MALAWI GOVERNMENT

In partnership with

AFRICAN DEVELOPMENT BANK (AFDB)
EUROPEAN UNION (EU)
GERMANY
NORWAY
UNITED KINGDOM (UK)
WORLD BANK (WB)

International Monetary Fund, United Nations Development Program and Ireland (Observers)

Common Approach to Budget Support (CABS)

February 2013 Review

AIDE MEMOIRE

Lilongwe, March 2013

CONTENTS

ACRONYMS AND ABBREVIATIONS

AfDB	African Development Bank
ACB	Anti-Corruption Bureau
CABS	Common Approach to Budget Support
DfID	Department for International Development (United Kingdom)
DPs	Development Partners
EITI	Extractive Industries Transparency Initiative
EU	European Union
ECF	Extended Credit Facility
EUR	Euro
GBP	British Pound
GDP	Gross Domestic Product
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
JF	Joint Framework
MGDS	Malawi Growth and Development Strategy
MDGs	Millennium Development Goals
MK	Malawi Kwacha
MoF	Ministry of Finance
NOK	Norwegian Kroner
PAC	Public Accounts Committee
PAF	Performance Assessment Framework
PFEM	Public Financial and Economic Management
RBM	Reserve Bank of Malawi
UA	Unit of Account
UNDP	United Nations Development Program
USD	United States Dollars
WB	World Bank

A: INTRODUCTION

1.0 BACKGROUND

1.1 This Aide Memoire contains findings and conclusions of the joint biannual review of the Government of Malawi and the Common Approach to Budget Support (CABS) Development Partners, which took place in Lilongwe, on 27th February 2013. The review was co-chaired by the Minister of Finance, Hon. Dr. Ken Lipenga, M.P and the German Ambassador who is the current CABS Development Partners Chair, Dr. Peter Woeste. The review had representation from various Government ministries and departments, CABS Development Partners as well as private sector, civil society, media, Legislators, and non-CABS Development Partners. The review focused on the underlying principles of budget support, Public Financial Management, 2011/12 budget outturn, 2012/13 Mid- Year budget performance, outlook for the 2013/14 Budget, and the annual review of the Second Malawi Growth and Development Strategy (MGDS II) as well as the Economic Recovery Program (ERP). The aim was to dialogue on key issues affecting program implementation[1], which form part of the budget support disbursement conditions.

1.2 The CABS Development Partners (DPs) entered into a partnership with the Government of Malawi (GoM) in 2000 to provide aid through harmonized budget support. The partnership is guided by the Joint Framework (JF), signed in 2005, which among other things, spells out principles that govern the budget support cooperation, the instrument for measuring performance on the overarching Government program of poverty reduction, and the timeframes for undertaking the reviews. Efforts are underway to revise the JF in light of current underpinnings and expectations that have arisen both in-country and in the international community.

1.3 The JF requires that joint reviews be conducted semi-annually. According to the Framework, the assessment of the Performance Assessment Framework (PAF) is carried out in the February-March review, while the September-October review focuses on understanding the Government priorities as revealed in the current fiscal year and on preliminary assessment of the previous fiscal year. However, it was agreed in May 2012 that the assessment of performance under the PAF and the setting of future PAF targets be undertaken in the September/October review[2].After the September/October review, the CABS DPs will inform Government about financial commitments for the following fiscal year after.

1.4 The CABS partnership will continue to dialogue on ways of effecting further improvements in the review process itself. For the first time, pre-CABS review meetings were held between CABS DPs and civil society for the purpose of strengthening their participation in CABS and soliciting written input to contribute to the review. Civil society was also part of the joint technical wrap-up and evaluation of the review.

[1] Program refers to the fulfillment of the Millennium Development Goals (MDGs) through the Malawi Growth and Development Strategy (MGDS) using the Government budget as a central mechanism for doing so.
[2] Efforts to formally amend the JF are underway. However, some suggested amendments to the JF are already being applied, by mutual agreement.

B: KEY FINDINGS

2.0 PRINCIPLES OF BUDGET SUPPORT AND MUTUAL ACCOUNTABILITY

2.1 Government reiterated its commitment to fulfill the underlying principles of budget support and staying the course on the reforms path, with the aim of strengthening public financial and economic management as well as consolidating democratic governance. The budget support fundamental principles enshrined both in the JF and the Constitution of the Republic of Malawi, include respect for human rights, democratic principles, sound macroeconomic management, good governance, strengthening of public financial management systems, accountability, effective anti-corruption programs, and rule of law. Human rights and basic freedoms continued to be respected over the review period, demonstrated for example, by the biggest leap of all countries on the 2013 World Press Freedom Index - ranking 75th this year as opposed to 146th in 2012. Budget transparency[3] also improved in 2012 with a score of 52 percent out of 100 possible scores on the Open Budget Index as compared to a score of only 47 in 2010. Tripartite elections have been planned for 2014 and preparations are at an advanced stage. Above all, the international community has confidence in the Government's direction on the unprecedented economic management reforms that commenced in May last year.

2.2 Government commitment to the macroeconomic and structural reforms was confirmed by the successful conclusion of the first IMF review of the Extended Credit Facility (ECF) Program in the second quarter of the 2012/13 financial year, with IMF Board's approval of ECF funding of US $20 million for Balance of Payments (BOP) support. Besides the programmed general budget support disbursements in the first half of the financial year by the AfDB (UA26 million), WB (US $50 million), and the EU (€40 million), Germany and the UK disbursed emergency budget support in December 2012, amounting to €5 million and £20 million respectively[4].

2.3 Policy reforms are under consideration in all areas of the budget support underlying principles and the CABS DPs support the continued reform agenda of the Government. The on-going processes to strengthen and give independence to the accountability institutions, such as, the National Audit Office (NAO), the Anti-Corruption Bureau (ACB), and the Office of the Director for Public Procurement (ODPP) are important for improvements in public financial management and transparency. In the context of the fight against corruption the DPs urged the Government not to discriminate when prosecuting corruption cases and that high profile cases including those involving senior Government officials should be pursued and concluded. In addition, further improvements were expected in the extractive industries to improve transparency. Continued legal reforms to improve human rights are also positive. Just after the review, the Parliament passed the Gender Equality Bill, which among others, seeks to promote equal integration of women and men in all functions of society. The Government also presented a plan for further reforms including the adoption of the

[3] Open Budget Index surveys are conducted biennially.
[4] Refer to the Disbursement Plan, Annex 1, p9.

Access to Information Policy and the enactment of the Access to Information Bill and the Asset Declaration Bill.

2.4 Both the Government and the CABS DPs acknowledged that alliances and partnerships with the private sector and civil society are crucial in the fight against poverty and in the drive to achieve a more inclusive and diversified economic growth. In the spirit of mutual accountability, the CABS DPs will continue to disclose budget support information in a timely manner for aid transparency and predictability. Disbursement conditions for the budget support are outlined in the JF and/or the bilateral agreements. However, it is acknowledged that the conditions for resuming the budget support do vary among the CABS DPs and as such the CABS DPs will continue dialogue with the Government. To increase harmonization and efficiency in the aid administration, the CABS DPs will make efforts to improve coordination of missions and assessments.

3.0 MACROECONOMIC FRAMEWORK

3.1 Despite the enormous challenges in the country, the economy has started to show some signs of recovery aided by increased availability of the foreign exchange, fuel and the returning credit lines. It is anticipated that economic growth will rebound in 2013 as GDP growth is projected at 5.5 percent, driven largely by the agriculture and service sectors. The outlook for the current agriculture season is positive on the back of expected good maize crop, increased production of tobacco, cotton, legumes and other cash crops, and good tobacco prices this year. Inflationary pressures persist as evidenced by the acceleration in the headline inflation to 35.1 percent in January 2013 from 34.6 percent in December 2012[5], driven largely by the increase in food prices, especially maize and non-food prices, including fuel. However, inflation is expected to start tapering off in March/April 2013 as the new harvest kicks in.

3.2 Notwithstanding the challenges being faced by the private sector (including insufficient supply of foreign exchange and exchange rate variability), the authorities have managed to clear most of the external payment arrears, which were much higher at about US$ 600 million, than earlier estimated. The liquidity squeeze in the banking system in the aftermath of the economic reforms saw an increase in a number of banks seeking accommodation through the Reserve Bank of Malawi (RBM) discount window, prompting fears of a liquidity crisis in the sector. A temporary non-collateralized window that was introduced by the RBM to provide relief to stressed banks was behind the sluggish growth in reserve money, despite the tightening of the monetary policy evidenced by the several hikes in benchmark rates from 13 percent in April 2012 to 25 percent in December 2012. Pressures on the Kwacha resurfaced in February 2013, partly reflecting the peak of the lean season for foreign exchange as well as market speculations, but the Kwacha is expected to stabilize at the peak of the tobacco auction season in May-June 2013. While the liquidity situation has somewhat improved with the shutting down of the non-collateralized lending to banks, a number of banks still face liquidity constraints and are increasingly making use of the collateralized discount window at the RBM and the interbank market.

[5] The CPI was rebased this year therefore headline inflation comparisons may not be meaningful.

3.3 While the foundation for economic recovery has been laid, the recovery remains fragile with serious fiscal pressures, especially wage demands, in a pre-election year. Effective implementation of the recently announced expenditure control measures will be crucial in maintaining fiscal discipline. In the meantime, the tightening of the fiscal policy would be key in containing pressures on the exchange rate; as such deliberate efforts to reprioritize and cut expenditure would be needed.

3.4 A second review of Government's ECF program with the IMF took place in February 2013. The Government reached staff level understanding with the IMF on policies for completing the second ECF review. Overall performance under the ECF was satisfactory, with most quantitative targets met. However, the indicative targets on reserve money and social spending were narrowly missed, the latter due to program implementation delays at the start of the financial year. The IMF Executive Board is expected to meet and discuss the findings of the second review in April 2013.

