

INTERNATIONAL MONETARY FUND
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

MALAWI

**Preliminary Document on the Enhanced Initiative for
Heavily Indebted Poor Countries (HIPC)**

Prepared by the Staffs of the International Monetary Fund and
the International Development Association¹

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Abbreviations and Acronyms

ADMARC	Agricultural Development and Marketing Corporation
CIRR	Commercial Interest Reference Rates
DSA	Debt Sustainability Analysis
ESAF	Enhanced Structural Adjustment Facility
ESCOM	Electricity Supply Corporation of Malawi
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
MASAF	Malawi Social Action Fund
MDC	Malawi Development Corporation
MTEF	Medium Term Expenditure Framework
NFRA	National Food Reserve Agency
ODA	Official Development Assistance
PER	Public Expenditure Review
PCC	Petroleum Control Commission
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
RBM	Reserve Bank of Malawi
SGR	Strategic Grain Reserve
WEO	World Economic Outlook

I. INTRODUCTION

1. This paper presents a preliminary assessment of Malawi's eligibility for assistance under the Enhanced Initiative for Heavily Indebted Poor Countries (HIPC).
2. Since the 1980s, Malawi has pursued economic reform programs supported by the International Monetary Fund (IMF) and the International Development Association (IDA). The focus of economic policy in recent years has been to reduce inflation, improve the fiscal position, and liberalize domestic markets and external trade. However, Malawi remains one of the poorest countries in the world, with a per capita GDP of US\$164 in 1999, a life expectancy of 42 years and an infant mortality rate of 134 per thousand live births. Moreover, it faces an unsustainable debt burden: the net present value (NPV) of debt was US\$1,472 million at end-1999, equivalent to 262 percent of exports of goods and nonfactor services and 512 percent of government revenues, even after the application of traditional debt relief mechanisms.
3. The outcome of the debt sustainability analysis prepared by the staffs of the IMF and IDA in collaboration with the Malawian authorities is that Malawi could qualify for assistance of US\$629 million in NPV terms, or an estimated US\$1,095 million in nominal terms, based on the export criteria under the Enhanced HIPC Initiative. The paper proposes that Malawi could proceed to a decision point once an arrangement under the Poverty Reduction and Growth Facility (PRGF) is concluded and an Interim Poverty Reduction Strategy Paper (PRSP) has been assessed.
4. The paper is structured as follows: Section II assesses Malawi's eligibility under the Initiative by presenting the country's macroeconomic adjustment record as well as its progress in the structural and social domains. Section III presents the policy outlook over the medium term. Section IV provides the debt sustainability analysis (DSA) prepared by the staffs of the IMF and IDA in collaboration with the Malawian authorities.² Section V concludes with the staffs' recommendations and issues for discussion by the Executive Directors.

² The DSA was prepared during missions in December 1999 and March 2000. The Fund staff team comprised Mr. Shields (head), Messrs. Fanizza, Odedokun, Tadesse and Benicio. The IDA staff team included Messrs. Chitale, Moll, Zaman and Ms. Le Manchec.

II. ASSESSMENT OF ELIGIBILITY

A. PRGF and IDA Status

5. Malawi is currently a PRGF-eligible and IDA-only country with a per capita GDP estimated at US\$164 in 1999. Twenty year projections indicate that Malawi's per capita GDP would increase to US\$307 by 2020, assuming a sustained per capita real GDP growth rate of 3 percent.³ In the medium term, Malawi is likely to remain a PRGF-eligible and IDA-only country, and will be in need of substantial external assistance on concessional terms.

B. Macroeconomic Track Record

6. Malawi has since the 1980s been implementing successive economic reform programs supported by substantial financial and technical assistance from the Fund, IDA, and bilateral and multilateral donors. Programs with the Fund include two arrangements under the Enhanced Structural Adjustment Facility (ESAF) in 1988-94 and 1995-99. IDA has supported Malawi with project credits as well as 10 structural and sectoral adjustment loans since 1966. The African Development Bank (AfDB) has co-financed a number of the adjustment programs as well as provided substantial financial assistance for projects. The European Union, Japan, the UK, USAID and other bilateral donors have also provided substantial resources in support of the stabilization and adjustment programs.

7. The macroeconomic record of Malawi has been highly variable over the past twenty years, with periods of crisis often followed by periods of adjustment and growth. In general, macroeconomic conditions in Malawi have been characterized by: (i) erratic patterns of GDP growth reflecting a combination of climatic factors and inconsistent policies; (ii) a failure to achieve low inflation on a sustained basis as a result of frequent exogenous shocks and periodic slippages in monetary and fiscal policies; (iii) adverse terms of trade developments; and (iv) large external current account deficits financed by a high level of official transfers as well as concessional borrowing and at times by large drawdowns in reserves.

8. During the 1980s, per capita GDP fell at an average rate of 1.3 percent per annum, despite some initial efforts towards reducing macroeconomic imbalances and broadening market-oriented reforms. In the early 1990s, Malawi suffered from severe regional droughts, a deterioration in the terms of trade, and the suspension of balance of payments support owing to donor concerns about governance and overspending in the final years of the Banda regime. For the first half of the decade, real GDP stagnated, the fiscal deficit (excluding grants) averaged 13 percent of GDP and average end-period inflation stood at 33 percent (Table 1a).

³ Figures expressed in 1999 dollars. On the alternative Atlas method, GNP per capita was US\$190 in 1999, rising to US\$343 by 2020.

Table 1a. Malawi: Macroeconomic Track Record

Average yearly rates	1990-95	1995-99
Real GDP growth (percent)	0.3	6.4
Consumer price inflation, end-period (percent)	32.6	23.3
Reserve money (percent growth)	43.6	24.5
Current account balance, excl. grants (percent of GDP)	-15.0	-13.5
Fiscal balance, excluding grants (percent of GDP)	-13.3	-11.0
Deficit financing from banking system (percent of GDP)	1.7	-0.5
Gross international reserves, in months of imports	1.7	3.3

Sources: IFS and staff estimates.

9. Against this backdrop, the authorities adopted a medium term economic program supported by an ESAF arrangement in 1995. Economic performance improved substantially during 1995-96: real GDP growth rebounded to an average of 12 percent as a result of favorable weather conditions and the liberalization of production and marketing arrangements in agriculture; the fiscal deficit (excluding grants) fell sharply from 28 percent of GDP in 1994/95 to 7.5 percent of GDP in 1996/97; and end-period inflation declined from 75 percent in 1995 to 7 percent in 1996. The external outlook also improved considerably with gross international reserves rising from 0.7 to 3.5 months of imports between end-1994 and end-1996. However, the period of policy adjustment proved to be short-lived and a large expansion in unprogrammed spending in the third quarter of 1997 widened the fiscal deficit to 11.5 percent of GDP in 1997/98, which caused the ESAF-supported program to go off-track.

10. With the support of an IMF Staff Monitored Program, the authorities regained control over the spending surge and the overall budgetary situation in the middle of 1998, in part through the strengthening of efforts at revenue collection.⁴ However, a sharp depreciation of the Malawian kwacha in August 1998 complicated monetary control and led to an increase in end-period inflation from 15 percent in 1997 to 53 percent in 1998.⁵ The ESAF arrangement

⁴ A report by the Auditor-General in December 1999, however, identified domestic expenditure arrears amounting to about 1.2 percent of GDP, which had been accumulated between end-March 1998 and end-October 1999. The report also estimated that the stock of arrears at end-March 1998 had been about 2 percent of GDP.

⁵ The real effective exchange rate had appreciated by about 30 percent in 1996 and 1997. The nominal US dollar exchange rate depreciated by 44 percent between end-August and end-December 1998.

was resumed in December 1998 and improvements in the fiscal position, together with a bumper maize crop, assisted in the reduction of inflation to 28 percent by the end of 1999 and the achievement of real GDP growth of 4.5 percent in the year.

11. Despite the setbacks in 1997 and 1998, the 1995-99 period of the ESAF program showed an improvement in macroeconomic conditions compared with the early 1990s: (a) inflation was nine percentage points lower on average; (b) real GDP grew at an average rate of 6 percent per annum; (c) the fiscal deficit was lower on average by around 2 percentage points of GDP; and (d) external reserves reached a level sufficient to cover 3.3 months of imports, from only 1.7 months of imports in the earlier part of the decade. In the view of the staffs, this track record in implementing macroeconomic policies provides an adequate basis for Malawi to qualify for debt relief under the HIPC Initiative. However, continued efforts at macroeconomic stabilization are still needed to reduce inflation further and to keep in place monetary and fiscal policies conducive to accelerating growth and reducing poverty.

C. Structural Reforms

12. To complement the macroeconomic stabilization efforts, the Government has implemented wide-ranging structural reforms aimed at reducing state controls in favor of market based growth, and at alleviating the country's widespread poverty (see Appendices III and V for details). The reforms have included public sector reforms (including *inter alia* civil service reforms and expenditure prioritization), private sector development (including *inter alia* privatization, deregulation, regulatory reform and agricultural liberalization) and external sector reforms (trade reform and the capital account). Indicators of the principal outcomes of these reforms are presented in Table 1b, and are discussed in the ensuing paragraphs.

13. **Public sector reform.** These reforms, undertaken both in the context of projects and of two IDA adjustment operations, have been aimed at streamlining the role and functions of the Government and restructuring the **civil service** to improve efficiency. The Government has accelerated the retirement and retrenchment of employees in low priority functions; undertaken functional reviews of 16 ministries; performed a job grading exercise; and contracted out some 18 functions (including some large cross-Ministerial functions such as security and cleaning services). Important tasks that the Government plans to undertake are the decompression of civil service salaries, a concomitant rationalization of staff, and the implementation of ministerial restructuring, taking into account the planned decentralization.

14. The Government also undertook a major reform of budgeting procedures through the introduction of the **Medium Term Expenditure Framework** (MTEF) in 1995. This has entailed an expenditure prioritization exercise in advance of each annual budget, a reorientation of spending to the social sectors, and tightened expenditure control measures. A list of priority expenditure floors and selected expenditure ceilings was established. The priority items were to receive adequate funding, subject to a floor, even if there were budget

Table 1b. Malawi: Structural Track Record

	1995	1999
<i>Trade and exchange regime</i>		
Maximum tariff rate on consumer goods (percent)	45	25
Weighted average tariff rate (percent)	19	14
Export tax rate (percent)	8	0
Size of inter-bank foreign exchange market (US\$ millions)	526	725
<i>Private sector development</i>		
Number of cellular telephone operators	1	2
Number of cellular telephones	5,000	24,000
Number of Internet Service Providers	1	12
Number of commercial banks	2	4
Valuation of the stock exchange (US\$ millions)	0	154
Number of employees involved in the privatization of government-owned firms, to date	0	9,000
<i>Agriculture</i>		
Number of registered tobacco clubs	2,400	24,119
Burley tobacco production by smallholders (kg millions)	21	90
Contribution of root crops (sweet potato and cassava) to national calorie requirements (percent)	10	35

cuts. Conversely the selected non-priority items (e.g. foreign travel) were subject to a ceiling in nominal terms even if there were a budget increase. Progress of the adherence to the ceilings and floors was monitored on a quarterly basis. The targets were largely achieved in the 1998/99 financial year. One of the outcomes of the cash budget has been much closer correspondence between planned and actual spending on the recurrent account. For instance, actual expenditures in agriculture exceed budgeted expenditures by between 40 percent and 57 percent in the period 1992/93 and 1994/95, but after the implementation of the cash budget, the excess of budgeted over planned expenditures was never greater than 5.6 percent in the period 1995/96 to 1997/98. Nevertheless, the procedures are imperfect, as witnessed by the budgetary overrun of late 1997 and the re-emergence of arrears. Further strengthening is now under way.

15. Private sector development. Malawi's formal sector was in the past dominated by a handful of large enterprises, both financial and non-financial, with interlocking interests stemming in part from substantial ownership of these enterprises by large parastatals, such as

the Agricultural Development and Marketing Corporation (ADMARC) and the Malawi Development Corporation (MDC), as well as by the Government itself. This dominance declined during the 1990s, partly on account of new entry (for instance, the conglomerate Press has reduced its operations in the tobacco trade owing to the rise of small-scale "intermediate buyers"). The Government's medium term strategy calls for rapid growth of the private sector in nonagricultural activities, and this will require both encouragement of private entry and further dismantling of the existing structure of ownership in the formal sector so as to subject it to the discipline of competition. Hence, one of the key elements in the Government's strategy is **privatization**.

16. Malawi's privatization program is being implemented on a sound legal basis under the Privatization Act approved in December 1996. The program envisaged the sale, over the following five years, of some 100 government-owned firms, most of them purely commercial enterprises. As of the end of 1999, 40 of these commercial enterprises had been brought to the point of sale, involving over 9,000 employees, or some 4 percent of Malawi's total nonagricultural employment. Malawi Railways was successfully concessioned in 1999. Plans for the divestiture of the assets held by MDC and ADMARC have been initiated. Finally, significant progress has been made towards increasing private sector participation in the power and telecommunications sectors (see more detail below).

