



TOGETHER
for a sustainable future

OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.



TOGETHER
for a sustainable future

DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as “developed”, “industrialized” and “developing” are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

FAIR USE POLICY

Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

18784

5/A

PRE-FEASIBILITY STUDY FOR

AN EXPORT PROCESSING ZONE

IN MALAWI

REPORT COMMISSIONED BY

UNIDO

FROM

TOM KELLEHER - *Consultant*

INTERNATIONAL DEVELOPMENT IRELAND LTD.

*Backstop Eff. Mr. Kapumba
PPD/PREPA/OD/IDDA*

OCTOBER 1990

TABLE OF CONTENTS

1. Background and Terms of Reference
2. Conclusions and Recommendations
3. The Export Processing Zone - An Overview
4. An Export Processing Zone in Malawi

Appendix I - Organizations and Documents consulted

Appendix II - Export Processing Zones and other duty free systems compared

Appendix III - Export Processing Zone organization - some principles

Appendix IV - Site Specification

Appendix V - Foreign Currency Accounts

CHAPTER ONE

1. BACKGROUND AND TERMS OF REFERENCE

Agriculture is the main source of employment and income in Malawi and will continue to dominate the economy of Malawi for many years to come. Nevertheless the growth and development of the industrial sector is seen as essential for the future prosperity of the country.

The expansion and diversification of export earnings has the highest priority. Major agricultural crops account for 92% of domestic exports. Thus the expansion of manufactured exports will be a key issue in years to come. Policy for medium and large scale industry in particular will be dominated by the need to stimulate exports.

In order to encourage manufactured exports a package of export incentives including duties, taxes, credit, insurance and access to foreign exchange is being introduced. The possibility of establishing an export processing zone (EPZ) is being considered.

The objective of this study is to consider whether or not the basic pre-conditions exist in Malawi for the successful development of an EPZ and to make recommendations on (i) the important issues to be considered in the context of a full feasibility study and (ii) an action programme for the Government.

CHAPTER TWO

CONCLUSIONS AND RECOMMENDATIONS

2.1. Conclusions:

(i) The basic conditions necessary for successful free zone development exist in Malawi or can be created without too much difficulty. The infrastructure in Blantyre and Lilongwe is good - better in fact than what is available in many competitor locations. The workforce is willing and labour costs are low. There is a positive attitude within the government towards foreign investment. The major drawback is transport costs. The bureaucracy associated with establishing a business is complex and needs to be streamlined.

(ii) There is wide agreement among the diplomatic and business community on the need for an EPZ type facility to promote and develop manufactured exports. (iii) Lilongwe and Blantyre are both suitable locations. (iv) Competition for free zone industry within Africa is growing rapidly and most countries in Sub-Sahara Africa are planning free zones. Malawi should therefore move quickly to announce its intentions to investors.

2.2. Recommendations:

- 1) The Government of Malawi should proceed with a full scale feasibility study for an export processing zone along the lines proposed in the World Bank Aide Memoire of June 28, 1990. In addition to the issues to be addressed in the draft terms of reference, the study should cover:-

- (i) the drafting of suitable EPZ legislation;
- (ii) the organizational arrangements for promoting the zone(s), evaluating investors proposals and managing the zone(s);
- (iii) the Customs procedures involved in moving goods, checking stock accounts etc.;
- (iv) the arrangements for making and receiving payments in foreign currency. In this context the operation of a foreign currency account under the control of the Reserve Bank should be considered - a possible model and the logic behind it is set out in Appendix V.

(v) the staffing requirements for the zone(s) including Customs personnel and the training involved. Consideration should be given to the addition of a Customs Procedures Expert and Banking Specialist to the study team.

- 2) The government should alert potential investors in Malawi and overseas that it is proceeding with such a study and would welcome investment. This could be done through a press statement (or a statement at some suitable forum) made by a very senior government official. The statement should be given the widest possible publicity in Malawi and abroad. It can be used later by Consular officials and others promoting investment.
- 3) The successful development of export processing zone(s) requires high level co-operation among many different branches of government. To this end a co-ordinating committee should be established with representatives from the Ministries of Finance, Economic Planning, Industry, Trade and Tourism (who could provide a secretariat) and possibly the Reserve Bank.

The committee should establish lines of communication with all those organizations who will be involved in the development of the zone. These include the Ministry of Lands; Ministry of Housing and Physical Planning; ESCOM; Post Office (Telecommunications Branch); the Water Boards in Lilongwe and Blantyre; Air Malawi (Cargo Services); Malawi Housing Corporation; Malawi Development Corporation; Malawi Export Promotion Council; Press Holdings; Chambers of Commerce and Industry. It is assumed that communication with the Dept. of Customs and Excise will be through the Ministry of Finance.

