C. THE ROLE OF ADMARC AND THE LIBERALIZATION OF AGRICULTURAL TRADE

1. *Findings*

A general finding that should be noted in looking at the process of formulating the conditions associated with the various tranches, is the recurrence of certain themes in the CPs. In a number of these cases, despite the formal agreement between USAID/M and senior MOAI officials, the substance of the reform process was not really implemented in a way that internalized a commitment within the GOM to a more market-oriented approach, and that a number of key components of the reform ran counter to the preferred policy and practice of the Ministry. An example, analyzed in more detail below, is the recurrence of ADMARC as an object for repeated efforts at radical restructuring and reform. Even now, ADMARC is admittedly making losses in almost every activity it manages, and currently presides over a chain of stores that are generally empty, and which GOM has agreed should be put on the market and liquidated. Despite the above, a new General Manager has been appointed; he sees his mandate as restoring ADMARC to its former role and status as a subsidized buyer and seller of farmers' needs.

Seasonal and territorial price uniformity still appears to be an implicit or explicit policy for maize, hybrid seed, and for virtually any goods handled by the Government or by the parastatals or other agencies. The reasons for this policy are some combination of political, administrative, and humanitarian imperatives. Politically, the same government agency charging (or paying) different prices in different areas tend to result in strong opposition from those who feel themselves discriminated against by a less favorable price. The result is strong political pressure for a uniform price. Unless they handle major brand-name products with significant market power and profit margins, commercial traders must maintain their competitiveness and cover their costs in their various market operations. Conversely, it is hard for government or parastatal officials to know what transport or storage cost differences are between different areas and seasons, let alone to administer a price system that reflects those differences.

In the above circumstances, traders make it their business to be knowledgeable about present and future prices, and the market estimations of local, regional and external surpluses, or about deficits that determine them. A well-functioning market system, using the best current information and the best future estimates available, provides farmers and traders with the most likely prices that they will experience when their crop reaches the market in a particular area. Using these future price and supply estimates, producers and the various transport, storage and other market agents, including consumer households, will respond, e.g. by increasing their transport, storage or other trading activities. The effect of such activities right through the market system is to mitigate the extreme price rises or declines that might otherwise occur.

ADMARC's uniform (pan-territorial and pan-seasonal) price approach runs directly counter to that of the market. It dates from the period when it had exclusive market rights with no competition from traders. At a uniform price, it made high profits in the nearby locations where transport costs were low, and this occurred shortly after harvest, before storage costs could accumulate. It then used these profits for an internal cross-subsidization to the long-haul markets, where transport costs are high, and late-season consumption when high storage costs had accumulated. On the other hand, it has been suggested by some that the issue of pan-territorial and pan-seasonal pricing is a bogus one, or at least one of little significance. Indeed, companies like Coca Cola, and Monsanto, the country's largest wholesaler of fertilizer, practice pan-territorial and pan-seasonal pricing. As the argument goes, reviewers should be more concerned with the overall profitability of ADMARC, rather than with its pricing policies. Lastly, since Malawi will always require a rural safety net, why not establish ADMARC as such, to be operated on a break-even basis.

Nevertheless, with the arrival of private sector transporters and storage agents, these traders successfully took away business from the parastatal where the costs were low relative to the uniform price, leaving ADMARC to incur the high costs of serving the rest of the market. The result was that ADMARC was left with the obligation to cover those locations and time periods where the transport and/or storage costs were high, without generating the profits necessary for its traditional internal cross-subsidization. The direct result of being left with the high cost segments of the market, and a pricing system that did not allow it to cover those costs, has been the rapidly mounting losses and budgetary deficits that ADMARC has experienced. There is also evidence that, perhaps for reasons of management, vehicle maintenance and the like, ADMARC's transport and other operating costs are substantially higher than those of a number of the private sector firms.

