

MALAWI

AGRICULTURE SECTOR

ASSISTANCE PROGRAM

(ASAP)

612-0239

PAAD AMENDMENT

SEPTEMBER 1994

ACTION MEMORANDUM FOR THE DIRECTOR, USAID/MALAWI

FROM: Thomas D. Lofgren, PPD *HLofgren*
SUBJECT: Agricultural Sector Assistance Program (ASAP);
Program Assistance Approval Document (PAAD)
Supplement
NPA Number 612-0239
DATE: September 29, 1994

I. PROBLEM:

You are requested to approve the PAAD Supplement for the Agricultural Sector Assistance Program (ASAP) which: a) increases anticipated life of program (LOP) funding by \$35 million to a new total of \$55 million; b) extends the program assistance completion date by four years from September 30, 1994 to September 30, 1998; and c) authorizes \$13 million of NPA for obligation in FY94.

II. DISCUSSION:

A. Background:

ASAP was authorized on September 26, 1991 with a three-year life of program and a combination of NPA and project funding totalling \$30 million (\$20 million in NPA and \$10 million in project assistance). The original ASAP design envisioned two phases, each involving grant funding of \$20 million in NPA. Project funding, also planned over the two phases of the program, was considered an integral and complementary part of ASAP, and was included to support GOM implementation of the reform agenda. Based on the results of a mid-term evaluation, the project component of ASAP was amended in August, 1993, to expand the scope of activities, to provide an additional \$5 million in LOP funding (from \$10 million to \$15 million), and to extend the PACD by two years from September 30, 1996 to September 30, 1998.

This PAAD Supplement amends the NPA component of ASAP and provides the justification, analytical framework and actions required for the second phase of ASAP, or ASAP II. The Supplement also extends the completion date of the program by four years, from September 30, 1994 to September 30, 1998; and increases NPA funding by \$35 million to a new total of \$55 million. The strategy actions and reforms presented in this Supplement support the GOM's policy and institutional reform efforts as reflected in the Ministry of Agriculture and Livestock Development's draft strategy statement. The attached Letter of Request from the GOM (Annex D) requests U.S. Government support for the reform program included in this PAAD Supplement.

The ASAP II reform agenda complements both the Mission's revised development strategy in Malawi (1994) and the policy and institutional reform efforts of other donors. Development of this Supplement was guided by the results of the above-mentioned mid-term (1993) evaluation, by numerous technical and policy-related studies, and by an ongoing dialogue, at all levels, between USAID and the GOM on agricultural policy and institutional reforms. Additionally, as discussed in the PAAD, the Supplement reflects USAID's commitment to stakeholder involvement in program design and implementation.

ASAP II continues efforts initiated under ASAP I to bring about major structural adjustments, essentially the breakdown of dualism and the reduction of government control in the Malawian rural economy over time. The intended impact of this program, combined with other donor efforts, is the transformation of the Malawian economy into an economy where all Malawians have equal access to private markets and productive resources, and that is free of biases for or against any category of farmer.

The most dramatic set of policy reforms enacted to date under ASAP I included eliminating prohibitions against smallholder production and marketing of high value export crops, especially burley tobacco, the most lucrative cash crop in Malawi. The impact of these liberalization measures alone has accounted for approximately \$16 - \$20 million in increased income to some 30,000 smallholder families.

B. Program Description:

Because of the dramatic change in Malawi's political culture since the design of ASAP I, these initial reforms are now irreversible, and have provided the foundation and momentum for the broader reform package included in this Supplement. ASAP II expands the reform process by taking further bold steps to reverse the marginalization of the rural poor by integrating them fully into the economic mainstream.

The goal, purpose and strategy of ASAP II remain the same as for ASAP I. As described in PAAD Section IV, titled Program Description, the presentation of program themes has been modified to reflect the inter-relationships between the original PAAD design's four basic themes. The ASAP II program comprises a package of policy and institutional reforms that is categorized under two themes:

1. Increasing equity and efficiency through liberalizing input markets; and
2. Increasing equity and efficiency through expanding market competitiveness and institutional reform.

ASAP II reforms under the first theme involve removing constraints to private sector participation in input supply

and distribution. Reforms contained under the second theme are divided into four groups: tobacco subsector; producer and consumer price liberalization; government owned/sponsored agricultural organization reform; and rural market development.

The Tobacco Subsector category contains reforms which focus on eliminating ADMARC's exclusive tobacco marketing arrangements, improving the overall efficiency of the national burley quota system, and developing appropriate policies for strengthening smallholder credit and marketing clubs.

The Consumer and Producer Price Liberalization category includes reform actions designed to stabilize maize prices and eliminate all limitations on private sector buying and selling of smallholder produced commodities.

The category of Government Owned/Sponsored Agricultural Organization Reform includes an examination of the purpose and performance of statutory bodies, government trusts, government-sponsored organizations, and parastatals operating in the agricultural sector. Based on this examination, the GOM will prepare an action plan for reforming these organizations and implement action plan recommendations.

Finally, the Rural Market Development category involves a broad set of actions such as developing and implementing policies for ADMARC to sell, lease and rent its retail facilities; improving the process for obtaining import/export licenses; implementing a national business licensing system; developing improved investment incentives for rural enterprises; and establishing a duty reduction system for the import of agricultural and agri-business inputs.

A policy framework for ASAP II is contained in the PAAD Policy Matrix. Specific language for conditions precedent and covenants is contained in the draft Agreement Amendment No. 1, Annex C.

III. DISBURSEMENT MECHANISM:

On September 22, 1994, the Assistant Administrator for Africa approved: a) the use of the cash transfer disbursement method for ASAP and b) an exemption from dollar separate account legislation pursuant to Section 537 (b)(4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act. This exemption was notified to Congress as described below in Section X., Special Concerns. The Assistant Administrator's approval for "a" and "b" above is contained in Annex H.

As a result of the exemption, dollar disbursements do not have to be deposited in a separate account and programmed for specific uses. Further, there will be no local currency generations or deposits made by the GOM under ASAP II. However, it is anticipated that the GOM will make a counterpart contribution under ASAP II of \$24 million, bringing total counterpart funding under both phases of ASAP

to an estimated \$39 million. Counterpart funding under Phase II will be budgeted for and expended on budget line items supporting the policy and institutional reform agenda. USAID will monitor GOM financial commitments through GOM Letters of Intent (LOI). LOIs will be required prior to the initiation of each tranche period and, among other requirements, will include a description of the financial resources to be provided by the GOM in support of reform activities contained in the upcoming tranche. The Grant Agreement will require USAID satisfaction that the funds committed by the GOM in the LOIs were actually made available prior to USAID disbursements.

IV. FEASIBILITY:

The PAAD Supplement includes updates of all the standard USAID-required feasibility analyses, including a significantly more comprehensive economic analysis than was included in the original PAAD. ASAP II has been found to be economically, technically, socially, and institutionally feasible.

V. FINANCIAL PLAN:

Financial plans for ASAP are contained in the PAAD Supplement. The PAAD facesheet authorizes FY94 funding of \$13 million. Additional obligations totalling \$22 million (\$11 million each in FY95 and FY96) are anticipated over the LOP.

VI. ECPR ISSUES:

On September 7, 1994, representatives from PPD, AFS, FMO and REDSO/RLA met to review the ASAP II PAAD Supplement and identify issues and other concerns for executive review consideration. The executive review with the same representatives, chaired by the Mission Director, was held on September 9, 1994. The issues raised at the ECPR and how they have been addressed in the PAAD are summarized below:

A. Does the PAAD represent a sufficiently comprehensive perspective on how ADMARC will/should be transformed under ASAP II? Instead of dealing with a series of conditions which affect ADMARC's role in smallholder production as the PAAD currently does, should ASAP approach these conditions by subsuming them under a plan to develop a new role for ADMARC? The ECPR concluded that the two-pronged approach contained in the PAAD was the best option. This approach permits the opportunity for rapid reform in areas where the momentum resulting from ASAP I is greatest - for example, in the tobacco subsector. Over the medium term, the results of a broader review of ADMARC and its role in a liberalized agricultural economy will be undertaken, and mutually agreed upon results implemented.

B. Given the GOM's concern about raising fertilizer prices to smallholders as a result of the condition to eliminate fertilizer fiscal subsidies, should ASAP take a more gradual approach to subsidy elimination? The ECPR recommended that the PAAD remain firm in the requirement to eliminate the

fiscal subsidy by the 1995/1996 crop season. The GOM has the option of "cushioning" the transition to import parity prices by using funds generated from non-buffer stock fertilizer sales as described in the PAAD.

C. If the GOM distributes free maize seed for planting next year because of the drought, will this affect ASAP II's condition in tranche 5 to completely eliminate the subsidy? As with (B), above, ASAP seeks to eliminate fiscal subsidies. Targeted distribution of free donor maize seed as a form of drought relief poses no problem.

D. Lack of credit is cited repeatedly as a constraint in the PAAD. How is this constraint being addressed by ASAP II? The ECPR noted this is a very tough issue, and that the GOM and the World Bank are currently grappling with restructuring the credit system. The decision was made to monitor progress in this area over the next year. If at that time there is a rationale for USAID/M involvement we could do so through an amendment to the agreement.

E. Some of ASAP's conditionality/action plans will be the responsibility of organizations outside the MOA (e.g. EP&D, OPC). How do we insure that the organizations that should have responsibility for an action are actually given that responsibility in the implementation of ASAP? The ECPR endorsed the requirement contained in the PAAD of having letters of intent identify the responsible agent for each condition or required action. This was deemed to be a more effective method of fixing responsibility than trying to do so through the program management committee.

F. Additional funding: If as anticipated, USAID/W provides the Mission with additional funds to incorporate into ASAP II, how do we modify the conditionality? The ECPR recommended providing a new, earlier tranche, making ASAP II a four rather than a three tranche program. Conditions to be included in this initial tranche would likely include those relating to a) deregulating marketing channels for all tobacco, and b) raising maize producer prices to at or near export parity prices. (Additional funding was provided and the PAAD modified to reflect the above recommendation.)

G. Earmark: USAID/W is exploring whether some level of ASAP II funds could be included in the FY94 environmental earmark. The ECPR had no problem in this regard and is waiting for further information and guidance on the matter from USAID/W.

H. Role of Women: The recommendation was made to expand the discussion of gender issues in the PAAD. The ECPR concurred and the PAAD now reflects this recommendation.

VII. CONDITIONS PRECEDENT TO DISBURSEMENTS:

The conditions precedent to disbursements are contained in the PAAD Policy Matrix and in the draft Program Agreement Amendment No. 1, contained in Annex C.

VIII. OTHER CONCERNS:

A. Notification to Congress: A Congressional Notification (CN) was submitted to the Congress on August 14, 1994, which: a) increased authorized LOP funding by \$30 million to a new total of \$50 million; and b) contained an exemption for the separate dollar account and tracking requirement pursuant to Section 537 (b)(4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act. That CN expired without exception on August 26, 1994. A second CN was submitted on September 14, 1994, which increased authorized LOP funding by an additional \$10 million to a new total of \$60 million. This CN expired without exception on September 29, 1994.

B. Exemption for Dollar Tracking: As stated above, the CN which expired on August 26, 1994, contained an exemption to the separate dollar account and tracking requirement.

C. Cash Transfer Approval: The action memorandum for the cash transfer was approved by AA/AFR on September 22, 1994.

D. Waiver of Returned Interest to U.S. Government: Per Kleinjan-Vance e-mail of September 29, 1994, it is our understanding that a waiver has been granted to exempt this program from the requirement to track interest earnings on cash transfers per State 205189.

E. Technical Reviews: Relevant sections of the PAAD Supplement have been reviewed by the RLA, the Mission Controller, and appropriate other USAID/M staff. All clearances have been noted on the PAAD facesheet.

F. Initial Environmental Examination (IEE): Categorical Exclusions and Negative Environmental Determinations have been approved by USAID covering all reform activities included in this PAAD Supplement. To assure continued progress in the environmental program, the IEE made several recommendations which have been incorporated into the covenants and conditionality of ASAP II. The IEE is contained in PAAD Annex B.

G. Statutory Checklist: The RLA determined that no statutory checklist was required under this PAAD Supplement.

IX. DELEGATION OF AUTHORITY:

State 262062 provided a delegation of authority (DOA) to the USAID/M Mission Director, or to the person acting in that capacity, to authorize a \$35 million amendment to ASAP for a new authorized LOP of non-project assistance not to exceed \$55 million, and to extend the PACD to September 30, 1998. This ad hoc DOA shall be exercised in accordance with the terms and conditions of DOA 551, except for the dollar amount limitation on the total combined project/program amounts of ASAP.

X. RECOMMENDATIONS:

That you:

- A. Approve the PAAD Supplement for the Agricultural Sector Assistance Program (ASAP) which: 1) increases anticipated Life of Program (LOP) funding by \$35 million to a new total of \$55 million; and 2) extends the Program Assistance Completion Date by four years from September 30, 1994 to September 30, 1998;
- B. Authorize \$13 million of NPA for obligation in FY94 under Program No. 612-0239; and,
- C. Sign Amendment No. 1 to the ASAP Program Grant Agreement thereby obligating \$13 million in DFA grant funds.

APPROVED

Cynthia Flozell

DISAPPROVED _____

DATE

30 September 1994

Attachments:

- 1. PAAD Facesheet
- 2. PAAD

Clearances:

MSarhan, PROG: *[Signature]* 9/27/94
TLOfgren, PPD: *[Signature]* 9/29/94
KRockeman, AFS: *[Signature]* 9/29/94
GROzell, AFS: *[Signature]* 9/29/94
MPowdermaker, CONT: *[Signature]* 9/29/94
TFillinger, RLA(ID) 9/15/94
SScott, DD: *[Signature]* 29 Sept. 94

Drafted: DHimelfarb *[Signature]* 9/27; file p:\afs\actmemo

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AID 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT		1. PAAD NO. 612-T-604A (612-0239)	
			2. COUNTRY Malawi	
			3. CATEGORY Non Project Sector Assistance	
			4. DATE September 27, 1994	
5. TO: Cynthia F. Rozell Mission Director		6. OYB CHANGE NO. N/A		
7. FROM: Thomas D. Lofgren, PPD, USAID/Malawi <i>T. Lofgren</i>		8. OYB INCREASE TO BE TAKEN FROM: N/A		
9. APPROVAL REQUESTED FOR COMMITMENT OF \$ 13,000,000		10. APPROPRIATION - BUDGET PLAN CODE 72-114-51014 GSS4-94-3161-2-KG39		
11. TYPE FUNDING LOAN GRANT X	12. LOCAL CURRENCY ARRANGEMENT INFORMAL FORMAL NONE X	13. ESTIMATED DELIVERY PERIOD 9/94 - 9/98	14. TRANSACTION ELIGIBILITY DATE Satisfaction of all actions required in tranches 4,5,6 & 7.	
15. COMMODITIES FINANCED None.				
16. PERMITTED SOURCE U.S. only:		17. ESTIMATED SOURCE U.S.: N/A		
Limited P.W.:		Industrialized Countries:		
Free World:		Local:		
Cash: \$ 13,000,000		Other:		
18. SUMMARY DESCRIPTION (See attached)				
19. CLEARANCES		20. ACTION		
DATE		APPROVED <input checked="" type="checkbox"/> DISAPPROVED <input type="checkbox"/>		
MSarhan, PPD	<i>[Signature]</i> 9/29/94	<i>Cynthia F. Rozell</i> AUTHORIZED REPRESENTATIVE DATE: 30 Sept 1994		
KRockeman, AFS	<i>[Signature]</i> 29 Sept. 1994			
GRozell, AFS	<i>[Signature]</i> 29 Sept 1994			
MPowdermaker, CONT	<i>[Signature]</i> 9/29/94			
TFillinger, RLA (In Draft 9/15/94)				
SScott, DD	<i>[Signature]</i> 29 Sept. 94	Cynthia F. Rozell Mission Director, USAID/Malawi		

PAAD SUPPLEMENT FACESHEET, ITEM 18, SUMMARY DESCRIPTION

The attached PAAD Supplement contains the justification and analytical framework for increasing LOP funding by \$35 million in NPA funds to cover the second phase of the Agricultural Sector Assistance Program. Of this amount, the PAAD Supplement facesheet authorizes \$13 million in FY94 resources for cash disbursements. This supplement, together with the original phase one program, brings the anticipated total LOP amount to \$55 million in NPA funds.

As under the first phase of ASAP, the purpose of this second phase program is to support agricultural sector reforms which increase smallholder access to agricultural inputs, output markets, cash crop production alternatives and labor market information. Phase two funding will be disbursed over four tranches subject to USAID satisfaction of required actions linked to each tranche. These actions, together with such other terms and conditions deemed appropriate by USAID, are presented in PAAD Annex C, which contains the draft Program Agreement Amendment No. 1.

ASAP II will be exempt from the separate dollar account and tracking requirement pursuant to Section 537 (b)(4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act. Congress was notified of USAID's intent to allow this exemption through the normal Congressional Notification process. The program will not generate local currency nor require a special local currency deposit.

Pursuant to Chapter 10 of the Foreign Assistance Act of 1961, as amended, and provisions of Title II of the FY 1991 Foreign Operations, Export Financing and Related Programs Appropriations Act, under the heading "Sub-Saharan Africa, Development Assistance," I hereby approve for obligation the non-project component described herein.

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

NPA: 612-0239

**Program Assistance Authorization Document (PAAD)
Supplement**

**September 29, 1994
USAID/Malawi**

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

NPA: 612-0239

PROGRAM ASSISTANCE APPROVAL DOCUMENT (SUPPLEMENT)

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ATTACHMENTS:

- Annex A: Bibliography
- Annex B: Initial Environmental Examination
- Annex C: Draft Agreement Amendment No. 1
- Annex D: Letter of Request
- Annex E: Logical Framework
- Annex F: CN Release Cable
- Annex G: DOA Cable
- Annex H: Action to AA/AFR for Cash Transfer

GLOSSARY OF TERMS AND ACRONYMS

ADMARC	Agricultural Development and Marketing Corporation
AH	Action Holdings
ASAC	Agricultural Sector Assistance Credit
ASAP	Agricultural Sector Assistance Program
DREA	Department of Research and Environmental Affairs
EC	European Community
EMP	Environmental Management Program
EMEMP	Environmental Monitoring, Evaluation and Mitigation Program
EP&D	Ministry of Economic Planning and Development
FAO	Food Agricultural Organization
FSNU	Food Security and Nutrition Organization
GDP	Gross Domestic Product
GOM	Government of Malawi
ha	Hectare
HIID	Harvard Institute of International Development
HYV	High Yielding Variety
IBP	Intermediate Buyers Program
IDA	International Development Agency
IEE	Initial Environmental Examination
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
kg	Kilogram
KFCTA	Kasungu Flue Cured Tobacco Authority
MEDI	Malawi Entrepreneurs Development Institute
MOA	Ministry of Agriculture
MIPA	Malawi Investment Promotion Agency
MT	Metric tons
MRFC	Malawi Rural Finance Company
NEAP	National Environmental Action Plan
NRDP	National Rural Development Program
NSCM	National Seed Company of Malawi
NSO	National Statistics Office
NSSA	National Sample Survey of Agriculture
ODA	Overseas Development Administration
PAAD	Program Assistance Approval Document
PIC	Project Implementation Committee
PMC	Project Management Committee
SACA	Smallholder Agricultural Credit Administration
SFFRFM	Smallholder Farmers' Fertilizer Revolving Fund of Malawi
SGR	Strategic Grain Reserve
TAMA	Tobacco Association of Malawi
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USAID/M	United States Agency for International Development Mission in Malawi

I. EXECUTIVE SUMMARY

A. Program Description:

1. Introduction

For the purpose of this Supplement, the term ASAP I refers to program activities which took place from September 1991 to September 1994, under tranches 1, 2, and 3. ASAP II refers to program actions which take place under this Supplement comprised of tranches 4, 5, 6, and 7.

The Grantee will continue to be the Government of Malawi (GOM), acting through the Ministries of Finance and Agriculture. Development of the Supplement was guided by the results of an ongoing dialogue, at all levels, between USAID and the GOM on agricultural policy and institutional reform. The proposed reforms complement the GOM policy framework contained in the Ministry of Agriculture and Livestock Development's draft strategy statement. As such, the program works in concert with the Grantee's approach to, and goals for, liberalization of the agricultural economy.

2. Background

ASAP I was authorized on September 26, 1991 with a three-year life of program and a combination of NPA and project funding totalling \$30 million (\$20 million in NPA and \$10 million in project assistance). The original ASAP design envisioned two phases, each providing \$20 million in NPA upon the successful completion of program conditions. Project funding, also anticipated for both phases, was included to support implementation of the reform agenda.

This PAAD Supplement amends the NPA component of ASAP and provides the justification, analytical framework and actions required for ASAP II. The Supplement also extends the completion date of the program by four years, from September 30, 1994 to September 30, 1998; and increases NPA funding by \$35 million to a new total of \$55 million. The policy and institutional reforms presented in this Supplement: a) support the GOM's goals for liberalizing the agricultural sector; b) incorporate the findings of the 1993 mid-term evaluation of ASAP I; c) complement both the Mission's revised development strategy in Malawi (1994) and the policy and institutional reform efforts of Malawi donors; and c) draw from the numerous analytical and policy studies undertaken under ASAP I.

Reflecting USAID's commitment to stakeholder involvement in program design and implementation, the Supplement also incorporates the findings of a 1994 Malawi case study on participation in economic policy reform, as well as the results of interviews with some 350 predominately smallholder farmers and additional survey data on 700 farmers (20% of which were women). Finally, the analytical development of ASAP II was guided by an ongoing dialogue, at all levels, between USAID and the GOM on agricultural policy and institutional reform.

3. Discussion

ASAP II continues efforts under ASAP I to bring about major structural adjustments, essentially the breakdown of dualism and the reduction of government control in the Malawian rural economy over time. The intended impact of this program, combined with other donor efforts, is the transformation of the Malawian economy into an economy where all Malawians have equal access to private markets and productive resources, and that is free of biases for or against any category of farmer. Official policies and extensive regulations governing virtually all economic activity have historically been geared to controlling agriculture by favoring estate production. In addition, statutory bodies established with the intent of encouraging and supporting the smallholder sector have, over time, increased government control, limited producer choice, and acted as a barrier to dynamic growth and investment in the sector. It became apparent in the late 1980s that, due to this structure, the high growth rates attained by Malawi during the 1970s/80s were not improving the living standards of the majority of Malawians -- smallholder farmers and tenant laborers. As a result, rural areas in Malawi are characterized by a lack of private markets and chronic shortages of household food supplies for a large proportion of the population.

The most dramatic set of policy reforms enacted to date under the first phase of ASAP included eliminating prohibitions against smallholder production and sale of high value export crops, especially burley tobacco, the most lucrative cash crop in Malawi. It is difficult to overstate the significance of this achievement given that returns from this profitable cash crop were the exclusive domain of the economic elite and government officials for some three decades. The impact of these liberalization measures alone has to date accounted for approximately \$16 - \$20 million in increased income to some 30,000 smallholder families. ASAP I opened the door; not a side door, but the main entrance for smallholder growth and equity.

4. ASAP II

The goal, purpose and strategy of ASAP II remain the same as for ASAP I. The package of reforms contained in ASAP II builds on the accomplishments of Phase I, and expands the reform process by taking further bold steps to reverse the marginalization of the rural poor through integrating them fully into the economic mainstream. The policy and institutional reform package for Phase II is divided into two major themes:

- * Increasing equity and efficiency through liberalizing input markets; and
- * Increasing equity and efficiency through expanding market competitiveness and institutional reform.

ASAP II activities under the first theme primarily involve removing constraints to private sector participation in input supply and distribution, including, but not limited to: eliminating fiscal subsidies on fertilizer and seed; expanding private sector participation in the importation and distribution of fertilizer; developing and implementing a framework to eliminate restrictive input pricing policies; abolishing restrictions on participation of ethnic minorities in agricultural production and marketing activities; streamlining procedures for obtaining land for agri-business production purposes; and addressing constraints to the development of effective and affordable rural transport services.

Reform actions contained under the second theme are divided into four groups: tobacco subsector; producer and consumer price liberalization; government owned\sponsored agricultural organization reform; and rural market development.

Tobacco Subsector - Activities included in this subsector focus on eliminating ADMARC's exclusive tobacco marketing arrangements, improving the efficiency of the national burley quota system, and strengthening private smallholder marketing and credit clubs.

Consumer and Producer Price Liberalization - Under this category are a set of reform actions designed to improve the system for stabilizing maize prices and eliminate all limitations on private sector buying and selling of smallholder produced commodities.

Government Owned/Sponsored Agricultural Organization Reform - This category requires the GOM to examine the purpose and performance of statutory bodies, government trusts, government-sponsored organizations, and parastatals which operate in the agricultural sector. Based on this examination, the GOM will prepare an action plan for reforming these organizations, and implement agreed upon recommendations.

Rural Market Development - This category comprises a broad set of actions relating to rural market development and agricultural investment. These include developing policies and procedures for ADMARC to sell, lease and rent its retail facilities; removing all agricultural commodities with the exception of maize from the negative list for import/export licensing requirements; improving the system for obtaining import/export licenses; implementing a national business licensing system; and improving investment incentives for rural enterprises in support of agricultural diversification and growth.

5. Environment

As in ASAP I, ASAP II focuses on policy and institutional reform, and Negative Determinations and Categorical Exclusions have been approved by USAID for the activities included in this PAAD Supplement. ASAP I included project funding to develop a capacity within the Department of Research and Environmental Affairs to monitor the impacts of economic development activities, establish GOM environmental policies and conduct environmental research activities. The initial phase of implementation achieved notable progress in most of these activities. To assure continued progress the Initial Environmental Examination (IEE) undertaken as part of this Supplement made several recommendations which have been incorporated into the covenants and conditionality of ASAP II.

6. Disbursement Mechanism

Utilizing the cash transfer disbursement method, ASAP II funds will be provided in four separate disbursements or tranches (tranches 4, 5, 6, and 7). ASAP II has received an exemption from dollar separate account legislation and therefore there will be no local currency generations. However, the GOM is expected to provide the equivalent of \$24 million in counterpart funding in support of ASAP II reform activities. USAID/M will monitor GOM financial commitments through GOM Letters of Intent (LOI) required prior to the initiation of each tranche period. LOIs, among other requirements, will include a description of the financial resources to be provided by the GOM in support of reform activities contained in the upcoming tranche. The Grant Agreement will require, prior to disbursement, USAID satisfaction that the funds committed by the GOM in the LOIs were actually made available.

7. Summary Program Budget

A summary of the program budget follows below:

Summary Illustrative ASAP Program Budget
(NPA/\$millions)

<u>Phase</u>	<u>FY91</u>	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>	<u>Total</u>
ASAP I	20,000	-	-	-	20,000
<u>ASAP II</u>	<u>-</u>	<u>13,000</u>	<u>11,000</u>	<u>11,000</u>	<u>35,000</u>
Total	20,000	13,000	11,000	11,000	55,000

B. Policy Matrix:

The policy matrix is presented on the following pages.

POLICY MATRIX

AGRICULTURAL SECTOR ASSISTANCE PROGRAM PHASE II

Agricultural Sector Assistance Program Phase II	
Goal and purpose	Impact indicators
Goal: To increase agricultural productivity, employment, and incomes.	Real per capita smallholder income increases by 3 % per annum or by 24 % by the year 2000. Food availability increases from 1750 calories per capita daily in 1993 to 2200 calories by the year 2000. Growth rate in employment in rural enterprises increases from a baseline estimate of 10 % per year in 1993 to 15 % per year by the year 2000.
Purpose: To increase smallholder access to agricultural inputs, output markets, cash crop production alternatives, and labor market information.	Smallholder land planted to non-maize crops increases from 24 % in 1993 to 45 % by the year 2000. Contribution of HYV maize production to total maize production increases from 49 % in 1993 to 60 % by 1997. Total value of agricultural export earnings increases by 10 % per year. Value of all tobacco grown by smallholder farmers increases from US\$18 million in 1993 to US\$50 million by the year 2000. Amount of fertilizer delivered by the private sector increases from 37 % in 1993 to 50 % by the year 2000.

