TRADE POLICY AND INDUSTRIALISATION IN MALAWI: THE NEED FOR A STRATEGIC APPROACH

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Abstract

The industrial strategy pursued in the first fifteen years of independence in Malawi focused on the promotion of import substitution industrialisation, and promotion of agricultural exports. This strategy paid dividends and the manufacturing sector grew from 8 percent of gross domestic product in 1964 to 12 percent in 1979. However, the economic crisis that emerged in 1979 lead to a switch towards the export promotion industrialisation strategy embedded in the structural adjustment programs that Malawi started to implement in 1981. Industrial and trade policy reforms have been central to the promotion of the export-led growth strategy, such that by 1994 the trade regime in the economy was fully open. In addition, Malawi has entered into bilateral and regional trade protocols without a proper strategy. It happens that 1994 was also the year Malawi switched from a one party political state to multiparty democracy. However, the available data show that manufacturing production, for both domestic consumption and exports has been dwindling since 1994. This paper reviews the performance of manufacturing sector during the period of import substitution (1964-79), the period of structural adjustment and export promotion (1980-1993) and the period of open trade with export promotion and democracy (1994-2000). The main argument in the paper is that Malawi has pursued non-strategic trade policy adjustments, with adverse consequences on manufacturing production for both domestic consumption and exports. If Malawi is to develop her manufacturing industry in the new global economy, it will be necessary to embark on a strategic trade policy with selective protection or assistance to key industries that will enable the manufacturing sector to be on a competitive footing in the domestic and export markets in addition to investments in infrastructure.
1. Introduction

There is consensus among economists that the performance of the Malawi economy was strong in the first fifteen years of independence, 1964-79. The early success of the economy is associated with a decisive import substitution industrialisation strategy and export-led agricultural development. As such the share of manufacturing output in gross domestic product increased from 8 percent in 1964 to 12 percent in 1979, and growth in domestic product averaged 5.3 percent per annum. However, this success was interrupted by the economic crisis in the late 1970s partly due to external shocks such as the 1979 oil shock and the international transport bottlenecks due to the civil war in Mozambique.

The economic crisis led to the adoption of IMF stabilisation and World Bank structural adjustment policies starting from 1981. This also provided the opportunity for Malawi to switch its industrialisation strategy from import substitution to export orientation by design of the structural adjustment packages. However, the performance of the economy since Malawi started implementing structural adjustment programs has been less than satisfactory and inconsistent, and economic conditions have worsened after the democratic transition that coincided with completion of the implementation of major policy reforms. Economic growth during the period of adjustment has been erratic, the economic base has remained undiversified and government operations still heavily rely on donor financing and price instability remains a major factor holding back economic growth and development. In terms of trade policy, during the democratic era, the trade regime has been fully liberalised and the influx of imports of manufactured goods has adversely affected manufacturing production for both domestic consumption and exports.

The object of this paper is to take stock of the policies and policy changes that have shaped the industrialisation process in Malawi during the post-independence era and during the transition to democracy. In addition, given the new economic trading system under the World Trade Organisation (WTO), regional integration and bilateral trade agreements, I examine the policy options that are available for Malawi to industrialise. First, I review the trade and industrial policy reforms that have been pursued in Malawi in the post-independence era. Second, I link the trade and industrial policies to the performance of the manufacturing sector in particular and economic growth in general. Third, I look at the options available for Malawi within the context bilateral trade agreements, regional integration and multilateral trade agreements such as WTO. Finally, I provide concluding remarks.

2. Trade Policy and Industrialisation in Malawi

The development policies in Malawi have undergone several changes since independence in 1964 and different ideological approaches have been emphasised in particular periods. ¹ The different ideological approaches have also shaped the path of industrialisation. With respect to industrialisation strategies the post-independence period can be categorised into three periods. The first fifteen years after independence (1964-79) can be characterised as a period in which industrial development was based on import substitution strategy.² This industrial strategy was

¹ Weiss (1990) and Jenkins (1992) provide a comprehensive review of alternative theoretical approaches to industrial development.

² Chanthunya (1996) concludes that Malawi adopted an outward-looking, export-oriented development strategy based on agriculture, with no policy for developing industry between 1964 and 1980. While the former is the right characterisation, the latter is not necessarily true because the development plans and the first statement of industrial development were based on import substitution strategy.
heavily influenced by the structuralist views, by focusing on import-substitution policies and the role of the state in industrial development. The structuralists argue that the structure of the economy, particularly the size of the industrial sector, is a key determinant of long-run growth, and do not believe that industrial development will occur purely through the market mechanism and justify the protection of domestic manufacturing industries. The period between 1980 and 1994 is the adjustment period and can be associated with the export promotion industrialisation strategy postulated by neo-classical economists and advocated by the Bretton Woods institutions. A phased program of structural reforms has been implemented during this period following the adoption of Structural Adjustment Programs (SAPS) under the sponsorship of the World Bank and International Monetary Fund. The third period, 1994 to date, is the period of complete liberalisation with most trade policies favouring export-oriented manufacturing. Table 1 presents a summary of policy actions towards industrialisation.

