1. Country and Sector Background

1. In response to the crisis, the Government of Malawi has proposed the implementation of immediate short term safety net mitigation measures to cushion the negative financial effects of the exchange rate liberalization and the price increase on the population by providing cash support to the poorest people in the first three quintiles, approximately 1.72 million rural and urban households or 8.6 million people. These mitigation measures would be implemented through various support mechanisms including Public Works Cash Transfers, Unconditional Cash Transfers, and Agriculture input subsidies and irrigation infrastructure supports.

2. The proposed Second Additional Financing (AF II) would scale up the targeted cash transfers through the Third Malawi Social Action Fund (MASAF 3) APL II to the ultra poor urban and rural Malawians about 585,938 households or 2.9 million people, representing 20 percent of the population.

3. The proposed AF II Project would build on the positive impacts of the original MASAF Project through the Community Livelihoods Support Fund Component of Local Authority Fund to scale up the Public Works Sub-project Program (PWSP). MASAF is ideally positioned to immediately and efficiently target cash transfers to smoothen incomes of the poorest Malawians through public works. The Second Additional Financing is part of the World Bank Rapid Response Package to immediately address the crisis currently facing Malawi. Following the Additional Financing, a new credit for MASAF will be prepared in FY14 which could include expanding the design of the current program.
Sectoral and Institutional Context
1. The Poor in Malawi: The current national policy framework is laid out in the draft Social Support Policy and the draft National Social Support Policy (NSSP) identifies three categories of the poor to target for assistance:

i) The moderately poor who account for 25 percent (3.5 million people)
ii) The ultra-poor with labor who account for 5 percent (0.73 million people)
iii) The ultra-poor and incapacitated and 10 percent (1.5 million people).

2. The objective of the NSSP is to provide a framework for prioritizing targeting of support to reduce poverty and enable the poor to move out of poverty and vulnerability. It consists of four main pillars: (i) provision of welfare support; (ii) protection of assets; (iii) promotion of productivity enhancement; and (iv) policies to reduce exclusion.

3. The following are the principal vulnerable groups identified in studies of poverty in Malawi (Details in Annex 3): (i) the food insecure households are most dependent on agriculture, earning almost three-quarters of their income from farming; (ii) those with very small landholdings, the land holdings tend to be small throughout Malawi, due to high population density and repeated sub-division of plots; (iii) female-headed households make up about 23 percent of the population. They tend to own less land, make less from off-farm work, and be more food-insecure; on average they have 14 percent lower consumption than male-headed households. Widows and divorced women suffer particularly as the result of lack of assets; (iv) child-headed households, elderly and single-parent-headed HHs; orphans. There were about 873,000 orphans in 2008, representing 12 percent of the child population. Poverty is particularly acute among child-headed households, and those in which grandparents are supporting orphans with no working aged-adult in the household; (v) About 4 percent of the population is aged 65 or older, and another 3.8 percent are estimated to live with some form of disability (and clearly there is a lot of overlap between these two groups); (vi) Households in Malawi are affected by both drought and flooding; (vii) the HIV prevalence rate in Malawi was 11 percent in 2009, the eighth highest in the world. By this estimate some 0.9 million persons are living with HIV/AIDS; and (viii) unemployed/under-employed in urban areas - wage employment opportunities are scarce in Malawi, with less than 10 percent of the work force employed in the formal sector.

4. While the lack of employment results in substantial impoverishment for some urban dwellers, it needs to be emphasized that deep poverty in Malawi is still overwhelmingly a rural phenomenon, with 96 percent of the 3.4 million ultra-poor living in rural areas in 2005. Of all of the risks and shocks affecting the poorest in Malawi, those associated with agricultural productivity – drought and reduced yields, and higher food and input prices – are cited in surveys as by far the most prevalent ones, and the ones which most concern the poor.

