A Failed Special Economic Zone Experiment: Malawi 1995-2023

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KEY TAKEAWAYS

In 1995, Malawi passed the Export Processing Zones Act.

The Act was a disastrous example of poor policy making, creating few if any benefits for Malawi. By the mid-2000s it had collapsed.

In 2023, Malawi passed a new Special Economic Zones Act.

Executive Summary

In 1995, Malawi embraced the strategy of Special Economic Zones (SEZs) as part of the effort to promote export-oriented manufacturing and passed the Export Processing Zones Act No. 11 (hereafter referred to as The Act).

This policy brief first shows that The Act was a failure relative to its stated intentions regarding exports, employment, investment, and economic linkages. By the 2000s, it had all but collapsed. There were some external events that can be considered to be 'bad luck' for Malawi, including the ending of the Multi-Fiber Agreement (MFA) in 2005 and the onset of the Global Financial Crisis in 2008. The failure of The Act was not, however, due to bad luck, but to poorly drafted legislation.

This policy brief gives four examples from The Act that undermined the functioning of EPZs in Malawi: i) the Composition and Responsibilities of the Appraisals Committee; ii) Sectoral Priorities; iii) Tax and other Incentives, Government Credibility, and Profit Repatriation; and iv) Infrastructure and Bureaucracy.

To borrow the title of a famous novel, *Chronicle of a Death Foretold*, the story of the collapse of the EPZ model in Malawi after 1995 was not about bad luck, it was about bad policy; it was destined to fail.

The Government of Malawi, finally, after nearly three decades into a failed experiment, passed a new Act in 2023. In another policy brief, CCI will explore to what extent the new legislation has learned from the failures of The Act.[1]

Introduction

After independence in 1964, Malawi followed a model that substituted industrialization with imports. During the early 1980s, as in many other developing countries, Malawi shifted to a model of market liberalization and export-oriented industrialization. In 1995, Malawi embraced the strategy of Special Economic Zones (SEZs) as part of its effort to promote export-oriented manufacturing[2] and passed the Export Processing Zones Act No 11 (hereafter referred to as The Act[3]). Several African countries had launched SEZs in the 1970s, including Liberia in 1970, Mauritius in 1971, and Senegal in 1974. Malawi in the early 1990s joined a pioneering new wave of African countries that included Ghana, Kenya, Uganda and Zimbabwe, who adopted the SEZ model[4]. This wave had been inspired by China, who set up four SEZs in 1980, which were regarded as great successes.

The Act was passed by the Ministry of Industry and Trade (MoIT) and was intended to promote export diversification away from Malawi's traditional staples – tobacco, tea, cotton, and coffee – towards manufacturing. The aim was to attract foreign investment, boost employment, and to create linkages with domestic industry. In Malawi, export processing firms (EPFs) were not compelled to locate in a demarcated area, as was the case in the usual SEZ models, but were allowed to locate anywhere in the country. A single factory could be designated as an SEZ (EPZ in Malawi) and receive the incentives mandated by The Act. EPFs were not allowed to sell any of their output onto the domestic market as firms had to be 100% export-oriented[5]. The implementation of The Act was in the hands of a newly formed EPZ Appraisal Committee.

This policy brief first demonstrates that The Act was a failure relative to its stated intentions with respect to exports, employment, investment, and economic linkages, and by the 2000s had all but collapsed. There were some external events that could be considered to be 'bad luck' for Malawi, including the ending of the Multi-Fiber Agreement (MFA) in 2005 and the onset of the Global Financial Crisis in 2008. The failure of The Act, however, was not due to bad luck, but to poorly drafted legislation. This policy brief gives four examples from The Act that undermined the functioning of EPZs in Malawi: i) the Composition and Responsibilities of the Appraisals Committee; ii) Sectoral Priorities; iii) Tax and other Incentives, Government Credibility, and Profit Repatriation; and iv) Infrastructure and Bureaucracy.