Theme One: Increasing Equity and Efficiency Through Liberalization of Input Markets				
Tranche 4	Tranche 5	Tranche 6	Tranche 7	Program indicators
	<p>Completely eliminate fiscal seed subsidies.</p> <p>Develop TOR for seed import liberalization study which will analyze the advantages and disadvantages of liberalizing seed imports and make recommendations for modifying current seed import policies.</p>	<p>Complete seed liberalization study and incorporate results into revised seed import policy.</p>		<p>Value of total HYV maize seed marketed through private traders increases from 25% in 1993 to 50% of total sales by 1997.</p> <p>Indicators to be developed upon completion of seed import study.</p>
<p>Establish procedure whereby private traders may purchase non-buffer fertilizer stocks.</p>	<p>Completely eliminate fiscal fertilizer subsidies.</p> <p>Develop feasible and mutually agreeable framework and action plan to eliminate ADMARC's pan-territorial/pan-seasonal input pricing policies.</p>	<p>Allow private importers/traders to buy and/or replace GOM fertilizer buffer stocks.</p> <p>Implement action plan recommendations for eliminating ADMARC's pan-territorial and pan-seasonal input pricing policies.</p>	<p>Complete review of maize fertilizer use and publish recommendations.</p>	<p>From 1993 to 1997:</p> <p>Amount of fertilizer sold through private channels increases from 37% to 50%.</p> <p>Amount of fertilizer delivered to revolving fund by private traders increases from nil to 25%.</p> <p>Amount of fertilizer released by revolving fund to private traders increases from nil to 50%.</p>
	<p>Complete plan for eliminating existing laws and administrative practices which allow discrimination on the basis of gender or ethnic background.</p>	<p>Implement anti-discrimination action plan.</p>		<p>Indicators to be developed upon completion of plan.</p>
		<p>Analyze constraints to efficient, affordable rural transport and prepare plan to address constraints.</p>	<p>Implement plan for improving rural freight and transport service.</p>	<p>Indicators to be developed upon completion of analysis.</p>
		<p>Implement improved land lease/sub-lease policies and procedures.</p>		<p>Gazette notifications.</p>

Theme Two: Increasing Equity and Efficiency through Expanded Market Competitiveness and Institutional Reform

Tranche 4	Tranche 5	Tranche 6	Tranche 7	Program Indicators
	<p>Complete overview of statutory bodies, government trusts, and other parastatals and government sponsored organizations operating in the agricultural sector. Study will list such entities, describe their relevance and structure, and provide plan for specific management and financial audit recommendations.</p>	<p>Implement plan concerning statutory bodies, government trusts, parastatals and other government sponsored organizations.</p>		<p>Indicators to be developed upon completion of overview and plan.</p>
<p>Increase maize producer prices to at or near export parity prices for the 1994/95 crop season.</p>	<p>Release ADMARC from pan-territorial/pan-seasonal consumer and producer pricing obligations for all crops except maize.</p> <p>Require that ADMARC operates as fee paying Intermediate Buyer.</p> <p>Develop TOR for developing a model for stabilizing maize prices based on price band analysis or alternative system.</p>	<p>Eliminate exclusive marketing arrangements of ADMARC and all limitations on private sector buying and selling of smallholder produced commodities.</p> <p>Complete model for stabilizing maize prices and establish an open tendering system for supplying maize to, and removing maize from, the Strategic Grain Reserve (SGR).</p>	<p>Implement model for maize producer and consumer price stability.</p> <p>Amend GOM/ADMARC Memorandum of Understanding to delete the requirement that ADMARC ensure smallholder access to output markets for all crops.</p>	<p>Producer price of maize at or near parity.</p> <p>Value of smallholder crops marketed by private sector increases by 5% per year.</p> <p>Amount of maize delivered to the SGR by private traders increases from nil in 1993 to 20% of total deliveries by 1997.</p> <p>Amount of maize released by the SGR to private traders increases from nil in 1993 to 20% of total deliveries by 1997.</p> <p>Area under HYV maize as proportion of total maize area increases from 25% in 1993 to 35% by 1997.</p>

Theme Two: Increasing Equity and Efficiency through Expanded Market Competitiveness and Institutional Reform

Tranche 4	Tranche 5	Tranche 6	Tranche 7	Program Indicators
<p>Deregulate all smallholder tobacco prices and publicly announce that smallholder producers of all tobaccos, except oriental, have direct access to all legal marketing channels.</p> <p>Legalize direct trading of oriental tobacco between growers and buyers at freely negotiated prices.</p>	<p>Assess feasibility of transferring tobacco quota allocation and administration responsibilities from MOA to TCC.</p> <p>Develop TOR for computerized, performance-based quota allocation scheme based on performance criteria.</p> <p>Ensure that Intermediate Buyers' (IB) marketing quotas continue to be additive to national quota and not subject to maximum ceiling.</p>	<p>Improve the efficiency of the national burley quota system by 1) implementing the computerized, performance-based quota allocation scheme; 2) ensuring annually, sufficient new quota and/or reallocated quota to fully meet all effective smallholder demand; 3) eliminating annual quota application requirements except for first-time applicants; and (4) publicizing information on the quota allocation.</p>		<p>Fully operational computerized system.</p> <p>Gazette notification and radio broadcasts.</p> <p>Total amount of unused quota declines from current estimate of 30% to 5% by 1997.</p> <p>Share allocated to smallholders consistent with allocation scheme to be mutually agreed upon in tranche 5.</p> <p>Share of total value of tobacco sales marketed by Intermediate Buyers increases from nil in 1993 to 25% by 1997.</p> <p>Total value of all tobacco grown by smallholders increases from US\$18 million in 1993 to US\$40 million in 1997.</p>
	<p>Develop TOR for assessing policies and procedures which permit ADMARC to sell, rent, or lease its retail facilities.</p>	<p>Implement plan concerning policies and procedures for ADMARC selling, leasing and renting its retail facilities.</p>		<p>Unused or under utilized ADMARC facilities reduced by 50% through sale or lease of such facilities by the year 1997.</p>

Theme Two: Increasing Equity and Efficiency through Expanded Market Competitiveness and Institutional Reform

Tranche 4	Tranche 5	Tranche 6	Tranche 7	Program Indicators
		<p>Implement national business license system.</p> <p>Remove all agricultural commodities with the exception of maize from the negative list for import/export licensing requirements.</p> <p>Replace duty drawback system with a duty reduction system for the import of agricultural and agri-business inputs.</p> <p>Implement a national import/export licensing system which eliminates the requirement for prior approval by the Ministry of Agriculture of import/export licenses for agricultural produce, and which provides appeal procedures for licenses that are denied or rescinded.</p>	<p>Legalize improved investment incentives for rural enterprises in support of agricultural diversification and growth.</p>	<p>Gazette notifications and supporting documentation.</p>
		<p>Develop policy on the future institutional framework for smallholder credit and marketing clubs.</p>		

Other Concerns				
Tranche 4	Tranche 5	Tranche 6	Tranche 7	Program indicators
<p>Submit technical assistance request to USAID for establishing Economic Policy Support unit.</p>	<p>Make available sufficient financial and staff resources to implement environmental monitoring and mitigative agroforestry activities.</p>	<p>Make available sufficient financial and staff resources to implement environmental monitoring and mitigative agroforestry activities.</p>	<p>Evaluate environmental monitoring, research and mitigative agroforestry activities, redesign them as recommended, and provide sufficient financial and staff resources to effectively implement them.</p> <p>Implement representative environmental monitoring program nation-wide to identify environmental impacts of ASAP reform.</p>	<p>Letters of intent and budgetary line items consistent with resource requirements.</p>
<p>Submit to USAID Letter of Intent covering each activity/action included under tranche 5 containing: 1) comprehensive list of actions grantee intends to take; 2) name of representative/entity responsible for implementing each action; and 3) line-item budget of financial resources to be committed by GOM for program activities.</p>	<p>Provide the budgetary resources contained in its Letter of Intent requested under Tranche 4 for expenses related to Tranche 5 activities.</p> <p>Submit to USAID Letter of Intent covering each activity/action included under tranche 6 containing: 1) comprehensive list of actions grantee intends to take; 2) name of representative/entity responsible for implementing each action; and 3) line-item budget of financial resources to be committed by GOM for program activities.</p>	<p>Provide the budgetary resources contained in its Letter of Intent requested under Tranche 5 for expenses related to Tranche 6 activities.</p> <p>Submit to USAID Letter of Intent covering each activity/action included under tranche 7 containing: 1) comprehensive list of actions grantee intends to take; 2) name of representative/entity responsible for implementing each action; and 3) line-item budget of financial resources to be committed by GOM for program activities.</p>	<p>Provide the budgetary resources contained in its Letter of Intent requested under Tranche 6 for expenses related to Tranche 7 activities.</p>	<p>Letters of intent and budgetary line items consistent with resource requirements.</p>

Covenants: Quota Allocation, GOM resources, Policy Research, Annual Evaluations, and Environment (See details Sections 5.3 to 5.7 of draft Amended Agreement)

II. BACKGROUND

A. Introduction:

The Agricultural Sector Assistance Program (ASAP) was authorized on September 26, 1991 with a three year life of program and NPA funding level of \$20,000,000. The original program design envisioned two phases, each involving disbursements of \$20,000,000 upon the satisfactory completion of program conditions mutually agreed upon by USAID and GOM. Project funding, also planned over both phases of ASAP, complements the NPA program. Since September, 1991, USAID/M has made two disbursements totalling \$10 million in NPA to the Government of Malawi (GOM) under ASAP's first phase. Each of the NPA disbursements followed the Government's completion of agreed-upon policy and institutional reforms laid out in the Program Agreement. One major condition remains to be met by the GOM prior to the release of the final tranche of \$10 million under the first phase.

B. Goal and Purpose:

The goal of ASAP is to increase agricultural productivity, employment and incomes. Its purpose is to increase smallholder access to agricultural inputs, output markets, cash crop production alternatives and labor market information. The long-term intended impact of this program, in combination with other donor programs (the World Bank, the European Community, British ODA, and UNDP), is a liberalized agricultural economy in which there is equal access to the means of production and there are no barriers to market entry nor other practices that are biased for or against any category of farmer.

C. Strategy:

As noted above, program objectives are to be achieved through a combination of NPA and project assistance designed to increase smallholder production and marketing of crops, improve the efficiency of agricultural input delivery, promote equity among smallholder farmers and estate laborers and tenants, and identify opportunities for, and constraints to, agricultural diversification. The original PAAD described policy, institutional and regulatory reforms identified as critical to the achievement of ASAP's goal and purpose. This reform package was incorporated into the program agreement with the GOM. The project component was incorporated into the overall ASAP design to provide implementation support for the policy reform package. The project component includes: (1) the establishment of an agricultural policy research unit at the Bunda College of Agriculture; (2) support for agroforestry extension and food security monitoring activities; (3) the establishment of an environmental monitoring program to monitor the environmental effects of increased agricultural production and structural change; and (4) a variety of policy-related studies which investigate specific constraints to sustainable and more equitable growth in Malawi's agricultural sector.

D. Political Context for ASAP I (1990-91):

Design of ASAP I was initiated by USAID/Malawi in 1990. The program was closely coordinated with the World Bank's Agricultural Sector Adjustment Credit (ASAC), which had initiated a "pilot scheme" in which smallholder farmers could, for the first time, legally produce and market burley tobacco, one of the most lucrative cash crops in Malawi. That program, and subsequently the ASAP program, sought major structural changes in the Malawian rural economy - changes that challenged the status quo and the economic interests of powerful elements in Malawian society. Through ASAP I, USAID was able to expand the opening in smallholder burley production that had been achieved by the Bank's agricultural sector adjustment lending program. High level policy dialogue challenged the Government's commitment to poverty alleviation and eventually secured support and agreement on ASAP I policy reforms. Notwithstanding this difficult beginning, ASAP I has made steady progress in meeting its objectives over the past three years and, in some cases, has surpassed the targets contained in the original design.

E. Political Context for ASAP II (1994):

In May 1994, almost thirty years of autocratic rule ended when Malawians voted the leader of the populist United Democratic Front (UDF) party, Mr. Bakili Muluzi, into power as president. Thus, the ASAP program is currently operating in a vastly different political context than that which existed during project design and early implementation. This transition represents a dramatic change in the political culture of Malawi. With government officials, technocrats, academicians and farmers now free to express their views on social and political issues, the opportunity exists to expand stakeholder involvement in program design and implementation.

In this context, senior GOM representatives and technical specialists, private sector stakeholders and beneficiaries have participated actively and extensively throughout the analytical phase of ASAP II. For example, representatives of the MOA, the MOF and the private sector attended a series of meetings with USAID/M counterparts to discuss the views of an analytical team regarding issues being considered for inclusion in ASAP II. The Mission has received preliminary endorsement for the major elements of ASAP II from MOA and MOF staff, with the full endorsement of the political leadership pending further discussion. Also incorporated in this Supplement are findings of a 1994 Malawi case study on participation in economic policy reform, as well as staff interview results of some 350 farmers (primarily smallholders) and additional survey data, based on a more rigorous sample design of 700 farmers -- of which 20% were female. These combined efforts provided an opportunity for government officials, private sector representatives and program beneficiaries to express their preferences, re-affirmed the appropriateness of the original PAAD design, and instructed the policy and institutional reform agenda contained in this Supplement.

Regarding the stated intentions of the new Government, the Mission believes that the UDF will strive for a more open economy in which the private sector plays the predominant role and the GOM serves a more facilitative function. In the President's first address to the Parliament (June 30, 1994) he stated that poverty alleviation, particularly in rural Malawi, was "the core priority of the Government". He noted the restrictive policy environment in rural agriculture and stated that the "Government is determined to remove all policy constraints that hinder the efficient performance of the agriculture and livestock sector. It is therefore the Government's intention to overhaul all policies in this regard in order to create a policy environment where this objective can be achieved."

If these stated intentions are translated into specific actions, the environment for ASAP II's reform program could not be better. One must bear in mind, however, that Malawians are still actively defining the mechanisms of governance under their new multiparty democracy. Moreover, there remain vested interests among individuals, both in and out of government, who will seek to maintain the status quo. Finally, while there may be greater agreement on the reform principles contained in ASAP II under the new Government than the old, the process of making implementation decisions will almost certainly become more complex given the open and participatory nature of the new Government. The risks of a setback under the new regime are small compared to the high risks USAID assumed when the program was initiated in 1991. While it is too soon to draw definitive conclusions about how ASAP II will be affected by the emerging program of the new GOM, there are reasonable grounds to believe that the leadership of the UDF will provide significant support for the policy and institutional reforms proposed in this supplement.

F. USAID Development Strategy in Malawi:

The ASAP program is the principal instrument for achieving the Mission's broader strategic objective in the agricultural sector -- To increase agricultural productivity and production. Under the ASAP program, smallholder incomes are increasing through expanding smallholder participation in newly available production and marketing opportunities -- opportunities formerly granted to a privileged few. This broader participation resulted from policy and institutional reforms. While building on the achievements of ASAP I, this second phase will significantly expand the reform agenda by emphasizing sector-wide policy and institutional constraints in agriculture, thus further contributing to this strategic objective.

ASAP supports the overarching Mission program goal: To enhance the economic well-being of the average Malawian household. Given the importance of the agricultural sector to the vast majority of Malawi's population, expanded smallholder production and marketing opportunities will contribute directly to increased household resources, food security and economic growth. The Mission goal, in addition to including the agricultural strategic objective, encompasses three other objectives, as follows:

- Reduce fertility;
- Reduce infant and child morbidity and mortality; and
- Control the spread of AIDS

G. Assessment of ASAP Phase I:

In March 1993 a mid-term evaluation of ASAP was conducted by a five member team of REDSO/ESA officers and private consultants. The purpose of the evaluation was to assess the effects of ASAP since inception and to recommend specific actions for the Mission in preparing for Phase II of the program. The evaluation concluded that "ASAP has already begun to contribute in a measurable way to the achievement of the purpose and goal set out in the PAAD." At the time of the evaluation, 29,000 rural households, an estimated 12.5% of which were headed by women, were participating in the program. While their estimated production was a very small proportion of national burley output, for the first time in independent Malawi significant numbers of the majority population had been given access to the cash crop opportunities formerly restricted to the privileged few. Indeed, sales of smallholder burley on the auction floors have already exceeded the original projections of the ASAP program. During the ASAP design phase the Mission anticipated that 10,000 kgs of burley would be sold by smallholders on the auction floor in 1992 and 50,000 in 1995. In fact, roughly a million kgs were sold in 1992 and 5.8 million kgs were sold in 1993. This program has contributed an estimated \$16 to \$20 million (including projected sales, now ongoing, for the 1993/94 season) to smallholder incomes since its inception and has put tremendous pressure on the Government to continue liberalizing the smallholder sector.

In the approximately 18 months since the evaluation, market liberalization has been further expanded and consolidated through the opening of an additional marketing channel for burley tobacco, the Intermediate Buyer program. Ministry of Agriculture crop data indicates that higher smallholder incomes resulting from ASAP may be among the factors contributing to crop diversification. Expanded cultivation of sorghum/millet and groundnuts provides evidence of this trend. Moreover, while cultivation of HYV maize was significantly lower in 1993/94 than the previous year (due to weather and credit delivery problems), land planted with HYV seed has continued to expand over the longer term.

Together with its achievements, the operation of the smallholder burley program has raised new and complex challenges which the GOM must confront. These challenges include further liberalizing tobacco-related market activities, broader institutional reform in the smallholder sector, and strengthening the capacity of smallholders to fully benefit from emerging private sector marketing opportunities.

The following section provides background on these issues and draws from numerous analytical studies carried out with ASAP project funds. These studies have helped guide the development of the Phase II program, and have played a valuable role in consultations between USAID and the GOM concerning Phase II conditionality.

One major condition still remains to be met by the GOM prior to the release of the third and final tranche of ASAP I. This concerns the clarification and public announcement of the adjudication procedures for estate labor and tenant disputes.

III. CONSTRAINTS TO EXPANDED LIBERALIZATION OF THE SMALLHOLDER AGRICULTURAL SECTOR

A. Introduction:

The original PAAD provided a broad description of constraints to smallholder agricultural development. That description remains valid. However, almost three years of program implementation and the funding of numerous analytical studies warrant a more specific treatment of several of the areas examined in the original PAAD. That is the purpose of the following section. More detailed information on the subject areas is available through the research and policy studies listed in the attached bibliography (Annex A).

B. Distortions in Input Markets:

1. Fertilizer

a) Fertilizer Subsidy

Malawi has traditionally provided a fiscal subsidy for maize fertilizer to encourage smallholder use and to help ensure adequate food crop production. However, fiscal constraints and targeting problems have led to a commitment to phase out fertilizer subsidies. In fact the process is well underway. Subsidies on low analysis fertilizers were eliminated in 1991/92 and the GOM plans to remove all remaining fertilizer subsidies by 1995/96 (HIID, June 1994). This decision is supported by evidence that access to credit, not price, is the predominant constraint to increased fertilizer use by smallholders. USAID/M fully supports the Government's intention to eliminate the remaining fertilizer subsidy by 1995/96, and believes it imperative that the GOM follow through on this commitment.

USAID/M also recognizes that smallholders have confronted unprecedented difficulties in recent years, all of which affect food security: the major devaluation of the kwacha; two droughts in the past three years; and the collapse of the credit system. Some interim relief may be needed to cushion these impacts. For example, if prices for urea and 23:21 (the most effective maize fertilizers), were increased to full import parity in 1995, the percentage increase over the previous season's retail price would be 85% and 76%, respectively (HIID, June 1994). Such large increases could reduce fertilizer demand below its current depressed level, leading to decreased maize production and food shortages.

In this context, some price relief on fertilizer may be needed during a transitional period to full import parity prices. Preferably, this relief would not be financed from already strained Treasury resources. One alternative financing source could be funds generated from non-buffer stock sales of the Smallholder Farmer Fertilizer Revolving Fund of Malawi, described below.

b) Access to Non-Buffer and Buffer
Smallholder Fertilizer Stocks

Until 1983, ADMARC was the sole supplier of subsidized fertilizer to smallholders. As a result of its poor performance in this regard, the Smallholder Farmer Fertilizer Revolving Fund of Malawi (SFFRFM) was created in 1983 with support from IDA and IFAD, and charged with responsibility for procuring and distributing all fertilizer to the smallholder sector.

SFFRFM currently manages a 90,000 MT buffer stock and a 100,000 MT non-buffer stock. With liberalized input marketing, there is no reason for a parastatal to continue importing and distributing fertilizers. In addition, the size and composition of the buffer stock (essentially insurance against disruption of supply) is far too large, and its composition does not reflect current fertilizer demand.

SFFRFM should be limited to managing a reduced buffer stock, with supplies of fertilizer made available at SFFRFM warehouses to dealers and suppliers at replacement cost. Buffer stock recycling can be done through sales to private importers on a replacement basis with letters of credit as security. Private traders should also be allowed to access the non-buffer stocks until they are completely drawn down. Funds generated from the sale of these stocks, purchased prior to devaluation, could be used to cushion fertilizer price increases across the board to targeted smallholders.

c) Fertilizer Application Guidelines

Improved extension recommendations for the amounts and types of fertilizers that should be used for maize are urgently needed. Current MOA recommendations for nitrogen and phosphorus are too high for many soil types, resulting in over application and reduced profitability of maize production. The present method recommended for applying

fertilizer is unduly labor intensive and less effective than it otherwise could be. Additionally, experiments on the response of maize to phosphorus have revealed positive responses at only a very few sites. Since fertilizer is the most expensive production input, the Government urgently needs to update guidelines for its use.

2. Seed

The seed sector is characterized by government intervention in domestic marketing and pricing of seeds as well as onerous import restrictions on seed varieties. Under the current system access by farmers to a range of suitable seed varieties is poor, administrative controls and price distortions impose a strain on the government budget, and development of the private sector seed industry is restrained. As a result of these factors, the number of seed varieties available in Malawi is limited, and seed prices have been significantly higher than seed prices in other countries in the region.

a) Maize Seed Subsidy

Through ADMARC, the government marketing parastatal, the GOM has historically subsidized HYV maize seed to encourage adoption. Studies have shown that demand for HYV seed has grown markedly as long as credit was readily available. This has been the case despite significant increases in the subsidized price. Furthermore, maize seed accounts for a relatively small portion of the total production costs of maize -- about 14-15 percent. The main constraint to acceptance of HYV maize is not the cost of seed but rather the availability of credit for seed and fertilizer. Liberalized production and marketing of HYV should lead to increased supplies and reduced prices even without the subsidy.

b) Seed Imports

Currently the GOM allows unrestricted importation of non-maize and non-tobacco seeds with the standard provisos of phytosanitary and germination/purity certificates. However, draft recommendations are under consideration which would restrict these imports and subject them to the onerous review and multi-year testing procedures of the Seed Variety Release Committee. Imposing this review process would constrain the introduction and proliferation of new crops into Malawi and impede agricultural diversification.

Regarding maize seed production, Malawi has developed a system which is totally dependent on domestic contract growers and which does not allow for importation of seed varieties which already have been released by the Seed Varietal Release Committee. To some extent this is justifiable in that it makes full use of domestic resources. However, to the extent that it deprives the Malawian farmers of less expensive sources of seed, the system merits examination.

3. Input Price Controls

As indicated above, pricing of agricultural inputs in Malawi (seed, fertilizer, chemicals and implements) is subject to a mix of government regulations, policies and marketing board (ADMARC) practices which result in de facto control of input prices. In addition to existing subsidy structures, the system is further complicated by ADMARC's pan-territorial pricing policy for input sales. Prices for seed and fertilizer are the same in every ADMARC outlet throughout the country despite significant differences in transportation and distribution costs in many areas. While the system leaves room for some private traders to compete on a price basis with ADMARC in major markets, it limits commercial trade in remote rural areas where ADMARC's subsidized prices undermine competition.

C. Lack of Competitive Trading Opportunities:

1. Limited Marketing Choices and Administered Producer Prices in Tobacco Sector

a) Exclusive Marketing Role of ADMARC

Prior to 1991, all smallholders had to sell their tobacco to ADMARC. Historically the pass through price from ADMARC to the farmers was a mere fraction of the price of what ADMARC received for the same product in the international market. Under ASAP, new marketing opportunities were opened up for a certain category of tobacco -- burley. One was the auction floor and the other, a pilot intermediate buyers program. These two mechanisms apply, however, exclusively to burley tobacco. Smallholder production of non-burley tobaccos -- dark-fired, sun-air cured and oriental -- is significant, amounting to more than 15 million kg produced by 70,000 growers on an estimated 30,000 hectares of customary land in 1990. Currently, the only legal marketing channel for these tobaccos is ADMARC.

The price signals which ADMARC sends to smallholders distort the farmers' sense of world demand for his/her product (virtually all of Malawi's tobacco is exported). For example, in recent years low producer prices set by ADMARC have resulted in a level of domestic production far below world demand for Malawi's coveted dark-fired leaf. As a result, Malawi has been losing market share to other lower-quality African producers, notably Uganda, Kenya, Zaire, and Tanzania.

Production of oriental tobacco is relatively small, around 500,000 kg annually. Because it grows in very poor soils and needs little fertilizer, it can be grown by farmers on marginal land without displacing foodcrop production. Resident buyers believe the market for oriental tobacco could clear 1.5 million kg annually. However, ADMARC's producer pricing policies discourage production. While oriental tobacco is not traded on the auction floor, producers should be able to sell it directly to buyers (including intermediate buyers who can provide grading, baling and transport services).

b) Intermediate Buyer Program (IBP)

The MOA initiated the IBP for the 1993/94 crop season. The program provides an additional marketing channel for burley producers. In its present form, IBP allows estates to purchase a license to market smallholder burley in excess of their production quotas. To date, a total of 48 licenses with a total marketing quota of 965,000 kg have been issued.

The major drawback of the current IBP is that it excludes dark-fired and sun-air cured tobaccos. As discussed above, these products make a significant contribution to overall tobacco production, but limited marketing opportunities have distorted their prices and artificially dampened production. As in the case of burley, including these two tobaccos in the IBP will lead to increased smallholder incomes, greater market shares for Malawi, and increased overall foreign exchange earnings.

Smallholder Burley Clubs: Notwithstanding the training programs for smallholder clubs currently underway, many of the 1,250 smallholder burley clubs will remain organizationally and financially weak entities for some time and thus may not be in a position to market their production directly on the auction floor. Under the IBP, licensed intermediate buyers not only compete directly with ADMARC for smallholder burley, but also provide baling, transportation, and certain record-keeping services that would otherwise be required for direct access to the floors.

Quota Liberalization: Progress toward full quota liberalization requires an IBP marketing quota that is both additive to the nation's total quota and not subject to a maximum ceiling. The IBP will tend to increase the amount of tobacco grown until the concept of production quotas becomes meaningless, thus providing a more orderly and smooth transition to quota liberalization than simply removing quotas in one season. Such an approach will tend to mitigate against sharp price fluctuations and help ensure a stable supply to buyers who might otherwise seek more reliable markets elsewhere.

Illegal production: An estimated 20 percent of burley tobacco is grown illegally. Most illegal growers receive very low prices for their tobacco. Under the existing ASAP-supported system of smallholder marketing clubs and IBP, formerly illegal smallholder burley growers are being given legal and market-oriented options for selling their tobacco, with the expectation of receiving fair market value for their crop.

Small Estates: The IBP may benefit the smaller and more efficient estates. The majority of estates are less than 30 hectares, and in 1993 approximately 7,000 of 30,000 estates were issued quotas which were too small to market their production on the auction floor (a minimum entry of 3,000 kg is required). The IBP provides a potential legal outlet for these estates, as well as for those producers who need immediate cash and/or assistance in grading, baling and transportation.

c) Ineffective Quota System

The quota system was ostensibly designed to control the amount of burley tobacco production in Malawi, thus helping ensure stable prices (and profits) and market shares. However, the national system has not promoted an efficient use of Malawi's limited resources. Inefficient burley producers continue to receive quota, while more efficient producers who are capable and willing to produce more than their quota are precluded from expanding production. In 1992/93, there were 33 million kg of burley quota which were allocated to estates, but never produced; yet demand for increased quota far exceeds supply. The quota allocation is based on obscure criteria which is never published and the allocation itself takes place too late for sound nursery bed decisions.

An improved quota allocation system would allocate resources more efficiently, rewarding farmers with demonstrated capacity to produce more with higher quota, and penalizing farmers who consistently fail to meet their allocation with reduced quota.

All growers are required to renew their quota entitlement every year. The process is particularly onerous to the MOA since it is the responsibility of the extension service to register all smallholder tobacco growers annually -- 30,000 smallholders in 1993/94. This complex and lengthy process uses scarce MOA resources which could be better used providing technical services to smallholder farmers.

2. Producer and Consumer Price Controls on Smallholder Crops

ADMARC's price controls are not limited to the tobacco subsector, but extend to nearly all commodities produced by smallholders. Government administered prices are set through an extraordinary and complex planning exercise involving the MOA, Treasury, Trade, Industry, the Reserve Bank of Malawi, and ADMARC. The prices ultimately established by the GOM are rarely consistent, even for exportable items, with their border price equivalent. The distorted price signals received by producers artificially determines production decisions, resulting in disequilibrium and uncertainty in agricultural markets. In addition, as noted above, ADMARC's pan-territorial pricing policy discourages the development of private markets in remote areas.

3. Strategic Grain Reserve

The GOM places high priority on maintaining stable national maize supplies and prices. For this purpose, the GOM established the 180,000 MT Strategic Grain Reserve (SGR) in Kanango. ADMARC manages the SGR on behalf of the Government under the terms of a Memorandum of Understanding signed between the two parties. ADMARC is the only entity with the authority to replenish the SGR. It does this by purchasing maize through its vast network of markets and depots throughout the country. Purchases could be anywhere from 60,000 MT to 180,000 MT depending on the size of Malawi's total maize production in a given year and the drawdown the previous year.

Evidence suggests that the efficiency by which the GOM/ADMARC fulfills its mandate is poor. Following the 1991/2 drought, SGR stocks were drawn down to less than 10,000 MT, but the GOM failed both to release SGR maize in a timely manner and to recognize the need for commercial imports. (ADMARC/GOM's price fixing policy further contributed to diminished commercial supplies.) These problems result from a weak decision-making process surrounding the replenishment, release and distribution of stocks, rather than a problem with the physical management of buffer stocks themselves. Similarly, in 1993, ADMARC's maize selling price to the SGR was 40% over its buying price. This spread appears excessive given that the Government also pays ADMARC separately for management of the SGR. The large spread between producer and seller prices suggests that the SGR system may be more costly to operate than it need be. Finally, although the SGR physical facility provides for a substantial reserve, the actual amount of stocks needed to stabilize prices and serve as a food security reserve needs to be reviewed. That review could also consider the possibility of leasing excess SGR maize storage capacity to private interests.

4. Statutory Bodies and Parastatal Entities

ADMARC is only one among several statutory bodies established with the intent of providing goods and services to the smallholder sector. In addition, the Government established various trusts, procured assets, such as large farms, and sponsored farmer associations, with a similar intent. In reality, however, many of these GOM-controlled organizations ultimately led to increased government control, deepened structural inequalities, and severely constrained dynamic growth and investment in the smallholder sector.

The new multi-party government presents the opportunity for examining the current role of these organizations in the agricultural sector. More specifically, there is a need to better understand what specific influence their operations are having in such areas as smallholder production and marketing, capital accumulation, income distribution, and private sector access to land and other production inputs.

D. Government Regulations and Administrative Practices Constraining Rural Market Development:

In addition to the impediments discussed above with respect to ADMARC's intrusive role in the agricultural sector, there exists an additional range of government regulations and administrative practices which impede the development of markets in the smallholder sector.

1. External Marketing

The GOM has a history of restricting private commodity trade on an ad hoc basis with intermittent export (or import) bans, export (or import) restrictions and cumbersome licensing requirements. Often these restrictions cannot be justified on grounds of protecting food security and too often adversely effect production and the development of stable marketing channels. For example, in 1992 and again in 1993, the GOM prohibited external trade in groundnuts to protect the domestic food supply. The result was the suppression of what otherwise would have been a profitable commercial activity and lucrative source of foreign exchange. Groundnut production plummeted to the lowest level ever, decreasing demand for seed and causing ADMARC's and NSCM's seed stocks to deteriorate.

Additionally, the application process for an import or export license is particularly cumbersome for traders and the process is lengthy and uncertain. Requests for licenses are subject to either refusal or cancellation without appeal, and the requested quantity to be exported under the license can be reduced at the discretion of ADMARC.

2. Land Availability

One of the more serious obstacles to new investment in rural Malawi is the difficulty of obtaining a secure title or lease to land for agricultural and agri-business purposes. The new Government, through the Malawi Investment Promotion Agency (MIPA), is currently examining this problem with the objective of streamlining and clarifying the process for obtaining land leases. Currently, procedures for obtaining a lease are onerous, often taking over a year to complete. At least five separate bureaucracies are involved. The Department of Surveys must survey each plot, but their resources are limited and the Department's vehicles and equipment are antiquated and break down frequently. Moreover, the process of reviewing applications is not clear. There are no written criteria that would allow an investor to assess either his or her chances of obtaining a lease, or how long the process might take.

3. Restrictive Licensing

In some cases, while the pertinent legislation has been improved at the policy level, broad latitude in implementing guidelines provides enormous leeway for government officials to continue traditional practices which impede rural market development. The Agricultural Produce (Marketing) Regulations of 1994, was enacted to stimulate

market liberalization in agricultural trade by permitting private traders to compete with ADMARC in marketing specified agricultural produce. However, the new act does not specifically address past practices of requiring that each trader apply and pay for trading licenses at each of the eight Agricultural Development Divisions (ADD). Such practices are costly, time consuming and burdensome to the potential trader and traditionally have been employed to exclude Asians, mulattos and Malawians (from other regions).

