



# 2005/2006 BUDGET STATEMENT

DELIVERED IN THE  
NATIONAL ASSEMBLY OF MALAWI

BY

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MINISTER OF FINANCE

AT

THE NEW STATE HOUSE, LILONGWE

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## 2005/2006 BUDGET STATEMENT

### *Motion*

1. Mr. Speaker, Sir, and Honourable Members, I beg to move that the estimates of the Recurrent Account and the Development Account of the 2005/2006 budget be referred to the Committee of the whole to consider them Vote by Vote and by Head and, thereafter, that they be adopted.

### *Introduction*

2. Mr. Speaker, Sir, before I proceed with the presentation of the budget, allow me to acknowledge the support my Ministry has been privileged to enjoy as we implemented the 2004/2005 financial year budget. Let me, Honourable Members, first single out the guidance from His Excellency the President, Dr. Bingu wa Mutharika, which has been so important to me. I have relied on His Excellency's political and technical inspiration and his determination to succeed. The President has encouraged me by highlighting our achievements and by constantly inspiring me with his vision whose goal posts are so relevant to what our country has to do. Your Excellency, let me, on behalf of my Cabinet colleagues, publicly acknowledge how grateful we have been for your leadership during the first year of our stewardship. There is a well known adage within the international donor community. In these circles, it is strongly believed that an indication of a country's ability to succeed in its

economic management and in carrying out its economic development agenda is provided by how the leader of a nation conducts himself in matters of public finance. In this respect. I want to say how grateful we have been to His Excellency the President this first year.

3. Mr. Speaker, Sir, it will also be remiss of me to omit paying tribute to this Honourable House for creating what I consider to have been a vibrant parliamentary environment. I have been impressed that regardless, at times, of acrimonious debates that have prevailed, eventually where it has mattered, we have rallied support behind the public good and emerged with a consensus that has been considered vital to our people. Honourable Members will wish me to publicly state that this accomplishment has been due to your fatherly leadership, Mr. Speaker, Sir. On behalf of my Cabinet colleagues and, here may I dare also to speak on behalf of all Honourable Members, may I, with all candor, express our gratitude also to the leadership that constitutes our Business Committee. The fact that the Committee comprises the country's cream of political leaders, eminent and experienced statesmen has counted in leading the House to rally behind the vital interest of our people. This will be even more important during the 2005/2006 financial year.

4. I say this, Mr. Speaker, Sir, because, as I proceed with my presentation of the budget, you will see that the country will need this statesmanship of the House more than ever. For I believe that the year could be a defining one for the country. The House will be called upon to oversee a huge public investment programme that could have an immediate positive impact on the welfare of the people. The question that is continuously posed and is being posed now is whether we will continue to be guided by the public interest as has been the case so far, or whether we will put parochial interests above those of our people. In my view, we are being challenged by the availability of resources which donors have dangled before us. This money could prevent the prevalence of hunger, it could permit the rehabilitation of our roads, the construction of schools and hospitals and the creation of employment opportunities for our people. Therefore, I hope as we have done throughout the year, we could rally round this development programme and emerge with a consensus to move ahead in the interest of reducing the suffering of our people.

5. Mr. Speaker, Sir, in March 2005, I made a comprehensive report to the House about the first half budgetary outturn. I also gave a forecast of the financial budgetary outcome at the end of the 2004/2005 financial year. In some detail I reported to the House the outcomes of the initiatives that had been implemented. Here, with the

permission of the House, I will restrict the 2004/2005 budgetary review to our final projections of the financial outcomes of that year's budget.

6. Mr. Speaker, Sir, the House also will recall that the budget was anchored by a Staff Monitored Programme of the International Monetary Fund. The implementation of this programme commenced on July 1<sup>st</sup>, 2004 and covered the entirety of the 2004/2005 financial year. I am pleased to confirm to the House that on the basis of a successful implementation of this programme, the IMF and the government completed discussions of a formal PRGF programme that could replace the Staff Monitored Programme. The programme is expected to be presented for the IMF board approval shortly after the 2005/2006 budget is approved by Parliament.

#### *Fiscal Performance for 2004/2005 Financial Year*

7. Mr. Speaker, Sir, let me now summarize our fiscal performance for the year 2004/2005. The majority opinion including that of the international community, particularly the World Bank and the International Monetary Fund, is that this year, Malawi's fiscal performance has been good. However, as I have so often said, to intensify this fiscal improvement, we should now push on with the re-establishment of an administrative mechanism that strengthens the adherence to our own financial procedures, rules and regulations. This will ensure the prevalence of a culture of managing financial affairs within given budgetary limitations without the prodding of

the Treasury. Ministries must make adherence to the budget as approved by Parliament to be a limitation to what they wish to do. We must learn to do much with the little that we have. This must be the cornerstone of our financial management. Only then can we establish real fiscal discipline.

8. With this caution in mind, Mr. Speaker, Sir, as I indicated to the Honourable Members in March, I wish to inform the House that we will most certainly end 2004/2005 with total revenues and grants which will be approximately K2,900 million higher than the approved amount. We collected more domestic revenue than projected and despite the absence of a formal programme with the IMF, a number of donors disbursed their Balance of Payments support.

9. On the expenditure side, Mr. Speaker, Sir, it is expected that most Votes will have lived within their ORT expenditures as Honourable Members will see from the financial statements for the 2004/2005 financial year. Because some Votes underspent their allocations, the overall net total over-expenditure will be just under K2,000 million. This is about 2.0 percent of total expenditure and 0.8 percent of GDP and relatively small by international standards. That is why the international community has been satisfied with our performance.

