

**IMMEDIATE
ATTENTION**

EBD/08/94

September 8, 2008

To: Members of the Executive Board

From: The Secretary

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

Attached for the **information** of Executive Directors is the advisory note, prepared jointly by the staffs of the Fund and the International Development Association, on Malawi's poverty reduction strategy paper progress report (EBD/08/93, 9/8/08). At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Malawi indicating that they consent to the Fund's publication of this paper. It is intended to post this paper on the Fund's external website after **Thursday, September 11, 2008**.

Questions may be referred to Mr. Berg (ext. 38843), Ms. Teferra (ext. 37301), and Mr. Maehle (ext. 36499) in AFR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, September 16, 2008; and to the African Development Bank, the European Commission, the Food and Agriculture Organization, and the United Nations Development Programme.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL DEVELOPMENT ASSOCIATION
AND INTERNATIONAL MONETARY FUND

MALAWI

**Joint Staff Advisory Note on the First Annual Progress Report of the Second
Poverty Reduction Strategy Paper—The Malawi Growth and Development
Strategy**

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

Approved by Michel Wormser (IDA),
Robert Corker and Anthony R. Boote (IMF)

September 5, 2008

I. OVERVIEW

1. **The Government of Malawi has finalized the first annual progress report (APR) of its second poverty reduction strategy, the Malawi Growth and Development Strategy (MGDS).** The APR (also referred to as “the report”) covers the period July 2006 to June 2007.¹ It was completed in June 2008 and formally circulated to the Boards of the World Bank and the IMF in September 2008. Staffs of IDA and the IMF have prepared this Joint Staff Advisory Note (JSAN) in order to provide feedback on the assessment of MGDS implementation as reported in the APR, and offer suggestions toward improving implementation, monitoring and evaluation in selected key areas.

2. **The MGDS provides an overarching national policy framework for reducing poverty in Malawi and covers the period 2006 to 2011.** The strategy is built around five themes: sustainable economic growth; social protection; social development; infrastructure development; and improved governance. Within these broad themes, the strategy also emphasizes on six priority areas: agriculture and food security, irrigation and water development; transport and infrastructure development; energy generation and supply; integrated rural development; and prevention/management of HIV/AIDS and nutrition. The MGDS has specific targets to be achieved by 2011, and the purpose of the annual review was to report on progress achieved in the year 2006/07.

3. **Staffs welcome the role that the APR played in providing transparent information on implementation of the MGDS to key domestic and external stakeholders.** In particular, as mentioned in the report, the annual review process became a channel of dialogue between Government, civil society and development partners to understand progress in the alignment of sector activities and donor support

¹ Malawi’s fiscal year runs from July 1st to June 30th.

to the MGDS, and progress being made towards the achievement of desired sector outcomes. However, due to data problems, the review process took so long that it may not have significantly informed the budget preparation process. In particular, due to delays in receiving data from various ministries and departments for the evaluation of performance against targets, the review was only completed in April, when the budget preparation process was at an advanced stage.

4. In spite of progress made in certain areas in implementing the MGDS, Staffs wish to highlight that Malawi's development challenges remain immense. With per capita income of only \$240, and half the population living below the poverty line, Malawi is still a very poor country. Private savings have been negative and private investment less than 5 percent of GDP for over a decade. Malawi is landlocked and therefore faces high transportation costs that make imports very expensive and exports less competitive. Further, the economy remains heavily dependent on rain-fed agriculture, and therefore highly susceptible to droughts. Therefore, Malawi's performance in implementing the MGDS needs to be much stronger if there is to be noticeable progress towards achieving the medium-term development objectives. At current rates, Malawi may only be able to achieve three Millennium Development Goals (MDGs) - gender equality, child mortality, and combating HIV/AIDS and other diseases.

II. PROGRESS IN IMPLEMENTATION

5. The APR presents progress made in carrying out activities under each of the priority areas as well as themes of the MGDS. In this regard, the APR is comprehensive, covering progress made in almost all the sectors and sub-sectors. However, given the limited budgetary resources available, staffs wish to highlight one of the key principles of the MGDS – that of prioritization. This requires Government to determine better the relative importance of the MGDS objectives and sequence interventions over the medium-term. The next three sub-sections provide Staffs' advice in response to progress made on macroeconomic performance; selected sector policies and programs; donor harmonization and alignment; and, monitoring and evaluation.

