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To: Members of the Executive Board

From: The Secretary

Subject: Malawi - Enhanced Structural Adjustment Facility - Policy Framework Paper, 1991/92-1993/94

Attached for consideration by the Executive Directors is the policy framework paper under the enhanced structural adjustment facility for Malawi, which is tentatively scheduled for discussion on Monday, September 30, 1991.

Mr. R. C. Williams (ext. 7643) or Mr. R. P. Hicks (ext. 6520) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

MALAWI

Enhanced Structural Adjustment Facility

Policy Framework Paper, 1991/92-1993/94

Prepared by the Malawian authorities in collaboration with the staffs of the Fund and the World Bank

August 30, 1991

I. Introduction

1. In updating the third-year policy framework paper (PFP) 1990/91-1992/93 and extending the horizon to mid-1994, this paper reviews the progress that has been made in implementing the structural adjustment program and describes economic developments during the program period. It also outlines the medium-term development strategy and discusses the macroeconomic and sectoral policies to be pursued, as well as social and longer-term issues central to the development effort. The objectives and policies of the Government of Malawi's adjustment program remain basically unchanged from the three previous PFPs.

2. From independence until the late 1970s, Malawi maintained stable financial conditions within a liberal policy environment. Buoyed by an expansion in the agricultural estate sector, real GDP per capita increased on average by 3 percent over the period 1964-79. In the early 1980s, however, the economy was subject to a number of adverse exogenous shocks, including droughts, a worsening of the external terms of trade, and the onset of external transportation problems arising from the unrest in neighboring Mozambique. To address these difficulties, the Government of Malawi, supported by the Fund and World Bank, implemented a series of adjustment programs with significant success. However, its efforts were obstructed by a new round of unfavorable developments starting in the mid-1980s, which included a further worsening of the terms of trade, the full closure of the main external trade route, and a large influx of displaced persons from Mozambique. The imbalances generated by these factors were compounded by the emergence of a substantial fiscal deficit and the introduction of direct controls on imports, which had detrimental effects on production and growth.

3. In February 1988, the authorities introduced a new growth program based on the Statement of Development Policies (DEVPOL) for 1987-96 and supported by a 15-month stand-by arrangement with the Fund. This was followed by a three-year structural adjustment program covering the period April 1988 to March 1991, supported by arrangements under the Fund's enhanced structural adjustment facility (ESAF), the World Bank Industrial and Trade Policy Adjustment Credit (ITPAC) and an

Agricultural Sector Adjustment Credit (ASAC), and significant donor cofinancing. Structural adjustment in the program period, July 1991 to June 1992, is to be supported by a fourth annual arrangement under the ESAF and by World Bank lending operations.

II. Policy Implementation and Economic Performance

4. The objectives of the adjustment program are the maintenance of high rates of economic growth, with due regard to poverty reduction, and a macroeconomic environment conducive to price stability and to an improvement in the external position consistent with achieving long-run viability. In common with the three previous PFPs, the intent of fiscal and monetary policies is to achieve domestic and external balance, while structural policies--including import liberalization and reforms in the financial, parastatal, and tax system--are designed to improve efficiency and longer-term economic growth and to reduce poverty. Specifically, the program sought to achieve an annual average growth in real GDP of around 4 percent, a deceleration in the rate of inflation from 31 percent in 1988 to around 8 percent in 1990, and maintenance of foreign exchange reserves at a level equivalent to 4 months of nonmaize imports. These objectives have been achieved to a large degree. With the import liberalization program now completed and significant progress having been made with regard to the tax reform program, the remaining key elements of the initial structural policies are completion of reform of the agricultural, transportation, and financial sectors and increased investment in social sectors.

5. Against a background of significant external financing, fiscal policy under the program has aimed at closely monitoring central government expenditure and constraining the overall deficit to permit the transfer of financial resources to the private sector, thereby reducing macroeconomic imbalances while supporting a recovery of private investment. In line with this strategy--and as a result of revenue boosted by tax reform, improved administration and strong growth of liberalized imports, as well as improved expenditure controls--the central government deficit (excluding official transfers) declined from 9.7 percent of GDP in 1987/88 to 7.4 percent of GDP in 1988/89 and to 6.8 percent of GDP in 1989/90 while expenditure increased broadly as planned. The deficit declined further in 1990/91 to 5.6 percent of GDP, somewhat lower than targeted. However, there were major shortfalls in revenue in 1990/91, attributable both to external factors (such as the Middle East crisis and the closure of the Tete route through Mozambique) and to sharply reduced surtax receipts. The latter mainly reflected stock accumulation related to the import liberalization program, and to a lesser extent, weaknesses in tax administration. These revenue shortfalls made it necessary to restrain expenditures below the desired

level to keep the overall deficit within the program target. 1/ Nevertheless, as a result of temporary but substantial delays in the receipt of balance of payments support and of higher-than-foreseen repayment of external debt, the Government was unable to release financial resources to the private sector to the extent planned. The improvement in the Government's position with the banking system of just MK 19 million in 1990/91 was far below the programmed improvement of MK 230 million, and compared with MK 101 million in 1988/89 and MK 53 million in 1989/90.

6. Targets for monetary expansion under the adjustment program were set to facilitate a marked slow-down in inflation. Credit policy was designed, in combination with tight fiscal policy and sizable external financing, to ensure a significant shift in financial resources to the private sector. Over the three-year program period, bank credit to the private sector rose at an annual average rate of 17 percent relative to the broad money stock at the beginning of the period, while net bank credit outstanding to the Central Government fell--albeit unevenly--on average by 13 percent annually over the period relative to the broad money stock at the beginning of the period; in these circumstances, broad money increased on average by 14 percent annually over the three-year period. Against this background, the inflation rate, which had fallen from 31.4 percent on an average basis in 1988 to 15.7 percent in 1989, fell further to 11.5 percent in 1990, somewhat above the target of 9.0 percent envisaged in the third-year PFP. The progress in bringing down inflation reflects not only the tightening of financial policies, but also the impact of nominal exchange rate stability and import liberalization. With the deceleration in inflation, interest rates have been positive in real terms since 1990, which should serve both to stimulate the flow of financial savings through the banking system and to strengthen allocative efficiency.

7. With respect to trade policy, the import liberalization program, which was implemented in phases over the program period--beginning with raw materials, extending to intermediate goods, and finally encompassing consumer goods--was completed on January 10, 1991, with all imports except those on a narrow negative list now free from the requirement of prior foreign exchange approval. 2/ Following implementation of the final phase, 98.3 percent of non-petroleum imports (based on the 1984 composition of imports) 3/ are no longer subject to prior foreign

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1/ The deficit target for 1990/91 excluded expenditure on the five-year investment program for the parastatal power company described in paragraph 44 and expenditure on the Northern Transport Corridor Project in Tanzania.

2/ The negative list contains certain luxury items (principally alcoholic beverages, precious metals, noncommercial motor vehicles, and electrical goods).

3/ Petroleum products have never been subject to prior foreign exchange approval.

exchange approval. The import liberalization program has already stimulated economic activity, increased capacity utilization, and helped lower the inflation rate.

8. As regards sectoral reforms, the Government took a number of important steps in 1990/91. In agriculture, new reforms were introduced under the ASAC program aimed at improving food security, smallholder income, and efficiency of resource use. In the smallholder sector, producer prices were adjusted in line with border price equivalents, production restrictions on high-value crops such as burley tobacco were lifted, seasonal credit facilities were expanded, and new measures to increase productivity among the poorest farmers were introduced. In the estate sector, the new Estate Extension Service became fully operational. Regarding sugar, a comprehensive plan for the sugar industry was established, and the domestic sugar price was raised by 7 percent in April 1990 and by 19 percent in January 1991, in accordance with the Government's policy of boosting production potential and increasing supplies for export.

9. The Government has continued with its program of financial sector reforms, which aim at expanding the role of market forces in resource allocation and monetary policy. Following the progress made in 1989/90--in establishing the legislative framework for financial restructuring, introducing a statutory reserve requirement and liberalizing interest rates--various steps were taken in 1990/91, consistent with the authorities' objective of switching from direct to indirect methods of monetary control. These measures included an enhanced role for the bank rate as an initial step toward establishing discount and lending facilities at the Reserve Bank of Malawi, the removal of direct credit controls on the commercial banks and the initiation of periodic auctions of Reserve Bank of Malawi paper. Steps have also been taken toward increasing the competitiveness of the banking system, with some financial institutions being permitted to accept corporate deposits, while efforts have been made to encourage the entry of new financial institutions into Malawi.

10. Reform of the parastatal sector is an essential structural element of the adjustment program. Financial performance of the parastatal sector strengthened significantly over the three-year program period and financial targets established under the program were essentially observed. The focus of parastatal reform during the past five years has been the restructuring of ADMARC, which included elimination of ADMARC's monopsony position in smallholder marketing, divestiture of assets, not related to its marketing functions, a number of cost-cutting measures, and restructuring of ADMARC's development and commercial functions. This effort is largely completed and, as a result, ADMARC has moved from a net loss of MK 11 million in 1986/87 to a net profit (before taxes) of MK 29.6 million in 1989/90 and an estimated MK 23.3 million in 1990/91. Moreover, ADMARC paid more than MK 7.7 million in corporate income tax to the Government in 1990/91. The Electricity Supply Commission (ESCOM) continued to record significant profits in 1990/91, which financed part

of its investment program. For the other major parastatals, net profits or broadly balanced positions were recorded for 1990/91, apart from Malawi Railways where sharply rising costs and operational difficulties adversely affected financial performance.

