

INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

MALAWI

**Malawi Poverty Reduction Strategy Paper—Progress Report
Joint Staff Assessment**

Prepared by the Staffs of the IMF and IDA

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I. INTRODUCTION

1. **Malawi has prepared its first Annual Review of the Malawi Poverty Reduction Strategy (MPRS).** The progress report was undertaken from February to April 2003. The final progress report was formally submitted to the International Monetary Fund (IMF) and the World Bank on September 17, 2003.¹ The progress report assessed progress made in implementing the Malawi Poverty Reduction Strategy Paper (MPRSP) during the first half of FY 2002/03 with the aim to provide inputs for FY 2003/04 budget preparation.² The strategy, which was launched in April 2002, was endorsed by the Boards of the IMF and the IDA on August 5, 2002 and August 29, 2002, respectively.

2. **The progress report concluded that the implementation of the MPRSP has been unsatisfactory as actual funds allocated for pro-poor activities have been substantially lower than envisaged in the strategy paper** (See para. 5). The progress report also underscored the fact that Malawi's economic program supported by the Fund's Poverty Reduction and Growth Facility (PRGF) arrangement has been off track since the beginning of 2001, and this has led to the suspension of external budgetary assistance and to increased recourse to domestic borrowing to finance large budget deficits. The resulting increase in domestic debt of the government required more resources for debt service and thereby reduced the resources available to finance pro-poor activities. Moreover, the review observed that the actual allocation of funds to the various pillars of the poverty reduction strategy has been substantially below what was

¹ Malawi Government (2003), *The Annual Review of the Malawi Poverty Reduction Strategy Paper*, Ministry of Economic Planning and Development.

² Fiscal year runs from July to June the following year.

anticipated in the MPRSP and that poor flow of funds to line ministries contributed to the diversion of funds from pro-poor activities to finance other recurrent transactions (ORT).

3. **The progress report does not analyze in detail the implementation of the sectoral and policy reforms identified in the MPRSP.** The staffs' assessment of these initiatives, some of which are not covered in the progress report, indicates that although many of these reforms have been initiated, the pace of implementation has been slower than envisaged in the MPRSP. For instance, although the land policy has been approved by cabinet, there has been a delay in translating it into law. Similarly, although some progress has been made in implementing the privatization agenda and various public expenditure management (PEM) initiatives, the pace has been slower than expected. Substantial progress has, however, been made in tracking pro-poor expenditures (PPEs), preparing and approving the micro-finance policy, developing the wage policy, and developing and passing the new Public Finance Management, Public Audit, and Public Procurement Bills.

II. MACROECONOMIC FRAMEWORK

4. **Macroeconomic developments during 2002 were, as noted in the progress report, below expectations.** Real GDP growth was adversely affected by drought and flood conditions, as well as by high real interest rates, and was significantly lower than targeted in the MPRSP. After contracting by about 4 percent in 2001, the growth rate in 2002 was less than 2 percent, and this originated mainly in areas not directly beneficial to the poorer segments of the population. Moreover, food shortages prompted a large-scale humanitarian effort and increased imports of maize by the government. On the other hand, inflation decreased from an average rate of 30 percent in 2000 to less than 10 percent in June 2003, albeit at a slower rate than anticipated. Real interest rates averaged over 30 percent, reflecting an expansionary fiscal policy in combination with offsetting open market operations by the Reserve Bank of Malawi (RBM).

5. **Malawi's economic program, predicated on significant budgetary assistance from donors, aimed at a strong fiscal adjustment while channeling an increasing share of budgetary resources to pro-poor activities.** Although revenue mobilization exceeded expectations owing to improved tax administration, most budgetary targets were missed due to weak expenditure control and monitoring. The suspension of budgetary assistance by donors did not result in reduced overall expenditures but instead in increased domestic borrowing, which contributed to high interest rates and a rise in domestic debt. The relative improvement in fiscal policies during the second half of FY 2002/03 reflected the sustained good performance in revenue collection, including the introduction of new revenue enhancing measures, and a renewed effort to contain expenditures. Realized pro-poor expenditures over the fiscal year are estimated to have exceeded budgeted levels, reflecting a shift of noninterest spending into poverty alleviation including famine relief. The review indicated that pro-poor spending in the 2002/03 budget was well below that envisaged in the MPRSP. This reflects some diversion of funds from pro-poor activities to nonpriority spending, but also possible problems with classification. Better monitoring measures outlined in the report should help reduce such problems in the future.

