

AID 1180-1 (8-88) PAAD PROGRAM ASSISTANCE APPROVAL DOCUMENT Amendment # 4	DEPARTMENT OF STATE AGENCY FOR INTERNATIONAL DEVELOPMENT	1. PAAD NO 391-K606B (391-0492) <i>63900</i> 2. COUNTRY Pakistan 3. CATEGORY Commodity Financing (Standard Procedures) and Sector Grant 4. DATE
5. TO: The Director, USAID/Pakistan	6. OYB CHANGE NO. 7. OYB INCREASE	8. TO BE TAKEN FROM
9. FROM: The Agricultural Development Officer, USAID/Pakistan	10. APPROPRIATION - ALLOTMENT 72-119/01037 QES9-89-37391-KG-13	
9. APPROVAL REQUESTED FOR COMMITMENT OF: \$26,100,000		11. TYPE FUNDING <input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT <input type="checkbox"/> INFORMAL <input type="checkbox"/> FORMAL <input type="checkbox"/> NONE 12. LOCAL CURRENCY ARRANGEMENT <input type="checkbox"/> NONE
13. ESTIMATED DELIVERY PERIOD June 1988-Sep 1993		14. TRANSACTION ELIGIBILITY DATE June 1989

The commodities financed under this program are wheat and such other private and/or public sector imported commodities and equipment as A.I.D. and GOP may agree from time to time.

Loan and Grant Agreements

15. PERMITTED SOURCE U.S. only: 26,100,000 Limited F.W.: Free World: Cash: Partial Pakistan (Minimum)	16. ESTIMATED SOURCE U.S.: 26,100,000 Industrialized Countries: Local: Other: Pakistan (Minimum)	FM/LMD (if Loan) FM/PAFD FM/CAD GC/ANE ANE/Desk ANE/TR Officer ANE/PD Officer & File PFC/CDIE/DI ✓
TITLE: AGRICULTURAL SECTOR SUPPORT PROGRAM (391-0492)		

This PAAD authorizes \$26.1 million in ESF grant funds, subject to the availability of funds in accordance with the AID/OYB allotment process, to finance the foreign exchange and local costs for commodity imports, a Sector Grant and/or Training and Technical Assistance (TATA). A grant of up to \$11.1 million from these funds will be used for continuing support to TATA activities described in the original PAAD dated September 24, 1987, and as amended on August 4, 1988 and January 23, 1989. The balance will be used for a Sector Grant and/or importation of private and/or public sector commodities and equipment as A.I.D and GOP may agree from time to time. The Sector Grant portion may be made available to the GOP contingent upon the acceptance of mutually agreed upon policy benchmarks for FFY 1989/90. The proposed policy agenda for PFY 1989/90 is attached as Appendix "A" to this amendment.

With this amendment the total amount authorized under ASSP will be \$195 million.

18. CLEARANCES ARD: TMolson (draft) ARD: RHGoldman (draft) <i>8/21/89</i> PRO: VDMiedema (draft) PDM: GHWest (draft) RLA: TBCarter EM: RADeBruce DD: JPGuedet	19. ACTION <input checked="" type="checkbox"/> APPROVED James A. Norris <i>9/25/89</i> AUTHORIZED SIGNATURE Director, USAID/Pakistan
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AGRICULTURAL SECTOR SUPPORT PROGRAM, (391-0492)
AMENDMENT NO. 4 : FY 89 POLICY BENCHMARKS

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I. BACKGROUND AND SUMMARY

The FY 1988 PAAD Amendment (Amendment No. 2) authorized \$110 million, \$50 million of which was provided to the GOP as Sectoral Assistance and the remaining \$60 million for wheat importation under the Commodity Import Program. While disbursements for wheat procurement are in progress, \$50 million of Sectoral Assistance was credited to the GOP account in September 1988.

The Sectoral Assistance Program (SAP) of FY 88 was based on the GOP's commitment to implement benchmarks specified in Section 4.4 of the Agreement No. 88-13B of August 4, 1988. In the course of negotiations leading to this Agreement, it was made clear to the GOP that future tranche of SAP would depend upon progress made in implementing the agreed upon policy reforms and the nature of policy changes that the GOP commits itself to carry out in the future.

