



**Republic of Malawi – European Community**

**Country Strategy Paper  
and  
National Indicative Programme**

**for the period 2008-2013**

The Government of the Republic of Malawi and the European Commission hereby agree as follows:

- (1) The Government of the Republic of Malawi, represented by Mr Goodall E. Gondwe, Minister of Finance, and the European Commission, represented by Mr Alessandro Mariani, Head of the European Commission Delegation in the Republic of Malawi, hereinafter referred to as the "parties", held discussions in Lilongwe from March 2006 till September 2007 with a view to determining the general approach to cooperation for the period 2008 – 2013.

During these discussions, the Country Strategy Paper and an Indicative Programme of Community Aid in favour of the Republic of Malawi were drawn up in accordance with the provisions of Articles 2 and 4 of Annex IV to the ACP-EC Partnership Agreement, signed in Cotonou on 23 June 2000 as revised in Luxembourg on 25 June 2005. These discussions complete the programming process in Malawi.

The Country Strategy Paper and the Indicative Programme are annexed to the present document.

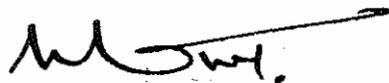
- (2) As regards the indicative programmable financial resources which the Community envisages to make available to the Republic of Malawi for the period 2008-2013, an amount of **€ 436 million** is foreseen for the allocation referred to in Article 3.2 (a) of Annex IV of the ACP-EC Partnership Agreement (A-allocation) and of **€ 15 million** for the allocation referred to in Article 3.2 (b) (B-allocation). These allocations are not entitlements and may be revised by the Community, following the completion of mid-term and end-of-term reviews, in accordance with Article 5.7 of Annex IV to the ACP-EC Partnership Agreement.
- (3) The A-allocation is destined to cover macroeconomic support, sectoral policies, programmes and projects in support of the focal or non-focal areas of Community assistance. The Indicative Programme under Part 2 concerns the resources of the A-allocation. It also takes into consideration financing from which the Republic of Malawi benefits or could benefit under other Community resources. It does not pre-empt financing decisions by the Commission.
- (4) The B-allocation is destined to cover unforeseen needs such as emergency assistance where such support cannot be financed from the EU budget, contributions to internationally agreed debt relief initiatives and support to mitigate adverse effects of instability in export earnings. The B-allocation shall be triggered according to specific mechanisms and procedures and therefore does not yet constitute a part of the Indicative Programme.
- (5) Resources can be committed within the framework of the present Country Strategy Paper and Indicative Programme upon the entry into force of the 10<sup>th</sup> EDF multi-annual financial framework for the period 2008-2013 of the revised ACP-EC Partnership but not before 1 January 2008. Financing decisions for projects and programmes can be taken by the Commission at the request of the Government of the Republic of Malawi within the limits of the A- and B-allocations referred to in this document. Financing decisions can also be taken on the basis of Article 15(4) in conjunction with Article 4(1)(d) of Annex IV to the APC-EC Partnership Agreement for support to non-State actors or on the basis of Article

72(6) to the ACP-EC Partnership Agreement for humanitarian and emergency assistance funded from the B-allocations. Financing decisions shall be taken and implemented according to the rules and procedures laid down in the EC Council regulations on the implementation of the 10<sup>th</sup> EDF and on the financial regulation applicable to the 10<sup>th</sup> EDF and in Annex IV to the ACP-EC Partnership Agreement.

- (6) The European Investment Bank may contribute to the implementation of the present Country Strategy Paper by operations financed from the Investment Facility and/or from its own resources, in accordance with Paragraphs 2c and 3 of Annex Ib to the ACP-EC Partnership Agreement regarding the 10<sup>th</sup> EDF multi-annual financial framework for the period 2008-2013.
- (7) In accordance with Article 5 of Annex IV to the ACP-EC Partnership Agreement, the National Authorising Officer and the Head of Delegation shall undertake an annual operational review of the Indicative Programme and a mid-term review and an end-of-term review of the Country Strategy Paper and the Indicative Programme in the light of needs and performance at the time.  
The mid-term review shall be undertaken in 2010 and the end-of-term review in 2012. Following the completion of the mid- and end-of-term reviews, the Community may revise the resource allocation in the light of prevailing needs and performance.  
Without prejudice to Article 5.7 of Annex IV concerning reviews, the allocations may be increased according to Article 3(5) of Annex IV in order to take account of special needs or exceptional performance at the time.
- (8) The agreement of the two parties on this Country Strategy Paper and the National Indicative Programme, subject to the ratification and entry into force of the revised ACP-EC Partnership Agreement and the 10<sup>th</sup> EDF multi-annual financial framework of for the period 2008-2013, will be regarded as definitive within eight weeks of the date of the signature, unless either Party communicates the contrary before the end of this period.

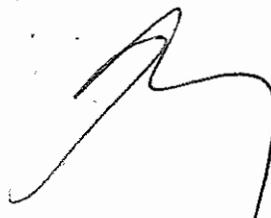
Done at Lisbon on 9 December 2007.

For the Government of  
the Republic of Malawi



**Goodall E. GONDWE**  
Minister of Finance  
National Authorizing Officer

For the European Commission



**Louis MICHEL**  
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## LIST OF ACRONYMS

ACP	African Caribbean and Pacific
ADB	African Development Bank
APRM	African Peer Review Mechanism
ARI	Acute Respiratory Infection
ART	Anti-Retroviral Therapy
AU	African Union
CABS	Common Approach to Budgetary Support
COMESA	Common Market for Eastern and Central Africa
CSP	Country Strategy Paper
CPI	Consumer Price Index
DAS	Development Assistance Strategy (of the GoM)
DfiD	Department for International Development (UK)
DPP	Democratic Progressive Party
DTP	Direct Transfers Programme
EBA	Everything But Arms
EC	European Commission
ECHO	European Commission Humanitarian Office
EDF	European Development Fund
EHP	Essential Health Package
EIA	Environmental Impact Assessment
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa
ESCOM	Electricity Supply Corporation of Malawi
EU	European Union
FIDP	Farm Income Diversification Programme
FLEX	Fluctuations in Export Earnings
FP	Financing Proposal
FY	Financial Year
GBS	General Budget Support
GDP	Gross Domestic Product
GDI	Gender Development Index
GFTAM	Global Fund to Fight AIDS, Tuberculosis and Malaria
GNP	Gross National Product
GoM	Government of Malawi
GTZ	Gesellschaft für Technische Zusammenarbeit
HDI	Human Development Index
HIPC	Highly Indebted Poor Country
HIV/AIDS	Human Immuno-Deficiency Virus/Acquired Immune Deficiency Syndrome
HMIS	Health Management Information System
HoMs	Heads of Mission
HQ	Headquarters
IFMIS	Integrated Financial Management and Information System
IHS	Integrated Household Survey
IGPWP	Income-Generating Public Works Programme
IMF	International Monetary Fund

JICA	Japanese International Development Agency
JPR	Joint Programme Review (of the GoM)
LDC	Least-Developed Country
MDGs	Millenium Development Goals
MDHS	Malawi Demographic and Health Survey
MDRI	Multilateral Debt Relief Initiative
MEPD	Ministry of Economic Planning and Development
MGDS	Malawi Growth and Development Strategy
MK	Malawi Kwacha
MoAFS	Ministry of Agriculture and Food Security
MoF	Ministry of Finance
MoHP	Ministry of Health and Population
MoLVT	Ministry of Labour and Vocational Training
MoTPW	Ministry of Transport and Public Works
MoTPSD	Ministry of Trade and Private Sector Development
MPVA	Malawi Poverty Vulnerability Assessment (GoM and WB)
MRA	Malawi Revenue Authority
MS	Member States (of the EU)
MTR	Mid-Term Review
NAC	National Aids Council
NAF	National HIV/AIDS Action Framework
NAO	National Authorising Officer
NER	Net Enrolment Ratio
NGO	Non-Governmental Organisation
NICE	National Initiative for Civic Education
NIP	National Indicative Programme
NRA	National Roads Authority
NSAs	Non-State Actors
NSO	National Statistical Office
NSNS	National Safety Net Strategy
ODPP	Office of the Director of Public Procurement
PAF	Performance Assessment Framework
PEFA	Public Expenditure Financial Accountability
PFM	Public Financial Management
PMU	Project Management Unit
PPP	Parallel Purchasing Power
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Paper
PS	Principal Secretary
PWP	Public Works Programme
RBM	Reserve Bank of Malawi
RSP	Road Sector Programme
RTA	Road Traffic Authority
RF	Road Fund
SADC	Southern Africa Development Community
SAPP	South African Power Pool
SMP	Staff Monitored Programme (of the IMF)
SWAP	Sector Wide Approach

TA	Technical Assistance
TCF	Technical Cooperation Facility
TIP	Targeted Input Programme
TNP	Targeted Nutrition Programme
TWG	Technical Working Group
TWAB	Tripartite Wage Advisory Board
UDF	United Democratic Front
UK	United Kingdom
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Education Fund
UNFPA	United Nations Population Fund
USD	United States Dollar
WB	World Bank
WTO	World Trade Organisation

## SUMMARY

The cooperation between the Government of Malawi and the European Commission over the period 2008-2013 will manifest itself through the alignment of support to the overriding policy objectives of the MGDS<sup>1</sup>, which was approved by the Government on 3 November 2006. The main policy objective is to create wealth through economic growth and infrastructure development as a means of achieving poverty reduction. The five MGDS themes of sustainable economic growth, social protection, social development, infrastructure development and improved governance represent the broad national priorities. Within this context, the Government has singled out six specific priorities on which efforts will be concentrated in the next five years. These are agriculture and food security, irrigation and water development, transport infrastructure development, energy generation and supply, integrated rural development, and prevention and management of nutrition disorders, HIV and AIDS. These priorities are fully supported by non-state actors<sup>2</sup>, which also underscore the importance of good governance.

The EC/GoM co-operation will be in close complementarity with support to be provided by the EU Member States and other main donors active in Malawi. Specific attention will be paid to seeking out synergies attainable with EU MS and the World Bank, under the coordination of the Government of Malawi. Development of sector programmes will be systematically promoted. In terms of financing modalities, in line with the Paris Declaration, budgetary aid will be the preferred modality whenever possible, followed by joint financing with other development partners.

The Malawi-EC Strategy under the 10<sup>th</sup> EDF will be developed within both good governance and macro-economic stability frameworks. One of the main elements of EC/GoM development cooperation under the 10<sup>th</sup> EDF will be the provision of **General Budget Support**, which will foster the continuation of efforts made since mid-2004 to consolidate and improve the country's macro-economic situation, strengthen public finance management systems and carry out policy reforms in the areas of education and health. Furthermore, the EC/GoM cooperation will concentrate on two focal sectors: **i) Agriculture and Food Security** in the context of national development and regional integration **ii) Regional Interconnection** with focus on Road Infrastructure.

In relation to the non-focal sectors of cooperation, support will be provided to the following areas: a) Good Governance; b) Support to Economic Partnership Agreement – Investments and Trade; c) Support to fight HIV-AIDS and Promote Gender; and d) Institutional Capacity-Building.

Other sectors like energy, water and sanitation can be financed via the EU-Africa Infrastructure Partnership and the investments from the European Investment Bank.

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<sup>1</sup> MGDS: Malawi Growth Development Strategy

<sup>2</sup> Consultative process in July 2006 with three seminars in Blantyre, Lilongwe and Mzuzu.

## **PART 1: STRATEGY PAPER**

### **CHAPTER I: THE FRAMEWORK OF RELATIONS BETWEEN THE DONOR AND THE PARTNER COUNTRY**

#### **I.1.1. General Objectives of the EC's External Policy**

In accordance with Article 177 of the Treaty Establishing the European Community, the purpose of community policy in the sphere of development cooperation is to foster:

- the sustainable economic and social development of the developing countries, and more particularly the most disadvantaged among them;
- the smooth and gradual integration of the developing countries into the world economy;
- the campaign against poverty in the developing countries.

Europe should project a coherent role as a global partner, inspired by its core values in assuming regional responsibilities, promoting sustainable development, and contributing to civilian and strategic security.

The Union has developed a broad spectrum of external relations tools in the shape of the common trade policy, cooperation under bilateral and multilateral agreements, development cooperation, humanitarian aid and financial assistance as well as the external aspects of internal policies (energy, environment, transport, justice and home affairs, etc.).

EU external action including the Common Foreign and Security Policy, common trade policy and cooperation with third countries provides a framework both for integrating all EU instruments and for developing gradually a set of common actions based on common positions in the broader sphere of political relations.

Enlargement has placed upon EU even greater responsibilities, as regional leader and as global partner. It should therefore strengthen its capacity to promote human rights, democracy and the rule of law as well as its capacity to focus on the fight against poverty, both in its neighbourhood and through its multilateral and bilateral policies aimed mainly at sustainable development and political stability. Thus, the EU will achieve genuine coherence between its domestic and its external agendas, thereby contributing to global security and prosperity.

#### **I. 1.2. Strategic objectives of cooperation with the partner country**

The Treaty objectives are confirmed in Article 1 of the *ACP-EU Partnership Agreement*, signed in Cotonou on 23 June 2000 and revised in Luxembourg on 25 June 2005. The overarching objective of the *Cotonou Agreement* is to promote the development of a common strategic approach to poverty reduction, consistent with the objectives of sustainable development and the gradual integration of ACP countries into the world economy. Cooperation between the Community and Malawi will pursue these objectives, taking into account the fundamental principles set out in Article 2, in particular the encouragement of "ownership" of the strategy by the country and populations concerned, and the essential elements and fundamental element as defined in Articles 9 and 11b of the Agreement.

While the Treaty and the Cotonou Agreement provide the legal basis for EC cooperation with ACP countries, the recently adopted *European Consensus on Development* sets the general policy

framework at EU level. The primary and overarching objective of EU development policy is the eradication of poverty in the context of sustainable development, in line with the international agenda, paying particular attention to the Millennium Development Goals (MDGs). Human rights and good governance are recognised as other important objectives.

Better aid effectiveness is essential to achieving poverty eradication. The EU will therefore advance coordination, harmonisation and alignment. It will promote better donor complementarity by working towards joint multiannual programming based on partner countries' strategies and processes, common implementation mechanisms, joint donor wide missions, and the use of co-financing arrangements. The EU will take a lead role in implementing the Paris Declaration commitments on improving aid delivery and it will capitalise on new Member States' experience to strengthen their role as donors.

Policy coherence for development will advance in a number of areas. The aim is that all EU non-aid policies should make a positive contribution to developing countries' efforts to attain the MDGs.

The principle of concentration will guide the Community country and regional programming. This means selecting a limited number of priority areas of action, through dialogue with partner countries, rather than spreading efforts in too many sectors. In this context the Community will be primarily active in the following nine areas, bearing in mind its comparative advantage in a number of them: trade and regional integration; the environment and sustainable management of natural resources; infrastructure, communications and transport; water and energy; rural development, territorial planning, agriculture and food security; governance, democracy, human rights and support for economic and institutional reforms; conflict prevention and fragile states; human development; social cohesion and employment.

The mainstreaming approach will be strengthened for four cross-cutting issues: democracy, good governance, human rights, the rights of children and indigenous peoples; gender equality; environmental sustainability; and the fight against HIV/AIDS.

In December 2005, the European Council agreed an **EU Strategy for Africa**. The Strategy provides a long-term, strategic framework for interaction between Europe and Africa at all levels: with pan-African institutions such as the African Union, regional organisations and national authorities. It defines how the EU can best support Africa's own efforts to promote sustainable development and reach the Millennium Development Goals (MDGs). The Strategy rests on three pillars: (i) promoting peace, security and good governance as central prerequisites for sustainable development; (ii) supporting regional integration, trade and interconnectivity to promote economic development; and (iii) improving access to basic social services (health, education) and protecting the environment to reach the MDGs 1-6 faster.

### **I.1.3 Main bilateral agreements**

In terms of development cooperation, Malawi has been a signatory to ACP-EU Partnership Agreements (Lomé Conventions 1975-2000 and Cotonou Agreement 2000-2020). In the area of trade relations, Malawi is negotiating an Economic Partnership Agreement (EPA) with the EU under the Eastern and Southern Africa (ESA) grouping. EPAs are expected to enter into force in 2008 and are viewed as an integral part of the Cotonou Agreement. EPAs will replace the present unilateral trade preferences and create a World Trade Organisation (WTO) compatible framework for reciprocal preferences and mutual cooperation.

## **CHAPTER II: COUNTRY DIAGNOSIS**

### **II.1. Analysis of the political, economic, social and environmental situation in the recipient country**

#### **II.1.1 Political and institutional situation**

Multi-party democracy was established in Malawi in 1994. The last Presidential and Parliamentary general elections, held in May 2004, elected Dr Bingu wa Mutharika as Malawi's second democratically elected State President. The EU Observer Mission, which was one of the accredited election observer groups, declared the elections to be free, but that they fell short of international standards. In accordance with the provisions of the Malawi Constitution, which provides for holding of general elections every five years, the next Presidential and Parliamentary elections are due in May 2009. Local government elections were due to take place in May 2005 in accordance with the Constitution.

Malawi is a young democracy and national political parties and constitutional bodies are weak, partly as a result of inadequate funding. The Constitution provides for separation of powers between the executive, legislature and judiciary. Parliament has powers to approve the national budget, oversee key public appointments and government expenditure, and pass laws. In practice, Parliament's oversight of the executive is weak, mainly because of its infrequent sessions, which are subject to funding made available by the executive. More regular and constructive parliamentary sessions and adequate funding in support of the Parliament's political mandate are viewed as critical in ensuring that the country can steadily move forward its very demanding and large development agenda. Recently, the Parliamentary Reforms Committee set a date to finalise the strategy to implement the Resolution for reforms passed by the National Assembly in June 2006.

The political party of the President of Malawi, DPP<sup>3</sup>, has grown in number within Parliament. At the by-elections held in December 2005, the DPP won all seats with the election of the first six DPP Members of Parliament. Since then a substantial number of Members of Parliament have defected and joined the DPP or have declared themselves independent and ready to work with the DPP for the development of their constituencies. However in November 2006 the Constitutional Court interpreted the section 65 of the Constitution (i.e.: "crossing the floor") to the effect that MPs who have defected and joined another party represented in Parliament would be deemed to have crossed the floor. If this is implemented by the Speaker of Parliament, there will be need for by-elections in many constituencies. This being said, the Parliament of Malawi is characterised by the fact that the Government does not have a clear majority, a complex scenario even in mature democracies, and by the large number of independent MPs. The judiciary is independent. However its major constraint is the inadequate number of magistrates and judges, with people living in rural areas having limited access to justice.

The Government of Malawi views good governance as a prerequisite for growth and poverty reduction and, indeed, good governance is one of the pillars of the Malawi Growth Development Strategy. The promotion of the rule of law is seen not only as an instrument for regulating human conduct but also as an instrument for economic growth and development. Following his election, the State President launched a vigorous and much needed anti-corruption campaign, which created political tensions with Malawi's former President, Dr Bakili Muluzi, who is the chair of the UDF<sup>4</sup> party, which had campaigned to support the election of Dr Bingu Wa Mutharika. The

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<sup>3</sup> Democratic Progressive Party

<sup>4</sup> United Democratic Front

anti-corruption campaign has continued under the authority of the Anti-Corruption Bureau with some positive results and more to come. Because of a large caseload at the Anti-Corruption Bureau and an overstretched judiciary, results from the anti-corruption drive have been slow to materialise. The much needed amendment of the legislation that presently requires the Director of the Anti-Corruption Bureau to obtain the consent of the Director of Public Prosecutions before prosecuting corruption cases is yet to be passed by Parliament. This will allow the Director of the Anti-Corruption Bureau to move swiftly in dealing with corruption cases. Recently the Director of the ACB was suspended immediately after having briefly arrested the former President Muluzi, who was charged with 42 counts of corruption, fraud and abuse of office. He finally resigned. The anti-money laundering bill was recently passed by Parliament.

Human rights in Malawi are guaranteed by the Constitution. Institutions such as the Human Rights Commission, the Ombudsman, the Anti-Corruption Bureau, NGOs and media contribute substantially to the publicising and prosecution of human rights violation. Effective enforcement is dependent on the human and financial resources of the relevant institutions, which are currently limited. There are no acute human rights issues in Malawi and the law provides for equal rights for all. However in practice there is a persistent and widespread discrimination against women and girls (e.g. access to school, inheritance, access to work, role in political parties). Domestic violence, especially wife beating, is common. In response to this situation Parliament has recently passed a law that specifically prohibits domestic violence. A positive development has been the recent increase of the number of women in Parliament and in senior positions in Government, though it is still below the agreed SADC benchmark established in Blantyre. Prison conditions are harsh with overcrowding, inadequate nutrition, substandard sanitation and lack of health care. Hard labour is an integral component of sentences. With regard to the death penalty, the country maintains the possibility to condemn convicts but has systematically turned all death sentences into life imprisonment. The death penalty has not occurred in the last twelve years.

As regards children, extreme poverty creates the need for them to start work at an early age in rural areas, while the situation of children in urban areas is slightly better. With reference to children trafficking two main routes have been identified in Malawi: a) international route, which includes trafficking to Europe and to South Africa and is usually related to the commercial sex industry and; b) domestic route, which includes trafficking of children from rural areas to urban areas for the sex industry, as well as trafficking of children in the rural areas to provide cheap manpower to tobacco, tea and coffee plantations during the harvesting period. There is a lack of documented data and only anecdotal evidence exists. Despite limited resources Malawi has made significant progress particularly in the areas of prosecuting traffickers and educating the public to recognise human trafficking<sup>5</sup>.

Fundamental freedoms are provided by the law and generally respected in Malawi. There is no limitation to movement of people, no limitations to religious freedom, to freedom of expression or to freedom of assembly and association. People have been free to express their views without fear of reprisal. Although taken for granted, these are fundamental rights that Malawians have enjoyed for only twelve years. While standards of journalism are low, freedom of information remains within acceptable parameters with a growing media (press, radio, TV) providing different views and opinions. Regular self-censorship by journalists and, at times, some political interference is reported.

In terms of security Malawi remains a generally peaceful country. The Muslim population is showing tendencies of feeling marginalised. Civil unrest is rare and demonstrations are usually

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<sup>5</sup> 2006, US Department of State, Trafficking in Persons Report

peaceful. Malawi is not involved in external conflicts. Neither is there any ethnic strife between the Chewa, Yao and Ngoni who are the main tribes of Malawi. In relation to regional security, Malawi has contributed within its means to peacekeeping missions of SADC, AU and UN. Malawi is committed to fighting terrorism. However the country's capacity to combat terrorism and trafficking of weapons is weak due to poorly functioning border controls and security services.

The Government has commendably agreed to undergo the African Peer Review Mechanism (APRM), which is about to start. This initiative and the action plan which may arise will be closely followed up to identify areas for possible support within the framework of the 10<sup>th</sup> EDF, in line with the Good Governance Initiative announced in the EU Strategy for Africa

A Constitutional review process coordinated by the Malawi Law Commission is ongoing. Malawi's political and social landscape since the advent of multiparty democracy in 1994 has been characterised by diversification and growth of Non-State Actor (NSA) activities especially in the areas of advocacy and service delivery (particularly in health, education and food security). Civil society organisations played a significant role in the delivery of civic education prior to and after the 2004 elections. NSAs have also been involved in the preparation of the Malawi Growth and Development Strategy (MGDS).

## **II.1.2 Economic and commercial situation**

### *Economic situation, structure and performance*

Agriculture is the backbone of Malawi's economy, accounting for about 36% of GDP. The agriculture sector is made up of smallholder and large-scale sub-sectors. Over recent years the sector has been characterised by low and stagnant yields particularly in maize production due to over-dependence on rain-fed farming and a low level of irrigation development, declining soil fertility, high cost of inputs and overall low-technology agricultural practices. Low profitability of smallholder agriculture has been influenced by weak links to markets and limited access to land and credit. In terms of sectoral contribution to GDP, the agriculture sector is followed by distribution, manufacturing, transport and communications and financial and professional services.

Malawi's exports are principally tobacco, sugar and tea accounting for more than 80% of export earnings. Tobacco alone accounts for about 60% by value of export earnings. Diversification of the export base is critical for the exploitation of global trade opportunities and, consequently, for economic growth.

The average annual rate of growth in the last five years was 2.5% which is below the 6% level commonly accepted as needed to have a significant impact on reduction of poverty. The trend of growth was quite erratic with a maximum of 5% in 1997 and a minimum of -4.1% in 2001. If poverty reduction is to be tackled in a meaningful way, there is an urgent need for solid growth and mitigating measures have to be taken to make agriculture less dependent on rain-fed farming, for example through the introduction and expansion of irrigation schemes based on appropriate technologies.

The average annual inflation rate fluctuated between a minimum of 10.1% in 2003/04 and a maximum of 27.2% in 2001. The annual average inflation rate is primarily influenced by the food consumer price that constitutes 55.5% of the CPI. The non-food consumer price is largely influenced by fuel prices that have recently been on the increase. The experience of 2005 reconfirms that food insecurity influences high inflation levels in the country, with negative

effects in terms of real economy and in terms of fiscal performance for the country which has a domestic debt to serve. Malawi suffers from a structural negative current account balance linked to its trade deficit and the inflow from exports, which is highly cyclical and concentrated in the period of tobacco sales. The foreign reserve position is, therefore, highly dependent on the level of budget support from the donor community. Under these circumstances the flexibility of the exchange rate, advocated by the IMF and development partners, is important.

Malawi achieved the HIPC completion point at the end of August 2006. Achievement of the HIPC completion point has enabled Malawi to qualify for further debt relief from the World Bank and International Monetary Fund under the Multilateral Debt Relief Initiative. Though significant, debt relief equivalent to about 8% of total domestic expenditure (excluding donor-funded projects), does not represent a dramatic increase in resources <sup>6</sup>(see Annex 8 – Debt Sustainability Analysis).

With regard to the investment climate, an unfavourable macro-economic environment, high interest rates, volatile exchange rates, high tax levels, an interventionist approach by the Government and poor utility services have hindered private sector investment<sup>7</sup>. Malawi is also a landlocked country with nearly all goods being transported via the road network largely as a consequence of a non-functional railway network<sup>8</sup>. Transport costs are reportedly much higher than those of neighbouring countries – due to over-reliance on road transport<sup>9</sup>, limited competition amongst the few road transporters, cyclical nature of Malawi's exports and a major constraint on export performance. In addition, the country's potential to increase food security and agricultural production through irrigation has been undermined by low investment in the irrigation sector (see Annex 1: Country at a glance – Economic situation).

#### *Structure and management of public finances*

The fiscal latitude prior to 2004 has left the country with a high domestic debt burden (amounting to more than 9% of GDP in 2003/2004). However, since mid-2004, the new Government has developed its budget within the framework agreed with IMF Staff Monitoring Programme (SMP) in 2004/05 and Poverty Reduction Growth Facility (PRGF) since August 2005. The completion of the SMP and the satisfactory performance under the PRGF in 2006 resulted in unlocking the flow of aid from donors. The present fiscal policy aims at reducing the weight of the Government's domestic debt, whilst allowing for increases in pro-poor (health and education) and pro-growth (infrastructure and agriculture) expenditure. Nevertheless, the proportion of budget spent on pro-poor expenditure in 2004/05 was 16.2% below the target of 18.9%<sup>10</sup> mainly because of the need to respond to the food security crisis by importing maize and fertilizer.

The Government budget is highly dependent on donor aid inflows. There is a structural imbalance between domestic revenues and expenditure in the order of over 15% of GDP. Achievements made during the last few years in increasing the level of domestic revenues (presently in the order of 24% of GDP) have been offset by increasing government expenditure.

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<sup>6</sup> Common Approach to Budget Support (CABS), September 2006 CABS Review Aide Memoire, 18.10.2006.

<sup>7</sup> According to the 'Doing Business in 2006-Malawi Country Profile' indicators (WB/IFC), Malawi ranks 96<sup>th</sup> (out of 155 countries) in terms of economy (aggregate) rankings. Bank interest rates have remained unchanged at 25% since June 2004.

<sup>8</sup> The international routes are by rail through Mozambique to the ports of Nacala (Nacala Corridor) and Beira (though currently dysfunctional), by road to the ports of Beira (Beira Corridor) in Mozambique, Dar-es-Salaam (Northern Corridor) in Tanzania and Durban (Southern Corridor) in Republic of South Africa.

<sup>9</sup> The Case for a National Export Strategy: Key Issues and Possible Response, MoTPSD, September 2005

<sup>10</sup> March 2006, CABS Review, Aide Memoire.

### *Assessment of the reform process*

The Public Finance Management (PFM) system in Malawi, although based on a sound legal framework was, prior to mid-2004, typified by non-compliance with rules and regulations, lack of enforcement of sanctions and political interference in processes and procedures. Although the present administration has shown strong political commitment to reverse the trend, the challenge is to translate the achievements into sustainable systems with, in particular, appropriate internal and external checks and balances in the management of funds. The computerisation of the Credit Ceiling Authority, review of the Chart of Accounts, verification of the scale of domestic arrears, and the issue of new Treasury Instructions are positive moves which are reflected in the mid-2006 Public Expenditure Financial Accountability (PEFA) report. The improvement is attributable, amongst other things, to the implementation of the Integrated Financial Management Information System (IFMIS), leading to some improvements in expenditure control and timely financial reporting, considered as an impressive achievement by the IMF particularly when viewed against international experience in implementing similar systems. However the PEFA review confirmed that internal and external audit capacity is extremely limited in Malawi which has implications for control over the data being maintained in the IFMIS system. Currently there is little capacity to perform systems audits. The situation with procurement has improved, although there are still concerns about some specific procurement processes (see Annex 10 (a) Public Finance Management in Malawi). A number of donors are supporting the Office of the Director of Public Procurement and progress is expected soon. Within this framework the Government has pursued with vigour the anti-corruption campaign.

The Government has developed an action plan on public finance management, approved at the end of October 2006, focusing on priority measures to be taken so as to address the main weaknesses, and indicating activities to be implemented with a clear timetable to be jointly monitored. This plan will guide the GoM and all donors in their support in this very strategic area (see Annex 10 (b) PFEM Action Plan).

In August 2006 Parliament passed a Money Laundering and Terrorism Financing Act. The Reserve Bank issued directives and guidelines to commercial banks in line with recommendations on money laundering and terrorism financing which the banking sector has implemented (see Annex 1: Country at a glance – Assessment of the reform process).

The separation of the Road Fund Administration and Road Authority operations through two Acts of Parliament should significantly improve management and accountability of the Road Fund. The new legislation gives a framework for “purchase” of services from one agency by another and a Procedures Agreement (still under discussion between the two boards) gives implementation details and explains financial management and audit requirements. Successful operation under this new regime is still to be demonstrated.

### *Trade policy and external environment, in particular regional cooperation agreements and EPAs*

The economy remains relatively open and there has been a substantial reduction in average tariffs, tariff peaks and barriers to trade over the last few years. However, the country continues to experience shortages of foreign exchange as earnings from exports do not cover import requirements. The trade balance has been worsening since 2001. In the last six-year period, exports have increased only by 35% (from USD 421 million to USD 572 million), while imports have increased by almost 80% (from USD 585 million to more than USD 1,050 million). As a result the trade deficit has increased from 9% to approximately 23% of GDP. This reflects the limited diversification and competitiveness of the local economy as well as stronger domestic

demand and higher oil prices. While Malawi's participation in EU trade remains extremely limited (0.01% to 0.02% of total EU exports/imports), the EU continues to be Malawi's largest trading partner in terms of the country's exports (about 37%). In terms of imports Malawi's main trading partner is South Africa (38%) followed at a great distance by the EU (18%).

The formulation of the National Export Strategy was a notable development in 2005 together with the establishment of a Competition Commission. The challenge ahead lies in the implementation of the strategy and the level of involvement of the private sector.

Malawi as a Least-Developed Country (LDC) benefits from the EU "Everything But Arms" (EBA) initiative allowing free access for all Malawian products to the EU markets except for sugar which is to be granted duty-free access in 2009. At present, Malawi's annual sugar exports to the EU average 40,000 metric tonnes<sup>11</sup>, which includes 20,000 metric tonnes under the sugar protocol. The preferential prices for sugar exports to the EU have been important to Malawi's revenues and it is in light of this that the GoM and the industry have pulled together to formulate a national adaptation strategy in response to the new EU sugar reform. The new EU sugar reform is expected to open opportunities for the Malawi's sugar industry in the medium to long term. To this end a Malawi-EC Sugar Adaptation Strategy has been approved (see Annex 11 – Malawi EC Support Strategy under the Sugar Protocol).

Malawi's eagerness to pursue regional trade agreements aiming at establishing free trade areas has resulted in membership of a number of overlapping preferential arrangements with COMESA and SADC. This is not unique to Malawi and is instead a feature in the sub-region where the majority of countries are members of different regional organisations. Malawi is negotiating an Economic Partnership Agreement (EPA) with the EU under the Eastern and Southern Africa (ESA) grouping. Concerning the EPA negotiation process, Malawi continues to hold the view that the EPA will benefit Malawi. The GoM is concerned that the EPA process may come with adjustment costs, which will need to be addressed in the near future. To this end, impact assessments and studies at national and sector level are planned.

At WTO level, Malawi's positions are aligned to the common positions of the African Union (AU), the Least-developed Countries (LDCs) and the ACP group of States. Malawi's specific priorities include (i) the preservation of existing trade preferences, (ii) financial and technical assistance for addressing supply-side and other capacity constraints and (iii) the development of mechanisms for increasing access to the essential medicines for all illnesses and public-health conditions at affordable prices. Furthermore, Malawi advocates increased Aid for Trade and compensation with regard to adjustment costs. Recent studies indicate that Malawi will lose 6.6% of its total export earnings in the multilateral liberalisation process. On agriculture, Malawi calls for the total elimination of trade-distorting export subsidies and a reduction in domestic support measures especially on cotton exports (see Annex 1: Country at a glance – Trade policy).

### **II.1.3 Social situation, including decent work and employment**

With a nominal GDP per capita at 164 USD (IMF August 2006) and a Human Development Index ranking of 165 out of 177 countries (2005), declining since 1995, Malawi is one of the poorest LDCs in the world<sup>12</sup>. Malawi is one of the continent's least urbanised countries with 80 to 85 per cent of the population (estimated at 12.3 million in 2005) living in rural areas and deriving their livelihoods from agriculture. Much of the countryside is "deeply rural" in that it is characterised by a poor rural road network and poor physical, economic and social infrastructure.

<sup>11</sup> Reserve Bank of Malawi, Monthly Economic Review, October 2005.

<sup>12</sup> "Beyond Scarcity: Power, poverty and the global water crisis". UNDP Human Development Report 2006.

Malawi is characterised by one of the fastest population urbanisation growth rates (estimated at 6% per year)

There is a positive trend in the education sector as far as primary school enrolment is concerned. The gross enrolment rate is the highest in the world (140%), indicating inefficiencies and a high burden of under-aged and over-aged children (due to repetition) on the primary education system. There is a decline in the quality of teaching, the root causes being the insufficient number of teachers and consequently large class sizes, a high teacher attrition rate largely due to HIV/AIDS, the very low level of teacher qualifications, the poor curriculum and poor school infrastructure. The drop-out rate is high and additional efforts are needed to improve completion rates for primary schooling.

The delivery of health services remains among the worst in the world, with the health system in a state of disrepair. Malawi's health system is grossly under-funded with an annual per capita expenditure of approximately USD14, insufficient for the delivery of even a narrow package of essential health services. Many nurses and doctors prefer to work abroad where they are much better remunerated. Recently the Government has launched a donor-sponsored programme increasing salaries in order to retain health personnel in the country. Access to formal health services in Malawi is very low with only 54% of the rural population having access to formal health services within a 5-kilometre radius<sup>13</sup>.

HIV/AIDS constitutes a serious threat to the country as a whole, affecting all aspects of Malawi's social and economic fabric, including smallholder agriculture where those affected may not be able to prepare the ground for planting or be able to husband their crops. The estimated HIV/AIDS prevalence among adults (15 to 49 years) in Malawi (2005) is 14% with a range from 12% to 17%, giving a total estimated number of 790,000 infected adults<sup>14</sup>. The level of HIV infection in the adult population has remained stable during the last nine years, and is lower in urban areas and declining amongst youth. This is in itself an achievement, particularly when compared to some other countries. Women and girls are particularly vulnerable to infection of HIV/AIDS for both cultural and biological reasons, including their limited ability to negotiate safe sex because of their lower status and fear of violence. The use of contraceptives by men is low as reflected by the high fertility rate of over 6 (meaning a doubling of the population every 30 years), with 60% of women giving birth before the age of 20. The pandemic means that, in the next decade, over half the deaths in Malawi will be due to AIDS. At present, HIV/AIDS-related conditions account for over 40% of all in-patient admissions<sup>15</sup>, putting enormous pressure on the health system. The National AIDS Commission was created in 2001 and works on prevention, treatment, care and impact mitigation. At the operational level, the National HIV/AIDS Action Framework galvanises an expanded, multi-sectoral, national response to the epidemic for the period from 2005 to 2009. The NAF is a fundamental reference point for all stakeholders involved in the national response to HIV and AIDS. Access to basic services remains very low despite the significant contribution of the Global Fund for Aids, Tuberculosis and Malaria (GFATM), one of the highest per capita in the world which places AIDS support at a similar or even higher level than the overall public funding for health. During the 2005/06 fiscal year, the GFATM disbursed about USD 32 million to Malawi.

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<sup>13</sup> Situation Analysis on Human Resource in the light of the EHP Implementation June 2003, Health Services Planning Department, Ministry of Health and Population. Lilongwe: Ministry of Health and Population.

<sup>14</sup> "HIV and Syphilis Sero-Survey and National HIV Prevalence Estimates Report 2005", December 2005, Ministry of Health National Aids Commission

<sup>15</sup> "A Joint Programme of Work for a Health Sector Wide approach (SWAp) (2004-2010)", Dept of Planning, MoH, December 2004.

There is effectively no social security system in Malawi. The main elements of social protection consist of subsidised/free food distribution, public works (cash-for-work) and subsidised/free agricultural inputs. The National Safety Net Strategy (NSNS) was adopted in 2002, aiming at rationalising the many competing programmes into a centrally coordinated, government-directed and nationwide programme. The strategy has four main components: Public Works Programme (PWP)<sup>16</sup>; Targeted Input Programme (TIP); Targeted Nutrition Programme (TNP) and Direct Transfers Programme (DTP). Challenges remain in relation to lack of coordination in the design and implementation of safety net programmes and lack of capacity of District Assemblies to effectively supervise all programmes at district level. Despite recent efforts to rationalise the use and scope of the above programmes, there are concerns in relation to targeting mechanisms, inconsistent receipt of assistance and high administration costs linked to the implementation of these measures.

Agriculture accounts for approximately 80-85% of employment in Malawi and is the main source of livelihood for the great majority of the poor population. Only about 10% of the population is formally employed in commerce and retailing, with the remainder in manufacturing, construction and services. In terms of labour standards, the Ministry of Labour and Vocational Training (MOLVT) sets separate urban and rural minimum wage rates based on recommendations of the Tripartite Wage Advisory Board (TWAB) composed of representatives of labour, government, and the private sector. Minimum wage rates do not provide a decent standard of living and wage earners often supplement their incomes through farming activities. Furthermore, there are gender gaps both in terms of remuneration<sup>17</sup> and in terms of jobs performed by men and women.

The law allows workers to form and join trade unions and workers exercise this right in practice. However, union membership is low due to the small percentage in the formal sector, the lack of awareness of worker rights and benefits and reluctance on the part of many employees to join unions. The law also provides for the establishment of industrial councils in the absence of collective agreements for sector-level bargaining. In practice, this law is not effectively implemented due to lack of resources.

The Gender Development Index of 0.374 indicates the existence of large disparities between men and women in Malawi. Despite constituting about 51% of the population and being a major force in the country's socio-economic activities, women remain marginalised in social and economic spheres and are unable to effectively contribute to social, economic and political development. Furthermore, owing to their relatively high illiteracy level, women have less access to employment opportunities, in both the public and private sectors and do not have equal access to technology and other key market information to support their business activities (see Annex 1-Country at a glance - Social situation and Annex 12 – Gender Situation).

