RESPONSE OF THE MALAWI CONFEDERATION OF CHAMBERS OF COMMERCE AND INDUSTRY TO THE 2019/20 NATIONAL BUDGET PRESENTED TO PARLIAMENT ON 9TH SEPTEMBER, 2019

1. PREAMBLE

The Malawi Confederation of Chambers of Commerce and Industry (MCCCI), as an advocacy and lobby body for its members, would like to submit the following response to the 2019/20 Budget Statement delivered in Parliament on 9th September, 2019. The observations made are from the perspective of its members. MCCCI also made a contribution during pre-budget consultations and therefore looks at the Budget from the angle of the issues it put before government.

2. INTRODUCTION

MCCCI notes the theme of the budget, being **"Inclusive Growth and Economic Empowerment: The Future We Want",** and the budget's five key objectives of Economic Growth, Job Creation, Economic Empowerment, Sustainable Debt Management, and Infrastructure Development. This theme and objectives are predicated on the government's assertion that it has made a lot of progress in the past five years reflected in decline in inflation rates into single digits, falling of interest rates, and stability of exchange rate. The Confederation notes these developments. As the success of any economy is primarily measured by an increase in the wealth created in these years, i.e. Gross Domestic Product (GDP), the question remains why these 'positive' economic developments have not led to improvement in economic growth, which has remained subdued during this period. In 2012 GDP growth was 2.1 percent. In 2013, it was 6.3 percent; in 2014, it was 6 percent; in 2015 the economy grew by 3.1 percent; in 2016 the growth rate was 2.9 percent; in 2017 it was 5.1 percent; and in 2018, it was 4.1 percent. It is projected that the economy will grow by 5 percent in 2019. These statistics do not present a period of successful economic management. The Malawi economy has been able to grow at impressive rates before, such as 9 percent a decade ago, and yet during the period under consideration the country did not get any closer to such growth rates. MCCCI attributes this paltry economic growth record partly to the persistent obstacles to doing business which are yet to be resolved. The following challenges have consistently chocked business operations:

a) Inadequate and erratic supply of electricity;
b) Cost and availability of long term finance;
c) Uncertainty in economic and regulatory policies;
d) Quality and Cost of telecommunication services; and
e) High levels of Corruption.
f) Government borrowing

Unfortunately these challenges were not resolved during the period under review. In 2014, government promised to turn on Kammwamba Coal Fired Power Generation Plant in 2017. This never happened despite raising hopes in the business community. The start date was then postponed to 2017. Again nothing happened. A new date of 2021 has been given but as it appears, this deadline is unlikely to be met as arrangements for the financing of the project using the EXIM Bank of China loan does not seem to be making any progress.

Whilst progress was made in increasing the electricity carrying capacity of the national grid, thanks to Millennium Challenge Corporation for returning to Malawi in December 2012 after initially pulling out on account of governance related issues, there is need for electricity to be wheeled through this expanded capacity. This is what EGENCO Ltd and other Independent Power Producers (IPPs) should have been doing but it did not happen. The IPP regime took time to start operating.

The Confederation sees lack of seriousness in increasing electricity generation as one reason why private sector has not responded to positive developments in the macroeconomic management arena.

The cost of finance has been coming down but long term finance is still slippery. The Malawi Agriculture and Industrial Investment Corporation, although launched with pomp, is not operational yet.

Uncertainty in the policy environment continues to be a thorn in the flesh of the private sector. Frequent changes in policies in industry and trade area, sometimes without consultation, remains a big challenge. At other times consultations serve only as lip service. Government continues to be of the view that it is a master rather than a servant. Uncertainty is an enemy of business and therefore deters meaningful long term investment.

Telecommunications service quality continues to be subpar. The cost, relatively to quality, is not commensurate. These factors impact significantly on the cost of doing business. As such the Malawi Communications Regulatory Authority needs to act with sincerity.

Corruption has increasingly become a disease to the extent that those involved in it do not feel ashamed at all. The level of government borrowing may partly reflect how much public resources are not being accounted for. By government's own admission, its borrowing has gone out of control. The impact of high government borrowing is unreasonably high levels of taxation. Businesses fear to invest where future tax rates are likely to be high, paying for non-productive use of resources. Likewise, ethical businesses, which the economy badly needs for job creation, do not want to be involved in corrupt practices. An environment where getting a government contract requires bribing makes doing business very expensive.

