THE DWINDLING OF CUSTOMS REVENUE COLLECTION BY INTRA-REGIONAL TRADE LIBERALIZATION: IS THERE A POSSIBLE WAY OUT FOR DEVELOPING AND LEAST DEVELOPED COUNTRIES? CASE STUDY OF MALAWI.

Murendere Chaponda*

Abstract

This paper examines the routes that least developed and developing countries may take after seeing their Customs duties downsizing due to an effect of intra-regional trade Agreements. It further investigates the new roles that customs administrations in the LDCs as Malawi will undertake after their traditional role of revenue collection is reaped off due to the effect of trade liberalization. The motivating aspect that led to the development of this paper are the current trade developments in Africa on the expansion of intra-regional agreements that have seen the coming up of the COMESA External Tariff that is binding on COMESA member countries. In addition the undergoing discussions among member countries of SADC, COMESA and EAC regional trade blocs (commonly known as the 'Tripartite') on the proposition of having one free trade union has also been a questioning factor of what will be the future of Customs revenue collection on countries like Malawi that have a considerable dependence on trade taxes. This study used Malawi as a case study country and investigated if domestic tax reform route, exports route or import substitution route could be the probable options for trade revenue replacement. The study is thought to be significant because Malawi is one of the least developed countries that highly depend on taxes of which import taxes forms a substantial revenue base for national income. The research found that Malawi will benefit from increased revenue gains if it implores the option of export growth as opposed to domestic taxes path; as long as those exports are aligned to strike Malawi's balance of trade within the trade union region. The option of import substitution was found viable for Malawi as long as it is tactfully made to be a preparatory phase for setting up a vibrant export regime. Findings on the new path of Customs role after losing out its traditional role of revenue collection indicated that the future orientation of Customs will require moving towards a knowledge-based and customer-orientated model which support timely customer-focused processes and services that minimize the administrative burden on legitimate trade. In addition a more focused approach of the SAFE Framework of Standards and Intelligence-driven risk management will take its course.

Key Words:

Trade Taxes, Trade Liberalization, intra-regional Trade Agreements

1. INTRODUCTION

In many Developing Countries (DCs) and Least Developed Countries (LDCs), import duties and related taxes represent a significant proportion of the national revenue. Owing to this, revenue collection understandably becomes the prime focus for Customs administration of the DCs and LDCs. There has however, been increasing focus on trade facilitation and border protection measures in many DCs, with particular emphasis on the enforcement of import and export prohibitions and restrictions, including those arising from Free Trade Agreements. The current global trend shows a paradigm shift, even among DCs and LDCs, from Customs traditional focus on revenue collection to diversified activities that promote trade facilitation, global free trade and border security.[1] Frameworks such as the WCO SAFE Framework of Standards to Secure Global Trade, The Kyoto Convention and World Trade Organization (WTO) Trade Facilitation Agreement have provided a higher standard for Customs that goes beyond revenue collection.

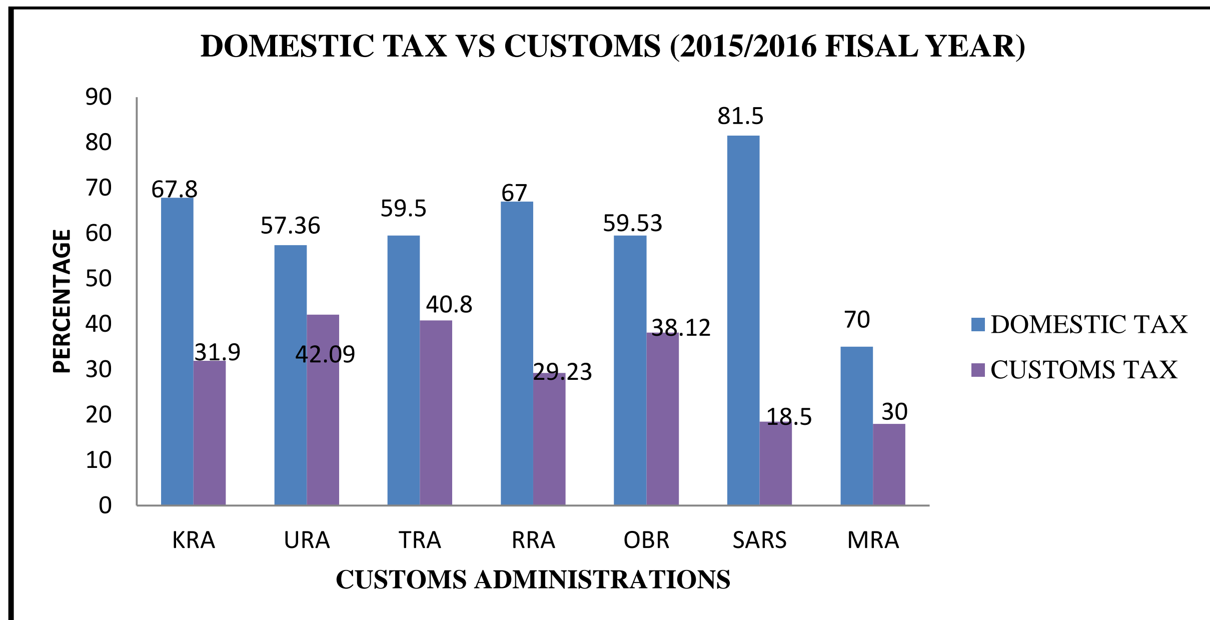
Customs focus on revenue collection is to continually diminishing on one hand because of the integration of trade among countries through tariff liberalization reached through multilateral and bilateral trade agreements. These agreements have in one way or the other affected the trade regime of the signatory countries and Customs authorities have been the first players to experience the impact of trade liberalization through distortions in collection of trade revenues. Removal or reduction of trade taxes is a major issue for consideration in undertaking tariff liberalization. This research found that trade taxes still form a significant contribution to overall tax collection by revenue administrations in East and Southern Africa. The graph below covers the fiscal year 105/2016 and presents the percentage of Customs collection against domestic tax collection in some of the Eastern and Southern African member revenue authorities. It covers the Kenya Revenue Authority (KRA), Uganda Revenue Authority (URA), Tanzania

