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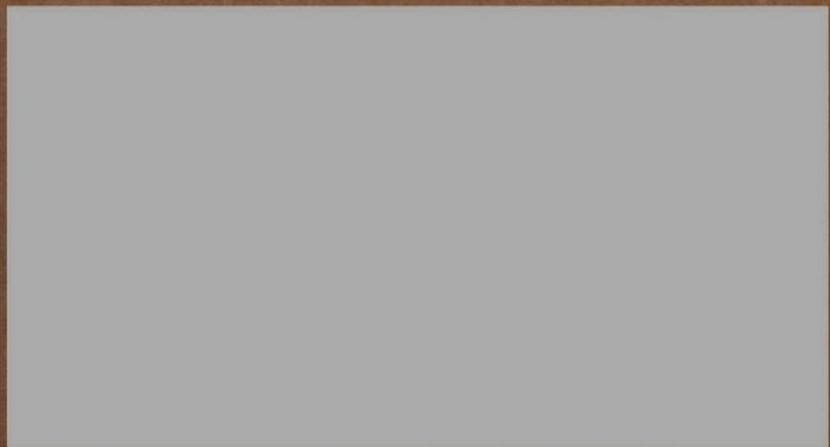
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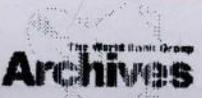
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BANK-FUND
SAF POLICY FRAMEWORK
PAPERS

M
B-2D

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B-2D

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MADAGASCAR

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: May 20, 1987

TO: Distribution

FROM: A. Edward Elmendorf, Chief, EA2IO

EXTENSION: 34302

SUBJECT: MADAGASCAR: Policy Framework Paper

Attached for information is a copy of the draft Policy Framework Paper for Madagascar, as approved by SVPOP; negotiations are now taking place in Antananarivo on the basis of this text.

Attachment

Distribution

Messrs./Mmes. Wiehen, Dubey, Doyen, Otten, Schloss, Isenman,
Armstrong, Wackman, Buky, Lethem, Colliou, Fox,
Bronfman (3), Hyde, Gervais, Devaux, Imam
Abu-zobaa (5)

Madagascar Country Team

AEE:vlj



Record Removal Notice

File Title Bank / Fund Structural Adjustment Facility (SAF) - Policy framework papers Countries M - B-2D		Barcode No. 1085615		
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Correspondents / Participants				
Subject / Title IMF Structural Adjustment Facility Policy Framework Paper 1987-1989				
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OFFICE MEMORANDUM

DATE: May 4, 1987

TO: Operations Policy Committee

FROM: Basil ~~Kavalsky~~^{Sgt.}, Acting Director, CPD

EXT.: 61463

SUBJECT: MADAGASCAR: Policy Framework Paper (PFP)

1. Attached for your review and comment is the Policy Framework Paper on Madagascar. The paper is consistent with the policy framework discussed in the Initiating Memorandum for the Industrial and Trade Policy Adjustment Credit (ITPAC) approved by the Loan Committee on April 16, 1987.
2. The key indicators table in this PFP suggests that per capita consumption will continue to decline significantly even under the SAF policy framework. This raises questions about the political feasibility of the program. This is particularly important since the projected Investment/GDP ratio remains low making it seem that the capital base for faster growth in the future is not being built up. The Region's view is contained in para. 3 of the attached transmittal memorandum from Mr. Elmendorf to Mr. Dubey. It indicates that the constraints on growth are both the country's absorptive capacity and its access to foreign financing. The paper might usefully consider the feasibility of greater financial inflows on appropriate terms and investment on the one hand and GDP growth on the other.
3. You are invited to send your comments, if any, on this paper directly to the Region, with copies to the Chairman, OPC and to CPD, by c.o.b. Friday, May 8, 1987.

Attachment

Cc. without attachment: Messrs. Dubey (o/r), Choksi, El Serafy,
Huang, Myers, Tidrick

OFFICE MEMORANDUM

DATE: May 1, 1987

TO: Mr. Vinod Dubey, CPDDR

FROM: A. Edward Elmendorf, Chief, EA2IO

S&S for 066

EXTENSION: 34302

SUBJECT: MADAGASCAR: Policy Framework Paper

1. Following the April 28 discussion between your colleague, Mr. Myers, and Messrs. Gervais and Hyde of my division, various passages have been revised to enhance clarity. These changes have been cleared by the IMF staff working on Madagascar.

2. The IMF mission members are leaving tonight, so as to begin work in Madagascar on Tuesday, May 5. They will review progress under the Stand-by Arrangement, after which the PFP discussions will commence -- on about May 11, according to current plans. A Bank staff member will be with them at that time.

3. It has been noted that our Key Indicators show continued decline in per capita consumption through 1990, the last year of the projection shown in the table, despite the 3% real GDP growth rate. This is partly due to a sharp decline in Madagascar's external terms of trade in 1987, caused by a drop in world coffee prices. It is also partly due to the adjustment process, however, wherein the Investment-Savings and Import-Export gaps are reduced. The central question here concerns the speed of adjustment. We are completely open to suggestions from CPD and the OPC in this regard, and would simply point out that an assumption of faster GDP growth would raise difficult questions concerning the responsiveness of economic agents (there are tremendous inertial forces in Madagascar) and the availability of financing.

Attachment

cc: EA2IO Mag Team

GLH



Record Removal Notice

File Title Bank / Fund Structural Adjustment Facility (SAF) - Policy framework papers Countries M - B-2D		Barcode No. 1085615		
Document Date April 1987	Document Type Report			
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Withdrawn by Ann May	Date May 17, 2017			

OFFICE MEMORANDUM

SAF
files

DATE: February 18, 1987

TO: Mr. Naguib Abu-zobaa, IMF

FROM: Gary L. Hyde, Acting Division Chief, EA2IO *GLH*

EXTENSION: 34310

SUBJECT: MADAGASCAR: PFP

1. As Mr. Elmendorf mentioned to you recently, we have done some additional work on the draft PFP. The attached product consists of a presentation which shows language to be added/deleted (in bold face) and a presentation in final form.

2. We recognize that whatever document is used for discussion with the Malagasy authorities is likely to be substantially changed. Since the attached paper represents the most complete exposition of our thinking on medium adjustment issues, we suggest that it serve as the basis for our discussions with the authorities.

3. We have yet to finalize our medium-term projections and look forward to discuss them with you and your colleagues. For this reason, all figures in paras. 44 to 47 have been deleted.

Ccc: Messrs./Mmes. Wiehen, Doyen, Bronfman, Fox, Otten, Schloss
J. Brown, Lethem, Isenman, Armstrong, Gusten,
Colliou, Wackman
MADAGASCAR TEAM



Record Removal Notice

File Title Bank / Fund Structural Adjustment Facility (SAF) - Policy framework papers Countries M - B-2D		Barcode No. 1085615		
Document Date November 1986	Document Type Report			
Correspondents / Participants				
Subject / Title Draft IMF Structural Adjustment Facility Policy Framework Paper 1987-1989				
Exception(s) Information Provided by Member Countries or Third Parties in Confidence				
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		<table border="1"><tr><td>Withdrawn by Ann May</td><td>Date May 17, 2017</td></tr></table>	Withdrawn by Ann May	Date May 17, 2017
Withdrawn by Ann May	Date May 17, 2017			

OFFICE MEMORANDUM

DATE: November 3, 1986

TO: Distribution

FROM: Wahid Hadjeri, Acting Chief, EA2IO

EXTENSION: 72569

SUBJECT: MADAGASCAR: Policy Framework Paper under IMF Structural Adjustment Facility

RECEIVED

1986 NOV -4 PM 4: 03

cc: VD
YH

LP

1. Attached for your consideration is a draft Policy Framework Paper on Madagascar prepared jointly by EA2IO and IMF staff. It is intended for use in connection with the new IMF Structural Adjustment Facility. In view of the special importance of this paper and Mr. Elmendorf's absence, Mr. Wiehen has agreed to chair the working level review, which will be held on Thursday, November 6, at 11 am, in Room B-1208.

2. The PFP is intended, as the title suggests, to establish a framework for our work, and that of the Fund, on the adjustment of the Malagasy economy in the next three years. For this reason, it is a particularly important document for us in the Bank: it provides an agenda of future action. Thus, we urge all our colleagues, particularly those in the sector divisions, to review it closely and, where appropriate, to propose specific amendments to the text and matrix. Bear in mind, however, that we are not considering all economic policy changes but specifically changes of a structural character.

3. You have our apologies in advance for the short notice of the meeting. The accelerated calendar is required by the timetable of IMF and IBRD missions.

Attachment

Distribution:

Messrs./Mmes. Jaycox, Isenman (ESAVP); Wiehen, Armstrong (EA2DR);
Wyss, Doyen, Gusten (EAPDR); Dubey, Choksi (3) (CPDDR);
Rogers (VPERS) (3); Jansen (PBDCP) (3); Colaco (INDDR);
Iskander (EGYD2); Goldberg (INDD1);
Schloss (EAPID); Otten (EAPCA); Wackman (EAPEG);
Buky (EAPWU); Colliou (EAPED); Lethem (EAPIT); Fox (CON);
Bronfman (2), Hyde, Gervais, Devaux, Blay, Sylla (EA2IO)
Mr. Abu-zobaa (4) (IMF)
Madagascar Country Team

AEElmendorf:vlj



Record Removal Notice

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Subject / Title Draft IMF Structural Adjustment Facility Policy Framework Paper 1987-1989				
Exception(s) Information Provided by Member Countries or Third Parties in Confidence				
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→ R-10.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 8, 1986

TO: Mr. A. M. Choksi, CPDDR

cc: LF

FROM: Gary L. Hyde, EA2IO *GLH*

EXTENSION: 73511

SUBJECT: MADAGASCAR: SAF Policy Framework Paper

1. As indicated in the attached memorandum, EA2IO aspires to a Working Level Review of the Madagascar PFP this month. We are working toward that goal, together with the IMF staff.

2. As you may surmise from the memorandum, we have gone through four IMF drafts of the PFP in recent months but have yet to obtain the kind of paper that would satisfy Bank requirements. We remain optimistic, nonetheless, that an acceptable draft will emerge soon.

3. One major problem appears to have been resolved only yesterday, during a Bank/Fund meeting, when the two sides agreed on a strategy for exchange rate adjustment and exchange allocation. The PFP will reflect this agreement (which, of course, may not prove agreeable to Government). There do not seem to be any other major policy differences, so the task is primarily one of organizing and writing the paper in such a way as to satisfy both the Bank and Fund.

4. We would be grateful for your suggestions, including comments on the attached draft Outline. It is our desire to produce a document that fully satisfies Bank standards and expectations.

Attachment

cc: Doyen, Louise Fox, Gusten, Isenman (with Attachment);

Robert Armstrong, Elmendorf, MAG Team (without Attachment).

GLH

6. We believe, as indicated in the CG meeting, that pursuit of a 3% real GDP growth rate is an appropriate goal for the medium term. The challenge is to manage the balance of payments and the external debt so as to prevent them from destroying growth possibilities. We must try to identify new approaches, including new ways of coping with the external debt problem. Citing further import cuts, as necessary to satisfy the balance of payments constraint, is tantamount to saying that the growth target will not be achieved.