A. Macroeconomic Performance

6. The APR appropriately describes progress made in strengthening the macroeconomic framework. It notes in particular the rebound in economic activity since 2006, with real GDP growing at around 8 percent in 2006 and 2007, supported by good performance in the agriculture sector; and the easing of inflation brought about by the good harvest. The report also notes that prudent fiscal policy helped reduce interest rates and facilitated an increase in credit to the private sector.

7. Macroeconomic policies were broadly in line with MGDS priorities. The authorities continued pursuing prudent policies that promoted macroeconomic stability. Revenue performance and expenditure execution have been strengthened. Reforms in these areas have contributed to further fiscal consolidation, consistent with the objectives of increasing fiscal space for higher pro-growth and pro-poor spending. For example, in revenue collection, reforms in the area of tax administration have

contributed to increased tax revenues. In expenditure execution, a central payments system has been introduced to consolidate improvements in expenditure control achieved through the rolling out of the Integrated Financial Management System (IFMIS). However, major challenges remain. In particular, as pointed out in the Report, public financial management (PFM) performance has fallen short of expectations, largely due to capacity constraints. In this regard, measures are needed to strengthen PFM in order to make effective use of expanding fiscal space while preserving fiscal and debt sustainability. Particularly, there is a need for improvement in revenue and expenditure forecasting, development project evaluation and costing, monthly in-year monitoring of budget execution and reconciliation with RBM data and financial controls and audits, which the report could have usefully discussed.

8. **The APR would also have benefited from a broader discussion of medium-term macroeconomic objectives and of the challenges that lie ahead.** It could have considered in particular the challenge of maintaining macroeconomic stability in the face of low international reserves and rising international prices for oil and fertilizer. The report on exchange rate policies would benefit from a discussion of the real exchange rate, the role of the exchange rate and its flexibility in ensuring macroeconomic balance and competitiveness, and reforms needed to the foreign exchange market. Similarly, the APR could have discussed the country's debt management strategy and its role in the overall development agenda. Debt relief received from enhanced HIPC and MDRI, plus additional bilateral debt forgiveness, reduced the country's external debt to around 15 percent of GDP at end-June 2007, and a debt management strategy will thus play a crucial role in preserving debt sustainability over time. The report could also have discussed Malawi's record with regard to aid effectiveness in the post HIPC-MDRI era as it is likely to be important for the implementation and impact of the MGDS. The Paris Declaration on Aid Effectiveness would provide a useful framework for assessing progress in this regard.

B. Progress in Sector Policies and Programs

Sustainable Economic growth

9. **Staffs welcome progress made in improving agricultural productivity, although the challenge now will be how to maintain this progress or even improve on it, in light of increasing global fertilizer prices.** The APR presents progress made in improving agriculture productivity as a result of the input subsidy program. There is now need to articulate a clear strategy that spells out how this achievement can be maintained or even enhanced in the wake of recent increases in fertilizer prices. Such a strategy could particularly focus on improving effectiveness and efficiency of the program, making it fiscally sustainable, and ensuring that it promotes private sector development in input markets. One of the measures to improve fiscal sustainability is by providing extension services designed to help farmers use fertilizer more efficiently in crop production.

10. **In order to enhance the contribution of the agriculture sector to economic growth, efforts should also focus on the promotion of agro-processing.** As noted in the APR, it is envisaged in the MGDS that the agriculture sector's contribution to economic growth will be through increased smallholder productivity and agro-processing. However, the report is silent on progress made in agro-processing. The draft Agriculture Development Program that has been prepared by the

Government provides detailed actions for promoting agro-processing, complete with targets.² Progress in this area will therefore depend on the extent to which these actions can actually be implemented.

