mill in 2002.

The production of beverages fared better, reaching $78 million in 1998 from $13.8 million in 1988. The other products in which production increased after liberalization were industrial chemicals, other chemicals, plastic products and fabricated metal products. However, their production levels have since been declining. .

This disappointing performance stems from a variety of factors, including macroeconomic instability that was due to economic mismanagement and weak infrastructure. During the mid-1990s, fiscal mismanagement triggered inflation. This had a negative impact on the manufacturing sector. Borrowing to expand production became expensive and a number of small businesses were forced to close down. Even imports of machinery, which had picked in 1997 to $207 million from $156 million in 1989, fell to $161.9 million in 2001.

Malawi's economic performance following liberalization has been mixed. Between 1990 and 2002, its GDP grew at an annual average rate of 3.2 per cent. However, in 2001 growth was below 2 per cent, and in 2002 the economy shrank. Key to the dismal performance in 2001 and 2002 was the deteriorating manufacturing sector. Between 1993 and 2003, the sector declined on average by 2 per cent per annum. In 2002 the sector declined by 11.4 per cent, thereby reducing its share in GDP to 9.9 per cent.

3.4. Development impact of trade liberalization

Malawi suffers from poor statistics on key development indicators such as employment. However, the available statistics show that life expectancy has declined significantly. This is mainly due to HIV/AIDS and not to trade liberalization. Of course, trade liberalization has not assisted in creating the wealth that will enable people to have a balanced diet and afford to buy essential medicines. The illiteracy rate has declined due to the introduction of free primary education. However, this has been followed by a drop in the quality of education due to a higher student–teacher ratio and to the hiring of untrained schoolteachers.

Trade liberalization has not had a significant impact on Malawi's economic development. The country remains one of the poorest in the world and the poorest in Southern Africa.

Box 2. Key development indicators, 1988–2001

1988 1991 1998 2001

Life expectancy45.8344.08 38.54 37.82

Adult female illiteracy rate (% of ages ≥15 yrs)65.5763.76 53.49 52.43

Adult male illiteracy female (% of ages ≥15 yrs) 32.2431.20 25.54 24.99

Source: World Bank, *World Development Indicators* (various years)

4. Policy lessons and implications

Malawi's record of economic reforms has been mixed, although some significant headway has been made during since 2000. The slow rate of progress in reducing existing economic distortions may explain the country's weak growth record. The poor quality of the infrastructure of services and utilities adversely affects exports. High transportation costs will continue to limit Malawi's exposure to international competition.

An important aspect of Malawi's trade reform agenda is resolving the problem of overlapping membership in regional trade arrangements (RTAs). The country's membership of both SADC and COMESA produce distorted incentives and bureaucratic problems as a result of the possible adoption of inconsistent obligations. With the introduction of free trade areas by both regional blocs, with different initial tariff structures and rules of origin, Malawi's trade with other members (such as Zimbabwe and Mauritius) are governed by competing conditions. Existing bilateral agreements compound the problems. Differences in external tariffs among the countries provide perverse incentives for trade and opportunities for rent-seeking.

Based on the direction of trade, Malawi trades more with SADC member states, while COMESA's role in Malawi's external trade is insignificant. Malawi could therefore work towards improving market access in the major SADC economies (Mozambique, South Africa, Zambia and Zimbabwe). This could be done by ensuring that the SADC trade protocol is implemented and by accelerating the transition towards a SADC customs union, since Malawi's external tariffs are already lower than those of the Southern African Customs Union (SACU).

Malawi's trade liberalization programme has, in general, been appropriately sequenced and has produced an open and transparent regime. The emphasis placed on eliminating non-tariff barriers has exposed domestic industries to international competition, but has failed to improve the capacity of domestic firms to compete. Concurrent measures to find alternative sources of tax revenue have enabled the reforms to proceed without major policy reversals, thus increasing their credibility. However, new taxes have prevented consumers from benefiting from lower tariffs.

