

**Malawi: Poverty Reduction Strategy Paper—Third Annual Progress Report—
Joint Staff Advisory Note**

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper Third Annual Progress Report for Malawi, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Poverty Reduction Strategy Paper Third Annual Progress Report to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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INTERNATIONAL DEVELOPMENT ASSOCIATION
AND INTERNATIONAL MONETARY FUND

MALAWI

**Joint Staff Advisory Note on the Poverty Reduction Strategy Paper
Third Annual Progress Report**

Prepared by the staffs of the International Development Association
and the International Monetary Fund

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I. OVERVIEW

1. **The Government of Malawi has finalized its third annual progress report (APR) of Malawi's Poverty Reduction Strategy (MPRS) for the period July 2004 to December, 2005.**¹ The APR was completed in February 2006 and formally circulated to the Boards of the World Bank and the IMF in April, 2006.² This Joint Staff Advisory Note (JSAN) has been prepared by staffs of IDA and the IMF. The JSAN provides feedback on the assessment of MPRS implementation as reported in the APR and offers suggestions toward improving policy implementation, monitoring and reporting in selected key areas.

2. **The government's strategy as described in the MPRS focuses on reducing poverty through creating a stable macroeconomic environment and undertaking activities in four interrelated pillars.** These comprise actions to promote sustainable pro-poor growth, human capital development, improvements in the quality of life of the most vulnerable, and good governance. The strategy also emphasizes that addressing cross-cutting issues of gender and empowerment, HIV/AIDS, science and technology, and the environment, will be given priority.

¹ Malawi's fiscal year runs from July 1st to June 30th. Although the MPRS expired in mid-2005, the authorities still used the policies and strategies in it as a basis for formulating the 2005/06 budget. The Malawi Growth and Development Strategy (MGDS) is the successor to the MPRS. The MGDS is due to be submitted for final Cabinet approval at end-August 2006. The 2006/07 budget that was recently presented in Parliament was guided by the draft MGDS.

² The first year of MPRS implementation was 2002/03, for which a progress report was submitted to the Executive Boards of the IMF and the World Bank on October 10, 2003. The second APR was submitted to the Executive Boards in June 2005.

3. **Staffs recommend that in future review processes, extra effort is made to ensure greater participation by the private sector and key members of parliament.** The government has aligned the PRSP processes further with its existing national planning and reporting processes and has continued to consult extensively with civil society and the development community. The APR states that the reviews have become central to the policy formulation process in Malawi. Although the preparation of the APR coincided with a comprehensive review of MPRS implementation over the three fiscal years (2002/03 to 2004/05), staffs agree that it was still completed in a reasonable time to provide feedback into the budget formulation process. However, while efforts were made to involve stakeholders in government, civil society, and the development community in the exercise, participation from the private sector and parliamentarians was still minimal.

4. **Future reviews should also include annual targets for all the sectors against which reported achievements can be evaluated.** Staffs note that as recommended in last year's JSAN, the APR focuses on presenting those achievements that relate to the priority activities outlined in the MPRS. In some cases, the APR also compares these achievements to the targets that were set for the year. However, this analysis is done only in a few cases and could usefully be expanded.

5. **The provision of transparent information on implementation of the MPRS to key domestic and external stakeholders should be a key function of the APR process.** In last year's JSAN, staff recommended that the review process be seen as an opportunity for the government to engage with various stakeholders in improving implementation of the country's poverty-reduction strategy. In this regard, the value of the APR would have been greater if it had outlined how its findings would help improve implementation of the next phase of the government's poverty reduction strategy.

6. **The APR concludes that despite resource constraints, MPRS implementation during the review period has improved significantly compared to the first two years.** It notes that macroeconomic performance first underpinned by a Fund Staff-Monitored Program, and later by a Poverty Reduction and Growth Facility (PRGF)-supported program has been broadly satisfactory. Further, despite being constrained by a large domestic interest bill inherited from the past, and food related expenditures in the wake of a drought, substantial progress was made in implementing MPRS priority activities in agriculture, education, health, safety nets, public expenditure management, public sector reform, and corruption prevention. In addition, budgetary allocations earmarked for pro-poor expenditures (PPEs) were released timely and fully. Staffs commend the authorities for this satisfactory progress and urge them to put in place measures that ensure that ministries and departments will continue to implement priority activities.

