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AFRICAN DEVELOPMENT FUND

PROGRAMME: POVERTY REDUCTION SUPPORT GRANT I (PRSG I)

COUNTRY: MALAWI

APPRAISAL REPORT

Final Draft (19 January 2009)

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Currency Equivalents

As of November 2008

Currency Unit	=	Malawian Kwacha
1 UA	=	209.760
1 US$	=	140.939
1 UA	=	US $1.48830
1 UA	=	0.920175 Pound Sterling
1 UA	=	1.16665 Euro
1 UA	=	9.82666 Kroner

Fiscal Year

1 July to 30 June

Weights and Measures (If relevant)

1metric tonne	=	2204 pounds (lbs)
1 kilogramme (kg)	=	2.200 lbs
1 metre (m)	=	3.28 feet (ft)
1 millimetre (mm)	=	0.03937 inch (“)
1 kilometre (km)	=	0.62 mile
1 hectare (ha)	=	2.471 acres

Acronyms and Abbreviations

ACB	Anti-corruption Bureau
ADB	African Development Bank
ADF	African Development Fund
CABS	Common Approach to Budget Support
CoA	Chart of Accounts
CPI	Corruption Perception Index
CPIA	Country Policy and Institutional Assessment
CSP	Country Strategy Paper
CPRR	Country Portfolio Review Report
DBS	Direct Budget Support
DFID	Department for International Development
DPP	Democratic Progressive Party
GDP	Gross Domestic Product
GFEM	Group on Financial Economic Management
GoM	Government of Malawi
HIPC	Heavily Indebted Poor Countries
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
ICP	Investment Climate Profile
JF	Joint Framework
MCB	Malawi Congress Party
MEC	Malawi Electoral Commission
MDRI	Multilateral Debt Relief Initiative
MGDS	Malawi Growth and Development Strategy
MK	Malawian Kwacha
MWFO	Malawi Field Office
NAO	National Audit Office
ODPP	Office of the Director of the Public Procurement
PAC	Public Accounts Committee
PAF	Performance Assessment Framework
PEFA	Public Expenditure and Financial Accountability
PFEM	Public Financial Expenditure Management
PFM	Public Finance Management
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSG	Poverty Reduction Support Grant
PRSL	Poverty Reduction Support Loan
RBCSP	Result Based Country Strategy Paper
SAL	Structural Adjustment Loan
SWG	Sector Working Group
UNDP	United Nations Development Programme
UA	Unit of Account
UDF	United Democratic Party

GRANT INFORMATION

Client's information

GRANT RECIPIENT: Republic of Malawi

EXECUTING AGENCY: Ministry of Finance

Financing Plan for 2008/09

Source	Amount (UA)	Instrument
ADF	24.89 million	Grant/Loan*
World Bank	26.87 million	Grant
EC	22.29 million	Grant
DFID	25.00 million	Grant
Norway	7.12 million	Grant
TOTAL COST	**106.17 million**	**Grant (UA91.28)**

* The ADF amount includes the proceeds of the PRSL (UA14.89 million loan) in support of the 2007/08 budget but recently disbursed on 2 December 2008.

ADB/ADF key financing information

Grant currency	USD
Interest type*	N/A
Interest rate spread*	N/A
Commitment fee*	N/A
Other fees*	N/A
Tenor	N/A
Grace period	N/A

**if applicable*

Timeframe - Main stepping stones (expected)

Concept Note approval	November 2008
Board approval	March 2009
CABS Review	March 2009
Effectiveness	March 2009
Disbursement	April 2009
Completion	June 2009
Last repayment	N/A

Programme Executive Summary

Paragraph	Topics to cover
Programme Overview	Programme Name: Malawi – Poverty Reduction Support Grant (PRSG.I) Geographic Scope: Entire nation Overall Timeframe: 2008/09 Fiscal Year Overall Grant Amount: UA 91.28 million, of which the ADF is UA 10 million. Program Output: The program key outputs will include: (i) Revised budget classification structure and associated Chart of Accounts adopted; (ii) 2005/06 and 2006/07 audits reports submitted to Parliament; and (iii) Procurement audit finalized.
Programme Description	The overarching goal of Malawi Growth and Development Strategy (MGDS) [2006/07-2010/11] is to accelerate economic growth and poverty reduction. The PRSG.I supports the implementation of the MDGS. The specific objective of the PRSG.I is to support Public Financial Management (PFM) reforms as laid out in the MDGS. The PRSG.I focuses on budget, audit and procurement reforms.
Programme Outcomes and Beneficiaries	The direct outcome of the programme is improvement in the credibility of the budget process; the strengthening of external scrutiny and audit functions to enhance accountability and value for money; and the strengthening of public procurement functions by accelerating the implementation of the Public Procurement Act. Thus, the PRSG.I will contribute to robust fiduciary arrangements that ensure transparency and accountability in the use of public resources. Delivery of basic (pro-poor) services is enhanced through better financial management and expanded through grants which increase fiscal space. The direct beneficiaries are Malawi key public institutions of PFM and social delivery. Thus the indirect beneficiaries are the population of Malawi, who will benefit from better public financial management, improved pro-poor budgetary allocation for social services delivery and better quality of life.
Needs Assessment	Malawi ranks 164 out of 175 countries in the United Nations Development Programme (UNDP) 2007/08 Human Development Index (based on the 2005 survey). To address the poverty problem, the Government of Malawi (GoM) has prepared the MGDS with a strong focus on poverty reduction and macroeconomic stability. The successful implementation of this programme requires sustained donor support. In the 2008/09 budget, external assistance accounts for 43 percent of government revenue and over 77 percent of the development budget while budget support accounts for 9% of the total revenue and 22 percent of the external resources. The proposed ADF grant has been taken into account in the 2008/09 budget and is required to help close the financing gap.
Bank's Added Value	The Bank has in the past provided three policy-based operations for Malawi amounting to UA 41.9 million. The proposed support will build on the previous operations and complement other donors' direct budget support. The PRSG.I is designed in the context of the Common Approach to Budget Support (CABS) and the joint Performance Assessment Framework (PAF) derived from the MGDS. The decision by donors to coordinate budget support and adopt a common PAF provides a significant opportunity to improve donor harmonization and alignment to the country system. It also allows the Bank to leverage its limited resources across a broad range of critical policy reforms. The focus of the PRSG.I (PFM transparency and accountability) is an area in which the Bank is exercising leadership role in its Regional Member Countries in terms of regional mandate and its capacity to deliver.
Institutional development and Knowledge building	The programme will contribute to institutional development and knowledge building in the area of public financial management, particularly improved budget process, audit timeliness and follow up and improved public procurement capacity. The Bank will capture the knowledge from this program through careful monitoring and effective participation in the joint CABS review of the programme and the Programme Completion Report (PCR).

VII. Results Based Logical Framework (based on the Performance Assessment Framework)

HIERARCHY OF OBJECTIVES	EXPECTED RESULTS	REACH	PERFORMANCE INDICATORS	INDICATIVE TARGETS TIMEFRAME	ASSUMPTIONS / RISKS
Goal: 1.0 Reduction in poverty through improved economic governance	**Impact:** 1.0 Extreme poverty is reduced and standard of living is improved.	**Beneficiaries:** 1.0 Malawians	**Impact Indicators:** GDP annual growth rate Poverty headcount Source: MGDS Annual Review Report; Malawi MDG Annual Review Report; World Bank, World Development Indicators, ADB/OECD: World Economic Outlook.	**Progress anticipated in the long term:** Sustained annual GDP growth rate of 6% over the MGDS period (2006-2011) Halve the poverty rate from 52.4% in 2005 to 27 % by 2015 (MDG target) Time frame: 2005-2015	**Assumption**: (i). Improved financial management and expanded grants increase fiscal space for pro-poor growth (ii) The political and macro economic conditions remain stable. **Risks:** *Risk* #1: External macro-economic shock with rising fuel & fertilizer price Mitigation: CABS are augmenting DBS while the IMF provides ESF. Sustained decline in global oil and fertiliser prices would also help. *Risk* #2: Political instability in the run up to and following the 2009 Presidential and Parliamentary elections *Mitigation*: Shift from grant to loan and donor support to the Malawi Electoral Commission. The CABS Group continue to monitor the political risks

Program Objective:	**Outcomes:**	**Beneficiaries:**	**Outcome Indicators:**	**anticipated in the medium term Timeframe:**	**Assumption statement:**
1.0 Improved public financial management, accountability and transparency	Malawi CPIA Ratings improved.	Malawi key public PFM and social delivery institutions.	Selected CPIA Ratings	*From 2007 to 2008*: (i) Economic Management CPIA score improves from 3.7 to 3.8. (ii) Governance CPIA score improves from 3.5 to 3.6. (iii) overall CPIA score improves from 3.6 to 3.8.	*Assumption*: (i) The interim PFM programme becomes operational in early 2009 and PFM reforms remain top government priority after 2009 elections. *Risk*: PFM implementation capacity constraints. *Mitigation*: The use of common PAF to ensure focus on delivery. SWAp agreed to enhance capacity and support implementation of the PFM reform.
	Credibility of the budget improved.		Composition of expenditure out-turn compared to approved budget	For 2007/08 in year relocation between votes amounts to less than 10% as against 9% in 2006/07.	
	Expenditure on essential public services (budgeted ORT) sustained.		Budgeted ORT appropriations (especially in pro-poor sectors).	For 2008/09 budgeted ORT appropriations is not less than the 2007/08 level.	
	External audit and scrutiny in the use of public resources improved.		(i) External audit coverage	Audit coverage improves from 50% of ministries and departments in the 2004/05 audit to 60% in the 2007/08 audit.	
			(ii) Time lag in submitting audit report to Parliament	Time lag in submitting audit report to Parliament reduces from 18 months for the 2006/07 audit report to 10 months for 2007/08 audit report.	
	Management of the public procurement system enhanced.		Procurement audit. Source: CABS reviews;	Procurement audit finalized by December 2008 as against no procurement audit by December 2007. Time frame: 2008-09	

<u>Activities and Inputs:</u>	**<u>Outputs:</u>**	**<u>Beneficiaries:</u>**	**<u>Output Indicators:</u>**	**<u>Progress anticipated in the short term:</u>**	**<u>Risks:</u>**
Implement the interim PFM programme as a bridge towards SWAP. Mission costs for PRSL PCR, PRSG.I appraisal and joint donor review. Staff time (country and sectoral departments) ADF: UA 10 million Grant	Pro-poor budgetary allocation increased. A revised structure of budget classification and associated chart of accounts (CoA) finalized. Backlog of audit reports cleared and submitted to Parliament. Procurement audit finalized.	1.0 Government of Malawi – Ministry of Finance 2.0 National Audit Office 3.0 Office of the Director of Public Procurement 4.0 Public Accounts, and Budget Finance Committees 5.0 Pro-poor sectors.	Pro-poor budgetary allocations as percent of total budget Revised budget codes. Audit reports submitted to parliament Procurement audit report. <u>Source: CABS review</u>	By March 2009 CABS review agree target for 2009-2010 PAF. *Baseline: (2008/09 PAF)* By December 2008, a revised structure of budget classification and associated chart of account (CoA) developed. *(Baseline: IMF 2007 Review of Budget Process).* By December 2008, audit reports for 2005/06 and 2006/07 submitted to Parliament. *(Baseline: 2003/04 report submitted to Parliament by December 2007 and 2004/05 in November 2008.* Procurement audit finalized by December 2008. *(Baseline: No procurement audit to date).* <u>Time frame</u>: 2008/09	*Assumption*: Donor DBS contributions are predictable and disbursements are timely. *Risk*: Government continued minority representation in Parliament results in delays in the approval of the budget. *Mitigation*: Donor to jointly develop a strategy of engagement with parliament by drawing lessons from the past operations. Donor support to PAC and budget and finance committee in place.

I THE PROPOSAL

1.1 Management submits the following report and recommendations on a proposed grant to the Republic of Malawi for UA10 million to finance the Poverty Reduction Support Programme. It is a general budget support programme and will be disbursed in one-tranche in the 2008/09 fiscal year. The programme was appraised between 24 November and 5 December 2008. It results from a request of the Government of Malawi (GoM) and is consistent with the Malawi Growth and Development Strategy (MGDS) [2006/07-2010/11] and the Results Based Country Strategy Paper (RBCSP) for Malawi (2005-2009) adopted on 24 November 2005 and the RBCSP Mid-Term Review adopted on 4 November 2008. The MGDS was endorsed by donors in September 2005. The design of the Poverty reduction Support Grant (PRSG.I) programme has taken into account good practice principles on conditionality and Bank Group provisions on non-concessional debt accumulation policy.

1.2 The broad goal of the programme is to increase Government capacity to deliver against its priorities, which are broadly pro-poor as set out in the MGDS and the national budget for 2008/09. Thus, the programme aims to contribute to economic growth and poverty reduction through improved economic governance. Its operational policy objective is to improve public financial management accountability and transparency by supporting reforms of the budget, audit and public procurement functions. It has the following expected outcomes: (i) improved budget process, (ii) enhanced external audit and scrutiny in the use of public resources, and (iii) improved public procurement capacity.

II – COUNTRY AND PROGRAM CONTEXT

2.1 Government overall development strategy and medium-term reforms priorities

2.1.1 The government's medium-term reform priorities and development programme are articulated in the MGDS, which currently provides the basis for donor support to Malawi. The key pillars of the MGDS are: (i) Sustainable Economic Growth, (ii) Social Development, (iii) Social Protection, (iv) Infrastructure Development, and (v) Good Governance. Each pillar specifies medium-term outcomes and strategies to achieve them. The MGDS was prepared through extensive consultations with the various stakeholders. The implementation of the MGDS is through the government budget and the government encourages that an increasing proportion of aid be delivered in the form of direct budget support. The MGDS implementation progress and results are being monitored through annual reviews (see Box 1)

Box 1: MGDS 2006/07 Annual Review

The Government has published the MGDS annual review for 2006/07 while that for 2007/08 is under preparation. The review examines the alignment of the MGDS to the Government Budget, the prevailing macroeconomic environment under which programme implementation is taking place and the overall aid harmonization agenda of various development partners. The 2006/07 review indicated an improved macroeconomic environment with low inflation and high economic growth. Sector performance varied, high in some and mixed in others. Generally, key priority areas were reported to have performed exceptionally well. These are Agriculture and Food Security; Nutrition, HIV and AIDS; Mining; ICT; Economic Governance and Fight Against Corruption. It was however noted that lack of data hindered an effective assessment of performance in some sectors. Going forward, Sector Working Groups (SWGs) that will be actively involved in data collection for monitoring results are being set-up to improve monitoring and evaluation of performance.

2.1.2 Malawi successfully completed a three-year arrangement under the IMF Poverty Reduction and Growth Facility (PRGF) on 8 July 2008. To assist in adjusting to terms-of-trade shock the IMF approved a one-year Exogenous Shock Facility (ESF) arrangement of US$77.1 million for Malawi on 3 December 2008. Malawi is the first country to benefit from this new IMF facility, reflecting its status as a fiscally vulnerable country (World Bank list) as well as ownership of its reform programme. Over the medium term, government reform priorities will focus on keeping inflation moderate, reducing the domestic debt, promoting growth, and strengthening the PFM and the financial sector. During the next one year covered by the ESF arrangement, the main focus of government programme will be on adjusting to the terms-of-trade shock and rebuilding Malawi's international reserve buffer. At the same time, the GoM is preparing a medium-term programme to reform the money and foreign exchange markets and modernize the monetary policy framework. Government also plans to remove the current multiple currency practice and introduce a more flexible exchange rate system. To strengthen PFM, the GoM is designing an interim programme as a first step towards a longer term SWAP, to improve coordination and inject more pace into the reform process. The Government also plans to prepare a medium-term financial sector reforms based on the 2008 Financial System Stability Assessment. A new three-year PRGF arrangement is envisaged following the implementation of the ESF arrangement.

2.2 Recent economic-social developments, perspectives, constraints and challenges

Recent Macro-economic Performance

2.2.1 Malawi's economic performance has been strong over the past three years. Economic growth was robust, inflation was moderate while debt sustainability has significantly improved. Real GDP growth rate rose from 5.0% in 2005/06 to 8.7% in 2007/08 and is projected at 7.6% in 2008/09. This high growth performance has been propelled by strong recovery in the agriculture sector (particularly growth in tobacco and tea); financial services, construction, telecommunications, and manufacturing. Sustained policy reforms and favourable donor support have also contributed to the GDP rebound. Other macroeconomic indicators have improved as well. Average annual inflation declined from 16.1% in 2005/06 to 7.7% in 2007/08 and is projected to rise slightly to 8.4% in 2008/09 due to terms-of-trade shock caused by rising global fuel and fertilizer prices in the first part of 2008/09 fiscal year. Recent declines in the global prices of these products should help over the medium term when new contracts benefit from the lower prices. Nominal interest rates have also been declining reflecting the falling inflation up to 2007/08, with the latest reduction by the Reserve Bank of Malawi of the Bank rate from 17.5% to 15% in November 2007. Gross external reserves have generally been low and have been less than 1.5 months of export cover by 2007/08. Table 1 presents the trend in macroeconomic indicators.

