FOR AGENDA

EBS/83/183

CONFIDENTIAL

August 26, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Request for Extended Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Malawi for an extended arrangement equivalent to SDR 100 million. A draft decision appears on page 38.

It is proposed to bring this subject to the agenda for discussion on Monday, September 19, 1983, subject to agreement by the Executive Board to request to shorten the circulation period for this document to less than the usual four weeks.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Edo (ext. 73763) or Mr. Bell (ext. 74324).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

MALAWI

Request for Extended Arrangement

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by J.B. Zulu and S. Kanesa-Thasan

August 25, 1983

I. Introduction

In the attached letter dated July 29, 1983, the Minister of Finance and the Governor of the Reserve Bank of Malawi request from the Fund an extended arrangement for a three-year period in an amount of SDR 100 million, or the equivalent of 350.9 percent of Malawi's quota (SDR 28.5 million). 1/ Of this amount SDR 18.525 million (65.0 percent of quota) would be from ordinary resources and SDR 81.475 million (285.9 percent of quota) would be made available from borrowed resources. A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement is required.

Under the proposed arrangement, up to SDR 15 million would be available to Malawi until the end of the current fiscal year. After an initial purchase of SDR 5 million, purchases would be made quarterly, provided Malawi satisfies the relevant performance criteria. As of July 31, 1983, Fund holdings of Malawi kwacha equaled 424.8 percent of quota (or 327.7 percent of quota excluding special facilities). 2/ If Malawi draws the full amount available under the arrangement, the Fund's total holdings of Malawi kwacha (after taking account of scheduled repurchases) would rise to 589.5 percent of quota by the end of the arrangement, or 541.5 percent of quota excluding purchases under special facilities. 3/ Malawi's expected purchases and repurchases under the extended arrangement are shown in Table 1.

1/ This amount would correspond to 268.8 percent of Malawi's proposed new quota under the Eighth General Review (SDR 37.2 million).

2/ Malawi's relations with the Fund and the World Bank Group are summarized in Appendix I.

3/ In relation to the proposed Eighth Review quota, these figures would be 451.6 percent and 414.9 percent of quota, respectively.

Table 1. Malawi: Schedule of Purchases and Repurchases

(In millions of SDRs)

	1983	1984		1985	1986	Total
	Sept.-Dec.	Jan.-June	July-Dec.		Jan.-Sept.	
Net purchases	7.4	0.6	6.9	21.0	13.2	49.1
Purchases under EFF	10.0	10.0	18.0	36.0	26.0	100.0
Ordinary resources	8.5	5.0	5.0	--	--	18.5
Borrowed resources	1.5	5.0	13.0	36.0	26.0	81.5
Repurchases	2.6	9.4	11.1	15.0	12.8	50.9
Buffer stock	--	--	--	--	0.2	0.2
Compensatory financing	2.6	4.8	3.8	0.7	1.9	13.8
Credit tranches	--	2.8	4.4	7.3	5.6	20.1
Supplementary financing	--	1.8	2.9	7.0	4.8	16.5
Enlarged access	--	--	--	--	0.3	0.3
Fund holdings of kwacha 1/	126.3	126.9	133.8	154.8	168.0	
Percent of quota 2/	443.2	445.3	469.5	543.2	589.5	

Source: IMF Treasurer's Department.

1/ End of period.
2/ Present (Seventh Review) quota.

Staff teams visited Malawi in February-March and June-July 1983 to negotiate the extended arrangement and assist the Malawian authorities in preparing a comprehensive medium-term economic and financial program. 1/ A delegation of Malawian officials visited Washington in July 1983 to complete the negotiations. Staff from the World Bank visited Malawi in early June to undertake the appraisal for a proposed second Structural Adjustment Loan (SAL II).

The three-year economic and financial program is described in the attached letter and in an annexed "Memorandum of the Government of Malawi on its Economic and Financial Policies" (Appendix IV). The memorandum outlines the government's policies over the course of the arrangement and stipulates the performance criteria to be observed until the end of the current fiscal year (March 1984). The Government will reach understandings with the Fund on the corresponding performance criteria for 1984/85, 1985/86 and the first half of 1986/87 before the end of April 1984, April 1985, and April 1986, respectively.

II. Economic Background and Performance Under Previous Fund-Supported Programs

Until the late 1970s, Malawi was able to achieve relatively high rates of growth without incurring large fiscal or external payments imbalances. The average growth rate of GDP during the 1970s was 5.5 percent, based on policies oriented towards agricultural production and exports which grew in volume terms by 5.5 percent and 6.8 percent respectively between 1973 and 1979. During this period there were high rates of domestic savings and investment, 2/ efficient utilization of capital stock, and wage restraint, which resulted in relatively low unit costs of production. The authorities pursued sound economic and financial policies, and Malawi was able to attract large official transfers and net capital inflows.

Malawi's present economic and financial difficulties started to emerge in the years 1978-80, as a result of declining terms of trade, disruptions to its traditional trade routes (the country is landlocked), and drought conditions in 1979 and 1980, combined with a rapid growth in government expenditure, sharply higher foreign borrowing on non-concessional terms and the increase in international interest rates. In 1978, lower prices for tobacco and tea caused export earnings

1/ Participating in the various missions were Messrs. Edo (head-AFR), Bell (AFR), Sharer (AFR), Greene (AFR), Kimaro (WHD, previously AFR), Abisourour (ETR), Mrs. Nairn (secretary--AFR) and Mrs. Campbell (secretary--ETR).

2/ The trends in GDP savings and investment are shown in Appendix Tables I, II and III.

to decline, while imports rose sharply in response to strong domestic demand and large government investment expenditure. Export volume increased rapidly in the three subsequent years and the volume of imports fell sharply (Table 2). Nevertheless, the current account remained in serious imbalance throughout 1979 and 1980, due to the weakness of export prices (tobacco prices in 1980 were 34 percent lower than in 1977), and the higher cost of imports, particularly petroleum. During the period 1976 to 1981 the terms of trade deteriorated by 40 percent. The problem was aggravated by recurrent disruptions in the country's overland routes to ocean ports, caused by instability in neighboring countries. Export and import merchandise had to be transported by much longer surface routes or by air freight. This caused freight costs to rise substantially, and led to delays and shortages in the supply of essential imports such as fuel, fertilizer and other intermediate imports, as well as the accumulation of substantial stocks of goods for export, especially such bulky goods as sugar.

The growth of GDP declined after 1978 as investment and savings ratios fell and the efficiency of capital utilization declined largely because of the concentration of investment in low yielding public sector projects associated with the construction of the new capital, and the associated crowding out of the private sector. When work on these projects subsequently came to an end, the output of the construction sector fell sharply. Agricultural production stagnated as a result of drought in 1979 and 1980, the failure to adjust producer prices for many crops during the late 1970s, and the poor auction prices available for tobacco, Malawi's principal export crop.

This weak economic growth was associated with the relatively poor performance of some major parastatal enterprises and Press Holdings Ltd. (PHL), a quasi-public conglomerate with commercial interests in most sectors of the economy. 1/ These enterprises made substantial losses as tobacco and sugar prices declined while the cost of imported inputs increased. Government subsidies were required to support several loss-making parastatals. Press Holdings also made large losses, and although formal subsidization was not undertaken, the Government, as guarantor, assumed responsibility for servicing part of PHL's external debt. Moreover, PHL borrowed heavily from domestic banks causing considerable weakening in the financial position of the banking system.

Interest rates generally were not fully adjusted to keep pace with domestic inflation, so that during the late 1970s they were negative in real terms (Appendix Table XIV). An adjustment of the rates in 1980 and a decline in the rate of inflation allowed lending rates to become

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1/ A more detailed appraisal of the parastatal entities and Press Holdings is made in Section III below.

Table 2. Malawi: Selected Economic and Financial Indicators, 1976-82

	Averages		1982	
	1976-78	1979-81	Program 1/	Actual
	(Annual percent changes, unless otherwise specified)			
National income				
GDP at constant market prices	6.5	1.9	1.8	2.7
GDP deflator	7.7	11.1	13.8	18.1
Consumer prices	5.7	13.0	9.0	8.8
External sector				
Exports, f.o.b. (millions of SDRs)	154.1	214.2	224.3	212.1
Imports, c.i.f. (millions of SDRs)	216.0	317.5	306.8	268.4
Export volume	--	15.3	3.0	-1.0
Import volume	-5.0	-10.0	-2.5	-14.2
Terms of trade (deterioration -)	-1.7	-10.7	-4.6	14.3
Nominal effective exchange rate, year-end (depreciation -)	2.3	-0.9	...	-3.9
Real effective exchange rate, year-end (depreciation -)	-1.6	0.4	...	-2.8
Government budget 2/				
Revenue, including grants	20.1	14.7	15.3	8.7
Total expenditure	19.7	16.6	2.2	-1.1
Money and credit 2/				
Domestic assets 3/	16.0	37.0	36.3	20.7
Credit to government 3/	1.7	28.1	20.9	6.8
Money and quasi-money (M2) 3/	15.9	10.7	15.0	12.7
Velocity (GDP relative to M2)	4.8	5.1	5.2	5.1
Interest rate (annual rate, one-year savings deposits) 4/	5.5	8.75	8.75	8.75
	(As percentages of GDP unless otherwise specified)			
Central government budget deficit 2/				
Excluding official transfers	9.2	12.9	11.2	9.4
Including official transfers	7.0	9.1	7.2	7.1
Domestic bank financing 2/	0.4	4.7	3.5	1.1
Foreign financing 2/	5.6	4.7	3.5	4.9
Gross fixed investment	25.1	23.7	17.2	15.4
Gross national savings	15.0	9.1	10.0	11.4
Current account deficit				
Excluding official transfers	2.2	16.8	11.8	9.1
Including official transfers	8.9	12.7	7.7	6.7
External debt, (inclusive of use of Fund credit) (in millions of SDRs) 4/				
Debt service ratio 5/	276.0	665.1	...	701.5
Pre-debt rescheduling	9.7	19.9	43.5	48.7
Post-debt rescheduling	...	...	37.1	42.1
Overall balance of payments (millions of SDRs)	-3.7	-20.9	-43.1	-46.7
Gross official reserves (months of imports c.i.f.)	2.8	1.9	1.5	0.9
External payments arrears	--	--	--	--

1/ Under stand-by arrangement which expired on August 5, 1983.
2/ Fiscal year beginning April 1.
3/ As a percentage of money and quasi-money at the beginning of the period. Period averages are the arithmetic averages of annual rates of change.
4/ End of period.
5/ In percent of exports of goods and nonfactor services. Based on data provided by the IBRD and including IMF charges and repurchases.

positive in real terms, but real savings and deposit rates remained negative until mid-1983, when a further adjustment was made. 1/

In view of Malawi's weak economic performance and increasing financial imbalances, the authorities undertook a stabilization program in 1980/81 and 1981/82, supported by a two-year stand-by arrangement from the Fund. Some correction was achieved under this program but was not sufficient to achieve the targets established under the arrangement. The financial imbalances remained large and growth performance was unsatisfactory.

Recognizing the serious imbalances and structural maladjustments that had developed in Malawi during the years through 1981, the authorities requested a further one year stand-by arrangement from the Fund for 1982/83. The government viewed this in the context of a medium-term strategy to restore the economy to a faster growth path in a more stable financial environment. The principal objective of the program was to achieve a greater degree of financial stability and restraint on domestic demand, with particular emphasis on the government budget and the parastatal sector.

A number of measures were taken in support of this objective. In April 1982 the Malawi kwacha was devalued by 15 percent in domestic currency terms. Substantial increases were announced in the agricultural producer prices offered for the 1982/83 growing season. Measures were taken on both the revenue and expenditure sides of the government budget to reduce the overall deficit. A program to phase out fertilizer subsidies over three years was introduced. The parastatal enterprises were strengthened by the appointment of new boards of management, the introduction of more effective financial controls, and increases in the prices of key products or services.

In contrast to the programs in the preceding two years, performance in 1982/83 was satisfactory throughout and all purchases were made following the observance of the ceilings on net credit to Government, net domestic assets of the banking system and external borrowing (Table 3). In several areas performance exceeded expectations. GDP was projected to grow by 1.8 percent, but rose by 2.7 percent, in large measure due to good agricultural output, which more than offset the effects of a decline in industrial activity (Table 2). The rise in consumer prices was in line with the rate projected. The improvement in the external position, as measured by the ratio of the current account deficit to GDP, was slightly better than anticipated (Table 2 and Appendix Table VI). This was due largely to a rise in export prices and a large reduction in the volume of imports caused by the disruption in external trade routes.

1/ This adjustment, performed as a prior action to the proposed extended arrangement, is described in Section IV.

Table 3. Malawi: Quantitative Performance Criteria for the 1982/83 Program

	Sept. 1982	Dec. 1982	March 1983
	(In millions of Malawi kwacha)		
Net domestic assets of the banking system 1/			
Ceiling	464.1	488.0	503.7
Actual	463.8	474.6	487.0
Net bank credit to the Government 2/			
Ceiling	199.5	215.0	223.7
Actual	193.8	211.4	216.9
	(In millions of SDRs)		
External borrowing contracted or guaranteed by Government 3/			
1-12 years maturity			
Ceiling	10	10	10
Actual	--	--	--
1-5 years maturity			
Ceiling	5	5	5
Actual	--	--	--

Sources: Letters of intent and policy memorandum of June 11, 1982 and January 24, 1983; and data supplied by the Malawi authorities.

1/ Defined as net credit by the banking system to the Government, and gross credit to the statutory bodies and the private sector, plus the other domestic assets (net) of the banking system.

2/ Defined as gross credit to Government less government deposits with the commercial banks and the Reserve Bank of Malawi, plus any use of the local currency counterpart of purchases from the Fund other than Trust Fund purchases, or external borrowing by the Government for balance of payments support.

3/ Non-concessional external debt contracted or guaranteed by Government.

The budget deficit target was observed in 1982/83, even though revenue and grants rose more slowly than anticipated (Table 2 and Appendix Table X); the 1982/83 deficit (including official transfers) was equivalent to 7.1 percent of GDP, compared with 10.6 percent in 1981/82 (excluding officials transfers, the ratios were 9.4 percent and 14.0 percent, respectively). Total expenditure fell in nominal terms by about 1 percent, or by at least 10 percent in real terms; slow project implementation led to underspending on the development account, and receipts from grants were correspondingly lower. The growth of current expenditure was also contained, reflecting the effectiveness of the expenditure control and monitoring procedures that were introduced under the program.

The smaller overall deficit and higher net foreign inflows to the budget allowed the Government to reduce significantly its recourse to the banking system: domestic bank financing represented only 1.1 percent of GDP in 1982 compared with 4.7 percent in the previous year. The increase in net domestic assets of the banking system was reduced to 29.3 percent of the broad money stock (Table 4) compared to 48.1 percent in 1981.

The large fiscal and external payments deficits of the years 1978-81 were financed by external borrowing on commercial terms. Malawi's debt service obligations rose rapidly (Table 2); at the beginning of 1982, they were projected in the absence of debt relief to exceed 50 percent of exports of goods and non-factor services by 1983 and to continue at high levels in 1984 and 1985. In the circumstance, Malawi approached the Paris Club and the London Club (commercial banks) for the rescheduling of official and commercial bank debt. Agreements were concluded in both cases to provide for rescheduling of debt falling due in 1982/83. The Paris Club agreed to consider rescheduling for a further year and it is expected that a meeting will be held in October 1983. The London Club provided for a further year's rescheduling subject to a similar agreement with the Paris Club, and to Malawi continuing to meet the requirements of a Fund program and an IBRD structural adjustment loan. A separate agreement was concluded with the Commonwealth Development Corporation.

The Malawi kwacha was pegged to the SDR in June 1975. Its rate against the new peg remained unchanged until the devaluation of 15 percent in April 1982, which offset an appreciation of 13.5 percent in the nominal (import weighted) effective exchange rate since December 1980, and an estimated 6.7 percent appreciation in the real effective rate in the same period. Since the adjustment of April 1982, the effective exchange rate has appreciated by about 5 percent in nominal terms and 12 percent in real terms. This reflects both the high weight of the U.S. dollar in the SDR relative to Malawi's distribution of trade, and the acceleration in domestic inflation in late 1982 and early 1983 which has accompanied the costly re-routing of the country's external trade.

Table 4. Malawi: Monetary Survey, 1979-83

(Twelve month change as percent of money and quasi-money at the beginning of period)

	1979	1980		1981		1982		1983
	Dec.	March	Dec.	March	Dec.	March	Dec.	March
Net foreign assets	-42.2	-33.4	3.9	-0.8	-13.4	-25.1	-28.0	-12.5
Net domestic assets	41.2	33.5	12.0	31.4	48.1	46.0	29.3	20.7
Credit to Government (net)	11.1	13.2	10.6	28.9	44.1	42.2	18.1	19.1
Credit to statutory bodies	3.4	2.1	1.2	1.0	1.8	-0.7	1.4	6.8
Credit to private sector	28.8	25.2	6.8	2.3	4.9	12.6	11.3	10.0
Other assets (net)	-2.2	-7.0	-6.6	-0.7	-2.7	-8.1	-3.4	1.6
Capital account, SDR allocations, and long-term liabilities of Reserve Bank	-1.9	3.4	3.3	8.5	8.5	5.8	-4.0	-4.7
Money plus quasi-money	0.9	-3.2	12.6	22.0	26.1	15.1	14.5	12.6

Source: Appendix Table XIII.