To borrow the title of a famous novel, *Chronicle of a Death Foretold*[6], the story of the collapse of the EPZ model in Malawi was not about bad luck, it was about bad policy from the outset. The model was destined to fail.

The Malawi Government, finally, after nearly three decades into a failed experiment passed a new Act in 2023. This Act reverted to a more traditional model of SEZs based in particular geographical locations, with four initial SEZ sites being designated: Dunduzu, Lilongwe, Matindi, and Chigumula **(https://mitc.mw/invest/index.php/investment-climate/special-economic-zones).**

The Failure of the 1995 Export Processing Zones Act

The Act of 1995 was an undoubted failure relative to its stated intentions with respect to exports, employment, investment, and economic linkages. The failure was dramatic; after a bright start in 1996, the scheme imploded and firms fled the EPZ program. The failure was also political in nature in that the government introduced reforms in 2007 (cancelling the corporate tax exemption) and in 2011 (ending the freedom to repatriate profits) that accelerated the decline of the scheme, but waited for decades, until 2023, before passing new SEZ legislation that hopefully has taken this previous experience into account. Each of the four areas of intention will now be considered individually.

Exports: agriculture constitutes about 80% of the workforce in Malawi and generates more than half of the country's exports. Those exports consist mainly of unprocessed tobacco, tea, and legumes. There were some encouraging signs early on in 1995 and after 1996, when firms joined the EPZ program to add some domestic value-added to agricultural products, which were then exported. These agro-based sectors included macadamias in 1996, coffee in 2004, mango and banana puree in 2012, and dhal after 2016. Overall, exports from Malawi grew by 8% p.a. between 2006 and 2015[7], providing encouraging but limited overall impact. Around 82% of export earnings from Malawi were generated from unprocessed agricultural products in 2006 and this figure had only marginally declined to 79% in 2015[8].

There is not much direct data available on exports from the EPZs in Malawi, but such evidence as there is suggests that The Act failed in terms of promoting the volume and diversity of exports. Interviews with EPZ firms showed that none of them introduced any new products between 2006 and 2016. During the same years, only two EPZ-dominated sectors made it onto the list of top-ten exports from Malawi, and by 2015 these had dropped to 14th and 16th. The share of EPZ exports to total exports in Malawi declined from 4.7% in 2006 to 2.8% in 2015[9].

The Act also failed to help Malawi adjust to the twin shocks of the abolition of the Multi-Fiber Agreement (MFA)[10] in 2005 and the onset of the Global Financial Crisis in 2008. Exports of textiles and garments from Malawi dropped by 80% between 2006 and 2015[11].

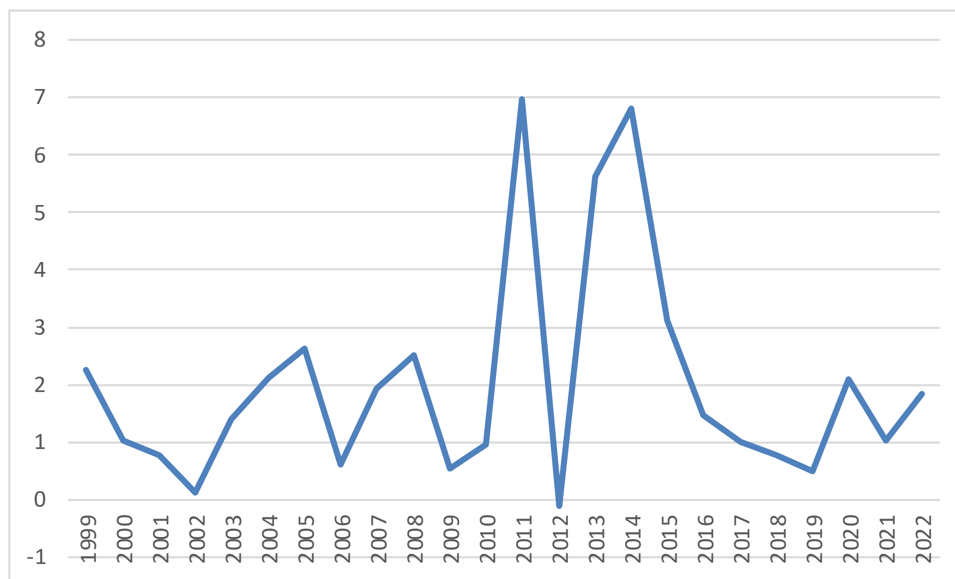
Employment: the first decade of the EPZ program had some positive outcomes in terms of employment creation. Between 1996 and 2006, more than 10,000 jobs were created in the EPZ program. This was significantly less than the nearly 40,000 jobs created in Lesotho between 1999 and 2004. Almost 80% of the increase in Malawi was in the 22 textiles and garment firms that established EPZ factories. Of these textile and garment firms, by 2006 there were only eight still operating, and by 2015 this had furthered reduced to two. There is little reason to believe this employment was imparting skills or training to workers as more than 90% off these jobs were for unskilled laborers. Interviews in 2016-2017 show that the majority of local employees were working on a part-time basis[12].

