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Policy Backgrounds

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Agricultural Policy Reforms in Malawi

Hardwick Tchale, Franklin Simtowe and Osten Chulu¹

1.0 Introduction

This paper outlines the policy reforms in the agricultural sector of Malawi following the country's adoption of the Structural Adjustment program. The performance of the Malawian agricultural sector is currently influenced by policy reforms mostly adopted during the period of 1990–96. Although the impacts of some of these policies have been discussed in other research and evaluation reports, the analyses underlying the assertions made in these earlier reports were in general not rigorous and have tended to ignore multiple confounding factors. This paper highlights some of the major policy questions in need of further analysis in order to facilitate the assessment of policy impacts and to advise policy makers on alternative policy decisions or implementation approaches. These are covered in the last section on conclusions.

The paper starts with an outline of the structure of the agricultural sector and a decomposition of the contributions made by the small and large scale sub agricultural sectors to the country's agricultural gross domestic product (GDP). The sections following present the actual reforms that have been implemented in the agricultural sector since the late 1980s to the present. Both micro or farm level policy reforms and market level, land policy and national food security policy reforms are presented.

2.0 Structure of the Agriculture Sector in Malawi

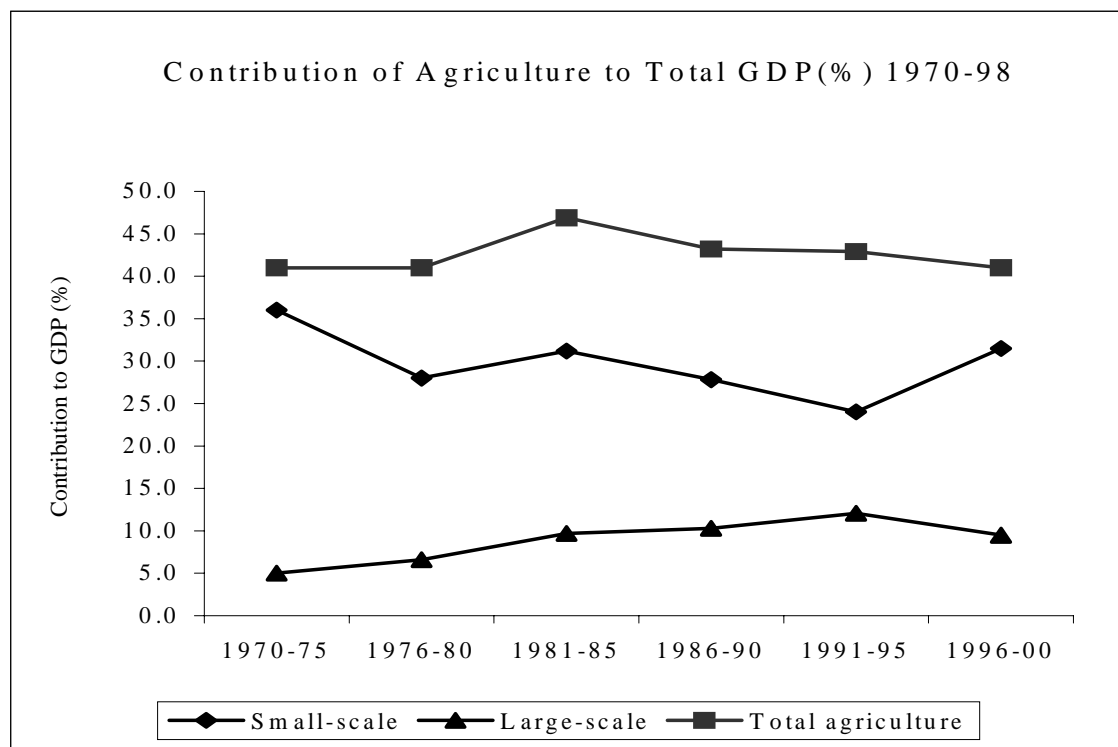
Malawi's agriculture is composed of two main sub-sectors: the smallholder farmers and the estates. Smallholder farmers comprise an estimated 2 million farm families. They cultivate about 4.5 million hectares under the customary tenure, where they produce about 80% of Malawi's food and 20% of the agricultural exports (World Bank 1995). Smallholder production is characterized by low input/low output production and low resource endowment. It is estimated that 25% of the smallholder farmers cultivate less than 0.5 hectares on average; 30% cultivate between 0.5 and 1.0 hectare; 31% cultivate between 1.0 and 2.0 hectares; and 14% cultivate more than 2.0 hectares.

The estate sub-sector encompasses farms that occupy leasehold or freehold land. In order to have an estate status, it was required that a farm has a minimum size of 10 hectares. In the 1970s, when there was a deliberate policy to encourage estate registration, the number of estates increased by 63 fold from 229 in 1970 to 14,335 in 1989 and the total area increased almost tenfold from 79,000 hectares to 759,400 hectares during the same period. The estate sub-sector is the nation's principal foreign exchange earner. While it contributes only about 20% of the total national agricultural production, it provides over 80% of the agricultural exports mainly from

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tobacco, sugar and tea and to a lesser extent from tung oil, coffee and macadamia (Ng'ong'ola 1996).

Figure1: Agricultural contribution to GDP: Small-scale versus large-scale farmers



Source: Own calculations based on data collected from Economic Reports of various years

Throughout the 1970s, 80s and early 90s, the growth in the estate sub-sector has been markedly faster than in the smallholder sub-sector (except for the years of 1976, 1978, 1984 and 1991). The share of the estate sub-sector in total agricultural gross domestic product (GDP) has been rising steadily from about 13% in the early 1970s to over 20% in 1998. During these past 25 years, the estate sub-sector has been contributing to over 60% of the growth in the agricultural sector (see Figure 1 for relative growth of small-scale versus estate farming). Smallholder sub-sector growth rates have been low averaging about 4% between 1973 and 1980, and 2% between 1980 and 1992 (World Bank 1994a; Ng'ong'ola 1996).

3.0 Agricultural Policy Reforms in Malawi

Malawi's agricultural development has always been defined by the dual nature of the sector. The country's agricultural policy during the pre-liberalization period tended to favor the minority estates at the expense of over 2 million of smallholder farm families and tenant labourers (Sahn and Arulpragasam 1991). In an attempt to redress this situation and improve the living standards of the majority of Malawians, the Government of Malawi began in 1981 to implement economy-wide policy reforms aimed at improving the policy environment and correct other macro-

economic imbalances. In the agricultural sector, special attention was given to regulations and policies with negative impact on smallholder participation in the national economy and in the privatization of government functions within the sector.

3.1 Micro / Farm level agricultural policies

Malawian agricultural policies have generally gone through a number of reforms following the country's adoption of the Structural Adjustment Programs (SAPs)² in 1981. The policies have evolved from government control oriented, such as the allocation of production quotas and crop restrictions and provision of input subsidies, into one of total government deregulation, with a complete removal of farm input subsidy and a liberalization of the agricultural market.

3.1.1 Crop Allocation and Production Quotas

Policies prior to 1990/91 restricted the production of burley and flue-cured tobacco to the estate sub-sector. The estates were issued licenses and production quotas on an annual basis by the Ministry of Agriculture. The quotas were based on the annual production targets issued by the Tobacco Exporters Association of Malawi (TEAM) to the Tobacco Control Commission (TCC).

In 1990, a Smallholder Burley Scheme was initiated under which licenses were allocated to smallholder farmers to grow burley tobacco on customary land. The objective of the scheme was to enhance smallholder access to diverse sources of income generating activities as a way of reducing poverty. The scheme was supported by the amendment, in the same year, of the Special Crops Act.

In line with the repeal of the Crops Act, the Government of Malawi has since 1990 allocated an increasing share of the national tobacco quota to smallholder farmers. This even includes burley, a long time estate crop. The quota is offered to farmers who organize themselves into clubs. Members of tobacco clubs obtain improved access to credit and extension packages. They also have access to the Auction floors. Farmers are also allowed to sell to estates and intermediate buyers (since 1993). These policy changes have resulted in a rise in smallholder farmers' access to the auction market from 10,000 in 1990 to about 55,000 in 1995.

Furthermore, policy changes have boosted tobacco production by smallholders in general. Smallholder aggregate tobacco production experienced a rapid increase in the 1990s. In 1995 the total smallholder tobacco production was estimated at 35,438 tones, which was an increase of 24.4% over the 28,477 tones produced in 1993 and an increase of 128.5% over the 15,507 tones in 1994. The rise in tobacco output was attributed to the increased production of smallholder

² The Malawi government under the auspices of the World Bank and the International Monetary Fund (IMF) embarked on SAPs in 1981 in order to address both domestic and external economic imbalances. The objectives of the SAPs were to provide incentives for stimulating production of tradable goods, for rationalizing government tax base and expenditure and for strengthening key sectors and institutions. So far more than seven Structural Adjustment Loan facilities have been adopted, i.e., SAL I (1981); SAL II (1984); SAL III (1986); ITPAC (1988); ASAC (1990); ASAP (1991); etc.

burley tobacco by 255% to 20,759 tones and the increased production of northern division dark fire tobacco by 69% to 12,419 tones.

Currently, as a result of the policy changes, tobacco is the most widely grown crop after maize, covering more than 150,000 hectares. Since smallholder farmers were permitted to grow tobacco, the total crop output has nearly doubled and Malawi now accounts for about 20% of the total world production of the crop (Keyser 1997).

The tobacco industry supports a population of 1.1 million, mostly in the rural areas where approximately 250,000 laborers and 282,000 tenants are employed by the tobacco estates. In 1997, a total of 157 million kilograms of all types of tobacco were sold with an estimated revenue of US\$249 million. The 1998 sales/ revenue was an increase of about 11.4% over that of the previous year.

This underscores the importance of tobacco both for the livelihood of the rural masses as well as to the economy as a whole. The massive increase in burley production is a result of a relaxed policy environment that now allows smallholders to grow burley tobacco.

3.1.2 Farm Inputs and Subsidies

Fertilizers and hybrid seed for the smallholder sub-sector were subsidized up until the early 1990s. Following the commitments under the Agricultural Sector Assistance Credit (ASAC), the government adopted a process of phasing out the subsidies. The commitments under the ASAC were that the overall subsidy rate on fertilizers was not to exceed 30% in 1990/91, 25% in 1991/92, and 20% in 1992/93, while total subvention as a proportion of total government expenditure was not to exceed 2%, 1.6%, and 1.3% in 1990/91, 1991/92, and 1992/93 seasons respectively.

The government had also agreed in principle to eliminate all subsidies on hybrid maize seed during the 1994/95 season. Only the poorest farmers were to be provided with free seed and fertilizer under the Drought Recovery Program during the 1994/95 agricultural season. The removal of subsidies has been effected through the Fertilizer Subsidy Removal Program (FSRP) with the target for complete removal of all subsidies being the 1995/96 season.

The Agricultural Development and Marketing Corporation (ADMARC) still remains as the main organization that distributes fertilizer and hybrid, composite and improved local varieties of seed to smallholder farmers. Most of the fertilizers to the estate sub-sector are supplied by private companies through direct imports or from a limited number of private local companies, e.g., OPTICHEM and Norsk Hydro.

The supply of seeds and agrochemicals originates in the private sector. The National Seed Company (NSCM), where Cargill International holds the majority share, is the main supplier of certified hybrid tobacco and maize seed, of which 90% are then distributed by the ADMARC. The government liberalized the production and marketing of hybrid maize seeds in 1993/94, however the market remains far from being competitive.

Table 1: Fertilizer value: cost ratios and utilization among smallholder farmers

Year	VCR local maize	VCR hybrid maize	Nutrient utilization (tones)
1980/81	1.94	3.31	15,800
1981/82	3.28	5.57	13,900
1982/83	2.43	4.14	17,000
1983/84	2.40	4.11	17,800
1984/85	2.07	3.54	21,200
1985/86	1.73	2.95	19,900
1986/87	1.71	2.93	22,200
1987/88	1.86	3.17	28,200
1988/89	2.41	4.11	36,000
1993/94	1.80	2.10	-
1994/95	2.50	2.90	-

Source: Sahn and Arulpragasam, 1991, and unpublished Ministry of Agriculture data.

3.1.3 Credit Policies

The Smallholder Agricultural Credit Administration (SACA), a government organization established in the MoALD in 1988 was the only agency involved in supplying smallholder credit through farmers' clubs. The loan recovery was among the highest in the third world. But that changed especially during the Multi-party era in 1993/94 season. SACA was then phased out around the same time. In its place, the Malawi Rural Finance Company (MRFC) was established as a limited liability company to overcome the low recovery problems experienced by SACA, thereby eliminating heavy dependence on government support and accelerating the privatization of the rural credit system. The second phase targeted at the privatization and transformation of MRFC into a rural bank. MRFC has a line of credit component to finance mostly short-term credit over a three-year period. The main market niche is for the smallholder farmer through the farmers' club, small estates, and micro-, small- and medium-scale enterprises (MSMEs) with an average annual turnover of up to MK500,000.

The government and IFAD finalized the design of a Malawi Mudzi Financial Services Project (MMFSP) for financing developmental costs related to group formation and training. MRFC manages a credit window designed for this group having compensation and insulation from the inherent risk of lending to the resource-poor households.