#### **II.1.4 Environmental situation**

Malawi is facing five major environmental challenges: increasing land degradation; advanced ongoing deforestation; diminishing water resources, declining biodiversity and climate change.

In a country with a high average population density of 105 people per km<sup>2</sup> (143 people per km<sup>2</sup> in the Southern Region), reportedly one of the highest in Africa, the principal factors exerting pressure on the environment are that some 90% of households depend on income derived from smallholder farming and often resort to survival strategies that exploit the natural resources in an

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<sup>16</sup> Supported by the EC under the Income-Generating Public Works Programme.

<sup>17</sup> According to the 2006 GoM/WB Poverty Vulnerability Assessment, the median daily wage for women was MK 78 as compared to MK 124 for men.

unsustainable manner in order to achieve food security and other basic needs. This has led to deforestation and high rates of soil erosion and decline in soil fertility<sup>18</sup>. The total forest cover has declined from 47% in 1975 to 26% in 2006 and is continuing at an annual rate of about 3%. Furthermore, soil erosion has an adverse impact on water supplies (quantity and quality), fisheries, electricity generation (water could be envisaged as an alternative to charcoal and wood), agriculture and irrigation.

Biodiversity in Malawi is seriously threatened. While there are over 4,000 species of animals, including the greatest freshwater biodiversity in the world with over 500 endemic species of fish, little has been done to protect or ensure the sustainable use of such resources. Fish account for approximately 70% of the animal protein intake, yet there is little management of the fisheries stock and as a result annual per capita fish catches have declined from 12.9 kg in 1972 to 6.4 in 2003. This decline in fish stocks has serious nutritional consequences in a country with already high malnutrition rates. Habitat encroachment, the introduction of alien species and poaching have reduced animal populations, even in the National Parks and reserves, undermining the Government's drive to increase tourism in Malawi.

Malawi is endowed with substantial surface water systems, includes a network of rivers and lakes, including Lake Malawi, the third largest freshwater lake in Africa, as well as groundwater resources. While it is estimated that Malawi only uses 5.8% of its annual renewable water resources, the availability and quality of these resources vary greatly seasonally and across the regions.

While most major rivers are still perennial, smaller rivers and streams have become seasonal over the past 40 years due to the marked changes in land use and deforestation. Increasing population pressures has led to more water being extracted, mainly for irrigation. In turn, increased agriculture, coupled with inappropriate agricultural practices, has led to increased siltation and levels of pollution.

Domestic water consumption has also rising significantly. Approximately 67% of Malawians have access to safe water, but in urban areas water quality has declined. In addition only 65% of boreholes are properly functioning. Poor sanitation and disposal of wastes have resulted in water contamination and outbreaks of communicable diseases, such as diarrhoea and cholera.

A country which relies heavily on its natural resource base, such as Malawi, needs to seriously consider the implications of climate change, which risks undermining progress in increasing agricultural production and improved food security .

The above issues are important challenges for the Government which, if not dealt with adequately, could prevent the country from developing on a sustainable basis (see Annex 3 – Executive summary of the Country Environmental Profile).

### **II.1.5 The country in the international context**

Malawi is signatory to a number of International Conventions and Regional Instruments<sup>19</sup>, but these are not speedily transposed into domestic law and are not fully implemented. The foreign

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<sup>18</sup> The EC supports re-afforestation through IGPWP and FIDP programmes

<sup>19</sup> Including International Convention on Economic, Social and Cultural Rights (1966); International Convention on Civil and Political Rights (1966); Convention on the Rights of the Child (1989); Convention on the Elimination of Discrimination Against Women (CEDAW, 1979); Convention Related to the Status of Refugees (the Geneva Convention) and its associated Protocol (1951); Convention for the Suppression of Traffic in Persons and the of Exploitation of Prostitution of Others (1949); Convention on the Africa Charter on Human and Peoples Rights (1981); Protocol on the Rights of Women in Africa (2003).

policy of Malawi is aligned with that of the African Union and of the sub-regional organisations, which Malawi adheres to, with particular reference to SADC. Malawi is making great strides towards providing a peacekeeping contribution to the SADC/AU brigades. It has already contributed with human resources to various peacekeeping initiatives under UN auspices, and with donor support is hoping to augment this. Malawians have served with distinction in Mozambique – helicopter squadron on humanitarian mission in 2000 – Sierra Leone, DRC and Kosovo. Malawi is keen to contribute to Darfur as well, resources allowing. Malawi serves in the AU Peace and Security Council for two years.

As regards migration, skilled personnel continue to leave Malawi for much better paid employment overseas, the majority being nurses that migrate to Europe, Australia and other countries. Over the period 2000/05 an estimated total of approximately 400 health personnel migrated to other countries with approximately 300 leaving for the UK. It is estimated that 95% of these migrants are nurses. During the period 2000/02, about 400 labour immigrants were recorded to have entered Malawi. Most of these were business managers followed by construction workers, engineers and medical personnel. The country continues to host refugees from Rwanda, Burundi and Congo. According to UNHCR an estimated total of 7,694 refugees are in the country. At least an additional 1000 refugees are not registered with the authorities.

## **II.2. Poverty reduction analysis**

Poverty alleviation in Malawi has shown very little progress in the last decade. In 2005, about 6.4 million Malawians (or 52.4% of the population) were estimated to be living below the Government-calculated poverty line of approximately USD 0.35 per day against a figure of 53.9% in 1998. In addition, the overall figure masks the fact that about 22 per cent of the population is ultra-poor. This means that one in every five persons lives in such dire poverty that they cannot afford to meet the minimum standard for daily recommended food intake. The geographical distribution of poor people in Malawi is revealing. Almost 50% of the poor population lives in the rural areas of the Southern Region and about 30% live in the rural areas of the Central Region<sup>20</sup>. This is broadly in line with the population distribution. The percentage of urban poor has also increased from 18 per cent in 1998 to 25 per cent in 2005. The main determinant of poverty is the insufficient rate of growth, which can be boosted by increasing the level of production in agriculture, graduating from a rain-fed to an irrigated agriculture, increasing the level of diversification, improving access to markets, post-harvest techniques and the agri-food business. The rate of growth can also be boosted by reducing the transport costs, improving infrastructure for the private sector, fostering regional integration and increasing the level of education. In a country where about 55% of average household expenditure is allocated for food, poverty and food insecurity are inextricably linked. It is estimated that 70% of all households in Malawi run out of their own self-produced food by December, some three to four months prior to the harvest<sup>21</sup>. As a result, the majority of rural farming households are net purchasers of maize, and hence highly dependent on market supply (and prices) to obtain food. Low-income households in urban areas face food insecurity because of their low salaries and purchasing power, placing them at risk when maize prices increase.

Most smallholder Malawian households are unable to achieve adequate food and income security in an average year as rain-fed agricultural productivity is low and vulnerable to annual rainfall

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<sup>20</sup> “Poverty in Malawi from the Second Integrated Household Survey 2005”, An extract of findings by the Ministry of Economic Planning and Development, National Statistical Office and The World Bank, 2005.

<sup>21</sup> “Can Malawi reverse the growing chronic and acute food and nutrition insecurity?” Concept note for a regional conference on food and nutrition security, June 19 –21 2006, Economics Association of Malawi and Ministry of Agriculture, November 2005. In the food crisis of 2001/2002, about 93 per cent of households ran out of food before harvest time.

volatility. Soil fertility is declining, there is limited access to inputs, extension services are near collapse, land reform is pressing, and HIV/AIDS is severely impacting on the sector.

Poverty has a distinct gender dimension in Malawi. Women are disproportionately affected by constraints on agricultural production due to lack of access to land, capital, extension services and markets. The incidence of poverty and ultra-poverty is higher in female-headed households. About 51% of the people who live in male-headed households are poor, while 59% of people living in female-headed households are poor. Regardless of household size, women grow crops for home consumption to a greater extent than men, who are more likely to cultivate cash crops<sup>22</sup>.

Overall progress towards achieving the MDGs remains mixed. Malawi is unlikely to achieve the 50 per cent poverty reduction target by 2015. However, there are some indications of progress in the attainment of the MDGs. Maternal mortality has decreased in recent years, although the figure is still one of the highest in the world at 1,120 deaths per 100,000 live births. There has been slow progress in increasing the proportion of births attended by a doctor, clinical officer, nurse or mid-wife<sup>23</sup> and a decrease in the percentage of underweight children (under five years of age), with a drop from 30% in 2000 to 22% in 2005. However the prevalence of protein energy malnutrition (PEM) remains high, with stunting in 48% of under-five children. There has also been a decrease in the childhood mortality rate, but the figure is still high with one in eight children born in Malawi dying before reaching their fifth birthday. Malaria is a major killer, accounting for up to 40% of all under-five hospitalisations and 40% of under-five hospital deaths in Malawi<sup>24</sup>, while diarrhoea ranks second. It is clear that increased use of mosquito nets, access to safe water supplies, access to rehydration therapies and nutrition education could save the lives of many under-five children (see Annex 1 - Country at a glance – Millennium Development Goals).

### **II.3. The recipient country's development strategy**

The Malawi Growth and Development Strategy (MGDS), the overarching strategy for Malawi for the next five fiscal years from 2006/07 to 2010/2011, was approved by the Cabinet on 3 November 2006. This will be the main government reference document that will guide the implementation of prioritised and sequenced activities in order to reduce poverty. The MGDS recognises the need to achieve the MDGs since these are also long-term aspirations for Malawians.

The MGDS is built on five strategic themes: sustainable economic growth; social protection; social development; infrastructure development and improved governance. Within these broad themes, six specific areas have been identified on which the Government will concentrate its efforts in order to achieve the overall objective of economic growth for poverty reduction in the medium term. These are agriculture and food security, irrigation and water development, transport infrastructure development, energy, integrated rural development, and prevention and management of nutrition disorders and HIV and AIDS.

The main thrust of the MGDS is to create wealth through economic growth and development as a means of achieving poverty reduction. The MGDS recognises the important role of the private sector in promoting economic growth, the need to invest in the social development through

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<sup>22</sup> Tobacco (the most important cash crops in Malawi) is grown in 19 percent of male-headed households compared to just 7 percent of female ones.

<sup>23</sup> "Poverty in Malawi from the Second Integrated Household Survey 2005". An extract of findings by the Ministry of Economic Planning and Development, National Statistical Office, end of 2005

<sup>24</sup> Annual Report of the work of the Malawi Health Sector (July 2004-June 2005), Planning Department Ministry of Health, 15.09.2005

education and health, and the need to reduce and mitigate the negative consequences of HIV and AIDS. The MGDS emphasises macroeconomic governance, decentralisation, the rule of law and the promotion of human rights. It also recognises the need to protect the most vulnerable through social protection measures.

The MGDS has been well received by the donors. The recent Joint Assessment by IMF/WB staff concludes that the “*MGDS provides a comprehensive framework for growth and poverty reduction in Malawi*”. It also states *inter alia* that the “*MGDS appropriately focuses on the need to expand agricultural output and productivity by improving irrigation and increasing the use of farm inputs*”, ... “*staff support the priority given to building food security*” and that “*measures need to focus on removing infrastructure constraints within Malawi, such as reducing transportation and marketing costs and increasing access to credit*”.

Donors have expressed support for the strong Government ownership of the MGDS, though there is a need for a communication strategy on the role of various stakeholders to ensure that ownership is broadly shared. There is also a need for clear prioritisation of expenditure within a realistic resource envelope consistent with the macro-economic framework and a need for stronger linkage of the MGDS to the annual budget process cycle, together with a strengthened annual progress review that seeks to monitor the annual targets set. Moreover there is a need to make a link between findings of the Malawi Poverty and Vulnerability Assessment study and the poverty reduction strategies and policies identified in the MGDS. Finally, it is important that while placing emphasis on growth the role of social expenditure and social protection in supporting growth is not underplayed.

#### **II.4. Analysis of the viability of current policies and the medium-term challenges**

The principal challenges to viability of the MGDS are scarce financial resources, limited institutional capacity of line ministries, lack of human resources, inadequate coordination among central government institutions as well as policy implementation limitations at both central and local level. There is also a need to improve government internal control systems and strengthen public finance management. Meeting the objectives of the MGDS will require a substantial increase in external financing to supplement Malawi’s low domestic savings. This includes both donors’ investments and the private sector’s investments. Against this background, it is important for donors to move the harmonisation agenda and reduce transaction costs to the minimum by promoting the use of budgetary aid where possible.

### **CHAPTER III: OVERVIEW OF PAST AND PRESENT EC COOPERATION, COMPLEMENTARITY AND CONSISTENCY**

#### **III. 1 Overview of past and present EC cooperation (lessons learned)**

In the years preceding the May 2004 general elections, poor economic governance and lack of political will had a direct and immediate effect on EC-Malawi cooperation, making it difficult to implement the budget support programme and reducing the amount of resources allocated to the focal transport sector programme. Furthermore, a severe food crisis in 2002 overshadowed virtually all medium-term concerns, and many activities in the agriculture and natural resources focal sector were re-focused on short-term responses to the crisis. The Mid-Term Review (MTR) was delayed and took place only in mid-October 2004, allowing the new Government which came into office in May 2004 to establish a track record to enable possible resumption of donor budget support and to honour commitments in the road sector. The MTR concluded with a reduction of envelope B by €42.5 million, leaving a balance of €21.3 million, while maintaining

the strategy and the funds available under envelope A (€276 million). A re-adjustment in allocations took place with reductions in budgetary aid and funds for the transport sector, and an increase in funds for the agriculture/food security and non-focal sectors.

An evaluation of the previous CSP was made. One of the main recommendations was that governance should be placed at the centre of all cooperation programmes as both an end in itself (across sectors) and a means (to achieve impact and sustainability). The evaluation highlighted democratic governance and accountability as of paramount importance to the success or failure of all other interventions, noting that objectives in public finance management should be pursued primarily through the macro-financial instrument. The evaluation also stated that the Commission should strengthen the articulation between development aid, political cooperation and trade policy. In addition, the evaluation noted that enhancing the capacity of non-state actors to express themselves, to demand accountability (of local and central governments) and to participate in policy was a key element of a comprehensive poverty reduction strategy.

External monitoring has shown that NGO projects are particularly successful, not least in terms of longer-term sustainability, specifically in the area of food security and water and sanitation. Moreover, evaluations have shown that infrastructure projects, such as the construction of large hospitals in a country like Malawi, lack sustainability because necessary financial and medical staff resources to operate and maintain large facilities are not available. These are lessons learned which will inform the implementation of the 10<sup>th</sup> EDF.

In terms of donor coordination, the European Commission is part of the Common Approach to Budget Support (CABS) group which constitutes a formal forum of discussion and exchange for development partners involved in budget support<sup>25</sup>. CABS has paved the way for a better alignment of donor assistance, with donor funds increasingly channelled through GoM systems. To strengthen national monitoring and evaluation systems, the GoM initiated a Monitoring and Evaluation programme in early 2006 to be implemented up to 2011, which should allow for a result-based approach to MGDS implementation.

By conducting joint reviews and sharing analyses and studies, members of the CABS have gradually been drawn into collaborating further in sector areas and have been able to provide the GoM with coordinated responses on a number of topics from macro-economic to social sector issues and good governance. The CABS experience is very positive and it is clear that the budgetary aid which the EC intends to provide under the 10<sup>th</sup> EDF will be provided within the CABS forum.

### **III.1.1 Focal sectors (and macroeconomic support)**

**Focal sector 1: Rural development, Agriculture, Food Security and Natural Resources:** Malawi has been affected by recurrent food crises in particular in 2002/03 and 2005/06. These crises highlight the fact that there are structural issues to be addressed such as dependence on rain-fed agriculture, weak linkage to input and output markets as well as isolation of produce from markets due to poor rural infrastructure. Furthermore, there are weaknesses in the current public agricultural extension service, which have undermined productivity, with the extension worker to farmer ratio standing at 1:3000. There is a need to facilitate access to credit, to foster private-public partnerships for increased investments, to improve security for land tenure, to promote diversification of produce, and to promote marketing and post-harvest techniques. The

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<sup>25</sup> The CABS currently consists of 4 full members (DFID, Norway, Sweden and EC) and five observers (Germany, World Bank, IMF, UNDP and the African Development Bank). Both Germany and the World Bank are expected to formally join the Group as full members by 2008.

main lesson learned is that there is an urgent need to develop a sectoral approach where the GoM, NSAs and development partners can act in a coordinated manner. This will also mitigate the risk of recurrent government policy changes to which development partners have contributed with conflicting recommendations. The Ministry for Agriculture and Food Security has started the development of a sector-wide approach which is expected to represent the framework for interventions aimed at supporting agriculture and food security under the 10<sup>th</sup> EDF. Another lesson learned is that there is a need to move in a pragmatic manner, which may be based initially on a fairly simple shared framework, characterised by clear objectives, activities, timetable, financial costs and indicators. The framework can then be expanded and refined over the years. A gradual approach seems to work. The EC has traditionally worked in Malawi in this sector where it is the largest donor, accumulating very rich experience. Moreover, the EC is well placed to assist the Government in fostering links between agriculture and food security, on the one hand, and infrastructure investment (transport; irrigation) on the other hand. It is also in the best situation to assist the Government in enhancing the regional dimension, offering its unique expertise in regional integration processes.

**Focal sector 2: Transport:** In the mid to late 1990s, Malawi made significant advances with respect to policy reform commitments, culminating in the establishment of an autonomous National Roads Authority (NRA) responsible for maintaining and developing the road network and a dedicated Road Fund in 1998. The fuel levy is the main source of internal revenue for the NRA, contributing approximately 80% of the total income to the Road Fund, the remainder coming from transit charges levied at border posts on foreign-registered commercial vehicles entering the country. This policy reform process has resulted in a much improved main road network, some 85% of which is in good condition. However, in the period from 2002 to 2004, the reform process stalled mainly because of a drop in funds for road maintenance as a result of the fuel levy not being adjusted to offset the effects of kwacha depreciation and inflation, together with a diversion of road maintenance funds to other spending categories. The change of Government in May 2004 brought a new start in the donor dialogue with Government on transport sector policy. To address the weaknesses in road management, the Government separated the functions of the road fund administration from the road management operations in May 2006 and announced its intention to establish a Road Traffic Authority. This significant institutional reform places the Road Fund under the authority of the Ministry of Finance, thus enabling more accountable and efficient use of Road Fund resources. The development of a Road Sector Programme is a key objective agreed by the Government and donors. It includes establishment of the components necessary for sector budget support by the beginning of the 10<sup>th</sup> EDF in 2008. Under the focal sector of transport infrastructure, the main lessons learned are that: 1) a balanced multi-modal transport sector policy and programme is required to foster competition and reduce transport costs; b) emphasis on road maintenance operations rather than upgrading is critical, since the current road network overall is not sustainable; 3) local contracting and consulting capacity is limited and project implementation without careful design and implementation is going to suffer; 4) capacity of relevant organisations needs to be improved so as to make it possible to provide sector budget support. The EC has traditionally worked in Malawi in this sector where it is the largest donor, accumulating a wealth of experience. Past interventions have been designed to support government priorities in the road sector, which are backlog maintenance to bring the network up to maintainable standard, development of routine maintenance capacity, and support to the autonomous agencies running the sector and development of the private sector. More recently attention has been paid to rural access, in line with government aims in the MGDS, with earth and gravel road rehabilitation and repair and replacement of wooden bridges. In particular, rural access of agriculture importance has been

considered, to reinforce the government's food security aims. The EC is also well placed to assist the Government in fostering links between transport investments, on the one hand, and regional integration as well as food security and agriculture, on the other hand. The sector is characterised by high barriers to entry for most development partners.

**General Budget Support:** A stop and go situation characterised the early 2000s. During 2002, successive IMF missions were not able to conclude their review of the PRGF. In the run-up to the May 2004 elections, the Government failed to keep public expenditures under control, leading to the discontinuation of the IMF Poverty Reduction Growth Facility (PRGF). Shortly after the elections in May 2004, the new Government agreed an IMF Staff Monitored Programme (SMP), which was successfully completed and was followed by the ongoing three-year PRGF programme signed in August 2005. In July 2005, the EC approved a Poverty Reduction Budgetary Support programme (€41.5 million) for the fiscal year 2005/06. A new operation for €34 million was signed in 2006 to contribute to the budget in the next two fiscal years (2006/07 and 2007/08). Donor budget support provided since 2004/05 has assisted the GoM in achieving macro-economic stability, with the interest rate falling from 45% in 2003 to 20% in 2006. This is expected to have a positive impact on private sector investments and on growth. Budget support has been instrumental in helping the country to achieve the HIPC Completion point in August 2006. The ability to provide budget support to Malawi will depend on open and frank dialogue, macro-economic performance and sustained improvements in public finance management. The budget support will be provided within the Performance Assessment Framework (PAF) established between the GoM and the CABS group. The PAF, a set of indicators to monitor progress in the governance area, social sectors and public finance management will be aligned with the MGDS indicators as from 2007. As regards risks associated with budgetary aid, it will be important to mitigate them through an open and frank dialogue, including CABS and Article 8 Cotonou meetings. As opposed to the past, actions and associated risks are openly discussed to enhance mutual understanding.

### **III.1.2 Projects and programmes outside focal sectors**

Within the non-focal sectors, the priorities of GoM-EC co-operation under the 9<sup>th</sup> EDF were reviewed at the mid-term review of 2004 and more support was provided to good governance, civic education, micro-projects, health, non-state actors and institutional capacity-building (A short account of the projects is provided in Annex 6 – Overview of cooperation in the non-focal sectors).

### **III.1.3 Utilisation of Envelope B**

The 2004 Mid-Term Review of GoM/EC development cooperation saw a reduction of the B-Envelope allocation for Malawi by €42.5 million. The B-Envelope of €26.5 million is fully committed comprising: a) €5.17 million contribution for the Africa Peace Facility; b) €6.5 million for the "Sustainable Nutrition Rehabilitation Programme (SNRP)"; c) €10 million to mitigate the adverse effects of export revenue instability ("FLEX"); and d) €4.8 million for the Emergency Food Aid Programme during the 2005/06 food crisis.

### **III.1.4 Other instruments**

Malawi received a significant amount of additional resources (€103 million) via EU budget lines in the period 2001-2006: specifically, €73 million under the Food Security budget line and €30 million under thematic budget lines (including the NGO-Cofinancing and Sexual and Reproductive Health budget lines). In terms of intra-ACP initiatives, one proposal has been selected under the Water Facility with an EC contribution of about €2.7 million.

During the ten years of the Lomé Conventions, the EIB signed loan commitments for a total of €73 million, of which €6.5 million was from the Bank's own resources. Debt service to the Bank has been satisfactory. The EIB's operations in Malawi have been concentrated on the public sector infrastructure, e.g. water and power (€38 million), and on support to the private sector with global loan facilities (€16.5 million). So far no projects have been financed under the Cotonou Agreement as a result of the fragile macro-economic situation until 2004. Several potential projects are presently under appraisal by the EIB.

Following the declaration of national disaster by the State President of Malawi in October 2005, the European Commission Humanitarian Office (ECHO) provided €5.0 million for emergency aid to support the most vulnerable people.

### **III.2 Information on the programmes of the Member States and other donors (complementarity)**

The total donor global financial commitment (grants and soft loans) to Malawi in the period from 2002 to 2006 is in the order of €1,700 million (or about €300 million per year). The main donors are the UK, EC and the World Bank who provide about 70% of the aid. The three Member States represented in Malawi are the UK, Germany and France.

The UK (via DfID) is the largest bilateral donor providing half of its funding via general budget support and sectoral support to health. Other areas of UK support are in education, growth, social protection, good governance and justice. The total UK financial commitment (2002-2006) is above €300 million. France and Germany, as two principal contributors to the European Development Fund, pursue their development aid objectives via the EU. Germany has a small bilateral programme of some €30 million (2002 to 2006) focusing on education, health and good governance projects. France has no formal bilateral programme, but has provided funds for maize purchases in times of food shortages. The WB has a large portfolio covering many sectors, notably health, education, infrastructure, private sector development and public sector management and recently re-engaged in agriculture.

As regards future perspectives, the UK is expected to increase its bilateral level of support to Malawi and to continue investing primarily via general budget support and sector programmes in the social sectors, growth and social protection and good governance. A possible new theme may be in the area of water and sanitation. Coordination between the UK's bilateral programme and the EU is well established for budget support (within the CABS group), as well as for other sectors like food security and good governance where regular donor coordination meetings are established. The relevant rules and regulations do not at present allow joint financing between the EC and Member States. Division of labour is also established in the sense that the EC focus is on infrastructure and agriculture, whereas the UK focus is on health and education.

The new World Bank Country Assistance Strategy (FY 2007 to 2010) has been developed in tandem with the present EDF Country Strategy Paper, with dialogue and consultations at all stages of the programming. The new WB Country Assistance Strategy focuses on infrastructure, agriculture and rural development, public sector management and HIV/AIDS. In the area of infrastructure there is an agreement between the EC and WB to the effect that the EC takes the lead in road infrastructure while the WB leads on energy infrastructure. The possibility of joint funding is being explored either via the budget of the Government or through common funding arrangements (see Annex 2 – Donor Matrix- 1. Financial Donor Matrix 2002-2006).

### **III.3 Other EC policies**

Of particular significance for Malawi is the EU Sugar Reform, agreed by the EU in November 2005. It is expected to have a significant impact on the Malawian economy due to the important role of sugar exports in the country's trade (see Annex 11- Malawi EC support strategy under the Sugar Protocol). The reform aims at enhancing the competitiveness and market orientation of the EU sugar sector while ensuring conformity with the rules of the WTO. In this context, the EC has allocated to Malawi €667,000 for the year 2006. This amount is expected to increase in subsequent years. The EC has supported the development of a GoM sugar sector National Adaptation Strategy (NAS) in Malawi, which was finalised in April 2006. A multiannual support strategy has since been developed and the following specific areas will be considered for potential EC support: reviewing of the national regulatory framework in the context of the sugar sector; initiatives to increase out grower production through the improvement of cane yields, area expansion and infrastructure development; and initiatives to reduce the cost of production/increase competitiveness.

### **III.4 Description of the political dialogue with the partner country**

A political dialogue between the Government and the EU ("Cotonou meetings") was launched in late 2005 in line with the provisions of Article 8 of the ACP-EU Cotonou Agreement. Two subsequent meetings took place with the Minister of Foreign Affairs. In June 2006, EU Heads of Mission (HoMs) met with the State President within the same framework. Two further meetings with the new Minister of Foreign Affairs took place in August and October 2006 respectively. The Minister wanted regular meetings with the EU (Cotonou meetings) to be held on a monthly basis. Political dialogue is relatively new but open and constructive. There may be scope to increase the frequency of these political dialogue meetings.

### **III.5 Description of the state of the partnership with the recipient country and progress towards harmonisation**

Overall the state of partnership is good. The Government has enhanced the level of relations with the EU as regards the European Development Fund. Since January 2006, following a Cabinet decision, the EDF NAO in Malawi is for the first time ever the Minister of Finance.

In March 2006, and in keeping with the spirit of the Paris Declaration on Aid Effectiveness, the Government of Malawi carried out its first annual Joint Programme Review (JPR) with the Department for International Development (DfID), the European Commission (EC), the World Bank, German Technical Cooperation (GTZ) and Norway. The review focused on identifying linkages and gaps between MGDS medium-term expected outcomes in different sectors (rural development and food security, infrastructure, governance, trade and private sector development, education, health and HIV/AIDS) and current donor/GoM support programmes. The main conclusions of the first JPR process outlined the need for the Government of Malawi to have

clear sector strategies. The Government, in close consultation with donors, is currently developing a Development Assistance Strategy (DAS) that will provide a coordination framework for development partners.

The GoM will take measures to prevent sector Ministries unilaterally negotiating with donors for assistance. Also in the spirit of the Paris Declaration, CABS will seek to channel an increasing proportion of funds through GoM systems, with the Government managing projects in line with best practice in development co-operation. This is viewed as an effective way of ensuring the transparency of development expenditure and its accountability to Parliament. Furthermore, using GoM systems will help strengthen GoM capacity to effectively audit and monitor expenditure.

## CHAPTER IV: RESPONSE STRATEGY

### IV.1 Overview

The cooperation between the Government of Malawi and the European Commission over the period 2008-2013 will manifest itself through the alignment of support for the overriding policy objectives of the Malawi Growth and Development Strategy (MGDS – refer to Chapter II.3) and within the objectives of the three pillars of the EU Strategy for Africa. The main policy objective is to create wealth through economic growth and infrastructure development as a means of achieving poverty reduction. The EC/GoM co-operation will tie in closely with support which is going to be provided by the EU Member States and other main donors in Malawi. The forward-looking donor matrix indicates a concentration in social sectors (in particular education by UK, D, USAID, World Bank, AfDB and UN and health by UK, D, World Bank, Norway, AfDB and UN) both in terms of number of donors and in terms of financial resources. The EC/GoM cooperation will focus on systematically seeking out synergies attainable with EU MS, and the World Bank. Development of sector programmes will be systematically promoted. In terms of financing modalities, and in line with the Paris Declaration, budgetary aid will be the preferred modality whenever possible followed by joint financing with other donors.

The **Malawi-EC Strategy** under the 10<sup>th</sup> EDF will be developed within both good governance and macro-economic stability frameworks. In particular, in order to consolidate and improve the country's macro-economic situation and strengthen public finance management systems and policy reforms in the areas of education and health, the provision of **General Budget Support** will be reinforced thus fostering the continuation of efforts made since mid-2004.

Furthermore, to respond to three of the six specific priorities identified by the GoM within the MGDS, the EC will concentrate its support in two focal sectors: **i) Agriculture and Food Security** in the context of national development and regional integration **ii) Regional Interconnection** with focus on Road Infrastructure. In selecting these two focal sectors, careful account has been taken of the strategic indications of the forward-looking donor matrix (see Annex 2 – Donor Matrix- forward-looking donor matrix) and the comparative advantage that can be offered by the EC. This is based on experience accumulated in more than 30 years of operations in Malawi and synergies which can be fostered between the two focal sectors.

In addition to the above-mentioned support, the strategy responds, through the non-focal sectors of co-operation, to the following areas: a) Good Governance, reinforcing the global framework of the strategy; b) Support to Economic Partnership Agreement – Investments and Trade, complementing the support to regional integration; c) Support to fight HIV-AIDS and Promote Gender as well as d) Institutional Capacity-Building.

As regards the fight against HIV/AIDS, it is envisaged that HIV/AIDS components will be mainstreamed in all interventions to be funded. In order to fulfil this commitment, support to fight HIV/AIDS is specifically provided for in the non-focal sector as a means of mainstreaming the process.

Possible support to Energy Infrastructure, Water Supply and Sanitation will be provided outside the bilateral co-operation through the Infrastructure Partnership and possible direct investments from the European Investment Bank.

#### **IV.2 General Budget Support (35% – 40% of financial resources)**

Malawi fully recognises in the MGDS that a favourable macroeconomic environment is a prerequisite for attaining sustainable economic growth and development, which are necessary elements for the reduction of poverty. From the above analysis (in Chapter II.1.2 and Annex 1), continuation of general budget support is paramount for improving the economic situation and setting an economic framework conducive to poverty reduction. To this end, the Government is committed to implementing prudent fiscal policy, aimed at reducing the domestic debt burden through expenditure restraint in combination with lower interest payments and improving public finance management systems. Savings on domestic interest payments will be used to support pro-growth (infrastructure; agriculture) expenditure and pro-poor (health and education) expenditure. All the above is expected to lead to low fiscal deficit, low interest rates and inflation, high investment and economic growth. A prudent fiscal policy will be complemented by monetary policy aimed at securing price stability and by a flexible exchange rate policy geared to protecting international reserves. Restoring international reserves is a key priority for the Malawian economy.

To achieve the above objectives, the EC general budget support will be provided jointly with other donors including EU Member States in the framework of the CABS Group and will contribute towards the Government's main economic objectives:

- Macro-economic stability;
- Implementation of policy reforms in social sectors so as to increase health services and educational opportunities;
- Implementation of the policy reforms in the area of public finance management so as to enhance the effectiveness and efficiency of public expenditure;
- Improve the education and health MDG indicators;

The planned support of approx. €25-30 million per year is aligned with the IMF PRGF programme expectations and justified by the country's regular need for foreign exchange. This does not account for external shocks, which may necessitate additional assistance. The amount of €25-30 million per year will make the EC a key provider of budget support.

As regards the accompanying technical assistance, this will be mobilised to foster reforms in public finance management and social sectors, health and education. Future reforms and policy dialogue in the social sectors will be supported by technical assistance which will always be provided within the framework of the respective SWAPs, in close coordination with the relevant line ministry and development partners.

### **IV.3 Agriculture and Food Security in the context of national development and regional integration (25% -30% of financial resources)**

The overall objective of the focal area is to reduce poverty and hunger in an environmentally sustainable manner. The MGDS considers food security as a prerequisite to economic growth. The objective of poverty reduction is also synonymous with the first Millennium Development Goal.

This overall objective can be achieved by realising the self-reinforcing specific objectives of increasing agriculture-led economic growth and increasing food security. For example, an increase in income levels can significantly contribute to food security, while increased food security increases peoples' productivity. While interventions to achieve these two specific objectives will take place across a broad spectrum of Malawian society, in general terms food security interventions will be targeted at the more disadvantaged households, while agricultural interventions will tend to cover households with greater productive capacity. However, in order to better coordinate government and donor activities in agriculture, the government will develop a sector-wide approach. It is important that policies for both agriculture and food security activities take into account and mitigate against both annual climatic variations, as well as longer term climatic shifts due to climate change. In doing so Malawi will be able to sustain its agriculture productivity and ensure food security in the medium term.

#### **Agriculture**

The MGDS seeks to transform Malawi from a “*predominately importing and consuming country to a predominately producing and exporting nation*”. Agriculture is recognised as the core of the economy and hence plays a key role in achieving sustainable economic growth. Medium-term expected outcomes from the MGDS include support to specific core sectors such as tea, tobacco, cotton and sugar, as well as a more general drive to increase productivity and produce greater value from agriculture, both through diversification and agro-processing. In short, to consider farming as a business activity rather than as a means of subsistence. And lastly, to increase the productivity of natural resources, such as fisheries and forests, through better management.

The 10th EDF will support these objectives by focusing on complementary actions in the areas of **1) natural resource management, 2) productivity, 3) competitiveness, 4) marketing and adding value, and 5) capacity-building**

- 1) In Malawi, about 90% of households depend on income derived, wholly or in part, from the exploitation of the natural resource base, be it through farming, fishing or other activities. Malawi is currently facing five main environmental threats: land degradation, deforestation, diminishing water resources, declining biodiversity and climate change. Unless these are adequately addressed, yields will continue to decline. Therefore, the **sustainable management of natural resources** will not only help increase agricultural productivity, through improving soil fertility and reducing soil loss, but will also help to increase non-farm incomes through the sustainable use of natural resources such as forests.
- 2) Increases in **productivity** will be stimulated by providing a package of measures to help ensure that farmers grow the most productive and profitable crop corresponding to their own factors of production and geo-physical situation (rather than simply growing maize by default), and that yields are increased through improving soil fertility and reducing land degradation. This package of measures will include inputs, access and training on credit, agricultural extension activities, and most importantly information on efficient

agricultural practices - notably on soil conservation and water harvesting - and marketing possibilities. This information will help to empower farmers to choose the crops that they grow and determine the agricultural services that they require. Where justified from an economic perspective, productivity can be further enhanced by the provision of irrigation on either a small or medium scale.

- 3) Measures to increase Malawi's **competitiveness** will be taken at a number of levels. The first step is to ensure that diversification stimulates production of crops where Malawi may have a comparative advantage on the global market in the short and medium term, such as sugar, cotton, tea and coffee. Other measures include the improvement of transport infrastructure from improved international connections to a better developed network of rural feeder roads. Any significant reduction of transport costs will reduce costs and hence increase competitiveness. Competitiveness can also be enhanced by innovation and research.
- 4) Efforts aimed at **improving the marketing** of agricultural products underpin the drive for diversification and competitiveness. Marketing information that connects farmer organisations to regional and national hubs can provide information on price and services, empowering smallholder farmers. This will not only help to ensure that diversification is demand driven, as opposed to production driven, but will ensure more efficient allocation of factors of production. Developing agro-processing, in partnership with the private sector, will help to ensure that Malawi creates greater added value. The potential for fair trade and biological/organic agriculture, which gives rise to significantly higher margins, will be explored.
- 5) These four key issues will be completed by **capacity-building of government, smallholders and non-state actors**. Capacity-building of the Government will focus on streamlining its involvement in playing an enabling and regulatory role in the sector with a view to increasing efficiency and stimulating private investment. Capacity-building of smallholder organisations will ensure that they are better able to respond to information disseminated. Capacity support will also be given to key organisations and non-state actors (NSAs), including NGOs, that play critical roles in the commodity chain. In fostering capacity building attention will be given to create links with existing international agricultural research co-operation activities and centres either supported by Europe directly through successive Research Framework Programmes or through the CGIAR (Consultative Group of International Agriculture Research) and specific African centres at regional and sub-regional level.

## **Food Security**

The MGDS sees food security as a prerequisite for sustainable economic growth. The objective is to ensure that food is available in sufficient quantities, either through domestic production or through importation, so that Malawians have access to sufficient nutritious food to lead a healthy and productive life. The MGDS also recognises that food insecurity often leads to a diversion of resources to address short-term crises that could otherwise be invested in longer-term development. Food security is based on the classical three-pillar model which emphasises availability, access and nutrition. The 10th EDF will support actions under each of these three pillars as well as capacity-building.

- 1) **Availability** is a factor of both own production and importation, so activities that stimulate production should also increase food availability. For example, diversification can increase the availability of food at both household and national level by focusing on

producing more drought-resistant crop varieties, or crops such as cassava, that can mature during the typical hunger season. In addition, small-scale irrigation – including water harvesting and small dam construction – can reduce current dependence of smallholders on rain-fed production. National food availability can also be ensured by means of innovative approaches such as weather insurance and SAFEX (South African Future Exchange Markets) options, combined with more traditional approaches such as the National Food Reserve Agency.

- 2) **Accessibility** to food depends on both household incomes and food prices. Changes in production and the cost of food – which in turn is influenced by transport costs – will affect the population’s accessibility to food over time. Accessibility can be addressed by both conditional and unconditional transfers. Conditional transfers will be targeted at able-bodied groups and will include safety-net activities such as cash for work programmes. These programmes not only increase the purchasing power of beneficiaries, in turn stimulating supply, but also ensure the construction, rehabilitation or maintenance of assets that benefit and develop the community. Care will be taken to minimise dependency and integrate gender considerations. Unconditional transfers will be made to vulnerable groups, such as children under 5 years old, orphans, HIV/AIDS sufferers and the incapacitated. These transfers may be either in kind, such as school feeding programmes for the under-fives, or in cash, such as cash transfers for the incapacitated under social protection schemes.
- 3) **Nutrition** will be addressed through stimulating the production of foods with higher nutritional value as well as through awareness-raising and education on dietary matters. Particular attention will be given to vulnerable groups, notably children and HIV/AIDS sufferers.
- 4) **Capacity-building** will focus on building the Government’s ability to respond and coordinate donors’ responses to food insecurity. Support will also be given to further develop food security and nutrition security monitoring information systems for both crises and chronic situations. Where appropriate, non-state actors (NSAs) and NGOs will be funded to help communities recovery from crisis situations.

The EC will assess progress in the accompanying measures during the identification stage in order to determine the most appropriate means of intervention.

#### **IV.4 Regional Interconnection with focus on Road Infrastructure (15% to 20% of financial resources)**

Better regional interconnectivity entails improving the current state of transport infrastructure and facilitating institutional improvements to optimise the efficiency and capacity of road, rail, water and air transport. The reduction of transport costs<sup>26</sup> as regards the country’s imports and exports is a primary objective so as to increase the competitiveness of the country and its potential to grow, thus contributing to the overall objective of poverty reduction (see Annex 1-Country at a glance). The link between infrastructure improvements and poverty reduction has been well established and is one the fundamentals of the EU-Africa Partnership. On the assumption that the Government is aiming at attracting private sector funding for the railway network and at reinforcing co-operation with Mozambique, the primary focus in terms of investments for the European Commission will be on the road transport sector, which is expected to remain the most

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<sup>26</sup> 2005 SADC report indicates that transport costs as a percentage of landing costs are at least double those of the SADC region.

important transport mode. For its part, GoM is expected to take all necessary measures to increase the level of competition amongst transport companies and to increase its level of funding for the sector.

