

Trade Policy Briefing

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The SAIA Trade Policy Briefing Series is intended to elicit debate on critical issues relating to South Africa's overall trade strategy. The broad focus of the series is on the political economy of the international trading system and South Africa's strategic responses to it. This covers the full spectrum of our trade strategy, from the multilateral trading system, to strategic regional and bilateral partnerships, and particular issues within the trade agenda.

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MALAWI AND THE REGIONAL OVERLAP PROBLEM

Trade policy options

by George Naphambo

In 2008 COMESA is supposed to graduate from being a free trade area to being a customs union. Whether this will be possible, is doubtful. One of the problems that could impede the formation of the customs union is the fact that some members of COMESA belong to SADC, Malawi being one of them. That being the case, Malawi finds itself at a crossroads of whether to take the COMESA route or the SADC route. This brief looks at the different options available to Malawi and the key players which have helped shape its position on its dual membership. It first looks at Malawi's trade profiles; then the respective roles of government, and the private sector. It concludes with some policy options.

Why dual membership is a problem

A country cannot belong simultaneously to two customs unions as this is technically not possible. For instance, it would mean that a country would have to have two tariff schedules – one in terms of the SADC agreement and another in terms of the COMESA agreement. This would cause complications especially to third parties wishing to export to that country.

The problem of dual membership has also been of concern at the recent Eastern and Southern African-European Union (ESA-

EU) negotiations on the Economic Partnership Agreement (EPA) held in Mombasa. The European Commission (EC) was worried that dual membership of countries affected the transparency and predictability of the negotiations and made it hard to assess how far regional integration has progressed and the priorities of states. Currently it is widely believed that regional integration is widening even more within COMESA rather than SADC so countries that belong to both regional

Dual membership of countries affected the transparency and predictability of the EPA negotiations and made it hard to assess how far regional integration has progressed.

economic communities have a schizophrenic approach in that they have to engage certain gears when it comes to SADC and different ones when it comes to COMESA.

The EC further raised the concern that, since the EPA text is going to be a legally binding agreement, to be ratified by the EU parliament, the ESA grouping is problematic as it is not a legally recognised entity: there are no documents creating ESA so if an EPA is signed it would be invalid.¹ It has been argued

