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PARASTATAL DIVESTITURE:

AGRICULTURAL DEVELOPMENT AND MARKETING CORPORATION

FY1986 AFRICAN ECONOMIC POLICY REFORM PROGRAM GRANT

(612-0227)

USAID/MALAWI

JULY, 1986

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. 612-0227 612-T-602

2. Country: MALAWI

3. Category: CASH TRANSFER

4. Date: August 15, 1986

5. To: Mark L. Edelman, AA/AFR

6. OYB Change Number: AFR-86-81

7. From: Laurence Hausman, AFR/PD

8. OYB Increase: $10,000,000

To be taken from:

9. Approval Requested for Commitment of: $10,000,000

10. Appropriation Budget Plan Code: GDAA-86-31612-A
72-1161021.3 (643-61-612-00-50-61)

11. Type Funding: ☐ Loan ☒ Grant

12. Local Currency Arrangement: ☐ Informal ☐ Formal ☐ None

13. Estimated Delivery Period: 8/86 - 2/88

14. Transaction Eligibility Da: Grant Obligation

15. Commodities Financed

N/A

16. Permitted Source

U.S. only

Limited F.W.

Free World

Cash 10,000,000 (Cash Transfer)

17. Estimated Source

U.S.

Industrialized Countries

Local

Other

18. Summary Description

The AID program encourages and assists the divestiture of the Agricultural Development and Marketing Board's (ADMARC) estate and non-marketing assets to the private sector. Divestitur will improve ADMARC's liquidity situation and help strengthen its capacity to manage agricultural marketing operations.

The program will: (1) ensure a more efficient utilization of resources through the movement o resources from the public to the private sector; (2) inject critically needed foreign exchang into the economy; and (3) increase the amount of credit available to the banking system for lending to private borrowers. The program consists of a $ 15 million cash grant, conditional on divestment of assets, and a $ 500,000 grant for technical assistance, studies and training to help the divestiture program. The cash grant will be provided in two tranches, one of $ 1(million and one of $ 5 million. The kwacha equivalent of the $ 15 million cash grant will be used by the GOM to finance MK 27 million of its MK 46.6 million requirement for the purchase of the Strategic Grain Reserve from ADMARC. $ 10 million of the grant is being approved in this document.

Prior to the first disbursement under the grant, or to the issuance by A.I.D. of documentatio pursuant to which disbursement will be made, the GOM will, except as the parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

Clearances		Date
DAA/AFR: ESaiers		8-14-86
AFR/GC: A. Mattice	AM	8-14-86
AFR/SA: RCarlson		8-14-86
AFR/DP: JPatterson		8-14-86
FM/PAFD: E. Owens	EO	8-14-86
AFR/PD/SAP: WStickel		8/14/86

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: Mark L. Edelman

Date: 8-15-86

Title: ASSISTANT ADMINISTRATOR

1120-1 (5-82)

CLASSIFICATION:

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I. EXECUTIVE SUMMARY

A. Program Objectives and Expected Policy Reforms

The goal of this US $15.5 million African Economic Policy Reform Program is to assist Malawi in its efforts to re-establish a stronger financial and institutional basis for sustained economic growth. The program addresses the following specific objectives:

(1) Ensure a more efficient utilization of resources through the movement of resources from the public to the private sector;

(2) Inject critically needed foreign exchange into th economy; and

(3) Increase the amount of credit available to the banking system for lending to private borrowers.

To accomplish this, the program focuses on the divestiture of the Agricultural Development and Marketing Corporation's (ADMARC) investments in agro-industry, manufacturing, transportation and finance. The total value of ADMARC's equity share holdings in these firms is MK 46.6 million (US $25.9 million). Through this policy reform program, the Government of Malawi (GOM) has agreed to a minimum of MK 30 million (US $16.7 million) in divestiture, which represents 64 percent of ADMARC's investment portfolio. This will help strengthen ADMARC's capacity to manage its agricultural marketing operations. The program also encourages the GOM to move toward the eventual divestiture of MK 45 million (US $25.0 million) or 97 percent of the holdings.

B. Program Description and Anticipated Impact

The program is divided into a US $15 million cash grant element and a US $0.5 million grant for technical assistance and training to support the attainment of the program's objectives. The foreign exchange will provide urgently needed additional resources to ease the inflationary pressures caused by increased short-term borrowings by the GOM which have resulted from its efforts to ease ADMARC's liquidity crisis. These borrowings have the agreement of both the World Bank and the IMF and are expected to be covered by further concessional foreign assistance. The GOM will use the local currency counterpart funds from the foreign exchange to finance MK 27.0 million of its MK 46.6 million requirement for the purchase of the strategic grain reserve and silo storage complex from ADMARC as part of its commitment to the third Structural Adjustment Lending program.

The program should have a positive impact on the economy and improve ADMARC's operations.

(1) Through the transfer of parastatal shareholdings to the private sector the management of resources will be more responsive to price signals and be motivated to use human, financial and physical resources more effectively.

(2) As ADMARC's portfolio is streamlined, management of both its marketing operations and any remaining agro-industrial holdings should be strengthened.

(3) There will be an increase in the amount of capital available for investment because of the liquidation of ADMARC's outstanding loans as holdings are purchased by private businesses.

(4) Malawi's balance of payments will be improved as funding tranches are released.

C. Conditions Governing Release of Funds

The release of US $10 million is conditional on a minimum of MK 30 million of divestiture of ADMARC's equity share holdings in agro-industries, manufacturing, transportation and finance. The funds will be disbursed at a ratio of US $1.00 for MK 3.00 of divestiture as the sale of these assets to the private sector occurs. These funds support the GOM's decision to proceed with the liquidation of share holdings in six firms and provides an incentive for this to be done as rapidly as possible.

The conditions governing the release of the balance of US $5.0 million provides two options or a combination of both with respect to the MK 16.6 million in equity share investments which will remain after the divestiture of MK 30.0 million. Option one encourages the GOM to continue with the divestiture of a further MK 15 million in equity holdings. If this is done, the conditions governing the initial US $10.0 million are applied. Option two permits the GOM to have access to these funds once a strategy is developed and adopted for handling any assets which remain following this divestiture program. Rather than prescribing what this strategy should be, AID has described a series of factors which need to be taken into account in arriving at the strategy. These factors promote maximum

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participation of the private sector in the ownership and management of the remaining assets and the establishment of managerial responsibilities and financial controls and liabilities which are independent of ADMARC. They are essentially designed to ensure that the conditions which caused the current liquidity crisis will not recur in the future.

Given the relative thinness of Malawi's capital market, the program also provides for a series of studies to explore ways in which the capital market can be broadened and strengthened to tap additional domestic and international private sources of investment capital. The studies are likely to deal with interest rate policies, regulations governing commercial banks and financial institutions, establishment of a market mechanism for the exchange and transfer of public shares and government bonds, and ways to promote various schemes such as pension programs to generate additional sources of capital. Funding for these studies will come from the US $0.5 million technical assistance component of the program.

II. BACKGROUND

A. The Macroeconomic Framework

1. Economic Growth (1964-1978)

At independence Malawi had one of the lowest incomes in the world, limited infrastructure and little trained manpower. The major assets of the country were moderately fertile soil and a favorable climate. To develop these resources, Malawi adopted an outward-looking, export-oriented development strategy based on agriculture. This included substantial foreign investment. The private sector played a major role in this market-oriented economic framework while the government concentrated on development of infrastructure and area development programs for smallholder farmers.

The strategy worked well. Real GDP grew at an average annual rate of 6 percent for 15 years, domestic savings and investment grew rapidly and there was diversification within agriculture as production of tobacco, tea, sugar, coffee and cotton rapidly expanded.

Flaws in the economic structure were also developing, although the 15-year period of economic growth was basically well founded and a particularly notable feat for a small, landlocked, least developed economy. Exports were concentrated in three commodities: tobacco, tea, and sugar. Investment had risen at a high rate, but a considerable portion of investment was in two large capital projects (construction of the new capital city of Lilongwe and its international airport) with low economic rates of return. Commercial institutions of a quasi-government nature proliferated with increasingly close and complex relationships with the banking sector. The government sector expanded more rapidly than did the rest of the economy.

The tax ratio to GDP rose from 10 percent in 1970 to nearly 20 percent in 10 years;

Government expenditures increased by 10 percentage points per annum over the decade of the 70's while constantly exceeding revenues;

The public sector's share of total fixed capital formation rose from 54 percent in 1973 to 70 percent by 1979;

The share of government and official entities in domestic credit increased from 10 percent in 1970 to 44 percent by 1980.

The stage was set in 1978-1980, when drought, disruption of overland transport links and adverse terms of trade combined to bring about a severe economic recession.

2. Economic Recession (1979-82) and Recovery (1983-85)

After fifteen years of growth the Malawian economy experienced a serious recession starting in 1978-79. Although production started to recover in 1982, 1985 saw GDP slump again. Significantly, the economy continued to be burdened by debt from the recession period and some of the causes for the recession remained a drag on growth. The origins of the recession were external. In addition to a major international recession, the shortest rail links to the sea through Mozambique were closed. The additional estimated $50 million per year in freight costs and the associated delays reduced the competitiveness of Malawian exports. The drought of 1979 and 1980 required that maize be imported into a country which ordinarily was a surplus producer. During the same period net long-term capital inflows declined.

The economic recession highlighted several structural problems which made recovery more difficult and greatly increased the need to restructure the economy. Some of the more significant problems were a weak managerial and financial structure in the industrial and agricultural sectors; excessive reliance on price controls, including agricultrual pricing; and weaknesses in several important parastatals and quasi-public corporations.

Real GDP (at constant 1980 prices) fell at an average annual rate of 9.7 percent between 1979 and 1982, then resumed growing at an average rate of 3.4 percent per annum between 1982 and 1985. With a 3 percent population growth rate, real GDP per capita declined over 7 percent between 1979 and 1984 although GDP growth was a robust 7.6 percent in 1984. Consumption remained more or less constant but increased slightly as a proportion of total demand between 1979 and 1982 as GDP was falling. With GDP stagnant and donor flows (foreign savings) falling, the share of investment in GDP fell drastically from a peak of 31 percent in 1978, to 16 percent in 1981. Whereas GDP rebounded in 1983 and 1984, investment remained depressed at only 14 percent of GDP in 1985.

The balance of payments was profoundly affected by the recession and the decline in donor flows. The deficit on current account increased from the preceding five-year average of 11 percent of GDP to 15 percent over the 1979-82 period. The current account deficit reached historical peaks in 1979 and 1980, in the range of 22.5 percent of GDP. The current account deficit declined to the range of 7 percent by 1984 when stocks were exported after having accumulated during 1983 because of the transport stoppage.

One response to the rising current account deficit was a major cutback in the volume of imports which, after peaking in 1979 declined 50 percent by 1984. The largest import reductions were in investment goods and construction materials, but imports of intermediate and consumer goods fell as well. Export growth during the recession period was erratic but generally favorable as export prices tended to increase, led by tobacco and sugar in 1981 and tea in 1984. Export volumes, however, fell between 1980 and 1983 then rose again in 1984. The end result was an average annual growth rate of about 8 percent per year between 1979 and 1984.

Another response to the balance of payments situation was an increase in external borrowing at commercial rates: external debt increased from approximately $550 million in 1979 (53% of GDP) to $775 million (67% of GDP) by late 1982. The debt service ratio doubled from a level in the range of 20 percent to near 40 percent (after debt relief). As the deficit in the overall balance of payments persisted through 1983, the country's reserves were drawn down from the desired level of three months to less than one month of imports.

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The 1979-81 recession was also reflected in the government budget as the deficit (as a percentage of GDP) expanded after 1979 to reach 16.5 percent in 1981 then fell back to its historical level in the range of 8 percent by 1985. Although revenues from income taxes and customs duties started to fall rapidly in 1979, expenditures increased as interest payments increased. Development expenditures (18 % of GDP in 1981) rose through the 1970s to 1981 after which they were cut drastically (to 7.5 percent by 1985) as the government instituted its adjustment program. The stress on the government budget also increased starting in 1980 as the ten major parastatals began to incur losses and were unable to service their government-backed foreign debts.

The inflation rate increased relative to previous periods although it has tended to vary appreciably over time (it averaged about 8% during the 1970s up to 1979). In 1979 inflation (based on the annual change in the consumer price index) was 11 percent, but it doubled in 1980 then declined to about 12 percent for the next three years before increasing again to 20 percent in 1984. Increases in the rate of growth of the money supply contributed to the higher inflation rates but prices were also pushed up by sharp upward changes in the prices of imports, higher transport costs and the depreciation of the Malawi Kwacha by 44 percent (against the dollar) between 1980 and 1984. Average annual growth in money and quasi-money was 9 percent between 1973 and 1978 during which period there were two years of appreciable monetary contraction. Between 1978 and 1984 the average increase jumped up to 26.4 percent per annum, abetted by a 40 percent change in 1979. The main contributor to the expansion in domestic credit during this period was credit to the government as it borrowed to cover deficits. The government reduced its demand for credit in 1982 but there was a 35 percent increase in the money supply between 1983 and 1984.

The overall economic outlook to 1990 for Malawi, according to World Bank estimates, is for a 3.7 percent annual GDP growth in real terms. Agriculture should grow at about 3.5 percent; industry near 4 percent; and the other sectors at rates somewhat less than 4 percent. To achieve these growth rates, however, fixed capital formation must increase from around 13 percent of GDP in 1984 to about 15.5 percent by 1990 and capital must be used more efficiently. Domestic savings will need to rise from 14.1 percent of GDP (in 1979-84) to 15 percent; for this to happen the public sector needs to become a net saver rather than a net dissaver and the budget deficit must continue to fall.

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B. Policy Framework--Period of Structural Adjustment

1. Structural Adjustment Program I

The GOM, in consultation with the World Bank and the IMF, started to formulate a medium-term structural adjustment program when it became clear in 1980 that the conditions causing stagnating growth, growing domestic and foreign deficits and borrowing were not transitory. The restructuring program was designed to run through 1986. The strategy was a classic one of short-term stabilization measures to moderate the growth of aggregate demand using IMF stand-by arrangements (until 1983) and a medium-term structural adjustment program with the objective of increasing aggregate supply. The latter effort got underway with a World Bank $45 million Structural Adjustment Loan (SAL I) initiated in June 1981.

SAL I encompassed policy changes in four areas:

(1) The balance of payments--stress was put on increasing exports by such measures as higher prices for export crops, a larger recurrent cost budget allocation for the Ministry of Agriculture and a variety of studies to increase efficiency and to diversify agricultural producton.

(2) Prices and incomes systems--greater flexibility was to be introduced in wages, utility and transport prices by introducing more frequent adjustments. Associated studies were also initiated and the exchange rate was more closely monitored.

(3) Management of resources--this stressed changes in borrowing and debt management, more flexibility in interest rates, and a larger share of resources for directly productive activities.

(4) Institutional improvement--this included the establishment of an Investment Coordinating Committee to oversee all major investments; technical assistance to planning and budgeting ministries and restructuring of Press Holdings.

2. Structural Adjustment Program II

SAL II, a $55 million program, started in December 1983 and an Extended Fund Facility (EFF) was initiated in the same month. The EFF was approved by the IMF in September 1983 for approximately $100 million. The objectives were to establish medium-term balance of payments sustainability within three years, while returning to a higher growth rate and a lower inflation rate. The Malawi Kwacha was devalued by 12 percent in September 1983 and tied to a basket of currencies in January 1984, with a further devaluation of 3 percent. Because the schedule of drawings was interrupted in 1984 and 1985 the program was rescheduled and the total amount reduced to SDR 81 million.

SAL II essentially continued the work started under SAL I with an emphasis on implementation of the plans developed in the previous two years. The government also agreed to eliminate the subsidy on fertilizer by 1985/86 and to continue work on reorganizing the Agricultural Developoment and Marketing Corporation (ADMARC), the Malawi Development Corporation (MDC) and Press Group.

Substantial changes were achieved in pricing policy. The prices of agricultural export commodities are being raised and price controls have been removed from 47 of 56 price-regulated items. The effectiveness of the higher commodity export prices was demonstrated as sales to ADMARC of tobacco, cotton and groundnuts, increased by factors of 3, 3 and 2.5 respectively between 1983/84 and 1985/86.

Starting in 1984 a number of measures were enacted to restructure Press Group, a private holding company encompassing numerous manufacturing, service firms and estates. At the time of the restructuring Press was heavily in debt to the commercial banks and to ADMARC. Press' excessive debts were transferred to the government, a new Chief Executive Officer (CEO) was appointed with a strong reform mandate and the investment portfolio was restructured in a series of share exchanges with ADMARC and MDC (See Annex C for details). MDC also underwent a reformation in 1984 including the selling of MK 4.8 million of assets, converting about MK 13 million in debt to the government into equity, arranging to pay its remaining debt and strengthening its project staff. As a result, MDC has been able to resume its main function of attracting investment for new projects and turning over its existing investments to produce cash for new projects.

The large, three-way exchange of holdings among Press Group, ADMARC and the MDC in 1984 and 1985 resulted in a rationalization and concentration of assets. The end results for ADMARC were that its holding portfolio was more concentrated in agricultural-related enterprises and that it had given up several profitable enterprises in exchange for several loss-making enterprises.

3. Structural Adjustment Program III

SAL III was initiated in December 1985 and is scheduled to run to September 1987. (SAL III was initially a $100 million program but its dollar value has appreciated to approximately $130 million reflecting the higher dollar value of the yen and Deutchmark components). The program continued to stress price increases for agricultural exports and reduction in price controls, liberalization of industrial licensing regulations, and liberalization of constraints on imports which competed with domestically produced products.

A tax study was undertaken with the intent of examining broadening the tax base and reducing rates; shifting taxes from external trade to domestic trade and from production to consumption taxes; and tax simplification. The tax study has been completed and accepted by the GOM. The GOM, with Bank assistance, is now arranging for technical assistance to facilitate implementation of the reforms.

Although the government increased fertilizer prices, its efforts under SAL II to reduce the fertilizer subsidy were outstripped by increased transportation costs because of closing of the Mozambican routes. In 1985, AID took the lead in this effort with the Fertilizer Subsidy Removal Program. Under this program a schedule for reduction of the subsidy through 1989 was adopted with complete removal of the subsidy by 1990. It is anticipated that the increase in farmers' unit costs will be offset by importing fertilizer in more concentrated form. AID has funded a demonstration program for using the new, high analysis fertilizer.

The present status of SAL III is that a World Bank mission reviewed the program in June 1986 to prepare recommendations for the second tranche release. It was found that progress had been made in most of the areas under the SAL program. Smallholder producer price proposals were considered to be appropriate to encourage crop diversification and export expansion, price decontrol was deemed completed with only five items of a critical or strategic nature remaining regulated, and an action plan was formulated for ADMARC asset rationalization. Some work remains to be done concerning the calculation of the fertilizer subsidy, export promotion and estate management training and extension.

Under the first two SAL programs the GOM took steps to reorganize ADMARC, MDC and Press Group. The effort concerning ADMARC was least successful. After earning large profits in the 1970s, ADMARC by 1984/85 was confronted with a serious lack of

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liquidity. The reasons for this had to do with costs associated with establishment and maintenance of the strategic grain reserve, poor management of tobacco marketing and a high producer price for maize.

ADMARC's marketing operations have greatly expanded since 1980. The volume of produce and inputs almost doubled between 1980 and 1985 and the payments made to the rural sector tripled from MK 27.8 to MK 84 million between 1981 and 1985. At the same time there was a major shift toward maize, a shift for which ADMARC's transportation and storage systems were ill suited. ADMARC incurred additional costs because of the closing of the shorter transport links through Mozambique and the establishment of the strategic grain reserve (SGR). In spite of these adverse changes, ADMARC's costs--including the SGR--as a percentage of material handled, did not increase appreciably; thereby, demonstrating ADMARC's strong inherent operating management capabilities. The data on cost ratios are shown in Table 1.

Table 1. ADMARC Cost Ratios

	1979/80 to 1980/81	1981/82 to 1984/85
Selling expenses/ Gross sales	6%	4 to 8%
Crop purchases/ Gross sales	47 to 50%	47 to 68%
Buying expenses	31 to 32%	22 to 31%
Net admin. expen	8 to 9%	7 to 11%
Net profits	less than 1%	7 to 20%

Source: World Bank, ADMARC Rehabilitation Report, Dec. 1985

4. Structural Adjustment Program IV

SAL IV is still in the planning stages. SAL II can be characterized as establishing targets in key areas such as agricultural exports, export diversification, the national budget and parastatals. SAL III concentrated on provision of technical assistance to design programs in these key areas. The general thrust of SAL IV will be to assist in establishing the institutions to administer the programs.

C. The Structure of Malawian Business and Financial Sectors

1. Business and Financial Organizations

Business enterprises in the Malawi economy fall into the broad categories of publicly owned statutory bodies, variously owned commercial banks, internationally owned development institutions, and the holding company, Press Group, which until recently was wholly owned by the Life President. A number of these organizations were in place prior to independence and formed the basic structure of the Government. They are British and South African in origin and were continued without significant change (See Annex A for a detailed description of these).

Shortly after independence in 1964, several special-purpose organizations were added to those inherited. The Malawi Development Corporation (MDC) was one of the first and was patterned on the International Finance Company (IFC) and Press Holdings established by the Life President.

The Farmers Marketing Board was the predecessor to ADMARC. In 1970, in an effort to increase agricultural productivity, the marketing function of the Board was expanded to include developmental farms designed to introduce new techniques and crops. The Board was renamed the Agricultural Development and Marketing Corporation (ADMARC). ADMARC now owns and operates over 13 estates, spread throughout the country and producing a wide variety of crops and livestock. In addition, ADMARC performs its original functions of providing inputs to the agricultural community and collecting, transporting, and marketing the production of smallholders, estates, and commercial farms. In addition, over time it became involved in a wide array of agricultural-related, industrial and commercial investments as an outgrowth of its development mandate.

The investments of these indigenous business development enterprises were complemented by those of the Commonwealth Development Corporation (CDC). CDC had operations in many parts of the world before Malawi's independence, and served as an example of profitable development activities, combining the discipline of private enterprise with humanitarian concerns. From CDC's activities in Malawi sprang the idea for a multinational financial institution, the Investment and Development Bank of Malawi, LTD. (INDEBANK).

INDEBANK was formed in 1972 with shareholders from the United Kingdom (CDC), Netherlands, Germany, and Malawi (ADMARC). In 1978, the IFC joined the original group of shareholders, thus increasing the capitalization.

In addition to these five investment groups, the commerical banking sector provides the short-term funding necessary for commercial activity. The National Bank of Malawi was formed in 1971 by merging Barclays Bank and Standard Bank, both in competition prior to the merger. After the merger, each had a 10 percent share, while Press took 47.4 percent and ADMARC 32.6 percent. National Bank of Malawi is the larger of today's banks. The Commercial Bank of Malawi was originally formed in 1969, with the Banco Pinto da Soto Mayor of Portugal owning 60 percent, MDC 20 percent, and Press 20 percent. Around 1975, ownership was changed, and the Portuguese interests were taken over. The restructured ownership includes Press with 40 percent, Bank of America with 30 percent, MDC with 20 percent, and ADMARC with 10 percent.

These corporate and financial organizations had many common characteristics. First, they tended to have highly leveraged capital structures. This is obviously a function of the original scarcity of capital. Second, there is the practice of risk sharing. It is not uncommon for many of the corporations in the country to have common shareholders and, in some instances, common directors. Management talent is frequently transferred from one corporation to another. Third, there is the inclusion of a foreign partner. This is evident in most of the larger concerns and provides external capital, markets, management and technology. Finally, each enterprise has a goal and a purpose very much its own, despite its ownership. Business decisions are frequently made with the interests of the company foremost in mind rather than those of the shareholders. For example, when the Import and Export Company of Malawi, owned 51 percent by MDC and 49 percent by Press, made a profit last year not all of it was paid out in dividends despite the critical need for liquidity by both MDC and Press.

2. Savings and Investment

Domestic savings and foreign capital resources provide the necessary funds to finance the development of new agricultural and nonagricultural enterprises. Foreign savings are important, because a developing country cannot readily generate sufficient savings from domestic resources to accelerate development.

At the time of Malawi's independence in 1964, capital resources were extremely scarce. Domestic savings were negative. The government could not finance its own recurrent budget. Imports of goods and nonfactor services exceeded exports of goods and nonfactor services by 25 percent of GDP.

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Between 1964 and 1980, overall savings increased by 358 percent. Government savings went from -12.5 percent of GDP to +1.8 percent and the resource gap decreased to 13 percent of GDP (See Table 2). Throughout the post-independence period, private sources have accounted for approximately one-third of savings. Since independence, foreign resources largely in the form of concessional assistance have been critically important to Malawi's development, averaging over the period 1964 to 1980, 57 percent of total savings. However, at independence it accounted for nearly 85 percent of savings and fell to 35 percent between 1976 and 1978. This was largely due to the growth of savings by the GOM and capital inflows from public enterprises.

Table 2: Sources of Savings, 1964-1980 (Percentage Share)

Year	Government	Public Enterprise	Private Monetary	Private Smallholders	Foreign
1964-66	-33.8	4.6	38.2	6.2	84.8
1967-69	-16.6	5.5	31.6	5.3	74.2
1970-72	0.7	12.9	33.1	2.9	50.4
1973-75	10.7	12.7	26.9	2.5	47.2
1976-78	10.2	15.6	36.6	2.2	35.4
1979-80	13.5	-0.3	34.3	2.1	50.4
Mean	-2.2	8.5	33.5	3.2	57.0

Source: Table 5, The Private Sector and the Economic Development of Malawi. AID Evaluation Special Study No. 11, U. S. Agency for International Development, March 1983, p. 17.

Most of the savings from public enterprises were accounted for by ADMARC. These savings represented ADMARC's trading margins, the difference between the prices it paid for smallholder crops and the prices for which it sold them. In the earlier years when producer prices were low relative to international prices, this was in effect a tax on the smallholder. Although private sources of savings have averaged about one-third of total savings, they are the largest domestic source of savings. However, a significant percentage of private savings come from large firms, many of which are owned or partially owned by the three major holding companies in which Government has substantial involvement - Press Group, MDC and ADMARC.

The share of the public sector in total investment has been relatively high (Refer to table 3). There has been a trend toward an increase in the share of government investment while public enterprises has decreased over time.

Table 3: Malawi Share of Investment Expenditure 1964-1980
(Percentages)

Year	Government	Public Enterprise	Private Monetary	Private Subsistence
1964-66	NA	52	42	6
1967-69	31	18	46	5
1970-72	26	24	47	3
1973-75	38	16	43	3
1976-78	39	22	37	2
1979-80	53	10	35	2

Source: Table 7, The Private Sector and the Economic Development of Malawi, AID Evaluation Special Study No. 11, U. S. Agency for International Development, March 1983, p. 23.

As this brief discussion of Malawi's business and financial sectors indicates, the primary sources for channelling domestic savings and foreign exchange earnings into investments in agriculture and industry have been the three major investment holding companies - Press, MDC and ADMARC. Although the commercial banking system became involved in the late 1970's in equity lending, its financial position was severely compromised by a series of poor investments. Since then the banking system has retreated to its former position of largely relying on investments in government bonds. It is true that the funds from the banking system have found their way back into private sector investments to the extent that funds have been lent by government to ADMARC and the government has assumed the debts of

Press and MDC through the restructuring which occurred under SAL I and II.

ADMARC has played a critical role in capital formation. With the substantial profits on its trading accounts in the early 1970's largely the result of low buying and high selling prices, it was able to channel substantial amounts of resources into new agricultural and industrial investments. ADMARC essentially mobilized the savings from the smallholder sector for investment in agricultural and industrial development. In the next section, the discussion will focus on what went wrong with this strategy resulting in ADMARC's present liquidity crisis. It is, however, important to keep in mind that any solution to this crisis must take into account the underlying thinness and weakness of Malawi's financial and corporate institutional structure.

