CLASSIFICATION:

AID 1120-1 (8-66)

PAAD

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE
APPROVAL DOCUMENT

1. PAAD NO.: 612-T-603 (612-0233)

2. COUNTRY: Malawi

3. CATEGORY: Malawi Enterprise Development Program

4. DATE: August 25, 1988

5. TO: Charles Gladson
Assistant Administrator for Africa

6. OYB CHANGE NO.: N/A

7. FROM: James Graham, AFR/PD
Acting Director, Office of Project Devel.

8. OYB INCREASE: N/A

TO BE TAKEN FROM: DFA ($15,115,000) 72-118 1014

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 15,115,000

10. APPROPRIATION - ALLOTMENT: BPC GSSA-88-31612-KG39 (814-61-612-00-53-81)

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☐ INFORMAL ☒ FORMAL ☐ NONE	9/88 - 9/91	Upon fulfillment of conditions

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $15,115,000	Other:

18. SUMMARY DESCRIPTION

See attached narrative

19. CLEARANCES	DATE
DAA/AFR:WBollinger	8/26/88
DAA/AFR:ELSaiers	
AFR/SA:LPompa	8/25/88
AFR/DP/ JGovan	8/25/88
FM/PAFD:ESOwens	8/25/88
GC/AFR:MAKleinjan	8/25/88
AFR/PD/SA:: MARiegelman	8/25/88

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE: 8/27/88

TITLE: Assistant Administrator for Africa

CLASSIFICATION:

4

<u>PAAD facesheet, Block 18, Summary Description</u>

The purpose of the Malawi Enterprise Development Program (MED) is to revitalize existing businesses and create new enterprises, particularly small and medium scale enterprises (SME's), by supporting policies directed at reducing economic, institutional, and fiscal distortions which inhibit the development of a more open, competitive, and dynamic private sector. The sector as defined for this program consists of private industrial and commercial enterprises, including agro-industry.

The MED program, which is fully justified in the attached PAAD, consists of two components: (a) a $35,000,000 policy and institutional reform component, disbursed in three tranches as a cash grant; and (b) a $1,600,000 technical services component, which is authorized by a separate project authorization. The policy and institutional reforms component will be obligated over three years and consists of $29,900,000 in DFA funds and $5,100,000 in ESF funds. This PAAD facesheet approves for obligation $15,115,000 in DFA funds.

Prior to the disbursement of the first tranche of $15,000,000 under the policy and institutional reform component, or to the issuance by A.I.D. of documentation pursuant to which such disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, evidence that the Grantee has:

i. Maintained a flexible exchange rate policy during the previous 12 months;

ii. Adcpted the first and second stages of foreign exchange allocation liberalization which covers a total of 75 percent of the 1984 base year's value of raw material and spare parts imports;

iii. Revised the Industrial Development Act to permit a streamlining and rationalization of industrial licensing;

iv. Reduced the ratio between the budget deficit and GDP for its FY 1987/88 budget to a level less than that which existed for FY 1986/87; and

v. Established a Special Local Currency Account in the Reserve Bank of Malawi for the deposit of all local currency generated pursuant to this program.

Prior to the disbursement of the second tranche of $10,000,000 under the policy and institutional reform component, or to the issuance by A.I.D. of documentation pursuant to which such disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, evidence that the Grantee has:

i. Reduced the number of items for which import and export licenses are required;

ii. Streamlined the foreign exchange approval and payment processes;

iii. Established support to the SME sector in a unit in the Ministry of Trade, Industry, and Tourism;

iv. Issued a policy statement regarding terms and conditions for the provision of funds to financial institutions involved with SME's. This policy should address, without limitation, areas such as on-lending by the GOM, measures to assure the commercial viability of the institutions, promoting access to private sources of capital, and minimizing the need for GOM resources over the long run; and,

v. Reduced the ratio between the budget deficit and GDP for its FY 1988/89 budget to a level less than that which existed for FY 1987/88.

Prior to the disbursement of the third tranche of $10,000,000 under the policy and institutional reform component, or to the issuance by A.I.D. of documentation pursuant to which such disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, evidence that:

i. The Grantee has continued liberalization of foreign exchange allocation for the import of industrial inputs, and has agreed to and implemented the third stage of foreign exchange allocation liberalization;

ii. The Grantee has streamlined import and export licensing procedures and systems;

iii. INDEFUND's and SEDOM's Deeds of Trust have been amended to allow them to extend credit to ventures involving foreign technical partners who are prepared to bring equity finance and expertise to the enterprise;

iv. The Grantee has established a SME subsector investment promotion program which maximizes the use of private sector organizations and institutions;

v. Institutional arrangements and/or mechanisms, identified through program financed studies, have been established in order to enable efficient financial intermediation; and,

vi. The Grantee has reduced the ratio between the budget deficit and GDP for its FY 1989/90 budget to a level less than that which existed for FY 1988/89.

The Grantee shall covenant, with respect to the $35,000,000 policy and institutional reform component, except as A.I.D. may otherwise agree in writing, that:

i. Information regarding foreign exchange applications will be provided to A.I.D upon request to permit monitoring of program performance and any subsequent impact evaluation that might be conducted.

ii. It will maintain a flexible exchange rate from the date of the program agreement until one year after the final dollar disbursement.

iii. It will conduct annually a joint review of the A.I.D. bilateral program, which will include a joint determination of the specific uses of the local currencies generated under the program, within the parameters established below.

The funds in the Special Local Currency Account shall first be used in support of the sector program objectives, to the extent permitted by the budget limitations established by the Policy Framework Paper as negotiated or amended with the IMF and the World Bank. This is subject to the proviso that 10 percent of each tranche of local currency counterpart funds deposited into the Special Local Currency Account shall be made available for the needs of the United States in conducting its assistance program in Malawi. Any remaining funds in the Special Local Currency Account not used for the above purposes shall be used for other development purposes as mutually agreed by the Parties. The local currency will be disbursed over a period of up to six years.

AA/AFR hereby delegates authority to the Director of USAID/Malawi to amend the PAAD facesheet to increase the funding for the policy and institutional reform component of the MED program, up to a total life of program funding level of $35,000,000, in accordance with the basic terms, conditions, and covenants of the PAAD as approved herein.

MALAWI ENTERPRISE DEVELOPMENT PROGRAM
(MED)

612-0233

PAAD

4

MALAWI ENTERPRISE DEVELOPMENT PROGRAM

TABLE OF CONTENTS

	Item	Page
	Action Memorandum to the Assistant Administrator	
	PAAD Facesheet	
	PP Facesheet	
	Project Authorization	
	Table of Contents	1
I.	SUMMARY AND RECOMMENDATIONS	5
II.	ANALYTICAL FRAMEWORK AND SECTOR ANALYSES	8
	A. The Economic and Policy Context	8
	1. The Economic Environment	8
	2. The Policy Environment	8
	B. Macroeconomic and Employment Analyses	9
	1. Macroeconomic Overview	9
	2. Implications of Macroeconomic Situation for MED Program Priorities	11
	a) Introduction	11
	b) Foreign Exchange Availability	12
	c) Domestic Credit Availability	15
	d) Inflation	16
	3. Analysis of Employment	17
	a) Introduction	17
	b) The Contribution of Small and Medium Enterprises to Employment Generation	19
	c) Smallholder Agriculture	21
	d) International Migration	22
	e) Wage Structure and Policy	22
	C. Defining MED Program Priorities and Linkages to USAID/Malawi's Program	25
	1. Increasing Utilization of Industrial Capacity and Labor	25

x 9

2. Broadening the Foundation for an Open and Competitive Economy 26

3. Expanding Employment Opportunities 26

D. Sector Financing Requirements 29

III. PROGRAM DESCRIPTION 30

A. Problem Statement and Program Rationale 30

B. Program Goal and Purpose 31

C. Policy Reform Agenda 33

D. Description of Program Activities 34

1. Introduction 34

2. Policy Reform Conditionality Matrix 34
a) Reform Objectives 34
b) Progress Indicators 35
c) Conditionality and Tranching 37
1) Conditions Precedent to Initial Disbursement 38
2) Conditions Precedent to Second Disbursement 38
3) Conditions Precedent to Third Disbursement 39
d) Covenants 40
e) Monitoring and Assessment 40

3. Policy Dialogue and the Role of Project Financed Activities 41
a) Deepening Reforms 41
b) Technical Assistance 42
c) Studies 42

4. Social, Political, and Environmental Risks and Implications 43

a) Background 43
b) Structural Adjustment and Poverty Alleviation in Malawi: An Overview 44
c) Potential Effects of the MED Program on the Vulnerable 46

5. Relationship with USAID's and Other Donors' Activities 48

10

IV. FINANCIAL ARRANGEMENTS 49

A. Illustrative Budget 49

B. Obligation Plan 50

C. Disbursement Mechanism 50

D. Local Currency Use Plan 50

1. Trust Fund 51

2. Sector Support and Other Developmental Uses 51

3. Reporting and Monitoring 52

V. MANAGEMENT ARRANGEMENTS AND EVALUATION PLAN 53

A. Management 53

1. USAID/Malawi 53

2. Government of Malawi 54

3. Contractors 54

4. RIG and REDSO 54

B. Contracting Mechanism and Nationality of Services 55

C. Methods of Implementation and Financing 56

D. Evaluation and Audit Plan 56

VI. STATUS OF NEGOTIATIONS WITH GOM 57

ANNEXES

A. MED Program Policy Reform Matrix

B. Statistical Tables

C. Analysis of Structure of Industry and Commerce

D. PAIP Cable

X

11

E. Statutory Checklist

F. Letter of Request from Government of Malawi

G. Draft Program and Project Grant Agreements

H. Bibliography

I. Initial Environmental Examination

I. SUMMARY AND RECOMMENDATIONS

The $36.6 million Malawi Enterprise Development Sector Assistance Program supports the policy reforms being initiated by the Government of Malawi to create a more open, competitive and dynamic private sector which will be the engine for sustained economic growth and increased employment opportunities for a rapidly growing labor force. The program concentrates on three areas. The first is removing the immediate constraints to increasing the utilization capacity of existing enterprises and labor employed in the private sector. The second is establishing a more open and competitive environment for the creation of enterprises, particularly small and medium ones. The third is to enhance the employment absorptive capacity of the economy by increasing opportunities for more labor intensive small and medium enterprises.

Up until the end of the 1970's, Malawi experienced remarkable economic growth. Annual GDP rose on average 6 percent and annual per capital income grew 3 percent. While government policy favored the development of estate agriculture and industry, the period was marked by few macroeconomic distortions and constraints on private sector growth. There were few restrictions on imports and the exchange rate was essentially market determined.

By 1979, the economy had reached a turning point. Malawi's balance of payments position had deteriorated sharply due to excess borrowings in the light of soaring oil prices, plummeting world prices for its agricultural exports and the gradual closure of its traditional trade routes through Mozambique. To contain its growing fiscal deficit, the GOM took steps to increase its revenues through expanded duties, taxes and tariffs, many of which had adverse effects on production. As the deficit continued to mount, the Government became the major consumer of domestic credit, crowding out further the private sector.

The GOM responded quickly to these deteriorating circumstances in the 1979-81 period through the launching of a series of Structural Adjustment Loans with the World Bank and stand-by arrangements with the International Monetary Fund. While the SAL's over the period 1981-86 resulted in noticeable improvements in the larger macroeconomy and in the efficiency with which resources were allocated, it became increasingly clear that greater attention needed to be focused on problems of expanding industrial capacity and increasing the productivity of smallholder agriculture. In late 1987, the GOM began discussions with the World Bank and other donors including A.I.D. for a major program focused on strengthening the industrial and commercial sector and stimulating the expansion of export industries. This led to the development of the World Bank's Industrial and Trade Policy Adjustment Credit Program and the A.I.D. Malawi Enterprise Development Program.

X 13

It should be noted in passing that during the course of the next year, A.I.D. will join hands with the World Bank in addressing the question of enhancing productivity in agriculture. This will begin with an Agricultural Policy Symposium to be financed by USAID/Malawi and held in November 1988. This symposium coupled with further policy studies and assessments of problems in smallholder agriculture will establish the basis for a proposed major agricultural policy reform program in FY 1991.

The analyses of the economy, industry and employment which form the basis for the MED Program concluded:

1. Years of restrictive Government policies largely directed at providing the Government with the necessary resources to combat a growth in the public sector deficit and mounting inefficiencies in the parastatal sector have eroded the capacity of the private sector to serve as an engine of economic growth. While the three SAL's have gone a long way in correcting these imbalances, a more focused and concentrated effort is required at this point in time. The single most important need to redressing the problem in the immediate future is to expanding the access of the private sector to foreign exchange to finance raw materials, spare parts, and intermediate capital goods. This will stimulate an increase in utilization of existing industrial plant capacity and contribute to increased utilization in the existing industrial labor force. Given the urgency of tackling the problems associated with underutilized industrial plant capacity and labor, the first tranche release of $15 million under MED is focused on policy reforms associated with a freer and easier access to foreign exchange and continued reductions in the public sector deficit.

2. If industry and commerce are to expand, it is necessary to establish a more supportive economic, institutional, and financial environment which aggressively promotes the expansion of enterprises and private sector initiative. This involves continuing to eliminate the competition by Government for scarce domestic credit resources combined with innovations to generate an expansion in institutional mechanisms for channelling domestic savings into the private sector. This obviously requires continuing to restrict Government demand for domestic credit while maintaining real positive interest rates and a foreign exchange rate which reflects market conditions. Therefore, MED's second tranche of $10 million has conditionalities which build on reforms to open up and establish greater competition in the economy.

3. The analysis notes that Malawi's economy will have to increase its ability to offer employment opportunities to a rapidly expanding labor force. While an open and competitive environment will help, it is insufficient. The key to enhancing the labor absorptive capacity of the economy is to ensure a policy framework which supports the growth of small and medium enterprises. This does not mean establishing a set of discriminatory policies and

programs but rather breaking down and eliminating the institutional and financial barriers which restrict the expansion of SME's. Malawi's low wage policy has established a favorable macroeconomic environment for the development of labor intensive enterprises. For this reason, both the second tranche and the third tranche of $10 million focus on increasing the competitiveness of SME's and removing those constraints which work against their expansion.

MED is a program which closely parallels the World Bank's ITPAC during the first year by focusing on broader macroeconomic and institutional constraints to enterprise expansion. As it moves into years two and three, it continues to complement the Bank's ITPAC but places greater emphasis on policy reforms directed at SME development and employment generation.

Of the total planned $36.6 million in USAID's contribution to MED, $35 million will be disbursed to support policy reforms. As indicated above, disbursements will be made in three tranches ($15 million, $10 million, and $10 million). The first tranche is expected to be released shortly after initial obligation of funds at the end of August. The GOM is expected to have met the policy conditionality associated with this first tranche at that time. The second tranche is likely to be disbursed in the third quarter of FY 1989 with the third tranche occurring in the same quarter of FY 1990. Release of the second and third tranches will be based on progress in satisfying the key indicators outlined in the PAAD. As part of its implementation of the program, USAID/Malawi will continue to monitor progress toward the attainment of these indicators. The Mission will be supported in this by technical assistance and studies financed from the $1.6 million project component of the program.

The $1.6 million for project assistance under the program will not only support the Mission efforts to monitor and track the program but also to assist the Government of Malawi to achieve its policy reform objectives. The technical assistance, studies and training will permit the Government to explore in greater depth how to best meet its reform objectives. These resources might be thought of as funds to deepen and enrich the policy dialogue and reform processes.

The GOM's staunch and determined commitment to undertake difficult policy reform and to rely increasingly on the private sector to establish the foundation for long-term growth deserves the support of A.I.D. USAID/Malawi has played and will continue to play a critical role in the ongoing process of reform in Malawi.

X

15

II. ANALYTICAL FRAMEWORK AND SECTOR ANALYSES

A. The Economic and Policy Context

1. The Economic Environment

Malawi is a landlocked economy bordered by Tanzania, Zambia, and Mozambique. The topography is varied. Much of the land is mountainous, 20 percent of the country is water, and approximately 36,200 square kilometers are fertile land that supports a variety of temperate, tropical, and subtropical crops. Its limited mineral deposits are not commercially viable at this time.

The country has three administrative regions. The Southern Region is where most of Malawi's commercial and industrial sector is found. The Central Region is a fertile high plateau where the administrative capital, and thus most government activities, are centered. Both the Southern and Central Regions are well populated. Fertile land has become an important constraint to agricultural production. Already, some 30 percent of smallholders cultivate 0.7 hectares or less, hardly enough to support the average family. The Northern Region although sparsely populated is mountainous, relatively infertile, and has little industrial activity.

The economy is dominated by agriculture. There is a modest industrial sector based largely on agro-processing and simple import substitution activities. 89 percent of the population resides in rural areas; only 11 percent of the population is urban. At present, agriculture accounts for 36 percent of GDP, manufacturing contributes 12 percent and construction and services make up the remaining 52 percent of GDP. Despite the relatively small share of agriculture in the total value of the nation's output, the farm sector employs 88 percent of the labor force, with the manufacturing and construction and services sectors contributing approximately 3 percent and 4 percent, respectively, to total employment. On account of slow growth, particularly in the smallholder agricultural sector, incomes have remained virtually stagnant for several years and have declined since the mid-1980's. Average GDP per capita was $160 in 1987, making Malawi one of the poorest countries in the world.

2. The Policy Environment

The GOM is committed and receptive to policy dialogue and policy reform as exhibited by its strong determination to tackle its economic problems since the early 1980's. There has been no tension between the GOM and the donor community regarding the acceptance of often difficult policy choices. Under the conditionalities of past structural adjustment loans by the World Bank and others in the donor community and of standby stabilization credits by the IMF, the GOM has embarked on major policy changes largely favoring competitive efficiency in a more open economic environment. Unfortunately, since the adjustment process started in 1981, external events, particularly the drop in the economy's external terms of trade, the closing of Malawi's traditional external trade routes to the Mozambican ports and the huge influx of Mozambican refugees, have diminished much of the initial impetus to growth resulting from these reforms. Nonetheless, the economy continues to show resilience. A remarkable achievement has been its ability to grow, albeit at a modest 3.7 percent average annual rate in real GDP terms, during the difficult 1982-86 period following structural adjustment.

B. Macroeconomic and Employment Analyses

1. Macroeconomic Overview

For a decade and a half following independence in 1964, Malawi experienced remarkable economic growth. Annual GDP rose on average 6 percent and annual per capita income grew 3 percent. This strong economic performance was accompanied by a considerable restructuring of Malawi's traditional economy largely favoring growth. Development policy emphasized estate production of tobacco, tea and sugar for exports and the emergence of a manufacturing sector linked to the processing of agricultural commodities and to simple import substitution. There were also few macroeconomic distortions during this period. The economy remained relatively open with low import or protective duties and reasonable exchange rate interventions. Government expenditures remained within tolerable bounds and annual inflation over the 1973-79 period averaged a modest 8.2 percent.

By 1979 however, the economy reached a turning point (see Annex B, Table 1). Malawi's balance of payments position deteriorated. Because of soaring oil prices, plummeting world prices for its agricultural exports, and the gradual disruption of the country's traditional trade routes to the Mozambican ports, the economy's terms of trade dropped by some 28 percent between 1978 and 1981. The effects of these external shocks were compounded by domestic drought in 1979-80 which forced the government to import maize in 1980-81 and by the growing weakness in the management of parastatals. To finance existing demand levels amidst growing external and internal difficulties, the government resorted to deficit spending largely by contracting foreign debt at commercial rates. To contain the growth of its fiscal deficit, the government also increased import duties, its principal source of revenue. These hardly solved the pressing balance of payments and budgetary difficulties as the current account deficit averaged 18.4 percent of GDP and the fiscal deficit was 8.7 percent of GDP in the period 1979-81, up from 9.5 percent and 6 percent, respectively, for the period 1973-78. Real GDP, which managed to rise 3.3 percent in 1979, dropped 5.2 percent in 1981.

The economic downturn in the 1979-81 period convinced the government of the need to improve its deteriorating domestic and external financial position in the short term and of the importance of restructuring the economy to improve Malawi's medium and long-term economic performance within the context of manageable internal and external disequilibria. A broad based structural adjustment program was started in 1981 supported by Malawi's first structural adjustment loan (SAL) from the World Bank, also cofinanced by the donor community. Successive standby credits by the IMF supported short-term stabilization efforts. There have since been three SAL's and a SAL supplement supporting an overall program to rationalize agricultural and industrial prices (with the removal of most price controls and subsidies), improve government resource mobilization and use, rehabilitate and/or restructure key public institutions and parastatals, and rationalize domestic interest rates and the exchange rate with the general move towards liberalization.

Malawi, unlike many of its African neighbors, has demonstrated a willingness to undertake often painful structural reforms. Indeed, the immediate consequence of the broad based programs under the SAL's was a reduction in the fiscal and current account deficits in 1982-85 and the resumption of economic growth as real GDP rose at a 3.7 percent annual rate during this period. Unfortunately, this resurgence was short-lived as the terms of trade gradually deteriorated (dropping 18 percent from 1982 to 1985) and rail links to Beira and Nacala in Mozambique were closed completely in end-1984 as a result of persistent insurgent attacks. Moreover, expenditures on debt servicing, while temporarily checked by a debt rescheduling in 1982, rose from 6.3 percent of GDP in 1982 to 14.1 percent in 1986. Also, the influx of Mozambican refugees into Malawi further strained an already overburdened economy. In order to accommodate increasing nondevelopmental expenditures within the confines of fiscal restraint, government fixed investments dropped to 8.6 percent of GDP in 1982-85 from 14.5 percent in 1979-81. Total gross fixed investment dropped to 13.6 percent of GDP in 1982-85 from 21.4 percent in 1979-81, undermining future growth prospects and contributing only to furthering overall recessionary pressures. Not coincidentally, real GDP grew only 2.8 percent in 1986 and dropped 0.2 percent in 1987. Real per capita GDP in 1987 was only 1.7 percent higher than in 1979.

While structural adjustment in 1982-85 resulted in noticeable gains in reducing Malawi's fiscal imbalances and current account shortfall, it failed to reverse completely these twin deficits. In response to the persistence of these macroeconomic disequilibria, government responded with devaluations of the Kwacha (see Table 2), stricter pre-approval rules for imports including the tighter allocation of foreign exchange and the drawing down of international reserves. It also reverted to increases in taxes and tariffs as revenues from import duties dropped with the curtailment of imports. The government established limits to civil service wage increases, further reduced public capital expenditures, and improved the monitoring and control of the budget. Local interest lending rates were liberalized to improve domestic resource allocation while deposit rates were increased to encourage domestic resource mobilization.

While the balance of payments position improved in 1987, the successive devaluations of the Kwacha by 20 percent in February 1987 and by 15 percent in January 1988 have not significantly improved the balance of trade surplus. Malawi's improved external competitiveness from these devaluations was immediately eroded by domestic inflation. Fortunately, higher net transfers have improved the capital account. However, debt servicing has become more difficult on account of the Kwacha's devaluation. In 1987, the debt-service ratio was 46.1 percent. A rescheduling of Malawi's commercial and bilateral debt was approved by the Paris and London Clubs on April 22, 1988.

At present, the government still faces a host of macroeconomic problems. The continued influx of displaced persons from Mozambique threatens to increase unbudgeted expenditures on food and security and could subvert government measures to limit fiscal spending. Foreign exchange remains scarce and will continue to remain so unless agricultural prices and hence agro-based exports pick up in the near term. This lack of foreign exchange has already cut back production and labor earnings in the industrial sector which remains heavily import dependent. There is a program to loosen foreign exchange availability by gradually withdrawing the number of commodities under import control. However, this hardly guarantees the availability of foreign exchange even in the medium term unless this liberalization program is complemented by successes in increasing agro-based exports.

The GOM faces huge external financing gaps through the early 1990's. These external resource requirements can only be addressed by increased concessional assistance. Assuming that the real GDP increases 1.5 percent this year, 4.0 percent in 1989 and 4.3 percent in 1990, the economy's total financing requirements according to World Bank estimates are $263.4 million, $291.9 million, and $282.2 million, respectively. After factoring in disbursements from existing and anticipated external commitments to Malawi, including the recent debt relief from the London and Paris Clubs, the total net external financing gaps that remain are $0.0 for 1988, $24.2 million for 1989, and $40.1 million for 1990. It should be noted that in calculating these funding gaps both the GOM and World Bank have included the proposed $35 million in foreign exchange under the MED Program.

2. <u>Implications of Macroeconomic Situation for MED Program Priorities</u>

a) <u>Introduction</u>

Improving the macroeconomic environment, in particular, the domestic and external financial position of the economy, is an important prerequisite for sustained growth. However,

X 19

complementary and more focused sectoral programs are also necessary to address directly the question of poverty and of growth itself. Although progress on the agricultural front is crucial for poverty redressal and sustained economic growth in Malawi, there are immediate and sizable gains from a program such as A.I.D.'s MED and the World Bank's Industrial and Trade Policy Adjustment Credit (ITPAC) Program designed to revitalize and develop enterprises and generate employment in the non-agricultural economy. Increasing nonfarm employment, particularly through the promotion of SMEs in simple manufacturing and commercial activities, is complementary to an overall thrust towards agricultural development. SME activities (such as the manufacture of hand tools, furniture and simple building materials; the processing of food and cash crops; and the transport and distribution of these products) are not only labor intensive but generally require less foreign exchange as well. They also absorb redundant labor (or those who are seasonably underemployed or unemployed particularly in smallholder agriculture), thereby increasing rural labor productivity and wages. Finally, SME development provides a formal and viable link between the agricultural and industrial sectors from which the industrialization process can evolve.

The success of any program to generate employment in the industrial sector, whether it be based on large scale enterprise development or the promotion of small and medium scale enterprises, depends on a conducive macroeconomic policy environment. In Malawi, there are a number of macroeconomic conditions that constrain the performance of the manufacturing sector. These include the lack of regularly available foreign exchange, domestic credit, skilled labor and management, and reliable transport routes and facilities. While those constraints are felt most severely by larger enterprises, they also constrain the development of medium and small scale enterprises, albeit to a lesser degree. It is important to understand these for they establish the broad context in which MED will operate. They also indicate the importance of addressing these constraints in the initial year of MED, for they form the very basis on which MED's efforts to stimulate competition and open up opportunities for SME's depend.

b) <u>Foreign Exchange Availability</u>

Because of the chronic balance of payments difficulties, a system of foreign exchange allocation has been in place in Malawi for some seven years now. While initially intended as a temporary measure, controls on the use of foreign exchange gradually became more stringent despite a relatively flexible exchange rate policy. For one, the government crowded out the private sector in foreign exchange use such that by 1986, the share of private sector imports in total imports was only 44 percent, down from 65 percent in 1982 (see Table 3). Moreover, the difficulties in prioritizing importers' claims to scarce foreign exchange made for a discretionary allocation system (see Table 4). And because of

20

difficulties encountered in forecasting receipts of foreign currencies, this problem was compounded by backlogs in payments to foreign suppliers of up to 18 months.

In all, difficulties with obtaining regular allocations of foreign exchange, while effectively and severely compressing imports, have also cut back value added if not capacity utilization in Malawi's industrial economy. Although the foreign exchange scarcity has forced local companies to look for alternative domestic sources of inputs, industry still imports 66 percent of its total raw material needs. Only the food processing (at 34 percent) and textile and clothing (at 34 percent) industries have less than 50 percent import content. The cement and glass industry has a 54 percent import content, the third lowest among the industrial subsectors (see Table 5). It is therefore not too surprising that actual capacity utilization in the industrial sector is only 47 percent, with utilization rates of over 70 percent found only in the local food processing (at 70 percent), textile and clothing (at 72 percent) and cement and glass (at 77 percent) industries. The infusion of foreign exchange in the economy over a sustained period, if made accessible to the private sector, would immediately increase total value added if not capacity utilization in Malawi's industrial economy.

With the support of the IMF, the World Bank, and planned A.I.D. assistance, the government has recently embarked on a program to liberalize progressively existing quantitative restrictions on the approval of foreign exchange applications with respect to private sector imports, while maintaining its flexible exchange rate policy. In February 1988, prior foreign exchange allocation approvals comprising 25 percent of imports raw materials and industrial spare parts (including fertilizer, agricultural chemicals, and petroleum) were removed. In all, this liberalized list comprises 25 percent of the total import bill. A second stage, announced for implementation on August 8, 1988, expands coverage to 75 percent of total raw materials and industrial spare parts including a small amount of finished manufactures. Subsequent liberalization measures will be according to resource availability and will be determined by the government with the collaboration of the World Bank and the IMF. Total liberalization will be phased in over three years. Parallel to this program to remove the foreign exchange allocation system is the removal of import licensing requirements which at present cover 15 percent of the total import bill under 34 specific categories and all goods from some 34 countries. These licensing requirements will be dropped to 7 categories and 22 countries.

The World Bank, in cooperation with major donors, has recently approved an Industrial and Trade Policy Adjustment Credit (ITPAC) program for Malawi aimed, in part, at supplying foreign exchange support for this import liberalization effort. A.I.D.'s MED program, while different in thrust from the overall ITPAC

x 21

reform program, is complementary to it inasmuch as MED will promote enterprise development and employment generation in the industrial/commercial sector and provide $35 million in foreign exchange over three years. Under a more liberal import environment, ITPAC and MED funds allow the industrial sector to meet most of its immediate foreign exchange needs. Production bottlenecks arising from the present rationing of foreign exchange would ease, allowing increased capacity utilization and output and some expansion of employment in the industrial sector.

