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Case study: Experiences and prospects for industrial policy in Malawi

Malawi is a landlocked least developed country. According to latest World Bank figures, its gross domestic product (GDP) was US$3.7 billion in 2013. With a population of 16.36 million, it has a GDP per capita of US$226.5. The country has experienced mixed economic fortunes in recent years, characterised by low growth between 1994 and 2003, a spurt between 2005 and 2009, and balance of payments and fiscal difficulties since then. Its overarching development policy – the Malawi Growth and Development Strategy (MGDS) - aims to transform the economy from a "predominantly importing and consuming … to … predominantly producing and exporting one." This export-oriented approach is being pursued through a National Export Strategy. Meanwhile, new trade policy and industrial policy documents are currently being formulated.

The term 'industrial policy' is sometimes used interchangeably with policies aimed at developing the manufacturing sector. However, 'industry' must be seen as covering all economic activities, more importantly as they relate to the structure of an economy. Diebold[1]defines industrial policy as "relatively lasting arrangements affecting the use of resources and patterns of production and trade resulting from them". This view of industrial policy has become predominant in recent years. Hausmann, Hwang and Rodrik[2] have postulated that the value of products exported strongly correlates with the level of development that a country experiences. The traditional approach to development of exports that focusses on fundamentals such as endowments of physical and human capital, natural resources, and quality of institutions is

[1] Diebold, W. 1980. *Industrial policy as an international issue*. New York: McGraw-Hill.

[2] Hausmann, R., Hwang, J., and Rodrik, D. 2006. *What You Export Matters*. https://www.sss.ias.edu/files/pdfs/Rodrik/Research/What-you-export-matters.pdf.

acknowledged as important. However, it is proposed that government policy has an important role in shaping the production structure towards higher value products, especially by addressing the cost-structure of the economy. The private sector is seen to have a key role in cost-discovery in an economy. Related to this, Porter[3] had also posited that it is not just comparative advantage that determines the gains from trade, but also competitive advantage measured by the capacity of firms to innovate and upgrade. This ideally happens within the context of a diamond of national competitive advantage, which includes factor conditions e.g. skilled labour or infrastructure; demand conditions; related and supporting industries; and firm strategy, structure and rivalry. These viewpoints from Hausmann et. al. and Porterform the basis for effective industrial policy in a strategic and balanced manner; with the former focusing on supply-side constraints, and the latter on demand-side considerations.

As with most countries in sub-Saharan Africa, Malawi's industrial policy track has come full circle. After independence in 1964, the country's efforts centred on developing the productive structure of the economy. Infrastructural development was given priority in the construction of the new State. Import substitution industrialisation policies were followed, with government the main player in the productive sector, including in agriculture and manufacturing. Due to strong exogenous pressures on the economy – including the global oil crisis of the 1970s and the civil war in Mozambique which cut Malawi's export route to the sea – the country underwent a period of structural reform from around 1982, under the World Bank and IMF sponsored structural adjustment programmes (SAPs). This entailed liberalisation and deregulation of the economy, including privatisation of a wide range of State owned enterprises. By 1994, the economy was fully liberalised as it continued to participate in regional and global trade, within which trade liberalisation was continuing to gather pace. At the same time, policy focus shifted from the productive side of the economy towards social sectors of the economy such as education and health under the Poverty Reduction Strategy Papers (PRSP) approach. Since 2006, however, the MGDS has re-focussed on infrastructural development as a means for promoting development. The way that the different policy decisions were implemented over the years resulted in falling industrial output, particularly in the manufacturing sector[4] (see Chirwa, 2002). The country's export base has remained narrow and export revenues low. This has resulted in continually declining terms of trade, and balance of payments difficulties, particularly in recent years.

Challenges relate mainly to the supply side of the economy. The landlocked nature of the country and its reliance on road transport significantly increase production costs, making its products less competitive. Other infrastructural challenges include sub-optimal electricity generation, and high communication costs. Low levels of skilled labour also represent a significant challenge. Effectively dealing with these and other binding constraints on production and trade is the necessary first step in the country's industrial policy.

The second step relates to identification and development of specific products with the potential to be highly competitive in regional and global markets. Insights on how best to do this would start from analysing Malawi's trade profile in recent years. From 2001 to 2013, the country's import and export structure has remained largely unchanged with some interesting trends in specific products over the

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[3] Porter, M. 1990. *The Competitive Advantage of Nations*. http://dl1.cuni.cz/pluginfile.php/50387/mod_resource/content/0/Porter- competitive-advantage.pdf.