The performance under the 1982/83 program indicates that the process of financial stabilization has begun. The authorities believe that the serious maladjustments which remain require measures to strengthen the productive sectors of the economy, in addition to the continuation of demand management policies. The need to undertake these measures, the time required for their implementation and the progress made under the last arrangement (which expired on August 5, 1983) all suggest the appropriateness of a medium-term program.

III. The Medium-Term Economic and Financial Program

1. Macroeconomic objectives

The authorities have adopted a program covering the period from April 1, 1983 to September 5, 1986 that is designed to promote structural change in the economy and to address the related problems of low economic growth and financial imbalances. The authorities will continue relatively constrained demand management policies while implementing measures to improve domestic supply and effecting appropriate institutional reforms to provide the base for economic growth.

The economy is expected to achieve an average annual rate of increase in real GDP of about 3.5 percent during the program period, rising from 2.5 percent in 1983 to 4.5 percent in 1986 (Table 5). It also aims to reduce the current account deficit of the balance of payments from an estimated 9.1 percent of GDP in 1982 to 5.4 percent in 1986, a level that can be sustained in the light of expected net capital inflows (including official transfers), after allowance is made for rescheduling the country's external debt in 1982 and 1983. The overall balance of payments is projected to show a turnaround from a deficit of SDR 38.5 million in 1982 to a small surplus in 1986. Exports are projected to rise at an average annual rate of 11 percent, as a result of increases in both the volume and the value of some of the main export crops, while imports are expected to rise at an annual average rate of 9 percent. Domestic inflation, as measured by an index of retail prices for low income households, is expected to rise to 13 percent in 1983, a result of measures to liberalize the price control system and the increased cost of imports caused by the diversion to longer routes of most of the country's external trade; thereafter the rate of domestic inflation is expected to be reduced progressively to about 7 percent in 1986.

Gross fixed investment is expected to rise from about 15 percent of GDP in 1982 to about 19 percent in 1986, a return towards the rates achieved in years prior to 1978. It is expected that an increasing proportion of this total will be financed by domestic saving, which is projected to rise from 13 percent of GDP in 1982 to about 18 percent in 1986. Total final consumption expenditure is expected to grow by

Table 5. Malawi: Macroeconomic Targets of the Medium-Term Program

(In percentage except where otherwise stated)

	1983	1984	1985	1986
Growth of GDP at constant market prices 1/	2.7	3.0	4.0	4.5
Gross fixed capital formation/GDP	15.4	16.6	18.1	19.2
Domestic savings/GDP	13.3	14.1	16.6	17.5
Domestic inflation				
Consumer prices	13.0	10.0	8.0	7.0
GDP deflator	9.7	9.7	8.1	8.3
Overall budget deficit/GDP 2/ 3/	6.4	5.4	4.8	...
Total expenditure/GDP 2/	25.6	25.2	24.5	...
Revenue/GDP 2/	16.6	16.9	16.7	...
Expansion in net bank domestic assets	11.7	12.2	11.2	10.5
Increase in credit to Government	8.7	11.0	7.8	7.3
Increase in money plus quasi-money	12.7	14.7	14.6	15.9
Growth of imports in nominal terms 4/	7.6	8.0	9.7	12.6
Growth of exports in nominal terms	4.0	12.5	15.3	12.0
Change in terms of trade	-13.7	1.7	4.1	1.2
Current account deficit/GDP 5/	8.0	7.0	5.6	5.4
External debt service ratio 6/				
Before rescheduling	42.7	39.5	30.8	27.4
After rescheduling	22.0	30.5	33.2	31.5

Sources: Tables 6, 7, 8 and 9; Appendix Table XVII; and staff estimates.

1/ The program target is an average rate of growth of about 3.5 percent during the period of the extended arrangement.
2/ Fiscal year starting April 1 of the year indicated.
3/ Including grants.
4/ Imports f.o.b.
5/ Excluding official transfers.
6/ Including public and public guaranteed debt and use of Fund resources.

an average of 2.4 percent in real terms in the period 1983 to 1986, thereby falling from 87 percent of GDP in 1982 to 82 percent by 1986. It is anticipated that the investment effort will be supplemented by an improvement in the marginal efficiency of capital, reflecting a higher utilization of capacity and a shift away from high cost, low yielding projects to investment oriented toward industrial and agricultural development. The incremental capital-output ratio is thus expected to decline from 5.8 in 1983 to 4.5 in 1986. If the increase in the domestic savings effort and the improvement in the efficiency of investment are slightly less than implied in these figures, the rate of growth could be nearer to 3.0 percent than the 3.5 percent shown in Table 5. To achieve the program's investment targets, the authorities are committed to the implementation of a three-year public sector investment program that has been prepared in close consultation with the World Bank in connection with a second structural adjustment loan.

2. Policy measures

Attaining the objectives outlined above will require policies that stimulate domestic supply as well as those intended to constrain demand. Accordingly, two broad categories of policies are distinguished in this section, although it is recognized that there is considerable overlap between them.

a. Supply-oriented policies

The measures proposed on the supply side include the stimulation of agriculture by means of improved incentives, the adoption of a detailed public sector investment program, and further rationalization of the public and quasi-public enterprise sector. In view of the very difficult external transport situation the public investment program will devote significant resources to developing alternative routes.

(1) Agricultural producer pricing

Malawi has an extensive system for purchasing smallholder crops for resale both domestically and abroad through the government-owned Agricultural Development and Marketing Corporation (ADMARC). Between 1977 and 1982 ADMARC made few adjustments in its schedule of prices paid for smallholder produce, the major one being a 67 percent increase in the price paid for maize announced for the 1981/82 growing season. This increase, prompted by severe shortages attributable to two years of poor harvests in 1979 and 1980, led to substantial increases in maize production in 1982 and 1983 at the expense of traditional smallholder crops such as groundnuts and dark-fired tobacco. Small steps were taken at the start of the 1981/82 and 1982/83 growing seasons to offset these effects by increasing the prices of cotton, dark-fired tobacco, and chalimbana (export-grade) groundnuts while keeping maize prices unchanged, but these increases have not been sufficient to restore the relative attractiveness of these crops.

During the 1982/83 program, in cooperation with the World Bank, the Malawian Government adopted a new procedure which relates producer prices to the "farmgate" export price (export unit value less transport and marketing costs) for all smallholder crops. Consistent with this procedure, in April 1983 prices paid for smallholder tobacco were increased more than 40 percent, the first substantial price rise for tobacco since the late 1970s. Prices paid for domestic-grade (manipintar and malimba) groundnuts, peas, and certain other pulses were also increased by amounts ranging from 50 to 80 percent, again the first substantial increase for these products since the late 1970s. These increases, although implemented too late to affect planting during the 1982/83 season, are expected to influence crop decisions during the 1983/84 crop year.

The Malawian Government will continue to implement the new methodology for setting producer prices, making adjustments as needed to maintain real rates of return for smallholders and to reduce existing disparities in gross margins per day of labor across competing smallholder crops. In particular, the prices for tobacco and groundnuts will be increased relative to maize, providing a further incentive for production with the aim of restoring exports of these crops at least to the levels of the late 1970s. Further price increases will also be considered for cotton, to maintain domestic production and to reduce the need for imports. In addition, further adjustments in the prices of key pulses have been proposed partly in response to anticipated demand from neighboring countries.

During the 1983/84 growing season, the Government will impose special quotas on the production of burley tobacco, to prevent a recurrence of the excess supplies that developed in late 1983 as a result of strong worldwide production and a major shift in both the estate and smallholder sector to higher burley output. According to present proposals individual growers will be restricted to 58 percent of the average burley acreage planted during the 1981/82 and 1982/83 growing seasons. This action is designed to help stabilize local prices and to allow the approximately 20,000 metric tons of burley expected to remain at the end of the 1983 auction to be sold in the following year.

(2) Public sector investment program

Projects undertaken by the Government and statutory bodies represent the bulk of all investment activities in Malawi. Since the late 1970s, more than two thirds of the costs of these projects have been funded through the government budget.

Over the past several years, Malawi's public sector investment efforts have been hindered by the absence of a coherent overall strategy, with the notable exception of the projects organized under the National Rural Development Program (NRDP). Despite the importance of agriculture in Malawi's economy, a relatively small portion of all public sector investment outlays have gone toward crop development and related activities since 1977/78, although the percentage has risen during the past two years. Also, although Malawi's existing trade routes have proved susceptible to serious disruptions, only limited resources have been devoted to developing alternative transport links.

As part of the proposed extended arrangement, the authorities have adopted a public sector investment program for the period 1983/84-1985/86 giving greater emphasis to productive projects in key sectors. This program has been found broadly acceptable by the World Bank for its second structural adjustment loan to Malawi (SAL II). It will devote more than 16 percent of central government development expenditures over the 1983/84-1985/86 fiscal years to crop development and about 38.5 percent to transport. Another 7 percent will be devoted to post and telecommunications projects, while 5 percent will go toward forestry and game projects, a critical area for Malawi because of the country's dependence on firewood for tobacco curing and the continuing depletion of existing timber reserves. Currently available figures indicate that, of the MK 494.4 million (SDR 407.9 million) in anticipated budgetary expenditure for the investment program during these years, 30 percent will be spent in the 1983/84 fiscal year and 33 percent in fiscal year 1984/85. It is expected that about 88 percent of total expenditure will be financed externally.

Among individual projects, most of those in agriculture are focused on the smallholder sector. Nearly 75 percent of all budgetary development expenditures for agriculture would go toward various National Rural Development (NRDP) projects. About half of the remaining funds would go toward establishing a revolving fertilizer fund (14 percent) financed in part by the World Bank. Another major recipient would be Malawi's Natural Resources College (1.3 percent). In the transport sector, substantial resources are allocated for the Fifth Highway Road Project, which would provide access from the South to the Tanzanian Border and from there by rail or highway to the Indian Ocean port of Dar-es-Salaam. An allocation is also provided for purchase of an additional tanker to be used on Lake Malawi. This acquisition could be used to develop a low-cost shipping link to Tanzania if the current facilities at the Tanzanian port of Mbamba Bay were upgraded.

Current data do not provide a full indication of investment projects to be undertaken by parastatals outside the central government budget. The available information suggests the likelihood of about MK 83.2 million (SDR 68.6 million) in parastatal investment outlays over the three fiscal years 1983/84-1985/86, of which about MK 52 million would be financed externally largely through funds disbursed through the government budget. Current projections show nearly all of the remaining MK 30 million as self-financed. Of the latter amount, however, only the MK 13.5 million forecast for the Electricity Supply Company of Malawi (ESCOM) seems assured, because of the doubtful financial position of the other leading parastatals. About MK 33 million of the total outlays during calendar years 1983-85 would come from ESCOM, of which completion of the rural electrification project and installation of two additional generators at the Nkula B power plant will represent the largest single projects. An additional MK 21.4 million in outlays is forecast for Malawi Railways, nearly all of which are to be externally financed, including MK 5.3 million for rolling stock. Parastatal investment outlays would rise by another MK 26.6 million in 1985 if construction of the Kapuchira Falls electrical project, now scheduled to begin in 1986, is started a year earlier.

(3) Statutory bodies

Since 1979/80, there has been a considerable deterioration in the financial performance of several parastatals, in particular, ADMARC, the Malawi Development Corporation (MDC), the Malawi Housing Corporation (MHC), the Capital City Development Corporation (CCDC), and the Electricity Supply Company of Malawi (ESCOM); all except ESCOM have run substantial deficits during the past three fiscal years. ADMARC and ESCOM have had to defer paying interest on government provided loans, while investments in slow-yielding projects have left the MDC without significant working capital to undertake new projects.

Certain steps have already been taken to improve parastatal performance. Consultants' studies of ADMARC, MDC, and MHC were undertaken as part of the World Bank's first Structural Adjustment Program approved in 1981. In addition, ADMARC has already made significant changes in its administrative staff, including the appointment of an independent controller and a new general manager. MDC has begun making plans to dispose of unviable properties, while ESCOM has postponed certain capital projects as a way of cutting costs. ESCOM and the Blantyre Water Board have been granted regular tariff increases of 10-15 percent a year, while Malawi Railways has increased its rates on domestic routes. In addition, Malawi Airways, which was making losses at the beginning of the decade, has eliminated costly routes and is now earning a profit on current operations.

ADMARC is still burdened with inefficient investments made during the 1970s and with the costs of maintaining maize stocks and of subsidizing fertilizer purchases by smallholders. Under the proposed program, the costs of maize storage will be transferred to the government budget, although ADMARC will remain responsible for the cost of building and maintaining its silos. ADMARC will also be allowed to phase out the remaining 50 percent of fertilizer price subsidies (based on the ex-Beira price) during the 1983/84 and 1984/85 fiscal years, although the increase in transport costs resulting from disruption of rail service from Beira will be subsidized. ADMARC is also expected to improve efficiency by centralizing marginal purchasing stations and streamlining administrative staff. The MDC will continue to strengthen its management, reduce nonessential expenses, and review its portfolio so that more funds are available for supporting new ventures, MDC's underlying objective. These divestitures will be arranged through a special committee appointed to oversee the rationalization and divestiture of assets at ADMARC, MDC, and Press Holdings. The MHC and CCDC, which are projected to require MK 1.1 million and MK 3.8 million, respectively, in government budget support during 1983/84, will increase rentals so as to cover their costs. Malawi Railways, whose cash deficit in 1983/84 is projected to exceed MK 2.4 million (the overall deficit is likely to exceed MK 4 million), presents a special problem because efforts to raise tariffs on its key international routes to Mozambique are likely to generate corresponding increases by the Mozambicans, leading to net revenue losses for the railway. Because of the Railway's strategic importance, it is probable that the Government will have to cover its losses on international traffic for an extended period. A consultant's report has determined that Malawi Railways is making substantial efforts to minimize costs and operate efficiently. Nonetheless, the Railway will be expected to monitor its operations so that losses can be minimized and traffic restored once the current difficulties involving the lines to Beira and Nacala are eliminated.

(4) Institutional reform of Press Holdings Ltd.

During the 1970s the group of companies controlled by Press (Holdings) Ltd. (PHL) assumed an increasingly important role in the Malawian economy. In more recent years financial problems have arisen which affect many areas of economic activity: employment, industrial and agricultural output, the government budget and the financial position of the banking system.

PHL, generally considered to be a private company, was incorporated in 1969 as an investment holding company, with its equity shares originally held in trust for the Malawian people by the Life President, although subsequently the shares were transmitted to the Press Trust. The income of this trust (including dividends declared by PHL) was to be used by the trustees for expenditure of national benefit. After its formation PHL grew rapidly, establishing or acquiring commercial interests in agriculture, manufacturing, energy, distribution and transportation, construction and financial services. By 1981 the turnover from its majority owned activities was about MK 125 million, with a further MK 325 million arising from its minority interests. The combined turnover of the group and its associated companies represented 39 percent of GDP in 1981, and it accounted for about 10 percent of wage employment in that year.

By the end of 1981, PHL was in a weak financial position as a consequence of losses in a number of its subsidiary companies, poor management, inadequate observance of standard accounting practices, and payments and loans to Press Trust substantially in excess of PHL's after-tax profits. PHL became unable to service a large part of its domestic and external debt, placing considerable financial strain on other sectors of the economy. The Government, in its role as guarantor of external debt, had to assume additional expenditure, while some of PHL's domestic creditors, including the commercial banks and the key Agricultural Development and Marketing Corporation (ADMARC), found their liquidity position seriously affected.

In consultation with the World Bank during the implementation of its first structural adjustment loan the Government of Malawi commissioned a detailed study intended to provide guidelines and recommendations for dealing with the problems of the group. The authorities have already embarked on a fundamental restructuring of the Press Group. The primary objective of the plan is to establish PHL as an entity able to operate on strictly commercial principles, while retaining its identity as a nongovernmental organization. Considerable emphasis was placed on consolidating the liabilities of the group to domestic creditors, in particular the Government, the banking system and ADMARC, in a way that would not place an undue burden on their budgetary or liquidity requirements while allowing PHL's indebtedness to these bodies eventually to be discharged. The plan also recognizes that the purpose for which PHL was initially established, to provide income to the Press Trust, would continue to represent a demand on the restructured group. Therefore a formal arrangement would be needed to ensure that transfers to the Trust do not constitute an unmanageable burden on the company.

