

AFRICAN DEVELOPMENT FUND



REPUBLIC OF MALAWI

FOOD CRISIS RESPONSE BUDGET SUPPORT PROGRAMME

APPRAISAL REPORT

OSAN DEPARTMENT

October 2016

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Currency Equivalents

(July 2016)

1 UA	=	1.39884 USD
1 UA	=	995.1698 MWK
1 USD	=	711.4251 MWK

Fiscal Year1st July to 30th June**Weights and Measures**

1 metric tonne (mt)	=	2,204 pounds (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

AISP:	Agriculture Infrastructure Support Project
CABS	Common Approach to Budget Support
CARLA:	Climate Adaptation for Rural Livelihoods and Agriculture
CFRA:	Country Fiduciary Risk Assessment
DCAFS:	Donor Committee on Agriculture and Food Security
DoDMA:	Department of Disaster Management Affairs
DPP:	Democratic Progressive Party
DPS:	Development Partners
ECF:	Extended Credit Facility
ERP:	Emergency Response Plan
FCRBS:	Food Crisis Response Budget Support Programme
FISP:	Farm Input Subsidy Programme
GDP:	Gross Domestic Product
GFEM:	Group on Financial and Economic
GoM:	Government of Malawi
GRP:	Government Response Plan
IFMIS:	Integrated Financial Management Information System
MDGs:	Millennium Development Goals
MGDS II:	Malawi Growth and Development Strategy II
MoAIWD:	Ministry of Agriculture, Irrigation and Water Development
MoFEPD:	Ministry of Finance, Economic Planning and Development
MTEF:	Medium Term Expenditure Framework
MTI:	Ministry of Trade and Industry
MVAC:	Malawi Vulnerability Assessment Committee
NFRA:	National Food Reserve Agency
NPP:	National Procurement Procedures
PAF:	Performance Assessment Framework
PBO:	Programme Based Operation
PFM:	Public Finance Management
PPDA:	Public Procurement and Disposal of Asset Bill
PSRP	Public Sector Reform Programme
SDGs:	Sustainable Development Goals
SGR:	Strategic Grain Reserve
SIVAP:	Smallholder Irrigation and Value Addition Project

GRANT INFORMATION

Client's Information

GRANT RECIPIENT:

Republic of Malawi

EXECUTING AGENCY:

**Ministry of Finance, Economic Planning and
Development**

FINANCING PLAN

	Amount (US Dollars in Millions)
Total Requirements	395.1
Pledges/Financing	
AfDB (ADF Grant)	17
AfDB (SRF Grant)	1
World Bank	173
IMF	49.2
EU-ECHO	12
US	56.5
DFID	31.7
China	11
Japan	7.3
Irish Aid	1.1
Total	359.8
Financing Gap	35.3

ADF Financing Information

ADF Grant:

UA 12 million

Time-frame: Main Milestones

Request from GoM for an ADF Grant	May, 2016
Appraisal Mission	July, 2016
Board consideration of Programme	October, 2016
Effectiveness Grant	October, 2016
Disbursement Grant	November, 2016
Programme Completion (PCR)	October, 2017

ANTICIPATED RESULTS BASED LOGICAL FRAMEWORK

Country and project name: Malawi-Food Crisis Response Budget Support Programme

Purpose of the project: To contribute to the Government of Malawi's Emergency Response Plan to mitigate the current food crisis through the purchase of maize for immediate distribution to vulnerable households.

RESULTS CHAIN		PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/MITIGATION MEASURES
		Indicator (including CSI)	Baseline	Target (June 2017)		
IMPACT	Improved food security situation in the country (Government Emergency Response Plan)	Reduction in the number of food insecure people (proportion)	6.5 million (out of a total population of 17.8 million) (36.5%)	Zero (0%)	MVAC Reports	Risk: Security risks associated with maize importation. Mitigation: Government will initially endeavour to buy maize from within the country and use safe routes when importing the grain. Efforts are being made by SADC member states to ensure that peace prevails in the region.
	Improved food availability (Bank's contribution)	Number of people provided with adequate food under the programme	0	722,000 (51% female) (60 female and child headed households)	MVAC Reports	Risk: Fiduciary risks on use of country systems. Mitigation: The resources 'ring-fenced' and to have dedicated accounts, designated signatories and be audited.
OUTPUTS	Maize purchased and distributed	Quantity of maize purchased (MT)	0	36,100	NFRA Reports/ DoDMA Reports	Risk: Unavailability of maize locally Mitigation: Government will be allowed to import maize from regional and international markets and from large scale companies currently producing maize under irrigation.
	Approved National Irrigation Policy	National Irrigation Policy approval	NIP prepared and submitted to Cabinet for approval (2016)	National Irrigation Policy approved by Cabinet (2016)	NIP and approval letter	

KEY ACTIVITIES	SGR study Report and recommendations adopted	SGR study Report and recommendations adoption	SGR Report completed & submitted to Government for adoption of recommendations therein.	SGR study Report and recommendations adopted by Minister of Agriculture (2016)	SGR and adoption letter	Risk: Politicisation and delays in maize distribution to the target beneficiaries. Mitigation: GoM will engage cooperating partners, WFP and Non-Government Organization (NGOs) identifying vulnerable households and the distribution of relief food maize. This will follow the guidelines from the manual in coming up with the beneficiaries registers and the people and areas in need of food will be established by a professional committee (MVAC).	
	Contract Farming Strategy approved	Contract Farming Strategy in place	Contract Farming Strategy in draft and being reviewed	Contract Farming Strategy approved by Minister of Agriculture (2016)	CFS and approval letter		
	COMPONENTS						INPUTS
	Component 1 : Direct Maize Purchases						Component 1 : UA 12 million

PROGRAMME EXECUTIVE SUMMARY

Programme Name	Malawi-Food Crisis Response Budget Support Programme (FCRBSP)
Overall Timeframe	1 July 2016 to 30 June 2017
Programme Cost	ADF Grant UA 12.00 million
Programme Context	<p>The Government of Malawi (GoM) has been implementing macro-economic reforms aimed at resuscitating the economy since 2011. The reforms, which include foreign exchange market liberalization and removal of fuel subsidies, impacted positively on growth through improved availability of foreign exchange and elimination of fuel shortages. Recent multiple shocks including the suspension of budget support due to loss of public resources through theft (the 'Cashgate'), and food insecurity resulting from heavy flooding and prolonged drought, have negatively impacted on the growth prospects of the economy. These weather related disasters affected 25 of the 28 Districts of the country with 2.86 million people affected in the FY 2014/15. Due to effects of El Nino, about 6.5 million people are food insecure in the FYs 2015/16 and 2016/17. As a result of the drought and floods, real GDP declined to 3% in 2015 from 5% in 2014 following its recovery from 1.9% in 2012. The June 2016 Malawi Vulnerability Assessment Committee (MVAC) Report and Government's July 2016 Emergency Response Plan estimate total cost of addressing the crisis at USD 395.1 million out of which USD 359.8 million has so far been pledged. The resource gap is USD 35.3 million.</p>
Programme Overview	<p>The operation is a Crisis Response Budget Support (CRBS) programme aimed at assisting the Government of Malawi in addressing overall food gap estimated at 970,000 metric tonnes. This will be achieved through direct maize purchases to replenish the Strategic Grain Reserve (SGR) for immediate distribution to the target beneficiaries. The Bank's contribution (UA 12 million) will target the direct maize purchases locally and internationally. The Bank resources will enable Government procure about 36,100 metric tonnes (mt) of maize.</p>
Program Outcomes and Beneficiaries	<p>The FCRBSP will contribute to short-term food self-sufficiency at household and national level and economic stability. It is estimated that the programme will benefit 722,000 food insecure people, most of whom are women and vulnerable children.</p>
Needs Assessment	<p>The design of the operation has been guided by the MVAC Report and the Emergency Response Plan which found that following the floods and drought between 2014/15 and 2015/16 seasons, the number of food insecure people is expected to rise to at least 6.5 million during the 2016/17 season. The crop production estimates released in April 2016 by the Ministry of Agriculture, Irrigation and Water Development (MoAIWD) showed that staple maize production for the 2014/15 agricultural season dropped by 12.4%, and is estimated at 2,431,313 metric tonnes compared to 2,776,277 metric tonnes during the previous season. The national maize requirement is estimated at 3.2 million metric tonnes translating to a maize deficit of about 768,687 metric tonnes. In 2014/15 Malawi recorded another maize deficit of about 223,000 mt.</p>
Institutional Development and Knowledge Building	<p>The Bank will further augment its knowledge in the use of the CRBS instrument to support socio-economic and governance reforms. By using the country systems, in line with the Paris Declaration on Aid Effectiveness, the Programme will contribute to fostering institutional capacity building. The reforms in areas on irrigation, contract farming and strategic grain reserves will further strengthen GoM's capacity mitigate against risks arising from climate change and maize grain storage losses.</p>
Bank's Added Value	<p>The Bank brings into this operation considerable experience in budget support operations, and expertise gained from implementing similar programmes in RMCs. The Bank also add value in terms of dialogue, as it is a member of the Donor Committee on Agriculture and Food Security (DCAFS) group in Malawi.</p>

I. INTRODUCTION

1.1 **Management submits the following report and recommendation for a proposed grant of UA 12.00 million to the Republic of Malawi to finance the Food Crisis Response Budget Support Programme (FCRBSP).** This is a Crisis Response Budget Support (CRBS) programme designed to support the Government of Malawi's (GoM's) request, received in May 2016, to help address the food insecurity situation currently facing the country. The food crisis has exacerbated the fiscal challenges faced by the Government following suspension of general budget support by Development Partners (DPs) since FY2013/14. The Bank has been providing budget support to Malawi since 2002 as part of the Common Approach to Budget Support (CABS) group. However, CABS members suspended budget support in September 2013 following revelation of widespread theft and corruption 'cash-gate' scandal in the Government. The Government is taking necessary measures to address weaknesses that led to the 'cash-gate,' including strengthening internal controls through on-going public financial management (PFM) reforms. The Government has also strengthened its macro- economic policy and structural reforms which has brought the IMF Extended Credit Facility (ECF) Programme back on track following the policy slippage in September, 2015.

