A Comprehensive Analysis and Review of Investment, Production and Export Incentives in Malawi

19 December 2016

The Deputy Resident Representative
United Nations Development Programme
P.O. Box 30135
Lilongwe 3
Malawi

Dear Madam,

We are pleased to submit our final report in line with the scope of the assignment undertaken as per the contract dated 10 August 2016.

This final report has been prepared based on the facts and background information obtained from desk review and consultations with key stakeholders. We are pleased to submit our final report for the assignment: **A Comprehensive Analysis and Review of Investment, Production and Export Incentives in Malawi**.

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We welcome your review comments and further suggestions, should they be necessary.

Best regards,

Ranwell R Mbene
Director

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Acronyms

ASYCUDA	Automated System for Customs Data
BOT	Build, operate and transfer
BOOT	Build, own, operate and transfer
COMESA	Common Market for Eastern and Southern Africa
CIF/FOB	Cost, insurance and freight/free on board
CIP	Competitiveness industrial performance
CIT	Corporate income tax
CoR	Cost of registration
CPC	Customs Procedure Code
DFID	UK Department for International Development
EPZ	Export processing zone
ESC	Economic service centres
EU	European Union
FDI	Foreign direct investment
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GiZ	Gesellschaft internationaler Zusammenarbeit
GoM	Government of Malawi
IMD	Institute of Management Development
IPA	Investment Promotion Agency
IRS	Industrial Rebate Scheme
MCTI	Zambia Ministry of Commerce, Trade and Industry
MERA	Malawi Energy Regulatory Authority
METR	Marginal effective tax rate
MFA	Multi-fibre arrangement
MFEZ	Multi-Facility Economic Zones
MGDS	Malawi Growth and Development Strategy
MIDA	Malaysia Industrial Development Authority
MIGA	Multilateral Investment Guarantee Agency
MITC	Malawi Investment and Trade Centre
MK	Malawi Kwacha
MoITT	Ministry of Industry, Trade and Tourism
MoF	Ministry of Finance
MRA	Malawi Revenue Authority
NES	National Export Strategy
NGO	Non-governmental organisation

NSO	National Statistics Office
OECD	Organisation of Economic Cooperation and Development
PDV	Present discounted value of annual net earnings
PS	Principal Secretary
PwC	PricewaterhouseCoopers
R&D	Research and development
RoR	Rate of return
SADC	Southern African Development Community
SEZ	Special economic zone
ToR	Terms of Reference
TRIPS	Agreement on Trade Related Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organisation
USD	United States Dollars
VAT	Value Added Tax
WAIPA	World Association of Investment Promotion Agencies
WEF	World Economic Forum
WHT	Withholding tax
ZDA	Zambia Development Agency
ZMK	Zambian Kwacha

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Executive summary

Background

The Government of Malawi developed and launched the National Export Strategy (NES) in December 2012 with the primary objective of boosting and promoting exports of the country's prioritised productive sectors. However, the contribution of the industrial sector to GDP has fluctuated between 13% and 22% over the previous five decades, while that of manufacturing within it averaged only about 10%. As the country aims at promoting private sector development and industrialize in order to become self-sufficient and reduce its reliance on donor support, it is imperative for Malawi to become a competitive destination for both domestic and foreign investment through, *inter alia,* the provision of a business friendly and enabling environment and strategic incentives for investments in the potential productive sectors.

Problem Statement

A favourable business climate is essential for attracting both foreign and local private investment. Investors prefer to invest in economies with a healthy business climate – where cost, delay and risks are minimized. Malawi lacks many requisites to encourage investment in different sectors of the economy as evidenced by the low ranking in the doing business index and the multiple constraints to doing business. To compensate for these deficiencies, the country offers a number of tax incentives as a way of attracting investment in addition to improving the business climate by making it easier, cheaper and faster to do business.

Objectives and approach

The study was commissioned to develop comprehensive incentives, fiscal and non-fiscal, which can be used by the Ministry of Industry and Trade and its marketing Agency, the Malawi Investment and Trade Centre (MITC), in marketing the country's productive sectors to potential domestic and foreign investors and promote existing investors. Further, it was meant to produce a compilation of strategic investment and export incentives that would make Malawi an attractive place for investment and complement efforts by the Ministry of Finance, Economic Planning and Development in the field of taxes and revenues.

The study approach involved review of relevant documents and literature, conducting informative interviews with key stakeholders in the public and private sector. This deepened consultant's understanding of the real issues affecting the configuration of the fiscal incentives as well as general business climate in Malawi.

Main findings

The study revealed that, although tax incentives may influence investment decisions in some instances, in general, they have led to heavy revenue losses in other countries. In Malawi, it was found that with the existing incentives, investment attraction is low and the benefits are limited. The study also found that some of the incentives that Malawi is offering do not make any difference to investment decisions. Some incentives are not well structured such that they are prone to abuse while other tax incentives benefit investors only. It was also noted that there is general unawareness about the incentives that government offers to investors and a need for transparency in the award of incentives. It was further noted that most countries in SADC and COMESA region offer tax incentives which puts pressure on Malawi (and the other countries) to offer even more tax incentives. While the METR analysis showed that relief of the tax burden is somewhat targeted to priority sectors, more can be done to improve targeting.

Competitiveness is considered a key criterion in assessing the success of companies, industries and countries. Hence, increasing levels of competitiveness is essential to any economy as a country must perform well both in the domestic and international arena in order to survive.

Malawi's immediate challenges hampering industrial development are in the areas of corruption, macroeconomic instability, bureaucratic inefficiencies, and inadequate infrastructure. The longer term challenges lie in the area of education, science and technology, and innovation.

The tax incentives have an effect on the marginal efficiency tax rate. The METR computations reveal that tax incentives affect the sectors differently despite having a similar corporate income tax rate of 30%.

Revenue forgone as a result of various tax incentives were estimated at 25%, 15% and 9% of the total tax revenues for the years 2014, 2015 and 2016, respectively.

Malawi's incentive instruments are not different from other countries. However, there are administrative challenges that need to be ironed out if the GoM is to benefit more from them.

PwC developed an analysis grid based on literature consulted, international best practices and on experience. The grid summarised in Figure 5.5 uses four criteria to assess the performance of the incentive instruments in Malawi. The results are colour coded with red signifying non-performance, yellow signifying partial performance and green being performing incentives. It is noted from the figure that none of the incentives satisfy the performance criteria which is an indication of the structural teething problems of the taxation and fiscal incentives regime in Malawi.

The bulk of revenue forgone is from the industrial rebate scheme.

Main recommendations

PwC recommends that GoM should continue to use the current mix of incentive instruments, namely, income tax, capital and investment allowances and customs and excise.

Incentive		***Industry/Sector***	***Required Action***
Type	Incentive		
Income Tax	Tax holidays (not more than 10years) and reduced CIT	Priority industries	The GoM to gradually move away from awarding automatic tax holidays to a mix of performance-based incentives—both fiscal and financial.
	Capital allowances-investment allowance	Manufacturers	The GoM to maintain the capital allowances incentive
	Export incentives	Exporters of non-traditional goods.	The GoM to maintain the export incentives to compliment the drive to make Malawi a producing and exporting country.
Customs and Excise	Industrial Rebate Scheme (IRS)	Manufacturers	The GoM to reform administration of the incentive.
	Export Processing Zones (EPZs)	Exporters under the EPZ	The GoM to retain the EPZ as an industrial promotion tool but the incentives provided under the EPZ Act should be mirrored in the Taxation Act.
	Import Duty Exemption for Electricity	Electricity generation and distribution	To retain the incentive with the objective of enticing more players in the sector.

Generation and Distribution		
Duty and excise exemptions	Crosscutting	Streamline and develop simple and transparent guidelines for the administration of these duty and excise exemptions.

To ensure that tax incentives achieve their intended goals, the following recommendations are made:

i. Incentives should only be considered when the good/service has a large public good externality and it is cheaper/more efficient to provide it through this externality than directly. This would include investments encouraging environmentally friendly/research rich production or anchor investments (investments that provide multiplier effects through signaling.

Administering tax incentives

ii. The GoM may wish to consider developing tax incentives according to the three Ts—timely, targeted and temporary:
   a) Stipulate by law the length of the incentive period and the entities eligible for incentives
   b) Ensure that incentives awarded through legal instruments and regulations other than the Taxation Act, are **mirrored in the Taxation Act**. Avoid the granting of discretionary incentives, whether through bilateral negotiation or certification.
   c) Mandate tax authorities to administer the award and monitoring of incentives. This will lower administration costs and increase transparency as tax authorities are best placed to ensure that investors receiving incentives are eligible and provide the necessary documentation.
   d) Process applications for incentives quickly, to promote transparency and reduce opportunities for abuse.
   e) Establish One-stop-shop services for business facilitation services.
   f) Monitor the application of incentives to guard against abuse. This would include measures to discourage the false declarations to meet incentive eligibility requirements, ensuring compliance with performance requirements including environmental and social performance, and most importantly, limiting distortions created by new investments that are not viable—or are only viable at the expense of existing projects.

iii. *Redesigning fiscal incentives*
   a) Maintain a 10 year sunset clause for tax holidays applicable to priority industries. This would allow proper assessment of the effectiveness of this provision. Ensure that incentive policies are clearly time-limited. This would also simplify administration-to ensure that investors file tax returns and face audits as required and that tax authorities produce tax expenditure statements to make the cost of the incentive transparent.
   b) Maintain capital allowances: capital allowances are true "cost-based tax incentives" and have generally been noted to attract investment as they are directly related to the investment and it is easier to estimate their costs. However, the process of eligibility approval should be changed to a less discretionary one by removing minister's power to declare.

c) Review Export incentives: there is a need to harmonise tax law to remove overlap and complexity. Specifically, mirror the provisions in the Export Incentives Act with the Taxation Act for deductions to taxpayers registered under Export Incentives Act.

d) Retain the EPZ as an industrial promotion tool but the income tax incentives provided under the EPZ Act should be mirrored in the Taxation Act.

e) Review administration of Industrial Rebate Scheme and include exit strategy: The Industrial Rebate Scheme (IRS) is deemed an effective incentive. However, there are problems of administration and process and it is associated with great revenue loss. To remove the administrative challenges and also to reduce the revenue loss, it is important to ensure that only eligible firms qualify and also that the eligibility procedures are clear and transparently applied.

f) Include claw-back provisions: for major tax incentives such as industrial rebate, and tax holidays to ensure that taxpayers do not abuse the system.

g) Introduce tax tribunal and public-private adjudication committee to deal with appeals. First, the GoM should tie the administration of fiscal incentives in with tax laws and the overall corporate tax system as a whole. Investors have confidence in a well-administered tax system that transparently gather and spend revenues. This is a critical indicator of economic stability and ease of doing business.

h) Incentives should be administered by the Ministry of Finance and Malawi Revenue Authority (tax authorities) and not by sector ministries. Incentives, like all subsidies, are foregone revenues and need to be accounted for in budgeting processes. This will generate intelligence for the wider debate on the costs and benefits of investment policies. Measure the effectiveness of incentives occasionally. The most commonly used indicator is the cost of jobs created by the tax expenditure

i) The GoM should avoid discretionary fiscal and financial incentives. Such non-transparent practices are prone to abuse and lack the necessary checks and balances to maintain a predictable investment climate.

j) Build on the performance-based incentives also make the case for equivalent incentives or flat corporate tax rates. A well calibrated, flat corporate tax rate (instead of a long-term tax holiday) can send important market signals that the investment climate and fiscal regimes are transparent and predictable. However, lowering the corporate tax rate can reduce government revenues. The objective should be to balance the competing objectives of attracting investment and ensuring the revenue base.

iv. Non-fiscal incentives

Infrastructure

GoM should seek to create modern infrastructures for transportation, communications, electricity and water. In doing so, they should consider whether public-private partnerships can achieve infrastructure policy goals. Once infrastructures are built, they must be maintained, and this requires long-term planning.

Human investment

- GoM should invest significantly in education and vocational and technical training in fields that will keep the workforce competitive for the future.
- GoM should make efforts to educate the public on the basic economics of market economies, and should promote specialized education in entrepreneurship.

Political stability

- GoM that will guarantee creation of a political and legal environment that will ensure security of property and life, protection and guarantee of foreign investor rights, legislative stability, freedom from corruption and good governance.

Macroeconomic stability

- Government should create a stable macroeconomic environment and opportunity rich framework for business by reorienting macroeconomic policy towards economic growth, continue to open up the economy and pursuing economic diversification.

Pro-business environment reforms

- To strongly embark on business environment reforms particularly on governance and reforms.

1. Introduction

1.1. Overview and objectives

The Consultant, PricewaterhouseCoopers Advisory Services Ltd. (PwC), presents this final report for the assignment, "**A Comprehensive Analysis and Review of Investment, Production and Export Incentives in Malawi"**. The contract for this assignment was signed on 10 August, 2016 and was kicked off on the 16 August 2016.

1.2. Background and Context

This assignment is one of several studies commissioned by the Government of Malawi (GoM) as part of the process of tax review. The results and recommendations of this assignment are intended to be used to form a basis for the development of a comprehensive tax review in Malawi. The Malawi Growth and Development Strategy II (MGDS II) 2011-2016 which has been the overarching medium term strategy for the GoM aims at reducing poverty through sustainable economic growth and infrastructure development. The focus on wealth creation and reduction of poverty entailed designing complementary national strategies to transformation of the country from being a predominantly importing and consuming economy to a predominantly producing and exporting economy. The reduction in donor aid, coupled with widening trade deficit has necessitated the need for government to raise more domestic revenues while at the same time providing conducive environment for the private sector to thrive and grow.

To this end, the GoM launched a five year National Export Strategy (NES) in December 2012 with the primary objective of boosting and promoting exports of the country's prioritised productive sectors. The NES essentially provides a prioritised road-map for developing the country's productive base to allow for both export competitiveness and economic empowerment of the poor, farmers, women and other vulnerable groups. It is based on four priority areas:

i. *Export Clusters:* development of priority clusters that have the potential to complement tobacco and drive exports through value addition. These clusters are oil seed and sugar cane products and manufactures (beverages, agro-processing including dairy and maize, wheat, horticulture and pulse value addition);
ii. *Conducive Environment* to economic competitiveness and economic empowerment of youth, women, farmers and micro, small and medium enterprises;
iii. *Supportive Economic Institutions to Build the Productive Base of the Economy:* invest in supportive economic institutions, specifically on consumer, financial and market information systems, and improve communication and dialogue; and
iv. *Competencies, Skills and Knowledge:* invest significantly in competencies, skills and knowledge as a foundation of Malawi's productive base and its export capacity.

The limited sources of Malawi's economic growth have confined the country to reliance on the export of raw or semi-raw commodities. The manufacturing sector, which contributes around 10% to Gross Domestic Product (GDP), relies mainly on the processing of agricultural commodities (tea, tobacco and sugar) and is predominantly inward-oriented as around 15% of manufactured products are exported. The low contribution of manufacturing to Malawi's GDP is due to the limited investments in the sector over the past few decades. Hence, it is imperative for Malawi to attract increased private investment by, among other things, providing a business friendly and enabling environment. This report focuses on the extent to which providing an enabling business environment, especially through fiscal and non-fiscal incentives, to investors, would lead to increased investment.

1.3. Objectives and scope

The Study is to undertake **"a comprehensive analysis and review of investment, production and export incentives in Malawi**". The assignment will propose fiscal and non-fiscal incentives to enhance the attractiveness of investing into the country's priority sectors to existing as well as potential domestic and foreign investors. The output of the assignment will be use to inform the GoM's Comprehensive Tax Review.

To achieve the objectives of this assignment, the team has focused on the areas that have been clearly identified in the Terms of Reference, undertaking the following tasks:

i. Conduct an industrial sectoral analysis in Malawi in order to determine the existing and potential viability of the various productive sectors that require government support through targeted incentives. This will include, but not limited to, a thorough analysis of the key productive industrial sectors in Malawi (Manufacturing, Sugar, Oilseeds, Agriculture, Aquaculture, Energy, Agro Processing, Mining, and Tourism) with a view to determining the production levels, share of products in domestic market, share of exported products, employment levels, potential for exports and import substitution, and the need for incentives to boost exports and generate revenue.

ii. Provide a comprehensive review of fiscal and non-fiscal incentives including existing investment and export incentives and propose strategic ones that could attract investment and develop exports in the country.

    a. Review the existing investment, production and export incentive schemes (including Industrial Rebate Scheme, EPZs and others) to determine their effectiveness, administration and management by the government of Malawi. Determine the benefits of the current incentives to the industries and companies that are currently using them.

    b. Assess the weaknesses of the current tax incentives in boosting industrialisation, sectoral development and export growth and development.

    c. Propose productive industrial and other sectors of the economy that require progressive incentives based on the outcome of the sector analysis above.

    d. Develop a package of strategic investment and export incentives for the identified competitive industrial and other sectors that have high potential to attract investments and develop exports in the country, reengineering the existing incentives regime by developing both financial and non-financial incentives.

    e. Develop and recommend non-fiscal incentives that are key to fast-track industrialization in Malawi.

    f. Develop guidelines for the administration of the strategic tax and non-tax incentives based on industry performance.

    g. Determine the bottlenecks of domestic entrepreneurs to identify specific incentives to target them.

    h. Determine levies that would be imposed on exportation of primary products to encourage processing and value addition, and ways to administer such levies.

    i. Align the outcomes of the exercise with the planned Comprehensive Tax Reform in Malawi.

iii. Give a brief overview of the more general business attraction, retention and expansion options ('…the provision of a business friendly and enabling environment…') for Malawi as outlined above, and ways to achieve the realization of such options.

iv. Suggest options on how to make the information package on the incentives and other supporting measures available to the targeted investors (e.g. marketing via website, brochures, participation in trade fairs).

1.4. Our methodology

PwC reviewed the existing investment incentives in Malawi. Investment incentives are government schemes aimed at stimulating private sector interest in specific types of investment. These incentives may take the form of direct subsidies (investment grants) or corporate income tax credits (investment credit) that compensates the investors for their capital costs. In Malawi, incentives mainly take the form of tax incentives which are designed to remove part of or all the tax burden from a market transaction (the excess burden or deadweight loss on a business transaction).

This report is based on a review of the existing literature on tax incentives, a review of studies and document on investment incentives in Malawi, interviews and roundtable discussions with stakeholders (mainly Malawi Revenue Authority (MRA), Ministry of Finance, the private sector), data from National Statics Office (NSO) and MRA, and questionnaire. Simple analysis of secondary and primary data helped in coming up with decisions related to the study. Excel package was used to analyse data, which was presented using simple graphs. The terms of reference for the study and the list of stakeholders consulted are attached as Annex 3 and Annex 4, respectively.

PwC circulated a questionnaire to selected businesses in order to obtain a sense of the problems and issues. The key results from the responses were:

- Few indicated that it had made any investment because of the tax incentive. The exceptions listed additional investment, increase in efficiency and employment creation as a result of tax incentives.
- The main **problems** pointed out were around administration and process.
  - Delays in processing returns and approvals. Slow decision-making time.
  - Delays in getting final tax returns
  - Lack of clarity
  - Applications not consistently handled
  - Many grey areas
  - MRA capitalises on genuine mistakes to collect taxes unfairly
  - Inadequate information on conditions for tax incentives schemes
  - Bureaucracy or delays in processing approvals
  - Taxes in the country are too high and too many that in the end stifle the businesses
  - Delays in processing new applications or renewals.
- Most said that negotiation with MRA was required.
- A surprisingly large amount of respondents indicated that they would prefer the government to spend the revenue lost from tax incentives on other public expenditures, such as infrastructure.
- With regard to whether they would prefer for all firms to be taxed more equally, views varied. While some felt that equality would favourable, adding that it was important for fairness and market efficiency, others said that different sectors should be taxed differently because of different profit margins and risks. There were also suggestions to lower tax rates and apply capital allowances to all firms. Another suggested fewer non-income tax charges.

To fully understand the impact of any policy implementation, governments, policy makers and businesses around the world require accurate and reliable data on trends in the sector before and after the implementation. The basic requirement of data is to help assess policies that govern future industry development and to provide knowledge to help guide successful and sustainable investment decisions. The general lack of data on levels of financial investment and firm tax payments in Malawi compromised the full conclusion on actual levels of investment and revenue forgone in various industries and the extent to which the country benefit or lose due to tax incentives. There was also a general tendency by interviewees and questionnaire respondents to respond positively in situations where negative response was eminent. Because of this, published information was preferred due to lack of bias.

1.5. Structure of the report

The structure of the Report is designed to address the objective of the study: **“a comprehensive analysis and review of investment, production and export incentives in Malawi**”.

This Report has begun by presenting the executive summary and recommendations. This introduction sets the background and context to the study.

Section 2 summarises the main points on tax incentives in the general theoretical and empirical literature as well as evaluations and other reports available on Malawi’s tax incentives and business climate.

Section 3 contains a situational assessment of the manufacturing sub-sector in Malawi. It identifies opportunities for, and binding impediments to, the development of the manufacturing sector and, ultimately, recommends actions necessary to strengthen and enhance its development.

Section 4 benchmarks other countries in the region both in terms of their general tax offer and competitiveness and looks particularly at the incentives regime of neighbouring countries Zimbabwe and Zambia. It also contains case studies that examine Mauritius’ economic success story, an example of an economic corridor that has been deemed successful, and a section on lessons learned from other export processing zones (EPZs).

Section 5 lists the existing incentives regime. Each incentive type is presented as a fact sheet with a brief description, pros and cons, estimated revenue foregone (where available), and recommendations.

Section 6 contains recommendations for a reformed tax incentives regime in Malawi. This includes policy options and recommendations on fiscal and non-fiscal incentives; proposals to improve administration of incentives; proposals to improve communication and promotion of incentives to private sector.

2. Literature review

2.1. General literature on fiscal and non-fiscal incentives

There are three main perspectives on fiscal incentives. First, supporters (e.g. Bora, 2002; Blomstrom and Kokko, 2003) argue that, under certain conditions, they increase investment, create jobs and other socio-economic benefits. Second, opponents (e.g. Halvorsen, 1995; Wilson, 1996; Osman, 2000; Wells et al, 2001) believe that fiscal incentives may not be the first-best mechanism for attracting FDI and the costs of incentives to attract FDI outweigh the benefits. They believe that incentives may exacerbate problems like governance and corruption and it would be better to improve the local infrastructure and stabilise the macro-economy. The third group is a mixed which believe that incentives do matter but it depends on situation, type and structure.

The literature on investment incentives, especially tax incentives, has been reviewed extensively elsewhere (Bolnick 2009). There is a continued debate in the literature on the effectiveness of incentives in attracting investment. Some experts believe that the benefits of incentives, particularly tax incentives, rarely outweigh their costs. Others, by contrast, argue that investment incentives have contributed significantly to the rapid economic growth in some countries and can help sway investment decisions. Some of the arguments are summarised below:

Arguments in favour:

- Incentives leave investors with a higher net rate of return, incentivising greater investment into targeted activities;
- Incentives can correct market failures, especially underinvestment in activities with positive externalities, such as technology transfer, training and dynamic benefits to the domestic economy;
- They can lure foreign investors who would otherwise invest elsewhere; in particular, can help developing countries compete with comparable destinations for investments to stimulate growth and employment;
- They can signal a government's commitment to supporting investors;
- They can steer investment into business that maintains local production and curb reliance on imports; and
- Incentives can compensate for other costs and risks faced by investors such as poor infrastructure, weak rule of law and low skills of the workforce.

Costs and risks to be taken into account:

- Direct revenue loss to the government;
- Indirect revenue loss if tax-favoured activities undercut the profitability of other producers who pay taxes;
- Revenue leakage through avoidance and evasion if tax incentives create opportunities and incentives for aggressive tax planning, tax evasion and misreporting (for example, income shifting through transfer pricing, sale and leaseback of depreciated equipment, false declaration of exports to extract export subsidies, or firms closing and re-establishing themselves as new companies to re-qualify for tax holidays);
- Higher costs of collection as tax incentives complicate tax administration;
- Economic distortions as tax incentives foster investments with low or marginal rate of return and draw resources away from more productive activities. However, the "distortion" can be worthwhile if the sectors generate large positive externalities and dynamic benefits to the economy;
- Tax compliance costs for business, particularly if there is uncertainty and discretion;

- Negative effects on voluntary compliance if the tax regime is deemed unfair as incentives by definition favour a specific group over others; and
- Reduced transparency as tax incentives tend not to undergo the same level of scrutiny as direct budget outlays.

Turning to the practice on investment incentives, the **empirical literature has yielded the following**[1]:

1. Investment incentives are widely used but this may be the result of lobbying from firms seeking a reduction in their costs more than proof of effectiveness. In fact, incentives are rarely monitored or analysed for their effectiveness in reaching their intended goals.
2. The effectiveness of investment incentives varies between countries and sectors.
3. Tax incentives have worked to lure and steer investments in some countries, with Mauritius and Ireland being oft quoted examples. Famous examples include Korea, Singapore, and Mauritius where tax incentives seem to have encouraged rapid industrialization. However, the success cases have also shown that other fundamentals were in place, without which tax incentives may not have been effective, and they were part of a broader strategy to attract investment.
4. A country's taxation system has a statistically significant effect on investment, but this effect is smaller for developing countries than for developed countries.
5. Tax incentives work best where they are oriented towards exporting firms.
6. Investment incentives can have negative effects such as unfair competition, tax avoidance and abuse. They can also reduce legitimacy of the tax system and negatively affect compliance if the system is deemed unfair and discretionary.
7. According to business climate surveys, tax incentives rank low in low-income countries among factors that influence investment decisions.
8. While other policies such as improving infrastructure and macroeconomic stability have stronger effects on business decisions, all things being equal incentives have favourable effects on investment.
9. Tax incentives may be very costly in terms of revenue loss, especially if they are not effective in enhancing growth and investment, and reduce funds available for infrastructure, public services or other government expenditures.
10. In South Africa, qualitative and quantitative evidence have shown that comparatively favourable investment incentives there have had a negligible effect on generating additional investment in manufacturing.

2.2. *Lessons learnt and key messages from literature review*

The bottom line is that tax incentives are often not used as efficiently as they can be. Where they are prevalent, efforts should be made to make them more effective, in line with this assignment. Some **lessons learned to make tax incentives more effective** include the following:

1. Many governments are trying to move away or revise their investment promotion strategies from broad based to incentive regimes that are tailored to the value chains of prioritized industries and business activities.
2. The design of incentives conforms to good practice principles (simplicity, clarity, certainty and non-discretionary). The application and administration processes of incentives are as simple, clear and as concise a process as possible.

[1] See IMF, 2015; Tanzi and Shome, 1992; Abbas and Klemm, 2013; James, 2013; Fjeldstadt and Heggstad, 2011.

3. Countries have opted to use investment tax credits and accelerated depreciation over tax holidays and income tax exemptions as these yield more investment per dollar spent.
4. Enabling conditions—good infrastructure, macroeconomic stability, rule of law, etc.—are important for tax incentives to be effective. Incentives cannot and should not compensate for a competitive weakness.
5. Tax incentives are governed by tax law and legislative process and fiscal costs are reviewed annually as part of a tax-expenditure review.
6. The approval process of tax incentives involves several stakeholders, but is ultimately best consolidated under the authority of the Minister of Finance and enforced and monitored by the tax administration.
7. The granting of tax incentives is based on rules rather than discretion.
8. To minimise revenue costs, governments only offer incentives to those marginal investors who would not have invested otherwise, though this is difficult to identify, especially through automated, non-discretionary rules.
9. Incentives are not the key drivers of investment location decision by most foreign investors.
10. The use of fiscal incentives as part of an attractive business environment is limited and precisely targeted.
11. Holders/beneficiaries of investment incentives remain within the fiscal reporting system even where tax holiday incentives exist.
12. Full costing and reporting of incentives is undertaken annually, with an analysis of the costs of the fiscal incentives and the benefits from the investment.
13. Integration of new incentives into existing incentive regimes, especially where there are multi-levels of government, is crucial to avoid unintended consequences. There should be full commitment and coordination from the Ministry of Finance as well as the ministry within which the investment promotion agency is positioned on the provision of incentives as well as the monitoring and evaluation processes.
14. Awareness and information of investment incentives is crucial for their uptake as is the capacity of the relevant monitoring/administrative/regulatory Ministries, Departments and Agencies ("MDAs").
15. The overall investment climate issues tend to be overshadowed by overuse of fiscal incentives because of the ease with which governments can pass the fiscal incentives law as opposed to longer term, more intensive action required to improve the overall business climate.
16. Most of the incentive frameworks lack a clear evaluation and monitoring procedures and if they do, there is often a lack of information on the costs and benefits of the incentives. With incentives-measure, report, account, and apply high standards to their design to their administration and develop clear monitoring and evaluation processes and cost-benefit models.
17. A well-staffed fiscal analysis unit is created at the highest level, preferably in the Ministry of Finance with one of its principal responsibilities to monitor tax policy and the special provisions that deviate from the standard tax treatment to determine revenue consequences and the likely economic/investment effects.
18. An inter-agency data exchange system is established to break information silos and serve policy and tax analyses and modelling. This normally involves indexing, classifying and linking information and data bases together including the development of a common data identifier.

2.3. Reports on Malawi context

The literature review centred on an analysis of the key reports listed in the table below. The recommendations made by these reports are elaborated and referenced further below in this report. This report also draws on further reports and publications as listed in the "References" section at the bottom of this report.

Table 2.1 Key reports examined

Report references	Description
Kobetsky, Michael. 2015. "**Malawi: Tax Incentives Study 2015**", GIZ report.	An extensive report on Malawi's tax incentives complete with literature review and best practices, problems of and potential solutions to current tax incentives and guidelines for granting tax incentives.
Bisso, Ricardo. 2014. "**Review of Malawi Industrial Rebate Scheme**", report commissioned by UNDP.	Reviews Malawi's Industrial Rebate scheme with a view to identifying problems and proposing changes towards its improvement.
Forster, Ian and Andrew Parker. 2015. "**Investment Mapping Report**" and "Investment Marketing Profiles" Imani Development	Profiles the agro-processing, beverages, plastics and packing and assembly sub-clusters and provides sector-specific information, analysing investment opportunities
Nsiku, Nelson. 2012. "**Assessing Investment Incentives in Malawi**". The International Institute for Sustainable Development (IISD): Tax Knowledge Network Policy Brief.	Provides an overview of Malawi's economic and industrial policy and Malawi's investment incentives and critiques these.
Malawi Confederation of Chambers of Commerce and Industry "2013 **Malawi Business Climate Survey Report**"	Discusses main obstacles to doing business as identified by survey of businesses in Malawi.
Bolnick, Bruce. 2005. "**Effectiveness and Economic Impact of Tax incentives in the SADC Region**". Nathan Associates – MSI Group, report commissioned by USAID/RCSA, SADC.	Examines the effectiveness and impact of tax incentive programmes in the SADC region.

3. Malawi's industrial landscape

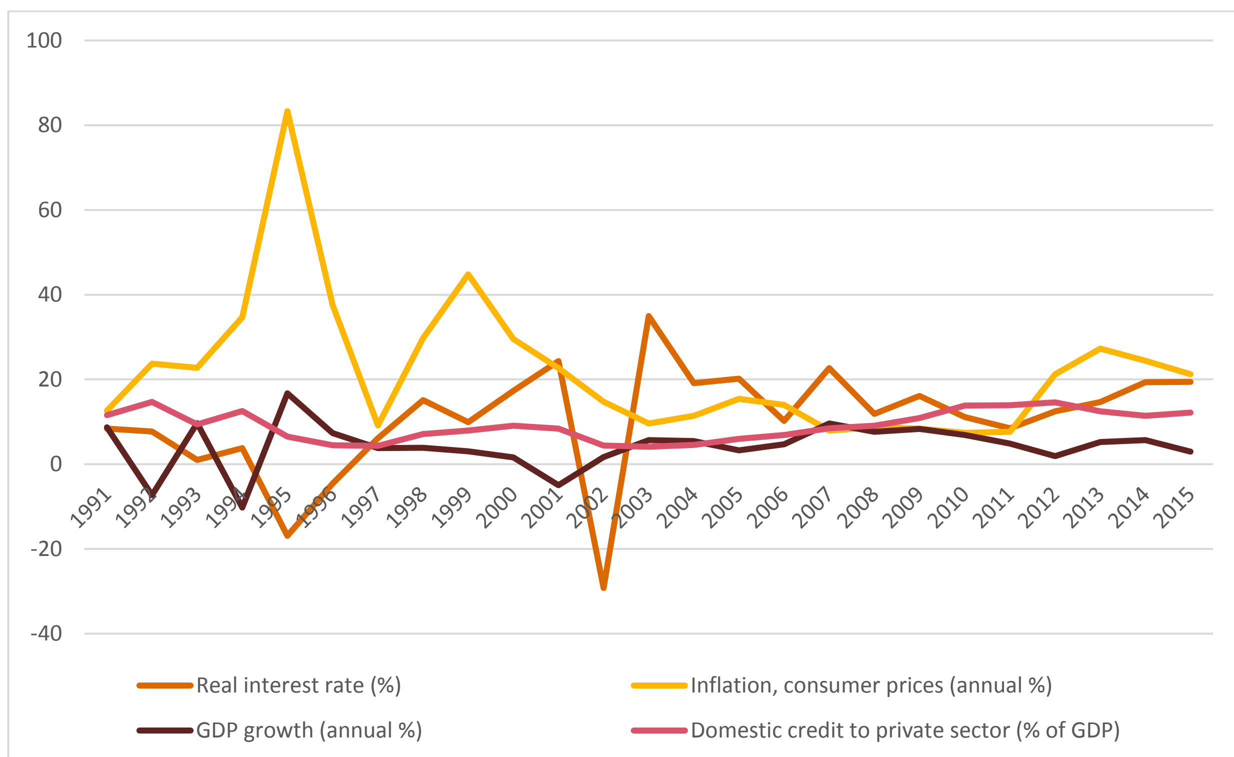
This section outlines a situational assessment of the manufacturing sub-sector in Malawi. It identifies opportunities for, and binding impediments to, the development of the manufacturing sector and, ultimately, recommends actions necessary to strengthen and enhance its development. The assessment was based on information mobilised through a review of the literature, policy documents, and other study reports; analysis of relevant data from different (local and international) sources; and consultations with key stakeholders. Based on key findings from the analysis, PwC recommends policy actions necessary to strengthen and promote the development of the country's manufacturing sector.