A corollary to increasing capacity utilization is diversification of the export base. The Malawi Government and the World Bank have therefore considered various steps to diversify and promote both traditional and nontraditional exports. These include the simplification of export procedures, tax incentives for exporters, the creation of an export revolving fund, strengthening the institutional capabilities of the Malawi Export Promotion Council, and the continuation of a flexible exchange rate policy. These are components of the ITPAC program.

While the MED program does not itself directly answer the full range of needs to promote exports, other USAID/Malawi programs indirectly contribute to it and re-inforce the objectives of MED and ITPAC. These include:

1. Assistance to increase agricultural diversification with a shift to higher value cash crops in the Malawi Agricultural Research and Extension (MARE) Program (612-0215);

2. Promotion of agricultural processing industries in the Rural Enterprises and Agribusiness Development Institutions (READI) Project (612-0214);

3. Improvement of new international routes in the Northern Transport Corridor Project (690-0237);

4. Development of a Malawian international trucking capacity in the Commercial Transport Project (612-0218); and

5. The planned Regional Rail Systems Support Project (690-0247).

The program's medium term goal is one of import substitution without the usual protectionist wall of administered import quotas. By fostering less import dependent industrial and commercial SME activities, the MED program will decrease the average import content of locally manufactured goods as well as the need to import some finished consumer goods in the medium term. This will also decrease dependency on commodities imported from the Republic of South Africa. While SME's will still require some foreign exchange for certain basic imports, unlike the case with

22

increasing and sustaining capacity utilization rates in existing large scale industries, the success of the MED program is not as crucially dependent on a long term solution to Malawi's chronic foreign exchange difficulties.

Unfortunately, existing foreign exchange allocation procedures do not distinguish requirements of industrial enterprises according to size. Although SME's presumably require less foreign exchange per unit of output than their large scale counterparts, there remains the pressing need to study and monitor among other things, the foreign exchange and import requirements of SME's and their means of access to these scarce resources. This would help policy makers establish strong guarantees that SME's are not crowded out by the foreign exchange allocations to government and large scale enterprises, particularly in the rationing of foreign exchange during the import liberalization process.

c) <u>Domestic Credit Availability</u>

The Government of Malawi is committed to increasing private sector activity by removing the administrative system of foreign exchange allocation, continuing its support of a liberal pricing system, simplifying rules and regulations pertaining to industrial investments, maintaining appropriate interest rate levels to encourage savings and improve the efficiency of capital allocation, and strengthening the institutions and increasing the resources devoted to the promotion of SME's. It is also committed to maintaining fiscal discipline by reducing the fiscal deficit to a level that can be financed entirely by concessional foreign loans and grants. This is not only to dampen domestic inflationary pressures but also to guarantee that adequate domestic resources are made available to the private sector.

Much of the burden for financing the budgetary deficit has fallen on the private sector not only by way of higher inflation and tighter access to foreign exchange but also through a domestic credit squeeze. In the past, the government has relied increasingly on domestic credit to finance the public deficit. Except from 1981 to 1984 when government restraint on domestic credit use was achieved, the central government's share (excluding statutory bodies) in total net domestic credit has soared from 24.5 percent in 1979 to 65.9 percent in 1987. Meanwhile, the share of private sector claims has dropped considerably, from 63.9 percent in 1979 to 27.6 percent in 1987 (see Table 6).

This crowding out of private sector access to domestic credit has, of late, been partly attenuated by the build up in the liquidity of companies and commercial banks following the increase in nominal interest rates in mid-1987. The continuation of a market determined interest rate policy should help in the mobilization of domestic savings for private use and help finance private sector expansion within the framework of a tight monetary policy. Perhaps more importantly, market determined interest rates better discriminate between efficient and inefficient uses of available credit. In the context of the MED program, this should contribute to SME development inasmuch as relatively higher interest rates encourage labor rather than capital intensive industries. The Government targets a 24.2 percent increase in credit to the private sector in 1988/89.

While better access to domestic credit should improve the overall performance of the industrial/commercial sector, larger enterprises are still likely to gain more than SME's. Formal credit is less accessible to SME's not only because of physical distances between where commercial banks (or other intermediaries) are located and where SME's operate but also because of the lack of collateral and/or credit guarantees among SME entrepreneurs. As with the case of foreign exchange, there is the need to monitor SME credit requirements and their access to it through formal financial channels. This would help policy makers formulate measures to guarantee reasonable SME shares in total domestically available credit.

At present however the Government hopes to strengthen and expand SME operation by providing financial and technical assistance, with donor assistance, to existing SME development groups such as the Small Enterprise Development Organization of Malawi (SEDOM), the Investment and Development Fund (INDEFUND), and the Malawian Entrepreneurs Development Institution (MEDI). As a program dedicated to SME development, the MED program will reinforce GOM's commitments in this area. This can be achieved by guaranteeing full funding of Government activities relating to SME development that are presently in the Government's Public Sector Investment Program (PSIP). The MED program would then help address the need to study and develop institutions such as a credit guarantee scheme for SME's while expanding both the quality and extent of technical assistance and the pool of funds available for lending to SME's.

d) <u>Inflation</u>

On account of government deficit spending, the liberalization of most price controls, and the increased cost of manufactured goods because of successive devaluations of the Kwacha and the high cost of transport, consumer prices rose an average 14.9 percent annually in the past five years. Inflation peaked in 1987 when the composite consumer price index soared 26.8 percent. This has adversely affected the vulnerable groups, particularly the poor on fixed incomes or who are net consumers of food.

To contain future inflation, the government is committed to reducing the fiscal deficit to 8.1 percent of GDP in 1988-89, down 2.6 percent percentage points from the previous fiscal year. This is within the guidelines set in cooperation with the IMF and will be achieved by raising revenues through increases in the surtax

24

rate, excise taxes, company and personal taxes and licenses and fees and by decreasing expenditures by, among other things, freezing government wages and civil service employment. As agreed with the IMF future budgetary deficits as a proportion of GDP should progressively decline according to the following deficit/GDP ratios by 1989/90 to 6.8 percent; 1990/91 to 6.2 percent; and 1991/92 to 5.2 percent. Thus, the present program of broadening the revenue base and improving the control and efficiency of government expenditures is expected to extend beyond this fiscal year.

Further liberalization of price controls is not likely to result in significant price increases in the foreseeable future. At present, only five critical commodities (low-grade meat, fertilizer, fuel, sugar and vehicle spare parts) are subject to price controls. This is well below the 50 price controlled commodities at the start of the structural adjustment program. Thus, the gradual price decontrol for low-grade meat as planned and periodic adjustments of other controlled prices should result in only minor inflationary pressures. What has perhaps more strongly pushed up inflation in the more recent past is the spiraling cost of imports because of the devaluations of the Kwacha and the continued high cost of external transport. The injection of $35 million in foreign exchange under the MED program would help alleviate downward pressures on the value of the Kwacha and forestall inflationary pressures from this source. Also, expected increases in the outputs on the domestic industrial sector on account on easier access to foreign exchange with liberalization should help contain local price increases.

Within the context of the MED program, however, caution will be exercised so as not to build up domestic inflationary pressure in the process of allocating $35 million in Kwacha counterpart funds in the economy. By carefully spacing the release of these funds over several years and by funding only those budgetary items in the Public Sector Investment Program and the GOM's approved budgets expenditure/development which directly contribute to the purpose of the MED program and/or USAID's overall investment strategy, local spending under the MED program can be brought in line with government's budgetary guidelines as has already been set in coordination with the IMF. This is discussed in more detail in the Program Description part of the PAAD.

3. <u>Analysis of Employment</u>

a) <u>Introduction</u>

While improving the macroeconomic environment is important to establish the foundation for growth, it is essential that this growth provide jobs for a growing labor force. The heart of the difficulty is that the present and expected size of the labor force is simply too large to be absorbed by formal sector employment alone. The fault does not lie in the slow rate of growth of formal sector employment, but rather, in its extremely low base. Under even the most optimistic scenarios, growth of formal sector employment simply cannot absorb the growing number of new job seekers. The result is that some of the unabsorbed labor force will join the growing ranks of the unemployed, a large fraction will remain underemployed in smallholder agriculture, and some will be absorbed in informal activities.

Population growth remains the primary impetus to labor force growth in Malawi. Current and expected population growth rates for Malawi are high. This is largely the result of high and sustained birth rates and small and moderate declines in mortality rates. The total fertility rate of 7.8 percent in 1982 is among the highest for low income countries in sub-Saharan Africa. Furthermore, the population is very young (46 percent of the population is less than 15 years of age) and population density is on the rise. Nonetheless, urbanization is very low (11 percent of the population resides in urban areas as of 1987), although it has been increasing at a relatively rapid pace of 7.0 percent per year from 1966 to 1987 (see Table 7). The population pressure is translated into estimates of annual labor force growth of 3.2 percent to 4.0 percent over the next ten to thirty years. If labor force participation rates remain relatively unchanged over the next five years, economic activity will have to generate from 110,000 to 130,000 new jobs each year to preclude increases in labor underutilization. Unfortunately, if total employment continues to grow as it has over the last ten years, the economy will experience a shortfall in jobs for approximately 30,000 to 36,000 workers per year over the next five years.

The slowdown in economic activity which has characterized the 1977-86 period is reflected in the growth of formal sector employment over the period. From 1968-77 formal sector employment grew rapidly, largely due to the expansion of the agricultural estate sector. The estate sector drew considerable labor from smallholder agriculture as formal rural farm employment more than tripled over that period. Rural wage data is notoriously poor, and it is not possible to conclusively determine the direction of wages in the estate sector during the 1970s. But low productivity and increasing population pressure on smallholder land in conjunction with limited off-farm employment opportunities fomented labor mobility from the subsistence smallholder sector to commercial farms with little upward pressure on wage rates. Increased commercial lending and considerable acreage expansion (a ten-fold increase between 1970 and 1980) in tobacco estates provided the appropriate environment for the growth of the sector during the 1970s. Between 1977 and 1986 the growth of the estate sector slowed considerably as constraints to land availability tightened. The estate sector cannot, and should not, be counted upon to lead formal sector employment as it did during the 1970s.

The future growth of formal sector employment depends on industry and commerce. (See Annex C for a fuller discussion of the structure of industry and commerce.) Industry and commerce were the only areas to increase employment at a faster rate than the labor force from 1977-86 (see Table 7). After 1977 it surpassed formal agriculture (excluding smallholders) to become the largest employer in the formal sector. However, in relation to total employment, industry and commerce remains small. Only 8.1 percent of total employment is in formal nonfarm activities as of 1986 (see Table 8). The expansion of this sector is due, in good measure, to wage policies that encourage labor intensive development. But a host of bottlenecks in the form of inadequate infrastructure, foreign exchange constraints, limited managerial expertise and entrepreneurial development, and insufficient domestic demand have prevented industry and commerce from becoming a major contributor to employment. The development of this sector, in conjunction with rising agricultural productivity, holds the key to sustained economic development in Malawi.

Government plays a major role in the labor market, both as a large employer of the labor force as well as a regulator of the structure of wages. Public sector employment and employment in parastatals (statutory bodies) makes up over thirty percent of total formal sector employment (see Table 10). Although the budgetary difficulties of the GOM have slowed the growth of employment in central and local government, this has not been the case in parastatals. But recent attempts to rationalize parastatal activities has limited their expansion and enhanced accountability and competitiveness. Many of the large parastatals such as ADMARC have seen substantial reductions in their employment. Thus, private sector employment must be encouraged to fill the employment gap left by the decline of public sector involvement in administrative and private enterprise activities. Increased opportunities to compete in areas traditionally open only to parastatals should stimulate private sector enterprise development.

It is unlikely that immediate structural reform, resulting in needed foreign exchange, will promote substantive employment generation in the short run. Apparently, firms have adjusted to the economic slowdown by holding the line on nominal wage increases and allowing real wages to decline sharply rather than reducing their workforce. Thus, unused capacity due to an inability to obtain needed imported inputs (via the foreign exchange constraint) is reflected in idle machinery and underemployed labor. In the longer term, structural reform of industry will allow existing firms to use their labor force more effectively and add to their productive capacity.

b) <u>The Contribution of SME's to Employment Generation</u>

Elimination of institutional and structural constraints to private sector expansion as embodied in MED and ITPAC will provide the necessary stimulus for Malawi to effectively confront its present and future employment problem. In this regard, the expansion of SME activities will be especially important if employment growth is to keep pace with the growing labor force.

The majority of private sector establishments are small scale enterprises employing less than 20 workers. Approximately 55 percent of all private sector establishments are small scale, a figure that has remained relatively constant over the last four years (see Table 11). However, this constancy masks important differences among industry groups. The majority of commercial agricultural activities employ 50 or more employees, a trend that appears to be on the increase. Industrial sector activities, primarily manufacturing and construction, are predominately small scale, although there is an increasing trend toward larger scale enterprises. In contrast, the commercial sector is largely small scale and will continue so. The advantage of small and medium scale enterprises for employment purposes is that they serve as a cost effective source of employment. In a poor country, facing increasing demands for employment and scarce capital resources, SME expansion offers the most direct avenue for providing significant numbers of jobs.

SME activities span a broad range of different types of establishments, from tiny informal sector household production units using self-employed and unpaid family labor to larger scale registered establishments using wage employment. Although the sector produces and distributes a broad range of products, there is considerable concentration in a few select areas (such as food processing, clothing) and need for diversification. This might be achieved by increasing the opportunities of SME's to bid on contracts by the parastatals. It is also noteworthy that SME's provide a vital link in the production - consumption chain that ties rural and urban populations. Improvements in distribution and transportation networks throughout the country are fundamental if economic development is to be shared nationwide. This cannot occur in the absence of SME's in rural areas. The void left by Asian traders in rural Malawi has not been filled and remains an obstacle preventing improvements in the welfare of the rural population.

The employment impact of the SME sector is considerable in both urban and rural areas. It is estimated that approximately one quarter of SME establishments are in urban areas and three quarters in rural areas. According to the 1986 READI Project (612-0214) survey, 57 percent of SME's employed one or more workers with an average employment of 2.5 workers per establishment. This information makes it possible to estimate the direct employment effect of the SME sector on formal sector employment. The results suggest that from 1968 to 1986, SME related employees made up 40 percent of total formal sector employment (both agricultural and non-agricultural) and 65 percent of total formal nonagricultural employment. Since SME employment is largely concentrated in rural areas (78 percent of the READI surveyed establishments were located in rural areas) and non-SME formal sector employment is largely urban, the contribution of SME's to rural off-farm employment is especially noteworthy. The employment effect of an SME focused development initiative such as MED is substantial because of its (1) low effective cost per unit of labor compared to large firms; (2) low import use and stability in the face of external shocks; (3) potential for providing needed income in rural areas (thus improving the distribution of income); and (4) its intensive use of unskilled workers and women workers. The labor intensive, rural focused nature of much of SME activity will, in the medium term, significantly increase domestic demand for agricultural production and create necessary linkages between agriculture, industry and commerce, and between urban and rural areas.

c) Smallholder Agriculture

By far the largest sector in Malawi is smallholder agriculture. It consists largely of subsistence farming on very small plots of customary land with some production of cash crops as well as off-farm activities. It also includes small leaseholders, some of whom hire labor on a seasonal basis or as needed to produce cash crops. Smallholders with more land have been known to hire labor on a permanent basis. Various forms of communal labor are also common to smallholder agriculture. In effect, smallholders are not a homogeneous group and reflect considerable socioeconomic differentiation.

Between 1966-1977 smallholder agriculture increased slowly as estate agriculture expanded rapidly. Although wages were extremely low in the estate sector, it did provide smallholders with alternative income earning opportunities. The encroachment of estate agriculture and leaseholding on customary lands reduced the ability of many smallholders to provide for themselves. Subsequently, sluggish growth of estate agriculture between 1977-1986 reduced employment and income opportunities for smallholder households and exacerbated problems of land scarcity and low productivity.

The 1980/81 national sample survey of agriculture found average annual cash income per household to be MK137. For a six day workweek and fifty-two weeks per year, this comes to 44 tambala per day per household. This figure corresponds roughly to the nominal statutory minimum wage for a wage earner in rural areas in 1980/81. To further illustrate the precarious position that smallholder households face, it should be noted that the sale of food and cash crops only provides 33 percent of smallholder average annual income. Business activities, such as grocery shops, beer brewing, tailoring, carpentry and other handicrafts accounted for 28 percent of the total, while labor income contributed 15 percent. Obviously, those smallholder households that depend disproportionately on the production of food and cash crops for their livelihood are the groups most at risk. It is imperative for smallholders to have access to off-farm employment to complement their earnings from farming. SME growth and expansion in rural areas, especially in nontraditional products, plays a major role in the GOM's and USAID's strategy designed to increase smallholder productivity and income.

d) International Migration

Smallholder agriculture has been a repository of surplus labor in the absence of both alternative off-farm employment and a social network to provide compensation while unemployed. As the number of underemployed in rural areas increases, so does the strain on scarce resources in smallholder agriculture. Migration to other southern Africa countries has been an important, albeit temporary, source of employment and income as well as foreign exchange. Historically, most migration has been to Zimbabwe as domestic workers and South Africa and Zambia as miners. South Africa remains the largest source of external employment.

Malawians are contracted by the Employment Bureau of Africa, Ltd., to work in the mines of South Africa. Since 1977, between 14,000 and 20,000 workers per year were under contract to work in the mines, constituting 10 to 12 percent of foreign migrants in South Africa (see Table 12). Contract periods are limited to one year. The attraction of working in the mines is obvious when one compares the difference between the statutory minimum wage in Malawi and starting wages in South African mines. Between 1972 and 1988, the minimum underground wage in South Africa has gone from two to ten times the highest statutory minimum wage possible in Malawi. These earnings have translated into remittances which have averaged MK29 million per year between 1980-85 (see Table 13). This represents a considerable contribution to scarce foreign exchange. In addition, the 1986 READI survey reports that 33 percent of all entrepreneurs in SME's sampled worked outside Malawi for more than nine months, comparing favorably to the national average of 35 percent of the male population (ages 15 and older). Moreover, 51 percent of those entrepreneurs who worked abroad found that this experience helped them start their enterprise (primarily by providing initial capital) and the majority returned to rural areas. Thus, the migratory experience is a common characteristic of Malawian SME entrepreneurs.

e) Wage Structure and Policy

One objective of the MED program is to stimulate industry and commerce in an effort to generate employment. An obvious advantage of targeting this sector is its considerable potential for increasing productivity and earnings. Moreover, while open unemployment is low in Malawi, low agricultural productivity and limited rural incomes serve as a major impediment to development of

30

the domestic market. Therefore, effective employment generation requires increased job availability and labor productivity that will contribute to rising incomes and increased utilization of industrial capacity.

Malawi's economic development has followed a labor intensive path. Given the rapid growth of population and labor force, and the limited development of skills and educational attainment, the strategy of labor intensive development is sound. Official wage policies, a largely nonunionized labor pool, and private sector wage restraint have provided an environment suitable for labor intensive growth. Likewise, the freeing of domestic interest rates has avoided preferential treatment in the purchase of capital equipment, and hence, relative prices of capital and labor have tended toward equilibrium levels. Government has, in the past, absorbed a large fraction of formal sector employment and has considerable influence on the structure of wages as well as wage growth through its minimum wage policies and role as wage leader. Minimum wages are established for both urban and rural areas with the latter fixed at approximately two thirds of the former (see Table 14). Revisions to the minimum wage are infrequent and small, giving way to rapid erosion of purchasing power due to inflation. Although the 1980s have seen more frequent minimum wage revisions than the past, both urban and rural real minimum wages are still lower in 1986 than they were in 1981. Urban and rural real minimum wages in 1986 are approximately 80 percent of 1981 levels. In many respects, for unskilled workers, the statutory minimum wage serves as both floor and ceiling and largely represents a level of income not far from subsistence.

Even slight upward revisions in the minimum wage tend to result in a considerable shift in wage structure. This is an indication that a large fraction of the working population is employed at minimum wage levels. Nonetheless, Government has managed to encourage the private sector to hold the line on wage increases by allowing selective, as opposed to across the board wage hikes, and limiting public sector wage increases. There is no indication that the government will deviate from its strategy of labor intensive development. Currently, real wages in the formal sector are approximately 75 percent of what they were nine years ago (see Table 14). The figure is even lower (58 percent) when one compares current industrial real wages with its counterpart nine years ago. The downward trend in real formal sector wages has not been smooth as minimum wage revisions over the period sought to recoup losses in purchasing power due to inflation. However, these small gains were quickly eroded.

One result of Government's tight wage policies has been to reduce wage differentials between and within sectors. Since Government is generally the wage leader, its ability to contain wage increases in public sector employment has avoided large wage dispersion across industrial sectors. In fact, the wage gap

x 31

between agriculture and industry, and agriculture and services, has declined in the last decade. It is very difficult to conclude whether the pattern of wage differentials accurately reflect differences in labor productivity across sectors. By influencing wages at both the upper and lower ends of the wage distribution, Government has been able to hold both inter-industry and occupational wage differentials to a minimum.

Urban and rural wage differentials also do not appear to be widening sharply. This has succeeded in reducing rural-urban drift and overurbanization problems, so common in many developing countries. On the other hand, the policy of low urban wages that has constrained rural-urban migration has kept the smallholder population from making significant gains in agricultural productivity and incomes. The freeing of underemployed agricultural labor can only occur in an environment where productivity, wages, and employment are rising simultaneously in the formal sector. As long as underemployed labor continues to place demands on scarce agricultural resources, the economy will continue to face food shortages and lack of development.

The issue of wage differentials and rural-urban migration needs to be examined carefully. Women make up a large fraction of smallholder farmers, while men largely pursue income earning opportunities as estate laborers, urban workers, or migrants to South Africa, Zimbabwe and Zambia. Thus, remittances and transfers contribute significantly to rural household income (approximately 14 percent according to the 1980/81 National Sample Survey of Agriculture). An increase in the rural-urban wage gap might result in (i) increased out-migration of males, putting further stress on the family unit and women in particular, (ii) increased remittances to rural areas leading to higher household income, and/or (iii) out-migration of entire rural households leading to excessive pressure on urban infrastructure and services. Though one may argue convincingly that Malawi is underurbanized, the danger always exists that the transfer of human resources from rural to urban areas could create a disbalance between the demands of the urban population and the ability of the metropolis to satisfy them. Visions of Mexico City, Calcutta, and Bombay leave one wary of introducing policies that might foment massive rural-urban migration.

Government-led wage restraint has proven beneficial to a labor abundant economy such as Malawi. It is important, however, for wages to serve as signals that accurately reflect relative productivity across sectors, and hence, induce labor mobility from low to highly productive activities. It is necessary to carefully study whether the policy of wage restraint has impeded the growth of domestic demand and limited migration to the detriment of smallholder productivity. The implication is that a trade-off between employment growth and growth of effective demand must be avoided if economic development is to proceed uninterrupted. Indeed, this is a major challenge facing the Government of Malawi in the years ahead. If the MED program is to support liberalization measures and increased reliance on markets, then the same should apply to labor markets and wage policies.

C. Defining MED Program Priorities and Linkages to USAID/Malawi's Program

The analyses of industry and employment point to a number of financial and institutional policy constraints which restrict the growth of the private sector and employment. These constraints may be grouped into a policy reform strategy which focuses on three major areas. The first is the removal of barriers which can result in an immediate increase in the utilization of industrial capacity and the labor force employed in the formal private sector to reverse the current downward spiral of the economy. The second is expanding and laying a better foundation for a more open and competitive economy. This requires the further dismantling of restrictive policies, regulations and procedures that limit competition and the growth in new enterprises. This foundation is essential for long-run growth and development. The third is increasing the employment multiplier in the economy by concentrating on the development of a stronger policy and institutional environment for the growth of SME's. Just creating an open economy is not enough to ensure the growth in employment and an economy less dependent on imports. There is the need to increase the labor absorptive capacity of the economy by encouraging and promoting labor intensive SME's and a more efficient use of Malawi's capital and labor resources.

1. Increasing Utilization of Industrial Capacity and Labor

The absence of sufficient foreign exchange over the last few years is probably the single most important factor which has caused industry to reduce its output. At the present time, the industrial sector is operating at 47 percent of capacity, largely because of its inability to obtain foreign exchange for raw materials, spare parts, and intermediate capital goods. The only reason that this reduction in capacity utilization has not resulted in a significant loss of employment in the private sector is that historically wages in Malawi have been significantly less than labor productivity. This has permitted firms considerable margin to continue to employ workers in an underutilized capacity despite significant curtailment in production. Thus, MED's focus, as ITPAC's, in the first year is on supporting the liberalization and streamlining of the foreign exchange allocation process. Without this immediate stimulus to the industrial sector, it will be extremely difficult to achieve the growth and employment targets envisaged by the Government of Malawi in its Statement of Development Policy (1987-96) (DEVPOL) and the Policy Framework Paper negotiated with the World Bank and the IMF. Therefore, the PAAD analysis argues for USAID to parallel closely the ITPAC conditionality in the first year of MED. For this reason, MED's first tranche conditionality is linked to recent GOM efforts to overcome three constraints. The first is limited access to foreign exchange, the second is the crowding out of the private sector by the public sector, and the third is the need for a market determined exchange rate.

2. Broadening the Foundation for an Open and Competitive Economy

Simply providing additional foreign exchange will not in and of itself create the basis for sustained economic growth. As DEVPOL states, the engine which will drive growth over the next decade is the private sector. The GOM is firmly committed to a development strategy which will restore the openness and competitive environment which characterized Malawi's development up through the mid-1970's. A major thrust of MED is assisting the GOM to move a policy regime which restricts, inhibits, and regulates competition to one that encourages individual initiative and enterprise. This foundation is extremely important if Malawi's private sector is to earn the foreign exchange and create the jobs required to sustain growth over the long term. While concessional assistance will give the private sector the necessary boost in the short term, it is up to a dynamic export-led private sector to generate the foreign exchange essential to sustainable growth and an enlarged SME subsector to provide the increased employment opportunities.

To contribute to a more open economy, MED conditionality will continue to stress in the second and third years the need to streamline and simplify access to foreign exchange. However, establishing greater competition will depend on an environment more supportive of SME's. As the analysis clearly indicates, this translates into policy initiatives to strengthen access to capital both in the form of loans and equity and to reduce legal and licensing barriers to the entry of SME's into the market. It also means a stronger capacity within the Ministry of Trade and Industry and institutions such as the Malawi Export Promotion Council to promote and encourage the expansion of SME's.

3. Expanding Employment Opportunities

As the employment analysis notes, Malawi must create between 110,000 and 130,000 new jobs each year over the next five years, simply to cater to the expected growth in the labor force. At the current projection of growth in GDP, there will be an annual shortfall in employment of 30,000 to 36,000. Although a more rapid growth in GDP would go a long way in reducing this shortfall, there are structural anomalies and constraints in the economy which, if removed, would result in more jobs created even at the current forecast growth rates. Considering the difficulty that Malawi will have in returning to a positive real growth rate over the next several years, it is imperative that the employment multiplier in the economy be increased. To do this will necessitate a focus on policies which favor the growth in more labor intensive SME's.

At the present time, the growth in SME's is constrained by a number of structural, institutional, and financial factors. The economy is dominated, as the analysis in Annex C indicates, by the three large parastatal and quasi-public holding companies. These are the Malawi Development Corporation (MDC), Press Holding, and the Agricultural Development and Marketing Corporation (ADMARC). Most large enterprises and key industries in Malawi are owned in whole or in part by these three or some combination of the three. They also share interlocking directorates. Since most are private limited companies, there is little opportunity for broader ownership. These companies are the ones with greatest access to investment and technical resources from both the domestic and foreign markets.

To stimulate greater opening up of the private sector to SME's and broader participation by Malawians requires a number of steps by the GOM to eliminate the structural, institutional, and financial barriers. First, legislative constraints such as licensing requirements and restrictions on access to foreign capital and expertise need to be relaxed. This requires modifying and streamlining licensing procedures and revising the Industrial Development and Control of Goods Acts. Furthermore, it will necessitate amendments to the Deeds of Trust for INDEFUND and SEDOM to allow them to participate in loans to SME's which have attracted a foreign technical or financial partner. Second, the GOM's Ministry of Trade, Industry and Tourism's Small Industry Department is understaffed to perform its role to promote SME's. Similarly, the Malawi Export Promotion Council and other business orgranizations are biased toward large enterprises. Thus, a major component of MED will be policy reforms which establish a more solid and supportive institutional framework. This includes strengthening the MTIT's and Malawi Export Promotion Council's capacities to encourage the expansion of SME's and the opening of new market opoortunities for SME's in the export sector.

Finally, the primary sources of financial resources for SME's are SEDOM and INDEFUND. SME's have no access to either commercial banks or to equity financing. To facilitate greater access to investment capital, MED focuses on the issuance by the GOM of clear policy guidelines on financial terms and conditions under which SEDOM and INDEFUND should operate, with the objective of moving these institutions in the direction of greater commercial self-sufficiency.

