

**PROGRAM INFORMATION DOCUMENT (PID)  
CONCEPT STAGE**

Report No.: AB7221

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<b>Operation Name</b>	Malawi Development Policy Operation 1
<b>Region</b>	AFRICA
<b>Country</b>	Malawi
<b>Sector</b>	General agriculture, fishing and forestry sector (20%);General industry and trade sector (20%);Central government administration (20%);General public administration sector (20%);Public administration- Other social services (20%)
<b>Operation ID</b>	P133663
<b>Lending Instrument</b>	Development Policy Lending
<b>Borrower(s)</b>	GOVERNMENT OF MALAWI
<b>Implementing Agency</b>	
<b>Date PID Prepared</b>	September 27, 2012
<b>Estimated Date of Appraisal</b>	April 5, 2013
<b>Estimated Date of Board Approval</b>	May 28, 2013
<b>Corporate Review Decision</b>	Following the corporate review, the decision was taken to proceed with the preparation of the operation.
<b>Other Decision {Optional}</b>	<i>Teams can add more if they wish or delete this row if no other decisions are added</i>

**I. Key development issues and rationale for Bank involvement**

**The new administration under President Mrs. Joyce Banda, which came into office in April 2012, has made good progress in the implementation of the critical macroeconomic and structural reforms since May 2012.** These reforms have facilitated the removal of market distortions (especially in the petroleum sub-sector and foreign exchange markets) and the strengthening of the macroeconomic management while putting in place programs to cushion the poor and the most vulnerable from the impact of the adjustment process. The Government of Malawi's (GoM) efforts to address some of the governance concerns and the normalization of relations with its neighbors and the international community, has yielded positive results as evidenced by improved relations with Mozambique and the resumption of the budget support and significant increases in aid inflows, in the form of dedicated grants.

**While the foundation for the economic recovery has been laid, the recovery remains rather fragile buffeted by a much more difficult external environment.** The significantly reduced tobacco production in the 2011/12 season meant much lower than projected accumulation of foreign exchange from tobacco sales and inadequate supply of foreign exchange in the system, which in turn started to exert significant pressures on the kwacha since September 2012. The country is also trying to respond to the impact of drought conditions in the southern half of the

country, which has left close to 2 million people under threat of being food insecure in the period before the next harvest in March 2013. The recovery process also continues to be affected by inadequate power supply, the rising cost of doing business and the fact that the economy continues to remain undiversified.

**In spite of these challenges, the Government of Malawi remains committed to these reforms.** Through the Public Finance and Economic Management Reform Program (PFEMRP), the authorities continue to implement critical PFM reforms to improve the credibility of budget, strengthen internal controls, address the domestic payment arrears problem, improve the timeliness of follow-up on audit recommendations and tax administration, all of which are supported by this operation. The authorities are also pushing forward reforms to improve the regulatory and legal environment for the energy sector with a view to create a conducive environment that would attract Independent Power Producers, while at the same time adjusting the electricity tariffs towards the regional rates. To support the agriculture modernization and transformation of smallholder subsistence farmers, the authorities are in the process of reviewing the important legislative and regulatory pieces, including the Seeds Act, to create conducive environment for smallholder farmer to be able to participate effectively in the growth and poverty reduction processes, as well as improve efficiency in the fertilizer market.

**Evidence from 2010/10 Integrated Household Survey clearly indicate that growth has not been as inclusive**, especially in the rural areas, where poverty has increased from 55.6 percent in 2005, to 56.6 percent in 2011. While poverty has remained stagnant nationally, urban poverty has been reduced from 25.4 percent in 2005 to 17.3 percent in 2011. This gain was counterbalanced by a slight increase in rural poverty from 55.9 percent to 56.6 percent. Evidently, improvements in consumption and welfare in urban have been significant and broad based, which reflect that fact that the urban population have responded positively to the GoM's policies implemented over the recent past. Despite large state outlays targeting the rural communities (eg. Farm input Subsidy Program and extension services), real consumption of the poorest in rural areas has declined and income inequality has increased from 0.34 to 0.38. There is therefore the need to promote the leading role for rural growth and development, with a substantial focus on smallholder agriculture, tourism development, infrastructure, and other non-farm employment creation in support of a more inclusive growth agenda. Efforts are also underway to improve the efficiency in the coordination of social safety net programs through the harmonization of targeting system, maintaining a unified national registry of beneficiaries, among others, with increased focus on more productive social protection interventions.

## **II. Proposed Objective(s)**

The operation aims to: i) strengthen macroeconomic and public financial management through reforms geared towards improving budget credibility, strengthening controls, reporting and oversight of government finances, as well as improving tax administration; and, ii) promoting economic development and diversification through the implementation of reforms that focuses on removing constraints to growth (e.g. energy) and promoting economic diversification through agriculture modernization and transformation, improving statistics, and enhancing efficiency in the provision of social protection. The rationale behind the proposed operation is the need to help the government consolidate the implementation of the macroeconomic and structural reforms

supported through the Rapid Response Program as well as to prepare the ground for longer term structural reforms in the post-2014.