A review of the GOP's agricultural policy reform initiatives indicate that the GOP: (a) has made significant progress in implementing the agreed upon ASSP's FY 88 benchmarks; (b) has implemented policy reforms which though not specifically covered in the Agreement, support the ASSP's objectives of price rationalization, subsidy reduction and increased privatization; and, (c) is in the process of implementing major economic policy reforms in the context of the World Bank's Agricultural Sector Loan and the IMF's Stand-by Arrangement and Structural Adjustment Facility. Under the FY 89 tranche of SAP, the GOP has also agreed to undertake several agricultural policy changes which should prove to be a significant step in movement towards a market based economy. Given the desirability of maintaining the momentum of these positive developments, it is proposed to maintain the FY 89 tranche of SAP at the previous level of \$25 million.

II. REVIEW OF PROGRESS OF IMPLEMENTATION OF FY 88 BENCHMARKS

The FY 88 Program specified 11 policy benchmarks. Of these 11 benchmarks, 5 (DAP retail price increase, rationalization of wheat prices, elimination of restrictions on the number and conditions under which entities may import poultry feed ingredients, release of funds for the Statistics Division, and union of agricultural research and education in NWFP) have been fully met; 1 benchmark (elimination of import tariffs on poultry feed components) has been partially met; 1 benchmark (announcement of private sector led fertilizer production) is likely to be met shortly; and, 3 benchmarks (water charge assessment study, restrictions on public sector tubewells in fresh ground water areas, and institutionalization of the Directorate of Agricultural Policy) have witnessed considerable progress and their intent should be realized by November 30, 1989. The remaining benchmark relating to inter-provincial movement of imported fertilizers has not been met as yet and is still under consideration of the GOP. Progress in respect of each benchmark is recorded separately hereunder.

A. Policy Area: Fertilizer

Benchmark No. 1

By the end of calendar year 1988, increase the retail price of DAP fertilizer by ten percent (10%) from the December 1987 price of Pakistani Rs 161 for 50 kg. This benchmark is to be obtained as part of a longer term plan to eliminate DAP fertilizer subsidies within four years of the date of this agreement.

Progress

In October 1988, the GOP increased the DAP price from Rs 161 to Rs 185 per 50 Kg bag -- an increase of about 15 percent. Benchmark has been met.

Benchmark No. 2

By August 31, 1988, permit private sector inter-provincial movement of not less than 10 percent of the private sector's total imported fertilizer allotment.

Progress

The benchmark has not been met as yet. The GOP has been reminded of the need to implement this benchmark at the earliest.

Benchmark No. 3

By August 31, 1988, announce the decision to provide highest priority to private sector expansion of fertilizer capacity and to allow new public sector fertilizer plants only upon documentation that the private sector does not respond to existing demand by expanding the private sector capacities of existing plant(s) or investing in new plants.

Progress

The Ministry of Industries has agreed to make the required announcement. Benchmark is likely to be met shortly.

B. POLICY AREA: WHEAT

Benchmark No. 4

By July 31, 1988, increase the wheat release price to not less than 102 percent of procurement price (net of the cost of bags).

Progress

In April 1988, the GOP raised both release and procurement prices to Rs 2,100 and Rs 2,062 per metric ton, respectively. The release price thus became about 101.8 percent of procurement price. Benchmark has substantially been met.

C. Policy Area: Feed

Benchmark No.5

By July 31, 1988, eliminate restriction on the number and conditions upon which entities may import poultry feed components.

Progress

The situation on two principal importable feed ingredients - soybean meal and corn - is as follows: for soybean meal the distinction between "commercial" and "industrial" importers has been done away with as desired; and the recently announced trade policy has allowed private sector importation of corn. Benchmark has been met.

Benchmark No. 6

By July 31, 1988, eliminate import tariff (with the exception of iqra and import surcharge) on animal feed ingredients including but not limited to soybean meal.

Progress

There are no import tariffs (with the exception of iqra and import surcharge) on soybean meal. Corn imports, however, are subject to 40 percent import duty. Benchmark has only been partially met.

D. Policy Area: Water

Benchmark No. 7

By May 31, 1989, complete and adopt a water charge assessment study to improve collection.

Progress

The study is in progress and is expected to be completed by October 31, 1989.

Benchmark No.8

By August 31, 1988, announce that the provinces shall not undertake any future investments in new or replacement of tubewells for public operation in fresh ground water areas; and that the Punjab and Sind shall privatize existing tubewells in such fresh ground water areas according to schedules to be negotiated under the A.I.D. financed Irrigation Systems Management (ISM) project.

Progress

The GOP has agreed that except for South Rohri and Ghotki areas in Sind, no investment would be undertaken in new or replacement of tubewells for public operation in fresh ground water areas. Studies on the schedules for proposed privatization of such existing tubewells in Punjab and Sind, however, are being awarded for completion by October 31, 1989.