6. **Monetary policy in 2002/03 was strained by the large fiscal deficit that in part reflected the emergency maize operation.** The resulting monetary expansion contributed to the depreciation of the kwacha by about 30 percent in the year ending in June 2003.

7. **The discussion of the macroeconomic framework in the annual review of the MPRS highlights the negative impact of the macroeconomic slippages on poverty reduction.** First, the progress report observed that the limited economic growth that took place had not been pro-poor. The challenge is to stimulate increased economic activities in sectors where the poor participate. Second, even though inflation declined during the review period, high real interest rates continued to constrain private sector development. The progress report observed that these macroeconomic developments had not been conducive to growth and poverty reduction. The progress report noted that budget implementation departed from the MPRS, and registered larger deficits due to lack of expenditure control. The progress report concluded that the resulting sharp increase in domestic debt could reach an unsustainable position, which—unless addressed urgently—could jeopardize the objectives of the MPRS.

8. **The authorities' program for 2003-04, which is being supported by the IMF through an extension of the current PRGF arrangement through the end of 2004, aims at achieving a decisive turnaround in the fiscal situation through the reestablishment of fiscal discipline.** To this end, the authorities have taken steps to improve revenue performance and generate substantial expenditure savings in fiscal year 2003/04, so as to ensure that domestic expenditures are brought more closely in line with domestic revenue, and that no new domestic borrowing is undertaken. In addition, the government has initiated a number of measures (see para. 19) to restore fiscal discipline. As confidence is restored in the authorities' management of the budget and donor budgetary flows resume, a strong effort will be made to repay domestic debt. This will facilitate a decline in domestic interest rates, thereby improving the environment for increased bank lending to the private sector and a resumption of sustainable growth. The decline in budgetary interest payments will also provide more scope for an orderly implementation of poverty reduction programs and policies (these are not covered in the report).

III. POVERTY ANALYSIS AND MONITORING

9. **In the absence of reliable data, the progress report was not in a position to assess the impact of the implementation of the MPRS on poverty reduction.³** According to the MPRSP, poverty in Malawi is widespread and deep, and is reflected by

³ Latest data in the Report of the 2002 Malawi Core Welfare Indicators Questionnaire Survey (2003) does not provide a good basis for making comparisons.

poor social indicators.^{4,5} However, owing largely to external factors, including drought and floods, poverty in Malawi may have worsened over the past few years, largely on account of low agricultural output.⁶ Moreover, under pillar 3 of the MPRSP, safety nets, expenditures on public works, welfare, targeted nutrition and direct transfers were all under funded in 2002/03 in relation to MPRSP targets.

10. **The annual review acknowledges the weaknesses in monitoring the poverty reduction objectives during the assessment period.** It explains that a workable monitoring framework was not established in time for the first review, in part because of institutional constraints and because information was not collected on a systematic basis. However, a technical task force has finalized an MPRSP monitoring and evaluation master plan to address these and other impediments. The master plan will be adopted by end-2003 and should facilitate a systematic analysis of the MPRSP implementation.

IV. THE PARTICIPATORY PROCESS

11. **The MPRSP process involved several stakeholders, including government officials, civil society organizations (CSOs), the faith community, traditional leaders, donors, politicians, and members of academia.** A Ministerial Committee led the process by providing political and policy directives, while a National Steering Committee (NSC) of Principal Secretaries undertook the overall management of the process. Below the NSC was a Technical Committee drawn from the Ministry of Economic Planning and Development, the Ministry of Finance, and the Reserve Bank of Malawi, which coordinated the drafting of the strategy by Thematic Working Groups composed of members of government, Parliament, CSOs, faith-based communities, the academia, employers associations, and the donor community. Thus, the MPRSP process in Malawi was highly participatory. Although the MPRSP benefited from a strongly participatory process, this momentum was not sustained during the period reviewed by the progress report. The MPRS review involved largely government officials and to a limited extent donors and civil society organizations. The staffs urge the authorities to ensure that the preparation of future progress reports is participatory by involving not only government officials but also other stakeholders, including donors, the private sector, the faith community, and civil society organizations.

V. PROGRESS IN SECTORAL AND POLICY REFORMS

12. **The government has made progress on several sectoral and structural reforms but the implementation of these reforms has been slower than envisaged in**

⁴ Malawi Government (2002), *Malawi Poverty Reduction Strategy Paper*, Ministry of Finance and Economic Planning.

