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Competition issues in the Tobacco Industry of Malawi

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Abbreviations

ADMARC	Agricultural Development and Marketing Corporation
AHL	Auction Holdings Limited
ARET	Agricultural Research and Extension Trust
ATC	Agricultural Trading Company
CFTC	Competition and Fair Trading Commission
CISANET	Civil Society Network on Agriculture
ECAMA	Economic Association of Malawi
FISP	Farm Input Subsidy Programme
GDP	Gross Domestic Product
GOM	Government of Malawi
MCCCI	Malawi Confederation of Chambers of Commerce and Industry
MDPC	Ministry of Development Planning and Cooperation
MEJN	Malawi Economic Justice Network
MIT	Ministry of Industry and Trade
MoAFS	Ministry of Agriculture and Food Security
MOAM	Minibus Owners Association of Malawi
NASFAM	National Association of Smallholder Farmers' of Malawi
NDDF	Northern Division Dark Fired
NSO	National Statistical Office
RTOA	Road Transport Operators Association
SDDF	Southern Division Dark Fired
TAMA	Tobacco Association of Malawi
TCC	Tobacco Control Commission
TEAM	Tobacco Exporters Association of Malawi
TIL	Tobacco Investment Limited
USAID	United States Agency for International Development

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Executive Summary

The tobacco industry plays a major role in the Malawi economy. Tobacco is the main cash crop and the main foreign exchange earner in the economy. Tobacco exports account for more than 60 percent of export earnings. The main type of tobacco grown in Malawi is burley which in 2010 accounted for 94 percent of total tobacco production. Other types of tobacco grown in Malawi are northern division dark fired, flue-cured, southern division dark fired, sun-air and oriental tobacco. Prior to liberalisation in 1992, burley tobacco was only cultivated by large scale estate owners while smallholder farmers were only allowed to grow fire-cured, air-cured and oriental tobacco. Since liberalisation, the smallholder sector has dominated burley cultivation producing about 98 percent in 2009 from 63 percent in 2006. There are several stakeholders in the tobacco industry at various stages of the value chain interfacing with the regulatory institutions and other service providers. The institutional arrangements in the industry and the structure of the industry have implications for the promotion of competitive behaviour.

The main objective of this study is to analyse the context, the structure and functioning of the tobacco sector in terms of competition at various stages of the tobacco value chain. Some of the issues highlighted in the study include the structure of the tobacco industry, the nature of the competitive process, the institutional and regulatory framework and capacity issues in the regulatory institutions. The main limitation of the study is the lack of data at firm level that would have enabled a multivariate analysis of the relationships between market structure, conduct and performance at various stages of the tobacco value chain. This lack of data partly reflects the capacity constraints and weaknesses in the regulatory regime in the tobacco sector.

Support Policies and Support Programs

There are several policies in place supporting the development of the tobacco sector in Malawi. However, there is no specific policy for the tobacco sector but most of the strategies for the sector are articulated within agricultural sector wide policies or /and national development strategies. One internal trade policy that adversely affects the competitive marketing of tobacco is the restriction imposed on the sale of tobacco outside the auction system. This implies that smallholder farmers cannot sell raw tobacco to intermediate buyer or export raw tobacco, although the system of intermediate buyers has been associated with better returns to farmers. The other policy that also affects smallholder farmers is the imposition of a withholding tax of 7 percent on sales of tobacco at the auction floors. Although, this generates revenues for the government, it amounts to a turnover tax that does not take into account the cost of production; and among smallholder farmers this has the potential to wipe out the profitability of tobacco cultivation.

There are two main support programs associated with the tobacco sector. The first is the Hessian Scheme which funded by deductions at the auction market and procures hessian bags for tobacco and sold at a reduced price to smallholder farmers. The second is the farm input subsidy programme which provides fertilizers at subsidized prices, although tobacco fertilizer was excluded since the 2009/10 agricultural seasons. These programs lower the cost of production among smallholder farmers. However, there have been concerns raised by smallholder farmers about the administration and the management of the Hessian scheme – in

some cases smallholder farmers buy hessian bags from the market at higher prices than under the scheme.

Institutional and Legal Framework

The institutional and legal framework in the tobacco sector focuses on policy formulation; regulation of growers and buyers; promotion of competitive behaviour; provision of support services, and organisation of smallholder farmers. In terms of policy, the main institution is the Ministry of Agriculture and Food Security with powers for policy directions under the Tobacco Act and the Control of Tobacco Auction Floors Act. The Ministry also appoints the Board of Directors of the regulatory body in tobacco, the Tobacco Control Commission (TCC). More recently, the Ministry has also been setting minimum prices of tobacco for various grades sold at the auction markets. However, the Ministry have several constraints that affect their effectiveness including inadequate number of staff and skills, weak policy formulation, weak monitoring and evaluation of policies and inadequate finance resources to enable enforcement of regulations.

With respect to regulation of growers and buyers, the Tobacco Control Commission is the responsible under the Control of Tobacco Auction Act. The functions of TCC include regulating the production, manufacture and marketing of tobacco; advising government on the sale and export of tobacco; promoting and expanding the sale of tobacco; collating statistics relating to tobacco; controlling and regulating the sale of tobacco; registering and licensing tobacco growers and sellers; and defining tobacco grades and classes for the purposes of selling and buying. Over time the TCC has not been able to manage the number of growers of tobacco after liberalisation in 1992 and this has led to oversupply of tobacco on the auction floors. The TCC has also not been able to deal with the alleged collusion of buyers on the auction market. The major weakness in the TCC in its regulatory role is its lack of independence from the stakeholders it is expected to regulate – its Board of Directors is drawn from growers, buyers or exporters of tobacco and government – this situation makes it prone to regulatory capture. In addition, TCC does not have the necessary information to monitor the performance of the industry; this weakens its regulatory functions.

With regard to promotion of competition in the sector, the main institution responsible is the Competition and Fair Trading Commission (CFTC) established under the Competition and Fair Trading Act of 1998 whose main function is to investigate and prohibit anti-competitive practices and unfair trading practices. As an enforcing agency on competition issues, the CFTC is severely constrained in its operations – it is poorly resourced and does not have a technical secretariat to independently investigate cases. Similar to the regulator in the tobacco industry, the CFTC is not independent of the private sector by the composition of the commissioners as stipulated in the Competition and Fair Trading Act of 1998. This lack of independence and the absence of a secretariat leaves it exposed to regulatory capture, and has contributed to its ineffectiveness in investigating allegations into anti-competitive behaviour in the tobacco and other sectors of the economy.

Support services in the tobacco industry are provided by Ministry of Agriculture and Food Security (MoAFS) and the Agricultural Research and Extension Trust (ARET). These institutions provide extension services to farmers across the country. However, they do experience several challenges in the provision of these services. The MoAFS is understaffed in the area of extension and it is operating at 40 percent of its capacity and only 13 percent of smallholder farmers have access to extension advice. Similarly, ARET, which has been

critical in the development and dissemination of technologies in the tobacco sector face the challenge of technology transfer and the limited outreach it has in the country.

The legal and regulatory framework in the tobacco sector focuses on the regulating the entry and conduct of growers under the Tobacco Act and special Crops Act; the entry and conduct of buyers and exporters and the entry and conduct of tobacco auctioneers under the Control of Tobacco Auction Floors Act; and the general regulations regarding competition and fair trade under the Competition and Fair Trading Act. There are so specific conflicts in the provisions of these pieces of legislation that impose barriers to competitive behaviour in the tobacco industry. Most of the issues are administrative barriers. For example, the continued monopolisation of auction markets by AHL is not statutory, but rather due to strong lobbying with government not to allow entry of other investors. Government has some indirect investment in AHL that can be used to block the entry of other investors in tobacco auction markets. In addition, the pieces of legislation lack enforcement in many areas due to capacity constraints in institutions responsible for the provisions and also due to the web of vested interests in these regulatory institutions that dilute their independence.

Market Structure and Performance

The tobacco industry chain includes cultivation, transportation, grading, marketing and export of tobacco with different market structure configurations and interactions. The sector has a web of vertical relationships with the potential to facilitate anti-competitive behaviour in the market.

Tobacco Cultivation

The tobacco cultivation sector is the most competitive in terms of number of smallholder farmers producing burley tobacco. There are more than 20,000 smallholder farmer clubs are involved in burley tobacco production. Most of the smallholder farmers belong to two main farmer organisations in the tobacco sector: the Tobacco Association of Malawi (TAMA) and the National Association of Smallholder Farmers in Malawi (NASFAM). These farmer organisations provide services to their members including agronomy technical advice, inputs, transportation of tobacco to the auction market and market access. Smallholder farmers also have access to a competitive market for the supply of fertilizers and other inputs with many suppliers, although the tobacco seeds market is less competitive with only one producer of certified seeds.

Transportation of Tobacco

The transport market is also a potentially competitive market in terms of number of transporters in the road haulage transport sector. However, due to existence of a brokerage transport association, the Road Transport Operators Association (RTOA), the pricing processes and the inefficiency of the auction markets lead to uncompetitive prices being offered to TAMA and NASFAM. The RTOA, as a brokerage association, recommends prices for transport services as guide to its members, but these act as collusive prices when members are bidding for the transportation of tobacco from association depots to auction markets. In

addition, due to long queues at tobacco auctions exacerbated by congestions at the auction markets and more recently frequent suspension of markets due to low prices, transporters tend to charge higher prices for tobacco than other dry cargo because of these long waiting periods that tie transporters capital at auction markets.

Tobacco Marketing

Tobacco in Malawi is largely marketed through the auction system, with a small proportion through contract farming system. It should also be noted that the contract sales also go through the auction system, and sellers that are not satisfied with the contract prices have the opportunity to switch to the auction market once. It is in the tobacco marketing stage of the value chain where a lot of questions have been raised about the competitiveness of the sector. There are several issues that hinder the promotion of competitive behaviour in the marketing of tobacco. Firstly, all tobacco auctions in Malawi are owned and operated by one company, the Auction Holdings Limited (AHL). AHL also owns a company that buys tobacco on the auction, the only tobacco re-handling company for regarding of smallholder tobacco and an agricultural input supply company. AHL is also heavily aligned with the Government of Malawi through shareholding by one of the state owned enterprises. The monopoly power in auction markets and re-handling is not regulated and has the potential to disadvantage farmers in terms of the cost of services. The barrier to entry for other investors in auction markets is administrative, as a result of lobbying against new entry by the existing operator that has links to the government through ownership by a state-owned enterprise.

Secondly, there is high buyer power in the auction market. In 2010, there were 7 companies that participated in the auction market, 3 of which are fully owned foreign companies, 2 with joint foreign/local ownership and 2 locally-owned companies. TAMA, the smallholder growers association, has minority ownership in one of the joint foreign/local owned firm. These main buyers are also members of the Tobacco Exporters Association. However, there has been a decline in buyer concentration with the three firm concentration ratio falling from 95 percent in 2000 to 69 percent in 2010. Similarly, the HHI has fallen from 0.37 in 2000 to 0.21 in 2010. The examination of the trend in concentration and average auction prices reveals no clear relationship between market power and prices, suggesting that the behaviour of prices on the auction cannot only be attributed to buyer market power. The low prices of tobacco at the auction are a function of many factors including supply issues of poor grading of tobacco by farmers, over production of tobacco due to weak regulations and the poor quality of crop forecasts leading to unexpected price swings.

Thirdly, there are allegations of tacit or explicit collusion by the major buyers of tobacco in the market leading to low prices, but in the presence of many other problems with tobacco from the supply side, it is difficult to establish the extent such collusion exert downward pressure on prices in the market. Others argue that the fact that major buyers are also exporters, the membership of buyers to the Tobacco Exporters Association provides opportunities for buyers to agree on market sharing and price ceilings. It must be noted, however, that although government has recently introduced a system of minimum prices,

most tobacco is sold at prices below the statutory minimum prices partly due to supply side issues such as poor grading and over supply.

Fourthly, there have been international mergers and acquisitions that have affected the level of competition in the domestic market – this has led to a reduction in the number of buyers over the years.

Nonetheless, the main cause of concern in the tobacco market is the extent of vertical relationships among major players in the market, relationships that may well facilitate practices that are not competitive. For instance, the growers' association, TAMA has shareholding in one of the major buying company, and it becomes difficult to balance the profit motive and the returns to their members. AHL, the monopolist auctioneer has a wholly owned subsidiary that also purchases tobacco on the market and a wholly owned subsidiary that re-handles tobacco on the auction market.

Conclusions

The nature of competition at various stages of the tobacco value chain varies considerably in Malawi. The following conclusions emerge from the analysis:

- In terms of number of players there are many players in production (cultivation of tobacco) of different sizes (large, medium and smallholder farmers), such that no one player has a dominant position to influence market outcomes. A larger proportion of tobacco is produced by smallholder farmers.
- In transport services, the number of transporters in the haulage sector is large, but the activities of the transport brokerage association, the Road Transport Operators Association, through its guide prices to its members result in cartel prices when transporters bid for the transportation of tobacco from production areas to auction markets.
- The major challenges of competition in the tobacco industry are in the marketing of tobacco with lack of competition in auction services and the small number of buyers that participate in the auction. There is also dominant position of the largest three buying companies which account for 70 percent of the tobacco purchases in the market. The main buyers are also members of an export association, the Tobacco Exporters Association of Malawi, which has the potential to provide opportunities for price fixing and market sharing or actions intended to restrict prices that can be offered at the auction. The buyers have processing facilities, and these horizontal relationships enable them to export tobacco as exports of raw tobacco are not allowed. Entry in auction market as a buyer is determined by international forces, particularly the link between the buyers and the oligopolistic international cigarette manufacturing industry.