(a) **Decisive Import Substitution Industrialisation (1964-1979)**

The development strategy in this period was based on increased government involvement in the production process through acquisition of agricultural land and establishment of state holding corporation to lead in the industrialisation process, justified by the lack of an indigenous entrepreneurial class. The first development plan (1961-64), the second development plan (1965-69) and the first statement of development policies (1971-79) indicate that the strategy for the development of the manufacturing sector focused on import substitution industrialisation based on domestic demand and agricultural resources.

Silumbu (1992) notes that specific focus was made on the identification of markets for import substitution industrial goods without creating specific mechanisms for export markets and the declining ratio of exports to domestic sales between 1965 and 1969 reflected the significance of import substitution industrialisation. Only limited protection was accorded to manufacturing through tariffs combined with a variant of non-tariff trade barriers such as import and export licensing. Incumbent firms also enjoyed protection from competition in the domestic market through heavy industrial regulation under the Industrial Development Act of 1966 and the Control of Goods Act of 1968.\(^3\) The import substitution strategy during this period was based on the active participation of the government in manufacturing industries in ownership partnership with domestic and foreign private capital. Chirwa (2000b) notes that 51 out of 54 large-scale manufacturing enterprises in which the government had full or partial ownership were established between 1964 and 1979. In addition, the exchange rate was a fixed peg and the stability ensured its overvaluation, a situation that provided incentives to import substitution industries. These policies were reinforced by a stable macroeconomic environment characterised by low inflation and price stability, low balance of payments pressure, low interest rates and manageable fiscal budget deficit.

development policies were clear about the import-substitution industrialisation strategy. Moreover, even in terms of policy actions, state ownership in the manufacturing sector was in enterprises producing import substitution goods.

\(^3\) Although, the Control of Goods Act served to curtail monopolistic pricing behaviour in a highly oligopolistic manufacturing sector, it also protected incumbent firms from new entry by imposing a statutory limit price.
### Table 1

#### Policy Actions under Various Trade Regimes, 1964 - 2001

<table>
<thead>
<tr>
<th><strong>Orientation</strong></th>
<th><strong>Period</strong></th>
<th><strong>Major Policy Actions</strong></th>
</tr>
</thead>
</table>
| **Import Substitution** | 1964 - 1979   | - Active government involvement in manufacturing industries (MDC and ADMARC investments)  
- Overvalued exchange rate system - fixed peg  
- Limited tariff protection  
- Non-tariff barriers to trade such as import licensing and implicit foreign exchange rationing.  
- Macroeconomic stability - low and stable inflation, low and stable interest rates. |
|                       | 1980 - 1986   | - Periodic Devaluation of the Malawi Kwacha  
- Periodic increases in interest rates  
- Restructuring of state owned enterprises  
- Liberalisation of output prices and limited entry liberalisation  
- Increases in trade taxes and foreign exchange rationing |
| **Transition to Export Orientation** | 1987 - 1993   | - Liberalisation of interest rates in 1989  
- Periodic devaluation of the Malawi Kwacha  
- Elimination of quantitative trade restrictions  
- Reduction in foreign exchange rationing  
- Privatisation of state-owned enterprises  
- Introduction of duty drawback system in 1988  
- Reduction in tariffs and introduction of surtax credit scheme in 1989  
- Bilateral trade agreement with South Africa in 1991  
- Liberalisation of entry into manufacturing in 1991 |
| **Export Orientation** | 1994 - 2002   | - Floatation of the Malawi Kwacha in February 1994  
- Export Processing Zones incentives in 1995  
- Bilateral trade agreement with Zimbabwe in 1995  
- Reduction in base surtax to 20 percent in 1996  
- National Privatisation Programme in 1996  
- Devaluation of the Malawi Kwacha in 1999  
- COMESA Free Trade Area by 2000 |

**Source:** Chirwa (2000a)

The encouraging economic performance during the first five years of independence compelled the Malawi Government to continue pursuing an import substitution industrialisation strategy. In contrast to the two development plans covering 1961-69 period, the first statement of development policies covering the 1971-80 period, had clear policies in support of import substitution industrialisation (Malawi Government, 1971). The trade regime become more protective, culminating into use of tariff and non-tariff barriers such as import and export licensing, industrial licensing and granting exclusive monopoly rights. Although as others have
argued that the restrictive trade regime was motivated by the revenue needs to finance the budget (World Bank, 1989; Chanthunya, 1996; Mulaga and Weiss, 1996), it provided extra incentives for import substitution industrialisation. Silumbu (1992) further notes that fiscal and commercial policies of the 1970s tended to favour import substitution industrialisation vis-à-vis export orientation for manufacturing and agriculture. The coverage of manufacturing goods under price control was extended and entry into manufacturing was still regulated under the provisions of the Industrial Development Act of 1966.

(b) **Indecisive and Non-Strategic Transition to Export Orientation (1980-93)**

The post-independence period of prosperity and industrialisation was however interrupted by an economic crisis in 1979 when the economy experienced a sharp reduction in economic growth from 8.3 percent in 1978 to 3.3 in 1979 followed by negative growth rates of -4.4 percent in 1980 and -5.2 percent in 1981. The crisis also manifested in deterioration of financial positions of public and private enterprises and rapid exacerbation of balance of payment pressure, deterioration of terms of trade, rising fuel costs and adverse weather conditions leading to weak internal demand (Malawi Government, 1987). This economic crisis is what led to the adoption of structural adjustment programs in Malawi.

