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AID FOR TRADE FROM MALAWI'S PERSPECTIVE

ABSTRACT

World trade ministers met during the 6th World Trade Organisation (WTO) Ministerial Conference in Hong Kong, China in December 2005 and reaffirmed that Aid for Trade should aim at helping developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them implement and benefit from WTO Agreements and more broadly to expand their trade.

This was in recognition to the fact that many poor countries see limited benefits from the round unless their supply-side capacity constraints are addressed. Others fear that they only stand to lose from preference erosion under multilateral liberalization, and that they would have to forego scarce fiscal revenue or suffer other adjustment costs. Addressing these concerns is an important part of ensuring overall success of the Doha Round and a strong and effective multilateral trading system both of which are very much in the interests of poor countries as well as of the global trade community as a whole.

In order to reach the MDGs, growth must be accelerated in many countries. Trade can be an important engine of growth, but many poor countries lack the basic infrastructure to trade and face considerable supply-side constraints in participating in global markets. These difficulties can be compounded by own trade policy settings that create disincentives to enter international markets, such as maintenance of high unbound tariff. It is agreed that subsequent trade and associated economic policy reforms will require adjustment both economical and social costs especially from the conclusion of the Doha Development Round. For instance taking advantage of improvements in market access will entail additional domestic policy reform to facilitate trade as well as trade-related capacity building. In addition to addressing Institutional weaknesses a country like

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Malawi needs to tackle supply-side constraints of the economy that are crucial for it to diversify its production and export base, raise productivity and competitiveness, produce and market its products competitively and thus integrating in the global trading system.

In this paper we identify Malawi’s economic and political rational for it’s “aid for Trade” and thus spell out conditions for its effective implementation. We argue that “aid for trade” should not be piecemeal, should be properly directed based on proper needs assessment. These needs include; capacity building for Malawi’s effective participation within the international trade, infrastructure development and human knowledge. We indicate that “aid for trade” will create more impact and achieve its objectives if its demand-driven, based on perceived capacity deficiencies and priorities of the recipient country in our case Malawi, we thus argue that the recipient country should take an upper hand in designing the implementation of this assistance.

The paper puts forward a number of proposals for effective implementation and utilisation of “aid for trade” for Malawi, which include; utilisation of existing structures on the basis of Integrated Framework (IF) principles i.e. promotion of emerging aid framework, greater donor harmonisation (both bilateral and Multilateral), and provision of aid in the context of a country’s overall development strategy and poverty reduction objectives.

Thus meaningful Aid for Trade for Malawi should be tailored to address the needs beyond those identified under the IF Diagnostic Trade Integration Study (DTIS) as it does not generally take into consideration vital infrastructure such as Roads, Energy, health and education etc which are the real impediments to production in LDCs. In addition Aid for Trade should differ from the IF process in terms of donor response after the identification of priority areas.

1.0 INTRODUCTION

Malawi is a small landlocked country with an area of 118,484[1] square kilometers. Its population is estimated at 12.8 million in 2006 by the Malawi National Statistical Office (NSO). With a per capita income of approximately $170, Malawi is among the world's poorest least developed countries. Between half and two thirds of the population live below the poverty line. Majority of the poor are found primarily in rural areas and are mainly involved in subsistence farming, reflecting the links associated with other activities and lack of linkages to markets.

Malawi’s growth rates declined to 1.9% in 2005 from 4.6 % the previous year. This decline was attributed to the decline in growth in the agricultural sector to an estimated 2.7% from 6.7% due to the drought experienced in the 2004/5 crop season. The heavy dependency of Malawi economy on rain-fed agricultural production and commodities trade places the country in particularly vulnerable position in the event of climatic rainfall variability. Agriculture continues to dominate the production structure, contributing to 36 percent of GDP and 80 percent of export revenues in 2005. The performance of the tobacco sector is a key to short –term growth as tobacco accounts for over 50 percent of exports. Malawi remains heavily dependent on tobacco as a major source of export revenues. This makes the economy very vulnerable to adverse movements in terms of trade and long-term unfavourable prospects for tobacco. In this regard the need to diversify the country’s production and export bases becomes a major challenge for Malawian policy makers as well as their development partners. The mining sector contributes about 3 percent of total GDP while the services sector contributes about 49.6 percent to GDP. Tourism currently plays a relatively small role in the economy. However tourism has potential for growth and economic diversification.