3.1. Overview of macroeconomic performance

3.1.1. GDP, inflation, interest rate and real effective exchange rate

Malawi is highly dependent on agriculture, which accounts for almost 30 % of the country's gross domestic product (Malawi Government, 2015), nearly 70% of the rural workforce, close to 16% of urban workforce [2] and about 60 % of export earnings. Real gross domestic product (GDP) grew by 5.7% in 2014 but slowed down to 2.8% in 2015 as Malawi suffered from dual challenges of adverse weather conditions and macroeconomic instability (Figure 3.1). PwC is of the opinion that weak fiscal discipline and natural disasters have been the core driver of macroeconomic instability over the years.

Figure 3.1 Malawi GDP growth and inflation, 2004-2015



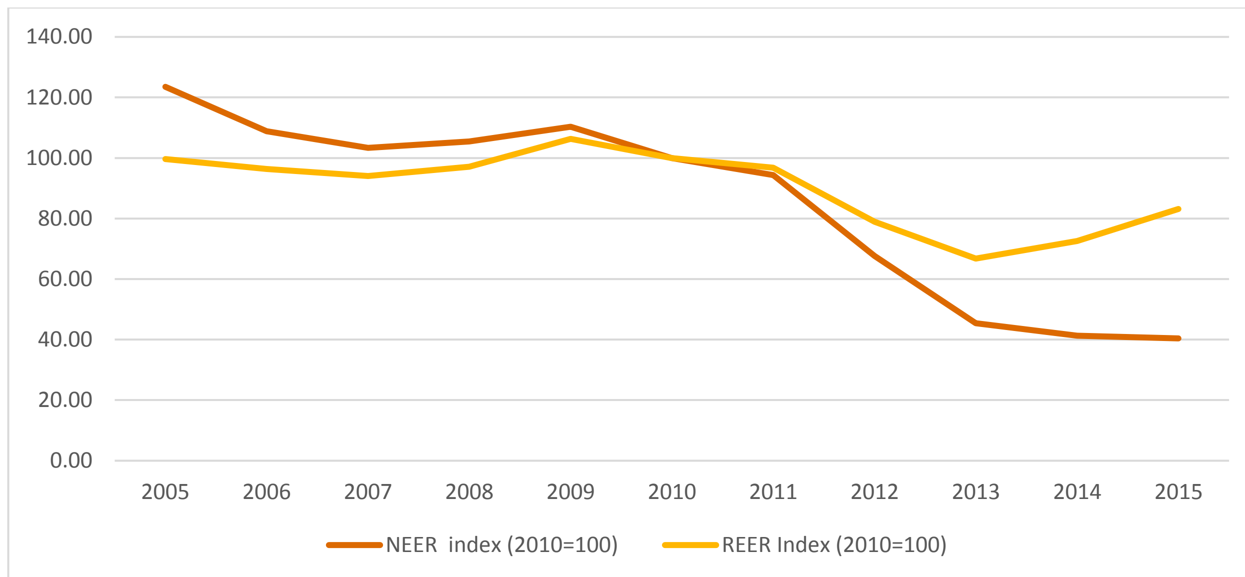
Source: NSO

The real effective exchange rate (REER), which measures the development of the real value of Malawi's currency against the basket of the its trading partners, is a frequently used in assessing the equilibrium value of a currency, the change in price or cost competitiveness, the drivers of trade flows, or incentives for reallocation production between the tradable and the non-tradable sectors. It can be observed in Figure 3.2 that the real effective exchange rate depreciated over long periods through end-2013, reflecting further loss of

[2] Malawi Labour Force Survey 2013

competitiveness. Since then, the GoM's has committed pursuing flexible exchange rate regime mechanism that has necessitated the depreciation of the Malawi kwacha by more than 50percent between 2012 and 2015.

Figure 3.2 Real and nominal exchange rate indices, 2005-2015

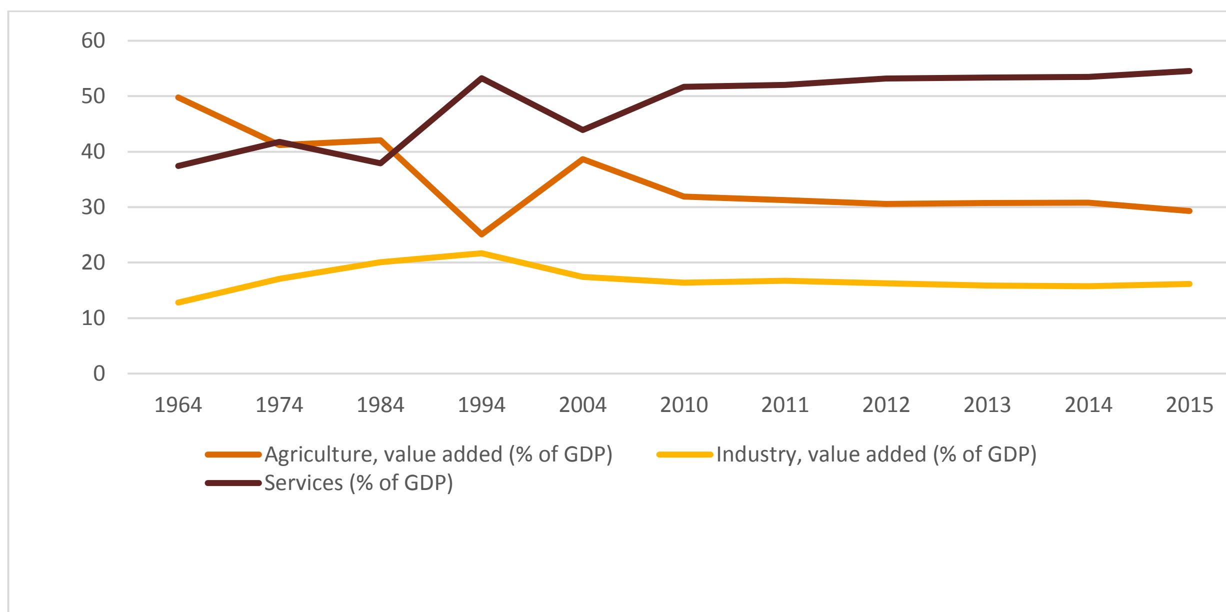


Source: IMF, International Financial Statistics

3.1.2. Structure of the Economy

The structure of Malawi's economy has changed, with agriculture's contribution to GDP declining from about 50% in 1964, to 39% in 2004, and 29% in 2015. In contrast, the share of the services sector is growing fast, with its contribution to GDP rising from 37% in 1964 to around 55% in 2015 (Figure -5.3). However, the contribution of the industrial sector to GDP has fluctuated between 13% and 22% over the previous five decades, while that of manufacturing within it averaged only about 10% (Figure 3.3).

Figure 3.3 Value added as a percentage of GDP by sector, selected years



Source: Malawi Government, Economic Reports

The experience of South East Asian countries show that as the share of agriculture to GDP declined, industry and in particular manufacturing was the main driving force of economic development. However, data from Malawi tell a different story in that, while the share of agriculture to GDP has declined, industry has largely remained stagnant over the past two decades (Table 3.1 and Figure 3.4). Although agriculture continues to employ nearly 85% of the households in Malawi (IHS3), but its share of value-added has been falling over the past five decades, dropping from nearly 50% in 1964 to just around 30% in 2015. Instead of being replaced by an expanding manufacturing sector as was the case in South East Asia, the decline has been offset by an expanding services sector which accounts for around 55% of GDP. This raises the question of the long-term viability and sustainability of the observed growth path of development where the rising services sector bypasses the manufacturing sector to become a major pillar for economic growth.

Table 3.1 Value added as a percentage of GDP by sector, selected years

	1964	1974	1984	1994	2004	2013	2014	2015
Agriculture, value added (% of GDP)	50	41	42	25	39	31	31	29
Industry, value added (% of GDP)	13	17	20	22	17	16	16	16
Services (% of GDP)	37	42	38	53	44	53	53	55

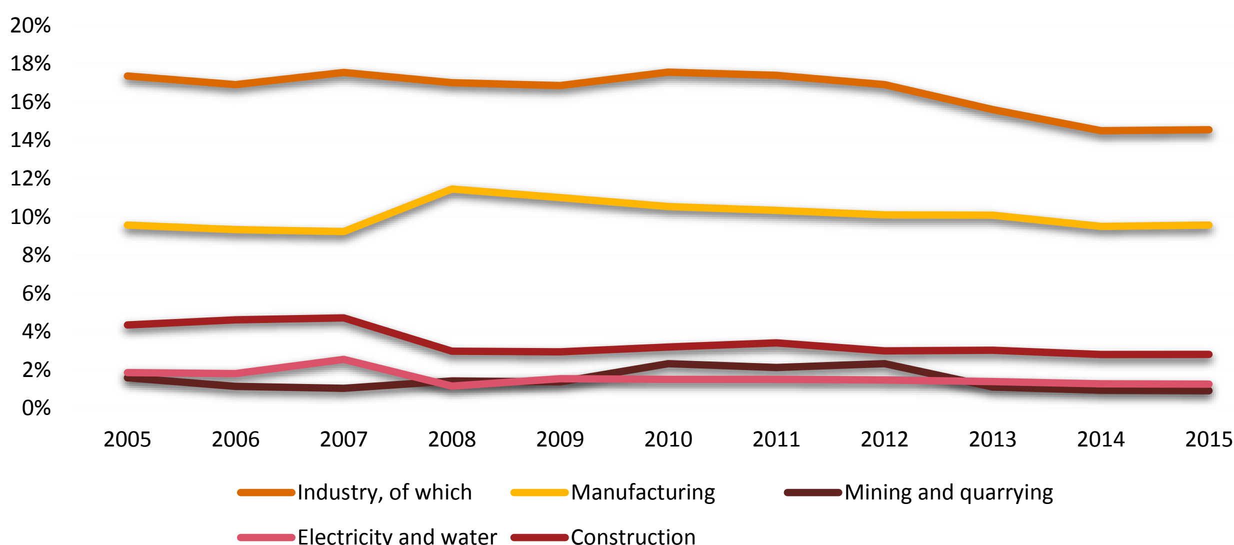
Source: Malawi Government, Economic Reports

The structure of Malawi's economy has changed, with agriculture's contribution to GDP declining from about 50% in 1964, to 39% in 2004, and 29% in 2015. In contrast, the share of the services sector is growing fast, with its contribution to GDP rising from 37% in 1964 to around 55% in 2015 (Figure -5.3).

3.2. Industrial Sector

However, the contribution of the industrial sector to GDP has fluctuated between 13% and 22% over the previous five decades, while that of manufacturing has stagnated at about 10% (Figure 3.4).

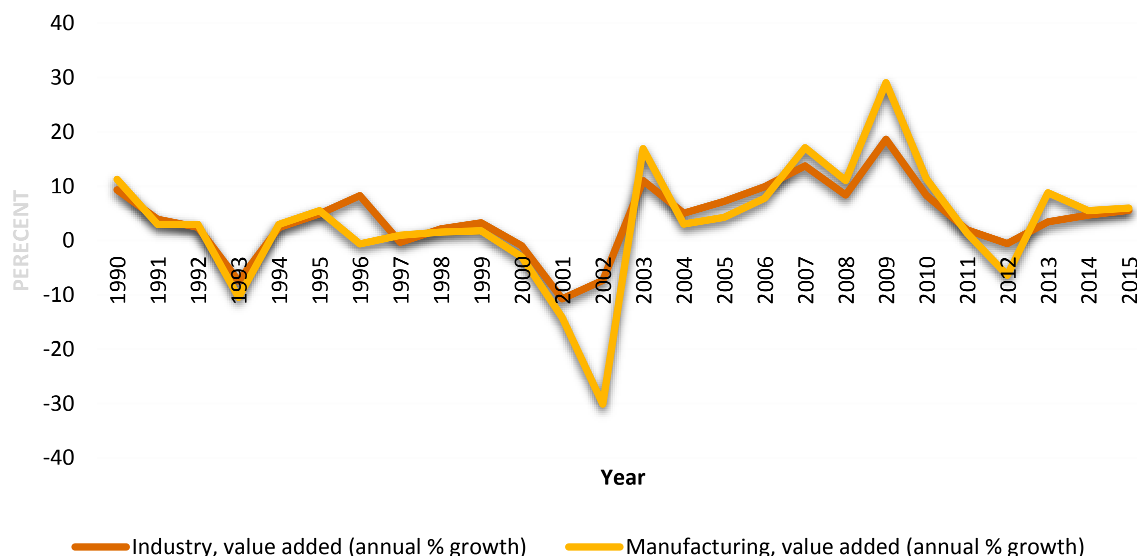
Figure 3.4 Value added as percentage of GDP of the industrial sector with breakdown into manufacturing, mining and quarrying, electricity and water, and construction, 2005-2015



The analyses of historical performance and present structure are based on information from the National Statistical Office (NSO) in Zomba. Industrial growth has been subject to wide fluctuations, with differences as large as 30 points from one year to the next, as illustrated in Figure 3.5. The performance of Malawi's manufacturing sector remains unimpressive. Malawi lags

behind regional role models in terms of both the quantity and quality of industrial goods produced and exported. It continues to rely heavily on an unproductive agricultural sector, the extractive sector and low value-added manufacturing. Manufacturing value-added (MVA) as a share of GDP has mostly stagnated at roughly 10 percent between 2005 and 2015, which is still below the average for the SADC region of 12 percent, making Malawi one of the least industrialized countries in the world.

Figure 3.5 Industrial sector growth, 1990-2015



3.3. Manufacturing sub-sector in Malawi

3.3.1. Rationale for Manufacturing

Expanding manufacturing production is now recognised as essential for economic growth in low-income countries, given that manufacturing has the potential for value-addition on the country's existing resources. Empirical works (UNIDO 2010, 2011b, and 2012a) show that the production and export of manufactures have been a leading factor in all successful and catching-up developing countries. Manufacturing has been a key factor in many emerging Asian and Latin American countries, which have experienced rapid growth in productivity and employment creation, as well as technological upgrading.

The shift of resources towards manufacturing provides at least four linked and mutually reinforcing major benefits, namely productivity growth, development of linkages and spill overs, economies of scale, and new export opportunities. The manufacturing sector has the potential to create economies of scale and rapidly increase productivity largely due to a high rate of technical change. Labour productivity in manufacturing activities increases through the adoption, development, and mastery of new technologies (Ocampo and Vos 2008). Manufacturing has considerable potential to develop deeper, more dynamic, and stronger forward and backward linkages not only within the sector itself (upstream and downstream activities), but also with other sectors (UNIDO 2011a). It provides potential for diversification into a variety of economic activities, as well as for employment creation and income generation. The complexity of products tends to be higher in manufacturing than in most agriculture- and resource-based industries.

3.3.2. Structure of Manufacturing Sub-Sector

The pattern of manufacturing in Malawi is typical of countries at an early stage of industrial development. The bulk of industrial production stems from 3 sub-sectors of food,

beverages and tobacco, which in 2013 together accounted for 76 percent of gross output, 73 percent of MVA and 68 percent of industrial employment as Table 3.2 shows.

Table 3.2 Malawi-Structure of the Manufacturing Sub-Sector, 2013, percentages

	Output	Employment	Value added	Inputs/ outputs
Food processing , agro-processing including sugar	37%	50%	36%	81%
Beverages	11%	3%	14%	78%
Tobacco manufacture	28%	15%	23%	85%
Textiles, clothing leather goods and footwear	2%	8%	2%	116%
Sawmill and wood products	2%	7%	3%	73%
Packing materials, printing and publishing	1%	2%	2%	65%
Chemicals and fertilizers	3%	1%	4%	74%
Pharmaceuticals, paints, chemicals, detergents, soaps & cooking oils	3%	3%	1%	98%
Fibres, rubber and Plastic products	3%	4%	4%	78%
Non-metallic mineral products	4%	2%	7%	85%
Metal products other than machinery	3%	2%	2%	92%
Machinery and motor vehicle assembly	1%	2%	1%	84%
	100%	100%	100%	63%

Source: Malawi Government, NSO

Manufacturing consists predominantly of last-stage (end-product) assembly and raw materials processing, a high share of which is food processing. Both of these are low value added activities. There are very few capital goods industries. In addition, manufacturing firms in Malawi are high-cost producers and are characterised by high excess capacity, with capacity utilisation of the installed capacity in the range of 40-55%.

Following from the literature review and focus group discussion with the private sector, it becomes apparent that owing to its landlocked position, Malawi's transport costs are very high and provide a natural barrier of protection against imports, but also a formidable obstacle against exports. The CIF/FOB margin[3] is now about 50%. Such high transport costs markedly reduce the profitability of industrial exports, especially those based on imported raw materials, and render domestic prices about 40 percent higher than exports even in a free trade situation. High transport costs have contributed to keeping exports down.

3.3.3. Malawi's Exports of Manufactured Products

Despite efforts aimed at diversifying the export base, Malawi, alongside other African exports remain highly focused on commodities. At present, industrial exports account for only about 3-8 percent of all exports. High dependence on commodity exports means that terms of trade fluctuate with commodity prices, which may have a negative effect on the country's growth. Government finances also fluctuate with commodity prices, possibly affecting governments' fiscal stability and leeway. In sub-Saharan Africa alone, for example, 10 economies are fiscally dependent on natural resources. In

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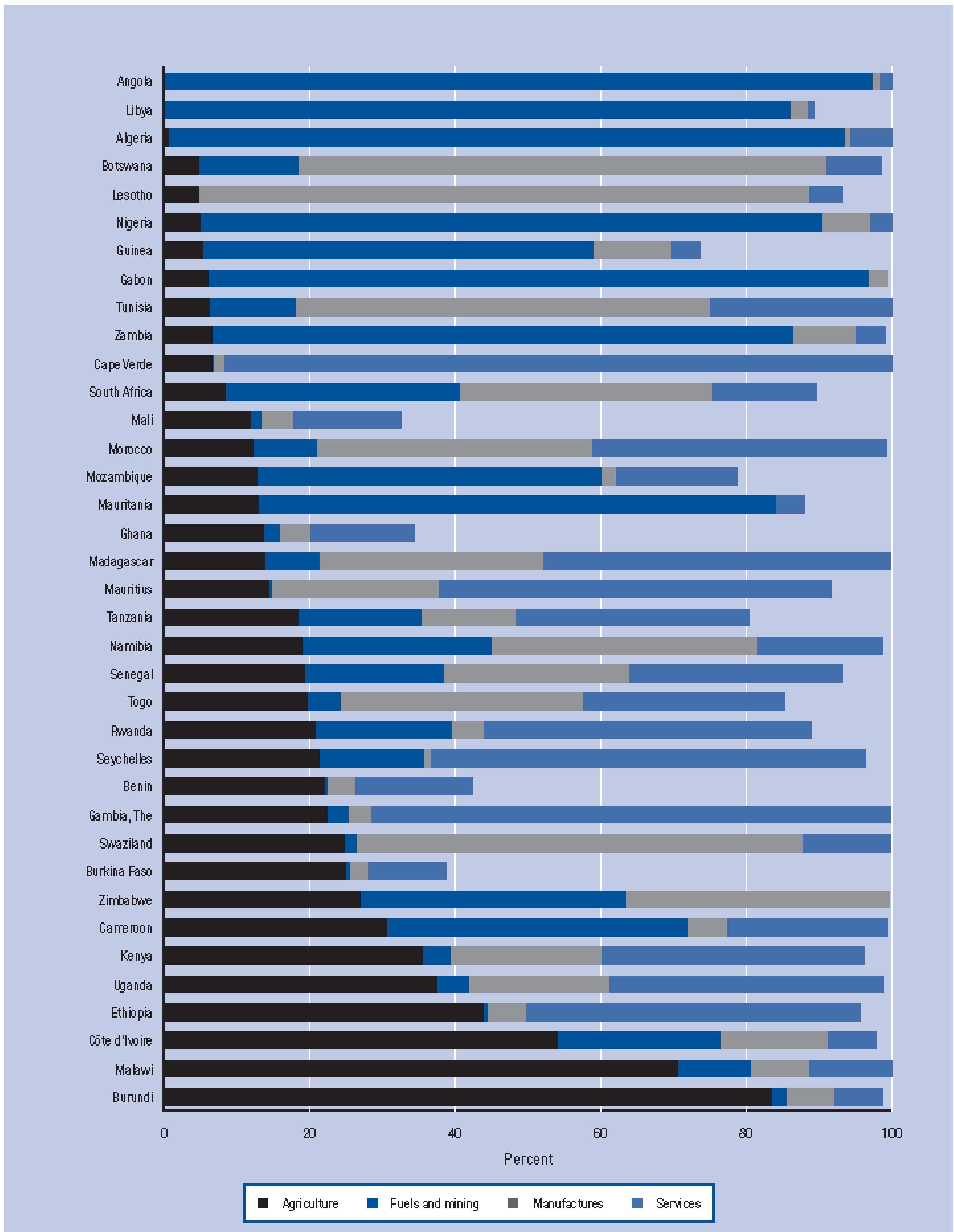
[3] The cif/fob margin measures the ratio of cost of imports inclusive of insurance and freight (cif) to imports exclusive of insurance and freight (fob). A higher ratio indicates that transport costs are higher for that area or country. For developed countries, this ratio is below 10%. The average for sub-Sahara Africa is 20%. Thus, at 50%, the cif/fob ratio for Malawi is very high which puts the country at a competitive disadvantage.

contrast, another set of countries—including Burundi, Côte d'Ivoire, Ethiopia, and Malawi—are highly dependent on agricultural exports (see Figure 3.6). Against this backdrop, export diversification—both in goods and services and also across markets—is key to raising Malawi's resilience to external shocks.

Many regional trading initiatives have been launched on the continent over the last several decades, yet Africa's markets remain poorly connected with each other. The share of Africa's intra-regional goods trade in total goods exports is just 12 percent, compared with 25 percent in the Association of Southeast Asian Nations, 65 percent in the European Union, and 49 percent in the North American Free Trade Agreement bloc in 2011. Although these estimates probably underreport the actual volume of trade because of the high levels of unregistered cross-border activity. Survey results suggest that informal border flows may comprise up to 90 percent of trade.

Figure 3.6 Export share of total exports by category, 2014



Source: UNIDO

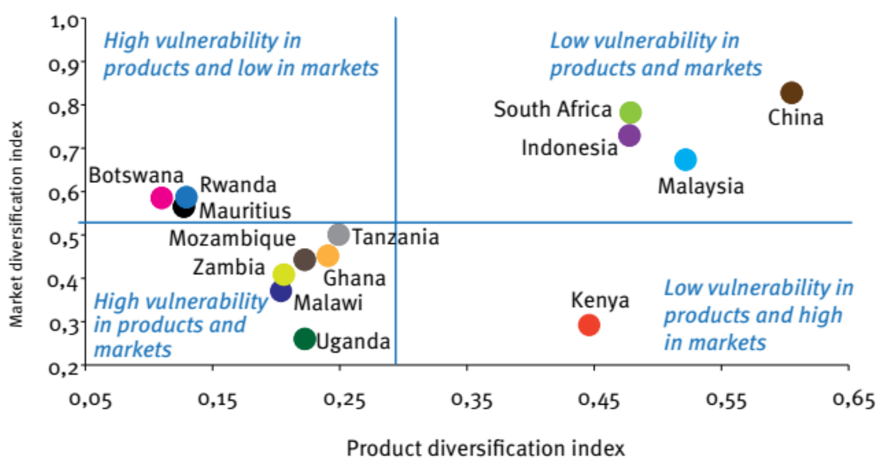
Based on the information in

Figure 3.6, agriculture, which is vital for Malawi's economy, is therefore the key sector to be targeted for industrialization through the establishment of agro-food industries. In summary, therefore, this analysis suggest that, there is still scope for product diversification and a huge potential for investment in agro-processing if the Malawi is to increase exports in manufactures. Both the National Export Strategy and the National Industrial Policy spell out the key measures towards a new pathway for industrialization and export-orientation of the productive sectors placing emphasis on agro-processing and value-addition.

3.3.4. Threat to Malawi manufacturing

The vulnerability matrix (Figure 3.7) combines the manufactured product and market diversification indices and positions countries relative to comparators along the market and product diversification scales. Four vulnerability quadrants are created using the index value averages. The rationale is that higher levels of diversification (in products and markets) reduce vulnerability. It is less risky to serve a large number of markets with a large number of products rather than concentrating on a very narrow product spectrum in a few selected market destinations.

Figure 3.7 Threats to industrial competitiveness



Malawi displays high vulnerability in both markets and products. The lack of diversity in the product mix for export illustrated in the analysis highlights the need to reduce its dependence on a small group of products. This requires active policies to promote new manufacturing activities and attract investment and expertise for these sectors. The lack of a more diversified market coverage suggests that the manufacturers are not actively participating in several important world markets.

3.4. Malawi's Manufacturing Competitiveness and Comparative Advantage

3.4.1. Competitiveness and comparative advantage

Sustained increase in competitiveness of an economy is a hallmark of economic strength and stability of that economy. Worldwide, there has been an increasing awareness improved competitiveness to face the realities of the globalised trading environment. At micro level, it is relatively easy to define competitiveness of a firm, which is the ability to do better than comparable firms in sales, market share or profitability; but competitiveness of a country is interpreted broadly on development or growth strategy. However, a narrower, more tractable, definition is to take the country's ability to compete in international trade. Thus, a country may be termed competitive if it is able to sell its products at a lower (or same) price and earn the same (or higher) return as its competitors. Variables such as remuneration of factors of production, exchange rate and productivity through the use of

better technical skills and human resource development as also economies of scale are having greater influence in deciding the extent of competitiveness of export products in the globalised setting.

OECD defines competitiveness as the degree to which a nation can, under free trade and fair market conditions, produce goods and services, which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long-term. The World Economic Forum (WEF) defines competitiveness as the ability of a country to achieve sustained high rates of growth in GDP per capita. Hence, competitiveness is a concept that is important at a range of levels, from the level of an individual firm to the level of an industry, from the level of a small local region to the level of an association of nation states. The concept of competitiveness, thus, can contribute to an understanding of the distribution of wealth, both nationally and internationally, if it is recognised that it can be applied at both the enterprise and the country level; when applied at the enterprise level, it relates to profits or market shares; when applied at the country level, it relates to both national income and international trade performance, particularly in relation to specific industrial sectors that are important in terms of employment or productivity and growth potential (UNCTAD, 2004).

PwC used the Balassa (1965) methodology, to identify industry activities which in which Malawi has competitive advantage were identified. The **Revealed Comparative Advantage (RCA)** is an index used in for calculating the relative advantage or disadvantage of a certain country in a certain class of goods or services as evidenced by trade flows.

$\text{RCA} = (\frac{\text{Eij}}{\text{Eit}})/(\frac{\text{Enj}}{\text{Ent}})$, where:

RCA- revealed comparative advantage; E-Exports; i-country index; n-set of countries; j-commodities index; and t-set of commodities.

That is, the RCA is equal to the proportion of the country's exports that are of the class under consideration (E_{ij}/E_{it}) divided by the proportion of world exports that are of that class (E_{nj}/E_{nt}). A comparative advantage is “revealed” if RCA>1. If RCA is less than 1, the country is said to have a comparative disadvantage in the commodity or industry. According to Wu and Chen (2004) a higher RCA is evidence that a country possess a greater competitive advantage in the production of the product. Although the RCA index has some measurement problems, since it is defined in terms of autarkic price relationships that are not observable (Bender and Li, 2002; Batha and Jooste, 2004). The major assumption that the true pattern of competitive advantage can be observed from post-trade data, and trade statistics reflect only post-trade situations. Given that trade patterns may be distorted by government interventions (e.g. import restrictions, export subsidies), this may to an extent distort the RCA index, thus causing misrepresentation of underlying competitive advantage. Despite this, Bender and Li (2002) and Batha and Jooste (2004) are of the opinion that the RCA index is still acceptable since the impact of changes in trade policies can be deducted from movements of the RCA, even though it fails to distinguish between a region’s factor endowments. The concept of comparative advantage is applied to explain the propensity for countries to export commodities which they produce relatively more efficiently when compared to trading partners in a reference trading bloc. This implies that countries will have a tendency to export those commodities that they produce at the lowest cost. If this idea is pursued, it can be useful because it can encourage countries to specialize in commodities that they produce more efficiently and through trade, this will result in a more efficient use of scarce resources. There is
no reason why this important trade concept cannot be used to inform agro-processing and value addition in Malawi.

On the basis of the foregoing assurance, PwC used the RCA index methodology to compute the indices of the products where Malawi is competitive (Table 3.3) using 6-digit level data from the International Trade Centre on Malawi and the world exports from 2009 to 2013. The analysis shows that Malawi has significant competitive advantage in textiles, vegetable products, machinery/ electricals, foodstuffs, wood and wood products and plastics and rubber industries.

Table 3.3 Malawi' industry competitive advantage

Product Description	RCA Index
Textiles	53-194
Vegetable products	73-280
Machinery/electrical	6-125
Foodstuffs	50-2,100
Wood and wood products	14-40
Chemicals and allied industries	4-56
Animal and animal products	6-17
Mineral products	5-11
Raw hides, skins, leather and furs	9-50
Metals	7-47
Plastics/Rubber	9-54

Source: Pwc Computations

These observations that most of Malawi's exports are in primary form (Figure 3.6) and the RCA for Malawi (Table 3.2) clearly support a case for strong value addition through industrialization and trade facilitation. The concept of RCA as initially defined by Ballasa in 1965 has guided and informed the agro-industrialisation options for Malawi with particular focus on developing agricultural productivity and agro-processing industries.

3.4.2. Competitive Industrial Performance Index

The United Nations Industrial Development Organisation (UNIDO) also publishes in its annual report, the competitiveness of the industrial sector of a number of economies and their ranking. The UNIDO's Competitive Industrial Performance (CIP) ranking is a benchmark for industrial activity comprising four variables, viz., manufacturing value added per capita, manufactured exports per capita, industrialisation intensity and export quality. The measures used by UNIDO are divided into two categories. The first set of indicators are combined to gauge the ability of countries to produce and export manufactures competitively. The second set is focused on the "drivers" of industrial performance, or factors that affect the first set. Industrial competitiveness ranking of a majority of the southern African countries are higher than Malawi. Malawi's rank has improved slightly from 133 in 1990 to 128 in 2015 among the list of 142 countries (

Table 3.4).

Table 3.4 Malawi's Industrial Competitiveness

Countries	1990	2000	2014
Malawi	133	136	128
Zambia	123	116	116
Mozambique	136	134	122
South Africa	42	43	44
Namibia	85	92	86

Source: UNIDO

The sub-sectoral review above has revealed an overall strained situation and unfavourable trend in most manufacturing sub-sectors. The analysis has also demonstrated that the GoM has at its disposal the requisite instruments to significantly change the future course of industrial development. By appropriate policy interventions, the GoM can facilitate the necessary restructuring of the existing sub-sectors, create a business environment where private sector initiatives can lead to new directions not yet foreseen and, in the process, facilitate the development of promising sub-sectors. The GoM should not nurture the ambition to create, from its own resources, entirely new 'sunrise' industries from scratch, as this would be beyond its present financial and human resources. Reinforcing existing trends and demonstrated strengths by the industry, as well as facilitating the business community to build on these trends and strengths should, however, be well within the reach of the government.

For Malawi, being at an early stage of industrialisation, it should take advantage of more opportunities to pursue inclusive and environmentally sustainable industrial development with a potential for rapid growth of labour-intensive industries and internationally tradeable services exporting to major world markets. This could boost both output and employment, thus promoting sustained and inclusive growth. As the country acquires skills and expand infrastructure, the opportunities for growth and employment generation could rise in other industries which are intensive in skills, capital and innovation. Therefore, it is recommended that Malawi should strive to add value to its exports as well as attract both local and foreign direct investment in order to improve value addition. This will build a good foundation for skills-based industries in Malawi.

3.5. Benchmark Indicators and Competitiveness of the Malawi Economy

There are two leading surveys on competitiveness at global level that document competitiveness of economies. Before analyzing and looking at Malawi's competitiveness, it is important to better understand the concept of competitiveness and have a look at already existing indicators. This section will first present a definition of competitiveness as given by the World Economic Forum (WEF) - the Global Competitiveness Index of Malawi as well as the World Banks Doing Business Report indicators.