A corollary to the expansion of employment is raising domestic demand for the goods and services produced by the private sector. While the primary means of this must be increased productivity in agriculture which leads to a general increase in per capita disposable income, the employment and wage analysis suggests that there may be scope for achieving some stimulus in domestic demand by increasing wages in the formal sector. Over the years, the GOM has, as a matter of policy, favored low wages. With inflation and the erosion of the Kwacha due to devaluations, real wages have declined dramatically and the wage differential between unskilled and skilled labor has narrowed significantly. The fact that industry has been able to operate at below 50 percent capacity without major layoffs of either skilled or unskilled workers is strong evidence that average real wages in Malawi are significantly below actual labor productivity. Taken in isolation, this would argue for some relaxation in the low wage policy.

However, without more analysis of this complex issue, it is not possible to suggest specific policy reforms related to national wage policy. For example, an increase in wages has negative implications for the GOM's budget deficit and urban growth. MED will pursue these questions as part of its studies and technical assistance component, but will not develop at this time a set of conditionality directed at modifying the GOM's low wage policy. The low wage policy contributes to investments in the economy which favor greater utilization of labor as opposed to capital.

MED's three program priorities are reinforced by USAID's broader development program strategy in Malawi. In determining whether MED makes sense, it is important to explore these linkages and complementarities. First, MED's focus on SME's and the program's conditionality are supported by the READI Project (612-0214). The baseline survey carried out by READI and its recommendations have played a key role in the formulation of the GOM's policy agenda for SME's as embodied in DEVPOL and supported by the MED Program. Second, the Parastatal Divestiture Program (612-0227) is playing a critical role in reducing the dominance of the largest parastatal, the Agricultural Development and Marketing Corporation (ADMARC), in the economy and opening up competition. Once this program is completed, the vast majority of ADMARC's holdings in industry, commerce, and finance will be controlled by a broader array of domestic and international private sector interests. Third, the policy reform dialogue accompanying the Fertilizer Subsidy Removal Program (612-0225) and the Malawi Agricultural Research and Extension Project (612-0215) are addressing some of the major barriers to increasing agricultural productivity. As the macroeconomic analysis emphasizes, it is the growth in agricultural productivity and rural incomes which over the long run will give the economy the stimulus for a sustained expansion in nonfarm employment opportunities. USAID/Malawi will in the next year be working with the World Bank and other donors on a major agricultural policy reform program which will put even greater emphasis on increasing agricultural productivity. Fourth, USAID/Malawi's program in transportation is tackling two major constraints on the economy. They are the high transportation cost for exporting and importing Malawi's goods through South Africa and the need to expand domestic truck haulage capacity. The Northern Corridor Project (690-0237), when completed in the early 1990's, will result in a 30 percent decrease in the cost of importing goods into Malawi. The Commercial Transport Project (612-0218), through the establishment of an enlarged domestic international truck haulage capacity, will lessen Malawi's dependence on foreign international haulers which also contribute to the foreign exchange cost associated with transporting goods from and to Malawi. In summary, the MED analyses and this brief discussion of linkages with USAID's other development activities clearly point to a program which is well targeted on some of the major impediments to both short-run and long-run growth.

D. Sector Financing Requirements

Calculation of the additional financing requirements of the program sector (private industry and commerce) is made difficult by two factors. First, data for Malawi often do not clearly differentiate between private firms on the one hand and government and parastatal enterprises on the other hand. Second, resources, and foreign exchange in particular, are fungible. Thus, it is difficult to specify a foreign exchange "gap" in one sector of the economy without knowing actual availabilities and uses of foreign exchange throughout the economy. Despite these difficulties, several observations can be made which indicate that the financing requirements of the program sector justify the proposed amount of A.I.D. resources to be provided under MED.

Sector financing requirements fall into two categories: local currency and foreign exchange. The local currency financing needs of private industry and commerce are potentially very large. The lack of domestic credit and equity financing is a key sector constraint identified by the Mission. The private sector's share of total domestic credit has shrunk from 64 percent in 1979 to 28 percent in 1987. The outstanding stock of credit to the private sector at the end of 1987 was equivalent to $79 million (at MK 2.60 = $1.00). If the private sector had received its 1979 share of total credit in 1987, the total stock of private sector credit would have been $183 million, which is $104 million more than it actually received. Furthermore, access to equity capital is virtually nonexistent for all but the largest firms. These problems of private sector financing are expected to attenuate over the medium term as fiscal, financial, and institutional reforms are put in place and economic growth accelerates. In the interim, an infusion of external resources can help ease the transition and increase the availability of domestic financing to the private sector. This can be accomplished directly through the programming of MED local currency for private sector uses. Examples of possible private sector uses of the MED local currency are discussed in the section on local currency uses, below. In addition, the programming of local currency for existing GOM budget line items, also proposed under MED, reduces the need for deficit financing by the government and thus reduces the crowding out of the private sector in capital markets.

X

The lack of foreign exchange to finance imports of raw materials, intermediate goods, and spare parts is also a key constraint to the growth of private industrial and commercial firms. Available data indicate that the private sector's share of imports dropped from 65 percent in 1982 to 46 percent in 1987, even as the dollar value of total imports declined from $357 million to $296 million. A major focus of the import liberalization program is to increase average import levels in 1988-90 to the 1982 level and to utilize the private sector as a major engine of growth. Under these circumstances, it is reasonable to assume that the 1982 distribution of imports (65 percent to the private sector) is closer to "normal" and with these additional external resources, the private sector's share would run at the 65 percent level attained in 1982. Under these assumptions, the private sector's share of imports would increase from $148 million (1987 level at 50%) to $233 million (1982 level at 65%) per annum, a difference of $85 million. This implies a total foreign exchange financing "gap" of $255 million over the three year dollar disbursement period for ITPAC and MED (1988-90). This is substantially more than the anticipated $170 million to be disbursed under ITPAC and MED.

Taken together, the above evidence regarding the projected financing requirements of the program sector indicate that the proposed A.I.D. nonproject assistance of $35 million is more than needed.

III. PROGRAM DESCRIPTION

A. Problem Statement and Program Rationale

Capacity utilization of Malawian manufacturers is low, production has declined, and collection and distribution of commodities from and to urban and rural areas has fallen. These changes in a previously active industrial and commercial sector have resulted principally from the belt-tightening fiscal and monetary measures undertaken by the GOM in the context of its structural adjustment program, the regional transport crisis, drought and the decline in agricultural productivity, and general economic stagnation. The Malawi Enterprise Development Program identifies those constraints which most severely constrain efficient private sector participation in industry and commerce, and supports GOM efforts to change the policy and institutional environment to support further private sector participation.

Specific constraints which limit the capacity of this sector to revitalize immediately and rapidly are the scarcity of foreign exchange available for the importation of both raw materials and spare parts, cumbersome procedures to procure imports and actively export commodities, and a variety of SME specific constraints related to management experience and entrepreneurial support, which limit the effectiveness of that potentially dynamic sector. The principal reforms to be supported through this program are the increased liberalization of the importation of raw materials and spare parts for manufacturers, removal of import licensing requirements on specific industrial and commercial items, and a streamlining of import and export licensing procedures. The specific needs of the SME sector will be tackled not through preferential policy treatment, but rather through enhancing their competitiveness by streamlining regulations and procedures, and by liberalizing and expanding financing mechanisms for SME's, as well as through a series of short term technical assistance and training visits to provide specific, practical assistance with business and management problems and market development.

The program is central to the Mission's efforts to establish a more favorable environment for individual enterprise and self sustaining development. It builds on prior USAID/Malawi experience with SME development and privatization, including the ongoing Rural Enterprise and Agribusiness Development Institutions project (612-0214) and the Parastatal Divestiture program (612-0227), as well as several major studies of constraints to SME development. Increases in capacity utilization, production, and commercial activity are directly related to the Mission's strategy to improve incomes and support the development of a larger and more efficient private sector which can serve as the foundation for the nation's development. In addition, the program will indirectly support efforts to promote exports, agricultural diversification, agricultural processing industries, and greater private sector efficiency and investment in input delivery and marketing.

Program assistance, rather than project assistance, is more appropriate to address these problems. As the foregoing analysis indicates, the fundamental constraints in the sector are policy ones, which can best be addressed by focusing on policy changes, rather than specific inputs. Additionally, the GOM has already designed a program to remedy these constraints and possesses the capacity to carry it out, with the addition of the small projectized element. Thus, a substantial amount of focused inputs, in the form of project assistance, is not needed.

B. Program Goal and Purpose

The goal of the Malawi Enterprise Development program is to:

increase incomes and the availability of employment in the private sector by stimulating growth of industry and commerce.

The purpose of the program is to:

revitalize existing businesses and create new enterprises, particularly small and medium scale enterprises, by supporting policies directed at reducing economic, institutional and fiscal distortions which inhibit the development of a more open, competitive and dynamic private sector.

USAID/Malawi has designed the Malawi Enterprise Development Program to stimulate the growth of industry and commerce by supporting policy and institutional reforms and by providing the GOM with scarce foreign exchange.

In the short term, capacity utilization and production of existing industries should rise. In the medium term, the program aims to create a more open and competitive environment which will enable new enterprises to become established and flourish. Greater levels of production and productivity will help raise real incomes of employees. Increased incomes will have the added benefit of increasing effective demand for consumer goods, thereby reinforcing the increase in production as well as encouraging a wider distribution of consumer goods than the country now experiences. In the long run, it is hoped that the growth of this sector will provide increasing employment for the rapidly growing labor force.

The design and focus of the program also recognize the substantial progress that the GOM has made in establishing a better policy and institutional framework for an increasing role for the private industrial and commercial sectors. As the analysis of the industrial sector shows, however, the announced reforms require continued support and consolidation before they can be regarded as successful. Therefore, MED will support those announced policy reforms which enhance the role of the private sector in industry and commerce, while at the same time providing an incentive for institutionalizing the role of that sector in the country's development program.

A principal concern with this reform program, as with many others, is the level of political and social risk associated with the planned reforms. MED is expected to suffer less from social risk factors specifically attributable to industrial and commercial development since the flow of primary benefits from the program -- enhanced incomes, production and distribution of consumer goods, and, potentially, employment -- to the target beneficiaries of urban and rural producers and consumers is expected to enhance equitable development in the country. Political risk is perceived to be greater, however, than social risk, particularly if rapid industrial and commercial growth occurs which causes a shift in incomes, power, and influence from the urban civil service sector to the urban industrial and commercial sector. At the present time, the risks attendant with such a potential shift in economic power appear to be low since industrial expansion is not expected to be that rapid, and also because many of the controls imposed as a result of the stabilization process have been in place for such a short time that they have not yet become institutionalized. Thus, political risk from the structural aspects of the policy reform are expected to be low.

MED brings substantial resources to attain the purpose statement described above. The first is the $35 million in a cash grant supplied to the GOM in response to the risk it undertakes by implementing the reforms outlined below. According to World Bank estimates, the financial risk, or financing gap, of the program is substantial. For the import of raw materials and spare parts used by traditional and nontraditional firms used in the manufacture of export items only, the World Bank estimated the 1988 demand at a minimum level of $25 million. The total value of imports for the base year used in this text, 1984, was nearly $300 million. Thus, as liberalization of the import regime expands, the allocations for which the GOM will no longer issue prior approval will increase dramatically, with the dollar risk of rapid liberalization exceeding the dollar resources provided to the reform program. The reform agenda related to the cash grant, and the program of conditionality upon which release of funds rests, are discussed below.

The second principal resource of the program are the local currencies to be generated by the cash grant. It is anticipated that 10 percent of these funds will be used for the Mission's Kwacha denominated OE trust fund. A substantial portion of the remaining local currency resources will be programmed to support the sector program objectives, through the financing of existing GOM budget line items and through private sector activities, to the extent the private sector has the institutional capacity to absorb the funds without creating inflationary pressures. This is discussed in the section under local currency uses.

Lastly, a small amount of dollar financing, $1.6 million, will be used to provide short term technical assistance, training and studies in direct support of the program's goal and purpose. These uses are discussed in more detail below.

C. Policy Reform Agenda

The policy dialogue agenda fits well within the scope of the program's goal and purpose. The agenda itself, however, is more broad in scope and intent than the conditionality associated with the program due to the evolving nature of industrial and commercial rehabilitation and growth. The policy agenda has four main foci:

1. Trade and Industrial Policy and Exchange Rate Management
2. Small and Medium Scale Enterprise Development
3. Financial Sector Reform
4. Fiscal Policy Concerns

X 41

Both the GOM and USAID/Malawi are interested in pursuing issues related to each of these topics. Already, a sizable body of information has been developed regarding these policy areas as a result of the stabilization process and specific program and project interventions undertaken to date. Thus, for the most part, there is a high degree of correspondence between the reform agenda, reform objectives, and program specific conditionality. This correspondence is presented in the following section.

In a few areas, however, information and understanding are incomplete at this time to warrant specific program conditionality. In these cases, a small number of studies have been proposed to further the understanding of USAID/Malawi, the GOM, and the private sector regarding the study topics. These topics include such items as constraints to capital market development in Malawi and linkages between industrial and agricultural production and consumption. A full list of proposed studies, and their particular relevance to policy reform objectives, is presented below.

The final component of the program, which concerns the health of the industrial and commercial sectors, addresses firm specific problems. While these concerns form an integral part of the program's efforts to improve the efficiency and effectiveness of the private sector, these problems do not constitute elements of the reform agenda itself. To address these problems, the program contains a small component of technical assistance and training to firms to help them deal effectively with production and management problems which hinder their productivity and growth. These technical assistance and training activities are discussed in more detail in the following section.

D. Description of Program Activities

1. Introduction

To illustrate the high degree of correspondence between the reform agenda, reform objectives, program conditionality, and progress indicators, as well as the specific role of studies and technical assistance, USAID/Malawi has developed a Policy Reform Conditionality Matrix. This matrix is presented in its entirety in matrix form as Annex A to this PAAD. The discussion below extracts major points from the matrix, illustrating the structure and presenting a description of the program.

2. Policy Reform Conditionality Matrix

a. Reform Objectives

The first column of the policy reform conditionality matrix presents the reform agenda, which was discussed in the preceding section. The matrix goes on to identify reform objectives for each item on the dialogue agenda. Indicators for each set of objectives

42

are defined for monitoring and evaluating progress made in achieving the objectives. The relevant areas of conditionality, upon which tranched release of funds rests, evolves directly from the objectives. The final component of the matrix, monitoring and concerns, is comparable to the assumptions column of the traditional logframe, in that the assumptions, risks, and problems associated with each element are identified. It differs somewhat from the logframe, however, in that specific topics for study and technical assistance requirements are identified to reduce uncertainty and either confirm or refute basic assumptions.

Specific reform objectives which USAID/Malawi will support are:

Trade and Industrial Policy and Exchange Rate Management:

- reduce administrative controls on the import of commodities and the export of finished goods.
- maintain a satisfactory exchange rate.
- create a favorable investment climate for industrial and commercial expansion.

Small and Medium Scale Enterprise Development:

- promote small and medium scale industries to support industrial growth, equitable resource allocations, and expansion in off-farm employment opportunities.
- support the flow of domestic credit to SMEs.

Financial Sector Reform:

- broaden and deepen capital markets.

Fiscal Policy Concerns:

- reduce the fiscal deficit to check the crowding out of foreign exchange to the private sector.
- reduce the fiscal deficit to check the crowding out of domestic credit to the private sector.

b. Progress Indicators

Indicators which will be monitored in order to evaluate the achievement of these specific objectives include both items which indicate the GOM's willingness to undertake certain actions, as well as their effectiveness in institutionalizing reform. As a result, the following indicators have been identified for the program's reform objectives:

Trade and Industrial Policy and Exchange Rate Management:

- ITPAC and ESAF agreements.
- Private sector access to FX increases.
- Reduction in time required to obtain FX approval and to effect payment once goods are received.
- Reduction in time required to obtain import license.
- Share and va ue of private sector and SME receipts of FX have increased.
- Monitor applications and the value of nontraditional exports increasing as well as their share of total exports (30 percent of total value in 1985).
- Increase in the share of employment and national income coming from the industrial and commercial sector.
- Increase in share of imports going to the private sector, up from 44 percent in 1986.
- Reduction in the 34 categories and 34 countries subject to import licensing requirements. The target is to bring this down to 7 categories and 22 countries.
- Increase in ratio of value added to gross output from current 35 percent.
- Increase in private sector plant utilization capacity in the industrial sector from the present average level of 47 percent.

Small and Medium Scale Enterprises:

- Number of SME's increases.
- Barriers to entry for SME's, including zoning and licensing requirements, are relaxed.
- Policy decisions should address issues such as:
  1. High cost of extending credit to SME's.
  2. GOM's role in securing concessional assistance to the financial institutions.
  3. Passing credit funds on to financial institutions at a fair, market cost.
  4. Need for financial institutions to charge commercial interest rates.
- Formulation of a policy proposal to enhance the flow of commercial bank credit resources to SMEs.
- Amended Deeds of Trust to permit joint ventures of 25 percent or more in equity financing.
- Expansion of the capacity of Malawi Export Promotion Council to undertake following activities vis-a-vis SME's:
  1. Investment promotion.
  2. Facilitate access to FX.
  3. Packaging investment proposals.
  4. Monitoring progress.

5. Assistance with managerial, institutional and bureaucratic problems.
6. Research and studies.

- Increase in number of SME's involved in external trade.
- Improved data on SME sector.
- Revised legislation, rules, and laws.
- Reduction in number of ministries and authorities involved in licensing of SME's.
- Decrease in time required to register and obtain license.
- License mainly for purpose of information collection and monitoring SME's and to facilitate provision of services.
- Increase in formal sector employment from 427,000 in 1987.
- Increase in average rate of growth of formal sector employment from 3.61 percent which characterized the 1977-87 period.
- Reversal in trend toward larger scale enterprises - those employing more than 20 persons. Increase in 55 percent share of all private sector establishments which are small scale.

Financial Sector Reforms:

- Increased availability of net domestic credit to the private sector over and above 1987 level of 27.6 percent disaggregated by subsector. The target is to return to the 1979 level of 75.5 percent.
- Increase in equity investments.
- Interest rates which reflect the true cost of capital.
- Reduction in the 1987 inflation rate of 26.8 percent.
- Real GDP increased above the planned 1.5 percent in 1988.

Fiscal Policies:

- Progressive reduction of budget deficit to levels agreed to with IMF.
- Private sector access to domestic credit increases.
- Sha.e and value of private sector receipts of domestic credit have increased.

c. Conditionality and Tranching

Disbursements of the grant will be made in three tranches. The first tranche release is expected immediately following the signature of the grant agreement. The amount of this first disbursement will be $15 million. The release of the second tranche is expected in mid FY 1989, although it is possible that rapid compliance with the conditionality could move disbursement forward somewhat. The size of the second tranche release will be

$10 million. Release of the third tranche is intended for the third year of the grant agreement, FY 1990. Disbursement will fall in the middle to latter part of that year since compliance with third tranche conditionality may require a bit more time to work out. The size of the third tranche will also be $10 million.

In addition to the cash grants to be released upon meeting conditionality requirements, USAID/Malawi and the GOM will also sign a project grant agreement in FY 1988 for $1.6 million. The purpose of this project component, as discussed elsewhere, is to finance the small studies and technical assistance component of the program, as well as to provide adequate financing for the monitoring and evaluation of the program. The estimated breakdown of costs is presented in the illustrative budgets in the Financial Plan section.

The conditions for the release of the three tranches of the cash transfer are discussed below.

1) <u>Conditions Precedent to Initial Disbursement</u>

Prior to the disbursement of the first tranche of $15 million under the agreement or to the issuance of documentation by A.I.D. pursuant to which such disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, evidence that the Grantee has:

i. Maintained a flexible exchange rate policy during the previous 12 months;

ii. Adopted the first and second stages of foreign exchange allocation liberalization which covers a total of 75 percent of the 1984 base year's value of raw material and spare parts imports;

iii. Revised the Industrial Development Act to permit a streamlining and rationalization of industrial licensing;

iv. Reduced the ratio between the budget deficit and GDP for its FY 1987/88 budget to a level less than that which existed for FY 1986/87; and

v. Established a Special Local Currency Account in the Reserve Bank of Malawi for the deposit of all local currency generated pursuant to this program.

2) <u>Conditions Precedent to Second Disbursement</u>

Prior to the disbursement of the second tranche of $10 million under the agreement or to the issuance of documentation by A.I.D. pursuant to which such disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, evidence that the Grantee has:

i. Reduced the number of items for which import and export licenses are required;

ii. Streamlined the foreign exchange approval and payment processes;

iii. Established support to the SME sector in a unit in the Ministry of Trade, Industry, and Tourism;

iv. Issued a policy statement regarding terms and conditions for the provision of funds to financial institutions involved with SME's. This policy should address, without limitation, areas such as on-lending by the GOM, measures to assure the commercial viability of the institutions, promoting access to private sources of capital, and minimizing the need for GOM resources over the long run; and,

v. Reduced the ratio between the budget deficit and GDP for its FY 1988/89 budget to a level less than that which existed for FY 1987/88.

3) <u>Conditions Precedent to Third Disbursement</u>

Prior to the disbursement of the third tranche of $10 million under the agreement or to the issuance of documentation by A.I.D. pursuant to which such disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, evidence that:

i. The Grantee has continued liberalization of foreign exchange allocation for the import of industrial inputs, and has agreed to and implemented the third stage of foreign exchange allocation liberalization;

ii. The Grantee has streamlined import and export licensing procedures and systems;

iii. INDEFUND's and SEDOM's Deeds of Trust have been amended to allow them to extend credit to ventures involving foreign technical partners who are prepared to bring equity finance and expertise to the enterprise;

iv. The Grantee has established a SME subsector investment promotion program which maximizes the use of private sector organizations and institutions;

v. Institutional arrangements and/or mechanisms, identified through program financed studies, have been established in order to enable efficient financial intermediation; and,

vi. The Grantee has reduced the ratio between the budget deficit and GDP for its FY 1989/90 budget to a level less than that which existed for FY 1988/89.

d. Covenants

The Grantee shall covenant, with respect to the $35,000,000 policy and institutional reform equipment, except as A.I.D. may otherwise agree in writing, that:

i. Information regarding foreign exchange applications will be provided to A.I.D upon request to permit monitoring of program performance and any subsequent impact evaluation that may be conducted.

ii. It will maintain a flexible exchange rate from the date of the agreement until one year after the final dollar disbursement.

iii. It will conduct annually a joint review of the A.I.D. bilateral program, which will include a joint determination of the specific uses of the local currencies generated under the program, within the parameters established in the agreement.

e. Monitoring and Assessment

Finally, the question of monitoring and assessing progress toward the achievement of such an extensive program must be addressed. Since the reform program will be undertaken within the framework of an evolving reform environment, a program of constant monitoring of the progress made toward achieving the program objectives will be required. This regular monitoring will be assured by the designation of a USDH economist assigned to USAID/Malawi as the program manager.

In addition to ongoing management, a system of external review will be established to determine whether sufficient progress has been made to fulfill the conditions for second and third tranche release of funds. The review will be external to ensure objectivity in the assessment. AID/Washington, REDSO/ESA, or a private consultant in conjunction with one of the above offices will be utilized as an external reviewer. Progress will be assessed on the basis of the illustrative indicators presented above, to be supplemented by additional indicators if deemed appropriate by the external review team.

The reviews will use information available at the beginning of the program as baseline data for comparative purposes. In certain circumstances, such as exchange rate and budget deficit statistics, baseline information already exists. In other areas, such as the structure of the SME subsector and its access to financial credit, the READI survey will constitute baseline data. In still other areas, such as current levels of the availability of foreign exchange and domestic credit to the private and SME sectors, a separate baseline study will be conducted. Finally, although the program design has shown that few people are expected to be disadvantaged by the range of policy reforms proposed in this document, the Mission will nonetheless carefully monitor segments of the population deemed at risk by the program. This, too, will require a baseline study for use in future evaluations.

After assessing reform progress, the reviewer will prepare a report with findings, conclusions, and recommendations to USAID/Malawi regarding progress, compliance, and the appropriateness of disbursement. The Mission will then review the findings and recommendations of the report, and prepare for Mission Director approval an Action Memorandum which will outline reasons for recommending release, or refusal of release, of the funding tranche. Only on the basis of the approved memorandum will funds be released.

3. Policy Dialogue and the Role of Project Financed Activities

a. Deepening Reforms

The economic and sectoral analyses show the potential positive impact of policy and institutional reforms that exists on many different levels: there was no question that program support of a sectoral policy reform agenda had a great potential to increase incomes, availability and distribution of consumption goods and inputs, and eventually to increase employment.

There was also no question, however, that a limited amount of technical assistance for the industrial sector as well as a small number of carefully chosen studies would increase dramatically the effectiveness of the policy reforms being undertaken. For technical assistance this happens because some firms require specific assistance to respond to their production and management problems. Thus, they may not be in a position to either demand or utilize increases in domestic credit and foreign exchange until some of these problems are resolved. The preceding analysis showed the problem to be most acute in the newer, nontraditional, or smaller enterprises. Since these are of particular interest to A.I.D. due to their employment potential and role in diversifying the sector, specific support to their needs to enable them to take advantage of the increased resource flows is warranted.

X

In a second area, the need for better understanding of certain key issues was apparent. This applies both to A.I.D.'s understanding of the problem in question, but also for the GOM. Thus, in key areas, a discrete series of studies has been recommended. These will be undertaken with the full cooperation of the GOM, and results will be widely disseminated and discussed throughout government and the private sector. In this way, issues about which information is too limited at the present to allow serious dialogue can be discussed in the near future.

Both technical assistance and studies are discussed in greater detail below.

b. Technical Assistance

The program has been designed to allow a number of visits from, as well as to, technical experts to enable firms to address practical production and management problems on the spot. This part of the project component anticipates 28 business consultancies over the programs three year period, or nine to ten per year. Experts will provide short term technical assistance in the areas of production, management, quality control, organizational structure, business operations, and market development to a small number of firms, particularly SME firms, which seem able to utilize these services. The purpose of this activity is to increase productivity, increase operational efficiency, improve product quality, and expand market development.

The second component of technical assistance will involve a series of 12 specialized workshops (specific training). Working closely with the READI project, the Mission will identify a range of skill needs for the SME subsector. Preliminary examples include bookkeeping, accounting, and inventory skills. The series of workshops will be designed so that those firms most able to respond immediately to the training, that is, those firms for which the lack of these skills proves a binding constraint in the pursuit of domestic credit, will be able to participate. The workshops will be less intense and intimate than the business consultancies since they will not offer one on one training. However, participation in each workshop will be limited to a small number of firms facing the same problem.

c. Studies

The MED program will support a small number of studies useful to enhancing knowledge of the industrial and commercial sector, especially the SME subsector, and to improving our monitoring of the program implementation. As noted below, whenever data is collected, it will be collected in a manner so that information regarding the program's impact on the poor and the vulnerable will be available. Finally, every effort will be made to disseminate the results of the studies broadly throughout the GOM and Malawi's private sector. This will include the use of seminars and workshops, as well as the distribution of the studies to interested parties, in order to stimulate awareness of the status and development of Malawi's private sector.

Studies which have been mentioned in other parts of the program document include can be clustered into a few relevant headings. These are studies to improve the understanding of: SME's in Malawi; operation of the labor market, improvements to the capital market, and linkages between agriculture and industry. Specific studies which have been identified include the following.

SME's in Malawi: imported input requirements of SME's in Malawi and the impact of the tariff schedule on prices and effective rates of protection; READI baseline survey update; SME investment promotion program design; barriers to the entry of new industries, and SMEs in particular, including zoning; and, investigation of amending the Industrial Development and Control of Goods Act to assist reduce possible bias against SME's.

Labor Market Operations: wage policy study.

Expansion of the Capital Market: feasibility and design of a credit guarantee scheme; equity financing in Malawi.

Linkages between Agriculture and Industry: exploration of the consumption and production market links between agriculture and industry.

Completion of these studies, and their widespread distribution and discussion, will play an integral role in the Mission's policy dialogue with the GOM. This is particularly true for identifying the role of SME's in industry and commerce, as well as their role in employment generation. Moreover, it will become increasingly important to discuss the implications of, and constraints to, the growth of SME's posed by the agricultural sector. Thus, the studies component constitutes a small but important component of the MED program.

4. Social, Political, and Environmental Risks and Implications

a. Background

The USAID Malawi Enterprise Development sector assistance program is distinctive in that a awareness of social policy objectives is taken into account and will be carefully monitored during program implementation. The following section discusses vulnerability within both the context of the broad structural reform process and the more narrow focus of MED. A categorical exclusion for the program has been approved by the Bureau's Environmental Officer and cleared by GC/AFR.

X 51

b. Structural Adjustment and Poverty Alleviation in Malawi: An Overview

Poverty and vulnerability in Malawi can be viewed as a consequence of four main factors. First, there is the character of the natural resource endowment which sets limits on the kind of development that is possible. Second, there are the vagaries of the external environment over which Malawi has little control such as the disruption of external transport routes, and influxes of refugees. Third, there is the legacy of certain inappropriate policies that have necessitated more or less drastic adjustment measures. Finally, there is the increased vulnerability engendered by specific policies undertaken within the ambit of SAL.

In Malawi, "vulnerability" is an economy-wide problem and cannot be conveniently addressed in sectoral terms. Before attempting to specify groups, it is worth making a few general comments on basic social welfare indicators and the incidence of poverty in the country as a whole.