11. In conjunction with these stabilization and adjustment efforts, the Government embarked on policies to strengthen human resource development and reduce poverty. A new social sector strategy was presented at the May 1990 Consultative Group Meeting, which was strongly endorsed by the donor community, comprising increased expenditures for health and education, expanded child spacing activities, and new targeted poverty interventions.

12. The adjustment program envisaged the promotion of growth through higher investment supported initially through foreign savings and increasingly through domestic resource mobilization. After an initial widening of the external current account deficit following import liberalization, the program targeted a gradual reduction of the deficit excluding official transfers. The response to import liberalization exceeded the program's expectations, with import volume rising by 25 percent in 1988 and 8 percent in 1989 and certain factor services and transfer payments increasing sharply. The effect on the current account deficit in 1989 was exacerbated by delays in shipment of tobacco, tea, and coffee exports leading to large stock accumulation at the end of the year; accordingly, the current account deficit rose to 12.9 percent of GDP compared with 9.1 percent of GDP in 1988. In 1990, substantial clearing of the large build-up of exportable stocks, together with an increase in tobacco production, led to a decline in the current account deficit to 8.6 percent of GDP, in line with the program target. Import volume growth was 8 percent in 1990, continuing the substantial increases of 1988-89. The current account in 1990 was not significantly affected by the Middle East crisis, reflecting the Government's pricing policy and the small share of petroleum products in total imports. However, because of temporary delays in the receipt of balance of payments support, the surplus in the overall balance of payments of SDR 13 million fell far short of the program target of SDR 41 million. Gross official reserves, while rising to SDR 96 million or 3.3 months of nonmaize imports at end-1990, were below the targeted level of 4.0 months of nonmaize imports.

13. Implementation of the structural adjustment program has already had a favorable effect on economic performance. Real GDP growth has increased steadily from 0.5 percent in 1987 (at factor cost) to 3.3 percent in 1988, to 4.1 percent in 1989, and 4.8 percent in 1990, while inflation decelerated as indicated above. Import liberalization, the ITPAC reform program, and the more stable financial conditions have led to a particularly strong recovery in manufacturing, electricity, construction, and financial services. This improved output performance has supported an expansion in fixed investment, which increased from 13.5 percent of GDP in 1987 to 16 percent in 1989 and 1990, and has set the stage for real gains in per capita consumption; about one half of the investment has been financed through national saving.

III. Medium-Term Objectives, Strategy, and Policies

14. The broad objectives for the 1991/92-1993/94 program period--of achieving higher rates of economic growth, consistent with reduction in poverty, a viable medium-term balance of payments position and relative price stability--remain fundamentally unchanged from the three previous PFPs. To achieve these objectives, the Government remains committed to a strategy of macroeconomic stabilization and structural reform, together with the restoration of liberal economic policies aimed at fostering private sector activity. Policy will continue to be focused on two elements. First, policies to ensure both domestic and external macroeconomic balance will be maintained, including consolidation of the process of fiscal improvement after the disappointing performance of revenue in 1990/91. Other key elements are continuation of restrained monetary and credit policies, with additional strengthening of financial instruments, and continued progress in trade liberalization. Second, policies to reduce the remaining structural impediments to growth will be implemented in each of the main sectors of the economy. Table 3 presents, in matrix form, a summary of the Government's structural adjustment program, and the timetable for its implementation.

15. In the light of the economy's performance during 1990/91, the expected catch-up in balance of payments support following the temporary delays in 1990/91, and the prospects for external financing in the medium term, certain assumptions and macroeconomic targets in the previous PFP have been revised. The projections assume that progress in alleviating transport difficulties and infrastructural bottlenecks will be made in the period ahead, with the Northern Transport Corridor (NTC) route through Tanzania becoming fully operational by end-1991 and the Tete corridor being reopened. However, the projections do not assume further reopening of the Nacala line which would significantly improve economic prospects. The annual average inflation rate is targeted to decline over the program period to 9 percent in 1991, 6 percent in 1992, and 5 percent for the remainder of the program period.

16. With regard to the program's external projections, recent estimates indicate that the total financing requirement will average SDR 190 million a year in 1991-94, compared with an average of SDR 170 million for 1991-93 projected in the third-year PFP (Table 2). The principal factor underlying the increase in the financing requirement is the larger-than-expected response on both the trade and services account to the liberalization steps (referred to in paragraph 7) combined with the authorities' intention to continue with this liberalization process. Import volume growth averaging about 4.5 percent annually is projected for the program period, consistent with unitary import demand elasticity and the growth objectives. Import unit values are expected to rise sharply in 1991, primarily as a result of the closure of the Tete route which is estimated to increase the c.i.f. margin to 41.5 percent from 38 percent in 1990; thereafter, with the reopening of the Tete route and greater utilization of the NTC, the margin is assumed to decline steadily to 35 percent by 1994. Export volumes in 1991 are expected to increase by

4 percent, with destocking again contributing to exports, although with a less pronounced impact than in 1990. By 1993-94, export volume is projected to rise by about three percent annually supported by an increase in burley tobacco, sugar, and manufactured exports. The current account deficit (excluding grants) in 1991 is projected at 8.8 percent of GDP with favorable export prices for tobacco offsetting the effect of the closure of the Tete route on the c.i.f. margin. The deficit relative to GDP is expected to decline steadily to around 7 percent by 1994, a somewhat higher level than assumed in the previous PFPs as a result of a stronger response to import liberalization than expected. The overall balance of payments surplus is expected to decline slowly, but remain positive, through the program period. International reserves are expected to amount to the equivalent of 3.3 months of nonmaize imports at the end of 1991, the same as a year earlier. The end-year reserves target for 1992-94 will approximate four months of nonmaize imports.

17. The program is designed to support continued real per capita increases in output. Real GDP is projected to grow by 4.8 percent in 1991, boosted by a 12 percent increase in smallholder agriculture and a 6 percent increase in transport and communication. The strong smallholder performance, which arises from a significant increase in maize production, is attributable to the successful implementation of the Government's agricultural sector program and favorable weather conditions. Real GDP is projected to grow by 4.5 percent from 1992 in line with the growth targets of the previous PFPs. The key sectors for growth will be smallholder agriculture, where further productivity gains are expected with increased adoption of higher yielding crop varieties; estate agriculture, supported by efficiency gains in tobacco production and expansion in sugar planting; manufacturing and distribution, where increased agricultural production will support expansion of the agro-processing sub-sector; and service sectors, following the introduction of new reforms in the finance and smallscale enterprise areas.

18. Increased investment will be required to meet growth targets and private sector fixed investment is expected to increase from 11.7 percent of GDP in 1990 to 14.0 percent in 1994. In line with the targeted improvement in the external current account, national savings will play an increasingly significant role in financing domestic investment. National savings as a ratio to GDP is projected to increase from 10.0 percent in 1991 to 12.6 percent in 1994 as a result of more efficient domestic resource mobilization arising from ongoing reforms in the financial and capital markets. Nonetheless, increased output levels are expected to permit real per capita growth in consumption in 1991-1994.

IV. Macroeconomic and Sectoral Policies

a. Macroeconomic policies

External sector policies

19. With exchange rate stability a centerpiece of the anti-inflation effort, the nominal exchange rate of the Malawi kwacha during the first two years of the program was kept unchanged relative to the basket to which the kwacha is pegged. Despite the considerable success in reducing inflation, the index of the real effective exchange rate at the end of 1989 was well above the level prevailing after the January 1988 devaluation. In order to reverse this loss of external competitiveness and to support the import liberalization, the kwacha was devalued by 7 percent against its basket in March, 1990. However, with inflation still high in relation to major trading partners, the gains from this devaluation were eroded by the end of 1990. Emphasis will thus continue to be placed largely on nonaccommodating financial polices to help ensure a sustained improvement in external competitiveness for the export- and import-substituting sectors. Exchange rate policy will be closely monitored with particular attention paid to the need for export diversification and the achievement of external objectives.

20. Although Malawi's high level of external debt remains of concern, the debt-service ratio has declined significantly in recent years as a result of the high proportion of external financing obtained on concessional terms, the 1988 London and Paris Club reschedulings, and bilateral debt relief. The debt-service ratio--at 25 percent of exports of goods and nonfactor services in 1990--is projected to decline to 17 percent by 1994. Accordingly, Malawi will continue to follow a prudent policy with strict limits on nonconcessional external borrowing (including a ceiling on 1- to 15-year maturities, a subceiling on 1- to 5-year maturities, and a separate ceiling on short-term net disbursements). Malawi remains a poor country but, like other such countries which are meeting debt payments on schedule and remain on a path of external viability, might wish nevertheless to benefit from any future debt initiatives.

