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The World Bank

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Report No. 13603

PROJECT COMPLETION REPORT

MALAWI

**AGRICULTURAL SECTOR ADJUSTMENT CREDIT
(CREDIT 2121-MAI)**

OCTOBER 14, 1994

**Agriculture & Environment Division
Southern Africa Department
Africa Regional Office**

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CURRENCY EQUIVALENTS

Annual Average Exchange Rates

	MK/US\$	US\$/MK
1985	1.719	0.582
1986	1.861	0.537
1987	2.209	0.453
1988	2.561	0.391
1989	2.730	0.366
1990	2,729	0.366
1991	2,803	0.357
1992	3.680	0.272
1993 (April)	4.200	0.238

MK 1 = 100 Tambala

WEIGHTS AND MEASURES

Metric System

GOVERNMENT OF MALAWI FISCAL YEAR

April 1 - March 31

ABBREVIATIONS

ADMARC	-	Agricultural Development and Marketing Corporation
ASAC	-	Agricultural Sector Adjustment Credit
CSR	-	Center for Social Research
DEVPOL	-	Statement of Development Policies
EEC	-	European Economic Community
EP&D	-	Economic and Planning Department
ESAF	-	Enhanced Structural Adjustment Facility
GDP	-	Gross Domestic Product
GOM	-	Government of Malawi
HESSEA	-	Household Expenditure and Small Scale Economic Activities Survey
INDEBANK	-	Investment and Development Bank of Malawi
IMF	-	International Monetary Fund
ITPAC	-	Industrial and Trade Policy Adjustment Credit
LVD	-	Lands and Valuations Department
MF	-	Ministry of Finance
MFNR	-	Ministry of Forestry and Natural Resources
MOA	-	Ministry of Agriculture
MOU	-	Memorandum of Understanding
NSO	-	National Statistics Office
ODA	-	United Kingdom Overseas Development Administration
PD	-	Planning Division (MOA)
PER	-	Public Expenditure Review
PFP	-	Policy Framework Paper
POSB	-	Post Office Savings Bank
PPM	-	Project Planning Manual
PSIP	-	Public Sector Investment Program
PTF	-	Poverty Task Force
RBM	-	Reserve Bank of Malawi
SACA	-	Smallholder Agricultural Credit Administration
SAL	-	Structural Adjustment Loan
SDA	-	Social Dimensions of Adjustment
SFFRFM	-	Smallholder Farmers' Fertilizer Revolving Fund of Malawi
SGR	-	Strategic Grain Reserve
SPSF	-	Social Program Support Fund
UNDP	-	United Nations Development Program
USAID	-	United States Agency for International Development

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

Office of Director-General
Operations Evaluation

October 14, 1994

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

Subject: Project Completion Report on Malawi -
Agricultural Sector Adjustment Credit (Cr. 2121-MAI)

Attached is the Project Completion Report on Malawi - Agricultural Sector Adjustment Credit (Cr. 2121-MAI) prepared by the Africa Regional Office. The Borrower prepared Part II.

Both project design and implementation proved deficient. The very limited attempt to "liberalize" maize and fertilizer marketing did little to change the basic role and mode of operation of the inefficient parastatal company that dominated these markets. The attempts to rationalize and increase the insignificant land-tax on the estates and to induce them to produce their own fuel-wood were without effect. The review of public expenditure in agriculture was weak. Nothing came of the pilot schemes to target fertilizer subsidies and credit to poor farmers. The attempt to halt the transfer of land from smallholders to the estates failed, possibly a desirable development since this helped small farmers to escape the disadvantages of smallholder status: as tenants on estates they were allowed to produce higher value crops and to get better prices at sale.

One important achievement stands out: the end of the estates' monopoly on burley-tobacco production. Under an ASAC condition, the government permitted thousands of smallholders, officially farming less than a hectare each, to produce burley tobacco, a most profitable and labor-intensive export crop and a plus factor in land-scarce, labor-surplus Malawi. With support from USAID, these traditional, cash-poor, subsistence farmers responded by producing burley of better quality than that of the estates. They were also able to use the cash from burley sales to purchase high-yielding, hybrid-maize seeds plus fertilizer, thereby improving their precarious food security.

The PCR is adequate. The project outcome is rated as unsatisfactory, institutional development as modest, and sustainability of the completed reforms as likely.

An audit is planned.

Robert Picciotto
by H. Eberhard Köpp

Attachment

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PROJECT COMPLETION REPORT

MALAWI

AGRICULTURAL SECTOR ADJUSTMENT CREDIT (Cr. 2121-MAD)

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PROJECT COMPLETION REPORT

MALAWI

AGRICULTURAL SECTOR ADJUSTMENT CREDIT (Cr. 2121-MAI)

PREFACE

This is the Project Completion Report (PCR) for the Agricultural Sector Adjustment Credit (ASAC) to Malawi, for which the IDA Credit 2121-MAI in the amount of SDR 52.6 million was approved on 3 April 1990. IDA reflows of SDR 4 million for Malawi (Cr. 2121-MAI) were approved in late 1991. A Dutch Grant of Dfls 5.0 million and a UK Program Aid Grant of £ 10.0 million were also disbursed. The credit became effective on 18 April 1990 and was closed on 31 December 1992, one year behind schedule. Of the total amount of SDR 56.6 million, about SDR 70,000 remained undisbursed as of 2 April 1993. The last IDA credit disbursement was on 5 March 1993.

Parts I and III, as well as Preface, Evaluation Summary and the Annexes, were prepared by the Southern Africa Agriculture and Environment Division of the World Bank and the FAO/World Bank Cooperative Program (FAO/CP). Part II was prepared by the Planning Division of the Ministry of Agriculture, Government of Malawi.

Preparation of this PCR was started during a World Bank and FAO/CP mission^v to Malawi in April 1993, and is based *inter alia* on the President's Report No. P. 5189-MAI, the Credit Agreement, supervision reports, correspondence between the Bank and the Borrower, memoranda and interviews of Bank staff and Government officials.

^v Messrs/Mmes: V. Scarborough (Task Manager, AF6AE); R. Suppa (Mission Leader, FAO/CP); G. Rozell (Agricultural Economist, AF6ML) and C.G. Ramasubbu (Macro-Economic Specialist, Consultant).

MALAWI

AGRICULTURAL SECTOR ADJUSTMENT CREDIT (Cr. 2121-MAI)

EVALUATION SUMMARY

Background

The Government of Malawi undertook various stabilization and structural adjustment measures in the 1980s, supported by 3 IDA-financed SALs and other external assistance. These efforts led to some improvement in the fiscal and current account balances and modest growth in industry, estate agriculture and some parts of the smallholder subsector. However, the supply response to these measures was not sufficient to raise per capita incomes appreciably, nor eliminate the need for balance of payments support. This was because a number of policy induced structural constraints in the economy, in particular in the agricultural sector, remained. The ASAC sought to address these constraints through a combination of macro-economic and agricultural policy reforms.

Objectives

The primary objective of ASAC was to support the Government's on-going adjustment program aimed at achieving sustainable economic growth and reducing poverty and food insecurity. To these ends, the credit supported measures to continue and deepen on-going macro-economic and agricultural policy reforms, as well as initiate new policy changes to further enhance agricultural growth and thereby poverty reduction.

The sub-objectives of the macro-economic reforms were to maintain the competitiveness of exports and enhance the efficiency of import-substituting, industrial enterprises and public resource utilization. The macro-economic measures proposed under ASAC comprised: (a) maintaining a flexible exchange rate policy through periodic adjustments; (b) implementing a duty drawback system for exports; (c) completing the process of import liberalization; (d) maintaining the fiscal deficit at levels that could be financed by available external concessional loans and grants; (e) increasing the efficiency of public resource utilization, through reorienting the Public Sector Investment Program (PSIP) towards high priority investments, a review of public expenditures in agriculture, a reduction of fertilizer subsidies and tax reforms; and (f) developing an improved framework for monetary management and a market-based financial structure.

In the agricultural sector, the main sub-objective was to address structural constraints on the sector's supply response capacity, in particular constraints to increasing land productivity in the smallholder subsector. The focus was on ensuring that smallholders faced price incentives that would encourage increased production and productivity, and had access to efficient input and output markets. Two additional subobjectives were to increase the efficiency of production in the estate subsector and improve the effectiveness of targeted interventions.

The reforms proposed were: (a) permitting smallholders to grow burley tobacco; (b) introducing a two-payment price system for smallholder tobacco producers, to bring prices nearer export-parity levels; (c) expanding the private sector's role in marketing smallholder produce, by increasing maize marketing margins and legalizing private seed cotton marketing; (d) increasing the efficiency of fertilizer marketing by expanding private sector participation in distributing fertilizers and improving the management and financing of the buffer stock agency; (e) improving the role played by the agricultural price stabilization agency, by rationalizing its functions and the financing of its non-commercial activities; (f) reorienting the maize research program towards the development of high yielding varieties more appropriate to farmer and consumer preferences; (g) addressing the smallholder land constraint by stopping the transfer of customary land to the estate subsector; (h) improving the efficiency of land use in the estate subsector through the provision of private extension services and increasing land lease rents, and (i) implementing pilot programs aimed at increasing the effectiveness of interventions targeted to the resource-poor.

Implementation Experience

The implementation of ASAC was mixed - full and prompt for some measures and weak or delayed for others. Among the macro-economic policy actions, experience was satisfactory for most structural reforms, including import liberalization, tax reform, provision for market-oriented banking and associated institutional development. Fiscal and monetary restraint were also maintained, despite being challenged by the severe drought and suspension of external donor support in 1992. However, the PSIP process, though improved, has yet to be fully streamlined and no significant progress was made in the proposed reform of public expenditures in agriculture. Successful performance in both these areas awaits broader improvement in budget management procedures.

Among the agricultural sector reforms there is a similarly mixed picture. The most notable achievements were the initiation of smallholder burley tobacco production; the development of hybrid varieties of maize suited to smallholder storage and processing preferences; the establishment of a two payment price system for smallholder tobacco sales to ADMARC, and the reduction of fertilizer subsidies. In addition, the Government continued the annual producer price review process, and conveyed the results of this to the Bank for comments, as agreed; it implemented a policy to pay a 20% premium for maize delivered to ADMARC depots in lots of one metric ton or more and it liberalized seed cotton markets. Progress was also made in the ADMARC divestiture program and in increasing the supply of fertilizer to the smallholder subsector. However, the formal liberalization of fertilizer markets, allowing private sector participation, was delayed until mid-1993. Similarly, the Memorandum of Understanding (MOU) between the Government and ADMARC, which outlines the 'developmental roles' the parastatal is to undertake on behalf of Government and the means by which these will be financed, was only finalized and signed in December 1993. Finally, the implementation of the ASAC strategies on land allocation, improved estate land use efficiency and increasing the effectiveness of resource-poor targeted interventions have not been effective and there was little progress in establishing woodlots on estates and in making arrangements for the monitoring and evaluation of policy reforms.

Results

The impact of some of the ASAC actions, especially structural reform, will be clear only in the medium-term. In addition, some of the short-term results, though evident, cannot be easily measured, due to the absence of monitoring and evaluation arrangements and thereby data. Therefore, the evaluation of the results and impact of some of the reforms is tentative.

At the macro-economic level, the response of the private sector to the more favorable policy environment and institutional framework would perhaps have been more pronounced but for the intervening drought and the resulting setback to economic recovery. The stabilization measures implemented in 1990 appear to have contributed to improvements in 1991 in terms of increased GDP, agricultural (and smallholder) production, and exports. The severe drought and withdrawal of non-humanitarian donor support in 1992, however, led to a deterioration in terms of the fiscal deficit, expansion of bank credit beyond anticipated limits and an adverse balance of payments on the current account.

In the agricultural sector, the positive results pertain to the production of burley tobacco for the first time by smallholders and the income effects of this; the elimination of subsidies on some fertilizers and their reduction on others, with a consequent decline in the budgetary burden, and the development of high yielding maize varieties suited to smallholder storage and processing preferences. The progress in developing high yielding, hard endosperm varieties of maize has exceeded expectations. Hybrid varieties were planted to 25% of the land allocated to maize in 1992/3, as opposed to 3% in 1986/7. Although a variety of factors has contributed to this increase, the development of the hard endosperm varieties is one of them. Tangible indicators of progress in the provision of efficient marketing and supply services to smallholders include an increase in the number of private traders engaged in agricultural produce marketing and in size of their operations, as well as an increase in the number of ADMARC delivery depots (i.e., markets at which a 20% premium is offered on maize deliveries in excess of one metric ton). However, the results of other measures have been less positive, for a number of reasons. For example, delayed implementation in the case of the liberalization of fertilizer markets and the rationalization of ADMARC's functions, means that the results of these reforms is not yet apparent. In other cases, weaknesses in design have made implementation difficult or ineffectual (e.g., the cessation of the transfer of land from customary to leasehold tenure and increasing the effectiveness of targeted interventions).

Sustainability

The institutional developments and structural reforms which were initiated under the ASAC and other adjustment programs seem likely to be continued and strengthened over the years as means of developing and supporting private sector activity. Although the stabilization measures (such as trade and exchange liberalization and restraint in fiscal and monetary policies) were strongly challenged by the drought and donor withdrawal in 1992, they were maintained. Moreover, the Government has recently intensified some liberalization processes, for example implementing a foreign exchange auction and allowing this to determine the

exchange rate. These developments suggest that both stabilization and adjustment measures at the macroeconomic level will be sustained.

Likewise, in the agricultural sector, some of the reforms implemented are likely to be maintained, including the legalization of smallholder burley tobacco production and the development and production of more appropriate maize technologies. However, there is more uncertainty with respect to some of the other agricultural reforms. This uncertainty stems from two sources - the poor design of some elements and the degree of Government commitment to others. For example, the attempt under ASAC to cease, through administrative means, the transfer of land from the customary subsector to the estate subsector was not successful. Therefore the objectives and instruments behind this area of reform need to be reassessed. On the other hand, Government commitment to the development of private sector markets appears to be uncertain. The Government liberalized all smallholder agricultural produce markets (except for those related to cotton and tobacco) in 1987. Moreover, under ASAC it liberalized cotton markets. However, while ASAC attempted to support the further development of private agricultural markets, the Government delayed in liberalizing fertilizer markets and it reversed its liberalization policies with respect to some commodity markets.

Main Lessons Learnt

Three main lessons can be learnt from the experience of ASAC, as well as a number of minor lessons.

- (a) Government commitment to reform programs is essential to ensure effective implementation and it cannot be substituted by conditionality. In turn, this implies a need for close collaboration with Government both in preparation, design and supervision, in order to ensure that there is agreement on the principles and elements.

The delays experienced in finalizing the Memorandum of Understanding between the Government and ADMARC and in the liberalization of fertilizer markets, suggest that complex and far reaching institutional reforms should be incorporated within the framework of adjustment operations only after the necessary preparatory work has been completed and agreement reached among the concerned parties on the details of implementation. Likewise, the failure to implement some of the agreed actions during the credit period, together with an apparent lack of consideration of the constraints to such implementation during supervision missions, highlights the need for more thorough and collaborative preparation and for closer and more comprehensive supervision on the part of the Bank.

- (b) There is a need to address the root causes of problems or constraints to increased growth or poverty reduction if these are to be alleviated. Attempts to lift these constraints through other means are likely to fail.

For example, one flaw in the design of ASAC was an the attempt to use legal measures to resolve market failures. The effort to halt the transfer of land from the customary to the estate subsector through making such transfers illegal failed, because the incentives to transfer land

in this manner were not addressed (i.e., the monopoly of the estate subsector on burley tobacco production rights). Likewise, the attempt to increase the planting of trees on estates by making this a legal requirement was unsuccessful, largely because fuelwood prices are subsidized and therefore the estates can obtain wood on the market at prices that are lower than the costs of own-production.

- (c) It is important to consider links between different elements of the policy framework and to avoid designing reforms or other interventions in isolation. In some cases, ASAC reforms failed to have the impact expected, because other influences on the predicted outcomes had not be sufficiently considered.

Three examples of this problem emerge from ASAC. Given the importance for ASAC of the formulation of the Government's investment program and the link between development and recurring expenditures, ASAC should have addressed issues relating to public expenditure in agriculture in a broader perspective, seeking provision for a review of the overall budget management policies and procedures, which have a close bearing on both the PSIP and agricultural expenditures. Similarly, more attention should have been paid, at the design stage, to the pacing and sequencing of reforms. For example, exchange rate adjustments were infrequently implemented, which lead to the need for large scale devaluations in 1992. In addition, liberalizing imports when the Kwacha was over-valued, exposed domestic producers to unnecessarily intense international competition. Lastly, it appears that a number of pilot targeted interventions, supported by various multilateral and non-Government organizations to tackle different aspects of rural poverty in Malawi, have had results which have been localized, piecemeal and inconclusive. This suggests that there is a need for Government to develop a more comprehensive strategy for and coordination of targeted interventions, based on an evaluation of the many pilot interventions.

Three additional lessons emerge from the ASAC, which are not so generally applicable. One is that smallholders in Malawi can produce very high quality burley tobacco, which had been doubted previously. Moreover, such production has been efficient and profitable. This promising opportunity to encourage increased smallholder incomes should therefore be actively pursued and expanded from the point of both efficiency and poverty reduction. Another lesson is that, after years of effective repression, the private sector in Malawi at the end of the 1980s was very weak. In order to establish an environment in which private sector markets would flourish, a more comprehensive, diverse and sustained effort than that envisaged or implemented under ASAC was probably required. Finally, considering the broad agenda of adjustment actions proposed under ASAC and the likelihood that many of them would need to be pursued beyond the short period of the quick-disbursing credit, and in the light of delays and ineffective implementation experienced in some aspects of the program, it appears that the arrangements for management and coordination should have been more effectively institutionalized, with provision for them to be continued on a medium-term basis.

PROJECT COMPLETION REPORT

MALAWI

AGRICULTURAL SECTOR ADJUSTMENT CREDIT (Cr. 2121-MAI)

PART I: PROJECT REVIEW FROM THE BANK'S PERSPECTIVE

1. Project Identity

Project Name : Agricultural Sector Adjustment Credit (ASAC)
Credit No. : Cr. 2121-MAI
RVP Unit : AF6AE
Region : Africa
Country : Malawi
Sector : Sectoral Adjustment Credit

2. Background

2.1 Malawi's economy has been severely handicapped by a combination of problems, notably a poor resource base, high population growth rate, and landlocked position far from any sea port. However, starting from a very low economic base, Malawi was able to achieve impressive growth during the first fifteen years after Independence in 1964. Real GDP grew at an average rate of 5.2% per annum during 1967-79, well above the rate of population growth. The balance of payments and fiscal positions remained fairly stable, with the current account deficit varying between 7% and 9% of GDP and the fiscal deficit averaging less than 8% of GDP. However, the economy suffered a major setback in 1979 and, for three years, Malawi experienced a sharp decline in growth and deterioration of the balance of payments and fiscal positions. GDP fell by a total of 9.5% during 198-82. The current account deficit rose to 21.2% of GDP in 1980 and the fiscal deficit, before grants, to 15.5% in 1981. From 1984 to 1988, real GDP rose on average by only 2% a year while population grew by over 3% per annum. Despite a further recovery of over 4% in 1989, GDP per capita was more than 20% below its level a decade earlier. This deterioration of the economy resulted from a combination

of external shocks, namely: (a) a sharp rise in import prices, especially those of fuel; (b) severe droughts in 1980 and 1981, and (c) rising transport costs due mainly to disruption of the rail route to the sea through Mozambique. This crisis exposed some structural weaknesses in the economy, including a narrow export base; a stagnant smallholder agricultural subsector; heavy import dependence in the industry and energy sectors; deficient incentive frameworks; inefficient public enterprises and weak public resource management capacity. In response to this crisis and these structural weaknesses, the Government, with IDA and IMF assistance, formulated a stabilization and structural adjustment program. Stabilization and structural adjustment efforts have continued since then and ASAC was an integral part of these (see paragraph 2.3-2.4).

2.2 Agriculture is the backbone of Malawi's economy. Up to 1990, it accounted for about 40% of GDP, and 85% of exports and employment. Maize is by far the most important crop in terms of cultivated area, number of growers, and food security. Other major food crops include groundnuts, pulses, cassava and rice. Exports are dominated by three crops: tobacco, tea and sugar. Production is predominantly under rainfed conditions. Malawi's agriculture is characterized by a wide range of farm sizes, but three main categories can be identified - smallholders, small estates and larger estates. Smallholder and estate agriculture are differentiated by regulations concerning production, marketing, pricing and land tenure. However, over the 1970s and 1980s the development of a large number of small estates has led to the emergence of farms which exhibit characteristics of both the estate and smallholder subsectors. Small estates are legally bound by laws pertaining to estates, but are managed in ways similar to smallholder farms. Estate production focuses mainly on export crops, while the smallholder subsector accounts for about 80% of food production and only 10% of exports. The smallholder subsector involves about 1.8 million families operating under customary land tenure on about 1.75 million hectares, producing primarily for subsistence.