11. **Further progress in trade and private sector development could be made by accelerating reforms that reduce the cost of doing business in Malawi.** The APR outlines progress made in the promotion of export-oriented private sector development as reflected in the increasing number of firms involved in export trade. However, the report also indicates that progress in improving the share of the private sector investment in GDP was less than targeted. This underscores the need for Malawi to accelerate reforms for improving the business climate. Malawi's ranking in the World Bank's Doing Business Survey has recently been slipping. Some of the weakest areas include starting a business, dealing with licenses, registering property, and getting credit. In this regard, completion of the process currently underway to streamline the business licensing regime and create a one stop investment centre could significantly improve Malawi's position. A discussion of the role financial sector reform in improving the money and foreign exchange markets to reduce impediments to exports and competitiveness is also warranted.

12. **The APR could have discussed progress towards export diversification and outlined a clear plan for moving forward.** There is no discussion in the APR on export diversification, perhaps because the MGDS itself is silent on this topic. But as indicated earlier, Malawi's exports are highly concentrated in a few primary commodities. Tobacco, sugar, tea, and coffee account for 80 percent of total export. This makes the economy highly vulnerable to exogenous shocks. The annual review offered an opportunity to strengthen the MGDS sub-theme on export-led growth. The APR could have therefore benefited from a discussion of a clear plan for promoting export diversification. Such a discussion could have focused on the identification of sectors with untapped export potential, constraints currently faced, and strategies for removing such constraints.

13. **A discussion of factors behind the poor performance in water and irrigation was warranted.** The APR indicates that the outturn on most indicators was less than the target for the year. For example, the target was to construct three water supply schemes during the year under review, but none was actually constructed. Similarly, the target on rehabilitation of irrigation schemes was not met. Given that water and irrigation is a priority sector in the MGDS, a more in-depth analysis of factors behind the rather poor performance was warranted. Such a discussion could have provided useful insights into solutions for accelerating progress.

14. **With regard to transport infrastructure, greater progress can be made by allocating more resources to road maintenance.** According to the report, less than satisfactory progress was made in the area of transport infrastructure. The targets set for improving the condition of roads and reducing the share of transport costs in international trade were not met. This confirms the finding of the 2007 public expenditure review that not enough resources are allocated to road maintenance.

² Some of the proposed actions include the promotion of research in agro-processing technologies and provision of training in tried and tested technologies.

Staffs commend the Government for allocating more resources to road maintenance in the proposed budget for FY2008/09.

15. **Staffs note the progress made in increasing access to electricity and concur with the report's recommendation for renewed efforts to reduce power outages.** The APR reports that the number of trading centers that were connected to electricity during the year under review exceeded the target, as was the percentage number of households with access to electricity. However, the report is silent on progress made in reducing power outages, likely because the MGDS does not have indicators for tracking progress in this area. Nevertheless, staffs concur with the APR's recommendation for renewed efforts to achieving progress on the electricity interconnection between Malawi and Mozambique to allow Malawi access the benefits of energy trading within the Southern Africa power pool.

Disaster Management and Social Protection

16. **Staffs commend the Government for its commitment to the promotion of disaster risk reduction which will reduce the need for recurring disaster response exercises.** Staffs note and commend the considerable efforts at managing emergency operations as reported in the APR. However, the report could also have mentioned ongoing work which is focusing on developing institutional and human capacity in Government, as well as providing technical support to strategic activities in order to enhance preparedness and ex-ante risk reduction at national and district levels.

17. **Staffs also welcome progress made in the development of a social protection policy, but wish to highlight the capacity and funding challenges that still remain.** The APR reports progress in the development of a social protection policy which provides guidelines for coordination and best practice principles to all players involved in social protection. Staffs concur with the APR that this policy needs to be finalized and made operational. Further, it is hoped that efforts will also focus on improving the capacity of the social protection unit which is critical to ensuring that various players adhere to the policy. In particular, staffing levels at the unit need to be increased. Staffs also concur with the recommendation that more financial resources will be needed for some of the social protection programs recommended in the draft social protection policy to be undertaken. However, this will require an increase in the Government's own financial contribution to social protection. Until January 2008, one of the sources of domestic funding for social protection programs was the safety net levy on fuel which has since been removed as a mitigating measure against the impact of global fuel price increases. Other internal sources of funding may therefore need to be identified.

