

B. DEREGULATION OF SMALLHOLDER TOBACCO PRICES AND ENSURING THAT SMALLHOLDERS HAVE DIRECT ACCESS TO ALL LEGAL MARKETING CHANNELS

1. Findings

The CPs related to smallholder tobacco production and marketing appear to have been met, despite the opposition of the Tobacco Association of Malawi (TAMA), primarily reflecting the views of the larger estates. These agents foresaw the likelihood of quality declines, and also foresaw the complete undermining of the system by which inputs would be provided on credit to smallholders, to be recovered when the smallholder tobacco was delivered to the estates. When Independent Buyers (IBs) came into the market, smallholder producers could sell their tobacco to them, bypassing the estates. Many of these IBs were not knowledgeable about tobacco grading, and in some cases the average tobacco quality did deteriorate. Market penalization of low quality tobacco, which faces much lower prices on either the auction, or under the various other possible contracting arrangements, rapidly provided incentives for improved grading right through the system. In a number of cases, estates became IBs, sometimes providing considerable technical and other assistance to smallholders, and selling the tobacco under their own registration number.

Despite some of the problems that arose, there can little doubt that smaller producers benefited enormously from the removal of the price and market restrictions that had earlier governed their activities, and that the change resulted in major improvements in income distribution. The immediate result was a rapid increase, to an estimated 315,000 to 330,000, in the number of smallholder growers. Between 1994 and 2000, estimated production by smallholders grew from 11,000 to 94,000 tons, falling back, along with the size of the total crop, to 88,000 in 2001. During the same 1994-2001 period, the smallholder share of aggregate production rose from 16 to 70 percent and the shares of small, medium, and large estates fell from 84 to 30 percent²⁸. Tobacco incomes in the hands of smallholders generated major changes in rural welfare, in other on-farm investments such as housing and a variety of small business enterprises and, not least, in additional education.

In terms of tobacco marketing, stories abound of traders with cash in hand visiting farmers early in the season, when they are particularly short of cash, and offering them substantially less than the future market price for their crop. Despite these cases, and some residual pressures to revert to the old systems, particularly from those involved in running them, it is now widely recognized that such problems are better resolved by improving the information available to farmers than by restricting the market channels available to them.

In the face of a predominantly smallholder production system in Malawi, a multifaceted smallholder support and development strategy, the policy corollary to the structure of the sector, is either not in place, or not in good order. The Agricultural Research and Training Trust (ARET), the research and advisory service for tobacco, has no functioning mechanism to reach even a portion of the smallholder producer population, and the efforts to work with the Ministry to create such a capability have essentially foundered for lack of resources.

²⁸ S. Jaffee, World Bank, 2002.

No doubt as a result of some combination of the above difficulties, affordability difficulties with input supplies, and the more general declines in fertility associated with poor agronomic practices, Malawi has experienced a decline in burley productivity, from 1,150 kg/ha in 1990 to 922 kg/ha in 2001. Yields are substantially less than half those of the US or Zimbabwe (in the year 2000) and, by a large margin, the lowest of any of any of the significant producers with which it competes.

An unfortunate setback, occurring in recent years, has been the sharp decline in world prices for tobacco, and particularly burley, the prime smallholder crop. Producers expressed their anger with vigorous demonstrations, and in some cases blamed the new intermediaries, including the estates, with whom they were dealing. In general, however, it was evident that the various market intermediaries, along with producers, were joint victims of the decline.

An additional reform in the domestic trade and price regime was also introduced by way of a major devaluation. While this devaluation provided an essential and welcome increase in the MK prices of the country's exported products, it also increased the domestic prices of imports, including farm inputs and vehicle transportation services, thereby particularly hurting those in more distant locations.

2. *Conclusions*

There were a number of short-term penalties associated with the reforms in smallholder tobacco marketing and pricing. In particular these involved quality problems, generally associated with inexperienced Intermediate Buyers (IBs), as large numbers of inexperienced people – virtually any Malawian with money available – entered the trade in search of rapid returns. Despite such problems, there is no question that farmers received a substantially larger share of tobacco export earnings as a result of the reforms. Since this new population of smallholders includes many of the poorest people in the country, it is also probable that the reforms resulted in a significant improvement in Malawi's income distribution.

3. *Recommendation*

Despite some residual pressures to return to the pre-reform marketing and trading regime, the distributional benefits of the reforms should, and undoubtedly will counter any such reversion, maintaining an open system. In the face of poor market performance or non-competitive behavior, there is a strong tendency to respond by official interventions that further impede open competition and the drive to maintain efficiency. It is important for domestic reformers, with the support of their international partners, to resist such a tendency.

4. *Lessons Learned*

- ▶ One of the useful things about an open, competitive system and market-determined prices is that, unlike a system of official or regulated prices, the entire process is relatively transparent, and is open to new entrants. The result is that it tends to be removed from the domestic political arena, minimizing the pressures for fixed or politicized prices, and for the budgetary demands that almost inevitably arise to sustain them.

- ▶ Farmers and their families, groups of farmers and entire farming communities are developing an increasingly sophisticated understanding of market prices, quality differences and their determinants. Within the limits of their technical and financial capabilities, they then respond to relative input and output prices, quality distinctions, and the like, in a fashion that maximizes their net earnings. Rather than restricting farmers' access to what they see as the most attractive marketing systems available to them, the key development strategy is to improve both the technical information and the price and market information available to producers and traders, disseminating it widely, by radio and other means. It is also to facilitate the competitiveness and the efficiency of the delivery systems and supplies available to them.