3.2 Agricultural Market Policies

In Malawi, agricultural marketing has been dominated by the Agricultural Development and Marketing Corporation (ADMARC), a government parastatal which replaced the Farmers Marketing Board in the 1970s. ADMARC has been responsible for distributing fertilizer and the hybrid and composite seed varieties especially to the smallholder farmers. The other responsibilities of ADMARC include managing the country's strategic reserves of maize and

defending a set price band for maize. Even though agricultural produce markets were liberalized, ADMARC continues to play a dominant role especially in the remote areas where private traders do not have a presence (See Table 2 for ADMARC price setting). However, the government is in the process of adjusting the role of ADMARC into a buyer of last resort for staple food crops. A Memorandum of Understanding was reached in 1993 between the government and donor institutions, notably, the World Bank and the IMF.

Table 2: ADMARC Producer Price as % of Free Market Price for Selected Smallholder Crops

Year	NDDF tobacco	SDDF tobacco	Sun/air tobacco	Oriental tobacco	Maize
1981/82	15.5	21.8	16.6	155.5	68.1
1982/83	26.3	34.0	27.3	110.1	58.4
1983/84	38.9	44.3	30.7	45.9	62.2
1984/85	67.7	85.6	79.4	95.5	62.2
1985/86	45.2	41.4	39.1	112.9	49.6
1986/87	29.5	30.2	25.0	43.2	n.a.
1987/88	240.4	22.1	22.6	n.a.	47.4
1988/89	23.5	19.7	27.3	n.a.	n.a.

Source: Ministry of Agriculture Planning Division

Note: Free market = for tobacco, auction floor export prices obtained by ADMARC for maize, domestic local prices.

In response to the liberalized environment, ADMARC has been undergoing several reforms. With the assistance from the USAID, ADMARC has been implementing a divestiture program to reduce some of its inefficient activities. This has resulted in a reduction of its number of market outlets by 125 from a total of over 1000. Currently there are proposals to completely commercialize all the activities of ADMARC as a way of removing the fiscal pressure ADMARC imposes on the government treasury.

Currently ADMARC operates alongside private traders in both the input and output markets. However, it still maintains a monopoly given its extensive market infrastructure compared to the private traders.

3.2.1 Smallholder Fertilizer Procurement Policy

Until the liberalization of the agricultural inputs market, the procurement of smallholder fertilizer was the sole responsibility of the Smallholder Farmers Fertilizer Revolving Fund of Malawi (SFFRFM). Fertilizer for estates was and still is procured by commercial companies such as Norsk Hydro and Optichem. SFFRFM has been responsible for managing the fertilizer buffer stock and facilitating the distribution of the fertilizer provided under commodity aid agreements. SFFRFM used to operate as a separate unit within the ADMARC, but was later transformed into

a trust corporation under government control in 1988. SFFRFM fertilizer imports have increased from about 80,000 tones in the late 1980s to over 135,000 tones in the 1990s. Currently, SFFRFM is undergoing changes operationally as a result of the changes in the policy environment. There are proposals to commercialize its activities, as was the case of its former parent company ADMARC.

Under the Agricultural Sector Assistance Credit, released as part of the SAPs in the late 1980s, it was decided that a 5-year projection of fertilizer requirements as well as operational guidelines for the management of the buffer stocks would need to be prepared. In addition, the government was to continue reducing the subsidies and facilitate private sector participation in the marketing of fertilizers. In 1993, the government finalized and publicly announced its policy to open up smallholder fertilizer markets to the private sector. As a result, members of the public were allowed to purchase fertilizers from SFFRFM on the wholesale market and then to resell them to farmers on the retail market.

3.2.2 Tobacco Marketing

In Malawi, tobacco marketing is still controlled or regulated by the Tobacco Control Commission (TCC), a government statutory body. The TCC was established in 1938 by the Minister of Agriculture under the control of the Tobacco Auction Floors Act Cap. 65.03. The TCC keeps a register of all tobacco growers and is financed by the tobacco growers through a levy on the auction floors. This body is responsible for all aspects of tobacco marketing, from organizing and supervising auction sales for all types of tobacco (except oriental) to issuing licenses to auction floors and buyers, including the allocation of quotas to growers. The TCC also regulates the packing arrangements for tobacco.

The key buyer countries of Malawi's tobacco are, currently, the United States, Switzerland, Germany and the Netherlands. These countries together purchase 40% of all tobacco produced in Malawi. Recently however, it has become evident that the export market for Malawi's tobacco is under threat from the following new market circumstances:

- Strong anti-smoking campaign especially in the US and western Europe;
- The rising number of litigations in the US against tobacco manufacturers;
- The reduction of American buffer stock from three years to eighteen months, leading to an oversupply in the world market;
- The Asian financial crisis that has reduced market demand for tobacco and other goods;
- Increased consumption of blended cigarettes; and
- The increasing share of multinational tobacco companies.

Malawi's total tobacco production is currently estimated at 90 million kilograms against a total demand of 140 million kilograms estimated by the Tobacco Exporters Association of Malawi (TEAM). Two factors are believed to explain this gap between the supply and demand. The first is the fluctuating and lower than average price price-setting that discourages production. Related to this is the limited effective demand for fertilizers due to limited access to credit for financing tobacco production.

3.3 Land Reform Policies

Until recently, there had not been a comprehensive policy on land ownership, land use, management, control and transmissibility. However, there was an attempt to formulate a policy for customary land. The motivation was the concept that customary land would impede development. As a result, a program aimed at privatizing customary land was developed. First there was a systematic adjudication and registration of land rights, then customary land was converted into leasehold land. Under the Land Act, leasehold land would be privately owned as farms by people prepared to pay leases. The land leases were given for 21, 66 and 99 years depending on the nature of the proposed development. Under the first concept of adjudication and registration of land rights, a Customary Land Development and the Registered Land Act were formulated. Since then Malawi has three main land tenure systems: customary, public, and private. Within the private tenure, there is a division between the leasehold versus freehold systems.

These programs triggered the conversion of extensive areas of land from being smallholder owned into estates owned. Starting from the early 1970s, the estate sub-sector has experienced tremendous growth and a large percentage of land supposedly suitable for arable agriculture was alienated to estate sector. Combined with the pressure from population growth, land has become increasingly scarce to smallholder farmers. This is in contrast to the large tracts of land that are left uncultivated in the estate sub-sector. Due to the lower land rents that land owners in the leasehold sector pay to the government, now at about MK50 per hectare per year, estates have the liberty to keep large tracts of land. This is even exacerbated by the lack of enforcement to pay land rents. As such Malawi has experienced a number of land disputes between the smallholder farmers and the estates involving the encroachment of public/protected areas or reserves as well as private estate land. Recognizing this problem, the president appointed a commission of enquiry on land reform. Its mandate was to examine, with the help of the communities, the possibility of instituting a land reform policy. The commission has since finalized its work but a comprehensive policy on land reform is still to be formulated. One of the proposed approaches of increasing land productivity has been to revise the land rents to reflect the true economic value of this scarce resource. This is justified on the premise that land for which rent is not paid is appropriated by the government and distributed to other estates or transferred to the customary tenure for distribution to smallholder farmers. Given the large potential administrative costs involved in such a proposal, the government needs to do a thorough economic analysis of such a land reform policy.

3.4 Food Security Policy

Food Security in Malawi has often been equated to the production of maize, the country's staple crop. Until very recently, efforts at addressing food security in terms of research and extension had focused mainly on maize. Maize production takes up over 70% of the cultivated land. Since 1990, total maize output has averaged 1.3 million metric tones against a total requirement of 1.38 million metric tones (Government of Malawi 1996). During the years of 1991/92, 1994/95 and 1997/98, when the country went through droughts, the average production of maize dropped to a

mere 0.65 million metric tones. Apart from droughts, the output level is also highly impacted by the large proportion of land allocated to producing low-yield local varieties³. Based on a sixteen year average over the period of 1982–99, the data show that more than 80% of the smallholders' arable land was allocated to producing local maize, 15% to hybrid maize and the rest to composite varieties.

Over the last two agricultural seasons, the government with the support of donors has put in place targeted production and input support programs. These programs include the Agricultural Productivity Investment Programme (APIP), the Starter Pack Initiative (SPI), the Sasakawa Global 2000 Program and the Supplementary Input Programs. These programs, coupled with the generally good weather conditions, have given Malawi output surpluses in the past two seasons, after years of food deficits.

In order to ensure food security, Malawian government has retained some control over its maize market. This is due to a key feature of the grain market liberalization in Malawi – a general increase in maize prices – which produced ambivalent effects on the food security for smallholders the majority of whom are both producers and purchasers of maize. The rising consumer prices of maize have eroded the purchasing power of net purchasers, among the urban population as well as the rural poor smallholder farmers. Thus, in order to cushion against any likelihood of maize stock shortfalls in the country, one of the major government undertakings in the area of food security has been the establishment of the buffer stock and the Strategic Grain Reserve (SGR) scheme. The intention of the government is to store about 180,000 metric tones of maize – capable of providing a lead-time⁴ of about three months – the length of time required to import maize from abroad. An additional objective has been to stabilize the maize buyer and seller price. This is done by setting and protecting a maize price band or buffer. The government has recently formed the National Food Reserve Agency (NFRA) that has taken the responsibility to oversee all government maize stocks and price stabilization programmes. Besides drought relief programs, NFRA is mandated to purchase or sell maize whenever the maize price falls outside the band. It is supposed to operate purely on a commercial basis without government subsidy.

The Draft Policy Statement on the operations of the NFRA notes that although the pricing of all other agricultural commodities has been completely de-regulated, maize pricing shall continue to be governed via the price band. The band is intended to send clear signals to the private sector that there will be no intervention to inhibit the importation or exportation of maize. The band is set as follows: the ceiling price is equated to the prevailing landed cost (import parity price), plus

³ There are a lot of hybrid varieties that have been developed in and adapted for Malawi. However, the adoption rates are still low because of the increase in the real prices of these hybrids and the accompanying inorganic inputs. The increase in the real prices of improved technology is as a result of the policy reforms under SAPs. Along with the agricultural liberalization policy, the Malawi government also floated its foreign exchange regime and removed the input subsidy. This meant that input prices were subjected to changes in the value of the domestic currency relative to the US dollar especially that Malawi most of its inorganic inputs. Smallholder farmers have not coped with the input subsidy removal because they are having to face input prices that respond almost instantaneously to exchange rate changes against output prices that take a considerable lag to respond to the same changes.

⁴ At the time of design of the SGR, this corresponds to an adequate amount for national consumption and also is enough time for the country to import maize from abroad.

a 20% margin to cover the distribution costs; the floor price is equated to the export parity price less a 20% margin to cover the distribution costs. The exporting and importing of maize is no longer subject to any licensing procedures. NFRA is supposed to review the band every three months to have it reflect any changes in border prices.

Despite the critical role that this set-up plays, critics have pointed out that the price band is not justified in a liberalized environment where even the prices of inputs are completely de-controlled. In addition, the administering of the price band entails fiscal commitments that take away governmental resources for socio-economic development.

3.5 Proposed Safety Net Policy

In line with ensuring food security particularly for the vulnerable groups without the capacity to cope with a competitive environment, the Malawi government has been pursuing a number of safety net programs. Examples of these safety nets include the food-for-work programs, the public works programs implemented through the Malawi Social Action Fund and the more recent Starter Pack Initiative implemented with funding from the European Union and the World Bank.

The major arguments regarding these safety nets have centered on issues of sustainability and, in particular, the fact that most of them are implemented by individual institutions without any regulatory effect from the government. As such the government is putting together a safety net policy that will give the government some regulatory role in the implementation of all safety net programs in the country. The proposals put forth in the policy include an expanded public works program, a targeted inputs program (as opposed to a wholesome program implemented under the SPI), and the use of vouchers in input programs, as opposed to direct distribution of the inputs by the government or other implementing institutions.

4.0 Conclusions

The impacts of the agricultural policy reforms on the farming communities have been mixed. While some level of market competition has been induced along with a greater variety and choice of crops to grow and markets to sell them in, there appear to be negative impacts among the vulnerable households that have little capacity to take advantage of the market and price improvements. Among them are the resource poor smallholder farmers. These segments of the population need assistance to engage themselves in the mainstream economic activities. As such, the country needs a safety net policy of some sort. However, there is still a lot thinking necessary to determine a most effective and efficient way to approach the issue. With this paper, the authors hope to have contributed to such an undertaking. The following are a number of policy issues in need of further analysis to provide the basis on which a safety net policy proposal can be evaluated:

- What would be the impact of a targeted program, vis-à-vis the wholesome program currently being implemented, on food security?

- Is the starter pack better than direct government subsidy on the price of intermediate inputs in terms of food security and the government budget?
- What is the impact of the starter pack program on the development of the agricultural input supply sector, i.e., direct government involvement versus the use of vouchers?
- What is the impact of an expanded public works program on rural income and employment provision?
- Can the SPI be sustained without donor support? How can the government raise the total cost of the SPI without donor support?