17. Starting in 1993, a number of policy reforms have been initiated to deepen **financial markets** and improve the efficiency of financial intermediation and resource mobilization. Controls on interest rates were abolished in 1993, and the foreign exchange system was partially liberalized in 1994. The entry of two new foreign banks and one discount house was approved in order to increase competition and deepen financial markets. There is now an active secondary market in treasury bills, and there are interbank markets in domestic and foreign currency. The stock exchange, opened in 1995, now lists six companies with a capitalization of US\$154 million. The Government has decided to reduce the size of public sector holdings in the two largest banks. So far the Commercial Bank of Malawi has been brought to the point of sale, though as of early 2000 a qualified investor had yet to be located.

18. The Government is seeking to improve the performance of the **telecommunications** sector through extensive reforms. The Communications Act (December 1998) encourages private entry into the sector, which is now governed by an autonomous regulatory body. The sector has been partially liberalized and there are now two cellular telephone operators, with some 24,000 cellular telephones, and twelve Internet service providers.

19. Access to **electricity** is limited, with fewer than 55,000 of Malawi's two million households having access to grid-supplied electricity. Furthermore, the poor performance of the Electricity Supply Corporation of Malawi (ESCOM), together with the past policy of lower-than-cost tariffs, has required Government support in the form of a debt-to-equity conversion. The Government is addressing these problems. The Electricity Act (July 1998) encourages private sector entry into the power sector. In 1998 ESCOM was incorporated under the Companies Act. Further steps towards unbundling are being considered. An independent regulator for power has been operational since 1999.

20. In 1999 the Government eliminated the restrictions on the importation of **petroleum** products, which had been instituted in 1994. An association of private firms issued a tender for provision of a year's supply in September 1999, and the highly competitive prices arising from this process are expected to have a favorable impact on the pump price during 2000. Since May 1998, the authorities have been regularly adjusting the pump price of petroleum products to ensure the pass-through of changes in import prices.

21. Important steps have been taken in **agricultural diversification** away from the dominant staple, maize. Due to concerted efforts in agronomic research and dissemination of planting materials by Government assisted by non-governmental organizations, root crops (sweet potatoes and cassava) are bulking larger in the Malawian diet. Whereas root crops provided 10 percent of the national calorie requirement in 1992/93, in 1998 they provided 35 percent. This represents important progress because maize is more climate-dependant than several other crops, particularly root crops, so that the diversification has improved household food security.

22. Significant progress has been made in liberalizing **agricultural marketing**. The elimination of quotas for burley tobacco production enabled smallholders to grow burley and to trade it freely. Nine thousand smallholders were registered to grow 2 million kg of burley tobacco in 1990; after liberalization production shot up to 82 million kg in 1998 and 90 million kg in 1999. A new class of tobacco traders, the "intermediate buyers", has arisen, numbering about 6,000 as of 1999. The expansion of burley has implied a large infusion of cash and incomes into the rural economy, and positive demand effects in generating growth in the service sector.

23. The monopsonistic position of the state agricultural marketing company, ADMARC, was reduced in 1995 with the removal of restrictions on domestically traded agricultural products. The licensing requirements for fertilizer imports were removed in 1996. The private trading community has been expanding into retailing, long-distance transport and importation, but ADMARC continues to dominate urban maize retailing and large scale storage. From 1987 to 1999, the Government operated a Strategic Grain Reserve (SGR) which held some 80,000 tons of maize at its annual peak. The SGR was replaced by the National Food Reserve Agency (NFRA) in 1999.

24. **External sector reforms.** The reform program has made Malawi's **trade system** liberal and transparent. Non-tariff barriers were almost completely eliminated in 1997. Maximum tariffs have progressively been reduced from 45 percent in 1995 to 25 percent effective July 1, 1999; the average tariff fell from 19 percent in 1994 to 14 percent in 1999.⁶ Foreign currency deposit accounts are allowed for exporters. Malawi has liberalized

⁶ Based on an IMF index of the 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 for sub-Saharan African countries.

restrictions on **capital movements** by non-residents. Foreigners are allowed to make direct investments and repatriate investment proceeds without restriction. Given the continued need for macroeconomic stability, the authorities are moving cautiously towards removing administrative restrictions on capital outflows on the part of residents.

D. Social Policies

25. Malawi's social indicators are among the weakest in the region, reflecting in part its lower per capita income relative to the average sub-Saharan country (Table 2). Life expectancy is 42 years, compared with sub-Saharan Africa's average of 50; this *inter alia* reflects the AIDS epidemic in Malawi. Infant mortality is very high at 134 per thousand. Nevertheless Malawi has made considerable efforts in the social sectors, and has achieved notable progress in some areas. Education expenditure has risen from 2.4 percent of GDP in the 1970s to 4.6 percent on average in the second half of the 1990s. The measles immunization rate rose from 49 percent in the 1980s to 87 percent in the 1990s, well exceeding the average in sub-Saharan Africa (58 percent) and other low-income countries (80 percent).

Table 2. Selected Social Indicators in Malawi and Other Countries, 1993-98

	Malawi	Sub-Saharan Africa	Low-Income Countries
GNP per capita (US\$)	210	510	520
Population with access to safe water (percent)	45	...	...
Immunization rate for measles (percent under 12 months)	87	58	80
Life expectancy at birth (years)	42	50	63
Infant mortality (per thousand live births)	134	92	68
Women at ante-natal care clinics who have HIV (percent)	31	12	...

Source: 2000 World Development Indicators CD-ROM, World Bank

26. Analysis of household survey data suggests that there are about **4.8 million absolute poor** in Malawi, that is, about 45 percent of the population falls below a poverty line of US\$40 per capita per annum. Projections indicate that a GDP growth rate of about 6 percent per annum would be required in the medium term just to prevent the number of poor from increasing. Accordingly the country's strategy for poverty alleviation includes an important focus on economic growth, accompanied by a social safety net to protect the most vulnerable, and fostering rural development.

27. The Government launched a **Poverty Alleviation Program** (PAP) in 1994 as a process through which the poor are empowered to improve their livelihoods. Among the interventions introduced has been the Malawi Social Action Fund (MASAF), a quick-disbursing instrument that supports developmental initiatives at the grass roots level. Other initiatives to provide targeted assistance include food-for-work programs and the distribution of "starter packs" of fertilizer and maize and legume seeds to farm households.

28. The Government introduced universal free primary **education** in 1994. This has meant an increase in education spending from 9.9 percent of total recurrent account spending in 1993/94 to a projected 21.0 percent in 1999/2000 (Table 3a).⁷ Primary enrolment rose from 1.8 million in 1994 to 2.9 million in 1997. Incidence analysis shows that this focus on primary education and the abolition of fees has benefited the poorest 20 percent of the population. The expansion required the employment of an additional 22,500 untrained teachers, which has negatively affected the quality of instruction;⁸ some 16,000 of these teachers have received in-service training. In addition, the capacity of the secondary schooling system has remained extremely low. Efforts are now being directed at improving the quality of primary education and raising access at the secondary level.

29. The **health** sector has seen substantial increases in expenditures: health received 5.4 percent of total (recurrent and development) expenditure in 1993/94, rising to a projected 13.1 percent in 1999/2000 (Table 3a). Health spending was about 2 percent of GDP in 1993/94, and is projected at 2.8 percent of GDP for 1999/2000. During the 1990s, an increasing share of the health budget has been allocated to primary facilities at the expense of central headquarters administration, though Malawi's health system nevertheless remains top-heavy as measured by standard facility-to-population ratios. Some successes have been registered (Table 3b): falling infant mortality (163 per thousand in the 1980s, 134 in the 1990s), immunization (49 percent in the 1980s, 87 percent in the 1990s) and access to safe water in rural areas (32 percent to 45 percent). Several of the indicators of outcomes have stagnated or deteriorated during the 1990s, however: one of the best "summary" indicators, the infant mortality rate, has stagnated at around 134 in the late 1990s, partly on account of the impact of AIDS, and child malnutrition appears to have increased from 24 percent of under-fives in the 1980s to 30 percent in the mid-1990s. Another factor explaining the failure to achieve generalized improvement during the 1990s is that the sector is facing severe shortages in skilled human resources, especially nurses, and administrative difficulties have impeded the flow of drugs to the intended beneficiaries. Hence the Government intends to

⁷ The figures up to 1997/98 are actuals, while those for 1998/99 and 1999/2000 are budgeted, and hence may not be exactly comparable. The dollar per capita spending figures are high in the period 1997/1998 on account of the overvaluation of the kwacha; after the devaluation of August 1998, the dollar figures are lower. In addition to giving attention to the overall ministerial envelopes, the Government has focused on specific priority items. During 1998 the Government created a list of priority expenditure items which were to be protected even if there had to be budget cuts. The list included, for example, teaching and learning materials in the education ministry. In FY 1998/99 these were budgeted to represent 1.4 percent of all spending on goods and services; actual spending on this item was 2.0 percent of all spending on goods and services.

⁸ The decline in the quality of public education has sparked the founding of numerous private primary schools, particularly in urban areas.

focus on training programs for health personnel and on improved methods of administration in order to ensure adequate distribution of medical drugs.

Table 3a. Trends in Social Expenditures

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000
Education Expenditure							
Share in Total Expenditure	8.9	10.5	17.9	16.2	18.4	14.1	17.6
Share in Recurrent Expenditure	9.9	9.4	16.0	18.2	18.3	15.6	21.0
Share in Development Expenditure	6.6	18.0	26.4	8.4	18.6	10.6	13.3
Total Education Expenditure as Percent of GDP	3.3	3.2	5.4	4.0	5.5	3.3	3.8
Total Education Expenditure per capita (US\$)	6.2	4.5	9.1	9.0	11.8	5.4	6.75
Health Expenditure							
Share in Total Expenditure	5.4	6.3	11.4	7.8	7.5	12.8	13.1
Share in Recurrent Expenditure	6.0	6.5	9.7	8.8	7.5	8.8	12.6
Share in Development Expenditure	4.1	4.8	18.9	3.6	7.2	22.4	13.7
Total Health Expenditure as Percent of GDP	2.0	1.9	3.4	1.9	2.2	3.0	2.8
Total Health Expenditure per capita (US\$)	3.8	2.7	5.8	4.3	4.8	4.8	5.0
<i>Memo items:</i>							
Interest Expenditure (Percent of GDP)							
Domestic	1.9	3.1	4.3	4.1	2.1	2.1	2.0
External	1.2	2.0	2.2	1.1	1.1	1.7	1.3

Source: *Recurrent Actual Estimates* and *Development Actual Estimates*, various years. Actual figures for 1993/94-1997/98, budgeted figures for 1998/99 and 1999/2000.

Table 3b. Selected Educational and Health Indicators

	1980-85	1993-98
Education		
Primary school enrollment rate, total (percent of age group)	43	76
Primary school enrollment rate, male (percent of age group)	46	76
Primary school enrollment rate, female (percent of age group)	41	76
Health		
Safe water (percent of population with access)	32	45
Immunization, measles (percent of children under 12 months)	49	87
Immunization, DPT (percent of children under 12 months)	52	95
Child malnutrition (percent under 5 years)	24	30
Life expectancy at birth, total (years)	45	42
Mortality rate, infant (per thousand live births)	163	134
Mortality rate, under 5 (per thousand live births)	265	229

Source: 2000 World Development Indicators CD-ROM, World Bank

30. The increasing incidence of **HIV/AIDS** is affecting all sectors. The combination of malaria, the HIV/AIDS epidemic and other infections has reduced life expectancy from 52 years in the early 1990s to 42 years, and AIDS is now the leading cause of death in the age group 20-48 years. Malawi is among the worst affected countries in sub-Saharan Africa: 31 percent of women reporting to ante-natal care clinics in urban areas have HIV, well above the

sub-Saharan African average of 12 percent. The increasing numbers of AIDS deaths among productive adults in the public and private sectors are depleting the country's capacity and deterring developmental efforts. Epidemiological evidence suggests that HIV prevalence continues to be high among young adults – thus prevention efforts have yet to slow the spread of the virus. There is also a need for assistance for the growing number of AIDS orphans. The Government's response is detailed in the next section.

III. POLICY OUTLOOK

31. The Government's medium term development strategy focuses on the alleviation of poverty and the promotion of equitable growth through macroeconomic stability, a deepening of the process of structural reform and the implementation of measures to increase further the population's access to basic social services. The additional investment required for increased growth will necessitate strengthening the level and productivity of private investment and an intensification of measures to ensure market competition. At the same time, progress in the structural and social domains will require an enhanced effectiveness in the use of public sector resources, particularly those devoted to education and health.

A. Macroeconomic Objectives and Policies

32. The Government's macroeconomic objectives and policies for the medium term are to: (i) increase the rate of GDP growth from about 4.5 percent in 1999 to 5 percent in 2000 and 6 percent in 2002; (ii) reduce end-of-period inflation from 28 percent in 1999 to 19 percent in 2000 and 5 percent in 2002; (iii) continue the process of fiscal consolidation consistent with a new PRGF arrangement; and (iv) strengthen the balance of payments position, with gross international reserves rising to 4.3 months of import cover by end-2000 and 5 months of import cover by end-2002.

