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EBS/88/118

CONFIDENTIAL

June 17, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Malawi - First Review Under the Stand-By Arrangement and Request for Arrangements Under the Enhanced Structural Adjustment Facility

Attached for consideration by the Executive Directors is the staff report for the first review under the stand-by arrangement for Malawi and its request for arrangements under the enhanced structural adjustment facility (ESAF). A draft decision on the review under the stand-by arrangement appears on pages 41 and 42. The formal ESAF proposed arrangements (ATTACHMENT I) and a draft decision on the request for arrangements under the ESAF will be issued separately.

This subject, together with the policy framework paper for Malawi (EBD/88/155, 7/7/88) is proposed to be brought to the agenda for discussion on Friday, July 15, 1988.

Mr. Edo (ext. 8752) or Mr. Sharer (ext. 8515) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

MALAWI

Staff Report for the First Review Under the Stand-By Arrangement and Request for Arrangements Under the Enhanced Structural Adjustment Facility

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

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

Approved by A.D. Ouattara and A. Basu

June 17, 1988

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I. Introduction

A staff mission consisting of Messrs. Edo (head-AFR), Sharer (AFR), Dicks-Mireaux (AFR), Holzmann (FAD), De La Torre (ETR), and Mrs. Yupangco (secretary-TRE) visited Lilongwe and Blantyre during March 12-31, 1988, to conduct the first review of the current stand-by arrangement, to discuss a policy framework paper, and to negotiate a program that could be supported by arrangements under the enhanced structural adjustment facility (ESAF). During the review under the stand-by arrangement, performance criteria were established for end-September 1988, end-December 1988, and end-March 1989. The discussions were completed in Washington during May 12-20, 1988. Mr. Messenger and Ms. Krumm of the World Bank participated in the discussions on the policy framework paper. The Malawian representatives included Mr. L.J. Chimango, Minister of Finance; Mr. S. Chimwemwe Hara, Governor of the Reserve Bank of Malawi; Mr. S.M. Kakhobwe, Secretary to the President and Cabinet; Mr. J.C. Malewezi, Secretary of the Treasury; Mr. F.Z. Pelekamoyo, General Manager of the Reserve Bank of Malawi; and other senior officials concerned with economic and financial matters. Mr. S.M. Hassan, Advisor to the Executive Director, was present at some of the policy discussions.

In a letter to the Managing Director dated May 27, 1988 (Attachment II), the Malawian authorities have requested loans under the ESAF. Attached to this letter is a memorandum in which the Government of Malawi reviews the performance under the current stand-by arrangement, describes its adjustment program for the period April 1, 1988 to March 31, 1989, and outlines the macroeconomic and structural policies it intends to pursue through March 31, 1991. The policy framework paper, was issued to the Executive Board separately (EBD/88/155, 6/7/88). The proposed three-year arrangement under the ESAF would be in an amount equivalent to SDR 55.8 million, or 150 percent of quota, with six equal semiannual disbursements thereunder, each equivalent to SDR 9.3 million, or 25 percent of quota. The first disbursement will become available upon Executive Board approval of the first annual arrangement under the ESAF covering the period April 1, 1988-March 31, 1989. The second disbursement under the first annual arrangement would be subject to observance of performance criteria for end-September 1988, and completion of a midyear review with the Fund before end-December 1988.

On March 2, 1988 the Executive Board approved the current 15-month stand-by arrangement in an amount equivalent to SDR 13.02 million, or 35 percent of quota. To date, Malawi has made only the first purchase in an amount equivalent to SDR 9.25 million. As of end-April 1988, Malawi's outstanding use of Fund resources was 217 percent of quota (Table 1). Although all the performance criteria for end-March 1988 have been observed, Malawi has not made the second purchase, and the authorities have indicated their intention to make no further purchases under the stand-by arrangement (amounting to SDR 3.77 million or 10.1 percent of quota) following Executive Board approval of their

Table 1. Malawi: Schedule of Proposed Purchases and Repurchases, April 1988-March 1991

	Outstanding at April 30, 1988	1988/89 May-June	1988/89 July-Sept.	1988/89 Oct.-Dec.	1988/89 Jan.-March	1989/90 April-Sept.	1989/90 Oct.-March	1990/91 April-Sept.	1990/91 Oct.-March
	(In millions of SDRs)								
Net use of Fund resources		-4.77	5.77	3.73	-4.19	-1.57	1.88	2.20	2.95
Transactions under tranche policies		-3.04	-1.80	-3.84	-2.47	-7.42	-7.42	-7.10	-6.35
Purchases 1/		--	--	--	--	--	--	--	--
Ordinary resources		--	--	--	--	--	--	--	--
Borrowed resources		--	--	--	--	--	--	--	--
Repurchases		-3.04	-1.80	-3.84	-2.47	-7.42	-7.42	-7.10	-6.35
Ordinary resources		--	-0.42	-0.72	-0.71	-1.54	-1.54	-1.54	-1.54
Borrowed resources		-3.04	-1.38	-3.12	-1.76	-5.88	-5.88	-5.56	-4.81
Transactions under special facilities		-1.73	-1.73	-1.73	-1.73	-3.45	--	--	--
Purchases		--	--	--	--	--	--	--	--
Repurchases		-1.73	-1.73	-1.73	-1.73	-3.45	--	--	--
Enhanced structural adjustment facility loans		--	9.30	9.30	--	9.30	9.30	9.30	9.30
Total Fund resources outstanding	80.90	76.15	81.92	85.66	81.47	79.90	81.78	83.97	86.92
Under tranche policies	70.55	67.52	65.72	61.89	59.42	52.00	44.58	37.47	31.12
Under special facilities	10.35	8.63	6.90	5.18	3.45	--	--	--	--
Under enhanced structural adjustment facility	--	--	9.30	18.60	18.60	27.90	37.20	46.50	55.80
	(In percent of quota)								
Total Fund resources outstanding	217.48	204.70	220.22	230.27	219.01	214.78	219.83	225.74	233.66
Under tranche policies	189.66	181.51	176.67	166.36	159.73	139.78	119.83	107.74	83.66
Under special facilities	27.82	23.19	18.55	13.91	9.27	--	--	--	--
Under enhanced structural adjustment facility	--	--	25.00	50.00	50.00	75.00	100.00	125.00	150.00
Memorandum item:	(In millions of SDRs)								
Trust Fund									
Repayments		-0.46	-0.56	-0.64	-0.20	-0.84	-0.84	-0.26	-0.06
Amount outstanding	3.85	3.39	2.83	2.19	1.99	1.15	0.31	0.06	--

Source: IMF Treasurer's Department.

1/ Assumes that only the first purchase under the current stand-by arrangement is made by Malawi.

request for loans under the ESAF. Assuming that no further purchases will be made under the stand-by arrangement, total use of Fund resources, excluding the ESAF, would be reduced to 156 percent of quota upon expiration of the stand-by arrangement at end-May 1989; outstanding use of Fund resources, together with resources from the ESAF Trust, would be 231 percent of quota. By the end of the three-year arrangement under the ESAF, outstanding use of Fund resources would be 84 percent of quota excluding the ESAF, and, together with resources from the ESAF Trust, would amount to 234 percent of quota assuming that all disbursements under the proposed ESAF are made.

The Fund and the World Bank staffs have collaborated closely in the discussions with Malawi. The World Bank's Board is expected to approve an Industrial and Trade Policy Adjustment Credit in an amount of US$160 million, including US$90 million of cofinancing, in mid-June 1988. Summary statements on Malawi's relations with the Fund and with the World Bank Group are provided in Appendices I and II, respectively; basic economic and financial data and summary social and demographic indicators are given in Appendix III; and the schedule of purchases during the period of the stand-by arrangement is shown in Appendix IV.

II. Recent Developments and Performance Under the Stand-By Arrangement

The main objectives of the program supported by the current stand-by arrangement are to restore real GDP growth rates to historical levels, to reduce the rate of inflation, and to move to a viable balance of payments position over the medium term while removing existing restrictions on current payments and eliminating external payments arrears. At the outset of the program, the authorities recognized that the adjustment effort would need to be continued over the medium term, and they viewed this as an initial stage in a comprehensive medium-term structural adjustment program for which they intended subsequently to request support from the Fund under the ESAF.

Since the introduction on January 1, 1988 of the 15-month program supported by the stand-by arrangement, developments have been broadly as envisaged, and all the performance criteria for end-March have been observed. On the basis of revised information, real GDP is now estimated to have declined by 0.2 percent in 1987 compared with 0.4 percent previously estimated; the underlying trends were largely the same

(Table 2). 1/ The annual average rate of inflation in 1987, as measured by the consumer price index (CPI), was 27 percent compared with the previous estimate of 26 percent. By January 1988, the 12-month rate of change of the CPI had risen to 37 percent compared with 15 percent in January 1987, and indications are that no deceleration occurred during the first quarter of 1988. The persistence of high inflation reflected, inter alia, continued shortages of domestic food supplies, the large expansion in liquidity, and the effects of the January 1988 devaluation. At present, despite a noticeable curtailment of earlier expansionary fiscal policy, inflationary expectations of the private sector appear to be high.

For the period October 1987-March 1988, there was a significant shortfall in domestic food supply, exacerbated by further large inflows of displaced persons from Mozambique (now estimated to have reached almost 500,000). The Government, with the assistance of the international community, successfully responded to the situation, and, although imported supplies did not meet the shortfall in full, malnutrition was largely averted. With regard to the transport sector, progress in rehabilitating the Nacala rail line, the lowest cost routing for Malawi's external trade, was less than envisaged owing to continued security difficulties; this rail link is now not expected to be reopened on a low-traffic basis before the end of 1988.

Preliminary data indicate that the outturn for the overall central government deficit (before grants) for 1987/88 (April-March) was more favorable than originally programmed. The deficit is estimated to have been MK 310 million (equivalent to 10.2 percent of GDP) compared with the program target of MK 323 million (or 10.7 percent of GDP); this represents a reduction of 2.3 percentage points of GDP from the 1986/87 outcome (Table 3). Revenues amounted to MK 575 million (18.9 percent of GDP), MK 31 million above the program target. This was because of higher-than-targeted nontax revenues from Treasury fund receipts (stemming from postal and telecommunication tariff increases), departmental receipts and fees, and loan reimbursements. 2/ Total expenditures amounted to MK 884 million (29.1 percent of GDP),

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1/ A new series for real GDP, for 1987 onward, has recently been introduced. Certain wage payments to non-established posts (largely consultants), which had previously been either omitted or classified as government consumption have been reclassified under government services. Figures on the basis of both the old and new series are available only for 1987. The GDP figures in this report for 1987 and earlier are on the basis of the old classification, and for 1988 onward reflect the new classification. For 1987, the two series are close; the higher figure is 0.9 percent larger than the lower figure.

2/ Press Group Limited (a major private sector company) had improved profitability, which allowed it to make larger-than-anticipated repayments of government holdings of its debt arising from the reconstruction of Press Holdings in 1984.

Table 2. Malawi: Selected Economic and Financial Indicators, 1985–88

	1985	1986	1987 Program (EBS/88/25)	1987 Est.	1988 Program (EBS/88/25)	1988 Revised program
	(Annual percentage change, unless otherwise specified)					
National income						
GDP at constant factor cost	4.2	2.8	-0.4	-0.2	1.5	1.5
GDP deflator	13.6	10.8	26.2	25.4	20.0	20.0
Consumer prices	14.9	14.8	26.2	26.7	20.0	20.0
External sector						
Exports, f.o.b. (millions of SDRs)	246.1	211.6	223.8	214.2	204.5	206.6
Imports, c.i.f. (millions of SDRs)	282.4	218.9	230.3	229.4	267.1	261.2
Export volume	-3.9	3.0	5.8	-1.0	-7.6	-5.1
Import volume	11.9	-13.0	0.3	-0.4	5.0	5.3
Terms of trade (deterioration -)	-11.1	-8.2	-2.4	-0.4	-1.0	0.5
Nominal effective exchange rate, year-end (depreciation -)	-6.3	-21.4	-12.4	-12.4	...	...
Real effective exchange rate, year-end (depreciation -)	-4.4	-15.2	1.4	1.4	...	...
Government budget 1/						
Revenue	25.1	11.5	10.3	16.6	23.4	19.4
Total expenditure	27.9	25.2	8.7	10.9	11.2	11.0
Money and credit 1/						
Net domestic assets (increase) 2/	27.8	10.4	6.0	-6.1	2.1	-7.1
Credit to Government (increase) 1/ 2/	21.5	18.7 3/	19.5	11.6	10.5	-3.1
Money and quasi-money (M2) (increase) 2/	-3.5	20.6	45.0	30.3	15.7	4.3
Velocity (GDP relative to M2)	5.8	5.9	5.4	5.4	5.4	6.1
Interest rate (annual rate, 12-month time deposits)	14.25	14.25	17.25	17.25	...	13.25 4/
	(In percent of GDP)					
Central Government						
Overall deficit 1/						
Excluding official transfers	9.6	12.4	10.7	10.2	8.1	8.1
Including official transfers	7.5	9.2	7.1	7.1	4.9	3.4
Domestic bank financing 1/	3.5	2.5	2.5	1.5	1.7	-0.4
Foreign financing 1/	3.2	4.7	3.4	3.2	2.6	3.9
Gross investment	17.9	10.8	12.2	12.3	13.8	13.5
Domestic saving	14.2	9.5	9.4	12.7	9.2	10.4
External current account						
Excluding official transfers	-8.2	-6.2	-3.6	-4.1	-7.3	-7.3
Including official transfers	-6.1	-3.8	-2.0	-1.8	-5.8	-3.4
Debt service ratio 5/	44.5	56.9	45.8	48.8	49.9	48.0
Interest payments 5/	16.2	19.3	16.7	16.9	16.4	16.5
	(In millions of SDRs, unless otherwise specified)					
Overall balance of payments 6/	-45.7	-67.0	51.9	44.0	1.3	6.4
Gross official reserves (weeks of imports, c.i.f.)	7.3	3.7	8.0	8.0	9.0	11.3
External debt (disbursed and outstanding, end of period)	853.9	845.1	865.1	875.2	892.6	918.2
External payments arrears (end of period)	—	43.8	33.2	33.2	—	—

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

1/ Fiscal year beginning April 1 of the year indicated. Excludes the payment into the Reserve Bank's blocked account for government debt service payments subject to rescheduling.
2/ As a percentage of money and quasi-money at the beginning of the period.
3/ Excludes transfers to the Reserve Bank of Malawi in the form of non-interest-bearing promissory notes to cover central bank revaluation losses on net foreign liabilities.
4/ Effective April 11, 1988.
5/ Including IMF charges and repurchases, and estimated debt service on private debt. Before debt relief.
6/ Before debt relief but after SAL and related inflows.

Table 3. Malawi: Central Government Operations, 1985/86-1990/91

(In millions of Malawi kwacha)

	1985/86	1986/87	1987/88 Program (EBS/88/38)	1987/88 Prelim. outturn	1988/89 Program (EBS/88/25)	1988/89 Revised program	1989/90 Projections	1990/91
Revenue (excluding grants)	442.0	492.9	543.9	574.6	671.0	685.9	769.0	828.1
Tax	373.4	391.0	443.4	452.1	554.8	548.8	624.2	681.7
Nontax	68.6	101.9	100.5	122.5	116.3	137.0 2/	144.8	146.7
Expenditure	643.5	797.0	861.6	884.2	964.0	981.5	1,045.1	1,111.8
Current expenditure	457.3	560.5	639.2	656.4	700.5	706.1	749.4	792.1
Wages and salaries	104.6	132.0	155.6	156.1	163.4	165.1	181.1	198.5
Interest	124.9 1/	152.2	159.6 3/	175.2 3/	184.7 3/	173.0 3/	172.9 3/	170.4
Other current expenditure	227.8	276.3	324.0	325.1	352.4	368.0	395.5	423.1
Other goods and services	155.1	207.9	259.4	...	...	...	...	...
Of which: special expenditure	(...)	(32.5)	(28.0)	(...)	(...)	(...)	(...)	(...)
Grants and subsidies	43.6	53.2	57.1	...	...	...	...	...
Other	29.1	15.2	7.5	...	...	...	...	...
Development expenditure	160.2	189.8	215.0	208.5	251.3	270.4	296.7	319.6
Domestically financed	29.3	33.8	35.8	29.3	...	38.8	42.5	45.9
Foreign-financed	130.9	156.0	179.2	179.2	...	231.6	253.2	273.8
Extrabudgetary expenditure	26.0	46.7 4/	7.4	19.3	12.2	5.0	—	—
Strategic grain reserve	26.0	46.7	—	—	—	—	—	—
Net cost emergency maize imports 5/	—	—	7.4	19.3	12.2	5.0	—	—
Errors, omissions, adjustments	—	—	5.1 6/	—	—	—	—	—
Overall deficit (excluding grants) 4/	-201.5	-304.1 4/	-322.8	-309.6	-293.0	-295.6	-276.1	-283.6
Grants	44.8	79.3	106.2	95.0	117.0	171.9	144.7	97.5
SAL-related	—	21.8	45.3	18.4	26.7	94.7	60.3	6.2
Others	44.8	57.5	60.9	76.6	90.3	77.2	84.4	91.3
Overall deficit (including grants)	-156.7	-224.8	-216.6	-214.6	-176.0	-123.7	-131.4	-186.1
Financing (excluding grants)	156.7	224.8	216.6	214.6	176.0	123.7	131.4	186.1
Foreign (net)	51.8	115.0	103.6	97.6	95.8	140.7	205.1	259.5
Borrowing	137.7	218.3	214.2	215.8	234.4	260.4	305.3	336.7
Project loans	...	93.0	127.0	148.1 7/	132.0	154.4	168.8	182.5
SAL-related	...	125.3	87.2	67.7	102.4	106.0	136.5	154.2
Repayments	85.9	103.3	110.6 3/	118.2 3/	138.6 3/	119.7 3/	100.2 3/	77.1
Domestic (net)	104.9	109.8	113.0	117.0	80.2	-17.0	-73.7	-73.4
Banking system 8/	72.4	60.9 4/	76.8	45.5	60.0	-15.9	...	...
Other	32.5	48.9	36.2	71.5	20.2	-1.1	...	...
Memorandum items:								
GDP (fiscal year)	2,087	2,432	3,030	3,044	3,619	3,635	4,102	4,525
				(In percent of GDP)				
Revenue (excluding grants)	21.2	20.3	17.9	18.9	18.5	18.9	18.7	18.3
Expenditure	30.8	32.8 4/	28.3	29.1	26.6	27.0	25.5	24.6
Overall deficit (excluding grants)	-9.6	-12.5 4/	-10.7 9/	-10.2	-8.1	-8.1	-6.7	-6.3
Overall deficit (including grants)	-7.5	-9.2 4/	-7.1 9/	-7.1	-4.9	-3.4	-3.2	-4.1

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

1/ Estimate.
2/ Includes a small amount of direct foreign transfers related to asset sales by ADMARC.
3/ On due basis; the domestic counterpart of debt relief will be blocked by the Reserve Bank.
4/ Excluding transfers to the Reserve Bank of Malawi, in the form of non-interest-bearing promissory notes, to cover central bank valuation losses on its stock of net foreign liabilities.
5/ Net of expenditures financed by external grants.
6/ Mainly reflects movements in net domestic financing during the first two quarters of the year, which could not, at the time, be explained by above-the-line revenue or expenditure developments.
7/ Includes MK 7.6 million of loan disbursement not yet fully recorded.
8/ Excludes payments into the Reserve Bank's blocked account for government debt service payments subject to rescheduling.
9/ Includes the MK 5.1 million of errors, omissions, and adjustment which are not included in the revenue/GDP and expenditure/GDP ratio figures.

MK 23 million above the programmed level. 1/ This reflected an overrun of MK 16 million on higher interest payments, and of MK 12 million on extrabudgetary provisions for net outlays on emergency food procurement on account of a slower-than-expected pace of donor reimbursements for these purchases. Recurrent outlays, excluding interest payments, were virtually as programmed, reflecting the successful implementation of improved expenditure monitoring and control during the latter half of 1987/88, while development expenditures were MK 6 million below the program target. A temporary shortfall in early 1988 in grants and loan disbursements associated with the World Bank's structural adjustment lending (SAL) was only partially offset by higher foreign inflows from other sources. The combined shortfall in foreign inflows was more than compensated by domestic nonbank borrowing, which was about MK 35 million higher than programmed in 1987/88. As a result, recourse to domestic bank borrowing was some MK 31 million less than targeted, and the performance criterion on net claims on Government by the banking system at end-March 1988 was observed.

Revised information on the balance of payments for 1987 shows that the current account deficit (excluding official transfers but including emergency food grants) 2/ amounted to SDR 41.4 million or 4.1 percent of GDP (Table 4), compared with the previous estimate of SDR 37 million or 3.6 percent of GDP. This reflected lower-than-anticipated export receipts which were partially offset by the higher receipts of nonfactor services. The shortfall in export revenues stemmed largely from a delay in tobacco shipments into early 1988. Combined inflows of grants and capital were slightly lower than envisaged owing to lower official transfers, and the overall balance of payments registered a surplus of SDR 44 million, compared with SDR 52 million as previously estimated.