There is a need to consolidate and improve the road network. Malawi's paved road infrastructure is in fair condition as compared with its neighbours, but has to be maintained in a timely manner and in the order of priority of firstly routine maintenance, then periodic maintenance, and lastly road rehabilitation. Legitimate aspirations for the expansion of the paved network must be firmly controlled so as to avoid stretching the limited financial resources for maintenance and to forestall negative medium to long term effects on the entire sector. One significant challenge lies in improving the unpaved network and rural access notably during the rainy season. This is particularly important in areas of high agriculture potential or productivity where lack of access for farm inputs and for getting produce to markets is a substantial constraint on commercial viability. This is expected to be done in close coordination with the agriculture and food security interventions and to have a positive social impact.

More efficient and realistic maintenance planning and continued and predictable donor support is required to protect the existing investment in roads. The maintenance plan must give priority to the routine/periodic maintenance and rehabilitation needs of the main connecting corridors of the regional road network. This will be followed by the maintenance of the other paved and unpaved roads, with greater attention being paid to financing interventions on those peri-urban and rural roads serving agriculture production areas and areas which are structurally food insecure and need to be reached. This will have to be done in accordance with appropriate intervention standards and the financial constraints. Assistance is also needed for the Road Authority, following the separation of Road Fund and Road Authority functions. Particular areas requiring support are road safety (including facilitation of institutional reform to create a Road Traffic Authority), axle load control, network survey capacity, development of maintenance plans and public and private sector technical capacity and training. There will also be substantial volumes (€50 million) of 9<sup>th</sup> EDF backlog and periodic maintenance work under way in the period 2008-2010 for which the Road Authority will need support in its supervisory capacity. All road sector issues, including cross-cutting components are to be addressed in the Road Sector Programme, through which development assistance will be focused.

The EC/GoM bilateral cooperation will focus on the following:

- Within the framework of a Transport Sector Programme to be developed, support for the development and implementation of the Road Sector Programme, covering all institutional and operational aspects of network management, and including both main corridors and improved access to rural areas
- Capacity-building to support the agencies delivering the Road Sector Programme and developing sector policy
- Studies and assistance to develop the multi-modal transport sector programme, in particular to ensure improved performance of the rail network and concession holders. Studies will include a strategic environmental analysis to assess the impact of road infrastructure development.

Following the recent institutional reorganisation, Malawi is a good candidate for budget support to the road sector, provided that remaining capacity and organisational shortcomings or deficiencies can be fully addressed in the next eighteen months. Therefore support to implement the road sector programme will be mobilised preferably via sector budgetary aid. The use of project support should be maintained for capacity-building only.

Other regional interconnection investments like those in the railways network as well as in energy, water, telecommunication and fibre optics could well be supported via the Infrastructure Partnership.

#### **IV.5 Non-Focal Sectors (10% to 20% of financial resources)**

Under the 10<sup>th</sup> EDF, non-focal sectors will be Governance, Regional Integration - Trade, HIV/AIDS & Gender and Capacity-Building, aimed at assisting the smooth implementation of, and complementing, the focal sector activities in particular by increasing transparency, accountability and respect for essential rights. These areas are highlighted as priorities in the MGDS as strategic areas and/or cross-cutting issues.

##### **Governance**

The Governance aspect, being a building block of the MGDS, will aim at promoting a sound governance environment. This may include support for the rule of law and human rights institutions, promotion of democratisation at grass-roots level, electoral processes managed by the Malawi Electoral Commission (MEC), civic education programmes, regular work of Parliament and Governance Institutions, registration of citizens with coverage from birth, population census', capacity to report on and implement international conventions (e.g: ILO conventions on child labour), completion of a relevant migration profile, as well as a number of governance priorities identified in the African Peer Review Mechanism expected in 2007. As regards the electoral processes, it is essential that the recommendations deriving from previous elections are properly addressed (see Annex 13- Recommendations of the 2004 EU Electoral Observation Mission). The Government, for its part, has made five important commitments<sup>27</sup> (Ref: prospective governance commitments matrix), with specific reference to the electoral process. As in previous election processes, EC participation in a pool fund to be managed by UNDP is envisaged. With regard to the regular work of Parliament and other Governance Institutions, the Government has committed itself to ensuring, as a minimum, that funding for Parliament will remain constant in real terms (baseline FY 06/07) to enable Parliament and its committees to increase their sitting period. A similar commitment has been made as regards the funding of Governance Institutions. As these areas are part of the regular CABS dialogue, it is envisaged that support will mainly come via general budgetary aid. With regard to civic education, the EC/GoM cooperation will promote further the successful National Initiative for Civic Education (NICE) programme. Support will also be geared to the development of the capacities of the Non-State Actors involved in development cooperation, in accordance with the principles of the Cotonou Agreement and the Commission's Communication on Governance of 30 August 2006<sup>28</sup>. Non-State Actors (NSAs) in Malawi have effectively played a double role as vehicles for both advocacy and implementation of development co-operation. Support to NSAs will reinforce the support provided to Public Finance Management reforms under the general budget support programme and the governance dialogue under the CABS.

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<sup>27</sup> These cover the following areas: timely holding of the local elections and the presidential and parliamentary elections; revision of the voter register to be used in the presidential and parliamentary elections; equal access to the media by all political parties; the revision of the Malawi Electoral Commission (MEC) Strategic Plan and Action Plan with Electoral Commissioners appointed according to objective criteria; and the provision of adequate funding to the MEC for it to effectively manage the electoral process.

<sup>28</sup> "Governance in the European Consensus on Development-Towards a harmonised approach within the European Union" , COM(2006)421 final, Communication from the Commission to the Council , the European Parliament, the European Economic and Social Committee and the Committee of the Regions, 30.08.2006.

## **Regional Integration, Trade and Investment**

The promotion of trade, investment, regional integration and ultimately the integration of the country into the world economy will be undertaken to complement investment in the two focal sectors under the National Indicative Programme as well as those in the Regional Indicative Programme. Support for EPA implementation and reforms will be the main operational objective, to consolidate and complement the assistance, which will be primarily provided at the regional level. In this framework specific attention will be given to improve and foster sustainable food safety and agricultural health since the respect of SPS standards is essential for an agriculture based economy to open up new opportunities and market access to the region and EU under the EPA (revamped laws and regulations; improved risk assessment and management capacity; improved inspection and monitoring; adjusted and improved testing facilities; developed staff skills). Within the objective of economic diversification, assistance is also foreseen for the revision of the mining sector regulatory framework and for eventual participation with other main development partners in the updating of the geological mapping of the country.

## **Gender and HIV/AIDS**

Promotion of gender and the fight against HIV/AIDS are priorities in Malawi. Supporting the Government's commitment to reducing gender inequalities in accessing productive resources, development opportunities and decision-making will contribute positively to the acceleration of the economic growth and development. While the main entry point for the fight against HIV/AIDS remains the Global Fund<sup>29</sup>, support will be given to complement and reinforce the country's endeavours to mainstream gender and HIV/AIDS aspects in all GoM and EC funded programmes. The actual amount allocated for this intervention will be used for capacity-building amongst stakeholders (national counterparts, project managers, NGOs) and to establish monitoring mechanisms which are able to differentiate impact on poor women and men with the aim that all interventions equally benefit and empower poor women and men.

## **Institutional Capacity-Building**

The 10<sup>th</sup> EDF will continue to support efforts aimed at promoting the capacity of GoM institutions managing and implementing EC funded development programmes. The support will include specific assistance to the National Authorising Officer as well as Technical Assistance services to partner institutions through a Technical Cooperation Facility (TCF). The TCF will also be used to assist the Government of Malawi in preparing sector plans, strategies, medium-term expenditure frameworks, pre-feasibility and feasibility studies which may be a prerequisite for accessing funds under the Infrastructure Partnership and the EIB. Possible funding of environmental policy-making, the country's participation in Multilateral Environmental Agreements and the monitoring system of indicators on sustainable management of natural resources are also envisaged<sup>30</sup>.

## **IV. 6 Sectors outside bilateral development co-operation**

### **IV.6.1 Energy supply and generation**

The provision of electricity in Malawi is inadequate, unreliable and inaccessible to many who need it due to small grid coverage (about 5% of the population), inability to pay and under

<sup>29</sup> The combined EU MS and EC contributions account for more than 50% of the Global Fund against Malaria, TBC and HIV/AIDS.

<sup>30</sup> Suggested indicators to be monitored are: percentage of forests on total land; rate of desertification; percentage of farmers producing according to soil fertility management; percentage of income from forests and protected areas.

investment in the struggling power utility ESCOM. It is expected that in the medium term, Malawi may have increased access to electricity via the interconnection of its electricity grids to other regional sources in addition to increasing domestic production. The interconnection with Cahora/Bassa in Mozambique is of great importance to Malawi, but will not immediately solve the problem of lack of grid coverage in rural areas. The Government attaches high importance to rural electrification, as reflected in the Rural Electrification Master Plan and the MGDS, and is trying to gain donor support in this area. Government aims for the electricity sector overall are: a significant change in the energy balance from firewood to electricity-based, liberalisation of the energy supply, increased generating capacity to 1000 MW (from current 304 MW), and linkage to the South African Power Pool (SAPP). In this sector the European Union intends to assist Malawi via the Infrastructure Partnership and the EIB. Synergies and joint operations, primarily with WB and EU MS, are likely.

#### **IV. 6.2 Water supply and sanitation**

Efforts in this sector will concentrate on ensuring that water resources are well protected and managed. There is a need to improve sustainable access to water supply and sanitation in urban, peri-urban and rural areas, for example by establishing water supply and sanitation systems using demand-responsive and demand-driven approaches, and through the establishment of contingency water supply reserves and sanitation backups. Urban water boards are unable to function as commercial concerns because of dilapidated infrastructure, high water losses and low tariff collection. A particular difficulty facing water boards is supply to rapidly growing but very poor peri-urban areas with people who have a very limited ability to pay. The SWAP under development for the water sector needs to achieve maturity and wider acceptance in the framework of the current donor-supported National Water Development Plan II. The EDF-supported National Sanitation Policy drafted in 2006 (not yet adopted by the Government) lays the groundwork for improvements in rural and urban sanitation. In the water and sanitation sector, the EC intends to assist Malawi via the Infrastructure Partnership and the EIB. Synergies and joint operations, primarily with WB and EU MS, are likely.

#### **IV. 7 Support through the European Investment Bank**

Interventions by the Bank in the form of various risk capital instruments from the Investment Facility or loans from its own resources will remain essentially demand-driven. The focus will continue to be on the provision of long-term financial resources for sound and productive investments, mainly in the revenue-generating sectors, promoted either by public or private sector entities. The following main areas of possible intervention for the Bank have been identified:

- i) Support to large infrastructure projects, notably in the power and water sectors e.g. co-financing the proposed Malawi-Mozambique power inter-connection within the framework of the EU-Africa Infrastructure Partnership, rehabilitation and expansion of the hydro-electric generating facilities of ESCOM, and co-financing with the EU Water Facility of the Malawi Peri-Urban Water and Sanitation Project.
- ii) Support to small and medium-scale enterprises through a global loan or guarantee scheme, which is currently under consideration.

The overall extent to which the Bank will be able to commit resources will largely depend on the macro-economic framework and on the business environment, which is itself largely determined by the economic policy of the Government of Malawi.

## Annex 1: “Country at a glance” table

### Table of Macroeconomic indicators

		2000	2001	2002	2003	2004	2005	2006	2007
<b>Basic data</b>									
1	Population (in million) <sup>1</sup>	10.4	10.8	11.2	11.5	11.9	12.3	12.8	13.2
	- annual change in % <sup>1</sup>	3.1	3.2	3.3	3.3	3.3	3.3	3.3	3.3
2a	Nominal GDP (in billion MKW)	101.6	121.9	148.4	171.9	207.2	245.7	303.5	345.2
2b	Nominal GDP per capita (in USD)	165.5	160.4	160.3	143.1	150.9	161.4	167.2	171.8
2c	- annual change in %								
3	Real GDP (annual change in %)	1.1	-4.2	2.1	3.9	5.1	2.1	8.4	5.6
4	Gross investment (in % of GDP)	9.6	1.0	10.4	10.9	14.4	14.5	15.6	18.5
<b>International transactions</b>									
5	Exports of goods and services (in % of GDP)	23.7	25.2	21.8	24.9	24.6	25.4	26.0	25.3
6	Trade balance (in % of GDP)	-9.5	-9.4	-15.8	-19.9	-22.2	-22.9	-22.6	-19.5
7	Current account balance (in % of GDP)	-5.4	-6.9	-11.2	-7.6	-9.3	-5.9	-7.7	-1.8
8	Net inflows of foreign direct investment (in % of GDP)	1.6	1.7	1.9	2.4	2.3	1.3	1.3	1.4
9	External debt (in % of GDP)	156.7	162.1	143.3	158.9	148.1	136.8	47.8	31.9
10	Service of external debt (in % of exports of goods and non-factor services)	22.1	20.0	18.3	21.8	22.9	21.5	16.2	6.4
11	Foreign exchange reserves (in months of imports of goods and non-factor services)	4.0	2.7	1.5	1.6	1.5	1.5	1.2	2.2
<b>Government</b>									
		<b>00/01</b>	<b>01/02</b>	<b>02/03</b>	<b>03/04</b>	<b>04/05</b>	<b>05/06</b>	<b>06/07</b>	<b>07/08</b>
12	Revenues (in % of GDP)	26.9	28.6	26.7	34.7	37.6	44.1	41.8	39.0
	- of which: grants (in % of GDP)	8.1	10.6	6.7	12.2	12.5	19.2	17.6	14.8
13	Expenditure (in % of GDP)	25.5	30.2	38.3	42.5	43.1	46.1	43.1	39.4
	- of which: capital expenditure (in % of GDP)	6.5	8.2	7.4	11.1	11.1	11.9	14.7	13.3
14a	Deficit (in % of GDP) including grants	1.5	-1.6	-11.6	-7.8	-5.6	-2.0	-1.3	-0.4
14b	Deficit (in % of GDP) excluding grants	-6.6	-12.2	-18.3	-20.0	-18.1	-21.2	-18.9	-15.2
		<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
15	Debt (in % of GDP)	165.6	173.4	160.7	181.2	170.7	158.7	67.5	46.6
	- of which: external (in % of total public debt)	94.6	93.5	89.2	87.7	86.8	86.2	70.8	68.5
<b>Other</b>									
		<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
16	Consumer price inflation (annual average change in %)	29.6	27.2	14.9	9.6	11.4	15.5	13.1	7.2
17	Interest rate (for Treasury Bill, annual rate in %)	na	50.4	41.7	39.3	28.6	24.4	na	na
18	Exchange rate (annual average of national currency per 1 €) <sup>2</sup>	53.09	65.48	70.86	107.36	134.19	147.16	na	na
19	Unemployment (in % of labour force, ILO definition)								
20	Employment in agriculture (in % of total employment)								

Source: IMF (August 2006)

<sup>1</sup> National Statistical Office – Projected Population based on 1998 Malawi Population and Housing Census

<sup>2</sup> Info-euro exchange rates

### *Economic situation, structure and performance*

In the past ten years, the growth rate remained substantially below the level required (around 6%) to have a significant impact on the reduction of poverty in the country and showed quite an erratic trend with a maximum of 5% in 1997 and a minimum of – 4.1% in 2001. The average annual rate of growth in the last five years was 2.5%. These data demonstrate: a) the urgent need for a solid growth oriented strategy if poverty has to be tackled in a meaningful way; b) the fact that the economy of Malawi is highly vulnerable to weather conditions and that mitigating measures have to be taken as a matter of priority. In this framework, the introduction and expansion of irrigation schemes, based on appropriate technologies, is strongly advocated by Government. In 2005 the harvest of Malawi's food staple was badly affected due to a prolonged dry spell during the growing season in early 2005 and lack of adequate resources, which negatively affected the agriculture sector. This caused a serious food crisis possibly the worst in decades. This was addressed in a much more effective and efficient manner than previous food crisis due to the prompt GOM reaction and strong response of the donor community. In 2006, Malawi experienced one of the best harvests in terms of maize (400,000 tons estimated surplus) and other produces as well (cassava, potatoes, pulses, etc). This notwithstanding the recent MVAC underlined that a number of isolated areas fail to benefit from the increase of maize harvest and of overall agricultural production due to dry spells or devastating floods, while household access to food is undermined by low incomes perpetuating their vulnerability<sup>1</sup>.

The average annual inflation fluctuated between a minimum of 10.1% in 2003/04 and a maximum of 27.2% in 2001. The annual average inflation rate is primarily influenced by the food consumer price that constitutes 55.5% of the CPI. The non-food consumer price is largely influenced by fuel prices that have recently been on the increase. In 2005 the annual average inflation increased from 11.4% to 15.5% largely due to increased maize prices following the poor harvest and the sharp increase in the world fuel prices. The experience of 2005 re-confirms that food insecurity influences high inflation levels in the country, with its negative effects in terms of real economy and in terms of fiscal performances for the country, which has a domestic debt to serve.

In the first half of 2006 the Malawi Kwacha depreciated by 22% against the Euro and by 12% against the USD. Malawi has finally achieved the HIPC completion point at the end of August. Achievement of the HIPC completion point has enabled Malawi to qualify for further debt relief from the World Bank and International Monetary Fund under the Multilateral Debt Relief Initiative. This will reduce pressure from foreign debt repayment and release resources for poverty reduction and economic development related activities. The weight of foreign interest payments is expected to decline from 1.16% of GDP in 2005/06 to 0.57% of GDP in 2006/07 and amortization is expected to decrease from 2.83% of GDP to 1.88% of GDP.

With regard to the investment climate, unfavourable macro-economic environment has hindered private sector investment. These include high interest rates, volatile exchange

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<sup>1</sup> According to Malawi Vulnerability Assessment C---- Forecast for 2006-2007, about 833,000 people will not have adequate food, while the economic and living conditions of a further 147,800 people need to be closely monitored.

rates, high tax levels, interventionist approach by Government and poor utility services<sup>2</sup>. In particular, electricity supply is erratic due to limited power generation capacity and lack of connectivity to regional networks.

Furthermore, Malawi is a landlocked country with nearly all goods being transported via the road network<sup>3</sup> and limited use of the railways. Transport costs are reportedly much higher than neighbouring countries<sup>4</sup> and Malawi's export performance constrained by the high cost of trade, of which transport costs account for an average of 56%<sup>5</sup>. This is due to a combination of factors: over-reliance on road transport because of a non-functional rail network; limited competition amongst the few road transporters; cyclical nature of Malawi's exports, which negatively affects possibility of synergies between imports and exports flows.

The reduction of transport of costs as regards the country's imports and exports is a primary objective so as to increase the competitiveness of the country and its potential to grow, thus contributing to the overall objective of poverty reduction. Import costs are high, critically for agricultural inputs. Transport costs for exports, mainly agricultural commodities at present, are also high (a 2005 SADC report indicates that transport costs as a percentage of landing costs are at least double those of the SADC region). This is due to over-reliance on the road transport mode, cyclical nature of Malawi's exports and imports with impact on transport costs (trucks may make one journey empty), and limited competition amongst service providers within the road transport sector. Prime recommendations of a World Bank funded transport costs study, carried out last year, concerned improvements to the Nacala corridor rail link, which offers potentially the cheapest export route to the coast and can reduce freight volumes on the roads with positive effects on road maintenance needs. Rail transport has, however, been decreasing in importance. In 2002 about 20% of exports by weight were by rail, but this reduced to practically zero following the Rivi Rivi bridge washout in 2003. The reinstatement and improvement of rail operations depends largely on effective concession arrangements and good sector regulation. Capital investments are required for rehabilitation of rail infrastructure. Assumption is made that Government should aim at attracting private sector funding for the railway network, on the one hand, and at reinforcing co-operation with Mozambique, on the other hand.

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<sup>2</sup> According to the 'Doing Business in 2006-Malawi Country Profile' indicators (WB/IFC), Malawi ranks 96<sup>th</sup> (out of 155 countries) in terms of Economy (aggregate) rankings. Bank interest rates have remained unchanged at 25% since June 2004.

<sup>3</sup> The international routes are by rail through Mozambique to the ports of Nacala (Nacala Corridor) and Beira (though currently dysfunctional), by road to the ports of Beira (Beira Corridor) in Mozambique, Dar-es-Salaam (Northern Corridor) in Tanzania and Durban (Southern Corridor) in Republic of South Africa.

<sup>4</sup> Transport costs in landlocked countries in Africa are generally high, though in Malawi they are higher than most other countries in the continent. According to Comesa, transport costs expressed as a percentage of the value of exports were 56% for Malawi, compared with 14% for the average for Africa (17% for Zambia), and an average of 8.6% for all developing countries. Clearly this illustration highlights an unacceptable situation for Malawi. The Malawi Transport Costs Study in 2005 cited many varying reasons for the high transport costs. In this context, lack of competition between transport modes particularly with the rail sub-sector was shown as a major factor. The transport cost study advocated some measures to reverse the trend and these include creating one stop border post on all major transport corridors to allow for the smooth flow of traffic, investigation into VAT rebates for Malawi international carriers, improvement to regulatory instruments and procedures for customs clearance, regional integration and standardisation of freight tariffs. Additionally the establishment of Regulators is needed for those sub-sectors where concessions are granted. Ref: The Case for a National Export Strategy: Key Issues and Possible Response, MoTPSD, September 2005

<sup>5</sup> The Case for a National Export Strategy: Key Issues and Possible Response, MoTPSD, September 2005

### *Structure and management of public finances*

The new government (since mid 2004) has shown a strong commitment to improve fiscal performance, bring government expenditure under control and achieve a reasonable degree of macro-economic stability. The most important achievement was stopping the fiscal latitude of the past, which has left the country with a high domestic debt burden<sup>6</sup>. In the fiscal year 2004/05, for the first time in more than ten years, the Government managed to stay within the budget approved by Parliament.

Since 2004/05, the country has developed its budget within the framework agreed with IMF Staff Monitoring Programme (SMP) in 2004/05 and Poverty Reduction Reduction Growth Facility (PRGF) since August 2005. The successful completion of the SMP and the satisfactory performance under PRGF, re-confirmed by the IMF Board on 30 August 2006, helped to unlock the flow of aid from donors, including DFID, Norway, Sweden, WB and the European Commission. The present fiscal policy aims at reducing the weight of government's domestic debt, while allowing for increases in pro-poor (health and education) and pro-growth (infrastructure; agriculture) expenditure. Nevertheless, the proportion of budget spent on pro-poor expenditure in 2004/05 was 16.2% below the target of 18.9%<sup>7</sup>. In the fiscal year 2005/06, government was under pressure to control expenditure whilst faced with pressing need to respond to the food security crisis by importing maize and fertilizer<sup>8</sup>. However it is now expected that this policy will be pursued with an even higher commitment and vigor in the current fiscal year and the following ones. In the FY2006/07, the PRGF has programmed the Net Domestic Debt/GDP ratio at 16.5% down from 20.0% in FY2005/06 and 23.8% and 24.8% in FY 2004/05 and 2003/04 respectively. The PRGF has further set targets of 12.8% and 8.6% for FY2007/08 and FY2008/09, respectively. The programmed proportion of domestic interest payments to GDP has likewise followed a declining trend. In the FY 2006/07, the PRGF has programmed domestic interest payments/GDP ratio at 4.3% down from 5.4% during FY2005/06 and 7.4% and 9.1% in FY 2004/05 and 2003/04 respectively. The PRGF has further set targets of 3.1% and 2.2% for FY 2007/08 and FY 2008/09.

### *Assessment of the reform process*

According to the PEFA based PFM Assessment report of June 2006, although the PFM system in Malawi remains weak, some aspects of it has improved since the last similar exercise completed in July 2005. This was also noted during the CABS reviews held in March and September 2006. The improvement is attributable, among other things, to the recent implementation of the Integrated Financial Management Information System (IFMIS) thus leading to some improvements in expenditure control and timely financial reporting... According to the IMF, the implementation of the IFMIS system has been an impressive achievement particularly when viewed against international experience in implementing similar systems. However the PEFA review confirmed that internal and

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<sup>6</sup> This is a heavy inheritance from the past that the government is trying to manage under the present difficult situation – political, weather condition, oil prices - domestic interests accounted for more than 9.0% of GDP in 2003/2004

<sup>7</sup> March 2006, CABS Review, Aide Memoire

<sup>8</sup> According to CABS Estimates, unforeseen food security operations (food imports) account for the largest increase in unbudgeted expenditure, being forecast to cost MK 6.0 billion more than the approved MK 5.6 billion budget, though most of the excess was funded by donors. Furthermore, expenditure on fertilizer is expected to be MK 2.1 billion higher than the MK 4.8 billion originally budgeted.

external audit capacity is extremely limited in Malawi and this has implications for control over the data being maintained in the IFMIS system. Currently there is little capacity to perform systems audits and this is an area that the Auditor General should address through training of staff and procurement of suitable system audit software. The situation with procurement has improved, although according to CABS remains of concern for some specific procurement processes. A number of donors are supporting the office of the Director of Procurement and progress is expected soon.

Within this framework the Government has pursued with vigor the anti-corruption campaign. Moreover the Government has developed a new action plan on public finance management, approved at the end of October 2006. The plan focuses on priority measures [i.e: a) Planning (systems and models for national and sector planning; coordination of planning processes); b) Resourcing the national development strategies (effective revenue mobilization; strategic approach towards resource allocation); c) Budgeting for the MGDS (efficiency of budget preparation; accounting and financial procedures); d) Monitoring systems for management decision taking (strengthen internal controls and accounts reconciliations; baseline parameters and data sourcing); e) Reliable reporting system (reporting for accountability and control); f) Directing improved proficiency in Public Finance and Economic Management (steering the PFM process; managing the MGDS)] to be taken so as to address the main weaknesses and indicates activities to be implemented with a clear timetable to be jointly monitored.

In August 2006 Parliament passed a money laundering and terrorism financing Act. The Reserve Bank has also issued directives and guidelines to commercial banks in line with recommendations on money laundering and terrorism financing. In addition, the banking sector is known to have taken the initiative to implement the required arrangements, checks and controls without the legal framework in place.

*Trade policy and external environment, in particular regional cooperation agreements and EPAs*

Tobacco remains Malawi's largest foreign exchange earner accounting for approx. 50% of total exports while sugar is second accounting for approximately 10% of total exports. Malawi has experienced declining competitiveness in a number of products (mainly tea, textiles and cotton). Apart from low investment incentives due to macro-economic instability, low saving rates, high interest rates and low annual manufacturing value added, Malawi's export performance is constrained by (i) high costs of trade, mostly due to high transport costs (on average, 55% of the cost of production),<sup>9</sup> (ii) weak institutions in trade support network involved in enforcing the regulatory framework. The formulation of the National Export Strategy was a notable development in 2005 together with the establishment of a Competition Commission. The challenge ahead lies in the implementation of the strategy and the level of involvement of the private sector.

While Malawi's participation in EU trade remains extremely limited (0.01% to 0.02% of the total EU exports/imports), the EU continues to be Malawi's largest trading partner in terms of the country's exports, as approx. 37% of Malawi's exports are destined to the

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<sup>9</sup> The Case for a National Export Strategy: Key Issues and Possible Response, MoTPSD, September 2005. Value added per capita in Malawi is rated at US\$25, one of the lowest figures in the region (2000 figures from UNIDO 2004 study).

EU<sup>10</sup>. The overall balance of trade in 2005 with the EU remains in Malawi's favor with a trade surplus of close to € 60 million. The main products being exported by Malawi into the EU are tobacco (67 %), sugar (17%) and tea (9%). These three products alone make to 93% of Malawi's total exports to the EU valued at € 172 million. After the EU, Malawi's main trading partners for its exports are South Africa (14%), the USA (12%) and Egypt (8%). The remaining 29% constitutes mainly of SADC and ESA member states. In terms of imports Malawi's main trading partner is South Africa (38%) followed at a great distance by the EU (18%), India and Mozambique (at 8% respectively), Zimbabwe at 7% and Tanzania at 5%.

Malawi's eagerness to pursue regional trade agreements has resulted in membership of a number of overlapping preferential arrangements. The most notable of these is the membership of COMESA and SADC – which are both expected to establish free trade areas and aiming for their respective full customs union in the near future. This is not unique to Malawi and is instead a feature in the sub-region where the majority of countries are members of different regional organizations, thus over-complicating the regional integration process. Although Malawi is a member of SADC, it has decided to pursue the Economic Partnership Agreement (EPA) negotiations with the EU with its COMESA partners under the Eastern and Southern Africa (ESA) grouping. However there is no doubt that Malawi will continue to follow closely the developments within the SADC group and may envisage a rapprochement between the two regional groupings, bearing in mind the strategic role of South Africa. Concerning the EPA negotiation process, Malawi's (EPA) Impact Assessment Study (IAS) revealed that the recommendations offered were too general and not practical and relevant in terms of what Malawi's approach to the negotiations process should be. Further on developmental issues and agriculture in particular they are not specific and not detailed enough.

At WTO level over the past three Ministerial meetings<sup>11</sup>, there has been a positive shift in the quality of Malawi's participation and representation in trade negotiations. Trade and trade-related capacity building in Malawi has contributed to this development, as have regional and international organisations in assisting with the development of common negotiating strategies and positions.

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<sup>10</sup> External Trade, Volume 6 fiches pays 2005, The European Commission Directorate General for Trade.

<sup>11</sup> Doha (2001); Cancun (2003) and Hong-Kong (2005).

Table of indicators for the Millennium Development Goals								
	Indicator	1998 <sup>12</sup>	2000 <sup>13</sup>	2002 <sup>14</sup>	2005 <sup>15</sup>	2011 MGDS Target	2015 MDG Target	
Impact	1. Proportion of population below the poverty	53.9 %	---	---	52.4%	44.4%	28%	
	2. Prevalence of underweight children (Under-five years of age)	---	30%	---	22%	15%	15%	
	3. Under Five mortality	---	189 per 1000 live births	---	133 per 1000 live births	36/1000		
Outcome	4. Net enrolment ratio in primary education	---	78%	81%	93% <sup>16</sup>	95%		
	5. Primary Completion rate	---	---	---	28%	48%		
	6. Ratio of girls to boys in:	---	1:1	1:1	1:1	1:1		
		-primary education	---	1:1.1	1:1.1	1:1.1	1:1.1	
		-secondary education	---	---	---	---	--	
	-tertiary education	---	---	---	---	--		
	7. Proportion of births attended by skilled personnel	---	56%	---	38% <sup>17</sup>	75%		
	8. Proportion of 1 year old children immunized against measles	---	70%	---	82% <sup>18</sup>	85%		
	9. HIV/AIDS prevalence amongst 15 – 24 year old pregnant women	---	17% <sup>19</sup>	---	16.9% <sup>20</sup>	14.7%		
	10. Proportion of population with sustainable access to improved water source	---	---	65.6 <sup>21</sup>	66.3 <sup>22</sup>	80%	85%	

<sup>12</sup> 1998 Integrated Household Survey – 1.

<sup>13</sup> 2000 Demographic and Health Survey 2000.

<sup>14</sup> 2002 Demographic Health Survey Education Data Survey.

<sup>15</sup> 2005 Integrated Household Survey.

<sup>16</sup> Assessment of PFM, economic and social indicators governing the disbursement of the variable tranche of the PRBS1. GoM Draft report - February 2006.

<sup>17</sup> Ministry of Health, Health Management Information System (HMIS) figure for 2004/2005 as reported in the Performance Assessment Framework (PAF) of August 2006.

<sup>18</sup> Ministry of Health, Expanded Programme of Immunization (EPI) figure for 2005 as reported in the Performance Assessment Framework (PAF) of August 2006.

<sup>19</sup> "HIV and Syphilis Sero-Survey and National HIV Prevalence Estimates Report 2005", December 2005, Ministry of Health National Aids Commission.

<sup>20</sup> "HIV and Syphilis Sero-Survey and National HIV Prevalence Estimates Report 2005", December 2005, Ministry of Health National Aids Commission.

<sup>21</sup> MPRS Comprehensive Review First Draft Report, November 2005.

<sup>22</sup> MPRS Comprehensive Review First Draft Report, November 2005.

### *Social situation*

Since the introduction of free primary education in 1993/1994, enrolment has increased from 1.9 million to over 3 million at present. Net Enrolment Rate (NER) in primary education (EP1) has reached 80% in 2005 according to government statistics (IHS2). Gross enrolment rate at 140 % (UIS statistics for 2002/03) is the highest in the world, indicating inefficiencies and a high burden of under-aged and over-aged children (due to repetition) on the primary education system. However, only three out of 10 children starting primary school reach grade 5, the survival rate of 32.8 % being one of the lowest in sub-Saharan Africa. While progress was made in terms of access there is a unanimous criticism of the declining quality, which is monitored and reported by all Malawians. The root causes are the insufficient number of teachers and consequently large class sizes, a high teacher attrition rate largely due to HIV/AIDS, the very low level of qualification of teachers recruited, the poor curriculum and poor school infrastructure. Whilst the gender gap in primary education is small, girls' secondary school enrolments are below those of boys, particularly for girls from poor households. In this context, additional efforts are needed to reduce primary school dropouts and improve completion rates of primary schooling.

Education, or lack of it, is a key factor for women's empowerment. The IHS-2 asserts that in general, more women, especially female-headed households are poorer than their male counterparts due to various social, cultural, economic and/or political factors. Women are also likely to have less access to education, credit, land, and property than men. Further and due to their relatively higher lack of education women have less access to employment opportunities, in both the public and private sectors and do not have equal access to technology and other key market information to support their business activities. However, 2005 has seen some small progress in the proportion of women in decision making positions with a rate reaching 14% in 2005, a percentage point increase when compared with 2004 figure<sup>23</sup>. Moreover in April 2006 Parliament passed the bill on domestic violence.

The delivery of health services remains one of the worst in the world. As is to be expected in a poor country, Malawi's health system is grossly under-funded. Progress is expected for FY06/07 and FY 07/08 with a strong increase in nominal terms due to the implementation of a SWAP in the Health sector. Actual per capita expenditure is approximately USD14, which is insufficient for the delivery of even a narrow package of essential health services. Many nurses and doctors prefer to work abroad where they are much better remunerated. Recently the Government has launched a donor-sponsored programme to retain as much as possible health personnel in the country. Some questions are raised about the sustainability but the urgency of immediate needs call for intervention. While the majority of Malawians live in the rural areas, 97% of government-employed clinical officers and 82% of government-employed nurses are in the urban areas. Only 54% of the rural population has access to formal health services within a 5 kilometers radius<sup>24</sup>. This, taken together with already very low aggregate level of health expenditure and the non-even distribution of health personnel means that access to formal health services in Malawi is very low. In any case, the health system throughout the country is in a state of disrepair. The limited availability of drugs and medical supplies in hospitals is due to a lack

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<sup>23</sup> Assessment of PFM, economic and social indicators for the PRBS1 variable tranche – Draft GoM 2006

<sup>24</sup> Situation Analysis on Human Resource in the light of the EHP Implementation June 2003, Health Services Planning Department, Ministry of Health and Population. Lilongwe: Ministry of Health and Population.

of a properly functioning national procurement, distribution and stock management systems<sup>25</sup>.

### *Millennium Development Goals*

Maternal mortality ratio doubles in the period 1992-2000 and only recently has possibly declined but still remains one of the highest in the world (1.120 per 100.000 live births). A closely related issue is that there has been slow progress made in increasing the proportion of births attended by a doctor, clinical officer, nurse or mid-wife. There is also a significant difference between urban and rural areas where traditional practices still prevail<sup>26</sup>.

On a more positive note, the prevalence of underweight children (under five years of age) has dropped from 30% in 2000 to 22% in 2005. However the prevalence of malnutrition remains high<sup>27</sup> and much remains to be done to accelerate the trend. Protein energy malnutrition (PEM) is very high in Malawi with under five children stunting at 48%. The problem of malnutrition in children under age five is spread throughout the population and there is not much difference in the prevalence of malnutrition between urban and rural areas. Another positive note is that childhood mortality has decreased. During the 1990s there was a gradual decrease in infant mortality and under-five mortality. This trend appears to have accelerated in the last five-year period. Infant and under five mortality were about 76 and 133 deaths per 1000 live births respectively in the 2000- 2004 period, as compared to the higher figures of 104 and 190 deaths per 1.000 live births in the 1990-1994 period. Despite this improvement, one in eight children born in Malawi dies before reaching their fifth birthday. Malaria is a major killer, accounting for up to 40 % of all under-five hospitalizations and 40% of under-five hospital deaths in Malawi<sup>28</sup>, while diarrhoea ranks second. It is clear that improved mosquito net coverage, access to safe water supplies, access to rehydration therapies and nutrition education could save the lives of many under-five children.

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<sup>25</sup> A Joint Progr.of Work for a Health Sector Wide approach (SWAp) (2004 –2010)”, Dept of Planning, MoH, December 2004, p.9

<sup>26</sup> “Poverty in Malawi from the Second Integrated Household Survey 2005”. An extract of findings by the Ministry of Economic Planning and Development, National Statistical Office, end of 2005

<sup>27</sup> “Malawi Demographic and Health Survey 2004”, Preliminary Report, National Statistical Office. End 2005.

<sup>28</sup> Annual Report of the work of the Malawi Health Sector (July 2004-June 2005), Planning Department Ministry of Health, 15.09.2005

## Annex 2 –Donor Matrix

### 1. Financial Donor Matrix 2002-2006<sup>1</sup> (in € million)

Donor/Sector	Rural Development	Health	Food Security	Budget Support	Education	Good Governance	Transport	Economic Management	Judicial	Water	Trade Development	Energy/ Environment	Decentralisation	Gender	Urban Development	Total
European Union	89.4	10.8	90.4	67.5	-	36.3	67.5	11.4	1.5	-	1.6	-	-	-	0.1	376.4
DFID	50.0	82.6	38.6	67.1	21.8	25.3	-	15.5	16.8	-	-	-	-	-	-	317.7
USAID	32.6	52.5	127.0 <sup>2</sup>	-	78.7	4.1	-	-	0.4	-	-	-	-	-	-	295.3
World Bank	105.8 <sup>3</sup>	41.7	4.8	66.7	30.2	-	- <sup>4</sup>	20.3	-	-	12.5	0.3	-	-	0.5	282.8 <sup>5</sup>
AfDB	46.5	25.1	-	11.7	50.3	20.1	22.9	-	-	16.1	-	-	-	-	-	192.6 <sup>6</sup>
NORAD	7.4	62.9	20.5	15.9	-	4.0	-	6.4	-	2.3	-	-	-	-	-	119.4
IMF	-	-	-	46.6	-	-	-	-	-	-	-	-	-	-	-	46.6 <sup>7</sup>
Germany	2.3	4.9	-	-	7.0	2.9	0.3	1.4	-	-	-	4.9	4	1.3	-	29.0
France	-	-	2.8	-	0.3	-	-	-	-	-	-	-	-	-	-	3.1
<b>Total</b>	<b>334.0</b>	<b>280.5</b>	<b>281.3</b>	<b>275.5</b>	<b>187.9</b>	<b>92.7</b>	<b>90.7<sup>8</sup></b>	<b>55.1</b>	<b>18.7</b>	<b>18.3</b>	<b>14.1</b>	<b>5.2</b>	<b>4</b>	<b>1.3</b>	<b>0.6</b>	<b>1,660</b>

<sup>1</sup> Global commitments (approximate) made during the 2002-2006 period

<sup>2</sup> USAID's Food Security Support includes US\$149 million (approx. €124 million) for the purchase and distribution of 300,000 tonnes of maize through the WFP in the 2002-2006 period.

<sup>3</sup> World Bank Support to Rural Development includes US\$60 million (approx. €50 million) for MASAF III, of which, US\$27.2 million is a grant and US\$32.8 million is a concessional loan.

<sup>4</sup> World Bank & Nordic Development Fund (NDF) support to the transport sector is a loan of \$37 million (approx. €30 million, ROMARP Programme, 1999-2006) committed in 1999 (not shown in the matrix).