The tasks of the Committee will include

- i) Reviewing the terms of reference of the feasibility study;
- ii) Identifying potential sites in Lilongwe and Blantyre as per the site specification set out in Appendix IV;
- iii) Clarifying any problems that may exist with regard to title, zoning, servicing etc. prior to the study team arriving;
- iv) Keeping the various interested parties informed of progress and in particular ESCOM, the Water Boards and Post Office (Telecommunications Branch).

Final decisions on sites should not be made until the feasibility study is complete.

4. The government should use the EPZ concept because of its promotional value and the fact that it is easy to create special legislative and administrative arrangements within an EPZ. The format of the EPZ is a matter for consideration in the context of a full feasibility study i.e. a formal fenced in area or an administrative concept as in Mauritius where investors who are granted EPZ status can locate anywhere on the island.

CHAPTER THREE

THE EXPORT PROCESSING ZONE - AN OVERVIEW

3.1. The Export Processing Zone - its Role

An EPZ is a policy/promotion instrument used by countries when they are beginning their efforts to attract foreign export oriented manufacturing investment. The free zone, properly planned and developed, provides (1) streamlined operating procedures, (2) good infrastructure, and (3) an EPZ authority who will assist investors in obtaining various approvals and permits.

The arguments or justification for a free zone in the early stages of a country's attempts to promote export oriented foreign investment are (i) the country's infrastructure is underdeveloped and the concentration of services in a well chosen site, close to international communications (transport and telecommunications) and recreational facilities, is desirable; (ii) customs procedures for import/export are often complex and difficult and can be simplified in a free zone, and (iii) there is a need for a dedicated promotion oriented organization to assist the investor in completing necessary formalities and helping him to get established.

As the country's infrastructure develops, customs procedures are streamlined and bureaucracy becomes more attuned to the needs of export industry, the need for special arrangements, in the form of an export processing zone, diminishes. Export manufacturing industry can be accommodated in a range of standard industrial estates where bonded facilities are available.

In practice this is how the situation evolved in those countries which pioneered the EPZ concept e.g. Ireland, Korea and Taiwan. The EPZ played an important role in the early years (first five years) of those countries' attempts to attract Export

Manufacturing Industry (EMI). Zone exports increased significantly in absolute terms and as a percentage of total manufacturing exports for 5-6 years. Thereafter while zone exports continued to increase their share of the country's total manufacturing exports declined. New export oriented industries were established in industrial estates with open bonded facilities throughout the country. The country's non-free zone manufactured exports increased dramatically and the EPZ share of total manufacturing exports declined.

In recent years the concept of the export processing zone has expanded. Special zones or facilities are being created together with special incentive packages to cater for the requirements of international service industry and research and development activities.

Another trend in free zone development which has accelerated in recent years is that of private free zones. The reasons being that (i) in many countries privately owned/managed zones have outperformed their public sector counterparts as many Government run zones have failed to provide a businesslike management, and (ii) there is a shortage of investment funds from Government sources.

3.2. EPZ's around the World

A survey by the Starnberg Institute in 1987 on free zones showed that 19 countries had free zones in 1975. The number had increased to 42 in 1986. Since then another 20-25 countries around the world have carried out feasibility studies. At this point in time there are upwards of 50 countries with free zone facilities.

Employment in these zones in 1986 was estimated at 1.3 million people with an additional 620,000 people in other offshore manufacturing facilities bringing the total to almost 2.0 million people. This figure is a conservative estimate. In some of the more successful free zones there has been a substantial increase in employment in recent years, e.g. Dominican Republic - 100,000 are employed as against 36,000 in 1986; Mauritius - 100,000 now versus 60,000 in 1986; Mexico - 250,000 in 1986 to in excess of 400,000 at present. Morocco and Tunisia have also experienced substantial increases.

3.3. The Key Question of Institutions

The question of the wide variation in the performance of different free zones is part of the general issue of why some countries develop faster than others. Increasingly, economists have taken the view that "political organization and the administrative competence of government is the single most important explanatory variable". The choice of appropriate institutional rules and policies (and the way in which institutions are run, and rules and policies implemented) enhances economic development. By affecting resource mobility and the incentives for innovation an accumulation of wealth, institutions may encourage or hinder economic efficiency. There is no priori reason to believe that institutions are efficient, many have been made so. Often reasonable strategies and adequate resources may fail because the organizational capacity to carry out such a strategy is lacking. A study of 115 market economies concluded that the institutional framework had significant and large effects on the growth rate.

