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***Final Report: An Evaluation of Marketing Options for Smallholder
Burley Growers***

***Malawi: Agricultural Sector Assistance Program
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AN EVALUATION OF MARKETING OPTIONS
FOR
SMALLHOLDER BURLEY GROWERS

Prepared for

**The Ministry of Agriculture
Republic of Malawi**

and

**Agricultural Sector Assistance Program
The United States Agency for International Development
Lilongwe, Malawi**

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Annex Terms of Reference

List of Abbreviations

ACDI	Agricultural Cooperative Development International
ADD	Agricultural Development Division
ADMARC	Agricultural and Development Marketing Corporation
AHL	Auction Holdings Limited
ASAC	Agricultural Sector Adjustment Credit (World Bank)
ASAP	Agricultural Sector Assistance Program (USAID)
ATC	Agricultural Trading Company
CAETO	Chief Agricultural Extension and Training Officer
DEMATT	Development of Malawian Traders Trust
EEST	Estates Extension Service Trust
EPA	Environmental Planning Area
FA	Field Assistant (extension)
GR(V)	General Receipt
GoM	Government of Malawi
IB	Intermediate Buyer
IFAD	International Fund for Agricultural Development
MIS	Smallholder Burley Management Information System
MK	Malawi Kwacha
Mkg	Million kilograms of (green, unprocessed) tobacco
MoA	Ministry of Agriculture
MUSCCO	Malawi Union of Savings and Credit Co-operatives
NRDP	National Rural Development Program
PM	Program Manager
PVHO	Plant & Vehicle Hire Organization (GoM)
RDP	Rural Development Project
SAO	Senior Agricultural Officer
SEDOM	Small Enterprise Development Organization of Malawi
SFFRFM	Smallholder Farmer Fertilizer Revolving Fund of Malawi
TAMA	Tobacco Association of Malawi
TCC	Tobacco Control Commission
TEAM	Tobacco Exporters' Association of Malawi
USAID	United States Agency for International Development

Executive Summary

Smallholder burley clubs offer their members a choice between selling collectively on the central auctions or as individuals, to either ADMARC or the estates. The collective decision is in many ways preferable. It should maximize individual returns, strengthen the credit system and, by behaving in the same way as estates, secure acceptance of the clubs within the industry. However, selling collectively is not always easy. Delivery quotas make cash flow slow and tempt leaders to favor themselves. This option demands high standards of management within the clubs and this can only be achieved with considerable outside support. It is not yet clear whether the clubs are sustainable without it.

The option of selling as individuals weakens the collective potential. Some smallholders seem to sell in all three markets at once, either by withholding tobacco from their club or overproducing. At present there is no effective check on their ability to do so. Measures are proposed here to link ADMARC's registration to the Ministry's and make it easier and to monitor ADMARC clubs. But while the third channel (estates) remains, even registered smallholders may over produce. This is complicated by the extent of illegal growing.

A proposal is made for a liberalized third option, intermediate buyers, which should satisfy the conditions of ASAP. Although less certainly, this option would tackle the problem of illegal growers. Intermediate buyers would initially be estates and would be able to trade in smallholder burley openly with a separate marketing quota. Distinguishing trader from producer is vital as the principle that sellers may only sell their own production is obviously breaking down.

The danger is that recognizing this problem will only add to the pressures behind it. Many more smallholders wish to grow burley than can be accommodated in the existing schemes. The presence of intermediate buyers would encourage some to risk illegal growing, though the severity of the effect is conjectural.

The original estate proposal assumed it would be feasible to control quota with coupons. Upon examination this seems impractical. The quota system, in need of reform, is complex and inefficient enough as it is. Added measures for transferrable quota are liable to be cumbersome, costly, and corruptible.

This report's main task was to propose measures to expand the estate option to include new marketing entities, without at the same time encouraging overproduction. As far as the consultant can see, this is impossible. If the coupon idea is flawed, perhaps the whole third channel envisaged in ASAP is also flawed. This is a liberty gone too far. It could paradoxically end in de-stabilizing the very source of benefits to the few registered smallholders whose best chance is collective sales. Important strategic decisions need to be made on whether to concentrate on the clubs.

1. INTRODUCTION

1.1 This report follows earlier studies by ACDI on smallholder burley marketing (October 1992), organizational and training needs, including an evaluation of the 1991-92 season (December 1992), and registration for 1992-93 season and the burley management information system (March 1993, draft only, not circulated). These studies have been funded under the terms of the Agricultural Sector Assistance Program (ASAP) agreement between the governments of Malawi and the United States.

1.2 The present report re-covers much of the ground explored in the first report on smallholder burley marketing, taking into account developments in the year since October 1992 and addressing the marketing issues identified in more detail.

1.3 The three marketing choices open to registered smallholder burley growers, guaranteed under ASAP, are:

- 1) Club sales on the auction floors owned by Auction Holdings Limited (AHL) - the private (though closely regulated) auctioneers who organize the sale of practically the entire Malawi tobacco crop. To put the smallholder scheme in broad perspective, in 1993 AHL will handle around 140 million kgs (Mkg, or 1,000 tons) of tobacco, of which perhaps 5 Mkg will be identified as belonging to registered smallholder burley clubs. Of the 20,000 or so licensed sellers with whom AHL must deal with this year, less than 1,000 are registered smallholder clubs.
- 2) Individual sales to the Agricultural Development and Marketing Corporation (ADMARC) - a parastatal Organization with its origins in smallholder tobacco and a formidable network of market points covering all of Malawi. ADMARC, in turn, offers tobacco on the floors in its own name. In 1993 this will include about 1 Mkg of smallholder burley. ADMARC is a major shareholder in AHL.
- 3) Individual sales to estates and other recognized marketing entities who, again, will ultimately sell on the floors. Though some measures have been put in place to formalize this market, it remains illegal and underground, making it difficult to ascertain hard facts. It is certainly complex and may involve as much as 20 Mkg of burley. It is, in brief, the main focus of this report.

1.4 The three smallholder marketing choices are not equal. Direct access to AHL involves collective action, while the other two options are essentially individual choices. The market does not finish with the auctioneers. Tobacco is bought by a small group of merchant and processing companies, known variously as the buyers or the trade, and represented by the Tobacco Exporters Association of Malawi (TEAM). The trade is dominated by four companies which are affiliates of the major international, mostly US-based, merchant companies. A single group

accounts for nearly half of the crop sales (all tobacco types). Oriental tobacco, alone, is not sold by auction.

1.6 For the purposes of this report we can assume that TEAM represents the final market. However, its members are subject to the shifting pressures of changing international demand, alternative sources of supply, and the costs of stocks and shipping which make up the world burley market - a market in which Malawi, though one of the most important actors, does not dominate.

1.7 USAID has recently commissioned a study by Abt Associates which will describe the world market and Malawi's role in it. In particular, the study will hopefully throw some light on the central question of whether Malawi can hope to sustain the recent growth in burley production. Yet, it is a question that has no definitive answer.

1.8 Before we go on to the smallholders themselves, other actors need some introduction.

1.8.1 The Ministry of Agriculture (MoA) has three distinct roles in smallholder burley marketing:

- (a) General policy in the tobacco industry, including the coordination of the aid agencies' increasing attention to this sub-sector.
- (b) The registration, licensing, and allocation of production quota to all growers (clubs and estates). This system has been described in previous ACIDI reports. Therefore, the description is not repeated here except to note that the decentralization to ADDs planned earlier has not yet taken full effect since the Ministry is still responsible, for instance, for seed form issue.
- (c) As promoter, mentor, financier and guardian of the clubs, the ADDs (from Program Management to field assistants) are closely involved in the day to day management of club affairs. MoA's role as financier (through SACA) is supposed to change in the near future.

1.8.2 The Smallholder Agricultural Credit Administration and the Malawi Rural Finance Company (SACA/RFC) is also a major actor in burley club marketing. SACA is due for transformation into the RFC in October 1993, under the World Bank-supported Rural Financial Services Project. RFC is to have the form and status of a private sector corporation but it is difficult to see how it will have the substance. Present overall recovery rates are dismal and it seems that effectiveness of the finance package is tied to recoveries of 90 percent. This is now impossible before the 1993-94 season starts and the short-term future of rural credit in Malawi is difficult to predict.

1.8.3 The Tobacco Control Commission (TCC) is a Government Statutory Body, in force since 1938. Its Board is appointed by the Minister of Agriculture and includes:

- (a) A Chairman appointed by the Minister
- (b) One member to represent ADMARC
- (c) Two members to represent TAMA
- (d) Two members to represent TEAM
- (e) Two members to represent Government

1.8.4 TCC is thus the single institution in which all the main parties to the industry are represented. It has wide formal powers to collate statistics, disseminate market information, act as Government's advisor in the industry, promote and expand the sale of tobacco, and most importantly to control and regulate the sale of tobacco on the Auction Floors in Malawi.

1.8.5 In the present context, the latter function includes the registration of sellers and the allocation and administration of delivery (i.e. marketing) quotas. Historically, TCC also administered production quotas but this function was assumed by Government itself some years ago, as a result of irregularities in TCC's performance.

1.8.6 TCC is financed by a cess (in 1992, 0.72 timbale/kg), payable equally by seller and buyer, as well as a number of other license fees. Its operations are in the hands of the General Manager, appointed by the Board, and his staff. As a result of careful financial control by the Board, it would seem that the present staff is slim and fully employed

1.8.7 All registered growers of flue-cured and burley tobacco are automatically members of the Tobacco Association of Malawi (TAMA). TAMA is financed by a levy on all sales of these tobaccos. The curious consequence is that smallholder clubs selling through AHL are TAMA members, while those who sell purely through ADMARC or estates are not represented. TAMA has recently created a position on its governing Council to represent smallholder clubs. The councillor is nominated by MoA and not, as with other councilors, elected by area constituencies representing growers of both kinds of tobacco. The councillor has yet to attend a TAMA meeting.

1.8.9 Most TAMA members are estates which, to the extent that the interests of smallholders and estates conflict, results in a problem of representation that has yet to be fully addressed, as noted earlier. It is not considered further in this report, except to note that TAMA's sometimes adversary relationship with TEAM benefits smallholders as much as estates and is necessary to support prices.

2. CLUB SALES THROUGH AHL

2.1 Introduction

2.1.1 This option is the most innovative feature of ASAP. The number of clubs using it will increase and will probably be replicated in other programs including the Smallholder Food Security sub-project proposed by IFAD (a sub-project of the World Bank sponsored Agricultural Services Project).

2.1.2 The operational details were established in the 1991-92 season and have continued into the second season. The basic principle is that once tobacco leaves the club, it is treated exactly the same as estate tobacco. Clubs are subject to the same rules as estates and AHL accounts for them in the same way. However, it is possible to distinguish them on the AHL computer and has been most helpful in providing data from time to time to enable monitoring of prices and volumes.

Recommendation An analysis of club sales in 1993, similar to that carried out last season, should be made as soon as is practicable.

2.1.3 Club sales seem to be the most popular option, though not overwhelmingly so. It is estimated that about half the 1991-92 smallholder crop was sold in this way (ACDI, December 1992) and about 75 percent of registered smallholder quota is notionally committed to club sales in the present 1992-93 season. But it is too early to say at present whether this figure will be reached.

2.2 Clubs - advantages to smallholder farmers

2.2.1 The most obvious and important advantage is financial. Club sales offer members the opportunity to maximize cash realized from burley farming by assuming the costs (and potential margins) of marketing on their own account.

2.2.2 The other advantage is social-developmental. The evident pride and satisfaction of club members selling direct on the floors is one of the most encouraging features of the scheme, suggestive of increased empowerment. It remains to be seen how durable these formations will be. ADD staff continue to play a key role in organizing sales and distribution of proceeds.