To achieve these objectives a number of more detailed proposals were made. A corporate structure will be established with four new subsidiary companies of PHL. The first of these, Press Group Ltd. (PGL), will be assigned all the existing assets and liabilities of PHL, becoming the vehicle for receiving income from the subsidiaries, and for distributing this income in the form of debt servicing payments and dividends or other payments to the ultimate owner, Press Trust. For operational purposes the new master company will be Press Companies Ltd. (PCL), financed by the issue of equity and income notes to PGL, and it in turn would hold majority interests in two subsidiaries. One of these, Press Agriculture Ltd. (PAL), will be the center of consolidation for all PHL's existing majority-owned farming interests, while the other, Press Investment Trust Holding Ltd. (PITH), will be assigned the group's minority shareholdings with a view to their eventual sale to domestic or foreign private investors.

The financial aspects of PHL's restructuring exercise have a particular relevance for the Government and the banking system. The

Government will assume PHL's debt to the commercial banks, which at present amounts to MK 55 million, through a special issue of Local Registered Stock (LRS) issued at 8 percent and redeemed over 25 years. In return PGL, the new holding company, will issue an equal amount of income notes, redeemable over 25 years, at an interest rate sufficient to compensate the government for the cost of servicing the special LRS issue. The Government will also take over PHL's ownership of shares in the two commercial banks, with a corresponding reduction in the group's liabilities to the Government. PHL's liabilities of MK 54 million to ADMARC will be consolidated into a similar issue of income notes. The Press Group's ability to service and reduce its debt to ADMARC will be matched by an arrangement under which ADMARC will reduce its liability to the Reserve Bank of Malawi by an equal amount. To prevent excessive expansion of bank liquidity, strict limits will be placed on the degree to which the Local Registered Stocks can be used as part of the base on which the commercial banks liquidity ratios are calculated.

To improve PHL's financial position, a substantial reduction in headquarters staff was implemented in 1982, and an action plan prepared for each subsidiary. As a result of these measures, there was some improvement in the Group's financial performance in 1982.

b. Demand-oriented policies

On the demand side, policies are designed to continue the process of financial stabilization. These include appropriate policies with regard to the budget, monetary policies, and pricing policies.

(1) Subsidies

At present, Malawi subsidizes the cost of fertilizer purchases by smallholder farmers, although the cost is borne by ADMARC rather than the government budget. The Government also provides substantial subsidies in the form of low-cost tuition to primary and secondary students, personal allowances and free tuition to post-secondary students, below-cost fees for health services, and low rents for government-supplied housing to civil servants and others. The fertilizer subsidy is estimated to have cost ADMARC MK 3.8 million in fiscal year 1982/83. Housing subsidies are estimated to cost the Government more than MK 3 million a year.

Under the 1982/83 stand-by program, in cooperation with the World Bank, the Government eliminated 50 percent of the subsidy on smallholder purchases of fertilizer and undertook to remove the remaining subsidy 1/

1/ This refers to the subsidy on the price ex-Beira. Additional temporary costs have been incurred owing to the diversion of shipments to longer routes through Durban or Dar es Salaam.

by the end of fiscal year 1986. In 1982 the Government also introduced the first rise in primary and secondary school fees since 1975. In addition, the Government made a first step towards reducing housing subsidies by increasing rents for civil service housing for furnished and unfurnished units to 15 percent and 12.5 percent of salary respectively, an increase equal to 2.5 percent of salary for each employee.

During the proposed EFF program, the Government intends to complete the elimination of fertilizer subsidies before the start of the 1984/85 growing season. At the request of the World Bank, the Government will also consider a reduction in personal allowances and the imposition of fees at the national university, to reduce costs and allow a shift of expenditure to other areas.

(2) Fiscal policy

The principal objectives for fiscal policy under the proposed program are twofold: (1) to allow sufficient funds for maintaining real government expenditures and (2) to reduce the government budget deficit to a level consistent with a sustainable balance of payments deficit and the availability of sufficient domestic credit for private sector expansion. To achieve this latter end, the budget deficit (including grants) will be reduced from 7.1 percent of GDP in fiscal year 1982/83 to 6.4 percent of GDP in fiscal year 1983/84, 5.4 percent in 1984/85, and 4.8 percent in 1985/86. Excluding official transfers, these figures would correspond to deficits of 8.7 percent of GDP in 1983/84, 8.0 percent in 1984/85, and 7.5 percent in 1985/86 (Table 6).

The above deficit targets will be achieved by a combination of revenue measures and expenditure limitations. On the revenue side, the Government will implement measures designed to prevent the further erosion of revenue effort, which declined to 16.6 percent of GDP in fiscal year 1982/83 from 20.3 percent in fiscal year 1979/80, largely because transport difficulties have limited revenue from customs duties and the surtax. In the tax area, the Government will choose from among measures that would increase surtax and import duty rates, impose a tax on maize sales to help finance the cost of the national maize reserve, and increase the elasticity of fixed excise and duty rates on motor vehicles and other consumer goods. Efforts will also be made to increase revenues from the agricultural sector. To this extent, consideration has been given to raising rentals for estate leases, which remain far below market levels, and for introducing appropriate forms of taxation in the smallholder sector. This latter reform will be treated cautiously, however, so as not to counteract other measures designed to maintain the real level of agricultural producer prices. Among nontax revenues, the Government will consider ways of increasing receipts from departmental enterprises and from miscellaneous fees and charges. Many of these items have not been revised since the 1970s, and this lack of adjustment has contributed significantly to the decline

Table 6. Malawi: Central Government Budgetary Operations, 1982/83-1985/86

	1982/83 Prelim.	1983/84 Budget	1983/84 Revised	1984/85	1985/86
	(In millions of Malawi kwacha)				
Total revenue and grants	274.8	328.5	314.9	362.8	402.4
Revenue	241.1	279.4	272.9 1/	313.6	347.4 2/
Grants	33.7	49.1	42.0	49.2	55.0
Total expenditure	378.5	418.5	419.8	462.2	502.4
Recurrent	255.6	266.0	272.3 3/	297.0 4/	320.7 4/
Development	122.9	152.5	147.5	165.2	181.7
Overall deficit	-103.7	-90.0	-104.9	-99.4	-100.0
Financing	103.7	90.0	104.9	99.4	76.7 5/
Foreign (net)	83.5	76.2	74.9	69.4	46.7
Borrowing	(96.0)	(88.4)	(84.3)	(99.3)	(95.8)
Repayment	(-12.5)	(-12.2)	(-9.4)	(-29.9)	(-49.1)
Domestic	20.2	13.8	30.0	30.0	30.0
Of which:					
Banking system	(19.7)	(13.0)	(23.1)	(20.0)	(20.0)
	(Ratios to GDP)				
Total revenue and grants	18.9	20.0	19.2	19.5	19.4
Revenue	16.6	17.0	16.6	16.9	16.7
Grants	2.3	3.0	2.6	2.6	2.7
Total expenditure	26.0	25.5	25.6	24.9	24.2
Recurrent	17.6	16.2	16.6	16.0	15.4
Development	8.4	9.3	9.0	8.9	8.8
Financing of overall deficit	7.1	5.5	6.4	5.4	4.8
Foreign	5.7	4.7	4.6	3.8	3.4
Domestic	1.4	0.8	1.8	1.6	1.4
Of which:					
Banking system	(1.4)	(0.8)	(1.4)	(1.1)	(1.0)
Memorandum item:					
GDP at current market prices	1,454.2	1,639.9	1,639.9	1,857.7	2,078.7

Sources: Economic Report; Ministry of Finance; and staff estimates.

1/ Including MK 16.1 million in revenues from new measures implemented in March 1983.
2/ Includes MK 11.1 million and MK 12.4 million in revenues from new measures in 1984/85 and 1985/86.
3/ Includes MK 6.3 million in extrabudgetary expenditure.
4/ Includes MK 8.6 million in extrabudgetary expenditure.
5/ Currently projected. Additional foreign financing will be sought to fill the currently projected shortfall.

in overall revenue effort. In its 1983/84 budget, the Government has already announced certain changes (detailed below in Section IV) in personal income taxes, the surtax, certain specific excises, and import duties that together would maintain total revenues at about 16.6 percent of GDP.

On the expenditure side of the budget, the Government will exercise substantial restraint so that outlays are consistent with available revenue, foreign financing, and the deficit targets. With the implementation of revenue measures in the 1983/84 budget and the enactment of some MK 11 million in further measures during the 1984/85 fiscal year (yielding MK 12.4 million in 1985/86), total expenditures will be held to MK 419.8 million in 1983/84, MK 462.2 million in 1984/85, and MK 502.4 million in 1985/86, corresponding to respective increases of 10.9, 9.8 and 9.0 percent (Table 6), or slightly more than the projected rates of inflation during these years. The expenditure figure for 1985/86 is dependent on obtaining about MK 25 million more in foreign financing than assumed in the current balance of payments projections, and the Malawi authorities intend to make a special effort to obtain additional foreign financial assistance.

Within these total expenditure limits, development spending is projected to grow by amounts ranging from 20 percent in 1983/84 (because of low spending realizations in 1982/83) to 10 percent in 1985/86. Recurrent and extrabudgetary spending will increase to MK 272.3 million in 1983/84, MK 297.0 million in 1984/85 and MK 320.7 million in 1985/86, corresponding to increases of 6.5 percent, 9.1 percent, and 8.0 percent, respectively.

Since the World Bank has advised the Government to maintain current real levels of expenditure for education, rural projects, and road maintenance, little room will be left for increasing other forms of recurrent expenditure. In fiscal year 1983/84 the Government has already made important strides in this direction by subjecting recurrent spending outside these functions to a reduction in real terms, and not allowing any general wage increase. In order to make expenditure controls effective, in 1982/83 a system of monthly allocations to individual government ministries was introduced.

(3) Monetary and credit policies

Targets for credit or net domestic assets of the banking system will be formulated annually in the light of expected budgetary requirements and balance of payments situation. Preliminary projections indicate that between 1982 and 1986, net domestic assets of the banking system will increase at an average annual rate of 11.4 percent, while net domestic credit will expand at an average rate of 10.3 percent (Table 7); both rates of increase are below the average growth of nominal GDP. Net credit to government is projected to increase at an

Table 7. Malawi: Monetary Survey, 1982-86 1/

(In millions of Malawi kwacha)

	1982	1983 2/	1984 2/	1985 2/	1986 2/
Foreign assets (net)	-144.9	-162.7	-174.9	-183.4	-181.3
Net domestic assets	474.6	530.2	595.0	661.5	730.9
Net domestic credit	495.9	551.2	612.0	670.5	732.9
Net credit to Government	211.4	229.7	255.0	275.0	295.0
Credit to statutory bodies	65.5	65.0	67.2	69.7	72.7
Credit to private sector	219.0	256.5	289.8	325.8	365.2
Other assets (net)	-21.3	-21.0	-17.0	-9.0	-2.0
Long-term liabilities of Reserve Bank, SDR allocations and capital account	55.7	56.0	62.8	68.7	75.0
Money plus quasi-money	276.4	311.5	357.3	409.4	474.6
Memorandum item:					
Velocity of circulation	5.10	5.10	5.02	4.93	4.77

Sources: Data provided by the Malawian authorities; and staff estimates.

1/ End of period.
2/ Projected.

annual rate of 8.7 percent between 1982 and 1986, and only a very small change is expected in the level of credit to the statutory bodies, reflecting an improved financial outlook for the main statutory bodies. Credit to the private sector is expected to grow by 13.6 percent annually, rising from 44 percent of net domestic credit in 1982 to 50 percent in 1986. Taking into account the relatively small decline in net foreign assets, the projected expansion of the banking system's net domestic assets implies an average annual increase in money plus quasi-money of 14.5 percent between 1982 and 1986, somewhat more than the average growth of 12.5 percent projected for nominal GDP. Consequently, the income velocity of circulation is estimated to decline slightly from 5.1 in 1982 to 4.9 in 1986, thus returning towards the velocity observed in the period 1973 to 1978.

The authorities intend to undertake periodic interest rate adjustments to reflect changes in price levels, maintaining interest rates at least equal to the underlying rate of inflation. By this means it is expected that, in the long run, the level of domestic savings will be raised, and the extent of financial intermediation increased.

Although Malawi relies heavily on agricultural production, no separate institution exists to provide credit to agricultural enterprises either for long-term development or for seasonal financial requirements. The Government provides limited assistance to smallholders (farmers with less than 10 hectares under cultivation), but credit to all other farmers has been provided by commercial banks. The authorities, in close consultation with the banks and other financial institutions, are examining proposals to establish a facility for providing medium-term agricultural credit or credit guarantees. This would enable the commercial banks to reduce their exposure in this type of lending.

(4) Price policies

Until 1983 the Malawian system of price controls has operated at four levels. At the first level, a small number of commodities either regarded as essential items of household budgets or considered to require close surveillance are subject to statutory control requiring ministerial approval and formal notification before any price increase can be implemented. A second group of goods consists of the output of seventeen domestic industries having a significant impact on consumers and for which there is little or no competition. Although these industries are required to give the Government advance notice of any price increases, prior approval is not required, although in practice, by convention or ministerial request, these industries seek prior approval. In the third and fourth groups, consisting of imported or custom-made goods, there is no formal or informal requirement to obtain ministerial approval, but companies prefer to obtain official sanction for increases.

The prices of these goods are subject to approval or inspection by officials without reference to government ministers. In general, there have been few goods for which price increases were rejected, but the large number of goods processed by the Price Control Board and the limited number of officials administering the system has caused serious delays in implementing increases. Thus the system has created inefficiency and reduced profitability, although there has been little evidence of excess demand arising from price control.

The authorities have decided to conduct a comprehensive review of the system of price controls during the first year of the program leading eventually to a substantial reduction of the list of items subject to control. As a first stage in this process measures to streamline and liberalize the existing system will be introduced. The most important of these is the introduction of a time limit of 60 days within which the authorities must respond to proposed price increases, failing which the requested increases will become effective automatically. The new measure is to be introduced before the end of September 1983. After it has been in operation for a few months, the system will be reviewed with the intention of reducing the time limit for most goods to 30 days. In addition, the authorities intend to establish a timetable for progressively reducing the number of items subject to price control, and they will identify an initial list of goods for early decontrol; these actions are expected before the completion of the first review of the program.

c. External sector

(1) Balance of payments objectives and policies

The program's objective in the external sector is to strengthen the balance of payments position so that the current account deficit will be reduced from 9.1 percent of GDP in 1982 to 5.6 percent in 1985 (Table 8). This deficit, which amounted to SDR 106 million in 1982, was twice as high as Malawi's total net capital inflow during the same year prior to debt rescheduling. It is, however, expected that the program policies of containing demand and stimulating output will encourage the growth and diversification of exports while restraining import demand, and this will reduce the current account deficit by 1985 to a level well within Malawi's net capital inflow projections without further debt relief after 1983/84.

The program's projections are based on the general assumption that the capacity of the export sector to serve as a leading growth sector will be reduced by the slow growth of demand in the industrial countries and by the likelihood that price and income elasticities of demand in major industrial countries for several primary products will be lower in the 1980s than in the last two decades. The program's projections are also based on the assumption that the Malawi Government's medium-term growth strategy aims at diversifying export production with greater

Table 8. Malawi: Balance of Payments, 1982-87

(In millions of SDRs)

	1982	1983	1984	1985	1986	1987
Current account	-106.3	-105.1	-98.8	-88.4	-95.6	-98.7
Trade balance	24.3	18.4	29.9	46.6	50.8	51.0
Exports (f.o.b.)	212.1	220.5	248.1	286.0	320.3	338.3
Imports (f.o.b.)	-187.8	-202.1	-218.2	-239.4	-269.6	-287.3
Services and transfers, net	-130.7	-123.5	-128.7	-135.0	-146.4	-149.7
Nonfactor services, net	-89.9	-84.6	-91.7	-100.2	-112.7	-119.2
Factor services, net	-33.2	-31.4	-29.4	-26.6	-24.5	-20.1
Of which:						
interest payments	(-52.5)	(-47.2)	(-44.0)	(-41.8)	(-40.4)	(-36.9)
Private transfers	-7.5	-7.5	-7.6	-8.2	-9.2	-10.4
Capital account	51.6	37.2	63.3	89.5	112.4	127.4
Long-term capital	41.3	37.2	63.3	89.5	112.4	127.4
Government transfers (net)	28.5	33.0	37.7	41.3	48.9	52.6
Government borrowing (net)	29.9	25.5	36.8	49.0	52.5	59.0
Credit	(69.5)	(63.4) 3/	(71.6)	(82.3)	(81.6)	83.7
Debit	(-39.6)	(-37.9)	(-34.8)	(-33.2)	(-29.1)	(-24.7)
Statutory bodies (net)	-14.4	-15.9	-10.4	-3.2	4.7	4.7
Private enterprises (net)	-2.6	-5.4	-0.8	2.4	6.3	11.0
Short-term capital and errors and omissions	10.2	--	--	--	--	--
Overall balance before debt relief	-54.8	-67.9	-35.4	1.1	16.7	28.7
Debt relief 1/	16.3	53.2	25.8	-7.8	-15.1	-22.1
Overall balance after debt relief	-38.5	-14.7	-9.6	-6.7	1.6	6.6
Financing	38.5	14.7	9.6	6.7	-1.6	-6.6
Use of Fund resources (net)	-1.7	26.4	7.5	21.0	5.1	-22.6
Change in reserves	40.2	-11.7	2.1	-14.3	-6.7	16.0
Memorandum items:						
Current account deficit as percent of GDP	9.1	8.0	7.0	5.6	5.4	5.0
Current account deficit after debt relief (SDR million) 2/	-102.3	-97.6	-98.3	-91.8	-100.1	-103.2

Sources: Data provided by the Malawian authorities; and staff estimates.