While trade plays a critical role in Malawi’s economy, its contribution to GDP has declined in recent years; exports fell from 30% to 26% of GDP while imports fell from 67% to 44% over the 1994-2002 period. As the Diagnostic Trade Integration

[1] Malawi Government Official Website

Study (DTIS) notes, 'Malawi's export trade has remained stagnant.' Low export growth has contributed to Malawi's poor overall economic performance. This partly reflects falling prices for its primary commodity exports, supply-side constraints and macroeconomic instability are also key factors affecting Malawi's traditional exports and the development of non-traditional exports.

Malawi's industrial production continues to be tied to the agricultural sector performance (which it relies heavily on for inputs), and affected by high real interest rates, a heavy tax burden and regional competition.. The sector is also dependent on some imported key imported inputs, which means successive depreciations of the currency have eroded gains in competitiveness. In addition high utility of transport costs attributed to the landlocked status and macroeconomic instability continue to act as disincentives for domestic start ups. Despite low labour costs, labour productivity is poor and production techniques are out dated. Malawi's work force also does not have all the necessary skills and expertise, and the HIV/AIDS epidemic is reducing the limited skill base. Finally power supply is erratic and expensive. These constraints among others prevent the Malawian industry form taking advantage of the Duty Free access to the US market under the African Growth and Opportunity Act (AGOA) and from the benefits provided by the European Union's Everything but Arms (EBA) initiative. They also reduce the competitiveness of Malawian firms within COMESA and SADC.

Malawi's main export products are Tobacco, Sugar and Tea and its major destination market is the European Union (EU). These three products alone make up to 97% of Malawi's total exports to the EU. After the EU, Malawi's main trading partners for export are South Africa (22%), the US (15%), Egypt (5%) and Japan (5%). In terms of imports Malawi's main trading partner is South Africa (46%) followed by Zambia (13%), the EU (12%), the US (6%) and others (23%).

The government has sought various ways to reduce the country's dependence on tobacco, which still accounts for over 60% of exports, by promoting other crops, manufactured exports and services. It has cut and simplified tariffs and reduced other duties to the point where it has one of the most open trade regimes in East and Southern Africa. Presently the Malawi Growth and Development Strategy (MDGS)[2] has been adopted replacing the Malawi Poverty Reduction Strategy (MPRS), spanning a five year period in which the country will be transformed from an importing and consuming economy into a producing and exporting economy. Basically the MDGS discusses five pillars which according to Malawi are essential and this includes: (i) Sustainable economic growth (ii) protection of vulnerable groups (iii) social development (iv) infrastructure development and (v) good governance**.** However, in the medium term, donor organisations will have a key role to play in creating the conducive environment for economic growth by supporting policy reforms and providing resources to support government.

It is expected that the MDGS will enhance the achievement of high economic growth through the stimulation of trade and investment, and the restoration of macroeconomic stability. It also recognises the need to stimulate domestic supply in the three core (sugar, tea and tobacco and five high growth potential sectors[3] for the country to meaningfully benefit from domestic and international trade.

The government's other new medium-term development strategy is built around the MDGS. This strategy fully recognises that creating a healthy enabling environment for private sector development is a pre-requisite for sustainable economic and social development. At the implementation level, working closely with stakeholders in the private sector, the Ministry of Trade and Private Sector Development is leading efforts to implement a National Export Strategy and a Private Sector Development Strategy. The National Export Strategy aims at highlighting export issues as development issues and target improved export volumes and value addition. In addition, the Private Sector

[2] The MDGS is a home grown development agenda which has been designed by the government, in partnership with all the relevant stakeholders- civil society, donors and private sector

[3] cotton, textiles, tourism, mining and agro processing

Development Strategy aims at addressing the cross-cutting constraints to doing business in Malawi and tackles thematic areas such as credit and finance, skills and productivity, investment and technology, licensing and taxation, among others.