1.2 Despite recent improvement in policy performance, Malawi's economic performance and food security situation has worsened. Agriculture, which is the main stay of the economy, is highly vulnerable to weather related shocks which undermines agricultural productivity and consequently food security in the country.

1.3 For almost 8 years, starting from 2005/06 season, Malawi managed to achieve food security through the Farm Input Subsidy Programme (FISP). However, during the past two years, the country has experienced severe droughts and floods which affected crop production resulting in food deficits. These weather related disasters affected 25 of the 28 Districts of the country, with 2.86 million people in need of food in 2014/15. The effects of El Nino in 2015/16 further increased the number of food insecure people to 6.5 million in 2016/17 consumption season. It is therefore imperative to intervene with food assistance to meet immediate food needs of the affected people. The mitigation of the food crisis and building of resilience of the agriculture sector will significantly contribute to macro-economic stability in the country and prevent the erosion of the social development gains Malawi has achieved.

1.4 The Food Crisis Response Budget Support Programme (FCRBSP) is based on the June 2016 Malawi Vulnerability Assessment Committee (MVAC)¹ Report prepared by the Government in conjunction with Development Partners (DPs), and Civil Society Organizations (CSOs). Implementation of the MVAC Response will be through the Government's Emergency Response Plan (ERP, July 2016). The overall goal of the FCRBSP is to contribute to achieving short-term food security at household and national level, and economic stability in the country.

¹ The MVAC comprises Government, Inter-government, academic and non-profit member organizations that seek to provide Information to inform public action. Participating MVAC member institutions include: Ministry of Finance, Economic Planning & Development; Ministry of Agriculture, Irrigation & Water Development; Ministry of Local Government and Rural Development; Department of Disaster Management Affairs; National Statistics Office; United Nations Agencies (WFP; UNDP; UNICEF, WHO, FAO); Irish Aid; and Non-Governmental Organizations (Concern International, Oxfam, Save the Children, Concern Universal, Famine Early Warning Systems Network (FEWS NET), CISANET); and Lilongwe University of Agriculture and Natural Resources (LUANAR).

II. COUNTRY CONTEXT

2.1 Political Developments and Governance Context

2.1.1 Politically, Malawi has been a stable country with few sporadic unrests arising from socio-economic and governance challenges. Multi-party democracy continues to be consolidated. In May 2014, Malawi held its fifth multi-party elections, ushering the Democratic Progressive Party (DPP) into government. The elections were highly competitive and at Parliamentary and Local Government levels, no political party enjoys a clear majority.

2.1.2 Malawi's progress in governance since 2012, as measured by the score on the Country Policy and Institutional Assessment (CPIA) governance cluster, has been steady, though 2014 saw a slight decline compared to 2012 (-0.13). The 2015 Mo Ibrahim Index ranks Malawi 17th out of 54 countries with a score of 57 on a scale of 100, higher than the average for Africa (50). In July 2016, Government tabled in Parliament an Access to Information Bill which, once passed into law, will go a long way in strengthening transparency and accountability. Four land related Bills were passed into law during the same sitting of Parliament and these Bills, once enacted, will improve land related governance. However, theft of public funds in September, 2013 dubbed "*Cash gate*", exposed serious weaknesses in Malawi's Public Finance Management (PFM) system. The scandal eroded confidence of the citizenry, Development Partners, and other stakeholders in the PFM system leading to suspension of General Budget Support. The current administration has shown strong resolve to improve Governance and rectify weaknesses in PFM. Government is implementing the PFM Reform Action Plan, part of a comprehensive Public Sector Reform Programme (PSRP), launched in February, 2015 with a view to improve accountability, transparency and effectiveness in public service delivery. The Q4 (October-December) 2015 update on PSRP implementation shows that there is commendable progress in implementation of the reforms in some areas. For example, the automation of systems at the Directorate of Road Traffic and Safety Services (DRTSS) and the Department of Immigration have led to increased non-tax revenue collection. Improved economic management has earned the country restoration of the IMF Extended Credit Facility (ECF) program. So far, all concluded cases on the 'cash-gate' have led to convictions and Government has successfully recovered some of the assets connected to the theft of public resources.

2.2 Recent Economic Developments²

2.2.1 Malawi's economy has recently experienced multiple shocks, including suspension of budget support and food supply deficits resulting from heavy flooding in 2015 and prolonged drought. The weather shocks have negatively impacted on the growth prospects of Malawi's economy, which is agro based. The agriculture sector contributes 30% of GDP, 90% of national exports, and 80 % of employment. Maize, the main agricultural crop, is key for the agricultural sector growth and food security. According to national crop estimates, maize production declined by 12.4% in 2015/16 compared to 2014/15, and by 42% compared to 2013/14 season. Statistics further show that this is the lowest production for the past 8 years, and the second consecutive year when overall maize production has fallen short of the national food requirements. The sharp decline in maize output and overall agricultural sector growth has contributed to the significantly lower real GDP growth of 3% in 2015 from 5.7% in 2014. Reduced agricultural incomes and

² The sources of the macro-economic data are IMF Country Report No. 16/182, June, 2016 and Malawian authorities

consumer demand, in turn, affected performance of other sectors, particularly wholesale and retail, and manufacturing sectors which account for 20% and 9% of GDP, respectively. Real GDP growth in 2016 is expected to remain subdued at 2.7 % due to the effect of El-Nino induced drought on agricultural production and macro-economic uncertainty caused by high inflation and interest rates.

2.2.2 Besides frequent weather related disasters, maize output growth in Malawi has been constrained by low productivity, estimated between 2.0 to 2.3 MT/ha against potential yields of 8-10 ton/ha. The low maize productivity is attributed to poor access to inputs, credit, extension services - about 13% accessing extension services (National Statistical Office, 2005)- and low irrigation development currently estimated at 104,000 Ha of the potential 408,000 Ha (Irrigation Master Plan, 2015). In addition weak farmer organizations, market information and linkages, and failures in technology transfer have affected maize productivity in the country. The aforementioned sectoral challenges will need to be addressed in order for Malawi to sustain high and stable economic growth.

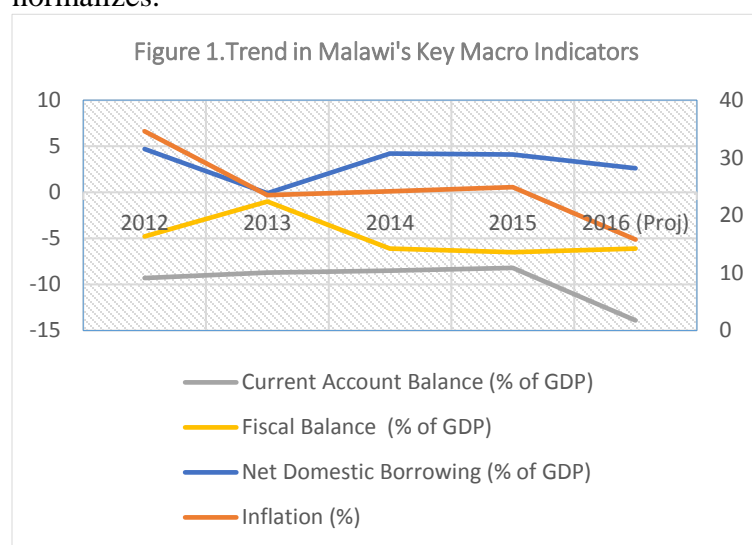
2.2.3 Malawi has faced challenges on the fiscal side in recent years. After a relatively strong fiscal performance in FY 2013/14, Malawi's fiscal position weakened in FY 2014/15. This was due largely to shortfalls in external grants and domestic revenues, coupled with higher than budgeted expenditure on wages and salary, domestic debt interest payments, and fertilizer subsidies. The overall fiscal deficit rose from 1.7 % of GDP in FY 2012/13 to 6.5 % in FY 2014/15, the large part of which was financed through net domestic borrowing³. The Government has strengthened its fiscal consolidation efforts through among other measures, stricter enforcement of commitment controls and reforming the fertilizer subsidy scheme. During the first half of FY 2015/16, Government managed to contain expenditures within budget, ensuring that net domestic borrowing is kept within the ceiling set under the IMF ECF Programme. The need to respond to the food crisis, however, has added to the fiscal pressures. The fiscal deficit in FY 2015/16 is estimated at 5.5 % of GDP and is projected to decline to 5 % in FY 2016/17. Given the limited resource envelop, the FY 2016/17 budget approved by Parliament in July, 2016 stresses fiscal discipline, and has been informed by the Government's short-term and medium term policy priorities. The priorities seek to address pressing socio-economic challenges as follows: a) increase domestic resource mobilization so that tax revenues grow by close to the rate of growth in nominal GDP; b) ensure that adequate resources are allocated for maize procurement and irrigation farming; c) ensure that the wage bill is maintained below 8 % of nominal GDP, while permitting the recruitment of critical frontline staff; and d) ensure that resources allocated to the health, education and other critical social sectors constitute a significant proportion of the budget. Allocations to non-priority expenditures have been cut in order to create fiscal space for pro-poor expenditures and the food crisis response.

