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IFAD

Investing in rural people

# Republic of Malawi

# Transforming Agriculture through Diversification and Entrepreneurship Programme

# Feedback from Executive Board Project Consultations

# Addendum

Executive Board — 128th Session
Rome, 10-12 December 2019

For: **Approval**

# Transforming Agriculture through Diversification and Entrepreneurship Programme

## Addendum

The attention of the Executive Board is drawn to the following addendum and modifications to the President's report on the Transforming Agriculture through Diversification and Entrepreneurship Programme (EB 2019/128/R.25). The following table presents the main questions and observations received during the project consultations of 28 November 2019 and IFAD's response to the same.

For ease of reference, any modification to the text of the President's report resulting from the consultations is indicated below. Changes are shown in boldface, while strikethrough indicates deleted text.

| *Question/observation*[1] | *IFAD response* |
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| 1. The proposal could make clearer how the smallholder producer organizations, once organized, will be linked to off-takers and/or small or medium-sized enterprises to ensure sustainability. This will be especially challenging when targeting the "very poor" households. It is not clear whether the proposal has considered alternative options such as scaling up commercial agricultural models (e.g. anchor farms), which are able to bring in large numbers of smallholders to their supply chains and provide sustainable agronomic and extension advice to raise yields, as well as critical inputs such as seeds, fertilisers, pesticides, inoculants and irrigation (a critical factor in Malawi). | The smallholder farmers will be linked to off-takers, mainly through farmers' organizations such as cooperatives, producers' groups and commodity associations. The Transforming Agriculture through Diversification and Entrepreneurship Programme (TRADE) will focus on contributing to an enabling environment for public-private-producer partnerships (4Ps), which will be implemented through various models (e.g. contract farming and outgrower schemes), building on and scaling up of the previous IFAD-supported commercialization programme (Rural Livelihoods and Economic Enhancement Programme [RLEEP]).<br><br>TRADE will build the capacity of farmers' organizations to sustainably engage with off-takers/private sector, including through sustainable legal mechanisms and bulking/collective selling services. TRADE will ensure that smallholder producers: achieve sustainable economies of scale in production and marketing; have access to inputs and extension services; and are provided with adequate infrastructure to support linkages to commodity off-take points. |
| 2. The seven value chains are not consistent in the document. It would be good if this were clarified. Those listed in paragraph 16 are different to those listed in paragraph 29. | The seven commodities as listed in paragraph 16 are correct and as follows: groundnuts, soybean, sunflower, Irish potato, dairy, beef and honey. The President's report is modified as follows:<br><br>Page 6, paragraph 29<br><br>The second sentence should read:<br><br>The programme will initially support investments in the **groundnut, soybean, sunflower,** dairy, red meat, Irish potato and honey VCs. |

[1] Questions/observations made prior to receipt of the project design report (PDR).

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| 3. It would be good to know what analysis has been done on the mark-ups possible on the commodities, as we have seen analysis that sunflower actually yields a lower value (after cost) than maize. | The analysis was based on both information gathered during the programme design and peer-reviewed references. Indeed, it is true that sunflower yields a lower value (after cost) than maize, since the maize sector has not experienced as many constraints as the sunflower value chain. (Source: *Markowitz, C (2018). Driving a sunflower value chain in Malawi: challenges and opportunities. South African Institute of International Affairs, Policy briefing 179*).<br><br>One of the factors inhibiting agricultural production efficiency is the availability and use of certified seeds. Specifically, producers cannot obtain high sunflower yields and will not obtain good profit margins without certified seeds. In the past, certified sunflower seed was not available in Malawi. Until recently this reflected policymakers' and industry associations' lacklustre prioritization of sunflower. Moreover, other factors have contributed to this trend: maize seed is still the primary revenue earner, resulting in other crops not being prioritized. |
| 4. It might be useful to conduct more analysis of the types of smallholders that IFAD wants to support: i.e. the size of land holdings, the commodities produced, etc. | Based on a detailed targeting and social inclusion strategy (see paragraph 37-39 of the PDR), TRADE will tailor interventions to the needs of different groups of poor people as categorized by the Malawi National Social Support Policy. TRADE's primary target groups are:<br><br>– Ultra-poor, non-labour-constrained households (50 per cent) with the potential to graduate to higher poverty ranks, who are predominantly subsistence producers and often food-insecure, own small land holdings, and are more vulnerable to impacts of climate change.<br>– Ultra-poor households (25 per cent) living in extreme/severe poverty, unable to meet basic food needs, resource-constrained and with limited access to land.<br>– Transient poor households (25 per cent), who are economically active, produce some surplus for market, are often food-secure and have the ability to move out of poverty, but are at risk of slipping back into the lower ranks of poverty due to economic or climate shocks.<br>– TRADE will focus on households that are actively engaged in production of the priority commodities, or have the potential to become engaged in their production, and are located in areas where production of priority commodities is concentrated. The targeting approach will have four aspects: (a) ensuring selection of new commodities with the potential to bring about the inclusion of poor households, women and youth and positively impact nutrition and climate change adaptation; (b) mapping of production, market demand, stakeholders, poverty, social |