II. PROGRESS IN IMPLEMENTATION AND THE WAY FORWARD: CRITICAL AREAS OF SUCCESS

A. Macroeconomic Performance and the Medium-Term framework

7. **Staffs commend the authorities for improving macroeconomic performance under the Staff Monitored Program with the IMF during 2004/05**, which paved the way for the approval of a new PRGF arrangement in August 2005. The authorities are to be commended for tackling the domestic debt spiral. Staffs agree with the APR that the authorities were broadly successful in enforcing fiscal discipline through 2004/05 and the first half of 2005/06.
8. **The APR could have benefited from a broader discussion of macroeconomic performance, and of the challenges that lie ahead with regard to maintenance of macroeconomic stability.** The discussion of macroeconomic performance in the first half of 2005/06 focuses on the execution of the budget. During this period, policy implementation was complicated by the onset of a severe food crisis as a result of the significant dry spell that adversely affected the 2004/05 crop. This imposed a severe strain on budgetary resources. Despite these pressures, program performance under the PRGF through end-December 2005 remained broadly satisfactory. However, inadequacies emerged in the management of the exchange rate. The exchange rate was kept artificially overvalued for an extended period, and this put pressure on external reserves, resulting in an accumulation of private external payment arrears on imported goods and services. In this regard, the APR could have flagged some of the risks to macroeconomic stability that still remains.
9. **Staffs believe that the APR could have been strengthened by a discussion of macroeconomic objectives through the remainder of 2005/06 as well as an outline of the objectives for the coming fiscal year 2006/07.** A forward-looking discussion is entirely absent from the APR. It is staffs' understanding that the government's forward-looking policies will be discussed at greater length in the MGDS.
10. **Macroeconomic performance in the second half of 2005/06 was affected by several developments.** The food security crisis was deeper than anticipated, leading to higher expenditures. Foreign exchange shortages and persisting arrears on import payments made an inflexible exchange rate policy difficult to sustain; as a result, the exchange rate was allowed to depreciate and the arrears on import payments were eliminated. To contain inflation, the Reserve Bank of Malawi was forced to withdraw excess liquidity following reductions in the liquidity reserve ratio. All quantitative targets agreed under the PRGF for end-June 2006 are likely to have been met except the performance criterion on domestic borrowing and the indicative target on discretionary spending, largely due to the higher food security expenditure.

B. Progress in Poverty Reduction

11. **The APR could have benefited from a discussion of the possible factors explaining the lack of progress in reducing the poverty head count and the measures needed to improve the outcome going forward.** The APR states that poverty remained high over the implementation period of the MPRS. Using data from the first Integrated Household Survey (IHS1), the poverty headcount in 1997/98 was 54.1 percent while according to the second Integrated Household Survey (IHS2) conducted in 2004/05, 52.4 percent of the population is still living in poverty, which amounts to 6.3 million Malawians.

12. **Given the availability of the IHS2 and the new MGDS, the government should embark on an evaluation of the effectiveness of the PPEs so as to enable a better monitoring of the impact of PPEs on the poor.** Staffs commend the authorities for ensuring that PPEs received their budgeted resources even while pressures emerged to reallocate government spending because of the weather-related shock that affected the 2004/05 crop season. The government has continued to earmark resources, partly coming from the Heavily Indebted Poor Country (HIPC) Initiative savings, toward PPEs. However, an evaluation of the effectiveness of PPEs would assist with prioritization and scaling up of those PPEs that are most effective in reaching and helping the poor in Malawi. Further, as recommended in last year's JSAN, future APRs should also include an analysis of the consistency of Malawi's poverty reduction targets with those of the Millennium Development Goals (MDGs).