2.2.4 Malawi has recorded high and persistent inflation since 2012, due largely to exchange rate depreciation and weak fiscal management. The Reserve Bank of Malawi has kept monetary policy tight, which contributed to the fall in annual average inflation from 28.3 % in 2013 to 21.9 % in 2015. The period October 2014-March 2015 saw a sharp deceleration in inflation, but this trend was reversed from first Quarter of 2015, due to rising food prices and the Kwacha's sharp depreciation on account of a strong US Dollar and macro-economic uncertainty. While the fall in global oil prices has provided some respite, this has largely been offset by the effect of

³ Net domestic borrowing increased to 3.3 % of GDP in FY 2014/15 from a repayment of 0.1 % of GDP in FY 2012/13.

depreciation. Since January, 2016, inflation has gradually eased, driven mainly by the deceleration in non-food inflation, aided by stabilization of the Kwacha and tight fiscal policy. Inflation is projected to decline to 18 % by end 2016. Nonetheless, food inflation, which stood at 27.7 % in June, 2016, is expected to remain elevated following the poor maize harvest caused by the El-Nino induced drought. Current maize prices are approximately 200 % higher than the five year average price.

2.2.5 Malawi has recorded persistent current account deficits reflecting the narrow export base and high import dependence. In 2015, the current account deficit decreased marginally from 8.5 % of GDP in 2014 to 8.2 %. The fall was largely driven by reduced import demand, lower international oil prices, and higher tobacco exports. The current account deficit is projected to widen to 13.6 % of GDP on account of higher level of maize imports to meet the food deficit. The deficit is expected to fall back to within the range of 7 to 8 % of GDP in 2017 as the food situation normalizes.



2.2.6 *Status of IMF ECF Arrangements:* Malawi's ECF Programme was derailed in September, 2015 following slippage on the end June, 2015 net domestic financing quantitative target and PFM related benchmarks. The Government has since strengthened macro-economic and structural reforms which has brought the programme back on track following completion of the seventh and eighth ECF Reviews by the IMF Board in June 2016. In completing the

reviews, the Board also approved extension of the current ECF arrangement to end December, 2016 and augmentation of access by about US \$ 49. 2 million to strengthen Malawi's response to the humanitarian crisis caused by the El-Nino induced drought. The Government is committed to sustaining the reforms under the ECF in order to achieve inclusive growth, reduce inflation to single digit, and maintain foreign exchange reserves at a minimum of three months imports cover.

2.2.7 *Medium Term Economic Outlook & Risks:* Malawi's real GDP growth is projected at 4.5 % and 5 % in 2017 and 2018 respectively. The projected recovery in growth is largely predicated on normalization of weather conditions; alleviation of prevailing food crisis; restoration of macro-economic stability; and rebound in consumer demand and investment. Inflation is projected to fall to 9.4% by 2018 as food supply improves and fiscal consolidation takes hold. The downside risks to the economic outlook, however, remain significant. These include erratic weather pattern and fall in global demand for Malawi's exports.

2.3 Competitiveness of the Economy

2.3.1 Commercial farmers in Malawi are reluctant to invest in the agriculture sector because of Government's intervention in markets, cumbersome export licensing requirements, and discretionary export bans that create uncertainty. This uncertainty affects the country's agricultural competitiveness and leaves Malawi almost entirely dependent on smallholder producers who are the most vulnerable to climatic changes. To break the cycle and avoid recurrence of similar situation, medium to long term reforms are required to encourage commercial farming and create an enabling environment for private sector involvement in agriculture. The reforms, among others, include: (a) encouraging private sector participation through clear policy on contract farming; (b) having an Agriculture Policy that clearly outlines plans to increase production; (c) reforming the arbitrary nature of Control of Goods Act that tends to restrict exportation of certain agricultural commodities; (d) reducing red-tape required to obtain export licences to stimulate investment in agriculture; (e) reviewing and enacting remaining land tenure and related Acts to ease access to land for investment; (f) fulfilling Malawi's commitment to SADC by making the Seed Policy and Seed Act compliant with SADC Seed Harmonization Agreement to increase Malawian farmers' access to quality improved seeds; (g) stabilizing the economy with a view to bring inflation and interest rates down; (h) Creation of a Development Bank or Cooperative Bank targeting, among others, the agriculture sector, will also have some effect in easing access to finance; and (i) purchasing maize locally and soon after the harvest so that (smallholder and commercial) farmers are guaranteed both local and international markets.

2.4 Public Financial Management

2.4.1 The Bank concluded a comprehensive Country Fiduciary Risk Assessment (CFRA) on Malawi in April 2014 which was subsequently updated in November 2014. Further updates of the CFRA were done in July 2016 to take into account the changes within the public financial management arena. The country's PFM systems have come under public scrutiny due to the weak accountability environment and the misuse of public resources. The Government has taken steps to implement the PFM Reform Programme and Action Plan with a focus on the management of government bank accounts, cash management, commitment control systems, budgeting, internal audit, arrears management, reinforcement of the legislative framework and the enforcement of PFM operational guidelines. The role of the National Audit Office (NAO) and Central Internal Audit Unit are being enhanced with a view to reinforce the internal control environment and public accountability. The audited financial statements for the year ended 30 June 2012 were signed off by the Auditor General and tabled before Parliament in December 2014. The Auditor General expects to finalize the audit reports of 2013, 2014 and 2015 by end of 2016. The delays were a result of the absence of the Auditor General following the retirement of the incumbent in September 2012 followed by the revelations of the 'Cash-gate' and execution of two forensic audits of the national accounts.

2.4.2 Over the last three years, fundamental weaknesses have been identified within the internal control environment which enabled the misappropriation of public funds. The poor quality of accounting records, the absence of fundamental controls like bank reconciliations, the overriding or flouting of controls, collusion and weak supervisory practices exposed the Government to significant financial losses. In the Audit Report for the year ended 30 June 2012, the Auditor General indicated that the suspected financial loss amounted to MWK 88.98 billion (approximately USD 121 million at current exchange rates). The Auditor General has engaged the services of

forensic auditors that are currently working to determine the extent of the financial losses. The forensic audit covers the period 2009 to 2013. The Government is undertaking criminal proceedings against persons suspected of misappropriation of the funds in question. In order to support the PFM reform initiatives of the Government, the Bank is financing PFM Institutional Support Project (I and II) whose objectives include the enhancement of transparency, compliance and control in the use of public resources, public procurement reform and the strengthening of revenue administration capacity. In addition to the ongoing PFM reform work, it is essential to have adequate fiduciary safeguards for this proposed programme.

2.5 Inclusive Growth, Poverty and the Social Context

2.5.1 Malawi's progress in poverty reduction has been slow. Currently, about half (50.7 %) of the population live below the poverty line with about 24.5 % living in extreme poverty. Rural poverty has decreased only marginally from 56.6 % (2005) to 55 % currently. Income remains unevenly distributed with a Gini-coefficient deteriorating from 0.39 (2005) to 0.45 currently. Poverty and low human development outcomes have been exacerbated by high household vulnerability to weather shocks and high population growth.

2.5.2 Although Malawi increased its efforts towards achieving Millennium Development Goals (MDGs) targets, only 4 out of 8 were met by 2015. The four MDG targets lagging behind were the eradication of extreme poverty, universal primary education, promotion of gender equity, and reduction of maternal deaths. The unfinished MDG agenda will, thus, taken forward into the Sustainable Development Goals (SDGs) under the successor Malawi Growth and Development Strategy (MGDS, 2011-16) in order to put Malawi on a sustainable development trajectory. Malawi has an exceedingly low Human Development Index of 0.445 (2014), placing it at 173 out of 188 countries. Malawi's 2014 HDI of 0.445 is below the average of 0.505 for countries in the low human development group and below the average of 0.518 for countries in SSA. Malawi's poverty is exacerbated by high levels of unemployment amidst a rapidly growing population. The SDGs for Malawi will thus prioritize gender and poverty related targets that were missed under the MDGs goals.

2.5.3 Malawi performs relatively well on gender related indicators. The Africa Gender Equality Index 2015 of the AfDB ranked Malawi at 5th out of 52 countries, with a score of 72.8 out of 100. The 2014 female HDI value for Malawi was 0.423 in contrast with 0.467 for males, resulting in a Gender Development Index (GDI) (female/male ratio) value of 0.907. For SSA, the GDI was 0.872. However, the GNI per capita, which measures command over economic resources, is 0.679 and 0.815 for females and males respectively. With a Gender Inequality Index (GII) value of 0.611, Malawi is ranked 140 out of 155 countries in the 2014 index. The SSA GII is 0.575. Female participation in the labour market is 84.6 % compared to 81.5 for men. Gender equality is guaranteed by the Constitution and the country has enacted several laws to ensure gender equality. Almost all rural households in Malawi participate in on-farm activities, with more than 60 % of their income coming from agriculture.

2.5.4 Majority of the population is in subsistence farming. The 2013 Malawi Labour Force Survey estimates employment rate at 80%. Males have a higher employment rate than females at 86 % and 74 % respectively. The bulk of employed persons work as own account workers who constitute 54 % of all persons in employment. The agriculture sector employs 64% of the population of which 70% are women. Rural women play a pivotal role as subsistence farmers, yet their productivity is hindered by gender inequalities mainly to do with land ownership and access

to credit. It is estimated that youth unemployment (15-34 years) is at 23% and the rate is high amongst females at 28.3%.