As a first step in their program to progressively remove existing restrictions on the approval and availability of foreign exchange for private sector imports, the authorities on February 1, 1988 removed controls consisting of prior approval of foreign exchange applications for certain raw materials and spare parts amounting to 25 percent of total imports of these goods in 1984 (excluding petroleum). In support of this process and to improve external competitiveness, the Malawi

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1/ Both revenues and expenditures in 1987/88 were below their respective levels in 1986/87 when revenues were equivalent to 20.1 percent of GDP and expenditures were equivalent to 32.6 percent of GDP.

2/ The grant counterpart of emergency food imports given by donors has been included in the definition of the current account to remove the distortionary effect of these temporary donor food grants on the trend in the current account deficit. In the staff report for the 1987 Article IV consultation and request for stand-by arrangement (EBS/88/25, 2/9/88), the current account deficit was defined to exclude all official transfers, including these food grants.

Table 4. Malawi: Balance of Payments, 1982-1988

(In millions of SDRs)

	1982	1983	1984	1985	1986	1987 Prov.	1988 Program (EBS/88/25)	1988 Revised program
Current account	-115.4	-124.9	-16.2	-95.2	-65.0	-41.4	-78.6	-74.9
Exports, f.o.b.	217.1	230.3	308.0	246.1	211.6	214.2	204.5	206.6
Imports, c.i.f.	-276.9	-288.9	-263.3	-282.4	-218.9	-229.4	-261.8	-261.2
Nonmaize imports (f.o.b.)	-179.9	-188.0	-158.0	-169.3	-131.4	-134.2	-141.5	-143.1
C.i.f. margin	-97.1	-100.9	-105.3	-113.1	-87.6	-89.6	-94.3	-95.4
Emergency maize, c.i.f.	—	—	—	—	—	-5.6	-26.0	-22.7
Services and private transfers, net	-55.6	-66.2	-60.9	-59.0	-57.8	-29.9	-41.9	-39.1
Of which: interest payments	(-38.5)	(-41.4)	(-43.3)	(-44.1)	(-45.6)	(-39.6)	(-36.2)	(-37.7)
Emergency maize grants	—	—	—	—	—	3.7	20.6	18.8
Capital account	67.1	42.5	58.4	49.5	-2.0	85.4	79.9	81.4
Long-term, net	37.8	34.6	59.7	41.9	60.1	76.6	79.9	78.4
Official transfers	32.9	27.6	23.8	24.1	24.9	22.9	39.9	40.3
Of which: SAL-related	(—)	(—)	(—)	(—)	(9.3)	(6.4)	(19.6)	(22.0)
Public sector borrowing	2.0	-6.4	38.2	12.2	31.2	51.8	38.1	35.6
Disbursements	68.4	61.6	91.2	69.0	89.8	95.8	86.4	81.9
Of which: SAL and cofinancing	(18.1)	(—)	(52.0)	(7.7)	(63.9)	(40.8)	(27.1)	(25.9)
Amortization	-66.4	-68.0	-53.0	-56.8	-58.6	-44.0	-48.3	-46.3
Private sector (net)	3.0	13.5	-2.3	5.6	3.9	1.9	1.9	2.4
Short-term and unidentified	29.3	7.9	-1.3	7.6	-62.1	8.8	—	3.0
Overall balance	-48.3	-82.3	42.2	-45.7	-67.0	44.0	1.3	6.4
Financing	48.3	82.3	-42.2	45.7	67.0	-44.0	-1.3	-6.4
Official net foreign assets (- increase)	31.4	27.0	-65.2	39.0	20.8	-34.8	-14.3	-12.1
Of which: IMF (net)	(2.1)	(23.9)	(17.4)	(7.0)	(-20.6)	(-23.6)	(-8.4)	(7.9)
Change in arrears	—	—	—	—	43.8	-9.7	-33.3	-34.1
Import-related	—	—	—	—	43.8	-26.4	-17.6	-17.4
Debt-service related 1/	—	—	—	—	—	16.7	-15.7	-16.7
Debt relief 2/	16.9	55.3	23.0	6.7	2.4	0.4	38.9	39.7
Current maturities	16.9	55.3	23.0	6.7	2.4	0.4	28.5	25.6
Arrears	—	—	—	—	—	—	10.4	14.1
Financing gap	—	—	—	—	—	—	7.4	—
Memorandum items:								
Current account (percent of GDP) 3/	-10.8	-10.9	-1.4	-8.2	-6.2	-4.1	-7.8	-7.3
Gross official reserves								
End-period stock	20.5	12.8	58.0	39.8	15.7	34.4	40.6	51.8
In weeks of imports 4/	3.9	2.3	11.5	7.3	3.7	8.0	9.0	11.3
C.i.f. margin 5/	35.0	35.0	40.0	40.0	40.0	40.0	40.0	40.0

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

1/ Figure for 1987 is equal to debt service payments to official creditors and principal payments to commercial bank creditors which have been suspended since late August 1987, pending Malawi's request for rescheduling.

2/ Figures for 1986 and 1987 reflect reschedulings of Dwangwa Sugar Corporation's debt. Figures for 1988 are estimates based on the Agreed Minute with Paris Club creditors and the Heads of Terms with London Club creditors. Rescheduling of Commonwealth Development Corporation (CDC) debt has also been assumed for 1988, under terms and conditions similar to those of the Paris Club rescheduling.

3/ Excluding official transfers.

4/ Imports on c.i.f. basis, excluding emergency maize.

5/ As a percent of c.i.f. value.

kwacha was devalued by 15 percent on January 16, 1988 (Chart). 1/ Reflecting initial administrative difficulties and a lag in private sector awareness of the precise list of specific goods liberalized, the impact of the liberalization on the level of imports was small at first. The authorities responded quickly to overcome these impediments; at the same time, they made efforts to facilitate the approval of non-liberalized imports that were complementary to those that have been liberalized. There are no import quotas in Malawi, and most goods are imported under open general license.

Under the current stand-by arrangement, it was envisaged that as a performance criterion, import-related trade arrears, which amounted to SDR 17.6 million at end-December 1987, would be reduced to SDR 5.0 million by end-March and eliminated by end-June 1988. However, in view of the importance the Government attached to restoring international confidence in Malawi and re-establishing normal short-term trade financing arrangements, these payment arrears were eliminated by end-January 1988. During the early months of 1988, principal and interest payments to Paris Club creditors and principal debt service payments to London Club creditors continued to be suspended pending their rescheduling (see below). All other debt obligations have continued to be met on a timely basis.

As regards monetary and credit developments, the performance criteria for end-March 1988 on net domestic assets of the banking system, net claims on the Central Government by the banking system, and net claims on statutory bodies by the banking system were observed. At end-March 1988, net domestic assets of the banking system amounted to MK 585 million, some MK 48 million below the program ceiling (Table 5). This outcome reflected lower levels of net credit to Government and to statutory bodies. As noted earlier, the lower budgetary recourse to domestic bank borrowing reflected higher nonbank borrowing in the last quarter of 1987/88. For 1987/88 as a whole, net domestic assets fell by MK 24 million, equivalent to 6.1 percent of the beginning period broad money stock. For 1987/88 net credit to Government increased by MK 46 million, or 10.5 percent, equivalent to 11.6 percent of beginning period broad money stock. The lower use of net credit by the statutory bodies, which was only MK 5 million during 1987/88, was due to higher-than-expected deposits of the Fertilizer Revolving Fund at end-March 1988, which more than offset the larger-than-programmed access to credit of the Agricultural Development and Marketing Corporation's (ADMARC).

Private sector demand for bank credit picked up during the first quarter of 1988, and at end-March 1988 was virtually at the same level

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1/ The real effective rate remained within a narrow range from 1978 to 1985; since 1985, the rate has been on a broadly declining trend, and the February 1988 level was equivalent to a depreciation of about 20 percent in real effective terms, compared with the level at the beginning of 1985.

Table 5. Malawi: Monetary Survey, March 1987-March 1989

(In millions of Malawi kwacha)

	1987		1988	1988			1989		1988			1989
	March	Dec. 1/	March	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March
			Actual	Program (EBS/88/25)					Revised			Program
Foreign assets (net)	-341.1	-247.5	-277.4	-290.6	-292.5	-231.0	-201.0	-213.3	-239.0	-158.5	-206.3	-219.0
Gross foreign assets	65.9	106.4	...	110.6	139.1	187.4	190.2	181.1	152.5	219.5	197.3	171.2
Foreign liabilities	-407.0	-353.9	...	-401.2	-431.6	-418.4	-391.2	-394.5	-391.7	-378.0	-403.6	-390.2
Domestic assets (net)	608.8	618.9	584.9	632.5 2/	692.7 2/	715.2	648.8	644.7	640.3	624.5 2/	589.8 2/	548.3 2/
Domestic credit	692.2	745.5	741.6	789.7 2/	864.4 2/	919.5	873.3	894.6	831.9	833.0 2/	801.2 2/	787.4 2/
Credit to Government (net)	432.1	490.9	477.6	508.9 2/	528.3 2/	562.6	551.6	568.9	480.8	468.1 2/	479.5 2/	461.7 2/
Credit to statutory bodies (net)	19.1	49.2	23.7	40.8	61.1	84.9	69.1	43.7	61.1	84.9	69.1	43.7
Credit to private sector	241.0	205.4	240.3	240.0	275.0	272.0	252.6	282.0	290.0	280.0	252.6	282.0
Other assets (net)	-83.4	-126.6	-156.7	-157.2	-171.7	-204.3	-224.5	-249.9	-191.6	-208.5	-211.4	-239.1
Of which: new blocked deposits at Reserve Bank 3/	(—)	(-48.7)	(-90.6)	(-83.8)	(-104.3)	(-143.9)	(-165.1)	(-192.5)	(-126.2)	(-151.6)	(-153.0)	(-176.7)
Other items (net)	-125.2	-214.8	-204.4	-228.0	-228.0	-228.0	-228.0	-228.0	-204.5	-204.5	-204.5	-204.5
Reserve Bank revaluation accounts 4/	-148.0	-237.6	-227.2	-250.8	-250.8	-250.8	-250.8	-250.8	-227.3	-227.3	-227.3	-227.3
SDR allocation	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8	22.8
Money plus quasi-money	392.9	586.2	511.9	569.9	628.2	712.2	675.8	659.4	605.8	670.5	588.0	533.8
Money	168.7	244.8	245.3	...	...	...	...	...	...	...	...	...
Quasi-money	224.2	341.4	266.6	...	...	...	...	...	...	...	...	...
				(Twelve-month change as a percentage of beginning period broad money stock)								
Memorandum items:												
Domestic assets (net)	10.4	-8.5	-6.1	6.0	-8.0	6.2	5.1	2.1	-17.9	-8.1	-5.0	-7.1
Domestic credit	5.7	-1.8	12.6	24.8	12.4	23.6	21.8	18.4	6.3	10.0	9.5	8.9
Credit to Government (net)	18.7	7.7	11.6	19.5	10.9	16.6	10.4	10.5	1.9	1.8	-1.9	-3.1
Money plus quasi-money	20.6	34.7	30.3	45.0	19.0	12.0	15.3	15.7	14.7	5.5	0.3	4.3

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

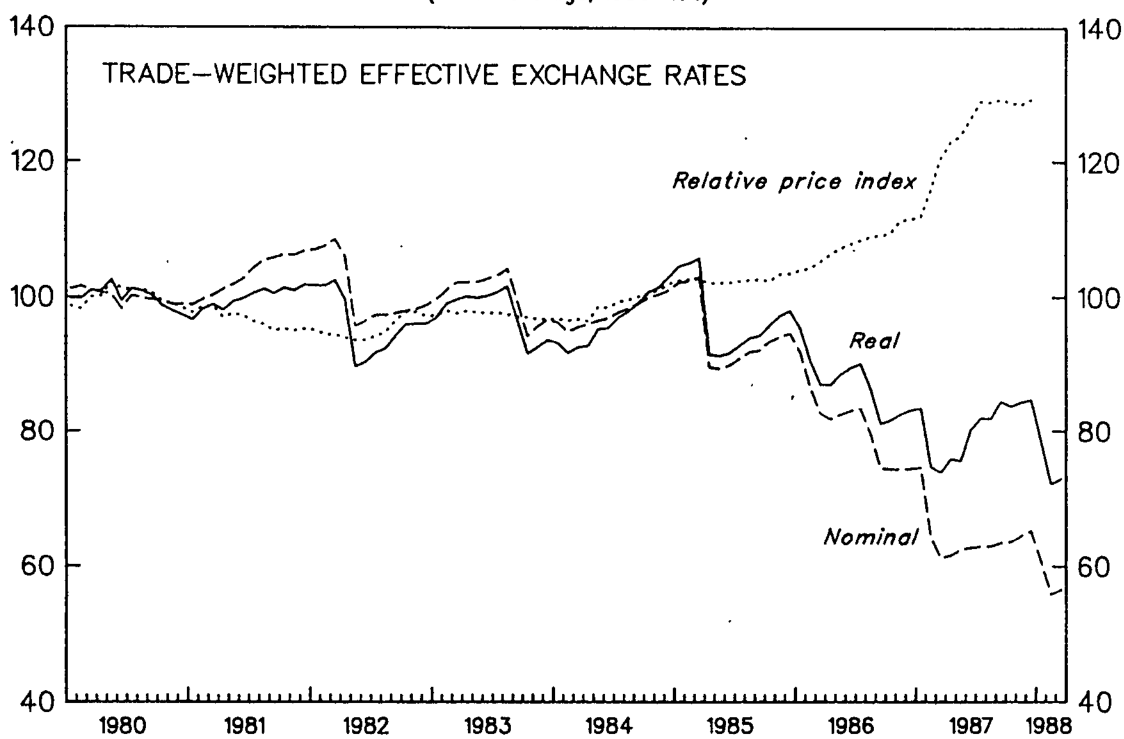
1/ The data for net domestic assets, domestic credit, credit to statutory bodies (net), and money plus quasi-money have been revised from EBS/88/25. Deposits preliminarily classified as deposits of statutory bodies have been subsequently reclassified as private sector deposits under money plus quasi-money.

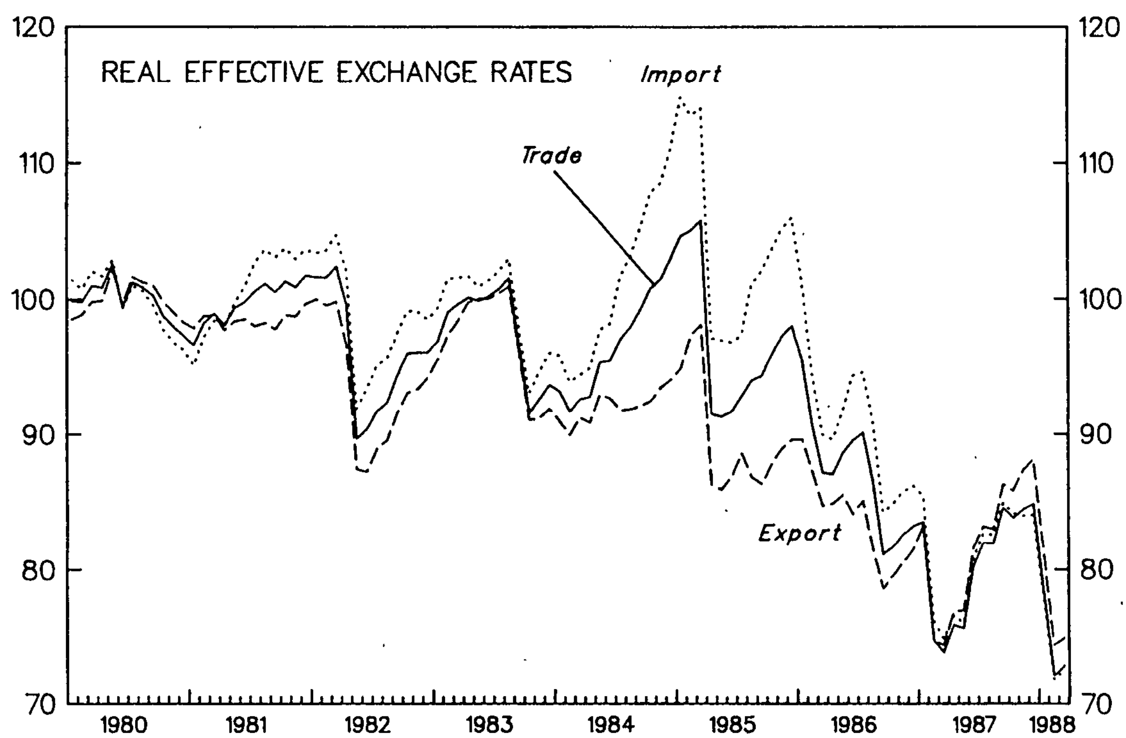
2/ Performance criteria.

3/ The kwacha counterpart of government and statutory bodies' debt service payments which have beeen rescheduled are being paid, as they fall due, into blocked accounts at the Reserve Bank.

4/ Comprises the sum of the Reserve Bank's profit and loss on devaluation account and the value of promissory notes issued by the Government in respect of the Reserve Bank's devaluation losses on its outstanding stock of net foreign assets.

CHART 1
MALAWI
INDICES OF EFFECTIVE EXCHANGE RATES, JAN. 1980 TO MAR. 1988
(Period average, 1980=100)





Sources: *International Financial Statistics;* and IMF staff estimates.

as at March 1987. The authorities pointed out that this takeup of credit was largely of a seasonal character and that the underlying demand for credit continued to be stagnant. This reflected the high level of company liquidity, in part owing to large foreign exchange receipts during the latter part of 1987 and the continued constraint on imports and its effect on domestic activity, as well as the impact of the 4 percentage point rise in lending rates to 20 percent that followed the increase in regulated deposit rates in July 1987 (the 12-month deposit rate was raised to 17.25 percent). In comparison with the average rate of inflation in 1987 (27 percent as measured by the CPI), deposit rates and most lending rates were negative in real terms; maximum lending rates were, however, about 26 percent in nominal terms. Furthermore, after the rise in interest rates in July 1987, a number of inter-company lending operations had taken place at interest rates below those of the banks. Reflecting the increase in company liquidity and the foreign exchange restrictions, the money supply rose by 30 percent in 1987/88, compared with 21 percent in 1986/87.

As a result of the generally low level of private sector demand and the absence of alternative investment opportunities during 1987 and early 1988, the banks placed the bulk of their resources with the Reserve Bank, earning interest at 13 percent compared with the regulated minimum rate paid on savings deposits of 13.25 percent. Thus, commercial bank liquidity ratios increased progressively to more than 70 percent in the first quarter of 1988 compared with the obligatory requirement of 30 percent. The interest payments due on the commercial banks' reserves, which have been at exceptionally high levels since late 1986, placed the Reserve Bank in a loss-making position. In response to this deterioration in its own finances, effective February 15, 1988, the Reserve Bank limited the amount of commercial bank reserves on which it paid interest to 30 percent of deposits with it. The commercial banks reacted by refusing any additional time and fixed deposits in order to reduce their own payments to depositors and avoid losses.

The 1987/1988 financial outturn of the statutory bodies was weaker than expected under the program, with the ten major parastatals showing a combined net loss of MK 6.3 million, as against a profit of MK 3.2 million envisaged under the program (Table 6). This, however, did represent an MK 5 million improvement over the loss of MK 11.3 million recorded in 1986/87, reflecting the tariff and price increases and structural and cost-cutting reforms implemented during the year. Excluding ADMARC, a combined profit of MK 3.1 million was achieved in 1987/88, compared with the program objective of MK 7.8 million. Thus, while over half of the worse-than-anticipated performance by the major parastatals was due to ADMARC, the profits of Malawi Railways' and Wood Industries also fell short of projections by MK 2.8 million and MK 1.2 million, respectively. For Malawi Railways, this shortfall stemmed from unanticipated costs associated with the Nacala line, repairs for damage to boats on Lake Malawi, and higher-than-budgeted costs arising from the two recent devaluations; and for Wood Industries, it was the result of plant closures caused by domestic input shortages.