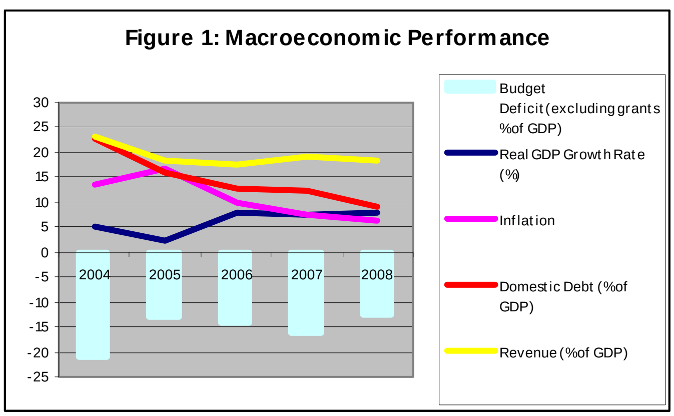


Figure 1: Macroeconomic Performance

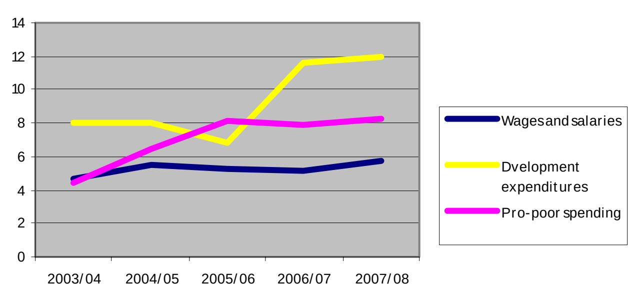
Table 1: Key Macroeconomic Indicators on a Fiscal Year Basis (2005/06-2010/11)

	2005/06 Act.	2006/07 Act.	2007/08 Prel.	2008/09 Proj.	2009/10 Proj.	2010/11 Proj.
Real GDP (%)	5.0	7.7	8.7	7.6	6.9	6.1
Consumer Price Index (end period) (%)	15.3	7.6	8.5	8.5	6.6	6.4
Consumer Price Index (annual average) (%)	16.1	10.0	7.7	8.4	7.0	6.6
Growth in M2 (%)	18.7	24.7	41.3	9.5	13.7	13.4
Fiscal Balance (% of GDP)	-0.0	-1.3	-2.7	-3.7	-2.5	-2.5
Current Account Balance (% of GDP)	-9.0	-2.7	-5.3	-6.0	-4.8	-5.3
External Debt – Public Sector (% of GDP)	14.3	14.5	16.5	17.4	19.4	23.2
External Debt Service (% of exports)	14.1	3.2	2.9	3.3	3.7	1.9
Net Domestic Debt (Central Govern.) (% of GDP)	14.6	12.2	17.1	14.6	11.7	9.3
Net Consolidated Domestic Debt (% of GDP)	13.8	14.6	11.6	7.8	6.4	5.9
Domestic Interest Payment (5 of GDP)	4.0	3.1	2.1	2.6	2.1	1.6
Gross Reserves (months of imports cover)	1.1	1.2	1.3	1.5	2.0	2.6
Average Interest Rate (91 days T-Bill Rate)	24.4	20.9	10.1	-	-	-

Source: IMF: Malawi - Exogenous Shock Facility, Staff Report, 3 December 2008.

2.2.2 Debt relief through the Highly Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) has increased Malawi's debt sustainability. As against 143% before debt relief, external public debt stock/GDP ratio stood at 16.5% in 2007/08 and debt/export ratio declined from 229% to 18.1% while future risk to external debt distress is moderate. The authorities have used the fiscal space created to accommodate (i) increases in wages and salaries in the public sector, (ii) increases in domestic development expenditure, (iii) retiring of domestic debt and (iv) increases in pro-poor expenditure. Pro-poor sectors are the major beneficiaries of the MK4.7bn public sector wage and salary increases namely, the education sector with MK2.1bn and the health sector with MK0.9bn. Infrastructure has been the major beneficiary of the domestic development expenditure increases with MK1.0bn and MK0.9bn going to transport and water sectors respectively.

Figure 2: Utilisation of fiscal space (% of GDP)



2.2.3 The sixth and final review of the PRGF concluded on 8 July 2008 by the IMF indicated positive medium-term outlook. Average annual GDP growth rate is projected at about 7% in the medium term while inflation should stay contained at the 2008/09 level. Uranium production from 2009 would spread growth beyond agriculture and raise exports by 25%. The gross foreign exchange reserves are projected to rise marginally from 1.3 months of import cover in 2007/08 to 2.6 months by 2010/11 partly due to uranium exports.

Key Features of the Investment Climate

2.2.4 The September 2008 CABS Review expressed concern about the slow progress in improving the business climate. Malawi ranks poorly on both the Investment Climate Assessment (ICA) and the Ease of Doing Business Index. A key objective of the ICA survey is to assess the ease or difficulty of doing business in terms of the constraints to doing business, the predictability of public decision making, administrative efficiency, and the level to which businesses have to contend with multiple visits from public officials. Overall, the top ten constraints identified by firms in the 2006 ICA for Malawi are: cost of financing macroeconomic policy, high factor costs, tax rates, tax administration, access to financing, customs and trade regulation, skills and education of available workers, electricity, and regulatory policy uncertainty (see annex 2). Malawi also ranked low on the World Bank ease of doing business index, and slipped again for a third year from 127 out of 178 in 2008 to 134 out of 181 countries in 2009. In all the ten indicators measured (see Annex 2), Malawi's 2009 rankings deteriorated in six, remained constant in one and only improved in three.

2.2.5 To sustain economic growth, the authorities have acknowledged the need to pursue reforms to improve the enabling private sector environment. In this regard, Government has started implementing various reforms aimed at improving the business environment. Among these was the establishment of commercial court in 2007 aimed at reducing the amount of time taken to resolve commercial disputes. However, the Government needs to take further actions to make Malawi more attractive to investors, including clearing the backlog of commercial court cases at the General Division of High Court, streamlining business license regime and adopting a one-stop shop as quick win measure to promote trade and investment in the country.

Recent Developments in Poverty and Social Indicators

2.2.6 Malawi's ranking was number 164 in the 2007/08 Human Development Index (HDI) and 143 in the Gender-related Development Index (GDI), out of 175 countries, based on 2005 survey. Other social indicators are also generally poor, although there has been progress in some areas. Out of ten social indicators (see Table 2), Malawi performed worse than the African average in six and better in only four. Malawi's development efforts are also being challenged by the HIV/AIDS pandemic with the adult prevalence rate estimated at 12% in 2007. Government is improving the institutional and policy arrangement to combat the pandemic, by establishing the National AIDS commission (NAC), protecting financing for HIV/AIDS related activities, promoting awareness campaigns and mainstreaming HIV/AIDS strategy in all Ministries.

Table 2: Malawi – Social Indicators

Indicator	Malawi	Average for Africa	Performance against African Average
Life expectancy at birth in years (2007)	34.1	33.4	Worse
Adult literacy rate (% of population in 2007)	48.3	54.2	Worse
Gross primary enrolment (% in 2006)	119	94.4	Better
Infant mortality per 1'000 live births (2007)	89.4	85.3	Worse
Child mortality per 1'000 (2007)	131.8	130.2	Worse
Maternal mortality per 100'000 (2007)	984	723.6	Worse
Access to heath service as % of population (2004)	35	61.7	Worse
Proportion of births attended by skilled personnel (2006)	53.6	50.4	Better
Access to safe water as % of population (2006)	76	62.3	Better
Access to sanitation as % of the population (2006)	88.2	45.8	Better

Source: African Development Bank: Comparative Socio-economic Indicators, 2008.

Recent Development in Governance

2.2.7 Malawi's political climate remains tenuous given the fact that the Government has a minority representation in Parliament and political tension might be heightened in the run-up to the

May 2009 general elections. A number of members of Parliament from the two major Opposition Parties, the Malawi Congress Party and United Democratic Front, crossed over to join the ruling Democratic Progressive Party, which the President formed in 2005. In response, the opposition has asked the Speaker of Parliament to invoke Section 65 of the Constitution, by declaring the vacant seats of members of the National Assembly who have crossed over to another political party. In view of this minority representation, there were delays in approving a number of bills submitted to Parliament, including the national budget and the ratification of the ADF PRSL Loan agreement. The political stalemate has also led to delays in the confirmation of key presidential nominees to the Anti-Corruption Bureau, the National Audit Office, and the Malawi Electoral Commission.

2.2.8 The above not withstanding, the current Government has made a significant progress in key aspects of governance. In particular, there has been a marked improvement in economic governance, political freedoms and rights. There has also been progress in addressing pervasive corruption through government zero tolerance policy against corruption. Allegations regarding public officials are routinely investigated and brought to the courts. Some progress has also been observed in global governance indicators such as Transparency International (TI) Corruption Perception Index, Mo Ibrahim Index on African Governance, the Bank Group CPIA rating and the World Governance Index. The TI ranked Malawi as number 115 out of 180 countries in 2008 compared with 118 out of 179 in 2007 with the score improving from 2.7 to 2.8. On the Mo Ibrahim Index of African Governance, Malawi was ranked number 11 out of 48 countries in both 2007 and 2008, with the scores marginally improving from 63.7% to 63.9% respectively. Malawi's performance places her in the sixth position in the South African Development Community (SADC) region and above all her neighbouring states. Malawi has also recorded improvements in the Bank Group CPIA ratings between 2005 and 2007 (see Table 3).

Table 3: Trend in Malawi CPIA Ratings (2005-2007)

		2005	2006	2007
A	Economic Management	3.0	3.7	3.7
B	Structural Policies	3.3	3.2	3.5
C	Policies for Social Inclusion/Equity	3.5	3.6	3.7
D	Public Sector Management and Institutions	3.2	3.2	3.5
	Overall Rating	3.26	3.41	3.62

2.2.9 The trend in Malawi's performance on the World Governance Index (WGI) from 2002 to 2007 is presented in Table 4. The WGI reflects performance in six governance indicators namely, voice and accountability, political stability - no violence, government effectiveness, regulatory quality, rule of law and control of corruption. Malawi's performance in these indicators has fluctuated over time, but if the 2002 and 2007 rankings are compared, Malawi's performance improved in all the indicators with the exception of regulatory quality[1].

Table 4: Trend in Malawi's World Governance Indicators: 2002 - 2007

(Rank %)

	Indicator	2002	2003	2004	2005	2006	2007
1	Voice and Accountability	30	34	33	32	38	40
2	Political Stability no violence)	41	40	43	49	46	42
3	Government Effectiveness	25	24	22	27	20	31

[1] However, there is a caveat that a country's rankings in these indicators are subject to margins of error and precise country ratings should not be inferred from the data.

4	Regulatory Quality	33	37	31	30	25	30
5	Rule of Law	36	44	45	45	45	45
6	Control of Corruption	17	23	23	22	27	26

Source: World Bank – World Governance Indicators, 1996-2007 (Released June 2008).

Key Medium-Term Constraints and Challenges

2.2.10 Malawi faces a number of key medium-term constraints and challenges including (i) aid dependency, (ii) low foreign exchange reserve despite increasing exports and high GDP growth, (iii) impact of exogenous shocks and (iv) political impasse. Malawi is highly dependent on external aid which accounts for 43% of government revenue and over 77% of the country's development budget in 2008/09 fiscal year. This aid dependency syndrome is not healthy for sustainable development. Malawi's foreign exchange reserves have also been traditionally low (below 1.5 months of import cover up to 2007/08) in spite of recent rise in exports.

2.2.11 Development challenges have increased with exogenous shocks arising mainly from rising global fuel and fertilizer prices. Treasury indicated that the fuel import bill has risen from about US$10 million per month during the first half of fiscal year 2008/09 to about US$30 million per month by September 2008. The global fertilizer price also rose from US$750/ton budgeted to the tendered price of US$1220/ton. These price increases have put pressure on the national budget and balance of payment and created a substantial fiscal gap which stood at MK10 billion (US$70 million) in September 2008. Through revenue and expenditure adjustment policies, the Government has been able to narrow the fiscal gap to MK6 billion (US$40 million). The fiscal gap is being filled by the ESF, augmentation of budget support proceeds by the CABS Group and the UA4.7 million by the AfDB freed through portfolio restructuring in response to the food crisis. While the global financial crisis and the recent appreciation of the US dollar would have potential impact on Malawi, their actual impact is unclear at this stage.

2.2.12 The political impasse could potentially threaten the sustained success of government economic programme and this political risk needs to be closely monitored in the run-up to the 2009 general elections. The 2008/09 budget was approved following a lengthy impasse. The delay in the confirmation of the Auditor General, also due to the political impasse, resulted in slippage in the submission of the 2004/05 audit report to Parliament thereby threatening the credibility of Malawi's PFM and accountability system. Under the Public Audit Act, it is only the substantive Auditor General that can submit an audit report to Parliament.

2.2.13 Key PFM challenges are also indicated by the 2008 PEFA assessment. These include: disparity in the composition of expenditure out-turn compared to the approved budget; effectiveness in collection of tax payments; weaknesses in the procurement function; scope, nature and follow-up of external audit; and legislative scrutiny of external audit reports. Also, capacity constraints are generally identified as a problem in all PFM functions including the weak capacity of Parliament to monitor the budget and follow up on audit findings. To this end, plan is underway to establish a Parliamentary Budget Office. The capacity of civil society organisations to hold government accountable at central and local government levels also needs to be enhanced.

2.3 Bank Group Portfolio Status

2.3.1 As at end-November 2008, the Bank Group total commitments (net of cancellations) in Malawi amounted to UA 162.3 million for 13 operations. Out of this amount, UA 65.1 million has been disbursed representing a disbursement ratio of 40.1%. The social sector accounted for the largest share of total commitment (42.3%) followed by Agriculture (26.7%), Water and Sanitation (21.9%) and multi-sector (9.1%).

2.3.2 The 2008 Country Portfolio Review Report (CPRR) show that the overall score for portfolio performance in Malawi (2.2) is satisfactory. While the overall performance remains satisfactory, the portfolio is facing a number of challenges, including weak capacity of the Project Implementation Units, weak project M&E system and slow project implementation rates due to disbursement and procurement delays. The National Audit Office 2006 Annual Audit Report on Projects, highlighted weaknesses in internal control systems and the use of Special Accounts funds to cover counterpart funds and payment for ineligible expenditures. Skills and capacity shortages at the NAO were also reported. Recently, some improvements have been recorded in terms of improved staffing at the NAO and a reduction in incidences of improper application of Special Account funds. However, follow-up on audit recommendations still remains weak.

2.3.3 The establishment of the Malawi Field Office (MWFO) in 2007 is helping to improve dialogue and portfolio monitoring. The MWFO conducts PIU management meetings every two months to discuss progress and share lessons. The disbursement seminar conducted by MWFO in February 2008 for government staff and implementing agencies of Bank-financed projects will become an annual event. The same will be done for procurement seminar. The MWFO is also closely following up on audit recommendations as a priority activity and will work with Sector Departments to develop a portfolio performance improvement plan to ensure better portfolio performance in the remaining period of the RBCSP. The recent institutionalization of quarterly project monitoring reports in the Ministry of Finance will also contribute to improved portfolio monitoring and performance.

III RATIONALE, KEY DESIGN ELEMENTS AND SUSTAINABILITY

3.1 Link with the CSP, Analytical Works Underpinnings and Country Readiness Assessment

Link with the CSP

3.1.1 The decision to provide direct budget support has been identified and rationalized in the 2005-2009 RBCSP Mid-Term Review endorsed by the Board on 4 November 2008. The proposed PRSG is linked to the fifth Pillar of the MGDS - improving governance - and the second pillar of the Bank Group 2005-2009 RBCSP for Malawi - developing human capital and institutional capacity including governance. The RBCSP mid-term review concluded that the Bank's priorities for Malawi should focus more on budget support, good governance and PFM reforms. The proposed PRSG is also consistent with the Bank's Governance Strategic Directions for 2008-2012, which promote economic and financial governance.

Analytical Works Underpinnings

3.1.2 The design of the PRSG.I programme has been guided by various studies such as the Public Expenditure Review (2007), the UNDP PFM capacity assessment report (2008), Public

Procurement Assessment Report (PPAR)[2007], the PEFA assessment (2008), the Governance and Corruption Survey (2005), the Service Delivery Perception Survey (2006), the CABS reviews (2008) and the IMF ESF Staff report (2008). Important conclusions from these upstream diagnostic work are that: (i) commitment to PFM reform exists and progress was noted by the PEFA assessment; (ii) macro-economic and financial performance has significantly improved since 2004; (iii) there is need to further improve the integrity of public procurement system and strengthen human resource capacity in procurement functions as noted in the PPAR. In addition to these diagnostic work, program design also benefitted from extensive consultations with country stakeholders especially PFM institutions, the anti-corruption bureau, parliament and civil society organizations.