C. Progress in Sector Policies and Programs

13. The APR outlines progress made in carrying out activities under each of the strategic pillars of the MPRS.

Pillar 1. Sustainable pro-poor growth

14. **Staffs recommend that poverty and social impact analyses be conducted to evaluate whether programs designed to improve access to inputs and credit are having their intended impact.** The APR outlines activities taken in the year to expand and strengthen access by farmers to agricultural inputs in order to increase incomes. The MPRS strategy for increasing access to agriculture inputs includes expanding credit (through Savings and Credit Cooperatives (SACCOs)) and through Public Works Programs (PWP). During the year, SACCOs were formed based on farmers' cooperatives and associations and the number of farmers accessing inputs through the Targeted Input Program (TIP) was increased. However, the design and implementation of these programs would greatly benefit from the findings of impact analyses.

15. **Similarly, the APR could have benefited from a discussion of progress, or lack thereof, in conducting an assessment of the impact and performance of the different irrigation schemes.** Staffs note that progress was made in the promotion of small scale irrigation schemes and drainage. Some of the achievements included the distribution of

treadle pumps, excavation of canals, installation of motorized pump based schemes, and rehabilitation of sprinkler irrigation schemes and dams. Since these represent diverse types of irrigation technologies, useful insights would be obtained from an assessment of performance of each type of technology.

16. **Since mining is still a developing sector in Malawi, staffs recommend that future progress reports provide more details on this activity, including the specific types of minerals that offer the greatest prospects.** The APR mentions that steps were taken to promote small-scale mining, an activity that the poverty reduction strategy identified as having significant potential for bringing about pro-poor growth. Small-scale miners were trained in appropriate mining techniques and skills and in mineral processing. The Department of Mining facilitated access to loans for most small-scale miners, the mining policy was reviewed, and the inventory of mines was updated. Nevertheless, future implementation of these measures could benefit from a discussion of progress that is presented within a more defined context with regard to the type of minerals.

Pillar 2. Human Capital Development

17. **While the APR outlines the actions that were undertaken to improve access and quality in education, it could have benefited from a more candid assessment of the lack of progress in the indicators that measure quality of education, and the need to rationalize expenditures across the sector.** The APR indicates that facilities to improve the quality of primary school teachers through in-service training were constructed, and guidelines were prepared for the deployment of teachers from urban to rural areas. Staffs also note that more secondary schools were built and that university intake was substantially increased through the introduction of parallel programs. Access to the university by disadvantaged pupils was improved through the introduction of a loan trust fund. Staffs further note that the APR addressed last year's JSAN recommendation to reduce tertiary education reliance on subvention. However, significant inequities persist in the education system. Staffs urge the authorities to redouble their efforts to eliminate these disparities.

18. **The APR could have been strengthened by a more detailed discussion of the current status of efforts to improve the independence of the Central Medical Stores (CMS).** Staffs welcome government's efforts to improve the quality of essential health care through procurement and distribution of basic equipment, and through the training and retention of more frontline staff and reforms at the Central Medical Stores (CMS). During the review period, new ambulances were procured and distributed to all district health offices and central hospitals. Further, radio communication equipment was installed in health facilities in most districts. With regard to human resource development, the Ministry of Health embarked on a six year emergency training program and doubled the intake in its various training institutions. Further, a salary top-up scheme was introduced in order to retain staff and reforms at the CMS continued, notably, the rolling out of a system for delivering

drugs and medical supplies directly from regional medical stores to districts. But given that progress has been slow in the past, the APR could have been more comprehensive in the presentation of progress in reforming the CMS.