<sup>5</sup> World Bank total support consists of approximately €105.4 million in form of concessional loans and €177.4 million in form of grants.

<sup>6</sup> African Development Bank support comprises approximately €113.9 million concessional loans and €78.7 million grants.

<sup>7</sup> IMF support is the US\$55 million (2005-2008) PRGF Programme.

<sup>8</sup> Not included is the BADEA/OPEC/KUWAIT Fund US\$40 million (approx.€33 million) loan for construction of the Naminga-Chiponde-Mangochi Road Project which started in 2001.

## 2. Forward looking donor matrix (in € million)

	General Budget Support	Agriculture and food security	Water	Transport/ infrastructure	Health	Education	Good governance/ public sector management	Trade	Private sector development	Other
EU (2008 to 2013) <sup>9</sup>	135	105		70			15	10 <sup>10</sup>		14 <sup>11</sup>
World Bank (2007 to 2010) <sup>12</sup>	86.0 <sup>13</sup>	43.0	19.6	47.0	15.7	23.5	19.6 <sup>14</sup>		11.8	
UK (DfID) 2007 to 2009 <sup>15</sup>	89	44			89 <sup>16</sup>	51	44			
USA (2007) <sup>17</sup>		11.0 <sup>18</sup>			16.5 <sup>19</sup>	4.7	21.0 <sup>20</sup>		5.5	
Norway (2007) <sup>21</sup>	6.1	6.2			18.2		7.0 <sup>22</sup>			4.3
IMF	16.5 <sup>23</sup>									
AfDB (2005 to 2007) <sup>24</sup>				27	9	9	9			
Germany (2006 to 2007) <sup>25</sup>					9.3	13.6	13.0 <sup>26</sup>			2.0
EIB <sup>27</sup>			X	X					X	
France (2007 to 2009) <sup>28</sup>										3.0
UNICEF & UNDP (Y 2007)		1.6	1.7	0.8	7.4	2.9	3.8		0.5	4.4
JICA (proj. 2007)				0.5	0.22	2.6				

<sup>9</sup> Figures given refer to global commitments in the period 2008 to 2013 (total €349 million).

<sup>10</sup> Economic Partnership Agreement-Investments and Trade.

<sup>11</sup> Cross-cutting: Institutional Capacity Building (€10 million) and HIV/AIDs and gender (€4 million).

<sup>12</sup> Figures given refer to global commitments in the period 2007 to 2010 (total €266 million). Grant element is expected to be around 45%, with remainder on IDA credit terms.

<sup>13</sup> MGDS Development Policy Credit.

<sup>14</sup> Public Sector Management SWAp/MASAF III-II

<sup>15</sup> DfID indicative disbursement of €317 million for the period 2007/08; 2008/09; 2009/10, subject to a new country strategy.

<sup>16</sup> Including support for the retention of health workers

<sup>17</sup> USA annual disbursement is about € 58.7 million (USAID, CDC, Food for Peace, Millennium Challenge Account)

<sup>18</sup> Food for Peace. The Food for Peace program consists of donations of American grain (in Malawi's case wheat) that are given to NGOs. The NGOs then sell the grain at world market prices to local millers. Proceeds are used to fund agricultural development projects in the country.

<sup>19</sup> USAID €12.5 million, Center for Disease Control (CDC) €4 million (HIV/AIDS)

<sup>20</sup> Millennium Challenge Account (€16.4 million), USAID (€4.6 million)

<sup>21</sup> Indicative disbursement figures for 2007. Disbursement of € 42 million per annum

<sup>22</sup> Support to government and civil society, general

<sup>23</sup> Disbursements for 2007 and 2008 under the three-year Poverty Reduction Growth Facility (PRGF) Agreement.

<sup>24</sup> Global commitments for the period 2005 to 2007. Pillar I – Expanding Rural Infrastructure, Pillar II – Developing Human Capital and Institutional Capacity (better education, improve health service delivery and strengthen institutional capacity. 100% grant element.

<sup>25</sup> Figures given refer to global commitments in the period 2006 to 2007 (total €38 million)

<sup>26</sup> Support to democratic decentralization.

<sup>27</sup> Amounts not indicated yet

<sup>28</sup> Some €3 million for projects to be decided.

## **Annex 3: Executive Summary of the Country Environmental Profile Summary**

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### **1.1 State of the environment**

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About 85% of Malawi's estimated population of over 12.3 million lives in rural areas and this is expected to double over 20 to 25 years. The average population density is 105 people/km<sup>2</sup>, but higher, at ~143/km<sup>2</sup>, in the southern region. There are over 6 million smallholders (75%) farming on fragmented customary land and ~1/3<sup>rd</sup> of all agriculture taking place on unsuitable land.

The over-riding environmental issue is land degradation resulting from population and land pressure, especially in the densely populated southern region, with key issues of soil erosion, decreasing soil fertility and deforestation, and extreme climatic variations all affecting agricultural production and all linked sectors of the economy through a multiplier effect. Major problems currently are:

- Inappropriate land management practices and agriculture on unsuitable land, and widespread use of fertile soils, timber and firewood for brick production and construction.
- Very high soil erosion rates (10-43t/ha/yr) negatively affecting services such as water supplies, fisheries, lake and river transport, electricity generation, agriculture and irrigation. The main threats to water quality include increasing soil sediment loads, pollution with sewerage in urban areas and with agro-chemicals in rural areas, and the proliferation of invasive plants. The country's lakes, rivers and wetlands and wetland ecosystem functions are all under threat.
- There is high energy demand, with 93%, from fuel wood and charcoal. Forest cover has declined from ~47% in 1975, to ~26% in 2006 (4.4 to 1.9 million ha from 1972 to 1992), with 21% under Forest and Wildlife Reserves and National Parks, leaving only 7% on customary land. Deforestation continues at a rate of ~2.8% -3.4% per year.
- Changes in hydrological regime over the past 40 years have been from perennial to seasonal, mainly due to significant variations in weather patterns, ranging from severe droughts to extreme flood events with associated landslides and strong winds. This has also led to aridification in some areas of the country – mainly in the central and southern Shire Valley.

Malawi's biological diversity is highly varied with ~100 plants, reptiles, amphibians, and ~500 endemic fish species in Lake Malawi. There are 33 protected large mammals and 11 protected tree species, most of which are found in the five National Parks and four game reserves, covering 11.6% of the country's land area, or in the lakes, wetlands and rivers. Biological diversity is now seriously threatened, mainly due to habitat encroachment and

decline, over-harvesting, and the introduction of alien species. About 60% of the country has been modified, leaving only 36% under natural vegetation.

Poaching, mainly using wire snares, has caused the decline of many of the large mammal species. Nyala, waterbuck and sable antelope populations have significantly declined in National Parks and reserves, and the elephant population is now reduced to vulnerable status. Game hunting is limited to a few small game species, but game bird hunting is permitted, and trapping is recognised as a major economic activity. Trapping continues in the nesting season though, so the activity is non-sustainable.

Fish species and aquatic biodiversity are also under serious threat, and the fish stocks are declining due to over-fishing, siltation of spawning grounds, and the prevention of fish migration to breeding areas in rivers because of weirs and other obstructions.

The general living conditions, characterized by widespread poverty and decreasing trends in food and economic security create a dependence on short-term income generation instead of long-term, sustainable natural resource management. With so many people producing staple food crops on very small, manually cultivated, rainfed plots (<0.5ha/family), there is little opportunity for food and income security, and with shifting agriculture no longer possible, soil fertility and crop yields are rapidly declining. Meanwhile, livestock and range productivity are limited by the lack of availability of grazing land. Livestock numbers are low, so impacts from livestock are restricted to marginal areas such as hill sides, where they cause erosion, and to wetlands and riverine areas, affecting wetland function.

These problems have encouraged non-sustainable Income-generating strategies such as live tree-felling to make charcoal to sell, and cropping on riverbanks and in seasonally dry stream beds.

National energy requirements are mostly met by fuelwood/charcoal (93%). By 1992 it was estimated that the annual wood consumption of 5.2 Mm<sup>3</sup> exceeds sustainable supply by 3.3 Mm<sup>3</sup> and a fuelwood crisis is looming. NTFP are increasing sources of alternative or complementary income and a risk of over exploitation exists due lacking management. Fire mostly of human origin, is one of the greatest threats to forestry, with productivity regularly destroyed by bushfires.

The fisheries sector is very important, with artisanal fisheries located mainly in rivers and inshore areas accounting for 85-95% of the annual catch of ~50,000 tons. Aquaculture and fish farming are not yet well developed. Fish provide 60-70% of the country's animal protein intake, but per capita supplies have steadily fallen (12.9 kg/yr in 1976 to 6.4 kg/yr in 2003) due to over-fishing. This has caused in declining catches, a reduction in size and age of catch, altering the species composition and biodiversity of fish-stocks and decreasing protein supply.

Irrigation development has quadrupled over the past 40 years and water-related vector-borne diseases prevail around irrigation schemes. Meanwhile, domestic water consumption is steadily rising, with surface water and groundwater quality still acceptable for human consumption but the major rivers showing increasing pollution.

Urban growth is increasing at a rate of ~6.7%, with the current urban population estimated at 1.4 million. Of this, 60-70% live in traditional housing areas and unplanned squatter settlements. Poor or disregarded planning has resulted in extreme urban squalor and deprivation, poor sanitation, and the rapid spread of communicable waterborne diseases. Improper disposal of wastes (liquid and solid), agro-chemicals (fertilisers and pesticides), and effluent from industries, hospitals and other institutions are major urban problems with only 77% of proper disposed waste and most of the waste water enters the river systems that provide drinking water for downstream communities as raw sewerage.

The environmental impact of mining and industries is still limited due to the minor economic role of the sectors, but extraction of construction materials e.g. sand and clay for bricks, lime for cement (with a high demand for fuelwood for brick-making), are increasing. Sand and gravel extraction leave large holes, providing environments for disease vectors and waterborne pathogens, and disrupting fish breeding grounds. Industries, mainly in agro-processing, compound the pressure on the urban waste management systems. Other mining and industry issues include cement-making, which is the second greatest contributor to GHGs in Malawi, after agricultural-related causes, and creation of noise, dust, air pollution from furnaces, and effluent by-products, but these impacts are currently very low.

The importance of a national environmental information system (EIS) was clearly stated in the NEAP in 1996, but a regular systematic survey has never been implemented.

### **Environmental policy, legislative and institutional framework**

The institutional framework for environmental management is set through the Environmental Management Act (1996). The framework is divided into 4 administrative levels and the Environmental Affairs Department (EAD) is the central coordinating body. The current Institutional Framework is highly complex due to the number and size of the institutions involved in administering environmental affairs. This includes confusion about responsibilities and a general lack of awareness of cross-cutting environmental issues and how to include them into project design. In addition, the delivery of environmental management services is fragmented across NRM sector ministries dealing with environmental issues, resulting in a lack of coordination.

GoM accords an important position to civil society in the environment management system. District Assemblies are responsible for managing local development plans, ensuring the implementation of concrete environmental actions, and including EIA and environmental and natural resource utilisation programs by CBOs and NGOs, who, along with Scientific Research Institutions, are included in the policy development process at national level. But there is still a lack of understanding of roles and responsibilities in environmental management at the village level, often resulting in expectancy that the government has to manage and pay for everything.

Human capacity is generally constrained starting from Departmental level, right through to the District and village level. The technical capacity within the environmental management system is lacking, with key personnel not in place. At the District level, EDOs are either absent or their role is carried out by unqualified/untrained staff. Most of the GoM structures are operating with less than 50% of the necessary staff and key tasks especially implementation, monitoring, control and coordination are not assured. Lack of adequately trained people is a problem in some technical disciplines, especially in the 'brown environment' (waste water and solid waste management, air pollution control). Research institutions are not being proactive enough in adapting student courses to deal with new issues and social and technical needs.

District technical support and community programs have been assumed by NGOs and CBOs through donor funds due to missing capacities (human and finances) in the districts. Lack of management capacities exist at all levels including NGOs, and communities often get inadequate or incomplete support resulting from programs that are often subsequently not sustained.

Funding of environmental activities is insufficient at all levels. The budgets requested by the different departments are never fully allocated, mainly resulting in reduced field activities such as control and supervision missions and surveys. Due to a low number of paying clients and increasing urban environmental problems, the maintenance and extension of basic services cannot be provided adequately in urban areas by the City Assemblies. Districts have neither equipment nor recurrent budgets to operate extension and maintenance operations. This results in rapid deterioration of infrastructure developments.

Since 1996, a large number of sectoral and overall policies related to environment have been developed and implemented. There is a generally good environmental legislative framework including EIA, standards and norms, but there are aspects that need better harmonisation and some legislation still awaiting approval. Malawi is also a signatory to many International and Regional Treaties and Conventions concerning Environment and Natural Resources

The actual problem is that the policy and legislative framework are very complex and relevant documents are often only known about in the concerned department or ministry. There are few follow-ups and/or concrete actions aside from policy development and existing regulations for the different economic sectors are not always respected, which is mainly due to a lack of priority within Government, and a lack of funding, manpower, and equipment in the technical departments for control.

At the national level, information exchange and circulation are already very slow, but when added to the weaknesses in implementation capacity, effective, sustainable NRM, is further impeded.

### **EU and other donor co-operation with the Country from an environmental perspective**

Most of the assistance is implemented through specific sector Programs of each donor corresponding to the GoM's priorities. SWAPs for the environment-related sectors (mainly agriculture) are not yet developed. After environment-specific programs in the period 1990 to 2000, environmental issues are now generally embedded as cross-cutting issues in sector programs.

The EU has been one of the most important donors in the sector for some time now (EDF 7, EDF 8). The ongoing EDF 9 focuses on agriculture/food security/natural resources, transport/ infrastructure and macro-economic support. Justice, governance, non-state actors, health and trade are also supported as non-focal sectors.

Several Programs have significant environment components mainly in sustainable agriculture, forestry and water/sanitation. They include: Support to Implementation of the Malawi Land Reform Program, 4th Micro-Projects Program (MPP4), Farm Income Diversification Program (FIDP), Improved Forest Management for Sustainable Livelihoods (IFMSL), Institutional Development across the Agro-Food Sector (IDAF), Sustainable Nutrition Rehabilitation Program (SNRP), Multi-Annual Food Security Program (MAFSP), 2002 Emergency Food Aid, Income-Generating Public Works Program (IGPWP).

Environmental aspects are included in the preparation phase of new projects, and regular monitoring (through mid-term reviews and reporting) are specific to project objectives with the risk that secondary environmental effects may not be fully appreciated. Environmental impact monitoring should be done by the concerned districts, but their capacities are usually too weak or completely lacking. Recently, no EIA has been done because the EU's 'road maintenance programs' have now been completely implemented. SEA and/or environmental audits have never been done.

Other donors are funding a large number of programs and projects with an environmental focus and/or anticipated impacts (WB, ADB, USAID, JICA, CIDA, Norway, UNDP, WFP, FAO, IFAD, and UNICEF).

A Donor Coordination Committee is operational in the agriculture/food security sector (DCAFS) but it focuses on agriculture production while environmental issues are rarely targeted as a priority. Coordination has improved, but fragmented and/or non-harmonised actions and approaches still limit the benefits. A specific Donor Committee on environment no longer operates and the lack of coordination has resulted in fragmented environmental actions and lack of a holistic view.

The general impact of donor activities on environment is still limited, with the main problem being non-sustainability of the outputs. The creation of parallel structures concentrates the best human capacity into well-paid project jobs, resulting in the loss of capacity in the Government and local administration. Donor interventions have contributed to better environment awareness, and a more or less complete legal framework and action plans, but the implementation of sustainable NRM is still at early stage. In general, the direct support to combat environmental problems has decreased with the conversion of environment and natural resource management programs into a cross-cutting issue. This is because little effort has been made to address the country's environmental-poverty nexus through the realisation of environmental management and planning.

### **Conclusions and recommendations**

Conclusion 1: Widespread poverty, land pressure and population growth, absence of land tenure and associated lack of incentives to reinvest inland and natural resources, inadequate agricultural practices, deforestation, erosion, degradation of wetlands and biodiversity continue to be the principal threats to the natural resources. Environmental degradation is still increasing. The importance of key environmental pressures and their linkages on the predominantly agrarian society's natural resources are only well-understood and described in the upper administrative levels, while the concepts are only poorly understood and poorly implemented at the local level.

Conclusion 2: The natural resource policies, strategies and acts are, in general, written and approved by GoM. Environmental issues are also integrated in sector and overall policies (NSSD, MGDS). Some sector strategies need more harmonisation, while policies for waste, waste-water and air pollution are not yet approved. But the key problem is the extremely low level of implementation. This situation is due to two main problems:

The institutional framework is too complicated. Effective management is difficult and many people do not understand the framework.

Lack of predominantly human capacity for strategic planning and coordination, lack of staff and finances for implementation and control, and lack of technical equipment.

Conclusion 3: Decentralisation, transfer of competences and cooperative management systems are potential mechanisms to enhance more sustainable use of natural resources, but the tasks are unclear and the process has not yet been accepted by all stakeholders. Implementation efforts are isolated and have not yet had any significant positive impact on the conservation and sustainable use of natural resources.

Conclusion 4: The important function of environment monitoring and information sharing/circulation seems to be neglected. The absence of coordinated regular and viable data collection/sharing and the lack of an operating national environmental information system (EIS) prevent the objective evaluation of environmental impact (through SEA) of government and donor funded Programs.

Conclusion 5: Increasing urban environmental problems are very poorly addressed by the government and the donor community.

## **Recommendations**

### Institutional

Simplify the institutional framework and reduce/eliminate parallel structures due to projects and not harmonised national structures.

Promote SWAP and sector budget support especially in agriculture, forestry, water/irrigation, wildlife and fisheries, to harmonise and coordinate Programs and conduct SEA for the main (sub) sectors, especially irrigation and the GoM's identified growth sectors.

Give EAD an independent status as an Environmental Protection Agency, or attach it at a high institutional level (Office of the President & Cabinet), and leverage GoM to be more efficient in staffing allocations

Clarify the roles and tasks of stakeholders, GoM, NGOs, CBOs, Private Sector, and Donors, in implementation, leaving GoM to focus on the core functions: policy, coordinating, regulations and control. Encourage civil society to adopt management and implementation roles

Ensure the application of existing environmental laws and legislations by enforcement of human and financial capacities at decentralised and national level

### Information/communication/monitoring

Promote environmental awareness and understanding by sharing, circulation and transparency of environmental information and adapted explanatory material for the public

Identify simple standardised nationwide key indicators for environmental monitoring, and implement a National Environmental Information System able to translate the performance of sustainable development across all sectors.

Promote social programs to reduce the population growth rate, through health, and family planning education.

#### Decentralisation

Promote the transfer of competence for natural resource management (human and financial capacities, cooperative management systems) to decentralised structures (Districts, CBOs)

Promote local land use planning and holistic approaches concerning NRM

Make sub funds available for environmental micro-projects and associated technical assistance at local level (District, CBO) and help them to develop self-financing mechanisms for NRM

#### Rural development

Encourage and support the land reform process to promote ownership and responsibility for natural resources, and to support the use of a wider range and better cultivation techniques for soil conservation

Promote alternative income generation in rural areas using multiple resources (permaculture systems) for sustainable natural resource use, agriculture combined with economics, management and financial training

Promote household energy saving Programs to reduce firewood consumption and dependence on wood-energy in urban areas

#### Urban development

Ensure that urban services for waste and waste water management are effective and functional.

Support waste reducing and recycling by appropriate waste management systems and promote the use of proper technologies by adopting fiscal and other financial regulations

Urgently implement the 'pollutant pays' principal, starting with the most polluting industries and private sectors.

Promote the integration of environmental aspects in urban planning and ensure the application of the plans

#### Biodiversity

Implement specific programs for protected areas based on cooperative management systems to conserve biodiversity and conserve the potential for the tourist sector development

EU specific recommendations

Integrate environmental performance indicators and monitor these, and conduct general environmental audits for the focal sectors

Support and direct the focus of priority sectors on implementing concrete actions.

Continue the support to MAGIC and promote their integration into a National Environmental Information System. Encourage GoM Departments to share and provide access to their baseline information for its most effective use in the development process.

Facilitate access to EU finance mechanisms outside the EDF, especially budget line environment, ACP facilities for water and energy.

## Annex 4 - Country migration profile<sup>1</sup>

Total Number of Residents	12,765,593
Of which: Own nationals:	12,757,483
Immigrants:	416 (officially recorded)

### **Immigrants**

#### *Status of immigrants*

Refugees:	8,694
Labour migrants/permanent:	416
Labour migrants/seasonal:	data not available
Internally displaced persons:	not applicable

#### *Immigration trend*

Number of arriving immigrants in 1995/2000:	data not available
Number of arriving immigrants 2000/2004:	data not available

*Education* data not available

#### *Main country of origin:*

Refugees mainly from Burundi, Rwanda and Democratic Republic of Congo

*Rate of return/Number of immigrants leaving Malawi:* --

#### *Finance*

Amount of outgoing migrant remittances:	US\$239,900
Remittances as % of GDP:	0.012%

### **Emigrants**

*Total number of emigrants in 2000/2005:* 400

#### *Status emigrants*

Refugees:	not applicable
Labour migrants/permanent:	400
Labour migrants/seasonal:	data not available

*Educational level of emigrants:* Medical personnel of which 95 percent are nurses

*Main country of destination:* United Kingdom

*Rate of return:* data not available

#### *Finance*

Amount of incoming migrant remittances (2005):	US\$16,600
Remittances as % of GDP:	0.001%

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<sup>1</sup> Data source: Ministry of Economic Planning and Development

### **Any other comments**

According to UNHCR an estimated total of 7,694 refugees are in the country.

#### **PROFILE OF REFUGEES IN MALAWI**

<b>Age Group</b>	<b>Male</b>	<b>Female</b>	<b>Total</b>
0-5	852	879	1,731
5-17	1,145	1,090	2,235
18-59	2,255	1,398	3,653
60+	46	29	75
<b>Total</b>	<b>4,298</b>	<b>3,396</b>	<b>7,694</b>

The Refugees are based in two camps namely Dzaleka in Dowa (about 5,000) and Luwani in Neno (about 3,000). Half of the refugees are from Rwanda, the other half are from Burundi and Democratic Republic of Congo. Others, though in insignificant numbers are from Somalia, Sierra Leone and Ethiopia. There are also almost 1,000 refugees who are not in camps but are still under UNHCR international protection.

The country continues to receive labour immigrants from other countries. During the period 2000/02, 416 labour immigrants were recorded to have entered Malawi. Most of these were business managers followed by construction workers, engineers and medical personnel. Data on cross-border migration is very unreliable because recording is done manually at border posts. Furthermore, borders with Mozambique, Zambia and Tanzania are very porous, and hence the recorded figures are by far an underestimation of the real situation. It is clear that the official remittances figures are by far an underestimate of the actual situation.

Skilled personnel continue to leave this country for better livelihood in other countries. The majority of people leaving this country are nurses that migrate to Europe, Australia and other countries. Over the period 2000/05 an estimated total of 378 health personnel had migrated to other countries with 317 having migrated to the UK. It is estimated that 95% of these migrants are nurses.

For the past few years, the country has experienced an increasing trend of rural-urban migration mainly in search of work in cities and towns. About 86% of the population are in rural parts of the country with 14% in the urban areas. Recent estimates estimate an average national population density of 105 persons per square kilometre. At regional levels, the southern region has the highest population density estimated at 146 persons per square kilometre with the northern region having the lowest at 46 persons per square kilometre. Currently, Lilongwe city, the capital city, is classified as one of the fastest growing cities in Africa. The city's population has increased by more than 38% over the last decade. In general urban areas have a high population density estimated at 277 persons per square kilometre. This high population density is largely on account of increasing rural-urban migration mainly in search of work and better means of livelihood. This is an issue of concern as Cities Assemblies find it difficult to meet the social demands of sanitation and so on.

## **Annex 5. CSP drafting process: Involvement of Non-State Actors and Local Authorities**

### **1. Introduction**

The Government of Malawi in consultation with the European Commission Delegation initiated the programming exercise for the 10<sup>th</sup> European Development Fund (EDF) in February 2006 after the regional meeting in Gaborone. The Government made a joint review of its co-operation with several donors, prepared the JAR for 2005 and then set up a Steering Committee and a Technical Working Group of sector experts from the Line Ministries to put together issues and propose interventions that could benefit from 10<sup>th</sup> EDF funding. So as to guarantee the maximum level of alignment with the Malawi Growth Development Strategy (MGDS), the Technical Working Group of sector experts was the re-vitalized Task Force in charge of the development of the MGDS.

A number of sectors that could benefit from the 10<sup>th</sup> EDF resources were identified and proposed, including macroeconomic growth; agriculture and food security; irrigation, transport and infrastructure development; trade and private sector development; water and sanitation; as well as energy generation and supply. These were largely based on the country's development priorities outlined in the Malawi Growth and Development Strategy (MGDS). Consideration was also given to these sectors where the European Commission has comparative advantage vis-à-vis other donor agencies represented in the country, including the Member States (UK, France and Germany). An issues paper was developed and highlighted the key sector issues and proposed interventions that could be supported by the European Commission under the 10<sup>th</sup> EDF.

In the context of the Cotonou Agreement and its provisions on the involvement of Non-State Actors in the development process, the Government of Malawi and the EC Delegation to Malawi organised jointly three regional consultation meetings with Non State Actors. The meetings were held in Mzuzu (North), Lilongwe (Centre) and Blantyre (South) on 17<sup>th</sup>, 19<sup>th</sup>, and 21<sup>st</sup> July 2006, respectively. The issues paper formed the basis for discussions and was circulated to invited civil society organisations prior to the meetings.

The main objective of the meetings was to solicit comments, views and inputs of local authorities and NSA representatives on the areas proposed by the Government for EC support. The meetings were generally well attended and the level of participation was quite high. Furthermore, the outcome in terms of inputs and comments was of high quality. The main comments/recommendations put forward by participants have been summarised in the Section 5.3 of this Annex.

The organisation of the consultation meetings with Non-State Actors is in line with and complementary to the following initiatives jointly undertaken by the Government and the EC Delegation: i) Completion of a study on 'Diagnosis and Mapping of the Non-State Actor Community and its Environment in Malawi-Identification of Potential EC Support Strategies' (June 2005); ii) The formulation of a NSA Support Programme for Malawi (of €5 million) recently approved by Brussels; iii) The involvement of NSAs in discussions on the Joint Annual Report and on overall GoM-EC development co-operation; iv) The active contribution and involvement of NSAs in the implementation of EC-funded programmes in different areas, including food security and agriculture, water and sanitation, sexual and reproductive health, as well as environmental management and sustainable livelihoods.

## 2. Methodology and assessment<sup>1</sup>

*-Timing of the consultation process:* The consultation meetings took place approximately two months before the deadline of end-September 2006 for submitting the CSP to Headquarters in Brussels. Furthermore, the issues paper was distributed to participants one week prior to the meetings. There was sufficient time for Non-State Actors to study the document and provide comments either prior or during the consultative meetings, as well as for integrating comments received from Non-State Actors in the Country Strategy Paper.

*-Criteria for NSA selection:* The NSAs were jointly selected by the Malawi Government and the EC Delegation. Some of the main criteria adopted for their selection were the following: prior involvement in policy dialogue on GoM-EC development co-operation issues; participation in the meetings on the drafting/compilation of the NSA mapping study and the preparation of the NSA Support Programme in Malawi; involvement in the implementation of GoM/EC funded development programmes; specific competence/expertise in one of the focal/non-focal areas of GoM-EC co-operation (agriculture, food security, management of natural resources, macro-economic issues, trade, good governance etc) or in cross-cutting issues (gender, human rights etc).

The meetings were generally well attended and the level of participation was quite high. There was representation of different NSA categories, including Non Governmental Organisations (NGOs); Labour organisations and Trade Unions; the Chamber of Commerce and private sector associations; Universities and the Media. In total, 43 representatives of the non-state actor organisations and 24 district assemblies representatives participated in the consultation meetings.

The revised issues paper, taking into consideration of the inputs provided by non-state actors, has filtered through into the country response strategy section of the CSP. The consultation report and a revised issues paper were sent to all participants.

## 3. Issues raised by Non-State Actors representatives during the consultation meetings

Major issues highlighted by the NSA representatives during the consultation meetings were both of general nature and more sector-specific. A number of questions were raised and recommendations were made in relation to the following issues:

*General GoM-EU co-operation under the 9<sup>th</sup> and 10<sup>th</sup> EDF*

- Status of implementation of 9<sup>th</sup> EDF programmes and lessons learnt;
- Importance of integrating environmental issues in the programmes to be supported under the 10<sup>th</sup> EDF.
- Level of involvement of key stakeholders in the implementation of the various interventions proposed for the 10<sup>th</sup> EDF, including private sector associations, civil society and non-governmental organizations;
- Fiscal discipline, debt cancellation and implications for Malawi's economic growth and development;
- Need to integrate governance in the discussions and future programmes as a cross-cutting issue;

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<sup>1</sup> The assessment is largely based on the indicators outlined in the 2004 DG DEV paper, "Implementation of the Cotonou Agreement provisions on Non-State actors involvement in the programming exercise: An assessment".

- Need to address inter-linkages between the different sectors (especially between agriculture-food security-irrigation-transport and trade) in a comprehensive way.

#### *Agriculture and Food Security*

- Importance of identification of markets (at local, regional and international level) and development of smallholder farmers' marketing capacity (complementarity with efforts to promote diversification of agricultural production).
- Measures should be developed to support large-scale farming along specific initiatives that support and integrate needs and priorities of smallholder farmers.
- Depletion of soil fertility;
- Capital constraints faced by smallholder farmers and need to examine the underlying causes of poverty especially of farmers involved in subsistence agriculture;
- Continuation and strengthening of capacity building initiatives targeting public institutions, such as the Ministry of Agriculture;
- The role of the private sector in the extension service delivery;
- Selection of crops and Malawi's competitiveness in international markets.
- Importance of agricultural mechanisation and technology transfer in the context of policies aiming at achieving food security and increasing agricultural production;

#### *Transport and Infrastructure*

- Institutional barriers in the transport sector;
- Need to combine measures/programmes on both road maintenance and road management;

#### *Trade*

- Importance of upgrading facilities (such as laboratories) that will ensure the quality and competitiveness of Malawian products at international and regional markets;
- Importance of covering adjustment costs that might be incurred by the private sector and the government following an EPA agreement.

### **4. Relations between the Government and Civil Society**

Malawi has a rich history of NSA development. The Multiparty Democracy period (1994-present) has been characterised by growth and diversification of NSA activity in all development areas. A number of Malawian NSAs are actively involved in advocacy on different areas of concern (e.g. food security, democratisation and human rights, economic development, trade and private sector policy, gender, environment and social development), many of them supported by international NSAs. Advocacy institutions such as Economists Association of Malawi (ECAMA), Malawi Economic Justice Network (MEJN) and Human Rights Consultative Committee (HRCC) were formed and have expanded their activities during this period. The high rate of NSA expansion and diversification created a need for inter-NSA coordination, which has been met through the creation of several NSA networks.

Collaboration between Government and NSAs is good particularly at the sector and the District level. In several sectors, for example in agriculture, health, education and the environment, there is complementarity between Government and NSAs, both at policy and the operational level.

The growth and development of NSA activity has been an uneven process and the NSA sector is heterogeneous, with its weaknesses and strengths. Today the challenges surrounding the NSA sector are, *inter alia*, the need for a more enabling policy and regulatory environment, addressing a number of organisational and capacity weaknesses, and the need to develop greater financial self-reliance and mobilisation of financial resources within Malawi. Moreover, in many cases NSAs' definition of strategic plans and policy agendas seem to be closely derived from donor priorities rather than internal reflection and policy/problem analysis.

NSAs are regularly involved in economic and human rights advocacy and have successfully lobbied for adjustments to the MPRSP, the MEGS, several sector policies and the National budget.

Government does recognize the important roles NSAs play in the socio-economic development of the country. Over the past year NSAs were involved in the development of the Malawi Growth and Development Strategy (MGDS) which is the new medium-term strategic document for Malawi for the next five years. NSAs were involved throughout the development process and this makes the MGDS a national document as it was developed through a highly participatory and consultative process. In addition, NSAs have also been involved in the MPRS review whose findings have informed the strategies in the MGDS. The involvement of NSA in the development of the Government budget is quite limited. However, NSAs do influence resource allocations through advocacy and campaigns targeting specific sectors.

In terms of NSA involvement in trade policy, NSAs can and do influence the trade agenda by means of national consultative forums such as the National Working Group on Trade Policy, which includes both public and private sector interests and is supported financially by the EU. However, NSA influence on trade issues can be increased if support is given to building the capacity for the analysis and negotiation capacities of NSAs, such as the Malawi Chamber of Commerce and Industry (MCCI), involved in the discussion of the formulation of trade policy).

## **5. EC co-operation with Non-State Actors in Malawi: An overview**

The EC has been supporting Non State Actors for several years through two main vehicles: the Food Security budget line, which funds NGO projects, and the National Initiative for Civic Education (NICE), an initiative aiming at promoting civic education at grassroots level. NSAs' participation and involvement has also been 'mainstreamed' in the implementation of a number of programmes supported by the EU in Malawi, including the 4<sup>th</sup> Micro-Projects Programme (MPP), the Income Generating Public Works Programme (IGPWP), the Capacity Building Programme for the NAO Support Unit, the Technical Co-operation Facility (TCF) and the Support Programme to the National EPA (Economic Partnership Agreements) Secretariat.

The experience accumulated in the context of project implementation, service delivery, and policy dialogue with regard to GoM/EC development cooperation annual reviews in 2003, 2004 and 2005 have paved the way for closer co-operation between the EC, Government of Malawi and some of the Non State Actors in the country.

In this context, the €5 million NSA Support Programme in Malawi of duration 2006 to 2010 aims at strengthening NSA capacity to define independently their policy agenda and be more actively involved in policy dialogue with the Government and the European Union. The overall objective is that government and donor policies and programmes become increasingly responsive to the needs of the Malawi population (with focus on vulnerable groups) with the long-term aim to achieve socio-economic development.

The focus of activities -supported through the programme- will be on building capacities of NSAs in the following areas: programme identification and management; network development; fundraising; service delivery; research, lobbying, and advocacy. The programme will also contribute to increased and more effective co-operation between the Government, NSAs and the EU through support -among other activities- towards: creation of linkages between NSAs and Parliamentary Committees; formulation of NSA Policy and finalisation of the NGO Code of Conduct; establishment of international and national strategic advocacy alliances; development of NSA network campaigns and advocacy programmes; publication of position papers on GoM policies and on issues linked to GoM/EC co-operation; organisation of consultation meetings on Government policy, legislation and strategy development; development of a mechanism for NSA monitoring of Malawi-EU development co-operation.

Beneficiaries of the programme will be: grassroots/community based organisations, legally registered service delivery organisations, umbrella and platform organisations as well as thematic networks.

## **6. Involvement of Non-State Actors in the implementation of the 10<sup>th</sup> European Development Fund**

The Country Strategy Paper and National Indicative Programme for Malawi in relation to 10<sup>th</sup> EDF foresee a very important and strategic role for NSAs especially in the Agriculture and Food Security Focal Sector. NSAs will have a role in advocacy activities and will be a vehicle for implementation in food security, farm income diversification programme, microprojects programme, small and medium irrigation schemes. Furthermore, it foresees funding for a specific NSA Support Programme aiming at further strengthening the involvement of Non-State Actors in the development process.

## 1. OVERVIEW OF PAST AND PRESENT EC COOPERATION, COMPLEMENTARITY AND CONSISTENCY

**Focal sector 1: Rural development, Agriculture, Food Security and Natural Resources:** Malawi has been affected by recurrent food crisis. In 2002/03 a severe one plunged the country into a humanitarian crisis and overshadowed virtually all medium-term concerns in the agriculture and natural resources focal sector. An even more severe one occurred in 2005/06 but thanks to the prompt reaction of the Government, the coordinated efforts of the GoM and development partners, in which the EC played an important role, the use of innovative instruments (e.g. options) a humanitarian crisis of large proportions was averted. Recurrent food crises underscore that there are structural issues to be tackled. Today agriculture is mainly rain-fed. There are weak linkages to input and output markets, and isolation of produce from markets locks farmers into production of the staple food maize. Poor rural infrastructure also prevents the smooth distribution of food from surplus to deficit areas in times of need. There are weaknesses in the current public extension service, which have undermined productivity, with the extension worker to farmer ratio standing at 1:3000. This situation has been further exacerbated by high staff turnover and HIV/AIDS. There is need to facilitate access to credit, to foster private-public partnerships for increased investments, improve security for land tenure, promote diversification of produce, promote marketing and post harvest techniques. All these cannot happen in isolated projects. The main lesson learned is that there is an urgent need to develop a sectoral approach where GoM, NSA and development partners can move in a coordinated manner. This will also mitigate the risk, very evident up to twelve to eighteen months ago, of recurrent policy changes to which development partners have contributed with conflicting recommendations. Another lesson learned is that there is a need to move in a pragmatic manner, which may be based initially on a rather simple shared framework, characterized by clear objectives, activities, timetable, financial costs, and indicators. The framework can then be expanded and refined over the years. A gradual approach seems to work. The Ministry of Agriculture has started the development of a sector wide approach, which is expected to represent the framework for interventions aimed at supporting agriculture and food security under the 10<sup>th</sup> EDF from 2008 onwards.

The European Commission has traditionally worked in Malawi in this sector where it is the largest donor and has accumulated a very rich experience. Moreover the European Commission is very well placed to assist the Government in fostering links between agriculture and food security, on the one hand, with infrastructure investment (e.g.: transport; irrigation) on the other hand. It is also in the best situation to assist the Government in enhancing the regional dimension (linkages with trade and EPA; regional food security; etc) offering its unique expertise in regional integration processes.

**Focal sector 2: Transport:** To enhance economic development of rural areas and regional trade, the 8<sup>th</sup> EDF concentrated on improving road infrastructure, with the objectives *inter alia* of completing/rehabilitating the main road network and key connecting corridors to Malawi's neighbours, and establishing an efficient institutional and legislative framework for managing and funding road maintenance. Significant early achievements were made with respect to policy reform commitments, culminating in the establishment of the

National Roads Authority (NRA) and a dedicated Road Fund in 1998, both of which were constituted under the NRA Act that was passed in 1997. Following the NRA Act of 1997, NRA has had the responsibility of maintaining and developing the road network in Malawi.

Strong commitments were made to ensure the autonomy of the NRA and to protect the integrity of the Road Fund. The fuel levy remains the main source of internal revenue for the NRA and contributes approximately 80% of the total income to the road fund, the remainder being income from transit charges levied at border posts on foreign registered commercial vehicles entering the country. This policy reform process has resulted in a much improved main road network (based on visual condition assessment<sup>1</sup> some 85% of the main road network is now reportedly in good condition). However, by 2002 there was a sharp decline in the policy commitments and the reform process resulting in the NRA becoming fragile and less effective. The decline continued into 2003, with a number of serious issues continuing to threaten the sustainability of the reform programme and ultimately the road network. In particular insufficient financing for road maintenance, coupled with political steering and a general erosion of NRA's (National Road Authority) autonomy were of concern to the sector donors. The primary reason for the depleting maintenance expenditure was that the fuel levy was not being adjusted to offset the effects of kwacha depreciation and inflation. Also, only 60 percent of the revenue of the fuel levy was actually used for road maintenance, reflecting a diversion to other Government spending categories as well as NRA's increasing operational expenditures. The fuel levy has had five revisions from its initial level of MK1.25 per litre of petrol and diesel set in July 1998, to the current level of MK 8.7 per litre for petrol and MK 6.7 per litre for diesel. This fuel levy now equates to US\$ 0.056 per litre, against a generally accepted rule of thumb target of US\$ 0.1 per litre.

In terms of total income to NRA, there have been annual increases in Kwacha terms from MK 306m in FY98/99 to MK 1,660m in FY02/03, and MK 2,290m in FY05/06. However, in US\$ terms, this equates to US\$ 7.5m in FY98/99, US\$16.9 in FY02/03, and US\$ 8.8m in FY05/06. Whilst maintenance and construction costs are not fixed to the US\$, this illustrates the inflationary pressures that affect the industry.