The world Development Report of 1987 shows that life expectancy in Malawi is 45 years compared with 50 years for sub-Saharan Africa. The population growth was estimated at between 3.4 percent and 3.7 percent during the 1980-1985 period, one of the highest on the continent. The infant mortality rate is measured at 156 per 1,000, considerably higher than the corresponding figure for sub-Saharan Africa (104) and one of the highest child mortality rates in the world. GNP per capita was reported as being the equivalent of $170 in 1985. Last year the Government conducted its decennial census and, though the full analytical report is not yet available, the preliminary report indicates that Malawi's total population stands at around 8 million people. Given the low rates of economic growth during the intervening years, the population estimate implies an even lower per capita income level for 1988.

An unpublished discussion paper by Uma Lele brings together some observations on the relationship between SAL policy, agricultural development, and poverty in Malawi. This document underlines the critical significance of intense land pressure on the basic welfare of the people. Over 50 percent of rural households, comprising an average of five members, have land holdings of less than one hectare. At the regional level the pressures are still greater. Almost half of Malawi's population lives in the Southern Region where the land availability per capita is a mere 0.33 hectare. Some of the highest rural population densities in the entire continent are to found in Malawi's southern districts.

Six out of every 10 full-time farmers in Malawi are women, which is again a markedly higher figure than for the sub-Saharan region overall. Moreover, almost 1 in 3 farm households are headed by women. More important from the standpoint of identifying the vulnerable is the fact that three-quarters of the smallholdings farmed by women are less than 1 hectare in size. Broadly speaking, the high incidence of full-time female farming is suggestive of land pressure since it is customarily the male who migrates when the farm holding is too small to support a household.

Migrants have traditionally sought employment in the mines of South Africa and on the Copperbelt of Zambia but in recent times, especially throughout the 1970's, there has been a significant volume of internal migration, particularly of males seeking jobs on large agricultural estates. The tobacco estates of the Central Region became an especially important employer of male migrants. The important issue here as far as vulnerability is concerned is the trade-off between the cash value of remittances and the importance of the migrant's contribution to the household labor force.

Some of the basic areas of SAL policy that need to be addressed in the light of this broad characterization of the vulnerable in Malawi are those which are concerned with the imposition of tight discipline on public spending, measures concerned with the recovery of the costs of social services from users and steps that have been taken to remove subsidies and decontrol prices.

In certain respects Malawi's restructuring efforts have led to specific policy changes which may be directly beneficial to the poorest communities. Because of a historical legacy of under-investment in the spheres of health and education, the World Bank has actively encouraged the Government to spend more on basic rural health services and primary education during the adjustment process. The Bank has provided credits to both these sectors and since 1985 has shown a greater interest in nutritional problems. Nevertheless, health and education infrastructure is still woefully inadequate.

Also on the positive side of the equation is the performance of the agricultural sector. Kydd has shown that the index of the "real value of ADMARC payments" has been rising since 1981 and argues that the initial beneficiaries have been the larger smallholder farmers. However a more general transmission of benefits throughout the rural economy could ensue as the relatively prosperous smallholders hire labor and consume rural goods and services. Thus, policies to increase producer prices and create a more favorable economic environment do benefit those at the bottom of the social and economic ladder.

In general the focus of attention with respect to vulnerability is not on equity trends per se. For example, it can demonstrated that the incomes of the poorer workers have been dropping less sharply than those of the better-off groups but this is not as important from our point of view as the fact that real incomes have been declining for all workers.

The growth and income objectives of the MED program will have beneficial effects on vulnerable groups in at least four ways:

1. By increasing the capacity of formal sector private enterprise to absorb more labor directly.

2. Through indirectly increasing demand for the intermediate goods produced by small-scale informal enterprises.

3. By creating a climate in which there is an increased demand for the goods and services produced by small-scale informal enterprises.

4. By enabling rural households to have greater access to essential goods and services.

A major negative impact of the broad structural adjustment program is urban unemployment and redundancy created by public expenditure cuts. However, the employment stimulus which the MED program will provide should off-set some of the more acute negative effects of these reductions.

c. <u>Potential Effects of the MED Program on the Vulnerable</u>

It seems entirely reasonable to suppose that provision of general foreign exchange support under the MED program is a positive step that in itself should not adversely affect the welfare of any social group in Malawi. Adjustment policies, by contrast, are a combination of restraints and incentives and confer both beneficial and adverse effects on various groups in society. The task of identifying the "winners" and "losers" in relation to this broad spectrum of policies is arguably easier than that of suggesting any potential vulnerability arising from the narrow range of positive economic incentives embodied in the MED program itself.

Of most direct relevance to the MED program are the ways in which benefits of the program are likely to be unevenly distributed in such a way that an unintended or unanticipated consequence of the program is that it benefits some groups more than others. Clearly, this is a "distributional" issue rather than a "vulnerability" issue per se.

Also, it is worth considering ways in which the program itself is vulnerable. The program is a process of policy adjustment with profound political and social implications. Throughout the lifetime of the program there needs to be awareness of its opportunity costs. There is a need to be conscious of the effect of lending considerable economic support to commerce and industry when vital social expenditures in the fields of health and education may be under severe budgetary strain. Moreover, the middle-class public servants who will be involved in the implementation of the program have themselves suffered from a steady erosion of their living standards. In short, and perhaps paradoxically, it could be said the program is potentially vulnerable if it fails to take into account the social and political milieu within which it will operate.

The following are some potential adverse consequences of the MED program.

1) The SME Sub-Sector

The MED policy reforms apply to the industrial and commercial sector as a whole with specific emphasis on the SME sub-sector. A potential difficulty with policy adjustments that provide incentives to the industrial sector "across the board" is that the larger firms that are well established in the formal sector are better placed to take advantage of the assistance and reforms.

The READI survey demonstrated that SME's in Malawi are modestly endowed with resources and limited in the scope and range of their activities. Easier availability of foreign exchange is, therefore, in many ways less relevant to the SME sub-sector than large scale enterprise. Likewise, a liberalization of the economic regime as far as imports and exports are concerned is unlikely to have a marked short-term impact on SME's. In sum, there is a risk that an "even-handed" approach to policy reform towards the industrial and commercial sector as a whole may have the unwelcome effect of benefiting the large-scale formal sector enterprises disproportionately.

Also, SME's can only really be expected to flourish when there are significant increases in per capita income which will increase domestic demand. In summary, the specific medium to long-term assistance rendered to the SME sub-sector under the MED program may take time to materialize in comparison with the short-term benefits accruing to the more sophisticated, large scale enterprises.

2) The Industrial and Commercial Labor Force

A basic tenet of the MED program is that it will increase industry and commerce over time and will generate additional employment for Malawians. A number of observations can be made here. First, the initial beneficiaries of the program are likely to be the relatively small, urban labor force. One potential problem with the program is that it may facilitate rapid expansion of formal sector activity without any noticeable generation of jobs, to the extent that there is substantially underutilized labor. Second, given the existence of surplus labor, growth of the urban labor force may cause workers being taken on in the industrial and commercial sector at wages that are on the margins of subsistence.

3) Women in Industry and Commerce

A study of barriers to establishing new industrial activities which was carried out by the Mission's READI project showed that the number of female entrepreneurs in Malawi was quite low. In an effort to support the role of women in the industrial and commercial sectors, and the SME subsector specifically, this program will support efforts of women to establish and run their own firms. Here, in the administration of the business consultancies, workshops, and studies, USAID/Malawi will pay particular attention to the role of women as entrepreneurs, managers, and employees. In addition, to the maximum extent possible, data will be collected on a sex disaggregated basis and the information generated will be used to modify the implementation of the program so as to enhance the role of women in this sector.

4) Vulnerability as a General Problem

While the program is aware of the pitfalls and constraints and the need to be concerned with both issues of vulnerability and equity, the basic assumption is that a program targeted on the industrial and commercial sector in general, and on the SME sub-sector to the extent practicable, and combined with a greater focus on increased agricultural productivity offers the best option to a general increase in the standard of living for the majority of Malawi's people. The program proposes no conditionality related to vulnerability, but plans to monitor it carefully throughout the life of the program. The wage study, for example, will be an important source of information on how to avoid some of the adverse effects mentioned above. As the analysis of employment suggests, a general increase in wages might actually serve as an incentive to generate employment from its positive impact on consumer demand.

5. Relationship with USAID's and Other Donors' Activities

As mentioned earlier, the MED program is closely aligned with the other program and project activities of the Mission. It builds on prior USAID/Malawi experience with SME development and privatization, including the ongoing Rural Enterprise and Agribusiness Development Institutions project (612-0214) and the Parastatal Divestiture program (512-0227), as well as several major studies of constraints to SME development. In addition, by increasing industrial and commercial activity, the program is designed to promote agricultural diversification and agricultural processing industries, both of which are central to the Mission's agricultural sector strategy. Finally, the program is an important step into the future, when the Mission expects to begin addressing agricultural policy issues more aggressively, including the linkages between the agricultural and industrial sectors directly.

The program has also been designed in close cooperation with the World Bank and its Industrial and Trade Policy Adjustment Credit (ITPAC) program, which is receiving parallel financing from the EC, the Japanese, and the British. Although AID is not providing co- or parallel financing to ITPAC, the MED program nonetheless complements the ITPAC in its support to the industrial sector. In limited ways, specifically the inclusion of commercial activities to broaden the linkages between the consumer and rural producer and the industrial sector, the MED program is slightly broader than the ITPAC. For the most part, however, MED seeks to dig deeper in the industrial sector than the ITPAC, in order to support expansion of established firms and SME's and to enhance the position of women in commerce and industry.

IV. FINANCIAL ARRANGEMENTS

A. Illustrative Budget

The budget for the activities described in the preceeding sections may be summarized as follows:

Table 1: Summary Cost Estimates and Financial Plan
(US Dols "000s)

Item	AID
Policy Reform Support:	
Cash Grant	35,000
Studies, including dissemination of results:	
Baseline and Monitoring	250
Policy Studies	500
Subtotal	750
Technical Assistance:	
Business Consultancies 28 @ 15,000	420
Subtotal	420
Training:	
Workshops 12 @ 15,000	180
Seminars	100
Subtotal	280
Monitoring, Evaluation and Audit:	150
Program Total	36,600

Table 2 - Projection of AID Expenditures by Fiscal Year

Fiscal Year	1988	1989	1990	1991
Program Component	15,000	10,000	10,000	0
Studies	0	400	300	50
Technical Assistance	0	140	220	60
Training	0	80	100	100
Monitoring, Evaluation & Audit	-	50	50	50
Total	15,000	10,670	1C,670	260

B. Obligation Plan

Of the total $36.6 million AID financing, up to $21.815 million for this program will be obligated in FY 1988. Obligations of the balance are expected to be split evenly over the two subsequent fiscal years. The annual obligation of these funds will be justified on the basis of progress made toward the achievement of the program's objectives, as discussed in the preceding section.

C. Disbursement Mechanism

The dollars provided in support of the policy reform component of the grant is expected to be deposited in a special account held by the Reserve Bank of Malawi in the Federal Reserve Bank of New York. Disbursement of the funds will be accomplished through the issuance of a Financing Request once the conditionality governing the tranche release has been satisfied. Control over these funds will rest with FM. Funds central to project activities will be transferred to USAID/Malawi. These funds will be disbursed using mechanisms similar to the Mission's other bilateral activities.

D. Local Currency Use Plan

Upon the release of each tranche of dollar funding, the GOM will deposit the Malawian Kwacha equivalent of the disbursement, calculated at the highest legal rate of exchange on the date of the dollar disbursement, into a special account held by the Reserve Bank of Malawi. The program is expected to generate MK 91.0

million in counterpart funds (at the current exchange rate of US $1.00 = MK 2.60). Up to ten percent of each deposit will subsequently be transferred by the Reserve Bank to a U.S. Treasury account in a Malawi commercial bank. These funds will help finance the operating expenses of USAID/Malawi. The remaining local currency will be jointly programmed by USAID/Malawi and the GOM first to support the objectives at MED and, to the extent they cannot be so used, for other developmental purposes.

1. Trust Fund

Local currency counterpart in the equivalent of ten percent of the policy reform support component, estimated at MK 9.1 million, will be made available to USAID to cover local currency costs of operating the USAID program in Malawi. Disbursements of funds to the Trust Fund will be made within seven days of any deposits into the local currency special account in the Reserve Bank of Malawi and in accordance with existing procedures. These disbursements from the special account at the Reserve Bank will be deposited into the U.S. Treasury account which the Mission maintains at the Commercial Bank of Malawi. Disbursements from the Trust Fund account will be made according to the Mission's need for local currencies funded operating expenses.

2. Sector Support and Other Developmental Uses

The first use of local currency, after the Trust Fund, will be in support of the sector program objectives, revitalization and growth of the private commercial and industrial sector. A substantial amount of this will finance existing budget line items to support the program purpose. This will be done in such a way as to maintain compliance with the public sector investment program which limits budget expenditures as negotiated among the GOM, IMF, and World Bank and within the context of the Policy Framework Paper (PFP). A portion of the local currency will also be used in support of program objectives outside the GOM budget, in the private sector directly. Options to be explored for private sector uses include but are not limited to: (1) endowments to SEDOM, INDEFUND, and DEMATT to decrease their dependency on the GOM for financial resources; (2) initial capitalization of a unit trust to support the divestiture program's efforts to broaden equity ownership in the economy; and (3) additional capital to the commercial banks for investment by the private sector.

Assuming that current budgetary outlays are indicative of future years, MED local currency resources will finance MK 10.4 million annually in support of activities directly related to the industrial and commercial sector (primarily support to SME's). Thus, over the six year period, a total of MK 62.4 million, or 69 percent of the total estimated local currency counterpart including Trust Funds, will finance existing budget line items that directly support of the program objectives. The extent to which additional local currency can be programmed outside of the budget, in the private sector directly, will depend on the institutional capacity of the private sector to absorb the funds without creating inflationary pressures.

Africa Bureau guidance for implementing nonproject assistance under the DFA requires that all local currency be programmed in support of the sector program objectives. The guidance also provides that, under exceptional circumstances, the PAAD may justify the use of the local currency for other developmental purposes. Taking into account the above, the AA/AFR is requested to approve an exception to the Bureau guidance, provided that the GOM and USAID/Malawi will program the local currency in support of sector program objectives to the maximum extent permitted within the above parameters. It should be noted that compliance with the PFP and efforts to contain inflation, which may limit the amount of local currency that can be programmed for the sector, are themselves in furtherance of program objectives. The PFP establishes the macroeconomic policy basis for the long term growth of the private sector in Malawi. A reduction in inflation, through fiscal discipline and other means, is a key component of the PFP and is necessary to provide the climate of stability within which the private sector can expand.

The local currency that cannot be programmed in support of the sector program objectives will be used to finance budget line items that directly support the Mission's program priorities in agriculture, economic policy reform, health, transportation, and human resources development.

USAID/Malawi and the GOM will engage in annual program budget reviews, prior to the GOM's negotiations with the World Bank and IMF, to ensure that the local currencies will be attributed to those components of the Malawi budget consistent with the purpose of this sector program. The first of these meetings will be held in late September or early October, 1988.

Local currency used in support of program objectives may be considered as host country counterpart. Based on the above estimates of the amount of local currency that will be used to support the industrial and commercial sector, the requirement of Section 110 of the FAA that the host country finance at least 25 percent of total program costs will be satisfied.

3. <u>Reporting and Monitoring</u>

A covenant in the program agreement will specify that USAID/Malawi will conduct an annual joint review with the GOM on the programming of MED generated local currencies.

Monitoring will take place through the program review which is due to take place before the disbursement of the second and third dollar tranches, through periodic reviews or audits, and through regular meetings with the World Bank and participating Ministries to review the progress of work and the use of funds. USAID/Malawi will also monitor the local currency expenditures through the review of all related project reports and discussions with other A.I.D. funded activities supported with on-budget local currency expenditures as well as occassional site visits.

V. MANAGEMENT ARRANGEMENTS AND EVALUATION PLAN

A. Management

The MED Program will be managed jointly by USAID/Malawi and the Government of Malawi with assistance from various external parties. The responsibilities of each of these parties is outlined below.

1. USAID/Malawi

Within the USAID/Malawi office, the USDH economist, who reports directly to the Program Officer, will be the project manager with primary responsibility for: tracking performance under the reform program in close collaboration with host country counterparts, the World Bank and other donors; preparing scopes of work and overseeing implementation of studies and technical assistance; and monitoring disbursements from the local currency accounts and verify that expenditures follow agreed uses. The economist will be assisted by an FSN program assistant. The program assistant will have primary responsibility within the USAID Mission for data gathering necessary to monitor program progress and for overseeing the implementation of the training component of the project. The Mission's Project Development Office, which has management responsibility for all other private sector development activities, will assist in planning business training programs.

Policy dialogue and negotiations with the GOM will be carried out jointly by the economist and Program Officer, under the overall direction of the Mission Director and Assistant Director.

The Mission Controller will be responsible for development of scopes of work for financial audits and for quarterly reporting to AID/W on Special Account transactions.

x 61

2. Government of Malawi

The GOM entities to be involved in this program include the Ministry of Finance (MOF), the Department of Economic Planning and Development (EP&D) in the Office of the President and Cabinet, and the Reserve Bank of Malawi.

The MOF will have primary responsibility for program management. Policy and institutional reforms will be negotiated with and decided upon by this Ministry. The MOF will be responsible for presenting to A.I.D. all documentation necessary for determining whether conditions precedent to disbursement have been satisfied. The Secretary to the Treasury will review annually, with A.I.D., performance on policy and institutional reforms and determine mutually with A.I.D. annual programming of local currency generation. The Accountant General, within MOF, will manage disbursements of local currency generations and will prepare periodic reports on the status of the Special Account.

EP&D will be responsible for monitoring program progress and impact. It will be the GOM entity responsible for collaborating with USAID on the development of scopes of work for the various studies, analyses and evaluations to be carried out under the program. In the case that the Host Country Contracting mechanism is used for such activities, EP&D will manage contract execution.

The RBM will establish and manage the local currency special account and will be responsible for periodic reporting to A.I.D. on special account transactions. The RBM will also make all necessary transfers to A.I.D.'s Trust Fund from the special account.

3. Contractors

USAID and the GOM will contract with various U.S. and local institutions to conduct the studies and training and provide technical assistance envisioned under the U.S. $1,600,000 project component. USAID will use IQC's or the GOM will contract with local management consultants and institutions to carry out the studies. Possible sources of business advisory services include the International Executive Service Corps (IESC) and Entrepreneurs International. Finally, a local accounting firm will be retained to conduct annually a nonfederal audit of local currency disbursements under the program.

4. RIG and REDSO

The Regional Inspector General's Office will be asked to help develop the scope of work for the annual financial audits, to ensure that the local audit firm to conduct the work meets audit firm qualifications and performance standards, and to review the resultant audit report, including workpapers.

From time to time the Mission will require REDSO assistance in monitoring and evaluating the program or developing scopes of work for specific studies.

B. Contracting Mechanisms and Procurement Source

The key factors considered in determining the most appropriate mechanisms for procuring services required by MED were: 1) AID/Malawi's relatively small staff and resulting limited administrative capability; 2) the limited capacity of the host country institutions in contract management; and 3) a desire to use local institutions and resources to implement project activities wherever possible. Thus, the services of contractors to manage the activities discussed above will be obtained through competitively-selected host country or direct A.I.D. contracts and IQCs. Efforts will be made to open these contracting opportunities to qualified small, disadvantaged, or women-owned firms. However, no specific set-asides have been identified at this time.

Since the program assistance will be disbursed as cash, procurement requirements are not applicable to it. Under the project assistance component, Code 941 is authorized for ESF funds and Code 935 is authorized for funds from the Sub-Saharan Development Assistance (DFA) appropriation, as well as Malawi for both types of funds. In accordance with the requirement in the DFA guidance to maximize U.S. procurement to the extent practicable, it is anticipated that most, if not all, of the technical assistance and training will be of U.S. or Malawian nationality. Long term technical assistance and training are not anticipated. It is anticipated that virtually all procurement will be of technical assistance and training services, and that commodities, if any, will be in support of these services.

Although Code 935 is the authorized source for A.I.D. financing of shipping with DFA funds, this is subject to the normal cargo preference requirements that 50 percent be shipped on U.S. flag vessels unless a prior determination of nonavailability has been obtained from M/SER/OP/TRANS.

Procurement with ESF funds will occur under normal A.I.D. rules and procedures, while procurement with DFA funds will occur under the April 1 and April 4, 1988 guidance approved by the AA/AFR concerning DFA funded procurement.

C. Methods of Implementation and Financing

The chart below shows the proposed methods to be used to implement and finance activities under the MED project component.

Activity	Method of Implementation	Method of Financing	Amount
Policy Reform Support	Cash Grant	Electronic Funds Transfer	$35,000,000
Studies			
-baseline and monitoring	AID Direct Contract	Direct Payment	250,000
-various policy-based	AID Direct/HCC	Direct Payment	500,000
Technical Assistance			
-business consultancies	AID Grant or Contract	Direct Payment	420,000
Training			
-workshops	AID Direct Contract	Direct Payment	180,000
-seminars	AID Direct/HCC	Direct Payment	100,000
Evaluation and Audit	AID Direct Contract	Direct Payment	150,000

D. Evaluation and Audit Plan

In addition to the ongoing monitoring of the program that will be carried out by the USAID economist and the GOM's EP&D, a mid-term and end-of-project evaluations and three annual financial audits will be conducted.

The mid-term evaluation is planned for December 1989. The scope of work for this evaluation will be as follows:

- to assess whether project activities are proceeding as planned, and whether the project environment has changed in any substantial way;
- to review the disbursement of local currency counterpart for approved uses;
- to assess the degree to which project activities are contributing to the achievement of the project purpose;
- to determine whether the policy reform agenda remains valid, and if so, whether additional A.I.D. foreign exchange resources should be made available to the GOM during fiscal year 1990;
- and finally, to make recommendations for any changes in the policy reform agenda, project activities, or implementation arrangements needed to assure achievement of the project goal and purpose.

A team consisting of a macroeconomist, labor economist and a private sector development specialist will be fielded through an IQC to conduct the evaluation.

An end-of-program evaluation will be conducted in September 1991 to assess the degree to which programmed project activities resulted in the achievement of the program purpose and goals, and to make recommendations on the basis of lessons learned for future USAID/Malawi involvement in similar types of activities.

Annually (in September/October) during the project life, USAID/Malawi will arrange for REDSO/RFMC to issue a delivery order under its IQC to one of the certified public accounting firms, which has offices in Malawi, to carry out a financial review of the local currency accounts under the program. The scope of work for the accounting firm is limited to financial and compliance matters and will be prepared by USAID/Malawi's Controller with assistance from RIG/N.

Project funds have been budgeted for the planned evaluations and financial reviews/audits.

VI. STATUS OF NEGOTIATIONS WITH THE GOVERNMENT OF MALAWI

The World Bank approved the Industrial and Trade Policy Adjustment Credit (ITPAC) Program in June 1988. As discussed in the PAAD, the MED Program provides associated finance to ITPAC. ITPAC and MED share considerable overlapping conditionality in the first year. However, MED concentrates on the removal of the financial and institutional constraints which inhibit the expansion of the SME subsector. Thus, MED complements ITPAC's broader focus on the industrial sector by its emphasis on SME's.

The MED conditionality was discussed with the Ministry of Finance on August 1, 1988. On August 2, 1988, the Secretary to the Treasury issued a letter to USAID/Malawi formally requesting the program (See Annex F). The Government of Malawi has assured USAID that it will expedite the review of the Program and Project Grant Agreements in order to sign them by August 29, 1988, assuming expiration of the Congressional Notification.

ANNEX A

MED PROGRAM POLICY REFORM MATRIX

MALAWI ENTERPRISE DEVELOPMENT SECTOR ASSISTANCE PROGRAM

(612-0233)

POLICY REFORM MATRIX

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
A. Trade and Industrial Policy and Exchange Rate Management				
-Reduce administrative controls on the import of commodities and the export of finished goods.	Trade regime was relatively open in 1960s and 1970s, with few quantitative restrictions on imports. External shocks and fiscal pressures in 1980s precipitated imposition of administrative controls on foreign exchange allocation, higher tariffs, and new trade regulations. Despite active exchange rate management in 1980s, there has been a shortage of foreign exchange since 1986.	-1st tranche: GOM has maintained a flexible exchange rate policy during the previous 12 months.		-compliance with PFP and terms of ITPAC.
-Creation of a favorable investment climate for industrial and commercial expansion.		-1st tranche: GOM has adopted the first and second stages of foreign exchange allocation liberalization which covers a total of 75% of the 1984 base year's value of raw materials and spare parts imports.	-ITPAC and ESAF agreements. -private sector access to FX increases. -reduction in time required to obtain FX approval and to effect payment once goods received.	-gazetting of licensing changes. -want to ensure real and significant increases in private sector access to FX (interview applicants in addition to review of FX applications and allocations)
-Maintenance of a satisfactory exchange rate.		-2nd tranche: GOM has reduced the number of items for which import and export licenses are required.	-reduction in time required to obtain license.	-additional info on FX applications received (possibly requiring modification of RBM form).
		-3rd tranche: GOM has continued liberalization of foreign exchange allocation for the import of industrial inputs and has agreed to and implemented the third stage of foreign exchange allocation liberalization.	-share and value of private sector and SME receipts of FX have increased.	
		-2nd tranche: GOM has streamlined	-monitor applications and	-allocations of FX.

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
		the foreign exchange approval and payment processes. -<u>3rd tranche</u>: GOM has streamlined import and export licensing procedures and systems.	the value of non-traditional exports increasing as well as their share of total exports (30% of total value in 1985).	-study to be conducted during first year of program.
			-increase in the share of employment and national income coming from the industrial and commercial sector.	
			-increase in share of imports going to the private sector, up from 44 percent in 1986.	
			-reduction in the 34 categories and 34 countries subject to import licensing requirements. The target is to bring this down to 7 categories and 22 countries.	
			-increase in ratio of value added to gross output from current 35 percent.	
			-increase in private sector plant utilization capacity in the industrial sector from the present average level of 47 percent.	

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
B. Small and Medium Scale Enterprises				
Promote small and medium scale industries to support industrial growth, equitable resource allocations, and expansion in off-farm employment opportunities.	Despite high productivity, small and medium scale firms account for a small portion of industrial output, reflecting financing and human resource constraints. GOM is strongly committed to expanding small-scale subsector. USAID and EEC provide significant financing and technical assistance to support SME development.	-2nd tranche: GOM has established support to the SME Sector in a unit in the Ministry of Trade, Industry and Tourism. -2nd tranche: GOM has issued a policy statement regarding terms and conditions for provision of funds to financial institutions involved with SME's. This policy should address, without limitation, areas such as on-lending by the GOM, measures to assure the commercial viability of the institutions, promoting access to private sources of capital, and minimizing the need for GOM resources over the long run.	-no. of SME's increases. -barriers to entry for SME's, including zoning and licensing requirements, are relaxed. -Policy should address issues such as: 1.High cost of extending credit to SME's 2.GOM's role in securing concessional assistance to the financial institution. 3.Passing credit funds on to financial institutions at a fair, market cost. 4.Need for financial institutions to charge commercial interest rates.	-work with WB to study impact of differential tariffs on SME's. -READI study to serve as baseline; to be updated to assess program progress/ impact. -effective assistance to SME's in applying for FX and confirming lines. -Building on the work already done by READI Project in this area, the Project Implementation and Coordination Unit for READI will assist the MTIT in the formulation of this policy. The basic groundwork for it has already been done.
Support the flow of domestic credit to SMEs. X	SMEs in Malawi have a difficult time procuring credit from the two, relatively conservative commercial banks. USAID and the GOM will explore ways in which the flow of such resources to SMEs can be enhanced, without violation of sound business practices and with the cooperation of the existing commercial banks.		-Formulation of a policy proposal to enhance the flow of commercial bank credit resources to SMEs.	-USAID, GOM and Commercial Bank review READI managed study of credit guarantee scheme for SMEs. -Credit Guarantee Scheme would involve sharing the risk between the GOM and the commercial banks similar to arrangement worked out recently

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
				to finance purchases of estates being being offered for sale by ADMARC. To establish Scheme, the project element of the program would finance a study during the first year of the program to develop proposal for implementation by GOM. Study would develop the risk sharing formula between the GOM and banks and explore other problems of implementation.
		-3rd tranche: INDEFUND's and SEDOM's deeds of trust have been amended to allow them to extend credit to ventures involving foreign technical partners who are prepared,to bring equity finance and expertise to the enterprise.	-Amended Deeds of Trust to permit joint ventures of 25% or more in equity financing.	-The GOM is likely to have concern about allowing technical partners to have majority shareholding status. Thus, it is likely that they will insist that Deeds of Trust only permit up to 49 percent ownership by foreign investers.

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
		-3rd tranche: GOM has established a SME subsector investment promotion program which maximizes the use of private sector organizations and institutions.	-Expansion of the capacity of Malawi Export Promotion Council to undertake and develop a proposal for vis-a-vis SME's. 1) Investment promotion 2) Facilitate access to FX 3) Packing investment proposals 4) Monitoring progress 5) Assistance with managerial, institutional and bureaucratic problems 6) Research and studies -Increase in number of SME's involved in external trade. -Improved data on SME sector.	During the 1st year, a study will be undertaken to better understand and establish a SME investment promotion program. Study will examine capacity of MEPC and other institutions such as DEMATT to undertake this. The study will form basis for recommendation to achieve policy objective. Upon acceptance of the study, TA and LC resources would be available to assist with implementation of recommendations.