Figure 1: Malawi: lakes and rivers, roads, and railways

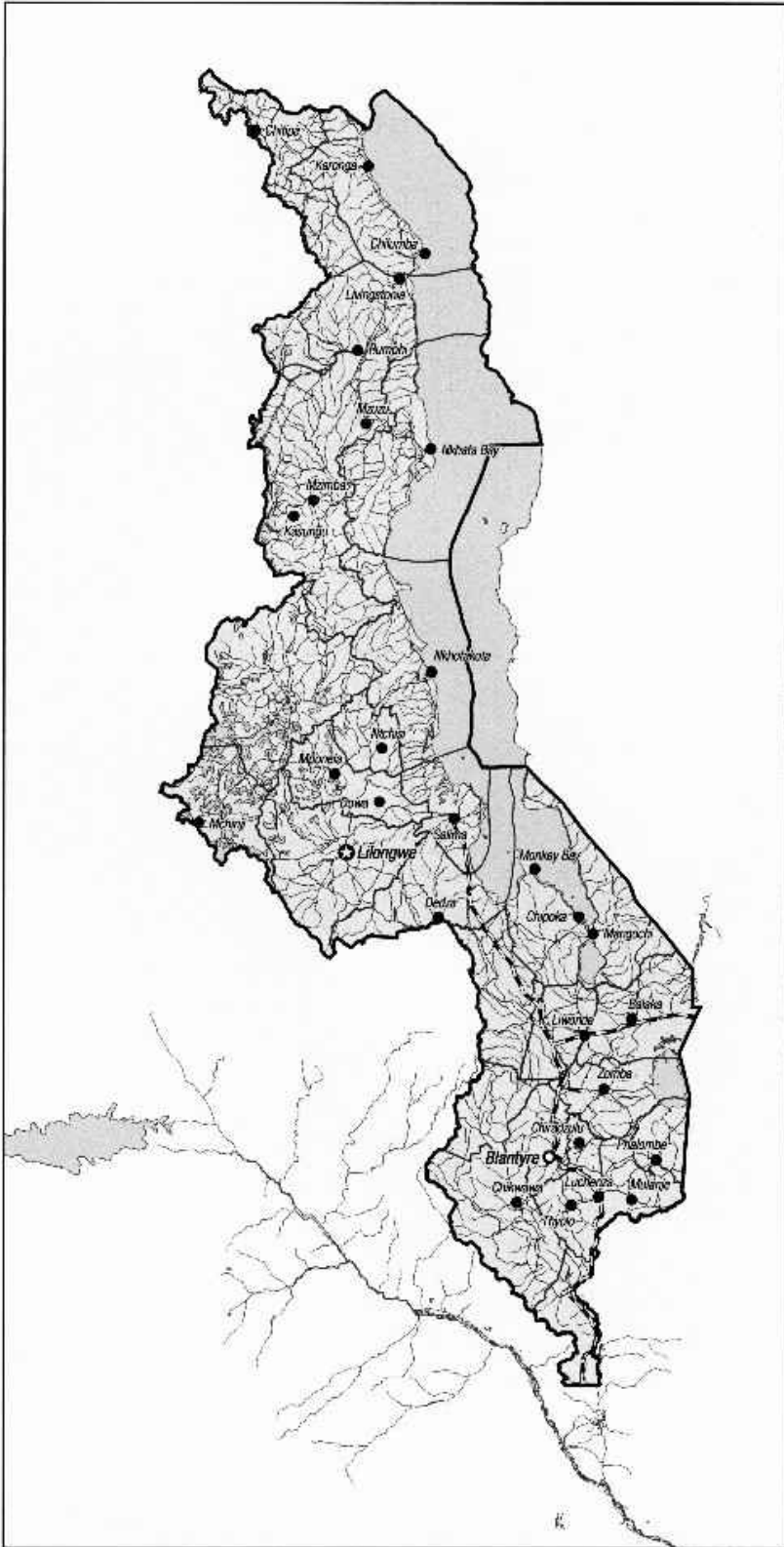


Table 1: Exports by Main Commodity (% share of Total Exports)

| Main commodity | 2000 | 2001 | 2002 | 2003 | 2004 |
|----------------|-------|-------|-------|-------|-------|
| Tobacco | 78.0 | 61.4 | 58.6 | 50.3 | 54.1 |
| Tea | 11.7 | 8.6 | 8.4 | 9.2 | 9.9 |
| Sugar | 3.8 | 8.4 | 11.2 | 12.2 | 8.5 |
| Cotton | 2.9 | 1.1 | 0.8 | 1.2 | 3.9 |
| Other | 3.6 | 20.5 | 21.0 | 27.1 | 23.6 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Reserve Bank of Malawi Report and Accounts for 2004

that for countries to side-step this issue while negotiating EPAs as a group, each country, can sign the EPA agreement as a bilateral agreement, not as a group of countries.

From these sentiments it seemed the EC would have preferred to negotiate separately with COMESA states without any additional states (be they SADC members or not) as one cluster and with SADC states as another cluster. Those members such as Malawi which belong to both groups would have to make a choice and leave one group.

This is also important because European Development Fund (EDF) funding will now be based on a regional economic community (REC) and a country cannot receive EU funding from both RECs as this would mean it having double access to funds compared to other states.

From the foregoing, it is clear that should both COMESA and SADC become customs unions, Malawi will have to choose which REC to belong to. In fact the pressure is already mounting for it to belong to one REC even before any customs union is formed. It is therefore no wonder that trade circles have started debating the issue in light of Malawi's trade interests.

Malawi's Trade Profile

Malawi is an agricultural economy, with the bulk of its exports comprising agricultural goods. The key exports are tobacco, tea, sugar and cotton, with tobacco accounting for more than 50% of total exports. (Refer to Table 1.)

