

BUFF/ED/00/192

December 20, 2000

**Statement by Mr. Rustomjee on Malawi  
Executive Board Meeting 00/129  
December 21, 2000**

1. Let me begin by expressing the appreciation of my Malawian authorities to the Executive Board, management and staff as well as the donor community for continued support as they seek to alleviate widespread poverty in the country. The outcome of this meeting on possible assistance by the Fund under the PRGF and debt relief under the enhanced HIPC Initiative is being awaited with eagerness. The authorities are keenly aware that the program now underway provides an important reference point in their intensified efforts to address the formidable challenges that confront the economy. They wish to acknowledge the cooperation they have been receiving from management and staff in designing and formulating their program; the staff has been tireless in working to produce a set of very candid papers.

2. At the outset, the Malawian authorities wish to underscore the importance they attach to the steadfast implementation of bold policies and comprehensive economic adjustment and reform measures which will be essential in restoring macroeconomic stability, promoting efficiency and growth and reducing widespread poverty. They are hopeful that with their firm commitment to the pursuit of all the policies outlined in their Memorandum of Economic Policies and the Interim PRSP, Malawi will be able to earn the confidence of the donor community to press ahead with more aggressive poverty reduction efforts.

**Background**

3. Malawi is a small landlocked country that remains one of the poorest in the world, with very weak social indicators: a very low per capita income (\$163 in 1999), a low and declining life expectancy (42 years) and a very high infant mortality rate (134 per thousand births). Over the years, several attempts have been made to introduce economic reforms with the support of the Fund and the World Bank to promote broad-based growth. Since the 1980s progress has been made towards improving the environment for private sector investment and growth. However, the authorities are increasingly aware that the attainment of strong and sustainable growth has been elusive, reflecting the convergence of a number of adverse factors, including in particular, unfavorable weather conditions, a secular decline in the terms of trade, the high incidence of HIV/AIDs, and slippages in policy implementation.

4. In the circumstances, economic performance has been mixed and growth has been modest, leading to a low growth in per capita income. Real per capita GDP growth averaged about ½ percent between 1989 and 1999. In the last five years (1995-1999) renewed attempts were made in the context of a Fund-supported program under the Enhanced

Structural Adjustment Facility (ESAF). During this period, growth strengthened, albeit still mixed and moderate. Real GDP is expected to rise to 3.2 percent in 2000. The rate of inflation subsided substantially, although pressures intensified at mid-2000, reflecting mainly the sharp depreciation of the exchange rate and the weakening of policies. More significantly, notable steps were taken to introduce structural reforms with a view to promoting economic efficiency. In this connection, a number of public sector enterprises were brought to the point of sale at the end of 1999 in order to enhance the role of the private sector.

5. Furthermore, interest rates have been decontrolled since 1993 and the foreign exchange system has been liberalized. To improve financial intermediation, two foreign banks and a discount house have already established operations, while the government is taking steps to reduce its holding in the two major commercial banks. Following the introduction of substantial trade reforms, Malawi now maintains a very liberal trade regime, with the IMF index of restrictiveness estimated at 3 and compares favorably with other developing countries.

### **The Challenge**

6. Notwithstanding the achievements in deregulating the economy, Malawi continues to face the formidable tasks of restoring and sustaining macroeconomic stability, putting the economy on a path of higher growth as the basis for substantial and durable reduction in poverty. Some studies at the World Bank have estimated that Malawi needs to generate a minimum of a 5.3 percent real annual rate of growth in output in order to prevent the number of the poor from increasing. This is a difficult challenge to overcome particularly when the HIV/AIDs pandemic threatens to weaken the very foundations upon which further progress is predicated. It is estimated that 7 percent of the population, mainly those in the working age group, are affected and the disease will significantly lower productivity, reduce private savings and increase public spending.