2. Objectives
The Project Development Objective is to improve the livelihoods of poor and vulnerable households and to strengthen the capacity of authorities to manage local development.
3. Rationale for Bank Involvement
Malawi has faced a number of exogenous shocks in the past few years arising from volatility in international commodity prices, foreign aid, climate change and natural disasters including an earthquake in 2010. The Bank provided support through an additional financing credit from the Crisis Response Window in 2010 for the reconstruction of education infrastructure in the two affected districts and scale up of safety net through labor intensive public works for thirteen drought stricken districts in the Southern Region. The shocks Malawi has faced have had considerable ramifications for macroeconomic indicators as well as at household level, where rising food and fuel prices are placing a heavy burden on poor and vulnerable families, jeopardizing human capital gains achieved in previous years. In order to effectively mitigate the adverse effects of exogenous shocks at both levels, the Government has requested additional support, to address macroeconomic imbalances as well as food and fuel price increases in the face of the recent shocks to the economy. The Government, therefore, has proposed the implementation of an immediate short term safety net mitigation measures in 2012-13 to cushion the necessary financial effects of the 49 percent exchange rate liberalization that has led to the price increases for food and other basic needs for the population (in the bottom quintiles 1, 2, and 3) or approximately 1.72 million rural and urban households or 8.6 million people. The envisaged mitigation measures would be implemented through various support mechanisms including PW cash transfers, direct cash transfers, agriculture input subsidies and irrigation infrastructure support. MASAF is positioned and recognized for being able to quickly scale up the delivery of mitigating cash transfers to the poorest households through Labor Intensive Public Works Program it has run for over 17 years.

4. Description
The original Project includes the following three components: (i) Community Livelihoods Support Fund; (ii) Local Authority Capacity Enhancement Fund; and (iii) National Institutional Strengthening Fund. The Additional Financing will only fund the first and third components.

i. Community Livelihoods Support (CLS) Fund (US$50.3 million(Original P and the AF)): The Community Livelihoods Support Fund finances two sub-components:

- Local Authority Fund (US$ 25.1 million): Based on local councils’ Annual Investments Plans produced through Village Participatory Planning. This subcomponent finances labor-intensive investments that create public assets benefiting poor households. The Public Works Sub-projects Program targets poor households for twelve days as an annual intervention to address food security related shocks that affect these households around the time they need to purchase agricultural inputs, grains, and other basic necessities.

- A Community Fund (US$26.4 million): This sub-component supports participatory planning processes and direct community financing to improve the functionality of existing educational facilities as well as educational outcomes at the community level. This sub-component also entails interventions to promote a culture of savings and investments, in particular among participants of the public works program, to enable them get on a pathway to graduating out of poverty.
ii. Local Authority Capacity Enhancement (LACE) Fund (US$5.3 million): This component supports the development of a comprehensive framework for addressing capacity needs for Local Councils to effectively manage the grants they receive, perform the functions allocated to them under this project, and prepare them to perform anticipated responsibilities as devolution proceeds and more resources are available under the LDF or any other longer-term Government grant arrangement.

iii. National Institutional Strengthening Fund (US$7.2 million): The component finances national-level crosscutting issues aimed at improving accountability and transparency in the use of project resources.

5. Financing
Source: ($m.)
BORROWER/RECIPIENT 0
International Development Association (IDA) 50
Total 50

6. Implementation
1. Over the last 17 years MASAF has developed a credible reputation in Malawi. It is associated with reaching the poorest communities by providing access to basic services, community empowerment, participatory development, transparency, accountability and integrity. MASAF has made significant contributions to the social protection agenda and it is also one of the few government Programs to have developed a comprehensive targeting methodology. MASAF’s procurement and financial management systems and procedures are nationally regarded as more transparent than those adopted in other public sector managed development programs.

2. The Project also continues to manage ring-fenced funds for other Bank-funded projects including the Land Acquisition and Farm Development component in the amount of US$16.50 million under the Community Based Rural Land Development Project, and the Farmer Services and Livelihoods Fund of $25.07 million under the Irrigation, Rural Livelihoods and Agricultural Development Project as laid out in the Financing Agreements of those projects. Both sub-components are implemented through the Local Development Fund, a financing mechanism aimed at channel both government funds as well as external assistance to local authorities.

3. The MASAF 3 APL II Project was approved by the Board on June 20, 2008. The original Credit, which provided financing in an amount of SDR30.7 million (USD 50.0 million equivalent), was signed on November 25, 2008 and became effective on March 24, 2009. The project received an additional Financing Credit in the amount of US$14.0 million in 2010 from the Crisis Response Window.

Project Status and Performance

4. Over a period of 17 years MASAF has evolved and: (i) developed and implemented comprehensive methodologies for poverty and vulnerability targeting; (ii) provided models
for capacity building of district councils for involving and focusing programs of support on poor and vulnerable groups; (iii) ensured that beneficiaries are better heard and represented in decision-making arenas and policy processes related to social protection; (iv) designed systems for monitoring and evaluation of social protection indicators; and (v) developed supply-driven IEC campaigns raising awareness on social protection outcomes and social accountability.