3.5.1. World Economic Forum -Global Competitive Index

The GCI takes into account the fact that countries around the world are at different stages of economic development and offers guidance on the priority areas for reforms. Specifically, the GCI distinguishes three stages of development. In their first stage, economies are *factor-driven* and countries compete based on their factor endowments—primarily unskilled labour and natural resources. Maintaining competitiveness in this stage depends primarily on well-functioning public and private institutions (pillar 1), well-developed infrastructure (pillar 2), a stable macroeconomic environment (pillar 3), and a healthy and literate workforce (pillar 4). As wages rise with advancing development, countries move into the second, *efficiency-driven* stage of development, when they must

begin to develop more efficient production processes and increase product quality. At this stage, competitiveness is driven by higher education and training (pillar 5), an efficient goods and services market (pillar 6), frictionless labour markets (pillar 7), developed financial markets (pillar 8), the ability to make use of latest technological developments (pillar 9), and the size of the domestic and foreign markets available to the country's companies (pillar 10). Finally, as countries move into the third, *innovation-driven* stage, they are able to sustain higher wages and the associated standard of living only if their businesses are able to compete with new and unique products. At this stage, companies must compete through producing new and different goods using the most sophisticated production and business processes (pillar 11) and innovation (pillar 12).

In the 2016-2017 edition of the Global Competitiveness Report published by the World Economic Forum (Figure 3.8), Malawi is ranked 134 out of 138 countries. The best record for Malawi was in 2012 and the worst rating was in 2014.

Figure 3.8 Malawi's Competitiveness ranking, 2009-2016

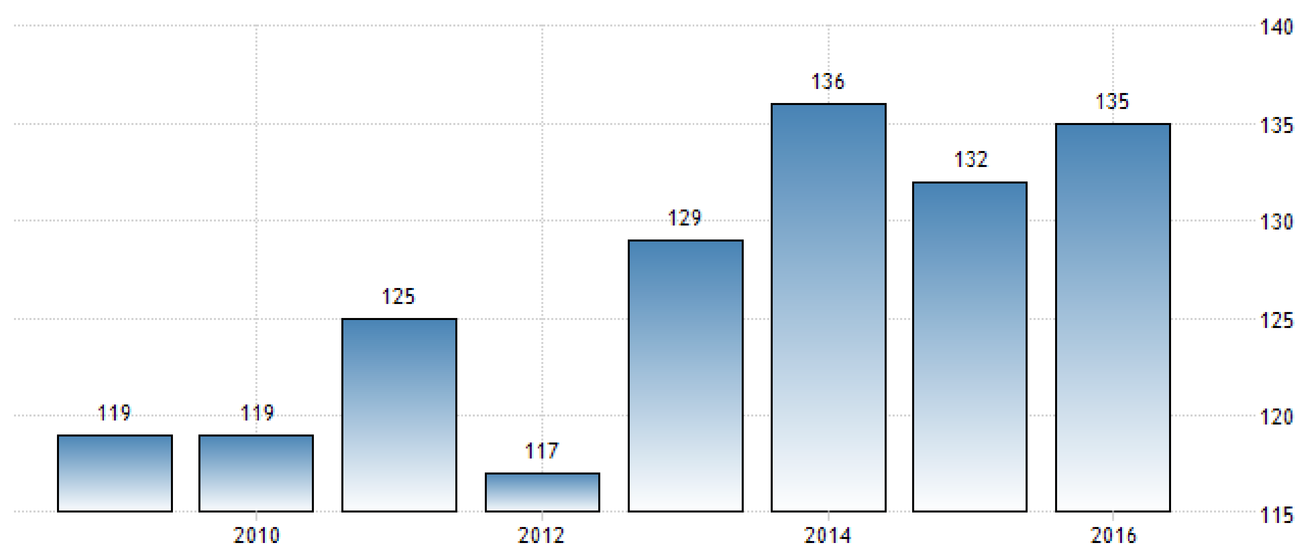


Table 3.5 provides WEF detailed overview of the stages of development of selected African economies and places these into context with other regions. It suggests that a competitiveness agenda for most African countries, classified as factor-driven economies, should make putting into place the basic fundamentals as their first critical step toward improving productivity and competitiveness. That is, these economies should prioritize providing sound institutions and macroeconomic policies, adequate infrastructure, and the means for ensuring a healthy and literate workforce before moving on to the next stages

Table 3.5 Selected Economies by level of development

Stage	**African countries**	**Other countries in this stage**	**Important areas for competitiveness**
Stage 1 (factor-driven)GDP per capita < US$2,000	Benin, Burkina Faso, Burundi, Cameroon, Chad, Côte d'Ivoire, Ethiopia, Gambia, Ghana, Guinea, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nigeria, Rwanda, Senegal, Sierra Leone, Tanzania,	Bangladesh, Nicaragua, Pakistan, Vietnam, Yemen	Basic requirements - Pillar 1 to 4-(60 percent); efficiency enhancers – Pillars 5 to 10- (35 percent), and innovation factors –Pillars 11 and 12- (5 percent)

Stage	African countries	Other countries in this stage	Important areas for competitiveness
	Uganda, Zambia, Zimbabwe		
Transition from 1 to 2GDP per capita US$2,000 to US$3,000	Algeria, Botswana, Egypt, Gabon, Libya	Azerbaijan, Bolivia, Brunei Darussalam, Iran, Islamic Rep., Venezuela	Basic requirements - (between 40 percent and 60 percent), efficiency enhancers (between 35 percent and 50 percent), and innovation factors (between 5 percent and 10 percent)*
Stage 2 (efficiency-driven) GDP per capita US$3,000 to US$9,000	Cape Verde, Mauritius, Morocco, Namibia, South Africa, Swaziland	Albania, Belize, China, Costa Rica, Indonesia, Jordan, Mexico	Basic requirements – Pillar 1 to 4- (40 percent), efficiency enhancers (50 percent), and innovation factors (10 percent)
Transition from 2 to 3 GDP per capita US$9,000 to US$17,000	Seychelles	Argentina, Brazil, Chile, Croatia, Malaysia, Mexico, Russian Federation, Turk	Basic requirements (between 20 percent and 40 percent), efficiency enhancers (50 percent), and innovation factors (between 10 percent and 30 percent)
Stage 3 (innovation-driven) GDP per capita > US$17,000		Germany, Republic of Korea, Norway, Spain, United Kingdom, United States	Basic requirements (20 percent), efficiency enhancers (50 percent), and innovation factors (30 percent)*

Source: *World Economic Forum, Africa Competitiveness Reports*

3.5.2. World Bank Doing Business Report

The World Bank's Doing Business indicators provide a ranking of 190 countries in the world, based on the ease for a local entrepreneur start and operate a business while complying with local regulations. It considers ten areas that are part of a business lifecycle. This ranking gives an overview of the business environment of a country but has to be used carefully, as it does not include all the aspects that may influence the business environment or the competitiveness of the country. Malawi is ranked at 133 out 190 countries.

Figure 3.9 shows Malawi's competitiveness since 2008. Malawi's competitiveness worsened between 2009 and 2013, but has since started to improve. During the past one year, Malawi's competitiveness improved by 8 steps largely due to efforts made to make it easier to start a business by eliminating the legal requirement to use a company seal. Malawi strengthened access to credit by adopting a new law on secured transactions that implements a functional secured transactions system and establishes a centralized, notice-based, online collateral registry.

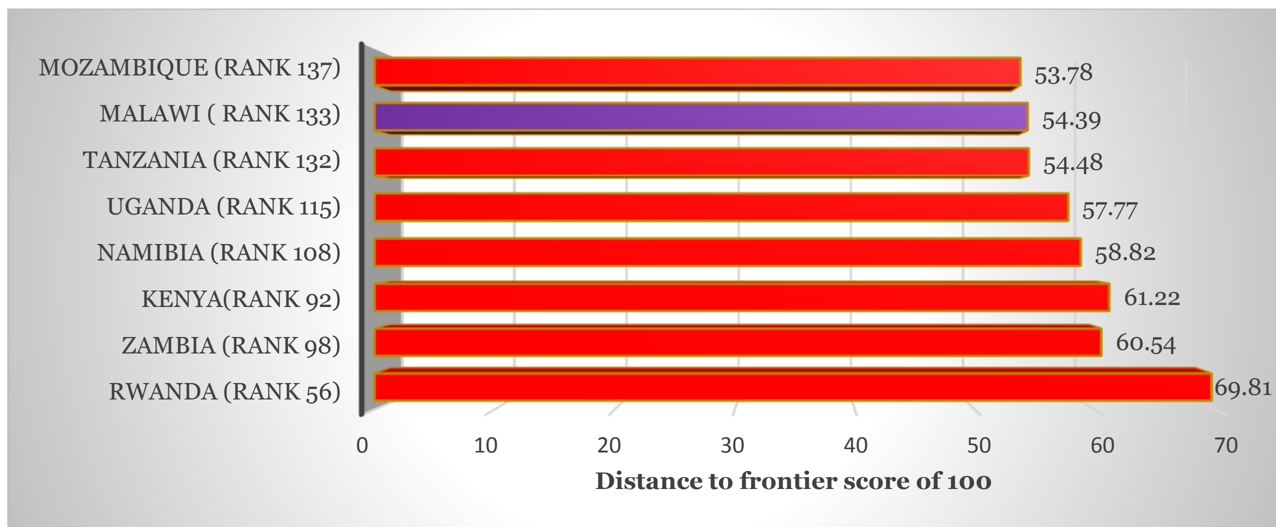
Figure 3.9 Malawi's ranking on doing business indicators

Source: World Bank. Doing Business Report (Various issues)

Figure 3.10

Figure 3.9 shows Malawi's competitiveness compared to comparator countries. It shows that Malawi has to do quite a lot to break into the top 100 destination of choice for investors and to effectively compete with some of the of the regional countries – Rwanda, Kenya and Zambia. Whatever strategy an enterprise follows in a given situation, the quantity and quality of investment flowing into a country always depends upon the returns that an investor expects and the this associated risks. From an investor's viewpoint, Malawi which is competing for Foreign Direct Investment (FDI) in today's globalizing world will have to work through an enabling business environment and to market itself accordingly. This is against that backdrop that that Malawi lacks the necessary capital to stimulate its economy. It cannot access international capital markets while at the same time official development assistance is dwindling. Hence, improving access to FDI through a competitive business environment is, therefore, the only viable option for the development of Malawi's economy.

Figure 3.10 Malawi and comparator economies rank on the ease of doing business



Source: *Word Bank, Doing Business Report 2017.*

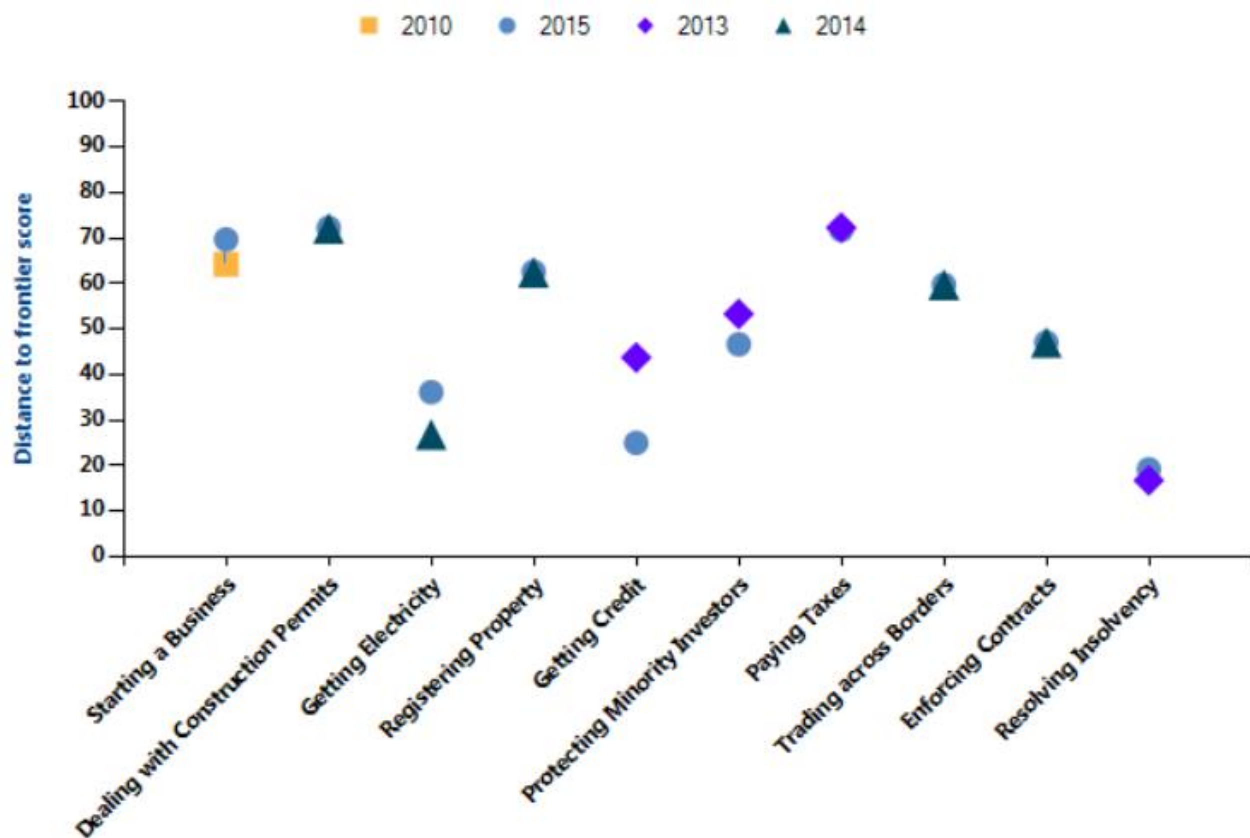
Figure 3.11 below summarizes Malawi's different scores on each of the Doing Business indicators. Therefore, it will be important for GoM to supports measures that improve and secure the competitiveness of the industry. The GoM should ensure that its industry is not put in a position where it becomes uncompetitive internationally. Furthermore, the GoM should proactively influence and support the implementation of a competitive regulatory framework in order to avoid high industry costs.

Figure 3.11 Malawi's Competitiveness across indicators

When comparing Malawi's performance in each indicator across several years

Figure 3.12), there is a sense that a significant amount of work needs to be done to institute and implement hard reforms. On average, Malawi is nearly 45 points below the 100 which forms the pinnacle in excellence.

Figure 3.12 Malawi-Changes in doing business indicators



The analysis shows that countries, like companies, compete. Countries compete for investments, trade, trade in services, and tourists. This focus on national competitiveness has been increasingly reinforced by global competitiveness rankings published, on a regular basis, by a variety of institutions such as the World Bank and World Economic Forum. These comprehensive reports benchmark the country's performance and attractiveness to private investors.

Global rankings are important to Malawi for two reasons. First, they are a set of diagnostic tools, which highlight the strengths Malawi can build on, as well as the challenges that must be overcome, in order to become more globally competitive. Second, foreign investors pay close attention to the indicators and use the information to assess the country standings across a variety of metrics.

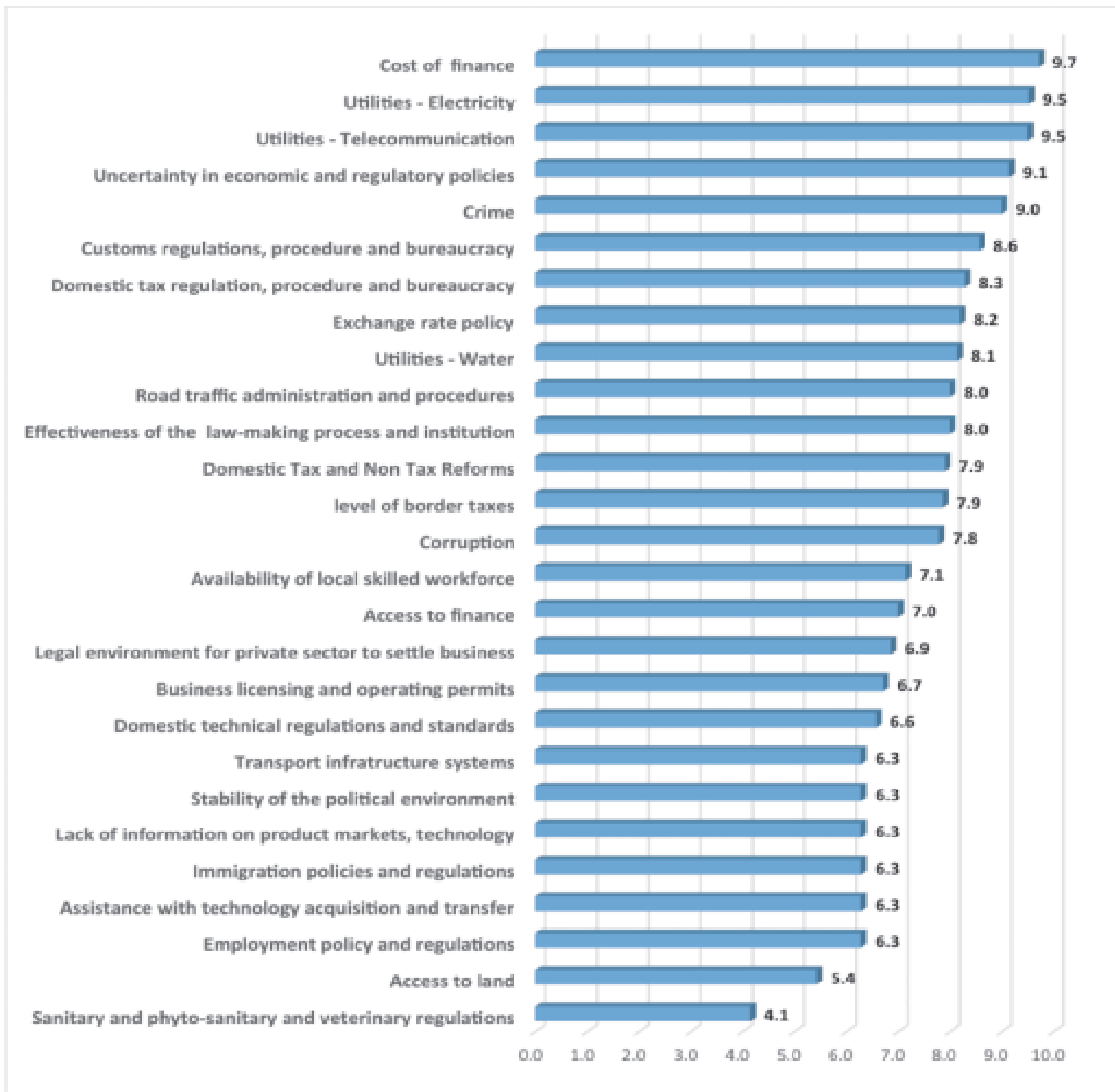
Malawi has continued to feature among the least competitive economies in the world irrespective of the yardstick used. While Malawi has not ranked favourably in many of these surveys, it is encouraging to see an improvement in recent years in the World Bank's ease of doing business indicators. In Transparency International's Corruption Perception ranking, Malawi slipped by 2 positions to 112.

Competitiveness is considered a key criterion in assessing the success of companies, industries and countries. Hence, increasing levels of competitiveness is essential to any economy as a country must perform well both in the domestic and international arena in order to survive. This means that Malawi's top 3 immediate challenges, as defined by the surveys, **are in the areas of corruption, inefficient bureaucracy, and inadequate infrastructure. The longer term challenges lie in the area of education, science and technology, and innovation**.

3.6. Local Industry's Perspectives on Malawi's obstacles to doing business and Competitiveness

The MCCI Business Climate Survey report spells out that Malawi major impediments to business competitiveness are inadequate and/or high-cost infrastructure – including electricity, telecommunications and road and overland transportation; macroeconomic instability; and domestic tax regulations, procedures and bureaucracy (Figure 3.13). The interpretation of the ratings are that 1 to 5 are minor, 6 to 7 are moderate and 7 or higher are major obstacles.

Figure 3.13 Obstacles to Doing business and competitiveness in Malawi



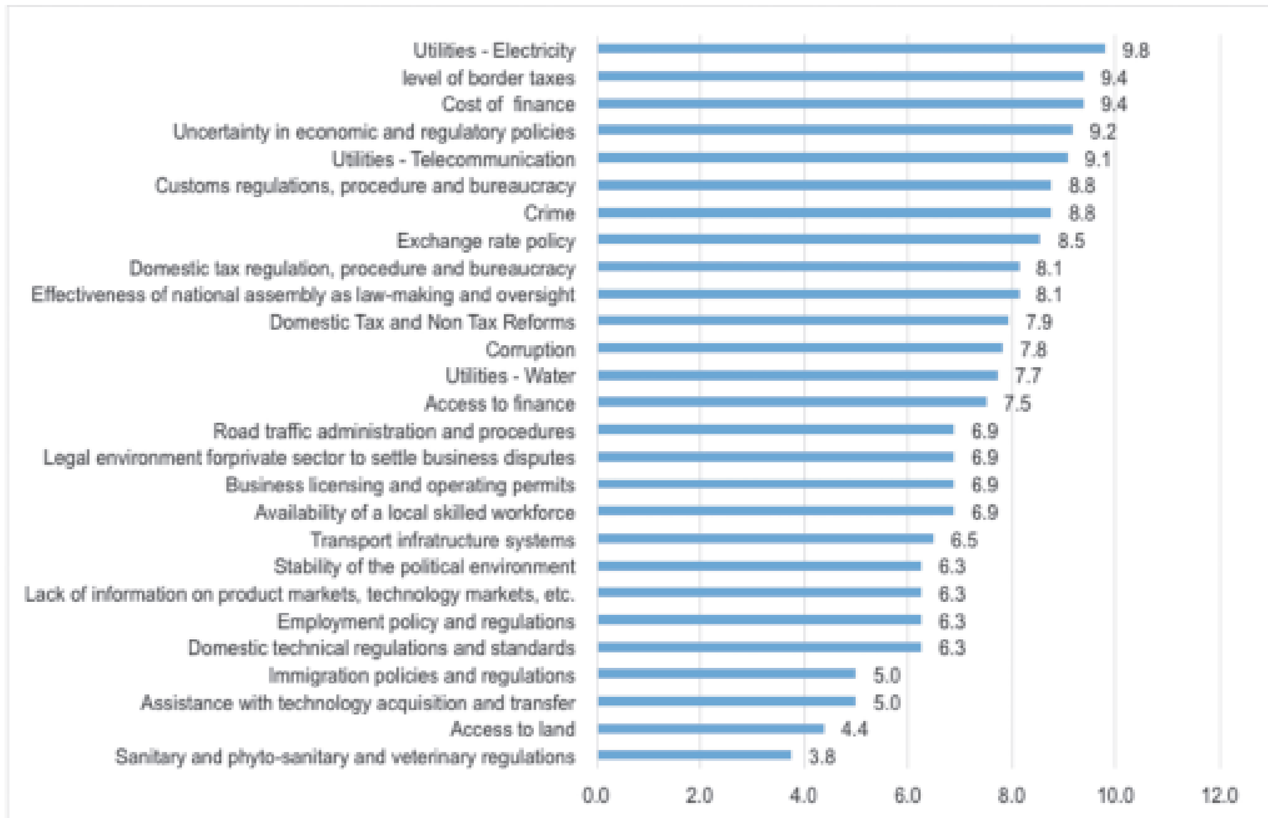
Source: MCCCI

Domestic tax and non-tax reform was also listed as a major obstacle (7.9 - 12th). Regarding non-tax reform, "businesses feel that the way non-tax charges such as land rates and labour safety inspection charges are raised is very unpredictable and during some occasions the charges are hiked several times the existing charges" (Malawi Business Climate Survey Report, p. 19).

More generally, uncertainty and inconsistencies in regulations and procedures are also consistently listed as impeding business planning and operations and efforts should be made to reduce these.

With regard to the manufacturing sector, the survey results show that the level of border taxes is regarded as the second biggest impediment to doing business, after electricity (see Figure 3.14).

Figure 3.14 Obstacles to doing business in the manufacturing sector in Malawi



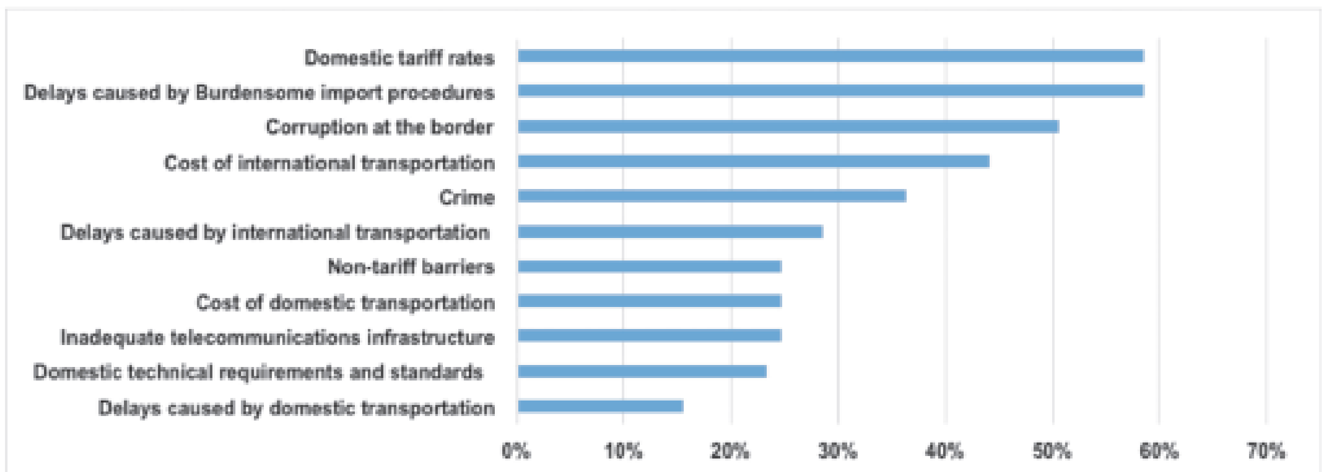
Source: MCCCI

The Malawi Business Survey Report further explains that the high level of border taxes is seen to contribute to the inability of Malawian products to compete on the basis of price in foreign markets, especially for manufacturers using imported raw materials. The manufacturing sector currently imports most of its raw materials.

For importers, domestic tariff rates and delays caused by burdensome import procedures are seen as the biggest obstacles (

Figure 3.15).

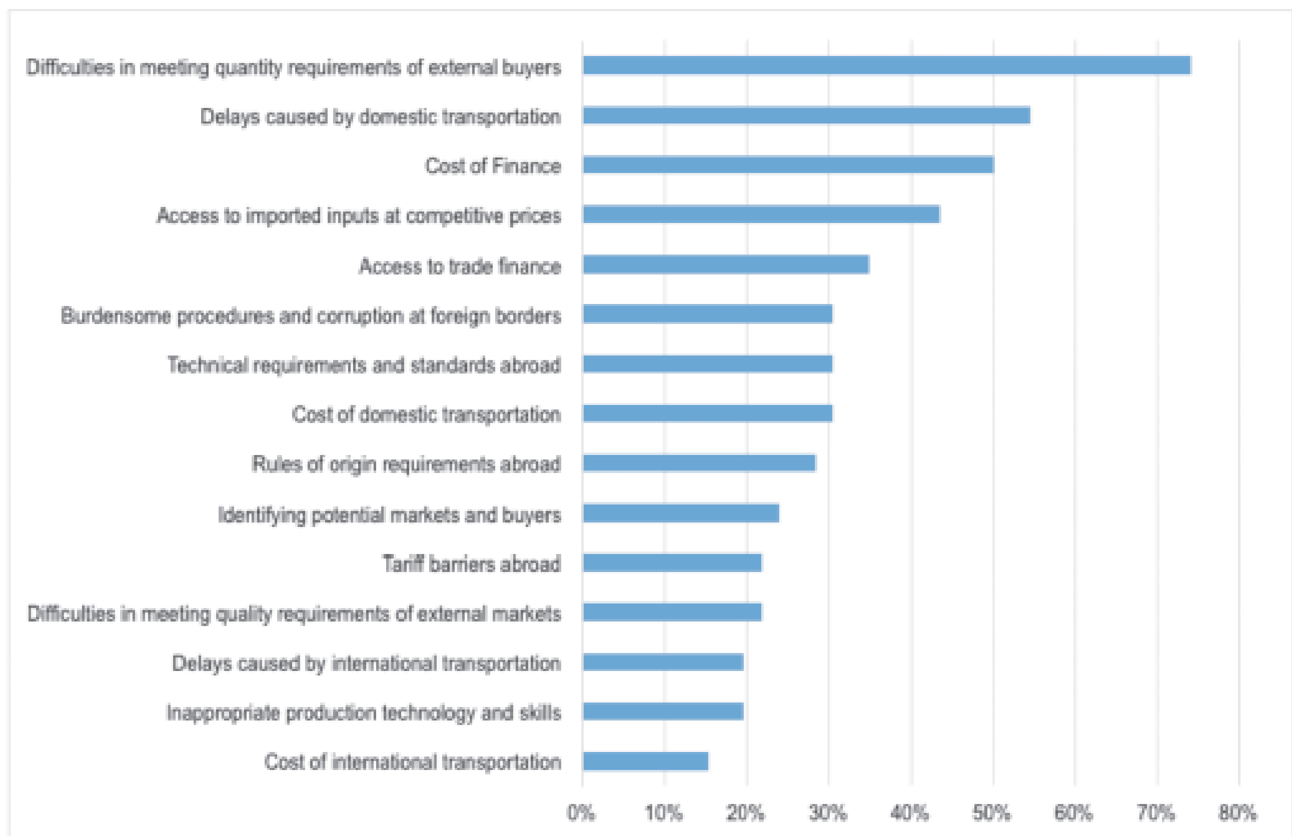
Figure 3.15 Problematic factors for importers in Malawi



Source: MCCCI

Among the problematic factors to export, in turn, access to imported inputs at competitive prices was regarded as the fourth largest obstacle (see Figure 3.16).

Figure 3.16 Problematic factors to exporters in Malawi



Source: MCCCI

The analysis from the MCCI business survey shows of intervention is infrastructure, including road infrastructure, communication systems, water and electricity supply etc and enhancing the efficiency of the public sector in service delivery. Such infrastructure forms the basis for any kind of development in urban and rural areas alike.

3.7. Conclusions and policy recommendations

The macroeconomic environment must be managed with the overriding goal of maintaining and improving competitiveness for the productive sector, in particular the manufacturing sector. The important macroeconomic parameters are the real exchange rate and the interest rate.

The analysis above point to the need for GoM to provide predictable and stable macroeconomic policies that enhance private sector competitiveness and encourage investment in the productive sectors of the economy. This should cover low inflation, stable and market-determined exchange rate, low interest rates and low fiscal deficit. Economic growth and macroeconomic stability are mutually dependent on each other. An economy that has low and stable inflation rates and predictability in tax and spending allows individuals and businesses to plan and invest more effectively for the longer term.

Malawi's manufacturing sector will have to double its contribution to GDP to 20 per cent, a share similar to present day middle income countries. The manufacturing sector will need to grow by al at least 10 per cent per annum and at a rate comparable to China and Southeast Asian countries in the 1980s and 1990s. Given its relatively small manufacturing base and low labour costs, this is certainly achievable provided the country can attract increased domestic and foreign investment, and provide, stable macroeconomic and quality investor and trade facilitation services and a conducive regulatory and business environment. Policy makers in Malawi must realize that the context of policy making has changed significantly over the past three decades. The international rules of the game discourage or rule out policies that were implemented during the 1970's and 80's, some examples of which are selective import protection, local content requirements, restricting competition, export subsidies, and performance and entry rules for foreign investors. However, there are also benefits and opportunities from the more open and transparent regime, including greater access to Chinese, Indian, European, USA and regional markets and technology flows. The challenge for Malawi is to design competitiveness policies that would overcome market failures without violating the international rules of the game.

Several policy recommendations flow from the analysis in this chapter for improving Malawi's competitiveness. Many efforts are still needed for Malawi to diversify and enhance its competitiveness so that the economy can absorb the million new entrants to the labour force every year. The need for increasing competitiveness is even more critical as the Malawi economy is still recovering from a number of shocks. Thus, focusing on competitiveness will provide possible solutions to the record high level of unemployment, finding a path toward fiscal balance and rebuilding the crumbled pillars of the economy. In an attempt to increase country competiveness, policymakers must focus on the drivers of competitiveness. Some of these drivers include:

General Business Environment/Investment climate Issues*:* It is recommended that the GoM fast-tracts whole of government and public sector reforms on a number of business environment related issues spanning the realm of transaction costs, policy inconsistency and reversals to issues of administrative and procedural red tape, delays in processing cases and enforcement of decisions by the courts, customs procedure delays at the borders, the tariff structures and the poor conduct of trade policy (import prohibitions, export bans, etc. The leadership on this should be provided by no lesser person that the head of state.

Remedy deficiencies in the key pillars of competitiveness – The GoM is encouraged to champion the mobilization of resources towards infrastructure development such as power, roads, ports, airports, air travel, national border posts, national electronic single window, telecommunication, water, cold storage, warehousing and even railways. Malawi should attempt to focus on these twelve factors in striving for increase in national competitiveness. However, it may not be able to focus on all twelve pillars at once. Based on the experience of the East Asian newly

industrialised countries, the five pillars (institutions, infrastructure, macroeconomic environment, health and primary education and higher education and training) are considered as the basic requirements for increasing competitiveness. These five factors impact on country productivity and is a start in trying to improve national competitiveness.