The above five obstacles have contributed substantially to worsening the business environment in Malawi and have led to private sector not responding to government calls for business expansion and new investment. If government is serious about delivering on its budget theme and objectives, it must earnestly champion generation of electricity through EGENCO Ltd, stop formulating policies that tamper with private sector operations without honest consultations, and most importantly not only be rhetoric about fighting corruption but be seen to be on top of its fight to the conviction of the general public, the business community included. Without addressing these challenges, the 2019/20 National Budget will end up being another hollow piece, as those that have come before it.

3. REVENUE MEASURES

The Confederation has noted that domestic revenue, comprising tax revenue and non-tax revenue, are projected to increase by 22 percent, being K1.369 trillion in tax revenue And K55.8 billion in non-tax revenue. Even if inflation and the unlikely-to-be achieved projected GDP growth of 5 percent are built in, the increase is over-ambitious especially because the economic environment has continually become hostile as reflected in declining profit reports by major taxpayers. It is also important not to underplay the impact of civil disobedience on productivity of all sectors of the economy. We therefore deem this projection to be out of tune with reality.

The major risk of maintaining this estimate is that the expenditure side, which may be committed, will not be controlled. As such the economy will end up with another enormous budget deficit compared to that which has been projected. This has been the characteristic of all the budgets of the past five years, by government's own admission. The consequence has been the plunging of the economy into unsustainable cumulative debt to the magnitude of 62 percent of GDP by December 2018, according to official records. We urge government to tread consciously with matters of state resource management since the impact of estimates that are decoupled from reality will fall squarely on citizens including the corporate citizens through accumulation of arrears, and increased tax rates to pay for such sins. Citizens deserve better.

3.1. Specific Tax Policy Measures – Customs Duty and Excise Tax Measures

The Confederation's interest are the measures that direct and indirect impact on improving competitiveness of its members and that impact the cost of doing business.

a) Under Customs Procedure Code (CPC) 477 customs duty on equipment and items that focus on promotion of aquaculture has been removed. This is certainly a positive move. However, there is need of a grand plan to establish and sustain this industry. Customs duty was only one element. Whilst appreciating the fact that a budget statement cannot be detailed, the responsible need is to come up with an action plan to build a thriving aquaculture industry. Customs duty removal is by its nature only a temporary relief. It is competitiveness of the industry that will count and sustain the industry in the end.

b) Under tariff heading 22:03, reduction of excise tax on malt beer from 90 percent to 65 percent has given the impression that the beer industry such as Castel Malawi Limited, SAB Miller (Chibuku Products Ltd) may be saved from becoming extinct. The Confederation believes that the new excise tax rate will continue to apply on **production cost** as has been the case before and **not on sales revenue** as government has been pondering, otherwise this is tantamount to misinformation. It is estimated that if the base of taxation changes the producers will be paying 20 percent to 25 percent more taxes using the new tax rate.

The Confederation is actually concerned that government tends to act after some damage has taken place, instead of having listening ears on and be proactive. This is said in the context of retrenchment of staff that has already taken place. In an economy where virtually no new jobs are being created, government should do everything to save existing jobs and not see the bleeding before reacting.

It is surprising to further note that under tariff heading 22:08 government has increased excise tax on un-denatured spirits from 95 percent to 110 percent, again on the assumption that this is based on production cost. One would wonder what sense there is in 'giving away and taking back' at the same time. Is the above supposedly positive policy move a façade? That needs introspection. Perhaps even more significant, is the objective to stop alcohol products producing industries from diversifying their product base? What kind of diversification is government promoting in that case?

c) The introduction of 10 percent excise tax on all plastic products such as plastic pipes, tubes, and hoses (under tariff heading 39:23), plastic articles for conveyance or packing of goods, plastic sacks and bags for packing of goods (under tariff heading 63:05) is very bizarre. The excuse given of aligning excise tax rates for purposes of harmonization is not justifiable. The reason for not subjecting these products to excise tax seem glaring clear – to reduce costs for the end users and promote industries such as construction industry. The Confederation considers the introduction of 10 percent excise tax on plastic sacks, which are generally used by the ordinary subsistence farmers for storing their commodities as a killer, and as such implores upon government to reverse the measure.