Country Readiness Assessment

3.1.3 Malawi adequately meets the general and technical prerequisites for GBS as specified in the 2004 Guidelines on Development Budget Support Loan (DBSL). The summary assessment of the programme is presented in Table 5 below and further elaborated in Appendix 7.

3.2 Collaboration and coordination with other donors

The PRSG.I programme is designed in close consultation and coordination with the CABS Group. It will also be implemented within the CABS/PAF framework, which is the donor coordination mechanism and accountability framework for budget support in Malawi. The CABS/PAF arrangement also provides a significant opportunity for program implementation review by participating donors. The Bank, through the MWFO, will continue to support donor coordination efforts and actively participate in the regular review processes to monitor progress and improve policy dialogue. Malawi continues to be highly dependent on external assistance. Donors finance 43 percent of government revenue, and over 77 percent of the country's development budget in fiscal year 2008/09. Besides the Bank, major donors include the EU, World Bank, IMF, DFID, Norway, GTZ, JICA and UN agencies. The planned disbursement of the CABS partners and the World Bank in support of the 2008/09 budget is presented in section 4.3 (Table 7), while the timing of their disbursement is presented in annex 6. The Debt and Aid Division in the Ministry of Finance coordinates donor funding and the Government has in place a Development Assistance Strategy (DAS) aimed at enhancing effectiveness of donor funding and donors' approaches to conditionality.

Table 5: A summary assessment of the prerequisite conditions of the programme

Prerequisite conditions	Focus	Comments on current situation
General prerequisites	Political stability	• Overall political environment is stable and significant progress has been made in key aspects of governance including improvement in political freedom and rights. • While there is fear that political tension may rise in the run up to the May 2009 general elections, Malawi has a good track record of peaceful elections in the past.
	Economic stability and Government's commitment	• Malawi has in recent years enjoyed economic stability. Macro economic performance has improved. GDP growth is estimated to average 7% over the medium term. • Malawi reached completion point and benefited from debt relief under the HIPC and MDRI.
Technical prerequisites	Existence of well designed PRSP or NDP and effective implementation mechanisms	• The MGDS is the overarching national development programme covering the period 2006 to 2011. Through policy dialogue, the Bank will ensure that the MGDS remains relevant and central to Government priorities and that the lessons learnt are used to accelerate progress towards MGDS objectives. • Sector Working Groups are being set up with the aim of strengthening data collection as well as implementation, monitoring and evaluation of the MGDS results.
	Viable macro-economic and financial medium term framework	• PRGF was successfully implemented over 2005-08 and a follow-up ESF arrangement was approved on 3 December 2008. A new three-year PRGF arrangement is expected to follow the ESF. • The ongoing design of an interim PFM programme offers a bridge into a longer-term SWAP, which should improve coordination and inject more pace into the reform process. Efforts are on for this programme to be up and running from early 2009. The Bank is committed to supporting this process. • Malawi's budget is pro-poor and aligned to the priorities set out in the MGDS. Half the budget in 2008/09 is directed towards five key sectors: agriculture and food security (14%), health (14%), education (12%), roads (7%) and irrigation (3%). Government revenue is expected to increase by 20% over the actual revenue in 2007/08 and expenditure by 24.7%. • Over the medium to long term, Government aims to increase revenue (excluding grants) to 20% of GDP by implementing revenue measures and promoting a private sector-led growth.
	Strong partnership between RMC and donors	• A Joint Framework (JF) on budget support operation and PAF agreed between Government and donors provides the platform for donor coordination and partnership. The PAF helps to monitor progress/results and mutual accountability. • One of the objectives of the JF is to support national ownership through alignment of donor support to MGDS using country's PFM systems.
	Strong partnership among donors	The CABS Group is the main forum for coordinating DBS and meets on six-monthly basis. The GFEM also meets monthly to monitor PFM indicators between CABS reviews.
	Satisfactory fiduciary review of the public financial management system (use of country system)	• PEFA, PER, and Procurement Assessment have been undertaken for Malawi. Significant progress has been made since 2005 in improving PFM and reducing corruption, as demonstrated by the improved trend in the PEFA scores. • The ODPP has also developed a three-year procurement action plan with the aim of accelerating the implementation of the Public Procurement Act and improving procurement functions.

3.3 Outcomes of past and on-going similar operations and lessons

3.3.1 The Bank Group has in the past provided three policy-based operations for Malawi amounting to UA 41.9 million. These are a Structural Adjustment Loan (SAL) of UA 15 million; Support for Good Governance Loan (SGGL) of UA 12 million; and Poverty Reduction Support Loan (PRSL) of UA 14.9 million. The SAL was designed to support the GoM reforms in achieving fiscal sustainability, improve delivery of social services, privatization and diversification of agricultural production and export. The SGGL was designed in coordination with other donors to support the implementation of the country's first poverty reduction strategy 2001-2005 with focus on strengthening public sector governance. The Bank successfully disbursed in one-tranche when all conditions were met in May 2005. Clear lessons from the SGGL and other donor's programmes were identified and the conclusion was that the Bank and the other budget support donors should place more reliance on government budget process and PFM systems.

3.3.2 The PRSL approved on 11 April 2007, became effective only on 18 November 2008, and disbursement was effected on 2 December 2008 due to delay in Parliament ratification of the loan agreement and submission of the legal opinion to the Bank. All along however, the Bank has been actively engaged in policy dialogue and monitoring of the reforms contained in the PAF through the CABS reviews. Thus, the policy measures envisaged by the PRSL were implemented and fully justified before disbursement was effected. Keeping disbursement in view provided legitimacy for Bank's participation in the CABS reviews. The PCR finalized in January 2009 drew lessons for future operations. The first is the need to carefully consider political risk and possible mitigation measures. The design of PRSG.I has taken political risk into account in view of the forthcoming May 2009 general elections and mitigated it by shifting from loan to grant and reducing programme timeframe from three years to one year operation. The second key lesson in the PCR is lack of consistency between the PAF indicators and the PRSL monitoring framework. The design of the PRSG.I took this lesson into account by ensuring consistency with the PAF. The third key lesson is the need for greater selectivity, which the PRSG.I also took into account by focussing more on the PFM reform. Major lessons have also been learned from the 2008 CABS reviews and the RBCSP review (2008), which pointed out areas requiring further attention namely, budget execution, payroll management, procurement and audit reforms.

3.4 Relationship to on-going Bank's operations

3.4.1 The RBCSP envisaged a number of interventions which would contribute to its positive outcomes (see annex 3). The various operations were all designed to support the pro-poor outcomes of the RBCSP. The PRSG.I will enhance the fiduciary arrangements for the implementation of Bank Group investment projects and contribute to additional funds for social delivery. Thus, it will reinforce the social dimension of the Bank's overall portfolio in Malawi (currently 42.3%) by supporting higher pro-poor expenditure. Delivery of basic services is enhanced through grants which increase fiscal space. The programme will in particular reinforce other poverty-focused Bank funded operations such as the Poverty Reduction and Institutional Support project which has resulted in 288 District executive Committee members trained in participatory extension; 1,704 Village Action Plans produced; 7 districts Socioeconomic profiles produced; and 507 community sub-projects supported. Also, the Skills Development and Income Generation project has resulted in 36,419 people made literate, 25% of which are in business skills; 8,394 people trained in production skills; and 10,058 people trained in business management.

Finally, PRSG.I will build on the achievements of the PRSL, which was also designed in the context of the CABS framework.

3.4.2 The impact of the Bank's operations on key cross-cutting issues has also been largely positive. Improved productivity and enhanced incomes of the target groups in the agriculture project intervention areas have contributed to poverty reduction. Reducing the time taken to access water has helped free time for women to engage in other productive activities and helped girls to attend school. Through improved sanitation intervention, the Bank has contributed to the health of the rural communities. Provision of health facilities has also contributed to control of population growth and HIV/AIDS. The budget support operation will complement these social or human development projects by promoting improved public financial management and pro-poor expenditures in the strategic priorities as set out in the MGDS. It is anticipated that improved budgeting and public procurement would enhance the the quality of service delivery.

3.5 Bank's comparative advantage

The Bank has been involved in Malawi's policy and institutional reforms through policy dialogue and its policy-based operations. As mentioned in paragraph 3.3.1, the Bank has in the past financed three policy based operations in Malawi, which have contributed to policy reforms. The focus of the PRSG.I is an area where the Bank is exercising a leadership role in its Regional Member Countries in terms of its regional mandate on governance and its capacity to deliver. Since adopting its Governance Strategic Directions and Action Plan, the Bank has streamlined its approach to governance with focus on PFM. In doing this, it has scaled up its resources and reoriented its policy and institutional actions to respond to the challenges in key PFM reform areas. The Bank has developed experience and competency to promote transparency and accountability in the use of public resources across the continent. Thus, the Bank will develop this comparative advantage in Malawi within the CABS Group. The Bank also brings to bear on such an operation, its diverse experience in similar operations in other African countries. Furthermore, the Bank's DBS operation complements those of the other CABS Group and reinforces commitment to pro-poor expenditure for enhanced social delivery which Malawi needs in the form of untied resources for the implementation of the MGDS.

3.6 Application of good practice principles on conditionality

The program applies good practice principles on conditionality as indicated in the Bank's BSO annotated format (2008) for budget support operations. These principles are

(i) *Reinforce ownership*: The MGDS, the overall development programme of Malawi, was prepared by the Government through broad-based consultations with the stakeholders. Thus, it is a fully country-owned programme accepted by the Development Partners as the main framework for supporting Malawi's poverty reduction efforts. The Government is committed to the successful implementation of the programme and there is clear evidence of analytical work helping in the process of policy formulation (see paragraph 3.1.2). Basing the PRSG.I on the MGDS reinforces ownership.

(ii) *Agree on a coordinated framework*: The Government and the CABS Group have agreed on a Joint Framework for direct budget support. They have also agreed on a PAF as the accountability framework for measuring progress. Like the other DBS participating donors, the Bank draws its support programme and disbursement triggers from the PAF.

(iii) *Customize the accountability framework and modalities of Bank's support to country circumstances*: The PRSG.I programme reflects government expressed intentions. The modalities and timing of development assistance also meet country needs. The change from loan to grant is appropriate for a country emerging from debt distress and will mitigate political risk which could jeopardize program start up. The programme will also use country own systems and monitoring mechanism built around the CABS/PAF framework. This system is transparent and focuses on results.

(iv) *Select only actions that are critical for achieving results as conditions of disbursement*: The policy actions chosen by the Bank as triggers for disbursement are the ones critical for achieving results and they are derived from the agreed PAF. They also focus mainly on the PFM and social delivery, which are the main focus on the PRSG.1. Conditionality design within the CABS Group is further developed in paragraph 5.1.4.

3.7 Application of Bank Group non- concessional borrowing policy

Malawi satisfies the Bank Group's non-concessional borrowing policy for ADF grant and HIPC/MDRI debt relief beneficiaries as Malawi has no record of non-concessional borrowing. Malawi has benefited from both HIPC and MDRI and has enjoyed debt cancellation from the Bank. Both the Government, and the Joint World Bank and IMF Debt Sustainability Analysis of 2007 indicated improved debt sustainability.

IV – THE PROPOSED PROGRAMME

4.1 Programme's goal and purpose

The overarching goal of the programme is to contribute to poverty reduction through improved governance while the objective is to improve public financial management accountability and transparency through support for PFM reforms. More specifically, the programme will support key reform measures aimed at enhancing the budget process, audit and procurement functions (details are contained in the log frame and highlighted in the PAF in appendix 2). A sound PFM and grants support will result in efficient use of public resources and create fiscal space for enhanced pro-poor expenditure and social delivery, thus contributing to the achievement of the MGDS targets.

4.2 Programme's pillars, operational policy objectives and expected results

4.2.1 **Programme design:** The proposed PRSG.I of UA10 million has been designed within the context of the CABS/PAF arrangement. The PAF provides the basis for measuring progress towards the implementation of the MGDS, poverty reduction and donor decisions on budget support disbursement. The commitment to disburse based on triggers selected from PAF places no additional transaction costs on the Bank Group and the Government. The Bank Group participates actively in the CABS biannual and annual reviews and has contributed to the PAF thus ensuring alignment with its priorities.

4.2.2 **Components:** The PRSG.I supports PFM reforms laid out in the MGDS. The 2008 PEFA assessment found significant progress since the 2006 assessment, but also identified challenges (see para. 2.2.13). The CABS review and the IMF report have also indicated PFM priorities. Areas included in the PAF are budget execution, payroll management, audit backlog, and procurement. A number of PFM reforms are being implemented to address some of the identified challenges. These include the establishment of a PFM Secretariat in the Ministry of Finance to enhance coordination of PFM reforms; the establishment of a cash management unit in the Accountant General Office; and the roll out of an Integrated Financial Information System (IFMIS) to all ministries to improve budget execution. Government is also currently working on a format for fiscal monitoring and looking into the possibility of rolling out IFMIS to district and local assemblies to enhance reporting quality and timeliness. Based on the identified PFM priorities, the key areas of PFM reforms to be supported by the PRSG.I are budget, audit and procurement. These are elaborated upon below while Table 6 summarizes the triggers for the disbursement of the ADF grant based on the PAF. The prior actions will be verified during the March 2009 CABS review.

4.2.3 **Improving budget process:** The key areas of concern in budget reform which are included in the PAF relate to the need to enhance the credibility of the budget - composition of expenditure out-turn compared to original approved budget (rated D+ in the 2008 PEFA assessment), sustaining budgeted other recurrent transactions (ORT) appropriations and improving payroll management. While the PRSG.I programme will support improvements in these areas, the trigger for disbursement will focus only on one action namely, *developing a revised structure of budget classification and associated Chart of Accounts (CoAs),* given that the reforms of the budget process seeks to set a foundation for improved linkages between the budget and the MGDS. There is a significant progress on this action which was expected to be completed by December 2008 *in the form of the issuing of a revised Budget Classification Guideline by the Ministry of Finance*. In addition, the Government plans to introduce a budget calendar that incorporates all budget related activities, including the MGDS annual progress review; introduce value for money reforms by coming up with prioritized delivery targets to drive key outputs in the major ministries; prepare a budget manual; and enact a budget law to help facilitate implementation of the budget (see Appendix 2 - Letter of Development Policy).

4.2.4 Strengthening **external scrutiny and audit functions:** Some weaknesses have been identified in the area of external auditing in Malawi. Due to limited human capacity, not all ministries and departments are audited in a year (limited to 50% of ministries in 2004/05) and there is time lag between preparation of the audit reports and submission to Parliament. There is also usually no follow up on audit recommendations made by the Auditor General and the Public Accounts Committee of Parliament. These weaknesses were identified in the 2008 PEFA assessment which scored the scope, nature and follow-up of external audit; and legislative scrutiny of external audit reports as D+. Audit reports for 2004/05, 2005/06 and 2006/07 were still outstanding at the time of the 2008 PEFA assessment, thus jeopardizing accountability. During the September 2008 CABS review, the NAO committed to clearing the audit backlog by December 2008. Since then, there has been a significant progress. The audit report for 2004/05 was submitted to Parliament in November 2008, the 2005/06 audit report has been finalized while the audit opinion for 2006/07 has been issued by the Auditor General. The 2007/08 account has also been provided to the NAO. To promote accountability, *the submission of the audit reports for 2005/06 and 2006/07 to Parliament by December 2008 will be a trigger for the disbursement of the ADF grant*. To enhance the audit function, the human capacity of National Audit Office is being strengthened and already 60 new assistant auditors and 20 interns have been recruited. In view of this improved staffing, more ministries will now be audited than in the past. Government also plans to improve the follow up of recommendations in the audit reports. To this end, Government will start producing reports indicating actions taken by ministries and departments on audit related recommendations by the Public Accounts Committee (see Appendix 2 - Letter of Development Policy).