The policy response to the economic crisis was the switching of the development strategy from a mixed approach towards the neo-classical market approach with export orientation directing the path of structural reforms and industrial and trade policy. The second statement of development policies covering the 1987-96 period, provided the clearest policy switch towards outward orientation of the economy, embracing the structural adjustment agenda (Malawi Government, 1987). The 1980-93 period witnessed a shift in industrial policies that were the bedrock of success in the first fifteen years of independence. There were periodic devaluations of the Malawi Kwacha, periodic adjustments in interest rates, liberalisation of industrial and input prices, abolition of exclusive monopoly rights and privatisation of state-owned enterprises, and a freeze on new industrial investments by state holding corporations.

According to Ahsan et al. (1999), Malawi has undergone two phases of policy reforms between 1981 and 1994. The first phase, 1981-6 is characterised by emphasis on fiscal and external stabilisation, restructuring of major state-owned and private enterprises, limited liberalisation of prices and limited liberalisation of entry into manufacturing. However, the end of this period experienced macroeconomic instability arising partly from increases in international transport costs due to the intensification of the Mozambican civil war and the influx of refugees. These developments increased the current account deficit to 13 percent of gross domestic product in 1986 from 7 percent in the previous year and the fiscal deficit also increased to 13 percent of gross domestic product. Mulaga and Weiss (1996) and Ahsan et al. (1999) also note that this period was associated with tightening controls and raising trade taxes, introducing a system of foreign exchange rationing and quantitative restrictions on imports that significantly increased protection from import competition. These policies were in direct conflict with the export orientation strategy under structural adjustment programs.

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4 See Harrigan (1991), Mhone (1992) and Kaluwa et al. (1992) for a detailed analysis of the economic crisis and structural adjustment programs in Malawi.

5 Also see Mulaga and Weiss (1996).
The second phase, 1987-94, was characterised by indecisive liberalisation of trade and tariff policies. Quantitative restrictions were eliminated and foreign exchange allocation was phased out and only 20 percent of imports were subject to foreign exchange controls in 1989. The duty drawback system was introduced in 1988, although the administration of the scheme has been inefficient. Tariffs were lowered and reforms in the surtax regimes unified surtax rates for domestic production and imports. Chanthunya (1996) notes that the highest tariff rate was 130 percent before reforms, but this was reduced to 45 percent and the government introduced a surtax credit system in 1989. The base surtax rate was reduced from 35 percent in 1991 to 25 percent in 1992. Nonetheless, Mulaga and Weiss (1996) argue that the changes that took place did not generate immediate reductions in protection because there were still substantial variations in effective protection afforded by tariffs in manufacturing industries by 1991. In addition, Chirwa (2000a) using data between 1984 and 1986 find that manufacturing enterprises in three of the four industries were becoming more technically inefficient.

Another significant policy instrument during this period was the exchange rate management. In the late 1980s and early 1990s, the government pursued a policy of periodic devaluation of the Malawi Kwacha. The flotation of the Malawi Kwacha in February 1994 led to its depreciation by more than 300 percent by the end of the year. Exporters were also allowed to retain 90 percent of their foreign exchange earnings in foreign denominated accounts at commercial banks, a policy that was reversed to a 10 percent retention rate before the end of the year. In 1990, Malawi entered into an asymmetric bilateral trade agreement with South Africa in which South Africa admits free of customs duty goods grown, produced or manufactured with 25 percent local value-added while Malawi provides the most favoured nation treatment to imports from South Africa (Imani-Capricon, 2001). In terms of manufacturing products, it seems it is the textile industry that has taken full advantage of the trade agreement between Malawi and South Africa.

(c) Complete Open Trade Regime and Non-Strategic Industrialisation (1994-2002)

The 1994-99 period represents the post-trade policy adjustment era although policy refinements have been taking place during this period. The base surtax rate was reduced to 20 percent by 1996 from its 25 percent level in 1992. The other incentives for export promotion that were introduced in this period were bonded factories and Export Processing Zones (EPZ) schemes were introduced in 1995 and a national program of privatisation commenced in 1996. This period is associated with the strengthening of regional integration and trade openness within regional blocs. During this period, Malawi entered into a reciprocal bilateral trade agreement with Zimbabwe in 1995 which accords duty free status on all goods that have at least 25 percent local value-added and that conform to the national standards of the importing country. Malawi also acceded to the Common Market for Eastern and Southern Africa (COMESA) free trade area, which commenced towards the end of 2000. The countries that have acceded to the COMESA free trade area have reduced tariffs on intra-trade by 60-90 percent, which allow imports of finished goods from these countries duty free while imports of raw materials and intermediate goods from other countries attracting duty. Others have argued that the tariff biases that arise from bilateral trade arrangements and trading blocs on the treatment of finished products and inputs from other countries, create disincentives that could be attributed to the uncompetitiveness of some manufacturing production in Malawi.