This conclusion, applied generally to economic growth accross a range of developing countries, can also be applied to export processing zones. There are upwards of 200 free zones around the world. There are major variations in performance which cannot be explained in terms of financial or economic variables. The factor which most satisfactorily explains the difference in performance of various zones is management and organization. A primary reason for establishing an export processing zone is to overcome the bureaucracy and procedural difficulties and delays in:

- (i) Approving export-oriented investment including foreign projects.
- (ii) Importing machinery and materials and exporting the finished product free of duty and without delay.

Many free zones have failed to overcome these bureaucratic and procedural problems. Investors in the less successful zones have to wait months for investment approval and experience delays of days and even weeks in clearing goods through Customs.

This stems from poor organization or management.

Good organization begins with the legislation which gives the zone authority and others associated with zone development and operation, power to act expeditiously and efficiently. This must be followed by a good organization structure and support from relevant government agencies. The organization must be staffed by people who are qualified and motivated to establish and manage the operation. Ultimately this means a high level and enthusiastic government commitment to the project and a willingness to give the Zone Organization the power, finance, personnel and support to succeed.

CHAPTER FOUR

An Export Processing Zone in Malawi

4.1. Introduction

Boosting the level of foreign exchange earnings from both traditional and non-traditional sources will be a central target of Malawi's economic policy over the coming decade. This will involve a series of measures and actions to ensure that the right climate exists and that institutional arrangements are appropriate and adequate to support this export drive. Among the measures being considered are improvements in the existing duty drawback scheme, bonded manufacturing facilities and export processing zones.

The object of an EPZ or bonded manufacturing facility is to attract investors producing exclusively for the export market using imported materials. In the early stages of development the emphasis will be on foreign investors as Malawi enterprises, with some exceptions, lack the production and marketing expertise necessary to succeed in export markets.

The type of industry which benefits most from free zone facilities are those who require regular (weekly) supplies of materials from foreign sources and whose output is destined for world or regional markets. Examples include clothing, leather, some plastic goods, sports goods, electronics, light engineering, medical products, light consumer durables such as lighters, sunglasses, jewellery, artificial flowers and cutting and polishing of precious and semi-precious stones.

Attracting export oriented foreign investment is a very competitive business. This is particularly true of "good quality" investment. While the volume of such investments will probably increase on a worldwide basis in the coming years, the competition to attract such investment will intensify as an increasing number of countries seek to increase and diversify their exports. Most countries in Sub-Saharan Africa are conducting feasibility studies with a view to establishing EPZ's and bonded facilities.

The designation of an area as an EPZ does not automatically make a location attractive as a location for foreign export industry. The basic conditions for attracting such investment must exist - otherwise the investment will be smaller in quantity and lower in quality than expected.

4.2. Review of Facilities and Investment Conditions

- 4.2.1. Political and Economic Stability: For most investors this is a most important consideration. What investors seek is (i) a consistent economic policy favouring private enterprise, foreign investment and export development and (ii) a politically stable environment. In Malawi the Government is committed to private enterprise, foreign investment and export growth. A flexible exchange rate favouring exports is part of the Government's policy. The Foreign Investment Advisory Service (FIAS) mission to Malawi earlier this year found that Malawi "had made significant gains towards creating an enabling environment conducive to the private sector".
- 4.2.2. A liberal investment code: The main concerns of the investor under this heading are (i) taxation; (ii) threats of nationalization. Most successful EPZ's offer a five year tax holiday, provide guarantees on repatriation of capital and profits and assurances against nationalization. A group of senior Malawi government officials are currently in Washington discussing a new investment code with FIAS and others.
- 4.2.3. Regulations and Procedures: Surveys among investors have shown that what they look for in a free zone are (i) a clear picture of the Government's policies and rules with regard to investment in the zone; (ii) an outline of the rights and obligations of an investor; (iii) minimum contact with Government agencies (ideally investors would prefer to deal with one organization) and (iv) an efficient set of procedures for purchasing raw materials and moving goods into and out of the zone.

The Government will want to control investors whose actual performance is very much at variance with the original plans set out by the investor. The Customs Authorities will want adequate powers to ensure that duty free goods do not enter the domestic market or that prohibited goods (i.e. arms, drugs) are not handled in the zone. In addition the estate management will want powers to ensure that investors behave as good neighbours (e.g. noise, pollution, parking etc.).

The present regulatory environment in Malawi could be regarded as inhibiting investors. Procedures for company formation, industrial licencing, export registration are lengthy. Foreign exchange control regulations have been liberalized in recent years. Nevertheless there is scope for further improvement in order to facilitate and encourage the export oriented manufacturing investors. These issues were raised by the business community in interviews during the course of this study. The FIAS study also commented on the regulatory environment - "Government regulations and administrative procedures have failed to keep pace with liberalization and are now inhibiting investment".