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
		-1st tranche: GOM has revised the Industrial Development Act to permit a streamlining and rationalization of SME licensing.	-Revised legislation, rules and laws. -Reduction in number of ministries and authorities involved in licensing of SME's. -Decrease in time required to register and obtain license. -License mainly for purpose of information collection and monitoring SME's and to facilitate provision of services. -Increase in formal sector employment from 427,000 in 1987. -Increase in average rate of growth of formal sector employment from 3.61% which characterized the 1977-87 period. -Reversal in trend toward larger scale enterprises - those employing more than 20 persons. Increase in 55% share of all private sector establishments which are small scale.	-DEVPOL presently outlines the GOM's intention to amend the Industrial Development and Control of Goods Acts. This policy reform is directed at further streamlining and rationalization to reduce the number of steps, organizations, and time involved in registration. USAID would provide assistance under the technical assistance component to facilitate these changes and lead to their adoption.
C. Finance Sector Broaden and deepen capital markets.	Finance sector is small, with two commercial banks and one GOM	-3rd tranche: Institutional arrangements and/or mechanisms,	-Increased availability of net domestic credit to the	-domestic credit issues to be studied.

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
	institution to mobilize rural savings, and is relatively undeveloped, with little term credit and equity financing available. IFI's face institutional constraints and legal restrictions to improved performance. Reserve Bank has kept to tight monetary and credit targets. To finance BOP and fiscal deficits, net domestic credit to Government and official external borrowing have increased significantly.	identified through program financed studies, have been established in order to enable efficient financial, intermediation.	private sector over and above 1987 level of 27.6% disaggregated by subsector. The target is to return to the 1979 level of 75.5%. -increase in equity investments. -interest rates which reflect the true cost of capital. -reduction in the 1987 inflation rate of 26.8%. -real GDP increased above the planned 1.5% in 1988.	-DHS capital market study to serve as baseline for monitoring; further study to explore capital market development. -information on formal and informal credit flows provided to USAID. -examine ways to increase working capital and equity financing for SME's.

OBJECTIVES	BACKGROUND	MED CONDITIONS	INDICATORS	MONITORING AND CONCERNS
D. Fiscal Policies				
-Reduce fiscal deficit to check crowding out of and annual recurrent and foreign exchange to the private sector.	In response to high fiscal deficits in late 70's and early 80's, SAL I-III focused on improved public sector management and instituted the following reforms: programmatic budget, foreign borrowing plan, tariff increase and parastatal restructuring. Deficit reduced from 15% of GDP in 1981 to 9% in 1984. But it increased to 12% in 1986 due to high debt-service and external shocks, including drought, refugees and security.	-1st tranche: GOM has reduced the ratio between the budget deficit and GDP for its FY87/88 budget to a level less than that which existed in FY86/87.	-progressive reduction of budget deficit to levels	-compliance with PFP, annual agreements on rolling PSIP, agreed to with IMF. development budgets.
-Reduce fiscal deficit to check crowding out of domestic credit to private sector.		-2nd tranche: GOM has reduced the ratio between the budget deficit and GDP for its FY88/89 budget to a level less than that which existed for FY87/88.	-private sector access to domestic credit increases. -share and value of private sector receipts of domestic credit have increased.	-want to ensure real and significant increase in private sector domestic credit.
		-3rd tranche: GOM has reduced the ratio between the budget deficit and GDP for its FY89/90 budget to a level less than that which existed for FY88/89.		

Covenants

I. Information regarding foreign exchange applications will be provided to A.I.D. upon request to permit monitoring of program performance and any subsequent impact evaluation that might be conducted.

II. GOM will maintain a flexible exchange rate from the date of the program agreement until one year after the final dollar disbursement.

III. GOM will conduct annually a joint review of the A.I.D. bilateral program, which will include a joint determination of the specific uses of the local currencies generated under the program, within the parameters established in the agreement.

ANNEX B

STATISTICAL TABLES

Table 1

MALAWI

Key Macroeconomic Indicators, 1979-1987

		1979	1980	1981	1982	1983	1984	1985	1986	1987
1.	GDP Growth Rate (nominal) (%)	8	16.3	10.2	12.4	15.4	18.9	18.4	13.7	24.5
2.	Real GDP Growth Rate (%)	3.3	-0.4	-5.2	2.8	3.5	4.5	4.1	2.8	-0.2
3.	Real GDP/Capita Growth Rate (%)	-	-3.4	-8	-0.1	2.6	1.1	0.9	-0.3	-3.1
4.	Gross Fixed Investment/GDP	26.8	22.2	15.1	14.6	13.7	13.1	12.8	11.1	11.5
5.	Domestic Savings/GDP	18.1	17.9	17.5	15.1	15.2	14.8	13.3	8.4	10
6.	Public Fixed Investment/GDP	15.7	17.5	10.2	8.4	8.3	9.8	8	8.2	8.1
7.	Public Fixed Investment/Private Fixed Investment	140.6	367.7	207.3	137.2	154.6	297.7	163.5	341.6	226
8.	Government Revenue/GDP [1]	21	23	23	21	21	19	21	22	19
9.	Government Expenditure/GDP [2]	29	31	33	26	29	28	27	26	29
10.	Government Deficit/GDP	8	8	10	5	9	8	6	4	10
11.	Foreign Financing of Govt. Deficit/Total Financing [3]	9	79	36	54	3	58	-9	21	39
12.	Export Growth Rate (%)	16.7	25.5	7	3.7	14.3	52.4	-2.6	7.5	33.6
13.	Exports/GDP	21	22.7	22	20.3	20.1	26	21.2	20.1	21.5
14.	Import Growth Rate (%) [4]	14.1	10	12.6	3.3	12.5	5.2	29.1	-3	37.2
15.	Imports/GDP	37.6	35.5	28.2	25.9	25.3	22.3	24.3	20.8	22.9
16.	Consumer Goods/Total Imports	14.4	11.4	13.3	13.8	13	11.9	12.6	13.6	-
17.	Current Account Balance (K million)	-205.8	-208.2	-119.5	-131.9	-169.4	-29	-166.2	-141.6	-118.2
18.	Trade Balance (K million) [5]	-71.7	-27.4	26.7	45.9	37.8	211.8	134.2	175.3	218.5
19.	Current Account/GDP	-23.8	-20.7	-10.8	-10.5	-11.8	-1.4	-8.2	-6.2	-4.2
20.	Debt Service (K million)	-	18.7	35.2	78.5	63.6	135.3	199.5	325.4	313.6
21.	Debt Service/GDP	-	1.9	3.2	6.3	7.3	13.5	9.9	14.1	11
22.	Debt Service/Exports of Goods and Services [6]	-	7.5	12.9	28.1	20	27.9	41.2	63.7	46.1
23.	Consumer Price Index (CPI)	-	100	110.4	120.1	136.2	151.2	173.8	199.5	252.9
24.	CPI Growth Rate (%)	-	-	10.4	8.8	13.4	11	14.9	14.8	26.8
25.	GDP Deflator	-	100	115.0	124.9	136.2	149.8	165.5	184.4	208.7
26.	Exchange Rate (K/US$), annual average	0.8165	0.8104	0.8958	1.0553	1.1762	1.4105	1.7098	1.8632	2.2108
27.	Exchange Rate (K/US$), end of year	0.8006	0.8258	0.9084	1.0984	1.3009	1.5669	1.6814	1.9549	2.0564

1. Revenues include grants
2. Expenditures include appropriations-in-aid
3. Total financing includes below-the-line accounts
4. Imports on c.i.f. basis
5. Both imports and exports on f.o.b. basis
6. Services include non-factor services

Source: Reserve Bank of Malawi

Table 2

Devaluation of the Malawi Kwacha

Exchange Rate Since 1982

Date of Devaluation		Percent	Against
1.	24 April, 1982	15	S.D.R.
2.	17 September, 1983	12	S.D.R.
3.	2 April, 1985	15	Basket
4.	16 August, 1986*	10	Basket
5.	7 February, 1987	20	Basket
6.	16 January, 1988	15	Basket

* The Reserve Bank also adopted a crawling peg which in effect resulted in a further devaluation of the Kwacha for the year.

Source: Reserve Bank of Malawi

Table 3

Distribution of Total Imports

(K'000)

Year	Private [1]		Government		Total [2]
	Amount [1]	%	Amount	%	
1982	210069	65	112660	35	322729
1983	201673	56	161195	44	362868
1984	228877	60	152828	40	381705
1985	234288	48	258262	52	492553
1986	209425	44	268565	56	477990
1987	303327	46	351913	54	655240

Notes: [1] Approved Import Payments

[2] Total Imports as per National Statistical Office bulletins

Source: Reserve Bank of Malawi

Table 4

Annual Percentage Changes in Foreign Exchange

Allocation to Six Major Foreign Exchange

Users in Malawi, 1986 and 1987

	% Change from Previous Year	
	1986	1987
1. Firm 1	60.3	-16.3
2. Firm 2	-10.1	0.0
3. Firm 3	60.0	24.3
4. Firm 4	-12.8	40.2
5. Firm 5	-25.2	-14.6
6. Firm 6	8.1	59.6
All Six Firms	-3.0	6.2

Source: Reserve Bank of Malawi

Table 5

Malawi Capacity Utilization and

Import Base in the Industrial Sector

Industrial Subsector	Number of Activities in the Sample	Direct and Indirect Import Content of Recurrent Imports	Actual Capacity Utilization
1. Food Processing Products	8	34%	70%
2. Beverages and Tonacco	6	75%	47%
3. Textiles and Clothing	15	34%	72%
4. Leather and Footware	4	74%	33%
5. Wood and Paper Products	11	91%	56%
6. Plastics and Pharmaceuticals	20	83%	53%
7. Chemicals and Fertilizer	18	85%	59%
8. Cement and Glass	1	54%	77%
9. Steel Products	16	96%	8%
10. Miscellaneous Products	1	96%	35%
Average weighted by value added	100	66%	47%

Source: Garcia, Jorge, "Domestic Reserve Cost and Effective Protection in the Industrial Sector of Malawi: An Analysis of the Results of the World Bank Survey," December 1987, mimeo.

Table 6

Share in Total Domestic Credit by End User

Year	Private	Official Net		Total
		Government	Statutory Bodies	
1979	0.639	0.245	0.116	1.00
1980	0.587	0.268	0.145	1.00
1981	0.482	0.420	0.098	1.00
1982	0.465	0.448	0.087	1.00
1983	0.471	0.468	0.061	1.00
1984	0.419	0.497	0.084	1.00
1985	0.344	0.531	0.125	1.00
1986	0.314	0.607	0.079	1.00
1987	0.276	0.659	0.066	1.00

Source: NSO, Monthly Statistical Bulletin

Table 7

Population, Labor Force, and Employment in Malawi

selected years

(in thousands)

	1966	1977	1987	Average Annual Growth Rate (%) 1966-77	1977-87
Total Population (all ages)	4,039.6	5,547.5	7,982.6	2.88	3.64
Urban	203.3	470.6	878.1	7.63	6.24
Rural	3,836.3	5,076.8	7,104.5	2.55	3.36
	1968	1977	1986	1968-77	1977-86
Labor Force [a]	1,775.5	2,288.3	3,171.5	2.82	3.63
Formal Sector Employment [b]	164.6	309.0	427.8	7.00	3.61
Agriculture, Forestry and Fishing	44.2	155.1	185.1	13.95	1.96
Industry [c]	34.5	59.8	101.8	6.11	5.91
Services [d]	55.9	94.1	140.9	5.79	4.48
Unallocated	30.0	0.0	0.0	-	-
Informal Sector Employment [e]	44.9	84.3	116.7	7.00	3.61
Smallholder Agriculture and Residual	1,566.6	1,848.4	2,435.4	1.84	3.06
Unemployed	-	46.6	191.6	-	15.71

Source: Data obtained from various publications of the National Statistical Office as well as published and unpublished documents of the World Bank. See World Bank, Employment Aspects of Economic Development in Malawi, May 8, 1981.

a Labor force estimate for population ten years of age and older. Estimated by applying 1977 ratio of labor force ten years of age and older to total population, all ages, to population census estimates.

x 43

b Formal sector figures are primarily from NSO, Reported Employment and Earnings. The unallocated are based on an estimate of 30,000 employees working in small establishments (those with less than 20 employees) not covered in figures for 1968.

c Includes mining and quarrying, manufacturing, electricity and water, and building and construction.

d Includes wholesale and retail trade, hotels and restaurants, transport, storage and communications, financing, insurance and business services, and community, social and personal services.

e Figures based on constant 1977 ratio of formal to informal sector employment. Excludes self-employed in agriculture, forestry, and fishing.

Table 8

Estimates of Sectoral Employment and

Share of Total Employment in Malawi, 1968, 1977 & 1986

(in thousands)

		Formal (Wage-Employment)		Informal (Self-Employment)		Total	
Urban	1968	90.3	(5.1%)	5.9	(0.3%)	96.2	(5.4%)
	1977	115.4	(5.1%)	13.0	(0.6%)	128.4	(5.7%)
	1986	182.0	(6.1%)	25.7	(0.9%)	207.7	(7.0%)
Rural Non-Farm	1968	30.1	(1.7%)	39.0	(2.2%)	69.1	(3.9%)
	1977	38.5	(1.7%)	71.3	(3.2%)	109.8	(4.9%)
	1986	60.7	(2.0%)	91.0	(3.0%)	151.7	(5.0%)
Rural Farm	1968	44.2	(2.5%)	1,566.6	(88.2%)	1,610.8	(90.7%)
	1977	155.1	(6.9%)	1,848.4	(82.4%)	2,003.5	(89.4%)
	1986	185.1	(6.2%)	2,435.4	(81.8%)	2,620.5	(88.0%)
Total	1968	164.6	(9.3%)	1,611.5	(90.7%)	1,775.7	(100.0%)
	1977	309.0	(13.8%)	1,932.7	(86.2%)	2,241.7	(100.0%)
	1986	427.8	(14.3%)	2,552.1	(85.7%)	2,979.9	(100.0%)

Notes: Sums do not always add to 100% due to rounding.

The distribution of urban formal and rural non-farm formal employment is 3/4 urban 1/4 rural. Based on estimates of the National Physical Development Plan.

The distribution of urban formal and rural non-formal informal employment is 13.2% urban informal, 86.8% rural non-farm informal for 1968; 15.4% urban informal, 84.6% rural non-farm informal for 1977; and 22% urban informal, 78% rural non-farm informal for 1986. This distribution is initially based on the READI survey with some adjustments for urban growth.

The informal rural farm sector consists of smallholder agriculture and residual.

Table 9

Estimates of Sectoral Employment Growth

1968-77 and 1977-86

(average annual growth rates)

		Formal (Wage-Employment)	Informal (Self-Employment)	Total
Urban	1968-77	2.7%	8.8%	3.2%
	1977-86	5.1%	7.6%	5.3%
Rural Non-Farm	1968-77	2.7%	6.7%	5.1%
	1977-86	5.0%	2.7%	3.6%
Rural Farm	1968-77	13.9%	1.8%	2.4%
	1977-86	2.0%	3.1%	3.0%
Total	1968-77	7.0%	2.0%	2.6%
	1977-86	3.6%	3.1%	3.2%

Source: Based on Table 8.

Table 10

Private, Statutory, and Public Sector

Employment, selected years

(in thousands and percent)

Year	Private		Statutory		Public		Total	
1974 (old series)	160.5	(70.7%)	-		66.4	(29.3%)	226.9	(100%)
1977	204.9	(66.7%)	35.4	(11.4%)	68.6	(22.2%)	308.9	(100%)
1978	233.0	(68.7%)	38.2	(11.2%)	68.1	(20.1%)	339.3	(100%)
1979	248.3	(69.4%)	39.9	(11.1%)	69.6	(19.4%)	357.8	(100%)
1980	249.7	(68.0%)	41.2	(11.2%)	76.4	(20.8%)	367.3	(100%)
1981	214.9	(65.6%)	36.6	(11.2%)	76.1	(23.2%)	327.6	(100%)
1982	217.9	(66.7%)	31.4	(9.6%)	77.2	(23.6%)	326.5	(100%)
1983	273.6	(70.7%)	33.9	(8.7%)	80.0	(20.6%)	387.5	(100%)
1984	261.6	(68.7%)	40.1	(10.5%)	79.1	(20.8%)	380.8	(100%)
1985	283.1	(69.2%)	45.5	(11.1%)	80.7	(19.7%)	409.3	(100%)
1986	295.1	(69.0%)	48.4	(11.3%)	84.3	(19.7)	427.8	(100%)

Source: National Statistical Office, Employment And Earnings Annual Report, selected years.

x 91

Table 11

Number of Private Sector Establishments (including Statutory Bodies) by

Employment Size and Industry

(in number and percent)

	1983				1984				1985				1936			
	-20	20-49	50+	Total	-20	20-49	50+	Total	-20	20-49	50+	Total	-20	20-49	50+	Total
All Industries	1737	537	884	3158	1786	552	909	3247	1812	578	961	3351	1892	581	1001	3474
	(55%)	(17%)	28%)	(100%)	(55%)	(17%)	(28%)	(100%)	(54%)	(17%)	(29%)	(100%)	(54%)	(17%)	(29%)	(100%)
Agriculture	275	189	394	858	273	158	449	880	272	128	503	903	286	172	478	936
	(32%)	(29%)	(46%)	(100%)	(31%)	(18%)	(51%)	(100%)	(30%)	(14%)	(56%)	(100%)	(31%)	(18%)	(51%)	(100%)
Industry	297	96	110	503	240	91	202	533	254	92	210	556	258	96	221	575
	(59%)	(19%)	(22%)	(100%)	(45%)	(17%)	(38%)	(100%)	(46%)	(16%)	(38%)	(100%)	(45%)	(17%)	38%)	(100%)
Services	1258	305	234	1797	1279	288	267	1834	1287	358	248	1892	1348	313	302	1963
	(70%)	(17%)	(13%)	(100%)	(78%)	(16%)	(14%)	(100%)	(68%)	(19%)	(13%)	(100%)	(69%)	(16%)	(15%)	(100%)

Source: National Statistical Office, Employment And Earnings Annual Report, selected years

Table 12

Malawians Employed in the Mines of South Africa

Under Contract with the Employment Bureau of

Africa Limited, 1974-1985 [1]

Year	Number of Contract as at End of Year	Number of Attested Per Year [2] [3]
1975	2,711	-
1976	-	-
1977	17,443	18,206
1978	17,891	16,431
1979	19,128	17,873
1980	14,236	11,230
1981	15,156	13,230
1982	16,049	13,982
1983	15,785	13,144
1984	18,180	16,232
1985	19,621	17,415

1 Previously known as Witwatersrand Native Labour Association (WENELA).

2 Attested persons are those who have been contracted and informed about the conditions of employment by a Labour Officer of the Malawi Government.

3 People were attested only up to April, 1974 and from June, 1977.

Source: Ministry of Labour

Table 13

Remittances by or on behalf of Migrant Workers by Country and by Channel Through which Remitted, 1975 - 1985

(thousands Kwacha)

Year	Total	Country and Channel of Remittance										
		South Africa							Zimbabwe			Zambia
		Total	Malawi Post Office	T.E.B.A. (Wenela) [1]	New Series Deferred Pay [2]	Deposit Payment	Malawi Govern't Rep.	E.S.D. [3]	Total	Malawi Post Office	Z.A.L.-S.C. [4]	Malawi Govern't Rep.
1975	32,105	30,793	1,499	27,135	-	-	705	1,454	1,312	1,115	88	109
1976	4,250	3,195	671	2,219	-	-	209	96	1,055	933	26	96
1977	2,433	1,505	1,274	36	-	-	189	6	928	792	-	136
1978	13,153	12,563	3,218	4,970	-	-	2,309	2,086	575	488	-	87
1979	11,027	11,027	3,384	680	6,963+	-	-	-	-	-	-	-
1980	27,696	27,696	4,672	-	22,112+	912	-	-	-	-	-	-
1981	30,988	30,988	4,891	-	24,849+	1,248	-	-	-	-	-	-
1982	36,990	36,990	5,527	-	29,873+	1,590	-	-	-	-	-	-
1983	25,002	25,002	-	-	23,511	1,485	-	-	-	-	-	-
1984	25,610	25,610	-	-	23,554	1,491	-	-	-	-	-	-
1985	29,860	29,860	-	-	28,854	1,006	-	-	-	-	-	-

1 The Employment Bureau of Africa Limited, previously known as the Mines Labour Organization (Wenela).

2 Part deferred pay that was paid through the National Bank and Commercial Bank.

3 Employment Service Division, Ministry of Labour.

4 Zimbabwe African Labour Supply commission, Limbe.

SOURCE: Ministry of Labour

Table 14

Nominal and Real Daily Earnings
Including In-kind Benefits, By Industry [a]

(in Malawi Kwacha)

	CPI[b]	All Industries	Agriculture[c]	Industry[d]
1977	70.0	1.21 (1.73)	0.50 (0.71)	1.64 (2.34)
1978	75.9	1.42 (1.87)	0.58 (0.76)	1.73 (2.28)
1979	84.5	1.50 (1.77)	0.58 (0.69)	1.85 (2.19)
1980	100.0	1.75 (1.75)	0.64 (0.64)	2.29 (2.29)
1981	111.8	1.98 (1.77)	0.77 (0.69)	2.42 (2.16)
1982	122.8	2.31 (1.88)	0.99 (0.81)	2.94 (2.39)
1983	139.4	2.18 (1.56)	0.89 (0.64)	2.83 (2.03)
1984	167.3	2.36 (1.41)	0.97 (0.58)	2.62 (1.57)
1985	184.9	2.52 (1.36)	1.08 (0.58)	2.72 (1.47)
1986	210.7	2.73 (1.30)	1.09 (0.52)	2.88 (1.37)
1977	2.12 (3.03)	0.40 (0.57)	0.25 (0.36)	0.39 (0.56)
1978	2.61 (3.44)	0.40 (0.53)	0.25 (0.33)	0.39 (0.52)

	Services [e]	Urban [f] Minimum Wage	Rural [g] Minimum Wage	Subsistance [h] Household Income
1979	2.89 (3.42)	0.40 (0.47)	0.25 (0.29)	0.39 (0.46)
1980	3.20 (3.20)	0.45 (0.45)	0.30 (0.30)	0.44 (0.44)
1981	3.51 (3.14)	0.70 (0.63)	0.50 (0.45)	0.68 (0.61)
1982	3.77 (3.07)	0.81 (0.66)	0.58 (0.47)	0.79 (0.64)
1983	3.97 (2.85)	0.81 (0.58)	0.58 (0.42)	0.79 (0.57)
1984	4.17 (2.49)	0.81 (0.48)	0.58 (0.35)	0.79 (0.47)
1985	4.45 (2.41)	1.00 (0.54)	0.70 (0.38)	0.95 (0.51)
1986	4.69 (2.23)	1.11 (0.53)	0.77 (0.36)	1.04 (0.49)

[a] The computation of daily earnings is based on a six-day workweek and 52 weeks per year. Earnings are defined as the total cash amount (gross of tax) paid to employees during the reference period. Included are all cash payments, acting and duty allowances, gratuities, bonuses and leave grants. In the case of expatriates, Government allowances which are not paid in Malawi are excluded. Terminal gratuities and other lump-sum payments are also excluded. Also included are benefits-in-kind which are defined as the value, at cost to the employer, of supplying meals, rations and housing on a free or subsidized basis. Real earnings appear in parentheses and are constructed using the low income Blantyre consumer price index with base 1980 = 100.

[b] Blantyre low income household consumer price index (1980 = 100) used to deflate nominal earnings.

[c] Includes agriculture, fishing, and forestry.

[d] Includes mining and quarrying, manufacturing, electricity and water, and construction.

[e] Includes wholesale and retail trade, restaurants and hotels, transport, storage and communications, financing, insurance, real estate, and business services, and community, social and personal services.

[f] Statutory minimum wage for Blantyre.

[g] Statutory minimum wage for all areas other than Blantyre, Lilongwe, Zomba, and Mzuzu.

[h] Based on the 1980/81 Census of Agriculture estimate of annual household income of MK 137. Figures for other years were computed using estimates of rural or urban minimum wage growth (whichever was smallest).

ANNEX C

ANALYSIS OF STRUCTURE OF

INDUSTRY AND COMMERCE

I. INDUSTRIAL AND COMMERCIAL ENTERPRISES

A. Structure of Industrial and Commercial Enterprises

The focus of this section is on the current status of industrial and commercial enterprises and constraints to their broader participation in Malawi's economy.

1. Sector Definition

There is no formal definition of industrial and commercial enterprise scale in Malawi. Although it is generally accepted that large scale industry is dominated by three holding companies: the Malawi Development Corporation (MDC), Press (Holdings), and the Agricultural and Development Corporation of Malawi (ADMARC); there is some confusion on the definition of medium scale industry, and in particular small-scale enterprises. However, a plausible general definition could be: medium scale enterprises are those with an initial investment of K30,000 to K200,000, regularly employ between 20 to 200 workers, and are eligible for Investment and Development Fund (INDEFUND) financing; secondly, small scale enterprises can be divided into modern small scale enterprises regularly employing between 10 to 20 workers, and traditional small scale enterprises, regularly employing between 3-10 people, both eligible for Small Industries of Malawi (SEDOM) financing up to K70,000 with sufficient collateral; and, finally, micro enterprises employing 1 to 3 persons, operating without a license and with an initial investment up to K1,000.

B. Profile of Large Scale Industry

1. Structure of Large Scale Enterprises

The basic structure and character of large scale enterprises (LSEs) in Malawi is based on its domination by the parastatal holding companies, MDC and ADMARC; and a privately held enterprise, Press Holdings. The operating holding companies control most of the modern manufacturing enterprises, and are major factors in distribution/trade through interlocking share holdings and directorships combined with many instances of joint owned ownership with multinationals. Additionally, these three companies control most of the domestic credit institutions through interlocking relationships. It should be noted, however, that the Parastatal Divestiture Program (612-0227) will substantially reduce the dominium of the parastatal sector in industry and commerce.

The concentration of ownership parallels the concentration of manufacturing and distribution/trade in the Blantyre-Limbe area. According to UNIDO, the foodstuff and beverage industries manufacturing value added in the last several years accounts for 50% of total MVA and is the fastest growing sub-sector followed by textiles, leatherware, and tobacco products; the MVA contribution from intermediate capital machinery and equipment industries is minimal, although there have been relatively recent joint ventures with the multinationals such as Lever Brothers, Optichem and David Whitehead in high priority areas of chemicals, animal feed and fertilizer, and quality textiles.

LSEs have been indifferent to SMEs considering them too inefficient to be potential sub-contractors, and in some cases they have encroached upon niches traditionally dominated by small enterprises such as bakeries, the production of vegetable oils and soap.

The large and medium scale manufacturing account for 12% of GDP in 1986 and approximately 21% (50,000) of total commercial and industrial sector employment. Correspondingly, wage earners in the large and medium sized commercial enterprises totaled approximately 18,000. In contrast, employment in the small-scale sector, ranging from small scale modern to micro enterprises is an estimated 179,000.

2. Market Profile

The core domestic consumer market for LSE industrial and trading companies is essentially limited to the non-farm wage earners and wealthier farmers (more than 1.5 hectares). However, the current market capacity for luxury items, i.e., telephones, electrical appliances, intermediate equipment is much less, and is limited to as little as 100,000 persons.

Malawi's 1988 FOB merchandise exports are projected to be level to 1987's $300,000 figure, and subsequently increase by approximately 10% annually for the next several years. Merchandise exports declined by 13% between 1984 and 1987, principally due to the lower scales of its traditional products in the UK and the U.S./Canada. Correspondingly, non-traditional exports, the major trade component with the PTA/SADCC region declined largely due to Zimbabwe's stiffened import controls to protect its own industries coupled with its own aggressive export promotional program to the other PTA/SADCC numbers. However, total exports did increase to Western Europe, the Republic of South Africa, and there was greater demand for non-traditional exports in the U.K. and the U.S./Canada.

3. Management

When the economic climate began to deteriorate in the late 1970's, the general caliber of LSE management was unequal to the awesome task to adequately deal with the situation, and all of the LSEs suffered serious financial setbacks. As a consequences, in the mid 1980s, the GOM recruited highly qualified expatriates to assume top management positions, and sought outside assistance in restructuring the parastatals and Press Holdings in conjunction with the three SAL's.

The focus of the corporate restructuring program consists of asset swapping and divestitures so that each corporation will concentrate on those areas of its maximum expertise and potential. Accordingly, MDC concentrates on manufacturing, commerce, financial services, and tourism;

ADMARC concentrates on primary and secondary agriculture; and Press concentrates on investment where it has 100% majority control in exchange for asset swaps with MDC and ADMARC.

Additionally, corporate top management has effected substantial cost-cutting and production improvements, middle management has received enhanced training, and the product range is being broadened.