1/ Debt rescheduling is assumed only up to mid-1984. Repayments of rescheduled debt start in 1985, and are reflected as negative flows.

2/ Reflects higher actual interest payments in 1985-87.

3/ Assumes a first disbursement under the second IBRD structural adjustment loan equivalent to SDR 20.6 million.

encouragement to coffee, groundnuts, and manufactures, while increasing the efficiency of production of the current major export crops (tobacco, tea, and sugar). To restrain import demand, the program also involves policies to increase production of goods using local materials (textiles, paper, furniture, beverages, etc.) for the domestic market in substitution for otherwise imported goods.

Exports are projected to grow at an average annual rate of 10.5 percent over the program period. The medium-term projections for individual commodities reflect both price forecasts of the Fund and the IBRD and estimates of growth in industrial countries' demand for primary goods. The price assumptions imply that the terms of trade, which improved in 1982 with higher tobacco prices, will decline somewhat in 1983-85. Imports are projected to increase annually at an average rate of 8.4 percent during the period 1982-85.

Total net capital inflows are projected to increase during the program period to reach SDR 90 million in 1985. This takes into account disbursements under the second IBRD structural adjustment loan (SAL), assumes the satisfactory conclusion of a third SAL, and reflects the financing plans for projects in the public sector investment program. Moreover, a donors' conference, which is to be convened in late 1983 or early 1984, is expected to result in further concessional assistance from traditional, as well as nontraditional, donors in support of Malawi's medium-term economic program. No net short-term capital inflows are assumed for the program period. Repayments on the two-year debt relief of 1982-84 (see section below) are estimated to start from 1985 and continue for seven years, with a peak of SDR 22 million in 1987. A third year of debt relief for 1984/85 is not assumed in these projections.

In view of these assumptions and with the implementation of the above policies, the medium-term balance of payments projections show that the overall external payments position will be restored to balance by the end of the EFF program. Gross reserve levels are projected to remain during the program period at levels equivalent to about one month of imports.

(2) External debt policies

In the recent past, the Malawian Government has borrowed heavily in the international financial markets to finance major investment projects and budgetary outlays particularly those related to the construction of the new capital. The program policies recognize that such external borrowing needs to be restrained within the global framework of overall credit policy and the debt servicing capacity of the country. Towards the objective of establishing and maintaining an appropriate debt service profile, the Malawian authorities have approached the Paris Club for a second-year rescheduling of debt service payments due in 1983/84. Under the existing agreement, such further rescheduling would require that Malawi continue to satisfy the requirements of adjustment programs supported by the Fund and the Bank. A second year's rescheduling is provided under the agreement reached with the London Club commercial banks, and is subject to a second-year agreement with the Paris Club. These policies are expected to contain the debt service ratio, after debt relief, at an average level of 29 percent (including Fund credit) during the program period. The ratio is projected to rise to a peak level of 33 percent in 1983 (the first year of repayments under the rescheduling arrangements), and to decline thereafter (Table 9).

(3) Exchange and trade policies

The Malawi kwacha was devalued by 15 percent in April 1982, and since then its effective exchange rate has appreciated by about 5 percent in nominal terms, and about 12 percent in real terms. The nominal effective appreciation of the kwacha has been due in large part to the strength of the U.S. dollar, which has a larger weight in the SDR basket, to which the Malawi kwacha has been pegged since June 1975, than it would have in a currency basket based on the geographical pattern of the country's international trade. The Malawi Government has decided to change the currency peg from the SDR to a more appropriate basket of currencies. The Government will also take supplementary action to implement a flexible exchange rate policy during the program to strengthen the competitive position of the Malawi economy.

Malawi will continue to maintain a liberal trade system and an exchange system that is free of restrictions on payments and transfers for current international transactions.

IV. The Program for 1983/84

The program for the fiscal year 1983/84 (April 1, 1983 to March 31, 1984) is designed to continue the process of financial stabilization in an environment which is expected to be less favorable than the previous year, a consequence of disrupted external trade routes, unfavorable climatic conditions and weak commodity prices. The performance criteria are presented in Table 10 and the principal policy components for 1983/84 are summarized in Table 11.

1. Fiscal policy

Fiscal policy represents a critical element in restoring Malawi's economic growth and external balance. The 1983/84 budget limits the central government deficit to 6.4 percent of GDP, compared with 7.1 percent during the previous fiscal year. To preserve credit for the private sector, domestic financing of the deficit will be limited

Table 9. Malawi: Debt Service Projections and Indicators, 1982-87

(In millions of U.S. dollars)

	1982	1983	1984	1985	1986	1987
Debt service before relief 1/						
Principal	68.3	64.6	63.5	57.1	51.4	46.3
Interest	46.3	39.9	36.6	32.9	29.6	26.7
Total	114.6	104.5	100.1	90.0	81.0	73.0
Debt relief 2/						
Principal	14.8	50.2	29.1	-3.9	-13.7	-20.6
Interest	3.9	7.9	0.5	-5.0	-3.6	-4.7
Total	18.7	58.1	29.6	-8.9	-17.3	-25.3
Debt service after relief 1/						
Principal	53.5	14.4	34.4	61.0	65.1	66.9
Interest	42.4	32.0	36.1	37.9	33.2	31.4
Total	95.9	46.4	70.5	98.9	98.3	98.3
Fund credit						
Repurchases	12.6	9.9	21.4	15.8	22.0	23.7
Charges	7.3	5.7	8.5	10.8	13.2	13.5
Total	19.9	15.6	29.9	26.6	35.2	37.2
Total external public debt						
Principal	66.1	24.3	55.8	76.8	87.1	90.6
Interest	49.7	37.7	44.6	48.7	46.4	44.9
Total	115.8	62.0	100.4	125.5	133.5	135.5
Debt service ratios 3/						
Before rescheduling	47.6	42.7	39.5	30.8	27.4	26.0
After rescheduling	41.0	22.0	30.5	33.2	31.5	32.0

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

1/ Includes scheduled service on public and public guaranteed debt outstanding as of May 31, 1983 (Central Government and statutory bodies) as well as debt service on projected commitments for the period June 1983-December 1987.

2/ Repayments of rescheduled debt starts in 1985 (negative numbers).

3/ Including Fund credit.

Table 10. Malawi: Quantitative Performance Criteria
Under the Extended Arrangement in 1983/84

	1983				1984
	March 1/	June 1/	Sept. 2/	Dec. 2/	March
	(In millions of Malawi kwacha)				
Net domestic assets of banking system 3/	487.0	519.8	538.3	555.2 5/	548.3 5/ 6/
Net bank credit to Government 4/	216.9	232.3	244.3	254.7 5/	240.0 5/ 6/
	(In millions of SDRs)				
New non-concessional external borrowing contracted or guaranteed by Government in the maturity range (cumulative): 7/					
1-12 years maturity	...	...	5.0	5.0	
1-5 years maturity	...	...	--	--	

Sources: Letter of intent and policy memorandum of July 29, 1983; data supplied by the Malawi authorities; and staff estimates.

1/ Actuals.
2/ Performance criteria.
3/ Defined as money and quasi-money, long-term liabilities of the Reserve Bank, banking system capital accounts, and SDR allocations, less net foreign assets of the banking system.
4/ Defined as commercial banks' and Reserve Bank of Malawi's credit to the Government less government deposits, plus any use of the local currency counterpart of purchases from the Fund, plus external borrowing by the Government for balance of payments support.
5/ The credit ceilings for December 1983 and March 1984 were prepared on the assumption that disbursement under the second IBRD Structural Adjustment loan for an amount equivalent to MK 25.0 million would be made in the first quarter of 1984. In the event that any part of this amount is disbursed before December 1983, the ceilings on net domestic assets and net credit to Government will be adjusted accordingly.
6/ Indicative target. The ceiling will be set during the mid-year review.
7/ The authorities also intend not to contract any short-term borrowing, other than for normal trade financing purposes.

Table 11. Malawi: Summary of Program for First Year of Extended Arrangement, 1983/84

Assumptions (1983)

Real GDP growth: 2.7 percent (1982: 2.7 percent of GDP)
GDP deflator increase: 9.6 percent (1982: 18.1 percent)
Consumer price index increase: 13.0 percent (1982: 8.8 percent)
Terms of trade change: -13.7 percent (1982: 14.3 percent)
Exchange rate (year average): SDR 1 = MK 1.2393 (1982:SDR 1 = MK 1.1633)

Targets (1983)

Current account deficit (excluding grants): SDR 105.1 million, or 8.0 percent of GDP (1982: SDR 106.3 million, or 9.1 percent of GDP)

Overall balance of payments deficit after debt relief: SDR 14.7 million (1982: SDR 38.5 million)

Principal elements

Budget: Treasury deficit including grants in 1983/84 equal to 6.4 percent of GDP (1982/83: deficit equal to 7.1 percent of GDP). Revenue measures expected to yield the equivalent of 1.0 percent of GDP. Real expenditure growth limited to development outlays and recurrent costs of education, agriculture and roadbuilding projects; no general salary increase.

Expenditure monitoring: Quarterly ceilings set for each Ministry and Reserve Bank empowered to supervise the expenditure of each Ministry.

Parastatals: Reductions in subsidies; quarterly expenditure and revenue monitoring; continued strengthening of management; rationalization of assets among main parastatal holding companies with transfers, mergers or closures as necessary.

Press Group: Organizational and financial restructuring; new management appointed and new boards to be established for key holding companies; unprofitable subsidiaries to be closed, sold or restructured. Government will assume Press liabilities to commercial banks by a new issue of bonds against income notes which will compensate the Government for the cost of servicing the bonds.

Public sector investment program: The program covering investment by the Government and the parastatals includes: agricultural crop development, improvement of internal and external transportation routes; electrification and water supply; and the development of skilled manpower.

Price liberalization: Price application will become effective automatically two months after submission unless the Government provides adequate justification for refusal; this period will be reduced to one month in 1984; further steps will be taken toward phased reductions in the list of controlled goods.

Exchange rate: Adoption of appropriate trade-weighted basket of currencies to replace the SDR peg; to be supplemented by action to restore the competitive position of the Malawi kwacha.

Agricultural producer prices: Increases for the 1983/84 growing season in accordance with IBRD methodology, to be announced before the program is presented to the Board.

Private sector credit: Ceilings allow private sector credit to rise by 14.0 percent in 1983/84 (11.2 percent in 1982/83).

External debt: In 1983, new commitments of non-concessional loans of 1-12 years maturity limited to SDR 5 million, with no increase allowed in non-concessional loans of 1-5 years maturity.

Exchange and trade system: Government will not introduce any multiple currency practices; impose any new restrictions on payments and transfers for current international transactions; enter into any bilateral payments agreements with Fund members which are inconsistent with Article VIII; or introduce any new or intensify any existing restrictions on imports for balance of payments reasons.

to MK 30.0 million, of which no more than MK 23.1 million will be provided by the banking system.

New revenue measures providing MK 16.1 million in additional tax receipts will play a role in reducing the Government deficit during the program's first year. Most of these measures, outlined in the budget speech of March 18, 1983, have already been implemented. Effective March 18, excises on soft drinks, and malt beer were raised by 10 percent, while excises on tobacco products were increased by 5 percent, for a projected revenue gain of MK 0.7 million. The surtax on domestic manufactures and imported goods was extended to previously exempt goods at a 5 percent rate, while the rate on designated luxury items was raised from 20 to 25 percent, for a total revenue gain of MK 2.2 million. Also on March 18, the temporary import levy was raised from 3 to 4 percent, yielding new revenues of MK 2.1 million, while import duties on tires, tubes, and methylated spirits were increased, for a gain of MK 1 million. The Government also announced a rise in the fuel levy of 4 tambala per liter, 1/ the standardization of motor vehicle transfer fees, and the elimination of personal allowances in the income tax, the revenue gains from which have not yet been specified. In addition, consideration has been given to imposing a levy on tobacco auction sales to improve compliance with company income tax liabilities among estate growers, although no action was taken in the 1983/84 budget.

On the expenditure side of the budget, the rise in combined recurrent and extrabudgetary outlays will be limited to 6.5 percent, less than the rate of domestic inflation, following the 10.2 percent rise in 1982/83. Development spending is projected to reach MK 147.5 million after the MK 1.3 million decline in development outlays during 1982/83. There is to be no general wage increase in 1983/84. In addition, purchases of goods and supplies will be kept near their 1982/83 levels to allow for a 12 percent increase in expenditure for agriculture, education, and road maintenance, a condition for the World Bank's second structural adjustment program. As noted earlier, there will be a shift in development spending from government buildings to agriculture and transport. In addition, about 25 percent of development outlays will be financed locally, a sizable increase, reflecting the current scarcity of concessional funds from industrial countries.

2. Pricing policies

In September 1983 the modification to the system of price controls described in Section III is to be introduced. Regarding the pricing policies of parastatal enterprises, a number of increases were approved

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1/ This raised the price of gasoline to the equivalent of US$4.30 per U.S. gallon.

in late 1982 and the first months of 1983, including electricity and water charges, and the tariffs of Air Malawi and Malawi Railways. The rents charged on government housing were raised in early 1983, and

further increases will be considered in future years. The price and tariff structures of most parastatal enterprises will be reviewed during the course of the year. The agricultural producer prices expected to be announced in August 1983 propose moderate increases in some crops including rice, sunflower seeds and pulses, and the structure is intended to preserve incentives for the production of export crops. No increase in the maize price is expected, since large production surpluses, following a 67 percent price increase in 1981, have enabled Malawi to accumulate substantial stocks, and to export to neighboring countries.

Appropriate policies on wages will be continued during the first program year, to contain production costs and to increase the competitiveness of exports, and future wage increases will be related to increases in productivity and to the financial position of the public sector and of private sector enterprises.

3. Monetary and credit policies

Monetary policy in 1983/84 is consistent with the objectives of reducing the overall balance of payments deficit. Net domestic assets of the banking system are projected to grow by 12.6 percent in the year to March 1984. 1/ This expansion allows for faster growth in credit to the private sector than credit to the Government; the rates of increase are expected to be 14.0 percent and 10.7 percent, respectively. Credit to the statutory bodies is expected to show an increase of only 4 percent. However, if current expectations of a large maize crop are realized, the demand for additional financing for seasonal purchases by ADMARC could increase. If the credit permitted by the ceilings is fully utilized, and if the balance of payments target is realized, the money supply would expand by 12.8 percent, which is broadly consistent with the projected growth of nominal GDP. The measures to liberalize price controls and the adoption of more realistic pricing in key parastatals, combined with the impact of transport disruptions, are expected to result in a temporary increase in the rate of increase of domestic prices, which are projected to rise by about 13 percent in 1983 before falling back to 10 percent in 1984. However, it should be noted that the cost effects of longer external transport routes have not been fully quantified, and prices could come under further pressure if the situation does not improve.

1/ Projections of the principal monetary aggregates to March 1984 are shown in Appendix Table XIII.

The authorities, recognizing the need to maintain interest rates at appropriate levels, undertook an adjustment of the rate structure on June 1, 1983. Savings and deposit rates at banks and non-bank deposit-taking institutions were raised by two percentage points, and the rates offered on short- and long-term government securities were adjusted by the same amount. This action was sufficient to restore savings and deposit rates to positive levels relative to the underlying rate of inflation of about 10 percent. The rate on savings deposits was increased from 8.75 to 10.75 percent, while those on six month time deposits rose to 12.25 percent, and rates on 36 month deposits moved to 13.75 percent. Bank lending rates were previously set at a substantial margin over deposit rates, such that the maximum lending rate was 18.5 percent. Most lending to creditworthy borrowers was done in the 14-15 percent range, with very few loans being extended at or near the maximum rate. Thus the authorities decided to reduce the maximum rate to 16.5 percent, in view of the previous very wide spread between deposit and lending rates, in the belief that the remaining spread would be adequate to preserve the banks' operating margins. Preliminary indications are that most credit continues to be extended in the 14-15 percent range. The appropriateness of the interest rate structure will be examined further with the authorities during the first program review.

4. External policies

The deficit of the current account of the balance of payments is expected to decline during the first year of the program from 9.1 percent of GDP in 1982 to 8.0 percent in 1983.

