

PROGRAM ASSISTANCE
APPROVAL DOCUMENT
(PAAD)

1. PAAD Number 612-0225	612-K-601 C/TF 612-K-601 A
2. Country MALAWI	Initial File Copy
3. Category Cash Transfer	
4. Date Sept. 9, 1985	
5. To Mark L. Edelman AA/AFR	6. OYB Change Number N/A
7. From Larry Hausman AFR/PD	8. OYB Increase N/A To be taken from: ESF Account.
9. Approval Requested for Commitment of \$15,000,000	GESA -85-31612-KG31(537-61-612-00-50-51)
	10. Appropriation Budget Plan Code GESA-85-31612-KG39(537-61-612-00-53-51)

11. Type Funding <input type="checkbox"/> Loan <input checked="" type="checkbox"/> Grant	12. Local Currency Arrangement <input type="checkbox"/> Informal <input checked="" type="checkbox"/> Formal <input type="checkbox"/> None	13. Estimated Delivery Period 9/85- 9/88	14. Transaction Eligibility Date Grant Obligation
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15. Commodities Financed
N/A

16. Permitted Source U.S. only Limited F.W. \$1,900,000 (T.A.) Free World Cash \$13,100,000 cash transfer	17. Estimated Source U.S. \$1,000,000 Code 000 Industrialized Countries Local 900,000 Code 941 and/or Other Host Country
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18. Summary Description

This program will provide \$15.0 million in grant funds to support the structural adjustment program currently being undertaken by Malawi with the assistance from other donors. AID funds will be targetted to assist the GOM in developing a policy and institutional environment that will promote efficient diversification of smallholder agriculture in Malawi. Through a cash transfer, \$13.1 million will be disbursed in three annual tranches of \$4.0 million in years 1 and 2 and \$5.1 million in year 3. The remaining \$1.9 million will be used to fund technical assistance and training to carry out studies in support of the smallholder diversification objectives of the program as detailed on pg. 47 of the PAAD.

Prior to disbursement of the first tranche of \$4.0 million of the cash transfer, except as AID may otherwise agree in writing, the GOM will announce fertilizer prices such that the average subsidy level for 1985/86 does not exceed 22.6% of the marginal cost of fertilizer, and will present to AID tender documents indicating that at least 10% of the total tonnage of fertilizers to be procured for the 1986/87 crop year will be high analysis fertilizers (such as urea and diammonium phosphate).

19. Clearances	Date	20. Action
DAA/AFR:ELSaiers <i>EL</i>	9/18/85	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED
GC/AFR:TBork <i>GC</i>	9/13/85	
AFR/SA:RCarlson <i>RC</i>	9-17-85	
AFR/DP:HJohnson <i>HJ</i>	9/17/85	
FM/PAFD:ESowens <i>ES</i>	9/17/85	
AFR/PD/SAP:WStickel <i>WS</i>	9/17/85	Authorized Signature <i>Mark L. Edelman</i>
		Date 9/18/85
		Title Assistant Administrator

Prior to disbursement of the second tranche of \$4.0 million, except as AID may otherwise agree in writing, the GOM will announce fertilizer prices such that the average subsidy level does not exceed 17% of the marginal cost of fertilizer, and will present to AID tender documents indicating that at least 25% of the total tonnage of fertilizers to be procured for the 1987/88 crop year will be high analysis fertilizers.

Prior to disbursement of the third tranche of \$5.1 million, except as AID may otherwise agree in writing, the GOM will announce fertilizer prices such that the average subsidy level in 1987/88 does not exceed 12% of the marginal cost of fertilizer, and will present to AID tender documents indicating that at least 45% of the total tonnage of fertilizer to be procured for the 1988/89 crop year will be high analysis fertilizers.

In addition, several covenants will be included in the Grant Agreement, as follows:

[a] the GOM will submit to AID, in form and substance satisfactory to AID, a plan for the use of local currencies for purposes other than the Smallholder Fertilizer Revolving Fund (SFRF) and the Ministry of Agriculture's Agricultural Development Divisions revolving credit fund prior to the disbursement of local currencies for such purposes;

[b] for the purpose of this agreement, except as AID may otherwise agree in writing, the parties agree to define "subsidy" as the difference between the price the farmer pays for fertilizer at an ADMARC depot, and the marginal cost to the SFRF of delivering commercial imports to that depot. The "subsidy level" is the ratio of the subsidy to the marginal cost to the SFRF. By this definition, subsidy levels are deemed to include the five percent fertilizer levy. In the event that the levy is reduced, it is agreed that the measure of the "subsidy level" will also be reduced by the amount of the reduction of the levy.