4. Ethnic Restrictions

The manner in which some policies are written, while not explicitly restricting participation by ethnic minorities in many economic activities, nonetheless permits such restrictive practices to occur. "The exclusion of a very accomplished group of traders, the Asians, has removed an important set of buyers of smallholders' produce from the market, buyers who generally paid higher prices than did ADMARC. It also inhibited the flow of market information to smallholder growers, who rely on the traders' demand to plan their production" (DAI, 1994). The mechanisms through which Asians are restricted from trading activities include a combination of informal, across the board prohibition (as in the case of transport permits), or simply limited approvals of trading licenses and land leases. There is no transparency in the system for approving/denying applications for licenses, permits and leases. Criteria are not available and, in the case of land leases, officials are able to draw out the process for years in order to effectively deny the applicant access to property. An illustration of the ease of imposing restrictions is taken from the "Fertilizers, Farm Feeds and Remedies Act" which states that "the issue of a license may be refused, or quantities applied for curtailed, without assignment of any reason."

5. Inefficient Use of ADMARC Facilities

Passage of the 1994 Agricultural Produce (Marketing) Regulations (and, to a more limited extent, its predecessor, the 1987 Agricultural General Purposes Act), permitted private traders to compete with ADMARC in the marketing of a range of agricultural commodities. These acts have led to the withdrawal of ADMARC from some unprofitable locations amidst assumptions that the markets would be served by private traders. In areas where ADMARC has scaled back, ADMARC facilities often remain either empty or underutilized. ADMARC's leasing or selling of these and other facilities would help promote rural market development since there are currently few privately owned storage facilities available for small traders. Moreover, if ADMARC's territorial and pan-seasonal pricing policy is abandoned (part of ASAP II's conditionality), rural traders will have an added incentive to look for additional storage space and retail outlets. The leasing or purchase of these facilities will help obviate the need for extremely scarce construction capital. Currently such transactions are not addressed in the agreement between the GOM and ADMARC.

6. Duties and Taxes Incentives

To help local agricultural producers compete with foreign firms, and thus promote agricultural production and exports, the GOM introduced a duty drawback system. The drawback allows exporters to claim reimbursement of tariffs paid on imported inputs. The duty drawback system was established in lieu of simply a reduction in duties to discourage large scale importing of inputs for subsequent resale. The problem is that exporters must prove they have used the inputs to produce the export products before being entitled to a drawback. This requires that claimants undergo a complex, lengthy bureaucratic procedure to benefit from the incentive. Moreover, at a current interest rate of about 30%, the money tied up in duties effectively removes the value of the drawback as an incentive. The current process, therefore, not only poses particularly difficult cash flow problems for small and new firms, but it also undermines the original intent of the export incentive.

Additionally, current GOM investment promotion policies provide unequal tax treatment between non-traditional agricultural export activities and industrial/manufacturing export activities. The result is that producers of export crops receive virtually none of the investment incentives offered to other businesses. Two categories of firms receive virtually all the available (and very generous) tax, duty and accounting incentives -- industrial/manufacturing firms and firms manufacturing for export within export processing zones. Agricultural producers located outside these zones enjoy only duty-free importation of equipment and raw materials used in exports, and then only if the firm produces primarily for export. The inadequate incentive structure fails to provide sufficient incentives to promote investment in agricultural production and the unequal character of the incentive structure discriminates against rural based agricultural firms.

7. Transport Constraints

Transport is an essential element of rural market development. Among the major constraints to the provision of adequate, efficient and affordable rural transport services are:

- Lack of adequate and cost-effective goods and passenger services in the remote areas. Although there appears to be an overall surplus of freight haulage capacity in Malawi at present, the fleet is concentrated in the major urban centers where the bulk of internal transport business originates or terminates.
- High initial investment and operating costs for transport vehicles and equipment, including duties and duty-financing costs on smaller vehicles, spare parts and tires. Larger transport vehicles, over 10 MT, benefit from special duty privileges unavailable to smaller transport operators.

- High use costs for road transport, which result from GOM administered domestic freight rates (fixing minimum and/or maximum tariffs) based on political factors rather than on evaluation of actual transport costs. External freight rates, which have always been competitively based, are much lower than domestic transport rates.
- Barriers to entry into the transport sector for ethnic minorities deprives the industry of a source of investment capital and management expertise.
- Lengthy waiting period for processing the license required for transport operations. Lack of transparency in the review process serves to block particular operators, individuals and sections of the community from obtaining a transport license.
- Prohibitions on freight transporters carrying passenger traffic. Excluding freight transporters from carrying passengers removes an important source of backhaul revenue. This is especially the case for transporters operating in rural areas where other forms of public transport are scarce, costly, or unavailable.

Transport is a major input cost for every trader in rural markets and hence key transport constraints must be addressed in any program to enhance agricultural production.

E. Role of Women

With women performing 70% of all agricultural labor, their contribution to the agricultural sector is enormous. Yet women are discriminated against in rural labor markets, being offered lower wages for the same work as men and frequently being confined to the worst paying jobs. Moreover, women's smaller landholding sizes, labor constraints during peak seasons, and cultivation of some of the lowest value crops, make women more vulnerable to structural adjustment than their male counterparts. Women's more equitable participation in commercial agriculture is imperative.

ASAP has and will continue to address the constraints faced by women farmers. Efforts have been made at all levels to encourage their participation in both the design and implementation of the program. As mentioned earlier, the ASAP II design process included survey results of 700 farmers of which 20% were women. ASAP I included a covenant in the Program Agreement requiring that an increasing proportion of tobacco quotas be allocated to women. To satisfy this requirement MOA extension agents have successfully encouraged burley clubs to increase the proportion of women members. This covenant is also included in ASAP II conditionality. In addition, ASAP II activities addressing constraints in the areas of land availability, trading licenses, transport permits, and ethnic participation will help to expand opportunities for women in commercial agriculture.

F. Environmental Factors:

The focus of ASAP is on policy reform, and Negative Determinations and Categorical Exclusions have been approved by USAID for the activities included in this PAAD Supplement. USAID recognizes that environmental issues must be effectively addressed to ensure that program implementation does not exacerbate existing environmental vulnerabilities, particularly for forest, soil and water resources. To address this concern, ASAP I initiated an Environmental Monitoring Program (EMP) under the auspices of the GOM Department of Research and Environmental Affairs (DREA). All the requisite preparations for the EMP have been completed and it is expected that full-season monitoring of the resource base will begin in the 1994/95 agricultural season.

To ensure that planned Program environmental monitoring and mitigative activities are pursued in an effective and efficient manner throughout the second phase of ASAP, a number of recommendations have been incorporated into the conditionality of ASAP II. These recommendations, based on the results of the PAAD Supplement's Initial-Environmental Examination (IEE), include developing an environmental monitoring system to collect data on a national level, and increasing support for agroforestry activities to mitigate environmental impacts. The IEE is contained in Annex B.

IV. PROGRAM DESCRIPTION

A. Program Objectives and Strategy:

The original goal, purpose and strategy of ASAP remain unchanged in this PAAD Supplement. This Supplement modifies the original presentation of program themes. That presentation was as follows:

- Production and Marketing
- Efficiency of Input Delivery
- Equity
- Crop Diversification

The equity theme related to improving conditions for estate tenants and agricultural laborers. However, the casting of the equity theme in such a narrow context excluded smallholder farmers. These farmers comprise 48% of Malawi's population, compared to tenants and laborers who account for 5% of the population. Therefore, the presentation contained in this Supplement eliminates a separate equity category, but builds the equity theme into the remaining elements. This modification recognizes that implementation of the policy reforms embodied in ASAP I and II will lead to increased equity for smallholders and tenant/labor alike.

Additionally, the categories on production and marketing and crop diversification have been combined into a new supporting theme. This is because both of these original themes are essentially outcomes of liberalizing agricultural sector policies rather than areas of agricultural policy themselves.

As a result of these modifications, the ASAP II program comprises a package of policy and institutional reforms that can be categorized under two themes:

1. Increasing equity and efficiency through liberalizing input markets; and
2. Increasing equity and efficiency through expanding market competitiveness and institutional reform.

B. Program Elements:

Program Elements are presented within the framework of the above two themes. The policy changes that the GOM will undertake under each are presented below. The context and justification for the proposed policy agenda are contained in the BACKGROUND section of this PAAD Supplement and the original PAAD. More detailed information and analysis is contained in the attached annexes and the numerous studies undertaken by the GOM, USAID and other donors during ASAP I as listed in the Bibliography (Annex A).

Theme 1: Increased Equity and Efficiency in the Smallholder Sector Through Liberalizing Input Markets

The activities contained under this theme remove constraints to private sector participation in input supply and distribution, including the removal of subsidies.

a) Fertilizer

- The GOM will eliminate all remaining fertilizer fiscal subsidies by the GOM's 1995/96 fiscal year.
- The GOM will expand private sector participation in the importation and distribution of fertilizer by permitting private importers access to SFFRFM fertilizer buffer stocks (on a replacement basis) and non-buffer stocks (as private distributors).
- The MOA will gather all available information on maize fertilizer use on smallholder farms from researchers and extension workers. Based on this information, the MOA will update its guidelines on maize fertilizer use and develop regional as well as site- and soil-specific recommendations for major maize producing areas.

b) Seed

- The GOM will eliminate the fiscal subsidy for HYV maize seed and will allow free and open competition between private seed traders and ADMARC.

- The GOM will undertake a seed import liberalization study to identify and analyze issues relating to food security, seed supplies and seed prices under a scenario where restrictions on the import of seeds are lifted. The GOM will also agree to incorporate the endorsed recommendations from the study into the ASAP II policy reform agenda.

c) Input Price Controls

In addition to the elimination of fertilizer and seed fiscal subsidies noted above, the GOM will develop and implement a framework and action plan to eliminate pan-territorial and pan-seasonal input pricing policies.

d) Land Leasing

The GOM will develop and implement an improved process for approving lease and sub-lease applications for agricultural and agribusiness land. Any legal resident of Malawi should be able to lease/sub-lease land. Race, tribe, nationality, religion and gender shall be explicitly forbidden as factors in reviewing lease/sub-lease applications. The review process should be restricted to a reasonable time period, and formal, written criteria for this process will be published. A written appeals procedure will be developed that is enforceable through a timely and transparent judicial procedure.

e) Transport Constraints

The GOM will analyze the constraints to efficient and affordable rural freight and transport services, will prepare and implement a time-phased action plan to address identified constraints, and will implement the action plan. The plan will address, among other concerns, multi-purpose (passenger and freight) transport, import duties on domestic transport trucks (and spare parts and tires), and appropriateness of domestic rate guidance in a liberalized agricultural sector.

f) Ethnic Restrictions

The GOM will review existing laws and administrative practices which allow discrimination on the basis of gender or ethnic, tribal, and/or racial background. The review will address such discrimination in the areas of land leases/sub-leases, business trading activities, transport licenses and transport operations. Based on the review, the GOM will develop a detailed, time-phased action plan for eliminating these practices and/or modifying legislation; the plan will include procedures through which a party may appeal a government action or decision if the party believes discrimination was a factor. Within a USAID-GOM agreed upon timeframe, the GOM will implement this action plan.

g) Duty Drawback System

The GOM will replace the duty drawback reimbursement system with a more efficient and manageable duty reduction system for the import of agricultural and agribusiness inputs.

Theme 2: Increased Equity and Efficiency in the Smallholder Sector through Expanding Market Competitiveness and Institutional Reform

Reform actions contained under the second theme are divided into four groups: tobacco subsector; producer and consumer price liberalization; government owned/sponsored agricultural organization reform; and rural market development.

Tobacco Subsector -- Activities included in this subsector focus on eliminating ADMARC's exclusive tobacco marketing arrangements, improving the efficiency of the national burley quota system, and strengthening private smallholder marketing and credit clubs, as follows:

a) The GOM will de-regulate all smallholder tobacco prices and will publicly announce that smallholder producers of all tobaccos, except oriental, have direct access to all legal marketing channels (intermediate buyers, auction floors and ADMARC).

b) The GOM will authorize and publicly announce direct trading of oriental tobacco between growers and buyers at freely negotiated prices.

c) The GOM will require that ADMARC operate as a fee paying intermediate buyer of burley tobacco with no maximum ceiling on ADMARC's marketing quota.

d) The GOM will improve the efficiency and operation of the national burley quota system by:

- Assessing the feasibility of transferring quota allocation and administration responsibilities from the MOA to the TCC with the objective of identifying the most efficient and transparent allocation process;
- Developing and implementing a computerized, performance-based quota allocation scheme;
- Ensuring that marketing quotas under the intermediate buyers program continue to be additive to the national total production quota and are not subject to a maximum ceiling;
- Ensuring annually, sufficient new quota and/or reallocated quota to fully meet all effective smallholder demand (possible eligibility requirements could limit quota to organized tobacco clubs that are qualified to receive credit and that have applied for quota);

- Eliminating annual quota application requirements except for first-time applicants; and
- Evaluating the necessity of the quota system, and publicizing all relevant information on quota allocation.

e) The GOM will develop appropriate policies which permit smallholder tobacco clubs to become independent private agribusiness organizations capable of self-sustained management and operation.

Consumer and Producer Price Liberalization -- Under this category are a set of reform activities relating to improving the system for stabilizing maize prices and eliminating all limitations on private sector buying and selling of smallholder produced commodities, as follows:

a) The GOM will release ADMARC from pan-territorial and pan-seasonal pricing obligations for all crops except maize.

b) The GOM will raise maize producer prices to at or near export parity and develop and implement a model for stabilizing maize prices based on price band analysis or an alternative system.

c) The GOM will evaluate the size, cost and efficiency of the Strategic Grain Reserve, including establishment of an open tendering system for supplying maize to, and removing maize from, the strategic grain reserve.

d) The GOM will eliminate the requirement that ADMARC ensure smallholder access to output markets for all crops.

e) The GOM will eliminate the exclusive marketing arrangements of ADMARC and all limitations on private sector buying and selling of smallholder produced commodities.

Government Owned/Sponsored Agricultural Organization Reform -- Under this category the GOM will examine the role of statutory bodies, government trusts, parastatals and government sponsored farmer organizations on the performance of the smallholder agricultural sector. Specifically, the GOM will:

a) Conduct a review of these entities which have operations in the agricultural sector to determine how and to what extent they promote or restrain smallholder economic growth and equity.

b) Based on the results of the above review, develop an action plan providing specific management and financial audit recommendations; and implement action plan recommendations.

Rural Market Development -- This category comprises a broad set of actions relating to rural market development and agricultural investment. These include the following:

a) The GOM will assess issues relating to ADMARC's selling, leasing and/or renting its rural retail facilities; and will prepare and implement a time-phased implementation plan to develop appropriate policies and procedures for carrying out the sale (privatization), renting, and/or leasing of these facilities.

b) The GOM will develop and implement a national import/export licensing system which (1) eliminates the requirement for prior approval by the Ministry of Agriculture of import/export licenses for agricultural produce, and (2) provides appeal procedures for licenses that are denied or rescinded.

c) The GOM will remove all agricultural commodities except maize from the negative list for import and export licensing requirements effectively lifting the export bans on all non-maize crops.

d) The GOM will develop and implement a national business license system to replace the current system requiring that trading licenses be approved in each Agricultural Development Department where trading activities take place. Licenses under the new system will be valid throughout Malawi and will be available to all individuals who meet published criteria. The GOM will also establish a minimum review period and provide procedures for appealing negative decisions and settling disputes.

e) The GOM will develop and publicly announce improved investment incentives for rural enterprises in support of agricultural diversification and growth.

C. Program Conditionality:

ASAP I should be completed in September, 1994, by which time it is expected that the GOM will have satisfied the final, remaining, conditionality tied to the third and final tranche. Phase II will consist of four tranches, each of which will be disbursed upon the GOM's satisfactory completion of all of the actions described in each, respective, tranche. As of the date of this PAAD, the reform actions under each tranche are contained in the Policy Matrix and the draft Agreement Amendment No. 1 (Annex C).

D. Relation to Other Donor Programs:

In addition to USAID, the other principal donors in the agricultural sector are the World Bank and the European Community (EC). The World Bank-supported Agricultural Services Project (ASP), launched in December 1993, is a 5-year, \$46 million effort to improve extension service delivery and the administration of agricultural research. In addition, the World Bank is funding the Malawi Rural Financial Services Project, a \$25 million effort to transform the existing Smallholder Agricultural Credit Administration (SACA) into a stand-alone financial entity.

The EC, through the International Fund for Agricultural Development (IFAD), is currently planning a 5-year, \$48 million project to help improve food security through expanded smallholder use of fertilizers, the promotion of agroforestry and improved land husbandry techniques. This project is expected to begin implementation in early 1995. The World Bank and EC projects are mutually supportive of ASAP and directly relate to the Mission's strategic objective in agriculture. While other donors (including the African Development Bank, UNDP, the British ODA, the German GTZ, and the Japanese) are also active in the sector, their contributions are more limited and focused geographically.

V. PROGRAM IMPLEMENTATION

A. Implementation Plan:

1. Introduction

ASAP includes policy and institutional reform activities involving a variety of GOM ministries, as well as specific project activities in four different ministries and numerous institutions. Its complexity requires an implementation plan which accounts for its diversity, while providing a structure in which actions can be taken quickly but deliberately. To accomplish this two management committees were established early in ASAP I, a Program Management Committee (PMC) chaired by the Ministry of Finance, and a Program Implementation Committee (PIC) chaired by the Ministry of Agriculture. Both of these structures are discussed in detail below, along with the individual responsibilities of the GOM and USAID.

2. Management of Program and Project Implementation

a) Joint Host Country and USAID Responsibilities

The management of overall program implementation is at two levels. At the principal secretary level, there is a Program Management Committee (PMC) which includes relevant principal secretaries and the director of USAID. This committee monitors implementation progress, including progress toward achievement of conditionality. The committee meets at least twice annually, as well as on an ad hoc basis as the need arises.

At an executive level, there is the Program Implementation Committee (PIC) which includes office directors in areas relevant to program activities. Included on this committee is the USAID Agricultural Development Officer. This committee monitors program implementation on a more regular basis, and deals with implementation matters which require broader discussions and resolution. For example, decisions about study scopes of work and related issues may require discussions by the PIC since both conducting the study and

acting on findings and recommendations may involve a number of offices and ministries. The PIC meets as needed to review implementation and discuss actions to be taken. Sub-committees of the PIC may be formed to consider discrete program or project-specific areas. The composition of the committees, their specific scopes, and their schedules is the subject of discussions between USAID and the GOM, and are documented in a PIL.

As part of ASAP II, the PMC and the PIC will be assisted by an Economic policy Support Unit set up within the GOM to assist in conducting overall policy analysis and coordinating the implementation and monitoring of the ASAP policy agenda. The Unit will be composed of one resident senior Agricultural Policy Advisor, an agricultural economist, and a secretary. Unit responsibilities will include **assisting** the GOM in:

- Drafting terms of reference for required studies on behalf of the MOA, monitoring studies while in progress, and ensuring broad dissemination and discussion of the recommendations.
- Analyzing overall agricultural policy options, formulating policy recommendations, and coordination of complementary donor efforts;
- Identifying and addressing implementation issues as well as developmental and technical matters in a timely manner;
- Monitoring progress toward completing the actions required prior to the disbursement of ASAP funds, and assisting the MOA in complying with USAID reporting requirements; and
- Assist in coordinating ASAP policy and institutional research, as appropriate, with the Center for Social Research (CSR) at Chancellor College and the Center for Agriculture and Rural Development (CARD) at Bunda College.

To further strengthen program coordination and implementation, ASAP II conditionality will require that the GOM submit Letters of Intent to USAID/M at the end of each tranche period covering activities planned for the subsequent tranche. The LOIs will contain: a comprehensive list of actions the GOM plans to take; the name of the principal representative/entity responsible for implementing or causing to be implemented or accomplished, each action; and a list of budgetary resources the GOM has committed for program activities.

b) GOM Responsibilities

This implementation plan reflects three years of excellent GOM leadership in carrying out the activities of ASAP I. Through the Ministries of Finance and Agriculture, the GOM has demonstrated a sense of program ownership which is considered by the Mission to be fundamentally important to achievement of program objectives. GOM "ownership" is reinforced through the assistance modality -- cash transfer, selected by the Mission (see Section B.2., Disbursement of Funds, below).

The GOM, through the Ministry of Finance, has the leadership responsibility for implementing the program. This includes undertaking the necessary reform actions and managing the constituent program and project activities. Based on actions taken, the GOM is responsible for submitting to USAID evidence that mutually agreed upon reform activities have been completed. The GOM also ensures that covenants included in the program agreement are met. GOM responsibilities are executed through the various ministries in which the activities take place. Coordination in particular to see that overall program objectives are being met is undertaken through the PIC.

GOM management of studies is handled by PIC members. PIC sub-committees are formed to review and supervise the drafting of scopes of work and to review draft reports. The PIC is also responsible for reviewing final reports, considering recommendations and action plans, and identifying additional proposed project activities designed to implement action plans. For each study, the GOM selects one PIC member to be individually responsible for supervising day-to-day management tasks involved with study design and execution. Due to the size and complexity of ASAP II, it is essential that the Economic Policy Support Unit be established as soon as possible to assist the PIC.

c) USAID Responsibilities

Within USAID, the program is managed by the Agriculture and Food Security Office. Overall supervision of program implementation is the responsibility of the Supervisory Agricultural Development Officer (ADO). That officer is assisted by the deputy ADO and by other professional office staff. The ADO or deputy ADO represents USAID on the Project Implementation Committee, and participates on PIC sub-committees as required. The Mission Director represents USAID on the Program Management Committee.

An ASAP Program Committee has been established within USAID assist the ADO with program management. This committee includes representatives from the Project and Program Development (PPD) Office and the Controller's Office. The ADO is the chairperson of this committee. The function of the Mission Program Committee is to monitor progress of program and project implementation and to help identify and address potential problems and concerns. ASAP is a complex program, and requires a variety of resources from within the Mission for its successful implementation.

3. Implementation Schedule

The ASAP II reform package is organized sequentially by tranches. Funds for a particular tranche will be released when all the policy and institutional reform measures for that tranche have been successfully implemented. The "group" of actions described in each sequential tranche is based on several factors, including: a) the status quo, that is the current agricultural policy framework in Malawi toward the end of ASAP I; b) the Mission's best understanding of the interim policy measures that must be taken toward achievement of the Program's purpose; and c) the relative difficulty the GOM may have in implementing the activities contained in the reform package. Importantly, the GOM has scheduling flexibility in the implementation of reform activities both within specific tranches and between tranches. Therefore, the program portion of ASAP II does not provide a binding, time-phased implementation plan. However, for planning purposes, a schedule of anticipated completion dates for each tranche is presented below.

<u>Completion Date</u>	<u>Tranche No.</u>
December 1994	4
June 1995	5
September 1996	6
September 1997	7

B. Financial Plan:

1. Illustrative Financial Plan

An illustrative financial plan for ASAP funds is presented in Table 1, below. It proposes total life-of-program funding of \$55 million which would be disbursed as a cash transfer for budgetary support. Table 2 provides a summary of obligations by fiscal year. Under ASAP I, \$20 million in NPA was obligated in FY91. Under ASAP II, \$35 million in NPA is proposed for obligation in three fiscal years, FY 94 and FY 95 and FY96.

Table 1
ASAP II Illustrative Budget
(\$000)

<u>Source</u>	<u>ASAP I</u>	<u>ASAP II</u>	<u>Total</u>	<u>Disbursement</u>
DFA (NPA)	20,000	35,000	55,000	Policy Performance

Table 2
Summary of USAID Obligations by Fiscal Year
 (\$000)

<u>Source</u>	<u>ASAP I</u>		<u>ASAP II</u>		<u>Total</u>
	<u>FY91</u>	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>	
DFA/NPA	20,000	13,000	11,000	11,000	55,000

Estimated GOM counterpart contributions for ASAP are shown in Table 3. Contributions shown for ASAP I are actual GOM budgetary allocations from the Development Budget. ASAP II contributions are estimated based upon past allocation.

Table 3
Summary of Estimated GOM Counterpart Contributions
 (\$000)

<u>Source</u>	<u>ASAP I</u>	<u>ASAP II</u>			<u>Total</u>
	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>		
GOM Budget	15,000	8,000	8,000	8,000	39,000

2. Disbursement of Funds

For the second phase of ASAP the Mission has selected the cash transfer disbursement method and has requested an exemption to dollar separate account legislation. There are several factors that contributed to this decision: emphasis on program results rather than inputs; ownership of the program by Malawians; most efficient form of budgetary support; Mission confidence that USG dollar resources will be responsibly managed through Malawi's foreign exchange allocation system; and sound procedures in place, through a Letter of Intent mechanism, to ensure sufficient Government financial resources to implement ASAP II policy and institutional reform actions.

a) Results Oriented Approach

ASAP is promoting an agricultural economy free of artificial price and other structural and institutional constraints. Program success will be measured through a number of **results-oriented** goal and purpose level indicators -- indicators that are closely linked to program conditionality. These indicators (for more detail on indicators see the Monitoring and Impact Assessment, Section C., below) include, for example, increases in real per capita incomes, increases in food availability measured in calories/person/day, and growth in rural micro-, small and medium enterprise employment.

b) Ownership

GOM ownership and outstanding leadership have been fundamental factors contributing to ASAP I's success. Preserving these qualities is considered fundamentally important to achieving the challenging reform agenda included in this Supplement. The cash disbursement method ensures that the GOM and the MOA remain in charge of all the implementation actions required to achieve the policy reform program envisaged in ASAP. USAID/M firmly believes that the GOM must be in charge of the financial resources required to make that happen. A cash transfer modality, based on a phased, results-oriented process, enables the GOM to continue leading the process of liberalizing the agricultural sector better than the alternative, project modality, which makes the GOM dependent on USAID actions (such as advance/liquidation procedures).

c) Budget Support Program Rationale

NPA financing will enable the GOM to increase budgetary outlays in the agricultural sector necessary to fulfill the objectives of ASAP. All foreign-exchange financed commodities and services required to achieve the objectives are being provided on a project basis through the complementary ASAP Support Project. Budget resources are, however, required to facilitate the expansion of government-appropriate agricultural services to ever-increasing numbers of smallholders. Additionally, USAID/M has used the cash transfer disbursement successfully for several years in implementing sectoral programs, including the authorization and obligation of this Agricultural Sector Assistance Program. The mechanism is well understood in the Malawian financial, commercial and government communities.

d) Use of Dollars

Malawi's foreign exchange allocation system has undergone significant and positive changes. Recently, the GOM has eliminated all exchange controls and floated the country's currency, the kwacha. Under the new system, the exchange rate of the kwacha is determined on the basis of the supply and demand for foreign currency. The GOM has put in place several instruments to implement the new system. The Reserve Bank of Malawi conducts weekly fixing sessions (on Fridays) at which buyers and sellers of foreign exchange are matched to arrive at a reference market clearing rate. This clearing rate is applied to all official transactions handled by the GOM. During the week, authorized commercial banks and licensed foreign exchange bureaus and brokers buy and sell foreign currency at freely determined market exchange rates. Under the new system, all import orders and payments (except for commodities on the temporary negative list) are no longer subject to the prior approval of the Reserve Bank of Malawi. Additionally, limits on the amount of foreign exchange which could be purchased for foreign travel were raised and are now administered flexibly. At the same time, the GOM has abolished the surrender requirement on all export earnings, except for a temporary 10 percent levied on traditional exports such as tobacco, tea and

sugar. The new system also permits tobacco exporters to hold foreign currency denominated accounts (FCDAs) for their own day-to-day use. These reforms are expected to contribute greatly to increased confidence and to a more efficient and depoliticized exchange rate policy.

e) Accountability

USAID will disburse funds for a particular tranche upon the successful achievement of all policy and institutional reform actions contained in that tranche. Dollars will be disbursed directly to Malawi's account in the Federal Reserve Bank of New York. All disbursements will be against phased results, which are directly linked to expected end-of-program impacts. Prior to the initiation of each phase or tranche period, the GOM will submit a **Letter of Intent** which, within the parameters of the Project Agreement, (a) specifies the actions that the Government will take to achieve the conditionality under the subject tranche, (b) provides the name of the principal representative/entity responsible for each action detailed in the Letter of Intent, and c) provides a description of the financial resources to be provided by the Government to achieve the subject conditionality. A review of whether those budget resources were, in fact, made available in a timely manner, will be an integral part of the assessment of actions to be completed prior to each tranche disbursement. In this way, USAID will ensure that adequate local financing is made available through the budget to implement the program. This obviates the need for the creation and management by USAID of a special local currency account.

Pursuant to Section 537 (b)(4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act, USAID proposes to exempt this program from the dollar separate account and tracking requirement for the following reasons: (1) foreign exchange in Malawi can be accessed by individuals and businesses on demand at market-determined rates, (2) uses of foreign exchange are not administratively determined, and (3) trade licensing arrangements are not primarily aimed at restricting imports or allocating foreign exchange. Imposing a separate account and dollar tracking system would interfere with this open, non-directive system.

The disbursement modality proposed herein includes USAID oversight of host country expenditures through the GOM budgetary process. The GOM's policies and procedures for budgeting, accounting and controlling funds have been reviewed by USAID and other donors and found to be sound. RIG/A/Nairobi has, in fact, examined and certified the Auditor General's Office of the GOM as an approved audit entity, a rare distinction among governments in Africa. The Mission's General Financial Assessment of the GOM also makes a determination that the budgeting, accounting, and control procedures utilized by the GOM are worthy of highest confidence.

C. Monitoring and Impact Assessment:

The goal of the USAID/Malawi program, as expressed in the Country Development Strategy Statement (revised in 1994), is to enhance the economic well-being of the average Malawian household. This strategy identified four strategic objectives aimed at achieving this goal: increase foodcrop production and productivity, reduce fertility, decrease infant and child morbidity and mortality; and control the spread of AIDS. The ASAP program is the Mission's principal vehicle for increasing foodcrop production and productivity.

The anticipated impacts of the program have been identified with quantifiable indicators under the program goal and purpose. These indicators will be achieved through market liberalization, expanding market competitiveness and institutional reform.

1. Program Goal

The goal of the ASAP program is to increase agricultural productivity, employment, and incomes. Indicators that will be tracked on a regular basis for assessing achievement of this goal include:

- Real per capita smallholder income should increase by 3% per annum or by 24% by the year 2000.
- Food availability should increase from 1750 calories per capita daily to 2200 calories by the year 2000.
- Growth rate in employment in rural MSMEs should increase from a baseline estimate of 10% per year to 15% per year by 2000.

Sources for these indicators include annual MOA crop estimates, economic reports, data provided by the MOA Inputs Section, and the Impact Policy Survey conducted by the Monitoring and Evaluation Unit of MOA's Planning Division.

2. Program Purpose

The purpose of the program is to increase smallholder access to agricultural inputs, output markets, cash crop production alternatives, and labor market information. Several indicators will be tracked on a regular basis to ensure that the program is having its intended impact:

- Smallholder land planted to non-maize crops increases from 24% in 1993 to 45% by the year 2000.
- Contribution of HYV maize production to total maize production increases from 49% in 1993 to 60% by the year 1997.
- Total value of agricultural export earnings increases by 10% per year.