Investment: in 1996, a year after the passing of The Act, 40 firms quickly joined the scheme and more than half of them produced textiles and apparel. A decade later, in 2006, 17 firms remained, and by 2015 this number was down to 11, including the two textile and apparel firms mentioned above. The 11 EPZ firms in 2015 were small-scale and between

them accounted for a modest $105 million in investment[13]. Six of the remaining 11 firms in 2015 were involved in agro-processing, adding minimal value-added to agriculture. The scheme had clearly failed to promote industrialization.

Figure One shows that upward blips in 2011, 2014 and 2015 excepted, foreign investment in Malawi has remained low (1-2% of GDP) and has shown no upward trend during the 25+ years since The Act was passed.

Figure One: Foreign Direct Investment - Net Inflows, Malawi, 1999-2022 (% of GDP)

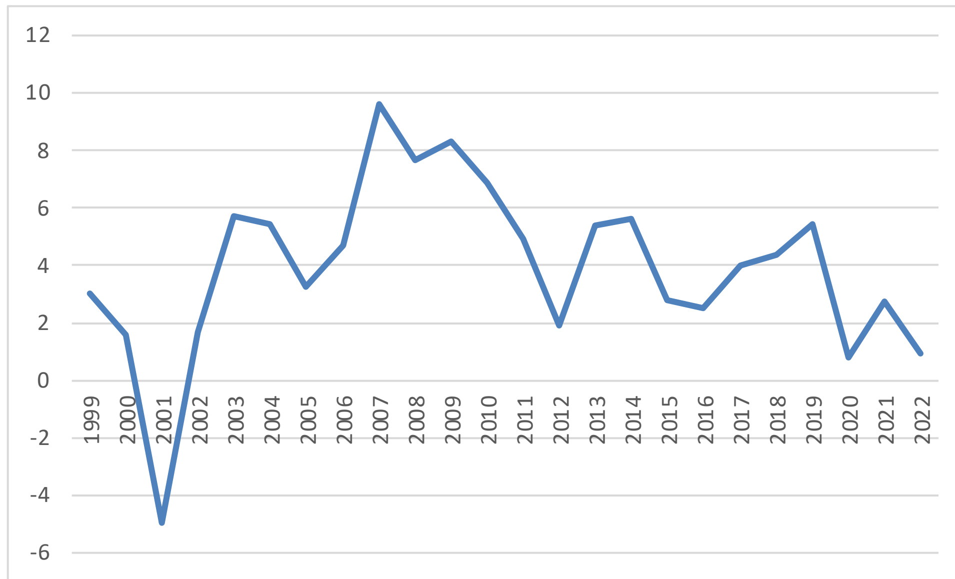


Source: World Bank (2024)

Domestic Linkages: there is limited evidence, but what is available suggests that the EPZ program generated few links with the local economy. There were no forward linkages as EPZ firms had to export 100% of their output. Interviews in 2016 and 2017 show that EPZ firms tended to import almost all their inputs, explained by the fact that local producers were unable to supply in sufficient quality and quantity (backward linkages). The EPZ firms in Malawi were predominantly labor-intensive low-technology assembly firms, relying on unskilled, part-time labor – there were few, if any, opportunities to utilize new technology[14].