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Appendix

Table A1: Summary of the farm and market level policy reforms in Malawi

Policy Reform	Progress/Status
1. Farm Level Policies	
Product quotas	Only tobacco production is restricted through a quota system Smallholders allowed to grow burley tobacco since 1990/91 season
Input subsidies	<ul style="list-style-type: none"> <input type="checkbox"/> Being phased out <input type="checkbox"/> 5% on average for smallholder fertilizer in 1994/95 season and to be completely phased out (0%) in 1995/96 <input type="checkbox"/> Phasing out of seed subsidies starts 1994/95
Credit	<p>Malawi Rural Finance Company (MRFC) established October 1, 1994 and has taken over responsibility for smallholder credit</p> <ul style="list-style-type: none"> <input type="checkbox"/> MRFC charges 40% interest rate <input type="checkbox"/> Commercial banks charge 36% interest rate <input type="checkbox"/> Estate obtain credit mainly from commercial banks
Input distribution	<ul style="list-style-type: none"> <input type="checkbox"/> Production and marketing of maize seed liberalized in 1993/94 <input type="checkbox"/> Import and distribution of fertilizers liberalized in May 1993
Research	<ul style="list-style-type: none"> <input type="checkbox"/> High yielding hybrid maize varieties (MH17 and MH18) developed, and released in 1990/91
Land reform	<ul style="list-style-type: none"> <input type="checkbox"/> Land rents increased from MK10/ha to MK30/ha <input type="checkbox"/> Land Act amended to ban further transfer customary land to estates
2. Market Level Policies	
Parastatal trading	<ul style="list-style-type: none"> <input type="checkbox"/> Divestiture of ADMARC started in 1986 and has stayed on course <input type="checkbox"/> Memorandum of Understanding signed between ADMARC and Government to enable ADMARC operate as a buyer and seller of last resort <input type="checkbox"/> Agricultural produce markets (except for cotton and tobacco) liberalized since 1987 <input type="checkbox"/> Marketing restrictions for cotton lifted in 1991 <input type="checkbox"/> Tobacco marketing liberalized in 1994
Output marketing and pricing	<ul style="list-style-type: none"> <input type="checkbox"/> Private exports of groundnuts, beans & pulses de-controlled in 1994 <input type="checkbox"/> Only maize exports are restricted because of its strategic importance <input type="checkbox"/> Progressive decontrol of produce prices, Government sets only smallholder maize prices
Strategic Reserves and Food Security	<ul style="list-style-type: none"> <input type="checkbox"/> Government, through ADMARC, operates a Strategic Grain Reserve which can hold up to 180,000 tons <input type="checkbox"/> SFFRFM operates a fertilizer buffer stock scheme of 90,000 tons

Source: Ng'ong'ola, 1996.

Table A2: Land Use

'000 ha	1974	1979	1984	1989	1998
Total area	1,848	11,848	11,848	11,848	
Land area	9,408	9,408	9,408	9,408	
Arable land	2,246	2,280	2,320	2,380	
Permanent crops	18	18	25	29	
Permanent pasture	1,840	1,840	1,840	1,840	
Forest and Woodland	4,850	4,750	4,290	3,740	
Other land	454	520	933	1,419	

Source: FAO, 1990.

Table A3: Agricultural Performance Indicators

Indicator	1984	1985	1986	1987	1988	1989	1990	1998
Maize production('000 mt)	1344	1295	1211	1427	1589	1343	1697	1534
ADMARC maize purchases ('000mt)	296	272	113	60	135	231	201	
Tobacco exports (MK mn)	230	176	244	374	475	458	770	9107
Tea exports (MK mn)	113	88	68	61	60	101	109	1141
Sugar exports (MK mn)	29	45	40	64	69	65	77	850
Coffee	4	12	22	20	25	17	28	379

Source: Government of Malawi, various issues.

Table A4: Real Agricultural Prices 1980/81- 1989/90 (t/kg)

Subsector/crop	1980/81	1981/82	182/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Estate										
Flue-cured tobacco	179.0	186.9	152.3	160.0	142.3	163.9	187.9	200.00		
Burley tobacco	232.0	193.2	106.7	123.4	108.8	157.4	187.9	198.5		
Smallholder										
Maize	6.6	9.9	9.0	8.8	7.3	6.6	5.8	6.3	6.8	6.5
Confectionery nuts	33.0	30.3	42.2	42.7	41.4	39.9	35.0	24.1	21.1	18.8
Oil nuts	13.0	12.1	15.2	17.7	25.1	22.8	23.2	20.4	18.8	19.3
Pulses	13.5	12.1	11.0	21.5	23.9	21.6	19.0	15.2	12.4	12.5
Cotton	23.0	29.1	34.2	33.0	27.5	27.0	26.1	20.8	21.8	20.1
NDDF tobacco	59.0	46.6	61.6	63.1	69.4	56.4	57.2	47.2	46.4	36.3
SDDF tobacco	59.0	39.1	54.7	58.4	55.4	39.7	38.7	36.9	35.1	55.1
Sun/air tobacco	59.0	39.7	52.2	52.9	57.5	44.8	36.1	38.7	29.0	43.8
Oriental tobacco	64.5	73.8	67.2	60.5	61.8	51.1	63.5	46.2	30.0	27.8
Sorghum	5.0	4.5	4.1	7.2	7.2	7.6	6.6	5.3	5.1	4.5
Millet	2.0	1.8	3.3	4.3	3.6	3.2	3.2	2.3	2.3	3.9
Cassava	3.0	2.7	2.9	2.9	2.4	2.2	1.9	2.3	2.8	3.0
Fertilizer	21.0	18.8	21.2	20.1	18.5	20.6	18.5	18.6	7.9	8.5

Source: MOA Planning Division

- Notes: 1. Prices are weighted averages for all grades per crop
 2. Nominal prices deflated using Malawi low- income Consumer Price Index
 3. Fertilizer = calcium ammonium nitrate

Table A5: Changes in agricultural yields 1981/82-1987/88 (tonnes/ha)

Subsector/crop	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1994/95	1997/98	1998/99
Estate										
Flue-cured tobacco	1.63	1.58	1.64	1.38	1.54	1.47	1.23			
Burley tobacco	1.18	1.05	1.11	0.96	1.30	1.07	1.10			
Tea	1.83	2.20	1.88	1.83	1.90	1.86	1.52			
Smallholder										
Hybrid maize	2.76	3.11	2.94	2.71	2.67					
Composite maize	1.79	1.75	1.73	1.64	1.20					
local maize	1.04	1.03	0.96	0.95	1.09					
Confectionery nuts	0.35	0.36	0.45	0.49	0.43	0.43				
Oil nuts				0.31	0.49	0.31				
Cotton	0.44	0.41	0.63	0.52	0.41	0.62				
NDDF tobacco				1.36	1.80	2.60				
SDDF tobacco				1.36	1.80	2.60				
Sun/air tobacco				1.50	2.34	2.75				

Sources: Compiled from World Bank, 1990: MOA Guide to Agricultural Production, various years; Government of Malawi: Economic Report, 1998b and 1999b; and UNDP/World Bank, 1990.

Export Agriculture in Malawi: Alternatives to Tobacco

Franklin Simtowe¹

1.0 Introduction

It is generally agreed that in order to achieve sustainable growth and poverty reduction, there must be decreased dependency on tobacco for export earnings, thereby lowering the risk attached to a crop with less than buoyant demand prospects (Jansen and Hayes 1994). Moreover, dependency on one crop has also been discouraged by the World Bank and IMF-supported structural adjustment program since its launching in the country (Mataya and Tsonga 1999). Consequently, there is a need for the development of alternative export crops.

This paper focuses on the opportunities for diversification away from tobacco and the constraints that impede such diversification. Section two of the paper outlines agriculture and its role to the national economy. Sections three and four discuss export agriculture in Malawi and alternatives to tobacco, respectively. The fifth section looks at constraints to diversification and the last section concludes the paper.

2.1 Agriculture in Malawi

Malawi has one of the highest population densities in Africa. This creates tremendous pressure on land, with 56% of the land under cultivation, representing most of the cultivatable land. Agricultural land is divided into smallholdings and estates (tea, tobacco and sugar). Some 1,400 hundred estates cover 9% of Malawi's land area (850,000 ha) of which a third is reportedly under cultivation (Government of Malawi 1997). Malawi's agriculture is therefore highly dualistic, comprising distinct estate and smallholder sub-sectors.

The vast majority of the poor in Malawi are smallholders. Currently, some 1.8 million smallholder families occupy 1.8 million hectares of customary land² while some of the poorest people in Malawi live and work as laborers on the estates (Government of Malawi 1997). Maize is the most dominant crop in Malawi occupying about 70% of the cultivated land in any growing season (Government of Malawi 1999). Beans, groundnuts, cassava and potatoes are among the other major crops grown by smallholder farmers. After the liberalization of burley tobacco in the early 1990s, smallholder farmers can now grow some estate crops such as burley tobacco.

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² Customary land means land held or used under customary law where control of use and allocation vest the village headman.

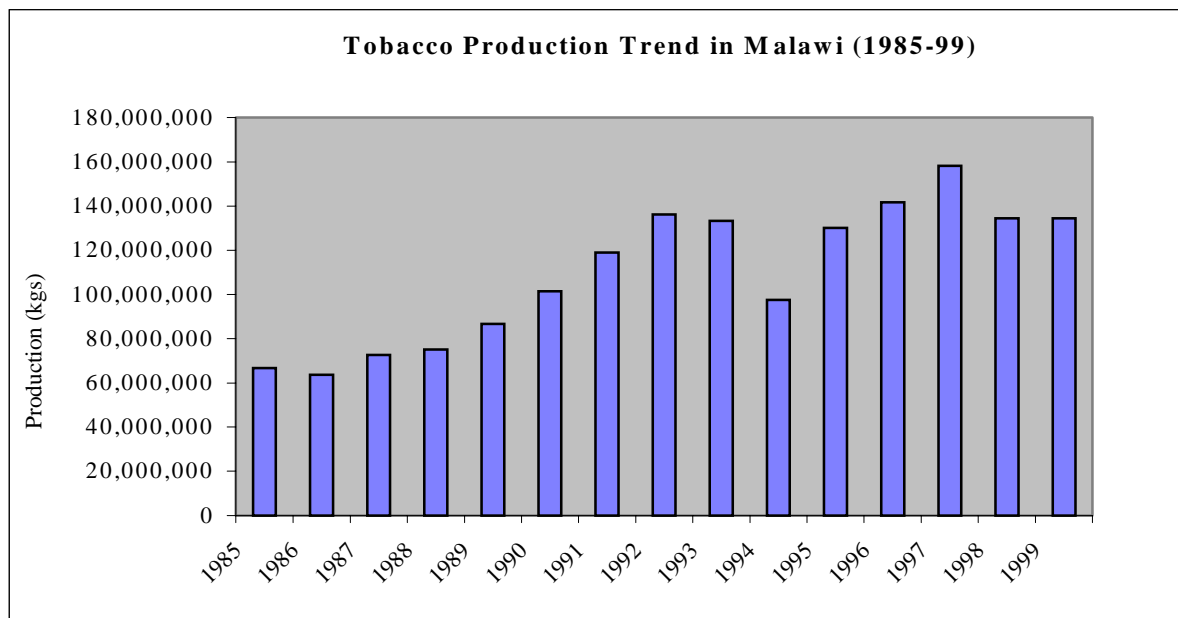
2.2 The role of agriculture in the national economy

Malawi's agricultural sector contributes up to 90% of the export earnings in a normal year, generates one-third of the GDP, expends half of those for paid employment and supports about 85% of the population (Ghai and Radwan 1990). The main staple food is maize. Other food crops grown include sorghum, millet, rice, pulses and roots. The main cash crops grown include groundnuts, tobacco, cotton and coffee. Tobacco, tea, sugarcane, rubber and macadamia nuts are mainly estate crops. Tobacco, tea and sugarcane contribute to about 70% of the country's export earnings (Carr 1997).

3.0 Export Agriculture in Malawi

Agricultural exports form a major source of foreign exchange. The agricultural export base for Malawi is dominated by tobacco which contributes to over 60% of the country's total export earnings (see Table 1). It provides employment to approximately 1.1 million workers and 390 thousand tenants. It is therefore not surprising that tobacco remains the main stay of the economy. In terms of production, tobacco is the most widely grown crop after maize covering more than 1,500 hectares of land (Government of Malawi 2000). The production of tobacco had risen steadily until 1997 when production started declining (see Figure 1). Output, especially of burley tobacco, increased after removal of the restrictive special Crops Act in 1989, resulting in an increased number of smallholder growers and a rise in area cultivated. Although this was a positive step toward poverty alleviation, it also resulted in a negative effect of a loss of quality. A list of other export crops is given in Table 1.

Figure 1: Total Marketed Tobacco 1985-99



Source: Ministry of Agriculture, Crop Production Plans 2000.

