

INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

MALAWI

**Poverty Reduction Strategy—2003/04 Annual Progress Report
Joint Staff Advisory Note**

Prepared by the Staffs of the IMF and IDA

July 22, 2005

I. INTRODUCTION

1. **Malawi has just finalized the second annual progress report of its poverty reduction strategy.** The review was conducted during the period October 2004 to January, 2005. The final progress report was completed in February and formally circulated to the Boards of the IMF and the World Bank in June, 2005. The progress report assessed implementation of the Malawi Poverty Reduction Strategy (MPRS) during the fiscal year 2003/04.¹ This note contains feedback to government on the second APR. It has been prepared jointly by staffs of the Bank and the Fund, and aims at providing feedback that will help strengthen the MPRS and its implementation.

2. **Staffs take note that this year's APR was finalized in a timely manner and commend the Government for preparing a much improved APR compared to the first one.** In line with the recommendations raised in the previous JSA,² the second APR was completed in time to provide feedback into the budget formulation process. Also, the report is relatively more comprehensive in its analysis of achievements and constraints, as well as in identifying areas for improvement. Staffs also take note that, in response to last year's recommendations, attempts were made to identify constraints and challenges that were faced in implementing the MPRS in 2003/04. Staffs note, however, that the APR could have benefited from better analysis of the comparison between the actual budget allocations and those recommended in the MPRS.

3. **The report concludes that implementation of the MPRS during the fiscal year 2003/04 was characterized by policy slippages, especially in the area of fiscal**

¹ The first year of MPRS implementation was 2002/03, for which a progress report was submitted to the boards of the IMF and the World Bank on October 10, 2003.

² Last year's JSA made the following main recommendations (a) the need for preparation of the APR to be done in a timely manner so that it could provide input into budget formulation (b) the need for future APRs to provide an analysis of data on poverty indicators as compared to targets specified in the MPRS and for them to discuss key macro, structural and sectoral policies that should be implemented to achieve the poverty targets, including priority actions and an updated macroeconomic framework. Other recommendations included identification of setbacks experienced in implementing the MPRS; the need to check consistency of Malawi's MPRS targets with those of the MDGs; establishment of an effective M&E system; the need to follow through reforms for improving the public expenditure management (PEM) system, especially through the issuance of regulations for enforcing PEM Acts and improving the tracking of Protected Pro-poor Expenditures (PPEs).

management, and under funding of pro-poor activities as compared to the MPRS.

In particular, the APR notes that fiscal indiscipline led to increases in domestic debt, interest rates, and inflation. This severely strained the government's relations with development partners, consequently resulting in reduced budgetary support. Ultimately, the share of resources allocated to pro-poor activities was considerably lower than envisaged in the MPRS.

4. **Staffs commend the new government since May 2004 for undertaking measures to restore fiscal discipline, the results of which have already become evident, and urge the authorities to stay the course.** As soon as the new government assumed office, it adopted sustainable macroeconomic policies which the IMF has supported with a Staff Monitored Program. These policies have been reflected in much improved macroeconomic performance on the basis of which donors have resumed budgetary support.

II. MACROECONOMIC PERFORMANCE AND THE MEDIUM-TERM FRAMEWORK

5. **Staffs welcome the candid assessment of past policy slippages included in the APR.** The report indicates that Malawi could not reach its macroeconomic targets owing mainly to expansionary fiscal policies, which resulted in higher-than-envisaged domestic debt, interest rates, and inflation. As underlined in the report, both the MPRS and the 2003/04 budget anticipated a small fiscal surplus. In the event, the budget reported a deficit was about 7 percent of GDP.

6. **Staffs commend the authorities' strategy to reduce poverty by further consolidating macroeconomic stability and promoting sustainable growth.** Staffs agree that the key medium-term objectives—of raising real GDP growth to about 6 percent and reducing inflation to around 7 percent—are attainable. Staffs support the authorities' strategy to reduce the government's domestic debt to free fiscal resources for development expenditures and ease credit costs for private sector-led growth.

7. **Staffs commend Government for presenting an updated macroeconomic framework, as suggested in last year's Joint Staff Assessment.** Staffs take note that an updated macroeconomic framework has been included in the APR, in order to take into account changing economic conditions. Staffs also note that the APR predates the budget for the coming fiscal year FY05/06, and that the macroeconomic framework presented in the APR has since been updated in the course of budget preparation.

8. **External financing projections are in line with the pledges of donors and multilateral creditors.** However, the APR could have indicated that some donor initiatives have been incorporated in the budget projections, for example, by mentioning that the new approach to the health sector, developed by the ministry of health in collaboration with donors and NGOs will be fully included in the 2005/06 budget. In addition, the APR could have mentioned the authorities' efforts to solicit projections of foreign assistance directly from donors to have a more realistic figure in the 2005/06 budget. Since Malawi will continue to depend on foreign assistance to finance a

significant portion of its spending, staffs consider that more emphasis should be placed on the importance of grants, rather than loan financing.