The change of Government in May 2004 brought a new start in the donor dialogue with Government on transport sector policy. To address the weaknesses in road management, the government prepared legislation that would effectively separate the functions of the road fund administration from the road management operations. The Government also announced its intention to establish a Road Traffic Authority. The long-awaited separation of functions of the Road Authority and Road Fund Administration was passed by Parliament and became law in May 2006 and the two Boards were appointed at the end of November 2006. This significant institutional reform places the Road Fund under the authority of the Ministry of Finance, thus enabling more accountable and efficient use of Road Fund resources. The development of a Road Sector Programme (within the scope of a more comprehensive Transport Sector Programme, which takes into account the railways network – an aspect which has been insufficiently addressed up to now) is a key objective agreed by Government and donors. It includes establishment of the components necessary for sector budget support by the beginning of the 10<sup>th</sup> EDF in 2008. Given the strategic importance of regional interconnection the Road Sector Programme will give top priority to the routine/periodic maintenance and rehabilitation needs of the main connecting corridors

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<sup>1</sup> "Five Year Strategic and Business Plan" - NRA - June 2005

of the regional road network. This will be followed by the maintenance of the other paved and unpaved roads with greater attention being paid to financing interventions on those peri-urban and rural roads serving agriculture production areas and areas which are structurally food insecure and need to be reached. New investments (including the upgrading of roads) should only be considered after meeting the above priorities, which could otherwise be jeopardized by the lack of funds.

Under the focal sector of transport infrastructure, the main lessons learned are that: 1) a balanced multi-modal transport sector policy and programme is required to foster competition in the transport market; b) emphasis on road maintenance operations rather than upgrading is critical, since the current road network overall is not sustainable; 3) local contracting and consulting capacity is limited and that project implementation without careful design and implementation is going to suffer; 4) capacity of relevant organizations need to be improved so as to make it possible to provide budget support.

The European Commission has traditionally worked in Malawi in this sector where it is the largest donor and has accumulated a very rich experience. Moreover the European Commission is very well placed to assist the Government in fostering links between transport investments, on the one hand, with regional integration as well as food security and agriculture, on the other hand. The sector is characterized by high barriers to entry for most development partners.

## **2. OVERVIEW OF GOVERNMENT OF MALAWI-EC CO-OPERATION IN THE NON-FOCAL SECTORS**

Within the non-focal sectors, the priorities of Government of Malawi-EC co-operation under the 9<sup>th</sup> EDF have been on good governance, civic education, micro-projects, health, non-state actors and institutional capacity building.

### ***-Good Governance-Civic education***

The Mid-Term Review of the Government of Malawi-EC development co-operation under the 9<sup>th</sup> EDF, which took place in October 2004 concluded with an increase in the allocation to non-focal sectors. More specifically, support in the Good Governance Sector proved to be crucial for the young democracy, and as the ***Rule of Law programme*** was the first of its kind to promote the rule of law and improved access to justice in Malawi, it gained a lot of momentum during the 9<sup>th</sup> EDF, as most of the institutions it supported had been created in the late 90s. The purpose of the programme was to strengthen and modernize the legal institutions primarily responsible for the administration of justice, resolving disputes, protecting human rights and consolidating democracy. Due to this extensive capacity building for a whole set of legal institutions in Malawi (including the Judiciary, the Law Commission, the Anti-Corruption Bureau and the National Compensation Tribunal) evaluations of the Rule of Law Programme, which ended in December 2005, concluded that its aims remain highly relevant to the Malawian economy and society. Investing in a system of justice which is recognised as fair, efficient and accessible has been recognized as an essential cornerstone for a thriving democracy as well as for the proper functioning of markets and private sector investment.

For both the institutions under the Rule of Law Programme and for the Civic and Voter Education Project (known as “***National Initiative for Civic Education***” or ***NICE***), the

General Elections of 2004 and the priorities of the new Government were a turning point, as the “zero tolerance” of corruption was a clear message sent to the Malawian population. NICE, which ended in July 2006, with its “bottom-up” approach, was very successful in reaching out to grassroots level with a whole range of civic education messages and important voter education and mobilization. Due to its nationwide outreach, it is unique in its kind and acknowledged as such. Since its inception, one of the main tasks of NICE has been to contribute to voters’ education and cooperate with the Malawi Electoral Commission (MEC). During the 6<sup>th</sup> December 2005 by-elections, MEC delegated on NICE the coordination of voter and civic education functions. Civic education activities take the form of adult literacy classes (specifically women’s literacy classes); training of young and senior politicians as well as of traditional and religious leaders on different issues including local governance and decentralization, human rights and rule of law; as well as awareness raising seminars on HIV-AIDS, gender and the environment. NICE also focuses on capacity building and supports activities of local NGOs and CBOs for the design and implementation of voter and civic education activities.

As a follow up, a successor to the two programmes, the ‘Promotion of the Rule of Law and Civic Education Programme’ started being implemented in 2006. This programme foresees continuation of support to constitutional and legal institutions which are still rather weak, while strengthening the role of NICE as a facilitator for the delivery of civic education messages to local communities. Under the 10<sup>th</sup> EDF, common understanding and coordination in the justice sector will hopefully lead towards a SWAP, with NICE being attached to a constitutional body as the official Malawian civic education institution.

#### ***-Microprojects Programme***

Consecutive ***Microprojects Programmes*** have been implemented in Malawi since 1995, completing over 1,700 projects up to 2003. The ‘Fourth Micro Projects Programme’ began field activities in 2004; it has already completed implementation of 350 micro projects and is currently supporting the implementation of 375 new micro-projects in the areas of education, health, water and sanitation, and community development. The 4<sup>th</sup> MPP has placed increased emphasis on co-operation with local development planning structures, facilitation and capacity building for local communities. In order to increasingly contribute to the objectives of the focal sector “Rural Development and Food Security”, the 4<sup>th</sup> MPP aims at increasingly supporting agriculture and other income generating initiatives of local communities. There remains a huge demand for micro projects from local communities; however, the national coverage of the programme presents challenges in terms of transformational processes at the local level. Poor planning capacity of District Authorities presents a substantial challenge to the objective of better integration of MPP’s planning into decentralised planning processes and also means that requested assistance tends to be limited to the provision of social infrastructure.

To address the gap between its ambitious poverty alleviation objectives and the physical outputs at community level, in 2005 a call for proposals resulted in 23 grant contracts being awarded to NGOS and CBOs who work in close and long-term association with communities. Cooperation with NSAs will be further extended, as a means of enhancing programme delivery and an avenue to diversify interventions to address socio-economic development. 4<sup>th</sup> MPP has expanded its presence at regional level, giving it more capacity to facilitate and train communities, and enabling a closer cooperation with District Authorities. The programme also engages in discussions with all District Authorities and

EU Member State and EDF funded programmes operating at the district level, with the objective of further defining capacity building activities while ensuring cooperation and complementarity of approaches. Enhanced co-ordination with other programmes targeting local communities can further increase MPP's impact towards poverty alleviation.

### ***-Health Sector***

As part of a comprehensive health sector support programme in Malawi and in consistence with the Governments health reform goals, the Support to the '***Health Reform and Decentralisation project***' was approved by the European Commission (EC) in December 1996 for an initial fund commitment of 18.7 million euros from the 7<sup>th</sup> European Development Fund (EDF, which was later increased to 21,156,713 euros.

The project intended to both strengthen health sector reform and policy implementation process and to improve the performance of the district health care system through the provision of technical assistance, physical infrastructure improvement and human resource capacity building. It consisted of support to both central and district level health service management.

The project has been instrumental in initiating the Ministry of Health (MOH) stakeholder coordination system; experience gained in this field has proven useful in the development of coordination and steering mechanisms that led to the establishment of a Sector-wide Approach (SWAp) in the Health sector. The project has also played a leading role in the establishment of the Malawi National Health Accounts NHA (-a tool for gathering and analyzing health expenditure data for a given period) and further steps towards NHA institutionalization have been taken.

A wider range of services, especially diagnostic and surgery has become available through the construction of two new (296 bed capacity) hospitals in Chiradzulu and Thyolo districts. Health Management Information System (HMIS) records show that an increased number of in- and out-patients from within and outside the districts are receiving health services in the new facilities constructed through the project.

The support provided through the project however, has certainly not yielded all expected results due to among other factors, the high turnover and loss of trained medical personnel and management staff.

### ***-Malawi Blood Transfusion Service***

Against the background of a growing HIV/AIDS pandemic, the project was initiated to create a ***Malawi National Blood Transfusion Service*** with the mission of providing adequate supplies of safe blood to meet the needs of all central and district hospitals. Voluntary and unremunerated blood donation from low risk donors is one of the key elements of the project.

Implementation of project activities was delayed for two years mainly due to lack of expertise by the Ministry of Health in this area, late recruitment of a Project Manager and delays in the recruitment of necessary key personnel. A MBTS Trust was finally established in August 2002, but implementation of activities started only with the arrival of the Project Manager in March 2003.

Since this time, rapid progress has taken place. In 2003, a temporary MBTS Headquarters in Blantyre was set up with offices for Finance and Administration, a laboratory, teaching

and conference facilities and a Blood Donor Centre for Static and Mobile Donor Teams. Today the MBTS is a fully functional organization with some 110 staff members. The management structure of the MBTS is as follows: Project Manager, Finance and Administration Director, Medical Officer and Quality Manager.

A revised Constitution for the Trust is operational and a Parliamentary Bill has been drafted in 2005 and is awaiting approval. Once approved, the Act will ensure the sustainability of the project, mainly by guaranteeing the autonomy of the MNBTS and Government funding in support of the project. The formation of Blood Donor Association in Malawi (BDAM) has been approved and incorporated into the MBTS Trust Constitution.

The biggest successes of the project lie in the establishment of 2 temporary Blood Transfusion Centres (in Blantyre in September 2003 and Lilongwe in January 2005) and the fact that since the beginning of 2005, all 4 Central Hospitals and 80% of District Hospitals in Malawi have received 100% of their blood supplies from MBTS. Five mobile teams collect more than 2,500 units of blood per month from voluntary unpaid blood donors from low risk populations.

The project is on-going and GoM has already started to take over some of the responsibilities like the purchase of reagents and consumable to prepare for the handover over the project.

#### ***-Institutional Support and Capacity Building***

The ***Capacity Building Project for Economic Management and Policy Coordination (CBPEMPC)*** is a €9.0 million project signed in 2001 and is expected to end in December 2007. The project was designed to provide support to government in the area of economic and public finance management through training of personnel in the key planning Ministries of Finance and Economic Planning and Development in specialist economic courses, financial management, administrative and human resources development courses. In addition, the project facilitates workshops and seminars; attachments and study tours; as well as studies and consultancies.

Implementation of the project has been through an implementing partner – Arcadis BMB – who manages the Project Support Unit and provides short term technical expertise required by beneficiaries. The initial allocation of €1.9 million to the technical assistance component of the programme was ‘reinforced’ with an additional allocation of €410,000 to take the project up to December 2007.

Project implementation has been satisfactory. According to a progress report issued in November 2005, a total of 259 officers have benefited from training organized by the project directly. A total of 28 government officers have benefited from long-term training in post-graduate studies in economics and financial management. A total of 120 officers have benefited from a range of short-term courses in economics, financial management, public administration and human resources development. The project also supported 47 officers on training in information technology and facilitated 20 attachments for experience in financial management systems, public investment programmes and policy research.

The ***Capacity Building Programme (to the NAO Support Unit within the Ministry of Finance)*** which was signed in mid-2005, was designed to be a follow-up to the NAO Support Unit (SU) capacity building programme previously financed from the Multi-Annual Food Security Programme (phase I). With its main objectives being to strengthen

the national ownership of the current CSP and NIP and to ensure efficient and effective project identification and implementation through the strengthening of the contractual, administrative and financial management of such projects, it can be said that the achievements of this programme have been thus far limited. The NAO SU has increased in size but still lacks the necessary civil service staffing agreed to in the Financing Agreement. As a result, there continues to be high degree of dependence on the presence of external long-term technical assistants. On a positive note, global and individual commitments have been on target as have other determining operations which show that the NAO SU is keeping in line with the project's overall objectives. The activities supported through the programme include provision of technical assistance to the NAO SU; recruitment and staff training for efficient implementation and monitoring of EDF programmes; periodic meetings between Ministry of Finance, Ministry of Economic Planning and Development, Line Ministries and other donors on preparation of key policy documents and reports; as well as information and co-ordination meetings with Non-State Actors.

The ***Technical Cooperation Facility (TCF)*** signed in June 2004 aims at facilitating the implementation of the 9<sup>th</sup> EDF National Indicative Programme. The programme provides: a Technical Assistance Facility (TAF) for the engagement of short to medium –term consultants to assist in different areas, including project identification and design as well as evaluation, monitoring and audit; Training Support for Projects and Programmes (TSPP) including financing of various educational and awareness-raising activities; Organisation of Conferences and Seminars on the priorities on the Cotonou Partnership Agreement as well as participation of Malawi Government officials and non-state actors in international conferences on trade and development issues.

TCF has been largely utilised for service contracts under the Framework Contract (initially under the FWC AMS 451 and currently under the FWC Beneficiaries). This is very much in line with the programme design which allocated €6 million out of a total of €7.5 million to such services (Technical Assistance Facility). The TCF under the 9<sup>th</sup> EDF has achieved its overall objectives thus, evaluations have emphasised the need that such a facility should be upheld in the forthcoming CSP.

#### ***-Support to Non-State Actors***

In terms of support to Non-State Actors, a new EC initiative –under the 9<sup>th</sup> EDF- follows a long tradition of support to NGOs through specific budget lines and mainstreaming of NSA involvement in a number of ongoing EC-funded programmes. There are at present several hundred Non-State Actors (NSAs) drawing into Malawi some US \$70 million (approximately €54 million) in international funding<sup>2</sup>. The challenges facing NSAs are inter alia the need for a more enabling policy and regulatory environment, addressing organisational and capacity weaknesses, the need to achieve greater financial self-reliance and the need to define advocacy agendas independent from donor priorities. Against this background, a ‘NSA Support Programme’ (€5 million over 3 years) was developed in 2005<sup>3</sup>. The Programme aims at strengthening NSA capacity to provide effective and improved service delivery to local communities; to define independently their policy

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<sup>2</sup> “*Diagnosis and Mapping of the Non State Actor Community and its Environment in Malawi and Identification of Potential EU Support Strategies*” by Geomar International SARL, June 2005. Study commissioned by the Government of Malawi/European Union

<sup>3</sup> The programme was approved in August 2006.

agenda and to be more actively involved in policy dialogue with the Malawi Government and the EU.

***-Cross-cutting issues***

Cross-cutting issues such as children and gender equality, HIV-AIDS, environmental concerns and institutional development have been integrated -to various degrees- in the majority of EC-funded programmes in the areas of food security, agriculture, nutrition as well as health and civic education. More specifically, HIV-AIDS has been addressed at project level in the transport sector, while institutional development initiatives have been developed in both the agriculture and transport sectors (providing technical assistance to Line Ministries). In relation to macro-economic support, the variable tranche component of PRBS 1 is designed to ensure that government gives due attention to efforts in critical areas of health, education, HIV-AIDS and gender equality. Yet, a more systematic approach is needed in order to ensure the integration of cross-cutting issues in programme formulation, implementation and monitoring.

## **Annex 7- Table including partner country positions in relation to key international conventions**

International Conventions signed and ratified by Malawi

### **1. GLOBAL INSTRUMENTS**

- Slavery Convention of 1926 (as amended) and the Supplementary Convention on the Abolition of Slavery and Slave Trade;
- The Universal Declaration of Human Rights (1948)
- International Labour Conventions (e.g., Convention on Freedom of Association and Protection of the Right to Organise of 1948, Convention concerning Forced or Compulsory Labour, Equal Remuneration Convention);
- Convention for the Suppression of Traffic in Persons and of the Exploitation of Prostitution of Others (1949);
- The Convention relating to the Status of Refugees (the “Geneva Convention”) and its associated Protocol (1951);
- Convention on Political Rights of Women (1952);
- International Convention on the Elimination of All Forms of Racial Discrimination (1965);
- International Covenant on Economic, Social and Cultural Rights (1966);
- International Covenant on Civil and Political Rights (1966);
- Universal declaration on Eradication of Hunger and Malnutrition (1975);
- Declaration of the Right of the Disabled persons (1975);
- Convention on the Elimination of Discrimination Against Women (CEDAW, 1979);
- International Convention Against Taking Hostages (1979);
- Convention Against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment (1984);
- Declaration on the Right to Development (1986);
- Convention on the Rights of the Child (1989);
- International Convention For the Suppression of Terrorist Bombing (1998);
- International Convention for the Suppression of Financing of Terrorism (1999).

### **2. REGIONAL INSTRUMENTS**

- OAU Refugee Convention (1969);
- African Charter on Human and Peoples Rights (1990);
- African Charter on the Rights and Welfare of the Child (1990);
- Grand Bay (Mauritius) Declaration and Plan of Action for the Promotion and Protection of Human Rights (1999);
- African Platform on the Right to Education (1999);
- Protocol on the Rights of Women in Africa (2003).

## Annex 8 - Debt Sustainability Analysis

Extract From:

INTERNATIONAL DEVELOPMENT ASSOCIATION  
AND INTERNATIONAL MONETARY FUND

REPUBLIC OF MALAWI

### **MALAWI: Debt Relief at the Heavily Indebted Poor Countries (HIPC) Initiative Completion Point and Under the Multilateral Debt Relief Initiative (MDRI)**

Prepared by the Staffs of the International Development Association  
and the International Monetary Fund

Approved by Gobind Nankani and Danny Leipziger (IDA)  
and David Nellor and Matthew Fisher (IMF)

August 14, 2006

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#### **F. Debt Sustainability Outlook After MDRI, 2006-25**

67. **The macroeconomic framework underpinning the debt sustainability outlook has been revised to take into account recent developments (Tables 3 and 4).** Over the medium term, the macroeconomic framework is in line with the government's economic program supported by the PRGF arrangement with the IMF. Long-term assumptions are based on information provided by the authorities regarding sectoral strategies, including in the MGDS—the new poverty-reduction strategy—as well as latest WEO prices and recent trends in macroeconomic variables. The main elements of the long term macroeconomic framework underpinning the debt sustainability analysis are outlined in Box 6.

68. **The MGDS aims to enhance growth by maintaining macroeconomic stability and implementing structural reforms to create an enabling environment for private sector investment (Box 6).** In addition, there is scope for output to recover from a prolonged period of poor performance. A key assumption is that measures are implemented to insulate the economy from the debilitating impact of periodic drought.<sup>1</sup>

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<sup>1</sup> The government has made food security a top priority and is implementing measures to improve performance in this sector. Measures include expanding the fertilizer subsidy scheme, investments to improve irrigation, measures to strengthen agricultural markets to aid crop diversification, and improving access to financial markets including weather-based insurance.

Consequently, it is projected that Malawi will be able to attain real GDP growth of around 6 percent per year on average between 2006 and 2011. Over the longer term, the outlook assumes a more cautious annual growth rate of 4.5 percent, consistent with the regional average and annual per capita growth of 2.5 percent.<sup>2</sup> It is also assumed that an increase in output growth by one percentage point would accelerate the annual rate of decline in the poverty headcount ratio by about 0.2 percentage points.

69. **The outlook assumes only a modest increase in aid flows and does not incorporate a substantial scaling up of aid.** Borrowing projections are based on current information available regarding future commitments. These commitments are likely to be at odds with the level of aid flows needed to meet the Millennium Development Goals. New borrowing is assumed to be kept at modest levels and is expected to decline as a share of GDP as the composition of aid shifts to grants. Moreover, new borrowing is assumed to be on concessional terms consistent with the average since the decision point (see Section IV.D above). The budget is expected to benefit from the increased routing of a portion of aid, currently passed outside the budget, through the central government as its capacity to utilize aid effectively increases.

70. **The outlook assumes full delivery of HIPC assistance as well as debt relief under the MDRI.** Two variations of the baseline outlook are considered: one with, and one without topping-up of HIPC assistance. To facilitate comparison, it is assumed that any additional debt service savings arising in the second variation are accumulated as external reserves.

#### **Excluding topping-up of HIPC Assistance**

71. **After HIPC and MDRI debt relief, Malawi's external debt is expected to remain below the HIPC threshold throughout the projection period under the baseline.** HIPC assistance, debt relief provided by bilateral creditors beyond HIPC assistance and the implementation of the MDRI is projected to reduce Malawi's NPV of debt outstanding as of end 2005 from US\$1.3 billion to US\$242 million at end-2006. As a consequence, Malawi's NPV of debt to exports ratio would drop from 245 percent as of

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<sup>2</sup> Long-term annual growth of 4.5 percent is less than the 5.5 percent annual average growth for 2010-20 assumed at the decision point and attempts to address the tendency for growth projections to be overly optimistic.

**Box 6: Macroeconomic Assumptions underlying the Debt Sustainability Analysis over 2006-25**

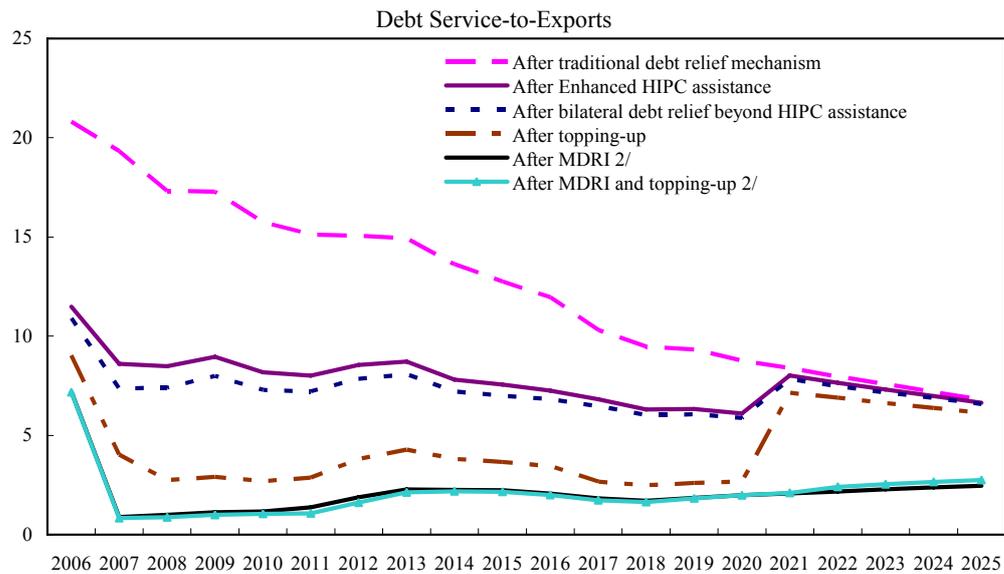
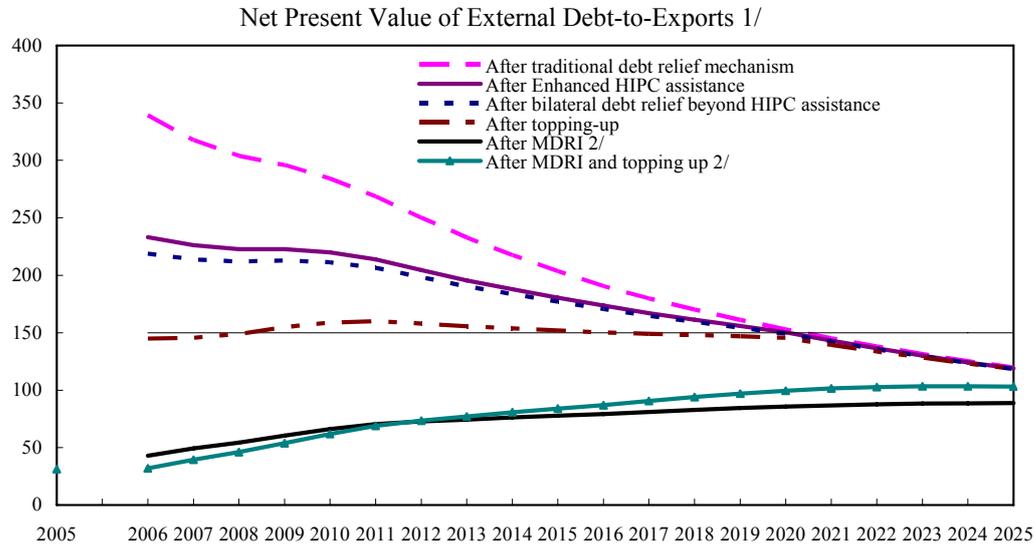
- **Growth.** Annual output growth is projected to amount to approximately 6 percent over the near term, and to drop to 4.5 percent in line with the regional long term average and consistent with annual per capita growth of 2.5 percent. This compares to a historical ten-year average of real GDP growth of 2.8 percent.
- **Inflation and exchange rates:** Inflation is expected to fall and remain in single digits within the near term. The real exchange rate is assumed to remain steady through the longer term.
- **Net official assistance** to Malawi is assumed to increase gradually and modestly by about 2 percent of GDP to about 23 percent of GDP by 2015, mainly as a result of debt relief. The share of grants in gross aid inflows is expected to increase from 78 percent in the first half of the decade to about 84 percent. The higher aid flows are assumed to have a high import content which will mitigate the threat of an aid-driven appreciation of the real exchange rate.
- **External official debt:** The outlook assumes the full delivery of HIPC assistance and debt relief under the MDRI. New debt is assumed to be issued on concessional terms consistent with the experience since the decision point. New borrowing is assumed to decline from 5.8 percent of GDP in the first half of this decade to 3.8 percent of GDP over the projection period.
- **FDI and exports:** Increasing and diversifying Malawi's export base is a high priority in the MGDS. Possible areas of export growth include tobacco and tea, other agricultural products, tourism, hydro electricity and mineral resources. If implemented, the export share of the economy will be increased, supported by stronger FDI inflows and growth in private sector investment.
- **Fiscal policy** is expected to target continued reduction of domestic debt to around 2 percent of GDP. The government is assumed to maintain a stable domestic revenue effort relative to GDP. A lower domestic interest bill and higher net aid inflows are assumed to support an increase in the development budget by 4 percent of GDP. In addition, poverty reducing current spending will be increased, including a rise in the wage bill to 8.5 percent of GDP to cover increased employment in social sectors. The ability of government to absorb additional aid will be a key constraint on the scaling up of aid.
- **Current account:** The current account balance is expected to deteriorate modestly. Higher exports will be offset by higher aid-driven imports and the tilt in the composition of gross aid toward loans.

73.

end-2005 to 43 percent by end-2006. Because of new borrowing, it would subsequently rise to about 89 percent at the end of the projection period. The NPV of debt-to-GDP ratio would decrease to 11 percent at end-2006 and gradually approach 24 percent at the end of the projection period. Finally, the NPV of debt-to-revenue ratio would decline to 44 percent in 2006 and trend upwards above 102 percent near the end of the projection period.

72. **Debt service is projected to remain low through the projection period.** After HIPC relief and relief under MDRI, annual debt service would average US\$17 million on average during 2006-15, the equivalent of about 2 percent of exports of goods and services.

**Figure 2. Malawi: External Debt and Debt Service Indicators for Medium- and Long-Term Public Sector Debt, 2005-25**



Sources: Malawian authorities; and IDA and IMF staff estimates and projections.

1/ Assumes full delivery of HIPC assistance.

2/ Includes bilateral debt relief beyond HIPC assistance.

## **Including topping-up of HIPC Assistance**

73. **After topping-up HIPC assistance and the subsequent implementation of MDRI, the NPV of debt-to-exports ratio would further drop to 32 percent at end-2006.** It would then rise to 103 percent at the end of the projection period. The NPV of debt-to-GDP ratio would decrease to 8 percent at end-2006. It is expected to reach above 28 percent by the end of the projection period. Finally, the NPV of debt-to-revenue ratio would decline to 33 percent in 2006 and would average about 108 percent over 2016-25.

74. **Debt service is projected to remain low through the projection period.** After HIPC relief, additional bilateral relief, topping-up and relief under MDRI, total annual debt service would decrease further to US\$16 million on average during 2006-15, the equivalent of about 2 percent of exports of goods and services. Debt service would remain around 2 percent of exports through the remainder of the projection period.

## **G. SENSITIVITY ANALYSIS**

75. **Even with debt relief under MDRI, Malawi's debt sustainability remains vulnerable in the long run.**<sup>3</sup> Possible risks include the contracting of new debt on inadequately concessional terms; high levels of new borrowing that, because of poor policy implementation, are associated with poor growth and weak export growth; and failure to insulate the economy from periodic shocks to which the country is vulnerable. These risks are illustrated in the accompanying three scenarios that assume the full delivery of HIPC assistance, additional bilateral assistance and debt relief under the MDRI, and that exclude topping-up. A fourth scenario considers the implications of a substantial scaling up of aid and debt (table 13).

### **Scenario 1: Borrowing on less than fully concessional terms**

76. **Debt relief under MDRI opens the scope for new borrowing on less than concessional terms.** Sound debt management is required to ensure that new borrowing is on adequately concessional terms to ensure that the external debt burden does not become unsustainable again. This scenario explores the consequences of new borrowing on less than fully concessional terms and assumes a grant element of 45 percent. To isolate the implications of poor debt management, this scenario assumes that output and export growth as well as gross aid flows are the same as in the baseline scenario. However, the higher cost of new borrowing reduces the long-term scope for expanding the fiscal spending envelope and hampers the accumulation of external reserves.

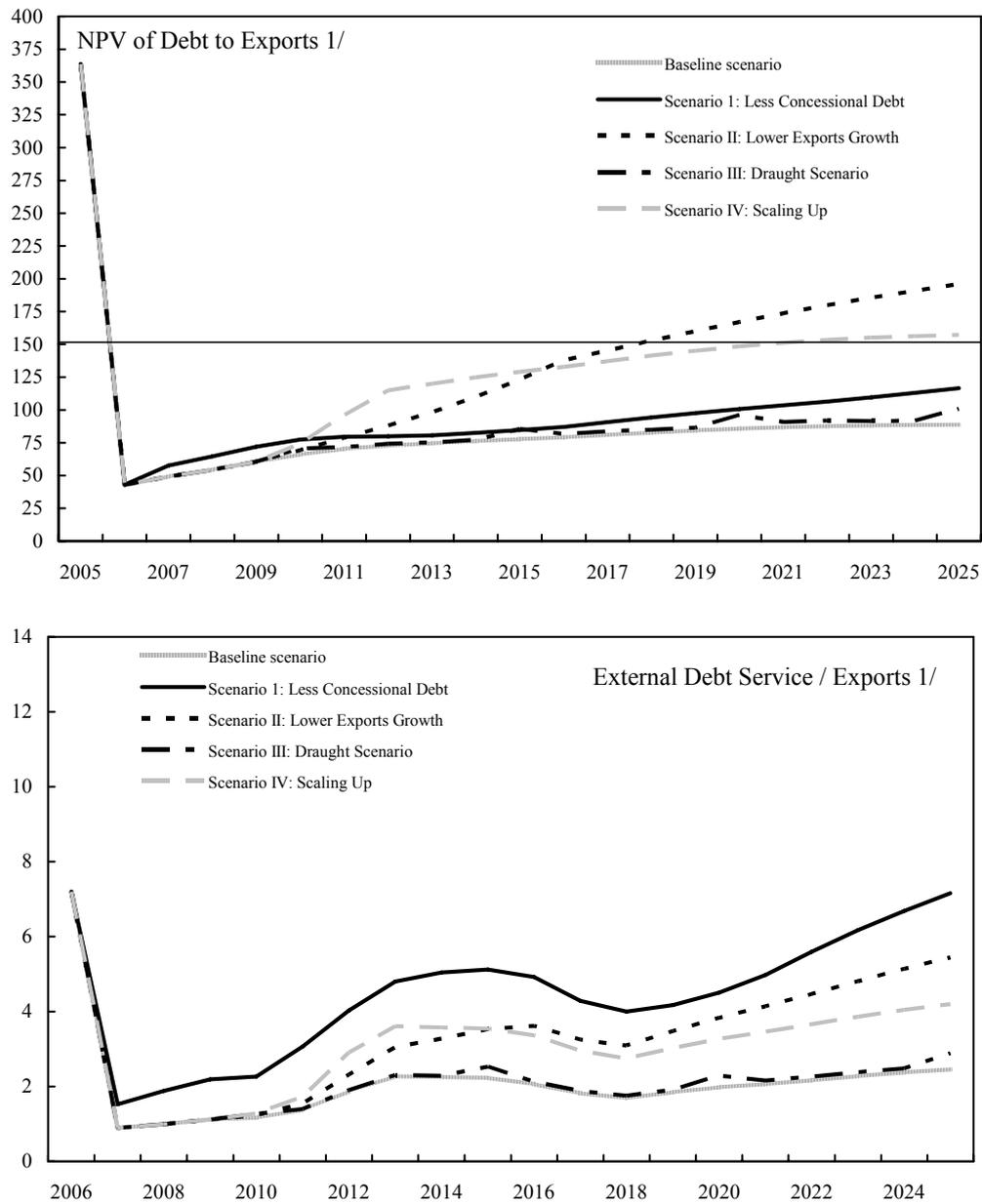
- As in the baseline scenario, Malawi's debt remains below the HIPC threshold throughout the projection period. However, by the end of the projection period, the

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<sup>3</sup> Given the small effect of topping-up on debt burden indicators after the implementation of MDRI (see figure 2), Malawi's debt sustainability outlook after MDRI remains unchanged when taking topping-up

lower concessionality raises the NPV of debt above 117 percent of exports and debt service above 7 percent of exports

Figure 3. Malawi: Sensitivity Analysis, 2005-2024  
(in percent)



Sources: Malawian authorities; and Bank-Fund staff estimates and projections.  
1/ Baseline assumes debt after additional bilateral assistance and MDRI debt relief.

## **Scenario 2: Higher borrowing and lower exports**

77. **Maintaining debt sustainability will depend critically on sound policy decisions as well as implementation.** This scenario assumes that the government supplements the baseline levels of aid with a higher level of borrowing similar to levels witnessed in the first half of the decade. However, efforts to implement structural reforms to enhance growth are assumed to be unsuccessful. The scenario further assumes that long-term global prospects for tobacco prices are poor and that efforts to diversify Malawi's exports from a reliance on tobacco meet with little success. As a result, output and export growth as well as external reserve accumulation are weaker than envisaged in the baseline scenario and the export sector's share of total output in the economy falls.

- Higher borrowing and weaker export growth lead to a steep increase in Malawi's NPV of debt-to-exports ratio. It breaches the HIPC thresholds by 2019, reaching 196 percent the end of the projection period. The debt service-to-export ratio also rises, climbing to 5 percent of exports by 2025.

## **Scenario 3: Failure to insulate the economy from periodic drought**

78. **Debt sustainability is vulnerable to the periodic droughts that Malawi has routinely experienced in the past.** This scenario reflects this past experience and assumes that Malawi fails to implement measures that adequately insulate the economy from the shocks. It is assumed that droughts were to occur every 5 years starting in 2010. During the year affected, drought reduces production, including exports. Despite increased donor support during drought periods, domestic government borrowing and external reserves are put under pressure, making it more difficult for the government to maintain low inflation and real interest rates. The vulnerability of the economy to shocks also has a longer term negative impact on the business environment: domestic borrowing, inflation and real interest rates are generally higher than in the baseline leading to lower private investment as well as lower output and export growth.

- After HIPC and MDRI, Malawi's NPV of debt to exports ratio remains below the HIPC threshold throughout the projection period. Given the assumption of substantial donor support in terms of grants during period of droughts, debt burden indicators under the drought scenario closely mimics the baseline.

## **Scenario 4: Scaling-up of aid and new borrowing**

79. **Malawi is likely to require a large scaling-up of aid if it is to meet the MDGs and make significant inroads into poverty.** However, scaling up aid through loans rather than grants could threaten Malawi's external debt sustainability. To illustrate this risk, this scenario assumes that aid to Malawi (including flows to the private sector and other institutions outside government) are increased by 5 percent of GDP to about 26.5 percent of GDP over 2011-25. The composition of aid between grants and loans remains broadly unchanged from recent experience, so that new borrowing rises to 6.8 percent of GDP, about 3 percent of GDP higher than in the baseline scenario. The additional aid is

assumed to be used effectively, increasing the annual growth of both output and export growth by 0.5 percent above the baseline.

80. Despite higher output and export growth, the additional borrowing assumed in this scaling-up would induce the NPV of debt-to-export ratio to breach the HIPC threshold before the end of the projection period. This clearly illustrates that Malawi would need to rely heavily on grant financing if it is to make faster progress towards achieving the MDGs while maintaining debt burden indicators at sustainable levels.

81. **The sensitivity analysis shows that Malawi's debt sustainability remains vulnerable to exogenous shocks.** It is therefore important that the authorities make prudent use of the resources freed up through debt relief and strengthen their public expenditure management. Moreover, the government would need to continue with the implementation of governance and structural reforms after the completion point in order to sustain strong economic growth and to avoid a deterioration of its debt burden indicators.