A further, and potentially more serious effect of the uniform pricing systems used by ADMARC, and by other agencies in which the GOM has some role, is that they systematically undermine the commercial system, and most importantly, its incentives to provide the transport and storage necessary to moderate prices in more distant areas and in late "hungry season" periods.

The mechanisms for transmitting information to producers, traders, other market intermediaries, and to consumers, are prices. Anticipated surpluses are signaled by price declines, and deficits by price increases. Market agents, such as ADMARC, which for political or bureaucratic reasons ignore price signals or, more seriously, transmit erroneous price signals -- distort the most pervasive and well-understood indicators and warning signs in the economy. They inform the entire production system, for example, that additional supplies are not worth producing, or that storage or transportation activities are not worth undertaking, when the opposite may be the case.

There is a reason why recurrent market-related CPs have reappeared in different guises in various tranches and in key areas. As is true in a number of countries, the reason is that the pervasive and continuing Malawian tradition is that it is the right, even the duty of the government to intervene, at will, in the most politically sensitive markets. Almost by definition, these markets have included the market for maize, the principal (and preferred) food crop, and a variety of the input and supply markets associated with it.

a. The Special Case of Entrepreneurs and Traders

In liberalizing markets and removing the monopoly powers of either private or state agencies, a key question arises: has the process resulted in the emergence of vigorous and capable domestic entrepreneurs in the marketing and trading arena, and how are these agents performing? As in most of the countries of the region, immigrant groups, particularly Asians, came into the country, often as laborers or craftsmen, in the colonial period. Gradually they moved into the business of trading and shop keeping, frequently operating isolated shops and trading posts, throughout the rural areas. Partly because they were willing to live cheaply in remote rural environments, far from extended family obligations, they often became the major suppliers of goods to rural people and, in many cases, the purchasers of both locally consumed and exportable products. Before long, this group provided the core of the country's commercial agents and market entrepreneurs. Along with a selection of other non-indigenous groups and families, they had the commercial and trading skills, the accumulated capital and business credibility, and the supply and other connections outside the area, which allowed them to offer a better range of goods, and better prices than most ethnic Malawian traders and entrepreneurs.

Malawi has strong educational and administrative traditions that have, in a number of cases, resulted in competent government agencies. There is also a longstanding tradition of trading in the country, along with traditions of dexterity, skill, and industriousness among the workforce. These attributes represent critical resources for business and commercial development. They are not, however, a good substitute for entrepreneurship, for savings accumulation and investment in, or the competent management of, commercial business operations.

Dating primarily from the Hastings Banda period, a series of discriminatory regulations were introduced to exclude Asian trading establishments in the rural areas. Some three quarters of these people left the country, while virtually all of the others migrated to the country's urban areas. For the most part, these people have done very well, generally making more money than they did in the rural areas. The laws and regulations that excluded them from rural area trading have now been reversed but, for the most part, they are not interested in going back.

One of the main imperatives for establishing state or parastatal marketing and trading agencies, such as ADMARC, was to provide a substitute for these private traders. The familiar problem with such official agencies is that they lack the independence and the flexibility of individual traders. They are also subject to a variety of pressures and objectives, often conflicting, on such key issues as pricing and coverage of the rural areas. They may also be pressured into taking over or making investments in projects where there may be some kind of political or other interest. Such pressures tend to be in direct conflict with the objective of maintaining business viability and covering the costs of these agencies.

In the case of ADMARC, the above problems have occurred in full measure, as analyzed above. Its operations and its pricing structure are politicized; it enters the market in an unpredictable fashion, and it is not required to cover its costs. Its vehicles also tend to be unreliable, are often lacking in critical spares, and suffer from chronic maintenance problems. The implication for private traders is that they may face competition from subsidized parastatal operations at any time, making it very hard to make rational business predictions and decisions. The ironic result is that ADMARC has become one of the principal impediments to the development of a viable and self-sustaining network of private traders, as it wrestles with its dual role of safety net provider.