Table 6. Malawi: Selected Indicators of the Financial Performance of the Major Statutory Bodies, 1985/86-1988/89 1/

(In millions of Malawi kwacha)

	1985 or 1985/86	1986 or 1986/87	1987 or 1987/88 Program (EBS/88/25)	1987 or 1987/88 Est.	1988 or 1988/89 Program (EBS/88/25)	1988 or 1988/89 Revised program
Combined accounts 2/						
Revenues	204.3	240.5	257.5	260.3	289.1	297.9
Interest charges	17.1	27.1	28.7	29.5	27.0	26.8
Profit or loss 3/	-21.0	-11.3	3.2	-6.3	18.6	24.8
Of which: ADMARC	(-19.7) 4/	(-10.6)	(-4.6)	(-9.4)	(-2.3)	(2.0)
Cashflow	...	12.8	0.2	-9.5	5.0	18.4
Gross investment	27.8	51.3	57.9	41.4	87.9	98.1
ADMARC						
Net operating profit or loss on crop trading accounts	-17.8	-16.6	2.5	-1.6	4.4	6.1
Of which: maize	(-5.6)	(-10.6)	(-4.4)	(-1.9)	(-2.8)	(-4.2)
tobacco	(-7.0)	(3.9)	(12.7)	(10.3)	(9.3)	(12.4)
groundnuts	(-4.8)	(-3.5)	(-2.1)	(0.1)	(-3.3)	(-2.3)
cotton	(-0.7)	(-7.8)	(-5.3)	(-7.3)	(-0.4)	(2.2)
Other revenues/expenses (net)	-1.9	6.0	-7.1	-7.8	-6.7	-3.9
Of which: net interest	(-1.6)	(-9.1)	(-10.2)	(-10.6)	(-7.1)	(-8.3)
Net profit or loss 3/	3.3 5/	-10.6	-4.6	-9.4	-2.3	2.0
Other operations (net) 6/	-19.7	11.3	16.6	8.8	13.8	21.3
Overall surplus/deficit	-16.4	0.7	12.0	-0.6	11.5	23.4
Financing	16.4	-0.7	-12.0	0.6	-11.5	-23.4
Reserve Bank	8.7	0.8	-0.7	-0.7	-4.1	-4.1
Commercial bank overdraft	10.3	-13.5	-5.9	6.0	-2.9	-14.8
Use of cash balances	-2.5	0.8	-1.9	-1.2	--	--
Government	12.1	8.7	--	--	-3.4	-3.4
Export financing	-8.6	1.7	-1.7	-1.7	--	--
Other borrowing	-3.6	0.8	-1.8	-1.8	-1.1	-1.1
Memorandum items:						
ADMARC's recourse to banking system (net)	74.0	72.2	65.6	79.5	60.5	60.5
Of which:						
Credit from Reserve Bank	(47.7)	(58.4)	(57.8)	(57.8)	(53.6)	(53.6)
Commercial bank overdraft	(29.2)	(15.7)	(9.8)	(21.7)	(6.9)	(6.9)

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

1/ Includes ADMARC, Malawi Railways, Lilongwe Water Board, Electricity Supply Commission, Malawi Development Corporation, Malawi Housing Corporation, Air Malawi, Blantyre Water Board, Malawi Book Service, and Wood Industries. The first four statutory bodies have fiscal years April 1-March 31; the latter six, January 1-December 31.

2/ Including ADMARC.

3/ After interest payments and depreciation.

4/ Excludes payment of MK 23 million by the Government for previous-year costs related to the strategic grain reserve.

5/ Includes government payment described in footnote 4.

6/ Includes net lending, investment, asset sales, stock movements, and changes in short-term payables and receivables.

The net operating losses on ADMARC's crop trading operations amounted to MK 1.6 million in 1987/88 as against an anticipated profit of MK 2.5 million. This was, however, a sharp improvement over the loss of MK 16.6 million recorded in 1986/1987. The shortfall from the projected level reflected mainly overruns on direct and selling expenses, in particular those related to tobacco, cotton, and general produce trading; for the latter two, lower sales volumes contributed to higher unit overhead costs. In addition, an overrun in administrative expenses emanated from unbudgeted termination benefits paid as part of ADMARC's retrenchment program. 1/ These higher-than-expected losses were in part offset by a better outturn on maize and groundnut operations. The former reflected a higher volume of sales (including a drawdown of stocks) resulting in lower unit fixed costs, and the latter, higher export sales to more profitable markets in neighboring countries. After taking account of other revenues and expenses, ADMARC's net loss after depreciation and interest was MK 9.4 million as against a projected loss of MK 4.6 million, and a loss of MK 10.6 million in 1986/87. In addition, there was a sharp buildup in net outstanding receivables of MK 7.4 million (whereas a drawdown of MK 4.2 million had been envisaged), owing principally to costs of emergency food transactions, to be recouped from the Government in 1988/89 as provided for in the Government's 1988/89 budget. In combination, the above developments led to an overall loss on all operations of MK 0.6 million, and an increase in ADMARC's outstanding commercial bank overdraft to MK 21.7 million by end-March 1988, MK 11.9 million above the program target of MK 9.8 million.

III. The Three-Year Program and the Medium-Term Balance of Payments Outlook

1. The three-year policy framework, 1988/89-1990/91

Since the late 1970s, financial and economic imbalances have hindered Malawi's growth performance. These difficulties have reflected both external developments and domestic policy-related factors. To address these problems, the Government implemented adjustment programs in the context of successive arrangements with the Fund, as well as three structural adjustment loans (SALs) with the World Bank. Considerable progress was made in reducing imbalances in the economy; however, in 1985/86 and 1986/87, there was a weakening of economic performance and a re-emergence of domestic and external financial imbalances. The principal objectives of Malawi's three-year program are to attain medium-term balance of payments viability, increase the rate of sustainable economic growth, and reduce the rate of inflation from its present high level. These objectives are to be achieved through a strategy of

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1/ This program, in combination with other rationalization measures, reduced ADMARC's average monthly level of employees from 24,000 in 1986/87 to 19,000 in 1987/88.

structural reform and financial stabilization, geared toward restoring Malawi's traditional liberal market-oriented policies with a virtual absence of controls and reliance on private sector production.

These objectives are presented in the Government's policy framework paper (EBD/88/155, 6/7/88) in the context of two medium-term scenarios. Under the first scenario, to which the authorities are committed as the basis of the three-year program, 1/ the major objectives are: (i) to attain a real rate of growth of 1.5 percent of GDP for 1988, after the decline in 1987, and thereafter to achieve real growth rates of 3.0-3.5 percent annually during 1989-91, rising to 4.0-5.0 percent by 1992; (ii) to reduce the annual rate of inflation as measured by the CPI to 20 percent in 1988, and thereafter to achieve a steady reduction to about 5 percent a year by 1991-92; and (iii) to move to a viable balance of payments position by the end of the program consistent with the growth objectives, while removing existing restrictions on current external payments (Table 7). This scenario, with the underlying policy measures, is predicated on conservative assumptions about the availability of external financial resources, as well as a cautious assessment regarding improvement in other elements of the external environment facing Malawi.

The second scenario illustrates the effects of possible additional concessional flows, which could enable Malawi to enhance the prospects for growth and diversification of the economy and for medium-term balance of payments viability, and to strengthen and facilitate the implementation of the policies envisaged under the program. The Government will be seeking additional external concessional support from donors, particularly in the context of the forthcoming Consultative Group meeting on June 22-23, 1988. For 1988/89, the second scenario is identical to the first, and contains the same policy measures and targets.

The improvement in Malawi's economic growth performance in the medium term is based on policies to address significant structural constraints in the agricultural, industrial, transport, and human resource sectors. In the agricultural sector--the source of income for most of the population and the bulk of export earnings--the main objectives will be to raise production and exports, while ensuring food security, raising agricultural incomes, and avoiding the deterioration of natural resources. Policies will focus on raising productivity in the smallholder sector through releasing land from maize production by encouraging the adoption of higher-yielding varieties of maize, and will include increasing access to inputs and extension and credit services, as well as developing more appropriate technologies. The continuing reform of ADMARC's marketing and financial policies will also contribute to greater efficiency in this sector. The benefits of the above

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1/ In the attached memorandum on economic and financial policies, the policies and targets described are consistent with the first scenario.

Table 7. Malawi: Key Economic Indicators, 1985-91

	1985	1986	1987	1988	1989	1990	1991
			Est.	Prog.	Projections		
			(Annual percentage change)				
GDP	4.2	2.8	-0.2	1.5	3.3	3.3	3.3
GDY 1/	0.5	-0.7	-0.1	1.6	3.2	3.2	4.1
GDY/capita 1/	-2.7	-3.9	-3.3	-1.6	—	—	0.9
Consumption/capita	0.9	-1.5	-6.7	0.5	-1.5	0.2	-1.5
GDP deflator	13.6	10.8	25.4	20.0	10.0	7.5	5.0
			(In percent, unless otherwise specified)				
Debt service (in SDR millions) 2/	114.5	130.0	113.6	69.7	103.4	90.4	85.4
Debt service/Exports (GNFS) 2/	42.1	56.4	48.6	36.8	41.7	34.5	28.7
Debt service/GDP 2/	9.9	12.3	11.3	6.8	9.4	7.7	6.9
Gross investment/GDP 3/	17.9	10.8	12.3	13.5	14.7	15.0	15.3
Domestic savings/GDP	14.2	9.5	12.7	10.4	11.6	10.8	11.8
National savings/GDP	9.7	4.6	8.2	6.2	7.6	7.5	8.9
Marginal national savings rate	-0.5	-2.4	0.6	-0.3	0.3	—	0.3
Public investment/GDP 4/	6.5	6.8	5.9	5.6	5.7	5.6	5.6
Public savings/GDP 4/	-2.8	-5.3	-4.8	-2.9	-1.4	-0.8	-0.3
Private investment/GDP 4/	11.4	4.0	6.4	7.9	9.1	9.4	9.6
Private savings/GDP 4/	12.5	9.9	13.0	9.1	9.0	8.3	9.2
Public/private investment (ratio)	0.6	1.7	0.9	0.7	0.6	0.6	0.6
Government revenue/GDP 5/ 6/	21.2	20.1	18.2	18.9	18.7	18.3	17.7
Government expenditure/GDP 6/	30.8	32.6	28.4	27.0	25.4	24.5	23.5
Deficit (-)/GDP 6/	-9.6	12.4	-10.2	-8.1	-6.7	-6.2	-5.8
Deficit (-) after grants/GDP 6/	-7.5	-9.2	-7.2	-3.4	-3.2	-4.2	-3.8
Exports growth rate (percent per annum)	-3.9	3.0	-1.0	-5.1	5.2	2.2	3.7
Exports (GNFS)/GDP	23.5	21.9	23.4	22.1	22.6	22.5	22.8
Imports growth rate (percent per annum) 7/	14.5	-14.7	-0.4	5.3	8.0	4.5	4.0
Imports (GNFS)/GDP	28.1	24.3	25.7	28.4	27.7	27.9	27.6
Current account (in SDR millions)	-95.2	-65.0	-41.4	-74.9	-77.9	-87.6	-79.9
Current account/GDP 8/	-8.2	-6.2	-4.1	-7.3	-7.1	-7.5	-6.4
Gross official reserves (in weeks of imports) 9/	7.3	3.7	8.0	11.3	12.5	14.3	15.3

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

1/ GDY=GDP adjusted for changes in the terms of trade.
2/ After debt relief; GNFS=goods and nonfactor services.
3/ Includes stockbuilding.
4/ Public sector excludes and private sector includes statutory bodies.
5/ Excludes public transfers.
6/ On fiscal year basis beginning April 1 of year indicated.
7/ Excludes emergency food imports (1987-88).
8/ Excludes official transfers and includes emergency food aid grants (1987-88).
9/ Defined in weeks of imports excluding emergency food (1987-88).

policies to be taken in this area are, however, expected to be largely realized after the program period because of lags in production responses.

Agricultural policy will also continue to focus on providing appropriate producer incentives to achieve the above objectives. For most export crops, producers are in the estates sector and receive actual export prices; for smallholder crops, including tobacco and groundnuts, administered output and input prices will continue to be reviewed annually, and, if necessary, adjusted in light of border prices, costs of production and marketing, and the level of domestic supply. For the medium term, the objective will be to move toward export parity prices while taking into account the other aforementioned factors. The World Bank and the Fund will be consulted on price proposals before they are announced at the outset of the planting season in August/September, in each year of the program. A critical element in raising productivity is the adequate availability and improved use of inputs, in particular a more widespread utilization of fertilizer by smallholders to encourage them to adopt higher-yielding maize varieties. Thus, while the Government is committed to the eventual removal of the fertilizer subsidy that is currently restricted to smallholders, the pace of its removal will take account of price and nonprice factors influencing its availability and use; the Government will reach understandings with the Fund and the World Bank by March 1989 on a program for the removal of the subsidy.

The development strategy for the industrial sector will continue to emphasize the private sector and will focus on restoring competition in domestic markets and improving investment incentives, so as to foster efficient export growth and import substitution. This strategy will be complemented by appropriate demand-management and external policies to reduce inflation and restore private sector confidence, as well as by efforts to attain a more efficient use of resources by the public sector. A key element will be the phased removal of administrative controls on the approval and the availability of foreign exchange for imports. The increased availability and more efficient use of imports will support stronger growth, particularly in the short run, as capacity utilization, which is currently below 50 percent, could be increased quickly. With regard to incentive policies, already only a few price controls remain; moreover, a comprehensive tax reform designed to improve allocative efficiency, achieve greater equity, and encourage productive activity is being implemented (see below), and investment licensing regulations are being simplified. In addition, institutional support for exporters and small-scale entrepreneurs will be expanded, including greater accessibility of the latter to commercial bank credit.

An important problem facing the economy continues to be the disruption of Malawi's traditional external transportation routes through Mozambique, which has raised the c.i.f. margin on imports from 22 percent in the late 1970s to 40 percent since 1984. The Government's objective in this area is to reduce the c.i.f. margin on imports to

38.5 percent in 1991 and 35 percent in 1993, which will lead to estimated savings of SDR 11 million in 1991 (or about 1 percent of GDP and 4 percent of exports) and cumulative savings of SDR 33 million by 1993. To attain this objective, major investments are under way in upgrading the Northern Corridor route through Tanzania with external assistance. By the early to mid-1990s, capacity on this route should reach about one third of Malawi's trade, compared with 5-7 percent at present, at a cost saving of some 20-40 percent over the southern route. In addition, the authorities are working with the Mozambican authorities to reopen the traditional rail link to the port of Nacala, which would have substantial returns. However, while some progress has been made, further progress remains uncertain owing to the security situation, and a cautious approach has been adopted in program projections concerning any short-term returns from this project. The Government's medium-term program also aims to improve the provision of education and health services and to increase nutrition levels, which are among the lowest in Sub-Saharan Africa. In line with these objectives, budget expenditure allocations to these sectors will be increased within the limits of the fiscal objectives of the program.

An important element of the adjustment strategy is the continued improvement of the economic and financial performance of the parastatal sector, which would reverse the flow of financial resources to this sector from the finnacial sector and the Government. Structural measures during the program period will focus on improving the management and planning capacity of the parastatals and giving them greater autonomy in decision making, while improving the performance monitoring and evaluation capabilities of the Department of Statutory Bodies (DSB) so as to enhance accountability. At the same time, the policy of timely price and tariff increases will be continued.

A key element of this reform is the continuing restructuring of ADMARC, which plays a critical role in the marketing and pricing structure of the smallholder agricultural sector. The Government's medium-term objective for ADMARC is a concentration on its market-stabilization role consistent with improving overall efficiency and productivity in this sector, combined with financial viability by 1990/91. With the support of the World Bank, a study to be completed by March 1989 will be undertaken to identify the costs of ADMARC's current functions and of market stabilization, their implications for ADMARC's pricing structure, and their impact on incentives and development in the agricultural sector. ADMARC's long-term financial position will also be reviewed in the light of existing short-term policies of asset divestiture, increased private sector participation in smallholder produce marketing, and improved management and financial control, in relation to the objective of financial self-sufficiency. The study will provide recommendations concerning the responsibilities to be retained by ADMARC consistent with these objectives and will outline appropriate reform measures, while taking into account transitional costs that might be borne by smallholders. In line with these objectives, ADMARC will implement a pricing policy that will ensure that each individual crop-trading account will achieve, on average, a surplus over a reasonable time horizon, and timely repayments of its financial obligations. During 1988/89, a number of actions (described below) are being undertaken to bring about significant improvements in ADMARC's financial performance.

Fiscal and monetary policies for the medium term will focus on restraining aggregate demand to a level compatible with available resources, while ensuring that those resources are adequate for the needs of the productive sectors, in support of the program's growth, external, and inflation objectives. The fiscal deficit of the Central Government will be progressively reduced to a level that can be sustained in the medium term entirely by prospective concessional foreign loans and grants. Thus, following an initial reduction from 10.2 percent of GDP in 1987/88 to 8.1 percent of GDP in 1988/89, the budget deficit (before grants) is targeted to decline to 6.3 percent of GDP in 1990/91, with a further reduction to below 6 percent of GDP in 1991/92. 1/ This will permit net repayments to the domestic banking system by the Government in each year of the program, and allow for a larger allocation of credit to the productive sectors. Fiscal objectives for the medium term will be reviewed during the program period, in the light of likely available foreign concessional inflows and progress toward attaining the program's overall domestic and external objectives. With regard to revenue, the major focus of policy will be on the implementation of a comprehensive reform of the tax system during the program period. The tax reform aims at broadening the effective tax base, improving allocative efficiency while achieving greater equity, and simplifying and strengthening tax administration. This will involve a shift in the burden of taxation from production and imports to consumption, and improved investment incentives. The envisaged shift from import duties to domestic consumption taxation will be implemented in line with progress on import liberalization. Measures that are being taken in 1988/89 are described in detail below.

In recognition of the relatively high tax burden on the economy, especially on the modern productive sector, the Government accepts that the burden of adjustment in achieving the medium-term fiscal targets will be borne by expenditure. The revenue to GDP ratio is projected to decline from 18.9 percent in 1987/88 to 18.3 percent in 1990/91; achievement of this is based on no new revenue measures in 1989/90 and 1990/91. In order to achieve the overall deficit targets, the overall expenditure to GDP ratio will be reduced by about 4.5 percentage points, from 29.1 percent in 1987/88 to 24.6 percent by 1990/91, involving a reduction in real terms of recurrent expenditures. Within this tight fiscal environment, a number of measures are being taken to ensure that budgetary outlays better reflect government priorities as well as to

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1/ After grants, the budget deficit would decline from 7.0 percent of GDP in 1987/88 to 3.4 percent of GDP in 1988/89, and would remain at about 3-4 percent of GDP in the following years.

further improve monitoring and control. With the support of the World Bank, a public expenditure review is currently being carried out and is expected to be completed during this fiscal year. A tax-inclusive budget is to be introduced in 1989/90, to eliminate the import bias in Government purchases arising from their present exemption from import duties. The Government also intends to pursue a policy of restraint for civil service wages and salaries and employment. Public sector investment will continue to be guided by the rolling three-year Public Sector Investment Program (PSIP).

The centerpiece of the Government's external policies is the progressive elimination of existing restrictions on the approval and availability of foreign exchange for private sector imports during the program period. As previously noted, there are no import quotas in Malawi, and most goods are imported under open general license. The pace and scope of liberalization will be reviewed periodically with the aim of complete liberalization in March 1990. In support of its external objectives, the Government intends to pursue an appropriate exchange rate policy throughout the program period to at least maintain external competitiveness, support the liberalization program, and re-inforce the balance between the supply and demand for foreign exchange to achieve an adequate level of reserves. In addition, several institutional measures are being undertaken, including the strengthening of the Malawi Export Promotion Council, along with pricing and incentive policies to foster export growth and diversification.

Monetary and credit policy will be consistent with the external and domestic objectives of the program, and will aim to improve the efficient allocation of financial resources through market-determined interest rates. For the medium term, policies will focus on ensuring adequate availability of credit to the productive sectors, and continued curtailment of monetary expansion, to reduce the rate of inflation.

2. The medium-term balance of payments outlook

Malawi's external position will remain difficult, and in view of the uncertainties involved, projections for the medium term have been based on cautious assumptions for the major variables. Following a sustained deterioration of about 20 percent over the past five years, the terms of trade are not expected to change during 1988-90, before showing some recovery of 4 percent and 5 percent in 1991 and 1992, respectively. After a decline of 5 percent projected for 1988, export volumes are expected to grow by about 3 percent annually during 1989-90, and by 4 percent thereafter in response to the improved policy environment and reflecting increased diversification of export commodities. The current targets provide for import volume growth to rise temporarily to some 5 percent in 1988 and 8 percent in 1989, before decreasing to about 4 percent in subsequent years; these trends are consistent with the program's real GDP growth targets and import liberalization objective. Despite these relatively high rates of growth, it is only by 1990-91 that f.o.b. import volumes will have been restored to their levels of the early 1980s. As regards external transportation, in view of the uncertainties involved, no reduction in the c.i.f. margin arising from a reopening of the Nacala rail line has been assumed. However, on the basis of likely progress on the Northern Corridor route, a reduction in the c.i.f. margin from 40 percent to 38.5 percent is projected in 1991, with a further decline to 35 percent by 1993. These projections indicate that the current account deficit will widen to 7.5 percent of GDP in 1990 before declining steadily to 4.0 percent by 1993 (Table 8). At the same time, the role of the private sector in the economy is projected to expand. The private sector is expected to account for most of the targeted increase in gross investment from 12.3 percent in 1987 to 15.3 percent by 1991. Private sector savings are expected to decline, and the rise in investment is projected to be financed by an increase in national savings which would be achieved entirely through higher central government statutory bodies' savings (as a percent of GDP), consistent with the projected decline in the government budget deficit and improved financial performance of the public enterprises. Overall, national savings are expected to increase consistent with the program's external current account deficit target.

Based on conservative assumptions for inflows, the capital account is expected to show a growing surplus during 1988-90, rising to SDR 106 million in 1990 before declining to about SDR 70 million by 1993. The bulge in projected inflows reflects adjustment lending inflows from the World Bank and associated bilateral cofinancing loans and grants. 1/ Beyond 1993, no further inflows of this nature are assumed. After taking account of the net use of Fund resources, the resulting overall balance of payments surpluses will enable reserves to increase to 15.5 weeks of imports by 1993, and no financing gaps are expected. Beyond 1993, indications are that with a continued gradual decline in the current account deficit, the reserve coverage of imports would be maintained at 15-16 weeks, and debt service obligations would be met on time; no financing gaps are expected, and no further need for debt relief is anticipated.