21. As described in paragraph 7 above, the Government completed the removal of prior foreign exchange approval for imports in January 1991, with controls now limited to a small negative list, for which prior approval is to be temporarily maintained. The negative list will be further reduced over time, as permitted by sustained improvement in the external position. Consistent with its policy of liberalizing the trade and payments system, the Government will continue to administer payments arrangements with respect to certain services and transfers in a liberal and flexible manner. The Government is currently reviewing the existing structure of trade taxes, with a view to minimizing the level of and dispersion in protection. Specific measures will be developed in 1991/92.

Public finances

22. The new program will aim at restoring and consolidating the improvements in the public finances achieved in the first two years of the program, specifically addressing the revenue shortfalls that occurred in 1990/91. The underlying strategy will continue to be the maintenance of strict fiscal discipline to ensure the availability of an adequate level of resources for the rest of the economy. In line with these objectives, the targeted central government deficit before grants (excluding the new power investment program) will decline from 6.0 percent in 1991/92 to 5.4 percent of GDP by 1993/94. The appropriate fiscal stance will continue to be reviewed during the program period, taking into account (i) the availability of domestic resources and of foreign concessional inflows, (ii) the progress toward attaining the program's overall domestic and external objectives, and (iii) the review of the Public Sector Investment Program, as spelled out below. The central government deficit after grants is projected to remain on average at about 2 percent of GDP in 1991/92-1993/94, which will permit sizable net repayments by the Government to the banking system.

23. To maximize the benefits and efficiency of budget outlays in the tight fiscal environment, the Government will continue to implement its action program to strengthen the budgetary allocation process. Drawing on the findings and expenditure options outlined in the Public Expenditure Review prepared by the World Bank, Government will strengthen the expenditure control process in sectoral ministries and review sectoral allocation priorities in 1991/92. In particular, Government will strengthen the role of the rolling three-year Public Sector Investment Program (PSIP) in expenditure planning. The PSIP, which includes all central government development projects, will be expanded to account for donor financing of recurrent expenditure and all parastatal investments involving government finances in 1991/92. Priorities and programs for development spending will be reviewed annually with the World Bank during the program period. The agreed PSIP will be shared in timely fashion with the donor community to facilitate the reorientation of donors' aid programs in line with the Government's expenditure priorities.

24. In its annual review of the PSIP, the Government will ensure its consistency with resource availability, assess its recurrent cost implications, and take into account the need to attain balance of payments viability. In line with the expenditure priorities outlined in DEVPOL and presented to the Consultative Group, in May 1990 sectoral allocations for education and health are projected to increase significantly, power and water allocations to increase moderately, agriculture and forestry allocations to remain relatively unchanged, and transport and buildings allocations to decline. Investments with low economic return will be avoided, and individual investment projects will be evaluated in terms of their contribution to economic growth and income distribution. The Government will improve the coordination between the development and recurrent budgets by updating recurrent cost coefficients.

25. In line with these revised expenditure priorities, the overall expenditure level is expected to be maintained at about 25 percent of GDP over the program period. Current expenditures are estimated at 18.6 percent of GDP in 1991/92 and include specific provision for: (i) security related expenditures on the Nacala rail line; (ii) a subvention to the Smallholder Farmers Fertilizer Revolving Fund of 1.6 percent of total budget expenditures which is consistent with the ASAC program as reviewed in paragraph 38; and (iii) government reimbursement of ADMARC for development-related marketing expenses. Excluding these special items, noninterest current expenditures are targeted to increase by about 7 percent in real terms in 1991/92, which will permit increased financing of high-priority programs in primary education and primary health care.

26. Wage policy will provide for appropriate and more regular increases in remuneration of the civil service, which is relatively small in size by regional standards, to redress wage compression and restore competitiveness. Consistent with the recommendations of the Bank's Public Expenditure Review, the wage bill is budgeted to increase from 4.3 percent of GDP in 1990/91 to 4.4 percent in 1991/92, permitting a real wage increase. Wage policy in future program years will ensure that total spending on wages and salaries does not exceed 5.2 percent of GDP. Similarly, the net rate of increase of civil service employment will continue to be limited to no more than 2 percent per annum. The Government is also committed to enhancing the productivity of the civil service and is reviewing public sector management policies. In particular, in 1991/92, the Government will develop appropriate plans (i) to improve the morale and productivity at all levels of the civil service; (ii) to coordinate and properly plan training programs, (iii) to further enhance decision making by strengthening communication within ministries and departments, and (iv) promote the use and coordination of information technology.

27. Development expenditures are expected to amount to 6.8 percent of GDP in 1991/92, consistent with real increases in public investment in priority social sectors. Development budget expenditures are to be met largely from grants and concessional loans identified at the May 1990 Consultative Group Meeting. The kwacha counterpart of government debt service payments that were rescheduled will continue to be held in a blocked account at the Reserve Bank of Malawi and will be debited as the corresponding external payments come due.

28. In addition to these current and development expenditure targets, the 1991/92 fiscal program also makes provision for an extrabudgetary purchase of MK 7.5 million of maize for the Strategic Grain Reserve, as reviewed in paragraph 69.

29. With the objectives of improving the efficiency, equity, and administration of the tax system, the Government embarked on a comprehensive tax reform program in 1987. The net impact of the reforms under the program was intended to be revenue-neutral, with expansion of the tax

base allowing for reduction in rates. However, the revenue shortfalls described in paragraph 5, have contributed to a significant weakening of the revenue/GDP ratio, which fell to 19.1 percent in 1990/91. Despite the tax cuts announced in the March 1991 budget, the revenue ratio is to rise to 19.4 percent in 1991/92 and further in the medium term. This will reflect the expansion of the surtax base to include certain utilities and services, improvements in tax compliance resulting from a strengthening of the Government's audit capacity, phased reductions in surtax exemptions, restoration of payments into the Petroleum Stabilization Fund, and reduction in the tax exemption period for goods held in bonded warehouses. Under the tax reform program indirect taxes have been restructured as follows. First, the surtax, previously operated under the ring system, was transformed into a value-added tax on the manufacturing sector. Second, export incentives have been provided through the zero rating of exports under the surtax and the recent introduction of a more efficient duty drawback system. Third, the Government has shifted excise and duty rates from a specific to an ad valorem basis and has eliminated the excise tax on goods with low income elasticities and on goods which yield little revenue. Fourth, the system of customs duties has been rationalized with the objectives of shifting the revenue function of trade taxes from tariffs to the surtax. With regard to direct taxes, a current payments system for company tax was introduced in 1988/89 and the company tax rate was reduced from 50 percent to 45 percent in 1990/91 and to 40 percent in 1991/92. Rates of personal income tax and graduated tax rates have also been reduced, with the top marginal rate of income tax being cut in line with the company tax rate. In 1991/92, the system of fringe benefits taxation was modified such that the tax is now levied on the company rather than the employee.

Monetary and credit policy

30. The stance of monetary policy will remain geared toward achieving and sustaining a low inflation rate and protecting the balance of payments, while structural reforms in the financial sector will continue to be implemented with a view to strengthening monetary control, enhancing domestic financial saving, and improving the allocative efficiency of investment. Consistent with external and price objectives and with the GDP growth target, monetary expansion in FY 1991/92 will be contained at 12 percent. Interest rates, which have recently been liberalized, are expected to remain positive in real terms. Credit to the private sector is expected to expand moderately consistent with the program's emphasis on promoting private sector based growth, which can be accommodated in the context of a restrained monetary stance because of the targeted improvement in the Government's position with the banking system. Targets set for net bank credit to the parastatals will be consistent with, and thus reinforce, the improvement planned in their financial performance.

31. The reform of the financial sector and of monetary control procedures will continue. The legislative framework for introducing

market-based monetary control and developing financial institutions and markets has been put in place. In November 1990, the Reserve Bank of Malawi introduced auctions of its own bills to the two commercial banks. This paper is issued at intervals, and with varying amounts and yields based on monetary policy considerations. In the medium term these bills will be offered to a wider range of potential investors and the yield will be moved closer to market-related levels. The rediscount rate and the auction rate for Reserve Bank of Malawi bills will be more closely related, with the rediscount rate the key element guiding interest rates, including commercial bank interest rates.

b. Sectoral policies

Agriculture

32. The Government has launched a comprehensive development program for the agriculture sector, which is supported by the 1990 Agriculture Sector Adjustment Credit (ASAC) and other projects funded by the World Bank and the donor community. The primary objectives include: (i) enhancing food security and raising incomes in the smallholder sector through increased production of food and cash crops, with emphasis on food deficit and female-headed households; (ii) improving the efficiency of resource use in the estate sector, with emphasis on expansion and diversification of agricultural and agro-industrial exports; and (iii) strengthening management of natural resources, with emphasis on fisheries, afforestation, and soil conservation.

33. In the smallholder sector, increases in food production will come through higher crop yields, as population pressure and land scarcity preclude any significant expansion of the cropping base. Yield reserves will be exploited through increased fertilizer use and adoption of high yielding crop varieties, with emphasis on maize. To increase fertilizer use and improve the efficiency of fertilizer distribution and use, the Government has (i) strengthened its fertilizer planning process; (ii) expanded the seasonal credit system; and (iii) completed a study to strengthen operations of the Smallholder Farmers Fertilizer Revolving Fund of Malawi operations. To spur the development and adoption of high-yielding maize varieties, the Government has (i) shifted maize research toward the development of flint varieties; and (ii) initiated measures to improve research-extension linkages and extension methodology. As part of the strategy to improve the effectiveness of agricultural support services, the Government is reviewing the size and composition of the agriculture budget, particularly the balance between recurrent and development expenditures.