III. STAKEHOLDER PARTICIPATION IN THE REVIEW PROCESS

9. **Staffs welcome the marked improvement in the participatory nature of the review process. They encourage the authorities to continue working towards broader based participation.**

The report mentions that officials from government and civil society were involved in the drafting of the report and that the draft report was extensively reviewed by government officials, civil society and donor organizations. However, the participatory process could be improved further by including other stakeholders as well, notably the private sector and parliamentarians.

10. **The report could have benefited from some indication of the extent to which progress reporting is being used in effect to provide transparent information on implementation of the MPRS to key domestic and external stakeholders.** While this year's review process was more participatory, it would be instructive for future reports to indicate the extent to which the review process is offering an opportunity for government to engage with various stakeholders in improving implementation of the country's policy strategy.

IV. PROGRESS IN SECTORAL AND POLICY REFORMS

11. **Staffs commend Government for making considerable effort to address sectoral and policy recommendations made in last year's Joint Staff Assessment.**

Staffs take note that (i) new treasury instructions were drafted to support implementation of the 2003 Public Finance and Management Act, (ii) Quarterly expenditure reports for Protected Pro-Poor Expenditures (PPEs) were submitted to the cabinet committee on the economy during the review year, and (iii) an M&E master plan was developed during 2003/04 and disseminated in July 2004.

12. **Staffs also note that there were some recommendations from last year's JSA on which little or no action was taken.** For example, the APR does not contain any analysis that tries to check the consistency of Malawi's PRS targets with those of the Millennium Development Goals (MDGs). Similarly, because the M&E master plan was not operationalized, the APR did not contain any analysis on the extent to which the poverty indicators compared to the targets specified in the MPRS.

13. **Staffs welcome the APR's assessment that the MPRS is weak in its coverage of trade and private sector development issues and are encouraged that steps are being undertaken to address the weakness.** The report mentions that during the review year, the Ministry of Commerce and Industry had started taking steps towards the mainstreaming of trade issues in the government's policy framework, through the donor supported Integrated Framework (IF) program. However, the report could have benefited from the provision of further details on the steps being taken.

14. **Staffs welcome progress in improving access to higher education, although the report could have also discussed specific steps being taken to reduce the reliance of tertiary education on government subvention and to improve the quality of primary and secondary education.** The report mentions that during the year, the University of Malawi undertook several activities meant to increase access and equity and to reduce reliance on government subventions. However, while it outlines progress made in improving access to higher education, especially by needy students, it does not indicate what steps have been taken to reduce the university's heavy reliance on government subventions. Also, staffs note that the report could have provided a more candid assessment of the lack of improvements in the poor quality of primary and secondary education, and the need to rationalize expenditures across the education sector.

15. **Progress made in improving availability of drugs in hospitals and health centers is commendable, although the report could have been more candid in its assessment of progress in reforming the Central Medical Stores (CMS).** The report describes progress made in the form of increased per capita annual expenditure on drugs although it acknowledges that the current level still falls below the minimum recommended in the MPRS. It also mentions that some progress has been made in improving the efficiency of drug distribution. However, the report could have been more candid in observing that reforms at the CMS have been slow.

16. **The report could have benefited from the provision of details on progress made in parastatal reform.** Under public sector review, the report notes that measures to improve the performance of parastatals were partially implemented. However, no further details are provided. Staffs recommend that the next APR should comprehensively review progress made in this area.

17. **Staffs welcome the authorities' concern with delays in the implementation of the Integrated Financial Management Information System (IFMIS).** The report notes that some progress was made in public expenditure management especially in the area of expenditure reporting, but expresses concern that implementation of IFMIS was very slow, in large part because of resource constraints.

18. **Staff commend the inclusion in the APR of extensive recommendations for future actions, but would also welcome some indication of which recommendations are being adopted.** The APR could have benefited from a more comprehensive discussion of priorities for the coming year, especially in the structural areas, and how these priorities fit in with the existing MPRS.

V. MONITORING AND EVALUATION (M&E)

19. **It is recommended that future APRs should clearly indicate planned targets against which progress in the review year is being assessed and that assessments of progress in implementation should be focused on policies outlined in the MPRS.** As noted earlier, the report provides a relatively comprehensive review of output achievements in the review year. It also outlines constraints and challenges faced, and makes recommendations for overcoming them. However, in most cases, the report does

not indicate the targets for the year against which the reported achievements can be evaluated. Further, the report tends to cover too many areas instead of focusing on those achievements that are the result of implementing policies contained in the MPRS.