It is assumed that external inflows will be largely on highly concessional terms, leading to a steady improvement in Malawi's debt profile. This objective will be reinforced by the program's ceilings on the debt to be contracted or guaranteed by the public sector. While the stock of debt is envisaged to increase from SDR 875.2 million at end-1987 to SDR 1.1 billion by end-1993, total debt service payments are projected to decline from SDR 114 million to SDR 87 million (Table 9). As a result, and also on account of rising exports, Malawi's debt service ratio is expected to decline from 49 percent to 26 percent

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1/ World Bank adjustment lending inflows and cofinancing are projected to amount to SDR 183 million during 1988-93, including a World Bank Industrial and Trade Policy Adjustment Credit (expected to be approved in mid-June 1988) and an Agricultural Sector Credit (expected to be approved in 1989/90).

Table 8. Malawi: Program Balance of Payments, 1987-1997

(In millions of SDRs)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
	Prov.					Projections					
Current account	-41.4	-74.9	-77.9	-87.6	-79.9	-62.9	-57.3	-54.5	-52.2	-49.6	-46.5
Exports, f.o.b.	214.2	206.6	224.5	237.3	257.2	280.8	306.7	329.5	354.0	380.3	408.5
Imports, c.i.f.	-229.4	-261.2	-266.6	-288.3	-302.8	-312.0	-328.9	-350.1	-372.7	-396.4	-421.5
Nonmaize imports, f.o.b.	-134.2	-143.1	-159.9	-173.0	-186.2	-199.7	-213.8	-227.6	-242.3	-257.7	-274.0
C.i.f. margin	-89.6	-95.4	-106.6	-115.3	-116.6	-112.3	-115.1	-122.6	-130.5	-138.7	-147.5
Emergency maize	-5.6	-22.7	—	—	—	—	—	—	—	—	—
Services and private transfers (net)	-29.9	-39.1	-39.8	-36.6	-34.3	-31.7	-35.1	-33.9	-33.4	-33.5	-33.5
Of which: interest payments	(-39.6)	(-37.7)	(-35.4)	(-33.3)	(-32.4)	(-31.5)	(-35.6)	(-34.3)	(-33.8)	(-33.7)	(-33.6)
Emergency maize grants	3.7	18.8	3.9	—	—	—	—	—	—	—	—
Capital account	85.4	81.4	94.9	105.7	104.9	80.0	68.3	66.4	68.4	70.8	67.0
Long-term (net)	76.6	78.4	91.9	105.7	104.9	80.0	68.3	66.4	68.4	70.8	67.0
Official transfers (net)	22.9	40.3	41.5	28.5	28.5	29.5	29.9	31.5	32.5	31.3	28.7
Of which: SAL related	(6.4)	(22.0)	(22.6)	(4.0)	(—)	(—)	(—)	(—)	(—)	(—)	(—)
Public sector borrowing	51.8	35.6	46.5	72.9	71.0	44.5	31.9	28.0	28.9	32.4	31.0
Disbursements	95.8	81.9	86.8	103.2	102.3	81.7	71.4	68.4	69.5	69.0	70.0
Of which: SAL and cofinancing	(40.8)	(25.9)	(33.8)	(50.7)	(42.3)	(16.7)	(7.2)	(—)	(—)	(—)	(—)
Amortization	-44.0	-46.3	-40.3	-30.3	-31.3	-37.3	-39.5	-40.4	-40.6	-36.6	-39.0
Private sector (net)	1.9	2.4	3.9	4.3	5.4	6.0	6.5	7.0	7.0	7.1	7.3
Short-term and unidentified	8.8	3.0	3.0	—	—	—	—	—	—	—	—
Overall balance	44.0	6.4	16.9	18.1	24.9	17.1	11.0	11.9	16.2	21.2	20.5
Financing	-44.0	-6.4	-16.9	-18.1	-24.9	-17.1	-11.0	-11.9	-16.2	-21.2	-20.5
Official net foreign assets											
(- increase)	-34.8	-12.1	-25.1	-18.1	-25.0	-17.1	-11.0	-11.9	-16.3	-21.1	-20.5
Of which: IMF (net)	(-23.6)	(7.9)	(-0.4)	(4.8)	(-15.2)	(-13.6)	(-5.2)	(-5.9)	(-8.4)	(-11.2)	(-11.2)
Change in arrears	-9.7	-34.1	—	—	—	—	—	—	—	—	—
Import-related	-26.4	-17.4	—	—	—	—	—	—	—	—	—
Debt-service related 1/	16.7	-16.7	—	—	—	—	—	—	—	—	—
Debt relief 2/	0.4	39.7	8.1	—	—	—	—	—	—	—	—
Financing gap	—	—	—	—	—	—	—	—	—	—	—
Memorandum items and assumptions:											
Current account (percent of GDP) 3/	-4.1	-7.3	-7.1	-7.5	-6.4	-4.7	-4.0	-3.5	-3.1	-2.8	-2.4
Gross official reserves											
End-period stock	34.4	51.8	63.8	79.0	88.8	92.3	98.1	104.1	112.0	122.0	131.3
In weeks of imports 4/	8.0	11.3	12.5	14.3	15.3	15.4	15.5	15.5	15.6	16.0	16.2
Average transport margins											
Imports 5/	40.0	40.0	40.0	40.0	38.5	36.0	35.0	35.0	35.0	35.0	35.0
Exports 6/	20.0	20.0	20.0	20.0	19.0	18.0	17.0	17.0	17.0	17.0	17.0
Transport cost savings 7/	—	—	—	—	10.7	16.1	8.8	—	—	—	—
As percent of GDP	—	—	—	—	0.9	1.2	0.6	—	—	—	—
					(Annual percentage change)						
Real GDP growth		1.5	3.3	3.3	3.3	4.5	4.5	4.3	4.3	4.3	4.3
Export volume		-5.1	5.2	2.2	3.7	4.3	4.3	4.3	4.3	4.3	4.3
Import volume (nonmaize)		5.3	8.0	4.5	4.0	3.6	3.5	3.4	3.4	3.3	3.3
SDR unit value of exports											
Including change in transport margin		1.7	3.3	3.4	4.5	4.7	4.7	3.0	3.0	3.0	3.0
Excluding change in transport margin		1.7	3.3	3.4	3.2	3.4	3.4	3.0	3.0	3.0	3.0
SDR unit value of imports											
Including change in transport margin		1.3	3.5	3.5	1.0	-0.5	1.9	3.0	3.0	3.0	3.0
Excluding change in transport margin		1.3	3.5	3.5	3.5	3.5	3.5	3.0	3.0	3.0	3.0
Terms of trade											
Including change in transport margin		0.5	-0.1	-0.1	3.5	5.2	2.7	—	—	—	—
Excluding change in transport margin		0.5	-0.1	-0.1	-0.3	-0.1	-0.1	—	—	—	—

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

1/ Figure for 1987 is equal to debt service payments to Paris Club creditors and principal payments to London Club creditors which have been suspended since late August 1987, pending Malawi's request for debt rescheduling.

2/ Estimates of amounts eligible for rescheduling based on the Agreed Minute with Paris Club creditors (April 22, 1988) and the Heads of Terms with London Club creditors (April 26, 1988). Rescheduling of CDC debt has also been assumed, under terms and conditions similar to those of the Paris Club reschedulings.

3/ Excluding official tranfers, but including emergency maize grants.

4/ Imports on a c.i.f. basis, excluding emergency maize.

5/ Defined as transport costs as a percent of total c.i.f. import value.

6/ Defined as transport costs as a percent of exports valued at world prices.

7/ Projected gains from lower import costs and higher export receipts resulting from a reduction in average transport costs associated with the completion of works on the Northern Transport Corridor.

Table 9. Malawi: Public External Debt and Debt Service Projections, 1987-97

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
	Est.	Projections									
	(In millions of SDRs)										
Debt outstanding 1/	875.2	918.2	953.6	1,024.8	1,081.5	1,113.4	1,141.4	1,164.4	1,185.8	1,207.7	1,228.4
Of which: debt to IMF 2/	(77.7)	(85.7)	(85.2)	(90.1)	(74.9)	(61.3)	(56.1)	(50.2)	(41.8)	(30.7)	(19.5)
Total debt service 3/	114.0	109.4	111.5	90.4	85.4	88.9	86.7	87.6	90.1	89.2	91.7
Principal	74.5	71.8	76.0	57.1	53.0	57.3	51.1	53.3	56.3	55.5	58.1
Interest	39.6	37.7	35.4	33.3	32.4	31.5	35.6	34.3	33.8	33.7	33.6
Debt service to IMF	30.3	25.7	24.0	17.6	18.0	15.3	6.5	6.2	8.6	11.4	11.3
Repurchases and ESAF repayments	23.6	19.9	19.0	13.8	15.2	13.6	5.2	5.9	8.4	11.2	11.2
Charges and ESAF interest	6.7	5.7	5.0	3.8	2.8	1.7	1.3	0.3	0.3	0.2	0.2
	(Ratios in percent)										
Debt outstanding 4/	87.4	89.2	82.2	79.5	77.4	72.6	68.5	64.8	61.1	57.9	54.8
Of which: debt to IMF 2/	(7.8)	(8.3)	(7.3)	(7.0)	(5.4)	(4.0)	(3.4)	(2.8)	(2.2)	(1.5)	(0.9)
Total debt service 3/ 5/	48.8	48.0	45.0	34.5	30.1	28.7	25.7	24.2	23.2	21.4	20.5
Principal	31.8	31.5	30.7	21.8	18.7	18.5	15.1	14.7	14.5	13.3	13.0
Interest	16.9	16.5	14.3	12.7	11.4	10.2	10.6	9.5	8.7	8.1	7.5
Debt service to IMF 5/	13.0	11.3	9.7	6.7	6.3	4.9	1.9	1.7	2.2	2.7	2.5
Repurchases and ESAF repayments	10.1	8.7	7.7	5.3	5.3	4.4	1.5	1.6	2.2	2.7	2.5
Charges and ESAF interest	2.9	2.5	2.0	1.5	1.0	0.5	0.4	0.1	0.1	0.1	0.0
Memorandum items:											
Debt relief (millions of SDRs)	0.4	39.7	8.1	—	—	—	—	—	—	—	—
Current maturities	0.4	25.6	8.1	—	—	—	—	—	—	—	—
Principal	0.4	23.1	7.2	—	—	—	—	—	—	—	—
Interest	—	2.4	0.9	—	—	—	—	—	—	—	—
Arrears	—	14.1	—	—	—	—	—	—	—	—	—
Debt service ratio after debt relief 5/	48.8	36.8	41.7	34.5	30.1	28.7	25.7	24.2	23.2	21.4	20.5

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

1/ End-period, public and publicly guaranteed, medium- and long-term external debt disbursed outstanding.
2/ Excludes the Trust Fund, but includes purchases under the 1988/89 stand-by arrangement and disbursements under the proposed ESAF arrangement for 1988/89-1990/91.
3/ Before debt relief.
4/ As percent of GDP.
5/ As percent of exports of goods and nonfactor services.

during 1987-93. The debt to GDP ratio would decline from 87 percent at end-1987 to 69 percent by end-1993.

IV. The Program for 1988/89 (April-March)

The discussions focused on policies during 1988/89, which is the first year of the proposed ESAF three-year program as well as the final 12 months of the program supported by the stand-by arrangement. Particular emphasis was placed on the budgets of the Central Government and ADMARC for 1988/89, exchange rate policy, interest rate policy, further import liberalization, developments with respect to Malawi's request for debt rescheduling, events relating to domestic food supplies, and policies concerning the fertilizer subsidy. In addition, performance criteria were established for end-September 1988, end-December 1988, and for end-March 1989.

1. Fiscal policies

In order to curtail aggregate demand pressures and achieve a significant reduction in the current high rate of inflation while promoting private sector activity, the Government attaches critical importance to a further reduction in 1988/89 in the central government budget deficit. Thus, the 1988/89 budget provides for a reduction in the overall deficit to MK 296 million, or 8.1 percent of GDP, compared with 10.2 percent of GDP for 1987/88 (Table 3). After grants, the deficit would be reduced from 7.1 percent of GDP in 1987/88 to 3.4 percent of GDP. This reflects a sharp rise in grants, from MK 95 million (3.1 percent of GDP) in 1987/88 to MK 172 million (4.7 percent of GDP) in 1988/89, on account of higher cofinancing inflows associated with World Bank program lending operations. 1/ On the financing side, net foreign financing will increase from MK 98 million to MK 141 million, again owing primarily to larger World Bank program loan disbursements. 1/ The deficit target, after taking account of estimated foreign financing inflows, thus provides for a net reduction of MK 16 million in the outstanding stock of bank credit to the Government (compared with an increase of MK 46 million in 1987/88), which will facilitate adequate provision of credit to private sector productive activities; the deficit target also provides for a slight reduction in the outstanding stock of nonbank credit to the Government. 2/

Revenues are projected to rise by 19.4 percent to MK 686 million, with the revenue to GDP ratio remaining at 18.9 percent. This increase

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1/ These inflows include disbursements delayed from 1987/88, and new commitments associated with the World Bank's Industrial and Trade Policy Adjustment Credit expected to be approved by mid-June 1988.

2/ The budget provides for the full amount of debt service falling due, and the kwacha counterpart of payments subject to rescheduling will be held in a blocked account at the Reserve Bank.

includes the net revenue effect, through the expansion of the tax base, the increase of some tax rates and the improvement of revenue cashflow, of the first stage of tax reform amounting to MK 14 million, and MK 16 million in additional revenues from higher business and motor vehicle license fees. Combined, the additional revenues are equivalent to 0.8 percent of GDP. The tax reform measures introduced in the 1988/89 budget represent a major first phase in the Government's overall tax reform program. Except where noted, the following measures were introduced on April 1, 1988. There were three measures to broaden the effective tax base or increase rates for indirect taxes. First, excise tax rates are being converted from a specific to an ad valorem basis, with some increase in effective tax rates, yielding an estimated MK 2.6 million in 1988/89. Second, the domestic surtax base has been expanded, yielding MK 2.0 million in 1988/89. Third, effective October 1, 1988, the luxury tax is to be moved from an import to a consumption basis (covering both imports and domestically produced goods), yielding MK 0.4 million in 1988/89.

In order to enhance allocative efficiency and improve incentives for efficient export and import-substitution production, the following actions were included in the budget. A tax allowance for export earnings and a more effective duty drawback system have been introduced at an estimated cost of MK 5.0 million in forgone revenues in 1988/89. A new surtax credit system that would exempt producers from payment of surtax on inputs is to be introduced October 1, 1988, involving a revenue loss of MK 2.0 million in 1988/89. With a view to promoting efficient investment, the Government has introduced a 40 percent expensing provision to replace the existing initial and investment allowance, 1/ for a revenue loss of MK 1 million in 1988/89. Finally, actions to strengthen and simplify tax administration have been taken. A four-year phase-in of a current payments system for company taxes is being implemented, with a revenue yield of MK 14.0 million in 1988/89. In addition, the import levy and duty have been merged, resulting in an increase in surtax revenues from imports of MK 3 million in 1988/89.

In order to achieve the program's deficit target without increasing the tax burden on the modern productive sector, the burden of adjustment will fall on expenditures. During the discussions, the authorities recognized both the need for this policy stance, and the difficult choices it entailed. For 1988/89, total outlays are budgeted to rise by 11 percent to MK 982 million, or 27 percent of GDP, compared with 29.1 percent of GDP in 1987/88. Current expenditures are budgeted to increase by 7.6 percent to MK 706 million, which implies a significant reduction in real terms over 1987/88 in both wage and nonwage outlays.

1/ Eligibility for the investment allowance was based on asset ownership, and was largely restricted to the manufacturing sector. Eligibility for the initial allowance was based on asset type. The expensing provision will initially only apply to manufacturing; extension to other sectors is to be reviewed at a subsequent date.

The wage bill is budgeted to rise by only 5.8 percent, reflecting no increase in government wage rates and no net increase in civil service employment. While a significant general increase in wages and salaries was granted in 1986/87, real wages are lower than they were in 1980. Other nonwage recurrent expenditures (excluding interest) are budgeted to rise by 13.2 percent to MK 368 million, and include provision for recurrent costs associated with the Government's efforts to reopen the Nacala rail line.

Development expenditures, which are largely foreign financed on concessional terms, are budgeted to rise 30 percent to MK 270 million. Expenditure priorities in 1988/89 have been reviewed with the World Bank in the context of a rolling three-year public sector investment program (PSIP). For 1988/89 both the PSIP and the development budget have been limited to ongoing projects, with the exception of certain health and education projects and the Northern Corridor transport project. Initiation of these latter projects reflects the increased emphasis that is to be given by the Government to these sectors in the medium term to improve growth performance and Malawi's external transport routes. Moreover, on June 22-23, 1988 the Government will be presenting its recently completed Statement of Development Policies for the decade 1987-96 to Malawi's Consultative Group to seek financing of priority expenditures encompassed in the PSIP.

The 1988/89 budget also includes a provision of MK 5 million for any net expenditures incurred for the purchase, transportation, or distribution of emergency maize imports. 1/ In view of the continued food shortages that are expected for 1988/89, the Government will not be able to rebuild its strategic grain reserve, and no budgetary costs are expected on this account. In the event that any such costs emerge, offsetting adjustments to other expenditures would be made to ensure attainment of the program's fiscal objectives. The 1988/89 budget also includes an amount of MK 8 million, slightly above the level incurred in 1987/88, to cover the cost of the subsidy for smallholder fertilizer purchases during 1987/88.

In order to maximize the benefit of budget outlays within the tight expenditure constraint, the Government is taking measures to ensure that the composition of expenditures will better reflect its priorities. The reform of the budgetary process will be continued, and the authorities are cooperating closely with the World Bank in this area: in 1988/89 the three-year forward budget will be activated and strengthened; an implementation schedule of institutional measures to strengthen the budgetary process will be agreed with the World Bank by December 1988; and the Government will be reviewing the findings of a public expenditure review being carried out with the support of the World Bank. In

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1/ The amount of MK 5 million is net of receipts from donor reimbursements during 1988/89 for similar outlays incurred by the budget during the latter part of 1987/88.

this context, the Government is also seeking ways to safeguard critical social outlays. The improvements in expenditure controls and monitoring introduced in 1987 are being rigorously pursued and supplemented. To further facilitate control of expenditures and attainment of the fiscal targets for 1988/89, quarterly indicative targets for government expenditures and for the overall budget deficit have been established (Table 10).

2. External sector policies

As noted in the context of the three-year program, the authorities are committed to the phased liberalization of existing restrictions on the approval and the availability of foreign exchange for private sector imports, while moving toward balance of payments viability in the medium term. The authorities have taken several exchange rate actions in the last few years, most recently in January 1988, and intend to continue to pursue an appropriate exchange rate policy to at least maintain external competitiveness and support the liberalization of the import approval system (see Chart). With a view to achieving an adequate level of official reserves, indicative maximum levels for the net foreign liabilities of the monetary authorities have been established for policy evaluation purposes: SDR 81 million at end-June 1988, SDR 62 million at end-September 1988, SDR 73 million at end-December 1988, and SDR 77 million at end-March 1989.

A second stage in the liberalization of existing restrictions on the approval of foreign exchange applications for private sector imports will be introduced no later than end-July 1988, with liberalization extended to a further 50 percent of imports of spare parts and raw materials (excluding petroleum); as a result, 75 percent of all such imports will be liberalized. A number of intermediate finished goods, which have benefited from much-higher-than-average levels of effective protection because of the foreign exchange restrictions, will also be liberalized. All of these goods are and will continue to be imported under open general licensing arrangements. The timing and scope of liberalization of the exchange system will be reviewed periodically with the aim of complete liberalization by March 1990.

In addition to exchange rate policy and liberalization, a package of measures is being implemented to improve export competitiveness and to develop nontraditional exports. A number of export incentives have been granted in the 1988/89 budget (as noted in Section IV.1) including a more effective export duty drawback system. A foreign exchange revolving fund is to be set up with external support, for exporters' requirements of imported inputs. This is intended as an interim measure and will be eliminated by the time of completion of the import liberalization program in March 1990. Furthermore, the capabilities of the Malawi Export Promotion Council are to be strengthened. Export licensing requirements--which apply to only 22 goods, largely of agricultural origin in the interests of food security and environmental protection--are limited in number and are to be reduced beginning in June 1988.

Table 10. Malawi: Indicative Targets for the Central Government's Expenditures and Overall Budget Deficit, 1988/89

(In millions of Malawi kwacha)

	Wage bill	Other current 1/ expenditure	Total 2/ expenditure	Overall 3/ deficit
April 1-June 30, 1988	41.3	117.1	212.3	-78.0
April 1-September 30, 1988	82.6	211.3	437.8	-141.6
April 1-December 31, 1988	123.9	296.6	712.4	-236.6
April 1, 1988-March 31, 1989	165.2	368.0	981.5	-295.6

Source: Memorandum on Economic and Financial Policies of the Government of the Republic of Malawi for the period April 1, 1988-March 31, 1991.

1/ Excluding debt service payments and including special expenditures.
2/ Including interest payments, and extrabudgetary expenditures.
3/ Before grants, defined from the financing side.