34. The Government's strategy to increase production and to improve productivity mainly targets farmers with plots less than one hectare, comprising more than one half of the rural population. To raise productivity and income of these smallholders, many of whom face seasonal food deficits and low nutrition levels, the Government is committed to expanding the range of high value cash crops available to

smallholders. In 1990/91 the Government revised the legislative framework and licensed about 8,000 smallholders to grow burley tobacco on customary land. Following on these reforms, the Government will license an additional 12,000 smallholders in the medium term. Government will continue with other measures to ensure that smaller farmers have sufficient resources to procure fertilizer and other inputs through (i) implementation of pilot projects to test food/fertilizer-for-work schemes and targeted credit schemes and (ii) continued expansion of the supply of fertilizer in small packets.

35. The Government remains committed to continuing the reform of the smallholder agricultural marketing system in line with its objective of encouraging private sector activity. Beginning in 1992, private sector marketing of smallholder burley and seed cotton will be allowed; marketing restrictions will therefore only remain on a few specialized types of tobacco.

36. The Government recognizes the importance of maintaining adequate smallholder incentives for domestic and export crops, and will continue to set smallholder producer prices in line with border-price equivalents, with the exception of maize. 1/ Since smallholder tobacco prices paid by ADMARC have been below export parity levels in recent years, the Government significantly increased producer prices for tobacco in 1990. Under the new arrangements, tobacco growers will receive a pre-planting incentive price equivalent to 45 percent of the rolling three-year average auction price. A second payment, to be made after closing of the auction floors, will be based on the actual auction price, with growers receiving 65 percent of the net profit of ADMARC's tobacco trading account after accounting for ADMARC's tobacco related marketing and overhead costs. Starting in 1991/92, the payment system for smallholder burley tobacco will be harmonized with the payment system for other tobaccos. During each growing season, the World Bank will be consulted in a timely manner on the proposed consumer and producer prices before they are announced.

37. In the area of input pricing, the Government is committed to the general principle of full cost recovery for smallholder inputs to promote efficient resource allocation. However, the Government has continued to maintain a small subsidy on smallholder fertilizer--amounting to MK 26 million or 1.9 percent of total government expenditures in 1990/91--in order to redress the market failure of limited access to credit, offset smallholder risk aversion, achieve national food production objectives, and avoid sharp increases in consumer food prices in view of the large number of rural poor who are net buyers of food.

1/ Given the high transport costs and low relative value, the Government will continue to treat maize as a nontradable commodity and base its price on domestic supply and demand conditions.

38. The Government is committed to the phased elimination of fertilizer subsidy, as follows. First, the Government will eliminate the generalized fertilizer subsidy in the medium term concurrent with the adoption of high-yielding maize varieties, expansion of rural credit, and reduction in external transport costs. Second, during the transitional period, the Government will reduce the subsidy rate in a phased manner to maintain producer incentives, limit maize consumer price increases, and minimize production distortions and fiscal subventions. Assuming continued commodity assistance from the donor community as specified in ASAC, fertilizer prices will be set so as to reduce: (i) the economic subsidy level to not more than 25 percent in 1991/92 and 20 percent in 1992/93, and (ii) the total amount of the subsidy to not more than 1.6 percent of total government expenditure in 1991/92 and 1.3 percent in 1992/93. Third, the Government will continue to improve the efficiency of fertilizer subsidies through: (i) expansion of pilot projects to test targeted fertilizer subsidies to food deficit households, and (ii) maintenance of differentiated subsidy rates promoting high analysis rather than low analysis fertilizer.

39. In the estate sector, the Government's strategy is to enhance productivity and to improve efficiency in resource use through further strengthening of the estate extension services, increased access to medium-term credit, and an appropriate land rent policy. To address the problem of underutilization of estate land, the Government is committed to strengthen the role of land pricing in resource allocation. To this end, the Government has revised the legislative framework to allow for more frequent adjustments of land rents. The Government doubled land rents with effect from April 1991 and introduced a system to collect land rents through the tobacco auction to reduce arrears. These measures will be supported by the following additional actions: (i) review of the feasibility of introducing differentiated land rents reflecting land quality; and (ii) increase in land rents to an average level at least equal in real terms to the 1985 rate by April 1992 in line with the phasing agreed under the ASAC. In response to the growing land pressure in the smallholder sector, the Government has recently enacted new legislation to halt the transfer of customary land to estates in densely populated areas. In order to enhance production incentives so as to increase export potential and yet meet a rapidly growing domestic demand, the Government remains committed to monitoring closely the adequacy of domestic sugar prices and adjusting them as the need arises.

40. The Government expects these land utilization and productivity measures to support an expansion of rural employment opportunities and to improve functioning of rural labor markets. In addition, to enhance stability in the rural labor market, the Government, in conjunction with the World Bank will review minimum wage policy, with a view to more frequent adjustments and tobacco tenancy pricing arrangements.

Industry, Finance, and Energy

41. The Government's development strategy for the industrial sector will continue to emphasize private sector activity and the maintenance of a market-determined pricing system. Following on the extensive reform program completed under the Industrial and Trade Policy Adjustment Credit, the Government introduced a new Investment Policy Statement in March 1991 that identified further policy changes to support industrial sector growth. These include: (i) elimination of the industrial licensing requirement, with the exception of a small negative list; (ii) streamlining of business registration and incorporation procedures; (iii) streamlining of land transfer procedures; (iv) encouragement of private sector development of industrial sites; and (v) establishment of an investment promotion agency.

42. Development of small-scale and micro-enterprises remains a core element in the Government's strategy to support economic growth, employment, and poverty alleviation. The Government is committed to removing the existing constraints in this area, such as limited access to credit for working capital, lack of initial investment capital, and restrictive regulatory and zoning policies. To this end, the Government will (i) significantly expand the pool of funds available for small-scale lending on commercial terms in 1991/92-1993/94 (for example, term and working capital credit, and lease financing); (ii) strengthen small-scale enterprise institutions through appropriate training and review of structure of services to enable institutions to reach a broad client base in 1991/92-1993/94; (iii) encourage the financial institutions serving the small- and medium-scale sector to implement a market-oriented interest rate policy that reflects the risk and operating costs of lending in this sector (for example, credit guarantee facilities); (iv) review the scope for replacing blanket prohibitions on business activity in certain residential areas with a selective prohibition on businesses that pose health or safety risks; and (v) evaluate its own procurement policies and practices during 1991-92 so that they can be adapted to the potential of local producers.

43. In the financial sector, the Government is undertaking a number of policy reforms to deepen financial markets and improve the efficiency of financial intermediation and resource mobilization, in conjunction with the monetary policy changes reviewed in paragraph 30. In 1990, the passing of the Capital Market Development Act and the issue of bonds in the local market by INDEBANK were a significant first step toward the development of a capital market in Malawi. Complementary policy measures in 1991/92 include: (i) rationalization of the tax treatment of owner occupied housing interest, (ii) establishment of a technical committee to facilitate the development of capital markets and (iii) support the development of a unit trust fund. Furthermore, the Government has put into place a new regulatory framework to promote competition in the highly segmented and concentrated financial market. The Government will enact additional measures to promote competition, as follows: (i) encourage entry into the banking system by both foreign

and domestic financial institutions; and (ii) finalize the restructuring plan for the Post Office Savings Bank by September 1991, which will be monitored under the Financial Sector and Enterprise Development Project.

44. In the energy sector, the Government will continue to support policies that protect the environment and are cost-effective. The Government recognizes the necessity of encouraging the most efficient use of power and petroleum products. Based on the results of the 1988 Least Cost Power Development Study, the Government has developed an appropriate expansion program for Malawi's electricity-generating capacity to meet the economy's future needs. ESCOM began expansion of the hydroelectric capacity at Tedzani in 1989/90, with complementary investments in distribution, transmission, and institutional strengthening. The investment program involves significant on-lending of external financing through the Government, equivalent to 1.5 percent of GDP in 1991/92. The World Bank will be consulted annually regarding this program.

45. In the area of energy pricing, Government will ensure that domestic prices of petroleum products reflect a full and timely pass-through of import and domestic distribution costs and taxes, consistent with budgetary requirements. Similarly, Government will continue to follow the policy of adjusting electricity tariffs in a timely manner on the basis of long-run marginal costs of production. The energy pricing study, presently in progress, will assist the Government to strengthen the role of energy prices in efficient resource allocation.

Infrastructure

46. The Government has continued to pursue a number of complementary strategies to alleviate the economic burden that has arisen from disruption of the external transport routes through Mozambique. First, the external traffic route through Tanzania, the NTC, will provide a viable and less costly alternative to the various routes to Durban. The NTC Project is designed to upgrade and expand the route to Dar-es-Salaam, and will reduce Malawi's overall c.i.f. margin to 35 percent by 1994. Second, the Government has been working closely with the Mozambican authorities to fully reopen the Tete and Nacala routes. Although some trains have begun to service the Nacala line again, problems of security and financing remain. While the full restoration of service along the Nacala line would result in a significant reduction in Malawi's external transport costs, this line at present cannot accommodate the bulk of Malawi's transport requirements. Hence, continued intensive use of the northern route will be required in the medium term to ensure a balanced transport network. Finally, the Government has encouraged an expansion of the Malawian-registered international road-haulage sector, which has led to more competitive tariffs, and foreign exchange savings.