The role of the private sector in economic growth and development can not be overemphasized as they can propel investment, creation of value, innovation as well as trade domestically and internationally. Stimulating investment, trade and profitability of businesses is, therefore, key to stimulating high economic growth. Domestic and external competition has often spurred innovation, the diffusion of technology and an efficient use of resources. It is time Malawi focused on higher value addition and non-farm activities.

If Malawi is to fully benefit from international trade liberalisation, it must be able to supply the high quality goods demanded in the export markets of our trading partners. It is in recognition of this fact that the Strategy would like to develop the production capacity of the core sectors and several sub-sectors deemed high economic growth potential in the economy.

But while Malawi's strategy to achieve high economic growth rates has been identified, there remain significant challenges including a narrow export base, weak physical infrastructure for trade and human resource constraints. It is against this background, therefore, that Aid for Trade is an essential package to achieve the much desired economic growth and development in the Malawi economy but more so to enable the country to be an effective participant in world trade.

2.0 AID FOR TRADE

In December 2005, at the Sixth WTO Ministerial in Hong Kong, World trade Ministers, endorsed in paragraph 57 of Ministerial Declaration[4] that, Aid for Trade should aim to help developing countries, particularly, LDCs, to build the supply-side capacity and infrastructure that they need to assist them to implement and benefit from WTO Agreements and, more broadly, to expand their trade and to integrate into the multilateral trading system. In the Ministerial Declaration ministers stated that:

"Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade. Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the DDA, particularly on market access. However, it can be a valuable complement to the DDA. We invite the Director-General to create a task force that shall provide recommendations on how to operationalize Aid for Trade."

At the July 2006 General Council WTO members approved the task force recommendations[5] on how Aid for Trade might contribute most effectively to the development dimension of the DDA. Among other things the task force submitted that Aid for Trade, guided by the Paris Declaration on Aid Effectiveness should be aimed at assisting developing countries to increase exports of goods and services, to integrate into the multilateral trading system, and to benefit from liberalized trade and increased market access. It is envisaged that effective Aid for Trade will enhance growth prospects and reduce poverty in developing countries, as well as complement multilateral trade reforms and distribute the global benefits more equitably across and within developing countries.

[4] WT/MIN(05)/DEC
[5] WT/AFT/1

The report by the task force further highlights that Aid for trade should be defined in a way that is both broad enough to reflect the diverse trade needs identified by countries, and clear enough to establish a border between Aid for Trade and other development assistance of which it is a part. It proposes that the scope of Aid for Trade should include and not necessarily restricted to the following areas: Trade policy and regulation, Trade developments, Building productive capacity and Trade-related adjustment

Aid for Trade relates fundamentally to an intergovernmental process. The additional resources must be forthcoming from governments. National Governments have the ultimate responsibility to implement trade regulations, as well as to create an environment conducive for economic growth and to materialize the opportunities created by the international trading system. Nevertheless, trade is far and large an endeavour for the private sector. It is the private sector that produces and distributes tradable goods and services. As actors on the field, private enterprises are better placed to identify problems and bottlenecks in trade infra-structure. An increased dialogue between the public sector and private entrepreneurs is most advisable necessary to guarantee an in -depth assessment of Aid for Trade needs as well as to evaluate the actual effectiveness of Aid for Trade projects. It is the private sector that produces and distributes tradable goods and services. Benefits of trade are materialized in the private sector, for instance through the creation of jobs. Any Aid-for-Trade mechanism should therefore fully appreciate the role of the private sector to ensure getting real results on the ground and give particular attention to pro-poor growth strategies. The private sector should therefore thus be engaged at the global, regional and country level in the planning and implementation of Aid for Trade.

3.0 AID FOR TRADE AND MALAWI’S ECONOMY

For trade to play a crucial role in economic growth and poverty reduction, Malawi will need to expand its production and exports of goods and services. Even with greater access to some markets, Malawi has been unable to seize the opportunities, because of insufficient human, institutional and infrastructural capacities, to participate effectively in international trade and expand the quality of goods and services that it can supply to world markets at competitive prices. It has become clear that market access on its own is not enough, that it means little in the absence of adequate trade infrastructure and supply-side capacity. The link between the provision of infrastructure and competitive production is made through enhancing economic opportunities, increasing access to markets, services and natural resources, reducing food insecurity and promoting capabilities. Removing the infrastructural constraint will help unleash the economic potential of the rural population and expand the opportunities for engaging in productive activities; therefore for market access to be utilized and provide development benefits, aid for trade is essential.