- There is a web of vertical relations within the tobacco industry particularly through interlocking ownership and directorship that has the potential to facilitate the proliferation of anti-competitive practices in the industry. For instance, AHL which operates markets has subsidiaries that participate in the buying of tobacco and a monopolist company that re-handles smallholder tobacco on the auction. TAMA has partial ownership in one of the tobacco merchants.
- The global cigarette manufacturing structure that determines the extent of entry into tobacco marketing at domestic level is highly oligopolistic. Cigarette manufacturers have specific contracts with merchants that participate in the auctioning of tobacco in Malawi.
- The international mergers and acquisitions have also affected the level of competition in the domestic market – this has led to a reduction in the number of buyers over the years.
- There is alleged collusive pricing behaviour and undervaluing of the quality of tobacco in the markets, which is difficult to detect given the many relationships that exist among growers, grower associations, industry regulator, auctioneers and tobacco buyers. However, the low prices at the auctions cannot be separated from the supply side factors such as poor quality of grading and over production of tobacco.
- The main challenge of promoting competition in the tobacco sector is the existence of vested interests and the weakness in regulatory institutions responsible for promoting competitive behaviour. The legal instruments are sufficient, but they lack enforcement by regulators for various reasons.
 - Firstly, the regulatory institutions are not independent of the stakeholders they are supposed to regulate; hence there are vested interests that lead to regulatory capture. For example, the membership of the Board of Directors for the TCC is dominated by tobacco exporters/buyers and tobacco growers, and they are likely to influence policy directions. The Competition and Fair Trading Commission by statutes also draws membership from the business community, and makes it difficult to investigate allegations of anti-competitive practices.
 - Secondly, the regulatory institutions do not have update information about the industry and this undermines their capability to monitor the behaviour of players in the sector. For example, the TCC, as the industry regulator does not have a database on the number of growers, the categories of growers and the market information from auction markets.
 - Thirdly, the regulatory institutions have scarce resources and face capacity constraints in terms of skills and number of staff. TCC lacks analytical skills to perform its regulatory role while the CFTC does not have a technical secretariat in place since its establishment in 2000.

- There is lack of transparency in the tobacco sector that exacerbates the problem of information availability to undertake rigorous analysis on the structure, conduct and performance of various stages of the value chain in the tobacco sector.
- The state is not only involved in policy and regulation of industry players, it is also involved in the operation of some of the activities in the tobacco value chain. This also undermines the enforcement of rules and regulation.

Recommendations

The analysis has highlighted that both the institutional failures and behaviour of various stakeholders in the tobacco industry have contributed to anti-competitive practices which have adversely affected the profitability of tobacco farming among smallholder farmers in Malawi. The following recommendations are made in light of the above analysis.

- There is need to improve the regulatory framework which allows competitive behaviour in the tobacco industry. Such competition may provide incentive for efficient tobacco production in Malawi. Several reforms may be important in the tobacco industry.
- The regulatory bodies should be free of vested interests. Both the Tobacco Control Commission and the Competition and Fair Trade Commission, by statutes, have on the Board of Directors individuals or organisations with vested interests. This implies that these regulatory institutions are not independent and are therefore susceptible to regulatory capture. This will require revision of the laws governing the operation of these regulatory bodies.
- There is need to carefully study the impact of horizontal relationships particularly through interlocking ownership on the welfare outcomes in the tobacco industry. Government should privatize its share holding in Auction Holdings Limited.
- The technical capacity of regulatory institutions must be strengthened through recruitment of appropriate staff. Some of the allegations of anti-competitive behaviour could easily have been investigated with adequate technical staff at the CFTC. Similarly, at the TCC, appropriate systems are required to ensure that industry level information is available and adequately analyzed in order to improve the regulatory functions.
- The many alleged anti-competitive practices in the tobacco industry need to be investigated. The only authority to investigate such cases and to impose punitive measures is the Malawi Competition and Fair Trade Commission. However, the CFTC is not adequately resourced and poorly funded to perform functions as empowered by the Competition and Fair Trading Act.

1. Introduction

1.1 Background and Context

The tobacco sector plays an important role in the agriculture-based economy in Malawi, and it is usually dubbed as the ‘green gold’ of the country. Tobacco is the main cash crop accounting for about 10 percent of gross domestic product (GDP) and more than 60 percent of total exports. Its history as a commercial crop in Malawi dates to the 1890s. It mainly remained a large-scale farm crop after Independence in 1964 due to restrictions imposed under the Special Crop Act of 1964 – which restricted smallholder farmers from participating in some of the commercial crops. With respect to tobacco, until 1992, smallholder farmers were restricted in cultivating burley and flue cured tobacco. In a dualistic agricultural system of estate and smallholder farmers, cultivation of high value crops such as burley and flue cured tobacco was the privilege of the estate sub-sector. Following the repeal of the Special Crop Act in 1993, the cultivation of burley tobacco and other cash crops was liberalised, allowing smallholder farmers to participate in the cultivation of high value crops. The liberalisation of tobacco cultivation led to declining profitability in the estate sector and smallholder farmers have become important players particularly for burley tobacco, although yields have declined. Tobacco is estimated to be cultivated by more than 20 percent of smallholder farmers in Malawi.

The competition issues in the tobacco sector need to be understood in terms of the organisation of production, transportation, grading and marketing, and the existing legal and regulatory frameworks. These processes involve different players including growers, grower associations, transporters, buyers, grading companies, auction markets, technical support and regulatory institutions. On the production side, there are two types of growers – estates and smallholder farmers. Smallholder farmers have recently become the main producers of burley tobacco. In terms of organisation, smallholder farmers are in two groups – individual farmers and those that are members of farmer organisations. There are two main farmer organisations that represent smallholder tobacco growers, namely: Tobacco Association of Malawi (TAMA) and the National Association of Smallholder Farmers’ in Malawi (NASFAM). These grower associations support the smallholder growers in agronomic issues, the transportation of tobacco to the markets and the marketing of tobacco at the Auction Holdings. Growers are being supported by technical institutions with respect to agronomic services, research and development and extension services such as the Agriculture Research and Extension Trust (ARET).

The marketing services for tobacco in Malawi are provided by the Auction Holdings Limited through their auction floors in various parts of the country: Limbe floors, Lilongwe Floors, Chinkhoma Floors and the Mzuzu floors. Auction Holdings Limited is also responsible for settlement of payments to growers through their bank accounts. Auction Holdings Limited is a group of companies with subsidiaries dealing with trading of agricultural inputs, purchase of tobacco on auction floors, and re-grading of tobacco returned from auction floors. Tobacco in Malawi is also marketed through a contract farming system in which tobacco buyers enter into a contract with growers to buy tobacco at agreed prices for specified grades of tobacco. On the demand side, there are several buyers that participate in the tobacco auction markets. There are currently eight tobacco buyers including Limbe Leaf, Alliance One, Stancom Tobacco, Premium TAMA, Africa Leaf, Associated Tobacco Company, Malawi Leaf and Japan Tobacco International. The tobacco buyers have an association known as the Tobacco Exporters Association of Malawi (TEAM).

There are two layers of regulatory activities in the tobacco sector. The overall policy guidance for the sector is provided through the Ministry of Agriculture and Food Security (MoAFS). The government through the MoAFS provides strategic direction for the development of the tobacco sector in Malawi. The regulatory function in terms of marketing of tobacco in Malawi is vested in the Tobacco Control Commission (TCC), a body created by an Act of Parliament, Tobacco Act Chapter 65:02. TCC draws its membership from government institutions, buyers' association and growers. The main mandate of TCC is to control and regulate sales of tobacco on auction floors.

1.2 Objectives of the Study

The main objective of this study is specifically to evaluate the context, the structure and the functioning of the tobacco sector from the competition point of view in order to identify the conditions of the competition in the tobacco sector at various stages of the value chain. The specific objectives of the study are:

- To analyse the structure of the tobacco sector and market,
- To establish the level of collaboration of the various regulatory authorities and the harmonization of the pieces of legislation that establishes them so as to facilitate entry into the market by new players and effective enforcement of competition laws,
- To determine capacity building requirements that may be necessary for the Malawi Competition Commission staff to enable the Commission to effectively carry out its mandate, and
- To give the Malawi Competition Commission a basis on which to effectively contribute to policy formulation with regards to structure and practices in the tobacco sector to promote competition.

1.3 Limitations of the Study

The main limitation of the study is the lack of recent data at firm level at various stages of the value chain in the tobacco sector. First, there are capacity constraints in all the main institutions that are supposed to keep data for the industry. The growers' database is supposed to be maintained by the Tobacco Control Commission, but the only data available goes up to 2007. The Tobacco Association of Malawi does also not have updated information about the membership. This lack of vital information for a sector is problematic for efficient and effective regulation of the industry. Secondly, there was unwillingness from Auction Holdings Limited to provide auction market data – volumes and prices at which each merchant purchased various types of tobacco. This data is also expected to be deposited with TCC as the industry regulator. Unfortunately, TCC does not have such data and a request to AHL through TCC to provide such data was not honoured in spite of several reminders. The lack of firm level data for tobacco buyers made it difficult to undertake multivariate analysis of the relationship between auction prices and the buyer power in the sector. Thirdly, there is limited literature on the structure and performance of the tobacco sector in Malawi and other countries in southern Africa. Most of the available literature is dated, published prior to 2007. This made it difficult to have an in-depth perspective of regional issues in the tobacco sector.

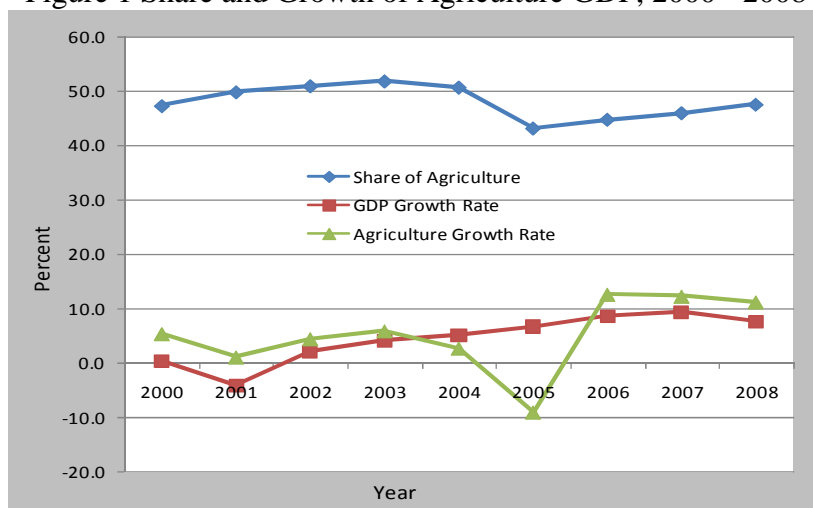
2. Economic and Social Context and Structure of the Tobacco Sector

2.1 Macroeconomic and Social Context

Malawi is an agriculture based economy dominated by rain-fed cultivation. The agricultural sector contributes significantly to the Malawian economy in terms of its contribution to national output, employment, international trade and rural livelihoods. The agricultural sector contributes more than 35 percent of Gross Domestic Product (GDP). Agriculture is also a major source of livelihoods for more than 85 percent of the population which is mostly rural. National surveys estimate that crop production accounts for 74 percent of all rural incomes (Chirwa, 2009a). The agriculture sector in Malawi is also dominated by a few crops based on mainly rain fed cultivation. The main agricultural commodities grown by rural households are maize, rice, cassava, groundnuts, pulses, sorghum, millet, cotton, tobacco, tea and coffee. The main crop grown by the smallholder farmers is maize, the main staple crop in Malawi. Maize is cultivated by smallholder farmers mainly to meet their subsistence needs, with less than 20 percent being produced as marketed surplus. Although maize is grown by almost all smallholder farmers in the rural areas, a large proportion of smallholder farmers do not produce adequate food to last them from one season to another and therefore rely on the market to provide food supplies.

The significant role of the agricultural sector in Malawi is evident from its contribution to the gross domestic product (Figure 1). Agriculture accounts for more than 40 percent of GDP and contributed more than 50 percent between 2002 and 2004. The manufacturing sector only contributes about 9 percent to Malawi GDP. The performance of the economy is also closely linked to the performance of the agricultural sector, except between 2004 and 2005 when the agricultural sector experienced a decline while GDP continued to grow at impressive rates.

Figure 1 Share and Growth of Agriculture GDP, 2000 - 2008



Malawi is one of the poorest countries in the world. The poverty incidence is also high in Malawi, with 52 percent of households living below poverty in 2005, which is lower than 54 percent in 1998 (GOM and World Bank, 2007). Since 2006, the poverty rate based on the model-based prediction has fallen to 39 percent in 2009 (NSO, 2010) as Table 1 shows.

Between 2005 and 2009 the urban poverty rate has fallen by 45 percent while the rural poverty rate has fallen by 19.5 percent.

Table 1 Trends in Poverty in Malawi, Headcount (%)

	1998	2005	2006	2007	2008	2009
National	54.1	52.4	45.0	40.0	40	39
Urban	18.5	25.4	25.0	11	13	14
Rural	58.1	55.9	47.0	44	44	43

Source: GOM and World Bank (2007), NSO (2010), GOM (2008)

Tobacco is the main cash crop in Malawi and it is estimated that the tobacco sector contributes about 13 percent to gross domestic product. According to GOM and World Bank (2007) about 15 percent of households from both middle and low income citizens grew tobacco in 2004. Tobacco plays an important role in improving the livelihoods of rural households in terms of employment and incomes. It has been shown that households that grow tobacco tend to have higher per capita consumption by 6 percent on average compared to those that do not grow tobacco (GOM and World Bank, 2003). Similarly, Murkherjee and Benson (2003) find that participation in tobacco cultivation increases per capita consumption by 9 percent and reduces poverty by 49 percent.

The tobacco industry generates employment at every stage of the value chain, directly or indirectly. Koester et al (2004) estimated that in 1999 about 1.6 million people were directly employed in the tobacco industry, of which 98 percent was generated in tobacco production (70 percent of these were farm workers) and the rest is generated grading, processing and marketing of tobacco.

The tobacco sector also plays an important role in international trade and the balance of payment position of the country. Tobacco remains the main source of foreign exchange earnings in Malawi. Table 2 presents the export composition and the share of tobacco exports between 1990 and 2009. More than 90 percent of exports in Malawi are agricultural commodities. Tobacco is the main export crop accounting for about 60 percent of export earnings, 23 percent of the tax base and about 10 percent of gross domestic product in the 1990s. Tea and sugar are the second and third most export crops, respectively. However, more recently, pulses, cotton, coffee and groundnuts are some of the emerging export crops. Tea and sugar are mainly grown under estate management with a small proportion of output produced by smallholder farmers. Since 1992, smallholder farmers began participating in the cultivation of tobacco. Most of the other crops such as maize, cotton, groundnuts have always been cultivated mostly by smallholder farmers.