2.3 Clubs - disadvantages to smallholder farmers

2.3.1 The club sales option also has risks. Cash flow is slow, as for all sellers on the floors, because of the restrictions of delivery quota. There is growing evidence that access to delivery quota within clubs is controlled by club leaders who arrange deliveries to benefit

themselves. This abuse has two forms. The lesser is where club leaders ensure that all their registered tobacco is sold early and other members (those lowest in the pecking order) may have to wait until the very end of the season to sell, particularly in areas with severe transport problems. This type of abuse is most common. However, in rarer more extreme cases, a dominant group within the club overproduces and sells out the entire club quota, leaving the weaker members to carry the club's collective overproduction penalties alone.

2.3.2 Apart from the obvious equity considerations here, this sort of behavior makes it unlikely that all members in such clubs will be able to repay their SACA/RFC credit, either partially or in time for the club's re-application in September. This leads (or should lead, if the rules are enforced strictly) to the club as a whole defaulting.

2.3.3 MoA is aware of these problems and the record-keeping package extended this year includes measures to check abuse or at least to record it. But even where clubs are conscientious, the temptation to make sales outside the club must be strong when there are sudden family expenses to be met - funerals, for example. All this adds to problems with credit.

2.3.4 Burley club recovery rates are much higher than rates for credit clubs as a whole. Nevertheless, they are well short of the 90 percent target requirement. At the time of writing it is still not clear whether they can catch up in time to be assured of inputs for the coming season. This has implications considered below in Section 2.5.

2.3.5 The most obvious potential disadvantage for the average member is the chance of being cheated by club officials. It is encouraging to record that no instance of outright embezzlement has been reported - a tribute to the checks on handling cash which MoA has put in place. Nevertheless, there are indications that club officials have few checks on the way in which they decide to use members' subscriptions.

2.3.6 Rigidities in the quota system present a problem (identified in ACDI's December 1992 report) which is not unique to the clubs but has special implications for them. If a club - or any farming business - is to develop, it needs to be able to expand. Given the present shortage of quota, it is unlikely that successful clubs will be able to apply for additional quota and thereby take on more members. This absence of incentive is liable to stunt the potential for development which the club system offers. Some system for rewarding developing growers - both estate and club - needs to be sought. Allocation of a proportion of whatever new quota is available should be in accordance to a formula which includes measures of quality and quota adherence.

2.4 Clubs - national and industry advantages

2.4.1 By maximizing individual returns, the club option would seem to fulfil the national policy goal set for ASAC and ASAP of transferring income to the rural areas, with multiplier

effects. No evaluation of this complex economic process has been attempted yet but it is worth noting a marked tendency for burley income to initially be spent on consumer durables with a large import content (bicycles, radios, etc.) These items rank ahead of clothing and school fees. However, this is not to say that a process of rural capital formation will not follow the consumption burst, nor that bicycles are as much vehicles of rural transport as they are consumer durables.

2.4.2 By grouping small producers together, more people gain access to the floors without swamping the AHL system. Many clubs are now bigger producers than most estates. Treatment of clubs on an equal footing with estates makes quotas enforceable (though the existence of other marketing options compromises this advantage - see below). Clubs also seem to produce better quality tobacco than small estates. All of this has resulted in a growing acceptance of the clubs within the industry.

2.5 Clubs - industry and national disadvantages

2.5.1 Yet, naturally enough acceptance within the tobacco industry is still conditional. The extension of burley production from a limited, and relatively controllable, group of estate owners to smallholders could eventually de-stabilize Malawi's main industry if a mass number of customary land farmers begin producing tobacco regardless of existing controls. The result would be tracts of customary land covered in early-flowering, limp, yellow burley yielding vast quantities of trashy, unsalable tobacco.

2.5.2 So far, this hasn't happened. Indeed, the quality of registered smallholder sales is above average. But it is clear that many individual growers are not content to limit production to 300 kg. This is not a problem of the club option, per se, but applies to the scheme as a whole.

2.5.3 It is also feared that the smallholder scheme may encourage theft from estates and acts as a conduit for illegal growers. Doubtless this happens but it may also be that registered smallholders have enough trouble selling their own crop, without also having to provide for stolen or illegal tobacco. These problems may develop in the future if the tendency for club quota to be cornered by a few dominant growers is left unchecked. This is a matter for widespread training in the rights and duties of club membership for all members, not just leaders. There is a need to formalize club constitutions and to provide for rotation of office-bearers. The present political climate is conducive to such developments.

2.5.4 The training required will take time and considerable resources. MoA and USAID have addressed this by providing long term technical assistance (furnished by ACDI) which is expected to be in place early in 1994. The IFAD proposal also concentrates on the need for smallholder training in these smallholder club management topics. Clearly both

schemes will need to be coordinated if the content of the training and the general perception of the role of clubs is to escape contradiction.

2.5.5 The credit problem described above from the farmers' perspective has a wider dimension. One of the reasons for smallholder burley's good performance in terms of average price is because, unlike small estates, clubs have been assured until now of proper inputs. This situation seems to be changing and the smallholder scheme is going into its fourth season with club and individual quotas being issued to growers who, because of default, have no formal source of input supply. The scale of this problem will not be clear until SACA/RFC finalizes credit availability towards the end of 1993.

2.5.6 It also remains to be seen whether defaulters will be able to find the cash for fertilizer purchases. The probability is that performance will become progressively more uneven with a second tier of un-financed, yet registered, smallholders emerging. This group will almost certainly produce poorer tobacco. This is highly undesirable and a mechanism for de-registering defaulting clubs needs to be sought.

2.5.7 There are problems with timing here. Many clubs cannot finish selling (and therefore repay credit) until after the registration process is complete and the individual quota slips distributed. Nevertheless, it would strongly encourage a truly collective approach to both credit and marketing if the cut-off date were put relatively early in the season beyond which defaulting clubs would have their registration withheld (August 1st for example). Any date later than this would compromise the administration of registration. Perhaps implementing this would call into question the "de-linkedness" of the RFC from the MoA but it appears that the "private" character of the RFC will remain little more than an ideological label.

Recommendation For the 1994 selling season, all smallholder burley clubs should be instructed that failure to complete credit repayment to MRFC by August 5 will result in de-registration for the 1994-95 season. This message would be accompanied by the extension message on the virtues of bale sharing and a fair club rota for deliveries. This is now part of MoA's extension approach and has been discussed in earlier ACDI reports but needs emphasis.

2.5.8 The "success" story so far has concentrated on average prices, rather than net returns to typical small growers. These net returns may be less than expected, particularly for the weaker members of clubs. As part of the monitoring and evaluation component of the club strengthening effort to be mounted by ACDI over the next three years, it is hoped that a far more detailed picture of what actually goes on in the villages will emerge. This process might include a series of sample audits of the affairs of randomly chosen clubs. It seems likely that clubs are not as successful for all their participants, as the simple measure of prices suggests. Why else does ADMARC continue to hold a significant proportion of the market?

2.5.9 The economic cost of MoA support to the clubs is considerable and may be unsustainable unless clubs become truly independent. The whole thrust of the MoA effort, in ASAP period, has largely been to support club sales over the floors. This is understandable and even commendable, given the equity objectives of the project. But it does open the question of how far ASAP's essential element of choice between the three options is compromised by the concentration of government (and indirectly, donor agency) support on a single marketing option.

2.5.10 Indications so far (see ACIDI, December 1992) are that field staff spend a disproportionate amount of time and resources on burley clubs. Continued dependence on MoA is obviously unsustainable and the maize club example - still highly dependent after many years of credit programs - is hardly encouraging. MRFC is supposed to recover the economic costs of credit, but this does not account for the cost of FAs' (and their superiors) time as ex-officio club administrators. What will happen to the clubs once the attention of funding agencies moves on and field staff are asked to implement a new development focus?

2.5.11 It is now widely recognized that ASAP's target group has generally proved, in practice though not design, to be the better-off echelons of smallholder society. The IFAD project promises to bring an additional 50,000 small to very small growers into the market. These small (usually poorer) farmers increase production, they are even more likely to become chronic defendants than those already involved. They will also cause possible conflict in the villages - as the 'poorest' compare their quotas (100 kg) with those issued under the present scheme (300 kg).

2.5.12 Finally, it now seems true that the introduction of burley has discouraged production of other smallholder tobaccos. This has damaging consequences for the reputation of Malawi tobacco as a whole and the country's position as a supplier of fire-cured is dangerously weakened. Consideration of this aspect of the scheme has been specifically excluded from the consultant's terms of reference but it is difficult to ignore.

3. SMALLHOLDER SALES TO ADMARC

3.1 Introduction

3.1.1 This report is written before the final results of the 1993 season are known but it is clear that ADMARC's volume of burley, at around 1 Mkg, has increased over previous seasons. Whether this represents a change in share of registered production will be established when an evaluation of the season's results is carried out.

3.2 ADMARC - advantages to smallholder farmers

3.2.1 ADMARC has some definite advantages to offer smallholders: familiarity, accessibility, reliability, and the chance of a bonus or second payment. The non-involvement of clubs avoids the risks of club sales described above and, generally, the smallholder can sell for cash as fast as the crop can be presented (though there were problems this year with shortages of scales and small currency denominations). ADMARC is the only option which will readily accept small lots of tobacco. Many smallholders have stated that they prefer it to the uncertainties of the estate option.

3.2.2 This option is a safety net for weak clubs. There are some intriguing geographical patterns to ADMARC sales. Why is it, for example, that all clubs in Phalombe (BLADD) sell to ADMARC, while their near neighbors on the Zomba side (Dzaone/Mayaka - LWADD) sell their full quota over the floors? [and, by all accounts, also overproduce for sale through estates]. Again, these are questions to be reviewed by the developing monitoring and evaluation effort.

3.3 ADMARC - disadvantages to smallholder farmers

3.3.1 Against these advantages is the vital consideration of price. The gap between ADMARC's announced prices and the average prices reported from the floors is so enormous as to deter many smallholders from going to ADMARC.

3.3.2 It is not always understood - and not only by smallholders - that the prices at auction are not net prices. In addition to commissions, levies etc. of around 10 percent, club sales at AHL involve marketing costs which do not apply to ADMARC. The most obvious of these are packing materials and credit repayments for baling presses and scales. The picture of transport costs is, for the moment, less clear as clubs seem to pay very different prices. These obviously vary with the distance from Kanengo or Limbe. The clubs' ability to organize transport on advantageous terms also seems to vary considerably, probably as a result of club leaders' connections with individual transporters. Finally, there are hidden costs to club membership in the form of supplementary membership fees levied to meet the cost of various miscellaneous expenses (ie., the leaders' visits to town for banking).

3.3.3 The consultant is not yet in a position to quantify all these costs but if the extension service is to be able to give unbiased advice to smallholders, specific numbers will be required.

Recommendation: A comparison should be made, based on sample audits of club records, of actual net returns to growers of AHL sales, with those selling to ADMARC.

3.3.4 The most probable result of this exercise is that club sales will still show a higher return, but not of the order of magnitude suggested by simply comparing ADMARC's first price with auction averages. This may affect the view of ADMARC contained in the push to get as many clubs onto the floors as possible.

3.3.5 ADMARC has a poor image with farmers throughout Malawi. This is a long and familiar story and it is not necessary to go into detail here. As it happens, the consultant is sympathetic to the difficulty - impossibility, perhaps - the corporation faces in reconciling its twin roles of quasi-commercialism and a pan-territorial social/marketing service. Nevertheless, one cannot ignore the fact that many people, not only smallholders, perceive ADMARC as intrinsically mean and in many cases, its officers in the bush-markets as actively dishonest. This image, whatever the more complex truth which underlies it, is a significant disadvantage to this marketing option.

3.3.6 Sales to ADMARC are individual transactions and it seems likely that this would lead to poorer credit recovery than collectively managed sales on the floors. Were ADMARC's crop purchasing records organized by club of origin rather than by market location, this hypothesis would be fairly easy to test. Since they are not, the exercise may prove difficult (see 3.5 below), but it is worth trying.