7. While attempting to restore macroeconomic stability, the authorities also realize the urgent need to boost savings and investment rates, to reinforce fiscal discipline as the key to reducing monetary expansion and interest rates, to foster competition in the real sector and to reduce existing monopolies. Land reform is also considered to be a key element in poverty reduction. The enforcement of accountability and improved governance is being pursued vigorously as an important element in increasing transparency in public finances.

### **The Medium-Term Objectives and the Poverty Reduction Strategy**

8. Against the backdrop of these daunting challenges, the authorities have adopted an economic adjustment and reform program that has been cast in a medium-term framework. Real GDP growth will accelerate to about 4.5 percent, the rate of inflation will be reduced to 5 percent and international reserves will increase to 4.5 months of imports of goods and services. The number of people under the poverty line will be progressively reduced.

9. At the same time, structural reforms will be broadened and deepened : the expenditure control and monitoring system is being improved and strengthened; the medium-term expenditure framework (MTEF) will be broadened and applied to prioritize government recurrent outlays; the Malawi Revenue Authority (MRA) will be strengthened to bolster revenue collection; civil service and financial sector reforms will be continued with the prospective privatization of commercial banks and the strengthening of the regulatory framework. The strengthening of relevant democratic oversight institutions including the Anti-Corruption Bureau (ACB), the Public Accounts Committee, the Public Prosecutor's Office and the Auditor General's Office, will be pursued as crucial components of the authorities' strategy in improving accountability and governance.

10. The Interim PRSP presents a detailed analysis of poverty in Malawi and constitutes a credible road map for effective utilization of debt relief resources. The formulation of this document has not only benefited from a process of consultation with a broad cross-section of the Malawian society and donors but also from a wealth of work already completed, including the Vision 2020 whose growth scenarios were recently calibrated by the National Economic Council, the Policy Analysis Initiative spearheaded by the Office of the Vice President, the National Strategic Framework for HIV/AIDs, the Public Expenditure Review and the MTEF Review both initiated by the Ministry of Finance. The authorities have acknowledged that gaps in the document remain to be filled in order to formulate a robust PRSP. They are also expecting to take into account the comments that will be made in the Board as they articulate their document. Meanwhile, a three-pronged approach has been adopted for growth and poverty reduction, focusing on interventions in the agricultural sector that directly target the poor, restoring macroeconomic stability, as well as increasing investment in social sectors and human capital. The timetable for completion of this exercise shows that the PRSP will continue to be developed in a participatory manner, involving local and district authorities, traditional authorities, the NGOs, parliament and the donor community.

### **The Program for 2000—01**

11. The macroeconomic objectives for the near term are to achieve a growth rate of about 3.0 percent, reduce the rate of inflation to 10 percent by December 2001, bring the current account balance of payments deficit to 7.7 percent of GDP and increase gross external reserves to the equivalent of 4.7 months of imports by the end of 2001. To achieve these objectives, the authorities will vigorously pursue firm financial policies with monetary policy actions focused on reducing the rate of inflation, consistent with the balance of payments objective. Accordingly, the open market operations in Reserve Bank of Malawi and treasury bills are being actively utilized to mop up excess liquidity and to bring money supply in line with program targets. The reserve requirement on domestic currency deposits has been reduced with the intention of lowering it further when liquidity conditions permit. Thus far, the authorities have indicated that the program remains broadly on track. The exchange rate of the kwacha is market determined and any interventions will be restricted to the achievement of the external reserve target and smoothing sudden substantial movements.