5. The targeting methodology used by the Project combines poverty/geographical targeting with a pro-poor menu and inclusive processes at the community level (e.g., participatory targeting tools), allowing coverage both of rural areas where vulnerability seems to be increasing and poverty more pervasive, and urban areas where pockets of poverty are growing at a faster rate than in rural areas.

6. Evidence from the Public Works Tracking Studies and the Beneficiary Assessment Survey (2012) found that the program has been effective in addressing food security, improving households’ access to health and education services and also contributed in formation and protection of household assets. The improved household income has enabled the beneficiaries to enhance their livelihoods by purchasing farm inputs (34.6 percent of PWSP wages were used to procure farm inputs); buying food for their families (62 percent of the PWSP wages went into buying food); meeting their health needs (10.6 percent of beneficiaries of PWSP spent their wages on health related expenditure); and covering education needs (12.6 percent of PWSP beneficiaries spent their wages on education). However, the studies also show that duration is too short to offer significant insurance and provide predictable source of income to poor households. Beneficiaries are proposing a longer PWP intervention of up to 3 months. The MK200 per day wage rate has been in place since APL II started thus it has been eroded by inflation over time, and coupled with the recent exchange rate liberalization, the beneficiaries are getting less than a dollar a day. Coverage of the program is low such that up to 25 percent of the beneficiaries reported to be sharing both the work and the wages as social capital.

7. In order to ensure the continuity of the complementary community savings activities encouraged in the MASAF 3 APL II program, an additional budget of US$2.25 million would be allocated for the COMSIP component. This additional support will strengthen the existing efforts and would ensure that the activities continue during the scaled up PW implementation. Where the PWP beneficiaries have been linked to Community Savings and Investment Promotion intervention, the increases in household income have been phenomenal up to an average of USD 13 per person in their passbook against the US$3 at entry of the program (Beneficiary Assessment 2012). This component would continue to be implemented through existing arrangements by the COMSIP Promotion Cooperative Union.

8. The undisbursed amount of the AF I under Credit Number 47880 of June 2010 for public works totaling US$3.0 million, is not sufficient to address the newly emerged need for additional safety nets needs. As evidenced by the MASAF Additional Financing experience demand for these temporary employment opportunities is large and growing and a second Additional Financing is needed to scale up the labor-intensive public works sub-project
program to protect households from falling (deeper) into poverty and protect the gains achieved through the program.

10. A Mid Term Review mission of the Malawi Third Social Action Fund (MASAF 3) APL II was carried out from January 2012. The team considers the overall progress towards achieving the development objective to be Moderately Satisfactory. The Additional Financing preparation mission (May 2012) endorsed the rating of Moderately Satisfactory. The mission noted the following PDO outcome achievements. Out of a set target of 900,000 households under the Public Works Subproject Program (PWSP), a total of 796,887 beneficiaries of whom 48.5 percent are female had received cash transfers. The total number of beneficiaries represents 88.5 percent of the target by January 2012. The improved household income has enabled the beneficiaries to enhance their livelihoods and enabled them to access basic household needs (such as education, health, food security) as discussed above (BA 2012). As of May 2012, most of the Additional Financing credit has been disbursed and only US$3.0 million remain to be disbursed. The amount is not enough for a full cycle to reach the anticipated 578,125. Implementation Progress was rated Moderately Satisfactory; and overall, Project management has been rated Moderately Satisfactory, with Financial Management rated Moderately Satisfactory, and Procurement remaining Satisfactory.

11. The most recent financial management review was carried out in January 2012 and covered budgeting, staffing, account systems, internal and external audit, flow of funds, and banking arrangements. The project has been using excel spreadsheet to process transactions and prepare reports since May 2011 when the Sun System crashed. The findings show that the financial management of MASAF is generally adequate with the exception of manual processing of transactions and reports that is error prone and consequently the FM was rated as moderately satisfactory. The implementing entity is compliant with the Bank’s financial management requirements; and there are no overdue audit reports and interim financial reports. Historically, annual audited financial statements have been received on a timely basis. The Audited Financial Reports have been prepared and submitted on time. All the reports have carried a clean audit opinion. The Technical Support Team is replacing the crashed Sun System with TEMPRO System which will be operational by June 30, 2012. Taking these factors into consideration, the financial management risk associated with this project has been rated moderate, and the same will apply to the second Additional Financing.