Social Development

18. **Staffs note the mixed progress in the health sector and wish to highlight the need for finalizing reforms to improve drug procurement and distribution.** The APR reports progress in such areas as TB cure rate, child immunization against measles, proportion of births attended by skilled personnel, and the doctor population ratio. Similarly, according to the report, significant progress has been made in HIV/AIDS and nutrition. For example, targets on reducing transmission of HIV from mother to child were exceeded, while in nutrition, good progress was also made in

reducing mortality from malnutrition related illnesses. At the same time, it is reported that the targets set for 2006/07 were not met in the areas of availability of drugs at health facilities, nurse population ratio, and the Government's financial contribution to the health sector. Given the continued poor performance in the area of drug supply to health facilities, the completion of reforms for improving the efficiency of the Central Medical Stores (CMS) will be essential. In this regard, staffs commend Government for the progress being made so far towards the transformation of the CMS into an independent trust. As recommended by the comprehensive review of the Malawi Poverty Reduction Strategy, the transformation of the CMS into a trust will require that it should also be re-capitalized for it to remain independent and financially sustainable.

19. **Staffs also wish to flag the risk to progress in the health sector paused by recent problems in the SWAp.** The Health SWAp has experienced a visible weakening in implementation progress, particularly with respect to fiduciary oversight, planning, and the strengthening of the M&E system. Further, there seems to be limited institutional memory of the SWAp's establishment, leading to complications in terms of donor coordination. As a result, there have been delays in addressing urgent issues, including the earlier momentum supporting stronger fiduciary management and decentralization. These developments pause a real risk to progress made in the sector. Government therefore needs to take the necessary corrective steps for ensuring that there is sufficient institutional capacity for the implementation of the SWAp.

20. **In education, there is need to continue with efforts aimed at improving the quality of primary education through improved availability of teachers in rural areas.** The report observes that while progress has been made in primary school enrollment, the outcomes in most quality indicators were lower than targeted. The report further identifies high pupil-teacher ratios as one of the main constraints to improvements in quality, especially in rural areas. In this regard, staffs concur with the report's recommendation on the need to improve incentives that would attract more teachers to rural areas, such as better teacher housing. Staffs further support other innovative approaches to dealing with the problem, such as the primary school teaching model being propagated by the international NGO, Humana People to People.³ Under the model, specialized teacher training colleges are established for the express purpose of training teachers that can work in rural areas. The curriculum is therefore carefully designed and delivered so as to motivate and prepare student teachers for service in rural communities. The model has proved successful in Mozambique and Angola, and has now been introduced in Malawi.⁴

³ The Humana People to People is an international membership organization comprising of national associations working in various countries. In Malawi, the national association is the Development Aid from People to People (DAPP).

⁴ In Malawi, DAPP has established Chilangoma Teacher Training College in rural Blantyre which is operating under this model. Construction of a second TTC is underway in Thyolo, and plans are to construct four more colleges. The Government and DAPP will soon be signing a memorandum of understanding which stipulates that DAPP will be responsible for constructing the colleges while the Government will be covering some of the operational expenses.

Improved Governance

21. **Staffs note that although most of the economic governance outcomes exceeded targets, progress on implementing the Public Finance and Economic Management (PFEM) action plan was slower than envisaged.**⁵ Most of the indicators in the MGDS under economic governance are for measuring progress in macroeconomic management. As noted earlier, macroeconomic performance has generally been strong, with most outcomes exceeding MGDS targets. However, the APR also indicates that implementation of the PFEM action plan needs to be accelerated to sustain the gains already made in public expenditure management. Although not mentioned in the APR, Staffs hope that the proposed joint donor PFEM support program will provide new impetus to the implementation of the action plan. In particular, it is hoped that the process of preparing a coordinated program will also involve a more detailed diagnosis of factors behind the slow implementation and identification of what needs to be done to accelerate progress.

22. **Despite progress being made to reduce corruption in Malawi, the main challenge remains capacity constraints at the anti-corruption bureau (ACB).** Staffs welcome progress made in the fight against corruption, with most outcomes exceeding targets for the year under review. In particular, progress has been made in terms of timeliness and success rates in the prosecution of corruption cases, as well as in the implementation of corruption prevention programs. At the same time, the report notes that the capacity of the ACB remains weak because many vacancies are still not filled. Unfortunately, the APR is silent on what needs to be done, not only to fill the vacant positions but, most importantly, to retain staff. Although the problem affects the whole public service, it is recommended that a competitive incentive structure be designed for retaining staff, and that once this is in place, vacant positions be filled.