4.0 THE 2011/12 BUDGET OUTTURN AND 2012/13 MID-YEAR BUDGET PERFORMANCE

4.1 The 2011/12[6] national budget was implemented in a difficult macroeconomic and governance environment, which was adversely affected by a combination of events, including significantly reduced donor inflows and tobacco proceeds, higher fuel/fertilizer prices, and the overvaluation of the kwacha, which led to fiscal and external imbalances. The much touted 'zero-deficit budget' was accompanied by a sharp deterioration of the fiscal balance as the Government, instead of adjusting its spending downwards, resorted to increased domestic financing to cover for the loss of budget support grants. The revelation of the accumulation of domestic payment arrears in April 2012 dating back to over 3 years was symptomatic of deficiencies in expenditure controls, in particular, and in the public financial management in general. Of the total outstanding domestic arrears of K72 billion, close to K37 billion accumulated by the State Owned Enterprises were owed to commercial banks.

4.2 There were no substantial increases in statutory expenditures in 2011/12 except interest payments, which increased by 57.8 percent from K19.8 billion to K31.2 billion[7]. This was due to heavy borrowing on the open market through Treasury Bills. Government also stayed within the budgets on internal travel and goods and services.[8] In terms of MGDS and non-MGDS related expenditures, the MGDS related accounted for 56 percent of the total budget.[9]

4.3 The FY 2012/13 National Budget projected half-year total expenditures and net lending of K249.9 billion while total revenues and grants were projected at K242.9 billion, giving a programmed deficit of K7.0 billion. However, the budget continued to experience pressures for the first six months, July to December, 2012 due to the second round effects of the

[6] Government of Malawi, Consolidated Appropriation Accounts for the Financial Year ended 30th June 2012, Vol. I.
[7] Ditto, p6.
[8] Ditto, p7 and Statement 5 (a), p26.
[9] Ditto, Statement 3(a), p20

floatation of the kwacha. The outturn of the first half of the fiscal year was K237.8 billion in revenues and grants against an actual expenditure of K242.6 billion; giving actual budget deficit of K4.8 billion (1 percent of total approved budget) [10]. The Mid-Year 2012/13 budget review projects an end of year domestic revenue collection of K278.8 billion up from K270.4 billion and grants at K182.5 billion up from K124.5 billion. Thus total expenditures and net lending have been revised upwards from K408.4 billion to K475.8 billion. Consequently, grants disbursements will be crucial to support and maintain the budget[11].

4.4 Total domestic revenue and grants for the mid-year budget were estimated at K242.9 billion comprising K133.2 billion domestic revenue and K109.7 billion grants. The K237.8 billion outturn in total revenues comprised K133.8 billion domestic revenue and K104.0 billion in grants. Thus total revenues and grants underperformed by K5.1 billion while grants alone underperformed by K5.7 billion[12]. Total expenditures and net lending also underperformed by K7.3 billion against a projected total of K249.9. At domestic level budget pressures emanated from underperformance of non-tax revenues by K3.6 billion, mainly on account of low fuel levies due to intermittent supply of fuel over the period. Dedicated grants and project grants underperformed by K8.2 billion and K3.6 billion respectively due to implementation capacity constraints in the sectors of health, agriculture and education. Norway did not disburse budget support during the second quarter as planned and reprogrammed the support to dedicated grants. The total revenue situation could have been adverse if it were not for over-performance in budget support, and on account of reprogramming of suspended budget support into dedicated grants, emergency disbursements by Germany and the United Kingdom, as well as exchange rate gains.

5.0 PUBLIC FINANCIAL MANAGEMENT

5.1 Sound public financial management is at the core of budget support and, ultimately, the use of country systems. The review identified a number of issues for close monitoring and/or follow-up, so that the Government builds a strong case for further budget support. It is pleasing to note that the Government and the World Bank have finally signed the Financial Reporting and Oversight Improvement Project (FROIP) under the Public Financial and Economic Reform Program (PFEM RP) and its implementation is expected to start from March 2013. The first phase of the FROIP has a budget of US $8 million out of the total budget of US $ 19 million and subject to positive results from the first phase, funding will be made available for the second phase. It was also noted that there were other PFEM initiatives, which did not require substantial amount of resources such that Government had to timely move forward on those reform areas.

5.2 There are other constraints that add to the challenges in proper financial management and expenditure control, such as the lack of timely submission of PAC Reports and consequently Treasury Minutes, and delays in submission of audit reports due to the absence of the Auditor

[10] Mid-Year 2012/13 Budget, Government of Malawi, pg 9-18.
[11] Ditto, pg 22-26. The salary increment with effect from January 2013 will be contained within the resource envelop.
[12] This grants outturn is against the October ECF review figures and not against original estimates, where grants would have over-performed.

General. These gaps compromise the integrity of the expenditure control systems. It was encouraging, however, to note that other improvements are underway especially in the area of rolling out the Integrated Financial Information Management System (IFMIS) to Local Councils and the enforcing of the Commitment Controls Module in IFMIS from 13th February 2013. Controlling officers will also be required to provide oversight over procurement activities in their institutions and by mid-February the Controlling Officers will also be able to approve high value expenditures online.

5.3 Malawi continues to closely monitor its debt to ensure that it remains sustainable in view of debt servicing pressures. As of December 2012, domestic debt stood at K170.7 billion while external debt was just over US$ 1.0 billion. Thus Malawi is moving cautiously on contraction of new debts. Interest payments were projected for K28.8 billion to the end of the 2012/13 financial year, domestic interest payments accounting for 88 percent. However, the figure is likely to rise on account of increased domestic interest rates and devaluation of the kwacha.

6.0 THE SECOND MALAWI GROWTH AND DEVELOPMENT STRATEGY (MGDS II) AND ECONOMIC RECOVERY PLAN (ERP)

6.1 The CABS DPs were expecting an update on the annual review of the MGDS II in February 2013. However, the update was deferred to a later date. There have been challenges in terms of submission of reports by some sectors. The delayed submissions from the institutions go without sanctions thereby limiting the incentive to comply. Thus, the slow pace in information collection was, among other things, due to administrative challenges, which Government will look into as soon as possible since this may also affect ERP implementation monitoring.

6.2 Efforts have to be made to sustainably accommodate the MGDS II annual reviews under the national budget and institutionalize monitoring and evaluation systems. It was also agreed that the Government will share the revised MGDS II M&E framework with CABS DPs and civil society in order to increase monitoring of MGDS II performance and accountability of public institutions. In future, it is necessary for Government to make strategic plans, such as the MGDS II and ERP, on the basis of the available resource envelop. This therefore, calls for prioritization and realistic costing.

Dated this day of 21st March, 2013

On Behalf of the Republic of Malawi:

Mr. Randson P. Mwadiwa.
Secretary to the Treasury

On Behalf of CABS Group Development Partners:

Peter Woeste
German Ambassador, Lilongwe

C: ANNEXES

ANNEX 1: CABS DISBURSEMENT PLANS[13]

Table 1A: CABS indicative disbursement plans in Millions of foreign currency

Fiscal year / CABS partner	2012/13				2013/14				2014/15	2015/16
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
AfDB (UA)[14]	**26**	**-**	**-**	**4**	**-**	**-**	**-**	**10**	**10**	**10**
DFID (GBP)[15]	**-**	**20**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
EU (Euro)	**-**	**40**	**-**	**-**	**-**	**29**	**-**	**-**	**29**	**-**
Germany (Euro)[16]	**-**	**5**	**-**	**-**	**-**	tbd	**-**	tbd	tbd	tbd
Norway (NOK)[17]	**-**	**-**	**-**	**50**	**-**	**50**	**-**	**35**	**70**	**-**
World Bank (USD)	**50**	**-**	**-**	**50**	**-**	**-**	**-**	**50**	**50**	**50**

[13] These are tentative figures as most DPs are still working on their new budget programs.

[14] The support provided by the AfDB in Q4 of 2012/13 is supplementary budget support to that provided in Q1 of 2012/13.

[15] The support provided from the UK in Q2 of 2012/13 was Emergency Budget Support rather than traditional General Budget Support. This table does not include any further planned disbursements from the UK since this EBS program only had one single payment, and no further program has as yet been approved. The UK will take a view on a possible future GBS program later in 2013.

[16] The support provided by Germany in Q2 of 2012/13 was Emergency Budget Support rather than traditional General Budget Support. The decision on the full resumption of General Budget Support and thus the disbursement of the remaining EUR 10 million will be taken in the course of 2013. Depending on this decision, a new commitment in General Budget Support covering the period starting in Q2 of FY 2013/14 will be discussed in the context of Government negotiations in the second half of 2013.

[17] This depends on approval from the Norwegian Parliament on a new agreement of budget support for Malawi. There are real uncertainties to this approval.

Table 1B: CABS indicative disbursement plans in Millions of local currency[18]

Fiscal year / CABS partner	2012/13				2013/14				2014/15	2015/16
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
AfDB[19]	10,236	-	-	1,574	-	-	-	4,739	4,739	4,739
DFID[20]	-	10,342	-	-	-	-	-	-	-	-
EU	-	14,320	7,160	-	-	13,704	-	-	13,704	-
Germany[21]	-	2,160	-	-	-	tbd	-	tbd	tbd	tbd
Norway[22]	-	-	-	3,178	-	3,178	-	2,224	4,449	-
World Bank	12,700	-	-	17,449	-	-	-	17,449	17,449	17,449

[18] These are tentative figures as most DPs are still working on their new budget programs. For past disbursements the exchange rate of the time of disbursement has been used. From Q4 of 2012/2013 the following exchange rates have been used: USD/MK:348.99; EUR/MK:472.57; GBP/MK:550.58; NOK/MK:63.56; UAPTA/MK:1.36.