Table 3. Malawi: Selected Economic Data, 2003-25  
(In percent of GDP, unless otherwise specified)

	Actual			Projections													Average	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2020	2025	2006-15	2016-25	
	96																	
<b>National income and prices</b>																		
Real GDP growth	6.1	7.1	2.8	8.4	5.6	6.0	6.0	5.5	5.0	4.5	4.5	4.5	4.5	4.5	4.5	5.5	4.5	
Nominal GDP (billions of kwacha)	172	207	246	304	345	393	447	506	570	639	717	804	901	1598	2832	563	1766	
percent change	15.9	20.5	18.6	23.5	13.7	13.9	13.8	13.2	12.7	12.1	12.1	12.1	12.1	12.1	12.1	13.9	12.1	
Gross domestic product, current prices, U.S. dollars	1765	1903	2076	2158	2280	2462	2661	2869	3079	3288	3512	3750	4005	5565	7732	3006	5854	
GDP per capita (in U.S. dollars)	148	155	166	172	176	187	198	209	220	230	241	252	264	330	414	215	341	
percent change	-10.8	5.5	6.9	2.7	1.8	5.0	5.0	5.6	5.1	4.6	4.6	4.6	4.6	4.6	4.6	4.4	4.6	
Consumer price index, percent change (period average)	9.6	11.4	15.5	13.1	7.2	7.5	7.4	7.3	7.3	7.3	7.3	7.3	7.3	7.3	7.3	7.9	7.3	
<b>Public finance</b>																		
Total revenues (including grants)	26.7	34.7	37.6	44.1	41.8	39.0	38.7	38.0	38.3	38.2	38.1	38.1	38.0	37.6	37.5	39.2	37.9	
Revenue (excluding grants)	20.0	22.6	25.1	24.9	24.2	24.2	23.7	23.7	23.7	23.7	23.7	23.7	23.7	23.7	23.7	23.9	23.8	
Grants	6.7	12.2	12.5	19.2	17.6	14.8	15.0	14.3	14.6	14.5	14.4	14.4	14.3	13.9	13.8	15.3	14.1	
Total expenditure	38.3	42.5	43.1	46.1	43.1	39.4	38.7	38.2	38.6	41.2	41.3	41.2	41.2	41.3	41.1	40.9	40.6	
Current expenditure	30.9	31.4	31.8	34.1	28.2	26.1	24.9	23.7	23.9	25.9	25.9	25.9	25.9	26.0	25.8	26.5	24.5	
Investment expenditure and net lending	7.4	11.1	11.4	11.9	14.9	13.3	13.8	14.5	14.7	15.3	15.3	15.3	15.3	15.3	15.3	14.5	16.1	
Overall balance	-11.6	-7.8	-5.6	-2.0	-1.3	-0.5	0.0	-0.2	-0.3	-3.0	-3.1	-3.2	-3.2	-3.7	-3.6	-1.7	-2.7	
Domestic financing	11.8	7.7	3.0	0.4	-0.4	-1.8	-2.6	-2.5	-2.5	0.2	0.3	0.2	0.2	0.3	0.2	-0.8	-0.7	
Domestic debt	20.4	24.8	23.8	20.0	16.5	12.8	8.6	5.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	7.3	-1.5	
<b>Savings and investment</b>																		
National saving	3.3	5.1	8.6	7.9	16.7	17.6	16.9	14.1	15.1	15.8	15.9	16.0	16.1	16.3	16.7	15.2	17.9	
Domestic saving	-11.7	-9.9	-10.3	-9.2	-3.5	-1.1	-1.6	-4.1	-3.0	-2.3	-2.1	-2.0	-1.8	-1.1	-0.2	-3.1	0.3	
Net factor income and private transfers	5.6	3.8	5.2	4.3	4.9	4.8	4.8	4.4	4.3	4.3	4.2	4.2	4.1	3.6	3.1	4.4	3.6	
Net official transfers	9.3	11.2	13.7	12.8	15.3	14.0	13.8	13.8	13.8	13.8	13.8	13.8	13.8	13.8	13.8	13.9	13.9	
Foreign saving	7.6	9.3	5.9	7.7	1.8	1.1	2.6	4.8	4.2	4.2	4.3	4.4	4.4	4.7	5.0	4.0	4.0	
Gross investment	10.9	14.4	14.5	15.6	18.5	18.7	19.5	19.0	19.4	20.1	20.2	20.3	20.5	21.1	21.7	19.2	21.9	
<b>External sector, public debt, and debt service</b>																		
Export of goods and services, US\$m	481	511	566	614	636	657	678	738	799	862	929	1001	1079	1571	2287	799.4	1669.5	
Export of goods and services	27.2	26.8	27.3	28.0	27.7	26.4	25.2	25.5	25.7	25.9	26.2	26.4	26.7	27.9	29.3	26.4	28.4	
Imports of goods and services	49.7	51.2	52.0	52.8	49.7	46.2	46.4	48.5	48.1	48.3	48.5	48.8	48.9	50.1	51.3	48.6	50.0	
Current account balance (excluding grants)	-17	-21	-20	-20.5	-17.1	-15.1	-16.3	-18.6	-18.0	-18.0	-18.1	-18.2	-18.2	-18.5	-18.8	-17.8	-18.0	
Current account balance (including grants)	-7.6	-9.3	-5.9	-7.7	-1.8	-1.1	-2.5	-4.8	-4.2	-4.2	-4.3	-4.4	-4.4	-4.7	-5.0	-3.9	-4.0	
Net official aid inflows to Malawi	20.0	18.9	23.8	21.8	24.7	22.2	22.1	22.9	22.8	22.7	22.6	22.6	22.5	22.5	22.5	22.7	22.7	
Net official aid inflows to government	11.2	12.2	16.0	15.3	18.3	16.2	16.2	17.1	17.1	17.0	17.0	17.1	17.0	17.0	16.8	16.8	17.1	
Gross aid inflows	14.3	15.7	18.8	19.1	20.0	17.7	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.9	17.7	
Debt service paid	3.2	3.5	2.8	3.8	1.7	1.6	1.3	0.4	0.4	0.5	0.5	0.4	0.5	0.5	0.7	1.1	0.6	
Official aid flows outside government	8.8	6.7	7.8	6.5	6.4	6.1	5.8	5.8	5.7	5.7	5.6	5.6	5.5	5.5	5.5	5.9	5.6	
Gross official reserves (in millions US dollars)	116	119	131	114	207	299	362	399	437	482	531	586	644	1034	1637	406	1117	
In months of annual imports of goods and services	1.4	1.3	1.4	1.2	2.2	2.9	3.3	3.4	3.5	3.6	3.7	3.8	3.9	4.4	4.9	3.1	4.5	
Exchange rate: Kwacha per US dollar, period average	97	109	118	...	...	...	...	...	...	...	...	...	...	...	...	...	...	

Sources: Malawian authorities and IMF staff estimates.

Table 4. Malawi: Balance of Payments, 2000-09  
(In millions of US dollars)

	Actuals						Projections			
	2000	2001	2002	2003	2004	2005	2006	2007 113	2008	2009
Current account balance (including grants)	-51	-117	-216	-134	-178	-122	-169	-42	-27	-67
Trade balance	-140	-158	-306	-351	-424	-473	-498	-456	-438	-511
Exports	402	427	421	441	470	524	572	593	611	630
Imports	-542	-585	-727	-792	-894	-998	-1070	-1049	-1049	-1141
Services balance	-66	-66	-154	-88	-85	-84	-85	-75	-76	-72
Interest public sector (net)	-21	-18	-20	-26	-28	-26	-19	-4	-1	8
Receipts	12	9	3	2	1	1	3	5	9	14
Payments	-33	-26	-23	-27	-28	-26	-22	-9	-10	-6
Other factor payments (net)	-16	-15	-24	-16	-17	-17	-19	-20	-21	-22
Nonfactor (net)	-29	-33	-109	-47	-40	-41	-47	-51	-55	-58
Receipts	45	54	50	40	41	41	42	43	46	48
Payments	-74	-87	-77	-87	-81	-83	-90	-95	-100	-106
Unrequited transfers (net)	155	107	243	305	331	435	413	488	487	516
Private (net)	8	10	8	141	118	151	132	136	139	145
of which Official aid to non-gvt	1	211	183	156	127	162	147	151	157	158
Official (net)	148	98	235	164	213	284	280	352	348	371
Receipts	148	98	235	164	213	284	280	352	348	371
Balance of payments assistance	78	51	13	42	64	97	46	99	92	98
Japan HIPC Initiative 2/	0	0	11	17	0	0	0	0	0	0
Project and humanitarian	70	47	211	105	149	187	234	253	256	273
Payments	-1	-1	0	0	0	0	0	0	0	0
Capital account balance (incl. errors and omissions)	39	85	61	96	152	92	111	89	90	108
Medium- and long-term flows	65	60	24	11	16	21	50	59	57	72
Official disbursements	125	127	81	97	95	98	113	91	86	100
Balance of payments support	31	55	0	18	35	18	33	18	24	27
Project support	94	72	81	78	50	79	80	72	62	72
Amortization (amounts due before HPC debt relief)	-60	-67	-57	-69	-75	-77	-63	-32	-29	-28
Foreign direct investment and other inflows	27	28	38	43	44	26	30	32	34	36
MDRI debt forgiveness on debt due after current year	0	0	0	0	0	0	1844	376	0	0
MDRI grants from ADF	0	0	0	0	0	0	0	376	0	0
MDRI grants from IDA	0	0	0	0	0	0	1798	0	0	0
MDRI grants from IMF	0	0	0	0	0	0	46	0	0	0
Other liabilities (MDRI-IDA and ADF loans)	0	0	0	0	0	0	-1813	-378	0	0
Short-term capital and errors and omissions	-53	-2	0	42	92	45	0	0	0	0
Overall balance	-12	-32	-155	-38	-25	-30	-58	47	64	41
Financing (- increase in reserves)	12	32	155	38	25	30	58	-47	-64	-41
Central bank	17	12	111	-3	-16	-49	6	-75	-85	-63
Gross reserves (- increase)	2	41	41	39	-6	-31	41	-93	-93	-63
Liabilities	15	-29	71	-42	-10	-18	-35	18	7	0
Of which: IMF (net)	-1	-6	17	0	-14	-11	11	18	7	0
Purchases/drawings	8	0	23	9	0	8	25	18	7	0
Repurchases/repayments	-9	-6	-6	-9	-14	-19	-14	0	0	0
Loans	0	0	50	-50	0	0	-54	0	0	0
Commercial banks	-6	-8	15	-7	-6	19	-9	-4	-4	-5
Arrears	0	0	0	0	0	0	0	0	0	0
Debt relief	0	27	29	48	47	60	46	30	26	27
MDRI debt forgiveness on debt due in current year	0	0	0	0	0	0	15	2	0	0
Residual financing gap (+ underfinanced)	0	0	0	0	0	0	0	0	0	0
Memorandum items										
Trade balance G&S	-170	-191	-333	-398	-464	-514	-545	-507	-492	-569
Total exports G&S	446	480	471	481	511	566	614	636	657	678
Total imports G&S	-616	-672	-803	-878	-975	-1080	-1159	-1143	-1149	-1247
Total net official aid inflows	181	364	465	370	369	493	515	600	584	621
Net aid flows to gvt	179	152	282	214	242	332	368	449	428	464
Gross official aid flows (incl. IMF)	281	225	339	270	309	390	419	460	441	471
Grants	148	98	235	164	213	284	280	352	348	371
Share of total	53	43	69	61	69	73	67	76	79	79
Loans	133	127	104	106	95	106	138	108	93	100
Program	118	106	36	69	99	124	121	135	123	126
Project-Other	163	119	292	184	199	266	311	331	318	345
Debt service after relief	102	72	57	56	67	58	51	11	13	7
Official grant aid flows outside gvt	1	211	183	156	127	162	147	151	157	158
Total grants share of total gross aid	53	71	80	75	78	81	76	82	84	84
Gross usable reserves	224.6	184.6	103.4	115.6	119.3	131.2	113.9	206.5	299.3	362.1
Gross reserves in months of current imports	4.4	3.3	1.5	1.6	1.5	1.5	1.2	2.2	3.1	3.5

Sources: Malawian authorities and IMF staff estimates.



	<p>undertaken by Government.</p> <ol style="list-style-type: none"> <li>Improving the prison conditions by carrying out periodic reviews on remandees for speedy trials (PAF Indicator 28); reducing the number of deaths among prisoners due to poor nutrition and HIV/AIDS (PAF Indicator 28b)</li> <li>Meet the PAF Indicator 27 target on Actual recurrent expenditure to governance institutions.</li> </ol>
<b>3. Control of corruption</b>	<ol style="list-style-type: none"> <li>Continue its fight against corruption at all levels, taking to court all corruption cases without fear or favour, reducing the number of months taken for the trial of corruption cases (PAF Indicator 23) and increasing the percentage of corruption cases completed within 12 months (PAF indicator 24).</li> <li>Appoint a new Director of the Anti-Corruption Bureau by December 2006 to spearhead the fight against corruption in Malawi.</li> <li>The implementation of the Anti-Money Laundering Bill that was approved at the June sitting of Parliament.</li> </ol>
<b>4. Government effectiveness</b> - Institutional capacity  - Public finance management	<ol style="list-style-type: none"> <li>GoM is committed to conduct both functional and strategic reviews of Ministries and departments to achieve optimal use of both human and financial resources for better results</li> <li>The implementation of the new PFM Action Plan approved in October 2006 by the Minister of Finance.</li> <li>The recruitment of the new Auditor General by the first quarter of 2007.</li> </ol>
<b>5. Economic governance</b>  - Private sector / market friendly policies         - Management of Natural Resources	<ol style="list-style-type: none"> <li>Maintain fiscal discipline in the implementation of the Poverty Reduction Growth Facility (PRGF) agreed with the IMF aimed at reducing the interest rates so that the cost of borrowing by the private sector can be lowered.</li> <li>The involvement of the private sector in the formulation of the national budget through a well structured forum for dialogue with the private sector.</li> <li>The implementation of the private sector development strategy including the establishment of Commercial Courts in order to create investor confidence in the country.</li> <li>The enforcement of National Environmental Policy will be strengthened through appropriate reviews of existing environmental protection laws.</li> </ol>
<b>6. Internal and external security</b>  - Internal stability and global security	<ol style="list-style-type: none"> <li>GoM is committed to maintaining peace and stability as a way of attracting direct foreign investments into the country. The GoM is committed to the establishment of a professional and accountable National Intelligence Service</li> </ol>
<b>7. Social governance</b>	<ol style="list-style-type: none"> <li>GoM wishes to commit itself to achieving all the Social PAF Indicators i.e. from indicator No. 12 to 19, on education, health, gender and HIV/AIDS.</li> </ol>
<b>8. International and regional context</b>	

<ul style="list-style-type: none"> <li>- Involvement in regional peer review mechanisms (e.g. APRM)</li> </ul>	<ol style="list-style-type: none"> <li>1. GoM has committed itself to undergo the APRM process/ comply with host requirement, e.g. setting up of a committee that will review the commitments.</li> </ol>
<p><b>8. Quality of partnership</b></p> <ul style="list-style-type: none"> <li>- Political dialogue</li> <li>- Programming dialogue</li> <li>- Non State Actors</li> </ul>	<ol style="list-style-type: none"> <li>1. As confirmed by the Minister of Foreign Affairs and International Cooperation, political dialogue meetings (Cotonou Meetings) will be held on a monthly basis with EU (EC and EU member states).</li> <li>1. GoM committed to engage EU (EC and EU member states) in programming dialogue under the frameworks of the Development Assistance Strategy (DAS) and the Common Approach to Budget Support (CABS).</li> <li>1. Engage the Non-State Actors by way of consultations on development issues as the case was in the formulation of the Malawi Growth and Development Strategy (MGDS) and the programming for the 10th EDF.</li> <li>2. Involve the NSAs in the monitoring of the MGDS implementation. Engage NSAs in Advocacy Policy Dialogue &amp; implementation issues</li> </ol>

**Annex 10(a)**

**PUBLIC FINANCE MANAGEMENT IN MALAWI**

## Main Abbreviations and Acronyms

CABS	Common Approach to Budgetary Support
CBI	Cross Border Initiative
CCA	Credit Ceiling Authority
CCS	Commitment Control System
CFAA	Country Financial Accountability Assessment
COMESA	Common Market for East and Southern Africa
CSP	Country Strategy Paper
DFID	Department for International Development
EDF	European Development Fund
EC	European Commission
EHP	Essential Healthcare Package
EU	European Union
FA	Financing Agreement
FIMAG	World Bank Balance of Payment Support Programme
FY	Financial or Fiscal Year
GCU	Government Contracting-Out Unit
GDP	Gross Domestic Product
GoM	Government of Malawi
HIPC	Heavily Indebted Poor Countries
HMIS	Health Management Information System.
IDA	International Development Association
IMF	International Monetary Fund
IFMIS	Integrated Financial Management Information System
JF	GoM/CABS Joint partnership Framework
M&E	Monitoring and Evaluation
MASAF	Malawi Social Action Fund
MFAAP	Malawi Financial Accountability Action Plan
MGDS	Malawi Growth and Development Strategy
MOU	Memorandum of Understanding
MSME	Medium, Small and Micro Enterprises
MTEF	Medium Term Expenditure Framework
(M)PRS(P)	(Malawi) Poverty Reduction Strategy (Paper)
NAO	National Authorising Officer
NGO	Non Government Organisation
NRA	National Roads Authority
NSO	National Statistical Office
ODA	Official Development Assistance
OPC	Office of the President & Cabinet
OPD	Out Patient Department
ORT	Other Recurrent Transaction
PAF	Performance Assessment Framework
PEM	Public Expenditure Management
PFM	Public Finance Management
PPEs	Pro Poor Expenditures
PRBS	Poverty Reduction Budget Support
PRGF	Poverty Reduction & Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSMR	Public Sector Management Reform
RBM	Reserve Bank of Malawi
SADC	Southern Africa Development Community
SAF	Structural Adjustment Fund
SSA	Sub Saharan Africa
SWAP	Sector Wide Approach Programme
TA	Technical Assistant
TEVET	Technical Entrepreneurial and Vocational Education & Training
UN	United Nations
WB	World Bank
WTO	World Trade Organisation.

## PART 1. RECENT DEVELOPMENTS

The government administration has made **continuous progress in exercising fiscal discipline** since 2004, linked with renewed discipline in expenditure from line ministries, reductions in the level of interest payable on domestic debt and the payment of some outstanding domestic arrears. After the successful completion of the second review in August 2006, the latest IMF mission, which visited Malawi during October 24 – November 7, 2006 to discuss the **third review under the GoM-IMF PRGF concluded that the country was well on track** with most of the program targets met for end-June 2006<sup>1</sup>. According to a statement from the IMF mission, fiscal performance has been sound through September 2006, facilitated by buoyant tax collection. On the economic reform agenda following the HIPC completion point, the GoM recognizes the importance of deepening reforms to strengthen growth prospects for Malawi. Key elements of the envisaged reform agenda for the coming years include: (i) strengthening economic management capacity, in particular through public financial management reforms and the development of an external debt strategy; and (ii) reducing the cost of doing business and improving financial intermediation.

On August 31<sup>st</sup>, 2006 the World Bank (IDA) and the IMF agreed that **Malawi had made sufficient progress to reach the completion point under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative**. Debt relief under the enhanced HIPC Initiative from all of Malawi's creditors amounts to US\$646 million in net present value (NPV) terms as of the decision point plus a topping-up of this amount in an amount equivalent to US\$411 million (NPV) as of completion point. In nominal terms, the assistance amounts to approximately US\$1.6 billion.

In reaching the HIPC completion, Malawi becomes eligible for further debt relief from the World Bank's IDA, the IMF and the African Development Fund (AfDF) under the Multilateral Debt Relief Initiative (MDRI). Debt service savings under the MDRI would amount to US\$1.4 billion. Average annual debt service savings are expected to increase from US\$39 million to US\$110 million between 2001-2005 and 2006-2025, respectively.

According to a June 2006 **PEFA based PFM Assessment** report, although the PFM system in Malawi remain weak, some aspects of it has improved since the last similar exercise completed in July 2005. This was also noted during the CABS reviews held in March and September 2006. The improvement is attributable, among other things, to the recent implementation of the Integrated Financial Management Information System (IFMIS) thus leading to some improvements in expenditure control and timely financial reporting.

According to the IMF, **the implementation of the IFMIS system has been an impressive achievement** particularly when viewed against international experience in implementing similar systems. Much of the success and speed of the implementation has been attributed to a streamlined project management approach where project governance structures were flexible and allowed for fast implementation of policy decisions.

However, the PEFA review confirmed that **Internal and external audit capacity is extremely limited** in Malawi and this has implications for control over the data being maintained in the IFMIS system. Currently there is little capacity to perform systems audits and this is an area that the Auditor General should address through training of staff and procurement of suitable system audit software. In addition, capacity of internal auditors needs to be developed to enable the audit of both central and regional payment office processes and procedures to ensure that they are maintaining adequate controls over expenditure and data in the system.

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<sup>1</sup> The targets on government domestic borrowing and discretionary expenditure were exceeded. This was expected as GoM had to face a food crisis during FY2005/2006. GoM had to increase its borrowing to face the cost of importing food security items in vast quantities. The IMF Board Meeting for the third review is expected in January 2007.

The situation with **procurement** has improved, although according to CABS, remains a source of concern for some specific procurement processes. A number of donors are supporting the Office of the Director of Procurement and progress is expected in the coming months.

Finally, the GoM has initiated a complete revision of its Malawi Financial and Accountability Action Plan (MFAAP). The **new Public Finance Management Action Plan - Public Finance and Economic Management (PFEM)** - has been prepared through a comprehensive review process within GoM institutions taking into consideration the previous MFAAP, approved in 2004, as well as the most recent PFM PEFA review. The Action Plan has been submitted to the Group on Finance and Economic Management in October 2006 and is expected to be finalised by mid November 2006 with inputs from all stakeholders. The new Action Plan will guide the EC Technical Assistance support provided under the PRBS 2 programme approved by the EDF Committee in October 2006 and the selection of PFM indicators for the variable tranche to be paid in 2008.

## **PART 2. MONITORING OF THE MAIN AREAS OF PUBLIC FINANCE MANAGEMENT**

### **1) Credibility of the budget**

Prior to FY2004/2005, the government budget was characterised by lack of effective control over ministries spending, failure to reduce expenditures in line with reduced inflows. This tended to result in high level of domestic debt and arrears. The implementation of a new accounting system, IFMIS, and the introduction of tighter payment controls by the new government administration, through a centralised payment system, has resulted into a reversal of the negative trend. For instance, in FY2003/2004 budgetary operations, actual expenditures deviated from approved by parliament by 37%. During the FY2004/2005, actual expenditures deviated by only 2%. The deviation of actual expenditures from the approved budget remained below 10% during the FY2005/2006, against a background of increased government spending related to maize purchases to avert the hunger situation.

With regards to payment of arrears, the National Audit Office finalised the verification of the arrears by end of June 2005. The GoM annual budgets have foreseen an annual repayment of Mkw 2 bn (around €11M- November 2006 exchange rate). Reacting to the apparent degradation of the situation with control and monitoring of arrears between 2005 and 2006, the September 2006 CABS review was reassured that a proper monitoring of the arrears was in place at the Accountant General office. A number of court case have however been lost by the GoM over the last two years thus offsetting the progress made by GoM in repayment of arrears.

**Progress made on credibility of the budget between the 2005 and 2006 review is summarised through indicators tabulated below<sup>2</sup>:**

<b>PEFA Performance Indicator</b>	<b>Score 2005 Review</b>	<b>Score 2006 Review</b>
Aggregate expenditure out-turn compared to original approved budget	C+	A
Composition of expenditure out-turn compared to original approved budget	D+	D
Aggregate revenue out-turn compared to original approved budget	D	A
Stock and monitoring of expenditure payment arrears	C	D+

<sup>2</sup> It must be emphasised, however, that the marking methodology used in the 2005 and 2006 reviews are slightly different such that strict comparison between the two years may in some cases not be practically possible.

## 2) Comprehensiveness and transparency

The revision of the Chart of Accounts and the implementation of IFMIS has introduced some improvements in the presentation of the accounts. The improvements include the capturing of government assets and liabilities, as well as codes for ministry outputs and activities.

A review of the comprehensive budget documents produced by the GoM indicates that despite some minor improvements, the budget documents remain extremely detailed and complicated. This notwithstanding, there is an improvement in the reporting on extra-budgetary operations including donor-funded operations, thanks in particular to the work conducted by the Ministry of Finance and the Group and Finance and Economic Management in 2005 and 2006.

In order to ensure wide coverage of the national budget, a structured, rules-based system of determining allocations amongst inter-governmental bodies is being applied by the National Local Government Finance Committee. Although the system experienced some teething problems in the past, it is encouraging to note that information on the allocation of funds to Local Assemblies was provided in 2005/06 much earlier than in previous years. Previous over-riding national cash flow constraints also do not seem to have affected the release of funds, as they did in previous years.

Until very recently, the level of monitoring undertaken by the GoM of Autonomous Government Agencies and Public Enterprises has been limited. As a result, significant payment arrears and other financial liabilities had been allowed to build. However, initial steps are now being taken to address these weaknesses – largely through a dedicated Unit within the Ministry of Finance - Public Enterprises Management Unit (PERMU) - and the work of the Department for Statutory Corporations.

Although access to key fiscal information by all stakeholders is somewhat hampered by the nature and format of the budget documents, which proves too detailed and complicated to untrained users, more and more fiscal information is published in the newspapers and is available on the Government website. Civil Society organisations such as the Malawi Economic Justice Network (MEJN) are helping in producing simplified budget information for the general population.

**Progress made on comprehensiveness and transparency of the budget process between the 2005 and 2006 review is summarised through indicators tabulated below: -**

<b>PEFA Performance Indicator</b>	<b>Score 2005 Review</b>	<b>Score 2006 Review</b>
Classification of the budget	B	B
Comprehensiveness of information included in budget documentation	C+	D
Extent of unreported government operations	B	B
Transparency of inter-governmental fiscal relations	D	C
Oversight of aggregate fiscal risk from other public sector entities	D+	D+
Public access to key fiscal information	D+	B

## 3) Policy-based budgeting

The design of the FY2006/07 budget framework was influenced by considerations for, among other priorities, the PRGF programme with the IMF, food security and accelerated economic growth. This

being the case, it is inevitable that a review of the multi-year planning, expenditure policy and budgeting systems will show slow progress in restructuring the current budget in a way that it fully complies with the MTEF and the recently approved MGDS.

The CABS, in agreement with IMF, considers that the current budget system is too ambitious in that the budget process and documentation appear excessively complex. Such an ambitious and complex system appears particularly inappropriate in Malawi given the lack of human resources and skills available to operate it both in central government and in line ministries.

The weaknesses of the system include: (i) MTEF subprogrammes do not necessarily align with Output Based Budgeting activities; (ii) the MTEF framework has not been used as a rolling three-year plan; (iii) since budget execution reports and accounts are prepared only on a line item basis, there is no reporting against activities or outputs. In light of these shortcomings, the GoM through the Ministry of Finance is in the process of commissioning an external assessment<sup>3</sup> to assess the current budget system. The exercise will review Malawi's budget system in light of international experience and GoM's limited human resources and to make recommendations on how the system can be both simplified and strengthened and made more appropriate to local conditions. The findings and recommendations from the assessment are expected to be taken into account when activating the budget module in the new IFMIS when preparing the FY2007/08 budget.

**Progress made on policy based budgeting between the 2005 and 2006 review is summarised through indicators tabulated below: -**

<b>PEFA Performance Indicator</b>	<b>Score 2005 Review</b>	<b>Score 2006 Review</b>
Orderliness and participation in the annual budget process	D+	B
Multi-year perspective in fiscal planning, expenditure policy and budgeting	D	D+

#### **4) Predictability and control in budget execution**

Continuing with the initiative to consolidate tax revenue collection, GoM has put in place a helpful framework in form of enabling legislation, which now covers Income Tax, Customs and Excise and Value Added Tax (VAT) functions, together with specific Ministry-based taxes and other revenues. Steps are now being taken to provide taxpayer information in more helpful and effective ways like drama and local languages.

The effectiveness of controls within the taxpayer registration and tax assessment systems suggests some improvements have occurred. For instance, manual linkages have been established between the separate taxpayer databases. However, there is room for improvement in the effectiveness of existing penalties for non-compliance with registration and declaration obligations. The MRA has established a separate Unit for audit and investigations work, which has so far undertaken some tax audits in the banks and fuel distributors.

The current systems to assess predictability in the availability of funds for the commitment of expenditures appear to be working quite well. Cash flow forecasts are prepared annually by ministries as part of the budget process. These are then combined into one overall cash flow by the Treasury Budget Division, which updates the cash flow forecasts quarterly to reflect cash availability. The frequency and transparency of adjustments to budget allocations, which are decided above ministries, departments and agencies level, through allocations between expenditure

<sup>3</sup> To be supported by DFID in collaboration with the IMF.

items is only allowed once a year and under the new arrangements is controlled by IFMIS. The budget is normally revised once a year in April.

When the GoM introduced its new Centralised Payments System during FY2005/2006, around 1,550 separate bank accounts were also closed. The new GoM accounting system (IFMIS) now only reconciles transactions with five core government bank accounts held at the Reserve Bank of Malawi (Recurrent, Development Budget - Part 2, Miscellaneous Deposits, Advances and Statutory Expenditure). Part 1 of the Development Budget (i.e. all donor funds) is still monitored through the “old” CCA system (involving a significant number of commercial bank accounts).

In the area of internal control, especially in public procurement, there is evidence of improvement on competition, value for money and procurement controls. This is based on some progress achieved by the Office of the Director of Public Procurement (ODPP). Nevertheless, the directorate continues to experience setbacks in a number of areas including lack of competent procurement personnel – both within the ODPP and within individual ministries.

Prior to the centralisation of all GoM payments and the introduction of the IFMIS accounting system, expenditure commitment controls were weak - votes were regularly over-committed and overspent and substantial payment arrears were accumulated. The system of allocation between expenditure items (virement) had also fallen into disrepute. However, increased financial discipline appears to have been introduced and expenditure commitments now appear to be subject to much tighter financial controls – especially those commitments that are controlled through IFMIS.

**Progress made on predictability and control in budget execution between the 2005 and 2006 review is summarised through indicators tabulated below: -**

<b>PEFA Performance Indicator</b>	<b>Score 2005 Review</b>	<b>Score 2006 Review</b>
Transparency of taxpayer obligations and liabilities	D+	C
Effectiveness of measures for taxpayer registration and tax assessment	D	C
Effectiveness in collection of tax payments	D	D+
Predictability in the availability of funds for commitment of expenditures.	D+	C+
Recording and management of cash balances, debt and guarantees	C+	C
Effectiveness of payroll controls	D+	C+
Competition, value for money and controls in procurement	D+	C
Effectiveness of internal controls for non-salary expenditure	D+	B
Effectiveness of Internal Audit	D+	D+

### **5) Accounting, recording and reporting:**

IFMIS, together with the centralisation of the payments function (also through 3 Regional Central Payments Offices) appears to have resulted in significant improvements in the timeliness and regularity of the account reconciliation systems. All IFMIS transactions are now paid through only five core bank accounts held at the Reserve Bank of Malawi. However, all payments for donor-funded projects (Development - Part 1) are still processed through the CCA system and are reconciled in arrear within two months of the transaction date. IFMIS has also helped to improve the reconciliation and clearance of suspense accounts and advances.

A growing volume of non-staff resources have now been transferred to Local Assemblies in respect of some aspects of primary health, education and agricultural services. However, only limited progress has been achieved in the level of information provided on resources received by individual service delivery units, such as primary schools and health clinics. The GoM has also undertaken a number of expenditure tracking studies. Civil Society Organisations such as MEJN have, on a number of occasions, also undertaken their own simple, independent assessments – including Service Delivery Satisfaction Surveys.

The budget execution and reporting picture at a national level appears to have improved as a result of the production of two budget execution reports at monthly intervals (or on demand) by IFMIS. One report provides an itemised commitment & expenditure report by cost centre for each Controlling Officer, while the second provides a cashbook for each Ministry and Vote. This shows all debits, credits (posted by the Central Payments System) and opening and closing balances. The cashbook closing balances are fully reconciled with the fund balances remaining within all cost centres and variances appear to have been investigated. In addition, there has been a significant improvement in the standard and timeliness of these reports.

A consolidated government financial statement is due to be prepared annually based upon Generally Accepted Accounting Practice (GAAP). In previous years, significant delays (often caused by delayed submission of Ministry data to the Accountant General) occurred in the submission of the annual financial statements to the National Audit Office (NAO). Significant improvements are expected in the quality and timeliness of annual financial statements, once the IFMIS system has been fully operational for, at least, one full fiscal year.

In order to progress and to move to the next phases of the implementation, a more strategic framework will need to be established for the IFMIS project. A number of crucial issues need to be addressed and this can only be done in the context of a strategic assessment of priorities, resourcing and a medium-term vision for the system. Key issues that need to be addressed include future IT requirements, the appropriate communications network, the need to review and further improve budgetary systems and the possible roll out to local government.

The IFMIS implementation has been reviewed by a dedicated IMF mission in Sept 2006. An IFMIS training need assessment has been conducted in April 2006 and a procurement need assessment was conducted through the summer 2006. These reviews, shared with all donors in the context of the Group on Finance and Economic Management (GFEM) will allow the Accountant General office to prioritise its needs to enhance the system while allowing development partners to harmonize the assistance provided.

Internal audit capacity is extremely limited in Malawi and this has implications for control over the data being maintained in the IFMIS system. Currently there is little capacity to perform systems audits and this is an area that the GoM should address through training of staff and procurement of suitable system audit software. In addition, capacity of auditors needs to be developed to enable the audit of both central and regional payment office processes and procedures to ensure that they are maintaining adequate controls over expenditure and data in the system. GoM and Donors have gradually responded to these needs and the Internal Audit Unit is being beefed up. A number of vacant positions have been filled and donor assistance has and will continue to increase.

**Progress made on accounting, recording and reporting between the 2005 and 2006 review is summarised through indicators tabulated below: -**

<b>PEFA Performance Indicator</b>	<b>Score 2005 Review</b>	<b>Score 2006 Review</b>
Timeliness and regularity of accounts reconciliation	C+	B

Availability of information on resources received by service delivery units	D	D
Quality and timeliness of in-year budget reports.	D	C+
Quality and timeliness of annual financial statements	D+	D+

## 6) External Scrutiny and Auditing

This area is certainly the weakest point in the PFM system in Malawi due to the fact that the National Audit Office still has very limited capacity and resources to enable it discharge its responsibilities effectively. This problem has been made worse, as a result of the continuing vacancy at Auditor General level since January 2006. Nevertheless, despite these constraints, the NAO does appear to have made some limited progress in 2005/06 – especially through specific audits of Education Pensions and Development contracts, as well as the Health Payroll. It is also currently undertaking a payroll audit of most ministries. In addition, the NAO attempts to audit all donor-funded projects annually, either by undertaking this work itself or by contracting it out to private sector auditors. Building capacity at the NAO will be a major priority for the GoM in the coming 12 to 24 months. CABS September 2006 reports that the office has been allowed to recruit more than a 100 auditors this fiscal year.

This should lead to progress in the coverage and comprehensive of external audits conducted on GoM business in the next few years. CABS has indicated its willingness to assist the National Audit Office in developing its capacities and support is already in place and will increase in the soon future, with some EC and WB involvement.

The Legislature in Malawi currently scrutinises the management of public resources through the Budget and Finance (BFC) and the Public Accounts (PAC) Committees of Parliament. The Budget and Finance Committee is responsible for scrutinising the government’s annual budget while the Public Accounts Committee (PAC) is responsible for external scrutiny of annual reports on Government Accounts produced by the National Audit Office. Currently PAC has a backlog in the scrutiny of these reports. Nevertheless, the two committees played a more active role in the new Parliament since 2004. There have been improved consultations between the committees and the executive arm of government on critical issues over the last few months and reportedly this has had an impact on the discipline of controlling officers throughout GoM institutions. However, both committees still suffer from lack of resources, staff and overall support.

**Progress made on external scrutiny and audit between the 2005 and 2006 review is summarised through indicators tabulated below: -**

PEFA Performance Indicator	Score 2005 Review	Score 2006 Review
Scope, nature and follow-up of external audit	D	D+
Legislative Scrutiny of the annual budget law *	D+	-
Legislative scrutiny of external audit reports.	D+	D+

\*: The PEFA Assessment team was not provided with sufficient information to score

## PART 3. EUROPEAN COMMISSION INSTITUTIONAL SUPPORT

The European Union and the Malawi Government in October 2005 signed a €41.5 million Poverty Reduction Budgetary Support (PRSB 1) financing agreement. The programme has set aside €3.0

million for supporting public finance management reforms through capacity building in strategic accountability institutions of the National Audit Office (€450,000), the Department of the Accountant General & the Internal Audit Office ((€1,550,000) via a contribution agreement with the World Bank. This is expected to be signed in the near future (early 2007). Part of the technical assistance (€800,000) will be used to support government's initiative of MPRS Monitoring and Evaluation, a programme that is being implemented through a trust fund managed by UNDP.

The European Commission funded Capacity Building Project for Economic Management and Policy Coordination (CBPEMPC) continues to provide support to government in the area of public finance management through training of personnel in key planning ministries in specialist economic courses, financial management, administrative and human resources development courses. The programme provides direct support to the MFAAP secretariat, which is charged with the responsibility of spearheading the implementation of activities of the action plan. Through the recommendations of the GFEM (which the EC Delegation co-chair) and other stakeholders, GoM is in the process of implementing a new PFEM action plan, which is aimed at prioritising and speeding up the implementation of PFM reform issues.

Finally, with the approval of the PRBS 2 programme in October 2006, the EC Delegation is expecting to be able to assist with the actual implementation of the new PFEM Action Plan presented by GoM with an amount of €1,500,000. The key priority areas are presented in the following section. The assistance provided by the EC will be carefully coordinated with other support programme implemented by development partners (mainly the US based Millenium Challenge Account programme of support, the MTEF II programme supported by DFID and the FIMTAP programme which is jointly funded by the WB and the EC (under the PRBS1).

#### **PART 4. EXPECTED INITIATIVES IN PFM**

In the short-term, GoM has, through the PFEM Action Plan presented in October 2006, lined up a number of reform activities that will see improvements in areas of planning; resourcing the National Development Strategies and budgeting for the Malawi Growth and Development Strategy; monitoring systems for management decision making; reliable reporting system; and steering the PFEM process.

The objective of the planning component is to develop systems and models for national and sector planning and coordination of the planning process. This will involve setting up of effective coordination for PFEM and its integration with MGDS while developing a framework for clarifying links between national and sector strategies and plans.

The objective of the Resourcing the National Development Strategies component is to achieve effective revenue mobilisation of both external donor assistance and domestic financial resources. In addition, the component seeks to develop a strategy for resource allocation, which is expected to result into improved allocation of resources to the Development Budget to meet MGDS requirements, optimise the allocation of recurrent resources to meet needs assessment and a budget made according to an output and activity format. This will involve, among other things, finalising and adopting the new Development Assistance Strategy; development of an action plan with set targets for the reduction and management of domestic debt; improvement of the domestic revenue forecasting methodology, modelling and capacity for such modelling; ensuring that the Development Budget captures all donor funding for all projects administered in support of government; completion of the Public Expenditure Review.

The objective of the budgeting for the MGDS is to achieve efficiency in budget preparation and in accounting and financial procedures. This will involve updating budget classification and coding to

align with GFS as well as output, activity and location format; developing a budgeting manual for central government; implementing an automated system of account reconciliations; completion of IFMIS coverage to ensure cash allocations are strictly done according to budget provisions; training of 4 pilot District Assembly personnel on use of customised IFMIS; installation of IFMIS in 4 pilot District Assemblies; and implementation of a new procurement module. Procurement support will include enhancing the capacity of the Office of the Director of Public Procurement as well as establishing special procurement units and positions.

The objective of the monitoring systems for management decision-making component is to strengthen internal controls and account reconciliations. This will involve institutional restructuring and capacity building of the National Audit Office and the Central Internal Audit Office; development of audit tools and techniques for auditing; building capacity to enable Audit staff audit automated systems; development of audit module; using IFMIS to produce financial records; implementation of a comprehensive financial accountability compliance and enforcement strategy; making of regular comparisons and analyses of budget allocations against actual financial cash expenditures for planned and actual inputs, activities and outputs; development of indicators of planned inputs, activities and outputs; and development of indicators of targeted outcomes and impacts.

The objective of the reliable reporting system component is to achieve improved financial reporting, activity reporting and evaluation reviews. This will involve completion of IFMIS coverage to ensure timely production of expenditure reports; establishment of a system of reporting that enables ongoing information for management of progress in activities compared to plans; establishment of a system for on-going evaluations of outcomes and impacts; and establishment of a system for timely internal and external audit reporting.

The GoM is currently establishing a PFEM Steering Committee and will appoint a PFEM coordinator that will champion the process from the GoM side. Steering Committee and Coordinator are expected to be in place by end of 2006.