33. **Fiscal policy** over the medium term focuses on three objectives. First, fiscal consolidation will aim to generate the needed savings to support the growth objectives and reduce demand pressures. Efforts will focus on expenditure restraint and continued improvements in tax administration, including adequate funding to the Malawi Revenue Authority, to attain the medium term fiscal targets. Second, increased resources will be devoted to high priority areas, notably education, basic health care and safety nets, by prioritizing budgetary outlays on the basis of the on-going Public Expenditure Review (PER). Third, the monitoring and accountability of budgetary operations will be strengthened to improve the cost-effectiveness of government spending and to prevent the accumulation of fiscal arrears. Moreover, with a view to providing a reliable and transparent means of

identifying the resources being made available through the HIPC Initiative, efforts will be made to improve monitoring of expenditure outcomes in key social sectors.⁹

34. **Monetary policy** will be aimed at achieving the Government's objective of reducing inflation substantially over the medium term. The central bank's monetary operations will be guided by reserve money targets specified within the context of the PRGF arrangement. The reserve money targets will seek to reduce the rate of growth of broad money. At the same time, a substantial net repayment by the Government to the banking system will be needed to allow for an increase in credit to the private sector to support economic activity.

35. **External sector policies** will be aimed at maintaining an adequate level of international reserves coverage over the medium term. The exchange rate for the kwacha will continue to be market-determined, with interventions by the central bank being guided by the international reserves target. In regard to trade policy, the Government will continue with measures to reduce tariffs and will eliminate any remaining non-tariff barriers, consolidate commitments made under the Cross Border Initiative (CBI) and pursue regional trade agreements under the Common Market for Eastern and Southern African (COMESA) and the Southern African Development Community (SADC).

B. Structural Policies

36. **Public sector reform.** During FY 2000 the Government has, with assistance from IDA, been undertaking a major PER in order to provide a sounder analytical basis for the **Medium Term Expenditure Framework** (MTEF), and to furnish the basis for a further round of public sector reforms. The recommendations of the PER are being incorporated in the FY 2001 budget. The **public procurement** system suffers from a number of problems that make it inefficient and vulnerable to fraud. The Government plans to introduce a new Public Procurement Act based on international standards, which will decentralize procurement to the purchasing agencies. The Government recognizes that its efforts in civil service reform have lagged behind expectations, and has recently made plans to push forward with a comprehensive public sector management reform program.

37. **Private sector development.** As noted above, the formal sector is still dominated by a handful of large enterprises/parastatals, even though their influence has weakened owing to new entry and market liberalization. In order to widen the structure of ownership in the formal sector and subject the sector to competition, the Government plans to continue the **privatization** process. Among the large firms to be brought to the point of sale during 2000 is Air Malawi.

⁹ While Malawi's annual budget documents provide adequate breakdowns of planned expenditure on a functional and economic basis, budgetary outcomes are classified only on an economic basis.

38. The split of **telecommunications** and posts is underway, as part of reforms that would bring Malawi Telecoms to the point of sale in 2000. Concerning the restructuring of the **power** sector, the Government is still deliberating the form of "unbundling" of the sector. Meanwhile, the managerial structure is being reorganized and tariff-setting is being placed on a non-discretionary basis. Achieving progress in improving electricity access and in the quality of service is a crucially important factor in attracting investment to the country, and hence in the facilitation of export diversification and job creation. This, in turn, has implications for poverty reduction.

39. Reform of the **petroleum sector** is continuing, so as to create more competition and greater transparency in arrangements for importation. The state-owned Petroleum Control Commission (PCC) has been split into a regulatory agency (which retains the name PCC), and an owner-operator of petroleum storage depots (ORTEX), which is to provide storage services and will be privatized by 2002.

40. **Financial sector development.** The Government intends to lower unremunerated reserve requirements on commercial bank deposits,¹⁰ in order to reduce the high implicit tax burden on the financial sector. To further develop a secondary market for government securities, the Government also intends to complete the implementation of the book-entry system for treasury bills. A review of financial sector legislation is under way with a view, *inter alia*, to introducing formal supervision procedures for all non-banking financial institutions. Efforts will continue to find a strategic partner for the Commercial Bank of Malawi.

41. As mentioned above, **ADMARC** retains a dominant presence in the trading of maize. There is a need to limit its role so as to strengthen the private sector in agricultural marketing. The Government is engaged in consultations over its privatization. The role of the **National Food Reserve Agency** (NFRA), which replaced the Strategic Grain Reserve, is still being deliberated, but it is anticipated that its mandate will stress disaster relief and that it will not intervene in the maize market during non-emergency situations.

C. Social Policies

42. The Government's strategy to reduce poverty—which will be developed further in the course of drafting the PRSP—encompasses macroeconomic and structural reforms, as detailed above, and also wide-ranging efforts in the social sectors. A summary of the principal social policies which the Government is pursuing is given in Box 1. They cover safety nets, education, health and AIDS.

¹⁰ The reserve requirement on commercial bank deposits in domestic currency was reduced from 35 percent to 30 percent on June 1, 2000.

Box 1. Key Social Policies

Safety Nets:	Make progress in implementing the National Safety Nets Strategy, including an expanded public works program. Develop ways of targeting the distribution of seeds and fertilizer so as to favor the least well off.
Education:	Raise quality of primary school instruction by improving and extending teacher training, particularly through in-service training, through increased availability of instructional materials, and through redressing the highly skewed geographic distribution of teachers. Increase the number of places in the secondary education system. Reallocate resources by increasing cost recovery at the tertiary level.
Health:	Accelerate training of essential staff such as nurses, possibly through lowering the entry requirements. Introduce a system of cost sharing which protects the access of the poorest to essential medical assistance. Improve the distribution of medicinal drugs and reduce the amount of pilferage and diversion, by restructuring Central Medical Stores.
AIDS	Implement behavior change interventions to slow the growth of the HIV infection. Undertake information, education and communication (IEC) interventions focusing on abstinence, partner limitation and condom use. Improve the quality of care for AIDS patients. Provide improved care for AIDS orphans

43. As mentioned above, Malawi has initiated various **poverty reduction programs**. The safety net components have tended to be fragmented, however, with weak targeting of the most vulnerable. To address these problems, the Government is engaged in completing a National Safety Nets Strategy in which the chief elements are an expanded public works program and a program of transfers for orphans, including AIDS orphans.

44. In **education**, the Government plans to implement its Education Policy Investment Framework. This focuses on raising the quality of instruction, particularly at the primary schooling level. This will entail improved and increased training for teachers—with an emphasis on in-service training activities—and efforts to raise the percentage of children graduating from primary school. Under the investment framework, the Government aims to increase the proportion of teacher trainers with junior degrees from 25 percent in 1998 to 40 percent in 2002, and to 60 percent in 2012. The Government also plans to increase the number of places in the secondary education system. Some of the resources needed for the increased focus on quality at the primary school level will be secured through gradual increases in fees at the tertiary level, which will be backed up by a bursary program for less well off students.

45. The **health** sector currently faces severe shortages in skilled human resources, particularly nurses. The Government intends to address these problems urgently through introducing fast-track training programs, and possibly lowering the entry requirements for training courses. Given the high cost of curative care as compared to preventive health, and the high cost of urban hospitals compared to rural clinics, overall improvements in health status can be obtained by reallocations of the Government subsidy element to preventive and rural health, which are also the domains in which the poor are likely to benefit most. Hence the Government is working on preparing a framework for cost sharing in health, to be executed in a manner which protects the access of the poorest to essential medical assistance.

The Government plans to reduce the occurrence of drug pilferage and diversion, through restructuring of the major Government distributing facility, Central Medical Stores.

46. In light of the expected doubling of AIDS cases over the next decade, there is an urgent need for changing behavior to arrest the spread of the disease, and for strengthening the coping mechanisms of communities. The Government has established a Cabinet Committee under the chairmanship of the Vice-President to oversee a mobilized response and developed a new Strategic Framework, based on community inputs, which was launched in 1999 by the President. A round table gathering was held to garner the necessary resources to implement the Strategic Framework. The strategy will pursue behavior change interventions to slow the growth of the infection and identify models of community-based care.

IV. DEBT SUSTAINABILITY, SENSITIVITY AND VULNERABILITY

47. The debt sustainability analysis has been prepared jointly by the Malawian authorities with the staffs of the IMF and the World Bank on the basis of loan by loan data for debt outstanding at end-1999. The DSA evaluates Malawi's prospects for attaining external debt sustainability through an examination of debt indicators in the context of a 20 year macroeconomic and balance of payments (BOP) framework. The debt estimates and net present value (NPV)¹¹ calculations are preliminary, pending a full reconciliation exercise with bilateral creditors.¹²

A. Debt Sustainability Analysis

48. At the end of 1999, Malawi's stock of external debt in nominal terms is estimated to have been US\$2,597 million, including US\$6.7 million in arrears.¹³ The net present value of

¹¹ The NPV of debt is calculated using the average currency-specific commercial interest reference rates (CIRRs) for the six-month period ending December 31, 1999. Loans in currencies other than the US dollar are converted using end-1999 exchange rates.

¹² In early 2000, the authorities sent letters to all their creditors requesting statements of their loans at end-December 1999. As of May 2000, the authorities received responses from the Nordic Development Fund, Japan, United Kingdom (ECGD), Austria, Spain (ICO), the Kuwait Fund, and China. On this basis, around 92 percent of bilateral debt has been reconciled. The mission provided the authorities with multilateral creditor statements, including those of the World Bank, the IMF, OPEC, IFAD, BADEA, and the EU/EIB; with the exception of PTA debt, all multilateral debt has been reconciled.

¹³ Of the US\$6.7 million in arrears, US\$6.2 million represented obligations on multilateral and post-cutoff date bilateral debt. Ninety-three percent of arrears are owed by parastatals. With a view to regularizing external arrears, a full verification of the outstanding stock will be undertaken before the decision point.

this debt is estimated at US\$1,479 million, or about 81 percent of GDP (Table 5).¹⁴ Of the total estimated external debt, 74 percent is owed to multilateral creditors, with debt to the World Bank alone constituting 51 percent of total debt. The main other multilateral creditors include the African Development Bank and the IMF, with 11 and 5 percent of total debt respectively. Bilateral creditors comprised 26 percent of total debt. Of the US\$388 million in bilateral debt, US\$310 million is owed to the Paris Club (largely Japan), US\$34 million is owed to Malawi's two non-Paris Club official bilateral creditors (China and Kuwait) and US\$44 million is owed to commercial creditors.

49. Malawi has benefited from three non-concessional Paris Club rescheduling agreements in 1982, 1983, and 1988, through which US\$78 million of bilateral debt has been rescheduled.¹⁵ Debt relief totaling US\$53 million has also been provided through cancellations from bilateral creditors in 1989 and 1990, namely from the US, France, and Denmark. Commercial debt has been subject to two reschedulings under the London Club in 1983 and 1988 covering a total of US\$59 million and US\$35 million respectively. In addition, Malawi received a cumulative total of around US\$49 million between 1989 and 1999 in IDA supplemental credits under the World Bank's Fifth Dimension Program. Debt service relief on principal and interest obligations due has been provided by Japan since 1998.

50. **Traditional debt relief mechanisms:** Debt eligible for traditional debt relief mechanisms accounts for only 3 percent of the NPV of Malawi's external debt at end-1999.¹⁶ As a result, the NPV of debt is reduced only slightly by the application of traditional debt relief mechanisms, from US\$1,479 million to US\$1,472 million, or by less than one percent (Table 5).

51. **Baseline macroeconomic and BOP assumptions:** Table 6 provides a description of external debt indicators in the context of 20-year macroeconomic projections. The macroeconomic projections, which are contained in Table 10, assume a continuation of prudent fiscal and monetary policies and a deepening of structural reforms. Real GDP growth

¹⁴ This represents the stock of debt before the full application of traditional debt relief mechanisms. In what follows, unless indicated otherwise, references are to debt stocks in NPV terms.

¹⁵ All prior to the Club's introduction of concessional reschedulings for low-income countries.

¹⁶ Pre-cutoff date commercial debt to the Paris Club is eligible for traditional debt relief mechanisms involving a stock-of-debt operation on Naples terms (67 percent NPV reduction), while pre-cutoff date ODA debt is eligible for rescheduling over 40 years, including 16 years grace. Non-Paris Club debt is assumed to be rescheduled on terms comparable to the Paris Club. The cutoff date for Malawi is June 1982.

is projected to average 6 percent per annum through 2009, and 5 percent per annum for the 2010-20 period on account of the strong performance of small-holder agriculture and services.¹⁷ Inflation after 2002 is expected to remain close to 5 percent. Gross international reserves are assumed to be maintained at 4.5 months of imports cover through 2009 and 4 months of import cover in the 2010-20 period.

52. To support the projected growth rates, gross domestic investment would need to increase gradually to 18 percent of GDP from 16 percent of GDP in 2000. Higher public and private savings would finance this increase, consistent with the balance of payments projections which imply a gradual decline in foreign savings over the projection period. The composition of gross investment would shift in favor of private investment, as a result of the impact of structural reforms on private sector activity and an increased availability of credit to the private sector, which in turn reflects a significant improvement in the financial position of the central government. Declining interest payments and lower public capital outlays would create the scope for increasing government spending on key public goods and the social sectors.

53. As regards the balance of payments outlook (Table 11), traditional exports are projected to grow at a rate of 3 percent, while non-traditional exports are projected to grow at a rate of 6 percent per year through 2009 and 4 percent per year thereafter.¹⁸ After improving at an annual rate of 0.7 percent through 2005, the terms of trade are projected to deteriorate over most of the rest of the projection period, on average by 0.4 percent per year.¹⁹ However, due to an improvement in the net services balance as a share of GDP, the current account deficit (excluding grants) would decline from an average of 10.6 percent of GDP in the 2000-

¹⁷ While real GDP growth stagnated for the 1990-95 period, it averaged 6.3 percent per year in the 1995-99 period.