Recommendation A comparison should be attempted of the credit recovery records of clubs selling principally to ADMARC with those selling through AHL.

3.3.7 It has been said that ADMARC is a safety net for weaker clubs - could this also mean that this option encourages dependency? This may be a minor consideration but one to weigh against the potential that club sales seem to offer in the way of self-reliance and the development of farmer based organizations.

3.4 ADMARC - industry and national advantages

3.4.1 ADMARC is a known, if sometimes controversial, quantity in the industry. Its procedures are well established and the pricing formula ensures that there are no hidden economic overheads to this option. If we assume that the corporation continues to function broadly as it does at present and that the club/AHL mechanism is still fragile, then at the very

least the ADMARC option gives some assurance of the sustainability of smallholder burley production.

3.4.2 Smallholder burley is an additional market opportunity for ADMARC itself. To the extent that the tobacco account subsidizes ADMARC's other social/equity functions, the smallholder burley scheme diversifies ADMARC's product base over which to recoup these costs (until GoM takes these on in the form of subventions under the proposed memorandum of understanding). But the ASAC price plus bonus formula seems to have been intended to limit this effect and the consultant is unclear as to whether smallholder burley continues to cross-subsidize ADMARC's other activities.

3.4.3 Like the club option (but perhaps unlike sales to estates), ADMARC's overall burley quota is controllable. At present ADMARC is permitted to sell tobacco over the floors equal in volume to the aggregate quota of all clubs declaring their intention to sell to the corporation. Once markets report that they have bought this amount (about 1.1 Mkg, in 1993), ADMARC closes the markets to burley, whatever the position with supply.

3.5 ADMARC - industry and national disadvantages

3.5.1 It is unlikely that ADMARC burley is all from 'ADMARC-declared' clubs or that all members of these 'weaker' clubs sell their whole crop to ADMARC. Given the discontinuity of registration systems (noted in earlier ACDI reports), it would be surprising if the corporation were not, in some cases, inadvertently buying illegal burley and closing markets to legitimate tobacco. Until ADMARC burley registration is tied to MoA's smallholder burley management information system (MIS) this is bound to continue.

3.5.2 The control achieved on the overall quota is obviously weakened by this discrepancy as it obscures the functioning of the market. With club sales, the club quota is known, the weight sold at AHL is a matter of record and, as the clubs' record keeping is progressively strengthened, it should be possible to identify patterns of individual sales within clubs. These things must be known if policy towards developing the smallholder burley scheme is to be made from an informed point of view.

3.5.3 It is desirable that a more detailed picture be obtained of what happens to ADMARC-declared quota. Under present regulations ADMARC is not required to ascertain or confirm MoA registration at the time it registers smallholders. This is due to the fact that the MIS is new and has not been completed in time, and that ADMARC's own procedures have been proven over many years. If we assume that the teething troubles in installing the MIS are behind us, next year it should be possible to devise a system which links MoA and ADMARC registration - not only pre-season but more importantly during the buying season. Would it be possible, for example, to introduce a third market card in addition to the grower's and the market's own? This would record tobacco purchases from all members of a single club.

Figures would then emerge, which are not available at present, on the performance of ADMARC-declared clubs.

Recommendation MoA should invite ADMARC to propose a system which a) links farmer registration to the MoA registration data base and b) records the amount of tobacco bought from individual clubs.

3.5.4 This idea needs some thought at this stage and it is not necessary to offer more than the following remarks. It should be possible to make farmer registration dependant on the possession of an individual quota slip and the endorsement of club leadership. Each market would then know, pre-season, how many clubs it was dealing with and, if the suggestion of a third market card is practicable, open this or some similar recording instrument. The details can be sorted out once it is agreed that this sort of information is needed.

3.5.5 Who pays? These procedures would mean extra work and cost for ADMARC and the obvious answer is that the smallholder would eventually pay, in the form of a reduced bonus. Is this fair, given that clubs selling on the floors enjoy a subsidy of some kind in the form of MoA technical assistance? The forthcoming project component on strengthening club performance may find it necessary to consider this question.

3.5.6 On a different topic, ADMARC sales are traditionally tied to the Limbe auction floors. This has the consequence that tobacco from Dedza northwards, for example, would normally end up in Kanengo and incur extra transport costs. Though not a major issue, this amounts to something of a national disadvantage as well as to the smallholders who pay for it through the bonus.

4. SMALLHOLDER SALES TO ESTATE

4.1 Introduction

4.1.1 Everyone seems to have a different picture of what "estates" are, depending on their point of view. In fact, estates vary so widely in scale, ownership, and efficiency that they have very little in common except a license to grow tobacco (or, in the case of most burley estates, "buy and resell" following the tenant system). The license in turn depends on a formal title to land. This "beyond dualism" argument has been made before but the term 'estate' is still misleading and sometimes seems to get in the way of proper debate.

4.1.2 If all licensed sellers (mostly estates but, for consistency, presumably also other clubs) are free to buy registered smallholder tobacco and sell it within their own quota then the smallholder gains by having access to a third market. This will have the effect of putting pressure on ADMARC to improve the deal it offers to smallholders. Competitive efficiency follows, markets clear, and all sellers on the whole gain. This is the underlying principle of much of ASAP.

4.1.3 If, as the present system is supposed to ensure, the total national licensed weight (production quota) is in line with what the market can absorb and there is an effective deterrent to sales over quota (the penalty system), the overall national picture is undisturbed. Any seller who for whatever reason, fails to produce licensed weight on their own, would be free to make up the shortfall by purchases from registered smallholders (or, if we are to be consistent, any other licensed grower, though this is not part of ASAP).

4.1.4 But such sellers would stop short of selling over their uplifted weight as a result of the penalty deterrent. Total national production would remain in line with quota and price stability would be ensured, fulfilling the purpose of quotas.

4.1.5 Several of the conditions outlined pertain imperfectly:

- In 1991/92, total national licensed weight (burley only) exceeded 140 Mkg in a market which expected to buy only 85 Mkg. As a result and in a difficult season, 100 Mkg were produced and prices predictably fell considerably towards the end.
- In 1992/93, MoA has taken steps to realign quota with market expectations but the tendency for licensed weight to be issued in excess of estimates is inbuilt. The political basis for this may be changing but it is unlikely to ever disappear completely while quota is scarce.
- A third force exists in the market - 'illegal growers'. They are neither registered clubs nor estates and their scale can only be guessed at. The model above makes no provision

for these people, though everyone concerned concedes that they exist. One estimate puts the volume of burley sold in contravention of the strict terms of the license as high as 20 Mkg. Kasungu ADD, to take probably the biggest example, estimates 7 Mkg in its area.

The penalty deterrent is retro-active. While it may teach a painful lesson for future seasons (even at 70 percent), it still makes sense for a seller to get rid of surplus production so long as the remaining 30 percent is greater than selling costs - including packing, transport, and auction charges.

4.1.6 At a more general level, market information is imperfect and an intrinsic feature of agricultural markets. People decide to grow a given acreage of tobacco without knowing the outcome, principally because of seasonality but also because of uncertain management variables such as availability of labor and finance. This is true of even the best managed estates and much more so of the small (minimum quota) estate which has come to be such an important feature of the Malawi burley scene.

4.1.7 Thus an estate may encourage neighboring smallholders to grow a crop. The encouragement lies in making it known that the estate is allowed and prepared to buy the crop and is almost like a contract. The smallholders may or may not be registered. The estate is acting in its best interests in order to hedge, for instance, against tenants absconding or otherwise failing. The introduction of the estate option legitimizes this activity and it certainly occurs. If, however, everything goes well on the estate and the estate meets quota from its own tenants, the smallholder production must look elsewhere for a buyer. There is in fact no contract.

4.1.8 This sort of process, repeated many times by thousands of small growers, makes the market much more complex and potentially unstable than it was before the introduction of the smallholder scheme (or than the idealized description in paras 4.1.4 - 4.1.6 would suggest).

4.2 Estate option - Advantages to smallholders

4.2.1 This is the most flexible market, with prices supposedly freely negotiated. It represents possible quick cash for the smallholder, who is often able to dispose of his or her entire crop in a single transaction. It seems that the crop is generally bought loose, avoiding grading and baling costs. There are also reports of smallholders selling forward.

4.2.2 Price competition, in theory, is healthy for ADMARC and should force them to offer better prices and to be more competitive. For smallholders as a whole, this has to be a good thing.

4.2.3 As far as individual smallholders are concerned, this is a private transaction. This leaves them with the greatest discretion in managing their collective obligations to the club - mainly for credit repayment.

4.3 Estate option - Disadvantages to smallholders

4.3.1 It is noteworthy that not a single club has formally committed itself to this option in the two years it has been on offer. And yet it goes on all the time. There are two reasons for this. The most important is the association with the existing illegal market. Many of the players are the same. And so, in spite of formal assurances from MoA, the estate option for registered smallholders remains uncertain, underground, maybe still illegal. The terms of its introduction are not generally understood by the field staff who must explain them to the clubs.

4.3.2 The second reason is that crooked operators abound. There are so many stories of estates renegeing on deals and swindling smallholders that this is obviously a common phenomenon. It is not so clear as to how often this happens with registered smallholders as the distinction between them and the illegals is not nearly as obvious as it may seem from the outside. The very illegality of many such transactions means that sellers have no recourse.

4.3.3 The explanation for cheating, other than simple dishonesty, lies in the financial weakness of many small estates. They are unable to finance tobacco purchases, including those from tenants, until the tobacco has been sold at AHL. It is probably something of a myth that the estate option is a quick and open cash transaction. For many participants it may be a lengthy process of promises, part-payment and disappointment.

4.3.4 As noted elsewhere, TAMA has said, with justification, that the extension service denigrates the estate option. There is still considerable uncertainty in the ADDs and the MoA, as to how to treat this third channel. Again, this is linked to the association with the illegal trade.

4.3.5 Though prices are supposedly freely negotiated, it seems that this is a comparatively unsophisticated market and a general price seems to be set which pertains for much of the season over most of the country. As noted in the ACDI 1992 report, this general price does swing, presumably as a lagged response to prices at AHL.

4.3.6 It is possible that the effective price, taking some non-payment into account, paid to smallholders may be lower in a bad season than ADMARC's. In fact, ADMARC's price is tied by the ASAC pricing formula. But despite this theoretical effect of price pressure, quota, and inevitable institutional rigidities, lower prices are possible.

4.3.7 As an individual decision, the estate option may tend to weaken clubs and possibly lead to poor credit recovery. As noted in section 2, this is undesirable from all points of view in the longer term. It will almost certainly result in deteriorating production quality.

4.4 Estate option - Industry and national advantages

4.4.1 If estates are able to make up shortfalls in quota (but not exceed it) by buying in registered smallholder burley, the industry should be strengthened. Estates could budget more effectively, banks and other suppliers' confidence is enhanced, and the trade gets the crop it was looking for. Everyone should gain.

4.4.2 But it has been argued that the reality is more complex, principally because of the existence of the third force - illegal growers. As neighbors and relations of the privileged few registered growers, they are difficult to distinguish and prevent from entering into burley production. Paradoxically, perhaps the greatest advantage of the estate option is that it forces policy consideration of this, the biggest area of uncertainty in the present market.

4.5 Estate option - Industry and national disadvantages

4.5.1 Estates are widely acknowledged to trade in smallholder (registered and illegal) burley. Though estimates of the volume have been made (perhaps 20 Mkg, of which the greater part must be illegal), there is no real idea of how many (registered sellers) are involved because of its illegality. This is inherently unstable and policy cannot easily address a problem whose dimensions can only be guessed.

4.5.2 This option essentially involves the transfer of quota between producers. The original proposal was included in ASAP on the assumption that it would be possible to account for this transfer using a system of coupons. This would ensure that only estates bought registered smallholder burley. If such a system could be made to work, the effect of encouraging other unregistered growers would be greatly diminished, though probably not eliminated altogether.

