PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

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Operation Name	Malawi Resilience DPO
Region	Africa
Country	Malawi
Sector	Central government administration (70%); General public administration sector (30%)
Operation ID	P153753
Lending Instrument	Development Policy Lending
Borrower(s)	Republic of Malawi
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Implementing Agency	Ministry of Finance, Economic Planning and Development
Date PID Prepared	June 7, 2016
Estimated Date of Appraisal	October 10, 2016
Estimated Date of Board Approval	December 6, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

Malawi's medium term development program is anchored on the Second Malawi Growth and Development Strategy (MGDS II), being implemented over the 2011-2016 period. The objective of the MGDS II is to create wealth through sustainable economic growth and infrastructure development as a means of achieving poverty reduction. The program is built around six strategic pillars: (i) sustainable economic growth; (ii) social development; (iii) social support and disaster risk management; (iv) infrastructure; (v) governance; and, (vi) cross-cutting issues covering issues of gender, capacity development population, employment and productive activities. The implementation of MGDS II is now approaching is completion point, with most of the strategy's laudable objectives remaining unmet. Macroeconomic instability, together with the breakdown of Malawi's public financial management system, and the resultant loss of on-budget development assistance, plus exogenous weather shocks have all played a role. This has triggered significant reflection ahead of the preparation of Malawi's next medium term development strategy beyond 2016. Key lessons learned include the need for a more realistic set of assumptions, including on the availability of financial resources, a more prioritized set of focus issues, and a greater focus on the "how to" of development rather than the "what to". The Bank is supporting this process, including through the preparation of a new Country Economic Memorandum (CEM) which will inform the preparation of the new strategy.

Since the election of a new Government in April 2014, Malawi's short-term policy focus has been driven by twin public financial management and public service reform plans. The Public Financial

Management (PFM) Reform Program, approved in January 2015 and prepared with the support of the IMF, is aimed at restoring financial controls and accountability through a series of short-term measures that emerged as a result of the "cashgate" scandal. To address the longer-term structural issues that have degraded the effectiveness of Malawi's public sector, the new Government commissioned an independent Public Service Reforms Commission. The key findings of this Commission, which reported in February 2015, form the basis of an ongoing public service reforms program being overseen by the Office of the Vice President.

Malawi is facing a twin crisis arising from two separate issues, these being vulnerability to climate shocks and fiscal management challenges. Both issues would be causing macroeconomic instability on their own, but together the impact is amplified. The vulnerability to climate shocks is being manifested in the declining growth rate and deteriorating poverty outcomes. Existing fiscal pressures are being exacerbated by pressure from weather shocks. However, even without these shocks, the fiscal pressures alone would be a significant problem. In particular, the current tendency in fiscal policy towards cutting development expenditure to make space for overruns in recurrent expenditure will cause long-term damage. Thus the two sources of fragility exacerbate each other.

Critical reforms are necessary for Malawi to restore macroeconomic stability and increase resilience. The current food security crisis has added urgency to the need to undertake difficult reforms. The proposed program outlines a series of initial policy and institutional reforms that the Government of Malawi is undertaking in order to reduce distortions in the agricultural sector, as well as boosting growth and resilience; and to restore basic public financial management and accountability systems.

The proposed operation is high risk and intended as a stabilizing measure given the multiple shocks that have affected Malawi. Equally the proposed operation, and the emerging reform agenda that it seeks to support, is high return and represents a necessary first step towards a more stable and resilient pathway that would in turn lead to sustainable economic growth and poverty reduction in Malawi.

II. Proposed Objective(s)

The objective of the proposed Resilience DPO series is to lay the foundations for a more resilient economy. Reducing agricultural market distortions, improving incentives for commercialization and restoring fiscal balances are essential prerequisites for sustainable economic growth and poverty reduction. These objectives support the Government's priorities as outlined in the Second Malawi Growth and Development Strategy (MGDS II), as well as the broader World Bank Group goals of ending extreme poverty and boosting shared prosperity.