There is no evidence that the aggregate economic contribution of The Act (exports, employment, investment, and domestic linkages) contributed to rapid and sustainable economic growth in Malawi. Figure Two shows that economic growth in Malawi increased rapidly in the late 1990s to reach around 10% in 2007, and has declined steadily over the last 15 years to an average of around 2% p.a. between 2020 and 2022.

Figure Two: Economic Growth in Malawi, 1999 to 2022 (% p.a.)



Source: World Bank (2024)

The following sections of this policy brief analyze (and mainly criticize) aspects of The Act, encompassing: i) the Composition and Responsibilities of the Appraisals Committee; ii) Sectoral Priorities; iii) Tax and other Incentives, Government Credibility, and Profit Repatriation; and iv) Infrastructure and Bureaucracy. Together, these four factors explain why The Act failed to generate positive economic outcomes for Malawi.

The Composition and Responsibilities of the Appraisals Committee

The Act legislated for the creation of a committee, known as the Export Processing Zones Appraisal Committee. The Act declared that: "*The Committee shall be responsible for appraising and reviewing applications for the establishment and operation of export processing zones and the production or manufacture of export products, and making appropriate recommendations to the Minister*" (p.4).

In relation to best practice elsewhere in Africa, The Act was successful in ensuring a wide-ranging and senior membership of the Committee but failed in securing the responsibilities and autonomy of the Committee.

The composition of the Investment Agency Board is important in contributing to the effectiveness of the Zone Committee or Agency. There are various aspects of the composition of the Board that contribute to its successful functioning. The Board has to include senior representatives from all of the relevant ministries as it can more easily offer visas for zone investors or commit to ensuring quick connections to the electricity grid if it contains representation from the ministries responsible for migration and electricity. There should be at least, "*one senior, seasoned civil service technocrat (ideally at the cabinet or permanent secretary level) in (or retired from) a Ministry interacting with business, and accustomed to confronting the limits of what government actually can and cannot accomplish*"[15]. It is also important to include private sector representation; not just a representative of the national Chamber of Commerce, but representatives of firms that are investing and trading in economic zones, especially if there is a formal association of zone members. Many scholars conclude that ideally the Board should comprise a majority of private sector members[16].

In this respect, The Act was close to best practice. The Committee was chaired by the most senior civil servant (the Secretary) from the Ministry for Commerce and Industry. The other members included the most senior civil servants from relevant ministries and government agencies. These included the Secretary from the Treasury, Economic Planning and Development, Agriculture and Livestock, and Labour and Manpower Development, the Controller of Customs and Excise and of Immigration Services, and the General Manager of the Malawi Investment Promotion Agency and the Malawi Export Promotion Council. In addition, an appointee from the Reserve Bank of Malawi and a private sector member were nominated by the Confederation of the Malawi Chambers of Commerce and Industry (*).

The Act did allow a loophole that empowered in each case the senior member to send a "*designated representative*" (p.4). The Act still required political leadership to ensure that senior members were present and making decisions that carried the authority of their office.

A second, though common, weakness of The Act is that the Committee was housed in a line ministry (Industry and Trade) rather than a more powerful central ministry (such as Finance), or ideally in the office of the Prime Minister or President. This likely weakened the ability of the Malawi Appraisals Committee to induce cooperation and coordination across other ministries, departments, and agencies[17]. In Ethiopia, the Industrial Parks Development Corporation, established in 2014, is mandated with the role of developing SEZs. The organization reports directly to the Prime Minister. In Ethiopia, the role of the Prime Minister's Office (PMO) is

fundamental not only for coordination among the senior representatives from line ministries such as foreign affairs, industry, finance and agriculture, but also for signaling high-level support for the SEZ strategy to potential investors[18].

