February 2001
IMF Country Report No. 01/38

Malawi: 2000 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; Public Information Notice and Press Releases on the Executive Board Discussion; and Statement by the Authorities of Malawi

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2000 Article IV consultation with Malawi and request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV consultation with Malawi and request for a three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **October 29, 2000,** with the officials of Malawi on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 11, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **December 21, 2000,** updating information on recent economic developments.
- a Public Information Notice (PIN) and press releases, summarizing the **views of the Executive Board as expressed during its December 21, 2000, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the authorities of Malawi.

The document(s) listed below have been or will be separately released.

Enhanced Heavily Indebted Poor Countries Initiative—Decision Point Document and Press Release
Interim Poverty Reduction Strategy Paper
Joint Staff Assessment of the Interim Poverty Reduction Strategy Paper
Letter of Intent by the authorities of the member country*
Memorandum of Economic and Financial Policies by the authorities of the member country*
Selected Issues and Statistical Appendix
Technical Memorandum of Understanding*

*May also be included in Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the 2000 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by Anupam Basu and Masood Ahmed

December 11, 2000

- Discussions on the Article IV consultation and on a program to be supported by a three-year Poverty Reduction and Growth Facility (PRGF) arrangement were held in Lilongwe during December 2–15, 1999; March 23–April 12, 2000; August 30–September 15, 2000; and October 29, 2000.

- The Fund staff teams included Messrs. Nowak (head for the December mission), Shields (head for the other missions), Kammer, Fanizza, Hossain, Odedokun, Atang (all AFR), Benicio, and Tadesse, Ms. Lukonga (all PDR), and Mr. Fournel (FAD). Mr. Gibson (Resident Representative) also made an active contribution. Mr. Munthali from the Malawi Executive Director's Office participated in some of the discussions. Members of the World Bank staff worked closely with the Fund, and many joint meetings were held with the authorities.

- The Fund teams met with President Muluzi, Vice-President Malewezi, Ministers of Finance Chilumpha and Chikaonda, Reserve Bank Governor Ngalande, and other senior government and central bank officials and representatives of Malawi's civil society.

- Malawi accepted the obligations of Article VIII, Sections 2, 3, and 4 in December 1995 and maintains an exchange regime free of restrictions.

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Executive Summary

Malawi is requesting support for an economic program under the Poverty Reduction and Growth Facility (PRGF) to succeed its 1995–99 ESAF arrangement. A decision point document for the enhanced HIPC Initiative is being distributed simultaneously.

During the 1995-99 ESAF arrangement:

- **Malawi achieved initially a high annual GDP growth rate (averaging 10 percent) and a substantial reduction in inflation (from 75 percent in 1995 to a low of 7 percent in 1996).** Subsequently, however, inflation picked up and growth slowed to 4 percent. A large proportion of the population remained in poverty.

- **Macroeconomic discipline was reestablished through a reduction in the fiscal deficit** (from 15 percent of GDP in FY 1994/95 to 3 percent in FY 1996/97) and **a tightening of the monetary stance.** Some of these gains were later lost during policy slippages and accumulation of arrears in 1997.

- A substantial program of **structural reforms** was implemented. These will help mitigate the effects of Malawi's **dependence on a single crop (tobacco)** and a secular decline in the **terms of trade.**

In 2000:

- Real **GDP** growth has been maintained at between 3 percent and 4 percent (see table below).

- **12-month consumer price inflation** is projected to end the year at 30 percent after a short-lived reduction.

- **The exchange rate has depreciated sharply.** It fell to MK 80 against the U.S. dollar at end-October from MK 44 at end-1999. Important influences were the real appreciation of 40 percent since end-October 1998, expectations that receipts from tobacco exports would decline, and a monetary expansion in midyear.

- The **fiscal deficit declined marginally** in FY 1999/2000 and the **current account deficit is narrowing** despite the increase in oil prices and lower tobacco prices.

- **Liberalization** of maize and petroleum marketing has been consolidated, and major improvements initiated in the **control and monitoring of public spending and borrowing.**

The discussions centered on a strategy to improve Malawi's growth record and raise the income levels of the poor. The major elements of the strategy are drawn from an interim poverty reduction strategy paper that was developed by the government in consultation with civil society:

- establishing macroeconomic stability;
- restructuring and prioritizing public expenditures and strengthening public sector management;
- eliminating the remaining obstacles to a free and competitive market economy; and
- designing and implementing a social safety net.

The fight against HIV/AIDS will also need to be strengthened and major governance issues should be tackled.

The program for 2000-01 will have the following features:

- **A reduction of inflation to 10 percent by end-2001**, growth of at least 3 percent, and an increase in the level of gross reserves to 4.7 months of imports.
- Money will be the nominal anchor. **Twelve-month reserve money growth will be slowed to 13.8 percent by end-2001**. The overall fiscal deficit (including grants) is to improve by nearly 5 percent of GDP, largely reflecting higher grants (see table below).
- The **expenditure control system will be strengthened**, financial operations of parastatals will be more tightly controlled, and privatization of public enterprises will be extended. At the same time, the liberalization of the agriculture and the petroleum sectors will be sustained.
- **Crucial governance issues will be addressed**, including the pursuit of charges in cases of fraud and corruption and the recovery of misappropriated funds.

The staff agrees with the authorities' objectives and believes that the quantitative targets, while ambitious in the light of recent exchange rate developments, are achievable. They will require steadfast implementation of the announced monetary and fiscal policies, and in particular a strengthening of the newly implemented expenditure control system. The staff recommends approval of the program.

Malawi: Selected Economic Indicators, 1999-2001

	1999	2000	2001
Real GDP growth (in percent)	4.0	3.2	3.0
Inflation rate (end of period, percent)	28.2	30.0	10.0
External current account deficit (after grants) (in percent of GDP)	-8.3	-7.8	-7.7
Fiscal deficit (after grants) (in percent of GDP) 1/	-5.0	0.0	0.0
Broad money growth (end of period, percent)	33.6	20.9	16.8

Sources: Malawian authorities; and Fund staff estimates.

1/ For 1999/2000, 2000/01, and 2001/02 (July/June).

I. INTRODUCTION

1. The 2000 Article IV consultation discussions took place between December 1999 and October 2000. The discussions also covered an economic program to be supported under the Poverty Reduction and Growth Facility (PRGF), and Malawi's eligibility for debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative).

2. Although agreement was reached with the authorities on a framework for economic policies on a preliminary basis in December 1999, discussions about finalization of the PRGF arrangement were protracted. This delay primarily reflected the slow pace of dealing with the consequences of the domestic spending arrears identified in December 1999 that had been accumulated in 1998 and 1999. Before being able to make commitments on fiscal policy, it was essential for the authorities to quantify arrears and to take effective steps to prevent their recurrence. This uncertainty also led to delays in bringing Article IV documentation to the Board.

3. In a letter to the Managing Director dated December 8, 2000 (Appendix I), the Malawian authorities outline the targets of economic policy for 2000 and 2001 and request support under a three-year PRGF arrangement. Access under the arrangement would be SDR 45.11 million (65 percent of quota) and be made available in seven equal semiannual tranches of SDR 6.44 million. Malawi's outstanding use of Fund resources amounted to SDR 56.9 million (82 percent of quota) as at October 31, 2000. Malawi's relations with the Fund are summarized in Appendix II.

4. The Executive Boards of the Fund and the World Bank decided, on August 23 and 24, 2000 respectively, that Malawi meets the eligibility criteria for consideration of debt relief under the enhanced HIPC Initiative. A HIPC Initiative decision point document is being issued to the Fund Board with this staff report. An interim poverty reduction strategy paper (interim PRSP) has been prepared by the authorities and discussed with the staffs of the Bank and the Fund; it is also being circulated concurrently, together with a joint staff assessment.

5. At the conclusion of the 1998 Article IV consultation with Malawi on December 18, 1998, the Executive Board welcomed the reestablishment of a track record of satisfactory policy implementation in the third year of the Enhanced Structural Adjustment Facility (ESAF) arrangement after slippages in carrying out the adjustment program under the second annual ESAF arrangement. Directors noted that the economy remained fragile and underscored the importance of more consistent policy implementation. In particular, they urged fiscal consolidation through improved management of public sector resources and a broadening and acceleration of structural reforms.

6. Malawi's economic program has been designed in close collaboration with the World Bank and other members of the international community. The World Bank is expected to approve a single-tranche adjustment credit in an amount of US$55 million under the third

Fiscal Restructuring and Deregulation Program in December 2000. Malawi's relations with the World Bank Group are summarized in Appendix III.

7. There are significant weaknesses in Malawi's national accounts, balance of payments, fiscal, and price statistics despite efforts, supported by an IMF-funded resident advisor, to effect improvements. Notwithstanding these weaknesses, staff expect that monthly data to be reported to the Fund should allow for adequate monitoring of the Fund-supported adjustment program, but with some risk. Statistical issues are detailed in Appendix IV.

II. BACKGROUND

A. Poverty and Growth in Malawi

8. Malawi is one of the poorest countries in the world. Per capita GDP was US$163 in 1999[1], and about half of the population[2] lives below the poverty line. Other critical social indicators confirm that, even by the standards of sub-Saharan Africa, conditions for Malawi's households are particularly severe (see table below). The HIV/AIDS pandemic[3] has compounded Malawi's development problems.

Selected Social Indicators in Malawi and Other Countries

	Malawi	Sub-Saharan Africa	Low income
Life expectancy at birth (years)	42	50	63
HIV/AIDS, adult prevalence rate (percentage, ages 15-49; latest year available)	16.0	7.6	1.2
Illiteracy rate (percent of people aged 15 and above)	41.8	40.5	31.3
Infant mortality (per 1,000 life births)	134	92	68

Sources: World Bank, *World Development Indicators 2000* and United Nations Development Program, *Human Development Indicators.*

[1] Using the Atlas method for computing per capita GDP, Malawi was ranked as the 7th poorest country out of 206 identified in the World Bank's, *World Development Report* 2000/01.

[2] Preliminary results of the Integrated Household Survey (IHS) put the number of people living below the poverty line (1997-8) at 64 per cent in the country as a whole, and 43.7 per cent in urban areas; other estimates are lower (for example, the World Bank, (*World Development Report,* 1995) identified 43 per cent of the population as living below a basic needs line).

[3] See Box 1 and "Selected Issues" (forthcoming).

9. Most of Malawi's population is dependent on subsistence farming. Hunger is common during the growing season of the basic crop, maize, and sporadic droughts compound the food security problem, although the last two years have seen bumper harvests. A high population density is leading to an overintensive use of land; soil degradation and deforestation are widespread. Malawi has limited exploitable natural resources, and the modern sector of the economy is rudimentary. The bulk of Malawi's export earnings (64 percent) still comes from tobacco.

10. Growth has been slow, and its fruits have been unequally distributed.[4] Per capita income has risen by less that 0.6 percent per year since 1975. This slow growth has been associated with low savings and investment rates, compared with the world and other sub-Saharan African countries (see "Selected Issues" forthcoming). Malawi has been the recipient of substantial foreign financing, leaving it with a stock of external debt at end-1999 equivalent in net present value terms to 82 percent of GDP and 269 percent of exports of goods and non-factor services. Sixty percent of nominal debt is owed to IDA.

B. The 1995–99 ESAF Arrangement

11. **During the first half of its 1995-99 ESAF arrangement, Malawi made overall progress in stabilizing its economy.** The overall fiscal deficit (including grants) was reduced from 15 percent to 3 percent of GDP between FY1994/95 and FY1996/97 (Table 2). This reduction reflected significant measures taken to curtail expenditures and to improve tax administration and revenue collection, and was achieved at the same time that social expenditures were expanded and free primary education introduced. The fiscal adjustment facilitated a tightening of monetary policy, supported by significant measures implemented by the Reserve Bank of Malawi (RBM), including the curtailment of automatic access by the government to central bank credit, open market-type operations, a wider base for reserve requirements and the raising of interest rates on central bank credit facilities. **In response, the 12-month inflation rate declined from 75 percent in 1995 to 7 percent in 1996. Real GDP increased by 10 percent** on average during the years 1995-97, reflecting in part a rebound from drought, assisted by favorable weather conditions and liberalization in the agricultural sector (Figure 1).

12. **A temporary loss of fiscal discipline in FY 1997/98** led to a rise in the cash fiscal deficit (excluding grants) of 4 percentage points of GDP and a substantial accumulation of arrears. The monetary stance was eased to accommodate the large domestic borrowing of the government, the external performance worsened, and the exchange rate depreciated by 40 percent between end-July and end-November 1998. **Following a break in the ESAF program, control over fiscal and monetary developments began to improve during a six-month staff-monitored program from April to September 1998, and during the**

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[4] The Gini coefficient has been estimated at about 0.6, one of the highest in the world.

third annual ESAF arrangement in 1998-99.[5] However, inflation rose again and remained high throughout 1999 (consumer prices were 45 percent higher than in 1998).

Box 1. HIV/AIDS

Malawi is among the countries most heavily affected by HIV/AIDS. About 16 percent of the adult population, roughly 1 million people, is currently known to be infected. The pandemic is still spreading. The serious obstacles this raises for development are described in "Selected Issues" (forthcoming). Among the features identified are the following:

Population growth. Recent projections suggest a fall to at least 2.5 percent per year and perhaps below 1 percent by the end of the decade, compared with just over 3 percent growth in the absence of AIDS.

Broad economic effects. Productivity may be declining, as there is a disproportionate effect on those of prime working age, and perhaps among better-educated and professional workers. Absenteeism and disruption of production, associated with caring for the sick and orphans, and time lost for funerals are reducing productive output.

GDP growth. One study suggests that AIDS will reduce GDP growth by 1.5 percentage points and per capita income by 0.3 percent per annum, compared with an actual annual increase in per capita income growth over the 1975-98 period of 0.6 percent.

Fiscal impact. Additional spending on health care, replacement of public sector employees (particularly in education), the accommodation of absences, and the absorption of lost revenue will have substantial effects on the budget. In addition, HIV/AIDS prevention and control measures already absorb about 1 percent of GDP.

13. **A broad-based structural reform program** was implemented during the ESAF program. Government monopolies and controls on agricultural marketing and trade were abolished, permitting a considerable expansion in smallholder production of cash crops. The ground was laid for the elimination of restrictions on petroleum importation, and petroleum prices became market based. Substantial progress was also made in improving tax administration, in particular with the establishment of the independent Malawi Revenue Authority (MRA) (which started operation in February 2000). An ambitious program for privatization was launched, although only 35 (mostly small) companies were sold out of an ultimate target of 100.

14. Developments in Malawi's **external current account** were influenced largely by the effect of exchange rate movements on import demand and the performance of the tobacco sector (Figures 2 and 3). Sharply lower imports, following the 32 percent real effective

[5] The cash budget was effective in delivering planned outlays; however unreported arrears of domestic spending were accumulated in contravention of a performance criterion. The Executive Board granted a waiver for misreporting on August 23, 2000 (EBS/00/145; 7/18/00).

depreciation of the kwacha in 1998, led to a temporary improvement in the current account deficit (excluding grants) in 1998; however, the deficit worsened again to 17.1 percent of GDP in 1999 as the nominal exchange rate stabilized and tobacco receipts fell (Table 5).

C. Recent Economic Developments

15. **GDP growth for 2000 is projected at 3.2 percent (Table 1).** Agricultural output has been strong, assisted by favorable weather conditions, but this has contributed only modestly to year-on-year growth as a bumper maize crop was also harvested in 1999. The modern sector of the economy has been restrained in 2000 by high real interest rates in the early part of the year and uncertainty over macroeconomic developments. **Twelve-month consumer price inflation declined** from 28 percent at the end of 1999 to 22 percent in June, but subsequently rose again to 35 percent in October 2000. The upturn partly reflected the **sharp depreciation of the exchange rate against the U.S. dollar beginning at end-April** and further petroleum price increases. The depreciation followed a period of relative stability in the nominal exchange rate against a background of much higher inflation in Malawi than in its trading partners: the real effective exchange rate was 40 percent higher at end-April 2000 than at end-October 1998 (Figure 2).

16. **The external current account deficit, excluding grants, is expected to show an improvement in 2000,** narrowing to about 15.2 percent of GDP from 17.1 percent in 1999. A substantial reduction is expected in import volumes from the high levels of 1999, but this will be offset by a sharp drop in the terms of trade as a result of a 60 percent year-on-year increase in oil prices and a 3½ percent decline in export prices for tobacco.

17. **The liberalization of agriculture has led to a rapid increase in the number and output of tobacco smallholders.** However, in the first three quarters of 2000, returns were squeezed as average prices of raw tobacco on the auction floors fell by about 25 percent, (considerably more than those of exported processed tobacco). In combination with low domestic maize prices and rising fertilizer costs, this decline reduced rural incomes, offsetting some of the positive effects on food security and poverty of the bumper maize crop.

18. **A major initiative to improve the control of public spending and borrowing was announced by the new Minister of Finance and Economic Planning in March 2000.** The **"10-point plan"** included measures to curtail extrabudgetary spending, improve the monitoring and control of spending commitments, formalize financial limits for parastatals, clarify responsibilities of ministries and officials, and make monetary policy decisions more effective and transparent. Parliamentary support for the proposals has been strong.

19. **The fiscal deficit (including grants and after allowing for identified domestic spending arrears) fell from 5.5 percent to 5.0 percent of GDP between FY 1998/99 and FY 1999/2000.** Revenue performance was strong: relative to GDP, revenue rose from both income taxes and international trade, despite cuts in customs tariffs. Wages and salaries fell

as a proportion of GDP. However, there was substantial unprogrammed expenditure on maize and vehicles.[6] Further domestic arrears were accumulated.

20. **A tight monetary stance was adopted at the beginning of 2000 in order to slow broad money growth from the 34 percent rate recorded during 1999.** Yields on three-month treasury bills were allowed to rise above 20 percent in real terms (Figures 1 and 4). **The RBM also provided much more foreign exchange to the market than normal.**[7] The kwacha remained fairly steady against the U.S. dollar until mid-April, and broad money growth began to fall. However, as the opening of the tobacco auctions approached and the size of the speculative buildup in foreign currency deposits became clear, the RBM stopped quoting daily foreign exchange rates and withdrew from its active stance in the market. The kwacha began to fall. Downwards pressure increased when the auctions opened as a result of the large fall in tobacco prices. Meanwhile, 91-day treasury bill yields were still around 40 percent in June.

21. **Subsequently, the RBM allowed 91-day treasury bill yields to fall,** with the rates reaching 24 percent by mid-September.[8] Money market liquidity rose strongly as large redemptions of treasury bills issued for sterilization as well as a cut in reserve requirements from 35 percent to 30 percent at end-June were not fully offset by mopping-up operations. The rate of depreciation of the kwacha increased, and by end-September it had fallen to MK 74 against the U.S. dollar. **Following discussions with Fund staff, the authorities tightened the monetary stance.** The RBM embarked on a program to mop up excess liquidity by issuing its own sterilization bonds and allowed interest rates to rise. Reserve money was cut by 12 percent (5 percent on a seasonally adjusted basis), interest rates on 91-day treasury bills rose from 26 percent to 34 percent, and the exchange rate began to stabilize at about MK 80 to the U.S. dollar at end-October.

III. Report on the Discussions

A. Medium-Term Strategy for Growth and Poverty Reduction

22. **The main challenge for Malawi is to move to a higher growth path**. Fund and World Bank staffs discussed with the authorities the inherent structural factors that have

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[6] The government also borrowed US$4 million on behalf of members of parliament (MPs) to purchase vehicles; MPs will repay the loans in kwacha at an interest rate currently set at 10 percent, with the exchange risk met by the government.

[7] Gross international reserves declined between end-December 1999 and end-April 2000 by US$31.6 million.

[8] The authorities surmised that interest rates had previously been higher than necessary for monetary purposes, reflecting some stickiness associated with oligopolistic financial markets and expectations that the policy stance would not be maintained.

impeded performance in the past, including highly concentrated agricultural production; susceptibility to drought and volatile commodity prices; a landlocked position in a region that has experienced disruptive conflicts; population pressures; and uncertainty over land rights. In addition, many structural policies before 1994 were distortive and inegalitarian. More recently, HIV/AIDS has imposed an extra burden. But these factors do not fully explain the poor performance relative to other sub-Saharan economies, particularly as Malawi has some major advantages, including civil peace, fertile agricultural and fishing resources, and a record of considerable donor support (see "Selected Issues" forthcoming).

23. Policy discussions with the authorities therefore focused on the main areas where it was clear that Malawi's recent performance could be improved: macroeconomic stability; the development of the private sector; and the size, efficiency, and priorities of the public sector. These issues are addressed in the interim PRSP that the government has produced in consultation with civil society. **The government's strategy has four main pillars for growth and poverty reduction:**

- **To attain macroeconomic stability** through monetary restraint and a further reduction in domestic borrowing by the public sector. This will reduce inflation, allow an expansion in private sector investment, and support growth.

- **To restructure and prioritize public expenditures**, strengthen public sector management, and improve the delivery of public services to the poor.

- **To create a conducive environment for private sector development**, in particular by improving marketing infrastructure and land tenure for smallholder farmers, and by creating a competitive environment and completing restructuring and privatization transactions in electric power, telecommunications, and banking.

- **To design and implement a comprehensive and cost-effective social safety net**, in the first instance by improving the targeting of the existing "starter-pack" program, which distributes free seeds and fertilizer to the rural poor and making the National Food Reserve Agency (NFRA) a strategic food reserve.

In addition, the fight against AIDS will require redoubled efforts to increase awareness, promote preventative measures, and provide care for the sick and their dependents.

24. The **key macroeconomic objectives for the period 2000–03** are to obtain sustainable growth in real GDP of at least 4½ percent; reduce inflation to 5 percent; increase gross international reserves to about 4.8 months of imports of goods and nonfactor services; and maintain a fiscal stance that will improve the domestic balance[9] and provide for a

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[9] The domestic fiscal balance only includes those components of the overall deficit that arise from transactions with the domestic economy and omits those transactions directly affecting (continued)

reduction in domestic debt (¶6-9).[10] Assistance is being sought under the enhanced HIPC Initiative of US$14.7 million in 2000/01, US$32.5 million in 2001/02, and US$44.2 million in 2002/03 (EBS/00/260, 12/7/00).

25. It is recognized that **growth performance will need to be enhanced** if average living standards are to rise appreciably and poverty is to be reduced. **Achieving this objective will require higher savings and investment rates over the longer term, together with further structural reforms and high levels of foreign aid.** Greater stability, increased economic opportunities, effective safety nets, and higher and better-targeted public spending in the social sectors will improve the circumstances and potential for the half of Malawi's population that is currently below the poverty line, as outlined in the interim PRSP.

26. **A priority will be to improve the targeting and efficiency of public services.** In recent years, weak public expenditure management has manifested itself in the buildup of expenditure arrears; weak recording of contingent liabilities and the activities of parastatals; and the government's resorting to supplier credits in financing budgetary expenditures. These problems will be addressed through the new system for controlling and monitoring commitments; the new credit allocation mechanism for government accounts; and the introduction of the Integrated Financial Management and Information System (IFMIS) and a new unit in the Ministry of Finance for monitoring parastatals. Priorities will be articulated and pursued through the PRSP, public expenditure reviews (PERs), and the medium-term expenditure framework (MTEF).

B. The Program for 2000-01

27. The authorities agreed that the macroeconomic program for 2000-01 should first and foremost focus on a firm reestablishment of macroeconomic stability. Inflation should be reduced to 10 percent by end-2001. The level of gross international reserves should rise to 4.7 months of imports. The authorities cautiously project real GDP growth of 3 percent for 2001 (¶12).

Fiscal policies

28. **Further reductions will be targeted in the domestic fiscal balance** to relieve demand pressures on domestic prices and reduce domestic debt. These reductions will also contribute to lower interest rates and provide room for increased private sector credit from the banking system. (¶18-25).

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the balance of payments, i.e., it attempts to measure the direct impact of government operations on domestic absorption.

[10] All paragraph references are to the Memorandum of Economic Policies, Appendix I, Attachment I.

29. **An overall fiscal balance (including grants) is targeted for FY 2000/01** compared with a deficit of 5.0 percent of GDP in FY 1999/2000. The improvement reflects a substantial further increase in grants (up by 4.1 percent of GDP over the previous fiscal year); the overall deficit, excluding grants, will decline from 12.3 percent of GDP to 11.4 percent of GDP. The large foreign aid inflows, amplified by the kwacha depreciation, reflect primarily the mobilization of multilateral and bilateral donors to foster Malawi's economic and social development (including interim relief under the HIPC Initiative) and, to a lesser degree, the sustained drive toward a better recording of foreign-financed projects within the budget.[11] Health and education expenditures are budgeted to increase to 7.6 percent of GDP in FY 2000/01 from 5.6 percent of GDP in FY 1999/2000.

30. With regard to **domestic budgetary arrears**, the Auditor-General reported on November 28 that arrears of MK 554 million[12] and contested claims of MK 475 million (relating to transactions in 1996-97 and compensation for late payment) were outstanding at end-June 2000. The authorities are committed to discharge the remaining arrears and contested claims, if verified, during the current fiscal year. A benchmark under the program also commits them to discharge any newly verified arrears within a quarter. To prevent new arrears, commitments entered into by line ministries are now being monitored through the new commitment control system in order to limit them to authorized ceilings.[13]

31. **Interim relief under the HIPC Initiative,** starting in January 2001, is expected to amount to more than MK 1 billion (1 percent of GDP) for FY 2000/01. The government has indicated that it intends to use HIPC resources of 0.4 percent of GDP for purchases of drugs and teaching materials. Once identified during the PRSP process, currently unallocated resources will go to priority areas.

32. **The ratio of tax revenue to GDP is expected to increase to 17.3 percent in FY 2000/01 from 15.7 percent in FY 1999/2000,** largely reflecting the impact of the kwacha depreciation and oil prices on import duties, excise duties, and the surtax on imports.[14] The other main factors enhancing revenue will be the increases in petroleum duties

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[11] Substantial donor funds nevertheless remain outside the budget.

[12] This includes arrears of MK 165 million that were discharged by issuing treasury bills to suppliers.

[13] Standards of performance are implemented to ensure that controlling officers abide by the guidelines.

[14] The buoyancy of the surtax is partially masked, as the surtax on imports was replaced by excise duties on petroleum products.