[19] The support provided by the AfDB in Q4 of 2012/13 is supplementary budget support to that provided in Q1 of 2012/13.

[20] The support provided from the UK in Q2 of 2012/13 was Emergency Budget Support rather than traditional General Budget Support. This table does not include any further planned disbursements from the UK since this EBS program only had one single payment, and no further program has as yet been approved. The UK will take a view on a possible future GBS program later in 2013.

[21] The support provided by Germany in Q2 of 2012/13 was Emergency Budget Support rather than traditional General Budget Support. The decision on the full resumption of General Budget Support and thus the disbursement of the remaining EUR 10 million will be taken in the course of 2013. Depending on this decision, a new commitment in General Budget Support covering the period starting in Q2 of FY 2013/14 will be discussed in the context of government negotiations in the second half of 2013.

[22] This depends on approval from the Norwegian Parliament on a new agreement of budget support for Malawi. There are real uncertainties to this approval.

<u>ANNEX 2:</u> CABS DPs ISSUES PAPER WITH GOVERNMENT RESPONSES

FEBRUARY 13, 2013

2.1.1 Constitutional and Legislative Amendments, Human Rights

Q: When will the constitutional review process be finalized?

Response:

- ✓ Government is still considering the Report of the Law Commission on the Review of the Constitution with a view to coming up with relevant legislative or other initiatives towards implementation of the recommendations of the report. This remains a priority for Government and some of the recommendations have been enacted such as amendments introducing tripartite elections.

Q: With regard to the elections please provide information on the timetable and the relevant budgetary implications. In particular the DPs would like to know how the Ministry of Finance has taken into account the plans of the MEC to introduce a new voter registration system, as no support from DPs can be expected in this regard. What measures will the Government put in place to facilitate an improved participation of women in the upcoming elections and in decision making?

Response:

- ✓ You may wish to note that a budget for the elections, as per attached copy, was presented to Government and has since been submitted to the Development Partners through UNDP for possible funding. However, we are yet to receive feedback, as such it is difficult to come up with a clear position on the relevant budgetary implications at this point in time.

- ✓ The final electoral calendar (Timetable) will be released as soon as the Elections Budget is approved

- ✓ With regards to facilitation of women participation in the upcoming elections and in decision making, it remains Government's policy to promote women into decision making positions. You may wish to note that MEC has proposed reduced nomination fees for aspiring female candidates in the Parliamentary and Local Council elections, subject to approval by stakeholders, in order to encourage their participation. Government will still continue with the 50:50 campaign.

- ✓ However, it must be noted that the choice of candidates is done at a party level and Government can only lobby but not control the outcome of the same.

Q: When is the Gender policy going to be finalized and what is the Government doing to improve the coordination of different efforts to achieve gender equality?

Response:

- ✓ The Gender policy was adequately reviewed with support from UNFPA. The review was completed and the policy is ready for submission to Cabinet.

- ✓ As regards coordination of different efforts to achieve gender equality, there are dialogue mechanisms in place. These include the Development Assistance Group on Gender, where DPs are involved, that meets on a monthly basis and other national technical working groups that meet to discuss specific interventions such as national response to gender based violence, as well as women, girls and HIV/Aids.

Q: Will the Access to Information Bill, the Asset Declaration Bill, the Public Audit Act Amendment, the Public Procurement Act Amendment and the Marriage Act Amendment Bill be presented to Parliament in the next sitting? If not, how will these processes be taken forward?

Response:

- ✓ It is unlikely that the bills above will be presented to Parliament during the current sitting. However, we wish to report progress as follows:

  - ➢ On the Access to Information Bill, as reported during the last review, the Access to information Policy is yet to be finalized after which the bill can be presented to Parliament. You may wish to note that consultations with key stakeholders have been made up to Directors' Level in the Civil Service. The Ministry is working to host a final consultation meeting with Principal Secretaries to enable them scrutinize and make their input into the document. After the Principal Secretaries' meeting the Policy document will be submitted to Cabinet for approval/adoption.

  - ➢ The Ministry of Information is committed to ensuring that the Bill is presented to Parliament during the Budget Sitting in May, 2013.

  - ➢ As reported during the last review, the draft Asset Declaration Bill is still before Cabinet.

  - ➢ The Public Procurement act review is on-going and once the process is completed including Cabinet endorsement, an amendment bill will be presented to Parliament.

  - ➢ The Marriage Act Amendment Bill was debated by Cabinet and it was referred back to the Law Commission for further consultation on two issues namely: 1) Polygamy and 2) Age at first marriage. After consideration by the Law Commission the Bill will be resubmitted to Cabinet for endorsement before it can be presented to Parliament.

2.1.2 Fight against Corruption, Transparency and Accountability

Q: How can the ACB be made more independent in practice, e.g. with respect to funding and reporting? Why have past ACB reports not been submitted to Parliament and when will they be submitted? What is hampering prompt action on concluded investigations? What progress has the ACB made towards the development of criteria to guide the prioritization of its scarce resources within its choice of investigations and prosecutions?

Response:

- ✓ Government will consider a Constitutional Amendment to make ACB a constitutional body with provisions of how it should be funded as a way of making it more independent. The Bureau can also be made more accountable if the appointment of Director and Deputy Director is made to be competitive such as through an open tender system so that the public is assured of its independence. In accordance with Section 4(4) the ACB reports to the President and the Minister responsible regarding the general conduct of the affairs of the Bureau. The Bureau is further required under Section 21(1) to report to the National Assembly, the President, Cabinet and the Minister on activities carried out in the previous year.

- ✓ The Bureau has not been able to timely submit its Annual Reports as required under Section 21(1) of the Corrupt Practices Act largely due to instability of leadership over the years. However, the Bureau has submitted reports for the years up to 2010/2011. The report for the year 2011/2012 has been finalized and will soon be submitted in accordance with the Act.

- ✓ Although the CPA provides for a lee way on issues of the DPPS's consent to prosecute, where the DPP provides reasons for not granting consent, it takes time for the ACB and the DPP to agree on the way forward. Sometimes ACB may conclude investigations locally but lack of support from other jurisdictions would significantly delay prosecution of certain matters. Requests to countries like South Africa, United States of America, Mauritius, and the United Arab Emirates have not been acted on for over three years now. This has hampered total completion of investigations of cases.

- ✓ The Bureau does prioritize cases by among other things considering the amount of money involved, public interest and potential to recover proceeds. Meanwhile arrangements are being made to engage a consultant to see if more can be done in this area.

Q: What progress has been made with respect to the external audit of the NAO's recurrent budget and the implementation of the NAO-operational plan?

Response:

- ✓ On request from Ministry of Finance to appoint an independent Audit firm for purposes of carrying out audits for the National Audit Office, the National Assembly commenced the procurement process. A technical team from Parliament has completed an evaluation of proposals and awaits approval of the Public Accounts Committee (PAC). PAC is expected to meet on 13th February 2013 to review the recommendations, once it is satisfied, a contract will be awarded to the successful bidder. If everything goes as planned, then an audit report is expected to be submitted to PAC by May 2013 and presented to the whole house during the budget sitting of June 2013.

- ✓ On the implementation of the NAO operational plan, it is worth noting that not much has been done due to funding challenges. However, most of the activities have been taken on board under the Financial Reporting and Oversight Improvement Project (FROIP) whose implementation is expected to commence soon.

Q: What is the proposed timeline for signing up to the Extractive Industries Transparency Initiative?

Response:

- ✓ Progress has been slow on the implementation of EITI in Malawi although the process started sometime back when a Taskforce was formed and a Champion was designated. However, for Malawi to have an EITI candidature status, there are a number of steps to be taken which are currently under consideration. In view of this, it may not be possible to come up with an appropriate time frame.

Q: What steps have the Police taken to strengthen their Internal Affairs Unit (IAU) and clear the backlog of cases of complaints? What progress has been made by the Ministry of Home Affairs and Internal Security on the establishment of an Independent Police Complaints Commission (IPCC) to complement the IAU?

Response:

- ✓ Currently, the IAU has three investigators. However, Government through the Malawi Police Service is strengthening the unit by among other things, recruiting additional investigators. A total of 20 additional investigators will be deployed to their regional offices. These officers, who are already in service, are expected to undergo a two weeks intensive training starting on 8th April 2013.
- ✓ Due to the current austerity measures the IPCC has not been established.

2.2 Macro-Economic Management

The Government continues on the reform path. The successful conclusion of the first quarterly review of the Extended Credit Facility in December 2012 reflects the Government's determination to stay the course. While the foundation for the economic recovery has been laid, the recovery remains rather fragile and is buffeted by a much more difficult external environment. Despite good progress in stabilizing the economy, monetary policy initially accommodated banks' liquidity pressures in the aftermath of the devaluation and there are enormous fiscal pressures from various budget lines. Commitment to implement the expenditure reducing/control measures recently announced is critical in restoring fiscal discipline, stabilizing the exchange rate and containing inflationary pressures. The economic recovery for 2013 is expected to be driven by the recovery in agricultural production and exports, especially tobacco plus other emerging cash crops, as well as other exports in keeping with the diversification drive. The assumptions underpinning the projected real GDP growth of over 5% include good weather, sustained implementation of sound macroeconomic policies to restore internal and external balance and strong aid flows.

Q: Please outline GDP growth rates by sector for the year 2012, including the impact of devaluation on the balance of payments.

Response:

- ✓ During the 2011/12 Fiscal Year, Malawi experienced a number of challenges that resulted in significant slowdown of the country’s economic performance. Malawi’s growth dwindled from an initial MGDS projection of 6.9% to 4.3% in 2011 and further to 1.9% in 2012 from an initial MGDS projection of 7.1%. This was mainly on account of reduced output from a number of sectors following shortages of foreign exchange and essential commodities such as fuel and inputs for manufacturing.