---

* Murendere is a Customs Officer who has worked in various Customs clearance departments which includes Declaration Processing Centre, Inland and Border Stations and Technical Department of the Malawi Revenue Authority's Head Office.

[1] Southern African Customs Union (SACU), *'SACU Customs Policy'* (2012). Available at http://www.sacu.int/docs/policy/2012/customspolicy.pdf

Revenue Authority (TRA), Rwanda Revenue Authority (RRA), Burundi Revenue Authority (OBR), South Africa Revenue Service (SARS) and the Malawi Revenue Authority (MRA).



Source: URA, 2017[2]

The graph above shows that Customs taxes forms a large percentage of the total fiscal revenue collection in several African States. For the fiscal year 2015/2016, Malawi and all countries in the East African Community had their trade taxes accounting for over 20% of their total fiscal revenue. Additionally, a study conducted by Amanda and Mathew noted that all the countries in the Southern African Customs Union (SACU) except South Africa heavily depend on Customs duties, with specific countries like Botswana, Lesotho, Namibia and Swaziland (commonly termed the 'BLNS') having their trade taxes accounting between 10% and 30% of GDP; and between 27% and 65% of government revenue.[3] These findings depicts the critical role that Customs revenue plays in financing governments activities.

The current global trend continues to show a shift towards free trade areas in Africa with member States of the Common Market for East and Central Africa (COMESA) trade bloc merging into a Common External Tariff (CET), with the East African Community (EAC) making a similar shift. In addition, The Tripartite Free Trade Area Agreement (TFTA) signed in Sharm-el-Sheikh, Egypt on 10 June 2015 by 26 member countries of COMESA, EAC and

---

[2] Uganda Revenue Authority, *"EARA Comparative Revenue Analysis"* (2017), p10. Available at http://www.ura.go.ug/Resources/webuploads/GNRART/EARA COMPERATIVE REVENUE ANALYSIS 2015-16.pdf

[3] Jitsing Amanda and Stern Mathew, *"VAT Practices within SACU and possibilities for harmonization",* World Bank Regional Integration Project (2008) p7.

the Southern African Development Community (SADC).[4] The agreement aims to create a continental free trade area that uses on Common External Tariff (CET) among member States of SADC, COMESA and the EAC. The question raised by these developments is: *'How will the shift from the traditional Customs role of revenue collection be adopted by DCs and LDCs to maintain the status quo in revenue collection?'*

This research investigates other alternatives for replacing the dwindling Customs trade taxes by focusing the possible tax bail out strategies for enhancement of national income, and further defines a new role for Customs. The research focuses on Malawi, which is a signatory to a number of regional trade agreements as well as bilateral and multilateral trade agreements.

2. PROBLEM STATEMENT

Looking at the available literature, previous research so far found that there is a direct correlation between countries' reliance on international trade tax and the country's income levels.[5] This assertion is positively proven with the understanding that most of the DCs and LDCs usually lack administrative capacity, which in turn reduces the efficiency of domestic tax collection. In addition, these economies also possess large informal and subsistence sectors implying that a considerable amount of transactions is not taxed. Taking the National fiscal budget into perspective and considering the narrow domestic tax bases, governments are thus geared to be highly depended on easy-to-tax sources like international trade taxes as the alternative to increasing their revenue scope in order to meet their fiscal needs. However, the shift towards trade facilitation and liberalization does pose a serious issue for governments in implementing trade and tax reforms.

Malawi, one of the LDCs located in the South-Eastern Sub-Saharan Africa that is substantially dependent on international trade taxes as a reliable means of financing its economy. On average, Malawi's Customs revenues contribute about 30% of the total trade taxes and 25% of the National fiscal Budget.[6] As noted above, although the international trade revenue has

---

[4] Luke David and Sodipo Babajide, "Launch of the Continental Free Trade Area: New prospects for African trade?" Bridges Africa, Volume 4 Number 6, 25 June 2015. Available at https://www.ictsd.org/bridges-news/bridges-africa/news/launch-of-the-continental-free-trade-area-new-prospects-for-african.

[5] Pupongsak Suparerk, `The effect of trade liberalization on taxation and government revenue`, University of Birmingham (2009) p142. Unpublished.