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| | and demographic trends to determine geographical locations (i.e. districts and extension planning areas [EPAs]); (c) within the EPAs, targeting will be based on the potential of poor smallholder producers, women and youth to profitably engage in a particular VC; and (d) targeted delivery mechanisms.<br><br>The beneficiaries will produce groundnuts, soybean, sunflower, Irish potato, dairy, beef and honey (as listed in paragraph 16). |
| 5. The report specifies that the programme will reach 1.32 million people - what is the rationale for this number and for the selection of districts? | In terms of number of beneficiaries (see paragraph 102 of the PDR), the programme assumes an average of 4.4 persons per household.<br><br>An estimated 127,000 rural poor households will directly benefit from the programme, of which: (a) 69,500 households will consolidate best practices and strengthen the results achieved in the value chains supported by RLEEP; and (b) 57,500 households will be targeted for scaling up of best practices and additional value chains in the potential new districts. In addition, it is expected that about 173,000 households will benefit indirectly from the access roads to be built and employment opportunities generated by commercial activities and infrastructure construction.<br><br>As regards the number of districts, these will be the same as those targeted under RLEEP, i.e. Mchinji, Nchisi, Dedza, Blantyre, Kasungu, Nkata Bay, Rumphi, Karonga, Lilongwe Rural, Thyolo and Chitipa. The rationale for their selection is that TRADE will consolidate and scale-up successes and good practices from RLEEP, while bringing in additional commodities. The interventions in the 11 districts will be based on the existing analysis conducted at completion of RLEEP, which identified gaps in the realization of optimum impacts and sustainability of RLEEP investments. |
| 6. A net present value (NPV) of US$84.4 million is calculated for the programme. This appears optimistic given the sectors in which IFAD works – low-value and non-lucrative markets. It would be good to see the analysis justifying this figure. The sensitivity analysis should not focus on a 20 per cent reduction of programme benefits, but rather on testing the robustness of the assumptions that generate an NPV of US$84.4 million. | A comprehensive sensitivity analysis was carried out. The results are as follows:<br><br>– A reduction in benefits of up to 20 per cent does not jeopardize the programme's economic suitability, as the NPV would be US$12.3 million and the economic internal rate of return (EIRR) would be 11.4 per cent. However, were the benefits to be reduced by 30 per cent, the NPV would fall below zero (negative US$26.5 million) and the EIRR would drop to 6.9 per cent, below the social discount rate of 10 per cent.<br>– An increase in costs by a maximum of 30 per cent would not seriously jeopardize the programme, as the NPV would remain positive at US$68.9 million and the EIRR would stay above the social discount rate, at 16.5 per cent. |