[15] The most prominent cost recovery measures are fees for motor vehicle, passport and immigration documentation and higher levels of tuition for tertiary education.

and cost-recovery measures announced in the budget.[15] Offsetting these will be some losses in customs duties as a result of the implementation of the Common Market for Eastern and Southern Africa (COMESA) free trade area (¶27) and some reductions in income taxes. Although the budget fell short of extending the surtax into a full-fledged value-added-tax (VAT), the existing surtax will be extended from the manufacturing sector to the wholesale and retail stages in FY 2001/02.[16]

33. **Current primary expenditure is expected to increase from 14.1 percent of GDP in FY 1999/2000 to 14.5 percent in FY2000/2001.** This rise is mainly accounted for by a substantial increase in the wage and salary bill, which reflects a catch-up with past inflation and the monetization of benefits-in-kind.[17] Nevertheless, the wage and salary bill will remain considerably below its average level in the mid-1990s in terms of share of GDP (5.3 percent in 2000/01, including 0.4 percent of monetized benefits-in-kind). Two important features of this year's measures are that they provide the possibility of considerably enhanced remuneration for higher-level public servants[18] and that they progress the monetization (and, hence, also transparency) of benefits-in-kind, including replacing the provision of costly, inefficient, and inequitable housing. These measures will decompress the wage structure. Although they have been widely advocated,[19] the measures may generate pressure for increased remuneration for other groups, and hence fiscal tensions.

34. **Considerable pressure may also arise in other areas of current primary expenditure, which is set to decline overall as a proportion of GDP.** Although some of the reduction in the ratio of spending to GDP results from the decision to stop maize purchases

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[16] This will be nearly equivalent to a full VAT; the submission of legislation on the extension of surtax is a prior action for the program.

[17] The rise in the wage bill includes a general wage increase for public servants of 15 percent, a wage creep worth 5 percent, and an increase in housing allowances for most employees from 15 percent to 25 percent of salaries. In addition, some top civil servants will be moving to performance-based contracts that provide for large increases in remuneration in return for lower job security; public servants living in houses rented on their behalf by the government will henceforth receive housing allowances; and transport allowances for Members of Parliament have been considerably enhanced in cash terms (¶ 19).

[18] The combination of the contract scheme and the changes in housing allowances could result in an estimated 300–400 percent increase in remuneration for some civil servants. Some 340 employees are eligible for the new contracts, and 75 have so far been allowed to retire and take up contracts.

[19] See EBS/99/192, Box 3 (10/7/99), for a presentation of the noncompetitiveness of the public wage structure.

and to improve the targeting of the starter-pack scheme, the need to accommodate a large projected increase in transfers (reflecting payments to HIV/AIDS victims and relatives) implies a substantial reduction in other expenditures. To this effect, the government will reduce its vehicle fleet, foreign travel expenditures, and outlays for embassies. **Interest payments will increase substantially in FY 2000/01, rising from 3.7 percent to about 4.5 percent of GDP.** The increase largely reflects, for domestic debt, the sizeable rollovers of treasury bills in FY 1999/2000, when interest rates were at very high levels, and, for foreign debt, the depreciation of the kwacha.

35. **There are two risks to the overall fiscal outlook that require particular attention**:

- The possibility remains of a further accumulation of **arrears**, although with a much diminished risk that they will not be identified. This reflects significant but incomplete progress in implementing the new commitment control system (CCS) (see Box 2). Remaining shortcomings include: (i) noncompliance on reporting requirements by a number of large ministries; (ii) uneven progress across ministries in the management of the new system; (iii) significant problems in the quality of data reported by ministries to the Ministry of Finance; and (iv) incomplete reconciliation of special transactions with CCS data.

- **The large parastatal sector may require further financial subventions from the central government.** The NFRA, in particular, has not been able to service the substantial debt toward commercial banks that it accumulated to finance maize purchases; its interest obligations alone now amount to MK 356 million on a principal of MK 550 million. Even if substantial further maize sales are concluded this year, the proceeds will be insufficient to cover operating expenses and service the loans during this fiscal year. Although the projections of central government spending already incorporate the costs of meeting the NFRA's interest payments, it is possible that further charges will fall on the central government. Similar concerns arise with other parastatals because information about their finances (including contingent liabilities) is poor and capacity to control their expenditure is currently weak. Improvements are being planned by the newly created Parastatal Enterprise Reform and Monitoring Unit in the Ministry of Finance, but gains are likely to come slowly.

36. Within the overall fiscal envelope, **the authorities are endeavoring to improve the prioritization and efficiency of government spending.** This effort has been assisted by the Medium Term Expenditure Framework (MTEF) in recent years, but the MTEF is still in development and is not yet integrated sufficiently into the budget process to have a sustained impact. The 2000/01 budget process did, however, reflect a PER conducted in 1999/2000. This led, for example, to improved focusing of outlays on some critical public services and more cost-recovery measures. Increasingly, the aim of such exercises will be to ensure that pro-poor expenditure is prioritized and protected.

Box 2. Spending Control

Malawi's capacity to monitor and control public expenditure has been weak. In December 1999, a technical assistance mission from FAD requested by the Minister of Finance identified some substantial unreported arrears that were later confirmed by the Auditor-General's investigations. These arrears have since been settled, and the IMF Executive Board has granted a waiver for the noncomplying disbursement implied by the unreported arrears.

However, this buildup of arrears symptomized serious deficiencies in the public expenditure management system: (i) an incremental approach to budgeting based on the previous years' budget; (ii) a reliance on cash rationing rather than commitment monitoring to control expenditure; (iii) insufficient coordination between the Ministry of Finance, the line ministries, and the central bank to monitor debt and cash management; (iv) the absence of routine controls and audits over line ministries' financial management and data reporting; and, more generally, (v) a lack of sustained willingness from the authorities to enforce hard budget constraints.

Improvements have been sought to remedy these shortcomings. In the short term, and with the support of IMF technical assistance, the authorities are implementing a commitment control system. The new reporting requirements will enable tracking of unreasonable lags between the commitment and the payment stages and allow for quick corrective actions. Moreover, new cash arrangements have been made with the commercial banks to avoid the simultaneous buildup of both idle cash positions and borrowing. In parallel, efforts to implement an Integrated Financial Management and Information System (IFMIS), allowing for immediate reporting on the status of commitments taken and payments made, have been stepped up with World Bank assistance. This computerized system will be tested on a pilot basis in four departments by the end of 2000.

37. **Improved procedures for monitoring and tracking spending allocations are also being adopted.** The authorities have improved the quality of monthly data sent to the Ministry of Finance on functional spending by departments. This information is being disseminated in a quarterly report, one month after the end of the quarter. The report shows spending in priority social areas, as well as in those nonpriority areas from which spending is being reallocated.[20]

Monetary policy

38. To prevent a repetition of the periodic weakening in monetary policy and exchange rate management, which have impeded stabilization efforts in the past, the following strict guidelines will be observed (¶14-17):

- **The authorities will use money as the nominal anchor in their disinflation effort.** Money supply growth is targeted to fall to 21 percent and 17 percent during 2000 and 2001, respectively.[21] Despite a relatively tight monetary stance in 2001, the reduction

[20] See Box 2 in EBS/00/260 (12/7/00).

[21] Velocity of broad money is projected to increase in 2000, reflecting the recent slippage in monetary policy and deeply entrenched inflationary expectations, before declining over the medium term.

in domestic financing of the budget will allow an increase in private sector credit of 35 percent in real terms.

- **Reserve money will be the operational target.** Growth in reserve money will be reduced to 18 percent and 14 percent during 2000 and 2001, respectively. Net domestic assets are projected to decline substantially, reflecting substantial net repayments of credit by the government and permitting achievement of a targeted increase in net foreign assets of almost 80 percent of beginning-of-period reserve money. To address temporary shortfalls in external assistance of the budget, the program has a built-in adjuster, which would allow for higher domestic financing. Given the highly seasonal patterns of government revenue and expenditure and the swings in the demand for broad money, together with the uncertain timing of external assistance, this approach will demand periods both of substantial injection of liquidity and its withdrawal. Open market operations will be the main instrument for managing liquidity in domestic money markets.

- **The exchange rate will be market determined.**[22] Intervention in the market will be limited to meeting the target on net foreign assets and performing seasonal smoothing operations. As external financing flows to the budget are substantial, the RBM will, however, be a net seller of foreign exchange.

39. **The reserve requirements were reduced at end-June, 2000 from 35 percent to 30 percent. However, they are still imposing a heavy tax on financial intermediation through the banking system.** Much of the spread between lending and deposit rates, of about 20 percentage points (Figure 4) is due to unremunerated reserve requirements. The staff urged a speedy reduction in reserve requirements, subject to monetary conditions. The authorities recognize the burden that the reserve requirements impose on financial intermediation and intend to lower them further, when liquidity conditions allow; an alternative would be to remunerate them in part or fully. **The staff welcomed the ceiling of 25 percent that had been established on the proportion of required reserves that could be kept on call at the sole discount house, the Continental Discount House (CDH).** They

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[22] In the past, Malawi's real effective exchange rate has exhibited considerable volatility. Large deprecations have been followed by periods of stability in the nominal rate, which, alongside higher inflation rates than its trading partners, have led to reversals of the gains in competitiveness. These periods of real appreciation have sometimes reflected attempts to stabilize the economy through (generally informal) exchange rate anchors and sometimes the impact of sizable aid flows (see "Selected Issues" forthcoming). The effects on the real economy have generally been adverse: nascent recoveries in nontraditional exports have been stifled and consumer imports have risen strongly. Consistent adherence to monetary targets and ambitious targets for reserves accumulation should limit the risk of a repetition of these events, while allowing the real exchange rate to reflect changes in the terms of trade or other fundamentals.

noted, however, that this still provided a substantial privilege to CDH. While designed to encourage the development of discount houses and, hence, more liquid debt and money markets, this privilege distorted incentives and complicated monetary management. **The staff therefore urged its elimination as early as possible.**

40. **The authorities are committed to further improving monetary management.** A Monetary Policy Committee of the RBM has been established to consider monetary conditions, determine and publish operational targets, and assess progress. It meets monthly and publishes minutes after its meetings.[23] The RBM will also implement a book-entry system to develop and foster competition and efficiency in the government securities' market (¶ 26).

41. **The banking system remains sound.** At end September, 2000, the banking system's average risk-weighted capital-to-asset ratio was at about 24 percent and nonperforming loans declined to about 2½ percent of assets. The authorities intend to further strengthen banking supervision and prudential standards in 2001 (¶31).

External sector

42. **Gross reserves are targeted to increase to 4.7 months of imports in 2001.** The authorities stressed that Malawi's vulnerability to terms of trade shocks, drought, and volatility in external aid flows required a strong buffer. There was a concern that if reserves were sustained much below current levels they might be insufficient for public confidence and that even temporary shortfalls could precipitate a currency crisis.

43. **Two factors are likely to dominate the short-term outlook for the balance of payments on external current account**: this year's rapid decline in the kwacha exchange rate and declining receipts from tobacco sales relative to the peak levels of 1997-98. The net effect in 2001 is expected to be a decline in the current account deficit —before grants— from US$151 million to US$135 million. However, there are considerable uncertainties, particularly concerning the response of trade volumes to the fall in the exchange rate. In 1998, the response was swift but short-lived, but this may mainly have reflected the widespread anticipation of the fall and the subsequent stickiness of the exchange rate in nominal terms.

44. Of more lasting consequence is the **prospect for tobacco,** which in 1999 accounted for 64 percent of exports (equivalent to about 15 percent of GDP). **The projections for 2001 and beyond assume that no further falls in prices will be experienced**: prices will rise

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[23] Government observers include the Secretary of the Treasury and the Principal Secretary of the National Economic Council (NEC). High-level and technical committees have also been set up to meet frequently to discuss the financing needs of the budget and the timetable for the disbursement of external assistance (¶ 33).

largely in line with World Economic Outlook (WEO) forecasts for world tobacco. The performance of **nontraditional exports** in 2000 has been disappointing, with values (equivalent to under 4 percent of GDP) projected to decline by over 4 percent. This performance has reflected restrictions on textile exports to South Africa and the effects on producers of high real interest rates. A strong recovery is now anticipated, assisted by agreements with South Africa consequential on the Southern African Development Community (SADC) trade pact that came into force in September 2000, and by the substantial real deprecation of the kwacha.

45. **The external current account is continuing to benefit from sizable foreign official transfers,** which will reduce the deficit in 2000 from 15.2 percent of GDP to 7.8 percent. Nevertheless, and despite capital inflows of US$104 million, there is expected to be an **overall balance of payments deficit** of US$31 million in 2000 and a reduction in the coverage of official gross reserves to 3.9 months of imports of goods and nonfactor services; these reserves will need to be rebuilt in subsequent years. In 2001, while capital inflows are forecast to rise even further, a financing gap of US$50 million is projected. This is expected to be met primarily through debt relief under the HIPC Initiative (see HIPC Initiative decision point document) estimated at close to US$34 million for 2001.

46. The immediate agenda for trade reform in Malawi is limited as it already has one of the most liberal trade environments in Africa. Based on an IMF index of restrictiveness of trade regimes, Malawi has a rating of 3 (on a scale of 1 to 10 with 10 being the most restrictive), compared to an average rating of 5.4 for sub-Saharan African countries and 4.5 for developing countries excluding Africa. There are no non-tariff barriers, except for restrictions that are maintained for health and security reasons. The maximum tariff rate is 25 percent and average tariffs are around 16 percent. Malawi joined the COMESA free trade area on its establishment on October 31, 2000 and will participate in the evolution of the SADC free trade area launched on September 1, 2000 ("Selected Issues" forthcoming).

Social Policies

47. The authorities are fully committed to alleviate poverty and have prepared, in consultation with civil society, a **National Safety Net Strategy.** The four major elements of this strategy will be a food security measure-the Targeted Input Program (TIP)- an expanded public works program, a targeted nutrition program, and direct voucher transfers to disadvantaged groups, such as orphans. The TIP will be a targeted version of the largely donor-financed **starter-pack** schemes of 1998/99 and 1999/2000 that distributed free fertilizer and seeds to all rural families. Responding to donor insistence that future schemes be more finely targeted, and to concern from Fund and Bank staff about the cost and the possible creation of dependency, the authorities will limit the number of starter packs under the TIP to 1½ million this year (from 2.9 million in 1999).[24] Further reductions will be made

[24] Donors will contribute US$10 million in FY 2000/01 toward the cost of this activity. An additional MK 100 million will come from domestic resources in the FY 2000/01 budget.

in subsequent years. The safety net strategy will involve use of the Malawi Social Action Fund (MASAF) and, for disaster relief, the National Food Reserve Agency (NFRA). This integrated approach is designed to provide support for vulnerable groups who would not otherwise share in economic growth or be protected against external shocks (¶35) (EBS/00/260).

48. **The NFRA will henceforward confine its operations to disaster relief** (¶ 29). As these operations can be effected through either physical or financial reserves, the NFRA will dispose, as quickly as possible, of maize stocks in excess of 60,000 metric tons. The restriction of the NFRA's mandate, and the commitment by the authorities not to allow any new borrowing by the NFRA, should considerably reduce the risk of further unplanned maize sales derailing the budget.

Structural policies

49. **Considerable progress was made during the 1990s in reducing structural rigidities** to improve Malawi's competitiveness and enhance its growth. Further action is proposed during 2000-2001 to consolidate the liberalization of agricultural production and marketing, open up and improve the regulation of the financial sector, and extend privatization. These reforms will, however, still leave much of the Malawi economy — including the financial sector —dominated by public enterprises and one semiprivate conglomerate, the Press Corporation (¶28-32).

50. **The marketing of maize** used to be the sole preserve of the Agricultural Development and Marketing Corporation (ADMARC), which also intervened in and distributed other agricultural products. These monopoly provisions have been removed, and ADMARC is no longer able to borrow for intervention activities under government guarantee. However, there is considerable resistance to full privatization, partly because of the difficulties involved in encouraging private traders to take over ADMARC's loss-making operations in far-flung rural areas. **For the time being, ADMARC will undergo further stages of commercialization.** The Fund and World Bank staffs urged retention of the target of full privatization by end-2002 but the authorities were unwilling to confirm such a commitment (¶28).

Box 3. Structural Performance Criteria and Benchmarks

By the completion of the first review under the PRGF arrangement, the Malawi government is committed to implement the following:

Structural performance criteria

- compilation by the Ministry of Finance of monthly reviews, which (i) summarize the monthly reports by line ministries on commitment levels and arrears and (ii) assess prospects for meeting budget targets in 2000/01;
- commencement of full operations, by the end of December 2000, of a unit in the Ministry of Finance to monitor the activities of parastatals, including quarterly borrowing returns and the provision of annual accounts, and completion of the first quarterly report on ten parastatals before the end of 2000;
- avoidance of any new borrowing by the National Food Reserve Agency (NFRA);

Structural benchmarks

- receipt from line ministries of 100 percent of monthly returns under the new commitment control system, starting with returns from December 2000.
- dissemination of quarterly reports on spending on priority (poverty-related) programs, starting with the third quarter of 2000 and with target publication date of one month after the end of the quarter;
- maintenance of uniform access by all growers to the tobacco sales network and preservation of the intermediate buyers' system, or equivalent mechanism;
- pursuit by official investigators and prosecutors of all evidence of fraud, corruption, and misappropriation of public funds identified in the reports of the Auditor-General, particularly in the cases of the Petroleum Control Commission (PCC) and public procurement;
- recovery, by February 2001, of at least MK 150 million of revenue lost through tax evasion—and application of available penalties—as assessed by the Malawi Revenue Authority, particularly in the case of large customs duties outstanding, and pursuit of any associated cases of corruption;
- removal of legal obstacles preventing implementation of a complete book-entry system for government securities before the end of 2000.

51. **Tobacco marketing** is still subject to controls. Tobacco can be exported only if it has been traded across the floor of the single auction house. Access to the auction floor is through license. However, the issue of licenses to large numbers of **Intermediate Buyers (IBs)** has permitted smallholders to dispose of their crops throughout the growing season and helped to compensate for the scarcity of credit. At the same time, theft of tobacco has increased, and the average quality of produce brought to the auction floor has declined. The government is considering placing new restrictions on tobacco traders this year; designated buyers will have to receive training and will be able to operate only within one region. **The Fund and Bank missions indicated, however, that restrictions that restored too much power to the large estates or reduced incentives to smallholder production could undermine one of the main achievements of liberalization and should be avoided (¶30).**

The government has undertaken to promote tobacco clubs and consider eliminating all restrictions on the export of tobacco.

52. The **privatization** program has slowed down, in large part, owing to a lack of willing buyers. Foreign interest has been low. But there have also been problems in preparing the large utilities for disposal as a result of management deficiencies, large legacies of debt, and internal resistance. With the splitting of the Malawi Post and Telecommunications Corporation (MPTC) into separate postal and telecommunications units, however, the ground has been set for the sale of Malawi Telecomm during 2001. In the banking sector, sale of some publicly owned shares in August 2000 in the National Bank of Malawi (NBM) and their listing on the Malawi Stock Exchange (bringing the number of listed companies to eight) has opened up the sector a little. Nevertheless, ownership in both the NBM and the Commercial Bank of Malawi (CBM) continues to be dominated by the public sector and the Press Corporation. Efforts in 1999-2000 to find a strategic partner and thus privatize CBM have been unsuccessful. The possibility, therefore, remains that the Press Corporation [25] will assume majority ownership in the NBM, while relinquishing its shares in CBM. **The staff indicated that this could raise serious conflicts of interest, given the dominance of the Press Corporation in many sectors of the Malawi economy.** It would require, among other actions, enforcing strong regulations governing insider and connected lending. More widely, consideration is being given to an improvement in the regulatory and supervisory environment for the whole of the financial sector; an action plan will be issued by February 2001 (¶31).

53. In the **petroleum sector**, the parastatal ORTEX, which was created out of the trading sections of the Petroleum Control Commission when the activities of the latter were limited to regulation, will be sold off by May 2002. **The authorities now believe that the public sector should have no part in the importation or marketing of petroleum**. The Fund and World Bank staff urged the early disposal of ORTEX to prevent further potential drain and possible misuse of public funds. A private sector consortium, PIL, took over responsibility for importation of the entire petroleum needs of the economy in May 2000 (¶32).[26]

54. The findings of the Functional Reviews and Job Evaluation studies have led to the initiation of some **rationalization measures in the civil service,** including the contracting out of some services. Nevertheless, productivity is still low, and serious problems of

[25] The Press Corporation is owned by a trust established for the benefit of all Malawians. It has substantial holdings in many financial and commercial companies.

[26] Although official ceilings are still set for the retail prices of gasoline, paraffin, and diesel, the determination of changes in these prices is now made by a committee from the private sector on the basis of an automatic formula; the only discretionary power left to the government is the right of the Ministry of Finance to challenge the calculations within a two-week grace period.

capacity, motivation, and remuneration remain. The service has also been hard hit by AIDS, which has resulted in losses of skilled personnel and time off for staff to take care of relatives and orphans and to attend funerals. The changes in remuneration this year, including performance-based contracts for top officials and monetized housing allowances, should improve the incentive structure a little.

55. **Land reform** is under consideration to formalize the distinction between customary land (managed by traditional authorities) and freehold titles on government land. It will also address other aspects of the use, transfer, and administration of land. Legal uncertainty over land titles and the distribution of ownership has constrained agricultural development.

Governance

56. **Governance** issues were discussed intensively with the authorities. Most of the cases that have aroused public concern have involved fraud, abuse of procurement procedures, tax evasion, or abuse of public office (see Box 4). Only limited progress has yet been reported in the investigation of two cases outstanding at the time of the October 1999 ESAF review: the pursuit of irregularities uncovered by the Auditor-General's reports on the Petroleum Control Commission (PCC) and the conduct of the Election Commission during the June 1999 general elections. Since then, the authorities have detected further abuses, including wide-scale fraud on building and other contracts at the Ministry of Education, invalid contracts for vehicle purchases and government identity cards, evasion of customs duties and corruption of officials, and public concern about the privileges accorded to ministers and top officials.

57. The seriousness of the alleged offenses and the scale of misappropriated, unpaid, or potentially misused government funds (equivalent to several percentage points of GDP) imply deep-seated problems in the management and receipt of public funds and pose a threat to the good conduct of macroeconomic policies. Furthermore, many of the cases have also implicated senior politicians and officials, and donors have expressed concern about possible abuse of their financial support. The authorities stressed their determination to resolve outstanding issues and to take action to prevent and uncover further abuse (¶33). Indeed, it is notable that many of the offenses have come to light as a result of institutional changes made in recent years, including the additional powers that have been given to the Parliamentary Accounts Committees and the Auditor-General, as well as the creation of the Anti-Corruption Bureau (ACB) and position of ombudsman. The press has also taken a strong role. **Evidence for the effectiveness of these arrangements include the action taken during 2000 to nullify apparently invalid contracts for government vehicles and identity cards; the charges that have been brought in the cases of the PCC and Ministry of Education; and the decision of the President to drop three ministers from his cabinet who had been identified in the report of the Parliamentary Accounts Committee.**

Box 4. Governance

Evidence has come to light in the last two years of substantial misappropriation of public funds, abuse of public office, evasion of taxes, and corruption of officials. There has also been concern about the conduct of senior officials and ministers in awarding contracts and in the privileges they have enjoyed. Among the main issues have been the following:

- **PCC.** Substantial losses were made by the Petroleum Control Commission in 1997/98 (amounting to 3 ½ percent of GDP). The Auditor-General reported in November 1998 that part of this loss reflected the fraudulent award of inflated contracts, unjustified expenses, and misappropriation of funds. Both the Anti-Corruption Bureau (ACB) and the Department of Public Prosecutions (DPP) are conducting investigations. One person identified in the report has been charged, and some of the misappropriated funds have recently been recovered.

- **Election Commission.** The Auditor-General reported widespread misuse of donor funds for the 1999 general elections, either stolen or lost through inflated, unused or unnecessary purchases. Although action was taken to avoid repetition in the 2000 Local Government elections, there has been little progress in charging individuals or recovering funds.

- **Police vehicles.** A contract that was awarded to Apex car sales had apparently been inflated by large commission payments and did not satisfy procurement and payment requirements. It was cancelled following non-performance on delivery.

- **Identity Cards.** A contract that was awarded to Secucom International Holdings Limited had apparently been inflated by large commission payments and did not satisfy procurement and payment requirements. It was cancelled following a court judgment against an appeal by Secucom to overturn a restriction by the ACB on the sale.

- **Ministry of Education.** The Auditor-General uncovered substantial misuse of public funds while responding to a request from the Ministry of Finance to quantify domestic spending arrears. The Parliamentary Accounts Committee reported that the Auditor-General had evidence of contracts being illegally awarded and inflated, buildings not finished, and other offenses. Furthermore, connections were alleged to senior officials and politicians. Charges have since been laid against some officials and contractors.

- **Ministerial vehicles and other perquisites:** An order was placed in early 2000 for 39 Mercedes Benz cars for ministers to replace the fleet purchased between 1995 and 1997. The purchases were approved in the 1999/2000 budget, and the cars were delivered at the beginning of the fiscal year. Following well-publicized complaints about extravagance, the President ordered that the cars should be sold. Measures have also been taken to reduce spending on workshops and conferences for public employees, limit the costs of overseas travel, cut the size of the government car fleet, and monetize in-kind benefits.

- **Evasion of customs duties.** The Director of the ACB ordered the arrest of nine customs officials in March, 2000 on suspicion of falsifying the valuation of imported shipments (although the DPP later ordered that seven be released). Subsequently, a major importer conceded that he had underpaid import duties and had made payments to various public officials. The Malawi Revenue Authority is now reported to be taking action to recover MK 141 million in unpaid duties and impose penalties.

- **Discretion in the award of contracts tax exemptions and privileges.** The award in November 1999 of a preshipment inspection contract to a company rejected by an advisory panel and the offer of a 15-year tax holiday to the Petroda Oil Distribution Company (in contravention of a 10-year limit) suggest that discretionary decisions by ministers are leading to inefficiencies, inequity, and rent seeking. Proposals for implementing clear guidelines for tax exemptions are being considered.