- ✓ Despite overall reduction in the country’s growth in 2012, five sectors registered significant growth. These are: forestry and logging, Fishing and aquaculture, mining and quarrying, information and communication as well as construction. The economy is however expected to perform better in 2013 on account of good agricultural production as well as stable macroeconomic environment.

- ✓ The table below represents GDP growth estimates for 2011 and 2012 preliminary estimates.

Table 1: 2012 GDP Real Growth Rate by Sector

Item Description	2011 Actual	2012 Preliminary
Agriculture, forestry and fishing	6.3	(2.9)
Crop and animal production, hunting and related service activities	6.8	(4.6)
Forestry and logging	5.0	30.6
Fishing and aquaculture	(7.3)	11.2
Mining and quarrying	(4.5)	18.7
Manufacturing	1.6	(6.4)
Electricity, gas and water supply	4.4	3.3
Construction	(2.4)	10.5
Wholesale and retail trade	3.5	2.9
Transportation and storage	2.7	4.8
Accommodation and food service activities	0.4	3.5
Information and communication	6.5	11.9

The Impact of Devaluation on Malawi's Trade Balance

- ✓ Malawi devalued its currency on 7th May 2012. The Malawi Kwacha (MWK) used to be pegged at a rate of MWK 165= US$1. Following the devaluation, the Reserve Bank of Malawi (RBM) has since adopted a floating exchange rate which has seen the MWK depreciate over time. As of 7th February 2013, the mid-rate on international currency markets was MWK 356= US$1. This has had a major impact on both Malawi's exports and imports.

- ✓ Malawi's main exports are agricultural products in particular tobacco, tea and sugar. As Malawi devalued after the harvesting season, farmers were unable to suddenly respond to the new incentive to grow more export crops. Given weaker international commodity prices, Malawi's exports for 2012 are projected to have fallen by 23.0 per cent in Dollar terms however in Kwacha terms Malawi's exports increased by 23.2 per cent in 2012, on the back of higher Kwacha prices. This latter effect is important in incentivizing farmers and manufacturers to re-orientate their business towards the export market, which should see exports in 2013 rise substantially in both Kwacha and Dollar terms. An example of this realignment is already being shown in the tobacco market, with a 60 per cent increase in the hectarage devoted to the crop in the current planting season relative to the past planting season. In 2013, exports are forecasted to rise by 21.0 per cent in Dollar terms and 90.5 per cent in Kwacha terms.

- ✓ In 2012, there were multiple effects impacting on volume and value of imports. The devaluation of the kwacha raised the price of imported goods and hence made domestically produced substitutes more competitive. On the other hand, the devaluation and donor inflow eased foreign exchange (forex) constraints in Malawi, allowing importers to access the raw materials and finished products that they needed. Immediately following the devaluation, the latter of these two effects dominated; the import bill rose because importers responded to a backlog of demand for fuel and raw materials, whose importation had been restricted in the preceding months by a forex queue. However, this effect was relatively short lived and production lines were beginning to be re-orientated towards domestic suppliers by the end of 2012. In 2013, the growth in imports is expected to be much slower than the growth in exports. Imports are expected to grow by 51.1 per cent in Kwacha terms but only 0.3 per cent in Dollar terms.

- ✓ With respect to financial accounts, the economy experienced an increase in public external debt in Kwacha terms although the Dollar amount may not necessarily have changed. This is owing to unfavorable movements in the exchange rate as the MWK continues to depreciate. The devaluation and floatation of the exchange rate was expected to unify official and parallel market exchange rates. It is now evident that the gap has narrowed to less than 5% from more than 80% initially. The reforms that Government undertook including exchange rate adjustment have also resulted in an increase in the foreign exchange reserve cushion. Negotiation of a new Extended Credit Facility (ECF) program with the International Monetary Fund (IMF) and consequently a resolution of misunderstandings with Development Partners resulting in resumption of assistance. Progress towards unification of the exchange rates and continued donor inflows has thus improved the country's reserve position from import cover of less than a month to slightly over one month import cover.

- ✓ Measured by the level of international reserves held by the Reserve Bank of Malawi, the Balance of Payments improved significantly in 2012. Gross official reserves stood at $215.4 million at the end of December 2012 compared to $120.8 million recorded end-April, 2012 soon before the exchange rate reforms were instituted in May 2012. The improvement in gross official reserves could have been even larger had the RBM not provided the magnitude of support it did to the foreign exchange market since May 2012. A total of $327.5 million was sold by the RBM to authorized dealer banks between May and-end December2012. At the same time official foreign payments amounted to US$166.0 million between May and December 2012. Official foreign payments were US$41.3 million during the year to end-April 2012. Meanwhile, the RBM purchased $150.1 million from commercial banks between May and December 2012 compared to zero purchases between January and April 2012. This meant that the system was able to generate some foreign exchange after the May 7, 2012 reforms. The system, nonetheless, needed support from the central bank to clear the import payments backlog that had arisen prior to the reforms.

Q: What measures have been put in place to improve the overall supervision of the banking sector to mitigate risks to banks from exposures to liquidity problems associated non-repayment of loans by suppliers and the deterioration in the quality of their loan portfolios from non-performing loans?

Response:

- ✓ In line with supervisory procedures, commercial banks are required to provide for non-performing loans. The liquidity problem that existed in the banking industry has disappeared. While it is normal for some banks to remain short and others long on their daily positions, it was rather abnormal that the banks could not lend among themselves. An interbank market has now evolved with banks now lending amongst each other to meet their daily liquidity demands. At the same time, banks that had intensive liquidity problems, immediately after May 2012, have corrected their positions and have since moved out of danger. Thus the dangers of a bank collapsing have also disappeared; thanks to the uncollateralized lending window that the RBM provided to banks in distress after May 2012. The uncollateralized window was closed on November 30 and despite the closure no further distress is observable in the financial system.

- ✓ Specifically, there are several prudential measures that have been put in place by the Reserve Bank of Malawi to improve the overall supervision of the banking system. These have mainly been through the following directives:

  (i) **Risks from Exposures:** The Directive on large exposures and credit concentration limits stipulates that a credit concentration shall not exceed 25% of a banking institution's core capital and the aggregate of a banking institution's large exposure and credit concentrations shall not exceed 800% of its core capital. Furthermore, the Banking Act empowers the Reserve Bank of Malawi to stop a bank from lending in the event of a perceived over exposure or risk, or deterioration of its loan book.

  (ii) **Liquidity Problems**: The Directive on Prudential Liquidity Reserve Requirements requires that every banking institution should maintain, at all times, a minimum Liquidity Ratio I of 30 percent and a Liquidity Ratio II of 20 percent. In addition, as part of supervisory intervention, the Reserve Bank of Malawi gave guidance to banks to mitigate liquidity risks. These included:

  - Curtailing lending or outright freeze on new loans;
  - Intensifying deposit mobilization;
  - Suspending expansions in branch network;

- Intensifying the recalling exercise on loans that are overdue;
- Loan securitization to unlock liquidity;
- Requiring banks to recapitalize ; and
- Allowing banks to borrow on the discount window without collateral.

(iii)**Deterioration in the quality of their loan portfolios from non-performing loans**.

The Directive on Asset Classification requires banks to be consistent with regard to valuation of assets and liabilities; impairment of assets, and recognition of income and expenses. The Directive also stipulates that banking institutions properly identify and make provisions on their non-performing assets in line with internationally recommended financial asset classification and provisioning standards.

(iv) Overall, the Bank Supervision Department conducts **quarterly off-site analysis** of the banking sector and prepares reports that help to monitor the overall performance of the sector. The Department also carries out **on-site examinations** to verify the practices on the ground.

Q: How effective has the issuance of Promissory Notes been in addressing the liquidity issues facing some of the big banks?

Response:

- ✓ Initially banks were reluctant to accept these promissory notes as they were skeptical being the first time. However, after discussions with the Reserve Bank, they are now comfortable with the arrangement which is now being used to off- set non performing private sector loans. Our expectation is that the balance sheets of these banks will be clean going forward.

Q: Given the risks associated with the assumptions underpinning the growth projections, what mitigation measures have been put in place to address those risks?

Response:

- ✓ One assumption underpinning the growth projections for 2013 is increased output from a number of sectors including agriculture and manufacturing.

- ✓ As mitigation measures for risks associated with this assumption, we will continue with various reforms that are already being undertaken in the agricultural sector including irrigation, crop diversification and export promotion. In addition, Government intends to stay the course with the economic reforms and the expectation is that inputs into production i.e. fuel and other raw materials will be available due to availability of foreign exchange on the market.

Q: What does the Government see as the key drivers of inflation and the exchange rate for 2013, and what is the outlook for these key variables?

Response:

- ✓ In 2012, the rate of inflation was largely driven by rising food prices following a poor harvest in some parts of the southern region and redistribution was a problem. The problem was compounded by rising energy prices (for both fuel and electricity] owing to the continued depreciation of the Kwacha and implementation of the full cost recovery tariff structure by ESCOM. Rising food prices in the period before the 2013 harvest season, coupled with energy prices and further depreciation of the kwacha remain key challenges in the immediate future. The tight monetary policy that has been adopted by the authorities, together with a tightening of the fiscal situation should help mitigate against these pressures. In addition, there is an expectation for a better tobacco crop in 2013 which should support the generation of foreign exchange, and therefore, the stabilization of the exchange rate and domestic prices.

- ✓ The annual average inflation for 2012 was 21.4%, representing about 14% increase from the 7.6% in 2011. This was mainly on account of unstable exchange rate coupled with increasing fuel prices, increased water and energy tariffs and also poor maize and tobacco production.

- ✓ Inflation rate for 2013 end of period is estimated to remain around 21% as the country is still recovering from the 2011/12 FY economic downturn. It is projected to go down by 10% in 2014 and further by 2% in 2015 as highlighted in the tables below.