⁵ Life expectancy at birth in 2000 was 39 years, infant mortality and mortality rates were 104 and 189 deaths per 1,000 live births. The poor have larger households than the rich as evidenced by the dependency ratio of 1.05 as compared to the national dependency ratio of 0.89 in 2000. A third of the poor households in Malawi are headed by women, and the number of orphans due to the HIV/AIDS epidemic is growing—about 16 percent of children under 15 years do not live with either of their parents.

⁶ Agricultural output declined by 6.2 percent in 2001 and increased marginally by 2.3 percent in 2002; small-scale agricultural output declined by 4.8 percent and increased by 0.4 percent, respectively.

the MPRS. In agriculture, the main source of income for the rural poor, funding for extension services and small-scale irrigation in the FY 2002/03 budget was substantially below what was proposed in the MPRS, and the actual implementation was below what was budgeted.⁷ A new land policy, designed to provide security of tenure and land to the rural poor, was approved by cabinet in 2002/03. However, it has not been translated into law, pending further consultations with major stakeholders. Although the government successfully managed the severe food shortages during 2002, a new food policy is urgently needed. The government is currently engaged in formulating a new food policy, and a draft is expected to be ready by July 2004. Finally, in the tobacco sector, the government is currently engaged in implementing the cabinet approved policies of contract farming and direct exports (not covered in the report).

13. **In education, the MPRS aims at improving quality, access, and relevance of education, and gender equity.** The Annual Review of the MPRS noted that many of the activities emphasized in the MPRSP such as the purchase of teaching and learning materials, construction of primary and secondary schools and housing for teachers, and improvement in teachers' salaries and training were appropriately funded, and the actual expenditure as percent of total amount budgeted has also been satisfactory. The amounts allocated for technical education, vocational and entrepreneurial training (TEVET), on the other hand, were substantially below those proposed in the MPRS, and, furthermore, the amounts actually executed for purchases of teaching and learning materials were well below budgeted levels.

14. **Education continues to face high teacher attrition rates owing to HIV/AIDS and poor remuneration.** Currently, wages and salaries for teachers are among the pro-poor expenditures that are protected. The government is yet to implement an education sector-specific strategic plan on HIV/AIDS, involving prevention and mitigation among teachers and pupils. Higher education continues to depend on government subventions as a result of failure to reduce costs of provision of higher education and generating alternative sources of revenues by commercializing or contracting-out non-core services such as catering and boarding as envisaged in the MPRS.

15. **The overall objective in health is to improve access to quality and equitable health services by implementing the essential healthcare package (EHP), improving health workers' training and the provision of drugs.** The progress report observed that in health, as in most areas, funding for health activities in FY 2002/03, including for the EHP, has been much lower than proposed in the MPRSP for 2002/03. As in education, the attrition of health workers—due to HIV/AIDS as well as low salaries—has posed a policy challenge for improving the delivery of health services.⁷ Training of health workers, as well as students at the College of Medicine—as measured by intake of students—has, however, increased during the period under review.

⁷ Malawi Government (2003), *The Impact of HIV/AIDS on Human Resources in the Public Sector*.

16. **The funding of activities covering safety nets has been mixed.** Allocations for the targeted input program (TIP)—which provided improved seeds and fertilizers for smallholder farmers—were larger than originally envisaged for 2002/03, while expenditures on public works, welfare, targeted nutrition, and direct transfers were all under-funded in 2002/03.

17. **To improve governance, the government has prepared amendments to the Corrupt Practices Act (CPA) expediting prosecution, making abuse of office an offence, protecting whistle blowers, and providing the Anti-Corruption Bureau (ACB) with a prosecutorial role.** These are expected to be submitted to Parliament before the end of 2003. To enhance the role of the ACB in fighting corruption, the government has increased the staffing of the investigative branch, and it plans to continue training more magistrates and judges in interpreting the CPA. The government also increased resources allocated for community policing and police training as a result of which there were increased reporting of cases to the police by community policing groups. Finally, the progress report noted that the actual funding for security and justice fell far short of the amounts envisaged in the MPRS and the 2002/03 budget.

