Sustainable Development Impacts of Investment Incentives

A Case Study of Malawi’s Tourism Sector

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Abstract

This study seeks to determine the link between investment incentives and foreign direct investment (FDI) flows in Malawi’s tourism sector and also to question whether these incentives have promoted sustainable development in the country. It finds that investment incentives do not determine FDI in the tourism sector; rather, decisions to invest were largely driven by the country’s natural resources; the cost of raw materials; the availability of relatively cheap labour; and the inflation, foreign exchange and interest rates. This suggests that the type, nature and quantity of FDI in the tourism sector is shaped by other government policy such as promoting increased private sector participation rather than by investment incentives per se. It therefore follows that this has implications for Malawi’s sustainable development goals, especially the role of investment incentives in shaping the economic and social impacts of investment, as well as environmental impacts, which the incentives seem to have affected negatively.

About the authors

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The Trade Knowledge Network (TKN) is a global collaboration of research institutions across Africa, Asia, Europe and the Americas working on issues of trade and sustainable development. Coordinated by the International Institute for Sustainable Development (IISD), the TKN links network members, strengthens capacity and generates new research to assess and address the impact of trade and investment policies on sustainable development.

The overarching aim of the TKN is to help ensure that trade and investment contribute to sustainable development, with social development and the environment equitably addressed in trade and investment policies. The TKN furthers this aim by generating compelling research with clear policy recommendations and communicating those effectively to decision makers nationally, regionally and globally.

The TKN is hosted by the International Institute for Sustainable Development, a Canada-based not-for-profit organization promoting change towards sustainable development. As a policy research institute dedicated to the effective communication of its findings, the Institute engages decision-makers in government, business, NGOs and other sectors in the development and implementation of policies that are simultaneously beneficial to the global economy, the global environment and to social well-being.

This study is part of a larger TKN project that seeks to better understand the impacts of investment incentives on sustainable development. Other research outputs include four country case studies looking at investment incentives for the mining and quarrying industry in Vietnam (by the Central Institute for Economic Management, Vietnam), the pharmaceutical industry in Singapore (by the Singapore Institute for International Affairs), the chemical industry in Indonesia (by the Center for Asia Pacific Studies at Gadjah Mada University, Indonesia) and the tourism industry in Malawi (by the University of Malawi and the South African Institute for International Affairs). The research findings were used as input for developing a checklist which sets out some key issues and questions to be addressed when assessing the impacts of investment incentives on promoting economic growth, social development and environmental protection. The project outputs are available on the TKN website.

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Sustainable Development Impacts of Investment Incentives: A Case Study of Malawi’s Tourism Sector
Abbreviations and Acronyms

ACP    African, Caribbean and Pacific
BIT    bilateral investment treaty
COMESA Common Market for Eastern and Southern Africa
CPA    Cotonou Partnership Agreement
CPC    customs procedure code
CSR    corporate social responsibility
EPA    economic partnership agreement
ESA    Eastern and Southern Africa
EU     European Union
FIP    Finance and Investment Protocol
FPC    foreign private capital
GATS   General Agreement on Trade in Services
GDP    gross domestic product
LDC    least developed country
MRA    Malawi Revenue Authority
MIPA   Malawi Investment Promotion Agency
MWK    Malawi kwacha
NSO    National Statistics Office
RTA    regional trade agreement
SADC   Southern African Development Community
SME    small and medium sized enterprise
VAT    value-added tax
WTO    World Trade Organization
Executive Summary

Malawi government policy to encourage investment is spelt out in the Statement of Investment Policy, which states that “investors, both domestic and foreign, may invest in any sector of the economy, with no restriction on ownership and there are no restrictions on the size of investment.”1 The Investment Promotion Act further provides “competitive investment incentives” to all investors.

Malawi has qualified for debt relief under the Highly Indebted Poor Country program, which means that the savings from debt servicing can be invested in the maintenance of public infrastructure and the construction of new infrastructure. The tourism sector, along with other sectors of the economy, benefits from these activities. It can be argued that these are among the various forms of investment incentives that are not easy to put a finger on, and therefore fall outside this study. Thus, this study focuses on just a few aspects of fiscal measures applied by government, except for expenditure like subsidies, grants or, indeed, the outright provision of infrastructure for use by specific firms in the sector. The fiscal measures referred to include indirect taxes such as customs duty or excise taxes, and taxable income on business profits, or adjustments to the definition of taxable income.

The Ministries of Finance and Tourism have worked alongside interest groups like the Malawi Tourism Association over the years to accord certain incentives to help develop the tourism sector. This has culminated in a new set of customs procedure codes (CPCs) for tourism that have been incorporated in Malawi's tariff schedule. Through the CPCs, (i) both import duty and value-added tax (VAT) are deferred, often for two years, although in theory they still remain payable; (ii) the Malawi Revenue Authority (MRA) commissioner general is mandated to completely waive the import duty and deferred if satisfied that the goods have been used for the stated purpose; and (iii) in 2007 the finance minister raised the first year investment allowance in the tourism sector from 40 per cent to 100 per cent.2

In the previous year, the finance minister announced that under the Rollover Relief scheme,3 a business will not have to pay tax on the capital gains from selling an asset, provided that the funds received are reinvested in assets of greater cost and of a similar type. The cost of the new assets for tax purposes will, however, be reduced by the amount of the relief, so that the tax will be recouped if the business subsequently sells the asset without replacing it. From a sample of the incentives listed above, this study estimates that through these deferred taxes, government has forgone about MWK 235 million in the 2007/08 fiscal year. At the top of the list are motor vehicles, where MWK 125 million (just over 53 per cent) in total has been forgone. Of this 53 per cent, about 29 per cent may not qualify for waiver by the commissioner general after a thorough review.

On the face of it, such investment incentives are often in conflict with the basic tenets of sustainable development. For instance, an examination of the top 10 imports qualifying for both the general incentives and the tourism-specific incentives show an interesting mix of policy targets. Firstly, the general incentives are given regardless of the industry targeted for development by the government. This is already problematic for any industrial policy, since it is difficult to measure its impact (allocating benefit to the tourism sector in particular is very complex). Because of this, it is difficult to assess the impact of general incentives on the development of the tourism sector. Secondly, the tourism-specific incentives clearly favour a few big “branded” and medium sized hotels, despite the fact that these

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1 This statement of intent is available at <http://www.malawi.gov.mw/investments/investmentPolicy.htm>.
incentives are intended for mostly small and more remotely located tourism operators. The study found that about 53 per cent of tax revenue lost may be going to the wrong target and not attracting the foreign direct investment (FDI) desired by Malawi.

Tourism-specific data that would have enabled the study to determine the link between investment incentives (as defined in this study) and FDI flows is scant. However, available FDI estimates point towards a decline in FDI inflows, despite the general incentives available in Malawi. In spite of these incentives, most investors cited the low cost of raw materials, the low cost of labour, the attractive environment, the availability of land, friendly people, proximity to South Africa, and the vast and unique resources of the country as the key reasons for establishing their ventures in Malawi. However, investors also observed that staff reliability, and their work ethic and training ought to improve generally. Utilities (telecommunication, water and electricity), airport and flights, and information provision to tourists is poor. This leads us to conclude that investment incentives do not determine FDI into the tourism sector; rather, natural and human resources are the main drivers of FDI decisions.

However, there are many small to medium sized businesses, mostly operated by foreign nationals dotted around the country, although the precise statistics are not available. Most medium sized tourism businesses took over government assets during the privatization period (the early 1990s). The lack of quality statistics regarding these also affects the proper measurement of the impact of investment incentives. In addition to this, the government is also a big investor in the tourism sector, as it making huge investments in ecotourism to champion investment in sustainable development. In the end, the type and nature of FDI in Malawi are shaped by other aspects of government policy such as increased private sector participation and ecotourism more than investment incentives per se. In such cases, investment incentives provided through various fiscal measures are secondary.

There is evidence that Malawi may have not given careful consideration to the type of tourism it requires, such that the extent to which the declared aims are realistic and the actions required to achieve those aims are questionable. Conspicuously missing are benchmarks/criteria for success. The current policy targets ecotourism as a niche market in this part of Africa. It must be made clear that this does not affect the tourism sector as a whole. As such, increasing domestic tourism and improving transportation links to tourist destinations have to be carefully isolated from the goal of achieving ecotourism development. Failure to separate these seemingly interdependent national goals would put more pressure on resources intended for achieving ecotourism goals and their measurement.

Furthermore, Malawi’s tourism policy is aligned with developments in the international tourism scene (e.g., ecotourism). The challenge is to formulate tourism sector policies that best reflect the new thinking. Some important areas that need policy reorientation or refocusing are consultation with local communities in the planning process; forging partnerships with the private sector; liberal immigration regulations to facilitate free tourist movement; and infrastructure development policy to facilitate tourism development, for the benefit of tourism and the wider society. The government has provided such a policy framework, but the key question remains: Have they provided the right instruments?

On the efficiency of delivery, for instance, the Tourism and Hotels Act provides for standards in the sector. Since the tourism sector is quite liberalized in Malawi, with extremely low barriers to entry, application of some of the national standards and compliance are rather elusive, simply because the cost of enforcement is high. More specifically, the Act does not attempt to ensure an ethical code of conduct. For instance, most projects have to pass an environmental impact assessment, often undertaken at the onset of the business’s establishment. However, what is conspicuously missing are the followup audits and monitoring mechanisms.
Institutional challenges also confront the MRA, whose staff have been unable to effectively follow up on the waivers granted, causing tourism investors to feel that the process is lengthy and expensive. This study revealed that the process is simply very expensive and not worth the incentives that are provided. As one manager from a resort in Cape Maclear reported in a questionnaire, “it [the investment incentive system] is for those in the city, not us in the bush,” while another operator in the northern region of Malawi complained that it is very expensive to travel back and forth to the capital, Lilongwe, to apply for a waiver to be given, “if you get it at all.”

Therefore, for these incentives to translate into tangible benefits for investors, the policy must be even more focused and measurable.

From the analysis, it is recommended that the Malawi government should do the following:

1. It should ensure that all policy goals are clearly set.

2. A specific type of FDI should be attracted by formulating a focused set of investment incentives that target a specific activity/set of operators. Such a policy should be very clear, measurable and specific. For example:

   ■ Incentives to encourage training of staff must target specific training needs.
   ■ The incentives that seek to encourage investors to invest in a specific location must specify the location and the duration of the incentives.
   ■ The 50 percent allowance for qualifying training costs must be used to finance the specified needs
   ■ Generally, incentives need to be targeted and not generalized to cover tourism only, otherwise government risks financing environmentally unsustainable investments.
   ■ Tourism should be included in land use planning, especially vis-à-vis the agricultural uses of land.

3. The MRA must be encouraged to enhance information sharing, develop a culture of knowledge creation and better analyze import data. The analysis clearly shows that the extent of the disaggregation of data that takes place at present is too limited for any meaningful government decision-making input.

4. The creation of a common code of ethics for private and public tour and travel operator must be encouraged. A special investment incentive to help promote the COMESA code of ethics would be useful.

5. Regional trade agreements should be utilized to access the resources needed to develop facilities.

6. Investment incentives on offer should be widely and energetically advertised.

7. While environmental and social impact assessments are commonplace, standards and regulations for economic impact assessments must be developed to enable the monitoring and auditing of existing tourist developments.
1. Introduction

1.1 Methodology

This study intends to capture the perceptions and experience of foreign investors in the tourism sector regarding the investment incentives aimed at encouraging investment in the tourism sector. It reviews relevant secondary data, such as general FDI stocks and flow into the Malawi tourism sector, reports from relevant studies, and broader government policy documents such as development policies and specific legislation on investment. Furthermore, a small sample of tourism operators in Malawi were interviewed to obtain primary data. This sample was drawn based on the following criteria: foreign players in the sector or a foreign stake in a firm; the geographical location where representation from each region was sought; and, finally, diversity in the size of the firms. This sample also included other relevant organizations such the Malawi Investment Promotion Agency (MIPA), tourism and business associations, and the MRA. Thus the primary data collected was both qualitative (visits to tourism businesses, including sometimes talking to employees, and face-to-face discussions with policymakers) and quantitative (the interviewees completing a survey questionnaire).

From these methods of data collection, simple analyzes of reports from enumerators and questionnaires were undertaken. In particular, information was sought on investment incentives and forms of government support that benefit tourism based firms. The incentives that were examined were largely fiscal measures—indirect taxes (such as the use of customs duty and taxable income reduction) and direct taxes (like income tax exemption). However, the research then took a more qualitative approach, because in-depth responses were needed to explore what underpins the perceptions of investors.

The major limitation was the chances of interviewees declining to participate due to the length of the survey, because the period after June through to December is the peak season for tourism in Malawi. To overcome this constraint, the qualitative approach complemented the survey, as unstructured engagement and observations were taxing on participants.

Thus the study involved the following main steps:

- a review of secondary data highlighting the importance and trends of the tourism sector in Malawi, including a review of government policies and legislation pertaining to investment incentives in the country generally and those of the tourism sector specifically, regionally and internationally;

- conducting preliminary interviews with government officials, business people and the related research community to gather general information;

- designing the questionnaire, pre-testing the draft survey instrument, and revising it based on the results of the pre-test;

- selecting firms to be interviewed (30 organizations were targeted, of which only 18 responded);

- analyzing the data collected; and

- preparing interim and final reports.
1.2 Scope of the study

The study starts by discussing the concept of investment incentives in the tourism sector and outlines the framework of the entire study. Apart from defining the investment incentives (as well as focusing on the type of incentives), the study gives an overview of FDI flows as one key variable to measure the impact of incentives on investment decisions. Similarly, another variable is the sustainable development concept in terms of the social, economic and environmental sustainability of the incentives in the tourism sector. In sum, the study seeks to establish the links among the incentives government offers, FDI in tourism and sustainable development in Malawi.

1.3 Outline of the study

Section 2 provides an overview of the importance of this sector to Malawi’s economic and development goals and will highlight the government’s economic and development policies that underline its importance, e.g., the Malawi Economic Growth Strategy of 2004, Malawi Poverty Reduction Strategy Paper 2006–2011 and Malawi’s industrial policy. The section will also provide an overview of Malawi’s investment framework as entrenched in its Constitution and Investment Promotion Act and various other policy statements.