Past Government Programs and External Assistance

2.3 In response to the crisis experienced in the late 1970s, the Government, with IDA and IMF assistance, formulated a medium-term stabilization and structural adjustment program covering 1981/82 - 1985/86. The program was supported by IDA through three SALs, by IMF through successive standby arrangements and special facilities, and by other donors through co-financing of the SALs and debt rescheduling in 1982 and 1983. The primary objectives were to stabilize the economy; accelerate agricultural growth; diversify the export base; increase the efficiency of import substituting enterprises and parastatals, and improve the mobilization and management of public resources.

2.4 To stabilize the economy, the exchange rate and interest rates were adjusted more frequently than had previously been the case; public expenditures were restrained, and measures were taken to expand the tax base, improve tax buoyancy, and curtail Government and parastatal deficits. With respect to agricultural growth and diversification, emphasis was placed on improving price incentives for smallholders. To this end the Government adopted and continued to use a producer price setting methodology designed with Bank assistance and

actions were also initiated to reduce fertilizer subsidies (paras 4.18-4.20). The legal framework was altered to enhance the efficiency of the industrial sector through increased competition; the operations and financing of a number of parastatals were rationalized; Government's analytical and planning capacity was strengthened, and improved budgeting methods were introduced. The Government implemented the program satisfactorily and the three SAL credits were fully disbursed. Moreover, although the performance of the key macro-economic variables remained uneven, the economy experienced significant improvement up to 1985. However, the economy deteriorated again in 1986, largely due to a recurrence of external shocks - further declines in export prices, another drought, and worsening regional political turmoil. In response to this continued deterioration, the Government in 1987 prepared a new strategy (articulated in the Statement of Development Policies (DEVPOL), 1987-1996), aimed at deepening adjustment reforms. This program was supported by IDA and other donors through a Supplemental Credit to the third SAL, and the Industrial and Trade Policy Adjustment Credit (ITPAC). The IMF also supported the program through a standby arrangement and an Enhanced Structural Adjustment Facility (ESAF) and by further debt rescheduling in 1988.

Results of Past Adjustment Operations

2.5 The adjustment efforts under these various operations helped to improve fiscal and current account balances in 1988/90, compared with the earlier years. In addition, the inflationary pressures that had built-up were reduced and inflation fell from 31% in 1988 to under 8% as of October 1989. However, efficiency in the industrial sector remained constrained by the fact that trade liberalization had not been completed. Past adjustment efforts contributed to modest growth in industry, estate agriculture and among the larger smallholders. However, due to remaining structural constraints, they did not succeed in eliciting the supply response necessary to generate sustainable growth in per capita incomes nor sufficient foreign exchange resources to eliminate the need for balance of payments support. For example, in the smallholder subsector, population pressure on the land is the primary constraint, with average farm sizes having fallen from about 2 hectares to 1 hectare over the 1970s and 1980s. This constraint has been exacerbated by inappropriate policies that have resulted in: (a) a lack of appropriate high-yielding food technologies (most importantly for maize); (b) inadequate supplies and use of inorganic fertilizers; (c) a lack of access to the rights to grow some high-value cash crops; and (d) a progressive reduction in the amount of land held in the subsector. Maize research programs and budgets were focused on the development soft-endosperm, dent varieties, which have unfavorable storage and processing characteristics. The use of fertilizer was constrained by limited supplies, in part due to subsidization policies and inefficient procurement and marketing. Under the Tobacco and Special Crops Acts (1965) smallholders were unable to obtain the rights to produce burley and flue-cured tobacco. This led, during the 1970s and 1980s, to many larger smallholders converting their customary land tenure rights into leasehold tenure, so as to be able to obtain a license to grow burley tobacco. (World prices for burley tobacco rose considerably in real terms in the 1970s and 1980s.) All these factors exacerbated the very low levels of land and labor productivity experienced by the majority of smallholders and, thereby to the fact that over half of the population lived in

absolute poverty. ASAC therefore attempted to address these and other remaining structural constraints to increased growth (particularly in the agricultural sector) and poverty reduction.

The Government's Development Objectives and Strategy

2.6 After the successive exogenous shocks of the 1980s, the Government placed great emphasis on the restoration of domestic and external balances in its medium-term development strategy. It was committed to maintaining a relatively flexible exchange rate policy and import liberalization, stimulating exports, and ensuring efficient import substitution activities. The Government's strategy also envisaged a continuation of fiscal and monetary discipline to reduce inflationary pressure and ensure adequate credit expansion to the private sector, and measures to maintain external competitiveness. Its strategy also provided for a comprehensive reform of the tax system. Moreover, as indicated in DEVPOL, the Government placed greater emphasis than it had done previously on promoting agricultural growth. Its primary objectives for the agricultural sector were, and continue to be to ensure food security at the household and national levels, improve rural incomes, and increase export earnings, while simultaneously protecting the environment. The strategy aimed at meeting these objectives included measures to ensure adequate producer incentives, the promotion of increased use of improved inputs and the development of an efficient marketing system for the smallholder subsector, and increased land utilization in the estate subsector. With respect to environmental concerns, the strategy includes promoting increased planting of fuelwood, improved tobacco curing methods and better soil conservation. In addition to increasing agricultural productivity, the strategy envisaged policies and investment measures to: (a) expand off-farm employment opportunities; (b) slow down the rate of population growth; (c) enhance the quality of human capital through improving access to education and health services; and (d) improve efficiency in the use of public resources. The Bank and other donors supported this strategy and continue to do so.

Bank's Overall Strategy

2.7 The primary objective of the Bank's country assistance strategy in Malawi is to provide effective support to the Government's effort in two critical areas: promoting economic growth and reducing poverty in ways that are sustainable, both environmentally and in the face of external shocks and shifting world markets. Based on lessons learned from earlier operations, the Bank's strategy at the time ASAC was prepared recognized the need to:

- (a) address remaining structural constraints to an increased supply response (as described in para 2.5 above);
- (b) strengthen Government's capacity for policy formulation and implementation;
- (c) sharpen the focus of adjustment operations in order to center policy dialogue on a smaller, more manageable set of priority reform measures;

- (d) better integrate macro-economic and sectoral policy reforms;
- (e) improve the efficiency of the donor program through increased coordination.

2.8 With regard to the agricultural sector, IDA's strategy was to support the Government's efforts to increase land and labor productivity in smallholder and estate subsectors, and particularly among the resource-poor smallholders and female-headed households. To achieve these ends, the strategy supported the development of policies and investments aimed at: (a) shifting research priorities so as to develop more appropriate high-yielding maize varieties; (b) improving the effectiveness of extension services; (c) expanding the use of fertilizers and access to credit; (d) expanding smallholder access to the rights to grow high-value cash crops; (e) ensuring adequate producer prices and efficient output and input markets; (f) increase the efficiency of land use in the estate subsector, and (g) conserving natural resources.

3. The Agricultural Sector Adjustment Credit (ASAC)

3.1 The agricultural sector adjustment program, supported by IDA through ASAC, was an integral part of the Government's medium-term strategy and on-going stabilization and structural adjustment program for the period 1988-91. The primary objectives of the program were to achieve sustainable growth and reduce poverty and food insecurity. To these ends, ASAC covered both macro-economic and agricultural sector reforms. Macro-economic reforms focussed on increasing the competitiveness of exports and the efficiency of industrial and public enterprises, as well as improving public resource utilization. To achieve these ends, reforms in the management of the external sector and public finances were implemented. Agricultural sector reforms centered on ensuring adequate producer incentives and efficient marketing services for smallholders; improving ADMARC's price stabilization capacity and increasing the efficiency with which land is used in the estate subsector. More specifically, ASAC envisaged measures to:

- (a) increase the flexibility of the exchange rate and continue restrained monetary and fiscal policies; improve export incentives; complete the final stages of trade liberalization; and revise the Banking Act to enhance monetary management and introduce a market-based monetary and credit system;
- (b) focus the Public Sector Investment Program (including agricultural expenditures) on areas of high priority and returns;
- (c) improve crop pricing and marketing policies through expanding the role of the private sector;

- (d) improve fertilizer availability and use among smallholders, through reducing fertilizer subsidies; liberalizing the distribution of fertilizer and improving the financial management and funding of the Smallholder Farmers' Fertilizer Revolving Fund of Malawi (SFFRFM);
- (e) rationalize the Agricultural Development Marketing Corporation's (ADMARC's) financing to enable it to more effectively implement its role as a price stabilization agency;
- (f) shift the maize research agenda and budget toward develop hybrid flint maize varieties that are high-yielding and have pounding and storage characteristics which are acceptable to smallholders;
- (g) allow smallholders to grow high-value cash crops, especially burley tobacco, in order to enhance incomes and thereby agricultural intensification and diversification;
- (h) halt the transfer of land from customary tenure to leasehold tenure and increase the efficiency of land use among estates through adjusting land lease rents more frequently and improving rent collection, and establishing extension services for the estate subsector;
- (i) review and restructure agricultural expenditures to ensure cost-effectiveness and consistency with sectoral priorities;
- (j) initiate pilot schemes to develop ways of targeting fertilizer subsidies and credit to the poor; and
- (k) strengthen the Government's capacity to monitor and redress impact of the adjustment program on the poor.

4. Implementation: Macro-Economic Reforms

External Sector

4.1 The exchange rate. The basic strategy under the ASAC was to continue and expand on-going structural reforms while maintaining an environment of macro-economic stability. This was to be achieved by following a more flexible exchange rate policy, supported by non-accommodating financial (fiscal and monetary) policies, while developing an increasingly liberal trade and exchange system. Discretionary exchange rate adjustments were to be made when differences in the rates of inflation between Malawi and its trading partners led to a deterioration in the competitiveness of its exports. Thus, the authorities devalued the Malawi Kwacha by 7% in March 1990, in relation to the currency basket to which it was pegged. Devaluation was implemented along with a set of other stabilization measures

including import liberalization, improved export incentives, and reforms in monetary and tax policies. These actions, together with the beneficial impact of favorable weather conditions and substantial external financial aid, led to a turn-around of the economy in 1991. However, Malawi was hit during the following year by three major economic shocks - the severest drought of the century, the suspension of non-humanitarian assistance by donors, and growing labor unrest which led to wage and salary increases and inflationary pressures. The Government met this situation by again taking various compensatory fiscal and monetary policy actions, including devaluing the Kwacha twice - by 15% in March 1992 and by 22% in June 1992. The Kwacha had appreciated substantially between March 1990 and March 1992, suggesting that devaluations were not as frequent as they should have been during this period.

4.2 Trade liberalization. The last stage of an import liberalization was completed under ASAC. By early 1991, the prior foreign exchange approval requirement had been removed for all imports, except a narrow negative list of luxury items. Import liberalization did lead to an increased access to imports, but this had a mixed effect. Although it eased access to spare parts and other inputs, in the context of an over-valued Kwacha the liberalization of imports also increased the level of competition domestic manufacturers faced from abroad. Better coordination between exchange rate and external trade policies could have prevented this situation. As regards exports, following on earlier actions to reduce the range of licensing requirements and provide tax allowances, the Government took further steps to improve incentives under ASAC. These measures included the development and introduction of a export duty drawback system based on widening the coverage of eligible goods and streamlining the procedures for refunds, and initiating a new export credit guarantee system. Unfortunately, the duty drawback system designed was administratively very complex. Consequently, it did not become effective until very recently.

Public Finance

4.3 Under ASAC, reforms in the external sector were expected to be accompanied by complementary fiscal and monetary policies in the domestic economy. Fiscal policy changes were expected to establish financial discipline, develop tax reforms and improve budgetary procedures. The Government was to continue reducing the budget deficit and keep it within the limits set by the available external grants and concessional loans. The maintenance of the deficit for 1990/91 at a level satisfactory to IDA was a condition for the release of the second tranche, which was met. The major development in the fiscal area was tax reform. This began in 1987 and was aimed at improving the equity, efficiency, administration and compliance in the system. The tax base was broadened; the incidence of taxation was shifted towards consumption and customs duties were rationalized with a view to minimizing the level of protection. In the case of the corporation tax, a system of advance payment was introduced and the tax was extended to cover parastatals. Other measures included the reduction of direct and indirect tax rates, expansion of the surtax base, elimination of exemptions, rationalization of the tax treatment of debt and equity instruments, and reduction of the tax exemption period for bonded imports.

4.4 Faced with declining revenues resulting from external factors such as the Middle East crisis and the closure of trade routes through Mozambique, Government had to cut several low priority investments (in areas such as roads and telecommunications) and some recurrent expenditures. Between 1989/90 and 1991/92, current expenditure as a proportion of GDP was reduced from 21.6% to 17.4%. Further actions were also taken to cope with the impact of drought-related expenditures and increases in Government salaries in the following period. Expenditure restraint was tightened, especially in regard to recurrent items, with steps such as a freeze on filling of civil service vacancies and cuts in non-wage spending ceilings, expenditure monitoring procedures were strictly enforced, and efforts were continued to broaden the tax base and improve tax collections. As a result of these actions, the overall budget deficit (excluding grants) was brought down to 5.7% of GDP in 1991/92, from 9% in 1988/89 (Annex 1, Table 1).

Banking and Monetary Policy

4.5 Reforms in the financial sector and of monetary control policies included an improvement of the regulatory framework; a switch from direct controls on liquidity in the banking system (e.g. through credit ceilings) to the use of indirect instruments (e.g., changes in reserve requirements), and a move from administered interest rates to those determined by market forces and changes in the Reserve Bank's rediscount rate. The bank rate, introduced in May 1990, was to be linked to an auction rate for official bills, and the first monthly auction of Reserve Bank of Malawi (RBM) bills took place in November 1990. The Reserve Bank Act was revised to reflect these changes and thus RBM's regulatory authority was extended to certain non-bank financial institutions and the RBM was enabled to carry out the traditional central banking functions, such as open market operations and being the lender of the last resort. Further, to promote greater competition in the banking system, the Investment and Development Bank of Malawi (INDEBANK) was licensed to accept corporate deposits, and applications of foreign banks to conduct business in Malawi began to be considered. In addition, the Post Office Savings Bank (POSB) is currently being restructured so as to reduce its reliance on Government paper and enable it to undertake alternative investment options. These reforms will increase the number of institutions in the formal financial sector and increase the range of financial instruments and services supplied. They should lead to a more competitive and market-based financial system, which could be expected to support a shift in credit from the public to the private sector and a restrained monetary stance.

Outcome

4.6 Government took a variety of actions under ASAC, partly to ensure macro-economic stabilization but also, by way of structural reform, to promote an institutional and policy environment in which private sector activity could be provided with the incentives, services and facilities to enable it to make its full contribution towards developing the Malawian economy. These reforms are believed to have contributed to some positive developments, including GDP growth at a real rate of 7.8% in 1991 (compared with 4.8% in 1990), improved

capacity utilization in the manufacturing sector, increased external competitiveness as reflected in the volume of merchandise exports which increased by 51.4% in 1990, and a reduction in the current account deficit in balance of payments from 13% of GDP in 1989 to 12.0% in 1990 (Annex 1, Table 1). However, in reviewing the likely impact of the various macro-economic policy reforms it should be recognized that several of the actions implemented during the period of the ASAC were elements of a broader program which had begun earlier and continued after the full disbursement of this credit. In addition, it is not easy to separate the effect of ASAC from exogenous developments, for example declining international tobacco prices and the 1992 drought. Thus the impact of actions implemented under ASAC is difficult to isolate. It is also relevant to recognize that the effects of macro-economic policy reforms on the efficiency of resource allocation within the economy are likely to become evident only in the medium-term.

4.7 Notwithstanding these reservations, the effects of the exchange rate adjustments, together with the tightening of fiscal and monetary policies, import liberalization, financial reform and improvement in the business climate in general, appear to have had a positive impact. For example, these changes helped strengthen the competitiveness of Malawi's tobacco exports. Likewise, following the lifting of restrictions, there was a significant upsurge in imports and manufacturing, construction and agro-processing sectors appear to have been the immediate beneficiaries, primarily in terms of improved rates of capacity utilization. It is not yet clear if the reduction in protection which is implicit in import liberalization had an impact on export-oriented or import substituting production activities. At least in the short run, while the Kwacha continued to be over-valued, some domestic manufacturers appear to have been hurt by competition from the liberalization of consumer good imports (e.g. textiles). However, further effects which could favor export diversification will emerge only over time, as they depend on additional policy actions, adequate financial support and, above all, on the development of the private sector. Moreover, it is likely that the response of the private sector to the improved policy environment and institutional framework would have been stronger had it not been for the continuation of various restrictions on private sector activities and the drought.

4.8 The effects of stabilization measures can, in many instances, be reversed by new adverse short-term developments. Thus, after the impressive results witnessed in 1991, there was a setback in 1992, primarily as a result of the drought, donors' withdrawal of non-humanitarian aid and labor unrest. These factors were further exacerbated by a continued deterioration in the terms of trade, in particular declining tobacco prices. As a result of all these developments GDP declined by nearly 8% in 1992, inflation accelerated to about 22% and the fiscal and external financial accounts deteriorated. In addition, the volume of domestic credit provided by the banking system to the Government and the private sector increased. Despite these challenges and the set-back to the performance of the economy, the Government maintained the external sector reforms implemented between 1998 and 1991 and continued the implementation of many sectoral and structural reform measures, albeit at a reduced pace. Thus the Kwacha was devalued twice during 1992 and fiscal and monetary policies were tightened in May 1993. These measures, together with high levels of agricultural production due to favorable weather and a resumption of donor assistance, have had a positive impact,

with inflation falling to 17% in September 1993 and economic growth for 1993 projected at around 11%.

Evaluation

4.9 It is appropriate to distinguish the impact of the stabilization measures implemented under the ASAC from the likely long-term effects of the structural reforms carried out under the same operation. The former are subject to the influence of short-term factors such as fluctuating levels of domestic agricultural production, developments in international tobacco markets, and the volume external economic assistance. Conversely, structural reforms are intended and likely to have a more enduring impact. The liberalization of the financial sector, the rationalization of tariffs, the improvement of the tax system and other such reforms implemented under ASAC have helped establish a new framework of laws, institutions and practices, but it will take some time for the private sector to respond to this.

4.10 It is difficult to evaluate the impact of either the stabilization or adjustment measures. In the case of stabilization, the magnitude of exogenous events like the drought and donor withdrawal make an evaluation difficult. Also, as noted above, it will be some time before the private sector can appraise the new circumstances that have developed as a result of the structural reforms. Finally, more time is needed for sufficient data to become available to indicate the nature and extent of the impacts of adjustment. However, in spite of enormous difficulties, the policy statements and actions taken by the Government of Malawi in the last few years reflect a strong adherence to market-oriented economic policies, at least at the macro-economic level. This suggests that the reforms will at least be sustained. Thus, while the implementation of agricultural sector reforms has not been quite as consistent, as will be discussed below, the future of the macro-economic adjustment and structural reform program is promising.

Public Sector Investment Program

4.11 The ASAC focused on three specific aspects of public finance management:

- promotion of a sound Public Sector Investment Program (PSIP);
- improvement in the efficiency of public expenditures in agriculture, and;
- reduction of fertilizer subsidies.

4.12 The PSIP is a 3-year rolling plan developed by various line ministries and coordinated by the Economic Planning and Development (EP&D) department in the Office of the President and the Cabinet. Increasingly, the PSIPs are being discussed in draft with donors to enable aid programs to conform with Government priorities. The PSIP is intended to serve as a screening mechanism to ensure that the proposed investment projects are in harmony with agreed Government priorities and that scheduling of investments is consistent with the overall expenditure ceilings and the absorptive capacity of the individual sectors. The PSIP presented

to the Bank in October 1990, for the period 1990/91 - 1993/94, was considered to be in need of revision, as levels of expenditure incorporated in it exceeded the fiscal targets set in the Policy Framework Paper (PFP), and inter-sectoral priorities did not correspond to those agreed at the May 1990 meeting of the Consultative Group, especially with respect to outlays for the social sectors. A modified PSIP was subsequently presented to the Bank and accepted in fulfillment of a condition for the release of the second tranche under the ASAC in October 1991.^{1'}

4.13 The PSIP has yet to evolve into an effective instrument for strategic planning of public investment with due concern for inter-sectoral priorities, on the one hand, and resource constraints, on the other. There are certain problems that will have to be overcome before the PSIP can perform this function. Some of these problems are, however, in the process of being addressed. For example, there has been a complaint that the financial ceilings within which investment plans are to be formulated are not provided to the individual ministries early enough in the planning process. In the absence of a realistic and timely determination of available resources, individual ministries sometimes initiate implementation of projects for which there is no assured source of funding. The accumulated backlog of such commitments for unfinished projects preempts the financing available for future projects. An attempt to remedy this situation, with information being furnished to the ministries at the beginning of the budget process, was made in 1993/94. However, there are additional constraints to the effectiveness of the PSIP. For instance, an emerging problem is that recurrent expenditure implications are not sufficiently taken into account in determining the investments which go to make up the development budget and in formulating the revenue budget. This partly reflects the fact that, in each Ministry, the planning and administrative sections deal with the development and revenue budgets separately, without an adequate institutional arrangement for coordination. This difficulty is compounded by insufficient coordination on the part of the EP&D and Ministry of Finance. Further, the coverage of the PSIP is not yet comprehensive as it excludes some grant-financed investment projects and off shore expenditures and does not take into account periodic cost revisions. In addition, in reviewing and controlling the actual expenditures with reference to budgetary allocations, the Ministry of Finance is handicapped by a lack of provision of regular and timely information from individual ministries.^{2'} The overall impression, therefore, is that the PSIP represents a well-defined process and is gradually establishing itself, but that there is need for further refinement so as to ensure the requisite coordination and consistency with national priorities.