47. In addition to these investment initiatives, the Government is committed to further policy reform to enhance efficient resource allocation in the road transport sector. In conjunction with the World

Bank, the Government intends to review the Road Transport Act, including policies on sector entry and exit, regulation of routes, tariff structure, and operations based upon vehicle size.

48. The restructuring of unprofitable transport parastatals is a key strategy for the transport sector. As reviewed in paragraph 56, the Government is committed to developing a restructuring plan for Malawi Railways and Lake Services in 1992 to strengthen their operating and financial performance. In addition, the Government will ensure that the Air Malawi investment program remains consistent with the airlines's debt service capacity and continued financial viability.

49. As regards the remainder of the infrastructure network, the Government recognizes the importance of maintenance and rehabilitation. It will continue its program of road maintenance covering all existing roads, upgrade the road network only where justified by projected traffic and consistent with overall expenditure priorities, and strengthen the maintenance capability for public buildings. Urban water supply will be expanded where financially viable and a ten-year sector investment program will be developed with the World Bank under the National Water Resource Project. Rehabilitation of borehole and gravity-fed water supplies will continue, including increasing reliance on community-based maintenance systems, and a plan for expansion of rural water access will be developed in 1991/92. With regard to water tariffs, the Government will ensure that the District Water Supply Fund's tariffs and the Water Boards' rates are reviewed annually to maintain financial viability.

50. In housing, the Government will seek to expand the national housing stock and the role of the private sector and local authorities in construction. In particular, the Government will (i) upgrade traditional housing areas in urban areas in line with the emphasis on infrastructure rehabilitation in 1991/92-1993/94; (ii) streamline the process by which serviced land is made available for building purposes; (iii) introduce less stringent planning and building standards to facilitate development of low-cost housing; and (iv) progressively withdraw from providing subsidized civil service housing. In line with the Government's objective of decentralization of urban services to local authorities, management of the Traditional Housing Areas will be transferred from Malawi Housing Authority to local governments in 1991.

51. In the area of urban services, the Government will strengthen local government management capability and review measures to improve local government finances. In particular, the Government will, in 1991/92, review the scope for (i) an investment fund for local authorities for priority rehabilitation of urban infrastructure; (ii) increased cost recovery by local authorities for their provision of services; and (iii) increased local autonomy in financial and staffing decisions.

Public Enterprise Sector

52. The parastatal sector in Malawi is relatively small, reflecting the historical emphasis on private sector production, and is relatively efficient. Nonetheless, the Government is committed to improving the financial control and performance of the parastatal sector to minimize budgetary transfers and ensure adequate financial returns to commercial parastatals. Government has implemented a comprehensive restructuring of the parastatal sector since 1987, comprising reorganization, divestiture, cost reduction, and regularization of financial flows, which has led to strong financial performance and improved operating efficiency. The 12 major commercial parastatals are expected to show an after-tax profit of MK 67 million in 1991/92, compared with an estimated MK 42 million in 1990/91 and MK 43 million in 1989/90.

53. As reviewed in paragraph 10, the focus of parastatal reform during the past five years has been on restructuring of ADMARC, which has been largely completed. To sustain the strong financial performance of ADMARC, Government will continue to implement the following measures during the program period: (i) finance priority developmental functions that are not consistent with ADMARC's financial viability directly out of the government budget; (ii) continue the asset divestiture program, with the creation of a holding company and a targeted disposal of two companies in 1991/92; and (iii) ensure that ADMARC's net use of seasonal commercial bank overdraft in any year will be zero by end-year.

54. As regards the rest of the parastatal sector, the Government will focus its efforts in three new directions. First, the regulatory framework for parastatal management will be strengthened. While the Department of Statutory Bodies (DSB) has played an effective role in monitoring parastatal financial performance and investment plans, further institutional strengthening is required to enhance its capacity to monitor sector-wide issues. In particular, the Government will recruit additional technical staff and will review the scope for moving the monitoring function of purely developmental subvented parastatals from DSB to parent ministries. These measures will be complemented by a strengthening of parastatal management, including an enhanced role of the Board of Directors in certain management decisions and introduction of performance contracts, with compensation linked to performance. Second, the operation of the Treasury Funds in the Ministry of Finance will continue to be reviewed, particularly the scope for transforming selected Treasury Funds into Statutory Bodies, with monitoring responsibility delegated to DSB, and for additional privatization.

55. Third, restructuring plans for the two remaining problematic parastatals in the sector, Malawi Railways (MR) and Wood Industries Corporation (WICO), will be developed. Malawi Railways has faced significant operational and financial problems over the past decade as a result of the closure of the Nacala rail link, aging track and equipment, and inadequate maintenance. Total losses amounted to an estimated MK 10.5 million in 1990/91, which was covered in part by a

budgetary subvention of MK 6.0 million. The 1991/92 budget projects a loss of MK 6.7 million, which is expected to be financed entirely by commercial bank overdraft with government guarantee.

56. Given the very small size of operations, MR will need to operate at an exceptionally high level of productivity and efficiency to compete successfully against alternative transport modes, even after complete resumption of Nacala traffic. Thus, Government is committed to developing a comprehensive restructuring plan for rail services by March 1992, in conjunction with the World Bank and ODA, which will involve the following broad elements: (i) reduction in cost of operations; (ii) reduction in investment intensity made possible by enhanced levels of utilization, with new investment targeted to replacement of key aging assets; (iii) reduction in the level of mixed passenger-freight train service; and (iv) adjustment of tariff levels as necessary. In addition, Government will also develop a separate restructuring plan for the unprofitable division of MR responsible for lake transport services by June 1992, comprising tariff policy institutional reorganization, and service changes. Implementation of the two restructuring plans, to be phased-in over three to five years, will be monitored under a World Bank operation. In 1991/92, the government guarantee of MR's commercial bank overdraft facility will not exceed MK 13.5 million.

57. Wood Industries Corporation, which produces sawn timber and related products from government forest reserves, has incurred losses since the mid-1980s as a result of sluggish demand, weak management, and marketing and operational problems. Total losses amounted to MK 4 million in 1989/90, followed by an estimated profit of MK 1 million in 1990/91, and a loss of MK 0.8 million is projected for 1991/92. Private firms have expressed interest in taking over WICO operations, and Government is pursuing a privatization strategy.

V. Human Resource Development

58. The Government will continue to implement a comprehensive program to strengthen human resource development in conjunction with its stabilization and structural adjustment policies. While social indicators have improved since Independence, they remain unfavorable by African standards, particularly with regard to nutrition, school enrollment, literacy, and infant and maternal mortality levels. In response to these problems, the Government will maintain and expand existing initiatives to support social development, with particular emphasis on the most vulnerable and disadvantaged groups. This strategy will involve an increased allocation in aggregate social sector outlays as well as a restructuring of expenditure priorities within the sectors toward cost-effective programs, which will ensure that the fiscal policy of strict containment of public expenditures does not erode the provision of essential services. This shift in social sector expenditures will be monitored under World Bank operations.

Education

59. The Government will build upon its Second Ten-Year Education Plan for 1985-95, with the support of the World Bank, AfDB, and other donors critical for its full implementation. The Government's strategy is aiming toward enhanced access to improved education and efficiency of education management, with emphasis on expansion and quality enhancement of primary education. Consequently, the Government will increase the budgetary allocation for education from 11 percent in the mid 1980s to 15 percent in 1991/92 and to 15.5 percent in 1992/93. The emphasis of Government's program will be on day schools, the sciences and technical skills, teacher training and provision of teaching materials, curriculum reform, and a reduction in primary school dropout rates. Special attention will be paid to increased access and retention rates for girls.

60. Following on recent improvements of the quality of teaching methods, curricula, and physical facilities, the Government will, during 1991/92, (i) implement the first phase of the decentralization of the Ministry of Education; (ii) introduce new regulations regarding repetition in primary schools; (iii) reduce the scope of secondary school curricula; and (iv) increase tuition fees for secondary schools and the University in line with the objective to improve cost recovery. Government, in conjunction with the World Bank, will review its strategy for post secondary education and develop an investment program consistent with sector priorities in 1991/92.

Health

61. The Government is implementing its National Health Program for the period 1986-95, with emphasis on improving the efficiency of resource use, strengthening peripheral outreach and preventive care, and increasing the level of recurrent financing in high priority areas. In particular, the Government will focus on the serious health problems caused by malaria, respiratory infections, diarrhoea, and AIDS and will promote related health education activities. In line with its commitment to increase funding of the health sector, Government will (i) raise the proportion of the total revenue budget allocated to the Ministry of Health (MOH) from 7.1 percent in 1990/91 to 7.6 percent in 1991/92 and 8.1 percent in 1992/93; and (ii) increase the development budget allocation to the MOH from MK 40 million in 1990/91 to MK 60 million in 1991/92 and MK 70 million in 1992/93.