7. There are a few specific items in the Fourth Draft that we should discuss -- viz., the proposed privatization of the trading companies in 1987 and the admission of foreign banks. And, of course, how to phrase the matter of exchange rate adjustment.

8. I am ready to sit with your staff for a period of intensive work on the draft PFP. Alternatively, I am willing to take the Fourth Draft as a starting point and proceed to write a new paper for your review. A suggested outline is attached.

Attachment: Outline

cc: MAG Team; Mr. Armstrong

GLH

MADAGASCAR: Policy Framework Paper
(1987-1989)

OUTLINE

- I. INTRODUCTION
 - A. Stabilization of the Economy in 1980-86
 - 1. Growth Performance
 - a. Agriculture
 - b. Industry
 - c. Other Sectors
 - 2. Public Finances
 - 3. Money, Credit, and Prices
 - 4. Balance of Payments
 - a. Exports
 - b. Imports
 - c. Financing and Debt Accumulation
 - B. Medium-term Objectives in 1987-89
 - 1. Reorientation of the Economy
 - 2. 3% Average Annual Real GDP Growth
 - 3. Reduction of Debt Arrears
 - 4. Increase in Exchange Reserves
 - 5. Rearrangement of External Debt Obligations
 - 6. Protection of Vulnerable Social Groups
- II. THE ECONOMIC ADJUSTMENT PROGRAM
 - A. Consistency of Medium- and Long-term Goals
 - 1. Need to Reserve Resources for Education, Health Care, and Other Essential Services
 - 2. Need to Balance Recurrent and Capital Expenditures
 - 3. Need to Monitor Population Growth, Environmental Conservation, and Other Long-term Phenomena
 - B. Changing Role of the Public Sector
 - 1. Increased Attention to Policy Formulation
 - a. Market Determination of Prices
 - b. Special Role of Exchange Rate
 - c. Domestic Resource Mobilization
 - 2. Decreased Participation in Production
 - 3. Improved Civil Service
 - 4. Reform of Public Enterprises
 - 5. Modernization of Financial System
 - C. Changing Role of the Private Sector
 - 1. Ownership/Management of Public Enterprises
 - 2. Expansion of Small-scale Enterprises
 - 3. Improved Access to Credit and Foreign Exchange
 - D. Coordination of External Assistance
 - 1. Role of the Consultative Group
 - 2. Strengthening of the Planning Directorate

- E. Sectoral Programs
 - 1. Agriculture
 - a. Rice
 - b. Export Crops
 - c. Other
 - 2. Industry
 - 3. Transport
 - 4. Energy and Mining

III. EXTERNAL FINANCING REQUIREMENTS, 1987-89

- A. Exports
- B. Imports
- C. Current Account Deficit
- D. Reduction of Debt Arrears
- E. Accumulation of Exchange Reserves
- F. Financing Requirement
- G. Expected Disbursements from Contracted Loans/Grants
- H. Required Disbursements from New Commitments
 - 1. Results of Paris Club IV, October 1986
 - 2. Estimated Debt Service, as Rescheduled
 - 3. Need for Further Rescheduling in Future
 - 4. Implied Value of New Commitments
 - a. IDA
 - b. IMF
 - c. Other
- I. Debt Service as % of Exports

IV. BEYOND 1989, TO THE YEAR 2000

- A. Rising Growth Expectations
- B. Emergence of New Export Products
- C. Gradual Decline in Debt Service Ratio

ANNEX I: Matrix of Adjustment Measures, 1987-89

ANNEX II: Table of Key Indicators, 1987-89

(End, first draft Outline of PFP, Oct. 6, 1986. For discussion and modification in consultation with IMF and Bank staff.)



Office Memorandum

→ B-20

TO: Mr. Hyde, IBRD

October 8, 1986

FROM: N. Abu-zobaa *NZ*

SUBJECT: Madagascar - Policy Framework Paper

Following our conversation today and in accordance with the suggestion of Messrs. Hino and Choksi, please find attached a revised outline of the PFP. The revised outline defines which sections will be drafted by the Fund and which will be drafted by the Bank. We will send you a reformatted version of the PFP incorporating our sections by Friday morning. Given the tight schedule, we would hope you could contribute your sections by next Tuesday.

Attachment

cc: Mr. Ouattara
Mr. Gondwe
Mr. Bhatia
Mr. Artus
Mr. Hino (ETR)
✓ Mr. Choksi (IBRD, CPDDR)
Mr. Elmendorf (IBRD, EA210)

Revised Outline

	<u>To be drafted by</u>
I. Introduction	IMF
1. Background	
a. Growth performance of different sectors	IMF
b. Extent of imbalances	IMF
2. Policy measures taken, 1981-85	
a. Agricultural sector	WB
b. Industrial sector	WB
c. Public finances	IMF
d. Money, credit, interest rates	IMF
e. External sector	IMF
Exchange rate	
Trade regime	
3. Results/outlook	IMF
II. The Economic Adjustment Program	
1. Medium-term objectives	IMF
2. Macroeconomic framework	
a. Fiscal policies	IMF
b. Monetary and credit policies	IMF
c. External sector policies	IMF
d. Changing role of the public sector	WB
3. Sectoral framework	
a. Agriculture	WB
b. Industry	WB
c. Financial	WB
d. Transport	WB
e. Energy and mining	WB
4. Social framework	
a. Education	WB
b. Health care	WB
c. Population	WB
d. Environment	WB
III. External Financing Requirements, 1987-89	
1. Expected debt service, 1987-89	IMF
2. Expected disbursements	IMF
a. Existing commitments	
b. New commitments	
IDA	WB
IMF	
Other	
3. Financing requirements	IMF
Annex I: Matrix of Policy Measures, 1987-89	
Annex II: Table of Key Indicators, 1987-89	

OFFICE MEMORANDUM

*File Copy cc: YH
SES
RM*

RECEIVED

1987 JAN 20 PM 6:46

DATE: January 20, 1987
TO: Distribution
FROM: Florent Agueh, Chief, EAISE
Hay
EXTENSION: 34049
SUBJECT: MALAWI - Policy Framework Paper

Please find attached, the draft Malawi Policy Framework Paper prepared in collaboration with the IMF. The working level review is scheduled for January 23, at 10:00 AM in Room J 11-009.

Attachment

DISTRIBUTION:

Messrs. Choksi (4), Myers (CPDBA)(2);
Isenman (ESAVP)(2); Poortman (EA1DR);
Jansen (PBDCP)(2); Michalopoulos, Rogers
(VPERS); Porter, King, Wolff, Lago-Gallego
(EAISE);
Mrs. M.O. Smith (FPAFS); Riley (EAISE).

RLago-Gallego/hml
[Mal-PFP(R1-H5)]

RECEIVED

1987 JAN 20 PM 6:46

MALAWI

Policy Framework Paper, 1987/88-1990/91 1/

I. Introduction

1. Malawi is a small, low-income and predominantly agricultural economy, with virtually no mineral resources, in Southeastern Africa. Its population of 7.15 million is growing at 3.2 percent per annum. Population growth is becoming a serious problem as the cultivable land frontier is being reached in many parts of the country. Income per capita is only US\$170, and life expectancy at birth is 44 years, both below the average for Sub-Saharan Africa. Exports are concentrated in tobacco, tea, and sugar, which account for 20 percent of GDP, and are subject to large price fluctuations in world markets. Malawi's landlocked location has made it particularly vulnerable to repeated disruptions in the external transport network.
2. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector and an open attitude toward foreign investment. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through 1978, with per capita income growing at 3 percent per annum. After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail

1/ Malawi's fiscal year runs from April to March.

links to the sea through Mozambique. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

3. During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply. The large public sector deficits were financed, in part, through nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

4. To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending (SAL) operations of the Bank and by successive stand-

by arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the smallholder agricultural sector. Key public sector institutions have been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

II. Current problems and medium-term objectives

5. Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of structural adjustment has to be continued. At the same time, there is need for achieving growth in per capita income which has barely risen since 1981. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: after encouraging signs in 1984, the external current account deficit rose to about 9.2 percent of GDP in 1985-86, and the debt service ratio was about 44 percent. By end-December 1986, gross official reserves had fallen to the equivalent of less than three weeks of imports and external trade-related payments arrears had risen to the

equivalent of over four weeks of imports. The deficit on central government operations remains unsustainably large. During recent years, these external and fiscal deficits have been financed by large foreign exchange inflows, which, however, are not expected to continue at the same rate beyond the next few years. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, has also been experiencing substantial financial difficulties of a structural nature. The Government believes that the above problems require concerted action on structural and macroeconomic policies.

6. The Government is working on a new Statement of Development Policies which will provide the basis for the development strategy in the next ten years. In addition, this document will help to coordinate external donor support. Some major structural constraints hampering sustainable economic growth have already been identified. In education and manpower development, the efforts to educate the labor force and train indigenous technicians need to be strengthened so as to address the continued shortages of skilled labor and reduce reliance on expatriate staff. In agriculture, insufficient diversification has taken place, while productivity needs to be increased among smallholders and estates. In industry, the development of small-scale enterprises and the emergence of indigenous entrepreneurship has not proceeded sufficiently rapidly. In domestic trade, there is excessive concentration of ADMARC in agricultural marketing, and the Malawi Development Corporation (MDC) and Press in wholesale and retail trade. In foreign trade, there has been increasing protection of domestic

industries--through higher tariffs and quantitative restrictions on imports--and inadequate financial and institutional support for the export sector. In transportation, the disruption of the external transport network has reduced the reliability of foreign supplies and added to the deterioration of the external terms of trade.

7. The medium-term adjustment program for the period 1987-89 will seek to achieve an annual average real growth rate of about 3.0-3.5 percent (which, if attained, could permit some increase in real per capita income) while ensuring a significant improvement in the balance of payments. To that end, the Government will seek to address the structural constraints noted above through appropriate incentives to the private sector and restructuring of the public sector (as outlined in Sections III A and B below). Over the medium term, Malawi intends to follow an export-led growth strategy, as the small size of the domestic market reduces the scope for efficient import substitution. Increased export growth should stem from improved agricultural productivity and diversification into nontraditional export crops, through more emphasis on the smallholder sector and on an industrial strategy based on agroindustries and small-scale enterprises. Special attention will be given to export commodities with a high-value weight ratio, since these minimize the burden of transportation costs. Within this framework, the external current account deficit would be reduced from SDR 86 million in 1986 (about 8.8 percent of GDP) to SDR 58 million (about 6.1 percent of GDP) by 1989, a level which appears to be sustainable. At the same time, official reserves would be increased to at least seven weeks of imports in 1987 and maintained at at least eight weeks of imports

subsequently, while external payments arrears will be eliminated in 1987.