^{1'} Bank missions have been, from time to time, reviewing the PSIPs in draft and offering their comments. The PSIP for 1993/94 which is in preparation reflects, to some extent, the desired shifts in sectoral allocation with moderately increased shares for water and sanitation, and agriculture and an unreduced allocation for education, though health, another important social sector, received only a reduced share.

^{2'} Such information is particularly critical in regard to local resources required: (a) to serve as counterpart contributions corresponding to external funds for financing investment schemes in the Development Budget and (b) to meet recurrent expenditures under the Revenue Budget. In the face of such procedural constraints and the overall stringency of resources, the Government has to meet the challenge of ensuring that certain essential minimal allocations are made for priority sectors such as health, education and agriculture, under both these categories.

4.14 **Agricultural expenditures.** It was expected under the ASAC that a comprehensive review of agricultural expenditures would be carried out, as a follow-up of the World Bank's Public Expenditure Review (PER) of 1990. The new review was to make recommendations to ensure that: expenditures remained within available resources, investments with low returns were excluded, and an appropriate balance was maintained between wage and non-wage expenditures and between investments and recurring expenditures. It is understood that a study to this end was completed towards the end of 1990, but that it did not come up to expectations. It was then suggested by the Bank that MOA explore the possibility of securing technical assistance through ODA for implementing suitable measures in this area, but no further action appears to have been taken in this direction. The need for attention to these matters again gained urgency in 1992/93 in view of the difficult budget situation, the inadequate counterpart funding for externally financed agricultural projects, and the consequential risks of reduced utilization of external resources and slow project implementation.

4.15 The investment program in agriculture, as in other sectors, is constrained by the difficult fiscal environment of Malawi, but not always planned with due concern for this factor. Thus, for example, the Bank supervision mission of August 1992 found it untenable that MOA had estimated development expenditure requirements at MK 87 million for 1993/94 and MK 110 million for 1994/95 in the face of budgetary ceilings of only MK 58 million and MK 70 million respectively. Another trend for a few years was for expenditure on goods and services within MOA's budget to grow faster than that on staff salaries. This, however, was recently reversed, following the increase of about 50% in civil service salaries in 1993, which had to be accommodated through a cut in the allocation for non-wage expenditures. It was in this context that the Bank supervision mission (referred to above) pressed for a minimum level of allocation of funds in 1993 for non-salary recurrent expenditures so as to cover essential agricultural services (especially research and extension) and for the inclusion in the budget for subsequent years an allocation for goods and services which would be consistent with the Ministry's mandate and operations. That this problem persists is clear from the following figures of from MOA Revenue Budget Accounts:

	1991/92	1992/93	1993/94
	(Actual)	(Revised Estimates)	(Estimates)
	(MK'000)		
A. Personnel Emoluments	27,471	55,191	57,023
B. Goods and Services	31,061	25,007	16,060
C. B as % of A	113	45	28

Source: Revenue Budget of Gov. of Malawi 1993/94.

4.16 Agriculture's share in the total development budget declined from about 19% in 1981/82 to 15% in 1992/93, but increased to about 17% in 1993/94. These figures reflect the impact not only of the overall stringency of funds, but also the failure of the MOA to fully use the amounts allotted to it in the past. To be able to obtain and effectively use larger funding for development expenditure in agriculture, the Ministry will need to demonstrate improved capacity for satisfactorily implementing investment programs, in terms of person-power and organization. Another persistent difficulty has been the tendency to under-estimate the resources required for meeting the recurrent expenditure needs arising from investment projects, both during their implementation and in the subsequent period. This has led in the past to the commencement of projects without the assurance of counterpart funding for development expenditures and of the revenue budget allocations for recurrent expenditures. In turn, this has led to the deferral of project completions and to uncertainty about the sustainability of such expenditures after project completion.

4.17 The problems involved in the formulation and coordination of the development and revenue budgets have been engaging the Government's attention for many years. Despite recent efforts to address these concerns by improving the budget procedures and the PSIP process, the outcome, in terms of resources allocated and the projects included in the development budget, is still largely determined on an ad hoc basis, mainly with reference to the demands of the individual ministries. Addressing this problem - which is pervasive across sectors - will require streamlining the overall budget process and establishing fiscal discipline. It is the responsibility of the Ministry of Finance and EP&D to ensure that, once a project is included in the PSIP, provision is made in the Development Budget for the required counterpart funding and in the revenue budget for the corresponding recurring expenditures. In order to do this, EP&D and MOF require realistic and timely estimates of needs from the line ministries. To this end, more accurate methods of estimating required recurrent expenditures have been designed under the IDA-financed Agricultural Services Project, as well as an improved budgetary planning procedure. However, the utility of these improvements at the line ministry level will be diminished unless the Ministry of Finance and EP&D are able and willing to respond to them.

4.18 **Fertilizer subsidy reduction.** Under SAL II, the Government of Malawi in 1983 committed itself to phase out the fertilizer subsidy completely by the 1988/89 season. The fertilizer subsidy removal program was, however, suspended in 1987, following a sharp rise in fertilizer costs resulting from the closure of transport routes through Mozambique and a decline in the marketed volume of maize production. Consequently, the rate of economic subsidy reached a level of 30% in 1989/90. With the increasing use of fertilizer by the smallholders, the total amount of subvention was rising and amounted to MK 27.2 million or about 2% of total Government expenditures that year. The subsidy was not only intended to encourage maize producers to use fertilizer, but also to protect consumers from the price effects of maize shortages. ASAC called for a resumption of the subsidy removal program, with a reduction in the maximum rate of economic subsidy to 30% in 1990/91, 25% in 1991/92 and 20% in 1992/93. It was also agreed that the total value of these subsidies would not exceed 2.0% of total Government expenditures in 1990/91, 1.6% in 1991/92 and 1.3% in 1992/93. Government is also committed, under an agreement with the EEC, to the elimination

of all fertilizer subsidies by the end of the 1995/96 cropping season. The aim of official policy is to proceed to that stage without risking a fall in maize production and deterioration of household food security. Underlying this approach are two expectations: that the high external transport costs would decline once the Northern Transport Corridor Project was completed and the Nacala Line through Mozambique became fully operational and that the introduction of high yielding flint maize varieties would improve fertilizer yield response rates and reduce production costs.

4.19 By and large, the Government has fulfilled its commitments on fertilizer subsidies. The total amount of subvention was reduced to 1.39% of total Government expenditure in 1992/93. At the same time, the subsidy was eliminated on sulphate of ammonia (SA) and calcium ammonium nitrate (CAN) and reduced to 15.3% for the compound 23:21+0+4S, 15.5% for urea and 17% for diammonium phosphate (DAP), so that in no case does it exceed 20% (see Annex 2, Table 11). These changes are also in line with the policy goal that high analysis fertilizers would receive relatively higher subsidies, in view of the proportionately lower transport costs per unit of plant nutrient. SFFRFM fertilizer sales for the 1988/89-1992/93 seasons are given in Annex 2, Table 12. While total smallholder fertilizer sales have increased since 1988/89, low analysis SA and CAN sales stabilized at around 3,000 tons and 30,000 tons per year respectively. By contrast, in line with Government policy, sales of high analysis Urea and DAP increased significantly over the same period, from 24,000 tons and 8,000 tons in 1988/89, to about 46,000 tons and 26,000 tons respectively.

5. Implementation: Agricultural Sector Reforms

Cash Crop Allocation

5.1 The most notable accomplishment under ASAC, the one that introduced authentic structural change into Malawi's agricultural sector, was allowing smallholder farmers to grow burley tobacco. Two actions in this regard were initiated under ASAC. First, the granting of burley production quotas to smallholders, and second, allowing smallholder clubs to sell their product directly on the auction floors, rather than through ADMARC. Prior to ASAC, burley production was only legal in the estate subsector (Annex 2, Table 1). The objective of this element was to allow smallholders access to a broader means of increasing their incomes, in order to reduce poverty and, simultaneously, provide farmers with a means of financing the intensification of their maize production. The latter would then contribute to improved food security and an increased ability to diversify agricultural production through releasing land from maize cultivation. For the last twenty years, burley tobacco has been the most profitable crop grown in Malawi. In 1990 prices, the production of 1,350 kg of burley per ha was estimated to result in a gross margin of MK 4,595 per ha (or approximately MK 3.65 per day for the 1,260 days of labor invested). By comparison, the production of 3,600 kg of hybrid maize was expected to yield a gross margin of MK 422 per ha (or a return of MK 2.59 per day for 163 days of labor)."

" USAID, "Mid-term Evaluation of the Agricultural Sector Assistance Program (ASAP), March 31, 1993.

5.2 The smallholder burley program is now in its third year. The aggregate smallholder production quota in the first two years was not completely filled due to a combination of factors, including initial lack of demand (knowledge) among small farmers and MOA's program administration. Thus, in 1990/91 and in 1991/92, actual production was about 70% of the quota. However, in 1992/93, when some 27,400 smallholders were legally allowed to grow burley, the quota of 7,000 tons was fully met (Annex 2, Table 2). About 12.5% of the smallholder burley licensees were female. As indicated in Annex 2, Table 3, smallholders with burley quotas were members of 1,125 clubs spread all over Malawi but in particular in the central (46%) and southern (40%) regions.

5.3 From the outset, smallholders have demonstrated their ability to produce a quality product. Burley which ADMARC sold on behalf of smallholders in 1990/91 fetched an average price of MK 7.29 per kg, compared with a national average auction floor price of MK 6.87 per kg. In 1991/92, the first year smallholder clubs were allowed to market directly on the auction floor, they received an average price of MK 6.19 per kg compared with a national average of MK 6.52 per kg. In 1992/3 it is estimated that 83% of smallholder produced burley was marketed directly through the auction floors (Annex 2, Table 5). The average price paid for this produce was MK 5.28/kg, while the national average was MK 4.89.

5.4 Other donor support for the smallholder burley program comes primarily under the USAID's Agricultural Sector Assistance Program (ASAP). ASAP has continued the structural adjustment of ASAC, substantially broadening the reform program with conditionality requiring specific Government actions dealing with improved targeting of smallholder burley quotas, management of production, marketing of burley, and efficiency in the delivery of inputs.

5.5 **Evaluation.** The smallholder burley program has been a success. Smallholders have demonstrated their ability to produce high quality tobacco at low cost. The net incremental income accruing the smallholder subsector as a result has been estimated at MK 3.5; MK 8.0 and MK 9.3 in each of the relevant years.¹¹ Moreover, although there has been a fall in world market prices for the crop, it has been estimated that world demand will rise by about 2% per annum in the long-term and that Malawi can be expected to expand its share of the market to around 10% from its current 9.2%, without affecting world market prices (Annex 2, Table 6). Further expansion of smallholder burley production is also possible through a re-evaluation of the distribution of quotas. The quantities currently produced by smallholders are a fraction of those produced by estates. For example, in 1992/3 the aggregate smallholder quota was only 5.8% of the total national quota and only 1.6% of smallholder farmers had access to a quota. However, there are a number of issues facing the Government and donors related to managing the growth of smallholder production. Paramount among these are the following:

¹¹ USAID ASAP evaluation reports. These estimates assume that burley tobacco has replaced hybrid maize production.

- (a) **Quota allocations and management.** Most industry experts consider the current quota allocation system to have been out of control even prior to the introduction of smallholder production. So far, the demand for additional quota by smallholders has been met by increased world demand and Malawi's increasing share of the world market. However, as noted above, it has been estimated that Malawi cannot expand its production of burley beyond 10% of the world market without lowering world prices. If the quota system of controlling burley production is continued, demand by smallholders for additional quota will, in the future, have to be met at the expense of the estate sector. However, given the success of the smallholder burley program, the current quota system can be characterized as not only inequitable, but also inefficient, since it excludes many potentially very efficient producers. As a result, the Government has embarked on a study of the costs and benefits of various means of controlling national production levels, including making quota allocations tradable, replacing quotas with an export tax and totally liberalizing burley production. The outcome of this study, in terms of policy changes related to burley tobacco, will have important implications in terms of future levels of smallholder burley production.
- (b) **MOA management.** Under ASAP, smallholder burley growers have been assisted in producing and marketing burley tobacco by the Ministry of Agriculture's extension services. MOA management being already thin, the question now is how well Ministry officials and the extension staff can manage the anticipated growth of the smallholder burley production. Adding new staff is not likely as long as current fiscal constraints remain. However, the separation MOA credit and extension functions (currently being implemented) will reduce the heavy work-load of extension agents. In addition, continued support of extension services under USAID's ASAP will help to improve and standardize burley registrations, allocations and compliance monitoring. Nonetheless, the impact of smallholder demand to participate in the burley program on the capacity of the extension services and credit supplies should be closely monitored.
- (c) **Targeting smallholders.** There were no data available to prove that at least 75% of licensed smallholder burley producers had less than 1 ha - the intention under ASAC. A new method of data collection on holding sizes and area cultivated with burley amongst registered growers is being instituted by MOA with support from USAID. This data system should greatly facilitate the monitoring process. However, targeting would be administratively less costly and realistic if it merely relied on giving particular emphasis to those areas, like Blantyre ADD, in which very small land holdings are common.

Output Prices

5.6 One of the principal ASAC actions, along with allowing smallholders to grow burley tobacco, was to ensure that ADMARC's tobacco buying prices were brought into line with their border equivalents by implementing a two-payment price system. ASAC conditionality required a first price of not less than 45% of a rolling 3-year average of auction floor prices to be paid on delivery at ADMARC markets, with a second payment at the end of the season (referred to as a "bonus payment") of at least 65% of ADMARC's net profits from sales of tobacco. In the past, ADMARC purchased tobacco (not burley, but oriental, sun-air cured and dark-fired) from smallholders at fixed prices which were rarely more than 30% of the price ADMARC received in selling these tobaccos on the auction floor.

5.7 The outcome of the ASAC strategy with respect to producer prices for tobacco has been the following:

- (a) The two payment system has ensured that a larger proportion of the profits from growing and selling all types of tobacco is returned to smallholder producers. As a result of this system, real ADMARC producer prices for tobacco have remained constant or have increased since 1990. In addition, the Government initiated a freer marketing system for burley tobacco, supported by the USAID funded ASAP. This involved enabling smallholder clubs to market burley directly on the auction floor). As a result of these two processes, rough estimates indicate that total gross revenue going to smallholder burley producers in 1992/93 was around MK 21.0 million. This implies a gross return to individual farmers of about MK 700 to MK 750 for an average quota of 240 kg (Annex 2, Table 8). A rural minimum wage in the same year amounted to about MK 500.
- (b) However, two issues regarding pricing remain to be addressed. One is that, despite falling world tobacco prices, ADMARC has felt unable to lower its producer prices for tobacco. Thus, currently smallholders may be being sent inaccurate signals concerning the shifts in demand for tobacco. Secondly, smallholder producers of other types of tobacco - namely Oriental, dark-fired and sun-air cured - are still not permitted to market their produce directly to the auction floors. Thus ADMARC prices are the only ones to which they have access.

5.8 **Evaluation.** The establishment and implementation of the two payment system for tobacco producers has been improving, despite initial miscalculations and misgivings by ADMARC and farmers concerning the second payment. A major issue for smallholder growers marketing through ADMARC has been with the second payment - initially the lack of a second payment, now the size and lateness of the payment itself. ADMARC's concern regarding the initial payment (not less than 45% of a rolling three year average) is that they will be forced to absorb heavy losses if prices fall in successive years. This concern could be

alleviated by the liberalization of all smallholder tobacco markets, with ADMARC operating in competition with other buyers and direct sales to the auction floor. If ADMARC's monopoly on tobacco markets was eliminated, and competitive tobacco marketing developed, the issue of ADMARC pricing would become less important. Nevertheless, until smallholder tobacco markets are liberalized, the two-payment pricing system will require additional analysis and modifications will need to be made in a number of areas. Some of these include:

- (a) Timely issue of the second or "bonus" payment (not later than October 31st) in order to allow small farmers to begin their nursery plantings for the next year's crop. This is particularly important for tobacco producers who do not have direct access to the auction floors - for example non-burley tobacco producers and remote burley farmers.
- (b) Improvements in the current burley quota system with a view to enhancing the equity and efficiency of quantitative controls on national production; (an evaluation of the costs and benefits of various ways of controlling burley tobacco production is currently being undertaken by Government).
- (c) The liberalization of non-burley smallholder tobacco marketing, in order to increase the efficiency of production and marketing and to allow for increased smallholder incomes where possible.

5.9 Another ASAC conditionality under the output prices strategy included "continuing annual price review and submitting the recommendations of the review to the Bank for comments at least 21 days before the announcement of revised prices". This appears to have been an administrative matter and according to the MOA and World Bank staff, is being done. However, regarding pricing policy itself, MOA continues to set minimum floor prices for range of crops, the number of which was reduced in 1991/92 however. Setting minimum prices will become less justifiable as controls on commodity marketing are removed and private traders take over more and more of the market. The official policy of MOA is "progressive decontrol". Prices for maize will probably continue to be set for some time to come however, given this crops' vital role in food security. Maize producer prices are determined primarily with the objective of stimulating production as part of Malawi's food security efforts and to equate supply and demand. However, it was intended that producer prices for other crops should be determined on the basis of export parity principles. This has not been the case. Real smallholder producer prices for selected crops during the period 1987/88-1991/92, along with the nominal protection coefficients they imply in 1987/8 and 1991/2, are given below:

Real Smallholder Producer Prices and Nominal Protection Coefficients for Selected Years

	1987/88	1988/89	1989/90	1990/91	1991/92
	..... (1980 tambala per kg/NPCs)				
Maize	5.00	6.24	6.07	5.63	5.72
Rice (Grade 1)	8.13	7.80	8.17	7.72	7.52
NPC for Rice	(0.20)				(0.13)
Groundnuts (GDA)	22.58	22.11	22.17	20.86	21.56
NPC for G'nuts	(0.87)				(0.44)
Cotton (Grade A)	19.57	20.03	18.90	16.90	17.30
NPC for cotton	(0.50)				(0.27)
Tobacco (NDDP av)	33.60	41.02	58.51	52.30	48.27
NPC for Tobacco	(0.26)				(0.45)

Source: World Bank Agricultural Sector Memorandum (forthcoming).

5.10 The nominal protection coefficients above show that smallholder producer prices for rice, groundnuts and cotton were further from their export parity levels in 1991/2 than they were in 1987/8, and that although the situation has improved with respect to tobacco, producer prices are still some way from export parity levels. Thus, although price reviews have been sent annually to the Bank for comment, and comments have been provided to the Government in response, it is not clear that this process has had an impact on the economic efficiency of the official pricing regime or on improving the smallholder incentive framework.

5.11 Implementation of the 20% premium maize price, called the "depot delivered price", for lots of at least one metric ton has helped private traders to generate additional working capital. According to ADMARC, MOA and other donors, private traders are actively taking advantage of the depot delivery price. The anticipated impact of this price policy on increased private trading, improved efficiency and better market coverage for the smallholder (especially in isolated areas) needs further investigation however. It is possible that it is creating a false dependency on ADMARC in the development of private markets, which could undermine the sustainability of such development in the longer-term. For example, one recent analysis of private agricultural produce founds found that, in the Central Region, many private traders were solely engaged in buying maize from farmers and selling at ADMARC depot markets. Thus, should ADMARC discontinue the premium pricing policy it is likely that these firms would go out of business. This issue should be considered in the monitoring and evaluation of policy and policy reforms. A more effective and efficient way of encouraging the development of private sector agricultural markets would be to remove the restrictions currently in place on private traders' participation in groundnut and export markets (see below).