18. **The government's efforts in privatization were affected by difficult market conditions.** Initial efforts to privatize Malawi Telecommunications Limited (MTL) were unsuccessful due to poor market response. The company has now been re-advertised and the transaction is expected to be completed by end-2003. The government is currently developing, with the assistance of the World Bank, a comprehensive plan for restructuring the Agricultural Development and Marketing Corporation (ADMARC) by separating its commercial and social functions. The government has undertaken to divest David Whitehead and Sons (DWS)—one of the subsidiaries of ADMARC—to a group of investors by end-December 2003. The government is well advanced in privatizing other main non-core assets of ADMARC, such as Cold Storage and Grain and Milling.

19. **Although Malawi has made some progress in improving Public Expenditure Management (PEM), many of the policy changes remain to be implemented.** In June 2003, parliament passed Public Finance Management, Public Audit, and Public Procurement Bills into law. Implementation of these laws will be critical to improvements in public expenditure management. The authorities have also committed themselves to strengthening expenditure control by placing senior treasury officials in the line ministries. This is because in the past problems have arisen due to the failure to impose penalties on Controlling Officers responsible for overruns. The government has completed a review of the Medium-Term Expenditure Framework (MTEF) and proposed an implementation institutional set-up.⁸ In addition, the Financial Management, Transparency and Accountability Project (FIMTAP), approved by the World Bank in March 2003, will improve financial management systems and enhance human capital development. Beneficiaries of the project include economic management agencies and ministries, independent and government accountability institutions, civil society, and public sector agencies and their employees. The objective of improving financial

⁸ Malawi Government (June 2003), *Medium-Term Expenditure Framework Phase II: Consolidation and Revitalization*.

management is to electronically link the government with an Integrated Financial Management Information System (IFMIS). The government also attempted an integration of the MPRS objectives into the budget process. Finally, the government has also undertaken to implement civil service reforms aimed at streamlining and rationalizing the payroll and pension systems.

20. **All these initiatives have not been adequately operationalized.** For instance, although some progress has been made in implementing the MTEF, including shifting resources to priority sectors and the preparation of detailed activity-based budgets by some ministries, there have been significant discrepancies between approved budgets and actual expenditures, weaknesses in resource forecasting and policy formulation, and delays with accounts reconciliation. Moreover, the implementation of IFMIS has been slower than envisaged. The progress report acknowledged that there has been a start in integrating the budget process with the MPRS, but recommended the strengthening of the links between the two by clearly spelling out this link, and by aligning and defining pro-poor expenditures consistently. Moreover, regular detailed reporting of expenditures by line ministries was considered necessary for tracking PPEs as well as for monitoring progress in implementing the MPRS. The government has made substantial progress in this area. The government has recently introduced electronic reporting of PPEs by line ministries and PPEs are being published on a quarterly basis in local newspapers and on the government website. Finally, the government has prepared a new wage policy that is proposed to be reflected in the FY 2004/05 budget.

21. **The MPRSP has also identified a number of cross-cutting issues that are crucial to poverty reduction in Malawi.** These include HIV/AIDS, gender, environment, and science and technology. The 2003/04 budget has attempted to mainstream HIV/AIDS by making budgetary provisions in the core activities of the ministries and departments. In addition, a fully staffed National Aids Commission (NAC) has been operational since end-2001 and the government has created a new Ministry of State in the President's Office responsible for HIV/AIDS. The World Bank recently (August 2003) approved a grant of US\$35 million for the Malawi Multi-Sectoral AIDS Project (MAP). The grant will assist Malawi implement a comprehensive multi-sectoral HIV/AIDS response with the combined objectives of reducing the transmission of HIV; improving the quality of life of those affected and infected with HIV/AIDS; and mitigating the impact of HIV/AIDS in all sectors and at all levels of Malawian society. On science and technology, Parliament passed into law a Science and Technology Bill in August 2003 to, among others, enhance integration of science and technology in overall national development planning and the educational system.

VI. CONCLUSIONS

22. **Little progress was made in implementing the MPRS during the period under the review.** The Annual Review of the MPRS highlighted the reduced allocation of budgetary resources to pro-poor activities and the slow progress made in implementing structural and sectoral policy measures. Nevertheless, the strategies presented in the MPRSP are credible policies to reduce poverty. The staffs strongly encourage the

authorities to pursue them as fiscal control is restored, domestic debt is lowered, and donor support picks up.

23. **The authorities have taken steps to reestablish fiscal discipline and achieve a decisive turnaround in the fiscal situation in 2003/04.** These measures are intended to ensure that domestic expenditures are brought in line with domestic revenue so that no new domestic borrowing is undertaken. The staffs welcome this program as it should restore confidence and allow donor budgetary support to resume.