Table 2 Share of Agricultural Commodities and Tobacco in Exports in Malawi, 1990 – 2009

Product	1990-1994	1995-1999	2000-2005	2006	2007	2008	2009
Tobacco	69.9	70.5	54.7	61.6	52.6	66.6	56.2
Tea	9.7	9.0	8.8	7.4	7.4	3.2	5.9
Sugar	6.7	7.0	11.4	5.7	8.4	6.0	5.8
Groundnuts	-	-	1.9	3.5	3.4	1.2	-
Cotton	1.1	1.7	2.1	2.0	3.1	2.5	2.3
Rice	0.2	0.5	0.2	0.2	0.2	0.1	-
Coffee	2.3	2.7	0.8	0.7	0.5	0.2	-
Pulses	0.5	1.7	0.8	2.5	1.8	0.7	-
Maize	0.1	0.3	-	-	-	-	-

Other (incl. manufactured)	9.5	6.6	19.3	16.3	22.6	19.6	-
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Source: Computed based on Reserve Bank (various) *Financial and Economic Review* data

The tobacco sector also plays an important role in the generation of government revenue through various takes including withholding taxes on every sale at the auction floors. The tax revenue from sale of tobacco by growers accounts for about 8 percent of budgeted domestic revenues.

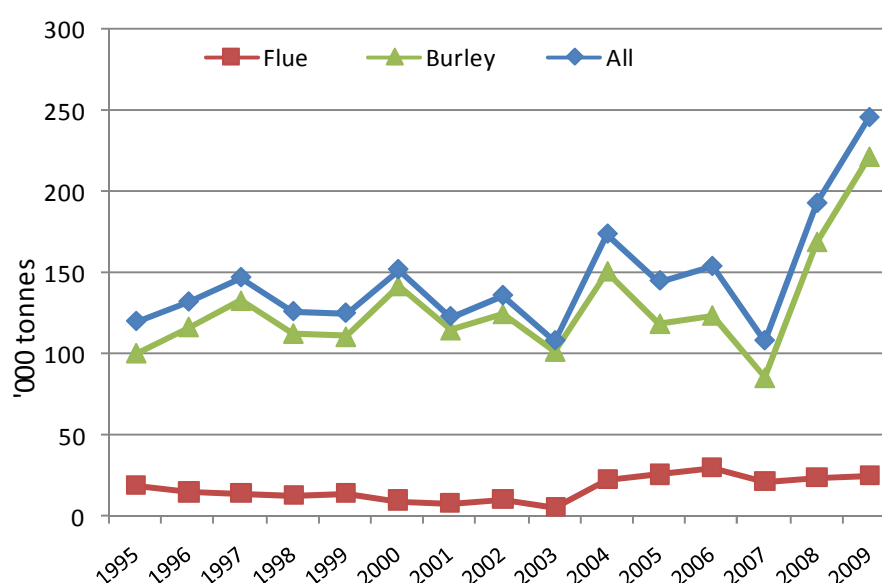
2.2 Tobacco Sector

The tobacco sector value chain constitutes production, transportation of tobacco to the markets, grading of tobacco and the marketing of tobacco on the domestic markets and exports. The size, characteristics and organisation of these stages of the value chain have implications on the nature of competition in the tobacco sector and the welfare of smallholder farmers.

2.2.1 Production

There are different types of tobacco grown in Malawi. Tsonga (2004) identifies six types of tobacco grown in Malawi including burley, flue-cured (Virginia), northern division dark fire cured, southern division fire cured, sun-air cured and oriental tobacco. However, burley tobacco is the main type of tobacco grown in Malawi accounting for more than 95 percent of the total tobacco production. Prior to liberalisation in 1992, smallholder farmers were only allowed to grow fire-cured, air-cured and oriental tobacco while burley and flue-cured tobacco were estate crops. Figure 2 shows the production trends of burley and flue-cured tobacco production in Malawi since 1995. The size of the tobacco sector in terms of production has averaged about 154,000 tonnes of between 2000 and 2009, of which 135,000 tonnes is burley tobacco. The growth of the tobacco sector has been erratic, although recently the sector has witnessed tremendous growth. It is estimated that smallholder farmers only account for 25 percent of the flue cured tobacco cultivation in Malawi; the rest is produced by estate growers.

Figure 2 Trends in Tobacco Production in Malawi, 1995 - 2009



Source: National Statistics Office 2010

With liberalisation, the smallholder sector has become the main producers of burley tobacco and there has been steady decline in the contribution of the estate sector in burley production (Negri and Porto, 2008). In 2006, the smallholder sector produced 63 percent of burley tobacco and this has risen to about 98 percent in 2009 (TAMA, 2008; NSO, 2008). Land under burley tobacco cultivation more than doubled from 59.195 hectares in 1995 to 128,940 hectares in 1997 (Koester et al, 2004). With the dominance of smallholder farmers in burley tobacco production, it can be argued that by removing institutional barriers to entry, the tobacco sector at production levels has become very competitive. The creation of tobacco growers clubs has also facilitated the entry of small-scale farmers with small land holdings to participate in a high value agricultural crop.

There are two categories of farmers in the production of tobacco in Malawi: estate farmers and smallholder farmers in farmer clubs. Estate growers are those that cultivate tobacco on leasehold or free hold land and register as individual growers. These are typically medium to large scale growers. Club growers are smallholder farmers who are organized in clubs of 10 – 30 farmers cultivating tobacco on customary land. Table 3 presents the number of registered estate growers and clubs by type of tobacco between 2000 and 2007. The table shows that the number of estate growers has been declining across all tobacco types and on aggregate the total number of estate tobacco growers has fallen from about 62,000 growers in 2000 to 11,000 in 2007. The movements in the number of smallholder tobacco clubs have no clear pattern but the total number of clubs has been about 20,000 per year.

Table 3 Number of Estate and Club Growers by Type of Tobacco

Year	Burley	Flue Cured	NDDF	SDF	S/Air	Total
<i>a) Estate Growers: Number of Estates</i>						

2000	48,688	1,100	12,045	1	-	61,834
2001	45,836	1,094	12,512	1	-	59,443
2002	44,216	1,830	10,129	17	-	56,192
2003	31,069	693	6,993	56	-	38,811
2004	25,381	706	2,948	30	-	29,065
2005	22,429	537	587	44	-	23,597
2006	19,500	747	279	2	-	20,528
2007	10,750	445	119	0	-	11,314
<i>b) Smallholder Farmers: Number of Clubs</i>						
2000	14,873	29	2,185	165	-	17,252
2001	13,768	140	2,283	178	-	16,369
2002	21,933	199	2,105	191	-	24,428
2003	18,288	175	5,030	409	-	23,902
2004	14,322	375	2,106	441	-	17,244
2005	19,610	451	548	456	-	21,065
2006	27,091	505	564	70	-	28,230
2007	14,988	460	428	1	24	15,901

Source: <http://www.tccmw.com>

Note: Data from 2008 onwards was not available.

2.2.2 Transport Services

Due to the limited number of tobacco auction markets in Malawi, the transport sector – particularly the road transport sector - is a critical sector in the tobacco value chain for smallholder tobacco farmers. The lack of competition and competitive services in the transport sector can have welfare-reducing effects on the producers of tobacco.

2.2.3 Tobacco Grading

Grading of tobacco is done by farmers. However, there is one grading company that offers grading services to farmers particularly for tobacco that has been rejected at the auction floors because of poor grading. This re-grading company, the Tobacco Investments Limited, is a wholly-owned subsidiary of Auction Holdings Limited. It is primarily responsible for re-handling tobacco bales that have been returned from the floors due to different reasons including mixing, nesting and bad hessian. The Tobacco Investments Limited also handles factory floor sweepings on behalf of buyers and operates in all the Auction Floors.

2.2.4 Marketing

The marketing services of tobacco involve grading of tobacco and the sale of tobacco on auction floors or through contract arrangements. These processes involve various players whose structure and conduct may have implications on the competitive outcomes. There are currently two official ways through which tobacco is marketed in Malawi: at the Auction Floors and through contract sales. There are reports that some of the tobacco is smuggled outside the country and hence unofficially marketed outside the country, but the volumes involved are not significant (Koester et al, 2004).

The Auction Floors are owned by the Auction Holdings Limited which is the only licensed company to offer tobacco auction markets. Trading at the Auction Floors is based on the American auction in which the start price, based on the quality of the leaf and other factors, is announced and buyers bid to purchase the bale of tobacco (AHL, 2007). However, the grower has the option to reject the final price if it is not satisfactory.

The contract market is quite recent and started operating in 2006. Growers and buyers sign contracts that state that growers shall sell their tobacco to the specified buyer for specified grades of tobacco at specified prices. These contracts are allocated and vetted by TCC. During the sale the tobacco is brought to the auction where it is auctioned between the contracting parties. Growers under the contract system have the option of selling their tobacco on the auction markets if they are dissatisfied with the prices under the contract system (AHL, 2007; Koester et al, 2004). The contract market system is operated parallel to the auction market such that contract tobacco is also brought to the auction, but when farmers feel that they can obtain better prices on the auction they are allowed to change the marketing system one. It is estimated that only 4 percent of the tobacco was marketed under contract arrangements in 2005/06 season but this increased to 25 percent in the 2007/08 season (TAMA, 2008) and to 31 percent in the 2009/10 season.

The tobacco market is characterized by many sellers of tobacco and very few graders and buyers. These buyers participate both in the auction markets and in contract arrangements with growers. It is, therefore, a market with low seller concentration but high buyer concentration. It is in the marketing of tobacco where competition issues and uncompetitive behaviour are a matter of greatest concern in this sector.

There have been changes in the number of buyers of tobacco over time. According to Koester et al (2004), in 2004 there were 5 buyers with the largest one accounting for 48 percent of the tobacco sold at the auction market and the three largest buyers accounting for 92 percent of the market. In 2009, the number of tobacco buyers increased to 7 companies including Limbe

Leaf, Alliance One, Premium TAMA, Africa Leaf, Associated Tobacco Company, Malawi Leaf and RWJ Wallace. Since 2000, there have been company exits such Tobacco Marketing Limited and Premier Leaf and new entrants including Premium TAMA, Associated Tobacco Company and Malawi Leaf. The market is dominated by Limbe Leaf and Alliance One - Stancom, accounting for more than 90 percent of the market (Jaffee, 2003; Otanez et al, 2007). However, there has been a decline in the share of the tobacco since 2007, with the share of the three tobacco merchants only falling to 69 percent of the burley tobacco market in 2010.

Another characteristic of the buyers in tobacco industry is that most of the companies are international companies, wholly owned subsidiaries or joint venture firms with local investors (Table 4). These international companies have contracts with tobacco manufacturers and are also the dominant buyers of tobacco in Malawi. In addition, there is interlocking ownership and directorship in the marketing institutions. For example, Premium TAMA is a joint venture between Premier Leaf and TAMA, in which TAMA holds 7.5 percent. Malawi Leaf is a wholly owned subsidiary of the Auction Holdings Limited. Malawi Leaf was introduced in 2006 to improve buyer competition at the time when there were strong concerns that existing buyers were manipulating prices through uncompetitive behaviour.

Table 4 Ownership Structure of Tobacco Buyers in Malawi 2010

Name of Buyer	Type of Ownership	Shareholders
1. Limbe Leaf	Foreign/Local	- Universal Corporation (USA) - Press Corporation (Malawi)
2. Alliance One	Foreign	Alliance One International (USA)
3. Africa Leaf	Foreign	Japan Tobacco International
4. Associated Tobacco Company	Foreign	Associated Tobacco Company
5. Malawi Leaf	Local	Auction Holdings Limited
6. Premier TAMA	Foreign/Local	- Premier Leaf Limited - Tobacco Association of Malawi
7. RWJ Wallace	Local	Private local investors

Source: Koester et al (2004) and TCC (2010)

2.4 International and Regional Perspectives

Internationally, there has been a general decline in average world prices of tobacco leaf (Poulton et al, 2007; Jaffee, 2003). The decline in international tobacco prices adversely affects the profitability of tobacco particularly for low productivity countries such as Malawi. The other international issues that have implications for tobacco production in Malawi are the international conventions that depress the demand for cigarettes such as the WHO Framework Convention on Tobacco Control for which a number of countries are using to ban smoking in public and tobacco advertising, and the recent proposal to ban burley ingredients in cigarettes.

The tobacco industry in Malawi faces several challenges due to the regional and international environment. Malawi is the second largest producer of tobacco leaf in Southern Africa following Zimbabwe. Malawi mainly produces burley tobacco which accounts for just 15

percent of world tobacco production, in contrast to flue-cured Virginia type of tobacco which accounts for 60 percent of world tobacco production. Compared with other countries such as Zimbabwe, the average yields of tobacco in Malawi are much lower. For example, Jaffee (2003) notes that Malawi farmers have been experiencing a decline in productivity, with Malawian farmers producing less than 1000 kg per hectare compared to more than 2000 kg per hectare among Zimbabwean farmers between 1990 and 2000. The low productivity has also led to declining profitability of tobacco farming in Malawi. With the resurgence of the tobacco industry in Zimbabwe due to the entry of the Chinese in the market, the demand for Malawi flue cured tobacco will face a major challenge although the Chinese seem to favour the type of flue cured grown in Zimbabwe. Another regional threat to Malawian tobacco is increasing commercialisation of tobacco production in neighbouring countries such as Mozambique where some of the buyers of tobacco in the Malawi auction are directly producing tobacco on their farms or through increased contract farming. This implies that Malawi tobacco is likely to be filling the residual demand which can adversely affect tobacco prices.