One of the key policy response would be to focus on large scale infrastructure renewal and development. This can be done by quickly embracing the private sector participation in infrastructure through various concession schemes.

> ***Improving energy***: PwC recommends that GoM should (1) expedite private investments in the diversification of the energy mix to reduce vulnerability of one source of energy and ensure sustainability; (2) promote energy efficiency and pursue green energy, which will address the energy deficit at no further cost to the environment; and (3) expedite entry into regional power pool coupled with the requisite legal and regulatory framework.
>
> ***Improving transportation***: The GoM is encouraged to facilitate investment in (1) upgrading rail transport links (Lilongwe-Blantyre, Blantyre-Beira) to ensure cost-effective transportation of bulky exports; (2) increasing storage capacity in the country; and (3) improving feeder and rural roads, thereby enhancing inclusiveness. In the transportation sector, outdated infrastructure and limited maintenance call for a pressing rehabilitation in all subsectors. Transport infrastructure is particularly important for a landlocked Malawi in that it faces prohibitive costs for businesses in getting their goods to market, thereby undermining the country's competitiveness.
>
> **Building skilful Human resources**- At the core of country competitiveness is the quality of the human resources of a nation. This is greatly influenced by the quality and standard of the education system. It is important that countries invest in proper education and training of the workforce to prepare them for the relevant jobs in industries where the country has a competitive advantage. The education system should be restructured to prepare the workforce for jobs in the global market. This means that skilled persons can export their services overseas or investors can outsource services to the country because of the availability of specialised skills.

Firm level competitiveness- Businesses are entities that create national wealth. As such, their productivity, efficiency and dynamism are key to country competitiveness. When businesses in an economy are collectively making profits, employing persons and exporting products and services in itself drives the competitiveness of the country. Firms should begin to take seriously the issue of building up local supply chain for their intermediate inputs. This would help reduce costs and improve competitiveness. Secondly, there must be a constant desire to improve operational efficiency. Firms should devote significant portions of earnings for internal restructuring, capacity building, technology upgrading and compliance with international standards.

4. Benchmarking/country comparisons

The chapter looks at the actual data extracted from diverse sources, the goal being to assess the pervasiveness of investment incentives in a variety of regions and jurisdictions. It draws on the findings of chapter 2 through an analysis of best practice in the area of investment incentives with a major focus on developing countries, especially those in Africa, as their circumstances are different to those of developed countries. Particular attention is paid to landlocked countries in the immediate neighbourhood: Zambia and Zimbabwe. The chapter concludes by identifying key policy issues and strategies that GoM can pursue in order to help discipline the use of incentives and ensure that, when used, they are adequately tailored to be consistent with and advance long term sustainable development.

4.1. International Perspectives

Tax incentives in one form or the other are used by nearly all countries in the world. Table 4.1 below shows the prevalence of the different tax incentives among the countries surveyed. It can be observed that tax holidays are most prevalent in South Asia, Eastern Europe and Central Asia and the East Asia Pacific countries while they are least prevalent in the OECD countries. This reflects the gradual move away from the use of tax holidays over time in the developed countries due to their ineffectiveness in aligning the incentives of increased investment with the tax benefits. There is now a much greater use of tax incentives for encouraging Research and Development with the OECD countries and the East Asia and Pacific countries using this tax incentive most often. Super-deductions, where deductions are allowed for more than the actual cost of certain expenses is most prevalent in South Asia mainly to reduce subsidize the cost of investments when starting a business. The use of tax and duty exemptions in Special Economic Zones (SEZs) is quite popular across all the regions.

Most notable is the use of discretionary procedures to provide tax incentives across all the regions. In such a system taxpayers "apply" for tax incentives to agencies outside the tax administration. The tax incentive that the taxpayer may qualify for may be specified in the tax law or investment code but it is generally given broad interpretation that requires an approval process. The "automatic" process on the other hand is when tax incentives are provided for in the tax legislation and there is no procedure to "apply" for them. Taxpayers in this case directly claim for their tax incentives during tax filing or during importation. Discretionary tax incentives are prone to corrupt practice, as the "approval" is sought for and valuable for investors. Sub-Saharan Africa uses discretionary procedures more than the other regions of the world. Interestingly, discretionary processes are not uncommon in the OECD countries.

Table 4.1 Prevalence of tax incentives

	Number of Countries Surveyed	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/ Tax credit	VAT exemption/ reduction	R&D Tax Incentive	Super-deductions	SEZ/Free Zones/EPZ/Freeport	Discretionary process
East Asia and Pacific	12	92%	92%	75%	75% *A*	83%	8%	83%	25%
Eastern Europe and Central Asia	16	75%	31%	19%	94%	31%	0%	94%	38%
Latin America and the Caribbean	24	75%	29%	46%	58% ^	13%	4%	75%	29%
Middle-East and North Africa	15	73%	40%	13%	60%	0%	0%	80%	27%
OECD	33	21%	30%	61%	79%	76%	18%	67%	27%
South Asia	7	100%	43%	71%	100%	29%	57%	71%	14%
Sub-Saharan Africa	30	60%	63%	73%	73%	10%	23%	57%	47%

Source: *Various Tax Guides*

4.2. Regional overview

The range of incentives offered is extensive and includes: tax holidays, preferential tax rates, grants, preferential loans, monopoly rights and preferential infrastructure access (Blomstrom and Kokko, 2003). Investment incentives can be divided into a number of broad areas, outlines of which are provided in Table 4.2. (A list of incentives offered by a sample of African countries is provided in Table 4.3):

1. A low general corporate tax rate which attracts a wide base, generally favored by small countries such as Lebanon or Mauritius.

2. Tax havens and export processing zones (EPZs), favored by countries in the Caribbean and Pacific. These have been successful in attracting FDI, though often only in mobile, global industries like banking, insurance and information technology (Morriset and Pirnia, 2000).

3. Tax holidays and tax exemptions, favored by poorer developing countries[4]. Some developing countries also offer financial incentives in the form of government grants, subsidized credit, subsidized services, government equity participation and preferential insurance and foreign exchange rates (UNCTAD, 1997)[5]. Certain developing countries attach conditions to their tax incentives in order to achieve certain goals such as the stimulation of an underdeveloped area or attraction of foreign exchange. For instance, India offers a tax exemption on profits of firms engaged in tourism or travel, provided their earnings are received in convertible foreign currency. Angola, Brazil, Ecuador, Ghana, India, Pakistan, Egypt, Colombia, Nigeria and Thailand all offer incentives with regional development and sector-specific objectives.

[4] Corporation tax exemptions are deductions from gross income allowed in the calculation of total taxable income. They may be given at the firm level to encourage specific activities (such as investment or recruitment) or at the macro-level to encourage industrial activities and exports in specific sectors (Biggs, 2007).

[5] Tax holidays are generally available for up to 5 years after an investment, but they can go up to 10 years and, occasionally, 25 years. Tariff concessions are often granted for periods of 5 to 10 years, but sometimes major projects may receive 15 to 25 years. Examples of financial incentives in developing countries include: grants for labor training during the first year of a manufacturing investment; loan guarantees from international credit sources; annual wage subsidies of up to 10 percent; and rebates up to 15 percent on the cost of electricity, water and sewage services (UNCTAD, 1997).

A few countries have instituted measures such as loss-carry forwards, which make tax holidays more attractive for firms with long gestation periods; reduced taxes on dividends and income paid abroad; preferential treatment of long-term capital gains; and tax allowances relating to the number of employees hired (UNCTAD, 2000).

4. Investment allowances and accelerated depreciation, generally favored by industrialized countries. These have advantages in that they are targeted at the desired activity and benefits are only gained if capital investments are made. They also cause less revenue leakage than tax holidays. However, they discriminate against companies with long gestation periods and can cause distortions in high inflation environments, as borrowing becomes disproportionately attractive (Tuomi, 2009).

Table 4.2 Types of Fiscal Incentives, with Country Examples

Incentive	**Description**	**Advantages**	**Disadvantages**	**Developing Country Examples**
Reduced corporate tax rate	lower corporate tax rates	• distortions minimized • longer benefit period • flat tax rates reduce confusion	• has to be below 35% to be effective • rewards old capital	All < 30%: Botswana, Korea, Nepal, Nigeria, Peru, Singapore, Sri Lanka, Tanzania, Uganda Flat tax rates: Poland, Romania, Russia, Slovakia, Uzbekistan
Sectoral incentives	reduced corporate tax rates for certain sectors/ activities	• signaling effect of government commitment • easier to implement	• may distort market	Botswana, Brazil, Ecuador, Egypt, Ethiopia, Ghana, Korea, Lesotho, Mauritius, Nepal, Nigeria, Peru, Philippines, Singapore, Sri Lanka, Tanzania, Uganda, Uzbekistan
Tax holidays	period of tax exemption/ reduced tax	• flexible, can be used to targets certain industries • immediate benefit to income-earning firms	• discretionary approach — distortions, potential for mismanagement • favors existing firms over start-ups • can lead to tax leakage and avoidance through transfer pricing • rewards short term investment in 'footloose' industries	(Years in brackets) Brazil (15), Ecuador (20), Egypt (5-20), Ethiopia (1-5), Ghana (5-10), Kenya (10), Korea (5) , Mauritius (10), Nepal (5-10), Nigeria (3-5), Philippines (5), Singapore (5-10), Sri Lanka (5), Tanzania (25), Uganda (10), Uzbekistan (7)
Investment tax allowances/credits	tax credit/ allowance for investment expenditure	• supports expansion in existing firms		Ecuador (tourism), Korea (6-10%),

Incentive	Description	Advantages	Disadvantages	Developing Country Examples
		• encourages long term investment • less revenue leakage		Mauritius (anti-pollution), Mexico (19-25%), Nigeria (5-20%), Philippines (75-100%), Singapore (33-50%)
Accelerated depreciation	depreciation deductions are calculated over a shorter time period	• supports expansion in existing firms • encourages long term investment • less revenue leakage	• eroded by high inflation	Botswana, Brazil, Ecuador (5-10%), Egypt (5-10%), Ethiopia, Ghana (5-20%), Kenya, Korea, Lesotho (5-25%), Mauritius, Mexico, Nepal (5-25%), Peru (3-20%), Rwanda (5-50%), Singapore, Sri Lanka, Tanzania (25-100%), Uganda (5-20%)
Input sales tax credit	tax credit against input sales tax, especially on capital goods			Argentina, Chile, Peru
Loss carry forward	write-off of losses against gross profits of following years			(years in brackets) Botswana (5), Brazil (4), Egypt (5), Ethiopia (3-5), Ghana (5), Kenya (unlimited), Korea (3), Mauritius (unlimited), Mexico (4), Peru (4),

Table 4.3 Most popular SADC incentives

Country	Incentive Count	Initial Capital Allowance	Preferential Tax Rates	Tax Holidays	Special Export Incentives	Accelerated Depreciation	Training and Employment	Investment tax credit
Angola	3		1	1		1		
Botswana	4	1	1	1			1	
DRC	4	1		1	1		1	
Lesotho	2		1				1	
Malawi	5	1	1	1	1	1		
Mauritius	6	1	1	1	1	1		1
Mozambique	6	1	1	1	1	1		1
Namibia	6	1	1	1	1	1	1	
Seychelles	4	1	1		1	1		
South Africa	5	1	1		1	1	1	
Swaziland	6	1	1	1	1	1	1	
Tanzania	3	1		1	1			
Zambia	5	1	1	1	1	1		
Zimbabwe	6	1	1	1	1	1	1	
Totals		12	12	11	11	11	6	2

Before turning to incentives, Table 4.4 below provides an overview of the general tax rates for VAT and CIT (plus social security contributions) for comparison with Malawi's general rates. It also shows the resulting tax revenue yields (as a percentage of GDP) and FDI inflows.

Table 4.5 further below places Malawi next to other countries in the region in terms of its global competiveness ranking and scores on the ease of doing business. For each indicator the best performing or most competitive are highlighted.

Table 4.4 General tax regime in selected countries, 2016

Country	Standard VAT rate	General CIT rate	Social security contribution (SSC)	Tax revenue as % of GDP	FDI inflows (USD millions) 2015
Malawi	16.5%	30%	Employer: 5% Employee: 10%	20.7%	142.5
Zambia	16%	35%	Employer: 5% Employee: 5%	16.1%	**1653**
Zimbabwe	15%	25.75%	**Employer: 3.5%** **Employee: 3.5%**	**27.2%**	421
Tanzania	18%	30%	Employer: 10% Employee 10%	12.0%	No data available
Mozambique	17%	32%	Employer: 4% Employee: 3%	13.4%	**3710**
Botswana	**12%**	**22%**	**No SSC**	**35.2%**	393.5
Rwanda	18%	30%	Employer: 5% Employee: 3%	14.1%	471
South Africa	**14%**	28%	Employer: 26% Employee: 9%	26.9%	1772
Mauritius	15%	**15%**	Employer: 6% Employee: 3%	19.0%	208

Source: PwC Worldwide Tax Summaries: Africa, 2016/17; Heritage Foundation Macro-Data 2015 for Tax revenue/GDP; UNTAD for FDI inflows, 2016

Table 4.5 Global competitiveness and Doing Business rankings, 2016

	Malawi	Zambia	Zimbabwe	Mozambique	Tanzania	South Africa	Botswana
Global competitiveness ranking (score)	135 (3.2)	96 (3.9)	125 (3.5)	133 (3.2)	120 (3.6)	**49 (4.4)**	**71 (4.2)**
Overall ease of doing business ranking	141	97	155	133	139	**73**	**72**
Overall Paying Taxes 2016 ranking	102	46	145	120	150	**20**	**71**
Payments (number per year)	35	**26**	49	37	49	7	34
Time (hours per year)	174.5	**157**	242	217	179	200	**152**
Total tax rate (% of profit)	34.5	**18.6**	32.8	36.1	43.9	28.8	**25.1**
Profit tax (% of profit)	20.4	**2**	18.8	30.8	**20.8**	21.7	21.5
Labour tax and contributions (% of profit)	12.4	10.4	5.6	4.5	16.9	**4**	**0**
Other taxes (% of profit)	**1.7**	6.2	8.4	**0.8**	6.2	3.1	3.6

*Source: *World Economic Forum Global Competitiveness Index; all others: World Bank Doing Business Report 2016.*

4.3. Overview of incentives regimes in Malawi, Zambia and Zimbabwe

As seen in Table 4.6 below, Zambia and Zimbabwe, like Malawi, have different types of incentives in place; They each have reduced income taxes for certain industries, all three countries have a tax holiday for new investments in priority areas, however, Malawi's tax holiday of 10 years is longest in length. Zimbabwe has an unlimited tax holiday only for industrial park developers yet for other more limited sectors there is a tax holiday of maximum 5 years.

Capital allowances are prevalent in all three countries in the form of investment allowances, though Malawi additionally provides export allowances. In terms of the extent of the allowance, Malawi and Zambia are most generous with 100% allowances for new industrial buildings, plant, and machinery in the manufacturing industry. Zimbabwe has a 100% allowance only for mining and its 25% allowances are limited in time (first 3 years) and geographically (growth point areas).

The reduction on import duties is far more generous in Malawi (with its Industrial Rebate Scheme and further removals of import duties) than in Zambia or Zimbabwe. While Zimbabwe has no reductions at all and instead charges a surcharge on some imports to protect local industries, Zambia's import duty incentives are limited to the first 5 years of a new investment's operations.

Each of the three countries have set up one-stop-shop facilities for investors and some form of EPZ, SEZ or industrial park.

Table 4.6 Overview of main incentives in place in Malawi, Zambia and Zimbabwe

Incentive	**Zambia**	**Zimbabwe**	**Malawi**
Reduced CIT for priority sectors	Yes 50% of profits (years 6-8); 75% of profits (years 9-10)	Yes Manufacturers exporting at least 50% of volume: 20%; BOOT and BOT*: 15%)	Yes 15% for priority industries incorporated in Malawi after 10 year holiday 20% for Malawi branches external companies
Tax holidays for new investment operations	Yes First 5 years for tourism, industrial park developer or min. USD 50,000 investment	Yes 0% CIT first 5 years for BOOT and BOT*; 0% CIT Industrial park developer	Yes Tax exempt income for first 10 years for priority industries
Extended loss carry-over periods	No	No	No
Accelerated capital expenditure depreciation rates	100% and 50% on plant, machinery, equipment	No	No
Capital allowances	Yes Capital allowances on industrial buildings used for the purposes of manufacturing entitled to a deduction of 10% in case of low cost housing and 5% for other industrial buildings; Initial and investment allowances at 10% for industrial buildings	Yes 25% for those in growth point areas (year 0-3); 25% for industrial buildings including hotels on cost of construction; machinery and implements; Deductions of investment allowance at 15% in growth point areas. Special initial allowance for SMEs of 100% (50% in the first year and 25% in the next 2 years) for construction of new industrial buildings; articles, implements, machinery and utensils purchased for purposes of trade.	Yes Investment allowance: 100% on new and unused industrial buildings, plant, and machinery in manufacturing industry (40% for used).
Mining allowances	25%	100%	100%
Zero withholding tax (WHT) rates on interest and dividends	Yes (year 0-5)	Yes WHT exemption for non-resident investors	Yes WHT exemption on local supplies for compliant resident taxpayers
Reduced or exempted import duties (customs, import duty, import VAT)	Yes Customs duty 0% (year 0-5 machinery and equipment)	No Some deferral of customs duty. 25% surtax on some imported goods (footwear, clothing, certain foodstuffs) to	Yes (Industrial Rebate Scheme; removal of import VAT for water supply; removal of duty on electronic fiscal devices; removal of

		protect local manufacturing	taxes on import of large buses)
Reduced VAT	No	Yes (0% tourism; deferred for farming and capital goods); Exemptions on import VAT	Yes Zero-rated VAT for fertilisers, motor vehicles for transport of goods; Machinery is exempt
One stop shop investment centre	Yes	Yes	Yes
EPZ/SEZ or similar	Yes, MFEZs (blended EPZ, FTZ, industrial park)	Industrial parks and tourism development zones (bill recently approved for SEZ prioritising mining, agriculture, manufacturing, services)	Yes, "EPZs" with no geographical boundaries

Source: This is based on information provided in PwC Worldwide Tax Summaries 2016
**See Section "Incentives in Zimbabwe" below for BOT and BOOT definitions*

4.4. Incentives in Zambia

Non-fiscal incentives that investors are eligible for under the Zambia Development Agency Act include:

- Investment guarantees and protection against state nationalisation.
  Free facilitation in applying for immigration permits, licenses, land acquisitions and utilities.
- The ability to own land under the company's name.

Fiscal incentives include a range of fiscal incentives in the form of allowances, exemptions, and concessions for investors meeting the required criteria. They include the following:

- 10 year extended tax **loss carry forward** periods for mining and energy sectors (5 years for other sectors).

- **Accelerated capital expenditure depreciation rates** at 100% and 50% on plant, machinery, equipment and buildings for selected sectors/investments.

- **Investment and development allowances** (manufacturing and farming respectively).

- **Reduced corporate income tax rates** for specific income sources as shown in Table 4.7 below.

- **Five year tax holidays** on approved priority sector activities (e.g. Manufacturing and Tourism) approved investment under the Zambia Development Agency Act. More specifically, investors who invest at least USD 500,000 in a priority sector gain the following benefits:
  - A corporate tax rate of 0% for an initial period of 5 years until the first year that profits are made by the company. For years 6 to 8 corporate tax rate is applied to only 50% of the profits, then 75% of the profits in years 9 to 10; and thereafter 100% of the profits. However, for as long as a company has not made any profits, no corporate tax is applied, it remains at 0%.
  - Dividends shall be exempted from tax for 5 years from the year of first declaration.
  - Improvement allowance of 100% on Capital Expenditure for improvement or upgrading of infrastructure.
  - Suspended Customs Duty to 0% for 5 years on machinery and equipment.

- **Zero Withholding tax rates** on payments of interest and dividends
    - Interest paid to individuals arising from deposit and savings accounts held with financial institutions.
    - Dividends paid by mining companies.
    - Five year holiday on dividends paid by farming companies.

- **Reduction or exemption on import duties and import VAT**.

Table 4.7 Sources of income subject to reduced corporate tax rates, 2016

Source of income	**CIT Rate**
Manufacturing of organic and chemical fertilisers	15%
Mining-base metals/gemstones/precious metals and other mining	30%
Export duty on copper and cobalt concentrates	10%
Import of copper blisters	15%
Export duty on all other unprocessed or semi-processed mineral ores	10%
Farming	10%
Import of non-traditional products	15%
Public benefit organisations	15%

Source: PwC Worldwide Tax Summaries: Africa, 2016/17

Table 4.8 Capital expenditures that allow for deductions

Category of qualifying expenditure	**Rate of allowance (calculated on a straight-line basis)**
Industrial buildings	Investment allowance of 10%
	Initial allowance of 10%
	Annual wear and tear allowance of 5%
Other commercial buildings	Annual wear and tear allowance of 2%
Implements, machinery, and plant – farming, manufacturing, tourism, generation of electricity, and leasing	Annual wear and tear allowance of 50%
Implements, machinery and plant – other	Annual wear and tear allowance of 25%
Commercial vehicles	Annual wear and tear allowance of 25%
Non-commercial vehicles	Annual wear and tear allowance of 20%
Patents, designs, trademarks, and copyrights	Premium allowance on straight-line basis over the life of period for which the right is granted
Mining expenditure	Mining deductions of 25%
Farm improvements	Farm improvement allowance of 100%
Construction and improvement of commercial and industrial buildings by person approved under the ZDA Act	Improvement allowance of 100%

Precise sector-specific incentives and general incentives offered to investors are provided in section 4.3.5 below.

4.4.1. Administration and process

The incentives regime is provided for in tax law and administered by the tax administration.

- The Zambia Development Agency (ZDA) approves investments for incentives if they qualify and notifies taxpayers on the applicable regime. However, the Zambia Revenue Authority (ZRA) still needs to confirm the qualifying incentives (which has caused some misunderstanding).
- The ZDA was set up as a one-stop facility to provide support to investors. The Zambia Development Agency sits under the Ministry of Commerce, Trade and Industry (MCTI), which in turn closely collabourates with the Ministry of Finance of Zambia and the ZRA.

Obtaining incentives generally follows this three-step process:

- **Step 1**: initial consultations with IPO between potential investors and the ZDA, covering tax, investment policies and immigration requirements and other permits. Report Fumpa-Makano and Imakando (2015):

- **Step 2**: Investor submits an application for a Certificate of Registration (CoR), awarded within 72 hours. A license fee of K7,670 is paid at the time of issuance of the certificate.

- **Step 3**: Once the CoR has been obtained, investors are eligible to apply for incentives. The investor applies through ZDA who recommends to the MoF for approval. The process is supported by IPOs.

There is a **claw back provision** available in the ZDA Act providing for suspension or withdrawal of tax incentives where an entity has not fulfilled its pledge on employment and training. The ZDA is empowered by law to monitor investments and withdraw an investment licence where a business abrogates conditions of the investment licence.

Monitoring of incentives, however, has been deemed weak and *ad hoc* with companies allegedly having taken advantage of the system, especially of the tax holidays, and much tax evasion remains undetected. According to Simpere (2010), only one in 12 mining companies paid tax on profits during 2009, while all others showed no profits. In November 2012, the Deputy Minister of Finance declared that "Zambia loses between USD$ 1.5 to 2 billion per year due to tax evasion and avoidance" and that this mainly occurs in the mining sector (Fumpa-Makano and Imakando 2015).

4.4.2. Estimated revenue losses due to tax incentives

Mulima and Funjika (2014) estimated that in 2012 Zambia **lost ZMK580 billion or 1.6% of GDP** in tax revenues through tax incentives. There has been a steady increase in revenue loss since 2006 when it was estimated at 0.05% of GDP.

- Revenue foregone through **import duties** from all firms were ZM**K966.94 million** (2006-12). Among these, revenue foregone from priority sectors amounted to ZMK 285.9 million.
- Revenue forgone from **income tax incentives** for priority sectors amounted to ZM**K10.4 million** (2006-2012) as a result of zero percent income tax rate for first 5 years granted in the form of tax holidays for priority sectors, Multi Facility Economic Zones and developers of industrial parks.
- ZDA incurred ZMK 2.2 million in administrative costs to manage tax incentives.

The investors' pledged investments fell short of actual investments in 2012 by 26% (a total of US$700 million was pledged against US$170 million actual investments). Only 33% of pledged employment generation was actually achieved.

4.4.3. Recent changes and developments

- Zambia has been streamlining the incentives that lacked sunset provisions or overlapped.
  - Tax holidays on income tax (such as for small and micro enterprises) and withholding tax were eliminated as was zero-rating of VAT on supplies for companies in export zones.
- Efforts were made to improve monitoring and evaluation of incentives mechanisms.
- Provisions that granted discretion to the Minister in awarding additional tax incentives, where an investment was more than USD 10 million (with the objective of promoting investment), was also removed.
- **Recent developments since the 2016 budget** (PwC 2016):
  - Capital allowances for implements, plant, and machinery used in the generation of electricity have been increased from 25% to 50% from 1 January 2016.
  - The carry over period of losses involved in generation of electricity using wind and solar power, excluding wood, has been extended from five to ten years
  - Since 2015, the CIT for mining operations increased from 0% to 30%, with a variable profit tax of up to 15%
  - CIT applicable on mineral processing companies was revised from 30% to 35% and variable profit tax on mineral processing was abolished.
  - Withholding will apply at 15% on management and consultancy services provided by resident consultants (up from 0%).

4.4.4. Special Economic Zone

The Multi-Facility Economic Zones (MFEZs) were introduced in Zambia in 2005 with support of JICA (Japanese International Cooperation Agency). They are special industrial zones for export-oriented and domestic-oriented industries with both physical and administrative infrastructure to attract enterprises. They blend features of free trade zones (FTZs), export processing zones (EPZs) and the concept of industrial parks.

The legislation governing the MFEZs is enshrined in the ZDA Act. The ZDA has the mandate to administer, control and regulate MFEZs in Zambia. The MFEZ incentives apply to all eligible investors, both domestic and foreign. Six (6) areas as MFEZs and /or Industrial Parks have been announced to date: Chambishi, Lusaka East, Lusaka South, Lumwana; and Ndola (Sub Saharan gemstones exchange) and Roma.

4.4.5. Sector specific incentives and general incentives in Zambia

The below lists in greater detail the specific incentives in place in Zambia by sector (as found on the website of the Zambia Revenue Authority).

Mining

1. Guaranteed input tax claim for seven years on pre – production expenditure for exploration companies in the mining sector.
2. 10 year period carry forward of Tax losses (5 years for Prospecting and exploration companies).
3. Any mining company holding a large – scale mining license carrying on the mining of base metals is taxed at 30%.
4. Other mining companies are taxed at 35%.
5. Dividends paid by a company holding a large – scale mining license and carrying on the mining of base metals is taxed at 0%.
6. 25% Capital allowances on Mining Equipment and related expenditure when assets brought into use.
7. The debt equity ratio has been reduced from 2.1 to 3.1, to encourage further investment in the Mining Sector.
8. Remission of duty on special mining vehicles and machinery specified as:
    a. Dump trucks-off highway 87042300
    b. Mine –Locomotives 84285000
    c. Transmission or conveyor Belt 59100000
    d. Conveyors 842831, 32, 33 – 84289000
9. Property Transfer Tax on transfer of mining rights is 10%.
10. Mineral Royalty is 6% on all minerals (Base, precious and gemstones).

Tourism

1. Zero Rate of VAT on tour packages throughout Zambia.
2. Zero Rate on other tourist services provided to foreign tourists and visitors other than those included in tour packages.
3. Refund of VAT for non – resident tourists and visitors on selected goods.
4. No import VAT on all goods temporarily imported into the country by foreign tourists.
5. Capital allowances at 50% of the cost of plant and machinery.
6. Investment allowance at 10% of the cost of an extension to an hotel (being an industrial building).
7. 5% wear and tear allowance to an extension to an hotel (being an industrial building).
8. 10% initial allowance on an extension to an hotel (being an industrial building) in the year the building is first brought into use.
9. Remove the 5 percent customs duty on helicopters and micro-lights for use in the tourism sector.

Agriculture

1. Guaranteed input tax claim for four years prior to commencement of production for vatable agricultural businesses.
2. Zero rating agricultural products and supplies when exported.
3. VAT deferment on importation some agricultural equipment and machinery.
4. Income tax at reduced rate of 10%.
5. Farm improvement allowance at 100% on fencing, brick or stone wall and an allowance of K10 million for farm occupied by farm workers.

6. Farm works allowance at 100% for the full cost of stumping and clearing, works for prevention of soil erosion, boreholes, wells, aerial and geophysical surveys and water conservation.
7. Dividends paid out of farming profit are exempt from tax for the first five years the distributing company commences farming.
8. Development allowance is given for any person who incurs expenditure on the growing of tea, coffee or banana plants or citrus trees or similar plants or trees. An allowance of 10% of such expenditure shall be deducted in ascertaining the gains and profits of that business.
9. No Import Duty on irrigation equipment and reduced Duty Rates on imports of other farming equipment.
10. Reduced Customs Duty at 5% on pre – mixes, being vitamin additives for animal feed.
11. Zero-rate Hammer Mills of HS code 8436 1000.

Manufacturing

1. Refund of Zambian VAT on export of Zambian products by non – resident businesses under the Commercial Exporters Scheme.
2. Guaranteed input tax claim for two years prior to commencement of production.
3. Income from chemical manufacturing of fertilizers is taxed at a reduced rate of 15%.
4. Capital allowances on industrial buildings used for the purposes of manufacturing shall be entitled to a deduction of 10% in case of low cost housing and 5% for other industrial buildings.
5. Persons who incur capital expenditure on an industrial building are entitled to claim a deduction called Initial Allowance at 10% of the cost incurred in the charge year in which the industrial building is first brought into use.
6. Any person who incurs capital expenditure on an industrial building is entitled to an investment allowance at 10% of such an expenditure in the first year that the building is used for manufacturing purposes.
7. Import Duty on PVC lining and eyelets used in the manufacture of shoes has been reduced to 5%.
8. Import Duty on semi refined wax and cerechlor used in the manufacture of paint, and on tapioca starch with dextrose powder which is used in the manufacture of biscuits has been reduced to 15%.
9. Import Duty on various textile machinery has been reduced to 0% and all woven fabrics of polyester imported for further processing, all imported sewing threads and gray fabrics has duty reduced to 0%.
10. Reduced Import Duty on the following inputs used in manufacturing:
    a. Crude Coconut(copra) oil of subheading 15131100 to 5%;
    b. Plates Sheets, film, foil and strip of unsaturated polyesters of heading 3920.63.10 to 5%.
11. Suspension of Import Duty on machinery, equipment and capital goods for assembling of motor vehicles, trailers, motorcycles and bicycles.

General incentives

1. Import VAT relief for VAT registered businesses on imports of eligible capital goods (VAT Deferment).
2. Zero rate of VAT on export of taxable products.
3. Guarantee of VAT refund within 30 days of lodgement of adequately supported claims within 30 days of submission of the claim.
4. Relief of VAT on transfer of business as a going concern.
5. Equal treatment of services for VAT irrespective of domicile of supplier (Reverse VAT).

6. Cash accounting for VAT members of the Association of Building and Civil Engineering Contractors, and mining companies.
7. Guaranteed VAT input tax claim for three months prior to VAT registration for businesses that have already commenced trading.
8. Reintroduction of voluntary registration for compliant businesses whose turnover is below K200 Million per annum subject to conditions stated above.
9. Registered businesses allowed to re – claim 20% of input VAT paid on petrol.
10. Exemption of interest component of Finance Leases.
11. Zero Rating of VAT on goods and services supplied or imported by developers of MFEZ and industrial parks and to business enterprises in such zones.
12. VAT relief on input tax paid for purchases made by registered suppliers.
13. Income from non – traditional exports is taxed at a reduced rate of 15%.
14. Duty on computer parts/components removed. Computer components on which duty was abolished is confined to the following:
    a. Motherboard without CPU and RAM
    b. Case with or without power codes
    c. CPU heat sink
    d. 32 bits CPU made of 2 or more ICS, this may include Pentium 3, Pentium 4 or Celeron processors
15. Increase the threshold for travellers' personal effects that are eligible for duty free from US$500 to US$1000.

4.5. Incentives in Zimbabwe

Zimbabwe offers a range of tax and customs incentives including tax holidays, reduced tax rates, and accelerated depreciation. The incentives are provided by sector, type of activity, form of organisation and geographic location of the investment.

The main objectives of Zimbabwe's fiscal incentives according to the Zimbabwe Revenue Authority (Zimra) are income generation, export promotion, employment creation and skills transfer, small business development, industrial development, and revenue inflows.

Table 3 below presents a summary of tax incentives available in Zimbabwe. Note that certain conditions should be met in order to utilise these incentives.