8. On the basis of the current information and outlook, the growth in export volume is targeted to reach 3.5-4.0 percent per annum (export value would increase annually by about 5 percent per annum). Given the planned decline in the current account deficit, achievement of these export increases would imply constraining import volume growth to 2.5-3.0 percent per annum. Although the exact linkages are difficult to specify precisely, the Government believes that this level of imports would be broadly consistent with the targeted growth in real GDP. In view of the considerable uncertainties underlying the above projections for exports (including those relating to the transportation situation in the region), the feasibility and consistency of the above scenario will be subject to close review throughout the program period. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1986. Assuming moderate improvements in the use of capital, gross investment (excluding stock building) would have to be around 14.5 percent of GDP to ensure consistency with the targeted real growth rate. Achievement of the current account deficit then would imply that national savings would finance a larger share of investment (about 55 percent compared to 46 percent in 1981-86).

III. Medium-Term Economic Strategy and Policies

9. The Government's medium-term macroeconomic and structural adjustment strategy, which was presented at the Consultative Group meeting in January 1986, is being further elaborated in the Statement of

Development Policies under preparation. The Government will continue to collaborate closely with the World Bank via the latter's participation in sectoral investments through project lending and donor coordination and in policy reform through structural adjustment lending. The main sectoral and macroeconomic policy areas to be addressed are outlined below.

A. Sectoral Policies

10. Education and manpower development - Malawi has traditionally spent less budgetary resources, as a percent of GDP, on education than most African countries. As a result, school enrollment rates both at primary and secondary school levels, are significantly below the average in the low income Sub-Saharan African countries. Consequently, trained manpower is a major bottleneck to development in most sectors, and the chronic shortage of indigenous skilled labor has made Malawi dependent on expatriate staff. A gradual substitution of Malawians for expatriates through greater emphasis on investment in education (the economic returns of which have been estimated to be in the order of 11-20 percent) is required. The Government has recently developed a Second Ten-Year Education Plan for 1985-95, the main principles of which include: increased emphasis on primary and secondary education, less focus on boarding schools in favor of day schools, especially in the field of sciences; adequate policies to reduce class repetition and drop-out rates in primary education; and measures to upgrade teacher training, improve teaching materials, raise cost recovery, and improve efficiency at university level.

11. Agriculture - The main objectives in this area are: increasing productivity of both the smallholder and the estate sectors; increasing diversification of production, in particular of nontraditional export crops; promoting food self-sufficiency; liberalizing agricultural marketing; and improving the living standards of smallholders. To achieve these objectives, the Government intends to implement a coordinated set of policies. Agricultural producer prices will continue to be reviewed annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops. Agricultural production will also benefit from measures to improve the estate sector's access to credit facilities to finance their investment, and the setting up of estate management training and extension services. In parallel, improved extension and research services for smallholders will also be provided to facilitate the transition towards high yielding maize varieties and nontraditional crops. The remaining subsidy on smallholder fertilizer will be removed by 1989. The current land tenure system will be examined to determine if it is inhibiting growth and efficiency in agricultural production. It is estimated that some portion of the land being leased by estates is currently uncultivated. Measures will be taken to ensure that the land is used productively or else returned to the smallholder sector. A food security policy will also be developed and will address both transitory food insecurity and chronic undernutrition. Agricultural marketing will be reformed along the lines stated in paragraph 24.

12. Industry - Malawian industry is embryonic, with the main activities being processing of export crops and production of consumer goods such

as food, beverages, and textiles. The main characteristic is the predominance of relatively large-scale plants, many of which are either subsidiaries of two parastatal holding companies (ADMARC and MDC), a private conglomerate (Press), or else represent foreign investment. Industrial growth has been hindered by insufficient development of small-scale enterprises, which would serve as the breeding ground for indigenous entrepreneurship (included in the category of small-scale enterprises is domestic wholesale and retail trade, often a training ground for future industrialists). Development of appropriate policies, including provision of credit and technical and institutional support, will be a priority. In addition, the policy actions outlined below in the areas of external competitiveness and export promotion will improve the incentive structure and will promote the development of a more efficient export-oriented industrial sector, with emphasis on agro-industries which provide backward linkages to domestic inputs.

13. Transportation - The disruption of the traditional export routes through Mozambique to the Indian Ocean has forced Malawi to use an alternative corridor through Zambia, Zimbabwe, and South Africa. This has increased transportation distance to the ocean from about 800 km to 3,500 km, and unit transport costs have increased three to four times. The resulting reduction in the border price of exports and increase in the c.i.f. price of imports poses an additional economic burden for the economy of more than US\$50 million a year, or 20 percent of the value of exports. To address this problem, the World Bank and other donors are financing the construction of an alternative Northern Corridor transport route to Dar es Salaam. The completion of this project, expected by the

end of the decade, will imply savings for Malawi of about 40 percent in transport costs, compared to that of the Southern routes now used.

14. Population and health - Malawi's population growth is putting pressure on the available cultivable land and the labor market. In addition, health services are clearly insufficient. To address these issues, the Government has formulated a National Health Program for the period 1986-95. In this framework, proposed policy actions include: the broad dissemination of family health and child-spacing concepts through educational programs; an emphasis on community-based health service delivery; and strengthening of the manpower development, planning and evaluation capacity of the Ministry of Health.

15. Energy - The key issues in the energy sector concern fuelwood, petroleum, electricity. The rapid depletion of forest resources in densely populated areas threatens to cause major environmental difficulties and reduce land fertility. To address this issue, the Government is implementing measures to expand sustainable fuelwood supply, through providing incentives to increase tree planting coupled with collecting adequate stumpage fees, and also to reduce consumption by introducing more efficient charcoal kilns and cookstoves. In the petroleum sector, the policy of passing through full costs of imported oil to users will be continued; and taxes on gasoline will continue to be used for cost recovery of road construction and maintenance. In electricity, the Government will prepare a least-cost expansion program to meet forecast demand; electricity pricing will continue to reflect long-run marginal costs; and required tariff increases will be approved in a timely manner.

B. Macroeconomic Policies

16. External sector policies - In recent years, Malawi has pursued a flexible exchange rate policy intended to stimulate the diversification and growth of exports, and to promote efficient import substitution. The aim of exchange rate policy will continue to be to maintain an adequate level of competitiveness relative to its major trading partners and competitors, and to achieve the desired external reserve targets. The authorities have adopted a phased plan for liberalization of existing quantitative restrictions on imports and are committed to shortening delays in import payments and improving the efficiency of the associated system of exchange control during the program period. Furthermore, all external payments arrears will be eliminated by mid-1987.

17. The pursuit of a more flexible exchange rate policy, together with the envisaged reform of the import duty system and the liberalization of quantitative restrictions on imports, will contribute to the removal of the anti-export bias of the existing incentive structure. Other measures being taken to foster export growth include: (i) the establishment of an export financing scheme, to be managed by the Reserve Bank, and which will provide pre- and post-shipment financing to exporters, especially nontraditional exporters; and (ii) the strengthening in terms of staff and resources of the Malawi Export Promotion Council to provide institutional support and advice to exporters.

18. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year period,

the Government intends to rely almost entirely on grants and external borrowing on concessional terms to finance the external current account deficit.

19. Policies in the public sector - In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. The medium-term financing prospects of the public sector also point to a need for a considerable strengthening of the fiscal position. Following a period of high external loan disbursements and low debt service (due to rescheduling) through 1985, debt service payments are projected to rise significantly in the coming years, and exceptional foreign inflows are likely to fall sharply by the end of the decade. In light of these prospects, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.6 percent of GDP in 1987/88 and to 6.4 percent of GDP in 1988/89 and to about 5.3 percent of GDP in 1989/90. It is considered that a deficit of the latter magnitude can be financed almost entirely by the prospective levels of concessional foreign loans and grants. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC, whose position deteriorated significantly in 1985/86. Following the implementation of some reform measures, together with higher tobacco quality and prices, as well as some one-time reimbursements from the budget, ADMARC is estimated to have achieved an overall surplus of about 2 percent of GDP in 1986/87. Further overall surpluses will be targeted in the coming years.

20. The achievement of the above fiscal targets will require strict limitations on the Government's total expenditures. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A strong centralized expenditure authorization system is being established, which, together with more realistic budgeting, should ensure more effective control over government expenditure.

21. The Government intends to undertake a comprehensive reform of the tax system in line with the recommendations of a tax study done in collaboration with the World Bank. The main objectives of the proposed system are simplification, greater equity, improved allocative efficiency and better tax administration. With respect to indirect taxation the reform calls for the introduction of a uniform surtax (sales tax rate) to be levied on both imports and domestically produced goods. Export duties have been eliminated and exports will be subject to a zero surtax rate. Wholesalers will be brought into the tax net. Additionally, since external transportation costs already provide a large shelter for import substitution industries, a reform of the import duty system is being undertaken, which may involve a lowering of certain duties and a reduction in the average dispersion. Excise taxes will be imposed, at two or three uniform rates, on selected groups of luxury commodities. With respect to direct taxation, in order to provide appropriate incentives, the initial depreciation allowances will be increased and the investment allowance phased out. With respect to tax

administration, measures to improve the identification and monitoring of taxpayers are being implemented. Finally, a tax analysis unit will be established in the Treasury. The tax reform will be phased in gradually starting in 1987/88.

22. Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity and infrastructural support. Individual investment projects will be evaluated primarily in light of their contribution to economic growth and will also take into account the need to improve income distribution. In the public sector investment program for the next three years, the sectoral composition of development expenditures is: transportation (24 percent); agriculture (17 percent); education (10 percent); health (8 percent); and other sectors (41 percent). In view of the issues noted in paragraphs 10 and 14, the shares of education and health will have to be increased in future years. In formulating the size of the investment program, the Government will take account of the constraints imposed by both external and domestic resource availability. While the immediate costs of investment are much easier to estimate than related future expenditure, attention will also be paid to future debt service and current expenditure obligations.

23. The public enterprise sector has recently been the subject of a comprehensive review in collaboration with the World Bank, and it is envisaged that restructuring of the sector will be implemented starting in 1987. It is the intention that commercially oriented public enterprises should operate on an efficient and a profitable basis. To

increase their efficiency, policies will aim at improving their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, regularizing existing debts and future financial flows between the enterprises and the Government. The Department of Statutory Bodies (DSB) will be reorganized and strengthened. A performance-oriented monitoring system will be established to allow for flexibility in parastatals management while holding those accountable for the results. The Government will also take further specific actions to improve the financial performance of Air Malawi and Malawi Railways.

24. An urgent priority is the continuation of the restructuring of agricultural marketing. A fundamental review of ADMARC's marketing role has been undertaken in consultation with the World Bank, with a view to increasing private sector participation in agricultural marketing and improving efficiency in the agricultural sector. Policy actions that are being taken include flexibility in the setting of producer and consumer prices so that each trading account is operated profitably--by April 1987, ADMARC's selling price for domestically produced products, including maize, will be set to cover domestic marketing and handling costs; closure of markets which do not meet commercial criteria and encouragement and assistance to increase private sector participation in the marketing of smallholder crops; introduction of an incentive pricing system to encourage private sector participation in ancillary activities, e.g., transportation, currently handled by ADMARC; reduction in employment; strengthening of corporate planning and management; and the completion of a study of private sector trade in smallholder crops

and certain farm inputs. ADMARC is also in the process of divesting six investments already identified and is developing a strategy for the disposal of other assets. In addition, the Government has acquired the strategic grain reserve and the silos in which it is stored, and a formal financial arrangement between ADMARC and the Government concerning the management of the reserve will be implemented. It is the intention that ADMARC achieve at least a breakeven financial position in 1987/88 and also settle existing arrears owed by it.

