

Malawi: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension and Rephasing of the Arrangement, and Additional Interim Assistance Under the Enhanced Initiative for Heavily Indebted Poor Countries—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Malawi

In the context of the first review under the three-year arrangement under the Poverty Reduction and Growth Facility, and requests for waiver of performance criteria, extension and rephasing of the arrangement, and additional interim assistance under the enhanced initiative for Heavily Indebted Poor Countries, the following documents have been released and are included in this package:

- the staff paper for the first review under the three-year arrangement under the Poverty Reduction and Growth Facility, and requests for waiver of performance criteria, extension and rephasing of the arrangement, and additional interim assistance under the enhanced initiative for Heavily Indebted Poor Countries, prepared by a staff team of the IMF, following discussions that ended on **August 3, 2003**, with the officials of Malawi on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 24, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **October 20, 2003** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its October 20, 2003 discussion** of the staff report that completed the request and/or review.
- a statement by the Executive Director for Malawi.

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

Joint Staff Assessment of the Poverty Reduction Strategy Paper Progress Report
Letter of Intent sent to the IMF by the authorities of Malawi*
Memorandum of Economic and Financial Policies by the authorities of Malawi*
Poverty Reduction Strategy Paper Progress Report
Technical Memorandum of Understanding*
*May also be included in Staff Report

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

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

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MALAWI

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria, Extension and Rephasing of the Arrangement, and Additional Interim Assistance Under the Enhanced Initiative for Heavily Indebted Poor Countries

Prepared by the African Department
(In collaboration with other departments)

Approved by Anupam Basu and Matthew Fisher

September 24, 2003

- On December 21, 2000 the Executive Board approved a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for Malawi for SDR 45.11 million (65 percent of quota) and an initial drawing of SDR 6.44 million.
- Since that time, several missions have held discussions relating to the first review. However, owing to recurrent policy slippages, the conclusion of the first review was delayed.
- During early 2003, the staff and the authorities agreed on a track-record program as a condition to complete the review, and the program was implemented during the period January–June 2003. A staff team visited Lilongwe during May–June 2003 to review performance under the track-record program through end-March 2003. A subsequent mission during July–August continued discussions on the first review under the PRGF arrangement, assessed performance under the track-record program through end-June 2003, and elaborated a macroeconomic framework for 2003–04.
- The July–August 2003 mission comprised Mr. Kakoza (head), Mr. El-Masry, (both AFR), Mr. Lombardo (FAD), and Mr. Tareen (PDR). Mr. Basu (AFR) participated in the policy discussions. Mr. Begashaw, the Resident Representative in Malawi, participated in all the missions' discussions.
- The mission held discussions with the President, Mr. Bakili Muluzi; Minister of Finance, Mr. Friday Jumbe; Governor of the Reserve Bank of Malawi, Dr. Ellias Ngalande; Secretary to the Treasury, Mr. Patrick Chilambe; and other senior officials of the government and public agencies. The mission also met with representatives of the donor community in Lilongwe.
- The last Article IV consultation with Malawi was concluded on August 5, 2002. Malawi accepted the obligations of Article VIII, Sections 2, 3, and 4 in December 1995 and maintains an exchange regime free of restrictions and multiple currency practices on the making of payments and transfers for current international transactions.

Contents	Page
Executive Summary	4
I. Introduction.....	6
II. Initial Objectives and Performance Under the PRGF-Supported Program	7
A. Overall Economic Performance During 2001 and 2002	8
B. Performance in Fiscal Year 2002/03	13
Fiscal policies.....	13
Monetary developments.....	19
Structural reforms.....	19
III. The Medium-Term Macroeconomic Objectives.....	20
IV. The Program for 2003–04.....	21
A. Fiscal Policy.....	22
B. Monetary Policy and Financial Sector Reforms	25
C. External Sector Policies and Reforms	26
D. Structural Reforms and Governance	27
E. Program Monitoring	29
F. Risks Associated with the Program	31
V. Staff Appraisal	32
 Boxes	
1. The 2002/03 Maize Operation	11
2. Measures Envisaged in the Track-Record Program to Strengthen Public Expenditure Management (PEM)	17
3. Status of Prior Actions in the Fiscal Area for the Completion of the First Review Under the PRGF Arrangement.....	18
4. Developmental Challenges Facing Malawi	20
5. Update of Malawi HIPC Initiative Completion Point Triggers	28
6. Structural Conditionality.....	30
 Tables	
1. Selected Economic and Financial Indicators, 2000–04	42
2. Central Government Operations, 2002/03	43
3. Central Government Operations, 2001/02–2003/04	45
4. Monetary Survey, 2001–04.....	47
5. Monetary Authorities’ Balance Sheet, 2001–04.....	48

6.	Balance of Payments, 2000–07	49
7.	Quantitative Performance Criteria Under the Poverty Reduction and Growth Facility (PRGF) Arrangement, 2000.....	50
8.	Structural Measures Under the PRGF Arrangement, 2000-03	51
9.	Indicators of the Use of Fund Credit, 2003-10	54

Appendices

I.	Letter of Intent	55
	Attachment I: Memorandum of Economic and Financial Policies	57
	Table 1. Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, 2003-04	70
	Table 2. Structural Performance Criteria and Benchmarks, 2003-04	71
	Table 3. Quantitative Fiscal Benchmarks Under the PRGF Arrangement, 2003-04	73
	Table 4. Disbursements and Test Dates Under the PRGF Arrangement, 2003–04	74
II.	Technical Memorandum of Understanding	75
III.	Relations with the IMF	82
IV.	IMF-World Bank Relations	85

Executive Summary

- **Macroeconomic conditions have deteriorated substantially during the last three years, marked by a generally stagnant economy, high inflation and real interest rates, and a persistently high incidence of poverty among the population.** This deterioration has been due to a highly inadequate stance of macroeconomic policies, particularly fiscal policy, and delays in implementing structural and sectoral reforms. It has been further aggravated by recurrent drought and famine.
- **Real GDP growth is projected to rebound during 2003 to about 6 percent, reflecting largely a recovery from the drought-induced stagnation during 2001-02.** Economic performance was also adversely affected by the very high real interest rates which averaged over 30 percent. Average inflation declined to less than 10 percent in June 2003, largely reflecting the fall in food prices from the drought induced levels in 2002. Gross international reserves of the Reserve Bank of Malawi (RBM) fell from 2.7 months of import cover at end-December 2001 to 1.2 months at end-July 2003. In the 12-month period ended July 2003, the Malawi kwacha depreciated by 28 percent against the U.S. dollar.
- **Fiscal performance during 2002/03 (July–June) was marked by buoyant revenue collection, slippages in expenditure control, and the severe impact of drought relief operations on the government budget.** The domestic budget deficit (excluding emergency maize operation) was 7.1 percent of GDP; including the maize operation, the domestic budget deficit amounted to 11.5 percent of GDP. Owing to the continued suspension of external budgetary aid, the budget deficit was financed by recourse to the domestic banking system. Budgetary reliance on bank financing was aggravated by the fact that the external support for emergency maize import operation was significantly lower than anticipated, leaving the RBM with depleted international reserves and a correspondingly high level of government debt.
- **Performance with regard to the track-record program (January–June 2003) was mixed, but broadly satisfactory:** fiscal targets for end-March and end-June 2003 were largely met; however, average reserve money targets for end-March and end-June 2003 were missed, owing to the low level of gross international reserves of the RBM and the very high interest cost of open market operations.
- **The macroeconomic framework for 2003–04 projects real GDP growth of 5-6 percent; end-of-period inflation falling from 9 percent in 2003 to 5½ percent in 2004; and usable gross international reserves of the RBM rising from a projected import cover of 1.9 months at end-2003 to 2.8 months at end-2004 (and further to 3-4 months by end-2005).** These objectives are to be achieved through substantial improvement in the fiscal position, with the domestic budget deficit (excluding the 2002/03 maize operation) narrowing from 7.1 percent of GDP in 2002/03 to 3.8 percent of GDP in 2003/04.

- **The implementation of the 2003/04 budget is to be closely monitored so as to hold monthly domestic expenditures in line with domestic revenue and avoid any arrears accumulation.** Budgetary aid is to be used partly to reduce domestic debt. This strategy is deemed essential initially to change inflationary expectations; restore confidence in the government's management of the budget, including, in particular, its control of public expenditures; and facilitate a fall in real interest rates. The program incorporates a complement of structural reforms aimed at advancing the reform and divestiture of public enterprises; launching medium-term civil service reform; and rationalizing regulatory requirements for the domestic financial system.
- **On the basis of performance under the track-record program and the policies outlined in the authorities' memorandum of economic and financial policies, the staff recommends the completion of the first review under the PRGF arrangement, the extension and rephasing of the arrangement through December 20, 2004, and additional interim assistance under the Heavily Indebted Poor Countries Initiative.**

I. INTRODUCTION

1. On December 21, 2000, the Executive Board approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement with Malawi. On the same date, Malawi reached the decision point under the Heavily Indebted Poor Countries (HIPC) Initiative. Since then, the completion of the first review under the PRGF arrangement has remained elusive because of repeated policy slippages.¹ On August 30, 2002, the Executive Board approved emergency assistance to Malawi of SDR 17.35 million (equivalent to 25 percent of quota) in support of food imports by the government to prevent the large shortage of maize that was expected during the 2002/03 crop year.

2. At the conclusion of the 2002 Article IV consultation, Directors noted that, while Malawi had made some progress in restoring macroeconomic stability, overall performance under the PRGF arrangement had been disappointing. They welcomed the authorities' renewed dedication to bringing the program back on track and stressed that success in this area would hinge critically on sustained and high-level commitment to fiscal restraint and reform of the parastatal sector. Directors also welcomed the finalization of the Malawi Poverty Reduction Strategy Paper (PRSP) and noted that it was prepared in a highly participatory process and provided a sound framework for reducing poverty and encouraging private sector-led growth.

3. Discussions on the possible completion of the first review under the PRGF arrangement continued in November 2002 and January 2003 in Malawi. In February 2003, the staff met with the authorities in Washington D.C. and reached understandings on an economic program for the period January–June 2003 that would facilitate the conclusion of the first review under the PRGF arrangement by allowing Malawi to establish a track record of sustained policy implementation and to obtain financing assurances from donor partners.

4. In the attached letter dated September 19, 2003 (Appendix I) and the accompanying memorandum of economic and financial policies (MEFP, Appendix I, Attachment I), the government of Malawi requests the completion of the first review under the current PRGF arrangement and its extension through December 20, 2004. It also requests a waiver for the nonobservance of performance criteria. In support of these requests, the MEFP reviews progress made under the track-record period and sets out macroeconomic policies to be implemented during July 2003–December 2004. The authorities are requesting that a disbursement of SDR 6.44 million be approved upon completion of the first review; the remaining undrawn balance of SDR 32.23 million be disbursed in five equal installments of SDR 6.44 million each upon completion of subsequent quarterly reviews; and interim debt relief from the IMF under the enhanced Heavily Indebted Poor Countries (HIPC Initiative)

¹ In June 2001, a staff report for the first review of the PRGF arrangement was circulated to the Executive Board but was not considered by the Board, owing to slippages in program implementation.

be resumed. The government has also indicated its intention to repurchase early the existing obligations of SDR 17.35 million under the IMF's emergency assistance policy in five equal installments, starting with the third disbursement under the PRGF arrangement available on November 15, 2003. Malawi's economic program is also being supported by the World Bank, the African Development Bank (AfDB), the European Union, and other bilateral and multilateral partners. Malawi's relations with the World Bank Group are summarized in Appendix IV.

5. While Malawi's economic statistics are adequate for program monitoring, a number of deficiencies need to be addressed, particularly in the real sector. Malawi is a participant in the IMF's General Data Dissemination System (GDDS). A mission to complete a Report on Observance of Standards and Codes (ROSC)—Data Module—visited Malawi in early September 2003.

6. **The political situation remains relatively calm as the parties prepare themselves for the general elections in May 2004.** President Muluzi is not eligible for reelection, having served two full terms. He has, however, opted to retain the chairmanship of the ruling United Democratic Front (UDF), while selecting the Minister of Economic Planning and former Secretary General of COMESA,² Mr. Bingu wa Mutharika, as its candidate for the May 2004 presidential election. Both decisions were endorsed by a UDF party convention in early August 2003. Although the President's choice of a presidential candidate caused a rift within the ruling party, the opposition parties appear to be rather fragmented.

II. INITIAL OBJECTIVES AND PERFORMANCE UNDER THE PRGF-SUPPORTED PROGRAM

7. **The medium-term program supported by the PRGF arrangement covered the period 2001–03 and was anchored in the Malawi Poverty Reduction Strategy Paper (PRSP).** The latter has four main pillars: (i) attainment of macroeconomic stability; (ii) restructuring and prioritization of public expenditures to improve public sector management and service delivery; (iii) creation of a favorable environment for private sector growth; and (iv) design and implementation of a comprehensive and cost-effective social safety net. The key macroeconomic objectives for 2001–03 were to (i) attain an average annual growth rate of about 4 percent in real GDP; (ii) reduce inflation to 5 percent; and (iii) increase gross official reserves to about five months of import cover (see table below).³ These objectives were to be achieved through efforts to substantially reduce the domestic budget deficit by increasing revenues and containing expenditures; control the growth of broad money; and implement key structural reforms. The structural reforms aimed at improving the marketing of maize and tobacco, and restructuring and privatizing public

² Common Market for Eastern and Southern Africa.

³ See IMF Country Report No. 01/38.

enterprises. The program was predicated on significant inflows of balance of payments assistance.

Selected Indicators - Performance under the PRGF Arrangement, 2000-02

	2000		2001		2002		
	Prog. Dec-00 (EBS/00/263)	Act.	Prog. Dec-00 (EBS/00/263)	Act.	Prog. Dec-00 (EBS/00/263)	Prog. Jul-02 (EBS/02/131)	Est.
	(Annual percentage change)						
Real GDP growth	3.2	1.1	3.0	-4.2	4.0	1.8	1.8
Inflation rate (average)	28.5	29.6	20.0	27.2	7.5	9.4	14.9
Broad money (end of period)	20.9	42.4	16.8	12.1	12.4	7.9	23.4
Reserve money (end of period)	18.0	13.9	13.8	20.9	11.3	7.4	30.8
	(In percent of GDP, unless otherwise indicated)						
External current account (excluding official transfers)	-15.2	-14.1	-15.4	-12.7	-12.2	-26.2	-23.9
Gross official reserves (in millions of US\$) 1/	224.0	224.6	276.0	184.6	293.0	129.9	103.5
Import coverage (months of current year's import)	3.9	4.0	4.7	2.7	4.8	2.1	1.7
Balance of Payment support (in millions of US\$)	81.0	78.4	73.0	51.0	56.0	74.4	12.8
	FY 2000/01		FY 2001/02		FY 2002/03		
Central government 2/							
Revenues (excluding grants)	19.0	18.7	19.0	17.1	18.9	18.0	20.5
Expenditures	30.4	33.9	27.3	31.7	25.5	30.2	35.2
Overall balance (cash basis, including grants)	0.0	-6.0	0.0	-7.8	1.5	-1.6	-7.8
Domestic balance (cash basis)	-1.3	-4.8	-1.2	-7.7	-1.0	-4.3	-7.1
Domestic primary balance (cash basis)	1.4	-1.7	-0.3	-3.8	-0.8	-1.0	-2.2
Grants	11.4	9.3	8.3	6.8	8.1	10.6	7.0

Sources: Malawian authorities; and IMF staff estimates.

1/ Excludes open letters of credit for the 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

2/ Excluding 2002/03 maize operation.

A. Overall Economic Performance During 2001 and 2002

8. Overall economic performance in relation to the objectives and targets under the original three-year program was disappointing during 2001–02:

- **Real GDP growth** rates in 2001 (–4.2 percent) and 2002 (1.8 percent) were well below the program targets (3–4 percent) for these years. This poor growth performance reflected a declining trend in agricultural output due to the incidence of droughts and floods, and the weak implementation of macroeconomic and structural policies. The declining trend in agricultural output had a depressing effect on agro-processing activities and caused food shortages, especially of maize. In addition, economic activity in the private sector suffered because the government's heavy reliance on domestic bank credit to finance its fiscal deficits and maize operations led to relatively high real interest rates and caused bank credit to the nongovernment sector to shrink in real terms by more than 30 percent over the 2001–02 period.

- Although **inflation** generally declined, it remained above the initial program targets. On an annual average basis, the inflation rate declined from about 30 percent in 2000 to 27 percent in 2001 and 15 percent in 2002.
- The annual **external current account deficits** (excluding grants) were also (on average) much larger than targeted for 2001–02, particularly because of large maize imports in 2002. As a result of these deficits and substantial shortfalls in foreign financing, the gross official foreign reserves of the Reserve Bank of Malawi (RBM) weakened significantly (from 4 months of import cover in 2000 to 1.7 months in 2002).
- As a result of weak policy implementation, especially fiscal slippages, several of the **original program’s quantitative and structural performance criteria for end-December 2000 were not met** (letter of intent, para. 3).

9. **During the two fiscal years 2000/01 (July–June) and 2001/02, fiscal policy was more expansionary than programmed under the PRGF arrangement.** Fiscal slippages occurred during this period principally on account of (i) repeated bailouts of parastatals that had accumulated significant amounts of domestic debt; (ii) the sharp increase in interest rates associated with the rising domestic public debt; (iii) overruns on the wage bill; and (iv) overspending on other current outlays. Consequently, the program targets for the domestic budget deficit were exceeded by substantial margins in both 2000/01 and 2001/02.⁴ Moreover, the government’s financial position was further weakened in the first half of 2002/03, particularly because of the substantial costs of its maize operation in the latter part of 2002. As the government’s deficits were financed by domestic borrowing, it caused real interest rates to increase. It is in the light of these developments that follow-up track-record programs focused on strengthening public expenditure management and fiscal consolidation. Moreover, under the proposed new program, the authorities have focused on reforming the parastatal sector and civil service wage policy, curtailing nonpriority public expenditure, and reducing the fiscal deficit to repay the domestic public debt.

10. **The government’s maize operation, which was largely carried out in the second half of 2002, was estimated to cost about 3 percent of GDP⁵.** However, because its ultimate cost was uncertain, the cost of the maize operation was explicitly excluded from the fiscal targets for 2002/03. In the event, the total net cost is now estimated to have amounted to 4.4 percent of GDP during 2002/03. This estimate reflected the cost of the maize imports

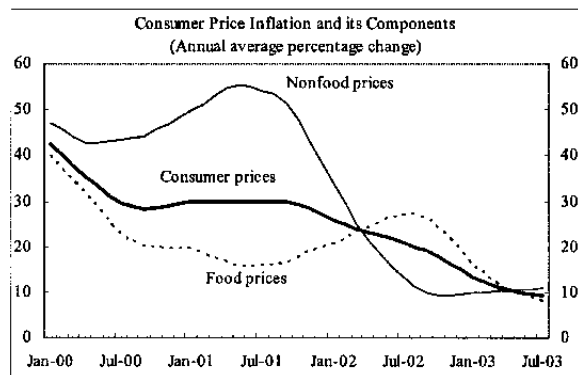
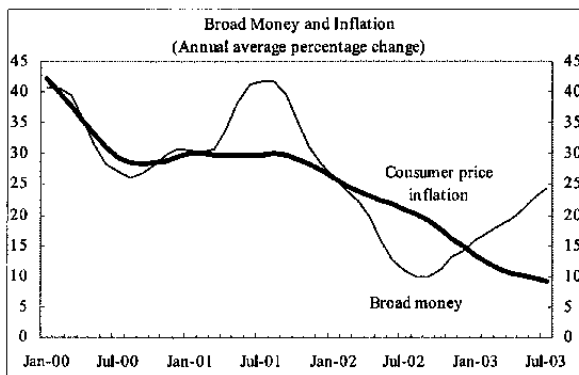
⁴ A description of fiscal performance during 2000/01 and 2001/02 was provided in IMF Country Report No. 02/181.

⁵ Payments for the 2001/02 maize operations mostly affected the 2002/03 budget. Earlier estimates of the likely cost of the 2002/03 operation were 1.1 percent of GDP in IMF Country Report No. 02/181 and 1.7 percent of GDP in IMF Country Report No. 02/196.

in late 2002 (4 percent of GDP) and interest and marketing charges (0.9 percent of GDP), less the proceeds from sales of maize (0.5 percent of GDP) (see Box 1).⁶

11. **The macroeconomic impact of the maize operation was significantly higher than indicated by the direct net cost of the maize.** First, government operating expenditure was higher due to the involvement of various government ministries in the relief operation. Second, the only partial disbursement of expected emergency relief from the World Bank left the RBM's external reserves at a low level, while government debt to the RBM remained at high levels. These factors contributed to the further rise in real interest rates.

12. **Given the shortfalls in budgetary external financing, the budget deficits (inclusive of maize operations) were financed largely by recourse to domestic bank borrowing.** The banking system's claims on government increased at accelerated rates in 2001 (27.2 percent) and 2002 (92.3 percent).⁷ Notwithstanding the heavy loss of official net foreign assets, reserve money expanded rapidly at an average annual rate of about 31 percent during 2001-02, substantially exceeding the initially envisaged targets (about 12.5 percent annually). Underlying these trends, however, there was some evidence of a slowdown in reserve money expansion between June 2001 and June 2002, which, in turn, was reflected in a parallel decline in the growth rates of broad money. This factor contributed to a sharp decline in nonfood inflation between the middle of 2001 and the end of 2002.⁸



⁶ The cost to the budget resulting from the larger domestic borrowing to finance the 2002/03 maize operation is actually underestimated because the resulting higher domestic interest rate applies not only to the maize-related borrowing (about 3.5 percent of GDP during 2002/03), but also to the much larger category of "other domestic borrowing" by the central government.

⁷ Change in percent of beginning-of-period broad money.

⁸ In addition, as the increases in food prices, which were substantial in the wake of the poor agricultural harvest in 2001, began to moderate toward the end of 2002, the overall inflation rate declined in 2002.

Box 1. The 2002/03 Maize Operation

The expected food crisis for the 2002/03 crop year was successfully averted through a combination of government and private sector maize imports, supplemented by generous humanitarian assistance. However, the macroeconomic impact of the government's food imports and sale at subsidized prices was larger than anticipated. Following the serious food crisis that threatened the population during 2001/02, the government of Malawi acted quickly to address the shortfall in food supply that had been projected in the summer of 2002 at about 580,000 tons by specialized agricultural agencies, including the World Food Program (WFP), and a major part (about 345,000 tons) was expected to be supplied by humanitarian organizations and the private sector. The government imported 235,000 tons of maize at an estimated cost of about US\$75 million. When added to the carryover stock of 16,000 metric tons from the previous fiscal year (July to June), the stock of maize available at the government's disposal during 2002/03 thus totaled 251,000 metric tons. The emergency maize imports were financed through borrowing from the Reserve Bank of Malawi (RBM) and the use of the RBM's foreign exchange reserves. It was envisaged that the government would sell the imported maize at subsidized prices, because a large part of the population was considered unable to afford to buy the imported maize at the landed cost of about MK 25 per kilogram. On August 30, 2002 the IMF Executive Board approved emergency assistance to Malawi of SDR 17.35 million in support of the government's maize imports in order to prevent large shortages of food.

In the event, the shortfall in local production was less pronounced than originally feared, and both the donor community and the government significantly underestimated the capacity of the private sector to respond to the potential food crisis. As a result, the government was only able to sell about 43,000 tons of maize during 2002/03, and, in July 2003, it announced a reduction in its selling price of commercial maize from MK 17 per kilogram to MK 10 per kilogram.

In 2003, the government designated 44,700 tons of maize to the Strategic Grain Reserve (SGR). Accordingly, as at end-June 2003, about 163,300 tons of maize were available for commercial sale. The government expects to sell this balance during 2003/04. It has already received an indication from the European Union that it would finance the purchase of 32,000 tons of maize. The government has also recently tendered a further 100,000 tons for commercial sale. The gross proceeds accruing to the budget from the above sale of maize during 2003/04 is estimated at about MK 1.5 billion (or about 0.9 percent of GDP). If the remaining 31,000 tons are also sold during 2003/04, additional revenue of about 0.2 percent of GDP could be realized.

Strategic Grain Reserve

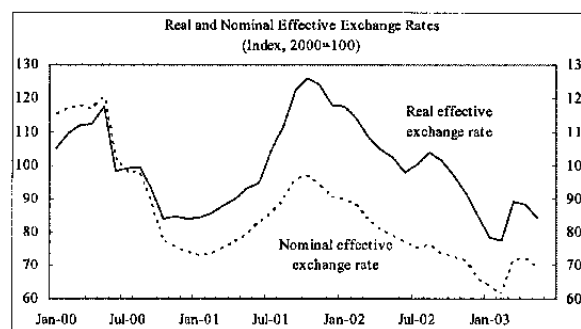
In order to avoid a recurrence of the regrettable experience of widespread food shortages in 2001/02, just as the government's maize buffer stocks were depleted, the government took steps to strengthen its food security strategy. In this context, it decided to raise the SGR to 100,000 tons of maize from a level of 11,000 tons as at end-June 2002. During 2002/03, the European Union contributed 18,000 tons to the SGR, and the government designated 44,700 tons of its commercial maize for the SGR. Thus, at end-June 2003, the level of SGR had risen to 73,700 tons. The European Union has pledged to make a further contribution of 22,000 tons to the SGR in early 2003/04 (as part of its purchase of 32,000 tons from the government, with the balance of 10,000 tons to be provided in support of the WFP's humanitarian relief efforts). This would raise the level of the SGR to 95,700 tons.

Maize Operation, 2002/03-2003/04

	In Millions of Malawi Kwacha	In Percent of GDP
Total cost to the 2002/03 budget	-6,715.9	-4.4
Cost of maize imports	-6,077.9	-4.0
Interest and other marketing charges	-1,353.0	-0.9
Proceeds from the sale of maize	715.0	0.5
Total income for the 2003/04 budget from the sale of maize	1,500.0	0.9
Overall fiscal cost	-5,215.9	-3.5

Sources: Malawian authorities; and IMF staff estimates.