[6] Bamusi Innocent, "Determinants of Customs Revenues in Malawi: The case of tariff Liberalization in Malawi 1994-2011", University of Malawi (2014) p7. Unpublished.

gradually become less important in many developed countries, it remains a major source of government finance for many developing countries like Malawi. For the period 2012 to 2014 Malawi lost approximately **US$11,722,793.09** (Computed from MRA's Customs ASYCUDA++ System) of trade taxes through bilateral and regional trade agreements. Noting the shift towards comprehensive trade integration among African with the growing popularity of the tripartite free trade agreement and other Customs Administration tariff alignments such as COMESA CET, there is need for a more clear understanding of what will replace the Malawi Government's trade taxes to keep the revenue at the same level of the foregone trade taxes. This paper explores domestic ways that are the best possible alternative that offsets the foregone Customs taxes. General answers as provided by previous studies in other countries are not likely to be very helpful for Malawi owing to the differences in economic structure, tax administration systems and political obstacles.

3. OBJECTIVES

The overall objective of this research is to investigate the possible revenue alternatives that will cover the foregone Customs taxes after Malawi fully commits itself to the upcoming intra-regional tariff phase down, including the COMESA CET programme and the tripartite agreement still in discussion. The paper also tackles the likely future direction that Malawi Customs Division will take after shifting from the traditional role of revenue collection. Specifically the research undertakes to achieve the following objectives.

1. To investigate the effect of the current Malawi's balance of trade on the economy and how best it may inform export revenue gains.
2. To investigate the position of domestic taxes on revenue growth worthy enough to cover phased down trade taxes.
3. To investigate if import substitution may be a good alternative for more revenue gains.
4. To investigate the future role that Customs administration will undertake after shifting from the tradition role of revenue collection.

4. LITERATURE REVIEW

Section 4.1 below presents the theoretical literature on trade taxes and trade liberalization while section 4.2 presents empirical literature on the same.

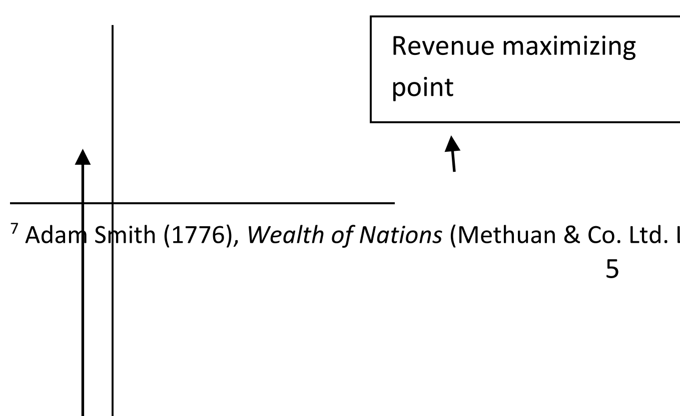
4.1. Theoretical Literature

The theoretical literature below will present the relationship between trade liberalization and government revenue in 4.1.1 and will present the association between trade liberalization and devaluation in 4.1.2.

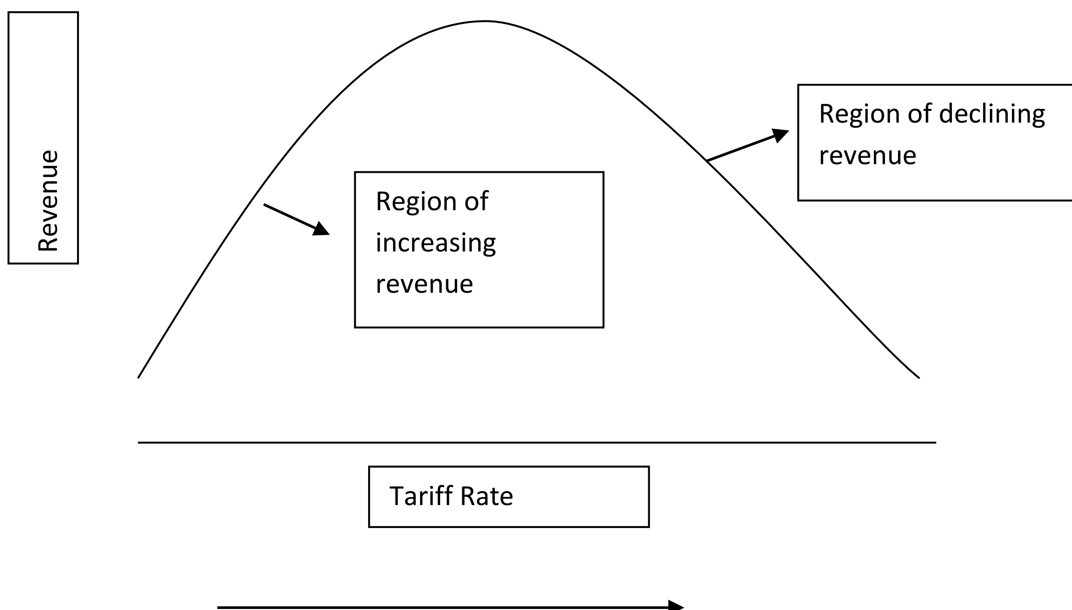
4.1.1 Trade liberalization and government revenue

Several theories have been developed on the effects of changes in tariff rates on government revenues. In the Wealth of Nations, Adam Smith[7] states that higher taxes may result in government yielding smaller revenues. He argues that the higher tax may on one hand deter importation hence diminishing the consumption of the taxed commodities locally, and on the other hand encourage smuggling as people will find means of by passing the revenue collecting body as a means of relieving themselves from higher trade tax charges. To illustrate this effect better, the Laffer curve has been used to show the relationship between tax revenues and the tax rate as given below. It plots total tax revenue against the tax rate and recognizes two rates at which given revenue can be collected, the normal range (being the region of increasing revenues as shown in Figure 4 below) and prohibitive range (region of declining revenues).