E. Policy Area: Agricultural Institutions

Benchmark No. 9

During Pakistan fiscal year 1988/89, agree to budget and release funds from the Statistics Division of the Ministry of Finance for the collection and dissemination of basic agricultural data, such as production, area and prices of basic crops etc.

Progress

This benchmark is aimed to provide more funds for agricultural data collection and publication activities under the Statistics Division. The development budget of the Statistics Division for Pakistan fiscal year 1988/89 is Rs 49.7 million of which Rs 26.5 and Rs 11.3 million have been allocated, respectively, to USAID-supported Agriculture Data Collection and Computer Modernization activities under the Food Security Management Project. No major issue is outstanding at the present relating to release of funds. The benchmark has been met.

Benchmark No. 10

By December 31, 1988, sanction the establishment of a Directorate of Agricultural Policy in Ministry of Food, Agriculture and Cooperatives with appropriate numbers of professional staff and adequate operating budget from Pakistani fiscal year 1988/89 onwards.

Progress

The Food and Agriculture Minister has approved a plan to merge the EPA Project Directorate and the Planning Unit within the Ministry of Food, Agriculture and Cooperatives. The merger plan seeks to create a "Planning Wing" comprising of four Directorates of Statistics, Economics, Policy and Projects. This plan has been approved by the Establishment Division and should be cleared by the Ministry of Finance as well in the near future. The merger plan when finally approved and implemented will meet the benchmark. It is expected to be completed before 1989 agreement is signed.

Benchmark No. 11

In NWFP establish administration and personnel procedures to effectively institute the union of agricultural research and education.

Progress

The Government of NWFP on October 29, 1988 issued a notification whereby the responsibility for management of research and education staff has been delegated to the Vice Chancellor. This effectively meeting the intent of the benchmark to facilitate the integration of agricultural research and education systems.

III. MAJOR POLICY REFORMS NOT SPECIFICALLY COVERED IN THE SAP'S FY 88 AGREEMENT

A. Policy Area: Credit

Benchmark

None.

Progress

In 1988, as a direct result of a USAID supported study, the GOP announced the replacement of mark-up (interest) free credit for agricultural inputs with credit at eight percent mark-up. Unfortunately, the GOP has recently reset the rate at seven percent. Nonetheless mark-up has gone from zero to seven percent, and mark-up free credit no longer appears to be considered a viable policy option by the GOP.

B. Policy Area: Seed

Benchmark

None.

Progress

Pursuant to recommendations of the USAID-supported Seed Industry Seminar (April 1987) and the National Commission on Agriculture (March 1988), a draft amendment in the Seed Act of 1976 on truthful labelling is under consideration in the Law Division.

C. Policy Area: Edible Oil

Benchmark

None.

Progress

Historically, the GOP decontrolled domestic prices of vegetable ghee and cooking oil (1986) and is maintaining variable tariff initiated earlier (1986) on imports. More recently, during the PFY 1988/89 budget, the requirement of license for edible oil/vegetable ghee based on local oilseeds, has been done away with.

IV. PROPOSED FY 89 BENCHMARKS

A. Policy Area: Fertilizer

1. Background and Objectives

Pakistan has been highly successful in developing a domestic fertilizer industry. An estimated 80 percent of Pakistan's farmers use fertilizer. However, much of this success has come at a high cost to the government in the form of subsidies largely on phosphatic fertilizers: government fixed DAP retail price formed about 63 percent of total financial cost prior to the October 1988 price increase and about 72 percent thereafter. The GOP also intervenes in the market to a major degree through distribution quotas for the imported fertilizers and state owned manufacturing plants.

The major objectives of policy change in the fertilizer area are to phase out fertilizer subsidies and to increase the role of the private sector in production, marketing and distribution.

2. Suggested Benchmarks

(a) By October 31, 1989, increase the retail price of DAP fertilizer by at least 25 percent from the October 1988 price of Rs 185 per 50 kg for DAP (new price should not be less than Rs 231 per 50 kg).

(b). By October 31, 1989, permit the private sector to allocate up to one-third of its quota for imported fertilizer (60 percent for the private sector) between provinces and markets without regard to provincial quotas.

(c) Announce that the Government does not intend to increase capacity in existing state owned fertilizer plants nor to build new plants, but that it will encourage the private sector to manufacture and market fertilizer. Increase in state owned fertilizer production capacity, if any, shall follow the procedures specified in Benchmark C of Agreement No. 88-13B of August 4, 1988.

B. Policy Area: Wheat

1. Background and Objectives

Wheat is one of the most important crops in Pakistan. The government is subsidizing 98 percent of the storage and handling costs which are estimated to be Rs 600 per metric ton.