62. To improve effectiveness and efficiency of financial resource use, Government will (i) increase relative funding for peripheral health services by at least 2 percent per year in 1991/92-1993/94; (ii) reduce the proportion of MOH recurrent budget allocated to the three major hospitals from currently 35 percent to 25 percent in 1995/96; and (iii) revise fee schedule for private patients annually and develop in

1992 an implementation plan to increase private patient fees to move toward full cost recovery by April 1995.

63. The Government is also committed to institutional decentralization from region to district level and improving staff management in the health sector. By 1992, the Government will prepare (i) detailed operating procedures for planning, financial and personnel management, and other administrative functions under the decentralized arrangements and (ii) a five-year manpower development plan. Furthermore, Government will improve staffing levels in peripheral health services over the program period.

64. The Government has begun a phased program to strengthen the local supply of doctors, with the development of new policy measures to encourage private practice, the introduction of the final year of clinical training in Malawi, and the awarding of the medical degree by the University of Malawi. The timing and content of subsequent phases of medical training will be reviewed with The World Bank in the context of the program's fiscal objectives.

Population

65. Malawi is one of the most densely populated countries in sub-Saharan Africa, with a current population growth rate estimated by the Government at 3.2 percent, exclusive of displaced persons. 1/ This rapid population growth threatens to exhaust the country's land resources and create a massive and unsustainable demand for food, energy, and social services. Malawi's long-term prospects for durable development and per capita income increases depend heavily on immediate and effective action to slow population growth. Thus, the Government had begun to implement new policies and programs, including: (i) establishment of the Population Planning Unit in the Office of the President and Cabinet; (ii) support to the new Family Welfare Council, which will promote and encourage the piloting of alternative family welfare service delivery methods; (iii) development of a comprehensive multi-sectoral five-year strategy for child spacing activities in 1991/92; (iv) expansion of child-spacing services in the Maternal and Child Health Program, including expansion of social marketing and community-based distribution of contraceptives; and (v) incorporation of population planning education in the school curriculum.

VI. Long-Term Development Issues

66. In addition to pursuing policies and programs designed to ameliorate structural constraints to growth in the short and medium

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1/ A recent World Bank report estimates the population growth at the slightly higher rate of 3.5 percent per annum.

term, the Government is also taking steps to address longer-term developmental problems.

Poverty

67. Malawi has one of the lowest per capita incomes in the world, estimated at about US$180 in 1989. The recent World Bank Country Economic Memorandum (CEM), which focused on poverty issues, identified that about one-half of the population lives below the poverty line, almost entirely in rural areas. The principal factors behind Malawi's poverty include: (i) limited employment opportunities; (ii) low physical productivity of land and labor, which results in low agricultural output; (iii) low health and education levels, which undermine development of efficient and productive human capital; (iv) rapid population growth, which creates severe pressure on land resources, labor markets, and provision of social services; and (v) minimal income transfers.

68. The Government's four strategies to reduce poverty are also important elements of the economic growth strategy. First, the Government seeks to increase employment opportunities and labor productivity, through liberalization of small-scale and individual enterprise regulations, introduction of labor-relieving and income-generating programs for women, and continued implementation of trade, finance, and industrial policies that promote labor-intensive production. Second, the Government aims to improve agricultural productivity of smaller farmers, as reviewed in paragraph 34. Third, the Government will increase social sector expenditures to strengthen human resource development, as reviewed in paragraph 58. Fourth, the Government will seek to expand both public and private income transfers during the transition period to higher growth and income levels, in line with the fiscal targets of the overall program. Transfer measures will include expansion of targeted agriculture and nutrition programs, support for greater involvement of nongovernmental organizations in poverty reduction, and introduction of a new Social Program Support Fund to fund pilot interventions that reduce poverty among the most vulnerable groups.

69. The poverty situation has been exacerbated by widespread food insecurity. On the national level, in response to the drought in early 1990, the Government released 12,000 metric tons of maize from the Strategic Grain Reserve (SGR), primarily through free maize distribution targeted to food deficit areas. In 1991/92, the Government intends to replace these stocks, which will restore the SGR to the full 180,000 ton level. The Government has improved operational guidelines for the SGR to identify the trigger conditions for the release of maize and the pricing policy governing the sale and restocking of maize. A food security monitoring and reporting system, set up in 1987, is now fully operational and a new national nutritional surveillance project is under way.

70. Food security at the household level is a critical factor in improving nutrition. It is estimated that almost 55 percent of all smallholders are unable to meet minimum caloric requirements from their own farms, because of growing land pressures and declining soil fertility, and thus, face seasonal food deficits. As reviewed in paragraph 34, the Government is expanding the scope of agricultural interventions to ensure that farmers with less than one hectare of land gain access to credit, inputs, and extension services so as to increase home production. Likewise, it is reorienting the research and extension program to make it more appropriate for smaller farmers. At the same time, smaller farmers will continue to rely on off-farm activities as an important source of income for food purchases. In addition, the Government is intensifying nutrition intervention efforts to raise nutrition levels among the most vulnerable groups, including an expansion of the feeding programs at health clinics and hospitals, and strengthening of nutrition education programs.

Women in Development

71. Reaching, organizing, and improving the lot of women have become integral to Malawi's development goals. The Government has shifted its emphasis from home economics training toward recognizing women as economic agents. Hence, there has been increased support to organizing women's groups to increase their access to technical information and credit in the agriculture and small-scale enterprise sectors. A strong institutional framework has been developed with the recent establishment of the national Commission on Women and a special WID department within the Office of the President and Cabinet. Several Ministries have established WID programs, including the Ministries of Agriculture, Community Services, and Local Government. Although many WID initiatives are relatively recent and have not reached their full potential, there have been noteworthy accomplishments, including: (i) expansion of the child-spacing program; (ii) increased access of women to smallholder credit; (iii) successful launching of the Grameen Bank-type Mudzi Fund; (iv) rapid adoption in urban areas of fuel-efficient stoves produced by a women's group; (v) increased technical assistance to help rural women in developing small businesses; and (vi) increasing access and retention rates for girls in secondary education. In 1991/92, the Government will (i) develop a comprehensive five-year WID plan outlining financial and staff resource requirements; (ii) develop a proposal for the administration of credit mechanism to be set up by the Ministry of Community Services (MOCS) as part of the intensification of its extension activities; and (iii) start implementation of pilot schemes for women's participation in small-scale income-generating activities, and schemes for appropriate technology dissemination and credit provision.

Environment

72. Given the central role of natural resources in the economy, the Government has become increasingly concerned about environmental protection and natural resource management. The rapid population growth and

the low productivity of existing agricultural technology have led to an increasingly unsustainable demand on land and forest resources, as evidenced by increasing soil erosion rates, declining soil fertility, and widespread deforestation. Other environmental problems include increasing scarcity of potable water in certain areas, water degradation, and over-fishing in localized areas.

73. Government has developed a relatively strong institutional and policy framework in response to these environmental problems, and existing programs support improved cultivation and livestock practices, social forestry, and new energy demand management measures. During the program period, the Government will undertake new measures to strengthen natural resource management, including adjustments in fuelwood rates and urban and district water tariffs, stricter enforcement of estate conservation and afforestation covenants, strengthening of regulatory framework for pesticide use and industrial pollution, improved management of nonexclusive resources such as fisheries and indigenous woodlands, development of new soil conservation measures, and institutional strengthening in environmental policy formulation. Government plans to develop an Environmental Action Plan that will map out a long-term investment and policy reform program.

VII. External Financing Requirements

74. Malawi has made considerable progress in its program of structural reform and sustained growth; continued progress will need to be supported by substantial concessional external resources. The revised medium-term scenario updates projections of the balance of payments in 1991-94, and is broadly in line with that of the previous PFP.

75. From 1991 to 1994, it is expected that the current account deficit (excluding official transfers) will decline from the equivalent of 8.8 percent of GDP to 6.9 percent. External reserves will be maintained at about four months of nonmaize imports. Although Malawi continues to be a heavily indebted country, the debt service profile is expected to improve substantially during 1991-94 as a result of the Government's successful efforts during recent years to increase the proportion of grants and concessional loans in balance of payments financing. In addition, a shift toward project lending and away from general import support is expected, although such support will continue to be needed in the short and medium term. The projection of total financing requirements for 1991-94 comprising the current account deficit, public sector amortization payments (including to the Fund) and the maintenance of external reserves at the equivalent of about four months of nonmaize imports, amounts to SDR 759 million over the period 1991-94 (Table 2). Disbursements from commitments existing as of early 1991 are expected to provide SDR 513 million of this total requirement. Disbursements from new commitments are expected to provide SDR 246 million of this total requirement. This policy-based scenario assumes no borrowing from the Fund following expiration of the ESAF arrangement and no new debt

rescheduling during the program period. The total financing requirement for 1991 and 1992 is estimated at SDR 196 million and SDR 206 million respectively; for 1991, almost all of the required financing is to be met from commitments existing as of March 1991. Over 1991 and 1992, about one-third of the total financing requirement is expected to be met from grants, with a similar proportion met from World Bank disbursements.