13. **After strengthening in 2001, the effective exchange rate for the Malawi kwacha has since depreciated in both nominal and real terms.** The recent weakness of the kwacha reflects the further substantial deterioration of the fiscal situation and the external accounts (see below).



14. **The external current account deficit widened further in 2002.**⁹ The current account deficit (including grants) rose to 11.6 percent of GDP in 2002 from 6.9 percent of GDP in 2001, largely on account of a surge in food imports (Table 6). Export earnings declined slightly below the 2001 level, and payments for nonmaize imports grew only marginally (1.2 percent). The terms of trade showed a small deterioration. The wider current account deficit was accompanied by a sharp drop in net capital inflows, largely due to a decline in balance of payments support. The gross official foreign reserves fell from US\$224.6 million (4.0 months of the following year's imports of goods and nonfactor services) at the end of 2000 to US\$103.5 million (1.7 months) at the end of 2002.

15. **Malawi is receiving interim debt relief under the enhanced HIPC Initiative from multilateral and bilateral creditors.** The World Bank, the African Development Bank, and the European Investment Bank are providing relief, while IMF relief for 2002–03 has been pending until the conclusion of the first review of the Poverty Reduction and Growth Facility (PRGF) arrangement. Regarding Paris Club creditors, Malawi has signed formal agreements with Austria, Italy, Spain, Sweden, and the United Kingdom and reached agreement with Germany, while discussions are ongoing with France. In the case of Japan—the largest bilateral creditor—Malawi received official development assistance (ODA) relief in 2001 in the form of a grant that has been deposited in an account in Japan and can be used for imports for economic development and the enhancement of people's welfare, but not for military use. Discussions on 2001 non-ODA relief and relief for 2002 from Japan are ongoing, and the authorities hope to delink the relief from import financing and treat it in the same way as any other HIPC Initiative debt relief. Japan intends to respond to Malawi's request, provided that the monitoring system for the appropriate use of such grants is confirmed by Japan. The Paris Club informed Malawi in January 2002 that the second phase of the agreement covering 2002 had not come into force; this phase is expected to be implemented once the PRGF arrangement is reactivated.

16. **Structural reforms during 2001–02 were aimed at consolidating the liberalization of agricultural production and marketing, strengthening financial reporting and expenditure management, improving governance, advancing the**

⁹ The deterioration in the external current account and balance of payments position in 2001 is discussed in IMF Country Report No. 02/181.

program of public enterprise restructuring and privatization, and opening up and improving the regulation of the financial sector. The implementation of these reforms was uneven (Table 8), and the main developments were the following:

- The monopoly of the Agricultural Development and Marketing Corporation (ADMARC) in the marketing of maize was abolished. However, the commercialization of its operations was not fully attained.
- In the tobacco sector, uniform access by all farmers to the sales network was maintained, as was the intermediate buyer's system for tobacco.
- In the petroleum sector, the parastatal body responsible for storage, distribution, and marketing of petroleum products was dissolved.
- The Commercial Bank of Malawi was privatized, and a timetable for the review of the financial sector regulatory framework was developed.
- In the area of governance, the government has increased the staffing of the Anti-Corruption Bureau (ACB), and has continued to train magistrates and judges in interpreting the Corrupt Practices Act.
- Measures aimed at improving financial reporting and expenditure management included the following: the compilation by the Ministry of Finance of summary monthly reports on expenditure commitments and arrears, and regular assessments of the prospects for meeting fiscal targets; the creation of a unit in the Ministry of Finance to track public enterprise performance; the dissemination of quarterly reports on pro-poor expenditures (PPEs); and the submission by all ministries of monthly expenditure returns under the commitment control system.

B. Performance in Fiscal Year 2002/03

Fiscal policies

17. **Faced with a rapidly deteriorating fiscal situation, in July 2002 the authorities intended to establish a track record over the period July to December 2002, and committed themselves to a significant fiscal adjustment under the 2002/03 budget.** They undertook to reduce the domestic deficit from 7.7 percent in 2001/02 to 4.3 percent in 2002/03 (excluding the maize operation) (Table 2).¹⁰ This adjustment was to be achieved mainly by increasing revenues by 0.9 percent of GDP and reducing nonpriority expenditures by 1.8 percent of GDP. Interest payments were also expected to decline by 0.7 percent of GDP on account of declining interest rates. The expected increase in revenues reflected the extension of the surtax to the retail stage, the introduction of a 40 percent bracket for

¹⁰ As outlined in the letter of intent (IMF Country Report No. 02/181).

personal income tax, the increase in excises for motor vehicles and alcohol, the reduction of discretionary exemptions, and the strengthening of the collection and auditing abilities of the Malawi Revenue Authority. On the expenditure side, the wage bill was to be reduced (by 0.7 percent of GDP), mainly by eliminating “ghost” workers. In addition, the expected savings from other nonpriority outlays were estimated to yield about 1.1 percent of GDP.

18. **The fiscal performance, as measured by the total financing mobilized, was on track through September 2002. It weakened somewhat in the subsequent quarter, and the domestic deficit for the period from July to December 2002 was estimated to be 0.5 percent of GDP higher than targeted (2.8 percent of GDP).** Although revenue collection was stronger than anticipated, staff missions in November 2002 and January 2003 assessed that expenditure pressures remained strong and would undermine the achievement of the deficit target for the fiscal year as a whole. The assessment of the staff mission in November indicated that, for 2002/03, revenue performance would be better than earlier anticipated by $\frac{3}{4}$ of 1 percent of GDP, but that it would only partially compensate for expenditure overruns (totaling $3\frac{3}{4}$ percent of GDP).¹¹ Based on this assessment, the staff estimated that the budgetary financing need would be higher by 3 percent of GDP unless remedial measures were taken. After the follow-up mission in January 2003, this financing gap was revised to $4\frac{1}{4}$ percent of GDP, due to further upward revisions in interest and other expenditures.

19. **Hence, in early 2003, the authorities committed themselves to implementing in the second half of FY 2002/03 (January–June 2003) a further track-record program, which was underpinned by a fiscal package of additional expenditure and revenue measures.** The revenue measures comprised the following: (i) the taxation of the housing allowances; (ii) an increase in the road fee and in license and registration fees for motor vehicles; (iii) the introduction of toll fees; and (iv) the collection of interim dividends and overdue obligations on on-lending arrangements from profitable parastatals. On the expenditure side, measures included (i) the reduction of funding for travel; (ii) the suspension of nonessential expenditures on locally financed development projects; (iii) the reduction of foreign service allowances; and (iv) the elimination of abuses in the payroll. Based on a realistic assessment of the impact of these measures, the track-record program allowed for a relaxation of the domestic deficit target (excluding the maize operation) to 6.8 percent of GDP (up from 4.3 percent of GDP).

¹¹ First, the projected interest bill was revised upward by $1\frac{1}{4}$ percent of GDP, as the original 2002/03 budget estimate turned out to be based on an understated debt stock, and interest rates had declined at a much slower pace than anticipated. Second, adjustments in civil servants’ housing allowances would cost 1 percent of GDP more than had been budgeted. Finally, several activities had been underfunded, and the costs of the previous (2001/02) maize operation, which were paid for in 2002/03, turned out to be higher than anticipated; together these expenditures amounted to an additional $1\frac{1}{2}$ percent of GDP.

20. **Overall fiscal performance in the second half of 2002/03 was broadly in line with the targets of the track-record program.**¹² The domestic budget deficit (excluding the maize operation) for the whole fiscal year (estimated at 7.1 percent of GDP) was close to the target (6.8 percent of GDP) of the track-record program.¹³ Indeed, as measured by a range of indicators of the fiscal balance, the authorities, with the exception of the domestic primary balance (excluding grants), broadly met their fiscal targets in 2002/03 (see table below).

Key Fiscal Indicators, 2002/03 (Excluding 2002/03 Maize Operations) 1/
(In percent of GDP)

	H1		H2		Fiscal Year		
	EBS/02/131	Act.	TR 2/	Prov.	EBS/02/131	TR 2/	Prov.
Overall balance (including grants)	-0.9	-4.8	-4.4	-3.0	-1.6	-9.4	-7.8
Total financing target	3.5	3.8	3.9	4.2	5.7	8.2	8.1
Domestic balance	-2.8	-3.3	-3.2	-3.9	-4.3	-6.8	-7.1
Primary balance (including grants)	1.9	-1.9	-0.3	0.5	3.0	-2.3	-1.4
Primary balance (excluding grants)	-3.9	-4.6	-3.4	-3.8	-7.6	-8.2	-8.4
Domestic primary balance (excluding grants)	-0.6	-1.0	0.1	-1.2	-1.0	-1.1	-2.2
Domestic primary balance (excl. project grants, but incl. budgetary grants)	4.0	0.1	2.0	1.6	7.2	1.8	1.8
Memorandum items:							
Grants	5.8	2.7	3.1	4.3	10.6	5.8	7.0
Project	1.2	1.6	1.2	1.5	2.4	2.9	3.0
Budgetary support	4.6	1.1	1.9	2.8	8.2	2.9	4.0
Pro-poor expenditures (PPEs)	3.2	3.2	3.3	4.0	6.2	6.1	7.2

Sources: Malawian authorities; and IMF staff estimates.

1/ Fiscal year from July to June.

2/ Track-record program indicative targets.

21. **Although the implementation of the additional revenue measures was uneven and yielded only 0.8 percent of GDP, overall domestic revenue for the fiscal year as a whole exceeded the track-record target by 0.6 percent of GDP.**¹⁴ Some of the revenue measures, such as the taxation of civil servants' allowances, were partially implemented;

¹² The fiscal outcome was, however, significantly different from the original program targets for 2002/03, (IMF Country Report No. 01/38) mainly on account of higher interest charges and other government expenditures, including the cost of the 2001/02 and 2002/03 maize operations.

¹³ The above-the-line estimate of the overall fiscal deficit (including grants) could be too high, given that the generally more reliable estimate of total financing mobilized was less than the estimated deficit by about 0.3 percent of GDP, and that no arrears are reported to have been accumulated.

¹⁴ The memorandum of economic and financial policies (MEFP) contains a discussion of the revenue measures and their impact in para. 5.

others, such as the introduction of road tolls, proved impractical and were replaced in June 2003 by higher levies on petroleum products.¹⁵

22. **On the expenditure side, the government's PPEs, estimated at 7.2 percent of GDP, were higher than programmed (6.1 percent of GDP), largely because revenues exceeded the program target (by 0.6 percent of GDP) and nonproject grants were higher than initially estimated (by 1.1 percent of GDP).** The increase in the PPEs accounted for a large part of the increases in the wage bill (0.2 percent of GDP) and other expenditure (1.4 percent of GDP). Reflecting improved expenditure control, the non-PPEs for wages and salaries and for domestically financed development outlays were curtailed below the initial program estimates. There was also some savings in the domestic interest bill (0.8 percent of GDP), reflecting the issuance of treasury bills, under which interest payments will be made in 2003/04.

23. **Reflecting efforts to align the domestic fiscal balance with the track-record program's target, the performance benchmarks set for the total financing of the budget deficit were met for end-March and end-June 2003.** Nevertheless, given the continued suspension of external assistance and its substitution by heavy domestic borrowing,¹⁶ the government's recourse to bank financing was substantial.

24. **The track-record program envisaged structural measures in the fiscal area aimed at strengthening public expenditure control (including the monitoring of domestic arrears), as well as strengthening the oversight of parastatals and completing the divestiture or liquidation of parastatals that rely on the budget.** The enactment of the Public Finance Management Act and the Procurement Act substantially improved the framework for managing public finances. Most expenditure control measures were implemented, although there were delays in some cases (Boxes 2 and 3). This being said, a closer monitoring of the expenditure commitments would have reduced the incidence of expenditure overruns in the line ministries. Although the external audit of arrears envisaged

¹⁵ The government decided to consider the extension of the tax on allowances to lower levels of the civil service in the framework of the civil service reform. It was realized that the consolidation of basic pay and allowance would need to be evaluated in the context of the rationalization of grades, as well as its impact on the government pension scheme and on the taxation of the poorer civil servants, who might be pushed up to higher tax brackets.

¹⁶ Domestic borrowing amounted to about 12½ percent of GDP, including 4.4 percent of GDP for the maize operation.

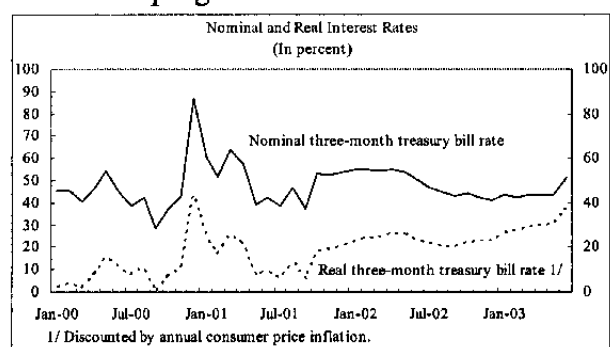
Box 2. Measures Envisaged in the Track-Record Program to Strengthen Public Expenditure Management (PEM)	
Measures	Status
Strengthening the cash management system	
Produce a comprehensive and reliable forecast of all inflows and outflows of the government, and prepare annual and quarterly cash plans for determination of quarterly ceilings and monthly cash releases. Specifically, issue quarterly expenditure ceilings for the fourth quarter of 2003 by March 15, 2003, fully backed by monthly cash releases in the first week of April, May, and June 2003.	Not done for FY 2002/03. To be done with the new budget cycle (July 2003-June 2004). Currently, weekly cash-flow meetings are held between Ministry of Finance and the Reserve Bank of Malawi.
Improving the operation of the commitment control system (CCS)	
Assign a commitment control officer to each vote (March 15, 2003);	Done.
Establish, by mid-March 2003, a committee (comprising the Accountant General, the Budget Director, and the Deputy Budget Directors) to review the monthly reports on overcommitments and unpaid bills by the end of the next month.	Done.
Enhance capacity of desk officers to recognize problems in the CCS returns (continuous).	In progress. Workshop held in April to streamline CCS returns.
Implement regular inspection visits to line ministries on the operation of the CCS (continuous).	Being observed.
Impose penalties for noncompliant controlling officers (continuous).	Overruns have been experienced in several lines, but evidence of penalties imposed is not available.
Improving the tracking of pro-poor expenditures (PPEs)	
Produce (within four weeks from the end of each month) a monthly report of PPE expenditure that compares expenditure against PPE funding and identifies the progress made with the activities under the relevant program or subprogram;	Done.
Produce a table on PPE expenditure for the last three years (by April 2003).	Done.
Improving the expenditure-reporting system	
Prepare, within four weeks of the end of each month, a report on expenditure returns to the Minister of Finance (MoF) senior management and the cabinet committee on the economy that presents the aggregate expenditure position and identifies actions to be taken by the MoF to address noncompliance, including the following:	Being observed.
(i) set up electronic collection of monthly expenditure returns first from the PPE ministries (end April 2003), and (ii) then from all other ministries (by end May 2003).	(i) Done. (ii) Not yet done. Envisaged to start in July 2003.
Take actions whenever any ministry fails to provide the expenditure return on a timely basis (continuous).	Being observed.
Strengthening the budget preparation process	
Prepare (by end-April 2003) a budget for 2003/04 that (i) is based on a sound budget framework; (ii) ensures that the provisions for each activity realistically assess the activity's costs; and (iii) is agreed upon and owned by the cabinet and the ministries and departments.	The budget presented to parliament vastly underestimated the interest bill (by about 4 percent of GDP) (see also Box 3).

Box 3. Status of Prior Actions in the Fiscal Area for the Completion of the First Review Under the PRGF Arrangement	
Measures	Status
Approval by parliament of a 2003/04 budget in line with macro-economic objectives.	The budget for 2003/04 was approved in late July 2003. However, it was based on a severely underestimated interest bill. Revenue and expenditure measures (described in the text, paras. 37-39) have been identified to bring the domestic deficit back in line with the macro-objectives.
Release of circular restating the requirements of the commitment control system (CCS) and reminding controlling officers of their obligations.	Done (May 2, 2003).
Release of a circular to ministries that lists the specific programs and subprograms relating to pro-poor expenditures (PPEs), explains how the PPEs will be funded, and specifies the Ministry of Finance's expectations that PPE funding will be used on PPEs only.	Done.
Regularization of the financial relations between the National Food Reserve Agency (NFRA) and ADMARC, including a government decision on the settlement of disputed cross-obligations related to the Strategic Grain Reserve in 2000/01, and adherence to the memorandum of understanding that governs the 2002/03 operation.	Done.
Implementation of the system to track pro-poor spending.	Ongoing. A system has been developed whereby PPE expenditure data is electronically submitted to the treasury.
Compilation by the Ministry of Finance of a consolidated fiscal report assessing the prospects for meeting budget targets.	Done. Reporting system is now in place.
Issuance by the Secretary to the Treasury of a letter of financial expectations to controlling officers.	Done.
Cabinet decision on the divestiture of ADMARC's noncore assets and transfer of control of the company David Whitehead and Sons to the Ministry of Finance.	Done.
Appointment of a Director for the Public Enterprise Reform and Monitoring Unit (PERMU) and his appointment to parastatal boards.	Done.
Completion of an external audit of the NFRA.	Done.
Submission to parliament of the amendments to the Corrupt Practices Act.	Done. The Amendment Act was referred back to cabinet for review.
Development of a medium-term wage policy.	Ongoing. The government has committed itself to implementing the recommendations of a study financed by the World Bank during 2003/04. See Table 2 of the attached memorandum of economic and financial policies (MEFP) for a list of measures that are performance criteria and structural benchmarks under the program.

for June 2003 has not been completed, the government contracted KPMG in May 2003 to undertake this task. In addition, the Ministry of Finance has centralized the payments of utility bills for the ministries that repeatedly incurred arrears in the past.

Monetary developments

25. **Reflecting the large liquidity injection emanating from the budget, broad money rose substantially during the first half of 2003.** Efforts by the RBM to mop up excess liquidity and contain the growth of broad money were hampered by the sharp decline in its external reserves, which precluded foreign exchange sales, and the high and rising costs of open market operations. Consequently, the RBM's operating targets for reserve money for end-March and end-June 2003 under the staff-monitored program were exceeded. These developments contributed to a pickup in the growth rate of broad money, as well as in the nonfood inflation rate. The recurrent need for large funding of the budget deficit in the treasury bill market and the mopping up operations of the RBM raised the treasury bill rate to over 50 percent by June 2003, and real interest rates to close to 40 percent. Interest spreads were also high, averaging about 15–20 percent during 2002. While credit to the private sector was on a declining trend, nonperforming loans rose to just under 20 percent of total loans at end-2002, an increase of over two-thirds over their level of a year before. Provisioning for the nonperforming loans amounted to about 20 percent of gross loans.



Structural reforms

26. Structural reforms adopted with the track-record program for 2002/03 sought to compensate for earlier delays in implementing them and broaden the scope of such reforms (Box 3).

27. **Progress was made in the public enterprise divestiture program, although in some cases this was constrained by the emergence of unforeseen difficulties.**¹⁷ In particular, the Lilongwe unit of Cold Storage (a subsidiary of ADMARC) and Sunbird Tourism (a subsidiary of the Malawi Development Corporation) were privatized. However, after the winning bidder was identified, the privatization of David Whitehead and Sons (a textile subsidiary of ADMARC) has been held up in litigation brought by employees and a creditor bank. In addition, only limited progress was made in restructuring the core operations of ADMARC, particularly in separating its commercial operations from its

¹⁷ See MEFP, para. 13.

subsidized social functions. The government was not successful in completing the privatization of Air Malawi, because the winning bidder withdrew his offer and no other bidder came forward.

28. **In the area of governance, progress has also been mixed.** While the authorities have continued to strengthen the judicial system by training magistrates and judges in the interpretation of the Corrupt Practices Act, important amendments that would strengthen the ACB have still to be passed by parliament (MEFP, para. 39). Reflecting its limited authority, the ACB has not yet prosecuted any high-profile cases.

III. THE MEDIUM-TERM MACROECONOMIC OBJECTIVES

29. **The authorities' strategy for growth and poverty reduction over the medium term is derived from the Malawi PRSP, focusing on improving income-generating opportunities for the poor, enhancing human capital, improving service delivery, and strengthening governance.** The PRSP status report discusses the progress in implementing this strategy. Malawi faces serious developmental challenges, which will need to be met for the country to achieve and sustain a high level of poverty-reducing growth (see Box 4).¹⁸

Box 4. Developmental Challenges Facing Malawi

Accelerating growth in Malawi will require implementing a number of policies and reforms, including the following:

- first, reforms to mitigate risks across sectors, including the establishing of a stable macroeconomic environment; reducing the cost and improving the reliability of the transport and other infrastructure; and reducing corruption and strengthening governance;
- second, reforms to reduce risks facing smallholder agricultural production, including establishing a reliable system for managing food security and emergencies, enhancing agricultural productivity, and improving marketing channels;
- third, reforms to improve the highly risky business environment through investment in infrastructure; development of a transparent and less discretionary tax/incentive regime; and development of more business-friendly public institutions; and
- fourth, reforms to check the spread of HIV/AIDS and improve public health.

This summary has been adapted from the World Bank's Country Economic Memorandum, January 2003.

30. **Malawi's medium-term macroeconomic framework aims at achieving macroeconomic stability,** in order to provide a sound basis for sustainable growth (with

¹⁸ The PRSP status report will be issued as part of the Board documentation pertaining to the first review.

rates rising to 5–6 percent per year during 2003–06), containing inflation at about 5 percent, and raising gross international reserves of the RBM to about 3½–4 months of import cover. These objectives are to be achieved by reestablishing fiscal discipline in order to eliminate the domestic fiscal deficit (excluding the maize operation), equivalent to 7.1 percent in 2002/03, by 2004/05, and by accelerating implementation of structural and sectoral reforms aimed at fostering private sector-led growth.

31. **The medium-term projections assume the resumption of balance of payments assistance, which would be key to reducing domestic debt and increasing PPEs to the levels required to reduce significantly poverty levels over the medium term.** The reestablishment of macroeconomic stability and acceleration of structural reforms should also facilitate Malawi’s progress toward the floating completion point under the enhanced HIPC Initiative, which is essential for Malawi’s long-term debt sustainability (see table below).

Debt Sustainability Indicators, 2001–10
(Ratios in percent)

	2001	2002	2003	2004	2005	2010
Current 1/ NPV of debt to exports	316.7	323.6	318.2	195.4	194.0	191.1
NPV of debt to revenue	310.9	271.6	214.3	121.1	114.4	88.5
Decision point NPV of debt to exports	309.1	180.7	176.9	171.9	169.0	157.7
NPV of debt to revenue	333.2	174.5	158.0	142.4	132.1	91.6

Source: IMF staff estimates.

1/ Assumes a delay in the completion point to end-2004 from the end-2002 date envisaged in the decision point document.

IV. THE PROGRAM FOR 2003–04

32. The discussions of the PRGF-supported program focused on measures aimed at (i) signaling a substantial turnaround in the fiscal position and prospects, as well as dealing with the domestic debt problem; (ii) improving the environment for the recovery of the private sector; and (iii) strengthening the regulatory framework for the financial sector in order to foster competition, reduce interest spreads, and increase lending to the private sector.

33. Provided that sound macroeconomic policies and critical structural reforms are implemented and external financial assistance from the international community is resumed, scope remains for a significant recovery in real GDP growth, while containing inflationary and balance of payments pressures. The main elements of the economic outlook are as follows:

- The real GDP growth rate would rise to 5–6 percent in 2003–04, assuming a better harvest under normal weather conditions and a pickup in private sector activity supported by substantially improved implementation of macroeconomic policies.
- The inflation rate, on an annual average basis, should continue to decline to about 9 percent in 2003 and about 7 percent in 2004. The pressures on the Malawi kwacha and the external account would also abate, while allowing for a gradual strengthening of the gross official foreign reserve position (to about two months of import cover in 2003 and about three months by 2004).

A. Fiscal Policy

34. **There were broad understandings between the staff and the authorities that the major cause of macroeconomic instability in Malawi had been the lack of fiscal discipline and the resultant large budget deficits, financed by domestic bank credit at continuously rising interest rates. In order to address this problem, a fiscal stance needed to be adopted that would entail significant repayments to the banking system and reduce the stock of government domestic debt.** This strategy assumes the resumption of donor budgetary assistance, which is crucial for its success, but the projections of aid inflows have been made cautiously with respect to both their timing and magnitude, based on discussions with Malawi's donors. Even before aid inflows resume, the strategy calls for significant expenditure reductions to bring domestic expenditure more closely in line with domestic revenue. Once aid inflows have resumed, the authorities will need to devote more resources to the essential public expenditure programs that have had to be curtailed or postponed, as well as to the repayment of the domestic public debt. This strategy is absolutely essential to reverse market psychology and facilitate a fall in real interest rates. Its achievements should be immediately and publicly visible. In addition, satisfactory assurances have been received that exceptional assistance will be provided to Malawi by other creditors under the enhanced HIPC Initiative.

35. **In discussing the above fiscal strategy for 2003/04 with the authorities, the mission explained that the budget that had been approved in late July 2003 needed to be supplemented by new revenue and expenditure-saving measures, mainly because of a substantial underestimation of the domestic interest bill and the possible revenue loss associated with a reduction of the surtax (VAT) rate.**¹⁹ A review of interest charges included in the budget revealed that these had been seriously underestimated, as the government had issued longer-term securities in 2002/03, locking in high interest rates and postponing interest payments into 2003/04. Consequently, domestic interest charges were revised from MK 7.8 billion (4.5 percent of GDP) to MK 14 billion (8 percent of GDP). As regards the surtax, the authorities argued strongly that its level was too high by regional

¹⁹ The reduction in the surtax (from 20 percent to 17.5 percent) had not been discussed earlier with the staff and not agreed in the context of the track-record program.

standards,²⁰ and that the reduction would improve compliance. They also pointed out that the tax base had been enlarged to include about 700 additional traders and 17 nonlife insurance companies. The staff agreed in principle that a reduction in the surtax rate to a level comparable to the regional average was desirable but argued that the timing was not opportune for such a reduction.