D. The Macroeconomic Rationale for the Program

The underlying reasons for the Program Grant and its general design were described in the preceding two sections. The divestiture aspect of the Program is one part of a larger restructuring program which has been underway since SAL I, continued on through SAL III and will be part of SAL IV. One major aspect of the Malawian structural adjustment program is reducing the size and scope of ADMARC and placing the institution on a more market oriented basis.

Simultaneous with the structural adjustment process, there has been a concerted effort, led by the IMF, to stabilize the Malawian economy and to maintain any gains. This Program Grant bridges these restructuring and stabilization efforts. The Program itself, as expressed in the conditions, pertains to the restructuring side while the $15 million grant applies to the macro economic stabilization aspect. As part of the restructuring of ADMARC, the government has agreed to relieve ADMARC of the responsibility for the strategic grain reserve (SGR) and the Smallholder Fertilizer Revolving Fund (SFRF). The purchase of these activities and the revenues from the sale of the investment portfolio should give ADMARC an adequate cash reserve to carry out its seasonal purchasing program during the harvest and allow ADMARC management to concentrate on implementing reforms in ADMARC itself.

The macroeconomic/economic stabilization aspect relates to the IMF performance criterion which restricts the growth of government debt. In principle the GOM could finance the purchases from ADMARC by borrowing or by use of budget resources. But the GOM is already running a budget deficit and therefore does not have the latter option. The government cannot borrow externally because of constraints on foreign borrowing. The remaining alternative would be to borrow from the banking system. However the resulting expansion in credit translates into an excessive rate of expansion of the money supply and, therefore, an increase in the rate of inflation. Besides being economically harmful in itself, the resulting inflation would also adversely affect the balance of trade.

The alternative is a foreign grant, i.e., this $15 million Program Grant. (This amount covers a substantial part but not all of the GOM expenditure requirement). The transfer of the $15 million to the GOM enables it to purchase the SGR and the SFRF, free up ADMARC to concentrate on marketing, and not aggravate the economic stabilization effort. Conformance with the IMF expenditure performance criterion per se is less important than the fact that the injection of the $15 million allows the restructuring to proceed without losing ground in the economic stabilization effort.

E. ADMARC's Liquidity Crisis

The deterioration in ADMARC's liquidity position occurred gradually, starting in the late 1970's. The main causes relate to the marketing of tobacco, cotton and maize, losses on the investment portfolio, subsidies on seed and fertilizers, and price controls. Each of these causes is discussed briefly below. A more comprehensive discussion is in Annex C.

1. Marketing of Tobacco

Over the years, ADMARC has depended on tobacco trading for its profit. Tobacco profits have offset the losses incurred on other crops, particularly maize.

In 1985, ADMARC suffered a serious loss in tobacco revenues due primarily to low auction floor prices. The loss in 1985 was MK 4.36 million compared to a profit of MK 15.7 million in 1984. These losses were critical because ADMARC could not internally finance purchases of other smallholder crops. ADMARC was forced to obtain a loan of MK 26 million from the government and to borrow a further MK 19 million from the Agricultural Development Districts and the Smallholder Fertilizer Revolving Fund to finance non-tobacco crop purchases of MK 65.1 million. The main reasons for the low auction floor prices for tobacco were oversupply and inferior quality.

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Oversupply resulted from increases in ADMARC's tobacco purchasing price coupled with a general relaxation in production quota controls. In 1985, ADMARC bought 19 million kilograms of tobacco against a market requirement of 14 million kilograms. With the increase in suppliers, quality sufferred. The problem was compounded by poor grading of the tobacco at the time it was purchased by ADMARC. The net result was that ADMARC's receipts on the auction floor where less than its disbursements to producers.

As part of the Structural Adjustment Lending program, ADMARC had increased producer prices for tobacco by 22 percent. The price increase further added to ADMARC's financial difficulties.

2. Marketing of Maize

Although ADMARC does not have a legal monopoly on the purchase and selling of maize, it has a de facto one. Most maize offered for sale by the smallholder is purchased by ADMARC and ADMARC is the primary seller of maize to the domestic grain milling companies.

ADMARC sells maize domestically at a price fixed by government.. This price has been less than ADMARC's imputed total cost including handling and administrative costs. The estimated amount of the subsidy in 1985 was 23.4 percent or MK 3.5 million and the estimate for the current year is 26.8 percent or MK 4.0 million. Relative to its purchase price, maize has a high administrative and transport cost associated with it. In fact, most of ADMARC's administrative cost are accounted for by its handling of maize. Historically this loss on the maize account has been made up by profits on the sale of tobacco.

3. Strategic Grain Reserve and Silo Complex

For the 10 years prior to 1981, annual sales of maize by ADMARC ranged from 80,000 to 136,000 metric tons. During this same time, domestic maize sales were, on average, equal to total purchases. The GOM decided to increase the producer price of maize as an incentive to create a strategic grain reserve. In 1982, the producer price was increased 66.6 percent from MK 66 per metric ton to MK 110 per metric ton. As a consequence, ADMARC's purchases of maize went from 136,000 metric tons in 1981 and to 296,000 metric tons in 1984 and 268,000 metric tons in 1985.

The strategic grain reserve is 180,000 metric tons. Its value at purchase price is MK 28.8 million. ADMARC also pays to maintain the reserve which amounts to around MK 420,000 per year. The cost of stock replacement to cover losses is a further MK 2.86 million per year.

The foregone income and the related costs of the strategic reserve have reflected themselves in the increasing overdraft requirements in recent years. The maize stocks, therefore, implicitly cost ADMARC an additional MK 4.8 million per year in interest on its bank overdraft. The current total cost of the grain reserve as estimated by ADMARC is MK 46.6 million.

ADMARC borrowed to finance the the construction of the silo complex and has shouldered the amortization burden of the silos. The annual loan repayment is approximately MK 1.9 million and interest payment in 1985 was MK 1.0 million.

4. Seed and Fertilizer Subsidies

ADMARC sells tobacco, cotton and maize seeds at less than their purchase price including transportation and distribution costs. The estimated subsidy in 1985 and 1986 was MK 0.9 million. In the past, the price for fertilizer has been directly subsidized by ADMARC until the establishment of the Smallholder Fertilizer Revolving Fund in 1982. ADMARC was required to contribute to the SFRF annually both in cash and fertilizer. By 1986, ADMARC had contributed a total of MK 13.5 million. The cash contributions in 1985 and 1986 were MK 5.96 and MK 4.26 million respectively.

5. Investment Porfolio

Since ADMARC's functions were expanded in the early 1970's to include investments in agricultural projects and industry, its equity share holdings have grown to MK 47.0 million. Because the investment portfolio did not perform, ADMARC instead of earning a return on its investments was forced to make loans to the firms and estates it held or managed. This drain further decreased ADMARC's cash reserves. See Annex B for a current list of ADMARC's equity share holdings and loans.

ADMARC's total equity share ownership in agricultural estates is around MK 0.4 million. However, the Corporation has loaned the 13 estates, eight of which are directly owned by ADMARC, MK 4.3 million in mostly noncollateralized loans and invested MK 10.5 million in various agricultural estate projects.

Excluding estates, ADMARC has equity share holdings of MK 46.6 million in approximately 28 enterprises. The overwhelming majority of the holdings are in Dwangwa Sugar Corporation (MK 10.7 million), Sugar Corporation of Malawi Ltd. (MK 9.3 million), David Whitehead and Sons (Malawi) Limited (MK 8.8 million), and Grain and Milling Company Ltd. (MK 5.4 million). These four companies account for MK 34.2 million or 73 percent of its holdings. With the exception of David Whitehead and Sons (Malawi) Ltd, these holdings have also been the source of considerable losses. Therefore, the portfolio is dominated by poor performers.

In 1985, ADMARC received dividend income of MK 1.3 from 11 firms: Auction Holdings Limited, Bata Shoe Company (Malawi) Limited, Cotton Ginners, David Whitehead and Sons, INDEBANK, Lever Brothers, Manica Mann George, National Seed Company, Optichem (Malawi) Limited, PEW Limited and United Transport (Malawi) Limited. Thus, on equity shares of MK 47.0 million, ADMARC earned a three percent return, substantially below the commercial interest rate (10 3/4%) or return on government bonds (16 3/4%).

By 1985, ADMARC had made loans of MK 52.8 million (See Annex B). Of this, MK 43.5 million was in the form of income notes to Press (MK 40.5 million) and INDEBANK (MK 3.0 million). The income note to Press is not producing interest. The total amount of interest received in 1985 was MK 1.0 million or less than 2.0 percent interest on all of its loans and income notes.

The overall financial position of ADMARC's investment portfolio worsened in 1984 and 1985 as result of a three-way exchange of holdings among MDC, Press and ADMARC. Essentially, ADMARC received from MDC and Press their equity shares in agro-related industries and turned over to them some of its holdings in other industries. The actual firms involved in the swap are discussed in Annex C.

F. Strategy to Resolve ADMARC's Liquidity Crisis

The GOM is in the process of implementing a number of policy reforms to overcome ADMARC's liquidity crisis. These reforms are supported by the World Bank under SAL III and by USAID under the Fertilizer Subsidy Removal Program. The following is a brief summary of these reforms.

(1) ADMARC has instituted tighter controls on the grading and purchase of tobacco.

(2) Producer price increases have been constrained.

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(3) Prices of most seeds with the exception of tobacco have been increased.

(4) The subsidy on fertilizer is to be gradually phased out by the 1989/90 crop year.

(5) The Government of Malawi has agreed to purchase the strategic grain reserve and reimburse ADMARC for the capital investment in the silo complex. Agreement has also been reached for the government to pay ADMARC for managing and maintaining the reserve on its behalf.

(6) Price controls on the selling of maize to the milling companies are being reduced.

(7) The government has agreed to undertake a series of studies related to the opening of agricultural marketing to private traders, and the determination of minimum stocks required for meeting its strategic grain reserve requirements.

(8) Agreement has been reached to begin the process of divestiture of the majority of ADMARC's portfolio and the rationalization of the remaining assets.

These reforms will substantially improve ADMARC's ability to meet its financial obligations. They will also relieve ADMARC of the burden of maintaining strategic grain reserves which are kept for national and regional security purposes. Furthermore, the elimination of subsidies and price controls and the opening up of agricultural markets to private traders will significantly improve the competitiveness of the agricultural sector.

III. PROGRAM DESCRIPTION

A. Goal and Purpose

The goal of this US $15.5 million African Economic Policy Reform Program is to facilitate the resumption of sustained economic growth. To accomplish this, the program will:

(1) Ensure a more efficient utilization of resources through the movement of resources from the public to the private sector;

(2) Inject critically needed foreign exchange into the economy; and

(3) Increase the amount of credit available to the banking system for lending to private borrowers.

B. Implementation

The program is divided into two components. The first is a US $15.0 million cash grant and the second US $0.5 million grant for technical assistance and training. The release of the cash grant is governed by conditions surrounding the divestiture of MK 30 million of ADMARC's MK 47 million in equity share holdings and the establishment of an economically sound strategy for the handling of the remaining MK 17.0 million equity share portfolio including a further divestiture of MK 15 million. The technical assistance and training element will be utilized to support the divestiture and portfolio rationalization process.

1. Conditions Governing Disbursements of the US $15.0 Million Cash Grant

a. US $10.0 million for Divestiture

US $10.0 million will be released when the following conditions have been satisfied. It is anticipated that these conditions will be met within one to four months of signing the Grant Agreement.

(1) Divestiture of Malawi Kwacha 30.0 million (US$16.7 million) Worth of Equity Shares in Non-estate Holdings

For purposes of complying with this condition, the value of assets will be based on (1) ADMARC's March 31, 1985 financial statement or (2) the actual sales agreement whichever amount is higher. In addition, a sale will be considered consummated upon signing of a legally binding sales agreement with the buyer(s) on any date after June 20, 1986.

Liquidation of assets through transfer or sale to another parastatal or to the Government of Malawi will not count toward satisfying this condition.

The amount of the US $10 million to be released will be determined by the ratio of US $1.00 for each MK 3.00 worth of assets liquidated. For example, if MK 21.0 million in assets were disposed of, the Government of Malawi would have access to US $7.0 million from the ADMARC divestiture program grant. The balance of US $3.0 million would be made available when the remaining MK 9.0 million is liquidated.

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Because foreign exchange is urgently needed by the Government of Malawi and to stay within its credit creation limit under the IMF stabilization program, funds will be disbursed as divestiture progresses.

The release of these funds is contingent on the liquidation of equity share holdings in agricultural estates, manufacturing, industry, transportation and finance. Also excluded are assets in the form of loans or income notes. Thus, these conditions apply to the MK 46.6 million equity shares in agro-industry, manufacturing, transportation and finance per ADMARC's March 31, 1985 audited accounts.

(2) Recruitment of Investment and Financial Technical Asssitance

To assist ADMARC and the Government of Malawi with the divestiture process and the development of a strategy for the handling of any remaining assets, it will be necessary to recruit long-term and short-term technical assistance experienced in financial and corporate management, divestiture and investment promotion . This assistance may also be used in the valuation and appraisal of assets prior to offering them for sale. This requirement might be met by hiring consultants locally or internationally with considerable investment experience to oversee the divestiture process and the development of a strategy for managing the assets which remain once divestiture is completed. Financing of this expertise would come from the US$500,000 technical assistance component of the Grant Agreement or may be met through the technical assistance component of the World Bank's SAL III.

Since delays may be experienced in the actual recruitment of this expertise, the release of the US$10 million will not be contingent on the expertise being in place. The condition will be satisfied if the process of recruitment is underway and the technical assistance is expected to be in country within a period of four months after recruitment is initiated.

b. Remaining US $5.0 Million

The remaining US $5.0 million will be released when the following conditions have been met. These conditions relate to the MK 16.6 million in non-estate equity share holdings, as defined in Section 1(E) above, which will remain

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after the MK 30 million divestiture. The Government of Malawi and ADMARC have the choice of taking either or both of the following options to obtain release of the US $5.0 million. It is anticipated that these funds will be disbursed within eighteen months of the signing of the Grant Agreement.

Option One: Divestiture of an additional MK 15.0 Million in Equity Share Holdings

The Government of Malawi and ADMARC may continue the divestiture process. In this case, the release of the US dollars will be governed by conditions surrounding the initial US $10 million. The GOM would be able to continue to have access to the foreign exchange as divestiture occurs at the ratio of US $1.00 for each MK 3.00 in shares liquidated. Thus, the program requires a minimum divestiture of MK 30 million but permits up to a maximum of MK 45 million. Therefore, the second condition outlined below would only apply to any assets which remain after divestiture is completed.

Option Two: Development and Adoption of a Plan for the Disposition of Any of the Assets Remaining After Divestiture:

It will be necessary to design a plan for the disposition of any remaining assets following the divestiture of a minimum of MK 30 million in non-estate equity share holdings. This strategy is important to the long-run resolution of ADMARC's current liquidity crisis and to avoid its reoccurence in the future. While it is AID's preference that this strategy center on the eventual divestiture of these assets to the private sector, AID recognizes the problems which this may entail and is prepared to accept a strategy which would involve retention of some of these assets in an investment holding company or trust. If an investment holding company or trust is established, it will have the following characteristics.

Its management and financial operations should be independent of ADMARC's.

To the extent that any borrowings are required, these will be handled through the commercial banks or other private sector financial institutions.

It will be established on the basis of sound commercial business principles to maximize the

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probability that the company will be profitable and managed efficiently.

It will encourage maximum private sector ownership and participation in the holding company or trust itself and in the companies owned by the holding company or trust.

2. Covenants

a. To Undertake a Study of the Capital Market in Malawi - Its Constraints and Ways to Strengthen It

With the easing of recession, improvements in the terms of trade, the increased availability of donor resources and the restructuring of Press, MDC and ADMARC, it is important to begin considering ways to strengthen and broaden the capital market in Malawi. Therefore, it is proposed that the Government of Malawi agree to undertake a series of studies of the Malawi capital market and options to improve it. These studies will be financed from resources available in the US $500,000 technical assistance component of this program. The specific studies to be financed will be determined in consultation with AID.

The following are some of the illustrative topics which may be studied:

Ways to spread risk sharing in the economy;

Means to tap resources and how to deploy them effectively in investments with high rates of return;

Reduction of controls on and rationalization of interest rates;

Broadening the deposit base and lending policies of the banking system to promote the expansion of credit for private sector investments;

Further development of the market for exchange of public shares and government bonds;

Examination of the legal and regulatory framework governing financial institutions to see whether definitions of liquidity and restrictions on equity investment might be amended or altered to promote financially sound investments;

Impact of taxes and fees on investment decisions with respect to incentives and disincentives;

Improvements in the foreign exchange allocation system; and

Promotion of funded pension schemes to generate additional investment resources.

b. To establish, if necessary, an equity financing facility for Malawian investors

The divestiture of assets and sale of the Strategic Grain Reserve will allow ADMARC to repay its bank debts, freeing liquidity in the banking system. However, there is currently no mechanism for providing loans to Malawians interested in making equity investments in divested firms. If the Capital Market Study recommends it, the Government of Malawi will establish an equity financing facility for these investments. The Government of Malawi and A.I.D. will jointly determine the level of financing for the facility.

c. To develop a plan for management of the Strategic Grain Reserve

A.I.D. will be assisting the Government of Malawi (under the FY85 EPRP - Fertilizer Subsidy Reserve) in making an assessment of food security requirements. The assessment will consider Malawian national requirements and Malawi's possible role in a regional grain reserve. The plan for management of the reserve will include adjustment of reserve levels according to recommendations of the assessment.

3. Use of $500,000 for Technical Assistance, Studies and Training

A number of studies, technical assistance and training needs have been identified during the design of this program. While it is likely that some of these planned uses may be picked-up by other donors or no longer be required, other needs will undoubdtedly arise. At this point, however, it is anticipated that the $500,000 component will be utilized as follows:

Technical Assistance

Divestiture and Restructuring Coordinator (on a cost sharing basis with the World Bank; A.I.D. providing $50,000 per year x 3 years)	$150,000

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Short-term assistance in establishing independent holding company and in developing divestiture/restructuring/ rehabilitation proposals for remaining holdings (assistance to be fielded under an existing IQC and/or recruited from local CPA firms; $10,000 per p.m. x 10 months) $100,000

Studies $120,000

In support of one of the Program's covenants, a series of studies will be funded to strengthen the capital market; illustrative topics are included in Section III.B.2. (to be conducted by local CPA firms, possibly under the coordination of an American expert in capital market formation; $10,000 p.m. X 12 months)

Training

Investment Appraisal and Management (2 participants x $17,500)	$ 35,000
Enterprise Management for Development (2 participants x $12,500)	$ 25,000
Public Enterprise Policy and Management (2 participants x $15,000)	$ 30,000
Public and Parastatal Enterprise - Management, Operation and Privatization (2 participants x $10,000)	$ 20,000
To be determined	$ 20,000

(anticipated institutions for the above training include Harvard University - HIID; University of Connecticut - IPS; Georgetown University - ILI; and others in the field of privatization and public enterprise management).

C. Foreign Exchange and Local Currency Utilization

The Government of Malawi in preparation for the Consultative Group Meeting in Paris on January 21-22, 1986, estimated that it faced a US $145 million resource gap over the next five years. Meeting this resource gap will require a significant infusion of additional concessional donor

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assistance. Malawi has historically had to rely heavily on concessional assistance to provide it with the resources needed for economic growth. Therefore, the US $15.0 million will cover approximately 10 percent of this gap.

Under the ADMARC restructuring component of the Structural Adjustment Lending program, the GOM has agreed to purchase from ADMARC the 180,000 metric ton strategic grain reserve for MK 46.6 million and storage silo complex for MK 17.8 million. Although ADMARC will continue to manage the grain reserve, it will charge a management fee to government to do so. The actual amount of the fee will be negotiated between ADMARC and the government and will be discussed with the World Bank prior to its formalization.

In 1985/86, ADMARC borrowed MK 26 million from the GOM. The government has agreed to write off this loan as partial payment of its obligation to purchase the strategic grain reserve. This leaves a balance of MK 38.4 million which will either have to be met through additional Government domestic borrowing or by an inflow of further resources through concessional donor assistance.

The government intends to use the counterpart funds from the U.S. $15.0 million cash grant to cover part of its remaining obligation for the purchase of the Strategic Grain Reserve. The foreign exchange available through this program is expected to create the equivalent of MK 2[illegible].0 million in local currency (based on a $ 1.00 = MK 1.80 which was the June 1986 average rate). After these funds have been paid to ADMARC, ADMARC will utilize them to repay some of its outstanding debt to the Reserve Bank and the commercial banks. The repayment of these debts will free up financial resources for further investment in the Malawian economy. To facilitate the channeling of some of these resources into participation of Malawians in ownership of some of the firms currently owned by ADMARC, the GOM will covenant to make a share of these resources available to credit institutions for this purpose. The mechanisms for doing this and the amount of credit to be made available would be explored in one of the studies of the capital market to be financed from the $500,000 set aside in this program for technical assistance, training and studies.

D. Impact of Proposed Policy Reforms

The program will favorably influence three areas: (1) the efficiency of economic resources; (2) the availability of capital for investment and; (3) ADMARC's capacity to manage its marketing operations. With respect to the first area, through the transfer of parastatal firms to the private sector the management of the resources will be more responsive to price signals and be more motivated to utilize human, physical and financial resources more fully. Privately owned entities will be less inclined to retain redundant staff and labor. Management of privately owned entities will be less subject to non-economic/business pressures in the conduct of their affairs. Because some of the divested entities will be purchased by foreign capital there will be increased access to foreign technology and management. As firms are sold by the holding company the company staff will be able to improve its management activities by concentrating on the remaining holdings.

There will be an increase in the amount of capital available for investment because of the liquidation of ADMARC's outstanding loans as holdings are purchased by private businesses. There will also be an increase in investment as the new owners refurbish their acquisitions.

The program will enhance ADMARC's capacity to perform its marketing operations for three reasons. First, ADMARC will be able to build up its cash balance (or decrease its net indebtedness position which will increase its ability to borrow short term). As noted above, this is a particularly important point because ADMARC must carry a substantial cash balance to meet the large seasonal fluctuations in demand for cash. Second, general management will have more time to concentrate on marketing operations. This will occur because it will no longer be necessary to devote time to investment for acquistion purposes and to managing debt problems. Although there is no guarantee that the liquidity problem will completely disappear, to the extent that ADMARC's liquidity/debt position improves it will also take less of management's time to look after liquidity concerns. Third, the program effectively removes the institution through which ADMARC made new investments. Therefore, general management will no longer be distracted by pressures to make certain special investments and to make or to secure loans not directly associated with ADMARC's agricultural marketing operations.

There are some negative effects associated with the program but they do not appear to be serious and many are expected to be temporary. One non-temporary negative effect is that given the existing structure of capital ownership in Malawi, there will be a tendency to increase the concentration of capital and possibly decrease the degree of competitiveness in some industries. This greater concentration will also increase the leverage of some of the largest private entities in influencing government policies. Such influence would tend to

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be strongly biased toward further decreasing competition. In the course of negotiations with potential buyers, therefore, it is critical that additional protection rights not be granted by the GOM.

Employment may fall as some firms are liquidated or overhauled. There is a welfare loss for the individuals involved, but to the extent their employment is economically redundant, their unemployment is not a loss to the economy. A temporary increase in formal unemployment is part of a larger move toward a more efficient use of resources. The loss of jobs is inevitable in any event because the original employing firm cannot sustain its position. The unemployment effect is likely to be partially offset in the short run as other firms receive new investment, are put back on sound financial bases and hire more labor. In the long run the change in pricing policies, and the change in the business climate should generate much greater employment than the former system.

There could be an adverse income effect if mid and upper level staff salaries and fringe benefits are reduced for divested firms but it is unlikely that wages for labor would fall. This effect would be limited to a handful of relatively skilled workers who are mobile and who happen to be in an economy with increasing flexibility.

While not a disadvantage of the divestiture program itself, the bias of the credit system to prefer larger over smaller borrowers means that the larger entities will tend to acquire a disproportionate share of the increase in credit. This expectation essentially reflects the fact that the program is finite and does not directly address structural aspects of the banking and credit sector, although the capital market studies are a start in addressing the problem.

Some partners in joint ventures might use the divestiture as an opportunity to sell their interests and leave Malawi. The transaction is not a disadvantage per se because in selling they would be replaced by another private entity. It does mean, however, that there is no net gain for Malawi. This is a weak proposition because if the asset owner is intent on selling in any event, the divestiture is unlikely to make much difference. Such a sale could even be advantageous if the buyer is more inclined to make new investments.

One of the main unanswered questions and one which the program does not address is who will take the lead in development investment in agriculture if ADMARC's Development and Investment Division no longer has this function? A long-term goal is for the private sector to be the cutting edge of economic growth and development. But there remain three immediate elements which tend to dull this edge: (1) the Malawian economy is so small that one or two firms can constitute an industry, therefore the government is concerned about monopolistic practices; (2) it is fundamental government policy to see indigenous Malawians increase their level of participation in the Malawian economy; and (3) so far, efforts to increase the availability of credit to small- and medium-size Malawian entrepreneurs have met only with limited success, a problem which is partially attributable to the structure of the banking system and to the pricing/ marketing system for smallholder agriculture.

E. Mission Management

The Program Planning and Implementation Division has responsibility for the management of the FY 1985 African Economic Policy Reform Program (612-0225). The division is headed by the Assistant Mission Director and consists of the Program Officer, the Project Development Officer and local professional staff. Since the Mission's economic and program management expertise reside in this division and it has taken the lead in the development of this proposal, it will also manage this new policy reform program.

There is considerable complementarity between this program and the FY 1985 one. Thus, it is not anticipated that the management of this new program will result in any significant increase in the amount of staff time devoted to its implementation. The Mission does not plan to hire any additional local staff to assist with program management.

F. Negotiation Status and Strategy

This program has been developed in close collaboration with the Ministry of Finance and the Economic Planning Division in the Office of the President and Cabinet. Staff from both of these government organizations have participated along with AID officials in discussions of the program's conditions with ADMARC. The conditions for the disbursement of the US $15.0 million cash grant have received GOM endorsement. Furthermore, this program has evolved and been considered within the context of the World Bank Structural Adjustment Lending program and the IMF's Standby Agreement. Therefore, no problems are anticipated in negotiating the Grant Agreement.

The program has been reviewed with the Regional Legal Advisor in Nairobi. She has proposed that there be two Grant

Agreements, one for the cash grant element and the other for th technical assistance component. They would be modelled along the lines of the two Grant Agreements for the first Malawian Economic Policy Reform Program (612-0225). Draft agreements will be prepared by the RLA in August following review of the PAAD in AID/Washington.

G. Relationship to Other Donor Policy Programs and Conditionality

The ADMARC divestiture program complements those of th World Bank and of the International Monetary Fund (IMF). No bilateral donors are directly involved in restructuring the investment side of ADMARC. As far as can be determined the program conditions do not conflict with or duplicate those of any other donor or international financial institution.

The divestiture program relates to the IMF's program which includes limitations on GOM borrowing from the central bank. The GOM has agreed to purchase the strategic grain reserve from ADMARC and assume ADMARC's MK 4.3 million obligation to the Smallholder Fertilizer Revolving Fund (SFRF). The net expenditure of about MK 41 million, after taking into account the writing off of the MK 26 million loan from the government to ADMARC as partial payment, will extend the government budget beyond the IMF's deficit limit. These actions, however, are a part of the set of conditions established by the Bank for the second tranche of SAL III. The Bank recognizes that these purchases will tend to create inflationary pressure and thereby pose a problem for the balance of payments.