In 1988, export proceeds are projected to fall, owing to a 5 percent decline in volume stemming largely from the adverse impact of the delayed rainfalls in late 1987 on tobacco output. In line with the import liberalization program, import volume (excluding emergency maize imports) is projected to rise by 5 percent. After five consecutive years of decline, the terms of trade are expected to improve slightly. After taking into account higher service payments and lower private transfers, the current account (excluding official transfers) is projected to widen to SDR 75 million or 7.3 percent of GDP. Net long-term capital inflows are projected to reach SDR 78 million, about the same as in 1987 but with a larger share in the form of official grants. Of this amount, inflows associated with World Bank adjustment lending account for SDR 48 million, including SDR 28 million of loan and grant disbursements from IDA and bilateral donors under the World Bank Industrial and Trade Policy Adjustment Credit. As a result of these capital inflows, an overall balance of payments surplus of SDR 6 million is projected for 1988.

After taking into account the first purchase under the stand-by arrangement, disbursements under the proposed ESAF arrangements, repurchases to the Fund, the reduction of arrears, estimated debt relief, and other liabilities, gross international reserves are programmed to increase from SDR 34 million (equivalent to 8 weeks of imports) at end-1987 to SDR 52 million (equivalent to 11 weeks of imports) by end-1988. Arrears on debt service payments are expected to be eliminated in the context of the rescheduling agreements with London and Paris Club creditors in April 1988. 1/ These reschedulings are expected to provide debt relief in 1988 amounting to SDR 39.7 million, and SDR 8.1 million in 1989. Pending the completion of the related bilateral rescheduling, the exchange restrictions arising from the arrears on debt service payments are subject to approval under Article VIII; when approving the stand-by arrangement on March 2, 1988, the Executive Board approved the retention of these restrictions by Malawi until December 31, 1988. As noted earlier, other external payments arrears were eliminated in January 1988. No new external payments arrears will be allowed to arise during the program period. The projected debt relief for 1988 is expected to reduce the debt service ratio from 48 percent to 36.8 percent. Consistent with the program's medium-

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1/ For details of the Paris Club rescheduling, see SM/88/119, (5/27/88). In summary, all arrears and all obligations falling due during the period April 1, 1988-May 31, 1989 with the exception of interest payments on previously rescheduled debt were rescheduled for 20 years with 10 years of grace. This is expected to provide debt relief of SDR 34 million. London Club creditors rescheduled the outstanding stock of debt of about SDR 23.8 million as of August 21, 1987, over 8 years, commencing March 31, 1988 including 4 years of grace, with an interest rate of 1 1/4 percent above LIBOR and with a restructuring fee of 1/2 percent. The rescheduled amounts would have fallen due during the period April 1988-August 1989.

term objective a cautious policy for external borrowing will be pursued. The program includes, as performance criteria, limits on external borrowing of up to 12 years' maturity, as specified in Table 11. Furthermore, the Government does not intend to seek further debt rescheduling from Paris and London Club creditors.

3. Monetary and credit policies

The program's monetary targets, ceilings and policies for 1988/89 are consistent with its overall objectives. Net domestic assets of the banking system are projected to decline in 1988/89 by an amount equivalent to 7.1 percent of beginning period broad money stock, and domestic credit is projected to increase by an amount equivalent to 8.9 percent of beginning period broad money stock. These targets represent a reduction in the expansion of net domestic assets and domestic credit compared with that envisaged under the original stand-by program. This reflects a shift from an expansion in net credit to Government during 1988/89 to net repayment by the Government to the domestic banking system; net credit to the Government is programmed to fall by MK 16 million (3.1 percent of beginning period money stock) during 1988/89, whereas under the original program, net credit to Government was to increase by MK 60 million (10.5 percent of beginning period money stock). The original program targets for net credit to statutory bodies remain unchanged, although these now imply a sharper rise in this aggregate during 1988/89 than previously anticipated; this rise reflects a much-higher-than-originally expected level of deposits of the Fertilizer Revolving Fund at end-March 1988, which is expected to decrease during the year. For credit to the private sector, an increase of 17.4 percent in 1988/89 is projected. Credit expansion during the period March-September 1988 is expected to be greater than previously envisaged, reflecting higher seasonal credit demands to finance tobacco purchases on the domestic auction floors. Taking account of the projected balance of payments surplus, and debt relief granted, the program provides for growth in broad money of 4.3 percent in 1988/89, which is estimated to be consistent with the objective of reducing the rate of inflation and adequate in light of the excess liquidity at the beginning of the year. During 1988/89, the money supply is projected to show a strong seasonal pattern, principally reflecting the timing of domestic agricultural produce purchases and export proceeds, as well as large projected program adjustment lending and cofinancing inflows.

As noted in Section V below, quarterly targets on the net domestic assets of the banking system, on net credit to Government, and on net credit to statutory bodies will constitute performance criteria. The targets on net domestic assets and on net credit to Government would be automatically adjusted downward should specified external cash loans and grants exceed programmed amounts. 1/ The target on net credit to

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1/ In contrast, there is no automatic upward adjustment of these targets in the event of a shortfall in the specified external cash loans.

Government would also be adjusted downward should there be a shortfall in government payments into the blocked account for debt service at the Reserve Bank.

With respect to interest rate policy, as noted earlier, in July 1987 commercial bank lending rates were deregulated, and, following an increase in controlled deposit rates of 3 percentage points, the banks raised their base lending rates by 4 percentage points. 1/ Since then, largely reflecting the low level of domestic activity, private sector demand for credit (abstracting from seasonal patterns) has remained low, and the commercial banks continued to have substantial excess liquidity, mainly held on deposit at the Reserve Bank. With the objective of eliminating these imbalances in the credit markets, the Reserve Bank removed all remaining controls on the interest rate structure of commercial banks on April 11, 1988, to facilitate the emergence of a market-clearing level of interest rates. Immediately following this action, commercial banks reduced their deposit rates and base lending rate by 3 percentage points. As a result, commercial banks' lending rates are presently 20-23 percent for most borrowers, and the 12-month fixed deposit rate is 13.25 percent. On the basis of the average inflation rate target for 1988 (20 percent) the lending rates are barely positive, and the deposit rates are negative. However, by end-1988, the 12-month inflation rate implied by the inflation target would be below 20 percent. The demand for private sector credit is expected to increase in line with seasonal agricultural needs, the import liberalization program, and the projected recovery in productive activity. The Reserve Bank will carefully monitor developments with a view to ensuring that interest rates rise toward positive levels in real terms as the recovery in private sector credit takes place, and that the program's external and inflation objectives are not jeopardized. The Reserve Bank recognizes that with the complete deregulation of interest rates, the effectiveness and responsiveness of its policies with respect to credit and monetary control should be reviewed, and changed where appropriate. Thus, with the assistance of the Fund's Central Banking Department, the Reserve Bank will complete a study of its monetary policy instruments by September 1988, with a view to introducing an enhanced system of monetary and credit control by the end of the year. In the interim, existing instruments will be administered to ensure attainment of the program's objectives.

The financial system in Malawi comprises the Reserve Bank, two commercial banks, 2/ a Post Office Savings Bank (POSB), a building society, an industrial development bank, and a number of insurance companies. At present, the commercial banks, POSB, and the building

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1/ As a result of the increase, the 12-month deposit rate became 17 percent, and commercial bank base lending rates rose to 20 percent (the maximum lending rates were about 26 percent).

2/ The Government has a 20 percent shareholding in one of the commercial banks.

society effectively compete for private deposits, but each serves a distinct clientele in its lending operations. In the period ahead, the Reserve Bank intends, with Fund technical assistance, to develop its supervisory capabilities over these institutions, and promote an integrated financial system.

4. Statutory bodies

Improvement in the performance of the parastatals, particularly ADMARC, is an important part of the program for 1988/89. Measures are being implemented to achieve an improved financial outturn as well as to make up for the shortfall from the anticipated outturn for 1987/88, particularly that for ADMARC. No transfers from the central government budget to statutory bodies are envisaged under the program for 1988/89. To achieve this improvement, management reform is being continued, several price and tariff increases have been implemented, and wage bills will be contained through tight control of net employment and no increase in general wage rates. At the same time, the Department of Statutory Bodies (DSB) is improving its monitoring and surveillance functions; the recommendations of a recently completed study assisted by the United Nations Development program (UNDP) are to be largely implemented during 1988/89 with a view to enhancing the DSB's performance monitoring, evaluation, and control capabilities.

As for the financial targets for the parastatal sector, the ten major parastatals, including ADMARC, are projected to achieve a combined profit of MK 24.8 million in 1988/89, compared with a loss of MK 6.3 million in 1987. As described earlier, the major shortfall in 1987/88, other than ADMARC, was experienced by Malawi Railways, and in response, tariffs have been increased by 25 percent (10 percentage points more than initially proposed), and other actions have been taken to cut costs and raise revenues to prevent a shortfall from its budgeted profit target for 1988/89.

With respect to ADMARC, a number of actions are being taken which, with the full-year effect of the cost-cutting measures taken during 1987/88, will allow for a significant improvement in ADMARC's financial performance. In particular, the original target will be met for ADMARC's outstanding commercial bank overdraft at end-March 1989 envisaged under the stand-by arrangement, notwithstanding the higher-than-anticipated level of the overdraft at end-March 1988. Negotiations with cotton ginning companies to reduce ADMARC's role in cotton marketing are in their final stages. Effective this season, raw cotton bought by ADMARC will be sold ex-depot. This will terminate ADMARC's involvement in subsequent marketing operations and will eliminate grading and ginning charges and reduce cotton transport costs by 50 percent. In recent years, these operations have resulted in net losses, partly reflecting market conditions. ADMARC is also to introduce this season a similar arrangement for the marketing of the rice crop. Another major change relates to groundnuts. Commencing with the 1988/89 buying season, an additional intermediate grade of groundnuts is to be introduced, which, in combination with stricter grading practices, will effectively reduce the producer price by 13 percent for some 85 percent of groundnut purchases. In addition, efforts are being made to speed up the pace of sales in 1988/89 under ADMARC's asset divestiture program. Some 12 companies and estates, for which sale during 1988/89 is thought to be feasible, have been targeted; in some cases, potential buyers have been identified. However, the timing and size of receipts will be sensitive to the course of negotiations and sales terms. The program's financial targets for ADMARC have been formulated with cautious assumptions concerning divestiture receipts.

ADMARC is also undertaking further actions to reduce its direct selling and administrative costs and to recoup some debts owed to it to improve its cash flow and thereby contain its bank overdraft interest charges. For 1988/89, ADMARC's net operating profit on crop-trading accounts is targeted at MK 6.1 million, as against a profit of MK 4.4 million originally anticipated in the program, and a loss of MK 1.6 million in 1987/88. The net profit/loss after interest and depreciation is targeted at a profit of MK 2 million, compared with a loss of MK 2.3 million originally envisaged under the program, and a loss of MK 9.4 million in 1987/88. This reflects a reduction in bank interest charges and capital gains realized on asset sales. After taking account of other operations, including the repayment of the debts owed to ADMARC which were accumulated during 1987/88, ADMARC's budget provides for a reduction in its commercial bank overdraft at end-1988/89 to MK 6.8 million, compared with MK 22 million at end-1987/88; this targeted improvement is sensitive to the size and pace of divestment receipts. In addition, ADMARC's budget provides for the timely payment of obligations falling due to the Government and the Reserve Bank.

5. Agriculture

Appropriate producer price incentives and other complementary supply-oriented policies will play major roles in promoting growth and diversification in this sector. In the estate sector (comprising primarily tobacco, sugar, and tea), which accounts for most exports, producers face market-determined prices for both their output and inputs. In the smallholder sector, administered prices apply through ADMARC's purchases; the main export crops are tobacco and groundnuts. However, private sector traders, whose participation has been encouraged since 1987/88, are free to offer higher prices, and measures to further reduce ADMARC's monopsonistic role are being undertaken during 1988/89. Producer prices for the current season--purchases are made largely between April and September--were announced in August 1987, prior to the planting season. The World Bank and the Fund will be consulted on the price proposals for the 1988/89 growing/buying season prior to their announcement at end-August 1988. These prices will be guided by world price expectations, input prices, and the level of domestic supply. The latter factor will be important with regard to maize, the major domestic food crop; current crop estimates for 1988 indicate a continued shortfall in domestic production for which international donor assistance is being sought. 1/ Over the last year, maize producer prices have been increased by 36 percent, and ADMARC's selling price of maize--a major determinant of the consumer price--by 48 percent.

In view of their concerns about the level of maize production, the authorities plan to continue the subsidy for fertilizer (which is limited to smallholders) in order to encourage planting of higher-yielding maize varieties. Smallholder fertilizer prices for the 1988/89 growing season will be announced at end-August 1988. However, the Government will reach understandings with the Fund and the World Bank by March 1989 on a program for the removal of the subsidy. Meanwhile, the budgetary costs will be limited to a level consistent with the program's fiscal objectives. Also, the enhanced utilization of fertilizer is being promoted through other means including improved access to credit and smaller packages. The completion of the study on ADMARC's current and future functions and their costs, and the formulation of a program by March 1989 for the removal of the fertilizer subsidy, will provide an opportunity to carefully review any price changes for smallholder inputs and output and ADMARC's domestic sales that may be necessary to promote efficient growth in the agricultural sector and ADMARC's financial viability by 1990/91.

V. Performance Criteria, Benchmarks, and Reviews

The following quantitative performance criteria will apply for the stand-by arrangement for end-September 1988 and end-December 1988 and for end-March 1989 (Table 11): (a) limits on the net domestic assets of the banking system; (b) limits on net claims on Government by the banking system; (c) limits on net claims on statutory bodies by the banking system; (d) limits on new nonconcessional external loans contracted or guaranteed by the Government and other public sector institutions; and (e) limits on the net increase in short-term external debt of less than one year maturity contracted or guaranteed by the Government and other public sector institutions. The performance criteria under the stand-by arrangement also include the usual clause regarding the exchange and payments system. There will also be a second review under the stand-by arrangement with the Fund to be completed by end-December 1988, which shall constitute a performance criterion.

The quantitative performance criteria for end-September 1988 under the stand-by arrangement shall constitute the semi-annual quantitative performance criteria for the first annual arrangement under the ESAF. A midyear review with the Fund to be completed by end-December 1988, as well as the usual clause regarding the exchange and payments system, shall also constitute performance criteria under the first annual

1/ This shortage will in practice emerge during September 1988-March 1989, after the harvesting season.

Table 11. Malawi: Quantitative Performance Criteria for the Stand-by Arrangement, 1988/89

	1988					1989
	March Program	March Actual	June	Sept.	Dec.	March
	(In millions of Malawi kwacha)					
Net domestic assets of the banking system	632.5	584.9	692.7	624.5	589.8	548.3
Net claims on the Government by the banking system 1/	508.9	477.6	528.3	468.1	479.5	461.7
Net claims on the Statutory Bodies by the banking system	40.8	23.7	61.1	84.9	69.1	43.7
	(In millions of SDRs; end of period)					
External payments arrears	5.0 2/	— 2/	—	—	—	—
New nonconcessional loans contracted or guaranteed by the Government and other public sector institutions (cumulative) of 1-12 years' maturity 3/	20.0	—	20.0	20.0	20.0	20.0
Of which: 1-5 years	(—)	(—)	(—)	(—)	(—)	(—)
Net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions of less than one year maturity 4/	—	—	—	—	—	—

Source: Memorandum on Economic and Financial Policies of the Government of the Republic of Malawi for the period April 1, 1988-March 31, 1991.

1/ These levels would be adjusted downward by any shortfall in payments into the Reserve Bank blocked account for Government debt service payments; and by the amount that disbursements of specified external cash loans and grants exceed MK 67.7 million during December 31, 1987-June 30, 1988, MK 115.2 million during December 31, 1987-September 30, 1988, MK 164.2 million during December 31, 1987-December 31, 1988, and MK 214.6 million during December 31, 1987-March 31, 1989.

2/ Excludes arrears on debt service for which a request had been made to Paris and London Club creditors for rescheduling. These debt service arrears were eliminated under the program by end-May 1988, through cash paymnets or through rescheduling.

3/ Excludes any debts related to debt rescheduling with Paris and London Club creditors.

4/ Excludes short-term trade finance.

arrangement. Quantitative benchmarks have been established for end-March 1989, the end of the first annual program under the ESAF; these benchmarks shall be used as a clear-cut base for monitoring performance, and for formulating the program for the succeeding year, as well as for assessing the adequacy of measures to be included in the program. ADMARC's net profit after interest and depreciation for 1988/89 shall constitute a quantitative benchmark under the first annual arrangement. Performance criteria and quantitative benchmarks are set forth in Tables 11 and 12. The following shall be structural benchmarks (Table 13): (i) the implementation of the second stage of import liberalization by end-July 1988; (ii) the review of smallholder agricultural producer prices with the World Bank and Fund prior to their announcement in August 1988; (iii) the introduction of a more appropriate system of monetary and credit control by December 1988; and (iv) the completion of the study of the financial costs of ADMARC's current functions and of market stabilization by March 1989.

The second review under the stand-by arrangement and the midyear review under the ESAF will focus on: exchange rate policy, taking into account changes in external competitiveness and developments regarding the net foreign liabilities of the monetary authorities compared with the indicative targets described in Section IV.2; monetary and credit control; import liberalization; progress in the study of ADMARC's functions and their costs; the timetable for the elimination of the fertilizer subsidy; and developments with respect to prospective external inflows.

VI. Staff Appraisal

For a long period until the end of the 1970s, Malawi succeeded in achieving high rates of growth in the context of an economic system characterized by outward-looking, liberal economic policies. Demand management was cautious, and the authorities emphasized development of the agricultural sector, in the absence of sizable mineral resources.

Since the late 1970s, a number of external circumstances have put severe strains on the economy. Increases in world oil prices in 1979, high international interest rates in 1981-82, and the rupture of traditional trade routes to Mozambique's ocean ports adversely affected the external accounts. Unfavorable weather conditions in 1980-81 and in 1985-86 reduced production. Since 1986, there has been a steadily increasing number of refugees from neighboring Mozambique. These developments have resulted in uneven growth performance in recent years and stretched the ability of the authorities to adjust. In 1985/86 and 1986/87, the budget deficit increased considerably, there were problems in the financial performance of the main parastatal (the Agricultural Development and Marketing Corporation--ADMARC), and balance of payments developments were such that, from late 1986, trade payments arrears were accumulated, and the authorities introduced controls on the approval and availability of foreign exchange for private sector import payments. In

Table 12. Malawi: Quantitative Performance Criteria and Benchmarks Under the Enhanced Structural Adjustment Facility, 1988/89

	1988				1989
	March (base data)	June Benchmarks	September Performance	December Benchmarks	March Benchmarks
	(In millions of Malawi kwacha)				
Performance criteria and quantitative benchmarks					
Net domestic assets of the banking system	584.9	692.7	624.5	589.8	548.3
Net claims on the Government by the banking system 1/	477.6	528.3	468.1	479.5	461.7
Net claims on the Statutory Bodies by the banking system	23.7	61.1	84.9	69.1	43.7
	(In millions of SDRs; end of period)				
External payments arrears 2/	—	—	—	—	—
New nonconcessional loans contracted or guaranteed by the Government and other public sector institutions (cumulative) of 1-12 years' maturity 3/	...	20.0	20.0	20.0	20.0
Of which: 1-5 years	(...)	(—)	(—)	(—)	(—)
Net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions of less than one year maturity 4/	...	—	—	—	—
	(In millions of Malawi kwacha)				
Quantitative benchmarks					
ADMARC's net profit after depreciation and interest	-2.3	...	...	...	2.0

Source: Memorandum on Economic and Financial Policies of the Government of the Republic of Malawi for the period April 1, 1988-March 31, 1991.

1/ These levels would be adjusted downward by any shortfall in payments into the Reserve Bank blocked account for Government debt service payments; and by the amount that disbursements of specified external cash loans and grants exceed MK 67.7 million during December 31, 1987-June 30, 1988, MK 115.2 million during December 31, 1987-September 30, 1988, MK 164.2 million during December 31, 1987-December 31, 1988, and MK 214.6 million during December 31, 1987-March 31, 1989.

2/ Excludes arrears on debt service for which a request had been made to Paris and London Club creditors for rescheduling. These debt service arrears were eliminated under the program by end-May 1988, through cash paymnets or through rescheduling.

3/ Excludes any debts related to debt rescheduling with Paris and London Club creditors.

4/ Excludes short-term trade finance.

Table 13. Malawi: Structural Benchmarks Under the Enhanced Structural Adjustment Facility, 1988/89

	Actions	Timing
1.	Implementation of the second stage of import liberalization, with liberalization extended to a further 50 percent of importsof spare parts and raw materials (excluding petroleum), and a number of intermediate finished goods	By end-July 1988
2.	Review of smallholder agricultural producer prices with the World Bank and the Fund	Prior to announcement of prices in August 1988
3.	Introduction of a system of monetary and credit control more appropriate to an environment of deregulated interest rates	By December 1988
4.	Completion of the study of the financial costs of ADMARC's current functions and of market stabilization	By March 1989

Source: Memorandum on Economic and Financial Policies of the Government of the Republic of Malawi for the period April 1, 1988-March 31, 1991.

August 1987, the authorities suspended debt service to official creditors and principal payments to commercial bank creditors, pending agreements on their rescheduling.

Beginning in July 1987, the authorities took a number of measures to arrest the deterioration in the fiscal position and to stabilize the economic situation. A number of new revenue measures were implemented. The expenditure control system was considerably strengthened through the introduction of regular meetings of all ministerial finance control officers, and the centralization of all ministerial accounts in the Reserve Bank. The price of petroleum products was increased, and interest rates were raised. These measures had the effect of checking the deterioration in the budgetary situation. With continued effective control of budget expenditures, the budget deficit (before grants) for 1987/88 was reduced to 10.2 percent of GDP, compared with a target of 10.7 percent of GDP and an outcome of 12.4 percent of GDP in 1986/87.