20. **The report candidly notes that a functioning M&E system is currently not in place and identifies this as an area where significant improvements are necessary.** The staffs strongly concur with the authorities' view, and recommend that implementation of the MPRS could greatly benefit from a better results-focus and a stronger M&E system. The report candidly observes that M&E systems in most sector institutions are yet to be established, as are district-based systems. The staffs note that, while the establishment of M&E systems in various institutions is an essential component of improved M&E, it is also important to have a system that will appropriately assess progress in the implementation of a policy strategy.

VI. GOVERNMENT PLANS TO REVISE THE MPRS

21. **Staffs take note of the government plans, highlighted in the APR, to review the current MPRS.** The MPRS was to be implemented for three years before undergoing a comprehensive review. The report indicates that in the medium term, the government's main priority will be to re-balance the allocation of resources between social and productive sectors. Staffs take note of the government's intention to allocate more resources towards growth and infrastructure investments in the future without reducing expenditure shares on social sectors, by reducing the domestic debt interest burden and improving efficiency in general administration. The staffs encourage the government to focus the new strategy on achieving shared growth.

22. **The staffs commend the government for its plans to consult stakeholders and take into account the findings of analytical work, in the process of developing the revised strategy.** The staffs support the authorities' commitment to consultations with stakeholders during strategy preparation process, and to ensure broad participation in the formulation of the revised strategy. The staffs also support the authorities' plan that the strategy preparation process will also benefit from the findings of a comprehensive review of the MPRS and the analysis of the data from the 2004/05 second Integrated Household Survey. Staffs are encouraged by this approach as the new strategy will be considered stronger if it takes into account updated information on the nature and extent of poverty in Malawi and its causes.³ The comprehensive review of the current MPRS is expected to provide insights into ways of enhancing implementation of the new strategy. In this respect, the staffs note that the APR candidly admits that a functioning M&E system is currently not in place and envisages that this will also affect the quality of the comprehensive review of the MPRS.

23. **The staffs urge the authorities to ensure that the revised strategy is better prioritized and is supported by a strong M&E framework.** Based on the experience of the implementation of the MPRS, the staffs believe that future policy strategies could greatly benefit from being more results-focused and having a strengthened M&E system

³ The current strategy drew substantively from analyses carried out in the year 2000 on data from the first IHS that was conducted during the period 1997-98.

that is built on monitorable results. As indicated above, the staffs believe that ensuring that the new strategy is more results orientated will also be critical to having an effective M&E system.

VII. CONCLUSIONS

24. **Staffs commend Government for preparing a much improved APR and making considerable effort to address recommendations made in last year's Joint Staff Assessment.** Staffs take note of the following actions in response to last year's recommendations: (a) this year's APR was prepared in a timely manner; (b) attempts were made to identify constraints and challenges that were faced in implementing the MPRS in 2003/04; (c) an updated macroeconomic framework was prepared in order to take into account changing economic conditions; (d) new treasury instructions were drafted in line with the 2003 Public Finance and Management Act; (e) Quarterly expenditure reports for Pro-Poor Expenditures (PPEs) were also being submitted to the cabinet committee on the economy during the review year; (f) an M&E master plan was developed.

25. **Staffs conclude that the APR is a candid assessment of difficulties in attaining macroeconomic targets during the review year, and concur with the general strategy to reduce domestic debt in order to free up resources for boosting economic growth.** The report highlights the extent to which fiscal indiscipline contributed to limited implementation of the MPRS, through reduced levels of resources for discretionally spending. Staffs concur that reduction of domestic debt should therefore be a key pre-condition towards the achievement of growth, the centerpiece of the new administration's development strategy. Staffs also commend the new government since May 2004 for pursuing sustainable fiscal policies and urge the authorities to stay the course.

26. **The APR broadly reflects the achievements that were made in the review year in various sectors as well as the challenges and constraints that were faced.** Staffs welcome efforts by government to outline comprehensively achievements in these sectors and also to identify the constraints and challenges that still lie ahead. But for purposes of monitoring the implementation of a policy strategy, staffs recommend that future reviews should be more focused, sticking only to those policies, actions, and targets that are clearly outlined in the strategy document. Staffs further advise that such reviews should also strive towards indicating how achievements for the review year compare to targets set in the policy strategy document.

27. **The staffs take note of the government plans to review the current MPRS.** The staffs encourage the government to focus the new strategy on achieving shared growth and urge the authorities to ensure that the revised strategy is better prioritized and is supported by a strong M&E framework. The staffs also commend the government for its plans to consult stakeholders and take into account the findings of analytical work, in the process of developing the revised strategy.