C. Monetary and financial system

25. Financial intermediation has an important role in promoting economic development. The authorities intend to keep interest rates sufficiently positive in real terms to encourage private savings and an efficient allocation of capital, and prevent capital outflows. With these objectives in mind, the authorities are also committed to a policy of greater interest rate flexibility than in the past. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector has been established under a World Bank-financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1987/88, with a timetable to be established for implementation during the following two years.

IV. Social impact

26. With an estimated per capita income of US\$170 Malawi is one of the

poorest nations in Sub-Saharan Africa. Some 90 percent of Malawians live in rural areas and work in the agriculture sector, most of them as smallholders. This group is, in turn, the poorest segment of the population. Some factors which explain their poverty are the scarce availability of land for smallholders' cultivation, their low level of education and the lack of off-farm employment. The majority of the policies intended in the program, such as adequate pricing of smallholder crops by ADMARC, development of a land allocation policy, improved extension and research services, crop diversification, promotion of smallscale enterprises, improved access to education and health, including the child-spacing program, and establishment of a food security program, will undoubtedly work to improve the living conditions of smallholders. By contrast, in the short run, some intended policies such as the removal of the fertilizer subsidy, the closure of ADMARC markets which do not meet commercial criteria, and the introduction of differential pricing of agricultural products to reflect transport costs may adversely affect smallholders' incomes until they can adapt to these changed prices. The effects of the program on smallholders and other vulnerable groups will be monitored.

V. External Financing Requirements

27. During the three-year program period, it is expected that the external current account deficit will decline by about 2.7 percentage points of GDP while aiming at achieving 3.0-3.5 percent growth in real GDP per annum. To ensure that the current account deficit can be financed, that debt repayments (including repurchases to the Fund) are

made as scheduled, that external reserves are maintained at a level equivalent to at least seven weeks of imports, and that external payments arrears are eliminated, gross inflows of grants and loans of about SDR [428] million over the period 1987-89 will be required. Disbursements of already committed loans (including the World Bank's SAL III and supplement, and cofinancing) are expected to be SDR [121] million, grants are projected at SDR [83] million, and new loan commitments are anticipated to amount to SDR [125] million. To help meet the residual financing need of SDR [99] million, the authorities have also requested assistance from the Fund of about SDR 32 million through the Structural Adjustment Facility (SAF) and under a stand-by arrangement, and the remainder is expected to be filled from other concessional inflows (including a possible SAL IV). In 1987, the overall financing need (as defined above) is estimated to be SDR [151] million. Already committed loans and grants (including SAL III-related operations) are expected to amount to SDR [48] million, while new loans are projected at SDR [103] million. The Fund is expected to provide SDR 7 million through a SAF loan. Also, the authorities have requested a one-year stand-by arrangement with the Fund for an amount equivalent to SDR 15 million from April 1987. In 1988-89 the overall financing need is estimated at SDR [277] million, which is expected to be met in part through already committed loans and grants of SDR [73] million, and new loan commitments of SDR [204] million. Second and third SAF loans are expected to amount SDR 10 million, and the authorities

hope to request a SAL IV. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support.

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement

Areas	Objectives and policies	Actions	Phasing of implementation
<u>1. Production, investment, and pricing</u>			
a. Agricultural producer prices	To ensure appropriate balance among food and export crops; and to enable profitable distribution and marketing.	Continue annual review of prices, in consultation with the World Bank, increasing the relative returns of selected export crops.	Major progress made through prices announced in September 1986. Annual reviews thereafter.
b. Export promotion and diversification*	To reduce export concentration in tobacco, tea, and sugar, while increasing total exports.	(i) Flexible exchange rate policy. (ii) Establish export financing facilities. (iii) Improve price incentives to smallholder farmers (see also section 1a).	Throughout the program period. Plans to be finalized during 1987/88. Implementation started during 1986 review of agricultural prices. Annual reviews thereafter.
c. Investment program*	Formulation of public investment program, paying due regard to financing and future recurrent cost implications.	Ensure consistence of each year's program with domestic and external budgetary resources.	Annual implementation within a three-year rolling framework; details to be established in consultation with the World Bank.
d. Retail prices*	Maintain liberal price regime.	No further action required.	
e. Fertilizer subsidies*	Full cost pricing of fertilizer sold to smallholders.	Eliminate subsidization.	Continue four-year phase out started in 1985/86 as agreed with World Bank and USALD.
f. Agricultural credit*	Provision of credit to estate agriculture.	Creation of a new facility within existing institutions.	World Bank project approved in 1985 provides the basis for expanded activity in subsequent years if needed.
<u>2. External policies</u>			
a. Exchange rate	Flexible exchange rate policy.	Exchange rate adjustment at least to prevent any real effective appreciation.	Initial adjustment made in 1986; regular reviews thereafter.
b. External borrowing	To decrease the external debt service ratio.	Limit the use of nonconcessional borrowing.	Quantitative targets.
c. Exchange regime	To promote a more liberal and comprehensible system of foreign exchange allocation.	Improve efficiency in import authorization and exchange controls through more active exchange rate policy.	To be implemented in parallel with 2 (a).
<u>3. Government</u>			
a. Budget	Progressive reduction in the overall deficit.	Expenditure restraints on wage bill and other recurrent and development components further measures to reach targets of 7.6 percent of GDP in 1987/88 6.4 percent in 1988/89 and 5.3 percent in 1989/90.	Annual implementation starting in Fiscal Year 1987/88 and through Fiscal Year 1989/90.
b. Expenditure control	To increase adherence to budgeted expenditure.	Quarterly targets on expenditure aggregates; introduce expenditure monitoring committee at highest level of the civil service.	Committee to start functioning in 1987.
c. Expenditure efficiency*	Institutional improvements in the civil service.	Review of implement as appropriate the recommendations of the Civil Service Commission.	Review to be completed in 1987.
d. Expenditure system*	Establish a system more conducive to tracking expenditure program.	Implement a restructured budget.	Experimental presentation in 1986/87, with fuller implementation in subsequent years.
e. Tax reform *	Simplification; move toward expenditure taxation; reduce effective protection; increased revenue elasticity; achieve greater equity; provide fiscal incentives to new investments.	Review recommendations of World Bank study and implement appropriate measures.	Progress to be achieved during the program period, through gradual phasing in of tax reform proposal.

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement (Continued)

Areas	Objectives and policies	Actions	Phasing of implementation
4. Public enterprises			
a. Agricultural Development and Marketing Corporation (ADMARC)*	Return to financial viability; redefinition of its role and activities.	(i) Crop trading accounts to be strengthened through better balance between purchase and selling prices; maize subsidy to be eliminated; (ii) Liquidity problems and recurrent cost to be addressed by Government's purchase of strategic grain reserve and silos; (iii) Divestment of development side of ADMARC's activities; (iv) Greater role of private sector in marketing. (Major assistance from World Bank).	Producer and consumer prices adjusted in 1986 and to be reviewed every year thereafter. Full cost maize pricing by April 1987. Transactions to be completed in 1987. Sale of six identified assets in 1987. Appointment of financial Coordinator to divest other non-marketing related assets. Throughout the program period.
b. Public enterprises*	Ensure viability and operation without government transfers. Allow flexibility in management while strengthening accountability for performance. Revamp the Department of Statutory Bodies.	Review of structure and role of the major statutory bodies, to be conducted by the World Bank. All enterprises to be subject to income tax. Enforcement of debt service obligations.	Study initiated in 1986/87, with reforms commencing in 1987/88.
5. Money and credit policy			
a. Credit policies	Monetary restraint and reduced bank claims on the public sector.	Net domestic assets of the domestic banks to be reduced by contraction in claims on the Government and the statutory bodies. (i) Maintain positive real interest rates; (ii) ensure adherence to fiscal (including public enterprise) borrowing targets; (iii) Seek to liberalize interest rates.	Starting fiscal year 1987/88. Continued restraint throughout the program period. Throughout the program period. Throughout the program period. Consider reduction in the number of borrowing and deposit rates set administratively.
6. Sectoral policies			
a. Education*	Increase school enrollment rates at primary and secondary education. More focus in the field of sciences and in day schools. Upgrade teacher training. Improve efficiency at university.	Increase share of expenditure to education in the public sector budget. Implement policies of the Second Ten Year Education Plan for 1985/95.	Throughout the program period.
b. Agriculture*	Increase productivity and diversification. Promote food self-sufficiency. Liberalize agricultural marketing. Improve living standards of smallholders.	Policies outlined in 1.a, i.e. 1.f and 4.a. Examine and restructure land tenure system. Implement food security policy. Provide management training and research services. Promote high yielding maize varieties.	Throughout the program period.
c. Industry*	Promote small scale enterprises and indigenous entrepreneurship. Emphasis on export oriented agroindustries.	Revise incentive structure. Provision of credit, technical and institutional support.	Throughout the program period.
d. Transportation*	Reduce transportation costs for imports and exports.	Construction of Northern Transport Corridor to Dar es Salaam.	Throughout the program period. To start operating in 1989.
e. Population and Health	Improve health services and moderate population growth.	Increase share of expenditure to health in the public sector budget. Implement child spacing program. Improve community based health service delivery. Manpower development.	Throughout the program period.

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement (Continued)

Areas	Objectives and policies	Actions	Phasing of implementation
6. Sectoral policies (Cont'd)			
f. Energy*	Arrest deforestation process	Expand sustainable fuelwood supply, through providing incentives for tree planting, and collecting stumpage fees. Restrain fuelwood demand by introducing more efficient kilns and cookstoves.	Throughout the program period.
	Use efficiently imported petroleum.	Continue full cost pricing of imported oil to users.	Throughout the program period.
	Recover cost of road construction and maintenance.	Establish adequate taxes on gasolines.	Throughout the program period.
	Implement an efficient electricity development.	Prepare least-cost expansion program. Electricity pricing to follow long run marginal cost principles. Required tariff increases to be implemented timely.	Throughout the program period.

* Asterisks show the policy actions which are formulated under IDA supported Structural Adjustment Operations.