Discussions with manufacturers using the bonded manufacturing facility indicated that the Customs Authorities have adopted a "helpful and pragmatic approach". Goods are cleared quickly. At present the Customs Act provides only for bonded warehousing. The authorities are proposing an amendment to the act to provide for bonded manufacturing.

Applications for bonded facilities are presently made to the Customs Authorities and the decision on whether or not to grant such facilities is made by the Controller of Customs. This decision-making process should be reviewed in the context of proposals to promote and develop EPZ's.

More detailed comments on organization, regulations and procedures are contained in Appendix 111.

- 4.2.4. Transportation and Communications Facilities:
High class transporation and communications facilities are essential for anybody involved in international trade. The type of transport facilities required in a free zone depends on the markets being serviced and the products involved.

In most free zones where the products have a relatively high value to weight ratio and the markets are distant (Europe/North America) air transport is a key consideration - both capacity and cost. Where products are aimed at regional markets efficient low cost surface transport is important. Raw material is often shipped from distant sources by surface transport, particularly where the price/weight ratio is low e.g. fabric for garments, or high grade steels for light engineering. Electronic components for assembly and precious/semi precious stones are airfreighted.

In Malawi high transport costs are a major problem. CIP margins representing 40-50% of import values (FOB) are among the highest in the world. Malawi's EPZ's will therefore have to concentrate on products and trade where transport costs are not significant e.g. (i) cutting and polishing precious and semi-precious stones; electronic assembly (although it will be difficult to attract electronic companies in the first years of operation); (ii) high fashion garments - where transport costs are less significant; (iii) garments for the South African market which can possibly be back hauled in empty containers returning to South Africa for a modest charge; (iv) leather products using leather sourced locally or in neighbouring countries; (v) garments produced from locally manufactured fabric (David Whitehead) - although garment producers claim this fabric is expensive. It is possible however that David Whitehead may extend into garment manufacture.

The traditional starting point in many EPZ's (Sri Lanka, Mauritius, Bangladesh) is to produce garments at the lower end e.g. shirts, trousers, skirts, for European and North American markets from fabric produced in the Far East. This trade accounts for up to 80% of the activity in these zones. It will be difficult for Malawi to engage in this trade because of the substantial transport costs involved. One bonded manufacturer in Malawi was supplying the North American market with garments made from Far East fabric but had to get out of the business because of transport costs - which accounted for over 50% of the total.

Transport and communications facilities in Malawi are adequate to cope with the existing demand. However the development of an EPZ will create new demands. It will be necessary therefore to keep Air Malawi and the Post Office advised of developments. In particular the Post Office will need to be informed in the near future of telecommunications requirements in Lilongwe as plans for extending capacity are being drawn up.

4.2.5. Market Access: Preferential market access can prove an important factor in attracting investment. In 1965 Ireland signed a free trade agreement with the U.K. which resulted in an inflow of investment into Ireland. More recently Fiji has benefited from duty free access to the Australian and New Zealand markets. A number of garment manufacturers (and others) from both countries have shifted production to Fiji to take advantage of lower labour costs. Caribbean countries have benefited from preferential access to the U.S. and Canadian markets. Greece, Portugal, Ireland and Spain have all attracted substantial overseas investment because they have duty free access to the EC market.

Malawi has recently signed a free trade agreement with South Africa. As an ACP country Malawi has duty free access to the EC market for manufactured products under certain conditions. Malawi should be able to exploit the South African trade agreement as Fiji has done with Australia/New Zealand. In addition some South African (and other) investors may be able to use Malawi as a base for gaining duty free access to the European market.

4.2.6. Physical Environment and Infrastructure: In general the physical environment for free zone development in Lilongwe and Blantyre is good. Water and electricity are readily available and the supplies are reliable. Both cities have a high standard of landscaping. However there is a shortage of industrial sites and factory buildings available for rent or purchase.

Work on the identification of suitable sites and the planning of infrastructure should begin immediately. However a final decision should await the completion of a full scale feasibility study as proposed in the World Bank Aide Memoire of June 28. Prior to the commencement of the study any zoning or other problems with sites should be cleared up so that there is no delay in completing the study (a site specification is set out in Appendix IV).

4.2.7. Labour availability: The cost and availability of labour together with the range of skills available is a key factor in determining both the volume and type of activity which takes place in a zone. "High Tech" investors will only be attracted if people with the required qualifications and skills are available. In most zones the labour force is unskilled, consequently the emphasis is on assembly type activity. In Malawi there are a number of positive features from a labour availability viewpoint:-

(i) there are large numbers of people willing to work for low wages; (ii) Malawian workers have a reputation for reliability, honesty and willingness to work; (iii) Malawi has developed a relatively small, flexible and good quality manpower training system. However experienced managers, engineers and accountants are in short supply.