The infusion of $15 million (MK27 million at the June 1986 exchange rate) via the ADMARC divestiture program will contribute significantly to offsetting the potential inflationary effects of the government expenditures in the ADMARC restructuring process. That is, the effect of the AID program will be to help keep the GOM within IMF credit constraint limits. The divestiture program is not only consistent with World Bank and IMF programs and conditions, it substantially facilitates their operation.

Two key elements in the Bank's design of the ADMARC restructuring program are to split off the investment portfolio from ADMARC and thereby:

(1) Allow ADMARC's management more time to concentrate on agricultural marketing.

(2) Remove the financal drain caused by the investment portfolio, improving ADMARC's cash reserves which are crucial to its marketing function.

Again, AID's involvement in the ADMARC divestiture program makes a critical contribution to the World Bank effort to improve the agricultural marketing system.

H. Evaluation Plan

The program will require continuous monitoring and evaluation as part of the disbursement process. The Mission anticipates that it will need to call upon local based international CPA and legal firms to assist it in the review of documentation pertaining to the selling of assets and the development of a plan for any remaining assets to ensure that conditions pertaining to disbursement of the foreign exchange component have been met.

In addition, the Mission plans to hold a joint review of the studies of the Malawi capital market when they are completed. These studies and the review are extremely important to the Mission's planned activities in the private sector such as the proposed FY 1988 CIP for Private Enterprise Development.

The final evaluation will probably take place in the third year after the signing of the Grant Agreement. The timing will depend on the status of the liquidation of ADMARC's assets. It is important that sufficient time has elapsed to permit quantitative analysis of the impacts of the program. This evaluation will concentrate on the following areas:

Improvements in ADMARC's financial position and marketing functions;

Utilization of the local currency to pay for the strategic grain reserve and silo complex and the impact of this infusion of funds plus those from the sale of ADMARC's assets on the commercial banking sector and the Reserve Bank of Malawi; and

Financial viability and extent of private ownership of any trust or trusts established to manage a residual set of former ADMARC assets.

This evaluation will be conducted by an external team consisting of a macroeconomist, management consultant and an investment banking specialist.

IV. FEASIBILITY ANALYSES

A. Institutional Analysis

The divestiture process will be handled by ADMARC staff with assistance from local CPA firms such as Deloitte Haskins and Sells, Peat Marwick and Mitchell, Price Waterhouse and Coopers and Lybrand. Some of these firms were involved in the earlier restructuring of Press and MDC. Furthermore, the investment coordinator to be recruited either by the World Bank under SAL III or by AID under this program, will function in a critical capacity to help implement the program. Given the likely timing of his arrival, his input will be more important in the development of the plan for the assets which remain after the initial round of divestiture.

Given the staff weaknesses which exist in the Development and Investment Division of ADMARC which manages the investment portfolio, the responsibility for the divestiture has fallen on the Financial Controller and the General Manager of ADMARC. The Financial Controller is an expatriate financed by the World Bank. The General Manager is a dynamic individual with considerable experience in business and finance in Malawi. They are presently managing the initiation of the divestiture program well, but it has placed a significant additional burden on them. USAID has suggested that funds under the Fertilizer Subsidy Removal Program might be used to finance short-term technical assistance to assist them over the next several months.

The divestiture process is proceeding reasonably well at the time this PAAD was being written. The GOM and ADMARC have designated six firms to be completely or partially divested. A list of the firms and proportions of shares to be sold to the private sector are listed in Table 4. ADMARC holds MK 31.5 million of shares in the six companies, of which the Corporation plans to sell off MK 24.1 million or 76.5 percent. Reduced interests will be retained in two of the six firms.

ADMARC is canvassing the other share holders in the six companies to ascertain their interest in purchasing its holdings. Because these are privately held companies, partners must be given the first option to purchase. Several of the share holders have expressed a willingness to exercise their option to buy. In some cases where the partners have declined, ADMARC has identified other potential international and domestic buyers and is proceeding with preliminary discussions.

Table 4: Planned Asset Divestiture of ADMARC's Equity Shares (in millions of Malawi Kwacha)

Name of Firm	ADMARC Share Holdings		ADMARC Shares to be Divested		Balance	
	Value* MK	Percent	Value MK	Percent	Value MK	Percent
Dwangwa Sugar Co	10.7	38	10.7	38	0.0	0
Sugar Corp. of Mal.	9.3	49	5.5	29	3.8	20
Lever Brothers (Mal)	0.6	20	0.6	20	0.0	0
David Whitehead and Sons (Malawi)	8.8	49	5.2	29	3.6	20
PEW	0.7	87	0.7	87	0.0	0
United Transport (Malawi)	1.4	35	1.4	35	0.0	0
TOTAL	31.5		24.1		7.4	

* Value as of March 31, 1985.

ADMARC has contracted with Peat Marwick and Mitchell to undertake a study of the various oprions for putting them under stronger management and on a more solid economic foundation. The study will analyze the potential for consolidating some estates, dissolving others and ways to attract investors.

In order to promote maximum private sector participation in the companies owned by ADMARC and to decrease their dependence on ADMARC management and financial resources, AID has stipulated that any investment holding company or trust established to manage assets which remain after MK 30 million have been divested must embody sound business principles, attract private sector investors and rely on commercial sources of capital to meet its financial requirements. In a business and financial community dominated by only a few large international and domestic corporate enterprises, this may present several practical problems. To attract smaller investors, it has been suggested during the design of this program that the GOM and ADMARC explore the options for incorporating the holding company as a public limited one instead of private limited. There are already in Malawi a few public stock companies such as Southern Bottlers, the manufacturer of soft drinks. Although the Malawian Companies Act permits public stock companies, the absence of a formal market for share capital creates a potential problem of trading shares. The limited public share capital in existence in Malawi is bought and sold through commercial banks and corporate law firms.

One of the key objectives of this program is to assist in the development of a stronger basis for long-term investment in Malawi's economy. It is important that this foundation be developed further to increase the stability of the financial system, to attract additional investment resources and to establish a more broadly-based capital market. An effort will be made to incorporate these objectives into the capital market studies.

The studies of the capital market in Malawi envisaged as part of this program would be carried out using funds available from the US $0.5 million technical assistance component of the grant. An illustrative set of topics was discussed in Part IV of the PAAD. These studies would be financed through a series of purchase orders or work orders to various AID contractors. To the maximum extent possible, AID and the GOM would plan to utilize local expertise. This is important to tap individuals with considerable knowledge and experience of the business and financial sector in Malawi and to help stimulate and promote the further development of this local capacity.

B. Other Special Issues

There was during the development of this PAAD and in recent technical reviews with the World Bank and IMF, one major policy concern on the part of the GOM and ADMARC which has been taken into account in the design of this program. Both the World Bank and USAID had suggested that the GOM agree in advance to the divestiture of all of ADMARC's assets and that, if an investment holding company were established that it be self-liquidating over time. The GOM while acknowledging the principle of removing government and statutory bodies from direct management and involvement in manufacturing and industry was unwilling to commit itself *a priori* to this for political and economic reasons. First, the GOM was concerned about the potential implications of increased foreign control and participation in the economy without a parallel expansion in Malawian participation as a counter balance. Second, in the absence of a stronger and more diversified capital market, the GOM felt that there was a need for some form of investment company to promote and encourage investments in agriculture-related industries, but was unsure how much private interest could be attracted to support the development of these businesses. Nevertheless, the GOM has agreed that the private

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sector will be encouraged and is desirable. This represents a major shift away from Malawi's development strategy of the 1970's. One of the important tasks of the investment coordinator will be to identify ways in which greater participation of the private sector in agro-related industries can be actively fostered.

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ANNEX A

DESCRIPTION OF THE MAJOR BUSINESS ENTERPRISES, STATUTORY BODIES AND FINANCIAL INSTITUTIONS IN MALAWI

I. Holding Companies and Statutory Bodies: The Big Three - Press Group, Malawi Development Corporation and the Agricultural Development and Marketing Corporation

A. Press Group Limited (PGL)

The Press Group was founded as a newspaper publishing company by the Life President H. Kamuzu Banda at independence in 1964. The Group is owned in trust for the Republic of Malawi. PGL is not a parastatal in the normal meaning of the term: it is not subject to the direction of the Department of Statutory Bodies or the Finance and Audit Act. Press Group companies are incorporated with private status. Throughout the decade of the 1970's PGL pursued an aggressive agriculture developmental and acquisition policy.

On the agricultural developmental side, PGL opened up a large number of estates on virgin land , primarily for the growing of virginia tobacco (General Farming Company Limited) and burley tobacco (Press Farming Limited). The majority of these estates are concentrated in the Kasungu and Mchinji Districts of the Central Region, and there is a cattle ranching operation near Liwonde in the Southern Region.

In recent years, steps have been initiated to diversify the tobacco and maize concentration. The effort has achieved differing degrees of success. Diversification efforts have included schemes to grow groundnuts, irrigated wheat and coffee. The estates started from extremely small equity capital bases and gradually increased their leverage positions as debts accumulated. Consequently, the estates were extremely vulnerable to the downturn in tobacco prices in the early 1980's. The PGL estates have been reorganized recently as part of the SAL process into an intermediate holding company (Press Agriculture Limited). Management has been reconstituted and the dependency on tobacco lessened through further crop diversification.

Press' acquisition policy has been governed by a strong desire to localize ownership of strategic enterprises and to diversify the industrial and commercial base of the country. This broad mandate has meant that there was little logic in the pattern of investments through the 1970s. Also many acquisitions suffered from weak financial management and undercapitalization. As a consequence they became a heavy drain on the national banking system in the late 1970's and early 1980's.

Although the PGL was one of the early victims of the recession, the situation was tackled resolutely during SAL I and SAL II. The Group and its finances were entirely restructured and the excessive exposure of the commercial banking system reduced. The Group was put under strong management and the investment portfolio was rationalized by exchanging some holdings with ADMARC and with MDC. Also various developmental and loss-making projects were eliminated.

The reorganized Press Group remains a major force in the Malawian economy; it operates on conventional business lines and it is generally competitive with the private sector. However, in some areas such as retailing, PGL is the only nationally organized entity.

B. Malawi Development Corporation (MDC)

MDC was formed as a statutory body shortly after Independence in 1964, modelled on the highly successful Industrial Development Corporation of South Africa and with initial management drawn from that same organization. In its early days, MDC was highly innovative and successful. Its objectives were to promote new investment in areas neglected by the private sector for one reason or another and to spin off investments to the private sector as they became mature. Towards this end, MDC invested heavily in real estate, hotels and industry and formed an investment trust company for the planned divestitures.

By 1970, the MDC was financially self-supporting. Also in 1970, the MDC was converted into a conventional limited liability corporation, wholly owned by the Government of Malawi. Shortly thereafter, its resources were stretched when it was used as the primary vehicle for the takeover of the Portland Cement Company. A period of weak management followed during which borrowed funds were in many cases injected into investment projects that failed to perform and the concept of divestiture of mature investments was de-emphasized.

The financial position of MDC became critical. However, since it was wholly owned by the GOM, the MDC became a drain on government resources rather than those of the commercial banking system. Under SAL I, the position of MDC was comprehensively studied. An investment rationalization program was initiated under SAL II involving share swaps with Press Group and ADMARC. The restructuring has proceeded further with the appointment of a new general manager. Over the past 18 months, he has reorganized management in MDC itself and its principal investments; commenced a divestiture process to release cash resources for new projects; and restored financial confidence in the organization. As a consequence, MDC is back on its original track.

C. Agricultural Development and Marketing Corporation (ADMARC)

The origins and certain of the primary operating features of ADMARC go back to the pre-independence period. ADMARC grew out of the Farmers Marketing Board. ADMARC's primary responsibility was to ensure the timely delivery of crop inputs and prompt purchase and payment for crops offered to it for sale from the smallholder sector. ADMARC has legal monopoly status for the purchase of tobacco and cotton, and a de facto purchasing monopoly for groundnuts and maize. ADMARC effectively insulated smallholders from short run fluctuations in world prices by means of the Price Equalization (Stabilization) Fund. Fund reserves were invested in government bonds. ADMARC's activities remain largely unchanged from its early days.

Over time, ADMARC has greatly expanded the access of the smallholder to inputs such as seeds and fertilizer and to markets for the sale of crops. Few smallholders are further than 15 kilometers from an ADMARC depot and until 1986 ADMARC has been obliged to purchase all that has been offered to it and to pay cash for it.

ADMARC has, therefore, been an accurate barometer of the subsistence agricultural sector's economic condition over the years in its mainstream activities, as reflected by its crop trading accounts. ADMARC's crucial role as a stabilizer of smallholder income became apparent in 1967 when the Corporation sustained a substantial loss due to poor crop yields, world commodity prices and selling policy. The banking sector, and indeed the economy, suffered but the problem was quickly and effectively dealt with and the Price Equalization Fund re-established.

Given the chronic shortage of capital constraining the country's development, ADMARC was reconstituted around 1970 with an additional, developmental role. The "cash cover" requirement for its Price Equalization Fund was fixed at MK2.0 million, with the balance being freed for investment in what were anticipated as being profitable direct and indirect development projects. Unlike MDC and Press, ADMARC became the only organization of its kind formally committed to the provision of capital for agro-related industrial development.

Unfortunately, ADMARC's investments incurred substantial losses. It acquired its portfolio of medium-sized estates as a last resort buyer of undercapitalized ventures facing closure. ADMARC assumed the assets of these estates as well as their debt liabilities. The MK 11.0 million investment in Dwangwa sugar, financed from borrowed funds, has been a particularly poor investment in large measure due to the vicissitudes of the world sugar market. The investment portfolio contained profitable investments such as PEW, United Transport of Malawi and David Whitehead, but the profits of these firms were not adequate to compensate for the losses of the other holdings. Thus, the investment portfolio became a net drain on ADMARC's resources.

ADMARC's financial problems were compounded when it was required to bear the cost of acquiring, maintaining and storing the strategic grain reserves. The Crop Price Equalization Fund had already been fully committed and could not bear the extra burden of the strategic reserve, particularly when compounded by the generally poor performance of the investment portfolio, the declining prices for cotton and tobacco, price controls on ADMARC's domestic market sales and skyrocketing transportation costs on imported inputs and crop exports.

II. The Structure of Banking and Finance

A. National Bank of Malawi (NBM)

The National Bank of Malawi was established as a commercial bank by Act of Parliament in 1970. Although created in this manner, it is a conventional limited liability corporation, and is not a statutory body, or under the supervision of the Department of Statutory Bodies. However, it is subject to the requirements of the Banking Act which prohibit equity investment by the bank in most cases and which require inspection by the Reserve Bank of Malawi.

The National Bank of Malawi was formed from Barclays Bank and Standard Chartered Bank each of which initially retained a 10 percent equity share in the new bank. Barclays subsequently sold its shares to Standard which now holds 20 percent equity holding in the NBM. The balance of the shares are held by the Press Group, MDC and ADMARC. The Standard Chartered Bank, however, provides senior management for the bank.

For its first few years, the NBM pursued conservative policies, lending largely on a seasonal overdraft basis and quietly but steadily increasing its deposit and retained earnings. However, in the latter half of the 1970's, it departed dramatically from this pattern. In response to the national priority then given to the development of estate agriculture by Malawians, and given the vacuum of other sources of capital for this purpose, it commenced on a program of substantial term lending of capital, as well as providing seasonal finance to these emergent entities. At the same time, a significant amount of its resources were channeled to the Press and Spearhead Groups.

With the onset of recession in the early eighties, NBM suffered heavy loan losses. The result was a serious erosion of the bank's capital base which is only now largely restored. The NBM has returned to a cautious lending policy which has resulted in its rebuilding of its cash base. Most of its funds are invested in government bonds and loans to parastatals to cover their deficits.

NBM's retreat from direct term financing was justified as a means to protect its depositors, but it has meant that the bank has not contributed to the financial requirements of the private sector. As long as higher interest can be earned on long-term government bonds than on higher risk lending to the private sector and given NBM's previous experience in term lending to the private sector, this situation is not likely to change in the near future without a significant change in interest rate policy.

B. Commercial Bank of Malawi Limited (CBM)

The Commercial Bank of Malawi Limited was established in the late sixties by Portuguese interests (Banco Pinto da Soto Mayor of Portugal) which sold out to the Bank of America and Malawi parastatals in 1974. During the recent recession, the Bank of America decided to liquidate its holdings and its management contract with CBM. The Government of Malawi under the economic conditions at the time had little choice but to pick up the Bank of America shares. The bank is presently owned by the GOM, PGL and MDC. ADMARC relinquished its equity interest in the Bank to MDC in 1984 as part of the MDC restructuring.

The development of CBM has been similar to that of NBM, but with one important difference. CBM has a smaller deposit base both absolutely, approximately one third of NBM, and relative to its lending. It was, therefore, extremely hard hit by events as they unfolded in the late 1970's and early 1980's and was forced to borrow heavily from the Reserve Bank of Malawi to cover its losses. Its situation was eased by the GOM taking over CBM's nonperforming loans to the Press Group. CBM's financial position has now stablized with the recovery of its deposit and capital base. However, like NBM, CBM pursues a conservative lending policy vis-a-vis the private sector and relies heavily on lending to the government and parastatal bodies.

C. Reserve Bank of Malawi (RBM)

The Reserve Bank of Malawi was established by a special Act of Parliament when the Reserve Bank of Rhodesia and Nyasaland was dissolved at the time the Federation dissolved. The RBM is a statutory body, wholly owned by the government, but is not subject to supervision by the Department of Statutory Bodies or most of the provisions of the Finance and Audit Act. Its primary functions are to issue and safeguard Malawi's currency and to serve as the central government's banker. Although it does not as a general rule act as a banker for the statutory bodies, it has on occasion engaged in lending to ADMARC.

RBM holds the national foreign exchange reserves and engages in foreign borrowings. It retains the statutory balances and overnight funds from commercial banks and lends to them in a last resort function to protect their deposits as it did in the case of CBM during the recent recession. It has become in the last few years the major creditor of the central government as a consequence of the need to finance the deficit and to cover the debts of the Press Group which were passed to government as part of the restructuring under SAL I and II. RBM does not accept deposits from or extend its lending to the private sector.

The RBM has had its financial base significantly eroded in recent years by the impact of government and parastatal borrowings (mainly ADMARC). It has also seen its foreign exchange position and foreign debt situation worsened by successive devaluations of the Malawi Kwacha.

D. Major Insurance Companies

The National Insurance Company Limited (NICO) is controlled by the Press Group. It competes on an equal basis with a number of foreign based general insurance companies. NICO's general insurance funds are understood to be invested wholly or at least substantially in government paper and the banking sector. This is in large measure to maintain fairly

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liquid assets to protect it in the event of having to meet a series of large claims.

NICO's life insurance funds, however, are available for broader investment as are those of the market leader in the life insurance and pension field, the Old Mutual of South Africa. These pension and life insurance funds are almost exclusively invested in government bonds and first class real estate and commercial mortgages. Again the dominance of government lending in their portfolio is affected by the higher interest rate and low risk associated with them compared to the higher risk inherent in equity share investments.

E. Post Office Savings Bank (POSB)

This institution is modelled after its British counterpart. Its primary function is to assist in mobilizing the funds of small savers through the nationwide network of Post Offices which have much greater national coverage than the commercial banks. However, it attracts substantial business and higher income depositors in view of its tax free status of the interest earned which make it competitive with other forms of term deposits. The POSB does not grant loans or permit overdrafts. It invests its funds exclusively in government paper. POSB deposits have been climbing steadily and are now around MK 60 million.

F. New Building Society (NBS)

The Government of Malawi has an equity holding, but not controlling one, in the New Building Society. Through its offices and agencies in Malawi's primary cities, the NBS accepts funds on interest-bearing savings or time deposits from individuals and corporate entities. Liquidity margins are covered by investing in government bonds. Subject only to this constraint, the whole of its available funds are loaned to corporations and individuals in the form of mortgages, repayable normally over 15 years. Interest paid on NBS mortgages is tax deductible. NBS is well administered and has had very few repossessions.

G. Investment and Development Bank of Malawi (INDEBANK)

INDEBANK was established in 1971 by ADMARC, IFC, CDC, EDB and FMO which fund it through a combination of equity share ownership, income notes and various lines of credit. INDEBANK also intermediates lines of credit from other entities including the World Bank. INDEBANK is about to become entirely locally managed, following a period of technical assistance from the Irish Development Association.

INDEBANK invests exclusively in new activities, normally by way of fully collateralized foreign-currency-denominated term lending but occasionally in Malawi Kwacha, and also to a limited extent in equity. INDEBANK's Kwacha resources are extremely limited and it does not accept local time deposits. Because its loans are denominated in foreign currency, INDEBANK has encountered resistance from potential borrowers during the recent, sucessive devaluations of the Kwacha. The foreign exchange risk associated with these loans are assumed entirely by the borrower. INDEBANK is a completely commercial operation and receives no subsidy from the government.

INDEBANK lends primarily to the industrial sector, but has made some investments in primary agriculture. There have been repeated attempts to join forces with the commercial banking system to mobilize outside and local financing to provide term financing for the development of estates, but so far with little success.

INDEBANK has founded a subsidiary INDEFUND (Investment and Development Fund) to lend to emergent Malawian businessman in amounts up to MK 100,000. These loans are mainly for smaller enterprises. The demand for INDEFUND loans is extremely strong and attractive because, unlike INDEBANK, they are denominated in Malawi Kwacha.

Both INDEBANK and INDEFUND are well managed. Project appraisals are carefully undertaken prior to lending. INDEBANK resources awaiting investment are held in government bonds.

I. <u>Malawi Union of Savings and Credit Cooperatives Limited (MUSCCO):</u>

MUSCCO acts as the umbrella for the savings and loan movement in Malawi. The movement started as a missionary-promoted enterprise in the Northern Region of Malawi, but has recently grown rapidly and extended its geographic coverage following an infusion of capital from USAID and technical asschnical assistance from USAID and the US Peace Corps.

The savings and loan movement basically revolves funds among low earning members of a community. Through MUSCCO and under its supervision, additional loan funds can now be made available primarily for such ventures as purchasing of maize mills or crop finance. This is almost the only source of finance available to the rural entrepreneur who lacks collateral and bank references.

ANNEX B

ADMARC'S EQUITY SHARE HOLDINGS AND LOANS BY CATEGORY BASED ON ITS MARCH 31, 1985 AUDITED ACCOUNTS (IN MILLIONS OF MALAWI KWACHA)

Name of Firm or Estate	Equity Shares Value	Equity Shares Percent Owned	Loans Coll-ateral	Loans Other	Direct Project Funds	Total Equity Loans
Experimental Farms Owned Directly by ADMARC					10.5	10.5
Owned Estates						
Buwa Tobacco Estates Ltd	0.0*	100	0.1	0.6		0.7
Chasato Estates Ltd	0.0*	40	0.0	0.4		0.4
Kasikidzi Estates Ltd	0.0*	100	0.2	0.6		0.8
Livilidzi Estates Ltd.	0.0*	100	0.0	0.6		0.6
Mangani Estates Ltd.	0.1	100	0.0	0.7		0.8
Mpira Estates Ltd.	0.0*	100	0.0	0.2		0.2
Tikondane Estates Ltd.	0.1	100	0.0	0.4		0.5
Tobacco Estates Ltd.	0.2	50	0.0	0.0		0.2
Subtotal	0.4		0.3	3.5		3.9
Managed Estates						
Chitale Estates Ltd.	0.0	0	0.0	0.1		0.1
Mayeso Company Ltd.	0.0	0	0.0	0.0		0.0
Mingoli Estate	0.0	0	0.0	0.1		0.1
Mphaso Company Ltd.	0.0	0	0.0	0.2		0.2
Nakawale Estate Ltd.	0.0	0	0.0	0.1		0.1
Subtotal	0.0		0.0	0.5		0.5
Agricultural Industries						
Cattle Feedlot Co. Ltd	0.1	50	0.0	0.0		0.1
Central Grading and Packing Company Ltd.	0.1	55	0.0	0.0		0.1
Dwangwa Sugar Corp.Ltd	10.7	38	0.0	0.0		10.7
Sugar Corp (Mal) Ltd.	9.3	49	0.0	1.0		10.3
Maldeco Fisheries Ltd.	0.5	100	0.0	0.0		0.5
Spearhead Holdings Ltd.	0.1	4	0.0	0.0		0.1
National Seed Co. of Malawi Ltd.	0.6	73	0.3	0.0		0.9
ADMARC Canning Co.Ltd.	0.1	100	0.1	0.8		1.0

Table : Continued

Name of Firm or Estate	Equity Shares Value	Equity Shares Percent Owned	Loans Coll-ateral	Loans Other	Direct Project Funds	Total Equity Loans
Auction Holdings Ltd. (Tobacco auction and suppliers)	0.8	58	0.0	0.0		0.8
Cold Storage Co. Ltd	1.1	100	0.0	0.0		1.1
Cotton Ginners Ltd.	0.2	49	0.0	0.0		0.2
Grain and Milling Co. Ltd. (Stockfeeds)	5.4	100	0.0	2.3		7.7
Lever Brothers (Malawi) Ltd.	0.6	20	0.0	0.0		0.6
Malawi Tea Factory Co. Ltd. (Smallholder tea)	0.0*	40	0.6	0.0		0.6
National Oil Industries Ltd. (Cotton oil seed expression)	1.4	100	0.4	0.0		1.8
Optichem (Malawi) Ltd. (Estate Fertilizer supply)	0.6	33	0.0	0.0		0.6
Central Tobacco Properties Ltd. (Tobacco warehousing)	0.0	0	0.5	0.0		0.5
Subtotal	31.6		1.9	4.1		37.6
General Manufacturing						
Advanx (Blantyre) Ltd. (Tire Remoulding)	0.1	50	0.2	0.0		0.3
David Whitehead and Sons Ltd. (Textiles)	8.8	49	0.0	0.0		8.8
P.E.W. Ltd. (Coachbuilding)	0.7	87	0.0	0.0		0.7
Blantyre Printing and Publishing Co. Ltd	0.0	0	0.0	0.1		0.1
Viphya Pulp and Paper Corp. Ltd.	0.0*	100	0.0	0.0		0.0
Gum and Chemical Co.	0.0	0	0.0	0.0		0.0
Subtotal	9.6		0.2	0.1		9.9

Table : Continued

Name of Firm or Estate	Equity Value	Shares Percent Owned	Loans Coll-ateral	Loans Other	Direct Project Funds	Total Equity Loans
Transportation						
Cory Mann George (Mal) Ltd. (Shipping/Forward)	0.3	50	0.0	0.0		0.3
Manica Freight Services (Mal) Ltd. (Shipping/Forwarding)	0.5	50	0.0	0.0		0.5
United Transport (Mal) Ltd. (Buses)	1.4	35	0.0	0.0		1.4
Subtotal	2.2		0.0	0.0		2.2
Financial Institutions						
Finance Corp. of Malawi Ltd. (Export Finance)	0.2	100	0.0	0.0		0.2
INDEBANK	1.0	22	0.0	3.0		4.0
National Bank of Malawi	2.0	33	0.0	0.0		2.0
Malawi Housing Corp	0.0	0	0.0	0.5		0.5
Subtotal	3.2		0.0	3.5		6.7
Conglomerates						
Press Group Ltd.	0.0	0	0.0	40.4		40.4
Press Holdings Ltd.	0.0	0	0.0	0.1		0.1
Subtotal	0.0		0.0	40.5		40.5
Dormant Holdings						
Tobacco Marketing Co. of Malawi Ltd.	0.0*	100	0.0	0.6		0.6
GRAND TOTAL	47.0		2.4	52.8	10.5	112.7

NOTE:

* Represent assets valued at less than MK 50,000.