12. At the Local Councils level, the Project will continue to use the Integrated Financial Management System (IFMIS) which now has added modules for project management, whereas in LCs where the IFMIS is not yet operational, the Local Authority Management Information System (LAMIS) will be used for the Second Additional Financing. The LAMIS has the ability to track physical and financial information pertaining to community-level investments.

14. Overall, the Project is in compliance with the applicable legal covenants. However, as noted by the appraisal mission, progress has been made towards full compliance with the safeguards covenant, given that by January 2012: (i) most of the previously vacant Environmental District Officer positions have been filled; and (ii) the Technical Support Team had carried out the orientation of the 27 Environmental District Officers now in place
and the district environmental subcommittee members to enhance their understanding of environmental assessment and monitoring at all stages of the sub-project cycle to ensure full compliance with the Original Project’s covenants. Following the May 2012 AF preparation mission, the government has prepared a comprehensive status report showing progress made on Safeguard issues and clear action plans for addressing the remaining issues in a few months to come.

7. **Sustainability**

An analysis of the PWP interventions in Malawi shows that they are wholly funded by donors. In order to build financial sustainability, the Government will start and increase gradually the percentage share PWP of the total budget. This will take place after an expenditure review has taken place. However, the current PWP under the MASAF 3 have led to sustainability at household level in as far as the beneficiaries are linked to the community savings and investment promotion which enables them to generate additional income which they use for household enterprises and mitigating other risks they face (Beneficiary Assessment, 2012).

8. **Lessons Learned from Past Operations in the Country/Sector**

The implementation of the MASA 3 APL II and the first additional financing supported poor households to move to improved household income which has enabled them to enhance their livelihoods and enabled them to access basic household needs (such as education, health, food security) as discussed below (BA 2012).

The Public Works Tracking Studies and the Beneficiary Assessment Survey (2012) both found that the program has been effective in addressing food security, improving households’ access to health and education services and also contributed in formation and protection of household assets. The improved household income has enabled the beneficiaries to enhance their livelihoods by purchasing farm inputs (34.6 percent of PWSP wages were used to procure farm inputs); buying food for their families (62 percent of the PWSP wages went into buying food); meeting their health needs (10.6 percent of beneficiaries of PWSP spent their wages on health related expenditure); and covering education needs (12.6 percent of PWSP beneficiaries spent their wages on education). However, the studies also show that duration is too short to offer significant insurance and provide predictable source of income to poor households. Beneficiaries are proposing a longer PWP intervention of up to 3 months. The MK 200 per day wage rate has been in place since APL II started thus it has been eroded by inflation over time, and coupled with the recent exchange rate liberalization, the beneficiaries are getting less than a dollar a day. Coverage of the program is low such that up to 25 percent of the beneficiaries reported to be sharing both the work and the wages. This was observed by the Beneficiary Assessment (2012) as a way of building social capital within the community.

Experience in the Original Project, the AF I and in Tanzania, has shown that the Community Savings and Investment Promotion (COMSIP intervention puts the beneficiaries on a pathway to getting out of poverty. In order to ensure the continuity of the complementary community savings activities encouraged in the MASAF 3 APL II program the AF II will continue to support the Community Fund sub component. This additional support will strengthen the existing efforts and would ensure that the activities continue during the scaled up PW implementation. Where the PWP beneficiaries have been linked to Community Savings and
Investment Promotion intervention, the increases in household income have been phenomenal up to USD 13 per person in their passbook against the US$3 at entry of the program (Beneficiary Assessment 2012).