Specifically, the section will present and analyze the investment incentives available in the country, followed by an exploration of the incentives in the tourism sector in particular. The latter incentives will be analyzed to illustrate how they have been used to meet the country’s economic goals and attract FDI to the tourism sector.

Section 3 will give an overview of the relevant bilateral and regional investment related agreements that the country has signed (and/or is currently negotiating). It discusses how these relate to the domestic incentive schemes generally, and specifically to the tourism sector. The section will also examine the extent to which these agreements have shaped the investment incentives offered at the national and sectoral level.

The fourth section will assess the likely role of investment incentives in shaping (i) volumes of investment; (ii) types of FDI flowing into the tourism sector; (iii) source countries of FDI; (iv) the geographical location of investments; and (v) the nature of the investments. Using both secondary and primary information (face-to-face discussions and a questionnaire), the section seeks to establish how accessible these incentives are and how they influence investor decision making. The section assesses whether the incentives are facilitating FDI or if there is no link at all between them and FDI. Then, in section 5, the paper discusses the impact of investment incentives on the tourism sector and their effect on the achievement of Malawi’s sustainable development goals. The section will assess the likely role of investment incentives in shaping the economic and social impacts of the tourism industry, as well as the environmental impacts. In its latter stages, the section assesses whether the incentives have served as an obstacle to or catalyst for the promotion of sustainable development in the sector.

In conclusion, section 6 reflects on the sustainable development impacts of investment incentives on the tourism sector in Malawi. Based on the analysis in the preceding sections, the section will assess the effectiveness of investment incentives; the effectiveness of the relevant national policies and regulations; and the impact of the investment incentives (and the associated FDI) on social, environmental and economic factors in Malawi.
Policy suggestions will then be outlined and specified, with reference to the agencies responsible for adapting domestic incentive measures in order to facilitate sustainable development. These include suggesting effective and inventive measures for the use of FDI to support sustainable development, and formulating positions for the negotiation of investment and other relevant bilateral and regional investment agreements. Finally, drawing on both the shortcomings identified and recommendations made within this concluding section, the study makes specific suggestions regarding future research.

2. An Overview of Investment Incentives in Malawi

2.1 The conceptual framework of investment incentives

Countries often strive to create favourable conditions for FDI by creating enabling regulatory environments and/or liberalizing their FDI regimes through, among other things, the use of investment incentives (subsidies) as tools to affect the location of investment. Investment incentives are “government measures designed to influence the size, location and industry of an investment” with the aim of increasing the rate of return of the particular FDI undertaking, or of reducing (or redistributing) its costs and risks. Obviously, these may range from government expenditure (including grants, the provision of infrastructure like access roads and other facilities, or even the construction of tourism structures like hotels for concession, etc.) to direct and indirect taxes.

As a factor in attracting investment, incentives are considered secondary to more fundamental determinants like market size, access to raw materials and availability of skilled labour, etc. However, this has not discouraged countries from offering incentives to foreign investors. If anything, incentives are now prevalent the world over and there is evidence that there is substantial pressure on governments not offering incentives to do so.

In fact, Thomas notes that “it is far easier to identify locations that have not given into the competitive pressure to inaugurate the use of incentives than it is to find governments that have abandoned their use.” This is a worrying trend, as the question of the efficacy of investment incentives as a means of attracting investment and sustainable development has never really been answered. In fact, like any subsidy to capital, investment incentives have potential efficiency, equity or environmental problems that all point to hampering the quest for sustainable development rather than furthering it.

Sustainable development in this paper refers to activities (in this case, specifically tourism activities) aimed at achieving sustainable economic growth, creating employment and improving the standard of living in a country while maintaining financial stability and environmental sustainability, and thus contributing to sustainable economic growth and development. At this stage, it is important to present the socioeconomic context of the discussion of investment incentives to the tourism sector in Malawi.

6 Ibid.
2.2 Socioeconomic and tourism profile of Malawi

Malawi is a small, landlocked, agriculture based economy and, despite remaining one of the poorest and least developed countries (LDCs) in Africa, is making real progress in terms of laying the foundations for economic recovery by achieving high levels of growth. In a bid to break away from overdependence on the agricultural sector, the government is focusing more attention on growing non-traditional industries such as mining, telecommunications and tourism. Of course, a prerequisite for initiating and boosting the growth of these new sectors is the injection of large amounts of capital, which has been relatively elusive in Malawi. Hence, attracting FDI is very high on the national development agenda.

Not all LDCs present favourable prospects in these non-traditional sectors. However, prospects in low income countries are expected to improve in the sectors where they have some comparative advantage, either because of their rich resource endowments (e.g., in agriculture) or because their natural situation can be easily exploited to develop other sectors, such as tourism.9 It is in this regard that Malawi has considerable potential to develop tourism. The sector was gradually taking off and the contribution of travel and tourism to GDP in Malawi was 5.9 per cent in 2008, but with the slump in the world economy it is expected to be 3.5 percent in 2009.10

Indeed, inbound tourism to Malawi has experienced steady growth in recent years. The number of tourists increased from 173,000 in 1995 to 420,000 in 2003 and 471,000 in 2004.11 The majority—65 per cent of tourist arrivals—were from African countries, mainly Mozambique and Zimbabwe, visiting Malawi to see family and friends and engage in cross-border trade (see also table A2 – 67 per cent were Europeans and 56 percent were Americans. Tourism businesses estimated 56 per cent being from African countries). Arrivals from Europe accounted for an estimated 16 per cent, with most coming from the United Kingdom and Ireland, who accounted for foreign exchange earnings estimated at US$ 33 million in 2004, compared with US$ 25 million in 2001 (making up approximately 6.7 per cent of total export earnings—which mainly comes from tobacco and other agricultural products—of approximately US$ 500 million in 2004).

Figure 1 shows that the majority of tourists come from South Africa and countries bordering Malawi, with all trends pointing upwards. In fact, others have referred to this overall upward trend as a positive development, but the Malawi Tourism Association (MTA) warns of overly simplistic analysis of this pattern, and prefers to look at the composition of the trends. The MTA’s argument refers generally to the definition of a tourist. However, the following generalizations are plausible: visitors from Zambia, Mozambique and Zimbabwe are mostly visiting friends/relatives because of the cultural and historical ties between Malawi and these countries. Many of those from Zimbabwe are also escaping the ravages of the economic meltdown in their country. Cross-border trade also takes place with these countries. This explanation also applies to East Africa (where Tanzania is the major cross-border trading partner).

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Other than South Africa, the above analysis leaves European, American and Canadian departures in the 20,000–40,000 range that the MTA refers to as tourists who mostly visit for leisure and recreation. In fact, the MTA, in its lobbying for incentives to attract FDI, hopes to improve the quality of service delivery for this target group.

In the Malawi Economic Growth Strategy, the government has put emphasis on attracting high spending tourists from developed countries, because it views the sector as having a potential of greatly benefiting the economy (2004). The National Tourism Policy is aimed at optimizing the contribution of the tourism sector to national income, employment and foreign exchange earnings. The policy encourages the creation of an enabling environment for private sector involvement in the industry, community participation and enhancing the role of the public sector in facilitating sustainable tourism development.

Malawi has a range of attractions, but these are generally underdeveloped, and in particular there is a lack of a critical mass of accommodation for leisure or recreational visitors. According to the MTA, by 2004 only three lake resorts offered accommodation suitable for international tourists. Government has been a significant investor in the accommodation sector, providing initial investment capital for most of the major city centre and tourism hotels. Beyond that, private sector investment in tourism accommodation has been low and focuses on smaller developments. Incentives provided through income tax waivers, and direct and indirect tax reductions/waivers are aimed at stimulating more substantial investment by the private sector.
It is widely recognized that in order to unlock the opportunities in the tourism sector and to attract investment in ecotourism, the climate for investment in tourism related infrastructure and business operations in the tourism sector needs to be improved. The 2006/07 and 2007/08 budget statements reveal that the government is adopting more aggressive sets of incentives for new investment and the refurbishment of existing facilities. Government has also made some investments to open up new opportunities through a special fund and is currently giving concessions to private management.

In addition to the natural factors that make Malawi a good tourist destination, other operating costs in the country also make the sector more competitive in comparison to neighbouring countries. For example, experts in the sector estimate that the operating costs for basic inputs are much lower in Malawi than in most other Southern Africa Development Community (SADC) countries; e.g., the minimum wage for a hotel worker is the equivalent of US$ 40 per month (plus a housing allowance of around US$ 0.50 per day), while the average in Tanzania is US$ 70. This study found that almost all foreign investors in the tourism sector find the low cost of raw materials to be the major reason for their investment, while over two thirds find the cost of labour to be cheaper in Malawi. This advantage is important, because large hotel and tourism groups seeking opportunities for maintaining both their profitability and their competitiveness can be attracted to invest in Malawi. Yet it reinforces the need for investment incentives for the training of tourism workers. Nearly 40 per cent of the investors find that skilled labour is not available in Malawi, and what there is is rather expensive because of its low supply.

Nonetheless, according to the World Travel and Tourism Council, the contribution of travel and tourism to GDP in Malawi was expected to be 5.9 per cent US$ 163.65 million) in 2008. Real GDP growth for the travel and tourism sector was expected to be 4.3 per cent in 2008 and to average 4.1 per cent per annum over the coming 10 years. These estimations fall within range of the Malawi Growth and Development Strategy long term goal to “increase the contribution of tourism to GDP from 1.8 percent to 8.0 percent by 2011,” which could be achieved through the Malawi government’s initiatives in infrastructure development, legislation and policy improvements.

2.3 Investment incentives affecting the tourism sector

While the spread of investment, management and development initiatives in tourism is currently wider among private sector initiatives, following the privatization process in the late 1990s, the government has nonetheless recognized the significance of tourism development. A clear policy of tourism promotion is spelt out in the Malawi Growth and Development Strategy that the long term goal is to “increase the contribution of tourism to GDP from 1.8 percent to 8.0 percent by 2011.”

Malawi’s strategy specifically entails increasing capacity to service additional tourists in internationally competitive accommodation, improving transportation links to tourism destinations, and increasing the attractiveness of national parks for tourism and ecotourism.

This strategy has naturally led to the evolution of investment incentives. In August 2007 the minister of finance increased the capital allowance for new investment from 40 to 100 per cent for first year allowances in manufacturing, agriculture and tourism (often written off against income tax, which meant paying almost no income tax at all) at an estimated cost of MWK 300 million (US$2.07 million)

for all the sectors given this incentive. Further, the minister introduced a zero duty on capital goods and zero duty for buses for a period of two years, together with a zero rate of VAT on buses of a capacity of 45 and more, at a cost of MWK 50 million (US$ 350,000 million).

As referred to above, general incentives have also been introduced that also benefit the tourism sector as follows:

- on income taxes:
  - 100 per cent investment allowance on qualifying expenditure for new buildings and machinery;
  - an additional 15 per cent allowance for investment in designated areas of the country; and
  - an allowance of up to 40 per cent for used buildings and machinery (see its revisions below);

- import taxes and duty free status:
  - duty free importation of buses with a seating capacity of 45 persons and above, and a zero rating of these buses for VAT;
  - duty free direct importation of goods used in the tourism industry, which includes building materials, catering and related equipment, and water sport equipment;

- free repatriation of dividends, profits and royalties;

- 50 per cent allowance for qualifying training costs where taxes such as withholding taxes are paid; and

- losses carry forward for up to seven years, enabling companies to take advantage of allowances.

In the 2006/07 budget statement, the finance minister also introduced the Rollover Relief program:

- A company is expected to pay tax when it disposes of an asset at a profit and distributes the funds received to the owners of the company. However, where the intention is to replace an existing asset with a newer or larger asset of the same kind, either to maintain the competitiveness of the business or to increase its production, the need to pay tax on the old asset acts as a discouragement to its replacement.

- Under Rollover Relief, a business will not have to pay tax on the capital gain from selling an asset, provided that the funds received are reinvested in assets of greater cost and of similar type. The cost of the new assets for tax purposes will, however, be reduced by the amount of the relief, so that the tax will be recouped if the business subsequently sells the asset without replacing it.

In the 2007/08 budget statement, the finance minister also announced the following:

- The first year investment allowance in the tourism sector was raised from 40 per cent to 100 per cent with effect from 1 August 2007.

- A new customs procedure code for tourism was introduced that will defer both import duty and import VAT for two years on the following:
  - all building materials;
  - industrial catering equipment;
  - motor boats, jet skis, kayaks, windsurfers and pedal boats; and
  - linen, cutlery and similar goods for hotel use indelibly marked with the hotel’s name.
The deferred duty and VAT will be permanently cancelled provided that the commissioner general of the MRA is satisfied within the two year period that the imported goods have been used for the stated purpose.

In the 2008/09 budget statement, taxation of gaming and betting, including lotteries, was granted another specific incentive:

- VAT exemption on gaming/betting and lotteries activities; and
- the application of a clean, simple, new excise tax of 10 per cent on the amount being staked by players.14

Box 1: Customs procedure codes (CPCs) for tourism

The incentives relevant to this study are to be found in the following package of fiscal measures and not in any other wider government expenditure to assist the economy, or, indeed, the tourism sector. Other tax waivers, such as the 50 per cent allowance on training costs, etc. are also not included here. In this case, the study exposes some of the weaker aspects of administrative procedures and effectiveness of the incentives.