A potential problem for free zone firms is the legal restriction on women working at night. Many free zone firms will have to work two shifts from time to time. Other problems raised during interviews were (i) absenteeism and (ii) undernourished workers - particularly before payday when money is scarce. Good transportation arrangements, including perhaps subsidized transport and canteen facilities (possibly subsidized) can help overcome these problems.

Difficulties between management and workers sometimes arise in free zones due to misunderstandings arising from language or cultural differences. Most free zone promotion organizations employ somebody to advise incoming investors on labour relations and intervene if or when difficulties arise.

A good working relationship between (i) the zone promotion organization; (ii) the investors and (iii) the education/vocational training authorities is essential if Malawians are to progress into supervisory, technical and management positions.

4.2.8. Existing Industry: It is an advantage to investors if there is an established industry sector with good management skills in the vicinity of the zone. Such a sector may be able to supply potential joint venture partners or support services to zone investors. It has been suggested during the interviews for this study that Malawi owned industry often lacks production and accounting skills.

4.2.9. Urban Environment: A good urban environment is necessary in order to attract suitable investors and expatriate personnel. Such an environment exists in Blantyre and Lilongwe. However a shortage of suitable accommodation for management personnel is a problem in Lilongwe which will have to be solved during the planning stage.

4.3. Location

Within Malawi both Lilongwe and Blantyre have many of the facilities necessary for free zone development - good infrastructure and a pleasant urban environment. From an air transport viewpoint Lilongwe with its international airport has an advantage over Blantyre. On the other hand Blantyre is a superior location from the viewpoint of existing industry, commercial support services, and overland transportation facilities at Blantyre are superior.

Overall it is not clear at this stage which city would be the best location for the first free zone. Investors who depend heavily on airfreight will probably prefer Lilongwe. Others may opt for Blantyre. Both cities could in fact offer free zone facilities thereby giving investors a choice - provided the costs involved are not significant. This could be done by offering bonded facilities in industrial sites in both cities. The matter can be considered in greater detail in the context of a full feasibility study.

4.4. The EPZ Format

The Government of Malawi in its statement of development policies talks of examining the possibility of establishing an export processing zone. The World Bank in its Aide Memoire of June 28 suggests a feasibility study for an EPZ. The FIAS Aide Memoire of July 9 talks of a feasibility study for an export estate. It recommends that the supply of serviced land be increased by the establishment of more industrial parks or estates, that the manufacturing in bond system be formalized and the establishment of an EPZ be deferred. FIAS point out that in bond manufacturing offers most of the features of an EPZ.

A traditional EPZ is a fenced in area with the entry/exit points manned by Customs staff. However, much of the Customs control within an EPZ is effected through the checking and balancing of stock accounts, combined with import and export declarations. All the output of an EPZ is exported - although some home market sales may be permitted as a concession and not a right.

An export estate with bonded facilities operates in much the same way as an EPZ except that there is no perimeter fence. Customs control is effected through checking of stock accounts and import/export declarations. The Mauritius EPZ is in fact a series of bonded manufacturing facilities spread throughout the island. There is no fencing.

In the case of Malawi the advantages of using the term EPZ rather than an export estate with bonded facilities are:-

(i) Promotional. The term EPZ is well known worldwide. It conveys an image of freedom and absence of bureaucracy.

(ii) Legislative. The EPZ is traditionally considered "extra territorial" in that it can be exempted from certain government regulations and procedures. Sometimes a government is reluctant to change certain regulations which may inhibit foreign

export oriented investment, but may make an exception within a free zone e.g. women working night shifts, operation of foreign currency account procedures for company registration and licencing. These exemptions can be incorporated in a free zone act. It is accepted in many countries that conditions inside a free zone will differ from those outside.

4.5. Activities, Size

In considering the range of activities to be permitted in a free zone or the minimum size of investment, there should be no limitations set out in the free zone act. Any activity which contributes to employment and export growth should in principle be permitted except for reasons of morality, security, pollution etc. Equally no minimum size should be set out.

The only criteria should be that the investor is of good character (i.e. that his references check out) and the project is reasonably well financed. The Zone Authority no more than anybody else can foretell the future or pick winners. The world is littered with examples of excellent projects being rejected initially - i.e. Rank Zerox or the Beatles. Guinness Peat Aviation in the Shannon Free Zone illustrates both points. The company was established in the mid 1970's with very modest capital. It was involved in aircraft leasing - which was a very new business at the time. Doubts were expressed about whether or not the company should be admitted to the zone. However, it was. Today it employs hundreds of highly qualified and highly paid executives. Profits exceed £500M annually. Guinness Peat Aviation is now establishing an aircraft maintenance facility at Shannon in association with Luftansa and Swissair which will employ 900 people together with about 1800 people in the surrounding region in ancillary industry.