Table 1: Principal Exports 1994-2000 (MK million)

	1994		1995		1996		1997		1998		1999		2000	
Agricultural crops	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
Tobacco	2,241	68.9	4,051	61.8	4,935	62.0	5,780	62.0	10306	62.0	12109	61.0	14,305	61.2
Tea	261	8.0	428	6.5	497	6.3	701	7.5	1,248	7.5	1,735	8.8	2,271	9.7
Sugar	229	7.0	482	7.3	498	6.3	393	4.2	1,563	9.3	1,020	5.2	1,470	6.3
Cotton	15	0.5	58	0.9	324	4.1	191	2.0	155	0.9	235	1.2	138	0.6
Groundnuts	0	0.0	4	0.1	10	0.1	0	0.0	0	0.0	0	0.0	0	0.0
Rice	8	0.3	25	0.4	25	0.3	29	0.3	74	0.4	110	0.6	52	0.2
Coffee	127	4.0	262	4.0	289	3.6	209	2.2	327	2.0	392	2.0	330	1.4
Pulses	13	0.4	126	1.9	240	3.0	106	1.1	134	0.8	285	1.4	364	1.6
Maize	17	0.5	81	1.2	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Other Exports	274	8.4	856	13.1	899	11.0	1,644	18.0	1,963	12.0	2,559	13.0	2,901	12.4
Total Domestic Export	3,185	98.0	6,372	97.1	7,717	98.0	9,053	97.0	15,770	94.0	18,444	93.0	21,833	99.0
Re-export	69	2.1	188	2.9	191	2.4	250	2.7	965	5.8	1,352	6.8	1,533	1.0
Total	3,254	100.0	6,559	100.0	7,909	100.0	9,302	100.0	16,735	100.0	19,795	100.0	23,366	100.0

Source: Adapted National Economic Council, Treasury and Reserve Bank of Malawi, 2000.

4.0 Alternatives to tobacco and their production prospects

Malawi ranks among the top three world exporters of two types of tobacco (fire-cured and burley). It also ranks second in tea production in Africa, after Kenya. This has resulted from the comparative advantage the country has in the production of these crops. It is anticipated that such performance can be replicated for other agricultural and related products that have potential in the domestic, regional and world markets. Non-traditional export commodities with large international markets for which Malawi has a comparative advantage include groundnuts, pulses, sunflower seed, natural rubber and pepper (World Bank 1994). There is a high demand for fruits and vegetables in Europe. In 1992, for example, the European Community imported US\$20 billion worth of fresh vegetables and fruits, of which 4% was supplied from South Africa. Malawi only contributed to 0.0004% of the total. The European Community also imported US\$10 billion worth of processed fruits and vegetables, to which Malawi contributed only 0.009% (World Bank 1994). The macadamia market is strong in the UK and the US and Malawi currently supplies 85% of UK's total import demand.

Malawi continues to face difficulties in finding a suitable substitute for tobacco both in terms of adaptability to multiple geographical locations and value. There is a need to diversify out of tobacco, especially considering that there has been a decline in the efficiency of resource use. Between 1994 and 1997, the Domestic Resource Cost ratio rose from 0.28 to 0.50 for estate burley tobacco and from 0.32 to 0.36 for smallholder burley tobacco (Mataya and Tsonga 1999).

According to Nakhumwa and Ng'ong'ola (1998), paprika is a crop with considerably high gross margins (US\$2000/ha) if properly managed. The major constraint with the development of this crop is limited market. Although there is a high demand for paprika in Asia and some parts of Europe, within Malawi there is only one major buyer (Cheetah Limited) that has not developed enough marketing infrastructure to cover a large number of farmers. Hence currently it is risky for farmers to grow paprika.

Jansen and Hayes (1994) suggest that pulses and oil seeds have the greatest potential in terms of income generation in both domestic and export markets. The major limitation to the development of these crops is the lack of technical knowledge by farmers which leads to low investments in these crops. It has also been observed that both local and foreign market potential is still highly risky for most of the industrial commodities such as horticultural and sericultural crops. The market potential can be improved by introducing agro-processing activities (Mataya and Tsonga 1999). Table 2 presents a summary of the characteristics and prospects of major commodities of export potential and a summary of the likely participants.

Table 2: Indicative Diversification Commodities, Characteristics and Market Prospects

Characteristics and Prospects						
Sub-Sector	Cereals & root crops	Pulses & oilseeds	Livestock	Tree nuts	Orchards	Horticulture & sericulture
Technical knowledge	Low	Low	Medium	Medium	High	High
Investment	Low	Low	Medium	Medium	High	High
Risk	Low	Low	Medium	Medium	High	High
Domestic Mkt	Good	Good	Good	Limited	Limited	Limited
Export Mkt	Poor	Good	Poor	Medium	Medium	Medium
Likely Participants in the Production						
Sub-Sector	Cereals and Root Crops	Pulses Oilseeds	Livestock	Tree nuts	Orchards	Horticulture and Sericulture
Resource poor	✓	✓				
Commercial smallholder	✓	✓				
Small estates		✓	✓	✓	✓	✓
Large estates				✓	✓	✓
Agro-processing		✓	✓	✓	✓	✓

Source: Jansen and Hayes (1994). Agricultural Diversification. Part 1: Methodological Framework and Indicative Results; and Part II: Analysis of Diversification Options and Constraints.

The participation of smallholder farmers and small estates in these crops is, however, limited as indicated in Table 2. Smallholder farmers are only likely to participate in the production of cereals and pulses because these are low input and low risk crops. All potential export commodities except cereals and root crops have potential for agro-processing which will add value.

Using the gross margin as an index of profitability, a study by the Agricultural Research and Extension Trust (ARET) shows that cultivation of horticultural crops is the major potential income source after tobacco production. Profits of MK230,000 per hectare from tomato production, and profits of MK180,000 and MK25,000 from growing leafy vegetables and onions respectively, can be realized (see Table 3).

Table 3: Comparison of Gross Margins of Horticultural Grown Under Smallholder Conditions.

Horticultural Crops	Gross margins (MK/ha)	Gross Margin at Reduced Prices (MK/ha)
Tomato	231,234	42,084
Leafy Vegetables	180,509	85,694
Onion	25,010	31690
Irish Potato	12,782	2,782
Citrus (Mangochi)	8,740	4,333
Banana, Thyolo (village sale)	7,500	2,750
Head Cabbage	3,178	2,972

Source: Agricultural Research and Extension Trust, Cited in LUSO Consult (1995).

The results of sensitivity analysis suggest that growing horticultural crops, especially leafy vegetables, tomato, Irish potato and bananas, would still be profitable even if tomato prices were lowered by 50% and prices for all other crops by 75%.

5.0 Constraints to diversification

The market outlook for potential export commodities discussed earlier, indicates potential trade opportunities that could have been captured by Malawi if had the strategies for diversification been developed and implemented. Although a number of recommendations have been made regarding potential areas of diversification, the response from farmers and potential investors has been weak. The response is in particular due to internal factors such as the lack of policy, poor infrastructure and perceived research bias toward tobacco and maize.

5.1 Lack of a policy framework and strategy for implementation

While diversification has been on Malawi's development agenda for a long time, there has never been a serious attempt to develop a strategic plan based on which diversification can be implemented.

Most policy documents do not provide details regarding the means and mechanism for diversification. The promotion of soybean in the early 1990s, for example, failed due to the nonexistent parallel development of agro-processing and utilization technologies. Farmers abandoned the crop in favor of alternatives such as burley tobacco (Mataya and Tsonga 1999). The lack of export financing for private traders exporting commodities such as paprika further limits the country's capacity to diversify beyond traditional commodities.

5.2 Weak Institutional Infrastructure

Several institutions have been put in place to identify and develop domestic and foreign markets, as well as facilitating trade between domestic and foreign investors through trade events such as like trade fairs and exhibits. These organizations, however, lack the capacity to induce structural changes in the country's agricultural production and exports.

5.3 Bias in Research, Technology Development and Transfer

Generally, the development of technology and research activities has been biased towards maize and tobacco. This has tended to marginalize potential substitutes for the two commodities. Most information about training services for developing potential alternatives to tobacco has not been readily usable and understandable, especially for smallholder farmers. There has also been a lack of vigorous campaign to promote commodities for diversification.

5.4 Poor Access to Resources

The limited availability of land, labor and capital has prevented farmers from engaging in potential farming activities that would compete favorably with tobacco. While several financial institutions have been established to provide loans to farmers, recent studies by Diagne and Zeller indicate that over 70% of the smallholder farmers still have no access to credit.

5.5 Poor Road Infrastructure and High Cost of Transportation

The road network in Malawi is poorly developed. This, coupled with a fragmented production structure, raises the cost of transfer from the farm-gate to the points of sale. The high haulage cost not only reduces the net benefits to traders but also forms a disincentive for the primary producers who are compelled to charge low prices.

6.0 Conclusions

Although efforts have been made since the late 1980s to diversify the crops produced in Malawi, tobacco is still the major export crop there and is expected to remain so for some time. The country has a potential to diversify beyond tobacco through commodities that are high value and less bulky such as spices, oil seeds, some horticultural crops, cotton and pulses. However, the major constraints to diversification into such crops include the lack of a policy framework and a strategy for implementation, poor dissemination of technical and economic information about the crops, inadequate value-adding activities, and deficient access to production facilities.

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The Economic Repercussions of Tax-Based Land Reform

Osten Chulu¹

1.0 Introduction

In a small, land-scarce country where agriculture is the mainstay of the economy and employs the majority of the population, it is not surprising to find intense land competition and conflict among the different farming groups. Malawi's population density stands at 104 people per square kilometer, one of the highest in Africa, with most of the people residing in rural areas relying entirely on rain-fed subsistence agriculture (National Statistical Office 2000). In the past two decades, government development policy emphasized the need to foster sustainable economic growth through the eradication (reduction) of poverty and the transformation of the agricultural base of the country. To this effect, numerous policy initiatives and developmental strategies were put in place to try and pull the vast majority of the population out of abject poverty. It is surprising however, that despite the realization of the critical role that land plays in national economic development, there has been no attempt yet to address imbalances in land distribution among the various tenure systems. This paper seeks to outline the historical context in which the land tenure systems have evolved, to trace the development of land (re)distribution policy if any, and finally to recommend specific policy scenarios on land redistribution.

The paper begins with a description of the land characteristics in Malawi, giving the physical and economic dimensions of the country. The second section briefly outlines the historical perspective from the arrival of missionaries in the 19th Century up until the post-independence era. An illustration of the evolution of the tenure systems is also given here. The third section provides an overview of land constraints and the extent of land utilization. In this section, land reform initiatives are addressed, with particular emphasis on tax-based land reform initiatives. The last section gives policy recommendations and their implementation strategies.

2.0 Historical Perspective

This chapter first highlights Malawi's land characteristics and points out the historical evolution of land distribution in the country. It will then describe the influence of colonialism and European settlement in the region and the resulting conflicts with traditional African land rights. In a final section the existing tenure categories of land are presented and put into the perspective with respect to the current land distribution in Malawi.

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2.1 Malawi Land Characteristics

Malawi is landlocked, occupying an area of 118,324 square kilometers of land and water. The total land area accounts for a total of 94,080 square kilometers, of which 53,070 are considered suitable for cultivation (Government of Malawi 1999). The rest of the area is taken up by water. Recent estimates indicate that the population of Malawi is approximately 10 million, and is growing at a rate of 1.9% per annum.² At this rate, the population is expected to double within the next twenty years. This will surely have far reaching implications on land distribution and land policy, especially considering the fact that an estimated 87% of the country's population lives in the rural areas and hence predominantly relies on agriculture for food, cash incomes and other needs.

2.2 Historical Evolution of Land Distribution

Before the advent of colonization and British rule, early land acquisition was made through military conquest and occupation of unoccupied or abandoned land. Strong tribal groups acquired the best agricultural and pastoral land not through treaties, concessions and documented negotiations, but on the basis of capitulation and progressive encroachment (Government of Malawi 1999). Land, according to custom, could not be sold as it was conceived to be sacred and not a commercial commodity. Vanquished tribal groups forfeited their rights to land and in many cases became slaves of the victors.

Early missionaries such as David Livingstone and others envisioned slavery to be unacceptable evil. There was thus a concerted effort to end slavery and spread Christianity by the early missionaries. This having been achieved, the next step was to replace slave trade with legitimate trade and thus came the settlers intent on setting up commercial and agricultural enterprises to supply European markets. Estates were established for tea and coffee through the grant of concessions by local chiefs. To the locals, concessions were perceived as in the nature of occupation licenses not at all conferring property rights to the foreigners. As more British missionaries, planters and traders came the need for protection was necessitated. This need became more urgent when the Portuguese based at Tete, Sena and Quelimane started to eye territory to the north, sending military expeditions to assert territorial claims over some areas settled by the British (Government of Malawi 1999). Protectorate status was proclaimed in 1891.

2.3 Colonialism, Settlers and African Land Rights

A number of grants were issued to white settlers who were unable or unwilling to negotiate with indigenous chiefs for concessions under the Acquisition of Land Order of 1898 in the name of the British sovereign. Concessions and grants did not legally mean land rights to settlers. This was not clear to settlers who, after enormous land acquisitions by companies such as the British

² The 1998 Malawi Census of Population and Housing estimate is at 9.8 million which some authorities believe is on the low side.