These exports are primarily destined for the South African market, with SADC neighbours Mozambique and Zimbabwe (also a COMESA member) featuring in the top 10. European

destinations – particularly former colonial master, the UK – are cumulatively more important than African destinations, whilst the United States is also an important partner. The question is what bearing these trading relationships will have on the Malawian government's final decision concerning which REC to join – should it come to that.

Membership in Different Trade Arrangements

Malawi is involved in a number of trade and development initiatives within Africa. It is a member of COMESA and is part of the COMESA FTA.

Malawi is also a member of SADC and most of its imports originate from this region especially from South Africa. Being a landlocked country, Malawi is dependent on SADC members' ports, notably Mozambique and South Africa – neither of which are COMESA members.

Malawi also has duty free access to South Africa under the so-called "MMTZ Agreement".² According to Government officials, most of the trade between these two countries is done in terms of this agreement rather than the SADC trade protocol. However, the agreement was meant to terminate in December 2006 but has now been extended to March 2007, when the

SACU's durability was rooted in SA's self-interested willingness to play a leading role in administering the customs union.

Table 2: Malawi's Top Ten Export Destinations, 2005 (Malawi Kwacha)

| Country | Value |
|-------------|----------------|
| RSA | 11,038,871,799 |
| UK | 6,831,180,649 |
| USA | 6,433,479,134 |
| Germany | 4,458,720,804 |
| Switzerland | 4,158,539,177 |
| Netherlands | 2,565,814,344 |
| Russian FE | 2,156,804,488 |
| Mozambique | 2,059,722,165 |
| Egypt | 1,842,364,498 |
| Zimbabwe | 1,331,929,562 |

Source: Ministry of Trade and Private Sector Development

parties will conclude talks of whether or not to extend the agreement. Should parties refuse to extend the agreement, the SADC trade protocol will inevitably become more important for exporters unless another agreement with SACU is entered into. Furthermore, since the MMTZ Agreement allows for the export of textiles and cotton only, then one must conclude that the rest of the trade between South Africa and Malawi is under the SADC Protocol.

Malawi is also a signatory to the Lomé Convention and has enjoyed preferential treatment under the Cotonou agreement. Exports of sugar have especially benefited from this agreement. As this agreement will expire in December 2007 Malawi is currently negotiating the Economic Partnership Agreement (EPA) under the ESA configuration in preparation for the expiry

Being an LDC, Malawi also has duty free access to the EU market under the Everything But Arms (the EBA) preference scheme. This scheme creates an alternative for maintaining duty free access as Malawi can opt not to sign the EPA agreement (which is reciprocal) and maintain its access to the EU market through the EBA. However, some critics have argued that Malawi has not benefited from market access under the EBA as its rules of origin are too strict. If true – and this has to be considered on a product-specific basis which is beyond the scope of this paper – it would make sense to enter into an EPA since in principle Malawi and its partners can negotiate terms that are more advantageous and relevant to Malawi.

Furthermore, the EBA does not have a development component to it while the EU has agreed in principle to incorporate development as part of the EPA agreement since ESA countries refused to enter into the EPA agreement if development was not a part of it. However, the value of this agreement is contestable given that the Commission has also displayed great reluctance to provide additional funds, and would really like to programme support under its existing vehicle (EDF 10).

Other critics have mentioned that since the EBA is perpetual, Malawi can use it as a fall back option for exporting to the EU and can still enter an EPA in order to create another option for exporting to the EU. However, since the EBA is a unilateral agreement rather than a contractual one, some fear that it could be renounced at anytime and that would leave Malawi in a bad situation. It is therefore, believed that signing an EPA will cover this risk.

The question of Malawi's status as an LDC and the fact that it can opt out of signing the EPA agreement is a crucial one, especially when one considers that Malawi is too small an economy to enter into a reciprocal trade agreement with the EU. Therefore the option of not signing an EPA agreement seems to be attractive.³

However, the fact that the ESA grouping contains developing and least developed countries complicates the issue since countries like Kenya have no option but to negotiate an EPA as they are not beneficiaries of the EBA. This is despite Article 37.6 of the Cotonou agreement which provides that:

In 2004, the [European] Community will assess the situation of the non-LDC [Least Developed Countries] which, after consultations with the

Malawi has not benefited from market access under the EBA as its rules of origin are too strict.