C. Profile of Medium Scale Enterprises

1. Structure

There is little data on medium scale enterprises (MSEs), potentially due to the fact that the sector's initial core is composed of Asians, who are required to limit their activities to Lilongwe, Mzuzu and the Southern urban centers of Blantyre and Zomba. They also prefer to maintain a low profile. Accordingly, most MSE enterprises are located in Blantyre, Lilongwe, Zomba, and Mzuzu. In contrast to LSE's, these firms are structured on an entrepreneur/proprietor manager basis, and receive most of their capital from successful trading activities, funding from Indefund for Malawian citizens and very limited financing from the commercial banks.

2. Market

The principal market for MSEs is the popular consumer market in urban and semi-urban areas. Lower priced clothing, shoeware, simple metal products, and trading companies. However, in recent years there has been diversification into agribusiness, popular priced hotels, and limeworks.

3. Management

At independence, this sector was dominated by Asians, who mostly engaged in trade, and they are still influential in the local garment market and international trade. Subsequently, the indigenerazation program broadened the sector to include Africans with less well developed entrepreneurial and management skills.

D. Profile of Small Scale Enterprise

In order to understand the constraints and effect appropriate policy dialogue to assist rural and urban SMEs, it is necessary to have a better focus on the character of three broad sub-sectors defined according to assets, managerial skills, market and average employment generation. The data base on each market segments major characteristics is very limited, and following information is based on interviews and extrapolation from available studies and comparison with other African economies.

1. <u>Modern Small Enterprises</u>

a. Assets averaging K40,000

b. Management is better educated, with at least a high school diploma, or a skilled technicians with basic management skills and is strong motivation. Frequently, the business is based on a successful traditional small enterprise which has become a relatively large business as a result of an outstanding product design or service requiring some modern equipment and organization. All these enterprises are licensed.

c. May include the following types of activities: detergent and household chemical mixers, agro-processing, agricultural handtools and containers, lower priced garment manufacturing, building blocks and wood or iron furniture manufacturing or electrical repair shops;

d. Employment generation varies between 10 and 30 permanent jobs; and

e. Generally located in peri-urban areas, although there are some start-ups in provincial towns with adequate transportation and electrical infrastructure.

2. <u>Traditional Small Scaled Enterprises</u>

a. Assets averaging K5,000 to K39,000.

b The entrepreneur generally has limited formal education, but may have some skilled technical training. Most in rural areas are not licensed.

c. May include the following types of enterprises: auto and battery repair shops, simple food processing, wood products, metal work, and small merchants.

d. Potential employment generation is 3-10 permanent positions, mostly family members.

e. Located almost exclusively in peri-urban and rural areas.

3. <u>Micro Enterprises</u>

a. Assets range up to K5,000.

b. The entrepreneur has no or limited formal education or business training, and may engage in business as a part time activity rather than as a vocation.

c. May include the following types of enterprises; shoemakers; tailors, food vendors, tinsmi hs, and carpenters.

d. Employment generation is generally 1-3 permanent positions (generally family members). The unregistered (informal) enterprise a sustenance income for the proprietors who are mostly located in rural areas, although more food vendors are now operating in major cities.

II. INDUSTRIAL AND COMMERCIAL ENTERPRISE CONSTRAINTS

Constraints

This section will explore the common problem affecting each sub-sector, and in particular, sector issues that should be the focus of the recommended policy dialogue in Section III.

A. Constraints Affecting Large Scale Industry

1. Economic Constraints

a. Narrow domestic market: Malawi's major economic constraint is the low per capita income, particularly in rural areas. Discretionary income is miniscule and limited to the major urban centers which results in industrial and commercial concentration and monopolistic inefficiencies.

Although the World Bank indicates Malawi has a relatively low industrial domestic resource cost (1.2) in comparison with its larger developing neighbors, this is predominately due to the heavy weighing of agricultural products in the calculation of the ratio. In addition, while the ratio of value added to gross output increased from 22.5% to approximately 35% currently, it is still below 42% for similar countries.

b. Price Control: Although the GOM lifted price controls on all but five politically sensitive products, the Development Plan hedges in stating "every appropriate measure is taken to support the reliable provision of essential goods to all consumers at reasonable prices". Consequently, informal price guidelines are discussed with the resulting disincentive to distribute or manufacture in secondary markets.

c. Shortage of Foreign Exchange: The single common constraint to every sub-sector is the shortage of raw materials and spare parts which are predominately imported. For example, the Reserve Bank of Malawi projects that 1987/88 raw material costs will account for 72% of their export revenues; additionally, spare parts and additional equipment will account for 59% of their export revenues.

The major consequence of the shortage of foreign exchange is low industrial capacity utilization, high unit costs, and increased commercial prices. Examples are the sheet metal conversion industry which operates at 30% capacity, the food processing industry at 70% capacity, and household product industry at 60% capacity. The largest textile manufacturer is the only industrial firm operating at 90% capacity, which is accountable to the aggressive marketing and marginal costing system of the managing partners.

d. Deterioration of the terms of exchange: As noted, lower demand for Malawi's traditional exports in its major markets and lack of an aggressive export marketing and diversification has contributed to the shortage in foreign exchange.

e. Disruption of transportation: The major disruptions in transportation through Malawi's neighbors has increased import costs by at least 45%.

2. Institutional Constraints

a. Lack of Ministerial Coordination: Even though national policies may be clearly enunciated on paper, their proper enactment is frequently hindered by lack of coordination between and within ministries. For example, importers are subject to sometimes arbitrary in the granting of import licenses and the allotment of descisions foreign exchange; The Ministry of Agriculture has hindered the development of reliable non-traditional crop diversification and processing on the pretext it threatens the smallholder.

b. Export Promotion: Even with the liberalization of foreign exchange a flexible exchange rate, the streamlining of export administrative procedures and some licensing requirements, fiscal incentives to exporters are not interesting enough to stimulate additional exports. Secondly, despite a strong GOM policy initiative to promote non-traditional exports, neither the Ministry of Trade, Industry and Tourism (MTIT) or the Malawi Export Promotion Council (MEPC) have been effectively empowered to carry out their mandates.

c. Lack of a financial market: The LSEs have full access to prime commercial bank overdraft lines and importer letter of credit confirmation (acceptance) facilities, however, the absence of a financial market is an obstacle to a broader based access to investment resources.

3. Technological Constraints

a. Obsolete equipment: Although many LSE units have modernized their equipment as part of their restructuring programs, a recent UNIDO industrial survey concluded that most manufacturers plant and machinery are obsolete and subject to frequent breakdowns. These breakdowns are the second major contributor to low utilization of capacity in the LSE sector.

4. Organizational Constraints

a. Lack of senior management: Although the LSE's have broadened their middle management ranks, there is a dearth of senior industrial and commercial talent. While Malawi is fortunate in attracting high caliber expatriate management, the medium and long term future will depend on the nuturing of national talent who are less hampered by political pressures.

b. Ambiguous status of the LSEs: The parastatals and Press Holding's difficulties were partially caused by the politization of their activities and senior management. Accordingly, the recent restructuring stresses total financial and organizational independence from the GOM; However, because the LSEs are expected to be at the forefront of national priorities, their responsibilities to GOM directives sometimes remain ambiguous.

B. Medium Scale Enterprises

1. Economic Constraints

a. Narrow market: MSEs face the same market constraints, however they have the advantage of a broader based domestic market for their more popularly priced products and a stronger entrepreneurial tradition and capability in both the domestic and export markets.

b. Shortage of foreign exchange: While well established trading companies have not experienced problems in sourcing foreign exchange because of their export connections, medium scale manufacturers, lacking the LSEs clout, end at the end of the FX queue. This poses a special hardship for enterprises that distribute or manufacture in secondary regions because of the lack of automotive spare parts.

2. Institutional Constraints

a. Lack of financial market: As few established enterprises have adequate lines with the commercial banks, but the majority of the MSEs depend upon Indebank and Indefund, if they have adequate collateral, or resort to family resources and retained earnings for financing. The absence of a capital market in an obstacle to MSEs being able to expand or seriously compete with the LSEs because of their inability to access capital for plant, equipment and inventory.

b. Licensing: Although licensing is not normally a difficult procedure, MSEs have a particular problem due to a greater representation of Asians. In 1986, 14% of the applications were rejected because of their Asian sponsorship. Subsequently, in 1987, there was a sharp decrease in approved applications because of additional rejections and cancellations caused only a loss of confidence in the Asian community and FX shortage constraints.

X

3. Technological Constraints

a. Obsolete Equipment: MSEs generally modernized their plant and equipment and many operate at 40 to 60% capacity. Although some industries like bakeries suffer low utilization rates because of the over saturation of the medium priced market.

4. Organizational Constraints

a. Uneven product quality and lack of managerial depth: MSEs are owner-managed and tend to have only a few key staff who possess any managerial responsibilities. Correspondingly, many SMEs, especially in secondary areas, have inadequate product design, marketing and production skills. Consequently, many SME products are perceived as substantially lower in quality than LSE products not commensurate with the lower price.

C. Small Scale Enterprises

1. Background

This section concentrates on modern small enterprises and traditional small enterprises in peri-urban and rural areas.

2. Modern Small Scale Enterprises

a. Economic Constraints

1) Narrow Markets: The small modern entrepreneurs achieved some degree of success identifying a competitive position in a narrow, often rural market i.e., agricultural hand tools, buckets or wheel barrows, or work clothing; correspondingly, their market span is limited, and an eventual major economic constraint. However, well positioned small modern enterprises will have an opportunity to expand their markets if they develop the capability to participate in the GOM guideline policy to locally produce 80% of spare part components by 1992 and eventually phase out raw material agro-based industry imports.

2) Lack of foreign exchange: These enterprises are severely impacted by the shortage of foreign exchange to obtain spare parts or purchase machinery because they do not have the workshop capacity of the LSEs and much of the equipment is not obtainable in Malawi. However, recently the GOM opened a special window for this manufacture group and it is now relatively easing for access foreign exchange from the MRB, on the other hand, they are unable to access letter of credit confirmation facilities or must pay exorbitant fees because of their lack of credit history and relationship with the commercial banks.

3) Lack of adequate internal transport: Even through small modern enterprises are located in peri-urban areas and secondary cities, the shortage of local transport vehicles makes if very difficult to access economic quantities of raw materials. Additionally, many potential markets are relatively inaccessible.

3. Institutional Constraint

a. Weak GOM support: Although the GOM has made small enterprise promotion a central policy initiative since the mid 1970's the Small Industry Department of MTIT is unable to carry out an important role due to a paucity resources and specific policy directives. A notable example is the lack of MTIT support to access GOM tenders which could be a major source of support for small modern enterprises.

b. Poor access to credit facilities: These enterprises need adequate working capital overdraft lines in order to operate properly, however, very few small modern enterprises have any contact with the commercial banks, limiting their financing requests to SEDOM and occassionally, Indefund. In contrast, most of these enterprises are potentially credit worthy because they possess some collateral, keep basic financial records and have relatively stable cash flows even under constrained conditions.

SEDOM and Indefund's emphasis of lending to industrial enterprises is another credit restraint to potential small modern whilesale/retailers such as agricultural supply stores or transporters.

D. Technical Constraints

Insufficient knowledge of production, plan layout and quality control: Small modern entrepreneurs are unable to properly manage all of these potential constraints because of limited training and back up personal. Unfortunately, many enterprises face insurmountable obstacles because of poor production techniques and uneven quality control.

E. Organizational/Managerial Constraints

Small modern enterprises are dominated by founder entrepreneurs who overreach their span of management control because of the lack of trained personnel and their own knowledge of marketing, promotion and basic bookkeeping or cash forecasting techniques.

1. Low participation of women in small modern sector: Although there are a some examples of middle class women entrepreneurs manufacturing garments for rural areas, there are few women entrepreneurs or managers in this sector other than spouses who may be responsible for the bookkeeping and administration.

F. Small Traditional Enterprises

1. Economic Constraints

a. Narrow Markets: Since the traditional small enterprise essentially serves rural areas, it is most affected by the low purchasing power of its clientel. Those enterprises that can operate close to a tarmac road and electricity have the best chance of survival because they attract a diverse clientel and better source merchandize and raw materials.

Poor access to credit although SEDOM finances a small number established enterprises that can provide some form of collateral, most business persons cannot access any form of credit due to lack of financial information and acknowledgement of banking application procedures, and the shortage of commercial or development bank field staff to monitor the loans.

b. Shortage of Raw Materials and Merchandise: Since the traditional enterprise sector is closer to the ultimate consumer, it has a better concept of its needs than subsidiaries of the LSE such as Chipiku, however, it is difficult for these entrepreneurs to obtain an adequate supply of the necessary raw materials. The combined effects of a lack of working capital, poor transportation, wholesalers reluctance to sell in small quantities, and the shortage of imported materials all serve to constrain this sub-sector.

2. Institutional Constraints - Regressive effect of the tax system

The traditional small enterprise subject to the same tax obligations as the LSE, however due to the general unavailability of financial records and the entrepreneur's lack of knowledge of the tax law and political clout, the enterprise is often appraised a sales turnover withholding tax that is in excess of its actual obligation and depletes its working capital.

a. Inflexible pricing: The national uniform price code and guidelines makes it frequently unattractive to sell many products even of an essential nature, in rural areas.

5. Technological/Organizational/Managerial Constraints

a. Limited capacity of entrepreneurial/business skills: Since Malawi does not have a strong entrepreneurial culture such as West Africa, traditional small business people need more assistance in pricing, marketing, inventory control and re-investment of profits. Manufacturing and service enterprises need technical assistance on appropriate technology regarding proper tools and efficient manufacturing processes.

b. Low participation of women: Women are under represented in an area where they are more active in West Africa and other continents. Although they have a higher participation in micro-enterprises, they represent less than 10% of SEDOM's loans to women which roughly is equivalent to their numbers in this sector.

ANNEX D

PAIP CABLE

ORIGIN AID-00

ORIGIN OFFICE AFPD-04
INFO AAAF-03 AFCO-02 AFEA-03 AFSA-03 AFDP-06 FPA-02 AFTR-05 AMAD-01 AAPF-01 PDPR-01 PPPB-02 GC-01 GCAF-01 PPEA-01 NS-03 FM-02 OL-01 SMO-02 PPMF-01 BIFA-01 STAG-02 STHE-03 PPR-01 STFN-02 SAST-01 POP-04 NNS-09 PVC-02 OMB-02 RELO-01 AFMG-03 PRE-06 /082 A0

INFO LOG-00 AF-00 /000 R

DRAFTED BY: AID/AFR/PD/SA:RROESER:ELD:4261L
APPROVED BY: AID/DAA/AFR:LSAIERS
AID/AFR/PD:CPEASLEY (DRAFT) AID/AFR/PD/SA:PTHORN (DRAFT)
AID/AFR/DP/PAR:JWOLGIN (DRAFT) AID/AFR/SA:FFISCHER (DRAFT)
AID/PPC/EA:ABATCHELDER (DRAFT) AID/GC/AFR:GBISSON (DRAFT)
AID/AFR/MDI:FJOHNSON (DRAFT)
------------------115278 182323Z /38

P 182318Z JUN 88
FM SECSTATE WASHDC
TO AMEMBASSY LILONGWE PRIORITY
INFO AMEMBASSY HARARE PRIORITY
AMEMBASSY NAIROBI

UNCLAS STATE 188188

AIDAC NAIROBI FOR REDSO/ESA

E.O. 12356: N/A

SUBJECT: MALAWI EXPORT REVOLVING FUND PAIP GUIDANCE (612-0233)

REF: (A) 87 STATE 327494
(B) 87 STATE 369925

1. THE ECPR APPROVED THE SUBJECT PAIP ON 4/19/88. THE ECPR WAS CHAIRED BY DAA/AFR, E.L. SAIERS, AND ATTENDED BY REPRESENTATIVES FROM AFR/SA, AFR/PD, AFR/DP/PAR, PPC/EA, AFR/PRE, GC/AFR, AND OTHER AID/W OFFICES AS WELL AS THE IBRD COUNTRY ECONOMIST FOR MALAWI. PROGRAM OFFICER R. DAY REPRESENTED USAID/MALAWI. THE MAJOR DECISIONS RESULTING FROM THE ECPR WERE TO FOCUS A.I.D.'S PROGRAM ON EMPLOYMENT AND INCOME GENERATION OBJECTIVES AND TO DISASSOCIATE A.I.D. FUNDS FROM THE CAPITALIZATION OF THE EXPORT REVOLVING FUND. THE PAAD WILL BE REVIEWED AND AUTHORIZED IN AID/W. THIS CABLE PROVIDES FEEDBACK FROM THE MEETING AND DETAILED GUIDANCE FOR PAAD DEVELOPMENT. WE APOLOGIZE FOR THE DELAY IN GETTING BACK TO THE MISSION.

2. PROGRAM OBJECTIVES AND CONSISTENCY WITH DFA.

THE DEVELOPMENT FUND FOR AFRICA LEGISLATION PERMITS USE OF DFA FOR NONPROJECT ASSISTANCE, BUT ONLY WHEN SUCH ASSISTANCE SUPPORTS POLICY AND INSTITUTIONAL REFORM AT THE SECTOR LEVEL. THE CRITICAL PRIORITIES FOR DFA INCLUDE AGRICULTURAL PRODUCTION AND NATURAL RESOURCES, HEALTH, VOLUNTARY FAMILY PLANNING, EDUCATION, PUBLIC ADMINISTRATION AND FINANCE, AND INCOME GENERATION, AS WELL AS THE ESTABLISHMENT OF A FAVORABLE ENVIRONMENT FOR INDIVIDUAL ENTERPRISE AND SELF-SUSTAINING DEVELOPMENT. BROAD MACROECONOMIC OBJECTIVES, SUCH AS INCREASING THE SUPPLY OF FOREIGN EXCHANGE, ARE NOT ACCEPTABLE AS ENDS IN THEMSELVES UNDER THE DFA.

THE ECPR AGREED THAT A.I.D.'S ASSISTANCE, WITHIN THE BROADER ITPAC PROGRAM, SHOULD SUPPORT EMPLOYMENT AND INCOME GENERATION. THE A.I.D. PROGRAM PURPOSE, AS STATED IN THE PAIP, AND THE PROGRAM TITLE SHOULD BE

MODIFIED ACCORDINGLY. THIS FOCUS OF THE A.I.D. PROGRAM SHOULD BE MANIFESTED THROUGH THE SECTOR ANALYSIS IN THE PAAD, THE CONDITIONALITY ATTACHED TO DISBURSEMENT OF A.I.D. FUNDS, THE MONITORING AND EVALUATION ARRANGEMENTS FOR THE PROGRAM, AND LOCAL CURRENCY USES, AS DISCUSSED BELOW. IT SHOULD BE EMPHASIZED THAT, ALTHOUGH THE CONCEPT OF PARALLEL FINANCING WITH THE IBRD'S ITPAC PROGRAM IS STRONGLY ENDORSED, CARE MUST BE TAKEN IN DESIGNING THE A.I.D. PROGRAM TO AVOID CREATING THE SITUATION WHERE A.I.D. IS AUGMENTING AN IBRD ACTIVITY RATHER THAN DEVELOPING A RELATED ACTIVITY WITH A.I.D.'S OWN OBJECTIVES.

3. SECTOR ANALYSIS.

A CRITICAL SECTION OF THE PAAD WILL BE THE SECTOR ANALYSIS WHICH DESCRIBES THE CONSTRAINTS TO EMPLOYMENT AND INCOME GENERATION AND ESTABLISHES THE RATIONALE FOR THE PROGRAM DESIGN, PARTICULARLY THE POLICY REFORM AGENDA. THE SECTOR ANALYSIS SHOULD FOLLOW THE OUTLINE IN HANDBOOK 1, PART VII. SPECIFIC GUIDANCE FOR PREPARING THE SECTOR ANALYSIS FOR THIS PROGRAM FOLLOWS.

(A) THE PAAD SHOULD SPECIFY THE ECONOMIC SECTOR OR SECTORS IN WHICH THE A.I.D. PROGRAM WILL SEEK TO INCREASE EMPLOYMENT AND INCOMES. FOR THE PURPOSES OF A.I.D. ASSISTANCE, A SECTOR IS DEFINED AS A SET OF ECONOMIC ACTIVITIES UNIFIED BY A COMMON OUTPUT NARROW ENOUGH TO HAVE AN ANALYTICAL IDENTITY AND BROAD ENOUGH TO CONTAIN SIGNIFICANT INVESTMENT AND POLICY ISSUES.

THE MISSION SHOULD NOT FEEL CONSTRAINED TO THE SECTOR DEFINED BY THE IBRD FOR THE ITPAC PROGRAM.

(B) THE PAAD SHOULD ANALYZE THE MAJOR CONSTRAINTS TO EMPLOYMENT AND INCOME GENERATION IN THE SELECTED SECTOR(S). THESE COULD INCLUDE POLICY, INSTITUTIONAL AND FINANCIAL CONSTRAINTS. THE PAAD SHOULD DESCRIBE ONGOING AND PLANNED EFFORTS TO ALLEVIATE THESE CONSTRAINTS, INCLUDING RELEVANT ASPECTS OF THE ITPAC AND OTHER DONOR AND GOM ACTIVITIES. IT SHOULD BE CLARIFIED THAT, ALTHOUGH EMPLOYMENT IS THE PURPOSE OF A.I.D.'S PARTICIPATION IN THE ITPAC, THE ANALYSIS SHOULD NOT BE RESTRICTED TO SECTOR LEVEL CONSTRAINTS (E.G., WAGE AND LABOR POLICIES, CREDIT FOR BUSINESSES). MACRO LEVEL CONSTRAINTS, SUCH AS EXCHANGE RATE AND FOREIGN EXCHANGE ALLOCATION POLICIES, CAN HAVE A NEGATIVE IMPACT ON CAPACITY UTILIZATION AND EMPLOYMENT. THE ANALYSIS SHOULD BE BROAD ENOUGH TO COVER ALL MAJOR CONSTRAINTS TO EMPLOYMENT AND INCOME GENERATION IN THE SPECIFIED SECTOR. THUS, IT IS IMPORTANT THAT THE PAAD DESIGN TEAM INCLUDE EXPERTISE IN MACROECONOMICS, LABOR ECONOMICS, AND BUSINESS DEVELOPMENT.

(C) ON THE BASIS OF THE SECTOR ANALYSIS, THE PAAD SHOULD IDENTIFY THE POLICY, INSTITUTIONAL, AND OTHER CONSTRAINTS MOST APPROPRIATE FOR A.I.D. TO ADDRESS UNDER THIS PROGRAM AND DESCRIBE THE STRATEGY FOR ALLEVIATING THESE CONSTRAINTS. THE PAAD SHOULD ALSO ATTEMPT TO ESTIMATE THE IMPACT ON EMPLOYMENT AND INCOMES OF THE A.I.D. PROGRAM, OR THE A.I.D. AND ITPAC PROGRAM COMBINED IF THIS IS MORE PRACTICAL.

(D) IT IS ASSUMED THAT MUCH OF THE MACRO AND INDUSTRIAL SECTOR ANALYSIS FOR MALAWI HAS BEEN PERFORMED BY THE IBRD AND IMF. THE IBRD HAS OFFERED TO MAKE DATA AVAILABLE AND ASSIST THE DESIGN CONSULTANTS IN WASHINGTON, PRIOR TO THEIR DEPARTURE FOR MALAWI.

4. CONDITIONALITY.

IT IS EXPECTED THAT THE IDENTIFIED CONSTRAINTS WILL BE ADDRESSED PRIMARILY THROUGH CONDITIONALITY LINKED TO DISBURSEMENT OF A.I.D. FUNDS. THE FOLLOWING POINTS SHOULD BE KEPT IN MIND IN DEVELOPING THE CONDITIONALITY.

(A) A.I.D.'S CONDITIONALITY SHOULD FLOW FROM A.I.D.'S OWN SECTOR ANALYSIS AND SHOULD TARGET SPECIFIC CONSTRAINTS TO EMPLOYMENT AND INCOME GENERATION. THERE MAY BE OVERLAP WITH THE ITPAC CONDITIONALITY, BUT IT

APPEARS UNLIKELY THAT A.I.D. WILL ADDRESS ALL OF THE CONSTRAINTS IDENTIFIED BY THE IBRD GIVEN THE SOMEWHAT DIFFERENT OBJECTIVES OF THE IBRD AND A.I.D. PROGRAMS. ON THE OTHER HAND, A.I.D. MAY IDENTIFY CONSTRAINTS AND REMEDIES NOT INCLUDED UNDER ITPAC, WHICH MAY BE APPROPRIATELY ADDRESSED BY A.I.D. THE PAAD ANALYSIS SHOULD STAND ALONE IN JUSTIFYING ALL CONDITIONALITY TARGETED BY THE A.I.D. PROGRAM, WHETHER OR NOT IT IS ALSO COVERED BY THE ITPAC.

(B) THE NEED CLEARLY TO DISTINGUISH A.I.D. AND ITPAC CONDITIONALITY WILL BE PARTICULARLY IMPORTANT FOR THE FIRST DISBURSEMENT. THE PAIP PROPOSES AS A CONDITION TO FIRST DISBURSEMENT THAT THE GOM AND IBRD SUCCESSFULLY CONCLUDE NEGOTIATIONS OF THE ITPAC PROGRAM AND THAT THE ITPAC BE APPROVED BY THE IBRD BOARD. A.I.D. MUST TAKE CARE TO AVOID ASSOCIATING OUR PROGRAM WITH THE FULL RANGE OF ITPAC OBJECTIVES AND REFORMS, IF IN FACT SOME OF THOSE REFORMS DO NOT ADDRESS CONSTRAINTS IDENTIFIED IN THE PAAD SECTOR ANALYSIS. IF THE MISSION WISHES TO RELEASE THE FIRST DISBURSEMENT ON THE BASIS OF PRIOR POLICY REFORMS AND GOM AGREEMENT ON A FUTURE REFORM AGENDA, IT IS PREFERABLE FOR A.I.D. TO IDENTIFY THE SPECIFIC REFORMS - PAST AND FUTURE - THAT RELATE TO THE A.I.D. PROGRAM PURPOSE RATHER THAN SIMPLY ENDORSE THE ITPAC REFORM PACKAGE IN ITS TOTALITY. ON THE OTHER HAND, THE PROPOSED CONDITION TO FIRST DISBURSEMENT WOULD BE APPROPRIATE IF APPROVAL OF THE ITPAC IS DEEMED NECESSARY TO ESTABLISH A GENERAL FRAMEWORK WITHIN WHICH THE A.I.D. PROGRAM WOULD BE VIABLE. THE PAAD SHOULD ESTABLISH THE RATIONALE FOR THIS PAIP CONDITION, AS QUALIFIED ABOVE, IF IT IS ADOPTED.

(C) THE PAIP PROPOSED AS ANOTHER CONDITION TO FIRST DISBURSEMENT THE ESTABLISHMENT OF AN EXPORT REVOLVING FUND. THIS CONDITION WOULD BE APPROPRIATE ONLY IF THE SECTOR ANALYSIS DEMONSTRATES THAT THE FUND WOULD RELIEVE A CONSTRAINT TO EMPLOYMENT AND INCOME GENERATION (SEE SECTION 7, BELOW).

(D) TO THE EXTENT THAT THE FIRST DISBURSEMENT IS BASED ON GOM AGREEMENT TO UNDERTAKE FUTURE REFORMS, THIS SHOULD BE CONTAINED IN A COVENANT IN THE A.I.D. GRANT AGREEMENT, RATHER THAN RELYING ON A GOM PROMISE TO THE IBRD IN A LETTER OF INTENT FOR THE ITPAC. DISBURSEMENT OF SUBSEQUENT TRANCHES SHOULD BE SUBJECT TO PROGRESS IN ACHIEVING SPECIFIC BENCHMARKS AGREED TO BY THE GOM AND A.I.D.

5. MONITORING AND EVALUATION.

A MAJOR JUSTIFICATION FOR THE DFA IS THAT IT WILL ALLOW A.I.D. TO ADDRESS DEVELOPMENTAL PROBLEMS IN A MORE CREATIVE AND EFFECTIVE WAY. THE TRADE-OFF FOR THE GREATER PROGRAMMING FLEXIBILITY AFFORDED BY CONGRESS UNDER THE DFA IS STRICT ACCOUNTABILITY FOR THE IMPACT OF OUR DFA-FUNDED ACTIVITIES. THIS IS PARTICULARLY TRUE FOR NONPROJECT ASSISTANCE USES OF DFA, WHERE THE AGENCY MUST BE ABLE TO DEMONSTRATE THE SECTOR LEVEL EFFECTS OF

POLICY REFORMS.

THEREFORE, THE PAAD TEAM MUST DEVOTE CONSIDERABLE ATTENTION TO THE DESIGN OF A MONITORING AND EVALUATION SYSTEM THAT WILL ENABLE A.I.D. AND THE GOM TO TRACK PROGRESS AT TWO LEVELS. THE FIRST LEVEL INVOLVES TRACKING GOM PERFORMANCE IN IMPLEMENTING THE REFORMS TARGETED BY THE A.I.D. PROGRAM IN RELATION TO BENCHMARKS SET FORTH IN THE GRANT AGREEMENT. THE SECOND LEVEL IS THE IMPACT OF THE PROGRAM ON EMPLOYMENT AND INCOMES. A.I.D. IS NOT REQUIRED TO TRACK THE IMPACT OF FACTORS IT HAS NOT CHOSEN TO ADDRESS, SUCH AS THE ITPAC PROGRAM AS A WHOLE. NEVERTHELESS, IT IS RECOGNIZED THAT IN PRACTICE IT WILL BE DIFFICULT TO SEPARATE THE IMPACT OF MUCH OF THE ITPAC PROGRAM FROM A.I.D.'S PROGRAM, AND THUS MUCH OF A.I.D.'S EVALUATION MAY INCLUDE EVALUATION OF THE IMPACT OF ITPAC.