36. Against this background, and given the authorities' objective of reducing the government's domestic debt, agreement was reached on a package of fiscal measures to reduce the domestic budget deficit (excluding the maize operation) to 3.8 percent of GDP in 2003/04 from 7.1 percent of GDP in 2002/03.²¹ The primary balance is projected to move from a deficit equivalent to 1.4 percent of GDP in 2002/03 to a surplus of 9.1 percent of GDP. During the same period, the domestic primary balance is targeted to shift from a deficit of 2.2 percent of GDP to a surplus of 4.2 percent of GDP. The resulting substantial improvement in the overall fiscal position and the expected increase in net foreign financing would provide scope for the government to repay its domestic debt by 1.0 percent of GDP in the first half and 2.1 percent of GDP in the second half of 2003/04 (Table 3). The authorities recognize that, once the macroeconomic situation stabilizes and foreign aid flows have fully resumed, there would be an opportunity to review these targets in the light of the need to better define the public expenditure program (MEFP, para. 24).

37. The authorities introduced additional measures to enhance revenue performance because they recognized that, with the reduction in the surtax rate and other minor tax reductions incorporated in the budget, the government's revenue target for 2003/04 could not otherwise be achieved.²² These new measures include significant increases in excise taxes on petroleum and other excisable goods designed to yield 1 percent of GDP in additional revenue. These measures, together with the broadening of the base for the surtax, would help raise the overall revenue-to-GDP ratio to 21.8 percent in 2003/04 from 20.5 percent in 2002/03. Moreover, steps have been taken to strengthen revenue administration.

38. The discussions on public expenditures focused on the need to reduce budgeted expenditure by about 1.9 percent of GDP and to provide higher allocations to PPEs. Expenditure savings are to be made from outlays on travel; the nonfilling of vacancies; a

²⁰ The average VAT rate in the region is estimated at about 13 percent (it is 17.5 percent in Zambia and Mozambique, and 10 percent in Botswana). These VAT rates are supposed to be harmonized at some stage under the Southern African Development Community (SADC).

²¹ In 2003/04, the maize operations are estimated to yield a net income of 0.6 percent of GDP. In addition, when the expected purchase of maize by the EU materializes, there would be an additional income of 0.3 percent of GDP.

²² See MEFP, paras. 20–22.

freeze on promotions; and the postponement of new domestically financed projects (see table below). The savings in the travel budget are to be realized through a 26 percent reduction across the board in the budget provision and its related funding. The savings in the wage bill will be made by the nonfilling of vacancies and the avoidance of promotions. The savings on domestically financed development projects would be realized through reduced funding of some projects and the nonfunding of others. Finally, the savings in nontravel, non-PPE outlays will be achieved by back-loading expenditure allocation to the second half of the fiscal year, with discretionary outlays postponed, as necessary, to meet the objectives for repaying the domestic debt. The authorities indicated that they preferred to rely on substantial expenditure reductions, rather than reversing the VAT rate or further increasing other taxes, to achieve their fiscal objectives in 2003/04. Based on the Auditor General's estimates of domestic arrears as of end-June 2003, amounting to MK 400 million, the program provides for the repayment of these arrears over a two-year period. The program also provides for no further accumulation of arrears.

Expenditure Savings, 2003/04		
	In Millions of Malawi Kwacha	In Percent of GDP
Reduction in travel budget	1,000.0	0.6
Nonfilling of vacancies	500.0	0.3
Postponement of development projects	443.0	0.3
Reduction in non-PPE funding to 30 percent in the first half of the fiscal	1,678.0	1.0
Total savings	3,621.0	2.1

Source: Malawian authorities.

39. **As indicated in the MEFP, expenditure control is to be reinforced by placing senior treasury officials in line ministries to control commitments and payments (MEFP, paras. 24, 28, and 29).** Despite recent efforts to strengthen expenditure systems, much remains to be done to improve the control and monitoring of expenditure management by the treasury. Under the current decentralized expenditure management system, treasury control on line ministry commitments and payments has been inadequate, as line ministries have limited capacity for financial management. Expenditures should be authorized on the basis of collected domestic revenue, and of actual disbursed, as opposed to expected, external budgetary assistance. The government intends to strengthen further the commitment control system (CCS) and credit ceiling authority (CCA) used to manage payments through the banking system. Expenditure control systems are expected to be strengthened by the implementation of the Integrated Financial Management Information System (IFMIS) financed by the World Bank. In addition, the Electoral Commission will need to exercise strict control over expenditures associated with the parliamentary and presidential elections

that are scheduled in May 2004.²³ The authorities have requested technical assistance to improve these systems and overall expenditure management.

40. **Following the completion of a consultant's report on civil service reform, the authorities have adopted a time-bound road map for the implementation of its recommendations, including during 2003** (MEFP, para. 25). The main conclusions of the report were that pay and conditions of service were inadequate to attract and retain qualified staff; that the compensation package was full of allowances and lacked transparency; and that the pay structure had many anomalies and too many grades. Accordingly, the medium-term wage policy that the authorities have adopted aims to consolidate basic pay with other benefits and allowances, improve performance-based incentives, and revamp the civil service pension scheme. The civil service and expenditure management reforms are being supported by financial and technical assistance from the World Bank (MEFP, paras. 25–27). The government is also determined to strengthen the implementation of the medium-term expenditure framework (MTEF) by enforcing fiscal discipline and better prioritizing public expenditures in line with Malawi's PRSP.

41. **The authorities expressed their desire to streamline and reduce the tax burden, particularly on business, in order to revitalize the private sector and encourage a strong supply-side response.** They agreed with the staff that such a reduction would need to be carefully phased and synchronized with the improvement in the government's fiscal position.

B. Monetary Policy and Financial Sector Reforms

42. **The successful implementation of the fiscal strategy to reduce the domestic financing of the budget deficit should ease pressure on monetary policy and on the exchange rate.** The RBM will continue to aim at containing annual inflation at about 9 percent in 2003 and 7 percent in 2004, and to increase modestly its international reserves. Broad money is programmed to increase by 15 percent in 2003 and by 10 percent in 2004. The RBM will attain its objectives by limiting the growth of its net domestic assets and mopping up excess liquidity. The RBM considers the fiscal strategy critical to its efforts of disinflation and of reducing the cost of its open market operations, which have soared in recent years with the rise in interest rates.

43. **The authorities underscored the importance of reducing real interest rates, as well as interest spreads.**²⁴ Apart from the fiscal strategy, there was agreement that it was important to reduce the costs on financial intermediation caused by the high and

²³ Donors have pledged to pay about one-third of the total cost of elections and are expected to participate actively in the monitoring of electoral expenditure.

²⁴ The assumptions regarding the average interest rates for the four quarters of 2003/04 are as follows: 45 percent in the first quarter, 27 percent in the second quarter, 24 percent in the third quarter, and 22 percent in the fourth quarter.

unremunerated liquidity reserve requirement (LRR) on banks of 30 percent, and to increase competition among financial institutions. The authorities plan to reduce the LRR over the coming months as the liquidity situation allows, with a view to lowering it to no more than 10 percent by end-December 2004 (see MEFP, para. 32).

44. **The reduction in the stock of government securities would deprive the banks of high-yield and low-risk investments and encourage them to look more aggressively for private clients.** The program provides room for an adequate increase in private sector credit (26 percent) during 2003/04, which would be accommodated within the targeted monetary expansion by a decline in net credit to the government (Table 4). The authorities agreed that, while increased bank lending to the private sector would be a welcome change, it would also call for increased vigilance on the part of bank supervisors in order to ensure that the quality of bank loans was not impaired.

45. **The implementation of the monetary program will focus on controlling the RBM's net domestic assets and the banking system's net credit to the government as operational targets (MEFP, para. 30).**

46. **The authorities believe the depreciation of the kwacha in nominal and real effective terms since 2002 has allowed Malawi to safeguard its international competitiveness in the face of loose financial policies,** and that the implementation of the policies described in the MEFP, particularly the fiscal strategy, should allow for a relatively stable exchange rate during 2003–04; in turn, this stability should support the RBM's disinflation efforts.

C. External Sector Policies and Reforms

47. **Reflecting the decline in the requirement for food imports and the projected modest increase in domestic exports, the external current account deficit (excluding official grants) is projected to narrow from about 24 percent of GDP in 2002 to 15 percent in 2003 and about 13 percent in 2004.** The capital account is projected to improve substantially from a net inflow of US\$66 million in 2002 to an average annual net inflow of about US\$110 million during 2003–04, owing mainly to the assumed resumption of balance of payments assistance (Table 6). Usable gross external official reserves are programmed to rise to 1.9 months of future import cover in 2003 and to 2.8 months in 2004.

48. **Malawi maintains a liberal trade and exchange system.** The exchange rate will continue to be market determined, with interventions by the RBM limited first to building up moderately its foreign reserves and, later, to smoothing exchange rate fluctuations. In the context of improving incentives for exporters, the authorities have reviewed the current requirements for the surrender of export receipts to authorized dealers. They feel that, in the current situation of very low international reserves, a reduction in the surrender requirements on exporters would have to be carefully timed. They plan to eliminate these requirements by end-September 2004.

49. **Malawi is a member of the World Trade Organization (WTO) and belongs to two main regional trade groupings, the Southern Africa Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA).** Malawi also maintains bilateral trade agreements with South Africa and Zimbabwe, and has preferential market access to the United States under the African Growth and Opportunity Act (AGOA) and to the European Union under the Everything But Arms (EBA) initiative. The government plans to replace, on a temporary basis, the quantitative restrictions on imports from Zimbabwe, which were introduced as a result of a trade dispute with that country, with tariffs. These temporary tariffs will be reviewed every six months. The authorities recognize that belonging to regional trade groupings with different trade liberalization agendas could lead to conflicting obligations and plan to keep this possibility in mind in future negotiations relating to the regional arrangements.

50. **The authorities plan to accelerate the reforms needed to attain the HIPC Initiative completion point triggers by end-2004 (see Box 5).** The authorities have requested the resumption of interim debt relief from the IMF under the HIPC Initiative.

51. **An updated Safeguards Assessment of the RBM in July 2003 concluded that the RBM has made progress in strengthening its safeguards, as recommended in the previous Safeguards Assessment of July 2001.** The assessment noted that there were still some unresolved issues at various levels of the bank's operations, including the need for timely publication of the audited financial statements, strengthened program data compilation procedures, and an enhanced external audit mechanism. The assessment proposed several measures to address these issues, and, in response, the authorities published the 2002 financial statements on July 4, 2003; some measures are included as structural benchmarks for the current program (Appendix I, Table 2).

D. Structural Reforms and Governance

52. **The government's structural reform program during 2003–04 (indicated in Box 6 and Appendix I, Table 2) will aim to address some of the impediments to growth highlighted in Box 4.**²⁵ With support from the World Bank, the authorities plan to undertake reforms in the agricultural sector focusing on implementing a new land policy supportive of efficient land use and of economic growth and equity. In addition, the government plans several reforms in the tobacco subsector aimed at increasing exports, reducing taxation,

²⁵ See also MEFP, paras. 37–41.

Box 5. Update of Malawi HIPC Initiative Completion Point Triggers (As of June 30, 2003)	
<p>Poverty reduction Preparation and satisfactory implementation of the full PRSP for one year, as evidenced by the joint staff assessment of the country's progress report.</p>	<p>Status PRSP finalized April 2002, and endorsed by the Executive Boards of the IMF and World Bank on August 5, 2002.</p>
<p>Macroeconomic and structural reforms Maintenance of macroeconomic stability and satisfactory implementation of the PRGF-supported program. Quarterly expenditure reporting as per format jointly developed by Ministry of Finance/IDA. Implementation of IFMIS in four pilot ministries. Microfinance— (i) approval by cabinet of the Microfinance Policy, (ii) establishment of a monitoring system covering all microfinance institutions, and (iii) increase by 20 percent in the number of microfinance clients. Submission of draft Land Law to parliament.</p>	<p>PRGF review not completed</p> <p>Implemented. In progress. (i) implemented; (ii) in progress; and (iii) in progress.</p> <p>Delayed to early 2004.</p>
<p>Governance Separation of fiscal management and audit functions under new legislation.</p>	<p>Approved by parliament in July 2003.</p>
<p>Social sectors Safety nets. Progress in the implementation of the National Safety Net Strategy, in particular (i) a targeted input program for 2001/02, (ii) a rationalization and prioritization of existing and new programs, and (iii) establishment of a monitoring and evaluation of the National Safety Net Strategy. Health. Progress toward a reduction of the human resource, drugs, and medical equipment constraints through (i) a share of health expenditure of at least 13 percent of discretionary recurrent budget; (ii) recruitment, training and deployment of at least 200 nurse technicians, 50 new medical assistants, and 20 radiography technicians per annum, and (iii) completion of "phase one" reforms of the Central Medical Stores (CMS) and a budget for drugs and medical supplies. HIV/AIDS. Progress in implementation of the National Aids Strategy, in particular (i) a fully staffed, functional, and autonomous National AIDS Control Secretariat; (ii) 75 percent of all condom outlet points with condoms in stock at any given time; (iii) continuous availability of testing kits at all blood transfusion sites by increasing the number of blood-testing kits from 1,500 to 2,500; (iv) implementation of an effective Behavior Change Communication Strategy; and (v) syndromic management of sexually transmitted infections (STI) in all central, district and major hospitals. Education. Progress toward raising the quality of education through (i) a share of education sector expenditure in discretionary recurrent budget of at least 23 percent; (ii) yearly enrollment of 6,000 students for teacher training and institution of in-service training for primary teachers (at least once each year); (iii) reallocation of budgetary resources from secondary school boarding (except for special needs education) to teaching and learning materials; and (iv) prepackaging of donor-supplied primary textbooks for each school and supply directly from the supplier to the schools.</p>	<p>(i) implemented; (ii) ongoing; and (iii) part of PRSP but not yet established.</p> <p>(i) implemented; (ii) in progress; (iii) not met.</p> <p>(i) implemented; (ii) incomplete; (iii) in progress; (iv) in progress; and (v) implemented .</p> <p>(i) implemented; (ii) not implemented; (iii) not implemented; and (iv) implemented.</p>
<p>1/ Provided by the World Bank. 2/ Ministry of Education, Universities, MANEB, MIE, scholarship fund and Polytechnic Board of Governors.</p>	

encouraging contract farming, and improving marketing arrangements. Furthermore, the government, with support from several donors, is working on improving food security and strengthening the early warning system. The task force on food security has produced an inception report, and a new food security policy is expected to be prepared by end-2003 (MEFP, para. 41).²⁶

53. **The restructuring and privatization of public enterprises will be continued as outlined in the MEFP (para. 39).** Public enterprise reform should reduce enterprises' dependence on budget subsidies and improve their operational efficiency. In particular, substantial progress is expected to be made this year with regard to completing the restructuring plan for ADMARC, divesting its noncore subsidiaries, liquidating its minority shareholdings, and removing social activities from its core functions. These reforms are being undertaken with the support of the World Bank (Box 6).

54. **The government has taken measures to strengthen the anticorruption regime, including increasing the staff of the Anti-Corruption Bureau (ACB) and training judges (MEFP, para. 39).** The long-awaited amendments to the Corrupt Practices Act are to be resubmitted to parliament during October 2003. These amendments specify a level of proof that ensures an expeditious prosecution process, makes abuse of office an offense under the Corrupt Practices Act, and establishes a "whistle-blower" program that makes it easier to pursue potential offenders. Following the completion of the external audit of the National Food Reserve Agency (NFRA), the ACB plans to review the audit report and identify any people or institutions that may have violated the law. The staff emphasized to the authorities that it was crucially important to actually apply the provisions of the amended Corrupt Practices Act; vigorously follow up on the findings of the external audit of the NFRA; and deal decisively with all cases of corruption and poor governance.

E. Program Monitoring

55. **In view of the authorities' request for an extension of the PRGF arrangement to December 20, 2004, the authorities and the staff have reached understandings on a program that covers the period from July 2003 to December 2004.** This program will be monitored through the quantitative and structural performance criteria and benchmarks specified in Tables 1-3 of Appendix I. Quantitative performance criteria have been set for end-September and end-December 2003. The quantitative performance criteria relating to the monetary program include a ceiling on net domestic assets (NDA) of the RBM, with a sub-ceiling on net credit to government (NCG) from the banking system and a floor on the

²⁶ The envisaged food security policy would include efforts to develop agricultural markets and food safety nets by the end of 2003 (MEFP, para. 38).

Box 6. Structural Conditionality

Coverage of structural conditionality

The structural performance criteria and benchmarks proposed as conditionality support the macroeconomic objectives of the government by emphasizing the government's objectives of

- reducing public enterprise reliance on budgetary support;
- improving the management of the civil service and rationalizing the wage bill;
- strengthening the legal framework for public expenditure management and improving accountability and transparency; and
- improving the regulatory framework for financial institutions and reducing intermediation costs.

Status of structural conditionality under the PRGF-supported program

The structural **performance criteria** include the issuance of regulations and instructions under the Public Finance Management Act, the completion of an audit of domestic arrears, measures relating to the civil service and pension reform, the issuance of a report by the Anti-Corruption Bureau on the NFRA audit, the submission to parliament of necessary amendments to the Anti-Corruption Act, and a limit on the subsidies to ADMARC (Appendix I, Table 2).

The structural **benchmarks** designed to improve financial management relate to measures to improve monetary data, the conduct of audits of the RBM's financial statements and its compilation procedures for program data, the adoption of acceptable accounting standards by the Ministry of Finance, and the establishment of a task force for improving debt management. The other structural benchmarks relate to the reduction of the liquidity reserve requirements applied to commercial banks and to the phasing out of the export surrender requirement.

Structural areas covered by World Bank lending and conditionality

The World Bank's lending program covers the following areas: public expenditure management, public enterprise reform, civil service reform, land policy, food security, and safety nets. A structural adjustment credit being prepared by the World Bank will have conditionality in the areas of land management, tobacco subsector reforms, parastatal reforms, and public expenditure management. Work on a comprehensive restructuring plan for ADMARC, which is being undertaken in consultation with the World Bank, other donors, and civil society, is expected to be completed by the end of 2003. The government also plans to liquidate ADMARC's shareholdings in National Bank of Malawi and SOCOMA, complete the privatization of its subsidiary, Cold Storage, and transfer the assets of David Whitehead and Sons to the prospective buyers by the end of 2003. Progress is also expected this year with regard to the privatization of Grain and Milling, and Shire Bus Lines. **These reforms are to be supported by the proposed structural adjustment credit from the World Bank, to be appraised later in 2003.**

RBM's net international reserves. These and other monitoring criteria and benchmarks are defined and explained in the technical memorandum of understanding (TMU). The program will also be monitored through quarterly reviews and test dates. A review will be conducted to reach understandings on the 2004/05 budget in conjunction with the end-March 2004 test date.

F. Risks Associated with the Program

56. **The unusually late request for the completion of the first review and for an extension of the PRGF arrangement by a full year requires careful consideration of the risks facing the new program.** Since the approval of the PRGF arrangement by the Board in December 2000, it has not been possible to complete the first review for a relatively long period, owing to weak policy implementation. The latter, in turn, has led to the withdrawal of donor support for a prolonged period. Against this background, however, one also needs to consider the authorities' recent efforts to strengthen their policy implementation over two successive six-month periods between July 2002 and June 2003 in the face of an economic situation seriously weakened by a severe drought and subsequent floods, as well as by shortfalls in donor support.

57. **In light of these considerations, the main risk with regard to program implementation is the potential for slippages in fiscal policy, owing either to spending overruns or inadequate political will, particularly with regard to controlling expenditures or raising adequate revenue in the run-up to the elections in May 2004.** The steps taken to strengthen expenditure control, as well as tax administration, should provide a safeguard against fiscal slippages. Nevertheless, the expenditure reductions envisaged will require strong discipline and political will to be sustained.²⁷ This will be a test of the government's commitment to strengthen fiscal discipline. This being said, the President has expressed his full commitment to implement the agreed program. The cabinet has endorsed the program, and the authorities have begun to put in place the key revenue and expenditure measures. The program and its measures have been publicly announced by the Minister of Finance and covered extensively by the local press. In addition, the President has undertaken to make a public statement to indicate his firm commitment to, and ownership of, the program. Furthermore, by implementing the last track-record program in a broadly satisfactory manner and by taking the prior actions needed to launch their fiscal program for 2003/04, the authorities have prepared a sound basis for ensuring the successful implementation of the proposed new program.

²⁷ Compressed expenditures amount to about one-third of budgetary appropriation for the first half of the fiscal year. Some of this could be restored as aid comes in later.

58. **Second, there is a risk that external budgetary aid may continue to be withheld or released with a substantial delay.** This would make the fiscal strategy difficult to sustain, as it is predicated on the expectation that donors would respond positively and in a timely manner to a demonstrated change in policy and discipline. In order to mitigate this risk, the program provides for quarterly reviews so that policy slippages can be recognized and addressed early and the program maintained on track. The staff's discussions with the local donor community indicated that they would provide support if the program were also supported by the IMF, and if policy implementation were closely monitored by the IMF and remained on track.

59. **Most important, given the improved policy implementation and the authorities' firm commitment to sustain it, a continuation of the reform effort, with support from the IMF and the donor community could help Malawi establish the basis for a resumption of strong economic growth and a renewed focus on poverty reduction programs and policies.**

V. STAFF APPRAISAL

60. **Malawi's economic performance during the last three years has been poor, owing to slippages in macroeconomic management and to frequent adverse exogenous shocks in the form of floods, drought, and famine that have aggravated the economic deterioration and increased the incidence of poverty.** The persistence of macroeconomic instability has damaged the economy, in particular by fostering high inflation and entrenching inflationary expectations, raising real interest rates, and depressing private sector activity and investment.

61. **Recently, Malawi has made serious efforts to stabilize the economic situation and accelerate the pace of structural reforms.** As a result, and despite a severe drought and related food shortage, some measure of fiscal discipline has been achieved, and the fiscal targets for the track-record program for end-March and end-June 2003 were largely attained. Attainment of the monetary program targets was impeded by the shortfall in external emergency and budgetary assistance, and by the failure to dispose of all the government's emergency maize imports. Progress was also made in implementing structural reforms and in meeting HIPC Initiative completion point triggers.

62. **Despite these modest gains, Malawi's main policy challenge is still to reestablish and maintain macroeconomic stability, which is a precondition for growth and poverty reduction.** Restoring fiscal discipline is key to the return to macroeconomic stability. Therefore, the execution of the 2003/04 budget, especially its objective of repaying the domestic debt, will be critical in signaling a fundamental change not only in policy but also in the government's political commitment to discipline itself. A clear demonstration of this commitment will be necessary to reduce entrenched inflationary expectations and facilitate a lowering of the very high real interest rates. A demonstration of political commitment to the program will be particularly important during the run-up to the general elections in May 2004.

63. **The main challenge in 2003/04 and over the medium term will be to manage domestic expenditures so as to align them closely with domestic revenue.** This strategy is ambitious but essential to reverse the fiscal deterioration and change expectations.

Expenditures should be authorized on the basis of collected domestic revenue and of disbursed, rather than expected, budgetary aid. A ceiling has been set on the maximum recourse to domestic financing of the budget deficit in the event of a shortfall in budgetary aid; this should be adhered to strictly to avoid excessive monetary expansion. Expenditure discipline will require that the measures taken to strengthen the CCS be applied rigorously to avoid incurring domestic arrears. Furthermore, the management of the CCA should be tightened in order to limit the carryover of unused balances into the new fiscal year, as this practice would undermine the capacity of the treasury to enforce spending discipline. In addition, strict control would need to be exercised over expenditures related to the upcoming elections, which are to be centralized at the Electoral Commission.

64. **The resumption of external balance of payments assistance will be essential** for the success of the fiscal strategy and for the reduction of the domestic debt burden and real interest rates, as well as for the programmed rebuilding of RBM's external reserve position.

65. **Monetary policy should continue to focus, in conjunction with a resumption of donor aid flows, on containing inflation and rebuilding foreign exchange reserves.** A tight fiscal stance should enable the RBM to better control domestic liquidity and to minimize operational losses resulting from its policy interventions. The reduction in the government's reliance on domestic financing should, with a change in inflationary expectations, allow for the issuance of longer-term government securities to improve the maturity profile of government domestic debt. The reduction in the government's domestic debt and in real interest rates should help energize the moribund private sector by increasing credit availability. It would also necessitate increased vigilance from bank supervisors, given the commercial banks' high interest rate exposure and the risk of a decline in credit quality as banks seek to increase their private sector lending.

66. **The exchange rate has depreciated significantly** in real effective terms since end-2001, and its current level appears to be consistent with economic fundamentals. While the exchange rate remains vulnerable to market sentiment about the future stance of macroeconomic policies, it should stabilize once fiscal and monetary policies have been tightened and inflationary expectations reversed.

67. **To advance toward the objectives envisaged under the Malawi PRSP and the country's Millennium Development Goals, Malawi needs to accelerate the pace of implementation of structural reforms.** The reforms envisaged in the agricultural sector are necessary to mitigate risks to farmers and improve food security. The reform of public enterprises should help these entities reduce their dependence on the government budget and improve service delivery. In particular, the divestiture of ADMARC subsidiaries and the removal of its social activities from its core functions should allow the enterprise to clarify its mandate and operate more efficiently.

68. **The program faces a number of risks, including potential policy slippages and delays in external budgetary support.** However, the staff believes that the risks associated with supporting the authorities in their reform efforts, however real, are worth taking and are outweighed by the far greater risks entailed by the IMF's not being engaged in Malawi at this critical juncture. Indeed, IMF engagement beyond the May 2004 elections would provide a stable environment for an orderly political transition.