Table 3: Exports to COMESA and SADC in million US Dollars from 2000-2005

| Region Year | 2001 | 2002 | 2003 | 2004 | 2005 |
|-------------|------|------|------|-------|-------|
| COMESA | 84.3 | 36.8 | 76.6 | 74.4 | 44.3 |
| SADC | 79.5 | 73.8 | 87.2 | 116.5 | 139.5 |

Source: Ministry of Trade and Private Sector Development

Table 4: Top 3 exports and their main destinations

| | 2003 | 2004 | 2005 |
|---------|-------------|-------------|-------------|
| Tobacco | Germany | Germany | Switzerland |
| | USA | USA | Germany |
| | Japan | Egypt | USA |
| | Egypt | Netherlands | Russia |
| | Netherlands | Switzerland | Netherlands |
| Tea | UK | UK | RSA |
| | RSA | RSA | UK |
| | Kenya | Kenya | Kenya |
| | USA | USA | USA |
| | Pakistan | Egypt | Pakistan |
| Sugar | Kenya | Kenya | UK |
| | RSA | UK | RSA |
| | Netherlands | Spain | Spain |
| | UK | RSA | Portugal |
| | France | Belgium | USA |

Source: Ministry of Trade and Private Sector Development

Community decide that they are not in a position to enter into economic partnership agreements and will examine all alternative possibilities, in order to provide these countries with a new framework for trade which is equivalent to their existing situation and in conformity with WTO rules.

Malawi therefore finds itself in a situation where it has to ask itself whether to betray its fellow ESA partners in pursuit of its interests or to stick with the group and try to get the best out of the negotiations. It would seem that Malawi has chosen the latter option.

Malawi has also signed a number of bilateral agreements with Mozambique, Zimbabwe and Botswana. The Zimbabwe and Mozambique bilateral agreements are of particular significance as they offer less stringent rules of origin than the COMESA and SADC agreements do. Therefore it would seem that exporters would prefer exporting under these agreements.

However, it is currently unclear as to how effective these agreements are, mostly because

statistics are scant and the rules of origin for the Malawi-Mozambique bilateral agreement only came into effect in August 2006. In addition to this, the Malawi-Mozambique agreement exempts sugar and tobacco (manufactured and unmanufactured) from preferential treatment.⁴ As Table 1 shows, these two products account for most of Malawi's trade. According to the TRALAC report, the Malawi-Botswana agreement is basically defunct.

Finally, Malawi has also benefited from AGOA, textiles and agricultural products being the two most important exports to the US under this programme.

SADC is a major export destination and one that surpasses COMESA at least from 2002-2005.

Key Players

The first key player is the private sector which is already in support of COMESA as it feels the rules of origin under COMESA provide better market access than the Rules of Origin under SADC. Also, Malawian exporters have a comparative advantage within COMESA which has enabled them to export competitively to this market such that COMESA is now a significant market for Malawi (see Table 3). The private sector has championed its support for COMESA through the National Trade Policy Working group (NTPWG) which is an organisation through which the private sector engages the government on issues of trade policy. It is headed by a member of one of the exporting companies and supported by a secretariat.

However, statistics seem to show that SADC is a major export destination and one that surpasses COMESA at least from 2002-2005. As Table 2 shows, in 2005, South Africa was the key destination for Malawian exports, accounting for almost twice the amount of goods exported to the US or the UK. Table 3, which compares exports to SADC and COMESA clearly shows that Malawi exported more to the SADC region rather than COMESA in the years between 2001 and 2005. Table 4 also shows the importance of South Africa – a key SADC member – as it is within the top five destinations for sugar and tea. According to media reports, Kenya might no longer be as important a destination for tea as tea production in Kenya is recovering from the drought which affected Kenya from 2003-2005 and which created demand for Malawi's tea as Kenya's domestic production was curtailed.