THE PAAD TEAM WILL NEED TO ADDRESS A NUMBER OF ISSUES IN THE DESIGN OF A MONITORING AND EVALUATION SYSTEM. FIRST IS THE SELECTION OF INDICATORS WHICH WILL PROVIDE SOME INSIGHT INTO PROGRAM IMPACTS ON EMPLOYMENT AND INCOMES IN THE SPECIFIED SECTOR. IT IS RECOGNIZED THAT MEANINGFUL MEASUREMENT OF THESE KINDS OF IMPACTS CAN BE DIFFICULT AND COSTLY. THE TEAM SHOULD CAREFULLY CONSIDER THIS ISSUE AND MAY WISH TO CHOOSE OTHER (OR ADDITIONAL) INDICATORS WHICH CAN REASONABLY SERVE AS PROXIES. THESE MIGHT INCLUDE, FOR EXAMPLE, CHANGES IN OUTPUT OR SALES. IN ADDITION, AFR/MDI SUGGESTS THAT THE TEAM CONSIDER TRACING THE UTILIZATION OF VARIOUS FINANCIAL AND TRADE INSTRUMENTS THAT EXIST IN MALAWI AND THAT MAY REFLECT EXPANDED ENTERPRISE ACTIVITY WHICH CREATES JOBS.

RELATED TO THE SELECTION OF INDICATORS ARE THE SOURCES OF DATA AND LEVEL OF ANALYSIS. THE PAAD TEAM WILL NEED TO CONSIDER WHETHER STATISTICAL SERIES EXIST AND ARE ADEQUATE FOR MEASURING THE IMPACT OF OUR PROGRAM OBJECTIVES OR WHETHER THERE IS A NEED FOR ADDITIONAL

DATA COLLECTION. FOR EXAMPLE, AGGREGATE STATISTICS MAY NOT ADEQUATELY COVER CERTAIN SECTORS OR SUBSECTORS TARGETED BY THE A.I.D. PROGRAM (E.G., SMALL ENTERPRISE) OR MAY BE TOO AGGREGATED TO GIVE INSIGHTS INTO SUCH ISSUES AS THE PERMANENCE OF NEW JOBS CREATED. FOR THESE REASONS, IT MAY BE NECESSARY TO SURVEY A SAMPLE OF FIRMS AT THE OUTSET OF THE PROGRAM AND ON A PERIODIC BASIS.

THESE ISSUES HAVE SIGNIFICANT COST IMPLICATIONS. AS IN THE DESIGN OF ANY MONITORING AND EVALUATION SYSTEM, THE MISSION WILL NEED TO ASSESS THE TRADE-OFFS BETWEEN THE COST OF THE SYSTEM AND THE QUALITY OF THE RESULTS. HOWEVER, GIVEN THE IMPORTANCE ATTACHED TO THE EVALUATION OF THE IMPACT OF NONPROJECT ASSISTANCE UNDER THE DFA, WE WOULD ANTICIPATE THAT A PROPORTIONATELY LARGER AMOUNT OF FUNDS WILL BE BUDGETED FOR EVALUATION OF THIS PROGRAM THAN IS TYPICALLY THE CASE IN A.I.D. PROJECTS.

6. FUNDING LEVEL.

THE NEED FOR A.I.D. FUNDING SHOULD BE JUSTIFIED IN TERMS OF THE IBRD ANALYSIS OF THE FOREIGN EXCHANGE RESOURCES REQUIRED FOR MALAWI TO ATTAIN ACCEPTABLE LEVELS OF ECONOMIC GROWTH OVER THE PROGRAM PERIOD. THE SENSE OF THE ECPR, BASED ON PROJECTED FUNDING AVAILABILITY AND THE NATURE OF THE EXPECTED REFORMS, WAS THAT A FUNDING LEVEL THE RANGE DOLS. 20-25 MILLION OVER TWO YEARS WOULD BE APPROPRIATE.

7. DOLLAR DISBURSEMENT.

THE ECPR DECIDED THAT THE A.I.D. DOLLARS SHOULD NOT BE DISBURSED INTO AN EXPORT REVOLVING FUND. RATHER, IN KEEPING WITH THE INTENT OF DFA NONPROJECT ASSISTANCE, THE DOLLARS SHOULD BE DISBURSED AS A CASH GRANT INTO THE GENERAL FOREIGN EXCHANGE RESERVES OF THE GOM IN CONJUNCTION WITH THE IMPLEMENTATION OF REFORMS RELATED TO EMPLOYMENT AND INCOME GENERATION. IF THE PAAD SECTOR ANALYSIS CONCLUDES THAT A REVOLVING FUND WOULD ADDRESS A CONSTRAINT TO EMPLOYMENT AND INCOME GAINS IN THE SELECTED SECTOR, IT MAY BE APPROPRIATELY INCLUDED AMONG THE POLICY REFORMS TARGETED BY A.I.D.'S CONDITIONALITY. CONSISTENT WITH THE VIEW THAT THE REVOLVING FUND IS A POLICY REFORM AND NOT A DISBURSEMENT MECHANISM FOR A.I.D. DOLLARS, THIS CONDITIONALITY SHOULD REQUIRE THAT THE FUND BE INITIALLY CAPITALIZED (WITH GOM OR OTHER DONOR RESOURCES) PRIOR TO THE DISBURSEMENT OF A.I.D. FUNDS.

GUIDANCE REGARDING THE MANAGEMENT OF DFA SECTOR ASSISTANCE (INCLUDING ISSUES RELATING TO SEPARATE ACCOUNTS AND TRACKING, APPLICABILITY OF A.I.D. PROCUREMENT RULES, ETC.) WILL BE ISSUED SHORTLY. IT IS THE EXPECTATION OF THE BUREAU THAT REQUIREMENTS WILL BE MINIMAL. THE MISSION SHOULD CONSULT WITH THE RLA AND AFR/PD ON THIS POINT DURING THE COURSE OF PAAD DESIGN.

8. LOCAL CURRENCY.

THE ECPR RECOMMENDED THAT THE LOCAL CURRENCY COUNTERPART TO THE A.I.D. DOLLARS BE USED TO FINANCE EXISTING LINE ITEMS OF THE GOM BUDGET, SO AS TO MAINTAIN COMPLIANCE WITH THE PUBLIC SECTOR EXPENDITURE LIMITS, COMPOSITION, AND PRIORITIES NEGOTIATED BETWEEN THE GOM AND THE IMF AND IBRD. LOCAL CURRENCY USES SHOULD BE RELATED TO THE A.I.D. PROGRAM PURPOSE (EMPLOYMENT AND INCOME GENERATION). FOR EXAMPLE, USES COULD INCLUDE LINES OF CREDIT TO INDEFUND OR OTHER SUPPORT FOR OTHER SMALL AND MEDIUM ENTERPRISE ACTIVITIES.

THE GOM-OWNED LOCAL CURRENCY MUST BE DEPOSITED IN A SEPARATE ACCOUNT AND BE PROGRAMMED, DISBURSED, AND MONITORED IN ACCORDANCE WITH THE AGENCY'S LOCAL CURRENCY GUIDANCE (REF A) AND THE AFRICA BUREAU'S SUPPLEMENTAL GUIDANCE (REF B). THE PAAD SHOULD PROVIDE A DESCRIPTION OF INTENDED USES AND THE MECHANISMS FOR MANAGING THE LOCAL CURRENCY AND ENSURING ACCOUNTABILITY. THE DFA AUTHORIZATION PROVIDES THAT LOCAL CURRENCY ACCRUING AS A RESULT OF DFA ASSISTANCE PROGRAMS MAY BE JOINTLY PROGRAMMED FOR DEVELOPMENT ACTIVITIES OR NECESSARY OPERATING EXPENSES OF THE LOCAL A.I.D. MISSION. THE ECPR CONCURRED IN THE PROPOSAL TO PROGRAM TEN PERCENT OF LOCAL CURRENCY ACCRUALS FOR ADMINISTRATIVE SUPPORT OF THE MISSION.

GC/AFR ADVISES THAT THE HOST COUNTRY OWNED LOCAL CURRENCY CAN BE CONSIDERED COUNTERPART TOWARD MEETING THE REQUIREMENTS OF SECTION 110 OF THE FAA, IF IT IS USED FOR ACTIVITIES THAT SUPPORT THE PROGRAM PURPOSE. THUS, A SECTION 110(A) WAIVER MAY NOT BE NECESSARY.

9. INITIAL ENVIRONMENTAL EXAMINATION.

IEE FOR THIS PROGRAM, RECOMMENDING CATEGORICAL EXCLUSION, APPROVED BY BUREAU ENVIRONMENTAL OFFICER AND CLEARED BY GC/AFR. COPY OF IEE POUCHED TO MISSION.

10. EXPORT REVOLVING FUND OPERATING PRINCIPLES.

THE ECPR COMMENDED THE MISSION ON THE DESIGN OF THE REVOLVING FUND. ALTHOUGH THE ECPR DECIDED THAT A.I.D. DOLLARS WOULD NOT BE DISBURSED INTO THE REVOLVING FUND, IT IS HOPED THAT THE POSITIVE FEATURES DESCRIBED IN THE PAIP ARE INCORPORATED IN ANY MECHANISM ESTABLISHED BY THE GOM WITH NON-A.I.D. RESOURCES.

AT THE SAME TIME, THE ECPR SIGNALED CAUTION ON CERTAIN ELEMENTS OF THE REVOLVING FUND, AS DESCRIBED IN THE PAIP, THAT COULD IMPEDE ACCESS TO THE FUND, RESULT IN A LESS THAN OPTIMAL ALLOCATION OF THE FUND'S RESOURCES, AND CREATE LARGE ADMINISTRATIVE COSTS. FOR EXAMPLE, THE REQUIREMENTS THAT (A) THE FIRM APPLYING FOR FOREIGN EXCHANGE HAVE AN EXPORT ORDER IN HAND, (B) THE FIRM PROVE THAT IT WILL SELL EXPORTS EQUAL TO AT LEAST TWICE THE VALUE OF THE IMPORTS FINANCED BY THE REVOLVING FUND, AND (C) THE FIRM'S APPLICATION BE SUBJECT TO BANK REVIEW FOR FINANCIAL VIABILITY, WOULD TEND TO DISCOURAGE NEW AND SMALLER EXPORTERS. THE PROHIBITIONS ON FINANCING OF ITEMS THAT CAN ALSO BE SOURCED LOCALLY AND ON RE-SALE OF THE IMPORTED ITEMS COULD REDUCE ECONOMIC EFFICIENCY. THE REVOLVING FUND SHOULD BE DESIGNED, TO THE EXTENT POSSIBLE, ON THE PRINCIPLES OF OPEN ACCESS, MINIMUM ADMINISTRATIVE INVOLVEMENT BY THE GOVERNMENT, AND MINIMUM INTERFERENCE IN THE DECISION-MAKING OF FIRMS. THE MISSION SHOULD ENCOURAGE THE GOM TO INCORPORATE THESE PRINCIPLES INTO THE DESIGN OF THE EXPORT REVOLVING FUND.

11. PAAD APPROVAL AND AUTHORIZATION VENUE.

SINCE THIS IS A SECTOR ASSISTANCE PROGRAM UNDER THE NEW DFA AND SINCE PROCEDURES FOR SUCH PROGRAMS ARE STILL EVOLVING, THE PAAD WILL BE REVIEWED AND AUTHORIZED IN AID/W. PLEASE ADVISE OF ESTIMATED SUBMISSION DATE AS SOON AS POSSIBLE. ARMACOST

ANNEX E

STATUTORY CHECKLIST

FY 1988 PROJECT STATUTORY CHECKLISTS

5C(1) - COUNTRY CHECKLIST - MALAWI FY 1982

Listed below are statutory criteria applicable to: (A) FAA funds generally; (B)(1) Development Assistance funds only; or (B)(2) the Economic Support Fund only.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FY 1988 Continuing Resolution Sec. 526. Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully?

   No.

2. FAA Sec. 481(h). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government), has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 30 days of continuous session, of a

resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, and to prevent and punish drug profit laundering in the country, or that (b) the vital national interests of the United States require the provision of such assistance?

N/A

3. Drug Act Sec. 2013. (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Section 481(h)), has the President submitted a report to Congress listing such country as one (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of the country?

N/A

4. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government?

No.

5. FAA Sec. 620(e)(1). If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

No.

6. FAA Sec.620(a), 620(f), 620D; FY 1988 Continuing Resolution Sec. 512. Is recipient country a Communist country? If so, has the President determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism? Will assistance be provided directly to Angola, Cambodia, Cuba, Iraq, Vietnam, Libya, South Yemen, Iran or Syria? Will assistance be provided to Afghanistan without a certification?

No.
N/A
No.

7. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property?

No.

8. FAA Sec. 620(l). Has the country failed to enter into an investment guaranty agreement with OPIC?

No.

9. FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5.

(a) Has the country seized, or imposed any penalty or sanction against any U.S. fishing vessel because of fishing activities in international waters?

No.

X 113

(b) If so, has any deduction required by the Fishermen's Protective Act been made?

N/A

10. FAA Sec. 620(q); FY 1988 Continuing Resolution Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1988 Continuing Resolution appropriates funds?

No.
No.

11. FAA Sec 620(s). If contemplated assistance is development loan or to come from Economic Suppor Fund, has the Administrator taken into account the percentage of the country's budget and amoun of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking int Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

Yes: taken into account by the Administration at time of approval of Agency OYB.

12. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No.
N/A

13. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)

Malawi was not in arrears as of December 31, 1987.

114

14. FAA Sec. 620A. Has the President determined that the recipient country grants sanctuary from prosecution to any individual or group which has committed an act of international terrorism or otherwise supports international terrorism?

    No.

15. FY 1988 Continuing Resolution Sec. 576. Has the country been placed on the list provided for in Section 6(j) of the Export Administration Act of 1979 (currently Libya, Iran, South Yemen, Syria, Cuba, or North Korea)?

    No.

16. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?

    No.

17. FAA Sec. 666(b). Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

    No.

18. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

    No.
    No.

19. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of such country to manufacture a nuclear explosive device?

    No.

20. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken into account? (Reference may be made to the Taking into Consideration memo.)

    Malawi is not a member of the Non-Aligned Movement.

21. FY 1988 Continuing Resolution Sec. 528. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States?

    No.

22. FY 1988 Continuing Resolution Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance?

    No.
    N/A

23. FY 1988 Continuing Resolution Sec. 543. Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

    Yes.

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

No.
N/A

FY 1988 Continuing Resolution Sec. 538. Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

No.

2. Economic Support Fund Country Criteria

FAA Sec.502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?

No.
N/A

FY 1988 Continuing Resolution Sec. 549. Has this country met its drug eradication targets or otherwise taken significant steps to halt illicit drug production or trafficking?

N/A

Country Checklist Clearance:
AFR/SA:TWare ______
AF/S:JOrdway ______

5C(2) PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A includes criteria applicable to all projects. Part B applies to projects funded from specific sources only: B(1) applies to all projects funded with Development Assistance; B(2) applies to projects funded with Development Assistance loans; and B(3) applies to projects funded from ESF.

CROSS REFERENCES:	IS COUNTRY CHECKLIST UP TO DATE?	Yes.
	HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?	Yes.

A GENERAL CRITERIA FOR PROJECT

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. If money is sought to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified?

   A Congressional Notification was submitted on August 11, 1988 and the 15 day waiting period expired without objection on August 25, 1988.

2. FAA Sec. 611(a)(1). Prior to an obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   Yes; Yes.

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is the basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislative action is required.

4. FAA Sec. 611(b); FY 1988 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, *et seq*.)? (See AID Handbook 3 for new guidelines.)

   N/A

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

   N/A

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

   The project was designed in association with the World Bank and will provide parallel financing to their Industrial and Trade Policy Adjustment Credit (ITPAC).

7. FAA Sec. 601(a). Information and conclusions on whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

   Assistance will encourage the competitiveness of industry and thereby regional trade. The project will provide technical assistance to private sector firms on business and management problems and market development. Increased access to foreign exchange by private sector firms can foster private competion and decrease monopolistic practices. Increased access to imported intermediate capital goods and raw materials will improve the technical efficiency of industry and commerce.

X 119

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

   The availability of foreign exchange will encourage importation of US products. US private enterprise will provide technical assistance to Malawian private sector firms.

9. FAA Sec. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

   The private sector firms which will be assisted by the TA will contribute local cost support for the contractors. The US does not own foreign currencies, which can be used in lieu of dollars for the project element.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

    The US does not own excess Malawian currency.

11. FY 1988 Continuing Resolution Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

    N/A

12. FY 1988 Continuing Resolution Sec. 553. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles or potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country

\20

markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

No.

13. FAA Sec. 119(g)(4)-(6). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

No.

14. FAA Sec. 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)?

N/A

15. FY 1988 Continuing Resolution. If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?

N/A

16. FY 1988 Continuing Resolution Sec. 541. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

N/A

X 121

17. FY 1988 Continuing Resolution Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained?

N/A

18. FY 1988 Continuing Resolution Sec. 515. If deob/reob authority is sought to be exercised in the provision of assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified?

A notification to both Appropriations Committees was submitted on August 11, 1988 and the 15 day waiting period expired without objection on August 25, 1988.

19. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

Case Zablocki Act will be satisfied.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FY 1988 Continuing Resolution Sec. 552 (as interpreted by conference report). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

N/A

b. FAA Sec. 102(a), 111, 113, 281(a). Describe extent to which activity will (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

x 123

The program of which this project forms a part is intended to establish a more favorable environment for individual enterprise and self-sustaining development. Although not directly targeted at the poorest of the poor, the Program will improve the efficiency of the Malawian economy as a whole, resulting in increased access to imported goods for all levels of the economy, and to increase access to export markets for agricultural and manufactured products.

c. FAA Sec. 103, 103A, 104, 105, 106, 120-21. Does the project fit the criteria for the source of funds (functional account) being used?

Yes.

d. FAA Sec. 107. Is emphasis placed on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

No.

e. FAA Sec. 110, 124(d). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes.

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

Yes.

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

The project will respond to identified needs of the Malawi Commerical and Industrial sector for assistance in enterprise development.

h. FY 1988 Continuing Resolution Sec. 538. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

No.

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide financial incentive to any person to undergo sterilizations?

No.

Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

No.

i. FY 1988 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization?

No.

X 125

If assistance is from the population function account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services?

N/A.

j. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes.

k. FY 1988 Continuing Resolution. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 20 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

No minority set-asides are contemplated, but to the extent possible, technical assistance financed under the project will be provided for Gray amendment entities.

l. FAA Sec. 118(c). Des the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological

x 127

diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (j) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k) utilize the resources and abilities of all relevant U.S. government agencies?

Yes.
No.
No.

m. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b) take full account of the environmental impacts of the proposed activities on biological diversity?

N/A

n. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas?

No.

o. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; (c) the colonization of forest lands; or (d) the construction of dams or other other control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

No.

p. FY 1988 Continuing Resolution. If assistance will come from the Sub-Saharan Africa DA account, is it (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) being provided in accordance with the policies contained in section 102 of the FAA; (c) being provided, when consistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; (e) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underdeveloped in urban and rural areas?

(a) The program, of which this Project forms a part, will improve the economic climate of Malawi, allowing for a growth of all productive sectors of the economy. (b) Because of its focus on small scale enterprise the program will stimulate rural development in accordance with Section 102 of the FAA. (c) Althrough assistance will not be channelled through PVO's, it will provide the nexessary foundation for a more sustainable grass-roots development over the next decade through growth in income and employment. (d) The thrust of the program is on stimulating private sector growth. (e) The expansion of industry and SME's will lead to increased job opportunities and a reduction in the number of unemployed and underemployed. .

2. <u>Development Assistance Project Criteria (Loans Only)</u> N/A.

a. <u>FAA Sec. 122(b)</u>. Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest?

c. FY 1988 Continuing Resolution. If for a loan to a private sector institution from funds made available to carry out the provisions of FAA Sections 103 through 106, will loan be provided, to the maximum extent practicable, at or near the prevailing interest rate paid on Treasury obligations of similar maturity at the time of obligating such funds?

d. FAA Sec. 122(b). Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

Yes.

b. FAA Sec. 531(e). Will this assistance be used for military or paramilitary purposes?

No.

c. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A.

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? Yes.
HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? Yes.

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

   A Congressional Notification was submitted on August 11, 1988 and the 15 day waiting period expired without objection on August 25, 1988.

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislative action is required.

3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

   The program is designed to complement the ITPAC Program of the World Bank.

132

4. FAA Sec. 601(a). Information and conclusions on whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

   The reform package is targetted on (1) increasing Malawi's volume of exports (2) promoting greater competition in private sectors and opportunities for individual initiation (3) decreasing monopolistic protection of larger industries and (4) the general efficiency of labor and capital resources.

5. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

   The removal of constraints on trade and increased competition will create improved opportunities for US investments and trade as barriers to industrial growth are eliminated.

6. FAA Secs. 612(b), 636(h); FY 1988 Continuing Resolution Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services?

   The US does not own Malawi currencies.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

   No.

8. FAA Sec. 601(e). Will assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

✓ 133

The Program is a cash grant; no contracts will be financed.

9. FAA 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipts and expenditures of A.I.D. funds?

N/A

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

Yes.

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities?

No.

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

Yes.

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A

e. FY 1988 Continuing Resolution. If assistance is in the form of a cash transfer: (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purpose for which new funds authorized by the FAA would themselves be available)? (c) has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

1985

The ESF funds disbursed as cash were appropriated under the FY ~~[illegible]~~ Continuing Resolution and thus are not subject to the provisions of the FY 1988 Continuing Resolution regarding separate accounts.

f. FY 1988 Continuing Resolution. Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for use, in accordance with an agreement with the United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U.S. Government?

A special account will be established for local currencies.

2. Nonproject Criteria for Development Assistance

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage domocratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

The program emphasises the development of labor intensive enterprises. The studies component will assist USAID in its policy dialogue to create increased opportunities for women and other disadvantaged groups.

b. <u>FAA Secs. 103, 103A, 104, 105, 106, 120-21</u>. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of

pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

N/A

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach.

N/A

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

N/A

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is:

(i) (a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

(iii) research into, and evaluation of, economic development processes and techniques;

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

(vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

✓ 139

(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multi-donor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?

N/A

c. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

No.

d. FAA Sec. 281(b). Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

By increasing the amount of available foreign exchange and by improving the climate for private enterprise in Malawi the Program will enable a fuller realization of the entrepreneurial potential of the Malawian private sector.

e. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

By improving the environment for individual enterprise in Malawi, the program will contribute greatly to the development of the economic base of Malawi, to an increase in productive capacity and self-sustaining economic growth.

141

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. PROCUREMENT

1. FAA Sec. 602(a). Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

   Offshore technical services will be contracted through, among other mechanisms, Indefinite Quantity Contracts and the Mission's Human Resources and Institutional Development Project. Both of these mechanisms offer opportunities to use 8(A) firms.

2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?

   Consistent with the DFA, offshore technical services financed by the program will be of U.S. nationality to the maximum extent practicable.

3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

   Malawi does not discriminate against U.S. marine insurance.

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If non-U.S. procurement of agricultural commodity or product thereof is to be financed , is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

   N/A.

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941, and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

   N/A.

6. FAA Sec.603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?

   No.

7. FAA Sec. 621(a). If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies will be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

   Yes. Technical assistance will be contracted from the private sector on a competitive basis. Use of Federal agencies or facilities is not anticipated.

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes.

9. FY 1988 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

Such provision will be included in A.I.D. direct contracts financed by the program.

10. FY 1988 Continuing Resolution Sec. 524. If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

Yes.

B. CONSTRUCTION

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used?

N/A.

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

N/A.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP), or does assistance have the express approval of Congress?

N/A.

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan repayable in dollars, is interest rate at least 2 percent per annum during grace period which is not to exceed ten years, and at least 3 percent per annum thereafter?

   N/A.

2. FAA Sec.301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?

   N/A.

3. FAA Sec. 620(h). Do arrangements exist to ensure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries?

   The program will not promote or assist a project or activities of any communist bloc country.

4. Will arrangements preclude use of financing:

   a. FAA Sec. 104(f); FY 1987 Continuing Resolution Secs. 525, 538. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or in part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; or (4) to lobby for abortion?

   (1) - (4) Yes.

X 145

b. FAA Sec. 483. To make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated?

Yes.

c. FAA Sec.620(g). To compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President?

Yes.

d. FAA Sec. 660. To provide training, advice or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

Yes.

e. FAA Sec. 662. For CIA activities?

Yes.

f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

No motor vehicle procurement is planned.

g. FY 1988 Continuing Resolution, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel?

Yes.

h. FY 1988 Continuing Resolution, Sec. 505. To pay U.N. assessments, arrearages or dues?

Yes.

1171

i. FY 1988 Continuing Resolution, Sec. 506. To carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)?

Yes.

j. FY 1988 Continuing Resolution, Sec. 510. To finance the export of nuclear equipment, fuel, or technology?

Yes.

k. FY 1988 Continuing Resolution, Sec. 511. For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?

Yes.

l. FY 1988 Continuing Resolution, Sec. 516; State Authorization Sec. 109. To be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?

Yes.

2247C

147

ANNEX F

LETTER OF REQUEST FROM

GOVERNMENT OF MALAWI

USA/2

In reply please quote No. ....

Telegrams: FINANCE, Lilongwe
Telephone: Lilongwe 731 311

Communications should be addressed to:
The Secretary to the Treasury

MINISTRY OF FINANCE
P.O. BOX 30049
LILONGWE 3
MALAWI

3rd August, 1988

Dr. Richard L. Shortlidge, Jr.,
Acting Mission Director,
USAID Mission to Malawi,
P.O. Box 30455,
LILONGWE 3

Dear Dr. Shortlidge,

MALAWI ENTERPRISE DEVELOPMENT SECTOR
ASSISTANCE PROGRAM (612-0233)

The Government of Malawi wishes to request the U.S. Agency for International Development to finance the $36.6 million Malawi Enterprise Development Sector Assistance Program. This important program will provide necessary financial and technical assistance to support the Government of Malawi's policy reforms directed at stimulating and promoting growth in the private sector, particularly small and medium enterprises. As you are aware, the Government of Malawi in its Statement of Development Policy (1987-96) places high priority on economic growth led by a dynamic private sector and the expansion of small and medium enterprises.

Your careful consideration to this request for assistance is most appreciated. The Government of Malawi looks forward to the continued close collaboration in the implementation of this program which has characterized its design.

Yours sincerely,

J. C. Malewezi
SECRETARY TO THE TREASURY

149

ANNEX G

DRAFT PROGRAM AND PROJECT GRANT AGREEMENTS

A.I.D Program No. 612-0233
Non-Project Assistance Grant No.________

PROGRAM GRANT AGREEMENT

Between

THE GOVERNMENT OF THE REPUBLIC OF MALAWI

And

THE UNITED STATES OF AMERICA

For

MALAWI ENTERPRISE DEVELOPMENT

- BALANCE OF PAYMENTS COMPONENT -

Dated: August 31, 1988

151

TABLE OF CONTENTS

		PAGE
ARTICLE 1 :	The Program	1
ARTICLE 2 :	The Grant	1
ARTICLE 3 :	Disbursement.	2
ARTICLE 4 :	Conditions Precedent.	2
ARTICLE 5 :	Terminal Date for Requests for Disbursement .	4
ARTICLE 6 :	Covenants	4
ARTICLE 7 :	Special Account for Development Activities. .	5
ARTICLE 8 :	Trust Fund.	7
ARTICLE 9 :	Program Evaluation	7
ARTICLE 10:	Taxation.	7
ARTICLE 11:	Use of Funds.	8
ARTICLE 12:	Records	8
ARTICLE 13:	Publicity	8
ARTICLE 14:	Communications.	8
ARTICLE 15:	Representatives	9

Program No. 612-0233
Non-Project Assistance Grant No.________

PROGRAM GRANT AGREEMENT

By this Agreement made and entered into on the 31st day of August, 1988, the GOVERNMENT OF THE REPUBLIC OF MALAWI (hereinafter referred to as the "Grantee") and the UNITED STATES OF AMERICA, acting through the Agency for International Development (hereinafter referred to as "A.I.D."), hereby agree as follows:

ARTICLE 1

The Program

A. The purpose of the Program, which is further described in Annex 1, is to assist the Grantee to support various policy and institutional reforms aimed at reducing economic and fiscal distortions and enhancing competition, in order to revitalize existing businesses and create new enterprises. The areas on which reform efforts will be focussed are: (1) trade and industrial policy and exchange rate management; (2) small and medium scale enterprise development; (3) finance sector; and (4) fiscal policies. Within the limits of this definition of the Program, elements of the detailed description in Annex 1 may be changed by written agreement of the Parties without formal amendment of this Agreement.

B. A.I.D.'s contribution to the Program will be provided in increments, the initial one being made available in accordance with Article 2 of this Agreement. Subsequent increments will be subject to availability of funds to A.I.D. for this purpose, and to the mutual agreement of the Parties, at the time of a subsequent increment, to proceed. It is anticipated that A.I.D.'s total life of project contribution to the Program will be thirty-five million United States ("U.S.") dollars ($35,000,000).