9. **Safeguard Policies (including public consultation)**

i. **Environment:** The original project has an Environmental and Social Category B classification and this remains the same for both the first and the Second Additional Financing. The original Project triggered safeguard policies 4.01, 4.09 and 4.12. The same policies are triggered by the Second Additional Financing investments and will be addressed in a similar manner and with the same tools as those prepared for the original project i.e., the Environmental and Social Management Framework (ESMF). The ESMF was prepared and disclosed in country and in the Bank's InfoShop for MASAF 3 APL II in April 2008. This ESMF was used for the first Additional Financing and had been re-disclosed in-country on May 28, 2010 and in the Bank's InfoShop on May 27, 2010. The ESMF was re-disclosed again at the InfoShop and in-country on May 22 and May 25, 2012, respectively. A total of 11 ESMPs have been prepared for the construction of teachers’ houses in the following districts: Kasungu, Dowa, Mzimba, Karonga, Ntchisi, Dedza, Ncheu, Salima, Mangochi, Machinga and Blantyre. The ESMP for Kasungu was already disclosed on May 22, 2012. The ESMPs are prepared in consultation with the Project Management Committees at community level. The Second Additional Financing allocated for public works will target sub-projects that increase community assets and also those that enhance communities’ natural resource management awareness and skills. Nonetheless, as discussed above, an estimated amount to mitigate any identified social and environmental concerns will be included in sub-project plans and budgets. The project has set aside resources for further capacity enhancement at all levels.

However, it is important to note that while MASAF 1 and MASAF 2 focused primarily on the delivery of social and economic infrastructure in support of the government’s poverty reduction targets, the MASAF 3 program is distinguished by its emphasis on: (i) improving the capacity of communities to effectively manage sub-project cycle activities and participate in local development in a meaningful way; (ii) enhancing the capacity of local authorities to deliver services; and (iii) acting as a catalyst for enhancing local government systems as part of the country’s decentralization agenda.

Under Component 1: Community Livelihood Support Fund, the menu of possible investments includes reforestation and tree felling activities. Under MASAF III, in the past 5 years, reforestation activities have yielded a total of 1.44 million ha in reforested areas across the country. The intention and practice, to date, is for communities to harvest the indigenous species used in the reforestation activities for household use to decrease deforestation and degradation of primary forests. Indeed, in an effort to promote environmental sustainability, the project design mandates that a minimum of 20% of the resources used by the communities from this Fund be applied to environmental enhancement subprojects such as the aforementioned reforestation activities.
Under this Additional Financing, since the current cumulative impact of the MASAF III reforestation activities are relatively large in scale with respect to tree planting and harvesting, and since the focus of the Additional Financing is to significantly scale up Component 1 activities, including reforestation and harvesting activities, OP 4.36 is triggered. Note, this OP was not previously triggered as it was not envisioned to be involve such a large area overall. Since OP 4.36 is now triggered, the Borrower will update the previously approved project ESMF to reflect the core considerations of this OP and include guidelines for preparation of forest management plans for each community that uses this Fund for reforestation and harvesting activities.

ii. Social Impacts. Social impacts are expected to be positive, with project activities would gradually lead to an improved quality of life for food-insecure and vulnerable groups by enhancing their access to social and economic opportunities. In addition to the advantages accruing to the target beneficiaries, there will be increased economic activity in the area surrounding the sub-project and in the rural economy. The project ensures that women are included to access the opportunities available. The vulnerable poor that cannot work at the PWP interventions will be included in the direct cash transfers. Public works beneficiaries will be selected through community-based participatory methods as in the case of the original project, which have been found to reach the intended beneficiaries successfully, as confirmed in the MASAF 3 APL II public works program baseline analysis and the Beneficiary Assessment (2012). There will be increased individual participating in savings to support beneficiaries in asset building and stop using negative coping mechanism when a shock occurs.

However, due to the fact that small works might be required under individual subprojects that may lead to loss of access to resources or livelihoods, OP 4.12 was triggered by the original Project. Given that the Additional Financing would finance similar investments that might require small works that that may lead to loss of access to resources or livelihoods, OP 4.12 was also triggered by the Additional Financing. To attend to the requirements of OP 4.12 under the original Project, the borrower prepared a comprehensive Resettlement Policy Framework (RPF), which provides detailed social safeguards policies and procedural guidance. This RPF will also be used to meet the requirements of OP 4.12 with respect to small works that may impact community access to assets under subprojects supported under the Second Additional Financing. To date no RAPs have been prepared because there has been no land acquisition for the projects funded from the credit proceeds. All social issues will also be reported accordingly. This instrument is to be applied in tandem with the ESMF for the Second Additional Financing investments. Ongoing support on the social safeguards side will be provided during implementation of the Second Additional Financing in close collaboration with the Bank’s social safeguards expert assigned to this Project. Overall, the safeguards work presents a minor to moderate risk to the proposed operation.

10. List of Factual Technical Documents

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