The expected results of the program include:

- Reorientation in the objectives of the Farm Input Subsidy Program towards boosting agricultural productivity, increasing fiscal space via a reduction in the scale of subsidies and increased efficiency of distribution.
- Maize markets work more effectively, resulting in reduced intra-seasonal price volatility.
- Improved incentives for commercial maize production.
- Reduced trade facilitation costs for imports and exports.
- Reduced costs of collateral for accessing finance.
- Improved land administration and tenure security
- Increased social safety nets for poor households.
- Strengthened management of the public sector wage bill.
- Improved transparency on the use of public funds, achieved via a reduction in the backlog of

published financial statements.
- Established operational independence of the public external audit function.
- Increased managerial accountability on the use of public funds, achieved via a reinstatement of monthly reporting by Controlling Officers.

III. Preliminary Description

The program includes two pillars of policy and institutional reforms aiming to contribute towards improved resilience: (a) making agricultural markets work—with an objective of reducing distortions and supporting the establishment of a growth and resilience oriented agricultural policy environment; and, (b) restoring accountability and confidence in public finances—with an objective of improving financial reporting, oversight and public expenditure management.

The proposed Resilience DPO supports the following prior actions:

- **A more efficient FISP scheme that imposes a reduced fiscal burden on Government.** Proposed reforms in the agricultural sector, supported under the DPO series, could build upon the longstanding engagement and policy dialogue between the Government and Donors on agricultural public expenditure issues in the framework of the Agriculture Sector Wide Approach (ASWAp). This dialogue is supported by the Agriculture Public Expenditure Review which highlights the growing share of the FISP in the budget of the Ministry of Agriculture and in the overall Government's budget, reaching 75 percent and 7 percent respectively in 2014/2015. While the role of FISP in increasing maize productivity and production in the country is widely recognized, the program is however dominating the overall agricultural budget and crowding out other important investments in agriculture. The FISP is also widely considered to be inefficiently implemented and has been a major source of budget overruns in recent years. One reason for the high costs of FISP is the extremely high subsidy rate, with farmers paying as little as three percent of the "market" price of fertilizer. Lowering the rate of subsidy by increasing farmers' required contribution would reduce Government costs. In addition, logistical costs could be reduced by involving private suppliers in the retail distribution of fertilizer, building upon the successful FISP experience with seeds which are delivered to farmers by private seed companies using their networks of rural outlets.

- **Improved maize price stability and production incentives, helping to break the cycle of food insecurity.** Over the past years, through sector operations, the Bank along with other donors has been advocating for proposed revisions to the management and operational modalities of Malawi's Strategic Grain Reserve (SGR). Following the guidelines presented in the Bank's publication on "Using public food grain stocks to enhance food security" (September 2012) and lessons learned in Malawi and other countries, the policy dialogue has been mainly focusing on clarifying: (i) the SGR objectives, especially on the dual approaches of the Malawi SGR around humanitarian assistance and price stabilization; (ii) the optimal level of maize reserve; (iii) the most efficient maize restocking and purchase modalities; and (iv) the appropriate, transparent and evidence-based mechanisms, for maize release. A study to analyze all these dimensions is being commissioned by MoAIWD with support from the ASWAp-SP. The guidelines for procurement, storage and drawdown of grains from the SGR for emergency and non-emergency purposes are currently under preparation. The government of Malawi has instituted a study to review the current grain management and release of maize from the SGR and develop guidelines to improve management of the SGR. Once the study is concluded, it will improve management efficiency of the SGR and provide comprehensive guidelines for emergency and non-emergency drawdown of maize from the SGR. In addition, a strategic review of ADMARC's functions, governance arrangements and oversight mechanisms provides an opportunity to consider critical reforms that would improve predictability and reduce distortions in Malawi's agricultural markets. Similarly, a review of the Control of Goods Act, provides an opportunity to reduce the discretionary powers that allow for the imposition of export bans or compulsory licensing requirements, which serve to undermine production incentives.