Table 1. Malawi: Key Macroeconomic Indicators, 1987-94

	1987	1988	1989	1990	1991	1992	1993	1994
	Actual				Projected			
	(Annual percentage change)							
GDP growth rate (factor cost)	0.5	3.3	4.1	4.8	4.8	4.5	4.5	4.5
GDY growth rate 1/	-0.5	3.1	5.9	4.0	4.2	6.5	5.6	5.2
GDY per capita growth rate 1/	-3.9	-0.4	2.3	0.4	0.7	2.9	2.0	1.6
Consumption per capita growth rate 2/	-6.4	-1.7	4.1	-3.6	0.4	2.8	0.9	1.4
	(In percent, unless otherwise specified)							
Debt service (SDR millions) 3/	109.3	113.3	101.8	84.9	82.7	86.9	75.5	78.4
Of which: interest	(39.0)	(38.7)	(38.2)	(33.3)	(31.9)	(32.4)	(32.1)	(33.3)
Debt service/Exports of goods and services	46.9	47.3	43.7	25.4	22.0	22.5	18.0	17.4
Debt service/Exports of goods and services (after debt relief)	46.8	32.9	37.6	25.4	22.0	22.5	18.0	17.4
Debt service/GDP	11.9	11.4	8.2	6.2	5.5	5.3	4.3	4.1
Gross investment/GDP	15.4	18.7	21.2	18.2	18.8	19.0	19.5	19.5
Private fixed investment/GDP 4/	7.7	9.7	10.7	11.7	11.9	13.4	13.9	14.0
Government fixed investment/GDP	5.8	5.6	5.2	4.5	4.9	4.6	4.6	4.6
Stockbuilding/GDP	1.9	3.4	5.3	2.0	2.0	1.0	1.0	1.0
Domestic saving/GDP 5/	13.5	12.6	12.2	14.2	14.1	14.6	15.7	16.1
National saving/GDP	10.3	9.6	8.3	9.6	10.0	10.7	12.1	12.6
Government saving/GDP	-5.0	-2.3	-1.6	-1.3	-1.0	-1.2	-0.9	...
Private saving/GDP	15.3	11.9	9.9	10.9	11.0	11.9	13.1	...
Marginal domestic saving rate 6/	...	...	...	0.27	0.14	0.19	0.27	0.20
Marginal national saving rate 6/	...	...	...	0.18	0.13	0.18	0.26	0.18
Government revenue/GDP 7/	20.7	21.3	21.8	19.1	19.4	19.5	19.6	...
Government expenditure/GDP 7/	30.4	28.7	28.6	24.7	25.4	25.2	25.1	...
Fiscal deficit/GDP 7/	-9.7	-7.4	-6.8	-5.6	-6.0	-5.7	-5.4	...
Fiscal deficit including grants/GDP 7/	-7.0	-1.7	-2.2	-3.5	-1.3	-2.5	-2.5	...
CPI change	26.8	31.4	15.7	11.5	9.0	6.0	5.0	5.0
Real exchange rate (index, 1985 = 100)	83.4	88.6	94.3	94.6	...	...	...	...
Export volume growth (merchandise)	-0.9	-2.7	-14.2 8/	50.4 8/	3.8 8/	-4.0 8/	3.1	2.6
Exports/GDP	25.4	24.1	18.8	24.3	25.1	23.8	23.9	23.8
Import volume growth (merchandise) 9/	-1.3	25.0	7.7	8.2	5.6	2.9	4.5	4.5
Imports/GDP	27.4	30.3	27.8	28.4	29.8	28.2	27.7	27.3
Current account (SDR millions) 10/	-46.6	-90.1	-159.8	-117.6	-132.1	-134.2	-129.4	-129.8
Current account/GDP 10/	-5.1	-9.1	-12.9	-8.6	-8.8	-8.3	-7.4	-6.9
Current account including grants/GDP	-2.6	-2.2	-8.2	-4.2	-4.4	-4.3	-4.2	-3.8
External reserves (SDR millions)	34.4	108.2	76.3	96.4	114.6	130.0	146.2	152.9
In months of nonmaize imports	1.8	4.8	2.9	3.3	3.3	3.7	3.9	3.8

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

1/ GDP adjusted for terms of trade changes.
2/ Consumption excludes emergency imports related to displaced persons.
3/ Before debt relief; excluding debt conversion; including interest on short-term debt.
4/ Statutory bodies not included in the central government budget are included in private sector investment; figure for 1991 excludes purchase of airplane.
5/ Saving excludes emergency grants and imports related to displaced persons.
6/ Defined as the change in domestic/national saving relative to the change in GDP.
7/ Fiscal year beginning in April of the year indicated; excludes foreign loan-financed development expenditures for a Post Office microwave facility in 1988, relending operations related to ESCOM's investment program in 1990-94 and expenditure on the Northern Transport Corridor Project in Tanzania in 1990.
8/ These volumes are affected by substantial stocks carried over at the end of 1989 and, to a lesser extent, at the end of 1990.
9/ Excluding emergency imports for displaced persons and purchase of airplane.
10/ Excluding official transfers and purchase of airplane; net of imports for displaced persons.

Table 2. Malawi: External Financing Requirements, 1988-94

(In millions of SDRs)

	1988	1989	1990 Prog.	1990 Est.	1991	1992	1993	1994
					Projected			
Total financing requirement	-271.6	-208.6	-202.9	-186.8	-195.6	-206.4	-182.6	-174.7
Current account 1/	-90.1	-159.8	-114.4	-117.6	-132.1	-134.2	-129.4	-129.8
Amortization (public sector) 2/	-53.1	-49.9	-28.9	-34.8	-30.1	-35.1	-32.8	-34.2
Change in arrears (increase +)	-34.1	--	--	--	--	--	--	--
Change in gross offical reserves (increase -)	-73.8	31.9	-35.3	-20.1	-18.2	-15.5	-16.2	-6.7
IMF repurchases	-19.9	-19.0	-13.8	-13.8	-15.2	-13.6	-4.2	-4.0
Change in other Reserve Bank liabilities (net)	-0.6	-11.8	-10.5	-0.5	--	-8.0	--	--
Disbursements (existing commitment) 3/	224.9	194.7	202.9	186.8	193.8	152.0	96.5	71.1
Net official transfers	68.2	58.1	78.1	59.8	64.4	59.1	30.1	21.7
Of which: SAL-related grants	44.3	14.0	48.8	29.7	26.2	22.0	--	--
Borrowing by the public sector	100.4	86.3	104.5	107.6	110.3	82.7	61.5	44.1
Bilateral creditors	30.1	25.9	31.3	32.3	21.2	10.9	7.3	5.8
Of which: adjustment lending	2.3	--	26.1	18.0	0.9	--	--	--
Multilateral creditors	69.3	59.4	72.1	74.2	85.3	68.9	52.1	36.8
Of which: adjustment lending	26.0	38.6	22.7	36.3	25.4	11.2	3.7	3.7
Private creditors	1.0	1.0	1.0	1.1	3.8	2.9	2.1	1.5
IMF (stand-by purchases)	9.3	--	--	--	--	--	--	--
ESAF credit 4/	9.3	18.6	18.6	18.6	14.9	5.6	--	--
Other capital (net) 5/	37.8	31.7	1.7	0.8	4.2	4.6	4.9	5.3
Disbursements (expected commitments)	--	--	--	--	1.8	54.4	86.1	103.6
Net official transfers	--	--	--	--	1.8	4.8	25.1	37.0
Of which: SAL-related grants	--	--	--	--	1.8	3.8	13.8	13.8
Borrowing by the public sector	--	--	--	--	--	49.6	61.0	66.6
Bilateral creditors	--	--	--	--	--	12.2	21.1	24.3
Of which: adjustment lending	--	--	--	--	--	3.7	7.5	7.5
Multilateral creditors	--	--	--	--	--	36.3	37.8	39.4
Of which: adjustment lending	--	--	--	--	--	35.0	22.5	3.7
Private creditors	--	--	--	--	--	1.1	2.1	2.9
Debt rescheduling	46.7	13.9	--	--	--	--	--	--
Financing gap	--	--	--	--	--	--	--	--

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

1/ Excluding official transfers and purchase of airplane; net of imports for displaced persons.
2/ Amortization is calculated before debt relief and after debt conversion. Includes public enterprises.
3/ Disbursements from commitments existing as at end-March 1991.
4/ Assumes disbursements under the fourth-year ESAF arrangement.
5/ Comprises net private sector borrowing, short-term credit, and errors and omissions.