58. Nevertheless, Fund missions have urged speedier pursuit of alleged offenses. A particular concern has been the case of the report on the PCC in October 1998 by the Auditor-General. Despite extensive evidence of invalid award of contracts, misappropriation of expenses, and illegal conduct, the matter was not referred to the Director of Public Prosecutions (DPP) until March 2000. **The authorities have given firm commitments that, in future, all evidence of offenses uncovered by the Auditor-General and other public investigating officers will be speedily pursued.** To assist this, the funding of both investigating and prosecuting agencies has been substantially increased. The Malawi Revenue Authority will also be given every support to recover revenue lost through tax evasion (it will raise at least MK 150 million in the current fiscal year) and to apply penalties. To limit the potential for further corruption and misuse of public funds, the authorities will also be tightening the authorization and monitoring of spending and the levying of taxes and other charges (¶34).

IV. Technical Assistance and Data Issues

59. Malawi has received extensive technical assistance in public expenditure control and management, and in the areas of balance of payments, consumer price index, national accounts statistics and monetary operations. (Appendices II and IV). Nonetheless, serious deficiencies remain in all these areas that impact on the authorities' and staff's ability to monitor economic developments. In particular, significant discrepancies remain between above-the-line and below-the line items in fiscal accounts that arise largely because—in the absence of up-to-date accounting records—fiscal accounts are constructed using information from different sources. Further technical assistance is envisaged.

60. The authorities are committed to promote transparency by disseminating adequate and timely information about the state of the economy and the affairs and activities of government (¶36-37).

V. Structural Performance Criteria and Benchmarks

61. Box 3 records the structural performance criteria and benchmarks agreed with the authorities. Most of these have clear, direct implications for the core mandates of the Fund: macroeconomic stability and the effective execution of monetary and fiscal policy. Four additional indicators are included since they are critical for achieving the objectives of the program and because the World Bank's structural adjustment credit does not incorporate future conditional tranches. The benchmark on intermediate buyers reflects concerns of both Fund and World Bank staff that setbacks to the rapid expansion of smallholder production would jeopardize the liberalization process, the pace of reduction in rural poverty and growth. On governance, failure to resolve outstanding issues could impede the effectiveness of the government and reduce foreign assistance. Transparency and effective tracking of spending allocations are crucial to implementation of the enhanced HIPC Initiative. In the case of the NFRA, the World Bank's structural adjustment credit includes as a prior action an amendment to its trust deed, permitting new borrowing only with the approval of the Ministry of Finance; the structural performance criterion in the PRGF arrangement

formalizes an agreement with the government that such borrowing will in fact not be approved.

VI. Access and Capacity to Repay the Fund

62. The level of access requested by the authorities (65 percent of quota) is consistent with the average level of access for African countries requesting a second arrangement under the PRGF (68 percent of quota). Over the program period, Malawi's balance of payments needs will be covered largely by official grants, concessional financing from multilateral development banks (primarily IDA and AfDB), and some foreign direct investment inflows. (Table 6). Additional financing from the IMF during the program period will aid in reversing the decline in gross reserves and months of imports covered projected at end-2000, and contribute to building reserves cover to 4.8 months of imports by 2003.

63. Malawi has a good track record of servicing past debts and should experience no difficulty in servicing its obligations to the Fund. Payments to the Fund during the 2001-09 period will peak at US$14.2 million in 2005, equivalent to 2 percent of exports of goods and nonfactor services and 4.4 percent of gross international reserves (Table 8). However, this excludes the debt relief Malawi is expected to receive from the IMF averaging US$4.6 million per year over the 2001-09 period and covering, on average, 44 percent of debt service due. As a result, after assistance under the HIPC Initiative, Malawi's debt service to the Fund will peak at US$6.1 million in 2005, or only 1 percent of exports of goods and nonfactor services and 1.9 percent of gross international reserves.

VII. Program Monitoring

64. Policy implementation will be monitored on the basis of semiannual quantitative and structural performance criteria and benchmarks as described in Box 3 and Table 9 and defined in the technical memorandum of understanding (Appendix I, Attachment II). The first review under the PRGF arrangement will be based on quantitative performance through end-December 2000. In addition to the assessment of macroeconomic performance, the review will focus on the implementation and operation of the new system of commitment and expenditure control and the monitoring, prevention and clearance of arrears by the government. An assessment will also be made of improvements in governance and actions by the government to collect evaded tax revenues and pursue charges against individuals in respect of whom either the Auditor General or the ACB has produced evidence of fraud or corruption.

VIII. Staff Appraisal

65. **Malawi's economic performance improved in the latter half of the 1990s.** However, despite sizable inflows of foreign aid, macroeconomic stability proved elusive and growth was inadequate. High and volatile inflation rates frequently imposed a heavy burden on the poor. Some of these problems stemmed from Malawi's vulnerability to external shocks—primarily drought and movements in tobacco and oil prices—but these difficulties

were compounded by occasional inconsistencies in the implementation of macroeconomic policy and a structural reform program that was not fully completed.

66. **There have been encouraging signs in both policies and performance in 2000.** Modest growth has been recorded, the fiscal deficit has been contained, and monetary growth has generally been kept to target. Inflation improved for a while. However, a lapse in monetary control in midyear contributed to an acceleration in currency depreciation, and the 12-month inflation rate rose again.

67. **Improving Malawi's growth record and raising income levels of the poor will require four essential elements.** First, macroeconomic stability must be firmly established. Second, the remaining impediments to a free, competitive market economy—largely affecting agriculture and finance—need to be removed. Third, government spending—particularly on food security, health, and education—should be better targeted at improving opportunities for the poor. Fourth, awareness, prevention, and the recuperative aspects of the fight against HIV/AIDS will have to be stepped up.

68. To address these issues, the authorities are developing a comprehensive program that will be articulated in a full, consultative PRSP in 2001. The interim PRSP provides an effective road map for this process. Additional resources are expected to be provided through debt relief under the enhanced HIPC Initiative. **It is crucial that foreign assistance be used to improve domestic policies rather than, as at times in the past, to promote unsustainable spending and deficits.**

69. **The authorities are firmly committed to establishing macroeconomic stability. Attainment of the inflation targets will require steadfast application of monetary policy** in the wake of the depreciation of the dollar value of the kwacha by 45 percent over the last year, particularly as cost pressures have been accentuated in recent months following rises in petroleum prices. The slackening of monetary policy in July and August, which allowed reserve money growth to accelerate and nominal interest rates to fall dramatically— in spite of a concurrent resurgence in the inflation rate—must not be repeated. Nominal interest rates will have to rise further.

70. The targeted reduction in the fiscal deficit as a ratio to GDP in FY 2000/01 reflects an expected rise in foreign grants, rather than a discretionary tightening in policy. Nevertheless, pressures on wages and salaries and on other recurrent transactions will require resolute application of fiscal discipline. **Much will be required from the new system for controlling and monitoring the expenditure of line ministries; repetition of the excess levels of commitments and consequential arrears of FY 1998/99 would derail the program.** Similarly, recourse to the subsidization of maize, petroleum, or parastatals, which has caused substantial overspending in the past, must be avoided.

71. **The 10-point plan to improve budget management has provided a clear and practical guide to controlling government borrowing and prioritizing expenditure.** Crucial elements are the elimination of nonemergency extrabudgetary outlays and borrowing;

the commitment to increased fiscal transparency; and the determination to invoke disciplinary measures. It is particularly encouraging that parliament is providing active support in these areas. Attention needs to be focused in the future on ensuring that potential calls from all government agencies are reflected in government accounts, and that improvements to be identified in the monitoring and control of parastatals are implemented as quickly as possible.

72. **Structural reform needs to be more vigorously advanced.** The program foresees further privatization, including of Malawi Telecomm, but the recent pace of privatization has been slow. Although Malawi has not so far proved to be a priority market for foreign buyers (as evidenced particularly by the failure to find a strategic partner for the Commercial Bank of Malawi (CBM)), much can be done to improve the attractiveness of its assets. This demands, in part, firmer action to liberalize markets and reduce cartelization, and, in part, resistance to vested interests. Similar considerations apply in agricultural marketing and production. The tightening up of licensing and supervision requirements for intermediate buyers of tobacco must not be allowed to restrict opportunities for smallholders to dispose of their crops at realistic prices. Tobacco producers should be free to export without resort to a monopsonistic auction process.

73. **One area where substantial gains could be made from enhanced competition is the banking sector**. The full privatization of the two dominant commercial banks, and the improvements being sought in the regulation of the financial sector should permit the emergence of a range of institutions (including providers of microcredit), that can effectively service smallholders, households and manufacturers, as well as the estates and traders. To achieve this, connected and insider lending must be restricted.

74. **Governance** issues remain of prime concern. The recent strengthening of the offices of the Anti-Corruption Bureau, Department of Public Prosecution, Ombudsman, Auditor-General and the Public Accounts Committee has helped to bring to light serious cases of fraud, corruption and misappropriation of government funds. Action is now being pursued against some alleged offenders. But sustained efforts to follow through these investigations and prosecutions are required; and a large amount of misused public funds remains to be recovered.

75. Improved economic and financial statistics are essential to the effective design and implementation of the economic program. Although the agreed monthly reporting data should be adequate for monitoring purposes, weaknesses in quality and timing present some risks.

76. **The Malawi economy is beginning to diversify,** reflecting shifts in the agricultural sector away from tobacco and the gaining of some ground by other nontraditional exports, such as textiles. It will need further diversification to overcome the disadvantages of a landlocked situation and relative lack of natural resources. **A stable macroeconomic environment and sustained structural reform offer the best routes to further gains.**

77. The risks to the program are high, given the recent weakness of the exchange rate, Malawi's mixed record of policy implementation and spending control, and its vulnerability to further shocks. However, the authorities' commitment is strong and parliament has supported both the overall approach to policy and the tightening of spending control. The staff recommends approval of the request for a three-year PRGF arrangement.

78. It is recommended that the next Article IV consultation with Malawi be held on the standard 12-month cycle.

Proposed Decision

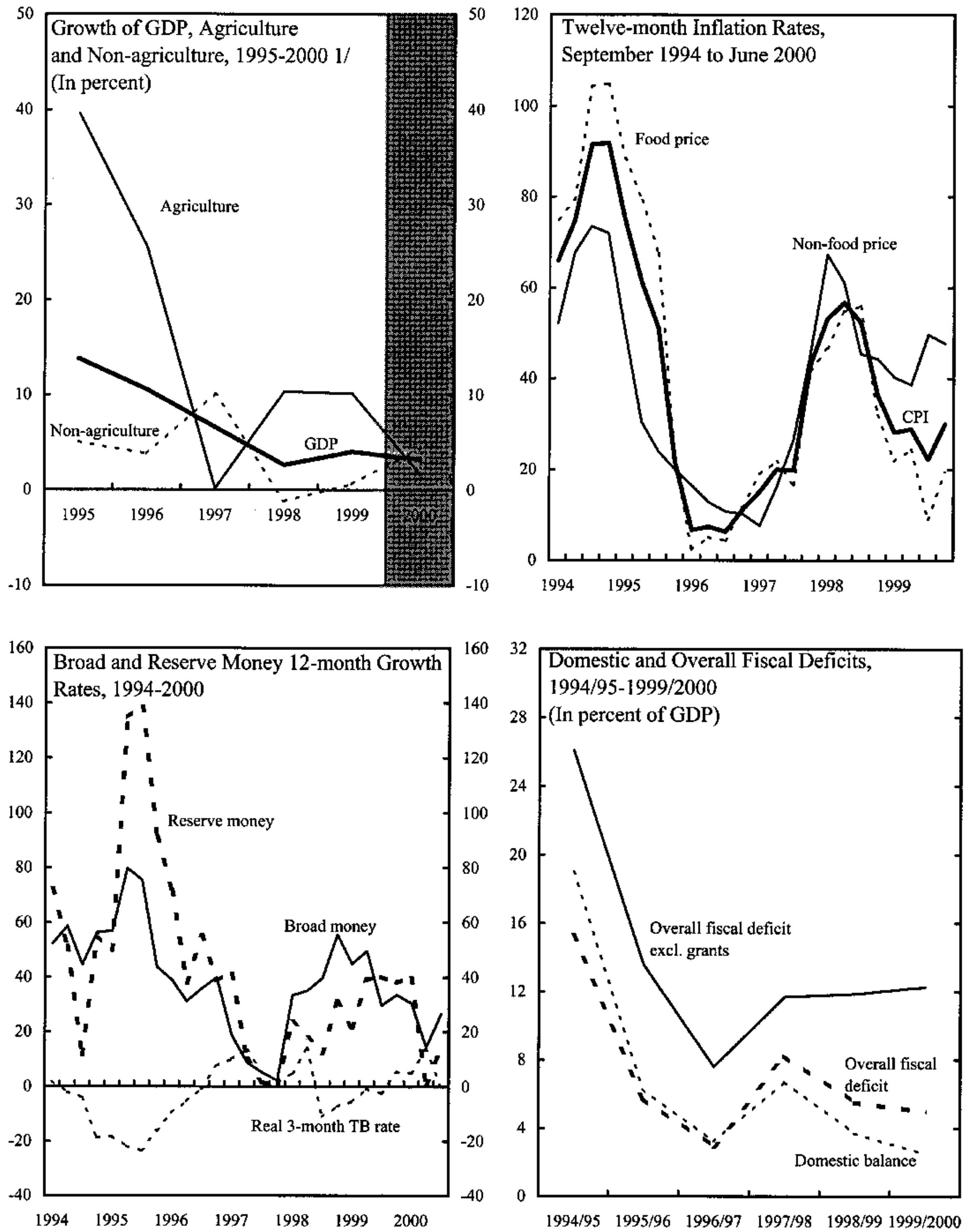
The following draft decision is proposed for adoption by the Executive Board:

1. The Government of Malawi has requested a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in a total amount equivalent to SDR 45.11 million.

2. The Fund determines that the interim Poverty Reduction Strategy Paper (PRSP) for Malawi set forth in EBD/00/117 provides a sound basis for the development of a fully participatory PRSP, for reaching the Decision Point under the HIPC Initiative, and for Fund concessional assistance.

3. The Fund decides to approve in principle the three-year arrangement set forth in EBS/00/263. The approval of this arrangement shall become effective on the date on which the Fund decides that the World Bank has concluded that the Interim PRSP submitted by Malawi provides a sound basis for the development of a fully participatory PRSP, for reaching the Decision Point under the enhanced HIPC Initiative, and for World Bank concessional assistance. Upon the approval of the arrangement becoming effective, Malawi may request the first disbursement under the arrangement, on the condition that the information provided by Malawi on the implementation of the prior actions specified in Table 2 of the Memorandum on Economic and Financial Policies attached to the letter dated December 8, 2000 is accurate.

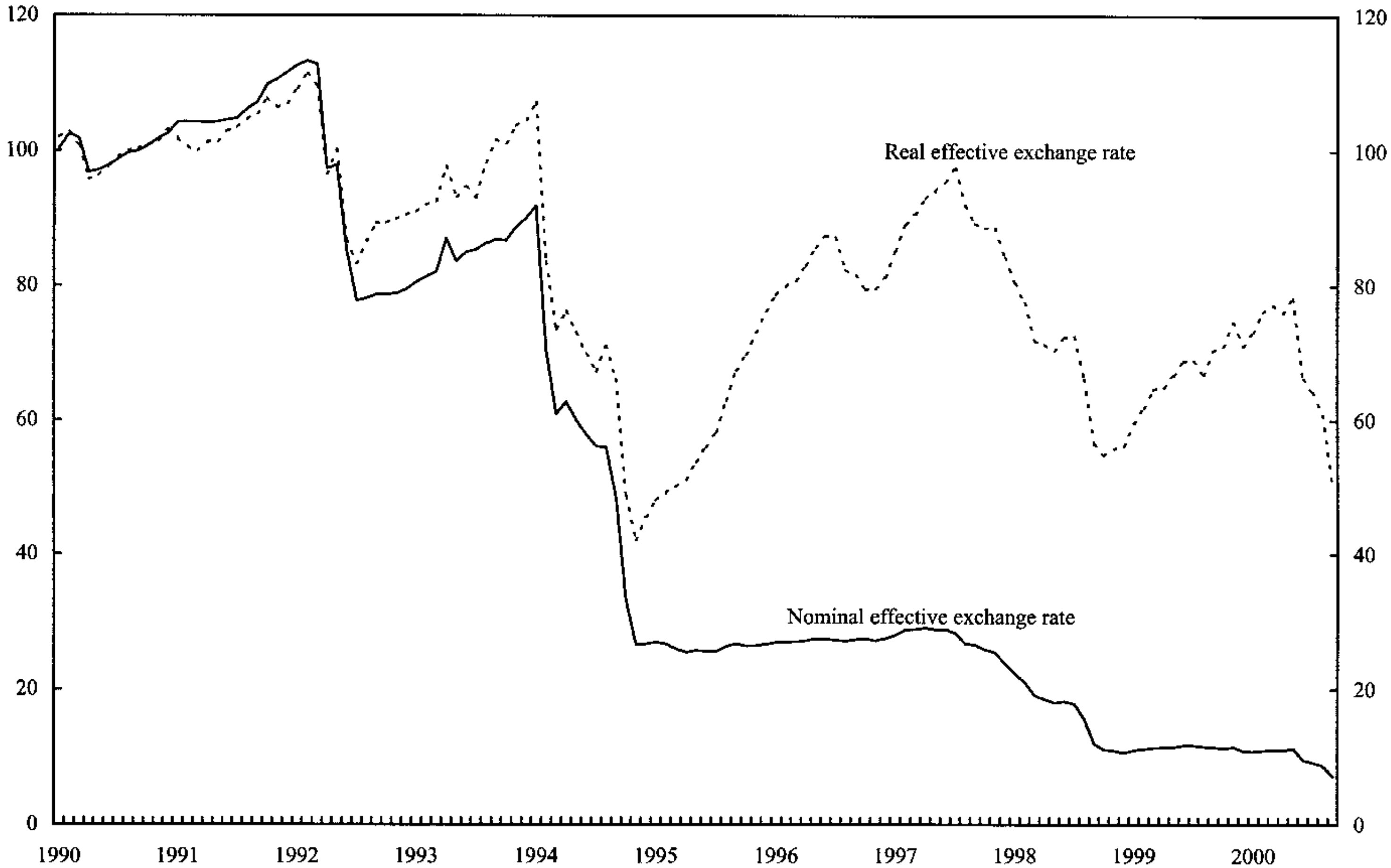
Figure 1. Malawi: Domestic Economic Indicators, 1994-2000



Sources: Malawi authorities and Fund staff estimates.

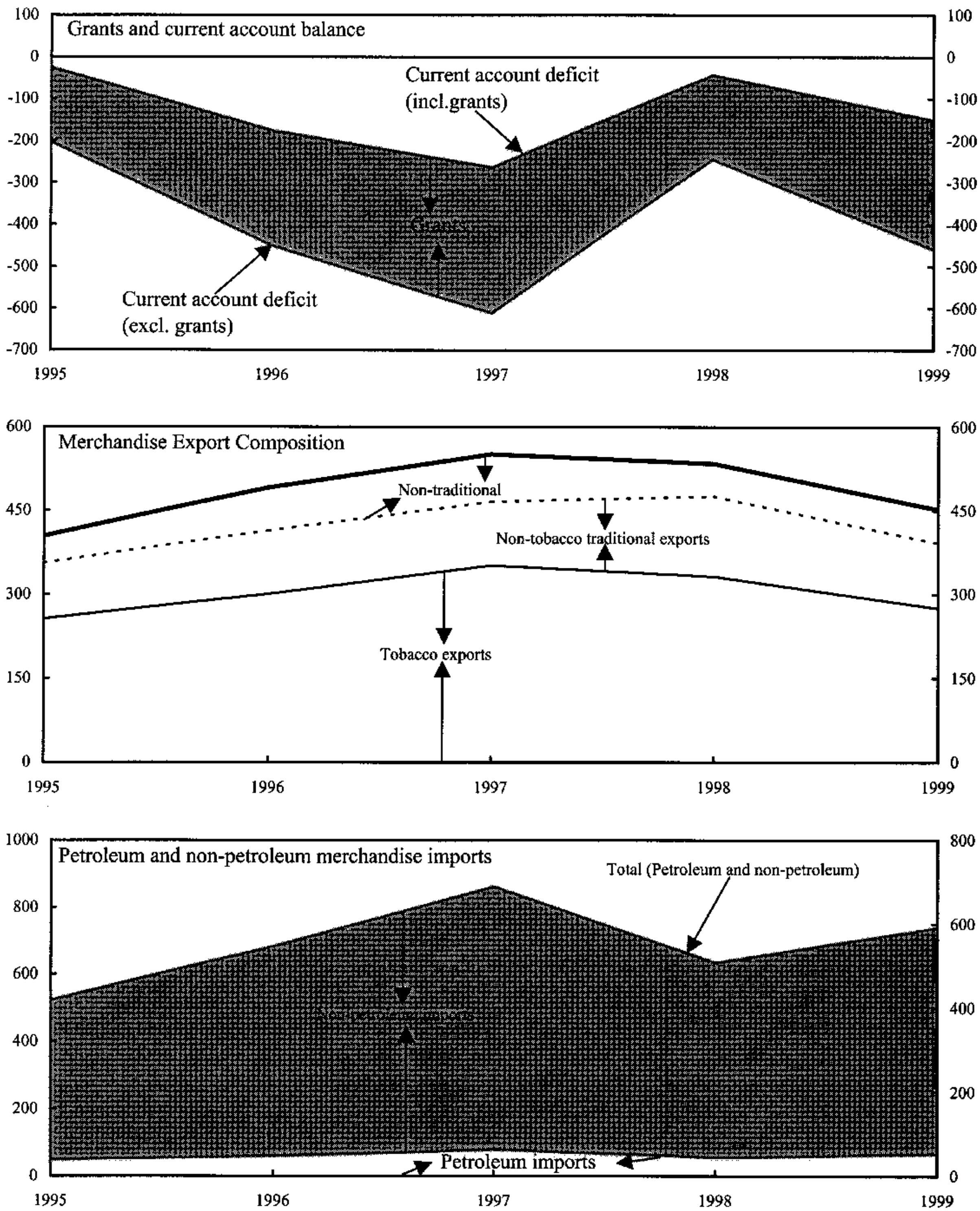
1/ Data for 2000 are based on staff projections.

Figure 2. Malawi: Effective Exchange Rates, January 1990-September 2000
(Index: 1990=100)



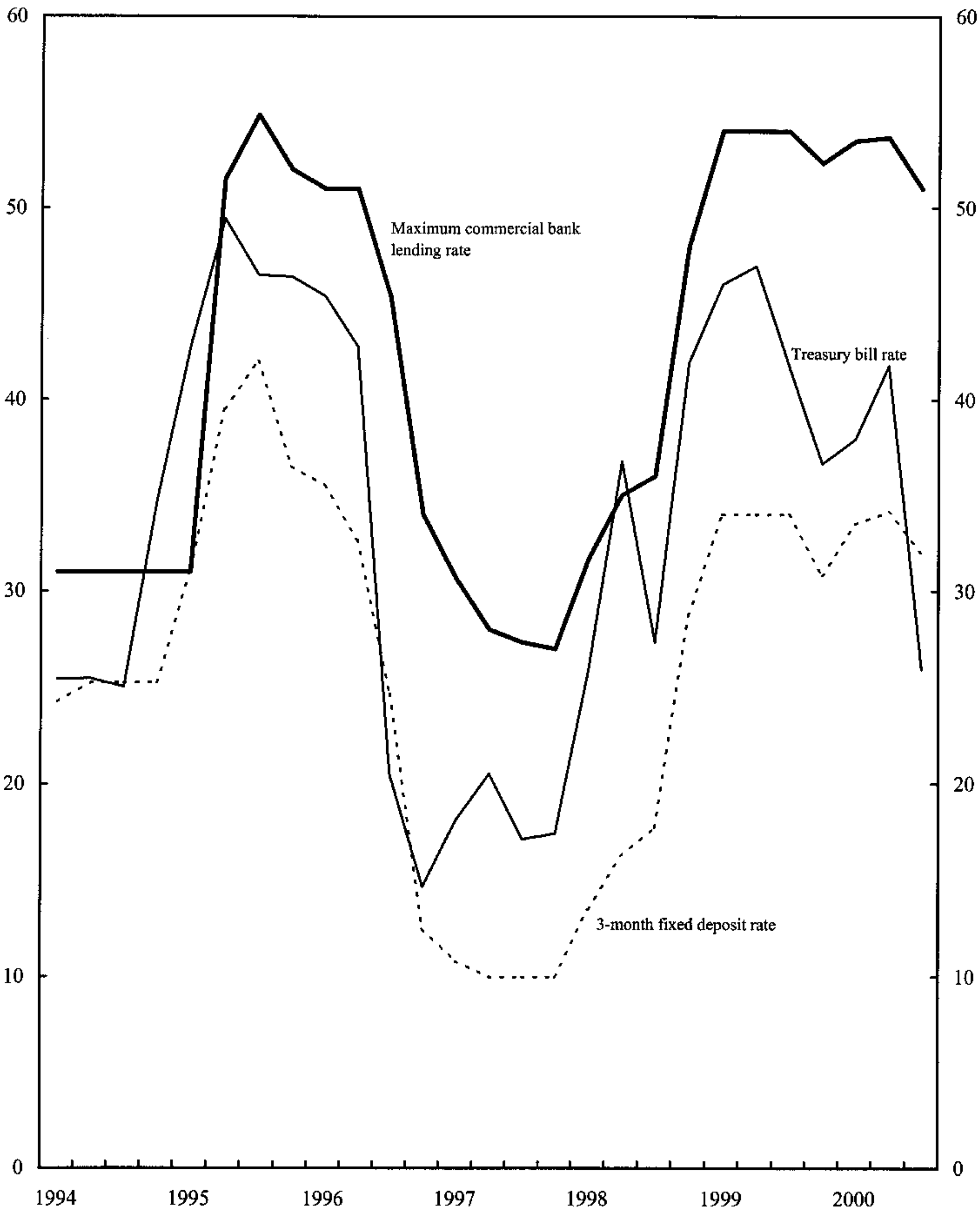
Sources: Malawi authorities and Fund staff estimates.

Figure 3. Malawi: External Trade and Current Account, 1995-1999
(In millions of US $)



Sources: Malawi authorities and Fund staff estimates.

Figure 4. Malawi: Interest Rates, 1994:Q1 - 2000:Q3



Sources: Malawi authorities and Fund staff estimates.