4.2.5 Strengthening **public procurement function:** Both the PPAR (2007) and the PEFA assessment (2008) indicate encouraging trends in the public procurement function. There is in existence a sound and adequate legal and regulatory framework focusing on transparency and accountability, public procurement oversight, and administrative review and appeal. Some control mechanisms and a framework facilitating efficient procurement operations and market practices have also been established. Approximately 88% of contracts, above the requisite threshold, are awarded based on open competition. The PEFA assessment rated competition, value for money and controls in procurement as 'B', with the sub-component of open competition as 'A'. However, weaknesses still exist including: capacity constraints both at the level of the ODPP (the oversight body) and procurement entities, lack of full compliance with the provisions of the legal framework by the procurement entities, and limited use of Standard Bidding Documents. There is also no comprehensive procurement audit to date, thereby limiting follow up on procurement actions. Thus, the main procurement action contained in the 2008 PAF is the *finalization of the procurement audit and this will be a trigger for the disbursement of the ADF grant.* Work has advanced on the procurement audit and will be finalized before the March 2009 CABS review. In addition, the ODPP has developed a three-year action plan to accelerate the implementation of the Procurement Act and has lined up several training programs for procurement personnel to enhance their skills. Furthermore, Government plans to ensure that the ODPP is well staffed to meet the challenge of increasing the number of ministries and departments covered each year by the procurement audit (see Appendix 2: Letter of Development Policy). Overall therefore, the public procurement system is good enough and acceptable to the Bank for the purpose of budget support.

Table 6: Summary of PAF Related PRSG.I Disbursement Triggers

Indicator	Baseline	Prior Action/Trigger
A. Budget Improved budget process	IMF 2007 Review of Budget Process	Develop a revised structure of the budget classification and associated Chart of Accounts (CoA) by December 2008.
B. Audit External Audit	By December 2007, the last audit report submitted to Parliament was for 2003/04 but the 2004/05 report was submitted to Parliament in November 2008.	2005/06 and 2006/07 audits reports submitted to Parliament by December 2008.
C. Procurement Public procurement improved Capacity	No comprehensive audit to date.	Procurement audit finalised by December 2008

4.2.6 **Expected results and benefits:** The proposed operation will support the GoM to pursue its policy objectives spelt out in the MGDS. In particular, it will contribute to economic growth and poverty reduction by addressing key reform measures related to PFM. Expected results are robust fiduciary arrangements that ensure transparency and accountability in the use of public resources. The budget support operation will therefore assist in the effective implementation of the MGDS, by contributing to the provision of untied resources for the execution of the Government's 2008/09 budget and social delivery.

4.3 Financing needs and arrangements

Table 7 presents the financing needs and financing arrangements for 2008/09 fiscal year. Total projected government revenue (including grants) for the fiscal year amounts to MK207.61 billion (equivalent to US$1,473.03 million) while expenditure and net lending is projected at MK231.08 billion (equivalent to US$1,639.60 million), leaving overall budget deficit (including grants) of MK23.48 billion (equivalent to US$166.57 million). Projected foreign financing, including through CABS, amounts to US$172.27 million, of which the CABS Group and the World Bank will contribute US$158.01 million. Direct Budget Support (DBS) as a proportion of total aid to Malawi has been on the increase over the past three years, rising from 16% in 2006/07 to 18% in 2007/08 and projected at 22% in 2008/09. There have also been an increasing focus on sector budget support namely, the Health SWAp, the recent Water and Sanitation SWAp (2008) and the Local Development Fund, which a program-based approach for local government financing (2009). The Bank has joined the SWAps and will also participate in the Local Development Fund.

Table 7: Financing needs and sources of financing, 2008/2009 (in millions of US$)

	2008/09 Budget	2008/09 Proj.
Total revenue (incl. grants)	1,476.33	1,473.03
Total expenditure and net lending	1,628.54	1,639.60
Financing gap	-152.21	-166.57
Foreign financing including through CABS	162.22	172.27
ADB	37.04*	37.04*
DFID (UK)	37.21	37.21
EC	33.17	33.17
Norway	10.59	10.59
World Bank	40.00	40.00
Domestic financing	-13.49	-9.06

* Includes UA14.89 million (US$22.16 million) approved for 2007/08 but recently disbursed.

Source: Derived from: Malawi – IMF ESF Staff Report, Table 2a; 3 December 2008.

4.4. Programme’s beneficiaries

The PRSG.I is designed to assist the GoM to implement its Poverty Reduction Strategy. The direct beneficiaries are Malawi key public institutions of PFM responsible for fiduciary control and social delivery. The indirect beneficiaries are the population of Malawi, who will benefit from better public financial management, improved pro-poor budgetary allocation for social services delivery and better quality of life.

4.5 Impacts on gender

The MGDS considers the consolidation of social stability and progress on social justice as a basic condition for achieving its growth and poverty reduction targets. Malawi’s National Programme on Gender Development, which is based on the National Gender Policy, is fully incorporated into the MGDS. The programme has two focal areas namely (i) Gender mainstreaming across sectors and (ii) Women Empowerment Programme. Specific guidelines have been developed on gender budgeting and human resources management. Focal points have also been set-up in the various sectors to identify gender issues within each sector and design relevant programmes to address them. The Women Empowerment Programme focuses on women economic empowerment (linking women with credit), capacity development for women and promotion and protection of women rights. The budget support program would impact on women largely through increasing the relative share of the budget allocation to education, health and agriculture, sectors through which progress can be made to close gender gap. The Government is committed to eliminating gender inequality between women and men in all social, economic and political spheres. The MGDS has set targets to improve the ratio of literate women, boys and girls in school, number of women in senior positions in the civil service and proportion of seats held by women in Parliament in line with the 50% SADC guideline. The PAF specifically contains an indicator on women in decision making positions.

4.6 Environmental Impacts

The environmental categorisation of the program is 3. The program has no potential direct negative impact on the environment and entails budget support for the effective implementation of the MGDS which puts emphasis on improved environmental sustainability. Furthermore, the Government has put in place a revised natural resource and national environment policy including the environmental management act, regulation on the management of waste disposal, and promotion of community participation in environment and natural resource management. The MGDS performance indicators include those specifically addressing environmental sustainability and there are strict requirements for Environmental Impact Assessment (EIA) in the course of implementation of economic activities. However, further progress needs to be made to provide alternative sources of power and reduce deforestation.

V. – IMPLEMENTATION, MONITORING AND EVALUATION

5.1. Implementation arrangements

5.1.1 Implementation Agency: The Ministry of Finance is the focal point for budget support and PFM reform. The Secretary to Treasury co-chairs the annual assessments with CABS members. The PAF provides a jointly agreed set of indicators for measuring progress against the MGDS objectives and targets. The Group on Financial and Economic Management (GFEM) composed of donors and government meets every month to monitor actions and review progress of PFM reform implementation. Other entities such as NAO, ODPP, ACB and sector ministries are responsible for carrying out their own programmes and attaining the respective performance indicators under the programmes.

5.1.2 Disbursement: The CABS Group has agreed to use a broad overall satisfaction of the PAF as evidenced by the March review to trigger disbursement, during following fiscal year following the review (the Yt+1 principle). In addition, Malawi is required to be on track with the IMF programme. Progress on the macroeconomic situation will be monitored through the IMF ESF regular review mission which is scheduled for March and September 2009 to inform the CABS annual and biannual reviews. All the proceeds of direct budget support are disbursed into a common CABS account at the Federal Reserve Bank of Malawi. The proposed PRSG.I of UA10 million will be disbursed in one-tranche into this account in support of the 2008/09 budget. The equivalent amount in Kwacha will immediately be transferred to the Treasury by the Reserve Bank and the Treasury will confirm receipt to the Bank.

5.1.3 To ensure predictability of aid flow to the budget, the Bank has informed the Government of the resource allocation for budget support for the next two fiscal years. Thus, PRSG.I will be followed by a two tranche operation (PRSG.2) covering 2009/10 and 2010/11. Disbursement of the PRSG.I proceeds will be triggered by satisfactory performance in specific conditions within the boundary of the 2008 PAF (see paragraph 6.2.2)[2], rather than by broad satisfaction of the PAF as evidenced by the March 2009 CABS review (which would have been an in-year conditionality). This is to prevent disbursement slippage to 2009/10 fiscal year, since it usually takes some time (2-3 months) before the CABS review aide memoire is concluded. Slippage in disbursement will create fiscal difficulties for the Government as the grant is already counted in the 2008/09 budget.

5.1.4 Other budget support donors are also using specific conditions for their 2008/09 operation for different reasons. The proposed World Bank PRSC.2 will be disbursed against specific conditions agreed with the GoM during the March 2008 review. DFID uses PAF as a log frame, with the 25 PAF indicators mapped against seven DFID Objectives (outputs)[3]. PAF as a whole is normally used to trigger disbursement but outputs are still specified for programme documentation. However, DFID is also using a specific condition (submission of audit reports to Parliament) exceptionally for the disbursement of its 2008/09 support in view of the importance attached to the issue of accountability. Norway is also using two specific conditions (approval of the 2008/09 budget and submission of audit reports to Parliament) exceptionally for its 2008/09 support. For the EC, the disbursement of the fixed tranche of 51% will be triggered by broad satisfaction in the PFM program as evidenced by both the March and September 2008 reviews while the disbursement of the 49% (maximum) variable tranche will be based on 10 indicators in the PAF (5 PFM and 5 social indicators).

5.1.5 <u>Procurement and audit</u>: CABS Group channel budget support funds using country systems, as agreed under the Joint Framework. Similarly, the proposed PRSG.I will follow government procurement and audit arrangements. Malawi has made good progress in audit and procurement reforms (see para. 4.2.4 and 4.2.5). Government is also committed to further reforms to improve public procurement and audit functions in line with the recommendations of the 2008 PEFA and 2007 Procurement Assessment reports. As part of the annual budget execution report, CABS donors have agreed to use the NAO's report for the purpose of auditing the budget support programme. In this regard, clearing the accumulated three years backlog of audit reports which were outstanding at the time of the 2008 PEFA assessment is a specific condition for all the CABS donors to further strengthen accountability.

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[2] The use of special conditions for disbursement would also be exceptional for PRSG.I. The PRSG.2 would be based on overall satisfaction of the PAF as evidenced by the March review of each of the preceding fiscal year to ensure full compliance with the Joint Framework.

[3] These are macro stability, expenditure on essential services, growth promotion, efficiency of resource use, financial management, governance and rights. Progress towards achieving these outputs is recorded on an annual basis around March.

5.2 Monitoring and evaluation arrangements

5.2.1 The PRSG.I will utilize a robust M&E mechanism based on the country system built around the CABS/PAF framework. The Joint Framework (JF) provides for two CABS reviews a year. The March review assesses progress against the PAF indicators while the September review focuses on the budget and economic trends. The Government commits to providing progress reports to the CABS Group two weeks before the reviews. The GFEM will also meet monthly to monitor PFM indicators between CABS reviews. The Bank is committed to stronger engagement in GFEM. Both the CABS review and GFEM meetings will help to monitor outputs (policy changes) and track budget implementation and economic trends. The MGDS annual review is also an important M&E tool. Furthermore, the PRSG.I will also rely on the IMF review of the ESF in tracking macroeconomic indicators. The UNDP-managed basket fund, which supports the National Statistics Office to implement the National Statistics System and generate disaggregated data, will facilitate the monitoring of indicators and outcomes.

5.2.2 The Malawi Field Office (MWFO) has been closely associated with the PRSG.I preparation and appraisal process and has been actively involved in CABS reviews and policy dialogue. The Office will continue to play a significant role in the M&E of the PRSG.I and MGDS. The Office maintains a close contact with the Ministry of Finance and the CABS partners. The Bank is committed to active engagement in these reviews and in the GFEM monthly meetings. To ensure that the Bank is on top of the status of programme implementation, outputs (policy changes), indicators and outcomes at any time during programme implementation life, the MWFO will prepare quarterly progress reports for management, based on its own assessment. The disaggregated data generated by the National Statistical Office would facilitate this task. The capacity of the MWFO has been strengthened by a country economist, a governance expert and a social sector specialist who, under the guidance of the Resident Representative, will follow-up on the PRSG.I implementation and social delivery. The final evaluation of the programme will be based on a joint programme completion report elaborated with the Government.

VI – LEGAL DOCUMENTATION AND AUTHORITY

6.1 Legal documentation

Grant Protocol of Agreement between the African Development Fund and the GoM

6.2 Conditions associated with Bank Group intervention

6.2.1 Conditions precedent to Entry into force of the Grant Agreement: The grant protocol of agreement shall enter into force on the date of signature by the Recipient and the Fund.

6.2.2 Conditions precedent to disbursement: The obligations of the Fund to make full disbursement in one tranche shall be conditional upon the fulfilment of the specific conditions listed below. The beneficiary would have provided evidence, in a form and substance satisfactory to the Fund:

(i) Of the existence of a common account at the Reserve Bank of Malawi dedicated to receive all budget support provided by the CABS group, including the proceeds of the

PRSG.1 (paragraph 5.1.2) **[Evidence required: Letter by Treasury indicating the account number].**

(ii) That the Government has issued a revised Budget Classification Guideline (paragraph 4.2.3).

(iii) That the audit reports for 2005/06 and 2006/07 have been submitted to Parliament (paragraph 4.2.4); **[Evidence required: A Copy of the audit reports and the letter by the Treasury transmitting them to the Speaker of the National Assembly]**

(iv) That the procurement audit report has been finalized by the Office of the Director of Public Procurement before the March 2009 CABS review (paragraph 4.2.5) **[Evidence required: Copy of the procurement audit report].**

6.2.3 The good practice policies on conditionality as indicated in the Bank's BSO annotated format (2008) have been applied in the formulation of these conditions (see section 3.6).

6.3 Compliance with Bank Group policies

6.3.1 This programme complies with all applicable Bank Group policies and guidelines. These include: (i) Bank Group provisions on non-concessional debt accumulation policy, (ii) the 2004 Guidelines for DBSL operations, (iii) the 2005-2008 RBCSP for Malawi and its Mid-term Review, (iv) the Bank's Governance Strategic Directions and Action Plan for 2008–12, and (v) the Environmental and Social Assessment Procedures (ESAP) and requirements on crosscutting issues.

VII. RISK MANAGEMENT

7.1 The following risks and mitigation measures have been identified:

7.2 Risk #1: *Exogenous shock:* Rising global fuel and fertilizer prices constitute a major risk to Malawi's macroeconomic stability and medium-term outlook. Both have put pressures on the national budget, inflation and external reserves with the global prices of fuel and fertilizer doubling in the first half of 2008. As a result, Malawi is faced with a fiscal gap of $40 million in 2008/09.

- Mitigation: The IMF ESF (US$77.1 million) approved on 3 December 2008 will bolster the reserve position while the scale-up of aid from the CABS donors is helping with fiscal position. Recent decline in global fuel and fertilizer prices will also help in the medium term. The Bank has also approved UA4.7 million as financial support for the government Input Subsidy program to further help address the fiscal gap.

7.3 Risk #2: *Governance Risk*. There are two risks for providing budget support in an election year. Firstly, the governance situation may deteriorate in the run up to the general elections in May 2009. Secondly, there is the risk of policy shift if there is change in government.

- Mitigation: Donors through UNDP-managed election trust fund are supporting the Malawi Electoral Commission to facilitate a credible election in 2009 and beyond. Whilst donor assistance alone cannot guarantee successful elections, it could enhance success. The fact that Malawi has a good track record of smooth transition through the electoral process also mitigates this risk. The CABS members will continue to monitor and mitigate political risks through its ongoing interaction with GoM. The Bank and other donor's support to demand-side of governance will also reinforce PFM transparency and accountability. The shift from loan to grant will also avoid the requirement of Parliamentary approval.

7.4 Risk #3: *Implementation capacity constraints:* CABS reviews have highlighted the human and institutional capacity challenges that Malawi faces. This has been aggravated by the high HIV/AIDS prevalence rate of 12%, which severely affects capacity of the country as this pandemic affects people at the most productive age, including public servants. The insufficient institutional capacity could lead to delays in the implementation of key PFM reform measures.

- Mitigation: The Ministry of Finance has established a PFM Secretariat supported by donor funded technical assistance with the aim of strengthening leadership and coordination of reforms. The UNDP funded capacity building assessment report and PEFA recommendations will be integrated into the medium-term PFM reform plans. A multi-donor funding arrangement is being developed for implementation from 2009. The GFEM also meets every month to monitor PFM indicators in between CABS review.

7.5 Risk #4: *Climatic Shock*: Droughts or weather shock constitutes a major risk to improved agricultural production and hence food security and growth, given that economic growth in Malawi is highly dependent on the performance of the agriculture sector. Late and low rainfall is already an issue and is certainly a risk in 2008/09 growing season.

- Mitigation: This is another exogenous shock over which the Government has little or no control. However, Government commitment to its fertilizer and seed input programme and donor support for the programme would, to some extent, mitigate the risk of substantial output decline. Malawi will also benefit, as other RMCs, from the Bank's adaptation activities as well as Clim-Dev Africa to better access climate information systems.

VIII – RECOMMENDATION

8.1 It is recommended that the Board of Directors approve that an ADF grant not exceeding UA10.0 million be made available to the Republic of Malawi for the purposes and subject to the conditions stipulated in this report.