Special Studies Document 1986/1

ANNEX C

UNITY AND FREEDOM

MALAŴI GOVERNMENT

REPORT ON ADMARC RECONSTRUCTION

MINISTRY OF FINANCE
AND
DEPARTMENT OF ECONOMIC PLANNING & DEVELOPMENT

April 1986

REPORT ON ADMARC RECONSTRUCTION

(Special Studies Document 1986/1)

Published by
MINISTRY OF FINANCE
AND
DEPARTMENT OF ECONOMIC PLANNING & DEVELOPMENT

PREFACE

ADMARC has, in recent years, been facing liquidity problems. These problems were not sudden but became acute during the 1985/86 financial year. A study team was, therefore, appointed by Government to look into the causes of these problems and make proposals about how to overcome them.

The study team comprized of Mr. E. W. Mponela of the Department of Economic Planning and Development, Mr. A. C. Gomani of the Ministry of Finance and Mr. A. Y. Kalawe, of the Ministry of Agriculture.

The team held discussions with ADMARC and various relevant institutions.

The Report is divided into four Chapters. Chapter 1 discusses ADMARC's objectives, functions and organization; Chapter 2 discusses ADMARC's performance prior to 1985/86; Chapter 3 discusses the emerging problems and finally, Chapter 4 presents conclusions and recommendations.

This study is, the-efore, an input into the on-going discussions aimed at resolving issues relating to ADMARC in the short- and medium-term.

J. C. MALEWEZI
Secretary to the Treasury

April 1986

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Chapter 1

OBJECTIVES, FUNCTIONS AND ORGANIZATION OF ADMARC

Objectives

According to the Agricultural Development and Marketing Corporation Act of 1971 (Cap. 67:03 section 5), the purposes of the Agricultural Development and Marketing Corporation are threefold:

(*a*) to promote the economic interests of Malaŵi by increasing the volumes of economic exportable crops and improving the standards of the Republic's agricultural produce;

(*b*) to produce and maintain an efficient system for supplying the agricultural requirements of persons farming on customary land; and

(*c*) to maintain and improve with a view to profitability, a system for the marketing of agricultural produce for export and to promote the consumption of such produce abroad and in Malaŵi.

Functions

In pursuance of the objectives, the Corporation is charged with the duty, among others, to buy, store, process, manufacture, adapt for sale, distribute, sell, grade, mark, pack, insure, advertise and transport cotton, livestock, produce, or tobacco grown on customary or public land and any commodity derived therefrom.

"In the exercise of its powers to market produce, the Corporation shall, in selling produce for consumption within Malaŵi, ensure that the selling price of such produce is not less than the price paid therefor together with all other expenses incurred in respect thereof by the Corporation:

"Provided that the Minister may, for good cause, authorize the sale of produce for consumption within Malaŵi at a price which is less than the price calculated as aforesaid, and whenever such sales occur the amounts of any losses incurred by the Corporation shall be made good by the Government from public funds."

As we review ADMARC's role, it is also interesting to note, from the same act, that the Corporation was given powers "to assist any organization, government, corporation, company or co-operative society with capital or credit by means of investment in stock, shares, bonds, debentures or debenture stock, or with other ways or resources for the prosecution of any works, undertaking, projects, schemes or enterprises relating to the development or improvement of the economy of Malaŵi".

Organization

The Agricultural Development and Marketing Corporation is divided into the four sections of—

(*a*) Primary Marketing;

(*b*) Sales;

(*c*) Development and Investment, and

(*d*) Finance and Administration;

their section functions being more or less as suggested. Below the head office in Limbe, control runs from three Regional Offices to several Divisional and Area Offices in each region, under which are parent or seasonal markets and associated produce storage depots.

Each seasonal market is headed by a Marketing Officer aided by about nine members of staff and some casual labour. The volume of produce forthcoming, and the average distance smallholders have to transport produce to sell, form important considerations for establishing a seasonal market.

Transportation of produce to storage and selling points is under the direction of the Transport and Storage Controller.

Although ADMARC own a number of vehicles for transporting produce, a greater role is played by private transporters. Traffic is allocated to these, who are organized in groups, by each Regional Transport Allocation Committee (consisting of the Ministry of Transport and Communications, the Road Traffic Commissioner, District Council representatives and the Ministry of Works and Supplies).

It is understood that, except in emergency or special circumstances, inter-regional transportation of produce is by rail, except, perhaps, where the road mode shows a clear cost advantage.

The rate at which ADMARC pays for rail shipment is based on Malaŵi Railways tariffs which are commodity specific and are revised from time to time. Road rates are determined by the Ministry of Transport and Communications in consultation with other relevant ministries. The present rates are 17.5t/tonne kilometer and 22.9t/tonne kilometer for bitumen and earth roads, respectively. Forward movements of load attract the full rate, but back-hauls are charged only 50 per cent, so that it pays to co-ordinate movement of produce from, and inputs for sale to, depots and markets.

As far as ADMARC export traffic is concerned, increasing use has been made of three routes to the sea:

(*a*) Lilongwe–Lusaka by road and whence to Durban by rail.

(*b*) Lilongwe–Lusaka by road and whence to Dar-es-Salaam by rail.

(*c*) Bangula–Chipoka by rail–Chilumba by lake and whence to Mbeya by road and to Dar-es-Salaam by either road or rail.

It is estimated that ADMARC has, at present, a produce storage capacity of about 547,896 tonnes, of which 145,221 or 27 per cent is in the Southern Region, 210,179 or 38 per cent is in the Central Region, and 192,496 or 35 per cent is in the Northern Region. These figures include the 180,000 tonne capacity represented by the maize silos located in Lilongwe. Other forms of storage include open stacks (tarpaulin covered) and sheds.

Chapter 2

ADMARC'S PERFORMANCE UP TO 1984/85

ADMARC's performance in terms of its role as a crop marketing organization has been impressive. However, its performance in terms of its investments has been mixed as we shall observe below. This Chapter has been divided into three sections. The first analyses its performance as a marketing organization designed to serve the smallholder sector, the second discusses ADMARC's investments and the last one discusses its financial performance.

Marketing Performance

ADMARC has played a vital role in the development of smallholder agriculture. Through a network of market facilities ADMARC has been able to buy commodities from remote areas where, otherwise, there were limited outlets for produce. As an indication of this, seasonal markets throughout the country number about 1,020. These are used for buying produce from smallholder farmers (principally tobacco, maize, cotton, groundnuts, rice and pulses) after harvest, and for selling such inputs as seed and fertilizer to farmers before each growing season.

The tables below show the value and volume of crops handled by ADMARC over the years. The increased volume and value of crops now handled is a clear indication of increased services ADMARC has provided to farmers, thereby contributing to the growth of rural incomes which has helped stimulate the secondary sector, and the economic well-being of the country.

By guaranteeing a market outlet for smallholders against prices announced in advance, ADMARC has enabled smallholders to plan their cropping patterns and relieved them from the insecurity regarding marketing opportunities at the moment of harvesting.

Additionally, since most smallholders sell their crops to the Corporation, the marketing system provides an instrument for guiding agricultural development through the price and other mechanisms.

TABLE 2.1: CROP PURCHASES
(K'000)

Year			Tobacco	Maize	Cotton	G/Nuts	Rice	G.P.*	Total
1971–72	..	..	3,993	883	2,466	3,907	1,223	1,486	13,959
1972–73	..	..	4,633	2,243	2,424	4,444	1,444	1,288	16,477
1973–74	..	..	3,608	2,079	1,960	3,709	1,724	2,987	14,343
1974–75	..	..	3,363	21,888	3,414	4,524	1,577	1,392	17,157
1975–76	..	..	4,353	5,748	2,846	5,192	1,242	1,077	20,459
1976–77	..	..	5,822	3,591	2,965	5,650	2,387	2,626	23,042
1977–78	..	..	11,509	4,954	4,022	3,488	2,343	1,542	27,857
1978–79	..	..	11,298	6,739	5,117	2,261	3,062	2,044	30,522
1979–80	..	..	8,105	4,249	4,902	7,494	2,119	1,369	28,238
1980–81	..	..	4,885	6,082	5,074	10,033	1,910	1,915	29,900
1981–82	..	..	6,141	9,049	4,657	6,200	1,615	1,196	28,858
1982–83	..	..	4,494	27,288	4,002	3,494	1,454	1,208	41,940
1983–84	..	..	6,873	27,115	4,909	5,077	1,231	842	46,048
1984–85	..	..	15,619	35,646	12,922	5,704	1,736	2,636	74,262
1985–86	..	..	20,141	32,696	13,511	12,058	1,815	5,023	85,243

Source: ADMARC.
*General Produce.

Up to 1980, the growth in purchases has been handled with little recourse to the banking system and external financial institutions. It has mainly been financed from internally generated funds such as ploughed back profits and accumulated depreciation.

In addition to its role as a crop marketing organization, ADMARC has also been involved in the provision of fertilizer and seed inputs to smallholders. These have been provided at subsidized prices and part of the subsidy has been borne by ADMARC costing, except for 1977/78, between K2.3 and K5.9 million as shown in the Appendix II.

TABLE 2.2: VOLUME OF ADMARC'S CROP PURCHASES
('000 Metric tonnes)

Year	Tobacco	Maize	Cotton	G/Nuts	Rice	G.P.	Total
1978	23.1	89.9	22.6	18.5	23.8	17.4	195.3
1979	23.7	120.3	24.2	11.1	30.8	18.9	229.0
1980	19.5	82.2	22.4	24.3	20.5	11.6	180.5
1981	11.3	91.9	23.1	31.4	17.5	17.7	192.9
1982	12.8	136.6	21.7	19.5	13.5	11.3	215.4
1983	18.8	246.1	15.1	10.6	12.5	9.6	302.7
1984	9.3	244.9	13.4	10.2	9.0	5.9	292.9
1985	19.2	296.4	32.1	9.9	10.2	9.5	377.3

Source: Economic Report

Investments

Over the years, ADMARC has made several investments. Available information shows that the Corporation now runs about 19 farms or estates (of which six are self-accounting subsidiaries), variously engaged in growing tobacco, maize, tea, coffee, macadamia, cashew, horticultural products and other crops. Some of these also raise livestock, such as beef and dairy cattle, poultry, sheep and pigs (see Appendix IV).

Financial statistics on dependent projects and farms do not seem to be very reliable, but it is estimated that these projects imposed a net cost on ADMARC amounting to K700,000 in the year up to March 31st, 1986 (the net cost of development projects was K810,635 in 1984/85 and K1,296,119 in 1983/84). ADMARC's recent deteriorating financial performance can therefore be partly attributable to these loss-making ventures (see Appendix II).

The main causes for this state of affairs have not been fully investigated yet, but will, it is understood, be the subject of planned re-appraisal with a view to improving management, probably with a technical partner.

Roughly the 13 dependent estates employ about 5,900 persons, of which about 5,500 or 93 per cent are estimated to be casual and/or seasonal.

Over the years, ADMARC has acquired shares in various companies amounting to a total of K46,871,546 in the period up to 31st March, 1985, and K36,969,441 in 1984, including shares in independent estates.

In 1984, as part of the Press (Holdings) Limited Reconstruction Agreement, ADMARC exchanged its shareholding in the Oil Company of Malaŵi, Enterprise Containers Limited and National Insurance Company for Press Shares in:

(*a*) Grain and Milling Company
(*b*) National Oil Industries
(*c*) David Whitehead and Sons
(*d*) The Sugar Corporation of Malaŵi, and
(*e*) Cattle Feedlot Company

In 1985, this "rationalization" of investments continued with ADMARC exchanging its shareholding in:

(*a*) Portland Cement Company
(*b*) Bata Shoe Company, and
(*c*) Commercial Bank of Malaŵi for the Malaŵi Development Corporation shares in:
  (i) David Whitehead and Sons
  (ii) National Oil Industries Limited
  (iii) Cold Storage Company, and
  (iv) MALDECO Fisheries Limited

The problem of estates has been discussed above. The other ADMARC shares are in agro-based firms and non-agricultural oriented firms. National Bank (K2,013,796), Investment and Development Bank of Malaŵi (K1,000,000), Lever Brothers (K575,000) Manica Freight Services (K500,000) and P.E.W. (K682,100) are the more important non-agricultural investments. Except for, perhaps, National Bank, these Investments have given some return in recent years.

Important investments in agro-based industries include Auction Holdings (K859,295 in 1985) Cold Storage Company (K1,079,000), David Whitehead and Sons (K8,847,020), Dwangwa Sugar Corporation (K10,227,998), Grain and Milling Company Limited (K5,440,000), MALDECO Fisheries Limited (K508,000), National Oil Industries Limited (K854,350) and the Sugar Corporation of Malaŵi (K9,300,000).

The three most significant investments in Dwangwa Sugar Corporation, Grain and Milling Company and the Sugar Corporation of Malaŵi have been idle, due to poor performance by the companies.

In the year ending 31st March, 1985, ADMARC received a total of only K1,327,845 in dividends from only 12 companies (Appendix V), representing 8.4 per cent of total shares of these companies valued at cost. A similar yield was realized in 1984. When non-yielding shares are included, the average yield was only 3 per cent in 1985.

Over the years, ADMARC has also given loans to various companies. In 1985 total debenturers and loans, including income notes, amounted to K54,639,005 (1984: K54,912,076). Four per cent of this total represented debentures and other secured loans. Sixteen per cent was in terms of unsecured loans which did not carry any collateral or guarantee. The rest, 79 per cent was represented by income notes to ADMARC by INDEBANK (K3,000,000) and PRESS (K40,420,660).

Interest receivable in the period up to 31st March, 1985 and 1984 amounted to only K1,030,103 and K2,851,295, respectively, an average of only 2 and 5 per cent of total debentures, loans and income notes valued at cost in 1985 and 1984 respectively.

Investment in fixed assets has grown at about 20 per cent per annum, other investments have grown at 29 per cent per annum and the value of stocks has grown at an average rate of 26 per cent per annum reflecting mainly surplus stocks of maize.

TABLE 2.3: GROWTH IN INVESTMENTS

Year	Investment in Fixed Assets (K'000)	Other Investments (K'000)	Investment in Crop Stocks (K'000)
1971–72	3,886	3,654	2,256
1972–73	5,139	4,949	3,221
1973–74	7,354	6,503	1,975
1974–75	9,428	15,777	2,953
1975–76	13,169	39,153	3,623
1976–77	14,814	50,753	7,725
1977–78	19,609	54,104	6,382
1978–79	22,144	53,695	13,893
1979–80	29,297	73,404	11,936
1980–81	39,005	83,443	8,661
1981–82	42,334	86,851	14,003
1982–83	41,294	96,655	34,820
1983–84	40,172	94,784	26,792
1984–85	41,056	98,000	45,888
	20% p.a. compound	*29% p.a.*	*26% p.a.*

Source: ADMARC.

This phenomenal growth of investment has been achieved with minimum dependence on banks and financial institutions. It was mainly financed from internally generated funds such as ploughed back profits and depreciation and long-term borrowings.

Government policy has encouraged local participation in foreign owned companies. This policy is aimed at ensuring that foreigners or foreign owned companies do not have full control of economic activities in the country. As a result of its good financial performance, ADMARC was seen as a key vehicle for fulfilling this policy. Some of the investments made were, therefore, a result of Government directives.

TABLE 2.4: TRADING PROFIT 1971–1985

Year	Tobacco	K'000 Other Crops	Total
1971–72	5,553	3,162	8,715
1972–73	3,541	2,786	6,327
1973–74	2,563	5,548	8,111
1974–75	4,911	6,236	11,147
1975–76	10,609	(633)	9,976
1976–77	15,760	6,925	22,685
1977–78	25,860	4,180	30,040
1978–79	4,225	(44)	4,181
1979–80	2,709	(2,639)	70
1980–81	3,233	(2,907)	326
1981–82	9,145	(282)	8,863
1982–83	18,622	(6,403)	12,219
1983–84	13,364	(6,814)	6,550
1984–85	15,734	(2,882)	12,852
TOTAL	135,829	6,233	142,062
	95.6%	*4.4%*	*100%*

Source: ADMARC.

Financial Performance

ADMARC has performed its marketing functions very well and has made positive profits as is shown on the profit and loss account (Appendix II). However, this performance has shown wide fluctuations. An analysis of the crop trading account together with the profit and loss account gives us an indication of the causes of these fluctuations.

Up to 1978, ADMARC's trading profit was well diversified between tobacco and other crops. However, from 1979 to date, ADMARC has become increasingly dependent on the profits from tobacco for its profitability as all the other crops combined have been yielding losses. This makes ADMARC vulnerable to smallholder tobacco output and auction floor prices. From the period to 1985 about 96 per cent of ADMARC profits came from tobacco.

Appendix I shows the costs related to the crop trading account. Costs related to the tobacco account have shown little growth over the years until after 1984 when producer prices of tobacco were raised substantially and this is clearly demonstrated in Chart I. Apart from the purchase value of the crop, the other costs have grown in relation to the volume bought.

On the other hand costs related to other crops, especially maize, have grown at astronomical rates. Additionally, since ADMARC relates administration costs to direct operating costs, net administrative costs have also grown in sympathy with the growth of Buying and Direct Expenses. (Chart III exemplifies this quite clearly.) The non-performance of Malawi's traditional export routes have added to this rise in costs as ADMARC have to rely on the expensive alternative routes.

From the above discussion it is abundantly clear that ADMARC has become structurally dependent on one crop for its operations and are, therefore, vulnerable to fluctuations in tobacco auction floor prices. Such fluctuations manifest themselves in the profit and loss account which shows that the profits transferred to reserves have fluctuated wildly and sometimes ADMARC has made losses.

In the past, fluctuations in the profitability of ADMARC have been absorbed through a decrease in its liquid assets, as shown in the Flow of Funds, Appendix III. The depletion of the net liquid assets have been accelerated by a number of factors among which are:

(*a*) The secular decline in overall profitability owing to:
- (i) declining dividend and interest income;
- (ii) increasing interest payments (Appendix II);
- (iii) the burden of subsidies to farmers as shown in the same Appendix;

(*b*) the purchases of strategic maize reserves; and

(*c*) Investments in non-liquid assets.

Chapter 3

EMERGING PROBLEMS

The financial year 1985/86 started with ADMARC having an opening deficit of K17.2 million. To enable it carry out its marketing operations, Government guaranteed an overdraft facility of K30 million. By July, it became apparent that some additional financing was required as ADMARC had already exhausted this amount by June. Government, therefore, had to extend a loan to ADMARC of K26 million in addition to the overdraft Government had already guaranteed for ADMARC.

It is estimated that at the end of the 1985/86 financial year, the closing deficit will stand at K35.4 million.

This deterioration in the liquidity of the corporation has not been sudden as shown by various indicators in the table below. The main causes of this deterioration include insufficient provision of marketable securities and other factors related to the marketing of tobacco and maize.

TABLE 3.1: ADMARC: SELECTED INDICATORS OF LIQUIDITY (K'000)

	1981	1982	1983	1984	1985	1986
1. Current Assets	34,532	34,878	43,664	34,993	52,481	47,590
2. Current Liabilities	22,560	23,342	31,672	27,238	53,528	54,242
3. Current Ratio (1/2)	1.53	1.49	1.38	1.28	0.98	0.88
4. Current Assets Less Inventories	15,834	13,207	11,067	17,403	21,590	20,190
5. Current Liabilities	22,560	23,342	31,671	27,238	53,528	54,242
6. Acid Test Ratio (4/5)	0.70	0.57	0.35	0.64	0.40	0.37
7. Liquid Assets + Marketable Securities	17,834	15,207	13,067	19,407	23,590*	22,190*
8. Average Operating Costs Per Day	175	145	137	246	306	389
9. Basic Defensive Interval (Days 7/8)	102	105	95	79	77	57

Source: ADMARC Annual Accounts and Estimates.
*Includes K2 million of L.R.S. not explicitly shown in accounts.
Line 8, 9: Assumes a year of 360 days.
Line 9: The number of days the corporation can finance its operations without sales.

TABLE 3.2: ADMARC: PROFIT MARGINS, RETURN ON CAPITAL AND TOTAL ASSET TURNOVER (K'000)

	1981	1982	1983	1984	1985	1986
1. Crop Trading Profit	326	8,863	12,219	6,550	12,852	−13,532
2. Sales	63,271	61,145	61,580	95,272	123,163	126,628
3. Crop Profit Margin (% 1/2) ..	*0.5*	*14.5*	*19.8*	*6.9*	*10.4*	*−10.7*
4. Overall Profit	−6.189	1,030	3,043	2,273	4,269	−26,029
5. Capital Employed	158.981	166,063	195,264	190,270	210,783	205,040
6. Return on Capital (4/5) ..	−3.9	0.6	1.6	1.2	2.0	−12.7
7. Asset Turnover (2/5)	0.4	0.4	0.3	0.5	0.6	0.6

Source: ADMARC Annual Accounts and Estimates.

This chapter is divided into four sections. The first deals with problems related to tobacco, the second deals with issues related to maize, the third deals with issues related to operating costs while the last section deals with input subsidies.

Issues Related to Tobacco

ADMARC is the sole buyer of smallholder tobacco (NDDF, SDDF, Sun/Air and Oriental) and cotton grown on customary land and sells the tobacco

at the Auction Floors. In addition ADMARC is empowered to purchase all other customary land produce and sell it both domestically and externally. ADMARC is thus charged with a vital role for the development of smallholder agriculture.

As observed above tobacco is the main profitable crop. Tobacco affects the viability of the whole Corporation and cross-subsidizes other crops on which ADMARC makes losses.

Table 3.3 shows that in 1985/86, tobacco sales suffered very low prices at the Auction Floors and this will result in an estimated loss of K4.36 million as compared to a profit of K15.7 million in the 1984/85 financial year. This problem which began early this financial year, adversely affected ADMARC's capability to purchase other produce from the smallholders since it recycles proceeds from tobacco sales to finance other crop purchases as shown in Appendix VII. ADMARC was therefore forced to obtain a loan of K26 million from Government and utilized an estimated K19 million from various ADDs and the Smallholder Fertilizer Revolving Fund to finance crop purchases. The main reasons for the low prices at the Auction Floors are said to be *over-supply, inferior quality* of the tobacco, and possible *collusion* among the buyers. These problems are described below in detail.

TABLE 3.3: TOBACCO AUCTION FLOOR PRICES

Year	Estate Tobacco		ADMARC Tobacco		
	Flue-Cured	Burley	NDDF	SDDF	Sun/Air
1980/81	100.95	117.74	124.45	88.09	83.57
1981/82	179.33	231.61	174.97	131.29	137.31
1982/83	208.81	216.24	343.69	199.64	276.17
1983/84	187.08	130.71	287.54	197.39	236.36
1984/85	122.55	162.59	230.21	175.53	229.68
1985/86	238.00	182.00	150.00	94.00	106.00

Source: ADMARC.

Oversupply

The increases of tobacco prices in recent years coupled with relaxation in production quota control have led to an oversupply situation. In 1985/86 ADMARC bought 19 million kilogrammes of tobacco against the trade requirements of about 14 million kilogrammes. High producer prices attracted many new registered and unregistered growers and it is believed that the latter were responsible for the oversupply situation. On the other hand ADMARC continued to buy all tobacco presented even when the production quotas had been exhausted. This was because of the requirement on ADMARC to buy all tobacco from growers.

Quality

During 1985/86 as in 1984/85 buying season ADMARC bought substantial quantities of low quality leaf at high prices (see Table 3.4). The following reasons contributed to poor quality.

(*a*) The number of unregistered growers has increased. These sometimes raise their own tobacco seed, usually of poor quality, lack supervision and have insufficient curing barns as well as firewood.

(b) Poor grading on the part of ADMARC classifiers. This was partly because of congestion at ADMARC markets resulting from frequent cash shortages. The marketing of tobacco is done in a rotational manner—a group of villages are allocated their own marketing days. When cash runs out growers keep on bringing their produce, causing congestion when the marketing reopens and ADMARC classifiers fail to classify the crop thoroughly. In addition, quality deteriorated during the waiting period.

(c) Poor classification was in some cases due to insufficient training of the classifiers.

(d) Poor grading, in turn, caused farmers to be less careful in handling their tobacco since they felt assured that their tobacco would fetch high prices anyway.

(e) Quality also deteriorated in the ADMARC sheds partly because of the congestion and poor design of the sheds, as well as poor transport co-ordination.

(f) The continued use of inappropriate fertilizers probably due to the high prices of appropriate fertilizers that result in low margins for the growers.

TABLE 3.4: COMPARISONS OF CLASSIFICATION PURCHASED AND SOLD—NORTHERN DIVISION DARK-FIRED TOBACCO (1984/85)

Grade	Purchased (Kg)	Sold (Kg)	Per cent Sold/ Purchased
C1	2,097,234	351,869	*17*
C2	2,324,622	264,771	*11*
K	—	50,240	—
H	—	794	—
F	577,709	52,240	*9*
L	1,898,246	1,865,079	*98*
G1	1,987,166	466,467	*23*
G2	3,295,597	1,231,959	*37*
X1	1,583,997	773,718	*49*
X2	1,474,832	8,919,002	*600*
SCRAPS	—	784,679	—
TOTAL	15,239,403	14,760,818	

Source: ADMARC.

This table illustrates the general performance of ADMARC classifiers. It shows that most of the tobacco classified by ADMARC classifiers to be of high grade turned out to be low grade after commercial grading. For instance only 17 per cent of the leaf bought by ADMARC as C1 was sold as C1, whilst 83 per cent was relegated to lower grades; only 11 per cent bought as C2 was sold as such whilst 89 per cent went to lower grades.

Action of Buyers

It is also felt that action by the buyers contributed to the low auction prices of ADMARC tobacco in the following ways:

(a) It is suspected that in reaction to the export levy there was collusion among buyers to force prices down.

(b) Buyers somehow had the foreknowledge of the oversupply situation. They, therefore, speculatively waited for low prices.

Other Factors

Another factor responsible for poor performance in tobacco is the *pricing* mechanism. Determination of input and producer prices is done by a pricing committee consisting of Government departments (Economic Planning and Development, Ministry of Agriculture, Ministry of Finance and Ministry of Trade, Industry and Tourism). Although ADMARC is consulted its commercial interests are not adequately considered. With regard to the current prices, for instance, it had originally been proposed to raise the price of tobacco by 75 per cent but through ADMARC insistence the increase was lowered to 22 per cent. Even this latter level had not been considered by ADMARC to be commercially acceptable as ADMARC had wanted an increase of 14 per cent.

Issues Related to Maize

Issues related to maize are divided into three, namely, the strategic maize reserve, surplus maize stocks and subsidies on domestic maize sales.

Strategic Maize Project

ADMARC is the exclusive agency in relation to this project of national importance. Construction of the silo complex was financed by long-term external finance arranged by ADMARC itself. This section analyses the impact of maintaining strategic maize stocks and servicing costs of the silo complex on ADMARC's liquidity position.

(a) *Strategic Maize Reserves*

For 10 years up to 1981, annual maize sales by ADMARC ranged from 80,000–136,000 tonnes. During this time, domestic maize sales were, on average, equal to total purchases. It was, therefore, necessary to increase the price of maize as an incentive for the smallholders to produce enough surplus both for local sales and for the silos. In 1982 the price of maize, was therefore, increased from K66 per tonne to K110 per tonne, an increase of 66.6 per cent.

The result of the above measure was an increase in ADMARC's purchases of maize from 136,000 tonnes in 1981 to 296,000 tonnes in 1984 and 268,000 tonnes in 1985.

The total amount of the strategic maize reserves kept in the silo complex is 180,000 metric tonnes which valued at purchase cost comes to about K28.8 million. Apart from the foregone income of about K28.8 million on these stocks, which do not yield ADMARC any return, ADMARC has to bear the cost of maintaining the National Maize Reserve which comes to about K420,000 per annum in addition to the costs of stock replacement, which during the 1985/86 financial year, are estimated at about K2.86 million.