4.6. The International Environment

The key points from a Malawi viewpoint are:-

(i) the speed with which change is taking place on a worldwide basis. For the most part these changes are positive. They involve peace talks and reduction of trade barriers, creating a more

interdependent world economically;

(ii) the peace process is underway in Southern Africa (South Africa and Mozambique). Successful talks in both instances would result in benefits in the free zone(s). The lifting of sanctions in South Africa would lead to increased economic growth there. Peace in Mozambique would improve Malawi's transport situation;

(iii) successful structural adjustment programmes in Zimbabwe, Zambia and Tanzania could lead to better trading prospects for Malawi;

(iv) there is growing competition within Asia for investment from the Far East;

(v) prospects for investment from Europe are diminishing as many European companies look to Eastern Europe;

(vi) there is a growing trend worldwide towards the formation of trading blocks - possibly inspired by the EC. Canada and the U.S.A. have formed a free trade area. Mexico may also negotiate a trade agreement with the U.S. Proposals to eliminate trade barriers in Central and South America are under consideration. Brazil and Argentina have been removing trade barriers since 1985. The prospect of free trade in Southern Africa in the medium term must be a realistic possibility.

In the short term Malawi should seek to exploit the opportunities offered by the trade agreement with South Africa and its ACP status by (i) encouraging South African and other investors to use Malawi as a base to supply the South African market and (ii) encouraging South African investors to use Malawi as a base to gain preferential access to EC markets. In the short term also Malawi should encourage investors to establish distribution bases in the country from which regional markets can be serviced.

In the medium term some of the distribution activities might be encouraged to evolve into assembly or manufacturing units, especially if there is a move towards free trade in Southern Africa.

4.7. Reaction of Interviewees

Organizations interviewed are set out in Appendix 1. These organizations can be divided into two main groups. Those concerned with what might be classed as the demand side and those on the supply side. The demand side group included (i) embassies from the main capital exporting countries where those concerned with trade and investment were interviewed; (ii) existing users of the bonded manufacturing scheme and (iii) David Whitehead and the associated Chambers of Commerce and Industry.

The general reaction of this group was that (i) the idea of promoting export manufacturing activity through the provision of EPZ type facilities is a good one. The home market is small and industrial growth will depend on export markets. (ii) Embassies are prepared to assist in promoting investment and are generally positive about the investment climate in Malawi. (iii) The workforce is good and wage levels are low. Skilled and managerial people are in short supply. (A number of skilled Malawians are attracted to Botswana and other countries by higher wages and salaries). (iv) Problems include the complex procedures for setting up in business, transport costs and occasional bottlenecks e.g. shortage of executive housing, especially in Lilongwe.

The supply side group includes various government departments, others involved in providing essential services (Air Malawi) and infrastructure (water, electricity and telephones). There was a general lack of awareness among this group about the government's intentions to promote and develop EPZ type facilities and the implications of such a decision for their organization. All those concerned with infrastructure would need 12-18 months advance notice of requirements in order to be in a position to supply services. This applies in particular to telecommunications and electricity. Accordingly it is suggested that a co-ordinating committee be established immediately, made up of representatives of key government departments. This committee should establish good lines of communication with other relevant organizations - Dept. of Town Planning, Dept. of Lands, ESCOM etc.

There were arguments put forward in favour of both Lilongwe and Blantyre as potential locations. Neither city had an overwhelming advantage over the other.

4.8. Potential Benefits

On the basis of past experience in other countries an exceptional performance would be the creation of 20,000 jobs in 5 years. A more realistic target would be 5-10,000 jobs in 5 years. The value added within the economy would be in the order of 2000S per job per annum. Thus every 5000 jobs created would mean net exports of 10M S. In the longer term the value added per job could increase significantly if a good working relationship is established between (i) industry; (ii) education/vocational training authorities and (iii) investment promotion agency. Such a relationship will result in a workforce with increasing skills. This in turn will lead to better quality (or "higher tech") investors coming to Malawi providing higher skilled, better paid employment opportunities.

APPENDIX 1

LIST OF ORGANIZATIONS AND DOCUMENTS CONSULTED

Organizations consulted

Ministry of Trade Industry and Tourism *MR Chris Kochiza*
MR Reiner Sturm
Ministry of Finance
Dept. of Economic Planning and Development
Dept. of Lands
Reserve Bank of Malawi
Dept. of Town Planning - Lilongwe
Dept. of Town Planning - Blantyre
Post Office - Telecommunications Branch
Air Malawi - Cargo Services
Lilongwe Water Board
ESCOM - electricity Authority
Malawi Department of Tourism
Malawi Export Promotion Council
Malawi Development Corporation
Malawi Housing Corporation
China (Taiwan) Embassy
U.S. Embassy
German Embassy
Korean Embassy
South African Embassy
World Bank

Press Corporation Ltd.