The other tobacco producing countries in Southern Africa are Zimbabwe, Tanzania, Zambia and Mozambique. The main characteristics of the market arrangements for tobacco in these countries are the high buyer concentration and the participation of the same buyers in different regional markets. Where auction marketing is the channel for marketing tobacco, auction services are also monopolized. However, in other countries such as Zimbabwe, new investors from China have opened a tobacco sales floor increasing the level of competition. This has increased the number on auction floors to 4 in Zimbabwe. Another development in the Zimbabwean market is the improvement in the price of tobacco with the coming of the Chinese who mainly buy flue-cured tobacco. The Chairman of the Tobacco Industry and Marketing Board was quoted as saying ‘Over the past years \$2.99 per kg was the ceiling price of our tobacco. A cartel of merchants used to fix the price but the Chinese have broken this. They are not members of this cartel.’¹ The average prices are in the range of \$3 - \$4.29 per kg in Zimbabwe. Tanzanian farmers sell their tobacco through contract arrangements (Rweyemamu and Kimaro, 2006) while in other countries such as Zambia and Zimbabwe there is a mix of auction and contract arrangements. In Zambia, there is also high buyer concentration with only a few buying companies, buying tobacco under contract from smallholder farmers (Likulunga, 2005).

3. Sectoral Policies and Main Support Programs

3.1 Tobacco Sector National Policy

There is no specific policy governing the tobacco sector. Most of the policies and strategies relating to tobacco are articulated within agricultural sector wide policies and/or national development strategies. For example, according to GOM (2006), the country strives to maintain the position of market leader in burley and to add value to tobacco. The main strategy is to increase production of flue cured, Northern Dark Fired tobaccos by rationalization of fees, creating a more efficient and fair system between farmers and auction houses, strengthening contract farming, and exploring additional markets for tobacco, including tobacco products (GOM, 2006).

¹ See http://news.xinhuanet.com/english2010/china/2011-02/22/c_13744500.htm

3.1.1 Internal Trade

The existing conditions on internal trade restrict the sale of tobacco other than on the auction floors or under contract arrangements with buyers. Previously, tobacco was also sold to intermediate buyers – who usually purchased tobacco from smallholder farmers. The intermediate buyers in turn sold the tobacco at the auction floors. This system of intermediate buyers was suspended by the Government in 2000, although they continue to operate unofficially. For instance, in 2004, about 14 percent of tobacco farmers sold their tobacco to intermediate buyers (Chirwa, 2009b). Some of the reasons for the suspension of the intermediate buyer system included lower prices paid to growers, reduction in the quality of tobacco and increased theft of estate tobacco by tenants (Koester et al, 2004). However, an econometric study of farmer organisation and profitability of tobacco among smallholder farmers reveal a significant relationship between use of intermediate buyers and profitability among smallholder tobacco growers (Chirwa, 2009b). The gross returns from burley farming were higher among farmers that sold tobacco to intermediate buyers than those that sold through auction markets, hence the argument that intermediate buyers offered low prices seem not to hold. Although the intermediate buyer system is not competitive, the higher benefits accruing to growers are a result of speculative behaviour of intermediate buyers many of whom were inexperienced and tended to offer better prices to farmers in anticipation of higher auction prices.

3.1.2 Foreign Trade

Tobacco is exported by the companies that participate in auction markets and contract arrangements. Most of the buyers have processing plants and export tobacco in semi-processed form. Smallholder farmers are prohibited from direct exportation of unprocessed tobacco, although there are reported cases of smuggling of tobacco to neighbouring countries. Tobacco exporters and importers require export and import permits from TCC as provided under the Control of Tobacco Auction Floors Act. Exports are subject to an export allowance of 15 percent of taxable income from export proceeds; this is an increase from 12 percent (GOM, 2010).

There is a lot of diversity in terms of the export destination of various types of Malawian tobacco. In 2006, burley tobacco was exported to 57 countries, with 5 countries accounting for more than 50 percent of exports – Germany (19 percent), USA (16 percent), Russia (8 percent), Belgium (5.7 percent) and RSA (5.4 percent). Flue cured tobacco was exported to 28 countries, with Zimbabwe, Germany, Australia accounting for 33.4 percent, 23.7 percent and 5.5 percent, respectively. Northern Division Dark Fired tobacco was exported to 11 countries, with 70.4 percent exported to Egypt while oriental tobacco was exported to 2 countries with the Netherlands accounting for 92 percent.

3.1.3 Fiscal Policy

The sale of tobacco at the Auction Floors is subject to withholding tax set at 7 percent of gross sales until 2008/09 agricultural season. According to GOM (2010), with effect from the 2010 marketing season the withholding tax on all tobacco sold at the Auction Floors was reduced from 7 percent to 3 percent. Between 2003 and 2009, smallholder farmers in farmer clubs or associations were exempted from payment of withholding taxes based on the fact that most of the farmers in clubs were poor farmers. However, over time it has been noted that some of the medium size farmers or estate growers were also registering under clubs in

order to evade withholding tax (GOM, 2010). As a result, the tax exemption for smallholder farmer clubs or associations has been removed and all tobacco is subject to withholding tax. Given that most of the burley tobacco is sold by smallholder farmers who were exempted from withholding taxes, the removal of the tax exemption is likely to improve Government tax revenue earned from tobacco sales. Using the recent 2010 sales, the withholding tax revenues from tobacco sold at the auction floors at the rate of 3 percent is equivalent to US\$10.8 million, about 8 percent of total budgeted domestic revenues. However, the disadvantage of the withholding tax is that it turns out to be a turnover tax that ignores the cost of production and among smallholder farmers this has the potential to wipe out the profitability of tobacco cultivation.

3.2 Main Support Programs

Two main support programmes can be associated with the tobacco sector in Malawi, particularly the smallholder tobacco sub-sector: the Hessian scheme and the farm input subsidy programme. In addition, the Government has been intervening in the tobacco market by providing minimum prices for various grades and types of tobacco traded at the auction floors.

3.2.1 Hessian Exchange Scheme

The Hessian Scheme was first managed by AHL prior to transferring this responsibility to TAMA in 2003. The Hessian scheme is operated by on the Hessian levy revolving fund that provides Hessian to tobacco growers (Maleta, 2004). In this scheme, growers contribute a fee that is deducted by AHL towards the replacement of worn out Hessian pieces which are recycled to the growers. The cost of the Hessian is not significant. Koester et al (2004) estimated that the Hessian levy ranged from 0.5 percent to 1.6 percent of the marketing costs.

However, compared with the cost of Hessians in the market, farmers under the Hessian scheme tend to benefit in form of reduced cost. The only problem with the Hessian scheme is that there seem to be lack of transparency in the management of the scheme and some of the farmers have difficulties accessing the Hessians although this is deducted from smallholder tobacco proceeds. In addition, not all smallholder farmers have access to Hessians although they get deducted; hence they end up paying twice which increases farmers' cost. Koester et al (2004) also argue that TAMA has incentives to service its members first than NASFAM farmers with the latter more likely to buy Hessians on the open market.

3.2.2 Farm Input Subsidy Programme

The smallholder tobacco sector also benefited from the targeted Farm Input Subsidy Programme (FISP) between 2005/06 and 2008/09 agricultural season. The FISP targeted smallholder tobacco farmers and provided them with two subsidy coupons to purchase 2 bags of fertilizers (1 bag of 50 kilograms of CAN and 1 bag of 50 kilograms of D Compound) at subsidized prices. The price that the farmers paid for fertilizers with a subsidy coupon has ranged between MK500 and MK800 per coupon redemption. The FISP has been benefiting 100,000 smallholder tobacco farmers and involved some 20,000 metric tons per year (Dorward et al, 2010). Since the 2009/10 agricultural season, GOM decided to exclude smallholder tobacco farmers from the subsidy programme and it is now focusing on maize and other food crops.

The subsidy programme benefited tobacco farmers in terms of reduced cost of fertilizers, with farmers saving as much as two-thirds on the commercial price. This was a significant cost reduction, especially in the 2008/9 season in which international fertilizer prices rose significantly. There have been concerns on the economic efficiency of the subsidy programme in Malawi. SOAS et al. (2008) show that benefit/cost ratios for the 2006/07 programme could, with reasonable variation in assumptions, range from 0.76 to 1.36, with a mid-estimate of 1.06. In the 2008/09 subsidy programme, Dorward et al (2010) find the benefit cost ratio in the range 0.8 to 1.10 depending on assumptions about fertilizer responses. This is a year in which international fertilizer prices increased substantially.

4. Institutional and Legal Framework

4.1 Institutional Framework

The institutional framework in the tobacco sector can be divided into five functions including policy formulation, regulation of growers and buyers, promotion of competitive behaviour, provision of support services and organisation of smallholder farmers. Various institutions play different roles in the provision of various services in the tobacco sector. Maleta (2004) provides a detailed analysis of the institutional and legal framework in the tobacco sector and the institutional changes witnessed up to 2004.

4.1.1 Policy Formulation and Directives

The policy direction in the tobacco sector is provided by the Government of Malawi through its strategic document and agricultural sector-specific policy and strategic documents. These strategic and policy issues are implemented by the Ministry of Agriculture and Food Security (MoAFS). The Minister of Agriculture and Food Security has powers for policy directions in the Tobacco Act and the Control of Tobacco Auction Floors Act. For example, under the Tobacco Act, the Minister for Agriculture is vested with powers to control uprooting of tobacco plants and approval of seed to be grown in Malawi and restrict tobacco production in scheduled areas and to only those growers (Maleta, 2004). Similarly, under the Control of Tobacco Auction Floors Act the Minister is responsible for the appointment of the Board of the Tobacco Control Commission, approves selling commissions and charges, and defines tobacco classes and grades.

More recently, beginning in 2006, the Government of Malawi, through the MoAFS started setting minimum prices for agricultural produce cultivated by smallholder farmers including different grades of tobacco, contrary to the price deregulation under structural adjustment programmes. This was due to concerns of lower prices offered by buyers due to perceived high monopsony power resulting in auction prices that were lower than the average cost of production of tobacco. In the 2008 marketing season, the minimum price prescribed by MoAFS for good quality leaf was US\$2.20 per kilogramme while in the 2010 marketing season the minimum price for burley tobacco was set at US\$2 per kilogramme (from \$2.15 in 2009). There is no government institution which is a buyer of last resort for the tobacco that is not purchased by buyers. When government first introduced minimum prices in 2006, buyers were reluctant to buy tobacco. The result was very high rejection rates and eventually the minimum mandated prices were lifted in the middle of the marketing season. Consequently, adherence to these minimum prices by buyers remains questionable and almost in each marketing season there are suspensions of auction markets due to disagreements over prices between growers and buyers.

Maleta (2004) documents several constraints facing the MoAFS in providing guidance to the tobacco industry. These constraints include capacity problems such as inadequate number of staff and skills, weak policy formulation, monitoring and evaluation, inadequate financial resources and overlaps of policy analysis and formulation by various Ministries and departments.

4.1.2 Regulation of Growers and Buyers

Entry into tobacco production, grading and marketing is regulated by the Tobacco Control Commission which was established under the Control of Tobacco Auction Floor Act, Chapter 65:03. The TCC is therefore the GOM regulatory authority for the tobacco industry. The functions of TCC include regulating the production, manufacture and marketing of tobacco; advising government on the sale and export of tobacco; promoting and expanding the sale of tobacco; collating statistics relating to tobacco; controlling and regulating the sale of tobacco; registering and licensing tobacco growers and sellers; and defining tobacco grades and classes for the purposes of selling and buying (TCC, 2010). The conditions for licensing growers, graders, buyers, manufacturers and exporters are provided in the Control of Tobacco Auction Floors Act.

The Control of Tobacco Auction Floors Act also stipulates that Board of TCC shall comprise the Chairman appointed by the Minister, two members from the Agricultural Development and Marketing Corporation (ADMARC), two members from TEAM, two members representing tobacco growers and two members representing the Government of Malawi. It is clear from the composition of the Board, that it is not an independent regulatory authority as it is dominated by stakeholders with vested interest and bodies that are regulated such as growers and tobacco exporters.

The liberalisation of burley tobacco in 1992 increased the number of smallholder growers who obtained production licenses. This created pressure on the staffing of TCC and its ability to ensure that only licensed growers were cultivating tobacco in designated areas as required under the Control of Tobacco Auction Floors Act. Matela (2004) also notes that TCC is ineffective in dealing with what is considered to be collusion and price fixing among the buyers on the auction floors. This weakness partly results from the lack of independence of the regulator from the regulated, which may lead to regulatory capture.

In addition, the TCC does not have the necessary information for the industry such as updated number of growers of different classes, the number of registered growers relative to those that actually cultivates tobacco and updated detailed auction market information. This lack of information also makes it a weak regulatory institution and prone to regulatory capture.

4.1.3 Promotion of Competition

The role of promoting competition in Malawi is vested in the Competition and Fair Trading Commission (CFTC) established by the Government of Malawi under the Competition and Fair Trading Act of 1998. The main function of the CFTC is to investigate and prohibit anti-competitive practices and unfair trading practices. The CFTC was established in 2005 but it has remained understaffed and under-resourced. Currently, it is driven by the Commission appointed by the Minister without a full complement of a technical secretariat. The CFTC relies heavily on the technical staff of the Ministry of Industry and Trade and consultants to

discharge its duties. The critical positions of the secretariat such as the Director General and other specialists were advertised more than a year ago, but by August 2010 these had not yet been filed.

These capacity issues are likely to make the CFTC ineffective in investigating cases of suspected anti-competitive behaviour. For example, there have been documented reports of collusion by buyers in the tobacco industry by the Anti-Corruption Bureau (Otanez et al, 2007), but the CFTC has not investigated these issues. Other anti-competitive practices and behaviour have been reported in the various sectors including in tobacco, banking and transport sectors and collusive pricing by associations, but there have been no investigations by the CFTC. For instance, Minibus Owners Association of Malawi (MOAM) openly agrees on prices, a practice that is contrary to section 34 of the Competition and Fair Trade Act of 1998. A study by TAG (2007) highlighted the setting of guide prices by the Road Transport Operators Association (RTOA) as potentially anti-competitive under section 34 of the Competition and Fair Trading Act. These practices have not been prohibited by the CFCT. The other problem with the institutional set-up of the competition commission is the absence of a strong technical secretariat that can discharge the functions of the CFTC independently. In addition, there are potential conflicts of interest in the composition of the Commission as provided by the Act as it includes persons representing business interests.

4.1.4 Provision of Support Services

Support services to tobacco farmers are provided by the Ministry of Agriculture and Food Security and the Agricultural Research and Extension Trust.