10. The overall picture as you will see from the various statements is that we will end the year with a fiscal deficit of K7,859 million in 2004/2005 which is lower than the deficit of K8,805 million that was sanctioned by Parliament. This is an important indicator that the Government and Parliament exercised fiscal discipline this year. As I said, if we can maintain this control of public expenditure, it should augur well for the attainment of a number of our economic goals. These must include the reduction of the domestic debt and interest rates. As we continue to reduce the budgetary deficit, the Government will also be able to contribute significantly towards the needed improvement of the domestic savings ratio, which, lamentably, continues to be negative.

### ***World Economic Outlook***

11. Mr. Speaker, Sir, and Honourable Members, the 2005/2006 budget is being formulated in the context of a rather favourable global demand for our exports and a favourable environment for aid flows to developing countries such as Malawi. We hope the practical results of the Paris conference on enhancing aid effectiveness will indeed lead to the reliability of pledged financial assistance from donors; without the interruptions, which this country has experienced, over the last decade.

12. Mr. Speaker, Sir, the world economy remained strong despite the adverse impact of high and volatile oil prices. The ever increasing petroleum prices over the

last year and the prospects of continued increase of oil prices are almost the only major adverse development within the global world. As of April, 2005 petroleum prices stood at an average of USD53 per barrel from an average of US\$37 per barrel a year before, representing an increase of 45 percent. During that year however, the Petroleum Pricing Committee has only allowed an increase of 19 percent in oil prices in Malawi. There are indications that price hikes will continue to about USD54/barrel in the remainder of 2005. As our price buffer mechanism is almost exhausted it will be imperative in the course of the year to increase oil prices in tune with the changes of world oil prices.

13. Despite these developments in the international oil market the world economy has been expanding consistently and the IMF estimates that the global GDP for 2005 will be growing at the rate of 4.3 percent and that during 2006 growth will continue at the rate of 4.4 percent. In fact the slower growth rate in 2005 is largely attributed to oil price increases and the aftermath of the natural disasters such as the Indian Ocean Tsunami in Asia.

14. Mr. Speaker Sir, within the global economy, growth in industrialized countries is estimated at 2.6 percent and is projected at 3.0 percent in 2006. The United States economy whose growth is projected at 3.6 percent in 2005 has continued to grow at

above that trend, and has largely been driven by strong domestic demand. In contrast, growth in the euro area, estimated at 1.6 percent in 2005 has been markedly slower. In Japan, estimates reveal that growth has stalled since the second quarter of 2004 due to poor performance in exports, investment and domestic consumption. For the euro area and Japan, sharp currency appreciation has been the major risk to growth, while the depreciation of the dollar has helped to improve the competitiveness of the American economy.

15. GDP growth for the sub-Saharan Africa is estimated to grow by 5.1 percent in 2004, largely due to prudent domestic macroeconomic policies, progress with structural reforms, buoyant commodity prices, ending of several armed conflicts as well as the impact of the debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. Looking ahead, prospects in 2005 remain favourable with growth of 5.2 percent and 5.6 percent in 2006, primarily due to continued strong growth in oil-producing countries. However, for this region, much depends on the improved political stability and weather conditions that often have significant bearing on the region's economic activity. On the whole, therefore, the global economy is experiencing continued heightened activity and should provide strong demand for primary commodities from African countries including Malawi.

16. Nearer home, Mr. Speaker Sir, within the SADC area, growth is expected to reach 5.9 percent in 2005 and 5.0 percent in 2006 compared to 4.9 percent in 2004. However, a number of important challenges to most SADC member states still remain including high oil prices, the elimination of world textile trade quotas, which will increase competition in the United States and Europe largely from low-cost Asian countries.

17. Focusing more on our major trading partner South Africa, its economy is experiencing strong output growth due to gains from increased employment in the formal sector. The country's GDP grew by 3.7 in 2004, and is expected to reach 4.0 percent in 2005. Economic activity is largely being driven by buoyant domestic demand, which has been fuelled by low interest rates and the wealth effects of booming asset prices.

### ***Malawi's Economic Outlook***

18. The economic performance in the SADC region contrasts sharply with the experience in Malawi where growth rate is estimated at just under 3.0 percent in 2005. The slow growth projection is attributed to the dry spell that the country has experienced during the last rainy season and which has severely devastated our agricultural production. However, within this dismal overall growth were some impressive sectoral growth rates. It is projected that construction will grow at the rate

of 17.1 percent and that the services sector will also grow strongly by 10.0 percent on account of continued growth in the transport, communications and distributions sectors. Depending on the weather conditions and the expected rebound in agriculture production, the IMF forecasts that in 2006 Malawi could attain growth rate of 8.2 percent. This would be due to the improved fiscal management in Malawi that could lead into low interest rates, stable exchange rates and a higher investment ratio as a result of a large Government capital expenditure that is being planned under the 2005/06 budget.

19. Headline inflation rate by the end of 2005 is projected at 16.9 percent compared to 13.7 percent in 2004. Most of the inflationary pressure is expected from the scarcity of food items as is reflected in the relatively higher food inflation rate of 19.2 percent by end 2005. However, the core inflation that excludes food is estimated at 13.8 percent. Looking further ahead into 2006, and again depending on favourable weather conditions and the mitigating effects of the irrigation programme that the Government has put in place, food inflation is projected to decline to 0.5 percent by December, thereby bringing headline inflation down to 3.9 percent. Mr. Speaker Sir, the Government is striving to achieve the stability of the real exchange rate, however, due to the projected increase in the inflation rate in 2005, the nominal exchange rate is expected to adjust somewhat. Interest rates are also expected to

decline progressively in 2005 and 2006 due to the stabilization and a possible reduction of the domestic debt stock during the 2005/2006 fiscal year.