Table 2A: Inflation Actual 2012

Year	Month	Overall Inflation		Food Inflation		Non Food Inflation	
		Actual	October 2012 Projection	Actual	October 2012 Projection	Actual	October 2012 Projection
2012	**Jan**	10.3	10.4	3.0	3.0	14.9	18.8
	Feb	11.2	10.9	7.4	6.8	15.5	15.5
	Mar	11.4	11.4	7.5	7.5	15.8	15.8
	Apr	12.4	12.4	8.9	8.9	16.1	16.2
	May	17.3	17.3	12.7	12.7	21.8	21.8
	Jun	20.1	20.1	17.3	17.3	22.7	22.7
	July	21.7	21.7	20.2	20.2	23.0	23.0
	Aug	25.5	25.5	26.0	26.0	25.1	25.1
	Sep	28.3	28.3	27.7	27.7	28.8	28.8
	Oct	30.6	30.1	32.0	28.2	29.4	31.7
	Nov	33.3	30.9	33.4	27.6	33.2	33.9
	Dec	34.6	31.0	34.6	27.9	34.5	33.9
Annual		**21.4**	**20.8**	**19.2**	**17.8**	**23.4**	**23.9**

Table 2B: 2013 Inflation Projections

Year	Month	Overall Inflation		Food Inflation		Non Food Inflation	
		February 2012 Projection	October 2012 Projection	February 2012 Projection	October 2012 Projection	February 2012 Projection	October 2012 Projection
2013	**Jan**	34.0	30.3	36.1	29.3	30.9	30.6
	Feb	31.8	28.0	33.9	27.2	28.7	28.2
	Mar	30.2	26.4	31.7	25.1	27.6	27.1
	Apr	28.5	24.8	28.7	22.2	27.2	26.8
	May	23.5	20.1	24.4	18.2	21.5	20.9
	Jun	20.7	17.5	19.5	13.6	20.6	20.0
	July	19.2	16.0	16.6	10.7	20.1	19.3
	Aug	15.7	12.7	11.2	5.6	18.2	17.4
	Sep	13.3	10.3	9.7	4.2	15.7	14.7
	Oct	12.7	10.2	6.2	3.8	17.4	14.9
	Nov	11.1	10.2	5.0	4.3	15.3	14.4
	Dec	9.9	10.0	4.1	4.1	14.5	14.5
Annual		**20.9**	**18.0**	**18.9**	**14.0**	**21.5**	**20.7**

Q: Please report on progress on the diversification and export generation activities scheduled to take place in FY 2012/13.

Response:

- ✓ Agricultural diversification is vital for economic recovery and recent trends in cash crop prices have only emphasized this. The Government is implementing programmes that are promoting increased production of crops that were identified as key in the Agriculture Diversification Strategy. Under Cotton up scaling, Government has distributed 3,934 MT of seeds to approximately 500,000 registered farmers that have been planted on 262,266 Ha. For tobacco production, Government approved the Integrated Production System in order to improve efficiency in the tobacco market. The system links farmers and buyers through contractual agreements as well as providing sustainable production and improved access to credit by farmers. The Government has expanded production of sugar through sugarcane out grower schemes in Salima, Nkhotakota and Shire Valley. Efforts are underway to develop a regulatory framework that will boost the industry. The Government has distributed legume seeds totaling 1,808 MT to 100,000 farmers, these seeds are sufficient to be planted on 24,305 Ha.

Q: What measures are in place to close the gap between the current electricity tariffs and the operational costs incurred by ESCOM?

Response:

- ✓ Government through the Millennium Challenge Cooperation and the World Bank funded Energy Sector Support project will be engaging a consultant to undertake a cost of production study. The results of this study will help Government and ESCOM in terms of the way forward on the level of electricity tariffs.

3.0 Budget Performance, Public Financial Management and Control

As provided for in the JFA, please provide the following information:

- Revised budget for FY 2012/13 as well as expenditure and revenue outturn for the first half of the fiscal year (once this is provided to Parliament).

Response:

- ✓ The 2012/13 Mid- year budget review will be submitted once it has been presented in Parliament

- The annual Auditor General's Report on the public accounts for FY 2011/12 including the Audited Consolidated Annual Appropriation Accounts for the fiscal year (once these are provided to Parliament).

Response:

- ✓ The Auditor General’s report for the year ended 30th June 2012 will be submitted once it has been presented to Parliament. The Consolidated Annual Appropriation Accounts for the 2011/12 Fiscal year have been finalized and submitted to the National Audit Office. You may also be aware that this year MDAs produced and submitted their financial statements to NAO, these too were submitted individually. We attach the Consolidated Annual Appropriation Accounts for the 2011/12 Fiscal year for your information.

- The most recent Public Accounts Committee (PAC) Chairperson's report.

Response:

- ✓ The most recent Public Accounts Committee (PAC) Chairperson's report was adopted by the Committee in April 2012 and was also adopted by the house. Please find enclosed hereto.

3.1 Outturn of the 2011/12 National Budget

Q: Please indicate to what extent the budget was executed in accordance with the priorities set in the 2011/12 budget.

Response:

- ✓ The 2011/12 Budget did not perform as planned and in accordance with set priorities as the resource envelope had contracted. There were also over expenditures in other votes and as a result, overall, there was heavy borrowing that took place in the year under review. A Financial Statement is provided for further details.

3.2 First Half Outturn and Performance in FY 2012/13

Q: In the first quarter of the 2012/13 fiscal year the Government stayed within the projected expenditure. This was largely due to under-expenditures in the Recurrent Budget, and in particular, subsidies and transfers, interest payments and wages and salaries. Will this result in higher expenditures in the upcoming months due to a backlog?

Response:

- ✓ While expenditures under performed in the first quarter of the year against the program target, Total Recurrent expenditures in the first half of the year were within the programmed amounts except for interest payments which under-performed on account of reduced Government domestic borrowing. To the end of the fiscal year, expenditures are programmed to remain within the Mid Year revised figures.

Q: Could the Government provide a summary of the expenditure and revenue outturn for the first half of the fiscal year and projections for the rest of the financial year broken down to the sectoral level (e.g. health, education) and also budget performance vis-à-vis stated priorities in the budget? Which budget lines overspent / underperformed, why (factors behind the deviations) and what measures are going to be put in place to avoid the same in the remaining half of 2012/13?

Response:

- ✓ A summary of expenditure and revenue outturn for the first half of the fiscal year and projections for the rest of the financial year will be provided once the 2012/13 mid- year budget review has been presented to Parliament.

Q: At the previous CABS Review it was agreed to create an inventory on the external stock of debt. Please provide a summary of foreign debt contracted in the 2012/13 FY by debt instrument. What are the budgetary implications of debt service obligations?

Response:

- ✓ Between July 2012 and January 2013, government has signed a total of eleven (11) new external loan agreements with multilateral and bilateral creditors totaling roughly USD400 million including the ECF loan from the IMF. One or two more loans are in the pipeline. This new borrowing is within the assumed borrowing plan for the 2012/13 fiscal year.

- ✓ According to the Debt Sustainability Analysis of 2012 (report enclosed), external debt service obligations culminating from this new borrowing are projected to remain within manageable levels with no extra pressure on the budget in the medium to long term. Notwithstanding, the instability in the exchange rate remains a major risk to external debt service obligations. We attach a list of the newly contracted loans for your information and further reference.

3.3 Outlook and Priorities for the FY 2013/14 Budget

Q: What measures are being put in place to improve the consultations in the budget preparation process for the 2013/14 national budget with the key stakeholders, including the CABS DPs? Consultations with the CABS DPs on the budget framework would be appreciated before finalization of the preparations and submission to Parliament and it is expected that a full range of budget documentation will be shared with CABS DPs after presentation to Parliament.

Response:

- ✓ The Ministry of Finance will continue to undertake pre-budget Consultations with all the relevant stakeholders in budget preparation including the CABS Group of Donors. The Ministry plans to improve on the pre-budget consultations timing so that the exercise is conducted much earlier than usual to allow enough time to consider issues raised in the consultations process for inclusion in the budget. The Ministry will inform the CABS group regarding the date and time of the meeting at which the Budget Framework for 2013-14 can be discussed with them.

Q: To what extent will the 2013/14 budget incorporate the initial findings from the Public Expenditure Review (i.e. prioritization of expenditures using economic criteria, proposals to include low case fiscal scenario in the event of a shock, efficiency gain issues etc.) in the key sectors, including agriculture, transport, education, health, and social protection.

Response:

- ✓ The 2013-14 budget process will strive to include issues presented in the initial findings from the Public Expenditure Review as highlighted in the preliminary report already issued. The issues raised will be discussed in detail with the respective Ministries during the time their budget proposals will be discussed with the Ministry of Finance. The Budget Hearings are also expected to be conducted much earlier and in more detail. Other players including the DPs can also be involved in these meetings especially for the major Ministries.

3.4 Public Financial and Economic Management

Q: A substantial delay in producing PAC reports and subsequent Treasury minutes has been frequently observed. The PAC through its secretariat has not issued any reports after discussing and examining the Auditor Generals Reports for FY ending June 30, 2008, 2009 and 2010. This situation considerably hampers the efficient follow up of the Auditor General's Annual Reports. While the Executive branch of the Government has, in the past, indicated that it has no control over the Legislature to ensure the timely delivery of PAC reports, it is incumbent upon the Government to ensure that all principles of budget support are observed. What steps have been taken by the Government to resolve the situation?

Response:

- ✓ Delays in producing PAC reports and subsequent Treasury minutes were a result of inadequate staff to support the operations of the Committee. The National Assembly has of late identified and allocated additional staff to support the operations of the Committee. The expectation is that the delays will be minimized or completely eliminated. Perhaps the CABS Group should find a way of engaging Parliament on issues that require their attention since the institution is independent.