These statistics clearly contradict the views of the Private sector that COMESA is the top export destination after the EU, and when one takes into account that some COMESA members also belong to SADC, it is clear that SADC is an important market for exporters and pulling out of SADC may mean putting these exporters out of business and entailing significant job losses.

Furthermore, most investment comes from the SADC region, South Africa accounting for

the bulk of this. This is not surprising because there is a growing trend of South African companies that are moving into the rest of Africa to find extra markets. In addition South Africa is seen by investors from other countries as the launch pad into investing in Africa. That being the case, South Africa is important to Malawi's investment priorities and the Private sector is eager to maintain its relations with South Africa; belonging to SADC solidifies this relationship.⁵

Malawi, at least in the short term, will not be leaving either of the two RECs.

The private sector as one of the key players in the EBAte would, therefore, be reluctant to withdraw from either SADC or COMESA as there are economic benefits in belonging to both.

Another key player is, naturally, government and the critical person is the President himself, Dr Bingu Wa Mutharika. It has been speculated that since he was instrumental in the creation of the COMESA FTA, as he was Secretary General of COMESA at the time, he would favour COMESA. However, looking at his vision for the country, the picture is not so clear.

If Malawi left SADC, it could lose fiscal revenue as most of its imports come from the SADC region.

This is because the President, together with key government officials within the Ministry of Finance and the Ministry of Trade and Private Sector Development (MITPSD) have come up with a plan for Malawi's growth which has so far earned dividends as witnessed by the recent cancellation of 90% of Malawi's external debt by the World Bank, the Paris Club and other multilateral donors. His plan also includes the improvement and development of infrastructure in order to reduce supply-

side constraints especially transport costs by improving the country's road network which is currently government's main priority.

Another major infrastructure project which the President has proposed is the construction of the Shire-Zambezi waterway which is estimated to cost US\$4 billion. The waterway will stretch from the Shire river to the Zambezi river and connect to the Indian Ocean through the port of Chinde in Mozambique. It is expected that if this project becomes a success, Malawi will transport the majority of its goods through this waterway and thus will cut transport costs and in turn reduce costs for most exporters. Currently most of its goods enter or exit Malawi by road which is quite expensive especially due to increases in fuel prices and the low tonnage that trucks can carry. It is, therefore, expected that should the waterway become a success the cost of transportation will be more significantly reduced, especially because goods will travel a shorter distance.

A pre-feasibility study on the waterway project has already been conducted and the green light has been given. However, more funds need to be sourced and the President is eyeing both SADC and COMESA to provide extra funds.

For instance, the Director of Trade in the MITPSD was recently quoted⁶ as stating that COMESA would partly fund the waterway project. Furthermore, the President bemoaned the lack of enthusiasm from the SADC secretariat as it has not expressed its support for the project. It would seem that the President and other key players believe SADC is more capable of providing the funds for such projects than COMESA especially through South Africa's regional banks such as the Development Bank of Southern Africa. It is therefore most likely that Malawi will not be pulling out of either SADC or COMESA as long as the waterway is one of Malawi's priority projects.

Indeed the President hinted about this on a recent visit to South Africa in October 2006 when he proposed that COMESA should focus on trade while SADC should focus on development especially because SADC was originally formed to promote development

and the trade protocol only came in at a later stage. Furthermore, SADC has a security dialogue while COMESA doesn't. If this was to happen it would mean Malawi would still belong to both RECs without any conflicts as it would pursue a development agenda under SADC and a trade agenda under COMESA. This is a clear sign that Malawi, at least in the short term, will not be leaving either of the two RECs.