The third weakness of The Act is in relation to its extremely circumscribed autonomy and devolved responsibilities. The Act created a committee responsible solely for producing a recommendation on whether a firm should be granted EPZ status, and that recommendation would then be accepted or rejected by the Minister for Industry. The expertise and potential decision-making authority of those senior members of the Committee were, in consequence, wasted as the Committee itself was given no authority to make decisions. Typically, SEZ authorities have much more wide-ranging responsibilities and autonomy to utilize those powers. In contrast, in Zanzibar for example, the Zanzibar Investment Promotion Authority (ZIPA) has the responsibility of issuing an Investment Certificate to prospective domestic or foreign investors, and does not simply produce a recommendation for someone else to act upon. Further, the ZIPA monitors the actions of investors, can repeal certificates, if need be, is responsible for the administration and management of the SEZ scheme, and acts as a focal point for investment policy.

Sectoral Priorities

The Export Zones Promotion Authority (EPZA) in Tanzania is typical of such authorities in Africa. The EPZA sets minimal criteria for investors and leaves the decision to investors on whether they then want to invest in Tanzania.

In Tanzania, firms may apply to invest in an SEZ if they are undertaking new investment (not re-locating an existing factory), have minimum capital of $100,000 (local investor) or $500,000 (foreign investor), and will be physically located within an SEZ (**https://www.epza.go.tz/pages/license-and-procedure**). Beyond that, the EPZA sees its role as a promoter of Tanzania, providing information to potential investors to encourage them to invest in the country. On their website, for example, under Agro-processing, the EPZA describes various opportunities for potential investors. These include "*huge potential for sugarcane farming and sugarcane production*", "*vast water sources, good climatic conditions, and huge market potential*", "*expansion and improvement of irrigation systems*", and the presence of many "*institutions who offer special financial assistance to agriculture-focused businesses through Tanzania agricultural development bank*" (**https://www.epza.go.tz/pages/kilimo**).

The Act in Malawi takes a completely different approach. The Appraisals Committee is legislated to be the entity responsible for making a decision on whether a prospective investment makes good business sense. The Act declares that the "*Committee shall have regard to the following considerations*" (p4), which include whether or not the project is labor intensive, will contribute to employment, will utilize advanced technology and local raw materials, whether there is sufficient warehousing available to store raw materials and export products, and whether the firm has documentary evidence of export markets for their export products (p.4-5).

A well-designed SEZ will incentivize central, and especially local, elites to pursue further economic reform. A poorly designed SEZ model may work in the opposite direction, encouraging more rent-seeking and corruption. The SEZ scheme in Poland, for example, has been criticized as one that is driven by companies spending their time and entrepreneurial energy lobbying for more tax and other concessions in the SEZ rather than competing in the market[19]. In India, SEZs failed to generate positive developmental outcomes and, instead, politicians sought SEZ status so that they could participate in lucrative land speculation, buying farming land cheaply and selling it for factory and housing construction in SEZs at vastly inflated prices[20].

The Act in Malawi enables the Minister of Industry on recommendations from the Appraisals Committee to declare "*any area of land on which a factory has been or is being or is likely to be built*", "*any factory*", or "*any area of land which immediately surrounds a factory or the plot on which a factory is being or is likely to be built*" to be an export processing zone (p.7). Many of the criteria by which the Appraisals Committee is legislated to consider are commercial decisions best left up to the individual firm. The criteria are also very vague and subjective, opening up the Appraisals Committee (in making a recommendation) or the Minister (in making a final decision) to lobbying and bribery on behalf of a single firm seeking to acquire the designation and its associated tax incentives. There is no indication in The Act as to what criteria the Minister should use to reach a final decision.