Output Marketing and Input Distribution

5.12 Regarding output marketing and input distribution, the strategy under ASAC was to expand private sector participation in the marketing of smallholder crops and agricultural inputs, especially fertilizers. At the same time, the strategy was intended to enable ADMARC to narrow its participation in these markets and increasingly focus on price stabilization and the management of the country's strategic grain reserve. Expanding the role of the private sector continues to be problematic in Malawi. Aside from the 20% wholesale maize price premium, ASAC called for a differentiation of fertilizer prices to provide for trading margins to stimulate farmer groups and their agents to become retailers, and included a provision allowing private sector participation in cotton seed marketing. The outcome of the ASAC strategy with respect to expanded participation of the private sector in output marketing and input distribution has been mixed:

- (a) The number of private traders in the agricultural sector has been expanding since liberalization in 1987. In 1990/91, ADMARC reported 605 registered traders, although several sources note that private trader registrations do not reflect the total number of traders due to the fact that many other private traders operate without a license. In addition, research has demonstrated the levels of turnover and investment have also increased. To further the development of this sector, the Government intends to revoke regulations requiring private traders to register and restricting their operating hours and locations will be abolished. Thus, considerable progress has been made in the development of private sector agricultural produce markets, before and during the ASAC period. Nevertheless, further development is possible. For example, legislation contained in Acts other than that specifically related to the agricultural produce marketing continues to inhibit private sector development (e.g. quantitative restrictions on exports, bans on buying/exporting groundnuts). In addition, research has demonstrated that three other critical constraints experienced by private agricultural produce traders and processors are access to foreign exchange, credit facilities and transportation services.
- (b) Liberalization of fertilizer marketing remained a major unresolved issue at the closing of the credit. Government only formally approved and announced its fertilizer market liberalization policies in May 1993. While the finalization and approval of the policy paper dealing with private sector participation in smallholder fertilizer markets represents a major step forward, its eventual impact will depend on Government's implementation performance and the response of the private sector. Efforts to differentiate ADMARC fertilizer prices, to provide a trading margin for retailers, were not implemented under ASAC pending enactment of Government's fertilizer liberalization policy. However,

given the concerns about the maize depot premium price, the wisdom of embarking on such a policy should be reassessed.

- (c) The study called for under ASAC to identify ways to facilitate participation by the private sector in seed cotton marketing was not carried out. The reason for this was that the Government went ahead and legalized private trading in seed cotton. To date, there has been no noticeable impact on the industry (in terms of production or pricing) which is still recovering from the severe drought in 1991/92. The sub-optimal location and the monopsonistic position of the ginneries and the textile mill continue to dominate the cotton industry. It remains to be seen whether increased private trading in seed cotton will affect prices offered to growers given this monopolistic processing sector.

5.13 Evaluation. This part of ASAC's strategy did not include sufficient policy reforms to have measurable impact on efficiency through the expansion of the private sector. While there was a focus in the design of ASAC on encouraging private sector market participation through pricing incentives, the policy framework that was in place prior to and during the credit was not conducive to encouraging such participation, particularly with respect to agricultural input marketing. In addition, a number of policy reversals took place during the ASAC period with respect to the liberalization of agricultural output markets. The inability of Bank supervision missions to collaborate with Government in finding other means to resolve the problems addressed by these reversals is disappointing. A more comprehensive and diverse effort to establish the requisite environment is still needed before private trading in the agricultural sector is likely to become an integral and dynamic part of Malawi's solutions to the alleviation of poverty and sustained economic growth. Continued Government intervention in and tight regulation of markets, and a lack of infrastructure and credit are among the factors that continue to constrain the growth of private agricultural trading in Malawi.

Rationalization of ADMARC Funding and Functions

5.14 The principal ASAC conditionalities regarding ADMARC's operations were continuing the divestiture program, and implementing a Memorandum of Understanding (MOU) with Government under which Government assumes financing of ADMARC's functions related to development and food security. In addition, Government was required to set prices of crops handled by ADMARC so that individual crop accounts at least break even on average over a three year period. ADMARC was also required to implement a commission agent system to replace its financially inviable market centers. The outcome of the ASAC strategy with respect to ADMARC is still uncertain. Some actions were taken, others were apparently taken halfway, while others have been delayed over long periods of time.

- (a) In the case of the divestiture program, ADMARC has stayed on course. USAID assisted ADMARC in the design and implementation of a divestiture program. At one time, ADMARC's operations included

farms, sugar estates, tea and macadamia estates, banks, rice and oil processing, flour milling, fishing, meat processing, fertilizer processing, tea processing, cloth manufacturing, cotton ginning, freight forwarding and others. Beginning in 1986, urged by the Bank and with USAID technical assistance, ADMARC divested itself of many of these holdings. Those that could not be disposed of due to lack of effective demand were placed in a holding company with the intention that restructuring and divestiture would continue from there (Annex 2, Table 10).

- (b) The MOU with Government specifically details ADMARC's developmental role in trading smallholder commodities as the "buyer and seller of last resort" for specified commodities on behalf of Government. It was envisaged under ASAC that ADMARC would, over time, withdraw from commercial trading and focus solely on implementing Government food security policy with respect to smallholder marketing and pricing. In return, Government would reimburse ADMARC for losses incurred in undertaking this developmental role. Thus, as Government's agent ADMARC would manage the price band for maize, maintain the strategic grain reserve, ensure that producer prices for scheduled smallholder crops remain above the minimum prices set by Government, distribute SFFRFM's fertilizer at target ceiling prices, ensure smallholder access to output markets throughout the country, and guarantee that production/consumption policies are implemented by buying and/or selling at other than stipulated prices when requested by Government (e.g., to ensure seed stock availability). ADMARC would have to fulfil various efficiency targets in undertaking these roles in order to be eligible for reimbursement of its losses.
- (c) Though the MOU was only signed in December 1993, its implementation began before then. In 1990/91, Government reimbursed ADMARC MK 15.0 million for its losses in carrying out development and food security programs. In 1992/93, though Government had reportedly budgeted MK 20.0 million for this purpose, it made no transfers to ADMARC, due in large part to revenue generated from the handling of commercial/drought relief maize (MK 20.6 million)".
- (d) In the 1991/92 crop year, ADMARC reported a total net trading account loss of MK 31.0 million which was primarily caused by the severe drought and resulting low volumes of produce, competition from private traders (especially in maize), two currency devaluations, fuel cost increases, rising interest rates and mandated salary adjustments. Specifically, the cotton account lost MK 3.0 million. The groundnut account managed a profit of MK 264,000 despite a drop in production.

" Source: ADMARC Annual Report 1991/92.

No doubt the ban on private sector groundnut purchases and exports contributed to the profitability of this account during the drought year. ADMARC claimed a MK 2.0 million subsidy reimbursement on its tobacco account and anticipates a similar claim for MK 31 million in 1992/93, despite a MK 149,000 profit reported on its burley sales. A profit was reported on the maize account of MK 7.0 million as a result of handling commercial drought relief maize and the sale of 13,000 tons of maize to Action Aid, to be given away to farmers as seed. The rice and input sales accounts also reported losses in 1991/92. Sufficient time has not elapsed to evaluate the conditionality that ADMARC's accounts at least break even on average over a period of three years. Based on the 1991/92 figures and ADMARC's own projections for 1992/93, however, the picture is not optimistic.

- (e) ADMARC attempted to implement a commission agent system for markets that are not financially viable, but despite "attractive" offers to sell or rent warehouses they found little interest among private traders, and the program was discontinued. ADMARC currently operates 40 depot delivery markets (5 more than the number foreseen at appraisal) and over 1,000 seasonal markets. While some ADMARC markets were closed in 1987/88, others were opened and some of the closed ones were subsequently re-opened. It is estimated that the net effect of these changes has been a reduction in the total number of markets by about 125.

5.15 **Evaluation.** ADMARC and Treasury should be given credit for the development of the draft MOU agreement. Nonetheless, this area of the ASAC adjustment program has been prolonged and delayed beyond the Bank operation due to difficult and lengthy negotiations. There appear to have been two major causes in this delay, namely the cost to Government of ADMARC's interventions on its behalf and ADMARC's lack of confidence that it would indeed be reimbursed in full for the losses it incurred. These problems and concerns should have been aired and addressed during preparation or appraisal of the operation, or failing that, during supervision missions. As a result of the delays, one of the major ASAC components has not yet resulted in structural change or measurable impact. This is a good example of the problem inherent in linking a major, but slow moving, policy adjustment with a fast disbursing credit. The divestiture program is continuing with the assistance of USAID. However, the fact that ADMARC recently agreed to purchase a private ginnery, not as a company holding, but as an "asset" to circumvent its own divestiture policy, implies that the continued divestiture process requires additional monitoring and evaluation.

Fertilizer Procurement and Financing

5.16 The initial ASAC actions were to assist Government in the preparation of a 5-year projection of fertilizer requirements as well as operational guidelines for the management of the buffer stock established with EEC support. In addition, Government was to continue to reduce subsidies (addressed above in para. 4.18-4.20) and take actions to facilitate private sector participation within the system (subject to evaluation of food security policies). The outcomes of the ASAC strategy with respect to fertilizer procurement and financing have been the following:

- (a) The preparation of the rolling 5 year fertilizer requirement projection was completed and incorporated into the EEC fertilizer support project along with measures to improve the overall financial and managerial efficiency of SFFRFM.
- (b) In addition, the EEC's fertilizer project, closely associated with ASAC, required Government to take additional measures including establishing a code of practice for drawing on buffer stocks, settling within three months of billing outstanding accounts owed to SFFRFM, ensuring that buffer stocks would not be reduced below the equivalent of 90,000 tons and ensuring submission of timely financial reports by the Fund's management.
- (c) It was only in May 1993 that Government finalized and publicly announced its policy to open up smallholder fertilizer markets to the private sector. Thus is too early to assess the impact of this reform.

5.17 **Evaluation.** Prior to the establishment of the SFFRFM, ADMARC procured and distributed all smallholder fertilizers. Under the present arrangement, the SFFRFM supplies ADMARC with fertilizers on a consignment basis with title of the commodity remaining with the SFFRFM until payment is received by ADMARC, at which time it transfers to the smallholder farmer who has purchased the fertilizer. As such, ADMARC simply acts as a distribution agent for the SFFRFM, for which it receives remuneration to cover storage, transport and marketing costs. Before the start of each fertilizer marketing season, ADMARC, MOA and the SFFRFM collectively prepare a fertilizer distribution plan for that season, based on the smallholder demands established by the MOA. The fact that, in the last six years, there have been stocks of fertilizer in some ADMARC markets remaining at the end of the crop cycle, has lead some observers to conclude that supplies are more than adequate to meet effective demand (Annex 2, Table 12). However, caution should be taken in using year end stocks to assess the relationship between supply and effective demand. The geographical distribution of ADMARC's supplies are calculated at the beginning of the season according to MOA estimates of needs in different areas. This administrative process has lead to local imbalances of supply and demand, with stocks being drawn down early in the season in some areas and remaining at the end of the season in others. This makes it impossible to determine whether national supply is meeting aggregate effective demand. In addition, it is likely that the

spatial distribution of available supplies is inefficient and that demand constraints prevent poorer smallholders from using fertilizer.

5.18 Fertilizer usage in Malawi is still amongst the lowest in Africa. However, sales to smallholders have continued to increase despite the relatively high and increasing costs - which suggests a supply constraint. In the last six years, SFFRFM fertilizer imports have increased from 77,500 tons to 136,251 tons, a 12.5% average annual increase (Annex 2, Table 13). Smallholder demand for fertilizer is expected to reach 247,000 tons by 1997/98 (Annex 2, Table 14). Given the land constraint in Malawi's smallholder subsector, and declining soil fertility, it is essential that both supply side and demand constraints on smallholders' use of fertilizers are addressed. Further increases in the quantity of fertilizer utilized in Malawi will be affected by increasing cash incomes (especially from burley tobacco and hybrid maize production and the complete liberalization of other produce markets); expanded access to credit; decreasing fertilizer costs following the rehabilitation of the rail route from Nacala and the development of competition in the fertilizer market. In addition, in order to increase demand it will be necessary to raise the efficiency of smallholder fertilizer utilization. It is expected that this problem will be addressed through the strengthening of the extension service as envisaged under the recently launched Agricultural Services Project. SFFRFM will continue to have an important role in importing fertilizer in the immediate future, although an increased commercialization of its operations in a liberalized market is to be expected. In sum, while there was some increase in the efficiency of fertilizer procurement and supply under ASAC, and levels of procurement were enhanced, the strongest part of this component was only implemented in 1993 - namely the liberalization of fertilizer markets. It is therefore too early to assess the impact of this part of ASAC, but it appears that supply, marketing and demand constraints continue to restrict smallholders' use of fertilizers.

High Yielding Flint Maize

5.19 The progress in developing hybrid maize varieties acceptable to farmers has exceeded expectations. Two hard endosperm (or flint) high yielding maize varieties (MH17 and MH18) were developed by MOA and released in 1990/1. In addition, a third has now been developed (MH19). Partly as a result of the development and release of MH17 and MH18, hybrid maize has substituted for local maize in production since 1990/1. Moreover, seed demand for flint hybrid maize varieties from smallholders is reputed to be high, and seed production companies in Malawi have started to respond positively to meet increased demand for hybrid seed. Under the on-going 5-year (1991/92-1995/96) hybrid maize program, research will continue to focus mainly on dialled crosses in the selected lines with the aim of developing flint single-cross hybrids, evaluating them in yield tests across the country and advancing the best single-crosses into three-way cross hybrids. However, smallholder access to improved seeds may be constrained and this issue should be addressed in order that the benefits of the development of flint varieties under ASAC can be fully exploited. It is thought that, as yet, supplies of MH17 and MH18 do not meet demand. Government liberalized the production, marketing and pricing of hybrid seed in 1993 to address this problem, but the continued subsidization of seeds sold through ADMARC is inhibiting private sector entry into this market.

Land Allocation and Use

5.20 Land Transfers. The transfer of customary lands into the estate sector has been a serious concern in Malawi since Independence. Land available to smallholder households, especially in the Southern and Central regions of Malawi, is decreasing as high population growth rates (currently about 3.4% per annum) and transfers of land to the estate sector continue. Average smallholder farm sizes are consequently decreasing, seriously affecting the economic welfare of smallholder families. The ASAC policy agenda attempted to address this issue through a conditionality that required Government to amend the Land Act to ban further transfers of customary land to the estate sector. Government did amend the Land Act, banning further transfers, but did so with exemption clauses that effectively minimized any positive impact. Moreover, the expectation that administrative and legal actions would be sufficient to address the causes for such transfers was unrealistic. The main reason smallholders converted their customary tenure to leasehold was because, until 1990/1, it was legally not possible to obtain a license to grow burley tobacco unless one had leasehold or freehold land tenure. Thus, the provision that smallholders themselves can now grow and market burley tobacco has probably done more to slow down the transfer process than the amendment banning transfers.

5.21 The Efficiency of Estate Land Utilization. Under ASAC, a private estate extension service. The purpose of the latter, along with conditionality of increasing estates' rents, was to improve land use efficiency and productivity in the estate subsector. In 1990, the Estate Extension Services Trust (EEST) was established, with ODA assistance, as an autonomous trust under the Tobacco Association of Malawi. Though small (10 field agents), it has initiated an extension program focused on smaller estates. While lease rents were increased from MK 10 per ha to MK 30 during the operation, they are still thought to be too low to have any noticeable impact on estate land use. It has been estimated that about 16% of cultivatable land in the estate subsector is not used. Moreover, although under-utilization is probably influenced by the low costs of establishing an estate and the low annual lease rents, inadequate access to capital appears to be the main constraint on more extensive utilization. The provision under ASAC to collect estate lease rents from the tobacco auction has been successful in improving revenue collection from both current and past accounts.

5.22 Evaluation. The attempt to prevent the further transfer of land from the customary to the leasehold sector was one of the least successful components of ASAC. Although meeting the general conditionality by passing the amendment to the Land Act, Government did so in a manner that essentially defeated its purpose. The exemption for those who could establish and substantiate a prior use for customary land (and the lack of definition of "customary land rights"), ensured that anyone with some resources could still establish an estate. Reportedly, village leaders often agree to substantiate an individual's request, given the proper connections and incentives. In addition to the poor initial design, one reason for the poor performance of this component was the weak position of the institution charged with monitoring and enforcement of the land transfers. The Commissioner of Lands submitted a reorganization plan and request for additional staffing to Government over two years ago and still has not received a reply. Although the mission was advised by Government that the plan had been approved in principle, operating funds to implement the reorganization, let alone the

hiring of additional staff, are still not available. Given these conditions and the lack of an institution building component, the initial ASAC concept seems not to have been sufficiently well thought out.

5.23 The current rate of transfer of customary lands to the estate sector is not known. How much customary land remains is also unknown. The Commissioner of Lands reported that the number of requests and pending applications had not decreased with the inception of the ban. Underlying the poor performance of this component is also the sensitive political issue of just how much regulation and oversight there should be of the estate sector by Government. More importantly however, it appears that a rather crude administrative instrument was designed to address an incentive system created by Government's policy to grant the estate subsector a monopoly on the rights to grow burley tobacco. Given the strong financial incentives to produce this crop, a more effective means of addressing the problem would have been to increase smallholder burley tobacco production quota allocations.

5.24 Government also agreed to maintain estate lease rents at the 1985 level in real terms using the GDP deflator, and has subsequently increased rents over the last three years. Currently lease rents are MK 30.00 per ha. An additional 30% to 35% increase (to MK 40 kwacha per ha) is in order in 1993/94 to maintain the rates at 1985 value in real terms. Discussions with Government regarding a 1993/94 increase in lease rents are currently underway. However, this element of the program was also poorly designed. There appears to be no rationale for choosing the 1985 rental rate as the one to be maintained. It would be desirable to develop a simple, differentiated rental system, that more closely links the level of rent with the opportunity costs of the land. However, currently the data required to estimate such differentiated rents is not available. Moreover, study to establish a basis to differentiate estate land quality and introduce differentiated land rents according to land quality, requested under ASAC, was not implemented and is probably not a viable option at this point in time given the institutional weaknesses described above.

5.25 It is too early to evaluate the impact of the Estate Extension Service Trust on the productivity of small estates. The small size of the service and the large and possibly growing number of small estates make their task difficult. Their current strategy is to focus on 60 farms as "models", stressing diversification within the tobacco rotation. ODA is currently assessing the possibility of funding a second phase in the development of the EEST, which will involve the restructuring of the institution and its services. The newer small estates continue to be one of the primary entry points for non-quota tobacco as they reportedly have difficulty filling their own quotas without purchases. If their productivity does not improve, competition from the smallholder burley growers could begin to edge them out of the market. A study to establish base line data of the estate sector is needed.

Woodlots

5.26 Under ASAC it was also envisaged that the inspectorate staff of the Department of Lands would be strengthened to enforce the establishment of woodlots, covering at least 10%

of the area owned/leased, by estates, except in cases where estates are able to obtain fuelwood from forest plantations and private sources. This action never materialized. Estates still continue to acquire wood from indigenous plantations and, in a few cases they apply to the Forestry Department of the Ministry of Forestry and Natural Resources (MFNR) to procure fuelwood. Almost no tobacco estates are self-sufficient in wood products. This, together with an absence of commercial forestry, is contributing to the depletion of the natural (miombo) forests. The situation is particularly grave in Mangochi (Namwera area) where large tobacco growing estates are located. However, attempting to force estates to cultivate their own tree reserves, in a context of highly controlled (and probably suppressed) wood prices, is another example of attempting to address a market failure with administrative means. It is because the incentives to plant trees are thus reduced that the efforts to encourage estates to plant woodlots have failed. A more effective, efficient and sustainable means of addressing this problem would be the liberalization of fuelwood prices.

Food Security

5.27 With one of its primary objectives being to enhance food security, the ASAC included a component to strengthen the Government's capacity to monitor the impact of the adjustment program on the vulnerable and resource-poor group. In addition, the Government committed itself to: (a) ensuring that at least 50% of fertilizers supplied by SFFRFM would be packaged in bags of not more than 25 kg; (b) setting fertilizer prices to provide a higher rate of subsidy on high rather than on low analysis fertilizers; (c) locating the smallholder burley production schemes in areas where at least 75% of landholdings are less than 1.0 ha; and (d) initiating implementation of the UNDP-funded project to test various ways of targeting agricultural credit and fertilizer subsidies to the food deficient households. Finally, to enhance food security at the national level, the Government agreed to implement a plan to improve operational guidelines for the management of the Strategic Grain Reserve (SGR).

5.28 The outcome of the fertilizer subsidy reduction policies and targeting burley production quotas have been addressed above. With respect to the other activities listed above, performance relative to the above objectives has been the following:

- (a) SFFRFM, in an attempt to better meet the requirements of the poorest smallholders in procuring fertilizer, initiated a pilot scheme for distributing fertilizers packaged in bags of up to 25 kg. Several options were tried, including bags of 10, 15 and 25 kg. Demand for 25 kg bags was indeed high and distribution was reported to be successful. On the contrary, demand for smaller bags was negligible, evidenced by the fact that last year almost 90,000, 10 kg bags remained unsold. This probably reflects the income constraint faced by smaller farmers. Furthermore, the cost of unbagging and rebagging proved prohibitive, and therefore SFFRFM has decided to discontinue the distribution of 10 and 15 kg bags.

- (b) The UNDP-funded targeting project was initiated in November 1990, with the objective of assisting resource-poor households to become regular credit clients in order to improve their food security situation. The project could not deliver its designated outputs because of a number of obstacles encountered during implementation, namely:
- external factors, such as the 1992 drought which affected two of the pilot areas in Liwonde agricultural development division (ADD);
 - the socio-economic survey supposed to produce essential data for targeting project activities was never completed;
 - poor utilization of project financial resources, which led to a project implementation rate of 40%;
 - institutional arrangements within the Ministry of Agriculture that led to deficiencies in management of the project.