The foregone income and the related costs of the strategic maize stock have reflected themselves in the increasing overdraft requirements in recent years. The maize stocks, therefore, implicitly cost ADMARC an additional K4.8 million per annum in interest on overdraft. See Table 3.5. The total cost of the stocks as estimated by ADMARC stand at K46.6 million.

(b) *Silos Complex*

As mentioned above, the silo complex was implemented by ADMARC. The construction of the silos was financed by long-term loans arranged by ADMARC for this purpose. The capital cost of the silo complex was K15.9

million. ADMARC has borne the capital cost relating to the silo complex, consisting of loan repayments and interest. The annual total loan repayment is approximately K1.9 million and interest payments are estimated to be K1.0 million in 1985/86.

TABLE 3.5: SOURCES OF FINANCING
K'000s

Year	Net Profit	Depreciation	Long-term Borrowings	Bank Overdraft
1971–72	7,797	329	1,915	—
1972–73	6,271	446	1,734	—
1973–74	8,267	545	1,474	—
1974–75	10,816	797	9,744	—
1975–76	7,369	977	33,208	—
1976–77	23,739	1,023	30,588	—
1977–78	17,395	1,240	27,541	—
1978–79	2,616	1,317	31,244	—
1979–80	(4,683)	1,479	37,884	979
1980–81	(6,197)	1,626	50,995	6,419
1981–82	618	1,861	55,586	5,714
1982–83	3,043	2,905	69,261	14,002
1983–84	7,914	2,550	66,043	8,308
1984–85	4,269	2,971	53,936	18,828

Source: ADMARC.

Surplus Maize Stocks

ADMARC keeps its own maize stocks apart from the strategic maize reserve and these too have increased in reaction to producer price increases and other factors. These excess stocks currently stand at 79,000 tonnes and are estimated to increase to 119,000 tonnes owing to the limited export demand and domestic consumption.

TABLE 3.6: MAIZE STOCKS

	1985/1986		1986/87 (Estimate)	
	MT	(K'000)	MT	(K'000)
Surplus	19,000	3,191	40,000	6,910
Stocks	60,000	10,708	79,000	14,353
	79,000	13,899	119,000	21,363

Source: ADMARC

The cost of these stocks, and storage costs incurred, arise through ADMARC being required to purchase all maize presented.

Developments in 1985 showed that exports of maize could not be relied upon as an outlet for the surplus maize. Owing to the fact that Zimbabwe, which was a net importer of maize from Malaŵi in 1984, had surpluses in 1985, Malaŵi's external market for maize was limited. Additionally, owing to high transport costs, Malaŵi could not compete with Zimbabwe, price-wise and as such most of the export orders went to Zimbabwe. Towards the end of the financial year ADMARC managed to export some of the surplus maize and it is estimated that total maize exports at the end of the financial year, 1985/86 would be 100,000 metric tonnes, leaving a surplus of 19,000 metric tonnes to be turned into stocks.

If we compare with 1984 it is apparent that the low maize prices on the export market are also a contributory factor on the big loss ADMARC are going to make on the maize account during the financial year ending 31st March, 1986.

In summary, another cause of the liquidity crisis related to maize arises from the fact that producer prices had to be increased sharply in order to cater for, among other reasons, the requirements of the strategic maize reserve and that ADMARC are required to buy all that is offered for sale. But the requirements for the initial strategic maize stocks were for only 180,000 metric tonnes. It is due to drought conditions in neighbouring countries that this crisis was not much worse than it would have been. Those export markets are now getting smaller owing to good rains in most of the drought affected countries. We should, therefore, expect further build-up of stocks in future.

Subsidy on Domestic Maize Sales

ADMARC sells maize locally at a price fixed by Government, which is less than ADMARC's imputed total costs. The subsidies thereby created are K3.5 million in 1985/86, according to ADMARC's valuation, increasing to K4.0 million in 1986/87 as shown in the table below:

TABLE 3.7: COMPUTATION OF MAIZE SUBSIDY

	1985/86 K	1986/87 K
Sales	150,000m.t.	150,000m.t.
Cost per m.t.	166.01	169.14
Selling Price per m.t.	155.55	155.55
Subsidy	10.46	13.59
Administration Costs per m.t.	12.96	13.17
Total Subsidy per m.t.	23.42	26.76
Total Subsidy	K3,513,000	K4,014,000

Source: ADMARC.

For ADMARC to break-even it implies that maize prices will have to be increased by 17.2 per cent in 1986/87.

If one looks at the crop trading accounts (Appendix I) over 50 per cent of net administrative costs are imputed on maize. The methodology used in attributing net administration costs on any particular crop is that they apportion those costs according to total buying and direct expenses. Since the direct costs on maize have been rising rapidly and those of tobacco have hardly risen at all, it has meant a faster increase in net administrative expenses imputed on maize. The question is, whether there is a direct correlation between buying and direct expenses and net administrative expenses.

Input Subsidies

Inputs, such as tobacco, cotton and maize seeds are subsidized by selling at less than purchase price, and by costs (transport, distribution, etc.) not being recovered. The estimated subsidy in 1985/86 and 1986/87 is K0.9 million. Additionally, in the past the price for fertilizer has been directly subsidized by ADMARC until the establishment of the Smallholder Fertilizer Revolving Fund (SFRF) in 1982/83. ADMARC was asked to contribute to the SFRF annually both in cash and fertilizer and by 1986/87 ADMARC will have contributed a total of K13.5 million. The cash contributions of 1985/86 and 1986/87 are K5.96 and K4.26 million, respectively.

Such large annual contributions have also placed a strain on ADMARC's overall profitability and hence its ability to build up reserves for crop purchases.

Operating Costs

TABLE 3.8: ADMARC: ESTIMATED TRADING ACCOUNT FOR YEAR ENDING 31st MARCH, 1986 (K'000)

	Cotton	Ground-nuts	Tobacco	Maize	Rice	Other	Total	% of Sales
Sales	27,150	15,174	25,590	46,273	3,605	8,836	126,628	*100*
Selling Expenses	1,290	607	1,960	950	50	122	4,979	*4*
Purchase of Crop	13,511	12,058	20,141	32,696	1,815	5,023	85,243	*67*
Stock Adjustment	2,910	2,181	0	1,684	11	705	7,491	*6*
Buying Expenses..	5,854	2,330	6,128	14,801	2,088	1,947	33,147	*26*
Trading Profit	3,585	−2,002	−2,639	−3,858	−359	1,040	−4,232	*−3*
Administration Expenses	1,642	654	1,719	4,153	586	346	9,300	*7*
Net Trading Profit	1,943	−2,655	−4,358	−8,011	−944	−484	−13,532	*−11*

Source: ADMARC.

The above table indicates that apart from the cost of crop purchases themselves, buying and direct expenses and administration are the more important categories of cost. In 1985/86, these represented 26 per cent and 7 per cent of total gross sales, respectively, compared to 27 and 7 per cent in 1984/85, and 23 and 7 per cent in 1983/84.

These figures suggest that Administration costs were allowed to keep pace with sales.

Buying and Direct Expenses

The following table shows a breakdown of direct and buying expenses since 1983/84. After growing by 55 per cent in 1984/85, total direct and buying costs decelerated in 1985/86 mainly due to reduced spending on bags and twine and fumigation, as the total volume of crop purchases declined from 379,452 tonnes in 1984/85 to 367,100 in 1985/86.

TABLE 3.9: ADMARC: DIRECT AND BUYING EXPENSES K'000

	1985/86	% of Sales	1984/85	% of Sales	1983/84	% of Sales
Marketing	8,700	*7*	7,097	*5*	5,278	*6*
Depot and Storage	2,900	*2*	2,837	*2*	2,034	*2*
Bag, twine, etc.	2,855	*2*	5,568	*5*	801	*0.8*
Grading and Ginning	5,456	*4*	4,823	*4*	3,026	*3*
Transport of crops	11,530	*9*	11,405	*9*	9,356	*10*
Fumigation	522	*0.4*	529	*0.4*	505	*0.5*
Insurance	284	*0.2*	266	*0.2*	203	*0.2*
Seed and Distribution	900	*0.7*	850	*0.7*	320	*0.3*
TOTAL	33,147	*26*	33,375	*27*	21,524	*23*

Source: ADMARC.

The main components of total direct and buying expenses are transportation, marketing, grading and ginning. The estimated cost per tonne purchased for each crop in 1985/86 is shown below.

The distribution of estimated total direct and buying expenses between crops in the years 1983/84 through 1985/86 is shown below.

It can be seen from the tables above that, although the direct costs of maize purchases per tonne are relatively low, the high volume (268,000 tonnes in

1985/86) results in around 50 per cent of total direct costs being attributable to maize.

TABLE 3.10: ADMARC: ESTIMATED DIRECT AND BUYING COSTS PER TONNE (K/m.t.) 1985/86

	Cotton	G/Nuts	Tobacco	Maize	Rice	Other	Total
Transport of Crops ..	41.7	40.0	44.9	28.2	48.0	27.0	31.4
Marketing	31.6	48.6	114.0	13.4	36.5	27.7	23.7
Grading and Ginning ..	56.0	28.6	105.0	0.0	88.0	—	14.9
Others	51.4	15.9	32.1	13.6	17.3	56.6	20.3
TOTAL ..	180.7	133.1	296.0	55.2	189.8	111.3	90.3

Source: ADMARC.

Also associated with this crop is the food security maize reserve silos in Lilongwe keeping about 180,000 tonnes. It is estimated that in 1985/86 these will cost about K420,000 per annum in maintenance of which 19 per cent represents expenditure on electricity, the power source used, and 59 per cent insurance cover against any dust explosion, fire, etc.

TABLE 3.11: ADMARC: DISTRIBUTION OF DIRECT EXPENSES BY CROP, 1983/84–1985/86

Crop	Direct Expenses 1985/86 (K'000)	1985/86 % of Total	1984/85 % of Total	1983/84 % of Total
Cotton	5,854	*18*	*18*	*12*
Groundnuts	2,330	*7*	*6*	*7*
Tobacco	6,128	*18*	*15*	*14*
Maize	14,801	*45*	*51*	*56*
Rice	2,088	*6*	*6*	*8*
Others	1,947	*6*	*4*	*4*
TOTAL	33,147	*100*	*100*	*100*

Source: ADMARC, Economic Planning and Development.

Tobacco and cotton also account for significant proportions of direct buying expenditures through the grading, ginning and other pre-sale processes.

TABLE 3.12: ADMARC: DISTRIBUTION OF SELLING EXPENSES (%), 1983/84–1985/86

Crop	1985/86	1984/85	1983/84
Cotton	*26*	*2*	*1*
Groundnut	*12*	*6*	*13*
Tobacco	*39*	*17*	*17*
Maize	*19*	*73*	*66*
Rice	*1*	*1*	*2*
Others	*2*	*1*	*2*
TOTAL	*100*	*100*	*100*
TOTAL SELLING EXPENSES (K)	4,979,000	10,106,990	6,744,930

Source: ADMARC, Economic Planning and Development.

Selling Expenses

The cost of sales may be decomposed into the cost of purchases, including stock carry-overs, and "Selling Expenses". The latter in 1985/86 is expected to cost K4,979,000 or 4 per cent of sales. The distribution of this between crops is as shown in Table 3.12.

A large component of selling expenses (51 per cent in 1984/85) is for freigh and shipment of produce, followed by expenses for bags and twine (34 per cen in 1984/85).

Following the closure of the Nacala and Beira rail routes to the sea, alter native routes have been sought resulting in sharp increases in transportatioı costs, which have been compounded by rising fuel costs. An other effect of thı re-routing of produce has been changes in transit time from 14 days to up tı four months to reach Dar-es-Salaam and Beira (via Harare).

The following table indicates the rise in external transport costs that havı come with the change in ADMARC's export routes.

TABLE 3.13: ADMARC: EXPORT TRANSPORTATION RATES, 1984–1985

Road and Rail Composite: Route	1984 US$ per m.t.	1985 US$ per m.t.	% Change
Limbe-Harare-Durban	96.00	125.00	*30*
Lilongwe-Lusaka-Durban	99.00	—	—
Limbe-Lilongwe-Lusaka-Dar-es-Salaam	194.25	223.38	*15*
Liwonde-Chipoka-Dar-es-Salaam	118.30	142.86	*21*
Liwonde-Beira (Inoperative)..	18.58	—	—
Liwonde-Nacala (Inoperative)	18.58	20.40	*10*

Source: ADMARC.

The effect of such increases has been an erosion of export-competitiveness especially with respect to maize, a crop which is bulky, yet low value. This has been compounded by low international prices and the availability of maize surpluses in neighbouring countries.

TABLE 3.14: ADMARC: SALES RECEIPTS, TOTAL TRADING COSTS, PROFIT AND CROP PURCHASE COSTS PER TONNE BY CROP 1985/86

Sales:	Cotton	G/Nuts	Tobacco	Maize	Rice	Other	Total
—Value (K'000)	25,150	15,174	25,590	46,273	3,605	8,836	126,628
—Quantity (m.t.)	38,546	19,922	20,700	248,590	11,060	19,416	358,234
—Value per tone	704	761	1,236	186	326	455	353
Domestic	565	773	1,236	156	200	452	348
—Export	1,118	746	—	233	481	456	352
Total Trading Expenses:							
—Value (K,000)	25,207	17,829	29,948	54,284	4,549	8,342	140,160
—Per tonne sold ..	654	895	1,447	218	411	430	391
Profit per tonne sold ..	50	−134	−211	−32	−85	25	−38
Crop Purchases							
—Value (K'000)	13,511	12,058	20,141	32,696	1,815	5,023	85,243
—Quantity	32,400	17,500	20,700	268,000	11,000	17,500	367,100
—Value per tonne	417	689	973	122	165	287	232

Source: ADMARC.

Movements in total trading costs in recent years are shown below. The implied compound growth is 26 per cent per annum.

ADMARC: TOTAL TRADING COSTS (K'000)

	1985/86	% Change	1984/85	% Change	1983/84
Total Trading Costs ..	140,160	*27*	110,311	*24*	88,722

Source: ADMARC.

Chapter 4

CONCLUSIONS AND RECOMMENDATIONS

Tobacco Related Issues

From the foregoing, it is clear that the tobacco problem is multidimensional and that it requires efforts by both ADMARC and Ministry of Agriculture to resolve. Secondly, it is clear that unlike problems to do with investments, the tobacco problem can be resolved in the short-term. The following proposals are made—

(*a*) The quota system needs to be enforced in order to control supply. This measure will also contribute to quality since it has been affected by ADMARC's incapability to handle too much volume of tobacco. It is proposed that only the tobacco presented by registered growers and up to the quantities registered should be bought first. Any excess tobacco should be assessed by ADMARC and Government who should make arrangements to finance subsequent purchases. In this regard a special facility should be established to finance excess purchases at prices commensurate with sale prices and related costs.

(*b*) Also to control supply and quality of the leaf, there is need for more strict procedure of registration of growers. Registration must take into account:

—availability of adequate barn accommodation;
—availability of adequate firewood for curing; and
—fulfilment of previous quotas.

It is proposed that, before the next growing season, the quantities registered be reviewed on the basis of the above criteria. If a grower does not satisfy any of the above conditions, his quota should be reduced accordingly. This action calls for closer co-ordination between Ministry of Agriculture and ADMARC at the headquarters level as well as at the field level where, in addition, the grower representatives should also be involved.

(*c*) Once the production quotas have been allocated to growers, there is need for a much closer supervision of farmers handling of tobacco by extension workers.

(*d*) Since poor classification has cost ADMARC a lot of money, it is recommended that a set of measures be taken to avoid this happening again. Firstly, classifiers must be properly trained every year before marketing begins. Secondly, each classifier must be assessed on the basis of commercial grades. Where a classifier has failed to reach a certain level of performance, appropriate measures should be taken. Thirdly, a feasible marketing rotation should be worked out and be more co-ordinated to avoid congestion at markets—a factor that is sometimes responsible for poor classification performance.

(*e*) ADMARC should ensure availability of cash at all times during the marketing season. This measure will ensure continuous buying and control congestion at ADMARC markets.

(f) To avoid congestion in ADMARC sheds and subsequent deterioration of quality there is need to ensure that transport is readily available.

(g) Information on tobacco production levels should be kept confidentially to prevent unfavourable buyer action.

(h) There is need that ADMARC should be more effectively represented in the pricing committee at various stages of pricing to safeguard its commercial interests. In this regard, producer pricing should consider the potential impact on ADMARC's overall profitability.

(i) ADMARC should have the mandate to withdraw and sell elsewhere any tobacco that fetches unsatisfactory prices at the auction floors. In this regard, ADMARC marketing intelligence needs to be strengthened.

(j) Government should strengthen the commercial section of embassies abroad to monitor, among other things, developments in the tobacco industry and markets.

Maize Related Issues

(a) Strategic Maize Project

It has been observed above that part of ADMARC's liquidity problems arose from the implementation of the strategic maize project which in turn was a directive from Government. The strategic maize project has affected ADMARC's liquidity in the following ways:

(i) A considerable part of ADMARC's capital is tied up in strategic maize reserves. The result of this is the growing overdraft requirements in recent years. This overdraft has been costing ADMARC some interest. In addition the maize stocks have to be maintained and replaced and these involve considerable costs.

(ii) The 66 per cent increase in producer prices of maize in 1982 and the resultant phenomenal increase in marketed output of maize have put a considerable strain on ADMARC's financial resources. Whereas in the past proceeds from tobacco sales helped to finance the other crops, this time it was not possible.

(iii) The phenomenal increase in marketed maize output has resulted in a build up of stocks in addition to those in the silos and has meant a lot of liquid assets being tied up in such stocks.

(iv) The interest and loan payments on the capital costs of the silos are costing ADMARC K2.9 million, per annum.

While ADMARC is incurring these considerable costs the project itself is not expected to yield any return to ADMARC. It is, therefore, recommended that in order to restructure ADMARC and put it on a commercial footing the following measures be undertaken:

(i) Government has decided to purchase the strategic maize stocks valued at K46.6 million by partly using the K26 million loan advanced to ADMARC. However, this would mean that there would be no additional cash injection into ADMARC and, therefore, their ability to purchase maize this year will be limited. It is, therefore, recommended that instead of offsetting the purchase of the strategic maize

reserves against loan advances to ADMARC, Government should consider turning the loan into a long-term loan under soft terms, and that Government should seek financing for the purchase of the strategic maize reserves.

(ii) ADMARC should continue running the silos as an agent for Government at an agreed fee.

(iii) Government should buy silo complex at an agreed price. The silos have cost ADMARC K15.7 million to build.

Since maize is grown by 90 per cent of the rural population, it is regarded as a major source of cash income for the rural areas. It is, therefore, further recommended that:

(iv) A study should be conducted on alternative rural income generating activities to lessen absolute dependence on maize as the major source of cash income.

(v) As an interim measure on the rising stocks both Government and ADMARC should determine minimum stocks required for commercial purposes. Any excess over and above that would not be commercial and as part of the restructuring programme, government should purchase those stocks. The total cost of all the stocks in 1985/86 stood at K13.9 million.

(vi) Related to (v) above the purchase of the stocks would only relieve ADMARC's problems temporarily because the overproduction of maize is expected to continue. It is therefore recommended that ADMARC should do some aggressive marketing both domestically and abroad to reduce the rise in stocks. In the case of exports, the possibility of barter trade should be considered.

(vii) It is believed that the incorporation of private traders could relieve ADMARC in the marketing of maize, but the implications of this on rural development are not yet clear. It is, in this light, recommended that a careful study should be conducted on the potential role of private traders and their impact on ADMARC and agricultural development.

(b) Subsidies on Maize

As we have observed above the act of requiring ADMARC to sell maize below costs is not a commercial one. Any losses arising from that should be covered from public funds. The size of the subsidy is however not very clear as we have observed above. It is therefore recommended that a careful study should be made on how best to apportion administrative costs on domestic maize sales, and arrive at an appropriate subsidy.

Investments

1. Government and ADMARC have already reached agreement on the Corporation selling off shares in unrelated fields and reducing its participation in some agro-based firms. As an immediate solution to the Corporation's liquidity problem, more concrete proposals should be made about the exact

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time, and to whom, those investments can and/will be sold, including the determination of the current market value of the investments (expressed at cost value, see Appendix IV).

2. Apart from looking after its primary marketing interests, the management of ADMARC is also burdened with having to look after its interests in the investments it has made, in addition to making new investment decisions. This places a considerable strain on the management's ability to look after ADMARC's interests properly.

It is, therefore, recommended as follows:

(i) that the Development arm be separated from the main body of ADMARC and that it should be formed as a subsidiary of ADMARC;

(ii) that all investment proposal should be made, appraised and executed by the subsidiary.

3. In the past, a substantial proportion of ADMARC's current assets have been in terms of trade debtors and stocks of produce. Only about K2 million were in terms of marketable securities. Total liquid assets (excluding inventories) have grown from only K1.8 million in 1981 to an estimated K2.2 million in the period up to March 31st, 1986, compared with total operating costs of K63 million in 1981 and K140 million in 1986 so that in the event of no sales, the Corporation could operate 102 days in 1981 and only 57 days in 1986. It is, therefore, suggested that in future sufficient investments should be made in liquid assets as security against volatility of tobacco and other agricultural prices.

Operating Costs

As attention is drawn on cross subsidization among crop accounts, a re-examination is needed on the methods used to apportion various expenses on buying, transport, storage, selling and administrative costs to particular crops.

As transport and freight costs for a substantial proportion of trading costs, another re-examination is required on:

(i) ADMARC traffic freight rates and the employment of private truckers;

(ii) the extent to which cost savings may be further realized on administration:

(iii) the expenses related to the pre-sale activities of grading and ginning for tobacco and cotton; and

(iv) the operating costs of the strategic maize reserve silos.

Input Subsidies

As observed above input subsidies are exerting a considerable strain on ADMARC's profitability. However, subsidies in such inputs as cotton, and tobacco seeds ensure that farmers use high quality seed which would, in the end, be beneficial to ADMARC. It is recommended that ADMARC continue bearing such costs. On the other hand, ADMARC should not be asked to contribute to the Fertilizer Revolving Fund as such contributions are not commercial.

APPENDICES

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CROP TRADING ACCOUNTS

APPENDIX I

	1979 Tobacco	Maize	GP	1982 Tobacco	Maize	GP	1983 Tobacco	Maize	GP	1984 Tobacco	Maize	GP	1985 Tobacco	Maize	GP	1986* Tobacco	Maize	GP
Sales	19.85	5.69	27.48	20.96	6.32	40.20	27.49	10.05	34.69	25.19	49.50	70.08	39.26	56.31	83.91	25.53	46.27	101.04
Less: Selling Expenses ..	0.70	0.26	0.95	0.93	—	2.53	0.86	—	1.55	1.14	4.42	5.60	1.49	7.35	8.61	1.96	0.95	3.02
Freight	—	—	1.38	—	—	2.24	—	—	1.16	—	2.61	3.50	—	4.53	5.15	—	—	—
Other	0.70	0.26	1.10	0.93	—	0.29	0.86	—	0.39	1.14	1.82	2.10	1.49	2.83	3.46	1.96	0.95	—
Movement of Stocks + (−) ..	1.54	2.30	6.04	—	7.25	3.53	—	24.43	20.65	—	−7.60	7.78	—	9.54	16.33	—	−1.68	−7.49
Net Sales	20.04	5.43	31.68	20.00	13.60	43.20	26.63	34.48	45.19	24.04	37.47	56.71	37.57	58.50	75.48	23.63	43.64	90.53
Buying and Direct Expenses ..	3.22	3.30	9.70	3.54	7.25	15.57	2.60	9.53	16.30	2.91	12.12	18.61	4.90	17.12	28.47	6.13	14.80	27.02
Transport	0.67	1.00	2.22	0.67	4.03	7.13	0.44	5.68	7.42	0.34	7.35	9.01	0.79	7.84	10.61	0.93	7.55	10.60
Other	2.55	2.30	7.48	2.87	3.22	8.44	2.16	3.85	8.88	2.57	5.77	9.60	4.11	9.28	17.86	5.20	7.25	16.42
Purchase of Crops	11.30	6.74	19.22	6.14	9.05	22.44	4.49	27.29	37.45	6.87	27.11	39.18	15.62	35.65	59.14	20.14	32.70	65.10
Net Admin. Expenses ..	1.31	1.02	2.79	1.18	2.41	5.18	0.91	3.44	5.84	0.90	3.73	5.72	1.31	4.57	7.77	1.72	4.15	7.58
Net Profit/(Loss)	4.23	−3.34	−0.05	9.14	−5.13	−0.28	18.60	−5.77	−6.38	13.36	−5.49	−1.15	15.73	1.18	2.88	−4.36	8.01	−2.17

GP = General Produce—includes maize.

* = Provisional.

Source: ADMARC.

PROFIT AND LOSS ACCOUNT

	1976	1977	1973	1979	1980	1981	1982	1983	1984	1985	1986*
Crop Trading Profit	9,976	22,685	30,040	4,181	70	326	8,862	12,219	6,550	12,852	−13,532
Add: Other Revenue											
Dividends	445	1,213	258	2,280	1,506	1,806	1,567	1,168	1,147	1,328	615
Interest	2,835	3,424	4,904	5,088	4,557	4,980	5,507	7,055	2,851	1,308	1,878
Other	1,689	127	1,457	−427	—	204	216	65	6,647	4,279	950
	14,945	27,449	36,659	11,122	6,133	7,316	16,152	20,507	17,195	19,767	−10,089
Less: Other Expenses											
Fertilizer and Farmers Aid ..	2,497	−621	2,262	2,081	4,194	5,903	4,174	2,445	4,814	4,010	3,929
Interest on long-term loan ..	2,015	2,522	3,074	2,996	4,246	6,530	6,235	9,270	6,782	6,464	9,758
Provision for Doubtful Debts ..	740	320	380	160	250	250	1,143	873	536	843	500
Miscellaneous Projects Net Cost	555	692	1,132	1,342	1,034	769	778	931	1,296	810	700
Grants and Contributions ..	175	175	175	36	—	—	—	—	—	—	—
Investments	998	243	—	—	—	—	—	—	—	—	—
Other	596	283	643	147	1,092	62	2,792	3,944	1,494	3,010	1,062
	7,576	3,614	7,666	6,762	10,816	13,514	15,122	17,463	14,922	15,137	15,940
Profit before Grants to Malawi Government	7,369	23,835	28,993	4,360	−4,683	−6,198	1,030	3,044	2,273	4,269	−26,029
Less: Grants to Malawi Government	—	96	11,597	1,744	—	—	412	—	−5,642	—	—
Profit Transferred to Reserves ..	7,369	23,739	17,396	2,616	−4,683	−6,198	618	3 044	7,915	4,269	−26,029

*Provisional.

Source: ADMARC.