¹⁸ Tobacco export volumes have shown steady growth averaging around 5 percent per annum over the past 20 years. A reduced rate of growth of 3 percent is projected over the medium term since substantial gains from the liberalization of this sector have already been realized and given poor world price prospects as well as finite limitations on crop acreage. For non-traditional exports, the assumption of a 6 percent annual growth through 2009 and 4 percent thereafter represents a realistic projection in light of the highly erratic performance of such exports observed during the past few years. Growth in import volumes is projected to be slightly less than real GDP growth, and is hence expected to average 5 percent per annum for the 2000-09 period compared to average GDP growth of 5.9 percent over the same period (Table 10).

¹⁹ Malawi's terms of trade have shown a secular deterioration over the past twenty years. Projections for the terms of trade over the medium term reflect prospects for tobacco prices from the Fund's World Economic Outlook (WEO) and the Bank's Commodity Division as well as partner country prices.

09 period to an average of 8.3 percent of GDP in the 2015-20 period. The projected deficit would be financed largely by official transfers amounting to 4.5 to 5 percent of GDP and by new borrowing on concessional terms.

Box 2. Malawi: Macroeconomic and Balance of Payments Assumptions

GDP Growth

- Real GDP is projected to grow by an average of 5.5 percent in the 2000-2002 period, 6 percent in the 2003-09 period and 5 percent in the 2010-2020 period.

Exports and Imports

- Volumes for traditional exports are projected to grow at an average rate of about 3 percent throughout the projection period; non-traditional exports are projected to grow at a rate of 6 percent in the 2003-09 period and 4 percent in the 2010-20.
- Import volumes are projected to grow at a rate of 5.0 percent in the 2000-09 period and 3.7 percent in the 2010-20 period.
- The terms of trade are projected to improve at an average annual rate of around 0.7 percent between 2000 and 2005, but are projected to deteriorate by an average of -0.4 percent beginning in 2010.
- Official transfers are expected to average 5 percent of GDP in the 2003-09 period, and 4.5 percent of GDP in the 2010-20 period.

Capital account

- Around 90 percent of new borrowing is expected to be made on IDA terms which have a grant element of around 75 percent. The remaining 10 percent of concessional borrowing is projected to be from bilateral creditors carrying a grant element of 35 percent.
- Foreign direct investment is expected to average about US\$30 million in the 2000-09 period, and US\$50 million in the 2010-20 period.

54. On the basis of the macroeconomic assumptions outlined above, Malawi's debt indicators—while showing some improvement towards the end of the projection period—are still expected to remain at unsustainable levels. The NPV of debt-to-exports ratio, which stood at 262 percent in 1999, would remain above 200 percent throughout the projection period, declining only slightly to a level of 223 percent by 2020 (Table 6). Malawi's debt to revenue ratio at end 1999 is estimated to be 512 percent.²⁰ The debt to revenue ratio remains

²⁰ Malawi's revenue to GDP ratio is 11 percent and its export to GDP ratio is 28 percent on the basis of three-year average (1997-99) data and consistent with the methodology utilized (continued...)

above 200 percent through 2007, but is projected to fall to 85 percent by 2020. Debt service on external debt is projected at 18 percent of exports of goods and non-factor services for 2000, and is expected to average 15 percent of exports for the projection period (Table 7).²¹

B. Sensitivity Analysis

55. Malawi's long-term balance of payments projections are subject to considerable uncertainty in light of the potential impact of climatic conditions, the terms of trade, and the nature of macroeconomic and structural policies. Given the dominant role of tobacco exports, which have comprised around 70 percent of merchandise exports in recent years, price and volume developments in this key sector will have a particularly significant impact on the balance of payments, notwithstanding the strong growth assumed for non-traditional exports.

56. Under the baseline scenario, export prices for tobacco are projected to grow by an average of 1.6 percent per year, while volumes are expected to grow by an average of 3 percent per year. However, if export prices instead show a long-term decline averaging 1 percent per year and if volume growth is lower at only 1 percent per year, then Malawi's export earnings would amount to US\$880 million in 2020 as compared to US\$1264 million under the baseline scenario (Table 6). Under this lower export earnings scenario, and given other assumptions as specified under the baseline, the NPV of debt-to-export ratio would be 320 percent in 2020 as compared to 223 percent under the baseline scenario. Debt service ratios would be higher at 20 percent of exports in 2020, as compared to 14 percent of exports in the baseline scenario (Table 7).

57. Malawi has traditionally received high levels of financing on concessional terms and the baseline scenario assumes that 90 percent of new borrowing will be on IDA terms. However, if only 60 percent new borrowing can be secured on IDA terms, then the NPV of debt will be higher at 238 percent of exports by 2020, as compared to 223 percent of exports in the baseline period. Even with a lower share of new borrowing taking place on IDA terms, the impact on Malawi's debt indicators is not as adverse as in the lower-exports scenario since the remainder of the new borrowing is still expected to be contracted on concessional terms involving a grant element of 35 percent.

for the HIPC Initiative. Given these ratios, Malawi does not qualify for assistance under the fiscal criteria of the Enhanced HIPC Initiative, which requires thresholds of 15 percent and 30 percent of GDP for the fiscal and export ratios respectively. In this context, the sensitivity analysis and calculations of assistance levels in the following sections focus on the NPV of debt-to-export ratio.

²¹ Figures for debt service are before any assistance under the HIPC Initiative.

C. Eligibility, Decision and Completion Points

58. Based on the above analysis of an unsustainable debt burden under the baseline scenario, and in light of an NPV of debt to exports ratio of 262 percent after the full use of traditional debt relief mechanisms, Malawi would qualify for assistance under the Enhanced HIPC Initiative. Malawi has established a track record of policy implementation under the ESAF arrangement completed in October 1999. Over the medium term, the authorities intend to accelerate the implementation of policies aimed at reducing poverty and increasing growth. They have also made substantial progress in developing a poverty reduction strategy and are finalizing an interim Poverty Reduction Strategy Paper (PRSP) to be considered by the Boards of the Bank and the Fund. Provided that the Boards consider the interim PRSP to be a satisfactory basis for a decision point, and in light of the above, the management and staffs of IDA and the Fund recommend Malawi reach the decision point following agreement on a new PRGF arrangement. The staffs are of the view that these conditions could be met by the last quarter of 2000.

59. A full specification of the actions to be taken by the authorities for reaching the floating completion point under the HIPC Initiative will be provided in the Decision Point document. These measures are expected to be consistent with those being formulated by the Government in its preparation of a full-fledged PRSP. The areas for policy reform expected to be monitored for reaching a floating completion point are outlined in Box 3.

Box 3: Possible Areas of Reform to be Monitored under the Floating Completion Point

Poverty Reduction Strategy Paper

- ◆ Completion of the PRSP and the first annual PRSP progress report.

Macroeconomic policies

- ◆ Satisfactory macroeconomic performance under the PRGF arrangement.

Social policies

- ◆ Improve and extend teacher training, and increase the provision of teaching and learning materials in schools.
- ◆ Train essential staff, and undertake reforms of the distribution system for medicinal drugs.
- ◆ Implement policies to slow the growth of the HIV infection.

Privatization process

- ◆ Progress with privatization and liberalization of telecoms.
- ◆ Progress with reform of the electricity sector, possibly including unbundling.

Governance

- ◆ Progress in the reform of procurement.

D. Potential Assistance Under the HIPC Initiative

60. With a target of 150 percent of NPV of debt-to-export ratio, the potential level of debt relief for Malawi is US\$629 million in NPV terms, or US\$1,095 million in nominal terms. Based on the composition of debt at end-1999, the share of multilaterals in the delivery of assistance under the HIPC Initiative is 74 percent, while the share of bilaterals and commercials is 26 percent (Table 9). Preliminary calculations by the staffs suggest that, in light of the relatively small amount of remaining pre-cutoff date debt, Paris Club bilateral creditors would need to take action on post-cutoff date debt and ODA in order to deliver their share of assistance. The common reduction factor for multilateral creditors would be 43 percent of their exposure in NPV terms.

61. The staffs estimate that assistance under the HIPC Initiative could translate into an annual debt service reduction averaging around US\$40 million to US\$50 million over the 2000 to 2020 period. The reduction would be equivalent to around 1.3 percent of GDP for the 2000-09 period and 0.7 percent of GDP for the 2010-20 period.²² By comparison, the combined spending on health and education amounted to 6.3 percent of GDP in 1998/99. A significant percentage increase in the resources devoted to health and education—of as much as 20 percent above current levels—could thus be realized if they were augmented by an amount equivalent to the level of assistance under the HIPC Initiative.

E. The Authorities' Views

62. The authorities noted that Malawi has implemented economic reform programs for a sustained period, although a variety of factors affected policy implementation, including periodic droughts, terms of trade deterioration and institutional weaknesses in public expenditure management. In spite of notable reforms on a number of fronts, poverty remains widespread and income inequalities are significant. There is a strong need to invest resources in social sectors and infrastructure, accelerate GDP growth, and reduce poverty. Debt relief that might become available under the HIPC Initiative would help provide financing for critical social and infrastructural programs.

63. The authorities reiterated their commitment to maintain prudent macroeconomic policies and deepen structural reforms. The authorities stressed the importance of continued access to external financing on highly concessional terms over the medium to long term. They noted that assistance potentially available under the HIPC initiative would help especially if it supplemented rather than substituted current levels of financial support. The Government has expressed its appreciation to all creditors for their continued support of Malawi's adjustment efforts, including in the context of the HIPC Initiative.

²² Interim assistance is estimated at approximately US\$7 million in 2000 and US\$29 million in 2001.

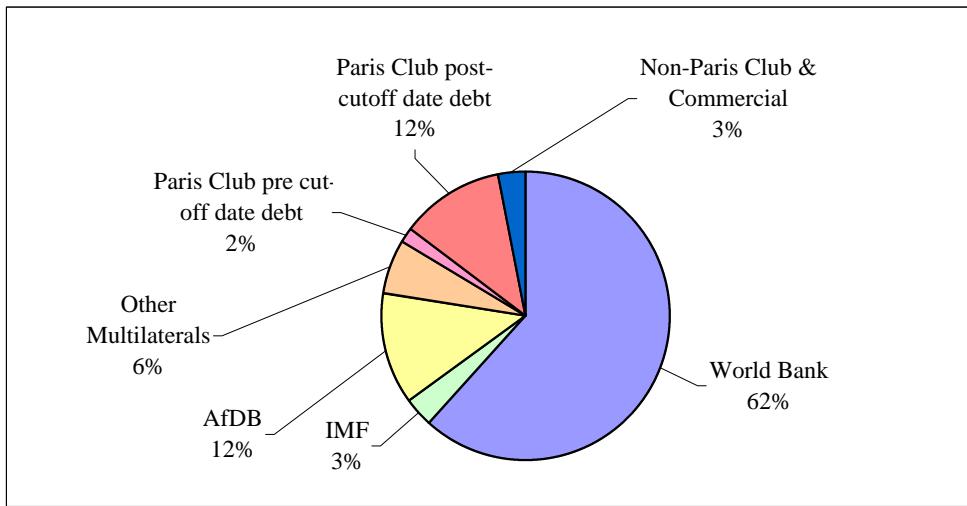
V. ISSUES FOR DISCUSSION

64. The preliminary debt sustainability analysis presented in this paper indicates that Malawi would be eligible for assistance under the HIPC Initiative. The debt relief that may be available under the Initiative would allow a reduction in Malawi's debt burden to sustainable levels and would also provide crucial resources for Malawi to strengthen services in the social sectors and build necessary infrastructure, while fostering financial policies that ensure macroeconomic stability. The staffs seek guidance from the Executive Directors on the following issues.

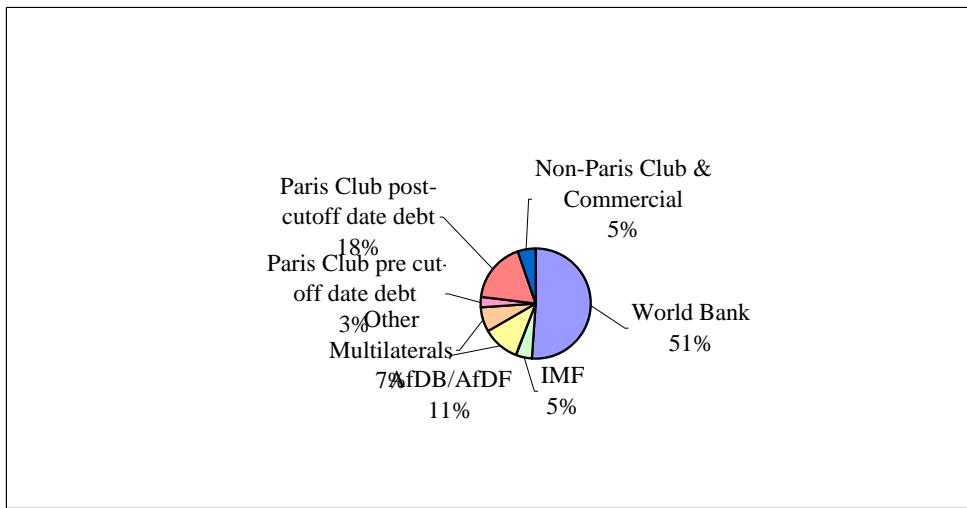
- **Eligibility:** Do the Directors agree that Malawi qualifies for assistance under the Enhanced HIPC Initiative?
- **Timing of the decision point:** Do the Directors agree with IDA and Fund management that, on the basis of an interim PRSP that the Boards consider is a sound basis for concessional IDA/Fund lending, the decision point could be reached by the last quarter of 2000, provided final agreement is reached on a new PRGF arrangement?
- **Floating completion point:** Do the Directors have comments on the proposed reforms to be enacted before the floating completion point?