20. Let me divert a little, Mr. Speaker, Sir, to highlight an important economic problem we are facing in Malawi. Over the past two decades or so, our ability to save and mobilize domestic funds for investment has continued to decline. As Honourable Members are aware the higher the amount of investment, the higher our economic growth will be of course. However, as of now far from increasing the savings ratio we have been living beyond our means. Our savings ratio this year, for example, is projected at minus 11 percent of GDP which means that we are consuming far more than we are producing and have not been able to generate internal financial resources for investment for a long time. In fact, we rely on external flows including official aid not only for investments but for sustaining our level of consumption as well. No country can sustain high economic growths unless it generates its own savings. Reversing this trend therefore ought to be one of the major cornerstones of economic policy and an objective of budgets. The 2005/2006 budget tackles this problem by providing for a large reduction of the budgetary deficit from K7.9 billion last year to just under K3.0 billion and next year to a possible surplus. But looking beyond the budget, it will be important for this country to change the mind set of its population to consume less of what they produce. The importance

that is attached to savings is a major difference between African and Asian countries and the Malawi of the 1970s and the Malawi of today.

### *Perspectives of the 2005/2006 budget*

21. Mr. Speaker, Sir, let me now highlight some of the landmarks of the budget that I am about to present. The first and foremost of course is a continuation of the strengthening of expenditure control mechanisms. It is expected that during the year we will implement the IFMIS public accounting computer system allowing us to centralize the government's payment system. This will enable us to revert to a system that Malawi practiced prior to the decentralization of government accounts where each ministry has its own bank accounts. It is expected that this system will contribute strongly to the improvement of budgetary management.

### *Domestic Debt*

22. Mr. Speaker, Sir, once again the budget has been formulated against a backdrop of a huge domestic debt. We have managed to stabilize the level of domestic debt during the latter part of this year but we must now start reducing it. A reduction of the domestic debt by a significant amount just over K2.5 billion will be one of the most important objectives of the budget. It is expected that with the continued fiscal discipline and the progressive confidence the Government will have gained in the domestic financial market, it will be possible to change the composition

of the domestic debt from one which is dominated by short term treasury bills to one that is dominated by longer dated local registered stocks with much lower interest rates. The reduction of the domestic debt and a restructuring of its composition will, it is hoped, sharply reduce interest rates and that the interest rate bill of the budget will be further reduced in the course of the year. The ability to achieve this goal will of course depend upon whether we can sustain fiscal discipline.

### ***Repayment of Arrears***

23. Mr. Speaker, Sir, another landmark of the budget will be the beginning of repayments of domestic arrears that had accumulated up to June 30, 2004. Starting from 1<sup>st</sup> July 2004 we have required ministries to use their own resources to pay outstanding bills so that we do not carry over arrears to the next year. We will enforce this policy rigorously. Mr. Speaker, Sir and Honourable Members, according to the Auditor General, as at end June 2004 total domestic arrears amounted to K10.3 billion. Arrears are distinctly separate from the K60,000 million domestic debt stock that is largely borrowed by Government through the issue of Treasury Bills and such other instruments. Domestic arrears, on the other hand, are “unpaid bills” by Government to suppliers of goods and services. The Auditor General has now completed his audit of the arrears and the government has formulated a strategy for tackling this problem.

24. Honourable Members, the strategy requires that the arrears be verified and be probed for their legality and transparency. A special unit within the Accountant General has now been created to deal exclusively with the verification and settlement of arrears. We will start paying arrears to the parastatals and small businesses in the order of when arrears became due. A statement on this programme will be issued shortly so that the public knows how the matter is being handled. During the 2005/2006 financial year we expect to pay an amount of K2 billion to clear a portion of these arrears.

### *Maize Imports*

25. Mr. Speaker, Sir, the disappointing harvest has necessitated that the importation of maize should once again be a major element of the budget. As a country, we expect to import approximately 300,000 tons of maize. This is the largest amount that has ever been imported and reflects the Government's view of the intensity of the maize shortage. Of this amount, 250,000 tons will be imported through this budget and has started to be distributed freely around the country. The rest will be imported and distributed commercially by the private sector. If this does not happen we have contingency plans for bringing in further supplies of maize which I will indicate later to the House. It is expected that close to K5.6 billion or more will be spent on the importation of maize through the budget and its distribution countrywide.

26. Mr. Speaker, Sir, I know that you will wish me to take this opportunity to thank particularly the Department for International Development (DFID) of the United Kingdom and the European Union for having agreed to join the Government in providing resources for maize imports and distribution. The House will also wish to be informed that several other countries such as Norway, the United States and Sweden are about to decide to join us and we would welcome this humanitarian gesture. The World Bank and the IMF have also indicated their financial support which will be crucial for the acquisition of the foreign exchange that this maize programme will need.

27. I also wish to record our continued appreciation of the work that is being done by the World Food Programme of the United Nations for having consistently and tirelessly assumed a leading role in the distribution of food to the needy in Malawi. WFP continues to be effective in its food distribution mechanism. On behalf of the Government I wish to reiterate our appreciation to both the WFP which has agreed to continue the distribution of food, particularly in the most acutely affected areas and DFID. DFID will not only co-fund together with the EU and the Government the importation of maize, but it will also provide the logistics for the food distribution in the Northern and Central regions. All in all, as has been the case in the past, the donor community as a whole has been extremely forthcoming in dealing with the

food situation in terms of providing financial assistance as well as ideas on how to tackle the problem.