The MRA tariff book shows the following specifications as regards incentives targeting the tourism sector:

- CPC 4071.437 (4071.450)(a) allows the purchase of one passenger carrying motor vehicle under tariff heading 87.02 every five years for hotels, lodges and inns licensed under the Tourism and Hotels Act. The incentives given are import duty reduced to 10 per cent (from the normal average of 25 per cent), excise duty reduced to 0 per cent (from 50 per cent) and VAT made payable at 16.5 per cent.
- CPC 4071.438(d) allows the purchase of three goods carrying vehicles every five years for the use of hotels, lodges and inns licensed under the Tourism and Hotels Act. These comprise vehicles of tariff heading 87.04 for use in production. The incentives given are import duty at 10 per cent (down from 25 per cent), excise duty reduced to 0 per cent (down from 5 per cent) and VAT rated at zero instead of 16.5 per cent.
- CPC 4071.442(a) covers the purchase of goods for hotels, lodges and inns, including glass, china porcelain, earthenware and stone articles of tableware; enamelware and hollowware for table use; electroplated nickel silver and plated ware; knives, forks, spoons and similar articles of cutlery; permanently or indelibly engraved, etched, stamped with the name (or some other identification mark approved by the commissioner general) of a hotel licensed under the Tourism and Hotels Act (chap. 50.01), and solely for use therein (ex-bonded warehouse). As incentives, import duty is waived completely (down from an average 20 per cent), excise is free (down from 25 per cent) and VAT is free (down from 16.5 per cent). A special requirement is that after three years the commissioner general of the MRA may demand duty if he/she feels that this waiver is not being used for the intended purpose.
- CPC 4071.443 covers motor vehicles for hire, except used motor vehicles, and specialized vehicles for safaris licensed under the Tourism and Hotels Act, subject to the production of a registration certificate for income tax and VAT. Incentives given include import duty reduced to 10 per cent (from 25 per cent), free excise and VAT at 16.5 per cent.

Further, the general list of goods for inclusion in the general customs duty and VAT incentive scheme include building materials for hotels, lodges and inns. This list is drawn from the main tariff schedule and some of the descriptions of the items include cement (ex-chap. 25.23 or simply a four digit HS code, 2523); bars; rods; channels;

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beams; sheets; wire for building structures (ex-chap. 72 or HS 7210 and 7214); iron or steel tubes; pipes and fittings (ex-chap. 73 or HS 7308); and other plates, sheets or plastics (HS 3920). Table B1a in Annex B lists the top five imports into Malawi in the period June 2006–July 2007, which were HS 252310, 721049, 721420, 252329 and 721041, in that order. Note that these items on the incentive list are also available to the general manufacturing, agriculture and other sectors too. Malawi, having qualified for debt relief under the HIPC program, has benefitted a great deal from donor support, as well as using the savings from debt servicing to invest in extensive maintenance of public infrastructure. Consequently, demand for the items listed in Table B1a obviously went up, and this demand may not easily be linked to investment into the tourism industry due to these incentives alone. Lack of quality data deters precise attribution of the extent of the attractiveness of these incentives to the tourism industry, and therefore these cannot be assessed for their impact on investment decisions in this context. However, this generally shows that there is some relationship among having increased resources (both public and private), tax waivers/reductions and decisions to build/maintain infrastructure.

Table B1b indicates that about MWK 235 million was retained by businesses in 2008 through deferred tax. At the top of the list are motor vehicles (HS codes 8702 and 8703), with deferred tax totalling MWK 125 million (just over 53 per cent). These include motor vehicles for the transport of 10 or more persons, including the driver, as well as, specifically, HS 87021030 “of a seating capacity of 45 persons or more persons including the driver.” HS 87032400 could be the type of motor vehicles principally designed for the transport of persons, and of a cylinder capacity exceeding 3,000 cc referred to in the 2007/08 budget statement, and not HS 87021030 or any other. In Table B1a, the top imports all fall under the capital allowance provision for mostly building materials. However, at the top on the list in Annex B, Table B1b are HS 8702 (motor vehicles), 8703 (motor vehicles) and 3924 (household and toilet articles of plastic). Thus, incentives have triggered investments in motor vehicles (supposedly for use in the tourism sector) but this is not really the type of tourism that Malawi needs. On the face of it, this investment incentive is in conflict with the basic tenets of sustainable environmental development and has a potential of missing the targeted policy goal, thus having a negative impact. About 53 percent of tax revenue may therefore be going to a wrong target and achieving no FDI of the type Malawi wants, i.e., ecotourism. However, further analysis needs to be undertaken, since transport revenue grew since 2006 compared to expenditure (excluding transport) in Figure 2. Meanwhile, the Micro and Small Enterprise Policy accords car hire and taxi services reserved list status (for Malawian nationals only).

Source: MRA (Malawi Revenue Authority), Tariff Book (Lilongwe: MRA, 2007)

Various challenges were experienced in our quest to assess the effect of the incentives scheme on investment in Malawi. Firstly, the MIPA captured data only from investors who seek the agency’s assistance, omitting those who do not pass through the agency. Secondly, with the financial liberalization process, all current account transactions do not need prior approval by the monetary authority, i.e., the Reserve Bank of Malawi. The challenge is that the Reserve Bank no longer centrally controls capital inflows, since private commercial banks manage various investors’ accounts. Thus, after the liberalization of exchange controls, there has been an increase in the number and value of unmonitored foreign exchange inflows and outflows in the form of private investments and remittances. Thirdly, the mushrooming of foreign exchange bureaus has created another problem of misreporting, and failing to report at all, on foreign exchange transactions. Furthermore, the operators in the tourism sector can handle huge volumes of funds inflows and outflows that can scarcely be tracked, even using modern technology. In this regard, even the balance of payments statistics are underreported. As observed in the analysis of the MRA above, the extent of possible disaggregation is limited. It was not easy to get

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even the minimum of data required (especially regarding other forms of income tax, like the tax on
capital gains, waivers associated with training and other tax holidays), yet the vast amount of
information the MRA has can make a huge difference in the quality of the decisions government makes.
Measurement of the economic impact on the sector and indeed the national statistics in this regard is
highly constrained. Therefore, the impact of investment incentives on FDI flow and stock to tourism
specifically could only be partially assessed.

3. The Legal Framework on Investment and Investment
Incentives

3.1 Bilateral investment agreements

Most bilateral investment treaties (BITs) apply themselves to the protection of foreign investors and their
investments by establishing rules related to standards of treatment of the investor, the protection of
the investment from expropriation, the transfer of funds and profits, and dispute resolution, as opposed to
investment promotion by actively encouraging investment flows between the parties. However a few
BITs mention the granting of incentives as a way to encourage and promote investments between the
contracting parties. Malawi has signed BITs with Egypt, Italy, Malaysia, the Netherlands, China16 and
Zimbabwe. None of its BITs explicitly guarantees the provision of incentives to foreign investors.

The BIT between Finland and Kuwait provides an illustration of one that guarantees incentives for
contacting parties. Article 2 of the treaty states that “each contracting state shall endeavour to take the
necessary measures for granting appropriate facilities, incentives and other forms of encouragement for
investments made by investors of the other Contracting party.” This proviso places an onus on the
parties to offer incentives to investors.

As attractive as this proviso might be to potential investors, it puts the contracting states in a position
where they constantly have to roll out incentives for investors or pay the price of contravening the
bilateral treaty. Even though the treaty may not stipulate the sectors in which the incentives ought to be
provided, its mere application makes the granting of incentives a permanent feature of the investment
regime of the countries concerned, which in the long run is not financially sustainable and could
eventually plant the seed of incentive wars with neighbouring countries.

Naturally, developing countries would find it very difficult to guarantee incentives, especially those of a
fiscal nature, in a BIT. For example, taxation policy is a sensitive issue in most countries and is handled
by authorities who are not part of the negotiation of a BIT. It would be ludicrous, then, for Malawi to
commit itself to providing such incentives, as such treaty provisions would limit its right to pursue fiscal
policies and could even be incompatible with its policy objectives.

3.2 Regional trade agreements (RTAs)

Malawi is a member of two regional economic communities, SADC and the Common Market for
Eastern and Southern Africa (COMESA). These regional groups are instrumental in promoting
regulatory cooperation, trade facilitation and cooperation aimed at infrastructure building.

16 It recently revoked the treaty it had with Taiwan, signed in 1995.
SADC has made steps towards the freeing of capital in the region and the protection of investment by creating rules enshrined in its Finance and Investment Protocol (FIP) to drive harmonisation of investment policies, inter alia so as to facilitate the creation of a favourable investment climate within SADC. The FIP provides investors with protection against nationalisation or expropriation, prohibits discrimination on the basis of nationality (the most favoured nation principle), allows the repatriation of investment and returns, and encourages the parties to accede to multilateral agreements designed to promote and protect investments.

While the FIP is silent on facilitating investments in services, at least the SADC Trade Protocol, aimed at streamlining trade and cooperation in various areas within the region, deals with trade in services. The Trade Protocol obligates members to adopt policies and implement measures in accordance with their World Trade Organization (WTO) General Agreement on Trade in Services (GATS) obligations with a view to liberalizing their services sectors. Pursuant to the mandate in Article 23 of the SADC Trade Protocol, an Annex on Trade in Services has been proposed for annexure to the Trade Protocol. The annex constitutes a body of law governing the progressive liberalization of trade in services, and in effect an increase of investment in services, among SADC Members.

On its part, the SADC Protocol on Trade in Services has also made attempts at incentivizing investment in the tourism sector by promoting trade liberalization in the sector and creating greater market access for players in the region, while at the same time ensuring equitable, balanced and complementary development of the tourism industry in the region. Malawi has been a beneficiary, as it has witnessed many more South African investors investing in the sector, as well as a steady increase of tourists from South Africa.

On the other hand, the SADC Protocol on the Development of Tourism focuses less on liberalization, but more on cooperation among SADC member states by encouraging multisectoral and plurilateral dialogue among nations so as to devise tourism friendly policies and standards. A product of its cooperative efforts is the Regional Tourism Organization of Southern Africa, an organization created to market the SADC region as a collective tourism destination. Numerous projects also give effect to the goals of the protocol. These include the 2002 Okavango Zambezi International Tourism Project (aimed at establishing coast to coast tourism, conservation and resource development), projects to ensure that all SADC members states participate and benefit from South Africa’s hosting of the FIFA World Cup in 2010, and the creation of a universal visa system to help facilitate intraregional travel or the harmonization of immigration procedures and movement of international tourists in the region.

COMESA also has regional investment rules found in its regional investment agreement that covers establishes the same investment rules for the protection of foreign investors as the SADC FIP, discussed above. COMESA’s regional investment agreement particularly advocates for wide and unconditional rights of repatriation of disinvestment proceeds and profits and the abolition of foreign exchange controls. The Malawi government has abolished foreign exchange controls, but approval by the Reserve Bank for the movement of funds is generally required, giving foreign investors access to their dividends and disinvestment profits, but at the risk of a high percentage of foreign exchange income earned leaking out of the country. The only saving grace is that there is a proportionate number of Malawians engaged in the tourism sector, which minimizes the incidence of repatriation of funds by foreign tourism companies through fees to hotel management companies, remuneration of foreign staff, etc.

17 FIP, Annex 1, art. 5.
18 Ibid., art. 6.
19 Ibid., art. 9.
20 Ibid., art. 21.
In the area of services, a COMESA-wide services trade liberalization program is currently being prepared, although some COMESA countries have embarked on certain services liberalization programs among themselves. These initiatives include programs aimed at the liberalization of air transport markets and the free movement of people. As far as the latter is concerned, COMESA has a Protocol on Free Movement of Persons to which Kenya, Rwanda and Zimbabwe are signatories. The non-signatories of the Protocol on Free Movement of Persons are, nevertheless, encouraged to remove restrictions on the movement of tourists within the region, promote regional tourist circuits and coordinate the policies governing the tourism industry. COMESA also recognizes the composite nature of tourism and is aware that the sector needs to establish formal links with sectors like transport and communication, whose inputs the industry requires for a complete tourism product.

Like SADC, COMESA’s strategy for tourism also aims at developing a collective and coordinated approach to the promotion and marketing of tourism in the region, and its Secretariat has embarked on creating the necessary regulatory and institutional framework for regional promotion, development, coordination and supervision of the operations of the tourism industry.

There is also work to prevent anticompetitive behaviour by the creation of a common code of ethics for private and public tour and travel operator, in order to standardize hotel classification and harmonize the professional standards of agents in the tourism and travel industry in COMESA.

The regional tourism policy also aims at promoting joint ventures between local and foreign entrepreneurs, and focuses on the promotion of conservation practices in order to ensure that the environment is preserved.

In addition to the treaties and protocols of SADC and COMESA that affect Malawi, it is signatory to bilateral trade agreements such as (i) the Cotonou Partnership Agreement (CPA), which is being renegotiated under the economic partnership agreement (EPA) banner; (ii) the Africa Growth and Opportunity Act, under which Malawi has increased exports of goods ranging from textiles and apparel to agricultural products such as nuts, beans and tobacco to the United States; and (ii) the Everything But Arms initiative of the European Union (EU), which qualifies Malawi, as an LDC, for duty free and quota free access to the EU market of all products originating from the country with the exception of arms and, during a period of transition, sugar, rice and bananas.

Of importance to this paper is the EPA being negotiated between the EU and Malawi under the auspices of the COMESA group. The EPA’s negotiations are aimed at replacing the current non-reciprocal and preferential trade relations, within the framework of four successive Lomé Conventions, between the EU and African, Caribbean and Pacific (ACP) states with new trade agreements that conform to the WTO’s rules. When concluded, EPA free trade agreements between regional groups of the ACP countries and the EU will cover not only the liberalization of trade in goods, but also other trade related matters such as the liberalization of services and the creation of investment rules. The COMESA group currently has an interim EPA with the EU and it is preparing for negotiations in the largely controversial areas of trade in services and investment.

21 Articles 37.1 and 37.6 of the CPA provide that the EU and ACP states have undertaken “to conclude new WTO compatible trading agreements, removing progressively barriers to trade between them and enhancing all areas relevant to trade … and to provide a framework which is equivalent to their existing situation and in conformity with WTO rules.”

22 There is a chequered history of attempts to establish multilateral rules on how countries regulate investment, from the first organization to initiate such ideas, the Organization for Economic Cooperation and Development, to the WTO.
3.2.1 Investment

The underlying controversy on investment-related rules in trade agreements is based on the divergent interests of developing and developed countries. Companies seeking to invest overseas are generally based in developed countries, which therefore seek to use investment agreements to protect the rights of their investors, optimize their profitability and increase their opportunities to invest. Developing countries, on the other hand, want to attract investment and manage it through regulation to minimize costs and maximize benefits to their countries. Unfortunately, binding international rules on investment for developing countries tend to limit these policy choices and do little to attract new investment.

With regard to the EPA, the European Commission proposes to establish a minimum platform for investment provisions in RTAs that incorporates and builds on current practice, encompasses the principles of most favoured nation on an investor’s pre- and post-establishment rights, prevents host states from imposing entry requirements on EU firms, bans legal entity requirements such as joint ventures with nationals of the host country, and permits the free flow of payments and investment-related capital movement. Unfavourable as these terms might be to ACP states, the European Commission is keen to have these investment rules in the EPAs that it concludes.