Another element to factor in when it comes to the problem of dual membership is that if Malawi left SADC, it could lose fiscal revenue as most of its imports come from the SADC region. Much would depend on how its trading partners reacted, although given that it is companies, not governments that trade, a wholesale withdrawal of exports would seem to be very unlikely. Yet according to a recent study by TRALAC⁷, this would be one of the negative impacts of leaving SADC as Malawi, like most other least developed countries, relies on customs duties for its revenues. This study points out that this is one of the reasons why Malawi has missed its tariff reduction targets under the SADC Trade protocol. However, Malawi will still lose revenue if it remains in SADC because it will be obliged to reduce its tariffs under the SADC trade protocol. So either way Malawi could lose revenue.

The TRALAC study identified three options for Malawi:

- It could either remain in COMESA and SADC and not participate in the processes for the formation of a customs union; or
- Malawi can stick to COMESA as far as trade is concerned and opt out of the SADC Trade Protocol while adhering to other SADC programmes and protocols; or
- It could participate in negotiations for the formation of both the COMESA customs union and the SADC customs union while conducting further research on which REC is the better option.

The TRALAC study favours the first option and this is in line with the President's stance.

Recently he made statements in the media that Malawi is not ready to belong to any customs union be it SADC or COMESA. He even stated that had he been President at the time the deadlines for creation of the Customs Union were agreed to, he wouldn't have allowed Malawi to sign on to the agreement. His fear is that joining a customs union before Malawi has strengthened its manufacturing, and hence export capacity, would only turn Malawi into a market for foreign goods and would not open up markets for Malawian exports. Since this stance is also in tandem with the Private Sectors interests, the President is likely to get support and stand firm on his position.

Alternatively, it has been questioned whether the creation of a manufacturing base is a realistic goal for Malawi taking into consideration the fact that Malawi will be pitting itself against countries such as China. These critics have stated that it would be better for Malawi to open to imports that are not domestically produced, taking due care of revenue considerations, and to liberalise core infrastructure services with a view to attracting investment to support more general economic growth, especially in agriculture and tourism.

Policy Options

When one looks at the full picture therefore, one can reasonably conclude that Malawi will remain in the SADC and COMESA FTAs as long as they remain FTAs as this option best serves Malawi's interests, at least in the short term. However, the impact this will have on the EPA negotiations needs to be looked at. It is clear that if it is to benefit from EU funding it has to belong to one REC only unless the EU comes up with a formula for funding countries which belong to more than one REC. If this formula is not developed, there will be pressure on Malawi to leave either one of the RECs before the end of 2007 and when push comes to shove, Malawi will have to make a decision because it cannot forego EU funding.

EDF funding is relevant to Malawi in the forms of budget support and project finance. For instance, in the 2005/6 budget

Malawi's Budget was pegged at US\$914 million.⁸ However, Malawi was only able to raise US\$482 million internally, with US\$383 million dollars coming in the form of grants from donor countries. From this US\$383 million, the EU contributed US\$55 million dollars representing 15% of all grants. It also funded road construction projects to the tune of US\$50 million. This grant for road construction meant that money which would have been granted for reconstruction of roads under the budget, could be diverted to other areas. In the 2006/2007 fiscal year Malawi's budget has been pegged at US\$986 million and out of this US\$284 million is expected to be in grants. Already the EU has granted US\$10 million.⁹ From these statistics it is clear that the EU is one of Malawi's major donors having contributed a total of 141.4 million Euros¹⁰ in 2005/2006 fiscal year. Without this funding Malawi would have had problems raising money to support its budget and to fight the famine which has gripped the country from 2003. EDF funding is therefore important to Malawi.

Another problem is that should Malawi still push for the proposal that SADC should focus on development and COMESA on trade as a reason for remaining in both RECs, it would entail an end to the trade protocol under SADC. This would possibly draw a lot of opposition because some countries such as Mozambique and Tanzania have given up their COMESA memberships to focus on SADC in its entirety and it is therefore unlikely that they would want a SADC agreement without a trade protocol, as this provides market access to other SADC members for these countries, despite the restrictive rules of origin.

Only time will tell how long Malawi will continue to sit on the fence. And as events keep unfolding, its position will undoubtedly vary. For instance, it remains to be seen what the impact of the debt cancellation will be on Malawi's investment attractiveness and thus development and how this will impact on the decision to belong to either SADC or COMESA, if at all.