Table 1. Malawi: Selected Economic and Financial Indicators, 1998-2003

	1998	1999 EBS/99/192	1999 Prel.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.
	(Percentage change, unless otherwise indicated)						
GDP and prices							
GDP at constant market prices	2.0	4.2	4.0	3.2	3.0	4.0	4.5
Consumer prices (end of period)	53.0	21.1	28.2	30.0	10.0	5.0	5.0
Consumer prices (annual average)	26.2	43.0	44.8	28.5	20.0	7.5	5.0
GDP deflator	26.2	42.7	41.1	25.5	16.8	7.5	5.0
Nominal effective exchange rate (end-period) 1/	55.2	...	2.6	...	...	...	...
Real effective exchange rate (end-period) 1/	33.5	...	-21.4	...	...	...	...
External sector							
Exports, f.o.b. (millions of U.S. dollars)	538.6	470.0	447.1	431.0	438.0	479.0	509.0
Imports, c.i.f. (millions of U.S. dollars) 2/	579.3	646.0	673.4	625.0	614.0	618.0	643.0
Terms of trade (1990=100)	71.9	72.2	62.3	58.5	59.8	62.4	63.2
Money and credit 3/							
Money and quasi money	53.1	28.9	33.6	20.9	16.8	12.4	9.7
Net foreign assets	110.0	36.8	11.5	31.1	47.0	14.9	14.0
Net domestic assets	-54.5	-7.9	22.1	-10.2	-30.2	-2.5	-4.3
Credit to the government	-29.9	-40.1	-2.9	2.7	-43.3	-49.8	-38.2
Credit to the rest of the economy	18.5	...	20.6	16.3	19.5	49.6	36.3
	(In percent of GDP, unless otherwise indicated)						
Central government 4/							
Revenue (excluding grants)	17.7	15.8	17.3	19.0	19.0	18.9	...
Expenditure	29.8	27.4	29.8	30.4	27.3	25.5	...
Domestic primary balance (cash modified basis) 5/	-1.9	-2.0	-0.5	1.4	-0.3	-0.8	...
Domestic balance (cash modified basis) 6/	-4.0	-3.0	-2.8	-1.3	-1.2	-1.0	...
Overall balance (cash modified basis, excluding grants)	-11.9	-11.6	-12.3	-11.4	-8.3	-6.6	...
Overall balance (cash modified basis, including grants)	-5.5	-2.3	-5.0	0.0	0.0	1.5	...
National saving	1.7	-1.3	-1.3	0.6	0.6	4.0	5.2
Domestic saving	5.8	2.4	0.3	2.3	2.2	5.5	7.1
Government	-4.7	...	-2.4	-1.3	-0.2	2.4	2.4
Nongovernment	10.5	...	2.6	3.6	2.4	3.2	4.7
Net factor income and private transfers	-4.1	-3.6	-1.6	-1.7	-1.6	-1.5	-1.9
Foreign saving 7/	11.6	16.7	17.1	15.2	15.4	12.2	11.2
Gross investment	13.3	15.4	15.8	15.8	16.0	16.2	16.4
Government	7.4	...	9.6	11.1	9.8	7.4	7.4
Nongovernment	3.6	...	4.0	2.7	4.2	6.8	7.0
Stock building	2.4	2.2	2.2	2.0	2.0	2.0	2.0
External sector							
Exports, f.o.b.	31.0	26.6	24.7	24.9	28.0	28.4	28.1
Imports, c.i.f. 2/	33.4	36.7	37.3	36.1	39.3	36.7	35.5
External current account (including official transfers)	-2.5	-7.6	-8.3	-7.8	-7.7	-6.7	-5.7
External debt	142.7	147.8	143.3	156.5	180.4	175.1	168.5
Debt-service ratio 8/	18.2	20.4	17.7	20.6	20.0	18.4	18.7
Of which: interest payments 8/	6.1	6.4	5.2	6.6	6.3	5.6	5.2
Gross official reserves 9/							
End-period stock (millions of US dollars)	257.8	279.0	244.2	224.0	276.3	293.1	307.3
In months of imports of goods and nonfactor services	4.0	4.5	4.2	3.9	4.7	4.8	4.8
External debt (disbursed and outstanding, end of period; millions of US dollars)	2,478.6	2,607.0	2,589.0	2,706.0	2,824.0	2,949.0	3,055.0
Memorandum items:							
GDP (in millions of kwacha)	54,417.0	78,093.0	79,854.0	103,424.0	124,423.0	139,105.0	152,633.0
Kwacha per U.S. dollar exchange rate (per. avg.)	31.1	...	44.2	...	...	...	...
Per capita GDP (in U.S. dollars)	157.8	...	163.1	...	...	...	...

Sources: Malawian authorities; and Fund staff estimates and projections.

1/ Negative value denotes appreciation of kwacha

2/ Including drought-related maize operations in 1998.

3/ Change in percent of money and quasi money at the beginning of the period.

4/ Fiscal year starting July 1.

5/ The domestic primary balance is defined as revenue less total expenditure, excluding the recently incurred domestic arrears, support for the Malawi Savings Bank, domestic and foreign interest, and foreign financed development expenditure.

6/ The domestic balance is defined as revenue less total expenditure, excluding the recently incurred domestic arrears, support for the Malawi Savings Bank, foreign interest, and foreign-financed development expenditure.

7/ External current account, excluding official transfers.

8/ In percent of imports of goods and nonfactor services in the following period.

9/ The ratio of reserves to short-term debt is not currently available.

Table 2. Malawi: Central Government Operations, 1994/95 - 2002/03 1/

	1994/95 Actual	1995/96 Actual	1996/97 Actual	1997/98 Actual	1998/99 Actual	1999/00 Actual Prel.	2000/01 Proj.	2001/02 Proj.	2002/03 Proj.
	(In millions of Malawi kwacha)								
Total revenue and grants	3,746.3	6,423.4	7,650.7	8,203.6	16,057.5	22,505.9	34,576.3	35,980.7	39,303.8
Total revenue	2,231.0	4,437.1	5,943.1	6,656.9	11,815.9	15,808.2	21,600.6	24,989.8	27,517.3
Tax revenue	2,031.5	3,854.3	5,651.4	6,144.4	10,029.0	14,353.3	19,702.6	22,856.0	25,062.3
Taxes on income and profits	767.8	1,428.5	2,498.2	2,568.4	4,544.3	6,590.5	8,093.1	9,360.6	10,362.6
Of which: companies	338.2	699.7	1,356.0	1,016.7	1,837.8	2,569.8	3,094.7	3,579.3	3,962.5
Taxes on goods and services	805.1	1,425.3	1,945.9	2,286.5	4,011.6	5,833.7	8,864.3	10,420.9	11,497.3
Of which: surtax	700.2	1,239.7	1,655.3	1,961.0	3,577.0	5,189.3	6,480.1	7,663.4	8,444.6
Taxes on international trade	458.6	1,121.4	1,358.8	1,468.0	1,750.2	2,241.3	3,284.3	3,656.0	3,813.8
Of which: import duty	457.0	746.4	1,018.2	1,201.6	1,720.9	2,200.6	3,235.9	3,600.0	3,751.9
Tax refund and tax arrears collection	0.0	-120.9	-151.5	-178.4	-277.0	-312.2	-539.1	-581.3	-611.4
Nontax revenue	199.5	582.8	291.7	512.5	1,786.9	1,454.9	1,898.0	2,133.7	2,454.9
Of which: maize sales 2/	0.0	45.0	0.0	40.0	1,042.2	0.0	0.0	0.0	0.0
Grants	1,515.3	1,986.3	1,707.6	1,546.7	4,241.7	6,697.8	12,975.7	10,990.9	11,786.5
Program	986.9	1,250.9	1,273.0	898.3	2,733.4	4,126.8	7,350.3	4,606.1	5,003.1
Project	100.4	445.4	434.6	648.4	1,508.3	2,571.0	4,081.0	2,917.5	2,313.9
HIPC interim resources 3/	...	...	...	...	...	...	1,152.3	2,653.4	3,685.6
Other 4/	428.1	290.0	0.0	0.0	0.0	0.0	392.1	813.9	783.8
Total expenditure	5,883.6	7,868.7	8,713.6	11,870.6	19,750.6	27,053.7	34,601.9	35,934.8	37,160.3
Current expenditure	4,761.3	6,133.5	6,692.6	9,394.5	12,132.6	16,347.3	21,239.6	21,735.6	22,918.6
Noninterest expenditure	4,044.6	4,479.9	4,811.3	7,972.6	9,597.5	12,947.8	16,103.0	18,644.4	20,444.0
Wages and salaries	1,018.5	1,664.2	1,771.4	2,515.4	3,209.3	4,295.6	6,065.9	7,015.8	7,766.9
Goods and services	1,936.6	2,034.4	2,666.3	4,200.3	4,120.0	6,614.9	7,202.0	8,684.6	9,422.0
Transfers (incl. separation benefits)	169.0	243.2	373.7	546.5	1,026.2	1,751.5	2,820.1	2,943.9	3,255.1
Maize 2/	920.5	305.1	0.0	710.4	1,230.0	285.8	0.0	0.0	0.0
Discretionary exemptions	0.0	232.9	0.0	0.0	12.0	0.0	15.0	0.0	0.0
Interest	716.7	1,653.6	1,881.3	1,421.9	2,535.0	3,399.5	5,136.6	3,091.2	2,474.6
Domestic	439.5	1,095.0	1,479.6	929.2	1,409.3	2,080.8	3,100.0	1,130.0	390.0
External	277.3	558.6	401.7	492.8	1,125.7	1,318.8	2,036.6	1,961.2	2,084.6
Other expenditure 5/	56.0	96.0	283.4	0.0	1,465.8	839.1	850.0	1,033.9	1,061.8
Expenditure attributable to HIPC 6/	...	...	...	...	...	...	460.0	2,653.4	3,685.6
Expenditure since March 1998 in arrears 7/	...	...	...	183.8	367.6	276.0	0.0	0.0	0.0
Development expenditure and net lending	1,066.3	1,639.2	1,737.6	2,292.3	5,784.7	9,591.2	12,052.3	10,511.9	9,494.2
Domestic	351.6	347.5	540.4	572.6	1,451.3	1,940.1	2,600.0	3,070.1	3,427.9
Foreign-financed projects 8/	714.7	1,291.7	1,197.2	1,719.7	4,333.4	7,651.2	9,452.3	7,441.8	6,066.3
Overall deficit (excluding grants, cash mod. basis) 9/	-3,652.6	-3,431.6	-2,770.5	-5,213.7	-7,934.7	-11,245.5	-13,001.4	-10,945.0	-9,643.0
Overall deficit (including grants, cash mod. basis) 9/	-2,137.3	-1,445.3	-1,062.9	-3,667.0	-3,693.0	-4,547.8	-25.7	45.9	2,143.5
Discrepancy	239.0	-4.2	23.2	-112.3	-29.1	776.0	0.0	0.0	0.0
Total financing	2,376.3	1,441.1	1,086.0	3,554.7	3,663.9	5,323.8	25.7	-45.9	-2,143.5
Foreign (net)	1,045.4	509.6	1,781.5	1,358.5	6,867.6	4,372.5	5,307.6	3,322.6	2,626.6
Borrowing	1,402.1	1,356.6	2,367.2	2,022.5	7,919.7	6,472.7	10,274.8	7,581.5	7,337.9
Program	0.0	0.0	1,912.4	951.1	4,619.6	1,392.5	4,903.5	3,057.2	3,585.6
Project	1,402.1	1,356.6	454.8	1,071.4	3,300.2	5,080.2	5,371.3	4,524.3	3,752.3
Special loans 10/	...	...	...	...	475.0	37.0	-879.0	-150.0	0.0
Repayments	-356.7	-847.0	-585.7	-664.0	-1,527.1	-2,137.2	-4,088.2	-4,108.9	-4,711.3
Domestic (net)	1,330.9	931.4	-695.5	2,196.2	-3,203.6	951.2	-5,282.0	-3,368.5	-4,770.2
Banking system	749.7	-137.0	-539.7	1,163.8	-2,774.4	-1,265.3	-2,584.0	-3,526.5	-3,955.2
of which HIPC account 6/	...	...	...	...	...	...	-692.3	0.0	0.0
Nonbanks	286.2	1,022.5	-7.8	308.4	-588.1	2,526.9	-2,409.0	-42.0	-1,115.0
Privatization proceeds	0.0	0.0	135.0	71.0	135.8	0.0	100.0	200.0	300.0
Change in arrears (- payment)	295.0	46.0	-283.0	653.0	23.1	-310.4	-389.0	0.0	0.0
New arrears 7/	...	...	...	...	367.6	276.0	0.0	0.0	0.0
Gross clearance of arrears	...	...	...	...	-344.4	-586.4	-389.0	0.0	0.0
Memorandum items:									
Domestic balance (cash-mod. basis) 11/	-2,660.7	-1,581.3	-1,171.6	-3,001.2	-2,475.6	-2,275.6	-1,512.4	-1,542.0	-1,492.1
Domestic primary balance (cash-mod. basis) 11/	-2,221.2	-486.2	308.0	-2,072.0	-1,066.3	-194.8	1,587.6	-412.0	-1,102.1
Health 12/	420.0	645.0	679.0	935.0	1,714.0	1,975.0	3,087.0	3,557.6	3,938.5
Education 12/	596.0	1,367.0	1,417.0	2,442.0	2,451.0	3,095.0	5,587.0	6,461.9	7,153.7
Defense 12/	159.4	172.0	354.0	461.0	446.0	697.0	800.0	925.3	1,024.3

Sources: Malawian authorities; and Fund staff estimates and projections.

1/ Fiscal year beginning April 1 until 1997/98; beginning July 1 from 1998/99 onward.

2/ The 1998/99 maize transactions were substantially smaller than originally projected.

3/ Amounts include IMF debt relief under the HIPC Initiative.

4/ For 1994/95 and 1995/96, amounts represent drought relief; for 2000/01 and after, amounts represent Paris Club pledges of debt relief beyond the HIPC Initiative.

5/ In 1998/99 - 1999/00, includes unrecorded vehicle purchase. From 2001/02, includes potential expenditure related to pledges by Paris Club creditors beyond the HIPC Initiative.

6/ Amounts from 2000/01 HIPC resources that are not yet allocated are meant to be later allocated to expenditures attributable to HIPC.

7/ From March 1998, estimate of new expenditures financed by arrears. Amounts estimated on the basis of the Auditor General's investigation.

8/ Starting in 1998/99, previously off-budget development expenditure are increasingly included in the budget.

9/ From March 1998, cash-modified basis defined as expenditure effectively paid and expenditure in arrears.

10/ Special loans include loans and/or repayments on three specific operations unrecorded in the fiscal accounts
(ADMARC Maize loan taken over by central government, police vehicle purchase, and member of Parliament car purchase).

11/ The domestic balance is defined as revenue less total expenditure, excluding foreign interest, and foreign-financed development expenditure.

12/ Current and development expenditure by ministry; figures from annual economic reports; from 2000/01 amount before HIPC expenditure.

Table 2. Malawi: Central Government Operations, 1994/95 - 2002/03 (concluded) 1/

	1994/95 Actual	1995/96 Actual	1996/97 Actual	1997/98 Actual	1998/99 Actual	1999/00 Actual Prel.	2000/01 Proj.	2001/02 Proj.	2002/03 Proj.
	(In percent of GDP, unless otherwise specified)								
Total revenue and grants	26.7	25.5	21.0	18.4	24.0	24.6	30.4	27.3	26.9
Total revenue	15.9	17.6	16.3	14.9	17.7	17.3	19.0	19.0	18.9
Tax revenue	14.5	15.3	15.5	13.8	15.0	15.7	17.3	17.3	17.2
Taxes on income and profits	5.5	5.7	6.9	5.8	6.8	7.2	7.1	7.1	7.1
Of which: companies	2.4	2.8	3.7	2.3	2.7	2.8	2.7	2.7	2.7
Taxes on goods and services	5.7	5.7	5.3	5.1	6.0	6.4	7.8	7.9	7.9
Of which: surtax	5.0	4.9	4.5	4.4	5.3	5.7	5.7	5.8	5.8
Taxes on international trade	3.3	4.4	3.7	3.3	2.6	2.4	2.9	2.8	2.6
Of which: import duty	3.3	3.0	2.8	2.7	2.6	2.4	2.8	2.7	2.6
Tax refund and tax arrears collection	0.0	-0.5	-0.4	-0.4	-0.4	-0.3	-0.5	-0.4	-0.4
Nontax revenue	1.4	2.3	0.8	1.2	2.7	1.6	1.7	1.6	1.7
Of which: maize sales 2/	0.0	0.2	0.0	0.1	1.6	0.0	0.0	0.0	0.0
Grants	10.8	7.9	4.7	3.5	6.3	7.3	11.4	8.3	8.1
Program	7.0	5.0	3.5	2.0	4.1	4.5	6.5	3.5	3.4
Project	0.7	1.8	1.2	1.5	2.3	2.8	3.6	2.2	1.6
HIPC interim resources 3/	...	...	...	...	...	...	1.0	2.0	2.5
Other 4/	3.1	1.2	0.0	0.0	0.0	0.0	0.3	0.6	0.5
Total expenditure	42.0	31.2	23.9	26.6	29.5	29.5	30.4	27.3	25.5
Current expenditure	34.0	24.3	18.4	21.1	18.1	17.8	18.6	16.5	15.7
Noninterest expenditure	28.9	17.8	13.2	17.9	14.3	14.1	14.1	14.1	14.0
Wages and salaries	7.3	6.6	4.9	5.6	4.8	4.7	5.3	5.3	5.3
Goods and services	13.8	8.1	7.3	9.4	6.2	7.2	6.3	6.6	6.5
Transfers (incl. separation benefits)	1.2	1.0	1.0	1.2	1.5	1.9	2.5	2.2	2.2
Maize 2/	6.6	1.2	0.0	1.6	1.8	0.3	0.0	0.0	0.0
Discretionary exemptions	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest	5.1	6.6	5.2	3.2	3.8	3.7	4.5	2.3	1.7
Domestic	3.1	4.3	4.1	2.1	2.1	2.3	2.7	0.9	0.3
External	2.0	2.2	1.1	1.1	1.7	1.4	1.8	1.5	1.4
Other expenditure 5/	0.4	0.4	0.8	0.0	2.2	0.9	0.7	0.8	0.7
Expenditure attributable to HIPC 6/	...	...	...	...	...	...	0.4	2.0	2.5
Expenditure in arrears 7/	...	...	...	0.4	0.5	0.3	0.0	0.0	0.0
Development expenditure and net lending	7.6	6.5	4.8	5.1	8.6	10.5	10.6	8.0	6.5
Domestic	2.5	1.4	1.5	1.3	2.2	2.1	2.3	2.3	2.4
Foreign-financed projects 8/	5.1	5.1	3.3	3.9	6.5	8.3	8.3	5.6	4.2
Overall deficit (excluding grants, cash mod. basis) 9/	-26.1	-13.6	-7.6	-11.7	-11.9	-12.3	-11.4	-8.3	-6.6
Overall deficit (including grants, cash mod. basis) 9/	-15.3	-5.7	-2.9	-8.2	-5.5	-5.0	0.0	0.0	1.5
Discrepancy	1.7	0.0	0.1	-0.3	0.0	0.8	0.0	0.0	0.0
Total financing	17.0	5.7	3.0	8.0	5.5	5.8	0.0	0.0	-1.5
Foreign (net)	7.5	2.0	4.9	3.0	10.3	4.8	4.7	2.5	1.8
Borrowing	10.0	5.4	6.5	4.5	11.8	7.1	9.0	5.8	5.0
Program	0.0	0.0	5.3	2.1	6.9	1.5	4.3	2.3	2.5
Project	10.0	5.4	1.2	2.4	4.9	5.5	4.7	3.4	2.6
Special loans 10/	...	...	...	...	0.7	0.0	-0.8	-0.1	0.0
Repayments	-2.5	-3.4	-1.6	-1.5	-2.3	-2.3	-3.6	-3.1	-3.2
Domestic (net)	9.5	3.7	-1.9	4.9	-4.8	1.0	-4.6	-2.6	-3.3
Banking system	5.4	-0.5	-1.5	2.6	-4.1	-1.4	-2.3	-2.7	-2.7
of which: HIPC account 6/	...	...	...	...	...	...	-0.6	0.0	0.0
Nonbanks	2.0	4.1	0.0	0.7	-0.9	2.8	-2.1	0.0	-0.8
Privatization proceeds	0.0	0.0	0.4	0.2	0.2	0.0	0.1	0.2	0.2
Change in arrears (- payment)	2.1	0.2	-0.8	1.5	0.0	-0.3	-0.3	0.0	0.0
New arrears 7/	...	...	...	...	0.5	0.3	0.0	0.0	0.0
Gross clearance of arrears	...	...	...	...	-0.5	-0.6	-0.3	0.0	0.0
Memorandum items:									
Domestic balance (cash-mod. basis) 11/	-19.0	-6.3	-3.2	-6.7	-3.7	-2.5	-1.3	-1.2	-1.0
Domestic primary balance (cash-mod. basis) 11/	-15.9	-1.9	0.8	-4.7	-1.6	-0.2	1.4	-0.3	-0.8
Health 12/	3.0	2.6	1.9	2.1	2.6	2.2	2.7	2.7	2.7
Education 12/	4.3	5.4	3.9	5.5	3.7	3.4	4.9	4.9	4.9
Defense 12/	1.1	0.7	1.0	1.0	0.7	0.8	0.7	0.7	0.7
GDP at market prices (in millions of Malawi kwacha)	14,005.0	25,211.0	36,418.1	44,555.1	66,905.5	91,638.9	113,923.4	131,764.0	145,869.0

Sources: Malawian authorities; and Fund staff estimates and projections.

1/ Fiscal year beginning April 1 until 1997/98; beginning July 1 from 1998/99 onward.

2/ The 1998/99 maize transactions were substantially smaller than originally projected.

3/ Amounts include IMF debt relief under the HIPC Initiative.

4/ For FY 1994/95 and 1995/96, amounts represent drought relief; for FY 2000/01 and after, amounts represent Paris Club pledges of debt relief beyond the HIPC Initiative.

5/ In 1998/99 - 1999/00, includes unrecorded vehicle purchase. From 2001/02, includes potential expenditure related to pledges by Paris Club creditors beyond the HIPC Initiative.

6/ Amounts from 2000/01 HIPC resources that are not yet allocated are meant to be later allocated to expenditures attributable to HIPC.

7/ From 1998/1999, estimate of new expenditures financed by arrears. Amounts estimated on the basis of the Auditor General's investigation.

8/ Starting in 1998/99, previously off-budget development expenditure are increasingly included in the budget.

9/ From March 1998, cash-modified basis defined as expenditure effectively paid and expenditure in arrears.

10/ Special loans include loans and/or repayments on three specific operations unrecorded in the fiscal accounts
(ADMARC Maize loan taken over by central government, police vehicle purchase, and member of Parliament car purchase)

11/ The domestic balance is defined as revenue less total expenditure, excluding foreign interest, and foreign-financed development expenditure.

Table 3. Malawi : Monetary Authorities' Accounts, 1998-2003
(In millions of Malawi kwacha, unless otherwise noted)

	1998 Dec. 1/ Actual	1999 Dec. 1/ Actual	2000 June 1/ Actual	2000 Sep. 1/ Actual	2000 Dec. 2/ Prog.	2001 Mar. 2/ Prog.	2001 June 2/ Prog.	2001 Dec. 2/ Proj.	2002 Dec. 2/ Proj.	2003 Dec. 2/ Proj.
Reserve money	4,295	5,930	6,058	7,047	6,996	6,312	7,731	7,961	8,863	9,589
Currency outside the RBM	2,216	3,610	3,844	4,514	...	...	...	...	...	...
Commercial bank deposits with RBM	2,078	2,320	2,215	2,533	...	...	...	...	...	...
Net foreign assets of the monetary authorities	5,828	7,398	7,544	9,683	9,388	9,878	14,320	14,998	15,892	17,529
Net foreign assets of the monetary authorities (in millions of U.S. dollars)	133	159	135	130	121	126	180	183	191	206
Gross foreign assets of the monetary authorities (in millions of U. S. dollars)	260	246	215	205	226	228	269	278	295	309
Foreign liabilities of the monetary authorities (in millions of U. S. dollars)	-127	-87	-80	-75	-104	-102	-89	-94	-104	-103
NDA of the monetary authorities	-1,533	-1,468	-1,486	-2,636	-2,392	-3,566	-6,589	-7,037	-7,029	-7,940
Credit to government (net)	-837	-781	-1,123	927	-552	-2,240	-3,987	-5,472	-5,222	-5,871
Credit to statutory bodies (net)	77	257	284	296	288	300	300	300	350	400
Credit to domestic banks	9	8	26	6	27	30	30	30	35	40
Other items (net)	-783	-952	-673	-3,865	-2,154	-1,656	-2,932	-1,894	-2,193	-2,509
Revaluation accounts	...	...	-1,305	-3,763	-4,163	-4,294	-4,432	-4,853	-5,152	-5,468
Open market operations: holdings of monetary policy bills	...	-197	-774	-1,251	711	1,341	203	1,662	1,662	1,662
Others	...	-755	1,406	1,149	1,297	1,297	1,297	1,297	1,297	1,297
Memorandum items:										
Reserve money (percentage change from previous Dec.)	31.1	38.1	2.2	18.9	18.0	-9.8	10.5	13.8	11.3	8.2
Reserve money: monthly seasonality factor	97.4	97.4	113.1	109.0	100.0	87.1	103.1	100.0	100.0	100.0
Deseasonalized reserve money (percent. change from previous Dec.)		38.1	-9.6	9.1	18.0	3.5	7.2	13.8	11.3	8.2
12-month percentage change in reserve money		38.1	0.8	13.8	18.0	10.5	27.6	13.8	11.3	8.2
Money multiplier	2.01	1.95	2.22	2.28	2.00	2.07	2.17	2.05	2.07	2.10
Currency-deposit ratio	0.30	0.35	0.35	0.34	0.35	...	...	0.35	0.35	0.35
Reserve-deposit ratio	0.31	0.27	0.22	0.21	0.25	...	...	0.23	0.21	0.20
Open market operations mop-up 3/	...	...	-202	477	-908	-630	1,138	-950	0	0

Sources: Reserve Bank of Malawi (RBM); and Fund staff estimates and projections.