5.29 As a result of the above, a World Bank consultant recommended termination of the project and activities stopped in January 1993. Taking this experience into account, and considering the Smallholder Agricultural Credit Administration's good past performance and potential in dealing with short-term credit operations for smallholders, it is possible a broader program for production credit should have been included under ASAC to support plans for increasing smallholder production for both burley tobacco and fertilized hybrid maize. As SACA has proved to be a successful institution, both in terms of financing a large number of smallholders (more than 390,000 members in 1993) and in recovering loans (exceeding a rate of 90% up to 1991), it would not have appeared risky to undertake an expansion of production credit on these lines.

5.30 As stated in the Government's Food Security and Nutrition Policy Statement, national food security in Malawi has traditionally been viewed in terms of the country's ability to produce, secure and maintain adequate levels of food to meet commercial demands throughout the year. Under ASAC, support was given to the Government plan to improve the operational guidelines for managing the Strategic Grain Reserve (SGR), including specific criteria for selling to and buying from the SGR, and for determining the optimum stock size.

5.31 In terms of emergency stocks, the SGR had proved its usefulness even before ASAC. In 1987/88, food supplies were reduced by localized drought, the cassava mealy bug, and pricing policies. At the same time food demand was expanded by aid agencies purchasing grain to help feed the rapidly growing population of Mozambicans sheltering in Malawi. While the SGR was rapidly drawn down, it provided a large infusion of food at a very critical point in the marketing year, and helped to meet domestic needs while a larger donor food aid effort was organized. Despite the availability of SGR maize, market prices rose sharply as ADMARC had to ration its remaining maize. A wide gap appeared between ADMARC consumer prices and open market prices, but without maize from the SGR, the situation would

have been far worse. Even more dramatically, in the drought of 1992, the SGR stocks proved critical to the nation's food security. Of the total of about 300,000 tons of commercial maize supplied to the market by ADMARC, one-third came from SGR stocks. Due to delays in placing orders for commercial imports, even this amount proved inadequate to moderate late season market price increases. A paper prepared for the workshop "Food, Agriculture and Nutritional Policy in Malawi (May 3-6 1993, Lilongwe)" gives a full analysis of the SGR operations. The paper concludes that "better information about the structure of both supply and demand will permit improvements in the models developed to help guide decision-making on the size and management of the SGR. Pragmatic research on the lessons of the drought can also improve these guidelines. The size of the stock needed for emergencies is largely a function of the lead times needed to identify the emergency; to mobilize aid; to decide on commercial imports; to order, load and transport the commodities. Analyzing last year's experience will ensure that realistic time lags are built into the models used to help inform decisions about the SGR". Thus, while the SGR has to date reduced the adverse effects of periodic shortages on food security, there appears to be room for further improvements in its management.

Social Dimensions of Adjustment (SDA)

5.32 The Social Dimensions of Adjustment Project (SDA) in Malawi forms part of a regional initiative for Sub-Saharan Africa which commenced in 1988, jointly sponsored by AfDB, UNDP and the World Bank, and supported by several bilateral and multilateral donors. The project was established in order to address, firstly, the problems of protecting poor and vulnerable groups from undue hardships resulting from structural adjustment and economic reform and, secondly, the integration of these groups into the economic mainstream.

5.33 The SDA project in Malawi is working with a variety of Governmental and non-Governmental partner institutions. A Project Unit has been established within EP&D of the Office of the President and Cabinet to perform the function of coordination. The project was planned to run for a period of four years, from 1990/91 with a budget of US\$ 6.5 million, of which US\$ 1.5 million were to be provided by IDA under ASAC. The IDA contribution has been fully disbursed. However, monitoring the impact of ASAC reforms on the poor has not yet started. The Household Expenditure and Small Scale Economic Activities Survey (HESSEA) was carried out by the National Statistics Office (NSO) between July 1990 and July 1991 but analysis and release of the results is still awaited. The final report is to be produced under the Poverty Task Force (PTF), which includes EP&D, NSO, the Ministry of Women's and Children's Affairs and Community Services and the Center for Social Research (CSR). The PTF is currently carrying out four studies: (a) a critical review of poverty literature; (b) a community study; (c) a targeted nutrition study; and (d) a poverty impact assessment of projects and programs since 1981. These studies are expected to be completed by the end of 1994. However, given the delays in implementing the SDA project and in publishing the results of the HESSEA study, the capacity of the PTF may need to be strengthened, if timely information regarding the effects of structural adjustment on the poor is to be provided. The other component of SDA is the Social Program Support Fund (SPSF), which finances pilot

interventions at the grass-root level to test innovative approaches or methodologies for poverty alleviation. The aim is to provide information to be utilized in the formulation of an effective social development policy. The program, being executed by EP&D, started in May 1992 and is expected to be completed by mid-1994. Financial support is being given by IDA, ODA and GTZ. The mission was unable to obtain data on the progress or results of this program.

6. Overall Evaluation

Credit Conditions and Covenants

6.1 Implementation of agreed ASAC actions showed mixed performance, full and prompt for some measures and weak, delayed or absent for others. A summary of the overall status of implementation is presented in Annex 3. With regard to macro-economic policy actions, experience was satisfactory for most of the structural reforms, including the implementation of more flexible exchange rate policies, import liberalization, tax reforms, more market-oriented banking policies, and fiscal and budgetary restraints. However, the Public Sector Investment Program process, though improved, remains to be fully streamlined and no significant progress was made in the proposed reform of public expenditure in agriculture. Among the agricultural sector reforms, the main achievements were:

- (a) a significant increase in the number of smallholders growing burley tobacco; the introduction of a two payment price system for all smallholder tobacco growers and the liberalization of smallholder burley tobacco marketing;
- (b) the reduction of fertilizer subsidies; a reorientation of subsidization towards high analysis fertilizers and increased supplies of fertilizer;
- (c) the development of hybrid maize varieties which are acceptable in terms of their storage and processing characteristics to smallholder farmers and consumers;
- (d) the continuation of the annual price reviews and their submission to IDA for comment; and
- (e) the implementation of the depot delivery maize price to private traders.

On the other hand, the MOU between the Treasury and ADMARC was only signed in December 1993; no progress has been made in relation to land allocation, nor in improved land use and the establishment of woodlots by estates; the full liberalization of fertilizer markets has been delayed and that of produce markets has not been sustained.

Weakness in Project Design

6.2 The main weaknesses in project design appear to have been related to some of the assumptions that were entailed and the lack of commitment on the part of Government and other implementing agencies to some aspects of ASAC. For example, it seems unrealistic to assume that ADMARC will completely withdraw in the future from performing commercial activities as foreseen under ASAC and agreement between all parties concerned in this issue appears not to have been attained. Similarly, the assumption that maintaining land lease rents at 1985 real values would have influenced the efficiency of land use by estates was unrealistic since no attempt was made to establish the opportunity costs of land and to determine how this related to such rents. A land classification study to enable the latter was not carried out. Further, a more effective means of increasing estate efficiency may be to expose them to competition from smallholder farmers. Government policy to restrict burley and flue-cured tobacco production rights to the estate subsector has prevented this. Likewise attempting to stop the transfer of land between the smallholder and estate subsectors through legal means was unrealistic, given the strength of the economic incentives to undertake such transfers. Government commitment to the liberalization of agricultural input markets appears to have been weak, which explains the delayed implementation of this element. Finally, the ASAC was a complex program, involving many components of a varied nature. This may explain the inability to resolve design problems during implementation, as well as the lack of implementation of some elements.

Performance of Government and IDA

6.3 **Government.** In general, Government took more vigorous and prompt actions in regard to the macro-economic conditionality set out under ASAC than on issues relating to the agricultural sector. A notable instance - which resulted in a slippage of the release of the second tranche - was the delay in decisions regarding the two payment system for tobacco grown by smallholder farmers. There was an absence of effective action in respect of the rationalizing public expenditures in agriculture, the monitoring and evaluation of the ASAC and strengthening the staffing of the Department of Lands. Moreover, there were long delays in the signing of a memorandum of understanding between Government and ADMARC and in liberalizing fertilizer markets. Some of the delays could have resulted from the preoccupation of the authorities with emergencies such as the severe drought in 1992, but in part they also reflect a lack of commitment on the part of Government. The failure to complete actions within target dates may also have resulted from inadequate monitoring arrangements. In retrospect, it therefore appears that implementation might have benefited from a more collaborative preparation process, as well as support for strengthening the Ministry of Agriculture's Planning Division. Minimally, the latter should have been provided with appropriate staffing and authority, and charged with the responsibility to maintain a vigorous and continuous focus on the ASAC agenda.

6.4 **IDA.** Aside from the design weaknesses already described, given the inherent difficulties in implementing major structural and institutional reforms within the limited duration

of a quick disbursing adjustment credit, the IDA supervision effort should have been stronger than it was, in terms of the personnel resources devoted to it and the frequency of the missions. The macro-economic elements of the ASAC package seem to have received the requisite attention, partly because they were subsumed under the broader umbrella of country economic work and also because of the overlapping policy agenda between the IMF and the Bank. The resources devoted to supervising the agricultural aspects of ASAC, on the other hand, seem to have fallen short of the requirements. With a stronger supervision effort, IDA would have been better informed of the status of some of the matters set out in the policy matrix and, in some instances, might have been able to accelerate borrower actions. In particular, there appears to have been little attention drawn to the lack of progress in liberalizing fertilizer markets. Further, it might have been useful to arrange for at least one visit by a fertilizer distribution specialist as part of a supervision mission, given the importance of various fertilizer related issues in the ASAC. Land allocation and use is another item which did not have the benefit of much prior analysis or supervision during implementation. On the other hand, a positive element in this picture is the emerging role of the Bank's resident mission, in Lilongwe, in maintaining a constant dialogue with the Malawian authorities. This provides a valuable means of monitoring, and assisting in, project implementation.

7. Second Tranche Release and Disbursement

7.1 The credit became effective in April 1990. The second tranche release took place in October 1991 after a 10 month delay, one of the main reasons for which was the delayed implementation of the two-payment system for smallholder tobacco. Of the total credit of SDR 56.5 million (including SDR 4.0 million as IDA reflows), together with a Dutch Grant of Dfls 5.0 million and a UK Program Aid Grant of £ 10.0 million, a balance of about SDR 70,000 remained undisbursed as of 2 April 1993 (Part III, Tables 2 and 3). Under ASAC some US\$ 1.5 million were made available to support the Social Dimensions of Adjustment (SDA) project currently being implemented by EP&D. The last IDA credit disbursement was on 5 March 1993.

8. Sustainability

8.1 **Macroeconomic Reforms.** Prospects for sustainability differ between the stabilization measures and the structural reforms, which together comprise the macro-economic policy package implemented under ASAC. The former represent actions such as those directed towards exchange rate stability with discrete periodic adjustments, restraint in fiscal and monetary policies, and liberalization of exchange and import controls. The actual implementation of these policies is bound to be influenced by changes occurring from year to year in the domestic economy and in external trade. More importantly, the adherence to the liberal policies pursued in these areas was strongly challenged by developments such as the 1992 drought, and the decisions made by the country's external donors in regard to the size and conditions of their assistance. There is a risk that, in such circumstances, the pressure on the country's foreign exchange reserves and fiscal accounts may lead the authorities to reverse or

modify some of the policies which, in their view, cannot be sustained in a climate of uncertainty regarding foreign exchange earnings and fiscal receipts. However, the Government maintained its stabilization programs despite these challenges. As a result of this, together with increased growth and the resumption of donor support in 1993, the prospects for the continuation of stabilization policies are good.

8.2 Likewise, it appears that the structural and institutional changes will be sustained. Thus, the possibilities opened up by the recent amendments to the banking legislation, the rationalization of various trading regulations and the tax structure, and the diversification of the institutions and instruments in the financial sector have a long-term relevance, and form part of a broad infrastructure which could be sustained and improved over the years. The Government is committed to deregulating the economy, the development of a vigorous, autonomous private sector and the progressive build up of the institutions and facilities to support such development. The recent efforts to develop fiscal discipline and refine the allocation and planning of public investment through the PSIP may also be expected to continue, as the recent resource constraints emphasized the need for improved coordination. The trend towards the reduction of fertilizer subsidies is also expected to continue. These expectations and judgements are based on Government's policy statements and actions carried out so far. However, it is possible that the direction will change in the face of new political circumstances.

8.3 **Agricultural Reforms.** In the area of reforms applying specifically to agriculture, again several actions taken so far represent potentially far reaching changes which are not likely to be reversed. Allowing smallholders to produce burley tobacco and the development of appropriate hybrid maize varieties are cases in point. Similarly, although delayed, fertilizer marketing has now been liberalized. On the other hand, progress has been less positive in other areas and the deepening of even the successful reforms may not be easy. For example, the further expansion of smallholder burley tobacco production is likely to require a reallocation of production away from the estates, given world markets and Malawi's role in them. The Government has expressed resistance to adopting such a strategy. Likewise, although agricultural produce markets were formally liberalized in 1987, the Government has implemented several apparent policy reversals since then, for example banning private participation in groundnut trading periodically. It has also not completed the liberalization process - smallholder tobacco markets (except for burley) remain monopolized. The major changes in ADMARC which have already been made seem likely to stay, but how far further changes will go is not clear in view of the delays which have occurred in finalizing the Memorandum of Understanding between Government and ADMARC. The same is true of the liberalization of fertilizer markets. Land allocation and use is another area in which sustainability cannot be assumed, since implementation has so far been disappointing, largely due to the intervention methods chosen. While none of the reforms implemented in the agricultural sector under ASAC are inherently unsustainable, there may be a need for greater Government commitment to the liberalization process. In addition, some of the reforms were poorly designed - for example the attempt to legally cease the transfer of land from the customary to the estate sector; the enforcement of woodlot establishment on estates and the

depot maize pricing policy. The continued implementation of these elements should therefore be reassessed.

9. Main Lessons Learnt

The Preparation, Supervision and Management of Structural Reforms

9.1 It was expected under ASAC that the Government of Malawi and ADMARC would enter into an agreement which would set out criteria for determining the developmental and food security functions to be carried out by ADMARC, establish a methodology for calculating the involved costs, define procedures for making budgetary subventions to ADMARC to cover losses resulting from such activities and define performance targets that the parastatal had to meet in order to be reimbursed for undertaking these activities. The process of drafting the proposed agreement has taken a long time and the agreement was only signed in December 1993. This seems to be illustrative of the difficulties faced in compressing a major structural or institutional reform within the duration of a quick disbursing adjustment credit. In such instances, either more preparatory work should have been completed before the approval of the IDA credit so that all necessary follow-up actions could be quickly taken. It is an unsatisfactory situation that, while the credit was fully disbursed, the implementation of a major reform included in ASAC had not been implemented. This experience seems to suggest that complex and far-reaching institutional reforms should not be incorporated within the framework of adjustment operations unless considerable preparatory work has been completed and agreement reached among all the concerned parties on the details of implementation. In addition, closer and more comprehensive supervision of the program on the part of the Bank may have alleviated some delays. Nonetheless, it is also important to note that the Government has continued or deepened several of the reform processes initiated under the ASAC through other programs. For example, the finalization and public announcement of the liberalization of fertilizer markets was completed under the Agricultural Services Project.

9.2 More collaborative and careful preparation could also have prevented weaknesses in the design of ASAC. One flaw in the design of ASAC was an attempt to use administrative measures to resolve market failures. For example, the attempt to halt the transfer of land from the customary to the estate subsector through making it illegal failed, because of loop-holes in the law and because the incentives to transfer land in this manner were not addressed (i.e., the monopoly of the estate subsector on burley tobacco production rights). Another example is the two-tiered price system devised for ADMARC payments to smallholder tobacco producers. This is a complex process and has led to increasing official prices in the face of falling world market prices. Liberalizing tobacco marketing would have addressed the root causes of the problems observed - i.e., the taxation of smallholder tobacco production - more directly. Similarly, the wisdom of offering private maize traders a 20% price increase for the delivery of produce in bulk to ADMARC depot markets has led to an unnecessary market distortion. Not only does this policy create a false dependence in private maize markets, but it does not provide a means of sustainably alleviating the problem it was intended to address - namely the shortage of working capital amongst private traders. In retrospect, ensuring that the

liberalization of produce markets was fully implemented and sustained, and addressing weaknesses in Malawi's financial markets (e.g., a lack of competition and of linkages between formal and informal financial sectors) may have provided a more effective and sustainable means of addressing the capital constraint on the development of private produce markets.

9.3 In addition, more attention should have been paid to the pacing and sequencing of implementation of the reforms during preparation. For example, currency devaluations were infrequently implemented, which led to the need for large scale devaluations in 1992. Also liberalizing imports when the Kwacha was overvalued, exposed domestic producers to intense international competition.

Smallholder Burley Tobacco Program

9.4 The rationale for expanding smallholder burley tobacco has been completely vindicated by the experience gained under ASAC. Its significance derives from its potential for spreading the benefits of a favorable export market among smallholders, the profitability of its cultivation, which generates the cash needed by the smallholders for purchasing agricultural inputs, and the boost which this additional income gives to the rural non-farm economy. This is a promising opportunity which should be pursued and expanded from the point of view of poverty reduction and growth. There is currently no consensus on the way in which this should be done, but the Government is undertaking a study of the costs and benefits of various ways in which the current system for allocating production rights could be improved, in terms of equity and efficiency.

Coordination and Follow-up

9.5 Although there was an inter-ministerial committee to deal with implementation of the various reforms proposed under ASAC, it appears that in practice coordination and implementation management was not fully effective, particularly in matters such as monitoring and evaluation. Considering the broad range of such actions and the likelihood that many of them would need to be pursued beyond the short period of the quick-disbursing credit, the arrangements for coordination and management should have been placed on a firmer institutional footing and continued on a medium-term basis. To this end, as suggested by the Government, financial support for the strengthening of the Planning Division of the Ministry of Agriculture may have been beneficial. In addition, a more effective coordination mechanism could have perhaps helped reduce the ten-month delay in complying with the conditions for the second tranche release, although it is also likely that a more collaborative approach to the preparation of ASAC could have alleviated this problem. Finally, supervision by the Bank could have been improved, both qualitatively and quantitatively.

Public Expenditures

9.6 As only limited progress was made in rationalizing agricultural expenditures, it appears that the conditionality under ASAC in this respect should have been more specific so as to commit the Government to definite actions beyond those cited in connection with the release of the second tranche. Further, given the related interest of ASAC in the formulation of the Government's investment program and the close relationship between the development and recurring expenditures to which the PER of 1990 had also drawn attention, issues relating to public expenditure in agriculture should perhaps have been addressed in a broader perspective. The program should, therefore, have sought for a review of the overall budget management policies and procedures, as they have a close bearing on both the PSIP and agricultural expenditures covered by ASAC.

Poverty-related Pilot Schemes

9.7 A review of the pilot efforts of various multilateral and non-governmental organizations to tackle different aspects of rural poverty in Malawi suggests that they have been localized, piecemeal and experimental with inconclusive results. There is a need for Government to develop a coherent strategy within which to coordinate all such pilot interventions, evaluate their impact, and determine how these efforts should be followed up to produce more effective results.

Environment

9.8 As indicated earlier, the Department of Lands was not able to enforce the establishment of woodlots by estates. In the context of controlled wood prices, most estates do not grow tress but purchase wood from commercial operators who continue to exploit the indigenous natural forests on customary land. Much faith is placed in restricting the exploitation of natural forests by commercial operators while preserving the rights of rural households to such resources; in improving barn efficiency, converting waste wood from pine forests into charcoal, and possibly extending the electricity grid to cover the rural flue-cured tobacco growing areas of central Malawi. However, the Government should put more emphasis on liberalizing/increasing fuelwood prices to enhance the incentives for tree planting.

PART II: PROJECT REVIEW FROM THE BORROWER'S PERSPECTIVE

1. BACKGROUND

The government of Malawi undertook various stabilization and structural adjustment efforts in the eighties, supported by 3 IDA-financed SALs and other external assistance. These efforts led to some improvements in the fiscal and current account balances and modest growth in the industry and estate agriculture and among the larger smallholders. However, because of structural constraints in the economy, the supply response to these measures was not sufficient to raise per capita incomes appreciably. The ASAC sought to address these constraints through a combination of macro-economic and sectoral reform, and help Malawi achieve growth and reduce poverty.

The credit became effective in April 1990. The second tranche took place in October 1991 with about 10 months delay over the foreseen date, one of the main reasons being the implementation of the two tier payment for burley tobacco. The total credit of SDR 56.5 million (including SDR 4.0 million as IDA reflows) has been fully disbursed together with a Dutch Grant of Dfls 5.0 million and UK Program AID Grant of 10 million pounds. Under ASAC some US \$1.5 million were made available to support the Social Dimension of Adjustment (SDA) project currently being implemented by EP&D. The last IDA credit disbursement was in March 1993. A balance of about SDR 70,000 remained as of April, 1993.