Figure 1: Laffer Curve



[7] Adam Smith (1776), *Wealth of Nations* (Methuan & Co. Ltd. London, 1904) p. 137.



Source: Bamusi, I.(2014)[8]

Observation from the Laffer Curve given above is that when the tariff rate is very high, reducing the rate increases revenues from the tax but when the rate is low, reducing the rate reduces revenues. Quantitatively the Laffer curve indicates that at zero tariff rate the collected revenue is zero while at 100% tariff rate the collection rate would still remain at 0. This implies that that revenue is at a maximum when the tariff rate is placed at a rate between zero and 100%. When the trade regime is very restrictive because of high tariff rates, trade volumes are likely to be severely compressed. Reducing restrictions will result in a strong increase in trade volumes. This will more than compensate for the lower tax rate, leading to higher trade tax revenues. However, when the trade regime is already fairly liberalized, any further reductions in restrictions will not cause a sufficiently large increase in trade volumes to offset the lower tariffs and the overall revenues will therefore decrease.[9] With unchanged import values, a reduction in tariffs reduces Customs revenues and can also be accompanied by reductions in revenues from excises and Value Added Tax (VAT) levied on imports at the importation stage. Such a change in relative prices would typically induce changes in the level and composition of imports and exports. The revenue outcome thus depends also on the price elasticity of

[8] Bamusi Innocent, "Determinants of Customs Revenues in Malawi: The case of tariff Liberalization in Malawi 1994-2011", University of Malawi (2014) p7. Unpublished.

[9] Ebrill Liam, Janet Stotsky, and Reint Gropp (1999) *"Revenue Implications of Trade Liberalization"*, IMF Occasional Paper 180, Washington D.C; Agbeyegbe Terence, Janet Stotsky, and Wolde Mariam, "Trade Liberalization and Tax Revenue Relationship in sub-Saharan Africa, IMF working paper, WP/04/178, September. 2004, p5.

demand for imports and the price elasticity of supply of import substitutes. If imports are sufficiently price elastic, there may be a revenue gain.

4.1.2 Association between trade liberalization and devaluation.

Trade liberalization is often accompanied by a devaluation of nominal and real exchange rates, which raises the domestic value of imports, with a positive effect on trade tax revenues.[10] In effect, the domestic cost of government spending programmes increases hence consumption switches from tradable to non-tradable goods. This incidence results in trade tax revenues declining and domestic indirect taxation increasing. Trade liberalization could have long-term revenue effects by enhancing the domestic market growth performance. If growth increases then increased income levels will translate into a large base for domestic direct taxation.[11]

4.2 Empirical Literature

Previous studies found varying results on the effect of trade liberalization. The Economic Commission for Africa (UNECA) study on fiscal implication of trade liberalization on African countries found that trade liberalization is a potential source of fiscal instability for African countries because of their high dependence on international trade tax.[12] UNECA used the Generalized Method of Moments of Arellano and Bond[13] to estimate both tax revenue and trade tax revenue Regressions. The estimation focused on all African countries except Democratic Republic of Congo, Eritrea, Liberia, Libya, and Somalia over the 1980-2002 period. The study found that the decrease in trade tax revenue can be matched by an increase in revenue from domestic tax, and in particular VAT. The study by UNECA concluded that that sound macroeconomic environment is critical to preventing fiscal distress during trade liberalization and effective institutional reform is likely to help fiscal consolidation.

In a review of African countries' experience of fiscal impact of trade liberalization, a study by Fukasaku (2003)[14] realised that the overall impact of trade liberalization in sub-Saharan Africa is ambiguous and depends on a multiplicity of facts such as the nature and sequencing of reforms. In an examination of 22 African countries, Fukasaku, found that trade liberalization

---

[10] United Nation Economic Commission for Africa (UNECA), 'Economic Report on Africa' (September, 2004). Available at https://www.uneca.org/sites/default/files/ PublicationFiles/era2004full.pdf

[11] Ibid.

[12] Ibid.

[13] Arellano Manuel and Stephen Bond, "Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations (1991)". *The Review of Economic Studies,* 58. pp. 277 – 297.

[14] Fukasaku, Kiichiro, "Fiscal Impact of Trade Liberalization: A Review of Recent Country Experience in Africa (2003)," UNECA, Addis Abbaba.

had contributed to declines in the ratio of trade to total government revenue of more than 20% in Mauritius, more than 10% in Côte d'Ivoire and Senegal, and more than 5% in Cameroon, Tunisia, and Mozambique. In many of the countries, it was found that domestic resource mobilization was fairly weaker. Similarly, a study by Ebrill et al. (1999)[15] found that many developing countries implemented trade reform as a means of avoiding significant revenue losses. The study concluded that trade liberalization could be tailored to avoid adverse consequences, for example, with improved Customs administration and reduction in exemptions, non-tariff barriers, and regulations. Nevertheless, the study found that in the long-term, trade liberalization inevitably reduces the total share of revenue derived from trade taxes and to ensure that revenue is maintained, domestic tax reforms must accompany trade liberalization.