The export outlook for tobacco, Malawi's major export crop, is somewhat depressed in 1983, mainly due to declines of 35 percent and 13 percent in the prices of burley tobacco and smallholder tobacco, respectively. As a result, total export earnings will increase by only 4 percent in 1983 to SDR 220.5 million. Total imports f.o.b. are estimated to grow by 7.6 percent to SDR 202.1 million, while the balance of net services and transfers is expected to improve slightly, although remaining substantially negative. The c.i.f./f.o.b. margin is estimated to average 30 percent, reflecting the substantial increases in transportation costs due to the interruptions on the rail routes through Mozambique and the consequent diversion of goods to higher cost routes through Durban and Dar es Salaam.

On the basis of loans already contracted and given the high debt repayments falling due, net capital inflow in 1983 is expected to decline. The overall balance of payments deficit before debt relief is projected to reach SDR 68 million. The Malawian Government concluded agreements with the Paris Club, the London Club, and the Commonwealth Development Corporation on debt rescheduling for 1982/83, and intends to seek a second year 1983/84 rescheduling or refinancing of the maturing debt obligations. The combined debt relief for the 1983 calendar year is estimated at SDR 53 million.

Given Malawi's external payments and debt situation, great importance has been attached to limiting further commercial borrowing under the program. In 1983, the contracting or guarantee by the Government of new non-concessional external borrowing of maturity of 1-12 years will be limited to SDR 5 million, of which none shall have maturity less than 5 years. The Government does not intend to contract any borrowing of less than one year's maturity except for normal trade financing.

Regarding exchange rate policy, the authorities will adopt immediately a more representative currency basket as the peg for the Malawi kwacha and will also implement a flexible policy to restore its competitive position.

5. Prior actions and performance criteria

The budget for 1983/84 introduced in March 1983 is in conformity with the requirements of the medium-term program. Also, as part of the program, the Malawian authorities increased deposit rates by two percentage points in June 1983 with the result that deposits are now (like lending rates) positive in real terms. Before the date of Board presentation of this arrangement, the Malawian authorities will change the peg of the currency from the SDR to a trade-weighted basket and introduce a more flexible exchange rate system. The authorities will introduce the administrative reform that limits to 60 days the period in which the Government must respond to applications for price increases. Further, before Board discussion of this arrangement, the Malawian authorities will have developed programs, which have the general approval of the World Bank, with regard to medium-term public sector investment and the reform of the parastatals and Press Holdings.

The performance criteria include: (1) quarterly ceilings on the net domestic assets of the banking system, with quarterly sub-ceilings on the banking system's net claims on the Government; (2) a ceiling on new nonconcessional external borrowing contracted or guaranteed in 1983 by the Government with a maturity between one and twelve years, and a subceiling on new borrowing with a maturity of one to five years; (3) a provision that the Malawian authorities will reach understandings with the Fund on performance criteria of a nature similar to (1) and (2) for the subsequent fiscal years of the program during reviews before April 30, 1984, April 30, 1985 and April 30, 1986; and (4) the standard provision relating to multiple currency practices, bilateral payments arrangements and restrictions on payments and transfers for current international transactions and on imports for balance of payments reasons.

V. Staff Appraisal and Proposed Decision

For several years until the late 1970s the Malawian economy registered relatively rapid economic growth, based largely on an agricultural policy oriented towards exports and the attainment of self-sufficiency in food production. The Government's pragmatic financial and economic policies resulted in relatively small fiscal and balance of payments imbalances.

Economic performance deteriorated sharply starting in 1979, as a result of a combination of exogenous factors and inadequate domestic economic management. The second oil price increase, combined with a decline in the prices of Malawi's primary commodity exports, caused a sharp deterioration in the terms of trade. High international interest rates at a time when Malawi had resorted to larger commercial borrowing to finance expansion and infrastructural development, led to a considerable increase in its service obligations. Drought in 1979 and 1980 resulted in a failure of the maize harvest and the need for emergency cereal imports in 1981. Prolonged periodic interruptions in the rail routes through Mozambique (due to insurgent activity in that country), on which Malawi depends for access to the Indian Ocean ports, have caused substantially higher freight charges and delays or disruptions in the flow of both imports and exports. Critical commodities, such as fuel and fertilizer, have often been in short supply, while some exports, notably sugar, cannot be transported economically by other routes.

As a result of these developments, the financial position of the Government, the key parastatals and Press Holdings (a quasi-public corporation) deteriorated significantly. The budget and balance of payments deficits increased and were financed substantially by external borrowing of relatively short-term maturities and on commercial terms. As a result, the debt service burden rose sharply. There was stagnation in real output in 1980 and 1981, productive enterprises sustained substantial losses, and the rate of inflation increased.

In attempting to deal with this situation Malawi adopted successive Fund-supported stabilization programs. Under the first of these, a two year stand-by during 1980/81 and 1981/82, Malawi was able to achieve some improvement, particularly in the external account, but the correction was not sufficient to achieve the targets established under the program. However, under the subsequent one-year stand-by in 1982/83 (approved by the Executive Board in August 1982) performance was in accordance with the terms of the arrangement. GDP growth was higher due to good agricultural output; inflation was held to the projected level of 9 percent; the Government's overall budget deficit was held within the targeted 7 percent; and the expansion of the banks' domestic assets and net credit to the Government were held well within the program's targets. A larger reduction in the external current account deficit was achieved, but this was the result of a large decline in the volume of imports in 1982, due, at least in part, to the transportation disruptions referred to above.

Although this improvement in the basic economic variables was achieved, by the beginning of 1983 the economy remained vulnerable to external shocks, and a number of fundamental structural maladjustments had still to be corrected. The extended arrangement requested by the authorities would support a program of adjustment intended to create the conditions for satisfactory economic growth and to reduce the fiscal and external deficits to sustainable levels. The proposed program, in drawing on the experience of the earlier arrangements, recognizes that demand management and financial policies are inadequate unless supported by action directed towards supply. Even under the most favorable realistic assumptions Malawi, like other developing countries, is unlikely to achieve in the 1980s the growth rates of earlier years. Slow growth and inelastic demand for primary commodities in the industrial countries will reduce the capacity of the export sector to generate growth in Malawi, and will also diminish its ability to diversify its export base. The program still aims at an average annual growth rate of 3.5 percent, while restoring the external accounts to a position of viability taking into account the heavy debt service burden that has already been incurred.

The World Bank is engaged in a comprehensive development program in Malawi (mainly through IDA credits). This has included a structural adjustment loan in 1981, and the preparation of a second such loan is under way. Close cooperation between Fund and Bank staff has been maintained throughout the preparation of the program and the Bank staff has made detailed recommendations in several areas affecting the proposed program: agricultural policy, the public sector investment program, and institutional reform. The policies and economic outlook developed by the Fund are broadly consistent with the framework proposed by the Bank. It should be noted that the Bank staff believes that levels of imports and foreign capital inflows higher than the Fund staff projections can be realized and may be necessary to achieve the rates of growth of output projected by the Fund staff.

Agricultural policies will be adopted to reduce unit costs, to increase the efficiency of investment in the export sector, and to facilitate farmers' access to adequate seasonal and medium-term finance. Appropriate pricing policies will be essential to provide adequate incentives to farmers, and a methodology developed in consultation with the World Bank is being applied to ensure a suitable price structure. Industrial policy is to be directed towards the development of agro-based production, increasing the use of domestic inputs, and where possible, promoting the production of exportable goods. The phased liberalization of the price control system that has been initiated will enable domestic producers to set prices at market-determined levels.

Further support in this regard will be provided by the continuation of appropriate wage policies to contain production costs and increase export competitiveness. The authorities have initiated a program of structural reform of the parastatal and quasi-public enterprises which are designed to reestablish the institutions on an efficient and profitable basis. The three year public sector investment program which the authorities have adopted, with the assistance of the World Bank, will provide infrastructural facilities required to support the development effort.

The program submitted by the authorities contains a commitment to increase revenues and restrain government expenditures, and to shift the emphasis of expenditures to priority development sectors. Appropriate pricing, incomes, interest rate and credit policies will be implemented to mobilize savings, direct resources to productive activities and increase the efficiency of investment.

The authorities' external policies have been formulated with the objective of achieving a reduction in the current account deficit to a sustainable level. The staff estimates that the ratio of the external current account to GDP will be progressively reduced over the program period to a level which will generate a small overall surplus by 1986. In view of the high level of debt service payments that are due, the program assumes that Malawi will obtain debt relief during 1983/84. Moreover, the program calls for stringent limits on new external borrowing on nonconcessional terms.

In support of the balance of payments objectives, the program calls for a more flexible exchange rate policy, including the adoption of a trade-weighted currency basket, to be supplemented by a flexible exchange rate policy which will provide an adequate incentive for exports and import substitution. Malawi's import requirements, for development purposes and to sustain industrial production, will require substantial resource transfers on concessional terms. The Donors' Conference that Malawi intends to convene in early 1984 will be critical in mobilizing the necessary financial and technical assistance.

The staff believes that the program which the Malawian authorities have proposed to the Fund in support of their request for an extended arrangement will make a major contribution to improving economic growth prospects and to restoring the medium-term viability of the balance of payments. The success of the authorities in implementing the 1982/83 program and the measures already undertaken in 1983/84 are evidence of their commitment to the objectives of the proposed arrangement. The authorities have indicated that they are prepared to review the program periodically, and, when necessary, adopt additional measures to ensure that the program's objectives are achieved.

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

1. The Government of Malawi has requested an extended arrangement for the period from September , 1983 to September , 1986 for an amount equivalent to SDR 100 million.

2. The Fund approves the extended arrangement attached to EBS/83/183.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

MALAWI - Relations with the Fund
(As of July 31, 1983)

Date of membership:	July 19, 1965	
Status:	Article XIV	
Quota:	SDR 28.5 million (proposed Eighth Review quota is SDR 37.2 million)	
Exchange rate system:	The Malawi kwacha is pegged to the SDR; since the devaluation of April 24, 1982, the rate has been MK 1.0 = SDR 0.8250.	
Fund holdings of Malawi kwacha:	Millions of SDRs	Percent of quota
Total	121.1	424.8
Under tranche policy	56.3	197.6
From ordinary resources	28.5	100.0
From supplementary financing facility	27.8	97.6
Under enlarged access resources	8.6	30.0
Under compensatory financing facilities	26.8	93.9
For exports	13.1	45.8
For cereals	13.7	48.1
Under buffer stock financing facility	0.9	3.2
SDR Department:	Millions of SDRs	Percent of allocation
Net cumulative allocation	11.0	100.0
Holdings	1.0	9.3
Trust Fund:	Malawi received loans of SDR 6.2 million during the first period and SDR 8.4 million during the second period.	
Direct distribution of profits from gold sales:	Malawi has received US$2.4 million.	
Gold distribution:	12,837 ounces of fine gold	

MALAWI - Relations with the Fund (concluded)

Recent contacts

Negotiations for a one-year stand-by arrangement took place during staff visits February 4-17, 1982 and May 8-20, 1982; the stand-by, approved by the Executive Board on August 6, 1982 (EBS/82/126), was reviewed during the Article IV consultations held October 28-November 11, 1982. (EBS/83/27 and SM/83/25). In addition, a sugar buffer stock financing facility for SDR 0.922 million was approved by the Executive Board on December 6, 1982 (EBS/82/201), while a compensatory financing facility for SDR 12.2 million was approved on February 28, 1983 (EBS/83/28). During February 19-March 4, 1983 a staff team undertook preliminary discussions toward the extended arrangement proposed in this paper. Negotiations took place during a subsequent staff visit June 15-July 5, 1983 and were concluded during a visit by the Malawian authorities to Washington on July 27-August 2, 1983.

MALAWI - Relations with the World Bank Group

Between independence and the end of 1982, the World Bank Group granted Malawi 24 IDA credits totaling US$274 million and 6 World Bank loans totaling US$75 million, of which 2 were on third-window terms. Of the entire funds committed, US$105 million (31 percent) were for agricultural projects, US$74 million (22 percent) for education, US$65 million (19 percent) for roads, US$45 million (13 percent) for structural adjustment, US$38 million (11 percent) for power projects, US$3 million (1 percent) for development finance companies, and the remainder for a combination of projects including water supply development, technical assistance, and financing feasibility studies for a pulp and paper mill at Viphya. In addition, between 1976 and 1980 the IFC provided US$20.4 million in funding, of which US$19.6 million were loans and the remainder equity. These amounts financed five separate projects covering a number of sectors, including textiles, sugar, ethanol production, and tourism.

Malawi's first Bank loan was approved in June 1976, on third-window terms, and its first standard Bank loan was approved in April 1977. Thus far, Malawi has had an excellent disbursement record, on average disbursing up to 85 percent of the Bank funds it has received.

The Bank's most recent commitments to Malawi, approved during March 1983, were for an SDR 6.3 million (equivalent to US$6.8 million) credit to the central government for health projects and an SDR 5.0 million (US$5.4 million equivalent) credit to finance, in conjunction with the Government and the Agricultural Development and Marketing Corporation (ADMARC), the establishment of a revolving fund to purchase fertilizer for smallholders. Between June 1984 and June 1988, the Bank plans to lend Malawi the equivalent of US$502 million, of which about 74 percent (US$372 million) would be IDA loans and the remainder IBRD commitments. Included in these totals are US$70 million for agricultural projects, US$45 million for education, US$50 million for power projects, US$77 million for highways, and US$75-105 million for structural adjustment. During its 1984 fiscal year, the Bank plans to lend about US$37 million for roads, US$55 million for its SAL II structural adjustment project, US$15 million for a wood pulp project, and US$5 million for technical assistance. All but US$10 million of the funds for road building would be on IDA terms.

Table I. Malawi: Gross Domestic Product by Industrial Origin, 1978-82

	1978	1979	1980	1981	1982
	(In millions of Malawi kwacha at 1978 factor cost)				
Gross domestic product	742.5	777.2	780.0	774.0	797.3
Agriculture	294.9	308.3	291.5	302.1	320.1
Estates	48.6	56.2	57.7	55.1	66.9
Smallholders	246.3	252.1	233.8	247.0	253.8
Industry	97.3	104.0	108.4	110.2	105.0
Construction	46.2	48.8	45.3	36.2	35.7
Services	304.1	316.1	334.8	325.5	335.9
	(Annual percentage changes)				
Gross domestic product	8.3	4.7	0.4	-0.8	3.0
Agriculture	2.9	4.5	-5.4	3.6	6.2
Estates	2.3	15.6	1.0	-4.5	21.4
Smallholders	3.1	2.4	-7.3	5.6	-2.8
Industry	6.0	6.9	4.2	1.7	-4.7
Construction	28.0	5.6	-7.2	-20.1	-1.4
Services	12.2	3.9	5.9	-2.8	3.2
	(As percentage of GDP)				
Agriculture	39.7	39.7	37.4	39.0	40.2
Estates	6.5	7.2	7.4	7.1	8.4
Smallholders	33.2	32.4	30.0	31.9	31.8
Industry	13.1	13.4	13.9	14.2	13.2
Construction	6.2	6.3	5.8	4.7	4.5
Services	41.0	40.7	42.9	42.1	42.1

Sources: National Accounts Report; Economic Report; and staff estimates.

Table II. Malawi: Gross Domestic Product and Expenditure, 1978-82

	1978	1979	1980	1981	1982	1978	1979	1980	1981	1982
	(In millions of Malawi kwacha at current market prices)					(As percentage of GDP)				
Gross domestic product	800.7	880.7	1,010.9	1,162.9	1,409.6	100.0	100.0	100.0	100.0	100.0
Consumption	636.4	749.6	896.2	1,006.9	1,218.7	79.5	85.1	88.7	86.6	86.5
Smallholders)	502.2	230.4	268.8	318.8	412.6	) 62.7	26.2	26.6	27.4	29.3
Other private)		355.1	441.1	475.7	583.3	)	40.3	43.6	40.9	41.4
Government	134.2	164.1	186.3	212.4	222.3	16.6	18.6	18.4	18.3	15.8
Gross fixed capital formation	247.1	240.1	259.6	212.2	216.9	30.9	27.3	25.7	18.2	15.4
Change in stocks	60.7	61.6	-0.4	34.1	69.7	7.6	7.0	--	2.9	4.9
Exports of goods and non-factor services	183.4	209.7	269.0	294.3	297.7	22.9	23.8	26.6	25.3	21.1
Imports of goods and non-factor services	326.9	380.4	413.5	384.6	393.4	40.8	43.2	40.9	33.1	27.9
Memorandum item:										
Net indirect taxes	58.2	83.9	97.2	112.7	122.5	7.3	9.5	9.6	9.7	8.7

Sources: National Accounts Report; Economic Report; and staff estimates.