- Value of all tobacco grown by smallholder farmers increases from US\$18 million in 1993 to US\$50 million by the year 2000.
- Amount of fertilizer delivered by the private sector increases from 37% in 1993 to 50% by the year 2000.

Sources for these indicators include MOA crop estimates the Economic Report data routinely collected by the MOA Inputs Section, and the Policy Impact Survey conducted by the Monitoring and Evaluation Unit of MOA's Planning Division.

3. Program Outputs

The ASAP program comprises a package of policy and institutional reforms that can be categorized under two themes: increasing equity and efficiency through liberalization of input markets, and increasing equity and efficiency through expanded market competition and institutional reform. Program indicators, categorized by theme are outlined below.

Increasing equity and efficiency through liberalization of input markets

Indicators the Mission will track on a regular basis under this theme include:

- Value of total HYV maize seed marketed through private traders increases from 25% to 50% of total sales by 1997.
- Amount of fertilizer sold through private channels increases from 37% to 50% of total sales by 1997.
- Amount of fertilizer delivered to the revolving fund by private traders increases from nil to 25% of total deliveries by 1997.
- Amount of fertilizer released by the revolving fund to private traders increases from nil to 50% of total deliveries by 1997.

Where further analysis is required and a plan is to be drafted and implemented, indicators are not specified. These must be developed at the time the plan of action is agreed upon. Sources for indicators specified above include data from the MOA Inputs Section, Lever Brothers, and National Seed company of Malawi, the Policy Impact Survey conducted by the Monitoring and Evaluation Unit of MOA's Planning Division, and the revolving fund report.

Increasing equity and efficiency through expanded market competition and institutional reform

Indicators to be tracked on a regular basis under this theme relating to maize include:

- Producer price of maize at or near export parity.
- Value of smallholder crops marketed by private sector

increases by 5% per year.

- Amount of maize delivered to the SGR by private traders increases from nil in 1993 to 20% of total deliveries by 1997.
- Amount of maize released by the SGR to private traders increases from nil in 1993 to 20% of total deliveries by 1997.
- Area under HYV maize as proportion of total maize area increases from 25% in 1993 to 35% by 1997.

Indicators to be tracked on a regular basis under this theme relating to tobacco include:

- Fully operational computerized system at TCC.
- Gazette notification and radio broadcasts.
- Total amount of unused quota declines from current estimate of 30% to 5% by 1997.
- Share of burley quota allocated to smallholders is consistent with allocation scheme to be mutually agreed upon in tranche 5.
- Share of total value of tobacco sales marketed by Intermediate Buyers increases from nil in 1993 to 25% by 1997.
- Total value of all tobacco grown by smallholders increases from US\$18 million in 1993 to US\$40 million in 1997.

The indicator to be tracked on a regular basis under this theme relating to ADMARC facilities is:

- Unused or under utilized ADMARC facilities reduced by 50% through sale or lease of such facilities by the year 1997.

Further analysis is required and a plan is to be drafted and implemented concerning statutory bodies as they affect the agricultural sector. Indicators must be developed at the time the plan of action is agreed upon.

4. Program Inputs

a) USAID inputs

Proposed USAID inputs amount to a total of \$55 million over the LOP, including \$35 million for ASAP II. ASAP II funds will be released upon the GOM's successful satisfaction of the conditionality in each of four anticipated tranches. Monitoring of these contributions will take place at the time of tranche release.

b) GOM inputs

Anticipated GOM inputs of \$24 million under Phase II will be monitored through GOM Letters of Intent and GOM performance on meeting conditionality.

5. Monitoring strategy

As in the case under ASAP I, comprehensive reviews of compliance with the letter and the intent of the conditionality contained under ASAP II will be undertaken. Monitoring and evaluation of the major program components is also critical to understanding the status of various activities and for identifying implementation constraints and opportunities.

Data sources for most of the impact and program indicators come from readily available public sources published routinely by the GOM. Where a policy reform involves a specific organization, the Mission will require reporting from that institution. These include operations of the strategic grain reserve, the fertilizer revolving fund, and the Tobacco Control Commission.

Monitoring of specific issues will require site and field visits. For example, USAID/M staff will be required to visit the TCC to ensure that the computerized quota allocation system is fully operational and that information is made readily available to insure transparency.

As part of our ongoing monitoring and evaluation activities, the Mission has provided technical support to a variety of activities: the famine early warning system, the household food security and nutrition survey, the national sample survey of agriculture, and the smallholder burley registration system. The Mission will continue with its support in these areas to help insure timely and reliable information.

Finally, the Mission supports survey and field work. Part of this work is being done through the collection and analysis of behavioral change among maize and tobacco farmers in Zambia south. This research, begun in 1985/86 and updated annually by Dr. Pauline Peters of HIID, provides a longitudinal data set for investigating the impact of the policy changes on rural smallholders. The Mission has capitalized on Dr. Peters' work by engaging her to update her work annually. Other field work involves occasional ad hoc surveys, both qualitative and quantitative, to address specific issues.

VI. SUMMARIES OF TECHNICAL ANALYSES:

A. Political Analysis:

1. Introduction

The ASAP program seeks major structural changes -- essentially the breakdown of dualism and the reduction of

government control -- in the Malawian rural economy. Particularly during early implementation, these changes challenged significant aspects of vested economic interests and political status quo, as well as the economic interests of major institutions long established in Malawian society. Because the changes made to date have not been easy to achieve, the Mission has made a serious assessment of the political feasibility of the policy initiatives to be undertaken under ASAP II. This analysis focused on constraints, as well as actions which should be taken to enhance the political feasibility of the program.

2. Background

Although ASAP I covered a broad range of policy issues, the most contentious involved eliminating prohibitions against smallholder production and marketing of burley tobacco. As noted earlier, much of Malawi's historic economic growth has been the direct result of agricultural exports. The benefits of this growth have accrued overwhelmingly to those agricultural estates who have enjoyed privileged access to the right to grow burley tobacco, the country's most profitable cash crop. The profitability of estate burley production has itself been the result of Malawi's special position in the international market as a high quality producer, and the ability of estates to capture the rents generated by this special position. These rents have been captured through a set of government policies and regulations which have kept factor prices artificially low: e.g., the token cost of estate lease fees has lowered the cost of land; subsidized credit has lowered the cost of capital; and restricted access to burley production quotas has lowered the cost of labor.

The profitability of burley has played a major role in shaping the country's political economy. Burley's economic and political importance led to the creation, in post-colonial Malawi, of an almost classic colonial-style social structure in which barriers to entry to income-earning opportunities have held down wage levels. Public policy and institutions have almost without exception served the interests of those who dominate the country's socio-economic structure.

There are three major interest groups which have been threatened by the opening up of burley production and marketing to smallholder farmers. First, Malawi's previous political leadership used the granting of estate leases and burley production quotas as a key element of its political patronage system. However, the rapid expansion in the number of small estates, combined with the opening up of the political system, has decreased the patronage value of such quotas and licenses. It is important to note that most of the country's top political leaders in all parties are also major tobacco (including burley) producers. These individuals may be threatened economically by the changes in burley production and marketing if they are unable to adjust to a more competitive environment. However, political realities may force them into at least a public posture of support for reform.

Second, senior civil servants, who have already obtained access to burley production quota or aspire to do so. Their applications for estate licenses have traditionally been approved in recognition of their political loyalty and good performance. They do not have many other economic alternatives, and to the degree they feel threatened by reforms, may resist change.

Third, the tobacco growers association, the Tobacco Association of Malawi (TAMA), which is the best-organized and most powerful interest association in the country. Although TAMA membership is dominated by the numerically-predominant small estates, its leadership overwhelmingly reflects large grower interests. TAMA continues to strongly oppose expansion of the smallholder burley scheme, which gives smallholder farmers other options than that of estate tenancy, upon which estate tobacco production is based.

All of these groups have, however, expressed a rhetorical commitment to change in the rural sector and to seeking new ways to increase the general welfare. They would also, like to preserve the benefits which have accrued to them through the existing burley production quota system. These sometimes conflicting perspectives certainly came into play in the early implementation of the pilot smallholder burley scheme under the World Bank's Agricultural Sector Adjustment Credit (ASAC). The ASAC scheme was plagued by administrative glitches, resulting ultimately in producers receiving a lower than expected price -- a price which was below production costs for most participants. Some problems were due to poor planning, but many observers believe that the scheme was intentionally derailed, either by GOM technocrats or politicians. Other observers believe that the pilot scheme was sabotaged by TAMA, and that the GOM was unwilling to put up a fight to save it.

3. Discussion

In May 1994, almost thirty years of autocratic rule ended when Malawians voted the leader of the populist United Democratic Front (UDF) party, Mr. Bakili Muluzi, into power as president. Thus, the ASAP program is currently operating in a vastly different political context than that which prevailed during project design and early implementation. For example, the politicians who have traditionally been responsive to estate sector concerns now appear to recognize that they need the support and votes of the smallholder farmers; consequently, they cannot afford to publicly denounce the program and its expanding registration of smallholder burley tobacco growers.

Moreover, it is likely that participants and non-participants perceive the burley program as facilitating the weakening of control of the existing system. As long as the political process continues to be open, there will be powerful incentives for both incumbents and challengers to support the program. (For example, the Malawi Congress Party (MCP) in its pre-election manifesto, claimed ownership of the reforms in the agricultural sector, especially the smallholder burley program, and deemed them a success of its leadership and administration.)

Notwithstanding the above, there is little doubt that some political risks remain in undertaking the next phase of ASAP. The program could, for example, be easily jeopardized if political leaders do not aggressively support its full implementation. They must be alert to potential manipulation by bureaucrats or local political leaders, and willing to counter interest groups such as TAMA which want to turn back the clock. To minimize the risk, senior GOM representatives and technical specialists, private sector stakeholders and beneficiaries have participated actively and extensively throughout the analytical phase of ASAP II. Representatives of the MOA, the MOF and the private agricultural sector attended a series of meetings with USAID/M counterparts to discuss the views of an analytical team regarding issues being considered for inclusion in ASAP II. The Mission has received preliminary endorsement for the major elements of ASAP II from MOA and MOF staff, with the full endorsement of the political leadership pending further discussion. Further, the ASAP II design incorporates the findings of a 1994 Malawi case study on participation in economic policy reform, as well as staff interview results of some 350 farmers (primarily smallholders) and additional survey data on 700 farmers -- of which 20% were female. These combined efforts provided an opportunity for government officials, private sector representatives and program beneficiaries to express their preferences, helped reaffirm the appropriateness of the original PAAD design, and instructed the ASAP II policy and institutional reform agenda.

While some risks remain, there are strong reasons for moving forward with the ASAP II. The most important is that if the program is successful, it promises a very substantial equity impact, and, in the longer run, the possibility of a much more broad-based economic growth path for Malawi.

In terms of the new Government's political ideology, it is believed that the UDF will strive for a more open economy in which the private sector plays the predominant role and the GOM serves a more facilitative function. In the President's recent State Opening of the Parliament of Malawi (June 30, 1994) he stated that poverty alleviation, particularly in rural Malawi, was "the core priority of the Government". He noted the restrictive policy environment in rural agriculture and stated that the "Government is determined to remove all policy constraints that hinder the efficient performance of the agriculture and livestock sector. It is therefore the Government's intention to overhaul all policies in this regard in order to create a policy environment where this objective can be achieved."

4. Conclusion

If these stated intentions are translated into specific actions, the environment for ASAP's reform program could not be better. One must bear in mind, however, that Malawians are still actively defining the mechanisms of governance under their new multiparty democracy. While there may be greater agreement on the reform principles contained in ASAP under the new Government than the old, the process of making implementation decisions will almost certainly become more complex given the open and participatory nature of the new Government. The risks of a setback under the new regime are small compared to the high risks A.I.D. assumed when the program was initiated in 1991. While it is too soon to draw definitive conclusions about how ASAP will be affected by the emerging program of the new GOM, there are reasonable grounds to believe that the leadership of the UDF will provide significant support for the reforms proposed under ASAP II.

While recognizing that the political context for implementing the ASAP II reform agenda is substantially more positive than under Phase I, it is nonetheless important that the Mission maintain its prior strategy of minimizing the potential risks that have been identified. Therefore, under ASAP II, the Mission will continue to do the following:

- Closely monitor implementation of the policy agenda and provide appropriate expert advice, as needed, on the myriad of complex issues that are likely to emerge;
- Explicitly include all stakeholders and beneficiaries in policy discussions;
- Continue to involve other donors in the efforts to expand market-based reforms;
- Move quickly to resolve issues and initiate mechanisms to organize farmers for smallholder production, e.g., for inputs as well as output marketing;
- Continue its on-going dialogue on these issues with the GOM, involving senior Mission management; and
- Advise the GOM that USAID is committed to an honest and continual appraisal of progress under ASAP, and that USAID will be prepared to cancel the program, if the GOM is not demonstrating sufficient commitment to the principles of the program.

B. Social Soundness Analysis:

1. Introduction

The social analyses focussed on two general sets of issues: (1) the current structure of employment, income distribution, and access to land and other resources (credit, labor and extension advice) among significant social

groups within the agricultural sector and, (2) the effects of ASAP on agrarian change and consequent impact on different social groups.

2. Employment, Income and Resource Access in Malawi

In 1987, 70% of full-time farmers and 25% of part-time farmers were women. 72% of the active labor force was employed in the smallholder sector and 9% was employed in the estate sector (World Bank, 1990). As such, smallholders and estates are of particular importance for ASAP.

a) Smallholders

The smallholder sector includes 1.8 million households, 30% of which are headed by women, and historically has been squeezed by four main factors: (a) a population growth rate of 3.0% per annum; (b) inadequate access to productive land, exacerbated by declining per capita cultivation from an average of 1.5 hectares in 1968/69 to less than 1.0 hectares in 1993/94; (c) an improving but still low farmer adoption rates of improved crop production technology and alternative crops; and, (d) a set of national policies that have either neglected the needs of smallholder agriculture or transferred wealth from smallholders to support investment in other sectors. This has resulted in a situation whereby 75% of all smallholder households cultivate less than 1.5 hectares of land. These smallest of smallholders are not, however, a homogenous group: 20% cultivate between 1 and 1.49 hectares and are considered subsistence farmers able to produce a small surplus in good years; 55% cultivate less than one hectare, which, at current productivity levels will supply a maximum of 75% of the family's basic nutritional needs; and 23% cultivate less than 0.5 hectares, which yields only 27% of their consumption requirements (World Bank, 1990).

The smallholder sector is faced with an increasingly skewed distribution of land and income (both regionally and within communities); a growing proportion of resource-poor, woman-headed households; a growing marginalization which has caused agriculture to become a residual activity providing a less and less meaningful contribution to household food and income; and a growing reliance on alternative, non-farm sources of employment to meet basic subsistence needs. Approximately 40% of all income derived by smallholders, including food retained for consumption, comes from off-farm sources, and 50% of all reported income is controlled by women (Peters and Herrera, 1989). For households where cash crops are a significant income source, there is a tendency for women's access to and control of income to decline. If present trends continue, with large proportions of rural society being unable to earn a living from their land, it is likely that the majority of Malawi's rural people will become landless or near landless laborers.

i) Women Headed Households

30% of smallholder households are headed by women, 72% of whom cultivate less than 1 hectare of land and cannot produce enough to meet their households' consumption requirements. This is in part due to the fact that women's access to land, labor, livestock and capital is largely determined by the nature of their current and past association with men, particularly with husbands or with male matri-kin in the South. It is also in part because about 40% of these women are married to men who are absent from home more than 50% of the time due to employment located elsewhere in Malawi. The situation for women farmers is bleak. The policies and institutions that have stifled Malawi's smallholder agriculture in general have had a particularly crippling influence on the opportunities available to women farmers. Marginalization of smallholder agriculture is felt most directly and deeply by women.

ii) Production of Cash crops

Smallholders have demonstrated that they are aware of market opportunities by responding to cash crop opportunities. Nevertheless, only 24% of smallholder land is dedicated to non-maize crop production. These low levels of other food and cash crop production in the smallholder sector are due to a variety of causes, including that which for most Malawian farmers is a paramount need: subsistence. Beyond that, although ASAP I removed some of the barriers to market channels and inputs for smallholder burley tobacco growers there are still a range of impediments to increased smallholder production and diversification. These include price disincentives on many smallholder crops; technical and legal constraints; and the inability of subsistence farmers to take risks.

Until 1990, smallholders were legally prohibited from growing burley tobacco, one of the most profitable types of tobacco. Since then the incomes of approximately 30,000 smallholder families have been substantially improved by the opportunities provided under the ASAP-supported smallholder burley program. Furthermore, rural households not directly growing burley tobacco also share in the benefits of the program through employment opportunities on burley-producing smallholder farms as weeders, curers and graders. In addition, the increased demand for goods and services spurred by increased farmer incomes is stimulating job creation in micro- and small business enterprises. Considerable potential remains for expanding smallholder burley production, especially in densely populated areas and for women. To achieve this objective, either the total burley production quota for smallholders will have to be increased -- and credit, extension services, seed and fertilizer made available to them -- or the burley production quota eliminated to make the opportunity available to all smallholders.

b) Estates

The estate sector was in the forefront of agrarian change in Malawi during the decade of the 1980's, and has had substantial influence on agricultural employment, incomes and the structure of the agricultural economy. In 1960, estates occupied 2% of Malawi's arable land; the owners were primarily corporations, businessmen, politicians and civil servants. In 1993, there were over 35,000 estates occupying 30% of Malawi's arable land and employing 7% of the working population. Increasingly, these leasehold estates have been established by smallholder families who converted their customary landholdings to estate status, or who fashioned estates from unallocated customary land held by chiefs (Mkandawire et al. 1990, Jaffee et al. 1991).

Obtaining an estate leasehold was, until 1991, the only way smallholders could gain legal access to burley production quota and security of tenure. However, many smallholders who have combined landholdings to achieve estate status have not been granted quotas to produce burley tobacco. These new estates are much more limited in their access to productive resources than many of the larger more established estates, and are highly dependent upon low tenant and wage prices for their profitability. Though there are some exceptions, these smallholder "graduated" estates are ineligible for the SACA credit program and the MOA extension services which are directed to smallholders. Because of their lack of collateral, they are also seen as too risky for commercial finance, and are not being effectively served by the recently established estate extension service.

i) Women as Estate Owners

Approximately 3% of Malawi's estates are registered in the names of women. Since there is no statutory requirement that imposes specific legal barriers to women's participation in the estate sector, this low rate of women's participation can only be explained by the presence of de facto or informal barriers (Ariza-Nino 1991). Moreover, for many women, access to land is being jeopardized through estate formation. As is the case elsewhere in Africa, formally gender-neutral land registration procedures can contribute to an erosion of women's rights to land. This is because women's names are not present on the legal documents that shift the land they currently cultivate from the customary domain (where access is based on community membership) into the leasehold domain (where access is based on individual identity).

ii) The Estate Labor Force

Four main types of workers are employed on estates: (a) paid and unpaid family members of estate leaseholders and managers (38,000 people) (b) tenants and their unpaid family members (255,000 people), (c) permanent laborers hired for a period lasting from a few months to year-round (163,000 people), and (d) casual (ganyu) laborers hired on a daily or weekly basis from surrounding smallholder communities (140,000 people). (Mkandawire et al., 1990, Jaffee et al., 1991).

Adult men constitute 70% of the total permanent work force and 42% of the casual work force. Adult women account for only 8% of permanent laborers, but 35% of casual laborers. Children (individuals under the age of fifteen) constitute 25% of both permanent and casual work forces. Men are paid 50% more than women (but on average, less than the agricultural minimum wage), while children are paid about half the adult male rate.

Real income from estate employment stagnated during the 1980's, but compares favorably with smallholder real earnings, which have declined during the period. (Jaffee et al. 1991). Taking into account all non-working family members, 12.5% of the total national population lives and works on estates. Over one-half of these people are tenant farmers and their families.

iii) Tenancy

All but a few of the largest estates rely on oral tenancy agreements which fail to specify the terms and conditions for tenants. This lack of specificity in the terms of tenancy creates uncertainty and misconceptions, leading to disagreements about earnings and prices charged for housing, food, inputs and other services; high rates of turnover; theft and burning of tobacco; and weak incentives to preserve tobacco quality. From the estate perspective, labor relations are one of the most significant constraints to increased production and improved quality; and from the tenant perspective, there is evidence of artificially low remuneration rates set through collusion and intimidation (Nankumba 1990). The situation is further complicated by the absence of clear and accepted administrative or legal processes for resolving disagreements between workers and managers. However, under ASAP I the GOM has taken action to require posting of the terms and conditions of tenancy, and has developed and publicized a Social Protection Policy for estate-tenants and estate-laborers to address some of these failings.

The Ministry of Agriculture, in conjunction with the Tobacco Association of Malawi, has historically set a maximum price for tenant tobacco (which is designed to reduce the price paid to the tenant below that which would otherwise be negotiated in a free market (Fitch and Carvalho 1991:27). However, smallholder burley club access to the auction floors, and the development of the Intermediate Buyer Program, are placing increasing pressure on tenant tobacco prices. Estates are increasingly finding it necessary to pay higher prices for

tenant tobacco to prevent it from "walking off" to other, more competitive, legal buyers.

Despite these conditions, smallholders still become tenants because approximately one in five achieve economic success. Jaffee et al. (1991) have shown that there are three significant categories among the tenant population: "accumulating tenants" (20% of all tenants), who are able to invest in livestock, small businesses and estates of their own; "middle tenants" (50% of all tenants), who earn higher incomes than most smallholders; and "poor tenants" (30% of all tenants), who manage to survive at levels that are comparable to or worse than conditions in the smallholder sector. These variations are an important source of dynamism in Malawian agriculture and tenancy has long been seen as an intermediate step between subsistence-oriented smallholder production and commercially-oriented estate production. However, this tie is breaking down as increasing numbers of smallholder farmers are obtaining legal access to burley production quota in their own right.

As stated above, ASAP I encouraged equity in the tenancy structure by requiring that estates post terms and conditions of tenancy and casual and permanent labor; and requiring clarification of adjudication procedures for estate-tenant disputes and estate labor disputes. Smallholder equity in terms of market access is also being encouraged as a result of the overall liberalization process, which will be further expanded under ASAP II.

3. Components of Agrarian Change and Policy Implications

a) Agrarian Change: The Estate-Smallholder Interface

Although our understanding of the estate-smallholder interface is not complete, the main sources of dynamism and tension that are driving agrarian change in Malawi appear to derive from (a) competition for land and other rural resources, (b) restrictions on access to commercial agricultural opportunities, and (c) the organization of rural labor markets.

i) Land and Land Use

Estates and smallholders compete for communal grazing land, fuel wood, building materials, and land for cultivation of food crops. From the estate side, this is perceived as encroachment; from the smallholder side, estate owners appear to be taking advantage of traditional community-based modes of rural resource access while at the same time using modern juridical mechanisms to gain exclusive access to lands under leasehold. The implication of these land transfers in terms of women's continued rights to land and inheritance are unclear, particularly where a number of households have combined their land resources in order to register under one name. While the future impact of legalizing smallholder burley production on the demand for leasehold registration is unknown, the desire for registration

may decrease as the number of quota-holding smallholder burley growers, and their collective production quota, increases.

ii) Commercial Opportunity

Malawi inherited and sought to maintain a rigid set of agricultural policies and institutions which were designed to provide a small minority with exclusive access to remunerative export crops. Since the early 1980's, this framework has come under great pressure for change, as evidenced primarily by (a) the rise of the category of "smallholder estates", (b) the increasingly common practice of using illegal smallholder "outgrowers" to produce export crops, and (c) manipulation of smallholder targeted input channels by estates to gain access to cheap farm input supplies. The result has been a de facto erosion of long standing policy and institutional barriers. While change was strongly resisted by those within the government and industry who maintain, manage, and benefit from the older alignment, ASAP 1 provided a scheme for smallholder burley tobacco production that has broken the barriers to more profitable marketing opportunities, supported the credit mechanism, and increased the number of supply channels for production inputs. Moreover, the initial balance between tentative internal champions and substantial external resisters of the program has shifted, allowing a more open and congenial process for policy change and dialogue.

iii) Rural Labor Markets

In rural labor markets little attempt is made to enforce national minimum wage laws, arbitrate disputes, or measure the magnitude and direction of market changes. The dynamic interface between estates and smallholders is captured in the following movements: (a) smallholders cultivating less than 1.0 hectare of land spend perhaps 30% of their time performing "ganyu" or casual agricultural labor on the farms of wealthier smallholders or estates (Peters and Herrera 1989, table C10); (b) annually about 140,000 smallholders find some employment as casual laborers on estates (Mkandawire et al. 1990); (c) about 160,000 landless or near-landless rural dwellers have found employment as permanent or semi-permanent laborers on estates (Jaffee et al. 1991); (d) a majority of Malawi's 100,000 tenant families appear to have migrated across district boundaries to find employment, and many have migrated across international boundaries (Jaffee et al. 1991); and (e) there has been a tendency for viable smallholders to seek employment first as laborers, and then as tenants, with the long-term objective of establishing estates or businesses with opportunities for commercial expansion. It is misleading to think of tenants and smallholders as members of two distinct groups; Jaffee et al. (1991) found that the size and distribution of customary landholdings among a sample of tenants was more-or-less indistinguishable from the size and distribution of landholdings among the rural population generally.

Women are discriminated against in rural labor markets, being offered lower wages for the same work as men and often being confined by the dominant gender division of labor to the worst paying jobs of seasonal nature. However, women work on average twice as many hours per day as men, with their agricultural labor only decreasing amongst the highest landholding group of smallholders. In contrast men's working hours increase with the size of land holding and the introduction of cash crops (World Bank, Engbera et al, Peters and Herrera, 1989). The effect of increased cash crop production on overall labor availability is, however, unknown.

The key implications here are: (a) rural people are earning a substantial and growing proportion of their incomes through agricultural employment; (b) the rural labor market appears to encompass all categories of agricultural labor, which will speed agrarian change; and (c) basic institutional mechanisms needed to monitor and successfully manage this aspect of agrarian change in Malawi are weak or absent.

b) Agrarian change: Policy Problem Areas

Agrarian change in Malawi thus has historically had three main components: (a) a continuing marginalization of smallholder agriculture as conventionally conceived, driven by population growth but accelerated by a stifling policy and institutional environment; (b) the emergence of a category of entrepreneurial "smallholder estates," driven by commercial opportunity and land security, that is comprised of the most viable members of the smallholder population; and (c) a rapidly-growing population of landless or near-landless rural people with few alternatives to estate employment. In principle, it should be possible to take advantage of several clear opportunities for growth, while acting to ameliorate those circumstances that will be most socially disruptive. With the advent of multi-party government, Malawi appears poised to support and respond to the currents of change in the following ways:

- By continuing to encourage and expand smallholder cash crop production. This entails removing constraints to: private trader participation in input supply and distribution; production and marketing of high value and other crops; participation by ethnic minorities in rural production and marketing activities; obtaining land for production and agribusiness purposes; and the provision of effective and affordable rural transport services. Similarly, it is necessary to increase the efficiency of the burley tobacco quota system, ensure the provision of government services for credit and technical support, and promote farmers' collective bargaining power through the organization and strengthening of voluntary farmer associations.

The broader issue of the role that statutory bodies, government trusts and government-owned assets (estates and commercial farms) play in the agricultural sector is also important. The continuing relevance of these government entities and of their influence on land availability, capital appreciation, rural market development, etc. needs to be better understood, and their future roles in a competitive agricultural economy defined.

- By continuing efforts to effectively manage and resolve current and foreseeable conflicts in labor relations. This entails increasing the transparency of contractual relationships in the agricultural sector; requiring full and specific unit costs of inputs and rations to be included in tenant and labor contracts; providing a legislative and administrative framework for the resolution of labor disputes; and fostering a more equitable sharing of the wealth generated by commercial agriculture.

- By continuing to increase security of tenure for women as well as men: encouraging female land legislation as well as joint leasehold arrangements which include women's names on lease hold documents.

Taken together, these policy changes have the following effects which should help Malawi equitably manage and continue the agrarian transition currently underway. First, they support small-scale agricultural development, which can be expected to be accompanied by growth in and broadening of employment opportunities in rural Malawi. Secondly, they accommodate the legitimate needs of a rapidly-growing population of agricultural laborers, while providing an institutional mechanism for managing the major stresses associated with rural structural change.

c) Conclusion

The challenge facing the new Government of Malawi is to ensure that access to the means of production (land, labor, inputs, credit, and extension) is broadened so that more smallholders can take advantage of income opportunities. At the same time the most vulnerable groups, including female-headed households (except those whose husbands work in RSA), estate workers and the urban poor) must be protected from the potential adverse impact that liberalization will have on purchasing power. If economic opportunities for vulnerable groups remain inaccessible, their already tenuous household food security situation could become further threatened. The negative effects of liberalization on vulnerable groups, however, are mitigated as increasing numbers of smallholders are paid a fair price for their crops, and as the terms and conditions for their tenancy or labor on estates reflect a fair return on their labor investments.

Given the absence of production inputs, including access to credit and timely market information, the majority of smallholders are unable to respond to price incentives. Of the primary ASAP beneficiaries (smallholders on customary lands), the inability of those cultivating less than one

hectare (55% of all smallholders) to meet subsistence needs underscores their limited income potential. These farmers are least able to bear the risk of cash crop production in a free market. Consequently, without special assistance they are unable to take advantage of the burley opportunity which is believed to be their best short-term means for escaping their poverty trap. ASAP will therefore focus on organizational constraints which may limit farmer participation in marketing associations to, as much as possible, provide all smallholders with the opportunity to participate in the cash economy.

ASAP has, and will continue under its second phase, to address the specific constraints faced by women farmers. Women's smaller landholding sizes, labor constraints during peak seasons, increasing involvement in agricultural labor, limited access to credit, extension and inputs, and current cultivation of some of the lowest value crops, make more women vulnerable to structural adjustment policies than their male counterparts. Customary, de facto, and legal barriers must be removed. Efforts have been made to encourage women's participation in ASAP at all levels. The extent to which women have the opportunity to: (1) increase production of food and cash crops; (2) take advantage of the extension service, and (3) obtain access to credit will continue to be expanded by ASAP II, and will largely determine the extent to which the majority of Malawi's rural households increase their quality of life. Women perform 70% of the agricultural labor and control 50% of household income expenditures. Therefore, their increased participation in commercial agricultural activities is critical to the achievement of ASAP objectives. In addition, ASAP, through the encouragement of more profitable agricultural enterprises on customary land, should also reduce the rate of family disintegration when men are forced to migrate for employment opportunities.

The direct beneficiaries of ASAP have been, and will continue to be all commercial smallholders, tenants, permanent and casual laborers on estates; and, private traders. Indirect beneficiaries are individuals who obtain employment from the growth in the rural economy and all people whose access to social services is increased by the expected increase in investment in rural areas. We have seen that people and groups that are negatively affected by ASAP's market liberalization objectives are smallholders who are unable to bear the risks of cash crop production. Estate owners may also be negatively affected as improvements in the terms and conditions of employment on estates and competition from smallholder burley production erode their profit margins and reduce their labor pool. Indeed many of the less capitalized and poorly managed estates may well be forced out of business.

