

# OED Précis



Operations Evaluation Department

March 1997

## Smallholder-led Growth in Malawi

*In more than a decade of agricultural adjustment programs, the World Bank's policy dialogue in Malawi missed the main issue: giving smallholders an opportunity to participate in the country's development. Handicapped by high taxes, the smallholder sector was effectively excluded from export production and had to rely on subsistence farming. The smallholder sector was used as a source of cheap labor by the estates. A Bank-funded Agricultural Sector Adjustment Credit, approved in 1990, was designed to change all this and give smallholders direct and untaxed access to export markets, particularly for tobacco.*

*The government proved reluctant to carry out the reforms as agreed, and the Bank was faced with a choice: either insist on the full implementation of reforms before releasing funds, or relax loan conditions in the interest of continued dialogue with the government. After a 10-month impasse, conditionality was softened. An audit by OED\* acknowledges that this allowed a continued policy dialogue, albeit at the cost of delayed policy change. The audit draws attention to the rapid progress achieved by a subsequent bilateral project, which made policy reform a precondition for lending.*

### Background

At independence in 1964, Malawi inherited an agriculture system consisting of a few large, foreign-owned, export-oriented estates and a smallholder sector of mostly poor, subsistence farmers. Colonial laws allowed estates to obtain the full value of export sales but prevented

smallholders from producing burley tobacco, the most lucrative export crop, and forced smallholders to sell through the Agricultural Development and Marketing Corporation (ADMARC). The government pursued this policy through the 1970s and 1980s (see table).

ADMARC used its high profits to subsidize the consumer prices for maize and invest in unproductive parts of the economy. At the same time, high taxes on smallholders ensured the success of the estate sector, which depended on an ample supply of cheap tenant labor and low prices for the products of smallholders.

The implied taxation averaged more than 50 percent of smallholders' gross revenues. This effectively excluded half of Malawi's land and 72 percent of its population from development. The resulting low cash crop production by smallholders also increased the country's reliance on estates for export income.

The 1980s saw five Bank-supported policy adjustment operations with a total value of \$200 million, but Malawi's economic performance was disappointing. Per capita income and consumption declined, macroeconomic imbalances persisted, and social indicators remained poor, even by African standards. In 1990 the Bank approved the Agricultural Sector Adjustment Credit, with the goal of allowing smallholders to grow burley tobacco and obtain full value for export sales.

### The project

The project was designed to mobilize a vast reservoir of potential export capacity and remove one of the leading causes of rural poverty in Malawi by changing the role of ADMARC and establishing new rules for the production and marketing of tobacco. The project envisaged a "new deal" for smallholders, who would obtain a substantial portion of market revenues from all tobacco sales and gain access, on a pilot basis, to the right to produce burley tobacco. Since burley tobacco yielded 10 times the income per hectare of hybrid maize (the leading subsistence crop), the reforms promised a strong attack on rural poverty.

The project also continued to support macroeconomic adjustments in line with earlier operations, and added steps to improve the efficiency of land use on estates; divest ADMARC of its noncommercial functions (or ensure their proper budgetary support); revise the Ministry of Agriculture's budget; and redi-

*\* Performance audit report: "Malawi: Agricultural Sector Adjustment Credit," by Wilfred V. Candler. Report No. 15641, May 23, 1996. Available to Bank executive directors and staff from the Internal Documents Unit and from regional information service centers. Précis written by Wilfred V. Candler and Stefano Petrucci.*

**Table: Implicit taxation of smallholder export crops (%)**

Year	Rice	Tobacco	Groundnuts	Beans	Cotton
1980-81	79	84	68	69	53
1984-85	60	22	26	27	73
1987-88	80	73	13	32	50
1991-92	87	55	56	29	73

rect maize breeding towards high-yielding flint hybrids.

### Implementation

The tobacco and ADMARC reforms were preconditions for release of the second tranche of the credit, originally scheduled for December 1990. The government, however, proved reluctant to dismantle the system that granted estates access to cheap labor.

The Bank rejected the alternatives proposed by the government, and the release of the second tranche was suspended. The Bank held its ground for 10 months, but it eventually released the second tranche after the government renewed its promise to implement the agreed reforms. The negotiations coincided with a sharp decline in bilateral aid, as donors became increasingly supportive of the opposition's demands for free and fair elections.

The Bank's action at the time may have been influenced by its awareness that USAID, the donor of a follow-up project, would demand full implementation of reforms as a precondition for disbursements. Another view is that the Bank, thanks to its patient negotiation, achieved a slight relaxation of constraints on the smallholder sector, opening the way for USAID to insist, in the follow-up project, on full deregulation. By keeping communications with the government open, Bank staff be-

lieve they paved the way for a smooth transition to a more democratic regime.

The subsequent Fiscal Restructuring and Deregulation Program supported by the Bank has several concrete achievements to its credit. These include the final abolition of tobacco quotas, liberalization of almost all agricultural input and product markets, and the creation of a land commission.

### Outcome

Actual achievements under the project were modest. Macroeconomic policy reforms were carried out without significant problems, but major sectoral reforms were still on hold when the project closed in 1992.

By 1996, agricultural policy in Malawi was dominated by reforms made under the bilateral follow-up project. Cotton and tobacco marketing have been completely liberalized, the cap on estate payments to tenants has been removed, a floating exchange rate is in place, and limits on tobacco licensing and private maize trading have been removed.

Two output variables highlight the benefits of policy changes initiated by the Bank's project and implemented by the follow-up project:

- *Poverty.* For the first time in 1995-96, the estate sector had difficulty in finding tenants. Demand for tenants has increased their wages, indicating increased prosper-

ity and reduced poverty in the smallholder sector.

- *Tobacco production.* A total of 110,000 tons of burley tobacco were sold at auction in 1995, compared with the initial target of 99,000 tons. The 1996 target was raised to 120,000 tons, a 20 percent increase in Malawi's most important export in one year.

### Lessons

- *Smallholders had to be treated as well as the large estates if poverty was to be reduced and food security strengthened.* Malawi could not achieve its full development potential as long as the smallholder sector was so heavily taxed. Maintaining two systems of land tenure never justified limiting the crops that could be grown or the marketing channels that could be used.

- *The decision to fund a minimal lending program in order to maintain policy dialogue may preclude significant progress towards policy reform.* The Bank can choose between continuing dialogue with a reluctant government or can insist that reforms be preconditions for lending. In Malawi, the Bank opted to keep lines of communication open at the expense of slower and less complete reforms than previously negotiated, but it maintained its role of an honest broker between the government, the donor community, and the political opposition. Even—or especially—with hindsight, Bank staff generally insist that in this instance, the decision to maintain policy dialogue was the right one.

*Editor's Note: The Bank's regional staff have a different view of the credit's impact and believe that the credit made at least as significant a contribution as bilateral programs to advancing dialogue on sectoral issues and policy reforms for Malawi's agriculture.*

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