Pillar 3. Improving the Quality of Life of the Most Vulnerable

19. **The change in the fertilizer distribution program may have a regressive effect, negatively affecting the most vulnerable farmers.** Since 2005/06, the government decided to discontinue the free TIP in favor of a targeted input price subsidy program. Staffs appreciate the authorities' frankness in noting that the program is still beset with problems of targeting. However, the APR should have outlined the measures that the government is taking to improve the targeting mechanism. Further, the APR should have discussed the distributional effects of a change in policy from implementing a free TIP to a targeted price subsidy inputs program. In this context, staffs note that the change to the new voucher subsidy is regressive in that the poorest farmers may be unable to pay for the subsidized fertilizer. Hence, staffs would urge the government to ensure that policies are introduced to protect the most vulnerable in society.³

20. **The APR could have benefited from a discussion of the key features of the Food and Nutrition Security Policy and could have noted any departures that there are from the nutrition strategies outlined in the MPRS.** The APR indicates that the major activities in the year with regard to promotion of good nutrition were the finalization of the Food and Nutrition Security Policy and the establishment of nutrition sentinel surveillance data sites in every district. In order to provide some direction to future implementation, a presentation of key features on the new policy was warranted.

Pillar 4. Good Governance

21. **Some progress has been made in public sector reforms; missing, however, is a description of developments in parastatal reform.** As envisaged in the MPRS, the Integrated Financial Management Information System (IFMIS) was introduced after several failed attempts. This should improve financial management and expenditure control in the public sector. However, in view of the fact that the rolling out of IFMIS has been beset with many hitches in the past, it would have been instructive if the APR highlighted some of the risks that lie ahead. Also, as recommended in last year's JSAN, the APR should have provided a comprehensive review of progress made in the area of parastatal reform. In particular, recent actions such as the privatization of Malawi Telecommunications Limited, which was envisaged in the MPRS, and initiation of the re-structuring of the Agricultural Development and Marketing Corporation (ADMARC) and the liquidation of Malawi

³ A Poverty and Social Impact Analysis was recently conducted by the Fiscal Affairs Department of the Fund. It concluded that the current voucher-based fertilizer scheme is not very successful in targeting the benefits to the intended recipients. Among other things, it recommended an increased focus on smallholder productivity, better targeting of the fertilizer by offering fertilizer instead of cash, and more involvement of the private sector.

Development Corporation should have been reviewed. Further, a discussion on the failed attempts to privatize Air Malawi should have been included in the APR.

22. **There is need for a detailed update on progress in reforming the public procurement system.** The APR mentions that several activities, mostly in the form of training, workshops, and public awareness campaigns, were undertaken in the period by the Anti-Corruption Bureau; with a view to help prevent fraud and corruption in various institutions. However, since most corruption in the public sector is related to public procurement, a more detailed update of reforms in this area could have been presented. As envisaged in the MPRS, the office of the director of public procurement has now been established and standard bidding documents of international standards have been prepared. Progress in this area therefore needs to be reviewed and additional constraints that may affect the effective functioning of the procurement system identified.

Cross Cutting Issues

23. **The APR could have benefited from a presentation of progress or lack thereof, in enhancing the participation of women in decision making.** The APR outlines progress made in mainstreaming gender issues in government programs, reducing gender-based violence, and promoting a gender-sensitive legal environment. However, future APRs should also include specific actions that the government is undertaking to ensure that women are actively involved in decision making at various levels in society.

24. **Staffs recommend that future progress reports should be more comprehensive in outlining progress made in the fight against HIV/AIDS.** While progress seems to have been made in sensitizing the young to HIV/AIDS-related issues, it is not clear what activities were undertaken to improve the quality of life of those already infected and to mitigate against the economic and social impact of HIV/AIDS as envisaged in the MPRS.

25. **The APR notes the progress made in strengthening the legal and institutional framework for environmental management, in particular the revision of the National Environmental Plan and the Environmental Management Act.** Staffs agree with the observation that there are problems in ensuring compliance with some aspects of the law. In particular, most new developers do not comply with Environmental Impact Assessment (EIA) requirements because licensing authorities do not usually refer these to the Department of Environmental Affairs. However, the APR should have indicated specific steps that will be taken to ensure that licensing authorities and developers comply with the requirements of the law.