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
1. External Sector			
a. Exchange rate and trade system	Maintain external competitiveness and encourage export diversification.	Monitor exchange rate and adjust if necessary.	1991/92, onward
	Promote efficient resource allocation.	Emphasize nonaccomodating financial policies.	1991/92, onward
	Minimize level of and dispersion in domestic protection.	Review structure of trade taxes and rationalize import duties toward more uniform rates of domestic protection.	1991/92-1993/94
b. External debt	Improve profile of external public debt.	Limit contraction of nonconcessional debt.	1991/92, onward
2. Public Finance			
a. Central government budget	Adjust fiscal position.	Maintain overall deficit at noninflationary and sustainable level.	1991/92, onward
b. Revenue	Improve efficiency, equity, and administration of tax system.	Expand surtax base to include certain services and utilities at appropriate rates.	1991/92-1992/93
		Strengthen government audit capabilities to improve tax compliance.	1991/92
		Reduce surtax exemptions and suspensions in phased manner.	1991/92-1993/94
	Strengthen nontax revenue performance.	Restore substantial payments into Petroleum Stabilization Fund.	1991/92
	Restructure direct taxes.	Implement modified tax system on fringe benefits.	1991/92
c. Expenditures	Improve budgetary allocation process.	Strengthen expenditure control process in line ministries.	1991/92, onward
		Review expenditure priorities in key economic and social sectors and revise expenditure allocations to meet sectoral targets.	1991/92, onward

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
	Ensure consistency of development and expenditure budget with resource availability.	Consult with World Bank on three-year rolling PSIP and share PSIP with donor community.	1991/92, onward
d. Civil service	Enhance productivity of civil service.	Review public sector management policies.	ongoing
		Coordinate and plan training programs.	1991/92, onward
		Enhance decision making by strengthening communication within ministries and departments.	1991/92, onward
		Promote the use and coordination of information technology.	1991/92, onward
3. Monetary Policies	Promote efficiency in the allocation of financial resources.	Increase frequency of issue of Reserve Bank of Malawi bills and move yield closer to market related levels.	ongoing
		Harmonize the movements of the discount rate and the auction rate for Reserve Bank of Malawi bills.	1991/92, onward
		Offer Reserve Bank of Malawi Bills to a wider range of potential investors.	ongoing
4. Agriculture			
a. Smallholder production	Increase smallholder productivity through increased use of fertilizer.	Expand seasonal credit system.	ongoing
		Expand supply of fertilizer in small packets.	ongoing
	Increase smallholder productivity through adoption of high-yielding crop varieties.	Shift maize research toward development of flint varieties.	ongoing
		Improve research-extension linkages, extension methodology and expand extension system.	ongoing

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
	Raise productivity and income through expanding range of high value cash crops available to smallholders.	Expand licensing of smallholders to grow burley tobacco on customary land.	ongoing
b. Estate production	Increase estate productivity through more efficient resource use.	Strengthen estate extension service and increase access to medium term credit.	ongoing
	Increase production and export potential for sugar.	Monitor adequacy of and adjust if necessary domestic price of sugar.	1991/92, onward
c. Land policy	Improve efficiency in land use through greater reliance on land pricing.	Review feasibility of introducing differentiated land rents by land quality.	by end 1992
		Increase land rents to an average level at least equal in real terms to the 1985 rate.	by April 1992
	Improve equity in land use.	Enforce restrictions on estate expansion in areas of high land pressure.	1991/92, onward
d. Pricing and marketing	Encourage efficient smallholder production through appropriate producer price incentives.	Consult with World Bank on annual producer price review.	1991/92, onward
		Introduce two-payment system for smallholder tobacco.	1991/92
	Encourage efficient use of fertilizer through appropriate pricing policy.	Reduce fertilizer subsidies as agreed with World Bank.	1991/92-1993/94
		Expand pilot project to test targeted fertilizer subsidies to food deficit households.	ongoing
		Maintain differentiated subsidy rates on high and low analysis fertilizers.	ongoing
	Encourage private sector marketing of smallholder inputs and production.	Allow private sector marketing of smallholder burley and seed cotton.	1991/92, onward
e. Rural labor market	Enhance stability in rural labor market.	Review minimum wage policy.	1991/92-1993/94
		Review tobacco tenancy pricing arrangements.	1991/92-1993/94

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
f. Food security and nutrition	Strengthen domestic food security, particularly for smaller farmers.	Restock Strategic Grain Reserve	1991/92
		Implement pilot projects to test food and fertilizer for work schemes and targeted credit schemes for food deficit households.	ongoing
		Implement national nutritional surveillance program.	ongoing
		Expand targeted feeding programs at health clinics.	ongoing
5. Industry, Finance and Energy			
a. Industry	Strengthen investment framework.	Introduce new Investment Policy Statement.	1991/92
		Eliminate industrial licensing requirement.	1991/92
		Review the scope for replacing business registration and incorporation procedures.	1991/92
		Establish investment promotion agency.	1991/92
	Support development of small-scale and individual enterprises.	Expand access to credit for small-scale enterprises.	ongoing
		Revise local and central government regulations regarding business location, licensing, and quality standards.	1991/92, onward
		Review government procurement policies and practices.	1992

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
b. Finance	Deepen financial markets and improve efficiency of financial intermediation and resource mobilization.	Support entry of new financial institutions.	1991/92, onward
		Finalize restructuring plan for Post Office Savings Bank.	by September 1991
		Rationalize tax treatment of owner occupied housing interest.	1991/92
		Establish Technical Committee to facilitate development of capital markets.	1991/92
		Support the development of a Unit Trust Fund.	1991/92
c. Energy	Promote efficient investment in power sector consistent with overall expenditure priorities.	Consult annually with World Bank on ESCOM's investment program.	ongoing
		Adjust electricity tariffs consistent with long-run marginal cost of production.	ongoing
	Promote efficient consumption of petroleum.	Set prices for petroleum products to reflect full and timely pass-through of import and distribution costs.	ongoing
6. <u>Infrastructure</u>			
a. Transport	Reduce external transport cost burden.	Complete Northern Transport Corridor Project.	1991/92
	Improve efficiency of domestic transport system.	Continue road maintenance program consistent with overall expenditure priorities.	ongoing
b. Water	Expand service and strengthen financial viability in water supply.	Increase water board and DWSF tariffs to ensure financial viability.	ongoing
		Expand water supply maintenance program with greater reliance on community-based maintenance.	1991/92, onward
		Develop plan for rural water access expansion.	1991/92

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
c. Housing	Expand housing stock.	Progressive withdrawal from the provision of subsidized civil service housing.	1991/92-1993/94
		Introduce less stringent planning and building standards for low-cost housing.	ongoing
		Upgrade traditional housing areas in urban areas.	ongoing
d. Urban services	Expand role of local authorities.	Transfer management of traditional housing areas to local government.	1991/1992
		Review scope for (i) strengthening local finances; (ii) increased local autonomy in financial and management decisions; and (iii) increase cost recovery for services provided.	1991/1992
7. Public Enterprises			
a. Commercial parastatals	Improve operational and financial performance.	Develop restructuring plan for Malawi Railways.	By March 1992
		Facilitate privatization of WICO.	1991/92
		Complete ADMARC divestiture program.	1991/92-1992/93
		Strengthen DSB's monitoring functions.	1991/92-1992/93
		Review scope for transferring developmental parastatals to parent ministries.	1991/92-1992/93
		Introduce performance contracts with compensation linked to performance.	1991/92-1992/93
b. Treasury funds	Strengthen organizational framework.	Review scope for transforming selected Treasury Funds into Statutory Bodies.	1991/92-1992/93
		Review scope for privatizing selected Treasury Funds.	1991/92-1992/93

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
8. Human Resources			
a. Education	Enhance quality of education.	Increase recurrent and development budget expenditures.	1991/92, onward
		Implement first phase of decentralization of Ministry of Education.	1991/92
		Introduce new regulations regarding repetition in primary schools.	1991/92
		Reduce scope of secondary school curriculum.	1991/92
		Review strategy for post-secondary education and develop an investment program consistent with sector priorities.	1991/92
	Expand services through improved cost recovery.	Restructure fees at post-primary levels for greater cost recovery.	1991/92
b. Health	Enhance quality of health services.	Increase recurrent and development budget expenditures.	1991/92, onward
	Improve efficiency of resource use.	Restructure relative funding between the health subsectors in favor of peripheral health services.	1991/92, onward
		Develop plan to achieve full cost recovery in private patient fees by 1995.	1991/92
		Develop decentralization program from region to district level of selected services.	1991/92
		Prepare five-year manpower development program.	1991/92
c. Population	Reduce population growth.	Incorporate population planning education in school curriculum.	1991/92, onward
		Expand child-spacing services and develop multi-sectoral five-year strategy for child spacing activity.	1991/92

Table 3. Malawi: Summary and Time Frame of Adjustment Policies, 1991/92-1993/94

Sector	Objectives and Policies	Strategies and Measures	Timing
9. Environment	Improve management of natural resources.	Develop new soil conservation programs for smallholder extension system.	1991/92-1993/94
		Strictly enforce afforestation and conservation covenants in estate land leases.	1991/92-1993/94
		Improve management of nonexclusive resources like fisheries and indigenous woodlands.	1991/92-1993/94
	Strengthen incentive framework for sustainable resource use.	Adjust fuelwood prices and urban and district water tariffs.	ongoing
		Review regulatory framework for pesticides and industrial pollution.	1991/92
	Strengthen environmental policy formulation.	Prepare environmental action plan.	1991/92
		Strengthen institutional framework for environmental assessment.	1991/92
10. Women in development	Strengthen access to technical information and credit in the agriculture and small scale enterprise sector.	Develop comprehensive five year WID plan.	1991/92
		Develop proposal for administration of credit mechanisms to be set up by MOCS.	1991/92
		Start implementation of pilot studies for women's participation in small-scale income generating activities, technology dissemination, and credit provision.	1991/92