APPENDIX 1
MAP OF MALAWI

APPENDIX 2
LETTER OF DEVELOPMENT POLICY

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MINISTRY OF FINANCE
P O BOX 30049
LILONGWE 3
MALAWI

Ref: DAD/5/1/7/12 **4th December, 2008**

MINISTER OF FINANCE

Dr. Donald Kaberuka
President
The African Development Bank
Tunis

Dear Dr. Kaberuka,

MALAWI: LETTER OF DEVELOPMENT POLICY

1. On behalf of the Government of Malawi, I wish to thank the Africa Development Bank (AfDB) for having provided the Poverty Reduction Support Loan (PRSL) of UA 14.9 million for the 2007/08 Fiscal Year (FY). It is regrettable that the disbursement of the PRSL which was designed to support implementation of Malawi Growth and Development Strategy (MGDS), Malawi's second generation of poverty reduction strategy only occurred in the 2008/09 FY due to delays by Parliament to ratify the loan. I wish to assure you, Mr. President, that Government will take all the necessary steps to avoid delays in the ratification of loans from donors in future.

2. The Government of Malawi is requesting the Africa Development Bank for a Poverty Reduction Support Grant (PRSG-I) of UA10 million equivalent, for further support to improved governance reform as provided for within the MGDS framework. The proposed PRSG-I will serve three purposes: (i) it will help the Government bridge a financing gap that exists in the implementation of the MGDS through the provision of funds to improve public financial management and accountability and transparency required for the MGDS to meet its medium-term poverty reduction goals; (ii) it will be a source of foreign exchange which Malawi needs to fill in an existing balance of payments financing gap; and (iii) it will also provide resources to Government to meet its counterpart fund obligations and support the effectiveness of the Bank Group funded investment projects.

3. The program goal is to contribute to economic growth and poverty reduction through improved economic governance. Its operational policy objective is to improve public financial management accountability and transparency by supporting reforms of the budget, audit and public procurement systems. It has the following expected outcomes: (i) increased credibility of the budget process, (ii)

enhanced external audit and scrutiny in the use of public resources, and (iii) improved management of the public procurement system.

4. The proposed PRSG will support governance reforms in the following areas: (i) Budgeting process, (ii) External audit and scrutiny in the use of public resources, and (iii) Management of the public procurement system. In the budgeting process, the reforms will focus on improving linkages between MGDS and the budget. In external audit and scrutiny in the use of public resources, the focus will be on ensuring the Audit reports are submitted to Parliament within the specified period under the law and that recommendations made by Auditor General are followed. In management of the public procurement system, emphasis will be put on strengthening the procurement systems in all ministries, departments and assemblies. More details on the proposed reforms to be supported under PRSG-I are set out in Part C of this letter.

A. Recent Macroeconomic Performance

5. Malawi has made significant progress in restoring macroeconomic stability. The current administration which came to power in May 2004 inherited a highly unstable macroeconomic situation. Inflation had reached 30 percent in 2000. Domestic debt had risen to a record 25 percent of GDP in fiscal year 2003/04, with interest rates reaching as high as 45 percent. The fiscal balance including transfers was around negative 10 percent of GDP. This led to a severe crowding out of private sector investment by Government borrowing. As a result of the fiscal slippages under the previous administration, an International Monetary Fund (IMF) Poverty Reduction Growth Facility (PRGF) program went off-track in early 2004 and subsequently was allowed to elapse.

6. Malawi struggled to reach the Highly Indebted Poor Countries (HIPC) completion point, having reached the decision point in December 2000. Exacerbated by poor rains, economic growth was very sluggish, averaging just around 1.6 percent between 2000 and 2004.

7. Against this poor performance, when the new administration came into office, it took rapid steps to improve the fiscal situation and pursue sustainable macroeconomic policies. Strict fiscal discipline was introduced in the management of public resources, and macroeconomic performance improved under the auspices of an IMF Staff Monitored Program (SMP). The successful implementation of the SMP led to an agreement with the IMF on a new PRGF program in August 2005. After successfully completing two reviews, Malawi finally reached the HIPC completion point in August 2006. This reduced Malawi's external debt stock from 229 percent of exports to 32 percent, in end-2005 net present value terms, which is below the HIPC acceptable threshold of 150 percent.

8. Malawi successfully completed a three-year arrangement under the IMF Poverty Reduction and Growth Facility (PRGF) on 8 July 2008. To assist Malawi to adjust to terms-of-trade shock the IMF approved a one-year Exogenous Shock Facility (ESF) arrangement of US$77.1 million to Malawi on 3 December 2008. Malawi is the first country to benefit from this new IMF facility. Over the medium term, government reform priorities will focus on keeping inflation moderate, reducing the domestic debt, promoting growth, and strengthening the PFM and the financial sector. During the next one year covered by the ESF arrangement, the main focus of government program will be on adjusting to the terms-of-trade shocks and rebuilding Malawi’s international reserve

buffer. A new three-year PRGF arrangement is envisaged to follow the implementation of the ESF arrangement.

9. Other macroeconomic indicators have also shown noticeable improvements. Buoyed by a bumper harvest, inflation fell to 7.1 percent in June 2008 from 17 percent in February 2007. Domestic debt is currently around 11.7 percent of GDP excluding recapitalization of the Reserve Bank of Malawi. The Bank Rate is down to 15 percent while interest rates on the Treasury bill market are around 13 percent on average. The economy still registered positive growth in 2007, of 8.6 percent. In 2008, the economy is projected to grow at 8.7 percent and during the last three years (2006-2008), growth is estimated by the IMF to have averaged 8 percent. This compares favorably with the 5.6 percent growth rate in the SADC region.

B. The Malawi Growth and Development Strategy

10. In November 2006, the Government of Malawi finalized its second poverty reduction strategy, the MGDS, which covers the period 2006 to 2011, prepared using participatory processes.' The strategy's overall objective is to reduce poverty through economic growth and is organized around five thematic areas as follows: (i) sustainable economic growth; (ii) social protection and disaster risk management; (iii) social development; (iv) infrastructure development; and (v) good governance. From these thematic areas, the strategy has identified six key focus areas that are seen as central to achieving the strategy's overall objective of reducing poverty through economic growth. These focus areas are agriculture and food security; infrastructure development; energy generation and supply; irrigation and water development; integrated rural development; and prevention and management of nutrition disorders, HIV and AIDS.

11. The MGDS emphasizes the need for Malawi to register sustained private sector and export-led growth in order to make a noticeable dent on poverty. The long-term vision of the MGDS is to transform Malawi from a predominantly importing and consuming country into a predominantly producing and exporting country. It seeks to achieve growth rates of at least 6 percent a year. The strategy concentrates on agriculture as the driver of growth. It focuses on increasing agricultural productivity and integrating smallholder farmers into commercial activities. In the long term, the Government has also identified four sectors with potential for high growth: tourism, mining, manufacturing, and agro-processing.

12. The MGDS also acknowledges the role of social development in health, education, economic empowerment and social protection among others. It recognizes that a healthy and educated population is necessary if Malawi is to achieve sustainable economic growth. The strategy further recognizes the importance of increasing the assets of the poor and vulnerable so they can contribute to and benefit from economic growth.

13. The strategy has identified long-term goals, medium-term outcomes, and constraints to achieving these outcomes. It then outlines the strategies and key actions that will contribute towards achieving the defined outcomes. Implementation of the strategies and actions will entail undertaking capital investments, maintenance of assets, and implementation of policy and institutional reforms. However, in this endeavour, Malawi is faced with the challenge of mobilizing resources to implement the MGDS. Although the various strategies and actions have been prioritized, there exists a financing gap for the Government to implement even the top priorities, and hence this request for financing.

C. Specific Reforms to be implemented

14. In line with the MGDS, and in consultation with the Government, the African Development Bank has outlined its proposed medium-term support to Malawi. In this context, I would like to highlight the various reforms that the Government of Malawi intends to undertake not just for purposes of the proposed PRSG-I to which this financing request directly relates, but also under subsequent PRSGs so as to present a holistic picture of the Government's reform program.

Public Sector and Finance Management Reforms

15. In order to consolidate the gains achieved in restoring macroeconomic stability, the Government plans to undertake several policy reforms in the area of budget process, payroll management, external auditing, debt management, and corruption prevention.

(i). Budget processes

16. With regard to the budget process, the reforms seek to set a foundation for improved linkages between the budget and the MGDS. First, it intends to introduce a budget calendar that incorporates all budget related activities, including the MGDS annual progress review. Secondly, the Government plans to revise the structure of the budget classification and the associated Chart of Accounts so that the two are fully consistent with each other. This will make it easier to monitor and report progress on the implementation of the MGDS. Thirdly, Government plans to introduce value for money reforms by coming up with prioritized delivery targets to try and drive key outputs in the major ministries. In addition, The Government plans to come up with a budget manual and a budget law to help facilitate implementation of the budget.

(ii). External audit and scrutiny in the use of public resources

17. An evaluation of how well the budget has been executed is a critical element of sound public financial management. In this connection, the Malawi Public Audit Act and Public Financial Management Act provide for internal auditing, external auditing and Parliamentary scrutiny of the audit reports. Although some progress has been made in the area of internal auditing, there are still weaknesses in the area of external auditing. Firstly, due to limited human capacity, not all ministries and departments are audited in a year. Secondly, there has been time lag between preparation of the audit reports and submission to Parliament. Thirdly, there is usually no follow up on audit recommendations made by the Auditor General and the Public Accounts Committee of Parliament.

18. In order to deal with these problems, the government has put in place several measures. Firstly, the capacity of National Audit Office is being strengthened and already 60 new assistant auditors and 20 interns have been recruited. This means that more ministries will now be audited than in the past. Already, more than 50 percent of central government entities were audited for financial years starting 2004/05. This percentage is expected to increase further in the next few years. Secondly, the roll out of IFMIS will go a long way to ensuring the timeliness of the final accounts. However, this will not be realized immediately because some reporting systems are yet to be completely converted into the new software of IFMIS. With the increase in the staffing levels at National

Audit Office, the government plans to be able to submit the Audit Reports to Parliament within 10 months of the end of the fiscal year 2007/2008. In the medium term, the aim is to be able to submit the reports within 6 months as required by law. Finally, the government plans to improve follow up of recommendations in the audit reports. In this regard, the government will start producing reports indicating actions taken by ministries and departments on audit related recommendations by the Public Accounts Committee.

(iii). Management of public procurement systems

19. Although there has been progress in the area of public procurement management, it is being felt that there is still room for improvement. In some ministries and departments, procurement units have been set up. However, some posts still remain vacant due to shortages of qualified personnel on the labour market. In this regard, Government plans to embark on initiatives that will strengthen procurement capacity in ministries and departments. Among other things, Government through the Office of the Director of Public Procurement (ODPP) will ensure that procurement units are operational in all ministries and departments. The Internal Procurement Committees (IPCs) are functional in all ministries including local authorities. In addition, the ODPP has lined up several training programs for procurement personnel to enhance their skills. In terms of procurement audit, Government plans to increase the number of ministries and departments covered each year by ensuring that the ODPP is well staffed to take on this challenge.

(iv). Payroll management

20. The Government would also like to continue with reforms it has been undertaking with regard to the public sector wage system. The focus is now on strengthening the management of the payroll in order to reduce wastage of public finances through ghost workers. In this regard, Government introduced a new system in September 2006 for managing personnel and payroll records, the Human Resource Management Information System (HRMIS) to replace the then existing system - the Personnel, Payroll, Pensions and Advances Integration (PPPAI) - which among other weaknesses, could not update the payroll whenever there was a change to some personnel records. For the system to operate with clean data, the Government embarked on a data reconciliation exercise of payroll with the backlog of personnel data which was finalized towards the end of last year, and is a prior action proposed to be supported under PRSG-I. The Government also plans to carry out an independent review of the HRMIS in order to establish its robustness. Once this exercise is accomplished, a payroll audit will be undertaken in order to see what the payroll looks like since the introduction of the HRMIS. Finally, the Government is also contemplating the decentralization of the HRMIS in various ministries in order to reduce delays in updating personnel records, and strengthening the payroll control.

(v). Debt and aid management

21. Although progress has been made in reducing the stock of external and internal debt in the last two years, Malawi remains heavily burdened with domestic debt. Further, there is need to have in place measures to ensure that Malawi does not build up unsustainable levels of external debt again. Dealing with the debt problem will require more than exercising fiscal discipline - systems of debt management would also need to be improved. In order to improve the management of public debt, the Government is planning to undertake a multi-year reform program. First, it has conducted a comprehensive and systematic debt management performance assessment with technical assistance

from the World Bank in 2007. This exercise has provided a systematic assessment of strengths and weaknesses of Malawi's debt management system, and identified possible areas for improvement. Secondly, the Government plans to finalize the debt management policy that is currently in draft form and have it approved by cabinet. The policy will outline clear guidelines for contracting of both domestic as well as external debt.

22. The Government also plans to increase staffing levels and capacity in the Debt and Aid Division (DAD) of the Ministry of Finance (MOF), and will establish mechanisms to improve the coordination between the Reserve Bank of Malawi and the Ministry of Finance. The expectation is that the MOF will among other things work with the Reserve Bank of Malawi in determining and forecasting liquidity needs of the government when deciding how much to borrow on the domestic market. The MOF, through the DAD, will also analyze the costs and risks associated with different financing options and therefore advise the Government on least-cost financing options. Finally, the DAD will be preparing debt management reports for submission to Parliament.

(vi). Corruption prevention

23. Finally, the Government also plans to step up efforts in the area of corruption prevention. The Anti-Corruption Bureau (ACB) has been involved in conducting public accountability workshops aimed at educating people in various public institutions on various aspects of corruption. In some institutions, the ACB has helped develop anti- corruption policies. However, there is recognition that reforms need to be undertaken in certain public institutions in order to reduce the likelihood of corruption taking place in those institutions. Such reforms would focus on changing administrative systems and procedures that currently provide a conducive environment for corruption to take place. In this regard, ACB plans to undertake corruption risk assessments in selected institutions, where corruption is most severe according to the governance and corruption baseline survey, in order to identify weaknesses in procedures and systems in such institutions that may be responsible for high incidences of corruption. The plan is to undertake risk assessments and implement their recommendations in at least two public institutions by end of the 2008/09 financial year. Further, the ACB also plans to ensure that the respective public institutions implement the recommendations coming out of the risk assessments. In this regard, a list of priority recommendations will be drawn out between the ACB and the concerned institutions. Above all, the ACB has developed a National Anti-Corruption Strategy which would be launched in early 2009. The strategy encourages participation of all stakeholders in the fight against corruption in Malawi. The strategy also promotes establishment of Internal Integrity Committees (IICs) within Government institutions in order to take forward the anti-corruption campaign and to develop Client Service Charters.

I am confident that the outlined policies, programs and reforms will create a conducive environment for the effective and efficient utilization of any assistance the African Development Bank Group may provide, towards enabling the government to implement its poverty reduction goals set in the MGDS.