4.5.3 The consultant has argued against coupons as cumbersome, costly, and corruptible (ACDI, October 1992). This view seems to have been generally accepted. But the present licensing process stipulates that estates account for where tobacco was procured at season-end. This has deterred any effective formal take-up of this option in 1993 because it places the onus of distinguishing registered from illegal tobacco on the estates. In spite of the acknowledged extent of this market, in terms of the formal provisions introduced under ASAP, it has so far utterly failed.

4.5.4 Without a coupon-type system, there is very little to prevent even registered smallholders producing enough to meet club quota at AHL and then selling any overproduction to estates.

4.5.5 Because the process is invisible, it is impossible to distinguish registered from illegal tobacco on the floors. The conclusion is that the formal existence of the option must tend to encourage illegal growing, leading eventually to price instability. That said, it should be noted that the ASAP estate option is not itself responsible for illegal growing. This is something which has gone on for years. But there is no doubt that the smallholder scheme in general, and this marketing option in particular, complicates the picture considerably.

4.5.6 To repeat the point - it is clearly undesirable that perhaps a fifth of the national crop is being produced and traded in contravention to the existing regulations. Measures are needed to recognize this situation and seek either to stamp it out or to embrace it and adapt it to the requirements of a regulated market.

4.6 Estate purchases over quota

4.6.1 ASAP also provides for estates to be able to buy smallholder tobacco above their own quota. This is even more complicated. Some instrument of transferrable quota (eg., the coupon system) would be absolutely necessary if this provision is to work. It is otherwise impossible, since estates would not be able to convince TCC that they had not overproduced on their own license. Penalties could be applied which would be an effective deterrent to the option being expanded in this way.

4.6.2 By allowing estates to procure over quota provided they account for sources at end-season (ie, as this year), GoM might fulfil the letter of ASAP while ensuring that the option is scarcely used in practice. This would fudge the issue, by-passing the spirit or intent of the provision.

4.6.3 The argument against coupons was not that no formal instrument of transferable quota can work. But it is the consultant's view (see section 6.5) that they are not a practical option for Malawi at present.

5. NEW MARKETING ENTITIES

5.1 Introduction

5.1.1 The ASAP agreement between GoM and USAID stipulates that the estate option is to be further extended to permit registered smallholders to sell burley tobacco to recognized marketing entities. The agreement is deliberately cautious as to the criteria for recognition. It only states that these would be mutually agreed before the relevant tranche of grant funding is released. But the intention to gradually liberalize the third marketing channel is clear enough. The main purpose of this report is to make concrete recommendations on this topic.

5.1.2 How far are our hands tied by the precise terms of the ASAP agreement? Could it be argued that, with the pleasing success of club AHL sales, the third channel is unnecessary as far as ensuring that the smallholder has an adequate alternative to ADMARC? Need the estate option be expanded at all? Can't we simply drop the idea and avoid all the complications? Why not just concentrate on strengthening the clubs to ensure that they behave as responsible growers within the existing system?

5.1.3 Perhaps so, but ASAP is a commitment by GoM and it is assumed here that the difficulties of renegotiating it outweigh the benefits. We need a solution to the problems of the third marketing channel which preserves its intent. The intent is to open the burley market to customary land farmers, without at the same time complicating and de-stabilizing it and thus bringing potentially serious consequences for Malawi's main export industry.

5.2 Intermediate Buyers

5.2.1 The whole estate option (over, or within, quota) is undesirable insofar as it confuses and obscures two functions in the market - producer and trader. As previously recommended (ACDI 1992), the estate option should be eliminated as such. Instead, a new class of licensed seller on the floors could be introduced - a trading only license, ultimately open to anyone able to demonstrate an ability to handle tobacco.

5.2.2 What should these new entities be called? The term 'licensed trader' is open to confusion with the new marketing measures introduced to liberalize the maize and other foodstuffs markets. A separate nomenclature is needed to distinguish the tobacco industry as a market in which production controls have a legitimate place (see section 6). The term "Intermediate Buyer" is provisionally proposed.

5.2.3 What sort of person or organization should qualify for an Intermediate Buyer license? In practical terms the principle that the license should be open to anyone able to demonstrate an ability to handle tobacco would mean a person, partnership or company with an identifiable, and suitable, grading shed. It is vital that this restriction is made for hygiene

reasons (control of tobacco beetle) so that infestations can be traced through the seller's number on the bale.

5.2.4 Applicants would be mainly existing estates. It is recommended that in the first year, at least, the licensing authorities restrict the scheme to existing estates. If the measure is to be effective for the 1994 season there is probably insufficient time for any but existing estates to organize themselves. We should expect the measures to evolve from a limited beginning. This is expedient and would go some way to meeting concerns in the industry as to the wisdom of the third marketing channel. One practical measure to limit the number of applicants would be to set the license fee at a level high enough to discourage all but the serious.

5.2.5 In the earlier report the consultant suggested that commercial graders might be included. It is now recognized that this would lead to unacceptable conflicts of interest and it is recommended that they are specifically excluded.

5.2.6 What sort of person or organization would actually come forward for a license? A number of the bigger farming companies have expressed an interest, seeing an opportunity to diversify their tobacco activities in a time of squeezed margins on the farming side. This interest should surely be encouraged as these are the sort of organization that can be relied on to cooperate with the authorities in developing this channel.

5.2.7 This is not to say that the license should be confined to large companies. It is desirable that a spread is achieved which includes smaller operators who, with lower overheads, might be expected to push prices to the smallholders' advantage. Again, fulfilling the element of choice which is central to the ASAP concept.

5.2.8 Whether those estates which are presently involved in illegal growing would come forward is less clear. These are existing licensed sellers who are dependent - to a greater or lesser extent - on smallholder, not tenant, burley for their production. What would be in it for them? They seem to be able to operate well enough under present circumstances and the illegality itself probably gives them an advantage in dealing with smallholders.

5.2.9 But this would presumably change as they came into competition with licensed intermediate buyers able to operate openly, not buying by night. Eventually this competition should force existing operators either into the open, by applying for licenses themselves, or out of business. As an unlooked-for spin-off from ASAP, this would be an important and most welcome development.

5.3 Advantages of the Intermediate Buyer proposal

5.3.1 By combining the three stages of evolution of ASAP's third marketing channel in a single, quite bold, innovation, the intermediate buyer proposal should satisfy both the letter

and spirit of the ASAP agreement. GoM would have fulfilled its commitments and disbursement of ASAP funds should proceed according to plan.

5.3.2 The consultant believes that all parties would accept the arguments for introducing the proposal with initial limits on the numbers and qualifications of licensees. The proposal is quite new and there are potential draw-backs (which we have yet to consider). If after experience, these prove to outweigh the advantages, a limited scheme would be easier to re-structure than all-out liberalization.

5.3.3 This report is obviously primarily concerned to define a satisfactory third marketing channel in terms of the ASAP agreement but there must be wider advantages if the proposal is to succeed and gain acceptance in the industry.

5.3.4 Above all, the proposal recognizes reality. If it is true that 20 percent of the Malawi burley crop is not produced by those who sell it, this surely makes nonsense of the existing marketing regulations and some reform is necessary. There are two ways to deal with this: 1) a crack-down, which might involve a review of all licenses, probably including re-survey of leases; or 2) acknowledge its existence and find some way of bringing it into the open, in the interests of a more transparent market.

5.3.5 One can question whether a crack-down could work. In the changing political climate it is not clear that government has the will or the means to do this. The extension service is unwilling to forfeit the relationship of trust it has built up with small farmers by acting as a police force. A comprehensive search for phantom estates would run up against severe budgetary restraints for the land husbandry branch probably only serve to further enrich those few corrupt, or inefficient, officers responsible in the first place.

5.3.6 The earlier ACDI report, and others, have described the recent evolution of burley production. The biggest single share of production is now accounted for by small, minimum-quota estates, described as "graduated smallholders". There has been ASAC, but now ASAP and IFAD are coming. In the longer term it is difficult to predict exactly how the production side of the industry will evolve, but it seems to this author that the many different pressures for increased smallholder participation are so strong as to be unstoppable.

5.3.7 This proposal offers a new institution to channel production by proliferating small growers into the auction system, without at the same time swamping it. An adequate network of competitive independent intermediate buyers could be as attractive to many small estates as it should be to smallholders. It is possible that the measure could in time, actually reduce the number of sellers at AHL and make deliveries and sales much more manageable.

5.3.8 Finally, the future of the industry depends on maintaining the quality of Malawi burley. It is difficult for small growers to grade finely enough to fill bales with uniform grades.

Intermediate buyers, by bulking production from many small growers, could improve the standard of handling and presentation and actually add value to the crop.

5.3.9 These are substantial potential advantages - enough to make the proposal worth consideration and a trial. However, there are also two very considerable draw-backs.

5.4 Disadvantages of the Intermediate Buyer proposal

5.4.1 It was argued in the beginning of this section that the present activity of independent traders (still largely illegal) in the market is de-stabilizing. The danger is that without some way of ensuring that intermediate buyers only buy registered burley, they would tend to legitimize illegal growing. This could lead to rapidly increasing numbers of small growers until prices fall to the point where many existing producers are wiped out. If this happened, it would obviously overwhelm any of the advantages outlined above.

5.4.2 How fast this nightmare scenario would unfold, or how extensive it would turn out to be is less obvious than it might seem. There are many smallholders who would like to join the present scheme but who have been unable to find a place in the limited number of clubs for which quota has been made available. Not all of these will turn to illegal growing the moment licensed intermediate buyers appear in the villages. This is absurd. In fact, due to the timing, there would be no effect at all in 1994 since the crop to be bought will be well established before the proposal is widely known.

5.4.3 Even afterwards, most smallholders would probably still be deterred from entering into burley without the support of the credit and extension systems and official recognition through the clubs. After all, it's hard work, expensive, and risky. Also, some people are basically law-abiding. But the sheer pent-up productive capability of some 1.9 million small farm families in Malawi, many of whom have tobacco experience, make it inevitable that without controls on IB's sources of supply, the numbers of illegal growers would expand to some extent.

5.4.4 It has been said that it is not desirable to confuse the two roles of producer and trader. In an open marketing system, there is the principle that everyone, particularly regulating authorities, should know who they are dealing with. What is to prevent intermediate buyers, who may also be estates, from switching tobacco between their different quotas?

5.4.5 All this brings us back to the coupons and the whole question of quota, which the proposal so far has conveniently ignored.

5.5 Barter Trading

5.5.1 The terms of reference for this study (Annex, para 8) call for an examination of possible burley purchase arrangements between estates and smallholders, with reference to payments in kind, including consumer items, fertilizer and maize. Isn't the proper medium of liberalized markets is cash? Certainly, some parties may prefer to make and receive payments in kind. If both parties wish to barter trade then let them, but it should remain their business and be unregulated from outside.

5.5.2 Indeed, in view of the estates' bad reputation as payers, one could go further and recommend that licenses specifically stipulate that smallholder burley is to be purchased on a strictly cash basis.

6. QUOTAS

6.1 General

6.1.1 Quotas are not an eccentric institution peculiar to the Malawi tobacco industry. They are widely used production controls intended to stabilize prices and farm incomes. In the United States they were introduced on tobacco, groundnuts and sugar cane (to take examples relevant to Malawi) in the wake of the Great Depression. They have remained broadly fixed for some 50 years and attached to the particular farms they were assigned to at that time. The U.S. Department of Agriculture is able to control production by, from time to time, varying entitlement according to a (basic, +/- x percent) formula. Also, the European Common Agricultural Policy assigned quota to milk producers at a particular point in history in order to control dairy product surpluses. There are many more such examples, world-wide.