5. METHODOLOGY

This study is Qualitative and adopts an explanatory case study approach to match patterns from our analysis of the literature and key informant interviews. The research seeks to respond to the following question: *What key possible alternatives of revenue generation should Malawi Government undertake to replace Customs trade taxes when the region goes into a Free Trade Zone Area?* The research has been prepared following an extensive review of available literature and discussion with key informants in Malawi. The greater part of the findings of this research is based on Secondary data analysis and a little of primary data arising from discussions held with key informants of the Malawi Revenue Authority.

6. FINDINGS

In order to find the best alternatives for Customs trade tax replacement the research reviewed literature on what other developed and developing countries did or are doing to generate the required national revenue without relying on trade taxes. The research then analysed the capacity of Malawi by checking its weaknesses and strength and eventually defined the best possible position that Malawi could exploit to regain economic empowerment when trade tariffs are removed. The last part of the findings outlines the investigated reforms that Customs

---

[15] Ebrill Liam, Janet Stotsky, and Reint Gropp (1999) *"Revenue Implications of Trade Liberalization"*, IMF Occasional Paper 180, Washington D.C

authorities may undertake as part of their responsibility after being diverted from revenue focus.

A study by Pupongsak[16] identified three possible routes for dealing with the effects of decreased trade revenue collection by utilizing trade as a growth generator, namely; adopting an export promotion strategy, increasing in domestic demand, and import substitution. This research therefore undertook an in-depth analysis of Malawi stand in respect of these routes to unveil the most appropriate course for Malawi to take to generate revenue growth.

6.1 The Route of Exports Exploitation

In order to understand a country's trade regime, the study on balance of permits plays an important role. This research therefore studied how the import and exports trade between Malawi and the global community had been fairing for a period of ten years to 2016. The period of ten years was considered sufficient to enable drawing of reliable conclusions on Malawi's global trade position. Table 1 below presents a tabulated status of imports and exports performance of Malawi government for the period 2006 to 2016.

Table 1. Total Goods Trade flows and balance

Period	Imports		Exports		Balance		Total trade	
	Value (Mio£)	Growth* (%)	Value (Mio£)	Growth* (%)	Value (Mio£)	Growth* (%)	Value (Mio£)	Growth* (%)

[16] Pupongsak Suparerk, "The effect of trade liberalization on taxation and government revenue", University of Birmingham (2009) p142. Unpublished.

Annual data								
2006	967		532		-434		1499	
2007	1012	4.7	638	19.8	-374	-13.9	1649	10.0
2008	1504	48.7	604	-5.3	-900	140.6	2108	27.8
2009	1452	-3.4	848	40.5	-604	-32.9	2300	9.2
2010	1642	13.1	805	-5.0	-837	38.5	2448	6.4
2011	1747	6.4	1023	27.0	-725	-13.4	2770	13.2
2012	1816	3.9	921	-9.9	-895	23.5	2773	-1.2
2013	2145	18.1	910	-1.2	-1235	37.9	3055	11.6
2014	2091	-2.5	1011	11.1	-1080	-12.5	3103	1.5
2015	2085	-0.3	973	-3.8	-1112	2.9	3058	-1.4
2016	1885	-9.6	983	1.0	- 902	-18.9	2868	-6.2

Source: European Union, 2017

The results from table 1 above shows that just like many of the LDCs Malawi registered a trade balance deficit for the whole period of 10 years from 2006 to 2016. The growth rate of balance of permits indicates a fluctuated movement. However, the data shows that there were more increases than decreases in the growth rate of balance of permits. The overall trade shows there is growth for both imports and exports but with exports failing to grow exponentially compared to imports. In the year 2016 Malawi realized a balance of permits record figure of 902 million pounds. This current state on Malawi's balance of trade tells us that something has to be done to boost the exports industry but the question is: *how can Malawi boost its exports industry to benefit more out of trade liberalization in a way that offsets the losses made in trade taxes?* This requires further investigation on Malawi's top trading partners to determine if their partnership is capable of inducing exports growth. Table 2 below provides a list of Malawi's top trading partners.

Table 2. Total trading partners 2016

IMPORTS					Exports				Total Trade		
	Partner	Value	Share in world		Partner	Value	Share in World		Partner	Value	Share in World
		(Mio£)	(%)			(Mio£)	(%)			(Mio£)	(%)
	World	1,885	100.0		World	983	100.0		World	2,868	100.0
1	South Africa	377	20.0	1	EU 28	262	26.6	1	EU 28	488	17.0
2	China	257	13.7	2	Zimbabwe	127	12.9	2	South Africa	448	15.6
3	EU 28	226	12.0	3	Mozambique	108	11.0	3	China	302	10.5
4	India	203	10.8	4	South Africa	71	7.2	4	India	233	8.1
5	UAE	182	9.6	5	USA	58	5.9	5	UAE	209	7.3
6	Zambia	106	5.6	6	China	45	4.5	6	Mozambique	165	5.8
7	Mozambique	58	3.1	7	Egypt	36	3.6	7	Zimbabwe	147	5.1
8	USA	55	2.9	8	Russia	35	3.5	8	Zambia	115	4.0
9	Mauritius	51	2.7	9	India	30	3.0	9	USA	114	4.0
10	Japan	38	2.0	10	Ukraine	29	2.9	10	Russia	59	2.1