4.1.4.1 Ministry of Agriculture and Food Security

The MoAFS is responsible for providing extension services to all farmers in Malawi. However, its capacity to provide such services has been undermined by the decline and non-replacement of extension workers following structural adjustment programmes. It is estimated that the Government extension system is operating at 40 percent of its capacity. As a result a small proportion of farmers have access to extension services. National surveys estimate that only 13 percent of smallholder farmers receive extension advice from public extension services (GOM and World Bank, 2007).

4.1.4.2 Agricultural Research and Extension Trust

Tobacco farmers are also supported by extension and research services provided by the Agricultural Research and Extension Trust (ARET). ARET was established in 1985, as a successor to other government institutions, as a trust with GOM and TAMA as the trustees. According to Maleta (2004), ARET's mandate includes improving efficiency, diversity and sustainability of agricultural production; conducting research for agricultural improvements and crop diversification; providing agricultural training advice to estate owners, their employees and tenants; and improving the welfare of all tobacco farmers. ARET has been critical in the development of new tobacco varieties and in the dissemination of these technologies to tobacco farmers. ARET is the sole producer of tobacco certified seeds in Malawi. However, as Maleta (2004) notes, the major challenge has been the low adoption rates of technologies by smallholder farmers, consequently leading to low productivity in the smallholder sector.

4.1.5 Tobacco Markets

The marketing services for tobacco in Malawi are provided by the Auction Holdings Limited, an unlisted public company in which ADMARC – a state-owned enterprise – is the major shareholder (42.6 percent). AHL was created in 1965 as a successor to the Nyasaland Holdings Limited. The mandate of the AHL is open and includes operation of auction floors, brokerage of financial instruments, planting and cultivation of any agricultural produce, transportation and trading. AHL has three subsidiaries, the Agricultural Trading Company (ATC), the Tobacco Investment Limited (TIL) and the Malawi Leaf Company. ATC is involved in the retailing of agricultural inputs, TIL is involved in tobacco grading and re-handling and Malawi Leaf is one of the tobacco buying company at the Auction Floors. AHL tobacco auction operations are governed by the Control of Tobacco Auction Floors Act which gives TCC the authority to license and supervise the Auction Floors. Currently, AHL is the only institution that is holding the licence to provide a market place for the auctioning of tobacco in Malawi. Under the Control of Tobacco Auction Floors Act, all tobacco in Malawi, including under contract farming, is supposed to be sold at the Auction Floors. Hence, AHL enjoys monopoly rights in the provision of tobacco marketing services. With lack of competition in marketing services, there are no incentives to offer efficient services to growers and it becomes difficult to determine whether farmers are getting value for money services.

AHL had traditionally provided tobacco marketing services at Limbe and Lilongwe Auction Floors. More recently, AHL has opened two other markets: Chinkhoma Floors and the Mzuzu Floors. In addition, AHL operates mini auction floors at Mgoche in the Southern region, Linyangwa and Mpasadzi in the Central region and Kabwafu in the Northern region (TCC, 2006). Maleta (2004) notes that AHL's decision to open the Mzuzu Auction Floors was more political due to the fact that the throughput of tobacco in the northern region at the time did not make the market commercially viable. Although, the number of markets has increased, the problem of congestion at the markets remains a challenge for efficient market operations, particularly for the Lilongwe auction market. The congestion results from the number of bales with non-tobacco related materials, disagreements over auction prices which lead to suspension of market activities. These lead to slow clearance of the auction floors to create space for new tobacco and result in queuing of trucks outside the auctions for as long as 4 weeks. AHL has, however, improved on its payment system to growers through the introduction of electronic transfers to growers' bank accounts.

The dominant view from stakeholders and farmer clubs is that there is need to open more markets, but there seem to be opposition to entry of other investors in auction markets from the existing monopoly operator. Some farmer groups have officially approached Ministry of Agriculture and Food Security to open additional market in order to reduce transaction costs to smallholder farmers.

4.1.6 Farmer and Exporter Organisations

There are three farmer or export organisations that serve the interest of growers and exporters in the tobacco sector in Malawi. The Tobacco Association of Malawi (TAMA) and the National Association of Smallholder Farmers' of Malawi (NASFAM) are farmer

organisations that have members drawn from the small and medium scale tobacco growers.² The Tobacco Exporters Association of Malawi (TEAM) is a membership association of tobacco exporters. These associations operate in different parts of the country, and there is no evidence of geographical market sharing. It is possible in one particular area to find TAMA and NASFAM tobacco clubs.

4.1.6.1 Tobacco Association of Malawi

TAMA is the oldest tobacco farmers' association and dates back to 1929 as the Nyasaland Tobacco Association. According to Maleta (2004) TAMA registered under the Trustees Incorporation Act in 1982 and its main object is to promote and develop the tobacco industry in Malawi and to advance and protect interests of sections and classes of tobacco producers. The membership of TAMA includes corporate growers, estates, cooperatives, farmer clubs and individual tobacco growers. TAMA has minority shareholding (2.4 percent) in AHL and in one of the tobacco buying company, Premier TAMA in which TAMA holds 7.5 percent of shares. Through TAMA its members have benefited from satellite depots and warehouses throughout the country, transport brokerage, tobacco marketing, extension services, the Hessian scheme, policy lobbying and advocacy. In addition, TAMA has in the past facilitated access to agricultural credit and loans, although it no longer plays this role due to increased loan delinquency. Maleta (2004) notes that a large proportion of the membership is dissatisfied with the quality of services received from the association and the lack of transparency and accountability. Its main source of revenue is a levy imposed on the gross sales of tobacco for their registered members, at 0.7 cents per kilogramme and is enforced by the Government.

4.1.6.2 National Association of Smallholder Farmers of Malawi

NASFAM is another farmer organisation whose membership is drawn from smallholder farmers and is organized in member associations. The member associations either specialize in particular cash crops or in mixed crops. NASFAM was created in 1994 out of the Smallholder Agriculture Development Project funded by the United States Agency for International Development (USAID) to organize smallholder tobacco production. Over the years, the mandate extended to diversification into the production of other cash and food crops including groundnuts, rice, chilli, cotton, soya and other legumes. The vision of NASFAM is to promote farming as a business among smallholder farmers. It draws its membership from smallholder farmers who usually cultivate less than 1 hectare of land, producing 60 percent food and 40 percent cash crops and use a hand hoe as their main tool for farming activities. The membership of NASFAM has grown in terms of membership, geographical coverage, scope of services and the coverage of crops.

NASFAM offers several services to their members including training and capacity building in farming activities and management of associations, facilitating access to farming inputs, market access and crop marketing, extension services and advocate policy changes. The membership has grown to 110,000 smallholder farmers across the country. Groundnuts, that have always been a smallholder cash crop, have reappeared as one of the export crop, a situation attributed largely to the NASFAM (Chirwa et al., 2008). Some of the associations involved in groundnuts cultivation have a fair trade label, which enable them export the

² There are other farmer organisations in Malawi that are crop specific focusing on paprika, cotton, cassava. Most of these farmer organisations are members of the Farmers Union of Malawi.

groundnuts at a premium. In the tobacco sector, NASFAM managed to convince Government to waive withholding tax among NASFAM tobacco growers in 2003, but this waiver was discontinued in 2010 following abuse of the system by some growers. Maleta (2004) also notes that NASFAM continues to facilitate access to credit and loan delinquency has been minimal among NASFAM members and it has managed to negotiate better prices for the transportation of tobacco to the Auction Floors. Chirwa (2009b) finds that farmers belonging to farmer organisations tend to have lower profits from burley tobacco cultivation, significantly so among TAMA members compared to NASFAM members. However, Negri and Porto (2008) find that membership to clubs is positively associated with productivity and tobacco sales per acre.

4.1.6.3 Tobacco Exporters Association of Malawi

TEAM represents all buyers of tobacco on the auction floors, processors and manufacturers; and is involved in negotiations and dialogue with all stakeholders in the tobacco industry from the Government to grower associations to TCC, ARET and AHL (Maleta, 2004). There has been concern, however, that by its membership structure, TEAM acts as a potential cartel of buyers of tobacco and this adversely affect the prices that are offered to growers at the Auction Floors.

4.2 Legal and Regulatory Framework

There are two tobacco specific pieces of legislation that have governed the operations in the tobacco sector from production to marketing in the past two decades. These are the Tobacco Act of 1970 and the Control of Auction Floors Act of 1964. In addition, the tobacco sector was also affected by other general agricultural sector legislation particularly the Special Crops Act of 1964 as repealed in the Special Crops (Repeal) Act of 1992. These various legislations affect the conduct of various stakeholders in the tobacco sector. In addition, to tobacco specific legislation and other general agricultural legislation, the conduct of various players in the tobacco sector is also required to be consistent with the provision of the Competition and the Fair Trade Act of 1998.

4.2.1 Growers' Regulatory Framework

The Tobacco Act of 1970 provides powers to the Minister responsible for agriculture to control and promote tobacco production, marketing and processing. Under the Tobacco Act, the Minister for Agriculture is vested with powers to control uprooting of tobacco plants and approval of seed to be grown in Malawi; restrict tobacco production in scheduled areas and to only licensed growers; restrict the purchase of tobacco to the licensed auction floors; imposes tax at an expressed rate per stated unit of weight; designate a licensing authority for the issuance of licenses to buy tobacco; and make regulations for better administration of the Tobacco Act (Maleta, 2004). The various fees and levies that growers pay at the Auction Floors are also regulated by the Tobacco Act. The fees and levies include the Hessian levy at \$0.39 per kilogramme, the TAMA or NASFAM levy at \$0.70 per kilogramme, the ARET levy at 1 percent of sales, the TCC classification at \$0.35 per kilogramme, the TCC cess at \$0.10 per kilogramme and the AHL commission at 3.5 percent (Koester et al, 2004).

Another legislation that has played a critical role in the regulation of tobacco production is the Special Crops Act that restricted burley tobacco to large scale estate production and restricted smallholder participation in burley cultivation. Following the liberalisation in the

1980s and early 1990s, the Special Crops Act was repealed in 1992 and effectively opened the tobacco sector to smallholder farmers.

4.2.2 Tobacco Market Regulatory Framework

The Control of Tobacco Auction Floors Act of 1970 provides for the establishment of the TCC with powers to control the production and marketing of tobacco in Malawi. The main objective of the Act is to provide a framework within which licensed auction floors operators in Malawi can be regulated to control malpractices (such as collusive pricing) and protect growers from depressed prices. With the approval of the Minister responsible for agriculture, under the Act, the TCC is the authority that issues auction floors licences, auction floors buyer's licenses at the discretion of the Minister; register sellers at the auction floors and allocates production quotas; defines tobacco classes and grades; issues permits to export and import tobacco and issues grader's licence.

The Act also stipulates that the licensed sellers can only sell their allocated quotas on the auction floors. According to Kadzandira et al (2004) most smallholder growers dislike the quota system as it limits their production capacity and the fact that smallholder farmers find it difficult to sell the extra tobacco.

The Control of Tobacco Auction Floors Act also provides for the seller to refuse any bid price offered by the buyer at the Auction Floors, but it also stipulates that no seller who has made a bid for any tobacco being sold may refuse to accept the final price bid for such tobacco. The Act also stipulates the responsibilities of the buyers including the settlement of the buyer's account for the purchased tobacco.

4.2.3 Competition Policy and Legislation

In addition to establishing the Competition and Fair Trading Commission, the Competition and Fair Trading Act of 1998 also prohibits anti-competitive behaviour and practices. Some of the anti-competitive practices prohibited under the law include, *inter alia*, predatory behaviour, discriminatory pricing and discrimination, product tying, refusal to supply, market sharing agreements, resale price maintenance, trade agreements and collusive price fixing, unjustifiable exclusion from trade associations and price fixing and fixing terms of trade by associations (GOM, 1998).

The major problem is the lack of enforcement of the Competition Act in Malawi. This is due to institutional capacity constraints. There is no secretariat to serve the Competition Commission, although vacancies were advertised long time ago, the necessary technical positions have not been filled to date. The Competition Commission relies on MIT officials to undertake some of the administrative responsibility.

5. Production and Commercialization Services

5.1 Composition of Production and Producers

Malawi produces six main types of tobacco including burley, flue cured, northern division dark-fired (NDDF), southern division dark-fired (SDDF), oriental and sun/air cured tobacco. Koester et al (2004) note that in 1984 NDDF accounted for 410 percent, burley accounted for 35 percent, flue cured accounted for 20 percent and SDDF accounted for 4 percent of total tobacco production. However, in 2001 and 2003, burley tobacco accounted for 92 percent and 85 percent of total tobacco production, respectively. The dominant position of burley tobacco in total tobacco production has continued as presented in Table 5. Between 2004 and 2010, the share of burley tobacco in national tobacco production has ranged between 91 percent and 94 percent. The share of flue cured tobacco has almost remained stable while the share of NDDF has significantly declined from 6 percent in 2004 to 2 percent in 2010. Similarly, the share of SDDF has been declining while sun/air cured and oriental tobacco has been erratic with zero production in some years.

Table 5 Structure of Tobacco Production, 2004 – 2010 (percent)

Tobacco Type	2004	2005	2006	2007	2008	2009	2010
NDDF	6.44	2.11	2.33	3.06	2.07	1.76	1.91
Flue Cured	0.67	3.18	3.78	5.30	4.98	3.95	4.15
SDDF	1.48	0.21	0.24	0.17	0.15	0.07	0.01
Sun-air	0.00	0.00	0.00	0.06	0.04	0.00	0.00
Oriental	0.47	0.42	0.46	0.00	0.00	0.00	0.10
Burley	90.95	94.09	93.18	91.42	92.76	94.22	93.82
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Computed by author based on MoAFS Crop Estimates

The dominant position of burley tobacco in national tobacco production is also consistent with the increased participation of smallholder farmers in the cultivation of burley after liberalisation. The composition of farmers in the tobacco sector has substantially changed since the liberalisation of production of burley tobacco in 1992 in which smallholder farmers were allowed to grow burley. MTPSD (2004) note that in 2001, smallholders accounted for an estimated 70 percent of national burley tobacco production, approximately double their share in 1996. The dominance of smallholder farmers in burley tobacco production has continued such that by 2006 about 98 percent of burley tobacco was produced by smallholder farmers. Koester et al (2004) note that about 61 percent and 33 percent of burley tobacco was sold by estates and smallholder clubs in 2000, respectively. In 2003, the smallholder clubs accounted for 41 percent of burley tobacco sales.