Yours faithfully,

Goodall E. Gondwe, MP

APPENDIX 3

CABS PERFORMANCE ASSESSMENT FRAMEWORK

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
1	Macroeconomic program	PRGF 4th and 5th reviews completed in December 2007	PRGF 6th review completed and New PRGF agreed by December 2008, and on track with IMF	PRGF on track as of latest IMF review	IMF/GOM
2	***Credibility of the budget: In-year expenditure reallocation between primary expenditure votes***	***In-year expenditure reallocation between votes in 2006/07 was 9% of originally approved budget***	***For 2007/08 in-year expenditure reallocation between votes amounts to less than 10% of total approved budget*.**	For 2008/09 in-year expenditure reallocation between votes amounts to less than 10% of total approved budget.	***Source: Annual Consolidated Accounts*** ***Definition: PEFA PI2***[4]
3	**Expenditure on essential public services: budgeted ORT appropriations**	**2007/08 for 2009 review 2009/10 for 2010 review**	**For 2008/09 budgeted ORT will be no lower as a proportion of primary expenditure than their 2007/08 level**	For 2009/10 budgeted ORT will be no lower as a proportion of primary expenditure than their 2008/09 level	Source: Approved budget document no. 5 Consolidated indicator. Primary expenditure as per PEFA.[5]
4	***Improved budget process***	***IMF 2007 Review of Budget Process***.	***Develop a revised structure of the budget classification and associated Chart of Accounts (CoA) by Dec 2008***	(i) New budget classification and CoA is introduced in the 2009/10 budget; (ii) Budget preparation module is incorporated into IFMIS by Dec 2009	***Source: MoF Definition: as per recommendation of the 2007 IMF Budget Process Review. Will impact on PEFA PI5/ PI11***
5	Improved payroll management	HRMIS review and personnel audit under way in June 2008	By December 2008: Action Plans in place to address weaknesses identified in HRMIS review and personnel audit	By December 2009: (i) Implementation of agreed priority activities from Action Plans (ii) HRMIS-IFMIS interface developed and operational	Source: OPC/DHRMD and MoF Will impact on PEFA PI18
6	Expenditure reporting:	2006/07 Annual	2007/08 Accounts submitted to	2008/09 Accounts submitted to	Source: Accountant General's

[4] Deviation monitored for the largest 20 primary expenditure headings. Also for the following governance institutions: NAO, ODPP, DPP, ACB and Ombudsman

[5] Institutions monitored: Primary Education, Secondary Education, Health (which will be continued to be monitored using the Health SWAP formula for GoM's commitment), Parliament, National Audit Office, Malawi Prisons, MEC, Judiciary, Ag Extension, ODPP, DPP, ACB and Ombudsman

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
	timeliness and quality	Appropriation Accounts submitted within the statutory deadline	NAO within 6 months of FY end	NAO within 6 months of FY end	Department, MOF and NAO PFM Act states NAO to receive financial statement within 4 months of FY end
7	***External audit: timeliness and follow-up***	***By December 2007 the last audit submitted to Parliament was for 2003/04. Follow up to the audit had not been completed.***	***By December 2008:*** ***(i) 2004/05, 2005/06 and 2006/07 audits submitted to Parliament*** (ii) Treasury Minute for 2003/04 Audit issued	By December 2009: (i) 2007/08, and 2008/09 audit submitted to Parliament (ii) Treasury Minute for 2004/05, 2005/06 and 2006/07 expenditure issued	***Source: NAO and Public Accounts Committee*** ***PFM Act states Annual Accounts will be audited within two months of being submitted to NAO.*** Will impact on PEFA PI26/PI28
8	Resource Mobilisation: borrowing and domestic revenue	(i) Debt and Aid Management Policy in draft form (ii) IMF tax administration review available	By December 2008: Cabinet approved Debt and aid management policy Debt Coordination Committee is operational	By December 2009: (i) Improvement against identified indicators from new Debt Strategy (ii) Improved tax administration – implementation of IMF recommendations	Source: MoF Definition: Quarterly meetings of DCC start taking place as agreed in Debt and Aid Policy Will impact on PEFA PI17
9	***Public procurement: improved capacity***	***(i) No comprehensive procurement audit to date.*** (ii) Number of IPC – 170 (100%), and SPU – 29 (17%)	***By December 2008***: (***i) Procurement audit finalised*** (ii) All Ministries, Departments and Agencies established IPCs, increase in number of SPU, and SPUs are functional in 10 largest spending institutions (iii) Develop and implement a tool for monitoring the drugs supply chain	By December 2009: (i) Implementation of identified recommendations from 2008 procurement audit (ii) Supply chain monitoring results show an improvement of x% in the stock availability of essential medicines	***Source: ODPP, line ministries*** Source for (ii): Health SWAP review PFEM AP: C2 Will impact on PEFA PI19

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
10	Predictability	Not all CABS donors provide estimates of budget support disbursements in the medium term in accordance with Joint Framework.	(i)CABS budget support disbursements in 2007/08 according to estimate provided to GoM (ii) CABS provides indicative budget support information for 2009/10 and 2010/11 (iii) Develop Action Plan to accelerate use of country systems by December 2008	(i)CABS budget support disbursements in 2008/09 according to estimate provided to GoM (ii) CABS provide indicative information on budget support disbursements for 2008/09 and 2009/10. (iii) Improvement in reliability of disbursement estimates for all aid delivered by CABS members (iv) Start implementing priority actions in the Action Plan that will ensure Increased use of GoM procurement systems by CABS members	MoF Annual Debt and Aid Reports and CABS Aide Memoires (i) will be measured in terms of timeliness (ie quarter of delivery) and amount disbursed. Will impact on PEFA D1/D2
11	Improved business environment: contract enforcement and business licensing	(i) Commercial cases filed prior to the launch of Commercial Division are still at the General Division of the High Court (ii) Business licensing procedures are cumbersome	(i) Completion of audit of cases that are still at the General Division of the High Court to determine which to transfer to the Commercial Division (ii) Publication of the Malawi Investment and Trade Centre (MITC) Bill	(i) All backlog cases meeting Commercial Court threshold requirements are transferred from the General Division of the High Court to the Commercial Division (ii) Adoption of the new National Investment Policy of Malawi	Sources: (i) Commercial and General Divisions of the High Court (ii) Ministry of Justice (iii) Ministry of Trade and Private Sector Development
2	Improved functioning of agricultural output markets	As of December 2007 (i) MAWTCO incorporated but not	By December 2008 (i) Supply/price hedging (call option or report) implemented to	By December 2009 Warehouse Receipts System operational[6]	Source : Agriculture/MoF

[6] *Warehouse receipts system operational as measured by a) warehouse licensing agreement drafted, b) at least 2 warehouses registered to participate in receipts system; c) registration of at least one warehouse manager; d) registration of at least one warehouse inspector, e) maize grades and standards underlying warehouse receipts agreed by Malawi Bureau of Standards, GTPA and ACE.

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
		operational (ii) Substantial progress in ADMARC re-structuring as proposed in the agreed business plans in 2007.	complement physical storage of maize (ii) Weather derivative pilot implemented		
13	Improved functioning of agricultural input markets	(i) Private sector participation in distributing subsidised fertilizer down to 24% of total in 2007/08 (ii) Fertilizer performance indicators agreed and tested.	By December 2008 Medium-term action plan for input market development drafted in consultation with fertilizer and seed associations and published.	By December 2009 Medium-term strategy for input market development reflected in implementation plans for 2009/10 subsidy program	Source : Agriculture/MoF Action plan outlines public-private partnership strategy, associated actions and expected outcome indicators underlying the expansion of private sector investment in trade of high quality seed and fertilizer.
14	Pupil per qualified teacher ratio in primary schools in rural areas	2005 baseline 74:1 The ratio had risen to 95:1 by 2007	2008 SY 95:1	2009 SY 88:1 or less	Source: MoEVT/EMIS Definition: number of pupils divided by number of qualified teachers, in rural areas.
15	Survival rate in standard 5 and Girl's survival rate in Std 8	(i) 51.8% in 2005 for Boys (std 5) – had increased to 53.6% by 2007 (ii) 47.6% in 2005 for Girls (std 5) – had increased to 50.7% by 2007 (iii) 22.9% in 2005 of girls (Std 8) – had increased to 26.1% by 2007	(i) 54% in 2008 SY for Boys (std 5) (ii) 51% in 2008 SY for Girls (std 5) (iii) 26% in 2008 SY for Girls (std 8)	(i) 55% or above for 2009 SY for Boys (ii) 55% or above for 2009 SY for Girls (iii) 30% or above in 2009 SY for Girls (std 8)	Source: MoEVT/EMIS Definition: Percentage of a cohort of pupils (or students) enrolled in the first grade of a given level or cycle of education in a given school-year who are expected to reach a given grade, regardless of repetition (Unesco).

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
16	Proportion of one year olds immunised against measles: i) National level ii) Districts below 75% level [7]	As at June 2005: national level at 82% As at June 2007: national level at 80%, 4 districts below 75%	As at June 2008 (i) Maintain national level at least at the level of June 2005 and (ii) reduce the number of districts below 75% to a maximum of two	As at June 2009 (i) Maintain national level at least at the level of June 2005 and (ii) no districts below 75%.	Source: MoH/HMIS EPI. SWAP monitoring framework. Definition: ratio of children administered Measles vaccine by first birthday and estimated under one population for reporting period
17	Proportion of birth attended by skilled health personnel.	38% in 2005 42% in 2007	45% as at June 2008	54% by June 2009	Source: MoH/HMIS. SWAP monitoring framework. Definition: % of deliveries attended by personnel trained to give necessary supervision, care, and advice to women during pregnancy, labour, and the postpartum period, to conduct deliveries on their own, and to care for the newborn. (WHO) MGDS 2011 target is 75%.
18	Nurse population ratio	1:4000 in 2005 1:3,304 in June 2007	1:3,200 as at June 2008	1:3,100 by June 2009	Source: MOH/ HMIS SWAP monitoring framework.
19	HIV/AIDS Indicator[8]	(i) % of health facilities with at least the minimum package of PMTCT services**:** 2005 is 7% 2007 is 44%	By June 2008: (i) 55%	By June 2009: (i) 66% (ii) 35%	Source: MOH – PMTC Plan

[7] Districts below 75% as at June 2007 are: Ntcheu (74%), Mangochi (71%), Thyolo (67%), Chiradzulu (64%) – both Dedza and Nkhotakota were exactly 75%.
[8] Sub-indicator (i) will be measured until the 2010 review, after which it will be dropped. Sub-indicator (ii) will be measured from the 2010 review onwards.

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
		(ii) % of HIV+ pregnant women receiving complete course of ARV prophylaxis to reduce mother to child transmission: 2% in 2007			Minimum PMTCT package: 1. HIV testing and counselling (HTC) of pregnant women 2. Providing ARV prophylaxis to all HIV-positive pregnant women 3. CPT for all HIV-positive pregnant women 4. ART for eligible HIV-positive pregnant women (eligibility refers to CD4 count <250) 5. ARV prophylaxis for HIV-exposed infants
20	Gender Indicator	Women in Decision making positions: 15% in 2005 19% in 2007	(i) 21% in 2008	(i) 30% in 2009 (ii) Introduce African Gender Development Index by December 2009	Source : MOGWC, OPC Decision making positions: P5 to P2 in civil service; Deputy GM, Director or CEO, Ex Secretary in Parastatals.
21	Government compliance with the Constitution and rule of law.	(i) Local elections not held in line with the Constitution. (ii) 1,130 homicide cases awaiting trial (at least 2 years old) (iii) Weak compliance with constitutional provisions on declaration	(ii) Number of pending homicide cases reduced by 150 (13% of baseline) by December 2008	(i) 2009/10 budget includes allocation for 2010 local elections. (ii) Number of pending homicide cases reduced by further 300 ((26% of baseline) by December 2009 (iii) Implementation of declaration of assets legislation commences by	Source: Law commission, Judiciary (High Court), Malawi Election Commission.

[9] Currently the Economic Convention on Social and Cultural Rights, Convention on Racial Discrimination, Convention on Elimination of all Forms of Discrimination Against Women, and the Convention on the Rights of the Child are undergoing reporting processes;

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
		of assets (iv) Last convention reported against was in September 2007 (CRC)	(iv) Government (through MoJ) agrees to submit at least 2 state party reports to the UN by December 2008[9]	December 2009 (iv) [further state party reporting target to be agreed]	
22	Elections judged free and fair by local civil society and international observers	(i) 2004 elections judged free but not entirely fair because of abuse of incumbency by ruling party (ii) MEC in need of reform to be more competent and impartial (iii) Freedom House assess media as partly free. Score is 54 in 2005; 55 in 2006; 53 in 2007; 55 in 2008.	(i) 2009 elections are on track including: (a) disbursements against agreed budget; (b) deviation from agreed activities calendar; (c) MEC staffing adequate to meet capacity needs (ii) Communication Act modified to provide for independent Board for public media (ii) At a minimum Malawi maintains its score in Freedom House Media Freedom annual rating for 2008	2009 Elections deemed free and fair by international observers [New Media monitoring indicator and target to be considered] [New Freedom House target to be agreed]	Source : MEC/ OPC/Ministry of Civic Education and Information. For 2009 review target (b)(ii): the source: www.freedomhouse.org
23	Corruption: ACB performance	(i) 226 investigations concluded in 2007 (ii) 17 cases in court for longer than 2 years by end of 2007 (iii) 10 institutional inquiries/audits completed during 2007	(i) 360 investigations concluded during 2008 (ii) Cases in court for longer than 2 years down to 10 by end of 2008 (iii) 12 institutional inquiries/audits completed during 2008 and 70% of 2007 recommendations implemented	(i) 480 investigations concluded during 2009 (ii) Cases in court for longer than 2 years down to 5 by end of 2009 (iii) 15 institutional inquiries/audits completed during 2009 and 70% of 2007 recommendations implemented	Source: ACB. Targets are in line with ACB work plan.
24	Corruption: broad progress	(i) World Bank Control of Corruption indicator 25.7 in 2006 (ii) NACS in final stages of preparation	(i) World Bank Control of Corruption Indicator improves by 2 percentile points (ii) NACS finalisation and roll out: five institutional integrity	(i) World Bank Control of Corruption Indicator improves by 2 percentile points (ii) Progress in implementation of NACS: institutional integrity	Source: (i) World Bank Institute (ii) ACB.

No	Indicator	Baseline	Target for 2009 review	Indicative Target for 2010 review	Definition and source
			committees established.	committees established in 10 public institutions[10]	
25	Prison conditions No of deaths in prison –.	14 deaths per month per 10,000 prison population in 2005; 19 deaths per month per 10,000 prison population in 2007 (actual as per CABS 2007 review)	14 deaths per month per 10,000	11 deaths per month per 10,000	Source : Malawi Prisons. Definition: Number of prisoners per month per 10,000 prison population who die during the time they are under the jurisdiction of the Prison authorities. [11]

[10] Subject to amendment depending on 2009 review assessment of progress and effectiveness of indicator
[11] Early 2007 prison population stands at a little higher than 11,000. According to the ICRC death rates at 15 per month per 10,000 population require urgent remedial action. For the 2007 review 2006 prisons reported 19 per month, other reliable sources indicated 25.

APPENDIX 4
IMF COUNTRY RELATIONS NOTE

IMF Executive Board Completes Sixth and Final Review Under PRGF Arrangement for Malawi, Increases Financial Assistance to Mitigate the Impact of Fertilizer and Fuel Prices, and Approves US$ 24.7 Million Disbursement

Press Release No. 08/175
July 14, 2008

The Executive Board of the International Monetary Fund (IMF) has completed the sixth and final review of Malawi's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement.

In the context of this review the Executive Board decided to increase access under the program by SDR 10.41 million (about US$16.9 million) to SDR 48.58 million (about US$ 79.0 million), to help meet a larger balance of payments need brought about by higher fuel and fertilizer prices. The Executive Board also waived the non-observance of the end-December 2007 performance criterion on central government domestic borrowing. The completion of the review enables the release of SDR 15.18 million (about US$ 24.7 million), which will fully disburse the total amount available under the arrangement.

The three-year PRGF arrangement for Malawi was approved on August 5, 2005 (see Press Release No 05/188), originally for a total amount of SDR 38.2 million (about US$ 62.1 million) to support the government's economic program for 2005-2007.
Following the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"The Malawi authorities are to be commended for the performance under the PRGF-supported program. Helped by favorable weather and debt relief, growth has been robust, poverty has been reduced, inflation has fallen to single digits, and the debt situation has improved. A major fiscal consolidation supported a decline in interest rates and a large expansion in credit to the private sector.

"The strong growth is expected to continue and spread beyond agriculture, although rising fuel and fertilizer prices are increasing the downside risk and adding inflation pressure. Further efforts to improve the business environment would help support growth.

"Strong revenue performance helped fiscal policy implementation. However, repeated expenditure overruns remain a concern. Despite efforts to accelerate public financial management reforms, capacity constraints remain serious, and budget preparation, execution, and control need to be further strengthened. Firm fiscal discipline and continued strong political commitment will be required to meet the 2008/09 budget targets.

"Malawi has been hit hard by a large increase in the price of key imports in 2007 and 2008, notably of fuel and fertilizers. In this light, Malawi's low level of international reserves is a concern for financial stability and food security, and against that background, the Board agreed to Malawi's request for augmentation of access under the PRGF. Further consolidation of government net domestic debt will facilitate the further accumulation of international reserves without jeopardizing growth and crowding out the private sector. Additional donor support would help greatly in smoothing the needed adjustment.

"The monetary overhang and excess reserves in the banking sector need to be reduced. This will make monetary policy more effective in helping Malawi adjust to the external price shocks and prevent a reemergence of inflation," Mr. Kato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

IMF Executive Board Approves US$77.1 Million Exogenous Shocks Facility Arrangement for Malawi

Press Release No. 08/309
December 3, 2008

The Executive Board of the International Monetary Fund (IMF) has approved a one-year, SDR 52.05 million (about US$77.1 million) arrangement under the Exogenous Shocks Facility (ESF) for Malawi, to support the authorities in their adjustment to the terms of trade shock caused by rapid increases in fuel and fertilizer prices in the first part of 2008. The decision will enable Malawi to draw an amount equivalent to SDR 34.7 million (about US$51.4 million) from the IMF immediately.

This is the first ESF-supported program to be approved by the IMF's Executive Board. In September 2008, the Executive Board approved modifications to the ESF which provided for faster and higher access, made the facility easier to use, and enhanced its flexibility. These modifications took effect in late November following the receipt of all the necessary legal consents.

Following the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"Malawi's economic performance has been strong in recent years. Economic growth has been robust, inflation has been moderate, and debt sustainability has substantially improved.

"High world oil and fertilizer prices earlier in the year are putting pressure on inflation and foreign exchange reserves. Recent declines in the price of fuel and fertilizer should help over the medium term, but the negative effects of the earlier price hikes will persist over the next few months, because current imports of oil and fertilizers were contracted at earlier high prices. In this light, Malawi's current low level of international reserves is a concern for financial stability and food security.