Table III. Malawi: Investment and Saving, 1979-86

(In millions of Malawi kwacha at current prices)

	1979	1980	1981	1982	1983	1984	1985	1986
					Projections			
Fixed capital formation	240.1	259.6	212.2	216.9	244.0	297.6	365.1	435.1
Government	78.2	105.2	78.0	85.9	...	...	...	...
Statutory bodies	57.3	70.2	35.2	19.2	...	...	...	...
Private	104.6	84.2	99.0	111.8	...	...	...	...
Change in stocks	61.6	-0.4	34.1	69.7	57.4	44.8	48.4	52.0
Total investment/saving	301.7	259.2	246.3	286.6	301.4	342.4	413.5	487.1
Domestic saving	131.1	114.7	156.0	198.0	211.8	254.1	334.9	396.6
Net factor income	-34.8	-42.3	-47.5	-40.3	-38.1	-37.4	-33.9	-31.2
National saving	96.3	72.4	108.5	157.7	173.7	216.7	301.0	365.4
Transfers (net)	37.8	35.4	40.1	34.5	40.0	48.0	52.6	62.2
Short and long term capital (net)	96.4	158.0	62.8	47.7	69.6	65.5	51.4	61.6
Change in foreign reserves	71.2	-6.6	34.9	46.7	17.8	12.2	8.5	-2.1

Sources: National Accounts Report; Economic Report; and staff estimates.

Table IV. Malawi: Marketed Production of Principal Crops, 1978-82

(In thousands of metric tons)

	1978	1979	1980	1981	1982
Tobacco (auction sales)	51.1	54.0	54.4	50.7	58.5
Flue-cured	20.9	25.2	26.3	19.7	22.6
Fire-cured					
Northern division	15.4	11.1	8.6	8.9	6.5
Southern division	1.0	1.2	0.8	0.9	0.6
Burley	10.6	14.9	16.7	18.8	27.6
Other	3.2	1.6	1.5	1.3	1.2
Tea	31.7	32.6	29.9	32.0	38.5
Sugar	93.5	107.6	147.4	166.6	171.5
Maize 1/	120.6	82.2	91.9	136.6	246.1
Groundnuts 1/	11.1	24.3	31.4	19.5	10.4
Cotton 1/	24.2	22.4	23.1	21.7	14.8
Rice 1/	30.8	20.5	17.5	13.5	12.5
General produce 1/	18.9	11.6	17.7	11.2	9.8

Sources: Economic Report; and Monthly Statistical Bulletin.

1/ ADMARC purchases.

Table V. Malawi: Selected ADMARC Producer Prices, 1978/79-1983/84 Growing Seasons 1/

(In Malawi kwacha per metric tons)

	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84
Maize	50	66	66	110	110	110
Rice						
Grade 1	100	100	100	100	115	115
Cotton						
Grade A	231	230	230	285	325	380
Groundnuts						
Grade A	330	330	330	370	550	550
Tobacco						
Grade G-2	440	440	440	440	530	770

Sources: ADMARC Annual Report; Monthly Statistical Bulletin; and data provided by Malawian authorities.

1/ Prices are actually paid during the following fiscal year.

Table VI. Malawi: Balance of Payments, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982
Current account	-49.1	-144.3	-167.0	-166.9	-141.3	-106.3
Trade balance	14.3	-64.9	-68.0	-36.5	1.0	24.3
Exports	171.0	147.4	172.1	226.3	241.9	212.1
Imports	156.7	212.2	-240.1	262.9	-240.8	-187.8
Net services and unrequited transfers	63.4	-79.5	-99.0	-130.4	-142.4	-130.7
Of which: interest payments	-6.9	-15.9	-24.0	-39.3	-56.1	-52.5
Capital account	82.3	125.6	99.5	173.1	116.9	51.6
Long-term capital	88.1	118.1	128.8	136.6	89.1	41.3
Government transfers (net)	17.0	31.1	36.1	38.4	42.4	28.5
Government borrowing (net)	50.4	58.5	67.3	76.9	40.0	29.9
Statutory bodies and Reserve Bank borrowing (net)	11.0	12.9	13.9	9.5	5.9	-14.4
Private borrowing (net)	0.9	15.7	11.5	11.8	0.8	-2.6
SDR allocation	--	--	2.0	2.0	2.0	--
Short-term capital and errors and omissions	-5.7	7.5	-29.3	34.5	25.8	10.2
Overall balance before debt relief	33.2	-18.8	-67.5	6.2	-24.3	-54.8
Debt relief	--	--	--	--	--	16.3
Overall balance after debt relief	33.2	-18.8	-67.5	6.2	-24.3	-38.5
Change in net total reserves (- increase in assets)	-33.2	18.8	67.5	-6.2	24.3	38.5
Commercial bank reserves	8.9	-4.6	25.9	-7.3	-16.9	0.5
Net IMF position	5.4	-3.7	20.4	21.1	23.6	-5.5
Other official reserves	-47.5	27.0	21.2	-20.1	17.6	43.5
Memorandum items:						
Current account/GDP (percentages)	7.1	19.0	20.0	17.4	12.8	9.1
Gross reserves (months of imports c.i.f.)	4.4	2.6	1.9	2.0	1.7	0.9

Sources: Data provided by the Malawian authorities; and staff estimates.

Table VII. Malawi: Value of Exports, 1978-82

(In millions of SDRs)

	1978	1979	1980	1981	1982
Tobacco	78.5	91.6	101.5	95.7	123.2
Tea	26.5	28.5	28.9	30.1	35.6
Sugar	11.2	15.0	35.1	64.5	24.8
Groundnuts	4.2	8.3	15.4	10.1	3.3
Other	15.2	20.5	37.1	33.9	21.0
Domestic	135.7	163.9	217.8	234.4	207.9
Re-exports	6.2	5.1	13.3	10.7	4.1
Total	141.9	168.9	231.1	244.9	212.0

Source: Data provided by the Malawian authorities.

Table VIII. Malawi: Imports (c.i.f.) by End-Use, 1978-82

(In millions of SDRs)

	1978	1979	1980	1981	1982
Maize	--	--	--	17.8	--
Other consumer goods	39.8	55.1	45.3	32.7	28.2
Transport equipment	35.2	42.8	58.7	28.8	29.1
Machinery	53.3	41.5	48.0	38.7	40.0
Building materials	21.8	23.5	30.0	18.9	17.3
Industrial inputs and parts 1/	85.1	102.6	117.3	130.2	127.3
Petroleum products	19.5	35.4	43.3	40.8	35.4
Miscellaneous	7.3	1.0	1.3	4.8	1.8
Total	262.0	301.9	344.0	312.6	280.0
Memorandum items:					
Nonmaize, nonpetroleum imports	242.5	266.5	300.7	254.0	243.6
Percent change in nonmaize, nonpetroleum imports	40.6	9.9	12.8	-15.5	4.1

Sources: Economic Report; Malawi Monthly Statistical Bulletin; and staff estimates.

1/ Including inputs to agriculture.

Table IX. Malawi: Terms of Trade, 1978-82

(1978 = 100)

	1978	1979	1980	1981	1982 1/
Exports					
Unit value	100.0	88.9	87.4	110.0	132.8
Quantum	100.0	133.3	173.3	153.4	151.9
Imports					
Unit value	100.0	116.7	140.8	154.7	163.2
Quantum	100.0	97.8	88.8	73.0	60.2
Terms of trade	100.0	76.2	62.1	71.1	81.3

Source: Data on six key agriculture exports and on five categories of imports. Based on 1978 trade weights.

1/ Preliminary.

Table X. Malawi: Central Government Budgetary Operations, 1977/78-1982/83

	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83 Prelim.
			(In millions of Malawi kwacha)			
Total revenue and grants	132.3	174.6	221.6	242.5	263.2	274.8
Revenue	116.3	148.6	187.0	199.2	221.0	241.1
Grants	16.0	26.0	34.6	43.3	42.2	33.7
Total expenditure	178.5	248.0	305.8	358.6	392.8	378.5
Recurrent	101.9	134.5	177.9	183.7	268.6	255.6
Development	76.6	113.5	127.9	174.9	124.2	122.9
Overall deficit	-46.2	-73.4	-84.2	-116.1	-129.6	-103.7
Financing	46.2	73.4	84.2	116.1	129.6	103.7
Foreign (net)	42.5	61.8	71.0	40.0	31.3	83.5
Borrowing	(47.2)	(66.6)	(76.1)	(62.3)	63.1	96.0
Repayment	(-4.7)	(-4.8)	(-5.1)	(-22.3)	31.8	12.5
Domestic	3.7	11.6	13.2	76.1	98.3	20.7
Of which: Banking system	(-11.7)	(10.9)	(22.8)	(48.1)	(85.7)	(19.7)
			(Ratios to GDP)			
Total revenue and grants	17.7	21.3	24.3	23.1	21.5	18.9
Revenue	15.6	18.1	20.5	19.0	18.0	16.6
Grants	2.1	3.2	3.8	4.1	3.4	2.3
Total expenditure	23.9	30.2	33.5	34.2	32.1	26.0
Recurrent	13.7	16.4	19.5	17.5	21.9	17.6
Development	10.3	13.8	14.0	16.7	10.1	8.4
Overall deficit	6.2	8.9	9.2	11.1	10.6	7.1
Foreign	5.7	7.5	7.8	3.8	2.6	5.7
Domestic	0.5	1.4	1.5	7.3	8.0	1.4

Sources: Economic Report; data provided by the Malawian authorities; and staff estimates.

Table XI. Malawi: Central Government Revenue, 1978/79-1983/84

(In millions of Malawi kwacha)

	1978/79	1979/80	1980/81	1981/82	1982/83 Prelim.	1983/84 Revised
Total tax revenue	121.9	143.8	166.9	179.1	207.6	230.6
Taxes on income and profits	57.2	59.2	64.9	61.8	79.5	88.0
Companies	38.9	38.1	39.4	34.1	45.2	48.0
Individuals	18.3	21.1	25.5	27.7	34.3	40.0
Minimum	(2.0)	(2.1)	(2.1)	(2.2)	(2.5)	(2.5)
Minimum remittances	(--)	(--)	(0.0)	(--)	(--)	(--)
Graduated	(2.5)	(2.6)	(2.8)	(3.1)	(3.2)	(4.1)
PAYE deductions	(13.6)	(16.1)	(20.4)	(22.2)	(28.3)	(33.1)
District commissioners' assessments	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	38.3	51.3	59.2	66.1	73.8	83.5
Surtax	30.5	43.3	48.6	54.0	58.3	64.9
Excise duties	5.8	6.0	7.8	9.0	11.6	12.9
Licenses for goods and activities	2.0	2.0	2.9	3.1	3.5	4.9
Business and professional	(0.5)	(0.5)	(0.6)	(0.7)	(1.0)	(1.6)
Motor vehicle tax	(1.6)	(1.5)	(2.2)	(2.4)	(2.5)	(3.3)
Accommodation and refreshment tax	--	--	--	--	0.5	0.8
Taxes on international trade	25.8	32.7	42.1	50.2	52.4	57.0
Import duties	25.8	32.7	42.1	50.2	52.4	57.0
Customs duties	(25.6)	(32.4)	(41.6)	(49.7)	(51.6)	(56.5)
Other	(0.3)	(0.3)	(0.5)	(0.5)	(0.8)	(0.5)
Stamp duties	0.5	0.6	0.6	0.8	1.8	1.5
Nontax revenue	26.6	43.2	32.4	41.9	33.5	42.3
Receipts in respect of departmental services	0.7	2.9	1.3	2.7	3.8	3.1
Rents	1.5	1.9	1.6	1.8	2.3	2.9
Miscellaneous	7.9	9.2	7.8	10.0	1.2	2.0
Appropriations-in-aid	15.8	26.7	21.6	27.4	26.2	34.4
Other (development budget)	0.7	2.5	--	--	--	--
Total revenue	148.6	187.0	199.2	221.0	241.1	272.9

Sources: Financial Statement; and Ministry of Finance; and staff estimates.

Table XII. Malawi: Economic Classification of Recurrent and Development Expenditures, 1978/79-1983/84

(In millions of Malawi kwacha)

	1978/79	1979/80	1980/81	1981/82	1982/83 Prelim.	1983/84 Revised
Recurrent account	134.5	177.9	183.7	268.6	255.6	272.3
Gross consumption	87.8	102.7	121.6	149.5	161.4	165.2
Wages and salaries	(40.6)	(44.7)	(49.3)	(59.7)	(67.8)	(78.9)
Other goods and services	(47.2)	(58.1)	(72.4)	(91.8)	(93.6)	(86.3)
[Less: fees, sales, and recoveries]	[11.6]	[5.2]	[9.1]	[10.2]	[7.9]	[7.0]
[Net consumption]	[76.2]	[97.5]	[112.6]	[139.3]	[153.5]	[158.2]
Interest	14.3	20.2	32.5	53.8	57.3	60.0
Grants and subsidies	15.2	17.9	19.9	21.1	33.0	27.3
Local authorities	(1.3)	(1.8)	(1.7)	(1.6)	(2.2)	(2.3)
Public bodies	(1.3)	(7.9)	(13.1)	(17.1)	(23.5)	(18.3)
Private	(12.0)	(7.4)	(4.1)	(1.4)	(5.8)	(1.7)
Abroad	(0.7)	(0.8)	(0.9)	(1.0)	(1.5)	(4.9)
Gross fixed capital formation	16.5	13.6	9.5	6.7	3.5	11.2
Loans and capital transfers	--	2.2	0.2	0.5	0.4	1.3
Extrabudgetary	--	21.3	--	36.7	--	6.3
Of which: maize purchases	--	(21.3)	(--)	(36.7)	(--)	(--)
strategic maize reserves	--	(--)	(--)	(--)	(--)	(4.0)
Press reconstruction plan	--	(--)	(--)	(--)	(--)	(2.3)
Development account	113.5	128.0	174.9	124.2	122.9	147.5
Gross consumption	4.6	7.9	7.2	6.0	6.1	11.5
Wages and salaries	(1.2)	(1.3)	(1.9)	(0.6)	(0.1)	(2.0)
Other goods and services	(3.4)	(6.6)	(5.3)	(5.4)	(6.0)	(9.5)
Agricultural subsidies	--	--	--	--	5.7	17.5
Other grants	--	--	--	--	--	--
Gross fixed capital formation	98.9	109.6	154.5	113.9	104.1	118.1
Buildings	(11.4)	(42.4)	(20.7)	(25.0)	(43.8)	(41.0)
Construction and works	(64.0)	(38.7)	(93.7)	(49.9)	(22.0)	(38.3)
Of which:						
Roads and bridges	[20.7]	[16.4]	[18.0]	[26.0]	[20.1]	[21.1]
Services	(6.1)	(9.1)	(12.0)	(5.5)	(3.3)	(6.0)
Equipment	(0.9)	(1.6)	(4.1)	(7.4)	(9.7)	(10.6)
Other	(16.6)	(17.7)	(24.0)	(26.0)	(25.3)	(22.2)
Loans (to public enterprises)	(10.0)	10.5	13.3	4.2	7.0	5.4
(Less: unallocated reductions)	--	--	--	--	--	-5.0
Total expenditure	248.0	305.9	358.6	392.8	378.5	419.8

Sources: Economic Report; Ministry of Finance; and staff estimates.

Table XIII. Malawi: Monetary Survey, 1978-84

(In millions of Malawi kwacha)

	1978	1979	1980	1981		1982		1983				1984
	Dec.	Dec.	Dec.	March	Dec.	March	Dec.	March	June	Sept. 1/	Dec. 1/	March 1/
Foreign assets (net)	-9.0	-80.2	-73.6	-86.8	-99.3	-137.8	-145.0	-167.7	-157.6	-171.7	-162.7	-195.0
Gross foreign assets	71.7	58.2	64.7	45.8	51.0	32.2	33.9	39.6	49.7	...	...	...
Foreign liabilities	-80.7	-138.4	-138.3	-132.6	-150.3	-170.1	-178.9	-207.3	-207.4	...	...	...
Net domestic assets	221.7	291.2	311.6	345.0	403.7	438.5	474.5	487.0	519.8	538.3	530.2	548.3
Net domestic credit	219.5	292.7	324.3	356.3	421.6	466.3	495.8	511.0	541.5	559.3	576.7	569.3
Credit to Government	46.6	65.4	83.4	115.3	167.8	201.0	211.3	216.9	232.3	244.3	254.7	240.0
Credit to statutory bodies	50.7	56.5	58.5	58.3	62.0	56.9	65.5	62.3	69.7	66.0	65.0	65.0
Credit to private sector	122.2	170.8	182.4	182.7	191.8	208.4	219.0	231.8	239.5	249.0	256.5	264.3
Other assets (net)	2.2	-1.5	-12.7	-11.3	-17.9	-27.8	-21.3	-24.0	-21.0	-21.0	-21.0	-21.0
Long-term liabilities of Reserve Bank	--	--	--	9.1	9.1	9.1	10.2	10.3	10.3)			
SDR allocation	5.4	7.4	9.5	11.6	11.6	11.6	13.3	13.3	13.3)	56.0	56.0	56.0
Capital account	38.7	33.5	37.1	34.2	42.2	46.0	29.7	32.2	35.2)			
Money plus quasi-money	168.6	170.1	191.5	203.3	241.4	234.0	276.4	263.5	303.3	310.6	311.5	297.3
Money	93.8	90.6	97.2	103.8	114.8	106.1	130.8	111.7	139.5	...	...	...
Currency outside banks	29.8	32.3	35.3	32.9	39.4	37.1	49.5	44.9	59.5	...	...	...
Demand deposits	64.0	58.3	61.9	70.9	75.4	68.9	81.3	66.8	80.0	...	...	...
Quasi-money	74.8	79.5	94.3	99.5	126.6	127.9	145.6	151.8	163.8	...	...	...