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6 However, Beltchika et al. (2001) observe that surtax system does not operate effectively, and is dogged by delays in reimbursements for taxes paid on inputs used for export production and this may erode confidence and encourage non-compliance in the long term.
Other measures to facilitate industrialisation and development include improvements in the provision of transport, telecommunication and power facilities through restructuring and regulatory reforms. These services constitute non-tradable inputs in the manufacturing sector and the transaction costs associated with these services can be significant sources of competitiveness. Mody (1999) argues that the efficient supply of non-tradable inputs is critical both to increase national productivity and to participate in international commerce. The importance of infrastructure development is critical to any industrialisation strategy. In East Asian economies, the drive towards international commerce and investment made telecommunications, ports and airports critical to the overall economic strategy (Mody, 1999). Collier and Gunning (1999) attributes Africa’s slow economic growth to low social capital, poor infrastructure and poor policies that create high-risk environment. However, Soderbom and Teal (2001) caution that it is not obvious that improvements in the policy environment and reductions in transaction costs will lead to growth in manufactured exports in Africa.

3. Trade Policy and Performance of the Manufacturing Sector

The economic strategy at independence was to diversify the economic base from an agricultural-based towards the development of the manufacturing sector through import-substitution and limited export promotion. At independence in 1964, the manufacturing sector accounted for only 8 percent of gross domestic product but increased to 12 percent in the 1970s. However, in the 1980s and 1990s, the share of manufacturing in gross domestic product has been relatively stable, around the 12 percent level. The popular belief among major players in the Malawian economy is that de-industrialisation is taking place, particularly following an active trade policy adjustment since 1993.

Table 2 presents the growth in the index of manufacturing production between 1970 and 1999. The trends in industrial production and growth rates are plotted in Figure 1 and Figure 2, respectively. In terms of the trade regime, the 1970-79 period data represent the performance of the manufacturing sector in the decade of the import substitution industrialisation strategy. The performance of the economy between 1964 and 1969 was moderate but encouraging. The real growth rate in gross domestic product averaged 4.3 percent per annum and per capita income grew at 1.4 percent per year. The drive towards industrialisation paid some dividends, a number of new manufacturing firms established and old ones expanded. Moreover, the composition of gross domestic product changed, with manufacturing contribution rising from 8 percent in 1964 to 12 percent in 1970 and the share of agriculture falling from 60 percent to 40 percent. With encouraging results of the 1964-69 period, the government reinforced its import substitution strategy in the 1970s, which resulted in further impressive performance of the economy. The annual growth rate of real gross domestic product was 5.9 percent. Manufacturing production as measured by the index of industrial production grew at 8.2 percent per annum in the 1970s (Table 2) and the upward trend in manufacturing production is unquestionable in Figure 1. Value added in manufacturing grew by 10.1 percent per annum (Mulaga and Weiss, 1996). However, there was very little structural transformation in the economic base. The contribution of the manufacturing sector to gross domestic product was 12 percent with the agriculture sector contributing 40 percent, the levels achieved in the 1965-69 period.

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7 The import substitution industrialisation strategy dates back to 1964. Due to data problems for the earlier period, we only use the data from 1970.
The impressive growth of the manufacturing sector was slowed in the 1980s following the economic crisis. The structural adjustment programs have done very little to restore the growth path of manufacturing industries. Table 2 shows that manufacturing production increased on average by 1.3 percent per annum during the 1980-89 period and by 2.2 percent during the 1990-93 period, compared to 8.2 percent in the 1970s. Manufactured goods for export markets grew at an average growth of 1.2 percent per annum in the 1980-89 period. The trade policy reforms of the early 1990s led to the manufacturing growth of 5.95 percent per annum in the 1990-93 period. Increases in export orientation were also evident at industry level, with the proportion of exports in the textile and wood products sectors amounting to more than 20 percent in 1991 from less than 5 percent in 1979 (Ahsan et al., 1999). Figure 1 also shows the declining trend in the early 1980s, but production started to increase in 1988 before it started to decline again in 1991-92. The 1991-92 period is the period of transition to democracy, and the fall in manufacturing output could have been partly due to the uncertainty in the political and economic environment. The trends in the growth rate of manufacturing output in Figure 2 shows that the lowest growth rate between 1980 and 1993 occurred in 1987, particularly due to a fall in production for the domestic market. The other down swing in manufacturing production occurred during the transition period (1991-93).