### **III. Preliminary Description**

The Development Policy Operation series will focus on two policy areas below:

**i) Strengthening Macroeconomic and Public Financial Management:** Where support will focus on broad reform program on macroeconomic management and the management of the public resources. Specifically, it covers two specific reform objectives, namely: i) supporting macroeconomic stability and fiscal consolidation through clearance of payment arrears and improvement in tax administration; and ii) enhancing the efficiency and transparency of the public financial management by improving controls, reporting and oversight of government finances at national and sub-national levels.

- **Prior action 1:** The Recipient, through the Ministry of Finance, has validated the outstanding payment arrears and developed the arrears clearance plan. This will help support the fiscal consolidation process and restore the credibility of the budget.
- **Prior action 2:** The Recipient, through the Malawi Revenue Authority, has rolled out of self-assessment scheme (SAS) for filing tax returns by Large Tax Payers. This will help improve the domestic resource mobilization to restore fiscal sustainability and credibility of the budget.
- **Prior action 3:** The Recipient, through the Minister of Finance, has approved the Budget Policy Framework Paper for 2013/14. This will help improve the use of MTEF as a strategic planning and budgeting tool and will also aid the government in addressing efficiency issues in the budget over the medium term, which will ultimately create the much needed fiscal space.
- **Prior action 4:** The Recipient, through the Ministry of Finance, has submitted Treasury Minutes for 2006/2007 to Parliament. This will help strengthen accountability and minimize waste in the use of public resources through timely follow-up of audit recommendations.
- **Prior action 5:** The Recipient, through the Ministry of Finance, has instructed 10 largest spending ministries<sup>1</sup> to ensure that their internal audit committees are functional as evidenced by the issuance of IAC meeting minutes. This will help strengthen the institutional mechanisms for the follow-up of audit recommendations and reduce incidences of unresolved audit queries.

**ii) Promoting Economic Development and Diversification:** Focus will be on supporting the recovery process and the drive towards a more broad based and inclusive growth through measures to strengthen reforms in the energy sector, promote the modernization and transformation of the agricultural sector, strengthen the country's statistical capacity and improved the targeting of social safety net system.

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<sup>1</sup> Health, Education, Agriculture, Finance, Office of the President and Cabinet (OPC), Transport and Public Works, Home Affairs, Defense, Local Government, and Energy and Mines

- **Prior action 6:** The Recipient, through the Malawi Energy Regulatory Authority, has started to undertake monthly reviews of the Automatic Tariff Adjustment Formula for electricity. This will enable the Utility Company to meet its operational costs and more closer to the average regional rate to attract private sector players in the market.
- **Prior action 7:** The Recipient, through the Ministry of Agriculture and Food Security, has assessed the legal and regulatory framework for quality seed production. This will improve the legal and regulatory framework for seeds production, marketing and quality control.
- **Prior action 8:** The Recipient, through the Ministry of Agriculture and Food Security, has revised the Farm Input Subsidy Program (FISP) fertilizer procurement modalities with a refined bid evaluation methodology. This will improve efficiency in the fertilizer market and help reduce the fiscal burden.
- **Prior action 9:** The Recipient, through the Office of the President and Cabinet, has finalized and approved the National Social Support Program. This will help improve efficiency and targeting of social safety net system and move towards more productive social protection.

#### **IV. Poverty and Social Impacts and Environment Aspects**

##### *Poverty and Social Impacts*

The proposed operation is expected to have positive or neutral impact on poverty and social conditions in Malawi. Strengthening of macroeconomic and public financial management will enhance efficiency of spending as well as efficiency in the delivery of key services. These reforms will also help reduce wastage of resources and improving accountability in the use of public resources. This is expected to improve the GoM's capacity to more effectively manage its resources and the savings generated could be used for investment purposes. These investments are also likely to benefit lower income groups through job creation in constructions of public infrastructure, among others.

Reforms under this program will therefore help improve the cost effectiveness in the procurement of fertilizer under FISP and the policy environment for enhancing seed production. The proposed measures will enhance productivity of smallholder farmers through use of quality seeds and modern ways of farming, and will also help improve the coordination mechanisms for the provision of social safety nets as well as the targeting of existing programs, which will help bring about quick gains for the poor and most vulnerable groups. The improved targeting is especially important for women as poverty incidence for women tends to be higher. This will help improve the welfare of low-income groups, especially women and children, by ensuring that those exposed to shocks at any given time are reached on time. The improvements of statistical capacity and M&E systems will allow for better targeting of social program in the future. Reforms in the energy sector are likely to have an intended negative impact on the poor through rising prices. It should be noted that the country's electrification rate is very low at about 8.7 percent- as such majority of the poor do not have access to electricity.

## *Environment Aspects*

The specific actions supported the DPO series are not expected to cause significant effects on the environment, forests, and other natural resources of Malawi. The policies supported under this programmatic DPO largely touching on institutional and regulatory environment. Economic governance reforms should lead to more efficient use of public resources, which may indirectly generate environmental benefits in the form of better use of modern technologies. Environmental issues related to irrigation and agriculture intensification activities are already being taken care of through the existing sector investment lending operations, which have their own safeguard instruments and proper monitoring of environmental issues. While reforms in the energy sector are focusing on improving institutions (cost effectiveness in the provision of electricity) and the regulatory environment, there are potential indirect effects.

## **V. Tentative financing**

Source:	(\$m.)
BORROWER/RECIPIENT	0
IDA Grant	50
Borrower/Recipient	
IBRD	
Others (specify)	
	Total

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