2. OBJECTIVES OF ASAC

The objectives of ASAC were clearly spelt out in the ASAC appraisal document and are outlined in part I of the PCR prepared by the Bank in collaboration with FAO. The primary objectives of the program were to achieve sustainable growth and to reduce poverty and food insecurity. To these ends, ASAC included both macro-economic and agricultural sector reforms. Macro-economic reforms focused on management of external sector and public finance. Agricultural sector reforms centered on measures to improve incomes and food security among smallholders and land use efficiency in estates.

More specifically, ASAC envisaged reforms comprising measures to:

- a) continue the flexible exchange rate and restrained monetary and fiscal policies; improve export incentives; complete the final stage of trade liberalization; revise the Banking Act to enhance monetary management and induce a market-based monetary and credit system;

- b) focus the Public Sector Investment Program (including agricultural expenditures) on areas of high priority and returns;
- c) improve crop pricing and marketing policies through expanding the role of the private sector;
- d) reduce fertilizer subsidies, improve fertilizer availability and use among smallholders, liberalize the distribution of fertilizer and improve the financial management and funding of the SFFRFM;
- e) rationalize ADMARC's financing to enable it to play the role as a price stabilization agency more effectively.
- f) shift agricultural research policy and financing to develop hybrid flint maize varieties that are high-yielding and acceptable to most smallholders; and
- g) allow smallholders to grow high-value cash crops, especially burley tobacco.

3. PERFORMANCE OF THE ECONOMY

Between Independence and the end of the 1970s, the Malawi Economy enjoyed vigorous economic growth and development. The real growth rate in Gross Domestic Product (GDP) averaged over 6 percent, corresponding to an average annual growth of per capita income of 3 percent. This impressive GDP growth rate was attributable to substantial increases in output from the agricultural sector, providing a wide export base and also fuelling the expansion of secondary sectors such as manufacturing. Total productive activity also benefitted from the balanced development of basic infrastructure, in particular, roads, railways and public utilities. In the external sector, the overall balance of payments position during the period was favorable, due to the rapid growth of exports from the estate subsector and a sizeable amount of capital inflows. Performance of the government budget was satisfactory largely due to increased government revenue and relatively small recurrent requirements for institutional support. The impressive economic performance pre-1979 was due mainly to a development strategy based on liberal economic policies which gave priority to raising agricultural productivity.

Since the late 1970s, the Malawi economy has suffered a series of external shocks, which include worsening external terms of trade, rising import prices of capital goods and intermediate goods, increasingly severe debt service problems, and a disruption of the country's traditional routes to the sea. Consequently the post-

1979 period was one of generally depressed growth. Growth in GDP fell from 3.3 percent in 1979 to -5.2 percent in 1981. The overall balance of payments position also deteriorated (except for 1980). The current account balance has throughout been in deficit during the post-1979 period. Net capital inflows were inadequate to finance the current account deficit. This was due to increases in interest rates on the international money markets. By 1982, the external debt service payments had reached an unsustainable level of 44 per cent. Accordingly, the country rescheduled its debt under both Paris and London club agreements.

The adverse factors mentioned above also affected the budget. In relation to GDP, the deficit was 9.7 percent in 1979/80 and increased to about 12 percent in 1981/82. The Government, accordingly undertook to implement measures aimed at restoring the external equilibrium of the economy and improve its growth prospects. These measures covered a wide area and were put together in the form of a medium-term program supported by an International Monetary Fund stand-by arrangement and a Structural Adjustment Loan from the World Bank. Arising from these measures, a balance of payments surplus of K 91.0 million was registered in 1984. Real gross domestic product grew by over 3 percent during the 1982-83 period. The country's debt service ratio progressively declined to 38 percent in 1984. Beginning in 1985, further external shocks buffeted the economy. The rail lines to the ports in Mozambique were cut off completely. The terms of trade took another nosedive as tea and tobacco prices weakened and the balance of payments underwent a dramatic deterioration. The current account deficit rose to 9 percent of GDP in 1985. Combined with decreased inflows on the capital account, this led to increasingly rapid reserve losses. The country also suffered more setbacks in 1986 and 1987 in the form of adverse weather conditions, and the increase in the flow of displaced persons from Mozambique, further strained the food and other resources of the country. The debt service ratio rose sharply to 57 percent in 1986. As a result real GDP stagnated and inflationary pressures intensified.

In response to the continuing deterioration of the economy, the Government in 1987 prepared a new strategy, which is set out in its statement of Development Policies, 1987-1996. It also formulated a three year program covering the period April 1988 to March 1991 aimed at continuing and deepening adjustment reforms to: align aggregate demand with available resources through stricter fiscal, monetary and credit policies, together with active exchange rate management; increase productivity through addressing policy and investment constraints on the performance of the major economic sectors; strengthen the role of the private sector through liberalization and improved incentives; and enhance the efficiency of public resource utilization. This adjustment program was supported by the World Bank through the Industrial and Trade Policy Adjustment Credit (ITPAC) approved in 1988, by the IMF through a stand-by arrangement and an Enhanced Structural Adjustment Facility (ESAF) and by further debt rescheduling in 1988.

The policy adjustment program envisaged over the decade is clearly spelt out in the statement of development policies 1987-1996, published by the Department of Economic Planning and Development. The Government remains committed to the creation of a general climate that encourages enterprise and investment, both domestic and foreign. It gives priority to increasing the productivity of assets available to the poor, mainly labor and land, and to reducing population growth. In addition to increase agricultural productivity, the strategy envisages policies and investment measures to: expand off-farm employment opportunities through promoting the informal sector, other labor-intensive enterprises, and agro-industries; slow down the rate of population growth through child-spacing programs; enhance the quality of human capital through improving access to education and health services; and improve efficiency in the use of public resources.

4. PERFORMANCE OF THE ECONOMY WITHIN ASAC PROGRAM PERIOD.

Since 1988 the economy has shown signs of recovery. Real GDP grew by 3.3 percent in 1988, 4.3 percent in 1989 and 4.8 percent in 1990. During 1991 real GDP growth reached 7.8 percent. The main driving force behind the rise in GDP has been increased agricultural production and increased industrial production and distribution.

The rate of inflation which averaged 31.4 percent in 1988 decelerated substantially to 15.7 percent in 1989 and 11.6 percent in 1990. In 1991, it increased slightly to 11.9 percent reflecting the impact of the closure of the Tete route and excessive monetary expansion. Inflation has abated in response to tight monetary and fiscal policies and the impact of nominal exchange rate stability and availability of commodities due to import liberalization program.

The fiscal deficit (including grants) fell from 8.7 percent of GDP in 1987/88 to 6.7 percent and 6.3 percent in 1989/90 and 1990/1991, respectively. This shows a steady improvement in fiscal performance at least up to 1991. This improvement has come from revenue growth, expenditure monitoring and control measures.

The performance of the balance of payment's has been mixed as a result of varying export performance during the period and the impact of the import liberalization program. The current account deficit rose from 8.2 percent of GDP in 1988 to 13.4 percent in 1989. This was largely on account of delays in shipment of tobacco, tea and coffee exports which led to large stock accumulation. The situation improved in 1990 as the export stocks were cleared leading to a decline in the current account deficit to 7.8 percent of GDP. In 1991, the current account deficit ratio deteriorated to 12.0 percent. With the exception of 1989, the

overall balance of payments position has been recording surpluses as reflected in the changes in net foreign assets of the banking system.

5. POST-ASAC IMPLEMENTATION PERIOD PERFORMANCE

After a record performance in economic growth to the tune of 7.8 percent in real GDP in 1991 there were disturbing signs in 1992 on the economic front. The principal underlying cause for this was the damaging effect of a shortfall in the smallholder agricultural production in 1992. The shortfall was mainly due to the drought that seriously affected the country in 1992. For example, relative to the bumper crop of about 1.6 million tons of maize production in 1991, an output of 657,000 tons during the 1992/93 season represented a significant loss. The repercussions have permeated throughout the economy. The drought adversely affected all smallholder production including rice, groundnut, cassava and many other root-crops. Consequently real GDP declined in real terms by 7.9 percent during 1992. To maintain some minimum living standards for the smallholder subsistence sector, there was importation of foodgrains supported by foreign aid contributions, supplemented by the extra costs of distribution of maize that the Government had to incur in its budget provisions in the fiscal year 1992/1993. The neighboring countries in the SADC region also suffered from the drought, with related economic impacts. This called for massive imports of foodgrains, resulting in balance of payments deficits in those countries. This caused pressures on the international aid pool and donor rationing both in food supply and in aid.

6. POLICIES PROPOSED UNDER ASAC

Several policies were proposed under the ASAC program. These can be broadly divided into agriculture policy and macro-economic policy.

6.1 Macro-Economic Policies

Macroeconomic policy reforms which were proposed under ASAC can be divided into three major categories, i.e., external sector policy, public finance policy, and monetary policy.

External sector policy was aimed at improving the efficiency of resource allocation and increasing exports. Actions which were proposed to be undertaken under ASAC included:- maintaining the exchange rate at levels satisfactory to IDA; implementation of the fourth stage of an import liberalization program; removing the requirement of prior approval of foreign exchange for all imports except for a short list of luxury items satisfactory to IDA; reviewing the import tariff structure and reducing levels; and developing and initiating implementation of a more effective duty drawback system for exports. It should be noted that the exchange rate policy, the import liberalization policy, as well as the export

promotion activities proposed under ASAC program were a continuation of actions recently undertaken under structural adjustment loans from the IMF and through the World Bank supported ITPAC .

Public finance policy was aimed at containing inflation, improving efficiency in the use of public resources, easing the pressure on the balance of payments, and releasing resources to the private sector. These were to be achieved through the following instruments: restraining fiscal deficits; improving the quality of the public sector investment program (PSIP); restructuring agricultural expenditures; reducing fertilizer subsidies, and reforming the tax system. Actions which were to be undertaken under this program included maintaining the fiscal deficit and preparing PSIP for 1990/91-1992/93 satisfactory to IDA; completing the review and beginning the implementation of recommendations of the findings of the public expenditure review (PER) completed by the World Bank in 1988; maintaining the economic rate of fertilizer subsidies at a level not exceeding 30 percent in 1990/91, 25 percent in 1991/92, and 20 percent than in 1992/93, with total subsidy subventions not more than 2 percent of total Government expenditure in 1990/91, 1.6 percent in 1991/92, and 1.3 percent in 1992/93; and revising the income tax structure. These was also a continuation of earlier policies by IMF and other donors.

Monetary policy was aimed at containing inflation through improving monetary management; and enhancing the efficiency of the financial system through introduction of a more market based monetary and credit system. Actions to be taken by the ASAC were to present a revised Banking Act to parliament, which would allow the Reserve Bank of Malawi to fully play the conventional role of a Central Bank.

6.2 Macro-Economic Policies Implemented

(a) External Policies

The following policy instruments which were proposed under ASAC were implemented:

- (i) Exchange Rate: To pursue the goal of restoring external competitiveness and to support import liberalization, the Malawi Kwacha was devalued several times against its basket in 1990, 1991 and by 15 percent and 22 percent in May and June 1992 respectively. The 1992 devaluations restored external competitiveness to levels equivalent to 1987/88, the period with the most depreciated real exchange rate.

Ceteris paribus a depreciation of the kwacha should have made agriculture exports more profitable and induced expansion, assuming

the additional cost of imports does not wipe out incremental profitability (major imports being fertilizer, pesticides, fuel/transportation, equipment, spare parts, etc); It may be argued that while international prices for fertilizers (in Dollar terms) fluctuated or were stable over the years, the changes in the exchange rate have pushed up the equivalent cost in kwacha. This argument can be applied to all imported inputs and transportation services. The government has tried to alleviate the situation by subsidizing, for example, fertilizer but it also has committed itself to phase out fertilizer subsidies by 1994/95.

- ii) **Import Liberalization:** This came as an improvement over foreign exchange rationing, supported by the International Development Agency and other donors. A final phase of liberalization in 1991 targeted the remaining raw materials, spare parts, and intermediate and capital good. At the end of the program the allocation of foreign exchange had been devolved to the commercial banks. For the first time the commercial banks became exercising agents for foreign exchange allocation.
- iii) **Export Promotion:** The government had earlier reduced the range of goods requiring an export license and introduced a tax allowance for exports. It was proposed to develop and initiate implementation of a more effective duty drawback system for exports. The investment promotion Act of 1991 provided for special incentives for export manufacturing in the proposed Export Processing Zones (EPZ) and general ones for non traditional exports (mainly manufacturing). The stipulated incentives for EPZ manufacturing include: a corporate tax rate of 15 percent; no withholding tax on dividends; no duty on capital and raw materials and packaging materials made in Malawi; no value added tax; and a transport tax allowance amounting to 25 percent of international transport costs.

(b) Public Finance Policy

- i) **Fiscal policies:** This component included the development of a tax reform program and a strengthening of budget procedures. As a result there was a substantial reduction in the Central Government budget deficit between 1986/87 and 1991/92. However, the deficit rose again in 1992/93, due to expenditures on the referendum campaign and drought relief efforts. Structural reforms in budgetary planning included the introduction of 5 year rolling public sector investment program. There has also been a comprehensive tax reform aimed at improving tax administration and allocative efficiency.

ii) **Agriculture Expenditure/Public Expenditure Review:** To ensure an accurate reflection of development priorities in the agricultural sector, while trying to minimize expenditure or maintain expenditures within budget ceilings, there has been close monitoring of the size and composition of the public sector investment program. A public sector management review was completed in 1991 and serves as the basis of improving economic management in the current tight fiscal environment.

(c) **Fertilizer Subsidies**

The government's commitments under ASAC were that the overall subsidy rate on fertilizers was not to exceed 30 percent in 1990/91, 25 per cent in 1991/92, and 20 percent in 1992/93, while the total subvention as a proportion of total government expenditure was not of exceed 2 percent in 1990/1991, 1.6 percent in 1991/92, and 1.3 percent in 1992/93. The government has been meeting these targets, but for the 1992/93 season, facing more adverse circumstances than anticipated, it negotiated an allocation of K 25 million for the fertilizer subvention, an estimated 1.4 percent government expenditure, slightly above the target previously set. Even this required an increase in fertilizer prices of between 20 and 40 percent in 1992/93.

From 1980 to 1991 total sales of fertilizer to smallholder more than doubled, and there is an indication of success in the attempt to move towards higher analysis fertilizers. However, smallholder use of fertilizers in Malawi remains extremely low. Further, within the smallholder subsector, fertilizer use is highly skewed towards larger farmers on customary lands who have access to credit.

Thus the government is caught between upward pressure on fertilizer prices, continuing currency devaluations, transport problems and its commitment to phase out fertilizer subsidies and its need to increase fertilizer consumption by smallholders. It should be noted that official prices for fertilizers have risen substantially in real terms since 1980, while ADMARC real producer prices for the main crops have stagnated or fallen.

(d) **Tax Reforms**

The government strengthened the collection of income taxes and the extension of taxation of fringe benefits in 1990/91. It also began lowering tax rates, with a decrease in the highest marginal corporate and individual income tax rate, in 1989/90 without jeopardizing the revenue base. In 1991/92 the government combined a reduction in the base surtax

rate with a widening of the base, (i.e., expanding it to include electricity and telephone, as well as other services). Some specific measures implemented in the 1992/93 budget include the elimination of surtax exemption for domestically produced goods and the consolidation of the protective effect of domestic surtax exemption into the existing tariff rates to a maximum of 75 percent. In addition the government is currently reviewing, and will implement appropriate measures to strengthen customs administration, to increase compliance and increase customs revenue.

(e) Monetary Policy

The Reserve Bank of Malawi is involved in trading monetary instruments and securities as is reflected in the Reserve Bank of Malawi Act of 1989. Direct regulation of commercial bank credit has, however, discontinued. These banks and other financial institutions now independently determine their interest rate structure.

The government under the same act has established a framework to improve competition in the financial market and promote investment. Also, in order to enable Post Office Savings Bank to play a more effective role in mobilizing resources, there has been an initiative to restructure it.

Another element of the financial reform program is the encouragement of new capital market activity, based on the Capital Market Development Act, 1990.

7. AGRICULTURAL POLICY REFORMS

The key policy reforms in the agricultural sector involved changes in the allocation of cash crop rights; the liberalization of output marketing and input distribution; rationalization of ADMARC's funding and functions; institutional reforms with respect to fertilizer procurement and financing; changes in laws surrounding land allocation and use; food security targeting; encouraging research into high yielding flint maize varieties, and monitoring the social dimensions of adjustment and woodlots on estates. The outcome of some of these key policy reforms are discussed below.

7.1 Cash Crop Allocation

Under ASAC the government introduced a structural change into Malawian agriculture by changing burley tobacco growing and marketing regulations to allow smallholders to grow this lucrative crop. The enthusiasm of smallholders in growing the tobacco far exceeded the authorized quotas placing considerable demands on the government to increase planned levels of quota

allocated to them. The current number of smallholder burley tobacco growers represents only 1.6 percent of the total 1.8 million smallholder in Malawi. Increasing amounts of illegal production of burley are widely reported. The marketing of burley has been further liberalized by inclusion of other marketing options like direct sales to auction floors and estates in addition to ADMARC.

7.1.1. The Bank may wish to note that a number operational problems have been encountered.

a) The crop can only be grown by a small proportion of the smallholders and one questions why the Bank could not have considered other options that would complement the burley option. Burley is not the only cash crop or enterprise that can improve farmers income. Other donors have also emphasized the same crop even after the collapse of prices in 1992 and 1993 seasons.

b) The target group of farmers with 1.0 ha and less has caused some problems in some areas, with families with larger holdings having poor incomes and food security problems because they do not have the cash to buy purchased inputs and access to markets. Farm size is not the only constraint that smallholders are facing. In some ADDs farmers are poor not because they don't have enough land, but because capital is a key constraint among others.

c) As a result of providing more market options, the majority of farmers growing burley opted to sell directly to the auction floors given the fact that this option has been resulting in higher prices than selling to ADMARC and the added problem of late second payment by ADMARC. While this gives farmers the best price, the major bottleneck has been transportation of the product from remote areas to the auction floors. This has at times left farmers in a situation where they have sold their tobacco to ADMARC, estate owners or illegal traders at give away prices.

7.1.2. The estate farmers have not really welcomed the introduction of smallholder burley production, because they have perceived it as something that will destroy the tobacco industry. Any move that the ministry has undertaken has been looked at critically by the estate sector. Part 1 of the PCR raises two questions as regards the introduction of smallholder burley production. First, is the issue of estate

tenants and how the tenancy system responds to the new opportunity now available to the smallholder. Second, is diversification in which estates must eventually take the lead. The issues are that (a) tenants should be free to enter and exit the estate sector depending on the opportunities that exist and (b) whether the estate sector takes the leading role in diversification or not will essentially depend on the type of commodity.

To promote various diversification options will require technical support, access to finance, organization and institutional arrangements, appropriate technologies, transportation and identified markets. The Government recognizes that the estate subsector has been protected for a long time and this has been at the expense of the smallholders. It is high time these subsectors were given equal opportunity.

7.2 Rationalization of ADMARC Funding and Functions

The principal ASAC conditionalities regarding ADMARC's operations were continuing the divestiture program and implementing the critical Memorandum of Understanding (MOU) with government financing ADMARC functions related to development and food security. In addition, Government was required to set prices of crops handled by ADMARC so that individual crop accounts at least break even on average over a three year period.

7.2.1 Memorandum of Understanding

The document has not been signed to date. There is need to critically analyze the magnitude of subsidy that government will be committing (i.e., there is need to compare the subsidy levels with and without MOU). The principle behind the MOU seems justifiable, but it is possible that ADMARC may end up getting the subsidies and not the intended beneficiaries (i.e., the smallholder farmers). The drawing up of the MOU should have preceded ASAC and the policy implications carefully analyzed before putting it as a condition of the program. A major problem appears to be that ADMARC is not sure of government's financial commitment to MOU.

7.2.2 Improved Efficiency through Expansion of the Private Sector

Until 1990/91 ADMARC maintained a legal monopoly over the marketing of all smallholder produce including tobacco, cotton and groundnuts. Historically it has paid low prices to smallholders, averaging some 20-30% of world market prices. In 1992 Government adopted improved policies (e.g, bonus second payment for tobacco producers, higher prices, more

marketing options) which were intended to increase smallholder production and income. Since 1987 ADMARC's legal monopsony in the marketing of maize and other crops has been relaxed, and private traders have been permitted to purchase directly from smallholder, based on minimum prices, so as to promote better returns for those farmers with a surplus for sale.

Some high value crops are still controlled and have to be marketed through ADMARC. Generally the prices paid by ADMARC for cash crops have been lower than their export parity value, but under new pricing reforms implemented in the 1990/91 season, ADMARC is beginning to pay the export parity prices. For example, food crops like rice have recently received close to export parity prices.