d) Removal of customs duty and excise tax on gas cylinders indeed a relief to users and will promote the use of alternative sources of energy. The beneficiaries though are likely to be those in the life style bracket that does not necessarily rely on charcoal for cooking but electricity. There may therefore be minimal impact on reducing the rate of deforestation.

e) Imposition of 50 percent export tax on treated timber was certainly misplaced and the correction is thus welcome. In future government may wish to clarify qualification boundaries of treatment or value addition to avoid such misplaced decisions.

f) The introduction of surcharge on imported products that have local substitutes such as vegetables, fruits, sugar, cooking oil, cement and others to encourage growth of local industries, save foreign exchange, and promote industrialisation may appear attractive to concerned industries on the surface. In practice, there are likely to be three-fold consequences to this policy move:

   i) As the prices of imported products have increased, the prices of domestically produced substitutes will tend to adjust to the prices of these imported products over time, generally to capture the potentially increased margins. Government has no mechanism of ensuring that the prices of local commodities remain lower than those of imports. This has been the trend in nearly all cases where government has intervened in this fashion. Eventually therefore the impact of the 'surcharge' will fall on local consumers who will now have to pay higher prices on both domestically produced commodities and imported commodities. To what extent local industry will grow, foreign exchange will be saved, and industrialisation will be promoted is indeterminate.

   ii) The second effect of this policy is the promotion of local industry to be producing for the local market rather than making efforts to consider export markets too. As the local producers will eventually be charging prices that have an increased margin after adjusting prices of their commodities to match those of imports, these producers will surely see no reason to test export markets that are riddled with all kinds of risks. The end result will be that the country's policies will be self-defeating; instead promoting export orientation, it is production for the domestic market that will be encouarged. The country will be promoting non-tradable based economy. In addition the level of production of each commodity is likely to be kept to a minimum to match the size of the local market, thus countering the need for business expansion and new investments in the appropriate industries, which are the basis for job creation and economic growth. These are some of the reasons why the Malawi economy continues to fail to produce enough commodities for export. Local prices are good enough to sustain them! This should be discouraged at all cost.

   iii) Perhaps even more significantly, the likely increases in the prices of domestically produced commodities, as explained in (i) and (ii) above, will effectively 'reduce' export prices of these commodities. What would motivate an industry player to earn less by exporting (take the border price of imports – i.e. the price of imports before adding border taxes that include surcharge – as a dummy or proxy export price), instead of earning the same or even more revenue from the same or less level of production! The Confederation's view is that no rational producer would do that. In this instance therefore, one much regard surcharge on imports as equivalently a surcharge on exports – both have the same effect of reducing export revenues, the surcharge of imports reducing export earnings through encouragement of domestic orientation production (and not exports), while the surcharge on exports reduces exports by making them uncompetitive in the export market!

In the Confederation's view the instituted policy must have a sunset close, i.e. it must have a time limitation and more significantly government, alongside industry, must embark on a splendid industry restructuring plan to improve the competiveness of the industries involved. Tariff relief is always temporary; it is industry competitiveness that lasts.

g) Removal of customs duty on flat iron sheets is welcome but introduction of excise tax on tubes, which are also used in house construction, defeats the intention of this policy objective.

h) Removal of customs duty on motor cycles of cylinder capacity of not more than 100 CC and the attendant request to register such with authorities including Malawi Revenue Authority (MRA), Directorate of Road Traffic and Safety Services, and the Police will formalize the sector and reduce incidences of passengers being robbed or even robbed midway through their journey. The authorities, however, will surely use this as one way of broadening the tax base.

3.2. Specific Tax Policy Measures - Income Tax Measures

a) With respect to Pay As You Earn, expansion of the tax free bracket from K35,000 per month to K45,000 per month is a positive move as the effect is to increase disposable income for those in employment. Critical though is to increase the number of people through provision of an attractive business environment that permits existing businesses to expand and new businesses to emerge so that many people benefit from this policy objective. Meanwhile, companies have been retrenching staff, especially those who would have significantly benefitted from this change.