MALAWI

Structural Adjustment Facility
Policy Framework Paper

KEY INDICATORS	Actual						Projected		
	1981	1982	1983	1984	1985	1986 ^{2/}	1987	1988	1989
GDP (Growth Rate)	-5.3%	3.0%	3.6%	3.3%	2.8%	2.9%	3.2%	3.3%	3.5%
GDY (Growth Rate)	-0.4%	4.8%	1.9%	3.6%	-1.7%	2.9%	2.8%	3.8%	4.3%
GDY/Capita (Growth Rate)	-3.5%	1.6%	-1.3%	3.9%	-4.7%	-0.3%	-0.4%	0.6%	1.1%
Consumption/Capita (Growth Rate)	N.A.	-4.2%	4.8%	-0.6%	5.0%	-2.2%	-0.5%	0.0%	0.3%
Debt Service (US\$)	112.7	101.7	78.6	116.7	99.5	121.0	114.5	108.4	95.8
Debt Service/XGS	33.0%	34.0%	28.0%	33.0%	36.0%	42.0%	38.0%	33.0%	27.0%
Debt Service/GDP	9.3%	9.0%	7.1%	11.0%	9.2%	10.6%	9.4%	7.9%	6.3%
Gross Investment/GDP	17.7%	21.5%	22.8%	13.9%	15.7%	16.4%	16.7%	16.9%	17.0%
- Public Investment/GDP	10.3%	8.4%	8.3%	8.5%	9.1%	9.0%	8.5%	8.0%	8.0%
- Private Investment/GDP	4.9%	6.2%	5.4%	4.0%	5.1%	5.4%	6.2%	6.9%	7.0%
- Stock Building/GDP	2.5%	6.9%	9.1%	1.4%	1.5%	2.0%	2.0%	2.0%	2.0%
Public/Private Investment (Ratio)	2.1	1.3	1.5	2.1	1.8	1.7	1.4	1.2	1.1
National Savings/GDP	6.9%	10.9%	11.0%	12.6%	6.6%	7.5%	8.1%	9.4%	11.0%
- Public Savings/GDP	-1.0%	-1.3%	-0.2%	-0.7%	-1.0%	-1.0%	0.0%	0.5%	1.0%
- Private Savings/GDP	7.9%	12.2%	11.2%	13.3%	7.6%	8.5%	8.1%	8.9%	10.0%
Domestic Savings/GDP	11.9%	15.1%	15.2%	16.6%	10.7%	13.1%	13.2%	14.0%	15.2%
Government Revenues/GDP ^{1/}	20.0%	19.7%	19.9%	20.9%	22.6%	22.7%	21.9%	21.6%	21.8%
Government Expenditures/GDP ^{1/}	35.6%	32.2%	30.1%	29.8%	33.2%	31.4%	29.4%	28.0%	27.1%
Deficit (-)/GDP ^{1/}	15.6%	12.5%	10.2%	8.9%	10.6%	8.7%	7.6%	6.4%	5.3%
Exports (Growth Rate)	-19.2%	-7.9%	4.0%	25.8%	2.7%	5.8%	3.8%	3.9%	4.0%
Exports/GDP	22.2%	20.5%	18.9%	26.0%	23.1%	24.9%	26.0%	26.2%	26.7%
Imports (Growth Rate)	-23.9%	-5.0%	1.5%	-12.0%	13.6%	3.0%	2.3%	2.5%	3.0%
Imports/GDP	28.4%	25.9%	25.3%	22.6%	26.9%	28.5%	28.9%	28.8%	27.6%
Current Account Deficit (US\$)	133.2	124.8	144.1	15.5	99.7	101.6	79.4	81.8	69.5
Current Account Deficit/GDP	10.8%	10.6%	11.8%	1.3%	9.3%	8.8%	8.1%	7.8%	6.1%

^{1/} Fiscal year runs from 1st of April to 31st of March; data for 1981 refers to FY81/82, and so on.

^{2/} Preliminary estimate.

Source: Economic Report 1986, IMF and World Bank estimates.

[pfpattach(rlg2)]

MALAWI

External Financing Requirements, 1987-89

	1987	1988	1989
	----(in millions of US\$)----		
Current account, excluding official transfers	79.4	81.8	69.5
Amortization	48.1	49.5	40.2
Change in reserves ^{1/}	25.7	30.6	14.4
Repurchases	28.3	23.9	22.8
Total financing requirement	181.5	185.8	146.9
<u>Disbursements: Existing Commitments</u>	<u>57.6</u>	<u>51.4</u>	<u>36.5</u>
Grants	--	--	--
Loans	57.6	51.4	36.5
Bilateral creditors	3.5	1.5	0.4
Multilateral creditors	54.1	49.9	36.1
Of which: World Bank	35.4	35.0	22.9
Of which: adjustment lending	10.0	--	--
Private creditors	--	--	--
IMF purchases	--	--	--
<u>Disbursements: Expected New Commitments</u>	<u>123.9</u>	<u>134.4</u>	<u>110.4</u>
Grants	35.0	30.0	35.0
Loans	69.3	91.2	69.4
Bilateral creditors	10.0	10.0	12.0
Multilateral creditors	59.3	81.2	57.4
Of which: World Bank	46.2	71.9	42.5
Of which: adjustment lending	20.0	40.0	20.0
Private creditors	--	--	--
IMF purchases	10.7	7.2	0.0
SAF	8.9	6.0	6.0
Total identified financing	181.5	185.8	146.9
Financing gap	--	--	--
Debt rescheduling	--	--	--

^{1/} Includes payment of arrears.

[pfpattach(rlg2)]

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FROM: The Deputy Secretary

August 12, 1986

MALAWI: Policy Framework Paper*

1. Attached is a Policy Framework Paper for Malawi. The paper was prepared jointly by the staffs of the Bank and the Fund and the Government of Malawi. The medium-term policy framework outlines the Government's objectives for the next several years, and these reflect agreements reached with the Bank in the context of previous lending for structural adjustment. A policy matrix summarizing these agreements, as well as macro-economic indicators which were prepared by the Bank's staff, are attached to the paper.

2. The paper also indicates the estimated external financing requirements over the program period. A part of this requirement is expected to be met by future IBRD/IDA lending. But the volume of timing of such lending, both project and adjustment related, will depend on the continuation of a satisfactory growth-oriented adjustment program, appropriate investment opportunities, and the Bank's normal decision process.

3. The attached document does not fully reflect the nature of the development constraints facing Malawi or the range of actions to address them. Accordingly, the Policy Framework Paper must be read in the light of existing documentation summarizing Malawi's structural adjustment efforts and program, in particular the Government's Letter of Development Policy attached to the Third Structural Adjustment Operation (IDA/R85-138) distributed to the Board on November 26, 1985.

4. This document will be considered by the Executive Directors meeting as the Committee of the Whole on August 26, 1986.

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

*Questions on this document should be referred to Mr. King (x69624)

MALAWI

Policy Framework Paper

(August 1986 - July 1989)

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector in recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply. The large public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending operations of the Bank and by successive stand-by

arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the smallholder agricultural sector. Key public sector institutions have been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of structural adjustment has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: after encouraging signs in 1984, the external current account deficit rose to about 9.1 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 41 percent. The deficit on central government operations remains large. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is need for achieving growth in per capita income which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

For the coming three-year period, GDP growth is projected at 3.0-3.5 percent per year, which will permit an increase in real income per capita. To that end, the Government will seek to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in Sections 3, 4, and 5 below) so as to achieve an improvement in the balance of payments. In this framework, the current account deficit would have to be reduced to a sustainable level, which, on the basis of current information and outlook, would fall from about 7.8 percent of GDP in 1986-87 to about 6.3 percent of GDP by 1988 and 1989 while maintaining official reserves of at least two months of imports. The current account targets are based on projected export volume growth of about 3.5-4.0 percent per annum and import volume growth of about 3.0 percent per annum during 1986-89. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985, and is projected at 11.5 percent per year in 1986-87. To achieve a GDP growth rate of 3.0-3.5 percent and assuming moderate improvements in the use of capital, gross investment (including stock building) would have to be around 18 percent of GDP. The current account deficit (foreign savings) as a percentage of GDP would be reduced from an average of

8.7 percent in 1981-85 to about 6.3 percent in 1989, on the assumption that national savings would have to finance a larger share of investment (about 60 percent compared to 46 percent in 1981-85).

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as presented to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production, to increase exports, and to promote self-sufficiency in food. The primary objective will be to increase exports (including cotton, textiles, and tree crops) through agricultural pricing policies, and the provision of supporting services for export promotion and financing. Agricultural producer prices, which have been frequently adjusted in the past, normally will continue to be reviewed annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management training and extension service. Improved extension and research services for smallholders will also be provided, while the remaining subsidies on smallholder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of the decade, the alternative northern route, to the port of Dar es Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank and other donors, will reduce freight costs significantly, and will offer Malawi an alternative access to the sea, even when traditional routes through Mozambique can be reopened.

The Government will place additional emphasis on the health and education sectors, which are currently supported by sectoral lending programs of the World Bank.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports, and to promote efficient import substitution. Following the significant adjustment of the exchange rate which has already taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The authorities are committed to shortening delays in import payments during the program period and to improve the efficiency of the system of import authorization and exchange control. Finally, as the debt service ratio, although

progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants and external borrowing on concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the three-year period of the structural adjustment program.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. In particular, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.8 percent of GDP in 1986/87 and to 6.2 percent of GDP in 1987/88 and to about 5.5 percent of GDP in 1988/89. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC, whose position deteriorated significantly in 1985/86. Including receipts from the sale of the strategic grain reserve to the Government, ADMARC will achieve an overall surplus of 2.1 percent of GDP in 1986/87 (see below). Excluding these receipts, its deficit will be reduced to 0.3 percent of GDP. Thereafter, ADMARC is expected to begin to show small surpluses. Assuming some increase in external financing of the Government, this fiscal position is sustainable. These objectives will be pursued also in the context of a stand-by arrangement with the Fund. The achievement of these targets will require careful review of the Government's expenditure which, together with realistic budgeting coupled with more effective control, should permit a modest expansion in development expenditure. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a comprehensive reform of the tax system with the objectives of simplification, greater equity, more rational indirect taxation and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget, in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity and infrastructural support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the

appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth and on improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that commercially oriented public enterprises should operate on an efficient and a profitable basis, so that they can contribute to the central government budget. To increase the efficiency of these enterprises, policies will aim at improving their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, regularizing financial flows between the enterprises and the Government, and strengthening financial management. The scope for privatization will also be examined. The Government will adopt a strategy and timetable for the restructuring during 1986.