"The economic program to be supported by high-level access to IMF resources under the Exogenous Shocks Facility will help to contain the pressure on the balance of payments and rebuild external reserves. Financing will be complemented by fiscal and monetary tightening. Additional donor support has been forthcoming, and will be critical to facilitate the economy's adjustment to the terms of trade shock.

"The government's planned reduction in domestic borrowing in 2008/09 is a key element of the fiscal adjustment. To this end, it will be important to enhance fiscal discipline, including through further improvements in public financial management. Spending pressures will need to be resisted, particularly in the run-up to the May 2009 general elections, in order to safeguard foreign exchange reserves and priority investments," Mr. Kato said.

Recent Economic Developments

Over the last three years, Malawi's economy has experienced high real GDP growth and moderate, but recently rising, inflation. Consumer prices increased by 9.3 percent in the 12 months to September 2008, largely because of a 25 percent increase in fuel prices in June 2008. Food price inflation continues to be subdued, although domestic maize prices reportedly increased sharply in some areas in the first half of 2008.

Malawi's terms of trade deteriorated significantly in 2008, despite solid increase in tobacco export prices and the recent easing of world oil prices. Significantly higher world prices of oil, fertilizers, and other imported goods for most of 2008 adversely affected Malawi's trade balance. In 2008 the net impact on the trade balance from this worsening of Malawi's terms of trade could amount to US$156 million. Recent declines in the price of fuel and fertilizer should help over the medium term, but the negative effects of the earlier price hikes will persist over the next few months, because current imports of oil and fertilizers were contracted at earlier high prices. Although international reserves have been temporarily buttressed by the seasonal concentration of tobacco proceeds in April-September, gross reserves at the end of September 2008 were only US$175 million, corresponding to 1.1 months of imports.

A tight budget for the fiscal year 2008/09 has been approved despite significant political hurdles. Targeted domestic debt repayment in 2008/09 is 0.1 percent of GDP, compared with borrowing of 1.3 percent of GDP in 2007/08.

Monetary policy has brought short-term interest rates up to levels more consistent with medium-term inflation objectives and the reserve situation.

The government continues to place substantial weight on stabilizing the nominal exchange rate against the U.S. dollar, which has held steady since May 2006.

Program Summary

The government's program is designed to support continuing financial and macroeconomic stability, growth, and poverty reduction. During the ESF arrangement the main focus will be on adjusting to the terms-of-trade shock and rebuilding Malawi's reserve buffer while preserving medium-term momentum on growth and poverty reduction. The government aims to achieve these goals through a combination of restrained domestic demand and increased external support. At the same time, it is preparing a medium-term program to reform the money and foreign exchange markets and modernize the monetary policy framework.

Improving public financial management is crucial for ensuring financial stability, rebuilding international reserves, and achieving the goals set out in the Malawi Growth and Development Strategy (MGDS).

APPENDIX 5

Malawi: Selected Economic Indicators 2006/07-20010/11

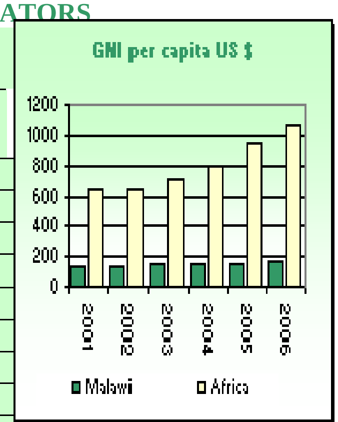
	2006/07 Act.	2007/08 Prel.	2008/09 Proj.	2009/10 Proj.	2010/11 Proj.
National accounts and prices					
GDP at constant market prices	7.7	8.7	7.6	6.9	6.1
Nominal GDP (MK billions)	466.1	547.3	638.0	731.7	826.5
Nominal GDP per capita (US$)	252.8	288.5	329.0	363.8	385.4
GDP deflator	14.6	8.0	8.3	7.3	6.5
Consumer prices end of period)	7.6	8.5	8.5	6.6	6.4
Food	6.8	6.5	7.3	6.0	6.2
Nonfood	8.6	10.7	9.7	7.1	6.7
Consumer prices (annual average)	10.0	7.7	8.4	7.0	6.6
Investment and savings (percent of GDP)					
National savings	21.7	21.5	18.6	19.8	18.0
Government	10.3	8.9	5.0	8.3	7.3
Private	11.4	12.6	13.6	11.5	10.7
Gross investment	24.4	26.9	24.5	24.6	23.3
Government	11.5	11.7	8.7	10.8	9.7
Private	12.9	15.2	15.9	13.8	13.5
Saving-investment balance	-2.7	-5.3	-6.0	-4.8	-5.3
Government	-1.2	-2.7	-3.7	-2.5	-2.5
Private	-1.5	-2.6	-2.3	-2.3	-2.8
Central government (percent of GDP)					
Revenue (excluding grants)	18.1	19.2	19.4	19.5	20.0
Grants	13.6	10.9	13.2	12.2	12.7
Expenditure and net lending	33.0	32.8	36.2	34.2	35.1
Overall balance (excluding grants)	-14.9	-13.6	-16.9	-14.7	-15.2
Overall balance	-1.3	-2.7	-3.7	-2.5	-2.5
Foreign financing	0.8	1.4	3.8	3.5	3.6
Domestic financing	0.5	1.3	-0.1	-1.0	-1.1

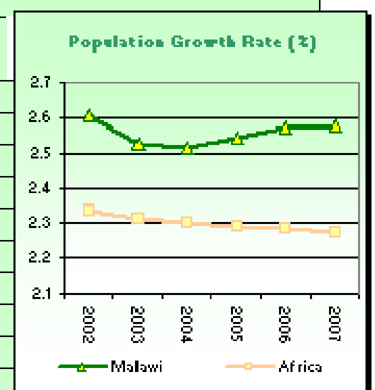
Money and credit (contribution to M2 growth)					
Money and quasi money	24.7	41.3	9.5	13.7	13.4
Net foreign assets	19.7	-2.6	-4.1	11.0	12.9
Net domestic assets	5.0	43.9	13.6	2.7	0.6
Credit to the government	-9.8	51.2	0.9	0.5	-5.2
Credit to the rest of the economy	18.9	22.3	13.1	9.0	10.8
Velocity	5.1	4.3	4.6	4.7	4.6
Money and credit (percent change)					
Money and quasi money	24.7	41.3	9.5	13.7	13.4
Net foreign assets	91.4	-7.8	-18.9	68.9	54.2
Net domestic assets	6.3	65.7	17.3	3.2	0.8
Credit to the government	-29.2	101.5	3.2	1.8	-22.7
Credit to the rest of the economy	46.8	46.8	26.5	15.8	18.6
External sector (millions of US$)					
Exports, f.o.b.	610.0	829.4	1,030.6	1,104.2	1,175.4
Imports, c.i.f.	-1,140.7	-1,274.4	-1,447.5	-1,536.8	-1,673.1
Usable gross official reserves	181.3	202.6	256.5	371.2	505.0
(months of imports)	1.2	1.3	1.5	2.0	2.6
Current account	-2.7	-5.3	-6.0	-4.8	-5.3
Current account (excluding official transfers)	-16.4	-17.2	-17.5	-17.1	-17.0
Nominal effective exchange rate	-2.6	-1.4	...	...	...
Real effective exchange rate	0.8	-1.2	...	...	...
Domestic debt (percent of GDP)					
Net domestic debt (central government)	12.2	17.1	14.6	11.7	9.3
Of which: excluding recapitalization of RBM	12.2	11.7	9.9	7.7	5.7
Net consolidated domestic debt (central bank and central government)	14.6	11.6	7.8	6.4	5.9
Domestic interest payment	3.1	2.1	2.6	2.1	1.6
Treasury bill rate (period average)	20.9	10.1	...	...	...

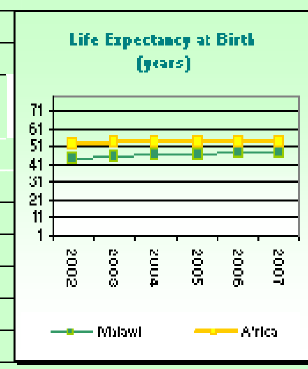
Sources: Malawian authorities; and IMF staff estimates and projections in the ESF Document.

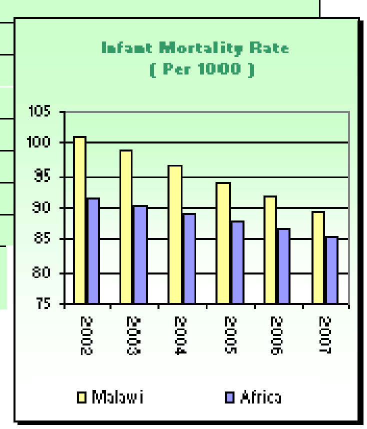
APPENDIX 6 - MALAWI: COMPARATIVE SOCIO-ECONOMIC INDICATORS

	Year	Malawi	Africa	Developing Countries	Developed Countries
Basic Indicators					
Area ('000 Km²)		118	30 307	80 976	54 658
Total Population (millions)	2007	13.9	963.7	5 448.2	1 223.0
Urban Population (% of Total)	2007	18.4	39.8	43.5	74.2
Population Density (per Km²)	2007	117.5	31.8	65.7	23.0
GNI per Capita (US $)	2006	170	1 071	2 000	36 487
Labor Force Participation - Total (%)	2005	46.3	42.3	45.6	54.6
Labor Force Participation - Female (%)	2005	48.5	41.1	39.7	44.9
Gender -Related Development Index Value	2005	0.432	0.486	0.694	0.911
Human Develop. Index (Rank among 174 countries)	2005	164	n.a.	n.a.	n.a.
Popul. Living Below $ 1 a Day (% of Population)	2006	45.0	34.3	...	...
Demographic Indicators					
Population Growth Rate - Total (%)	2007	2.6	2.3	1.4	0.3
Population Growth Rate - Urban (%)	2007	4.7	3.5	2.6	0.5
Population < 15 years (%)	2007	46.9	41.0	30.2	16.7
Population >= 65 years (%)	2007	3.1	3.5	5.6	16.4
Dependency Ratio (%)	2007	99.0	80.1	56.0	47.7
Sex Ratio (per 100 female)	2007	98.9	99.3	103.2	94.3
Female Population 15-49 years (% of total population)	2007	22.2	24.2	24.5	31.4
Life Expectancy at Birth - Total (years)	2007	48.3	54.2	65.4	76.5
Life Expectancy at Birth - Female (years)	2007	48.4	55.3	67.2	80.2
Crude Birth Rate (per 1,000)	2007	40.7	36.1	22.4	11.1
Crude Death Rate (per 1,000)	2007	14.8	13.2	8.3	10.4
Infant Mortality Rate (per 1,000)	2007	89.4	85.3	57.3	7.4
Child Mortality Rate (per 1,000)	2007	131.8	130.2	80.8	8.9
Total Fertility Rate (per woman)	2007	5.6	4.7	2.8	1.6
Maternal Mortality Rate (per 100,000)	2004	984.0	723.6	450	8
Women Using Contraception (%)	2006	41.7	29.9	61.0	75.0
Health & Nutrition Indicators					
Physicians (per 100,000 people)	2004	2.1	39.6	78.0	287.0
Nurses (per 100,000 people)	2004	56.3	120.4	98.0	782.0
Births attended by Trained Health Personnel (%)	2006	53.6	50.4	59.0	99.0
Access to Safe Water (% of Population)	2006	76.0	62.3	80.0	100.0
Access to Health Services (% of Population)*	2004	35.0	61.7	80.0	100.0
Access to Sanitation (% of Population)	2006	88.2	45.8	50.0	100.0
Percent. of Adults (aged 15-49) Living with HIV/AIDS	2005	14.1	4.7	1.3	0.3
Incidence of Tuberculosis (per 100,000)	2005	409.4	300.7	275.0	18.0
Child Immunization Against Tuberculosis (%)	2006	99.0	83.7	85.0	93.0
Child Immunization Against Measles (%)	2006	85.0	75.4	78.0	93.2
Underweight Children (% of children under 5 years)	2006	19.4	28.6	27.0	0.1
Daily Calorie Supply per Capita	2004	2 077	2 436	2 675	3 285
Public Expenditure on Health (as % of GDP)	2005	8.7	2.4	1.8	6.3
Education Indicators					
Gross Enrolment Ratio (%)					
Primary School - Total	2006	119.0	96.4	91.0	102.3









Primary School - Female	2005	121.6	92.1	105.0	102.0	
Secondary School - Total	2006	29.0	44.5	88.0	99.5	
Secondary School - Female	2004	25.0	41.8	45.8	100.8	
Primary School Female Teaching Staff (% of Total)	2004	45.7	47.5	51.0	82.0	
Adult Illiteracy Rate - Total (%)	2007	34.1	33.3	26.6	1.2	
Adult Illiteracy Rate - Male (%)	2007	21.9	25.6	19.0	0.8	
Adult Illiteracy Rate - Female (%)	2007	46.1	40.8	34.2	1.6	
Percentage of GDP Spent on Education	2006	5.3	4.5	3.9	5.9	
Environmental Indicators						
Land Use (Arable Land as % of Total Land Area)	2005-07	19.9	6.0	9.9	11.6	
Annual Rate of Deforestation (%)	2000-07	2.4	0.7	0.4	-0.2	
Annual Rate of Reforestation (%)	2000-07	8.0	10.9	…	…	
Per Capita CO2 Emissions (metric tons)	2005-07	0.1	1.0	1.9	12.3	

Sources : ADB Statistics Department Databases; World Bank: World Development Indicators; UNAIDS; UNSD; WHO, UNICEF, WRI, UNDP; Country Reports

last update : July 2008

Note : n.a. : Not Applicable ; … : Data Not Available;

APPENDIX 7
PREREQUISITE CONDITIONS FOR THE PROGRAMME

Economic and political stability: Malawi has successfully completed the 2005-2008 PRGF and is considering a follow up program with the IMF. The Fund and the Government agreed that the objectives of the new program will be to maintain macroeconomic and financial stability in view of the global economic crisis. The political situation has remained stable but tension arising from the Government's minority position might be heightened as the country moves towards the 2009 elections.

Government commitment: There is a credible government reform program with a number of donors supporting PFM and anti-corruption activities in a coordinated manner through the Group on Financial and Economic Management. The MGDS with its poverty focus combined with macro-economic stability offers the opportunity to support Government-led development plans.

PRSP and implementation mechanisms: The MGDS provides the framework for development in Malawi while budget reforms seek to set a foundation for improved linkages between the budget and the MGDS. The existing institutional structure for the MGDS process will be used to implement and monitor performance and policy reforms. The Ministries of Finance and Economic Planning are responsible for implementation, monitoring and evaluation. Sector Working Groups (SWGs) have also been established to coordinate and monitor MGDS implementation across government Ministries. The SWGs will be responsible for guiding the effective coordination and implementation of sector strategies and policies. They will also ensure that development partners work together under Government leadership to support Government's priorities, PFM, and M&E systems as well as be actively involved in the process of data collection to facilitate performance evaluation. Furthermore,

Viable macro economic and financial medium term framework: The Mid-term economic outlook is positive although the country remains vulnerable to bad weather and rising global commodity prices. Rising global fertilizer prices have contributed to the US$40million fiscal gap for 2008/09 while rising global fuel price has contributed to the slow push on inflation. Government's intention is to continue with fiscal discipline and to further reduce domestic debt. Government has successfully completed the 2005-2008 PRGF and a follow up one-year ESF was approved by the IMF on 3 December 2008. This is expected to be followed by a new three-year PRGF arrangement.

Partnership among key donors: Partnership among the key direct budget support group is strong. In September 2005, the Common Approach to Budget Support (CABS) Group and GoM agreed on a Joint Framework (JF) which is a memorandum of understanding on principles governing budget support cooperation in Malawi. The JF sets out roles, responsibilities, and process for budget support review and policy dialogue. The CABS Group includes the African Development Bank (ADB), European Commission, the United Kingdom Department for International Development (DFID) and Norway. The Bank became a full member in 2007 after signing the JF, thus allowing it to actively participate in the CABS reviews. The World Bank is preparing to sign the JF while the IMF, Germany, UNDP and Ireland participate in the CABS as observers. The fundamental principles of Malawi's budget support cooperation are based on commitment to poverty reduction and respect for human rights, democratic principles, sound macroeconomic management and good governance, including a robust public financial management and accountability, and effective anti-corruption programmes. The CABS arrangement provides significant untied resources for the country's poverty reduction strategy over the medium term.