This agenda fails to draw lessons from the experience of FDI and investment agreements in developing countries and it has implications for the CPA’s goals of sustainable development and poverty eradication, i.e., rules that take a developmental approach. Fortunately, the CPA does not stipulate that an investment agreement should be part of an EPA, nor is there any WTO obligation to include investment provisions in an RTA. In Article 75(b) of the CPA, the parties agreed to “take measures and actions which help to create and maintain a predictable and secure investment climate” and “enter into negotiations on agreements which will improve such climate.” Therefore, Malawi does not have to sign an investment agreement of the traditional variety dealing predominantly with investor rights and freedoms to the detriment of the host state as part of the Eastern and Southern Africa (ESA)–EU EPA.

The ESA–EU EPA has an extensive chapter on development in which provisions on investment and private sector development are included as areas of cooperation. This commitment by the EU provides a strong starting point for negotiating areas of cooperation and therefore these areas require appropriate prioritization over investment rules. In EPA negotiations, another primary offensive interest is to attract EU investors to COMESA. ESA countries would be well advised to adopt a broad approach that goes beyond investment rules to include mechanisms for the promotion of a good image for these countries as attractive investment destinations. As signatories to the EPA, EU countries could undertake measures to encourage enterprises based in their territories to establish investments in ESA countries.

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23 Research has revealed that such rules-based investments do not necessarily help governments to address the poor track record of investment contributing to development and warns that these could expose policy makers to potentially large scale liabilities and curtail the feasibility of different reform options.

24 The European Commission is motivated by the recognition that in negotiating investment agreements it ought to establish strategic relations and to ensure that any regimes in potential markets are more compatible with those in operation in its own member states, noting that if countries “were to align their regulatory practices with those of the United States, this would place the EU at a competitive disadvantage” (Christian Aid, *EPAs and investment*, 2006, <http://www.christianaid.org.uk/images/epas_and_investment.pdf>).

25 After the failed Cancun ministerial, talks on creating multilateral investment rules were formally removed from the negotiating agenda of the WTO Doha Round in July 2004. Any commitments on investment by ACP countries would automatically be WTO plus (i.e., in excess the minimum legal requirements of WTO agreements).

26 This is not specifically a COMESA–EU EPA, because COMESA countries are negotiating EPAs in different clusters/configurations.
3.2.2 Services

The opportunities and conditions for investment are related to and very important to the liberalization of service sectors. As such, ESA countries are discussing a chapter on the liberalization of services with the EU in terms of Article 41.4 of the CPA, which states that “the parties agree to extend their partnership to encompass the liberalization of services in accordance with the provisions of GATS and particularly those relating to the participation of developing countries in liberalization agreements.”

Article 41.5 of the CPA obliges the European Commission to support ACP states’ efforts to strengthen their capacity to supply services. This clause promises to pay attention to the enhancement of the competitiveness of ACP country services related to labour, business, distribution, finance, tourism, construction and related engineering services. The main aim of any liberalization of the services sector would therefore be to enhance competitiveness with a view to creating a sound infrastructure for key service sectors and at competitive rates. The liberalization of services sectors would also enable Malawi to strengthen its regulatory capacity.

EU investment provisions (related to services) in RTAs with developing countries have historically been limited, but are showing increasing ambition. The latest EU–Chile association agreement is the most far reaching in both scope and depth, and adopts, among other things, a “negative list approach” for market access to outside services in order to achieve the widest possible liberalization. However, this approach is not provided for in the CPA or in the EPA negotiating mandates, and Malawi would be well advised to advocate for a positive list approach. In addition to the above, the country should demand the removal of domestic regulation that restricts market access in EU countries.

Like most developing countries, Malawi has an interest in securing EU market access for the temporary movement of natural persons (mode 4 liberalization), i.e., the export of independent professionals, and semiskilled and unskilled labour to the EU. There are sustainable development benefits through mode 4 liberalization, as it has a specific developmental and poverty alleviation dimension. A study undertaken by the Commonwealth Secretariat reveals that if Organization for Economic Cooperation and Development countries were to grant a 3 per cent quota of the low skills labour market to developing countries and LDCs, these countries would derive benefits totalling US $150 billion in remittances. These benefits are arguably a lot more than benefits likely to be derived from any liberalization in trade in goods. The country should also consider carefully the conditions it would attach to any offers it and COMESA intend to grant to the EU as part of the ongoing services negotiations.

3.2.3 Multilateral agreements

The WTO’s Subsidies and Countervailing Measures Agreement has little effect on the investment regime and the granting of investment incentives in Malawi.27

Much of international trade in services at present is clouded by discriminatory practices and protectionism. In tourism, these restrictions affect companies in many ways, such as their ability to move staff to a foreign company, create and open branch offices, use trademarks, etc. Thus, negotiations on services trade liberalization under the WTO’s GATS have an impact on the tourism industry because they create opportunities for countries to develop tradable services, like tourism services.

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They do so by incorporating rules on investment deemed necessary to address services that are provided by onsite investments through a local (commercial) presence in the foreign country. The investment provisions of the GATS, however, are subsidiary to its service trade liberalizing provisions and are mainly designed to avoid hidden protectionism and to protect investments that are an integral part of services, such as banking and transport.

Some WTO member countries interpret the GATS narrowly as a tool to pry open service sectors in developing countries, ignoring the pro-development spirit of the Doha Round. Admittedly, their objective is in line with GATS provisions, such as Article IV on “increasing participation of developing countries” in international services trade. However, Article XIX, under the title of “progressive liberalization,” flags the flexibilities that the GATS grants to developing countries to pursue liberalization in line with their levels of development and national policy objectives.

It is in Malawi’s interest to pursue liberalization in a sequenced and sensitive manner in line with Article XIX of the GATS. Such a pro-developmental approach would include attaching the necessary pro-development conditions and limitations to these countries’ offers, e.g., requirements for technology transfer and staff training; local employment, including at the managerial level; local sourcing of staff; the use of local partners to establish companies in the market; government programs targeted at strengthening domestic service providers; and zoning and land use regulations aimed at preserving natural environments.

The EU, for example, advocates further liberalization of related sectors such as environmental services—where it has a clear comparative advantage and export interests—developing countries remain concerned that liberalization does not equal socioeconomic benefits to their populations. In such a situation, Malawi would choose the sectors related to tourism where it wishes to make commitments. For example, if a properly working financial services sector is an important precondition for development, including tourism development, the policy choice about the liberalization or not of financial services may need to be based on the merits of liberalizing the sector and not only because of its connection to tourism.

As mentioned above, making more specific commitments would not suffice to ensure the sustainable development of the tourism trade. Instead, WTO members must create disciplines to overcome obstacles caused by anti-competitive practices (e.g., travel agencies, tour operators, wholesale tour operators, computerized reservation systems and global distribution systems). A draft annex on tourism suggests tackling anti-competitive practices by adopting a series of measures to prevent (i) abuse of dominance (through exclusivity clauses, refusal to deal, tied sales, quantity restriction or vertical integration); (ii) discriminatory use of information networks, ancillary services to air transport, predatory pricing or the allocation of scarce resources; and (iii) misleading or discriminatory use of information.

4. Impacts of Investment Incentives on FDI Decisions

Tourism is multifaceted and its economic dimension cannot occur without inputs of a social, cultural and environmental nature. These issues and the geographical location of tourism investment will be discussed under the section on sustainability, below. Learning from investors that have already invested in the tourism sector in Malawi, this section will consider the role of investment incentives in determining FDI decisions in the tourism sector, and the sections that follow will attempt to identify linkages among FDI decisions in terms of volumes of investment, types of FDI, source countries, geographical locations, and the linkages between investments and investment incentives.
The impacts of “competitive” investment incentives, available to investors in the tourism sector, may be felt at two levels: the macro or national level and the micro or subnational level. At the former level, tourism is expected to foster sustainable economic growth through foreign exchange earnings and an increase in state revenue (VAT, tax on profits and other taxes). For instance, arrivals of visitors doubled between 1990 and 2000, and tripled six years later (Figure 2). It can be estimated that revenues (derived from the expenditure of visitors) increased by nearly 30 per cent in the same period, as reflected in the level of economic activity. At the micro level, the impact may be observable through an improvement in people’s wellbeing in the areas of job creation, revenue or income distribution, and regional development.

Figure 2: Malawi tourism indicators, 1990–2006

4.1 The role of investment incentives in FDI decisions in Malawi’s tourism sector

FDI is concentrated in the southern and central regions of Malawi. On one hand, it can be argued that FDI decisions follow natural resources- and market-seeking criteria in Malawi (discussed below). This study found that 80 per cent of investors interviewed who had registered their head offices in Malawi would have established themselves in Malawi even if there were no investment incentives. Neither was the nature of their business establishment influenced by the incentives package. Other than the degree of competition within the sector and infrastructure, which is also rated less important for decision making, market size, market growth, and the cost of raw materials and labour are the main drivers of FDI decisions (Annex A, table A4). The cost (wage) of unskilled labour is moderately low, while skilled labour cost is moderate (Annex A, table A17). Although a National Statistics Office (NSO) et al. study concluded that the quality and skills of the labour force must be enhanced in Malawi, this average
perception by investors seem to benefit from the status quo, i.e., cheap labour.\textsuperscript{28} It is moderately expensive to train skilled workers, but the reverse is true for unskilled workers. However, investors in the tourism sector in Malawi observe that staff reliability, work ethic and training ought to improve generally.

Utilities (telecommunication, water, electricity), airport and flights, and information provision to tourists are poor; investors were indifferent on the issue of solid waste collection and disposal services; while ratings were above average on the government’s provision of roads, public transport services, policing and security, and general cleanliness. With respect to transport, the NSO \textit{et al.} study generally negatively rated “the cost and efficiency” of all forms of transport, with the exception of the efficiency of airports and air transport. Negative perceptions were strongest with regard to the cost of road transport. For utilities, the pattern in tourism sector is similar to other sectors, i.e., frequent disruptions reducing productivity.\textsuperscript{29} Investors in tourism also seem not to worry much about poverty, crime and terrorism, but do worry about corruption. Thus the availability of infrastructure and other resources that facilitate efficiency, and political and macroeconomic stability are also central determinants. With most of the investors, the relative cost of production is the most important determinant (100 per cent cited the low cost of raw materials as very important—see Annex A, table A4). Investors in the tourism sectors almost unanimously cite the following factors as influencing their decision to invest in the Malawi tourism sector: the attractive environment; the availability of land and the cost of land/rent; in relation to Africa, friendly people (Malawi, the warm heart of Africa); proximity to South Africa; and vast and unique natural resources. The exception was the issue of housing developments in the specific location chosen for a business (see Annex A, table A20b). Therefore, this section reinforces the fact that there is a weak link between investment incentives and the form that FDI takes.

Box 1, above, suggests that, predominantly, incentives for car hire and hotels determine investment into the tourism sector. However, if one looks at the list of incentives beneficiaries for the 2008/09 financial year given in Annex B, table B2, it is predominantly Malawian investors who took advantage of the incentives, and once again, no conclusion can be drawn as to whether FDI was attracted. Tables 20a and 20b in Annex A clearly expose the misfit of the fiscal incentives provided. Finally, it is worth recalling that the respondents in the survey were targeted foreign nationals.

### 4.2 Investment volumes

Owing to the scarcity of tourism-specific data, this section relies heavily on secondary data and inferences to illuminate FDI volumes into the tourism sector. According to the NSO, \textit{et al.} study,\textsuperscript{30} the annual \textit{World Investment Report 2000} estimated that FDI inflows to Malawi were US$ 51 million in 2000, compared to US$ 60 million in 1999 (the MIPA records close to an estimated US$ 27 million in 2000, down from US$ 40 million in 1999\textsuperscript{31}). Both estimates point to a decline in FDI inflows, despite the general incentives that were available during 1999. However, this is too short a period to make any meaningful judgements. Figure 3 shows a very small growth rate for Malawi over the period 1996–2006, but the lowest stock levels relative to neighbouring countries (Mozambique and Zambia), whose growth rates are faster (except for Zimbabwe) and volumes higher. The reasons may not entirely be attributed to the incentive packages vis-à-vis the neighbouring Zambia, with a boom in its copper industry and vast natural resources for tourism, while the political transformation in Mozambique and problems in Zimbabwe obscure the impact of investment incentives anyway.

\textsuperscript{28} NSO (National Statistical Office) \textit{et al.}, \textit{Malawi foreign private capital and investor perceptions survey} (Lilongwe: NSO, 2005).
\textsuperscript{29} \textit{Ibid.}, pp. 52–53.
\textsuperscript{30} \textit{Ibid.}.
\textsuperscript{31} MIPA (Malawi Investment Promotion Agency), \textit{MIPA investment database} (Lilongwe, 2008).
In fact, Figure 3 shows that Malawi is generally not as “competitive” in influencing investment decisions relative to its neighbours Mozambique and Zambia. Similarly, the economic growth in Mozambique positions the country at a greater advantage, to the detriment of Malawi, even with the current investment incentive regimes. Key factors like strong national economic growth and natural resources, but with comparable low labour costs, suggest that these two countries have an advantage over Malawi insofar as determining FDI location and volumes.
FDI flow was high only in 1999 and 2001, but plummeted in 2002 before picking up again (Figure 4). The general trend of FDI stock is steady, showing no significant tendency to be responsive. Data from the MIPA (a closer to home source) proportionately shows that investment into the tourism sector in Malawi constitutes less than 20 per cent of total FDI volumes, which is far less compared to the manufacturing and agriculture sectors.32

Therefore, in a country where there are no substantial FDI inflows and domestic investments tend to tilt more towards agriculture and manufacturing, there is no clear indicator of the significance of incentives. In Figure 4 the FDI flows seems to have moved up a bit, while Figure 5 shows an indicatively huge decline in investment in tourism in the years 2005 and 2006. The uranium investment seems to be responsible for the positive movement in Figure 4. In the year 2007 some effect on tourism is indicated that coincided with the incentive announcements. However, exact numbers from the MIPA were as follows: amounts of US$ 194,000,00 (2006) and US$ 10,000,00 (2007) were invested by Malawians, while US$ 1,512,900.00 (2006) and US$ 1,967,000.00 (2007) were invested from outside the country.33 Furthermore, this only represents investors’ indicative investments. This only confirms that investment incentives (fiscal measures) do not have a direct positive link to investment volumes.