28. I wish to repeat to the House what His Excellency the President announced some four days ago that the distribution of food has already started. In order to make doubly sure that there shall be enough maize and other basic food requirements to distribute to the needy people; this year, over and above the importation of maize, we will purchase options from suppliers of maize in South Africa. This will enable us to bring in further supplies of maize if food requirements become larger than our present estimates indicate or if the private sector does not perform as expected. This is the first time that, with the assistance of our High Commission in South Africa, such an arrangement is being used. Many countries including Angola, Lesotho, parts of the Congo, Swaziland, Zambia and Zimbabwe will experience acute shortages of maize because of the drought conditions that have afflicted our region. Malawi's devastation appears quite comparable to other countries such as Zambia apart from Zimbabwe which faces a much higher food shortage.

### ***Fertilizer Subsidy***

29. Mr. Speaker, Sir, based upon the ideas that were contributed by the House last year and during the last Parliamentary sitting, we have formulated a new fertilizer subsidy scheme which we are confident will work better. One complication

last year was the involvement of too many fertilizer companies. It was difficult to verify the timely availability of fertilizers from all of them and it became difficult to reconcile the actual foreign exchange spent on the exercise. It has therefore, been decided to use only one company to import 70,000 tons of the fertilizers that the Government will subsidize universally to those who will produce maize. Following a public tender for the contract, the Smallholder Farmer Fertilizer Revolving Fund of Malawi (SFFRFM) to be supported by ADMARC has been selected to procure and distribute the fertilizers.

30. We are confident that the fertilizers will start flowing into Malawi soon in time for the distribution and sales to commence in July/August. The Government stands ready to support both SFFRFM and ADMARC in this respect. It has been decided, again as announced to the House, that we intend to universally subsidize the production of maize. The fertilizers that will be subsidized are the 23:21:0+4s and Urea which are used mostly for maize production. Subsidized quantities of each of these two types of fertilizers will be available in quantities of 30kg to each farmer who will grow maize. The Government realizes that some farmers will be tempted to use the fertilizer to grow tobacco. However, as the amounts available will be in limited quantities and as people who use fertilizer on tobacco are likely to produce less maize, they will be forced to spend their income from tobacco on the purchasing

of maize. Therefore within the limitations of the quantities that are available to an individual, the subsidy facility will be universally available. The Government is confident that based on this arrangement the scheme will succeed.

31. As I indicate below, although DFID has decided to withdraw the TIP, the Government has organized a Public Works Programme in every district that will provide families with opportunities to earn incomes with which to purchase subsidized fertilizers. Again a number of Parliamentarians including the leadership of the Opposition strongly argued that such a programme should replace TIP and that those who do not have the money to buy fertilizers should be empowered to earn the means of buying fertilizers. Thus the subsidy scheme will operate in parallel with Public Works Programme and replace TIP which the opposition parties were vehemently against. The EU and MASAF have run these programmes successfully so far and the government is merely extending their application. We intend to spend K2.2 billion on the fertilizer subsidy scheme and nearly K1.8 billion on the Public Works Programme.

### ***Public Works***

32. The dominant development activity that Government will invest in, this year, will be the rehabilitation and maintenance of roads which will be brought to a gravel standard. It is expected that every district all over the country will have designated

segments of roads that can be rehabilitated. This rehabilitation of roads will use direct labour in the mode of Public Works Department of the colonial times. The aim is to use intensive labour methods of road rehabilitation so as to achieve the dual objectives of creating rural employment opportunities and generate incomes which the public can use to buy food as well as the subsidized fertilizers. This programme will continue for the next five years and it is hoped that we can create employment of 2 million man-days over this period. Thus the programme rolls into one the following; an employment creation programme, a road rehabilitation programme and work for food and fertilizer programme. I would like to thank the European Union for having made the sum of approximately \$5.5 million available for this programme.

### ***Civil Service Reform***

33. Mr. Speaker, Sir, and Honourable Members, we continue to with the civil service wage reform. Government intends to grant a general salary increase again this year that will be effective on 1<sup>st</sup> October, 2005. Let me take the opportunity to address the misconception that the application of the wage reform that last year included a 48 percent general increase, did not result in increased take home pay of individuals. In fact only groups of people in certain grades in the teaching, health and lawyers were in this a situation for a period of a few months. This is because some of their allowances were not transparently given some four years ago and were not reflected as part of the budgetary personnel emoluments bill. They were therefore

not captured by the reform exercise and could not be paid. When they became known, the allowances once more became part of the remuneration of teachers, health staff and lawyers in specific grades and the problem was resolved. We invited those civil servants who continue to receive less take home pay than before to come forward so that their ordeal can be resolved. I would like to inform the House, Mr. Speaker, Sir, that none has done so for the past six months.

34. We intend to press on with these reforms and will yet again award the general salary increase whose level will be known when we know the cost of rectifying the anomalies. The majority of civil servants, the Police and the Army have had their salaries substantially increased. With the tax changes that I am about to announce and the general salary increase, the reforms will undoubtedly improve the welfare of public servants further. We are engaging a new Wage Consultant who this time will be supported and assisted by officials from each of the ministries that are aware of structural anomalies of last year.

### *Tax Review*

35. Lastly, the implementation of the results of the tax review will also be a landmark of the budget.

### *2005/2006 Fiscal Year Budget*

36. Mr. Speaker, Sir, these then are the topical issues of the budget. The 2005/2006 budget has a projected total revenue and grants of K116,188 million (equivalent to 44 percent of GDP) against a total expenditure of K118,801 million (45 percent of GDP). The overall deficit, therefore, is projected at K2,613 million. The budget is therefore planned to educe the deficit from an actual deficit of K7,859 million, (3 percent of GDP) in 2004/2005 to K2,613 million (1 percent of GDP) in 2005/2006. This is a large planned fiscal consolidation of about K5,246 million and underlies a significant fiscal effort to radically improve Malawi's financial position.