69. **On the basis of progress made under the track-record program and the policies described in the authorities' MEFP, the staff recommends the completion of the first review, the granting of a waiver of performance criteria, the proposed rephrasing of the disbursement of amounts outstanding under the PRGF arrangement, and the extension of the PRGF arrangement through December 20, 2004. Given the assurances received that exceptional assistance will be provided to Malawi by other creditors under the enhanced HIPC Initiative, the staff also recommends the resumption of IMF interim assistance to Malawi under the HIPC Initiative.**

Table 1. Malawi: Selected Economic and Financial Indicators, 2000-04

	2000 Act.	2001 Act.	2002			2003		2004 Proj.
			EBS/02/131	Track Record	Prel.	EBS/02/131	Proj.	
(Percentage change, unless otherwise indicated)								
GDP and prices								
GDP at constant market prices	1.1	-4.2	1.8	1.8	1.8	4.5	5.9	5.0
Consumer prices (end of period)	35.4	22.1	5.0	7.6	7.6	5.0	9.1	5.5
Consumer prices (annual average)	29.6	27.2	9.4	14.9	14.9	5.0	9.2	7.3
GDP deflator	25.9	25.2	12.2	17.5	17.5	4.7	6.9	6.2
Interest rates (end of period) 1/	86.6	54.6	...	40.8	40.8	...	...	...
Nominal effective exchange rate (end period) 2/	-32.0	22.0	...	-31.2	-29.6	...	...	...
Real effective exchange rate (end period) 2/	-15.6	40.2	...	-38.3	-33.3	...	...	...
External sector								
Exports, f.o.b. (millions of U.S. dollars)	401.8	426.5	421.1	428.9	421.1	451.2	434.1	466.5
Imports, c.i.f. (millions of U.S. dollars)	563.2	584.5	768.2	738.6	726.9	657.2	624.1	626.4
Terms of trade	-4.9	-0.1	5.9	-1.5	-1.6	1.8	0.0	3.0
Money and credit 3/								
Money and quasi money	42.4	12.1	7.9	23.4	23.4	13.4	15.0	10.0
Net foreign assets	46.8	-15.1	-17.5	-69.7	-68.9	41.8	26.5	24.6
Net domestic assets	-4.4	27.2	25.3	93.2	92.3	-28.4	-11.5	-14.6
Credit to the government	6.9	33.7	12.1	46.0	45.5	-34.4	10.5	-20.6
Credit to the rest of the economy	12.4	-5.1	27.6	3.3	3.7	-2.5	1.7	7.7
(Percent of GDP, unless otherwise indicated)								
Central government 4/								
Revenue (excluding grants)	18.7	17.1	18.0	19.9	20.5	17.8	21.8	20.6
Expenditure	33.9	31.7	31.4	35.2	35.2	28.5	35.2	29.8
Domestic primary balance (cash modified basis) 5/	-1.7	-3.8	-2.2	-1.1	-2.2	-2.3	4.2	2.3
Domestic balance (cash modified basis) 6/	-4.8	-7.7	-5.4	-6.8	-7.1	-3.2	-3.8	0.0
Primary balance (cash modified basis, including grants) 6/	-1.2	-2.7	2.0	-2.3	-1.4	2.3	8.8	4.9
Overall balance (cash modified basis, including grants) 6/	-6.0	-7.8	-2.7	-9.4	-7.8	-0.1	-0.8	1.2
Domestic saving								
Domestic saving	-2.8	-10.3	-15.9	-10.2	-10.1	0.7	-5.0	0.0
Net factor income	-2.1	-2.0	...	-2.0	-2.0	...	-2.5	-2.3
Unrequited transfers	9.1	6.4	...	12.9	12.9	...	7.6	7.9
Net official transfers	8.7	5.8	...	12.3	12.3	...	7.0	7.3
Net private transfers	0.5	0.6	...	0.5	0.5	...	0.6	0.6
National saving								
National saving	4.2	-5.9	-2.3	0.7	0.8	7.2	0.1	5.6
Gross investment								
Gross investment	9.6	1.0	9.0	12.4	12.4	13.9	8.2	11.5
Public	10.0	8.4	8.0	7.9	7.9	9.6	9.1	9.7
Private	2.6	2.9	1.0	1.7	1.7	4.4	0.8	1.8
Stock building	-3.0	-10.3	0.0	2.9	2.9	0.0	-1.7	0.0
External sector								
Exports, f.o.b.	23.5	25.3	22.2	22.6	22.1	23.1	24.6	25.7
Imports, c.i.f.	33.0	34.6	40.5	38.8	38.2	33.6	35.3	34.5
External current account (including official transfers)	-5.4	-6.9	-11.3	-11.7	-11.6	-6.7	-8.2	-5.9
External debt	156.7	162.1	147.6	145.8	145.8	147.6	161.7	160.7
Debt-service ratio 7/	22.1	20.0	20.4	19.7	20.1	20.7	22.0	21.4
Of which: interest payments 7/	7.0	6.3	6.2	6.0	6.1	5.8	6.0	5.6
(In millions of U.S. dollars, unless otherwise indicated)								
Gross official reserves (authorities' definition)								
End-period stock	243.6	202.9	129.9	162.1	162.1	228.4	136.5	199.5
In months of imports of goods and nonfactor services 8/	4.3	3.0	2.1	2.7	2.7	3.4	2.2	3.1
Gross official reserves (program definition) 9/								
End-period stock	224.6	184.6	...	101.7	103.5	...	117.5	180.5
In months of imports of goods and nonfactor services 8/	4.0	2.7	...	1.7	1.7	...	1.9	2.8
External debt (disbursed and outstanding, end of period)	2,674	2,736	2,803	2,773	2,773	2,883	2,859	2,922
Memorandum items:								
GDP (in millions of kwacha)	101,621	121,872	144,175	145,811	145,811	157,783	165,100	184,100
Domestic debt (in percent of GDP) 10/	8.9	11.3	...	15.6	15.6	...	18.9	19.1
Kwacha per U.S. dollar exchange rate (per. avg.)	59.5	72.2	...	76.7	76.7	...	...	...
Per capita GDP (U.S. dollars)	165.5	160.4	...	177.0	177.0	...	...	...
Population (millions)	10.3	10.5	10.7	10.7	10.7	11.0	11.0	11.2

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

1/ Compounded three-month treasury bill interest rate.

2/ Positive value denotes appreciation of kwacha.

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

4/ Fiscal year starting July 1; information for 2001 refers to fiscal-year 2001/02, etc. Excludes the 2002/03 and 2003/04 maize operations.

5/ The domestic primary balance excludes grants, domestic and foreign interest, and foreign-financed development expenditure.

6/ Cash-modified basis defined as cash spending and expenditure in arrears.

7/ In percent of exports of goods and nonfactor services. Excludes debt relief.

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

9/ Excludes open letter of credit for 2002/03 maize operation, blocked deposits, and reserves pledged for bridge loan.

10/ Central government debt instruments and RBM bills held by the private sector.

Table 2. Malawi: Central Government Operations, 2002/03 (Excluding 2002/03 Maize Operation) 1/

	Prog.	Prog.	H1		H2		Year	
	EBS/00/263	EBS/02/131	EBS/02/131	Est.	TR	Est.	TR	Est.
(In millions of Malawi kwacha)								
Total revenue and grants	39,304	43,153	21,969	18,574	20,824	23,520	39,468	42,094
Revenue	27,517	27,144	13,245	14,442	16,128	16,977	30,509	31,419
Tax revenue	25,062	24,259	11,888	12,836	13,427	14,415	26,089	27,251
Taxes on income and profits	10,363	10,584	4,859	5,708	6,669	6,438	12,204	12,146
Individual	...	4,722	2,133	2,525	3,422	3,183	5,877	5,708
Corporate	...	3,300	1,279	1,643	2,167	2,035	3,715	3,678
Withholding tax	...	2,562	1,448	1,541	1,081	1,219	2,612	2,760
Taxes on goods and services	11,496	11,077	5,768	5,863	5,347	6,515	11,177	12,379
Surtax	8,445	7,986	4,131	4,339	3,858	4,983	8,086	9,322
Excise duties	3,051	3,091	1,637	1,524	1,490	1,532	3,091	3,056
Taxes on international trade	3,814	2,928	1,435	1,461	1,569	1,675	3,038	3,136
Other (incl. refunds)	-611	-330	-174	-197	-158	-212	-330	-410
Nontax revenue	2,455	2,885	1,357	1,606	2,700	2,561	4,421	4,168
Departmental receipts	...	1,330	579	734	1,152	880	2,055	1,614
Petroleum levy for NRA	...	1,232	616	629	611	593	1,232	1,222
Petroleum levy for safety nets	...	324	162	209	161	255	324	464
Grants	11,787	16,009	8,724	4,132	4,696	6,544	8,959	10,675
Program	5,003	9,042	5,322	13	1,259	1,207	1,329	1,220
Food security program	0	0	0	188	0	0	0	188
Project	2,314	3,558	1,758	2,316	1,823	2,288	4,398	4,604
HIPC debt relief	4,470	3,409	1,644	1,615	1,614	1,974	3,232	3,588
Japanese debt relief	0	0	0	0	0	1,075	0	1,075
Total expenditure and net lending	37,161	45,612	23,362	25,962	27,528	28,053	53,945	54,015
Total expenditure	37,161	45,612	23,362	25,927	27,528	28,027	53,945	53,954
Current expenditure	27,667	33,174	17,177	19,231	20,918	22,936	40,813	42,167
Wages and salaries	7,767	9,283	4,519	5,361	5,310	5,568	10,633	10,930
Of which: PPE	...	2,855	2,332	2,881	2,459	2,781	4,540	5,662
Interest payments	2,475	7,046	4,291	4,413	6,232	5,343	10,879	9,756
Domestic	390	4,870	3,279	3,509	5,135	4,134	8,873	7,642
Foreign	2,085	2,177	1,012	904	1,098	1,210	2,006	2,114
Other current expenditure	17,425	16,844	8,366	9,456	9,375	12,024	19,301	21,481
Goods and services	9,422	10,591	5,266	5,548	5,926	8,502	11,761	14,049
Generic goods and services	9,422	10,351	5,066	5,271	5,535	6,836	10,662	12,108
Of which: PPE	...	6,163	2,391	1,788	2,464	3,067	4,433	4,855
Japanese debt relief account	...	0	0	73	291	1,127	339	1,200
Targeted input program (TIP)	...	160	160	128	0	460	600	588
National / local elections	...	0	0	10	0	0	10	10
Vehicle purchase	...	79	40	65	100	79	150	144
Subsidies and other current transfers	8,003	6,254	3,100	3,909	3,450	3,523	7,540	7,431
Development expenditure	9,494	12,439	6,186	6,696	6,610	5,091	13,132	11,787
Part I (foreign financed)	6,066	9,853	4,868	5,622	5,361	3,899	10,924	9,521
Part II (domestically financed)	3,428	2,586	1,317	1,074	1,249	1,192	2,208	2,266
Of which: PPE	...	310	158	186	152	356	332	542
Net lending	0	0	0	35	0	26	0	61
Lending	0	0	0	50	0	92	0	142
Repayment	0	0	0	-16	0	-66	0	-81
Overall balance (including grants)	2,144	-2,459	-1,393	-7,388	-6,704	-4,533	-14,477	-11,921
Total financing	-2,144	2,459	1,393	7,541	6,704	3,848	14,477	11,389
Foreign (net)	2,627	10,178	4,422	459	4,236	-1,188	4,425	-730
Borrowing	7,338	9,881	6,697	3,306	6,128	1,611	9,116	4,917
Program	3,586	3,587	3,587	0	2,590	0	2,590	0
Project	3,752	6,295	3,110	3,306	3,538	1,611	6,527	4,917
Amortization	-4,711	-4,771	-2,180	-2,598	-2,434	-2,851	-5,090	-5,448
Special loans (net)	0	-191	-94	-323	-107	0	-299	-323
Japanese debt relief account	0	0	0	73	649	52	697	125
Domestic (net)	-4,770	-7,719	-3,029	7,083	2,468	5,036	10,052	12,119
Statistical discrepancy	0	0	0	-153	0	685	0	532
Memorandum items:								
Total financing target (flow) 2/	3,577	8,616	5,249	5,863	6,039	6,492	12,511	12,355
Total financing target (cumulative) 2/	3,577	8,616	5,249	5,863	12,511	12,355	12,511	12,355
Primary balance (after grants)	4,619	4,587	2,898	-2,975	-472	810	-3,598	-2,165
Domestic balance 3/	-1,492	-6,439	-4,237	-4,994	-4,942	-5,968	-10,505	-10,962
Domestic primary balance 4/	-1,102	-1,569	-958	-1,485	193	-1,834	-1,633	-3,319
Expenditure that can be postponed 5/	...	9,232	5,398	6,869	6,102	8,127	13,077	14,996

Table 2. Malawi: Central Government Operations, 2002/03 (Excluding 2002/03 Maize Operation) 1/ (concluded)

	Prog.	Prog.	H1		H2		Year	
	EBS/00/263	EBS/02/131	EBS/02/131	Est.	TR	Est.	TR	Est.
(In percent of GDP, unless otherwise indicated)								
Total revenue and grants	26.9	28.6	14.6	12.1	13.6	15.3	25.7	27.4
Revenue	18.9	18.0	8.8	9.4	10.5	11.1	19.9	20.5
Tax revenue	17.2	16.1	7.9	8.4	8.8	9.4	17.0	17.8
Taxes on income and profits	7.1	7.0	3.2	3.7	4.3	4.2	8.0	7.9
Taxes on goods and services	7.9	7.3	3.8	3.8	3.5	4.2	7.3	8.1
Taxes on international trade	2.6	1.9	1.0	1.0	1.0	1.1	2.0	2.0
Other (incl. refunds)	-0.4	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2	-0.3
Nontax revenue	1.7	1.9	0.9	1.0	1.8	1.7	2.9	2.7
Departmental receipts	...	0.9	0.4	0.5	0.8	0.6	1.3	1.1
Petroleum levy for NRA	...	0.8	0.4	0.4	0.4	0.4	0.8	0.8
Petroleum levy for safety nets	...	0.2	0.1	0.1	0.1	0.2	0.2	0.3
Dividends	0.0	0.0	0.0	0.0	0.5	0.5	0.5	0.6
Grants	8.1	10.6	5.8	2.7	3.1	4.3	5.8	7.0
Program	3.4	6.0	3.5	0.0	0.8	0.8	0.9	0.8
Food security program	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.1
Project	1.6	2.4	1.2	1.5	1.2	1.5	2.9	3.0
HIPC	3.1	2.3	1.1	1.1	1.1	1.3	2.1	2.3
Japanese debt relief	0.0	0.0	0.0	0.0	0.0	0.7	0.0	0.7
Total expenditure and net lending	25.5	30.2	15.5	16.9	17.9	18.3	35.2	35.2
Total expenditure	25.5	30.2	15.5	16.9	17.9	18.3	35.2	35.2
Current expenditure	19.0	22.0	11.4	12.5	13.6	15.0	26.6	27.5
Wages and salaries	5.3	6.2	3.0	3.5	3.5	3.6	6.9	7.1
Of which: PPE	...	1.9	1.5	1.9	1.6	1.8	3.0	3.7
Interest payments	1.7	4.7	2.8	2.9	4.1	3.5	7.1	6.4
Domestic	0.3	3.2	2.2	2.3	3.3	2.7	5.8	5.0
Foreign	0.0	1.4	0.7	0.6	0.7	0.8	1.3	1.4
Other current expenditure	11.9	11.2	5.5	6.2	6.1	7.8	12.6	14.0
Of which: PPE	...	4.1	1.6	1.2	1.6	2.0	2.9	3.2
Development expenditure	6.5	8.2	4.1	4.4	4.3	3.3	8.6	7.7
Part I (foreign financed)	4.2	6.5	3.2	3.7	3.5	2.5	7.1	6.2
Part II (domestically financed)	2.4	1.7	0.9	0.7	0.8	0.8	1.4	1.5
Of which: PPE	...	0.2	0.1	0.1	0.1	0.2	0.2	0.4
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	1.5	-1.6	-0.9	-4.8	-4.4	-3.0	-9.4	-7.8
Total financing	-1.5	1.6	0.9	4.9	4.4	2.5	9.4	7.4
Foreign (net)	1.8	6.7	2.9	0.3	2.8	-0.8	2.9	-0.5
Borrowing	5.0	6.6	4.4	2.2	4.0	1.1	5.9	3.2
Program	2.5	2.4	2.4	0.0	1.7	0.0	1.7	0.0
Project	2.6	4.2	2.1	2.2	2.3	1.1	4.3	3.2
Amortization	-3.2	-3.2	-1.4	-1.7	-1.6	-1.9	-3.3	-3.6
Special loans (net)	0.0	-0.1	-0.1	-0.2	-0.1	0.0	-0.2	-0.2
Japanese debt relief account	0.0	0.0	0.0	0.0	0.4	0.0	0.5	0.1
Domestic (net)	-3.3	-5.1	-2.0	4.6	1.6	3.3	6.6	7.9
Statistical discrepancy	0.0	0.0	0.0	-0.1	0.0	0.4	0.0	0.3
Memorandum items:								
Total financing target 2/	2.5	5.7	3.5	3.8	3.9	4.2	8.2	8.1
Total financing target (cumulative) 2/	2.5	5.7	5.3	5.5	14.6	13.9	8.2	8.1
Primary balance (after grants)	3.2	3.0	1.9	-1.9	-0.3	0.5	-2.3	-1.4
Domestic balance 3/	-1.0	-4.3	-2.8	-3.3	-3.2	-3.9	-6.8	-7.1
Domestic primary balance 4/	-0.8	-1.0	-0.6	-1.0	0.1	-1.2	-1.1	-2.2
Pro-poor expenditure (PPE)	0.0	6.2	3.2	3.2	3.3	4.0	6.1	7.2
Expenditure that can be postponed 5/	...	6.1	3.6	4.5	4.0	5.3	8.5	9.8
Nominal GDP (in millions of kwacha)	145,869	150,794	150,794	153,381	153,381	153,381	153,381	153,381

Sources: Malawian authorities; and IMF staff projections.

1/ Fiscal year from July to June.

2/ Total financing and grants, excluding foreign project-related financing.

3/ Overall balance excluding grants, foreign financed development expenditures, and foreign interest payments.

4/ Domestic balance, excluding domestic interest payments.

5/ Non PPE ORTs plus other transfers (excluding pensions and transfers to MRA and NRA, and elections for FY 2003/04) plus non-PPE domestically financed development expenditures.

Table 3. Malawi: Central Government Operations, 2001/02 - 2003/04 (Excluding 2002/03 Maize Operation) 1/ (concluded)

	FY 2001/02	FY 2002/03			FY 2003/04							
	Est.	Prog. EBS/02/131	Track Record	Year Est.	Prog. EBS/02/131	Track Record	Budget	QI Proj.	QII Proj.	QIII Proj.	QIV Proj.	Year Proj.
(In percent of GDP)												
Total revenue and grants	23.9	28.6	25.7	27.4	28.4	33.5	33.9	8.1	8.8	8.8	9.0	34.7
Revenue	17.1	18.0	19.9	20.5	17.8	20.8	20.8	5.1	5.3	5.4	5.9	21.8
Tax revenue	15.2	16.1	17.0	17.8	16.1	18.0	18.0	4.6	4.4	4.5	4.8	18.3
Taxes on income and profits	7.1	7.0	8.0	7.9	7.0	8.4	8.4	1.9	1.7	2.1	2.3	8.1
Taxes on goods and services	6.7	7.3	7.3	8.1	7.4	7.7	7.7	2.2	2.2	2.0	2.0	8.4
Taxes on international trade	1.8	1.9	2.0	2.0	1.9	2.0	2.0	0.5	0.5	0.5	0.5	2.1
Other (incl. refunds)	-0.3	-0.2	-0.2	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.3
Nontax revenue	1.8	1.9	2.9	2.7	1.7	2.8	2.8	0.5	0.6	0.6	0.8	2.5
Departmental receipts	0.9	0.9	1.3	1.1	0.9	1.8	1.8	0.3	0.3	0.3	0.5	1.4
Petroleum levy for NRA	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.2	0.2	0.2	0.2	0.8
Petroleum levy for safety nets	0.1	0.2	0.2	0.3	0.0	0.2	0.2	0.1	0.1	0.1	0.1	0.3
Dividends	0.0	0.0	0.5	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Revenue measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3	1.0
Grants	6.8	10.6	5.8	7.0	10.7	12.7	13.1	3.0	3.5	3.3	3.1	13.0
Program	1.9	6.0	0.9	0.8	5.1	6.4	5.3	0.6	1.8	1.3	1.0	4.7
Food security program	0.4	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing of elections	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.1	0.1	0.1	0.1	0.3
Project	2.6	2.4	2.9	3.0	2.2	2.6	3.3	0.8	0.8	0.8	0.8	3.3
HIPC	1.3	2.3	2.1	2.3	3.5	3.1	3.5	0.7	0.9	1.1	1.2	3.9
Japanese debt relief	0.6	0.0	0.0	0.7	0.0	0.6	0.8	0.8	0.0	0.0	0.0	0.8
Total expenditure and net lending	31.7	30.2	35.2	35.2	28.5	32.2	33.3	9.1	8.3	9.3	8.5	35.2
Total expenditure	31.7	30.2	35.2	35.2	28.5	32.2	33.3	9.1	8.3	9.3	8.5	35.2
Current expenditure	24.4	22.0	26.6	27.5	20.4	23.4	24.1	7.3	6.4	7.4	6.5	27.6
Wages and salaries	6.9	6.2	6.9	7.1	6.2	7.1	6.6	1.6	1.6	1.6	1.7	6.6
Of which: PPE	0.0	1.9	3.0	3.7	2.0	3.3	3.1	0.9	0.9	0.9	0.9	3.6
Interest payments	5.1	4.7	7.1	6.4	2.4	5.4	6.0	2.9	1.9	2.9	1.8	9.6
Domestic	3.9	3.2	5.8	5.0	0.9	3.9	4.6	2.6	1.5	2.5	1.4	8.0
Foreign	1.2	1.4	1.3	1.4	1.4	1.4	1.4	0.3	0.4	0.4	0.4	1.5
Other current expenditure	12.4	11.2	12.6	14.0	11.9	10.9	11.4	2.9	2.8	2.9	2.9	11.5
Of which: PPE	1.8	4.1	2.9	3.2	3.6	3.2	3.2	0.8	0.8	0.8	0.8	3.2
Development expenditure	7.3	8.2	8.6	7.7	8.1	8.7	9.3	2.3	2.4	2.4	2.4	9.6
Part I (foreign financed)	5.8	6.5	7.1	6.2	6.1	6.9	7.8	2.0	2.0	2.0	2.1	8.1
Part II (domestically financed)	1.5	1.7	1.4	1.5	2.0	1.8	1.5	0.4	0.4	0.4	0.4	1.5
Of which: PPE	0.0	0.2	0.2	0.4	0.2	0.2	0.2	0.1	0.1	0.0	0.0	0.2
Expenditure measures 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.6	-0.4	-0.4	-0.4	-1.9
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including grants)	-7.8	-1.6	-9.4	-7.8	-0.1	1.3	0.5	-1.0	0.5	-0.6	0.6	-0.5
Total financing	6.8	1.6	9.4	7.4	0.1	-1.3	-0.5	2.3	-0.5	0.6	-0.6	1.8
Foreign (net)	-0.2	6.7	2.9	-0.5	3.3	4.6	5.1	-0.3	3.0	1.0	1.0	4.8
Borrowing	3.2	6.6	5.9	3.2	6.6	8.4	8.2	1.2	3.9	1.9	1.9	8.8
Program	0.0	2.4	1.7	0.0	2.7	4.0	3.7	0.0	2.7	0.6	0.7	4.0
Project	3.2	4.2	4.3	3.2	4.0	4.4	4.5	1.2	1.2	1.2	1.2	4.8
Amortization	-2.6	-3.2	-3.3	-3.6	-3.3	-3.8	-3.7	-0.8	-1.0	-1.0	-1.0	-3.7
Special loans (net)	-0.2	-0.1	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Japanese debt relief account	-0.5	0.0	0.5	0.1	0.0	0.0	0.6	-0.6	0.1	0.1	0.1	-0.2
Domestic (net)	7.0	-5.1	6.6	7.9	-3.2	-5.9	-5.6	2.5	-3.5	-0.5	-1.6	-3.1
Statistical discrepancy 3/	1.0	0.0	0.0	0.3	0.0	0.0	0.0	-1.3	0.0	0.0	0.0	-1.3
Memorandum items:												
Total financing target 4/	6.8	5.7	8.2	8.1	4.7	4.4	4.5	3.2	1.0	1.8	0.4	6.4
Total financing target (cumulative) 4/	6.8	5.7	8.2	8.1	4.7	4.4	4.5	3.2	4.2	5.9	6.4	6.4
Primary balance (after grants)	-2.7	3.0	-2.3	-1.4	2.2	6.7	6.6	1.9	2.4	2.3	2.4	9.1
Domestic balance 5/	-7.7	-4.3	-6.8	-7.1	-3.2	-3.0	-3.3	-1.7	-0.6	-1.4	-0.1	-3.8
Domestic primary balance 6/	-3.8	-1.0	-1.1	-2.2	-2.3	1.0	1.3	0.9	0.9	1.0	1.4	4.2
Pro-poor expenditure (PPE)	5.3	6.2	6.1	7.2	5.8	6.7	6.5	1.7	1.7	1.7	1.8	7.0
Expenditure that can be postponed 7/	9.5	6.1	8.5	9.8	8.0	7.1	6.4	1.6	1.6	1.6	1.6	6.3
Nominal GDP (in millions of kwacha)	133,842	150,794	153,381	153,381	163,628	169,250	173,279	174,600	174,600	174,600	174,600	174,600

Sources: Malawian authorities; and IMF staff projections.

1/ Fiscal year from July to June.

2/ The authorities have indicated that these savings will result from a reduction of the travel budget, nonfilling of vacancies, a freeze on promotions, the postponement of new domestically financed development expenditure, and additional postponement of discretionary outlays.

3/ The statistical discrepancy in the first quarter of 2003/04 reflects payments relating to the float from the previous year and other unidentified expenditures during July 2003.

4/ Total financing and grants, excluding foreign project-related financing.