The main areas of changes in wheat policy are price (and subsidy), supply to mills from public sector stocks, and quality. In October 1988, the GOP announced a new procurement price for the 1988/89 crop to be Rs 2,125 per metric ton, an increase of about 3 percent over the 1987/88 procurement price of Rs 2,062.5 per metric ton. As a part of the on-going policy negotiations, the GOP in April 1989 announced a new and higher release price of Rs 2,300 per metric ton, or an increase of 9.5 percent from the previous release price of Rs 2,100 per metric ton. This change increases the gap between the procurement price and the release price to 8.2 percent and reduces the GOP operating fiscal cost from Rs 4.3 billion to about Rs 2.4 billion. This pricing change also results in a saving of over Rs 1 billion by not having to construct additional storage capacity.

Following derationing in April 1987, the GOP began supplying wheat to mills in unlimited quantities. However, the GOP has increasingly reimposed restrictions on the quantity supplied and limited the number of purchasers. At the present wheat is only offered to flour mills based on 10-12 hours milling capacity. This is rationing. With targeted favorable release-procurement price relationships, the GOP is in a market clearing position and rationing is not needed.

The other area for policy change is wheat quality. The government currently has a policy of "no loss," which means that the government does not recognize the existence of normal handling or storage losses or shrinkage in buying and selling wheat. The Government also has a policy of "Fair Average Quality," or FAQ, which does not take into account the differences in such items as foreign matter, broken kernels, straw and moisture content in different lots of wheat. These two policies are currently being studied under the Food Security Management project by the Food and Feed Grain Institute of Kansas State University in collaboration with the Pest Management Institute of Karachi.

2. Suggested Benchmarks

(a). Subject to the quantity of 1990 wheat harvested, target a wheat release-procurement price ratio of 115 percent in 1990. The new release price should be announced in early May 1990 (when wheat harvesting is in full swing) and be effective July 1, 1990 (when the wheat procurement is about completed).

(b). By August 31, 1989, publicly and explicitly reaffirm the Government's policy that the release of wheat from public sector godowns will be unrestricted in both quantity and with regard to purchaser.

(c). Based on the study of "no loss" policy and "Fair Average Quality" conducted by Food and Feed Grain Institute, Kansas State University and Pest Management Research Institute, the Government will conduct a seminar/workshop to review the recommendations of the study and as appropriate, eliminate the "no loss" policy and modify grain quality standards. Policy changes, as appropriate, will be implemented by June 30, 1990.

C. Policy Area: Sugar

1. Background and Objectives

The EAN study, The Pakistan Sugar Industry: An Economic and Policy Analysis, October 1988, points out impressive deregulation of the industry in recent years. The study, however, suggests changes in mill location approval procedures. Investors intending to set up new sugar mills require location approval from provincial governments. This can cause delay and discrimination. An alternative to this current system is to announce a list of approved "negative" areas where mills may not be established and entrepreneurs may be free to set up mills in areas not on the "negative" list. Punjab and Sind provinces have recently developed "negative" list procedures. The NWFP province, however, has not; while sugarcane output is not significant in the Balochistan province.

2. Suggested Benchmark

By August 31, 1989, announce a list of negative areas where sugar mills may not be established and announce that mills may be established in areas not in the list in the Punjab, Sind and NWFP.

D. Policy Area: Basmati Rice

1. Background and Objectives

Recently private sector participation in rice exports has increased: in April 1988 the requirement for private sector to use the stocks of

Rice Export Corporation of Pakistan (RECP) for its exports was discontinued and in May 1988 private traders were allowed to export Basmati rice in packages of 20 Kgs compared with 10Kgs earlier. This progress notwithstanding, RECP continues to have a dominant role in export marketing. The private sector has long been suggesting the reduction of export duty (Rs 4,000 per metric ton) and permission to export in 25 Kgs bag like the RECP. In the context of IMF and the World Bank agreements, a study on the cost structure of RECP is planned by the GOP to be completed by October 1989 to provide a basis for recommendations for efficiency improvements.

2. Suggested Benchmarks

(a). By November 30, 1989, convene a meeting to be attended by USAID/Islamabad representatives to review the study on the cost structure of the Rice Export Corporation of Pakistan and private and public performance in basmati rice exports during Pakistan fiscal year 1988/89, and to agree upon measures to increase private sector participation in rice trade.