12. The implementation of a tight fiscal policy stance remains the centerpiece of the program. It is intended to rapidly restore fiscal discipline, initiated by the ten-point plan which was enunciated when the new Minister of Finance was appointed earlier in the year. For the fiscal year 2000-01, the overall cash budget deficit will be limited to 11.4 percent of GDP, with the domestic budget deficit amounting only 1.3 percent of GDP. This will be achieved through adherence to the budget projections on wages and salaries which allows for a general increase, the implementation of a new housing allowance scheme and the introduction of contractual employment for top civil servants. The intention is to effect a decompression of the wage scale. At the same time, ministers and members of parliament will receive the same treatment as the majority of civil servants who are not on contract. Nonpriority expenditure has been curtailed in favor of antipoverty programs so that outlays on social sectors will increase relative to GDP. Cost recovery measures on administrative and public services have been adopted, while spending on utilities are being closely monitored; the cost of internal and external travel has been curtailed while the cost of representation abroad is being reviewed. Perhaps more significantly a new expenditure and control system has been put in place with the assistance of the Fund and should help to improve overall expenditure management and to avoid the recurrence of domestic arrears which became subject of the management's report on noncompliant purchase and which was considered by the Board in August. Meanwhile, revenue performance will be strengthened through continued improvement in tax administration and through appropriate incentives given to MRA.

13. As already indicated structural reforms will be widened and deepened through the introduction of a wide range of measures that include the further liberalization of trade in agricultural products coupled with the expansion of private sector involvement. Meanwhile, steps are being taken to commercialize the Agricultural Development and Marketing Corporation (ADMARC) in anticipation of its full privatization in 2002. The National Food Reserve Agency is being reformed and recapitalized with the assistance of the international donors. The production of tobacco has been liberalized with smallholders production expanding substantially in recent years. The role of Intermediate Buyers is being redefined to ensure that quality is not compromised. Financial sector reforms will focus on the privatization of the two main commercial banks while completing an action plan for the introduction of a new and comprehensive regulatory framework early in the new year.

14. In the area of governance, the focus is on combating corruption and fraud, especially in the light of the recent incidents that were unearthed by Public Accounts Committee and the Auditor General. Accordingly, the government has stepped up its assistance to the work of the democratic oversight institutions, including the Anti-Corruption Bureau. All previous cases of corruption and fraud will be pursued diligently by mounting careful investigations and prosecuting the officials involved. The Public Accounts Committee has released its report and introduced it for debate in parliament this week. Meanwhile legislation will be tightened to improve safeguards against corruption, while a new Procurement Code and Procurement Authority will be established to decentralize and bring about transparency in the procedures to be followed by purchasing agencies.

15. In order to reduce income inequality and poverty, the government in consultation with civil society and with technical assistance from the World Bank has formulated a National Safety Net Strategy, focusing on low-income households to ensure food security. To this end, a "starter pack" program involving the distribution of seeds and fertilizer inputs has being refined to better target the poor.

### **The Decision Point**

16. The debt sustainability assistance has confirmed what the authorities have known all along, that Malawi's debt is high and unsustainable. My authorities therefore welcome the efforts of the international community to respond positively to their request for debt relief assistance that would allow them to take a more aggressive approach to poverty reduction initiatives. As already indicated, the authorities are aware of the remaining gaps in their Interim PRSP and have set out a realistic timetable in which a more robust document could be produced through a more intensified process of consultation with civil society. The Decision Point Document has presented carefully articulated triggers which the authorities view as appropriate in order to satisfy the floating Completion Point. My authorities believe that the proposed interim assistance is consistent with the provisions of the HIPC Initiative.

16. Malawi has a long history of commitment to economic adjustment and reform and the reduction of poverty, supported by the Fund, the World Bank and the donor community. There has been appreciable progress along the way, with a much improved environment for the development of the private sector. The current program is a further attempt to bring the process of reform and adjustment forward as basis for poverty reduction. A reasonable track record has already been established with the implementation of the previous three-year program under ESAF, albeit with the difficulties that required waivers. The current program holds promise given the commitment and renewed vigor expressed by the authorities in their ten-point plan.

### **Conclusion**

17. In the light of the foregoing, I request approval for Fund assistance to Malawi under the PRGF and debt relief under the enhanced HIPC Initiative. The NPV of debt-to exports ratio will remain high above the threshold of 150 percent. It will be important to keep the case under close review with a view to reassessing the amount of assistance to Malawi at the Completion Point.