The relative importance of estate and smallholder tobacco over time can be gleaned from grower registration data.³ Table 6 shows the declining trend of estates registered to grow tobacco of different varieties and the increasing number of smallholder clubs growing

³ Recent data on the actual volumes produced by estates and smallholder farmers was not made available to enable analysis of the composition of production by type of farmers.

tobacco. For burley tobacco, the number of estate growers declined to 10 750 growers in 2007 from 48 688 estate growers in 2000. The trend in the registration of smallholder is more erratic, but increased from 14 873 growers in 2000 to a high of 27 090 growers in 2006. The number of estate growers for other types of tobacco has also been declining.

Table 6 Composition of Estate and Smallholder Producers, 2000 - 2007

Year	Burley	Flue Cured	Northern Division Dark-Fired	Southern Division Dark Fired	Sun/Air Cured	Total
<i>Number of Registered Estates</i>						
2000	48,688	1,100	12,045	1	-	61,834
2001	45,836	1,094	12,512	1	-	59,443
2002	44,216	1,830	10,129	17	-	56,192
2003	31,069	693	6,993	56	-	38,811
2004	25,381	706	2,948	30	-	29,065
2005	22,429	537	587	44	-	23,597
2006	19,500	747	279	2	-	20,528
2007	10,750	445	119	0	-	11,314
<i>Number of Registered Smallholder Clubs</i>						
2000	14,873	29	2,185	165	-	17,252
2001	13,768	140	2,283	178	-	16,369
2002	21,933	199	2,105	191	-	24,428
2003	18,288	175	5,030	409	-	23,902
2004	14,322	375	2,106	441	-	17,244
2005	19,610	451	548	456	-	21,065
2006	27,091	505	564	70	-	28,230
2007	14,988	460	428	1	24	15,901

Source: Tobacco Control Commission

Note: Data from 2008 was available from the Tobacco Control Commission.

5.2 Seeds and Fertilizers

The degree of competition in the input supply markets for the tobacco sector varies by types of inputs. The market for seeds is highly concentrated while the market for fertilizers is an oligopolistic and vertically integrated market.

5.2.1 Seeds

Tobacco seeds are produced and sold by the Agricultural Research and Extension Trust (ARET). ARET produces certified seeds for the tobacco industry as approved by the Government of Malawi. There are several channels through which farmers obtain certified seeds. First, ARET has 15 satellite offices in the main tobacco growing areas from which tobacco farmers obtain their seeds. Secondly, most of the seeds are sold to farmers during the grower registration processes. Thirdly, certified seeds are also sold through the Agricultural Trading Company (ATC) retail outlets in various parts of the country. However, the retail outlets for seed supply remain limited and ARET has not linked with private sector input suppliers to distribute seeds. Some of the farmers use recycled seeds and it is believed that the certified seeds produced by ARET are high fertilizer consumers and adoption of the

hybrid seeds by resource poor farmers tends to be low. More information on the ARET website at: http://www.aretmw.com/about_us.html.

5.2.1 Fertilizers

The market for fertilizers is oligopolistic with vertical relationships between importers and retailers. The fertilizer supply market is divided into procurement and distribution/retail. There are about 13 companies in Malawi involved in the importation and sale of fertilizers at procurement level (Table 7). The procurement is segmented into large and well-established commercial importers, government companies, small importers and cooperatives. Most of the merchants also supply fertilizers to the Farm Input Subsidy Programme. The supply of fertilizers is dominated by two commercial companies.

Table 7 Major Fertilizer Suppliers in Malawi

Category	Name of Supplier	Ownership Status
Large/Well Established private operators	- Farmers World/Agora	- Domestic (private)
	- YARA/Agricultural Resources Limited	- International
	- National Association of Smallholder Farmers of Malawi (NASFAM)	- Domestic (private)
Small/New Entrants private operators	- Export Trading	- International
	- Nyiombo Investments	- International
	- Omnia	- International
	- Optchem	- International
	- Sealand	- International
	- Muli Brothers	- Domestic (private)
	- Simama	- International
Government	- Transglobe	- Domestic (private)
	- Smallholder Farmer Fertilizer Revolving Fund of Malawi (SFFRFM)	- Domestic (government)
	- Agricultural Development and Marketing Corporation (ADMARC)	- Domestic (government)

Source: Kelly et al (2010)

The fertilizer retail sector is highly volatile with multiple entries and exists each year (Kelly et al, 2010). There are a lot of vertical relationships between the fertilizer merchants and the retail outlets. Most of the merchants involved in the importation of fertilizers have their own retail outlets in different parts of the country. Government companies involved in the supply of fertilizers, SFFRFM and ADMARC (668 outlets), have outlets in most parts of the country. Among the private sector operators, Farmers World/Agora has the most presence in various parts of the country operating 103 outlets, followed by Nyiombo with 66 outlets, Transglobe with 55 outlets, NASFAM with 43 outlets and Export Trading with 19 outlets (Kelly et al, 2010). In addition to these vertically linked outlets, there is also a network of agro-dealers supported by special programmes. The agro-dealer network is a network of small-scale input sellers located mainly in the rural area. In 2009, it was estimated that there were more than 220 active agro-dealers in Malawi retailing fertilizers.

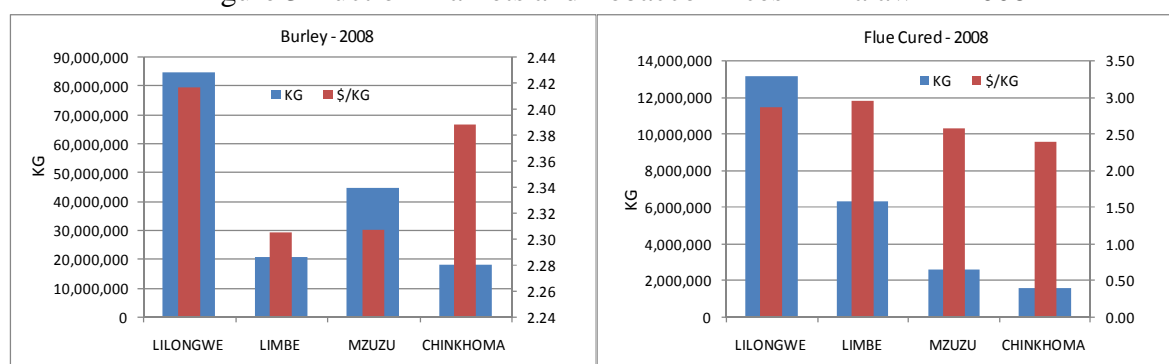
The commercial and private companies and agro-dealers are not involved in the retail of fertilizers under the subsidy programme while ADMARC and SFFRFM are the only companies involved in the distribution of subsidized fertilizers. Due to financial problems ADMARC is facing, in the past 5 years, it has mainly been dealing with subsidized fertilizers.

SFFRFM apart from distributing subsidized fertilizers, it also sells fertilizers to farmers on commercial basis.

5.3 Prices and Auction Markets

Tobacco in Malawi is sold through two parallel systems – auction market and contract marketing or direct buying by the registered buyers. In addition, smallholder farmers sell their tobacco informally to intermediate buyers, although the system of intermediate buyers was suspended by the government. Malawi operates a system of centralized auction markets with the main markets located in the three major commercial cities of Blantyre, Lilongwe and Mzuzu. However, more recently rural auction markets have been opened, such as Chinkhoma, to ease congestion on the main markets. Koester et al (2004) find that trucks could queue as long as 4 weeks to deliver tobacco at the auctions, implying higher marketing costs for farmers. The rural markets have been helpful in easing access to marketing services by smallholder farmers, thereby reducing transaction costs such as cost of transportation. Figure 3 shows the volume and the prices of burley and flue cured tobacco in 2008. It is apparent that the Lilongwe market handles most of the tobacco that is sold through auction markets for both burley and flue cured tobacco. In burley tobacco, Mzuzu is the second dominant market while for flue-cured tobacco Limbe is the second dominant market.

Figure 3 Auction Markets and Tobacco Prices in Malawi in 2008



There are also interesting variations in the average prices at which tobacco is being sold in different markets, although this also depends on the quality of tobacco being sold. With respect to burley tobacco, Lilongwe offers highest average prices, followed by Chinkoma, while Limbe and Mzuzu tend to offer similar prices. It is worth noting that Lilongwe and Chinkhoma markets are located in the main tobacco production areas in Malawi. In contrast, spatial prices for flue cured tobacco tend to be much more even compared to burley tobacco, with the Limbe market offering marginally higher prices than the Lilongwe market.

Table 8 shows the distribution of sales and prices by the type of marketing system for different types of tobacco. For burley tobacco, 79 percent was sold through the auction markets in 2010. Direct or contract marketing is a dominant form of marketing flue cured and dark fired tobacco accounting for 84 percent and 61 percent, respectively. The data also shows that contract marketing offers higher prices on average than auction marketing for all the three types of tobacco.

Table 8 Volume of Sales and Prices by Type of Market and Tobacco in 2010

	Burley		Flue Cured		Dark Fired	
	Volume (Kg)	Av. Price (U.S \$/Kg)	Volume (Kg)	Av. Price (U.S \$/Kg)	Volume (Kg)	Av. Price (U.S \$/Kg)
Auction	152,594,136	1.7348	3,963,926	2.4661	978,511	2.4869
Direct	39,728,274	1.9443	20,351,027	2.8129	1,549,799	2.5338
Total	192,322,410	1.7781	24,314,953	2.7498	2,528,310	2.5156

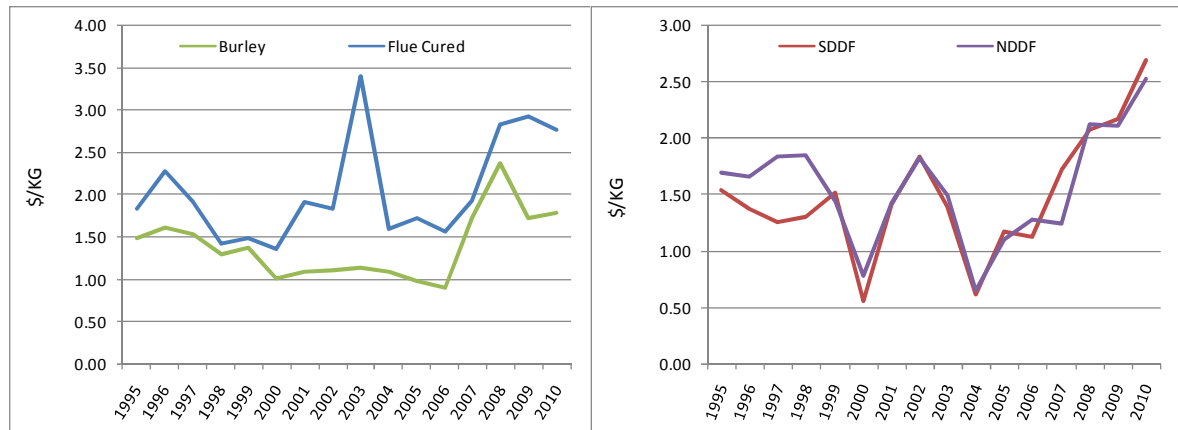
Source: Associated Tobacco Company Limited (2010) Malawi Monthly Crop and Market Report, November

The contract market system facilitates access to agricultural inputs and services by smallholder farmers through their linkages to buyers. In these vertical relationships in flue cured tobacco between buyers and smallholder farmers, buyers provide management supervision; purchase and distribute inputs; provide technical extension training; facilitate and guarantees access to input and monitor crop production and curing processes. These contract arrangements are organized around clubs. For example, the partnership between Limbe Leaf Tobacco Company (LLTC) and smallholder farmers is structured as follows

“Each smallholding project comprises of 1,600 farmers from local villages. There are eight schemes comprising of 200 farmers each. Growers are organised into clubs of 20 members each. Growers produce one hectare of Flue-Cured tobacco and one hectare of maize each. Attendance at the extension-training programme is compulsory. Farmers cooperate in labour-intensive production tasks. Farmers follow prescribed curing/ handling methods. The crop is marketed within clubs.” (Limbe Leaf Tobacco Company, 2010)

Figure 4 shows the trend in average prices for various types of tobacco between 1995 and 2010. There is a lot of variability in the prices of tobacco, particularly for flue cured and dark fired tobacco. With respect to prices of burley tobacco, there is a declining trend in the prices between 1995 and 2006, and a short upward movement in 2007 and 2008. The declining trend in burley prices prior to 2007 is consistent with the increasing trend in the production of burley tobacco. In contrast, dark fired tobacco has witnessed increasing prices since 2004, although prior to 2004 the price movements seem more erratic. The production of dark fired tobacco has generally been declining and the rising prices are just a reflection of limited supply. The production of flue cured tobacco has been increasing since 2004, but prices also show an increasing trend particularly since 2006.

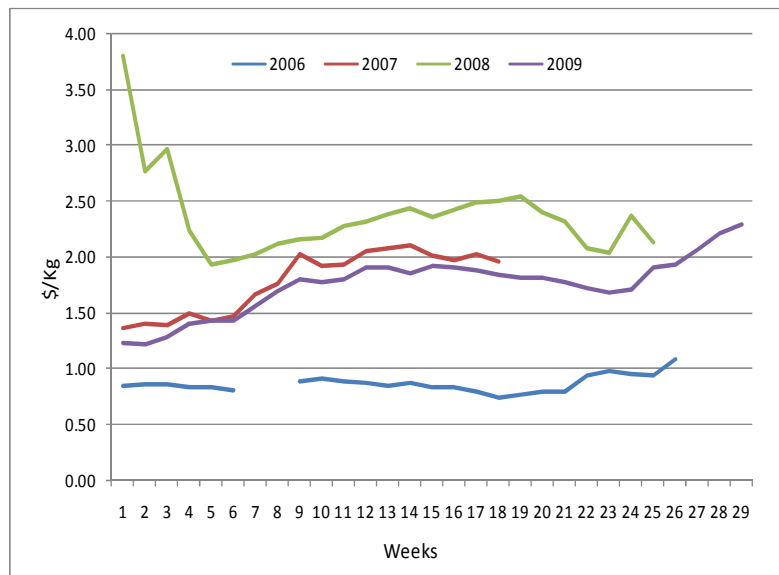
Figure 4 Average Tobacco Prices in Malawi, 1995 - 2010



Source: Tobacco Control Commission

However, these annual price movements mask the price movements within the marketing season. Figure 5 shows average burley prices by week of trading between 2006 and 2009. Consistent with production levels, 2008 burley prices were higher every week during the period. The prices of burley tobacco in 2009 were much lower and even lower than the 2007 prices. It is interesting to note that 2008 prices are very high in the first week of the auction and the first four weeks of the auction and the levelling off thereafter. The movement is consistent with the supply expectations in which the first estimated production projected limited supply (121,000 MT) while the revised estimate indicated good production (145,000 MT).