Aid for Trade for Malawi should therefore be provided within the framework of the challenges and major constraints the country faces as well as what the country considers as its priorities, as envisaged in the national development strategies. In this context, it is imperative that such aid should be demand-driven; targeted and focused. Trade-related assistance for Malawi should aim at helping the country use trade more effectively to promote growth, development and poverty reduction and achieve its development objectives.

For Malawi, therefore, meaningful aid for trade should be tailored to address the following three key challenges: (i) supply-side constraints; (ii) adjustment costs due to loss of preferences; and (iii) trade policy development and participation in the multilateral trading system.

3.1 Addressing supply side constraints

A key challenge that faces the Malawian economy as a land-locked least developed country (LLLDC) is how to improve productivity and competitiveness in an increasingly globalized production and trading system**.** Malawi’s landlocked status is a major disadvantage to businesses as it increases the costs to importers and exporters relative to regional competitors. The weakness of the transport infrastructure includes poor access to ports, limited air links and freight capacity, limited rail capacity and poor condition of roads serving manufacturing, mining, tourism and rural producing areas. In addition, the problems with utilities (water, electricity and communication) affect production in Malawi because they are not only unreliable but also inefficient and expensive. The capacity of information technology is weak in both the private sector and the public sector.

The modern global economy is a labyrinth of complex production structures and interlinkages between production, distribution and marketing. The major constraints to Malawi's engagement in regional and international markets are supply-side weaknesses which to a larger extent contribute to the critically low level of exports as they drive up costs for exporter. They more specifically include costly and inefficient transit and border crossings, customs delays, delivery uncertainty, weak institutional and human capacity, lack of standards compliance, excessive business regulations, and lack of access to capital and finance.

Assistance is needed to help Malawi enhance its productive capacity through helping the enterprises engage in trade, improving the business climate, increasing access to trade finance, and promoting trade in productive sectors[6]. Substantial investments are needed to address supply-side constraints and allow the farmers and local businesses to become more competitive and diversify into higher value products. The importance of investments in infrastructure for trade and development in Malawi cannot be over emphasized[7]. Improved road networks (including rural transport links) and modernization of customs and border procedures will facilitate efficient transportation, storage and distribution of products to local, regional and international markets. Funds are also needed to cover costs related to improvements in, *inter alia*, energy, and information technology and communications infrastructure. Testing facilities are needed

[6] These may be as identified in the MDGS

to help ensure products can meet technical regulations and sanitary standards in Malawi's export markets.

Value chain analysis is one mechanism that could be used to help prioritise actions to remove constraints encountered in the production, marketing, distribution and transport (PMDT) chain

3.2 Trade system costs: adjustment and implementation

Loss of market access is a key concern especially for countries like Malawi that have relied on preferential markets. If the Doha Round succeeds in its aspirations for non-discriminatory reduction of tariffs in developed countries, it will undermine the benefits of these preferences lessening the competitive advantage currently granted to poor country recipients. Malawi is likely to be faced with costs including: Preference erosion, higher food prices, costs of compliance to product standards, costs of implementation of WTO agreements, costs of tariff revenue loss, One recent study[8] on preferences erosion reveals that LDCs and low income developing countries that heavily depend on exports of Bananas, Cocoa, Fisheries, Sugar, Textiles and Tobacco[9] will seriously be affected by the problem of preference erosion.

In some of the 50 poorest countries in the world Least Developed Countries, (LDC), like Malawi, sugar is an important agricultural product. For Malawi after tobacco, the largest foreign exchange earner, sugar is the second most important crop in Malawi when it comes to foreign exchange earnings. It accounts for up to 10 % of the country's total export earnings. Malawi's total sugar exports to the EU average 40,000 MT[10] of sugar,

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[7] Infrastructure has been identified by NEPAD and the African Union as an essential component of trade development at national and regional levels.

[8] Subramanian, A,2003, Financing of Losses from Preference Erosion, Paper prepared for the World Trade Organisation, WT/TFFFF/COH/14 Geneva

[9] The most affected LDCs , according to the study by Subramanian are: Bangladesh, Cambodia, Cape Verde, Haiti, Malawi, Mauritania, Sao Tome and Principe and Tanzania.