- **A more predictable and transparent investment climate for commercial agriculture and agribusiness.** Every member of the World Trade Organization (WTO) has an obligation under Article X of the General Agreement on Tariffs and Trade to publish all trade related information promptly and transparently. More specifically, Article 2.3 of the WTO Trade Facilitation Agreement requires that such information should be published on the internet. The Trade Portal is a tool which will enable these commitments to be fulfilled and to be widely seen to be fulfilled by the world at large. **In** Malawi, transparency regarding which trade regulations are currently in force is lacking. As a result of limited transparency, traders often arrive at borders without all relevant documentation, resulting in delays and increased costs as traders need to complete the required documentation, which is often only possible in Lilongwe. To address this issue, Malawi prioritized increasing transparency by including the introduction of a Trade Portal in the DTIS Action Matrix outlining the key priorities for reform. The Malawi Trade Portal will be a website that contains all regulatory trade related information for import, export and transit. This information will comprise all laws, regulations and other legal instruments, all license and permit requirements, prohibitions, restrictions, technical standards, sanitary and phytosanitary measures (generally known as non-tariff measures), the entire commodity classification and tariffs, all procedures for license/permit application and clearance, copies of all forms as well as plain language instructions. This information will be collected from all the agencies that carry out a control function in relation to import/export/transit control, e.g. Customs, Trade and Industry, Agriculture, Health, Quarantine, Transport, Science/Technology, etc. The information will be aggregated and integrated on the Malawi Trade Portal so that it can be presented dynamically in response to traders' queries the objective being that traders would be able to see, in response to a single query, all the obligations they need to comply with in order to import or export specific goods.

- **Restored basic financial controls and accountability; improved transparency and financial reporting on a regular and consistent basis.** All governments are liable to be transparent and accountable for the public funds they manage and the Government of Malawi is no exception. This is done through regular financial reporting to the public. The Public Finance Management Act (PFMA) 2003 provides that on quarterly basis, a summary of receipts and payments shall be prepared within a month after each quarter-end and sent to the Auditor General. This statement is to be published in the Gazette. The PFMA also provides that not later than October 31 of each year, the annual financial statement shall be prepared and submitted to the Auditor General. The Auditor General is required by the PFMA to complete his audit and return the audited financial statement to the Secretary to the Treasury by December 31 and the Minister shall lay the statement before the National Assembly. These reporting requirements are currently not complied with and bank reconciliation statements are carrying huge amounts of unreconciled items or "discrepancies". The latest audited annual financial statement is for the year ended 2011 and the date for the latest quarterly summary of receipts and payments of the Consolidated Fund is unknown. Clearing the discrepancies on the bank reconciliation statements, restoration of quarterly and annual financial reporting and publishing them up-to-date are basic prerequisites for the resumption of budget support.

- **Strengthened managerial accountability by ensuring compliance with rules and procedures.** Compliance with rules, regulations and internal controls is also key to restoring confidence in the public financial management system in Malawi. Several violations have been reported and documented by the auditors but efforts at implementing these audit recommendations have not been satisfactory over the years. It is therefore necessary that when audit observations and recommendations are adopted or approved by the Parliament, the decisions are communicated to the Ministry of Finance by the Public Accounts Committee. The Ministry then has a duty to ensure implementation of the decisions of Parliament and report back to the Public Accounts Committee through the issuance of treasury minutes explaining the actions taken in each case. The latest treasury minute was issued in 2013 on the audit reports of 2011.

- **Independence of internal and external audit to provide assurance that PFM systems are working as required.** To restore confidence in the public financial management, it is crucial to strengthen the oversight duties of both internal and external audits. The internal and external audit function across the Government remains weak and as such the ability of Government to assess with reasonable credibility, the cost-effectiveness of the internal controls and projects undertaken with public resources is limited. At the present time, the internal and external audit functions provide very limited assurance of the public financial management system. It is therefore necessary that changes be made in the legal framework to (i) ensure independence and professionalism in internal auditing, (ii) provide the Central Internal Audit Unit with the mandate to oversee internal auditing in the public sector, provide guidance, professional development, quality assurance, and follow-up on audit findings, and (iii) establish the reporting relationship between Controlling Officers, Audit Committees and the Central Internal Audit Unit. The Constitution, the Public Audit Act and Public Finance Management Act provide the regulatory framework and for external auditing requirements for government entities and the role of the office of the Auditor General. INTOSAI auditing standards are applied by the office of the Auditor General but the level of compliance with these standards needs to improve.