Associated Chambers of Commerce and Industry of Malawi

David Whitehead and Sons (Malawi) Ltd.

Press and Shire Clothing Ltd.

UNDP Office - Malawi

Industrial Consultancy Services - A UNDP/UNIDO MTIT Project

Dept. of Economics, Chancellor College

Documents consulted

Statement of Development Policies (1987-96)

Economic Report - 1990 - Dept. of Economic Planning and Development

Industrial Development Review of Malawi - UNIDO 1987

Malawi Human Resource Development Study - World Bank 1990

Annual Report of UN Resident Co-ordinator in Malawi 1989

Trade agreement between the government of the republic of South Africa and the government of the Republic of Malawi

Industrial Development Act

Draft Appraisal Mission Aide Memoire - World Bank June 28, 1990

Investment Prospects in Malawi

Towards an Integrated Industrial Development Programme for the PTA Framework and Guidelines - 2nd Industrial Development Decade for Africa.

APPENDIX 11

Export Processing Zones and other Duty Free Systems Compared

The other duty free systems are:-

(i) The bonded warehouse or bonded manufacturing system where materials are kept in a Customs controlled store on the manufacturers premises and released under Customs supervision.

(ii) The duty free license system where the manufacturer is licensed to import specified amounts of particular materials over a certain period of time - provided it is re-exported in finished products.

(iii) The inward processing system in operation in the European Community wherein a manufacturer is permitted to import materials free of duty provided the finished product is exported or duty is paid on the imported material content of those products sold on the EEC market.

(iv) The duty drawback system where the manufacturer pays duty on imported materials but receives a refund on the imported content of exported products.

The advantages/disadvantages of each are as follows:-

Export Processing Zone

Advantages: (1) Streamlined Customs procedures and no bond cover needed for goods in the zone; (2) no sales tax payable; (3) no restrictions on imported equipment or materials free of duty; (4) EPZ organization to provide a "one stop" investor service; (5) good infrastructure services available (assuming the zone is well planned) and (6) tax and other incentives can be made available for export service activity.

Disadvantages: (1) Choice of location normally limited to areas designated as EPZ; (2) home market sales not usually permitted and (3) the EPZ must attract a large number of companies to make the project viable.

Bonded Manufacturing Warehouse

Advantages: (1) Duty free access to raw materials although Customs procedures are more restrictive than those in the EPZ; (2) wider choice of sites than those in an EPZ and (3) home market sales usually allowed.

Disadvantages: (1) The facility must be bonded and under Customs control at all times - which is an expense; (2) there may be restrictions on importing machinery or equipment free of duty and (3) sales tax may be payable and later refunded.

Duty Free License System

The advantages and disadvantages are similar to those of the bonded manufacturing system except that the duty free license manufacturer is not involved in the expense and occasional inconvenience of a bonded store within the factory. On the other hand amendments to the license are necessary each time a new material is sourced.

Inward Processing System

The advantages/disadvantages are similar to the duty free license system except that machinery imported from outside the European Community is liable for duty.

Duty Drawback System

Advantages: (1) Duty on raw material is refunded; (2) the manufacturer has a choice of location and (3) there are usually no restrictions on home market sales.

Disadvantages: (1) Refunds of duty and sales tax are slow; (2) cash is tied up for long periods and (3) Customs procedures can be complex.

Summary

From the point of view of the investors involved in export industry processing imported raw materials, the export processing zone provides the most attractive set of Customs procedures. The EPZ may also offer some minor financial advantages. The import licensing system or bonded manufacturing system allows the investors a wider choice of location. If an investor hopes to sell a significant portion of his output on the domestic market (50% +) the duty drawback system may prove to be the most effective solution.

APPENDIX 111

FREE ZONE ORGANIZATION - SOME PRINCIPLES

Legislation

The Export Processing Zone is about the absence of bureaucracy. It projects an image of freedom. This idea appeals to many foreign (and domestic) investors. Essentially, what an investor seeks in a free zone is:

- 1) A clear picture of the government's policies and rules for the EPZ.
- 2) An outline of what might be termed the rights and obligations of investors.
- 3) A minimum of contact with government organizations - ideally a one stop shop or one window system.
- 4) Efficient procedures for moving goods into and out of the zone.

The government will want control over investors to ensure that:

- 1) They establish projects for which they were approved and not something else.
- 2) The actual performance of investors is in line with what is set out in the investor's proposal.

The Customs Authority will want adequate powers to ensure that (i) duty free goods do not enter the domestic market without the payment of appropriate duties or without the consent of the government and that (ii) prohibited goods are not stored or handled in the zone.