6.1.2 In these cases, quotas became capital assets. In the US case, these add to (and distort) land values. In the EU, quotas give rise to a legal market in quota transfer, both sale and lease. This has become a big business in its own right, with specialist private sector quota traders and auctioneers. An important incidental effect of the examples given is the barrier they present to new entrants into an industry by introducing rigidities which impede development. The point is that agricultural quota has intrinsic economic and financial value.

6.1.3 Both the examples given were linked to complicated price support measures which are not relevant here. In principle, Malawi tobacco quotas are also much more flexible. In Malawi, a special crops license is not automatically renewed every year but must be re-applied for annually. This leaves the authorities (ultimately the MoA, but described in more detail in ACIDI, 1992) with the discretion to vary both the total licensed weight and individual licensees' share of it.

6.1.4 There are presently at least two quotas: the License to Grow and Sell and/or Buy and Resell (production) and delivery quotas (marketing). Though delivery quotas are derived from licensed weight, they are essentially independent in function.

6.1.5 Given the uncertainties of farming, a production quota might best be expressed in area terms (acreages). The present license does this, in an attempt to ensure adequate rotation, by relating area applied for as a proportion of the applicant's total landholding. However, this is all but impossible to police and the figure that really matters is the licensed weight.

6.1.6 Inefficiencies in the administration of the present system have introduced a third instrument of quota - the seed form. This form makes the License a practically redundant formality yet has no legal force (again, see ACIDI, 1992). ASAP has added to this complication by introducing individual smallholder quota slips, doubling as seed forms. Issuing these things

is the end product of the computer-based smallholder burley management information system installed in all ADDs over the past two years. Though the system is now [end 1993] functioning well in a technical sense, it will not be possible to evaluate its impact until next year. None of the smallholders received their seed forms in time for it to have a positive impact on their planting decisions for 1994. This is an ASAP requirement (though its legal force is uncertain) but is costly. It is important that it be evaluated once it has had a fair chance to influence smallholder decisions.

6.1.7 In the auction system a marketing (delivery) quota is absolutely indispensable. In 1993, a number of innovations were made to improve the recurring chaos described in the earlier ACIDI report and, doubtless, these measures will continue to evolve. The present situation is stressful enough. All growers would prefer to be able to sell when it suits them but unregulated access to the floors is quite unthinkable.

6.1.8 Delivery quotas are assigned on the basis of production quotas, with some rounding of numbers and aggregation of categories to simplify and make the system more transparent. They are administered by a different body (TCC) to production quotas (MoA). This, in itself, is the source of much of the inefficiency of the present system. The consultant, and others, have argued before for the whole system to be put under one roof and that TCC would be the proper place for this. It is not necessary here to repeat these arguments.

6.2 Advantages of quotas

6.2.1 Quotas have two distinct functions. Perhaps the more contentious one is of limiting overall production, with the goal of price stability. This is supposed to give relative assurance of profitability to all existing license holders and to other sectors (finance and farm supplies) involved in the industry. Continuity of production is assured with positive benefits to the trade, as well as to the balance of payments. Also, limiting smallholder cash crop acreage serves food security policy goals by obliging many smallholders to grow maize as the only available cash crop.

6.2.2 The requirements of the centralized auction system dictate that some measures are in place to ration daily access to the floors, hence delivery quotas. The advantages of linking them to production quota are obvious. If all was well with production quotas, TCC (with AHL) would have a single base figure on which to work and plan an orderly progression of deliveries and sales. In short, a well organized marketplace.

6.2.3 This is expedient but, in logic alone, the link is not necessary. AHL could, for example, sell delivery quota in a separate auction. Theoretically this should be the most efficient economic solution. It would also provide an interesting source of additional revenue for the various institutions involved to squabble over, as with the present penalty fund. But this sort of measure is not recommended. But it would require far more sophistication (and efficient

communications) than most estate and club growers have access to. Any such innovation would be sure to discriminate against smaller growers.

6.3 Disadvantages of quotas

6.3.1 Recently, production quotas have not been very effective. As noted in 4.1.5, in 1992 the relation between trade requirements, total licensed weight and the eventual size of the crop were loose and meaningless. As a result of a determined campaign within MoA, this year's figures should be more in line. The production trend since 1986 (roughly 25% growth annually) has regularly outstripped trade indications. Real prices have fallen recently and the two trends are surely related.

6.3.2 An excellent discussion paper on overproduction (MoA, Planning Division, October 1992) describes the last major crisis in the market, in 1983. Burley production jumped from 27 Mkg to 42 Mkg, 56 percent in a single season, and prices fell by 40 percent in nominal terms. Production fell by some 25 percent the following year and stagnated for three years before taking off again in 1987. As one would expect, the paper finds a strong positive relationship between production increases and the previous year's prices.

6.3.3 It would be useful if this analysis were reviewed to include the relationship between production and quota. The consultant has been unable to find a reliable time series on total licensed weight. This is unsatisfactory and may be worthwhile for MoA Planning (with TCC) to use its superior resources. They could test the hypothesis that while production quota is obviously decisive in ordering who is able to sell tobacco, it has been a relatively ineffective instrument in controlling how much they sell.

6.3.4 The present system requires an immense effort to operate correctly. Few growers receive the actual license before they have made crucial decisions (seedbeds and land prep.) which will determine what they actually produce. One wonders what the relationship is between the MK 50 application fee (unchanged after several years' inflation) and MoA's actual costs in administering the licensing process.

6.3.5 The system seems to have an in-built tendency to inflation of total licensed weight. This is related both to the value of quota itself and, particularly, to the link with delivery quota. It makes good commercial sense to obtain the highest possible quota, whatever the grower's actual production plans. This would enable growers to sell the crop quickly and in deliveries which fill available transport as near as possible.

6.3.6 Rigidities protect existing license holders, however inefficient, and discriminate against both new entrants and efficient producers wishing to expand. The present system is far from transparent and places too much discretion and responsibility in the hands of relatively few personnel in MoA. Most MoA personnel would probably welcome a formula based on past

performance - as measured by AHL records - which would automatically redistribute quota annually.

6.3.7 This would require some work in marrying the two MoA data bases with AHL's records. However, there is a serious timing problem in that licenses should be issued before the previous season's sales are complete. Nevertheless, in concept, it is achievable if the industry and authorities can agree that it is needed.

6.4 Other controls on production

6.4.1 At the time of the consultant's visit (September, 1993) it seemed possible that substantial stocks of over-quota tobacco might be offered at the end of the season. Reports and estimates vary critically and it is difficult to know how production will compare with last season's 100 Mkg. It may also be that the crop turns out to be lighter than expected. As a result of high mid-season rains, that prices will actually rise towards the end of the season. Whatever the outcome, it will give important signals to all producers.

6.4.2 On balance it seems that both estates and smallholders in general will experience a credit squeeze in the 1993/94 season. The bigger estates are retrenching, the banks are alarmed by low prices, and SACA/RFC may be in serious crisis. Financial pressure should contain production as effectively as production quotas have managed to do, confirming the experience of 1983-86. If this is so, the coming season offers a rare opportunity to change the present system with minimum disturbance. A better time could hardly be chosen to implement the intermediate buyer proposal.

6.5 Transferable Quota

6.5.1 The argument against coupons in the earlier report may be worth repeating. It was as follows:

"The extreme difficulty the authorities would have in distinguishing registered from illegal smallholder growers has been generally recognized but a plan exists to meet it and a system of coupons is proposed. Consider how these might work.

Registered smallholders would receive, in addition to their club's license and their own seed form/quota slip, a number of printed coupons, in 25 and 50 kg denominations, equal to the amount of their quota. The committed would surrender their's to the club whilst others might choose to hang on to them and play the market. Coupons would not be needed for club tobacco sold on the floors and, perhaps, the club would simply destroy them.

Members choosing to market outside the club would, however, present them with the tobacco to either ADMARC or a licensed estate so as to give assurance that the tobacco originates from a duly registered smallholder. The purchaser would surrender the coupons on delivery to the floors, though an estate would only really need to do this if it had already filled its own quota.

A formidable organizational problem would ensue in accounting for this quota transfer. AHL cannot simply accept sales over an estate's (uplifted) licensed weight - they are required to withhold 70 percent of such sales as a penalty. To alter licensed weight on their computer requires explicit TCC authorization. TCC would have to take on the paper work, count up the value of the coupons and issue authorization to AHL, while the estate tried to fit these delays into its delivery quota.

Assume 10 million kgs quota in 25 kg denominations and the paper in circulation becomes phenomenal. The denominations could scarcely be bigger if the system is to suit the number of grades and lot sizes that ADMARC markets commonly accept. Both AHL and TCC are, understandably, opposed to the idea.

Further, if an estate bought tobacco while it was still under its own quota it would be free to simply save the coupons, perhaps for later use against illegal tobacco, or to sell them in the informal secondary market in transferrable quota which would certainly spring up.

Once introduced, the coupons would immediately have value. This opens up the further possibility of leakage of coupon certificates between MoA headquarters and members (MoA-ADD-RDP-EPA-Club: 5 levels at which coupons would have to be issued and accounted for). The possibility of forgery would also exist.

This is all too plausible and would create a new currency... MoA should drop plans for the issue of quota coupons. The idea is unworkable and would give rise to corruption." (ACDI, 1992, p. 33)

6.5.2 This is not to say that no formal instrument of transferable quota can work. As we have seen, they do in other countries. But it is the consultant's view that they are not a practical option for Malawi at present. The necessary infrastructure is lacking and the argument against auctioning delivery quota applies equally here. Any conceivable system for many individual, small transfers of quota would tend to operate against the interests of the unsophisticated, smaller grower. They would also entail very considerable administrative costs.

6.6 Quota for intermediate buyers

6.6.1 Intermediate buyers would need some form of quota. At the very least they would have to have a delivery quota. To fit the present system, it should be based on a licensed weight, a figure analogous to production quota, but essentially different. If it is true that no system of transferable quota is practicable, then IB quota would have to be "free" quota - outside, or in addition to, the present total licensed weight.

6.6.2 This conclusion seems inescapable and is the most worrying aspect of the proposal. It obviously entails double counting and, in principle, must weaken the major ostensible function of production quotas. How seriously, depends to some extent on the reader's point of view. The alarmist tendency, the view that there are hordes of potential illegals ready to take advantage of a liberalized third channel, is perhaps exaggerated (as argued in 5.4.2 - 5.4.3). But the danger exists.

6.6.3 IB quota would be free only in an arithmetical or technical sense. A decision needs to be made on how much would be offered for application and also on the price to be put on it (in the form of a license fee). Perhaps it could be auctioned?

6.6.4 A distinction between club AHL sales and the other two channels has come to be recognized over the past two seasons. Once a club has declared its intention to sell on the floors, its members are deemed to forego the choice of other markets. The idea here is that clubs would fail to meet quota if their members were free to sell elsewhere and that this might have repercussions for future allocation of collective quota. This subtlety, which includes a moral point about the conflicts of individual and collective liberties, was not envisaged at the ASAP design stage. Once accepted, it has an important consequence.

6.6.7 Say 75 percent of clubs declare for the floors. This leaves 25 percent of registered smallholder quota to be apportioned between ADMARC and the third channel. But so far no clubs have declared for the estate option and the entire balance has been assigned to ADMARC. This is consistent with the principle described for AHL sales. The MoA has argued, more than once, that this renders the third channel unnecessary. The difficulty with this view is that there is abundant evidence, if few hard facts, that the estate option is used by many registered smallholders, not to mention the illegals. This is a wider argument for third channel quota than the basic ASAP commitment to it.

6.6.8 How much IB quota should be then provided? 20 Mkg ? Obviously not, as by satisfying the whole estimated illegal trade the incentive for it to expand would be enormous. In fact, in all the arguments considered, there is no sure logical basis for putting a definite number on the amount to be offered.