III. GOVERNMENT DEVELOPMENT PROGRAMME

3.1.1 The Government of Malawi (GoM) adopted in April 2011 the second Malawi Growth and Development Strategy II (MGDS, 2011-2016), as its development programme for the medium-term. The MGDS-II aims to create wealth through sustainable economic growth and infrastructure development as a means of achieving poverty reduction. The MGDS II has six thematic areas: (i) sustainable economic growth; (ii) social support and disaster risk management; (iii) social development; (iv) infrastructure development; (v) good governance; and (vi) gender and capacity development. The MGDS II recognizes that its successful implementation depends on the prevalence of good governance, and therefore addresses issues related to access to economic opportunity, efficient stewardship of public resources, promotion of democratic governance institutions, and justice and the rule of law. The 2016 MGDS II Review highlighted various challenges in its implementation, but acknowledged that during the period, Malawi made important progress towards achievement of Millennium Development Goals (MDGs) and in fostering gender mainstreaming in sectoral plans and legislation. The Review noted that most of the assumptions on which MGDS II were premised, including a conducive macro- economic environment and effective aid management, were not realized. During MGDS II period, Malawi experienced high and persistent inflation and rising fiscal deficits. Actual growth (averaging 4%) was below the 7 % target, hence growth was not sufficient to reduce poverty. Cash gate and development partners' suspension of budget support, as well as weather shocks, were among the key factors which contributed to the low growth. The Review has recommended an aggressive economic turnaround strategy. A successor poverty reduction plan, building upon MGDS II, is currently being developed to cover the period 2017-2022.

3.1.2 *Agriculture Sector Strategies:* The Government, cognizant of the significance of the sector, has prioritized agriculture and food security in the Malawi Growth and Development Strategy and has identified the sector as the key driver of economic growth and macroeconomic stability. The sector is dominated by rain-fed agriculture and is therefore vulnerable to weather related shocks which undermine agricultural productivity and consequently food security. It is against this backdrop that the Bank is preparing this proposed program to intervene with short-term measures to address the current food shortage challenges. The Government has also adopted a number of policy and strategic measures which are aimed at addressing some of the medium to long term challenges in the sector. These include: (i) *FISP Reforms*-. Government has agreed to implement some reforms on the FISP program for 2016/17 season in order to improve its sustainability. The reforms include increasing the participation of private sector, reducing number of beneficiaries and budget and increasing farmer contribution; (ii) *National Irrigation Policy*- It aims at addressing critical issues affecting the irrigation sector that include spatial and temporal water shortages; customary tenure land disputes; and poor operation and maintenance of infrastructure. The policy is designed to address the three priority areas of sustainable irrigation, management and capacity development. The policy acknowledges several opportunities that exist for accelerated irrigation development, namely; effects of climate change, public private partnerships, improved governance reforms in water and land management, and increasing interest by stakeholders; (iii) *Agriculture Contract Farming Strategy*- The strategy aims at creating an enabling environment for contract farming activities to take place in Malawi in an efficient, competitive and fair manner. The expected impact is to create wealth, and to reduce poverty and

inequality by increasing profitable market access for farmers and buyers of agricultural output, through contract farming arrangements where appropriate; and, (iv) *Strategic Grain Reserve Study*: The SGR was established as a safeguard against shortfalls in availability of food grains, but has since its inception strived to fulfill its function of ensuring food security with varying degree of success due to inconsistency in production levels, food crisis arising out of natural calamities, and lack of clear guidelines which affected the efficiency of its operations. The study aims at providing improved guidelines for the management of the SGR.

3.1.3 Government is also implementing the social protection programs which include social cash transfer and public works programs targeting mostly the vulnerable households including women and child headed households. These programs help to increase the purchasing power for food and inputs for production amongst the poor households. Government also paid for the Africa Risk Insurance facilities and is also developing a warehouse receipt system legislation to enable farmers' access to fair prices. The Parliament recently approved the Land Bill which will enhance access to land by women.

3.2 Challenges to Sector Development Program

3.2.1 *Agriculture sector development challenges account for Malawi not attaining the 6% Comprehensive Africa Agriculture Development Programme (CAADP) growth target. While the agriculture sector budgetary allocation has surpassed the 10% of national budget target set by CAADP, this has largely been attributed to the allocation of resources to the Farm Inputs Subsidy Program (FISP) which has accounted for over 60% of the total allocation of the MoAIWD. The planned reforms on FISP for the coming year will free some resources which will be allocated to other activities in the sector, such as irrigation, extension and research which are currently underfunded. These interventions will increase the likelihood of Malawi attaining 6% agricultural growth rate. Increased investments in irrigation and water harvesting technologies will help to address the problems arising from dependency on rain fed agriculture. Malawi's agriculture currently depend on rain , with over 90% of production being rain fed and thereby rendering the sector vulnerable to weather related natural disasters. Other challenges include poor access to credit, weak marketing system and weak farmer organizations, and land tenure issues which undermine overall agricultural productivity and incomes.*

3.3 Consultation and Participation Process

3.3.1 Malawi has a history of broad consultation and participation in the development of key strategic and policy frameworks. GoM and development partners have set up functioning Sector Working Groups (SWG) in the Public Financial Management, Agriculture, Vulnerability, Disaster Risk and Management sectors. The MVAC Report and Emergency Response Plan, were prepared by Government in collaboration with Development Partners, NGOs and Civil Society Organisations (Section 1.4). During the programme preparation and appraisal, the following stakeholders were consulted, among others: World Bank, EU, WFP, JICA, Japanese Embassy, Irish Aid, Civil Society Agriculture Network (CISANET) and the Malawi Farmers Union. They all confirmed their support for the Government's ERP and the need to scale up donor support to the crisis.

IV. BANK SUPPORT TO GOVERNMENT STRATEGY

4.1. Link with Bank Strategy

4.1.1 The Bank's 2013-2017 Country Strategy Paper is anchored on two pillars: Pillar 1: *Addressing infrastructure bottlenecks to competitiveness and growth*; and Pillar II: *Support Actions to expand private sector investment and trade*. The proposed programme, being a food crisis response operation, does not fit squarely into any of the two pillars. However, it can be associated with the Second Pillar on enhancing private sector development, by direct purchases of maize from some local companies and engaging the non-governmental organizations in the distribution of the food relief and encouraging the Government to finalize the contract farming strategy. Moreover, by promoting macro-economic stability, the programme will contribute towards creation of an enabling environment for private investment. The program is aligned to agriculture and food security, and social support and disaster risk management priority areas under MGDS II. The operation is also in line with the High Fives on - Feed Africa and Improving Livelihoods by ensuring that all the affected people are food secured and that their livelihoods return to normalcy after the operation (Table 1).

Table 1
Link between the Sector Strategy, the CSP and the Proposed Operation

Sector Strategy and priorities	CSP	Proposed Operation
Agriculture and Agribusiness Strategy: to contribute to Africa's sustainable development and poverty reduction by promoting broad based economic growth, ensuring food security and nutrition and unlocking Africa's agribusiness potential through (i) developing agriculture infrastructure (ii) agribusiness and innovation and (iii) promoting resilience and sustainable natural resources management	Pillar II: supporting actions for enhancing private sector development	Overall objective: to contribute achieving short-term food security at household and national level and economic stability in the country through reduced food inflation Specific Objective: To save lives and restore livelihoods of the food insecure households

4.2. Meeting the Eligibility criteria

4.2.1 The operation is a Crisis Response Budget Support (CRBS) with the following features: (a) it will provide resources to the Treasury to support implementation of the budget FY 2016/17; (b) its objective is to mitigate the adverse effects of the 2015/16 and 2016/17 hunger situation arising from floods and drought in many parts of the country; (c) while, as CRBS, this operation provides little room for policy dialogue, it will influence, and open doors for, policy dialogue in areas of commercial farming, irrigation and management of national strategic grain reserves (SGRs); (d) it will have a one-off, single tranche disbursement to assist GoM to procure maize for the SGRs which will be distributed to vulnerable groups; (e) is using simplified eligibility criteria to respond to the call for partners to assist in addressing the food shortages in Malawi; and (f) while an effort was undertaken to streamline its processing with a view to expedite Bank's contribution to macroeconomic and fiscal stabilization and mitigate the hunger situation, this was hampered by delays by Government to finalize the MVAC Report and ERP which were a prerequisite for the programme design.

4.2.2 Malawi fully meets the two eligibility criteria for Crisis Response Budget Support: (a) commitment to poverty reduction; and, (b) harmonization. On the third criteria, fiduciary risk, the assessment shows the residual risk is ‘substantial’ due to the inherent control weaknesses which comprise the non-compliance with financial management regulations and the overriding or flouting of key controls. However, the operation, which focuses on maize procurement, has put in place measures to ensure (a) the resources are put to the intended purpose; (b) achieve value for money; and (c) are properly accounted for (Pars 6.5.1, 6.6.3, Annex 1 – Vol. 2). Among other measures, dedicated foreign currency and local currency accounts will be opened; funds will be earmarked for maize procurement; authorised signatories will be designated; quarterly reports will be submitted on use of the funds; and an independent external audit shall be undertaken. The Bank opted for this instrument as it is an appropriate instrument that would contribute to fast track additional poverty safety net spending on procuring maize, in order to mitigate the impact of the shock arising from the food shortage crisis.