An urgent priority will be the restructuring of ADMARC. As a first step, during 1986/87, the Government will form a new holding company to take over ADMARC's nonmarketing-related investments. This company will divest six investments already identified and develop a strategy for the disposal of other assets. In addition, the Government has decided to acquire the strategic grain reserve and the silos in which it is stored. A fundamental review of ADMARC's marketing role is under way in consultation with the World Bank. The policy actions being considered include flexibility in the setting of producer and consumer prices so that each trading account is operated profitably; closure of markets which do not meet commercial criteria; introduction of differential pricing to minimize transportation costs; reduction in employment; and strengthening of corporate planning and management. These measures will facilitate private sector involvement in agricultural marketing. It is the intention that ADMARC achieve at least a breakeven financial position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private savings and an efficient allocation of capital. In the context of the program, the authorities will continue to explore the possibilities for moving toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector is being established under a World Bank-financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of appropriate macroeconomic and structural policies will promote efficiency in the economy and stimulate production. Production of both traditional and nontraditional commodities for export is expected to benefit from these measures, in particular appropriate producer prices. Export performance should permit a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and achievement of GDP growth of 3.0-3.5 percent per annum during 1986-89. To achieve these objectives, gross inflows of grants and loans of about SDR 530-550 million over the period 1986-89 will be required. The World Bank is expected to contribute to the financing through SAL III and an anticipated SAL IV, of which SAL III and related cofinancing that has already been committed will amount to about SDR 95 million, while the Fund is expected to provide about SDR 17 million through the structural adjustment facility (SAF). In 1986 gross capital inflows are expected to amount to about SDR 165 million, of which the World Bank is likely to contribute about SDR 95 million through SAL III and cofinancing, and the remainder is committed through concessional credits and grants. The Fund is expected to provide SDR 7 million through a SAF loan. Also, the authorities have requested a 19-month stand-by arrangement with the Fund for an amount equivalent to SDR 24 million, from August 1986. In 1987 total loans and grants are estimated at SDR 135 million, which is expected to be met through additional disbursements under SAL III, including cofinancing, and possible additional support through SAL IV and anticipated concessional credits and grants which have been committed by bilateral donors. The second SAF loan is expected to amount to SDR 5 million. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations, and to maintain its relations with the Fund, at this stage in the context of a stand-by arrangement.

Malawi: Principal Elements of a Common Policy Framework

Targets

Real GDP growth	3.0-3.5 percent per annum in 1986-89
Increase in consumer prices	About 11.5 percent in 1986-87 and about 7 percent in 1988-89
External current account deficit	About 7-8 percent of GDP in 1986-87 to about 6.3 percent of GDP in 1988-89
Real import growth	About 3 percent per annum in 1986-89
Real export growth	About 3.5-4.0 percent per annum in 1986-89
Gross official reserves	At least 2 months of imports in 1986-89

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing aiming at promoting export crops and food self-sufficiency (continuous)

External sector

Flexibility in exchange rate management
Reduction in payment restrictions and more efficient foreign exchange allocation system (from 1986)
Restrained nonconcessional external borrowing (continuous)

Public sector

Central government deficit (excluding grants) 7.8 percent of GDP in 1986/87 to 5.5 percent of GDP in 1988/89
Institutional improvements in the civil service (from 1986/87)
Tax reform (from 1986/87)
Increased programmatic approach to expenditures (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focusing on productive and export activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC restructuring: asset disposal (1986/87); breakeven in current operations (1987/88); review of marketing role (1988/89)

Monetary and financial sector

Real interest rates positive (continuous)
Financial schemes for export promotion and estate agriculture (from 1986)

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89

Areas	Objectives and policies	Actions	Phasing of implementation
1. <u>Production, investment, and pricing</u>			
a. Agricultural producer prices *	To ensure appropriate balance among food and export crops; and to enable profitable distribution and marketing.	Continue annual review of prices, in consultation with the World Bank, increasing the relative returns for selected export crops.	Major progress to be made through prices to be announced in September 1986. Annual reviews thereafter.
b. Export promotion and diversification *	To reduce export concentration in tobacco, tea, and sugar, while increasing total exports.	(i) Flexible exchange rate policy. (ii) Establish export financing facilities. (iii) Improve price incentives to smallholder farmers (see also section 1a).	Throughout the program period. Plans to be finalized during 1987/88. Implementation to start during 1986 review of agricultural prices.
c. Investment program *	Formulation of public investment program, paying due regard to financing and future recurrent cost implications.	Ensure consistency of each year's program with domestic and external budgetary resources.	Annual implementation within a three-year rolling framework; details to be established in consultation with the World Bank.
d. Retail prices *	Maintain liberal price regime.	No further action required.	
e. Fertilizer subsidies *	Full cost pricing of fertilizer sold to smallholders.	Eliminate subsidization.	Continue four-year phase out started in 1985/86 as agreed with World Bank and USAID.
f. Agricultural credit *	Provision of credit to estate agriculture.	Creation of a new facility within existing institutions.	World Bank project approved in 1985 provides the basis for expanded activity in subsequent years if needed.
2. <u>External policies</u>			
a. Exchange rate	Flexible exchange rate policy.	Exchange rate adjustments at least to prevent any real effective appreciation.	Initial adjustment to be made in 1986; regular reviews thereafter.
b. External borrowing	To decrease the external debt service ratio.	Limit the use of nonconcessional borrowing.	Quantitative targets.
c. Exchange regime	To promote a more liberal and comprehensible system of foreign exchange allocation.	Improve efficiency in import authorization and exchange controls through more active exchange rate policy.	To be implemented in parallel with 2(a).
3. <u>Government</u>			
a. Budget	Progressive reduction in the overall deficit.	Revenue measures equivalent to 2.0 percent of GDP; and expenditure restraints on wage bill and other recurrent and development components.	Budget introduced in March 1986, as supplemented by measures taken through August.
b. Expenditure control	To increase adherence to budgeted expenditure.	Quarterly targets on expenditure aggregates; introduce expenditure monitoring committee at highest level of the civil service.	Committee to start functioning in 1986/87.
c. Expenditure efficiency *	Institutional improvements in the civil service.	Review and implement as appropriate the recommendations of the Civil Service Commission.	Review to be completed in 1986.
d. Expenditure system *	Establish a system more conducive to tracking expenditure programs.	Implement a restructured budget.	Experimental presentation in 1986/87, with fuller implementation in subsequent years.
e. Tax reform *	Simplification; move toward expenditure taxation; reduce effective protection; increased revenue elasticity.	Review recommendations of World Bank study and implement appropriate measures.	Progress to be achieved during the program period.

(*) Asterisks show the policy actions which are formulated under IDA supported Structural Adjustment Operations

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89 (continued)

Areas	Objectives and policies	Actions	Phasing of implementation
<u>4. Public enterprises</u>			
a. Agricultural Development and Marketing Corporation (ADMARC)*	Return to financial viability; redefinition of its role and activities.	(i) Crop trading accounts to be strengthened through better balance between purchase and selling prices; maize subsidy to be eliminated; (ii) Liquidity problems and recurrent cost to be addressed by Government's purchase of strategic grain reserve and silos; (iii) Divestment of development side of ADMARC's activities; (iv) Greater role for private sector in marketing. (Major assistance from World Bank is envisaged.)	Producer and consumer prices adjusted in 1986. Full cost maize pricing by April 1987. Transactions to be completed in 1986/87. Sale of selected assets in 1986/87; establishment of self-liquidating investment subsidiary in 1986/87. Throughout the program period.
b. Public enterprises *	Ensure viability and operation without government transfer.	Review of structure and role of the major statutory bodies, to be conducted by the World Bank. All enterprises to be subject to income tax.	Study to be initiated in 1986/87, with possible reforms commencing in 1987/88 with effect from 1987/88.
<u>5. Money and credit policy</u>			
a. Credit policies	Monetary restraint and reduced bank claims on the public sector.	Net domestic assets of the domestic banks to be reduced by contraction in claims on the Government and the statutory bodies in 1986/87.	Through fiscal year 1986/87. Continued restraint throughout the program period.
b. Financial intermediation	Promote greater financial intermediation; increase domestic saving; extend use of credit by private sector.	(i) Maintain positive real interest rates; (ii) ensure adherence to fiscal (including public enterprise) borrowing targets; (iii) Seek to liberalize interest rates.	Throughout the program period. Throughout the program period. Consider reduction in the number of borrowing and deposit rates set administratively.

(* Asterisks show the policy actions which are formulated under IDA supported Structural Adjustment Operations.

MALAWI

Structural Adjustment Facility
Policy Framework Paper

KEY INDICATORS	Actual					Projected			
	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP (Growth Rate)	5.3%	3.0%	3.6%	3.3%	2.8%	3.1%	3.3%	3.5%	3.7%
GDY (Growth Rate)	-0.4%	4.8%	1.9%	3.6%	-1.7%	4.7%	3.4%	3.6%	4.7%
GDY/Capita (US\$)	-3.5%	1.6%	-1.3%	3.9%	-4.7%	1.5%	0.2%	0.4%	1.5%
Consumption/Capita (Growth Rate)	N.A.	-4.2%	4.8%	-0.6%	5.0%	-4.2%	0.2%	-0.8%	-1.3%
Debt Service (US\$)	112.7	101.7	78.6	116.7	114.4	122.2	120.8	122.4	112.8
Debt Service/XGS	33.0%	34.0%	28.0%	33.0%	38.0%	37.0%	33.0%	31.0%	26.0%
Debt Service/GDP	9.3%	9.0%	7.1%	11.0%	10.5%	11.0%	9.5%	8.6%	7.2%
Gross Investment/GDP	17.7%	21.5%	22.8%	13.9%	15.7%	17.0%	16.7%	17.4%	17.8%
- Public Investment/GDP	10.3%	8.4%	8.3%	8.5%	9.1%	10.0%	8.8%	8.3%	8.0%
- Private Investment/GDP	4.9%	6.2%	5.4%	4.0%	5.1%	5.0%	5.9%	7.1%	7.8%
- Stock Building/GDP	2.5%	6.9%	9.1%	1.4%	1.5%	2.0%	2.0%	2.0%	2.0%
Public/Private Investment (Ratio)	2.1	1.3	1.5	2.1	1.8	2.0	1.5	1.2	1.0
National Savings/GDP	6.9%	10.9%	11.0%	12.6%	6.6%	8.9%	9.1%	10.4%	12.4%
- Public Savings/GDP	-1.0%	-1.3%	-0.2%	-0.7%	-1.0%	0.5%	1.0%	1.5%	2.0%
- Private Savings/GDP	7.9%	12.2%	11.2%	13.3%	7.6%	8.4%	8.1%	9.0%	9.7%
Domestic Savings/GDP	11.9%	15.1%	15.2%	16.6%	10.7%	14.3%	14.2%	15.2%	16.7%
Government Revenues/GDP ^{1/}	20.0%	19.7%	19.9%	20.9%	22.6%	23.4%	23.4%	23.4%	23.4%
Government Expenditures/GDP ^{1/}	35.6%	32.2%	30.1%	29.8%	33.2%	31.2%	29.6%	28.9%	28.9%
Deficit (-)/GDP ^{1/}	15.6%	12.5%	10.2%	8.9%	10.6%	7.8%	6.2%	5.5%	5.5%
Exports (Growth Rate)	-19.2%	-7.9%	4.0%	25.8%	2.7%	3.5%	3.7%	3.9%	4.0%
Exports/GDP	22.2%	20.5%	18.9%	26.0%	23.1%	24.8%	24.7%	23.8%	23.3%
Imports (Growth Rate)	-23.9%	-5.0%	1.5%	-12.0%	13.6%	3.0%	3.1%	3.2%	3.3%
Imports/GDP	28.4%	25.9%	25.3%	22.6%	26.9%	26.8%	26.3%	24.9%	23.4%
Current Account Deficit (US\$)	133.2	124.8	144.1	15.5	99.7	93.2	96.2	99.5	85.0
Current Account Deficit/GDP	10.8%	10.6%	11.8%	1.3%	9.1%	8.1%	7.6%	7.0%	5.4%

^{1/} Fiscal year runs from 1st of April to 31st of March; Data for 1981 refers to FY81/82, and so on.