6.6.9 Arbitrarily, we might decide to limit the amount to total registered quota (8.5 Mkg in 1994), less the amount committed to club AHL sales. The result would be of the order of 2 Mkg - not a great number and not in itself de-stabilizing. But this would double count ADMARC quota and would still, in principle, legalize overproduction by registered smallholders by that amount. And this provision would lose any of the possible advantages discussed in the way of bringing the illegal trade out into the open. Maybe the most satisfactory solution would be to make no limits in 1994. Also, to accept that this is an exploratory stage and offer IB licenses to any who want them and simply see what happens.

6.6.10 Should the license be issued for a definite quantity? For delivery quota purposes, it has to be. The license would carry a seller's number. AHL has to know that this seller, like any other, has a certain delivery entitlement. For delivery purposes, the IB would also have to indicate which geographical group the license would be included in.

6.6.11 It has been suggested that licenses be issued in fixed amounts, possibly 3,000 kgs, and renewable when exhausted. This is not recommended as the paper work involved would probably discourage many potential operators, as well as creating additional administrative costs. The possibility of auctioning IB licenses has economic merit but is not recommended in the pilot year. The complications of organizing it in time are probably too difficult.

6.6.12 The alternative would be to set the license fee as a fixed price per kg (15t/kg, for example) and leave it open to the applicant to decide the scale on which they wish to operate. Note that this amounts to offering delivery quota for sale, a loophole which would soon be spotted by some estates.

6.6.13 The more open the third channel, the more likely it is to be taken up in 1994. This would offer lessons for its further development or, if obviously necessary, abandonment. The arguments for and against the proposed Intermediate Buyer license are summarized in the report's conclusion, together with a detailed recommendation (see section 9.4)

7. IMPLICATIONS FOR ADMARC, ESTATES, AND OTHER INSTITUTIONS

7.1 Introduction

7.1.1 Much remains to be said about the intermediate buyer proposal and discussion will likely extend beyond the conclusion to this report. What are the consequences for other parties (not only of the IB proposal) and of the smallholder burley scheme as a whole?

7.2 Consequences for ADMARC

7.2.1 To the extent that the clubs' success shuts ADMARC out of this new market, the effect is significant. It seems that the corporation must accept this and plan its operations and prices accordingly, to be competitive. ADMARC complains that MoA staff actively discourage clubs from selling to ADMARC. It is the consultant's view that this complaint has justification, though its explanation is more complex than mere hostility to ADMARC. From most points of view, a high level of club sales on the floors has come to constitute success and it is understandable that MoA field staff should pursue this. The goal of transferring income to rural communities seems definitely to support the club-AHL option. On the other hand, the intent of ASAP, is that farmers should have choice not that they should go down one route rather than another

7.2.2 The point has been made that the comparison between ADMARC market prices and smallholder averages at AHL is simplistic. This may distort policy-makers' view of the scheme as a whole and the present emphasis on club sales, both by MoA and the donors, could be misdirected. The consultant would like to suggest that ADMARC itself has ample resources to address this question. It may be in their interests to do so and would be most interesting to see the result. The ACDI team due to implement the proposal for strengthening the clubs will also address the question.

7.2.3 ADMARC has managed to buy its entire quota this year, based on the declared intentions of clubs. At first glance this suggests that the estate option (third channel) is important only in a season with good prices. On the little data available, this is impossible to prove. It is as likely that the reality is much more chaotic and barely controlled. The consultant believes that all three channels - club, ADMARC, and estates - involve some mix of registered and illegal production.

7.2.4 Obviously the mix varies from place to place. In some areas ADMARC is not buying burley because no clubs have declared for this option. In others, whole clubs are prepared to admit that they all sold to estates. In order to make up for this, ADMARC must logically have bought an equivalent amount of either over-quota registered burley or illegal production. As noted earlier, this is not ADMARC's fault but a result of uncoordinated registration.

7.2.5 If intermediate buyers are to be allowed to apply for any amount of quota, this would discriminate against ADMARC, which is bound by clubs' declared intentions. This is unfair. ADMARC should be given, as far as possible, the same liberties as the 'new entities'. Even so, ADMARC is still hindered in competing as it is unable to vary prices during the season. This is because it is bound to announce pre-season prices and, as a large organization, it would be difficult to give its markets the discretion to follow local prices.

7.2.6 Even AHL-club members would like to sell some of their crop to ADMARC to raise cash for transport or to meet social responsibilities such as funerals. The present system discriminates against ADMARC by channelling this part of the market, by default, to the estates. There are evidently limits to how level the playing field can be made.

7.2.7 The clubs' perceived success puts ADMARC under pressure to improve the deal offered in traditional ADMARC tobaccos. It may only be a matter of time before the interests of small-holders, TAMA, TEAM and the aid agencies all coincide in the question "if burley club sales work, why not allow dark fired clubs similar access to AHL?".

7.3 Impact on tenant system

7.3.1 Historically, the private sector has supplied land, credit, extension, and marketing services to small farmers. However, the state was unprepared to supply these things in so concentrated a form. This, together with the landlords' profit, is the essence of the tenant system. As long as estates are able to recruit and retain tenants, what they offer is of value to both the tenants and the economy as a whole. After migration to the mines, this process may have been the most important source of rural capital formation in Malawi.

7.3.2 Government is now competing in this market with subsidies. These subsidies are direct, through the extension service's organizational impact, and indirect to the extent that rural credit is in transformation to a truly commercial basis. It may seem bizarre against the background of the triumph of the free market that all this is happening with the aid agencies' assistance and indeed at their instigation.

7.3.3 This must have an impact on the tenant system. It is designed to do so, precisely because of the difference between the incomes of a few estate owners and those of the mass of small farmers. How severe an impact will depend on the extent of the smallholder scheme, particularly in areas of traditional tenant recruitment. The IFAD project's target group - resource poor farmers, particularly in the Shire Highlands - is the traditional recruiting ground for tenants.

7.3.4 IFAD has secured an extension of guaranteed smallholder burley quota to just under 16 Mkg and it is by no means clear that this is the end of the process. However, it is important to recall that the extension of registered smallholder quota is to be gradual. The

combined target of 10.7 Mkg (ASAC/ASAP) plus 5 Mkg (IFAD) is not expected to be reached until 1998.

7.3.5 The impact will also depend, perhaps critically, on the extent to which registered smallholder production tends to mask and encourage illegal growing. If prices are continually squeezed by overproduction (and an overvalued kwacha, although a separate issue), it is easy to discern the makings of an unpleasant cycle of estate failure. The result would be returning tenants to the villages where they could either turn to illegal growing or, at least, exert political pressure on the present limits of registered smallholder quota by demanding new clubs. Such pressure may be difficult to resist.

7.3.6 If the logic of the evolution of the ASAP third channel follows through, most of the "new marketing entities" will be existing estates who have comparative advantages in infrastructure and knowledge of the market. This is the basis of the intermediate buyer proposal. A tendency to abandon production and become purely traders, which already exists with the phantom estates, would be accelerated. In itself this is surely desirable. The Malawi burley industry, like any other, must continue to evolve. An evolving industry must make space for new, specialist services as the demand for them arises.

7.3.7 This process would be considerably eased by a more open, objective formula for awarding quota. In time, this would allow smaller growers who find the costs of marketing overburdensome to give up their marketing quota. At the same time any producer wishing to market independently on the floors, as at present, would be free to continue to do so. In the interests of economic efficiency, they should market independently and be rewarded for good performance (and behavior) with additional quota.

7.3.8 More immediately, the estates are threatened by the prospect of IBs buying their tenants' tobacco. An outsider can always afford to offer a higher price, leaving the estate with the production costs it has advanced to the tenant. This is potentially a real danger. It already forms some part of the illegal trade and may be further complicated by tenant sales through the clubs. Clubs, IBs, and the tenants themselves must not be allowed to steal from estates but the criminal law is quite unable to deal adequately with this problem.

7.3.9 TAMA might reasonably demand some policing of this aspect of smallholder production. But any conceivable system of inspectors would be costly and ultimately wouldn't work. Under present arrangements all licensed sellers are TAMA members. This includes clubs selling through AHL and should also include IBs, (in their separate capacity). TAMA is a self-regulating body. An important aim of the IB proposal is to bring the third channel into the open. Obviously, TAMA should be supported in opposing the licenses of its own members who are known to be involved in receiving stolen property. But this is not as easy as it sounds. It involves burden of proof and the uncomfortable truth is that the estates have little recourse in all but the most flagrant abuses of the system.

7.4 Consequences for AHL clubs

7.4.1 If the third channel is put on a sounder footing than at present, there will be the tendency for members to make sales outside the club in spite of their supposed commitment to the floors. Amongst other things, this may weaken the credit system and expose the club to loss of collective quota.

7.5 Consequences for other institutions

7.5.1 AHL If the tobacco auctions are to continue to function there must be no discrimination between sellers. An auction cannot work otherwise. ASAP has no intention to disturb the overall market on the floors - only to modify the categories of who may sell. This principle is already embodied in the way that clubs sell - exactly the same as estates. Any further development should be neutral as it effects AHL.

7.5.2 TCC TCC is not all that it may seem. Though it has the legal standing to do the job, much of the day to day business of controlling the tobacco industry is actually out of TCC's hands. MoA continues to dispense production quota. The position in 1992, though since improved, shows how out of touch the Ministry's procedures can get with the industry's needs. More than this, the consultant has been repeatedly struck by how ill-informed much of the industry has been about the development of the smallholder burley scheme. Doubtless, the World Bank consulted widely before introducing ASAC. Also, USAID has developed both an extensive informal network and a formal institution (the ASAP PIC - Project Implementation Committee, to which the consultant reports) to continuously monitor the scheme.

7.5.3 Nevertheless it was astounding to learn, at a recent PIC meeting, that the IFAD proposal has gone ahead over MoA's explicit objection. Many present at the meeting were hearing of the project for the first time. It seems that Treasury, beset by balance of payments problems and the aid embargo, overrode the advice of its relevant technical department. Almost as if the policy initiative in this radical development in the country's main export industry has passed out of the hands of indigenous institutions into the those of the aid agencies. This has to be wrong. There is surely a case for a more permanent Malawian institution, in which all sides of the industry are represented, and with the authority to coordinate decisions effecting it.

7.5.4 Though information on developments in smallholder burley is now much improved through the ASAP PIC. It is by nature a temporary institution which will be wound up when ASAP is complete in about three years time. Its mandate is confined to ASAP and it may be that its activities will be duplicated by a similar body for the IFAD project.

7.5.5 In the earlier report on marketing, the consultant described an enterprising farmer in Chitipa who, in 1991/92, was growing burley, NDDF, and oriental as he said, "to see which was best". What happened? This season he dropped NDDF and oriental and concentrated on

burley. It is easy to see why. Burley yields are higher, reaping and curing is far simpler than both oriental and NDDF. Through his club, the farmer was also able to sell direct on the floors. Even with the transport difficulties from Chitipa, this gave him a better return on his efforts. This sort of decision is being repeated throughout the country. The future for dark fired is worrying. At a time when the buyers are actively promoting oriental schemes in all regions, the response is likely to be disappointing while smallholders have the burley alternative. Smallholder burley has an effect on the production of all other types of tobacco, except flue-cured.

7.5.6 There is obviously a need for closer coordination of policy and this suggests the creation of a smallholder tobacco authority. This need not be a new and expensive bureaucracy on the lines of the Smallholder Tea Authority, for example. It would not need to involve itself directly in either production or marketing. These functions are already handled by the extension and credit systems, the clubs, ADMARC, and the third channel. All that may be needed is some central body with the authority (and this is the operative word) to take decisions on the development of all tobacco production by smallholders.

7.5.7 In TCC, we already have such an institution. A standing committee of TCC board members (see Introduction, para 1.8.3) could be formed to constitute, to all useful intents and purposes, a smallholder tobacco authority. This institution would be complete with existing legal powers, executive officers, and an unparalleled overview of the industry. This would be both minimal and adequate.