Another critical issue is politics. If Dr Bingu Wa Mutharika leaves the Presidency in the upcoming elections in 2009, or in 2014, will the next president have a different stance or

will he stay the course? Furthermore, as his party struggles politically, will he be forced to abandon his current economic plans in order to focus on politics, and attain a majority in parliament, so that he can easily pursue his economic plans?

Whatever the situation, it is clear that the decision to leave COMESA or SADC has to be made on economic rather than political grounds. Furthermore, as the statistics show,

SADC is a much more important trading partner than COMESA and thus the view that most of Malawi's exports are going to the COMESA region needs to be revisited. Since the primary aim of creating an FTA or customs union is to promote trade, trade ought to be the main economic factor in determining which FTA to belong to. Assuming the current trends in trade continue, then Malawi ought to choose SADC over COMESA should it come

to the situation where it has to choose one over the other.

Still, such a decision will have significant opportunity costs. In the short term, Malawi is better off not entering a SADC or COMESA customs union and remaining in both FTAs. This option will benefit exporters exporting to both SADC and COMESA.

Endnotes

- 1 Malawi being an LDC can opt out of the EPA negotiations. Still it seems that the Malawi government does not want to exercise this option because there is a feeling that Malawi is better off signing an EPA than not.
- 2 The MMTZ Agreement is an agreement between SACU and four other countries, i.e. Malawi, Mozambique, Tanzania and Zambia, all LDCs. It grants duty-free access to textiles and clothing exports destined for the SACU market on a non-reciprocal basis subject to quotas. It was expected to expire by 2006 but the parties agreed to commence negotiations in March 2007 in order to determine whether or not to extend the agreement. According to commentators resistance to the extension could be expected from Lesotho, Namibia, South African clothing producers (not retailers), and most notably the Congress of South African Trade Unions (COSATU).
- 3 This view has been criticized because many economists argue that in principle, the trade and investment complementarities are strong and hence likely to deliver a positive impact. This the EBA is indeed on-going and both sides have merit. It is submitted that, though opening up could be beneficial in the long run, the short term impact of such a policy could be detrimental to most small-scale farmers who wouldn't be able to compete with subsidised EU products. Since the agricultural sector in Malawi employs about 90% of all employees and the manufacturing sector is dominated by agro-processing and manufacturing, most workers would suffer. Such loss would be exacerbated by the lack of social safety nets such as the US's Trade Adjustment Arrangement or the EU's Globalisation Adjustment fund which compensate people who lose jobs due to liberalisation. These funds also provide money for retraining ex-employees. Since Malawi can simply not afford such a programme, job losses resulting from liberalisation could hit workers hard.
- 4 See page 22 and 23 of Trade Policy Options On Malawi's Regional And Bilateral Trade Arrangements (2006) report by the Trade Law Centre (TRALAC). This report was commissioned by Malawi's Ministry of Industry, Trade and Private Sector Development and is as of yet unpublished. It was aimed at exploring the different avenues available to Malawi in deciding whether or not to belong to SADC or COMESA.
- 5 Some have argued that South African Companies would still invest in Malawi whether or not it belongs to SADC as long as such investments remain profitable.
- 6 See article entitled "Malawi To Use Comesa Fund On Waterway" in the Daily Times of 6th November 2006.
- 7 See paragraph 42 of the TRALAC report cited in footnote 4.
- 8 See Paragraph 12 of the Minister of Finance's 2006/07 Budget Statement presented in the National Assembly available at <http://www.finance.gov.mw/downloads/budget2006.pdf>.
- 9 See press release dated 11 December 2006 available at http://www.delmw.ec.europa.eu/en/eu_and_malawi/Delegation%20Press%20Releases/PRBS2%20signing%20press%20release%20111206.doc.
- 10 See Development Cooperation In Malawi Overview available at the EU-Malawi government website i.e. <http://www.delmw.ec.europa.eu/en/index.htm>