ARTICLE 2

The Grant

To assist the Grantee to meet the objectives of the Program, A.I.D., pursuant to the Foreign Assistance Act of 1961, as amended, hereby grants to the Grantee under the terms of this Agreement twenty million two hundred fifteen thousand United States ("U.S.") dollars ($20,215,000).

153

ARTICLE 3

Disbursement

Disbursement of the funds made available under this Agreement will be made in tranches pursuant to requests for disbursement by the Grantee. The requests for disbursement will be submitted to the United States A.I.D. Mission in Malawi in accordance with instructions provided by A.I.D. separate from this Agreement. Pursuant to the requests for disbursement, A.I.D. will transfer the funds to the Grantee, subject to satisfaction of the conditions in Article 4.

ARTICLE 4

Conditions Precedent to Disbursement

SECTION 4.1. First Disbursement. Prior to the first disbursement under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

A statement of the name of the person holding or acting in the office of the Grantee specified in Article 15, and of any additional representatives, together with a specimen signature of each person specified in such statement.

SECTION 4.2. Conditions Precedent to Individual Disbursements. Disbursements of the funds made available under this Agreement will be made in three tranches pursuant to requests for disbursements by the Grantee to the USAID Mission to Malawi. Pursuant to the requests for disbursements, A.I.D. will transfer the funds to the Grantée, subject to satisfaction of the conditions outlined below.

SECTION 4.3. Conditions Precedent to the First Disbursement of U.S.$15.0 million. Prior to the disbursement of any of the initial U.S.$15.0 million provided hereunder, except as A.I.D. may otherwise agree in writing, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., documentation indicating:

(a) GOM agreeement to reduce the number of items for which import and export licenses are required.

(b) GOM agreement to maintain a flexible exchange rate policy.

(c) The first and second stages of foreign exchange lioeralization nave been undertaken, covering a total of 75% of the 1984 base year's value of materials and spare parts.

(d) GOM agreement to progressively reduce its budget deficit as a percentage of GDP.

SECTION 4.4. Conditions Precedent to the Second Disbursement of U.S.$10.0 million. Prior to the disbursement of any of the U.U.$10.0 million provided hereunder, except as A.I.D. may otherwise agree in writing, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., documentation indicating:

(a) Continued import liberalization of industrial inputs agreed to by the GOM and implemented.

(b) Streamlining of the foreign exchange approval and payment processes.

(c) Consolidation of GOM support to small and medium enterprises (SME's) under a single unit in the Ministry of Trade, Industry and Tourism.

(d) Issuance of a policy statement by the GOM regarding terms and conditions for provision of funds to financial institutions involved with SME's. The policy statement should address the financial institutions' need for concessional and, in some cases, grant on-lending terms by the GOM to finance investment capital, working capital, venture capital and equity capital.

(e) Evidence that the GOM FY 88/89 budget deficit as a percentage of GDP is below the percentage of FY 87/88.

SECTION 4.5. Conditions Precedent to the Third Disbursement of U.S.$10.0 million. Prior to the disbursement of any of the U.S.$10.0 million provided hereunder, except as A.I.D. may otherwise agree in writing, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., documentation indicating:

(a) Streamlining of import and export licensing procedures and systems.

(b) GOM will make on-budget grants to SEDOM and INDEFUND to enable those institutions to make equity investments in SME's.

(c) Amending INDEFUND's and SEDOM's Deeds of Trust to allow them to extend credit to ventures involving foreign technical partners who are prepared to bring equity finance and technical know-how.

(d) Establishment of an SME investment promotion program.

K 155

(e) Revisions to the Industrial Development and Control of Goods Acts to permit streamlining and rationalization of SME licensing requirements.

(f) Establishment of institutional arrangements and/or mechanism to enable private trading in equities.

(g) Evidence that the FY 89/90 budget deficit as a percentage of GDP is below the percentage for FY 88/89.

SECTION 4.6. Notification. When A.I.D. has determined that the condition precedent specified in Section 4.1 have been met, it will promptly notify the Grantee.

SECTION 4.7. Terminal Date for Conditions Precedent. If the condition specified in Section 4.1. has not been met within 90 days from the date of this Agreement, or such later date as A.I.D. may agree to in writing, A.I.D., at its option, may terminate this Agreement by written notice to Grantee.

ARTICLE 5

Terminal Date for Requests for Disbursement

The terminal date for requests for disbursement of funds made available under the Agreement will be three years from the date of this Agreement, except as A.I.D. may otherwise agree in writing.

ARTICLE 6

Covenants

1. The Government of Malawi agrees to furnish to A.I.D. information regarding foreign exchange applications necessary to monitor program progress and impact.

2. The Government of Malawi agrees to conduct annually a joint review of the A.I.D. bilateral program and to mutually determine at such time priorities for programming Malawi Enterprise Development program-generated local currencies.

3. The Government of Malawi agrees to provide A.I.D. access to budget documents necessary to verify the expenditure of program-generated local currencies.

ARTICLE 7

Special Account for Development Activities

A. The Grantee agrees to open an interest-bearing Special Account in its name in the Reserve Bank of Malawi for the purposes of financing program activities set forth herein. For such purposes, the Grantee agrees to deposit in a Special Account the local currency equivalent of each U.S. dollar disbursement made under this Agreement within thirty (30) days of each disbursement. The highest rate of exchange that is not unlawful in Malawi on the date of U.S. dollar disbursement shall be used in determining the total amount required to be deposited in the Special Account.

B. A.I.D. and Grantee agree that funds deposited in the Special Account shall be used to fund various items and activities within the Government of Malawi's recurrent and development budgets including, in the following order of priority:

- private sector development, in furtherance of program objectives;
- health services and agriculture development, in support of the USAID/Malawi assistance strategy;
- assistance to the most vulnerable groups, including basic education;

and for other mutually agreed upon purposes.

(1) Prior to the disbursement of any local currency funds from the Special Account, the Grantee will submit to A.I.D., in form and substance satisfactory to A.I.D., a plan for such use of local currency funds.

(2) A.I.D. will notify the Grantee of its approval or non-approval by Program Implementation Letter.

(3) Upon receipt of notification of approval from A.I.D., the Grantee may proceed to authorize withdrawal of funds from the Special Account to the appropriate department or activity for which disbursements were approved.

C. The Grantee agrees to provide to A.I.D. at specified intervals and until such time as all funds have been disbursed, the following reports:

(1) Quarterly (period ending March 31, June 30, September 30, December 31), cumulative deposits to and disbursements of local currency from the Special Account furnished pursuant to this Agreement;

(2) Semi-annually (period ending March 31, September 30), for each program or activity receiving Special Account funds under this Agreement, the budget amount, disbursements made during the quarterly period, and cumulative disbursements; and,

(3) Semi-annually (period ending March 31, September 30), for each program or activity receiving Special Account funds under this Agreement, a general description, satisfactory to A.I.D., of the activities, services, structures, facilities, or commodities financed during the reporting period and, if applicable, an indication of progress towards completion.

The reports called for in subsections C (1), (2) and (3), shall be certified as correct by an authorized representative of the Grantee, and submitted to A.I.D. within ten (10), thirty (30) and sixty (60) days respectively after the close of each applicable reporting period.

D. The Grantee will, at mutually agreed upon times, afford representatives of A.I.D. the opportunity to observe programs financed under the Special Account.

E. In the case of any disbursement from the Special Account which is not supported by valid documentation evidencing expenditure for purposes specifically agreed by the Parties, or any disbursement which is not made or used for agreed purposes, A.I.D. may require the Grantee to restore to the Special Account all or any part of the amount of such disbursement and to use such funds in accordance with the terms of the Agreement.

F. Any interest or other earnings on the funds deposited in the Special Account prior to their use by the Grantee for agreed development purposes shall be deposited into and become a part of the funds in the Special Account and will be used for such economic development purposes as may be mutually agreed upon by the Parties.

ARTICLE 8

Trust Fund

The Grantee agrees to transfer ten percent of the local currencies deposited in the Special Account to a Trust Fund for use by the A.I.D. Mission to Malawi. This transfer will be effected within seven days of any deposit into the Special Account.

ARTICLE 9

Program Evaluation

The Parties agree to establish an evaluation system as part of the Program. Except as the Parties otherwise agree in writing, this will include, during the implementation of the Program and at one or more points thereafter:

(1) evaluation of progress toward attainment of the objectives of the Program;

(2) identification and evaluation of problem areas and constraints which may inhibit such attainment;

(3) assessments of how such information may be used to help overcome any such problems; and,

(4) evaluation, to the degree feasible, of the overall development impact of the Program.

Details concerning this evaluation system will, from time to time, be discussed between the Parties and embodied in Program Implementation Letters.

ARTICLE 10

Taxation

This Agreement and the amount to be granted hereunder shall be free from any taxation or fees imposed under any laws in effect within Malawi.

X

159

ARTICLE 11

Use of Funds

The Grantee agrees that the funds provided hereunder shall not be used to finance military, guerrilla, or paramilitary requirements of any kind, including the procurement of commodities or services for those purposes, or luxury goods.

ARTICLE 12

Records

The Grantee agrees that financial records relating to the utilization of funds granted by A.I.D. and the funds deposited into the Special Account by the Grantee under this Agreement shall be kept in accordance with the Grantee's usual accounting procedures. All such financial records shall be maintained for at least three (3) years after the disbursement of funds from the Special Account and shall be made available at any reasonable time to authorized representatives of A.I.D. for the purpose of examination and inspection.

ARTICLE 13

Publicity

The Grantee agrees to provide appropriate publicity with respect to this Grant.

ARTICLE 14

Communications

Communications submitted by either party to the other under this Agreement will be in writing or by telegram, cable or radiogram, and will be deemed duly given or sent when delivered to such Party at the following addresses:

To the Grantee:

Mail Address:	Secretary to the Treasury Ministry of Finance P.O. Box 30049 Lilongwe 3, Malawi
Cable Address:	FINANCE - LILONGWE Telex No. 4407 FINANCE MI

To A.I.D.:

Mail Address:	Mission Director USAID/Malawi P.O. BOX 30455 Lilongwe 3, Malawi
Cable Address:	Telex No. 4627 AMEMBLLMI

Other addresses may be substituted for the above upon the giving of notice.

ARTICLE 15

Representatives

For all purposes relevant to this Agreement, the Grantee will be represented by the individual holding or acting in the Office of Minister of Finance, and A.I.D. will be represented by the individual holding or acting in the office of Mission Director, USAID/Malawi, each of whom, by written notice, may designate additional representatives for all purposes other than revising the terms of this Agreement. The names of the representatives of the Grantee, with specimen signatures, will be provided to A.I.D., which may accept as duly authorized any instrument signed by such representatives in implementation of this Agreement, until receipt of written notice of revocation of their authority.

X

161

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

FOR THE GOVERNMENT OF THE REPUBLIC OF MALAWI

By: ______________________

Louis J. Chimango
Title: Minister of Finance

Date: August 31, 1988

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA

By: ______________________

George A. Trail, III
Title: United States Ambassador to Malawi

Date: August 31, 1988

By: ______________________

Carol A. Peasley
Title: USAID/Malawi Mission Director

Date: August 31, 1988

Program No: 612-0233
Grant No:
Appropriation:
Budget Plan Code:
Amount:
Authorization: State

2264C

162

A.I.D. Program No. 612-0233
Grant Agreement No.________

PROJECT GRANT AGREEMENT

Between

THE GOVERNMENT OF THE REPUBLIC OF MALAWI

and the

GOVERNMENT OF THE UNITED STATES OF AMERICA

for

MALAWI ENTERPRISE DEVELOPMENT

- TECHNICAL ASSISTANCE, STUDIES AND TRAINING -

Dated: August 31, 1988

163

Table of Contents

Project Grant Agreement

		Page
Article 1:	The Agreement	1
Article 2:	The Project	1
Article 3:	Financing	
SECTION 3.1.	The Grant	1
SECTION 3.2.	Grantee Resources for the Project	2
SECTION 3.3.	Project Assistance Completion Date	2
Article 4:	Condition Precedent to Disbursement	
SECTION 4.1.	First Disbursement	2
SECTION 4.2.	Notification	3
SECTION 4.3.	Terminal Dates for Condition Precedent	3
Article 5:	Special Covenant	3
Article 6:	Procurement Source	
SECTION 6.1.	Foreign Exchange Costs	3
SECTION 6.2.	Local Currency Costs	3
Article 7:	Disbursements	
SECTION 7.1.	Disbursement for Foreign Exchange	4
SECTION 7.2.	Disbursement for Local Currency Costs	4
SECTION 7.3.	Other Forms of Disbursements	5
SECTION 7.4.	Rate of Exchange	5
Article 8:	Miscellaneous	
SECTION 8.1.	Communications	5
SECTION 8.2.	Representatives	6
SECTION 8.3.	Standard Provisions Annex	6

x 164

ANNEX I

Amplified Project Description 7

ANNEX II

Project Grant Standard Provisions Annex 14

Article A: Project Implementation Letter 14

Article B: General Covenants

SECTION B.1. Consultation 14
SECTION B.2. Execution of Project 14
SECTION B.3. Utilization of Goods and Services 15
SECTION B.4. Taxation 15
SECTION B.5. Reports, Records, Inspections, Audit 15
SECTION B.6. Completeness of Information 16
SECTION B.7. Other Payments 16
SECTION B.8. Information and Marking 16

Article C: Procurement Provisions

SECTION C.1. Special Rules 16
SECTION C.2. Eligibility Date 16
SECTION C.3. Plans, Specifications and Contracts 17
SECTION C.4. Reasonable Price 17
SECTION C.5. Notification to Potential Suppliers 17
SECTION C.6. Shipping 18
SECTION C.7. Insurance 18
SECTION C.8. U.S. Government-Owned Excess Property 19

Article D: Termination; Remedies

SECTION D.1. Termination 19
SECTION D.2. Refunds 19
SECTION D.3. Nonwaiver of Remedies 20
SECTION D.4. Assignment 20

A.I.D. Program No. 612-0233
Grant Agreement No.__________

PROGRAM GRANT AGREEMENT

Dated August 31, 1988

Between

The Government of the Republic of Malawi ("Grantee")

And

The Government of the United States of Ameirca, acting through the Agency for International Development ("A.I.D.").

ARTICLE 1

The Agreement

The purpose of this Agreement is to set out the understanding of the parties named above ("Parties") with respect to the undertaking by the Grantee of the Project described below, and with respect to the financing of the Project by the Parties.

ARTICLE 2

The Project

The Project, which is further described in Annex I, supports the Grantee's efforts to revitalize existing businesses and create new enterprises through various policy and institutional reforms. Technical assistance, special studies, training, and evaluation and audit costs will be provided. Annex I, attached, amplifies the above definition of the Project. Within the limits of the above definition of the Project, elements of the amplified description stated in Annex I may be changed by written agreement of the authorized representatives of the Parties named in Section 8.2. without formal amendment of this Agreement.

ARTICLE 3

Financing

SECTION 3.1. The Grant. To assist the Grantee to meet the costs of carrying out the Project, A.I.D., pursuant to the Foreign Assistance Act of 1961, as amended, agrees to grant the Grantee under the terms of this Agreement an amount not exceeding one million six hundred thousand United States ("U.S.") dollars ($1,600,000) ("Grant").

X

The Grant may be used to finance foreign exchange costs, as defined in Section 6.1., and local currency costs, as defined in Section 6.2., of goods and services required for the Project.

SECTION 3.2. Grantee Resources for the Project. The Grantee agrees to provide or cause to be provided for the Project all funds, in addition to the Grant, and all other resources required to carry out the Project effectively and in a timely manner.

SECTION 3.3. Project Assistance Completion Date.

(a) The "Project Assistance Completion Date" (PACD), which is September 30, 1991, or such other date as the Parties may agree to in writing, is the date by which the Parties estimate that all services financed under the Grant will have been performed and all goods financed under the Grant will have been furnished for the Project as contemplated in this Agreement.

(b) Except as A.I.D. may otherwise agree in writing, A.I.D. will not issue or approve documentation which would authorize disbursement of the Grant for services performed subsequent to the PACD or for goods furnished for the Project, as contemplated in this Agreement, subsequent to the PACD.

(c) Requests for disbursement, accompanied by necessary supporting documentation prescribed in Project Implementation Letters are to be received by A.I.D. or any bank described in Section 7.1. no later than nine (9) months following the PACD, or such other period as A.I.D. agrees to in writing. After such period, A.I.D., giving notice in writing to the Grantee, may at any time or times reduce the amount of the Grant by all or any part thereof for which requests for disbursement, accompanied by necessary supporting documentation prescribed in Project Implementation Letters, were not received before the expiration of said period.

ARTICLE 4

Condition Precedent to Disbursement

SECTION 4.1. First Disbursement. Prior to the first disbursement under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

167

A statement of the name of the person holding or acting in the office of the Grantee specified in Section 8.2., and of any additional representatives, together with a specimen signature of each person specified in such statement.

SECTION 4.2. Notification. When A.I.D. has determined that the condition precedent specified above has been met, it will promptly notify the Grantee.

SECTION 4.3. Terminal Date for Condition Precedent. If the condition specified in Section 4.1. has not been met within 90 days from the date of this Agreement, or such later date as A.I.D. may agree to in writing, A.I.D., at its option, may terminate this Agreement by written notice to Grantee.

ARTICLE 5

Special Covenant

The Government of Malawi agrees to undertake a study....

ARTICLE 6

Procurement Source

SECTION 6.1. Foreign Exchange Costs. Disbursements pursuant to Section 7.1. will be used exclusively to finance the costs of goods and services required for the Project having, with respect to goods, their source and origin, and with respect to services their nationality, in Code 941 of the A.I.D. Geographic Code Book as in effect at the time orders are placed or contracts entered into for such goods or services ("Foreign Exchange Costs"), except as A.I.D. may otherwise agree in writing, and except as provided in the Project Grant Standard Provisions Annex II, Section C.1(b) with respect to marine insurance. Ocean transportation costs will be financed under the grant only on vessels under flag registry of the Republic of Malawi and countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing.

SECTION 6.2. Local Currency Costs. Disbursements pursuant to Section 7.2. will be used exclusively to finance the costs of goods and services required for the Project having their source and, except as A.I.D. may otherwise agree in writing, their origin in the Republic of Malawi ("Local Currency Costs") to the extent provided for under this Agreement, "Local Currency Costs" may also include the provision of local currency resources required for the Project.

ARTICLE 7

Disbursement

SECTION 7.1. Disbursement for Foreign Exchange Costs.

(a) After satisfaction of conditions precedent, the Grantee may obtain disbursements of funds under the Grant for the Foreign Exchange Costs of goods or services required for the Project in accordance with the terms of this Agreement, by such of the following methods as may be mutually agreed upon:

(1) by submitting to A.I.D., with necessary supporting documentation as prescribed in Project Implementation Letters, (A) requests for reimbursement for such goods or services, or (B) requests for A.I.D. to procure commodities or services in Grantee's behalf for the Project; or,

(2) by requesting A.I.D. to issue Letters of Commitment for specified amounts (A) to one or more U.S. banks, satisfactory to A.I.D., committing A.I.D. to reimburse such bank or banks for payments made by them to contractors or suppliers, under Letters of Credit or otherwise, for such goods or services, or (B) directly to one or more contractors or suppliers, committing A.I.D. to pay such contractors or suppliers for such goods or services.

(b) Banking charges incurred by Grantee in connection with Letters of Commitment and Letters of Credit will be financed under the Grant unless Grantee instructs A.I.D. to the contrary. Such other charges as the Parties may agree to may also be financed under the Grant.

SECTION 7.2. Disbursement for Local Currency Costs.

(a) After satisfaction of conditions precedent, the Grantee may obtain disbursements of funds under the Grant for Local Currency Costs required for the Project in accordance with the terms of this Agreement, by submitting to A.I.D., with necessary supporting documentation as prescribed in Project Implementation Letters, requests to finance such costs.

(b) The local currency needed for such disbursement may be obtained:

(1) by acquisition by A.I.D with U.S. Dollars by purchase; or

169

(2) by A.I.D. (A) requesting the Grantee to make available the local currency for such costs, and (B) thereafter making available to the Grantee, through the opening or amendment by A.I.D. of Special Letters of Credit in favor of the Grantee or its designee, an amount of U.S. Dollars equivalent to the amount of local currency made available by the Grantee, which dollars will be utilized for procurement from the United States under appropriate procedures described in Project Implementation Letters.

The U.S. dollar equivalent of the local currency made available hereunder will be, in the case of subsection (b)(1) above, the amount of U.S. dollars required by A.I.D. to obtain the local currency, and in the case of subsection (b)(2) above, an amount calculated at the rate of exchange specified in the applicable Special Letter of Credit Implementation Memorandum hereunder as of the date of the opening or amendment of the applicable Special Letter of Credit.

SECTION 7.3. Other Forms of Disbursement. Disbursements of the Grant may also be made through such other means as the Parties may agree to in writing.

SECTION 7.4. Rate of Exchange. Except as may be more specifically provided under Section 7.2., if funds provided under the Grant are introduced into the Republic of Malawi by A.I.D. or any public or private agency for purposes of carrying out obligations of A.I.D. hereunder, the Grantee will make such arrangements as may be necessary so that such funds may be converted into currency of the Republic of Malawi at the highest rate of exchange which, at the time the conversion is made, is not unlawful in the Republic of Malawi.

ARTICLE 8

Miscellaneous

SECTION 8.1. Communications. Any notice, request, document or other communication submitted by either Party to the other under this Agreement will be in writing or by telegram or cable, and will be deemed duly given or sent when delivered to such party at the following addresses:

To the Grantee:

Mail Address: Secretary to the Treasury
Ministry of Finance
P.O. Box 30049
LILONGWE 3, MALAWI

X 170

Alternate address for cables:

FINANCE - LILONGWE
TELEX NO. 4407

To A.I.D.:

Mail Address: Mission Director
USAID/Malawi
P.O. Box 30455
LILONGWE 3, MALAWI

Alternate address for cables:

Telex 4627
American Embassy

All such communications will be in English, unless the Parties otherwise agree in writing. Other addresses may be substituted for the above upon the giving of notice.

SECTION 8.2. Representatives. For all purposes relevant to this Agreement, the Grantee will be represented by the individual holding or acting in the office of Minister of Finance and A.I.D. will be represented by the individual holding or acting in the office of Mission Director USAID/Malawi, each of whom, by written notice, may designate additional representatives for all purposes other than exercising the power under Section 2.1. to revise elements of the amplified description in Annex I. The names of the representatives of the Grantee, with specimen signatures, will be provided to A.I.D., which may accept as duly authorized any instrument signed by such representatives in implementation of this Agreement, until receipt of written notice of revocation of their authority.

SECTION 8.3. Standard Provisions Annex. A "Project Grant Standard Provisions Annex" (Annex II) is attached to and forms part of this Agreement.

171

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

THE GOVERNMENT OF THE
REPUBLIC OF MALAWI

By: ______________________

Louis J. Chimango
Title: Minister of Finance

Date: August 31, 1988

THE GOVERNMENT OF THE
UNITED STATES OF AMERICA

By: ______________________

George A. Trail, III
Title: United States Ambassador
to Malawi

Date: August 31, 1988

By: ______________________

Carol A. Peasley
Title: USAID/Malawi Mission Director

Date: August 31, 1988

PROJECT NO: 612-0233
GRANT AGREEMENT NO:
OBLIGATED AMOUNT: $1,600,000
APPROPRIATION NO:
BPC NO:
ALLOWANCE:
Authorization:

2266C

172

ANNEX H

BIBLIOGRAPHY

BIBLIOGRAPHY

1. G.A. Cornia, R. Jolly and F. Steward (Ed.), Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth, (Vol. I), Clarendon Press, Oxford, 1987.

2. L. Demery & T. Addison, The Alleviation of Poverty Under Structural Adjustment, World Bank, Washington, D.C., 1987.

3. Economist Intelligence Unit, Malawi: Country Report No. 1, 1988.

4. Ettema, W. "Small-Scale Industry in Malawi," Journal of Modern African Studies, Vol. 22, No. 3, 1984.

5. Garcia, Jorge G. "Report on the Industrial Sector of Malawi: Structure, Performance, Efficiency and the Importance of Macroeconomic Policies," World Bank, December 1987 (mimeo).

6. Garcia, Jorge G. "Domestic Resource Cost and Effective Protection in the Industrial Sector of Malawi: An Analysis of the Results of the World Bank Survey, "World Bank, December 1987 (mimeo).

7. Garcia, Jorge G. "Money, Domestic Credit and Resource mobilization in Malawi," World Bank, December 1987 (mimeo).

8. Kydd, Jonathan. "Policy Reform and Adjustment in an Economy under siege: Malawi 1980-87," IDS Bulletin, Vol. 19, No. 1, 1988.

9. U. Lele, " Structural Adjustment, Agricultural Development and the Poor: Some Observations on Malawi", mimeo., December 14th, 1987.

10. Malawi Government, National Statistical Office, Urban Household Expenditure Survey 1979/80, (Government Printer, Zomba 1983).

11. Malawi Government, National Statistical Office, National Sample Survey of Agriculture 1980/81, Vol. III (Government Printer, Zomba, 1984).

12. Malawi Government, National Statistical Office. Malawi Population Census, 1977, Vol. I-III (Government Printer, Zomba 1984).

13. Malawi Government, Department of Town and Country Planning. National Physical Development Plan. June, 1987

14. Malawi Government, National Statistical Office, Population and Housing Census, 1987: Preliminary Report, (Government Printer, Zomba, 1987).

15. Malawi Government, Economic Planning Division. Statement of Development Policies 1987-96. (Government Printer, Zomba, 1988).

16. Malawi Government, 1988, Statement of Development Policies 1987-1996.

17. Malawi Government, National Statistical Office, Reported Employment and Earnings Annual Report, 1977-85. (Government Printer, Zomba, selected years).

18. Malawi Government, National Statistical Office. Monthly Statistical Bulletin (Government Printer, Zomba) various issues.

19. Malawi Government, Reserve Bank of Malawi. Reports and Accounts. (Blantyre Print and Packaging, Blantyre), various issues.

20. Malawi Government, Reserve Bank of Malawi. Financial and Economic Review (Blantyre Print and Packaging, Blantyre), various issues.

21. Malawi Export Promotion Council, 1986, Malawi Buyers Guide 1986/87

22. National Statistical Office. Statistical Yearbook, 1985. (Government Printer, Zomba, October 1986).

23. National Statistical Office. Annual Economic Survey (Government Printer, Zomba), various issues.

24. Price Waterhouse, Malawi Business Reference Guide, 1986.

25. Price Waternouse, Taxation in Malawi, 1986.

26. S. Reutlinger, "Poverty and Malnutrition Consequences of Structural Adjustment: World Bank Policy", Food and Nutrition Bulletin, Vol 9, No. 1, 1987.

28. Industrial Sector Survey 9/88 - UNDP/MTIT

29. USAID, READI. New Directions for Promoting Small and Medium Scale Enterprises in Malawi, June 1987.

30. World Bank. Malawi: The Development of Manufacturing. (Washington, D.C., 1981).

31. World Bank. Malawi - Employment Aspects of Economic Development (Washington, D.C. 1981).

32. World Bank, Structural Adjustment Lending: A First Review of Experience, World Bank, Washington, D.C. 1986.

33. World Bank. Report and Recommendation of the President of the International Development Association to the Executive Directors on a Proposed Credit in an Amount Equivalent to US $70 Million to the Republic of Malawi for an Industrial and Trade Policy Adjustment Program. (Washington, D.C., May 25, 1988).

34. World Bank, Malawi Small Enterprise, 1987

35. World Bank, Small-Scale Industry in Malawi, 1988

36. World Bank. Human Resources Development in Malawi: Labor and Employment, World Bank Discussion Paper, draft.

2269C

ANNEX I

INITIAL ENVIRONMENTAL EXAMINATION

REVISED

INITIAL ENVIRONMENTAL EXAMINATION

CATEGORICAL EXCLUSION

Country:	Malawi
Title of Activity:	Malawi Employment Generation Program (MEGP)
Funding:	FY 1988 - $21.0 million
LOP Funding:	$36.0 million
IEE Prepared By:	Richard C. Day, Program Officer
Environmental Action Recommended	Categorical Exclusion

Discussion: This activity meets the criteria for Categorical Exclusion in accordance with Section 216.2(c) of Regulation 16 and is therefore excluded from further review. A cash grant of $21.0 million in FY 1983 with an additional $15.0 million in FY 1989 will be provided to support the GOM's policy reforms related to employment and income generation. Of the total $36 million, $1.0.million will be used for technical assistance and training. The use of cash grant funds as well as project funds for technical assistance and training is not tied to either finance specific commodities or construction of a specifically identifiable project or project activities and thus it may be considered as an action which "does not have an effect on the natural or physical environment" which, according to Section 216.2(c)(1)(i), is the criteria for categorical exclusion.

Concurrence:

John F. Hicks, Mission Director

Bureau Environmental Officer's Decision:

Bessie L. Boyd, AFR/TR/ARD

Approved: X

Disapproved:

Date: 6/7/88

Clearance:GC/AFR: [signature] for GC DATE: June 7, 1988

8216Q

178