(b). By December 31, 1989 reduce export duties for private sector from the existing Rs 4,000 to Rs 2,000 per metric ton provided it is not at variance with the findings of the study (expected to be completed in October 1989) on the cost structure of the Rice Export Corporation of Pakistan and subsequent discussions with the World Bank.

E. Policy Area: Agricultural Credit

1. Background and Objectives

In 1988 the GOP announced the replacement of markup free credit with credit at eight percent markup. This, however, has recently been scaled down to 7 percent. It is proposed to continue to encourage the GOP to align the mark up rate more closely with the generally prevalent market rate of 14 percent (which nonetheless is still lower than the true market rate).

2. Suggested Benchmark

By May 31, 1990, with the assistance of USAID/Islamabad, complete a study to determine the impact of changes in mark up rate on flow of credit to small farmers.

F. Policy Area: Milk and Milk Products

1. Background and Objectives

Capacity in the UHT (Ultra High Temperature) milk industry is utilized only to the extent of 35 percent primarily due to limited demand for processed milk products in Pakistan. The industry can increase

production, income and employment through exploiting potential markets abroad particularly in the Middle East. The industry however, is seriously constrained in its export endeavor by the presence of export restrictions on milk and milk products.

2. Suggested Benchmark

By September 30, 1989, revise Export Control Trade Order 1987, as amended by SRO 553 (1) 88 of June 30, 1988 to allow the private sector to export UHT milk and milk products.

G. Policy Area: Agricultural Research

1. Background and Objectives

One of the perennial problems of researchers in Pakistan is the lack of operational funding for research. Recently the problem has gotten worse. For example, up to 90 percent of the PARC FY 1988/89 budget is for salaries and allowances etc., which leaves very little funding for research, travel expenses, gas and oil, and other operating expenses associated with field research.

Another budgeting issue is that the Government of Pakistan needs to provide enough budget cover for continuing USAID funded projects, even during periods of budget contingency. USAID funded projects cannot function satisfactorily without adequate budget cover under the Annual Development Plan (ADP).

2. Suggested Benchmarks

(a). For the 1989/90 fiscal year budget not more than 80 percent of the budget for agricultural research institutions (PARC, NARC, etc.) will be for salaries and allowances etc. Operational research expenses will be increased to Rs. 125 million in PFY 1989/90, freeze on numbers of overall staff will appropriately be imposed until operating cost is about 40 percent of the research budget.

(b). For the 1989/90 fiscal year budget will provide adequate funding and ADP budget cover for all continuing USAID funded agricultural and rural development projects in accordance with the projected requirements, unless otherwise agreed upon by USAID and the relevant Ministry involved. In the case of research, the total 1989/90 development budget will be Rs 180 million of which the estimated required GOP local currency funding is Rs 46 million.

H. Policy Area: Policy Analysis

1. Background and Objectives

Export restrictions, aimed to relax demand pressures in the domestic market, prohibit full exploitation of the export potential and, in the

final analysis, adversely impact national income and employment. While the information on negative affects of export restrictions on rice and milk is relatively clear, the impact of restrictions on other commodities needs study. It is important to fully analyze the public revenue, income and employment impact of export duties on agriculture related products to formulate an effective export policy. Export duties on tomatoes, peppers and the like decrease farmers' income, reduce employment, take away Pakistan's comparative advantage, and distort market signals. A worst case scenario is if Pakistan continues to capriciously change the export environment, donors would stop financing technology transfer, training and infrastructure for exports.

2. Suggested Benchmark

By August 31, 1989, the GOP with the assistance of USAID/Islamabad, will develop and approve the terms of reference of an export restriction study to be funded under the Technical Assistance and Training component of ASSP.

V. UNACCOMPLISHED FY 1988 BENCHMARKS INCLUDED IN FY 1989 AGREEMENT

According to 1987 PAAD understanding (section III.D.1), any benchmark not implemented in a given year will automatically be included on the next year's benchmarks list. The following three unaccomplished FY 1988 benchmarks are thus included in FY 1989 benchmarks list.

A. Benchmark No. 1: Fertilizer

Announce decision regarding private sector led fertilizer production (benchmark No. 3 of section II). The GOP has agreed to make the required announcement, which should come forth by December 31, 1989.

B. Benchmark No. 2: Water Charges

Complete and adopt a water charge assesment study to improve collection (benchmark No. 7 of section II). The on-going study in this respect should be completed by October 31, 1989.

C. Benchmark No. 3: Public Tubewells

Announce schedule for privatization of public tubewells in fresh groundwater areas (benchmark No. 8 of section II). The studies aimed at developing schedule for privatization of existing public tubewells in Punjab and Sind provinces should be completed by October 31, 1989.