Tax and Other Incentives, Government Credibility, and Profit Repatriation

Tax and Other Incentives: the number of SEZs globally has increased from an estimated 176 zones in 47 countries in 1986, to 3,500 zones in 130 countries in 2006, and to 5,400 zones across 145 countries in 2019, with 500 SEZs in the development pipeline[21]. The number of SEZs in Africa increased from 20 in 1990 to 237 in 2020. Currently, 38 African countries have SEZs, while more are planned elsewhere[22].

The incentives offered by SEZs globally have tended to provide a very similar package. For example, SEZs in Zanzibar, Tanzania, Kenya, South Africa, Mozambique, Uganda, and Zambia all offer exemption on VAT on local purchases, reduced rates or tax holidays on corporate taxation, and zero import tariffs for inputs and capital equipment. Most SEZs also offer non-tax incentives (discussed later) such as easy access visas for foreign workers, better infrastructure (especially water, electricity, and roads), and streamlined regulatory processes (customs, immigration, and licenses).

The Act offered investors only one incentive – zero import tariffs for inputs and capital equipment for production by EPZ firms and factories (p.10). In addition to The Act, Malawi legislated for a tax holiday on the 30% rate of corporation tax for EPZ firms. In 2007, the government of Malawi abruptly removed this incentive and required firms to start paying corporation taxation.

Interviews in 2016 and 2017 show that firms were deterred from investing in Malawi due to the relatively poor incentives offered and left the EPZ program after the abolition of the corporate tax incentive in 2007[23].

Government Credibility: most SEZ programs offer investors a license conditional on fulfilling certain criteria, such as new investment and certain investment thresholds (as noted above). There are also clear criteria to explain the circumstances under which that license may be revoked. Recent legislation in Zanzibar, for example, stipulates that an investor license may be revoked if it was obtained by fraud, if the investor has not commenced investment within one year of the license being granted, and if the investor abandons the project.

In Malawi, by contrast, The Act stipulated that, "*A certificate shall be valid for a period of five years and may thereafter be renewed for successive periods of two years*" (p.9). This means that after five years, and thereafter every two years, an investor would have to re-apply to the Appraisals Committee to renew their EPZ status. As we have already noted, permission is granted on very vague and subjective criteria, which opens up the whole process to politically-influenced lobbying and bribery.

The Act grants the Minister significant discretionary powers over the conditions of the investment: "*the Minister may, by notice in writing addressed to the export enterprise, at any time amend any certificate or any condition attached to a certificate*" (p.9). The low-level of investments in EPZ projects highlighted earlier can be explained in part by this provision.

Why would an investor undertake expensive fixed investment in an EPZ project if they have to renew their right to continue that investment (their property rights) after five years and thereafter every two years?

Profit Repatriation: typical of SEZ programs in Africa is the provision in Zanzibar that, subject to complying with financial laws, investors can repatriate in a freely convertible currency any profits or dividends attributable to their investment project. These include: any royalties, fees and charges incurred as part of a technology transfer agreement; payments to foreign employees; or any proceeds from the sale of all or part of the business (**https://www.zipa.go.tz/fez-incentives/**).

In Malawi, none of these investor freedoms was legislated for in The Act, meaning investors were vulnerable to changing rules. Before 2011, EPZ firms in Malawi were free to repatriate their profits overseas. The rules were changed in 2011, so that all exporters were compelled to repatriate 100% of their export proceeds back to Malawi and register them with the Reserve Bank of Malawi within six months of exporting. In practice, firms violated this rule with apparent impunity and after 2010 textile firms only repatriated 14% of their $47 million of export revenue[24]. It is not clear how the rules were circumvented; presumably, through a mixture of lobbying and corruption?