South Africa Company, mounted pressure for the clarification of their rights under grants and concessions. Colonial authorities responded by calling for submissions of claims to land and supporting documents if any (Government of Malawi 1999). These claims were certified by the Secretary of State or the Commissioner for British Central Africa who conferred land rights to the claimants. The formalization of white settlement through the issuance of claims deprived indigenous communities of more than 1,482,102 hectares of land. Of this land, one company alone—the British South Africa company—acquired 1,080,000 hectares. This land was however not vacant. The status of indigenous communities who were occupants of the land soon became an issue requiring urgent attention. The certificates themselves proclaimed that no African villages or plantations existing at the time of grant should be removed or disturbed without the consent of the commissioner. Once the consent for removal was given, then the site of such villages reverted to the holder of the certificate. It is interesting to note that certificate holders routinely ignored the provision to protect African villages with the full knowledge of the colonial authorities.

Two Land commissions, the first appointed in 1903 and the second in 1920, recommended some kind of legislative protection for Africans residing on settler land. These were routinely ignored by the settlers. The effect was that indigenous communities lost ownership and control of their land, and lost all the unalienated³ land to the colonial state under the notion that title to the whole of Malawi was vested in the British monarch. This was not the understanding of the chiefs when they granted concessions in the first place.

2.4 Tenure Categories

The 1902 English Land Law had, up until 1967, formed the basis of Malawian Land Law. The legislation adopted in this period recognized three tenure categories:

- **Public Land Tenure:** applies to all land which is occupied, used or acquired by government, and any other land, not being customary or private land, and includes land which reverts to government upon expiry of a lease or the falling in of a freehold[®]. National forests, game reserves, townships, municipalities and cities all fall under the category of public land tenure. Public land is vested in perpetuity in the President of the Republic.
- **Private Land Tenure:** Freehold and leasehold land types are recognized as forming Private Land Tenure under the Land Act. Freehold land is land held absolutely in fee simple[®] and leasehold is a periodic tenure regime issued for various purposes with terms ranging from 21 years to 99 years. People displaced by the creation of this tenure system do not appreciate the system and have been known to continue cultivating and using land in private hands as if it were still customary land.
- **Customary Land Tenure:** This is any land held, used or occupied under customary law and is vested in the President of the Republic in perpetuity for the benefit of the people of Malawi. This category comprises nearly 6.5 million hectares, approximately 67% of the total land area (Chanthunya 1998). It offers adequate security of user rights. Land is regarded as not having a market value except for value emanating from its capacity to produce and can

³ Alienated land refers to land transformed from customary land into private or public land.

therefore not be sold. Rights of occupation depend on being accepted as a member of the community (Liuma and Associates 1998). Customary land is inheritable. Chanthunya (1998) notes that the head of the family owning a specific landholding has the right to share part of the land with any of his relatives or offspring. In recent times, however, village heads have lost almost all their powers over land distribution. Because of the scarcity of unallocated virgin land, people seeking land no longer go to chiefs but buy or rent it from individuals, leading to an increase in the price of rent for land (Chanthunya 1998).

It is the Private Land Tenure category that we now concentrate our attention. Liuma (1998) notes that this tenure system has not been very fair and equitable since alienation of land has been done without those affected fully understanding the effects on their rights to use and occupation once land has become private. Most of the estate land has been transferred from customary land. People have conceded customary land to estates either through sale or joining of farming plots into one estate (Government of Malawi 1999). The NSO gives the land balance as shown in Table 1.

Table 1: Land Balance

	Land Area (ha)	Area (ha) Possible for Cultivation	Area (ha) under Cultivation	Unutilized Suitable Land
Malawi	9,408,000	5,307,000	1,445,000	3,862,000
Northern Region	2,687,000	1,236,000	206,000	1,030,000
Central Region	3,552,000	2,249,000	617,000	1,632,000
Southern Region	3,169,000	1,822,000	622,000	1,200,000

Source: National Statistical Office, 1995.

However, according to the Public Land Utilization Study (PLUS) of 1997 quoted in Chanthunya (1998), the land balance is as shown in Table 2.

Table 2: Land Balance According to PLUS

Land Balance (ha) According to PLUS (1997)	
Tenure Type	Area
Suitable Customary Land	4,100,000
Unsuitable Customary Land	2,100,000
Public land	1,800,000
Estate Land	1,100,000
Urban	300,000
Total	9,400,000

Source: Chanthunya, 1998.

3.0 Land, Reforms and Economies of Scale

According to the Ministry of Agriculture, a smallholder should have at least 1.5 hectares for farming to attain the minimum levels of sustenance throughout the year. If this were followed, the majority of farming households would not have enough land. The national average smallholder farm size is estimated at 0.63 hectares (Chanthunya 1998). The Ministry of Agriculture estimates that 55% of households have an average land holding size of less than 1.0 hectare. The smallholder sector does not enjoy economies of scale as a direct result of their small holding sizes. The sector devotes a considerable share of the farm area to maize, which is more of a subsistence than cash crop. Taking into consideration the food security constraint, smallholder farmers are forced to cultivate maize with a very low average yield on their limited land at the expense of more lucrative high value crops.

3.1 Land Constraints and Underutilization

One of the major constraining factors to increased agricultural productivity and viability is the availability of excess land on which to expand on. A lot of customary land has been converted into public or estate land. With growing population pressure on land, the need to create more land is ever more urgent. Table 1 gives the estimated idle land that could be put to use. Customary land is normally put into full use if and when it is deemed suitable. Estates fall in the private land category and overall, 29% of suitable land on estates is underutilized, and 75% of all estates have land which could be cultivated but is not (Chanthunya 1998). The major reasons for this include:

- Problems of slow start-up due to the slow pace at which lease applications are reviewed and capital for estate development procured.
- Leases in the 1970's were issued to civil servants and others who had enough money to obtain lease, but not enough financial or managerial capacity to farm the land.
- Absentee landlords and lack of management capacity.

Underutilization of land come in several forms, among which the following stand out:

- Physical underutilization where a certain portion of land is suitable and available for cultivation but is not being cultivated.
- Efficiency in the use of land where farmers are producing below potential due to constraints such as capital shortfalls, limited access to credit and over dependence on rain-fed agriculture
- Suitability which depends on the type of crop regime or level of management of the farmer (Chanthunya 1998).

3.2 Land Reform

Experiences in various countries worldwide indicate that certain types of land reform can be detrimental to some agricultural development while yielded positive impact on sustainable food output in other contexts. When communal land is privatized, individuals are able to purchase it and utilize it in any way they deem fit. In some instances, the utilization is done in such a way as to yield short term profit, but environmentally damaging in the long run. On the other hand, international experience also shows that when a land previously owned by absentee landlords is sold, given or otherwise reallocated to small scale farmers, food production often rises, as for instance in the 1950s in Japan, Taiwan and South Korea (Chanthunya 1998). Other experiences such as the recent Zimbabwe land redistribution programme could result in previously highly productive commercial agricultural production being replaced by inefficient, low yielding traditional forms of agriculture which may not augur well with food security considerations. Reforming unjust land tenure is, therefore, more than a matter of justice. It is an important part of the drive to increase and sustain food production (Chanthunya 1998). Other examples of international experiences show that land reform can work well when it is backed up by credit, technical advice, training and infrastructure for small scale farmers (Chanthunya 1998).

In Malawi, no comprehensive land ownership policy exists. Rather, there have been moves made by government to address the land problem through a series of consultative fora geared toward the eventual formulation of a land policy. Customary land, which is predominantly occupied by smallholders, has been perceived by many as being a hindrance to growth. Moves towards transforming customary land into leasehold land had been developed in the past, albeit on a small scale.

3.3 Tax-Based Land Reform⁴

Large-scale (estate) agriculture was for a long time the focus of agricultural development in Malawi. Soon after the independence, the government embarked on an aggressive process of expansion through the alienation of land under customary tenure. Customary land, as was the case under colonialism, has in effect become a vast reservoir for public and private land.⁵ The result of these policies was that estate operators have always had the best land. Notwithstanding, indications are that rural freehold estates, particularly those under tea, coffee, tobacco and macadamia, are an important component of Malawi's economy. It is also recognized that freehold estates support a substantial population of residents and seasonal employees and their families. Most of the freehold estates are owned by foreign nationals or corporations. As for leasehold tenures, it has been noted that a lot of the estates under this tenure are generally in a poor state of husbandry (Government of Malawi 1999). This tenure regime is the one mostly responsible for the unutilized suitable land shown in Table 1 above. With the emergence of acute population pressure on limited land, two questions arise:

- If the private land were to be taxed, would land owners give up those tracts of land not currently being utilized? And what would the tax rate be to induce such a change?
- If the land tax does not induce land redistribution, and Malawi still faces concerted population pressure, what measures would the government take to pacify the many landless people. How would this tally with food production policies?

It has been argued that in order to enforce better and more efficient land use practices, land taxation should be introduced in Malawi to encourage better land utilization and improve the distribution of income and wealth. Chanthunya (1998) argues that one of the expected benefits of land taxation is the lowering of land prices which facilitates the development of a land market by making it easier for new farmers to buy or rent land. Land tax, in many developing countries, is seldom an important source of revenue. Currently, the annual rate of tax is MK50 (about US\$0.80) per hectare of agricultural land. There is an absence of well-established property rights to a lot of land, further complicating the administration of a comprehensive land tax. Land taxes are also politically unpopular in that estates on freehold the tenure system are exempted from land taxation, hence the burden of raising land tax falls mainly on small leaseholders who are in the majority of those falling in the land-taxable category.

In Malawi, Local governments currently employ a property tax on the structure values and the Central Government a land tax; property taxes are considered superior to land taxes since it is difficult to separate land and structure values. There are several ways in existence to assess property value such as the use of annual net rental payment or the market value of the property. However, rural land and property values are difficult to assess since much of the rural land has never been sold, therefore has no property rights attached to it, and is communally farmed. The

⁴ Land redistribution based on a tax regime. Impose a tax on land such that only economically viable land is held for productive purposes.

⁵ Between 1967 and 1994, more than 1 million hectares of customary land was lost in this manner (Government of Malawi 1999).

transformation of this land into another tenure regime would invariably bring forth complications in valuing for taxation with the limited analytical capacity currently available. Chanthunya, (1998) suggests a presumptive tax based on the volume of production. Since aggregate measures of smallholder production are available, it would be easy to record production by smallholders. In the absence of information on production by smallholders, a tax could be assessed on the basis of land under cultivation adjusted for location, fertility and other indicators of agricultural activity.⁶

4.0 Conclusions and recommendations

The problem of availability of land for smallholders is a complex one. There are several factors to consider when tackling the problem of land redistribution:

- 1) The redistribution of unutilized estate land to smallholder farmers on customary land will not have a significant impact. To have the greatest impact, a substantial proportion of utilized estate land will have to be redistributed to smallholders.
- 2) There is also substantial unutilized customary land due to factors such as distribution of population and land preservation practices by certain individuals.
- 3) The redistribution of estate land to smallholders will provide a short term solution to the land problem. As long as the population continues to grow at present rates, the land scarcity problem will resurface sooner or later. There is need for more concerted efforts on population control. In addition, alternative livelihood means, such as small cottage industries and other income generating activities should be critically looked at and promoted.
- 4) Land redistribution from estates to smallholders would result in increased maize output but probably result in reduced output of estate produce, which still forms the backbone of the economy.
- 5) The input requirements for smallholders would increase once more land is made available to them. Pressures would arise for more government subventions in the form of free or subsidized inputs (the programme is already in place) which would exert enormous pressure on the government finances.

Despite the problems associated with land redistribution, it is still politically and socially prudent to undertake some form of land redistribution. The most viable way, though administratively cumbersome, is through land taxation. A land tax should be introduced and be payable by all estates. Smallholder farms and customary land should be left out as this would not be administratively feasible. Estates are registered, and hence it would be easy to administer the land tax. To achieve this, it is recommended that:

- 1) Land tax should be progressive to ensure equity between land of different productivity

⁶ This would be difficult since most smallholders do not have rights to own land, but rather they only have rights to cultivate it. It may thus be difficult to map particular pieces of land with particular individuals for tax purposes.

- and fertility. More fertile land should be taxed at a higher rate than less fertile land through the use of land assessment values based on regular fertility and productivity tests. Extension workers in the Ministry of Agriculture already undertake such measures.
- 2) Land that lies idle for a long time should be taxed at a higher rate than land that is under cultivation in order to induce estate owners to make use of all their land and get rid of land they do not really need.
 - 3) All freehold land should be transformed into leasehold status and be taxable.
 - 4) Customary land that is lying idle should be appropriated by government and be converted into leasehold land for use by potential estates. There are instances where customary land is left fallow for long periods of time while commercially oriented farmers are land scarce.

Based on an average yield of 1,090 kg/ha of maize or 1,500 kg/ha of burley tobacco, a value for potential productivity of 1 hectare of land can be calculated and a tax rate based on some sensitivity analysis determined. The tax would then be applied to all estate agriculture.