C. Donor Harmonization and Alignment

23. **Staffs welcome the extension of the assessment to include donor harmonization and alignment to country systems as agreed under the Paris Declaration on Aid Effectiveness.** The review finds that in many areas, development partners are not harmonized and are not using country systems (such as procurement and public finance management) in the delivery of their assistance. The review further finds that donors are reluctant to use country systems because of current weaknesses in the systems. Staffs concur with the report's recommendation to establish Sector Coordination Groups that will bring together Government institutions and development partners in order to come up with strategies for improving donor harmonization and increasing use of country systems.

D. Monitoring and Evaluation

24. **Staffs note continued improvements in the presentation of progress made in MGDS implementation during the year under review and the data challenges that still remain.** There have been further improvements in the presentation of achievements during the year under review. In particular, the report

⁵ The PFEM action plan outlines activities that the Government intends to undertake in the medium terms in order to improve planning, budgeting, accounting, procurement, auditing, monitoring and accountability.

presents more systematically the targets that were set for the year, the baseline data, and the outturn. However, there are still gaps in certain sectors where either targets or outturn, or both, are missing. In this regard, Staffs concur with the report's recommendation for sectors to ensure that annual targets are set for all MGDS indicators, and that systems are put in place for ensuring that data on actual accomplishments are readily available at the time of the review. However, given constraints in current institutional capacity for M&E, there is need to focus on the most critical indicators.

25. **Staffs also recommend that attention be paid towards ensuring that the indicators for measuring progress in various areas are appropriate.** This should include checking if the indicators are consistent with the policy choices and strategies and that they can indeed capture progress towards a specific outcome. For example, the MGDS outcome under fish management is “increased productivity of small and large scale fisheries.” However, the indicators used for measuring progress towards achieving this outcome are simply “total amount of fish produced” and “total fish landing.” It is not clear how appropriate these two indicators are.

26. **In some cases, the linkage between findings of the review and the recommendations could have been stronger.** Staffs note that some of the recommendations made in the APR, although reasonable, are not directly related to the findings of the review. For example, under the chapter on transport infrastructure (Chapter 5), it is recommended that the Ministry of Finance should source funds to finance projects such as the automation of passenger traffic information project and feasibility study for Mzuzu Airport. However, it is not possible to trace where this recommendation came from in the discussion of the review findings. Future reports should therefore ensure that all recommendations are based on the findings of the review and the analysis of constraints that need to be removed for progress to be sustained or enhanced. Similarly, future reports could also try to identify those recommendations which can be implemented in the short-term, medium-term, and long-term.

27. **The APR could have benefited from an assessment of potential risks to MGDS implementation next year.** Global increase in food prices, escalating cost of fertilizer and fuel, aid volatility as well as the forthcoming general elections present significant fiscal challenges, and may therefore affect how resources are allocated to MGDS priorities. The low international reserves also pose additional challenges to the Malawi's food security strategy. Staffs recommend that future APRs should include a section containing an analysis of such risks and how the Government intends to ensure that they do not derail implementation of the MGDS.

28. **There is a need for further analysis of how the MGDS contributes to achieving the Millennium Development Goals (MDGs).** The report would have benefited from a discussion of progress towards meeting the targets and whether there is a need to revise the strategy in light of developments during the reporting period.

III. CONCLUSION

29. **In general, Staffs welcome progress made in the implementation of the MGDS as reported in the APR and make some recommendations for improving performance.** Staffs note progress that has been made in: maintaining a stable macroeconomy; achieving some of the targets set in key sectors such as agriculture, infrastructure, education, and health; and monitoring and evaluation.

30. **However, as the APR also observes, immense challenges still remain.** Greater efforts are therefore required for there to be noticeable progress in overcoming these challenges, beginning with measures to ensure that the review of the MGDS is undertaken in a timely manner for it to inform the budget preparation process. There is also need for attention to be focused on the most binding constraints to development. In this regard, Staffs hope that the advice provided in this note will help the authorities to focus on some of the areas that would be critical to achieving further progress in the selected areas.