4.3. *Collaboration and Coordination with other Partners*

4.3.1 The preparation process of this proposed FCRBSP operation was fully consultative involving GoM, DPs and CSOs present in Malawi. Consultations were held with members of the Donor Committee on Agriculture and Food Security (DACAFS), supporting the humanitarian response under MVAC. These included World Bank, DFID, EU, Irish Aid, World Food Program and USAID. The consultations were also held with Civil Society Agriculture Network (CISANET), an umbrella organization for Non-Governmental Organizations operating in the agriculture sector, as well as with the Farmers Union of Malawi (FUM) to exchange views on the objectives of FCRBSP and implementation modalities. Stakeholders noted that the proposed FCRBSP will not only save lives of the affected people, but also contribute to the restoration of livelihoods and building resilience for the next seasons.

4.4. *Relationship with Other Bank Operations*

4.4.1 The Bank Group’s active portfolio in Malawi, as at July 2016, comprised 17 on-going projects for a total commitment of about UA 199.63 million (Annex 10 of Technical Annexes). The portfolio comprises 16 public sector projects and a multi-national project. There is currently no active private sector operation in the portfolio. The sectoral composition of the portfolio is as follows: Agriculture (23%), Transport (32%), Poverty Alleviation and Micro-finance (14%), Water and Sanitation (13%), Education (13%), and Others (5%). The 2016 Country Portfolio Review assessed the overall performance of the portfolio as satisfactory based on Implementation Progress and Results Reporting (IPR) and SAP ratings.

4.4.2 The Bank has successfully implemented seven previous PBOs in Malawi, including the Restoration of Fiscal Stability and Social Protection crisis response budget support (2012), and the Protection of Basic Services Programme (PBS, 2015), and demonstrated ability to engage in policy dialogue with GoM and other partners. The proposed operation will complement on-going operations in agriculture and irrigation, such as the Smallholder Irrigation and Value Addition Project (SIVAP), Agriculture Infrastructure Support Project (AISP), Climate Adaptation for Rural Livelihoods and Agriculture (CARLA) and other operations being processed (the Agriculture Infrastructure and Youth in Agri-Business Project, and the Shire Valley Irrigation Project). The projects aim to mitigate the challenges arising from dependency on rain fed production, such as climate change evidenced by frequent occurrences of droughts and floods.

4.4.3 **Lessons Learnt:** The lessons learnt from the Restoration of Fiscal Stability and Social Protection (RFSSP) crisis response operation, the Protection of Basic Services (PBS), and other PBOs have informed the design of this operation. Among others, the RFSSP found that it is critical that in times of crisis, government should show strong leadership skills in terms of designing and implementing policy reforms, with development partners solely providing advice and financial support. The RFSSP, which enabled the Bank to provide timely and effective financial support to Malawi, proved to be highly effective instrument. Coordination among development partners, the Government and the Bank made it easier to monitor the outcome of RFSSP, through common policy dialogue frameworks such as the Common Approach to Budgetary Support (CABS) framework. Other lessons include: the design is based on national policies with a view to strengthen GoM ownership of reforms; and align disbursement triggers to the harmonized frameworks to reduce transaction costs, enhance timely GoM's achievement of conditions, and increase donor harmonization. In view of all these, the Food Crisis operation: (a) is based on the MVAC and ERP designed by Government with support from other stakeholders; (b) uses the MVAC implementation and M&E frameworks; (c) its focus is based on specific areas of intervention as requested by Government and that will enable the Bank intervene in a timely manner; and (d) disbursement conditions are simplified..

Table 2
Lessons Learned from Previous Bank Operations in the Country

Key lessons learned	Action taken to integrate lessons into the Programme
Country ownership and commitment, including aligning programme to country's development strategy and reform agenda	The proposed operation is based on the MGDS-II and MVAC, and supports policy actions as defined in social support and risk management, and sustainable economic growth Policies and Strategies on social protection, risk mitigation, irrigation and contract farming.
Ensure specificity in the selection of disbursement conditions to facilitate implementation and ease performance assessment	The appraisal of the proposed FCRBSP operation included consultations, on evidence required for disbursement, with Government. The disbursement conditions have been derived from MVAC and ERP which was agreed between Development Partners and the Government.
Shared fiduciary risk analysis and macroeconomic analysis, critical to success, sustainability of budget support in Malawi.	The macroeconomic, fiduciary risk and other underlying analysis were done by the Bank.
Address capacity constraints in implementation of social sector interventions (RFSSP, 2012).	The proposed programme is complemented by a PFM Institutional Support Project (PFMISP I and II) approved in 2013 and 2014. The design of the ISP was coordinated with other DPs.

4.5. Analytical Works Underpinning the FCRBSP

4.5.1 Being a Food Crisis Response operation, the design of the operation has been guided by the Malawi Vulnerability Assessment Committee Report and Government Response Plan. The MVAC has found that, following the floods and drought between 2014/15 and 2015/16 seasons, the number of food insecure people is expected to rise to at least 6.5 million during the 2016/17 season. This figure represents 39 % of the population, an increase of 129 % from 2.8 million people assisted during the 2015/16 response, and will be the largest humanitarian response in the country's

history. The severity of the 2015/16 El Nino was officially announced through a disaster declaration by the President of the Republic of Malawi in April 2016. The MVAC estimates that total humanitarian food assistance required is about 493,000 metric tonnes, with a total maize consumption deficit of 790,000 metric tonnes.

4.5.2 *The Emergency Response Plan (ERP)*, developed by the Government of Malawi in collaboration with the UN through the humanitarian clusters, identifies food security, nutrition, agriculture, health, education, protection and water and sanitation (WASH) as the key priorities for immediate assistance. Based on recommendations from the MVAC, the food security cluster will provide lean season life-saving relief food assistance targeting 236,028 beneficiaries in July 2016, reaching the peak of 6.5 million people by January 2017. The budgetary requirements of the various clusters are presented below:

Table 3
Summary ERP Cluster Budgets

	Cluster	Total Budget (USD)
1	Food Security	307,505,000
2	Agriculture	30,800,000
3	WASH	22,087,500
4	Nutrition	291,48,630
5	Protection	306,926
6	Education	4,237,255
7	Health	1,046,500
	Total	395,131,811

Source: 2016/2017 Food Insecurity Response Plan (July 2016)

Table 4
Breakdown of the Food Security Cluster Response Budget

Food Commodity Item	Tonnage (MT)	Total Cost (USD'000)
Cereal	261,555	87,987
Pulses	52,311	37,272
Super-cereal	15,536	9,469
Super-cereal Plus	10,358	9,371
Vegetable Oil	9,625	7,796
Total	349,385	151,895
Associated Cost		81,800
Total Food and Associated Costs		233,695
Cash and Vouchers Transfers and Associate Costs		73,810
Total: Food, Cash & Vouchers Transfers		307,505

Source: 2016/2017 Food Insecurity Response Plan (July 2016)

V. THE PROPOSED PROGRAMME

5.1 **Programme Goal and Purpose:** The objective of the proposed program is to contribute to achieving short-term food security at household and national level, and thereby contribute to supporting economic stability and social welfare in the country. The purpose of the operation is to assist the Government of Malawi by contributing to reducing the food gap estimated at 970,000 metric tonnes, through direct maize purchases to replenish the Strategic Grain Reserve (SGR) for immediate distribution to vulnerable households.

5.2 **Programme Component:** The Programme is the Bank's contribution to Government of Malawi's Emergency Response Plan to deal with the food shortage crisis, as articulated in the findings of the Malawi Vulnerability Assessment Committee Report. It will target direct food maize purchases locally and internationally, and an amount of UA 12 million has been earmarked for this purpose. The Government, through the National Food Reserve Agency, will buy maize from international sources, as well as from local suppliers that have stocks from the 2015/16 crop. The Bank resources will enable Government procure about 36,100 mt of maize (assuming a landed-Lilongwe price of USD 450 per mt).

5.3 **Policy Dialogue:** Although this is a Crisis Response Budget Support, which is not tied to any specific policy reforms, key policy dialogue, which came out strongly during the preparation of the crisis response operation include the need to fast-track funding to address the immediate food crisis, while encouraging agricultural policies and strategies that will increase resilience in the future. In this regard, the Bank has engaged in policy dialogue on strategic issues that are critical in addressing the main challenges in the agricultural sector and breaking the cycle of food insecurity in the country. Government has appropriately taken short term actions to protect the vulnerable groups during this crisis, and also critical steps for embarking in future reforms in the areas of food security. The Bank will remain engaged and support a collaborative engagement with the Government and Development Partners to create an enabling environment with appropriate agribusiness policies and regulations that foster competitiveness and participation in agricultural value chain. To this end, the Government has taken several measures from the time the Bank initiated dialogue with the Government and submitted documentary evidence to the Bank before the operation is presented to the Board. These are: (i) Cabinet Approval of the National Irrigation Policy, (ii) Adoption of the Agriculture Contract Farming Strategy, and (iii) Adoption of the recommendation of the Strategic Grain Reserve Study (Table 5).