Figure 5: Tourism as a proportion of total investment in Malawi, 2005–08*

* First quarter of 2008 only.
Source: MIPA (2008)

In a recent study, key data sources (MIPA,34 NSO, Reserve Bank of Malawi) acknowledged that the speculation that there has been an increase in private capital flows over the years into Malawi is not supported by sufficient information about the composition, cause, magnitude and sustainability of such flows, due to lack of proper monitoring mechanism.35

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32 Ibid.
33 Ibid.
34 Available information from the Ministry of Tourism and MIPA are largely intents.
35 NSO (National Statistical Office) et al., Malawi private capital stocks survey (Lilongwe: NSO, 2002).
Basically, too short a period has elapsed since the investment incentives were announced (2006, 2007 and 2008) to measure their impact. Further, the nature of the incentives (fiscal measures) may not be a good criterion to determine the role that investment incentives play in shaping the volume of FDI stock in Malawi generally.

4.3 Types of FDI in Malawi

An eclectic paradigm for FDI suggests that the decisions of Malawi tourism sector firms to invest depends on the country’s locational advantage. Dunning defines four types of transnational companies:

- market-seeking (i.e., serving the market through investment rather than through exports);
- efficiency-seeking (e.g., seeking low labour costs);
- natural resources-seeking; and
- strategic asset-seeking (seeking technology and skills, or to take over brand names).

Using this classification, for Malawi it is expected that investors are more likely to invest in seeking natural resources and markets.

To a smaller extent, strategic asset-seeking involves big regional brand names like Sunbird and Protea Ryalls hotels, with some exceptions like the Chinese restaurants that are following Chinese investments in the textile industry, Chinese diplomatic missions and the prospects of Chinese funded project personnel. To this extent, these are market-seeking as well, as are, similarly, the numerous small scale restaurants in urban areas, including casinos.

Malawi has some of the comparative advantages that are absent or already overexploited in the rest of the world. Some of these comparative advantages are:

- excellent, usually unspoilt natural attractions suitable for nature based forms of tourism; renovated forms of beach tourism in warm environments and more exotic landscapes; and all forms of ecotourism and adventure tourism. As regards incentives, government is spending to make more economically attractive the 50-metre Manchewe Falls adjacent to the Nyika National Park and Livingstonia, a late Victorian/Edwardian township established by Scottish missionaries at the end of the 19th century, which is a major cultural heritage attraction in its own right. In the southern region, Likhubula Falls, the Miombo woodland and Mt. Mulanje are also benefitting from upfront government spending. The Malawi government is seeking partnership with private investors to invest US$ 5,963,300 in ready ecotourism projects;

- unique, authentic cultural attributes, including less-known, rare archaeological historical sites (such as the museum in Karonga, into whose construction government sunk public funds), as well as features of intangible cultural heritage, including folklore, cultural dances, handicrafts, etc.;

37 Ibid.
abundant, low cost labour, especially women and young people, who can easily be trained to work in tourism occupations. The Malawi Institute of Tourism is a wholly government funded training school that targets the training of cooks, waiters, front office workers, etc.; and

- abundant land for extensive tourism developments.

In sum, the vast and unique natural resources, like the body of fresh water, mountains and forest within the Lake Malawi National Park, are the focus of ecotourism investments of all sizes. The type of investment into the tourism sector would mostly be natural resource-seeking. The role of investment incentives here (in the form of direct or indirect taxes) is visibly dwarfed by this factor. Despite a link between efficiency-seeking criteria (low labour cost) and FDI, the link to investment incentives is weaker, since investors still invest even though they are fully aware of the unskilled labour (and risk inefficiency) in the sector, which signals that labour costs per se are a very strong pull factor.

The government of Malawi is investing in ecotourism in order to encourage investment in sustainable development. Three domestic investors are seeking joint ventures and financing for tourism projects worth US$ 12,450,612. In this type of greenfield investment, which has nothing to do with FDI, initiating such projects demonstrates even further the weak link between investment incentives and the type of FDI.

During the period of privatization, some large regional hotel names, like Sunbird and Protea, bought company ownership (or a portion of the portfolio) from government. Casinos, like Pirates Casino, operate in their private capacity and invested directly in the sector soon after the law allowing gaming was passed. These factors also show that the role of investment incentives is weaker than the general enabling environment.

4.4 Sources of FDI in Malawi

The main sources of FDI in the tourism sector include Europe (Germany, United Kingdom, Poland and Denmark), Asia (Pakistan, China), the United States and Canada, and SADC (South Africa, Zimbabwe and Zambia).38

While there may be some relationship between the sources of FDI and where visitors to Malawi come from, there is equally a strong reason to believe that international relations or cooperation plays a role. A specific example, apart from the bilateral agreements signed with almost all of the source countries, is that of Chinese restaurants in Malawi. These clearly follow the new Chinese bilateral agreement, and therefore investors in tourism who open such restaurants are targeting Chinese workers in Malawi while they exploit the language and cultural difference advantage for the time being.

Furthermore, investment incentives in Malawi do not discriminate against local investors,39 except investment in car hire and taxi services, which are reserved for local investors. Foreign investors have to appreciate the overall incentive packages in Malawi and compare them to those of other countries. Such structuring of the investment regime does not target any investor other than a few specified in a particular BIT (often highlighting non-discrimination, if any such a clause exists).

38 MIPA (2008).
39 Ministry of Finance, National investment policy (Lilongwe: Malawi government, 2006b).
Once again the role of incentives (as in specific fiscal measures like direct and indirect taxes) per se to influence FDI decisions is rather dismal.

### 4.5 Geographical location decisions

The distribution of foreign private capital (FPC) seems to suggest the market size of the regions and the extent of natural resource endowments. The southern region of Malawi, and particularly the lake shore area, is a natural magnet for international investors, as table 1 indicates.

<table>
<thead>
<tr>
<th>Region</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central liability</td>
<td>85.1</td>
<td>73.0</td>
<td>91.1</td>
<td>170.1</td>
</tr>
<tr>
<td>FDI</td>
<td>83.0</td>
<td>71.6</td>
<td>90.1</td>
<td>167.5</td>
</tr>
<tr>
<td>Northern liability</td>
<td>12.1</td>
<td>9.8</td>
<td>9.1</td>
<td>9.0</td>
</tr>
<tr>
<td>FDI</td>
<td>11.8</td>
<td>9.6</td>
<td>8.8</td>
<td>8.9</td>
</tr>
<tr>
<td>Southern liability</td>
<td>383.2</td>
<td>344.7</td>
<td>341.4</td>
<td>426.5</td>
</tr>
<tr>
<td>FDI</td>
<td>324.2</td>
<td>309.3</td>
<td>311.1</td>
<td>386.0</td>
</tr>
<tr>
<td>Total FPC liability</td>
<td>480.3</td>
<td>427.6</td>
<td>441.6</td>
<td>605.6</td>
</tr>
<tr>
<td>Total FDI</td>
<td>419.0</td>
<td>390.5</td>
<td>409.9</td>
<td>562.3</td>
</tr>
</tbody>
</table>

Source: Adapted from NSO et al. (2005, p. 34, table 19)

Despite the general incentives available to all industries in Malawi, there is an additional 15 per cent allowance for investment in designated areas of the country. With respect to geographical location, the southern region of Malawi is preferred for natural resources and infrastructural development (and investment generally). Fiscal investment incentives (via taxes) are seen as relatively minor determinants of FDI decisions. While they might tilt the investment decision in favour of one of several otherwise similar investment locations, overall the effects are very marginal.

### 4.6 The nature of investment

There are many small and medium sized tourism businesses dotted around the country, mostly operated by foreign nationals, although the precise statistics are not available. In the past, the Malawian government used to run a number of hotels and lodges in the country. However, as part of the privatization process that is meant to stimulate competition in the tourism industry through private sector involvement, the government awarded concessions and, in some cases, sold its lodges and other investments to private sector investors to run the hotels and lodges and carry out further tourism investment. So most medium sized tourism businesses took over government assets during the privatization period (the early 1990s).

For instance, the companies that have been granted concessions include the South African based Africa Parks and Science Company, which was recently awarded a concession for tourism infrastructure development at the government protected Majete Game Reserve in the Southern Shire Valley district of Chikwawa. A tour operator, Land and Lake Safaris, won a concession for tourism development at Lilongwe Nature Sanctuary in the capital city district of Lilongwe. The Malawi Development Corporation\(^{40}\) won a concession for tourism infrastructure development at Liwonde National Park in the southern district of Machinga and at Cape Maclear, a tourism haven in the southern lake district of Malawi.

\(^{40}\) The Malawi Development Corporation, an investment arm of the government, has since gone bankrupt.
Mangochi. Some investors, like Sunbird Hotels, a large scale hotel company listed on the Malawi Stock Exchange, sold one of the lodges in the capital, Lilongwe, called Lingadzi Inn, through a management buyout. Such is the mixture and nature of investment in the sector.

In the end, the type and nature of FDI in Malawi is shaped by other aspects of government policy such as increased private sector participation and ecotourism more than by investment incentives per se. In such cases, investment incentives (direct and indirect taxes) are secondary, while other forms of government spending, such as infrastructure developments, including buildings provided for tourism firms, are the major drivers.

5. Sustainable Development Impacts of FDI in the Tourism Sector

As alluded to earlier, the working definition of sustainable development in tourism activities refers to the aim of achieving sustainable economic growth, employment and a rising standard of living in a country, while maintaining financial stability and environmental sustainability, and thus contributing to sustainable economic development. Sustainable forms of tourism, and especially ecotourism, can be strategically important for preserving delicate ecosystems and biodiversity in Malawi and providing a sustainable form of economic use. Similarly, cultural tourism can help in preserving and restoring cultural, historical and archaeological objects and buildings, which often fall into decay due to a shortage of financial resources. Cultural tourism also helps in educating tourists and residents alike about the spiritual and cultural values of these sites.

Investment into the tourism sector in Malawi has some possible sustainable development impacts. In this section, the study looks at FDI and its impact on sustainable development, with specific reference to tourism.

This will be discussed in three subsections dealing with economic, social and environmental impacts. The section also assesses the effectiveness of the relevant national policies and regulations available that attempt to mitigate the negative impacts of investment and maximize opportunities.

5.1 Economic impacts

In discussing economic impacts, there is the need to delineate the relative roles of private local and foreign investment in Malawi. The key issue is that foreign investments into tourism businesses do have wider economic consequences for Malawi. It is therefore imperative that such investors recognize the implications of their actions in the overall interest of the long run economic sustainability of the tourism sector.

5.1.1 Employment

The major challenge is the need to develop human resources, particularly indigenous personnel, both for reasons of delivering quality services to tourists and enhancing the general skills of the local workforce. A nationwide study by NSO et al. undertaken in 2005 concluded that the quality and skills of the labour force must be enhanced. The study also found that employment patterns indicate that the majority of investors engage unskilled workers who are often inefficient. In the tourism sector, the composition of unskilled workers is nearly the same as the skilled (Figure 6).

Despite the challenges to obtain data on wages, it is clear that most unskilled workers are paid minimum wages, currently stipulated as MWK 55 (US $0.38) per day in urban areas and MWK 37 (US$ 0.26) per day in rural areas. Most investors find Malawi’s cost of labour, particularly unskilled labour, to be low, with the minimum wage being less than US$ 1 per day. Although such labour is cheap in terms of wage levels, the level of productivity is observably low, as evidenced in the levels of service delivery.

The NSO household study of the wage earners’ distribution across the employment sector reveals that 35 per cent of wage earners are employed in the social and community services sector; 22 per cent in the agriculture, forestry and fishing sector; 17 per cent in the manufacturing industry; and 12 per cent
in the construction industry.\textsuperscript{42} Mining and quarrying remains the smallest industry in the country, with less than 1 per cent of workers.\textsuperscript{43} This study implies that workers in the tourism sector are even fewer than those in mining and quarrying; however, the lack of clarity is largely due to the lack of disaggregated data. The study does not break down social and community services any further, under which elements of cultural and entertainment would rightly fall.

The tourism sector creates jobs in two ways. Firstly, jobs are created immediately through employing local citizens in hotels, restaurants, and entertainment and tourist services that cater directly to tourists. Secondly, tourism creates jobs through the multiplier effect. For example, by creating demand for local products supplied to establishments that would not have existed without tourists, tourism can create employment in related service industries; tourism can also create jobs to serve the additional demand from otherwise unemployed local citizens working in other sectors. The classic example is the increase in the number of car hire businesses that are directly linked to other tourism businesses (which, of course, also benefit from direct investment incentives).

The tourism industry, however, can also destroy jobs or reduce job creation, and to the extent that it does, policymakers have to adjust the multiplier effect. If tourism displaces farmers, loggers, fishermen or other productively employed individuals, it destroys these individuals’ jobs and those of individuals in related service and support industries. Earlier in 2008 there was a shooting incident when a scuffle broke out between residents of the area surrounding Majete Game Reserve and game scouts. When the matter was discussed in the national parliament, it was noted that the people in the surrounding areas were encroaching on the Game Reserve in search of fertile land for agriculture, or, as a result of sheer deprivation, were trying to earn their livelihoods from activities like extracting honey from the natural forests. Similar incidents are also frequent in areas surrounding Liwonde National Park. In some instances, the local fishermen at Lake Malawi have been forced to sell their fish to tourists along the road or from their dugout boats on the lake.

\section{5.1.2 Foreign exchange}

At current levels of FDI, the number of tourists has not grown fast enough to put pressures on the local currency and affect the tobacco industry. If tourism increases demand for the local currency and drives up the local currency’s value in foreign exchange markets, it will drive up the price of the country’s exports, the main one of which is tobacco. The more expensive exports will encounter decreased demand in foreign markets, thereby affecting jobs in the country’s export industries. However, in Malawi the scenario is slightly different from that pertaining elsewhere. Apparently, only a few large scale investors whose finances are tractable, e.g., Protea Hotels and Sunbird Hotels, airlines, and a few medium sized tour operators, may be making foreign currency available in the “formal” market. The liberalization of the financial market (effectively a move towards a managed float system) makes the measurement of such pressure on the foreign exchange market difficult. Already, it is clear that US$ 1 may be fetching more than the official MWK 145 on the parallel market (2007/08 average). This implies that the local currency is not highly sought after, although it is highly managed. Malawi has only one major export, tobacco, hence there is less than the expected pressure on local currency overall. On the other hand, the managed US dollar exchange rate enables Malawians to import essential commodities like fertilizer and fuel. Therefore, tourism has a smaller impact on foreign exchange.