Q: Please provide an update on the implementation of the Financial Reporting and Oversight Improvement Project. Which are the immediate priorities for the first year of implementation? Has the Government defined annual working plans with clear indicators for each of the components (External and Internal Audit/Financial Reporting)?

Response:

- ✓ The Financial Reporting and Oversight Improvement Project (FROIP) under the PFEM Reform Programme is in the final stages of preparation. Grant negotiations between

Government and the World Bank, have been concluded. Currently the World Bank is finalizing the internal approval processes and the grant is expected to be signed within February 2013. Currently, procurement processes for both equipment and consultancies are at an advanced stage and Government will soon sign contracts with various consultants and suppliers of equipments.

- ✓ The FROIP focuses on IFMIS and Accounting, Payroll Management, Local Assembly IFMIS, Internal Audit, External Audit and PFEM RP Management as the priority areas. Government has already embarked on the development of the Annual Work Plans to be ready at the time of signing the agreements for the project. Once the work plans are finalized. Government will be engaged in developing lower level indicators which will help track progress of the reforms being implemented.

- ✓ Government expects that once the FROIP is underway, appraisal and project preparation for the remaining components of the PFEM RP will proceed.

- ✓ It is important to note that apart from preparation of the FROIP Government continues to implement other reforms with financial assistance from some Development Partners. These include: support for the IFMIS Business Process Reengineering (BPR) by the EU, finalization of IFMIS roll-out to Local Councils by GIZ, among others. All in all, the PFEM reform process is on track.

3.5 Budget and Expenditure Control

Q: What measures are being put in place to address the risk of contingent liabilities arising from the operations of State-Owned Enterprises, including NOCMA?

Response:

- ✓ Government through the Ministry of Finance (MOF) always strives to minimize the costs and risks associated with guarantees and other contingent liabilities by scrutinizing all proposals for guarantees and direct borrowing by all State-Owned Enterprises. The procedures for managing the Government guaranteed foreign debts are contained in the "*Guidelines on External Debt Management in Malawi*" issued in July 2007.

- ✓ There is a Guarantee Review Committee established under the said Guidelines that reviews all requests from State-Owned Enterprises (SOEs) / parastatals and make recommendations to the Minister of Finance. This comprises the Debt & Aid Management Division (DAD) and the Public Enterprise Reform Management Unit (PERMU), Budget Division, Economic Affairs Division, Accountant General's Department and the Ministry of Economic Planning and Development. The Ministry of Finance also collaborates with the Department of Statutory Corporations when processing applications for guarantees.

- ✓ The MoF through DAD and PERMU monitors implementation of the project for which a guarantee is issued and servicing of the concerned loans. As part of this monitoring process, all SOEs are required to submit to MoF monthly reports on their debt portfolio. The SOE is also required to pay a guarantee equivalent to 0.1% of the nominal value of the guaranteed loan in addition to a specified guarantee processing fee. As for direct borrowing, SOEs are required to seek consent of the Minister of Finance as provided for in the Public Finance Management Act, 2003.

Q: What is the status of the verification of outstanding payment arrears and what concrete measures are in place to ensure that there is no build-up of new arrears? How have commitment controls and the IFMIS control environment been strengthened, and have there been any other measures implemented over and above IFMIS commitment controls? Is there an effective monitoring system to ensure that prompt actions are taken to stop MDAs from accumulating/or attempting to accumulate new arrears?

Response:

- ✓ Verification of outstanding payments and arrears is almost complete. Where possible Government is honoring these payments through promissory notes which can be discounted on the market. For the Development budget, all fast moving projects that require immediate payment, settlement of these outstanding payments is being made and resources are being reallocated within the vote from projects that are stalling. This is particularly common in the Education and Health sector. As for all other arrears outside those sorted out through issuance of promissory notes, the plan is to clear them over time through budgetary provisions.

- ✓ In order to strengthen Commitment Control, the Accountant General's Department has started enforcing the issuance of Ordinary Local Purchase Oder's (LPO) Module in IFMIS. The Ordinary LPO module has been activated and End – Users in Ministries, Departments and Agencies (MDAs) have been trained. LPO Printers have been procured and have since been delivered to the MDAs ready for Implementation. Some Ministries such as OPC, Agriculture and Local Government have already started processing payments through the LPO Module.

- ✓ Further, MDAs have been advised that starting from 13th February 2013, only system generated LPOs will be recognized for purposes of making payments.

- ✓ The department will also implement the issuance of Long term LPOs to reserve the Budget and keep track of Long Term Commitments. This will be installed on the Live Production System from 22nd February 2013. It is estimated that roll out to all MDAs should be finalized by end of April 2013.

- ✓ Other measures implemented over and above IFMIS Commitment control include:

- ✓ The Directive from the Office of the President and Cabinet that Internal Procurement Committees should be chaired by Controlling Officers will enhance oversight over procurement.

- ✓ The Department has issued a circular aimed at enhancing the internal controls environment. The circular has among other issues emphasized on the following:

  - ➢ Intention by the Department to enforce online segregation of duties between accountants and functional managers.

  - ➢ That the Department will by 15th February 2013 activate system based approval threshold. This will compel controlling officers to approve high value expenditures online.

- Reminded MDAs on the usefulness of Reconciliation as a tool for validating data integrity. (copy of the circular attached)

Q: Please provide an update on the impact of the recently announced austerity measures on expenditure, i.e. whether savings are being made and if so where

Response:

- ✓ It is important to note that the austerity measures were announced in December 2012 and these measures have not yet been evaluated to see their impact. We may have to wait for at least three months have to elapse to meaningfully assess the effect on the budget.

4.0 Sector Issues

Q: Is the Government planning to reform the financing system linked to the procurement of medicines to ensure that adequate funding is available (for instance a model where a substantial portion of funds is transferred directly to CMST, with CMST operating virtual accounts for DHOs)?

Response:

- ✓ Following the persistent drug shortages Government has swiftly and poignantly moved in, reviewed the mechanisms and systems for procuring and supplying drugs in our Hospitals and began implementing measures that will decisively and efficiently deal with the problem. A number of systemic weaknesses and challenges in the Drug procurement and supply were observed. Notably, the review has established that there are major accountability and management challenges across the supply chain. The review has also showed that there is a lot of drug pilferage, misuse and thefts.

- ✓ This is also being compounded by the fact that there is weak legislation and mechanism for dealing with the culprits caught in these malpractices. Often times, cases for people caught in these malpractices do not end in successful convictions and even where one has been found guilty and convicted; the penalties are too lenient to act as a deterrent to other would be offenders. Against this backdrop, Government intends to tighten legislation surrounding this matter as well as achieve effective prosecution of the culprits involved so that on one hand, all those caught involved in these malpractices should be successfully convicted and prosecuted and on the other hand, sentences that should be meted out on those convicted should be tough enough to deter others from engaging in these malpractices.

- ✓ These proposals will be presented to the National Assembly for debate and eventual passing into Law. A proposal to have all the Drugs and Medical supplies dispersed through our Hospitals properly labeled as Malawi Government is also being pursued to deter those who sell or exchange them outside our Hospital system.

- ✓ Government also plans to re-programme the way Drugs are procured and supplied to District Hospitals and Referral Hospitals, the plan will be that Hospitals will simply supply their requirements to the Central Medical Stores, and once delivered; payments to Central Medical Stores will be either direct from Treasury to CMST or through MoH or Local Government Finance Committee. To regulate the provision of medical supplies and equipment from Private Suppliers Government intends to develop legislation that will be passed by the National Assembly to regulate this business.

Q: What is the Government planning to do to prevent rising food insecurity other than the FISP? How does the Government plan to take forward the discussion on the long-term future of the FISP?

Response:

- ✓ The Ministry of Agriculture & Food Security and its collaborating partners are making efforts to deal with issues of rising food insecurity through various programs in an attempt to promote increased and diversified agricultural production. The Ministry has put in place programs such as the Sustainable Agriculture Production, Aquaculture Production, Fruit Promotion, Cotton Up-Scaling, Legume Production, and Livestock Development Programs, among others. The goal of all these programs is to contribute to poverty reduction and improved food security among the rural poor and in the process overcome prospects of food insecurity.

- ✓ The Implementation of the Farm Input Subsidy Program (FISP) is being guided by the Farm Input Subsidy Program Medium Term Plan. The Medium Term Plan provides a clear implementation direction so as to help project resources required and coordinate mobilization of such resources for its successful implementation. The Plan is from 2011 to 2016 and will be reviewed thereafter. It will be therefore during that review period that discussions pertaining to the long-term future of the program will be initiated. The recommendations that will be made will determine the future of the Farm Input Subsidy Program.

Q: Please provide information on how ADMARC has performed on the procurement of maize for the Strategic Grain Reserves for FY 2011/12 in line with the allocations in the National Budget for replacements. Is the Government planning to amend the guidelines for managing the Strategic Grain Reserves, given that these guidelines require funding for the replenishment to be in place before any release of maize, which in 2012 almost resulted in a refusal to distribute available maize from the reserve to those in need? How does the Government plan to provide emergency food aid in the future in a case where donors are not able to step in on short notice?

Response:

- ✓ ADMARC was allocated MK1.3 billion to buy 20,000 MT (later adjusted to 19,690 MT due to price fluctuations) for replenishment of the Strategic Grain Reserves. The Corporation managed to purchase 18,442 MT of maize during the period. While in the process of procurement, authority from Treasury was granted to ADMARC to use the maize procured by selling to the public with the agreement that the proceeds from the sales will be used to replenish the SGR during FY 2012/13. A report summarizing the activities of ADMARC was shared with Ministry of Finance.