**Annex 10(b) - Public Finance and Economic Management**

Results required	Key Tasks	Verifiable Output	Responsibility	Deadline or Timeframe	Donor	PEFA
<b>A: Planning:</b>						
<b>A1: Systems and models for national and sector planning:</b>						
A1.1: Improved coordination mechanisms developed for Public Finance and Economic Management.	Set up effective coordination for PFEM and its integration with MGDS.	PFEM established and functioning.	MOF, MEPD, OPC	janv-07		12
	Implementation plans prepared for MGDS, according to Budget Calendar.	MGDS implementation rolling plan.	MOF-Budget Div./MEPD-Econ. Planning	mars-07	EC,MCC	11,12
	Specify input requirements and planned outputs from MGDS costings.	Schedule of MGDS input requirements and outputs planned.	MOF-Budget Div./MEPD-Econ. Planning	FY 07/08	EC,MCC, UNDP	6
<b>A2: Coordination of planning processes:</b>						
A2.1: Improved coordination mechanisms developed for National and Sector planning.	Implement framework for linking national and sector strategies and plans.	Framework developed for clarifying links between national and sector strategies and plans.	MEPD-Econ. Planning, Dev. Division,M&E	juin-07	EC	6
A2.2: Improved coordination mechanisms developed for inclusion of District planning.	Update planning manuals in line with general national strategy, enabling the integration of District plans with the National and Sector programmes.	Comprehensive national planning manuals updated.	MEPD-Dev. Division/MLG&RD	juil-07	EC, GTZ, JICA	
	Update the project planning manual.	Project planning manual updated.	MEPD-Dev. Div.	juin-07		
<b>B: Resourcing the National Development Strategies:</b>						
<b>B1: Effective Revenue mobilisation.</b>						
B1.1: Effective mobilisation of external Donor assistance:	Finalise and adopt the new Development Assistance Strategy.	Development Assistance Strategy finalised, adopted and signed up by development partners.	MOF- Debt & Aid	déc-06	Most donors	D2
	Complete and maintain an updated comprehensive donor database.	Comprehensive report produced from the donor database.	MOF-Debt & Aid	déc-06	EC, DFID, CIDA	D2

	Inform potential donors about MGDS and set up an alignment of donor support.	Guidelines on what constitutes alignment produced and disseminated. Donor support aligned to MGDS.	MEPD-Dev. Division/ MOF-Debt & Aid	févr-06		
	Clarify Malawi guidelines with each donor, including criteria for best practices as in the Paris Declaration.	Regular system monitoring of DAS/PD targets involving development partners is established.	MOF- Debt & Aid	déc-06	Most donors	
B1.2: Effective mobilisation of internal financing resources:	Develop guidelines for new loans	Guidelines produced and followed	MOF-Debt&Aid	Jun.07	IMF	9
	Formulate and get approved Debt & Aid Policy	Policy document approved	MOF-Debt&Aid	Dec 07.	EC	
	Set up an operational Domestic Debt Unit in the MOF.	DDU is staffed and equipped .	MOF-Debt & Aid	Aug.07		9
	Produce Action Plan and set targets for reduction and management of domestic debt	Action plan produced, targets set for reducing and managing domestic debt.	MOF-Debt & Aid	nov-07	IMF	9
	Encourage private sector investment by reducing compliance costs of the tax system.	Improved dissemination and enforcement of tax laws.	MOF-Revenue Division	juin-07	MCC	15
		On-line filing of tax returns introduced and being operational	MRA	juin-09		15
	Improve method of domestic revenue forecasting, modelling and capacity for such modelling.	Suite of costings models developed, for Governments main revenue flows.	MOF-Revenue Div.	déc-07	EC, IMF	16
	Conduct review of non tax revenue and incentives to improve efficiency and effectiveness	Review Report	MOF-Revenue Div.	févr-06	EC	13,14
	Improve administration of non tax revenues and incentives within the budgeting system.	Administration of non-tax revenues and incentives improved.	Revenue Division	juin-07	EC	14
	Improve effectiveness of the tax collection system.	Country's major border points computerised and linked.	MRA	juin-07	MCC	13
		Income tax and VAT departments of MRA computerised.	MRA	juin-07		15
		Deviation between tax base and tax net reduced.	MOF-Revenue Div/ MRA	juin-08		
		Pre-shipment inspection replaced with destination inspection of imports.	MOF-Revenue Div/ MRA	juin-07		15

	Review revenue generation and retention at decentralised centres.	Improved and clearer policies on local revenue generation and use.	MOF-Revenue Div	juin-08	MCC	8,16
		Appropriations basis for departmental revenues adopted.	MOF-Revenue Div	juin-07		
<b>B2: Strategic approach toward resource allocations:</b>						
B2.1: Improved allocation of resources to Development account to meet MGDS requirements:	Ensure the Development Budget captures all donor funding for projects administered in support of Government.	Development budget captures all donor funding for projects.	MEPD-Dev. Div./ Budget Division Debt & Aid	avr-07		6
	Ensure that legally binding MOU commitments on Part II funding are met	MOU commitments on Part II funding met.	MOF-Debt & Aid	juin-07		11
	Prioritise GOM funding to meeting Part II counterpart provision requirements where they are in support of MGDS.	Part I and Part II resource allocations synchronised in support of MGDS.	MOF-Budget Div./MEPD-Dev. Div.	avr-07		11
	Update the PSIP database to include briefs for all projects.	Updated PSIP database.	MEPD- Dev. Division/Debt & Aid	Apr- 07.	EC	11
	Ensure General Budget Support aligned to MGDS priorities through budget allocation mechanisms and Sector Budget Support aligned to MGDS through agreed, MGDS compliant sector strategies and through budget allocation to the relevant sectors.	General Budget Support and Sector Budget Support better aligned to MGDS in budget allocations.	MEPD/Budget Division	FY 07/08	EC,MCC, WB	6
	Improve coordination between Revenue Division and Budget Division	Coordination system established between Revenue and Budget Divisions improved	Revenue/Budget Divisions	Feb-07.		3
	Prioritise allocations to Development account funded according to MGDS requirements.	Development account allocations according to MGDS requirements.	MEPD/ Budget Division	Feb-07.		11
Allocate GOM resources to provision of key staff and input items identified with the needs of MGDS.	Recurrent account allocations include resourcing of MGDS requirements.	MOF-Budget Div./MEPD-	FY 07/08			
Complete and update Public Expenditure Review	PER document	MOF-Econ. Affairs	7-avr	WB, EC	1,2,7	

B2.2: Recurrent resources allocation optimized to meet Needs Assessment:	Improve allocation of GOM resources toward maintenance and servicing of essential working environment.	Funding of working environment for GOM activities improved and maintained	MOF- Budget Div./MEPD-Econ. Planning	FY 07/08	EC, MCC, WB	19
	Implement a strategic approach to verify and securitise arrears	Reduction of arrears	AGD MOF-Econ. Affairs /Bud Div	juin-07		4
	Review non-tax revenue policy to enable local revenue generation and allocation for use by local assemblies.	Improved local revenue generation and allocation at appropriate cost centres.	MOF-Rev. Div/MDAs	FY 07/08		8
B.2.3:: Budgeting made according to an output and activity format:	Improved formats for budgeting based on outputs and activities targeting and the inputs required for achievement of each.	Budget document.	MOF-Budget Division	FY 07/08	EC, MCC ,WB	5,11
	Build capacity in the Budget Division as per TNA Report	Training programmes implemented as per TNA	MOF-Budget Division	Jun.07	EC, MCC ,WB	11
	Improved budget coding system used to enable identification of financial allocations on an output and activity basis.	Budget document.	MOF-Budget Division	FY 07/08	EC, MCC ,WB	5
<b>C: Budgeting for the Malawi Growth and Development Strategy:</b>						
<b>C.1: Efficiency of budget preparation.</b>						
C.1.1: Adoption of the improved budget calendar:	Sensitise all stakeholders about the requirement for efficient Budget Calendar implementation.	Dissemination of documentation and requirements of the Budget Calendar.	MOF-Budget Division	janv-07	EC	
	Disseminate Economic and Fiscal Policy Statement to Members of Parliament and other key stakeholders.	Economic and Fiscal Policy Statement disseminated.	MOF-Economic Affairs.	déc-06	EC	10, 23
			MOF-Budget		EC, MCC	5

C.1.2: Adoption of appropriate budget coding on an output and activity format.	Update budget classification and coding to align with GFS as well as output, activity and location format.	Budget classification codes according to GFS standards, output, activity, location format.	MOF-Budget Division/ Economic Affairs	mars-07		5
C.1.3: Rationalise budget approval process linking national and local governments:	Develop budgeting manual for central government.	Central Government Budgeting Manual developed	MOF-Budget Division / Rev.	juin-07	EC	
	Link local and national budgeting procedures.	Guidelines for local budgeting procedures included in Central Government Budgeting manual.	MOF-Budget Division / MLG&RD	juin-07		8
	Train Assembly personnel on use of the Local Government Budgeting manual	Training programme for Assembly personnel developed and implemented.	MOF-Budget Division / MLG&RD	déc-07		
<b>C.2: Accounting and Financial Procedures:</b>						
C.2.1: Projects clearly identified:	Develop standard coding system for the identification of projects and cost centres.	Standard coding system developed.	MOF-Budget Division	FY 07/08	EC, MCC	5
	Improved coordination to ensure standard project naming and identification.	Standard project naming and coding comparing PSIP, Debt & Aid and Budget Division databases.	MEPD-Dev. Div./MOF-Debt & Aid, Budget Division.	FY 07/08		
C.2.2: Adoption of budget code in line with IFMIS Chart of Accounts	Codes linked to enable verification of correct application of funds according to MGDS input and activity requirements.	Budget codes aligned with IFMIS Chart of Accounts.	MOF-Budget Division / Rev. Div./AGD	FY07/08	EC, MCC, IMF	1
C.2.3: Linking of Development and	Develop common coding systems for Development and Recurrent Budgets to enable full output costing	Development and Recurrent budget codes linked.	AGD/MOF/Budget Division	FY 07/08		5
C.2.4: Improved cash flow management:	Implement an automated system of account reconciliations.	Daily account reconciliations achieved.	AGD/RBM	nov-06	WB, IMF	1,3,22
	Incorporate debt repayment through IFMIS	Debt repayment using IFMIS	AGD/MOF-Debt & Aid Div	mars-07		17
	Develop mechanism for more effective monitoring of Ways and Means	Monitoring mechanism in place	MOF/RBM	juin-07		3,17

	Complete IFMIS coverage to ensure cash allocations strictly according to budget provisions.	Adherence to budget provisions achieved.	AGD/ All cost centres.	Nov.06		1
C.2.5: Implement consistent financial procedures at both local and national levels:	Develop through IFMIS a system for regular payments on utilities	Release of funds not of utility payments	AGD	mars-07		20
	Develop and implement improved cash management systems	Revised system in place	AGD/Budget Div./RBM	juin-06	IMF	17
	Undertake manpower capacity assessment for Financial Officers at Local Government level.	Manpower assessment report.	MLG&RD / AGD	mars-07		
	Customise IFMIS to suit Local Government situation	Local Government IFMIS in place.	MLG&RD / AGD	mars-07	MCC	8
	Train 4 pilot District Assembly personnel on use of customised IFMIS.	Training reports on 4 pilot District Assemblies.	MLG&RD / AGD	avr-07		
	Installation of IFMIS in 4 pilot District Assemblies	IFMIS operational in 4 pilot District Assemblies.	MLG&RD / AGD	juin-07		
	Installation of IFMIS in all District Assemblies.	IFMIS operational in all District Assemblies.	MLG&RD / AGD	déc-08		
	Produce IFMIS Accounting Procedures Manual	Document produced	AGD	avr-06	EC	
C.2.6: Implement Local Authorities Model Financial Regulations (2002).	Revise and issue financial regulations.	Revised Financial Regulations issued.	AGD	Dec 06.		17
C.2.7 Financial Management Systems for Parastatals in Place	Sensitise Assembly personnel on the revised financial regulations.	Training report.	AGD/MLG & RD	juin-07		23
	Systematic review of parastatals financial management systems completed	Reports from PERMU	PERMU	juin-07		9
C.2.8: Improvements in procurement procedures achieved	Implement new procurement module	Procurement module implemented	ODPP / AGD	juin-07		19
	Enhance capacity building in ODPP	Key TNA recommendations adopted.	ODPP/Ministries	juin-07	MCC, UNDP	19
	Establish special procurement unit/posts of Internal Procurement officers.	Procurement units/positions established	ODPP/DHRMD.	juin-07		19
<b>D: Monitoring systems for management decision making:</b>						

<b>D.1: Strengthen internal controls and account reconciliations</b>						
D.1.1: Financial monitoring and accountability	Financial monitoring of parastatals	Reports on parastatals checked	PERMU	juin-07	IMF, MCC, WB, EC	17
	Undertake TNA for NAO	TNA undertaken	National Audit Office	févr-07		
	Institutional restructuring and capacity building of the National Audit Office and the Central Internal Audit Office.	Recruitment of qualified personnel for National Audit Office and Central Internal Audit Office	NAO/CIAO	juin-07	NOR	21
	Internal auditing coordinated	Central Audit committee functioning.	NAO/CIAO	juin-07		21
	Develop audit module that incorporates tools and techniques for auditing automated systems	Computer Assisted Audit Tools and Techniques (CAATs) developed	NAO/CIAO	Jun.07		26
	Use computer assisted audit tools and techniques to audit automated systems	Audit Reports on automated systems	NAO/CIAO	FY07/08		26
	Build capacity to enable Audit staff audit automated systems	Training Reports	NAO/CIAO	Jun.07		26
	Review Public Audit Act	Revised Public Audit Act	NAO/CIAO/Law	juin-08		28
	Sanitise HRMIS to reflect the true establishment position	HRMIS records reflect true position	DHRMD	mars-06		18
	System develop for HRMIS to incorporate regular entry, exit and changes of personnel in civil services.	System developed and in place	DHRMD	juin-06		18
	Effect regular reconciling of wage bill with personnel database	Integrated HRMIS and IFMIS systems	AGD/DHRMD	juin-08		18
	Capacity building in financial records management throughout GOM	Financial records from IFMIS in place.	AGD	juin-07 On going process	WB, IMF	17
	Integration of Development Account Part I into IFMIS	Financial records from IFMIS in place.	AGD/Budget Div/Econ Aff.	juin-07		2
	Establish network links and security systems among GOM ministries	Network links in all Ministries	DISTMS/AGD	juin-07		23
		Network links with District Assemblies	DISMS/AGD/M LG & RD	juin-07		23

	Use IFMIS to produce financial records.	Financial records based on IFMIS analyses.	EA /AGD Budget Division	juin-07	MCC	22
	Design and Implement a comprehensive financial accountability compliance and enforcement strategy	Financial accountability targets set and functional.	OPC/ AGD MOF-	déc-07		20,22
		Performance evaluation mechanisms in place	OPC	déc-07		2
		Procedural guidance for reporting non-compliance	OPC/MOF	déc-07		2
D.1.2: Improved linkage between financial cost records and physical monitoring.	Work planning of inputs, activities and outputs linked to budgeting and costing codes on same basis.	Inputs, activities and outputs linked to budgeting and costing codes on same basis	MEPD-Dev. Div./ MOF- Budget Division	mars-07	EC	6
	Regular comparisons and analyses made of budget allocations against actual financial cash expenditures for planned and actual inputs, activities and outputs.	Comparisons and analyses made of budget allocations against actual financial cash expenditures for planned and actual inputs, activities and outputs.	MEPD - Dev. Div./ MOF- Budget Division/AGD	juin-07	EC, MCC, WB	2
	IFMIS facility to enable timely on-going output cost comparisons.	IFMIS facility in place	MOF-Budget Division/AGD	janv-07	MCC	2
<b>D.2: Baseline parameters and data sourcing:</b>						
D.2.1. Data and information sources defined.	Primary data sourcing plan.	Primary data sourcing plan defined	MEPD/NSO/Bu dget Division	déc-06		
	Secondary data sourcing plan.	Secondary data sourcing plan defined.	MEPD/NSO/Bu dget Division	déc-06		
D.2.2 Key indicators identification	Indicators of planned inputs, activities and outputs.	Planned indicators identified.	MEPD/NSO/Bu dget Division	déc-06	EC, UNDP	
	Indicators of targeted outcomes and impacts.	Targeted indicators identified	MEPD/NSO/Bu dget Division	déc-06	EC, UNDP	
D.2.3 Situation Baseline for progress comparisons.	Baseline of economic, social, infrastructural, resource, environmental and services parameters.	Situation baseline established	MEPD/NSO/Bu dget Division	juin-07	UNDP, EC, DFID	
	Baseline of targeted parameters.	Baseline of targeted parameters established		juin-07		

<b>E. Reliable Reporting System:</b>						
<b>E.1. Reporting for accountability and control:</b>						
E.1.1: Improved financial reporting.	Summary financial reports to show costs of implemented outputs and activities. To be done after output based budget is incorporated in the Chart of Accounts.	Output and activity costings available for management decision making at cost centres.	MOF-AGD	Jun.08	MCC	2,23,24,25
	Complete IFMIS coverage to ensure timely production of expenditure reports.	Timely expenditure reports available	AGD / MOF-Budget Division	Dec .06		1,25
	Summary financial reports to show Part I and Part II progress compared to budget.	Expenditure summaries of Part I and Part II	MOF-AGD/ All Cost Centres.	Jun.08		2,24
E.1.2. Improved activity reporting.	Establish a system of reporting that enables ongoing information for management of progress in activities compared to plans.	Clear and timely reports available on a quarterly basis.	MEPD-M&E/MDAs	mars-07		2
	Establish a system for progress reviews that provide comparisons between targeted and actual inputs and outputs.	Clear and timely reports available on a twice yearly basis.	MEPD-M&E/MDAs	juin-07		2
E.1.3: Improved evaluation reviews.	Establish a system for on-going evaluations of outcomes and impacts.	Mid-year and annual development reports produced.	MEPD-M&E	juin-07	UNDP, EC, DFID	
		Regular evaluations comparing time trends in resource and development profiles.	MEPD-M&E	déc-07		
E.1.4: Improved Audit reports.	Establish a system for timely Internal and External Audit reporting.	Audit reports produced within six months of financial period.	National Audit Office/ Central Internal Audit Office.	déc-07	NOR, EC, UNDP	21, 26
<b>F: Directing improved proficiency in Public Finance and Economic Management.</b>						
<b>F.1: Steering the PFEM process.</b>						
	Establish PFEM Steering Committee.	PFEM steering committee established and routine of meetings determined.	OPC/MOF/MEPD	déc-06		
		PFEM steering committee establishes routine reporting to Minister of Finance.	MOF-Coordinator	déc-06		
	Appoint a PFEM Coordinator.	PFEM Coordinator in post.	MOF-Coordinator	déc-06		

F.1.1: Effective instruments developed for steering the PFEM process.	Strengthen the PFEM Technical Working Committee.	Terms of Reference for PFEM Technical Working committee defined and confirmed.	PFEMAP Tech Comm	déc-06		
	Adopt this Action Plan as the 'Modus Operandi' of the new PFEM Technical Working Committee.	PEFM action plan finalised and adopted.	PFEMAP Tech Comm	déc-06		
	PFEM Technical Working Committee reports to PFEM Steering Committee.	Reports to the PFEM steering committee.	PFEMAP Tech Comm	déc-06		
<b>F.2: Managing the Malawi Growth and Development Strategy.</b>						
F.2.1: Effective instruments for national participation.	Establish Technical Committees for the six Stakeholder Thematic Groups, to be in line with MGDS implementation	Thematic groups committees established and routine of meetings started.	MEPD/MOF/OP C	déc-06		
	Develop system of reporting for the six Stakeholder Thematic Groups.	Thematic groups steering committees report to Minister of Finance.	MEPD/MOF/OP C	déc-06		
F.2.2: Effective instruments for strategy coordination.	Establish a GOM Technical Committee for MGDS Coordination.	GOM Technical Committee established	MEPD	déc-06		
	GOM Technical Committee for MGDS Coordination reports	Reports	MEPD	déc-06		
	Interface monitoring MGDS with M&E System	M&E master plan	MEPD-M&E	déc-06		

**EC MULTI ANNUAL ADAPTATION STRATEGY FOR MALAWI, FOR THE PERIOD 2006 – 2013,  
UNDER THE ACCOMPANYING MEASURES FOR SUGAR PROTOCOL COUNTRIES**

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## EXECUTIVE SUMMARY

The project initiatives are derived from the Government of Malawi's National Adaptation Strategy (NAS) to the EU Sugar Reform and subsequently, to the assistance from the EU's accompanying measures to the Sugar Protocol countries in this regard.. It is in light of this that the EC made the decision to provide an assistant package towards the adjustment process, notably with the decrease in internal EU prices and the integration into the global prices for Sugar Protocol countries, through the accompanying measures. The proposed EC support strategy therefore aims at supporting the overarching objectives identified in the Government of Malawi's (GoM's) NAS which are to achieve (i) an increase in sugar cane production and factory capacity in Malawi's sugar sector and (ii) an increase in sugar cane production in Malawi's sugar sector through efficiency in both field and factory operations.

The importance of the sugar sector to Malawi's economy is significant, as the sector contributes approximately 5-6% to GDP. Sugar is also the second most important crop in terms of foreign exchange earnings, accounting for close to 20% of total national exports. Illovo Sugar (Malawi) Ltd is the second largest employer in the country, after the GoM<sup>1</sup>. The Illovo owns production estates and factory mills/refineries at Nchalo and at Dwangwa, which account for all of the country's milling and refinery capacity, in which Illovo has invested heavily. Smallholder cane growers account for approximately 9% of national agricultural activity, and the sugar industry in Malawi is identified in both the Malawi Economic Growth Strategy and the subsequent Malawi Growth and Development Strategy as one of the drivers of growth and sustainable development in the national economy. The creation of increased employment opportunities in the agricultural sector is another overall objective in the MGDS. The sugar industry, which will be the main implementer of the NAS, therefore attaches great importance to the development of outgrowers, in addition to increased sugar cane production and factory capacities, given its contribution to poverty alleviation and employment generation in Malawi.

Although Malawi's sugar sector has a crucial social and economic impact on the economy, it also comes with its challenges and weaknesses, which must be overcome if the sustainability of the sector and increased sugar production are to be ensured. At national level, these challenges mainly comprise supply-side constraints and the lack of an enabling environment (not only for the sugar sector but for most trade, industry and development sectors). At industry level, the sugar sector is faced with poor infrastructure, which inflates the costs of exporting and distributing sugar. The skill levels of outgrowers and their management further limit the sustainability of the existing outgrower schemes.

In spite of the above mentioned problems, Malawi is highlighted as being "a world-class producer," with low production costs despite the aforementioned transportation costs. The existing strategies outlined in the Sugar Industry Action Plan (IAP), which Illovo and other players in the sector plan on taking maximum advantage of, are aimed at "offsetting the effects

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<sup>1</sup> However, the 2006 Annual Economic Report states that by the close of 2005, sustained improvements in export prices for tea meant that tea had regained its position as the second major export for Malawi (proceeds from tea in 2005 were MWK 5.94 billion compared to MWK 5.41 billion (close to 5% GDP) for the sugar sector, out of a projected total national revenue of MWK 122.1 billion). MWK 515 million was the total revenue earned from outgrower cane areas alone.

on earnings as a result of reduced EU prices” – this being the main area of concern with regard to the impact of the reform of the EU sugar regime on Malawi.

The NAS has identified support for sugar industry outgrowers as one of the most crucial areas (multiannual plan). This includes the development and rehabilitation of feeder roads, irrigation projects, development of the management capacity of service providers and loan schemes or on-lending programmes. The NAS also highlights the lack of an adequate regulatory framework to ensure the implementation and sustainability of the strategic measures identified in the NAS.

The NAS’ specific objectives are twofold:

Objective 1: The Malawi sugar sector should aim to increase cane production and factory capacity.

Objective 2: The Malawi sugar sector should also aim to increase production through efficiency in both field and factory operations (competitiveness).

The specific EC sugar-related assistance for Malawi, with €0.667m under the accompanying measures for 2006, therefore targets three areas of intervention: (1) studies and reviews of the regulatory framework to ensure an enabling environment for the implementation of the proposed measures outlined in the NAS (€0.267m), (2) a Farmer Training and Capacity Building programme (€0.200m), and (3) an Institutional Capacity Building programme to develop the management capacity of outgrower service providers (€0.200m). The most appropriate delivery mechanism for support in these three areas has been identified as centralised operations, with detailed arrangements to be decided at the formulation stage.

Since it is indispensable that there is a single EU strategy for each ACP country covering all Community instruments, the EC Multiannual Adaptation Strategy will be incorporated into the Malawi Country Strategy Paper (CSP) and subject to the system foreseen for the CSP monitoring and review process under the Cotonou Agreement.

## 1. SITUATION OF THE COUNTRY AND THE SUGAR SECTOR

Malawi is a small, landlocked, developing country with a population of approximately 12 million, of which 52.4 percent live below the poverty line<sup>2</sup>. It has a GDP per capita of US\$ 162 and is bordered by Tanzania, Mozambique and Zambia. Malawi covers an area of 118 500 km<sup>2</sup>, of which approximately 48% of the land area is potential agricultural land. The economy is thus agriculture-based with most manufacturing derived from agricultural produce.

Tobacco continues to be Malawi's largest foreign exchange earner, accounting for 53% of total exports in 2005<sup>3</sup>. Since 2002, sugar has overtaken tea to become Malawi's second largest merchandise export in value terms (foreign exchange earnings), accounting for close to 10% of the country's total export earnings and contributing 5-6% to GDP<sup>4</sup>. Furthermore, the sector has a strong multiplier effect throughout the economy. This makes a positive contribution to rural development in the cane growing areas, which provide growth poles of economic activity outside the main urban areas. The GoM is therefore committed to ensuring a sustainable future for the sugar industry.

Since 1998, when the Illovo Sugar Group bought out the Lonrho stake in the Sugar Company of Malawi (SUCOMA), the sugar industry in Malawi has been dominated by the majority stakeholder, Illovo Sugar (Malawi) Ltd, a subsidiary of the South-African-incorporated Illovo Sugar Group, which controls 76% of the market value of the company.<sup>5</sup> Illovo Sugar (Malawi) Ltd (or rather the sugar sector) is also the second largest employer in Malawi after the GoM itself, directly employing approximately 14 500 people and indirectly a further 3 000 in supporting industries, such as independent cane cutters, haulers, internal and external sugar distributors and service suppliers. Taking into account the national average of seven dependants per employee, the industry can be said to support more than 120 000 people directly and many thousands more via the indirect support mentioned above.

Illovo owns production estates and factory mills/refineries at Nchalo and at Dwangwa, which account for all of the country's milling and refinery capacity, in which Illovo has invested heavily. Nchalo Estate is situated in the Lower Shire Valley in the south-east of Malawi and has been functioning (i.e. crushing cane) since 1966. Dwangwa Estate is situated on the shore of Lake Malawi at the delta of the Dwangwa River (in mid-central Malawi) and has been crushing sugar cane since 1979. In recent years, the area under cane has varied between 18 500 and 20 500 ha<sup>6</sup>. The Nchalo-Kasinthula outgrower scheme has expanded to an average area of 752 ha out of 12 741 ha (or 6%) over the last three years while the Dwangwa outgrower scheme has expanded by an average area of 1 200 ha out of 7 355 (18%) per year over the last three years. The

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<sup>2</sup> Malawi Growth and Development Strategy, MGDS, 2005.

<sup>3</sup> Government of Malawi 2006 Annual Economic Report, Budget Document No 2, Ministry of Economic Planning and Development.

<sup>4</sup> However, the 2006 Annual Economic Report states that by the close of 2005, sustained improvements in export prices for tea meant that tea had regained its position as the second major export for Malawi (proceeds from tea in 2005 were MWK 5.94 billion compared to MWK 5.41 billion (close to 5% GDP) for the sugar sector, out of a projected total national revenue of MWK 122.1 billion). MWK 515 million was the total revenue earned from outgrower cane areas alone.

<sup>5</sup> Other shareholders of Illovo Sugar (Malawi) Ltd include public and institutional bodies (14%, of which ADMARC owns 1.7% and Old Mutual 10%). As of July 2006, however, British Foods is the majority shareholder of the Illovo Sugar Group — specific details of the takeover are not yet known at this time.

<sup>6</sup> If 0.01km<sup>2</sup> = 1 hectare, this represents approximately 0.36% of Malawi's agricultural land (5 688 000 ha in total).

combined total number of outgrower households involved directly in the growing of cane is approximately 600 (of which 20% are headed by women).

Although Malawi's sugar sector has a significant social and economic impact on the economy, it also comes with its challenges and weaknesses, which must be overcome if the sustainability of the sector and increased sugar production are to be ensured. At national level, sugarcane represents a large proportion of the commercial agricultural sector but has a very limited presence on the domestic market. Furthermore, Malawi's dilapidated railway system inhibits domestic and export market performance, placing more stress on the road network. The cost of borrowing (or access to micro-credit) at local level is also prohibitive, thus affecting profitability and severely restricting investment and re-investment. At industry level, the sugar sector is faced with poor infrastructure, which inflates the costs of exporting and distributing sugar. The skill levels of outgrowers and their management further limit the sustainability of the existing outgrower schemes.

Despite both factories being classed as 'world leaders' in terms of low-cost production, with excellent cane growing conditions and abundant supplies of water and agricultural land, they are also characterised by weaknesses and threats to their long-term production. These challenges include: unsustainable debt burdens at Kasinthula (details in section 2.1 below); the lack of human resources to improve the efficiency and management of the smallholder production schemes; lack of access to finance for smallholder farmers to undertake investments and to fund short-term seasonal operations; the fact that smallholders currently pay surtax (17.5%) on inputs and services without being able to offset this against cane sales; the theft of irrigation pipes and the lack of the required capital investment and infrastructure for increased production and distribution (internal and external).

Several studies, including the analysis carried out prior to the finalisation of Malawi's National Adaptation Strategy (NAS) in response to the EU sugar reform, show that Malawi is one of the Sugar Protocol (SP) countries that should remain competitive after the European Union (EU) sugar reform if national sugar production can be scaled up. This is despite the high local transport costs, which may amount to up to 50% of production costs<sup>7</sup>. (In this respect, there is room for building synergies with the EC-funded transport programme, which has for some time been a focal area of EC cooperation with Malawi).

There is therefore much emphasis placed on the fact that Malawi needs to strengthen sugar production for both domestic and export markets, also bearing in mind, that under the EBA Initiative, LDCs including Malawi will have unlimited access to the EU market at zero import tariff as from 2009. Furthermore, Malawi is highlighted as being "a world-class producer," with low costs, in spite of the above mentioned transportation costs.

As noted above, the ratio of outgrower to estate cane production is heavily biased towards estate-based capital-intensive schemes, thus reinforcing the case for the much-needed interventions in outgrower schemes and at the same time justifying the need to direct Malawi's 2006 allocation under the accompanying measures to the areas identified here for support. Furthermore, of Malawi's current sugar production (270 000 tonnes per year), 130 000 tonnes were exported in 2005/06 (100 000 tonnes raw and 30 000 refined). Of this amount, 58 000 tonnes went to preferential markets (48 000 tonnes to the EU and 10 000 tonnes to the US). Although the SADC market has opened up as a new and modest market for refined sugar, the major growth in

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<sup>7</sup> The Case for a National Export Strategy: Key Issues and Possible Response, MoTPSD, September 2005.

Malawi's sugar exports over recent years has been to other countries, principally to Kenya. A recent UNCTAD study (2005) also estimates that more than 20% of sugar produced in Malawi is exiting the country to Mozambique, Zambia and Tanzania through informal cross-border trade.

## **2. MALAWI'S POLICY AGENDA**

### **2.1. NATIONAL ADAPTATION STRATEGY IN RESPONSE TO THE SUGAR REFORM**

The NAS is the result of a process put into motion by the GoM together with key players from the sugar industry and the national working task force on sugar in Malawi, with the global objective of "assessing the impact of the erosion of the EU preferences and the new market conditions on the country's sugar industry, identifying mechanisms and options for restructuring and adjusting to the prevailing conditions and developing strategies in areas of profit sustainability, competitiveness, diversification, value addition and productivity improvement". Considering the central role of Illovo Sugar in the sugar sector and the priority to be given to developing the sugar sector in the light of its strengths and opportunities, the NAS focuses on the sector itself rather than on diversification activities, and largely builds on the company's strategy. The specific objectives of the NAS are twofold:

**Objective 1:** The Malawi sugar sector should aim to increase cane production and factory capacity;

**Objective 2:** The Malawi sugar sector should also aim to increase production by improving efficiency in both field and factory operations (competitiveness).

Illovo Sugar (Malawi) Ltd. has projected medium- and long-term strategies for 2006-2010 and 2010-2015, respectively. These strategies envisage an increase in sugar production from a total of 270 000 tonnes in 2005 to over 295 000 tonnes in 2010 (+9%), and then to 350 000 tonnes in 2015 (+25%).

The Short- to Medium-Term Strategy in the NAS (2006 to 2009/10) envisages (1) an increase in sugar production by 28 000 tonnes (through maximum use of installed capacity), (2) an increase in the production of sugar cane (through existing and new outgrower schemes), (3) an increase in the efficiency of operations and improved competitiveness and (4) diversification through identified strategic actions.

The Long-Term Strategy in the NAS (2009/10 and beyond) follows on from the short- to medium-term strategy but is not as detailed. It envisages (1) increased production of sugar through a quantum increase in production capacity, (2) increased production of sugarcane through new outgrower schemes, (3) improved competitiveness and (4) diversification by adding value to industry by-products.

The EC response strategy for 2006 is built around the outgrower schemes (expansion and capacity building), which are identified as (i) one of the main areas recognised in the NAS as opportunities for the sugar sector over the next ten years<sup>8</sup> and (ii) essential for alleviating poverty in the short, medium and long term. Similarly, the EC response strategy has an initial focus on the regulatory framework and constraints in order to ensure further progress with the other two

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<sup>8</sup> The main areas recognised are: (i) increased market access to the EU market under the EBA initiative, and to regional and local markets, (ii) increased involvement of outgrowers (direct impact on poverty reduction and rural development) and (iii) diversification into new products (ethanol and electricity production for sale to the national grid – value addition to by-products).

areas (market access and production of ethanol and electricity). (Details are given under section 4 of this document). Another reason why expansion is the main area of focus is that the sector's own Industry Action Plan aims to increase production capacity and to address some of the field and factory bottlenecks, particularly through improvements to infrastructure, soil management and quality of cane and through investment in health and social services. Although the industry (both factories) has indicated that preference will go to outgrowers for the capacity expansion planned to cater for the necessary increase in production, the outgrowers will need to at least maintain their production levels to ensure that they are not left behind when the industry begins implementing its plan. Assistance for the outgrower scheme should therefore be a priority.

The poverty focus and importance of the sugar sector is also identified in the Malawi Growth and Development Strategy (MGDS), which aims to achieve poverty reduction and sustainable economic growth. The creation of increased employment opportunities in the agricultural sector is another overall objective of the MGDS. The sugar industry, which will be the main implementers of the NAS, therefore attaches great importance to outgrower development, given its contribution to poverty alleviation and employment generation in Malawi, and this is reflected in the choice of intervention set out in the MGDS<sup>9</sup>. Regarding food security in rural areas, it is noted that returns from sugar cane are substantially higher than those from other cash crops, but growers (particularly in Kasinthula) are lumbered with expensive development loans<sup>10</sup> and other costs, which reduce earnings potential considerably. On a more positive note, both outgrower schemes facilitate the production of additional food crops by either providing inputs and/or providing irrigated fields for farmers to grow such crops, therefore ensuring additional subsistence on top of the income generated from cane. A considerable proportion of the income of sugar cane farmers and employees is also spent in the local area on consumption goods, household assets and social welfare (e.g. schools and clinics). The two outgrower schemes can therefore be said to have had a catalytic effect on rural and enterprise development. The fact that Kasinthula's outgrower scheme is Fair Trade certified is already a good indicator of the social role of the sector. The Dwanga scheme has also applied for Fair Trade certification.

The implementation of the NAS will require a combination of domestic and external finance on the one hand and private, bankable investments and public funding on the other. Of the total cost of €170.2m, €30.3m would be required from donor funding and the rest would come essentially from investment by Illovo. GoM interventions have not been costed yet, but are intended mostly to provide an enabling environment for the sector to flourish, which largely means the procurement and installation of capital-intensive infrastructure. Although the MGDS recognises the importance of intensifying outgrower schemes in the sugar sector, this is also still being costed and so it is difficult to place an exact figure on the amount needed. Moreover, the 2006/07 national budget addresses the sugar sector within the broader context of the agriculture and infrastructure sectors, so it is again difficult to compare the figures outlined in the NAS with those in the budget.

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<sup>9</sup> Under Theme One of the MGDS (Sustainable Economic Growth), the sugar sector is identified as one of the core sectors of the economy. The expected outcome in the MGDS is for, sugar production to increase in the medium term by 25% through the expansion of outgrower schemes, while the industry continues to move up the value chain. Furthermore, GoM implementation of the strategies outlined in MGDS Theme 4 (Infrastructure) will provide the main boost to the sugar sector.

<sup>10</sup> Kasinthula is crippled by interest payments on the loans taken out to develop the irrigation infrastructure – the interest is denominated in foreign currency whereas the cane revenue is in local currency, which has devalued substantially making repayments difficult.

The NAS also clearly recognises that the prospects of the sugar sector largely depend on the improvement of the general environment for economic competitiveness, with specific needs in the infrastructure sector, both for transport and for irrigation. It identifies new opportunities for the sector to diversify, in particular into electricity generation and power ethanol (which seems particularly relevant given the increase in fuel costs, and which at the same time would help alleviate the burden of fuel imports on the GoM's national budget).

## **2.2. ANALYSIS OF THE NATIONAL STRATEGY**

As indicated above, Malawi is one of the most competitive Sugar Protocol (SP) countries, and analyses show that it can remain competitive in sugar production following the EU reforms despite the high level of transportation costs. However, it will need to improve efficiency (among other things through economies of scale) to consolidate the sector's competitiveness. The NAS states that economic and financial sustainability will be maintained if the Malawi sugar sector follows the short-, medium- and long-term orientations outlined above.

However, the NAS does not address the relatively high border protection afforded to the sugar sector, and hence the lack of competition on the national sugar market, which could have a negative economic impact not only for the sugar sector but also for the national economy in the longer term. One other area which seems to have been insufficiently addressed in the NAS is the environmental impacts of the sector, both positive and negative, and including the renewable energy aspect.

In addition, the successful implementation of certain core elements of the NAS will depend on the existence of a conducive policy framework, in particular for access by small farmers to land and water, as well as an energy policy that stimulates the development of production and use of renewable energies. The NAS mentions these as key (pre)requisites, but the GoM will have to commit to undertaking the necessary policy review, in consultation with the relevant stakeholders.

The institutional set-up of the sugar industry in Malawi is sustainable — despite the lack of competition — as it is centred on private-sector-led growth, one of the nationally recognised engines for economic growth and development. Illovo, the only company in Malawi's sugar sector, has multi-annual and strategic plans that already have in-built and feasible social corporate responsibilities and environmental impact assessments. The lines of action in the NAS reflect the areas already incorporated in the sector's five-year Industry Action Plan (IAP). Accordingly, the existing institutional system has demonstrated its capacity to implement the NAS.

The political decision on Malawi's adaptation strategy has been driven by national policy as a whole. The Minister of Industry, Trade and Private Sector Development has been mandated to champion the entire process and other Ministries, such as Agriculture and Food Security, Irrigation and Water Development and Transport and Public Works, have also been associated with the process. The GoM has already established a sectoral task force, in which the private sector and sugar industry are heavily involved, to ensure full implementation and ownership of the adaptation strategy by the industry, the Ministry of Agriculture and the Ministry of Industry, Trade and Private Sector Development. The Trade Policy National Working Body serves on this sectoral task force as well, as the body that aligns Malawi's bilateral, regional and multilateral trade agreements with implementable activities at national level. Issues of regional integration,

the WTO Doha Development Agenda and the Economic Partnership Agreements (EPAs) with the EU have therefore also informed the development of the NAS.

### **3. RELEVANT LESSONS LEARNT FROM EC COOPERATION**

The EC, in its cooperation with Malawi, has substantial experience in the area of rural development and agricultural production as a focal sector of the current EC-GoM Country Strategy Programme. It can also draw lessons from the implementation of STABEX projects.

Other financial institutions and donors have valuable experience in specific areas of relevance to the NAS. Notably, existing programmes and on-lending schemes for smallholder farmers in Malawi's sugar sector have been very successful in the recent past and have had the full backing of the country's sugar industry. The lessons from the difficulties they encountered will be of direct use for the implementation of the NAS. (For example, the experience of the indebted farmers at Kasinthula does not reflect a 100% success story).

The European Investment Bank also has substantial knowledge of the sugar sector, which it has been supporting through various loans for some 30 years<sup>11</sup>.

### **4. EC RESPONSE STRATEGY**

#### **• 4.1. OBJECTIVES OF EC SUPPORT**

EC support aims at creating medium to longer-term improvements in the sector. The main objective of the EC support strategy is to contribute to the implementation of the GoM's NAS.

The overall objective of the EC support strategy for Malawi in the context of the sugar reform (the sugar reform is primarily an unavoidable internal market reform that brings the sugar sector in line with the reform that has been taking place with other agricultural products (i.e. towards sustainable production for the market). It will reduce the price paid to ACP countries by 5% in 2006 and a total of 36% by 2009) is to assist it in its plans for expansion of the sugar cane sector, with a view to enhancing its contribution to poverty reduction while also seeking to ensure that EC support has a multiplier effect for the rural and overall economy. This translates into a focus on two main areas:

- Strengthening and development of outgrower schemes in the cane sector;
- Support for rural infrastructure development.

In parallel with its support for the NAS, the EC will also pay specific attention to and engage in dialogue with the GoM on the policy environment required for the investments to bear fruit (in particular as regards access to land and water, energy policy and the regional integration of sugar markets — the latter in the context of the Economic Partnership Agreement).