- **Reduction of payroll fraud, stronger controls, and a more balanced wage bill.** Malawi’s public sector wage bill has grown rapidly over recent years, crowing out of other running costs and making the Government heavily dependent on donor funding for service delivery. The wage bill in Malawi is currently 9.6 percent of GDP and salaries and allowances account for 32.4 percent of the recurrent budget. Past weaknesses in personnel controls have rendered the Government payroll vulnerable to fraud. Accordingly, the Government has initiated a payroll audit exercise, which in the first phase is scrutinizing establishments, nominal rolls, payrolls and actual payments of salaries and allowances. Preliminary indications suggest substantial discrepancies. On completion of the audit, the Government is expected to take action on irregularities. Once this has been done, the Government is expected to proceed with headcounts.

- **Re-established formal systems of personal and financial management accountability, progressive improvement in organizational accountability for service delivery.** Both the recently announced PFM Reform Program and the PSR Program launched in February 2015 stress the need to restore accountability within the public sector in Malawi. At the heart of the Government accountability system in countries like Malawi are the responsibilities attached to heads of ministries and agencies as vote holding “Controlling Officers”. On taking up the post of administrative head of a ministry or agency, the officer concerned is traditionally issued a letter of appointment as “Controlling Officer”, listing his/her statutory duties to ensure compliance by the ministry/agency with financial and personnel regulations, ensure that proper records are maintained, and public assets safeguarded. These responsibilities are spelled out in the Public Finance Management Act 2003 (Section 10), and the Public Service Act 1994 (Sections 21-25). Included also are reporting requirements to the Secretary to the Treasury on financial matters and the Secretary to the Department of Human Resources Management and Development (DHRMD) (on behalf of the Chief Secretary) on personnel matters. This system has broken down in Malawi. Although the role is clearly spelled out in the Permanent Secretary’s Handbook, Controlling Officers are no longer formally appointed, statutory reports are irregularly furnished, and many heads of ministries and agencies do not clearly delegate financial and personnel responsibilities to subordinate officers, hold them accountable for compliance with rules and regulations, and discipline when necessary. Formal systems of management and accountability have thus lapsed into informality. A well performing and accountable

Government cannot be recreated in Malawi unless the personnel and financial management responsibilities of heads or ministries and agencies, as Controlling Officers, are restored.

IV. Poverty and Social Impacts and Environment Aspects

The poverty and social impact of policy and institutional reforms supported under the DPO are expected to have positive or negligible negative effects on welfare and distribution. Reforms supported under the Resilience DPO will both directly and indirectly contribute towards improving livings standards of the poor through reforms to strengthen expenditure management and budget execution, public accountability and transparency, and create additional fiscal space for pro-poor expenditures.

The proposed Resilience DPO is supporting reforms aimed at strengthening macroeconomic and fiscal management, which will contribute towards improved transparency and accountability of public funds, as well as the restoration of fiscal discipline, oversight and controls. Since the budget is an important tool for delivering pro-poor development programs, it is expected that these measures will help improve the Government's ability to direct scarce resources to high impact expenditure programs in the social sectors. Similarly, public sector reforms are expected to help improve the delivery of public services to the population, including vulnerable and disadvantaged groups.

Macroeconomic instability, and in particular sustained high inflation, has exacted a heavy toll on Malawi's population, especially the poor and vulnerable groups who have limited access to safety nets. Restoring macroeconomic and fiscal balances is a key, and necessary, first step towards returning Malawi to a pathway of sustainable economic growth and poverty reduction.

Increased public sector accountability and transparency is expected to benefit all citizens, but particularly disadvantaged groups, including women. Efforts to move towards a more open government and improve public service delivery, as supported under the DPO, can help to offset some of the disadvantages associated with outsider status.

However, reforms to FISP supported under the program are expected to have short-term distributional effects through the reduction in the level of subsidies provided to poor households. While the FISP was never intended to serve as a social safety net, it has in effect acted as a form of cash transfer for land and labor constraints households who have sold on their coupons. These issues are been revised through a comprehensive Poverty and Social Impact Analysis (PSIA) of the proposed FISP reforms.

The prior actions supported by the DPO are not expected to result in significant effects on the environment. The implementation of measures to strengthen the management of public finances, improve accountability in the public sector and reform subsidy programs are expected to have a neutral effect on the environment. However, there are clear linkages between environment degradation and weak macroeconomic management and governance. Hence, it is expected that there will be positive indirect effects on the environment associated with policy and institutional reforms supported under the program.

V. Tentative financing

Source:		($m.)
International Development Association (IDA)		50.00
	Total	50.00

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