Table 4.9 Summary of tax incentives in Zimbabwe

Person for whom incentive is available and duration of incentive	**Tax incentive**	**Tax treatment for normal taxpayers**
Taxpayers operating at designated growth point areas.	The capital allowance is calculated as 25% of the cost of construction of a commercial or industrial building in growth point areas in the year when the building enters service and 25% during the three years that follow the year of construction.	Capital allowances are calculated as 25% of the cost of construction of industrial building in the year when the building enters service and 25% during the three years that follow the year of construction.
Taxpayers operating at designated growth point areas.	Deduction of an investment allowance at 15% on cost of specified assets.	No investment allowance granted.
For all taxpayers in build, own, operate, and transfer (BOOT) or build, operate, and transfer (BOT) arrangements.	First five years: Taxed at 0%. Second five years: Taxed at 15%. Thereafter: Taxed at normal rate.	Taxed at 25%.

Exporting taxpayers.	An additional allowance of 100% of cost incurred in an export country in order to export Zimbabwean goods to such country may be deducted.	Export expenditure incurred is deductible for tax purposes.
For all manufacturing taxpayers exporting 50% or more of output (by volume).	Taxed at a reduced rate of 20%.	Taxed at 25%.
Mining company holding a special mining lease.	Taxed at a reduced rate of 15%.	Taxed at 25%.
Operator of a tourist facility in a tourist development zone.	First five years: Taxed at 0%. Thereafter: Taxed at normal rate.	Taxed at 25%.
Industrial park developer.	First five years: Taxed at 0%. Thereafter: Taxed at normal rate.	Taxed at 25%.

Source: PwC Zimbabwe, July 2016

More detailed information on investment incentives is found in the list of incentives in Section 4.4.4 below.

4.5.1. Administration and process

Fiscal incentives are administered by Zimra while non-fiscal incentives are administered by the Ministry of Industry and International Trade, the Industrial Development Cooperation and the Zimbabwe Investment Authority.

4.5.2. Estimated revenue losses

Total revenue foregone in 2015 was estimated at USD 233.1 million, amounting to 2% of GDP and 6.5% of total revenue for 2015 (Chizema 2015).

4.5.3. Recent developments

The Minister of Finance has announced that Zimbabwe is moving away from taxation incentives. The government is also considering the introduction of Special Economic Zones in the near future (likely to be effective from January 2017). (Source: PwC Zimbabwe and PwC Worldwide Tax Summaries).

4.5.4. List of investment incentives in Zimbabwe

The following lists incentives as found on the website of the Zimbabwe Investment Authority for Income tax and VAT.

INCOME TAX

Build Own Operate and Transfer (BOOT) and BOT Arrangements

- Contractors may enter into contracts with state or Statutory Corporation under which he undertakes to construct infrastructure for the state or statutory corporation.
- This will be in consideration for the right to operate or control for a specified period after which the contractor will transfer ownership or control of the item to the state or statutory corporation.
- Enjoys tax holiday for first 5 years.
- Taxed at 15% for the second five years.

Manufacturing Companies

Taxable income from manufacturing or processing company which exports 50% or more of its output taxed at a special rate of 20%.

Mining Companies

- All capital expenditure on exploration, development, and operating incurred wholly and exclusively for mining operations is allowed in full.
- There is no restriction on carryover of tax losses; these can be carried forward for an indefinite period.
- Taxable income of a holder of special mining lease is taxed at a special rate of 15%.

Special Initial Allowance (SIA)

- This is a capital allowance which ranks as a deduction.
- Allowed on expenditure incurred on construction of new industrial buildings, farm improvements, railway lines, staff housing and tobacco barns. Also allowed on additions or alterations to existing items as already mentioned.
- SIA is also allowed on articles, implements, machinery and utensils purchased for purposes of trade.
- Allowance is optional and once claimed this replaces wear and tear.
- Allowed at the rate of 25% of cost from year one.

Farmers Special Deductions

- Farmers are allowed special deductions over and above the normal deductions.
- Examples include expenditure on fencing, clearing and stamping land, sinking boreholes, wells, aerial and geophysical surveys.

Double Taxation Agreements

- Zimbabwe has signed several Double Taxation Agreements.
- These are meant to avoid or mitigate double taxation of the same income in the two countries to the agreement, that is, where a business entity operates in the two territories.
- The agreements restrict some withholding taxes to the amounts specified.
- The DTAs offer reduced rates of withholding taxes on dividends, interest, royalties and technical fees.
- As an example, almost all the DTAs signed limit the rate of tax on Technical Fees to 10% or less.

VALUE ADDED TAX

Services supplied by designated tourist facility operator [Section 10(2)q]

Tourist facility operators conducting business in approved tourism development zones or an operator of a hunting safari are required to charge VAT at 0% for services offered to persons who are not residents of Zimbabwe and who are required under the exchange control Act to pay for such services in foreign currency. Such operators end up in a refund position for goods and services acquired locally.

Farming inputs and equipment are subject to VAT at 0% [Section 10 a. r. w. 2nd schedule of the Regulations]

Most farm inputs such as animal feed, animal remedy, fertiliser, plants, seeds and pesticides and equipment or machinery used for agricultural purposes are zero rated.

Deferment of collection of VAT on the importation of capital goods [Section 12A]

Value added tax can be deferred on some capital equipment for exclusive use in mining, manufacturing, agricultural and aviation industries whose investment generally relies on imported capital. The whole amount becomes due within 90 days from the date of deferment.

VAT Relief to certain Diplomats and Diplomatic and Consular Missions [Section74]

VAT refund may be granted to:

- Any person who is not a citizen or permanent resident of Zimbabwe, and enjoys full or limited rights or privileges, in terms of the Privilege and Immunities Act or,
- Any diplomatic or consular mission of a foreign country, established in Zimbabwe for official supplies. The refund shall not be payable to a citizen or permanent resident of Zimbabwe.

According to the Zimbabwe Investment Authority, there is a 100% remittance of after tax profit for industrial park developers, BOOT and BOT arrangements and tourism development zones:

Table 4.10 Reduced income tax in Zimbabwe

	First 5 years	Thereafter
Industrial park developers	0%	25%
BOOT and BOT arrangements	0%	15%
Tourism development zones	0% plus rebate of duty on approved capital goods for use in the TDZs	25%

Mining

1. Rebate of duty on goods imported for specific mine development operations and where there is a special mining lease agreement
2. 15% tax for holders of special mining lease
3. Reduced taxation for companies exporting 50% of output, at a rate of 20%.
4. National project status
5. Duty exemption on imported capital goods

Fiscal Incentives in Agriculture

- Farmers Special Deductions – Farmers are allowed special deductions over and above the normal deductions. Examples include expenditure on fencing, clearing and stamping land, sinking boreholes and wells and on aerial and geophysical surveys.
- Value Added Tax – Farming inputs and equipment are subject to VAT at 0%. Most farm inputs such as animal feed, animal remedy, fertilizer, plants, seeds and pesticides and equipment or machinery used for agricultural purposes are zero rated.

4.6. Further experiences and lessons learned

4.6.1. Mauritius' growth story

Many explanations have been brought forward to explain Mauritius's transformation, largely through reliance on trade-led development, from a poor sugar island into one of Africa's most successful economies and as a pace-setter in FDI attraction. We list first the fiscal and non-fiscal incentives used to encourage investment and move on to other influencing factors deemed key to Mauritius' success:

4.6.2. Incentives

Protectionist policies were implemented in the 1960's and 1970's to encourage domestic industrialisation including high tariffs and import licencing. However, import substitution industrialisation is said to have had a marginal impact on the local economy while the Export Processing Zone (EPZ) scheme was deemed far more important. Protectionist policies faded in the 1980's. Import licencing was eliminated in the early 1990's.

- **The Export Processing Zone** was used to support exporters of key manufacturing goods, providing incentives to manufacturers catering to foreign markets. Key components were:
    - Protective import duties and quotas for infant industries
    - Suspension of import duties on other raw materials and components for specified industries
    - Favourable long-term loans
    - Relaxed labour market regulations for EPZ firms allowed them to benefit from relatively cheap labour Duty free inputs for manufacturing exports was key in expanding Mauritius' export competitiveness on world markets)

- More recently, the following reforms to **incentives for foreign investors** has led to a major boost in FDI inflows:
    - Removal of the tax on capital account transactions
    - Removal of requirement for approval by Bank of Mauritius for foreign investors to carry out activity
    - Low **corporate tax rate of 15%**, plus **subsidies** for foreign investors of 10% (leading to an effective tax of 5%).

- **Special tax treatment given to investments that come through Mauritius** to India has made Mauritius into a quasi- tax haven for foreign funds invested there. Approximately 80% of FDI into India flows through Mauritius via private-equity, hedge funds and mutual funds.

- A large number of **double taxation avoidance agreements**

4.6.3. Other factors

- Trade treaties:
    - Preferential access provided by trading partners in sugar, textile and clothing sectors (which make up 90% of its total exports) implicitly subsidised the export sector.
    - Mauritius was guaranteed a certain volume of sugar exports to the EU following independence at 90% above the market price from 1977-2000. Domestic savings from this rent were used to finance domestic investments.
    - The Multi-Fiber Arrangement (MFA) established by the US and EU awarded country-specific quotas, limiting imports of textiles and clothing from any individual country, which worked to Mauritius' benefit.

- Macroeconomic factors
    - Mauritius overcame macroeconomic imbalances in the early 1980s and has had a relatively stable currency.
    - Mauritius has no capital controls.

- Political/cultural factors
    - Mauritius has never had a government advocating confiscation and nationalisation policies.

- A vibrant democracy and open media
- A culture of transparency, participatory politics, with early warning and feedback mechanisms;
- Culture of adaptability and receptiveness to new ideas: embraced new sectors (light manufacturing, offshore banking and financial services, ICT services)

4.7. Paraguay's economic corridors

In Paraguay, the development of interior trade chains and linking economic corridors to regional markets was deemed highly successful in creating growth and increasing exports in the land-locked country.

Previously, products from the interior of Paraguay did not make it to the cites nor to the MERCOSUR markets despite regional trade agreements and the construction of connecting highways. Investments decreased and many production facilities remained unproductive.

The economic corridor approach took market demand as its starting point and all activities worked backwards to solve the problems that stood in the way of satisfying that market demand. The approach was to find demand first, and help create or improve supply to suit that demand. Within this, the Vende team focused on trade chains: linking buyers and sellers, the countryside and the city, and exporters with external markets.

First, the poorest districts in Paraguay were located and ways were determined to integrate them with main roads and cities. Three broad corridors were created in which economic service centres (ESCs) facilitated transactions and helped lift restrictions on trade and investment. For instance, one ESC developed an alliance between private and public organisations to expand producers' farming areas for sesame seed, sugarcane, and herb producers. Specifically, they supported soil analysis and improvement, farming and management techniques, logistics, seed quality, and sales prices.

Even when producers can meet guaranteed demand, companies sometimes need organizational assistance. Many business owners have already done the work to guarantee enough supply to meet demand, but they have not devoted enough time to finding new buyers or increasing sales to current clients. The East Corridor ESC dedicated most of its work to this type of support. Source: *http://pdf.usaid.gov/pdf_docs/Pdacl272.pdf*.

Experience has shown that it is advisable to promote sales first and pursue investment later. Outsiders, domestic or international, are unlikely to invest in many economic corridors where buyer led programs establish presence because it requires trust, which doesn't develop overnight. First it is necessary to convince outside business people. Once trust is developed with suppliers – something that can take several years – then they are more disposed to investing in plant and equipment.

4.7.1. Export processing zones (EPZs)

In this section we summarise global experiences with export processing zones. We first define them and show what defines their success and then move on to lessons learned.

While there is great variation of different EPZs, special economic zones (SEZs), etc., their basic features tend to be the same:

1. Geographically limited and usually physically secured, offering benefits to enterprises physically located within the zone.
2. Unlimited, duty-free imports of raw, intermediate input and capital goods necessary for the production of exports.
3. More flexibility with labour laws and other regulations for enterprises in the zone than in the domestic market.
4. Generous and long-term tax concessions to the firms.

5. Above average (compared to the rest of the host country) infrastructure and communications services (many subsidise utilities and rental rates).
6. Zone firms can be domestic, international or joint ventures. The role of FDI tends to be prominent.

Note that Malawi's current "EPZs" are not fenced in, therefore not providing a concentration of much needed reliable infrastructure and communications services. It may consider to create such a zone.

What determines success or failure? EPZs have been very successful in China, Singapore, Malaysia, South Korea, Jordan, and Mauritius, but less successful elsewhere, especially in most sub-Saharan African countries (only Mauritius, Kenya, Madagascar, and possibly Ghana have had relative success).

1. According to Zeng (2015), the **main reason for success in China** is that "governments made a great effort to build a sound business environment. They not only put in place a conducive regulatory environment for reforms, an efficient administrative system such as "one-stop-shops", but also good infrastructure for the zones".
2. To encourage firms (especially FDIs) to invest in the zones, the SEZs had in place various fiscal[6] and non-fiscal incentives and preferential policies, including streamlined administrative process, sound infrastructure, rapid customs clearance, concessionary tax rates, and flexibility in hiring and firing workers, among others. Favourable policies were also in place to attract skilled labour, such as the provision of housing, research funding, education subsidies, etc. "The cheap labour and good infrastructure in the SEZs, as well as the Open Door policies coupled with various incentives, provided a great opportunity for FDI to flow into China."
3. Other success factors:
    - **Technology learning, innovation, upgrading, and strong links with the domestic economy.** One of the key strengths of the SEZs is that they have a high concentration of very skilled people, including many R&D personnel.
    - **Competition**: Clear goals and targets were set in GDP growth, exports, employment, revenues, FDI generation, and the like. These expectations put a great deal of pressure and responsibility on the shoulders of the zone management. Meanwhile, the SEZs are highly competitive among themselves. Such competition helps make them more efficient and competitive.
    - **Location advantages.** Most SEZs in China are located in the coastal region or near major cities with a history or tradition of foreign trading or business and thus are better linked to the international market. They also have good access to major infrastructure, such as ports, airports, and railways.

The main reason for lack of success in other countries has been a weak business environment. In African zones, power shortages are still high (on average the reduction is about 54% compared to 92% in non-African zones). Custom clearance time is not significantly reduced in most African zones, and in some cases, it actually takes longer within the zones than outside. Constraints are imposed in terms of registration, licensing, taxation, trade logistics, foreign exchange, and service delivery. Many one-stop-shops for investors do not live up to their names.

Lessons learned on what is needed (Zeng 2015):

1. ***Use EPZs to address the market failures or binding constraints that cannot be addressed through other options.*** Creating zones can be an expensive undertaking and require skilled planning, design and management so the costs and benefits need to be carefully assessed. Many local governments and cities began to imitate the SEZ approach and

[6] Many incentives were applied only for FDI. For example, for foreign firms the corporate tax rate was 15 percent compared to 30 percent for domestic firms—plus exemption from local income tax. This was later streamlined to 25% for both foreign and domestic firms.

set up various industrial zones/parks to attract investments without any appropriate assessment and planning. This led to the waste of resources and environmental damage, and many of them have failed.

2. ***Improve the business environment inside the zone***, including efficient services, such as one-stop shop and adequate infrastructure. In most Chinese zones, all basic infrastructure are provided and one-stop-shop services and aftercare are very efficient and effective.
3. ***China had used generous fiscal incentives given its heavy constraints***; however, today's macro-environment is very different. "Many African countries are the destinations of industrial transfer from East Asia. Instead of focusing on tax incentives, they should put more efforts on improving the business environment including infrastructures and consider "smart incentives" that encourage skills training, technology transfer and local economic linkages" (Zeng, 2015).
4. ***A sound legal, regulatory framework and effective institutions***. Relevant laws and regulations need to be in place immediately when the programme is launched.
5. Ensure knowledge and ***expertise and operational know-how of zone management***
6. ***Strong and long-term government commitment*** is also needed to ensure policy continuity and adequate provision of various public goods. It is also important to establish good dialogue and cooperation across different government agencies.
7. ***Adopting a suitable development model through strategic planning and industrial positioning.*** It is important to conduct an in-depth analysis of the base conditions through a strategic planning and industrial positioning exercise. This would include a rigorous assessment of the local market condition, connectivity, industrial base, supply chain, business environment, and land and labour supply. Such an exercise will also help the zones to better leverage foreign technologies and know-how, optimally catering to the local needs.
8. ***A realistic scheme - starting small and implementable.*** It is crucial to make one or two zones work at very strategic locations first before scaling-up.
9. ***Skills training and technology transfer and diffusion.*** This is crucial for the zones to acquire sufficient manpower and make their products competitive. In China, many zones have well-equipped skills training centres, which work closely with technical and vocational schools, colleges and universities to provide relevant skills training and technology support for the firms in the zones. Local governments also have talents strategy to attract highly skilled people to work in the zones.
10. ***Better linkages with local economy.*** Zones need to build on local comparative advantages and have local suppliers/clusters as part of their value chains. In China, unlike many African countries, most zones are well plugged in the existing local clusters, so the zones and local clusters reinforce each other through business linkages. Chinese zones also encourage foreign investors to establish joint-ventures with local counterparts. Governments have also encouraged the backward linkages through technical assistance and other policy interventions.

4.8. Suggestions for Incentives Policy

From the benchmarking analysis, it would appear that an ideal incentive scheme ought to be transparent, stable and would achieve policy objectives with a minimum leakage of tax revenue. It is suggested that prior to embarking on an incentive scheme, governments determine the role of FDI in their economy, the potential for further FDI, to what extent the regulatory framework is supportive of this potential, and what improvements could ensure its realization[7]. The GoM should then list the

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[7] UNCTAD has initiated a series of Investment Policy Reviews, to assist individual governments with these objectives.

objectives of the incentive (i.e. the market imperfections that the incentive is designed to reduce), which can be compared to the costs of granting incentives. This comparison should then be subject to periodic review (UNCTAD, 2000).

More specific guidelines include:

When to use fiscal incentives

Incentives should only be considered when the good/service has a large public good externality and it is cheaper/more efficient to provide it through this externality than directly. This would include investments encouraging environmentally friendly/research rich production or anchor investments (investments that provide multiplier effects through signaling.

Administering tax incentives

The GoM may wish to consider developing tax incentives according to the three Ts—timely, targeted and temporary:

g) Stipulate by law the length of the incentive period and the entities eligible for incentives
h) Administer incentives through corporate tax codes.
i) If incentives are awarded through legal instruments and regulations other than corporate tax codes, these provisions **should be mirrored in the tax code**.
j) Mandate tax authorities to administer the award and monitoring of incentives. This will lower administration costs and increase transparency as tax authorities are best placed to ensure that investors receiving incentives are eligible and provide the necessary documentation.
k) Avoid the granting of discretionary incentives, whether through bilateral negotiation or certification.
l) Process applications for incentives quickly, to promote transparency and reduce opportunities for abuse.
m) Establish One-stop-shop services for business facilitation services.

Monitor the application of incentives to guard against abuse. This would include measures to discourage the false declarations to meet incentive eligibility requirements, ensuring compliance with performance requirements including environmental and social performance, and most importantly, limiting distortions created by new investments that are not viable—or are only viable at the expense of existing projects.

Redesigning fiscal incentives

First, the GoM should tie the administration of fiscal incentives in with tax laws and the overall corporate tax system as a whole. Investors have confidence in a well-administered tax system that transparently gather and spend revenues. This is a critical indicator of economic stability and ease of doing business.

Second, incentives should be administered by the Ministry of Finance and Malawi Revenue Authority (tax authorities) and not by sector ministries. Incentives, like all subsidies, are foregone revenues and need to be accounted for in budgeting processes. This will generate intelligence for the wider debate on the costs and benefits of investment policies.

Third, the GoM should avoid discretionary fiscal and financial incentives. Such non-transparent practices are prone to abuse and lack the necessary checks and balances to maintain a predictable investment climate.

Fourth, gradually eliminate blanket exemptions from corporate income tax even though removing them or reducing their duration is a politically charged issue.

Fifth, ensure that Incentive policies are clearly time-limited. This will also simplify administration-to ensure that investors file tax returns and face audits as required and that tax authorities produce tax expenditure statements to make the cost of the incentive transparent.

Sixth, measure the effectiveness of incentives occasionally. The most commonly used indicator is the cost of jobs created by the tax expenditure.

Seventh, move towards performance-based incentives in the form of credits, allowances or accelerated depreciation.

Finally, build on the performance-based incentives also make the case for equivalent incentives or flat corporate tax rates. A well calibrated, flat corporate tax rate (instead of a long-term tax holiday) can send important market signals that the investment climate and fiscal regimes are transparent and predictable. However, lowering the corporate tax rate can reduce government revenues. The objective should be to balance the competing objectives of attracting investment and ensuring the revenue base.

4.9. Conclusion

The overall recommendation of this chapter is that the GoM should not immediately move away from offering incentives-but rather gradually move away from awarding automatic tax holidays to a mix of performance-based incentives—both fiscal and financial where possible. This can be complemented by a flat corporate tax rate that will help create a level playing field for both domestic and foreign investors.

This Study also argues that incentives should not be viewed as a form of compensation for a poor investment climate. Given Malawi's weak investment climate, the private sector consultations revealed that incentives can turn out to be a waste of tax revenues which could otherwise be used to upgrade public services and infrastructure, and to improve ease-of-doing-business indicators. While incentives are important determinants of FDI, what investors seek most is access to resources, access to skilled labour, ease of doing business, reliable infrastructure, a transparent and predictable fiscal code and, ultimately, opportunities to do business in the domestic market and beyond.

Hence, the study recommends that the GoM should consider introduction of time-limited incentives and performance incentives linked to capital injection and expansion (such as allowances, credits and accelerated depreciation) in view of Malawi's investment profile which is characterised by aggressive tax competition from the regional countries while at the same time it is seeking to diversify sources of FDI and target sectors.

5. Assessment of existing incentives in Malawi

This chapter assesses the current investment incentives in Malawi in order to provide the basis for a reformed investment incentives regime. It begins with an overview of the main incentives and then presents the individual incentives in the form of 'fact sheets' with brief outlines containing their description, an evaluation, revenue foregone, and recommendations. Finally, it contains further analysis and discussion including METR analysis, their effect on tax revenues, their effect on tax burdens, as well as a comparison of incentives in terms of simplicity, transparency, consistency, and fairness.

5.1. Overview of main incentives and their costs and benefits

Investment incentives in Malawi are predominantly fiscal in the form of tax breaks and concessions, industrial rebates, special exemptions and deductions. Tax-based incentives are enshrined in the main tax legislation including the Taxation Act, the Customs and Excise Act, and the Export Incentives Act, the Export Processing Zones (EPZ) Act. The Malawi Revenue Authority (MRA) is the key tax policy implementation agency (MRA, 2012).

Table 5.1 shows some of the major tax incentives that some economic sectors currently enjoy for both direct and indirect taxes in Malawi. A list of all the available incentives is provided as an annex (see **Annex 1**).

Table 5.1 Major tax incentives in Malawi

Sector	**Incentive**
Manufacturing	• Industrial Rebate Scheme
	• Investment Allowance
	• Tax holiday for up to 10 years for priority industries (Agro-processing)
Energy Generation and Distribution	• Tax holiday for up to 10 years
	• Duty waivers on building materials
	• Duty waivers on consumable products in the sector
Agriculture, pastoral and farming operations	• 100% expensing of amounts incurred on: *(a)* the stumping, levelling and clearing of lands; *(b)* works for the prevention of soil erosion; *(c)* boreholes; *(d)* wells *(e)* aerial and geophysical surveys; *(f)* any water control work (which includes any canal, channel, dyke, furrow and any flood control structure, whether of a permanent nature or otherwise) in connection with the cultivation and growing of rice, sugar or such other crop as the Minister may approve.
Tourism	• Industrial rebate scheme where units with room capacity of more than 50 qualify for duty free waivers on furniture, motor vehicles, 2 mini buses, curtains, television sets, carpets and equipment. Those with lower room capacity have limited access to duty free on waivers. • For one to benefit, they should be a member of the Malawi Tourism Council.
Mining	• 100% expensing of expenditure in the initial year.

Construction	• Import duty and excise free importation of crane lorries, concrete mixer lorries, mobile drilling derricks and track laying tractors for the construction industry.
Export Processing Zones	• Duty free importations of raw materials, equipment and machinery for production of export goods. • There are considerations that up to 10% of the production could be sold locally.

The structure of trade incentives under various trade protocols is detailed in Table 5.2 below.

Table 5.2 Structure of trade incentives

Type	**Description**
SADC	• Goods manufactured within SADC member states, except some few goods from South Africa, are duty free. • For qualification, a certificate of origin obtained from a chamber of commerce of the country of origin is required.
COMESA	• Goods manufactured within COMESA member states, except some few goods from South Africa, are duty free. • For qualification, a certificate of origin obtained from a chamber of commerce of the country of origin is required.

Incentives have been provided since 1969 in Malawi and generally, they have been for the purposes of fostering industrial growth and promoting exports as well as import substitution. The incentives have largely targeted manufacturing, agriculture, energy generation as well as tourism.

The **common problems** with the incentives have been:

1. Abuse of the incentives by the taxpayers;
2. Complexity of the investment incentives regime;
3. Lack of clear practical guidance on claiming the incentives leading to uncertainty;
4. Overlapping of incentives;
5. Lack of credible data to objectively ascertain revenue forgone and potential revenue gains by the provision of the incentives; and
6. Lack of evaluation and monitoring of the performance of the incentives.

The **general recommendations** have been:

1. Redraft incentives with greater clarity.
2. Simplify by streamlining incentives (repealing overlapping and redundant schemes).
3. Centrally register and record subordinate legislation.
4. Impose time limits (sunset clauses).
5. Improve monitoring of schemes and evaluation of their impact.

5.2. Analysis of individual incentive schemes

This section summarises the incentives schemes individually, with a brief description, their duration, the date they were introduced, the policy objective, beneficiaries, an evaluation of pros and cons, revenue foregone and an outline of other costs and benefits where information was available, as well as recommendations. Particular focus is placed on the IRS as this is the scheme associated with the highest revenue loss.

5.2.1. Income tax

Tax holidays and reduced CIT for priority industries

Description:	Companies working in the priority industries are exempt from paying income tax.
Duration:	First 10 years of operation.
Policy objective:	Encourage value addition in agricultural products and encourage investment in energy generation and distribution.
Law:	Taxation Act
Introduced:	2013
Beneficiaries:	Main beneficiaries are established profit-making businesses and those with short lead-times between commencing investment and deriving profit. According to Keen and Mansour (2010), tax holidays in general are most attractive to the most footloose firms, which are those likely to bring the least benefit to the wider economy (such as textiles and assembly of light manufacturing goods.
Evaluation:	*Pros:* A tax holiday is considered by firms to be the most generous form of incentive. It also has the benefit of low administrative costs for tax authorities and possibly low compliance costs for taxpayers (though may still be required to submit tax returns). Zambia and Zimbabwe provide tax holidays (though only for 5 years) *Cons:* Tax holidays are prone to abuse and avoidance. They provide firms with a strong incentive to use transfer pricing and financial arrangements to shift taxable profits from ineligible activities and to restructure their business at expiry date to gain a new tax holiday period (risk of perpetual access to holidays without new investments). Investments may be lower than under regular regime as firms have an incentive to defer investment to later periods (unless depreciation allowances can be carried forward out of the holiday period). Tax holidays signal lack of trustworthiness in the tax regime.[8] They also make it difficult for MRA to measure cost to revenues. Tax holidays and special reduced CIT are relatively inefficient because they are not related to amount of capital invested.

[8] According to Keen and Mansour (2010), "By offering tax holidays, a government is to some degree signalling its own untrustworthiness in tax matters: otherwise, a firm that intends to stay beyond the holiday period would find even more attractive the promise of a low, constant rate of tax implying a present value of payments below that implied by the holiday. Many companies apparently find holidays attractive because they spare them the necessity of dealing with corrupt or inefficient tax administrations. Therefore, offering a holiday can itself signal a corrupt or inefficient tax administration, and distract from the need to address such underlying problems."

Revenue foregone: To the knowledge of the authors, only one firm has benefited from this incentive. However, it is difficult to quantify the revenue forgone since the financial documents for the company are not readily available.

Recommendations: The GoM should gradually move away from awarding automatic tax holidays to a mix of performance-based incentives—both fiscal and financial. However, caution should be exercise in removing this incentive considering that it has just been offered to investors in the priority industries.

5.2.2. Capital allowances

Investment allowances for the manufacturing industry

Description: Includes *investment allowances* (entitled to deduct expenditure) and *other capital allowances* (new farm improvements; farm fencing; industrial buildings. Also plant and equipment purchased for trade or farming business)

Law: Taxation Act

Introduced: 1969

Beneficiaries: Manufacturers (broadly defined as a business carried out in industrial buildings; includes primary producers for certain capital allowances).

Evaluation: *Pros*: Not prone to tax avoidance as taxpayer must acquire capital assets ahead of claiming the allowance. Effective as tax incentive is directly related to the investment. It's possible to estimate costs to revenue (revenue foregone).

Cons: Possible distortions as creates preference for assets with a short life span in order for a new allowance to be claimed on replacement.

Revenue foregone: Not quantified here as it requires analysis of sensitive revenue data which was not provided for this report.

Recommendations: The GoM should maintain the capital allowances incentive.

Export incentives

Description: Schemes for import substitution as well as promoting exports

Law: Multiple acts (Taxation Act; Export Incentive Act; Export Processing Zone Act)

Policy objective: Promote exporting and contribute to narrowing the trade deficit

Beneficiaries: Exporters of non-traditional exports.

Evaluation:

- Lack of clarity of tax law for exporters with provisions in multiple acts with overlap between different incentives. This creates uncertainty, high compliance costs for taxpayers and high administrative costs for MRA.
- Rationale is unclear as many eligible materials may only be used as inputs, not final consumptions goods
- Absence of clear criteria and administrative procedures
- Deemed discretionary and ad hoc in nature, leading to discrimination between manufacturers and complexity. The discretionary nature of the exemptions leaves room for corruption.

Revenue foregone: Not quantified as it is dependent on sensitive tax compliance data that was not provided by MRA

Recommendations: The GoM should maintain the export incentives to compliment the drive to make Malawi a producing and exporting country.

Mirror and harmonise the provisions of the Export *Incentives Act* with s 36A of the *Taxation Act* to provide deductions to taxpayers registered under the *Export Incentives Act*.

Eliminate potential for duplicity which emanate from deduction of international transport allowance with export allowance under s 36A. (Both s 41B and s 36A provide eligible taxpayers with deductions for exports of non-traditional goods.

5.2.3. Customs duty and excise

Industrial Rebate Scheme (IRS)

Description: This scheme exempts manufacturers from paying customs duties and excises on selected materials that they import to be used in the production of eligible goods. In order to benefit from the scheme, there has to be at least 20% value addition.

Duration: Not defined

Introduction: 1994

Law: Customs and Excise Procedure Code 4000.401 (Eighth Schedule of *Customs and Excise Act)*

Policy Objectives: To support domestic production and, in the process, promote the export of manufactured goods. According to documentation relative to the scheme, the goals are:

- To encourage setting up of manufacturing industries in Malawi
- To make the country more self-sufficient in the supply of manufacturing goods
- To provide employment and more earning capacity and prosperity

- To generate revenue from taxes to be collected from the industries and their employees
- To save foreign exchange by substituting imported goods and to earn forex by exporting
- To promote statistical measures in support of economic analysis for the government]

Process:

1. Apply for IRS license
2. Use warehouse that complies with certain requisites (to ensure no leakage of materials for other purposes)
3. Must demonstrate minimum 20% of value added of goods produced
4. Acquire bond that can cover eventual payment of duties and excise in case later audits show non-compliance with the requisites.
5. Eligible materials are listed in the Eighth Schedule. Companies may apply for inclusion of further materials.

Beneficiaries: This is a cross sector incentive and currently benefits about 20 industries and 103 manufacturers.

Imports under the IRS account for 5% of total imports (Malawi Diagnostic Study, para. 11, p.43). Main products included cement, soya beans, soap nodules and woven fabric.

Foregone revenue: Goods reported under IRS:

- Total revenue loss: MK 9,666,857,224
- Excise duty revenue loss: MK 657,568,757
- Import duty revenue loss: MK 9,009,288,467

Goods reported under IRS without payment of excise:

- Total revenue loss: MK 613,302,304.15
- Import duty revenue loss: MK 58,123,477
- Surtax revenue loss: 555,178,827

According to MRA, foregone customs duty: MK 12.7 billion in 2012/13 across 3531 tariff lines (12 of which accounted for 50% of the total value).

Evaluation: *Pros:*

- Encourages firms to formalise to take advantage of cheaper imports.
- Potential revenue generation from increased investment.
- Potential for spill overs to other industries and backward linkages.

Cons:

- Very high revenue loss (see Figure 5.2), amounting to nearly 10% of government budget in 2013.
- Perception that IRS favours larger manufacturers at the expense of MSMEs.
- The value add requirement is not incorporated in the legislation[9].
- Administration challenges:-

[9] Some consider the value addition requirement of 20% to be too high for firms to reach and it depends on the activity. Others claim it is too low and allows unfair competition from "labellers" (i.e. aren't really adding value/traders).

        - Customs officers appear to have discretionary powers in processing the incentive under the IRS.
        - Adjudication Committee could draw on sector exports when necessary to help decide on items.
        - The evaluation committee takes time to meet and therefore approvals may take more than 6 months. However, according to MRA, the process up to filing the application with the Commissioner General is quick and it can be completed within days.
        - Flow of communication between IRS and companies is poor, without justification and large changes are not communicated in advance.
        - Requests to incorporate new materials into the IRS Schedule may take over 1 year and there is little communication from authorities.
        - MRA's has, at times, taken retroactive decisions that create uncertainties for businesses.
    - Inefficient utilisation of foreign exchange.
    - Risk of abuse if not properly administered due to limited capacity to administer, which:-
        - Promotes use of imported finished products meant to be raw materials, contributing to loss of domestic production.
        - Leads to cheating at border and direct selling from warehouses which leads to unfair competition
        - Unintended beneficiaries have infiltrated the scheme[10].