Fiduciary review: The 2008 PEFA report noted progress in PFM reform, as reflected in five out of the PEFA six criteria, with only external scrutiny and audit showing 'no improvement' (see Annex 5 for details). The CABS review and IMF report have also identified PFM challenges and priorities that need to be addressed namely, budget execution, payroll management, audit backlog, and procurement. To improve financial management, Government is in the process of designing an interim PFM program. The design of an interim programme offers a bridge into a longer-term SWAP, should improve coordination and inject more pace into the reform process. It is expected that the interim programme will be up and running early in 2009. Thus the PFM programme and government commitment to further reforms gives assurance that progress can be made to strengthen public financial management and to minimize fiduciary risk.

Anti-Corruption: The Government has adopted a zero tolerance policy against corruption and plans to step up efforts in the area of corruption prevention. The Anti-Corruption Bureau (ACB) has been involved in conducting public accountability workshops aimed at educating people in various public institutions on various aspects of corruption. In some institutions, the ACB has helped develop anti-corruption policies. Government also plans to undertake reforms in certain public institutions in order to reduce the likelihood of corruption taking place in those institutions. Such reforms would focus on changing administrative systems and procedures that have provided a conducive environment for corrupt practices. In this regard, the ACB plans to undertake corruption risk assessments in selected institutions, where corruption is revealed to be most severe by the corruption baseline survey, in order to identify weaknesses in procedures and systems in such institutions that may be responsible for high incidence of corruption. The plan is to undertake risk assessments and implement their recommendations in at least two public institutions by end of the 2008/09 financial year. Furthermore, the ACB plans to ensure that the respective public institutions implement the recommendations coming out of the risk assessments. In this regard, a list of priority recommendations will be drawn out between the ACB and the concerned institutions. Above all, the ACB has developed a National Anti-Corruption Strategy which would be launched in early 2009. The strategy encourages participation of all stakeholders in the fight against corruption in Malawi.

TECHNICAL ANNEXES

ANNEX 1:

MONITORING AND EVALUATION

The PRSG.I will utilize a robust M&E mechanism based on the country system built around the CABS/PAF framework. The Joint Framework (JF) provides for two CABS reviews a year. The March review assesses progress against the PAF indicators while the September review focuses on the budget and economic trends. The Government commits to providing progress reports to the CABS Group two weeks before the reviews. The Financial and Economic Management (GFEM) also meets monthly to monitor PFM indicators between CABS reviews. The Bank is committed to stronger engagement in GFEM. Both the CABS review and GFEM meetings will help to monitor outputs (policy changes) and track budget implementation and economic trends. The MGDS annual review is also an important M&E tool. Furthermore, the PRSG will also rely on the IMF review of the ESF in tracking macroeconomic indicators. The UNDP-managed basket fund, which supports the National Statistics Office to implement the National Statistics System and generate disaggregated data, will facilitate the monitoring of indicators and outcomes.

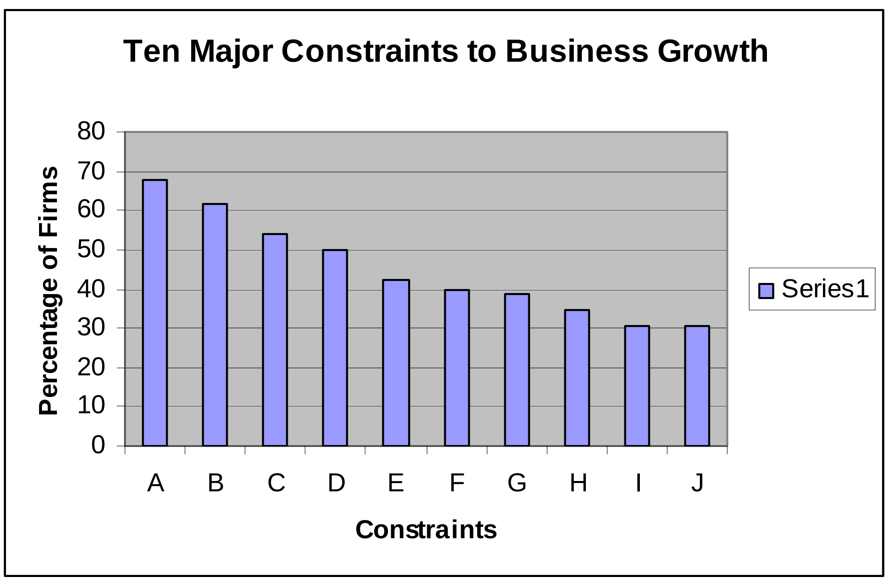
The Malawi Field Office (MWFO) has been closely associated with the PRSG.I preparation and appraisal process and has been actively involved in CABS reviews and policy dialogue. The Office will continue to play a significant role in the M&E of the PRSG.I and MGDS. The Office maintains a close contact with the Ministry of Finance and the CABS partners. The Bank is committed to active engagement in these reviews and in the GFEM monthly meetings. To ensure that the Bank is on top of the status of programme implementation, outputs (policy changes), indicators and outcomes at any time during programme implementation life, the MWFO will prepare quarterly progress reports for management, based on its own assessment. The disaggregated data generated by the National Statistical Office would facilitate this task. The capacity of the MWFO has been strengthened by a country economist, a governance expert and a social sector specialist who, under the guidance of the Resident Representative, will follow-up on the PRSG.I implementation and social delivery. The final evaluation of the programme will be based on a joint programme completion report elaborated with the Government.

ANNEX 2

DEVELOPMENTS IN THE INVESTMENT CLIMATE

A. Investment Climate Assessment (2006)

Investment Climate Assessments (ICAs) provide standardized way of measuring and comparing investment climate conditions in a country and/or across countries. They allow better identification of the features of the investment climate that matter most for productivity and hence income growth. They also provide policymakers, investors and development specialists with the analysis and insight needed for identifying steps that ca be taken to improve the business climate. ICAs are based on the World Bank's Enterprise Surveys, which are establishment level surveys designed to analyse the investment climate of the participating countries. The surveys capture firms' experience in a range of areas, including infrastructure, access to finance, governance, regulation, tax policy, labour relations, conflict resolution, infrastructural services, supplies and marketing technology and training. Every year, surveys cover 15-30 countries, with updates for each country every 3-5 years. Malawi was included in the 2006 Survey. The survey, among other things, reveals the most important factors perceived by entrepreneurs as binding constraints to private sector growth. The ten severe obstacles for operations and growth of business as rated by firms (% of firms rating the factor as a major constraint) are presented in figure 1. Top on the list are cost of financing (68%), macroeconomic instability (61.5%), high factor cost (53.8%), tax rates (50%) and tax administration (42.3%). Others are access to financing (40%), customs and trade regulations (38.5%), skills and education of available workers (34.6%), electricity (30.8%), and regulatory policy uncertainty (30.8%).



Key

A. Cost of financing, B. Macroeconomic instability
C. High factor cost D. Tax rates
E. Tax administration F. Access to financing
G. Customs and trade regulations H. Skills and education of available workers
I. Electricity (30.8%), J. Regulatory policy uncertainty

B. Ease of Doing Business Indicators (2009)

Malawi was ranked 134 out of 181 countries on the 2009 Ease of Doing Business index (based on 2008 assessment) compared with its ranking of 131 out of 178 countries in 2008 (based on 2007 assessment). In all the ten indicators measured Malawi's 2009 scores deteriorated in six, remained constant in one and only improved in three of the indicators. To sustain economic growth, the authorities have acknowledged the need to pursue reforms aimed at enhancing the enabling environment for private sector development. Government with support from the World Bank and EU has started implementing various reforms aimed at improving the business environment. The Business Environment Strengthening Technical Assistance Project (BESTAP) has four components (i) Strengthening Property Rights Institutions and Business Facilitation (ii) Strengthening Private Sector Development Support Institutions and Services (iii) Promoting Access to Finance and Productivity Enhancement (for SME development) and (iv) Project Implementation Capacity. One notable action already taken was the establishment of the commercial court in 2007 aimed at reducing the amount of time taken to resolve commercial disputes.

Malawi - Ease of Doing Business Rankings (2007-2009)

Selected Indicators	2008	2009	Change
Ease of Doing Business	131	134	-3
• Starting a business	112	122	-10
• Dealing with licenses	157	156	+1
• Employing Workers	95	96	-1
• Registering property	89	96	-7
• Getting credit	79	84	-5
• Protecting investors	66	70	-4
• Paying taxes	62	58	-4
• Trading across borders	167	167	0
• Enforcing contracts	137	138	-1
• Closing a business	138	135	+3

Source: Ease of Doing Business, World Bank 2009.

ANNEX 3

RESULTS OF BANK INTERVENTIONS 2005-2008

Project	Key Result	Status
Expanding Rural Infrastructure		
1. Integrated Rural Water Supply for Central and Northern Region Water Boards	1,389 new water points constructed against target of 1,100. 622 sanitation facilities, almost twice the number expected at appraisal	80% of the works completed, By project end 40 and 57% of the population in Mzimba and Ntchisi respectively will be provided with safe water raising coverage in the 2 districts to 80%.
2. Horticulture and Food Crops Development	1236 Ha mostly maize under irrigation 201 staff and 6,278 farmers trained, 4 fruit nurseries established, 16 cooperatives established	Overall achievement is 70% of project targets.
3. Small-Holder Out-Grower Sugarcane Production	525 Ha sugarcane under irrigation. 41.6 km access roads constructed. 7staff and 80 farmers trained	The average income for farmers has increased from US $ 262 per Ha to US $ 865 per Ha.
4. Macadamia Small-Holder Development	1,283Ha under macadamia target (1200), 87 boreholes drilled , 53km access road constructed 3,600 farmers (target 2,500), 128 nurseries (target 100)	Harvesting of Macademia nuts has just started.
5. Small Holder Irrigation	1862 Ha mostly maize under irrigation Productivity increased from 1.6 to 3.5 tons/Ha. 216 staff and 10,000 farmers trained. 2 Residential Training Centers rehabilitated	Overall achievement is 78% of project targets. Yield of maize increased from 1 to 3 tons/Ha, average household incomes increased from US$122 to US$366
6. Small Holder Crop Production and Marketing	PIU established	Project just started
Building Human Capital and Institutional Capacity		
1. 1.Support to Community Day Secondary School (Education IV)	1,149 science teachers and 300 head teachers trained. 80 classrooms to accommodate 4000 students built, 20 laboratories and 20 libraries	Achieved 85% of overall target. The Bank is one of the major development partners in secondary education
2. Skills Development and Income Generation	36,419 people made literate and 25% of these are in business, 8,394 trained in production skills and 10,058 in business management	By close of project, up to 45,000 people made literate, 400 literacy instructors trained, 20,000 trained in business management
3. Lake Malawi Artisanal Fisheries Development	12 Fishing Economic Units provided with boats 9 ice plants and cold rooms procured 13 schools and 3 clinics constructed	Project has an overall achievement of 40%.
4. Rural Health Care III	Construction of 12 rural health facilities across Malawi	Project closed
5. Poverty Reduction and Institutional Support	288 District executive Committee members trained in participatory extension. 1,704 Village Action Plans produced 7 district Socioeconomic profiles produced, 507 community sub projects supported	Project closed
6. Education V	PIU in place	Project just started
7. Support to Health SWAP	Through training and provision of basic equipment, health facilities offering Basic Emergency Obstetric New Born Care has increased from 2 to 36%. 77 motorcycle ambulances procured	Project directly impacts on MMR by upgrading rural health centres into BEMOC facilities and improving maternal referral system
8. Poverty Reduction Support Loan	Disbursement effected in early December 2008.	Bank support is through CABS Group

ANNEX 4

APPLICATION OF GOOD PRACTICE PRINCIPLES ON CONDITIONALITY

The program applies good practice principles on conditionality as indicated in the Bank's BSO annotated format (2008) for budget support operations. These principles are

(i) *Reinforce ownership*: The MGDS, the overall development programme of Malawi, was prepared by the Government through broad-based consultations with the stakeholders. Thus, it is a fully country-owned programme accepted by the Development Partners as the main framework for supporting Malawi's poverty reduction efforts. The Government is highly committed to the successful implementation of the programme and there is clear evidence of analytical work helping in the process of policy formulation (see paragraph 3.3.1). The PRSG.I is based on the MGDS, thereby reinforcing ownership.

(ii) *Agree on a coordinated framework*: The Government and the CABS Group have agreed on a Joint Framework for direct budget support. They have also agreed on a PAF as the accountability framework for measuring progress. Like the DBS participating donors, the Bank draws its support programme and disbursement triggers from the PAF.

(iii) *Customize the accountability framework and modalities of Bank's support to country circumstances*: The PRSG.I programme reflects government expressed intentions. The modalities and timing of development assistance also meet country needs. The change from loan to grant meets the circumstances of a country emerging from debt distress. The programme will use country's own systems and monitoring will be done, in the context of the CABS reviews, twice a year in March and September. These reviews are transparent, focus on results and point out areas of weaknesses requiring further attention.

(iv) *Select only actions that are critical for achieving results as conditions of disbursement*: The policy actions chosen by the Bank as triggers for disbursement are the only ones critical for achieving results and they are derived from the agreed PAF. They also focus mainly on the PFM, which is the main focus on the PRSG.1. Conditionality design within the CABS Group is further developed in para. 5.1.2 in the body of the document.

ANNEX 5

SUMMARY OF PFM PERFORMANCE SCORES BASED ON THE 2008 PEFA ASSESSMENT

PFM Performance Indicator	**Score**	**Method**
A. Credibility of the Budget		
1. Aggregate expenditure out-turn compared to original approved budget	**A**	M1
2. Composition of expenditure out-turn compared to original approved budget	**D**	M1
3. Aggregate revenue out-turn compared to original approved budget	**A**	M1
4. Stock and monitoring of expenditure payment arrears	**<NS>**	M1
B. Comprehensiveness and Transparency		
5. Classification of the budget	**B**	M1
6. Comprehensiveness of information included in budget documentation	**B**	M1
7. Extent of unreported government operations	**<NS>**	M1
8. Transparency of Inter-Governmental Fiscal Relations	**B+**	M2
9. Oversight of aggregate fiscal risk from other public sector entities.	**C+**	M1
10. Public Access to key fiscal information	**C**	M1
C (i) Policy-Based Budgeting		
11. Orderliness and participation in the annual budget process	**C+**	M2
12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	**B**	M2
C (ii) Predictability and Control in Budget Execution		
13. Transparency of taxpayer obligations and liabilities	**B**	M2
14. Effectiveness of measures for taxpayer registration and tax assessment	**C+**	M2
15. Effectiveness in collection of tax payments	**D+**	M1
16. Predictability in the availability of funds for commitment of expenditures	**B**	M1
17. Recording and management of cash balances, debt and guarantees	**A**	M2
18. Effectiveness of payroll controls	**C+**	M1
19. Competition, value for money and controls in procurement	**B**	M2
20. Effectiveness of internal controls for non-salary expenditure	**C+**	M1
21. Effectiveness of internal audit	**C+**	M1
C (iii) Accounting, Recording and Reporting		
22. Timeliness and regularity of accounts reconciliation	**B+**	M2
23. Availability of information on resources received by service delivery units	**D**	M1
24. Quality and timeliness of in-year budget reports	**C+**	M1
25. Quality and timeliness of annual financial statements	**C+**	M1
C (iv) External Scrutiny and Audit		
26. Scope, nature and follow-up of external audit	**D+**	M1
27. Legislative scrutiny of the annual budget law	**B**	M1
28. Legislative scrutiny of external audit reports	**D+**	M1
D. Donor Practices		
D-1 Predictability of Direct Budget Support	**<NS>**	M1
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	**C**	M1
D-3 Proportion of aid that is managed by use of national procedures	**C**	M1

M1 scorings are based upon the lowest scored dimension making up that indicator
M2 scorings represent an aggregate scoring of the dimensions making up that indicator.
<NS> indicator could not be scored due to unavailability of data or the lack of reliable data.

ANNEX 6

DONORS' DIRECT BUDGET SUPPORT FOR 2008/09
AND TIMING OF DISBURSEMENT

Donor	Amount (in million)	Amount (in UA million)	Donor Share of total DBS	Donor Share of total DBS %	Remarks
DFID (UK)	₤27	25.00	37.21	23.6	Already approved; disbursement in December 2008
Norway	70 Kroner	7.12	10.59	6.7	Already approved; disbursement in January 2009.
AfDB*	UA 24.89	24.89	37.04	23.4	Board consideration of the new grant proposal of UA10.0 million in March 2009; disbursement in April 2009.
World Bank	US$ 40	26.87	40.00	25.3	Adopts a three-year programmatic approach to budget support operation. PRSC-I has been completed and the preparation of PRSC-II is underway. Board consideration is scheduled for March 2009 while disbursement will be in April 2009.
EC	Euro 26	22.29	33.17	21.0	Already approved; disbursement in December 2008
Total		106.17	158.01	100.0	

* The amount for the AfDB includes the PRSL of UA14.89 million approved in 2007 for the 2007/08 Budget but recently disbursed on 2 December 2008 due to delay in ratification of the loan agreement by Parliament.