Sources: Reserve Bank of Malawi; and staff estimates.

1/ Projections.

Table XIV. Malawi: Interest Rates, 1978-83

(In percentages; end of period)

	1978	1979	1980	1981	1982	1983 2/
Bank rate						
Nominal	7.0	8.0	10.0	10.0	10.0	10.0
Real 1/	-5.8	-6.6	-13.2	-0.4	0.5	...
Commercial bank lending rate (maximum)						
Nominal	15.0	16.5	18.5	18.5	18.5	16.5
Real 1/	1.2	0.8	-6.4	7.3	8.2	...
Savings deposits						
Nominal	5.5	6.75	8.75	8.75	8.75	10.75
Real 1/	-7.1	-7.6	-14.1	-1.5	-0.7	...
Time deposits (over 35 months)						
Nominal	8.5	9.75	11.75	11.75	11.75	13.75
Real 1/	-4.5	-5.0	-11.7	1.2	2.1	...

Sources: Reserve Bank of Malawi; Financial and Economic Review; and staff estimates.

1/ Deflated by high-income Blantyre retail price index.
2/ June.

Table XV. Malawi: Index of Retail Prices in Blantyre, 1978-82

(1970 = 100)

	Weights	1978	1979	1980	1981	1982
Low-income index	100.0	185.2	206.1	243.9	267.2	290.8
Foodstuffs	47.9	190.0	216.4	269.9	300.0	311.4
Drink and tobacco	7.7	158.1	170.0	188.6	201.1	219.7
Footwear and clothing	17.6	151.4	162.1	174.4	199.6	233.5
Household goods	19.8	223.8	245.4	284.0	295.8	335.2
Domestic help	1.6	161.5	169.2	172.5	197.7	236.1
Transport expenses	1.8	211.1	251.9	277.3	303.1	395.3
Other	3.6	129.7	139.8	151.0	159.2	176.0
High-income index	100.0	240.8	278.3	352.2	388.9	425.9
Foodstuffs	23.3	179.5	206.7	245.5	280.4	305.2
Drink and tobacco	6.7	172.5	190.9	225.2	246.4	267.7
Footwear and clothing	5.8	200.5	211.1	221.4	230.7	244.3
Household goods	12.3	230.9	263.3	310.1	333.9	384.2
Domestic help	6.7	161.5	169.2	172.5	197.7	236.1
Transport expenses	26.4	314.3	387.7	526.5	574.8	606.7
Other	18.8	262.5	314.1	416.8	465.8	528.7

Sources: Malawi Monthly Statistical Bulletin; data supplied by the Malawian authorities; and staff estimates.

Table XVI. Malawi: Accounts of Leading Public Enterprises, 1979/80-1983/84

(In thousands of Malawi kwacha)

	Revenue	Net profit or loss	Finance charges	Deprecia-tion	Gross investment	Cash Flow
ADMARC						
1979/80	50,835	-4,683	4,246	1,479	7,294	...
1980/81	56,215	-6,197	6,530	1,626	11,372	...
1981/82	63,198	1,030	6,830	1,861	5,271	
1982/83	82,817	8,890 1/	7,457	3,000	289	-9,848
1983/84 (budget)	82,318	3,400 1/	9,498	3,540	600	1,039
Malawi Railways						
1979	15,752	-1,666	892	1,165	7,558	...
1980	18,959	-249	1,495	2,742	986	...
1981	20,308	-2,154	119	2,848	100	...
1982/83 (15 mos.)	21,326	-5,761	113	3,119	100	...
1983/84 (budget)	15,438	-4,198	430	2,635	6,529	-3,188
ESCOM						
1979	13,409	4,885	2,361	2,130	20,213	...
1980	15,814	6,113	2,359	2,258	35,485	...
1981	18,144	3,890	4,972	3,299	13,301	...
1982	20,316	412	8,768	4,670	5,344	...
1983/84 (budget)	23,690	-590	9,898	7,559	8,422 2/	-2,838
Malawi Development Corporation						
1979/80	2,722	-1,624	--	--	--	...
1980	2,710	-1,628	2,143	66	1,290	...
1981	2,006	-48	2,600	62	1,290	...
1982/83	1,897	-2,761	2,970	54	560	...
1983 (budget)	1,938	-1,617	2,299	69	563 2/	-1,045
Capital City Development Corporation						
1979/80	5,420	36	2,882	365	4,284	...
1980/81	4,650	-897	2,835	425	2,150	...
1981/82	5,663	-1,036	3,259	421	2,846	...
1982/83 (rev. est.)	6,717	-1,036	3,259	410	2,846	...
1983/84 (budget)	6,693	55	3,134	473	1,173	258
Malawi Housing Corporation						
1979	5,137	634	1,085	1,134	2,350	...
1980	6,132	400	1,157	1,195	961	...
1981	6,613	1,070	1,255	1,254	3,972	...
1982	6,871	-272	1,470	1,269	2,000	...
1983 (budget)	6,567	-983	1,555	1,342	1,153	-1,994
Air Malawi						
1979	16,219	-5,933	421	1,935	303	...
1980	10,914	-4,324	823	740	122	...
1981	15,408	-356	84	670	153	...
1982	17,474	700	12	460	100	...
1983 (budget)	17,605	730	490	1,283	694	849
Blantyre Water Board						
1979	3,452	338	685	495	2,718	...
1980	4,488	824	878	550	1,841	...
1981	4,787	212	896	765	6,809	...
1982	5,171	104	944	917	6,577	...
1983 (budget)	5,671	5	910	1,275	3,227 2/	603
Malawi Book Service						
1979/80	2,881	210	6	27	90	...
1980/81	3,887	452	7	30	134	...
1981/82	3,898	943	--	39	41	...
1982/83	4,425	347	--	34	207	...
1983/84 (budget)	4,400	656	--	45	454	419

Sources: Office of Comptroller of Statutory Bodies; and Economic Planning Division, Office of the President and Cabinet.

1/ Before provision for unsold maize stocks.
2/ Economic Planning Division estimate.

Table XVII. Malawi: Gross Domestic Product and Expenditure, 1982-86

	1982	1983	1984	1985	1986
	(In millions of Malawi kwacha at current prices)				
Gross domestic product at market prices	1,409.6	1,588.1	1,795.1	2,017.4	2,262.4
Gross fixed capital formation	216.9	244.0	297.6	365.1	435.1
Increase in stocks	69.7	57.4	44.8	48.4	52.0
Final consumption	1,202.5	1,366.9	1,531.8	1,672.1	1,853.2
Exports of goods and services	297.7	311.8	365.6	419.8	470.2
Imports of goods and services	377.2	392.0	444.2	488.0	548.1
	(In millions of Malawi kwacha at 1978 prices)				
Gross domestic product at market prices	870.9	894.7	921.5	958.4	1,001.2
Agriculture	320.7	335.7	345.8	360.3	376.2
Manufacturing	89.5	91.3	94.2	98.5	103.4
Other	460.7	467.7	481.5	499.6	521.6
	(Ratios: in percent of GDP at current prices)				
Gross fixed capital formation	15.4	15.4	16.6	18.1	19.2
Final consumption	85.3	86.1	85.3	82.9	81.9
Exports of goods and services	21.1	19.6	20.4	20.8	20.8
Imports of goods and services	26.8	24.7	24.7	24.2	24.2
	(Growth rates: in percentages)				
GDP at market prices	2.7	2.7	3.0	4.0	4.5
Agriculture	6.2	4.7	3.0	4.0	4.5
Manufacturing	-6.1	2.0	3.2	4.6	5.0
Other	2.2	1.5	3.0	3.8	4.4
Memorandum item:					
Deflator of GDP market prices (1978 = 100)	161.9	177.5	194.8	210.5	225.9

Sources: Data provided by the Malawian authorities; and staff estimates.

Malawi: Extended Arrangement

Attached hereto is a letter dated July 29, 1983 from the Governor of the Reserve Bank of Malawi and the Minister of Finance of Malawi, together with an accompanying Economic Policy Memorandum of the Government of Malawi, requesting an extended arrangement and setting forth:

(a) the objectives and policies that the authorities of Malawi intend to pursue for the period of the extended arrangement;

(b) the policies and measures that the authorities of Malawi intend to pursue until the end of the current fiscal year (year ending March 30, 1984); and

(c) understandings of Malawi with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Malawi will pursue during fiscal years 1984/85 and 1985/86, and the first half of fiscal year 1986/87.

To support these objectives and policies, the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of three years from September __, 1983, Malawi will have the right to make purchases from the Fund in an amount equivalent to SDR 100 million, subject to paragraphs 2, 3, 4 and 5 below, without further review by the Fund.

2. (a) Until April 30, 1984, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 15 million, provided that purchases shall not exceed the equivalent of SDR 5 million until October 31, 1983; and the equivalent of SDR 10 million until January 31, 1984.

(b) Until April 30, 1985, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 47 million.

(c) Until April 30, 1986, purchases under this arrangement shall not without the consent of the Fund exceed the equivalent of SDR 83 million.

(d) The right of Malawi to make purchases during the year ending April 30, 1985, during the year ending April 30, 1986, and for the remainder of the period of the extended arrangement shall be subject to such phasing as shall be determined.

3. Purchases under this arrangement shall be made from ordinary resources until total purchases under this arrangement reach the equivalent of SDR 7,171,822, then each purchase shall be made from ordinary resources and from borrowed resources in the ratio of one to one until purchases under this arrangement reach the equivalent of SDR 29,878,178, then each purchase shall be made with borrowed resources only, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Malawi will not make purchases under this arrangement:

(a) until April 30, 1984, during any period in which:

(i) the limit on the net domestic assets of the banking system as specified in paragraph 32 of the Economic Policy Memorandum annexed to the attached letter, or

(ii) the limit on net bank credit to the government from the domestic banking system as specified in paragraph 32 of the Economic Policy Memorandum annexed to the attached letter, or

(iii) the limits on external borrowing as specified in paragraph 33 of the Economic Policy Memorandum annexed to the attached letter are not observed, or

(b) after December 31, 1983, if understanding has not been reached on measures necessary for the purposes of achieving the objectives of the program, as contemplated in paragraph 34 of the attached Economic Policy Memorandum, or

(c) after April 29, 1984, April 29, 1985, and April 29, 1986, if suitable performance clauses have not been established in consultation with the Fund for fiscal years 1984/85 and 1985/86 and the first half of fiscal year 1986/87, respectively, as contemplated in paragraph 34 of the attached memorandum; or if such clauses, having been established, are not being observed; or

(d) throughout the duration of the arrangement, if Malawi:

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

(ii) introduces multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Malawi is prevented from purchasing under this arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Malawi, and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Malawi's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Malawi. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this agreement will be resumed only after consultation has taken place between the Fund and Malawi, and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Malawi, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this extended arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Malawi will consult the Fund on the timing of purchases involving borrowed resources.

8. Malawi shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Malawi shall repurchase the amount of its currency that results from a purchase under this arrangement, and is subject to charges under Article V, Section 8(b), in accordance with the provision of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Malawi's balance of payments and reserve position improves.

(b) Any reductions in Malawi's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above, in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this extended arrangement will be normally either the 6th or the 26th of the month, or the next business day if the selected day is not a business day, provided that purchase will be completed not later than seven years from the date of purchase.

10. During the period of the arrangement Malawi shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Malawi, or of representatives of Malawi to the Fund. Malawi shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Malawi in achieving the objectives and policies set forth in the Economic Policy Memorandum of the Government of Malawi annexed to the attached letter.

11. In accordance with paragraph 3 of the attached letter, Malawi will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government, or whenever the Managing Director requests consultation because any of the criteria under paragraph 3 above have not been observed, or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Malawi has outstanding purchases under this arrangement, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Malawi's balance of payments policies.

Ministry of Finance
Lilongwe, Malawi

July 29, 1983

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière,

1. The attached memorandum describes Malawi's broad economic and financial objectives and policies for the three years 1983/84-1985/86 (April-March), and the measures that are being implemented in the first program year (1983/84). For the second and third years of the program, we intend to formulate detailed economic policies in a flexible manner in the light of the domestic and international circumstances prevailing at the time.

2. Since 1979, the Government of Malawi has been engaged in a continuing effort to restrain demand in response to adverse developments in the terms of trade, high international interest rates, external transportation bottlenecks, and adverse weather conditions. Budgetary expenditures have been significantly reduced in real terms, domestic interest rates have been raised, wages have continued to be restrained, and agricultural producer prices have been increased substantially. As a result of this effort, Malawi has observed all the performance criteria under the current one-year stand-by arrangement (approved by the Executive Board in August 1982). It is now the Government's intention to pursue a program over the next three years that will combine policies to moderate demand with policies to improve productive efficiency, diversify export production, and increase the production of goods for the domestic market. These policies are described in the attached memorandum. In support of this economic program, Malawi requests a three-year extended arrangement for an amount equivalent to SDR 100 million.

3. The Government of Malawi believes that the policies being implemented in 1983/84, which are described in detail in the attached memorandum, are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any appropriate measures, in accordance with the policies of the Fund on such consultations. In particular the Government will review with the Fund the progress made in implementing the program, normally about mid-way through each year, as part of its continuing dialogue with the Fund. With respect to the program for the first year, the

Government will consult with the Fund before December 31, 1983 on the Government's measures and reach such understandings with the Fund as will be necessary for the purposes of achieving the objectives of the program.

Yours sincerely,

/s/

J.Z.U. Tembo
Governor
Reserve Bank of Malawi

/s/

L. Chakakala Chaziya
Minister of Finance
Government of Malawi

Memorandum of the Government of Malawi on its Economic and Financial Policies

Introduction

1. During the 1960s and for the greater part of the 1970s, Malawi's economic performance was relatively satisfactory. The average real rate of economic growth was 6 percent in the 1960s, and 5.5 percent in the 1970s, and these rates were achieved without large fiscal or balance of payments imbalances. Malawi successfully promoted production of tobacco (which increased from 11,000 tons in 1960 to almost 60,000 tons by 1982) and of sugar (which increased from 34,000 tons in 1973 to about 170,000 tons by 1982). Malawi has generally been self-sufficient in maize, which is the major food staple.

2. The emphasis on agriculture has been the focus of the Government's development strategy since independence in 1964. Malawi has no known mineral resources and is landlocked, leading to high transportation costs. Thus Malawi's endowments have not been favorable for a growth strategy based on mining or manufactured goods, and the Government has implemented policies to maximize the country's agricultural production. These policies have included a pragmatic incomes policy, which has kept wage costs in Malawi below those in neighbouring countries; the creation of an agricultural development and marketing agency to assist small-holder producers; the provision of infrastructural facilities for the movement of inputs to the producing areas and of crops to the markets; and producer pricing policies to provide appropriate incentives for the crop mix and the level of output.

3. Since 1979, the performance of the Malawi economy has been less satisfactory, due primarily to adverse external developments. The terms of trade deteriorated by 47 percent from 1977 to 1980, and remained in 1982 at a level 42 percent below the 1977 level. This deterioration mainly reflects sharp declines in tobacco prices between 1977 and 1980 and of sugar prices in 1981 and 1982 together with the rise in oil prices in 1979 and 1980. Moreover, drought severely impaired Malawi's maize production in 1979 and 1980, forcing significant maize imports in 1981. In the late 1970s, Malawi had recourse to international commercial borrowing to promote the development of sugar estates, the expansion of tobacco production, and the construction of infrastructural facilities, with low short run rates of return. The servicing of this debt therefore became a rapidly increasing burden as export prices declined at the end of the 1970s and as international interest rates rose to unusually high levels. A further problem has resulted from intermittent disruptions to Malawi's transit routes through Mozambique to Indian Ocean ports; these routes normally carry the bulk of Malawi's export and import goods. The routes were virtually out of operation in late 1979, for much of 1980 and again for extended periods in late

1982 and early 1983. There has since been some improvement in operations but damage to rail lines is limiting their effectiveness. Alternative southern routes are being used, but at significantly higher costs. In consequence of these developments the external situation has tightened, the volume of imports has been reduced and the growth capacity of the economy has been severely constrained with real GDP virtually unchanged in 1980-81.