5/ Overall balance excluding grants, foreign financed development expenditures, and foreign interest payments.

6/ Domestic balance, excluding domestic interest payments.

7/ Non PPE ORTs plus other transfers (excluding pensions and transfers to MRA and NRA, and elections for FY 2003/04) plus non-PPE domestically financed development expenditures.

Table 4. Malawi : Monetary Survey, 2001-04
(In millions of Malawi kwacha, unless otherwise indicated)

	2001	2001	2002	2002	2003		2003		2003	2003	2004	2004	2004	2004	
	June	Dec.	June	Dec.	March		June		Sep.	Dec.	March	June	Sep.	Dec.	
	Act.	Act.	Act.	Act.	TR 1/	Act.	TR 1/	Act.	Act. 2/	Proj. 2/	Proj. 2/	Proj. 2/	Proj. 2/	Proj. 2/	
Money and quasi money 3/	20,059	18,438	20,973	22,758	21,596	22,812	24,454	26,812	26,891	27,524	26,172	25,093	29,499	30,277	28,789
Money	10,996	9,312	11,772	12,223	...	12,120	...	15,758	15,758	...	...	...	...	...	...
Quasi money	9,063	9,126	9,201	10,535	...	10,693	...	11,055	11,133	...	...	...	...	...	...
<i>Of which: foreign currency deposits</i>	3,020	2,630	2,896	3,450	...	3,873	...	3,612	3,612	...	...	...	...	...	...
Net foreign assets (NFA) 3/	19,588	11,777	10,066	-920	-1,074	-3,315	5,509	1,606	1,606	274	5,107	5,944	10,193	11,322	11,534
NFA (in millions of U.S. dollars)	264	175	133	-10	-12	-23	59	12	12	3	57	66	113	126	128
Gross foreign assets	353	263	181	145	109	91	161	109	109	101	165	174	222	234	238
Foreign liabilities	-89	-88	-48	-156	-121	-113	-102	-97	-97	-98	-108	-108	-108	-108	-110
Monetary authorities	15,932	8,769	7,193	-3,546	-3,840	-6,494	2,096	-1,153	-1,153	-2,123	1,742	3,440	7,852	8,274	7,449
NFA of the monetary authorities (in millions of U.S. dollars)	215	130	95	-40	-42	-45	22	-9	-9	-24	19	38	87	92	83
Gross foreign assets	290	203	128	104	65	63	110	81	81	65	117	136	186	190	180
Foreign liabilities	-75	-73	-33	-143	-106	-108	-88	-89	-89	-88	-98	-98	-98	-98	-98
Commercial banks	3,656	3,009	2,873	2,626	2,766	3,179	3,413	2,760	2,760	2,396	3,366	2,504	2,341	3,049	4,085
NFA of the commercial banks (in millions of U.S. dollars)	49	45	38	29	30	22	37	20	20	27	37	28	26	34	45
Gross foreign assets	63	60	53	42	45	28	51	28	28	37	47	38	36	44	58
Foreign liabilities	-14	-15	-15	-13	-15	-6	-15	-8	-8	-10	-10	-10	-10	-10	-12
Net domestic assets (NDA)	471	6,661	10,907	23,678	22,670	26,127	18,946	25,206	25,284	27,251	21,064	19,149	19,306	18,954	17,254
Credit to government (net)	-2,134	5,661	4,490	14,049	17,212	16,822	16,135	18,374	18,374	22,580	16,437	15,625	12,825	12,321	11,051
<i>Of which: maize operation 4/</i>	0	0	0	5,263	6,458	6,037	4,740	6,716	6,716	...	...	...	...	...	...
Credit to statutory bodies (net)	826	-45	507	-77	-164	-547	-166	-608	-608	-631	-655	-670	-686	-703	-720
Credit to private sector	4,479	5,289	5,901	6,010	6,746	6,017	6,983	7,249	8,033	6,559	6,970	7,031	10,105	8,421	9,058
Other items (net)	-2,701	-4,244	9	3,697	-1,123	3,835	-4,006	191	-515	-1,259	-1,687	-2,837	-2,938	-1,085	-2,134
Revaluation accounts	-4,405	-2,377	-3,685	-4,848	-4,892	-4,904	-4,882	-4,856	-4,856	-4,856	-4,856	-4,856	-4,856	-4,856	-4,856
Open market operations: holdings of monetary policy bills	-1,871	-6,829	-6,026	-5,188	-7,366	-6,250	-7,381	-8,278	-8,278	-8,164	-8,629	-9,778	-9,879	-8,027	-9,076
Encumbered reserves	0	0	2,001	5,094	3,596	5,025	1,775	2,607	2,607	1,708	1,744	1,744	1,744	1,744	1,744
Others	3,575	4,962	7,718	8,639	7,540	9,965	6,483	10,718	10,012	10,054	10,054	10,054	10,054	10,054	10,054
Memorandum items:															
Velocity of money (annual GDP divided by average broad money)	...	7.0	...	7.1	...	...	...	...	...	...	6.7	...	...	...	6.6
Broad money (12-month percentage change)	48.8	12.1	4.6	23.4	23.8	30.7	16.6	27.8	28.2	25.0	15.0	10.0	9.7	12.9	10.0
Reserve money (12-month percentage change)	29.6	20.9	13.0	30.8	24.5	20.3	7.9	10.8	10.8	25.9	11.7	24.8	26.0	8.4	-17.5
Private sector credit (12-month percentage change)	-6.2	3.2	15.7	13.6	14.1	1.7	18.3	22.8	36.1	13.9	16.0	16.9	25.8	25.7	30.0
Net foreign assets (NFA) total	19,588	11,777	12,067	4,174	2,522	1,710	7,284	4,213	4,213	1,982	6,851	7,689	11,937	13,067	13,279

Sources: Reserve Bank of Malawi; and IMF staff estimates and projections.

1/ Track record program indicative targets.

2/ Includes merger between Stanbic Bank (formerly Commercial Bank of Malawi, CBM) and CBM Financial Services (formerly a nonbank financial institution).

3/ For actuals, NFA is calculated at the actual end-period exchange rate; for projections, NFA is calculated at the program exchange rate.

4/ The cost of the maize operation was projected as parastatal borrowing, but is now borne by the budget.

Table 5. Malawi : Monetary Authorities' Balance Sheet, 2001-04
(In millions of Malawi kwacha, unless otherwise indicated)

	2001	2001	2002	2002	2003		2003		2003	2003	2004	2004	2004	2004
	June Act.	Dec. Act.	June Act.	Dec. Act.	March		June		Sep. Proj.	Dec. Proj.	March Proj.	June Proj.	Sept. Proj.	Dec. Proj.
					TR 1/	Act.	TR 1/	Act.						
Reserve money	7,854	8,165	8,878	10,682	9,023	8,717	9,579	9,836	12,434	11,927	10,882	12,393	10,662	9,834
Currency outside RBM	5,411	4,209	6,224	6,198	5,856	5,729	6,542	8,000	7,500	6,551	6,318	8,356	8,250	7,206
Commercial bank deposits with RBM	2,443	3,956	2,655	4,483	3,167	2,988	3,037	1,835	4,934	5,376	4,564	4,037	2,412	2,628
Net foreign assets (NFA) 2/	15,932	8,769	7,193	-3,546	-3,840	-6,494	2,096	-1,153	-2,123	1,742	3,440	7,852	8,274	7,449
NFA (in millions of U.S. dollars)	215	130	95	-39.7	-41.6	-44.7	22.0	-8.6	-23.6	19.4	38.3	87.3	92.0	82.8
Gross foreign assets	290	203	128	103.5	64.6	62.8	110.0	80.6	64.8	117.5	136.4	185.5	190.3	180.5
Foreign liabilities	-75	-73	-33	-143.3	-106.3	-107.5	-88.0	-89.2	-88.4	-98.1	-98.2	-98.2	-98.3	-97.6
Net domestic assets	-8,078	-604	1,685	14,228	12,863	15,211	7,483	10,989	14,557	10,185	7,442	4,541	2,388	2,385
Credit to government (net)	-3,794	3,663	1,072	9,666	12,829	11,334	11,752	10,617	14,823	10,880	10,786	7,986	7,482	6,994
Of which: maize operation 3/	0	0	0	5,263	6,458	6,037	4,740	6,716	6,016	6,016	6,016	6,016	...	...
Credit to statutory bodies (net)	296	166	314	0	-86	0	-86	0	0	0	0	0	0	0
Credit to domestic banks	4	4	6	3	3	118	3	3	3	3	3	4	2	3
Other items (net)	-4,584	-4,437	294	4,559	117	3,758	-4,186	370	-269	-698	-3,347	-3,448	-5,096	-4,612
Revaluation accounts	-3,346	-1,653	-2,601	-3,474	-3,498	-3,495	-3,488	-3,513	-3,513	-3,513	-3,513	-3,513	-3,513	-3,513
Open market operations: holdings of monetary policy bills	-3,801	-7,746	-6,621	-5,850	-8,095	-7,018	-9,956	-8,383	-8,164	-8,629	-11,278	-11,379	-13,027	-12,544
Encumbered reserves	0	0	2,001	5,094	3,596	5,025	1,775	2,607	1,708	1,744	1,744	1,744	1,744	1,744
Others	2,563	4,962	7,515	8,789	8,115	9,246	7,483	9,658	9,700	9,700	9,700	9,700	9,700	9,700
Memorandum items:														
12-month percentage change in reserve money	29.6	20.9	13.0	30.8	24.5	20.3	7.9	10.8	25.9	11.7	24.8	26.0	8.4	-17.5
Money multiplier	2.6	2.3	2.4	2.13	2.39	2.62	2.55	2.73	2.21	2.19	2.31	2.38	2.84	2.93
Currency-to-broad money ratio	0.27	0.23	0.30	0.27	0.27	0.25	0.27	0.30	0.27	0.25	0.25	0.28	0.27	0.25
Banks' reserves-to-broad money ratio	0.12	0.21	0.13	0.20	0.15	0.13	0.12	0.07	0.18	0.21	0.18	0.14	0.08	0.09
Annual open market mop-up operation (relative to previous period)	3,027	6,483	2,819	-1,896	2,187	1,110	3,335	1,762	964	2,779	4,261	2,997	4,863	3,915
Net foreign assets (total)	15,932	8,769	9,194	1,548	-244	-1,469	3,871	1,454	-414	3,486	5,185	9,596	10,018	9,194

Sources: Reserve Bank of Malawi; and IMF staff estimates and projections.

1/ Track record program indicative targets.

2/ For actuals, NFA is calculated at the actual end-period exchange rate; for projections, NFA is calculated at the program exchange rate.

3/ The cost of the maize operation is borne by the budget.

Table 6. Malawi: Balance of Payments, 2000-07
(In millions of U.S. dollars, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007
	Act.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance (including grants)	-91.5	-116.6	-219.9	-144.2	-107.7	-109.6	-102.5	-113.5
Trade balance	-161.4	-158.0	-305.7	-190.0	-159.9	-164.4	-160.4	-174.2
Exports	401.8	426.5	421.1	434.1	466.5	498.1	527.1	548.3
Imports	-563.2	-584.5	-726.9	-624.1	-626.4	-662.5	-687.5	-722.5
Services balance	-85.8	-66.3	-159.1	-88.6	-90.8	-94.9	-98.8	-103.5
Interest public sector (net)	-20.6	-17.8	-21.7	-28.0	-24.3	-18.9	-16.7	-14.9
Receipts	12.1	8.7	2.5	1.5	4.9	9.8	11.6	13.1
Payments (amounts due before debt relief)	-32.7	-26.5	-24.2	-29.4	-29.2	-28.8	-28.3	-28.1
Other factor payments (net)	-15.8	-15.3	-15.6	-16.5	-17.4	-18.3	-19.3	-20.4
Nonfactor (net)	-49.4	-33.1	-121.8	-44.1	-49.2	-57.6	-62.8	-68.2
Unrequited transfers (net)	155.6	107.7	244.9	134.3	143.0	149.7	156.7	164.2
Private (net)	7.8	9.9	10.2	10.3	10.5	10.7	10.9	11.1
Receipts	21.8	21.8	22.3	22.6	23.0	23.4	23.8	24.3
Payments	-13.9	-11.8	-12.1	-12.3	-12.5	-12.7	-12.9	-13.2
Official (net)	147.8	97.7	234.7	124.0	132.5	139.0	145.8	153.1
Receipts	148.4	98.3	235.3	124.6	133.1	139.6	146.4	153.7
Balance of Payments (BOP) assistance	78.4	51.0	12.8	46.5	73.2	79.6	86.4	93.7
Japan HIPC Initiative	0.0	0.0	11.0	11.4	0.0	0.0	0.0	0.0
Donor humanitarian grants	0.0	0.0	135.4	0.0	0.0	0.0	0.0	0.0
Project related	69.9	47.3	76.1	66.8	59.9	60.0	60.0	60.0
Payments	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7
Capital account balance (incl. errors and omissions)	80.7	85.1	65.6	117.9	102.6	107.5	104.8	106.0
Medium- and long-term flows	65.0	59.8	23.8	80.2	56.9	56.5	52.0	48.3
Disbursements	124.9	127.0	81.0	146.0	127.4	127.7	128.0	128.4
Balance of payments support	31.4	55.0	0.0	60.0	28.8	29.1	29.4	29.8
Project support	93.5	72.0	81.0	85.9	98.6	98.6	98.6	98.6
Amortization (amounts due before debt relief)	-59.9	-67.2	-57.2	-65.8	-70.5	-71.2	-76.0	-80.1
Foreign direct investment and other inflows	27.0	28.0	37.6	38.7	45.8	51.0	52.7	57.7
Short-term capital and errors and omissions	-11.3	-2.7	4.1	-1.0	0.0	0.0	0.0	0.0
Overall balance	-10.8	-31.5	-154.4	-26.3	-5.1	-2.1	2.3	-7.5
Financing (- increase in reserves)	10.8	31.5	154.4	26.3	5.1	2.1	-2.3	7.5
Central bank	16.6	11.8	109.2	-18.2	-64.8	-52.3	-51.7	-38.7
Gross reserves (- increase)	1.7	40.7	40.8	25.6	-63.0	-38.5	-39.3	-29.4
Liabilities	14.9	-28.9	68.4	-43.9	-1.8	-13.7	-12.4	-9.3
Of which: IMF (net)	-1.8	-7.8	15.6	3.3	-1.9	-13.8	-12.4	-9.3
Purchases/drawings	8.4	0.0	23.0	17.5	35.1	0.0	0.0	0.0
Repurchases/repayments	-10.2	-7.8	-7.4	-14.3	-36.9	-13.8	-12.4	-9.3
Bridge loan	0.0	0.0	50.0	-50.0	0.0	0.0	0.0	0.0
Commercial banks	-5.7	-7.7	14.6	-7.0	-8.0	-9.0	-10.0	-10.5
Debt relief	0.0	27.4	30.6	51.5	77.9	63.3	59.4	56.7
Residual financing gap (+ underfinanced)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Gross official reserves								
In millions of U.S. dollars	243.6	202.9	162.1	136.5	199.5	238.0	277.3	306.7
In months of imports 1/	4.3	3.0	2.7	2.2	3.1	3.5	3.9	4.1
In months of imports 2/	4.4	3.6	2.4	2.3	3.3	3.7	4.1	4.3
Usable gross official reserves								
In millions of U.S. dollars	224.6	184.6	103.5	117.5	180.5	219.0	258.3	287.7
In months of imports 1/	4.0	2.7	1.7	1.9	2.8	3.2	3.6	3.9
In months of imports 2/	4.1	3.3	1.5	1.9	3.0	3.4	3.8	4.1
Current account balance (percent of GDP)								
Excluding official transfers	-14.1	-12.7	-23.9	-15.3	-13.3	-12.8	-11.7	-11.8
Including official transfers	-5.4	-6.9	-11.6	-8.2	-6.0	-5.6	-4.8	-5.0
Export value growth (in percent)	-10.1	6.1	-1.2	3.1	7.5	6.8	5.8	4.0
Import value growth, excluding maize (in percent)	-16.4	2.3	1.1	4.2	0.4	5.8	3.8	5.1
Prospective BOP financing (grants & loans) (millions of US\$)	...	...	...	106.5	102.0	108.8	115.9	123.5
Identified financing	...	...	...	106.5	...	...	...	...
Financing expected but not yet confirmed	...	...	...	0.0	102.0	108.8	115.9	123.5

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

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

2/ In months of current year's imports of goods and nonfactor services.

Table 7. Malawi: Quantitative Performance Criteria Under the PRGF Arrangement, 2000 1/
(In millions of Malawi kwacha, unless otherwise indicated)

	End-December 2000 2/			Comment
	Program 3/		Actual	
	Unadjusted	Adjusted		
Ceiling on the stock of reserve money 4/ 5/	6,980	6,980	7,119	Not observed
Floor on the net foreign assets (NFA) of the monetary authorities 6/ (in millions of US\$)	121	113	141	Observed
Ceiling on the net domestic financing of the central government 7/, 8/	976	867	2,135	Not observed
Clearance of new domestic budgetary arrears 9/	...	...	... 10/	Observed
Ceiling on the stock of external arrears 11/	0	0	0	Observed
Ceiling on contracting or guaranteeing of external debt by the central government and the Reserve Bank of Malawi (RBM) Medium and long term 12/	0	0	0	Observed
Short term 13/	0	0	0	Observed
Memorandum items:				
Balance of payments support for NFA adjuster as defined in December technical memorandum of understanding (TMU) (in millions of US\$) 14/	62	...	54	
Balance of payments support for net credit to the central government adjuster as defined in December 2000 TMU (in millions of US\$) 15/	62	...	62	
Transfers from the RBM to the central government	0	0	0	

1/ Targets for reserve money and net foreign assets relate to the respective stocks. All other targets are expressed as cumulative changes from June 30, 2000.

2/ Performance criteria.

3/ As set forth in EBS/00/263 (12/11/00).

4/ The ceiling is set as averages of monthly end-period reserve money.

5/ The ceiling has been adjusted downward (upward) to reflect any decrease (increase) in the RBM reserve requirements on deposits.

6/ The floor has been adjusted downward (upward) for any shortfall (excess) of balance of payments support from its programmed levels, up to a maximum of US\$50 million.

7/ The ceiling has been adjusted upward (downward) for any shortfall (excess) of balance of payments support from its programmed level, up to a maximum of US\$50 million.

8/ The ceiling has been adjusted downward (upward) for any transfer in excess of (below) the baseline from the RBM to the central government.

9/ Any new domestic budgetary arrears verified during the quarter, to be cleared by the end of the following quarter.

10/ No new domestic budgetary arrears were accumulated in July-September 2000.

11/ Applicable on a continuous basis.

12/ Excluded from the limit is the use of Fund resources; adjustment lending from the World Bank, the African Development Bank, and other multilateral agencies; debt to restructure, refinance, or repay existing debts; and concessional debts.

13/ Includes debt with maturity up to and including one year. These limits do not apply to any disbursements from (i) debts classified as international reserve liabilities of the monetary authorities; (ii) debts to restructure, refinance, or prepay existing debts; (iii) kwacha-denominated treasury bills and local registered stocks held by nonresidents; (iv) normal import financing; and (v) export performance guarantees by the RBM.

14/ Includes IMF disbursements and excludes HIPC Initiative debt relief and a U.S. Agency for International Development railways disbursement of US\$8 million, received by the RBM on June 28, 2000 but passed on to the central government's account only on July 7, 2000.

15/ Includes IMF disbursements and excludes HIPC Initiative debt relief.

Table 8. Malawi: Structural Measures Under the PRGF Arrangement, 2000-03

Measures	Objectives	Timing	Status as of July 2003
I. Structural Performance Criteria (EBS/00/263)			
1. Compilation by the Ministry of Finance of a consolidated fiscal report assessing the prospects for meeting the budget targets in 2000/01.	Enable government to meet budget targets in 2000/01 and beyond.	June 2001	Implemented; reporting system is in place for current budget targets.
2. Commencement of full operation of the Public Enterprise Reform and Monitoring Unit (PERMU) in the Ministry of Finance to monitor the activities of parastatals.	Ensure that parastatal bodies are run on a sound commercial basis and avoid drain of budgetary resources.	End-December 2000	Implemented by July 2002.
3. Avoidance of any new borrowing by National Food Reserve Agency (NFRA).	Ensure that no additional financial burden is put on the budget.	Continuous	Breached in September 2001; implemented since then.
II. Structural Benchmarks (EBS/00/263)			
1. Receipt from line ministries of 100 percent of monthly returns under the new commitment control system (CCS), starting with returns from December 2000.	Strengthen expenditure control system.	End-January 2001.	Implemented by December 2002.
2. Dissemination of quarterly reports on spending on priority (poverty-related) programs starting with the third quarter of 2000 and with target publication date of one month after the end of the quarter.	Strengthen expenditure control system and ensure proper accountability of pro-poor expenditures (PPEs).	End-December 2000.	Implemented by June 2001.
3. Maintenance of uniform access by all growers to the tobacco sales network and preservation of the intermediate buyers' system or equivalent mechanism.	Promote direct exports, facilitate contract farming.	Continuous	Implemented by June 2001.

Table 8. Malawi: Structural Measures Under the PRGF Arrangement, 2000-03

Measures	Objectives	Timing	Status as of July 2003
4. Pursuit of official investigators and prosecutors of all evidence of fraud, corruption, and misappropriation of public funds identified in reports of Auditor General, particularly in the case of the Petroleum Control Commission (PCC) and public procurement.	Ensure accountability for public funds and root out corruption and abuse of office in the public sector.	Continuous.	Partially implemented. The external audit of the National Food Reserve Agency was completed, and the Anti-Corruption Bureau (ACB) plans to review the audit report and identify any people or institutions that may have violated the law. The staffing of ACB is being increased, and judges presiding over anti-corruption cases are being trained. Amendments to Corrupt Practices Act are to be resubmitted to parliament in October 2003, which would expedite the work of the ACB and allow it to prosecute cases without prior approval of Director by the Public Prosecutions.
5. Recovery of MK 150 of revenue lost through tax evasion as assessed by the Malawi Revenue Authority (MRA).	Strengthen revenue collections.	End-February 2001.	Not implemented; the MRA could not provide sufficient evidence in court to pursue the case; and the case closed by July 2002.
6. Removal of legal obstacles preventing implementation of complete book-entry system for government securities before end-2001.	Improve the management and reporting of government debt.	End-December 2000.	Implemented in May 2001.
7. Formalization of the system for authorizing parastatal borrowing.	Improve the management and control system of public sector debt.	End-April 2001.	Implemented and codified in the Public Finance Management Act of May 2003.

Table 8. Malawi: Structural Measures Under the PRGF Arrangement, 2000-03

Measures	Objectives	Timing	Status as of July 2003
III. Measures Introduced in July 2002 (EBS/02/131)			
<p>1. Commercialization of the Agricultural Development and Marketing Corporation (ADMARC) in preparation for its privatization (including its subsidiaries: Cold Storage; Shire Bus Lines; Grain and Milling; and David Whitehead and Sons).</p>	<p>Prepare privatization of subsidiaries of ADMARC to increase private sector participation, intensify competition, and reduce drain on government budget.</p>	<p>End-March 2003.</p>	<p>Partially implemented.</p> <ul style="list-style-type: none"> • Lilongwe unit of Cold Storage was privatized. • Privatization of David Whitehead and Sons held up in court.
<p>2. Privatization of the two main subsidiaries of Malawi Development Corporation (Sunbird Tourism and Malawi Property Investment Company); Malawi Telecom Limited (MTL); and Air Malawi.</p>	<p>Increase private sector participation, intensify competition, and reduce drain on government budget.</p>	<p>End-December 2002.</p>	<p>Partially implemented:</p> <ul style="list-style-type: none"> • Sunbird Tourism was privatized in March 2003. • The selected bidder for Air Malawi withdrew his offer. • Privatization of several companies has been delayed because of difficult macroeconomic situation.

Table 9. Malawi: Indicators of the Use of Fund Credit, 2003-2010 1/

	2003	2004	2005	2006	2007	2008	2009	2010
	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of SDRs)							
Outstanding credit (end of period) 2/	75.2	91.8	79.4	61.5	48.1	42.8	39.9	38.7
IMF disbursements	12.9	25.8	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service	4.0	9.9	13.0	18.3	13.7	5.6	3.0	1.5
Repayments	3.6	9.2	12.4	17.9	13.4	5.4	2.8	1.3
Charges and interest	0.4	0.7	0.7	0.5	0.3	0.2	0.2	0.2
	(In percent)							
Fund credit outstanding/total debt	3.6	4.2	3.6	2.8	2.2	1.9	1.7	1.7
Fund credit outstanding/total quota	108.4	132.2	114.4	88.7	69.4	61.6	57.6	55.7
Debt service to the Fund/total debt service	5.0	12.1	15.6	21.4	15.9	6.4	3.4	1.8
Debt service to the Fund/exports of goods and services	1.1	2.6	3.2	4.2	3.1	1.2	0.6	0.3
Debt service to the Fund/total quota	5.8	14.3	18.8	26.4	19.8	8.0	4.3	2.1
Debt service to the Fund/gross external reserves	4.0	6.8	7.7	9.2	6.3	2.3	1.1	0.5
Debt service to the Fund/GDP	0.3	0.7	0.9	1.2	0.8	0.3	0.2	0.1
Memorandum items:	(In millions of SDRs)							
Quota	69.4	69.4	69.4	69.4	69.4	69.4	69.4	69.4
Stock of external debt	2,111.4	2,167.3	2,179.9	2,209.1	2,237.8	2,265.3	2,291.4	2,324.8
Total debt service (without any debt relief)	79.1	82.3	83.5	85.7	86.3	87.5	89.2	81.7
Total exports of goods and nonfactor services	360.8	385.3	409.4	431.6	448.1	465.1	485.5	504.0
Gross external reserves	100.3	146.4	169.8	198.3	219.6	240.8	269.4	289.1
Nominal GDP	1,294.1	1,328.0	1,431.6	1,562.5	1,663.7	1,792.3	1,904.7	2,052.6
Exchange rate (US\$ dollars per SDR 1)	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36

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

1/ On an obligation basis.