<table>
<tr><td></td><td>– A delay in accrual of programme benefits of 2 years would not jeopardize the economic profitability of the programme, as NPV would remain positive, at US$5.3 million and the EIRR would drop to 10.4 per cent.</td></tr>
<tr><td>7. There is no mention of political economy risks. The country development diagnostic recently issued by the Department for International Development (DFID) highlights the unpredictable and often short-term nature of political decisions in Malawi, which can prove damaging to longer-term growth. It would be useful to have more information on whether/how the design of the programme allows the flexibility to navigate this difficult political environment. This should also be flagged as a potential risk in the risk table.</td><td>During development partners' coordination meetings, IFAD will obtain real-time updates on the changes in the political economy, notably to reduce the potential risk of elite capture for IFAD operations. Indeed, IFAD will benefit from the country presence of its development partners, such as DFID, and draw on their analysis of changes in the political economy.<br><br>A flexible programming approach will also ensure that TRADE can make needed adjustments and reduce risks related to the political economy during implementation.</td></tr>
<tr><td>8. Macroeconomic risk should be rated as high. Malawi has achieved macroeconomic stability; however recent events (e.g. non-food inflation increasing to above 15 per cent) and the Government budget mean that this risk should be higher.</td><td>The President's report is modified as follows:<br><br>Page 7, table 4<br><br>The macroeconomic risk rating should read:<br><br><table><tr><td>Macroeconomic</td><td>~~Medium~~ High</td><td>Community-based implementation and mobilization of cofinancing to address potential exchange rate deterioration and inflation.</td></tr></table></td></tr>
<tr><td>9. IFAD should conduct a more thorough debt sustainability analysis (DSA) using the new framework of the International Monetary Fund (IMF). While the risk of debt distress is rated moderate against external debt, the overall debt distress risk is actually high according to the IMF's latest DSA, which shows that domestic debt (on highly non-concessional terms) as a proportion of total debt is rising.</td><td>The debt sustainability analysis (see paragraph 38 of the President's report) is based on the findings of the Joint Debt Sustainability Analysis – 2018 Update by the International Development Association and IMF, which was performed using the latest version of the Joint World Bank-IMF Debt Sustainability Framework for Low-Income Countries dated 2018.<br><br>While the high overall risk of debt distress for Malawi is confirmed, IFAD's concessional financing relates to external debt sustainability, which the 2018 update assesses as having a moderate risk of distress. The President's report also highlights the need to enhance fiscal discipline to avoid accumulation of domestic debt at high interest rates.</td></tr>
<tr><td>10. Any programme that will lead to Malawi taking on more external debt – however concessional it is – should make a more convincing case for transformational growth in order</td><td>Untapped export opportunities in the Southern African Development Community region comprise a mix of Malawi's traditional and novel export sectors. Among the traditional exports, raw cane sugar, black fermented tea, groundnuts, maize seeds for sowing, dried peas and wood-related products offer</td></tr>
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| to generate the revenues to service that debt. There is a risk that the programme succeeds on the resilience objectives but fails on the growth objective in the face of severe strain on agricultural land use from the twin pressures of rapid population growth and environmental degradation. | room for export growth, potentially of US$30.6 million.<br><br>Among non-traditional exports, Malawi recently increased its exports of chickens' eggs to Mozambique dramatically (353 per cent annual growth between 2011 and 2015), a performance that opens the door to further regional opportunities valued at US$29.7 million for chickens' eggs.<br><br>Other diversification opportunities in the sugar and poultry sectors could lead to exports of cane molasses, refined sugar, macadamia nuts (shelled and unshelled), dried shelled common peas, chickpeas, raw cane sugar, and fresh and frozen poultry products.<br><br>In addition, Malawi's climate conditions appear suitable for diversification of production into oil seeds, including sunflower seed.<br><br>Promoting Malawi's export potential is based on improving its competitiveness by: (i) integrating markets through commodity exchanges and warehouse receipting; (ii) infrastructure to reduce transaction costs (access to finance, information and communications technology and roads); and an enabling policy environment. TRADE speaks to these much-needed investments, but in a demand-driven way, with sustainability at the heart. |
| 11. In terms of lessons learned, there could be more analysis on the broader aid environment in Malawi: what are the other ongoing or planned agricultural support programmes and how will those be linked with the synergy-building mentioned in paragraph 23. | In order to address the problem of overproduction, the Government has reintroduced a quota system to regulate production, increase quality and reduce supply.<br><br>The World Bank is providing support to Malawi to develop a new national agriculture policy and a seed policy. In order to find alternatives to tobacco as an export crop and protect Malawi's biodiversity, the European Union is supporting production of sugarcane and coffee, while the United States Agency for International Development is promoting honey production.<br><br>The Green Belt Initiative is working to irrigate 1 million hectares of land within 20 km of the country's three lakes and 13 rivers. So far, shortage of fuel for water pumps has limited uptake, but there are plans for gravity-fed water projects in Mulanje, Blantyre and Phalombe. For other farmers, the initiative is encouraging them to group together, use organic manure, construct ridges to collect rainwater, and adopt improved plant spacing.<br><br>To strengthen effectiveness of aid from various donors supporting agriculture and rural development in Malawi, TRADE offers several partnership opportunities with other development partners (see paragraphs 87-88 of the PDR). The programme contributes to pillar 3 – Inclusive and Resilient |