With structural adjustment and market liberalization, ADMARC was put on a sounder commercial base. The most significant aspect of the re-organization has been the closure of a number of ADMARC markets considered to be financially inviable in terms of low volume of throughput. These markets are in remote rural areas. While ADMARC improved its financial performance, re-organization has adversely affected the poorer segments of the rural population. Closure of the ADMARC markets in the remote areas leaves poorer households extremely vulnerable to rising maize prices in local markets, especially if maize is scarce and some markets were reopened as a result. Private buyers have not filled the void of ADMARC in these areas and its questionable if they will replace the role of ADMARC. The main constraints facing the private traders include lack of access to investment and working capital, training and technical requirements, availability of transport at low cost, and a set of administered prices that do not make private operations profitable. The key constraint to the development of the sector is the scarcity of transport services and capital.

7.2.3 Divestiture Program

A USAID technical assistance team assisted ADMARC in the design and implementation of a divestiture program. ADMARC divested itself of many of these holdings. On page 22, point 5.12 of part I of the PCR, it is stated that "the fact ADMARC recently agreed to purchase a private ginnery not as a company holding but as an asset to circumvent its own divestiture policy, implies that the continued divestiture process requires additional monitoring and evaluation". The move to acquire the ginnery is a strategy to cut down on ginning costs incurred by ADMARC and not the objective suggested in the above quoted statement.

7.3 Fertilizer Procurement and Financing

The initial ASAC actions were to assist Government in the preparation of a 5 year projection of fertilizer requirements, as well as operational guidelines for the management of the bufferstock established with EEC support. In addition, Government was to continue to reduce subsidies and take actions to facilitate private sector participation in the system (subject to food security policies). The policy of Government supported by ASAC and other donors, continues to be the elimination of fertilizer subsidies altogether by 1995/96.

SFFRFM has been successful in terms of procuring fertilizer for the smallholder subsector. It operates as a non-profit making agency and is dependent on government subsidies. However, SFFRFM's capacity to respond to increased smallholder fertilizer demand is eroded each year by its:

- (i) inability to apply profit margins to the fertilizer it trades at Government fixed prices;
- (ii) Government delays in funding its operating losses (annual subsidies to smallholder consumed fertilizer); a fixed nominal capital and eroding real capital;
- (iii) general inflation in fertilizer prices;
- (v) eroding purchasing power to meet the demand for fertilizer. In the recent environment of liberalized marketing policies, SFFRFM is faced with the issue of its financial viability and future role.

Under ASAC the Government has committed itself to phasing out of fertilizer subsidies once it is possible to do this without risking a fall in maize production and deteriorating household food security. The reduction of subsidies in the 1992/93 cropping season, with eventual removal by the 1995/96 season, will be concurrent with liberalization of fertilizer market implementation starting from 1993/94 season.

Fertilizer usage is still among the lowest in Africa, however, its use continues to increase. The increase in use of fertilizer has to be interpreted with caution because, even though fertilizer is subsidized, prices have increased substantially over the past decade due to the devaluation of the Kwacha, increased external transport costs, increased international fertilizer prices and the reduction in government subsidy. Fertilizer sales are closely tied to the credit system of SACA and the extension service of MOA. However, there is leakage of fertilizer (estimated as high as 25-35% in 1989) to the estate

subsector. Therefore increased sales to smallholders may not reflect increased utilization by smallholders.

7.4 Food Security

Under ASAC, particular emphasis was given to support the Government's attempt to achieve sustainable growth and to reduce poverty and food insecurity. The credit also included a component concerned specifically with the vulnerable and resource-poor groups.

Malawi's development policy and goals have emphasized national self-sufficiency in food production and attainment of national food security. But nearly 55% of smallholder households are food insecure even in the best seasons, in spite of the surplus marketed through ADMARC which has given the impression that the country is food self-sufficient and food secure. The per capita production of maize (which is the staple food) declined from 204 kg in 1970 to an average of 162 kg in 1990 and household food security remains precarious.

There are two major issues in the underlying cause of household insecurity namely:

- i. low agricultural productivity;
- ii. limited off-farm employment opportunities and low levels of incomes.

The national prevalence of malnutrition amongst adults is difficult to determine in the absence of data, but the assumption is widely accepted, particularly as it related to rural women who suffer malnutrition and weight losses to a great extent during the pre-harvest and heavy labor demand period. The NSSA survey of 1980/81 revealed that approximately 56% of under fives in rural Malawi suffered from chronic malnutrition. A 1991 survey found that about 59% of the children in poor urban areas were stunted.

In Malawi poverty is significant and widespread, prevalent in both rural and urban areas, and it encompasses a little more than half the population, or approximately 55%. The World Bank estimates that about 60% of smallholder population is living below the poverty line. In the estate subsector, about two thirds of the population, consisting of estate tenants and estate workers, is described as living below poverty line and the extent of poverty among women headed households is significant. Poverty in the urban areas is as marked as it is in the rural areas, although the actual numbers of people involved is low.

Malawi's development performance in macro-economic management has been impressive. However, poverty at the household level amongst various groups is widespread and persistent as shown above.

8. OTHER COMMENTS ON THE PCR

- 8.1** Government agrees with the Bank that complex far reaching institutional reforms should not be incorporated within the framework of adjustment operations unless considerable preparatory work has been completed and agreement reached among the concerned parties on the details of implementation. The delays in finalization of MOU is a typical example.
- 8.2** The Aid Memoire of the Bank's supervision mission of November 1991 refers to a discussion with government officials of various suggestions for monitoring and facilitating field level implementation. These included proposals for the formal designation of a senior officer with supporting staff and funds for this purpose and convening of quarterly review meetings chaired by a senior government official. There is no indication that these suggestions were endorsed by the Bank in its communication to GOM on this supervision mission or implemented by the authorities in the field.
- The Bank and Government should certainly take note of this anomaly and in future make sure that a proper M & E system is put in place.
- 8.3** Government agrees that the rationalization of agricultural expenditure should have been spelt out in specific terms so as to commit the government to define actions which should have gone beyond those cited in connection with the release of second tranche.
- 8.4** Government is still having problems with getting a second payment from ADMARC to tobacco farmers prior to the beginning of the agricultural season so that farmers can use the cash to buy inputs. There is need to design a system that would overcome this problem.
- 8.5** Instead of increasing the export base through export diversification, the number export crops has actually declined over the last decade.
- 8.6** The ASAC pricing formula for tobacco has resulted in the Government subsidizing the tobacco crop. In 1993/94 season, the weighted average of the current ruling prices for all smallholder tobaccos was in excess of the 45 percent calculated price. If this situation occurs, it is not corrected by a reduction in price according to the MOU. There is need to revise the formula or liberalize the tobacco markets.

- 8.7 Removal of subsidies has increased production costs for smallholder farmers. Alternative means of providing cheaper fertilizer and seed should be explored.

9. FUTURE AGRICULTURAL ADJUSTMENT PROGRAMS

- 9.1 From an agricultural sector perspective, we recommend that future adjustment programs should concentrate on sectoral issues and not mix sector with macro-issues and the funding should allow enough time to realize the impact of the policy changes in the agricultural sector. Financial commitment to support implementation of these policy reforms should be provided, and not just policy reforms.
- 9.2 A more targeted approach to the subsidization of smallholders is needed. A review of various piece meal poverty alleviation efforts should be made to come up with a unified approach. Sufficient funds should be made available for this aspect to alleviate poverty and related problems.
- 9.3 Solid linkages between sector and local industry will provide a more stable income base than does the present precarious dependence on crops like tobacco that have an endangered future due to a reduction in international demand. For example, much of the abundant fruit production capacity is not linked to industry and crops like cassava and sorghum are not even officially marketed although they have a potential in processing for starch and wheat substituting flour, respectively.
- 9.4 Greater capitalization of agriculture will be required than is presently the case and this should include greater investment in improved seed/seedling propagation (e.g. for high quality fruit growing) and in irrigation to reduce the impact of the seasonality factor and cyclical incidence of drought condition.
- 9.5 The potential for increasing off-farm non-agricultural incomes should be explored in areas where land is becoming a severe constraint.

10. CONCLUSION

In conclusion, it appears macro-economic reforms do bring short-term gains, but for long-term gains there is need to concentrate on sectoral reforms and supporting funds should be provided in aforementioned areas to allow time for long-term impact. Part 1 of the PCR has dwelled very much on the positive side of the program and little attention has been given to the negative side.

PART III: STATISTICAL INFORMATION

Table 1. Related Bank Loans/Credit

Loan/Credit Title	Main Objectives	Fiscal Year	Status
SAL I (Ln-2026)	Diversify export base; encourage efficient import substitution; ensure appropriate prices and income policy; improve public sector's financial performance; strengthen GOM economic planning and monitoring capability.	1981	Closed 8/12/82
SAL II (Cr-1427)	Diversify export base. encourage efficient import substitution; ensure adequate incentives; improve public sector's financial performance; strengthen policy-making capability.	1984	Closed 6/30/85
SAL III (Cr-1644)	Diversify export base; promote export; strengthen GOM policy making capability; improve performance of Development Institutions.	1986	Closed 9/30/88
SAL III Supplement (Cr-A-9)	Expand role of private sector in making of smallholder crops; improve financial performance and operational efficiency of ADMARC; strengthen food security planning capability.	1987	Closed 9/30/88
Industrial and Trade Policy Adjustment Credit (Cr-1920)	Improve policy environment for the manufacturing sector to increase efficiency of resource use and expand employment and exports.	1988	Closed 6/30/93

Table 2. Credit Data

	Original	Disbursed	Cancelled	Repaid	Outstanding
	..... (SDR million)				
IDA Credit No. 2121 MAI	52.6	52.53 ^{1/}	-	-	52.6
IDA Credit No. 2121-1 MAI (Reflow)	4.0	4.0	-	-	4.0
Dutch Grant (Dfls million)	5.0	5.0	-	-	-
UK (£ million)	15.0	10.0	-	-	-

^{1/} A balance of about SDR 70,000 remains undisbursed as of April 2, 1993.

Table 3. Credit Timetable

	Planned Credit Dates	Revised/Actual Dates
Initiating Memorandum		June 22, 1989
Letter of Development Policy		March 12, 1990
Negotiations	October/November 1989	February 22, 1990
Board Approval	December 1989	April 3, 1990
Credit Agreement	April 11, 1990	April 11, 1990
Effectiveness	April 18, 1990	April 18, 1990
Second Tranche Release	December 1990	October 10, 1991
Closing Date	December 31, 1991	December 31, 1992
PCR		April/May 1993

Table 4. Cumulative Credit Disbursement

	..... Fiscal Year			
	1988/89	1990/91	1991/92	1992/93
	..... (SDR'000)			
(i) Planned	26,000.0	52,600.0	56,600.0 ^v	-
(ii) Actual	15,137.0	26,653.0	55,774.4 ¹ /	56,530.3 ^v
(iii) Actual as % of Planned	58.2	50.7	98.5	99.9

^v Including IDA reflows of SDR 4 million approved for Malawi in late 1991.
^v About SDR 70,000 remained undisbursed as of April 2, 1993.

Table 5. Use of Bank Resources

A. Bank Staff Inputs
(staff weeks)

Task	FY88	FY89	FY90	FY91	FY92	FY93	FY94	Total
Prep	9.4	53.5						62.9
Appr		3.3	0.1					6.4
Spn				24.3	13.3	7.1		34.7
PCR							6*	6
Total	9.4	56.8	0.1	24.3	13.3	7.1	6*	110.0

* Projection

B. Mission Data

	Month/Year	No. of Weeks	No. of Persons	Staff Weeks	Date of Report
Preparation	February/March 1989				
Appraisal	July 1989				March 6, 1990
Supervision 1	May 1990	1	1	1	June 22, 1990
Supervision 2	September 1990	2	1	2	October 10, 1990
Supervision 3	December 1990	1	2	2	January 28, 1991
Supervision 4	August 1991	n.a	n.a	n.a	August 23, 1991
Supervision 5	November 1991	1	2	2	January 2, 1992
Supervision 6	July 1992	4 ^v	3	6	August 20, 1992
PCR	April 1993	2	3	6	May 1993

^v Combined with Agricultural Marketing and Estate Development Project. Only two weeks attributed to ASAC.

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**AGRICULTURAL SECTOR ADJUSTMENT CREDIT
(Cr. 2121-MAI)**

ANNEX 1

MACRO-ECONOMIC REFORMS

Table 1. Economic Indicators (1989-1993)

	1989	1990	1991	1992	1993 ^u	
 (%)					
Real GDP Growth	4.1	4.8	7.8	(7.9)	11.2	
Agricultural Growth	2.4	(0.2)	12.8	(25.7)	40.0	
- Smallholder production	0.2	(3.4)	14.8	(34.4)	63.5	
Growth of Merchandize Exports	(1.3)	51.4	18.7	7.1	5.3	
External Account Deficit	13.0	7.8	12.0	12.2	10.6	
	(88/89)	(89/90)	(90/91)	(91/92)	(92/93) ^u	(93/94)
Fiscal Deficit (as % of GDP)	-9.0	-6.7	-6.5	-5.7	-12.3	-5.7 ^u

Source: Economic Report 1993.

^u Estimates.

Table 1. Production and Export of all Malawian Tobaccos, 1986-1991

	1986	1987	1988	1989	1990	1991
Production (million kg):						
Burley	30.2	36.8	45.5	61.2	64.0	75.0
Flue-cured	21.0	24.5	20.7	19.8	21.8	25.7
Northern dark-fired	10.9	9.8	7.7	4.6	13.6	15.1
Souther dark-fired	0.5	0.5	0.4	0.3	0.5	0.6
Sun-air cured	1.0	0.9	0.6	0.4	1.4	2.0
Oriental	0.1	0.1	0.2	0.3	0.2	0.5
Sales Revenues (MK million):						
Burley	88.0	238.9	238.9	226.5	331.1	511.2
Flue-cured	63.7	109.6	109.6	99.8	141.4	205.8
Northern dark-fired	24.8	34.1	34.1	32.2	63.7	51.3
Souther dark-fired	0.8	1.2	1.6	1.7	1.6	2.1
Sun-air cured	1.6	2.4	2.3	1.9	5.3	7.4
Oriental	0.1	0.1	0.2	0.5	0.4	0.7
Export Earnings (MK million):						
Burley	119.2	187.6	282.1	273.8	484.2	
Flue-cured	89.2	136.9	132.5	152.8	166.1	
Northern dark-fired	36.2	48.7	56.4	41.3	80.3	
Souther dark-fired	1.2	1.0	1.9	1.0	n.a	
Sun-air cured	2.8	3.1	3.4	2.5	6.7	
Oriental	0.4	0.3	0.5	1.1	0.6	

Source: Malawi Tobacco Directory.

MALAWI

**AGRICULTURAL SECTOR ADJUSTMENT CREDIT
(Cr. 2121-MAI)**

ANNEX 2

AGRICULTURAL SECTOR REFORMS

Table 1. Production and Export of all Malawian Tobaccos, 1986-1991

	1986	1987	1988	1989	1990	1991
Production (million kg):						
Burley	30.2	36.8	45.5	61.2	64.0	75.0
Flue-cured	21.0	24.5	20.7	19.8	21.8	25.7
Northern dark-fired	10.9	9.8	7.7	4.6	13.6	15.1
Souther dark-fired	0.5	0.5	0.4	0.3	0.5	0.6
Sun-air cured	1.0	0.9	0.6	0.4	1.4	2.0
Oriental	0.1	0.1	0.2	0.3	0.2	0.5
Sales Revenues (MK million):						
Burley	88.0	238.9	238.9	226.5	331.1	511.2
Flue-cured	63.7	109.6	109.6	99.8	141.4	205.8
Northern dark-fired	24.8	34.1	34.1	32.2	63.7	51.3
Souther dark-fired	0.8	1.2	1.6	1.7	1.6	2.1
Sun-air cured	1.6	2.4	2.3	1.9	5.3	7.4
Oriental	0.1	0.1	0.2	0.5	0.4	0.7
Export Earnings (MK million):						
Burley	119.2	187.6	282.1	273.8	484.2	
Flue-cured	89.2	136.9	132.5	152.8	166.1	
Northern dark-fired	36.2	48.7	56.4	41.3	80.3	
Souther dark-fired	1.2	1.0	1.9	1.0	n.a	
Sun-air cured	2.8	3.1	3.4	2.5	6.7	
Oriental	0.4	0.3	0.5	1.1	0.6	

Source: Malawi Tobacco Directory.

MALAWI: Agricultural Sector Adjustment Credit (Cr. 2121-MAI)
Annex 2: Agricultural Sector Reforms

Table 2. Smallholder Burley Tobacco Growers

Year	No. of Growers			No. of Clubs	Production (kg)		Sales (kg)			Total
	Target	Registered	Actual		Target	Actual	ADMARC	A. Floors	Estates	
1990/91	5,000	8,790	6,970	n.a.	3,000,000	2,186,120	2,186,120	-	-	2,186,120
1991/92	12,000	11,670	7,539	332	3,500,000	2,442,000	393,000	1,165,000	804,000	2,442,000
1992/93	20,256	27,384	28,947	1,125	7,000,000	6,989,650	n.a.	n.a.	n.a.	n.a.

Source: MOA.

Table 3. Burley Club Membership, 1992-1993
(by Region)

Region/ADD	No. Clubs	..... No. of Members			Average No. of Members
		Women	Men	Total	
North:					
Karonga	46	108	637	745	16
Mzuzu	110	372	2,155	2,527	23
Central:					
Kasungu	233	478	5,307	5,785	25
Salima	53	174	813	987	19
Lilongwe	232	841	4,770	5,611	24
South:					
Liwonde	251	1,109	5,268	6,377	25
Blantyre	150	355	5,071	5,426	36
Ngabu	50	226	1,263	1,489	30
Total:	1,125	3,663	25,284	28,947	26

Source: MOA Department of Extension and Training.

Table 4. Smallholder Production and Hectarage: Maize and Tobacco

Crops	Average 1983/84-1987/88		1988/89		1989/90		1990/91		1991/92 ^v		1992/93 ^v	
	Area	Product	Area	Product	Area	Product	Area	Product	Area	Product	Area	Product
	(000'ha)	('000 t)	(000'ha)	('000 t)	(000'ha)	('000 t)	(000'ha)	('000 t)	(000'ha)	('000 t)	(000'ha)	('000 t)
Maize:												
- Local	1,098	1,115	1,160	1,221	1,184	963	1,194	1,041	1,132	373	1,006	989
- Composite	20	33	25	44	25	35	19	27	13	5	4	6
- Hybrid	64	187	86	245	135	345	179	521	217	283	327	1,014
Total:	1,182	1,335	1,271	1,510	1,344	1,343	1,392	1,589	1,362	661	1,338	2,009
Tobacco:												
- NDDF	29	13	17	6	24	11	26	14	25	14	19	10
- SDDF	3	1	1	1	1	1	1	...	1	...	1	1
- Sun-air	4	1	2	1	5	2	4	2	3	...	2	1
- Oriental	1	1	1	...	1	...	1	1	1	...	2	1
- Burley	...	...	...	...	...	...	1	1	2	3	20	21
Total:	37	16	21	8	31	14	33	18	32	17	44	34

Source: MOA.

- ^v Drought year.
^v Second crop estimates.

Table 5. Smallholder Market Options for 1992/93

Region	ADD	Total Allocation			Selling Directly to Auction Floors				Not Selling Directly to Auction Floors			
		# Clubs	Quota (kg)	%	# Clubs	%	Quota (kg)	Total Quota (%)	# Clubs	%	Quota (kg)	Total Quota (%)
North:	Karonga	46	220,000	3	40	4	196,150	3	6	3	23,850	0.3
	Mzuzu	110	680,000	10	110	12	680,000	10	0	0	0	0.3
		156	90,000	13	150	16	876,150	13	6	3	23,850	0.3
	Kasungu	233	1,414,000	20	211	23	1,242,400	18	22	11	171,600	2
	Lilongwe	232	1,092,000	16	216	24	910,950	13	16	8	181,050	3
Central:	Salima	53	288,000	4	37	4	206,700	3	16	8	81,300	1
		518	2,794,000	40	464	51	2,360,050	34	54	26	433,950	6
	Liwonde	251	1,898,000	27	251	27	1,898,000	27	0	0	0	0
	Blantyre	150	1,161,000	17	46	5	626,540	9	104	50	534,460	8
South:	Ngabu	50	249,000	4	5	1	27,150	0.4	45	22	221,850	3
		451	3,308,000	47	302	33	2,551,690	36	149	71	756,310	11
Total:		1,125	7,002,000	100	916	100	5,787,890	83	209	100	1,214,110	17

Source: Department of Agricultural Extension and Training, Ministry of Agriculture, April 22, 1993.