Recommendations[11]: The GoM is encouraged to adopt the following recommendations on to improve the efficacy of the IRS:

- Create a private-public Adjudication Committee (modelled on that existent in South Africa).
- Establish a maximum period for responses (i.e. 2 months).
- Rejections should be accompanied with justification
- Business Associations should have their own IRS Committee to gather complaints/problems shared by companies and communicate them to the MRA directly or through MITC
- Publish a Handbook, accompanied by a summary Leaflet for companies
- Consider applying differentiated value addition requirements by sector based on sector analysis.
- Stricter enforcement of warehouse lock requirement and at customs for better control of entry of inputs by border officers.
- Audit the required store books more often.

[10] It is alleged that traders make widespread use of the scheme even though it is intended for manufacturers. Leakages of bonded goods were estimated by MRA to cost MK 36-60 billion per year. In other cases, goods qualifying for the scheme used for non-qualifying purposes

[11] As per Bisso (2014)

Export Processing Zones (EPZs)

Description: These are not actual geographical locations but tax incentives provided to enterprises registered as export producing firms of non-traditional exports (i.e. not tobacco, tea, coffee, or cotton). The incentives are:

- Exemption from customs duty on equipment and raw materials
- Exemption from excise on purchases of raw material and packaging materials made in Malawi
- Zero rating for VAT (enabling input credits to be refunded)

Introduced: 1997

Policy objective: To expand export production in Malawi as it was concentrated on the traditional commodities. To attract FDI, create employment and encourage the transfer of technology.

Evaluation: According to a report commissioned by the Ministry of Industry, Trade and Private Sector Development - Nkoma (2007)[12], by 2007, 10 years after the EPZ measures commenced, 59 per cent of the Export Processing firms had either terminated their operations or moved to a foreign location. It was reported to have failed to encourage development of the industrial sector, failed to expand and diversify the export sector, and failed to increase economic linkages with the domestic economy. Fewer than 1500 new jobs were created, traditional crops continued to account for over 80% of gross national earnings. It was also unsuccessful in establishing a skilled workforce. It did however benefit the packaging industry.

EPZ measures were subsequently amended in 2013 in response to a report. The recommendations had included:

- Replacing the EPZ Monitoring and Evaluation Committee with an autonomous EPZ authority with members from the private sector with knowledge of business (with government and other stakeholders' input in the establishment and operation of this Committee).
- Scrapping the requirement that all products be exported to stimulate the participation of domestic enterprises.
- Including the "traditional" industries in the measure and shifting the emphasis on manufacturing higher value products to increase export revenue.
- Basing eligibility of the scheme on pre-defined growth statistics of the industry.

According to Malawi Diagnostic study (2014), it failed to attract foreign capital or stimulate growth in manufacturing.

According to an academic study by Kumwenda (2007)[13], which looks at the clothing industry specifically, the EPZs have failed to attract foreign capital or stimulate growth in manufacturing.

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[12] V. Nkhoma, 'Export Processing Zones: Is a Regime Worth the Sacrifice? The Case of Malawi', (2007), Integrated Framework Policy Analysis Working Paper Series No. 7, Ministry of Industry, Trade and Private Sector Development, p. 6

[13] M. Kumwenda, 'An Examination of Factors Related to the Improvement of the Apparel Manufacturing Industry in Malawi, (2011) Masters of Science in Apparel Design and Production, Oklahoma State University, p. 28. The author cites the following in support of her contention: R. Traub-Merz & H. Jauch (eds) *The African textile and clothing industry: From import substitution to export orientation* (2006) (Bonn: Friedrich-Ebert-Stiftung); D. Chikhasu, *An analysis of Malawi's trade competitiveness* (2007).

Do not benefit from better infrastructure or simplified/favourable regulation as not limited to specific geographic locations.

Beneficiaries: Only 14 firms are registered under EPZ Act (according to Malawi Diagnostic Study, 2014).

Revenue foregone: Total value of imports estimated at MK 40.3 million with a duty loss of MK 5.4 million.

Recommendations: The GoM should retain the EPZ as an industrial promotion tool but the income tax incentives provided under the EPZ Act should be mirrored in the Taxation Act.

Import Duty Exemption for Electricity Generation and Distribution

Description: Goods for use in electricity generation and distribution (fuses, transformers, sling, ring main unit, insulators, galle chain equipment, conductors, surge protectors, column duplex AAC/PVC and electricity supply meters) imported by any company involved in the generation and supply of commercial electricity as approved by the responsible Minister are not subject to import duties but VAT.

In addition, energy saver bulbs are import duty free in their own right in the Customs and Excise (Tariffs) Order. VAT is payable at the standard rate of 16.5%.

Solar products are import duty free in their right in the Customs and Excise (Tariffs) Order for example solar batteries and solar energy lamps. VAT is payable at the standard rate of 16.5%.

Law: Customs and Excise Procedure Code 4000.489.

Introduction: 2013

Policy Objectives: Promote electricity generation and distribution as a base for industrial development.

Process: Beneficiaries in this industry have to be registered with Malawi Energy Regulatory Authority (MERA) for them to qualify for the incentive. Administratively, an application has to be made to the Commissioner General (CG) of the Malawi Revenue Authority (MRA), who is mandated to grant approvals for the beneficiaries. According to the MRA, it takes at most 2 days for an approval to be granted.

Beneficiaries: 26 establishments, 4152 employees. 70% of the beneficiaries are large and medium while the rest are either small or micro (Figure 5.1).

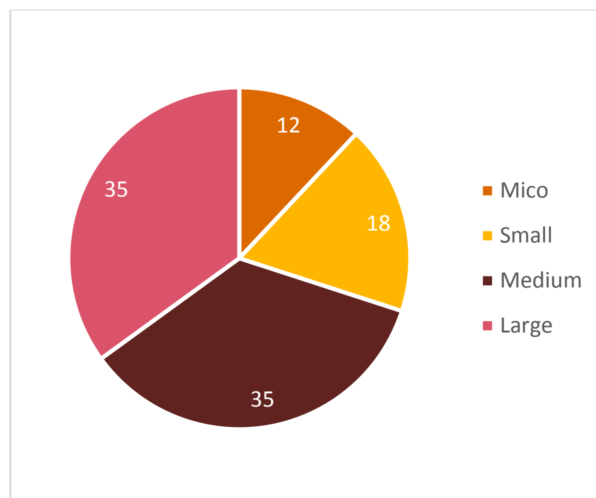
Evaluation: *Pros*

- It is addressing a major gap in infrastructure deficiency.

Cons

- Prone to potential abuse.

Figure 5.1 Share of micro, small, medium and large enterprises in electricity generation and distribution in Malawi, 2015



Source: BIRR (2016)

Revenue foregone: Import duty loss: 2,756,310,653

Recommendation: Considering the need for more investment in energy, this incentive should be maintained by the GoM to entice private investment in the power sector.

Duty and excise exemptions

Description: A broad range of different concessions. The main concession is the customs duty and excise exemptions. There are a number of organisations (such as NGOs, returning residents, charitable organisations, and diplomats, as well as persons such as the president, vice president, retired presidents, judges, members of parliament, and ministers who are entitled to duty free importation of some specified goods.

Laws: Customs and Excise Act.

Date introduced: 2005

Policy objective: Some goods are exempted.

Revenue foregone: According to the Malawi Diagnostic Study, import Duty Concessions in 2012: MK 13.8 billion (95% of total tariff revenue and 30% of total value of imports). Many of the imports that originate from within COMESA and SADC enter duty free because the importer/end user qualifies. Consequently the tariff revenue is foregone irrespective of the duty concessions under COMESA and SADC.

Evaluation: *Cons:*

- Discretionary, opaque and open to abuse. According to World Trade Organisation study (2010), “proliferation of exemptions for specific activities with each case requiring approval from the Commissioner General lacks transparency and leaves the use of these CPC codes

open to abuse. Designating specific activities as deserving duty free privileges also introduces end-user discrimination within the tariff structure".[14]

- Adds to complexity of Malawi's tariffs. (Malawi is a member of the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC), which have different speeds in terms of tariff elimination and separate schedules.)
- High cost to administer and high compliance costs for business (According to SADC *Malawi Profile* (2013).

Recommendations: GoM should consider the following recommendations:

- Retain waivers for diplomats as they are protected under the international conventions.
- Duty should be payable for all other entities including the presidents, with a correspondent forgone revenue adjustment in their remuneration.
- The tax authorities should publish simple and transparent guidelines for the administration of these duty and excise exemptions.

5.2.4. Incentives to other sectors

5.2.4.1. Tourism

Incentive	Customs Procedure Code	Analysis	Recommendations
Three goods carrying vehicles of Tariff heading 87.04, except used motor vehicles, in every five years for the use of hotels, lodges and inns licensed as such under Tourism and Hotels Act	4000.438		Retain this incentive.
Goods for hotels, lodges and inns	4000.442	Some goods are subject to the 50 bedroom threshold which cuts out SMEs, upmarket safaris and forest lodges.	GoM should consider including luxury tents, boats, other water sporting equipment and entertainment/artistic equipment in the list of goods under this CPC.
Two passenger carrying motor vehicles of Tariff Heading 87.02, except used motor vehicles, in every five years for hotels, lodges and inns with 50 rooms or more, licensed under the Tourism and Hotels Act	4000.450	The 50 bedroom threshold cuts out SMEs, upmarket safaris and forest lodges.	GoM should consider removing the 50 room threshold for accessing this incentive.

[14] Malawi Diagnostic Study, para. 116, p. 43, cited Kobetsky 2015.

Specialized vehicles for safaris for hotels, lodges and inns licensed under the Tourism and Hotels Act	4000.451		Retain the incentive
Concessionary rates for new vehicles in the hiring sector	Not provided currently	Spurs growth of the sector and increase efficiencies.	Consider reintroducing it with a performance based criteria for beneficiaries.
Duty free importation of building materials for tourism structures	Not currently provided	Enhancement of tourism structures and room capacity.	GoM may consider this incentive with a thorough and strict administration system.
Gaming and lottery equipment	Not currently provided		GoM to consider granting waivers to this sector.

5.2.4.2. Agriculture

Incentive	**Law**	**Analysis**	**Recommendations**
One goods carrying motor vehicle of Tariff heading 87.04, in every five years for direct use in the production of horticultural produce intended for export	CPC 4000.438	Most would be beneficiaries of these incentives are not aware of their existence let alone how they should be claimed	MRA, MITC and MCCCI should explore more effective mechanisms for packaging and communicating these incentives to the private sector.

5.3. Efficiency of the tax system

The discussion on efficiency is limited to the discussion on how taxes influence behaviour in terms of making choices and whether these match the intended behaviour. For example, the tax system may influence the choice of products to consume, whether to operate in the formal economy or in the informal economy and choice of location for investment. However, data on some of these aspects of efficiency is not available and therefore is only discussed in brief and in general terms because the scope of this study did not take this route.

Fundamentally, it is hard to tell whether an incentive is efficient as this requires knowing the motivations of firms (how much they are influenced by a tax incentive in their decision-making). In the same vain, it is also difficult to measure how much is gained in terms of extra revenue or extra contribution as the result of

However, a Marginal Effective Tax Rate (METR) analysis can give us some indication of the importance of the importance of a tax incentive to investment decisions.

5.3.1. Marginal Effective Tax Rate Analysis (METR)

The METR measures the extent to which the tax system reduces the real rate of return (ROR) on investment, at the margin, defined as follows:

$$METR = \frac{(ROR_{bt}) - (ROR_{at})}{ROR_{bt}} \qquad (1)$$

where ROR_{bt} and ROR_{at} are the before tax and after tax ROR respectively, whereby ROR is defined as:

$$\frac{Present\ discounted\ value\ of\ annual\ net\ earnings}{Capital\ expenditure} = \frac{PDV\ (E)}{K} \qquad (2)$$

For example, if the ROR on an incremental capital project is 20% before tax and 10% after, from the equation: METR = (20-10)/20 = 0.5 or 50%, then it has a METR of 50%. The higher the METR, the greater the burden on the investment. (The real rate of return is diminished by 50%).

By comparing METR across sectors, we can see where the largest bias lies and in how far incentives are effective in mitigating them.

The METR examines how much the tax and incentive system distorts the decision to invest. It does not, however, say anything about the profitability of one sector versus another. That is, two projects may have the same METRs but different rates of return. Highly profitable projects may remain profitable even if they have very high METRs. Changes in the METR will have their greatest impact on the most marginal investments.

Due to inability to access revenue data for all companies, PwC has selected representative industries in several important sectors to calculate illustrative METRs. These are shown in Table 5.3 below.

Table 5.3 Results of METR analysis

Industry	**METR (2015)**	**METR (2012)**
Agro-Processing	32.33	30.64
Manufacturing/Packaging	24.40	
Service	36.78	
Agriculture	29.59	
EPZ	22.28	
Telecommunications	31.08	41.62
Transport Infrastructure	-	
Commercial banking	31.14	33.76
Other Financial Services	24.83	38.22
Property	24.45	

The METR computations in Table 5.3 above show that the tax system places a wedge between the underlying profitability of a business operation and after tax return to the investor. It is also observed that the differences between the METRs reveal the tax induced biases in the fiscal incentives that drives the allocation of the productive resources. The EPZ companies are a beneficiary of those deliberately induced policy biases.

Currently the burden on the investment is highest for services, agro-processing, and banking. It is lowest for EPZ and manufacturing/packaging and property. Incentives may need to be realigned to better target to the priority sectors.

5.4. Effect on tax revenues

One of the tools for analysing tax incentives is to analyse foregone revenue. Tax reductions/ waivers/ preferences that result in foregone revenue are similar to budgetary expenditures as they take away from government budget (thus also referred to as tax expenditure).

To be sure, tax incentives are also hoped to create gains in productivity, in growth, and in incomes that will, in turn, translate into increased tax revenues. This again requires knowing how much more investment and growth is due to the tax incentive and how much may have occurred anyway.

What is important to government is to determine what could be done to promote certain sectors and growth most effectively while minimising the foregone revenue.

Figure 5.2and Figure 5.3 show foregone revenue by the following sectors: private sector, government, development partners, non-governmental organisations, and others as well as the cumulative foregone revenue, as estimated by the MRA. It reveals the following:

- It is apparent that the highest beneficiaries of forgone revenue are the development partners averaging 7.4% of total tax revenue and 1.3% of GDP).
- The next highest beneficiary is government benefiting 4.5% of total tax revenues and 0.8% of GDP.
- Following, in third, is the private sector who are supposed to be the greatest beneficiary of the tax incentives. Private sector benefits of the incentives averaged 3.3% of total tax revenues and 0.6% of GDP.
- The development partners and government, on average, benefit 74% of the total revenue forgone while the private sector on average benefits from 20% of total revenue foregone.
- Over the three year period, forgone revenue as a result of tax incentives has been declining between 2013/14 and 2015/16 from, 4.3% to 1.5% of total tax revenue and from 4.3% to 1.6% of GDP. This may be due to reduced donor assistance and a general decline in the economy.

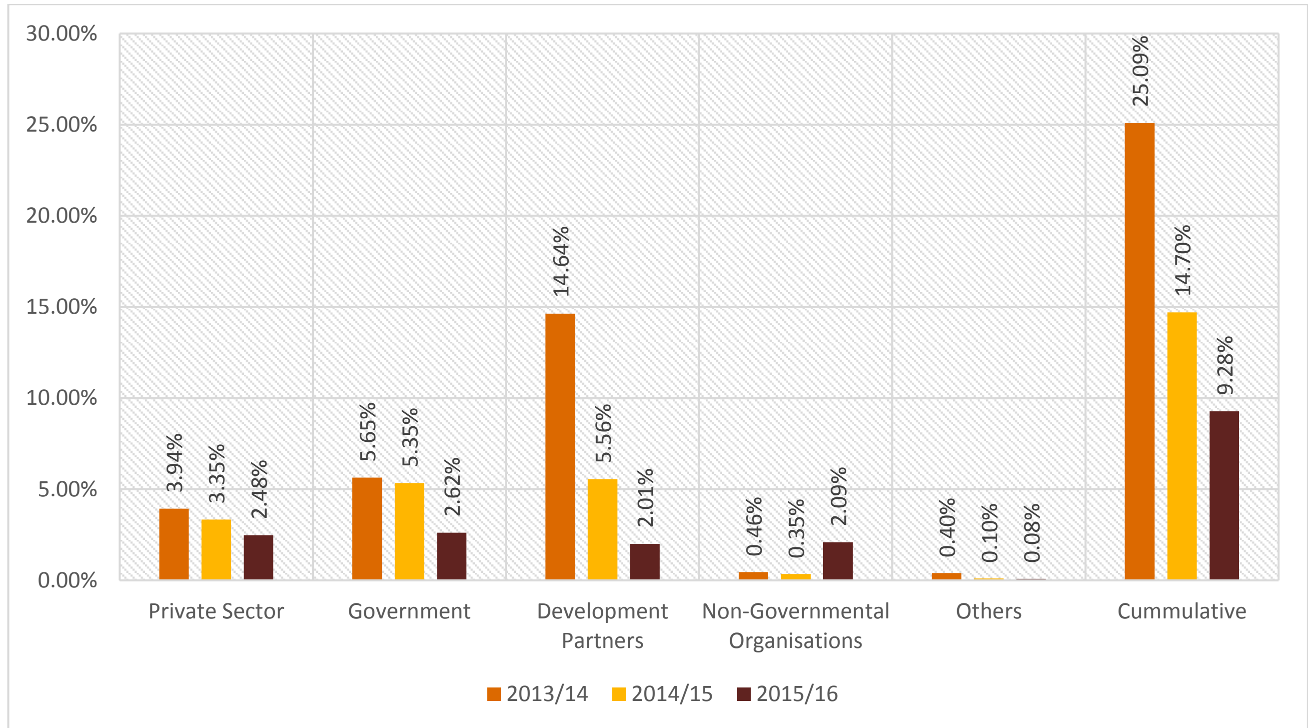
The amount of revenue foregone to GDP is far higher than in regional countries as shown in Table 5.4 below.

Table 5.4 Comparison of foregone revenue to GDP across countries

Malawi	Tanzania	Kenya	Uganda
4.3%; 1.6% (2013/14; 2015/16)	2.3% (2009/10)	1.1% (2008/09)	0.4% (2008/09)

Source: for Malawi: MRA; For Tanzania, Kenya and Uganda: Fjeldstatt and Heggstad (2011).

Figure 5.2 Tax Revenue Forgone due to Incentives: share of total tax revenue



Source: MRA and Malawi Government, Economic Reports

Figure 5.3 Tax Revenue Forgone due to Incentives: share of GDP

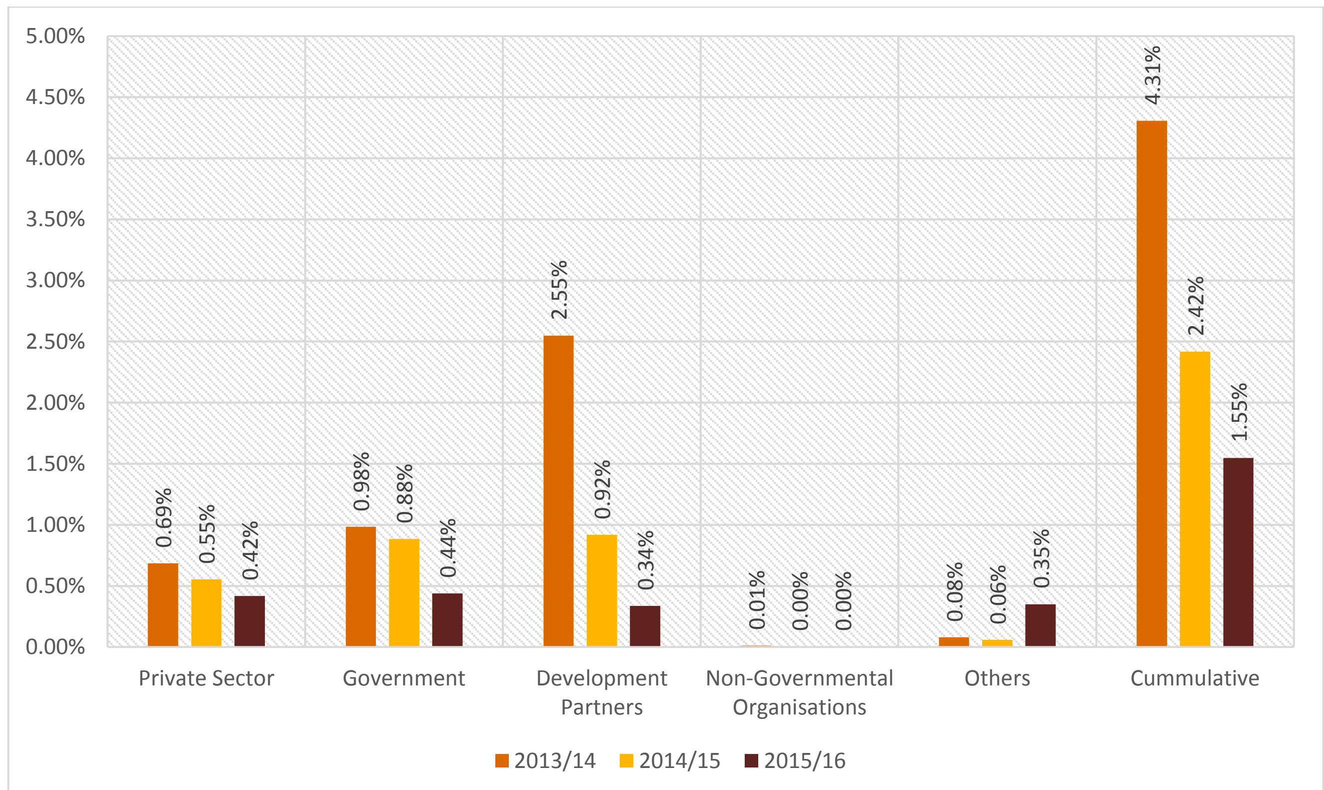
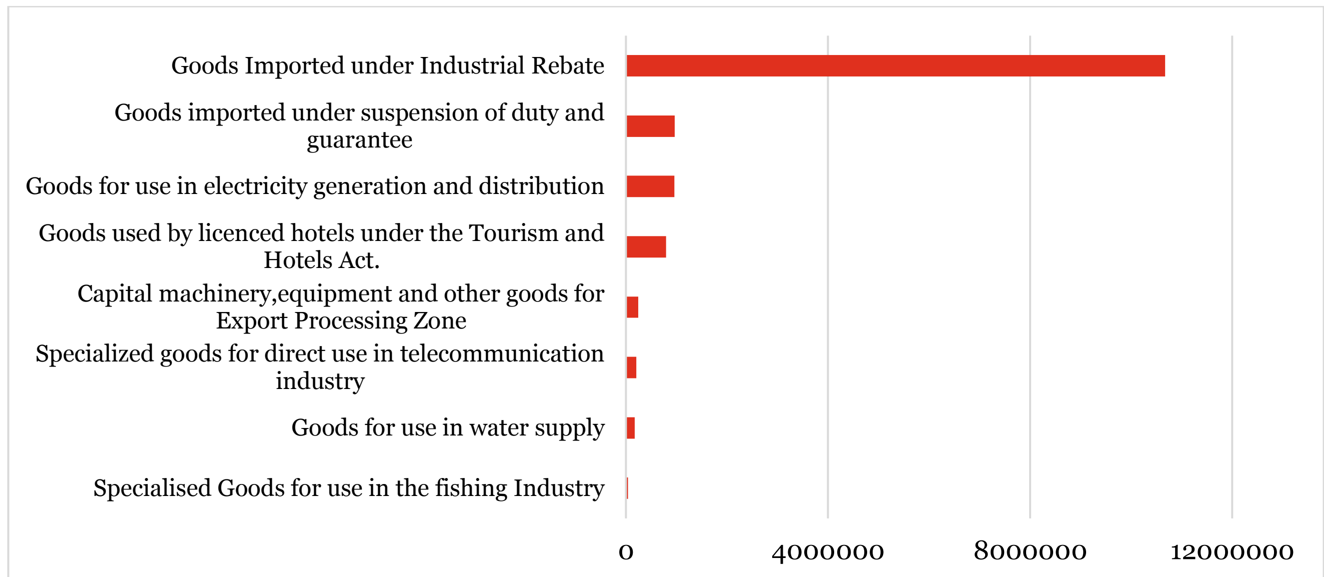


Figure 5.4 summarises revenue losses through various customs and excise duty exemptions in 2013. The bulk of the revenue losses are attributed to industrial rebate scheme whose estimated revenue loss is around MWK9bn. This is followed by goods under suspension of duty and guarantee then goods imported under electricity generation and distribution.

Figure 5.4 Revenue loss by type of goods, thousands of MKW, 2013



Source: MRA

PwC developed an analysis grid based on literature consulted, international best practices and on experience. The grid summarised in Figure 5.5 uses four criteria to assess the performance of the incentive instruments in Malawi. The results are colour coded with red signifying non-performance, yellow signifying partial performance and green being performing incentives. It is noted from the figure that none of the incentives satisfy the performance criteria which is an indication of the structural teething problems of the taxation and fiscal incentives regime in Malawi.

Figure 5.5 Summary of Performance of Incentives

Incentive	Simplicity	Transparency	Consistency	Fairness
1. *Industrial Rebate Scheme*	Yellow	Red	Green	Yellow
2. *Capital and Investment Allowances*	Green	Yellow	Green	Green
3. *Export Allowances*	Green	Yellow	Yellow	Green
4. *Tax Holiday*	Green	Yellow	Yellow	Yellow
5. *Export Processing Zones*	Green	Yellow	Yellow	Yellow
6. *Duty Waivers*	Green	Yellow	Green	Green

Key
- Red: *Non satisfactory performance*
- Yellow: *Moderately performing*
- Green: *Satisfactory performance*

5.5. Summary of Recommendations

An ideal incentive scheme ought to be transparent, stable and be able to achieve policy objectives with a minimum leakage of tax revenue. Firms engaging in direct foreign investments to enter new markets or to access and acquire new natural resources or strategic assets appear less motivated by incentives than the highly mobile and efficiency-seeking firms which focus on cost reduction for products destined for global markets. Hence, Malawi's incentives package should take into account the typology of FDI and responses to fiscal incentives. In this regard, PwC recommends that Malawi's direct and indirect tax incentives should be redesigned as suggested in Chapter 4.8 of this report.

The specific recommendations for GoM's consideration are summarized in Table 5.5. PwC further recommends that GoM should synchronise the role of the FDI in the country with the objective of the incentive regime.

Table 5.5 Summary of Incentives Recommendations

Incentive		***Industry/Sector***	***Recommendation***
Type	Incentive		
Income Tax	Tax holidays and reduced CIT	Priority industries	The GoM should gradually move away from awarding automatic tax holidays to a mix of performance-based incentives—both fiscal and financial.
	Capital allowances-investment allowance	Manufacturers	The GoM should maintain the capital allowances incentive
	Export incentives	Exporters of non-traditional goods.	The GoM should maintain the export incentives to compliment the drive to make Malawi a producing and exporting country.
Customs and Excise	Industrial Rebate Scheme (IRS)	Manufacturers	Reform administration of the incentive.
	Export Processing Zones (EPZs)	Exporters under the EPZ	The GoM should retain the EPZ as an industrial promotion tool but the incentives provided under the EPZ Act should be mirrored in the Taxation Act.
	Import Duty Exemption for Electricity Generation and Distribution	Electricity generation and distribution	Retain the incentive with the objective of enticing more players in the sector.
	Duty and excise exemptions	Crosscutting	Streamline and develop simple and transparent guidelines for the administration of these duty and excise exemptions.

6. Policy options and recommendations

6.1. General recommendations

In general, the specific tax policy recommendations presented in section 6.2 are made with the following key observations:

1. **Don't overlook other impediments to industrial growth**: the doing business report identifies a number of constraints to doing business in Malawi. Fiscal incentives should, therefore, not be regarded as a panacea to industrial development in the country. All efforts must be made to address the main identified bottlenecks such as poor provision of utilities (energy, water, telecommunication, etc.), and poor infrastructure (road, rail).
2. **Operate within the box**: Malawi's tax incentives are mostly driven by tax incentives provided in neighbouring countries especially Zambia and Zimbabwe. The general trend in tax incentives around the world is streamlining and at the same time reducing the corporate tax rate. However, Malawi should not drastically move into this direction considering that other countries in the region are offering various incentives. It is, therefore, important for the country not to divert much from the regional trend when offering its incentives.
3. **Provide cost-based tax incentives**: Cost-based tax incentives involve specific allowances linked to investment expenses, such as accelerated depreciation schemes and special tax deductions and credits. They are targeted at lowering the cost of capital and so make a greater number of investment projects more profitable at the margin. That is, they may generate investments that would not otherwise have been made. Less preferred incentives are profit-based tax incentives which generally reduce the tax rate applicable to taxable income; examples include tax holidays, preferential tax rates or income exemptions. One effect is thus to forego government revenue in order to make even more profitable investment projects that would be profitable anyway, and hence would have been undertaken even without the incentive.
4. **Remove redundant incentives**: Specifically, VAT exemptions on investment expenditure are mostly redundant, since full operation of the tax means that VAT charged on inputs does not 'stick' with the purchaser, but is fully recovered as a credit against VAT charged on sales. We take note that VAT exemptions can become beneficial for firms if VAT implementation is problematic as is the case in Malawi where there are imperfect VAT refund procedures. Thus, this rule should be followed with the understanding that VAT refunds will be made on time.
5. **Ensure clarity in the tax law and procedures**: For instance, tax incentives should be clear on who benefits, what is the eligibility criteria etc.
6. **Provide for monitoring**: Monitoring of tax incentives is critical to check for their effectiveness and any possible abuse. Most tax incentives do not achieve their objectives because they are not monitored and hence reviewed accordingly.
7. **Introduce sunset clauses**: Government should remove available tax incentives cautiously in order to maintain confidence and reliability in the tax system which assist taxpayer in their financial planning. To this end, government is encouraged to include "sunset closes" in all tax incentives. The sunset clauses can be introduced even for tax incentives that are already in existence.

6.2. Proposed new tax incentive regime

In this section, we provide specific tax policy recommendations in addition to what has been recommended in Chapter 4.8 and Chapter 5.5 that the Malawi Government should consider.

1. **Introduce sunset clause for tax holidays**: Tax holidays are "widely regarded as a particularly ill-designed form of investment incentive, and one that poses considerable dangers to the wider tax system" (Keen and Mansour, 2010). They are prone to abuse, signal an untrustworthy tax system, and make it difficult to measure the cost to revenues. Thus, it is important that this incentive be removed within the short to medium term. The delayed removal of this incentive will assist in instilling confidence in the private sector that tax incentives are stable considering that only 3 years have elapsed since this incentive was introduced. The recommended alternative, therefore, it is to include a sunset close (we propose 5 years-2021) after which this incentive will be removed.
2. **Maintain capital allowances:** capital allowances are true "cost-based tax incentives" and have generally been noted to attract investment as they are directly related to the investment and it is easier to estimate their costs. However: the beneficiaries of this incentive must be accountable under the tax reporting system and therefore the authorities can gazette those that have benefited as well as costs and benefits. Build the institutional capacity for management of the process of eligibility approval to inform the discretionary minister's power to declare.
3. **Review Export incentives**[15]: there is need to harmonise tax law to remove overlap and complexity. Specifically, repeal Export Incentives Act and amend Taxation Act to provide deductions to taxpayers registered under Export Incentives Act and to harmonise the incentives.
4. **Review administration of Industrial Rebate Scheme and include exit strategy**: The Industrial Rebate Scheme (IRS) is deemed an effective incentive considering that most companies would not be viable if this incentive was removed. However, there are problems of administration and process and it is associated with great revenue loss. To remove the administrative challenges and also to reduce the revenue loss, it is important to ensure that only eligible firms qualify and also that the eligibility procedures are clear and transparently applied. To this end, it is strongly recommended that admission of qualifying firms and raw materials into the scheme should be done by a committee. The committee should be comprised of various stakeholders (Ministry of Industry and Trade, MITC, Ministry of Finance, MCCCI and MRA). The main function of the committee is to ensure that only those firms that meet the 20% value addition are admitted. Malawi should also think of exit strategy with IRS considering the regional development especially under SADC which may lead to harmonisation of incentives and IRS is likely to be abolished. Inclusion of sunset clause for IRS would prepare manufacturers for this.
5. **Review EPZ scheme**: Other than machinery and equipment, the key incentive under this scheme is the duty free importation of raw materials. However, this incentive can be accessed through industrial rebate and most capital machinery and equipment are duty free in their own right if imported as a complete unit (see Chapter 84 of the Customs and Excise Act). It is further noted that since its introduction, the EPZ scheme has been on the decline. This shows the ineffectiveness of this scheme in meeting its goals. It is also noted that a) there is no specific zones demarcated for this

[15] Note that the scope for targeting tax incentives to exporters is constrained by the WTO Agreement on Subsidies and Countervailing Measures (SCM). See https://www.wto.org/english/docs_e/legal_e/24-scm.pdf

scheme. This means that it is difficult to monitor the activities of the firms under this scheme and b) only few imports (MK40 million) in 2014 were registered under this scheme which shows that the industries under this scheme are not very active.