\footnotesize
\textsuperscript{43} Ibid.
Tourism can either bring foreign exchange into Malawi or leak it out of the economy. Prior to the liberalization of the financial sector, the Reserve Bank of Malawi kept track of all foreign investment as the central point through which overseas investors moved their investments. However, the situation now is different in that any commercial bank can handle such foreign exchange transactions. Similarly, foreign currencies can move out of the country through the same commercial banks. It is the monitoring of such inflows and outflows that poses a real challenge. To date, there is no specific data estimating leakages. It is estimated that currently the private sector has more foreign reserves than the central bank has at its disposal to meaningfully regulate foreign currency market.

The challenge of leakages is exacerbated by other social problems. One consequence of the tourist explosion the world over seems to be illegal activities such as prostitution and dealing in drugs. In Malawi, some tourism businesses rely on the number of women visiting their premises, while some resorts are havens for the drug Indian hemp disguised as tourism businesses. Several small to medium sized tourism firms were hostile when asked to give simple business information for the purposes of this study. For many illegal activities, laundering cash through real estate, lodges, casinos and golf courses seems to offer lucrative and safe solutions, but these illegal activities create an underground economy and do not generate foreign exchange for Malawi. This is perhaps the major reason behind the Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act of 2006, which, among other things, is aimed at curbing the loss of government revenue and controlling the risk of thwarting privatization efforts.

### 5.2 Social impacts

Tourism is more than an economic activity. It is, in essence, a massive interaction of people demanding a wide range of services, facilities and inputs that generate opportunities and challenges for the Malawian government. For this reason, it is necessary to manage the growth of the sector and to have clear guidelines to ensure that growth brought about through new investment is compatible with national and sectoral objectives.

As can be observed in the National Tourism Policy for Malawi, tourism is important to Malawi and to all the individuals connected with this sector. Yet it is global, too, influenced by both local and international trends. In developing national strategies and activities for the sector, the government recognizes the importance of establishing partnerships between key parties by applying the following principles:

- Government should stimulate tourism growth.
- Tourism should be private sector driven.
- Tourism should be supportive of community involvement and vice versa.
- Tourism should have the potential of employment creation in a gender responsive manner.
- Tourism should be environmentally responsible and sustainable.

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44 NSO *et al.* (2005).
Although tourism development results in the provision of facilities and services such as electricity in such remote areas as Chembe village, the building of tarmac road to Salima and Senga Bay and other initiatives to access game parks, there are, however, instances when these facilities are not accessible to local residents, particularly if tourism development involves the creation of tourism enclaves. Several developments along the lake shore, for instance, want to designate certain beaches as no-go areas for local residents. At Cape Maclear, Chembe village along the beach has to give way to tourism investment and the whole sociocultural fabric is changing.

Of course, as some local residents have complained, hotel rates charged in foreign currencies (US dollars) are often beyond the reach of even average middle class citizens. Most domestic visitors to tourism facilities come from the urban areas of Blantyre and Lilongwe.

In addition, investment in tourism has been criticized for exacerbating societal problems: the destruction of social patterns, for instance, child abuse, poor labour conditions and the domination of European investors are not unusual mostly in the tourist attraction areas like Mangochi and Cape Maclear. In extreme cases, there is no respect for local societies and cultural values.

The sustainable development and management of tourism requires responsible behaviour from private tourism companies. Most tourism operators simply do not want to talk about their social responsibilities. The disclosure of any information that may indicate their level of profitability is seen as making themselves vulnerable to competition and the tax collector.

There are problems facing the local tourism sector, which is characterized by a large number of small and medium sized enterprises (SMEs). In Malawi, such examples are the restaurants, tour guides at the foot of Mt. Mulanje, etc. SMEs serve useful functions in tourism (e.g., the development of linkages, providing personal service, etc.), but for most of them, life is a daily struggle, with many of them operating at the margin of survival. They also lack the requisite experience to run tourism business according to modern management principles.

Furthermore, the nature of tourism renders them uncompetitive, as they are unable to capitalize on the advantages that accrue from economies of scale. Again, their limited resource base makes this objective hard to achieve. The real social challenge, though, is the proliferation of foreign investors running small restaurants targeting the same international tourists. Despite the availability of legislation to reserve certain sectors for Malawians, its enforcement is a huge challenge for the government. The upsurge of small (community based) restaurants, such as Chinese restaurants, is posing serious competition to local investors.

5.3 Environmental impacts

As well as absorbing natural resources, economic processes generate residues of waste materials that are released into the environment using water, air and land as “sinks.” It is very clear that, from a reading of the national budget, no calculations are being made regarding the extent of this practice so that the non-sustainable depletion of fish, forests and various habitats can be absorbed into the national accounting for income (see Annex A, table A7).

5.3.1 Environmentally sensitive subsectors

Car hire companies have lobbied hard to be included in the tourism sector (CPC 4071.337, 4071.338 and 4071.443). Investors in this subsector, who are supposedly “local,” benefit heavily from incentives
(direct and indirect tax incentives) (see box 1, above). This part of the transport industry is where the generation of air polluting fumes is higher such that the higher the number of visitors the higher the rate of pollution. The linkage between the economy and the environment is so pervasive that this aspect merits being treated as a separate area in its own right. Giving investment incentives to this subsector is thus effectively financing pollution.

Of course, Figure 4 demonstrates that tourism revenues increase when transportation is included (although it does not disaggregate air, rail and road transport). The key concern is the environmental cost versus the economic benefits of the revenues earned in the tourism sector.

Environmental degradation arising from investments in beach resorts, national parks and mountains varies according to tourists’ activities. Managing environmentally oriented tourism facilities as renewable, rather than finite, resources poses unique challenges. For instance, some of the most unique species of birds and fishes in this region of Africa are found in Malawi. Increased investment affects these natural habitats and raises fears of ecological damage—hence the specific drive by government for “ecotourism” despite poor environmental audit mechanisms is potentially a recipe for environmental disaster. Another concern is the increased damage from environmental degradation due to the increasing number of resorts being constructed very close to the breeding grounds of fish, which, together with subsequent tourism activities, is responsible for dwindling fish stocks, yet is undertaken with no serious environmental impact assessments (see Annex A, table A12). On the other hand, as tourism develops, the government also needs to maintain infrastructure, such as roads, electricity and telephone facilities. The Malawi government has, however, made strides in this area, and the introduction of mobile phones has increased accessibility to the various resort sites.

6. Conclusion and Recommendations

One might suppose that perhaps Malawi may have not given enough careful consideration to the type of tourism that it wants, to what extent the declared aims of its tourism policy are realistic, and what needs to be done to achieve those aims. Conspicuously missing are the benchmarks/criteria for success and failure. While the policy targets ecotourism, not the tourism sector as a whole, increasing domestic tourism and improved transportation links to tourism destinations would put more pressure on the resources needed to achieve ecotourism goals. It becomes difficult as a result to ensure the effectiveness of the incentives given to a wide range of unspecific targets such as increasing domestic tourism and improving transportation links to tourism destinations.

6.1 Effectiveness of investment incentives

This tourism sector study has revealed that the process of accessing incentives is simply very expensive and not worth the benefits gained. As one manager of a resort at Cape Maclear reported in a questionnaire, “it [investment incentives] is for those in the city, not us in the bush,” while another operator in the northern region of Malawi complained that it is very expensive to travel back and forth to the capital, Lilongwe, to apply for waivers to be given, “if at all you get [them].” The process is long and complex, and the conduct of government agencies involved in administering investment incentives is not what investors expect (see Annex A, table A11). Applicants have to renegotiate their agreements again and again and firms often have to put forward counterproposals.

Tourism operators interviewed rate corruption, poverty levels, crime and terrorism as of very high concern for the tourism business (see Annex A, table A15). Other sources confirm that corruption perception index has generally worsened since 2001 (Figure 8).

Figure 8: Malawi’s corruption perception index, 1999–2006

It must be mentioned at this stage that the firms interviewed were predominantly foreign SMEs spread across the country. The opinions given here largely represent these business’s perceptions of the sector and the investment incentives. However, most government agencies and large scale firms are of the view that the incentives need some time to translate into tangible benefits for the many small investors to see and appreciate.

6.2 Effectiveness of the relevant national policies and regulations

The traditional role of government is to formulate policy, in this case for the tourism sector. Today the focus has changed because of changing priorities occasioned by developments in international tourism (e.g., the emergence of consumer interests, ecotourism, etc.). The challenge for national governments is to formulate tourism sector policies that best reflect the new thinking. Some important areas needing policy reorientation or refocusing are consultation with local communities in the planning process; forging partnership with the private sector; liberal immigration regulations to facilitate free tourist movement; and a tourism infrastructure development policy to facilitate tourism development for the benefit not just for tourism, but the wider society. The last policy issue needs to be linked to devising viable and sensible options for financing tourism infrastructure. Other aspects of the policy refocusing process include entrepreneurial development initiatives and policies to extend tourists’ average length of stay. Last, but not least, a policy is needed to identify ways in which the benefits from tourism activity can be spread more evenly throughout society. The National Tourism Policy, Draft National Investment Policy, Employment of Expatriates and Employment Permit Guide, the Malawi Growth Development Strategy and other related national documents are focused on meeting the changing priorities in the international tourism scene.
There is a clear need for central and local government to take a leading role in policy formulation and ensuring that public and private sector agents in tourism accept the responsibility to manage the impact of tourism. There are a number of reasons that justify governmental action in the tourism sector:

- The tourism industry is very fragmented. It is difficult for the individual actions of many SMEs, or even large companies, to make a positive difference in terms of sustainability. Coordination is therefore required, both among all these small and medium sized service providers and the larger domestic and foreign hotel investors and tour operators. Such coordination should normally be provided, or at least stimulated, by the Ministry of Tourism and related organizations such as the Malawi Tourism Association.

- Sustainability relates to areas of public concern, such as water and air quality, natural and cultural heritage, protected areas, public spaces and the quality of life in general, all of which relate to tourism in one way or another. Moreover, many of these resources and a good number of tourism attractions (e.g., museums, archaeological sites, airports, etc.) are generally still owned and managed by government.

- The government of Malawi holds many of the tools that can be used to make a difference at the level of the social and environmental sustainability of tourism, such as the power to legislate and ensure compliance, the offering of economic incentives for investment, the establishment of fiscal regimes, and the resources and institutions to promote and disseminate good practices.

The Malawi government has provided both a policy framework and a suitable legal and regulatory environment that enable and encourage local and foreign private sector investors to respond to sustainability issues. This framework is provided for in the following legislation: the Tourism and Hotels Act, the Investment Act, the National Tourism Policy for Malawi, the Employment Act, the Draft National Investment Policy, the Employment of Expatriates and Employment Permit Guide, the Malawi Growth Development Strategy and other related national documents. The key question to ask is: Are these instruments the right ones? The uptake and utilization of these pieces of legislation comprise one such indicator, although some would argue that their uptake depends on the efficiency of delivery.

The Tourism and Hotels Act provides for standards in the sector. Tourism authorities often embark on enforcement activities to ensure adherence to quality and safety standards according to those set out in the Act. Furthermore, the Employment Act provides for the minister to review the minimum wage. Over the past two years, the minister of finance has moved the minimum tax threshold to approximately US$ 3 per day, thereby giving relief to lower paid workers (note that unskilled workers earn less than a US$ 1 per day).

Furthermore, the tourism sector is quite liberalized in Malawi, with extremely low barriers to entry. For most small and medium scale tourism businesses, the application of some of the national standards and compliance requirements is rather elusive, simply because of the cost of enforcement. Some investments are still not easily accessible by authorities. On the other hand, the Tourism and Hotels Act fails to ensure an ethical code of conduct. Most projects have to pass an environmental impact assessment often at the onset of business establishment (at least in theory—see Annex A, table A12). However, what is conspicuously missing are audits and monitoring mechanisms. The MIPA is in the process of devising instruments that allow it to follow up on the investments that it has promoted. However, the only way to generate fully sustainable tourism that contributes to sustainable development and increases the welfare of local communities is to promote the full exercise of corporate social responsibility (CSR) by all tourism companies present in the country.
The concept of CSR in tourism means that companies adopt transparent business practices based on ethical values with regard to their clients, their employees and the populations of the communities they operate in. The required conduct of the companies concerned in this respect, except for meeting hotel and certain environmental standards, does not appear in national legislation and policies. Most businesses focus on profits only and do not even have any reporting mechanism whereby social and environmental results are measured and reported along with financial results. Apparently, only a few large private investors publicize their financial reports annually. However, commitment to CSR by small and medium sized tourism enterprises is more difficult to determine, given their large numbers, yet there are excellent examples of SMEs working with local communities that fully respect the natural and cultural environments in which they operate and educate tourists about environmental, cultural or social issues in the areas visited.

The failure of Malawi’s national legislation and policies is largely in their performance measurement and enforceability. In the 2008 budget speech the finance minister announced the government’s intention to simplify the incentives system by formulating guidelines to enable investors to automatically qualify for the benefits offered. What remains is implementation; while the minister relinquishes the discretionary role, the implementing agencies and the individuals who work for them have yet to adhere to the expected transparency. As such, most national policies and legislations are detailed, but ineffective.

6.3 Policy recommendations

Malawi has set out a strategy to establish herself as a principal and leading ecotourism destination in Africa (e.g., in the Malawi Growth and Development Strategy, 2006 and the National Tourism Policy, 2006). The Growth and Development Strategy specifically entails increasing capacity to service additional tourists in internationally competitive accommodation, improving transportation links to tourism destinations, and increasing the attractiveness of national parks for tourism and ecotourism, thus achieving sustainable development. If improving transportation links to tourism destinations is left to the Ministry of Transport (since it is a type of incentive involving government expenditure), then FDI can be achieved in the remaining areas by formulating a specific set of investment incentives that target, say, safari operators, in order to ensure sustainable business growth through quality service. Such a policy should be very clear, measurable (against a prior benchmark) and specific.