Figure 5 Average Burley Tobacco Prices by Week of Trading, 2006 - 2009



6. Analysis of Structure, Conduct and Performance

6.1 Production Concentration and Performance

There has been a shift in production of tobacco from large estate farmers to smallholder production. However, there is lack of data on the relative production by smallholder farmers and estate growers. The MoAFS crop estimate data records all tobacco production as smallholder production, yet there are estates and buyers that are also cultivating tobacco in Malawi. TCC, as industry regulator, does also not have data disaggregated by the size of farmers. It is therefore not possible to analyse the relative performance of smallholder farmers and large growers.

Nonetheless, some of the smallholder tobacco farmers belong to associations such as TAMA and NASFAM. TAMA and NASFAM organize the transportation of tobacco from their satellite depots to the auction markets through a centralized system in which the associations contract specific transporters. It is noted that some of the growers and growers associations are also vertically linked in the value chain with some of the transporters of tobacco. In particular, some of the executive members of associations and clubs are also the main transporters of tobacco who get contracts by virtue of being executives and do not get services because they are competitive. In addition, TAMA has minority ownership stake in one of the tobacco buying companies and TAMA's interests are divided between promotion of growers' interest through better prices and its returns from investments in Premier TAMA. This weakens TAMA's bargaining power over the prices that would have benefited smallholder growers.

6.2 Transport Services Concentration and Performance

The dry cargo haulage transport services by number of firms and vehicle fleet is potentially competitive. However, the pricing behaviour through brokerage services of the Road Transport Operators Association (RTOA) facilitates anti-competitive behaviour. TAG (2007) observed that the price recommendations made by RTOA as a guide to its members constitute anti-competitive behaviour according to section 34 (1) (b) (i) of the Competition and Fair Trading Act of 1998.

In the tobacco industry, individual farmers, except for TAMA and NASFAM members, are responsible for direct contracts with transporters. However, for TAMA and NASFAM members, tobacco is transported to the auction market through a coordinated transport system. TAMA and NASFAM enter into agreement with rail operator, haulage operators and regional chapters of the RTOA in the north, centre and south to transport the tobacco to auction floors (TAG, 2007) using a system of competitive bidding. However, there is a belief among the transporters that tobacco being the main sector in Malawi, the bidding prices for transport services in the tobacco industry are believed to be higher than the general costs of transportation of goods. Koester et al (2004) also note that transport costs for tobacco are in the order of three times the cost of transportation of general merchandise, mainly due to demurrage due to long waiting times outside the auctions. The involvement of the RTOA as broker of transport services in the tobacco industry also provides opportunities for market sharing agreements among operators, a practice that undermines competition. Other stakeholders note that non-Malawian firms usually tend to bid low, but preference is always

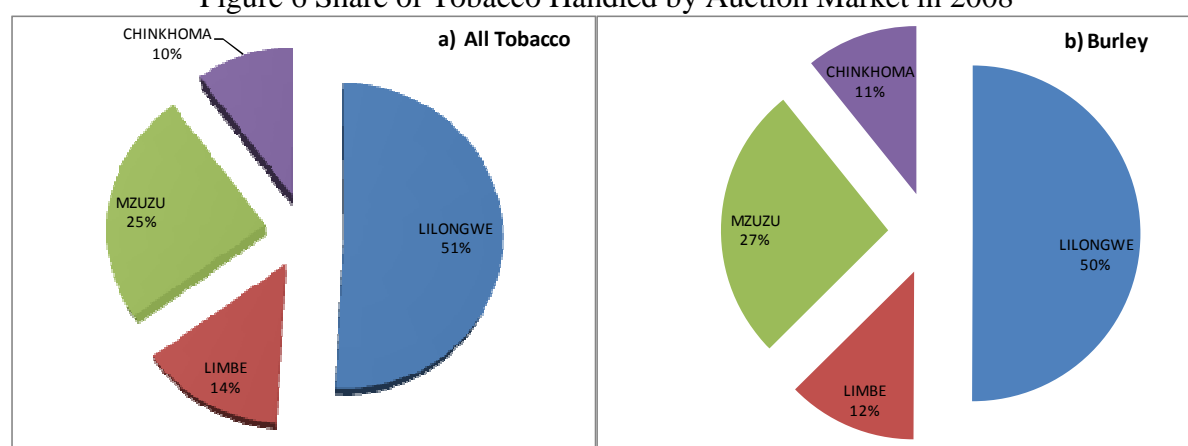
given to Malawian transporters although their prices are usually high. In addition, there are vested interest, with some of the big smallholder growers or the leadership of the tobacco associations owning transport facilities. Transporters have associations that negotiate transport services with TAMA or NASFAM and the competitive bidding process is not effective in such arrangements. These differences in sectoral transport costs of tobacco and similar dry cargo suggest uncompetitive behaviour and may justify allegations of collusive bidding for transport services through transporters associations.

6.3 Auction Markets, Buyer Concentration and Performance

6.3.1 Auction Markets and Performance

Detailed data on the trends in volumes and prices of tobacco at different auction markets was not made available for analysis in this study. However, based on cross-section information, Figure 6 (a) shows that 51 percent of all tobacco is sold through the Lilongwe Auction market while Mzuzu and Limber handles 25 percent and 14 percent, respectively. Chinkhoma, the only rural auction market handles about 10 percent of all marketed tobacco. The situation is similar for burley tobacco with Lilongwe, Mzuzu, Limbe and Chinkhoma handling 50 percent, 27 percent, 12 percent and 11 percent, respectively. Interestingly, Chinkhoma market throughput is closer to Limbe market, which is the oldest auction market in Malawi.

Figure 6 Share of Tobacco Handled by Auction Market in 2008



As noted above, in terms of prices in different markets, on average Lilongwe and Chinkhoma markets offered highest prices for burley tobacco in 2008 while Lilongwe and Limbe offered the best average prices for flue cured tobacco. There are prospects that the volume of trade will increase in Chinkhoma and Mzuzu markets. Action Holdings Limited, the only operator of tobacco auction markets has invested in market infrastructure at Chinkhoma to accommodate increased volumes of tobacco. The rural market is increasing its popularity such that there are demands from smallholder farmers through the Tobacco Association of Malawi (TAMA) for government to allow opening of more rural markets and to allow other investors to invest in auction markets.

All the auction markets in Malawi are owned and operated by AHL, as a monopolist in the provision of tobacco marketing services. Apart from being a monopolist in tobacco auction, AHL also has a subsidiary which also enjoys monopoly power in tobacco re-handling - for tobacco rejected at the auction because of poor grading and this service is also monopolized.

These monopolistic situations in tobacco auctioning and tobacco re-handling, which are not regulated, may be charging farmers uncompetitive prices. Competition in auction markets can have immense benefit to growers by offering freedom of choice.

6.3.2 Buyer Concentration and Performance

The buyer concentration in the tobacco market is oligopsonistic, with three dominant buyers accounting for more than 60 percent of the market. At any particular season, the number of buyers of tobacco has not been more than 10 companies and some of the buyers are vertically linked with other players in the tobacco value chain. There have also been some recent changes in the tobacco market in Malawi. Two of the three top tobacco buyers, Dimon and Standard Commercial, merged in November 2004 to form Dimon-Stancom. In 2005, Alliance One and Dimon-Stancom merged to form Alliance One International. There have also been new entrants, particularly from domestic investors, but these have provided fringe competition in the sector. Malawi Leaf was created in 2006 as a subsidiary of Auction Holdings Limited, but as LLTC (2006) notes its introduction in the market did not affect the performance of the market. Koester et al (2004) find that the three major buyers, multinational companies, accounted for more than 90 percent of the tobacco purchases between 2000 and 2004; hence a three-firm concentration ratio (CR3) that points to the oligopsonistic nature of the market. The average Herfindhal-Hirschman index (HHI) of monopoly power between 2000 and 2004 was 0.3456, indicating that the market is less competitive. Table 9 reveals the oligopsonistic nature of the market using various measures of buyer concentration. Using the HHI, there is stability in buyer concentration between 2000 and 2004. However, the market shares for burley tobacco from 2006 show a declining trend in buyer concentration from the HHI of 0.3733 in 2006 down to 0.2065 in 2010.

Table 9 Buyer Concentration and Burley Tobacco Prices in 2000 - 2010

Year	HHI	CR2	CR3	Price (\$/Kg)
2000*	0.3699	0.7450	0.9490	1.02
2001*	0.3599	0.7330	0.9490	1.10
2002*	0.3333	0.7100	0.9360	1.11
2003*	0.3206	0.6990	0.9240	1.14
2004*	0.3445	0.7160	0.9470	1.09
2006	0.3733	0.8400	0.9800	0.90
2007	0.2854	0.7000	0.8600	1.73
2008	0.2452	0.6300	0.7900	2.37
2009	0.2489	0.6369	0.7898	1.73
2010	0.2065	0.5320	0.6859	1.78

Note: * HHI, CR2 and CR3 figures based on total tobacco market, the rest are burley tobacco market shares.

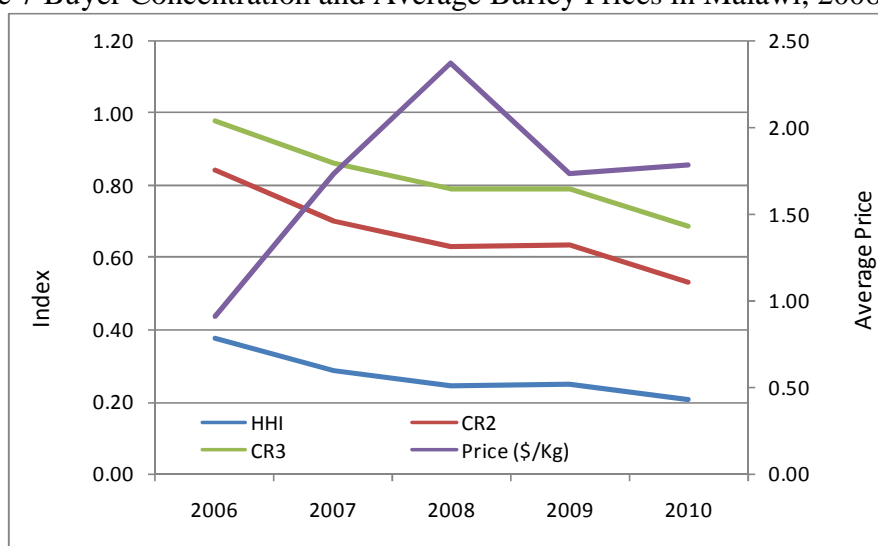
Source: Computed by author based on Koester et al (2004) and Limbe Leaf Tobacco Company Market Reports.

However, the decrease in buyer power as reflected in the trend of the HHI may not be a result of greater competition, but reflect the mergers and acquisitions that have taken place enabling more equal share of the markets. The trend in the two-firm concentration ratio (CR2) and CR3 reflecting the dominant position of the two and three largest buyers is reflective of the level of competition that exists in the market. The two main buyers still control a significant

amount of the market – more than 60 percent. The share of the three main buyers has been declining but they still control more than 68 percent of the market.

Figure 7 shows the trends in buyer concentration and the average prices for burley tobacco between 2006 and 2010. While the buyer concentration is showing declining trend, there is no clear relationship that the reduction in buyer concentration has resulted in higher average prices realized by growers. Average burley prices only rose between 2006 and 2008, but there is a sharp decline in prices in 2009. The setting of reserve minimum prices for tobacco started in 2006, and the improvement in the pricing in the next season may have been a result of the minimum prices although production in 2007 was 5 percent below the 2006 level. Although prices are affected by many factors, such as production and quality of tobacco, the high buyer concentration is worrying, and buyers may be using their market power to unfavourably offer low prices for tobacco. Koester et al (2004), using correlation analysis, find a high correlation of prices (99 percent) among the three dominant buyers while the correlation among small buyers was in the range of 84 percent and 94 percent.

Figure 7 Buyer Concentration and Average Burley Prices in Malawi, 2006 - 2010



Previous research in the competitiveness of the tobacco market revealed some market sharing arrangements based on explicit or tacit collusion, although these practices are very difficult to detect. Otanez et al. (2007) summarizes some of the ways in which the behaviour of the two dominant buyers in the market influences tobacco prices and their position in the regulatory body leads to regulatory capture. There is suspicion of market sharing arrangements at the auction market with buyers cautioning each other if they deviate from agreed daily proportions of tobacco to be purchased by each company. Another existing practice used by buyers is to give priority to purchasing of low to medium grade tobacco as a way of projecting depressed prices for the marketing season. The Malawi tobacco auction market has at times been suspended due to the disagreements over prices between growers and buyers. The introduction of Malawian buying companies such as Malawi Leaf (a subsidiary of AHL) and joint venture investments has not changed the market conditions, and these new companies have not offered better prices than the market leaders. In 2006, the year of entry, Malawi Leaf accounted for less than 1 percent of the burley tobacco market and by 2009 it only achieved 5.5 percent and 13.1 percent in 2010. The increased share of Malawi Leaf in burley between 2009 and 2010 does not seem to have a significant impact on the prices.

Nonetheless, the uncompetitive nature of the tobacco market is also driven by the structure of cigarette manufacturing with tobacco buying merchants having established contracts to supply tobacco to big cigarette manufacturers. Even if there is new entry in the market, the extent to which new buyers can purchase depends on the size of the residual market in cigarette manufacturing.