This focus for EC support is derived from the National Adaptation Strategy, and will be articulated with the capital investments and efficiency improvements to be undertaken by Illovo

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<sup>11</sup> Examples of relevant studies and assessments that set out the basic lessons learnt in the sector include: the Framework Contract Beneficiaries consultants' report 2006/115952 on the 'Preparation of the Sugar Reform Adaptation Strategy for Malawi', March 2006; 'The Impact of the EU Sugar Reforms on Malawi' by the Ministry of Trade and Private Sector Development (MoT&PSD)/ R. Record et al Nov 2005; 'The Sugar Market Outlook' by Illovo Sugar (Malawi) Ltd, 2004; and 'The Malawi Sugar Sector Value Chain (2002)', University of Durham et al, 2002.

and with the public investments and policy commitments to be put in practice by the GoM, as identified in the NAS. There will need to be close coordination with these and other sources of financing, e.g. the EC will seek, if and where appropriate, to develop synergies with the EIB in contributing to the country's adaptation process.

This EC assistance will also be fully coherent with and incorporated in the overall EC development cooperation approach with Malawi, as reflected in Country Strategy Paper for 2007-13. The use of EC finance under the "accompanying measures" and under the 10<sup>th</sup> EDF will in particular usefully complement each other within the broader context of rural development and infrastructure development (e.g. as regards irrigation). EC support at regional level can also usefully contribute to the NAS objective of enhancing competitiveness, since it will help address some of the transport infrastructure shortcomings of the region.<sup>12</sup>

The actions to be undertaken for the EC support strategy are specified below for 2006, taking into account the available financial amounts, while areas for EC support over the longer term are more generally defined.

#### • 4.2. AREAS FOR EC SUPPORT IN 2006

The specific EC assistance for Malawi's sugar sector, with an allocation of €0.667m under the accompanying measures for 2006, targets three areas of intervention: (1) studies and reviews of the regulatory framework to ensure an enabling environment for the implementation of the proposed measures outlined in the NAS (€0.267m), (2) a Farmer Training and Capacity Building programme (€0.200m), and (3) an Institutional Capacity Building programme to develop the management capacity of outgrower service providers (€0.200m).

(1) The support for further analysis, studies and review of the national regulatory framework is geared towards producing an enabling environment for the sugar cane sector to implement all the proposed measures efficiently and successfully. The NAS singles out such reviews, for example of the regulations governing access to land and water for outgrowers and the regulations governing the production and use of fuel ethanol and electricity from decentralised, renewable sources, as essential (pre)conditions for the implementation of most of the other schemes identified in the NAS. This will also provide an opportunity to carry out jointly a strategic environmental assessment of the NAS.

- Improving the skills of farmers to increase their production through the improvement of cane fields:

(2) The Farmer Training and Capacity Building programme (€1.2m over a period of three years, with €0.200m for 2006) is meant to address the still deficient technical skills base of farmers in cane farming. Additional support will ensure a stronger base to allow continuous improvements in yields. A comprehensive multiannual training programme for farmers at both Dwangwa and Kasinthula will help to improve this skills base.

- Strengthening services for outgrowers so as to increase their efficiency:

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<sup>12</sup> This is yet to be confirmed, but Nacala corridor and port sugar terminal is mentioned in both the Malawi and the Zambian NAS, while Beira terminal is mentioned in Mozambique's NAS.

(3) Development of the Management Capacity of Outgrower Service Providers: in order to increase operating efficiency and to become more effective, outgrower service providers need support to build their capacity. This will include providing services, i.e. finance and decision-support systems (e.g. Management Information Systems), and training in technical, managerial and administrative skills. The difference between this training and the capacity building programme under point (2) above is that the former targets the management (elected representatives who manage the outgrower schemes on behalf of the outgrowers), whereas the latter targets the smallholder farmers themselves. The estimated cost of this project is €1.2 m over a period of 4 years, with €0.200mn set aside for 2006. Similarly, synergies can be developed with the 9<sup>th</sup> EDF Farm Income Diversification Programme (FIDP), which is already operational and is expected to be financed further (2<sup>nd</sup> phase) under the 10<sup>th</sup> EDF.

The capacity building programmes, in both technical and management skills, should result in sustainable smallholder schemes in future while addressing the weakness identified earlier (the sector's lack of human resources to improve the efficiency and management of smallholder schemes). Both capacity building programmes (components 2 and 3) are considered as two activities forming part of one single operation, with the detailed arrangements to be defined at the project formulation stage.

As previously noted, both the Nchalo (Kasinthula) and Dwangwa outgrower schemes include other food crops in their operations, so the capacity building programmes will be available to all small farmers in these areas. This would also limit the risks of dependency on a single crop (cane) and help find a sustainable solution to the problem of knowing how to implement the remaining components of the response strategy when the time arrives (e.g. replanting initiatives).

#### • 4.3. POTENTIAL AREAS FOR EC SUPPORT IN 2007-13.

In the medium term (2007 – 2009/10), the EC could further contribute to outgrower development by continuing to support smallholder farmers (1) at farmer level and 2) at management level;

- Further support for both outgrower capacity building programmes mentioned above (2007 – 2008).

- Improving the skills of farmers to increase their production through the improvement of cane fields:

(4) The 'Replant Fund' component of the EC Response Strategy is geared to increasing outgrower production through the improvement of cane yields. Outgrowers struggle to access resources to replant sugar cane fields every 8-10 years, as required to maintain productivity levels. The solution to this problem is to set up a fund for replanting. Such a fund is already in place in the major cane growing area, Dwangwa, and appears to work well. It is recommended that resources be made available for a similar fund to be set up in Kasinthula. Discussions with the EIB regarding its involvement in such a fund are currently ongoing. It is further noted that the planting of new land under existing or potentially new outgrower schemes will also be considered here.

(5) The 'Outgrower Capital Replacement Fund' is geared towards area expansion and infrastructure development with the emphasis on maintaining the increased production levels. Outgrowers are unable to access funds to maintain and/or replace essential capital assets (buildings, pumps, machinery, canals, pipes etc) that are vital for production. It is proposed that a fund be set up with concessionary terms to provide resources to assist outgrowers with capital replacement. It would also function as a basic concessional fund, as it would finance the

profitable investments needed to ensure sustainable access to the finance provided by the fund. As above, discussions with the EIB on its involvement in this fund are ongoing.

It is essential to point out at this stage that components 2 and 3 of the EC response strategy will have a direct impact on the implementation of all other components, particularly the establishment of credit funds for replanting or new planting initiatives (component 4) and capital investment (component 5), which are included at this stage for consideration by the EIB or other partners that could take up these initiatives. Further analysis of the Commission's arrangements here is therefore required. Such analytical work could come under component 1 of the strategy and/or could just as easily be financed under the Technical Cooperation Facility (TCF).

- Improving road infrastructure to reduce the cost of production and increase competitiveness:

(6) Dwangwa Feeder Roads Programme: Dwangwa outgrowers do not have suitable access to their fields, which is essential for successful cane harvesting. An estimated 160 km of feeder roads with various drainage and flood protection works are required. The budget for this road infrastructure support is €0.45m. This will include provision to ensure the sustainability of these investments through appropriate maintenance. Synergies can be developed with the 9<sup>th</sup> EDF Rural Feeder Roads programme, which is due to become operational next year (2007).

The EC will encourage research and development institutions in Malawi to participate in the 7<sup>th</sup> Research Framework Programme, namely in theme 2: Food, Agriculture and Biotechnology, building the knowledge based bio-economy. Malawi is highlighted as being "a world-class producer, with its cost of production consistently ranked among the five lowest worldwide", therefore product innovations linked to the bio society concept of FP7 make sense.

In addition to the potential areas for EC support outlined above, complementary support may be given to the Kasinthula outgrower scheme, which could be financed by the financial institutions available, such as the EIB and/or stakeholders of the NAS<sup>13</sup>.

After 2009 and beyond (long-term strategy), the NAS calls for a further increase in sugar production, e.g. for the EU market. This requires much more funding to increase factory capacity, which is to be provided by private capital. It also requires further expansion of cane production. For that long-term period (2009-13), EC support under the accompanying measures should focus on the following areas:

(i) continuation of the above-mentioned outgrower schemes, as small farmers will often need at least medium-term assistance to acquaint themselves properly with new crops and cultivation techniques.

(ii) infrastructure in the form of small irrigation, feeder roads etc, which could be directly or indirectly linked to sugar production areas. Other potential measures could be assessed as they are developed, and considered for funding where feasible.

Table 1 (page 14) summarises the multiannual EC support strategy, setting out the likely areas for EC-specific support.

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<sup>13</sup> The development loans for Kasinthula Phase 1 and 2 require restructuring. However, if this is deemed impossible, the next possible option would be to concentrate on the expansion of the current outgrower scheme under more suitable financial arrangements to be determined at a later stage. The expected investment needed is approx. €3.3m.

## **5. ARRANGEMENTS FOR EC SUPPORT**

The private sector has expressed a strong preference for a project support approach as the preferred mechanism for funding the accompanying measures, also bearing in mind synergies with ongoing EC-funded projects under the 9<sup>th</sup> EDF. The EC strategy takes these concerns into account, which is reflected in the choice of the preferred mechanism of support, namely project support. This approach is also justified given the amount that Malawi will receive as its 2006 allocation under the accompanying measures. As it is relatively small, it would be more effectively implemented and monitored if handled by centralised operations. However, this is only for 2006, thus allowing a degree of flexibility in the choice of arrangements for future assistance<sup>14</sup>.

As outlined in the NAS, the industry itself, with the guidance and approval of the Ministry of Agriculture and Ministry of Industry, Trade and Private Sector Development, will be responsible for the overall steering and coordination of the implementation of the NAS. This will ensure that all the stakeholders and in particular all the required sources of financing undertake their inter-related investments in a coordinated fashion.

The EC response strategy draws from the exhaustive consultation process resulting in a nationally endorsed adaptation strategy for Malawi. The EC however awaits an official communication from the GoM on the EC-specific sugar-response strategy, which has so far been agreed through consultation.

Since it is indispensable that there is a single EU strategy for each ACP country covering all Community instruments, the EC Multiannual Adaptation Strategy will be integrated into the Malawi Country Strategy Paper 2008-2013 and subject to the system foreseen for the CSP monitoring and review process under the Cotonou Agreement.

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<sup>14</sup> The planned implementation arrangements for Malawi in the first year will therefore involve centralised operations.

**TABLE 1: EC-SPECIFIC RECOMMENDED SHORT- TO MEDIUM-TERM MULTIANNUAL ASSISTANCE FOR SUGAR INDUSTRY OUTGROWERS**

<b>Projects</b>	<b>Impact</b>	<b>Total as per NAS<sup>15</sup> (€m)</b>	<b>2006<sup>16</sup> actual (€m)</b>	<b>2007 (€m)</b>	<b>2008 (€m)</b>	<b>2009 (€m)</b>
<b>1. Review of the Regulatory Framework</b>	Improved enabling environment	<b>€0.267</b>	€0.267	<b>tbc<sup>17</sup></b>	<b>tbc</b>	<b>tbc</b>
<b>2. Farmer Training and Capacity Building (Kasinthula &amp; Dwangwa)</b>	Improved Yields	<b>€1.2</b>	€0.200	<b>tbc</b>	<b>tbc</b>	<b>tbc</b>
<b>3. Capacity Development – management service providers (Kasinthula &amp; Dwangwa)</b>	Improved efficiency	<b>€1.2</b>	€0.200	<b>tbc</b>	<b>tbc</b>	<b>tbc</b>
<b>4. Replant fund – Kasinthula <sup>18</sup></b>	Improved Yields	<b>€0.2</b>	-	<b>tbc</b>	<b>tbc</b>	<b>tbc</b>
<b>5. Outgrower Capital Replacement Fund (Kasinthula &amp; Dwangwa)</b>	Sustainable production	<b>€0.4 mn</b>	-	<b>tbc</b>	<b>tbc</b>	<b>tbc</b>
<b>6. Dwangwa Feeder Roads</b>	Production expansion	<b>€0.45</b>	-	<b>tbc</b>	<b>tbc</b>	<b>tbc</b>
<b>Total potential EU Response</b>		<b>€3.717</b>	<b>€0.667</b>	<b>tbc</b>	<b>tbc</b>	<b>tbc</b>

As mentioned previously, in addition to the potential areas for EC support listed in the table above, there is the possibility of complementary support for the Kasinthula Outgrower Scheme to be financed by the EIB and/or stakeholders of the NAS.

<sup>15</sup> Actions not necessary financed from the EC accompanying measures

<sup>16</sup> Financing under the Accompanying Measures for 2006.

<sup>17</sup> tbc: To be confirmed

<sup>18</sup> Proposed support from Financial Institutions and other donors. Ongoing discussions with the EIB on national loan schemes or on-lending initiatives. This goes also for component (5).

## GENDER SITUATION

Country: MALAWI  
Initials of assessor BMS

Documents: Malawi CSP and NIP  
Date: 5/10/2006

Document Section Gender Integrated in :	Absent (0) / Mention (1) / Partly (2) / Fully (3)	Sex-disaggregated data	Comments
I. Framework	1	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Standard para on EU Consensus priorities includes mention of gender mainstreaming
II. Country Diagnosis	Average = 1.1	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	It takes into consideration gender disparities and the most urgent related issues that would need to be addressed
II.1.1. Political and institutional situation	2	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Provides info on most urgent issues related to women's human rights and discrimination
II.1.2. Economic and commercial situation	0	<input type="checkbox"/> Yes <input type="checkbox"/> No	No specific gender analysis, but clear identification of the possible impacts of trade liberalisation on poverty situation
II.1.3. Social situation, including decent work and employment	3	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Singles out gender issues in health, education and employment; well covered gender analysis of social issues
II.1.4 Environmental situation	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
II.1.5. The country in the international context	1	<input type="checkbox"/> Yes <input type="checkbox"/> No	Mentions CEDAW
II.2. Poverty reduction analysis	3	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Provides clear information of gender dimensions of poverty
II.3. Gender in the recipient country's development strategy	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	No specific mention of gender equality but MGDS aims at MDGs and clearly spells out priority of social justice, redistribution of growth and investment in social sectors/social protection
II. 4 Analysis of the viability of current policies and the medium-term challenges	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	The stated need to move from project approach towards budgetary aid poses challenges to promotion of gender equality which need to be considered (particularly compared to the high rate of sustainability of NGO projects )
III. EC cooperation	Average =0		This chapter is particularly attentive to policy coherence and poverty impact, however no specific analysis of gender impact is made.
III.1.1. Focal sectors (and macroeconomic support)	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	0 for agriculture 0 for transport; focus on social indicators might open good entry points
III.1.2. Projects and programs outside focal sectors	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	unfortunately no info is given on gender impact of NGO co-financing and food security + thematic budget lines. All these areas normally have great empowerment potential. The document mentions an Annex which could contain precious information but it is not attached to the CSP.

III.3 Other EC Policies	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	No specific gender impact but attention to poverty impact has gender implications
III.4. Description of the political dialogue with the partner country	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
III.5. Partnership and harmonization	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
IV. Response strategy	Average = 1.3	<input type="checkbox"/> Yes <input type="checkbox"/> No	
Focal sectors (and macroeconomic support)			
General Budget support	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Is directly linked to pro-poor growth and pro-poor social expenditure, with clear gender implications, but no explicit and measurable commitment is taken to ensure gender equity and non-discrimination.
Agriculture and Food Security	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	The sector has huge gender implications, which are not addressed directly in the text but may be addressed under "non focal sectors"
Infrastructure	0	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	The stated intention to focus on rural feeder roads and accessibility for poverty stricken areas is likely to have a positive gender impact..
Non Focal Sectors	3	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	specific funds in non focal sectors are dedicated to gender and HIV/AIDS mainstreaming in all sectors
Gender and HIV AIDS mainstreaming			
Annexes		<input type="checkbox"/> Yes <input type="checkbox"/> No	not available in current document
CSP drafting process		<input type="checkbox"/> Yes <input type="checkbox"/> No	not available
Overall assessment of the document	The country diagnosis provides useful information on gender disparities and issues to be addressed. The response strategy allocates specific funds for gender mainstreaming across all focal and non focal sectors. The actual amount foreseen should be adequate to allow not only for isolated intervention but for a. capacity building among all involved stakeholders		
Recommendations to improve the CSP	<p>Processes/ actors involved: .</p> <p>Content related resources/ references:</p> <p>The "Gender" allocation as a non-focal sector is highly commendable. It should be adequate to allow not only for isolated intervention but for a. capacity building among all involved stakeholders (national counterparts/project managers/NGOs etc.) b. establishing monitoring mechanisms which are able to assess the differential impact on (poor) women and men and ensure that all interventions equally benefit and empower (poor) women and men. This is particularly important in Focal Sector 1 where women might be discriminated both as producers and as food consumers.</p> <p>The Delegation is most likely to have in-house expertise and resources which need to be used in a systematic way and in coordination with other donors and the UN (UNDAF has also strong gender focus). The risks implied in the shift to budgetary aid and SWAP also need to be addressed systematically and upstream, to avoid not only evaporation of gender equality commitments but also the loss of existing good practices and expertise which have been developed at project level.</p>		

**OVERALL COMPARATIVE SCORE : 3**

## Recommendations of the 2004 EU Electoral Observation Mission

### 1. Constitutional and Legislative Framework

- Legislation should be amended to:
  - (i) clearly define the abuse of public resources and means that can be used to control this malpractice;
  - (ii) clearly prohibit the distribution of money by political contestants to voters;
  - (iii) require transparency in the declaration and use of campaign funds from private sources; and
  - (iv) state that electoral complaints should be resolved before the President can be inaugurated;
- Consideration should be given to introducing legal provisions to increase women's representation;
- All MEC and other public officers breaching the electoral process should be held accountable for their actions.

### 2. Voters' Roll

- Before the next national elections, a civil register should be established, from which a new voters' list can be created and updated annually.
- Regulations should be introduced to ensure greater rigor and transparency in making changes to the voters' register and a more effective system for voters who move and need to transfer their voting location.
- The voter registration and verification period should be clearly specified and sufficient time allowed for the process.

### 3. Election Administration

- Composition of the MEC and structure of the election administration should be reviewed with a view to ensuring confidence among political contestants and efficient administration of elections.
- The MEC should:
  - (i) provide clear, timely and comprehensive written instructions as well as clarification to regulations where necessary;
  - (ii) address complaints on issues within its competencies as outlined in electoral legislation in a timely and professional manner;
  - (iii) provide political party representatives, domestic observers and international observers with access to meetings at all levels of the election administration;
  - (iv) involve election stakeholders, including umbrella organisations for the handicapped and blind, prisoners etc., at an early stage in preparations to ensure improved accessibility;
  - (v) improve preparatory work, particularly to ensure careful checking of information on ballot papers, proper procurement arrangements and the efficient collection of sensitive materials after election day;
  - (vi) develop polling station forms that are easy to use, for example with carbon copies and serial numbers;

(vii) introduce necessary reconciliation and ballot security procedures. These should include a requirement for voters to mark the voters' roll upon receipt of a ballot paper, the stamping and/or signing of ballots upon issue, and a comparison of the total number of people marked as having received a ballot paper against the number of ballot papers issued;

(viii) swiftly publish results broken down by polling station as they are announced, including on the internet;

- District Elections Supervisory Teams (DEST) should include representatives of civil society but not members of state security organisations;
- Election officials should be better trained, particularly in counting and aggregation procedures;
- Polling stations should close at 16:00 rather than 18:00 to ensure that counting can be undertaken in daylight; and
- A revision of constituency boundaries should be undertaken to ensure that constituencies contain broadly equal numbers of people should this be (even if this means cutting across Territorial Authority boundaries).

#### 4. Civic Education

- Civic and voter education should be conducted by state bodies (such as education and public information services) and civil society organisations. The police and National Intelligence Bureau (NIB) should not be involved in such work.
- Increased efforts should be made to target civic and voter education at women, young people, the illiterate and other vulnerable groups, particularly in remote areas.
- Efforts should be made to increase public awareness of what can be expected from political representatives and leaders.

#### 5. The Media

- The roles of MACRA and MEC in regulating the media during an election campaign should be clarified and clearly defined to remove the possibility of a power vacuum or clashes between the two. There should be a clear division between the responsibilities of MACRA and MEC in this area.
- Clear instructions should be provided for the allocation of equitable free airtime on public media for political contestants during the campaign period.
- Coverage of the president by public electronic media should be regulated during the campaign period.
- A full licence should be issued to TVM.
- Action against the media should only be taken by the licensing authority and MACRA, and not by the police.
- Political debate and discussion programmes should be increased, particularly during the campaign period.
- Composition of management boards of MBC and TVM should ensure the confidence of election stakeholders.

#### 6. Stakeholders

- National Elections Consultative Forum (NECOF) meetings should be held on a regular basis during the pre-election period and recommendations emerging from the meetings properly implemented.

- Multi-Party Liaison Committee meetings should be held more regularly in the lead up to elections, and should include the participation of independent candidates.

#### 7. Political Parties

- Political parties should be required to declare their funding sources and how funds have been used. There should also be maximum limits for funding, donations received and funding expenditures.
- Training should be provided for political parties and candidates in a number of areas including (i) policy development, (ii) manifesto preparation, (iii) communication with voters, (iv) the role and rights of monitors (for example, on complaint mechanisms).

#### 8. Civil Society

- Training and support should be provided to civil society to strengthen capacity to conduct civic and voter education and election observation, including parallel vote tabulation.
- Sufficient resources should be provided to enable civil society to conduct civic and voter education and election observation in a comprehensive manner.

#### 9. Participation of Women

- Political parties should make serious efforts to (i) ensure that women are represented in senior positions, and (ii) select more women candidates in order to reach the SADC target of 30% female representation in parliament.
- The MEC should take steps to increase the representation of women in all levels of the election administration.

#### 10. Police

- Police should be properly trained on the role they should play on election day, specifically that they should not perform the tasks of polling officials.

## Annex 14

### Transport Sector Overview

#### 1. INFRASTRUCTURE

##### Road Network

The current classified network (after a 2006 re-measurement) is 15,451 km (4,038 km paved, 11,413 km unpaved). A Reclassification proposal was finalised in 2006 and recommended the implementation of the reclassification as shown below.

##### **Reclassified Road Network**

From pre-2005 classification (km)		To proposed 2006 classification (km)				
Class		M	S	D	C	Urban
<b>M</b>	3,587	3,572	15			
<b>S</b>	3,131	434	2,697			
<b>T</b>	4,168		1,455	2,713		
<b>D</b>	3,410		72	2,909	429	
<b>UD</b>	9,073		10	2,473	6,590	
<b>Urban</b>	1,560					1,560
<b>Total</b>	24,929	4,006	4,249	8,095	7,019	1,560

M - Main, S - Secondary, T - Tertiary, D - District, UD - Undesignated, C - Community

This indicated that there were 15,856 km currently designated (as opposed to 15,451 km previously reported), and that a further 9,073 km of previously undesignated roads will be reclassified as shown in the above table.

##### Road condition

Road condition data, related to International Roughness Index IRI) are given below

##### **Road Network Condition by Roughness**

	Paved Roughness		Unpaved Roughness	
	Range IRI	Condition 05/06	Range IRI	Condition 05/06
Good	< 4	79%	< 7	14%
Fair	4 – 6	19%	7 - 9	46%
Poor	> 6	2%	> 9	40%

Note: The percentage values above were based on the condition survey carried out from Oct 2005 to Sept 2006 that included M, S, T and D roads, as per the pre-2005 classification. This survey reported on 2,626 km of paved roads, and 10,028 km of unpaved roads. Urban/residential roads were not included in this survey.

For the paved network, this seems to present a reasonable picture, though other criteria need to be considered to provide a complete view. In particular there is a significant amount of edge break (25% in fair or poor condition) and shoulder erosion (29% in fair or poor condition).

### Density of Road Network

Using the new road classification: 0.0019 km/capita or 0.21 km/square km

### Passenger and freight services on road

In 2005, road infrastructure handled more than 70% of the internal freight traffic and 99% of internal passenger traffic. Additionally, road transport handled more than 90% of the international freight and passenger traffic.

### Other transport modes

Malawi has 810 km rail track, 4 major lake harbours, 3 airports and 33 smaller airfields.

## 2. ROAD SUB-SECTOR FUNDING

Road Sector revenues (current and projected are given below)

### **Projected Revenue - Secured Funding (in USD million)**

<b>Source of Funds</b>	<b>06/07</b>	<b>07/08</b>	<b>08/09</b>	<b>09/10</b>	<b>10/11</b>	<b>5yr Total</b>
<b>Non-targeted funds</b>						
Road Fund	13.44	13.62	15.16	15.39	14.53	72.14
<b>Targeted Funds for committed works</b>						
<b>Fuel Levy (MK1/litre) to PWP</b>	<b>0.86</b>	<b>1.76</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>2.62</b>
Government Funds	3.66	5.46	1.65	0.00	0.00	10.77
EDF (Targeted)	8.73	45.63	41.87	15.21	3.29	114.73
Arab Donors (BADEA, OPEC, Kuwaiti Fund)	20.18	44.39	53.35	43.35	22.50	183.77
World Bank	0.00	5.47	5.47	5.47	0.00	16.40
JICA	7.20	4.00	4.00	0.00	0.00	15.20
Republic of China	6.75	11.25	13.50	13.50	0.00	45.00
<b>Sub-total Targeted Funds</b>	<b>47.38</b>	<b>105.78</b>	<b>98.50</b>	<b>56.19</b>	<b>25.79</b>	<b>333.64</b>
<b>Total Revenue All Funds</b>	<b>60.82</b>	<b>119.40</b>	<b>113.66</b>	<b>71.58</b>	<b>40.32</b>	<b>405.78</b>

Excluding 10<sup>th</sup> EDF allocation (not yet committed)

PWP = GoM Temporary Public Works Programme

The allocation of the funding by intervention type is given as follows:

**Projected Expenditure - Secured Funding (USD million)**

<b>Expenses and Non-targeted funds</b>						
<b>Source of Funds</b>	<b>06/07</b>	<b>07/08</b>	<b>08/09</b>	<b>09/10</b>	<b>10/11</b>	<b>5yr Total</b>
Operating Expenses	3.40	3.50	3.55	3.55	3.55	17.55
Central Planning, Designs, Surveys	0.85	0.90	0.92	0.95	0.97	4.59
Maintenance (Road Fund),	9.19	9.22	10.69	10.89	10.01	50.00
<b>Sub-total</b>	<b>13.44</b>	<b>13.62</b>	<b>15.16</b>	<b>15.39</b>	<b>14.53</b>	<b>72.14</b>
<b>Targeted Funds for committed works</b>						
Feasibility and Design Studies, TA	1.18	6.18	3.94	5.26	3.29	19.85
Periodic Maintenance & Rehabilitation	11.45	44.31	40.11	14.59	0.00	110.45
Upgrading	34.75	55.29	69.61	51.73	22.50	233.88
<b>Sub-total</b>	<b>47.38</b>	<b>105.78</b>	<b>98.50</b>	<b>56.19</b>	<b>25.79</b>	<b>333.64</b>
<b>Total Expenditure</b>	<b>60.82</b>	<b>119.4</b>	<b>113.66</b>	<b>71.58</b>	<b>40.32</b>	<b>405.78</b>

Excluding 10<sup>th</sup> EDF allocation (not yet committed)

**2. INSTITUTIONAL ORGANISATION (ROADS SUB- SECTOR)**

The legislation that directly affects the roads sector is listed in the table below, together with general comments on the latest or proposed amendments.

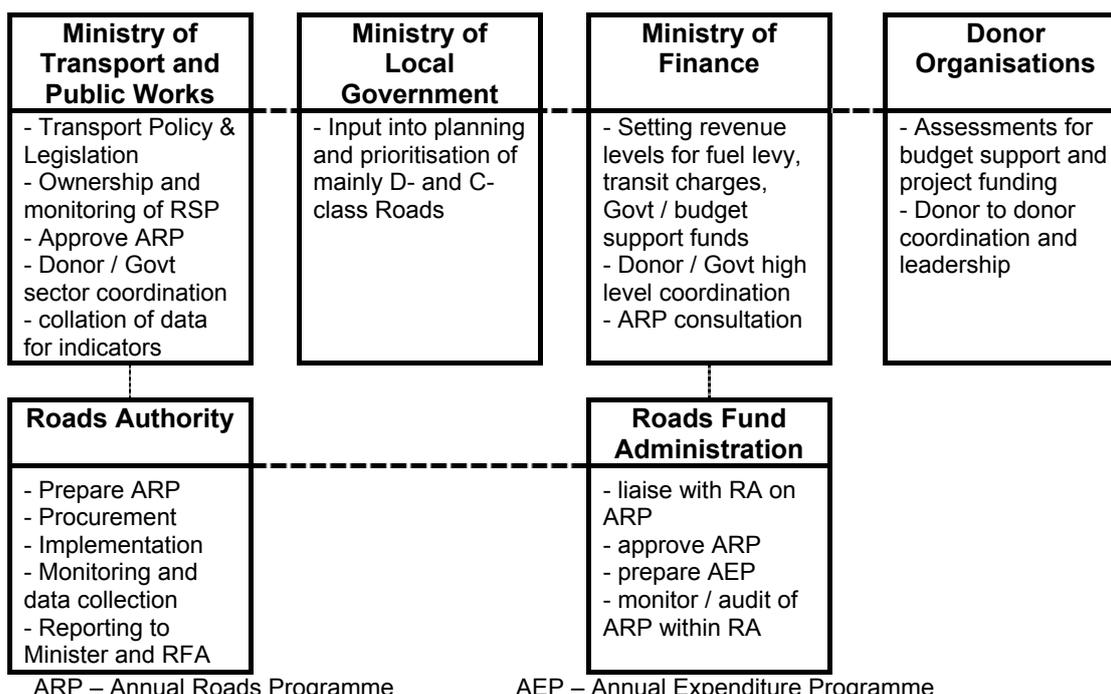
**Relevant Acts of Parliament**

<b>Act of Parliament</b>	<b>Comments</b>
Public Roads Act (1962) Last LRO 1/1992	This Act requires an amendment to include for the new reclassification of roads (based on the report submitted in March 2006), and the new organisational responsibility. A proposed Bill has been drafted under the Reclassification Study. The NRA (RA) should review this and submit to MoTPW for comment and further action.
National Roads Authority Act (1997)	This Act will be repealed when the RA and RFA Acts come into operation.
Roads Authority Act (2006)	This Act came into operation at the end of 2006. This Act and the RFA Act form the basis for the operation of the roads sector.
Roads Fund	This Act came into operation at the end of 2006..

Administration Act (2006)	This Act and the RA Act form the basis for the operation of the roads sector.
Road Traffic Act (1997) National Road Safety Council Act (1986)	A Bill has been drafted (2006) that combines the functions of the Road Traffic Department and the NRSC. Agreement on the draft Bill is required following a consultant study finished in 2007. The new Bill is aimed at improving road safety.
Local Government Act (1998) and National Decentralisation Policy (1998) and Strategy (2000)	This Act was revised in 1998 to provided legal framework for the National Decentralisation Policy. The Policy would seek to create road agencies within the Assemblies, subject to sufficient institutional capacity.
Public Procurement (2003)	This Act forms the basis for the procurement of works, services and goods. (Refer to <a href="http://www.odpp.gov.mw">www.odpp.gov.mw</a> )
Public Audit (2003) and Public Financial Management (2003)	These Acts form the basis for financial audits and for financial management.

A diagram showing the major organisations within the roads sector and their major roles and responsibilities is given below. This is further described in the following Sections. The role for the MoLGRD through the District and City Assemblies is subject to annual review.

**Table 7.2 – Major Organisational Roles within Road Sector**



## **Ministry of Transport, Public Works and Housing**

Within the MoTPWH, the Department of Roads has the main responsibility for roads sector functions. They are supported by and provide support to the Transport Planning Unit and the Road Traffic Department. The roles and responsibilities of the MoTPWH with respect to the road sector functions, and in particular this RSP, are summarised as follows:

- policy review and update of the National Transport Policy as pertaining to the roads sector
- review and update of legislation where necessary
- approval of standards with relation to road design in conjunction with RA
- ownership of this RSP, including reviewing and updating on an annual basis (in conjunction with the other stakeholders)
- Approval of the Annual Roads Programme
- collation of all data and final reporting of indicators, and ensuring their timely collection and reporting by the RA and RFA (refer to Section 5)
- performance monitoring and evaluation of the RA
- reporting of indicators to members of the Consultative Transport Forum and donors
- Donor / Govt sector coordination through the Consultative Transport Forum

The Road Traffic Department (RTD) within the Ministry covers issues relating to vehicle licensing and roadworthiness. It is intended that the RTD take over the responsibilities of axle load control from NRA. RTD currently has the responsibility for the approval of standards with relation to axle load and vehicle limits. It is planned that the RTD will merge with the NRSC to form the Road Traffic Authority, providing a firmer base to plan and enforce road safety issues.

Central Materials Laboratory falls under the control of the Department of Roads (within MoTPWH). This is a laboratory used by the construction industry, equipped to carry out most of the testing required, though much of the equipment is old, poorly maintained and requires replacing. Funding to the CML from the MoTPWH budget is limited, and affects their capacity.

The Department of Roads will take on the responsibility for the ownership of the RSP. This department will coordinate the monitoring and evaluation, and the updating of the RSP, is headed by the Director of Roads, who is supported by the Deputy Director of Roads, with one Principal Civil Engineer, 3 Civil Engineers, and 3 Technicians. Together with the resources of the Transport Planning Unit, this is considered sufficient capacity to accept the responsibility for the RSP.

## **Ministry of Finance**

On a sector level, the MoF is the senior Ministry within the roads sector as it has the responsibility for setting revenue levels for fuel levy, transit charges, Government funds, and funds to the sector from budget support. With the establishment of the RFA through the RFA Act, the MoF takes on new responsibilities that were not part of

its mandate under the NRA Act. Specifically, the RFA Board is now accountable to this Ministry.

This Ministry also has the primary responsibility for the public sector accountability and management systems, and the overall macro-economic environment.

Additionally, the MoF is also responsible for high level coordination between donors and Government, as stated in the draft Malawi Development Assistance Strategy (June 2006). This coordination group is chaired by the Minister of Finance and involves the Heads of Delegation, Heads of Mission and Resident Representatives of all of the Aid organizations active in Malawi. Other Ministers are invited as appropriate and a Secretariat also attends. The main purpose of this group is to resolve cross cutting or particularly difficult policy issues that have not been adequately dealt with at the lower level meetings.

Apart from the function of setting revenue levels to the roads sector, the MoF has a monitoring role, and will receive reports from the RFA necessary for this purpose and also for its own reporting and budgeting requirements. In preparation for SWAPs with sector programmes, the MoF has allocated certain officers within this Ministry to take responsibility for each major sector. Capacity to carry out these functions are assessed under the PEFA reviews, and have been considered adequate to receive general budget support from the IMF and other donors. Further capacity building is based on the recommendations of the PEFA reviews.

### **Ministry of Local Government and Rural Development**

The MoLGRD has embarked upon a policy of decentralisation that calls for a process of devolving political powers to the District Assemblies. This process is currently on-going. In the roads sector, in order for the local authorities to effectively manage their local road network they need adequate institutional capacity. This capacity is not yet developed, and capacity building with the Assemblies is still required.

The Decentralisation Policy specifically targets four key strategies:

- participation of the grassroots in decision-making
- elimination of dual administration
- promotion of accountability and good governance at the local level
- mobilisation of the masses for socio-economic development

Within the roads sector, these strategies will be mostly achieved under the RSP. In particular, with regard to the first strategy, it should be recognised that the NRA has established a central planning tool (RDM and HDM-4). Due to its specialist nature, this system is only sustainable at a central level and within NRA. However, there will be participation in the planning and prioritisation of the local roads programmes from the Assemblies.

The RSP in general seeks to eliminate dual administration and parallel systems within the roads sector (as per the principles of a SWAp). It provides systems that promote accountability, though not necessarily at a local level, and will also provide employment through the term maintenance and other contracts.

## Roads Authority

The Roads Authority was established during the first half of 2007. The staffing and expertise will be provided from the core team from the existing NRA. The primary roles for the RA are the preparation and implementation of the Annual National Roads Programme, in accordance with the RA Act, and will include:

- annual updating of:
  - o road condition surveys
  - o traffic volume surveys
  - o construction costs database
  - o vehicle operation costs
- data entry and storage in RDM
- analysis of data using RDM and HDM-4
- coordination with City and District Assemblies, and other stakeholders in the planning of district road programmes
- preparation of programmes for routine maintenance
- prioritisation of programmes for periodic maintenance, rehabilitation and construction
- planning and procurement of studies and designs
- preparation of ANRP
- gaining approval of ANRP from a) RA Board and b) RFA
- preparation of tender documents for works and services
- tender invitation and evaluation
- gaining approval of tender award from Director of Public Procurement and award of contracts
- monitoring of contractors and consultants
- certifying interim and final payments certificates
- forwarding payment certificates to RFA for payment
- reporting to Board, MoTPW and RFA
- coordination with MoTPW and RFA
- participating in the Consultative Transport Forum
- monitoring and evaluation of the ANRP
- administration of the RA
- payments relating to administration of the RA

Certain of these functions are covered under the Procedures Agreement between the RA and the RFA. This agreement includes the standard formats and procedures for the ANRP, certification for payments, and reporting.

The institutional capacity to carry out these roles and responsibilities within the RA is available. The technical sections within the RA will cover the following functions:

- Planning and Design
  - o Annual National Road Programme
  - o Traffic count surveys
  - o Road condition surveys
  - o Updating of vehicle operation costs
  - o Updating of calibration factors for HDM-4

- Road data management and analysis using RDM and HDM-4
- Prioritisation of programmes
- Feasibility and design studies
- Highway planning and design
- Bridge design
- Road safety engineering and design
- Environmental planning
- Procurement of services for surveys, studies and design
- Supervision of surveys, studies and design
- Monitoring and evaluation of ANRP
  
- Maintenance
  - Preparation of tender documents for routine maintenance and periodic maintenance for term maintenance contracts (TMC)
  - Procurement of contracts for routine and periodic maintenance for TMC
  - Supervision of TMC, checking and certification of interim and final payment certificates
  - Monitoring and evaluation, and feedback into the planning and prioritisation process
  
- Construction
  - Preparation of tender documents for rehabilitation and upgrading contracts
  - Procurement of contracts for rehabilitation and upgrading contracts
  - Supervision of construction contracts, checking and certification of interim and final payment certificates
  - Monitoring and evaluation, and feedback into the planning and prioritisation process

### **Roads Fund Administration**

The Roads Fund Administration is also expected to be established during the first half of 2007, with the staffing and expertise to be provided from the core team from the existing NRA. Its duties will include:

- Recommending levels for the fuel levy and transit charges
- Revenue collection from fuel levy, transit charges, Government and donors
- Approval of Annual National Roads Programme prepared by RA
- Preparation of the Annual National Expenditure Programme for approval by RFA Board
- Making payments for works and services through contracts under the RA
- Funds disbursement to the RA for their administration costs
- Monitoring and evaluation of expenditure through the Financing and Procedures Agreements
- Procuring and publishing financial audits for the RA and RFA
- Technical audits of the RA
- Reporting to MoF and to RFA Board
- Administration of the RFA

- Making payments relating to administration of the RFA

### **Private Sector**

In 2005 NRA carried out a survey of the capacity of locally based contractors in the NCIC categories of MK 50 million and above. The results showed that there was a total average annual turnover (2002 – 2004) from the 25 respondents of approximately US\$17 million. As there was an 80% response to the survey of those contractors in these upper categories, this implied a total average annual turnover of all of these contractors of US\$21 million. However much of this work was in short contracts with no continuity of work for many contractors. The introduction of term maintenance contracts, which run for a full 12 months within the FY, has provided some of this continuity.

It is known that the capacity of the local contracting industry within Malawi is affected by a shortage of capital to finance projects and by a lack of skills and expertise in some areas, particularly in management functions. The first issue can be partly resolved by ensuring contractors are paid promptly. To accommodate this within NRA/RA contracts, a maximum target of 28 days has been set from the date that the interim payment certificate is submitted by the contractor to the date that payment is made. Where funds from donors are still through project support, and not budget support, donors are requested to assist in achieving this same target.

A further issue affecting contractor capacity to satisfactorily perform works is the need to improve skills and expertise. This should be addressed by the National Construction industry Council) NCIC, but NCIC themselves do not have the sufficient appropriate skills or management expertise to serve the training needs of the contracting industry. This weakness in the system is proposed to be addressed by the forthcoming Technical Assistance under the 9<sup>th</sup> EDF.