[4] Chirwa, E. 2002. *Trade policy and industrialisation in Malawi: The need for a strategic approach*. http://wadonda.com/tradepo0202.pdf.

period[5]. The top 25 imports have largely consisted of manufactured products and capital goods. Top 25 exports have mainly included primary (and some processed) agricultural products, with mineral exports entering the export basket in 2009.

With regard to imports, petroleum products, fertilisers, and medicines have been dominant. Some shifts from agro-processed towards primary agricultural commodities suggest some increases in manufacturing capacity in some respects. This is the case, for example, with the relative decrease in imports of soya bean oil over the period and an associated increase in production and export of soya beans, which could signify more domestic processing of soya bean oil. It is also seen in the shift in imports from wheat or meslin flour towards wheat or meslin, though without resultant exports of wheat flour. Following such patterns provides cursory indications on Malawi's participation in global and regional value chains.

From the country's export profile, it can be noted that the country is at the base of most value chains for some of its top export products. Tobacco (almost half of its exports), ground nuts, dried vegetables, cotton, wood, natural rubber, and oil seeds are all exported in their raw form. Sugar and tea are the only processed products exported in significant amounts. Uranium entered the export basket in 2009 and is also exported in its primary form. Apart from carefully developing the mining sector, increased processing of such primary agricultural products represents a key first step towards production and export of higher value products in an inclusive way. Where they are exported to is the next key consideration, and demand factors play an important influence here.

An analysis of more imports and exports outside the top 25 – though with low associated export values - starts to bring out a more interesting picture. Intermediate products are imported from global markets, and the resultant processed products are exported to regional markets. For example, polyethylene and polypropylene are imported from South Africa, South Korea, Qatar and Thailand; and plastic products including sacks and bags, household articles, films and sheets, tableware and kitchenware are exported to Zambia, Mozambique, Zimbabwe and the Democratic Republic of Congo. Malt is imported from Denmark; and beer made from malt is exported to Mozambique and Zambia. On the global front, woven fabrics are imported from India, China and Taiwan; and women and girls' blouses are exported to the United States of America.

Although only cursory, these trends are instructive for focused and strategic industrial policy. It is such trends that need to be explored in detail to develop the competitiveness of specific sectors. Regional markets – particularly Malawi's neighbouring countries – present immediate opportunities for export of such products. Different cities in these neighbouring countries are forecast to continue growing strongly. This potentially represents growing demand for products that Malawi can aim to service. Targeting these sub-national markets would have to be accompanied by infrastructure that effectively connects production centres in Malawi to these markets. Joint preparation and implementation of cross-border infrastructural projects with the respective neighbouring countries is imperative. Renewed commitment by multilateral development institutions to increase financing to developing countries would need to be leveraged and effectively channelled, complemented by coordination in implementation of the Trade Facilitation Agreement of the WTO.

[5] Mwanza, W. 2015. *Malawi's trade profile 2001 to 2013*. http://www.tralac.org/images/docs/7185/s15tb022015-mwanza-malawi-trade-profile-2001-to-2013-20150325.pdf.

On the global level, some key policy decisions and trends will be of immediate importance to the country. For example, the expiry of the sugar quota of the EU in 2017 represents an opportunity for the country to increase exports to that region. In the US, the extension of the Africa Growth Opportunity Act (AGOA) will have implications on the few clothing exports that are destined for that market and for development of the clothing and textile industry in Malawi. Certain aspects – such as standards - that will be agreed in mega-regional agreements such as the Trans-Atlantic Trade and Investment Partnership (TTIP) between the EU and US may have a bearing on future access to these markets as well.

Malawi should also engage effectively in the WTO LDC services waiver negotiations and develop its human resource base in a way that takes advantage of opportunities opening up through this instrument. The joint request submitted by LDCs to the WTO includes services and service providers that are of immediate interest for Malawi such as accounting, auditing and bookkeeping, architects, consultancy, creative industry services, engineering, information and communication technology (ICT), lawyers and travel agents. Apart from the export of such services and service providers, there is also need for the holistic development of some important service sectors within the country, such as ICT, finance, and tourism.

All in all, although the country is experiencing significant economic challenges, there is considerable scope for implementation of an effective industrial policy that is highly varied, adaptable and tailored, in a way that would enhance production and trade, and hence enhance development.