37. This is a large planned fiscal consolidation of about K5,244 million and underlies a significant fiscal effort to radically improve Malawi's financial position. Net foreign borrowing after a repayment of K9,393 million is estimated at K4,908 million and we plan to reduce the domestic debt by K2,295 million (0.9 percent of GDP) during the 2005/2006. This is the first time since the escalation of the domestic stock debt, that a sizeable repayment of the domestic stock is likely to be possible. The House will wish to join me in thanking donors who contribute to the balance of payments support who have largely made this possible. These include the EU, DFID of the United Kingdom, the Governments of Norway and Sweden. I look forward to welcoming Germany to this group. If, therefore, the budget is implemented as planned, the financial year could represent a watershed for the domestic debt. We

will have started to achieve the twin goals of our fiscal policy to progressively reduce the budgetary deficit so as to contribute towards the reversal of the declining domestic savings and to reduce the domestic debt and restructure its composition.

38. As I have just reported to the House, we plan to repay an amount of approximately K2,000 million (0.8 percent of GDP) of the K10,300 million (4 percent of GDP) of total domestic arrears which represent the “unpaid bills” of the Government as at end June, 2004. Thus, the Government will devote approximately K4,295 million (1.6 percent of GDP) towards the repayment of the domestic debt and the arrears. I am confident that if we manage our affairs as we have started to do this year, these goals are achievable.

*Expenditure under the 2005/2006 budget*

39. Mr. Speaker, Sir, within the total projected expenditure the recurrent expenditure is estimated at K84,138 million which is approximately 70 percent of the total expenditure and represents 32 percent of GDP. The development expenditure is estimated at K34,663 million representing 13 percent of GDP and approximately 30 percent of the total expenditure. Thus the development programme has been increased by just under 48 percent over that of the 2004/2005 financial year. In terms of resources availability, the bulk of the resources will come from the donor community, which is contributing just over K30,000 million to this programme. I am

confident that if it is executed as planned, it will have an immediate economic impact on the country, both in terms of incomes that would be generated as well in the creation of the needed infrastructure throughout the country. His Excellency has already given an elaborate account of what we plan to do. For emphasis, I will highlight a few issues later.

40. Mr. Speaker, Sir, I wish to request Honourable Members to study particularly Document No.5 which has the details of projects that we wish to implement during the year. His Excellency the President in his speech also gave a detailed account of what we plan to do. In my speech, therefore, I do not intend to repeat this information. As I go along, I will merely mention some projects for emphasis purposes only.

41. Within this increased total expenditure, Mr. Speaker, Sir, the recurrent expenditure of Ministry of Health will be increased by 110.7 percent to approximately K11,058 million of which K4,075 million has been transferred to the district assemblies. Its development expenditure is projected at K1,721 million. The total amount of K12,780 million represents 11 percent of the total expenditure and a growth of almost 35 percent over last year's total budget for the Ministry of Health. This is a large expenditure increase that reflects the Government's concern of health

matters as well as the donor community's determination to contribute towards the attainment of the Millennium Development Goals of the United Nations in the field of health. Honourable Members will recall that the House authorized the Government to receive contributions to the Health SWAP consisting of grants from DFID of the United Kingdom that amounted to K22,284 million, K8,040 million from Norway and K1,812 million from the World Bank making a total of K32,136 million for a programme of six years. Approximately K5,000 million has been allocated from the SWAP programme. Honourable Members will further wish to know that over and above this allocation to the health sector, a further amount of K5,300 million has been allocated to the National Aids Commission for dealing with the HIV/AIDS pandemic. Thus, Mr. Speaker, Sir, an amount of approximately K18,000 million is being devoted to the health sector. This represents approximately 15.22 percent of the total expenditure of the 2005/2006 budget.

42. Mr. Speaker, Sir, the Ministry of Education that received the highest amount of resources in the 2004/2005 budget is being allocated a total amount of K11,935 million, of which K2,635 million will be spent on its development programme. However, with a total expenditure of K3,500 million on the universities, the total government expenditure in the education sector will amount to K15,435 million which

is 13.0 percent of total expenditure. This represents a 25 percent increase on last year's figure.

43. Mr. Speaker, Sir, if expenditure on maize and fertilizer subsidy is taken together with the Ministry of Agriculture's recurrent and development expenditure, the total allocation to the agricultural activities will amount to K12,559 million which is 11 percent of total expenditure. Of this amount K5,600 million will be allocated to the importation and distribution of maize and pulses as explained earlier. This total expenditure is well above the target for spending on agriculture contained in the Maputo SADC declaration. Approximately K2,200 million will be a direct allocation the fertilizer subsidy scheme while a further amount of K700 million for the Public Works Programme will be intended for the procurement of fertilizers by farmers.

44. Mr. Speaker, Sir, as I indicated earlier, one of the landmarks of the 2005/2006 development programme will be the construction and rehabilitation of roads. The Ministry of Transport and Works which will oversee this programme has been allocated a comparatively large increase in its budgetary allocation amounting to K1,173 million, of which approximately K493 million will be on the Development Account and only K679 million will be on the Recurrent Account.

45. Mr. Speaker, Sir, another matter that is worthy of note by Honourable Members, is the increased expenditure on a group of institutions that are responsible for the “governance oversight”. These include the Judiciary, the Ministry of Justice, the Director of Public Prosecutions, the Anti-Corruption Bureau, the Auditor General’s office and the Office of the Ombudsman. To reflect the importance which Government attaches to issues of good governance, and to emphasize its policy of “zero tolerance of corruption”, these institutions taken together have been allowed above normal increases in their budgetary allocations.