D. Monitoring and Evaluation

26. **The APR outlines progress made in developing a functioning national monitoring and evaluation (M&E) system.** However, such a system to monitor MPRS implementation is still not in place. A needs assessment of M&E capacity constraints in local

assemblies was carried out during the review period. Following the recommendations of the assessment, the process of recruiting district M&E officers was initiated and consultants were engaged to prepare training manuals for the officers. However, beyond the recruitment of M&E officers, no indication is given in the APR as to what remains to be done to make the system fully operational. In this regard, staffs would like to emphasize that the preparation of the new Malawi poverty reduction strategy provides an opportune time to introduce a strong M&E system, where goals are translated into operational plans, and indicators are identified to allow monitoring of progress in individual activities, as well as toward higher level goals. Linkages between planning, budgeting, accounting, and the policy review process also need to be elaborated.

27. Staffs nevertheless note improvements in the manner in which progress made in implementing the MPRS during the review period has been presented in the APR. As recommended in last year's JSAN, the current APR focuses on presenting achievements that are the result of implementing priority policies contained in the MPRS. It is also commendable that in some areas the APR presents outputs achieved against targets for the year. Staffs advise that in future, this approach should apply to all areas covered by the APR. Further, future APRs should also provide a summary of all the recommendations.

28. Looking ahead, the APR could have benefited from an assessment of risks to the strategy. These include the impact of a potential deterioration in the fiscal stance, an increase in poverty rates, and limitations in the government's institutional capacity to implement the strategy. It would be important that the upcoming APRs assess these risks and outline measures to mitigate them.

E. Comprehensive Review of the MPRS

29. The government has carried out a comprehensive review of the MPRS covering the three year period of implementation (2002/03 – 2004/05). This is separate from the APR assessed in this JSAN. The review process was highly participatory, involving government institutions, civil society, private sector and the development community. Staffs agree with the candid findings of the review, in particular, in acknowledging that despite some efforts to implement policy priorities outlined in the MPRS, poverty levels in Malawi have not changed. The review further observes that the targets that were expected to be achieved at the end of the three year period in various sectors were missed to a large extent because of lack of realism about availability of financing and implementation capacity.

30. Staffs agree with the analysis of lessons drawn from the comprehensive review. One key lesson is that there is need to set up institutionally embedded processes that will ensure that budgets are clearly linked to the strategy. Currently, although the guidelines for budget formulation state that line ministries should budget only on the basis of priorities outlined in the MPRS, the vetting of budget submissions is still not rigorous enough. Another key lesson learnt is the need for management to use M&E systems as a management tool.

This will help to ensure that actions are taken in good time to remove any constraints where progress is lagging.

31. **As mentioned in last year's JSAN, the authorities embarked on the preparation of a successor strategy that would improve on the MPRS.** The new strategy, the MGDS, takes into account new information about poverty in Malawi from the 2006 Poverty and Vulnerability Assessment (PVA)⁴ and incorporates improvements based on lessons drawn from the comprehensive review mentioned above. Covering the period 2006/07 – 2010/11, the MGDS, which includes an explicit results framework, has been prepared through a participatory process and was discussed at Cabinet on May 30, 2006. Cabinet adopted the strategy in principle, subject to the finalization of a human resource and capital needs assessment. The government intends to formally adopt the strategy soon.

III. CONCLUSION

32. **The government should be commended for preparing an APR that in the judgment of staffs represents a significant improvement over previous APRs.** In particular, staffs note the improved focus on achievements related to priority actions outlined in the MPRS. Staffs also commend the authorities for preparing the APR in a timely manner. However, it is recommended that in future, efforts should be made to ensure that the private sector and parliamentarians also participate in the review process. It is also recommended that the authorities indicate the extent to which progress reporting is being used to provide transparent information on implementation of the MPRS to key domestic and external stakeholders.

⁴ The PVA was based on data from the second integrated household survey (IHS2) carried out by the National Statistical Office covering the period March 2004-February 2005.