Because FDI is hard to attract, the government is tempted to invest itself, thus hoping to start the ball rolling. Greenfield investments come from tax money and are subsequently handed over to a concessionaire, who will also be granted incentives, in the hope that long term benefits will result in FDI and jobs.

It is recommended that investment incentives for training be provided in order to develop human capacity in tourism. Incentives regarding training costs are sustainable and have economic impacts. Yet it is a moderately expensive task for individual enterprises to train skilled workers. While government (investment) spending is outside the scope of this study of incentives, the other fiscal measures used need to be quantified a priori. For instance, an investment incentive clause that focuses on staff training like the “50 per cent allowance for qualifying training costs” is too vague and can lead to a waste of resources. Therefore, the investment incentive must be specific, and should focus on specific needs. This in turn implies that the specific needs are clearly formulated in the first place.

Another incentive that seeks to encourage investors to invest in a specific location states that an additional 15 percent allowance for investment in designated areas of the country will be advanced.  

This aims at unlocking the opportunities in the tourism sector and attracting investment in ecotourism. Again, it clear that ecotourism zones are known and project plans with feasibility studies are ready. It would be wise therefore to specify the locations and the duration of the incentives prior to their being granted.

Similarly, the achievement of intended goals can easily be defeated by financing environmentally unsustainable investments, e.g., the polluting and energy consuming motor vehicles benefitting from incentive schemes acquired by local car hire operators associated with the tourism industry. Incentives need to be specifically targeted and not generalized to tourism only. So far, the extent to which the environmentally damaging effect of these vehicles is offset by revenues resulting from transport in tourism has yet to be assessed. It is clear from the above analysis that the car hire subsector waivers (CPC 4071.337, 4071.338 and 4071.443) are all vehicle tax related waivers. The only truly tourism waivers are CPC 4071.442 and income taxes. This failure by the MRA to disaggregate the various incentives can adversely affect the effort to support ecotourism targets. The agency must be encouraged to enhance information sharing and develop a knowledge creation culture that can better inform policy.

The progress made by COMESA towards the creation of a common code of ethics for private and public tour and travel operator, to standardize hotel classification and to harmonize the professional standards of agents in the tourism and travel industry is a positive development. Malawi must seek to implement this code and become the champion of sustainable development, even at the micro level. Targeting a special incentive to help promote the code of ethics would be a useful investment incentive.

To sum up: from the analysis, it is recommended that to promote sustainable development in the context of tourism, the Malawi government should do the following:

1. Government should ensure that all policy goals are clearly set.

2. A specific type of FDI should be attracted by formulating a focused set of investment incentives that target a specific activity/set of operators. Such a policy should be very clear, measurable and specific. For example:
   - Incentives to encourage training of staff must target specific training needs.
   - The incentives that seek to encourage investors to set up businesses in a specific location must specify the locations and the duration of the incentives.
   - Generally, incentives need to be targeted and not generalized to tourism only, otherwise government risks financing environmentally unsustainable investments.
   - Tourism must be included in land use planning, especially vis-à-vis the agricultural uses of land.

3. The MRA must be encouraged to enhance information sharing, develop a culture of knowledge creation and better analyze import data. The analysis clearly shows that the extent of the disaggregation of data that takes place at present is too limited for any meaningful government decision-making input.

4. The creation of a common code of ethics for private and public tour and travel operator must be encouraged. A special investment incentive to help promote the COMESA code of ethics would be useful.
5. Regional trade agreements should be utilized to access the resources needed to develop facilities.

6. Investment incentives on offer should be widely and energetically advertised.

7. While environmental and social impact assessments are commonplace, standards and regulations for economic impact assessments must be developed to enable monitoring and auditing of existing tourist developments.

### 6.4 Areas for further research

After two years, the Ministry of Finance expects the MRA (the tax implementing agency) to review whether the incentives that have been given are really being used for their stated purposes. There have been pronouncements in this regard in the 2006/07 and 2007/08 budget statements. This implies that in 2009 the MRA has to undertake this review.

However, such a review would largely match the use of the incentives given against the actual use. It would be a good idea to widen the review to assess such issues as the level of employment created and the quality of the jobs created, the cost–benefit relationship, and sustainability impacts, as well as a review of the policy itself, i.e., that of developing the tourism sector (as recommended by stakeholders).

As noted elsewhere in this study and other mainstream studies, consistent sectoral studies need to be carried out on FDI flows, employment creation, environmental and social degradation, and other finer details that are used as proxies of sustainable development. These need not be extensive, and could, for example, be merely a mechanism to report the number of jobs actually created, the composition of jobs and the type of people employed. The tradeoff between jobs created in the tourism sector in terms of volumes and values relative to area-specific alternative use would be another useful study to assist in policy formulation. Similarly, the finer details of FDI flows should be studied (say, biannually). All these studies should first be carried out by government agencies, while other international institutions can support the process up to a self sustaining level to enable private operators and the government to perceive the value of such studies.

Most private businesses are small and do not go through the official investment promotion agency to establish themselves. Because of their size, the perceived risk is small and they choose to do their own research before entry into the tourism business in Malawi. There are also several small to medium sized businesses operating in the sector, apart from the conspicuous Protea and Sunbird hotel brands. Better understanding of these business establishments would inform future policy in terms of incentives to both domestic and foreign investors. Examining the critical success factors of small foreign owned businesses for entry to the nature based tourism sector would form a very useful study that could provide key insights.
Bibliography


*Sustainable Development Impacts of Investment Incentives: A Case Study of Malawi’s Tourism Sector*
Annex A: Primary Data Summary

Note: n.a. = no answer

Table A1: Residential status of businesses interviewed

<table>
<thead>
<tr>
<th>Residential Status</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>No answer</td>
<td>0%</td>
<td>0%</td>
<td>24%</td>
</tr>
<tr>
<td>Head office in Malawi</td>
<td>63%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Subsidiary</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Table A2: Areas of origin of clients

1 The columns in Table A2 and Table A3 should be aggregated, but each row should be read on its own, indicating the source of one particular group of tourists, as opposed to all the others.

<table>
<thead>
<tr>
<th>Area of Origin of Clients</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>67%</td>
<td>0%</td>
<td>33%</td>
</tr>
<tr>
<td>America</td>
<td>56%</td>
<td>0%</td>
<td>44%</td>
</tr>
<tr>
<td>Asia</td>
<td>56%</td>
<td>11%</td>
<td>33%</td>
</tr>
<tr>
<td>Africa</td>
<td>56%</td>
<td>11%</td>
<td>33%</td>
</tr>
<tr>
<td>North Africa</td>
<td>22%</td>
<td>11%</td>
<td>67%</td>
</tr>
<tr>
<td>Southern Africa</td>
<td>33%</td>
<td>11%</td>
<td>56%</td>
</tr>
<tr>
<td>Urban</td>
<td>44%</td>
<td>0%</td>
<td>56%</td>
</tr>
<tr>
<td>Blantyre</td>
<td>56%</td>
<td>11%</td>
<td>33%</td>
</tr>
<tr>
<td>Lilongwe</td>
<td>56%</td>
<td>11%</td>
<td>33%</td>
</tr>
<tr>
<td>Mzuzu</td>
<td>33%</td>
<td>0%</td>
<td>67%</td>
</tr>
<tr>
<td>Other</td>
<td>33%</td>
<td>0%</td>
<td>67%</td>
</tr>
</tbody>
</table>

Table A3: Predominant activities of tourists

<table>
<thead>
<tr>
<th>Predominant Activities of Tourists</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holiday/leisure</td>
<td>78%</td>
<td>0%</td>
<td>22%</td>
</tr>
<tr>
<td>Conference</td>
<td>22%</td>
<td>22%</td>
<td>56%</td>
</tr>
<tr>
<td>Transit</td>
<td>22%</td>
<td>0%</td>
<td>78%</td>
</tr>
</tbody>
</table>

Table A4: Drivers of investment

<table>
<thead>
<tr>
<th>Drivers of investment for the 80% of investors into the tourism industry who would still have invested in Malawi even without incentives</th>
<th>Very important</th>
<th>Moderately important</th>
<th>Not important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market size</td>
<td>50%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Market growth and raw materials are important factors</td>
<td>50%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Cost of raw materials</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Cost of labour</td>
<td>67%</td>
<td>33%</td>
<td>0%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>Competition in tourism sector in Malawi</td>
<td>0%</td>
<td>25%</td>
<td>75%</td>
</tr>
</tbody>
</table>

20% of investors into the tourism industry would NOT have invested in Malawi without incentives.

Relative importance of the incentive package

<table>
<thead>
<tr>
<th>Relative importance of the incentive package</th>
<th>Incentive</th>
<th>Very important</th>
<th>Moderately important</th>
<th>Not important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for investment</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Free repatriation of dividends, profits and royalties</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Corporate tax rate</td>
<td>0%</td>
<td>100%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Allowance for qualifying training costs</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Duty-free status</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td></td>
</tr>
</tbody>
</table>
Table A5: Drivers of the nature of business in tourism

<table>
<thead>
<tr>
<th>Nature of business not driven by incentives offered</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree of the tourism sector integration</td>
<td>50%</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>Size of business</td>
<td>100%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Quality of labour</td>
<td>100%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Cost of labour</td>
<td>100%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Ease of establishment</td>
<td>100%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Timing of entry</td>
<td>100%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Site location within the country</td>
<td>n.a.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table A6: Incentive administration in Malawi

<table>
<thead>
<tr>
<th>Tour operators’ expectations of treatment received</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected treatment: e.g., duty free</td>
<td>33%</td>
<td>67%</td>
</tr>
<tr>
<td>Actual treatment: Attracting investors</td>
<td>Too costly; too little received; nothing for car</td>
<td>Corruption; not honouring commitment by government</td>
</tr>
</tbody>
</table>

Note: All those applying have to negotiate the expected treatment. 100%

Table A7: Whether the incentives are factored into investment net present value (NPV) calculations

<table>
<thead>
<tr>
<th>Computation of incentives in NPV</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>12%</td>
<td>25%</td>
<td>63%</td>
</tr>
</tbody>
</table>

Table A8: Sources of information (during establishment)

<table>
<thead>
<tr>
<th>Sources of information (during establishment)</th>
<th>Very important</th>
<th>Less important</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ministry of Tourism</td>
<td>33%</td>
<td>0%</td>
</tr>
<tr>
<td>2. MIPA</td>
<td>0%</td>
<td>20%</td>
</tr>
<tr>
<td>3. MRA</td>
<td>0%</td>
<td>50%</td>
</tr>
<tr>
<td>4. Immigration</td>
<td>0%</td>
<td>25%</td>
</tr>
<tr>
<td>5. Malawi Tourism Association</td>
<td>20%</td>
<td>0%</td>
</tr>
<tr>
<td>6. District assembly</td>
<td>0%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Table A9: Business establishment process rated

<table>
<thead>
<tr>
<th>Business establishment process rated</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparent</td>
<td></td>
</tr>
<tr>
<td>Long and complex</td>
<td></td>
</tr>
</tbody>
</table>
Table A10: Government performance requirements

<table>
<thead>
<tr>
<th>Requirement</th>
<th>60% Yes</th>
<th>40% Yes</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local content (capital goods)</td>
<td>22%</td>
<td>0%</td>
<td>78%</td>
</tr>
<tr>
<td>Local content (materials)</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Foreign exchange deposits on:</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Materials imports</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Capital imports</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Dividend repatriations</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Debt/equity ratio limits</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Limits on use of used equipment</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Limits on use of expatriates</td>
<td>22%</td>
<td>0%</td>
<td>78%</td>
</tr>
<tr>
<td>Nationalization of labour force</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Joint venture requirements</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
<tr>
<td>Training requirements</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
</tbody>
</table>

Table A11: Government performance requirements rated

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Did the package of performance requirements influence location decisions?</td>
<td>33%</td>
<td>67%</td>
</tr>
<tr>
<td>When reviewing, monitoring and controlling performance requirements, was conduct of government agencies as expected?</td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>Have original agreements been renegotiated?</td>
<td>75%</td>
<td>25%</td>
</tr>
<tr>
<td>Did the firm make counterproposals to authorities providing investment incentives?</td>
<td>0%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table A12: Environmental impact assessment requirement (as perceived by tourism firms)

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Very Important</th>
<th>Less Important</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Construction or expansion &gt;50 people</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>a. resort facilities and hotels</td>
<td>0%</td>
<td>0%</td>
<td>11%</td>
</tr>
<tr>
<td>b. safari lodges</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>ii. Construction or expansion of marine facilities</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>iii. Development of a master plan</td>
<td>11%</td>
<td>0%</td>
<td>11%</td>
</tr>
<tr>
<td>iv. Projects proximity to</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. areas of unique significance</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>b. protected areas</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>c. water bodies, wetlands, etc.</td>
<td>11%</td>
<td>0%</td>
<td>11%</td>
</tr>
<tr>
<td>d. cemeteries or ancestral shrines</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Table A13: Perception of laws and regulations that affect investment decisions

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Good</td>
<td>33%</td>
<td>22%</td>
<td>45%</td>
</tr>
<tr>
<td>(b) Complete and readily available</td>
<td>22%</td>
<td>33%</td>
<td>45%</td>
</tr>
<tr>
<td>(c) Stable and consultative</td>
<td>33%</td>
<td>22%</td>
<td>45%</td>
</tr>
<tr>
<td>(d) Outdated</td>
<td>33%</td>
<td>22%</td>
<td>45%</td>
</tr>
<tr>
<td>(e) No idea</td>
<td>11%</td>
<td>0%</td>
<td>89%</td>
</tr>
</tbody>
</table>
### Table A14: Need for skill in dealing with government agencies

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>56%</td>
<td>0%</td>
<td>44%</td>
</tr>
<tr>
<td>Low</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>High skills with respect to:</th>
<th>Very important</th>
<th>Less important</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incentives</td>
<td>33% 11% 0%</td>
<td>0% 0% 56%</td>
<td></td>
</tr>
<tr>
<td>Performance requirements</td>
<td>22% 11% 11%</td>
<td>0% 0% 67%</td>
<td></td>
</tr>
<tr>
<td>Investment regulations</td>
<td>22% 0% 22%</td>
<td>0% 0% 78%</td>
<td></td>
</tr>
</tbody>
</table>