Figure 1. Malawi: Composition of Stock of External Debt, End-December 1999 1/

Nominal value of debt: US\$2,597 million



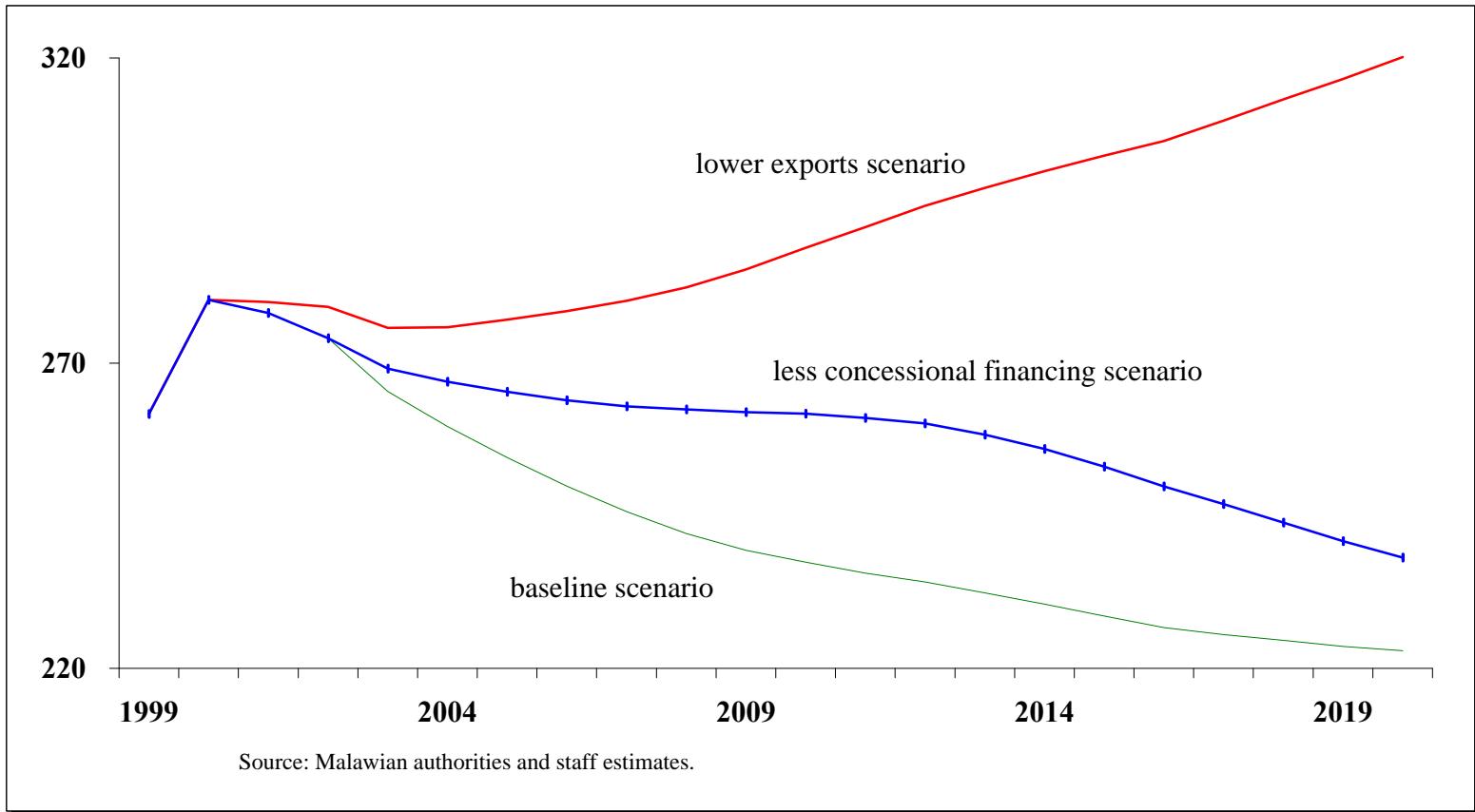
Present value of debt: US\$1,479 million



Source: Malawian authorities and staff estimates.

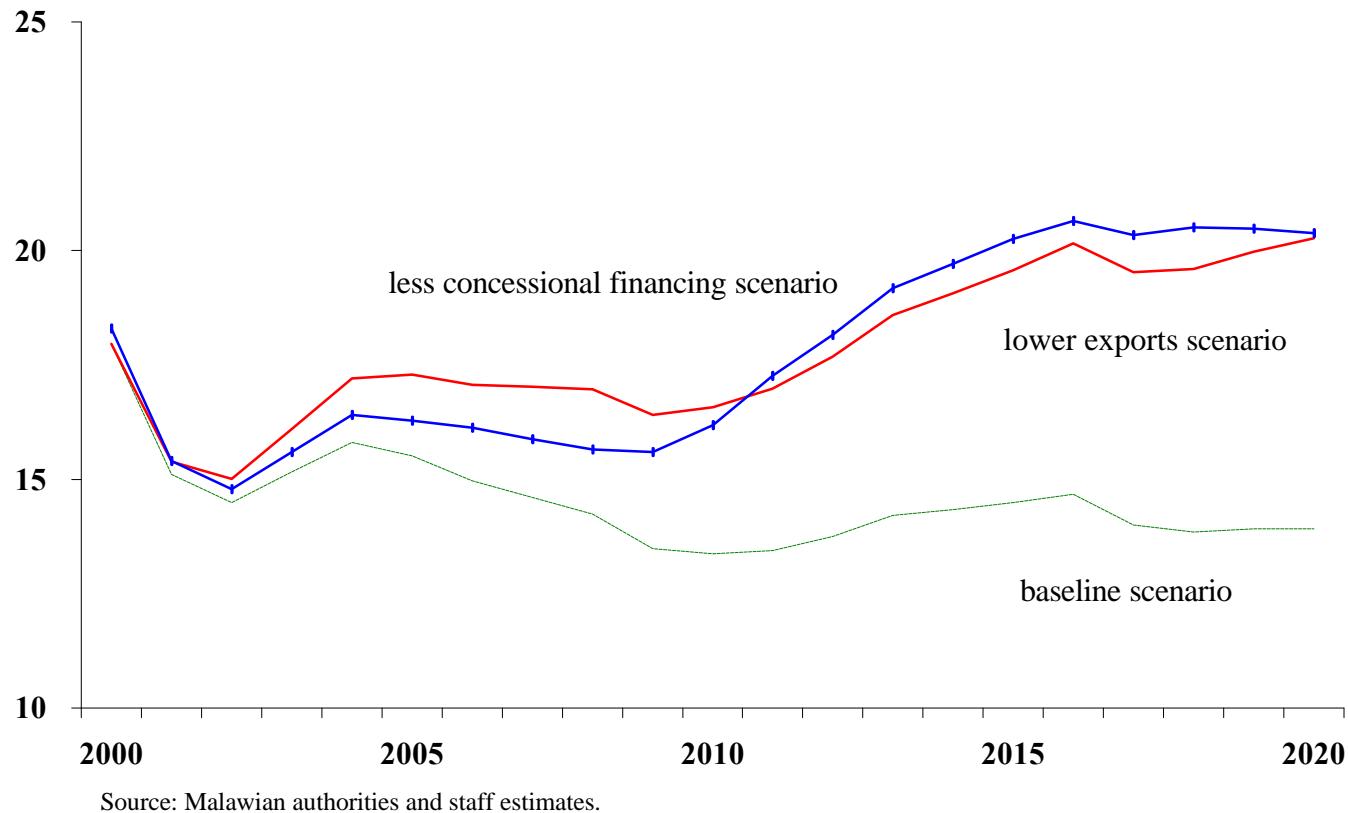
1/ Before full use of traditional debt relief mechanisms.

Figure 2. Malawi: NPV-of-Debt-to-Exports Under Alternative Scenarios 1/



1/ After the full use of traditional debt relief mechanisms, but excluding possible HIPC Initiative debt relief.

Figure 3. Malawi: Debt Service-to-Exports Under Alternative Scenarios 1/



1/ After the full use of traditional debt relief mechanisms, but excluding possible HIPC Initiative debt relief.

Table 4. Malawi: Selected Economic and Financial Indicators, 1997-2002

	1997	1998	1999	2000	2001	2002
		Prel.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise specified)						
GDP and prices						
GDP at constant market prices	4.9	3.1	4.5	5.0	5.5	6.0
Consumer prices (annual average)	9.1	29.7	44.8	27.4	14.1	7.3
Consumer prices (end of period)	15.2	53.0	28.2	19.2	10.0	5.0
GDP deflator	13.7	22.8	42.3	27.0	13.6	7.0
Nominal effective exchange rate (end-period) <u>1/</u>	13.6	55.2	2.6	...	...	...
Real effective exchange rate (end-period) <u>1/</u>	-3.7	33.5	-21.4	...	...	...
External sector						
Exports, f.o.b. (millions of U.S. dollars)	567	490	502	502	550	575
Imports, c.i.f. (millions of U.S. dollars) <u>2/</u>	783	662	595	654	707	758
Money and credit <u>3/</u>						
Money and quasi money	2.2	53.1	33.6	18.0	14.0	10.0
Net foreign assets	-3.1	100.7	10.1	24.6	21.3	9.1
Net domestic assets	5.3	-47.6	23.5	-6.6	-7.3	0.9
Credit to the government	2.4	-29.9	0.9	-13.0	-14.6	-8.4
Credit to the rest of the economy	4.4	18.5	20.6	13.0	8.9	10.0
(In percent of GDP, unless otherwise specified)						
Central government <u>4/</u>						
Revenue (excluding grants)	14.9	17.6	15.6	15.7	16.0	16.1
Expenditure	26.4	28.1	26.8	23.4	23.3	22.3
Domestic primary balance <u>5/</u>	-4.4	0.2	-0.7	-0.5	0.2	0.1
Domestic balance <u>6/</u>	-6.5	-2.5	-2.7	-1.5	-0.3	-0.2
Overall balance (excluding grants)	-11.4	-10.5	-11.2	-8.0	-7.4	-6.7
Overall balance (including grants)	-8.0	-4.2	-4.0	-1.4	-3.2	-2.2
National saving						
Domestic saving	3.6	-4.7	2.2	3.3	5.0	5.9
Public saving	6.0	-0.7	5.2	6.1	7.3	8.4
Private saving	-4.4	-4.3	0.1	0.2	1.0	1.6
Net factor income and private transfers	10.3	3.6	5.1	5.9	6.3	6.8
Foreign saving <u>7/</u>						
Overall balance (excluding grants)	-2.4	-4.0	-3.0	-2.8	-2.3	-2.5
Gross investment						
Public	8.7	19.0	13.3	13.1	11.8	11.2
Private	12.3	14.3	15.5	16.4	16.8	17.1
Stock building	7.1	9.0	9.9	9.6	8.6	8.1
External sector						
Exports, f.o.b.	2.7	2.4	3.3	4.6	6.3	7.2
Imports, c.i.f. <u>2/</u>	31.2	38.1	32.8	30.4	30.1	29.8
External current account (including official transfers)						
External debt (in nominal terms)	-9.3	-9.8	-5.4	-5.6	-6.4	-6.1
Debt-service ratio <u>8/</u>						
Of which: interest payments <u>8/</u>	14.6	19.8	19.2	18.0	15.1	14.8
Gross official reserves <u>9/</u>						
End-period stock	5.3	6.4	6.0	5.6	5.0	4.8
In months of imports of goods and nonfactor services	155	258	244	296	351	381
External debt (disbursed and outstanding, end of period)	2,281	2,479	2,597	2,706	2,824	2,949
(In millions of U.S. dollars, unless otherwise specified)						
Memorandum items:						
GDP (in millions of kwacha)	41,324	53,957	80,236	106,995	128,232	145,440
Kwacha per U.S. dollar exchange rate (per. avg.)	16.4	31.1	44.2	...	...	...
Per capita GDP (U.S. dollars)	242.0	157.8	165.0	...	...	...

Sources: Malawian authorities; and 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 April 1 for 1997, and July 1 thereafter.

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

7/ External current account, excluding official transfers.

8/ Debt service paid in percent of current year exports of goods and nonfactor services.