Table 5

Main Measures Taken since the Bank Engaged in Dialogue with the Government on the Operation

Policy Measures	Documentary Evidence
Adoption of the National Irrigation Policy (NIP)	A letter from Ministry of Finance, Economic Planning and Development confirming Cabinet on approval of the NIP.
Adoption of the Strategic Grain Reserve Study Report	A letter from Ministry of Finance, Economic Planning and Development confirming adoption of the SGR Study Recommendations.
Adoption of the Contract Farming Strategy	A letter from the Ministry of Finance, Economic Planning and Development confirming the adoption of the Contract Farming Strategy

5.4 Application of Good Practice Principles on Conditionality: Good practice principles on conditionality have been applied. The monitoring of performance will use country systems, through the MVAC mechanism around humanitarian food response cluster. While the resources will support the 2016/17 national budget, use of a special account method will reduce fiduciary risks associated with weak PFM systems. The resources from the operation will contribute to providing predictable financing for addressing food shortages as well as assisting achieve macro-economic stability.

5.5 *Financing needs and arrangements*

5.5.1 The Table 6 below shows the total financing requirements of the Emergency Response Plan, the available financing and the shortfall:-

Table 6
Financing Requirements of the ERP and Pledges Received

	Amount (US Dollars in Millions)
Total Requirements	395.1
Pledges/Financing	
AfDB (ADF Grant)	17
AfDB (SRF Grant)	1
World Bank	173
IMF	49.2
EU-ECHO	12
US	56.5
DFID	31.7
China	11
Japan	7.3
Irish Aid	1.1
Total	359.8
Financing Gap	35.3

5.5.2 The Bank contribution of UA12 million will meet part of the estimated overall financing gap, and is included in Fiscal Year 2016/2017 budgetary allocation of MWK 35 billion (equivalent to USD 50 million) for maize purchases and winter cropping irrigation. The contributions of other Development Partners will be channeled off budget, and managed through WFP. The IMF food crisis response financing is being provided through increased borrowing limit and will be spent on maize importation to avoid monetary expansion.

5.5.3 The Government FY 2016/17 fiscal framework is presented below (Table 7):

Table 7
Government FY 2016/17 Fiscal Framework

		2016/17 (MWK Million)
A	Total revenue and grants <i>Of which: grants (excl. budget support)</i>	965,767 190,976
B	Total expenditure and net lending <i>Of which: recurrent</i> <i>Of which: capital expenditure</i>	1,136,961 815,541 317,921
C	Overall balance Including Grants (A - B)	-171,194
D	Total Financing	-171,194
	<i>Of which: Net Foreign Borrowing</i>	111,194
	<i>Of which: Net Domestic Borrowing</i>	60,000

Note: The recurrent expenditure includes an allocation of MWK 35.5 billion, equivalent to USD 50 million for maize purchases and winter cropping irrigation.

5.6 Application of Bank Group Policy on Non-Concessional Debt Accumulation

5.6.1 Malawi is an ADF country with a moderate risk of debt distress as determined by the Debt Sustainability Analysis (DSA) by the IMF. Under the amended Bank Credit Policy, Malawi is eligible to access the ADB Sovereign Window to finance strategic and commercially oriented projects subject to (i) determination of headroom availability for Non-Concessional Borrowing by the IMF; (ii) Malawi having been deemed as having a sustainable macroeconomic position following a special risk assessment; and (iii) Malawi's request for financing being approved by the Bank's Credit Risk Committee. Malawi's current Operational Country Limit (OCL) is deemed to be sufficient to finance envisaged private sector operations and public sector operations, once eligible. The IMF's 2016 DSA has determined a head room of USD 71 million for Malawi to be used to finance strategic and commercially viable investment projects.

5.6.2 The new DSA by the IMF conducted in 2016 has revealed that the risk of debt distress faced by Malawi on its external debt remains moderate. The debt situation has, in fact, improved compared to the 2015 DSA due to the re-basing of Malawi's GDP. The Present Value (PV) of External Debt to GDP ratio is projected to decline from 24.5 % in 2015 to 18.1 % in 2018 while the PV of the Debt to Export Ratio is projected to decline from 97 % to 71 %. Similarly, the PV of Debt to Revenue Ratio is projected to decline from 133 % to 98% in 2017. Since HIPC Debt Relief, Malawi's external debt stock has increased rapidly. Malawi's external debt as at end 2015 stood at approximately USD 1.78 billion (37% of GDP). This represents an increase in debt stock levels of USD 873 million from when Malawi qualified for debt relief under HIPC/MDRI. 80 % of the debt is concessional. The recent surge in Malawi's domestic debt has largely been driven by increased domestic financing requirements to meet shortfalls in donor budgetary support. The domestic debt stock rose from MK207 billion end 2012 (14 % of rebased GDP) to MK 538 billion end 2015 (17 % of GDP). Fiscal consolidation is critical to ensure domestic debt sustainability. The GoM has drafted a new Debt Policy, which is geared to ensuring that the debt is prudently managed. The GoM has also reactivated the Debt Management Committee to enhance debt management.

VI OPERATIONAL IMPLEMENTATION

6.1. Beneficiaries of the programme

6.1.1 The Malawi population particularly the most vulnerable will benefit from the FCRBSP. The resources provided by the Bank will contribute to alleviation of food insecurity and restoration of livelihoods for the affected people through provision of relief maize. The program will save lives and restore the livelihoods of about 722,000 people of the 6.5 million people that need urgent food assistance. The relief maize will be distributed to the beneficiary farmers by World Food Program and International NGOs with each beneficiary receiving one 50kg bag of maize per month for a single distribution during the lean period. The cost of transportation and storage will be met by the Government with assistance from the development partners. Since most of the affected people include the resource poor, elderly, children and disabled the programme will help to sustain the livelihoods of the vulnerable and disadvantaged.

6.2. Impact on Gender, Poor and Vulnerable Groups

6.2.1 Women and children who are the most vulnerable will significantly benefit from the provision of food. It is estimated that the majority of the 6.5 million people affected by drought in 2016 are women and children. The agriculture sector employs 64% of the population of which 70% are women. The impact of drought on agriculture is therefore heavily affecting women. Half of the country's (50.7 %) of the population live below the poverty line with about 24.5 %age living in extreme poverty. By creating food insecurity for 6.5 million people, the recent drought is likely to have worsened income poverty. It is currently being estimated that the population of those in extreme poverty has increased to over 30% on account of drought in 2015/16 growing season. GoM estimates that over 60% of those affected are female and child headed households. The medium age of the 20% poorest population is estimated at 13 years thus indicating that the population most affected is also extremely youthful. The food insecurity situation exposes more women and girls to the risks of HIV/AIDS considering the positive correlation of economic poverty and HIV infections. National HIV/AIDS data indicate that HIV prevalence rates are higher than the national average of 9.1% in females aged 15-49 years than males, and higher among girls aged 15-24 years than boys in the same age bracket. In general, poverty and low human development outcomes have been exacerbated by high household vulnerability to weather shocks amongst the key factors.

6.2.2 The provision of emergency food support will have significant positive impacts on women, youth and the poor in general who are most vulnerable. The programme will also have far reaching impacts on other social services including the school feeding programmes, and the health and nutrition programmes whose beneficiaries are largely school going children and pregnant women as well as under five malnourished children. Currently the school feeding programme is being suspended in some rural schools while some nutrition rehabilitation units in rural health centres are dysfunctional due to shortage of maize. This has a negative impact on the achievement of education and health outcomes for the country. The implementation of the food crisis response programme will therefore have to institute measures to ensure that the most vulnerable benefit from the support.

6.3. Impact on Environment and Climate Change: The Programme has been classified as category 3 in the Bank's environmental classification. The program is not expected to generate any significant negative impacts on the environment and climate change, since it focuses on providing budgetary support for food crisis in form of maize purchases and distribution. However, GoM is expected to conduct thorough inspection of the imported maize to avoid introduction of pests and diseases into the country. Government has relevant institutions and facilities to conduct the required phytosanitary measures.

6.4 Implementation, Monitoring and Evaluation

6.4.1 Implementation Arrangements: The Ministry of Finance, Economic Planning and Development will be the recipient of the budget support, while the National Food Reserve Agency (NFRA) will be responsible for the procurement and storage of maize and the Department of Disaster Management (DoDMA) will be responsible for beneficiary identification and monitoring the programme from procurement, storage and distribution to target beneficiaries. The Director, Debt and Aid, MOFEPD, will be responsible for the overall coordination of the programme. The Strategic Grain Reserve and Commercial Maize Committee will serve as the Programme Steering Committee and will be the overall decision making body for ensuring that maize is available in sufficient quantities and quality, and is accessible at all times to all people of Malawi. The Committee is co-chaired by the Ministries of Agriculture, Irrigation and Water Development and Finance Economic Planning and Development. The committee comprises key Government Ministries, Departments, and Agencies; Civil Society Organisations; the private sector and development partner representatives. The National Disaster Preparedness and Relief Committee chaired by the Chief Secretary, and the Humanitarian Response Committee chaired by the Principal Secretary for DODMA will work closely with the SGR committee in identifying humanitarian needs and ensuring that maize is distributed to affected households. The DoDMA will work with the World Food Program and internationally accredited Non-Governmental Organizations for the distribution of maize to the targeted beneficiaries using its own funding from the national budget and from cooperating partners. Based on the successful implementation of the 2015 MVAC, WFP and NGOs have been assessed and found to have adequate capacity to implement the program.