Source: European Union, 2017[17]

The results from table 2 above depicts that on the import side, Malawi often trade with four countries from Africa and other six countries outside the African continent. A key feature of Malawi's four African trading partners is that they fall within the intra-region trade agreements of which Malawi is a member also. Thus the given countries belong to either COMESA or SADC or both. However, on the export side it shows that some of the African countries that Malawi imports most from are not available on the exports side for example Mauritius and Zambia. The Republic of South Africa (RSA) features in both sides but Malawi's import value from RSA surpasses the value of its exports to that member country. Similarly, when comparing the overall balance of trade between Malawi and its African counterparts it shows that imports values summation is £592 million while the Export side is £342 million.

The research further investigated the balance of trade between Malawi and other member States within the SADC/COMESA region. The aim was to investigate how active is Malawi in terms

[17] European Union (2017) *'trade in goods with Malawi'*. Available at *http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147317.pdf*

of trade with other individual members which it shares the same trade blocs with. The table 3 below provides balance of trade details in the 2015 fiscal year.

Table 3: Balance of Trade between Malawi and SADC/COMESA (2015)

COUNTRY	EXPORT (mioU$)	IMPORTS (mioU$)	TRADE BALANCE (mioU$)
EGYPT	56.90	5.82	51.08
ZIMBABWE	64.30	25.00	39.30
UGANDA	13.35	1.18	12.17
RWANDA	1.4	0.093	1.31
BURUNDI	0.737	0.002	0.74
SUDAN	1.62	0.0495	1.57
DRC	1.60	0.482	1.12
ETHIOPIA	0.273	0.657	- 0.38
SEYCHELLES	0.168	0.830	- 0.66
SWAZILAND	0.185	23.780	- 23.60
MADAGASCAR	0.096	4.63	- 4.53
KENYA	15.30	30.90	- 15.60
South Africa	75.30	448	- 372.70
Tanzania	21.10	53.30	- 32.20
Mozambique	46.90	70.70	- 23.80
MAURITIUS	4.24	21.00	- 16.76
ZAMBIA	21.20	119.00	- 97.80
TOTAL	**324.669**	**805.424**	**- 480.75**

Source:*oec tree map*

6.1.1 Implications

Although exports have boosted economic growth in several countries such as South Africa, Japan and China,[18] this current study has established that the Malawi Exports industry is not yet vibrant and its revenues may not replace the trade taxes that may come with trade liberalisation. In both table 2 and table 3, a problem has been realized that Malawi is not active in exporting goods to its trading partners within the region. Table 3 indicates that Malawi has a negative trade balance with most of its African trade partners within the SADC region. The implication is that in this case trade liberalization will work well for those actively exporting countries than actively importing countries. This research therefore serves as a wake-up call to Malawi and other Least developed countries to ensure that once they enter into intra-regional trade agreements they must create a substantial exports base to be traded in the partnering member states.

[18] Verah Songwe and Deborah Winkler, “Exports *and export diversification in sub-saharan Africa* (2012)”. Working paper 3, Brookings, Washington D.C, USA

The study further investigates Malawi's future outlook if it fails to increase its exports base in the presence of reduced trade taxes. The likely position is that the import volumes would increase hence worsening the trade balance and the eventual absence of corresponding export increases would lead to a trade deficit which would further result in a current account problem. In this regard there is need for political will to initiate the expansion of Malawi's export base beyond traditional exports to processed goods that would compete with other products in the liberalized region. Support by government through funding of exports-based infrastructure may be a better option coupled by a government appeal to appreciate locally made products as part of industrial growth strategy.