1/ Reserve money and NFA calculated at the actual end-period exchange rate.
2/ Reserve money and NFA calculated at the projected end-period exchange rate.
3/ Increases in net sales of treasury bills are shown as positive entries. The figures are annual for December and quarterly for March, June and September.

Table 4. Malawi : Monetary Survey, 1998-2003
(In millions of Malawi kwacha, unless otherwise noted)

	1998 Dec. 1/ Actual	1999 Dec. 1/ Actual	2000 June 1/ Actual	2000 Sep. 1/ Actual	2000 Dec. 2/ Prog.	2001 Mar. 2/ Prog.	2001 June 2/ Prog.	2001 Dec. 2/ Proj.	2002 Dec. 2/ Proj.	2003 Dec. 2/ Proj.
Money and quasi money	8,641.2	11,545.6	13,479.3	16,084.9	13,958.0	13,094.9	16,793.2	16,308.5	18,328.0	20,110.0
Money	4,385.0	6,416.5	7,396.7	7,733.2	...	...	...	...	...	...
Quasi money	4,256.2	5,129.1	6,082.6	8,351.7	...	...	...	...	...	...
Net foreign assets (NFA) of the banking system	7,856.1	8,851.0	9,762.4	12,609.0	12,442.4	13,146.8	18,215.7	19,004.2	21,429.5	23,992.8
NFA of the banking system (in millions of U.S. dollars)	179.0	190.6	174.3	169.8	160.9	167.7	229.1	232.5	257.0	282.1
Gross foreign assets of the banking system (in millions of U. S. dollars)	319.7	293.3	267.2	257.6	279.0	284.7	334.2	344.8	383.0	410.8
Foreign liabilities of the banking system (in millions of U. S. dollars)	-140.7	-102.7	-92.9	-87.6	-118.1	-117.0	-105.1	-112.3	-126.0	-128.7
Monetary authorities	5,827.9	7,397.5	7,544.4	9,683.2	9,387.9	9,877.9	14,319.8	14,997.6	15,892.2	17,528.9
NFA of the monetary authorities (in millions of U.S. dollars)	132.8	159.3	134.7	130.4	121.4	126.0	180.1	183.5	190.6	206.1
Commercial banks	2,028.2	1,453.5	2,218.0	2,925.8	3,054.5	3,268.9	3,895.9	4,006.7	5,537.3	6,463.9
NFA of the commercial banks (in millions of U.S. dollars)	46.2	31.3	39.6	39.4	39.5	41.7	49.0	49.0	66.4	76.0
Net domestic assets (NDA) of the banking system	785.1	2,694.6	3,716.9	3,475.9	1,515.6	-52.0	-1,422.5	-2,695.7	-3,101.5	-3,882.8
Credit to government (net)	-425.3	-675.8	-1,597.3	1,028.0	-365.4	-2,240.4	-4,181.4	-6,153.4	-9,263.4	-14,063.4
Credit to statutory bodies (net)	-310.4	1,288.7	1,046.5	911.5	1,417.6	1,451.8	1,486.8	1,559.3	1,637.3	1,719.2
Credit to private sector	3,186.2	3,365.3	4,856.5	4,678.1	5,122.8	5,570.2	6,289.7	7,440.3	10,445.0	14,808.5
Other items (net)	-1,665.4	-1,283.6	-588.8	-3,141.7	-4,659.3	-4,833.5	-5,017.6	-5,541.9	-5,920.4	-6,347.1
Revaluation accounts	...	...	-1,638.3	-4,764.8	-5,299.3	-5,473.5	-5,657.6	-6,181.9	-6,181.9	-6,560.4
Others	...	...	...	...	640.0	640.0	640.0	640.0	640.0	640.0
Memorandum items:										
Broad money (percentage change from previous Dec.)	55.6	33.6	16.7	39.3	20.9	-6.2	20.3	16.8	12.4	9.7
Velocity of money	6.2	6.9	...	...	8.1	...	...	8.2	8.0	7.9
Broad money: monthly seasonality factor	96.2	96.2	111.3	113.6	100.0	90.2	111.3	100.0	100.0	100.0
Deseasonalized broad money (percent. change from previous Dec.)	...	33.6	4.9	22.7	20.9	4.0	8.1	16.8	12.4	9.7
12-month percentage change in broad money	...	33.6	14.4	37.5	20.9	15.7	24.6	16.8	12.4	9.7
Credit to private sector (cumulative percentage change from prev. Dec.)	98.7	5.6	44.3	39.0	52.2	8.7	22.8	45.2	40.4	41.8

Sources: Reserve Bank of Malawi (RBM); and Fund staff estimates and projections.

1/ Broad money and NFA calculated at the actual end-period exchange rate.

2/ Broad money and NFA calculated at the projected end-period exchange rate.

Table 5. Malawi: Balance of Payments, 1995-2003
(In millions of U.S. dollars, unless otherwise specified)

	1995	1996	1997	1998 Revised Actual	1999 Revised Actual	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.
Current account balance (including grants)	-25.1	-175.9	-263.3	-43.1	-150.5	-135.0	-120.1	-113.2	-103.4
Trade balance	-69.9	-140.5	-244.0	-40.7	-226.3	-194.2	-176.0	-139.4	-134.6
Exports	404.2	483.4	539.4	538.6	447.1	430.9	438.4	478.7	508.6
Imports	-474.2	-623.9	-783.4	-579.3	-673.4	-625.2	-614.4	-618.1	-643.2
Services balance	-102.3	-107.7	-83.8	-134.2	-89.7	-80.0	-76.3	-77.5	-79.7
Interest public sector (net)	-34.2	-21.6	-20.2	-27.5	-16.8	-22.3	-16.6	-14.7	-13.1
Receipts	2.9	7.1	12.8	8.0	8.8	8.7	13.8	14.7	15.4
Payments	-37.2	-28.6	-33.0	-35.5	-25.6	-31.0	-30.4	-29.3	-28.5
Other factor payments (net)	-13.2	-17.4	-21.2	-19.0	-20.4	-19.3	-19.9	-20.7	-21.6
Nonfactor (net)	-54.9	-68.7	-42.5	-87.7	-52.5	-38.4	-39.8	-42.1	-45.0
Receipts	19.4	34.6	46.9	39.4	42.1	41.6	42.6	43.5	44.5
Payments	-74.3	-103.3	-89.4	-127.2	-94.6	-80.0	-82.4	-85.7	-89.5
Unrequited transfers (net)	147.2	72.3	64.6	131.8	165.4	139.1	132.2	103.7	111.0
Private (net)	-4.3	-24.3	-18.8	-25.2	8.9	11.2	11.4	11.7	11.9
Receipts	12.4	8.3	17.9	11.3	21.8	21.8	22.3	22.8	23.3
Payments	-16.8	-32.6	-36.7	-36.5	-12.9	-10.6	-10.9	-11.1	-11.4
Official	151.5	96.6	83.4	157.1	156.5	128.0	120.8	92.0	99.0
Receipts	153.5	98.9	85.2	158.6	157.9	128.6	121.4	92.6	99.7
Balance of payments assistance	88.3	73.2	60.8	75.6	86.0	81.4	73.4	55.6	59.8
Project related	36.4	25.7	24.4	63.0	65.9	47.2	48.0	37.0	39.9
Drought related	28.8	0.0	0.0	20.0	6.0	0.0	0.0	0.0	0.0
Payments	-2.0	-2.4	-1.8	-1.5	-1.3	-0.6	-0.6	-0.6	-0.7
Capital account balance (incl. errors and omissions)	130.7	291.7	214.7	134.1	168.0	103.6	142.5	86.8	63.9
Medium- and long-term flows	108.7	149.8	76.8	165.5	83.8	63.9	101.6	44.2	19.5
Disbursements	155.7	193.4	117.0	210.3	122.8	121.4	159.8	102.8	84.0
Balance of payments support	...	120.6	59.4	61.7	16.0	31.4	77.8	43.2	35.3
Project support	...	52.9	57.6	120.6	106.8	90.0	82.0	59.6	48.7
Other	...	19.9	0.0	28.0	0.0	0.0	0.0	0.0	0.0
Amortization (public sector)	-47.0	-43.6	-40.1	-44.8	-39.0	-57.5	-58.2	-58.6	-64.5
Foreign direct investment and other inflows	...	30.0	23.9	33.6	39.4	39.7	40.9	42.5	44.4
Short-term capital and errors and omissions	22.0	111.9	114.0	-65.0	44.8	0.0	0.0	0.0	0.0
Overall balance	105.5	115.8	-48.5	91.0	17.4	-31.5	22.4	-26.5	-39.4
Financing (-increase in reserves)	-105.5	-115.8	48.3	-91.5	-17.1	31.6	-72.0	-17.2	-25.8
Central bank	-87.0	-109.5	53.3	-76.2	-32.1	37.6	-62.0	-7.2	-15.8
Gross reserves (-increase)	-69.0	-112.4	63.0	-102.6	13.6	20.2	-52.3	-16.8	-14.5
Liabilities	-18.0	2.9	-9.7	26.4	-45.7	17.4	-9.7	9.6	-1.3
Of which: IMF (net)	1.7	7.4	-6.5	-7.2	-11.6	-0.1	10.3	9.6	-1.3
Purchases/drawings	11.6	22.2	10.4	17.9	10.6	8.9	17.8	17.8	8.9
Repurchases/repayments	-9.9	-14.8	-16.9	-25.1	-22.3	-9.0	-7.5	-8.2	-10.2
Commercial banks	-2.5	-6.3	-5.1	-15.3	15.0	-6.0	-10.0	-10.0	-10.0
Arrears	-16.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	-0.1	49.6	43.6	65.2
Debt relief	0.0	0.0	0.0	0.0	0.0	-0.1	31.1	32.8	54.1
Residual Gap: grant financing expected	0.0	0.0	0.0	0.0	0.0	-0.1	18.5	10.9	11.1
Memorandum items:									
Gross official reserves									
In millions of U.S. dollars	105.8	218.2	155.2	257.8	244.2	224.0	276.3	293.1	307.6
In months of imports 1/	1.7	3.0	2.6	4.0	4.2	3.9	4.7	4.8	4.8
Current account balance (percent of GDP)									
Excluding official transfers	-12.4	-12.1	-13.9	-11.6	-17.1	-15.2	-15.4	-12.2	-11.2
Including official transfers	-1.7	-7.7	-10.5	-2.5	-8.3	-7.8	-7.7	-6.7	-5.7

Sources: Malawian authorities; and staff estimates and projections.

1/ In months of following year's imports of goods and nonfactor services.

Table 6. Malawi: Gross External Financing Requirements
(In millions of U.S. dollars)

	1995	1996	1997	1998	1999	Projections 2000	2001	2002	2003
Total financing requirements	-340.7	-454.0	-348.9	-354.4	-373.8	-297.9	-388.9	-298.8	-301.6
Current account deficit (excluding grants)	-176.6	-272.5	-346.7	-200.1	-307.1	-263.0	-240.9	-205.2	-202.4
Amortization (public sector)	-47.0	-43.6	-40.1	-44.8	-39.0	-57.5	-58.2	-58.6	-64.5
Change in international reserves	-91.2	-123.2	54.8	-84.3	-5.5	31.6	-82.3	-26.8	-24.5
Gross official reserves	-69.0	-112.4	63.0	-102.6	13.6	20.2	-52.3	-16.8	-14.5
Official liabilities (- decrease)	-19.7	-4.4	-3.2	33.6	-34.1	17.4	-20.0	0.0	0.0
Commercial bank holdings (net)	-2.5	-6.3	-5.1	-15.3	15.0	-6.0	-10.0	-10.0	-10.0
Change in arrears	-16.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF repayments	-9.9	-14.8	-16.9	-25.1	-22.3	-9.0	-7.5	-8.2	-10.2
Sources of financing	340.8	454.0	348.7	353.9	374.1	298.0	339.3	255.1	236.4
Official grants (net)	151.5	96.6	83.4	157.1	156.5	128.0	120.8	92.0	99.0
Balance of payments support	88.3	73.2	60.8	75.6	86.0	81.4	73.4	55.6	59.8
Project support	63.2	23.4	22.5	81.5	70.6	46.6	47.4	36.4	39.2
Official loans (medium- and long-term)	155.7	193.4	117.0	210.3	122.8	121.4	159.8	102.8	84.0
Balance of payments support	...	120.6	59.4	61.7	16.0	31.4	77.8	43.2	35.3
Project	...	52.9	57.6	120.6	106.8	90.0	82.0	59.6	48.7
Other capital, net 1/	22.0	141.9	137.9	-31.4	84.2	39.7	40.9	42.5	44.4
IMF disbursements	11.6	22.2	10.4	17.9	10.6	8.9	17.8	17.8	8.9
Financing gap	0.1	0.0	-0.2	-0.4	0.3	0.1	49.6	43.6	65.2
Debt relief	0.1	0.0	-0.2	-0.4	0.3	0.1	31.1	32.8	54.1
Residual financing gap: grant financing expected	0.1	0.0	-0.2	-0.4	0.3	0.1	18.5	10.9	11.1

Sources: Malawian authorities; and staff estimates.

1/ Foreign direct investment, short-term inflows, and errors and omissions.

Amount (In millions of SDRs)	Availability Date	Conditions Necessary for Disbursement
6.44	21-Dec-00	Board approval of the three-year arrangement
6.44	15-Feb-01	Observance of December 31, 2000 performance criteria and completion of first review
6.44	15-Aug-01	Observance of June 30, 2001 performance criteria and completion of second review
6.44	15-Feb-02	Observance of December 31, 2001 performance criteria and completion of third review
6.44	15-Aug-02	Observance of June 30, 2002 performance criteria and completion of fourth review
6.44	15-Feb-03	Observance of December 31, 2002 performance criteria and completion of fifth review
6.44	15-Aug-03	Observance of June 30, 2003 performance criteria and completion of sixth review

Table 8. Malawi: Indicators of Fund Credit, 1999-2009

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
						(In millions of SDRs)					
Outstanding Fund credit 1/	90.1	80.5	72.8	64.9	54.8	42.0	27.8	16.8	9.0	3.3	1.3
IMF disbursement 1/	10.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service to the Fund	23.8	10.4	8.4	8.6	10.8	13.4	14.8	11.6	8.2	6.1	2.5
Repayments	22.8	9.6	7.7	8.0	10.1	12.8	14.2	11.0	7.8	5.7	2.1
Charges	1.0	0.8	0.7	0.7	0.7	0.6	0.6	0.6	0.4	0.4	0.4
						(In percent)					
Fund credit outstanding/total debt	3.5	3.0	2.6	2.3	1.9	1.5	1.0	0.6	0.3	0.1	0.0
Fund credit outstanding/total quota	92.2	87.4	79.4	70.3	59.0	44.9	29.8	18.0	9.7	3.6	1.4
Debt service to the Fund/total debt service	27.4	10.7	8.7	9.0	10.4	12.1	13.2	10.2	7.2	5.4	2.3
Debt service to the Fund/exports of goods and services	4.9	2.2	1.7	1.7	1.9	2.3	2.4	1.8	1.2	0.9	0.3
Debt service to the Fund/total quota	24.3	11.3	9.2	9.4	11.6	14.4	15.8	12.4	8.8	6.5	2.7
Debt service to the Fund/gross external reserves	6.9	3.5	2.3	2.2	2.6	3.3	3.4	2.6	1.7	1.3	0.5
Debt service to the Fund/GDP	0.9	0.5	0.4	0.4	0.4	0.5	0.5	0.4	0.3	0.2	0.1
Debt service to the Fund/central government revenue	5.4	2.4	2.1	2.0	2.3	2.6	2.6	1.9	1.3	0.9	0.3
Memorandum items:											
						(In millions of SDRs, unless otherwise indicated)					
Quota	97.7	92.1	91.7	92.3	92.9	93.3	93.3	93.3	93.3	93.3	93.3
Stock of debt	2,608	2,672	2,784	2,838	2,856	2,857	2,858	2,858	2,859	2,861	2,867
Total debt service (without any debt relief)	86.8	97.5	96.1	96.1	103.3	111.1	112.2	113.0	113.7	112.3	108.5
Total exports of goods and nonfactor services	489.2	472.6	480.9	522.3	553.2	578.8	606.6	634.5	663.9	694.9	727.5
Exchange rate (US dollars per SDR)	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3

Sources: IMF Treasurer's Department; Malawian authorities; and Fund staff estimates and projections.

1/ As of October 31, 2000.

Table 9. Malawi: Quantitative Benchmarks Under the PRGF Arrangement 1/
(In millions of Malawi kwacha, unless stated otherwise)

	2000	2001	
	End-December Program	End-March Program	End-June Program
Ceilings on the stock of reserve money 2/ 3/	6,980	6,370	7,321
Floors on the net foreign asssets of the monetary authorities 4/			
(in millions of U.S. dollars)	121	126	180
Ceilings on the net domestic financing of the central government 5/, 6/	976	-3,880	-5,282
Clearance of new domestic budgetary arrears 7/	...	...	...
Ceilings on the stock of external arrears 8/	0	0	0
Ceilings on contracting or guaranteeing of			
external debt by the central government and the Reserve Bank of Malawi (RBM)	0	0	0
Medium and long term 9/	0	0	0
Short term 10/	0	0	0
Memorandum items:			
Balance of payments support (in millions of U.S. dollars) 11/	62	141	177
Transfers from the RBM to the central government	0	0	30

1/ The targets for end-December 2000 are performance criteria; for end-March 2001 and end-June 2001, the targets are benchmarks. The targets are expressed as cumulative changes from June 30, 2000, except for reserve money and net foreign assets.
2/ These ceilings are set as averages of monthly end-period reserve money.
3/ The ceilings will be adjusted downward (upward) to reflect any decrease (increase) in the RBM reserve requirements on deposits.
4/ The floors will be adjusted downward (upward) for any shortfall (excess) of balance of payments support from its programmed levels, up to a maximum of US$50 million.
5/ The ceilings will be adjusted upward (downward) for any shortfall (excess) of balance of payments support from its programmed level, up to a maximum of US$50 million.
6/ The ceilings will be adjusted downward (upward) for any transfer in excess of (below) MK 30 million from the RBM to the central government.
7/ As defined in the technical memorandum of understanding, paragraph 23.
8/ Applicable on a continuous basis.
9/ Excluded from the limit is the use of Fund resources; adjustment lending from the World Bank, the African Development Bank and other multilateral agencies; debt to restructure, refinance, or repay existing debts; and concessional debts.
10/ Includes debt with maturity up to and including one year. These limits do not apply to any disbursements from (i) debts classified as international reserve liabilities of the monetary authorities; (ii) debts to restructure, refinance, or prepay existing debts; (iii) kwacha-denominated Treasury bills and Local Registered Stocks held by nonresidents; (iv) normal import financing; and (v) export performance guarantees by the RBM.
11/ Cumulative from end-June 2000. Excludes HIPC Initiative debt relief.

December 8, 2000

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler,

During Malawi's Enhanced Structural Adjustment Facility (ESAF) arrangement covering the period 1995-99, Malawi made progress in liberalizing its economy and implementing structural reforms that were aimed at laying a sound basis for sustainable growth. However, external shocks and inconsistent implementation of monetary and fiscal policies disrupted our macroeconomic stabilization efforts. These difficulties were compounded by uncertainty about the timing of disbursements from donors who provide crucial support for the Malawi economy. Inflation remains high and growth performance below expectations.

The poorest segments of our society have suffered most from macroeconomic instability and slow growth. We have therefore formulated and started executing a strengthened stabilization program with the aim of alleviating and reducing poverty and promoting equitable growth. Our objectives are outlined in our interim Poverty Reduction Strategy Paper (PRSP) and the elements of an economic program for 2000-01 are described in the attached memorandum on economic policies.

We are requesting support from the Fund under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement in the amount of SDR 45.11 million (65 percent of quota) and are seeking debt relief under the enhanced HIPC Initiative.

While we believe that the policies and our economic objective measures set forth in the attached memorandum are adequate to achieve our economic objectives over the next three years, we stand ready to take any additional measures that may prove necessary for this purpose. During the period of the PRGF, we will not, without Fund approval, introduce new or intensify existing restrictions on payments and transfers for current international transactions, nor introduce any multiple currency practice, conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, nor introduce or intensify import restrictions for balance of payments reasons. We will also consult with the Fund on the adoption of any additional measures that may be appropriate, either at our own initiative or at the request of the Managing Director. In addition, after the period covered by the first annual arrangement and while Malawi has outstanding financial obligations to the Fund arising from loans granted under this arrangement, Malawi will consult with the Fund periodically, at our own initiative or whenever the Managing Director requests such a consultation, on Malawi's economic and financial policies. Malawi will provide the Trustee with such information as the Trustee requests in connection with the progress of Malawi in implementing the policies and reaching the objectives of the program supported by the arrangement.

Sincerely yours,

/s/

Dr. Ellias E. Ngalande
Governor
Reserve Bank of Malawi

/s/

Dr. Mathews A. P. Chikaonda
Minister of Finance and
Economic Planning

MALAWI

Memorandum on the Economic Policies of the Government of Malawi

December 8, 2000

I. Background

1. Since the 1995–99 Enhanced Structural Adjustment Facility (ESAF) arrangement was completed in October 1999, Malawi's economic performance has been mixed. Growth has been moderate, with GDP expected to rise by 3.2 percent between 1999 and 2000. The 12-month increase in consumer prices fell to 22 percent in June, but has since rebounded to 35 percent. The fiscal deficit, including grants, in financial-year 1999/2000 was cut to 5.0 percent of GDP from 5.5 percent in 1998/99 while the rate of growth in broad money was 37.5 percent in the year to September 2000, compared with 29.7 percent a year earlier.

2. Structural and economic reforms have been extended. The importation of petroleum products has been fully liberalized, the intervention of the National Food Reserve Agency (NFRA) through the "maize price" band has been abandoned, revenue collection and administration have been improved, and the Malawi Revenue Authority (MRA) has been established.

3. The government now intends to consolidate progress under earlier ESAF programs by seeking support under the Poverty Reduction and Growth Facility (PRGF). This will help to advance the goals laid out in the interim poverty reduction strategy paper, which will be elaborated next year in a full poverty reduction strategy paper (PRSP).

II. Challenges and Strategies for the Medium-Term

A. Challenges Ahead

4. Despite progress on structural reform, Malawi faces many daunting tasks. The biggest challenge is to achieve a lasting reduction in poverty, and macroeconomic stabilization is an essential precondition.

5. High growth rates and poverty reduction will be achieved only if Malawi can address some fundamental weaknesses:

- Private saving and capital formation rates are inadequate.
- Lapses in fiscal discipline have led to monetary expansion and high real interest rates.
- Public expenditure monitoring and control have been weak.
- There have been substantial and unwarranted swings in economic policy.

- The formal sector of the economy of Malawi is still dominated by oligopolies.
- Land issues continue to constrain agricultural output.
- The momentum of civil service reform has declined.
- Accountability and sound governance have yet to be improved.
- International competitiveness is hampered by the high cost of utilities and domestic and international transportation.
- There is overdependence on foreign financial assistance.
- Statistics are not of sufficient quality or timeliness.

B. Medium-Term Objectives and Strategy

6. Under the PRGF arrangement, Malawi will seek to attain, by the last year of the program, sustainable real GDP growth of at least 4.5 percent; an inflation rate of 5.0 percent; gross official external reserves that would cover at least 4.8 months imports of goods and nonfactor services; a current account deficit (including public transfers) below 6.0 percent of GDP; and a reduction in the number of people living beneath the poverty line.

7. The government's strategy to accelerate growth and reduce poverty will be fully elaborated in its forthcoming poverty reduction strategy paper (PRSP). As outlined in the interim PRSP, the main sources of output growth in Malawi will be the agricultural sector and the diversification of the economy toward the manufacturing, tourism, and mining sectors.

8. **Private sector-led development**, involving increased private savings and capital formation, is a key element of Malawi's medium-term growth strategy. In this regard, policies to bring about macroeconomic stability, lower fiscal deficits, and liberalize the financial sector will be critical. In addition, policies aimed at ensuring competitive conditions in all sectors, involving improvements in the transportation network and other parts of the infrastructure, will play crucial roles. Remaining regulatory restrictions on the marketing of grains and tobacco will be removed, and the government will maintain a liberal framework for importing and marketing petroleum products.

9. To establish **macroeconomic stability,** fiscal discipline will be forcefully implemented. This will contribute toward higher public savings and a sustained reduction in inflation and real interest rates. The fiscal deficit (including grants) is projected to move into surplus during the arrangement. Growth in the stock of broad money will be contained below 10 percent per annum by the end of the program period by targeting reserve money, while the kwacha exchange rate will continue to be market determined.

10. The medium-term fiscal program takes account of expected assistance under the **enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative)** of

US$14.7 million in 2000/01, US$32.5 million in 2001/02, and US$44.2 million in 2002/03. It is projected that debt-service relief will commence in January 2001. In 2000/01, HIPC resources of US$6 million have been allocated for purchases of drugs and teaching material. Once further priorities are identified during the PRSP process, currently unallocated HIPC resources will formally be allocated to priority areas.

11. The government will continue to broaden and deepen other **structural reforms** by putting in place effective systems of expenditure control and monitoring; ensuring that public money will be better spent by prioritizing recurrent government expenditure through the use of the medium-term expenditure framework (MTEF); strengthening the Malawi Revenue Authority's (MRA) capacity for revenue collection; furthering civil service reform; continuing efforts to privatize commercial banks; and ensuring that a comprehensive financial sector regulatory framework is in place. Given past experience with waste and fraud in government, efforts will be intensified to improve accountability and governance. Measures will be implemented to increase fiscal transparency and improve the provision of economic and financial statistics. Social safety nets will protect the most vulnerable in society.

III. THE PROGRAM FOR 2000–01

A. Policy Strategy

12. The macroeconomic objectives for 2001 are as follows:

- real GDP growth of 3.0 percent;
- a reduction of 12-month inflation to 10 percent by end-December 2001;
- an external current account deficit (including official transfers) in 2001 of 7.7 percent of GDP, which, after taking into account other expected external financing, would allow gross external reserves to increase to 4.7 months of imports by end-2001; and
- a reduction in income inequality and poverty.