The free zone concept (and legislation) should be capable of being used to develop a wide range of export activity throughout a country and not only at one or two selected sites.

The above considerations can be set out in a Free Zone Act. This act is basically enabling legislation. The relevant ministers are given powers under the Act to make regulations to cover particular situations.

Management Organization Structure

In designing an organization structure for an EPZ it is necessary to consider a number of factors.

- (i) The proposed EPZ organization is a promotion and development organization. A very significant promotion effort is required to get the right kind of industry into the zone. Promotion is a quality that must infuse all of the organization - not just the promotion division.
- (ii) The reduction in bureaucracy is one of the key selling points in any free zone. Surveys have shown that bureaucracy is one of the most common causes of complaint by zone users.
- (iii) The organization must be a legal entity, able to enter into legal agreements, hold property, borrow money and do all things that a limited company or State Authority, such as the Electricity Authority can do.
- (iv) The organization will be controlled by the Government through a Board of Directors appointed by the Minister for Industry. However, it will have financial, administrative, and management independence, and be free from government control in its day to day operations.
- (v) Most of the functions involved in the development and operation of a free zone involve continuous contact with industry (both foreign and local) in a business or developmental context rather than a regulatory context. An organization dealing

with business in this way must be able to operate in a businesslike manner i.e. the operating conditions and decision making process must be flexible. Very often it is not possible for government departments to operate in this way because of restrictive operating conditions. The free zone organization must be free of traditional restrictions on decision making and spending money that exist in government departments and have a business culture.

(vi) The zone organization should have a relatively small flexible administrative staff with most technical expertise recruited on a contract or consultancy basis as required. The reasons for this are twofold:

a) the zone requirements in terms of technical support will change over time e.g. if the zone organization is targetting garment manufacturers it may need experts to advise it for a period. Later, the focus may be on electronics, thus different advisors are required.

b) the requirements for engineers and architects to plan and advise on construction activity will vary over time. Employment of consultants means the zone organization can cope more easily with fluctuations in demand. In addition, the zone organization will, through the use of consultant engineers, have access to a wide range of experience and expertise. It may of course recruit a small core of technical staff to supervise and handle basic construction matters and deal with consultants.

(vii) Span of Control: While there are no absolute rules on the span of control, the Chief Executive will have an important promotional and representational role. Thus a short span of control (3-4 people) is desirable - together with deputy directors with powers of decision on operational matters.

APPENDIX IV

SITE SPECIFICATION

The site for an Export Processing Zone should have the following attributes:

- A. 40 hectares or more in size.
- B. Ideally it will have a gentle slope for drainage.
- C. Reasonable ground bearing conditions for foundations.
- D. Good access by road.
- E. Reasonable availability of water supply of about 40,000 to 60,000 litres per hectare per day to accommodate mainly "dry industry".
- F. Good availability of electricity.
- G. Very good telecommunications facility (about 100 lines).
- H. Satisfactory disposal of storm water.
- I. Satisfactory disposal of sewage and effluent.
- J. Satisfactory disposal of dry waste.
- K. A clean and attractive environment.
- L. Within or close to a well developed urban centre.

APPENDIX V

FOREIGN CURRENCY ACCOUNTS

The conditions or restrictions under which foreign currency accounts could operate are as follows:-

- i) Accounts can be opened in any bank under the supervision of and with the approval of the Reserve Bank. As all free zone traders would be entitled to open a foreign currency account, permission from the Reserve Bank would be automatic unless the Reserve Bank had good reason to suspect that the facility would be misused.
- ii) The Reserve Bank would specify the type of transaction which can be put through the account - normal trading transactions and payments for equipment.
- iii) The account would always remain in credit. Thus, free zone accounts would not use any of the existing foreign exchange reserves.
- iv) Inflows into the account would be made up of sales receipts, investment capital from the promoters and loans from foreign sources. Traders would fill in an export declaration form with each export consignment. Customs officers would check the declaration against invoices. There would be a sample check of accounts to ensure that payments are lodged as per the declaration. In the case where payments for imports are set against payments for exports, special authorization should be received from the Reserve Bank.
- v) Payments for wages, salaries, dividends to local shareholders and local purchases should be made from a local currency account. Inflows into this account would be made up of transfers from the foreign currency accounts, payments for home market sales (where such as permitted) and investments by local shareholders and banks. Transfers would take place at the official exchange rate.

- vi) Dividend payments would be permitted only with the approval of the Reserve Bank. This approval would be forthcoming automatically once the trader submitted audited accounts showing that profits exist and that a dividend has been declared. Dividends to foreign investors would be paid in foreign currency and to local shareholders in kwachas.

- vii) Repatriation of capital would be permitted where the funds become available from the sale of assets or shares.