24. **While the progress report revealed a start in the right direction, the staffs believe that there are shortfalls in several analytical areas.** A major shortcoming of the Annual Review of the MPRS is that it does not provide adequate information and analysis with respect to whether or not key poverty targets of the MPRS are achieved. The review largely dwells on actual allocation of budgetary resources to pro-poor activities compared to what was envisaged in the MPRSP itself as well as in the 2002/03 budget without making any connection to indicators of poverty on the ground. It does not also highlight, in a systematic manner, key macro and or structural reforms that were deemed crucial in the MPRSP for achieving poverty targets and were supposed to be implemented.

25. **In particular, the review does not provide any insights with respect to specific policies and or sectors that would help accelerate growth to achieve poverty reduction.** However, recognizing that the recent economic performance has not been sufficient to make a serious impact on poverty, the government has developed The Malawi Economic Growth Strategy which has articulated specific sectors or sub sectors that would help accelerate growth and poverty reduction provided that an appropriate policy environment is created. The strategy emphasizes the promotion of private sector investment and the participation of the poor in the growth process.

26. **While the process of formulating the MPRS was highly consultative, the progress report involved only few government officials and, to a limited extent, some donors and civil society members.** Moreover, the review was not finalized early enough to have its recommendations incorporated in the 2003/04 budget. Also, it only covered the first half of the FY 2002/03 and, therefore, provided only a partial assessment of the implementation the MPRS. The staffs encourage the authorities to use the annual review process inform and involve domestic and international partners in the MPRSP implementation.

27. **Looking forward, the staffs suggest that future progress reports are done in a timely manner—say beginning in November and to be completed by February of the following year, and cover at least a full fiscal year.** The progress reports will need to look at, not only allocation of resources to pro-poor activities, but also provide an analysis of data on poverty indicators as compared to targets specified in the MPRS, and discuss key macro, structural and sectoral policies that should be implemented to achieve the poverty targets, including priority policy actions and an updated macroeconomic framework.

28. **The staffs also suggest that the government should make a comprehensive analysis of the setbacks experienced in implementing the MPRS in 2002/03 and take corrective actions.** The staffs suggest that the government should accelerate progress in several areas. The consistency of Malawi's PRS targets with those of the Millennium Development Goals (MDGs) should be checked and, if required, the two should be further integrated. The foci should, among others, be on the following: (a) updating the targets and indicators in view of experience of the past; (b) costing of activities in the MPRS; (c) the establishment of an effective monitoring and evaluation framework as outlined in the MPRS monitoring and evaluation master plan; and (d) better integration of the implementation of the MPRS progress reports and the budget process so that future progress reports are done timely and that they cover full fiscal years. The task force mandated to do this should be adequately funded, including for the consultative process and for a wider dissemination of the results of progress reports. Moreover, the composition of the task force should be expanded to include major stakeholders.

29. **The staffs also suggest that the government needs to vigorously follow through on the implementation of the various PEM reforms initiated in the past year.** While the implementation of the new Public Finance Management, Public Audit and Public Procurement Acts will improve public financial management as well as governance, the government, as a matter of urgency, needs to issue regulations on the three Acts so that they can be enforced. In addition, sufficient resources need to be allocated to security and justice to improve governance outcomes. Besides, the MPRS monitoring and evaluation master plan, once approved, should help improve MPRS implementation monitoring and evaluation by improving data quality through standardization in data collection, strengthening coordination among data collection institutions, and improving coordination of monitoring and evaluation (M&E) institutions. Finally, the government also needs to further improve the tracking of PPEs. The recently introduced electronic reporting of the PPEs from line ministries and the posting of senior Finance Ministry officials in the line ministries to control commitments and payments will improve PPE tracking. The inclusion of PPE's in the quarterly expenditure reports to the cabinet committee of the economy, and improving timeliness of their posting on the web would improve their monitoring by the government as well as the civil society organizations and help redress the systematic underspending on pro-poor activities in the future.

30. **In sum, in the view of the staffs of the World Bank and the IMF, Malawi's Poverty Reduction Strategy continues to articulate a sound set of policies and programs.** However, there has been only limited progress in implementation over the past 18 months due to a combination of policy slippages and exogenous shocks. Nevertheless, in light of recent reforms and policy commitments, the staffs consider that the strategy continues to provide a credible framework for World Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.