46. In this respect, the most important initiative will be, Mr. Speaker, Sir, as His Excellency the President said in his Budget Speech, the creation of commercial courts. These courts will not only ease the congestion of the courts system, but will also enhance the technical expertise of the Judiciary in financial matters. It is hoped, for example, that tax, trade, banking and other commercial disputes could be covered by such courts.

47. This initiative will also contribute towards the needed improvement of the investment environment of our economy. One of the deficiencies of our economy is the difficulty of settling commercial disputes swiftly and fairly by Judges that have technical expertise in these fields. The initiative will also aim at increasing the

number of professional staff in the DPP's office and the Anti-Corruption Bureau as well as to provide them with the needed technical expertise in financial matters. We are actively discussing the funding of the initiative with the European Union who have agreed in principle to fund the establishment of these courts.

48. Members will note, Mr. Speaker, Sir, that the Foreign Affairs Vote has also received a larger than normal increase. The main reason for this is that the Government has decided to close four embassies so as to augment the resources and effectiveness of the remaining embassies and to improve the conditions of service of our diplomats. I am pleased to inform the House that the World Bank has agreed in principle to fund the costs of the closure of the embassies which will amount to approximately K400 million.

49. Mr. Speaker Sir, sports enthusiasts will be pleased to note that we have doubled the ORT resources of both the Ministry of Sports, Youth and Culture and the Sports Council. I hope that our young men and women will make a prudent use of these scarce resources and redeem our sense of pride as a nation, internationally.

50. Mr. Speaker, Sir, Honourable Members will note that this year, the development programme is particularly concerned with improving the physical

infrastructure in parallel with the improvement of the macroeconomic environment, tax reforms and other schemes that aim at enhancing the competitiveness of Malawi. Furthermore, as His Excellency the President announced during the Opening of the Budget Session, the Government has decided to establish the Development Bank of Malawi that should significantly contribute to the empowerment of Malawian entrepreneurs. It is clearly evident that lack of capital prevents Malawians to participate meaningfully in the development of commerce and industry of their country.

51. Mr. Speaker, Sir, as His Excellency the President indicated during the opening of this Budget Session, most of our statutory or parastatals organisations are not performing well. Their major problem is mismanagement of resources. This is the major factor behind the eminent dissolution of the Malawi Development Corporation (MDC). The Government will take various measures to restructure and rationalize most statutory corporations so as to improve their efficiency. In some cases, forensic audits will be conducted so as to determine the future of the concerned corporations. Despite this serious problem of mismanagement some of these organisations have sound management systems that resulted in their making profits by December, 2004.

52. Mr. Speaker, Sir, and Honourable Members, our decision to construct the Zambezi-Shire canal that will link Malawi directly with the sea is a gigantic effort to circumvent our landlocked position. So far this year we have succeeded to sell the project conceptually to the international community. And now that the concept of this project has had the international acceptance, during the 2005/2006 financial year, we will launch the needed feasibility and design studies, preparatory to seeking funds for the construction of the canal. Our aim, Mr. Speaker Sir, is to realise a historical vision of opening up the country by permitting vessels to ply from the Indian Ocean to Nsanje which was named Port Herald by the British for this purpose.

***Revenue under the 2005/2006 Budget***

53. Mr. Speaker, Sir, I now wish to discuss the revenue side of the budget and will end with the tax proposals that are being recommended on the basis of the tax review that has just been conducted. As I said, we project total revenue and grants at K116,188 million. Of this amount we expect that K65,385 million will be generated domestically, of which K57,258 million as tax revenue and K8,127 million as non-tax revenue. Over and above domestically generated revenue we expect that the disbursement of pledged grants will amount to K50,803 million which is close to a doubling of the amount that was disbursed last year which itself was well above normal. The amount includes the programme or balance of payments support of K13,238 million compared with an amount of K5,418 million last year. The total of

project grants will amount to approximately K30,200 million compared with K16,444 million in 2004/2005. The HIPC debt relief at K7,445 million is a slight increase on an amount of approximately K6,000 million during the 2004/2005 fiscal year. Honourable members will see, that the amount of grants that has been pledged is large as we begin to benefit from the aid policy of replacing development loans with grants. It is projected that approximately K31 billion of the grants will fund our development programme and the rest will supplement our domestic revenue in designated areas to fund the recurrent expenditures.

#### *Tax Measures for the 2005/2006*

54. And now, Mr. Speaker, Sir, on to tax issues. We have been greatly helped by the tax review that I promised the House to conduct last year. Like His Excellency, let me take this opportunity to thank a cross section of the Malawi community that took part in this involved and technically complex subject. We believe that the private sector will welcome the tax policy and the administrative reforms that we propose to make. They pressed us to speed up the payments of tax refunds which we will make a statutory requirement and to spread the tax net to unregistered and under reporting tax payers which the MRA will do. The updating of the income tax thresholds will improve the disposable incomes of employees and will indirectly enhancing companies' productivity which will also benefit from the extension of depreciation allowances. Eliminating the discretionary powers of the Minister of Finance, which is

part of the tax reform should enhance their confidence in the fairness of the tax system.

55. Mr. Speaker, Sir, the review looked closely at reforms in the area of tax administration. There are a number of areas we want to address, some during this financial year. As I said we will make payment of tax refunds as a statutory obligation to ensure that there are no delays in making payments to avoid the impairment of business operations. Secondly, as the President said, with the assistance of the European Union, we will introduce commercial courts to adjudicate tax cases, amongst other matters, in order to ensure fairness in resolving tax cases. We will also establish an Internal Appeals Committee under the Commissioner General's office to give technical advice to the Commissioner General on appeal cases before proceeding with court actions. Thirdly, to avoid complaints of harassment of taxpayers by MRA officials, I have urged the Commissioner General of MRA to improve on MRA's customer care image. We will also reorient our bonus scheme with MRA so that it is rewarded for increasing the tax base as opposed to how much they collect for Government.