In January 1988, the authorities adopted a program that is supported by the stand-by arrangement approved by the Executive Board on March 2, 1988. The program was intended to be part of a medium-term structural adjustment effort for which Malawi is now seeking arrangements under the ESAF. In January, the authorities devalued their currency by 15 percent in foreign currency terms. In February, the authorities liberalized import payments for one fourth of imports of raw material and spare parts. In April, the authorities introduced the 1988/89 budget, which provides for a further reduction in the fiscal deficit (before grants) to 8.1 percent of GDP, mainly through restraint on expenditures. The budget includes revenue measures to make the tax system more efficient, expand the tax base, and increase some tax rates. In April, the authorities deregulated bank deposit interest rates; as lending rates had already been deregulated in 1987, all interest rates are now freely determined by banks in the light of financial conditions. Through a reduction in the average effective producer price of groundnuts, and administrative improvements in ADMARC as well as similar actions in other parastatals, the authorities have already implemented measures to improve parastatal financial performance in 1988/89. In January 1988, the authorities eliminated all trade-related arrears, ahead of the programmed timetable.

The sizable inflows of external assistance expected in 1988/89 will for the most part be channeled to the private sector, to revive activity (which was stagnant in 1987/88), increase capacity utilization, promote diversification (including expansion of irrigated acreage, which will permit a broader export crop mix), and replenish stocks which had fallen to very low levels in 1987. The domestic counterpart of these inflows will be a substitute for, and not an addition to, normal financing of the budget deficit. As a result, the Government's net debit position with domestic banks is programmed to fall in 1988/89. In April, the authorities reached agreement with the Paris Club and with the Steering Committee of the London Club on the rescheduling of debt; the terms were consistent with staff projections. The authorities will need to eliminate the existing arrears on debt service payments by end-December 1988 by completing the pending bilateral rescheduling agreements with Paris Club and London Club creditors. 1/

For the three-year structural adjustment program, the Government's objectives are to increase the growth rate, reduce inflation, and improve the external and internal financial balances. Specific areas of structural adjustment include: fiscal reform, which entails a restructuring of the revenue and expenditure system while reducing the budget deficit to a level that can be sustainably financed by autonomous levels of concessional assistance; import liberalization, which will involve the complete elimination by March 1990 of all controls on the approval and availability of foreign exchange for import payments; financial sector reform, including the introduction of an enhanced system of monetary and credit control by end-1988; agricultural sector reform, which will emphasize continued reform of ADMARC to make the institution financially self-sufficient and limit its purpose to a well-defined role in agricultural marketing; and improvements of external transportation routes to offset the effect of the closure of the traditional routes through Mozambique.

The staff considers that the measures that the authorities have implemented since July 1987 deserve commendation and that Malawi's medium-term program is worthy of the support of the Fund under the ESAF. Malawi has since independence been committed to liberal economic policies, and the program--together with the external assistance that Malawi is expected to receive during the next few years--will enable the authorities to re-establish financial balance, an economic system based on liberal policies, and opportunities for rapid economic growth. In the staff's judgment, the program has no financing gaps and will lead to a viable balance of payments position at the end of the program period. Following the liberalization of the exchange system, the external current account deficit would be declining. With the present borrowing policy to be pursued, the external debt service ratio would be decreasing noticeably. Moreover, Malawi's foreign reserve position would be improving over the medium term, to provide for an adequate coverage of imports.

Of importance in 1988/89 will be the continued application of stringent control of government expenditures. Since the scope for revenue increases is limited, there is no alternative to strict expenditure control if the fiscal situation is to improve. In this connection, the authorities have taken further steps to define expenditure priorities through a public expenditure review, now in progress, and through an examination of development expenditures which was carried out as part

1/ When approving the stand-by arrangement on March 2, 1988, the Executive Board approved the retention of the exchange restrictions arising from these arrears on debt service payments by Malawi until December 31, 1988.

of the preparation of the ten-year development perspective for 1987-96 (the Statement of Development Policies). However, should there be slippages in attaining the fiscal deficit target, the authorities should consider implementing further measures, including new revenue measures.

The rate of inflation, 14.7 percent in 1986 and 27 percent in 1987, continues to be a matter of concern. The target rate for 1988 (20 percent) is still high by historical standards. If the rate is to be reduced to 5 percent by the end of the program period, monetary policy will need to be restrained on a continuing basis. For 1988/89, the programmed rate of monetary expansion is 4.3 percent. The sharp deceleration from 1987/88 (when the rate of expansion was 30.3 percent) is feasible because of the high level of excess bank liquidity at the beginning of 1988/89, and because of the programmed reduction in the Government's net debit position with the banking system. The program provides for a reasonable rate of credit increase to the private sector; it is important for credit developments to be closely monitored, especially in the context of liberalized bank rates, and for the authorities to be prepared to use monetary policy instruments, especially statutory reserve requirements, to influence interest rates and credit developments if they believe that such developments may be inconsistent with the program's monetary objectives. In this regard, it will be important for the authorities to press ahead with the introduction of an enhanced system of monetary and credit control.

Another area that will require close attention is the performance of ADMARC. The authorities should be prepared to take additional measures (including, where appropriate, further changes in buying and selling produce prices) should the plans for asset divestiture be substantially delayed. Delays in asset divestiture will affect the financial forecasts for ADMARC. Steps should also be taken to ensure that progress toward profitability in each crop account is maintained; such progress may require politically difficult decisions on increasing producer prices or domestic selling prices, depending on food output and demand.

The commitment of the authorities to liberalization of import payments is firm; by the end of July 1988, they would already have liberalized 75 percent of private sector imports of raw materials and spare parts as well as a number of intermediate finished goods. The staff welcomes the authorities' intention to liberalize import payments and the steps so far taken in this direction. The authorities should stand prepared to take appropriate actions, including further exchange rate changes if necessary, to ensure that the timetable for import liberalization is maintained.

VII. Proposed Decision

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

Review Under Stand-By Arrangement

1. Malawi has consulted with the Fund pursuant to paragraph 4 (b) of the stand-by arrangement for Malawi (EBS/88/25, Supplement 1, 2/9/88) and paragraph 24 of the letter dated February 2, 1988 from the Minister of Finance and the Governor of the Reserve Bank of Malawi, in order to review progress made under the stand-by arrangement and establish performance criteria for the remaining period of the stand-by arrangement.

2. The letter dated May 27, 1988 from the Minister of Finance and the Governor of the Reserve Bank of Malawi shall be attached to the stand-by arrangement for Malawi, and the letter dated February 2, 1988 attached to the stand-by arrangement shall be read as supplemented by the letter of May 27, 1988 and its attached memorandum on economic and financial policies.

3. Accordingly, the references in paragraphs 4(a) of the stand-by arrangement for Malawi to paragraph 24 of the letter dated February 2, 1988 relating to net domestic assets of the banking system, net claims on the Government by the banking system, net claims on statutory bodies by the banking system, the limits on new nonconcessional external loans and on the net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions, shall comprehend references to paragraphs 32 and 33 and Annex II of the

memorandum on economic and financial policies attached to the letter of May 27, 1988.

4. The Fund decides that the first review contemplated in paragraph 4(b) of the stand-by arrangement for Malawi is completed.

Lilongwe, May 27, 1988

Mr. Michel Camdessus
The Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

1. On behalf of the Government of the Republic of Malawi, we are pleased to transmit herewith a Policy Framework Paper prepared in close collaboration with the staffs of the International Monetary Fund and the World Bank, setting forth the Government's basic economic and financial objectives for the period 1988/89-1990/91, and the macroeconomic and structural adjustment policies designed to achieve them. We are forwarding today the same paper to the President of the World Bank.

2. To facilitate a wider distribution of the Policy Framework Paper within the donor community, the Government of the Republic of Malawi authorizes you, at your discretion, to transmit the document to any international organization providing assistance to developing countries that requests it, for the exclusive use of that organization.

3. The Memorandum on Economic and Financial Policies accompanying this letter, which is consistent with the Policy Framework Paper mentioned in Paragraph 1 above, describes the structural adjustment program that the Government of the Republic of Malawi intends to pursue during the period from April 1, 1988 to March 31, 1991. It also describes in detail the objectives, policies, and measures for the first year of this period. In support of this program, Malawi hereby requests a three-year structural adjustment arrangement from the International Monetary Fund under the enhanced structural adjustment facility in an amount equivalent to SDR 55.8 million, or 150 percent of Malawi's quota, and the first annual arrangement thereunder. In view of our resource needs, we have also continued to seek and have received assurances of continued financial assistance from other major multilateral and bilateral creditors.

4. In our letter to you of February 2, 1988, we described the economic policies being pursued by the Government that should make it possible to achieve the objectives of the adjustment program, covering the period January 1, 1988 to March 31, 1989, supported by the 15-month stand-by arrangement approved by the Fund's Executive Board on March 2, 1988. The final 12-month period of the program supported by the stand-by arrangement coincides with the first year of the three-year structural adjustment program referred to in Paragraph 3 above. In the context of

our discussions with the Fund staff on the formulation of the structural adjustment program, a review of the program supported by the stand-by arrangement indicates that the program is on track. The performance criteria for end-March 1988 have all been met, the principal measures envisaged in the program have been implemented, and developments are satisfactory with respect to critical policy areas that were to be focused on during the first review of the arrangement, namely, the 1988/89 budget of the Central Government and of ADMARC; exchange rate policy; interest rate policy; further import liberalization; developments with respect to Malawi's request for debt rescheduling; developments with regard to domestic food supplies; and policies with respect to the fertilizer subsidy. At the same time, performance criteria were established for end-September and end-December 1988 and for end-March 1989.

5. The Government believes that the measures described in the attached Memorandum on Economic and Financial Policies are adequate to achieve the objectives of the program, but it will take any further measures that may become appropriate. The Government will consult with the Fund on the adoption of such measures as may be appropriate in accordance with the policies of the Fund on such consultations. In particular, the Government will reach detailed understandings with the Fund on any further measures that may be needed, including the establishment of suitable performance criteria in the context of the second review of the stand-by arrangement to be completed by end-December 1988, and in the context of the semi-annual reviews of the three-year structural adjustment program as set forth in the attached Memorandum on Economic and Financial Policies.

Yours sincerely,

/s/

S. Chimwemwe Hara
Governor
Reserve Bank of Malawi

L.J. Chimango, M.P.
Minister of Finance
Government of Malawi

Memorandum on Economic and Financial Policies
of the Government of the Republic of Malawi
for the Period April 1, 1988-March 31, 1991

1. Following a lengthy period of very favorable growth, Malawi's economic performance has progressively deteriorated since 1984, and substantial imbalances emerged, particularly in the external sector. These imbalances reflected persistent adverse external factors, mainly on account of prolonged regional political instability leading to the closure of our traditional transportation routes and adverse terms of trade, exacerbated by excess domestic demand pressures stemming largely from budgetary deficits of the Central Government and major statutory bodies. The deteriorating external outlook led, in 1986, to increasing delays in the externalization of current payments by the Reserve Bank of Malawi and the emergence of import payments arrears. Subsequently, administrative controls were introduced on the level and composition of Reserve Bank prior approvals of foreign exchange for private sector imports, in contrast to our traditional reliance on liberal market-oriented economic policies. During 1987 economic circumstances continued to be difficult, with our traditional transportation routes remaining closed. In the latter part of the year, budgetary and external pressures were exacerbated by a large inflow of displaced persons from a neighboring country combined with the emergence of a serious food shortage. During the year a number of actions were taken, in consultation with the staffs of the Fund and the World Bank, to address the deterioration in our domestic and external financial position. These actions included a number of measures to reduce the government budget deficit and to improve control over government expenditure, a depreciation of the exchange rate, a tightening of credit policy combined with an increase in interest rates, and actions to improve the performance of the parastatal sector, particularly the Agricultural Development and Marketing Corporation (ADMARC). Toward the end of the year, the Government adopted a comprehensive adjustment program covering the 15-month period January 1, 1988-March 31, 1989.

2. Our letter to you of February 2, 1988 detailed our economic adjustment program, in support of which we requested from the Fund a 15-month stand-by arrangement in the amount equivalent to SDR 13.02 million, or 35 percent of Malawi's quota. Our request was approved by the Fund's Executive Board on March 2, 1988. In introducing this program, supported by the stand-by arrangement, it was recognized that the adjustment effort would need to be continued over the medium term and that Malawi would be submitting to the Fund a request for a three-year structural adjustment arrangement under the enhanced structural adjustment facility (ESAF) and the first annual arrangement thereunder. The 15-month stand-by program should therefore be viewed as an initial stage toward achieving our medium-term objectives.

3. Since the introduction of the 15-month program supported by the stand-by arrangement, developments have been broadly as envisaged and

all of the program's end-March performance criteria have been observed. Revised estimates indicate that the performance of the real economy in 1987 was slightly better than previously estimated, with the decline in output being limited to 0.2 percent and the increase in prices (as measured by the GDP deflator) to 25.4 percent; by comparison the program envisaged a decline in output of 0.4 percent and an increase in prices of 26.2 percent. With respect to the external sector, revised information available on the balance of payments outturn for 1987 indicates that the current account deficit (excluding official transfers but including emergency food grants) amounted to SDR 41.4 million (4.1 percent of GDP) compared with a deficit of SDR 37 million envisaged in the program. This reflected lower export receipts on account of a lower-than-anticipated volume of tobacco exports that were partly offset by higher receipts from nonfactor services. Capital inflows were slightly lower than envisaged and the overall balance of payments registered a surplus of SDR 44 million, compared with SDR 51.9 million previously estimated. The program provided for a reduction in import-related arrears from SDR 17.6 million at end-December 1987 to SDR 5 million by end-March 1988. However, in view of the importance we attach to restoring international confidence in Malawi and re-establishing normal commercial relations with our trading partners, these payment arrears were fully eliminated in January 1988.

4. The outturn in the central government budget was somewhat more favorable than anticipated, with the deficit (before grants) for 1987/88 (April-March) amounting to MK 310 million (10.2 percent of GDP), compared with MK 323 million (10.6 percent of GDP) envisaged in the program. Revenues were MK 575 million, MK 31 million above the program estimate, owing to larger collections of company income tax arrears and higher nontax revenues under Treasury fund receipts and fees and reimbursements of loans. Total expenditures were MK 884 million, MK 23 million above the program target. This overrun was because interest payments were MK 16 million above the program estimate, and extrabudgetary outlays for emergency food procurement were MK 12 million higher-than-anticipated on account of a slower-than-expected pace of donor reimbursement for these purchases. Recurrent outlays, excluding interest payments, were virtually as programmed, reflecting the impact of measures to improve expenditure monitoring and control introduced during the year, while development expenditure was MK 6 million below the program estimate. A shortfall in foreign grants, again due to slower-than-anticipated disbursements from donors, was compensated by higher domestic nonbank borrowing, so that the program's performance criterion on net claims on Government by the banking system was observed.

5. With respect to monetary and credit developments, the performance criteria on net domestic assets of the banking system and on net claims on statutory bodies by the banking system were observed. However, credit to the private sector stagnated, remaining below levels of the previous year, and consequently commercial bank liquidity remained very high. Banks continued not to accept deposits of more than six months'

maturity and maintained the bulk of their reserves with the Reserve Bank at an interest rate of 1 point below bank rate, or 13 percent compared with the regulated minimum rate paid on savings deposits of 13.75 percent. These interest payments to the commercial banks placed the Reserve Bank in a loss-making position. In response to this deterioration in its own finances, effective February 15, 1988, the Reserve Bank limited the amount of commercial bank reserves on which it pays interest to 30 percent of such deposits. In response to the Reserve Bank's action, commercial banks were not accepting any additional time and fixed deposits to reduce their own payments to depositors and thus prevent the incurrence of losses.

6. The 1987/88 financial performance of the statutory bodies was somewhat below expectations although still representing a major improvement over the preceding year. The ten major parastatals showed a combined loss of MK 6.3 million as against a profit of MK 3.2 million anticipated in the program. This compares with a loss of MK 11.3 million experienced in 1986/87. Excluding ADMARC, the combined profit position was MK 3.1 million in 1987/88 compared with MK 7.8 million envisaged under the program and a loss of MK 0.7 million in 1986/87. Thus, while much of the worse-than-anticipated performance by the major parastatals was due to ADMARC, Malawi Railways' and Wood Industries' profits were also below projections by MK 2.8 million and MK 1.2 million, respectively. For Malawi Railways this was because of unanticipated costs associated with the Nacala line, flood damage to boats used on the Lake Service, and higher-than-anticipated costs that were due partly to the devaluation, and for Wood Industries this was the result of plant closures on account of input shortages. For ADMARC, a net operating loss on crop trading accounts of MK 1.6 million was recorded for 1987/88 as against an anticipated profit of MK 2.5 million, although again this represented a sharp improvement over the loss of MK 16.6 million experienced in the previous year. The deterioration reflected mainly overruns on direct and selling expenses, attributable largely to a higher quantity of purchases and sales not matched by an increase in gross trading margins, as well as to overruns on administrative overhead costs, reflecting unbudgeted termination payments to employees being retrenched and the impact of the exchange rate depreciation in January 1988. The lower-than-expected performance on the crop trading accounts, combined with overruns on projects to be divested, led to a net loss after depreciation and interest of MK 9.4 million, as against an anticipated loss of MK 4.6 million, and a loss of MK 10.6 million experienced in the previous year. In addition, there was a sharp rise in receivables, largely because of the cost of transactions for emergency food imports, which will be recouped from the Government during 1988/89; this reimbursement is included in the program's expenditure limits for 1988/89. These led to an increase in ADMARC's commercial bank overdraft to about MK 22 million by year-end, as against a programmed level of MK 10 million. A number of actions are being taken to redress this deterioration in ADMARC's financial performance, and to ensure that the program's targets and objectives for statutory bodies in 1988/89 are attained, as detailed in Paragraph 29 below.

7. As envisaged in our request for the stand-by arrangement, the Government of the Republic of Malawi has now formulated, in close consultation with the staffs of the Fund and the World Bank, a comprehensive three-year structural adjustment program covering the period from April 1, 1988 to March 31, 1991. The program aims at increasing the rate of economic growth so as to reverse the deterioration in the living standards of the population that has occurred in recent years, and eventually lead to a sustainable annual rate of increase in real per capita incomes. As an essential complement to our growth objectives, the program also seeks to promote balance of payments viability in a sustainable manner through mobilization of domestic and external resources, improvements in resource allocation, and the removal of structural impediments to improve economic performance. The structural problems facing the economy of Malawi and the policies to be followed to resolve them are described in the Policy Framework Paper accompanying this Memorandum.

8. The Policy Framework Paper presents two medium-term scenarios. The detailed policy measures and targets for the three-year program period described in this Memorandum have been formulated to be consistent with the first scenario, which is predicated on conservative assumptions regarding the availability of external resources, as well as a cautious assessment regarding improvements in other elements of the external economic environment facing Malawi. Under this first scenario the basic objectives for the three-year program period are: (i) to attain a rate of real growth of 1.5 percent of GDP for 1988 after the decline in 1987, and thereafter to achieve real growth rates of 3.0-3.5 percent per annum, rising to 4.0-5.0 percent by 1992; (ii) to reduce the annual rate of inflation as measured by the consumer price index to 20 percent in 1988, and thereafter to achieve a steady reduction to about 5 percent per annum by 1991-92; and (iii) to move steadily toward a sustainable external financial position consistent with our growth objectives while removing existing restrictions on current external payments. The second scenario is based on the possibility of additional concessional inflows. Malawi will be seeking additional external support from bilateral and multilateral donors, particularly in the context of the forthcoming Consultative Group meeting for Malawi, to enable the country to enhance the prospects for growth and diversification of the economy, and to strengthen and facilitate the implementation of the policies envisaged under the program. For 1988/89 the two scenarios are identical and contain the same policy measures and targets.

Structural Adjustment Policies for the Period April 1, 1988-March 31, 1991

9. The Government's growth strategy and the policies and measures to implement it are described in detail in the Policy Framework Paper. The strategy seeks to address key sectoral problems that are limiting growth performance, particularly in the critical agriculture, industry, trans-

port, and social services sectors. However, the major overall focus of our economic policy, upon which the restoration of Malawi's historically high rate of economic growth is based, is the restoration of the open, liberal, and market-oriented economic policies that have traditionally prevailed in Malawi, with an absence of controls and reliance on private sector production.

10. In the agricultural sector, which provides the livelihood of the majority of the population and virtually all Malawi's export earnings, our objective is to increase production and exports, while ensuring food security and raising agricultural incomes while avoiding the deterioration of natural resources. Policies will focus on releasing land from maize production through adoption of higher-yielding varieties of maize, and will include increasing smallholders' access to inputs, extension and credit services. The efficiency of the agricultural sector will also be greatly enhanced by the reform of the operating and financial policies and objectives of ADMARC, as detailed in Paragraph 15 below.