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External Sector Policies in Malawi

Osky Sichinga and Ralph Tseka¹

1.0 Introduction

Trade liberalization in Malawi was designed to achieve more efficient resource allocation and a more competitive structure of production. These in turn would improve the balance of payment outlook over the medium term (Government of Malawi). With regard to trade and tariff system, Malawi has signed various trade protocols like the Cross Border Initiative (CBI), Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC), etc., which entail a harmonization of duty rates. The need to increase trade comes in the wake of the need to diversify the economy away from its reliance on the crop – tobacco which has experienced an overall drop in prices in recent years. The large world price fluctuations of tobacco put a great challenge to Malawi, who has relied on tobacco as a major foreign exchange earner over the years.

The exchange rate in Malawi became market driven in 1994 and a formal inter-bank market was established in September of 1996, as part of the financial sector reform agreed to in the Industrial and Trade Policy Adjustment Credit (ITPAC). A factor leading to this change was a fundamental disequilibrium caused by the pressure on the balance of payments by the 1993 drought and the withdrawal of non-humanitarian development assistance by the international community on account of “good governance” issues (Reserve Bank of Malawi 2000). The change was also necessary for Malawi since in 1994, several member countries of the then Preferential Trade Area (PTA), now COMESA, had already adopted various types of market-determined exchange rates. By moving into a market determined/driven exchange rate system Malawi hoped to improve its export competitiveness as well as provide an efficient foreign exchange allocation mechanism.

In line with trade liberalization and the subsequent signing of various trade protocols, this paper attempts to provide the background for the policies that have been pursued in the external sector since the implementation of the structural adjustment programmes. The background information will help set the stage for later on simulations carried out to assess the impact of tariff cuts on exports, imports and government revenue. Furthermore, it will also assess the impact of a fall in tobacco export prices on total export earnings, trade deficit and the terms of trade. Finally, we address fluctuations in the exchange rate and their impacts on exports, imports and trade balance. This paper is organized as follows: the second section of the paper covers the economic background, followed by an analysis of the export sector. The third section discusses exchange rate management, and the final section concludes the paper.

¹ Reserve Bank of Malawi.

2.0 Economic Background

During the 15 years after the independence in 1964, the Malawian economy achieved high real GDP growth at an average rate of 6%, well exceeding the population growth of 3.3%. During the same period other macroeconomic variables displayed remarkable growth. At independence, domestic investment in Malawi constituted 8.6% of GDP, which rose to 28% in 1979 while domestic savings contributed 15.2% of GDP (Malawi Statement of Development Policies, various issues). Export volume grew at an average annual rate of 4.5%, slightly higher than the 3.5% import volume growth (Reserve Bank of Malawi 1980).

In 1979, however, the Malawian economy suffered a series of external shocks. These included in particular a steep rise in the price of imported fuel. Other elements included the rise in the import prices of capital goods and the decline in the export prices. In addition, political insurgency in Mozambique led to a disruption of the country's traditional routes to the sea, and the need to switch to new and more expensive routes. On the domestic front, the country was experiencing droughts. These shocks led to the non-competitiveness of Malawi's exports due to a doubling of the C.I.F. transport margin and a worsening in Malawi's terms of trade. Consequently, the post-1979 period was a period of generally depressed growth for Malawian economy. Growth in GDP fell from 4.4% in 1979 to 0.6% in 1980². The overall balance of payments position deteriorated in this period. Capital inflows were inadequate to finance the current account deficit and the foreign exchange reserve position continued to deteriorate. The economy also had to grapple with high debt service burden as a result of heavy borrowing on commercial terms.

As alluded to earlier, the external shocks that the Malawian economy faced in the late 1970s, mainly the deteriorating terms of trade and the external transport problems, caused serious external and internal imbalances in the economy and thwarted prospects for sustained growth. These shocks exposed structural weaknesses within the economy. These weaknesses included the dependence on few crops for exports, weak institutional support for export production and marketing, low productivity of smallholder agriculture, high dependence on fuel imports, and institutional deficiencies in parastatals and the central planning ministries. To redress the situation, the government with the assistance of the donor community implemented broad-based Structural Adjustment Programmes. These programmes were supported by several Structural Adjustment Loans from the World Bank and a series of International Monetary Fund Stand-by arrangements. They were designed to improve efficiency of resource use and to ensure that per capita GDP growth was restored and sustained in the medium and long-term.

Malawi started liberalizing its economy in 1984 under the Structural Adjustment Loan (SAL) II by reducing the number of items under price control by 41%³. In 1986, under SAL III, price controls were eliminated on all items with the exception of petrol, low-grade beef, fertilizer, sugar, and vehicle spare parts. In addition, in 1987, under SAL III supplement, intra-regional

² Calculations based on statistics annexed in the Economic and Financial Review 1980.

³ Information on structural adjustment programmes are contained in the report by the Special Task Force set by the Cabinet Committee on the Economy and the Cabinet Committee on Manufacturing on measures to reverse the increasing trend of disinvestments of Malawi's industries in May 1999.

differentiated maize producer and consumer prices were implemented in order to expand the role of the private sector in marketing smallholder produce.

The objectives of the SALs were, mainly, to diversify the export base, improve the allocative efficiency of resource use, improve the financial performance of the public sector, expand the role of the private sector in the marketing of smallholder produce, and strengthen the policy making capacity of the Malawian Government.

Subsequently, in 1988, the Government entered into an agreement with the World Bank for an Industrial and Trade Policy Adjustment Credit (ITPAC). This intensified the liberalization of the economy in that it involved the following actions:

- Decontrolling of beef prices,
- Reduction in the scope for industrial licensing requirements and elimination of authority to grant exclusive products rights, and
- Removal of the requirement for prior allocation of foreign exchange for 65% of all imports by the Reserve Bank of Malawi.

The final removal of foreign exchange control was effected in 1990 under the Agricultural Sector Adjustment Credit whose main objective was to improve the macroeconomic environment in Malawi. Nearly a full liberalization of the economy was marked in the early 1994 when the Malawi Kwacha was fully floated. There was no more requirement for import licensing except for a small negative list which since then has been reduced further under the Fiscal Restructuring and Deregulation Program (FRDP) I.

Malawi has a trade agreement with the Republic of South Africa, which is non-reciprocal and asymmetrical in nature based on considerations about the different industrial bases and different levels of development of the two countries. Most of the companies operating under the Export Processing Zone (EPZ) program, have taken advantage of this agreement. Malawi's exports of textiles and garments into the South Africa market have been increasing.

The government also put in place the Malawi Export Promotion Council (MEPC) an organization concerned with promoting non-traditional exports. It conducts research, general promotion, and training. There are institutional arrangements for the export sale of tea and tobacco. Other primary commodities such as cotton and maize are normally exported by ADMARC. In addition, the support of the government goes into ensuring the adequate transport and telecommunication structures.

According to Malawi's Policy Framework Paper 1996/97-1998/99, the goal of the medium term external sector policies is to strengthen the balance of payments position further so as to move it toward viability over the medium term. To achieve this, the government maintained a market determined exchange rate. In 1996 a formal inter-bank market was introduced and was expected to reduce RBM intervention in the market, being guided by the reserve target.

The government set medium-term targets for the maximum and average import tariffs, consistent with the CBI requirements. The tariff structure was rationalized by reducing the number of tariff bands. On April 1, 1996, the top tariff rate was reduced to 40%, and the weighted average tariff

rate declined to about 15%. Tariffs on capital and intermediate goods were cut by 33 to 50% (Government of Malawi 1996). The maximum tariff rate was further reduced to 25% in 1998. The reductions were expected to benefit Malawian producers whose competitiveness was adversely affected by tariffs on intermediate inputs.

Malawi retained a list of 19 items that require import licenses and 9 items that require export licenses in 1996. This was reviewed in 1997 and was reduced to only those items that were related to security, health or environmental matters, consistent with WTO regulations⁴.

Malawi accepted the obligations of the IMF Article VIII of Agreement in December 7, 1995. Accordingly, Malawi removed restrictions on current account transactions. The government was expected to liberalize the capital account gradually in order to encourage investment.

3.0 The Export Sector

Malawi is primarily an exporter of agro-products predominated by tobacco and tea. Allied industries have been developed so as to do deal simply with the semi-processing of tobacco and tea. The export earning capacity of these products have been eroded for a number of reasons. For tobacco, there has been a steady decline in world demand for the crop particularly in the OECD countries as a result of a general decline in tobacco consumption (prompted by an intensified anti-smoking campaigns). The supply side has also been unstable. The production of tobacco is highly sensitive to climatic variations for it takes only a week of bad weather to completely destroy the quality of the leaf produced. Accordingly, policy makers in Malawi are concerned with Malawian prospects that heavily rely on the export of tobacco. Malawi is currently considering policies aimed at exploring the possibilities of diversifying the economy so that the reliance on tobacco can be lowered.

Some of the causes of fluctuations in real export revenue in Malawi include:

- A high concentration among few products for exports,
- A high geographical concentration of export destinations,
- The type of goods exported, and
- The fluctuations in the quantities available for export.

Table 1 illustrates the degree of export concentration on a few commodities for Malawi. The tobacco earnings share in total exports fluctuated between 63% and 74% for the period of 1992-98. With this substantial share, any shock to the world price of tobacco would cause huge change to the overall export earnings.

⁴ See details in the Malawi Policy Framework Paper 1996/97-1998/99.

Table 1: Principal Export Commodities (% share of total value 1992-98)

	1992	1993	1994	1995	1996	1997	1998
Tobacco	74.0	69.0	62.7	68.5	63.4	67.1	65.4
Tea	8.0	12.0	9.7	6.2	4.7	8.1	7.9
Sugar	7.0	5.0	7.3	6.0	11.8	4.6	9.9
Cotton	1.0	1.0	0.6	0.9	2.5	2.2	1.0
Rice	0.0	0.0	0.7	0.3	0.3	0.3	0.5
Coffee	2.0	3.0	4.8	3.6	2.0	2.4	2.1
Pulses	1.0	0.0	0.9	1.9	1.2	1.2	0.9
Maize	0.0	0.0	0.6	1.2	0.0	0.0	0.0
Other crops	7.0	11.0	12.7	11.3	14.0	14.0	12.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *Economic Report*, Government of Malawi (various issues).

These primary commodities are vulnerable to instabilities. International market price instability is higher for these commodities for which the supply and demand curves shift easily because of high price elasticities.

Fluctuations in the quantities available for export cause another instability in the Malawi economy. Foreign buyers usually require consistency in the amount of supplies they receive, especially when these are used as intermediate inputs. Unless Malawi had considerable influence in the world markets, any fluctuation or inconsistency in its supply will not affect world price levels and therefore only result in reduced export values and what could be disastrous shocks to the economy.

Worse still, most of these primary products are exported to a concentrated and small number of buyers which means that Malawi is more prone to shocks and fluctuations in its buyer countries than would be the case under a more diversified buyer scenario.

The government has over the years realized the need to diversify the export base and explore ways of promoting non-traditional exports. The share of these crops increased from 7% to 14% from 1992 to 1996 and then declined to 13% in 1997 and to 12.4% in 1998 (see Table 1). However, there was not much progress made in export diversification. Malawi needs to embrace this strategy more vigorously to promote significant economic growth.

4.0 Exchange Rate Management

The exchange rate policy has evolved significantly over the years since the independence in 1964. The Malawi currency (Kwacha) was fixed at par to British pound and US Dollar until 1973. This was seen as less than ideal because the strengthening or weakening of the Malawi Kwacha rates automatically reflected movements in the pound or dollar rates.

From 1973 to 1984, the Kwacha was pegged to the Special Drawing Rights (SDR) of the IMF. For a while the peg seemed to be the solution for the economy, which experienced problems when major international currencies underwent large fluctuations. This was short lived, however, as the SDR (together with the Kwacha) started appreciating together with the dollar and constrained Malawi's export development. The authorities, therefore, then unpegged the Kwacha from the SDR in 1984.

From 1984 to 1994 the Kwacha was pegged to a weighted basket of seven currencies of Malawi's major trading partners so as to reflect the relative trade weights. Several adverse factors began to emerge, resulting in large fiscal and macroeconomic imbalances. The closure of the sea routes to Nacala and Beira due to the civil war in Mozambique greatly increased the country's transportation costs as the country had to switch to the long overland routes to reach the ports of Durban in South Africa and Dar es Salaam in Tanzania. This worsened the country's terms of trade. Thus a series of devaluation policies were implemented: in April 1985 the Kwacha was devalued by 15%, in August 1986 by 10%, in February 1987 by 20%, in January 1988 by 15%, in March 1990 by 7%, and twice in 1992, by 15% in March and 22% in July (Reserve Bank of Malawi 2000).

In 1994, the authorities floated the Kwacha in order to make its external value market determined. As a result the Kwacha depreciated in nominal terms against its major trading partners. By the end of November 1994, the Kwacha had depreciated by over 250% against the US dollar, by 300% against the British pound, by 279% against the South African Rand, and by 335% against the Deutschmark⁵.

The depreciation was so large for several reasons. First, weak policy implementation of demand management measures and delayed balance of payments support from donors resulted in less foreign exchange available in the market. Second, lack of confidence in and therefore credibility of the system fueled a speculative attack on the currency. Third, the huge external payments arrears and serious balance of payments problems contributed to the sharp fall in the Kwacha.