### Table 2

<table>
<thead>
<tr>
<th>Product Groups</th>
<th>Period 1</th>
<th>Period 2</th>
<th>Period 3</th>
<th>Total</th>
<th>Period 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food, Beverages and Tobacco</td>
<td>12.26</td>
<td>5.38</td>
<td>-5.11</td>
<td>3.60</td>
<td>1.88</td>
</tr>
<tr>
<td>Footwear, Clothing and Textiles</td>
<td>6.57</td>
<td>-4.49</td>
<td>5.47</td>
<td>2.48</td>
<td>7.91</td>
</tr>
<tr>
<td>Other Goods</td>
<td>9.17</td>
<td>7.18</td>
<td>0.78</td>
<td>4.86</td>
<td>1.23</td>
</tr>
<tr>
<td>Total Goods for Consumption</td>
<td>8.91</td>
<td>3.71</td>
<td>-2.31</td>
<td>3.07</td>
<td>2.28</td>
</tr>
<tr>
<td>Products for Construction</td>
<td>7.20</td>
<td>-2.51</td>
<td>-1.85</td>
<td>0.65</td>
<td>-1.59</td>
</tr>
<tr>
<td>Goods for Domestic Market</td>
<td>7.92</td>
<td>1.22</td>
<td>-2.49</td>
<td>1.87</td>
<td>1.04</td>
</tr>
<tr>
<td>Goods for Export Markets</td>
<td>9.42</td>
<td>1.21</td>
<td>1.74</td>
<td>3.87</td>
<td>5.95</td>
</tr>
<tr>
<td><strong>Total Manufacturing</strong></td>
<td><strong>8.16</strong></td>
<td><strong>1.29</strong></td>
<td><strong>-1.55</strong></td>
<td><strong>2.31</strong></td>
<td><strong>2.16</strong></td>
</tr>
</tbody>
</table>

**Note:** Other goods include soap, matches, and furniture, printing and publishing.

**Source:** Calculated by authors from NSO data.
The erratic performance of the manufacturing sector in the adjustment period, continued and worsened into the period of open trade regime. In any case, if the policy reforms were reinforcing each other, this would be reflected in sustainable improvements in economic performance and industrial development. Of course, the performance of trade policies is also conditioned by the macroeconomic stability. The recent evidence on the performance of manufacturing industries suggests that after the completion of major trade reforms, industrial performance improved over time.

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8 The performance of the manufacturing sector during this period may reflect the long-term effects of structural adjustment reforms undertaken during in early 1981-94 period as well as the short-term effects of recent reforms.
output both for domestic consumption and for exports is declining. The index of manufacturing production fell by 3.67 percent per annum during the 1994-00 period (Table 2 above), with production for domestic consumption falling by 4.51 percent per annum and production for export markets falling at 0.66 percent per annum. Interestingly, and contrary to those who advocate complete trade liberalisation, the active trade liberalisation policy in the post-1993 period has affected the performance of manufacturing for both domestic and export markets. Although the export performance has on average been better than the production for the domestic market, and visibly so in the 1990-93 period, export production fell by 0.66 percent per annum during the 1994-00 period. The trends in manufacturing production are also depicted in Figure 1 and Figure 2 above.

The data that includes the most recent period suggests that Malawi may indeed be on a de-industrialisation path, for both domestic and export production. Although growth rates in manufacturing production have been erratic for the whole period, the data show the declining trend in output and output growth in the late 1990s, respectively. However, such a trend is consistent in the 1990s, although the performance had picked up in 1996 due to export expansion, a phenomena that was short-lived. The export drive in manufactured products seems to have been lost and the economy is losing both its domestic market and export markets. The big question is whether these trends in the performance of the manufacturing sector reflect de-industrialisation. Thus, is more trade openness coupled with massive exchange rate depreciation and poor economic management to blame for the emerging trend towards de-industrialisation?

If Malawi is losing both its domestic and export markets, how does it revive the manufacturing sector in the new millennium?

Other studies in the manufacturing sector reveal weak performance of the manufacturing sector in the 1980s and 1990s, but the results do not support the de-industrialisation hypothesis. Mulaga and Weiss (1996) find that manufacturing value added grew at 10.1 percent per annum in the 1970s but only grew at 2.1 percent in the 1980-86 period and 4.8 percent in the 1987-91 period. Ahsan et al. (1999) find no evidence of de-industrialisation between 1979 and 1996, since manufacturing output neither contracted nor expanded significantly in the adjustment period but rather find evidence of restructuring with technology becoming more labour intensive. Jalilian and Weiss (2000) in a sample of developing countries, using the version of the pattern of industrial growth approach, find do not find evidence that the residuals from the predicted level of manufacturing activity are negative and growing to qualify for de-industrialisation between 1970 and 1993.

However, these studies show that the growth in manufacturing output has indeed retarded in the adjustment period compared with the performance in the 1970s. The case for de-industrialisation is not credible in these early studies. One explanation is that these studies cover periods during which trade liberalization policies were not active and during the period when trade policy adjustments were characterised by policy reversals. Greater openness of the Malawi economy was marked by a sustained depreciation of the Malawi Kwacha after its floatation in 1994 and sustained lowering of tariffs since 1993 and greater scope for regional co-operation in the past five years. Given that major trade policy issues have occurred after 1993, the above studies are unable to capture the full consequences of trade policies on manufacturing production.

In summary, Malawi witnessed remarkable industrial growth during the 1960s and 1970s, but industrial development has been sluggish and inconsistent since the government adopted structural adjustment programmes. During the first fifteen years of independence the industrial
strategy was based on import substitution. The adoption of structural adjustment programmes marked the demise of the import substitution strategy and the birth of the export promotion strategy. The presumption was that the import substitution industries will respond to market signals and would orient their activities towards the export markets, while effectively competing with imported goods in the domestic market. However, the evidence above does not seem to indicate that this expectation was realised, as industrial production for both domestic and export markets fell after trade reforms were completed in 1993.