C. Economic Analysis:

1. Introduction

ASAP seeks to bring about major structural reform through reducing government controls in the agricultural sector, particularly in such areas as input distribution, pricing policy and marketing. A major program

thrust is to open up the economy to expanded participation by smallholders in cash crop markets. The following economic analysis focusses on the returns to a liberalized tobacco market because tobacco is the largest and most profitable of all cash crops grown in Malawi. The analysis also addresses the broader ASAP II reform package in a non-quantifiable context. While ASAP is not a tobacco production program, proposed policy reforms in this subsector will continue to set bold policy precedents for all cash crops. In terms of conclusions, the economic analysis demonstrates that the tobacco marketing reforms directed at increasing smallholder incomes satisfactorily justify the cost of ASAP II.

2. Program Costs

The estimated program costs to the GOM of undertaking the ASAP II policy and institutional reforms is \$24 million. These costs are made up of the general budgetary support needed to implement the reforms, and the investment needed in the credit system to ensure that members of smallholder tobacco clubs receive credit at least once. They include:

- general budgetary support to the MOA and other agricultural sector institutions and parastatals as needed to fully implement and support the reform program (US\$12 million);
- funding for additional MOA extension support to smallholder marketing clubs, seed multiplication activities, and agricultural credit through MRFC or other qualified financial institutions (US\$9 million);
- GOM monitoring and evaluation of program activities, including environmental monitoring, nutritional surveys and crop estimates (US\$2.8 million); and
- public dissemination of agricultural price information and the publicizing of new agricultural reform measures by means of radio and newspapers (US\$200,000).

Additional budgetary support beyond that indicated above may be required to implement the reform program, but for the purposes of this analysis only costs associated with the items above, based upon the implementation experience of ASAP I, are used.

3. Program Benefits

In addition to the 30,000 smallholder farm households which have directly benefitted from the enactment of agricultural reforms under ASAP I, between 6,000 and 16,000 smallholder farm households are expected to benefit each year from the planned ASAP II reforms. Substantial associated benefits will also be derived from the injection of increased cash incomes into the rural economy, including increased demand for agricultural labor and an increased demand for rural-based goods and services such as construction materials, woven mats, containers, farm equipment and bicycle repair.

a) Tobacco Market Liberalization

The most easily quantifiable benefits of the ASAP II reform program accrue from the expansion of tobacco marketing reforms initiated under ASAP I. These reforms will allow smallholder producers of dark-fired and sun-air tobacco markets to market their tobacco on the auction floor or through intermediate buyers (IB), and permit smallholder producers of oriental tobacco to sell directly to buyers at competitively determined prices. The expected impact of these reforms is increased smallholder cash incomes, increased overall cash crop production, increased exports, and the injection of a significant amount of cash into the rural economy. Efficiency gains in terms of domestic resource use will also result as efficient smallholders producers replace less efficient estate producers.

(i) Expected Impact of Expanded Smallholder Burley Tobacco Production

Smallholders clearly have a comparative advantage in producing burley tobacco. A recent MOA study shows that smallholder burley production for direct sale on the auction floor is more efficient than that of a significant portion of the estate sector (Janson and Hayes, 1994). The break-even point at which burley production is no longer profitable is much higher for estates than for individual smallholders. The burley sub-sector is therefore expected to be increasingly characterized by smallholder production as estates diversify into other crops.

Annual household income for participating smallholder farmers from the sale of burley tobacco will increase by an estimated \$885 to \$1100 per hectare, depending on the price of inputs and the value of the production foregone. This is an increase of \$175 to \$220 per year for the an average smallholder cultivating a 0.2 ha plot of burley tobacco. If the opportunity cost of the burley production is valued at or near zero, as indicated by producer surveys, the increase in annual household income is even greater.

The following review begins with an expected base of 35,000 smallholder farmers with a burley production quota of 9 million kg for the 1994/95 production season. This amount was recently expanded in response to World Bank conditionality to 15 million kg, but for the purposes of this analysis it is assumed that this expansion occurs subsequent to ASAP I, which it does.

Annual increases of between 3 and 8 million kg per year in smallholder burley production quota will increase the area planted to burley by between 2,000 to 5,300 hectares per year, as shown below.

ANNUAL INCREASES

Smallholder Burley Production Quota	Area Planted to Smallholder Burley	# of Smallholder Burley Growers
3 million kg	2,000 ha	6,000
5 million kg	3,300 ha	9,900
8 million kg	5,300 ha	15,900

Thus, the total area planted to smallholder burley by the end of a ten year period would range between 36,000 and 59,000 hectares, and by the end of a twenty year period between 46,000 and 112,000 hectares, as shown below.

TOTAL SMALLHOLDER LAND PLANTED TO BURLEY

Annual Increment: Smallholder Burley Production Quota	Area Planted to Smallholder Burley After 10 Years	Area Planted to Smallholder Burley After 20 Years
3 million kg	26,000 ha	46,000
5 million kg	39,000 ha	72,000
8 million kg	59,000 ha	112,000

The number of smallholders benefiting from ASAP II reforms will vary depending on the size of the annual aggregate and the size of individual quotas. Assuming individual quotas of 500 kg, an additional 6,000 to 16,000 farmers join the program each year, and by the year 2005 between 95,000 and 194,000 smallholder households could be engaged in burley production. By the end of a twenty year period between ten and twenty percent of Malawi's current population of 1,800,000 smallholder farmers are expected to be benefitting from burley tobacco production, as shown in the table below.

TOTAL SMALLHOLDER BURLEY PRODUCERS

Annual Increment: Smallholder Burley Production Quota	# of Smallholder Burley Producers After 10 Years	# of Smallholder Burley Producers After 20 Years
3 million kg	95,000	155,000
5 million kg	134,000	233,000
8 million kg	194,000	353,000

The total amount of burley tobacco produced by Malawi's smallholder farmers under these scenarios ranges from 69 million to 169 million kg, as shown in the table below. Incremental returns to the economy from increased burley production alone will total between \$40 million and \$100 million over a twenty year period.

TOTAL SMALLHOLDER BURLEY PRODUCTION

Annual Increment: Smallholder Burley Production Quota	Smallholder Burley Production After 10 Years	Smallholder Burley Production After 20 Years
3 million kg	39,000,000 kg	69,000,000 kg
5 million kg	59,000,000 kg	109,000,000 kg
8 million kg	89,000,000 kg	169,000,000 kg

The market appears capable of absorbing the additional smallholder production, especially at annual increases in smallholder tobacco production of 3 to 5 million kg. The reallocation of estate quota resulting from the gradual withdrawal of less efficient estate producers from burley production over the period is expected to lessen the problems of oversupply and the resulting downward pressure on prices. In the short-run, the gradual increase in smallholder production quota will also mitigate the potential problem of oversupply which a complete liberalization would tend to exacerbate. In comparison, industry experts place the demand ceiling at 150-200 million kg for Malawi burley. Using world demand elasticities Larsen and Thigpen (1993) calculate that a production of 164,000 tons of burley in Malawi would depress prices by 11 percent in the short-run and by about 3 percent in the long-run.

(ii) Expected Impact of Expanded
Smallholder Production of Dark-fired,
Sun-air and Oriental Tobacco

Industry experts estimate that the market for Malawi's dark-fired and sun-air tobacco can absorb annual production of 10 million kg. However, production of dark-fired and sun-air tobacco has decreased significantly in recent years due to the low producer prices paid by ADMARC, and competition from the more lucrative smallholder burley program. Malawi's production of dark-fired and sun-air tobacco during the 1993/94 season was only slightly more than 4 million kg. In addition, experts estimate that the market for oriental tobacco can absorb 1.5 million kg in production annually (Vantreesse, 1993) compared to 1993/94 production of only 400,000 kg.

This analysis therefore estimates annual increases of 500,000 kg in dark-fired tobacco production up to a total of 8 million kg. Annual production of sun-air and oriental tobacco would increase by 200,000 kg annually, up to a total of 1 million kg each, as a direct result of ASAP II policy reforms. More than 40,000 additional smallholder households are expected to benefit from the production and sale of these tobaccos by the end of twenty years.

OTHER SMALLHOLDER TOBACCO

Smallholder Tobacco Type	Total Smallholder Area Planted	# of Smallholder Tobacco Growers
Dark-Fired	11,000 ha	55,000
Sun-Air	1,560 ha	7,800
Oriental	2,220 ha	11,100

Once reached, this increased production will provide smallholder dark-fired, sun-air and oriental producers with incomes of between \$3 and \$4 million annually.

(iii) Expected Impact of Intermediate Buyer Program

The continuation and expansion of the Intermediate Buyer Program (IBP) under ASAP II is expected to provide producers with a higher price for their crop than would have been available from ADMARC. The more efficient marketing of tobacco is expected to reduce marketing costs, and permit producers to capture a larger portion of the final price. The IBP also offers advantages to estate producers and the tobacco industry, including economies of scale in marketing operations, and also utilizes excess capacity existing within the estate sector. Finally, the IBP exposes "phantom" estates which buy illegal tobacco by legalizing the estate purchase of smallholders tobacco. The share of the total value of tobacco sales marketed by intermediate buyers is expected to increase from 0 to 25 percent by 1997, resulting in higher farmgate prices for smallholder tobacco.

(iv) Summary of Tobacco Reform Impacts

The potential impact of tobacco market reforms on smallholder incomes as a result of ASAP II, as discussed above, is substantial. These reforms alone are expected to directly benefit over 10% of Malawi's smallholder households. In addition, the spillover effect of direct injections of cash from the sale of burley tobacco in the rural areas will be substantial. Just one note of caution: the timely availability of smallholder credit for agricultural input purchase will have a significant impact on the magnitude of benefits derived from ASAP II reforms. Limited access to credit could limit smallholder farmer participation in the reforms (and hence income), especially for first-time producers. However, a significant proportion of smallholder tobacco producers are expected to be self-financing after two-three years, and able to purchase their inputs on a cash basis from retailers and suppliers.

b) Removing Input Market Distortions

The elimination of fiscal subsidies on maize seed and fertilizer are not expected to have a major positive impact on the rural economy. The magnitude of impact will depend upon the success of an entire package of reforms, including a variety of non-price factors such as the

availability of hybrid maize seed, fertilizer efficiency, and smallholder farmer access to credit and other inputs. It is also important to note that the majority of Malawi's smallholders do not have access to fertilizer, regardless of price. The underdeveloped status of private trade in the agricultural sector, which also inhibits supply response, will be relieved by reforms which promote the development of private trade in rural areas.

(i) Seed

The elimination of fiscal subsidies on maize seed is expected to improve availability and lead to an increased use of high yielding hybrid maize varieties. Although seed prices are expected to increase, this increase should not seriously reduce demand. Combined with price liberalization, increased availability of hybrid seed should help to increase national maize production, thereby improving national food security. In fact, consumer maize prices may fall in some areas due to high production levels.

In addition, unrestricted importation of non-maize and non-tobacco seeds will provide a timely and less expensive source of seed for alternative crops. This will help promote agricultural diversification, expand the food supply, and improve household nutritional levels.

(ii) Fertilizer

The elimination of fiscal subsidies on fertilizers will permit an increased role by private traders in input distribution and, in the long-run, promote more efficient fertilizer use. In the short-run the benefits of removing subsidies may be negative if increased fertilizer prices reduce smallholder demand. Reduced demand could decrease national maize production, leading to increased producer maize prices. A recent study showed that a 45 percent increase in fertilizer prices could ultimately cause a 25% to 30% increase in the market price of maize, thereby providing substantial benefits to maize producers.

c. Increased Private Market Participation

ASAP II support for the removal of GOM restrictions on private trade in agricultural commodities is expected to increase the overall efficiency of agricultural trading and increase market competitiveness. In particular, allowing private traders to tender bids to replenish SGR stocks will encourage increased private trade and help develop trader experience and expertise. Increased private trade should also result in higher producer maize prices since a more competitive market structure will be able to pay farmers more than ADMARC.

Streamlined and more transparent licensing procedures, which do not discriminate against ethnic groups, are also expected to benefit smallholders by providing additional market outlets for their produce. The resulting increase in competitive agricultural trade is expected to result in more remunerative

prices for smallholders, while the elimination of export and import licensing requirements will expand market opportunities for smallholder cash crops, and encourage diversification.

Replacing the duty drawback system with exemptions and a system of penalties to discourage diverting imported inputs will provide incentives for exporters, estates, agro-processors, and producers of cash crops (such as horticultural products) for the export market. Also, extending the incentives available to industrial investors to agricultural investors should attract more investors into agriculture, and lead to more diversified export markets.

Streamlining and improving transparency in the procedures for obtaining land leases will help accelerate the establishment of new rural processing and exporting firms in Malawi, increase employment opportunities for the rural population and accelerate the development of rural infrastructure. This is of particular benefit to resource-poor farmers, as it provides them with a source of off-farm employment.

Removing restrictions on private trade will reduce the monopoly role of ADMARC, and increase trade in presently restricted commodities. The removal of ADMARC's pan-territorial pricing and supply obligations will also provide small traders and transporters with opportunities to profitably provide inputs and carry produce to central or regional markets. The greatest impact of this policy may be in the most remote areas, where traders find it unprofitable to operate due to ADMARC's pan-territorial pricing practices. In addition, the removal of export licensing requirements will encourage cross-border trade with neighboring markets in Zambia, Tanzania, and Mozambique, develop new marketing channels, and result in better prices for producers.

d. Elimination of Producer/Consumer Price Controls

Releasing ADMARC from its government-mandated market presence and pan-territorial pricing obligations will open the market to private traders. In the long run increased competition should encourage agricultural diversification, and improve product availability and movement within Malawi in response to consumer demand.

The potential impact of decontrolling maize prices is difficult to predict. Given the importance of maize production to national food security, the possible short and medium-term ramifications will be carefully studied before proceeding with decontrol. However, the establishment a price band or other mechanisms to stabilize maize prices will increase the efficiency of SGR sales, increase private trade in the maize market, and provide a more cost-effective means of maintaining maize price stability.

Finally, the elimination of input price controls is expected to increase private trade in agricultural inputs, improve availability, and with lower transport costs through the Nacala route, reduce input prices in the long-run.

4. Internal Rate of Return

The economic analysis utilized the estimated costs to the GOM of implementing the ASAP II reform package, and the more easily quantifiable benefits resulting from tobacco market reform, to calculate an Internal Rate of Return (IRR) for over 27 different scenarios. The results of that analysis are summarized as follows:

<u>Scenario</u>	<u>IRR</u>
- 3 million kg/year increase in smallholder burley production quotas; liberalized marketing of dark-fired, sun-air and oriental tobacco.	53%
- 5 million kg/year increase in smallholder burley production quotas; liberalized marketing of dark-fired, sun-air and oriental tobacco.	76%
- 8 million kg/year increase in smallholder burley production quotas; liberalized marketing of dark-fired, sun-air and oriental tobacco.	112%
- 3 million kg/year increase in smallholder burley production quotas; liberalized marketing of dark-fired, sun-air and oriental tobacco; moderate increase in input prices.	48%
- 3 million kg/year increase in smallholder burley production quotas; liberalized marketing of dark-fired, sun-air and oriental tobacco; high increase in input prices.	46%
- 3 million kg/year increase in smallholder burley production quotas; liberalized marketing of dark-fired, sun-air and oriental tobacco; high input prices; 30% decrease in yield and producer prices (worst case scenario).	26%

Additional substantial benefits, while less easily quantifiable, are expected to accrue from increased efficiency and equity in both input and output marketing. These will be achieved by reducing market distortions and liberalizing agricultural trade. The lack of appropriate data makes it difficult to quantify the economic impact of many of the non-cash crop reforms, including input markets liberalization, de-control of producer and consumer prices, increased private sector participation, and other regulatory, fiscal, and institutional reforms. However, a preliminary analysis indicates that the benefits of these reforms will also be substantial.

5. Summary

The discounted net benefits for the GOM of undertaking the proposed ASAP II reforms indicate that the program is a highly acceptable investment in the short- and long-term under both optimistic and pessimistic scenarios. Using conservative assumptions to estimating net benefits to farmers and the impact on the agricultural sector, the internal rates of return in the worst case scenario was 26%, and in other scenarios ranged from 46% to 112%.

As a result, the tobacco marketing reforms can by themselves satisfactorily justify the cost of ASAP II. The potential costs and benefits were conservatively analyzed using multiple scenarios, ranging from optimistic to worst case scenarios. In all cases the program is economically justified.

Therefore, the economic analysis shows that the investment in the ASAP II policy reform agenda is economically sound, and highly acceptable even under the most pessimistic scenarios.

D. Institutional Analysis:

1. Introduction

Implementation of ASAP will require a broad set of policy reform actions, studies of agricultural development issues, identification of specific interventions, and management of project activities. Within the GOM, implementation responsibilities will rest with at least five different ministries, offices and organizations: Ministry of Finance (MOF), Ministry of Agriculture (MOA), Ministry of Economic Planning and Development (EP&D), Department of Research and Environmental Affairs (DREA), and University of Malawi Bunda College of Agriculture. An analysis of the capabilities of these institutions to implement ASAP indicates that while the technical expertise exists, the time demands of program implementation are substantial resulting in the need for the GOM and USAID to pay particular attention to ensuring that program activities are implemented expeditiously. Each concerned ministry and department must devote time to dealing with sometimes complex and sensitive policy matters. By including funds for major studies, ASAP has reduced the level of effort required of the GOM to research specific issues, but has not reduced the level of effort required to consider the issues and their resolution, all of which involve defining study agendas and scopes of work, reviewing recommendations, and developing action plans. In addition, the human, technical and financial resources required for providing and sustaining expanded extension services and delivery of credit and inputs, must be available for farmers to take full advantage of new income opportunities.

To help address this concern, as part of ASAP II the GOM will be supported by an economic policy support unit to assist in conducting overall policy analysis and coordinating the implementation and monitoring of the ASAP policy agenda. The unit will be appropriately located in the GOM to carry out its function, and composed of one resident senior Economic Policy Advisor, an agricultural economist, and a secretary.

2. Ministry of Finance

a) Organization and Function

The Ministry of Finance is well suited to serve as the GOM's overall coordinating ministry for ASAP. It has the requisite stature to guide high level decision making toward achievement of the policy changes which are the focus of the program, and can influence budget decisions that will be critical to implementation and achievement of policy objectives. The Ministry is involved in all major policy considerations, and has primary responsibility for preparation and presentation of Government's annual budget, as well as for maintenance of government accounts. It also is the primary contact for multilateral and bilateral donor agencies operating in Malawi. With respect to ASAP, the principal actors in the Ministry will be the Secretary to the Treasury, the Senior Deputy Secretary, and staff who deal with donor assistance and policy matters.

b) Role in ASAP Program implementation

The MOF is the overall coordinating ministry for ASAP. It has the following specific responsibilities: certification of GOM satisfaction of actions required and consequent request for disbursement by USAID of non-project assistance funds; chairmanship of the Program Management Committee (PMC); and coordination within the GOM of resolution of issues arising from study recommendations and the development of action plans. While the MOF does not have direct responsibility for the implementation of any specific project activities, its role as overall coordinating ministry requires substantial amounts of time and effort. In addition, as the GOM entity responsible for certifying conditionality satisfaction, the MOF works both with line ministries responsible for implementation of specific actions and with USAID, to see that conditions are met in a way which is acceptable to all concerned parties.

c) Capacity to Execute Role

The MOF has substantial responsibility within the GOM, and commensurate demands on the time of staff members, in particular those at a senior level. While the qualifications of staff are appropriate for the tasks envisioned under ASAP, the level of effort required imposes an additional burden on those staff. Non-project assistance, as opposed to project assistance which involves primarily a technical ministry, tends to require greater involvement of MOF senior staff, who must keep abreast of movement towards satisfaction of specific actions, intervening when necessary

with the technical ministries and negotiating when necessary with the donor. Because both the GOM and donors want to see disbursements in a timely fashion, the MOF's job is a full time one, a combination of monitoring, intervention and negotiation, which requires the efforts of various staff members, including the Secretary and Deputy Secretary themselves.

In addition to the above-mentioned ASAP II technical economic policy support unit, another means by which the management burden of the GOM can be reduced is through minimizing the number of ASAP actions required prior to disbursement. The complexity and breadth of ASAP II, however, limits the degree to which those actions can be reduced. In addition, although the MOF chairs the PMC, subcommittees should be able to perform many of the tasks required, particularly for the PIC, and these subcommittees do not always require MOF participation.

The MOF is fully and effectively assuming its responsibilities under ASAP and its understanding of the policy issues is comprehensive.

3. Ministry of Agriculture

a) Organization and Functions

The following MOA units are of particular importance to ASAP: MOA headquarters staff, the Department of Agriculture, Department of Agricultural Research (DAR), Department of Irrigation (DOI), and the Agricultural Development Divisions (ADDs). The program does not necessarily involve specific activities with each of these entities, but in terms of achievement of overall ASAP objectives each of these will be important.

Ministry headquarters staff are involved with both policy issues and the implementation of agricultural programs. The Principal Secretary (PS), the Chief Planning Officer (CPO), the Controller of Agricultural Services for the National Rural Development Program (CAS/NRDP), the Chief Agricultural Extension and Training Office (CAETO), the Chief Agricultural Research Office (CARO), and the Chief Irrigation Office (CIO) all have key roles to play in the areas of agricultural policy planning and development which are relevant to ASAP. In addition, the CAS/NRDP has significant supervisory responsibility for all programs of the Department of Agriculture (DOA), the Department of Agricultural Research and the eight ADDs.

The Department of Agriculture provides extension and training services to smallholders. Below the management structure are Subject Matter Specialists (SMS), who are extension agents for training, extension, tobacco, fertilizer, crops, and women's programs. In the field the Department's staff report through the ADD structure, while on technical issues they report directly to the Department of Agriculture at MOA headquarters.

The function of the ADDs is to organize the provision of extension services, and to manage the agents who provide the services. Technical staff in the ADDs come under one of the technical departments within the MOA in their respective area of expertise. However, in the day-to-day provision of extension services in the field, the technical staff are physically located and managed within the ADD structure, and come under the supervision of the Program Manager who is the Chief Operational Officer of an ADD. In addition, for budget purposes all the support mechanisms required for extension services, e.g. vehicles and maintenance, subsistence, etc., are the responsibility of the ADDs.

The procurement of inputs, in particular fertilizer, by smallholders often is dependent on access to credit. Until 1994, the MOA Smallholder Agricultural Credit Administration (SACA) was responsible for providing credit to smallholders for the procurement of agricultural inputs, and was virtually the only formal sector source of such credit. Political developments, weaknesses in the smallholder credit system, and poor weather all contributed to what is considered by most observers to be a collapse of the SACA credit system. With assistance from the World Bank, SACA is now being transformed into a limited-liability company, the Malawi Rural Finance Company (MRFC), which is expected to eliminate dependence on Government support and promote the privatization of the rural credit system. However, to assure that resource-poor farmers have access to financing, the GOM will need to help establish new, and strengthen existing, farmer groups/clubs to help make them credit worthy. It may also need to establish mechanisms to encourage other financial institutions to invest in this sector.

b) Role in ASAP implementation

While the MOF is the overall coordinating agency for ASAP, the MOA has the major role in the day-to-day management of program activities and in the achievement of program objectives concerning the development of smallholder agriculture. The CAS/NRDP, the Chief Agricultural Extension and Training officer (CAETO), the CPO and the PS are all actively involved with policy decisions. Their involvement with policy-related issues throughout ASAP I program implementation has been substantial, including: senior level participation in PMC and PIC meetings; definition of scopes of work for the various planned studies; review of findings and recommendations of those studies; and preparation and approval of action plans which result from the studies. Senior level staff also are involved with the design and implementation of the burley-specific program activities, i.e. the smallholder registration scheme, design of alternative marketing channels, and evaluations of the overall scheme's performance.

Two specific project activities located in the Ministry are the pilot agroforestry extension activity, and the food security survey activity. The Department of Agriculture is implementing the agroforestry activity, and the Planning Division is implementing the food security surveys. Both activities involve substantial ADD participation. In

addition, given that the development of smallholder agriculture depends to some extent on efficient and effective extension services as well as sufficient provision of credit and inputs, the MOA is closely involved with determining how services and inputs are provided and how the supply of credit and inputs can be restructured to place less of a burden on the central government and to improve farmer access. This includes the participation of the Department of Agriculture, the ADDS, and SACA/MRFC, as well as Ministry senior level staff. Other donors, most notably the World Bank, are also assisting the GOM with improving extension and credit services.

c) Capacity to Execute Role

i) Policy Reform

During the initial design and subsequent implementation of ASAP I the PS, CAS/NRDP and CAETO, along with support staff, were all involved heavily with planning and implementation activities. As a result, the MOA has a comprehensive understanding of the program's objectives and areas of activity.

The MOA's capacity to deal with policy reform has been strengthened through assistance by ODA to help establish a sustainable capacity for effective agricultural planning and policy formulation. As with the Ministry of Finance, the MOA has technical and managerial expertise, but the demands which ASAP places on senior level management as policy issues are raised, studied, analyzed and resolved is substantial. Overall, program implementation is management intensive, and a concerted effort is required by MOA along with other GOM entities and USAID to accomplish program objectives. The continued strengthening of the Planning Division, as well as the aforementioned establishment of a technical economic policy support unit within the MOA are therefore critical to the successful performance of the MOA's functions.

ii) ASAP Project Activities

For specific project activities under ASAP which require the provision of services by ADD staff and extension agents, a management structure has been designed and funds provided which will ensure that sufficient resources are available on a timely basis for implementation of project-supported activities. In addition, the technical skills required for activity implementation are available either through expatriate technical assistance, or through local expertise. Where expatriate TA is now being used, a plan exists to phase out that long-term TA during the life of the project.

iii) Achievement of Overall ASAP Objectives

Achievement of overall ASAP objectives requires in particular: (a) the provision of technical services to smallholders so that they can adopt profitable and "food-secure" crop mixes appropriate to their

physical and socio-economic environments; and (b) timely availability and access to productive resources and inputs. In terms of provision of extension services, the MOA has experienced problems providing adequate resources to its field staff. Real operating expenditures per person for the ADDs have dropped substantially since 1987. Nominal operating expenditure per person for the ADDs dropped from MK 896 in 1986/87 to MK 618 in 1990/91. Since that time budget allocations have not kept pace with the deterioration in the exchange rate and inflation. This same problem has been identified in the Department of Agriculture's Five Year Extension Strategy Plan, which states, "Supportive supervision visits of Field Assistants by the Development Officer, Assistant Development Officer and Subject Matter Specialists are infrequent and inadequate. This is often the result of a shortage of vehicles, fuel or subsistence allowances which prevent regular visiting schedules." (p. 14)

The underlying problem is both insufficient resources and inadequate planning and management. The strengthening activity of the Planning Division has improved the planning and management aspect, but the Division still suffers from staff turnover and lack of continuity. The establishment of an agricultural policy research unit at Bunda College under ASAP I will help build continuity into the policy reform program in the long-term, but in the short-term the process will continue to be supported by hired consultants. In addition, under ASAP various studies have examined different aspects of credit and input delivery systems, and identified constraints to providing adequate services to smallholders and ways of alleviating those constraints. Other problems identified in the Five Year extension Strategy Plan which have reduced the effectiveness of extension services are also the subject of analyses which will be conducted under ASAP, such as the involvement of the Field Assistants in activities which have reduced time available for providing extension services, and lack of relevance of extension messages to small holders.

The MOA, along with other GOM ministries and the donor community, will need to review study results carefully to determine what additional policy reform measures or project activities are required to promote smallholder development through improved provision of technical and other services. As part of that process, the World Bank has been assisting the Ministry of Agriculture in the development of a long-term Agricultural Strategy. Building upon the various collaborative analyses and studies undertaken during ASAP I, the draft MOA strategy virtually mirrors the policy agenda identified in ASAP II.

4. Ministry of Economic Planning and Development

a) Organization and Function

MEP&D is responsible for central planning and coordinating the GOM's sectoral ministries. Given its planning function, it is heavily involved with discussions and decisions concerning policy reform and major activities in the agricultural sector. MEP&D's civil service head, the Principal Secretary, his deputies, the Chief Economist and the

Deputy Chief Economist, and staff of divisions which deal with macroeconomic planning, agriculture, and food security all are involved with the implementation of ASAP.

One of ASAP's project activities involves assistance to one specific unit within MEP&D, the Food Security and Nutrition Unit (FSNU). The FSNU coordinates the development of GOM food security and nutrition policy, and monitors related activities. It is also the secretariat for the Interministerial Food Security and Nutrition Advisory Committee, which includes six ministries plus three branches of the University of Malawi.

b) Role in ASAP Program Implementation

MEP&D is involved with ASAP implementation on two levels. First, as with the Ministries of Finance and Agriculture, senior level staff, including the PS, Chief Economist and Deputy Chief Economist, all participate at one time or another in discussions and decisions about policy matters. In addition, either the Chief Economist or his deputy, plus other staff members, are involved in the deliberations and operations of the PIC and its subcommittees, particularly with those which define study agendas, analyze study results and prepare action plans.

MEP&D's second level of involvement with ASAP's implementation concerns the FSNU's role as coordinator of GOM's food security activities. MEP&D chairs both the National Crop Pricing Advisory Committee and the Early Warning Technical Committee, which recommend GOM pricing policies for each crop year and monitor conditions which impact on national food security. Under ASAP I a long-term advisor was located within the FSNU to assist with policy development and coordination in the area of food security.

c) Capacity to Execute Role

As with the Ministries of Finance and Agriculture, EP&D has the expertise to deal with policy matters. MEP&D's role with respect to food security activities and its capacity to execute that role is well established. USAID-supported activities are currently contributing to an ongoing program of institutional strengthening in the area of food security policy.

5. Bunda College of Agriculture, University of Malawi

a) Organization and Function

Bunda College is one of five constituent colleges of the University of Malawi system. The head of the college is a principal, assisted by a vice-principal. The college has five academic departments, each of which is managed by a Head of Department: Agricultural Engineering, Animal Science, Crop Production, Home Economics and Human Nutrition, and Rural Development. The Dean of the Faculty of Agriculture has responsibility for managing academic affairs. Bunda has recently established a new unit, the Center for

Agricultural Research and Development (CARD), which will include specific responsibility for agricultural policy research.

The Chancellor and Vice-Chancellor of the University of Malawi are responsible for the affairs of all colleges. The University is a statutory body, and as such has control over its own budget. Various functions are centralized at the University levels including overall accounting responsibility and physical development responsibility. Bunda College has responsibility for some accounting functions, and is allocated monthly disbursements from the University to make direct payments in specific areas.

b) Role in ASAP Program Implementation

Under ASAP I, support for the establishment of an agricultural policy research unit within the CARD has been directed to Bunda to establish a capability within the College to conduct research on policy matters, and assist with identification and resolution of issues and development of proposals for implementing recommended actions. The CARD is organized to work closely with relevant GOM offices and private and public firms so to involve broad participation in policy research. In support of the establishment and operations of the CARD the College has recruited appropriate staff (both for unit operations and research projects) and is constructing office facilities. ASAP Support Project funds are also being used to finance a cooperative agreement with a U.S. consortium to assist the College in this activity, while the College is the direct recipient of a grant to fund operational support for the unit and the construction of office facilities and staff housing. College staff have been, and will continue to be, involved in annual evaluations of the ASAP program.

c) Capacity to Execute Role

College staff participated in studies used for the design of ASAP, and their work was considered to be of high quality. College staff also participated in a recent case study of ASAP which focussed on participation in the context of policy reform. With the assistance of a U.S. consortium experienced in agricultural policy research and in organizational requirements, Bunda is working to establish the institutional capability to more effectively participate in the policy reform process.