Infrastructure and Bureaucracy

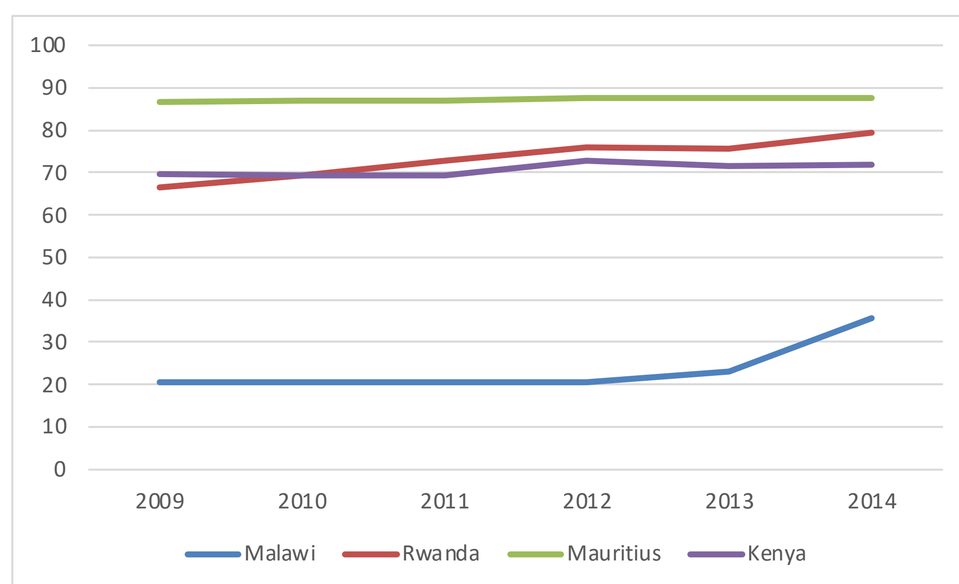
The World Bank conducted a survey in 2009 of more than 600 firms located in SEZs across 10 countries, including Africa Ghana, Kenya, Lesotho, Nigeria, Senegal, and Tanzania, as well as Bangladesh, Vietnam, the Dominican Republic and Honduras. The survey was based primarily on semi-structured interviews conducted in each country with investors, zone developers and operators, regulatory authorities, government representatives, and other stakeholders. The top three motivations identified for African investors to locate in SEZs were the 'cost and quality of utilities', 'access to transport infrastructure' and the 'business regulatory environment'[25].

Traditional SEZ programs based in geographically demarcated areas typically offer investors better infrastructure (especially water, electricity, and roads) and non-tax incentives such as easy access visas for foreign workers, and streamlined regulatory processes (customs, immigration, and licenses). Traditional SEZs are, thus, clearly aligned with the needs of investors in Africa.

In Malawi, the government opted for a single-factory model for its EPZ program, whereby factories located anywhere in Malawi could apply for, and be given, EPZ status. Such EPZs were not provided with any favorable infrastructure, so were constrained by the general infrastructural and bureaucratic deficiencies of the country. Figure Three gives a numerical measure for access to electricity produced by the World Bank Doing Business project[26].

Figure Three shows that potential EPZ investors in Malawi faced significant infrastructure constraints compared to other African countries with successful SEZ programs – Mauritius, Rwanda, and Kenya.