Table 6. World Burley Tobacco Production

	..... Area (ha) .....			..... Production (tons)		
	1990	1991	1992	1990	1991	1992
N. America	120,715	137,132	150,314	289,231	321	326,700
S. America	57,397	67,491	77,426	94,224	103,187	136,933
C. America	8,237	8,033	11,018	14,281	13,967	20,656
EC 12	31,727	31,298	31,200	84,998	90,499	86,710
Other W. Europe	671	633	628	1,265	1,365	1,320
E. Europe	13,454	12,517	12,050	16,935	19,065	16,695
N. Africa	11,500	11,173	11,760	13,741	12,739	13,259
Malawi	53,000	60,000	75,000	64,019	75,013	85,000
Zimbabwe	3,267	4,375	5,600	5,893	7,893	10,200
Sub-Saharan Africa	61,576	69,701	85,925	74,807	87,761	100,043
Asia	68,829	80,323	93,859	134,398	157,319	179,297
M. East	1,525	1,827	1,960	3,611	4,141	4,080
Oceania	17	17	17	30	30	30
Other	636	726	706	868	810	803
Total:	377,359	421,961	477,953	730,480	814,889	888,926
Malawi as a % of Total	14.04	14.22	15.69	8.76	9.21	9.56

Source: MOA.

Table 7. Burley Quota Allocations, Actual and Projected

Year	Estate Quota	Smallholder Quota
	..... (million kg)	
1984/85 (marketed)	30.4	0
1985/86 (marketed)	30.2	0
1986/87 (marketed)	36.8	0
1987/88 (actual)	56.9	0
1988/89 (actual)	64.7	0
1989/90 (actual)	72.4	0
1990/91 (actual)	102.4	3.0
1991/92 (estimated)	118.2	3.5
1992/93 (projected)	118.9	7.0
1993/94 (projected)		8.5
1994/95 (projected)		9.2
1995/96 (projected)		10.7

Source: MOA and USAID ASAP PAAD, p.4.

Table 8. Smallholder Burley Tobacco Growers

A. Weighted Average Price for Burley			
Season	Production^{1/} (tons)	Auction Floor Price (MK/kg)	Value of Production (MK million)
1990/91	2,186	6.87	15.0
1991/92	2,440	6.52	15.9
1992/93	7,000	4.52	31.6
Total:	11,626	5.38 (w. av. price)	62.5
B. Estimated Gross Revenue for Smallholder Burley Growers			
(1992/93)			
Burley Production (tons) ^{1/}		7,000	
No. of Smallholder Growers ^{1/}		29,000	
Production/Smallholder (kg)		241	
W. Average Auction Floor Price (MK/kg) ^{2/}		5.38	
Total Gross Revenue (MK million)		37.7	
First ADMARC Payment (MK million) ^{3/}		17.0	
Second ADMARC Payment (MK million) ^{4/}		4.0	
Total Gross Revenue to Smallholders (MK million)		21.0	
Gross Revenue for Smallholder (MK)		724	
Actual Price Obtained by Smallholders (MK/kg)		3.0 (or 56% of w. av. auction floor price)	

^{1/} See Table 2.

^{2/} See calculation above.

^{3/} 45% of Total Gross Revenue.

^{4/} 65% of Net Profit of ADMARC (estimated).

Table 9. Estimated Border Prices for Selected Crops (1992)

	Maize	Groundnuts	Cotton
	..... (US\$/tons)		
World market price: 1992 ^v	104	75	1,280
Freight and insurance	20	20	20
Port charges Durban	25	25	25
Cif Durban	149	120	1,325
Transport to Lilongwe	175	175	175
Cif Lilongwe	324	295	1,500
	..... (MK/ton) ^v		
Cif Lilongwe	1,192	1,086	5,520
Other charges ^w	60	54	276
Import parity price	1,252	1,140	5,796
Transport to factory	n.a	n.a	140
Cost ex factory	n.a.	n.a.	5,936
Factory cost (20%)	n.a	n.a	1,187
Economic value before factory	n.a	n.a	4,749
Yield cotton fiber/grain	n.a	n.a	35%
Parity price of 350 kg of fiber	n.a	n.a	1,662
By-product (110 kg of oil)	n.a	n.a	142
By-product (380 kg of cake)	n.a	n.a	379
Economic value of seed cotton	n.a	n.a	2,183
Transport to farm	140	140	140
Economic price farmgate (MK/ton)	1,112	1,000	2,043
Economic price farmgate (t/kg)	111	100	204
Producer price farmgate (t/kg)	43	91 ^w	92

- ^v World Bank commodity price projections.
^w US\$ 1 = MK 3.68 (1992).
^x Estimated at 5%.
^y Chalimbana variety (average grades GDA and GDY).

Table 10. Investments Transferred from ADMARC

Investments in Shares	Last Accounts
Auction Holdings Limited	31/12/89
Central Tobacco Properties Limited	31/12/89
Cold Storage Company Limited	31/12/89
Cory Mann George (Malawi) Limited	30/06/89
Cotton Ginners Limited - ordinary shares	31/05/89
Cotton Ginners Limited - preference shares	31/05/89
David Whitehead and Sons (Malawi) Limited	30/09/89
Dwangwa Sugar Corporation Limited	31/03/90
Finance Corporation of Malawi Limited	31/09/89
Investment and Development Bank of Malawi Limited	31/12/89
Malawi Tea Factory Company Limited	30/06/89
Manica Freight Services (Malawi) Limited	30/06/89
National Bank of Malawi	31/12/89
National Seed Company of Malawi Limited	31/05/89
Optichem (Malawi) Limited	31/12/89
Stagecoach Malawi Limited	01/04/90
Sugar Corporation of Malawi Limited	31/03/90

Source: ADMARC, 1993.

Table 11. Smallholder Fertilizer Prices and Subsidies 1991/92 and 1992/93

	1991/92 Price (MK/50 kg)	1991/92 Subsidy (%)	1992/93 Price (MK/50 kg)	1992/93 Subsidy (%)
S/A	42.00	6	49.80	0.0
CAN	48.00	7	69.40	0.0
23:21:0+4S	50.00	20	70.00	15.3
Urea	45.00	23	60.80	15.5
DAP	49.00	18	66.15	17.0

Source: MOA.

MALAWI: Agricultural Sector Adjustment Credit (Cr. 2121-MAJ)
Annex 2: Agricultural Sector Reforms

Table 12. Smallholder Fertilizer Requirement, Distribution and Sales 1988/89-1992/93

Season	S/A				CAN				23:21:0+4S			
	Required	Received	Sales	Stocks	Required	Received	Sales	Stocks	Required	Received	Sales	Stocks
..... (tons)												
1988/89	3,953	6,309	5,977	332	28,803	28,060	27,817	243	19,064	22,063	21,688	375
1989/90	4,462	2,943	2,256	687	34,222	34,419	32,438	1,981	20,623	25,207	24,621	586
1990/91	6,838	6,165	2,945	3,220	45,618	34,567	32,611	1,956	38,610	32,664	29,312	3,352
1991/92	4,240	4,510	3,464	1,046	31,114	38,305	34,344	3,961	39,261	36,509	32,999	3,510
1992/93	3,150	3,267	2,894	373	40,350	33,434	29,933	3,501	40,950	37,032	33,266	3,766

MALAWI: Agricultural Sector Adjustment Credit (Cr. 2121-MAD)
Annex 2: Agricultural Sector Reforms

Table 12 (continued)

Season	S/A				CAN				23:21:0+4S			
	Required	Received	Sales	Stocks	Required	Received	Sales	Stocks	Required	Received	Sales	Stocks
..... (tons)												
	Urea				DAP				Total			
1988/89	29,898	25,814	23,976	1,838	14,612	9,238	7,953	1,285	96,330	91,484	87,411	4,073
1989/90	48,817	46,559	28,864	17,695	19,830	12,154	10,926	1,228	127,954	121,282	99,105	22,177
1990/91	48,507	40,383	31,627	8,756	21,850	19,372	16,399	2,973	161,423	133,151	112,894	20,257
1991/92	46,162	44,855	38,621	6,234	22,118	25,228	19,040	6,188	142,895	149,407	128,468	20,939
1992/93	61,920	57,480	45,957	11,523	30,010	32,244	25,933	6,311	176,380	163,457	137,983	25,474

Source: MOA - ADMARC.

- Note:
1. 1992/93 figures are up to 26 February 1993.
 2. 23:21:0+4S figures for 1987/88 and 1988/89 are for 20:20:0.

Table 13. SFFRFM Fertilizer Imports 1987/88 - 1992/93

	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93
	..... (tons)					
S/A	8,500	-	3,000	3,000	3,000	-
CAN	30,000	20,000	41,300	20,000	31,500	25,000
20:20:0	20,000	-	-	-	-	-
23:21:0+4S	5,000	15,000	32,200	20,000	27,500	18,751
Urea	9,000	8,000	40,000	15,000	9,000	55,000
DAP	5,000	5,000	9,200	18,000	24,000	37,500
Total:	77,500	48,000	125,700	76,000	95,000	136,251

Source: Ministry of Agriculture.

- Note:
1. The fertilizer marketing season is from 1 April - 31 March.
 2. The 1992/93 figure for 23:21:0+4S includes 500 tons sourced locally from Optichem.

Table 14. National Total Fertilizer Demand and Supply Plan 1993/94

Fertilizer Type	National Smallholder Demand	National Estate Demand	National Total Demand	SFFRFM Supply	Optichem Supply	Norsk Hydro Supply	ADMARC Supply	Total Supply	Balance
..... (tons)									
Major Grades:									
S/A	3,470	2,100	5,570	3,600	1,600	-	-	5,200	-370
CAN	42,950	14,700	57,650	34,000	10,800	12,250	5,000	62,050	+4,400
23:21:0:4S	42,719	5,250	47,969	46,000	-	5,000	-	47,250	-719
Urea	60,900	8,600	69,500	42,000	1,350	3,900	-	51,000	-18,500
DAP	37,035	1,600	38,635	40,000	150	-	-	40,150	+1,515
Total:	187,074	32,250	219,324	165,600	13,900	21,150	5,000	205,650	-13,674

Source: MOA.

- Note: 1. Estate demand is assumed to be 5% up on 1992/93 estate consumption from Table 12.
2. Norsk Hydro Urea includes boron.

Table 15. Future National Fertilizer Requirement

Fertilizer Type	1993/94	1994/95	1995/96	1996/97	1997/98
Smallholder Sector:					
S/A	3,470	3,500	3,500	3,500	3,500
CAN	42,950	43,000	43,000	43,000	43,000
23:21:0+4S	42,719	43,000	43,000	43,000	43,000
Urea	60,900	63,945	67,140	70,500	74,025
DAP	37,035	38,890	40,830	42,870	45,015
Sub-total:	187,074	192,335	197,470	202,870	208,540
Estate Sector:					
S/A	2,100	2,205	2,315	2,430	2,550
CAN	14,700	15,435	16,200	17,020	17,870
23:21:0+4S	5,250	5,515	5,790	6,080	6,380
Urea	8,600	9,030	9,480	9,960	10,455
DAP	1,600	1,680	1,765	1,850	1,945
Sub-total:	32,250	33,865	35,550	37,340	39,200
Total:	219,324	226,200	233,020	240,210	247,740

Source: MOA.

- Notes:
1. Smallholder fertilizer demand projections assume no increase for low analysis fertilizers beyond 1993/94 and a 5% increase per annum for high analysis fertilizers.
 2. Estate fertilizer demand projections based on 1992/93 estimated consumption assuming 5% increase per annum.

MALAWI

**AGRICULTURAL SECTOR ADJUSTMENT CREDIT
(Cr. 2121-MAD)**

ANNEX 3

POLICY AGENDA ACTION MATRIX

Policy Issues and Objectives	Actions to be Taken Under ASAC	Action Taken
1. External Sector		
To improve efficiency of resources allocation and increase exports through: (a) ensuring appropriate exchange rate; (b) liberalizing imports; and (c) improving export incentives.	Maintaining exchange rate at levels satisfactory to IDA.	Implemented.
	Implementing the fourth stage of import liberalization covering non-industrial equipment and certain consumer products for which there is domestic competition.	Implemented.
	Removing the requirement of prior approval of foreign exchange for all imports, except for a short list of items satisfactory to IDA.	Implemented.
	Reviewing tariff structure and reduce levels.	Implemented.
	Developing and initiating implementation of a more effective duty drawback system for exports.	Implemented.
2. Public Finance		
To contain inflation, improve efficiency in the use of public resources, ease pressure on the balance of payments, and release resources to the private sector through: (a) restraining fiscal deficits; (b) improving the quality of Public Sector investment Program (PSIP); (c) restructuring agricultural expenditure; (d) reducing fertilizer subsidies; and (e) reforming the tax system.	Maintaining fiscal deficit for FY 90/91 at a level satisfactory to IDA and preparing PSIP for 1990/91-1993/94 satisfactory to IDA.	Implemented.
	Completing review.	Report not available.
	Beginning implementation of recommendations.	(see above).
	Maintaining economic rate of fertilizer subsidies at a level not exceeding 30% and total subsidy subventions at not more than 2% of total Government expenditures in 1990/91.	Implemented.

Policy Issues and Objectives	Actions to be Taken Under ASAC	Action Taken
	<p>Reducing economic rate of fertilizer subsidies to levels not exceeding 25% in 1991/92, and 20% in 1992/93, and total subsidy subventions to not more than 1.6% of total Government expenditures in 1991/92, and 1.3% in 1992/93.</p>	<p>Implemented.</p>
	<p>Revising income tax structure, including rates and depreciation policy.</p>	<p>Implemented.</p>
<p>3. Monetary Policy To contain inflation through improving monetary management; and to enhance efficiency of the financial system through introduction of a more market based monetary and credit system.</p>	<p>Presenting the revised Banking Act to Parliament.</p>	<p>Implemented.</p>
<p>4. Agriculture</p>		
<p>a) Output Prices. To increase production and rural incomes.</p>	<p>Gazetting a two-payment price system for smallholder tobacco, with pre-planting price of not less than 45% of a rolling 3 years average of auction prices, and a second payment at the end of the marketing season.</p>	<p>Implemented.</p>
	<p>Continuing annual price review and submitting the recommendations of the review to the Bank for comments at least 21 days before the announcement of revised prices.</p>	<p>Implemented.</p>
<p>b) Output Marketing and Input Distribution. To improve efficiency through expanding the role of the private sector.</p>	<p>Increasing the margin provided at ADMARC receiving markets to at least 20%; increasing the number of receiving markets to 35.</p>	<p>Implemented.</p>

Policy Issues and Objectives	Actions to be Taken Under ASAC	Action Taken
	Differentiating fertilizer prices to provide a trading margin of at least 5% for a minimum of 200 kg purchased from ADMARC receiving markets; and allowing bonafide groups of smallholders (or agents appointed by such groups or by ADMARC) to buy fertilizers at the differentiated price for their own use or for selling to other smallholders.	Not implemented.
	Carrying out a study to identify ways to facilitate participation by the private sector in seed cotton marketing.	Not carried out.
	Allowing private sector's participation in seed cotton marketing.	Implemented.
c) Fertilizer Procurement and Financing. To ensure adequate and timely supply of fertilizers.	Continuing preparation of a rolling 5-year fertilizer requirement projections.	Implemented.
	Introducing quarterly payments of budgetary subventions to SFFRFM for fertilizer subsidies due from the Government.	Implemented.
	Completing and submitting to IDA for review a study to improve the management of SFFRFM as may be necessary.	Implemented.
d) Rationalization of ADMARC Funding and Functions. Improve ADMARC's ability to carry out price stabilization functions by continuing its divestiture program relieving it the responsibility for financing non-commercial activities, and ensuring appropriate prices policy.	Continuing ADMARC's divestiture program.	Implemented.
	Implementing agreement between ADMARC and Government under which the Government will take over the financing of ADMARC's functions related to Government's development and food security objectives.	MOU only signed in Dec. 1993, implementation progress thus uncertain.

Policy Issues and Objectives	Actions to be Taken Under ASAC	Action Taken
	Setting prices of crops handled by ADMARC so that ADMARC's individual crop accounts at least breaks even on average over a period of three years.	To be verified on the basis of results for a 3-year period.
	Implementing a commission agent system for ADMARC market centers that are financially inviable due to low throughput and which can be made financially viable through such a system.	Not implemented because of lack of interest on the part of private traders.
e) Maize Research Focus. Increase smallholder productivity, improve food security and release land for non-food crops.	Shifting maize research focus and budget and implementing the 5-year action plan to develop high yielding flint maize.	Implemented.
f) Cash Crop Allocation. To increase smallholder productivity and cash incomes.	Amending the tobacco growing and selling regulations to allow smallholders to grow burley tobacco under customary land tenure.	Implemented.
	Licensing at least 5,000 smallholders to grow burley tobacco in areas where at least 75% of the farmers have land of less than 1 ha.	Implemented.
	Reaching agreement with IDA on the marketing system for smallholder tobacco.	Implemented.
g) Land Allocation and Use. To slow down decline of farm sizes in smallholder areas and to increase efficiency of land use among estates.	Amending Land Act to halt transfer of land from customary areas to estates, except in areas of low population density and experimental farms beneficial to smallholders; and cases involving conversion of established customary rights to formal rights.	Implemented (but with caveats).

Policy Issues and Objectives	Actions to be Taken Under ASAC	Action Taken
	Amending Land Act to enable adjustment of estate land lease rent at intervals of not more than 3 years.	Implemented.
	Announcing, through the official Gazette, an increased estate land lease rent of up to at least MK 20/ha to be effective in April 1991.	Implemented.
	Implementing a system to collect estate land lease rents through tobacco auction.	Implemented.
	Sending bills to estates for the payment of the increase rent of MK 20/ha with effect from April 1991.	Implemented.
	Undertaking a study to establish a basis for differentiating estate land lease rent according to land quality.	Not carried out.
	Introducing differentiated estate land rents at a weighted average at least equal to the 1986 level in real terms.	Not implemented.
	Establishing estate extension service as an autonomous trust body under the auspices of Tobacco Association of Malawi.	Implemented.
h) Establishing of Woodlots. To protect environment.	Strengthening inspectorate staff of Department of Lands to enforce establishment of woodlots by estate, except in cases where estates are able to obtain fuelwood from forest plantations and private sources.	Not implemented.

MALAWI: Agricultural Sector Adjustment Credit (Cr. 2121-MAD)
Annex 3: Policy Agenda Action Matrix (State of Implementation)

Policy Issues and Objectives	Actions to be Taken Under ASAC	Action Taken
<p>i) Food Security. To improve nutritional and health standards.</p>	<p>Initiating implementation of the UNDP-funded pilot schemes to best ways of targeting fertilizer subsidies and agricultural credit to the food deficit household; and locating the growing of burley tobacco by smallholders in areas where at least 75% of farm holdings are less than 1.0 ha.</p>	<p>Implemented.</p>
	<p>Ensuring a higher rate of subsidy on high analysis than on low analysis fertilizers.</p>	<p>Implemented.</p>
	<p>Packaging at least 50% of fertilizer supplied by SFFRFM in bags of not more than 25 kg.</p>	<p>Implemented.</p>
	<p>Improve operational guidelines for SGR.</p>	<p>Implemented.</p>
<p>j) Monitoring Social Impact of Adjustment. To analyze poverty issues and assess ways to alleviate adverse impact of adjustment program on the poor.</p>	<p>Strengthening capacity to monitor and analyze impact of adjustment program on the poor.</p>	<p>Implemented.</p>
	<p>Undertaking an integrated household socio-economic survey and studies on poverty issues, including comparative assessment of costs and benefits of fertilizer and direct consumer subsidies for maize.</p>	<p>Being carried out.</p>

PROJECT DATA SHEET

Input:

Date: 24th March 1994
 Name: Vanessa Scarborough

0.1

Report No: 88/93 CP-MLW 23 PCR	Country/FAO Code: MLW 456	Financing Institutions: IDA	Cost: SDR 56.6 million FE:
TITLE: MALAWI: AGRICULTURAL SECTOR ADJUSTMENT CREDIT			
Date: 21 March 1994	Sector: Sectoral Adjustment Credit		Type: PCR
Syst.Code:			Language: English
MISSION MEMBERS: V. SCARBOROUGH (Task Manager), R. SUPPA (Leader), C.G. RAMASUBBU and G. ROZELL (consultants)			
Date of Field Visit: April 1993			
Main Features:			
Objectives: To support the Government's ongoing adjustment program to achieve sustainable growth, food security and reduce poverty.			
Components: - Macro-Economic Reforms - Agricultural Sector Reforms			
Impact: Will be clear only in the medium-term. At macro-economic level, the stabilization actions implemented in 1990 appear to have led to improvement in 1991 in terms of increased GDP, agricultural production and export. The prospects for the following period remained difficult despite the promising agricultural harvest forecast for 1993. In the agricultural sector significant results include the production of burley tobacco for the first time by smallholders; the reduction of fertilizer subsidies; better input distribution and supply; better crop marketing services; introduction of flint hybrid maize varieties.			
Lessons Learned:			Ref. Page No.:
1. More preparatory work to reach commitment by and full agreement between implementing agencies. More coordination during implementation.			
2. Need to address root causes of problems and constraints, in particular those pertaining to market distortions.			
3. Expand smallholder burley tobacco production in relation to export possibilities.			
4. Government to coordinate all pilot targetted interventions to tackle the problem of rural poverty.			
KEY-WORDS:			