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

Table 5. Malawi: Nominal and Net Present Value (NPV) of Public and Publicly Guaranteed Debt Outstanding
(at end-December 1999, in millions of U.S. dollars)

	Before application of traditional debt relief 1/				After application of traditional debt relief 1/ 2/	
	Nominal		NPV		NPV	
	US\$ millions	Percent of total debt	US\$ millions	Percent of total debt	US\$ millions	Percent of total debt
Total Public and Publicly Guaranteed Debt	2597		1479		1472	
Multilateral Creditors 3/						
World Bank	2,173	84	1,091	74	1,091	74
African Development Bank	1,603	62	757	51	757	51
IMF	322	12	162	11	162	11
EU/EIB	88	3	69	5	69	5
IFAD	96	4	66	4	66	4
PTA Bank	50	2	26	2	26	2
NDF	7	0	8	1	8	1
BADEA	3	0	2	0	2	0
OPEC	2	0	1	0	1	0
	1	0	1	0	1	0
Bilateral Creditors	424	16	388	26	381	26
Paris Club	342	13	310	21	303	21
Japan	295	11	274	19	270	18
Austria	20	1	16	1	16	1
France	14	1	10	1	10	1
South Africa	3	0	3	0	2	0
United Kingdom	1	0	1	0	0	0
Spain	8	0	6	0	6	0
Germany	1	0	1	0	0	0
Non-Paris Club Official Bilateral	41	2	34	2	34	2
China	36	1	30	2	30	2
Kuwait Fund	5	0	4	0	4	0
Commercial	40	2	44	3	44	3
United Kingdom	26	1	28	2	28	2
Spain	3	0	3	0	3	0
Netherlands	9	0	10	1	10	1
South Africa	1	0	1	0	1	0
Sweden	1	0	1	0	1	0
United States	1	0	1	0	1	0
France	0	0	0	0	0	0

Memo Items:

Possible NPV relief by bilateral creditors under traditional debt relief mechanisms:

Source: Malawian authorities and staff estimates.

1/ Including \$6.7 million of arrears.

2/ Traditional debt relief involves a 67 percent NPV reduction of eligible debt by bilateral creditors and is applied before the consideration of debt relief under the HIPC Initiative. The stock-of-debt operation under Naples terms is assumed to take place at end-December 1999. Arrears on multilateral creditors (namely PTA Bank and EIB) as well as on commercial post cut-off date debt are assumed to be settled in the course of 2000.

3/ 98 percent of the multilateral debt has been contracted on concessional terms according to the DAC definition; non-concessional debt was contracted with the African Development Bank, IBRD, the European Investment Bank and PTA Bank.

Table 5. (continued) Malawi: Nominal and Net Present Value (NPV) of Public and Publicly Guaranteed Debt Outstanding
(at end-December 1999, in millions of U.S. dollars)

	Before application of traditional debt relief 1/		After application of traditional debt relief 1/ 2/	
	Nominal	NPV	NPV	
Total Public and Publicly Guaranteed Debt	2597	1479		1472
1. Multilateral Creditors	2,173	1,091		1,091
World Bank	1,603	757		757
African Development Bank	322	162		162
IMF	88	69		69
EU/EIB	96	66		66
IFAD	50	26		26
PTA Bank	7	8		8
NDF	3	2		2
BADEA	2	1		1
OPEC	1	1		1
2. Official bilateral and commercial	424	388		381
2a. Paris Club	342	310		303
Post-Cutoff	299	264		264
of which: ODA	299	264		264
Non-ODA	-	-		-
Pre-Cutoff	43	46		39
of which: ODA	30	30		34
Non-ODA	13	16		4
2b. Other Official bilateral	41	34		34
Post-Cutoff	41	34		34
of which: ODA	41	34		34
of which: non-ODA	-	-		-
Pre-Cutoff	-	-		-
of which: ODA	-	-		-
of which: non-ODA	-	-		-
2c. Commercial	40	44		44
Post-Cutoff	40	44		44
Pre-Cutoff	-	-		-

Memo Items:

Possible NPV relief by bilateral creditors under traditional debt relief mechanisms:

7

Source: Malawian authorities and staff estimates.

1/ Including \$6.7 million of arrears.

2/ Traditional debt relief involves a 67 percent NPV reduction of eligible debt by bilateral creditors and is applied before the consideration of relief under the HIPC Initiative. The stock-of-debt operation under Naples terms is assumed to take place at end-December 1999.

Arrears on multilateral creditors (namely PTA Bank and EIB) as well as on commercial post cut-off debt are assumed to be settled in the course of 2000.

Table 6. Malawi: External Debt Indicators 1/
 (In millions of US\$, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2015	2020
Nominal debt stock	2589	2706	2824	2949	3055	3158	3267	3380	3500	3627	3764	3907	4662	5589
Multilateral	2174	2126	2083	2038	1987	1930	1870	1810	1750	1689	1631	1571	1238	887
Bilateral	414	394	377	360	342	321	299	278	257	237	218	200	115	56
Paris Club	333	325	316	307	297	283	269	254	238	222	206	190	112	55
Non-Paris Club	41	39	36	32	28	24	20	17	15	14	12	11	3	1
Commercial	40	30	25	21	17	14	10	7	4	1	0	0	0	0
New debt	0	185	364	551	726	908	1097	1292	1493	1701	1915	2136	3309	4646
NPV of debt	1472	1511	1560	1614	1660	1701	1746	1794	1845	1902	1966	2035	2380	2817
Multilateral	1091	1083	1081	1079	1071	1058	1043	1026	1009	991	976	958	826	646
Bilateral	381	362	348	334	318	299	280	261	243	225	208	192	113	57
Paris Club	303	297	291	284	276	265	253	240	226	212	197	183	110	56
Non-Paris Club	34	32	30	27	24	20	17	14	13	12	11	9	3	1
Commercial	44	33	27	23	18	14	11	7	4	1	0	0	0	0
New debt	0	65	130	201	270	344	423	506	594	686	783	886	1441	2114
NPV of debt-to-exports of GNFS (in percent) 2/	262	280	278	274	265	260	255	250	246	242	239	237	229	223
NPV of debt-to-govt revenues (in percent) 3/	512	426	350	317	286	256	236	217	201	186	173	162	117	85
Memorandum items:														
Exports of GNFS, current year	541	545	595	626	655	685	718	751	785	821	859	892	1082	1313
Exports of GNFS, three-year average	562	539	561	589	625	655	686	718	751	785	822	857	1041	1264
Central government revenues	287	355	446	509	581	666	741	825	918	1022	1137	1254	2042	3327
Sensitivity analysis:														
Lower export earnings scenario 4/														
Exports of GNFS, three year average	562	539	557	578	602	617	630	644	659	673	689	705	783	880
NPV of total debt to exports ratio (in percent)	262	280	280	279	276	276	277	279	280	282	285	289	304	320
Lower concessional financing scenario 5/														
NPV of total debt	1472	1511	1560	1614	1683	1749	1820	1894	1975	2061	2152	2244	2635	3010
NPV of total debt to exports ratio (in percent)	262	280	278	274	269	267	265	264	263	262	262	253	238	

Sources: Malawian authorities and staff estimates

1/ After the application of traditional debt relief mechanisms. Excludes assistance under the HIPC Initiative

2/ Based on the three year average of exports of goods and non-factors services.

3/ Based on revenues exclusive of grants. The end-1999 exchange rate has been used for revenue projections.

4/ The lower exports scenario is based on a long-term decline in tobacco prices averaging 1.0 percent per annum during the projection period, and volume growth of only 1 percent per year.

5/ The lower concessional financing scenario assumes only 60 percent of new borrowing will be on IDA terms.

Table 7. Malawi: Projected Debt Service as of end-December 1999 1
 (In millions of U.S.dollars)

Table 7. (continued) Malawi: Projected Debt Service as of end-December 1999 1/

(In millions of U.S.dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2015	2020	Average 2000-09	Average 2010-19
2. Official bilateral and commercial	10	9	8	8	7	6	5	4	3	3	2	1	0	6	1
2a. Paris Club	5	5	5	4	4	4	3	3	3	2	2	1	0	4	1
Post-Cutoff	4	4	3	3	3	3	3	3	2	2	2	1	0	3	1
of which: ODA	4	4	3	3	3	3	3	3	2	2	2	1	0	3	1
Non-ODA	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pre-Cutoff	2	2	1	1	1	1	1	0	0	0	0	-	-	1	0
of which: ODA	1	1	1	1	0	0	0	0	0	0	0	-	-	0	0
Non-ODA	1	1	1	1	0	0	0	0	0	-	-	-	-	0	-
2b. Other Official bilateral	2	1	1	1	1	1	1	1	1	0	0	0	0	1	0
Post-Cutoff	2	1	1	1	1	1	1	1	1	0	0	0	0	1	0
of which: ODA	2	1	1	1	1	1	1	1	1	0	0	0	0	1	0
2c. Commercial	3	3	2	2	2	1	1	1	0	0	-	-	-	1	-
Post-Cutoff	3	3	2	2	2	1	1	1	0	0	-	-	-	1	-
3. New Borrowing	-	2	4	5	7	9	11	13	15	16	18	29	40	8	29
Multilateral	-	1	2	4	5	6	7	9	10	12	13	21	31	6	22
Bilateral	-	1	1	2	2	3	3	4	4	5	5	7	9	2	7
Memorandum items:															
Total debt service after rescheduling 2/	98	90	91	99	108	111	112	115	117	116	119	157	183	106	153
In percent of GDP	4.6	3.8	3.6	3.5	3.5	3.4	3.1	2.9	2.8	2.5	2.4	2.2	1.8	3.4	2.2
In percent of exports 3/	18.0	15.1	14.5	15.2	15.8	15.5	15.0	14.6	14.2	13.5	13.4	14.5	13.9	15.1	14.0
In percent of fiscal revenues 4/	27.6	20.2	17.8	17.1	16.3	15.0	13.6	12.5	11.4	10.2	9.5	7.7	5.5	16.2	7.5

1/ Debt service projections prior to the full use traditional debt relief mechanisms and before any assistance under the HIPC Initiative.

The payment of the outstanding arrears accumulated on multilateral and commercial post cut-off date debt (US\$6.7 million) is not included in the total debt service for 2000.

2/ After the application of full use of traditional debt relief mechanisms; i.e., a stock-of-debt operation under Naples terms was assumed to take place in December 1999. Moreover, a full settlement of outstanding external arrears of \$6.7 million is assumed to take place in 2000.

3/ The debt service ratio is measured in relation to current-year exports.

4/ Central government revenues (excluding grants) are converted into USD at end-1999 exchange rate.

Table 8. Malawi: Discount Rates and Exchange Rate Assumptions

Currencies	Discount Rates ^{1/} (in percent)	Exchange Rates ^{2/} (National currency per US dollar)
Austrian Shillings	5.47	13.70
Belgian Franc	5.47	40.16
Canadian Dollar	6.67	1.44
Chinese Yuan	7.04	8.28
Danish Kroner	5.32	7.40
Deutsche Mark	5.47	1.95
Euro	5.47	1.00
Finnish Markaa	5.47	5.92
French Franc	5.47	6.53
Great Britain Sterling	6.70	0.62
Irish Pounds	5.47	0.78
Italian Lira	5.47	1,927.40
Japanese Yen	1.98	102.20
Kuwaiti Dinar	7.04	0.30
Netherland Guilders	5.47	2.19
Norwegian Kroner	6.64	8.04
Portuguese Peseta	5.47	199.56
South African Rand	5.59	6.15
Spanish Peseta	5.47	165.62
Special Drawing Rights	5.59	0.73
Swedish Kronor	5.80	8.53
Swiss Franc	4.27	1.60
United States Dollar	7.04	1.00

Source: OECD and IMF, International Financial Statistics.

1/ The discount rates used are the six-month average Commercial Interest Reference Rates (CIRRs) for the respective currencies at end-December 1999. For all currencies for which the CIRRs are not available, the SDR rate is used as a proxy.

2/ The exchange rates are those at the base date (i.e., at the end of the period for which actual debt and export data are available).

Table 9. Malawi: HIPC Initiative: Alternative Assistance Levels Under a Proportional Burden-Sharing Approach 1/

NPV of debt-to-exports-target (in percent)	Assuming a Decision point in 2000 2/			<i>Memo item:</i> Required NPV debt reduction on comparable treatment on bilateral debt based on overall exposure (in percent)	
	Total Assistance under the NPV of debt-to-exports criteria				
	Total	Bilateral	Multilateral		
	(In millions of U.S. dollars)				
150	629	163	466		
Common Reduction Factor at the decision point 3/				43%	
Memorandum items:					
NPV of debt 4/	1,472	381	1,091		
3-year average of exports	562				
Current-year exports	541	...	...
NPV of debt-to-exports 5/	262	...	...
Paris Club Creditors	303			80	
of which pre-cod non-ODA	4			1022	
Non-Paris Club Creditors	34			80	
of which pre-cod non-ODA	-			...	
Commercial	44			80	
of which pre-cod	-			...	

Sources: Malawian authorities and staff estimates and projections.

1/ The proportional burden sharing approach is described in "HIPC Initiative--Estimated Costs and Burden Sharing Approaches" (EBS/97/127, 7/7/97 and IDA/SEC M 97-306, 7/7/97).

2/ Applies a hypothetical stock-of-debt operation on Naples terms and appropriate comparable treatment by other official bilateral creditors at end-December 1999.

3/ Each creditors' NPV reduction at the decision point in percent of its exposure at the decision point.

4/ Based on latest data available at the decision point after full application of traditional debt relief mechanisms.

5/ Uses a three-year average of exports of goods and nonfactor services centered on previous year.