### Table A15: Whether various factors are of concern or not

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poverty</td>
<td>60%</td>
<td>0%</td>
</tr>
<tr>
<td>Crime</td>
<td>60%</td>
<td>0%</td>
</tr>
<tr>
<td>Terrorism</td>
<td>60%</td>
<td>0%</td>
</tr>
</tbody>
</table>

### Table A16: Social, economic or political risk assessment undertaken frequently

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation rate</td>
<td>0%</td>
<td>33%</td>
</tr>
<tr>
<td>Foreign exchange rates</td>
<td>0%</td>
<td>33%</td>
</tr>
<tr>
<td>Interest rate</td>
<td>33%</td>
<td>0%</td>
</tr>
</tbody>
</table>

### Table A17: Significance of various factors for investment decisions

<table>
<thead>
<tr>
<th></th>
<th>Cheap</th>
<th>Moderate</th>
<th>Expensive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skilled</td>
<td>0%</td>
<td>80%</td>
<td>20%</td>
</tr>
<tr>
<td>Unskilled</td>
<td>40%</td>
<td>60%</td>
<td>0%</td>
</tr>
</tbody>
</table>

### Table A18: Language constraint for business operations

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chichewa</td>
<td>50%</td>
<td>33%</td>
<td>17%</td>
</tr>
<tr>
<td>English</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>French</td>
<td>50%</td>
<td>17%</td>
<td>33%</td>
</tr>
<tr>
<td>Chinese</td>
<td>17%</td>
<td>50%</td>
<td>33%</td>
</tr>
<tr>
<td>Other (state)</td>
<td>17%</td>
<td>17%</td>
<td>66%</td>
</tr>
<tr>
<td>Whether firms would consider training locally recruited personnel</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table A19: Malawi government’s provision of infrastructure/services

<table>
<thead>
<tr>
<th>Service</th>
<th>Excellent</th>
<th>Average</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roads</td>
<td>43%</td>
<td>29%</td>
<td>0%</td>
</tr>
<tr>
<td>Public transport services</td>
<td>0%</td>
<td>57%</td>
<td>14%</td>
</tr>
<tr>
<td>Airport and flights</td>
<td>14%</td>
<td>0%</td>
<td>29%</td>
</tr>
<tr>
<td>Utilities (telecommunications, water, electricity)</td>
<td>0%</td>
<td>0%</td>
<td>29%</td>
</tr>
<tr>
<td>Solid waste collection and disposal services</td>
<td>0%</td>
<td>29%</td>
<td>14%</td>
</tr>
<tr>
<td>Policing and security</td>
<td>14%</td>
<td>29%</td>
<td>43%</td>
</tr>
<tr>
<td>General cleanliness</td>
<td>0%</td>
<td>29%</td>
<td>29%</td>
</tr>
<tr>
<td>Information provision to tourists</td>
<td>14%</td>
<td>0%</td>
<td>43%</td>
</tr>
</tbody>
</table>

Table A20a: Reasons for choosing Malawi as an investment destination

<table>
<thead>
<tr>
<th>Reason</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The warm heart of Africa</td>
<td>83%</td>
<td>0%</td>
<td>17%</td>
</tr>
<tr>
<td>Proximity to South Africa</td>
<td>67%</td>
<td>17%</td>
<td>16%</td>
</tr>
<tr>
<td>Vast and unique natural resources</td>
<td>83%</td>
<td>17%</td>
<td>0%</td>
</tr>
<tr>
<td>Ease of access by air</td>
<td>50%</td>
<td>17%</td>
<td>33%</td>
</tr>
</tbody>
</table>

Table A20b: Reasons for choosing a specific business location

<table>
<thead>
<tr>
<th>Reason</th>
<th>Yes</th>
<th>No</th>
<th>n.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Availability of land</td>
<td>50%</td>
<td>17%</td>
<td>33%</td>
</tr>
<tr>
<td>Cost of land/rent</td>
<td>67%</td>
<td>17%</td>
<td>16%</td>
</tr>
<tr>
<td>Attractive environment</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Housing developments in the area</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
</tr>
</tbody>
</table>

Annex B: Secondary Data Summary

Table B1a: Top 10 imports, July 2006–June 2007

<table>
<thead>
<tr>
<th>Rank</th>
<th>HS code</th>
<th>Description</th>
<th>Value (MWK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>25231000</td>
<td>Cement clinkers</td>
<td>2,369,785,360</td>
</tr>
<tr>
<td>2</td>
<td>72104900</td>
<td>Flatrolled iron/steel, width&gt;=600 mm; zinc</td>
<td>2,030,682,698</td>
</tr>
<tr>
<td>3</td>
<td>72142000</td>
<td>Iron/steel bars &amp; rods, hotrolled, twisted</td>
<td>660,322,640</td>
</tr>
<tr>
<td>4</td>
<td>25232900</td>
<td>Portland cement (excl. white)</td>
<td>409,464,421</td>
</tr>
<tr>
<td>5</td>
<td>72104100</td>
<td>Flatrolled iron/steel, width&gt;=600 mm, plated</td>
<td>380,342,356</td>
</tr>
<tr>
<td>6</td>
<td>85442000</td>
<td>Co-axial cable and other co-axial electric cable</td>
<td>120,337,530</td>
</tr>
<tr>
<td>7</td>
<td>73082000</td>
<td>Towers and lattice masts of iron or steel</td>
<td>105,506,459</td>
</tr>
<tr>
<td>8</td>
<td>84192000</td>
<td>Medical, surgical or laboratory sterilizers</td>
<td>90,467,531</td>
</tr>
<tr>
<td>9</td>
<td>73089000</td>
<td>Structures and parts of structures, NES</td>
<td>63,804,302</td>
</tr>
<tr>
<td>10</td>
<td>39202000</td>
<td>Plates ... of polymers of propylene</td>
<td>63,788,521</td>
</tr>
</tbody>
</table>

Source: MRA (2007)
Table B1b: Top 10 CPC 4071.442

<table>
<thead>
<tr>
<th>HS code</th>
<th>Description of goods</th>
<th>Tax assessed (MWK)</th>
<th>Tax paid (MWK)</th>
<th>Tax loss to government (MWK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>8702</td>
<td>Of a seating capacity of 10</td>
<td>94,562,324</td>
<td>27,607,284</td>
<td>66,955,040</td>
</tr>
<tr>
<td>8703</td>
<td>Of a cylinder capacity exceeding 3,000 cc</td>
<td>84,046,138</td>
<td>25,601,102</td>
<td>58,445,035</td>
</tr>
<tr>
<td>3924</td>
<td>Blankets (excl. electric blankets), etc.</td>
<td>64,435,851</td>
<td>24,360,989</td>
<td>40,074,862</td>
</tr>
<tr>
<td>6301</td>
<td>Spoons, forks, ladles, skimmers</td>
<td>31,351,251</td>
<td>16,075,304</td>
<td>15,275,947</td>
</tr>
<tr>
<td>8516</td>
<td>Electric ovens, NES; cookers, cooking</td>
<td>23,396,700</td>
<td>10,345,462</td>
<td>13,051,238</td>
</tr>
<tr>
<td>6912</td>
<td>Ceramic tableware</td>
<td>19,020,433</td>
<td>10,313,012</td>
<td>8,707,421</td>
</tr>
<tr>
<td>6803</td>
<td>Tablecloths and serviettes of paper</td>
<td>16,220,822</td>
<td>8,157,273</td>
<td>8,063,549</td>
</tr>
<tr>
<td>7013</td>
<td>Drinking glasses (excl. of lead crystal)</td>
<td>16,216,729</td>
<td>8,849,776</td>
<td>7,366,953</td>
</tr>
<tr>
<td>5705</td>
<td>Other carpets and other textile flooring</td>
<td>17,766,004</td>
<td>10,452,552</td>
<td>7,313,453</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>382,247,213</td>
<td>147,597,437</td>
<td>234,649,775</td>
</tr>
</tbody>
</table>

8702 Motor vehicles for the transport of ten or more persons, including the driver
8702.1030 Of a seating capacity of 45 persons or more persons including the driver
8703 Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars
8703.2400 Of a cylinder capacity exceeding 3,000 cc. Other vehicles, with compression-ignition internal combustion piston engine (diesel or semi-diesel)

Source: MRA (2008)

Table B2: Indicative list of tax incentives beneficiaries,1 2008/09 financial year

<table>
<thead>
<tr>
<th>Project name</th>
<th>Project type</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Nkhwazi Eco-lodges Ltd</td>
<td>Lodge</td>
<td>Chitcheche/ Nkhatabay</td>
</tr>
<tr>
<td>2 Fundwe Leisure Garden</td>
<td>Lodge (eco lodge)</td>
<td>Likoma Island</td>
</tr>
<tr>
<td>3 J&amp;K Car hire</td>
<td>Car hire</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>4 Galaxy</td>
<td>Hotel</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>5 Pacific Hotel</td>
<td>Hotel</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>6 Mimoza Hotel</td>
<td>Hotel</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>7 Mufasa Lodges</td>
<td>Lodge</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>8 Cluny Lodge</td>
<td>Lodge</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>9 Pine Lodge</td>
<td>Lodge</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>10 Dalitso Lakeshore Holiday Resort</td>
<td>Lodge</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>11 Sino Garden Company Ltd</td>
<td>Lodge</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>12 Nature Sanctuary Lodge</td>
<td>Lodge (eco-lodge)</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>13 Ufulu Gardens</td>
<td>Lodge</td>
<td>Lilongwe</td>
</tr>
<tr>
<td>14 Michiru Gardens Lodge</td>
<td>Lodge</td>
<td>Lilongwe, Area 9</td>
</tr>
<tr>
<td>15 Wilderness Safaris</td>
<td>Safari</td>
<td>Lilongwe, city centre</td>
</tr>
<tr>
<td>16 Siku Car Hire Services</td>
<td>Car hire</td>
<td>Limbe</td>
</tr>
<tr>
<td>17 Ng’adzi Lodge</td>
<td>Lodge</td>
<td>Mangochi</td>
</tr>
<tr>
<td>18 Northern Car Hire</td>
<td>Car hire</td>
<td>Mzuzu</td>
</tr>
<tr>
<td>19 Paris Car Hire</td>
<td>Car hire</td>
<td>Mzuzu</td>
</tr>
<tr>
<td>20 The Lake View Ridge Country Club</td>
<td>Lodge</td>
<td>Mzuzu</td>
</tr>
<tr>
<td>21 Zulunkhuni River Lodge</td>
<td>Lodge</td>
<td>Nkhatabay</td>
</tr>
<tr>
<td>22 Mpatsa Lodge</td>
<td>Lodge</td>
<td>Senga &amp; Salima Bay</td>
</tr>
<tr>
<td>23 Sunbird Hotels</td>
<td>Hotel</td>
<td>Various</td>
</tr>
<tr>
<td>24 Luba Ethnic Lodge</td>
<td>Lodge</td>
<td></td>
</tr>
<tr>
<td>25 Free Eco-Tourist Resort Complex</td>
<td>Lodge (eco resort complex)</td>
<td></td>
</tr>
</tbody>
</table>

1 Nearly 76 per cent were local investors.

Sustainable Development Impacts of Investment Incentives: A Case Study of Malawi’s Tourism Sector
Annex C: Letter from the Executive Director of the Malawi Tourism Association to Nelson Nsiku

MALAWI TOURISM ASSOCIATION
P.O. Box 1044
Lilongwe
Tel. 01 770 010
Fax: 01 770 131
E-mail: mta@malawi.net
Website: www.malawi-tourism-association.org.mw

Ref. No. MTA 04/2

19th December, 2008.

Nelson Nsiku
Polytechnic
P/Bag 303
Blantyre 3

Dear Sir,

Comments on the sustainable development of investment incentives in Malawi’s tourism sector

It was nice to meet you and the rest of the team at Malawi Sun Hotel two weeks ago. Sorry I could not send my comments earlier than now due to other commitments. I wish to confirm my comments as follows:

(i) There have been many studies before on which no action has been taken. It will be a pity if this study will end up as just another academic exercise.

(ii) It is important that we know from the outset the objectives of the study and how it will help us all. We hope that somehow a way of making the recommendations actionable by the various authorities concerned will be found.

(iii) A comprehensive comparison of incentives in the region would help us a great deal in trying to convince the various authorities about changes in policies.

(iv) Although Malawi is endowed with many tourist attractions, it is not a very strong destination even if you compare it to our neighbours. For example, Zambia and Zimbabwe have two of the Wonders of the World besides plenty of game, better facilities and better accessibility from the tourist market sources. As such, incentives are important for us to attract investment.

(v) The subject of incentives should not be limited to fiscal issues only. Training, investment environment, provision of infrastructure, etc form part of incentives. As I pointed out, the provision of incentives should be considered as long term investment. In our case the current incentives regime is hardly two years old. I believe we need more time to assess its effectiveness. I am rather worried by your finding that the investors you interviewed said they would invest...
in Malawi whether there are incentives or not. This could be because most of the operators you met were medium/small scale investors. I believe big scale investors would need incentives in most cases.

(vi) Foreign exchange leakages are a major problem particularly in the developing world where most of the investors may be from abroad. Even the provision of such important services as air connections and hotel and other tourism enterprise management are mostly provided by foreign companies and expatriates.

(vii) The issue of right of indigenous people along the beaches is also important as sometimes they resent the presence of tourists if that denies them what they consider their birth right. However, in our case that has created health problems because of lack of or inadequate sanitation facilities. In some cases, people use the surrounding bushes as open toilets and the sandy nature of the soil make pit latrines difficult to maintain particularly during the rainy season. You will also find some practices worrisome, for example it is common to find people washing almost everything including baby's nappies in the lake, and of course using the lake as drink place for cattle and domestic animals. The issue of bilharzia in Lake Malawi is one of our major worries.

(viii) I wish to maintain that our interpretation of our tourism figures needs to be a bit careful as many of the people we count as tourists although it may be in accordance with the WTO definition. I honestly believe that most of the visitors that come from the region are cross border traders the net result of which could be a loss of the forex earned from tourism. This is of course my view and not MTAs because I have not sought a collective view from members but I believe most of them would agree with me.

Yours faithfully,

S.K. Botomani
Executive Director