What policies contributed to the difference performance of manufacturing industries in the pre- and post-adjustment periods? The period during which the Malawi government pursued import substitution policies witnessed remarkable industrial development in import substitution industrial goods. The policies that can be positively associated with industrial development in Malawi during the first fifteen years of independence include

- Active government involvement in manufacturing industries (MDC and ADMARC investments) and government commitment
- Strong coalition between private and government capital
- Overvalued exchange rate system - fixed peg
- Limited tariff protection
- Non-tariff barriers to trade such as import licensing and implicit foreign exchange rationing.
- Macroeconomic stability - low and stable inflation, low and stable interest rates.

The switch to export orientation has done little to revive manufacturing production in a sustainable way. The period of export orientation strategy is associated with sluggish growth in manufacturing output and a fall in output after trade reforms were completed. The policies that might have negatively contributed to industrial development include

- Over-depreciation of the Malawi Kwacha and volatility in the exchange rate system.
- Trade liberalisation without a strategic assessment of the impact on manufacturing enterprise, hence what Lall (2000) calls rapid, indiscriminate and sweeping exposure to international market forces.
- Low trade tariffs and differential tariffs for inputs imported from countries not covered in bilateral trade agreements.
- Weak coalition between private (domestic and foreign) and government capital and lack of effective consultation between government and private sector before liberalisation policies are implemented.
- Failure to attract manufacturing investments in new activities to replace public sector investment in manufacturing.
- Macroeconomic instability - high inflation and instability in the price level, the high cost of capital (high and unstable interest rates), public sector crowding out and high deficits.

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9 The positive benefits from import substitution complement the evidence from India where the government still pursues restrictive industrial policies (particularly on consumption industrial goods) to regulate the development and conduct of industry, and the government has encouraged economic self-sufficiency through import substitution (Siggel, 2001).
4. Options and Opportunities for Industrialisation

The options and opportunities that exist for industrialisation in developing countries will be conditioned by the existing and future multilateral and bilateral trade agreements. The new trading system under the World Trade Organization (WTO) greatly ties the hands of governments in developing countries to develop their manufacturing industry using differential incentives or trade protection.\(^{10}\) For instance, many of the instruments for export promotion that have been attributed to the success of East Asian economies, where incentives are directed at strategic industries would violate some of the WTO rules. Bora et al. (2000) note that although a number of rules that distort trade are allowed, the added discipline imposed by the WTO has reduced the flexibility of national governments to pursue development objectives. Lall (2000: 2) provides a good summary of the state of industrial policy by observing that

“The present climate for industrial policy is hostile. The ‘rules of the game’ set by the Bretton Woods institutions, WTO and major donors, are set against most forms of government intervention to promote industry. In the near future, governments will have almost none of the instruments of policy used through history to promote industrial development. Yet, targeted interventions in trade, industry and supporting institutions have played a critical role in industrialisation through history.”

Strategic Industry Policy under WTO

The policy instruments for the promotion of industries for investment and export growth under WTO are generic rather than specific policies to develop specific industries. More specifically, according to Bora et al. (2000) and Lall (2000), the WTO agreements impose restrictions on local content protection, discrimination of investors by origin and the use of export subsidies, but it is possible to institute export credit and insurance below market rates, concessional taxes and duty provisions, and export processing zones. Moreover, WTO provides special and differential treatment for developing countries to protect infant industries under Article VIII of GATT, with a possible five-year period for least developed countries (as defined in the UN classification).\(^{11}\)

However, Malawi does not seem to be taking advantage of the provisions for special and differential treatment under the WTO agreements. Now that complete liberalisation seem to have a negative effect on goods sold both in the domestic and export markets, there is increasing need to pursue a well-defined strategic industrial policy that revives manufacturing production. For instance, the limited protection like the licensing of sugar imports can be accorded to manufacturing industries within a defined period and for enterprises that can commit to improve their performance within the specified period. Other industries, that have been adversely affected by the outward orientation policies must be identified and supported, provided they commit to improve their performance during the period of protection.

Apart from the traditional industries of tobacco, tea and sugar as major contributors to the trade surplus, other industries in which Malawi can increase its exports of manufactured goods include edible vegetables, apparel and clothing, edible fruits, oilseeds and delicious fruits, and leather. Import substitution industrialisation can be promoted in manufactured goods such as vehicles

\(^{10}\) Bora et al. (2000) provides an excellent exposition of the limitation of a strategic trade and industrial policy in light of the agreements under WTO, especially those relating to Trade Related Investment Measures (TRIMs), Subsidies and Countervailing Measures (SCM) and Trade-Related Aspects of Intellectual Property Rights (TRIPS).

\(^{11}\) Whalley (1999) and Pangestu (2000) provide a detailed analysis of special and differential treatment for developing countries within GATT/WTO framework.
and parts, pharmaceutical products, nuclear reactors boilers and machinery, fertilisers, electrical machinery, and articles of iron and steel (Chirwa and Silumbu, 2001).

Given that the ‘rules of the game’ of WTO allow for negotiations and settlement of disputes, the problem in Malawi, like in most developing countries, is that there are considerable institutional constraints in government departments that negotiate trade agreements or provisions in the WTO. The available experts in government departments and trade promotion institutions lack analytical skills for negotiations and rarely consult with the private sector. In addition, the quality of information and analysis of the state of manufacturing industries is poor, and this further weakens the negotiation capabilities of those involved in trade negotiations.