2/ Assumes disbursements under the PRGF arrangement as per Appendix I, Table 4.

September 19, 2003

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

Dear Mr. Köhler:

1. On December 21, 2000, the Executive Board of the International Monetary Fund (IMF) approved a three-year arrangement for Malawi under the Poverty Reduction and Growth Facility (PRGF). The implementation of our poverty reduction and growth strategy supported by the arrangement has been slower than envisaged owing to serious slippages in macroeconomic policies, and recurrent droughts that severely complicated macroeconomic management and aggravated poverty conditions for our rural population. The government recognizes that the delayed implementation of macroeconomic and structural policy reform has also impeded Malawi's progress toward the completion point under the enhanced HIPC Initiative. To this end, the government has recently made serious efforts to improve macroeconomic management and accelerate the pace of structural reforms. These efforts culminated in the implementation of our track record program during the first half of 2003.
2. In light of the above, the government is committed to reestablishing macroeconomic stability and accelerating structural reforms. It is making serious efforts to put its macroeconomic program back on track. The attached memorandum of economic and financial policies (MEFP) describes Malawi's economic and financial policies for 2003/04 (July-June), which aim to consolidate the economic gains achieved in 2002/03 and facilitate the conclusion of the first review under the PRGF arrangement. The program is derived from the Malawi poverty reduction strategy paper and builds on the policy measures outlined in our letters of intent of July 19 and August 22, 2002, and of May 28, 2003. On this basis, and in light of performance under our track-record program implemented during January-June 2003, we request a waiver of the nonobservance of performance criteria specified in paragraphs 2 (a)(i) and (iii), and 2(b)(i)(1) and (2) of the arrangement with respect to the second disbursement. Specifically, in light of the corrective measures taken, waivers are being requested for the nonobservance of the following performance criteria: (i) the ceilings on the stock of reserve money; (ii) the ceilings on the net domestic financing of the central government; (iii) the commencement of full operations of a unit in the Ministry of Finance to monitor the activities of parastatals and the completion of a first quarterly report by December 31, 2000; and (iv) the compilation by the Ministry of Finance of monthly reviews which summarize the ministries' monthly reports on commitment levels and arrears and assess the prospects for meeting budget targets in 2000/01.
3. We also request that the first review under the PRGF arrangement be completed, and that a disbursement of SDR 6.45 million be approved upon completion of the review.

Furthermore, we request that the current PRGF arrangement be extended through December 20, 2004, and that the remaining undrawn balance of SDR 32.23 million be disbursed in five equal installments of SDR 6.45 million each upon completion of subsequent quarterly reviews. We intend to repurchase early existing obligations of SDR 17.35 million under the Fund's emergency assistance policy in five equal installments, starting with the third disbursement under the PRGF arrangement available on November 15, 2003. Finally, following the completion of the first review, we request that debt relief from the IMF, under the enhanced HIPC Initiative, be resumed. The second program review will be completed no later than November 14, 2003.

4. The government of Malawi believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Malawi will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation.

5. The government of Malawi authorizes the IMF to make this letter, the attached MEFP, and the IMF staff reports relating to our PRGF program, available to the public, including through the IMF internet website.

Sincerely yours,

/s/
Dr. Ellias E. Ngalande
Governor
Reserve Bank of Malawi

/s/
Friday A. Jumbe
Minister of Finance

Attachments

MALAWI

**Memorandum of Economic and Financial Policies
of the Government of Malawi**

September 19, 2003

I. BACKGROUND AND PROGRAM IMPLEMENTATION

1. **Notable progress was made during 2002-03 in reducing inflation and implementing structural reforms. Moreover, the food shortage that occurred during that period was successfully contained through a large-scale humanitarian aid effort and government maize imports.**
2. **Growth over the past few years, however, was too low to reduce poverty.** Real GDP contracted by more than 4 percent in 2001, and preliminary data indicate that growth remained below 2 percent in 2002. Growth in the manufacturing and services sectors is estimated to have remained negligible due to the low agricultural and agro-processing output and high real interest rates. Industrial activity shrank to its lowest level in more than a decade. Agricultural output is projected to rebound strongly during 2003; however, overall real GDP is expected to recover modestly as growth in other sectors continues to be negatively impacted by the persistent high real interest rates.
3. **The disinflation program has been broadly successful, but real interest rates remain high, raising concerns about output losses.** Since end-2000, inflation has fallen considerably. The official 12-month inflation rate declined to 8½ percent in June 2003, from 35 percent at end-2000, attributable largely to the sharp decline in food prices. Real interest rates, however, have remained at over 30 percent, owing to an expansionary fiscal policy and persistently high inflation expectations, which remain deeply entrenched because of a history of disinflation policy reversals.
4. **The 2002/03 (July-June) budget approved by parliament envisaged strong fiscal adjustment by reducing the domestic deficit to 4¼ percent of GDP (excluding the costs of the 2002/03 maize operation), from 7¾ percent of GDP in 2001/02.** However, certain pressures emerged that made it difficult to attain the budget's fiscal targets. First, the interest bill was higher by 1.7 percent of GDP, as the budget estimate relied on an understated debt stock and donor budgetary support was withheld. Second, adjustments in civil servants' allowances were underestimated adding about 1 percent of GDP to the wage bill. Finally, several line items were underfunded by about 2.7 percent of GDP. However, revenues were buoyant, exceeding budget projections by about 2.5 percent of GDP, reflecting in part to additional measures detailed below. The deficit was thus contained to 7.1 percent of GDP (excluding the 2002/03 maize operation), thanks to remedial revenue measures that were introduced in December 2002 and efforts to strengthen public expenditure management.

5. The following revenue measures were introduced, yielding additional revenue equivalent to 0.8 percent of GDP:

- the collection of interim dividends and overdue obligations on on-lending operations from parastatals in February 2003 (0.5 percent of GDP);
- the taxation of housing allowances of higher-ranked civil servants on February 1, 2003 (0.1 percent of GDP);
- an increase in the license fee and the frequency of the certificate of fitness (0.1 percent of GDP);
- the suspension of import duty remissions, except to NGOs, on January 1, 2003 (0.1 percent of GDP);
- an increase in the fee for the price stabilization fund for petroleum products in May 2003; and
- an increase in the road levy by 95 tambala per liter on February 1, 2003.

6. At the same time, measures were taken to reduce nonpriority expenditures. A circular from the Office of the President and Cabinet (OPC) was issued in December 2002 requiring cuts in outlays on travel, locally funded capital projects and foreign service allowances. In the event, these cuts proved difficult to put into effect or were offset by overruns in other current outlays. Nevertheless, the following measures succeeded in reducing outlays by effecting the remission to the treasury revenue collection previously used by ministries and government agencies:

- subvented parastatal organizations were funded only after they have presented evidence of remittances of the pay-as-you-earn (PAYE) tax to the Malawi Revenue Authority (MRA); and ministries were funded net of PAYE, with the Secretary to the Treasury remitting PAYE deductions directly to the MRA.

7. Control mechanisms were introduced in the payroll system to reduce ghost employees. Measures were taken to improve the system's security, establish a computer-assisted payroll audit system, and conduct pay parades in the ministries of education, agriculture, health, natural resources, defense and home affairs. All irregularities uncovered during these checks have been addressed.

8. Furthermore, the government took measures to enhance systems to control and monitor expenditure (Chapter 4.4.3.1),¹ and to improve the tracking of pro-poor expenditure, in order to implement the MPRSP priorities (Chapter 4.4.3.1) (see Table 3).

¹ All chapter references are with respect to the Malawi poverty reduction strategy (MPRS) paper.

9. The apparatus for monitoring, control, and clearance of domestic budgetary arrears was strengthened. To this end,

- regular monitoring of the arrears by the Budget Division in the Ministry of Finance was instituted in April 2003, including through monthly reports to senior management and follow-up with line ministries; and
- the government continued to pay off any new expenditure arrears within the current budgetary allocations of line ministries, and decided not to carry out offsetting operations, and to clear arrears within the calendar quarter in which they are verified.

10. The 2002/03 food shortage was successfully contained through a combination of food aid and the government purchase of commercial maize. Budgetary outlays in 2002/03 related to the government's maize operation are now estimated at about 4.4 percent of GDP (including interest costs and operational losses, but net of proceeds from the sale of maize during the fiscal year). As part of the food crisis response, the government imported 235,000 metric tons (which together with carryover stocks of 16,000 metric tons totalled 251,000 metric tons of maize) to partly fill the then estimated food gap of about 600,000 tons. In retrospect, the estimated food gap proved to be on the high side. Moreover, as the government and donors seriously underestimated the capacity of the private sector to respond to food shortages, the government was only able to sell about 43,000 tons of maize during the fiscal year. Following its decision in 2003 to increase the maximum stock of maize to be held as Strategic Grain Reserve (SGR) to 100,000 tons, the government has designated 44,700 tons to the SGR.² Accordingly, as at end June 2003, about 163,300 tons were available for commercial sale. The government expects to sell this balance during fiscal year 2003/04. It has already received commitments from the European Union to finance the purchase of 10,000 tons of maize in support of the WFP's humanitarian relief effort, and 22,000 tons of maize to restock the SGR. It has also recently tendered a further 100,000 tons for commercial sale. The gross proceeds accruing to the budget from the above sale of maize during 2003/04 is estimated at about MK 1.5 billion (or about 0.9 percent of GDP). If the remaining 31,000 tons are also sold during 2003/04, additional revenue of about 0.2 percent of GDP could be realized.

11. While the overall fiscal target for the first half of 2002/03 (July–December) was missed by ½ percentage point of GDP (excluding the maize operation), despite the higher-than-budgeted revenue collection, during the second half of the fiscal year fiscal performance remained broadly on target. Our track-record program targets for end-March

² As at end-June 2002, the stock of maize in the SGR was 11,000 metric tons. During fiscal year 2002/03, the European Union contributed 18,000 tons to the SGR, and the government designated 44,700 tons of its commercial maize for the SGR. Thus, at end-June 2003, the level of SGR rose to 73,700 tons. The European Union has pledged to make a further contribution of 22,000 tons to the SGR in early 2003/04 by purchasing maize from the government. This would raise the level of the SGR to 95,700 tons.

and end-June 2003 were achieved, thanks to continued better-than-projected revenue collection, and savings on interest charges because of a shift in these payments to the next fiscal year with the issuance of longer-maturity government debt. For the year as a whole, the domestic budget deficit (excluding the maize operation) amounted to 7.1 percent of GDP (11.5 percent of GDP, including the maize operation). Due to the large (11.5 percent of GDP) shortfall in external budgetary support, the budget relied heavily on domestic financing. The government intensified efforts to protect pro-poor spending, and, despite increased efforts to reduce expenditures, these programs were generally implemented as budgeted, reaching nearly 10.9 percent of GDP (including 3.7 percent related to the government's 2002/03 maize operation). Reports on pro-poor spending are now routinely published.

12. Monetary policy, which has been the cornerstone of the stabilization effort, slipped in the second half of 2002 and the first half of 2003. Attainment of the Reserve Bank of Malawi's (RBM's) policy objectives was greatly hampered by the higher-than-programmed reliance on domestic financing by the government budget, and by the fast decline in its foreign exchange reserve holdings, owing, in part, to the emergency purchase of food imports. For June 2002, the indicative target for reserve money, the RBM's operational monetary target, was exceeded by about 3 percent, and for December 2002 by 18 percent. For the greater part of the period January-June 2003, reserve money growth exceeded the RBM's operational target by 10-15 percent. This monetary expansion has contributed to a depreciation of the kwacha of 17 percent against the U.S. dollar since end-June 2002 and created the potential for inflationary pressure.

13. Progress was made in implementing structural reforms. Sunbird Tourism and many of government's minority shareholdings were divested through public offerings. The sale of the Lilongwe unit of Cold Storage was completed in early March 2003. Moreover, the government has reached an agreement with all concerned parastatals on the repayment of on-lending arrangements currently in arrears. Although several measures, including the privatization of Shire Bus Lines, Malawi Telecom Limited (MTL), and Malawi Property Investment Company (MPICO) have been delayed, progress is being made in preparing these enterprises for privatization by end-2003. The selected bidders for Air Malawi decided not to takeover the company. The preferred bidder for David Whitehead and Sons was announced in early February 2003, but the privatization process was interrupted by legal challenges by a creditor bank and company employees.

II. POLICIES AND MEASURES FOR 2003/04

A. Macroeconomic Policy Objectives

14. Our poverty reduction strategy aims at reducing the incidence of poverty to 59 percent in 2005 from 65 percent in 1998. We have adopted a four-pronged strategy to achieve the higher and sustained economic growth necessary to make a substantial dent on poverty (Chapter 1.3): to promote sustainable pro-poor growth by offering the poor an opportunity to increase their living standards and providing the private sector with an enabling environment for investment;

- to develop human capital, as a healthy and educated population will be more productive, and to reduce income inequality, as it restricts the productive potential of the poor;
- to improve the quality of life for the most vulnerable by strengthening their resilience to shocks through social safety net programs; and
- to establish good governance, thereby ensuring that public institutions and systems protect and benefit the poor.

15. **The medium-term macroeconomic framework envisages attaining sustained growth of 5½ percent, reducing inflation to below 5 percent, and depending upon the level of sustained donor support, rebuilding international reserves to about 3½ months of imports by end-2005.** Initially, the return to macroeconomic stability will provide the basis for lower interest rates and a rebound in private sector activity. Moreover, policies to promote broad-based growth in agriculture are expected to provide food security and income enhancement for the poor. Strong fiscal adjustment in 2003/04 will provide room for the repayment of the government's domestic debt, and for the required increase in private sector credit and investment, while pro-poor expenditure should increase with the decline of the government's interest bill. Monetary policy, in conjunction with a flexible exchange rate regime, will remain geared to achieving the targeted reduction in inflation. The external current account deficit should narrow in line with higher public and private savings, and external debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative will help Malawi progress toward long-term debt sustainability.

16. **The economic and financial policies for 2003-04 described in this memorandum emanate from the MPRS and aim at consolidating the progress achieved so far under the program and making progress toward the key objectives of our poverty reduction strategy.** The macroeconomic objectives for 2003-04 are the following: (i) a rebound in economic growth to 5-6 percent, driven by small-scale agricultural production, manufacturing, mining, and tourism; (ii) containing inflation at 9 percent in 2003 and 7 percent in 2004; and (iii) increasing international reserves to about three months of imports of good and nonfactor services by end-2004.

17. **During 2003, the government conducted workshops with MPRS stakeholders to review the MPRS, including its macroeconomic framework, and to make recommendations for the 2003/04 budget.** These workshops also reviewed the list of pro-poor expenditures (PPEs), with a view to establishing output-based monitoring in time for the 2003/04 budget (Chapter 6.2). The first annual review of the MPRS was completed in March 2003.

B. Fiscal Policy

18. **Large fiscal deficits have been crowding out private sector investment and led to a rapid increase in domestic debt to 15½ percent of GDP at end-2002, from less than 9 percent of GDP at end-2000.** A decisive turnaround in fiscal policy is needed to establish

macroeconomic stability, halt the increase in the domestic public debt, and create an environment conducive to private sector-led growth (Chapter 5.2.2):

- Strong fiscal adjustment in 2003/04, will be underpinned by the full year impact of fiscal measures introduced in 2002/03, the new fiscal measures, and the avoidance of extra-budgetary outlays. Some of the fiscal measures introduced but partially implemented in 2002/03 will have been fully implemented or replaced in the new fiscal year. For instance, road tolls have been replaced by a further increase in the fuel levy.
- In the medium term, large primary surpluses, after grants, will reduce the domestic debt stock and debt-service costs, and will allow for a sizeable expansion in private sector credit. In this context, understandings will be reached on the macroeconomic framework and the budgetary targets for 2004/05 at the time of the discussions relating to the third review to be conducted in May 2004.

The strategy for 2003/04

19. **For 2003/04, the government will target a domestic fiscal deficit (excluding maize operations) of 3.8 percent of GDP, to lay the basis for a sharp reduction in domestic debt in the medium term.** Much of the fiscal adjustment will be achieved as a result of the full-year impact of the fiscal measures already implemented and additional revenue and expenditure measures equivalent to 3.1 percent of GDP to bring about a more sustainable position, as described below. Moreover, the government expects that its debt and associated servicing costs will be reduced by the resumption of donor budgetary assistance. Reflecting projected donor grants equivalent to 13 percent of GDP, the overall balance (including grants) will thus improve sharply. The projected deficit³ would be reduced further when the excess 163,300 tons of maize is sold (para. 11). The program provides for reductions in the stock of domestic arrears (which are estimated at MK 400 million as of end-June 2003); these arrears are to be reduced by MK 100 million by end-December 2003. Thereafter, the stock of these domestic arrears, as determined through the external audit, will be reduced according to a timetable to be agreed by end-January 2004.

20. **Revenues are expected to rise to 21.8 percent of GDP from 20.5 percent of GDP in 2002/03.** The full-year effect of the tax on housing allowances and of the increase of the road fee and of the fee for motor vehicles' certificate of fitness are expected to yield additional revenues of about 0.6 percent of GDP, which will compensate for the dividends that were received in 2002/03. The surtax rate has been reduced from 20 to 17.5 percent. While this in itself would have reduced the proceeds by 0.75 percent of GDP, it will be compensated by the expansion of the domestic surtax base, thanks to the registration of 700 additional traders—a 30 percent increase vis-à-vis last year (yielding 0.25 percent of GDP)—

³ The domestic budget deficit (including maize operations) is defined as total domestic revenue less total domestic expenditures, including domestic interest charges (as defined in the TMU).

and of 17 nonlife insurance companies following the passage of the surtax amendment bill in March 2003 (yielding 0.5 percent of GDP).

21. **The government has taken several administrative measures to build upon last year's progress on revenue collection, which are expected to yield 0.25 percent of GDP.** First, the Malawi Revenue Authority (MRA) has hired 320 additional collectors (a 30 percent increase) and has been allocated MK 300 million for transportation and communications equipment. Additional administrative measures to boost revenue collection include the following: (i) a door-to-door trader verification campaign to ensure that the all surtax proceeds are remitted to the MRA; (ii) the provision that all declarations must be accompanied by a certified check to avoid the proliferation of bad checks; (iii) the migration to the automated system of customs declaration and administration (ASYCUDA) during 2003/04 with an advanced classification and valuation module; and (iv) the enhanced use of surtax turnover information for evaluation of income tax returns. Finally, duty waivers, remissions and mitigations will continue to be suspended.

22. **Additional measures have been implemented to enhance revenue during 2003/04:**

- Ad valorem excise tax rates on petroleum products have been doubled (to 40 percent for petrol and diesel, and to 20 percent on paraffin). This is expected to yield about 0.8 percent of GDP.
- The government will make use of any decrease in petroleum product prices to augment government revenue instead of lowering retail prices for petroleum products.
- The excise rate on alcohol products has been increased by 10 percent, yielding about 0.2 percent of GDP.

23. **Overall expenditure is projected to remain at about 35.2 percent of GDP.** The interest bill will rise significantly on account of the longer maturity government domestic debt issued during 2002/03, and the later-than-anticipated decline in projected real interest rates. Other current expenditure would decrease significantly, as expenditures for bailouts of parastatals and extrabudgetary commitments are avoided. **These projections incorporate additional outlays for local, parliamentary, and presidential elections in 2004. They also include new expenditure measures aimed at generating savings for about 1.9 percent of GDP.** These savings are realized through reductions in budgeted travel outlays, nonfilling of vacancies generated by attrition, avoidance of promotions, and postponement of new domestically financed projects and other nonpriority recurrent expenditures. Pro-poor expenditure on MPRS priorities is projected to reach 8.3 percent of GDP.⁴

24. **The implementation of the budget will be carried out on a cash basis in such a way as to hold on a monthly basis domestic expenditures (including domestic interest)**

⁴ This figure includes expenditures on Malawi Social Action Fund (MASAF) projects.

closely in line with the domestic revenues mobilized, with the least amount of new borrowing from the domestic banking system. When foreign budgetary aid is received, it will be used mostly to repay domestic debt. A major problem in controlling government expenditure has been the difficulty in controlling expenditure commitments at the treasury in the context of a decentralized expenditure management system. Line ministries have limited capacity for monitoring and enforcing expenditure commitments. In view of the fact that the Ministry of Finance has primary responsibility for fiscal management, the system of treasury agents in line ministries will be strengthened by placing senior Treasury personnel as agents under direct control of the Secretary to the Treasury, to control and ensure that expenditure commitments remain within authorized limits, and that payments by ministries conform with the treasury allocation.

25. Moreover, the government, with the assistance of the World Bank, developed a medium-term wage policy. The new wage policy, which resulted from a comprehensive consultancy, is aimed at improving the wage competitiveness, strengthening public sector performance, and lowering attrition rates (Chapter 4.4.3.2). Its major elements are the following:

- develop an action plan for a comprehensive revision of the public service pension scheme (September 2003);
- publish the Policy Statement on wage policy (October 2003);
- establish a Public Service Remuneration Board (by October 2003);
- engage a Pay Policy Advisor (by November 2003);
- rationalize salary grades and move towards a unified salary structure (by December 2003);
- consolidate allowances into the salary structure (December 2003);
- recruit of staff based on established position and only those budgeted for (on-going);
- enhance of salaries to attract and retain scarce and critical personnel (June 2004); and
- establish an upper limit for contract renewals as appropriate (June 2004).

26. The management of public finances was substantially improved by the coming into effect of the Public Finance Management Act (PFMA) and the Public Procurement Act (PPA) in June 2003. The PFMA replaces and improves upon the Finance and Audit Act, by adopting a more comprehensive concept of public finance management requiring the government to produce detailed economic, fiscal, and financial reports. The PPA creates a new office of the Director of Public Procurement (ODPP) and strengthens controls and safeguards on public procurement. A timetable and regulations for implementing these two acts are being elaborated with support from the World Bank.

27. **In 1995, the government introduced the medium-term expenditure framework to improve public expenditure management by linking fiscal policy and resource allocation to medium-term strategic priorities identified under the MPRS.** Although progress has been achieved in shifting resources to priority sectors, the implementation of the MTEF in line with the MPRS has been impeded by the suspension of external budgetary aid, significant extrabudgetary spending and continuing divergences between approved budgets and actual outlays. The government intends to strengthen the implementation of the MTEF by enforcing fiscal discipline and better prioritization of public expenditures in line with the MPRS.

28. **During 2000, the government introduced two expenditure control and reporting systems aimed at the better tracking and recording of expenditures commitments and payments: the Commitment Control System (CCS) and the Credit Ceiling Authority (CCA).** These systems, together with the quarterly funding reports, have provided the basis for expenditure reporting and control under a system of decentralized fiscal management. During 2002/03 we strengthened these systems by improving the tracking of the PPEs, and simplifying the requirements of the CCS to make it easier for controlling officers to comply. The government plans to strengthen these systems further by extending the Integrated Financial Management Information System (IFMIS), the accounting package, to more line ministries which should allow the Treasury greater overall control over commitments and payments. In the interim, the Accountant General has established a Performance Monitoring Unit which will work closely with the Budget Division of the Treasury to follow up on the implementation of the CCS system, the status of bank reconciliation, the submission of expenditure and commitment returns and the maintenance of records.

29. **To assist in strengthening the expenditure systems, the government plans to seek technical assistance to review and strengthen these systems, and to improve expenditure recording and monitoring.** The Ministry of Finance also plans to strengthen its capacity for economic and financial analysis and reporting. Line ministries have an urgent need to develop capacity for financial management and reporting.

C. Monetary Policy

30. **The RBM will continue to rely on the broad money stock (M2) as the nominal anchor to control inflation, with the RBM's net domestic assets (NDA) and the banking system's net claims on the central government (NCG) as the operational targets.** The RBM will rely on NDA and NCG as the principal instruments to achieve the monetary policy objectives. In addition, a floor will be placed on net foreign assets of the monetary authorities (NFA). The growth of broad money is to be limited to 15 percent in 2003 and 11 percent in 2004.

31. **Consistent with the use of money as the nominal anchor, the exchange rate of the kwacha will continue to be market determined.** The RBM's interventions will, therefore, be limited to meeting the NFA target and smoothing exchange rate movements.

32. Further actions will be taken to develop the financial sector and reduce the costs of financial intermediation, including by

- reducing the export surrender requirement from 40 percent to 20 percent by end-June 2004, with a view to eliminating it altogether by end-December 2004;
- lowering the liquidity reserve requirement from 30 percent to 10 percent by end-December 2004, while mopping up any resulting liquidity injection, as needed, by open market operations;
- implementing the timetable of measures for the review of the financial sector regulatory framework, which was developed through a consultative process (Chapter 5.2.2.3); and
- continuing to implement the recommendations of the safeguards assessment by addressing delays in issuing of annual financial statements of the RBM, and reconciling the foreign reserve balances on a daily basis by end-December 2003.

33. The government will continue to develop the microfinance framework to facilitate, in particular, small-scale agricultural development, agro-processing, and small-scale mining (Chapter 4.1.2.2). This emerged as a core national development priority during the MPRS consultations, on which the cabinet acted by approving in November 2002 a microfinance policy. The next step is to develop the regulatory framework for microfinance, which is expected to receive cabinet approval by end-2003.

D. External Sector

34. The external current account deficit (excluding official grants) should narrow sharply in 2003, to about 15 percent of GDP, and to about 13 percent in 2004, from some 24 percent of GDP in 2002. Most of the improvement reflects the discontinuation of maize imports as a result of the improved food situation and a noticeable recovery in exports. The current account deficit will be financed through disbursements of donor grants and of concessional loans from the World Bank, the African Development Bank, and other donors. Gross external reserves of the RBM are projected to rise to about 3½ months of import cover by end-2005.