7.5.8 TAMA The impact of smallholder burley on the estates has been discussed. Now that many (though not all) clubs are TAMA members, the association has taken steps to give them representation. It is too early to say how this will work out.

7.5.9 TEAM The trade's interests can be summarized as a consistent supply of consistent quality tobacco. As long as marketing controls work, smallholder burley should not harm the trade.

8. CHOICE, DECLARATIONS AND DEADLINES

8.1 Background

8.1.1 The requirement that clubs declare their market choice came about originally for purely practical reasons arising from SACA and ADMARC's operational planning. In the first season, SACA needed to know how many clubs would need baling presses and scales so that it could budget for them. Only clubs opting for the floors should need these things. SACA not only provides medium term credits to finance this equipment but actually procures and transports it to the ADDs. Considerable advance notice was needed for the public tendering procedures (which SACA, as an arm of MoA, was bound to) to be completed in a timely fashion. In fact, this year the tender failed and presses were only delivered very late in the season.

8.1.2 These requirements have continued since 1991/92. It may be that the transformed MRFC will be able to operate in a less paternal fashion, simply advancing finance to the clubs and leaving them to arrange procurement. In which case this particular need for an early declaration would no longer apply.

8.1.3 Similarly, ADMARC needs to know in which areas their markets should be staffed with trained burley classifiers and provided with a budget for burley purchases. These considerations will continue to apply as long as ADMARC's quota is fixed as a the sum of club declarations. As noted elsewhere, no club has declared its intention to sell to estates.

8.1.4 These may seem rather meager grounds on which to compromise the principle of individual farmer choice which underlies ASAP.

8.2 Choice

8.2.1 There remains considerable confusion as how free individuals are in fact and the extension message at the field level reflects this. On one hand, farmers and FAs know that there are three marketing options. There have been enough official announcements to confirm this. On the other hand, farmers are told that they must make an early choice between the three and stick to it. The uncertainty has resulted in a series of late decisions and changes of mind. It has not always been clear exactly how many clubs are supposed to be doing what.

8.2.2 Another principle has been identified - that the freedom of individuals to sell outside an AHL club compromises the club's collective chances of success. This is in fact the primary choice - whether or not to take a collective approach to both credit and marketing. It seems to follow that once a group of farmers have decided to sell collectively they should be supported by denying individual members the right to defect.

8.2.3 There is no similar principle involved in the choice between ADMARC and the third channel. Once a club has made up its mind that it is unwilling or unable to make the effort to get on to the floors, then surely the element of choice - essentially an individual one - should remain. As long as the third channel remains part of the scheme, there is no reason why farmers should be required to declare their intentions between the two individual selling options. It is obvious from all reports that the present declarations for ADMARC are no more than a formality in so far as they actually determine where people sell.

8.2.4 There is no disadvantage to ADMARC here. As long as ADMARC knows which areas have significant numbers of clubs which have not committed themselves to AHL, and what their quotas are, it can still plan its operations. And as long as it is permitted to sell up to the total of non-AHL declared quota, then ADMARC's position is unchanged.

8.2.5 The advantage of this proposal is that the club is given a single decision to make. Do they want to sell on the floors? If so, it must be made clear that all members forego any other choice. If not, then members may choose on their own to sell to ADMARC or through the third channel in whatever form is eventually recognized.

8.3 Deadlines

8.3.1 The timing of this decision is problematic. Once clubs have established themselves and know what is involved, it would be reasonable to insist that they re-affirm (or change) their decision at registration and when they apply (in May/June) for a fresh license, like any other grower.

8.3.2 This point may still be some way off and for new clubs such an approach is certain to result in one or two problem cases. Nevertheless, the scheme is complicated enough without an additional area for confusion. As experience of the advantages of different marketing options grows - both among extension staff and smallholders - it should become easier for all parties to reach an informed decision.

Recommendation Clubs should declare whether they intend to sell through AHL at the time they apply for a license. If they do so, it must be made clear to them that they have no chance of reversing this choice during the current season and that all their members are bound by the collective decision, freely arrived at. If they choose not to sell through AHL, there is no need for them to declare any choice between the remaining marketing options.

9. CONCLUSIONS AND RECOMMENDATIONS - SHORT TERM

9.1 Introduction

9.1.1 A number of recommendations have been made in appropriate places in the text and they are repeated here (with page references and supplementary conclusions). No concrete recommendation has yet been made for the third channel. This is presented in 9.4.

9.2 Club sales through AHL

9.2.1 An analysis of club sales in 1993, similar to that carried out last season, should be made as soon as is practicable (page 4).

9.2.2 This is the sort of task to be carried out by the proposed ASAP sub-project on strengthening the burley clubs. This project has been described elsewhere. It is enough to say here that its main focus is the training of club members and officers to avoid some of the problems described. For training to be effective, the sub-project must continually expand our understanding of how the clubs work and where the problems are.

9.2.3 For the 1994 selling season, all smallholder burley clubs should be instructed that failure to complete credit repayment to MRFC by August s will result in de-registration for the 1994-95 season. This message would be accompanied by the extension message on the virtues of bale sharing and a fair club rota for deliveries. This is now part of MoA's extension approach and has been discussed in earlier ACIDI reports, but needs emphasis (page 7).

9.2.4 Unless such a measure is taken soon, defaulting clubs with no guaranteed source of inputs will emerge. They will be producing poor tobacco and, ultimately, undistinguishable from illegal growers in all but the possession of a license. A two-class club system is to be avoided.

9.2.5 Clubs should declare whether they intend to sell through AHL at the time they apply for a license. If they do so, it must be made clear to them that they have no chance of reversing this choice during the current season and that all their members are bound by the collective decision. If they choose not to sell through AHL, there is no need for them to declare any choice between the remaining marketing options (page 36).

9.2.6 It seems important that the declaration issue is reduced to its bare minimum and that the rules are put in place as soon as possible. The recommendation is conceptually the simplest solution and would solve MRFC's problem with baling presses. It is sure to cause administrative problems, not least with the new IFAD clubs coming into the system. But the alternative, of allowing clubs to change their mind at will up to last minute, leaves the extension service with a far more complex message and open to confusion at all levels.

9.2.7 With these two exceptions, on credit and declaration, no immediate changes are needed in the way clubs function. Their performance on the floors and the way some members are treated should be improved by the strengthening project. But the operational principles seem, on the whole, to be adequate.

9.3 ADMARC

9.3.1 A comparison should be made, based on sample audits of club records, of actual net returns to growers of AHL sales with those selling to ADMARC (page 10).

9.3.2 MoA should invite ADMARC to propose a system which: a) links farmer registration to the MoA registration data base, and b) records the amount of tobacco bought from individual clubs (page 12).

9.3.3 It is not suggested that ADMARC, like AHL, needs to deal direct with the clubs on a collective basis. Merely that individual farmers can be identified by the club under which they are registered and that market returns can be analyzed to see which clubs consistently prefer ADMARC. Without this link, little can be said about this marketing option except in the broadest terms. If the scheme is to be improved, this is unsatisfactory.

9.3.4 Any extension of the third channel should not discriminate against ADMARC. In the interests of fair competition ADMARC should be free, if need be in the medium term, to become an Intermediate Buyer like any other.

9.4 Third channel

9.4.1 If the clubs, for all their shortcomings, are broadly on course, they will be taking about 75 percent of the market. While ADMARC, acting as a safety net for weaker clubs, is filling its quota with the rest. If this is true, then why are we even considering a third channel?

9.4.2 There are two reasons. First, ASAP is committed to it. Second, it happens. Together these are awkward but unavoidable.

9.4.3 The term, third channel, has been adopted because ASAP has three separate, but connected provisions: 1) estates buying registered smallholder burley within quota; 2) estates buying over quota; and 3) additional marketing entities (see Annex for details). The discussion so far suggests the following:

Intermediate Buyers License - Recommendations

Scope A new category of licensed tobacco seller is to be introduced for the 1994 auction season on a pilot basis. These will be known as Intermediate Buyers, who will

be licensed to purchase and resell registered smallholder burley tobacco. GoM reserves the right to modify the terms and conditions of the license at any time, in the best interests of the tobacco industry.

- Eligibility** Any person able to demonstrate an ability to handle tobacco may apply, excepting commercial graders. The location of the applicant's handling facility (grading shed) is to be stated on the application form and may be subject to inspection and verification. In the first year it is expected that only existing estates will be adequately equipped to fulfil this condition. Details of all existing sellers' licenses must be supplied with the application.
- Licensing** Licenses will be issued by the Tobacco Control
- Authority** Commission will be on the recommendation of Program Managers in the ADDs. Applications will be made, in the first instance, through the ADD. ADDs in which all smallholder clubs have declared their intention to sell in their own names will have the discretion to refuse to endorse applications. All applications to be made by (date to be decided).
- Restrictions** The license will apply only to purchases made within the ADD in which the application is lodged and where the applicant's grading shed is located. Payment to smallholders to be on strict cash basis.
- Licensed** This shall be subject to other provisions, no restrictions.
- Weight** This will be based on the amount of burley to be sold under the license except that it shall not exceed the amount applied for (no uplift). For the purposes of delivery quota, Intermediate Buyers will be treated as any other licensed seller, based on their licensed weight and geographical location.
- License** The fee for the license is fixed at n timbale
- Fee** The fee per kilogram (to be decided) applied for. Payment to be made to TCC (?) before license is issued.
- Reporting** The application form will include an undertaking to assist the authorities by providing operational information from time to time and, in particular, by filling in a questionnaire at season end.

9.4.4 This recommendation is written in the form it might take in a press release. To take each point as it appears:

9.4.5 Scope: The three ASAP conditionalities are compressed into one and can be met in a single move, retaining both the letter and spirit of the agreement. It is not in the interests of a controlled market to have traders posing as producers and so IBs are recognized as legitimate traders. The restriction to registered smallholder burley is formally emphasized, if not enforced. Governments can always change their minds and the last proviso may be unnecessary; it does however signal caution.

9.4.6 Eligibility: There really is no time for anyone except existing estates to get into this in time for 1994. The criteria will allow outsiders prepared to build or buy a grading shed and take on qualified staff to get into the business in subsequent seasons. There are unlikely to be many of these but ASAP requires it. The hygiene point is a real one and the problem of commercial graders is addressed. Details of existing licenses would allow subsequent analysis to search for evidence of quota switching, though only unwary operators will be easy to detect.

9.4.7 Licensing authority: As the parent body of both TCC and the ADDs, MoA remains the ultimate authority in this. The endorsement of the ADDs is important for two reasons: a) smaller potential IBs may not be known at higher levels and it is the nature of licenses that someone must recommend them; and b) the inspection of premises offers an instrument of control which is only practical in the hands of a decentralized authority. But the actual administration of licenses would be best placed as close as possible to the point of real control (i.e. access to the floors). In every sense this is where TCC lies. Whether it is desirable to set a closing date for applications is a matter for discussion.

9.4.8 Restrictions: If the ADDs are to be given the responsibility of recommending licensees, it is only fair to PMs that the license remains in their jurisdiction. It would be unreasonable, for example, to expect the PM of Liwonde ADD to have to account for some strange dealings in Chiradzulu by a licensee she had recommended. The question of barter trading has been discussed and, though it may be optimistic, the cash only restriction should be made known as widely as possible.

9.4.9 Licensed weight: If the option is to be taken up on any meaningful scale it has to be offered with as few restrictions as possible. The result will be that in illegal tobacco is being traded by IBs but it would end up on the floors anyway. It is too late for this openness to have any impact at all on the scale of illegal production in 1994. If the result of the pilot year is in any sense alarming, it can be curtailed in time and with enough publicity to prevent the wrong signals be given for the following season. Measures are proposed for the medium term designed to limit a tendency to promote overproduction. The provisions on delivery quota are straightforward.