6.2 The Domestic Tax Route

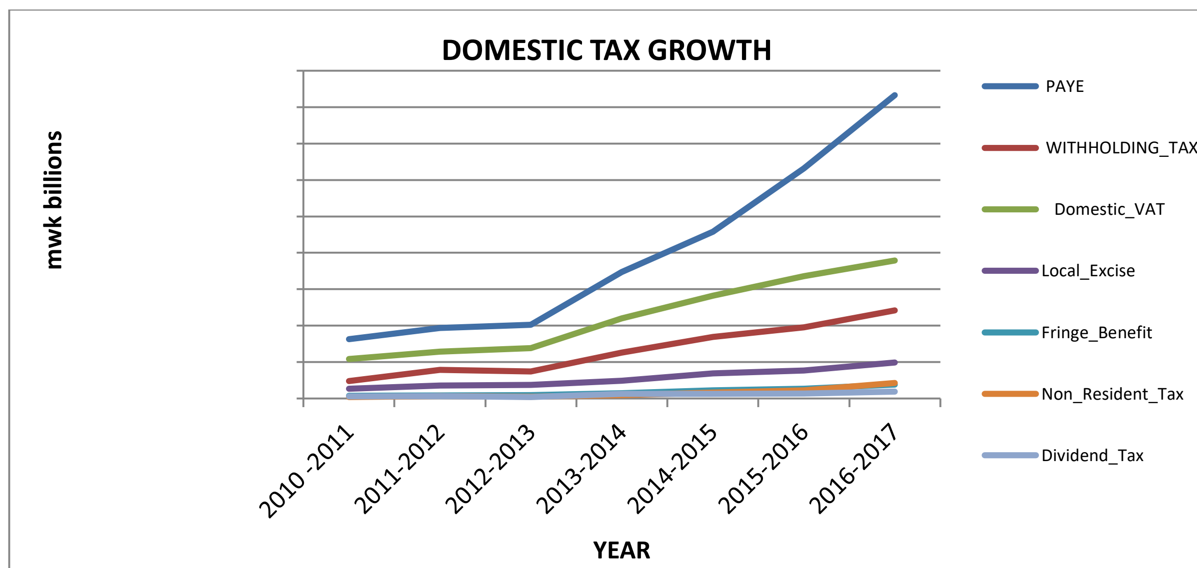
Increasing of domestic tax base is one of the suggested routes that this study adopted to explore if it may be a measure possible enough to generate the required revenue that may offset trade taxes for Malawi. The Malawi tax system is a mixture of direct and indirect taxes. Direct taxes are typically based on taxpayer's wealth/income. A direct tax is the one that the tax payer pays directly to the revenue authority for example income tax while indirect taxes are those which are collected indirectly by the revenue authority from the supplier who then attempts to pass on the tax to final consumer for instance VAT. There are basically five main groups of the domestic tax bands in Malawi, namely: taxes based on income (thus for both corporate or individuals e.g. Pay As You Earn), taxes based on wealth (estate duty), sales taxes (e.g. VAT, Turnover tax and withholding tax) and domestic excise duties. Investigation was undertaken to identify if the current position of the Malawi domestic tax system is sufficient to raise the revenues required to cover the foregone trade taxes.

A review of literature revealed that in the few past decades international institutions such as the World Bank and IMF had made suggestions to developing countries to consider replacing trade taxes with domestic consumption taxes particularly VAT, and income taxes particularly corporate income tax.[19] Presently, the Malawi Revenue Authority are doing their best to control leakages through modern methods of collecting taxes using technology based systems such as the introduction of electronic fiscal devices in 2014 and intensifying of web-based electronic payments.

[19] Reuven S. Avi-Yonah and Yoram Margolioth, "Taxation in Developing Countries", University of Michigan Law School (2007), p3.

However, the study established that Malawi has a relatively large informal sector (when compared to formal sector) which may not be easily taxed. It is noted that alike many developing countries, the income tax base in Malawi is mostly comprised of wages of public sector employees because most other taxpayers are self-employed or small businesses who completely evade payment of income tax by deliberately understating their financial position to be outside the tax brackets. The graph below shows the performance of various types of domestic tax revenue collection.

Graph 1: Revenue Performance by Domestic Tax Type



Source: *Author's computation (from MRA's Revenue Table 1)*

Results from the graph above indicate that among all tax types only PAYE has been having a sharp increase in revenue growth as compared to other tax types. In order to understand the reason, it was found that PAYE taxes comes from a pool of companies who are royal in tax remittance and it is easily done through direct deduction of the tax from employees' salaries. However narrow tax base and non-tax compliance of traders especially those in the informal sector (which forms a larger market size) affects revenue collection of the other types of taxes. This research found that like PAYE, the tax growth of VAT would have also been impressive but it faces more cases of system manipulation whereby people challenge the use of electronic fiscal devices by intentionally printing lower values than the selling prices to reduce the VAT taxable values.

This study therefore concludes that domestic tax revenue growth in a country characterized by an informal sector market where issues of tax evasion in domestic taxes are high like in Malawi,

trade taxes may not be easily replaced by domestic taxes. To this effect tax reforms to increase revenue collection base, encourage voluntary tax remittance and control tax avoidance and evasion in less developed and developing countries are critical for domestic tax revenue growth. Currently, Malawi is in the course of modernizing and automating its domestic tax systems for effective collection of domestic taxes through implementation of measures such as the electronic tax payment system (integrated with banks) and fiscal electronic fiscal devices for issuance of authorized tax invoices. However, there is still more to be done on automation and enforcement measures. Meanwhile it could not be objective for Malawi to completely move away from trade taxes until its domestic tax system is reformed to generate revenues enough to cover the percentage contribution of trade taxes in the National Income.

6.3 Import substitution route and Smart Protectionism

Finally import substitution is one such an option that a country may take to boost its trade domestically. Import substitution is a strategy that reduces the country's foreign dependency and appreciates the domestic production by substituting the imported goods with the locally produced goods.[20] This strategy works by having the State lead economic development through nationalization and subsidization of vital industries and aims at protecting the domestic industries (i.e. infant industries) up to the time that they will be able to compete with the foreign industries.[21]

In the sugar industry, Malawi has ILLOVO Sugar Corporation, which is benefiting from import substitution advantage and this helped the company with a sound financial muscle that has seen its products soaring on the world market.[22] Sugar is one of the main export products from Malawi. According to FAO,[23] sugar is currently the second largest export revenue earner in Malawi after tobacco. The first sugar cane plantation dates back to the 1960's in southern Malawi and the second plantation in the North Central region, along with the introduction of out-growers, to the 1980s. By 2009/10, approximately 300 000 tonnes of sugar, 73 000 tonnes of molasses and 19 million litres of alcohols, including ethanol, are being produced annually. Approximately 70% of the sugar is sold on the domestic market and 30% internationally (50%

---

[20] Brian Nelson, "*A comprehensive dictionary of economics*" (2009). p.88, e.d.