10 Reserve Bank of Malawi , Monthly Economic Review, October 2005

which includes 20,000 tons under the sugar protocol. The preferential prices for sugar exports to the EU have been important to Malawi’s revenues and it is in light of this that the GoM and the industry have pooled together to formulate a national adaptation strategy to the new EU sugar reform. Worth mentioning is that the new EU sugar reform is certainly expected to have a short term negative impact while it may open up opportunities for the Malawi’s sugar industry in the medium-long term.

Malawi is seeking compensation for its losses due to the new EU sugar market organisation as an adaptation support to improve their competitiveness[11]. There is need to critically review the planned compensations for the loss of preferences to be paid from the European Union Development Fund (EDF). The compensation might to some extent seem to be competing with other equally important social expenditures for instance health and education and more specifically the fight against HIV and AIDS.

The countries long-term goal is an independent sugar industry that does not need help from outside. In this, investments in the sugar sector and in trade-related infrastructure are a pertinent solution. Support for adaptation measures between the EU and the countries that lose their preference, would be a multilateral issue, as part of the whole negotiation process, which admittedly has winners and losers In this case compensation payments for preference erosion could be established in a multilaterally binding way and would no longer depend on the political decision-making processes of individual countries in any case the support has to be adapted to each country –in the case of Malawi this means support for the expansion of the sugar industry and for diversification.

Trade liberalization typically involves a reduction in customs and tariff revenues. In Malawi, and this is true for most least developing countries, customs and tariff revenues constitute a significant proportion of total fiscal revenue. It is predicted that were the Doha round to conclude it will cost sub-Saharan Africa US$ 1.7 billion in lost tariff

[11] As a participant in the EU- ACP Economic Partnership Agreement

revenues[12]. In such countries, it is costly to develop alternative sources of fiscal revenue. Malawi may have to undertake reforms in the tax system to maintain social expenditures and government services while complying with WTO provisions as well as meeting its obligations under the road map to the COMESA and SADC Customs unions.

While trade reforms may bring long-term benefits, they typically generate winners and losers in the short-run. The costs of implementing multilateral commitments include the macroeconomic adjustment costs to governments, and technical requirements, obligations to accept new standards, rules systems, and reporting obligations which governments must comply with in order to implement their new commitments. Implementing these commitments may require the creation of new institutions and the employment or relocation of the scarce skilled personnel, all of which are costly to government. Finger and Schuler, 2000 assert that it costs an estimated US$150 million per country to implement just three WTO agreements namely Trade related Intellectual Property (TRIPS), Sanitary and Phyto Sanitary (SPS) and Customs valuation Agreements (CVA). Additional resources are therefore needed to assist countries[13] meet these adjustment costs.

Malawi as a net food-importer is likely to face costs incurred from the likely food price increases, for the simple reason that world prices will rise as rich country agriculture subsidies are reduced. These additional costs pose a threat to food security and add to existing Balance of Payment difficulties. World Bank estimates indicate[14] that the magnitude of the likely losses of net food importing developing countries is between US$ 300 to 1.2 billion per year depending on the final DDA agreement.

[12] De Cordoba and Vanzetti, coping with trade reforms, UNCTAD, 2005, table 11.

[13] Countries like Malawi already struggling under the burden of debt and fiscal as well as human costs of diseases, starvation and illiteracy simply cannot meet these adjustment costs.

[14] D.Mitchell and M.Hoppe, from Marrakech to Doha : Effects of Removing Food Subsidies on the Poor, Chpt 29 in R. New farmer ed., Trade and development: a Window into the Issues, World Bank 2005.

In light of this the scope of the adjustment costs for Malawi therefore should be broad enough to encompass productive and competitive capacity of the private sector in addition to support to reducing transaction costs of trade.