The regional trading arrangements provide one mechanism for reducing trade barriers between Malawi and its neighbouring countries. However, it will be important to ensure that external tariffs are reduced alongside intraregional tariffs to avoid costly trade diversion, and that Malawi's obligations under the SADC trade protocol and COMESA are made mutually consistent. Participation in multilateral initiatives has the potential to increase the transparency and predictability of policy, but Malawi's bindings under the WTO were set at rates that were much higher than the applied tariffs, and thus leave substantial scope for maintaining a policy stance that is economically distorting and inefficient.

Overall, Malawi has not been able adequately to exploit the opportunities provided by lower tariff and non-tariff barriers, or the bilateral and multilateral agreements for market access, because of weaknesses in its productive capacity. This has meant that it has not been able to fully exploit the non-reciprocal market access provided by South Africa. The contraction of output in industries that were previously protected has not been offset by a corresponding development and growth of export industries; exports have continued to be concentrated in a few agricultural commodities. There is need for comprehensive reforms to tackle supply-side constraints and other bottlenecks, including high transportation costs and poor infrastructure.

Malawi's trade continues to be restricted by some remaining structural weaknesses. These have in the past included relatively high transport costs, associated with its landlocked situation, compounded by poor security conditions in neighbouring countries and oligopolistic practices. Greater competition in transportation should reduce these problems. However, haulers' charges are still high, reflecting inefficiencies in Malawi's industry and restrictions in the region on third-party carriers as well as low volumes.

5. NAMA negotiations

Malawi stands in stark contrast to a number of other developing countries because, as a least developing country, it has preferential access to most markets. However, it faces an enormous task in coping with the negotiations on Non-Agricultural Market Access (NAMA) set out in the Doha work programme. In many of the areas of the Doha Ministerial Declaration, and indeed in the July 2004 framework agreement, there is need for careful analytical work to identify the policy issues and where Malawi's interests lie. Such an analysis needs to be based on a solid empirical foundation that accurately reflects local polices and practices in Malawi.[6]

5.1. July framework agreement

Annex B of the July Decision provides the key elements that have to be negotiated through NAMA in order to fulfil the Doha mandate.In this new phase of the negotiations, it is important to concentrate the work of the NAMA negotiating group on the level of ambition to be achieved, and to establish different ways to achieve this objective.

The July framework agreement on NAMA is not specific; it merely outlines initial elements for future work on modalities. Indeed, for Malawi, there is need to address modalities in the NAMA negotiations. It is widely recognised that a non-linear formula is the core element of the negotiation. ***A***t the same time, it is acknowledged that developing Members need some room for flexibility. The result of the negotiations should provide developing countries with alternatives to enable them to address their differences in sensitivities (over the extent of the tariff cuts) without undermining the overall level of ambition. In line with paragraphs 6 and 9 of Annex B of the July Decision, Malawi will be exempted from this approach. However, considering its membership in SADC, which includes other developing countries, Malawi should actively participate in the negotiations bearing in mind that

[6] Country studies could expand on work done by Laird et al (2003) and Fernandez de Cordoba et al (2004a and 2004b).

SADC may move towards a customs union sooner rather than later, and that it is also negotiating an Economic Partnership Agreement with the European Union together with other developing countries.

Malawi should support an approach that would:

- Provide developing countries with appropriate flexibility in choosing the conditions for liberalization, while ensuring that the burden of commitments is evenly distributed among them.
- Provide different alternatives to deal with specific sensitivities of developing countries, which would increase the probability of reaching an agreement.
- Allow less than full reciprocity and special and differential treatment (to enable addressing the costs of adjustment resulting from a loss of preferences).

Under all approaches, Malawi will end up making greater cuts in its bound tariffs and will face greater proportional increases in imports. A formula approach would seem best to address Malawi's needs for improved access to major markets, given its lack of bargaining power. However, it would be necessary to analyse which formula will be the most suitable. For, example Malawi might support the one that allows the reduction of tariff escalation and tariff peaks on products of export interest to it, such as tobacco products, wood and wood products, and plastic products.