35. Debt relief under the enhanced HIPC Initiative will support Malawi's goal to attain long-term debt sustainability. While the net present value of debt-to-exports (including Paris Club pledges beyond Cologne terms) is somewhat less favorable than estimated earlier, it is projected to decline to below 170 percent by the end of this decade. An acceleration of export growth as a result of greater efficiency in tobacco-marketing arrangements and increased market access under the U.S. African Growth and Opportunity Act (AGOA) and the European Union's Everything But Arms (EBA) Initiative could further improve this key debt sustainability indicator. The government will continue efforts to secure debt relief from all external creditors.

36. The government imposed at end-2001 temporary import restrictions in response to claims of unfair trading practices by Zimbabwe. On a temporary basis, the government will introduce tariffs on imports from Zimbabwe to replace the current system of quantitative restrictions by end-December 2003. The tariffs will be reviewed every six months. The implementation of tariffs will automatically abrogate the Malawi-Zimbabwe bilateral trade agreement. At the same time, Malawi will finalize a Trade Remedies Law.

E. Structural Reforms

37. **The structural reform agenda—outlined in the MPRS—focuses on removing obstacles to growth (Chapter 4.1).** The MPRS recognizes that structural reforms, in particular in the agricultural sector, are key to achieving macroeconomic stability and reducing poverty.

38. **Reforms in the agricultural sector will aim at promoting the efficient utilization of land by improving incentives for efficient land use and developing transferable land rights, to be incorporated into a new land law to be submitted to parliament by end-December 2003, or by a date to be agreed during the upcoming review with the World Bank.** The government also plans to introduce reforms in the tobacco-farming sector aimed at promoting direct exports, reducing taxation and facilitating contract farming. Furthermore, the government will have developed a new food security policy based on the development of agricultural markets and food safety nets by the end of 2003. These reforms are being supported by the World Bank and other multilateral and bilateral donors.

39. **Other structural reforms during 2003-04 will focus on those elements of the reform agenda that have a potential to undermine macroeconomic stability.** These include strengthening the oversight of parastatals, completing the divestiture or liquidation of parastatals that rely on the budget, and further enhancing governance:

- **Strengthening oversight of public enterprises (Chapter 5.2.2.1).** The Public Enterprise Reform and Monitoring Unit (PERMU) will continue to monitor and control the financial performance of public entities and coordinate reform efforts. Consistent with the longer term goal to strengthen public debt management, the new Public Finance Management Act, among other things, provides a basis for developing an effective system for the authorization of parastatal borrowing by the Ministry of Finance. In addition, based on the agreements reached with all parastatals on a repayment schedule for on-lending arrangements in arrears, payments to the government resumed at the beginning of February 2003. Any borrowing by parastatals must have Ministry of Finance approval.
- **Completing the reform of those parastatals that relied heavily on budgetary resources in the past (Chapter 4.4.3.2).**
 - a. ADMARC remains insolvent and its liquidity position stretched. To make ADMARC viable, a comprehensive plan for restructuring its core operations is being developed during 2003, in consultation with the World Bank, other donors and civil society. The restructuring plan, expected to be agreed by end-

December 2003, will call for a clear separation of commercial operations from subsidized social operations. Subsidies for social operations will be budgeted and identified in a performance contract between the government and the management of the social operations.

- b. Regarding ADMARC's noncore operations, the government will divest ADMARC's investment portfolio by liquidating the minority shareholding in National Bank and SUCOMA by December 2003 to settle overdraft facilities and use the remaining sales proceeds, if any, to retire domestic debt. The government is finalizing the privatization of ADMARC's former subsidiaries by completing the privatization of Cold Storage by end-August 2003. The government intends to transfer of the assets of David Whitehead and Sons to the buyers before the end of 2003. In preparation for the privatization of Grain and Milling, an information memorandum was prepared and receipt of bids closed on July 31, 2003. With respect to Shire Bus Lines, a preliminary assessment of costs associated with servicing unprofitable bus routes was completed in February 2003, and a passenger service obligation survey was completed by June 2003. Based on the findings of this survey, government is expected to move forward with the privatization by December 2003.
- **Enhancing governance** (Chapter 4.4). The government has increased the staffing levels of the Anti-Corruption Bureau, in particular the investigative branch, from 14 at end-2001 to 25 at end-2002. The government will continue to train magistrates and judges in interpreting the Corrupt Practices Act. Moreover, draft amendments to the Corrupt Practices Act are to be submitted to parliament end-October 2003. The amendment specifies a level of proof that ensures an expedient prosecution process, makes abuse of office an offense under the Corrupt Practices Act, and establishes a "whistle-blower" program.
 - Following the completion of the audit of the NFRA in June 2003, the Anti-Corruption Bureau will review the audit findings and decide on the list of companies, institutions and individuals who may have violated the law by end-December 2003.

40. **As the government's maize operations gave rise to governance issues in the past, special emphasis has been placed on carrying out the current food security operation transparently.** First, a task force, comprising various government agencies, donors and NGOs, was established to monitor and control all aspects of the operation. Second, in November 2002 a memorandum of understanding that spells out the domestic distribution arrangement and ensures that the distribution is in conformity with the National Food Reserve Agency's (NFRA's) Trust Deed was agreed between government, NFRA and ADMARC. Third, CISANET, an agricultural umbrella NGO, is monitoring distribution at the retail level. Fourth, government is facilitating the monitoring of the food security operation by the general public by publishing on a monthly basis data on all aspects of the maize operation. Finally, in addition to the audits of the Auditor General and the investigation of the Anti-Corruption Bureau, an independent auditing firm conducted a forensic and operational audit of the NFRA, covering all NFRA transactions and operations

between 1999 and mid-2002, and made recommendations on improving operational procedures.

41. **The food crises have revealed deficiencies in our food security and agricultural policies, which are now being addressed, including through World Bank support.** The task force on food security has produced an inception report and a new comprehensive and multisectoral food security policy is expected to be prepared by end-2003 (Chapter 4.3.2). The Food and Agriculture Organization (FAO) is developing a framework for improved agricultural statistics, and the responsibility for compiling crop estimates has been moved to the National Statistics Office (NSO). These actions will help address the failure of the famine early warning system, which gave rise to a delayed response to the food crisis in 2001/02, and improve the reliability of food production data, the lack of which hampered the calibration of the 2002/03 food security operations. Finally, the government is in the process of revamping agricultural policies, including land policy and tobacco marketing arrangements, with a view to improving rural livelihoods (Chapter 4.1.1).

F. Statistics and Transparency

42. **The government is committed to improving its economic and financial statistics.** An action plan for improving the quality of the statistical database will be implemented, with particular emphasis on the national accounts, consumer price index, trade and external accounts. Moreover, the relocation of the economics section of the NSO to Lilongwe was completed in March 2003 and the entire NSO office will be moved at an appropriate time. Malawi's statistical system will be assessed in the forthcoming Report on the Observance of Standards and Codes—Statistical Data Module—and the Fund will provide assistance in developing statistical systems to meet General Data Dissemination System (GDDS) recommended practices under the Fund's GDDS Anglophone Africa project.

G. Program Monitoring

43. **Technical memorandum of understanding (TMU).** The program will be monitored using the definitions, data sources, and frequency of monitoring set out in the accompanying TMU.

44. **Performance criteria.** Tables 1 and 2 set out the performance criteria and benchmarks for end-September and end-December 2003, with indicative targets for end-March and end-June 2004.

45. **Program review.** The second review under the PRGF arrangement will focus on the implementation of the government fiscal strategy, including the strengthening of expenditure control mechanisms. The fiscal outlook and policies for 2004/05 will be discussed and agreed in the context of the fifth review discussions.

Table 1. Malawi: Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, 2003-04

	2003 End-June Actual Stock	2003		2004		
		End-Sep. Performance Criteria	End-Dec.	End-March	End-June	End-Sep. Indicative Targets
(In millions of Malawi kwacha)						
1. Ceiling on net domestic assets of the Reserve Bank of Malawi (RBM) 1/ 2/ 3/ 4/	10,989	3,568	-804	-3,547	-6,448	-8,601
2. Ceiling on banking system's net claims on the central government 2/ 3/ 4/	18,374	4,207	-1,937	-2,749	-5,549	-6,053
3. Reduction in the outstanding stock of domestic arrears of the central government 3/ 5/	400	50	100	150	200	250
(In millions of U. S. dollars)						
4. Floor on net foreign assets (NFA) of the monetary authorities 3/ 6/	-8.6	-15.1	27.9	46.8	95.9	100.6
5. Ceiling on the accumulation of external payments arrears 3/ 7/	0.0	0.0	0.0	0.0	0.0	0.0
6. Ceiling on the contracting or guaranteeing of external debt with original maturities of over one year by the central government, the RBM or other agencies on behalf of the central government. 3/ 8/	0.0	0.0	0.0	0.0	0.0	0.0
7. Ceiling on the contracting or guaranteeing of external debt with original maturities of one year or less by the central government, the RBM or other agencies on behalf of the central government. 3/ 9/	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item: Baseline for balance of payments support for NFA adjuster (in millions of U.S. dollars) 3/	...	25.5	122.6	178.1	229.8	278.4

1/ Defined as reserve money minus net foreign assets of the RBM.

2/ The ceilings on net domestic assets of the RBM and net banking system's claims on the central government will be adjusted downwards by the full amount by which the cumulative receipts from the baseline for balance of payments assistance exceed the program target; new domestic arrears are accumulated; and nonbank domestic borrowing is increased beyond the additional nonbank borrowing done in July 2003 (MK 320.1 million).

3/ Cumulative flow since June 30, 2003.

4/ Valued at the program exchange rate of MK 89.915 per US\$1.

5/ Any new domestic arrears of the central government accumulated during the quarter will be cleared by the end of that same quarter.

6/ The floor on NFA of the monetary authorities will be adjusted downward by the amount of the shortfall in balance of payments assistance, with a maximum limit of US\$30 million. Correspondingly, the floor will be adjusted upward by the full amount by which the cumulative receipts from the balance of payments assistance exceed the program target.

7/ Applied on a continuous basis.

8/ Loans contracted or guaranteed by the central government or the RBM with a grant element of less than 35 percent.

Table 2. Malawi: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, September 2003–December 2004

<u>Measure</u>	<u>Implementation Date</u>
1. Structural performance criteria	
1.1. Limit subsidies to ADMARC to MK 60 million	End-June 2004
1.2. Issue regulations and instructions under the Public Finance Management Act	End-March 2004
1.3. Issue report by Anti-Corruption Bureau on NFRA audit	End-December 2003
1.4. Complete Audit of Domestic Arrears	End-December 2003
1.5. Complete an action plan for a comprehensive revision of the public service pension scheme	End-September 2003
1.6. Publish the wage policy statement	End-October 2003
1.7. Establishment of a public service remuneration board	End-October 2003
1.8 Engage a pay policy advisor	End-November 2003
1.9. Consolidation of allowances into the salary structure	End-December 2003
1.10. Submit to Parliament amendments to the Anti-Corruption Act to allow the Anti-Corruption Bureau to prosecute cases without prior approval from the Director of Public Prosecutions	End-October 2003

Table 2. Malawi: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, September 2003 – December 2004 (concluded)

Measure	Implementation Date
2. Structural benchmarks	
2.1. The RBM will establish formal procedures to ensure that program monetary data are in accordance with the TMU	End-December 2003
2.2. The RBM Board will pass a resolution to require that, commencing with the audit of its 2003 financial statements, the audit opinion of the primary external auditor will be signed by a second office of the same audit firm located in an international financial center	End-September 2003
2.4. Adoption of generally acceptable accounting standards by the Ministry of Finance	End-September 2004
2.5. Establish a task force for improving domestic debt management	End-September 2003
2.6. RBM's external auditors should review data compilation procedures including the mapping of accounting data to program data sent to the IMF	End-March 2004
2.7. Reduce the commercial bank liquidity reserve requirement to 10 percent	End-September 2004
2.8. Eliminate the export surrender requirement	End-September 2004

Table 3. Malawi: Quantitative Fiscal Benchmarks Under the PRGF Arrangement, 2003-04

(In millions of Malawi kwacha)

	2003	2003		2004		
	End-June Actual	End-Sep. Indicative Targets	End-Dec. Indicative Targets	End-Mar. Indicative Targets	End-June Indicative Targets	End-Sep. Indicative Targets
Ceiling on central government wages and salaries 1/ 2/	10,929	2,714	5,571	8,441	11,444	14,558
Floor on pro-poor expenditures (PPEs) 3/	11,059	2,972	5,966	9,016	12,174	15,673

1/ Defined as personal emoluments (wages and allowances) and payment of past wage arrears.

2/ Cumulative flow since June 30, 2003. End-June 2003 figure refer to total for FY 2002/03.

3/ Expenditure for wages, goods and services and capital expenditure on pro-poor activities.

Table 4. Malawi: Disbursements and Test Dates Under the PRGF Arrangement, 2003-04

Fund Quota	SDR 69.40 million	
Amount approved	SDR 45.11 million	December 21, 2000
Amount disbursed	SDR 6.44 million	December 21, 2000
Undrawn balance	SDR 38.67 million	June 25, 2003

Proposed disbursement schedule and test dates

<u>Amount</u> <u>(In millions of SDRs)</u>	<u>Disbursement Dates</u>	<u>Conditions</u>
6.44	October 15, 2003	Completion of first review, based on performance through end-June 2003.
6.44	November 15, 2003	Completion of second review, and observance of performance criteria for end-September 2003.
6.44	February 15, 2004	Completion of third review, and observance of performance criteria for end-December 2003.
6.44	May 15, 2004	Completion of fourth review, and observance of performance criteria for end-March 2004.
6.44	September 15, 2004	Completion of fifth review, and observance of performance criteria for end-June 2004.
6.44	November 15, 2004	Completion of sixth review, and observance of performance criteria for end-September 2004.

Malawi: Technical Memorandum of Understanding

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

I. QUANTITATIVE PERFORMANCE TARGETS

2. Quantitative targets for September 30, 2003 and December 31, 2003 have been established with respect to
- ceilings on net domestic assets (NDA) of the Reserve Bank of Malawi (RBM);
 - ceilings on the banking system's net domestic claim on the central government (NCG);
 - floors on the level of net foreign assets (NFA) of the monetary authorities;
 - ceilings on the contracting and guaranteeing by the central government or the Reserve Bank of Malawi (RBM) of medium- and long-term external debt; and
 - ceilings on the contracting or guaranteeing by the central government or the RBM of short-term external debt.
3. A performance criterion that is applicable on a continuous basis has been established with respect to the ceilings on the stock of external arrears of the central government and the RBM.
4. A structural benchmark is applicable to the clearance of new domestic budgetary arrears of the central government.

II. INSTITUTIONAL DEFINITIONS

5. The central government includes all units of government that exercise authority over the entire economic territory. However, in contrast to the *System of National Accounts 1993* (*SNA 1993*) and *Government Finance Statistics Manual 2001* (*GFSM 2001*) standards, nonprofit institutions that are controlled and financed by the central government are excluded for the purposes of this memorandum.
6. The accounts of the monetary authorities include the balance sheet of the RBM and the central government's holdings of international reserves.¹

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

III. LIMITS ON MONETARY AGGREGATES²

A. Net Domestic Assets of the RBM

7. A ceiling applies on the net domestic assets (NDA) of the RBM. NDA of the RBM is defined as reserve money minus net foreign assets of the monetary authorities.
8. Reserve money consists of currency issued by the RBM and balances of commercial banks accounts with the RBM. It includes required reserves held for Malawi kwacha deposits and any other domestic currency-reservable liabilities and other demand and time deposits held with the RBM.

B. Limit on Net Foreign Assets of the Monetary Authorities

9. A floor applies to the level of net foreign assets (NFA) of the monetary authorities. NFA will be valued in U.S. dollars at a constant program exchange rate. Monetary gold will be valued at the fixed RBM accounting rate. NFA will be calculated as the difference between gross international reserve assets and international reserve liabilities.
10. **Gross international reserve assets** of the monetary authorities are defined as the sum of:
 - monetary gold holdings of the RBM;
 - holdings of SDRs;
 - Malawi's reserve position in the IMF;
 - central government (treasury) holdings with crown agents; and
 - foreign currency assets in convertible currencies held abroad that are under the direct and effective control of the RBM and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution;
 - but exclude any foreign currency claims on residents, capital subscriptions in international institutions, assets in nonconvertible currencies, and gross reserves that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.
11. **International reserve liabilities** of the monetary authorities are defined as the sum of:
 - outstanding liabilities of the RBM to the IMF; and
 - any foreign convertible currency liabilities of the RBM with an original maturity of up to and including one year;

² Monetary aggregates under the program are based on the 2-bank monetary survey.

- but exclude liabilities arising from balance of payments support of original maturities of more than one year.

12. **Balance of payments support** shall comprise all grant and loan external financing that is not automatically linked to additional budgetary expenditure. Project financing to fund particular activities is excluded from this definition, including food security funding from the European Union. Loan financing from the IMF is also excluded from the baseline balance of payments support. Given the large magnitudes involved, debt relief under the HIPC Initiative will be included in the projection of baseline balance of payments support.

13. The program exchange rate for all international assets and liabilities, including encumbered reserves, is the end-of-period exchange rate of June 2003, i.e., MK 89.915 per US\$1.

14. **Adjusters.** The ceiling on NDA of the RBM will be adjusted downward by the full amount by which the cumulative receipts from the baseline balance of payments assistance exceed the program targets. It will also be adjusted downward by the full amount by which new domestic arrears are accumulated and net credit to the central government by domestic nonbanks is increased beyond the nonbank borrowing undertaken in July 2003.³ The floor on the NFA of the monetary authorities will be adjusted downward by the amount of the shortfall in balance of payment assistance, with a maximum limit of US\$30 million. The floor on NFA of the monetary authorities will be adjusted upward by the full amount by which the cumulative receipts from the balance of payments assistance exceeds the program targets.

IV. LIMIT ON THE FINANCING OF THE CENTRAL GOVERNMENT

15. A ceiling will apply on the banking system's **net domestic claims on the central government (NCG)**. The banking system's NCG is computed as the sum of (i) net borrowing from the RBM (including ways and means advances, loans, holdings of local registered stocks, and holdings of treasury bills minus deposits), (ii) net borrowing from commercial banks (including advances, holdings of local registered stocks and holdings of treasury bills minus deposits), and (iii) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost. Excluded are promissory notes issued to cover RBM's operational losses in 2002 and 2003.

16. **Net credit from domestic nonbanks** includes (i) holdings of local registered stocks by the private sector and other financial institutions, (ii) holdings of Treasury bills by the private sector and other financial institutions, (iii) supplier credits, and (iv) holdings of promissory notes. The treasury bills and local registered stocks are valued at cost.

³ Nonbank borrowing by the central government in July 2003 is estimated at MK 320.1 million)

17. **Domestic budgetary arrears** are defined as the net accumulation of new budgetary arrears since June 30, 2003.⁴

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

19. The **account held with the Bank of Tokyo-Mitsubishi in Japan** was set up for the delivery of Japanese debt relief. The net deposit in the account is calculated as the cash debt relief deposited by Japan⁶ minus withdrawals from the account⁷ valued at the end-month Yen-kwacha exchange rate.

20. The definition of **external debt instruments** is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85) August 24, 2000. For the purpose of this memorandum, “other external debt instruments” of paragraph 16 include in particular special loans such as external supplier credits and external holdings of promissory notes, but excludes balance of payments support.

21. **Amortization** of external debt is defined as amortization of project loans, balance of payment loans, and other external debt instruments.

22. **Adjusters.** The ceilings on the banking system’s NCG will be adjusted downward by the full amount by which the cumulative receipts from the baseline for the balance of payments assistance exceeds the program target. It will also be adjusted downward by the full amount by which new domestic arrears are accumulated and net credit to the central government by domestic nonbanks is increased beyond the nonbank borrowing undertaken in July 2003.⁸

⁴ The stock of domestic budgetary arrears as at June 30, 2003 was estimated at MK 400 million.

⁵ Pension benefits that are being assessed following retirement are not considered to be in arrears.

⁶ Accounted for as a grant above the line.

⁷ Accounted for as expenditure above the line.

⁸ Nonbank borrowing by the central government in July 2003 is estimated at MK 320.1 million)

V. LIMITS ON EXTERNAL DEBT

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

23. A ceiling applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf of the central government on debt with nonresidents with original maturities of over one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from July 1, 2003 for the end-September 2003 and end-December 2003 targets.

24. The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979,⁹ and as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85) August 24, 2000.

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

26. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element is equal to nominal value minus NPV divided by nominal value). The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency-specific commercial interest reference rates (CIRRs), as published by the OECD. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program, the CIRRs published by the OECD for November 15-December 14, 2002 will be used (<http://www.oecd.org/>). For example, based on these CIRR rates, a U.S. dollar-denominated debt with a 10-year maturity would be considered concessional if the interest rate did not exceed 4.64 percent.

B. Limit on Short-Term External Debt

27. A ceiling applies to the contracting and guaranteeing by the central government, the RBM, or other agencies on behalf the central government of debt with nonresidents with original maturities of one year or less. The ceiling applies to debt and commitments contracted or guaranteed for which value has not been received. The ceiling is measured cumulatively from July 1, 2003 for the end-September 2003 and end-December 2003 targets.

⁹ [http://www.imf.org/external/pubs/ft/sd/index.asp?decision=6230-\(79/140\)](http://www.imf.org/external/pubs/ft/sd/index.asp?decision=6230-(79/140)).

28. The definition of debt, for the purpose of the limit, is set out in Executive Board Decision No. 6230-(79/140) of August 3, 1979, and as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85) August 24, 2000.

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

VI. LIMIT ON EXTERNAL PAYMENT ARREARS

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

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

31. Should at any time during the program new domestic budgetary arrears of the central government (as defined in paragraph 17 above) be verified, then the government will clear these arrears by no later than the end of the fiscal quarter following the fiscal quarter in which these arrears were accumulated (structural benchmark).

VIII. REPORTING REQUIREMENTS FOR TECHNICAL MEMORANDUM OF UNDERSTANDING

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

33. On a **weekly** basis within five working days of the end of the respective week, the balance sheet of the monetary authorities will be reported; and on a weekly basis (each Wednesday) with a two day lag, daily gross reserves, the daily U.S. dollar to kwacha exchange rate, daily net interventions of the RBM in the foreign exchange market, daily reserve money, the daily net volume on open market operations, and the results of treasury bill and RBM bill auctions will be reported (reporting agency: RBM).

34. On a **monthly** basis within 30 working days of the end of the respective month, the monetary survey, the monetary authorities' accounts, the commercial banks' accounts, the international reserves position, local registered stock holdings, treasury bill holdings, interest

rates, exchange rates, the consumer price index, guarantees extended by the RBM or central government on foreign operations of Malawian residents (reporting agency: RBM); and a consolidated table on total financing of the central government, including domestic and foreign financing will be reported (reporting agencies: RBM and Ministry of Finance).

35. On a **monthly** basis within 30 calendar days of the end of the respective month, the fiscal accounts of the central government, tables summarizing by line ministries achievement of commitment levels and arrears in the CCS3 and CCS4 returns, CCA, supplementary CCA, and reimbursement to commercial banks, central government reports on spending on pro-poor expenditure (PPE) programs, funding reports for wages, and other recurrent expenditure, and development expenditure, and account statements from the Tokyo-Mitsubishi account (reporting agency: Ministry of Finance); and, the revenue data and SGS import data will be reported (reporting agency: Malawi Revenue Authority (MRA)).

36. On a **monthly** basis within 45 calendar days of the end of the respective month, a review summarizing the monthly reports by line ministries on commitment levels and arrears and assessing prospects for meeting budget targets will be reported (reporting agency: Ministry of Finance).

37. On a **quarterly** basis within 45 calendar days of the end of the respective calendar quarter, the borrowings of the ten major parastatals (reporting agency: Ministry of Finance); a report on performance under the program (reporting agencies: RBM and Ministry of Finance); and a report on the verified expenditure arrears will be transmitted (reporting agency: Auditor General).

Malawi: Relations with the IMF
(As of July 31, 2003)

I. Membership Status: Joined 07/19/1965; Article VIII (December 7, 1995)						
II. General Resources Account:						
			<u>SDR million</u>		<u>%Quota</u>	
Quota			69.40		100.0	
Fund holdings of currency			84.46		121.7	
Reserve position in Fund			2.29		3.3	
III. SDR Department:						
			<u>SDR million</u>		<u>%Allocation</u>	
Net cumulative allocation			10.98		100.0	
Holdings			0.53		4.8	
IV. Outstanding Purchases and Loans:						
			<u>SDR million</u>		<u>%Quota</u>	
Poverty Reduction and Growth Facility (PRGF) arrangements			48.59		70.0	
Stand-by Arrangement			17.35		25.0	
V. Financial Arrangements:						
	<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>	
	PRGF	12/21/2000	12/20/2003	45.11	6.44	
	ESAF/PRGF	10/18/1995	12/16/1999	50.96	50.96	
	Stand-by arrangement	11/16/1994	06/30/1995	15.00	12.73	
VI. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):						
		<u>Forthcoming</u>				
		<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal		3.61	9.22	10.19	9.19	6.90
Charges/Interest		<u>3.91</u>	<u>0.37</u>	<u>0.32</u>	<u>0.27</u>	<u>0.23</u>
Total		7.52	9.59	10.51	9.46	7.13

VII. Implementation of HIPC Initiative:

	<u>Enhanced Framework</u>
A. Commitment of HIPC assistance	
Decision point date	12/21/00
Assistance committed (NPV terms) ¹	
Total assistance (US\$ million)	643.00
<i>Of which:</i> Fund assistance (SDR million)	23.14
Completion point date	Floating
B. Delivery of Fund assistance (SDR million)	
Amount disbursed	2.31
Interim assistance	2.31
Completion point ²	0.00
Additional disbursement of interest income	0.00
Total disbursements	2.31

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Reserve Bank of Malawi (RBM) is subject to a safeguards assessment with respect to the Poverty Reduction and Growth Facility Arrangement that was approved on December 21, 2000 and is scheduled to expire on December 20, 2003. An offsite safeguards assessment of the RBM was completed in July 2001. A follow-up on-site safeguards assessment was conducted in May 2003. The latter concluded that the RBM had made progress in remedying vulnerabilities, and it proposed steps to further strengthen the RBM's operations and safeguards, particularly in the areas of external audits, financial reporting, and internal controls.