To accompany the floatation of the Kwacha, the Malawi authorities took the following measures:

- Foreign exchange bureaus and brokers were introduced;
- Entry into the banking sector was relaxed while at the same time prudential supervision of the banks was intensified; and
- Foreign currency surrender requirements were eased and both the exporters and banks were allowed to retain part of the foreign exchange proceeds.

⁵ These are calculated from various issues of the Financial and Economic Review.

The determination of the exchange rate in Malawi is perceived with some skepticism by the business sector, resulting into continuous speculative behaviour on the part of the private business, which in turn creates further complications in the management of the exchange rate. However, in large part, the development of an inter-bank market in foreign exchange and the implementation of credible fiscal and monetary policies for macroeconomic stabilisation hold the key for the future management of the exchange rate as well as for the restoration of confidence in the functioning of the foreign exchange market.

5.0 Conclusion

Whilst Malawi has implemented far reaching economic reforms, which have resulted in the opening up of the economy to the foreign competing products, most of the regional markets remain closed. In some cases, Malawi has entered into agreements with regional partners without necessarily considering the impact of the differential industrial base. For instance, under the COMESA regime, Malawi has opened up to the products originating from the COMESA region by reducing tariffs by 70%. This will apply when the SADC Trade Protocol enters into force.

However, Malawi is unable to take advantage of the reduction of tariffs affected in the trade agreements because there is no level playing field. The rules of origin under COMESA and SADC respectively, require that 45% (35%) of the product content be from locally produced materials. It is hard for Malawi to meet this requirement because of its weak industrial structure compared to other economies in the region. In addition, Malawi's regional partners are still applying non-tariff barriers in one way or the other. Restrictive foreign exchange regime, bureaucratic hurdles, and the unwillingness by the authorities in some cases to recognize the authenticity of the goods from Malawi, are some examples of the barriers used. This makes Malawi less competitive in penetrating into regional markets.

The diversification of production in export sectors will depend on a continued reduction in transport costs, a further removal of barriers to entry, and a broadening of the ownership base. A continued development of human resources and further improvements in the social and physical infrastructure constitute critical elements of the development strategy.

In the final analysis, it must be mentioned that the maintenance of a stable exchange rate in the short-term requires many factors. First of all, the maintenance of adequate foreign reserves for currency stabilization is required. Second, fiscal discipline is critical in order to avoid domestically financed deficits. Third, a steady inflow of donor support or other capital flows is also fundamental in maintaining a stable exchange rate. In the long term, the diversification of the export base, increased investment to meet domestic demand for consumption goods and, the maintenance of a realistic exchange rate will be critical.

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Economic Effects of Alternative Scenarios for Government Deficit Reduction in Malawi

S.L. Mtonakutha¹

1.0 Introduction

From its independence to the late 1970s, Malawi has enjoyed economic growth with real GDP growing at an average rate of 6% and a corresponding average annual growth rate of per capita income of 3%. This growth emanated from increased output in the agricultural sector due to the factors of timely availability of inputs and credit, expanded provision of services, and increased research activity. The expansion in the agriculture sector also provided the base for the growth of secondary sectors like manufacturing.

In the fiscal sector, the need for increased public services and greater public sector investment had been apparent since independence. However, the tax base was small and vulnerable with foreign assistance covering even some of the recurrent expenditure. By 1973/74, domestic tax and other revenues were more than adequate to cover recurrent expenditure, and revenues continued to grow faster than GDP up to 1978/79.

From the late 1970s, the economy suffered from a series of external shocks. These included a worsening of external terms of trade mainly from the second oil price shock; and the decline in the export prices of tobacco, tea and sugar. The rise in interest rates on the international money markets made debt servicing for Malawi unbearable. The influx of refugees as a result of civil war in Mozambique added strain on an already ailing economy. The civil war also made Malawi's traditional routes impassable, thereby further weakening the balance of payments through increased transportation costs associated with foreign trade. Domestically, the country experienced two years of drought in 1980 and 1981 necessitating the importation of maize.

As a result of these shocks, three years immediately following 1978/79 saw rapid deterioration in the budgetary position. Major tax adjustments in 1979 and 1980 held up revenues, but recurrent expenditures led by interest payments, increased so rapidly that by 1981/82, they had overtaken revenues and Malawi had to finance part of its recurrent expenditure from borrowing again. The financial position of the quasi-public sector deteriorated in parallel.

To correct the situation, the government, assisted by the donor community (mainly the International Monetary Fund (IMF) and the World Bank), has been implementing a series of fiscal policies measures. These measures have aimed at both improving the tax instrument as a source of revenue and to restrain/cut down expenditures, as well as prioritizing sectoral allocation of funds. However, despite the implementation of several fiscal policies to improve the situation, the deteriorating fiscal position has persisted.

This paper endeavours to assess the effects of alternative measures that the government has been employing to reduce fiscal deficits. It will provide a basis for carrying out analysis using a Computable General Equilibrium (CGE) model of the Malawi economy developed

¹ National Economic Council of Malawi.

under the on-going IFPRI project on Collaborative Research and Capacity Strengthening for Multi-Sector Policy Analysis in Malawi and Southern Africa.

The paper is divided into three main sections. Section one is the introduction, section two describes the implementation of various fiscal policies in Malawi and section three the impact of fiscal reforms, highlighting current and on-going efforts. The paper ends with a concluding section.

2.0 Fiscal Policy Implementation in Malawi

In the late 1970s, Malawi's economy started to show an internal macroeconomic financial imbalance, indicated by government deficits. The deficits (excluding grants) have since been averaging over 10% of GDP. The deficits have arisen largely due to a higher growth in expenditure than that in revenues.

2.1 Tax Reforms

Several tax reforms have been carried out to improve tax performance in Malawi. The reforms were made by changing the rates of taxes, broadening the tax base by increasing the number of items and activities to which taxes apply, as well as by introducing new taxes. In addition to raising revenues, the tax reforms were aimed at meeting the objectives including provision of fiscal incentives for private sector investment as well as to ensure greater equity. The reforms also aimed at strengthening the administration and collection of taxes.

Steady progress has been made in reducing import tariffs in Malawi. The import tariffs have fallen from a weighted average of 19% to 14%. At the same time, surtax rates have been rationalized and the tax base extended. All taxes on exports were eliminated and the top import duty was reduced from 35% to 25%. The taxes on selected intermediate goods, raw materials and capital goods were reduced by five percentage points.

To compensate for the revenue loss arising from tariff rate reductions, the government continues to review surtax-exempt goods and services and considers introducing positive rates to expand the tax base. The surtax legislation is being reviewed to strengthen the administration of the tax². The long-term objective of the tax policies is to increase the reliance on surtax instead of taxes on trade; since surtax is much less distortionary as a result of credit provision for taxes paid on production inputs. The government is also considering measures to broaden the base for income tax and to strengthen tax administration, particularly in the area of auditing capacity.

The most far-reaching innovation in the tax system should be the introduction of a new revenue authority, which should strengthen tax administration and allow the government to increase revenues without resorting to higher tax rates.

² Surtax is a tax charged on commodities and services. It is meant to be charged on consumption, hence, it is demand driven.

2.2 Expenditure Reforms

A number of fiscal reforms instituted have aimed at restraining/cutting down expenditures and prioritizing sectoral allocation of funds. For example, under the World Bank's Fiscal Restructuring and Deregulation Program (FRDP) of the SAP, one of the measures was the cash budget system introduced in 1994.

Furthermore, the civil service reform is being implemented under the FRDP. Carrying out the government's fundamental macroeconomic and sectoral agenda requires an efficient and well-motivated civil service to implement the required policies. Given the resource constraints and tight expenditure ceilings being experienced by the government, the policy of the government was to rationalize the civil service, in line with the established priorities for public sector services. To achieve this policy objective, the government has carried out a strategic review and is currently completing a detailed functional review of all ministries. The number of ministries has been consolidated from 27 to 19. The government is now implementing a program to eliminate, privatize and out-source 30 agencies and functions in five major ministries that now employ more than 60% of all civil servants.

Under the FRDP, over 20,000 civil servants were retrenched in 1995-96, comprising workers in non-established positions in non-priority areas. Another 3,194 individuals were retrenched in 1997. Retrenchment will help to restrain the growth for several years in the proportion of the budget allocated to wages at the expense of capital and recurrent items. In the same year, the number of principal secretaries was cut down by 12.

Despite the success achieved in reducing the fiscal deficit in some instances, the government has had to deal with problems with the planning, quality and control of expenditure. To address these problems, the government adopted the Medium Term Expenditure Framework (MTEF) approach to budgeting under the IMF's Enhanced Structural Adjustment Facility (ESAF). The approach has been used in a few ministries in 1996/97 and eventually will cover all ministries. The main focus of MTEF is on restructuring expenditure both between and within sectors so as to direct sufficient resources to higher priority sectors/activities while either cut back on or eliminate altogether resources for lower priority areas.

3.0 The Impact of the Reforms, Current and On-going Efforts

Due to improved tax administration over the past few years, revenue collection has improved. As a percentage of Malawi's GDP, the net tax revenues improved from 18.1% in 1994/95 to 23.9% in 1995/96. After this period, they have been declining as a percentage of GDP. The most remarkable drop has been in the case of international trade taxes, where the rates have been gradually reduced due to regional and bilateral trade agreements. International trade taxes as a percentage of the GDP have declined from 7.0% in 1995/96 to 3.4% in 1997/98.

Although revenue performance in nominal terms improved between 1993/94 and 1998/99; tax buoyancy, change in tax revenue with respect to change in GDP, has on average been around 0.93%. This means that for every 1% growth in GDP, revenues have been increasing only by 0.93%. When the tax system of a country is not buoyant enough, the country may not be able to meet its financial obligations as the economy grows. One important reason for the reduction in expected revenues is the erosion of revenues from exemptions/deductions and regional trade protocols. Using exemptions as incentives to promote economic activity

results in the altering of the tax base and thereby lowering of tax buoyancy. It is generally agreed upon that only through the improvements in the structure of tax system over-time can tax buoyancy rise. The other reason for the low buoyancy is that a large share of the GDP structure of Malawi is taken up by the subsistence sector, which usually is untaxed.

The non-tax related revenues have continued to show poor performance. This is primarily a reflection of a poor performance of the Ministries and Departments that charge fees for their services. As a way of encouraging these Departments, the government now grants some of them to retain a portion of the revenue they collect for their budgetary needs. These collections are then offset against the amount that they are supposed to get from Treasury. It is hoped that this system will result in a marked improvement in departmental receipts.

It is expected that the operationalization of the Malawi Revenue Authority in February 2000 will result in an improved system for tax administration. It is envisaged that tax collections will improve from the current average by an amount of 15% of GDP.

Table 1: Central Government Revenue (MK million)

	1980/81	1990/91	1997/98	1998/99	1999/00	2000/01
In MK amounts:						
Gross Tax Revenue	166.9	888.0	8147.0	10432.9	13448.8	17309.4
Taxes on Income and Profit	64.9	371.2	3467.7	4629.1	6168.0	7708.00
Taxes on Goods and Services	59.2	347.2	2671.1	4053.6	5445.8	7141.4
International Trade Taxes	42.1	162.8	1976.4	1750.1	1835.0	2417.0
Non-Tax Revenue	32.4	155.2	533.31	728.2	1440.5	1899.1
Grand Total	199.2	1043.2	8461.66	10884.0	14628.3	18858.5
As a percentage of GDP:						
Gross Tax Revenue	15.9	17.6	13.8	15.4	14.6	15.9
Taxes on Income and Profit	6.2	7.3	5.9	6.9	6.7	7.1
Taxes on Goods and Services	5.6	6.8	4.5	6.0	5.9	6.6
International Trade Taxes	8.1	6.4	3.4	2.3	2.0	2.2
Non-Tax Revenue	3.1	3.1	0.9	1.1	1.6	1.7
Grand Total	19.0	20.5	14.3	16.1	15.9	17.3
GDP at Current Market Prices	1048.9	5079.4	59068.2	67578.2	91886.9	109059.7

Source: Ministry of Finance.

The increase in allocations to social sectors has affected allocations to other sectors, particularly the economic sectors. Within the economic sectors, only the agricultural sector has been receiving substantial resources while the allocations to the others have stagnated. It would have been ideal if all economic sectors, which are the productive sectors, were also being helped in order to support the social sectors. On the other hand, the general administration sector has not suffered as much. In fact up until 1997/98, the general administration sectors were getting more than any other sectors including the social sectors. Within the social sectors, the share of the administrative component is also high, implying that the general administrative sector has received higher priority than normally thought of. For instance, in education, the share of teaching and learning materials has averaged only

about 10% of its non-salary recurrent expenditures. This implies that a significant portion of the allocations within the social sectors is administrative in nature. The government should reduce the administrative expenditures and increase the allocations to the economic sectors. Any increase in the social sectors should be targeted towards the actual high priority activities such as teaching and learning materials, procurements of drugs and pharmaceuticals, etc. Otherwise, there should be no more increases to the sector. In the same vein, it is recommended that the economic sectors should be helped in building their capacity for efficient service provisions.