There is evidence pointing to the fact that some non-buyer related behaviour influences the prices offered in the auction. First, there is increasing concern that the quality of grading is generally poor and there has been an increase in non-tobacco related materials which has created uncertainty among buyers whether they are buying the best leaf or not. More recently, the prices of the bales are determined more by the existence of poor quality leaf in the bales. It has also become evident in the market that buyers are opting to buy low to medium quality leaf than high quality tobacco. The rejection rates of bales at the auction are reportedly as high as 38 percent for various reasons. According to TCC (2006), 69 percent of the bales were withdrawn for failure to meet reserve prices while 34 percent were rejected by buyers and poorly graded by farmers. Some stakeholders observed that the laxity in the inspection of contract tobacco has encouraged farmers to increase the inclusion of non-tobacco related materials in the bales that go to the auctions. Secondly, the quality of crop forecast also influence the prices on the markets. The low forecast of the annual production influenced one dominant buyer to offer high prices at the beginning of the season outbidding most of the buyers. According to LLTC (2008) the low estimate of production volumes resulted in a volatile market with buyers competing for market shares and offering high prices which were not sustainable for some buyers. This explains the large price spike observed in 2008. Increased tobacco production in 2009 and 2010 compared to the 2008 production levels may have attributed to the falling average prices in 2009 and 2010. Thirdly, other stakeholders also argue that the lack of control on the supply side is damaging for the market. The current regulations require that TCC provides quotas to farmers according to what the farmers have requested. This creates a problem of over-supply leading to low prices offered by buyers.

Another feature in the tobacco market that is a concern with respect to competitive processes in the market is the restrictions on the export of tobacco directly by smallholder farmers. Export of tobacco is only allowed for processed leaf and smallholder farmers are not allowed to export unprocessed tobacco, although some farmers are willing to take their tobacco to neighbouring countries whenever prices are low on auctions in Malawi. Most of the buyers on the auction market own processing facilities and as such also hold tobacco export licenses. These exporters belong to the Tobacco Exporters Association which is a club of merchants that participate in the auction market. This arrangement can influence policy directions on the liberalisation of export of tobacco leaf to the detriment of smallholder farmers who could otherwise earn more income from foreign markets. The Tobacco Exporters Association may also facilitate market sharing arrangements that may adversely affect prices at the auction markets.

6.4 Vertical Integration and Vertical Relationships

There are a number of vertical relationships in the tobacco value chain in Malawi that have the potential to undermine competition. These vertical relationships exist at levels of production and marketing in the tobacco value chain. At production level, in terms of tobacco cultivation, the proliferation of contract farming lock-in smallholder farmers to particular buyers. These vertical relationships entail buyers providing inputs and technical services to farmer groups in return for the buyers to have the first right to buy tobacco from farmer clubs.

The vertical relationships between buyers and smallholder farmer groups is regulated by the Tobacco Control Commission which allocates contract tobacco to buyers and also set the pre-market price based on a cost of production plus 15 percent margin (LLTC, 2008). According to LLTC (2009), with respect to burley tobacco, TCC allocated 60 000 MT contract volumes on an equal basis to four major buyers and smaller volumes to two smaller domestic buyers at an agreed price of \$2.15 per kilogram. The growth in contract marketing implies less competitive marketing of tobacco.

There is growing pressure from buyers to engage in more contract marketing system, but contract marketing can be a barrier to new entry while facilitating access to inputs by smallholder farmers. Contract marketing also requires increased capacity of growers to understand the nature of business. Most of the tobacco associations do not have the capacity to manage contracts, and without regulation and monitoring, these contracts could be to the disadvantage of growers. In addition, some of the buyers such as Wallace have their own estates and are not major participants in tobacco auction. This weakens competition in the auction market. Currently, the auction market provides an alternative market to contract growers to opt out of the contract sale once and put their tobacco on the auction if they believe that they will get better prices on the auction market.

At marketing level, there are a few vertical relationships through interlocking ownership. First, there is a relationship between growers and one of the buyers through interlocking ownership by the growers' association. TAMA invested in Premier TAMA with the objective of being more involved in various stages of the value chain. In addition, TAMA is a minority shareholder in Auction Holdings Limited. Secondly, the company that provides auction services, Action Holdings Limited, has one subsidiary that participates in the purchase of tobacco - Malawi Leaf, and one subsidiary, Tobacco Investment Limited, specializing in tobacco re-handling.

6.5 Regulatory Capture and Vested Interests

One major challenge in the tobacco industry affecting the degree of competition is the extent of regulatory capture and entrenchment of vested interests. There are many vertical relationships that exist in the tobacco industry and generally emerge from the complex institutional, regulatory and ownership arrangements that constrain competition in the industry. There are weaknesses from a regulatory point of view, due to institutional arrangements for the promotion of competition in the sector. Firstly, the Tobacco Control Commission has a Board of Trustees dominated by vested interests such as buyers on the Auction markets and tobacco exporters who benefit from weak enforcement of rules and regulations in the tobacco industry.

Secondly, the Government is heavily involved in some of the institutions such as some ownership in Auction Holdings Limited through a state owned enterprise, ADMARC. Such vested interest has created condition that has block entry of other investors in providing tobacco auctioning services, unlike in Zimbabwe where there is some sort of competition in auction services.

Thirdly, there is some level of regulatory capture in the tobacco industry, in which most stakeholders consider TCC as a weak regulator of the industry. TCC does not have adequate information and data on different segments of the value chain – such as limited information on the classes of producers, lack of control of production, outdated market information and

lack of sanctions for misbehaviour. Such information problems exacerbate TCC problems in being an effective regulator of the industry.

Fourthly, there are also capacity constraints for enforcement of competition and fair trading practices in Malawi to investigate some of the alleged infringement of competition law. The MCFTC does not have technical staff to undertake investigation into anticompetitive behaviour of firms. The members of the MCFTC Board do not have statutory investigative powers. The board is expected to examine the recommendations by the secretariat and make a determination of the cases. The absence of a full fledged secretariat limits the effectiveness of the Board in resolving competition cases. Due this scenario, there is a general lack of enforcement of competition law in Malawi and this promotes anti-competitive behaviour.

7. Conclusions

The lack of effective competition and the weakness in the enforcement of laws is adversely affecting the profitability of smallholder tobacco farming in Malawi. The most significant impact of alleged anti-competitive practices and poor regulation in the Malawi tobacco industry has been poor tobacco prices. This has meant that many smallholder farmers are not making profits from tobacco farming and due to lack of alternative cash crops they seem to be locked in tobacco production. Although low prices are not only a result of monopsony power and transaction costs that farmers experience, there are regulatory issues and industry structure issues that have also contributed to low prices. Tobacco farming in Malawi has not improved in terms of productivity and the system does not provide adequate incentives for farmers to improve their productivity. The quality of tobacco has been declining over time, and the rates of rejection at the auction markets have been unexpectedly high.

With liberalisation of burley tobacco production, which allowed smallholder farmers to produce tobacco, the industry regulator has not been able to manage the supply of tobacco, in many cases leading to oversupply of tobacco leaf. This has adversely affected the prices of tobacco in Malawi. The failure to regulate production has also contributed to the poor quality of tobacco and poor grading that has increased rejection rates at auction markets. The incidence of non-tobacco related materials has been increasing as farmers desperately attempt to improve their incomes by increasing weights of bales by putting non-tobacco materials. The high incidence of non-tobacco related materials has increased the risk for buyers as they are not sure as to whether the tobacco in each bale is of equal quality.

7.1 Conditions Prevailing in the Market

Burley tobacco is the main tobacco produced in Malawi. The tobacco value chain can be categorized into different stages including production, transportation, domestic marketing and export marketing. The nature of competition in these various stages varies considerably in Malawi. In terms of production, with the liberalisation of burley tobacco farming by smallholder farmers in 1992, there has been increased entry of smallholder tobacco farmers, who have mainly been organized into farmer clubs and associations. The smallholder farmers now dominate the production of burley tobacco either under contract or auction sales. It can be concluded that tobacco production is competitive, with no single dominant producer to exercise market power.

The transport sector, by number of transporters, has varied players. However, with respect to transportation of tobacco to auction markets, there is preference of domestic transporters who usually bid higher than international transporters. As a result, the cost of transporting tobacco tends to be higher than general merchandise in Malawi. There are allegations of collusive tendering in that the Malawian transporters tend to uniformly bid high through a pricing arrangement agreed in the transporters association. In addition, there is proliferation of vested interests, in some cases the transporters are also tobacco farmers and, therefore, tend to give preference to transporting their tobacco than tobacco of other club members. The benefits of the competition that exists in the transport sector can be extended to the smallholder farmers with the adoption of strictly competitive bidding for transport services.

The main challenges of competition in the tobacco industry in Malawi are in the marketing of tobacco. The lack of competition is evident at two levels: auction floors and buyer concentration. In terms of auction floors, the marketing services of tobacco are monopolized by the Action Holdings Limited that operates all tobacco auction floors in Malawi. Although, the Auction Floors Act does not prohibit other auction floors by other investors, AHL is highly aligned to the Government of Malawi through investment by the Agricultural Development and Marketing Corporation – a state marketing agency. Although other investors have expressed interest and tobacco farmers are demanding more auction markets, the existing monopolist lobby against new entry had been strong due to this interlocking ownership. In addition, tobacco proceeds are central to Malawi's export earnings and the government finds it convenient to deal with one central agency for marketing of tobacco. In terms of buyer concentration, the market is oligopsonistic, with three of the seven buyers accounting for more than 60 percent of the market. Some of the buying companies have relationship with growers and tobacco auctioneers through ownership stakes in the buying companies. These interlocking directorships or ownership makes the marketing arrangements for tobacco complex, and perhaps difficult to get a sense of the extent to which market power determine the price outcomes. The buying companies have contracts with the major cigarette manufacturers to deliver specific quantities of tobacco. These arrangements have made it difficult for entry of tobacco merchants at domestic level. Unlike in Zimbabwe, where the Chinese are becoming major market players in flue-cured tobacco, the Malawi market is dominated by traditional buyers some of which have merged through international mergers and acquisitions. This buyer concentration has partly resulted in lower tobacco prices in Malawi, although issues of overproduction and quality are also attributed to low tobacco prices in Malawi.

In the export market, the same buyers of tobacco at the auction markets are involved in the export of tobacco and also own processing facilities. Smallholder farmers cannot directly export raw tobacco, although many farmers want government to allow them to sell their tobacco at auctions in neighbouring countries such as Zambia.⁴ Although smallholder farmers can benefit from direct exports, tobacco is the main export earner for the economy in Malawi. Uncontrolled liberalisation of exports can have detrimental effects to export earnings and domestic revenues. Such liberalisation will require better monitoring mechanisms to ensure that export revenues are reverted back to the economy through official market channels and to the government taxation system.

7.2 Role of the State and Public Policies in the Sector

⁴ It is estimated that about 15 percent of tobacco is smuggled into Zambia (Koester et al, 2004).

The state plays several roles in the tobacco market by putting in place institutions, policies and regulation governing the production and marketing of tobacco. More recently, government has been announcing minimum prices at the beginning of each marketing season for different grades of tobacco. However, the main problem is lack of enforcement of various provisions of policies and laws. The government has not been successful in detecting any suspected collusive tactics of the buyers, the minimum prices are not adhered to all the time as in most cases buyers tend to justify low prices because of poor grading of tobacco by farmers. The regulatory institutions are captured by the buyers as institutionally buyers are represented on the Board of Directors of the regulatory body, TCC. The regulatory framework is therefore not conducive to promoting competitive behaviour in the sector.

7.3 Transparency in the Sector

Transparency is one of the major problems in the tobacco sector. The lack of transparency is exacerbated by the lack of information in the tobacco sector. The information systems are not well coordinated and are not regularly updated. For example, the industry regulator, TCC, does not have updated information on the number of growers, the categories of growers and the marketing information from AHL. Without access to industry information, the regulator is highly weakened, and this makes it a less effective regulator. Stakeholders are also suspicious of the failure for government to liberalize entry into auction houses by other investors in Malawi, and there is belief that AHL is lobbying against new entry in order to maintain its monopoly position.

7.4 Practices Restricting Competition in the Sector

There are several practices in the industry that limit competition in the tobacco industry in Malawi. First is the global cigarette manufacturing structure that determines the extent of entry into tobacco marketing at domestic level; the global market is highly oligopolistic. Cigarette manufacturers have specific contracts with merchants that participate in the auctioning of tobacco in Malawi. Secondly, there is also collusive pricing behaviour and undervaluing of the quality of tobacco in the markets, which is difficult to detect given the many relationships that exist among growers, grower associations, industry regulator, auctioneers and tobacco buyers. Thirdly, there are strong vested interests with many players in the market strongly aligned with the government and growers. Fourthly, the international mergers and acquisitions have also affected the level of competition in the domestic market – this has led to a reduction in the number of buyers over the years.

8. Recommendations

The analysis has highlighted that both the institutional failures and behaviour of various stakeholders in the tobacco industry have contributed to anti-competitive practices which have adversely affected the profitability of tobacco farming among smallholder farmers in Malawi. The following recommendations are made in light of the above analysis.

- There is need to improve the regulatory framework which allows competitive behaviour in the tobacco industry. Such competition may provide incentive for efficient tobacco production in Malawi. Several reforms may be important in the tobacco industry.
- The regulatory bodies should be free of vested interests. Both the Tobacco Control Commission and the Competition and Fair Trade Commission, by statutes, have on

the Board of Directors individuals or organisations with vested interests. This implies that these regulatory institutions are not independent and are therefore susceptible to regulatory capture. This will require revision of the laws governing the operation of these regulatory bodies.

- There is need to carefully study the impact of horizontal relationships particularly through interlocking ownership on the welfare outcomes in the tobacco industry. For example, government should privatize its ownership stake it is holding in Auction Holdings Limited through ADMARC.
- The technical capacity of regulatory institutions must be strengthened through recruitment of appropriate staff. Some of the allegations of anti-competitive behaviour could easily have been investigated with adequate technical staff at the CFTC. Similarly, at the TCC, appropriate systems are required to ensure that industry level information is available and adequately analyzed in order to improve the regulatory functions.
- The many alleged anti-competitive practices in the tobacco industry need to be investigated. The only authority to investigate such cases and to impose punitive measures is the Malawi Competition and Fair Trade Commission. However, the CFTC is not adequately resourced and poorly funded to perform functions as empowered by the Competition and Fair Trading Act.

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