A small number of relatively large businesses now dominate rural markets. While NASFAM has been fairly aggressive in developing its commercial operations, some of this activity has been assisted by external management and other assistance that is unlikely to continue. Most of the commercial trading operations that reach deeply into the rural areas depend on smaller individual traders. These agents often operate with pickups and other smaller commercial vehicles, and sometimes out of local shops and other rural trading operations.

In addition to the ADMARC-related unpredictability problems mentioned above, these small traders face the familiar financial, technical and security problems of small operators with inadequate capital resources, in dicey vehicles on bad roads. There can be little doubt that the condition of the road network in a number of the rural areas imposes serious costs on trade and transport activities, and thus on the prices that rural producers pay for their purchases or receive for their products. While road investment is typically justified by a high traffic load, it is also true that road improvements lead to declining transport costs and can generate both the expansion of traffic and the development of local productive activities that benefit from the decline.

Having experimented with pre-payments, loans, and other contractual arrangements with these traders, most larger firms maintain a “strictly cash” relationship with them. There are some longer-term relationships that develop between the larger firms and these smaller traders. There is also normal competitive activity that may play both traders and larger firms off against each other.

b. The Special Case of Exchange Rates

A final point that should be mentioned is that “real exchange rates,” the relative price of tradable and non-tradable goods, can be far more significant for agricultural product prices, and for the incentives of farmers, than explicit taxes or subsidies. A potential problem in this regard is that large inflows of foreign assistance, despite donors’ good intentions, can result in the appreciation of the MKwacha (a familiar “Dutch disease” phenomenon) by flooding the economy with cash or free goods. Any such lowering of the price of foreign exchange lowers the domestic value of tradable goods relative to non-tradables. Since agricultural products fall directly into the category of tradable goods, such currency appreciations can significantly hurt the producers of these products.

More important, however, is the case where a declining exchange rate increases the prices of imported commodities, especially those commodities that are used as inputs to agricultural production. In recent years for example, the nominal price of fertilizer has increased by 200 to 400 percent per year (which is the price that farmers must pay), while the current real price is 30 percent lower than it was in 1996. Other than in the case of tobacco, which is exported, this increase in the nominal price of inputs has not been matched by an increase in the production of other marketable commodities. Consequently, farmers are using far less fertilizer than they used in the past, with predictable declines in crop yields. Ironically, increases in competition in the fertilizer trade has led to the predictable declines in real prices, but these declines have been grossly negated by increases in the nominal price of fertilizer, due to devaluation.

2. Conclusions

Market prices, in Malawi as elsewhere, theoretically arise as a consensus of the complete range of market participants, including producers, traders, other intermediaries and consumers. They can be completely flexible and move rapidly in response to changes in information relating to the supplies available, and to the expected level of demand in the various locations and over time. These prices, in turn, the theory goes, provide a pervasive and fast-moving mechanism to inform all market participants about the current and the expected situation, and to provide them with clear economic incentives to act accordingly.

Market mechanisms and prices are well understood in Malawi. At the official GOM level, however, partly arising from the earlier days of the country's independence when Government virtually monopolized trading and marketing activities, there appears to be a residual preference for fixed and uniform prices, and for the politically controllable operations of official marketing agencies, especially when emergencies arise. This preference implies mistrust for open markets, and the perception that prices, unless they are controlled, may be dangerous or damaging to the economy, and to the welfare of the population. Alternatively, this preference may imply the desire to exert price controls for political reasons. There is also the possibility that the former may serve as the rhetorical rationale for the latter.

The approach to agricultural prices, markets, and trade epitomized by ADMARC, has been the subject of recurrent CPs in USAID's interaction with the GOM. There is clearly an implementation problem, however, perhaps relating to the GOM's perception and preferences as to how markets can or should work, and as to the appropriate role of Government in this area. The real issue is not ADMARC *per se;* it is the perceived legitimacy of an open and competitive marketing and trading system, and of the prices emerging from it vis-à-vis agrological famine in rural areas, followed closely by almost total economic collapse.