Table 2: Central Government Expenditure (MK million)

	1980/81	1990/91	1997/98	1998/99	1999/00	2000/01
In MK amounts:						
<i>Recurrent Expenditure:</i>	187.2	1060.2	12311.1	12609.5	16349.7	25967.3
General Public Service	59.6	399.8	3120.1	3556.9	3778.4	5430.6
Social and community services	44.2	239.0	4567.1	3375.4	5777.6	6436.7
Economic Services	33.1	161.0	940.0	688.7	1142.7	1551.8
Unallocable Services	70.7	402.4	2777.7	3461.9	3251.3	7156.3
<i>Development Expenditure:</i>	174.9	311.6	1808.1	5323.4	9238.8	12249.7
General Public Service	-	-	262.5	539.2	2026.8	2144.2
Social and community Services	21.4	89.1	748.6	3108.8	3419.6	4566.4
Economic Services	139.1	209.1	738.3	1455.9	3792.4	5341.1
Unallocable Services	14.3	13.5	58.8	219.6	-	198.2
As a percentage of GDP:						
<i>Recurrent Expenditure:</i>	17.8	20.9	20.8	18.7	17.8	23.8
General Public Service	5.7	7.9	5.3	5.3	4.1	5.0
Social and community services	4.2	4.7	7.7	5.0	6.3	5.9
Economic Services	3.2	3.2	1.6	1.0	1.2	1.4
Unallocable Services	6.7	7.9	8.5	5.1	3.5	6.6
As a percentage of GDP:						
<i>Development Expenditure:</i>	16.7	6.1	3.1	7.9	10.1	11.2
General Public Service	-	-	0.4	0.8	2.2	2.0
Social and community services	2.0	0.8	1.3	4.6	3.7	4.2
Economic Services	13.3	4.1	1.3	2.2	4.1	4.9
Unallocable Services	1.4	0.2	0.1	0.3	-	0.2
Deficits:						
Excluding Grants	-162.9	-328.7	-4751.4	-5522.4	-8560.6	-13966.5
Including Grants	-119.6	-216.0	-2659.0	-1480.8	-1618.6	-2646.8
Deficits as a percentage of GDP:						
Excluding Grants	-15.5	-6.5	-8.0	-8.2	-9.3	-12.8
Including Grants	-11.4	-4.3	-4.5	-2.2	-1.8	-2.4
GDP at Current Market Prices	1048.9	5079.4	59068.2	67578.2	91886.9	109059.7

Source: Ministry of Finance.

Table 2 shows that the prioritization process has not yielded the expected resource allocation. The MTEF process was expected to result in a re-allocation of resources from low priority sectors like general administration toward the high priority sectors of social sectors. One of the probable explanations for the continued dominance of the general administrative sectors is the slow pace of civil service reforms, which should have resulted in streamlining and

rationalization of the civil service. This implies that much as the MTEF has been successfully introduced in all Ministries, its success has been undermined by the slow pace of other reforms, especially civil service reforms. Therefore, the government should speed up the civil service reform program. This should result in a more streamlined and efficient service delivery system.

The quality of budget estimates has not been up to expected standards. In particular, Ministries and Departments have tended to try to do too much with their limited resources. The tendency has been to spread the resources too thinly across all activities. At the stage of budget implementation, it has often been the case that the initial allocations made were unrealistic and insufficient and extra-budgetary allocations became necessary. The budgeting problem has to do with the poor costing information and techniques in the spending agencies. It has often been found that Ministries and Departments that purportedly provide sufficient resources for their high priority activities run out of resources half way through the year, implying that they under-provide for their activities.

The problem of costing has been worsened by the instability of the Kwacha. Starting from 1993/94 when the country moved from a fixed exchange rate to a floating one, there have been a number of depreciations. These have impacted on the cost of providing services and the Ministries, instead of re-aligning their expenditures to be in line with the budgets, have tended to maintain their pre-devaluation expenditure levels.

Over expenditures have also arisen from political directives to spend on activities that were not originally budgeted for. The problem has been that Controlling Officers do not provide feedback to those issuing the directives on their final implications. Furthermore, the affected Ministries and Departments do not make the necessary adjustments in their allocations in order to remain within the budget.

In addition to the technical problems associated with the Malawian budget process, there are political and attitudinal problems as well. In particular, the budget process is seen as owned by the Ministry of Finance and the need to maintain hard budget constraints is not well appreciated. In many line ministries, the impression that extra funds can always be obtained from the Ministry of Finance persists. Thus, budget constraints are seen as soft and budget allocations not "locked in". This is perpetuated by the significant proportion of funds allocated to the Ministry of Finance, a history of funding extra-budgetary expenditures by the Ministry of Finance, and loopholes existing in the Finance and Audit Act.

Despite numerous circulars advising Ministries and Departments against spending on credit, one of the main cash budget principles, there is still a worrying trend of building up arrears. Part of the problem has been that private traders do supply these goods and services to the government on credit. These traders have continued supplying goods and services in the hope that somehow they will be paid eventually. In other words, the cash budgeting system is not being fully implemented by all parts of the government.

There has been a problem of arrears build-up regarding utilities, especially in water and electricity, and to a lesser extent in telephone sector. With the cash budget system, Ministries and Departments have found it easier to postpone payment for their utilities and instead spend the money on other services such as travels. Consequently, there has been a gradual build up of these arrears with the utility companies.

The other problem relates to the commitments made by donors towards the budget. Donors, on average, contribute about 85% of the resources for the Development Budget and about 25% of the Recurrent Budget. This means that any delays in the release of funds by the donors have serious repercussions on timely implementation of the budget. Quite often, the donors have not released the resources on the dates originally programmed and this has caused cash management problems. In the end, the government has had to resort to more short-term borrowing than originally planned.

With these problems still present, the fiscal deficit (excluding grants) has remained high with 9.3% in 1999/2000 and a projection of 12.8% for 2000/01. The deficit to revenue ratio remains also high at 58.5% in 1999/2000 and 74.1% in 2000/01. Revenue (excluding grants) as a percentage of GDP amounts for 15.9% in 1999/2000 and is projected to be 17.3% in 2000/01. This is still lower than the recommended 19%.

On the expenditure side, the allocation to general administration remains high at around 5% of GDP while the allocation to economic services has fluctuated between 1 and 2% of GDP. More than 50% of the recurrent budget is spent on gross consumption (wages and salaries as well as goods and services).

3.1 The 10-Point Plan

In an effort to charter a new direction for fiscal policy and planning in Malawi, the government came up with a 10-point plan in the 1999/2000 fiscal year which will focus on budget reform in the short to medium term. The budget will be restructured to achieve efficiency and effectiveness in program implementation. In this regard, a number of measures will be implemented and which include:

- All mini-treasuries in all parts of the government machinery will be effectively closed.
- Final decisions involving budgetary commitment have to be rightfully made only by the Ministry of Finance.
- All borrowing by ministries and other government agencies will be subjected to a process which will involve the ministry or agency; Treasury; the Reserve Bank; and Parliament.
- There will be no extra-budgetary expenditures except for unanticipated emergencies such as those occasioned by acts of nature.
- There shall be a full cost recovery for all activities where there is exclusive consumption, and benefits are internalized to the individual.
- There shall be an equitable cost-sharing scheme in areas of shared consumption with a generalized benefit to Malawian society such as in education (secondary and tertiary) and road maintenance.
- Implement an effective expenditure control program and cost-cutting measures by keeping the lid on aggregate spending as the only way of reducing inflation and interest rates; ensuring that expenditure is going for the purpose intended; and expenditure prioritization.
- Intensify efforts to improve expenditure management within the MTEF with a view to achieving effectiveness in public expenditures.
- Raise the level of fiscal transparency in program design and implementation through regular consultations with stakeholders.
- All parastatals will carry their weight, cover the costs, and service their debts. This calls for these organizations to streamline their operations, cut costs, and be realistic in their approach to the new competitive global economy.

- Future funding or financial assistance will only be available upon fulfillment of certain conditionalities and demonstrated financial prudence.
- Finally, there will be accelerated initiatives to take the pressure off the budget, foster economic growth, create employment, maintain a sustainable balance of payments position, and achieve price stability and overall macroeconomic stability.

To achieve the above, the government has already started implementing measures which are both non-tax and tax based as indicated below.

Non-tax Measures

The government has introduced full cost recovery on goods and services like:

- Passport and immigration documents whose fees have been increased from KW800 to KW2000 and KW400 to KW1000, respectively.
- Motor vehicle documents, like driver's licenses and motor vehicle registration whose fees have been increased.
- Police reports will be charged at KW2000 per report.
- House rents of government houses occupied by private sector employees will be at market based rates.

Partial cost recovery measures:

- Secondary school fees will be increased in a phased manner over the next three years.
- Starting from 2001, university fees will be increased from KW1,500 per student per year to KW46,000 per student per year.
- Partial cost recovery schemes will also be introduced for technical schools, nursing schools and the College of Health Sciences.

Expenditure reducing measures:

- The government will rationalize the diplomatic service and staffing levels at the diplomatic missions.
- The government vehicle fleet will be reduced by 25%.
- Subscription fee will be introduced for TV Malawi to reduce government subvention to the organization.

Tax Measures

Income tax measures:

- Increasing of income tax threshold exempt from tax from KW1000 to KW2000 per month.
- Expanding the income tax brackets from KW12,000, KW24,000 and KW42,000 to KW24,000, KW42,000 and KW60,000, respectively. All these are tax revenue reducing measures.

Custom measures—Revenue losing measures include:

- The remaining tariff rates on intermediate goods and raw materials have been reduced from 15% to 10%.
- Import duty rates on computers and related products have been reduced from 25% to free.
- Import duty rates under COMESA Trade Protocol will be eliminated by October 2000.
- Under SADC Trade Protocol there will be 10% reduction in import duty rates from 2001.

- Import rates on single cabin pick up motor vehicles of 2.99 tonnes and less have been reduced from 25% to 10%.

Custom measures—Revenue gaining measures include:

- Excise duty rates on alcohol, beverages and cigarettes have been increased by 20%.
- Surtax on petrol, diesel and paraffin have been converted to excise duty and increased from 5% to 10% for paraffin; and from 10% to 20% for petrol and diesel.
- Excise duty of 10% of 10% on selected goods like wheat flour, fruit juices, textiles and fabrics, photo copying, printing paper, foot wear, perfumes, furniture, video games and some tea foods.
- Extension of surtax to commercial transporters (excluding minibuses).
- Surtax on satellite and cable TV providers.
- Excise duty on 4X4 motor vehicles of 2000cc and above increased from 10% to 50%.
- Import duty on double cabin pick up motor vehicles of 2.99 tonnes and less increased from 20% to 25%.
- Excise duty on double cabin pick up motor vehicles of 2.99 tonnes and less increased from 5% to 10%.
- Goods carrying motor vehicles of 3 tonnes to 14.99 tonnes have been subjected to 10% import duty and 5% excise duty.
- Excise duty of 5% on goods carrying vehicles of 15 tonnes and above.

The above measures would result in revenue losses and gains as indicated in the Table 3. It can be seen that if the cited policies are successfully implemented there would be a net-gain in revenue.

Table 3: Revenue Gain and Loss in the 2000/01 Budget (MK Million)

Revenue Gaining Measures:	
<i>Non-Tax Measures:</i>	
Passports and Immigration Documents	25.0
Motor Vehicle Documents	310.0
House Rents	25.0
Tertiary Education (University)	150.0
Total	510.0
<i>Tax Measures:</i>	
Excise Duty on Alcoholic Beverages and Cigarettes	80.0
Surtax on Petroleum Products	600.0
Excise Duty on Selected goods like wheat flour	60.0
Surtax on Commercial transporters (excluding minibuses)	38.0
Surtax on Satellite and Cable TV Providers	10.0
Excise Duty on 4x4 vehicles of 2000cc	36.0
Import and Excise Duty on Double Cabin pick up	22.0
Import and Excise Duty on 3 to 14.99 tonner vehicles	19.0
Excise Duty on 15 tonner vehicles and above	17.0
Total	882.0
Grand Total	1392.0
Revenue Losing Measures:	
Broadening of Tax Brackets to Reduce Tax Burden	600.0
Reduction in Tariff rate on imported Raw Materials	100.0
Removal of Import duty on computers, UPCs and Printers	8.0
Removal and Reduction of import duty under COMESA and SADC	18.0
Grand Total	846.0
Net Gain	546.0

Source: Ministry of Finance.

4.0 Conclusion

The government of Malawi has made great strides in implementing deficit reduction measures. On the revenue side, considerable efforts have been made especially in rationalizing surtaxes and broadening of the tax base by way of introducing commodities and services that previously were not on the tax list. However, tax administration remains weak. It is hoped that the operationalization of the Malawi Revenue Authority will improve the situation.

On the expenditure side, the government continues to face planning, quality and control problems. Despite the adoption of the MTEF process to address these problems, obstacles seem to persist. The 10-point plan introduced in the 1999/2000 fiscal year, however, is expected to help Malawi achieve efficiency and effective program implementation.