SOURCES AND USES OF FUNDS

	1978	1979	1980	1981	1982	1983	1984	1985
SOURCES OF FUNDS								
Profit for the Year ..	17,395	2,616	—	—	1,030	3,043	7,914	4,619
Adjustment for the Items not involving the Movement of Funds ..	891	1,176	—	—	4,156	10,655	2,962	1,525
TOTAL FUNDS GENERATED FROM OPERATIONS ..	18,286	3,792	—	—	5,186	13,698	10,876	6,154
Long-Term Borrowing ..	10,391	10,593	11,853	18,307	9,166	34,415	49,127	451
Decrease in Net Liquid Funds ..	—	15,103	3,869	6,384	—	9,014	—	11,192
Other ..	27,427	−3,892	21,129	4,141	2,016	2,375	59,669	14,635
TOTAL SOURCES OF FUNDS ..	56,104	25,595	36,851	28,832	16,458	59,502	119,672	32,432
APPLICATIONS OF FUNDS								
Loss for the Year ..	—	—	4,683	6,198	—	—	—	—
Purchase of Fixed Assets ..	6,048	4,492	7,293	11,372	5,271	1,910	1,452	3,865
Purchase of Investment and Loan Grants ..	13,460	7,326	11,481	9,804	2,680	7,165	54,700	9,096
Repayment of Long-term Borrowing ..	10,316	5,987	6,580	5,196	3,477	22,310	52,590	5,725
Increase in Debtors ..	8,015	6,665	—	—	—	—	—	—
Increase in Net Liquid Funds ..	10,950	—	—	—	67	—	6,744	—
Other ..	7,315	1,126	6,814	−3,737	4,963	28,917	17,674	13,746
TOTAL APPLICATIONS OF FUNDS ..	56,104	25,595	36,851	28,832	16,458	59,502	119,672	32,432
MEMORANDA ITEMS								
Fixed Assets ..	19.61	22.14	29.30	39.00	42.33	41.29	40.17	41.05
Investment and Loans ..	54.10	53.69	59.03	64.75	64.25	68.86	88.75	94.80
Cash on Deposit ..	5.48	0.28	1.14	1.32	1.08	1.07	0.75	0.84
Cash at Bank and on Hand ..	16.82	6.91	2.04	2.04	1.64	0.92	2.29	1.53
Local Registered Stock ..	9.00	9.00	2.00	2.00	2.00	2.00	2.00	2.00

Source: ADMARC.

APPENDIX IV

LIST OF ADMARC'S SHAREHOLDINGS

Shares in Independent Estates are:	
Bua Tobacco Estates Limited	240
Cattle Feedlot Company	95,000
Chasato Estates	200
Kasikidzi Estates	200
Livilidzi Estates	100
Mangani Estates	72,364
Mpira Estates*	3,572
Tikondane Estates	100,000
Tobacco Estates	145,000
	K416,676
Investments in Agro-industries are:	
ADMARC Canning	40,000
Auction Holdings Limited	829,295
Central Grading and Packaging	50,000
Cold Storage	1,079,000
Cotton Ginners	251,934
David Whitehead and Sons	8,847,020
Dwangwa Sugar Corporation	10,227,998
Grain and Milling	5,440,000
Maldeco Fisheries	508,000
Malaŵi Tea Factory	4,000
Noil	1,394,350
National Seed Company	580,000
Spearhead Holdings	80,685
Sugar Corporation of Malaŵi	9,300,000
Tobacco Marketing Company	10,000
TOTAL	38,672,282
Investments in non-agricultural related activities are:	
ADVANX	183,280
National Bank of Malaŵi	2,013,796
Cory Mann George	280,000
FINCOM	220,000
INDEBANK	1,000,000
Lever Brothers	575,000
Manica Freight Services	500,000
OPTICHEM	567,792
P.E.W.	682,100
U.T.(M) Limited	1,391,960
TOTAL	7,331,148

*Leased out.

APPENDIX V

ADMARC: DIVIDENDS RECEIVABLE

	1985	1984
Auction Holdings Limited	221,841	134,092
Bata Shoe Co. (M) Limited	166,698	134,828
Cotton Ginners	34,546	6,120
David Whitehead & Sons	158,400	158,400
Finance Corporation of Malaŵi	—	69,600
INDEBANK	59,400	34,833
Lever Brothers	184,800	254,000
Manica Mann George	160,000	75,000
National Seed Company	52,200	52,200
Optichem (Malaŵi) Limited	10,947	(7,000)
P.E.W. Limited	174,000	130,500
U.T.(M) Limited	105,013	103,547
	1,327,845	1,147,120

ADMARC: INTEREST RECEIVABLE

	1985	1984
	K	K
ADMARC Canning Company	—	12,410
ADVANX 'A' Floating Deb.	—	10,150
Bua Tobacco Estates Ltd.	—	5,014
Central Tobacco Properties	39,890	40,110
Malaŵi Development Corporation	7,507	9,993
Malaŵi Tea Factory 'A' Deb.	14,250	17,275
Malaŵi Tea Factory 'B' Deb.	32,000	32,044
National Seed Company of Malaŵi	30,334	26,830
Press (Holdings) Limited	—	3,982
Kasikidzi Estates	—	19,550
INDEBANK	224,910	187,430
Press Group	555,784	—
Provident Fund Investments (Crown Agents) ..	—	14,346
Blantyre Print and Packaging	32,903	36,546
Bua Estates	—	36,546
Chasato Estates	—	10,734
Chi:·la Estates	—	8,807
Subordinated Loan DSC	—	154,869
Kasikidzi Estates	—	52,326
Livilidzi Estates	—	59,294
Malaŵi Housing Corporation	50,795	60,682
Mangani Estates	—	52,697
Tobacco Marketing	(198,103)	—
Press (Holdings) Limited	—	345,717
Press (Holdings) Limited (Ex. C.D.C.)	—	513,816
Press (Holdings) Kwacha Loan	—	91,756
Tobacco Estates	1,934	—
PHL/RBM Advance Account	—	841,626
LRS	200,000	200,000
Others	37,899	11,813
	1,030,103	2,851,295

Source: ADMARC.

SALES AND PURCHASE FLOWS 1984/85

Month	Tobacco (Domestic)			Maize (Domestic)			Other Crops (Domestic)			Export Sales	Requirement
	Sales	Purchases	Net Sales	Sales	Purchases	Net Sales	Sales	Purchases	Net Sales		
April	—	—	—	700	—	700	1,901	68	1,833	541	1,074
May	3,050	1,396	1,654	467	—	467	226	136	90	—	2,211
June	11,437	10,559	878	467	4,608	−4,141	—	8,159	−8,159	3,234	−8,183
July	17,156	2,148	15,008	700	9,215	−8,515	746	8,026	−7,281	—	−788
August	4,956	179	4,777	700	15,241	−14,541	2,676	6,572	−3,896	—	−13,660
September	762	—	762	1,167	6,380	−5,213	3,636	2,333	1,305	—	−3,146
October	762	—	762	1,167	—	1,167	3,284	294	2,990	565	5,484
November	—	—	—	1,867	—	1,867	4,421	—	4,421	3,208	9,496
December	—	—	—	3,500	—	3,500	3,455	94	3,359	1,923	8,782
January	—	—	—	3,733	—	3,733	2,441	187	2,254	1,586	7,573
February	—	—	—	4,200	—	4,200	2,450	112	3,338	1,586	9,124
March	—	—	—	4,607	—	4,667	1,648	—	1,646	1,586	7,899
	38,123	14,282	23,841	23,275	35,444	−12,109	26,882	25,981	1,900	14,229	27,851

Source: ADMARC.

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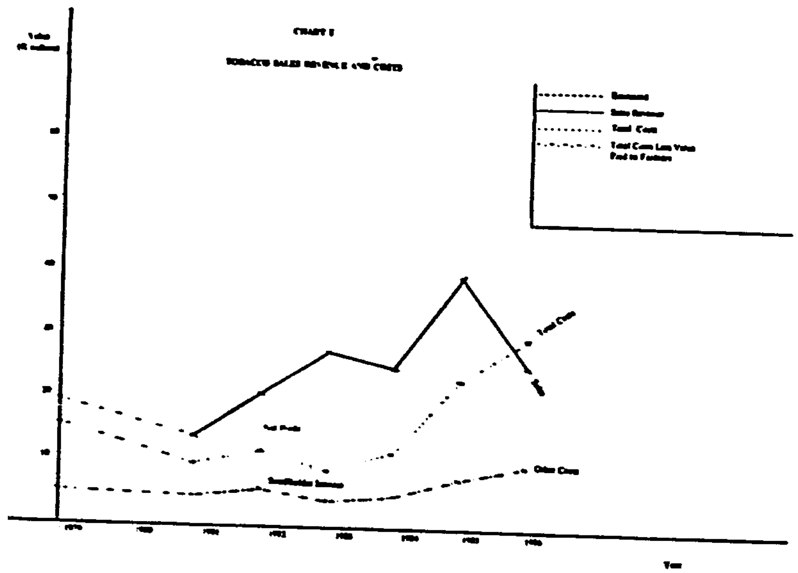

Total Costs

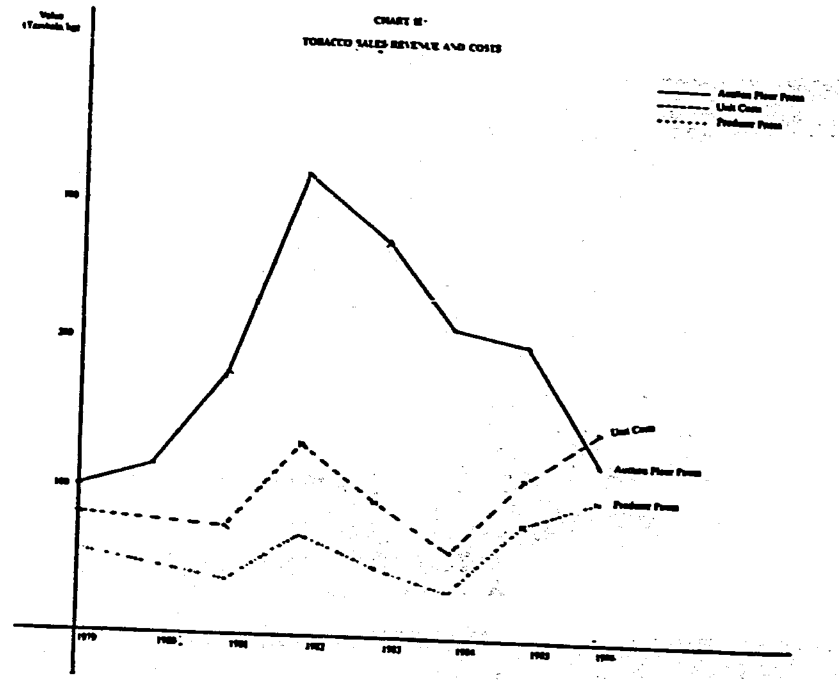
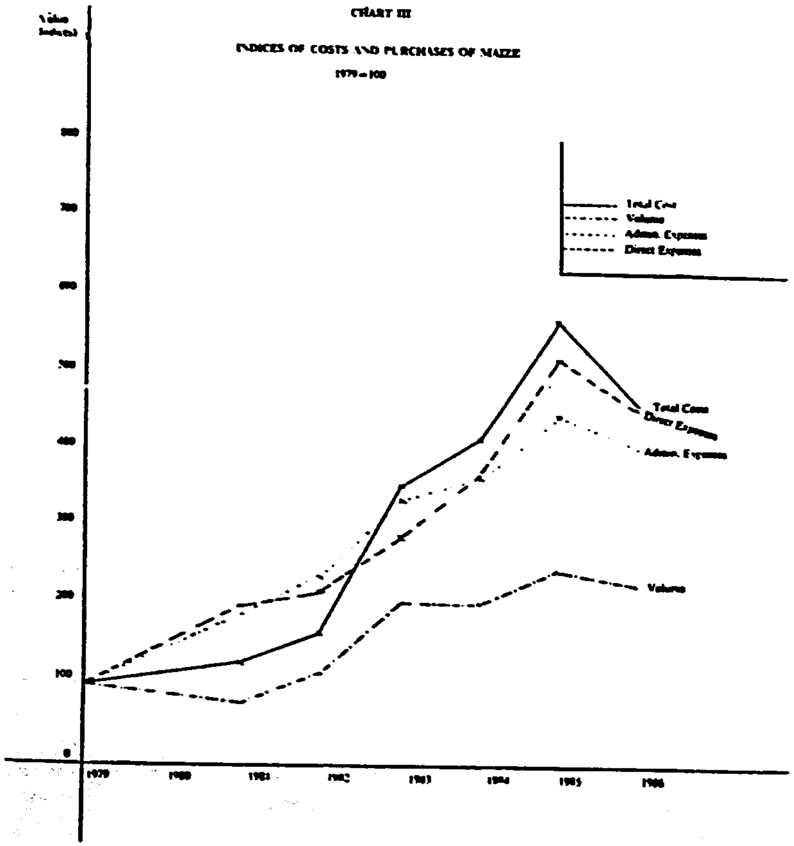


CHART II
TOBACCO SALES REVENUE AND COSTS
Unit Costs
Producer Prices

CHART III

INDICES OF COSTS AND PURCHASES OF MAIZE

1979 = 100



ANNEX C1

The World Bank's Proposed Reform Program vis-a-vis ADMARC

The major objective of the reform program is to reduce ADMARC's role in agricultural marketing to that of a buyer and seller of last resort. The Bank is considering funding this program in the amount of approximately $38.0 million ($8.0 million IDA credit) for approval on or about late-December 1986 or January 1987. The World Bank's proposed reform program is envisioned to address the three major elements discussed below:

A. Increased private sector participation in agricultural marketing. - Examples of activities that are being considered include: (1) public announcement by the GOM that the private sector is strongly encouraged to be involved more heavily in agricultural marketing; (2) adoption by the GOM of a system of differential pricing; (3) reduction in the number of ADMARC marketing outlets; and (4) provision of credit to enable the private sector to assume a heavier role in agricultural marketing.

B. Improvement of ADMARC's financial viability. - This requires a narrowing of the scope of ADMARC's activities as a means of addressing the financial crisis that it currently faces. In addition, measures will be recommended to improve ADMARC's management and operations, including a reduction in the number of ADMARC's personnel.

C. Achievement of food security. - The extent and nature of food insecurity in Malawi will be assessed, and recommendations will be made to address factors that affect the achievement of food security. The World Bank is further considering making a recommendation to the GOM to establish a Food Security Planning Unit to undertake the activities envisioned under this element of the reform program. The Unit will be staffed by 1 or 2 economists and several support staff.

ANNEX D

STATUTORY CHECKLIST
(Malawi FY 86)

Listed below are statutory criteria applicable generally to FAA funds, and criteria applicable to individual fund sources: Development Assistance and Economic Support Fund.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481(h) (1): FY 1986 Continuing Resolution Sec. 527. Has it been determined or certified to the Congress by the President that the government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971) which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully?

   No such determination has been made.

2. FAA Sec. 481(h) (4). Has the President determined that the recipient country has not taken adequate steps to prevent (a) the processing, in whole or in part, in such country of narcotic and psychotropic drugs or other controlled substances, (b) the transportation through such country of narcotic and psychotropic drugs or other controlled substances, and (c) the use of such country as a refuge for illegal drug traffickers?

   Such a determination has not been made.

3. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government?

   GOM is not so liable.

4. FAA Sec. 620(e) (1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

No such action taken by GOM nor its agencies and subdivisions.

5. FAA Sec.620(a), 620(f), 620D; FY 1986 Continuing Resolution Sec. 512. Is recipient country a Communist country? If so, has the President determined that assistance to the country is important to the national interests of the United States? Will assistance be provided to Angola, Cambodia, Cuba, Iraq, Syria, Vietnam, Libya, or South Yemen? Will assistance be provided to Afghanistan without a certification?

Malawi is not a Communist Country.

No. No.

6. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property?

No.

7. FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC?

No.

8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5.

(a) Has the country seized, or imposed any penalty or sanction against any U.S., fishing activities in international waters?

No.

(b) If so, has any deduction required by the Fishermen's Protective Act been made?

N/A

9. FAA Sec. 620(q); FY 1986 Continuing Resolution Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest under a program for which the appropriation bill (or continuing resolution) appropriates funds?

No.

10. FAA Sec 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking into Consideration" memo).

Yes, taken into account by the Administrator at time of approval of Agency OYB.

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

Malawi has maintained good diplomatic relationships with the United States. The initial bilateral assistance agreement is currently under negotiations.

12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)

Malawi is not in arrears with respect to U.N. obligations.

13. FAA Sec. 620A. Has the government of the recipient country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism?

Malawi Government has not aided or abetted international terrorism acts.

14. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?

Such a determination has not been made.

15. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

Negative.

16. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear explosive device? (FAA Se. 620E permits a special waiver of Sec. 669 for Pakistan.)

Negative.

17. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported illegally (or attempted to export illegally) from the United States any material, equipment, or technology which would contribute significantly to the ability of such country to manufacture a nuclear explosive device?

Negative.

18. SDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so,has the President taken into account? (Reference may be made to the Taking into Consideration memo.)

Malawi was not represented at the meeting and so was not associated with the communique.

19. FY 1986 Continuing Resolution Sec. 541. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

Negative.

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilization?

Negative.

Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

Negative.

20. FY 1986 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined as supporting or participating in the management of a program of coercive abortion on involuntary sterilization?

Not Applicable.

If assistance is from the population functional account, are any of the funds to be made available to family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services?

Not Applicable.

21. FY 1986 Continuing Resolution Sec. 529. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States?

Such a determination has not been made.

22. FY 1986 Continuing Resolution Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree?

Negative.

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria.

FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

No such determination has been made.

2. Economic Support Fund Country Criteria

FAA Sec.502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?

No such determination is presently in effect.

SD

5C(2) PROJECT CHECKLIST

Economic Policy Reform Program II:

Parastatal Divestiture

Number: 690-0237

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A. includes criteria applicable to all projects. Part B. applies to projects funded from specific sources only: B.1 applies to all projects funded with Development Assistance loans, and B.3. applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

A. GENERAL CRITERIA FOR PROJECT

1. FY 1986 Continuing Resolution Sec.524; FAA Sec. 634A

Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project.

CN expired without objection on August 14, 1986

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes, see Program Description.

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is the basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislative action is required.

4. FAA Sec. 611(b); FY 1986 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles, Standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See AID Handbook 3 for new guidelines.)

   Assistance is not for such purposes.

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

   N/A

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

   No.

7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

   a. Neutral.
   b. Yes.
   c. Neutral.
   d. Yes.
   e. Yes.
   f. Neutral.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

   U.S. training institutions will be utilized and U.S. expertise may be recruited to participate in the studies and technical assistance component.

9. FAA Sec. 612(b), 636(h); FY 1986 Continuing Resolution Sec.507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

   The GOM has agreed to contribute local currencies under the appropriate A.I.D. programs.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

    Not at this time.

11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

    Yes.

12. FY 1986 Continuing Resolution Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar competing commodity?

    Project assistance is not for the promotion of any specific commodity for export by Malawi.

13. FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16 . Does the project or program take into consideration the problem of the destruction of tropical forests?

    This project has no environmental impact and has been classified accordingly (categorical exclusion on IEE).

14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?

    This is not a Sahel project.

15. FY 1986 Continuing Resolution Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution?

No.

16. ISDCA of 1985 Sec. 310. For development assistance projects, how much of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

None.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d)promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

(a) A key objective of the program is increasing the availability of credit to small Malawian investors.
(b), (c), (d) not applicable
(e) The program includes a management plan for Malawi's strategic grain reserve that will consider regional food security.

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

Yes

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Not applicable

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

The requirement is being waived for Malawi, a RLDC.

e. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

Yes

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

The program will improve ADMARC's capacity to manage agricultural marketing functions for smallholders.

2. Development Assistance Project Criteria (Loans Only).

Not applicable.

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

b. FAA Sec 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S of more than 20% of the enterprise's annual production during the life of the loan?

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of part I of FAA?

Yes.
Yes.

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

No.

c. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin America (The "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

No.

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

Commodities are not being provided.

5C(3) - STANDARD ITEM CHECKLIST

EPRP II: Parastatal Divestiture Project Number 612-0227

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. PROCUREMENT

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

   Project financed contracts will follow AID contracting procedures which contain provisions for promoting small business participation.

2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?

   Yes.

3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

   Malawi does not descriminate against U.S. Marine Insurance.

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed , is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in the U.S.)

   No offshore procurement of agricultural commodities or products will be financed.

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries which are direct aid recipients and which are otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas? Do these countries permit United States firms to compete for construction or engineering services financed from assistance programs of these countries?

No construction or engineering services will be financed.

6. FAA Sec.603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates?

Shipping not excluded from compliance with said requirements.

7. FAA Sec. 621. If technical assistance is financed , will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

Planned technical assistance will be provided on a contract basis to the fullest extent possible.

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes.

9. FY 1986 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

Yes.

B. CONSTRUCTION

No construction will be financed under the program.

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used?

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million? (except for productive enterprises in Egypt that were described in the CP)?

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter?

N/A Grant financed assistance.

2. FAA Sec.301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?

N/A

3. FAA Sec. 620(h). Do arrangements exist to ensure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries?

Such arrangements exist.

4. Will arrangements preclude use of financing:

   a. FAA Sec. 104(f); FY 1986 Continuing Resolution Sec. 526. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or in part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

      1. Yes, arrangements will preclude such uses.
      2. Yes, arrangements will preclude such uses.
      3. Yes, arrangements will preclude such uses.
      4. Yes, arrangements will preclude such uses.

   b. FAA Sec. 488. To reimburse persons, in the form of cash payments, whose illicit drug crops are eradicated?

      Yes, arrangements will preclude such uses.

   c. FAA Sec.620(g). To compensate owners for expropriated nationalized property?

      Yes, arrangements will preclude such uses.

   d. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

      Yes, arrangements will preclude such uses.

   e. FAA Sec. 662. For CIA activities?

      Yes, arrangements will preclude such uses.

   f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

      Yes, arrangements will preclude such uses.

g. FY 1986 Continuing Resolution, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?

Yes, arrangements will preclude such uses.

h. FY 1986 Continuing Resolution, Sec. 505. To pay U.N. assessments, arrearages or dues?

Yes, arrangements will preclude such uses.

i. FY 1986 Continuing Resolution, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?

Yes, arrangements will preclude such uses.

j. FY 1986 Continuing Resolution, Sec. 510. To finance the export of nuclear equipment, fuel, or technology?

Yes, arrangements will preclude such uses.

k. FY 1986 Continuing Resolution, Sec. 511. For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?

Yes, arrangements will preclude such uses.

l. FY 1986 Continuing Resolution, Sec. 516. To be used for publicity or propaganda purposes within U.S. not authorized by Congress?

Yes, arrangements will preclude such uses.

ANNEX E

INITIAL ENVIRONMENTAL EXAMINATION

CATEGORICAL EXCLUSION

Country: Malawi

Title of Activity: Economic Policy Reform Program II: Parastatal Divestiture (612-0227)

Funding: FY 1986 - $15.5 million

IEE Prepared By: Richard C. Day, Program Officer

Environmental Action Recommended: Categorical Exclusion

Discussion: This activity meets the criteria for Categorical Exclusion in accordance with Section 216.2(c) of Regulation 16 and is therefore excluded from further review. A cash grant of $15.0 million will be provided to support the GOM's policy reforms related to privatization of a major parastatal's holdings and strengthening of its portfolio management. The use of cash grant funds is not tied to either financial specific commodities or for a specifically identifiable project or projects and thus it may be considered as an "action which does not have an effect on the natural or physical environment" which, according to Section 216.2(c)(1)(i), is the criteria for categorical exclusion. The balance of $0.5 million will be used to finance technical services, studies and training in support of policy reform measures. The portion of the grant meets the criteria for categorical exclusion provided in Section 216.2(c)(2)(xiv).

Concurrence: John F. Hicks, Mission Director

Bureau Environmental Officer's Decision:
Bessie L. Boyd, AFR/TR/PRO

Approved: X

Disapproved:

Date: AUG 1 1986

Clearance: GC/AFR: ALM DATE 8/4/86
Alice L. Mattice 8/4/86

ANNEX F

GLOSSARY OF ACRONYMS

ADMARC	Agricultural Development and Marketing Corporation
AID	Agency for International Development
CBM	Commercial Bank of Malawi
CDC	Commonwealth Development Corporation
CIP	Commodity Import Program
DID	Development and Investment Division
EFF	Extended Fund Facility
FY	Fiscal Year
GDP	Gross Domestic Product
GOM	Government of Malawi
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IMF	International Monetary Fund
INDEBANK	Investment and Development Bank of Malawi
INDEFUND	Investment and Development Fund
MDC	Malawi Development Corporation
MK	Malawi Kwacha
MUSCCO	Malawi Union of Savings and Credit Cooperatives
NBM	National Bank of Malawi
NBS	New Building Society
NICO	National Insurance Company Ltd.
PEW	Plumbing and Engineering Works Ltd.
PGL	Press Group Limited
POSB	Post Office Savings Bank
RBM	Reserve Bank of Malawi
SAL	Structural Adjustment Loan
SFRF	Smallholder Fertilizer Revolving Fund
SGR	Strategic Grain Reserve
USAID	United States Agency for International Development

Dollar--Kwacha Exchange Rates

1980	$1	:	K 0.8
1981	$1	:	K 0.9
1982	$1	:	K 1.1
1983	$1	:	K 1.2
1984	$1	:	K 1.4
1985	$1	:	K 1.7
1986	$1	:	K 1.8

ANNEX G

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CLASS: UNCLASSIFIED
CHRGE: AID 03/18/86
APPRV: JFHICKS
DRFTD: RLSHORTLIDGE
CLEAR: 1.RCDAY 2.MRBAK
DISTR: AID-2 AMB DCM E

AIDAC

FOR AFR/DAA L. SAIERS; AFR/PD L. HAUSMAN; AFR/SA R. CARLSON; AND AFR/DP/PAR J. WOLGIN

E.O. 12356: N/A
SUBJECT: PROPOSED FY 1986 MALAWI AFRICAN ECONOMIC POLICY REFORM PROGRAM

1. SUMMARY:

A. USAID/MALAWI PROPOSES A SECOND AFRICAN ECONOMIC POLICY REFORM PROGRAM GRANT OF US DOLS 15.5 MILLION FOR CONSIDERATION IN FY 1986. MISSION REALIZES THAT THIS IS A LATE SUBMISSION AND THAT FUNDS MAY NOT BE AVAILABLE FOR A PROGRAM IN MALAWI THIS YEAR. OUR EARLIER STRATEGY CALLED FOR DEVELOPING THIS PROGRAM FOR CONSIDERATION IN FY 1987. HOWEVER, WE WISH TO PROCEED WITH DEVELOPMENT OF THIS PROGRAM CONSIDERING URGENCY OF AGRICULTURAL DEVELOPMENT AND MARKETING CORPORATION (ADMARC) FINANCIAL CRISIS AND GOVERNMENT'S RECENT DECISION TO MOVE QUICKLY TO RESOLVE IT. IF PROGRAM CANNOT BE FUNDED THIS FY, MISSION WILL SEEK EARLY FY 1987 FUNDING. TO IMPLEMENT THE ADMARC REFORM PROGRAM A LARGE AMOUNT OF CONCESSIONAL EXTERNAL ASSISTANCE WILL BE REQUIRED AS DISCUSSED DURING THE PARIS CONSULTATIVE GROUP MEETING HELD JAN 21-22, 1986.

B. THIS GRANT WOULD BE TIED TO POLICY REFORMS DESIGNED TO ELIMINATE THE NON-MARKETING OPERATIONS OF ADMARC, SIGNIFICANTLY REDUCE GOVERNMENT INVOLVEMENT IN THE PRIVATE SECTOR, IMPROVE THE BALANCE OF PAYMENTS AND PROMOTE GREATER MOBILIZATION OF DOMESTIC AND INTERNATIONAL PRIVATE CAPITAL FOR INVESTMENTS IN MALAWI'S ECONOMY. US DOLS 15.0 MILLION OF THE GRANT WOULD BE CONDITIONAL ON DIVESTMENT OF 60 PERCENT OF ADMARC'S NON-MARKETING PORTFOLIO AND THE ESTABLISHMENT OF SEPARATE AND INDEPENDENT ORGANIZATION TO MANAGE A SIGNIFICANTLY REDUCED AND MORE PROFITABLE INVESTMENT PORTFOLIO. THE REMAINING US DOLS 0.5 MILLION WOULD FINANCE TECHNICAL ASSISTANCE AND PARTICIPANT TRAINING TO ASSIST WITH THE DIVESTMENT OF THIS PORTFOLIO AND IMPROVE THE MANAGEMENT OF THE NEWLY ESTABLISHED ORGANIZATION TO HANDLE ADMARC'S NON-MARKETING ACTIVITIES. WORLD BANK AND OTHER DONOR ASSISTANCE WILL HELP ADMARC IMPROVE ITS REMAINING MARKETING FUNCTIONS.