- ✓ The Strategic Grain Reserve Committee recommended that a Task Force made of the Ministry of Agriculture and Food Security, World Bank, USAID, Ministry of Finance, World Food Program (WFP), National Food Reserve Agency (NFRA), and Grain Traders and Processors Association (GTPA), meet to review guidelines in place for the Strategic Grain Reserves. The Task Force agreed that a comprehensive study was necessary. The objective of the study is to ensure that the Strategic Grain Reserve has clear guidelines for both emergency and non-emergency management and release of maize from the Strategic Grain Reserve. The Terms of Reference have been developed and currently the Task Force is in the process of procuring the services of a consultant to conduct the study with financial support from World Bank. The main expected outputs of the study are as follows:
    - Assessment report on the operations and management of the Strategic Grain Reserve;
    - “Options” report for improved management (improved governing and decision structures, modalities for decision and management, mechanism, etc.);
    - Proposed mechanism for regular adjustment of stocks in SGR; and Guidelines for SGR emergency and non-emergency draw downs.

Q: With indications that the Global Fund may be reducing its support to Malawi, what plans do the Government have to reduce donor reliance in fighting HIV and AIDS related challenges?

Response:

- ✓ The current US $ 208 million Global Fund (GF) SSF Grant will end in June 2014. The bulk of the resources in the SSF are for treatment, care and support including ART and PMTCT. As per GF policy patients already on ART will be supported by the GF for a further period of 24 month beyond the end date of the existing grant. If there is no follow up on GF grant after SSF, there will be a funding gap for HIV and AIDS interventions.

- ✓ Government through the department of Nutrition, HIV and AIDS (DNHA) with support from Development Partners came up with an options paper in 2012 which outlines possible avenues for mobilizing local resources to complement the current HIV /AIDS support most of which is external. Using this Options Paper government will engage stakeholders to come up with viable options for mobilization of resources for HIV /AIDS.

5.0 Poverty Reduction, Malawi Growth and Development Strategy (MGDS) and ERP

Q: What monitoring mechanism has been put in place for the ERP? What are the baselines and benchmarks?

Response:

- ✓ An M&E Framework for the ERP has been put in place for monitoring the implementation of the ERP. See the attached table for the baselines and benchmarks.

Q: When does the Government expect to complete the first MDGS II Annual Review and release the final report?

Response:

- ✓ The first MGDS II Annual review has been finalized and the final report is expected to be released by end February, 2013.

Q: What lessons does the Government draw from the sobering results of the IHS3? Which measures need to be undertaken by the Government and / or the DPs to ensure that future growth translates more effectively into poverty reduction?

Response:

- ✓]

ntegrated Household Survey (IHS3) collected information on demographic characteristics; education; health; time use and labour; housing characteristics; food security; household expenditures; household enterprises and agriculture among others. One of the *key findings* of the IHS 3 is the high poverty incidence across the country of

50.7 percent, with 25 percent of the population being ultra-poor despite the country's impressive growth rates in the last five years. Further to this, it was observed that there are high income inequalities between the urban and the majority of the population living in the rural; but also high fertility and mortality levels leading to poor quality of life and hence very little productive time for the majority of the population. These consequently wipe out the country's growth gains through the social sector i.e. the health sector

- ✓ In order to reduce the levels of poverty and ensure that economic growth and sustainable development are achieved, the Government will in addition to the national development strategies:

  - ➢ improve on the economic empowerment programmes of the rural masses especially women to ensure inclusive growth,
  - ➢ ensure that programmes aimed at reducing mortality and fertility rates should be emphasized in the country's development policies and strategies,
  - ➢ Will mainstream population issues including family planning in development planning at all levels, and
  - ➢ Will ensure that emerging issues such as issues of elderly persons, climate change are taken on board in implementation of development goals.

ANNEX 3: GOVERNMENT ISSUES PAPER WITH CABS DPs RESPONSES

A. ISSUES FOR THE FEBRUARY 2013 REVIEW

1.0 Aid transparency and predictability

- In 2008, Development Partners committed themselves to "publicly disclose regular, detailed and timely information, allocation and when, available, results of development expenditure to enable more accurate budget, accounting and audit by developing countries, support information systems for managing aid and provide full and timely information on annual commitments and actual disbursements".

- It is important to note that Malawi Government and most of its Development Partners including all members of the CABS group are International Aid Transparency Initiative (IATI) signatories. This implies that we are all committed to promoting aid transparency. However, disclosure of aid flows on a timely and regular manner remains a challenge, we therefore request as follows:

  - ✓ We are yet to get a disbursement plan for 2013/14 to 2015/16 and confirmation for 2013/14 commitments. Unless Government properly plans for aid, it can never yield intended results. **Can the CABS Development Partners provide information in a rolling three year to conform to the Medium Term Expenditure Framework and confirm the 2013/14 commitments?**

Response:

The CABS Development Partners are well aware of the importance of predictable funding information for the Government's budget preparations. Therefore we have provided a disbursement plan for the budget support after the May review in accordance with the Joint Framework. Government usually also requests all donors to provide information on disbursements during the budget process, and CABS Development Partners will respond to such request when it is made.

At the same time it should be noted that information on future commitments and disbursements can only be estimated. Reliability depends among other things on the ability of Development Partners to pledge budget support in general, the Government's adherence to the underlying principles of budget support, the outcome of CABS reviews and of the IMF's assessment and can be influenced by implementation issues. Moreover, estimates will naturally be more reliable at the beginning of a new programming cycle of a Development Partner than towards the end before a new agreement has been concluded with Government. Finally, it is only possible for Development Partners to provide data on plans in existing approved programs which may well not cover a three year period.

2.0 Aid Disbursement

- Government is worried with the shifting of "goal posts" in as far as disbursement conditions are concerned.

- The Government of Malawi plans its Budget based on funds pledged by donors and domestic resources. Withdrawal of support from cooperating partners in the course of the fiscal year on account of shortfalls in meeting funding criteria poses a great risk to the budget. Government of Malawi struggles to meet all current commitments and targets within its resource envelope.

  We propose as follows:

  ✓ **Once disbursement conditions have been agreed upon, both parties should not provide additional conditions in the course of implementing the agreement unless proper consultations are made.**

  Response:

  As a principle, Development Partners do not alter disbursement conditions after financing agreements have been signed. The impression that Development Partners are "shifting goal posts" might result from the fact that the underlying principles of budget support are not precisely defined in detail in an exhaustive list, but are general principles which are subject to concretization. This is due to the political nature of budget support: Budget support is a political instrument, not a technical mechanism. As such it contains financial transfers, political dialogue, capacity development and a performance assessment. The observation of the underlying principles is not just our goal, but a prerequisite for budget support to continue. Regarding pooled funding and discrete funded projects it is our impression that standard disbursement conditions – such as the proof of the use of funds for the intended purpose through the timely production of complete and unqualified audit reports – are sometimes not adhered to, and the resulting implementation of these standard conditions is then interpreted as a "shifting of goal posts".

  ✓ **Prior actions or triggers for disbursement must be within the agreed Performance Assessment Framework. It should also be clear to both parties on what conditions disbursement will be based.**

  Response:

  As donors we try to harmonize our disbursement conditions and be predictable. At the same time the PAF defines only a limited set of target indicators and does not incorporate the underlying principles that must be met for disbursements to be made. Therefore, Development Partners may have varying needs to explicitly reflect particular priorities of their decision making bodies in bilateral agreements that may not always be included in the PAF. Thus, fulfillment of PAF indicators does not necessarily mean that underlying principles are fully met.

- ✓ **All current year pledges of funds, once made and allocated, should be maintained in that year, and that sanction for breach of conditions on Government be made in the subsequent financial year.** In which case the Government of Malawi will be informed of the amounts to be available for disbursement in the forthcoming year at the point of planning.

Response:

We recognize that reliable funding information is important for the Government's planning processes and that this is part of the international declarations of aid predictability and efficiency that we have adopted. However this does not exclude anti-corruption measures and the strict conditions for budget support. If there is overwhelming evidence of large scale corruption / misuse of funds with donor aid in a program, it would not be sensible to continue disbursing money into that program and to wait for the next fiscal year to apply sanctions. Immediate action in case of severe breaches of conditions is an important part of justification of our aid to our taxpayers. Continued disbursements in such a high risk scenario would not aid the Government's development goals. Financial disbursements must be seen to be a means to an end and not an end in themselves. But as budget support partners we are committed to continue to make sure that in advance of the suspension of disbursements a political dialogue takes place which gives the Government the chance to avoid these consequences. This was the case for all Development Partners before their suspension of budget support in the beginning of 2011.

3.0 Alignment to Government systems /priorities and harmonization of Development Partners programs

- The current framework with regards to budget allocations to the various sectors is very rigid; up to 35% is to be allocated to the social sectors of Education 20%, and Health 15%. If Government is to fully align the budget allocations with the MGDS II priorities and indeed the Economic Recovery Program (ERP), it will require flexibility in budget allocations so as to be able to strike a balance between the social and economic sectors. **Is there room for donor consideration on flexibility in budget allocations so that budget allocations may be aligned with MGDS priorities and the ERP?**

Response:

The Abuja target of committing 15 % of domestic resources to health has been agreed upon by AU member states, including Malawi. Thus, it is not a Development Partner-imposed requirement. The HSSP JFA merely stipulates that the relative allocation of domestic resources to the health sector should not decrease over the course of HSSP implementation from its pre-HSSP level of 9.6 %. This corresponds to the nature of the Swap which should not lead to the crowding out of Government's budget allocations to a specific sector. Given the current situation in the health sector, where the Government is not able to procure the most essential medication for its population, it is highly questionable whether a further reduction of the allocations to the health sector would be justified. Whilst we agree that fiscal discipline is essential at this difficult time, these targets are percentages, not absolute figures, so they only require that restraint not be applied more strongly to health and education than to other sectors, not that there be no restraint at all.

- The country is currently facing serious economic challenges as a result of the recent policy changes. At the same time we are experiencing food shortages in some parts of the country which further draws on our limited resources and limits our ability to achieve our MDGs.