Source: Economic Report 1986, IMF and World Bank estimates.

ROUTING SLIP		DATE: August 12, 1986	
NAME		ROOM NO.	
Mr. Choksi			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:			
<p>Attached is the PFP on Malawi which went to Mr. Stern's office today.</p>			
FROM: Fred King		ROOM NO.: U 1250	EXTENSION: 69624

John cc. LF/JR

FROM: The Deputy Secretary

August 12, 1986

MALAWI: Policy Framework Paper*

1. Attached is a Policy Framework Paper for Malawi. The paper was prepared jointly by the staffs of the Bank and the Fund and the Government of Malawi. The medium-term policy framework outlines the Government's objectives for the next several years, and these reflect agreements reached with the Bank in the context of previous lending for structural adjustment. A policy matrix summarizing these agreements, as well as macro-economic indicators which were prepared by the Bank's staff, are attached to the paper.

2. The paper also indicates the estimated external financing requirements over the program period. A part of this requirement is expected to be met by future IBRD/IDA lending. But the volume of timing of such lending, both project and adjustment related, will depend on the continuation of a satisfactory growth-oriented adjustment program, appropriate investment opportunities, and the Bank's normal decision process.

3. The attached document does not fully reflect the nature of the development constraints facing Malawi or the range of actions to address them. Accordingly, the Policy Framework Paper must be read in the light of existing documentation summarizing Malawi's structural adjustment efforts and program, in particular the Government's Letter of Development Policy attached to the Third Structural Adjustment Operation (IDA/R85-138) distributed to the Board on November 26, 1985.

4. This document will be considered by the Executive Directors meeting as the Committee of the Whole on August 26, 1986.

Distribution:

- Executive Directors and Alternates
- President
- Senior Vice Presidents
- Senior Management Council
- Vice Presidents, IFC
- Directors and Department Heads, Bank and IFC

*Questions on this document should be referred to Mr. King (x69624)

MALAWI

Policy Framework Paper

(August 1986 - July 1989)

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector in recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply. The large public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending operations of the Bank and by successive stand-by

arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the smallholder agricultural sector. Key public sector institutions have been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of structural adjustment has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: after encouraging signs in 1984, the external current account deficit rose to about 9.1 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 41 percent. The deficit on central government operations remains large. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is need for achieving growth in per capita income which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

For the coming three-year period, GDP growth is projected at 3.0-3.5 percent per year, which will permit an increase in real income per capita. To that end, the Government will seek to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in Sections 3, 4, and 5 below) so as to achieve an improvement in the balance of payments. In this framework, the current account deficit would have to be reduced to a sustainable level, which, on the basis of current information and outlook, would fall from about 7.8 percent of GDP in 1986-87 to about 6.3 percent of GDP by 1988 and 1989 while maintaining official reserves of at least two months of imports. The current account targets are based on projected export volume growth of about 3.5-4.0 percent per annum and import volume growth of about 3.0 percent per annum during 1986-89. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985, and is projected at 11.5 percent per year in 1986-87. To achieve a GDP growth rate of 3.0-3.5 percent and assuming moderate improvements in the use of capital, gross investment (including stock building) would have to be around 18 percent of GDP. The current account deficit (foreign savings) as a percentage of GDP would be reduced from an average of

8.7 percent in 1981-85 to about 6.3 percent in 1989, on the assumption that national savings would have to finance a larger share of investment (about 60 percent compared to 46 percent in 1981-85).

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as presented to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production, to increase exports, and to promote self-sufficiency in food. The primary objective will be to increase exports (including cotton, textiles, and tree crops) through agricultural pricing policies, and the provision of supporting services for export promotion and financing. Agricultural producer prices, which have been frequently adjusted in the past, normally will continue to be reviewed annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management training and extension service. Improved extension and research services for smallholders will also be provided, while the remaining subsidies on smallholder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of the decade, the alternative northern route, to the port of Dar es Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank and other donors, will reduce freight costs significantly, and will offer Malawi an alternative access to the sea, even when traditional routes through Mozambique can be reopened.

The Government will place additional emphasis on the health and education sectors, which are currently supported by sectoral lending programs of the World Bank.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports, and to promote efficient import substitution. Following the significant adjustment of the exchange rate which has already taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The authorities are committed to shortening delays in import payments during the program period and to improve the efficiency of the system of import authorization and exchange control. Finally, as the debt service ratio, although

progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants and external borrowing on concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the three-year period of the structural adjustment program.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. In particular, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.8 percent of GDP in 1986/87 and to 6.2 percent of GDP in 1987/88 and to about 5.5 percent of GDP in 1988/89. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC, whose position deteriorated significantly in 1985/86. Including receipts from the sale of the strategic grain reserve to the Government, ADMARC will achieve an overall surplus of 2.1 percent of GDP in 1986/87 (see below). Excluding these receipts, its deficit will be reduced to 0.3 percent of GDP. Thereafter, ADMARC is expected to begin to show small surpluses. Assuming some increase in external financing of the Government, this fiscal position is sustainable. These objectives will be pursued also in the context of a stand-by arrangement with the Fund. The achievement of these targets will require careful review of the Government's expenditure which, together with realistic budgeting coupled with more effective control, should permit a modest expansion in development expenditure. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a comprehensive reform of the tax system with the objectives of simplification, greater equity, more rational indirect taxation and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget, in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity and infrastructural support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the

appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth and on improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that commercially oriented public enterprises should operate on an efficient and a profitable basis, so that they can contribute to the central government budget. To increase the efficiency of these enterprises, policies will aim at improving their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, regularizing financial flows between the enterprises and the Government, and strengthening financial management. The scope for privatization will also be examined. The Government will adopt a strategy and timetable for the restructuring during 1986.

An urgent priority will be the restructuring of ADMARC. As a first step, during 1986/87, the Government will form a new holding company to take over ADMARC's nonmarketing-related investments. This company will divest six investments already identified and develop a strategy for the disposal of other assets. In addition, the Government has decided to acquire the strategic grain reserve and the silos in which it is stored. A fundamental review of ADMARC's marketing role is under way in consultation with the World Bank. The policy actions being considered include flexibility in the setting of producer and consumer prices so that each trading account is operated profitably; closure of markets which do not meet commercial criteria; introduction of differential pricing to minimize transportation costs; reduction in employment; and strengthening of corporate planning and management. These measures will facilitate private sector involvement in agricultural marketing. It is the intention that ADMARC achieve at least a breakeven financial position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private savings and an efficient allocation of capital. In the context of the program, the authorities will continue to explore the possibilities for moving toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector is being established under a World Bank-financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of appropriate macroeconomic and structural policies will promote efficiency in the economy and stimulate production. Production of both traditional and nontraditional commodities for export is expected to benefit from these measures, in particular appropriate producer prices. Export performance should permit a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and achievement of GDP growth of 3.0-3.5 percent per annum during 1986-89. To achieve these objectives, gross inflows of grants and loans of about SDR 530-550 million over the period 1986-89 will be required. The World Bank is expected to contribute to the financing through SAL III and an anticipated SAL IV, of which SAL III and related cofinancing that has already been committed will amount to about SDR 95 million, while the Fund is expected to provide about SDR 17 million through the structural adjustment facility (SAF). In 1986 gross capital inflows are expected to amount to about SDR 165 million, of which the World Bank is likely to contribute about SDR 95 million through SAL III and cofinancing, and the remainder is committed through concessional credits and grants. The Fund is expected to provide SDR 7 million through a SAF loan. Also, the authorities have requested a 19-month stand-by arrangement with the Fund for an amount equivalent to SDR 24 million, from August 1986. In 1987 total loans and grants are estimated at SDR 135 million, which is expected to be met through additional disbursements under SAL III, including cofinancing, and possible additional support through SAL IV and anticipated concessional credits and grants which have been committed by bilateral donors. The second SAF loan is expected to amount to SDR 5 million. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations, and to maintain its relations with the Fund, at this stage in the context of a stand-by arrangement.

Malawi: Principal Elements of a Common Policy Framework

Targets

Real GDP growth	3.0-3.5 percent per annum in 1986-89
Increase in consumer prices	About 11.5 percent in 1986-87 and about 7 percent in 1988-89
External current account deficit	About 7-8 percent of GDP in 1986-87 to about 6.3 percent of GDP in 1988-89
Real import growth	About 3 percent per annum in 1986-89
Real export growth	About 3.5-4.0 percent per annum in 1986-89
Gross official reserves	At least 2 months of imports in 1986-89

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing aiming at promoting export crops and food self-sufficiency (continuous)

External sector

Flexibility in exchange rate management
Reduction in payment restrictions and more efficient foreign exchange allocation system (from 1986)
Restrained nonconcessional external borrowing (continuous)

Public sector

Central government deficit (excluding grants) 7.8 percent of GDP in 1986/87 to 5.5 percent of GDP in 1988/89
Institutional improvements in the civil service (from 1986/87)
Tax reform (from 1986/87)
Increased programmatic approach to expenditures (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focusing on productive and export activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC restructuring: asset disposal (1986/87); breakeven in current operations (1987/88); review of marketing role (1988/89)

Monetary and financial sector

Real interest rates positive (continuous)
Financial schemes for export promotion and estate agriculture (from 1986)

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89

Areas	Objectives and policies	Actions	Phasing of implementation
1. <u>Production, investment, and pricing</u>			
a. Agricultural producer prices *	To ensure appropriate balance among food and export crops; and to enable profitable distribution and marketing.	Continue annual review of prices, in consultation with the World Bank, increasing the relative returns for selected export crops.	Major progress to be made through prices to be announced in September 1986. Annual reviews thereafter.
b. Export promotion and diversification *	To reduce export concentration in tobacco, tea, and sugar, while increasing total exports.	(i) Flexible exchange rate policy. (ii) Establish export financing facilities. (iii) Improve price incentives to smallholder farmers (see also section la).	Throughout the program period. Plans to be finalized during 1987/88. Implementation to start during 1986 review of agricultural prices.
c. Investment program *	Formulation of public investment program, paying due regard to financing and future recurrent cost implications.	Ensure consistency of each year's program with domestic and external budgetary resources.	Annual implementation within a three-year rolling framework; details to be established in consultation with the World Bank.
d. Retail prices *	Maintain liberal price regime.	No further action required.	
e. Fertilizer subsidies *	Full cost pricing of fertilizer sold to smallholders.	Eliminate subsidization.	Continue four-year phase out started in 1985/86 as agreed with World Bank and USAID.
f. Agricultural credit *	Provision of credit to estate agriculture.	Creation of a new facility within existing institutions.	World Bank project approved in 1985 provides the basis for expanded activity in subsequent years if needed.
2. <u>External policies</u>			
a. Exchange rate	Flexible exchange rate policy.	Exchange rate adjustments at least to prevent any real effective appreciation.	Initial adjustment to be made in 1986; regular reviews thereafter.
b. External borrowing	To decrease the external debt service ratio.	Limit the use of nonconcessional borrowing.	Quantitative targets.
c. Exchange regime	To promote a more liberal and comprehensible system of foreign exchange allocation.	Improve efficiency in import authorization and exchange controls through more active exchange rate policy.	To be implemented in parallel with 2(a).
3. <u>Government</u>			
a. Budget	Progressive reduction in the overall deficit.	Revenue measures equivalent to 2.0 percent of GDP; and expenditure restraints on wage bill and other recurrent and development components. further measures to reach targets of 6.2 percent of GDP in 1987/88 and 5.5 percent in 1988/89.	Budget introduced in March 1986, as supplemented by measures taken through August.
b. Expenditure control	To increase adherence to budgeted expenditure.	Quarterly targets on expenditure aggregates; introduce expenditure monitoring committee at highest level of the civil service.	Committee to start functioning in 1986/87.
c. Expenditure efficiency *	Institutional improvements in the civil service.	Review and implement as appropriate the recommendations of the Civil Service Commission.	Review to be completed in 1986.
d. Expenditure system *	Establish a system more conducive to tracking expenditure programs.	Implement a restructured budget.	Experimental presentation in 1986/87, with fuller implementation in subsequent years.
e. Tax reform *	Simplification; move toward expenditure taxation; reduce effective protection; increased revenue elasticity.	Review recommendations of World Bank study and implement appropriate measures.	Progress to be achieved during the program period.