11. Appropriate producer incentives will play an important role in boosting agricultural production and encouraging diversification and an appropriate crop mix. Producer output and input prices will continue to be reviewed annually, and if necessary adjusted, on the basis of costs of production and marketing, border prices, and the level of domestic supply. For the medium term, the objective will be to move toward export parity prices while taking into account the other aforementioned factors. Prices are announced in August each year, prior to the planting season, and the staffs of the World Bank and the Fund will be consulted on the proposed prices, before they are announced, in each year of the program. Adequate availability and improved use of inputs, particularly smallholder uptake of fertilizer, is considered critical to improved agricultural performance. While the Government is committed to the eventual removal of the fertilizer subsidy, the pace of removal will take account of price and nonprice factors influencing its availability and use. The Government will reach understandings with the Fund and the World Bank by March 1989 on a program for the eventual removal of the subsidy. Meanwhile, the costs will be limited to a level consistent with the program's fiscal objectives.

12. Strategy with respect to the industrial sector will rely mainly on the private sector and will focus on an improved operating and investment environment through the reliance on market-oriented pricing and incentive policies, complemented by appropriate demand management and external policies to reduce inflation and restore private sector confidence. This strategy will be complemented by efforts to attain a more efficient use of public sector resources. Malawi already maintains an economic environment virtually free of price controls. The business environment will be spurred by: the phased removal of administrative controls on foreign exchange for private sector imports; a reform of the tax system designed to improve allocative efficiency, achieve greater equity, and encourage productive activity; and incentive measures being introduced to foster export promotion and diversification. These

policies are detailed below. In addition, the Government will simplify the rules and regulations for licensing industrial investment by June 1988, and will strengthen the recently established credit-guarantee scheme to make commercial bank credit more accessible to small-scale entrepreneurs.

13. The major structural problem facing the economy continues to be the external transportation bottlenecks resulting from the closure of our traditional rail links to ports in Mozambique. The c.i.f. margin on imports has risen to an estimated 40 percent, compared with 22 percent in the late 1970s and 35 percent in 1982. A reduction in the transportation margins for imports and exports of 1 percentage point from the present level is equivalent to an improvement of about 2 percent in the terms of trade. Investment is proceeding in the upgrading of the Northern Corridor route with the generous assistance of the Federal Republic of Germany, the Netherlands, the United Kingdom, the United States, the EEC, and the World Bank. Substantial progress has already been made, and the route is presently carrying some 5-7 percent of Malawi's total trade. Major areas of investment related to further improvement in the route involve handling facilities at lake terminals in Malawi and upgrading of roads, and the construction of cargo handling facilities for Malawi's traffic in Tanzania. By the early to mid-1990s, capacity should reach about one third of Malawi's trade at a cost saving of some 25-40 percent over the southern route. In addition, we are working with the Mozambican authorities to reopen the traditional rail link to the port of Nacala. While progress has been made, developments in this regard remain uncertain because of the security situation. Provision has been made in the budget for the special expenditures associated with this project, and progress will be evaluated on a continuing basis relative to the costs involved. The gains from reopening the Nacala route would be substantial, but in view of the uncertainties involved, a cautious approach has been adopted with respect to anticipating any returns from this project in the near future. Our overall objective with respect to improvement in external transportation is to reduce the c.i.f. margin to 38.5 percent in 1991, 36 percent in 1992, and 35 percent in 1993. These reductions would lead to cumulative savings in external outlays of SDR 11 million in 1991, SDR 27 million in 1992, and SDR 36 million in 1993.

14. With respect to the parastatal sector, the Government's objective is to improve the economic and financial performance of the sector, so as to halt the flow of financial support from Government while enabling parastatals to fulfill their investment, output, and service functions and to contribute to the Government budget where appropriate. To this end, a number of steps were implemented in 1987/88, including a wide range of cost-cutting measures and price and tariff increases, leading to a marked improvement in financial performance. Strict financial limits consistent with the program's objectives were introduced in the formulation of the 1988/89 budgets--no transfers from the Central Government are envisaged--and the Department of Statutory Bodies (DSB) has enhanced its monitoring of the parastatals; see Paragraph 28

below. Structural measures for the three-year program period will focus on continuing the reform efforts as well as on improving the management and planning capacity of the organizations, giving them greater autonomy in decision making, and improving the monitoring, evaluation, and control functions of the DSB. Furthermore, a detailed program of measures to achieve these performance-monitoring objectives, has been developed with the support of the UNDP, and is expected to be largely implemented during 1988/89.

15. The Government's major concern regarding the parastatal sector is the continuing reform of ADMARC. A large number of structural and cost-cutting measures have already been implemented, including the rationalization of marketing infrastructure and the encouragement of private sector participation in marketing smallholder agricultural produce, reduced staffing levels, management reform, and asset restructuring and divestment. A number of further policies and actions have already been implemented, as detailed in Paragraph 28 below, to ensure that the substantial improvement in financial performance already targeted for 1988/89 is achieved. The focus of continued medium-term structural adjustment policies will be to complement and ensure the sustainability of ADMARC's improved financial performance, by defining its role in market stabilization and the incentive structure and development of the agricultural sector. During 1988/89 a study will be undertaken with the support of the World Bank, to identify the financial costs of the marketing and developmental functions ADMARC currently undertakes and of market stabilization. The aim of the study, to be completed by March 1989, will be to assist in: (i) delineating the role that ADMARC can carry out consistent with attaining financial viability on the basis of its marketing operations by 1990/91, with no need for recourse to budgetary transfers; and (ii) defining measures to be taken to enable ADMARC to undertake this role. The study will also review ADMARC's long-term financial position in the light of existing short-term policies of asset divestiture, increased private sector participation, and improved management and financial control, in relation to the Government's objective of making ADMARC a self-financing institution with no recourse to budgetary transfers. ADMARC's financial position will be a significant factor in the annual reviews of agricultural prices noted above.

16. The program's structural adjustment objectives and policies will be supported by appropriate demand management policies for 1988/89 and for the medium term. Thus fiscal, monetary, and external policies will focus on restraining aggregate demand to a level consistent with the program's objective of sustainable growth and of reducing inflation in line with the targets outlined above. The program also contains a number of structurally oriented measures in the fiscal and external areas. As these measures are being substantially introduced during 1988/89, they are described under the program for the first annual arrangement under the ESAF.

The Program for April 1, 1988-March 31, 1989

17. The Malawi Kwacha was devalued by about 20 percent in 1986 and again by 20 percent in February 1987. On January 16, 1988 the Kwacha was further devalued, by 15 percent in foreign currency terms against its currency basket. The Government intends to continue to pursue an appropriate exchange rate policy throughout the program period so as to maintain external competitiveness, support the liberalization of the import approval system, and reinforce the balance between the supply of and demand for foreign exchange so as to achieve an adequate level of official reserves, while taking care to avoid undue exacerbation of the inflationary pressures in the economy. With a view to achieving the above objective for official reserves, the following indicative levels for the net foreign liabilities of the monetary authorities have been established for policy evaluation purposes: SDR 81 million at end-June 1988, SDR 62 million at end-September 1988, SDR 73 million at end-December 1988, and SDR 77 million at end-March 1989.

18. The Government is committed to liberalizing progressively the existing restrictions on the approval of foreign exchange applications for private sector imports, as a key element in its policy of restoring a liberal market-oriented economic system with emphasis on an appropriate incentive structure for private sector production. There are no import quotas in Malawi, and most imports are subject to an open general license system. The liberalization will therefore focus on lifting controls on the prior approval of foreign exchange for current payments. A first stage in this liberalization program has already been introduced, effective February 1, 1988, when controls consisting of prior approvals of foreign exchange applications were removed for goods amounting to about one fourth of total imports of spare parts and raw materials (other than petroleum). A second stage is to be introduced no later than end-July 1988, with liberalization extended to a further 50 percent of spare parts and raw materials imports as well as some intermediate finished goods. The pace and scope of further liberalization will be reviewed periodically with the aim of complete liberalization, by the end of the second year of the program, in March 1990.

19. The program will aim at enhancing the competitiveness of Malawi's existing exports and developing new areas of nontraditional exports. Most exports are marketed directly by producers who therefore benefit directly from any increase in export unit values. For those commodities exported by ADMARC, increases in export unit values, measured in domestic currency, will also be passed on to producers. In addition, an export promotion program is being introduced with several elements. Improved incentives are being granted through the tax system; duty drawback procedures are being simplified and streamlined so that exporters are promptly reimbursed for duties paid on imported inputs; and an income tax allowance is being introduced to allow companies to reduce taxable income generated through export activities. These measures have already been announced in the 1988/89 budget. An export

revolving fund is being created, supported by the World Bank, for exporters' requirements of imported inputs. This action is intended as an interim measure and will be eliminated by the time of the completion of the import liberalization program in March 1990. Also, the Malawi Export Promotion Council is to be strengthened to enable it to carry out more effectively its general export promotion activities, including assisting exporters in product development, marketing and distribution, and quality control. Lastly, export licensing requirements, which apply to only 22 goods largely of agricultural origin and are in the interests of food security and environmental protection, are to be reduced beginning in June 1988.

20. In 1988, export receipts are expected to fall because of a projected 5.1 percent decline in volume (largely as a result of the adverse effects of delayed rainfall on tobacco output). However, consistent with the import liberalization program, the volume of merchandise imports (f.o.b.) is projected to grow by about 5 percent and significant increases in payments for services and invisibles are forecast. As a result, the current account deficit (excluding official transfers) is expected to widen to SDR 75 million (7.3 percent of GDP), compared with SDR 41 million (4.1 percent of GDP) in 1987. Net long-term capital inflows are anticipated to reach SDR 78 million, SDR 48 million of which will be disbursements under World Bank adjustment lending programs, including SDR 28 million of projected disbursements from IDA and bilateral donors under a World Bank Industry and Trade Policy Adjustment Credit (ITPAC) expected to be approved by the Bank Board in June 1988. Owing to the relatively high level of capital inflows, an overall balance of payments surplus of SDR 6 million is projected for 1988. This--together with the purchase of SDR 9.25 million already made under the stand-by arrangement, disbursements under the proposed ESAF amounting to SDR 18.6 million, an estimated debt relief of SDR 40 million, and taking into account repurchases to the Fund of SDR 19.5 million and other liabilities amounting to SDR 36.6 million--is expected to enable the authorities to increase gross reserves from SDR 34 million (equivalent to 8 weeks of imports) in 1987 to SDR 52 million (equivalent to 11 weeks of imports) by end-1988. Arrears on debt service to Paris and London Club creditors were eliminated in the context of rescheduling agreements concluded in April 1988. All payments falling due according to the terms of the rescheduling agreements will be settled promptly. As noted above, other external arrears were eliminated in advance of the June 1988 schedule included in the stand-by program. No new arrears will be allowed to arise during the program period.

21. Medium-term projections indicate that the current account deficit will widen to 7.5 percent of GDP in 1990 before declining steadily to 4.0 percent of GDP in 1993. Export volumes are assumed to respond positively, but with a lag, to improved incentives, reaching an average rate of growth of about 4 percent per year during 1991-92. Import volume is projected to grow on average by 3.8 percent per annum during 1990-93, after a strong increase of 8 percent in 1989. Despite the

relatively high rates of growth, it is only by 1990-91 that f.o.b. imports, measured in real terms, will have been restored to their levels of the early 1980s. Based on conservative assumptions regarding capital inflows, the increases in the current account deficit during 1989-90, which are consistent with the projected response to the liberalization program of the private sector's demand for imports, are expected to be covered with gross reserves increasing to the equivalent of 14 weeks of imports. After 1990, the current account deficit is projected to decline progressively, with gross reserves being maintained at 15-16 weeks of imports, and no financing gaps are expected. Our debt service ratio is projected to decline steadily, and no further need for debt relief is anticipated. However, in the event that shortfalls in balance of payments aggregates emerge, appropriate policies will be implemented, including exchange rate flexibility, to ensure that the program's overall external objectives are not jeopardized.

22. In line with our overall balance of payments objectives, the Government will pursue a cautious policy in 1988 and throughout the program period, regarding new external borrowing on nonconcessional terms contracted or guaranteed by the Government and other public sector institutions. Such borrowing will be limited to no more than SDR 20 million per annum during the program period for debt of 1-12 years' maturity, with no borrowing in the maturity range of 1-5 years. In addition, no net increase in short-term external debt with a maturity of less than one year will be incurred by the Government and other public sector institutions, except for normal trade finance. Furthermore, we recognize the expense involved in debt rescheduling and do not intend to seek any further such rescheduling from Paris or London Club creditors. As new inflows will be predominantly in the form of grants and long-term debt on highly concessional terms, the maturity and interest rate structure of our debt will improve significantly during the program period, and our debt service payments (after debt relief) will decline from 49 percent of exports of goods and nonfactor services in 1987 to 30 percent in 1991 and 26 percent in 1993.

23. The Government recognizes the critical importance of further reduction in the central government budget deficit in order to curtail demand pressures while promoting private sector activity, particularly in view of the pressing need to reduce the current high rate of inflation. For this reason, the program's medium-term policy objective in this area is that the overall budget deficit will be broadly limited to a level that can be sustained by prospective concessional foreign loans and grants. The 1988/89 budget aims to reduce the overall budget deficit (before grants) to MK 296 million, or 8.1 percent of GDP, compared with a preliminary actual outturn of 10.2 percent of GDP for 1987/88. After grants the deficit would be reduced from 7.1 percent of GDP in 1987/88 to 3.4 percent of GDP in 1988/89, a level that can be financed entirely by foreign concessional inflows; the 1988/89 budget envisages negative net domestic financing of MK 17 million. Fiscal objectives for the medium term, and their impact on the level and composition of expenditures, will need to be reviewed during the program

period in the light of likely available foreign concessional inflows, and progress toward attaining the program's overall domestic and external objectives. However, it is presently envisaged that the deficit will be further reduced to below 6 percent of GDP by 1991/92, with the deficit after grants remaining in the region of 3-4 percent of GDP. It is further envisaged that these deficits will entail no net domestic financing requirement throughout the program period.

24. Attainment of these fiscal objectives is based on a number of further actions. With respect to revenue, the Government recognizes that the tax burden on the economy has been relatively high, particularly for the modern productive sector. Thus, in 1988/89 revenue measures have been limited to increases in licensing fees, and the effects of the tax reform in broadening the tax base and improving revenue cash flow, and the revenue/GDP ratio is projected to remain at 18.9 percent of GDP. Thereafter, no further increase in revenues relative to GDP is envisaged throughout the program period. Instead, the major focus of policy with respect to revenues is the implementation of a broad-based tax reform, as described in Paragraph 27 below.

25. To attain the program's fiscal targets, the burden of adjustment will need to be placed on expenditures. For 1988/89 total outlays are budgeted to rise by only 11 percent to MK 982 million, or 27 percent of GDP compared with 29.1 percent of GDP in 1987/88. This includes an increase of only 8 percent in current expenditure, representing a significant reduction in real terms. This curtailment reflects no increase in government wage rates nor any increase in total civil service employment. It also includes all special expenditures related to regional political developments, as well as a provision of MK 5 million for net costs to the budget of emergency food imports. While further imports of up to 75,000 tons of maize may be necessary during 1988/89, virtually the entire cost is expected to be covered by donors, although some pre-financing from the budget may be necessary, as occurred during 1987/88. Development outlays are projected to increase by 30 percent to MK 270 million, or 7.4 percent of GDP, compared with 6.9 percent of GDP the previous year, and most of the outlays will continue to be financed from foreign sources. The development budget includes an amount of MK 8 million for the fertilizer subsidy, slightly above the level incurred in 1987/88. Priorities and programs for development spending have been agreed with the World Bank in the context of the Government's rolling three-year Public Sector Investment Program (PSIP). For 1988/89 this consists primarily of ongoing projects, with the exception of certain high-priority health and education projects and the Northern Corridor transport project, which as noted above is a key component of the Government's structural adjustment strategy. For future years the PSIP will be revised on the basis of anticipated resource availability and taking into account the need to attain balance of payments viability; donor financing of priority expenditures will be encouraged. The budget for development expenditure and the PSIP are consistent with the detailed statement of development policies for the decade 1987-96,

which the Government will present to bilateral and multilateral donors at the next meeting of the Consultative Group for Malawi in June 1988.

26. To maximize the benefit of budget outlays within the tight overall expenditure constraint, measures are being pursued to improve the efficiency of resource allocation and ensure that priorities are reflected in the composition of expenditure. The improvements in expenditure controls and monitoring initiated in 1987 are being rigorously pursued and supplemented. To further facilitate control of expenditure and thus effective implementation of the budget, we have established quarterly indicative targets for the Central Government's expenditures and overall budget deficit (see Annex I).

27. As noted above the Government is implementing a far-reaching reform of the tax system, as envisaged under the stand-by program. The reform aims at broadening the tax base, increasing allocative efficiency, and improving incentives for productive activities, particularly for export-promotion and import-substitution activities. The first phase of this reform has already been introduced in the 1988/89 budget. In addition to the duty drawback scheme and income tax allowance introduced for exporters noted above, the reform covers direct and indirect taxation. For direct taxation it introduces a current payments system for business income taxes, and an expensing allowance to increase and widen incentives for investment. For indirect taxation it introduces a broadening of the surtax base, a tax credit system for the surtax (to shift the burden of taxation from production to consumption), a combining into one duty schedule of the previous levies and duties on imports, a shift in the excise tariff from specific to ad valorem rates, and a shift in the tax on luxury goods from the import duty to the surtax schedule. The second phase, to take effect in the 1989/90 budget, will extend the expensing allowance from manufacturing to other businesses and will merge the ad valorem excise tax on luxuries into the surtax system. Subsequently, a further shift from import duties to domestic consumption taxation is intended in line with progress on import liberalization. In addition, in 1989/90 a tax-inclusive budget will be introduced, eliminating the inherent bias toward imports in government purchases arising from their present exemption from import duties. While the tax reform does not involve an increase in tax rates, the effect of the broadening of the tax base and cash-flow effects from the current taxation of company profits, together with the impact of higher fees for business and vehicle licenses, lead to net additional revenues for 1988/89 of about MK 30 million.

28. The importance of improved performance by the parastatal sector, and the structural policies to be pursued in this area during the three-year program period were outlined in Paragraphs 14 and 15 above. The program also includes various measures and financial targets for the first year of the program to ensure that the shortfall from anticipated financial performance experienced in 1987/88, particularly for ADMARC, is reversed. For the other parastatals the major shortfall occurred for Malawi Railways as noted above. In response, a higher-than-envisaged

tariff increase has already been approved and other marketing and budgetary actions have been taken to cut costs and raise revenue. On this basis no reduction is expected in the previously budgeted profit for 1988/89. Similarly, other major parastatals are taking actions to ensure that their projected 1988/89 results are achieved, and parastatals other than ADMARC are expected to achieve the aggregate profit performance envisaged in the stand-by program. Thus, the ten major parastatals are projected to achieve a combined profit of MK 24.8 million in 1988/89; excluding ADMARC, profits of MK 22.8 million are programmed.

29. For ADMARC, to attain the original financial targets anticipated in the stand-by program, a number of actions are being taken further to the substantial adjustment measures already introduced in 1987. Negotiations are well advanced with cotton ginning companies to reduce ADMARC's role in cotton marketing. Cotton will in the future be sold ex-depot with ADMARC no longer participating in subsequent cotton marketing operations, which in the past have fluctuated between profit and loss depending on market conditions. This change, which is intended to begin in the coming season, will eliminate grading and ginning charges and reduce cotton transport costs by 50 percent. It is planned to extend the same form of arrangements to the marketing of the rice crop, although the savings will be smaller, as rice is a less significant crop in ADMARC's overall finances. A further major change relates to groundnuts. Effective with the 1988/89 season, stricter grading practices will be introduced, which will effectively reduce the producer price by 13 percent for some 85 percent of groundnut purchases. Also, efforts are being made to speed up the pace of divestment in 1988/89. Some 12 companies and estates have been targeted, for which the sales are to be completed and the proceeds received during 1988/89. Potential buyers have been identified for several of these companies, although it is recognized that actual receipts will be sensitive to sales terms and the course of negotiations. In addition, some further actions are being taken to rationalize and reduce direct selling and administrative costs and to unwind some debtor positions to improve ADMARC's 1988/89 cash flow and thereby contain interest rate charges. ADMARC's net operating profit on crop trading accounts is targeted at MK 6 million for 1988/89, as against a profit of MK 4.4 million anticipated in the program and a loss of MK 1.6 million for 1987/88. In addition, the net profit/loss after interest and depreciation is targeted at a profit of MK 2 million as against a loss of MK 2.3 million anticipated in the program, and a loss of MK 9.4 million in 1987/88. Also, the end-of-period commercial bank overdraft is targeted to be MK 7 million, the same level as was anticipated in the program, and compared with MK 22 million at the end of the previous year. This targeted improvement in cash flow is sensitive to the pace of receipts from divestment.

30. The program's monetary targets and policies are consistent with the program's overall objectives. Net domestic assets of the banking system are projected to decline by 6.3 percent during 1988/89 and the increase in domestic credit is projected to be 6.2 percent with a reduction in

credit to Government, in accordance with the program's fiscal policy as detailed above. An increase in credit to statutory bodies of MK 20 million is anticipated, reflecting primarily a rundown of the Fertilizer Revolving Fund's deposits to purchase fertilizer. Credit to the private sector is programmed to rise by 17.4 percent. Taking account of the projected balance of payments surplus the program provides for growth in the money supply of 4.2 percent, which is consistent with the program's objective of reducing the rate of inflation and which is considered adequate in light of the high level of excess liquidity at the beginning of the year. In the medium term the policy of reducing inflation will require that the rate of monetary expansion continue to be contained. The quarterly targets on the net domestic assets of the banking system, on net credit to Government, and on net credit to statutory bodies, as listed in Annex II, will continue to constitute performance criteria under the stand-by arrangement. The targets on net domestic assets and on net credit to Government would be automatically adjusted downward should specified external cash loans and grants exceed programmed amounts, or should there be a shortfall in government payments into the blocked account for debt service at the Reserve Bank.