[21] Street James and James Dilmus, "Structuralism and Dependency in Latin America (1982)". *Journal of Economic Issues,* 16 (3) p. 673-689

[22] Food and Agriculture Organization (FAO), "*Analysis of price incentives for sugar in Malawi 2005-2013*", Technical notes series, MAFAP, Rome (2015) p2.

[23] Food and Agriculture Organization (FAO), "*Analysis of price incentives for sugar in Malawi 2005-2013*", Technical notes series, MAFAP, Rome (2015) p2.

to Europe under preferential trade agreements). Borrowing from the same example, this paper finds import substitution as one of the better alternative which Malawi may benefit from and that in the long-run such companies may benefit from economies of scale and be able to compete their products on the international market. Import substitution may be important for Malawi as a preparatory phase in the first place for boosting its export base in the second phase. However achieving an import substitution method is not all that easy as it may appear. It will require a policy making body of the ministry of trade and industry to analyse the world market trend and come up with industries that shows potential of international business that Malawi may take advantage. This will result to boosting up of potential infant industries through import substitution pending for its growth to a vibrant export industry.

However, in-terms of exports, it may be important for the Government to promote locally based industries as opposed to foreign industries, which take privilege of Malawi's comparative advantage of cheap labour and resources but end up not remitting their export proceeds back to Malawi. In such a case Malawi is only used as a production base of whose profits are put in offshore accounts and not for the benefit of Malawi.

Nonetheless, import substitution alone cannot form a better base to yield enough revenue growth that replaces trade taxes but coupling it with a vibrant exports industry may be a success story.

6.4. The Future Role of Customs

The last part of the study undertook to investigate what will be the future role of Customs after shifting from the tradition of revenue collection. Through literature the research discovered that the future orientation of Customs will require moving towards a knowledge-based and customer-orientated model. Staff competencies will need to support timely customer-focused processes and services that minimize the administrative burden on legitimate trade. Following the provisions on SAFE Framework of Standards the Malawi Customs authority will have to migrate to a more *Intelligence-driven risk management*, which will have a more sophisticated understanding of the risk continuum. This will strengthen the cross-border security and as well protecting the society perspective. With removal of Customs duties, it is expected that the *Customs trade partnership will improve* as Customs authorities in the absence of strenuous revenue targets will better understand the concerns of business, while businesses will also better understand the requirements of Customs.

7. CONCLUSION

This study aimed at identifying ways that least developed countries like Malawi, which substantially depend on trade taxes, can take in order to forego trade taxes and further open their markets in response to the call for trade liberalization and regional integrations. The study sought to find options that may replace the foregone trade taxes to maintain the government's status quo in terms of national income. The study focused on the GDP's components of Net Exports and taxes which finance government expenditure.

The study found that Malawi's trade balance (net exports) is negative with most of the countries within the SADC/COMESA region. It further identified that Malawi is not active in terms of exports in Africa but has most of its export market mostly in agriculture produce outside of Africa.

In order to effectively gain from the intra-region trade liberalization agreements, this study proposes that Malawi needs to develop its export capacity, which will increase its share of goods being traded across the member countries that shares same trade bloc with Malawi. This will enable striking of a trade balance and reciprocal gains from trade partnership as the revenue collected from export proceeds may cover the revenues that were used to finance government expenditure from trade taxes perspective.

This research also explored the domestic taxes route to identify if Malawi has reliable domestic tax collection controls and collection base that can sustain the national income in the absence of trade taxes. The findings were that Malawi has a relatively large informal sector (when compared to formal sector) which is not easily taxed. Results indicated that among all tax types only PAYE had a sharp increase in revenue growth as compared to other tax types. It found that PAYE taxes were easy to collect as they were directly deducted from employees' salaries and comes from a pool of compliant companies. However, other taxes did not carry a similar growth potential due to narrow tax base and non-tax compliance of traders especially those in the informal market sector, which forms a larger market size for Malawi. This study therefore concluded that domestic tax revenue growth in a country characterized by an informal sector market where issues of tax evasion in domestic taxes are high like in Malawi, trade taxes may not be easily replaced by domestic taxes. The study therefore proposed for domestic tax reforms that will increase revenue collection base, encourage voluntary tax remittance and control tax avoidance and evasion.

The study found import substitution strategy as the best preparatory stage for growth of exports. However this is to involve the ministry of trade to select the products which when promoted would yield maximum economic gains on the external market to provide enough revenues that offsets the lost trade taxes. The Government would also take the course of funding industries that have potential of penetrating external markets. However strong remittance controls would have to be put in place such that the export proceeds would be retained for consumption in Malawi other than externalized.

In conclusion, this study found that reforming the domestic tax division for increased and effective revenue collection and growing the exports industry for intra-regional trade would form the best alternative to offset trade taxes that may be foregone due to intra-regional trade liberalization. However, the domestic tax reforms and exports growth has to firstly be achieved before fully removing the trade taxes.