[c] The parties agree that, except as AID may otherwise agree in writing, the subsidy level referred to in this Agreement is the weighted average subsidy for all fertilizer imports through the SFRF. Specific subsidy levels on different types of fertilizer will vary.

[d] Except as AID may otherwise agree in writing, to the extent that subsidies are required to encourage the increased utilization of high analysis fertilizers, the GOM agrees that the subsidies on high analysis fertilizers should be greater than the subsidies on the conventional types of fertilizers presently used in Malawi.

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ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/PD, Larry Hausman

Subject: The Malawi Economic Policy Reform Program (MEPREP)

Action: Your approval is required for a grant of \$15.0 million from the Economic Support Fund for subject program. The entire LOP funding will be obligated in FY 85.

Background: The impressive growth of Malawi's economy during the decade of the 70's came to a halt in 1979 and a decline by about 7% of GDP occurred in the following two years. The primary factors involved in this rapid reversal of what had appeared to be a bright economic future were primarily external but they revealed important structural weaknesses in the Malawi economy. Heavy concentration of exports in a small number of agricultural commodities left the economy too vulnerable to cyclical swings in export prices. Smallholders, the largest segment of the farm population, had depended upon a narrow base of commodities for export and growth in production of these commodities had declined substantially. Deteriorating financial conditions and management deficiencies of public enterprises providing agricultural services had contributed to the bottlenecks facing smallholders. Finally, the GOM was limited in its ability to respond to these problems due to growing budget deficits, restrictive price and wage policies, and balance of payments difficulties.

With the assistance of the international donor community, Malawi has been successfully restructuring its economy in recent years. GDP is exhibiting modest growth and budgetary imbalances are beginning to narrow. Malawi was selected as one of AID's EPRP countries because of the GOM's commitment to policy reform in the agriculture sector and recent progress in this area.

Program Description:

Long term growth and development depend on continued diversification, particularly in the smallholder sector. This program complements the larger structural adjustment program which the GOM is currently undertaking with the assistance of other donors, the World Bank through its Structural Adjustment Loans, and the IMF through its stabilization program.

AID funds will be provided through a cash grant mechanism as the GOM makes progress in eliminating subsidies and concentrates more resources on high intensity fertilizer. The purpose of eliminating fertilizer subsidies is to reduce the drain on fiscal resources, increase the efficiency with which agricultural development resources are allocated, and promote diversification of smallholder production into crops which require less fertilizer inputs.

Shifting to more high analysis fertilizers will substantially decrease the unit transport costs per fertilizer nutrient, contributing further to reduce the fiscal drain and promoting more selective use of fertilizer for higher value crops. The program consists of two components: (1) a cash grant of \$13.1 million to be disbursed in three annual tranches; and (2) a technical assistance component of \$1.9 million to be used to provide technical assistance and training in reducing the costs and increasing the efficiency of fertilizer use, to investigate ways to increase the efficiency of agricultural marketing, and to assist the GOM in managing its strategic grain reserve.

(A) Cash Grant Component

The cash grant will be provided in three annual tranches of \$4.0 million in each of the first and second years and \$5.1 million in the third year. Disbursement of each tranche will be conditioned on satisfying specific conditions precedent as described below.

The kwacha equivalent of the \$13.1 million cash grant, will be programmed jointly by AID and the GOM to promote agricultural diversification and rationalization of smallholder marketing. The specific local currency uses include the following, in order of priority:

- *capitalization of the smallholder fertilizer revolving fund (SFRF);
- *capitalization of the MOA Agricultural Development Divisions' revolving credit fund to offset, in part, the negative impact of fertilizer price increases on the incomes of smallholders;
- *assistance to the GOM in assuming some of the costs of maintaining the strategic grain reserve, including possibly the costs of purchasing maize and the costs of handling, fumigating and managing the stocks, all presently being borne by the Agricultural Marketing and Development Corporation (ADMARC); and
- *other activities in the areas of agricultural marketing and input delivery, such as feeder road construction, village-level storage facilities and credit for private traders.