Opportunities under Regional Integration and Bilateral Agreements

With regional integration the argument of a limited domestic market become less of a threat to industrialisation, although strategic orientation of manufacturing activities and technological progress becomes necessary if industries are to compete favourably in regional markets. ITC (2001) identifies pepper, sugar, oil cake, cotton and garments as products with high export potential for Malawi to the Southern Africa Customs Union (SACU). However, Malawi has to compete in similar products with other SADC members that have gained the competitive edge in the international market such as Mauritius (garments and sugar). It is apparent that the diversity of products with high export potential from Malawi manufacturing is quite narrow. There is great need to identify other manufactured products with high market demand in the region and in the world market in order to diversify the export. Exports of garments are being accorded greater promotion and as argued elsewhere due to the comparative advantage for many developing countries given the cheap labour resource (Soderbom and Teal, 2001). However, there is a need for African countries to move away from a one specialised export sector situation. The diversity of manufactured products Malawi is promoting in bilateral trade agreements, such as that with South Africa, remains narrow and dominated by textiles and garments.

The export potential and the import-substitution potential for Malawi can be determined from its trade balances with bilateral trading partners and regional economic blocs. Product lines that have positive balance reveal the potential for export expansion while those with a negative balance reflect room for import substitution. Trade statistics show that Malawi had favourable positive trade balances in 2001 with South Africa in products such as apparel and clothing, tobacco and manufactured tobacco substitutes, sugar and sugar confectioneries, and made-up textiles (Chirwa and Silumbu, 2001). On the other hand, the trade balance was in favour of South Africa in vehicles and parts, boilers and machinery, electrical machinery, fertilisers, paper and paperboard, and plastic products. Within the COMESA region Malawi has potential for export expansion in sugar and sugar confectioneries, beverages, spirits, vinegar, edible vegetable oils while import substitution could be harnessed in tobacco and manufactured tobacco substitutes, essential oils, products of milling industry, boilers and machinery. In the EU market, Malawi’s manufactured products trade advantages lie in tobacco and manufactured tobacco substitutes, edible fruits and nuts, oil seeds and oleaginous fruits, and articles of apparel and clothing.

However, the problem with the trade agreements be it bilateral or multilateral is that they are usually negotiated by government official without or with very little involvement of the main stakeholders – the business community. Usually, the adverse effects of these agreements are only observed after the policies have been implemented and it then becomes difficult to reverse such policies within the short term.
Opportunities under the African Growth and Opportunities Act (AGOA)

The African Growth and Opportunities Act (AGOA) is the latest initiative that provides trade and development opportunities for African countries through access to the biggest economy in the world – the United States of America. There is need for Malawi to strategically cultivate the benefits from AGOA and provides opportunities to diversify Malawi exports of manufactured goods. But so far, it seems the textile and garment industry is the only one taking full advantage of this opportunity. Of course, the US Trade and Development Act of 2000 (Section 111 - 120) singles out textiles and apparel for preferential treatment under AGOA (US Congress, 2000). However, under AGOA the US government extended duty-free treatment under GSP for more than 1,800 tariff line items in addition to the standard GSP list of 4,600 items. The extended list includes footwear, luggage, handbags, watches and flatware. AGOA has also extended the GSP for eligible Sub-Saharan African beneficiary countries to September 2008.

Infrastructure and Human Development

The landlockedness of Malawi poses a major threat to industrial development given the manufacturing sector’s high dependence on imported capital and raw materials. Naturally, one way of improving competitiveness is through the development of efficient domestic and internal transport networks and other support infrastructure. Underdevelopment of infrastructure lead to high transaction costs that impact negatively on the competitiveness of an economy. Inefficiency problems in transport services and other support services in Malawi are well known. For instance, Beltchika et al. (2001) find that the cost and unreliability of telecommunication and electricity services are the main constraints in capacity utilisation in a survey of business entities in Malawi. Besides, infrastructure development Malawi needs to focus on human capital formation and innovation policies. Soberdom and Teal (2001) attribute the export success of Mauritius to high skills of workers that is reflected in high labour productivity.

Research and Development, Information and Communication Technologies

Research and development is vital for the dynamism and growth of manufacturing activities, leading to quality improvements and cost reductions, both of which are essential to enable a less painful switch from inward-orientation to outward-orientation. However, these aspects are not considered as important ingredients of the production process in Malawi, may be due to the protection accorded to the manufacturing in the first twenty years of independence. Market research is another important ingredient of successful export performance through identification of export opportunities and locating cheaper sources of raw materials. International market research and product promotion has been made easier with the development of the Internet, coined e-commerce, although this is a recent phenomenon in Malawi. There is room for government to provide trade facilitation information, but this should just augment the efforts of the private sector. The diplomatic missions should play a greater role in identifying market opportunities for Malawian manufacturers. The use of internet for business in Malawi is limited and many manufacturing enterprises do not have internet facilities (MCCI, 2001).