3.3 Trade policy development and participation in the Multilateral Trading System

Aid for trade should provide for the assistance needed to address the human and institutional resource capacity constraints encountered in trade-policy making and trade negotiations. This would develop Malawi's capacity to take advantage of the new opportunities to trade. Technical assistance is needed to help Malawi negotiate, reform and participate fully in the multilateral trading system. Assistance is also needed to help Malawi and all Least Developed Countries at large, in their efforts to integrate trade policy into their overall development strategies and create strong public-private sector partnerships to engineer change and development**.** This includes activities like training officials, supporting institutional development, supporting national stakeholders to articulate commercial interests and identify trade-offs, and technical cooperation in setting and meeting standards.

4.0 AID FOR TRADE AND THE ENHANCED INTEGRATED FRAMEWORK

The Aid for Trade Initiative could build on the basic principles of the Integrated Framework[15] (IF), without necessary retaining the current structure of the IF. The key principles upon which the IF is built are country ownership, coherence and partnership. The Enhanced Integrated Framework (IF) is viewed as an essential foundation for strengthening the demand-side of Aid for Trade in LDCs. Likewise, the IF's objective of

[15] The IF brings together the key multilateral agencies working on trade development issues, e.g. the IMF, ITC, UNCTAD, UNDP, WTO and the World Bank seventeen bilateral donors and LDC governments. The OECD-DAC has observer status. The basic purpose of the IF is to integrate trade policy into a country's overall development strategy.

mainstreaming trade into national developing strategies signals to donors that trade is recognized as an important tool for development. In its present shape, the IF is a mechanism for relatively small projects and does not include infrastructure or supply-side components. Therefore, the Enhanced IF would represent an important tool in assisting Malawi to define its trade needs through an updated Diagnostic Trade Integration Study. This would also provide a mechanism for donors to align and harmonize their support around national priorities, and make use of national systems and channels.

5.0 POLICY RECOMMENDATIONS

Malawi needs to develop an intra governmental coordinated Aid Policy comprising of Ministries of Finance, Economic Planning and Trade which authorises the government's preferences in terms of:

1. Type of aid it wishes to attract from abroad
2. Processes to be used in management of external or foreign assistance
3. Enhancing national ownership of development activities.

The Malawi government needs to take the lead in establishing aid policies and managing relations with donors and this may entail cultivating a strong political will and commitment by the government to lead on the development agenda and own the development process. It is easier for donors to align to a recipient country's development plan when country strategies are prioritised and operationalised, and it is easier for recipient countries to lead when their priorities have been identified internally.

The private sector should have an equal, if not even a pre-eminent role, in determining the development needs of a country, in order to emphasize the importance in the broadest sense of the "business environment", and help to define the facilitatory and regulatory roles of the public sector, which would include opportunities for public-private partnerships. For reasons of sustainability also, private interests must be invoked since it is they who principally drive the development process, with or without donor support.

Since Malawi depends on tax revenues in order to gain from the liberalisation of its trade policies it will need to reform its tax systems to maintain social expenditures and government (public) services**.** Malawi may also require making more complementary reforms prior to its own trade reforms and in conjunction with those of other countries.

There is need for the government in conjunction with the donor community to take stock of what has already been done in relation to trade and trade related technical assistance so far as well as what needs to be done in the short and long term and how to structure this work.

6.0 CONCLUSION

Aid for trade has to address priority areas as defined in national development plans and strategies. Dedicated and additional funding can help only when trade competitiveness and integration are aligned with country policies and programmes. Meaningful Aid for Trade to Malawi should therefore be:

- predictable, secure and long-term (i.e. binding);
- needs-based and demand-driven;
- most importantly, unconditional on international and domestic trade policy positions of developing countries.
- shall not involve a trade-off with other development aids, i.e. to ensure ‘additionality’ of Aid for Trade resources rather than reshuffling of existing aid.

The role of the private sector in the design and implementation of Aid-for-Trade plans can take different forms such as an advisory role, participation in the management of activities for trade and private sector development, the development of action plans, or more directly creating public private partnerships to supply specific services or to deliver goods and services to the government or other companies. A very important topic that could be addressed in this context would be the involvement of the private sector in developing regulations and operational support for backbone support services (financial services, transport services, customs and port functioning, utilities).

A country specific approach to needs assessment is necessary in order to identify Malawi's priority needs and the additional assistance required. This could involve a diagnostic study at the national level or adoption of the IF Diagnostic Trade Integration Study (DTIS).

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