(B) Technical Assistance Component

Program-financed inputs under this component include:

- *a number of studies related to fertilizer use, agricultural marketing, and management of a strategic grain reserve;
- *training for ADMARC staff in financial management, logistics, planning and grain storage management and for key ministry staffs in national planning and budgeting; and
- *expansion of the Ministry of Agriculture's soil testing laboratory.

These studies will provide data needed for decisions on allocating local currency under the cash grant component of the program. The Mission plans to carry out the studies through existing contract mechanisms, including on-going cooperative agreements and

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centrally-funded projects, IQC's, PASA's, and host country contracts. The bulk of these contracting actions, if not all, would not require significant Mission backstopping support.

Conditions Precedent and Covenants:

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Prior to disbursement of the second tranche of \$4.0 million, except as AID may otherwise agree in writing, the GOM will announce fertilizer prices such that the average subsidy level does not exceed 17% of the marginal cost of fertilizer, and will present to AID tender documents indicating that at least 25% of the total tonnage of fertilizers to be procured for the 1987/88 crop year will be high analysis fertilizers.

Prior to disbursement of the third tranche of \$5.1 million, except as AID may otherwise agree in writing, the GOM will announce fertilizer prices such that the average subsidy level in 1987/88 does not exceed 12% of the marginal cost of fertilizer, and will present to AID tender documents indicating that at least 45% of the total tonnage of fertilizer to be procured for the 1988/89 crop year will be high analysis fertilizers.

In addition, several covenants will be included in the Grant Agreement, as follows:

[a] the GOM will submit to AID, in form and substance satisfactory to AID, a plan for the use of local currencies for purposes other than the Smallholder Fertilizer Revolving Fund (SFRF) and the Ministry of Agriculture's Agricultural Development Divisions revolving credit fund prior to the disbursement of local currencies for such purposes;

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[c] The parties agree that, except as AID may otherwise agree in writing, the subsidy level referred to in this Agreement is the weighted average subsidy for all fertilizer imports through the SFRF. Specific subsidy levels on different types of fertilizer will vary.

[d] Except as AID may otherwise agree in writing, to the extent that subsidies are required to encourage the increased utilization of high analysis fertilizers, the GOM agrees that the subsidies on high analysis fertilizers should be greater than the subsidies on the conventional types of fertilizers presently used in Malawi.

Negotiating Status: These conditions have been negotiated with the GOM and have been agreed to in principal. The Mission expects to sign the Grant Agreement by September 20, 1985.

Status of Pre-Authorization Actions: The program review meetings have concluded that the program approach is technically and economically sound, as well as socially acceptable. The ECPR recommended that the PAAD be approved subject to several changes, including:

*The elimination of the management support unit under the technical assistance component. The ECPR concluded that this would be better carried out either with the use of other than Economic Policy Reform funding or as an other-donor supported activity. The \$1.1 million budgetted for this activity has been transferred to the cash grant component of the program.

*The provision of information on the studies to be carried out under the Technical Assistance Component to satisfy 611 (a) considerations.

*The addition of a covenant requiring that the GOM submit a plan for use of local currency for other than capitalization of the SFRF or MOA's smallholder credit funds.

*An implementation plan covering both the local currency and T.A. components.

These changes have been incorporated in the PAAD.

The Bureau's Environmental Officer has reviewed the IEE and has concurred in a categorical exclusion.

There are currently no human rights issues in Malawi.

An Advice of Program Change was forwarded to Congress and the waiting period expired on August 9, 1985 without objection.

The USAID/Malawi Representative, John Hicks, will be the AID officer responsible for negotiating and implementing this program. The program backstop in AID/W will be Karen Nurick, AFR/PD/SAP.

Recommendation: That you approve the proposed Malawi Economic Policy Reform Program in the amount of \$15.0 million by signing the attached PAAD facesheet (Tab A).

Clearances:

DAA/AFR:	LSaiers <u>N</u>	Date	
AFR/SA:	RCarlson <u>RC</u>	Date	<u>9-17-85</u>
GC/AFR:	TBork	Date	
AFR/PD/SAP:	WStickel [draft]	Date	<u>9/17/85</u>
AFR/DP:	HJohnson <u>HJ</u>	Date	<u>9/17/85</u>
AFR/PMR:	DFBrown <u>DFB</u>	Date	<u>9/17/85</u>

KJN
 Drafted: KJNurick:0190L:x28818:9/9/85