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| | Growth – of Malawi's United Nations Development Assistance Framework 2019-2023.<br><br>Similarly, to contribute to national policy dialogue, IFAD is a member of several donor committees together with several other partners (the Food and Agriculture Organization of the United Nations, World Food Programme, World Bank, African Development Bank [AfDB], DFID, Irish Aid and the European Union). These committees include the Donor Committee in Agriculture and the Development Partners Coordination Group for Social Protection.<br><br>TRADE will build synergies with the commodity development and commercialization activities implemented by other development partners such as the World Bank; the recently approved Climate Adaptation for Rural Livelihoods and Agriculture project financed by AfDB; and the United Nations Development Programme's Malawi Innovation Challenge Fund in component 1 of the programme. IFAD has already met with other potential partners to agree on possible areas of collaboration: (i) the Clinton Foundation's legume VC development programme; (ii) the German Agency for International Cooperation's More Income and Employment in the Rural Areas of Malawi project based on the farmer business school approach, and (iii) the European Union KULIMA initiative, which supports value chains and inclusive business models. IFAD will continue to engage with other development partners in Malawi through the existing donor coordination framework and continued dialogue with the Government to ensure coordinated aid delivery in the country (see paragraph 88 of the PDR). |
| 12. Paragraph 37 states that the Adaptation for Smallholder Agriculture Programme (ASAP) will draw up fact sheets for each value chain. How is this envisaged? Is it expected that the Programme for Rural Irrigation Development (PRIDE) will provide these (quite possible if the same value chains are selected), or is ASAP funding envisaged through another route (ASAP 2)? | The fact sheets will be prepared based on a value chain approach, which entails analysing the climate risks for each value chain identified for TRADE. This approach is described in the IFAD how-to-do note on climate change risk assessments in value chain projects. The value chains will be analysed from production to market, and adaptation measures recommended for the various stages. The output from the University of Cape Town climate vulnerability analysis for Malawi, funded by ASAP 2, provides the scenarios for the future projection. These have been downscaled for development of the fact sheets. The fact sheets will be financed by TRADE resources and not ASAP.<br><br>The President's report is modified as follows:<br><br>Page 8, paragraph 37, the second sentence should read: |

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| | Climate factsheets for each VC will be drawn up**.** ~~under the Adaptation for Smallholder Agriculture Programme.~~<br><br>The linkages to PRIDE will be through the identified commodities, which will also be cultivated in PRIDE's irrigated and rainfed areas. The fact sheets will provide targeted and responsive climate resilience adaptation options for the PRIDE beneficiaries in the northern and southern regions and particularly in the districts that overlap with TRADE (Rumphi, Karonga and Chitipa). |
| 13. We note that the climate risk rating is high. While Malawi is certainly vulnerable to climate change impacts, it may be less so than countries with lower rainfall and higher variations between years. As an overarching point, there seems to be an issue of consistency in how IFAD assigns climate risk ratings between countries and between projects. A large project in the lowlands of Ethiopia that includes many semi-arid areas, presented at the last Board session, received only a moderate climate risk rating. | Climate risk ratings are standardized by applying screening questions. The resulting classification is validated in a consistent manner.<br><br>For TRADE the climate risk rating is high as the target area is exposed to frequent droughts and prolonged dry spells as well as floods, which have resulted in significant agricultural losses and infrastructure damage over the last few years.<br><br>In the case of the Lowlands Livelihood Resilience Project (LLRP) in Ethiopia, IFAD adopted the World Bank rating. (It is to be recalled that for LLRP the World Bank procedures are applicable.) The World Bank documents include an annex on climate change adaptation (detailing the risk analysis) and an Ex-ACT analysis on mitigation of greenhouse gas emissions, confirming that the programme is a carbon sink. |
| 14. The Ministry of Local Government, not the Ministry of Agriculture, is the lead implementing agency – is there a particular reason for this? | The Ministry of Local Government and Rural Development (MLGRD) is deemed best suited to be the lead agency for TRADE, given its strong presence at local level, supported by the decentralized organizational structure. This offers a conducive operational environment for TRADE-supported activities to be implemented by the decentralized local entities.<br><br>MLGRD will work with a wide range of stakeholders from public institutions and the private sector, such as the Ministry of Agriculture, Irrigation and Water Development, during the implementation to ensure the flow of required technical support to the programme. |