Table 10. Malawi: Main Assumptions on the Macroeconomic Framework, 1998 - 2020

(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2015	2020	2000-09	2010-14	2015-20
	Act.	Est.	Projected												Average			
Economic growth and inflation																		
Real GDP (percentage change)	3.1	4.5	5	5.5	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	5.0	5.0	5.0	5.9	5.0	5.0
Inflation, period average (percentage change)	30	45	27	14	7.3	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	8.4	5.0	5.0
National Accounts																		
Gross investment	14.3	15.5	16.4	16.8	17.1	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	18.0	18.0	17.3	17.9	18.0
Gross national savings	-4.7	2.2	3.3	5.0	5.9	7.0	7.1	7.3	7.5	7.7	7.9	8.0	8.3	9.4	9.9	6.7	8.9	9.7
Government revenue (excl. grants)	17.6	15.6	15.7	16.0	16.1	16.5	17.0	17.0	17.0	17.0	17.0	17.0	18.0	18.0	18.0	16.6	18.0	18.0
Government expenditure	28.1	26.8	23.4	23.3	22.3	22.5	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.3	22.0	22.0
Overall government balance (excl. grants)	-10.5	-11.2	-7.7	-7.3	-6.2	-6.0	-5.0	-5.0	-5.0	-5.0	-5.0	-4.0	-4.0	-4.0	-5.6	-4.0	-4.0	
Balance of payments																		
Current account, excluding grants	-19.0	-13.3	-13.1	-11.8	-11.2	-10.5	-10.4	-10.2	-10.0	-9.8	-9.6	-9.5	-9.2	-8.6	-8.1	-10.6	-9.0	-8.3
Current account, including grants	-9.8	-5.4	-5.6	-6.4	-6.1	-5.5	-5.4	-5.2	-5.0	-4.8	-4.6	-4.5	-4.7	-4.1	-3.6	-5.3	-4.5	-3.8
Gross official reserves, (in months of imports)	4.3	3.8	4.3	4.9	5.0	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.0	4.0	4.0	4.6	4.0	4.0
Exports volume growth (percentage change)	4.9	0.7	8.5	5.1	5.1	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.3	3.3	3.3	4.6	3.3	3.3
Imports volume growth (percentage change)	-10.1	-13.8	5.2	7.8	4.3	6.0	4.9	4.4	4.4	4.4	4.4	4.4	3.7	3.7	3.7	5.0	3.7	3.7
Terms of trade (percentage change)	-0.6	-13.0	-6.4	0.8	0.7	0.7	0.6	0.7	0.0	0.0	0.0	0.0	-0.4	-0.4	-0.4	-0.3	-0.4	-0.4

Sources: Malawian authorities and staff estimates (as at May 2000).

Table 11. Malawi: Balance of Payments, 1998-2020

(In millions of U.S. dollars; unless otherwise specified)

	1998	1999	2000	2001	2002	2005 Projections	2010	2015	2020
		Est.							
Current account balance	-171	-99	-121	-148	-156	-172	-234	-290	-356
Trade balance	-172	-94	-152	-155	-160	-200	-291	-415	-585
Exports, f.o.b.	490	502	502	550	575	664	832	1014	1237
Imports, f.o.b.	-662	-595	-654	-704	-736	-864	-1122	-1429	-1822
Services balance	-134	-123	-104	-97	-99	-111	-135	-158	-184
Interest public sector (net)	-27	-24	-21	-12	-11	-11	-14	-15	-15
Receipts	8	9	9	18	19	20	21	27	34
Payments	-35	-33	-30	-30	-30	-31	-35	-41	-49
Other factor payments (net)	-19	-16	-16	-17	-21	-25	-33	-42	-54
Nonfactor (net)	-88	-83	-68	-69	-67	-75	-88	-101	-115
Receipts	39	40	44	46	51	54	61	68	76
Payments	-127	-123	-111	-114	-118	-129	-149	-169	-191
Unrequited transfers (net)	135	118	135	104	103	140	192	283	413
Private (net)	-22	-23	-24	-23	-23	-25	-28	-31	-35
Receipts	15	16	16	18	19	20	22	25	28
Payments	-38	-38	-40	-41	-42	-45	-50	-56	-63
Official	157	141	160	126	127	165	220	314	448
Receipts	159	142	161	128	128	166	221	316	450
BOP assistance	76	86	99	65	63	100	133	189	270
Project-related	63	50	62	63	64	66	89	126	180
Drought-related	20	6	0	0	0	0	0	0	0
Payments	-1	-1	-1	-1	-1	-1	-1	-2	-2
Capital account balance	262	115	179	172	165	151	186	213	274
Medium- and long-term flows	165	79	128	122	129	120	145	161	208
Disbursements	210	127	185	179	187	189	230	280	341
BOP support	62	16	62	53	79	79	97	118	143
Project support	121	111	123	127	108	110	134	163	198
Other	28	0	0	0	0	0	0	0	0
Amortization (public sector)	-45	-49	-57	-58	-58	-69	-85	-119	-133
Foreign direct investment and other inflows 2/	34	39	25	25	26	31	41	52	67
Short-term capital and errors and omissions	0	0	0	0	0	0	0	0	0
63	-3	26	25	10	0	0	0	0	0
Overall balance	91	17	58	24	8	-20	-47	-76	-81
Financing (-increase in reserves)	-91	-17	-58	-54	-21	-44	24	-34	-40
Central Bank	-76	-32	-53	-44	-11	-34	34	-24	-30
Gross reserves (-increase)	-103	14	-52	-55	-21	-20	34	-24	-30
Liabilities	26	-46	-1	10	10	-15	0	0	0
Of which: IMF (net)	-7	-12	-1	10	10	-15	0	0	0
Purchases/drawings	18	11	9	18	18	0	0	0	0
Repurchases/repayments	-25	-22	-10	-8	-8	-15	0	0	0
Commercial banks	-15	15	-5	-10	-10	-10	-10	-10	-10
Arrears	0	0	0	0	0	0	0	0	0
Financing Gap	0	0	0	31	13	65	23	110	122
Memorandum items:	0	0	0	0	0	0	0	0	0
Gross official reserves	0	0	0	0	0	0	0	0	0
In millions of U.S. dollars	258	244	296	351	372	392	424	532	671
In months of imports 1/	4.3	3.8	4.3	4.9	5.0	4.5	4.0	4.0	4.0
Current account balance (percent of GDP)	-19.0	-13.3	-13.1	-11.8	-11.2	-10.2	-9.2	-8.6	-8.1
Excluding official transfers	-9.8	-5.4	-5.6	-6.4	-6.1	-5.2	-4.7	-4.1	-3.6
Including official transfers									

Source: Malawian authorities and staff estimates (as at May 2000).

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

2/ Figures for FDI do not reflect possible inflows relating to telecoms or other privatizations.

Table 12. HIPC Initiative: Status of Country Cases Considered Under the Initiative, July 19, 2000

Country	Decision Point	Target			Assistance Levels 1/					Percentage Reduction in NPV of Debt 2/	Estimated Total Nominal Debt Service Relief (In millions of U.S. dollars)	Satisfactory Assurances from Other Creditors
		Completion Point	NPV of Debt-to-Export (in percent)	Gov. revenue	Total	Bilateral	Multi-lateral	IMF	World Bank			
Completion point reached under enhanced framework												
Uganda					1,003	183	820	160	517		1,950	
<i>original framework</i>	<i>Apr. 97</i>	<i>Apr. 98</i>	202		347	73	274	69	160	20		<i>Received</i>
<i>enhanced framework</i>	<i>Feb. 00</i>	<i>May 00</i>	150		656	110	546	91	357	37		<i>Being sought</i>
Decision point reached under enhanced framework												
Benin	<i>Jul. 00</i>	<i>Floating</i>	150		265	77	189	24	85	31	460	<i>Being sought</i>
Bolivia					1,302	425	876	84	194		2,060	
<i>original framework</i>	<i>Sep. 97</i>	<i>Sep. 98</i>	225		448	157	291	29	53	14		<i>Received</i>
<i>enhanced framework</i>	<i>Feb. 00</i>	<i>Floating</i>	150		854	268	585	55	141	30		<i>Being sought</i>
Burkina Faso					398	56	342	42	162		700	
<i>original framework</i>	<i>Sep. 97</i>	<i>Jul. 00</i>	205		229	32	196	22	91	27	400	<i>Received</i>
<i>enhanced framework</i>	<i>Jul. 00</i>	<i>Floating</i>	150		169	24	146	20	71	20	300	<i>Being sought</i>
Honduras	<i>Jun. 00</i>	<i>Floating</i>	110	250	556	215	340	30	98	18	900	<i>Being sought</i>
Mauritania	<i>Feb. 00</i>	<i>Floating</i>	137	250	622	261	361	47	100	50	1,100	<i>Being sought</i>
Mozambique					1,970	1,235	736	141	434		4,300	
<i>original framework</i>	<i>Apr. 98</i>	<i>Jun. 99</i>	200		1,716	1,076	641	125	381	63		<i>Received</i>
<i>enhanced framework</i>	<i>Apr. 00</i>	<i>Floating</i>	150		254	159	95	16	53	9		<i>Being sought</i>
Senegal	<i>Jun. 00</i>	<i>Floating</i>	133	250	452	193	259	42	116	18	800	<i>Being sought</i>
Tanzania	<i>Apr. 00</i>	<i>Floating</i>	150		2,026	1,006	1,020	120	695	54	3,000	<i>Received</i>
Completion point reached under original framework												
Guyana	<i>Dec. 97</i>	<i>May 99</i>	107	280	256	91	165	35	27	24	410	<i>Received</i>
Decision point reached under original framework												
Côte d'Ivoire	<i>Mar. 98</i>	<i>Mar. 01</i>	141	280	345	163	182	23	91	6 3/	800	<i>Being sought</i>
Mali	<i>Sep. 98</i>	<i>Spring 00</i>	200		128	37	90	14	44	10	250	<i>Being sought</i>
Total assistance provided/committed												
Preliminary HIPC document issued 5/												
Cameroon	...	...	150		1,466	1,047	358	41	197	30	2,700	...
Chad	...	...	150		157	34	123	15	65	27	250	
Ethiopia	...	...	200		636	225	411	22	214	23	1,300	...
Guinea	...	...	150		638	256	383	37	173	34	1,150	
Guinea-Bissau	...	...	200		300	148	153	8	73	73	600	...
Nicaragua	...	...	150		2,507	1,416	1,091	32	188	66	5,000	...

Sources: IMF and World Bank Board decisions, completion point documents, decision point documents, preliminary HIPC documents, and staff calculations.

1/ Assistance levels are at countries' respective decision or completion points, as applicable.

2/ In percent of the net present value of debt at the decision or completion point (as applicable), after the full use of traditional debt-relief mechanisms.

BFA/ Includes additional assistance required to meet 205 percent debt-to-exports target at completion point. Topping up from the assistance levels indicated in the September 1997 decision point document is based on the completion point document issued in June and subject to Board approval.

3/ Nonreschedulable debt to non-Paris Club official bilateral creditors and the London Club, which was already subject to a highly concessional restructuring, is excluded from the NPV of debt at the completion point in the calculation of this ratio.

4/ Equivalent to SDR 515 million at an SDR/USD exchange rate of 0.744.

5/ Figures are based on preliminary assessments at the time of the issuance of the preliminary HIPC document; and are subject to change. Assistance levels for Ethiopia and Guinea-Bissau were based on the original framework and applied at the completion point; for Nicaragua, Tanzania, Guinea, and Honduras, targets are based on the enhanced framework and assistance levels are at the decision point.

Adjustment Record Under Fund Arrangements, 1980-2000

	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
ESAF	October 18, 1995	October 31, 1999	51.0	51.0
Stand- By	November 16, 1994	June 30, 1995	15.0	12.7
ESAF	July 15, 1988	March 31, 1994	67.0	67.0
Stand-By	March 2, 1988	May 30, 1989	13.0	9.3
EFF	September 19, 1983	September 18, 1986	81.0	57.0
Stand-By	August 6, 1982	August 5, 1983	22.0	22.0
Stand-By	May 9, 1980	March 31, 1982	49.9	40.0

Malawi: IDA Credits in the Operation Portfolio

(As of March 31, 2000)

Loan/Credit Number	Approval Date	Borrower/Purpose	IDA	Cancellations	Undisbursed
22200	26-Mar-1991	PHN Sector Cr.	56	-	8
22250	02-Apr-1991	FISHERIES DEV.	9	-	1
23790	04-Jun-1992	LOCAL GOVT.	24	-	6
23860	17-Jun-1992	POWER V	55	-	5
26240	09-Jun-1994	INSTIT. DEV. II	23		7
27530	28-Jun-1995	NAT WATER DEV.	79	-	33
28100	25-Jan-1996	PRIMARY EDUC. EM.	22	-	1
28530	30-Apr-1996	FISCAL RESTR&DERE	102	-	1
28560	09-May-1996	SOCIAL ACTION FUND	56	-	7
N0250	20-Jun-1997	ENV. MANAGEMENT	12	-	9
30510	24-Mar-1998	SECONDARY ED. PROJ	48	-	43
31360	15-Oct-1998	MASAF II	66	-	64
31330	23-Sep-1998	POPULATION/FP PROJ	5	-	5
31470	03-Dec-1998	FISCAL RESTR&DERE TA	2	-	1
32390	10-Jun-1999	ROAD MAIN & REHAB	30		29
Q1520	22-Mar-1999	PRIVATIZATION AND UTILITY REFORM CR.	1	-	0.3
Q1521	24-Nov-1999	PRIVATIZATION AND UTILITY PROJECT	1	-	0.6
Total for 17 active credits (a)			591	-	220.9
			Active Loans	Closed Credits	Total
Total Disbursed (IBRD and IDA)			370	1,287	1,657
Of which repaid				175	175
Amount sold:				-	-
Of which repaid				-	-
Total Undisbursed:			225	13	238

Source: World Bank

(a) All IBRD loans are closed.