6. Department of Research and Environmental Affairs

a) Organization and Function

The Department of Research and Environmental Affairs (DREA) is the primary coordination body on issues concerning the environment. Headed by a Principal Secretary, until recently it has been part of the Office of the President and Cabinet (OPC) and acted as the focal point in environmental monitoring activities capturing input from the relevant line ministries, namely Ministries of Forestry,

Agriculture and Works. DREA consists of five divisions, one of which is relevant to ASAP, the Division of Natural Resources and Environment. This division is mandated to assess the current state and forecasted trends in the quality of natural resources, and is also responsible for review of policies and programs related to sustainable development and enhancement of environmental quality. DREA consists of 18 staff positions and is headed by a Principal Environmental Officer. Once operational, it will coordinate data collection and analysis by the various line ministries for analysis and use in its monitoring and advisory role.

b) Role in ASAP Program Implementation

The DREA will play the major coordinating role in monitoring the impact of ASAP reform policies on the environment. The DREA will continue to rely on line ministries and departments for soil erosion, deforestation, and related information, and will work with those entities to improve data collection, compile available data, conduct analysis, prepare reports, identify problem areas and recommend corrective actions.

c) Capacity to Execute Rate

The DREA is a new department, so it is not possible to assess its capacity in terms of existing personnel and past performance. A recent decision to move DREA from OPC to the Ministry of Health brings into question the GOM's commitment to establishing an environmental monitoring system. However, this decision is currently being reconsidered due to donor pressure. Assuming it is satisfactorily resolved, two issues remain unanswered. First, how quickly can DREA staff learn to perform their functions? While project funding is currently available, and the necessary personnel have been hired, they must be built into an effective team. Second, the quantity and quality of data collected by line ministries which will be available and relevant to the Department is not yet clear. Project funds have been made available to assist both DREA and line ministries in establishing a comprehensive Environmental Monitoring Program (EMP), including establishment of data collection and monitoring systems. Full implementation of the EMP is set to begin during the 1994/95 production season.

7. USAID

a) Organization and Function

Within USAID, the program is managed by the Agriculture and Food Security Office. Overall supervision of program implementation is the responsibility of the Supervisory Agricultural Development Officer (ADO). That officer is assisted by the deputy ADO and by other professional office staff. The ADO or deputy ADO represents USAID on the Project Implementation Committee (PIC), and participates on PIC sub-committees as required. The Mission Director represents USAID on the Program Management Committee.

An ASAP Program Committee within USAID assists the ADO with program management. This committee includes representatives from the Project and Program Development (PPD) Office and the Controller's Office. The ADO is the chairperson of this committee. The function of the Mission Program Committee is to monitor progress of program and project implementation issues. ASAP is a complex program, and requires a variety of resources from within the Mission for its successful implementation.

b) Role in ASAP Program implementation

In terms of program administration, USAID, as the funding agency, ensures that the appropriate funding mechanisms are in place for proper disbursement so that program activities can take place without disruption. It must approve satisfaction of actions required under the program agreement prior to tranche releases. In addition, USAID is responsible for the procurement of various commodities for those activities, and for the negotiation of various service contracts and cooperative agreements. In a more substantive sense, USAID works directly with the GOM to see that progress toward the accomplishment of ASAP objectives is being achieved. This requires a high level of effort working with GOM ministries, both individually and through the Project Implementation Committee and its subcommittees. Progress toward meeting both short-term and long-term objectives must be monitored, and a working relationship with key GOM officials must be established to promote effective collaboration in all areas. In addition within USAID, regular monitoring of program implementation is done to ensure that all activities, including reform initiatives as well as project activities, are progressing in accordance with a planned schedule.

c) Capacity to Execute Role

Managing the implementation of ASAP within USAID requires drawing on the resources of various offices. While day-to-day implementation responsibility rests with the AFS Division, the participation of other offices, such as PPD is necessary given the combination non project/project assistance, the complexity of the policy reform issues and related studies, and the variety of project activities. In particular the multi-office ASAP committee is involved with assisting with discussion and resolution of policy reform issues, with implementation of the Bunda College policy research activity, and with the design of studies and identification of follow-on activities. Finally, ASAP is monitored through the Mission's regular system for project/program reporting, the Project/Program Implementation Reports (PIR) prepared every six months.

8. Joint GOM-USAID Coordination

As discussed in this PAAD's Implementation Plan, GOM-USAID coordination in the implementation of this program is essential to the achievement of program objectives. Formal coordination takes place through the Program Implementation Committee and its subcommittees, and through

the Program Management Committee. Informal coordination also involves frequent meetings between GOM and USAID project managers, and joint participation in the execution of the studies and reviews/evaluations of the program. In addition, project funds are provided for seminars and workshops at which study results and policy issues can be discussed in an open forum with representatives of the GOM, other public sector entities, the private sector and the donor community.

E. Environmental Analysis

The ASAP program is focussed on policy reform, rather than on specific development activities. As a result, direct environmental impacts are difficult to assess. Although certain policy reforms will likely intensify the development and utilization of agricultural land, the overall program can help reduce environmental degradation if appropriate mitigating measures are identified and put in effect in a timely manner.

Regardless, it must be noted that successful implementation of this program has the potential to increase the degradation of Malawi's soil, water and forest resources. For example, improved prices and increased levels of income could lead to an increased desire by many farmers to place more land under cultivation, including increasing the cultivation of varieties of tobacco which require large quantities of wood for construction of drying sheds and/or the curing of tobacco leaves (e.g., burley and dark-fired tobaccos, respectively). Although only slightly more than two-thirds of Malawi's arable land is under cultivation, the pressure to increase cultivation on steep, marginal and/or otherwise environmentally significant or sensitive lands in the more densely populated areas of the southern and central regions could increase. This could lead to increased soil degradation and erosion, deforestation, degradation of the vegetative cover of customary lands, and water quality deterioration. Similarly, intensified farming practices, including increased use of fertilizers, may increase the level of nitrates and phosphates in water supplies and result in eutrophication of surface waters.

Plant pests and diseases may also increase as a result of crop diversification. On the other hand, the value of some crops may decline if diseases and pests are not kept in check, or fertility levels drop as a result of inappropriate use of fertilizers. The probable increased level of agricultural activity could also increase the demand for fuelwood and construction timbers by tobacco and food processing facilities.

However, it is equally true that successful implementation of the ASAP II program will also create significant positive impacts, some of which will mitigate or offset these environmental concerns. For example, increased income and improved food crop yields will provide Malawian farmers with increased nutrition and cash per unit land area, to purchase food, health services, shelter and other amenities which should improve his/her quality of life. Similarly, the

emphasis on agricultural extension will focus on improved agricultural practices designed to decrease erosion, limit deforestation, and minimize the degradation of water quality while improving overall agricultural productivity. For example, the substantially enlarged support for agroforestry under ASAP II to enhance soil erosion control, improve soil fertility and provide significantly increased fuelwood sources on estate lands and those of smallholders, will serve to mitigate some of the negative aspects of the loss of soil fertility, pressure on forests and water quality noted above.

Finally, improved income opportunities for smallholder farmers through expanded tobacco production rights is expected to provide additional incentives for farmers to devote the time and effort required for the adoption of more environmentally sound and sustainable on-farm production techniques.

Environmental Determination

Based upon all of the above considerations, it is clear that ASAP II is largely a continuation of the agricultural reform process initiated in 1991 under the original ASAP program. Accordingly, the original IEE findings and recommendations also remain valid and appropriate for this second phase of Program implementation, including:

- a **Categorical Exclusion** for the technical assistance to be undertaken during ASAP II, based upon 22 CFR 216.2 (c) (2) (i);

- a **Categorical Exclusion** for ASAP II policy studies, based upon 22 CFR 216.2 (c) (2) (iii);

- a **Negative Determination** for the construction of the agricultural policy research headquarters, staff housing and other facilities on the grounds of Bunda College, based upon 22 CFR 216.3 (2) (iii), as there are no environmentally significant impacts that will occur as a result of additional construction on this already altered site; and

- a **Negative Determination** is recommended for the policy implementation portion of this Program, based upon 22 CFR 216.3 (2) (iii), since existing checks and balances in policy implementation and environmental monitoring will be continued through project support to the Agricultural Policy Research Unit, Food Security Unit and the Department of Research and Environmental Affairs.

Environmental Covenants and Actions

In the interest of ensuring that planned environmental monitoring and mitigative activities are pursued in an effective and efficient manner throughout the second phase of ASAP implementation, USAID/Malawi has incorporated the recommendations of the IEE into the agreement. These recommendations build upon the current pilot Malawi Environmental Monitoring Program (MEMP), which will be continued for at least two full cropping seasons (to the originally planned termination date. The implementation of the MEMP will be carefully evaluated at the end of that time

to insure that maximum benefit is gained from any "lessons learned" in the subsequent design of a greater national environmental monitoring program.

In addition to ongoing MEMP implementation, the following specific environmental covenants and actions have been incorporated within the agreement:

a) A representative national environmental monitoring program for Malawi, will be designed in accordance with NEAP environmental monitoring program objectives based upon the MEMP evaluation. The design will adopt a gradual, phased implementation transition from the pilot activity to the national system design, and begin to implement selected national-scale program modifications during the second season of pilot program operations. The environmental monitoring effort will be expanded thereafter, as time and resources permit.

b) Support will be provided for the implementation of the ASAP Environmental Research Program aimed at developing environmentally sustainable, alternative on-farm and post-harvest practices and technologies to mitigate any adverse impacts associated with the ongoing agricultural sector reform in Malawi.

c) Expanded implementation of the Malawi Pilot Agroforestry Extension Project (or suitable alternative) will also be supported, focussing on agroforestry interventions which are particularly appropriate for and applicable to tobacco production and processing operations.

USAID and the GOM will provide timely and sufficient resources to support the continued strengthening of environmental management in Malawi, in particular, for the Department of Research and Environmental Affairs (or its successor institution, as determined by the new government) in accordance with the ongoing NEAP process.

Timely and sufficient resources will also support the continued development of an appropriate national environmental monitoring and information management capability in Malawi, including home office and field staff support for DREA (or its successor institution), as well as for other concerned GOM ministries and departments.

USAID and the GOM will also support environmental research aimed at mitigating any adverse environmental effects of ongoing agricultural sector reform in Malawi, and provide support for agroforestry technology development and dissemination throughout Malawi to assist in mitigating the effects of expanded tobacco production and processing operations.

Finally, USAID/Malawi will treat the MEMP as an integral component of greater ASAP II monitoring and evaluation requirements in all future program monitoring and evaluation activities.

The careful implementation of these covenants and actions will ensure that the ASAP II policy reform agenda is conducted in an environmentally sound manner, and in accordance with all salient USAID policies and procedures.

ATTACHMENTS

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

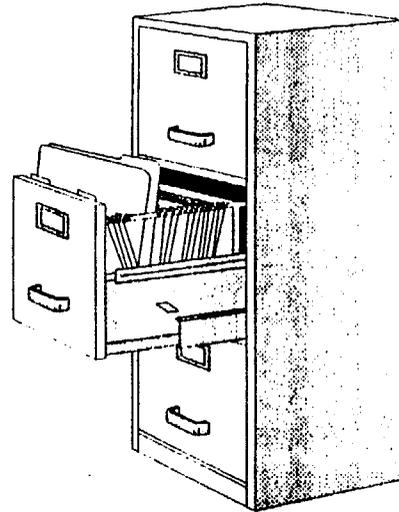
ATTACHMENTS:

Annex A: Bibliography
Annex B: Initial Environmental Examination
Annex C: Draft Agreement Amendment No. 1
Annex D: Letter of Request
Annex E: Logical Framework
Annex F: CN Release Cable
Annex G: DOA Cable
Annex H: Action Memo to AA/AFR for Cash Transfer

18

ASAP II Policies

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(1.2.16) Summary of USAID's Comments on the CEC Fertilizer Position Paper (24 June 1994)

1.6 Limit SFFRF Responsibilities To That of Managing Fertilizer Buffer Stock Including Stock Replenishment to Reduce Stock Deterioration by Commercial Sales at Market-Determined Prices.

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- 1.8 Simplify, Publicize, and Accelerate Process for Approval of Leasehold Land Applications and Sub-leases Thereof; Maximum of 6 Months.
- (1) MIPA. The Investment Implementation Process: A Road Map to Business in Malawi. 1994
- (2) LAWS OF MALAWI: LAND: Chapter 57:01. An Act to make provision with regard to land in Malawi and for matters incidental thereto. (7th June 1965).
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2.5 Remove All Agricultural Commodities With the Exception of Maize From the Negative List For Import and Export Licensing Requirements.

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- 2.7 Abolish Price Controls on Fertilizer, Seed, and Chemicals.
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- (1.2.16) Summary of USAID's Comments on the CEC Fertilizer Position Paper (24 June 1994)
- 2.8 Eliminate Producer and Consumer Price Controls On All Smallholder Crops and Establish Procedures to Stabilize Maize Prices Through SGR Sales and Purchases.
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- (1.1.17) Christiansen, Robert E. and Lee Ann Stackhouse. "The Privatization of Agricultural Trading in Malawi." December 1987.
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- 2.9 Simplify and Publicize Procedures for Duty-Drawback Privileges For Mixed Export-Domestic Businesses.
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- 3.1 Permit and Publicize Open Tendering For Supply To and Removal Of Maize From Strategic Grain Reserves (SGR).
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3.2 Revise Investment Promotion Act Such That 100% Non-Traditional Agricultural Export Businesses Are Accorded Identical Tax Incentives as Those Given to Export Processing Zones.

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AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX B:

INITIAL ENVIRONMENTAL EXAMINATION

INITIAL ENVIRONMENTAL EXAMINATION (IEE)

Malawi Agricultural Sector Assistance Program - Phase II

PROGRAM COUNTRY: Malawi

PROGRAM TITLE/NUMBER: Agricultural Sector Assistance
Program
612-0239 - Phase II
Amendment

PROGRAM FUNDING: \$US 50,000,000 (new LOP total)

LIFE OF PROGRAM (LOP): Seven Years (FY 1991-1998)

IEE PREPARED BY: E. Loken/R. Pellek, REDSO/ESA,
and K. Rockeman, MEO/ADO,
USAID/Malawi

ENVIRONMENTAL ACTION RECOMMENDED:

Categorical Exclusion	<u> XX </u>
Negative Determination	<u> XX </u>
Positive Determination	<u> </u>
Deferral	<u> </u>

SUMMARY OF FINDINGS:

ASAP II is largely a continuation of the national agricultural reform process initiated in 1991 under the original ASAP program. Accordingly, the original IEE findings and recommendations also remain valid and appropriate for this second phase of program implementation, including:

- a Categorical Exclusion for the technical assistance to be undertaken during ASAP II, based upon 22 CFR 216.2 (c)(2)(i);

- a Categorical Exclusion for ASAP II policy studies, based upon 22 CFR 216.2 (c)(2)(iii);

- a Negative Determination for the construction of the agricultural policy research headquarters, staff housing and support buildings on the grounds of Bunda College, based upon 22 CFR 216.3 (2)(iii), as there are no environmentally significant impacts that will occur as a result of additional construction on this already altered site; and

- a Negative Determination for the policy implementation

portion of ASAP II, based upon 22 CFR 216.3 (2)(iii), since existing checks and balances in policy implementation and environmental monitoring, research and agroforestry extension will be continued through support to the Agricultural Policy Research Unit, Food Security Unit, the Department of Research and Environmental Affairs, the Ministry of Agriculture and other concerned Malawian organizations and agencies.

However, in the interest of ensuring that planned Program environmental monitoring and mitigative activities are pursued in an effective and efficient manner throughout the second phase of ASAP implementation, this latter Negative Determination is made subject to certain Implementation Recommendations and proposed Environmental Covenants and Conditions Precedent which are included in Section IV. of this IEE.

MISSION DIRECTOR'S APPROVAL:

Cynthia F. Rozell
Cynthia F. Rozell, Director,
USAID/Malawi

Date: 20 September 1994

CUNCURRENCE:

J. H. Gullet
Bureau Environmental Officer,
AFR/ARTS/FARA, USAID/W

Date: 8/22/94

CLEARANCE:

WAK GC/FR, USAID/W Date: 9/1/94

INITIAL ENVIRONMENTAL EXAMINATION

Malawi Agricultural Sector Assistance Program (ASAP) Phase II

I. BACKGROUND INFORMATION

A. ASAP I

The Agricultural Sector Assistance Program (ASAP) is a \$50 million Non-Project Assistance (NPA) policy reform program committed to the development of a liberalized agricultural economy in which there is equal access to the means of production and where there are no barriers to market entry or other practices that discriminate against any category of farmer. ASAP is complemented by a \$15 million support project designed to assist the Government of Malawi (GOM) in the identification and elimination of policy, institutional and/or financial constraints to improved agricultural production and productivity. ASAP is oriented toward assisting smallholder (small-scale) farmers by: (1) increasing their opportunities to cultivate more lucrative cash crops; (2) broadening their access to agricultural marketing channels; (3) promoting their access to extension, credit, seed, and fertilizer inputs for food and cash crops; (4) providing timely producer commodity information; (5) improving the terms and conditions of tenancy; and (6) increasing the efficiency and transparency of the tobacco quota allocation criteria.

The initial Phase One Program (ASAP I) provided \$20 million in NPA, complemented by the \$15 million ASAP Support Project, towards the implementation of an agreed upon set of policy reforms. Technical assistance is provided under ASAP Support Project to collaborate on studies and specific efforts designed to explore, recommend and implement activities leading to more efficient and equitable distribution systems of credit, extension, seed, fertilizer and marketing channels for smallholder farmers. Studies to assess land use and tenure issues, crop diversification opportunities and constraints, and tenancy pricing structures are also provided for under the ASAP Support Project.

Project assistance is also being directed towards the following specific activities:

1. establishment of an agricultural policy research unit at Bunda College for designing and implementing studies related to assisting smallholder farmers to improve their economic plight;
2. continuation of funding for Ministry of Agriculture and the Department of Economic Planning and Development (EP&D) Food Security and Nutrition Unit to monitor and evaluate the extent to

which program reforms are improving household food security for rural Malawian households;

3. support, in conjunction with other donors (principally, the World Bank and UNDP), for the establishment and initial operation of a Department of Research and Environmental Affairs (DREA) within the Office of the President and Cabinet (OPC) for purposes of establishing GOM environmental policies, conducting environmental research activities, and monitoring environmental impacts of ongoing economic development activities, including most importantly ASAP-assisted agricultural policy reforms; and

4. support for the pilot Malawi Agroforestry Extension Project to improve agricultural sustainability and address problems associated with the degradation of Malawi's natural resources, in particular, its forest and soil resources.

The initial phase of program implementation (1991-present) achieved notable progress in most policy reform activities, including: (1) elimination of discriminatory regulations which prevented smallholders from growing and marketing lucrative cash crops; and (2) creation of multiple smallholder marketing channels for these crops, including formal allocation of an increasing share of the production quotas for these crops to smallholders. As a result of these reforms, smallholder farmers in Malawi now have significantly expanded choices and income opportunities.

The most visible impact of these reforms has been the legitimizing of smallholder farmer rights to grow burley tobacco, Malawi's most lucrative cash crop. Legally barred from growing the crop prior to 1991, over 30,000 smallholder farmers are currently growing an estimated 10% of Malawi's burley tobacco, sales of which have generated an estimated US\$18 million in gross income for smallholders during the past three growing seasons. This has been accomplished without an increase in overall tobacco production in Malawi, and without an increase in the quantity of tobacco exported from Malawi, through actions taken to increase equity in the allocation of production rights.

B. ASAP Environmental Experience To Date

The principal finding of the original ASAP IEE dated 19 July 1991 was a **Negative Determination** for the Program's planned policy and institutional reform agenda. As noted above, this finding resulted from concerns about potentially significant long-term adverse environmental impacts resulting from ASAP-supported policy reforms, which were partially offset by planned environmental monitoring, research and agroforestry mitigative activities. Examples of potentially significant impacts include: (1) expansion of cultivated area into environmentally significant or sensitive areas (either through the direct expansion of burley

tobacco cultivation into these areas, or through the encroachment of subsistence crops displaced by expanded burley production schemes); (2) increased use of unsustainable or environmentally detrimental cultivation practices; and (3) increased environmental contamination or degradation from intensified burley production and processing activities.

To address these concerns, the original IEE recommended implementation of an Environmental Monitoring Program (EMP) as an integral part of planned Project/Program activities to monitor the effects of ASAP policy reforms occurring throughout Malawi, identify any significant resultant adverse environmental impacts and recommend appropriate and timely mitigative actions designed to address these impacts. It was further agreed that this EMP would be implemented under the auspices of the GOM's newly created Department of Research and Environmental Affairs (DREA), acting in collaboration with other concerned GOM agencies.

In response to this mandate, USAID and DREA have designed and developed the EMP over the past two years to: (1) support DREA and other concerned GOM departments to monitor the environmental impact of national policy reforms, in particular, any significant impacts resulting from increased smallholder access to the burley tobacco market in Malawi; and (2) assist in the establishment of a national institutional capacity in Malawi to monitor and manage the nation's environment and natural resources. As currently designed, this EMP will utilize intensive data collection to monitor any environmental changes resulting from increased smallholder burley tobacco production in five small (i.e., 1,000 hectares each) pilot watershed study sites located throughout Malawi. In addition, this program also provides for a modest associated research effort designed to examine in greater detail the underlying causes for any observed environmental effects. The results of this combined pilot monitoring and research program will be used to identify areas of environmental concern for the timely implementation of appropriate mitigative measures.

As of this writing, the EMP has yet to get fully underway, with the first full-season monitoring effort scheduled to take place during the next agricultural year (1994/5). However, all of the requisite preparations for this monitoring activity have been completed, including procurement of technical, advisory and commodity support, DREA home office and field staff recruitment, staff training, aerial photography/videography of the target watersheds, solicitation of farmer participation in EMP implementation, development of research protocols, etc. While this initial pilot program has certain limitations, primarily with respect to the non-random selection/definition of the target watersheds, it should serve several valuable purposes, including: (1) building DREA's environmental monitoring capacity; (2) strengthening DREA's greater environmental management capabilities (especially in

collaboration with other key GOM agencies); (3) transferring important skills in environmental monitoring system design and implementation, in particular, as related to Geographic Information Systems technologies; and (4) gaining considerable operational and methodological experience for the design and implementation of a greater national environmental monitoring system for Malawi.

The Agroforestry Extension Project has also achieved notable progress to date. Some 197 farmers in five (different) pilot target zones have, in varying degrees, adopted a variety of improved agroforestry practices, including: (1) alley cropping with leguminous hedge species; (2) systematic interplanting of soil-improving trees that also provide secondary products such as wood, fodder, medicines and shade; (3) use of contour vegetation strips; (4) use of high-yielding, high-quality fodder or green manure banks as a cut-and-carry system for intensive livestock or cropping operations; (5) homestead and boundary planting of fruit trees and other multi-purpose trees; (6) use of living fences to protect gardens, crops and trees from outside agents; and (7) development of short-term fallow woodlots of soil-improving trees and shrubs. In addition, the project is also encouraging community self-sufficiency in agroforestry by assisting in the establishment of plant nurseries and seed orchards, and training extension staff and farmers in improved agroforestry technologies for wider dissemination of project benefits. Finally, in response to the ongoing agricultural reforms, the project has recently developed an additional focus on improved agroforestry practices associated with burley tobacco production and processing activities.

II. ASAP II PROGRAM DESCRIPTION

The objectives of ASAP will remain unchanged during this second phase of Program implementation (ASAP II). The goal of ASAP II remains to increase agricultural productivity, employment, and income. ASAP's purpose remains to increase smallholder access to agricultural inputs, output markets, cash crop alternatives, and labor market information. These objectives will continue to be pursued through a multi-faceted non-project assistance program aimed at reforming selected key GOM agricultural policies, in coordination with the ASAP Support Project.

The proposed Phase II program activities will continue this sectoral reform process, focussing on the following major policy areas:

1. increased efficiency and equity through liberalization of input markets: ASAP II will support the liberalization of input markets through: (1) the elimination of market-distorting subsidies on fertilizers and hybrid maize seed; (2) the liberalization of regulations and administrative

procedures governing the seed industry; and (3) the elimination of policy and regulatory impediments to private trade in agricultural inputs.

2. increased efficiency and equity through reduced distortions in output markets: ASAP II will support the removal of distortions in output marketing through: (1) the elimination of policies, price controls and administrative structures which constrain the marketing of smallholder produce; and (2) the development and implementation of policies to further expand smallholder access to markets for lucrative cash crops.

3. increased efficiency and equity in agricultural trading through increased market competitiveness: ASAP II will support agricultural diversification, market development and increased competitiveness in agricultural trading through: (1) the elimination of policy and regulatory constraints to the development of private domestic and export markets, including exclusive parastatal marketing and transport arrangements; and (2) the elimination of barriers which prevent legal residents of Malawi from acquiring land, freely trading agricultural produce or inputs nation-wide, and owning and operating the means of goods transport for reward.

These ASAP II activities will be implemented, as in Phase I of the program, through an integrated program of technical assistance, policy studies and policy reform/implementation, and various associated institutional strengthening and field extension and monitoring/evaluation activities designed to disseminate, monitor and manage/mitigate the effects of the agricultural reform process.

III. DISCUSSION OF ENVIRONMENTAL IMPACTS

A. Environmental Context

1. Soils: With 27% of Malawi's cropped land on steep slopes and a population density exceeding 225 persons per km² of cropped land, soil erosion is a serious and growing problem, especially in the Southern and Central Regions. This heavy erosion is primarily the direct result of increased cultivation, deforestation and overgrazing. A recent World Bank study (1990/91), based on modeling techniques but limited field data, concluded that Malawi as a whole suffers an aggregate soil loss of nearly 20 tons/ha/yr on gross arable land - a relatively high figure compared to other African countries where actual field data exist. The Land Husbandry Branch of the Ministry of Agriculture (MOA) is charged with the monitoring of soil erosion rates and, in response to the problem, has recently increased emphasis on soil conservation practices. However, the Branch has very limited funds to provide assistance, and erosion continues

to worsen. While soil fertility also continues to decline, it is generally accepted that if erosion can be limited and/or controlled, the decline in fertility can be arrested through increased use of fertilizers, manures and crop rotations.

2. Plant Diseases and Pests: In addition, it is expected that there will be an increase in the dispersion of soil-borne pests, such as nematodes, and plant diseases as more smallholders enter a liberalized tobacco market and engage in crop diversification with non-traditional crops. Burley, oriental, and dark-fired tobaccos bring higher prices than other smallholder cash crops; and increased smallholder production will increase the risks of plant disease and pest problems, particularly if recommended crop rotations are not followed. In addition, crop diversification into other, non-traditional crops brings with it the risk of introducing and/or proliferating exotic plant pests and diseases.

3. Forests: As is the case in most developing countries, Malawian forests are also being rapidly depleted and degraded. As the demand for firewood and poles increases, and as land is cleared for agricultural purposes, the rate of deforestation also increases. While specific data are limited, a 1985-86 study estimated Malawi's rate of deforestation at 3.5% per annum, one of the highest rates in Africa. At this rate, some 150,000 hectares of forest are denuded each year. This destruction of forests leads to increased degradation of soil and water resources, loss of plant and animal habitat and could ultimately result in an alteration of microclimates over a large area. While the Department of Forestry and Natural Resources is responsible for monitoring and controlling deforestation, they, like most other GOM departments, lack sufficient funds to properly execute their mandate.

An already severe fuelwood shortage in many parts of the country will be exacerbated as market liberalization leads to more people producing dark-fired tobacco, which requires more wood in the curing process. For example, dark-fired tobacco requires an average of 11.5 m³ of wood per ton of tobacco; compared to burley requirements of 5 m³ per ton of tobacco.

4. Water: Pollution of rural water supplies, particularly rivers and streams, has increased dramatically in recent years. The National Water Resources Master Plan indicates that 75% of rivers show faecal coliform counts in excess of 500/100 ml. in the dry season, well above the World Health Organization (WHO) guidelines. In the wet season, the situation contamination is much worse. Nitrate concentrations and discharges from agro-chemical pollution in groundwater supplies are also much higher than past estimates have shown. However, while some isolated boreholes have registered significantly higher levels of nitrates, such findings have been exceptionally

rare; and, overall, it is generally agreed that groundwater resources remain relatively free from pollution. If current trends in soil erosion and deforestation continue, however, both surface and groundwater degradation could become a major problem in the future.

In response to these potentially serious environmental problems (and in addition to the creation of DREA in 1991 for the purposes noted above), Malawi has also embarked on the development of a National Environmental Action Plan (or NEAP) intended to: (1) identify major environmental issues and measures to alleviate them; and (2) lay out an overall environmental plan for sustainable development. In meeting these objectives, the NEAP will provide specific guidelines for actions to be taken by national government, regional authorities and local communities to modify existing practices, programs and projects and identify new practices and projects designed to ensure that the nation's valuable natural assets are put to the best and most environmentally sustainable use. At present, the initial Malawi NEAP document and associated Environmental Investment Program are set to be released shortly.

B. Discussion of Environmental Impacts

The ASAP program is focussed on policy reform, rather than on specific development activities. As a result, direct environmental impacts are difficult to assess. Although certain of these policy reforms will likely intensify the development and utilization of agricultural land, the overall program can help reduce environmental degradation if appropriate mitigating measures are identified and put in effect in a timely manner.

Regardless, it must be noted that successful implementation of this program may increase the degradation of Malawi's soil, water and forest resources. For example, improved prices and increased levels of income could lead to an increased desire by many farmers to place more land under cultivation, including increasing the cultivation of varieties of tobacco which require large quantities of wood for construction of drying sheds and/or the curing of tobacco leaves (e.g., burley and dark-fired tobaccos, respectively). Although only slightly more than two-thirds of of Malawi's arable lands are under cultivation, the pressure to increase cultivation on steep, marginal and/or otherwise environmentally significant or sensitive lands in the more densely populated areas of the southern and central regions could increase. This could lead to increased soil degradation and erosion, deforestation, degradation of the vegetative cover of customary lands, and water quality deterioration. Similarly, intensified farming practices, including increased use of fertilizers, may increase the level of nitrates and phosphates in water supplies and result in eutrophication of surface waters. Plant pests and diseases may also increase as a result of crop

diversification. On the other hand, the value of some crops may decline if diseases and pests are not kept in check, or fertility levels drop as a result of inappropriate use of fertilizers. The probable increased level of agricultural activity could also increase the demand for fuelwood and construction timbers by tobacco and food processing facilities.