  Can donor support be expanded to assist Malawi in this challenging period including the implementation of the Economic Recovery Plan?

  Response:

  It is our view that Development Partners have been forthcoming in finding ways of providing support to Malawi in this period. From the time when the President came into office until the end of 2012 Development Partners have supported the Government with more than 600 million USD. Current FY grants amount to 124 billion KW (30.4% of the budget) as compared to 42.6 billion KW in 2010/11 (21.7% of spending) and 31.6 billion MK in 2011/12. In addition we have frontloaded part of our funding in order to make it available earlier than planned. It is now important to focus on a speedy implementation of projects in line with the original schedule so that the financial inflow can stay in line with the forecast. Development Partners will always be open to discuss additional specific funding needs which are necessary for the economic recovery of the country, but within limited capacity and available funding a clear prioritization from the Government is important.

- Government has noted with concern that Development Partners continue to field uncoordinated missions. This involves visiting the same institutions repeatedly which is time consuming and undermines institutional capacities. **Can these missions/ assessments be combined by having comprehensive TORs that address each donor's concerns?**

  Response:

  Development Partners agree that harmonisation and alignment are important. We have a strong interest in reducing parallel missions and are willing to explore options of joint Fiduciary Risk Assessments in the future.

B. ISSUES FOR DISCUSSION IN OTHER FORA

4.0 Alignment to Government systems /priorities and harmonization of Development Partners programs

- Basket funding is one of the preferred aid modalities for Malawi. It is for this reason **that Government would like to encourage its Development Partners in the Agriculture Sector to pool their resources**. Discussions are ongoing in the sector on funding modalities for the Agriculture Sector Wide Approach (SWAp). The current programming allows discrete funding, however this brings capacity challenges in the areas of planning, coordination, monitoring and reporting.

Response:

Development Partners acknowledge the use of discrete funding for this fiscal year 2012/2013. Development Partners are committed to greater harmonisation of resources, and welcome the Government's leadership in encouraging pooled resources. In particular, several development partners are looking to contribute to the pooled World Bank ASWAp Trust Fund over the next few months. We also look forward to further discussions with Government on strengthening their financial and planning systems, and dialogue with Development Partners (not all of whom are in CABS) around plans and resources, which are some of the pre-requisites needed to enable some development partners to move towards pooled funding. We would also encourage the Government to harmonise the various initiatives relating to agriculture (such as the ERP, NES, and Presidential Initiative) to make it easier for donors to align to a single Government plan. In addition, in order to facilitate pool funding, GoM is encouraged to strengthen PFM issues on Agriculture, specifically fostering transparency on procurement and budget controls on FISP.

- The country is currently facing serious economic challenges as a result of the recent policy changes. At the same time we are experiencing food shortages in some parts of the country which further draws on our limited resources and limits our ability to achieve our MDGs.

  Can donor support be expanded to assist Malawi in this challenging period including the implementation of the Economic Recovery Plan?

Response:

This question has been answered under 3.0.

- It has been noted that the agreed allocation to the health sector is narrow and that to impact on health status an inclusive approach is needed. **Classifications of support to health should be reviewed to include other sectors such as agriculture, nutrition, water and sanitation and HIV etc**.

Response:

The measurement of the health sector allocation follows the WHO definition which is based on an internationally recognized framework for the collection of expenditure information for National Health Accounts: http://apps.who.int/gho/indicatorregistry/App_Main/view_indicator.aspx?iid=93
In this context and considering that the HSSP JFA does not impose an absolute level of health spending (see above) it is questionable whether this debate should be pursued further. However, if the Government sees a need to deviate from international standards,

it needs to take up a respective discussion in the Health Donor Group. Should a revision be accepted, it cannot lead to duplication of accounting and the Government should provide retroactively figures following the new classification of health so we can assess that the Government allocation has not decreased.

- Government has noted with concern that Development Partners continue to field uncoordinated missions. This involves visiting the same institutions repeatedly which is time consuming and undermines institutional capacities. **Can these missions/ assessments be combined by having comprehensive TORs that address each donor's concerns?**

Response:

This question has been answered under 3.0.

5.0 Aid transparency and predictability

- In 2008, Development Partners committed themselves to "publicly disclose regular, detailed and timely information, allocation and when, available, results of development expenditure to enable more accurate budget, accounting and audit by developing countries, support information systems for managing aid and provide full and timely information on annual commitments and actual disbursements".

- It is important to note that Malawi Government and most of its Development Partners including all members of the CABS group are International Aid Transparency Initiative (IATI) signatories. This implies that we are all committed to promoting aid transparency. However, disclosure of aid flows on a timely and regular manner remains a challenge, we therefore propose as follows:

  - ✓ Unless Government properly plans for aid, it can never yield intended results. **Can Development Partners provide information in a rolling three year to conform to the Medium Term Expenditure Framework in a timely manner?**

Response:

This question has been answered under 1.0.

  - ✓ **Government finds it hard to access information from some embassies and international organizations instrumental in compiling its national accounts. Can information be made available to Government in good time to enable us compile our national accounts on time?**

Response:

CABS Development Partners provide regular information within the Government's Aid Management Platform or – if the Platform is not working – through excel sheets. If any information is missing, the Government should raise this bilaterally with the Development Partners that have not made the information available.

- ✓ Aid predictability remains a challenge both in terms of timing and amounts. When commitments have been made and confirmed they are not timely honored, often less than the agreed amounts, if honored at all. This creates pressure on the budget and has far reaching adverse effects on service delivery. This is more pronounced in sectors with the discrete arrangement. **To what extent is the CABS group able to advocate with other partners (both pool and discrete) in the sectors to ensure predictable and more effective use of aid?**

Response:

The CABS Development Partners are not responsible for the predictability and efficiency of other partner's assistance. The Government should raise this issue with the respective Development Partners in the relevant sector fora.

6.0 Provision of Technical Assistance

- Technical Assistance (TA) has the potential to address capacity issues, where it is well aligned to national priorities and policies. **Government remains concerned that provision of Technical Assistance (TA) in some cases is not demand driven.** Poorly aligned TA undermines the very capacity challenges it intends to address and depletion of resources. Can our Development Partners including the CABS partners help Government in reducing supply driven TAs? Can they further align their TAs with capacity needs of Government?

Response:

CABS Development Partners provide TA on the basis of a respective request from the Malawian Government. The Government providing the specific Terms of Reference for TA is a prerequisite for granting such assistance. Thus it is up to the Government to clearly define what type of support it needs. The CABS Development Partners encourage the Government to raise specific examples with the respective CABS Development Partner and to define in which areas more or less TA is needed.

- Results from a recent resource mapping in the health sector showed that large amounts of resources from some partners are spent on overheads and technical assistance and not much for direct service delivery. Can development Partners including the CABS partners help in reducing both overheads and technical assistance costs. Can provision of TAs first be provided local experts who will be less costly and other resources be utilized for direct service delivery?

Response:

The overheads and technical assistance for the health sector from the recent resource mapping includes the cost of the donor's management of the aid. It should be noted that running cost of the donors institutions are on separate budgets and will not be converted into grants in the case of savings. Several of the donors do also use locally recruited staff to provide TA, but in some cases international experience can also be highly beneficial for increasing the effectiveness of the programs in question. Further the PFEM challenges within the health sector have led to increased costs in the management and monitoring – some of these overheads for example are necessary to provide fiduciary safeguards in areas such as procurement. This was a precondition for resuming the support to the health SWAp. Implementation of the PFEM program and improvements in the national systems are expected to lead to reduced losses and improved value for money in this area in the future.

7.0 Use of Country PFM Systems:

- The Government understands the risk associated with channeling resources through national systems. Government is, however, concerned with the reluctance of the donors in using the country systems despite some improvements. It is worth noting that our country systems can only be improved if they are used. **Commitments are needed regarding using country systems, especially in the light of the PFEM Reform Program which is being implemented and will go a long way in improving the PFEM systems. Can our Development Partners including the CABS help us manage the risks associated with using our systems than avoiding them altogether? Can our DPs increase their financial assistance to the PFEM RP?**

Response:

Since the CABS Development Partners use country PFEM systems to the fullest extent possible by providing budget support and some also by providing pool funding to SWAps in education and health and support to the Multi Donor Trust Fund (MDTF) for the Public Finance and Economic Management Reform Program (PFEM RP), this concern should be directed to the appropriate non-CABS Development Partners. However, the use of country systems depends on their quality. This is reflected in the fact that strengthening PFEM systems is one underlying principle for the implementation of budget support programmes. Therefore, in order to persuade Development Partners to adopt aid modalities that use country PFEM systems to a greater extent, we encourage the Government to demonstrate that their country PFEM systems are sufficiently robust and are being reformed and improved continuously.

Development Partners acknowledge the efforts made by the Government to define a comprehensive PFEM Reform Program seeking to strength PFEM national systems. Nevertheless, it is worthwhile mentioning that PFEM systems remain weak in Malawi. The impact of the previous plan on the PFEM reform process has been limited, as is illustrated by the modest improvements between the PEFA assessments of 2008 and 2011. Some critical dimensions to increase the use of national systems as accounting, recording and reporting and

External scrutiny and audit ranked from C+ in 2008 to D+ in 2011. The implementation of the new comprehensive PFEM RP which has been formally adopted by the Government in February 2012, and the MDTF, has been limited. The formulation of the FROIP has not been completed. Moreover, at policy dialogue level, the Government committed to revive quarterly GFEM meetings during the last meeting in September 2012 but no follow up has taken place. Substantial donor funds which have been made available for this program have not yet been utilised. We would suggest that implementation needs to start before further funds are required. Moreover, Government systems will not only improve if they are used, rather they will improve more if these systems have greater independence (NAO, ACB) and stronger accountability structures with appropriate institutions. Development Partners provide significant support to the strengthening of institutions as the NAO and the ACB and various areas of the PFEM system.