¹ NPV terms at the completion point under the original framework; and NPV terms at the decision point under the enhanced framework.

² Under the enhanced HIPC initiative, the nominal amount of assistance disbursed will include an additional amount corresponding to interest on amounts committed but not disbursed during the interim period, calculated using the average return (during the interim period) on the investment of resources held by, or for, the benefit of the PRGF-HIPC Trust.

IX. Exchange Arrangements:

The exchange rate of the Malawi kwacha is market determined. On July 31, 2003, the exchange rate was MK 96.86 = US\$1.00.

X. Article IV Consultation:

Malawi is on the standard 12-month Article IV consultation cycle. The last Article IV consultation (EBS/02/131; 7/22/02) was concluded by the Executive Board on August 5, 2002.

XI. Technical Assistance:

<u>Date</u>	<u>Duration</u>	<u>Dept.</u>	<u>Recipient</u>	<u>Purpose</u>	<u>Form</u>
01/00	1 year	STA	National Statistical Office	Statistics	Advisor
06/00	1 year	FAD	Ministry of Finance	Revenue administration	Advisor
11/00	2 weeks	FAD	Ministry of Finance	Improving fiscal data and commitment control	Mission
9/01	1½ weeks	FAD	Ministry of Finance	Expenditure tracking and fiscal ROSC	Mission
11/01	2 weeks	MAE	RBM	Monetary operations and further developing financial markets	Mission
02/02	2 weeks	FAD	Ministry of Finance	Expenditure policy	Mission
05/02	6 months	FAD	Ministry of Finance	Expenditure Management	Advisor
07/02	2 weeks	STA	National Statistical Office (NSO), RBM	GDDS Anglophone project on national accounts statistics	Mission
08/02	2 weeks	STA	RBM	Monetary and financial statistics	Mission
02/03	2 weeks	MAE	RBM	Monetary operations, payments system, banking supervision	Mission
08/03	2 weeks	STA	NSO	GDDS Anglophone project on balance of payments statistics	Mission

XII. Resident Representative:

Mr. Girma Begashaw, since February 2002.

Malawi: IMF-World Bank Relations

A. World Bank Country Assistance Strategy (CAS)

1. The Malawi CAS was approved by the World Bank's Executive Board on May 14, 2003. The gray cover report (Report # 25906 MAI) outlined the current social, economic, and political situation in Malawi and proposed strategies for the next three fiscal years (FY 2004-06), based on the lessons learned from the previous strategies. This new strategy presents a transitional program that aims to help the government to address the urgent development issues as it is clear that a business-as-usual strategy will not achieve the results required.

2. The program is organized under three pillars (i) strengthening economic management; (ii) establishing a platform for growth; and (iii) improving service delivery and strengthening the safety net. Two ongoing projects (Financial Management Transparency and Accountability; and Privatization and Utility Reform), and one new project (Global Development and Learning Network) will assist attaining the objectives under pillar one. To support objectives of pillar two, three new projects are proposed: Community Land Reform Project, Infrastructure Services project, and Agriculture project in the base case. Finally, core World Bank interventions under pillar three include the HIV/AIDS project, and Third Malawi Social Action Fund project; and the Emergency Drought Relief project, besides two sectoral projects in the area of education, and health even in a low case.

B. Financial Relations with the World Bank Group

3. The World Bank has been active in Malawi since 1966. The World Bank Executive Board has since approved 92 IDA credits and 10 IBRD loans. The World Bank's lending to Malawi to date totals US\$2,273.6 million, of which US\$2,017.7 million have been disbursed. This support has been allocated as follows: 17 percent for agriculture; 33 percent for structural and sectoral adjustment; 15 percent for infrastructure and water; 11 percent for education; 7 percent for energy; 4 percent for health; and the balance (14 percent) toward development finance, technical assistance, industry, urban housing, and institutional development. Currently there are twelve active projects in Malawi with a total commitment of US\$450.7 million, and an undisbursed balance of US\$244.8 million (as of August 12, 2003).

4. The IFC's equity participation and lending since the inception of its operations in Malawi amounts to US\$31 million (gross) and includes nine investments in agribusiness, textiles, sugar, tourism, chemicals, plywood, a development finance corporation, and a leasing finance corporation. All credits have been fully disbursed. The current IFC portfolio is relatively small, with US\$2.9 million allocated to five ventures. The World Bank's assistance strategy supports policy reform in areas of concern to the IFC, thus aiding its active search for investment opportunities in Malawi. Two loans have been approved and are awaiting commitment. One of these is for the establishment of the Continental Discount House (CDH), which is the first discount house in Malawi. The CDH will intermediate

among financial institutions by trading and creating markets in bankers' acceptances, commercial paper, and treasury bills. The other involves the establishment of the first private-housing finance institution in the country. A possible area for future IFC involvement is the creation of a unit trust fund to broaden the ownership base of the economy and enhance domestic savings.

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

C. Areas Where the World Bank Leads

Education and Health

6. The World Bank currently has two ongoing human development operations in Malawi. In FY 1998, a Secondary Education project (US\$48 million), and in FY 1999, a Population and Family Planning (US\$5 million) were approved. The Multi-Sector AIDS project for (US\$35 million in grants) was approved in FY 2004, to assist the National AIDS Council, ministries, communities and civil society in reducing the transmission of HIV, and improve the quality of life of those who are infected and affected.

Social Protection and Community Development

7. The Second Malawi Social Action Fund project (MASAF 2, US\$66 million) was approved in FY 1999. A follow-up operation, MASAF 3 (US\$60 million, of which US\$27 million in the form of an IDA grant,) has recently been approved in FY 2003. MASAF 3 has five components. The project aims to empower individuals, households, communities, and their development partners in the implementation of measures which can assist them in better managing risks associated with health, education, sanitation, water, transportation, energy and food insecurity, and to provide support to the critically vulnerable through a variety of sustainable interventions.

Infrastructure

8. The National Water Development (US\$82 million) was approved in FY 1995 to support the implementation of government's water policy by improving water supply services in rural communities and small urban centers and upgrading the management of water resources. The Road Maintenance project (US\$30 million) was approved in FY 1999 to bring about sustainable improvements in the quality of Malawi's road infrastructure which will help economic growth and diversify the economy by reducing transport costs and improving access by: (i) strengthening and restructuring of the road sector institutional framework; (ii) reform of road sector; and (iii) addressing the backlog of road maintenance and rehabilitation. In the pipeline (FY 2005), there is also an Integrated Infrastructure Services project to primarily support rural energy and transport needs.

Privatization

9. Parastatal reform continues to be an urgent need in Malawi. In the past two years, with the assistance of two World Bank instruments, progress has been made in several privatizations: (i) the Privatization and Utility Reform project (PURP, US\$28.9 million), approved in FY 2000, aims to improve quality of and access to economic and physical infrastructure for private sector development; and (ii) the Fiscal Restructuring and Deregulation Program III (FRDP III) structural adjustment credit supports macroeconomic reforms and provides related technical assistance. After an initial period of slow progress, the performance of the PURP project has recently been upgraded to satisfactory.

Agriculture

10. The World Bank is currently preparing a Community based Rural Land Development project, expected to be approved in FY 2004. The new Structural Adjustment Credit, which is also under preparation, will support agricultural policy reforms (see below).

Environment

11. Direct World Bank involvement in the environment sector is currently limited to the Mulanje Mountain Biodiversity Conservation project (US\$7 million) that was approved in FY 2001. However, especially within the framework of MASAF, environmentally sound community development initiatives are promoted and community resource management projects are funded.

Poverty Monitoring:

12. The World Bank is supporting the National Statistical Office with one aspect of the poverty monitoring tasks identified in the Malawi Poverty Reduction Strategy Paper (PRSP) as requiring technical assistance. Through the PRSP trust fund, the World Bank is assisting the government in conducting the Second Integrated Household Survey, including the design, collection, processing, and dissemination of data covering not only household characteristics, but also community level indicators.

D. Areas Where the World Bank and the IMF Share the Lead

Poverty Reduction Strategy

13. The government of Malawi has finalized its PRSP in April 2002. A joint IDA-IMF staff assessment was presented to the Boards of IMF and the World Bank in August 2002. The IMF and the World Bank staff have maintained a collaborative relationship in supporting the government in the process. The Malawi PRSP is considered by the World Bank and the IMF to be highly participatory, having an appropriate macroeconomic framework, including a financing plan with a balanced approach to public policy, and having laid out a detailed action plan.

Debt Sustainability and Enhanced Heavily Indebted Poor Country (HIPC) Initiative

14. Staffs of the IMF and the World Bank prepared the *Malawi: Decision Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative* that was presented to the respective Boards in December 2000. The report recommended a reduction of US\$331 million in net present value (NPV) terms with respect to the debt owed by Malawi to IDA based on a proportional burden sharing approach accounting for 51 percent of total public debt, (69 percent of total multilateral debt). This is equivalent to 44 percent of outstanding World Bank Group debt in NPV terms at the end of December 1999.

15. The staffs of the IMF and the World Bank are currently working jointly on the update of the HIPC Activity Action Plan (AAP) report for Malawi.

Budgetary Planning, Revenues Administration and Public Expenditure Reforms

16. The World Bank's assistance in improving public expenditure management has also been channeled mainly via its most recent structural adjustment credit and its technical assistance component. The last adjustment operation (FRDP III for US\$55 million) was approved in FY 2000 and is fully disbursed; it supported budgetary reform, liberalization of the petroleum, telecommunications and financial sectors, and creation of an affordable social safety net. The FRDP III also comprised a technical assistance parallel project that is still ongoing.

17. A new structural adjustment credit currently under preparation (with a World Bank Board date envisaged in January 2004) will focus on three areas: (i) agriculture, (ii) parastatal reform and (iii) expenditure management.

18. More recently, the Financial Management, Transparency and Accountability Project (FIMTAP, US\$24 million, FY 2003) is assisting the government with improving financial management systems and introduce the use of the Integrated Financial Management Information System (IFMIS) software.

Civil Service and Wage Reform

19. The World Bank has financed a study to review civil service and wage policy issues and propose a road map for reform. The government has agreed to the road map, and has committed to begin implementation of the recommendations of the study in the last quarter of 2003. These include: streamlining the system of allowances; consolidating them in the base for personal income tax; rationalizing salary grades; and moving towards a unified salary structure. These reforms are also supported under the proposed IMF program.

Humanitarian Assistance

20. The World Bank approved an Emergency Drought Recovery Project (EDRP, US\$50 million, of which US\$21 million is in the form of an IDA grant) in FY 2003, with the following objectives: (i) to allow government to maintain key commitments to economic priorities and investments; (ii) to help restore the productive capability of the populations; and; (iii) to support longer-term disaster management by the government. In August 2002, the IMF Executive Board approved emergency assistance of US\$23 million to Malawi in support of food imports.

E. Areas in which the IMF leads

Macroeconomic stability, fiscal policy and monetary policy

21. Malawi is confronted with a number of macroeconomic challenges, including a history of repeated fiscal slippages and unpredictable monetary policies, a rapidly rising level of domestic debt, and a persistently high level of real interest rates. The IMF will work with the authorities to address these challenges, including through financial support, policy advice, and technical assistance.

**Statement by the IMF Staff Representative
October 20, 2003**

1. Since the staff report was issued, information has been received relating to the program implementation of policies and prior actions, including preliminary data on performance through end-September 2003. The thrust of the staff report remains unchanged.

2. All the envisaged prior actions were implemented as follows:
 - The authorities have confirmed to the staff that all the measures in the letter of intent and memorandum of economic and financial policies have been approved by the Cabinet.

 - The increase in the excise tax on petroleum products (the main source of additional revenue) was implemented, effective August 26, 2003. The implementation of the increase in excise duties on tobacco and alcohol, which should have been effective by October 1, 2003 was, however, delayed and took effect on October 9, 2003. The authorities believe that the earlier implementation of the excise duty on petroleum products will more than offset the impact of the slight delay in implementing the increase in excise duties on tobacco and alcohol.

 - The government has deployed senior Treasury accounting officers (chief financial officers) to major spending ministries to enforce the expenditure and commitment control system.

 - Preliminary data indicate that the quantitative performance criteria for end-September 2003 on the net domestic assets of the Reserve Bank of Malawi (RBM), net banking system claims on the government, and on net foreign assets of the monetary authorities appear to have been met.

 - The authorities stated that the action plan for the comprehensive revision of the public service pension scheme has been developed; a copy of the plan has been provided to the staff.

 - A task force on domestic debt management was established in September 2003, as envisaged under the program.

 - The RBM Board passed a resolution on August 7, 2003 requiring the audit opinion of RBM's external auditors in Malawi to be countersigned by their Johannesburg office, as recommended by the safeguards assessment report.

3. Other steps taken by the authorities are the following:
 - The staff has been informed that in an effort to strengthen management of the payroll, the government has introduced a smart card system, incorporating employee particulars and control data, which will be used in paying wages and salaries.
 - The authorities also reported progress in the implementation of their program of public enterprise reform. In this regard, payment has been received from the private investors for the Cold Storage abattoir in Blantyre. A management buy-out of the abattoir in Lilongwe is at an advanced stage of preparation, and discussions are continuing on the mode of payments.
4. The President made a public statement underscoring the critical importance of the authorities' program and his commitment to its implementation.
5. The authorities have indicated that at its next sitting planned in November 2003, they will seek Parliamentary ratification of all budgetary measures adopted under the program.



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FOR IMMEDIATE RELEASE
October 20, 2003

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Completes In Principle First Review of Malawi's PRGF Arrangement,
Approves in Principle US\$9.2 Million Disbursement, and Approves US\$6.6 Million in
Interim Assistance under the HIPC Initiative**

The Executive Board of the International Monetary Fund (IMF) today completed in principle the first review of Malawi's economic performance under a Poverty Reduction and Growth Facility (PRGF) arrangement and approved in principle the disbursement in an amount equivalent to SDR 6.44 million (about US\$9.2 million). The IMF Board's decision will become effective upon a further decision following the World Bank's Executive Board review of Malawi's Poverty Reduction Strategy Paper Progress Report, scheduled for October 23, 2003. The Executive Board also agreed to the authorities' request to extend the arrangement through December 20, 2004 and to resume interim assistance under the Heavily Indebted Poor Countries (HIPC) Initiative by approving the release of an amount equivalent to SDR 4.628 million (about US\$6.6 million) to help Malawi meet its debt service payments on its existing debt to the IMF.

As part of its review of Malawi's performance under its IMF-supported economic program, the Executive Board also granted waivers for nonobservance of performance criteria pertaining to the ceilings on the stock of reserve money and net domestic financing of the central government. The Board also approved waivers regarding the commencement of full operations of a unit in the Ministry of Finance designed to monitor the activities of parastatals and the completion of a first quarterly report on the parastatals that had been due by December 31, 2000. Another waiver was granted on the compilation by the Ministry of Finance of monthly reviews which would summarize commitment levels and arrears and assess the prospects for meeting the budget targets in 2000/01.

Malawi's PRGF arrangement was approved on December 21, 2000 (see [Press Release No. 00/79](#)), for SDR 45.11 million (about US\$64.5 million). So far, Malawi has drawn SDR 6.44 million (about US\$9.2 million).

The PRGF is the IMF's most concessional facility for low income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster

growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period.

After the Executive Board's discussion on Malawi, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, stated:

“Malawi has made broadly satisfactory progress in establishing a record of performance during the first half of 2003 to underpin the completion of the review under the PRGF arrangement. Despite a severe drought and related food shortage, some measure of fiscal discipline has been restored, and the fiscal targets under the track-record program have been broadly met. The attainment of the monetary program objectives, however, was impeded by the shortfall in emergency and budgetary aid, and the failure to dispose of the government's maize purchase as earlier envisaged.

“Notwithstanding these recent gains, Malawi continues to face daunting economic and social challenges. Sustained political commitment will, therefore, continue to be needed to reverse the economic deterioration, ensure macroeconomic stability, improve public service delivery, and promote poverty reduction.

“The strong fiscal adjustment envisaged in the 2003/04 budget will be key to signaling the return to macroeconomic stability, which is a precondition for growth and poverty reduction. In particular, the government's strategy to make substantial repayments on domestic debt will be critical to reducing high real interest rates and interest payments, and to revitalizing the private sector. It will be essential that the authorities continue to demonstrate their political commitment to the steadfast execution of this strategy, especially in the run up to the general elections in May 2004.

“Strengthened expenditure control will be crucial to restoring fiscal discipline, and treasury officials, to be placed in line ministries, will help secure overall treasury control on commitments and payments. Recent increases in pro-poor outlays are welcome, but further strong efforts to prioritize expenditures will be essential to increase the resources allocated to pro-poor expenditures in line with the Malawi Poverty Reduction Strategy (MPRS), and ensure more rapid progress in attaining the millennium development goals. It will also be critical that the authorities' adjustment efforts be supported by enhanced external financial aid.

“Sustained implementation of the fiscal strategy will greatly facilitate the Reserve Bank of Malawi's anti-inflation strategy aimed at reducing and maintaining inflation in the lower single digits. Together with a sufficiently tight monetary stance, this will be key to reversing entrenched inflationary expectations, and creating financial conditions supportive of private sector expansion.

“Looking ahead, it will be important for Malawi to accelerate the implementation of structural reforms. Key reforms in the agricultural sector with support from the World Bank and other donors will strengthen food security safeguards and safety nets. Civil service reform and continued public enterprise restructuring and divestiture will help reduce the need for budget

subsidies, improve service delivery, and allow the private sector to take over commercial activities. Further expeditious progress in improving governance will be essential to enhance the management of public resources and attract external financial support from donors.

“The authorities’ full commitment to the program at the highest level is encouraging. Going forward, strong ownership and decisive and unwavering implementation of the program by the Malawian authorities will provide a basis for continued support from the IMF. This will also protect the program against policy slippages and help ensure timely support from the international donor community,” Mr. Sugisaki stated.

Statement by Ismaila Usman, Executive Director for Malawi
October 20, 2003

Key Points

- Withholding external budgetary support for over two and half years, has resulted in:
 - ✓ Deteriorating macroeconomic condition with stagnant growth, high inflation and high interest rates
 - ✓ Run-down of the country's external reserves to just over one month of imports, currently and falling.
 - ✓ Depreciation of the kwacha which lost more than 15 percent of its value in August 2003 alone.
 - ✓ Unsustainable domestic borrowing by the government, in a period of excessively high interest rates, and crowding out of the private sector.
- Modest progress made in implementing reforms including legislation governing public financial management, improvement in expenditure controls, management of pro-poor expenditures, procurement procedures and privatization.
- Authorities have shown strong political will and commitment to see the program through.
- Malawi urgently needs IMF assistance to avoid the looming financial and political crisis, otherwise the country could implode into serious economic and political crisis and total collapse of the economy.
- The authorities request for an extension of the program by another 12 months and the resumption of IMF interim assistance under the HIPC Initiative and the resuscitation of donor support to the country.

Background Information

1. The IMF Executive Board approved Malawi's three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) on 21st December 2000. Donor budgetary support under the Common Approach to Budgetary Support (CABS), accounts for no less than 40 percent of the budget in any given financial year and hinges on the completion of the first review of the Fund program.

2. Due to a number of factors, the completion of the first review of the PRGF program, could not be achieved. These include, amongst others, having to deal with the devastating floods in 2000, followed by the drought in 2001, which subsequently led to severe food

shortages the following cropping year. These developments took place at a very delicate time of the program aggravating an already deteriorating economic situation. The authorities, faced with a humanitarian crisis as a result of the food shortages and uncertain donor support, borrowed heavily from the Reserve Bank of Malawi and the banking system, thereby crowding-out the private sector in the process.

3. The authorities believe that, if the country is to recover from the looming catastrophe of an economic and political implosion, urgent assistance has to be extended under the PRGF program and this would also pave the way for further assistance under the HIPC program and subsequent resuscitation of donor inflows.

Recent Reform Efforts

4. Notwithstanding strong resistance from the general public and the private sector, the authorities implemented, amongst other things:

- Hiking excise taxes on petroleum products from 20 percent to 40 percent on diesel and petrol and 10 percent to 20 percent on paraffin.
- Introducing a further 10 percent increase on excise duty on alcoholic products and cigarettes.
- Further efforts to improve tax administration in order to boost revenue were intensified including door-to-door collection of outstanding surtax proceeds by the business community and suspension of duty waivers, remissions and mitigations.
- On the expenditure side, cabinet approved and directed that funding to all ministries for all activities be limited to 30 percent of the approved budget during the first half of the 2003/04 fiscal year, with the exception of pro-poor expenditures (PPEs) and salaries, which should be funded in full.
- Cabinet further directed the Minister of Finance to refrain from further borrowing, and that no extra-budgetary funding be considered except for emergencies and essential items. Cabinet supported the creation of new positions, to monitor major spending ministries and regularly monitor progress in this respect. To further bolster these efforts, the Ministry of Finance and the Reserve Bank were instructed to meet weekly to monitor and assess the country's cash flow.
- Further decisions and directives pertaining to the completion of reforms of major parastatals were also taken, which were aimed at streamlining costs and reducing their budgetary dependence.
- There were further directives also pertaining to the completion of the preparation of a Draft Wage Policy by the first quarter of the 2003/04 financial year.

5. The authorities implemented most of the structural reforms aimed at consolidating liberalization of production and marketing in the agriculture sector. These included reforms of the maize marketing agency, the Agricultural Development and Marketing Corporation (ADMARC) and its parastatals. Further efforts include public service reforms and restructuring, privatization, opening up and improving regulation of the financial sector. Several state-owned entities were either commercialized, privatized or liquidated. The monopoly granted to ADMARC to market the country's staple food was abolished. Other measures aimed at improving financial reporting and expenditure management were implemented including submission of regular periodic reports by all ministries, articulating their performance on expenditure commitments and their prospects of meeting fiscal targets.

Fiscal Developments

6. The fiscal performance of the country was largely perturbed by the unfolding sequence of events with the subsequent maize operation further aggravating a steadily deteriorating government's financial position. The fiscal slippages could not be avoided given the non-availability of donor support resulting in parastatals accumulating significant amounts of domestic debt. A huge and rising interest bill coming with the steady increase in domestic borrowing by government further fuelled interest rate hikes, wage bill overruns, and overspending on other current outlays. These developments, including the humanitarian crisis, resulted in an expansionary fiscal policy with various government ministries involved in the relief operations. The shortfalls in budgetary external financing and the urgency of the crisis left the authorities with no option but to seek recourse to domestic borrowing.

7. The authorities are committed to the reduction of the domestic deficit from 7.7 percent in 2001/02 to 4.3 percent of GDP in 2002/03 through reining in revenue measures and reducing non-priority expenditures and interest payments. In this regard, the authorities have introduced additional revenue measures, which have at times exceeded the track-record targets. These measures were met with a certain degree of public resistance and dissent given the impact of the already precarious and difficult economic situation on the people. The authorities also introduced various measures under the track-record program, aimed at strengthening Public Expenditure Management (PEM) which were broadly implemented and are currently in place. On account of these new measures, the authorities were able to spend higher than the program targets on pro-poor expenditures (PPEs) accounting for 7.1 percent of GDP compared to the program target of 6.1 percent.

Monetary and Exchange Rate Developments

8. Monetary policy slippages have largely been a result of the surge in domestic credit to government and the monetization of this credit, due, in part, to the drying-up of donor support during the review period. The authorities' efforts to mop-up the excess liquidity arising from the government borrowing could not be pursued due to the low and falling external reserve position. This situation was made worse by the difficult economic conditions resulting from the surge in interest rates and inflation, which followed the food shortages. On the other hand, private sector credit was declining and non performing loans surged to over 20 percent of total loans.

9. The authorities are concerned with the level of interest rates, currently hovering over 45 percent, and would like to see these declining to levels conducive to investment. A fall in the prevailing interest rates can only come with the reduction of the government's domestic debt position and an improvement in external financial inflows. This would enable the authorities to also address the issue of the interest rate spreads, to lower the reserve requirement, and to introduce a monetary program in line with the MEFP so as to restore stability to the kwacha's exchange rate.

Structural Developments

10. Most structural performance criteria and benchmarks under the PRGF-supported program were broadly met and these included measures aimed at strengthening Public Expenditure Management (PEM).

11. Malawi pursues a liberal trade and exchange regime which seeks to promote export – led growth and development. The country maintains membership in a number of regional and international trading blocs and is a member of the WTO.

12. The authorities are committed to the 2003-04 structural program and are strongly committed to work with the Fund to oversee the successful implementation of the program. The privatization program, which is supported by the World Bank, is on track and will continue to be implemented in order to reduce dependency of parastatals on central government financial support.

13. Malawi has diligently implemented reforms needed to accelerate their reaching the HIPC Initiative completion point triggers and have requested interim debt relief from the IMF under the HIPC Initiative once the first review is completed.

Resuscitation of Donor Financing

14. Notwithstanding the modest performance achievement, the strong political will and commitment of the authorities, further delay in restoring the urgently needed donor support to the country, would result in these gains made so far to be lost. The country would be unable to build up sufficient reserves, to reduce their domestic debt stock and consequently bring down interest rates, to improve the investment climate to attract foreign direct investments, and to spur economic activity towards a sustainable job-creating growth. Such delay could also accelerate the looming serious financial and economic crisis that could lead to the total collapse of the economy.

Conclusion

15. The authorities have demonstrated the political will and commitment to maintaining the momentum of adjustment and reforms and improving on the modest progress made so far. They would like to put the traumatizing experience behind them as they forge ahead to improve the quality of life of the citizens and to address the pervasive poverty engulfing the country. In this connection, they recognize the importance of synchronizing fiscal and

monetary policy in order to return the country to a path of sustainable job-creating growth. They will continue to count on the understanding and support of the IMF Executive Board and indeed the rest of the international community in their determined efforts to face the daunting challenges.

16. The authorities therefore, request the extension of the program for another twelve months to the end of 2004 and the resumption of IMF interim assistance under the HIPC Initiative to consolidate the progress made thus far.