Domestic Competition Policies

The lack of domestic competition coupled with protection and state ownership before structural adjustment provided an economic environment that did not provide incentives for efficient industrial production. Despite decades of structural adjustments that signalled the end of the era
of protection, very few enterprises in Malawi manufacturing have responded in improving efficiency, and very few are taking advantage of the opportunities. While the barriers to competition have been eliminated under structural adjustment, the structure of manufacturing activities remains highly oligopolistic, and there is need to institute policies to curb restrictive business practices in the domestic market.

Fiscal Incentives and Macroeconomic Environment

The existing evidence on the performance of African economies demonstrates that inconsistencies could be responsible for slow growth (Collier and Gunning, 1999). These poor policies have created price instability consequently leading to high-risk environments and high transaction costs. In Malawi, macroeconomic mismanagement is a major threat to industrial development. Fiscal deficits are persistent and price instability and interest rates have been high. One policy in Malawi that has adversely affected the manufacturing sector is the exchange rate policy. Since the floatation of the Malawi Kwacha in February 1994, the currency has massively depreciated – reinforced by two massive devaluations in the late 1990s. As Soberdom and Teal (2001) rightly note, while the depreciation of the currency provides incentives for exports, the net effect will depend on the extent to which manufacturing industries depend on imported raw materials. This might be the case in Malawi. Word Bank (1989) observes that the manufacturing industries in Malawi import about 67 percent of raw materials. It is very likely that this pattern of input orientation has continued in the manufacturing sector. Furthermore, Beltchika et al. (2001) also note that the exchange rate policy has resulted in unstable and at times substantially overvalued exchange rate.

The other policy area that the government needs to consider is to replace the rebate and duty drawback systems that are currently working administratively inefficiently. One option is to accord duty-free status to importation of capital and raw materials for all manufacturing activities, whether export-oriented or import substitution industries. Although, this would entail revenue loss in the short-run, the medium and long term revenue potential from the resulting industrial development are likely to exceed the cost of this policy, given that the manufacturing sector respond positively to such a policy.

5. Conclusion

This paper has reviewed the evolution of industry and trade policy in Malawi since independence in 1964. We have observed that during the first fifteen years of independence, industry and trade policy centred on the promotion of import substitution industrialisation. This import substitution strategy was supported through active government investment in manufacturing activities by MDC and ADMARC, maintenance of a fixed and overvalued exchange rate, limited tariff protection and non-tariff barriers to trade. In addition, the macroeconomic environment was also conducive to investment due to low and stable inflation, controlled interest rates and manageable fiscal deficits. However, owing to the economic crisis of 1980-81, the import substitution strategy was deemed unable to revive economic growth and consequently Malawi started implementing structural adjustment programs supported by the International Monetary Fund and the World Bank in 1981. This marked the transition from the import substitution strategy to export orientation strategy embedded in structural adjustment programs. The government has implemented many policy reforms during the 1981-1993 period, including policy reversals in some cases. The major policy reforms implemented include periodic devaluation of the Malawi Kwacha, privatisation of state-owned enterprises, liberalisation of interest rates, elimination of quantitative trade restrictions, liberalisation of entry into
manufacturing, introduction of duty drawback and surtax credit schemes and entering into a trade agreement with South Africa. It was in 1994 that the export orientation strategy, after having accomplished most policy reforms, was fully embraced with the floatation of the Malawi Kwacha in 1994, introduction of the Export Processing Zones scheme, and reduction in base surtax and tariffs under the COMESA free trade area.

Despite the many policy reforms that have been implemented and the orientation of the industrial sector towards export markets, industrial performance remains dismal compared with the period under the import substitution strategy. Actually, the period of complete export promotion is associated with a fall in manufacturing production both for the domestic and export markets. Of course one problem with structural reforms in Malawi, as has been the case in many African countries, is that the process of liberalisation has been mismanaged and has not been pursued strategically. With associated policy reversals and uncertainty, the adjustment process has left Malawi manufacturing ill prepared to undertake necessary adjustments to orient activities to the development agenda. The main stakeholders in the economy, such as manufacturers, have rarely been consulted before policies are implementation or given a proper period to undertake adjustments.

The big question is how Malawi revives its manufacturing sector given globalisation and the new trading rules that prohibit many of the policies that have developed the industrial sectors of developed countries and successful East Asian economies. The WTO rules restrict the nature of assistance the government can accord to its manufacturing sector. However, there are a few negotiable exceptions that recognise the need for government intervention in least developed countries within a well-defined period. It is within this special and differential treatment that least developed countries like Malawi can pursue a strategic industry and trade policy to promote critical manufacturing industries and protect infant industries. However, taking advantage of this differential treatment requires capacity in government and private sector to effectively negotiate policies, an effective coalition between the private sector and government to identify target industries and availability of high quality data to justify government intervention.

Since it will be difficult, may be costly too, to reverse most policy decisions after liberalisation given the new economic order and the pressure from the Bretton Woods institutions and the donor community, manufacturing enterprise need to invest in various capabilities to improve competitiveness. Such capabilities include research and development, technological capabilities and information technology. At the same time, government must create a conducive macroeconomic environment through price stability, containing government expenditure and intelligent and market based intervention in the foreign exchange market to ensure exchange rate stability and through investments in infrastructure, education and human development.
References