13. To achieve these goals, the following actions will be taken:

- The rate of growth in reserve money will not exceed 27.6 percent in the year to end-June 2001 and 13.8 percent in the year to end-Dec 2001.
- Interest rates and the exchange rate will be allowed to adjust freely in order to meet the program's monetary and international reserve targets.
- Fiscal restraint will help to further bolster confidence, contain aggregate demand, and maintain a competitive exchange rate while easing upward pressure on both nominal and real interest rates. The overall fiscal accounts will be roughly in balance in 2000/01.

- Spending will be prioritized.
- The ongoing structural reforms will be deepened, widened, and more forcefully implemented.

B. Monetary Policy

14. Broad money stock (M2) will remain the nominal anchor and the primary tool for controlling inflation. Its 12-month growth rate will be reduced from 33.6 percent at end-1999 to 20.9 percent at end-2000 and 16.8 percent at end-2001. To achieve this, reserve money growth targets of 18.0 percent and 13.8 percent will be pursued in the 12 months to the last quarters of 2000 and 2001, respectively. The principal instruments to achieve these targets will be open market operations in Reserve Bank of Malawi (RBM) and treasury bills.

15. Consistent with the use of money as the nominal anchor, the exchange rate of the kwacha will be market determined, and the RBM's intervention will therefore be limited to meeting the net official reserves target and smoothing exchange rate movements.

16. The reserve requirement on domestic currency deposits has, with effect from June 1, 2000, been reduced from 35 percent to 30 percent and is now assessed on a weekly-average basis. The high reserve requirements are imposing a heavy tax on financial intermediation by increasing the spread between deposit and lending rates. The RBM will therefore lower them further when liquidity conditions allow or will consider full or partial remuneration.

17. The extent to which commercial bank deposits with the discount house are eligible in meeting the reserve requirement has been limited to 25 percent of the total requirement. This arrangement will be kept under review.

C. Fiscal Policy

18. A tight fiscal stance will be maintained in 2000–01. An overall fiscal balance (on a cash basis) will be targeted for the fiscal year ending June 2001 (including grants) and 11.4 percent of GDP (excluding grants). The domestic budget deficit[1] will be reduced to 1.3 percent of GDP in 2000/01.

19. Total spending on wages and salaries will increase by 41 percent in fiscal year 2000/01 including a general wage increase, the implementation of a new housing allowance scheme, the increased travel allowances for members of parliament (MPs), and the introduction of contractual employment for top civil servants. While these measures will decompress the wage scale, most civil servants will receive an increase in total remuneration, including housing allowances, of at least 25 percent. MPs and ministers will receive the same

[1] Defined as government expenditure, excluding foreign interest payments and foreign-financed development expenditure, minus revenue.

average increase in their salary and housing allowances as those civil servants not on contract or currently in government houses.

20. Revenue will be enhanced through continued improvement in the efficiency of the tax system and tax administration. The recently established MRA will be given adequate incentives and a value-for-money audit will be conducted to assess its current performance. Draft legislation for the extension of the surtax to the retail and wholesale stages will be submitted to parliament by December 18, 2000.

21. Government expenditure will decline as a share of GDP, with nonpriority expenditure further curtailed to increase outlays on antipoverty programs and, more generally, to allow expenditure in social sectors to increase as a share of GDP. This reallocation will take place within the context of the forthcoming PRSP and a strengthened MTEF.

22. To help achieve the targeted reduction in net spending, cost recovery measures on administrative and public services will be implemented. Measures to reduce expenditure will also be achieved through close monitoring of the consumption of utilities, a reduction by one-fourth in the fleet of administrative and government vehicles, a substantial reduction in the costs of local and external travel by government employees, and a review of government representation abroad.

23. To ensure appropriate monitoring of government spending, public expenditure management processes will be further strengthened. The new commitment control system (CCS) that has been implemented this year will be fully operational by December 2000 and will permit assessment of the stock of outstanding commitments, improve budget and cash-flow management, and avoid the recurrence of arrears. The government will ensure that, starting with returns from December 2000, 100 percent of monthly returns under the new commitment controls system will be received from line ministries by the Ministry of Finance. The Auditor-General reported, on November 28, his assessment of the stock of central government arrears as at the end of June 2000. These arrears and any contested claims that are subsequently verified, will be cleared during the current fiscal year. Within six weeks of the end of each quarter, the Auditor-General will verify the amount of any new arrears as at the end of that quarter. His verification will include a reconciliation with CCS returns of each line Ministry, and include specification of any disputed arrears. Any verified arrears will be cleared within the quarter.

24. Other measures in this area will aim at

- completing the withdrawal of government cash balances in commercial banks by the end of this calendar year, as planned under the new Credit Ceiling Authorization system;

- implementing the Integrated Financial Management Information System (IFMIS) in four pilot ministries by end-December, with a view to its subsequent extension to other ministries by mid-2002; and

- establishing a full internal audit function.

25. A proper monitoring of parastatals will be put in place by the recently created Parastatal Enterprise Reform and Monitoring Unit in the Ministry of Finance. Among its first actions will be the introduction of a quarterly report, including the overall debt position of each of the major parastatals, and a cross-check of arrears between government and parastatals.

D. Financial Sector Policies

26. Policies to develop and foster competition and efficiency in the primary and secondary markets for government securities are being put in place. To this effect, the RBM will, by end-December 2000, arrange for the removal of legal obstacles to full implementation of a complete book-entry system.

E. External Policies

27. External sector policies will seek to reduce remaining barriers to trade and rationalize the existing structure of tariffs. In line with its decision to join the Common Market for Eastern and Southern Africa (COMESA) free trade area at its inception on October 31, 2000 the government has removed all duties from trade with other participants. The government will also liberalize trade with other Southern African Development Community (SADC) members under the free trade area launched in September 2000 and will consolidate commitments made under the Cross-Border Initiative (CBI)—now the Regional Integration Facilitation Forum. The government will move cautiously toward removing the remaining export surrender requirements.

F. Competition Policies

28. Following the liberalization of trade in **agricultural products**, the private sector has been expanding into retailing in agricultural products, an area that used to be an exclusive preserve of ADMARC, the public distribution and marketing agency. As a continuation of this policy, the government is considering a detailed, time-bound plan for the commercialization and subsequent privatization of all of ADMARC's activities. It is expected that preparation for full privatization will be completed by end-2002.

29. Large purchases of maize were made by the **National Food Reserve Agency (NFRA)**, largely using borrowed resources soon after its inception in 1999 during the bumper maize harvest. Much of this maize remains in storage. It is now clear that the levels of stocks are far in excess of the nation's requirements for potential disaster and relief operations. Strong efforts are being made to find additional domestic and/or international buyers with the aim of reducing the level of stocks to 60,000 metric tons. As a consequence of a second bumper crop in 2000, receipts from these sales will not cover NFRA's purchase and storage costs. Expectations were that the NFRA would be capitalized with the assistance of the international community but this has yet to be concluded. As NFRA is unable to service its debt, it is seeking to reschedule part of the debt. The government will meet MK

356 million in interest payments due in 2000/01. In future, the NFRA will confine its operations to disaster relief, with holdings of maize limited to no more than 60,000 metric tons.

30. One of the great successes of the liberalization program in Malawi is the rapid increase in smallholder production of **tobacco**, particularly burley tobacco. This has been facilitated by the Intermediate Buyers (IB) system, which has permitted small growers to take advantage of broader markets and has provided a source of cash for those with limited access to credit. However, a deterioration in overall tobacco quality and increase in thefts have been attributed to the weak regulation of the IB system. As a result, the government is considering refining current licensing arrangements. This will, however, not result in any restriction in access to marketing opportunities for small growers. In addition to these modifications to the IB system, the government will consider the elimination of all restrictions on the direct export of tobacco.

31. There have been major developments in the **financial sector** in the last four years. A number of new banks have been licensed. However, the sector is still dominated by two banks in which the government has a considerable financial stake, the National Bank of Malawi and the Commercial Bank of Malawi. Much still needs to be done to promote competition and efficiency in the financial sector. Accordingly, the authorities will

- complete, by February 2001, an action plan to introduce a new comprehensive financial sector regulatory framework that will cover nonbank financial institutions and markets; strengthen banking and nonbanking supervision; improve loan classification, provisioning, and insider-and connected-lending requirements; and reduce interlocking ownership of the two large commercial banks;
- resume efforts to find a strategic partner for the Commercial Bank of Malawi; and
- ensure that no change in the ownership structure of the Commercial Bank of Malawi or the National Bank of Malawi can be secured without adequate safeguards for all of their customers.

32. In recent years, the **Petroleum Control Commission** (PCC) has been importing all of the country's petroleum requirements. However, with effect from May 2000, its role has been limited to that of regulating the petroleum market. This change has had the following consequences:

- All importation of petroleum products is now being handled by the private sector.
- Although a new company, ORTEX, was formed to take over the nonregulatory functions of the PCC, including oil storage, it is now clear that oil distribution and marketing are not appropriate activities for the public sector. Accordingly, ORTEX will be privatized by May 2002.
- The automatic petroleum pricing formula agreed with the Fund staff in 1998 is now being administered by a private sector committee under the chairmanship of the Malawi Chamber of Commerce. The only discretion accorded to the government

through the Ministry of Finance is a two-week period in which to challenge the validity of the calculations.

G. Governance

33. Prima facie evidence indicates that corruption and fraud remain major problems in Malawi. The government is fully committed to the prevention of fraud and corruption and prosecution of all identified offenders. Furthermore, the government is committed to supporting the work of the Anti-Corruption Bureau and the Auditor-General and is determined to achieve good governance. In pursuit of this commitment, the government will

- give all possible support to the Anti-Corruption Bureau (ACB) and the Director of Public Prosecutions (DPP) in their investigations and potential prosecution of former officials of the PCC implicated in the irregularities highlighted in the 1998 audit report on the PCC, and take steps to recover misappropriated funds;
- facilitate further action by the ACB and DPP in the cases of the disputed contract award to SECUCOM to provide identity cards and the attempted procurement of Land Rovers through Apex Motors;
- by end-February 2001, pursue the recovery of at least MK 150 million in cases of large-scale evasion of customs duties, together with appropriate penalties, and provide adequate resources for investigation and prosecution of such cases, including associated corruption issues;
- ensure that any evidence of fraud or corruption revealed in the reports of the Auditor-General is immediately pursued by the relevant investigating and prosecuting authorities; and
- consider further and, if possible, put in place mechanisms to accelerate the processing of cases of fraud and corruption during 2001.

34. The government will improve safeguards against corruption and abuse of office. To this effect, the government will during 2000-01

- present a bill to parliament to amend the Finance and Audit Act so as to separate the two functions of fiscal management and audit under new legislation;
- establish, under the proposed new legislation, the independence of the Auditor-General; and
- present a bill to parliament to establish a new Procurement Code and Procurement Authority that will decentralize procurement to the purchasing agencies.

H. Safety Net Strategy

35. The government is fully committed to the alleviation of poverty in Malawi and has prepared, in consultation with civil society and with technical assistance from the World Bank staff, a National Safety Net Strategy. One component of this will be targeted assistance to low-income households to alleviate food insecurity. The "starter-pack" program

implemented in 1998/99 and 1999/00 has been streamlined in 2000/01 to become a "Targeted Input Program" for lower-income households. In future years, the targeting of this program will be further refined.

I. Statistics and Transparency

36. The Government and the Reserve Bank of Malawi will promote transparency by disseminating adequate and timely information about the state of the economy and the affairs and activities of the government. To this end,

- the minutes of the monthly meetings of the Monetary Policy Committee are now being published immediately after the following meeting;
- the Reserve Bank will publish its monetary targets and data to assess its performance against such targets;
- the government will make available quarterly fiscal data, with a lag of not more than a month, through its website;
- the RBM will start providing monthly statistics on banking, finance and international reserves, with a lag of not more than a month and with effect from not later than end-2000, on its website;
- the government will start providing quarterly reports on spending on high-and low-piority programs on its website, starting with the third quarter of 2000 and with a target publication date of one month after the end of the quarter; and
- the Reserve Bank will continue to announce the amount of bills it offers for sale at auctions.

37. The government considers that adequate and timely information and statistics are indispensable to its policymaking and implementation. The government will, therefore

- develop, by mid-2001, an action plan for expanding the scope and improving the quality of statistical information to include data on sectoral national accounts, medium- and small-scale business activities, and local government finances;
- develop, in the context of the National Safety Net Strategy, an action plan for expanding substantially the scope of statistical information on poverty and antipoverty public actions, intermediate targets, and objectives; and
- ensure adequate funding for, and recruitment to, the National Statistical Office (NSO).

38. The government has been trying to improve information coordination among various interdependent ministries and departments. This is exemplified by the establishment of the Debt and Aid Management Division; biweekly meetings of the technical staff of the Ministry of Finance and Economic Planning, Reserve Bank of Malawi, and National Economic

Council (NEC) to review the accuracy of economic data; monthly meetings of the National Economic Management Committee (principal secretary level); and monthly reporting of information on economic program implementation to the Special Cabinet Committee on Budgetary Measures. These steps will be taken further through the establishment of a high-level Public Debt Management Committee, representing both the Ministry of Finance and Economic Planning and the Reserve Bank, with responsibility for planning and coordinating public debt-management strategy and monetary policy issues that jointly concern the two agencies; and appropriate supporting committees. The Accountant-General will hold weekly meetings with the Reserve Bank on cash-flow developments.

J. Program Monitoring

39. Indicative targets and quantitative performance criteria for the period through end of June 2001 are presented in Table 1 and structural benchmarks and performance criteria in Table 2.

40. There will be six semiannual program reviews. In addition to assessing progress on macroeconomic stabilization, the first review will focus on the implementation and operation of the new system of commitment and spending control. It will evaluate the monitoring, prevention and clearance of arrears by central government. A further consideration will be good governance. The review will seek to establish whether action has been taken to collect tax revenues evaded from the government and to pursue charges against individuals for which either the Auditor-General or ACB has produced evidence of fraud or corruption.

Table 1. Malawi: Quantitative Benchmarks Under the PRGF Arrangement 1/
(In millions of Malawi kwacha, unless stated otherwise)

	2000	2001	
	End-December Program	End-March Program	End-June Program
Ceilings on the stock of reserve money 2/ 3/	6,980	6,370	7,321
Floors on the net foreign asssets of the monetary authorities 4/ (in millions of U.S. dollars)	121	126	180
Ceilings on the net domestic financing of the central government 5/, 6/	976	-3,880	-5,282
Clearance of new domestic budgetary arrears 7/	...	...	...
Ceilings on the stock of external arrears 8/	0	0	0
Ceilings on contracting or guaranteeing of external debt by the central government and the Reserve Bank of Malawi (RBM)	0	0	0
Medium and long term 9/	0	0	0
Short term 10/	0	0	0
Memorandum items:			
Balance of payments support (in millions of U.S. dollars) 11/	62	141	177
Transfers from the RBM to the central government	0	0	30

1/ The targets for end-December 2000 are performance criteria; for end-March 2001 and end-June 2001, the targets are benchmarks. The targets are expressed as cumulative changes from June 30, 2000, except for reserve money and net foreign assets.
2/ These ceilings are set as averages of monthly end-period reserve money.
3/ The ceilings will be adjusted downward (upward) to reflect any decrease (increase) in the RBM reserve requirements on deposits.
4/ The floors will be adjusted downward (upward) for any shortfall (excess) of balance of payments support from its programmed levels, up to a maximum of US$50 million.
5/ The ceilings will be adjusted upward (downward) for any shortfall (excess) of balance of payments support from its programmed level, up to a maximum of US$50 million.
6/ The ceilings will be adjusted downward (upward) for any transfer in excess of (below) MK 30 million from the RBM to the central government.
7/ As defined in the technical memorandum of understanding, paragraph 23.
8/ Applicable on a continuous basis.
9/ Excluded from the limit is the use of Fund resources; adjustment lending from the World Bank, the African Development Bank and other multilateral agencies; debt to restructure, refinance, or repay existing debts; and concessional debts.
10/ Includes debt with maturity up to and including one year. These limits do not apply to any disbursements from (i) debts classified as international reserve liabilities of the monetary authorities; (ii) debts to restructure, refinance, or prepay existing debts; (iii) kwacha-denominated Treasury bills and Local Registered Stocks held by nonresidents; (iv) normal import financing; and (v) export performance guarantees by the RBM.
11/ Cumulative from end-June 2000. Excludes HIPC Initiative debt relief.

Table 2. Prior Actions, Structural Performance Criteria and Benchmarks

I. Prior Actions for Board Discussion

- Confirmation by FAD that the new interim central government expenditure-monitoring and control system is being effectively implemented, including the maintenance of commitment registers and submission to the Ministry of Finance of monthly reports on commitments and arrears by line ministries.

- Establishment by November 2000 of a High-Level Public Debt Management Committee by the Ministry of Finance and the Reserve Bank of Malawi and associated supporting committees.

- Submission to parliament by December 18, 2000 of a bill to extend the surtax base to the wholesale and retail stages.

II. Structural Performance Criteria

- Compilation by the Ministry of Finance of monthly reviews, that (i) summarize the monthly reports by line ministries on commitment levels and arrears and (ii) assess prospects for meeting budget targets in 2000/01.
- Commencement of full operations, by the end of December 2000, of a unit in the Ministry of Finance to monitor the activities of parastatals, including quarterly borrowing returns and the provision of annual accounts and completion of the first quarterly report on ten parastatals before the end of 2000.
- Avoidance of any new borrowing by the National Food Reserve Agency (NFRA).

III. Structural Benchmarks

- Receipt from line ministries of 100 percent of monthly returns under the new commitment control system, starting with returns from December 2000.
- Dissemination of quarterly reports on spending on priority (poverty-related) programs starting with the third quarter of 2000 and with target publication date of one month after the end of the quarter.
- Maintenance of uniform access by all growers to the tobacco sales network and preservation of the intermediate buyers' system or equivalent mechanism.
- Pursuit by official investigators and prosecutors of all evidence of fraud, corruption, and misappropriation of public funds identified in the reports of the Auditor-General, particularly in the cases of the Petroleum Control Commission (PCC) and public procurement.
- Recovery, by February 2001, of at least MK 150 million of revenue lost through tax evasion—and application of available penalties—as assessed by the Malawi Revenue Authority, particularly in the case of large customs duties outstanding; and pursuit of any associated cases of corruption.
- Removal of legal obstacles preventing implementation of a complete book-entry system for government securities before the end of 2000.
- Formalization of the system for authorizing parastatal borrowing by April 2001.

MALAWI: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which Malawi's performance under the program supported by a Poverty Reduction and Growth Facility (PRGF) arrangement will be assessed. Monitoring procedures and reporting requirements are also specified.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. Performance criteria for December 31, 2000, and indicative targets for March 31, 2001 and June 30, 2001 have been established with respect to

- ceilings on the stock of reserve money;
- floors on the level of net foreign asset of the monetary authorities;
- ceilings on the cumulative net domestic financing of the central government;
- clearance of new domestic budgetary arrears of the central government;
- ceilings on the contracting and guaranteeing by the central government or the Reserve Bank of Malawi (RBM) of medium- and long-term external debt; and
- ceilings on the contracting or guaranteeing by the central government or the RBM of short-term external debt.

3. A performance criterion that is applicable on a continuous basis has been established with respect to the ceilings on the stock of external arrears of the central government and the RBM.

II. INSTITUTIONAL DEFINITIONS

4. The central government includes all units of government that exercise authority over the entire economic territory. However, in contrast to the System of National Accounts (SNA) and government finance statistics (GFS) standards, nonprofit institutions that are controlled and financed by the central government are excluded for the purposes of this memorandum.

5. The accounts of the monetary authorities include the balance sheet of the RBM and the international reserves' holdings of the central government. [1]

[1] The counterpart entry to the central government's international reserve assets will be classified as "net credit to central government."

III. Limits on Monetary Aggregates

A. Reserve Money

6. A ceiling on the stock of reserve money applies. For the purposes of the program, the stock of reserve money for the quarter will be calculated as the arithmetic average (mean) of the stock of reserve money at the last day of each calendar month comprising the quarter.

7. Reserve money consists of currency issued by the RBM and balances of commercial banks accounts with the RBM. This includes required reserves held for kwacha deposits and any other domestic currency-reservable liabilities and other demand and time deposits held with the RBM.

8. **Adjusters**. The ceiling on the stock of reserve money will be adjusted downward for a decrease in the reserve requirement ratio and the ceiling will be adjusted upward for an increase in the ratio. For each month of a particular quarter, the following calculation would be undertaken: 0.75 **multiplied by** (the program baseline required reserve ratio **minus** the new required reserve ratio) **multiplied by** the amount of reservable deposit liabilities in commercial banks as at the end of the previous calendar month.[2] The adjustment for each month would be summed up and divided by three before being applied to the performance criterion for the respective quarter.

B. Limit on Net Foreign Assets of the Monetary Authorities

9. A floor applies to the level of net foreign assets (NFA) of the monetary authorities.

10. **NFA** will be valued in U.S. dollars at actual end-of-period exchange rates. Monetary gold will be valued at the fixed RBM accounting rate.

11. NFA will be calculated as the difference between gross international reserve assets and international reserve liabilities.

12. **Gross international reserve assets** of the monetary authorities are defined as the sum of

- monetary gold holdings of the RBM;
- holdings of SDRs;
- Malawi's reserve position in the IMF;

[2] The adjustment factor of 0.75 reflects the provision that allows 25 percent of reserve assets to be held with a discount house (Continental Discount House).

- central government (treasury) holdings with crown agents; and
- foreign currency assets in convertible currencies held abroad that are under the direct and effective control of the RBM and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- Excluded from the definition of gross reserves are any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

13. **International reserve liabilities** of the monetary authorities are defined as the sum of

- outstanding liabilities of the RBM to the IMF; and
- any foreign convertible currency liabilities of the RBM with an original maturity of up to and including one year.

Excluded from the definition are liabilities arising from balance of payments support of original maturities of more than one year.

14. **Adjusters**. The floor on NFA will be adjusted upward, up to a maximum of US$50 million, for balance of payments support (including grants and loans) in excess of the programmed level as set out in the table on quantitative performance criteria. The floor on NFA will be adjusted downward, up to a maximum of US$50 million for balance of payments support (including grants and loans) falling short of the programmed level as set out in the table on quantitative performance criteria.

IV. Limit on the Net Domestic Financing of the Central Government

15. A ceiling applies on the net domestic financing flows of the central government (NDFCG) measured cumulatively from June 30, 2000.

16. **NDFCG** are defined as the sum of the change in the stock of net credit from domestic banks, nonbanks, the change in domestic payment arrears, and privatization proceeds from government assets that accrue to the central government.[3]

[3] Some receipts from the privatization of parastatals have been split between the central government and the holding companies of the former parastatals at a ratio of 80:20. Only those receipts that accrue directly to central government constitute financing of the central government.

17. **Net credit from domestic banks** is computed as the sum of (i) net borrowing from the RBM (ways and means advances, loans, holdings of local registered stocks, and holdings of treasury bills minus deposits), (ii) net borrowing from commercial banks (holdings of local registered stocks, holdings of treasury bills minus deposits), and (iii) holdings of promissory notes. The treasury bills and local registered stocks are valued at their purchasing prices. Excluded are holdings of treasury bills issued by the RBM for monetary operations.

18. **Net credit from domestic nonbanks** includes (i) holdings of local registered stocks by the private sector and other financial institutions, (ii) holdings of Treasury bills by the private sector and other financial institutions, (iii) supplier credits, and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at their purchasing price. Excluded are holdings of treasury bills issued by the RBM for monetary operations.

19. **Domestic budgetary arrears** are defined as the sum of the changes in the stock of domestic arrears from their level as at June 30, 2000, of MK389 million[4] and the net accumulation of new budgetary arrears during the current fiscal year.

20. New budgetary arrears are defined as those payments delayed on central government commitments during the current fiscal year, including on wages and salaries, pensions, transfers, domestic interest, goods and services, and payments to the Malawi Revenue Authority (MRA) for tax refunds. Payments on wages and salaries, pensions, and transfers are in arrears when they remain unpaid for more than 30 days beyond their due date.[5] Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if they have not been made (i) within 30 days of the date of invoice, or—if a grace period has been agreed—(ii) within the contractually agreed grace period. Payments by the Ministry of Finance to the MRA for the purpose of tax refunds are in arrears if the payment has not been made within 30 days after the claim has been made.

21. **Adjusters.** The ceiling on NDFCG will be adjusted upward—up to a maximum of the kwacha equivalent of US$50 million—for any shortfall of balance of payments support from its programmed level as set out in the table on quantitative performance criteria. The ceiling on NDFCG will be adjusted downward – up to a maximum of the kwacha equivalent of US$50 million – for any excess of balance of payments support over its programmed level as set out in the table on quantitative performance criteria. For purposes of the program, the adjuster will be calculated using the average U.S. dollar-kwacha exchange rate during the respective calendar quarter in which the shortfall was experienced.

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[4] The Auditor-General reported on November 28, 2000 outstanding arrears as at end-June, 2000 of MK554 million. However, this included MK165 million, which had been cleared already through special treasury bills.

[5] Pension benefits that are being assessed following retirement are not considered in arrears.

22. The ceiling on NDFCG will be adjusted downward for any transfer over the program baseline from the RBM to the central government and upward for any shortfall.

V. CLEARANCE OF NEW DOMESTIC BUDGETARY ARREARS OF THE CENTRAL GOVERNMENT

23. Should at any time during the program new domestic budgetary arrears of the central government (as defined in paragraph 20 above) be verified, then the government will clear these arrears by no later than the end of the fiscal quarter following the fiscal quarter in which these arrears were accumulated.

VI. LIMITS ON EXTERNAL DEBT

A. Limit on Medium- and Long-Term External Debt

24. A ceiling applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf of the central government on debt with nonresidents with original maturities of over one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from June 30, 2000.

25. The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140), Point 9, as revised on August 24, 2000 (see Annex).

26. Excluded from the limit is the use of Fund resources; adjustment lending from the World Bank, the African Development Bank and other multilateral agencies; debts to restructure, refinance, or prepay existing debts; concessional debts; and any kwacha-denominated treasury bill and local registered stock holdings by nonresidents.

27. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element **is equal to** (nominal value **minus** NPV) **divided by** nominal value). The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD. For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculated the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through July 2001, the CIRRs published by the OECD in July 2000 will be used. For example, based on July 2000 CIRR rates, a U.S. dollar-denominated debt with a 10-year maturity would be considered concessional if the interest rate did not exceed 3 percent.