31. With regard to interest rates, as noted above, the level of private sector demand for credit has remained low and commercial banks continue to have substantial excess liquidity, mainly held on deposit with the Reserve Bank. In view of these imbalances in the credit markets, effective April 11, 1988 the Reserve Bank removed all remaining controls on the interest rate structure of commercial banks to facilitate the establishment of a market-clearing level of interest rates. The Reserve Bank will carefully monitor developments with a view to ensuring that interest rates rise toward positive levels in real terms, as soon as the demand for private sector credit picks up, which is expected to occur in line with the import liberalization program. With the assistance of the Fund's Central Banking Department, the Reserve Bank will undertake a study of its monetary policy instruments, to be completed by September 1988, with a view to introducing a system of monetary and credit control more appropriate to an environment of deregulated interest rates. This new system will be introduced as soon as possible; in the interim, existing instruments will be administered to ensure attainment of the program's objectives. Implementation of the new system will be reviewed at the time of the second review under the stand-by arrangement, and mid-year review under the ESAF, and is also a structural benchmark under the ESAF.

32. As indicated above and shown in detail in Annex II the following quantitative performance criteria will apply for the stand-by arrangement for end-September and end-December 1988 and for end-March 1989: (a) limits on the net domestic assets of the banking system; (b) limits on net claims on Government by the banking system; (c) limits on net claims on statutory bodies by the banking system; (d) limits on new nonconcessional external loans contracted or guaranteed by the Government and other public sector institutions; and (e) limits on the net increase in short-term external debt of less than one-year maturity

contracted or guaranteed by the Government and other public sector institutions. There will also be a second review with the Fund to be completed by end-December 1988, which shall also constitute a performance criterion. In addition, the stand-by arrangement will include the standard performance criterion regarding the exchange and payments system.

33. For the first annual arrangement under the ESAF, quantitative performance criteria established under the stand-by arrangement for end-September 1988 shall serve as performance criteria. A midterm review with the Fund, to be completed by end-December 1988, as well as the usual clause regarding the exchange and payments system, shall also constitute performance criteria under the first annual arrangement. Quantitative benchmarks have been established for end-March 1989, the end of the first annual program under the ESAF. In addition, ADMARC's net profit after interest and depreciation for 1988/89 shall constitute a quantitative benchmark under the first annual arrangement. Performance criteria and quantitative benchmarks are set forth in Annex III. Implementation of the second stage of import liberalization, the review of producer prices for agricultural output, completion of the study of ADMARC's functions and their costs by March 1989, and the introduction of a new system of monetary and credit control by December 1988, will constitute structural benchmarks under the first annual arrangement. The second review under the stand-by arrangement, and the mid-year review under the ESAF will focus on: exchange rate policy, taking into account developments regarding the net foreign liabilities of the monetary authorities compared with the indicative targets set out in Paragraph 17; monetary and credit control; import liberalization; progress in the study of ADMARC's functions and their costs; the timetable for the elimination of the fertilizer subsidy; and developments with respect to prospective external inflows. For the purpose of monitoring performance under the program, the definitions of the terms referred to in this memorandum will be as set forth in the technical memorandum prepared jointly with the Fund staff.

Table 1. Malawi: Indicative Targets for the Central Government's Expenditures and Overall Budget Deficit

(In millions of Malawi kwacha)

	Wage bill	Other current 1/ expenditure	Total 2/ expenditure	Overall 3/ deficit
April 1-June 30, 1988	41.3	117.1	212.3	-78.0
April 1-September 30, 1988	82.6	211.3	437.8	-141.6
April 1-December 31, 1988	123.9	296.6	712.4	-236.6
April 1, 1988-March 31, 1989	165.2	368.0	981.5	-295.6

1/ Excluding debt service payments and including special expenditures.
2/ Including interest payments, and extrabudgetary expenditures.
3/ Before grants, defined from the financing side.

Table 1. Malawi: Quantitative Performance Criteria for the Stand-by Arrangement, 1988/89

	1988					1989
	March Program	March Actual	June	Sept.	Dec.	March
	(In millions of Malawi kwacha)					
Net domestic assets of the banking system	632.5	584.9	692.7	624.5	589.8	548.3
Net claims on the Government by the banking system 1/	508.9	477.6	528.3	468.1	479.5	461.7
Net claims on the Statutory Bodies by the banking system	40.8	23.7	61.1	84.9	69.1	43.7
	(In millions of SDRs; end of period)					
External payments arrears	5.0 2/	— 2/	—	—	—	—
New nonconcessional loans contracted or guaranteed by the Government and other public sector institutions (cumulative) of 1-12 years' maturity 3/	20.0	—	20.0	20.0	20.0	20.0
Of which: 1-5 years	(—)	(—)	(—)	(—)	(—)	(—)
Net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions of less than one year maturity 4/	—	—	—	—	—	—

1/ These levels would be adjusted downward by any shortfall in payments into the Reserve Bank blocked account for Government debt service payments; and by the amount that disbursements of specified external cash loans and grants exceed MK 67.7 million during December 31, 1987-June 30, 1988, MK 115.2 million during December 31, 1987-September 30, 1988, MK 164.2 million during December 31, 1987-December 31, 1988, and MK 214.6 million during December 31, 1987-March 31, 1989.

2/ Excludes arrears on debt service for which a request had been made to Paris and London Club creditors for rescheduling. These debt service arrears were eliminated under the program by end-May 1988, through cash paymnets or through rescheduling.

3/ Excludes any debts related to debt rescheduling with Paris and London Club creditors.

4/ Excludes short-term trade finance.

Table 1. Malawi: Quantitative Performance Criteria and Benchmarks Under the Enhanced Structural Adjustment Facility

	1988 March (base data)	1988 June Benchmarks	1988 September Performance criteria	1988 December Benchmarks	1989 March Benchmarks
	(In millions of Malawi kwacha)				
Performance criteria and quantitative benchmarks					
Net domestic assets of the banking system	584.9	692.7	624.5	589.8	548.3
Net claims on the Government by the banking system 1/	477.6	528.3	468.1	479.5	461.7
Net claims on the Statutory Bodies by the banking system	23.7	61.1	84.9	69.1	43.7
	(In millions of SDRs; end of period)				
External payments arrears 2/	—	—	—	—	—
New nonconcessional loans contracted or guaranteed by the Government and other public sector institutions (cumulative) of 1-12 years' maturity 3/	...	20.0	20.0	20.0	20.0
Of which: 1-5 years	(...)	(—)	(—)	(—)	(—)
Net increase in short-term external debt contracted or guaranteed by the Government and other public sector institutions of less than one year maturity 4/	...	—	—	—	—
	(In millions of Malawi kwacha)				
Quantative benchmarks					
ADMARC's net profit after depreciation and interest	-2.3	...	...	...	2.0

1/ These levels would be adjusted downward by any shortfall in payments into the Reserve Bank blocked account for Government debt service payments; and by the amount that disbursements of specified external cash loans and grants exceed MK 67.7 million during December 31, 1987-June 30, 1988, MK 115.2 million during December 31, 1987-September 30, 1988, MK 164.2 million during December 31, 1987-December 31, 1988, and MK 214.6 million during December 31, 1987-March 31, 1989.

2/ Excludes arrears on debt service for which a request had been made to Paris and London Club creditors for rescheduling. These debt service arrears were eliminated under the program by end-May 1988, through cash paymnets or through rescheduling.

3/ Excludes any debts related to debt rescheduling with Paris and London Club creditors.

4/ Excludes short-term trade finance.

MALAWI - Relations with the Fund
(At April 30, 1988)

(Amounts in millions of SDRs, unless otherwise specified)

I. Membership status

a. Date of membership: July 19, 1965
b. Status: Article XIV

A. Financial Relations

II. General Department

a. Quota: 37.2

	Millions of SDRs	Percent of quota
b. Total Fund holdings of Malawi kwacha	115.90	311.57
c. Fund credit	80.90	217.48
Credit tranches (SBA)	9.25	24.87
Compensatory Financing Facility	10.35	27.82
Extended Fund Facility	17.81	47.88
Supplementary financing under SBA	1.72	4.62
Enlarged access	41.78	112.30
Under EFF	(36.75)	(98.78)
Under SBA	(5.03)	(13.52)
d. Reserve tranche	2.20	5.92

III. Current and previous arrangements and special facilities

	Date of arrangement	Duration (months)	Total amount	Utilization
a. Current arrangements				
Stand-by	Mar. 2, 1988	15	13.02	9.25
b. Previous arrangments				
Stand-by	Oct. 1979	30 1/	26.3	5.5
Stand-by	May 1980	24	49.9	40.0
Stand-by	August 1982	12	22.0	22.0
Extended arrangement	Sept. 1983	36	81.0 2/	57.0

1/ Arrangement canceled after seven months.
2/ Reduced from the original amount of SDR 100 million (EBM/85/77, 5/22/85).

MALAWI - Relations with the Fund (continued)

	Date of purchase	Total amount
c. Special facilities		
Compensatory financing (exports)	Aug. 1979	9.5
Compensatory financing (exports)	Nov. 1979	8.0
	Dec. 1979	1.5
Compensatory financing (cereals)	Sept. 1981	12.0
Buffer stock financing	Dec. 1982	0.9
Compensatory financing (exports)	Mar. 1983	12.2
Compensatory financing (exports)	Aug. 1984	13.8

	Amount	Percent of allocation
IV. SDR Department		
a. Net cumulative allocation	10.98	100.0
b. Holdings	0.73	--

	Amount
V. Administered accounts	
a. Trust Fund loans	
(i) Disbursed	14.66
(ii) Outstanding	3.85
b. SFF Subsidy Account	
(i) Donation	--
(ii) Loans	--
(iii) Payments by Fund	4.09

VI. Financial obligations due to the Fund

	Overdue Financial Obligations (4/30/88)	Principal and Interest Due 1988	1989	1990	1991
Principal	--	15.5	20.7	14.3	15.3
Repurchases	--	13.8	19.0	13.8	15.2
Trust Fund Repayments	--	1.7	1.7	0.5	0.1
Charges and interest including SDR and TF (provisional)	--	3.9	5.2	3.9	2.9
Total	--	19.4	25.9	18.2	18.2

MALAWI - Relations with the Fund (continued)

B. Nonfinancial Relations

VII. Exchange rate arrangement

The Malawi kwacha is pegged to an unannounced basket of currencies. The intervention currency is the U.S. dollar, for which the Reserve Bank of Malawi's rates are based on the U.S. dollar/SDR rate calculated by the Fund for the preceding day. The rate on April 30, 1988, was MK 1 = US$0.4037.

VIII. Last Article IV Consultation

The last Article IV consultation discussions were conducted during November 12-28, 1987. The staff report for the 1987 Article IV consultation (EBS/88/25) was discussed by the Executive Board on March 2, 1988, and the following decision was adopted:

1. The Fund takes this decision relating to Malawi's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1987 Article XIV consultation with Malawi, in the light of the Article IV consultation with Malawi conducted under Decision No. 5392-(77/63), adopted April 29, 1977 as amended (Surveillance over Exchange Rate Policies).

2. Malawi maintains the restrictive exchange measures described in SM/88/41 and Correction 1, in accordance with Article XIV, Section 2, except that the exchange restrictions evidenced by external payments arrears on commercial payments are subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to take measures to eliminate these arrears as soon as possible. In the meantime, the Fund approves the retention by Malawi of these restrictions, until the earlier of June 30, 1988 or the completion of the first review under the stand-by arrangement, and of any restrictions remaining pending the implementation of bilateral agreements under the Paris and London Clubs' rescheduling or refinancing of Malawi's external debt until December 31, 1988.

Malawi is on the standard 12-month Article IV consultation cycle.

IX. Technical Assistance, 1983-86

1. CBD
    a. Training Advisor to the Reserve Bank of Malawi, 1982-84.

MALAWI - Relations with the Fund (concluded)

b. Consultant on external debt, three weeks in March-April 1984.

c. Consultant on the computerization of Reserve Bank operations: approximately six months from March 1985.

d. Administrative Advisor to the Reserve Bank; 12 months from June 1986.

e. Advisor on Bank Supervision to the Reserve Bank; 12 months from June 1988.

f. Foreign Exchange Advisor to the Reserve Bank; 12 months from June 1988.

2. FAD: Budget Advisor to the Ministry of Finance, July 1985-July 1986.

3. STAT: Technical assistance in the area of money and banking statistics, November 23-December 8, 1983.

Technical assistance in the area of general economic data, October 13-24, 1986.

X. Resident Representative/Advisor

None.

MALAWI - Relations with the World Bank Group

Over the past 21 years, Malawi has received 38 IDA credits and one Special Fund credit, totaling about US$549 million, and 10 Bank loans totaling US$124 million, of which 2 were on third-window terms. Malawi has also received two African Facility Credits totaling US$50.0 million equivalent. Of Bank Group assistance, some US$182 million (25 percent) was for agriculture, US$135 million (19 percent) for education, US$114 million (16 percent) for roads, US$178 million (25 percent) for structural adjustment, US$39 million (5 percent) for power, US$31 million (4 percent) for water, US$18 million (2 percent) for health, and the balance of US$28 million (5 percent) for development finance, technical assistance, and urban housing.

For fiscal year 1987, the following credits were approved: a US$20.0 million equivalent for the Second Lilongwe Water Supply Project, a First Education Sector Credit ($27.0 million), a Second Family Health/Population Project ($11.0 million), a smallholder Agricultural Credit Project ($5.9 million), and a US$10.0 million SAL III supplemental credit from the African Facility. An Industrial and Trade Policy Adjustment Credit (US$70.0 million) is to be considered by the World Bank's Board in mid-June 1988. Additional lending operations are planned in agriculture, transport, and education.

IFC's equity participations and lending commitments in Malawi total about US$27.9 million and include investments in textiles, sugar, a development finance corporation (INDEBANK), tourism, the manufacture of alcohol from molasses, and a leasing and finance company. In addition, a US$40.5 million equity subscription and US$3.2 million loan investment in the Viphya Plywoods and Allied Industries United were approved in August 1984 and August 1986.

MALAWI - Basic Data

Area, population and GDP per capita

Area	118,500 square kilometers
Population: Total (1986)	7.30 million
Growth rate	3.2 percent
GDP per capita (1986)	SDR 143

	1983	1984	1985	1986	1987 Est.
Gross domestic product (at 1978 factor cost)	(In percent of total, except where stated)				
Total (in millions of Malawi kwacha)	770.7	805.1	839.3	862.7	860.7 1/
Agriculture	37.6	38.1	36.7	36.1	36.8
Manufacturing	12.7	12.5	12.0	11.7	11.6
Government	12.0	12.6	12.7	13.5	14.0
Other	37.7	36.8	38.6	38.7	37.6
Annual real rate of growth (percentage change)	3.5	4.5	4.2	2.8	-0.2
GDP at current market prices					
Total (in millions of Malawi kwacha)	1,435.9	1,706.9	2,021.7	2,301.5	2,871.1 1/
Domestic expenditure	107.6	98.1	104.6	102.4	102.4
Private consumption	67.6	69.5	69.7	72.8	72.9
Government consumption	16.4	15.7	17.0	18.8	17.1
Gross fixed capital formation	13.7	13.0	12.8	10.6	11.6
Stockbuilding	9.1	-0.2	5.1	0.2	0.8
Imports of goods and nonfactor services	28.4	26.4	28.1	24.4	25.5
Exports of goods and nonfactor services	20.8	28.4	23.5	22.0	23.1
Central government finance 2/	(In millions of Malawi kwacha)				
Revenue	286.0	353.3	442.1	492.9	574.6
Total expenditure	432.0	503.2	643.5	797.0	884.2
Recurrent expenditure	(289.1)	(364.8)	(457.3)	(560.5)	(656.4)
Development expenditure	(142.9)	(138.4)	(160.2)	(189.8)	(208.5)
Overall deficit (excluding grants)	-146.0	-149.9	-201.5	-304.1	-309.6
Foreign grants	33.7	40.5	44.8	79.3	95.0
Overall deficit (including grants)	-112.3	-109.4	-156.7	-224.8	-214.6
Financing	112.3	109.4	156.7	224.8	214.6
Foreign (net)	95.0	53.0	51.8	115.0	97.6 3/
Domestic (net)	17.3	56.4	104.9	109.8	117.0
Of which: banking system	(6.1)	(10.0)	(72.4)	(60.9)	(45.5)

MALAWI - Basic Data (continued)

	1983	1984	1985	1986	1987 Est.
Money and credit (end of period) 2/			(Annual percentage change)		
Net domestic assets	13.2	-0.1	18.4	5.9	-3.9
Domestic credit (net)	3.0	10.9	20.8	2.8	7.1
Government (net)	2.8	33.6 4/	24.2	16.4	10.5
Statutory bodies (net)	-78.9	382.6	78.3	-73.1	24.1
Private sector	16.9	-19.3 4/	5.7	4.2	--
Money plus quasi-money	0.6	39.6	-3.5	20.6	30.3
Prices					
GDP deflator	11.5	13.8	13.6	10.8	25.4
Urban consumer prices	12.4	12.4	14.9	14.8	26.7
Export price index 5/	-0.7	7.5	-16.8	-16.5	2.2
Import price index 5/	--	9.0	-6.4	-9.1	2.7
Terms of trade	-0.7	-1.4	-11.1	-8.2	-0.4
Balance of payments			(In millions of SDRs)		
Exports, f.o.b.	230.3	308.0	246.1	211.6	214.2
Imports, c.i.f.	-288.9	-263.3	-282.4	-218.9	-229.4
Of which: freight and insurance	(-100.9)	(-105.3)	(-113.1)	(-87.6)	(-89.6)
Trade balance	-58.7	44.7	-36.2	-7.3	-15.2
Services and private transfers (net)	-66.2	-60.9	-59.0	-57.8	-29.9
Current account balance 6/	-124.9	-16.2	-95.2	-65.0	-41.4
Capital account (including net errors and omission)	42.5	58.4	49.5	-2.0	85.4
Overall balance	-82.3	42.2	-45.7	-67.0	44.0
Gross official foreign reserves	12.8	58.0	39.8	15.7	34.4
In weeks of imports	2.3	11.5	7.3	3.7	8.0
External debt					
Disbursed and outstanding					
Including Fund credit	778.4	870.0	853.9	845.1	875.2
Excluding Fund credit	680.9	755.1	732.0	743.7	797.5
Debt service ratio 7/					
Including Fund credit	49.9	37.6	44.5	57.4	48.8
Excluding Fund credit	43.1	29.0	35.1	46.5	35.8

MALAWI - Basic Data (concluded)

Social and demographic indicators 8/

Population density (1986)	62 per square km
Population characteristics (1985)	
Life expectancy at birth	45
Infant mortality (aged under 1, percent)	156
Child death rate (aged 1-4, percent)	35
Health (1981)	
Population per physician	53,000
Population per nurse	2,980
Education (1984)	
Primary school enrollment (percent)	62
Secondary school enrollment (percent)	4

1/ A new series for real GDP has been introduced for 1987 onward. Certain wage payments to nonestablished posts (largely consultants) which had previously been omitted or classified as government consumption have been reclassified under government services. The GDP figure for 1987 is given on the basis of the old classification; the new series figure is MK 868.3 million.

2/ Fiscal year starting April 1 of year indicated.

3/ Includes MK 7.6 million of loan disbursements not yet fully recorded.

4/ Reflects the assumption by Government of the Press group's debt to the commercial banks and the reclassification of blocked government deposits. If adjusted to an equivalent basis with previous years, the change in net credit to Government and credit to the private sector was 4.5 percent and 0.7 percent, respectively.

5/ In SDR terms.

6/ Excluding official transfers.

7/ Debt service as a percentage of exports of goods and nonfactor services, before debt relief.

8/ Source: World Development Report, 1987, IBRD.

Malawi: Schedule of Purchases During Period of Stand-by Arrangement, May 1988-May 1989 1/

Amount	Schedule availability	Conditions necessary for purchase 2/
SDR 0.754 million	After May 15, 1988	Compliance with quantitative performance criteria as of March 31, 1988
SDR 0.754 million	After August 15, 1988	Compliance with quantitative performance criteria as of June 30, 1988 and completion of the first program review
SDR 0.754 million	After November 15, 1988	Compliance with quantitative performance criteria as of September 30, 1988
SDR 0.754 million	After February 15, 1989	Compliance with quantitative performance criteria as of December 31, 1988 and the completion of the second program review
SDR 0.754 million	After May 1, 1989	Compliance with quantitative performance criteria as of March 31, 1989

1/ The Malawian authorities have indicated their intention to make none of the above purchases--although Malawi has observed all the performance criteria for end-March 1988, no purchase has been made--following Executive Board approval of their request for loans under the ESAF.

2/ Other than generally applicable conditions under the arrangement and nonquantitative performance criteria (including the performance clause on the exchange and trade system).