56. Mr. Speaker, Sir, in order to improve the efficiency of administering the tax system and improve tax compliance, we are going to restructure the operations of

MRA along functional lines rather than by type of tax. The United States Department of the Treasury has committed to assist us in doing this. We are also reviewing the Pre-Shipment Inspection programme with a view to eventually discontinue it. In this respect, we will be training our customs officers in valuation and classification techniques to take over the function. I am sure, Mr. Speaker, Sir, that with the new management at MRA, we should be able to achieve our objective of improving tax administration in Malawi.

57. In order to achieve the objectives that were highlighted by His Excellency the President, the following tax measures will be implemented. Income tax measures will be effective on 1<sup>st</sup> July, 2005 while Customs and Excise and Surtax measures will become effective from mid-night tonight.

### *PAYE and Pensions*

- The non-taxable threshold for PAYE below which incomes are free of taxes will be increased from K36,000 to K60,000 per annum. This means that an employee's income of up to K5000 a month will not be taxed. Tax brackets and rates will be restructured with the objective of reducing tax bands from five to four as well as reducing marginal tax rates as follows:

- (i) Income from K0 to K60,000, per annum will be tax free.
  - (ii) Income of K60,000 to K102,000 per annum will be taxed at a rate of fifteen (15) percent;
  - (iii) Income of K102,000 to K1,200,000 per annum will be taxed at a rate of thirty (30) percent;
  - (iv) Tax rate on income above K1,200,000 per annum will be reduced from 40 percent to thirty-five (35) percent, and consideration will be given to the elimination of this tax bracket next financial year.
- 
- Pensions of up to K10,000 per month will be tax free but pension income of above K10,000 will be taxed at the new PAYE rates. This measure is aimed at increasing pensioners' disposable incomes.
  
  - Income tax at a rate of 15 percent will be introduced on incomes generated from pension funds.

### ***Capital Gains Tax***

- The basis for valuing capital assets for capital gains tax will be changed to allow a partial exclusion of capital gains from income tax. Only 60 percent of capital

gains will be subjected to income tax. This eliminates the problem of using inflation indices to adjust the "acquisition cost" of a capital asset in determining capital gains.

### ***Annual Allowances***

- A 2.5 percent annual allowance will be introduced on new commercial buildings (not stocks) that will be built as from July, 2005, and whose construction cost is more than K100 million. This allowance is being introduced for the first time and is aimed at encouraging investments in commercial buildings.
- An annual allowance on computers, calculated on declining balance, will be increased from twenty (20) percent to forty (40) percent to take into account their quick wear and tear and the need for their relatively frequent replacement.

### ***Loss Carry Forward Provision***

- The deduction of assessed losses from assessed income arising solely from trading operations will be allowed to be carried forward up to a period of not more than six (6) years.

### ***Provisional Tax***

- The date for payment of quarterly provisional tax will be changed from the 14<sup>th</sup> day to the 30<sup>th</sup> day of the month payments fall due. This is intended to allow taxpayers sufficient time to accurately assess their tax liabilities.

### *Withholding taxes*

- The withholding tax on fees and rents on buildings will be reduced to ten (10) percent from twenty (20) percent. The measure is in recognition that there is over withholding on most taxpayers whose operating costs are higher relative to incomes generated from fees and rents.
- The increase of the tax free income on PAYE to K60,000 per annum means that the majority of smallholder farmers will not pay tax (withholding tax). Thus the majority of these smallholder farmers will be exempted from taxes.
- In order to encourage the development of the security's market, the Malawi Revenue Authority will grant withholding tax exemption certificates to holders of securities papers in the secondary markets with proven track record of tax compliance.

### *Minimum Amounts of Income Tax for Companies*

- The brackets and amounts for minimum tax for companies with very low profitability or in loss making situations will be adjusted as follows:

- (i) turnover of up to K500,000 per annum, will be taxed at a rate of K30,000,
- (ii) turnover of K500,000 to K2 million per annum, will be taxed at a rate of K60,000,
- (iii) turnover of above K2 million per annum, will be taxed at a rate of K250,000,

The measure aims at reducing the number of brackets as well as adjusting the rates for inflation.

#### ***Surtax (Value Added Tax)***

- The Surtax Act will be repealed and changed to Value Added Tax (VAT).  
Mr. Speaker, Sir, I mentioned this in my statement at the last budget sitting of Parliament, however, we could not present the Bill to the House due to some technical problems. The renaming of Surtax to Value Added Tax is consistent with international best practice since "Value Added Tax" is the internationally recognized name for this tax.
- VAT will be introduced on all goods under Chapter 84 of the Customs and Excise Tariff Order except for goods used in agricultural trade. This measure is aimed at realigning our VAT system to international best practices.

- The date for accounting for VAT by a taxable person will be changed from the thirtieth (30) day to the twenty-fifth (25) day of the month. This is intended to facilitate the accounting of VAT by MRA by the thirtieth day of every month.
- The second schedule of the VAT Act will be amended to remove pharmaceutical and medical services. Pharmaceutical and medical services will now be exempt from VAT and included in the first schedule.