However, it is equally true that successful implementation of the ASAP II program will also create significant positive impacts, some of which will mitigate or offset these environmental concerns. For example, increased income and improved food crop yields will provide Malawian farmers with increased nutrition and cash per unit land area, to purchase food, health services, shelter and other amenities which should improve his/her quality of life. Similarly, the emphasis on agricultural extension will focus on improved agricultural practices designed to decrease erosion, limit deforestation, and minimize the degradation of water quality while improving overall agricultural productivity. For example, the substantially enlarged support for agroforestry under ASAP II to enhance soil erosion control, improve soil fertility and provide significantly increased fuelwood sources on estate lands and those of smallholders, will serve to mitigate some of the negative aspects of the loss of soil fertility, pressure on forests and water quality noted above. Finally, improved income opportunities for smallholder farmers through expanded tobacco production rights in expected to provide additional incentives for farmers to devote the time and effort required for the adoption of more environmentally sound and sustainable on-farm production techniques.

IV. RECOMMENDED ENVIRONMENTAL DETERMINATION

Based upon all of the above considerations, it is clear that ASAP II is largely a continuation of the agricultural reform process initiated in 1991 under the original ASAP program. Accordingly, the original IEE findings and recommendations also remain valid and appropriate for this second phase of Program implementation, including:

- a **Categorical Exclusion** for the technical assistance to be undertaken during ASAP II, based upon 22 CFR 216.2 (c)(2)(i);

- a **Categorical Exclusion** for ASAP II policy studies, based upon 22 CFR 216.2 (c)(2)(iii);

- a **Negative Determination** for the construction of the agricultural policy research headquarters, staff housing and other facilities on the grounds of Bunda College, based upon 22 CFR 216.3 (2)(iii), as there are no environmentally significant impacts that will occur as a result of additional construction on this already altered site; and

- a Negative Determination is recommended for the policy implementation portion of this Program, based upon 22 CFR 216.3 (2)(iii), since existing checks and balances in policy implementation and environmental monitoring will be continued through project support to the Agricultural Policy Research Unit, Food Security Unit and the Department of Research and Environmental Affairs.

However, in the interest of ensuring that planned Program environmental monitoring and mitigative activities are pursued in an effective and efficient manner throughout the second phase of ASAP implementation, this latter Negative Determination is made pursuant to the following more specific Implementation Recommendations:

1. The current pilot Malawi Environmental Monitoring Program (EMP) should be continued for at least two full cropping seasons (to the originally planned termination date), with the following modifications:

a. Delay deployment of automatic water quality samplers within the pilot program areas; and decide on, prepare, deploy and implement alternative water quality monitoring methodologies for use in the five catchment areas. Initiate discussions with concerned, knowledgeable local officials and experts regarding how the automatic sampling equipment might be put to the best and most cost-effective alternative use as an integral component of greater national environmental monitoring program system design (see d. below);

b. Proceed to implement the pilot monitoring program as designed in accordance with the participatory approach recommended by EMP resident advisor K. Burger (see Burger PAME piece of 4/26/94). This revised approach should be fully pursued and evaluated within this pilot effort for subsequent wider-scale application throughout the country (see d. below);

c. Carefully evaluate implementation of this pilot monitoring program to insure that maximum benefit is gained from any "lessons learned" in the subsequent design of a greater national environmental monitoring program (see d. below); and

d. Proceed with the design of a truly representative national environmental monitoring program for Malawi, in accordance with NEAP environmental monitoring program objectives. Adopt a gradual, phased implementation transition from the pilot activity to the agreed upon national system design, and begin to implement selected national-scale program modifications during the second season of pilot program operations. Continue to expand the environmental monitoring effort thereafter, as time and resources permit.

2. Continue to support implementation of the ASAP Environmental Research Program aimed at developing environmentally sustainable, alternative on-farm and post-harvest practices and technologies to mitigate any adverse impacts associated with the ongoing agricultural sector reform in Malawi.

3. Continue to support implementation of the Malawi Agroforestry Extension Project (or suitable alternative), focussing increasingly on agroforestry interventions which are particularly appropriate for and applicable to tobacco production and processing operations.

In order to ensure that the above recommendations are implemented in an appropriate manner, the Mission and GOM should consider inclusion of the following Environmental Covenants and Conditions Precedent within the greater ASAP II policy reform agenda:

1. Covenants

a. USAID and the GOM shall provide timely and sufficient resources to support the continued strengthening of environmental management in Malawi, in particular, for the Department of Research and Environmental Affairs (or its successor institution, as determined by the new government) in accordance with the ongoing NEAP process.

b. USAID and the GOM shall provide timely and sufficient resources to support the continued development of an appropriate national environmental monitoring and information management capability in Malawi, including home office and field staff support for DREA (or its successor institution), as well as for other concerned GOM ministries and departments.

c. USAID and the GOM shall support environmental research aimed at mitigating any adverse environmental effects of ongoing agricultural sector reform in Malawi.

d. USAID and the GOM shall provide support for agroforestry technology development and dissemination throughout Malawi to assist in mitigating the effects of expanded tobacco production and processing operations.

e. The ASAP Environmental Monitoring, Evaluation and Mitigation Program (or EMEMP) recommended herein will hereafter be considered as an integral component of greater ASAP II monitoring and evaluation requirements, and treated as such in all future program monitoring and evaluation activities.

2. Conditions Precedent

a. Prior to the release of the first tranche of ASAP II funds, the GOM shall furnish written evidence to USAID indicating that:

(1) all DREA and other cooperating agency home office environmental monitoring staff required to support successful EMEMP implementation are in place and ready to assume full duties;

(2) all protocols and other necessary arrangements have been completed for the successful commencement of the ASAP Environmental Research Program; and

(3) a satisfactory program of GOM and USAID support for agroforestry technology development and dissemination in Malawi has been agreed upon and is ready for implementation in accordance with the other planned ASAP II activities.

b. Prior to the release of the second tranche of ASAP II funds, the GOM shall furnish written evidence to USAID indicating that:

(1) all DREA and other cooperating agency environmental monitoring field staff required to support EMEMP are in place and ready to assume full duties;

(2) initial Environmental Research Program grants have been successfully awarded, with research activities underway; and

(3) implementation has begun of agreed upon ASAP II-supported agroforestry support activities.

c. Prior to the release of the third tranche of ASAP II funds, the GOM shall furnish written evidence to USAID indicating that:

(1) a suitable, agreed upon mechanism exists to ensure that the results of the various Malawi EMEMP environmental monitoring, research and agroforestry support activities are properly reviewed, analyzed and used to ameliorate any adverse impacts identified from the ongoing agricultural sector reform;

(2) all of the above-referenced Malawi EMEMP environmental monitoring, research and agroforestry support activities are proceeding in a satisfactory manner, as documented in an appropriate external evaluation report; and

(3) all of the above-referenced Malawi EMEMP activities continue to receive through PACD appropriate financial, personnel and other agreed upon support required from USAID and the GOM to continue the strengthening of Malawi's environmental management capacity, in accordance with the ongoing NEAP process.

V. CONCLUSIONS

If implemented as recommended in Section IV. above, the ASAP II Program will be conducted in an environmentally sound manner, in accordance with all salient USAID policies and procedures.

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX C:

DRAFT AGREEMENT AMENDMENT NO. 1

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DRAFT

Agreement No. 612-T-604
Program No. 612-0239

FIRST AMENDMENT

TO

PROGRAM GRANT AGREEMENT

for

AGRICULTURAL SECTOR ASSISTANCE PROGRAM

between

THE GOVERNMENT OF THE
THE REPUBLIC OF MALAWI

and

THE UNITED STATES OF AMERICA

acting through

THE AGENCY FOR INTERNATIONAL DEVELOPMENT

Dated: September 30, 1994

DRAFT

PROGRAM GRANT AGREEMENT AMENDMENT NUMBER ONE FOR

AGRICULTURAL SECTOR ASSISTANCE PROGRAM

(ASAP)

This Amendment Number One to the Program Grant Agreement No. 612-0239, dated September 30, 1991, between the Government of the Republic of Malawi ("Grantee") and the United States of America, acting through the Agency for International Development ("USAID"), together referred to as the "Parties" is hereby entered into to grant the Grantee additional United States Dollars, to expand the scope of the Program and to extend the Program Assistance Completion Date.

WHEREAS, the Grantee and USAID entered into a Program Grant Agreement dated September 30, 1991 (the "Agreement");

WHEREAS, the Grantee and USAID desire to amend the Agreement to reflect certain changes to the Program;

NOW THEREFORE, the Parties hereby agree that the Agreement shall be amended as follows:

1. Article 1 is hereby deleted and the following substituted in its stead:

"Article 1: The Grant

Section 1.1 USAID Resources for the Program. For the purpose of assisting the Grantee in its efforts to increase smallholder (i.e., individuals cultivating customary land) access to agricultural inputs, output markets, cash crop production alternatives, and labor market information (the "Program"), USAID, pursuant to the U.S. Foreign Assistance Act of 1961, as amended, hereby grants to the Grantee, subject to the terms and conditions of this Agreement, an additional amount not to exceed Thirteen Million United States Dollars (U.S.\$13,000,000). The total Grant under the original Agreement and this First Amendment shall not exceed Thirty-three Million United States Dollars (U.S.\$33,000,000) (the "Grant"). USAID plans, subject to the availability of funds, to grant to the Grantee an additional amount of Twenty-two Million United States Dollars (U.S.\$22,000,000) in future increments, subject to the availability of funds, bringing the overall planned program total to Fifty-five Million United States Dollars (U.S.\$55,000,000). The Program is described in more detail in Annex 1 to this Agreement. Within the limits of the above definition of the Program and the actions to be completed prior to disbursement set forth in Article 4 below, elements of the Amplified Program Description in Annex 1 may be changed by written agreement of the authorized representatives of the Parties named in accordance with Section 6.11, without formal amendment of this Agreement.

Section 1.2 Incremental Nature of the Program. USAID's contribution to the Program will be provided in increments. Each additional increment will be subject to the availability of funds to USAID and authorization by USAID for such purpose, and to the mutual agreement of the Parties, at the time of the subsequent increment, to proceed."

2. Article 2 is hereby deleted and the following substituted in its stead:

"Article 2: Financing

Section 2.1: Grantee Resources for the Program: General. The Grantee agrees to provide or cause to be provided for the Program all funds, in addition to the Grant, and all other resources required to carry out the Program effectively and in a timely manner.

Section 2.2 Grantee Resources for the Program: Specific. The additional resources to be provided by the Grantee for the Program will be not less than the equivalent of Ten Million United States Dollars (U.S.\$10,000,000). Grantee resources provided under the original Agreement and this First Amendment will be not less than the equivalent of Twenty-Five Million United States Dollars (U.S.\$25,000,000), including costs borne on an "in kind" basis.

Section 2.3 Dollar Disbursements. The Grant shall be disbursed in seven (7) separate tranches. Grantee may obtain disbursement of each tranche by written request to USAID following receipt of the notification described in Section 4.10 below that the actions to be completed prior to disbursement of that particular tranche have been satisfied. For each tranche, the funds shall be disbursed into a single account to be specified by Grantee in such request, in the name of Grantee or one of its agencies, and shall become part of the general foreign exchange reserves of Grantee, to be used in accordance with laws and procedures in effect at that time in the Republic of Malawi."

3. Article 3 is hereby deleted and the following substituted in its stead:

"Article 3: Project Assistance Completion Date

Section 3.1 The "Project Assistance Completion Date" (PACD), which is September 30, 1998, or such other date as the Parties may agree to in writing, is the date by which the Parties estimate that all activities contemplated by the Program will have been performed or furnished, respectively, as contemplated in this Agreement.

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Section 3.2 Except as USAID may otherwise agree to in writing, USAID will not issue or approve documentation which would authorize disbursement of the Grant for the Program as contemplated in this Agreement subsequent to the PACD."

4. Section 4.4 of Article 4 is hereby deleted and the following substituted in its stead:

"Section 4.4 Actions To Be Completed Prior to the Fourth Disbursement. Prior to the fourth disbursement under the Grant, which shall be in the amount of Five Million United States Dollars (U.S.\$5,000,000), or to the issuance by USAID of documentation pursuant to which disbursement will be made, the Grantee will, except as the Parties may otherwise agree in writing, furnish to USAID in form and substance jointly agreed to by the Parties, evidence that the following actions have been achieved.

General Actions

(a) a written opinion of counsel acceptable to USAID certifying that this Agreement and Amendment have been duly authorized and/or ratified by and executed on behalf of the Grantee, and that they constitute a valid and legally binding obligation of the Grantee to undertake the Program in accordance with the terms and conditions of this Agreement.

(b) a written statement of the names and titles of the persons holding or acting in the office of the Grantee specified in Section 6.11, and of any additional representatives, together with a specimen signature of each person specified in such statement.

(c) a Letter of Intent covering each activity/action to be included under the 5th tranche containing: 1) a comprehensive list of actions that the Grantee intends to take; 2) the name of the principal representative/entity responsible for implementing or causing to be implemented or accomplished, each action included on the list; and 3) a line-item budget of financial resources to be committed by the GOM for program activities.

Specific Actions

(d) The Grantee has de-regulated all smallholder tobacco prices and has publicly announced that smallholder producers of all tobaccos, except oriental, have direct access to all legal marketing channels (qualified intermediate buyers, auction floors and ADMARC).

(e) The Grantee has legalized, and publicly announced, direct trading of oriental tobacco between growers and buyers at freely negotiated prices.

(f) The Grantee has requested technical and financial assistance from USAID to establish an Economic Policy Support Unit for supporting implementation of the ASAP agenda.

(g) The Grantee has increased maize producer prices to at or near export parity prices for the 1994/95 crop season.

(h) The Grantee has established, authorized and published a procedure whereby private traders may purchase GOM non-buffer fertilizer stocks."

5. Section 4.5 is hereby deleted and the following substituted in its stead:

Section 4.5 "Actions To Be Completed Prior to the Fifth Disbursement. Prior to the fifth disbursement, which shall be in the amount of Ten Million United States Dollars (U.S.\$10,000,000), or to the issuance by USAID of documentation pursuant to which such disbursement will be made, the Grantee will, except as the Parties may otherwise agree in writing, furnish to USAID, in form and substance jointly agreed to by the Parties, evidence that the following actions have been achieved.

Liberalized Input Markets

(a) Grantee has eliminated all fiscal seed subsidies.

(b) Grantee has developed the terms of reference for a seed import liberalization study.

This study will analyze the advantages and disadvantages of liberalizing seed imports and will make specific recommendations, as appropriate, for modifying current seed import policies and regulations.

(c) Grantee has eliminated all fiscal fertilizer subsidies.

(d) Grantee has completed a time-phased action plan for eliminating existing laws and administrative practices which allow discrimination on the basis of gender or ethnic, tribal and/or racial background.

It is understood that the action plan will address such discrimination in the areas of land leases/sub-leases, business trading activities, transport licenses and transport operations; and will include procedures through which a party may appeal a government action or decision if the party believes discrimination was a factor.

(e) Grantee has conducted an analysis of ADMARC's pan-territorial and pan-seasonal input pricing policies, and has completed an action plan for implementing agreed upon recommendations.

The purpose of the analysis is to develop a feasible and mutually agreeable framework for eliminating these pricing policies.

Institutional Reform and Expanded Market Competitiveness

(f) Grantee has completed an overview, based on the terms of reference approved by USAID, of the statutory bodies, government trusts, parastatals, and government sponsored organizations operating in the agricultural sector. It is understood that the overview will include:

- (1) A list of such entities prioritized according to the extent to which they influence, through regulation or other means, the development of dynamic private agricultural markets;
- (2) A discussion of the continued relevance and appropriateness of such entities given the GOM's stated liberalization goals;
- (3) A discussion of how these entities are structured in terms of ownership, industry representation and revenue generation; and
- (4) Based on (1-3), above, a time-phased action plan providing specific management and financial audit recommendations, as appropriate.

(g) Grantee is liberalizing producer and consumer pricing by:

- (1) Releasing ADMARC from pan-territorial and pan-seasonal consumer and producer pricing obligations for all crops except maize;
- (2) Having developed the terms of reference for developing a model for stabilizing maize prices based on price band analysis or an alternative system; and
- (3) Requiring that ADMARC operate as a fee paying intermediate buyer of burley tobacco.

(h) Grantee is improving the efficiency of the burley production quota system by:

- (1) Having assessed the feasibility of transferring quota allocation and administration responsibilities from the Ministry of Agriculture (MOA) to the Tobacco Control Commission (TCC) with the objective of improving the efficiency and transparency of the allocation process;

- (2) Having developed the terms of reference for a computerized, performance-based quota allocation scheme based on performance criteria mutually agreed upon between the Grantee and USAID; and
- (3) Ensuring that marketing quotas under the intermediate buyers program continue to be additive to the national total production quota and not subject to a maximum ceiling.

(i) Grantee has developed the terms of reference for assessing the policy and procedures which permit ADMARC to sell, rent and/or lease its retail facilities.

The assessment will include, as appropriate, a time-phased action plan for the development and implementation of policies and procedures to carry out the sale, renting and/or leasing of these facilities.

Environmental Concerns

(j) Grantee is making available sufficient financial and staff resources to effectively and efficiently implement agreed upon environmental monitoring and mitigative agroforestry activities.

a:

Other

(k) Grantee has provided the budgetary resources contained in its Letter of Intent requested under Section 4.4 (c), Tranche 4, for expenses related to Tranche 5 activities.

(l) Grantee has submitted to USAID a Letter of Intent covering each activity/action to be included under the 6th tranche containing: 1) a comprehensive list of actions that the Grantee intends to take; 2) the name of the principal representative/entity responsible for implementing or causing to be implemented or accomplished, each action included on the list; and 3) a line-item budget of financial resources to be committed by the GOM for program activities."

6. Section 4.6 is hereby deleted and the following substituted in its stead:

"Section 4.6 Actions To Be Completed Prior To Sixth Disbursement. Prior to the sixth disbursement, which shall be in the amount of Ten Million United States Dollars (U.S.\$10,000,000) or to the issuance by USAID of documentation pursuant to which such disbursement will be made, the Grantee will, except as USAID may otherwise agree in writing, furnish to USAID, in form and substance jointly agreed to by the Parties, evidence that the following illustrative actions have been achieved. Tranche 6 actions may be refined when funding for tranche 6 is authorized and obligated:

Liberalized Input Markets

(a) Grantee has completed the seed liberalization study initiated under Section 4.5 (b), in Tranche 5, and Grantee-USAID endorsed results have been incorporated into revised, authorized and publicly announced seed import policies and regulations.

(b) Grantee has established and publicly announced a procedure whereby private importers and/or private traders are allowed to buy and/or replace GOM fertilizer buffer stocks.

(c) Grantee is implementing recommendations regarding ADMARC's pan-territorial and pan-seasonal input pricing policies in accordance with mutually agreed upon action-plan recommendations developed in Section 4.5 (e), Tranche 5.

(d) Grantee is implementing the anti-discrimination action plan in accordance with the schedule of activities agreed to between the Grantee and USAID under Section 4.5 (d), Tranche 5.

(e) Grantee has analyzed the constraints to efficient and affordable rural freight and transport services and has prepared a time-phased action plan to address identified constraints. The action plan will address, among other concerns, multi-purpose (passenger and freight) transport, import duties on domestic transport trucks (and spare parts and tires), and appropriateness of domestic rate guidance in a liberalized agricultural sector.

(f) Grantee has implemented and publicly announced improved land lease/sub-lease policies and procedures.

Institutional Reform and Expanded Market Competitiveness

(g) The Grantee is implementing the scheduled action plan activities prepared under Section 4.5 (f), Tranche 5, concerning statutory bodies, government trusts, parastatals and other government sponsored organizations.

(h) Grantee has eliminated the exclusive marketing arrangements of ADMARC and all limitations on private sector buying and selling of smallholder produced commodities.

(i) Grantee continues the process of producer and consumer price liberalization by:

- (1) Having completed the model for stabilizing maize prices based on the terms of reference approved under Section 4.5 (g)(2), Tranche 5; and
- (2) Establishing an open tendering system for supplying maize to, and removing maize from, the Strategic Grain Reserve (SGR).

(j) Grantee has improved the efficiency of the national burley quota system by:

- (1) Implementing the computerized, performance-based quota allocation scheme mutually agreed upon between the Grantee and USAID under Section 4.5 (h) (2), Tranche 5;
- (2) Ensuring annually, sufficient new quota and/or reallocated quota to fully meet all effective smallholder demand (possible eligibility requirement would limit quota to organized tobacco clubs that are qualified to receive credit and that apply for quota);
- (3) Eliminating annual quota application requirements except for first-time applicants; and
- (4) Publicizing information on the quota allocation.

(k) Grantee is implementing the scheduled action plan activities prepared under Section 4.5 (i), Tranche 5, concerning policies and procedures for ADMARC selling, leasing and renting its retail facilities.

(l) Grantee has implemented and publicly announced a national business license system to replace the current system requiring that trading licenses be approved in each Agricultural Development Division where trading activities take place.

(m) Grantee has removed all agricultural commodities except maize from the negative list for import/export licensing requirements effectively lifting the export bans on all non-maize crops.

(n) Grantee has replaced the duty drawback system with a duty reduction system for the import of agricultural and agribusiness inputs.

(o) Grantee has implemented and publicly announced a national import/export licensing system which eliminates the requirement for prior approval by the Ministry of Agriculture of import/export licenses for agricultural produce, and which provides appeal procedures for licenses that are denied or rescinded.

(p) Grantee has reviewed the role of smallholder credit and marketing clubs in developing a sustainable base for rural economic growth and has developed a policy on the future institutional framework in which such clubs are to function.

Environmental Concerns

(q) Grantee is making available sufficient financial and staff resources to implement agreed upon environmental monitoring, research and mitigative agroforestry activities.

Other

(r) Grantee has provided the budgetary resources contained in its Letter of Intent requested under Section 4.5 (l), Tranche 5, for expenses related to Tranche 6 activities.

(s) Grantee has submitted to USAID a Letter of Intent covering each activity/action included under the 7th tranche containing: 1) a comprehensive list of actions that the Grantee intends to take; 2) the name of the principal representative/entity responsible for implementing or causing to implemented or accomplished, each action included on the list; and 3) a line-item budget showing the financial resources to be committed by the GOM for program activities."

7. Section 4.7 is hereby added together with the following Sections 4.8, 4.9, and 4.10:

"Section 4.7 Actions To Be Completed Prior To Seventh Disbursement. Prior to the seventh disbursement, which shall be in the amount of Ten Million United States Dollars (U.S.\$10,000,000, or to the issuance by USAID of documentation pursuant to which such disbursement will be made, the Grantee will, except as USAID may otherwise agree in writing, furnish to USAID, in form and substance jointly agreed to by the Parties, evidence that the following illustrative actions have been achieved. Tranche 7 actions may be refined when funding for tranche 7 is authorized and obligated:

Liberalizing Input Markets

(a) Grantee has completed a review of fertilizer use and has published revised regional and soil-specific fertilizer recommendations for major maize producing areas.

(b) Grantee is implementing scheduled action plan activities for improving rural freight and transport services agreed upon in Section 4.6 (e), under Tranche 6.

Institutional Reform and Expanded Market Competitiveness

(c) Grantee is continuing the process of maize producer and consumer price liberalization and has eliminated producer and consumer price controls on all other smallholder produce by:

- (1) Implementing the model for maize producer and consumer price stability completed in Section 4.6 (i)(1), under Tranche 6; and
- (2) Amending the GOM/ADMARC Memorandum of Understanding to delete the requirement that ADMARC ensure smallholder access to output markets for all crops.

(d) Grantee has legalized and publicly announced improved investment incentives for rural enterprises in support of agricultural diversification and growth.

Environmental Concerns

(e) Grantee has evaluated its environmental monitoring, research and mitigative agroforestry activities, redesigned them as recommended, and is providing sufficient financial and staff resources to effectively implement agreed upon environmental monitoring, research, and mitigative agroforestry activities.

(f) Grantee is implementing a nationally representative environmental monitoring program to identify the environmental impacts of economic policy reforms undertaken as a result of ASAP.

Other

(g) Grantee has provided the budgetary resources contained in its Letter of Intent requested under Section 4.6 (s), Tranche 6, for expenses related to Tranche 7 activities.

8. Section 4.8. Prior Actions. It shall be a continuing requirement to disbursement of all tranches subsequent to the first that all actions taken or agreed to be taken or completed for previous disbursements shall not be rescinded or altered by Grantee in a manner which materially interferes with the objectives of the Program.

Section 4.9. Terminal Date for Satisfaction of Actions To Be Completed Prior to Disbursement of the Fourth Tranche. If the actions contained in Section 4.4 (a), (b), (c), (d), (e), (f), (g), and (h) have not been satisfied within ninety (90) days from the date of signature of this First Amendment to the Agreement, or such later date as USAID may agree to in writing, then USAID at its option may terminate or suspend this Agreement in whole or in part on thirty (30) days written notice to the Grantee.

Section 4.10. Notification. When USAID has determined that the actions to be completed specified in each of Section 4.4, 4.5, 4.6 and 4.7. have been satisfied, USAID will promptly notify the Grantee in writing."

9. Article 5, Sections 5.1, 5.2, and 5.3 are hereby deleted.

10. Article 5, Section 5.4, Special Currency Account, is hereby renumbered Section 5.1 and the following paragraph "d" is hereby added:

"(d) Paragraphs (a), (b), and (c) above do not apply to disbursements made subsequent to the third disbursement."

11. Article 5, Section 5.5, Utilization of Dollars, is hereby renumbered Section 5.2 and the following second paragraph is hereby added:

"Section 5.2 does not apply to disbursements made subsequent to the third disbursement."

12. Add to Article 5 Covenants, the following Sections 5.3, 5.4, 5.5, 5.6, and 5.7.

"Section 5.3 Quota Allocation. Of tobacco quotas issued to customary landholders, Grantee shall see that an increasing proportion is allocated to women.

Section 5.4 GOM Resources. Grantee shall ensure timely and sufficient funds for the manpower and operational expenses required to implement ASAP.

Section 5.5 Policy Research. Grantee shall provide timely and sufficient funds to the Bunda College of Agriculture to support agricultural policy research.

Section 5.6 Annual Evaluations. Grantee shall conduct annual evaluations of the ASAP Program including, but not limited to, the smallholder tobacco scheme and the quota administration process.

Section 5.7 Environment

(a) USAID and the GOM shall provide timely and sufficient resources to support the continued strengthening of environmental management and monitoring in Malawi for the Department of Research and Environmental Affairs (or its successor institution) in accordance with the ongoing NEAP process.

(b) USAID and the GOM shall support environmental research aimed at mitigating any adverse environmental effects of ongoing agricultural sector reform in Malawi.

(c) USAID and the GOM shall provide support for agroforestry development and dissemination throughout Malawi to assist in mitigating the effects of expanded tobacco production and processing operations.

(d) The ASAP Malawi Environmental Monitoring Program (MEMP) will be considered as an integral component of ASAP monitoring and evaluation requirements, and treated as such in all future Program monitoring and evaluation activities."

13. Section 6.10 is hereby deleted and the following is substituted in its stead:

"Section 6.10. Suspension and Termination

(a) USAID may suspend disbursement for up to ninety (90) days upon written notice to the Grantee.

(b) USAID may cancel any disbursement under this Agreement upon written notice to the Grantee, if at any time: (1) the Grantee shall fail to comply with any provision of this Agreement; (2) an event occurs that USAID determines to be an exceptional situation that makes it impossible either to attain the purpose of the Grant or for the Grantee to perform its obligations under this Agreement; or (3) any disbursement by USAID would be in violation of the legislation governing USAID.

(c) This Agreement may be terminated by mutual agreement of the parties at any time. Either Party may terminate this Agreement by giving the other Party thirty (30) days' written notice. Termination of this Agreement shall terminate any obligations of the Parties to provide financial or other resources pursuant to this Agreement.

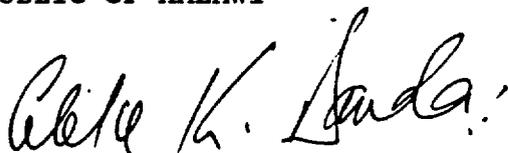
(d) Notwithstanding any suspension or termination, the provisions of this Agreement shall continue in full force and effect with respect to any portion of the Grant provided prior to or notwithstanding such suspension or termination."

All other terms and conditions of the Program Grant Agreement, as amended or rescinded herein, shall remain in full force and effect.

In WITNESS WHEREOF, the Grantee and the United States of America, each acting through its duly authorized representative, have caused this Amendment to be signed in their names and delivered as of the day and year first above written.

THE GOVERNMENT OF THE
REPUBLIC OF MALAWI

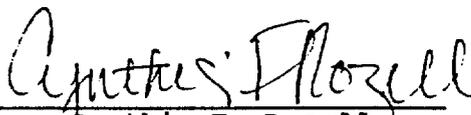
UNITED STATES OF AMERICA



Hon. Aleke Banda
Minister Of Finance



Peter Chaveas
Ambassador to the United
States of America



Cynthia F. Rozell
Mission Director

Annex: (1) Amplified Program Description

Fiscal Data:

Program No.:	612-0239.00
Appropriation:	72-114/51014
Budget Plan Code:	GSS4-94-31612-KG39
Allowance:	NA
Reservation Control No:	M240069
Obligation No.:	PA-612-T-604A
Obligation Amount:	\$13,000,000
Reference:	ST-258449 & ST-234824



AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX D:

LETTER OF REQUEST



REF. NO. USA/38

September 29, 1994

The Mission Director
USAID
P O Box 30455
LILONGWE

Dear Madam,

**RE: GIRLS' ATTAINMENT IN BASIC LITERACY AND
EDUCATION II (GABLE), AGRICULTURAL SECTOR
ASSISTANCE PROGRAM II (ASAP) AND MALAWI
RAILWAYS RESTRUCTURING (MRR) PROGRAM**

The Government of Malawi (GOM) hereby requests the assistance of the United States Government through USAID to continue a series of reforms in primary education and agriculture, and to initiate reforms to restructure Malawi Railways.

Based on discussions between USAID and GOM officials over the past several months and the successful negotiations last week, the Government of Malawi is committed to undertake the activities of GABLE II, ASAP and MRR as outlined in the draft agreements.

In support of the activities and reforms to be undertaken for these programs, we understand that new U.S. commitments will be as follows:

- GABLE II: US\$ 21 million for budget support and US\$ 4.5 million for the project element;
- ASAP II: US\$ 35 million for budget support;
- MRR : US\$ 20 million for budget support and US\$ 5 million for project support.

The Government appreciated US assistance for these programs and looks forward to signing the agreements on GABLE, ASAP and MRR.

Yours sincerely,

Handwritten signature of Aleke K. Banda in black ink.