6.4.2 Monitoring and evaluation arrangements: The country monitoring and evaluation systems will be utilized for this operation. The periodic MVAC monitoring reports will form the basis for monitoring and reviewing progress. The MoFEPD, MoAIWD, NFRA, and DoDMA through the aforementioned committees will work closely with WFP and CSOs in monitoring procurement and distribution of maize to affected families. Malawi Country Office (MWFO) will play a key role in the supervision and monitoring of the operation. The program will be jointly evaluated at the end of the operation through a project completion report. GoM and development partners have set up functioning Sector Working Groups (SWG) in the Public Financial Management, Agriculture, Vulnerability, Disaster Risk and Management sectors. SWGs hold regular dialogue through Technical Working Groups with meetings held on quarterly basis and these will provide feedback to the Bank on progress in implementing the program. MWFO will be participating in these meetings.

6.5 Financial Management, Procurement and Disbursement Arrangements

6.5.1. Country Procurement Risk Assessment and Country Fiduciary Risk Assessment (CFRA): The comprehensive CFRA concluded by the Bank in April 2014 (updated in July 2016) underpins the financial management design of the proposed operation with specific regard to the mitigation measures. The overall residual risk rating remains ‘Substantial’, and this risk rating was due to the inherent control weaknesses which comprise the non-compliance with financial management regulations and the overriding of key controls. The Government has taken steps to address public financial management weaknesses, with support from several development partners including the Bank. The various initiatives in the PFM arena fall under the scope of the Public Financial and Economic Management Reform Program (PFEMRP) which is aimed at improving macro-fiscal management, accountability and transparency in public financial management and public oversight. The Bank has supported the reform process through the PFM Institutional Support Project (I and II). The Government’s PFM Action Plan focuses on the management of government bank accounts, cash management, commitment control systems, budgeting, internal audit, arrears management, reinforcement of the legislative framework and the enforcement of PFM operational guidelines.

6.5.2 Procurement

6.5.2.1 The country procurement system has been reviewed by the Bank, together with the updated CFRA results were key in informing the procurement management design of this operation. The results of the assessment concluded that Malawi’s procurement system environment risk for its use in Bank-financed projects is rated at *Moderate*. This is due to the fact that the improvements committed under the 2015 PBS support at completing the legislative, institutional and operational frameworks of the public procurement system are still ongoing. The Table 8 below indicates the agreed Action Plan.

Table 8
2015 PBS Procurement Actions

	Undertaking	Timeline	Responsible Agency
1	Processing of Public Procurement and Disposal of Assets (PPDA) Bill	November 2016 sitting of Parliament	Ministry of Finance Economic Planning and Development
2	Full integration of procurement and payment processes in IFMIS	31 st October, 2016	Accountant General/Office of the Director of Public Procurement (ODPP)
3	Operationalisation of ODPP website	31 st October, 2016	ODPP

6.5.2.2 The Bank is aware that some progress is made to further reform the public procurement in the Country by improving transparency, accountability, and ensuring value for money in public procurement. The national public procurement system and regulations governed by the current Public Procurement Act (2003) has been reviewed by the Bank during this appraisal mission and found acceptable for use under budget support operation. Further, an assessment of procurement capacity of NFRA who have been entrusted with responsibility to manage procurement under this operation was found to be *Satisfactory*. Based on these considerations and the fact this intervention is a crisis budget support, the operation will use the National Procurement System with its relevant Standard Bidding Documents while the ODPP will provide oversight support in the course of project implementation. In accordance with the provisions of Procurement Policy for Bank Group funded Operation, October 2015, a Procurement Audit will be undertaken by an independent auditor to be engaged by GoM at the end of the operation.

6.6.3. Financial Management and Disbursement Arrangements

6.6.3.1 The current PFM environment necessitates fiduciary arrangements that incorporate mitigation measures to address the control gaps. The PBO will be disbursed into a dedicated foreign currency that will be opened in the Reserve Bank of Malawi. Transfers will be made from the foreign currency account to a dedicated local currency account to pay for local expenditures as required. The funds will be specifically earmarked for programme and activities spelt out in the financing agreement. Government will provide letters of undertaking issued by the bank(s) where the accounts will be held, to ensure that the accounts will be managed in accordance Bank provisions. Prior to requesting for the funds, Government shall advise the Bank in writing the designation of authorized signatories

6.6.3.2 All transaction supporting documents shall be systematically retained in accordance with the existing treasury regulations. Transactions shall be fully recorded into the Government's books of account. Quarterly reports will be submitted to the Bank indicating the use of funds under the program for both accounts within 45 days after the end of the respective quarter. In addition, the operation will be subjected to an audit by an external independent audit firm, with the audit report together with the management letter to be submitted to the Bank within six months after the end of the program's life.

6.6.3.3 The National Audit Office will be involved in the process of appointing the firm, as well as agreeing to the audit Terms of Reference, which shall be approved by the Bank. The costs of the audit to be carried out by the private external auditors would be financed by part of the PBO proceeds. In this regard, an external audit firm will be recruited immediately upon the effectiveness of the proposed operation.

VII LEGAL DOCUMENTATION AND AUTHORITY

7.1.1 The Programme will be financed with a proposed ADF Grant of UA 12 million ("Grant") in one tranche expected to be disbursed in November 2016. For the purposes of providing the tranche, the Fund will enter into a Grant Agreement ("Agreement") with the Republic of Malawi ("Recipient") of ADF UA 12 million from the Recipient's ADF 13 allocation. The Grant Agreement shall be governed by the *General Conditions Applicable to Protocols of Agreement for Grants of the African Development Fund* ("General Conditions"), as amended.

7.2 Conditions Associated With the Bank's Intervention

A Conditions precedent to entry into force of the Grant Agreement

7.2.1 The Agreement shall enter into force subject to fulfillment of the provisions of section 10.01 of the General Conditions. Specifically, the Agreement shall enter into force on the date of its signature by the Fund and the Recipient.

B Conditions precedent to the disbursement of the Grant

7.2.2 The Fund's obligation to disburse the Grant of UA 12 million shall be conditional upon the Recipient providing evidence in form and substance acceptable to the Fund of the opening of a foreign currency special account for the receipt of the proceeds of the Grant.

7.3 Compliance with Bank Group Policies

7.3.1 The FCRBSP programme complies with applicable Bank Group policies and guidelines including the Policy on Program-Based Operations (PBOs) and Operational Guidelines on the Programming, Design And Management of Program-Based Operations.

III RISKS MANAGEMENT

8.1 Key risks to implementation and achievement of program objectives and measures for the mitigation of the risks under the program are outlined in the Table 9 below.

Table 9
Risk Management

POTENTIAL RISKS	RATING	MITIGATION MEASURES
Unavailability of maize locally	Medium	Government will be allowed to import maize from regional and international markets and from large scale companies currently producing maize under irrigation.
Fiduciary risk involved in provision of resources through country's systems	Medium	The resources are 'ring-fenced'. Dedicated accounts to be opened; designated list of signatories to be put in place; quarterly report to be submitted; an external auditor to be engaged;
Security risks associated with maize importation and clearance delays at ports of entry due to increased volumes of imports	Medium	Government will endeavor to buy maize from within the country and use safe routes when importing the grain. Efforts are being made by SADC member states to ensure that peace prevails in the region. On delays at ports, GoM to engage with national Governments to expedite clearance processes.
Politicisation and delays in maize distribution to the target beneficiaries	Low	Government will engage cooperating partners, WFP and Non-Government Organization (NGOs) in identifying vulnerable households and distributing relief food maize. This will follow the guidelines from Manual for the Provision of General Food Distributions during Emergency Programmes in Malawi in coming up with the beneficiaries registers and the people and areas in need of food will be established by a professional committee (MVAC)

IX RECOMMENDATION

Management recommends that the Board of Directors approve the proposed Grant of UA 12 million for the Republic of Malawi in the form of a crisis response budget support for the purposes and subject to the conditions set out in this report.

Appendix 1
Letter of Development Policy

Telegrams: FINANCE, LILONGWE
Telephone: (265) 0178 9355
Telex: 44407
Fax: (265) 0178 8592
E-mail: finance@finance.gov.mw



Ministry of Finance, Economic
Planning and Development
P. O. Box 30049
Capital City
Lilongwe 3
MALAWI

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Dr. Akinwumi Adesina
President
African Development Bank Group
Immeuble CCIA, Avenue Jean Paul II
01 BP 1387 Abidjan 01
Cote d'voire

Dear Mr. President,

**FOOD CRISIS RESPONSE BUDGETARY SUPPORT PROGRAM: SUBMISSION
OF LETTER OF DEVELOPMENT POLICY**

On behalf of the Government of the Republic of Malawi, I write to request for an ADF Grant of UA 12 million equivalent in support of the Food Crisis Response Budgetary Support Program.

The Food Crisis Response Budgetary Support Program aims to support Government of Malawi procure maize on local and international markets for feeding millions of Malawians who are food insecure.

The program will assist Government of Malawi in addressing the fiscal challenges through recovery of the agriculture sector by reducing the food gap estimated at 1.3 million metric tonnes. The alleviation of the food crisis facing Malawi will help preserve the development gains Malawi has achieved over time.