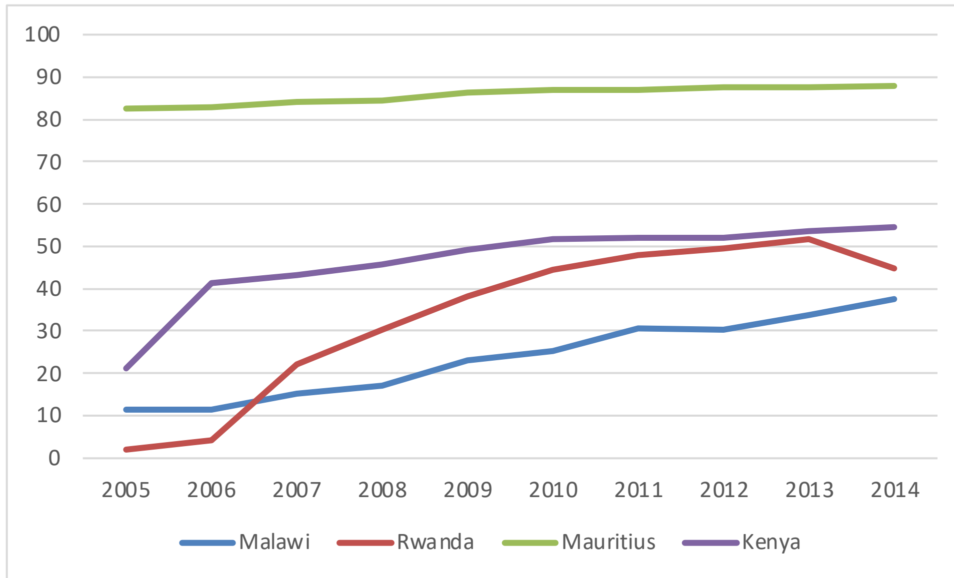
Figure Three: Infrastructure: Access to Electricity in Malawi (%), 2009 to 2014



Source: World Bank (2024)

Figure Four provides a measure of bureaucratic functioning in Malawi[27]. Though improving steadily between 2005 and 2014, the ability to export from an EPZ in Malawi remained slower and more costly compared to the three other African countries with successful SEZ programs.

Figure Four: Bureaucracy: Trading across borders in Malawi, 2005-2014



Source: World Bank (2024)

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1 Mason (2024).
2 Njima (2017).
3 The Export Processing Zones Act No.11 of 1995, Government of Malawi.
4 Farole (2010:4).
5 Njima (2017).
6 Marquez (1983).
7 Njima (2017:28).
8 Njima (2017:29).
9 Njima (2017:30).
10 The Multi-Fiber Agreement (MFA) was established in 1974 and imposed quotas on the amount of clothing and textiles that certain developing countries could export to developed nations. Some countries like Malawi were exempt, and were enabled to boost clothing and tex tile exports with less competition from countries such as China. The abolition of the MFA in 2005 allowed China and other developing countries to freely export clothing and textiles and many high-cost or weaker countries, including Malawi, were unable to compete.
11 Njima (2017:32).
12 Njima (2017:34).
13 Njima (2017:27).
14 Njima (2017:36).
15 Farole (2011:136).
16 Farole and Kweka (2011:6).
17 UNECA (2022:54).
18 Rodriguez-Pose et al. (2022:467).
19 Moberg (2017).
20 Alkon (2018).
21 Farole (2011); UNCTAD (2019).
22 Rodriquez-Pose et al. (2022:459).
23 Njima (2017:2).
24 Njima (2017:33).
25 Farole and Kweka (2011:6).
26 "The score for getting electricity is the simple average of the scores for each of the component indicators: the procedures, time, cost for a business to obtain a permanent electricity connection and supply for a standardized warehouse, as well as the reliability of supply and transparency of tariffs index. The score is computed based on the methodology in the Doing Business Reports from 2010 to 2015" (World Bank, 2024).
27 "Trading across borders measures the time and cost associated with exporting and importing a standardized cargo of goods by sea transport. The time and cost necessary to complete 4 predefined stages (document preparation; customs clearance and inspections; inland transport and handling; and port and terminal handling) for exporting and importing the goods are recorded. All documents needed by the trader to export or import the goods across the border are also recorded. The process of exporting goods ranges from packing the goods into the container at the warehouse to their departure from the port of exit. The process of importing goods ranges from the vessel's arrival at the port of entry to the cargo's delivery at the warehouse. For landlocked economies, since the seaport is located in the transit economy, the time, cost and documents associated with the processes at the inland border are also included. The score for trading across borders is a simple average of the cost to export and import, time to export and import, and the number documents to export and import. It is computed based on the methodology in the Doing Business 2006 to 2015 studies" (World Bank, 2024).

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