### *Customs and Excise Measures*

- An excise duty on woven fabrics and textile fabrics covered in Chapters 52 and 62 of the Customs Tariff Order respectively will increase from 20 percent to 50 percent.
- Excise duty rates on motor vehicles will be restructured by rationalizing appropriate national subheadings in the Tariff Order with the objective of reducing the excise tax rates and the number of excise tax rate bands on motor vehicles to only five. Excise duty rates on all motor vehicles will be reduced by fifty percent (50 percent) as follows:

- (i) Excise duty on 4 wheel drive motor vehicles of engine capacity not exceeding 1999cc will be reduced from 30 percent to 15 percent.
- (ii) Excise duty on 4 wheel drive motor vehicles of engine capacity exceeding 1999cc but not exceeding 2500cc will be reduced from 60 percent to 30 percent.
- (iii) Excise duty on 4 wheel drive motor vehicles of engine capacity exceeding 2500cc but not exceeding 3000cc will be reduced from 80 percent to 40 percent,
- (iv) Excise duty on 4 wheel drive motor vehicles of engine capacity exceeding 3000cc will be reduced from 100 percent to 50 percent,
- (v) Excise duty on passenger carrying motor vehicles of engine capacity not exceeding 1999cc will be reduced from 30 percent to 15 percent,
- (vi) Excise duty on passenger carrying motor vehicles of engine capacity exceeding 1999cc but not exceeding 2500cc will be reduced from 65 percent to 30 percent,
- (vii) Excise duty on passenger carrying motor vehicles of engine capacity exceeding 2500cc but not exceeding 3000cc will be reduced from 60 percent to 40 percent,
- (viii) Excise duty on passenger carrying motor vehicles of engine capacity exceeding 3000cc will be reduced from 100 percent to 50 percent,

- (ix) Excise duty on motor vehicles not propelled by petroleum products will be reduced from 80 percent to 40 percent.
- The rebate granted on accompanied luggage for returning residents will be increased to K20,000 from K10,000. The measure aims at adjusting the threshold for inflation.

#### *Tax Administration Measures*

- Fees charged on extra attendance of MRA officers on request by persons will be increased to K500 per hour per officer from K50.00 per hour per officer.
- The bond fee for a licensed Customs Agents will be increased to K500,000.00 from K200.00. This measure aims at protecting government revenue as well as controlling operations of customs agents.

#### *Measures on Public Finance Management*

- Section 38 of the Public Finance and Management Act will be amended to remove Ministerial discretionary powers in remitting, waiving, mitigating or deferring collection of revenue for purposes of giving incentives to businesses. It is important for the public to know that this means that the Minister of Finance will no longer have any powers to grant tax waivers. This is being done as part of the Government's

efforts to create a level of playing field for all taxpayers particularly potential investors.

### ***Non-Tax Revenue***

- Mr. Speaker, Sir, the review also looked at non-tax revenue, particularly departmental fees and charges, with a view of adjusting the fees and charges for inflation. It is not rational to subsidize fees and charges with taxes in the manner we are doing when the benefits of services are internalized to people consuming them. Currently departmental fees and charges only contribute about 4.6 percent of total domestic revenue. In line with the principle of full cost recovery, all fees and charges will, therefore, be adjusted for inflation and the new fees will be gazetted.

58. Mr. Speaker, Sir, it will not be possible to implement all the recommendations from the tax review in just one year. Other measures require major changes to the tax laws, others require structural changes to tax administration. We will, therefore, carry over some other tax changes to next financial year.

### ***Conclusion***

59. Mr. Speaker, Sir, Honourable members. Let me sum up my budget presentation by saying that the international community has put down a challenge to all of us. Donors have made it clear that substantial amounts of resources are

available to support our efforts to unlock the development potential of Malawi. However, we, the policy makers of this nation, Government, Honourable Members, must demonstrate that we can make full use of these resources to achieve our development goals. We must spend our resources in a way that truly benefits the poor and we must provide all Malawians with equal opportunities to pull themselves out of poverty, and therefore bring prosperity and development to the nation as a whole.

60. The budget that I have had the honour to present to you today is the government's response to this grand challenge. It is an action-packed program addressing immediate needs to ensure that the people of this country do not go hungry, even when faced with a disappointing harvest. However, it also includes a substantial scaling up of government programs to address key constraints to growth by allocating more resources to strengthen infrastructure, improve health and education services, and bolster agricultural production. This will lay the ground for Malawi to unleash her potential for development and growth.

61. The only way for the budget to achieve its ambitious goals for Malawi is for all of us, Parliament, Government and the civil service to work together in a dedicated fashion focusing our minds on how to meet the major needs of the people of this

country. This budget is a budget for the nation. It will take us further along the road towards development and prosperity. I therefore appeal to you, Honourable Members, for your support for the approval and implementation of this budget as a concrete step in realizing this endeavour.

62. Faced with substantial challenges and obstacles, we have turned the corner. Mr. Speaker, Sir, Honourable Members, let us now stay the course and build upon the progress we have achieved for the benefit of all Malawians.

63. Mr. Speaker, Sir, as a background to this Budget Statement, we have provided five documents for Members to scrutinize at their own time. The first of these documents is the Budget Statement that I am delivering. The second document is the Economic Report which captures fiscal, monetary and real sector trends. Document three is the Financial Statement, which is a summary of Government revenue and expenditure. Document four is the Draft Estimates of the Recurrent and Development Budget, Output Based which indicates ministry by ministry allocations and activities that ministries intend to implement and output to be achieved. And finally, Document five is the Detailed Estimates for Recurrent and Development Accounts Estimates, which is an accounting document that provides information by sub-items. This document, Mr. Speaker, Sir, gives details of the

projects that we plan to implement, will be of particular interest to Honourable Members. All these documents, except the first, provide information on the approved 2004/2005 budget, revised 2004/2005 budget, the draft estimates of the 2005/2006 budget and the projections for the 2006/2007 and 2007/2008 budgets.

64. Mr. Speaker, Sir, I beg to move.