A non-linear formula with two coefficients (one value for developed country Members and another for developing country Members) that would provide Members with a certain degree of flexibility with regard to how they fulfil the Doha mandate in the context of the NAMA negotiations will best serve Malawi's interests. The level of ambition provided by the formula, as expressed by the two coefficients, will be subject to further negotiations with the objective of fulfilling the ambitious mandate for the NAMA negotiations established by Ministers at Doha.

The formula should:

- Ensure a substantial reduction of peaks, high tariffs and tariff escalation by application of a Swiss-type formula where the coefficient establishes a maximum level of tariffs;
- Incorporate the concept of less than full reciprocity of the Doha mandate by using a modified Swiss formula with two coefficients, one for developed countries and the other for developing-country Members; and,
- Give members flexibility in deciding how to shape their contribution to the overall result through a concept of credits.

The formula should give developed-country Members credit for participation in all sectoral tariff components of export interest to developing countries. Participation in such components, that eliminate, or lower to an agreed level, tariffs on products of export interest to developing countries, is important in order to fulfil the goal of the Doha declaration of further integrating the developing countries into the global trading system. It is particularly important that members agree on a list of products of export interest to developing-country members, especially the least developed countries, and grant improved access to potential or current export markets for those products.

Malawi will also face greater adjustments involving industrial output and tariff revenue losses. It will require financial and technical assistance to upgrade the quality of some of the industries and design alternative sources of revenue. Malawi will, therefore, require policy space so that it could use tariffs during the adjustment period for industrial development purposes. However, Malawi's commitment under the SADC trade protocol will, in any case, require it to reduce tariffs. Since it is

trading more and more with SADC countries (especially South Africa), its tariffs will be reduced with or without NAMA.

5.2. Special and differential treatment and preference erosion

There is also a need to revisit the limited reciprocity strategy and exemptions from core rules. Special and differential treatment (SDT) should be recast to focus on the poorest countries and on addressing market failures. Existing WTO rules need to be reconsidered from an economic development perspective.[7]

Capacity constraints, implementation costs and priorities differ. There is therefore need for an ex ante analysis of benefits and costs, direct (administrative) costs, and considerations of the sign and size of net economic impact. The current system of using transition periods for SDT is an inadequate response. Instead there should be greater differentiation between countries. Rather than continue to focus on the existing proposals made to date, a new approach and new thinking should be introduced. Under the new approach, WTO rules should be reconsidered from an economic development perspective. For example, countries should consider moving towards greater country differentiation as part of a new framework for SDT. This should aim at identifying options that will make a real difference in terms of development outcomes, focusing explicitly on the needs of the poorer countries.

The General Council Decision adopted on 1 August 2004 calls for "... special attention to be given to the specific trade and development-related needs and concerns of developing countries ...", which include preferences, both in the agriculture and NAMA negotiations.[8]Furthermore, Annex B of the same Decision is more explicit in terms of what is expected from the negotiations with regard to preferences.

Trade preferences have played a crucial role in Malawi's trade. Paragraph 16 of Annex B recognizes that member countries receiving non-reciprocal preferences may face challenges as a result of the NAMA negotiations. Non-reciprocal preferences under the GATT have been cemented by the principle of SDT for developing countries and LDCs, which has evolved over time and remains an important part of the WTO legal framework.SDT in preferential tariff margins, has been realized by the principle of less than full reciprocity in Part IV of the GATT's Enabling Clause on exceptional circumstances which warrant a waiver of the MFN Principle of GATT Article 1.1, and other relevant circumstances in tariff negotiations, including fiscal, developmental and strategic.

Even though preferences are covered by a narrow range of tariff lines, they have made a positive impact on Malawi.For example, AGOA and non-reciprocal trade agreements with the EU and with South Africa have boosted clothing and textile exports from Malawi by attracting investment, creating employment and promoting diversification through the establishment of clothing and textile industries. This preferential initiative has also triggered upstream processing activities, with an enormous impact on poverty alleviation efforts. Additionally, Malawi has benefited from preferential exports to the EU market of such products as sugar, paper and leather goods, textiles and clothing.The phasing out of import quotas for clothing and textiles is a concern for Malawi. Its exports will face intensified competition, particularly from China, resulting from the termination of the Agreement on Textiles and Clothing as of 1 January 2005.