Note: Discrepancies are due to exchange rate valuation. Credit amounts reflect the exchange rate at the date of approval, while cancellations are valued at the rate prevailing on the day of cancellation, and in case of undisbursed amounts, they are valued at the end of month SDR/US\$ exchange rate.

Status of IDA-Supported Structural Reforms

Operation	Board Approval	IDA Credit (US \$ million)	Exchange Rate	Financial Sector Reforms and Liberalization	Trade and Tax Policy Reforms	Public Sector Management	Agriculture Sector Reforms	Industrial Sector Reforms	Parastatal Reforms
SAL-I	FY 81	45	Exchange rate adjusted	Interest rates adjusted	Tariffs, Tax rates and base Adjusted.	Macroeconomic and sectoral Planning capacity	Maize price adjustment		Financial reforms of MDC and Press Holdings
SAL-I	FY 84	55	Same	Same	Tariff and Tax structure adjusted		Smallholder Price adjustment		Some divestiture of ADMARC's non-marketing Assets
SAL-III	FY 86	30	Same	Same	Tax increases and tax system reforms.	Preparation of 3-year PSIP and Programmatic Budget Introduced	Same	Reduction in items subject to price controls	Some divestiture of non-market assets of ADMARC; MDC and PHL restructured
SAL-III Supplement	FY 87	10	Same	Same					Some of ADMARC's non-marketing activities divested
Industrial and Trade Policy Adjustment Credit	FY 88	79	* Same * Removal of exchange rate allocation requirements for 65% of imports	Revision of Reserve Bank Act	*Introduction of credit based surtax system * Export Licensing reduced and duty drawback introduced	Reduction of deficit	Beef prices decontrolled	Industrial Licensing requirement reduced	
Agriculture Sector Adjustment Credit	FY 90	70	Removal of exchange rate allocation requirements for 65% of imports				*Price changes of crops *Limited entry of smallholders in burley tobacco *Private entry in fertilizer trade * Estate rents adjusted		
Entrepreneurship Development and Drought Recovery Program (EDDRP)	FY 92	120	Exchange Rate Adjustments		* Expenditure targets set for education. * Budgeting reforms of district and peripheral health care.	*Expand smallholder access to burley tobacco	*Investment rules liberalized * Investment Promotion Agency set up. *Minimum wage introduced.		
Fiscal Restructuring and Deregulation Program	FY 96	100			Tariff and Surtax Reforms	* Introduction of the Medium Term Expenditure Framework	* Deregulation of smallholder burley tobacco production. * Liberalization of trade in inputs and	* Deregulation of transport tariffs and imports.	* Privatization program launched under the Privatization Act (1996)

Status of IDA-Supported Structural Reforms

Operation	Board Approval	IDA Credit (US \$ million)	Exchange Rate	Financial Sector Reforms and Liberalization	Trade and Tax Policy Reforms	Public Sector Management	Agriculture Sector Reforms	Industrial Sector Reforms	Parastatal Reforms	
Second Fiscal Restructuring and Deregulation Program	FY 99	90			<ul style="list-style-type: none"> * Top tariff rate reduced to 25% * New, flexible temporary employment permit policy to facilitate hiring of foreign technical staff 	<ul style="list-style-type: none"> * Civil Service Reform Plan and Implementation * Extension of MTEF to all ministries * Setting of priority spending targets and ceilings on non-priority items 	<ul style="list-style-type: none"> tobacco. * Land reform Commission set up. 	<ul style="list-style-type: none"> * Cabinet-approved plan for ADMARC privatization drawn up 	<ul style="list-style-type: none"> * Malawi Railways concessioned 	<ul style="list-style-type: none"> * Second cellular telecom license issued; investment advisers appointed for privatization of Malawi Telecom; independent regulator established.

External Debt Management Issues

External debt data in Malawi is maintained both at the Reserve Bank of Malawi (RBM) and at the Debt and Aid Management Division (DAMD) of the Ministry of Finance. The database of the RBM covers all public and publicly guaranteed debt, including its own liabilities, while DAMD records the debt of the central government, with some coverage of debts by parastatals. Both institutions use the Commonwealth Debt Reporting Management System (CS-DRMS). The DAMD is in charge of managing all external debt operations from contacting donors to processing all debt transactions in the system and thereafter transferring the data to the RBM. The latter institution compares the data transferred in the CS-DRMS database with a spreadsheet regularly updated with debt service payment orders received from the DAMD.

Malawi's debt management capacity has improved substantially, but notable deficiencies remain in data processing capacity, forecasting, and analysis. Progress has been made to fully operationalize the CS-DRMS at the Ministry of Finance. Past weaknesses in debt management included the existence of sometimes significant differences between the debt stocks reported by the RBM and the DAMD. In addition, the government has in the past accumulated "technical arrears," in part owing to delays in the receipt of bills from creditors. Some of the parastatal companies whose loans are guaranteed by the government have also fallen behind in their debt service payments.

To improve debt management, all debt transactions should be entered in the CS-DRMS on a regular basis and the two institutions should reconcile their databases more frequently. There is also a need to develop a system that would allow the authorities to be proactive in meeting their debt service obligations so as not to incur arrears due to lags in billing procedures. In addition, the government needs to develop a system for monitoring repayments of loans that have been lent to parastatals and for which the companies make direct payments. Finally, while a commendable effort has been made in compiling information on public and public and publicly guaranteed medium and long term debt, further efforts should be directed towards compiling comprehensive data on private sector debt as well as short term debt.

Key Structural Reforms in the 1990s

Fiscal, External Sector and Financial Policy Reforms

- ◆ A Medium-Term Expenditure Framework was introduced in 1995 to manage expenditures. The outcome was a far closer correspondence of planned and budgeted outcomes.
- ◆ In the context of an adjustment program (the Second Fiscal Restructuring and Deregulation Program, 1998-1999), a list of priority expenditure floors and selected expenditure ceilings was established. The priority items were to receive adequate funding, subject to a floor, even if there were budget cuts. Conversely the selected non-priority items (e.g. foreign travel) were subject to a ceiling in nominal terms even if there were a budget increase. Progress of the adherence to the ceilings and floors was monitored on a quarterly basis. The targets were achieved on a cash basis.
- ◆ In expenditures, the share of the education and health sectors increased from around 14.3 percent of expenditures (recurrent and development account) in 1993/94 to 26.9 per cent (budgeted) in 1998/99.
- ◆ Reforms in tariff and surtax policies, that have reduced average weighted statutory tariffs from 19 percent in 1994 to around 14 percent as of 1999. The maximum tariff on final goods was reduced to 30 percent in 1998 and to 25 percent in 1999. Tariffs on selected intermediate goods, raw materials and capital goods were reduced from 10 percent to 5 percent in 1998. All zero rated surtaxes, except those on exports, were changed to exempt status (in the case of unprocessed agricultural sector goods and certain merit goods), or to 20 percent.
- ◆ Controls on interest rates were liberalized in 1993.
- ◆ Greater exchange rate flexibility was introduced in 1994, and Malawi attained current account convertibility in 1995.
- ◆ A treasury bill market was launched in 1990 and extended in 1994, avoiding inflationary borrowing from the Reserve Bank. The size of the treasury bill stock has grown from less than 0.1 percent of GDP in 1994 to 9 percent of GDP in 1998. A secondary market in treasury bills arose in 1998.
- ◆ The stock exchange was opened in 1996. As of 1999, six firms were listed, and valued at US\$ 154 million.
- ◆ Reserve requirements on commercial bank deposits in domestic currency were reduced from 35 to 30 percent in June 2000.
- ◆ Export processing zones were introduced, while the processing of export duty drawbacks was improved to increase incentives for exporters. There is now a fledgling export oriented manufacturing sector in garments and cut flowers.

Civil Service Reforms

- ◆ The civil service structure has undergone significant changes as 22,500 new teachers were appointed in place of 20,000 other temporary employees who were laid off.
- ◆ A Civil Service Reform Action Plan was adopted and is now being implemented. Under this, the common services cadre was abolished, enabling better accountability and management in professional services.
- ◆ The first phase of functional reviews of the Government and rationalization of Government ministries was completed in 1996. Based on that the number of ministries was reduced from 27 in 1997 to 19 in 1998.
- ◆ As of 1999, detailed functional reviews of 16 ministries had been completed. Implementation of the recommendations—which covered reallocations of staff, outsourcing, downsizing and in some cases elimination of functions—had started in 1998.
- ◆ Based on the functional reviews, and in the context of an adjustment program (the Second Fiscal Restructuring and Deregulation Program, 1998 -1999), 18 Government functions were rationalized through outsourcing, privatization, merging or elimination.

Agriculture

- ◆ The monopolistic position of ADMARC, the state agricultural marketing company, was reduced in 1995 with the removal of restrictions on domestically traded agricultural products.
- ◆ Restrictions on smallholder production of tobacco were removed by amending the Special Crops Act.
- ◆ Private trading in fertilizer, seeds, and burley tobacco was liberalized.
- ◆ Generalized subsidies on fertilizer were removed.
- ◆ The agriculture financing system was revamped by introducing the Malawi Rural Finance Company (MRFC) on a sound financial basis in place of the Smallholder Agriculture Credit Authority that went bankrupt. The MRFC is to be privatized during 2000.
- ◆ In 1997 the operating arrangements of the Strategic Grain Reserve were changed. Instead of making purchases and sales through direct arrangement, all transactions were henceforth done by open tender.
- ◆ The Government prepared a detailed plan of privatization for ADMARC, which encompasses the direct sale of excess facilities, the hiving off of the cotton component, the sale as a single unit of the headquarters element and the tobacco interests at the end of three years, and other measures to reduce the dominance of the organization.
- ◆ The Government started a Presidential Commission on Land Policy Reform in 1996, which presented its final report to the President in 1999, proposing a large array of

reforms of tenure, rural and urban, and reforms of the land administration system and land markets.

Private Sector Development

- ◆ The Malawi Railways parastatal, previously a big drain on Government finances, was restructured. A new company was formed, and in 1999 it was transferred to private management as a concession.
- ◆ Minimum freight charges on domestic transport were eliminated (1996), and imports of second hand transport and equipment were deregulated, leading to more competition and services.
- ◆ A Privatization Law was passed (1996) laying the legal foundations and the institutional framework for privatization. As of 1999, some 40 companies had been brought to the point of sale.
- ◆ The Communications Act was passed by Parliament in 1998. A new regulatory body for the telecommunications sector, the Malawi Communications Regulatory Authority (MACRA) was established in 1998.
- ◆ A second license for a cellular telephone operator was granted in 1999.
- ◆ As of 1999 there were 12 holders of licenses for Internet Service Providers, and at least two of these were operational.
- ◆ In preparation for privatization, Telecoms and Posts were split physically (1999) and legally (July 2000).
- ◆ A new Temporary Employment Permit (TEP) policy aimed at ensuring investors that they can easily obtain TEPs for their key and necessary personnel was gazetted in October 1998.
- ◆ Two Acts, namely the Electricity Act (1998) and Electricity Supply Commission of Malawi Act (1998) were passed in 1998. Since then, ESCOM has been incorporated under the Companies Act as Electricity Supply Corporation of Malawi (ESCOM) and a new regulatory body, the National Electricity Council, has been established.
- ◆ ESCOM's debt was restructured in 1999 and tariffs were adjusted in order to restore the organization's financial viability.
- ◆ Petroleum importation was opened to the private sector in 1998. In 1999 a private sector consortium put out a tender for a year's supply of petroleum starting in early 2000.
- ◆ In 2000 the Petroleum Control Commission (PCC) was split into two: a regulatory body which retains the name PCC and an owner-operator of petroleum storage depots (ORTEX), which provides storage services.

Social Sectors

- ◆ In expenditures, the share of education, health and community development has increased from around 18 percent of expenditures in 1993/94 to 32 percent (budgeted) in 1999/00.

- ◆ Primary education was made free in 1994. In response, enrollment increased from 1.8 million in 1994 to 2.9 million in 1997. Government also launched a secondary education expansion program to accommodate the rising number of primary school graduates (1997).
- ◆ An IDA-funded Social Action Fund (MASAF) and a successor (MASAF II) is being used to help organize and finance community demanded projects and support public works. Communities play a key role in designing and funding these projects in building classrooms, boreholes, clinics, roads and irrigation.
- ◆ The Government has developed a new Strategic Framework, based on community inputs, to cope with the AIDS crisis. A round table gathering, opened by the President, was held to secure resources.
- ◆ A Poverty monitoring system has been launched to measure changes in household welfare through regular household surveys. The Integrated Household Survey, executed in late 1998, and encompassing 12,000 households, is producing its first tables. This was followed up by a panel survey of a subset of these households, executed in 1999. These data will be crucial in the drafting of the Poverty Reduction Strategy Paper.
- ◆ During 1999 the Government prepared a Safety Nets Strategy, the implementation of which is to begin in 2000. This is a key element in the Poverty Reduction Strategy which is under preparation.