It should be noted that in the presence of parallel prices, a virtually inevitable consequence of official price controls or attempts to monopolize markets, the non-official (open market) price tends to reflect unsatisfied demand and, as such, may rise extremely high. Investigations into who pays which price in these circumstances can be disturbing. The typical findings are that the very poorest people are not the beneficiaries of the controlled prices, and are frequently subject to high parallel market prices, which may significantly diminish their welfare. Successful measures to unify these markets and prices by removing the artificial controls may, depending on the aggregate supplies available, raise the price above former official levels. The universal experience, however, is that those who are relegated to paying the higher parallel market prices typically include the less well-connected groups.

Fixed and uniform prices, embodying substantial hidden subsidies, are at complete variance with the operations of commercial markets. By ignoring its various transport, storage, and other marketing costs, the ADMARC approach not only generates large, and totally unjustifiable budgetary problems, it also makes it difficult for a self-sustaining and self-financing marketing system to develop, or for unsubsidized traders and other agents to compete. However, by ignoring the social role of ADMARC, one runs the risk of eliminating the safety net function that it plays in remote rural areas.

3. Recommendations

Recommendation 1

Official marketing agencies such as ADMARC, should have their entire commercial operations directed at the provision of a safety net managed on a break-even basis. This is particularly true in all areas of their marketing and trading activities. Current activities make no useful contribution to the development of a self-sustaining and self-financing system of marketing and trade. By introducing uniform prices and subsidized operations, they undermine the development of a private network of competitive traders and of other market agents, whose costs tend to be lower and whose efficiency is higher.

Recommendation 2

Reverse the policy of market controls and fixed prices, and move to a policy of even-handed support for the development of an open and competitive market for agricultural products and inputs. This implies ignoring all pressures for favoritism and special subsidies, or other arrangements from individual firms or agents. It also implies reviewing and monitoring the various regulations and other potential impediments to the functioning of such a market, and making adjustments where necessary.

Recommendation 3

Avoid all efforts, such as currency or exchange controls, to suppress the price of foreign exchange. It must also be recognized that financial inflows from foreign donors can have the same effects on the exchange rate, that is, in appreciating the currency. Currency depreciations raise the prices of tradable goods and their substitutes. Farmers are quintessential producers of such goods. Conversely, appreciations of the Mkwacha (e.g. by large financial inflows) have the exact opposite effects. While they reduce the prices of imported goods, including farm inputs, they suppress the prices of what farmers produce. It must be recognized that such "indirect" effects on the prices of agricultural products, while they are less well understood, can be quantitatively more important than direct taxes and subsidies.

4. Lessons Learned

- Government institutions and policies that attempt to undertake or control marketing and trading activities in the agricultural sector tend to come under powerful political pressures to fix, and typically to suppress such prices. The result is almost inevitably a pricing and marketing system that ignores market factors and worsens producer prices. Most seriously, such a system destroys or distorts the incentives for the successful development of a self-sustaining system of competitive private traders and other market intermediaries.

- Rather than undermining the development of an open, competitive marketing system, the role of Government should be to ensure that such a market is functioning well. It should also analyze and remove any impediments that may arise to impair the performance of such a market.

- In a situation where, for whatever reasons, large numbers of people are without food, and without the incomes or resources to buy food, the free distribution of food to those people is the only tenable option. The dilemma is that large quantities of free food coming onto the market, sends a clear signal to farmers that it is not worth incurring the costs of producing marketable surpluses. In subsequent years, inadequate food may then be produced, creating the need for additional food aid. Without resolving the dilemma of food aid requirements on the one hand, and the need to maintain adequate producer/trader incentives to expand local food production on the other, the danger is that a cycle of dependency is created, and the productive capacity of the country is systematically undermined.