4. Since 1979, the Government of Malawi has taken measures to adjust demand and reduce the large domestic and external financial imbalances that had emerged. Budgetary expenditures have been strictly contained. In nominal terms, expenditures increased by only 9.5 percent in 1981/82 and declined by 3.6 percent in 1982/83; in real terms, expenditures fell by almost 12 percent in this two year period. Wages have also been strictly controlled, with no general increase in either 1982/83 or 1983/84. Regarding pricing policies, agricultural producer prices have been substantially adjusted. The producer price for maize was increased by 67 percent in 1981, and in 1982 there were substantial producer price increases for groundnuts (49 percent), cotton (15 percent), rice (15 percent), and smallholder tobacco (20 percent); there was a further 45 percent increase for smallholder tobacco in April 1983. There was an interest rate reform in 1980 which led to increases in all the key interest rates. In April 1982, the Malawi kwacha was devalued by 15 percent, and the full effect of the devaluation, as well as the higher transport costs for imports was reflected in consumer prices, including a sharp increase in the price of gasoline to the equivalent of US$4.30 per U.S. gallon.

5. With these policies, Malawi reduced the deficit of the current account of the balance of payments from 17.4 percent of GDP in 1980 to 9.1 percent in 1982 and brought down the budget deficit from 15.2 percent of GDP in 1980/81 to 9.4 percent in 1982/83 (these figures exclude official transfers). Real GDP rose by 2.7 percent in 1982 as increases in producer prices and favorable weather conditions resulted in good agricultural production, including a record output of maize. At the same time, the rate of increase of the consumer price index, which was 18 percent in 1980 fell to about 9 percent in 1981 and 1982 mainly due to the improved food supplies. In the latter part of 1982, Malawi reached agreement with the Paris and London Clubs to reschedule Malawi's external debt, thereby allowing a more even pattern of annual debt service obligations (without the rescheduling, debt service payments would have been bunched in 1982/84).

6. Following the adjustment already achieved in the past few years, the Malawi Government proposes to implement a three-year medium-term economic program, aimed at continuing the demand management policies of recent years, while at the same time giving greater emphasis to policies to improve the efficiency of production, diversify exports, and increase the production of goods for domestic consumption based on

local materials. These policies are described in greater detail in the following sections.

The Three-Year program

7. The medium-term objectives of the extended arrangement are to achieve an average rate of growth of GDP of 3.5 percent; reduce the rate of inflation gradually to about 7-8 percent; reduce the deficit of the current account of the balance of payments from 9.1 percent of GDP in 1982 to 5.6 percent by 1985; and reduce the budget deficit (excluding grants) from 9.6 percent of GDP in 1982/83 to 7.5 percent by 1985/86 (including grants, the budget deficit would decline from 7.1 percent in 1982/83 to 4.8 percent in 1985/86). These objectives will require the implementation of appropriate measures on both the supply side and the demand side.

8. Even under the most favorable assumptions, Malawi (like many other developing countries) is unlikely to achieve in the 1980s the growth rates of the 1960s and the early 1970s. The capacity of the export sector to serve as a leading growth sector is reduced by the slow growth of demand in industrial countries and by the likelihood that price and income elasticities of demand in industrial countries for several primary products will be lower in the 1980s than in the last two decades. Malawi's ability to diversify out of agriculture, or even within the agricultural sector, has been adversely affected by the substantial cumulative increases in the price of energy in the 1970s. Even the achievement of the target growth levels will require improved terms of trade and additional inflows of capital on concessional terms.

9. To reduce Malawi's vulnerability to adverse developments in external demand, the Government's medium term growth strategy will involve policies to increase the efficiency of production of the current major export crops (tobacco, sugar, and tea), policies to diversify export production (with greater encouragement to be given to groundnuts, coffee, and manufactures), and policies to increase production for the domestic market of goods using local materials (cotton, textiles, paper, furniture and other wood products, leather products, beverages and wheat products).

Supply policies

10. The effort to promote growth will be directed through a public sector investment program, through appropriate incentives for agricultural production, and through programs to restructure three key institutions engaged in production and marketing: the Agricultural Development and Marketing Corporation (ADMARC), the Malawi Development Corporation (MDC), and Press Holdings). We have been examining these

programs with the World Bank in the context of discussions on a second Structural Adjustment Loan (SAL II). We expect the corresponding plans to be set forth explicitly and to reach agreement with the World Bank on these plans by the middle of September 1983.

11. The public sector investment program, which includes the investments of the Government as well as the parastatals, emphasizes six key areas: agricultural crop development; forestry and game projects; the improvement of north-south transportation routes within the country; the developments of links at the northern border with rail and road links through Tanzania; the completion of electrification and water supply projects; and the development of skilled manpower.

12. With regard to the restructuring of ADMARC, MDC, and Press, new executive managers, financial controllers, and Boards of Directors have already been appointed or are to be appointed for each of these entities, and improved financial accounting systems are being introduced. A significant restructuring of Press Holdings is being implemented to establish the corporation on a strictly commercial basis. Staffing levels have been substantially reduced, new management has been appointed, a number of unprofitable companies have been closed, and financial targets have been established for each subsidiary. The group has already been returned to profitability on current operations, following significant losses in 1980 and 1981. To take account of the problem of past debts, a financial restructuring is being implemented with the Government assuming Press Holdings domestic debt in return for income notes with priority claims against the corporation's assets and current earnings. The domestic creditors, in lieu of the outstanding Press debt, will take government paper of long maturity and relatively low interest rates. This proposal will involve net payment by the Government of about MK 5 million per annum, an amount which will be reduced to the extent that Press is able to service its interest obligations to the Government. This amount is incorporated within the program's aggregate fiscal targets. Among the reforms being introduced into the operations of ADMARC is a rationalization of the distribution network (which will include the closure of unprofitable routes and distribution centers). The MDC is disengaging itself from direct management of enterprises to concentrate on its original intended function of developing new undertakings. An exercise is in progress to rationalize the equity holdings of ADMARC, MDC, and Press, in other enterprises, an exercise which will involve the closure of unprofitable subsidiaries, the sale of some marketable subsidiaries to domestic or foreign investors, and the reallocation of holdings among the three institutions.

13. Malawi is recognized as a relatively efficient producer of agricultural products, and Government policies will be designed to increase the efficiency of production still further. The measures to achieve this objective include management and institutional reform, expansion

of infrastructure and extension services, and crop and market research. Maintenance of existing production facilities is to be given priority over new expansion projects, the policy of installing qualified managers for the major estates is to continue, and consideration is to be given to the creation of institutions to supply and service agricultural machinery on purchase or hire/purchase terms. Under a project to be financed partly by the International Fund for Agricultural Development (IFAD) and the World Bank, a revolving fund is to be established to permit fertilizer to be imported well in advance of the growing season, to prevent the delays that have arisen in the past when disruptions to the transportation lines through Mozambique have impeded the deliveries of vital supplies of fertilizer during the growing season.

14. Appropriate pricing policies will be important to provide adequate incentive to farmers and encourage the efficient use of inputs. Following the effect of drought in 1979 and 1980, the producer price of maize was increased by two thirds in 1981; this resulted in a record crop in 1982 and another good crop is anticipated in 1983. In 1982, to encourage greater production of export crops, there was no increase in the producer price for maize, while there were significant increases for export crops as noted above. The Government is currently reviewing the producer prices for the 1983/84 season, which will be announced shortly. Following the large increases of 1981 and 1982, increases in 1983 will be moderate but will again be designed to raise production of export crops as no increase is anticipated in the producer price for maize.

15. We intend to continue with our policy of gradual adjustment of the fertilizer price with the intention of eliminating subsidies over time. In 1982/83 the subsidy was reduced by 50 percent, with a further 25 percent reduction based on the ex-Beira price being effected in 1983/84. All subsidies based on the ex-Beira price will be eliminated before the start of the 1984/85 growing season, with any remaining subsidies being related to the higher costs of transport by non-traditional routes. We expect such subsidies to decline as transport routes improve and additional costs decline.

16. Other than for a few basic commodities whose prices are directly administered, Malawi does not have a formal system of price control. However, there has been considerable public concern on occasions in the past when prices of imports or domestically produced manufactures have been increased to levels greatly in excess of the official guideline of a rate of return of 15-25 percent. In addition, firms have developed the practice of seeking government approval for price increases as a means of protecting themselves from public criticism. The relatively small size of the domestic economy and the landlocked position of the country create significant barriers to entry of new firms and the structure of the market in many product lines is monopolistic or oligopolistic. The Government therefore believes that the

exercise of a general surveillance role of prices is justified to ensure that increases are not exhorbitant. On the other hand, the Government is fully committed to the maintenance of a liberal economic system and the encouragement of the private sector, and considers adequate flexibility in prices essential for efficient resource allocation and to provide adequate incentives. Accordingly, the Government is introducing a new system of processing applications for price increases, under which requested increases become automatically effective two months from the date of application in the absence of a response from the Government. During the first review of the program, agreement will be reached with the Fund on a date for reducing this period from two months to one month. In addition, on the basis of a study to be done in cooperation with the World Bank, a timetable shall be prepared not later than the end of 1983 indicating the phasing of reductions in the list of items subject to price control. Agreement will be reached on this timetable or on a substantial number of items for immediate decontrol during the first review of the program, and we will not request a purchase after December 1983 under this arrangement until that review has been completed satisfactorily.

17. The prices of the products and services of several parastatals have been increased during the past two years. Utility prices have been increased and a schedule of future price increases in government rents on government housing has been introduced in 1983. The Government will regularly review the prices and tariffs charged by parastatals to ensure continued adequate financial returns to these bodies.

18. Despite these substantial price measures the Government has been able to maintain traditional policies of wage restraint. There was no general salary increase in the public sector in 1982/83 and none is anticipated in 1983/84.

Fiscal policies

19. With the slower rate of growth of imports, exports, and general economic activity projected for the next few years, the rate of increase of budgetary revenues is likely to be modest. The rate of increase of revenue has already declined significantly in recent years. Revenue rose at an average annual rate of 28 percent during the three fiscal years 1977/78-1979/80, but increased by an average of only 9 percent during the two years 1980/81 and 1981/82. In 1982/83 it rose by 11 percent. The ratio of revenue to GDP has declined from 21 percent in 1979/80 to 17 percent in 1982/83. Furthermore external support in the form of grants has also declined in relation to GDP. The deteriorating performance of revenue has severely limited the rate of growth of expenditure.

20. There is no immediate prospect of a resumption of high rates of growth of revenue, since the tax base is narrow and will not expand

appreciably in the next few years. However, we will examine several possible new revenue measures to increase the tax effort where marginal tax rates are not so high as to discourage activity, with a view to at least arresting the declining trend of revenue to GDP. Already in the 1983/84 budget significant revenue measures have been introduced, as noted in paragraph 23 below. Possible further measures to be considered for implementation during the remaining period of the extended arrangement include increases in the surtax on imports and domestic manufactured items; increases in rentals on agricultural land; and increases in the import levy. We also intend to ensure that specific taxes are adjusted regularly to maintain their value in real terms. Even with implementation of these new policy measures, the ratio of revenue to GDP is likely to remain at about 17 percent through 1985/86.

21. In view of the projected slow rate of growth of revenue, the rate of growth of expenditures will have to be strictly contained if the budget deficit is to be reduced. In order to achieve the budget deficit target mentioned in paragraph 7, the growth of expenditures will have to be limited to about 9.5 percent per annum during the period of the stand-by arrangement, which is about the same level as the expected rate of inflation.

Monetary policy

22. During the period of the extended arrangement, credit and interest rate policies will be used to promote productive efficiency, the mobilization and appropriate allocation of resources, and demand restraint. Particular attention will be paid to the need to limit government demand for credit and to provide for the legitimate credit needs of the private sector and parastatals directly engaged in production. This is being facilitated by the strengthened financial position of domestic commercial banks following the restructuring of Press Holdings. Following the increases already implemented, interest rates will be regularly reviewed to ensure that they remain positive in real terms.

External policies

23. The Malawi kwacha was devalued by 15 percent in April 1982, but since then the effective exchange rate has appreciated substantially. To facilitate a flexible exchange rate policy during the program, the Government will change the currency peg from the SDR to an unannounced basket of currencies. This action will be taken before the program is presented to the Fund's Executive Board. The Government will also take any other measures necessary to ensure the continuation of appropriate exchange rate policies during the period of the extended arrangement.

24. The Government of Malawi has approached the Paris Club for a meeting to reschedule debt service payments due in 1983/84. Under the existing agreement for 1982/83 such a further rescheduling would be

contingent on Malawi's economic performance continuing to be consistent with the requirements of Fund and Bank programs. The agreement with the London Club commercial banks for 1983/84 is subject to the same condition.

25. Malawi maintains a liberal trade system and an exchange system that is free of restrictions on payments and transfers for current international transactions. The Government is committed to the maintenance of this liberal system.

26. The Government of Malawi plans to convene in late 1983 or early 1984 a donors conference, to be held in Malawi, to seek further concessional assistance from traditional as well as nontraditional donors in support of Malawi's medium term economic program. The Government hopes that it will receive the assistance of the World Bank and the Fund in the presentation of its economic plans.

II. The 1983/84 Program

27. The objectives during the first year of the extended arrangement are to reduce the deficit of the current account of the balance of payments from 9.1 percent of GDP in 1982 to 8.0 percent in 1983, and to reduce the budget deficit (excluding grants) from 9.9 percent of GDP in 1982/83 to 9.0 percent in 1983/84. Including grants, the deficit is to decline from 7.1 percent in 1982/83 to 6.4 percent in 1983/84.

28. A number of measures to achieve this adjustment have already been implemented. The budget, announced in March, reflected restaint on expenditures and increased emphasis on the productive sectors. The rate of growth of total expenditures is limited to 8 percent in nominal terms, a decline of about 2 percent in real terms. Within the total expenditure provisions, relatively large allocations have been made for development expenditures and for selected current outlays (on agriculture, maintenance and repair of roads, and education). To achieve the revenue growth rate of 10 percent in 1983/84, a number of new revenue measures were introduced, including increases in excise duties on tobacco, beer, motor vehicles, increases in the sales tax on petroleum products, reduced exemptions and selected increases in the surtax on imports and domestic manufactured products and increases in import levies. In addition, personal allowances against income tax were abolished. The new measures represented a 5 percent increase in taxes on international trade, and an increase of 8 percent in total tax revenues.

29. With the substantial increases in producer prices in 1981 and 1982, and given the existing stocks of a number of commodities, increases in producer prices in 1983 will be modest, but will nonetheless be designed to encourage a shift of production to exportable products, as there will again be no increase in the producer price for maize.

30. In June 1983, the minimum commercial bank deposit interest rate was increased from 8.75 percent to 10.75 percent; all other deposit rates (for banks as well as nonbank deposit-taking institutions) were similarly increased by two percentage points. In view of the wide spread between deposit rates and the maximum lending rate of the commercial banks, this maximum lending rate was reduced from 18.5 percent to 16.5 percent; most bank lending continues to be at interest rates of 14-15 percent.

31. The Malawi Government plans to discuss with the Fund, well in advance of the normal budget preparation period, the framework of the budget for 1984/85.

32. The monetary and credit program for 1983/84 is designed to contain balance of payments pressures and reduce the rate of inflation, while at the same time ensuring tha the legitimate credit needs of the productive sectors are adequately met. Accordingly, the net domestic assets of the banking system, which amounted to MK 519.8 million at the end of June 1983, will not exceed MK 538.3 million at the end of September 1983, MK 555.2 million at the end of December 1983 and MK 548.3 million at the end of March 1984 (if a SAL II disbursement currently expected to be made in the first quarter of 1984 is in fact made in the last quarter of 1983, the ceiling on net domestic assets for December 1983 will be reduced by the amount of the disbursement). Net domestic bank credit to Government, which amounted to MK 232.3 million in June 1983, will not exceed MK 244.3 million at the end of September 1983, MK 254.7 million at the end of December 1983, and MK 240.0 million at the end of March 1984 (the December 1983 ceiling will be reduced by any SAL II disbursement made in the last quarter of 1983). The ceilings for March 1984 are indicative and will be reviewed during the mid-term review in light of economic developments and the policy actions taken by the authorities as part of the program. On the basis of these ceilings and the balance of payments projections, broad money will increase in 1983 by 13 percent (about the same rate of growth as nominal GDP), compared to 15 percent in 1982.

33. In view of the external payments and debt situation, external borrowing on non-concessional terms will be limited. In 1983, the contracting or guarantee by the Government of new nonconcessional external borrowing of maturity 1-12 years is to be limited to SDR 5 million, of which none shall have maturity less than five years. The authorities do not intend to contract any borrowing of less than one year maturity except for normal trade financing.

34. Before December 31, 1983 the authorities will consult with the Fund on the progress made in implementing the program in order to reach understandings on the performance criteria for domestic bank credit to government and net domestic assets for March 1984, limits on the contracting or guarantee by the Government of new nonconcessional

external borrowing in 1984, and on such measures as are necessary for the purposes of achieving the objectives of the program, including the appropriateness of the exchange rate, the structure of interest rates, the framework for the 1984/85 budget, and the steps necessary to continue the process of price liberalization. Moreover, before April 29, 1984, April 29, 1985 and April 29, 1986 the Malawian authorities will consult with the Fund in order to reach understandings on the policies, measures and performance criteria for fiscal years 1984/85 and 1985/86 and the first half of fiscal year 1986/87.