Malawi depends on non-reciprocal preferences for a large number of its exports; any further liberalization must take into account the negative impact on its already weak industrial base. In the NAMA modalities, reductions of MFN rates will reduce the preferential margin, with negative effects on Malawi's trade flows. Since the country relies on non-reciprocal preferences as a development tool,

[7] Hoekman, Michapoulos and Winters(2003) presents new ideas on implementing SDT.
[8] Paragraph 1(d) of WT/L/579, 2 August 2004.

any reduction of such preferences implies increased competition in its traditional export markets.Consequently, the resulting adjustment costs will disrupt the sequencing necessary for its further growth and industrialization. Therefore, Malawi's loss of preferential tariff margins, will need to be compensated by additional support to meet its trade and development needs.

There is general agreement that preference erosion is not inconsequential, but a matter of serious concern, the more so as it is a problem facing the weakest and the most vulnerable Members of the WTO. Thus the issue of preferences should be addressed as part of the NAMA negotiations, as well as in the overall Doha package.

The biggest challenge for Malawi lies in the formulation of strategies to help firms adjust to global competition. Government policies will play an important role in the adjustment process.[9] A key responsibility of the Government is to ensure that firms are given the "right" incentives to induce investment in activities in which Malawi has a comparative advantage, and to assist in facilitating adjustment to technological changes and policy shocks. The strategy should aim to overcome market failures and other distortions that may increase the cost of adjustment.

Consistency of government actions is a key factor in stimulating adjustment. If firms do not believe that the Government is serious about liberalization or if the Government pursues other policies that make the sustaining of reforms difficult, firms may choose not to adjust. Instead, they might lobby to overturn the reforms.

6. Negotiating capacity

6.1. Constraints on effective participation

Malawi cannot effectively participate in the NAMA negotiations due to its limited capacity both in Geneva and in the Ministry responsible for trade. It lacks the appropriate knowledge, technical skills and resourcesto negotiate effectively, implement trade agreements, meet ongoing trade obligations and defend its trade-related rights.This limits its ability to shape and to comply with the growing number of technical provisions and environmental, health, safety and product quality standards of the various multilateral and regional trade agreements.

These constraints are a product of small staff, limited resources for hiring and training, inadequate experience and high turnover. Malawi has fewer than three senior officials assigned to work on multilateral, regional and bilateral trade policy issues on a full-time basis. The Ministry of Trade has difficulty recruiting and retaining talented people for government jobs that typically offer lower pay and status than private sector jobs.

Ideally, Malawi should open a permanent office in Geneva, ensuring that its staff have the requisite skills to defend national interests at the WTO. This should be complemented by an equally qualified staff in the capital with the appropriate technical, legal and policy-making skills to provide support to the delegation based in Geneva.

6.2. Strengthening the capacity of the Trade Policy Department

The first step towards dealing with the Doha Work programme is to increase the capacity and functions of the Trade Policy Department within the Ministry of Trade. There are still problems in the way the department responsible for international trade is set up. To play an effective and influential role in the WTO, positions should be enunciated and well reasoned. This in turn requires a domestic

[9] See Hoekman and Beata Smarzynska Javorcik (2004) on policies for facilitating firm adjustment.

process for the formulation, preparation and submission of documentation that is streamlined with a clear demarcation of responsibilities between the Trade Ministry, the representative office in Geneva, and other competent ministries and affected bodies in the capital. At present, arrangements for dealing with WTO matters are characterized by unclear lines of communication, inadequate systems for including stakeholders, and a general lack of resources.

6.3. Implementation issues

An important issue for Malawi is the implementation of WTO agreements. It is common knowledge that WTO rules are often based on those prevailing in developed countries. Implementing them in Malawi will require substantial investment in the strengthening of institutions. There is need to ensure that WTO rules are useful to the country and that they be implemented consistently with a country's development strategy. It is for this reason that Malawi should ensure progress is made in negotiations on SDT. The outcome of the SDT negotiations will have a significant bearing on how Malawi implements whatever is eventually negotiated under NAMA.

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