AS ONE OF THE MOST SIGNIFICANT INSTITUTIONS IN

MALAWI, ADMARC'S OVERALL ECONOMIC AND FINANCIAL WELL-BEING HAS A DIRECT BEARING ON MALAWI'S ECONOMIC PERFORMANCE AND GROWTH. PRESENTLY, ADMARC HAS A SEASONAL AND NONSEASONAL DEBT OF CLOSE TO MK 100 TO 110 LLION (MK 40 MILLION SEASONAL AND MK 60 TO 70 MILLION NSEASONAL) (US DOL 1 EQUALS MK 1.70). THIS TOTAL DEBT REPRESENTS 12 PERCENT OF MALAWI'S MONEY SUPPLY. MOST OF ADMARC'S ASSETS ARE ILLIQUID, SINCE THEY ARE TIED UP IN ITS NON-MARKETING INVESTMENT PORTFOLIO CONSISTING OF AGRICULTURAL ESTATES AND AGRO AND NON-AGRO BASED INDUSTRIES. THIS DEBT IS SEVERELY AFFECTING THE PRIVATE SECTOR'S ACCESS TO CREDIT. THROUGH THIS AEPRP II, AID RESOURCES WILL HAVE THREE MAJOR IMPACTS. FIRST, US DOLS 15.0 MILLION IN FOREIGN EXCHANGE WILL MEET 10 PERCENT OF THE ESTIMATED BALANCE OF PAYMENT GAP OF US DOLS 145 MILLION FOR THE PERIOD 1986 TO 1990. THIS WILL LESSEN PRESSURE ON THE MALAWIAN GOVERNMENT TO FURTHER REDUCE IMPORTS. SECOND, LOCAL CURRENCY GENERATIONS COMBINED WITH CASH GENERATED BY ADMARC'S DIVESTITURE WILL PROVIDE MUCH NEEDED CAPITAL FOR INVESTMENT IN THE ECONOMY. THIRD, THE RESTRUCTURING OF ADMARC BY SPINNING OFF THE INVESTMENT AND DEVELOPMENT DIVISION WILL LEAD TO RATIONALIZATION AND LIMITATINN OF ADMARC'S ROLF AS AN AGRICULTURAL MARKETING ORGANIZATION.

2. MALAWI'S ECONOMIC ENVIRONMENT AND CONTEXT:

A. THE MALAWIAN ECONOMY CONTINUED IN 1985 ALONG THE PATH OF ECONOMIC RECOVERY WHICH BEGAN IN 1982. REAL GROSS DOMESTIC PRODUCT GREW IN 1985 BY AN ESTIMATED 2.8 PERCENT DOWN FROM 4.3 PERCENT IN 1984 AND 4.4 PERCENT IN 1983. THE LAST THREE YEARS WERE IN MARKED CONTRAST TO THE 1979-81 PERIOD IN WHICH GROSS DOMESTIC PRODUCT PER CAPITA DECLINED MORE THAN 10 PERCENT, CURRENT ACCOUNT AND BUDGET DEFICITS REACHED RECORD LEVELS, AND MALAWI WAS FORCED TO IMPORT ITS BASIC FOOD CROP MAIZE. THE 1979-81 ECONOMIC DOWNTURN AND THE 1985 DECLINE IN THE RATE OF ECONOMIC GROWTH WERE LARGELY THE RESULT OF EXOGENOUS FORCES OVER WHICH MALAWI HAD LITTLE, OR NO, CONTROL SUCH AS DETERIORATING TERMS OF TRADE, LOSS OF TRANSPORTATION ROUTES THROUGH MOZAMBIQUE, HIGHER PETROLEUM PRICES AND DROUGHT. THESE FACTORS EXPOSED

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SOME FUNDAMENTAL WEA[illegible] IN THE ECONOMY WHOSE RESOLUTION WOULD BE CRITICAL TO MEDIUM AND LONG TERM ECONOMIC GROWTH.

BRIEFLY THESE WEAKNESSES INCLUDE THE FOLLOWING:

(1) EXPORTS DURING THE LAST TWO DECADES HAVE BEEN NARROWLY CONCENTRATED IN THREE AGRICULTURAL COMMODITIES. THESE ARE TOBACCO, TEA AND SUGAR. THESE PRODUCTS HAVE HAD A HISTORY OF VOLATILE PRICE MOVEMENTS COMBINED WITH LOW ELASTICITIES.

(2) WHILE INVESTMENT RATES ROSE RAPIDLY IN THE FIRST DECADE AND HALF AFTER INDEPENDENCE, SOME OF THESE INVESTMENTS, PARTICULARLY IN THE LATE 1970'S, WERE IN PROJECTS THAT REQUIRED LARGE CAPITAL INVESTMENTS WITH LOW ECONOMIC RETURNS AND DID NOT CONTRIBUTE TO EXPANSIO OF ECONOMIC PRODUCTIVE CAPACITY. FURTHERMORE, PUBLIC AND PARASTATAL ORGANIZATIONS SUCH AS ADMARC EXPANDED AN DIVERSIFIED TOO QUICKLY AND TOO BROADLY.

(3) GOVERNMENT ITSELF GREW VERY RAPIDLY AND BECAME THE FOCAL POINT FOR ECONOMIC GROWTH. THE EXPANSION OF GOVERNMENT WAS PARTICULARLY PRONOUNCED IN FOUR AREAS. FIRST, THE TAX RATES TO GDP ROSE FROM 10 PERCENT AT THE BEGINNING OF THE 1970'S TO 19 PERCENT BY THE END OF THE DECADE. SECOND, GOVERNMENT EXPENDITURES CLIMBED SHARPLY, KEEPING AHEAD OF REVENUES. EXPENDITURES WENT UP FROM 23 PERCENT OF GDP IN 1973 TO 34 PERCENT IN 1981. THIRD, THE PUBLIC SECTOR'S SHARE OF TOTAL FIXED [illegible]PITAL FORMATION ROSE FROM 54 PERCENT IN 1973 TO 70 PERCENT BY 1979. FOURTH, THE SHARE OF GOVERNMENT AND OFFICIAL ENTITIES IN DOMESTIC CREDIT INCREASED FROM 10 PERCENT IN 1970 TO 44 PERCENT IN 1980.

C. WHEN THE EXTERNAL SHOCKS OF DECLINING TERMS OF TRADE, DROUGHT AND HIGHER COST AND LESS RELIABLE TRANSPORTATION CAME TOGETHER IN 1978-1981, THE COUNTRY DID NOT HAVE THE CAPACITY TO DEAL WITH THEM. THE GOVERNMENT OF MALAWI QUICKLY REALIZED THAT COMING TO TERMS WITH THESE EXOGENOUS FACTORS AND THE INHERENT WEAKNESSES IN ITS GROWTH STRATEGY REQUIRED (1) IMPROVING THE INCENTIVES FOR DIVERSIFICATION OF AGRICULTURAL AND TRADEABLE EXPORT COMMODITIES, (2) RATIONALIZING AND LIMITING GOVERNMENT EXPENDITURES, (3) STRENGTHENING THE EFFICIENCY AND NARROWING THE FOCUS OF KEY PUBLIC AND PARASTATAL INSTITUTIONS, AND (4) PROMOTING PRIVATE SECTOR CAPITAL INVESTMENTS.

3. OVERALL POLICY ENVIRONMENT:

A. THE GOVERNMENT OF MALAWI INITIALLY ATTEMPTED TO RESPOND TO THE ECONOMIC CRISIS IN THE LATE 1970'S AND EARLY 1980'S BY HIGH LEVELS OF COMMERCIAL BORROWING. THIS WAS BASED ON A BELIEF THAT THE ADVERSE ECONOMIC [illegible]CES WERE TRANSITORY. HOWEVER, THE GOM QUICKLY [illegible]LIZED THAT IT WAS DEALING WITH MAJOR AND FUNDAMENTAL STRUCTURAL PROBLEMS.

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THE GOVERNMENT OF MALAWI IN CONSULTATION WITH THE WORLD BANK AND THE IMF FORMULATED A MEDIUM-TERM PROGRAM COVERING THE PERIOD 1982-1986. THE PROGRAM ADDRESSED SEVEN MAIN ISSUES.

(1) THE HEAVY CONCENTRATION OF EXPORTS IN A FEW ESTATE PRODUCED AGRICULTURAL COMMODITIES (TEA, TOBACCO AND SUGAR);
(2) THE SLOW GROWTH OF SMALLHOLDER PRODUCTION FOR EXPORT;
(3) THE MODERN SECTOR'S DEPENDENCE ON COSTLY IMPORTED OIL AND THE DEPLETION OF DOMESTIC FUELWOOD SUPPLIES;
(4) THE DETERIORATING FINANCIAL POSITION OF PUBLIC ENTERPRISES;
(5) THE CENTRAL GOVERNMENT'S BUDGET DEFICIT;
(6) THE GROWING IMBALANCE BETWEEN GOVERNMENT RECURRENT AND CAPITAL EXPENDITURES; AND
(7) RIGIDITIES IN THE SYSTEM OF ADMINISTERED PRICES AND WAGES.

C. THIS PROGRAM WAS SUPPORTED BY A SERIES OF IMF STAND-BYS AND A WORLD BANK STRUCTURAL ADJUSTMENT LOAN (SAL I) OF US DOLS 45 MILLION IN JUNE 1981.

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D. IN 1983 SOME MODIFICATIONS AND SHIFTS IN EMPHASIS WERE MADE IN THE PROGRAM. THE SECOND PHASE OF THE GOVERNMENT OF MALAWI'S STRUCTURAL ADJUSTMENT PROGRAM WAS SUPPORTED BY A SECOND SAL OF US DOLS 55 MILLION ON IDA TERMS IN DECEMBER 1983 AND AN EXTENDED FUND FACILITY FROM THE IMF.

E. WHILE SAL II WAS PRIMARILY INTENDED TO CONTINUE PROGRESS MADE WITH SAL I, IT ALSO BRANCHED INTO OTHER AREAS. TO IMPROVE PERFORMANCE IN THE AGRICULTURAL SECTOR MORE ATTRACTIVE PRICES TO SMALLHOLDERS AND IMPROVED PROCUREMENT AND DISTRIBUTION OF FERTILIZER WERE DEEMED TO BE ESSENTIAL. THE GOVERNMENT COMMITTED ITSELF TO CONTRIBUTE TO A REVOLVING FUND ESTABLISHED UNDER AN IDA/IFAD SUPPORTED SMALLHOLDER FERTILIZER PROJECT, AND TO PROCURE AND DISTRIBUTE FERTILIZER TO SMALLHOLDERS. IT ALSO AGREED TO ELIMINATE THE REMAINING SUBSIDY FOR FERTILIZER. THIS SUBSIDY REMOVAL PROGRAM IS BEING SUPPORTED UNDER THE FIRST MALAWI ECONOMIC POLICY REFORM GRANT WHICH HAS TIED REDUCTIONS IN THE SUBSIDY TO INTRODUCTION OF HIGH CONCENTRATE FERTILIZERS TO OFFSET THE POTENTIAL NEGATIVE IMPACT OF THE SUBSIDY REMOVAL PROGRAM ON AGRICULTURAL PRODUCTION. THE GOVERNMENT UNDERTOOK A FAR-REACHING REORGANIZATION PROGRAM FOR ADMARC (AGRICULTURAL DEVELOPMENT AND MARKETING CORPORATION). THE GOVERNMENT ALSO AGREED TO ALLOCATE SUFFICIENT FUNDS IN THE BUDGET TO MEET THE RECURRENT COSTS OF AGRICULTURAL PROJECTS. IN ORDER TO RESTORE THE VIABILITY OF THE ESTATE SECTOR AND IMPROVE ITS PRODUCTIVITY, AN EXTENSION MANAGEMENT TRAINING AND CREDIT PROGRAM WAS TO BE DESIGNED. FINALLY, THE GOVERNMENT DECIDED TO GRADUALLY REMOVE FORMAL AND INFORMAL PRICE CONTROLS WHICH WERE SERIOUSLY HAMPERING INDUSTRY.

F. FOR THE 1984-85 CROP SEASON, IN ACCORDANCE WITH THE OBJECTIVE OF SHIFTING INCENTIVES IN FAVOR OF EXPORTED COMMODITIES, PRICE INCREASES OF 29 PERCENT FOR TOBACCO, 17 PERCENT FOR GROUNDNUTS, AND 9.5 PERCENT FOR COTTON WERE EFFECTED, WHILE THE PRICE OF MAIZE WAS HELD CONSTANT. SIMILAR PRICE INCENTIVES WERE USED IN THE 1985/86 CROP YEAR. GOVERNMENT HAD COMMITTED ITSELF IN THE EARLY 1980'S TO THE REMOVAL OF FERTILIZER SUBSIDIES AND WAS MAKING PROGRESS UNTIL CLOSURE OF THE RAIL LINE THROUGH MOZAMBIQUE CAUSED DRAMATIC INCREASES IN FERTILIZER COSTS. ADMARC'S MANAGEMENT WAS STRENGTHENED WITH THE RECRUITMENT OF CERTAIN KEY STAFF. CAPACITY UTILIZATION AND FINANCIAL CONTROL HAVE IMPROVED UNDER NEW MANAGEMENT. SOME PROGRESS WAS MADE TOWARDS THE RATIONALIZATION OF ADMARC'S ASSETS THROUGH DIVESTMENT AND SWAP ARRANGEMENTS WITH THE MALAWI DEVELOPMENT CORPORATION (MDC) AND PRESS HOLDINGS LIMITED, AND A LONG-TERM INVESTMENT STRATEGY AND PROGRAM, BASED ON STRENGTHENING OF EXISTING SUBSIDIARIES, WAS PREPARED. STEPS WERE TAKEN FOR SETTING UP A CREDIT FACILITY TO PROVIDE MEDIUM- AND LONG-TERM CREDIT TO TOBACCO ESTATES.

G. THE THIRD PHASE OF THE STRUCTURAL ADJUSTMENT PROGRAM

(SAL III) WHICH WAS SIGNED IN NOVEMBER 1985 WITH THE GOVERNMENT OF MALAWI WILL CONSOLIDATE AND EXPAND THE GAINS MADE DURING THE FIRST TWO PHASES, ATTACK SOME WEAKNESSES THAT HAVE BECOME EVIDENT, AND HELP TO SUSTAIN THE GROWTH OF PER CAPITA INCOME. WHILE GIVING PRIORITY TO GROWTH WITHIN THE PRIVATE SECTOR, THIS PROGRAM WILL EMPHASIZE HIGHER CAPITAL FORMATION TO SUSTAIN GROWTH OF AGRICULTURE AND INDUSTRY AND INCREASED FLOW OF EXTERNAL RESOURCES TO SUPPLIMENT DOMESTIC SAVINGS RATHER THAN FURTHER RESTRICTIONS ON IMPORTS. IN VIEW OF RELATIVELY HIGH-LEVELS OF EXTERNAL DEBT SERVICE, DONORS WILL BE REQUESTED TO INCREASE THE CONCESSIONAL ELEMENT OF THEIR ASSISTANCE.

H. IN GENERAL, THE GOM HAS DEMONSTRATED ITS COMMITMENT TO POLICY REFORM TO OVERCOME THE STRUCTURAL WEAKNESSES IN ITS ECONOMY. THIS INCLUDES SIGNIFICANTLY GREATER RELIANCE ON THE PRIVATE SECTOR AND MARKET FORCES.

4. POLICY REFORMS

A. UNDER THE FIRST TWO SAL PROGRAMS, THE GOVERNMENT OF MALAWI TOOK STEPS TO OVERCOME THE PROBLEMS FACED BY A NUMBER OF PARASTATAL AND SEMI-PRIVATE ORGANIZATIONS. IN

PARTICULAR, THE AGRIC[illegible] RAL DEVELOPMENT AND MARK[illegible]NG CORPORATION (ADMARC), THE MALAWI DEVELOPMENT CORPORATION (MDC), AND PRESS HOLDINGS LIMITED HAVE BEEN RESTRUCTURED. THIS REORGANIZATION HAS PROCEEDED FURTHER WITH MDC AND PRESS THAN WITH ADMARC. THUS, ADMARC IS TO RECEIVE GREATER ATTENTION IN SAL III.

B. ADMARC FACES A SERIOUS LIQUIDITY PROBLEM DUE TO SHARP FALLS IN NET AUCTION FLOOR EARNINGS OF TOBACCO. ALSO DESPITE LARGER DOMESTIC PRODUCTION IN 1985, THE VOLUME OF MAIZE EXPORTS DECLINED. ADMARC HAS EXCEEDED ITS OVERDRAFT LIMITS WITH THE COMMERCIAL BANKS, AND HAS BORROWED ADDITIONAL SUMS FROM THE GOVERNMENT AND THE RESERVE BANK OF MALAWI. THIS LIQUIDITY PROBLEM NOT ONLY IMPAIRS ITS ABILITY TO MARKET SMALLHOLDER CROPS, BUT ALSO HAS A SERIOUS IMPACT ON THE GOM'S BUDGET AND OVERALL DOMESTIC CREDIT. THE GOM RECOGNIZES THE SERIOUS NATURE OF THIS LIQUIDITY CRISIS AND ITS NEGATIVE IMPACTS ON THE NATIONAL ECONOMY. WITH TECHNICAL ASSISTANCE FROM USAID, THE GOM PLANS TO STUDY ITS MAIZE STOCK REQUIREMENTS AND THE COST OF MAINTAINING THESE STOCKS. THE GOM HAS DECIDED THAT THE COST OF MAINTAINING THESE STRATEGIC GRAIN RESERVES WILL BE BORNE BY THE GOVERNMENT AS OPPOSED TO ADMARC.

C. IN 1985 ABOUT HALF OF ADMARC'S TOTAL ASSETS (OR ABOUT MK 100 MILLION AT COST) WERE IN NON-MARKETING ACTIVITIES; ANOTHER 20-25 PERCENT WERE IN THE STRATEGIC GRAIN RESERVE, LEAVING ONLY ABOUT ONE-FOURTH OF ITS ASSETS IN MARKETING RELATED ACTIVITIES. THIS DIVERSION FROM MARKETING ACTIVITIES BEGAN IN THE 1970'S AND WAS PRIMARILY FINANCED BY PROFITS FROM THE CORPORATION'S LUCRATIVE TOBACCO TRADING ACCOUNT. THESE ASSETS ARE UNDER THE MANAGEMENT OF THE DEVELOPMENT AND INVESTMENT DIVISION AND INCLUDE 14 ESTATES, FARMS AND DEVELOPMENT PROJECTS, SEVEN OTHER ESTATES WHICH ARE LIMITED COMPANIES, 11 SUBSIDIARIES, 20 OTHER EQUITY HOLDINGS AND 33 LOANS. IN RECENT YEARS, THIS PORTFOLIO HAS SHOWN A PROFIT OF ONLY 2-3 MILLION KWACHA PER ANNUM, OR ONLY 2 TO 3 PERCENT PROFIT ON TOTAL PORTFOLIO VALUE.

D. IN ADDITION TO MANAGING THESE ASSETS, THE DEVELOPMENT AND INVESTMENT DIVISION IS RESPONSIBLE FOR PREPARING ALL PROJECT APPRAISALS AND ALL REHABILITATION PROGRAMS FOR ESTATES, DEVELOPMENT PROJECTS AND SUBSIDIARIES, AS WELL AS ASSISTING IN NEGOTIATIONS OF AND SUPERVISING IMPLEMENTATION OF PROJECTS, PROGRAMS AND LOANS. THE DIVISION ALSO PROVIDES CONSIDERABLE AD HOC SUPPORT TO THE GENERAL MANAGER FOR A VARIETY OF ANALYTICAL TASKS.

E. TO HANDLE ALL OF THIS WORK LOAD, THE DEVELOPMENT DIVISION HAS ONLY EIGHT PROFESSIONAL STAFF AND NONE OF THEM HAVE A FINANCIAL BACKGROUND. IT HAS A MANAGER, AN ASSISTANT MANAGER, FOUR PROFESSIONAL STAFF IN AN AGRICULTURAL DIVISION, A PROJECT APPRAISAL SECTION WITH NO PERMANENT STAFF, ALTHOUGH THE ASSISTANT MANAGER IS ACTING AS HEAD OF THE SECTION, A MONITORING SECTION WITH

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ONE PROFESSIONAL STAFF AND AN ACCOUNTING GROUP O_ __GHT SENIOR STAFF AND EIGHT CLERKS. IT DOES NOT HAVE A FINANCIAL ANALYST AND HAS MADE LITTLE PROGRESS ON THE
NNNN ESTABLISHMENT OF AN EFFECTIVE MONITORING SYSTEM.

F. IN 1984, AS PART OF THE PRESS HOLDINGS LIMITED RECONSTRUCTION AGREEMENT, ADMARC EXCHANGED ITS SHAREHOLDING IN THE OIL COMPANY OF MALAWI, THE ENTERPRISE CONTAINERS LIMITED AND NATIONAL INSURANCE COMPANY FOR PRESS SHARES IN GRAIN AND MILLING COMPANY, NATIONAL OIL INDUSTRIES, DAVID WHITEHEAD AND SONS, THE SUGAR CORPORATION OF MALAWI AND THE CATTLE FEEDLOT COMPANY. IN 1985, THIS RATIONALIZATION OF INVESTMENTS CONTINUED WITH ADMARC EXCHANGING ITS SHAREHOLDING IN PORTLAND CEMENT COMPANY, BATA SHOE COMPANY AND
NKNN COMMERCIAL BANK OF MALAWI FOR THE MALAWI DEVELOPMENT CORPORATION SHARES IN DAVID WHITEHEAD AND SONS, NATIONAL OIL INDUSTRIES, COLD STORAGE COMPANY AND MALDECO FISHERIES LIMITED.

G. FROM THE TOTAL SHARE INVESTMENT OF MK 46,472,886 IN 1985 AND MK 36,969,441 IN 1984, ADMARC RECEIVED DIVIDENDS OF ONLY MK 1,327,645 AND MK 1,147,120, RESPECTIVELY, AS MANY SHARES WERE UNYIELDING.

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H. THE COMPOSITION OF ADMARC'S NONMARKETING INVESTMENTS IS AS FOLLOWS:

- INVESTMENTS IN AGRO-INDUSTRIES ARE:

- FIRMS NAME	AMOUNT (MK)
ADMARC CANNING	40,000
AUCTION HOLDINGS	829,295
CENTRAL GRADING AND PACKAGING	50,000
COLD STORAGE	1,079,000
COTTON GINNERS	251,934
DAVID WHITEHEAD AND SONS	8,847,020
DWANGWA SUGAR CORPORATION	10,227,998
GRAIN AND MILLING	5,440,001
0030 MALDECO FISHERIES	508,000
MALAWI TEA FACTORY	4,000
NCIL	1,394,350
NATIONAL SEED COMPANY	580,020
SPEARHEAD HOLDINGS	80,685
SUGAR CORPORATION OF MALAWI	9,300,000
TOBACCO MARKETING COMPANY	10,000
- TOTAL	38,642,282

- INVESTMENTS IN NON-AGRICULTURAL RELATED ACTIVITIES ARE

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ADVANX	183,280
NATIONAL BANK OF MALAWI	2,013,796
CORY MANN GEORGE	280,000
FINCOM	220,000
INDEBANK	,000,000
LEVER BROTHERS	575,000
MANICA FREIGHT SERVICES	500,200
OPTICHEM	567,792
PEW	682,100
UTM	1,391,960
- TOTAL	7,413,928

I. THE GOVERNMENT OF MALAWI IS IN THE PROCESS OF FORMULATING A SERIES OF POLICY REFORMS TO ADDRESS THE MANAGERIAL AND FINANCIAL PROBLEMS FACED BY ADMARC THROUGH REORGANIZATION AND RESTRUCTURING, DIVESTITURE OF ITS NON-MARKETING PORTFOLIO AND IMPROVING ITS MARKETING FUNCTIONS. IT IS CURRENTLY ANTICIPATED THAT THE GOM WILL PROCEED WITH DIVESTING ADMARC OF 64 PERCENT OF ITS AGRO-INDUSTRIAL INVESTMENTS (TOTAL VALUE MK 24.8 MILLION) AND 36 PERCENT OF ITS NON-AGRICULTURAL RELATED INVESTMENTS (TOTAL VALUE MK 2.7 MILLION). TECHNICAL
0000 ASSISTANCE WILL BE PROVIDED THROUGH USAID'S FERTILIZER SUBSIDY REMOVAL PROGRAM AND BY THE UNDP. THE WORLD BANK IS CURRENTLY NEGOTIATING ADMARC'S REFORM PACKAGE WITH THE GOM. USAID HAS ALSO BEEN REQUESTED BY THE GOM TO PARTICIPATE IN THESE REFORMS THROUGH A NEW PROGRAM ASSISTANCE GRANT UNDER THE AFRICAN ECONOMIC POLICY REFORM PROGRAM. THE FOLLOWING OUTLINES THE SPECIFIC

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REFORMS CURRENTLY BEING CONSIDERED.

(1) THE GOM IS SERIOUSLY CONSIDERING CREATING A SEPARATE OPERATION FOR ADMARC'S DEVELOPMENT AND INVESTMENT DIVISION. THIS ORGANIZATION WOULD ACT AS AN INVESTMENT HOLDING COMPANY WHOSE ACTIVITIES WOULD PARALLEL THE INVESTMENT MANAGEMENT OPERATIONS OF THE MALAWI DEVELOPMENT CORPORATION AND INDEBANK. IT WOULD BE CHARGED WITH THE OBJECTIVE OF MANAGING ADMARC'S INVESTMENT AND DEVELOPMENT PORTFOLIO TO MAXIMIZE FINANCIAL PROFITABILITY AND NET CASH FLOW TO ITS SHAREHOLDERS. THIS SEPARATION OF ADMARC'S INVESTMENT AND DEVELOPMENT DIVISION WOULD FOCUS ADMARC'S ATTENTION ON IMPROVING THE MANAGEMENT EFFICIENCY OF ITS AGRICULTURAL MARKETING OPERATION.

(2) ADMARC CURRENTLY OWNS AND MAINTAINS THE STRATEGIC MAIZE RESERVE. CONSIDERING THE NON-COMMERCIAL NATURE OF THIS BURDEN ON THE CORPORATION AND ITS IMPORTANCE TO NATIONAL AND REGIONAL FOOD SECURITY, THE GOVERNMENT OF MALAWI HAS DECIDED TO PURCHASE THE RESERVE FROM ADMARC AND REIMBURSE ADMARC FOR ITS MAINTENANCE.