6. **Introduce Customs Procedure Code (CPC) to cater for capital machinery and equipment for investments above $5 million**. This CPC will ensure that capital equipment are imported duty and excise free in cases where these taxes exist. In addition, the repealing of EPZ scheme will necessitate this provision which will benefit all manufacturers.
7. **Include claw-back provisions**[16]: for major tax incentives such as industrial rebate, and tax holidays to ensure that taxpayers do not abuse the system.
8. **Sector specific incentives**: such as those for Mining, agriculture, tourism, and manufacturing are adequate. No additional incentives should be introduced. Alternatively, for the long run, Government should reduce corporate tax to 28% then 25% while at the same time removing most of the sectoral tax incentives including the IRS and EPZ. This will improve compliance while at the same time increasing acceptability of the new incentives scheme.

6.3. Non fiscal incentives

Non-fiscal incentives involve financial incentives, regulatory incentives and technical or business support incentives which form part of favourable business climate. A favourable business climate is essential for attracting foreign direct investment (FDI) and for the development of large as well as small and medium-size enterprises (SMEs). A poor business environment - i.e., one plagued by factors that impose heavy costs, delays and risks - impedes economic development and can frighten away FDI. FDI is the largest source of external finance in developing and transition economies. Malawi is well-positioned to compete for FDI if it can adopt pro-business policies, and laws and practices supporting investment and business development. As has been illustrated by the recent economic transformation of the Irish Republic, even those countries with relatively low levels of FDI can significantly increase their share of FDI by concerted efforts to improve the business climate.

Investors seek a predictable and acceptable return on their investment: "Money is a coward," is a common catchphrase. In order to attain a competitive return, an investor will seek to avoid three key obstacles: cost, delay, and risk. If a poor investment climate -through taxes, fees, fines, corruption and added need for services (lawyers, accountants, consultants, etc.) - increases the cost of the investment transaction, an investor may look elsewhere even though labour costs may be competitive. Likewise, if the impediments brought by the system delay the commencement of profit-making activity significantly, investors may seek to invest elsewhere despite competitive costs. Finally, even if the initial costs and delays are not a factor but the investor is worried about political upheaval, seizure of assets, or legislative changes that could diminish the return, the investor may be willing to accept a slightly less attractive return in another destination in order to minimize the risk.

Malawi which has few natural resources such as oil and gas has the option of only improving the business climates if it is to remain competitive. Although all business climate-related quality indexes show that the wealthier and the middle income countries have the stronger or faster chances of improving business climates, there is ample evidence that countries that have taken steps to improve their business climates have been rewarded with greater FDI and improved economic performance. While private enterprises must be responsible for their own success, it is still up to GoM to provide the best framework possible for those enterprises to operate successfully.

The GoM generally does have the means to make it easier, cheaper and faster for people to do business. While increasing the overall level of technology or spurring economic growth are complex and difficult matters, the changing laws regarding employment, simplifying permit and licensing procedures, developing a national land registry, or supporting infrastructure development are all

[16] Non-compliance should attract penalties.

things that the GoM can do. If governments wish to attract FDI, they have to engage in prudent policy-making. Weak regulatory regimes and/or poor institutional capacity leading to noncompetitive market behaviour or uncollected taxes are bound to have a negative effect on FDI.

The constraints to industrialization were identified in Chapter 3.5 to 3.7 and the remaining sections of this chapter discusses measures that may be taken to make Malawi's economy more competitive at the macro-level and to facilitate business operations at the micro-level using non-fiscal measures.

6.3.1. A Business-Friendly Political and Legal Environment is Critical to a Strong Investment Climate

Governments often consider that economic and fiscal conditions are the most critical factors for attracting foreign investment. While economic and fiscal conditions certainly are critical, the most important factor in establishing a favourable business and investment climate is arguably the political and legal environment. Countries may offer low tax rates and free land but if investors fear expropriation of assets, revocation of incentives, labour unrest, civil strife, or inability to deal with natural disasters, then they will be disinclined to invest. Investors have to be confident that the country in question is committed to attracting foreign investment and that investments are safe. Unstable political environments increase risk, which investors generally prefer to avoid. In addition, political factors such as corruption, bureaucracy, and lack of rule of law are not only risks but also add direct cost to the investment. The most important factors in establishing a political environment that supports a strong business and investment climate are:

- Security;
- Protection and guarantee of foreign investor rights;
- Legislative stability;
- Transparency;
- Freedom from corruption; and
- Good governance.

A stable political environment provides a sound foundation for economic development, and particularly for FDI. Without a stable political environment, there is risk. Risk deters investment. GoMs should ensure the establishment of a favourable political environment by:

i. Strengthening the perception of security through further integration into the world economy, participation in various forms of international, regional and bilateral co-operation, promoting democratic reforms, ensuring political stability, and promoting confidence-building measures and efficient contingency planning for disasters;

ii. Keeping legislation stable by changing legislation through transparent processes in defined periods, and maintaining an open dialogue with the private sector;

iii. Maintaining the highest levels of transparency possible through e-Government, publishing and reviewing administrative decisions, and a free and independent media;

iv. Combating corruption through codes of ethics, whistle-blower laws, less bureaucracy and simpler administration, ensuring civil servants are paid a 'living wage' on time, and creating an environment where oversight bodies function independently; and

v. Governing well, with fair and competitive tenders, systematic dialogue with the private sector, and ensuring the office of the ombudsman functions efficiently and effectively.

6.3.2. The Importance for the Business and Investment Climate of Policies that Support Macroeconomic Stability and Economic Growth

Macroeconomic stability and economic growth are essential to the promotion of economic development. For corporate investors, the most important indicators of macroeconomic stability are those which directly affect their balance sheets, such as growth in GDP and GDP per capita growth rates, inflation, population growth, and university graduation rates. In addition, interest rates are very important for SMEs and some foreign investors. A country's openness to foreign trade, foreign investors, and foreign workers can affect its success in promoting economic development. If countries with abundant natural resources wish to spread the wealth and lessen the shock of changes within a single industry, they should diversify their economies. GoM should adopt medium-term economic strategies, disciplined fiscal policies, and an open approach to foreign trade and international capital market flows.

Macroeconomic stability is considered a prerequisite for economic growth. The IMF defines macroeconomic stability as current-account and fiscal balances consistent with low and declining debt levels, inflation in the low single digits, and rising per capita GDP. This is one of many definitions. Some economists believe inflation in the low single digits is too stringent a requirement. A consistent upward trend is the key to macroeconomic stability. Falling GDP signals a stagnant marketplace. Businesses cannot function and make profit when costs are too high. Price fluctuations can devastate SMEs. A twenty per cent rise in the cost of raw materials can obliterate a small business. A strong and stable macroeconomic environment is necessary to support long-term economic growth. The positive signals to investors include:

- Stable currency ;
- Lowest inflation;
- Opportunities for growth in tourism;
- Protection of foreign investments;
- Modern financial sector;
- Law on Foreign Investments regulating the policy and principles of foreign investments;
- Foreign investors having the same rights as domestic investors; and
- Rights of foreign investors enjoy special protection

Investors and entrepreneurs seek opportunity. Economies that show growth and stability provide the highest levels of opportunity and will attract the highest levels of investment. GoM can create opportunity-rich frameworks for business by:

- Orienting macroeconomic policy toward economic growth. GDP growth is a critical indicator for corporate investors and raises the potential for investment.
- Opening up the economy. Open economies have the best chance of success. Policies embracing trade liberalization, free flow of capital, and free movement of workers stimulate economic activity.
- Diversifying the economy. Complete reliance on extractive industries leaves an economy susceptible to commodity price fluctuations, and stultifies job creation.
- Creating a strategy. Developing a medium-term strategy makes it easier for businesses to plan. The consequent higher degree of transparency also sends positive signals to investors and other important actors.

6.3.3. *Government actions and policies that improve the business climate*

A general policy that fosters competition among private actors rather than direct State management of the economy is a fundamental step in the right direction. Tax policies that are transparent, simple, and non-discriminatory are attractive to investors because they enable entrepreneurs to forecast their costs and potential profits more easily than a complex set of nominally low tax rates does. Special tax incentives for foreign investors can distort competition and undermine the financial health of domestic companies. Streamlining refunds of value-added tax on exports helps businesses avoid cash flow problems. Employment policies can stimulate labour market flexibility and support business development by giving employers the ability to hire and discharge workers with relative ease. Investment in infrastructure - roads, transport networks, utility distribution networks, water supply, telecommunications networks, public works and services, and customs systems - allows domestic and foreign companies to take full advantage of local and global markets. Similarly, investment in human capital - improving and maintaining education and job training and retraining -makes a country more internationally competitive. The lessons of regional economic integration, free trade areas, and investment compacts demonstrate that co-operation among trading partners is more likely to produce economic benefits for all parties than isolationism and protectionism are. Finally, the privatization of state-owned enterprises and evenhanded treatment of now privatized companies shows a firm commitment on the part of the GoM to allow competition to determine the success or failure of those companies and to ensure the kind of level playing field for business that is most likely to benefit consumers generally.

The opportunities and incentives for firms to invest, create jobs, and grow depend on expected profits. Profits are influenced by costs, risks, and barriers to competition. GoM can have a major impact on each of the following three factors.

- On costs: through the regulatory burden and red tape, taxes, levels of corruption, infrastructure services, labour market regulation, and finance;
- On risks: through policy predictability, property rights, and contract enforcement; and
- On barriers to competition: through regulations controlling start-up and bankruptcy, competition law, and entry to finance and infrastructure markets.

6.3.3.1. Recommendations

i. *Taxation policy*

In reforming their taxation systems, the tax authorities should:

- Strive to simplify the tax structure;
- Ensure speedy refunds of VAT;
- Speed up processing time, decision-making time;
- Provide more readily available guidance;
- Be more efficient in processing returns;
- Conduct effective taxpayer education services; and
- Offer online tax-filing.

ii. *Infrastructure policy*

GoM should seek to create modern infrastructures for transportation, communications, electricity and water. In doing so, they should consider whether public-private partnerships can achieve infrastructure policy goals. Once infrastructures are built, they must be maintained, and this requires long-term planning.

iii. *Human investment policy*

• GoM should invest significantly in education and vocational and technical training in fields that will keep the workforce competitive for the future.

• GoM should make efforts to educate the public on the basic economics of market economies, and should promote specialized education in entrepreneurship.

6.3.4. The importance of law and regulation to economic development

If countries are to reach their full economic potential, they need to have modern and efficient commercial legal systems to protect businesses' interests in land and personal property and to provide guarantees against arbitrary or uncompensated expropriation. Regulatory bureaucracies should be reduced. To encourage the development of land markets, authorities should make it clear which laws apply, and ensure that modern registration systems are in place, and that adequate resources are devoted to the development of land markets professions. Full freedom of contracts should be allowed between commercial entities, and contracts should be enforced in a timely, predictable, and cost-effective manner. To ensure access to finance for economic development, GoM should promote good corporate governance and should adopt modern systems for dealing with secured transactions and bankruptcy, and for the supervision and regulation of capital markets and banks. To stimulate economic development, GoM should enact modern legislation to protect intellectual property and to encourage the development of electronic commerce. Governments should also ensure the independence, training, and adequate funding of the judiciary, and should make arbitration and other forms of alternative dispute resolution widely available in commercial disputes.

The many elements of a successful economic development strategy are highly interdependent, and imbalances in the emphases given to a strategy's various components can impair its overall effectiveness. This is certainly true of legal systems, in which non-legal factors such as history, culture, education and financial resources affect the enforcement of, and acceptance of and voluntary adherence to the law. Moreover, solid legal foundations - such as basic rules relating to property; contracts; civil, economic, and political freedoms; and access to justice - are necessary for the proper working of more detailed legal systems such as those governing the functioning of stock markets. The strengths and weaknesses of one set of laws and regulations also can have a direct impact on the working of legislation in other subject matter areas. For all of these reasons, it is seldom wise or effective to take one country's laws and impose them on another country on a wholesale basis and without regard to local conditions. These common features are incorporated in the following recommendations.

i. *Money issues*

• Move towards a more liberal foreign exchange control regime.

• Reemphasise foreign investors' full freedom to repatriate capital and residual profits after payment of taxes.

ii. *Competition law and policy*

• Define the rationale of competition laws clearly. Normally, economic efficiency and the maximizing of consumer welfare are among the highest goals of competition policy.

• Conduct public education and promotional campaigns to foster a culture of competition.

• Let competition law and policy be informed by rigorous economic analysis, rather than being driven by overly formulaic or legalistic views of the negative impacts of economic activity.

iii. Intellectual property and e-commerce

- Bring national legislation into conformity with Agreement on Trade Related Intellectual Property Rights (TRIPS) standards. Care should be taken to clearly define all exceptions to protection under the law of patents, copyright, etc.

- Strive to achieve high quality in the patent-examining process by devoting adequate resources and personnel to the task.

- Conduct public awareness and education programmes to foster respect for Intellectual Property Rights (IPRs) and to communicate the seriousness of infringement as a crime and/or civil infraction.

- Conduct training and educational programmes for judges and law enforcement to deal with both legal and technical aspects of IPRs.

- Establish specialized intellectual property law enforcement units to conduct inspections, seizures, and arrests in cases of commercial piracy.

- Consider establishing specialized intellectual property courts or tribunals.

iv. Enforcement of contracts and other private rights

- Undertake structural, procedural, and management reforms necessary to produce independent, efficient, and professional court systems.

- Facilitate the availability of arbitration and the enforceability of arbitration awards in commercial cases.

- Support and promote the use of all forms of dispute resolution (including mediation and conciliation) as alternatives to court litigation.

6.3.5. Investment Promotion and Export Promotion

Many countries have been successful in attracting investment through the use of Investment Promotion Agencies (IPAs). IPAs perform a number of important functions, including serving the needs of investors, advocating business-friendly policies, and cultivating and projecting a favourable image of the country as an investment destination. In addition to using IPAs, the judicious use of investment incentives - such as reduced corporate tax rates, disadvantaged and incentive zones, and industrial parks - can help to improve the business climate, provided that they do not significantly discriminate among investors and that they do not take the place of the institutional reforms recommended throughout this report. In countries where key elements of a good investment climate are not yet fully functional, instruments such as sovereign guarantees and political risk insurance can help investors overcome some of their reluctance to do business.

Countries seeking greater FDI must engage in aggressive promotion. Investment and export promotion combines policy advocacy, image promotion, investment and export generation, and investor and exporter services. Ultimately, a better investment climate provides a better business proposition to present to the investor. Investment incentives are not a substitute for a favourable business climate and should be used as a complement to a superior business climate. Governments must be careful not to "stack" incentives, and must take care to assess and fully understand their fiscal implications. Otherwise, they run the risk of corruption and poor financial performance. Incentives should be applied in a non-discriminatory manner and should be available to foreign and domestic firms alike.

Recommended best practices are:

i. Investment promotion

- Improving investment promotion agency performance: strategic and operational best practices may be learned from the activities of leading IPAs such as IDA Ireland and MIDA. The MITC is advised to establish links with organizations such as Multilateral Investment

Guarantee Agency (MIGA) and the World Association of Investment Promotion Agencies (WAIPA).

• Developing targeted investment promotion campaigns: countries must be able to market the most competitive aspects of their economies - the most dynamic sectors, the growing regions - to the most likely investors.

ii. *Industrial parks*

Industrial parks are not a tool of economic development but a response to market needs. Nonetheless, industrial parks are present in nearly all thriving market economies. The GoM should ensure land is available at a reasonable price to the developers of private parks, and should develop GoM-sponsored parks that meet investor demand and do not restrain the private sector from developing its own industrial parks.

6.3.6. Small and Medium-Size Enterprises - Development and Promotion

The growth of small and medium-size enterprises (SMEs) is a fundamental component of economic development. SMEs are usually a significant source of employment and also help to stimulate innovation, economic dynamism, and competition. The report pays particular attention to the impact of SMEs on the economic and social development of Malawi and the importance of a favourable business and investment climate for the successful development of this sector. It also outlines how SME-specific actions initiated by the GoM in the areas of finance, education, and enterprise support can boost the SME sector without causing market distortions.

Given the importance of SMEs in job creation, poverty alleviation, economic growth and innovation, GoM should take responsibility for stimulating SME development. The following measures are recommended to governments intending to develop an "SME-friendly" legal, regulatory, and administrative environment.

i. *In the area of SME policies and programmes:*

• Designing SME programmes that will help SMEs overcome the effects of market failures, but without unduly distorting market structures or creating barriers to competition, and evaluating programmes regularly for effectiveness and efficiency.

• Focusing programmes on: improving management skills; making finance available on reasonable terms; increasing SMEs' ability to compete for government procurements; giving SMEs quick access to advice and information; building SME capability to exploit information and communication technologies; and improving linkages with other SMEs and large firms to encourage the emergence and development of innovative clusters.

ii. *In the area of business regulation:*

• Developing a simple, transparent, and low-compliance-cost tax system with fair tax rates, with consideration being given to reduced and/or simplified taxes for micro-enterprises.

• Simplifying the business registration system, and ensuring the availability of Internet-based registration.

• Streamlining business-licensing requirements.

iii. *In the area of financial services:*

Ensuring that financial sector regulations (banking, insurance, leasing) recognize SME constraints and that appropriate legal and regulatory instruments are introduced to make it possible for assets commonly available to SMEs to be used as collateral.

iv. *In the area of business culture, education, and training:*

• Developing entrepreneurial culture through business education and promoting a positive image of entrepreneurship.

• Providing SMEs with favourable conditions for setting up and joining membership organizations.

6.4. Proposals to improve administration of incentives

Generally speaking, the incentives offered to investors are applied consistently, but many companies complain about long delays in accessing the accrued benefits, especially those that require investors to spend first and claim later. Additionally, firms must negotiate their eligibility for these incentives with the responsible government entities. Some companies complain that this amounts to an undue burden, particularly because when the law changes, old incentive agreements are not automatically grandfathered in but must be renegotiated on a case-by-case basis. In all of these areas, foreign investors are generally accorded the same treatment as nationals. In order to deal with these administrative challenges, the following recommendations are made:

a. **Introduce a tax tribunal**[17]: this will ensure acceptability of appeal decisions including the decisions on whether a firm qualify or does not qualify to be under industrial rebate scheme or to benefit from a tax holiday.

b. **Introduce a private-public adjudication committee** modelled after the one existent in South Africa to oversee the admission into IRS scheme and also to review applications for tax holidays. This will protect MRA from unfair criticism where non-qualifying entities claim unfair treatment thereby improving compliance.

c. **Work to reduce processing time** for returns and approvals

6.5. Proposals to improve communication/promotion of incentives to private sector

In order to promote communication between MRA and taxpayers and also to promote the uptake of incentives, the government should undertake the following:

- Ensure that MRA and MITC websites have updated and complete information on tax incentives, illegibility criteria and application procedures.
- MRA should produce a service charter which will indicate timeline for responding to queries. MRA should strictly follow this service charter.
- Work to change culture towards working *with* business

[17] Tax tribunal is an administrative court that hears tax appeals

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Annex 1. List of Incentives and Allowances

TAX INCENTIVES IN MALAWI (2015/2016)

1. Introduction

Malawi offers a wide range of tax incentives with the aim of encouraging development, enhancing output, earning and saving foreign exchange, and expanding employment opportunities. These tax incentives are aimed at enabling business establishments to grow, and expand their operations, thereby contributing to the overall social-economic development of Malawi.

The incentives fall under two main categories of Taxes and these are, **Customs & Excise Taxes** and **Domestic Taxes**.

Customs & Excise Taxes are taxes imposed at a rate percent of the Cost, Insurance and Freight value of imported goods (i.e. CIF). Customs & Excise Taxes comprise of the following:-

1. Import Duty
2. Import Excise
3. Import Value Added Taxes (VAT) and
4. Export duty

The Malawi Customs & Excise Tariff book provides for various sector specific tax incentives through Customs Procedure Codes which give declaration of goods and conditions eligible for tax exemption.

Domestic Taxes are taxes collected from income generated within the geographical confines on the country. These include the following:-

1. Income Tax
2. Value Added Tax
3. Fringe Benefit Tax
4. Non-Resident Tax
5. Withholding Tax on Dividends
6. Domestic Excise

Domestic Tax Incentives in Malawi are mainly in form of tax exemptions against the levied taxes.

2. Customs and Excise Tax incentives

Customs & Excise Tax Incentives come in two (2) forms, i.e. General Incentives, and Specific Incentives. General Incentives are applicable to any Malawian taxpayer upon importation of a product. On the other hand, Specific Customs & Excise Incentives apply to those approved to operate in a specific sector under agreed conditions.

2.1 General Customs and Excise Tax Incentives

Malawi's General Customs & Excise Tax Incentives are in the form of duty exemptions on machinery targeting different sectors of the economy. These exemptions are offered in four (4) exemption approaches as follows:-

1. Import duty and import VAT exemption on importation of most Machinery.
2. Import duty exemption while VAT remains payable at 16.5% on importation of specific type of Machinery.
3. Import duty and import VAT exemption on importation of special purpose motor vehicles other than those principally designed for transport of persons or goods. Examples of special purpose vehicles are concrete mixer lorry, mobile drilling vehicles, etc.
4. Solar products are import duty free while VAT remains payable at 16.5%. Examples of such solar products include solar batteries and solar energy lamps.

2.2 specific customs and excise tax incentives

Specific Customs & Excise Tax Incentives in Malawi cover ten (10) sectors and these are, the Construction Sector, Energy Sector, Tourism Sector, Agriculture Sector, Transport Sector, Mining Sector, Education Sector, Health Sector, Manufacturing Sector, and Export Processing. Detailed information on the incentives is as follows:-

2.2.1 Construction sector

1. Duty and VAT free importation of Crane Lorries, Concrete Mixer Lorries, Mobile Drilling Derricks and Track Laying Tractors.

2.2.2 Electricity Generation and Distribution

1. Duty free importation but VAT payable at 16.5% on Electricity Generation equipment such as fuses, transformers, sling, ring main unit, insulators, galle chain equipment, conductors, surge arrestors, column duplex, AAC/PVC and electricity supply meters.
2. Duty free importation but VAT payable at 16.5% on energy saver bulbs, solar batteries, solar battery chargers, energy lamps, generators and inverters.

2.2.3 Tourism Sector

1. Investors in the tourism sector access free import duty, free import excise and VAT free importation on the following goods:-.

(i) Glass, China porcelain earthenware and stone articles of table ware, enamel and hollowware for table use electro plated nickel – silver and pated ware, knives, forks spoons and similar articles for cutlery.
(ii) Industry catering equipment, motor boats scuba diving, jet skis, kayaks, wind surfers, pedals, air conditioners, generators, gym equipment, message equipment, industrial washing machines, bar fridges, sauna, hot steam baths.
(iii) Off -road game/scenery viewing motor vehicles specially designed for safari purposes
(iv) Three goods carrying vehicles , except used motor vehicles imported every five years

Note for 1: In order for the items to benefit from the exemption, the items should be marked linen etched stamped or in any manner marked with the name of the hotel.

2. Further to accessing incentive (1) above, for hotels, Lodges and Inns with 50 rooms and above the same duty exemptions are applicable on the following:-
(i) Furniture and furnishings
(ii) Two (2) new passenger carrying motor vehicles except used motor vehicles imported every five (5) years i.e. shuttle buses

3. Further to accessing incentive (1) above, materials and equipment for the establishment of a conference centre of seating capacity of 200 people being:-
   - Public address system, video conferencing equipment, television screens, amplifiers, LCD equipment and industrial catering and bar equipment and indelibly engraved, itched, stamped or in any other manner marked with the name of the hotel, lodge or inn.

Note for 3: ***In order for the items to benefit from the exemption, the entity should also be operating a hotel or lodge.***

2.2.4 Agriculture Sector

Animal Breeding

1. Import duty and VAT free on importation of livestock meant for breeding such as live bovine animals, live swine, sheep and goats.

Note: *This incentive will be accessed after prior recognition from Principal Secretary of the Ministry of Agriculture, Irrigation and Water Development.*

Irrigation
1. Import duty, import excise and VAT free on importation of the following goods for direct use in irrigation:-
PVC Pipes, Asbestos Pipes/Rubber Seals, Galvanized Pipes, Elbow, Sprinklers, Drainers, Control Valves, Solvent Cement, Diesel Engine Ranging From 12kw-17 Kw with Tubes, Pressure Gauges and Nozzles Imported by a Farming Entity.
Note: *This incentive will be accessed after prior recognition from Principal Secretary of the Ministry of Agriculture, Irrigation and Water Development.*
Horticulture Production
1. Exemption of duty, import excise and VAT free on importation of the following products and equipment:-
Seeds, Cuttings, Seed Netting Greenhouse Structure, Climate Control Equipment, One Generator Set, Water Pump Or Borehole, Flower Power Lights, Pump, Electrical Engines, Diesel Engine for Irrigation with Tubing, PVC Piping, Valves, Sprinkler System, Irrigation Filters/Nozzles, Pressure Regulators, New Refrigerated Trucks per Five Years, Cold Rooms, Strapping Materials and Clips, Metal Wires, Strings Elastic Bands, Processing Equipment, Bag Strikers, Laboratory Equipment, Chemical and Reagents, Soil Testing Kits, Moisture Testers, Graders, Chemicals Rose Cutter, Spray Equipment and Fumigation Equipment.
Note: *This incentive applies to goods intended for export only and upon prior approval by the Minister of Industry and Trade.*
Fishing Industry
1. Import duty, import excise and import VAT free on importation of the following Equipment and Machinery:-
Machinery, Plant, Laboratory Equipment and Materials, Aerators, Pumps, Blowers, Diamond Mesh, Nets, Measuring Equipment, Separators, Specialized Tanks and Diffusers, Boat Engines and Trawlers for Deep Sea Fishing.
Note for Incentive 1*: In order to access this incentive, the Investor should be issued with a letter of recommendation from the Department of Fisheries.*
2. Duty free importation but VAT payable at 16.5% of fishing vessels, factory ships and other vessels for processing or preserving fishery products.
Poultry Farming
1. Duty free and VAT free importation of machines for cleaning, sorting or grading eggs
2. Duty free and VAT free importation of machinery for preparing animal feeding stuffs, poultry incubators.
Other Agricultural Goods
In addition to the incentives for the subsectors above, the following are some of the goods and equipment which are essential for farming:-
1. Duty Free and VAT free importation of agricultural goods: fertilizers, pesticides, herbicides.
2. Duty Free and VAT free importation of agricultural equipment: ploughs harrows, scarifers, cultivators, weeders, manure spreaders and fertilizer distributors and milking machinery.
2.2.5 Transport Sector
Road Transport
1. For Buses: Import duty, import excise and import VAT free on importation of new buses and buses used for a period not exceeding five (5) years of a seating capacity of forty five (45) persons or more persons including the driver.
2. For Minibuses: Import duty, import excise and import VAT free on importation of new minibuses and minibuses used for a period not exceeding five (5) years of a seating capacity of eleven (11) to forty four (44) persons or more persons including the driver.
3. For Trucks : Import duty and VAT free on new trucks and trucks used for a period not exceeding fifteen years of 15 tonnage or more capacity but attracts 5 % import excise. The same trucks used for a period exceeding fifteen years attracts 20 % import excise
Rail Transport
1. Import duty free and VAT free on importation of Railway materials.
Air Transport
1. Duty free and VAT free on importation of aero planes and other aircrafts of unloaded weight exceeding 2000 kg.
2. Duty free and VAT free on importation of equipment and materials for in-flight use in catering, hygiene or for similar purposes (only applicable for international scheduled services)

2.2.6 Export Processing Zone Scheme

1. Exemption of all duties (Import, Excise and VAT on capital machinery, equipment, and raw materials directly used in the production of goods for export. 10 % of the produced goods is allowed to be sold locally after seeking approval from Ministry of Trade and Industry

Note: *In order to access this incentive, the Investor should be issued with an Export Enterprise Certificate from the Ministry of Industry and Trade.*

2.2.7 Exploration and Mining

1. Duty free and VAT free on importation of specialized goods for use in mining, such as machinery plant and exploration equipment.

Note: *A license by the Ministry of Mines, Energy and Natural Resources is a prerequisite to accessing this incentive.*

2.2.8 Education Sector

1. Duty and import excise free clearance and VAT exemption on importation of School stationery, instruments, apparatus, appliances and other tuition requisites including specialized furniture for use in the classroom, workshop or laboratory, athletic and sports goods for tuition purposes.
2. Duty and import excise free clearance and VAT exemption on importation of photocopying machines, building materials, pianos, organs, keyboards and computers for pre-school play groups.

Note: *A license from the Principal Secretary of the Ministry of Education is required to access this incentive.*

3. Books of all types are import duty and VAT free.

2.2.9 Health Sector

1. Duty, excise, and VAT free on importation by Hospitals, Nursing Homes, Clinics, Surgeries, and Dispensaries of the following items:-

Instruments, Apparatus, Appliances and Requisites including parts thereof and including specialized furniture diagnostic and laboratory reagents for use in the diagnosis or treatment of diseases or infections of humans or animals.

Note for Incentive 1: *in order to qualify for this incentive, the health institution has to be registered and approved by the Principal Secretary for the Ministry of Health.*

2. Duty and VAT free on importation of Medical, surgical, dental and sight testing instruments.

2.2.10 Manufacturing Sector

Industrial Rebate Scheme

The Industrial Rebate Scheme applies to import and excise duty exemption of raw materials for designated manufacturing industries, but VAT is payable at 16.5%. However, raw materials for the manufacture of fertilizer, medicaments and pharmaceuticals are both import and VAT free under the scheme.

1. In order to qualify for the incentives under the Industrial Rebate Scheme, the following conditions should be met:-
   - (i) The manufacturing entity should be registered as an operator under the Industrial Rebate Scheme as detailed under 2 below.
   - (ii) Plant and machinery must be in place at the premises.
   - (iii) Value addition of 20% minimum[1]. Determination of the value addition is based on assessment of production cost. The investor should therefore submit this information to

Malawi Revenue Authority (MRA) prior to benefiting from the Industrial Rebate Scheme.

2. The scheme lists the specific type of industries that would benefit for exemption. In order to benefit from the Industrial Rebate Scheme the procedure is as follows:-
   - (i) If the industry is not already under the listed industries in the scheme, the investor should submit an application to the Commissioner General of MRA for inclusion of the new industry.
   - (ii) If the industry already exists under the listed industries in the scheme, and the manufacturing entity's raw materials are not presently provided for under the scheme, the investor should firstly submit an application to the Commissioner General of MRA to be registered as an operator under the scheme. After being registered as an operator, the investor should then submit an application for inclusion of the additional raw materials for that specific industry.
   - (iii) If the industry is already under the listed industries in the scheme, and the manufacturing entity's raw materials are presently provided for under the scheme, the investor should submit an application to the Commissioner General of MRA to be registered as an operator under the scheme.

[1] The minimum threshold is still 20 % regardless of the SADC 35 % requirement.

DOMESTIC TAX INCENTIVES

Domestic Tax Incentives are in two (2) forms, i.e. General Incentives, and Specific Incentives. General incentives are incentives which are accessible by every taxpayer operating as a 'business person' or business entity' in the country. On the other hand, Specific Domestic Tax Incentives are sector specific and are accessible by a taxpayer operating as a 'business person' or 'business entity' in that particular sector.

General Domestic Tax Incentives

There are 4 General Tax Incentives in Malawi and these are as follows:-

1. *Initial and annual allowances at various rates are granted besides the depreciation (annual) allowances.*

These are essentially Capital Allowances allowable on staff housing specifically for the agriculture sector. A detailed explanation of the operationalization of the claim is as follows:-

(i) Capital Allowances allow the loss of value of a business's capital items to be treated as a current expenditure and thereby be used in the assessment of a business's taxable income[1].

- This provision makes the loss of value of a capital item become an acceptable expenditure and is used to offset the gross profit, thereby reducing the total taxable income for Corporate Income Tax obligations.

(ii) There are 3 different forms of capital allowances, as follows: - Initial Allowances, Investment Allowances, and Annual Allowances.

Initial Allowance is given to the tax payer in the first year after the tax payer has claimed the allowance at the end of the year upon submission of financial statements.

Annual Allowance is given to the tax payer every year from the first year for the lifespan of the capital asset.

Investment Allowance is given to the tax payer in the first year only.

Please refer to table 7 and table 8 in section 3.4 for specific rates and corresponding capital items.

Note 1: *Initial or Investment Allowances are only claimed once in the first year of use of the capital asset.*

Note 2: No Investment Allowance can be claimed when Initial Allowance has been claimed. This entails that a business entity can only claim either Initial Allowance or Investment Allowance.

Note 3: Annual allowance is claimed at the end of each year, for the lifespan of the capital asset.

Note 4: Investment Allowance is not applicable as a General Incentive

(iii) In order to benefit from this incentive the business entity is supposed to submit a return of income attaching the capital allowances schedule at the end of the financial year

2. *Commercial Buildings with a construction cost of MK 100 million or above, are subject to an Annual Allowance of 2.5%*

These are essentially Capital Allowances allowable on staff housing specifically for the agriculture sector. A detailed explanation of the operationalization of the claim is as follows:-

For detailed explanation of capital allowances, please refer to section 3.1.