Aleke K Banda
MINISTER OF FINANCE

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX E:

LOGICAL FRAMEWORK

PROJECT LOGFRAME
 AGRICULTURAL SECTOR ASSISTANCE PROGRAM
 (NPA NUMBER 612-0239)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>PROGRAM GOAL Increase agricultural productivity, employment, and incomes.</p>	<ol style="list-style-type: none"> 1. Real per capita smallholder income increases by 3% per annum or by 24% by the year 2000. 2. Food availability increases from 1750 calories per capita daily to 2200 calories by the year 2000. 3. Growth rate in employment in rural MSMEs increases from a baseline estimate of 10% per year to 15% per year by 2000. 	<ol style="list-style-type: none"> 1. Economic report; 2. EP&D Food and Nutrition Unit data, Famine Early Warning System data; 3. Periodic surveys 	<p>GOM continues implementation of stabilization and adjustment programs.</p> <p>GOM remains committed to creation of level playing field.</p> <p>No further large depreciations.</p> <p>No further disruptions to or increases in the real costs of transportation.</p> <p>Increased incomes in agricultural sector are reinvested by farmers in agricultural production.</p>
<p>Program Purpose: Increase smallholder access to agricultural inputs, output markets, cash crop production alternatives, and labor market information</p>	<ol style="list-style-type: none"> 1. Smallholder land planted to non-maize crops increases from 24% in 1993 to 45% by the year 2000. 2. Contribution of HYV maize production to total maize production increases from 49% in 1993 to 60% by the year 2000. 3. Total value of agricultural export earnings increases by 10% per year. 4. Value of all tobacco grown by smallholder farmers increases from US\$18 million in 1993 to US\$50 million by the year 2000. 5. Amount of fertilizer delivered by the private sector increases from 37% in 1993 to 40% by the year 2000. 	<ol style="list-style-type: none"> 1, 2 and 4. MOA crop estimate; 3. Economic Report; 5. MOA inputs section, policy impact survey 	<p>Private sector in Malawi is robust and interested in moving into input/output markets vacated by public sector.</p> <p>Foreign exchange market in Malawi remains liberalized and access to foreign exchange by private traders remains open and unrestricted.</p> <p>World market for burley tobacco remains stable.</p> <p>Malawi retains its competitive edge in burley tobacco.</p> <p>Absence of major drought or natural disaster which dramatically reduce crop yields.</p> <p>Smallholders adopt improved varieties and practices.</p>

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
PROGRAM OUTPUTS			
Theme one: Increasing Equity and Efficiency through Liberalization of Input Markets			
Eliminate fiscal seed subsidies, analyze issues around seed imports and formulate and implement new policies relating to such imports.	Value of total HYV maize seed marketed through private traders increases from 25% in 1993 to 50% of total sales by 1997.	1. MOA, Inputs Section, Lever Brothers, and National Seed company of Malawi	Private sector capacity to expand marketing activities continues to develop.
Eliminate fertilizer fiscal subsidies, publish revised fertilizer recommendations, permit private traders/importers to purchase and replace GOM fertilizer buffer stocks. Develop and implement plan to eliminate ADMARC's pan-territorial and pan-seasonal input pricing policy.	1. Amount of fertilizer sold through private channels increases from 37% to 50% of total sales by 1997. 2. Amount of fertilizer delivered to the revolving fund by private traders increases from nil to 25% of total deliveries by 1997. 3. Amount of fertilizer released by the revolving fund to private traders increases from nil to 50% of total deliveries by 1997.	1. MOA Inputs Section policy impact survey; 2 and 3. Revolving fund report.	Sufficient resources are made available to meet increased smallholder credit requirements. Foreign exchange market in Malawi remains liberalized and access to foreign exchange by private traders remains open and unrestricted. MOA maintains policy of limiting variety release requirements to maize and tobacco only. MOA simplifies, publicizes, and accelerates varietal releases.
Analyze the constraints to efficient and affordable rural freight and transport services; prepare and implement plan to address identified constraints.	Indicators to be developed upon completion of analysis.		MOA allows pre-release of new maize and tobacco seed varieties by commercial seed distributors for trial production.
Complete and implement action plan for eliminating all existing laws and administrative practices which allow discrimination on basis of gender or ethnic background.	Indicators to be developed upon completion of analysis.		
Implement and publicly announce improved land lease policies.	Gazette notifications.	Gazette.	
Theme two: Increasing Equity and Efficiency Through Expanded Market Competitiveness and Institutional Reform			

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Complete an overview of the statutory bodies, government trusts, and other parastatals operating in the agricultural sector. Prepare and implement an action plan of activities concerning statutory bodies, government trusts and parastatals.</p>	<p>Indicators to be developed upon completion of the plan.</p>		
<p>Increase producer price of maize to at/near export parity for 1994/95 season. Release ADMARC from pan-territorial and pan-seasonal consumer and producer pricing obligations for all crops except maize. Eliminate the exclusive marketing arrangements of ADMARC and all limitations on private sector buying and selling of smallholder commodities. Require that ADMARC operates as fee paying Intermediate Buyer. Implement mechanism for stabilizing maize prices and establishing an open tendering system for supplying maize to, and removing maize from, the Strategic Grain Reserve (SGR). Amend the GOM/ADMARC Memorandum of Understanding to delete the requirement that ADMARC ensure smallholder access to output markets for all crops.</p>	<ol style="list-style-type: none"> 1. Price of maize at or near export parity. 2. Value of smallholder crops marketed by private sector increases by 5% per year. 3. Amount of maize delivered to the SGR by private traders increases from nil in 1993 to 20% of total deliveries by 1997. 4. Amount of maize released by the SGR to private traders increases from nil in 1993 to 20% of total deliveries by 1997. 5. Area under HYV maize as proportion of total maize area increases from 25% in 1993 to 35% by 1997. 	<ol style="list-style-type: none"> 1. Policy impact survey; 2 and 3. Report on SGR; 4. MOA crop estimates 	<p>Private sector capacity to expand marketing activities continues to develop.</p> <p>Disallow export bans.</p>

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Deregulate all smallholder tobacco prices and publicly announced that smallholder producers of all tobaccos, except oriental, have direct access to all legal marketing channels. Legalize and publicly announce direct trading of oriental tobacco between growers and buyers at freely negotiated prices. Assess feasibility of transferring tobacco allocation and administrative responsibilities from MOA to TCC; rationalize and make transparent quota allocation procedures using objective performance-based criteria; publicize additive nature of intermediate buyers' marketing quota; ensure annually sufficient new quota and/or reallocation of quota to fully meet all effective smallholder demand; eliminate quota application requirements except for first-time applicants; and publish information on quota allocation</p>	<ol style="list-style-type: none"> 1. Fully operational computerized system at TCC. 2. Gazette notification and radio broadcasts. 3. Total amount of unused quota delines from current estimate of 30% to 5% by 1997. 4. Share allocated to smallholders consistent with allocation scheme to be mutually agreed upon in tranche 5. 5. Share of total value of tobacco sales marketed by licensed Intermediate Buyers increases from nil to 25% by 1997. 6. Total value of all tobacco grown by smallholders increases from US\$18 million in 1993 to US\$40 million in 1997. 	<ol style="list-style-type: none"> 1. Site visits; 2. Gazette and radio; 3. Annual report from TCC indicating amount of unused quota from prior year ; 4. Annual report from TCC indicating quota allocation by size and type of farmer; 5. Annual report from TCC on intermediate buyer program. 6. Annual report from Crop estimates, AHL reported prices 	<p>New GOM honors former ASAP commitments and spirit and intent of the program.</p> <p>Intermediate Buyer Program progresses unimpeded.</p>
<p>Develop and implement an action plan activities concerning policies and procedures for ADMARC selling, leasing and renting its retail facilities.</p>	<p>Unused or under utilized ADMARC facilities reduced by 50% through sale or lease of such facilities by the year 1997.</p>	<p>Report from ADMARC, field visits.</p>	<p>Private sector capacity to expand marketing activities continues to develop.</p>

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Implement national business license system. Remove all agricultural commodities except maize from the negative list for import/export licensing requirements. Replace duty drawback system with duty reduction system for the import of agricultural and agri-business inputs. Implement national import/export licensing system which eliminates requirement for prior approval by the Ministry of Agriculture, and which provides appeal procedures for licenses that are denied or rescinded. Legalize improved investment incentives for rural enterprises in support of agricultural diversification and growth.</p>	<p>Gazette notifications and supporting documentation.</p>	<p>Gazette</p>	
<p>Develop policy on the future institutional framework for smallholder credit and marketing clubs.</p>			
<p>Other concerns</p>			
<p>Make available sufficient financial resources to effectively and efficiently implement activities agreed upon in each tranche and as well as environmental and related activities.</p>	<p>Letters of intent and budgetary line items consistent with resource requirements.</p>	<p>Budget documents.</p>	

DOC: p:\ppd\docs\logframe, Sept 19, 1994

1/25

Rationale:

Goal

Real per capita income increases by 3% per annum World Bank uses a rule of thumb that total GDP should grow at 5% per year. Given a population growth rate of 3%, this implies that per capita GDP grows at 2% per year. We are assuming that through our package of reforms, growth in smallholder incomes will be 1% higher than the growth rate in total GDP.

Food availability increases from 1750 calories per capita daily in 1993 to 2200 calories by the year 2000

This is the minimum daily level required (Policy). The indicator is phrased in terms of *availability* rather than *production*. Caloric requirements can come from any source, domestic or imported, and from any food crop.

Growth rate in employment in rural enterprises increases from a baseline of 10% per year in 1993 to 15% by the year 2000. Many of the reforms are expected to increase rural enterprise activities: sales of seed and fertilizer by the private sector, improved private sector transport, increased sales of smallholder production by private sector, removal of restrictions on ethnic minorities, etc. Therefore, we expect to be able to observe an increase in activity in rural enterprises. Employment was chosen because it is easily identified and measured. The baseline and follow-up data are provided through GEMINI survey.

Purpose

Smallholder land planted to non-maize crops increases from 24% in 1993 to 50% by the year 2000. From the crop estimates, the total share of all cultivated land planted to maize is currently around 24%. In the survey conducted by USAID on what farmers would do if there were no quota, the share of *cultivated* land planted to maize was 65%. Given sampling error and the different methods used, the estimate is reasonably close to that given by the crop estimates. In a quota-less environment, that share would drop to 46%, primarily because land currently idle would be brought into production. Although these results are not definitive, they are indicative. We based our indicator on this findings, and assumed, further, that the share between maize and non-maize should stabilize around 50%.

Contribution of HYV maize production to total maize production increases from 49% in 1993 to 70% by 2000. At the same time that the reform package encourages cash crop production, simultaneous policies to establish a producer price of maize at or above export parity (or at some level that encourages maize production) and to increase access to inputs will encourage maize production. It is anticipated that this increase will come through increased yields rather than increased hectareage. Anticipated share planted to HYV maize is discussed below and is directly correlated with maize produced. From this is derived the estimated contribution of HYV to total maize production.

Total value of agricultural export earnings increases by 10% per year This can be achieved by increasing the burley quota alone.

Value of all cash grown by smallholder farmers increases from US\$29 million in 1993 to US\$45 million by the year 2000. 1993 values have been derived from sales of tobacco, cotton, and soyabeans at 1993 producer prices. It is assumed that smallholder production will increase by 5 million kgs per year (an under estimate in my opinion) and sold at US\$70 per kg; 500 thousand kgs per year of dark-fired sold at US\$93 per kg and 200 thousand kgs per year sold at US\$93 per kg. Other cash crop production will increase by 10%.

Amount of fertilizer delivered by the private sector increases from 37% in 1993 to 50% by the year 2000. This indicator is the shakiest. It was chosen for the following reasons. Because the purpose of the program includes access to inputs, we needed an indicator of inputs used in maize and other production. Fertilizer is the most costly. We do not know how the effect of credit availability, reduction in subsidies, exchange rate changes, the use of the current extremely large stock of fertilizers, and revised recommended fertilizer applications levels will play out in terms of final smallholder use of fertilizer. The only thing we are certain of is that these policy changes should increase private sector participation. Therefore, we selected the share of all fertilizer marketed by the private sector. The private sector does not report how much it sold to estates and how much to smallholders. It does report how much it sold to all farmers. In 1992/93, this amounted to 37%. Meanwhile, there is a very large stock of fertilizer in country. Should the GOM opt to sell it to

reduce the stock and to buffer the effect on price of removal of the subsidy and exchange rates, and should the GOM allow private traders to purchase it, then private traders would purchase from this stock at least the amount they require for normal sales in the next few years. In addition, removal of the subsidies would encourage them to take a larger share of the stock. Having captured a larger share of the market, they will probably maintain it. However, there are a lot of assumptions, and considerable uncertainty around the target level.

Outputs

Value of total HYV maize seed marketed through private traders increases from 25% to 50% of total sales by 1997. Targetted level is purely a guess. In fact, the share jumped to 42% in 1993/94. This was due entirely to a substantial decline in ADMARC credit-related sales.

Amount of fertilizer sold through private channels increases from 37% to 50% of total sales by 1997. See purpose-level fertilizer

Amount of fertilizer delivered to the revolving fund by private traders increases from nil to 25% of total deliveries by 1997. Targetted level is purely a guess.

Amount of fertilizer released by the revolving fund to private traders increases from nil to 50% of total deliveries by 1997. See purpose-level fertilizer indicator.

Share of total value of tobacco sales marketed by Intermediate Buyers increases from nil in 1993 to 25% by 1997. It is assumed that at least 25% of all tobacco currently marketed by estates is through illegal smallholder production that will otherwise be marketed through intermediate buyers. According to the USAID survey, as much as 75% of all smallholders in areas where there is a high concentration of estates grow burley illegally. In addition, the survey of intermediate buyers indicated that some intermediate buyers were estates using their IB quota to sell their production in excess of their quota. Many registered smallholders will opt to sell through this channel. Finally, it is ultimately through this mechanism, because of its additive nature, that the quota will become meaningless. Considering all of these factors, 25% is likely a conservative estimate.

Total value of all tobacco grown by smallholders increases from US\$18 million in 1993 to US\$40 million in 1997. It is assumed that smallholder production will increase by 5 million kgs per year (an under estimate in my opinion) and sold at US\$.70 per kg: 500 thousand kgs per year of dark-fired sold at US\$.93 per kg and 200 thousand kgs per year sold at US\$.93 per kg.

Value of smallholder crops marketed by private sector increases by 5% per year. Baseline and source for this indicator will come from the Policy Impact Module, a survey being administered by evaluation officers at each ADD.

Amount of maize delivered to the SGR by private traders increases from nil in 1993 to 20% of total deliveries by 1997 and amount of maize released by the SGR to private traders increases from nil in 1993 to 20% of total deliveries by 1997. Targetted levels are purely guesses.

Area under HYV maize as proportion of total maize area increases from 25% in 1993 to 30% by 1997. With good prices for maize, and the use of the new flint hybrids, we assumed that the percentage of HYV as a proportion of total maize area will increase by about 5 percentage points by 1997.

Unused or underutilized ADMARC facilities reduced by 50% through sale or lease of such facilities by the year 1997. With proper mechanisms in place, ADMARC should, in fact, rent or sell all its unused facilities. 50% is a conservative estimate.

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX F:

CN RELEASE CABLES

UNCLAS AIDAC SECSTATE 265228

ACTION: AID-2
INFO: ECON-1 DCM-1 AMB-1

DISTRIBUTION: AID
CHARGE: AID

VZCZCLGO481
OO RUEHLG
DE RUEHC #5228 2730320
ZNR UUUUU ZZH
O 300321Z SEP 94
FM SECSTATE WASHDC
TO AMEMBASSY LILONGWE IMMEDIATE 4096
BT
UNCLAS STATE 265228

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: AGRICULTURAL SECTOR ASSISTANCE PROGRAM
(612-0239)

REF: STATE 252876

THE CONGRESSIONAL NOTIFICATION FOR ABOVE PROJECT FOR U.S.
DOLS 18,000,000 EXPIRED ON SEPTEMBER 29, 1994 WITHOUT
OBJECTION. OBLIGATION MAY NOW BE INCURRED.
SPERO
BT
#5228

NNNN

UNCLAS AIDAC SECSTATE 265228

10/15/94

ACTION TO:	
INFO:	
DIR	
DD	
A-S	
CCNTL	
ENO	
CSD	
HRN	
PROD	
PAE	
FID	
DUE DATE: 10/15/94	
INITIALS	DATE

ACTION: AID-2
INFO: ECON-1 DCM-1

DISTRIBUTION: AID
CHARGE: AID

VZCZCLG0736
PP RUEHLG
DE RUEHC #4824 2430218
ZNR UUUUU ZZH
P 310217Z AUG 94
FM SECSTATE WASHDC
TO AMEMBASSY LILONGWE PRIORITY 3856
BT
UNCLAS STATE 234824

AIDAC

E.O. 12356: N/A

TAGS:

SUBJECT: EXPIRATION OF CONGRESSIONAL NOTIFICATIONS

REF: STATE 221195

THE FOLLOWING CONGRESSIONAL NOTIFICATIONS EXPIRED ON
AUGUST 26, 1994 WITHOUT OBJECTION.

- AGRICULTURAL SECTOR ASSISTANCE PROGRAM (612-0239) DOLS
8,000,000
- GIRLS' ATTAINMENT IN BASIC LITERACY AND EDUCATION
(612-0240) DOLS 6,500,000.

OBLIGATIONS MAY NOW BE INCURRED.

TARNOFF

BT

#4824

NNNN

DATE: 09/01/94

ACTION TO:	
Schen - PPD	
INFO:	
DIR	_____
DD	_____
AFS	_____
CONT	<input checked="" type="checkbox"/>
EXO	_____
GSD	_____
HPN	_____
INDD	_____
PAE	_____
PIO	_____
DUE DATE:	
09/03/94	
ACTION TAKEN:	

INITIALS _____ DATE _____

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX G:

DOA CABLE

ACTION: AID-2
INFO: ECON-1 AMB-1 DCM-1

DISTRIBUTION: AID
CHARGE: AID

VZCZCLG0029
OO RUEHLG
DE RUEHC #2062 2702352
ZNR UUUUU ZZH
O P 272352Z SEP 94
FM SECSTATE WASHDC
TO RUEHLG/AMEMBASSY LILONGWE IMMEDIATE 4066
INFO RUEHNR/AMEMBASSY NAIROBI PRIORITY 3592
BT
UNCLAS STATE 262062

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: MALAWI AGRICULTURAL SECTOR ASSISTANCE PROGRAM
(NPA)

REF: STATE 65100

DAA/AFR, ACTING UNDER HER ALTER EGO AUTHORITY, HEREBY
DELEGATES AUTHORITY TO THE DIRECTOR, USAID/MALAWI, OR TO
THE PERSON ACTING IN THAT CAPACITY, TO AUTHORIZE A DOLLARS
35 MILLION AMENDMENT TO THE NON-PROJECT COMPONENT OF ASAP
(612-0239), FOR A NEW AUTHORIZED LOP OF THE NON-PROJECT
COMPONENT NOT TO EXCEED DOLLARS 55 MILLION AND TO EXTEND
THE PROJECT ASSISTANCE COMPLETION DATE TO SEPTEMBER 30,
1998. THIS AD HOC DOA SHALL BE EXERCISED IN ACCORDANCE
WITH ALL THE TERMS AND CONDITIONS OF DOA 551, EXCEPT FOR
THE DOLLAR AMOUNT LIMITATION ON THE TOTAL COMBINED
PROJECT/PROGRAM AMOUNTS OF ASAP.
CHRISTOPHER
BT
#2062

NNNN

AGRICULTURAL SECTOR ASSISTANCE PROGRAM (ASAP)

PAAD SUPPLEMENT: PROGRAM NO. 612-0239

ANNEX H:

ACTION MEMO TO AA/AFR FOR CASH TRANSFER

ANNEX H

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

SEP 21 1994

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

THROUGH: *Joseph B. Goodwin*
Joseph B. Goodwin, Director, AFR/SAFROM: *Cynthia F. Rozell*
Cynthia F. Rozell, Director, USAID/MalawiSUBJECT: Agricultural Sector Assistance Program (ASAP) in Malawi
(612-0239)--Proposed Non-project Assistance Cash
Transfer

Problem: Your approval is requested for the use of the cash transfer disbursement method under the Malawi Agricultural Sector Assistance Program (ASAP), A.I.D. No. 612-0239, and to forward to Congress a request for an exemption to dollar separate account legislation pursuant to Section 537 (b)(4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act.

Discussion: ASAP was originally designed and authorized in 1991, with a three-year life of program (LOP) and a combination of NPA and project funding totalling \$30 million (\$20 million NPA and \$10 million in project assistance). The original design envisioned two phases, each authorizing \$20 million in NPA upon the successful completion of program conditionalities. However, only Phase I of NPA funding was initially approved, authorized and obligated. Project-funded activities spanning both phases of the original program were considered an integral and complementary part of ASAP since they were designed specifically to strengthen the capacity of the Government of Malawi (GOM) to implement the challenging policy and institutional reform activities envisioned under the program component. Based on the results of a mid-term evaluation, the project component of ASAP was subsequently amended in August 1993 to expand its scope and provide an additional \$5 million in LOP funding.

This Action Memorandum addresses the NPA component of ASAP, which will be amended to extend the program assistance completion date by four years to 1998, and to increase the authorized LOP funding by \$30 million for a new NPA total of \$50 million. The amended program will continue and expand the scope of the agricultural policy and institutional reform efforts aimed at promoting agricultural diversification and liberalizing markets for

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increased efficiency and equity. The ultimate aim of this program is a fully liberalized agricultural economy in Malawi, with equal access for all farmers and private investors to the means of production and marketing, without barriers to market entry.

The following information is provided in accordance with the provisions of 1993 State 261639:

A. INDIVIDUAL RESPONSIBLE FOR THE DECISION TO USE CASH:
Cynthia F. Rozell, Mission Director, USAID/Malawi

B. AMOUNT:

Previous Obligations:	\$20 million
FY 1994 obligation:	\$13 million
Revised Life of Program:	\$60 million

C. DETERMINATION OF AMOUNT: The Mission's assessment is that an additional \$40 million in NPA, in conjunction with the earlier \$20 million NPA obligations and the complementary \$15 million project support activity, is necessary to achieve the program's expanded objectives. With the democratic change in Malawi's political environment, the opportunity for equity-oriented agricultural liberalization and institutional reform is tremendous. The new government wishes to dismantle the government controls and personal privileges that have marginalized the smallholder sector and severely limited new private investment for the past three decades. In its place, they wish to construct an agricultural sector in which all farmers are free to produce the crops they wish and sell them to the buyer of their choosing at the best price that they can get. To accomplish this, thirty years of controls which have established and maintained a dualistic and discriminatory agricultural economy need to be revamped. However, accomplishing this will take time and needs to be done carefully and in a manner that is cognizant of the overwhelming dependence of Malawi on its agricultural sector for nearly 100% of its export earnings and practically all of its food security.

The funding herein proposed will enable the GOM to implement an expanded list of policy and institutional reforms which will set the stage for sustainable growth in the agricultural sector. It will also enable the GOM to implement these reforms in an orderly and logical sequence to preserve the delicate balance between maintaining current production and expanding into new and riskier investments. The financing will also allow the GOM to absorb the increased costs of institutional reform related to implementing program activities while maintaining its commitment to its on-going economic stabilization and recovery program. An economic analysis of the program and its proposed funding level has determined that the economic benefit:cost ratio is sound and that

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the financial rate of return of the proposed investments is highly positive.

D. WHAT THE TRANSFER WILL ACHIEVE: The purpose of Malawi's ASAP is to increase customary landholder (smallholder) access to agricultural inputs, output markets, cash crop production alternatives, and labor market information. To achieve the program purpose, the second phase of the ASAP program will support a range of government policy and institutional reforms influencing the agricultural sector. Policy reforms include the liberalization of input markets through (1) elimination of input subsidies; (2) liberalization of regulations and administrative procedures; and (3) elimination of policy and regulatory impediments to private trade and investment. Reforms also seek the opening of statutory bodies, the liberalization of agricultural output markets through elimination of barrier policies, price controls and regulations, and the implementation of policies to further expand smallholder market access. Finally, the program will result in the development of competitive markets through the elimination of policy and regulatory constraints to private domestic and export market development, and a reduction of bureaucratic barriers to land acquisition, free trade in agricultural commodities, and improved in commercial transport.

E. HOW SUCCESS WILL BE MEASURED: The Mission will measure the success of ASAP in achieving its goal and purpose utilizing a number of indicators. These include the following: (1) increases in real per capita smallholder incomes; (2) increases in food availability measured in calories/person/day; (3) the growth rate in employment in rural micro-, small and medium enterprises; (4) increases in agricultural export earnings; and (5) increases in the proportion of smallholder land planted to non-maize cash crops.

The major outputs expected as a result of ASAP program include: (1) a liberalized and more efficient system for the delivery of agricultural inputs to smallholder farmers; (2) a liberalized and more efficient system for the marketing of smallholder produce; (3) the emergence of expanded domestic and export markets for smallholder agricultural produce; and (4) the expansion of smallholder participation in the production and marketing of high value export crops.

F. CONSIDERATION OF ALTERNATIVE MEANS: The Mission's decision to use the cash transfer disbursement mechanism is based on considerations related to the objectives of USAID program in Malawi, the ownership of the program by Malawian government and private sector officials, and extensive information received from smallholder farmers.

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USAID is supportive of the closely coordinated multi-donor activities assisting the GOM in carrying out major structural adjustment programs. This involves the implementation of a complex policy reform agenda which aims at achieving sustainable economic growth and development. One central element of the reforms which the GOM has already enacted is the recent elimination of all exchange controls and the floating of the country's currency, the kwacha. USAID, long a strong advocate of a market-determined exchange rate system, feels that the existence and successful implementation of such a system in an environment characterized by careful government control over its financial budgeting, accounting and control procedures negates the need for a commodity import program (CIP) mechanism. The fact that no foreign-exchange financed commodity specific to implementing the program is required also reduces the justification for a CIP. In addition, the use of a CIP mechanism in Malawi would run contrary to USAID's commitment to the free exchange rate system that is operating.

There are two additional considerations that influenced the Mission's decision to use a cash transfer mechanism. First, the NPA financing will enable the GOM to increase budgetary outlays in the agricultural sector necessary to fulfill the objectives. All foreign-exchange financed commodities and services required to achieve the objectives are being provided on a project basis through the complementary ASAP Support Project. Budget resources are, however, required to facilitate the expansion of government-appropriate agricultural services to ever-increasing numbers of smallholders.

Secondly, USAID/Malawi has used the cash transfer disbursement successfully for several years in implementing sectoral programs, including in the authorization and obligation of this Agricultural Sector Assistance Program. The mechanism is well understood in the Malawian financial, commercial and government communities.

The Africa Bureau February 1, 1993 Updated DFA Procurement Policy (p. 6) provides that cash, rather than a CIP, is appropriate "where the host country foreign exchange allocation regimes are reasonably transparent and market-determined." This is the case in Malawi.

G. USE OF DOLLARS (how dollars will be spent): Malawi's foreign exchange allocation system has undergone significant and positive changes over the past year. Because the current system is free and has no exchange or administrative controls or restrictions, the Mission has determined that USAID specification of dollar uses in advance of disbursement would require that the government interfere in the allocation and use of foreign exchange in Malawi. This, combined with the demonstrated ability of the GOM to account for USAID resources, provides the Mission

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the confidence to know that USG dollar resources will be responsibly managed through the country's foreign exchange allocation system.

In 90 State 59765, the Africa Bureau's policy on the use of this exemption provides that USAID would favorably consider use of this exemption where specifying the use of dollars would be intrusive into an open, market-based FX allocation system. Malawi meets this standard.

Funds will not be obligated under this exemption until it is determined whether interest mitigation measures apply in FY 1994.

H. ACCOUNTABILITY: USAID will disburse dollar resources upon successful completion by the GOM of each set of activities associated with a funding tranche. The dollars will be disbursed directly to the Reserve Bank of Malawi's account in the Federal Reserve Bank of New York. All disbursements will be against tranching conditionalities and phased results, which are directly linked to the expected end-of-program impacts. For each tranche of the program and prior to disbursement of funds associated with the previous tranche, the GOM will submit a letter of intent which outlines the actions the Government proposes to take during the subsequent phase to achieve the program results associated with that funding tranche.

Pursuant to Section 537 (b) (4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act, USAID proposes to exempt this program from the dollar separate account and tracking requirement for the following reasons: (1) foreign exchange in Malawi can be accessed by individuals and businesses on demand/freely at market-determined rates, (2) uses of foreign exchange are not administratively determined, and (3) trade licensing arrangements are not primarily aimed at restricting imports or allocating foreign exchange. Imposing a separate account and dollar tracking system would interfere with this open, nondirective system.

The most recent RIG/A/Nairobi audit certification of the GOM's Office of the Auditor General has found it to be fully qualified to conduct and certify audits of USAID funds. Also, the Mission's most recent general financial assessment of GOM has certified that government budgeting and accounting systems were worthy of a high degree of confidence.

I. STATUS OF MISSION NEGOTIATIONS WITH THE HOST GOVERNMENT: The Government of Malawi, private sector stakeholders and beneficiaries have participated actively and extensively throughout the design of ASAP II. Representatives of the Ministry of Agriculture (MOA) and the Ministry of Finance

(MOF) and the private sector attended a series of meetings with USAID/Malawi counterparts to hear the presentations of the analytical team regarding issues being considered for inclusion in ASAP II. The Mission has discussed the draft conditionality for the ASAP amendment with MOA staff, and is working with private sector stakeholders and the GOM to organize further review meetings. The Mission has received preliminary endorsement for the major elements of ASAP II from MOA and MOF staff, with the full endorsement of the political leadership pending further discussion.

J. HOW THE PROGRAM FITS WITH THE MISSION PROGRAM STRATEGY:

The ASAP program, through its support of a comprehensive policy and institutional reform agenda in the agricultural sector contributes directly to the Mission's strategic objective to "increase agricultural productivity and production." It also supports USAID/Malawi's overall goal of "enhancing the economic well-being of the average Malawian household. The ability of USAID to incrementally disburse budget support against policy and institutional accomplishments of the GOM keeps Malawians in the leadership of both the design and implementation of the program, while it protects USG resources by releasing financing only after accomplishments have been registered; i.e., USAID funds will directly finance results, not inputs. In sum, the cash transfer approach is well-suited to our program objectives, to the liberalization of the Malawian foreign exchange market, to the Malawian business and financial environment, and to Malawian participation and management objectives.

Recommendation: That you approve the use of the cash transfer mechanism in phase II of the non-project assistance component of the Agricultural Sector Assistance Program (612-0239) and include in the Congressional Notification language to request an exemption from the Separate Account requirements for cash transfers pursuant to Section 537 (b)(4) of the 1994 Foreign Operations, Export Financing and Related Programs Appropriations Act.

Approve: *J. F. Hill*

Disapprove: _____

Date: 9/22/94

Draft:USAID/Malawi:MSarhan:AFR/SA:LKeays/Welliott:8/10/94;rev.MScovill,9/16/94
x74327:O:\SAPUB\MALAWI\DOCS\ASAP.AM

Clearances:

AFR/SA:JHale {DRAFT}Date 8/15/94
 AFR/DP:PRader {DRAFT}Date 8/15/94
 AFR/DP:JGovan {DRAFT}Date 8/15/94
 GC/AFR:MAKleinjan{DRAFT}Date 9/19/94
 DAA/AFR,CPeasley Date 9/2/

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