   Since the government seems to be correcting anomalies, it has overlooked correcting another anomaly introduced two budget years ago where a portion of an employee's monthly salary in excess of K3 million per monthly is taxed at 35 percent and not 30 percent in line with tax rates on other incomes such as corporation tax. This anomaly needs to be corrected as well.

b) Increase in minimum wage from K962 per day (i.e. K25,012 in a 26 day month) to K1,346.15 per day (i.e. K35,000 per month) is a positive move for workers who fall in this category. However it is an additional tax on businesses imposed at a time when many businesses especially those who employ labourers are struggling to survive. Of course, many businesses were already offering more than this amount but the implication is that those labourers will now demand more than what they have been getting.
c) Introduction of a 50 percent deductible tax allowance on salaries of employees with disability is also positive and will encourage diversity at the workplaces and provide opportunities to all Malawians. For industry though, the definition of what constitutes a disability will be very critical and therefore appropriate authorities must make this

clear with urgency. It is likely that MRA will be clogged with claims they may not deem qualifying.

d) Increase in export tax allowance on export of non-traditional, processed products from 25 percent to 30 percent and reduction of the same on unprocessed products from 25 percent to 10 percent presumably with the objective of promoting export of processed rather than unprocessed non-traditional products), although makes sense, does not address the concern of qualifying exporters which is that the allowance should be based on **export revenues** rather than on **net profits related to those exports**. The economy directly benefits from the export revenue while the profits accrue to the exporters. With economy-wide benefits emanating from exports, government should compensate the exporters appropriately. If this is corrected, it will incentivize the exporters to declare export revenues in full which has been an issue of concern in the recent past.

e) The introduction of carbon tax adds another layer of taxation to the already dense fuel price build-up.

f) The introduction of 1 percent With-holding Tax (WHT) on non-bank mobile transactions based on transaction amount is draconian and counters the efforts of the Reserve Bank of Malawi, a government institution, which is promoting the use of non-cash transactions such as mobile money transfers (e.g. Airtel Money and Mpamba). Government must reconsider this move.

3.3. Specific Tax Measures – Value Added Tax Measures

a) Introduction of Zero Rate VAT on solar equipment and its ancillaries is critical in promoting access to electricity especially in rural settings where the national electricity grid has not reached or during times of blackouts even in towns and cities. It must be noted though that this provides relief at smaller scale especially to light up homes, and does not necessarily substitute the need for EGENCO Ltd and other large scale independent power producers to generate the much needed power for industrial use. Zero rating of VAT on liquefied petroleum gas (LPG) and gas cylinders will have similar effects.

b) Introduction of standard VAT rate on cooking oils other than those produced from sunflower, soya bean, palm and groundnuts require further explanation as it is important to determine where else cooking oil is produced from.

c) Introduction of Zero Rate VAT on laundry soap is positive as it will reduce the price of the final product to the consumer. Single product businesses without adequate input VAT with which to offset VAT paid at importation of raw materials will however suffer the same delays being faced now waiting for refunds from MRA. This will apply to importers of solar panels as well.

4. NON-TAX POLICY MEASURES

Increase in most user fees and charges raises operating costs of businesses and thus increases the cost of doing business in Malawi. This policy objective therefore does not serve the private sector well more so, that the charges are fixed and do not depend on whether the business is making any profits or not.

5. OVERALL OBSERVATION OF THE 2019/20

Whilst there have been a few positive tax policy measures, overall there are more punitive measures than positive ones. It is very clear that the intention is to raise as much money for government as possible and at any cost. This is clearly reflected in the estimated domestic revenue of K 1.425 trillion, consisting of K1.369 trillion as tax revenue and K55.8 billion as non-tax revenue, despite the fact that MRA managed to collect only K1.006 trillion in 2018/19. In a year when the business environment has become more hostile partly manifested by lower than anticipated reported profits of major (and some listed) tax payers, coupled with the effect of civil disobedience, it is unrealistic to assume a rosy picture. The key, in the Confederation's view, is for government to use the resources at its disposal EFFICIENTLY and EFFECTIVELY. Government needs to be seen to be fighting leakages of financial resources and not be at the center of financial scandals, whether perceived or real, as read in newspapers from time to time. That erodes the confidence of every economic player as they know they have to pay for the leakages through increased future taxes and non-tax payments. In a lot of cases the future is now as taxpayers are already being asked to pay more.

Efficiency can be achieved with the right personnel in the right places. There are numerous cases where individuals are given positions as a reward for personal loyalty or other non-professional connections. Most boards of parastatals are riddled with sycophants who do not add value to value creation objectives of their organisations. By no means is this encouraging. As a representative body of the majority of taxpayers we demand merit-based appointments in official positions as well as parastatal boards.