(3) BETWEEN APRIL 1985 AND AUGUST 1985, ADMARC BORROWED

VZCZCLGI *

HEAVILY FROM THE RESERVE BANK OF MALAWI, THE MALAWI GOVERNMENT, AND THE NATIONAL BANK OF MALAWI. ADMARC'S CURRENT INDEBTEDNESS PRESENTLY IS MK 62-72 MILLION IN EXCESS OF ITS NORMAL SEASONAL DEBT. THE IMF HAS REQUIRED THAT ADMARC REDUCE ITS EXCESS NONSEASONAL INDEBTEDNESS TO ZERO BY THE END OF SEPTEMBER AND THAT ADMARC SHOULD HAVE ONLY SEASONAL BORROWING OUTSTANDING THEREAFTER. THIS SUBSTANTIAL DEBT REDUCTION WILL BE ACCOMPLISHED BY THE SALE OF SURPLUS MAIZE AND DIVESTITURE OF NON-MARKETING ASSETS. THE GOVERNMENT OF MALAWI HAS TARGETTED MK 16 MILLION TO BE GENERATED BY SEPTEMBER THIS YEAR FROM THE DIVESTITURE OF THESE ASSETS. A STRATEGY FOR DIVESTITURE HAS YET TO BE FINALIZED. THE GOM HAS REQUESTED USAID ASSISTANCE IN THE DEVELOPMENT AND IMPLEMENTATION OF THIS STRATEGY. IN SOME CASES THIS WILL INVOLVE OUTRIGHT DIVESTITURE OF OWNERSHIP. IN OTHER CASES, GIVEN THE GOM'S REQUIREMENT FOR LOCAL PARTICIPATION, THE STRATEGY IS LIKELY TO EMPHASIZE REDUCTIONS IN ADMARC'S SHAREHOLDINGS.

(4) THE GOM HAS REQUESTED TECHNICAL ASSISTANCE FROM UNDP, WORLD BANK, AND USAID TO STRENGTHEN ADMARC'S MANAGEMENT AND THAT OF AN INDEPENDENT DEVELOPMENT AND INVESTMENT OPERATION.

(5) THE GOM WILL CONTINUE ITS AGRICULTURAL PRICING POLICY WHICH EMPHASIZES CROP DIVERSIFICATION BY ENCOURAGING PRODUCTION OF GROUNDNUTS, PULSES, OILSEEDS AND COTTON. WITH MANY CROP PRICES APPROACHING EXPORT PARITY, ADMARC IS BEING ENCOURAGED TO ADOPT A PRICING POLICY WHICH WILL MAINTAIN SUFFICIENT PRODUCTION LEVELS WHILE NOT DISTORTING ADMARC'S FINANCIAL POSITION. GOM WILL CONTINUE ITS COMMITMENT TO REMOVE CONSUMER PRICE SUBSIDIES TO ELIMINATE LOSSES INCURRED FROM ADMARC'S DOMESTIC TRADING OPERATIONS. TOWARD THIS END, THE SELLING PRICE OF A NUMBER OF PRIMARILY DOMESTICALLY MARKETED CROPS WILL BE INCREASED BY THE BEGINNING OF THE 1986-87 FINANCIAL YEAR.

5. AFRICAN ECONOMIC POLICY REFORM PROGRAM II - ADMARC RESTRUCTURING AND DIVESTITURE:

A. USAID/MALAWI IS PROPOSING A SECOND AFRICAN ECONOMIC POLICY REFORM PROGRAM GRANT OF US DOLS 15.5 MILLION. THIS GRANT WILL CONSIST OF US DOLS 15.0 MILLION AS A CASH GRANT AND US DOLS 0.5 MILLION FOR TECHNICAL ASSISTANCE AND TRAINING. THE PROGRAM IS TO BE TIED TO THE FOLLOWING SPECIFIC POLICY DECISIONS OF THE GOVERNMENT OF MALAWI.

(1) US DOLS 2.0 MILLION WOULD BE RELEASED TO THE GOM ONCE SPECIFIC STEPS HAVE BEEN TAKEN TO ESTABLISH ADMARC'S DEVELOPMENT AND INVESTMENT DIVISION AS A SEPARATE OPERATION. ALTHOUGH INITIALLY THE PRINCPAL SHAREHOLDER OF THIS INDEPENDENT ORGANIZATION WILL BE ADMARC, LIMITING IT TO THE MANAGEMENT OF A SIGNIFICANTLY REDUCED AND MORE PROFITABLE PORTFOLIO SHOULD OVER TIME ATTRACT PRIVATE INVESTORS TO PURCHASE ADMARC'S SHARES.

THIS WOULD FURTHER REDUCE ADMARC'S INVOLVMENT IN THE ECONOMY.

(2) US DOLS 13 MILLION WOULD BE TIED TO THE DIVESTITURE OF MK 27.5 MILLION OF ADMARC'S NON-MARKETING PORTFOLIO. FOR THE INITIAL MK 7.5 MILLION OF DIVESTITURE THE GOM WOULD RECEIVE US DOLS 1.0 FOR EACH MK 2.5 OF DIVESTITURE OR US DOLS 3 MILLION. BECAUSE DIVESTITURE WILL BECOME INCREASINGLY DIFFICULT, THE REMAINING MK 10 MILLION WOULD BE EXCHANGED AT A RATIO OF US DOLS 1.0 TO MK 2.0. THUS, THE US DOLS 13 MILLION WOULD BE RELEASED ACCORDING TO THE FOLLOWING SLIDING SCALE.

AMOUNT OF MK DIVESTED IN MILLIONS	AMOUNT OF US DOLS FUNDS RECEIVED IN MILLIONS
- 2.5	1.0
- 5.0	2.0
- 7.5	3.0
- 9.5	4.0
- 11.5	5.0
- 13.5	6.0
- 15.5	7.0
- 17.5	8.0
- 19.5	9.0

-	21.5	10.[illegible]
-	23.5	11.0
-	25.5	12.0
-	27.5	13.0

THIS MK 27.5 MILLION OF DIVESTMENT WOULD REDUCE ADMARC'S NON-MARKETING INVESTMENTS BY 60 PERCENT. THIS WOULD RESULT IN A CONSIDERABLY SMALLER AND MORE MANAGEABLE SEPARATE DEVELOPMENT AND INVESTMENT ORGANIZATION.

BOTH USAID AND THE GOM ARE CONCERNED THAT THE NUMBER OF DISBURSEMENTS OF THE CASH GRANT COMPONENT BE KEPT TO A MINIMUM. THUS, DISBURSEMENTS WILL ONLY OCCUR WHEN A SIGNIFICANT AMOUNT OF DIVESTITURE HAS TAKEN PLACE. THIS SHOULD RESULT IN THREE OR FOUR DISBURSEMENTS OVER THE LIFE OF THE PROGRAM.

(3) THE US DOLS 500,000 IN TECHNICAL ASSISTANCE WOULD BE USED FOR TWO PRIMARY ACTIVITIES. FIRST, TECHNICAL ASSISTANCE WOULD BE PROVIDED TO THE NEWLY CREATED SEPARATE DEVELOPMENT AND INVESTMENT OPERATION TO STRENGTHEN ITS MANAGERIAL AND FINANCIAL OPERATIONS. SECOND, TECHNICAL ASSISTANCE WOULD BE GIVEN TO FIRMS BEING DIVESTED TO IMPROVE THEIR ATTRACTIVENESS TO POTENTIAL BUYERS. TECHNICAL ASSISTANCE WOULD ALSO ASSIST IN THE OVERALL RATIONALIZATION AND DIVESTITURE OF THE PORTFOLIO. THIS TECHNICAL ASSISTANCE WOULD COME FROM US PRIVATE SECTOR FIRMS AND MANAGEMENT CONSULTING FIRMS WITH EXPERIENCE IN MALAWI. SOME OF THESE RESOURCES MAY BE SET ASIDE FOR FINANCING NON-DEGREE PARTICIPANT TRAINING FOR THE STAFF IN MANAGEMENT, PLANNING AND FINANCE.

6. POLICY IMPACT:

A. THIS AFRICAN ECONOMIC POLICY REFORM PROGRAM WILL HAVE THREE MAJOR IMPACTS ON THE MALAWIAN ECONOMY. FIRST, THE US DOLS 15 MILLION IN UNTIED AND CONCESSIONAL FOREIGN ASSISTANCE WILL PROVIDE ABOUT 10 PERCENT OF THE FOREIGN EXCHANGE NEEDED TO OVERCOME THE BALANCE OF PAYMENT GAP ESTIMATED AT US DOLS 145 MILLION FOR THE PERIOD 1986-1990. THESE RESOURCES WILL REDUCE THE PRESSURE ON THE MALAWIAN GOVERNMENT TO CUT IMPORTS FURTHER. THE CAPACITY TO SUSTAIN IMPORTATION OF CAPITAL EQUIPMENT IS CRITICALLY IMPORTANT TO ECONOMIC GROWTH IN THE NEAR AND MEDIUM TERM. MALAWI HAS ALREADY REDUCED ITS IMPORTS BY APPROXIMATELY 50 PERCENT SINCE 1979 AND HAS PROBABLY EXHAUSTED SHORT-RUN POSSIBILITIES FOR IMPORT SUBSTITUTION . THUS, ANY FURTHER REDUCTIONS IN IMPORTS WOULD SERIOUSLY ERODE OVERALL GROWTH POTENTIAL. SECOND, THE LOCAL CURRENCY FROM THE U.S. DOLS 15 MILLION CASH GRANT AND THE REPAYMENT OF ADMARC'S DEBT TO THE NATIONAL BANK OF MALAWI WILL MAKE AVAILABLE ADDITIONAL FUNDS FOR INVESTMENT IN THE ECONOMY AND WILL REDUCE GOVERNMENT CROWDING OUT OF THE PRIVATE SECTOR. IN THE 1970'S PRIVATE CORPORATIONS AND STATUTORY BODIES WERE MAJOR INVESTORS, BUT SINCE 1982 THE GOVERNMENT OF MALAWI HAS BEEN THE LARGEST INVESTOR. AS THE FINANCIAL

CONDITIONS OF BOTH PARASTATALS AND MAJOR PRIVATE CORPORATIONS HAVE DETERIORATED, THE ABILITY TO GENERATE FUNDS FOR INVESTMENT HAS BEEN REDUCED. THIRD, IMPROVING THE EFFICIENCY OF ADMARC AND THE NEW DEVELOPMENT AND INVESTMENT OPERATION WILL RESULT IN MORE EFFICIENT AND PROFITABLE RESOURCE UTILIZATION. THIS WOULD PERMIT ADMARC TO CONCENTRATE ON PROMOTING EXPORT CROP DIVERSIFICATION, OPERATIONAL EFFICIENCIES AND BETTER MANAGEMENT OF AGRICULTURAL PRICING POLICIES. BY IMPROVING ITS MARKETING OPERATION, ADMARC WILL BE IN A BETTER POSITION TO PROMOTE EXPORT OF MALAWI'S CASH CROPS WHILE AT THE SAME TIME MAINTAINING A DOMESTIC BUYING PRICE WHICH IS CLOSE TO PARITY WITH EXPORT PRICES.

7. PROGRAMMING OF THE ASSISTANCE:

A. THE US DOLS 15.5 MILLION IS DIVIDED BETWEEN A CASH GRANT COMPONENT OF US DOLS 15.0 MILLION AND A TECHNICAL ASSISTANCE AND PARTICIPANT TRAINING COMPONENT OF US DOLS 0.5 MILLION. THERE ARE ESSENTIALLY TWO TRIGERRING MECHANISMS. THE FIRST IS THE ESTABLISHMENT OF A SEPARATE ORGANIZATION FOR ADMARC'S NON-MARKETING OPERATION. US DOL 2.0 MILLION WILL BE RELEASED ONCE THE DECISION TO ESTABLISH THIS ORGANIZATION HAS BEEN MADE

AND LEGAL STEPS HAVE BEEN TAKEN TO SET IT UP AS A SEPARATE BODY. SECOND, THE US DOLS 13.8 MILLION WILL BE DISBURSED ACCORDING TO THE SLIDING SCALE OUTLINED IN SECTION 5A2. SINCE THERE MAY BE A TIME DIFFERENCE BETWEEN THE SALE OF SHARES IN A PARTICULAR FIRM AND WHEN ADMARC REALIZES THE CASH FROM THE SALE, THE DISBURSEMENT WILL BE TIED TO THE CONSUMMATION OF BINDING SALES AGREEMENT WITH DOMESTIC OR INTERNATIONAL BUYERS.

F. ADMARC'S FINANCIAL CRISIS, DUE LARGELY TO EXOGENOUS FACTORS BEYOND ITS CONTROL AS DESCRIBED ABOVE, HAS RESULTED IN A SERIOUS DECAPITALIZATION OF SEVERAL INSTITUTIONS CRITICAL TO NATIONAL ECONOMIC GROWTH. ALTHOUGH ADMARC WILL BE DIVESTING ITSELF OF HOLDINGS IN ORDER TO COVER ITS DEBTS, IT REMAINS TO BE SEEN HOW QUICKLY AND TO WHAT EXTENT THIS CAN BE ACCOMPLISHED. BECAUSE THE TERMS OF SALES AGREEMENTS WILL LIKELY PROVIDE FOR PHASED PAYMENT, ADMARC WILL NOT HAVE MOST NEW CAPITAL IMMEDIATELY IN HAND. CONSEQUENTLY, THERE WILL REMAIN A SHORT-TO-MEDIUM-TERM LIQUIDITY CRISIS IN THOSE INSTITUTIONS TO WHICH ADMARC HAS SIGNIFICANT, OUTSTANDING DEBTS. THE PRINCIPAL USE OF LOCAL CURRENCIES, THEN, WOULD BE TO PAY OFF ADMARC'S DEBT TO THESE INSTITUTIONS, PARTICULARLY THE NATIONAL BANK OF MALAWI, AND TO A LESSER EXTENT, THE SMALLHOLDER FERTILIZER REVOLVING FUND AND THE AGRICULTURAL DEVELOPMENT DIVISION'S RURAL CREDIT SYSTEM.

C. THE LOCAL CURRENCIES MADE AVAILABLE TO THE NATIONAL BANK OF MALAWI WOULD PROVIDE URGENTLY NEEDED CREDIT FOR INDUSTRIAL AND COMMERCIAL ENTERPRISE DEVELOPMENT. ALSO, THE CAPITAL FOR THE SFRF AND ADD CREDIT SYSTEMS WOULD COMPLEMENT USAID'S ON-GOING FERTILIZER SUBSIDY REMOVAL PROGRAM TO ASSURE CONTINUED AGRICULTURAL GROWTH, WHICH IS THE BACKBONE OF MALAWI'S ECONOMY.

D. AT THIS TIME, IT IS DIFFICULT TO OUTLINE PRECISELY HOW THE TECHNICAL ASSISTANCE AND TRAINING COMPONENT WILL BE PROGRAMMED. THIS WILL BE DETERMINED AFTER FURTHER CONSULTATIONS WITH THE GOM AND WORLD BANK. IT IS, HOWEVER, ANTICIPATED THAT USAID WILL MAKE USE OF, TO EXTENT POSSIBLE, EXISTING CONTRACTUAL ARRANGEMENTS WITH PRIVATE SECTOR MANAGEMENT CONSULTING FIRMS IN MALAWI AND PRIVATE SECTOR IQC'S MANAGED BY AID/W. ANY REQUESTS FOR EXTERNAL TRAINING WILL BE PROCESSED THROUGH ST/IT.

E. THE GRANT WILL BE DISBURSED OVER A THREE YEAR PERIOD. THE BULK OF THE GRANT WILL BE DISBURSED DURING THE FIRST TWO YEARS. SINCE THE RATE OF DISBURSEMENT DEPENDS ON THE RATE OF DIVESTITURE, IT IS DIFFICULT TO ESTIMATE WITH ANY PRECISION THE EXACT AMOUNT OF TIME THAT WILL BE REQUIRED TO DISBURSE THE FUNDS. DISBURSEMENT OF THE FIRST HALF OF THE GRANT WILL IN ALL LIKELIHOOD PROCEED MORE RAPIDLY THAN THE SECOND HALF, SINCE ADMARC WILL PROBABLY SELL OFF ITS MORE MARKETABLE ASSETS FIRST.

8. PROGRAM IMPLEMENTATION:

A. ASSUMING THAT THERE IS INTEREST IN AID/WASHINGTON IN CONSIDERING THIS PROPOSAL AND IF FUNDS ARE AVAILABLE IN FY 1986, THE MISSION WISHES TO PROCEED WITH THE DESIGN OF THE PAAD DURING MAY AND JUNE OF 1986. THE MISSION PROPOSES THAT THE PAAD DESIGN TEAM SHOULD CONSIST OF SIX INDIVIDUALS: THE ASSISTANT MISSION DIRECTOR AND PROGRAM OFFICER FROM USAID/MALAWI, A PROJECT DESIGN OFFICER FROM REDSO/ESA OR AID/W, AN AID/W ECONOMIST, AND TWO SPECIALISTS IN DIVESTITURE. THE MISSION WILL ALSO SEEK LEGAL AND FINANCIAL MANAGEMENT GUIDANCE THROUGH SHORT-TERM TDY ASSISTANCE FROM THE RLA AND RFMC IN NAIROBI.

GIVEN HIS ECONOMIC EXPERTISE AND EXCELLENT KNOWLEDGE OF MALAWI, THE MISSION REQUESTS THE PARTICIPATION OF JERRY WOLGIN IN THE PAAD DESIGN. MISSION WOULD APPRECIATE SUGGESTIONS FROM AID/W OF POSSIBLE OTHER TEAM MEMBERS.

B. THE MISSION BELIEVES THAT BOTH IT AND THE GOVERNMENT OF MALAWI HAVE THE HUMAN RESOURCES TO MANAGE THIS PROPOSED PROGRAM. THE PROGRAM WILL BE MONITORED AND MANAGED BY THE ASSISTANT MISSION DIRECTOR AND THE PROGRAM OFFICER. THE RESPONSIBLE AUTHORITIES ON THE

GOVERNMENT OF MALAWI SIDE WILL BE THE MINISTRY OF FINANCE, THE ECONOMIC PLANNING DIVISION OF THE OFFICE OF THE PRESIDENT AND CABINET, AND ADMARC. IT IS ENVISAGED THAT USAID, THE GOM, AND ADMARC WILL HOLD QUARTERLY CONSULTATIONS ON THE PROGRAM'S IMPLEMENTATION. THESE CONSULTATIONS WILL DEAL WITH THE FOLLOWING ASPECTS OF THE PROGRAM:

(1) PROGRESS MADE IN SETTING UP AN INDEPENDENT DEVELOPMENT AND INVESTMENT OPERATION;

(2) PROGRESS MADE IN DIVESTING ADMARC'S NON-MARKETING PORTFOLIO INCLUDING SALE OF FIRMS AND REDUCTIONS IN ADMARC'S SHARE HOLDINGS IN OTHER FIRMS;

(3) ANALYSIS OF TECHNICAL ASSISTANCE AND TRAINING REQUIREMENTS; AND

(4) ANALYSIS OF THE UTILIZATION OF THE LOCAL CURRENCY GENERATED BY THE SALE OF ASSETS TO DETERMINE IMPACT ON PRIVATE SECTOR INVESTMENTS.

9. DONOR COLLABORATION:

A. THIS PROPOSED PROGRAM DIRECTLY SUPPORTS THE POLICY REFORMS OF THE WORLD BANK AND IMF CONTAINED IN SAL III. ALSO THE WORLD BANK HAS RECENTLY COMPLETED AND SUBMITTED TO THE GOM A REFORM PROPOSAL WHICH FOCUSES ON IMPROVING AGRICULTURAL MARKETING AND FOOD SECURITY POLICIES AND ORGANIZATION IN MALAWI. MOST OF THESE REFORMS CONCERN THE ROLE OF ADMARC IN THE ECONOMY. THIS PROPOSAL WILL BE THE BASIS FOR THE DEVELOPMENT OF SAL IV LATER THIS YEAR. AS IN THE CASE OF THE MALAWI FERTILIZER SUBSIDY REMOVAL PROGRAM (AEPRP I), USAID WILL LIAISE CLOSELY WITH THE WORLD BANK AND IMF ON THE DEVELOPMENT AND IMPLEMENTATION OF THIS SECOND AEPRP.

B. ALSO UNDP IS INVOLVED IN THE PROVISION OF TECHNICAL ASSISTANCE TO ADMARC. SINCE THIS TECHNICAL ASSISTANCE PRIMARILY INVOLVES STRENGTHENING ADMARC'S AGRICULTURAL MARKETING FUNCTIONS, USAID WILL BE LESS INVOLVED WITH THEM ON THIS NEW AEPRP THAN IN THE CASE OF THE FIRST AEPRP.

10. PLEASE ADVISE SOONEST OF AID/W'S DECISION REGARDING THIS PROPOSAL.
ADAMS
BT
#1054

NNNN

ACTION: AID-2 INFO: AMB DCM ECON

HUGUVZCZCLGO058
PP RUEHLG
DE RUEHC #9740 0911719
ZNR UUUUU ZZH
P 011718Z APR 86
FM SECSTATE WASHDC
TO AMEMBASSY LILONGWE PRIORITY 9113
BT
UNCLAS STATE 099740

LOC: 158/9 1
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CN: 15014
CHRG: AID
DIST: AID

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AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: PROPOSED FY-86 MALAWI AFRICAN ECONOMIC POLICY REFORM PROGRAM

REF: LILONGWE 1054

1. PARAGRAPHS THREE THRU SIX BELOW PROVIDE COMMENTS ON TECHNICAL ASPECTS OF REFTEL PROPOSAL. BEFORE GETTING TO THAT, HOWEVER, MISSION SHOULD KNOW IT IS NOT REPEAT NOT LIKELY THAT FY-86 FUNDS WILL BE AVAILABLE FOR A MALAWI PROGRAM. OTHER PRIORITIES ARE EXPECTED TO DEPLETE FUNDS. FURTHER, IT IS TOO SOON TO SPECULATE ON WHAT CHANCES MIGHT BE FOR FY-87.

2. AFR WOULD NOT OBJECT IF MISSION PROCEEDS TO DEVELOP SUBJECT PROPOSAL AS A QUOTE SHELF ITEM UNQUOTE TO BE USED IF REPEAT IF AEPRP FUNDS BECOME AVAILABLE FOR MALAWI. TIGHT FUNDING AND COMPETING HIGH PRIORITIES, HOWEVER, REQUIRE AN UNDERSTANDING THAT DEVELOPMENT OF PROPOSAL DOES NOT IMPLY COMMITMENT.

3. WHILE WE AGREE WITH THE OVERALL PROGRAM PURPOSE, WE HAVE SEVERAL QUESTIONS ABOUT THE PROGRAM DETAIL AS PRESENTED REFTEL, PARAGRAPH FIVE. DOES THE PROGRAM CALL FOR PRIVATIZATION OF ADMARC HOLDINGS OR MERELY TURNING THEM OVER TO A NEW PARASTATAL WITH NO MARKETING RESPONSIBILITIES? IT WOULD BE DIFFICULT TO FIND SUPPORT IN WASHINGTON FOR A PROGRAM WHOSE SOLE PURPOSE WAS TO SEPARATE ADMARC INVESTMENT AND MARKETING OPERATIONS, HOWEVER LAUDABLE THAT GOAL MAY BE.

4. WE ARE UNCLEAR ABOUT THE USE OF THE PROGRAM FUNDS. REFTEL DISCUSSION RAISES SEVERAL QUESTIONS ABOUT LOCAL CURRENCY (LC) ASPECTS. FOR EXAMPLE: HOW DOES LC GENERATION OCCUR? WHAT ARE THE CRITERIA FOR LC UTILIZATION? WHAT GUARANTEE IS THERE THAT LC WILL REDUCE GOVERNMENT CROWDING OUT OF THE PRIVATE SECTOR?

5. AS YOU KNOW THE AEPRPS HAVE BEEN DESIGNED TO USE RESOURCES TO SUPPORT PROGRAM IMPLEMENTATION. ACCORDINGLY, WE WOULD LIKE TO SEE A MORE EFFECTIVE USE OF THE LOCAL CURRENCIES THAN MERELY TRANSFERRING THEM TO

THE GOM. ONE IDEA THAT COMES TO MIND IS THE ESTABLISHMENT OF SOME FORM OF CREDIT FACILITY TO HELP FINANCE PRIVATIZATION OF ADMARC INVESTMENTS. IN THE END, THE LOCAL CURRENCIES WOULD BE USED TO HELP PAY OFF ADMARC DEBT, AS IN THE MISSION PROPOSAL, BUT AT THE SAME TIME THE PROCESS OF PRIVATIZATION WOULD BE ABETTED. WE WILL POUCH A COPY OF THE RWANDA AEPRP WHERE THAT IDEA HAS BEEN DEVELOPED TO SOME EXTENT.

6. THE POLICY IMPACT SECTION OVERSTATES THE GAINS FROM THE PROPOSED PROGRAM. MANY OF THE BENEFITS CLAIMED WOULD BE THE SAME THROUGH ANY RESOURCE TRANSFER. THE POLICY GAINS COME THROUGH IMPROVEMENT IN THE MARKETING FUNCTIONS OF ADMARC AND IN THE REDUCTION IN FISCAL DRAIN ON THE TREASURY. WE BELIEVE THAT THE IBRD IS NOT AS CONCERNED AS IT SHOULD BE WITH RESPECT TO THE EFFICIENCY OF ADMARC MARKETING OPERATIONS, AND WOULD LIKE TO SEE THIS PROPOSAL INCLUDE AN EXAMINATION OF THE MARKETING ISSUES.

7. SEPTEL WILL FOLLOW ON AID/W PARTICIPATION ON DESIGN TEAM. SHULTZ
BT
#9740

NNNN

VZCZCLGI *
PP RUEHC
DE RUEHLG #1339 098 **
ZNR UUUUU ZZH
P 080840Z APR 86
FM AMEMBASSY LILONGWE
TO SECSTATE WASHDC PRIOITY 7776
BT
UNCLAS LILONGWE 01339

CLASS: UNCLASSIFIED
CHRGE: AID 03/26/86
APPRV: D:JFHICKS
DRFTD: AD:RLSHORTLID(
CLEAR: PO:RCDAY
DISTR: AID-3 AMB DCM/

AIDAC

1-B

E.O. 12356: N/A
SUBJECT: PROPOSED FY-86 MALAWI AFRICAN ECONOMIC POLICY REFORM PROGRAM

REFS: (A) STATE 99740; (B) LILONGWE 1054

1. APPRECIATE RESPONSE TO REF (B) CONTAINED IN REF (A). EVEN THOUGH FINANCING FOR A FY-86 MALAWI PROGRAM IS UNLIKELY, MISSION WISHES TO PROCEED DURING MAY AND JUNE WITH THE PAAD DESIGN FOR A SHELF PROGRAM. PROPOSED START DATE FOR PAAD DESIGN IS MAY 5, 1986. THIS DATE WOULD PERMIT A WEEK'S OVERLAP WITH THE WORLD BANK MISSION WHICH IS SCHEDULED TO BE INCOUNTRY FOR THREE WEEKS BEGINNING APRIL 21. PLEASE ADVISE ASAP OF AID/W PARTICIPATION ON DESIGN TEAM.

2. CONCERNS RAISED IN REF (A) PARAS 3, 4, 5 AND 6 ARE VERY CONSTRUCTIVE AND WILL BE TAKEN INTO ACCOUNT IN THE PROGRAM'S DESIGN.
ADAMS
BT
#1339

NNNN

ANNEX H

Telegrams: FINANCE, Lilongwe
Telephone: Lilongwe 731 311

Communications should be addressed to:
The Secretary to the Treasury

In reply please quote No. USA/2/IV/129

MINISTRY OF FINANCE
P.O. BOX 30049
LILONGWE
MALAWI

7/16

14th July, 1986.

PO

The Mission Director,
USAID,
P.O. Box 30455,
LILONGWE 3.

7/23

Dear Sir,

PARASTATAL DIVESTITURE: AGRICULTURAL DEVELOPMENT AND MARKETING CORPORATION - FY1986 AFRICAN ECONOMIC POLICY REFORM PROGRAM GRANT

You will recall that we have recently concluded discussions with you on diverstiture concerning the Agricultural Development and Marketing Corporation. I hereby formally request the USAID for assistance of an amount of US $15 - 20 million to assist the Malawi Government in its divestiture programme with the Agricultural Development and Marketing Corporation.

Yours faithfully,

J. R. Phiri
for: SECRETARY TO THE TREASURY

AID-5-169 (3-59)