9.4.10 License fee: The need for openness notwithstanding, some measure is needed to restrict the license to serious operators and, to some extent, limit speculation in delivery quota. How high to set the fee is a matter for discussion. But something of the order

of 2.5 to 5 percent rounded, of a notional average selling price per kg (perhaps the 1993 floor average) would seem reasonable. Whether the fee should be paid to Treasury, as with growers' licenses, or to TCC, as with buyers licenses, is not an issue for the consultant to decide.

9.4.11 Reporting: This provision is not intended to place the onus of distinguishing registered from illegal tobacco, as with the present, unused, estate license. Rather, it is to oblige licensees to cooperate in developing an understanding of how useful a place in the industry IBs are likely to take up.

9.4.12 This is not offered as a cynical solution to the immediate problem - how to fulfil the ASAP agreement and yet be able to reverse the process as soon as this particular and, in an industry-wide context, minor nuisance is out of the way.

9.4.13 The proposal has merit in itself. But we must accept that it has serious problems insofar as it offers no guarantees against over-production after 1994. Indeed, as it stands, the proposal has the potential to promote over-production on a grand scale. More measures would be needed in the medium term if the proposal is to work.

10. CONCLUSIONS AND RECOMMENDATIONS - MEDIUM TERM

10.1 Club sales through AHL

10.1.1 Following the World Bank's initial ASAC initiative in smallholder burley, the USAID-supported ASAP has since taken center stage in the program. It is soon to be complemented by the IFAD-supported Smallholder Food Security Project. This should be effective in time for the 1994-95 season and eventually aims to introduce an additional 5 Mkg of smallholder quota, applied to very small, resource-poor farmers. Marketing arrangements will follow those already established but there are certain to be conflicts as a result of two similar programs operating side by side in rural communities but involving different groups of people with different levels of individual quota.

10.1.2 The question of sustainability has been discussed. By the time the ASAP club-strengthening project (and IFAD's) are complete, we would all hope that the clubs are all settled down, functioning well, financially secure, and responsible TAMA members. This is, frankly, improbable. Smallholder tobacco growers will remain a turbulent lot requiring much support and intervention. At present MoA, with donor assistance, is able to provide this support. It is not clear that this is sustainable.

10.1.3 This lends support to the suggestion for a smallholder tobacco authority. To make detailed recommendations at this stage is beyond the consultant's terms of reference but it may be worth considering some of the things this body could do.

10.1.4 It would not need to be actively involved in marketing or production but could coordinate policy in the allocation of quota in all types of smallholder tobacco so as to protect and enhance Malawi's reputation as a supplier of many different kinds. This could include the promotion of new types (e.g., oriental) by ensuring that marketing and pricing options are competitive. These functions could be undertaken, as suggested, by the TCC Board, without the need for a costly new organization.

10.1.5 There are other functions which may be required which would involve cost. These include the responsibility for a unified smallholder registration and control system. As discussed in earlier ACDI reports, someone in the longer term, will have to bear the responsibility (and cost) for club audit, training, and control. The aim will be to promote a sustainable cooperative system of smallholder tobacco production and marketing. A smallholder tobacco authority might relieve GoM of the considerable cost of running the present scheme. This could be done by transferring the costs, via a cess, to the beneficiaries themselves, net of whatever donor support is still available.

10.1.6 These ideas need to be developed over the next few years in the light of the experience of on-going donor assisted projects. It would be useful if the industry as a whole took some initiative in this, in its own interest.

10.1.7 Otherwise, it is fairly safe to predict that many clubs will continue to function as successful licensed growers and sellers of burley. This is likely to remain the most popular option for some time. It may be that growers in the north will be given auction floors in Mzuzu within the next 5 years.

10.2 Intermediate buyers and overproduction

10.2.1 This report has dwelt on the dangers of overproduction and its terms of reference call for a third channel, which does not lead to it. In the present production quota system this is only conceptually possible with some coupon-type instrument of transferrable quota, which is not practical.

10.2.2 The IB proposal, as it stands for 1994, is obviously not sustainable. Its very openness is potentially lethal. More and more IBs, able to buy quota, must mean more and more unregistered growers. It has been argued that this would be a less catastrophic process than is sometimes supposed but the tendency is undeniable.

10.2.3 Some way is needed to bring IB quota into line with total licensed weight. This, as far as the consultant can see, can only be achieved by overhauling the entire quota system and changing its main focus to a purely marketing quota. The present system emphasizes both production and marketing and clearly does not work as well as it should. Only marketing quota is absolutely indispensable. The case for production quota is less persuasive. Illegal growers are undeterred by their lack of a producers license, sheltering, as they do, behind certain estates' sellers licenses.

10.2.4 A system which annually apportioned quota automatically, rewarding quality, adherence to quota and deliveries is achievable. This would be most easily carried out electronically, using the AHL computer. Doubtless this would take time and money. There would be much discussion on the criteria to be programmed into the system but it is achievable.

10.2.5 The total amount in the system would be set in consultation with the trade. If there are rewards there would have to be penalties, removing quota from those who do not use it, or otherwise abuse the system. Some of this would be made available to new sellers. The need for annual re-registration would disappear, saving MoA the immense effort it devotes to this every year. Control would be achieved where it matters most, at the point of sale.

10.2.6 If all sellers - estates, clubs, IBs, even ADMARC perhaps - were put into such a system, their share of total available quota would be decided at the moment the system

was installed. Their share thereafter would depend on performance. New entrants, including IBs, would have to compete with each other according to criteria which we need not consider in detail at this stage.

10.2.7 This is a big project. Though simple and attractive enough in outline, successful implementation would require a lot of work, consultation, and hardware. But it is the only way that ASAP's third channel can be integrated into the present market.

10.2.8 Even then, it does little or nothing to remove the worry that smallholders will grow more than the market can take, whether they are registered or not. The existence of a third channel - legal or not - will always encourage some smallholders to try and overcome the scarcity of available places in clubs. And members of otherwise successful clubs will also be tempted to produce more than their club can sell.

10.2.9 It is this natural trait of economic behavior which lies behind the concerns consistently expressed throughout the industry (and by the present writer) since the implications of the estate option and its successors were first discussed.

10.2.10 This report has attempted to explore all the possible ways in which the third channel can safely be introduced. There may be others, but the consultant is unable to firmly recommend any smallholder marketing option involving individual sales to either estates or new marketing entities, even considering some of the longer term benefits they might otherwise hold.

10.2.11 GoM may reasonably decide that fulfilling these particular terms of ASAP is not worth the effort and risks they entail.

11. THE LONG TERM

11.1 This year saw the celebration of 100 years of export-orientated tobacco production in Malawi. Smallholders have played an important part in that history, though their share of production has gone up and down. In the 25 years following Rhodesian sanctions the industry grew spectacularly, especially so in estate burley. But smallholders played their role here too. Others have described the financing of the initial growth in the estate sector around the early 1970s, when the banks on-lent the profit on ADMARC's tobacco account. We have seen how much of the growth in the 1980s is attributable to "graduated smallholders" and, for much of this period, the best opportunity open to smallholders was to become tenants.

11.2 There are those in the industry who see burley as a "peasant crop" - one best suited to smallholders. Others, naturally emphasize the virtues of well organized estates. It seems fairly clear that the balance is swinging, for the time being, towards the smallholder. But not everyone can grow burley. The market simply cannot absorb it. The simplest calculation of 2 million smallholder families sharing a market of 100 Mkg adequately makes this point. Economists may find it fascinating to speculate on the course such structural adjustment would take. Anyone with a stake in the existing industry finds the prospect too appalling to contemplate. Some combination of marketing and production controls has a long-term future in Malawi.

11.3 The institutions which will control smallholder production for as far as we can see (though this may not be very far) are being put in place now. In the club option we have the basis of a cooperative movement, though this was scarcely envisaged in ASAP. While Malawi has the legal basis for such a development, the cooperative tradition is almost entirely absent. In as much as the clubs have been organized, top-down, as part of a Government-sponsored program, the start is inauspicious. It is an axiom of cooperative development that success depends on a genuinely voluntary beginning. Much will depend on what is achieved by the club strengthening project over the medium term.

11.4 Very few outside the corporation are happy with the contradictions in ADMARC's role. Its monopsony defies economic theory and its balancing act between social and commercial responsibilities is the subject of repeated attempts at reform. Recent instability in the production of Malawi western types adds to these concerns. While it would be rash to predict the end of this durable institution, it does seem that the rise of other smallholder marketing channels must inexorably diminish ADMARC's share, perhaps not only in burley.

11.5 ASAP's insistence on choice does the clubs themselves no favors. As long as members have other options, both the credit and marketing functions of the clubs are weakened. If the third channel could be developed into a stable network of competitive intermediate buyers (though this reporter has been unable to convince himself that this is possible), many small growers would find that the rewards of direct marketing were not worth the effort. Though

there are potential benefits to such a development, all but the best-led clubs are unlikely to survive the competition.

11.6 Further, the strongest intermediate buyers could eventually command so great a market share that the auction system itself might be increasingly challenged. There are already hints that the largest growers see some advantage in selling direct to the trade, by-passing the floors. The present oriental scheme and the cost of a third floor could add to these pressures. This would be a shame as the auctions are the most open, intelligible tobacco marketing system available.

11.7 In the long term nothing is certain except that it is determined, to some degree, by actions in the short term. It may be that the time has come, now, to decide between the club route and the third channel.

A N N E X

TERMS OF REFERENCE FOR THE ASAP STUDY ON MARKETING OPTION
FOR SMALLHOLDER BURLEY

1. Evaluate the three current marketing options for smallholder burley, identify advantages and disadvantages of each, and describe the impact of each channel on the industry, smallholders, estates, MOA, and the marketing agents:
 - (a) direct access to the auction floors via registered burley clubs;
 - (b) individual sales registered smallholder burley growers to ADMARC within ADMARC's burley marketing quota; and
 - (c) individual sales of registered smallholder burley growers to estates licensed to buy smallholder burley during the 1992/93 season within existing estate quota.
2. Propose a system and a set of procedure whereby estates could buy smallholder burley in excess of estate quota without leading to over-production or illegal production and without unduly over-burdening Auction Holdings, MOA, TCC, estates, and others; describe the advantages and disadvantages of this proposed marketing channel;
3. Propose additional types of marketing channels (i.e. entities issued with marketing quotas to buy and re-sell) whereby registered smallholder burley can be purchased and sold on the auction floors; describe in detail the advantaged and disadvantages associated with each proposed channel. These marketing avenues would be in addition to those channels described in No. 1 and No. 2 above. Assess impact of each proposal on smallholder profitability, smallholder management capability, and MOA monitoring capacity;
4. Describe the consequences on ADMARC of each of the multi-market channels as described in Nos. 1,2, and 3 above.
5. Describe how a burley marketing system based on marketing and production quotas might operate in Malawi's best interest; identify advantages and disadvantages; identify impact on food production levels and international market shares;
6. Assess the impact of expanding smallholder burley marketing channels on the estate tenancy system and on estate pre-financing arrangements; describe the consequences;.
7. For estate purchase of smallholder burley within estate quota and possibly outside of estate quota, what set of

criteria will best serve Malawi; how has current set of criteria worked?

8. Examine and comment on possible burley purchase arrangements between estates and smallholder burley growers, i.e. cash only, cash plus consumer items/fertilizer/maize, or straight barter transactions. Which are in the best interests of smallholders and tenants?
9. Recommend deadlines for declaration of smallholder marketing choices and transfer of this information to SACA and ADMARC.
10. Based on findings and conclusions reached in numbers 1-9 above, recommend a set of marketing options for the short-term, medium-term, and long-term; describe a set of procedures for each and the consequences on ADMARC, TAMA, estates, smallholders, TCC, Auction Holdings, and the industry in general; identify areas of agreement/disagreement and concurrence/non-concurrence with TCC, MOA, TAMA, ADMARC, and Auction Holdings on each recommended marketing channel.

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ADMARC