B. Limit on Short-Term External Debt

28. A ceiling applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf the central government of debt with nonresidents with original maturities of one year or less. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received.

29. The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140), Point 9, as revised on August 24, 2000 (see Annex).

30. Excluded from the limit are (i) debts classified as international reserve liabilities of the RBM; (ii) debts to restructure, refinance, or prepay existing debts; (iii) kwacha-denominated treasury bills and local registered stocks held by nonresidents; (iv) normal import financing; and (v) export performance guarantees by the RBM. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VII. Limit on External Payment Arrears

31. A continuous performance criterion applies on the nonaccumulation of external payment arrears on external debt contracted or guaranteed by the central government or the RBM. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements.

VIII. Reporting

32. The authorities have committed themselves to using the best available data, so that any subsequent data revisions will not lead to a breach of a performance criterion. All revisions to data will be promptly reported to the Fund staff, particularly when the changes are significant. The likelihood of significant data changes will be communicated to Fund staff as soon as the risk becomes apparent to the authorities. All data will be reported electronically in the format and frequency set out below and within the period specified.

33. Subject to technical capacity being sufficiently built up, the RBM will commence reporting on a **daily** basis within one day, gross reserves, net interventions of the RBM in the foreign exchange market, reserve money, interest rates on standing facilities and market operations, net volume on open market operations, results of treasury bill auctions, and secondary market prices of outstanding treasury bills (reporting agency: RBM).

34. On a **weekly** basis within five working days of the end of the respective week, the balance sheet of the monetary authorities in the format specified for Table 1 will be reported (reporting agency: RBM).

35. On a **monthly** basis within 30 working days of the end of the respective month, the monetary survey (Table 2), the monetary authorities' accounts (Table 3), the commercial banks' accounts (Table 4), the international reserves position (Table 5), local registered stock holdings (Table 6), treasury bill holdings (Table 7), central government domestic borrowings (Table 8), central government foreign borrowings (Table 9), guarantees extended by the RBM or central government on foreign operations of Malawian residents (Table 10), interest rates (Table 11), exchange rates (Table 12), and the consumer price index (Table 13) will be reported in the format agreed for those tables (reporting agency: RBM).

36. On a **monthly** basis within 45 calendar days of the end of the respective month, the fiscal accounts of the central government (Table 14), the borrowings of the ten major parastatals, and reviews summarizing achievement of commitment levels and arrears will be reported in the agreed format (reporting agency: Ministry of Finance).

37. On a **quarterly** basis within 45 calendar days of the end of the respective calendar quarter, central government reports on spending on priority (poverty-related) programs will be transmitted (reporting agency: Ministry of Finance).

38. On a **quarterly** basis within 45 calendar days of the end of the respective calendar quarter, a report on performance under the program will be transmitted (reporting agency: RBM and Ministry of Finance).

GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 24, 2000

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Malawi: Fund Relations
(As of October 31, 2000)

I. Membership Status: Joined: 07/19/1965; Article VIII

II. General Resources Account:	SDR Million	%Quota
Quota	69.40	100.0
Fund Holdings of Currency	67.17	96.8
Reserve position in Fund	2.24	3.2

III. SDR Department:	SDR Million	%Allocation
Net cumulative allocation	10.98	100.0
Holdings	0.63	5.7

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Enhanced Structural Adjustment Facility/Poverty Reduction and Growth Facility arrangements	56.91	82.0

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESAF/PRGF	10/18/1995	12/16/1999	50.96	50.96
Stand-by	11/16/1994	06/30/1995	15.00	12.73
ESAF	07/15/1988	03/31/1994	66.96	66.96

VI. Projected Obligations to Fund:(SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue		Forthcoming			
	10/31/2000	2000	2001	2002	2003	2004
Principal		0.0	5.5	5.7	7.2	9.2
Charges/interest		0.2	0.7	0.7	0.7	0.7
Total		0.2	6.2	6.4	7.9	9.9

Exchange Rate Arrangement:

The exchange rate of the Malawi kwacha is market determined. The Reserve Bank publishes a reference rate, based on interbank transactions, on a daily basis. The rate was US$1 = MK 79.5 on October 31, 2000.

Article IV Consultations:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (EBS/98/209; 12/3/98) was concluded by the Executive Board on December 17, 1998.

Technical Assistance:

Date	Duration	Dept.	Recipient	Purpose	Form
5/95	2 weeks	STA	Central Statistical Office	Multisector statistics	Advisor
9/95	4 years	FAD	Ministry of Finance	Budget management	Advisor
9/2/96	2 weeks	FAD	Ministry of Finance	Customs administration	Mission
9/9/96	2 weeks	MAE	Reserve Bank	Bank supervision	Mission
10/21/96	1 year	FAD	Ministry of Finance	Customs administration	Advisor
1/6/97	1 month	FAD	Ministry of Finance	Tax administration	Advisor
2/25/97	3 weeks	MAE	Reserve Bank	Bank supervision	Advisor
3/17/97	10 weeks	MAE	Reserve Bank	Management of seasonal liquidity changes	Mission
4/15/97	3 weeks	MAE	Reserve Bank	Bank supervision	Advisor
6/24/97	2 weeks	FAD	Ministry of Finance	Establishment of National Revenue Authority	Mission
10/21/97	2 years	FAD	Ministry of Finance	Customs administration	Advisor
5/26/98	1 month	FAD	Ministry of Finance	Surtax administration and implementation of value-added tax	Mission
10/6/98	2 weeks	FAD	Ministry of Finance	Income tax policy and administration	Mission

Date	Duration	Dept.	Recipient	Purpose	Form
12/98	1 year	STA	National Statistical Office	Advisor	
1/24/99	1 week	MAE	Reserve Bank	Monetary operations	Advisor
1/31/99	4 weeks	MAE	Reserve Bank	Banking supervision	Advisor
8/2/99	1½ weeks	MAE	Reserve Bank	Monetary operations	Mission
12/1/99	1½ weeks	FAD	Ministry of Finance	Expenditure control	Mission
12/6/99	2 weeks	FAD	Ministry of Finance	Improvement and extension of surtax	Mission
12/99	1 year	FAD	Ministry of Finance	Expenditure management	Advisor
01/00	1 year	STA	Central Statistical Office	Statistics	Advisor
06/00	1 year	FAD	Ministry of Finance and Economic Planning	Revenue administration	Advisor
11/00	2 weeks	FAD	Ministry of Finance and Economic Planning	Expenditure commitment control	Mission

Resident Representative:

Mr. Thomas Gibson, since April 1998.

Malawi: Relations with the World Bank Group
(As of October 31, 2000)

1. The World Bank has been active in Malawi since 1966. The Bank Executive Board has since approved 84 IDA credits and 10 Bank loans. The Bank's lending to Malawi to date totals US$2,063 million, of which $1,809 million has been disbursed. This support has been allocated as follows: 18 percent for agriculture; 31 percent for structural and sectoral adjustment; 15 percent for infrastructure and water; 12 percent for education; 7 percent for energy; 4 percent for health; and the balance (13 percent) toward development finance, technical assistance, industry, urban housing, and institutional development.

2. In fiscal-year1995, the following credits were approved: National Water Development (US$79.20 million); Malawi Railways (US$16.20 million); and a supplement to the Entrepreneurial Development and Drought Recovery Project (US$44.6 million). In fiscal year 1996, three new credits were approved: Primary Education (US$22.50 million); the Fiscal Restructuring and Deregulation Program (US$106.40 million); and the Malawi Social Action Fund (US$56 million). The Fiscal Restructuring and Deregulation Program credit supports government policy reforms in the areas of public expenditures, tariff and export policy, civil service reforms, privatization, and agricultural liberalization. The Malawi Social Action Fund (MASAF) supports community development projects and includes a public works program to facilitate income transfer.

3. The Environment Management Project (June 1997, $12 million) is improving the regulatory capability of the Ministry of Research and Environmental Affairs and promoting a shift in the responsibility for sustainable resource management to the community level. The Secondary Education Project (March 1998, $48 million) is expanding access to schooling by constructing secondary schools and improving educational quality by providing teaching and learning materials.

4. In fiscal-year 1999, the following projects were approved: Malawi Social Action Fund II (October 1998, $66 million), the Second Fiscal Restructuring and Deregulation Program (December 1998, $90 million), the Second Fiscal Restructuring and Deregulation Technical Assistance Project (December 1998, $2 million), and the Road Maintenance and Rehabilitation Project (June 1999, $30 million,). The Malawi Social Action Fund II follows up on the first such fund, supporting safety net programs by creating temporary employment for the very poor and financing initiatives to assist the most vulnerable groups. The Fiscal Restructuring and Deregulation Program II supports policy reforms to accelerate economic growth by further improving expenditure management, rationalizing government functions, undertaking further reductions in tariffs, and promoting private sector development through regulatory reforms in the telecommunications and power sectors, and privatization, including preparations for the privatization of Malawi Telecoms and ADMARC and the concessioning of Malawi Railways. The Road Maintenance and Rehabilitation Project will strengthen the National Roads Authority, help increase capacity for rehabilitation and maintenance in local authorities, provide training for local contractors to take a larger share of road maintenance work, and finance some road rehabilitation.

5. The IFC's equity participation and lending since inception of its operations in Malawi amounts to US$31 million (gross) and includes nine investments in agribusiness, textiles, sugar, tourism, chemicals, plywood, a development finance corporation, and a leasing finance corporation. All credits are fully disbursed. (The current IFC portfolio is relatively small, with US$3.5 million allocated to seven ventures.) The Bank's assistance strategy supports policy reform in areas of concern to the IFC, thus aiding its active search for investment opportunities in Malawi. Two loans have been approved and are awaiting commitment. One of these is for the establishment of the first discount house in Malawi, which will intermediate among financial institutions by trading and creating markets in bankers' acceptances, commercial paper, and treasury bills. The other involves the establishment of the first private–housing finance institution in the country. A possible area for future IFC involvement is the creation of a unit trust fund to broaden the ownership base of the economy and enhance domestic savings.

6. IFC's Foreign Investment Advisory Service (FIAS) has assisted Malawi in designing its investment promotion strategy.

MALAWI: STATISTICAL ISSUES

1. Although Malawi's economic statistics are adequate for program monitoring, significant improvements are required in most areas. The authorities are making efforts to improve the quality and timeliness of the statistical data.

A. Real Sector

2. Real sector statistics covering the national accounts, prices, and trade statistics need substantial improvements. Only a limited set of source data is available (particularly for medium- and small-scale activities), and the quality and timeliness of the data need to be improved. In addition, not all available information is used in the compilation of national account statistics. Priorities include improvements in all aspects of the national accounts statistics and its source data, development of a producer price index, and improvements to the quality and timeliness of the trade data. A resident statistical advisor to the National Statistical Office (NSO), arranged by and reporting to the Fund and financially supported by the United Nations Development Program (UNDP), has, since October 1998, been assigned to assist the authorities. He has reported some progress in revising the sectoral output figures by incorporating all available data sources.

National accounts

3. The NSO has the responsibility for compiling the historical national accounts data. However, while the final estimates are comprehensive, covering GDP from the production side at current and constant prices, GDP by expenditure at current prices, gross national income and its components, national disposable income and use of disposable income and the capital finance account, the source data underpinning these estimates are weak. The NSO mainly relies on the production approach to compile estimates of GDP and reconcile use and distribution of income accounts. The production-based GDP estimates are mainly based on an annual economic survey, covering only a selection of large-scale enterprises that has been kept fixed since 1980, in addition to administrative data on agriculture, forestry, and fishing, as well as estimates on agriculture production from the Ministry of Agriculture. The resident statistical advisor to the NSO has recently reported some progress in revising the sectoral output figures by incorporating all available data sources. An analysis of the recent survey of medium-scale businesses, to determine growth rates in this sector, is also under way.

Prices

4. A consumer price index (CPI) is available on a timely basis. However, price collection and imputation methods have been poor. The index is based on the results of the Survey of Household Expenditure and Small-Scale Economic Activities conducted from July 1990 to June 1991 by the NSO. Indices are computed separately for low-, medium-, and high-income households in each of four major urban areas. In addition, a rural areas index is compiled from information on six predominantly rural markets or trading centers in three different regions of the country. Plans are under way to use the recently completed Integrated

Household Survey data to rebase the index and update the weighting. Imputation methods are also being improved.

Trade

5. Most trade data are reported with a significant lag. Improvements could focus on developing reliable, accurate, and timely detailed trade data for the compilation of the national accounts and the balance of payments.

6. The resident statistical advisor to the NSO has reported progress in a number of areas, including completion by end-1999 of a review of processing of trade data and completion in 2000 of a review of the collection and compilation of E-form data. Also, the f.o.b.-c.i.f. ratio has been recomputed, showing that c.i.f. figures reported in the past had been overestimated.

Other real sector statistics

7. The industrial production index is based on a survey of 50 of the larger firms, but it appears not to be a reliable indicator of activity. The selection of these firms and the weights applied in the index were determined by surveys conducted in 1984 and have not been updated since then. The manufacturing output figures in the national accounts are not consistent with the reported index of manufacturing production.

B. Government Finance

8. Malawi is not reporting government finance data in a timely manner for inclusion in the *Government Finance Statistics Yearbook (GFSY)* and in *International Financial Statistics (IFS)*. At present, data on the central government provided by the authorities for publication extend only through 1990.

9. Efforts are being made to implement the major recommendations (affecting government finance) of the multisector statistical mission in April-May 1995. The major specific recommendations include the need for (i) strengthening the statistical unit in the Ministry of Finance and Planning; (ii) compilation of data on expenditure by function and economic type; (iii) collection of detailed data on financing by type of debt holder and type of debt instrument; (iv) better reporting of government lending and of government loan repayments recorded in the recurrent account and in the Development Fund; (v) better collection and recording of data on grants from various sources; and (vi) improved documentation and data consistency, and elimination of discrepancies among documents published by different units of the Ministry of Finance.

10. Government expenditure-monitoring statistics have been inadequate. At the request of Fund staff, the authorities have put in place a control system, the effectiveness of which is under watch.

C. Monetary Accounts

11. Monetary statistics are generally in line with international standards. However, they are usually not available in a timely manner.

D. Balance of Payments

12. Balance of payments data are currently only available in *IFS* through 1994. Mainly as a result of the liberalization of exchange controls, the compilation of data relies on balance of payments surveys as the major available source of reliable information for major components in the balance of payments, such as services, direct investment flows, and other financial transactions of the private sector. Recently, however, new data sources have been sought, and data on direct investment now come from the Malawi Investment Authority, while portfolio investment data are from the Malawi Stock Exchange. Also, a register of companies with likely balance of payments transactions is being compiled for a revamped balance of payments survey.

E. Organizational Measures

14. The NSO is presently located in Zomba. The lack of proximity to the capital, Lilongwe, adversely affects the activities of the NSO. However, a plan is under way for relocation.

15. Statistics produced by various units of the government have often differed and are difficult to reconcile. Some progress has, however, been made in generating more consistent data. For instance, the NSO and the National Economic Council (NEC) now harmonize their national accounts figures and, in fact, present a common set of figures. Similarly, the Reserve Bank of Malawi and the Ministry of Finance and Planning now have meetings where government debt and related statistics are harmonized. These efforts need to be sustained and intensified.

Malawi: Survey of Reporting of Main Statistical Indicators
(As of November 3, 2000)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Treasury Bills interest rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt Service
Date of latest observation	11/00	10/00	10/00	10/00	09/00	10/00	09/00	06/00	1999	08/00	1999	1999
Date received	11/00	10/00	10/00	10/00	11/00	11/00	10/00	09/00	03/00	10/00	08/00	08/00
Frequency of data[1]	D	W	W	W	M	B	M	M	A	Q	A	...
Frequency of reporting data[1]	M	W	W	W	M	B	M	Q	Q	M	A	Mission
Source of data[2]	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting[3]	C	C	C	C	C	C	C	C	C	C	C	Mission
Confidentiality[4]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of publication[1]	M	M	M	Q	M	M	M	A	A	A	A	...

[1] D = daily; B = biweekly; M = monthly; Q = quarterly; and A = annual.
[2] A = direct report by the authorities; and N = official publication.
[3] C = cable or facsimile; and M = mail.
[4] C = unrestricted use.

Malawi
Three-Year Arrangement Under
the Poverty Reduction and Growth Facility

Attached hereto (See EBS/00/263) is a letter ("the letter") dated December 8, 2000, with an annexed Memorandum on Economic and Financial Policies for 2000-03 (the "Memorandum"), from the Minister of Finance and Economic Planning and the Governor of the Reserve Bank of Malawi requesting from the International Monetary Fund as Trustee of the Poverty Reduction and Growth Facility Trust ("the Trustee") a three-year arrangement under the Poverty Reduction and Growth Facility, and setting forth:

(a) the objectives and policies of the program that the authorities of Malawi intend to pursue during the three-year period of the arrangement;

(b) the objectives, policies and measures that the authorities of Malawi intend to pursue during the first year of the arrangement; and

(c) understandings of Malawi with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Malawi will pursue for the second and third years of the arrangement.

To support these objectives and policies, the Trustee grants the requested three-year arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Facility Trust.

1. (a) For a period of three years from December 21, 2000, Malawi will have the right to obtain loan disbursements from the Trustee in a total amount equivalent to SDR 45.11 million, subject to the availability of resources in the Poverty Reduction and Growth Facility Trust.

(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 19.32 million until December 20, 2001 and the equivalent of SDR 32.2 million until December 20, 2002.

(c) During the first year of the arrangement:

(i) the first disbursement, in an amount equivalent to SDR 6.44 million, will be available on December 21, 2000,[1] at the request of Malawi;

[1] Depending on the timing of the Board meeting.

(ii) the second disbursement, in an amount equivalent to SDR 6.44 million, will be available on or after February 15, 2001, at the request of Malawi and subject to paragraph 2 below; and

(iii) the third disbursement, in an amount equivalent to SDR 6.44 million, will be available on or after August 15, 2001, at the request of Malawi and subject to paragraph 2 below; and

(d) The right of Malawi to request disbursements during the second and third years of this arrangement shall be subject to such phasing and conditions as shall be determined. The phasing of, and conditions for, disbursements during the second year of this arrangement shall be determined in the context of a review of Malawi's program with the Trustee, the timing of which shall be established at the first or second reviews contemplated in paragraph 2(d) of this arrangement.

2. Malawi will not request the second and third disbursements specified in paragraph 1(c)(ii) and 1(c)(iii)above:

(a) If the Managing Director of the Trustee finds that, with respect to the second disbursement, the data as of December 31, 2000 and, with respect to the third disbursement, the data as of June 30, 2001, indicate that:

(i) the ceilings on the stock of reserve money, or

(ii) the floor on the net foreign assets of the monetary authorities, or

(iii) the ceiling on the net domestic financing of the central government, or

(iv) the clearance of new domestic budgetary arrears of the central government, or

(v) the ceiling on contracting or guaranteeing by the government or the Reserve Bank of Malawi of new medium- and long-term (with original maturity of over one year) external debt, or

(vi) the ceiling on contracting or guaranteeing by the government or the Reserve Bank of Malawi of new short-term (with original maturity of one year or less) external debt,

referred to in paragraph 39 of the Memorandum and specified in Table 1 of the Memorandum, was not observed; or

(b) If the Managing Director of the Trustee finds:

(i) with respect to the second disbursement, that Malawi has not carried out its intentions regarding:

(1) the commencement of full operations of a unit in the Ministry of Finance to monitor the activities of parastatals and the completion of a first quarterly report by December 31, 2000;

(2) the compilation by the Ministry of Finance of monthly reviews which summarize the ministries' monthly reports on commitment levels and arrears and assess the prospects for meeting budget targets in 2000/01,

as specified in Table 2 of the Memorandum; and

(ii) with respect to the third disbursement, that Malawi has not carried out its intentions regarding:

(1) the compilation by the Ministry of Finance of monthly reviews which summarize the ministries' monthly reports on commitment levels and arrears and assess the prospects for meeting budget targets in 2000/01,

as specified in Table 2 of the Memorandum; or

(c) If, at any time during this arrangement Malawi:

(i) accumulates any external payment arrears as specified in Table 1 of the Memorandum; or

(ii) fails to prevent any new borrowing by the National Food Reserve Agency, or

(d) If Malawi has:

(i) imposed or intensified restrictions on payments and transfers for current international transactions, or

(ii) introduced or modified multiple currency practices, or

(iii) concluded bilateral payments agreements that are inconsistent with Article VIII, or

(iv) imposed or intensified import restrictions for balance of payments reasons; or

(e) Until the trustee has determined, with regard to the second disbursement, that the first review of Malawi's program scheduled for completion by February 15, 2001 and referred to in paragraph 40 of the Memorandum has been completed and, with regard to the third disbursement, that the second review of Malawi's program scheduled for completion by August 15, 2001 and referred to in paragraph 40 of the Memorandum has been completed.

When Malawi is prevented from requesting disbursements under this arrangement because of this paragraph 2, such disbursements may be made available only after consultation has taken place between the Trustee and Malawi and understandings have been reached regarding the circumstances in which Malawi may request the disbursements.

3. In accordance with paragraph 4 of the Letter, Malawi will provide the Trustee with such information as the Trustee requests in connection with the progress of Malawi in implementing the policies and reaching the objectives of the program supported by this arrangement.

4. In accordance with paragraph 4 of the Letter, during the period of this arrangement Malawi, shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while Malawi has outstanding financial obligations to the Trustee arising from loan disbursements under this arrangement, Malawi will consult with the Trustee from time to time, at the initiative of the Government or whenever the Managing Director of the Trustee requests consultation on Malawi's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to Malawi or of representatives of Malawi to the Trustee.

Statement by the IMF Staff Representative
December 21, 2000

1. Since the staff report (EBS/00/263, 12/11/00) and the HIPC decision point document (EBS/00/260, 12/7/00) were issued, several developments have occurred. They do not alter the thrust of the staff appraisal.

2. All prior actions have now been fulfilled:

- An FAD mission has confirmed that line ministries are maintaining commitment registers and submitting monthly reports on commitments and arrears to the Ministry of Finance. However, coverage so far is incomplete and quality is mixed.
- The Minister of Finance and Economic Planning has established a loans review committee, which will, among other things, provide guidance in the management of public debt; it will hold its first meeting on December 22.
- The bill to extend the surtax base to wholesale and retail stages was submitted to parliament on December 15.

3. Staff has received additional information regarding inflation, fiscal and monetary developments:

- 12-month CPI inflation remained at 35 percent in November.
- Preliminary figures for the net domestic financing of the central government in the first quarter of the fiscal year (July-June) were slightly above projections.
- The level of reserve money at end-November was above target. In response, the central bank has recently stepped up the pace of open-market operations; treasury bill auctions are now being conducted every week rather than once every two weeks and yields on three-month treasury bills have risen to 42 percent from 34 percent in early November. Nevertheless, there is a risk that a small overrun on the reserve money target for the October-December quarter may occur since it is based on an average of monthly figures.

4. On December 13, 2000, the Paris Club agreed in principle to a flow rescheduling on Cologne terms. Creditors also agreed to change the cutoff date to January 1, 1997, with the consequence that all Paris Club debt is now classified as pre-cutoff date debt. The Paris Club creditors noted that, with Japan's policy of reimbursing all debt service paid to them by Malawi, actual debt service payments to Paris Club creditors would be effectively reduced to zero. The Paris Club is expected to meet to discuss the rescheduling for Malawi in January 2001.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/7
FOR IMMEDIATE RELEASE
January 23, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Malawi

On December 21, 2000, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Malawi.[1]

Background

Malawi is a predominantly agricultural country, with most of the population of about 11 million dependent on subsistence farming. Tobacco is the major export. It is one of the poorest countries in the world, ranking 7th lowest in terms of per capita GDP out of 206 identified in the World Bank's *World Development Report 2000/01*. Per capita GDP was US$163 in 1999. Income is unequally distributed, and about half of the population lives below the poverty line. The HIV/AIDS pandemic has compounded Malawi's development problems. Malawi is a member of the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA), both of which launched free trade agreements this year, and is a participant in the Regional Integration Facilitation Forum (RIFF). During the first half of its 1995-99 Poverty Reduction and Growth Facility (PRGF)[2] arrangement, Malawi

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the December 21, 2000 Executive Board discussion based on the staff report.

[2] On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It is intended that the PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a poverty reduction strategy paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. It is understood that all policy undertakings in the government's statement beyond the first year are subject to reexamination

(continued...)

achieved a high annual GDP growth rate (averaging 10 percent) and a substantial reduction in 12-month consumer price inflation (to a low of 7 percent in 1996 from 75 percent in 1995). Subsequently, however, inflation picked up and growth slowed. 12-month inflation was 35 percent in November, 2000 and growth between 1999 and 2000 is estimated at 3.2 percent.

Although external shocks, in the form of periodic droughts and fluctuations in tobacco prices, played a part in these variations in economic performance, problems have been compounded by occasional weakening in the implementation of macroeconomic policies. During the early part of the PRGF arrangement, the fiscal deficit was reduced dramatically (from 15 percent of GDP, including grants, in fiscal year 1994/95 to 3 percent in fiscal year 1996/97) and the monetary stance was tightened. The benefits of these policies were, however, dissipated in fiscal year 1997/98 by slippages involving excess public spending, the accumulation of domestic spending arrears, and an increase in the fiscal deficit to above 8 percent of GDP. Subsequently, control over fiscal and monetary developments improved, although the accumulation of domestic spending arrears, and sharp changes in the real exchange rate, continued to hinder economic management. During fiscal year 1999/2000, the fiscal deficit was 5 percent of GDP, while broad money growth was 34 percent through 1999.

Developments in Malawi's external current account have been influenced largely by the effect of exchange rate movements on import demand and the performance of the tobacco sector. Sharply lower imports, following a substantial depreciation of the kwacha in August 1998, led to a temporary reduction in the current account deficit (excluding grants) to 12 percent in 1998 from 14 percent of GDP in 1997. This was reversed in 1999, with a rise in the deficit to 17 percent of GDP before official transfers.

Malawi deepened and broadened its structural reform program in the latter half of the 1990s. Government monopolies and controls on agricultural marketing and trade were abolished; the ground was laid for eliminating restrictions on petroleum importation and allowing prices to reflect market forces; external tariffs and nontariff barriers were reduced; and substantial progress was made in improving tax administration. An ambitious program for privatization was also launched. Structural reforms were further consolidated in 2000 with resumption by the private sector of oil importation, a decision by the authorities to refrain from further intervention in the maize market, and the establishment of an independent revenue authority.