Note 4: *Only claims on Annual Allowance are allowable for the case of Commercial Buildings of MK100 million in value and not Initial and Investment allowances.*

(i) In order to benefit from this incentive the business entity is supposed to submit a return of income attaching the capital allowances schedule at the end of the financial year.

3. **A claim of 50% allowance of social contributions** paid directly into the building of a public hospital or school, or the sponsoring of youth sporting development activities. Where a tax payer wants to fund corporate social activities, they can claim 50% of the expenditure. Taxable expenses are reduced by 50% of the donation. As long as the taxpayer has a record of the donation and indicates on the tax return a claim of the tax allowance.

Specific Domestic Tax Incentives

Specific Tax Incentives in Malawi cover 4 sectors, the Manufacturing Sector, the Export Sector, the Agriculture Sector, and the Mining Sector.

3.2.1 Manufacturing Sector

1. *Pre-business expenses of up to 18 months are allowable expenses*

(i) 'Pre-business Expenses' are expenses incurred prior to commencement of trade as a person or business entity is preparing to launch their business.

(ii) 'Allowable Expenses' are acceptable current expenditures for purposes of operating the business e.g. salary of an

employee in the business.

(iii)'Up to 18 months' entails all expenses incurred 18 months prior to the commencement of production or trading.

- This provision allows an investor in the manufacturing sector to claim expenses incurred '18 months prior to commencement of production' against income, thereby reducing the Corporate Income Tax paid.

2. Capital Allowances are allowable on various capital items for the manufacturing sector.

Covering investment, initial and annual allowances

For detailed explanation of capital allowances, please refer to section 3.1.

3.2.2 Export Sector

Domestic Tax Incentives for the export sector are provided for under the Export Incentives Act.

1. 25% export allowance for non-traditional exports as outlined in the Export Incentives Act.

(i) 'Export Allowance' entails an allowance given to a taxpayer who is an exporter calculated on the taxable income of his business.

(ii) For a business person to qualify for this incentive, they have to be registered as an exporter

(iii) 25% of the taxable income (i.e. net profit) is acceptable as expenditure, therefore this entails 25% of the taxable income will not be subjected to Corporate Income Tax.

- This provision reduces the amount of Corporate Income Tax paid by the Business Entity.

2. 25% international transport allowance for nontraditional exports

(i) 'International Transport Allowance' entails an allowance claimed by the taxpayer who is an international transporter over and above the expenses incurred during the year.

(ii) Nontraditional Exports are exports excluded from the list of Traditional Exports outlined in the Export Incentive Act.

(iii) This incentive is applicable only to international transportation of nontraditional exports

(iv) A person engaged in mining operations shall not be eligible to claim any export allowance or any transport allowance for goods, materials or products exported from Malawi

(v) International transporters of nontraditional exports claim additional 25% of the international transport costs incurred as an acceptable expenditure for that particular year. It is computed by including together with total expenses, 25% of costs incurred during international transportation of nontraditional exports, thereby ultimately increasing expenditures and reducing the amount of taxable income (i.e. net profit)

- This provision reduces the amount of Corporate Income Tax paid by the Business Entity.

***Note 1:** This incentive is accessible to business entities involved in transportation.*

Note 2: Exporting entities, that also have their own transportation costs can also access this incentive

3. Exports are zero-rated for purpose of Value Added Tax.

This implies that exporters can claim input VAT in the course of production. A detailed explanation of the operationalization of the claim is as follows:-

(i) Value Added Tax (VAT) is a general tax on consumption expenditure that is levied on the 'value added' that has been created at various stages in the production and distribution chain. This tax is applied on a wide range of goods and services.

(i) There are 2 rates at which VAT is charged, i.e. Standard Rate and Zero-Rate

- Standard rate is used for supplies that are charged 16.5% VAT
- Zero-rated supplies are charged 0% VAT
- Exempt supplies are not charged VAT

(i) There are 2 types of VAT that are charged by business entities on purchased items and these are:-

- Input VAT is tax charged when one is purchasing items
- Output VAT is tax charged when one is selling items

(ii) Exporters claim from MRA input VAT on standard rated supplies and zero rated supplies.

(iii) Operationally, for Standard rated VAT an exporter will claim input VAT and offset it against output VAT, and remit the balance to MRA

(iv) Operationally, for Zero-rated VAT an exporter claims input VAT and since output VAT is zero, there is an excess and in such a scenario, the exporter claims a refund from MRA

(v) In order to be able to claim VAT, a 'business person' or business entity needs to be registered for VAT.

- Compulsory VAT Registration - business entities with an annual turnover of at least MK10 million have to register for VAT
- Voluntary VAT Registration - business entities with annual turnover of less than MK10 million and want to claim VAT register for VAT voluntarily
- Those trading in VAT exempt supplies (goods and services) do not have to register for VAT

Note: *This zero rate VAT on exports applies to any taxpayer engaged in the export of Malawi produced goods indicated by proof of export*

3.2.3 Agriculture Sector

(i) Claim on capital expenditures are provided for the agriculture sector in relation to the construction of dams, dykes and land preparation are claimable. In this incentive the taxpayer is eligible to claim the full cost on the dam, dyke or land preparation. Capital expenditure entails an element of improvement of a capital item. Revenue expenditures are expenses incurred in order for one to generate revenue.

(ii) For special traders and cases as in the agriculture sector, some capital expenses are treated as acceptable expenses and will therefore be used to reduce net profit and thus reduce income tax.

- This provision reduces income tax payable by the Business Entity.

Growers of tea, coffee, tobacco, sugar, cocoa or such other crop as the Minister may approve, at a plantation level are recognized as manufacturers which means they can claim all incentives available to a manufacturer A plantation is a large piece of land (or water) usually in a tropical or semitropical area where one crop is specifically planted for widespread commercial sale and usually tended by resident laborers.

1. **Annual and Initial allowances on staff housing in the agriculture sector is claimable.** These are essentially Capital Allowances allowable on staff housing specifically for the agriculture sector. A detailed explanation of the operationalization of the claim is as follows:-

(i) The capital allowances covers Initial Allowances, Investment Allowances, and Annual Allowances.

For detailed explanation of capital allowances, please refer to section 3.1.

Please refer to table 7 and table 8 in section 3.4 for specific rates and corresponding capital items.

Note 4: Investment Allowance is not applicable to the Agriculture Sector

(ii) In order to benefit from this incentive the business entity is supposed to submit a return of income attaching the capital allowances schedule at the end of the financial year.

3.2.4 Mining Sector

The whole capital expenditure on plant and machinery is claimable in the first year of operation.

A detailed explanation of the operationalization of the claim is as follows:-

(iii) Capital expenditure, or Capex, are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

(iv) Capital expenditure is treated as revenue expenditure and is used to offset the gross profit, thereby reducing the total taxable income for Corporate Income Tax obligations.

In order to benefit from this incentive the business entity is supposed to submit a return of income attaching proof of capital expenditure at the end of the financial year.

Note: *Those operating in this sector are expected to register but that is not the prerequisite to enjoying this incentive.*

3.2.5 Priority Industry

1. The Malawi Government has, through the Taxation (Priority Industries) Regulations 2013, designated two (2) industries as Priority Sectors, and these are:-

   (i) Agro-processing Sector; and

   (ii) Electricity Generation, Transmission and Distribution Sector.

2. The companies that are accorded the Priority Industry status are given either 0% Corporate Income Tax rates for a period not exceeding 10 years.
3. In order to qualify for the incentives under the Priority Industries Status, the following conditions should be met:-

   (i) Agro-Processing Industries

   - Minimum investment capital of USD 500,000 or its kwacha equivalent for 100 percent local shareholding.
   - Minimum investment capital of USD 5 million or its kwacha equivalent for foreign shareholding.
   - 35 percent value addition

   (ii) Electricity Generation, Transmission and Distribution Industries

- Minimum investment capital of USD 30 million for any type of shareholding

4. In order to benefit from the Priority Industries Status incentive, the procedure is as follows:-

(i) The business entity should submit an application to the Commissioner General of MRA requesting to be considered for the Priority Industry Status. The application should include the following:-

- Application Letter
- Business Plan (the recommended Business Plan outline is obtainable from Malawi Investment and Trade Centre as well as Malawi Revenue Authority)
- Malawi Investment and Trade Centre Investment Certificate
- Certificate of Incorporation in Malawi
- Memorandum and Articles of Association

(ii) Upon receipt of the application, a Tax Incentives committee assesses the application and makes recommendations to the Commissioner General accordingly.

(iii) Specifically the business plan will be assessed based on the following:-

- Shareholding Structure
- Level and Longevity of Investment
- Investment in Plant and Machinery
- Employment of Nationals (skilled and non-skilled)
- Strategic Importance and Forex Generation

Note 1: Submission of application for Priority Industry Status does not entail automatic access to the Priority Industry Status Incentives

Note 2: Priority Industry incentives are not given to an entity that has already accessed other incentives similar in nature to the incentives prescribed by the Regulations

3.3. Summary of Domestic tax Incentives

This section presents a summary of the domestic tax incentives that have been detailed in sections 3.1 and 3.2. Table 1 presents a summary of Income Tax Incentives, and Table 2 presents a summary of exemptions from income taxes.

Table 1: Summary of Income Tax Incentives

	Item	Description	Claimable Rate	Reference
1.	**Pre-business expenses for manufacturers**	In the course of establishing the business	Expenses up to 18 months before commencement of the business	**Section 41 of the Taxation Act**
2.	**Export allowance**	Allowance on taxable income on non-traditional exports (i.e. not un manufactured tobacco and tobacco	25% of taxable income from export sales	**Section 14 of Export Incentives Act and Section 36A of the Taxation Act**
3.	**International Transport Allowance**	Allowance on international transport costs incurred by the taxpayer for his non-	Additional 25% of international transport cost	**Section 41B of the Taxation Act**
4.	**Tax holiday**	Companies operating in priority industry so designated by the	0% not exceeding 10 year period	**Eleventh schedule of the Taxation Act**
5.	**Initial annual and Investment allowance**			**Capital allowances**

6.	Other tax incentives	(i) Duty free importation of qualifying capital goods used in manufacturing, tourism, mining, horticulture, information Technology, and telecommunication (ii) For manufacturing, duty free benefit also applies to raw materials (iii) VAT levelled at 16.5% is reclaimable (iv) Specific goods are VAT exempt or zero rated (v) Industrial rebate scheme: qualifying industries can import raw materials duty free

Table 2: Exemptions from Income Tax

	Item	Description
1.	Capital Gains and Capital Losses	(i) Transfer of capital assets between spouses or between former spouses (ii) Transfer of capital assets from an individual to a trust (iii) On disposal of a principal residence (iv) From shares held on the Malawi Stock Exchange for more than one year. (v) On disposal of personal and domestic assets. (vi) (realised by an individual not used in connection with any trade)
2.	Other	(i) Severance pay of up to K50,000 (only applicable when it is due to redundancy or retrenchment)

3.4.4 Value Added Tax

Value Added Tax (VAT) is a general tax on consumption expenditure that is levied on the 'value added' that has been created at various stages in the production and distribution chain. This tax is applied on a wide range of goods and services. Table 6 presents a detailed narrative of the execution of tax claims on VAT.

Table 6: Execution of Claims on Value Added Tax

Value Added Tax

1. There are 2 rates at which VAT is charged, i.e. Standard Rate and Zero-Rate
   - (i) Standard rate is used for supplies which are charged 16.5% VAT.
   - (ii) Zero-rated supplies are charged 0% VAT
   - (iii) Exempt supplies are not charged VAT.
2. There are 2 types of VAT that are charged by business entities on purchased items and these are:-
   - (i) Input VAT is tax charged when one is purchasing items
   - (ii) Output VAT is tax charged when one is selling items
3. Exporters claim from MRA input VAT on standard rated supplies and zero rated supplies.
4. Operationally, for Standard rated VAT an exporter will claim input VAT and offset it against output VAT, and remits the balance to MRA
5. Operationally, for Zero-rated VAT you claim input VAT and since output VAT is zero, there is an excess and in such a scenario, the exporter claims a refund from MRA
6. In order to be able to claim VAT, a 'business person' or business entity needs to be registered for VAT.
   - (i) Compulsory VAT Registration - business entities with annual turnover of at least MK10 million have to register for VAT
   - (ii) Voluntary VAT Registration - business entities with annual turnover of less than MK10 million and want to claim VAT register for VAT voluntarily
   - (iii) Those trading in VAT exempt supplies (goods and services) do not have to register for VAT
   - (iv) Produce an EFD generated invoice

3.4.5 Capital Allowances

Capital allowances entail a reduction in the amount of corporate tax payable, offered as an incentive for investment in large-scale projects. A certain percentage of the capital asset's cost is allowed as capital allowance during the accounting period in which it was purchased.

(i) Capital Allowances allow the loss of value of a business's capital items to be treated as a current expenditure and thereby be used in the assessment of a business's taxable income. This provision makes the loss of value of a capital item become an acceptable expenditure and is used to offset the gross profit, thereby reducing the total taxable income for Corporate Income Tax obligations.

(ii) There are 3 different forms of capital allowances, as follows:-

- Initial Allowances,
- Investment Allowances, and
- Annual Allowances.a

Initial Allowance is given to the taxpayer in the first year after the taxpayer has claimed the allowance at the end of the year upon submission of financial statements.

Annual Allowance is given to the taxpayer every year from the first year for the lifespan of the capital asset.

Investment Allowance is given to the taxpayer in the first year only.

Note 1: Initial or Investment Allowances are only claimed once in the first year of use of the capital asset.

Note 2: No Investment Allowance can be claimed when Initial Allowance has been claimed. This entails that a business entity can only claim either Initial Allowance or Investment Allowance.

Note 3: Annual allowance is claimed at the end of each year, for the lifespan of the capital assets.

Table 7: Summary of Capital Allowance Rates

	Item	Initial Allowance	Annual allowances	Investment Allowances
1.	**Farm Improvements, Railway lines**	10%	5%	-
2.	**Industrial Building**	10%	5%	• **40% on used buildings**
3.	**Plant or Machinery**	20%	• 10% normal shifts • 17.5% for 2 shifts	• **40% on used plant and machinery**
4.	**Farm Fencing**	33.3%	10%	
5.	**Staff Housing for manufacturers and large tobacco, tea, sugar & cocoa farmers**	10%	5%	
6.	**Commercial building of over K100 million Building**		2.5%	-
7.	**Article, Implements**	20%	Various as determined by Commissioner General	**Various**

Note:
Those who qualify for both Initial and investment allowances are required to choose either of the two but not both. Investment allowance is given to a taxpayer who is also a manufacturer.

Annex 2. Revenue Loss for Different Customs Incentives

National Proc (CPC Code)		Total Revenue Loss
000	Common regime	-
401	Goods Imported under Industrial Rebate	9,666,857,223.70
402	Goods imported under industrial rebate without payment of Excise	613,302,304.15
409	Goods for the use by the disabled	7,099,564.31
411	Equipment and materials approved by the CG for flight catering	38,986,573.53
412	Trade samples of negligible commercial value	1,024,311.14
417	Goods for administrative and technical personnel	483,066,321.87
424	Human remains and parts or ashes	3,266,048.05
427	Goods not being wines, tobacco of a value < MK20000.00 not for sale	233,639.92
430	Goods imported by persons on a bona fide transfer of residence to Mw.	2,745,819,836.13
433	Cups, medals and other trophies	1,925,553.76
436	Deceased person's used personal effects and not exceeding 2 M/V	31,630,226.34
437	One passenger carrying motor vehicle of TH 8702 in every 5 years.	45,042,317.35
438	Goods carrying motor vehicles for horticultural enterprises, education and health	61,330,409.60
439	One passenger carrying M/Vehicle of TH 87.02 in every 5 years for NGO	28,555,563.55
442	Goods used by licensed hotels under the Tourism and Hotels Act.	481,052,669.15
443	M/Vehicles for hire, except used M/vehicle specialised for safaris	922,231,425.88
446	Specific goods for direct use in irrigation as approved by Minister	7,897,640.06

448	Approved goods for horticulture intended for export	11,290,127.35
450	One passenger carrying M/Vehicle of TH 87.02 in every 5yrs for Hotels	19,085,823.26
475	Capital machinery, equipment and other goods for Export Processing Zone	341,644,452.80
477	Specialised Goods for use in the fishing Industry	61,366,883.55
478	Specialized goods for direct use in telecommunication industry	55,503,580.76
481	Goods for use in mining being machinery, plant, equipment & relevant mat	-
490	Goods imported under suspension of duty and guarantee	548,064,286.19
491	Goods cleared on Special Delivery Order	53,965,336.49
403	Goods for the use of the Government	2,949,017,006.03
405	Approved goods for use in Hospitals and surgeries	2,312,390,447.58
406	School stationary and tuition requisites	1,286,452,557.91
413	Tourism publicity documents and material	16,809,436.54
418	Goods for the use of the President of the Republic of Malawi	167,854,907.89
419	Motor vehicle for Cabinet Minister (One for each in every five years)	91,130,757.09
420	Motor vehicles for Member of Parliament (2 for each per term of 5 yrs.)	606,046,092.94
421	Military equipment, vehicles, uniforms & appointments	6,862,229,019.92
435	Sports equipment imported by the Malawi National Council of Sports	21,417,388.10
444	Goods for the use of the Vice President of the Republic of Malawi	41,762,230.21
447	Goods for the use of the retired President of the Rep of Malawi	1,172,778.42
488	Goods for use in water supply	7,047,088.78
489	Goods for use in electricity generation and distribution	2,756,310,653.10

415	Goods for diplomatic missions, embassies and high commissions	12,639,706,542.08
416	Goods for diplomatic personnel	500,647,211.47
422	Goods imported for the use of the church	165,389,312.76
431	Goods imported by Non-Governmental Organisations.	1,275,650,989.78
445	Agreement with other Governments, Organizations and Persons	12,377,700,571.87
451	Undefined	38,832,401.05
492	Undefined	346,488,908.23
		60,694,298,420.64

Source: MRA

Annex 3. Terms of Reference

1. BACKGROUND

The Government of Malawi developed and launched the National Export Strategy (NES) in December 2012 with the primary objective of boosting and promoting exports of the country's prioritised productive sectors. These sectors are the Oilseeds and Oilseeds products, the Sugarcane and Sugarcane products and the Manufacturing sector, which include sub-sectors like *Beverages, Agro-Processing, Plastics and Packaging and Assembly.* The NES is a clearly prioritized roadmap for building Malawi's productive-base and to generate sufficient exports to match the upward pressure on Malawi's imports. It is a key strategy in attaining the goals of Malawi's Growth and Development Strategy II (MGDS II) and central to accomplishing Malawi's desired move into exporting of high value-added goods and services and to reducing the country's reliance on the export of raw or semi-raw commodities. It is worth noting that the manufacturing sector in Malawi accounted for only 10% of GDP in 2011, relying mainly on the processing of agricultural commodities (tea, tobacco and sugar) and is predominantly inward-oriented as only 14% of manufactured products are exported.

The low contribution of manufacturing into Malawi's GDP is due to the limited investments attracted in the sector over the past few decades. As the country aims at promoting private sector development and industrialize in order to become self-sufficient and reduce its reliance on donor support, it is imperative for Malawi to become a competitive destination for both domestic and foreign investment through, *inter alia,* the provision of a business friendly and enabling environment and strategic incentives for investments in the potential productive sectors. Many countries in the region have also sought to improve on their investment climate through the extensive use of investment and export incentives. The effectiveness of incentives in attracting investment is, however, unclear as little consensus has emerged from the ongoing debate. Some experts believe that incentives are ineffective in attracting foreign direct investment, while others argue that investment incentives contributed significantly to the rapid economic growth of countries such as Singapore, Mauritius, China and South Korea.

The literature suggests that investors are attracted by strong economic fundamentals in the host country. The most important of these include available comparative advantages, market size and real income levels, skill levels in the host economy, the availability of infrastructure and other resources that facilitate efficient specialisation of production, sustainable and socially/ environmentally acceptable growth opportunities, trade policies, and political and macroeconomic stability.

The availability of (serviced) land or business premises via lease or purchase at competitive prices, availability of reliable services such as water and electricity, access to business finance, access to information and capacity building measures especially for MSMEs, smooth and transparent procedures for business and other licenses play an important role as well, as do safety and security and general living conditions. For foreign investors fast and transparent processes regarding permits, visa and opening of bank accounts are also crucial. However, the location of investments may also be influenced by various incentives offered by governments to attract foreign investors or encourage local investors to start or expand business. These incentives may take a variety of forms. They include for example fiscal incentives such as tax holidays, lower rates and taxes for investors over a certain period of time, financial incentives such as grants and preferential loans to investors, easy access to serviced land and/or business premises, as well as other incentives like market preferences and monopoly rights.

Although no reliable statistics of the size of these incentives are available, a detailed study by UNCTAD suggests that incentive activities have increased considerably since the mid-1980s. Empirical research shows that international investment incentives play only a limited role in determining the international pattern of foreign direct investment. Factors like market characteristics, relative production costs and resource availability explain most of the cross-country variation in investment inflows. Nevertheless, it is clear that international investment incentives might play a role for investment decisions on the margin.

It is against this background that the Government of Malawi through the Ministry of Industry and Trade (MoIT) in conjunction with the Malawi Investment and Trade Centre (MITC) is inviting Proposals from suitably qualified firms/companies for consultancy services to conduct a comprehensive analysis and review of investment, production and export incentives in Malawi, with a view to proposing and developing strategic and catalytic investment, production and export incentives that could generate the desired investments and exports by attracting both domestic and foreign investors into the competitive productive sectors. The final outcome of this exercise will also feed into the Comprehensive Tax Reform to be undertaken by the Ministry of Finance, Economic Planning and Development in the country.

2. SCOPE OF WORK, RESPONSIBILITIES AND DESCRIPTION OF THE PROPOSED ANALYTICAL WORK

The main objective of conducting this exercise in Malawi is to develop comprehensive incentives, fiscal and non-fiscal, which can be used by the Ministry of Industry and Trade and its marketing Agency, the Malawi Investment and Trade Centre (MITC), in marketing the country's productive sectors to potential domestic and foreign investors and promote existing investors. It would be a compilation of strategic investment and export incentives that would make Malawi an attractive place for investment and complement efforts by the Ministry of Finance, Economic Planning and Development in the field of taxes and revenues

The consultant will work under the supervision and leadership of the Ministry of Industry and Trade (MoIT), and closely with the Malawi Investment and Trade Centre (MITC) and the Department of Revenue in the Ministry of Finance, Economic Planning and Development.

The specific tasks of the consultancy firm shall include, but not be limited to, the following:

1. Conduct an industrial sectoral analysis in Malawi in order to determine the existing and potential viability of the various productive sectors that require government support through targeted incentives.
    a) Thorough analysis of the key productive industrial sectors in Malawi (Manufacturing, Sugar, Oilseeds, Agriculture, Aquaculture, Energy, Agro Processing, Mining, and Tourism) with a view to determining the production levels, share of products in domestic market, share of exported products, employment levels, potential for exports and import substitution, and the need for incentives to boost exports and generate revenue.

2. Provide a comprehensive review of fiscal and non-fiscal incentives including existing investment and export incentives and propose strategic ones that could attract investment and develop exports in the country.
    a) Review the existing investment, production and export incentive schemes (including Industrial Rebate Scheme, EPZs and others) to determine their effectiveness, administration and management by the government of Malawi. Determine the benefits of the current incentives to the industries and companies that are currently using them.
    b) Assess the weaknesses of the current tax incentives in boosting industrialisation, sectoral development and export growth and development.
    c) Propose productive industrial and other sectors of the economy that require progressive incentives based on the outcome of the sector analysis above.
    d) Develop a package of strategic investment and export incentives for the identified competitive industrial and other sectors that have high potential to attract investments and develop exports in the country, reengineering the existing incentives regime by developing both financial and non-financial incentives.

The incentives regime to be developed must be non-discretionary, non-discriminatory, transparent, automatic, performance based and time bound. Additionally, the regime must be designed in a manner that promotes value addition in exports as opposed to exporting primary products. Furthermore, it shall promote innovation and skills and knowledge development, encourage socially and environmentally acceptable business practices, and foster the inclusion of women, youths and people with disabilities in the mainstream economy.

Finally, the incentives regime must promote development of ancillary industries around big projects such as mining projects, exploring the potential of developing Industrial Development Zones (IDZs), and encourage investments in the districts of the country to promote Local Economic Development.

e) Develop and recommend non-fiscal incentives that are key to fast-track industrialization in Malawi.

f) Develop guidelines for the administration of the strategic tax and non-tax incentives based on industry performance.

g) Determine the bottlenecks of domestic entrepreneurs to identify specific incentives to target them.

h) Determine levies that would be imposed on exportation of primary products to encourage processing and value addition, and ways to administer such levies.

i) Align the outcomes of the exercise with the planned Comprehensive Tax Reform in Malawi.

3. Give a brief overview of the more general business attraction, retention and expansion options ('…the provision of a business friendly and enabling environment…') for Malawi as outlined above, and ways to achieve the realization of such options.

4. Suggest options on how to make the information package on the incentives and other supporting measures available to the targeted investors (e.g. marketing via website, brochures, participation in trade fairs).

Deliverables

The company will be required to deliver the following:

- *Inception Report*, highlighting the approach to the assignment and critical areas of focus
- *Draft Report*, detailing the analysed competitive industrial sectors that have high potential to attract investment in the Malawi economy, incorporating the outputs of the tasks outlined above and with reference to the methodology contained there-in.
- *Draft Proposal* of strategic investment, production and export incentives that target the identified competitive industrial sectors and export development in the country. The proposed incentives must be transparent, automatic, time bound and performance based; and comprehensive performance criteria for accessing the incentives.

The Draft Report and Draft Proposal will be presented by the consultant to key stakeholders during a validation workshop that will be funded directly by UNDP (not to be included in the financial proposal).

- *Final Report*, including the strategic investment, production and export incentives.

Implementation Arrangements

The firm/company is expected to be fully self-sufficient in terms of office equipment and supplies, communication, accommodation and transport. Also, the company shall arrange for its own meetings with stakeholders to be interviewed / consulted. The Ministry will assist with an introduction letter and contact details. The company will report and work under the guidance of the Principal Secretary (PS) in constant consultation with the Director of Industry and other allocated staff in the Ministry of Industry and Trade , as well as the Chief Executive Officer for the MITC and the Director of Revenue in the Ministry of Finance, Economic Planning and Development.

Timeframe

The assignment is expected to take 40 man days inclusive of field work, report writing and validation Workshop. The assignment will be conducted over a maximum period of four months. To be noted that the Validation Workshop will be funded separately by UNDP.

A. Methodology

Assignment Approach:

i. Develop a Framework for the assignment to be agreed upon with the Ministry of Industry and Trade prior to undertaking the specific tasks required by the assignment. Preparation of an inception report (4 working days);

ii. Conduct field work and develop draft report and draft proposal (30 working days);

iii. Conduct a validation workshop (1 working Day);

iv. Develop final report (5 working days).

Desk Review:

i. Review the various taxation and investments and trade promotion Acts, including Customs and Excise Act, Export Processing Zone Act, Export Incentives Act, Investment and Export Promotion Act, VAT Act, etc;

ii. The National Export Strategy, Volumes I, II, and III as a basis for this assignment and extract all relevant issues pertaining to the productive sectors;

iii. Use the National Industrial Policy, Trade Policy and other sectoral policies as a guide in the policy orientation of the Government in its industrialization program;

iv. Review the Export Incentives prepared by Malawi Revenue Authority (MRA);

v. Consult other relevant documents that provide information on tax and investment incentives in Malawi and abroad

Consultations:

i. Conduct individual and group consultations that will involve one-on-one interviews and group discussions with relevant Government Ministries and Departments (for example, Ministry of Industry and Trade, Ministry of Finance, Economic Planning and Development), Academia, Technical Agencies (e.g. Malawi Investment and Trade Centre), Development Partners and the Private Sector that are directly or indirectly involved with industrialization in the country;

ii. Facilitate and conduct a validation workshop where a draft industrial analytical report and strategic production incentives report will be presented to a wider group of stakeholders involved.

B. Report Requirements

i. Before each payment, the firm/company will produce a progress report on its work;

ii. Before the final payment, the firm/company will produce a final report compiling all its deliverables.

3. REQUIREMENTS FOR EXPERIENCE AND QUALIFICATIONS

Team consisting of two consultants

The Team Leader assigned by the firm/company to carry out this exercise needs to fulfil the following prerequisites:

- Hold a minimum of Master's Degree or equivalent in Economics or with a focus on industrial investment; development economics. Have a minimum of 15 years professional experience in the field of private sector development, investment promotion with a proven track record of conducting similar assignments in Southern Africa , preferably relating to investment and trade promotion, tax reviews; work experience in other regions of the world is an added value.
- Have thorough knowledge of investment incentives, taxation, industrialization and understanding of strategic issues relating to trade, private sector-led growth, with particular emphasis on the development of manufacturing industries, and ability to undertake sound economic analysis;
- Have knowledge and understanding of theories, concepts and approaches relevant to private sector development with a focus on taxation and investment and export incentives;
- Have ability to conduct data collection using various methods with conceptual analytical and evaluative skills to conduct independent research and analysis, including familiarity with and experience in the use of various research sources;
- Have experience in engaging with high level officials in government and the private sector.
- Have ability to apply judgment in the context of assignments given, plan own work, manage conflicting priorities. Must demonstrate professional competency and mastery of the subject matter;
- Must be conscientious and efficient in meeting commitments, and should observe deadlines and achieve stipulated results;
- Must have experience and social competencies to lead a team of professionals.

The Team Member assigned by the firm/company to carry out this exercise, under the supervision of the Team Leader, needs to fulfil the following prerequisites:

- Hold a minimum of Master's Degree or equivalent in Economics with a focus on industrial investment research; development economics research, industrial and investment policy development.
- Have a minimum of 7 years professional experience in the field of research and policy / strategy development including investment promotion.
- Have thorough knowledge of investment incentives, taxation, industrial policy and strategic issues relating to trade, private sector-led growth, with particular emphasis on development of manufacturing industries, and ability to undertake institutional and economic analysis both quantitative and qualitative;
- Have knowledge and understanding of theories, concepts and approaches relevant to private sector development, and investment promotion and industrial economics, with a focus on taxation and investment and export incentives;
- Have ability to conduct data collection using various methods with conceptual analytical and evaluative skills to conduct independent research and analysis, including familiarity with and experience in the use of various research sources, including desk review, interviews, electronic sources on the internet, intranet and other databases;
- Have ability to apply judgment in the context of assignments given, plan own work, manage conflicting priorities and show pride in their work and in achievements. Must demonstrate professional competency and mastery of the subject matter;

- Must be conscientious and efficient in meeting commitments, and should observe deadlines and achieve stipulated results;
- Must have experience to work in a team of professionals.

Annex 4. List of participants at the first consultation workshop on 7 September 2016

Name	Institution	Contact No.	Email
S.K Chisale (Chairperson)	MoITT	0999869323	chisalek@yahoo.co.uk
Joshua Nthakomwa	MITC	0993886658	jnthakomwa@mitc.mw
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Maurice Chafulumira	MoLYMD		mauricechafulumira@gmail.com

Annex 5. List of stakeholders consulted

Name	Institution	Title
Sungani Mwale	Carlsberg Malawi Limited	Tax Manager
Chiku Ghenti	Illovo Sugar Limited	Group Tax Manager
Fatchi Valeta	MRA	Commissioner, Customs and Excise
Timothy Makamba	MRA	Director, Policy,planning and Research
Mercy Njolomole	MRA	Research Officer, Policy, Planning and Research
Tapiwa Mzunga	MRA	Manager, Exports
Crispin Kulemeka	Ministry of Finance	Director of Revenue
John Mpoha	Ministry of Finance	Revenue Division
Edwin Mshani	Ministry of Finance	Revenue Division
Pokera Kayange	LafargeHolcim	Finance Manager
Martin Mpata	Mapeto DWS	General Manager
Ben Chitsonga	MACRA	Chief Finance Officer
Symon Itaye	Nampak	Managing Director
Ritesh Patel	Bakhresa	Financial Controller
Methuselah Mwangalika	Zagaf Transport	Finance Manager
Christina Chithila	CEAR	Chief Finance Officer
Fredrick Changaya	Candlex	Managing Director
Chaupi Chihana	Presscane	Chief Finance Officer
John Lungu	Quton Limited	General Manager
Tsilizani Ndau	Quton Limited	Accountant
Kedron Chisale	Ministry Industry, Trade and Tourism	Director of Industry
Carol Flore-Smereczniack	UNDP	Deputy Resident Representative
Cinzia Tecce	UNDP	Private Sector Development Specialist
Andrew Spezowka	UNDP	Portfolio Manager - Resilience and Sustainable Growth
Mark Mehrlander	UNDP	Programme Analyst
Titus Kavalo	UNDP	Programme Analyst
Joshua Nthakomwa	MITC	Director, Investment Promotion at Malawi Investment and Trade Center - Malawi Investment and Trade Center
Mtilda Palamuleni	MITC	Services Coordination Manager - One Stop Service Centre at Malawi Investment and Trade Centre
Noel Lihiku	MITC	Planning and Research Manager
Fredda Nyirenda	MITC	Tax Specialist