MACROECONOMIC PERFORMANCE AND DEVELOPMENTS

a) Economic Outlook

The Government of Malawi (GoM) has been implementing macro-economic reforms aimed at resuscitating the economy since 2011. The reforms, which include foreign exchange market liberalization and removal of fuel subsidies, impacted positively on growth through improved availability of foreign exchange and elimination of fuel shortages. Recent multiple shocks including the suspension of budget support due to loss of public resources through theft (**the ‘Cashgate’**), and food insecurity resulting from heavy flooding and prolonged drought, have negatively impacted on the growth prospects of the economy. Real GDP declined to 3.1% in 2015 from 6.2% in 2014 following its recovery from 1.9% in 2012. The floods also disrupted energy generation and damaged some roads and reduced growth in the services and industry sectors which accounts for 50% and 11% of GDP, respectively. Over 2012–14, real GDP growth and inflation averaged 4.3% and 24.5%, respectively. Growth is projected to rise gradually to about 5.5% over the medium term while inflation to fall within single digits if international prices for food and petroleum products remain low and the authorities remain on course in implementing tight monetary and fiscal policies. The external current account deficit will remain in the 8% range over the medium term reflecting the demand for imports associated with developmental projects, rapid population growth which exerts social delivery pressures on fiscus, and the slow pace of export diversification. The IMF supported Extended Credit Facility remains on track.

b) Fiscal Performance and External Sector

Malawi’s fiscal situation since FY 2012/13 has weakened considerably due to shortfalls in external grants and domestic revenues coupled with higher than budgeted expenditure on wages and salary, domestic debt interest payments, and fertilizer subsidies. Revenues and grants decreased to 30 % of GDP in FY 2014/15 from 39 % in FY 2012/13 while expenditure declined to 35.4 % of GDP from 39.1 % over the same period. Expenditure adjustment was inadequate in offsetting the decline in revenues, increasing the overall fiscal deficit from 1.3 % of GDP in FY 2012/13 to 5.4 % in FY 2014/15. The fiscal deficit was financed largely through net domestic borrowing. Net domestic borrowing increased to 4.8 % of GDP in FY 2014/15 from a repayment of 0.2 % of GDP in FY 2012/13. In FY 2014/15, actual domestic borrowing exceeded the budget by 3 % of GDP. The Government has since undertaken strong fiscal consolidation efforts to reduce the fiscal deficit and restrain domestic borrowing. The challenge facing Government is to sustain fiscal consolidation by, among other measures, restraining the high wage bill while protecting pro poor spending and improving expenditure efficiency.

Malawi’s total public debt rose from 45.3 % of GDP in 2013 to 48 % in 2015 with external debt/GDP ratio increasing from 24 % to 31 %. The 2015 Debt Sustainability Analysis by the IMF reveals that the risk of debt distress remains moderate, though the debt ratios are projected to rise before declining from 2018. Recognizing the risk posed by

rapid growth in debt, Government is undertaking measures to strengthen its debt management capacity, improve public finances, and restrain domestic debt.

Malawi's current account during the 2013-2015 period remained under pressure as export growth slowed down and the volume of external grants declined. The current account deficit improved, slightly from 8.7 % of GDP in 2013 to 7.9 % in 2015 reflecting restrained import demand and lower fuel import cost. The current account deficit is expected to range from 7 to 8 % in 2016 and 2017. Given the persistence of Malawi current account deficits, export diversification is crucial. As such, the Government will need to implement its National Export Strategy (NES) with greater vigour.

c) Public Financial Management Reforms

The Malawi Government has registered progress in financial reporting by the submission of draft annual consolidated financial statements for the financial year ended June 2015 to the Auditor General in February 2016. Progress has also been made towards bringing the audit of annual financial statements up to date. The government has, among other things, (a) improved the control environment for the Integrated Financial Management Information System (IFMIS) by the introduction of physical controls and new user profiles for all users-including super users; (b) carried out a head count exercise with the aim of removing staff not in lawful employment-dismissed, resigned, dead, or not employed-from the payroll; (c) been implementing the recommendations on the payroll system audit; (d) maintained the pace of efforts toward the procurement and implementation of the new IFMIS; (e) made efforts aimed at enforcing commitment control and expenditure management;

AGRICULTURE SECTOR REFORMS AND FOOD SITUATION

Malawi has been achieving food security through Farm Input Subsidy Programme since 2005/06 season when the weather conditions are favourable. However, for the past two years, the country has experienced severe droughts and floods which affected crop production resulting in food deficit. The country is experiencing one of the worst food security situation since independence with a record estimated food gap of 1.3 million metric tonnes and about 8 million people expected to be food insecure. The food insecurity situation is a result of the combined effects of dry spells and floods experienced in 2014/15 agricultural season and the effects of El Nino in 2015/16 season which led to dry spells in the Southern and Central Regions of the country and flooding in the Northern Region. Agriculture contributes about 30% of the National Gross Domestic Product (GDP), employs about 80% of the population and contributes about 90% of national exports. The sector is however, vulnerable to weather related shocks which undermine agricultural productivity and consequently food security in the country. It is therefore imperative to intervene with short to medium and long term measures to ensure the recovery of the agriculture sector. The recovery of the agriculture sector will significantly contribute to macroeconomic stability in the country.

Thus, Government has recently developed and is currently working on a number of policy and strategic documents which are aimed at addressing some of the challenges in

the sector. These include National Agriculture Policy, National Irrigation Master Plan, Seed Policy and Bill, Fisheries Policy, Agriculture Contract Farming Strategy, review of Agriculture Sector Wide Approach Investment Framework and study on Strategic Grain Reserve. It is envisaged the newly developed National Agriculture Policy will lead the transformation agenda of the sector, from being subsistence to commercial through development of (i) irrigation as stipulated in the master plan in order to hedge against effects climate change, that is drought and floods; (ii) mechanisation; and (iii) marketing systems, among others.

As a way of improving productivity, the seed policy and seed bill aims at addressing issues of development and accessibility of seed that is adaptable to weather. Under marketing, Government is developing the contract farming strategy to facilitate development of agriculture value chains. Government is also finalizing the terms of reference on drawdowns from the Strategic Grain Reserve as one way of ensuring sustainability of maize stock in the silos. Apart from these, Government will continue to reform implementation of Farm Input Subsidy Program so as to deal with inefficiencies for optimal benefits. These policies and strategic document stipulate short, medium and long term strategies that require heavy investments.

It is expected that the outlined policies, programs and reforms will contribute towards achieving food security in Malawi.

Please accept, Mr. President, the assurances of my highest consideration.

Yours sincerely,

Signed

Goodall E. Gondwe
**MINISTER OF FINANCE, ECONOMIC PLANNING
AND DEVELOPMENT**

Appendix 2

IMF Letter of Comfort or Country Relations Note

IMF Executive Board Completes Seventh and Eighth Reviews under Malawi's ECF Arrangement and Approves US\$ 76.8 Million Disbursement

Press Release No. 16/295, June 20, 2016

IMF Executive Board Completes Seventh and Eighth Reviews under Malawi's ECF Arrangement and Approves US\$ 76.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the seventh and eighth reviews of Malawi's economic performance under the program supported by an Extended Credit Facility (ECF) arrangement¹. The Board's decision enables the immediate disbursement of the equivalent of SDR 54.22 million (about US\$ 76.8 million), bringing total disbursements under the arrangement to the equivalent of SDR 119.3 million (about US\$ 169.1 million).

In completing the reviews, the Board also approved the authorities' request for an extension of the current ECF arrangement to end December 2016² and an augmentation of access by the equivalent of SDR 34.7 million (about US\$ 49.2 million or 25 % of quota). The requested extension would give the authorities more time to achieve the original objectives of the program while the additional financing will help to strengthen the country's response to the El Niño induced drought which has caused a humanitarian crisis. The Board also approved the authorities' request for waivers of non-observance of performance criteria related to net domestic borrowing by the government and net international reserves.

The three-year ECF arrangement for Malawi in the total amount of SDR 104.1 million (about US\$ 144.4 million) was approved on July 23, 2012 (see [Press Release No. 12/273](#)).

At the conclusion of the Executive Board's discussion, Mr. Min Zhu, Acting Chair and Deputy Managing Director, issued the following statement:

"The authorities have strengthened macroeconomic policies and stepped up the implementation of structural reforms over the last year to bring the program back on track. Nevertheless, Malawi's macroeconomic situation remains difficult, reflecting weather-related shocks and past policy slippages, which contributed to persistently high inflation. Real GDP growth declined sharply due to floods and drought in 2015 and is expected to drop further this year owing to the region-wide El Niño-induced drought. A poor maize harvest for a second consecutive year has placed half of the population at risk of food insecurity. Short-term risks that could arise from adverse weather conditions, lower global demand for Malawi's exports, and policy slippages continue to weigh on the outlook.

"The near-term policy mix should center on reducing inflation by combining tight monetary and fiscal policies. To this end, expenditures will have to be limited to available resources and monetary policy should aim at maintaining positive short-term real money market interest rates.

"Accelerating the implementation of public financial management reforms is indispensable to building trust and confidence in the budget process and ensuring control over fiscal operations. Strong commitment controls, routine bank reconciliations, and regular fiscal reporting remain critical to preventing potential misappropriation of public funds and reviving donor re-engagement.

“The pursuit of prudent fiscal policy is critical to safeguarding medium-term fiscal and debt sustainability. Improved revenue mobilization and expenditure efficiency will reduce aid dependency and create fiscal space for social spending in pursuit of Malawi’s sustainable development goals.

“Important steps have been taken over the last two years to safeguard and strengthen financial sector stability. Given recent weather-related shocks and the prevalence of credit concentration risks, the authorities are encouraged to consider additional measures, including higher capital requirements, improved credit assessments, higher provisioning, and bank mergers to mitigate risks.”

¹ The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems.

² A short extension of the arrangement from May 22, 2016 to June 30, 2016 was approved by the Board on May 13, 2016 to give to the authorities time to implement two prior actions for completing the seventh and eighth reviews. See Press Release No. 16/222.

IMF COMMUNICATIONS DEPARTMENT

Media Relations

E-mail: media@imf.org

Phone: 202-623-7100

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