The authorities have formulated an interim Poverty Reduction Strategy Paper (PRSP), which focuses on economic growth and targeted action to address poverty within a stable macroeconomic environment. It seeks to reprioritize public expenditures, create an environment

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and modification in line with the strategy that is to be elaborated in the PRSP. Once discussed by the Executive Boards of the IMF and the World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement. PRGF loans carry an interest rate of 0.5% a year, and are repayable over 10 years with a 5½ year grace period on principal payments.

conducive for private sector development, implement a comprehensive and cost-effective social safety net; and combat the HIV/AIDS pandemic.

The authorities' economic program will be supported by the first annual arrangement of the PRGF (see Press Release 00/125). It is based on objectives for real GDP growth of 3 percent for 2001; end-2001 inflation of 10 percent; and an increase in the level of gross reserves to 4.7 months of imports. The program provides for a balanced budget in the fiscal year 2000/01, while at the same time allowing increased shares of anti-poverty and other priority spending, particularly on education and health (including expenditure on AIDS). Targets are specified for reserve money, domestic financing of the government deficit, and net foreign assets of the monetary authorities. Issues of further structural reform and governance are addressed.

Executive Board Assessment

Directors noted with concern that, although Malawi's economic performance had improved in the latter half of the 1990s, macroeconomic stability had proved elusive, growth had been inadequate, and a large proportion of the population remains in poverty. While acknowledging Malawi's high vulnerability to external shocks, Directors observed that the country's economic problems have been compounded by occasional inconsistencies in the implementation of macroeconomic and structural policies, including the recent relaxation in monetary policy, which has contributed to currency pressures and a resurgence in inflation.

Directors welcomed the authorities' renewed commitment to implementing a comprehensive stabilization and reform program, for which they are requesting Fund support under the Poverty Reduction and Growth Facility (PRGF). They noted that the program is appropriately based on sound financial policies, reprioritized public spending, deeper structural reform, and a comprehensive and cost-effective social safety net. In addition, Directors urged intensified action to arrest the spread and debilitating effects of HIV/AIDS.

Directors noted the ambitious inflation target under Malawi's economic program for 2000-01 and stressed that achievement of this target would require the steadfast implementation of policies. They urged the authorities to adhere firmly to agreed monetary targets. Directors also emphasized that monetary policy must be underpinned by continued fiscal restraint, with a target of achieving fiscal balance in fiscal year 2000/01. They observed that this would critically depend on the authorities' determination to resist pressures on wages and salaries and on other recurrent expenditure.

Directors agreed that much will be required from the new system for controlling and monitoring the expenditure of line ministries, since a repetition of the excess levels of commitments and consequential arrears of the recent past could derail the program. Directors also welcomed other elements of the 10-point plan of the Minister of Finance and Economic Planning to improve budgetary management, particularly the undertakings to eliminate nonemergency extrabudgetary outlays; increase fiscal transparency; and invoke disciplinary measures under the new spending control mechanisms. They urged the authorities to improve expeditiously the monitoring and control of parastatals, and avoid the subsidization of maize or petroleum, which has caused substantial overspending in the past. Directors stressed the importance of improved targeting of government spending towards the poor, including food security, health and education; and welcomed the authorities' commitment to monitor and publish performance on a quarterly basis.

Directors welcomed the authorities' commitment to strengthen the structural reform program. They noted that the pace of privatization could be accelerated by improving the attractiveness of public sector assets to potential buyers through firmer action to liberalize markets and reduce cartelization, and emphasized the importance of enhancing competition in the financial sector by fully privatizing the two dominant commercial banks with safeguards against connected lending. Directors also emphasized that the gains to small holder agriculture from the liberalization of tobacco growing and marketing should not be put at risk by burdensome restrictions on tobacco buyers.

Directors welcomed recent initiatives to improve governance; including the strengthening of the offices of the Anti-Corruption Bureau, Department of Public Prosecution, Ombudsman, Auditor-General, and the Public Accounts Committee. They strongly urged the authorities to follow through vigorously on all investigations and prosecutions.

Directors noted that Malawi provides the core minimum data needed for surveillance and program monitoring, but observed that there are significant weaknesses with respect to the quality, timeliness, and coverage of economic statistics that hamper a more comprehensive assessment of economic developments. Directors urged the authorities to sustain efforts to improve data collection and dissemination, particularly in the area of fiscal statistics.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Malawi: Selected Economic and Financial Indicators, 1998-2000

	1998	1999 Prel.	2000 Proj.
	(Percentage change, unless otherwise indicated)		
GDP and prices			
GDP at constant market prices	2.0	4.0	3.2
Per capita GDP (in U.S. dollars)	157.8	163.1	...
Consumer prices (end of period)	53.0	28.2	30.0
GDP deflator	26.2	41.1	25.5
Money and credit 1/			
Money and quasi money	55.6	33.6	20.9
Net foreign assets	110.0	11.5	31.1
Net domestic assets	-54.5	22.1	-10.2
Credit to the government	-29.9	-2.9	2.7
Credit to the rest of the economy	18.5	20.6	16.3
	(In percent of GDP, unless otherwise indicated)		
Central government 2/			
Revenue (excluding grants)	17.7	17.3	19.0
Expenditure	29.8	29.9	30.4
Domestic balance (cash modified basis) 3/	-4.0	-2.8	-1.3
Overall balance (cash modified basis, excluding grants)	-11.9	-12.3	-11.4
Overall balance (cash modified basis, including grants)	-5.5	-5.0	0.0
Saving and investment			
National saving	1.7	-1.3	0.6
Domestic saving	5.8	0.3	2.3
Net factor income and private transfers	-4.1	-1.6	-1.7
Foreign saving 4/	11.6	17.1	15.2
Gross investment	13.3	15.8	15.8
External sector			
Exports, f.o.b	31.0	24.7	24.9
Imports, c.i.f. 5/	33.4	37.3	36.1
External current account (including official transfers)	-2.5	-8.3	-7.8
External debt	142.7	143.3	156.5
Debt-service ratio 6/	18.2	17.7	20.6
Terms of trade (1990=100)	71.9	62.3	58.5
Kwacha per U.S. dollar exchange rate (period average) 7/	31.1	44.2	59.1
Gross official reserves			
End-period stock (millions of U.S. dollars)	257.8	244.2	224.0
In months of imports of goods and nonfactor services	4.0	4.2	3.9
External debt (disbursed and outstanding, end of period; millions of U.S. dollars)	2,479	2,589	2,706

Sources: Malawian authorities; and Fund staff estimates and projections.

1/ End of period expressed as change in percent of money and quasi money at the beginning of the period.
2/ Fiscal year July 1-June 30.
3/ The domestic balance is defined as revenue less total expenditure, foreign interest, and foreign-financed development expenditure.
4/ External current account, excluding official transfers.
5/ Including drought-related maize operations in 1998.
6/ In percent of exports of goods and nonfactor services in the following period. Before any assistance under the HIPC Initiative.
7/ For 2000, January through November.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 00/79
FOR IMMEDIATE RELEASE
December 21, 2000

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves In Principle US$58 Million PRGF Loan for Malawi

The International Monetary Fund's (IMF) Executive Board today approved in principle a three-year SDR 45.11 million (about US$58 million) arrangement under the Poverty Reduction and Growth Facility (PRGF)[1] to support economic and structural reforms in Malawi.

A final decision by the Executive Board is pending discussion of Malawi's interim Poverty Reduction Strategy Paper (PRSP) by the World Bank's Executive Board, which is expected to today, as well. A final IMF decision will enable the release of a first loan under the PRGF arrangement in an amount equivalent to SDR 6.44 million (about US$8 million). Further disbursements under the credit arrangement will be on a semiannual basis and subject to Executive Board review.

After the Executive Board's discussion of Malawi's economic and structural reform program, Horst Köhler, Managing Director and Chairman, made the following statement:

"The interim PRSP provides a sound basis for concessional lending by the Fund and adequately outlines the process for the development of a full PRSP in a broad-based participatory manner. The authorities' schedule for completing the PRSP by mid-2001 is appropriate, as is the general framework for poverty alleviation in the interim PRSP, including its focus on macroeconomic stability, effective public services, private sector development, social safety nets and steps to address the HIV/AIDS pandemic. Directors noted that further analysis would be needed before completion of the full PRSP, so that interventions could be costed and prioritized and core targets and monitoring mechanisms developed.

[1] On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility, was renamed the Poverty Reduction and Growth Facility, and its purposes were redefined. It was intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a poverty reduction strategy paper, or PRSP. This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Malawi, pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is underway. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement. PRGF loans carry an annual interest rate of 0.5%, and are repayable over 10 years with a 5 ½ year grace period on principal payments.

“Directors noted the improvement in Malawi’s economic performance during the 1995-99 Poverty Reduction and Growth Facility (PRGF) and the policy achievements of the last year, in particular the establishment of firmer control over government spending and borrowing. The recent resurgence in the inflation rate and continued slow growth underscore, however, the need for sustained and comprehensive macroeconomic adjustment and reform, including adherence to monetary targets.

“The objectives of the authorities’ new three-year program include the achievement of a sustainable GDP growth of at least 4.5 percent, a reduction of inflation to low levels, a significant improvement in Malawi’s external position, and a reduction in the number of people beneath the poverty line. These objectives will be achieved by reducing monetary growth, achieving a balanced fiscal position, improving spending control, deepening structural reform, strengthening governance and prioritizing pro-poor expenditure. Reserve money will be the operational target for monetary policy and the exchange rate will be allowed to float freely.

“On the fiscal side, crucial features of the program are a new commitment control system and the avoidance of further spending arrears. Intervention in maize marketing and subsidization of petroleum will not be resumed. A new parastatal enterprise reform and monitoring unit is being established in the Ministry of Finance. The surtax will soon be extended to wholesale and retail stages, making it equivalent to a value-added tax. The authorities are committed to improved targeting and monitoring of government spending.

“The program seeks to preserve the gains to smallholder agriculture from the liberalization of tobacco growing and marketing, by avoiding any burdensome restrictions on tobacco buyers. Directors also underscored the critical importance of improving governance. They welcomed the authorities’ commitment to pursue outstanding cases of corruption, fraud, abuse of office and misappropriation of public funds and looked forward to a further strengthening of the institutional and legal environment in this area.

“A final decision on Malawi’s debt relief under the enhanced HIPC Initiative is pending action today by the World Bank’s Executive Board. A press release will be issued jointly with the World Bank following this action,” Mr. Köhler said.

ANNEX

Program Summary

Malawi is projected to maintain real GDP growth between 3-4 percent in 2000. Consumer price inflation in November reached 35 percent having fallen to 22 percent in June. The fiscal deficit declined marginally in FY1999/2000, and the current account deficit narrowed despite higher oil prices and lower tobacco prices. The PRGF-supported program for 2000-01 will have a number of important features, including a targeted reduction of inflation by end-2001 to 10 percent, growth of at least 3 percent, and an increase in the level of gross reserves to 4.7 months of imports.

On the fiscal side, the authorities are strengthening the expenditure control system, and moving to tighten the financial operations and monitoring of parastatls. Privatization of public enterprises will also be extended. At the same time, the liberalization of the agriculture and petroleum sectors will be sustained under the program. More broadly, crucial governance issues will be further advanced, including efforts to recover misapproriate funds and address fraud and corruption.

Malawi became a member of the IMF on July 19, 1965; its quota[2] is SDR 69.4 million (about US$90 million), and its outstanding use of IMF credit currently totals SDR 56.9 million (about US$73 million).

[2] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Malawi: Selected Economic and Financial Indicators, 1998-2001

	1998	1999 Prel.	2000 Proj.	2001 Proj.
	(Percentage change, unless otherwise indicated)			
GDP and prices				
GDP at constant market prices	2.0	4.0	3.2	3.0
Per capita GDP (in U.S. dollars)	157.8	163.1	...	...
Consumer prices (end of period)	53.0	28.2	30.0	10.0
GDP deflator	26.2	41.1	25.5	16.8
Money and credit 1/				
Money and quasi money	55.6	33.6	20.9	16.8
Net foreign assets	110.0	11.5	31.1	47.0
Net domestic assets	-54.5	22.1	-10.2	-30.2
Credit to the government	-29.9	-2.9	2.7	-43.3
Credit to the rest of the economy	18.5	20.6	16.3	19.5
	(In percent of GDP, unless otherwise indicated)			
Central government 2/				
Revenue (excluding grants)	17.7	17.3	19.0	19.0
Expenditure	29.8	29.8	30.4	27.3
Domestic balance (cash modified basis) 3/	-4.0	-2.8	-1.3	-1.2
Overall balance (cash modified basis, excluding grants)	-11.9	-12.3	-11.4	-8.3
Overall balance (cash modified basis, including grants)	-5.5	-5.0	0.0	0.0
Saving and Investment				
National saving	1.7	-1.3	0.6	0.6
Domestic saving	5.8	0.3	2.3	2.2
Net factor income and private transfers	-4.1	-1.6	-1.7	-1.6
Foreign saving 4/	11.6	17.1	15.2	15.4
Gross investment	13.3	15.8	15.8	16.0
External sector				
Exports, f.o.b.	31.0	24.7	24.9	28.0
Imports, c.i.f. 5/	33.4	37.3	36.1	39.3
External current account (including official transfers)	-2.5	-8.3	-7.8	-7.7

External debt	142.7	143.3	156.5	180.4
Debt-service ratio 6/	18.2	17.7	20.6	20.0
Terms of trade (1990=100)	71.9	62.3	58.5	59.8
Kwacha per U.S. dollar exchange rate (period average) 7/	31.1	44.2	59.1	...
Gross official reserves				
End-period stock (millions of US dollars)	257.8	244.2	224.0	276.3
In months of imports of goods and nonfactor services	4.0	4.2	3.9	4.7
External debt (disbursed and outstanding, end of period; millions of US dollars)	2,479	2,589	2,706	2,824

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

1/ End of period expressed as change in percent of money and quasi money at the beginning of the period.

2/ Fiscal year July 1 - June 30.

3/ The domestic balance is defined as revenue less total expenditure, foreign interest, and foreign-financed development expenditure.

4/ External current account, excluding official transfers.

5/ Including drought-related maize operations in 1998.

6/ In percent of exports of goods and nonfactor services in the following period. Before any assistance under the HIPC Initiative.

7/ For 2000, January through November.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 00/125
FOR IMMEDIATE RELEASE
December 28, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Gives Final Approval of PRGF Loan for Malawi

The Executive Board of the International Monetary Fund (IMF) has given its final approval of the three-year loan under the Poverty Reduction and Growth Facility (PRGF) for Malawi in an amount equivalent to SDR 45.11 million (about US$58 million—see Press Release No. 00/79).

The final decision by the IMF Executive Board was contingent on a decision by the World Bank Executive Board on December 21, 2000 which concluded that the interim Poverty Reduction Strategy Paper (PRSP) provides a sound basis for development of a fully participatory PRSP and for concessional assistance by the World Bank.

Under Malawi's three-year PRGF arrangement, the IMF Executive Board decision makes available immediately SDR 6.44 million (about US$8 million).

Statement by C.D.R. Rustomjee, Executive Director
for Malawi
December 21, 2000

1. Let me begin by expressing the appreciation of my Malawian authorities to the Executive Board, management and staff as well as the donor community for continued support as they seek to alleviate widespread poverty in the country. The outcome of this meeting on possible assistance by the Fund under the PRGF and debt relief under the enhanced HIPC Initiative is being awaited with eagerness. The authorities are keenly aware that the program now underway provides an important reference point in their intensified efforts to address the formidable challenges that confront the economy. They wish to acknowledge the cooperation they have been receiving from management and staff in designing and formulating their program; the staff has been tireless in working to produce a set of very candid papers.

2. At the outset, the Malawian authorities wish to underscore the importance they attach to the steadfast implementation of bold policies and comprehensive economic adjustment and reform measures which will be essential in restoring macroeconomic stability, promoting efficiency and growth and reducing widespread poverty. They are hopeful that with their firm commitment to the pursuit of all the policies outlined in their Memorandum of Economic Policies and the Interim PRSP, Malawi will be able to earn the confidence of the donor community to press ahead with more aggressive poverty reduction efforts.

Background

3. Malawi is a small landlocked country that remains one of the poorest in the world, with very weak social indicators: a very low per capita income ($163 in 1999), a low and declining life expectancy (42 years) and a very high infant mortality rate (134 per thousand births). Over the years, several attempts have been made to introduce economic reforms with the support of the Fund and the World Bank to promote broad-based growth. Since the 1980s progress has been made towards improving the environment for private sector investment and growth. However, the authorities are increasingly aware that the attainment of strong and sustainable growth has been elusive, reflecting the convergence of a number of adverse factors, including in particular, unfavorable weather conditions, a secular decline in the terms of trade, the high incidence of HIV/AIDs, and slippages in policy implementation.

4. In the circumstances, economic performance has been mixed and growth has been modest, leading to a low growth in per capita income. Real per capita GDP growth averaged about ½ percent between 1989 and 1999. In the last five years (1995-1999) renewed attempts were made in the context of a Fund-supported program under the Enhanced Structural

Adjustment Facility (ESAF). During this period, growth strengthened, albeit still mixed and moderate. Real GDP is expected to rise to 3.2 percent in 2000. The rate of inflation subsided substantially, although pressures intensified at mid-2000, reflecting mainly the sharp depreciation of the exchange rate and the weakening of policies. More significantly, notable steps were taken to introduce structural reforms with a view to promoting economic efficiency. In this connection, a number of public sector enterprises were brought to the point of sale at the end of 1999 in order to enhance the role of the private sector.

5. Furthermore, interest rates have been decontrolled since 1993 and the foreign exchange system has been liberalized. To improve financial intermediation, two foreign banks and a discount house have already established operations, while the government is taking steps to reduce its holding in the two major commercial banks. Following the introduction of substantial trade reforms, Malawi now maintains a very liberal trade regime, with the IMF index of restrictiveness estimated at 3 and compares favorably with other developing countries.

The Challenge

6. Notwithstanding the achievements in deregulating the economy, Malawi continues to face the formidable tasks of restoring and sustaining macroeconomic stability, putting the economy on a path of higher growth as the basis for substantial and durable reduction in poverty. Some studies at the World Bank have estimated that Malawi needs to generate a minimum of 5.3 percent real annual rate of growth in output in order to prevent the number of the poor from increasing. This is a difficult challenge to overcome particularly when the HIV/AIDs pandemic threatens to weaken the very foundations upon which further progress is predicated. It is estimated that 7 percent of the population, mainly those in the working age group, are affected and the disease will significantly lower productivity, reduce private savings and increase public spending.

7. While attempting to restore macroeconomic stability, the authorities also realize the urgent need to boost savings and investment rates, to reinforce fiscal discipline as the key to reducing monetary expansion and interest rates, to foster competition in the real sector and to reduce existing monopolies. Land reform is also considered to be a key element in poverty reduction. The enforcement of accountability and improved governance is being pursued vigorously as an important element in increasing transparency in public finances.

The Medium-Term Objectives and the Poverty Reduction Strategy

8. Against the backdrop of these daunting challenges, the authorities have adopted an economic adjustment and reform program that has been cast in a medium-term framework. Real GDP growth will accelerate to about 4.5 percent, the rate of inflation will be reduced to 5 percent and international reserves will increase to 4.5 months of imports of goods and services. The number of people under the poverty line will be progressively reduced.

9. At the same time, structural reforms will be broadened and deepened: the expenditure control and monitoring system is being improved and strengthened; the medium-term expenditure framework (MTEF) will be broadened and applied to prioritize government recurrent outlays; the Malawi Revenue Authority (MRA) will be strengthened to bolster revenue collection; civil service and financial sector reforms will be continued with the prospective privatization of commercial banks and the strengthening of the regulatory framework. The strengthening of relevant democratic oversight institutions including the Anti-Corruption Bureau (ACB), the Public Accounts Committee, the Public Prosecutor's Office and the Auditor General's Office, will be pursued as crucial components of the authorities' strategy in improving accountability and governance.

10. The Interim PRSP presents a detailed analysis of poverty in Malawi and constitutes a credible road map for effective utilization of debt relief resources. The formulation of this document has not only benefited from a process of consultation with a broad cross-section of the Malawian society and donors but also from a wealth of work already completed, including the Vision 2020 whose growth scenarios were recently calibrated by the National Economic Council, the Policy Analysis Initiative spearheaded by the Office of the Vice President, the National Strategic Framework for HIV/AIDs, the Public Expenditure Review and the MTEF Review both initiated by the Ministry of Finance. The authorities have acknowledged that gaps in the document remain to be filled in order to formulate a robust PRSP. They are also expecting to take into account the comments that will be made in the Board as they articulate their document. Meanwhile, a three-pronged approach has been adopted for growth and poverty reduction, focusing on interventions in the agricultural sector that directly target the poor, restoring macroeconomic stability, as well as increasing investment in social sectors and human capital. The timetable for completion of this exercise shows that the PRSP will continue to be developed in a participatory manner, involving local and district authorities, traditional authorities, the NGOs, parliament and the donor community.

The Program for 2000—01

11. The macroeconomic objectives for the near term are to achieve a growth rate of about 3.0 percent, reduce the rate of inflation to 10 percent by December 2001, bring the current account balance of payments deficit to 7.7 percent of GDP and increase gross external reserves to the equivalent of 4.7 months of imports by the end of 2001. To achieve these objectives, the authorities will vigorously pursue firm financial policies with monetary policy actions focused on reducing the rate of inflation, consistent with the balance of payments objective. Accordingly, the open market operations in Reserve Bank of Malawi and treasury bills are being actively utilized to mop up excess liquidity and to bring money supply in line with program targets. The reserve requirement on domestic currency deposits has been reduced with the intention of lowering it further when liquidity conditions permit. Thus far, the authorities have indicated that the program remains broadly on track. The exchange rate of the kwacha is market determined and any interventions will be restricted to the achievement of the external reserve target and smoothing sudden substantial movements.

12. The implementation of a tight fiscal policy stance remains the centerpiece of the program. It is intended to rapidly restore fiscal discipline, initiated by the ten-point plan which was enunciated when the new Minister of Finance was appointed earlier in the year. For the fiscal year 2000-01, the overall cash budget deficit will be limited to 11.4 percent of GDP, with the domestic budget deficit amounting only 1.3 percent of GDP. This will be achieved through adherence to the budget projections on wages and salaries which allows for a general increase, the implementation of a new housing allowance scheme and the introduction of contractual employment for top civil servants. The intention is to effect a decompression of the wage scale. At the same time, ministers and members of parliament will receive the same treatment as the majority of civil servants who are not on contract. Nonpriority expenditure has been curtailed in favor of antipoverty programs so that outlays on social sectors will increase relative to GDP. Cost recovery measures on administrative and public services have been adopted, while spending on utilities are being closely monitored; the cost of internal and external travel has been curtailed while the cost of representation abroad is being reviewed. Perhaps more significantly a new expenditure and control system has been put in place with the assistance of the Fund and should help to improve overall expenditure management and to avoid the recurrence of domestic arrears which became subject of the management's report on noncompliant purchase and which was considered by the Board in August. Meanwhile, revenue performance will be strengthened through continued improvement in tax administration and through appropriate incentives given to MRA.

13. As already indicated structural reforms will be widened and deepened through the introduction of a wide range of measures that include the further liberalization of trade in agricultural products coupled with the expansion of private sector involvement. Meanwhile, steps are being taken to commercialize the Agricultural Development and Marketing Corporation (ADMARC) in anticipation of its full privatization in 2002. The National Food Reserve Agency is being reformed and recapitalized with the assistance of the international donors. The production of tobacco has been liberalized with smallholders production expanding substantially in recent years. The role of Intermediate Buyers is being redefined to ensure that quality is not compromised. Financial sector reforms will focus on the privatization of the two main commercial banks while completing an action plan for the introduction of a new and comprehensive regulatory framework early in the new year.

14. In the area of governance, the focus is on combating corruption and fraud, especially in the light of the recent incidents that were unearthed by Public Accounts Committee and the Auditor General. Accordingly, the government has stepped up its assistance to the work of the democratic oversight institutions, including the Anti-Corruption Bureau. All previous cases of corruption and fraud will be pursued diligently by mounting careful investigations and prosecuting the officials involved. The Public Accounts Committee has released its report and introduced it for debate in parliament this week. Meanwhile legislation will be tightened to improve safeguards against corruption, while a new Procurement Code and Procurement Authority will be established to decentralize and bring about transparency in the procedures to be followed by purchasing agencies.

15. In order to reduce income inequality and poverty, the government in consultation with civil society and with technical assistance from the World Bank has formulated a National Safety Net Strategy, focusing on low-income households to ensure food security. To this end, a "starter pack" program involving the distribution of seeds and fertilizer inputs is being refined to better target the poor.

The Decision Point

16. The debt sustainability assistance has confirmed what the authorities have known all along, that Malawi's debt is high and unsustainable. My authorities therefore welcome the efforts of the international community to respond positively to their request for debt relief assistance that would allow them to take a more aggressive approach to poverty reduction initiatives. As already indicated, the authorities are aware of the remaining gaps in their Interim PRSP and have set out a realistic timetable in which a more robust document could be produced through a more intensified process of consultation with civil society. The Decision Point Document has presented carefully articulated triggers which the authorities view as appropriate in order to satisfy the floating Completion Point. My authorities believe that the proposed interim assistance is consistent with the provisions of the HIPC Initiative.

16. Malawi has a long history of commitment to economic adjustment and reform and the reduction of poverty, supported by the Fund, the World Bank and the donor community. There has been appreciable progress along the way, with a much improved environment for the development of the private sector. The current program is a further attempt to bring the process of reform and adjustment forward as basis for poverty reduction. A reasonable track record has already been established with the implementation of the previous three-year program under ESAF, albeit with the difficulties that required waivers. The current program holds promise given the commitment and renewed vigor expressed by the authorities in their ten-point plan.

Conclusion

17. In the light of the foregoing, I request approval for Fund assistance to Malawi under the PRGF and debt relief under the enhanced HIPC Initiative. The NPV of debt-to exports ratio will remain high above the threshold of 150 percent. It will be important to keep the case under close review with a view to reassessing the amount of assistance to Malawi at the Completion Point.