(*) Asterisks show the policy actions which are formulated under IDA supported Structural Adjustment Operations

Malawi: Summary and Time Frame for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89 (continued)

Areas	Objectives and policies	Actions	Phasing of implementation
4. Public enterprises			
a. Agricultural Development and Marketing Corporation (ADMARC)*	Return to financial viability; redefinition of its role and activities.	(i) Crop trading accounts to be strengthened through better balance between purchase and selling prices; maize subsidy to be eliminated; (ii) Liquidity problems and recurrent cost to be addressed by Government's purchase of strategic grain reserve and silos; (iii) Divestment of development side of ADMARC's activities; (iv) Greater role for private sector in marketing. (Major assistance from World Bank is envisaged.)	Producer and consumer prices adjusted in 1986. Full cost maize pricing by April 1987. Transactions to be completed in 1986/87. Sale of selected assets in 1986/87; establishment of self-liquidating investment subsidiary in 1986/87. Throughout the program period.
b. Public enterprises *	Ensure viability and operation without government transfer.	Review of structure and role of the major statutory bodies, to be conducted by the World Bank. All enterprises to be subject to income tax.	Study to be initiated in 1986/87, with possible reforms commencing in 1987/88 with effect from 1987/88.
5. Money and credit policy			
a. Credit policies	Monetary restraint and reduced bank claims on the public sector.	Net domestic assets of the domestic banks to be reduced by contraction in claims on the Government and the statutory bodies in 1986/87.	Through fiscal year 1986/87. Continued restraint throughout the program period.
b. Financial intermediation	Promote greater financial intermediation; increase domestic saving; extend use of credit by private sector.	(i) Maintain positive real interest rates; (ii) ensure adherence to fiscal (including public enterprise) borrowing targets; (iii) Seek to liberalize interest rates.	Throughout the program period. Throughout the program period. Consider reduction in the number of borrowing and deposit rates set administratively.

(*) Asterisks show the policy actions which are formulated under IDA supported Structural Adjustment Operations.

MALAWI

Structural Adjustment Facility
Policy Framework Paper

KEY INDICATORS	Actual					Projected			
	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP (Growth Rate)	5.3%	3.0%	3.6%	3.3%	2.8%	3.1%	3.3%	3.5%	3.7%
GDY (Growth Rate)	-0.4%	4.8%	1.9%	3.6%	-1.7%	4.7%	3.4%	3.6%	4.7%
GDY/Capita (US\$)	-3.5%	1.6%	-1.3%	3.9%	-4.7%	1.5%	0.2%	0.4%	1.5%
Consumption/Capita (Growth Rate)	N.A.	-4.2%	4.8%	-0.6%	5.0%	-4.2%	0.2%	-0.8%	-1.3%
Debt Service (US\$)	112.7	101.7	78.6	116.7	114.4	122.2	120.8	122.4	112.8
Debt Service/XGS	33.0%	34.0%	28.0%	33.0%	38.0%	37.0%	33.0%	31.0%	26.0%
Debt Service/GDP	9.3%	9.0%	7.1%	11.0%	10.5%	11.0%	9.5%	8.6%	7.2%
Gross Investment/GDP	17.7%	21.5%	22.8%	13.9%	15.7%	17.0%	16.7%	17.4%	17.8%
- Public Investment/GDP	10.3%	8.4%	8.3%	8.5%	9.1%	10.0%	8.8%	8.3%	8.0%
- Private Investment/GDP	4.9%	6.2%	5.4%	4.0%	5.1%	5.0%	5.9%	7.1%	7.8%
- Stock Building/GDP	2.5%	6.9%	9.1%	1.4%	1.5%	2.0%	2.0%	2.0%	2.0%
Public/Private Investment (Ratio)	2.1	1.3	1.5	2.1	1.8	2.0	1.5	1.2	1.0
National Savings/GDP	6.9%	10.9%	11.0%	12.6%	6.6%	8.9%	9.1%	10.4%	12.4%
Public Savings/GDP	-1.0%	-1.3%	-0.2%	-0.7%	-1.0%	0.5%	1.0%	1.5%	2.0%
- Private Savings/GDP	7.9%	12.2%	11.2%	13.3%	7.6%	8.4%	8.1%	9.0%	9.7%
Domestic Savings/GDP	11.9%	15.1%	15.2%	16.6%	10.7%	14.3%	14.2%	15.2%	16.7%
Government Revenues/GDP ^{1/}	20.0%	19.7%	19.9%	20.9%	22.6%	23.4%	23.4%	23.4%	23.4%
Government Expenditures/GDP ^{1/}	35.6%	32.2%	30.1%	29.8%	33.2%	31.2%	29.6%	28.9%	28.9%
Deficit (-)/GDP ^{1/}	15.6%	12.5%	10.2%	8.9%	10.6%	7.8%	6.2%	5.5%	5.5%
Exports (Growth Rate)	-19.2%	-7.9%	4.0%	25.8%	2.7%	3.5%	3.7%	3.9%	4.0%
Exports/GDP	22.2%	20.5%	18.9%	26.0%	23.1%	24.8%	24.7%	23.8%	23.3%
Imports (Growth Rate)	-23.9%	-5.0%	1.5%	-12.0%	13.6%	3.0%	3.1%	3.2%	3.3%
Imports/GDP	28.4%	25.9%	25.3%	22.6%	26.9%	26.8%	26.3%	24.9%	23.4%
Current Account Deficit (US\$)	133.2	124.8	144.1	15.5	99.7	93.2	96.2	99.5	85.0
Current Account Deficit/GDP	10.8%	10.6%	11.8%	1.3%	9.1%	8.1%	7.6%	7.0%	5.4%

^{1/} Fiscal year runs from 1st of April to 31st of March; Data for 1981 refers to FY81/82, and so on.

Source: Economic Report 1986, IMF and World Bank estimates.

OFFICE MEMORANDUM

c:LF o/r
JK o/r

RECEIVED

1986 AUG 12 AM 5:16

DATE August 11, 1986

TO Mr. W. Wapenhans, Acting Chairman, OPSC

FROM S. M. L. van smder Meer, Acting RVP, AENVP

EXTENSION 61811

SUBJECT Malawi: SAF Policy Framework Paper

The above paper circulated to the Operations Policy Sub-Committee raises some concern about the apparently discriminatory pricing and credit policies proposed in Malawi agricultural sector. Whereas the government's objectives emphasize both agricultural exports and food self-sufficiency, "the primary objective will be to increase exports" and one of the policy measures will be to raise "the relative prices of commodities that have an export potential." Although the information provided in the paper is insufficient to arrive at a clear understanding of the situation, the following questions arise: To what extent are domestic food requirements already being met satisfactorily, and is it wise to set up a price incentive system that would discriminate against domestic food production in favor of agricultural exports?

Similarly, is there a case for favoring the estate sector by improving its access to credit? Are the credit needs of smallholders already covered adequately?

cc: ✓ Mr. Dubey (CPD), Mrs. Hardy (EAIDR), Mr. Isenman (ESAVP) (o/r)
Mr. Agueh (EAISE) (o/r), Mr. Karaosmanoglu (AENVP) (o/r)
Mr. Yenil (AENVP) (o/r)

MKarcher:dic

OFFICE MEMORANDUM

DATE: August 6, 1986

TO: Operations Policy Sub-Committee

FROM: Vinod Dubey, CPD *V. Dubey*

EXT: 60063

SUBJECT: MALAWI: SAF Policy Framework Paper

1. The attached Malawi Policy Framework Paper (PFP) is being distributed to the OPSC on a no objection basis. If you wish a meeting to be held or have comments, please contact the Chairman (with a copy of comments to CPD) by c.o.b. Monday, August 11, 1986.
2. The PFP was prepared jointly by the Bank and Fund staff and has been discussed with the Government. The paper has not been reviewed previously by the OPSC. The contents of the paper are consistent with the provisions of Malawi's ongoing adjustment program, supported by SAL III, as well as with an IMF Standby to be discussed at the IMF Board at the same time as the PFP. In reviewing the paper, the OPSC members may wish to consider whether the paper adequately reflects the long-term development constraints of the country. The policy matrix has not been cleared by the Government, and the indicators table has not been cleared by either the Government or the IMF, but are consistent with the contents of the paper. These will be staff attachments to the paper. Any changes suggested by the OPSC would need to obtain the appropriate clearances before the paper could be circulated to the Board.

Attachment

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector in recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply. The large public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending operations of the Bank and by successive stand-by

arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the smallholder agricultural sector. Key public sector institutions have been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of a structural adjustment has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: after encouraging signs in 1984, the external current account deficit rose to about 9.1 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 41 percent. The deficit on central government operations remains large. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is need for achieving growth in per capita income which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

For the coming three-year period, GDP growth is projected at 3.0-3.5 percent per year, which will permit an increase in real income per capita. To that end, the Government will seek to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in sections 3, 4, and 5 below) so as to achieve an improvement in the balance of payments. In this framework, the current account deficit would have to be reduced to a sustainable level, which on the basis of current information and outlook, would fall from about 7.8 percent of GDP in 1986-87 to about 6.3 percent of GDP by 1988 and 1989 while maintaining official reserves of at least two months of imports. The current account targets are based on projected export volume growth of about 3.5-4.0 percent per annum and import volume growth of about 3.0 percent per annum during 1986-89. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985, and is projected at 11.5 percent per year in 1986-87. To achieve a GDP growth rate of 3.0-3.5 percent and assuming moderate improvements in the use of capital, gross investment (including stock building) would have to be around 18 percent of GDP. The current account deficit (foreign savings) as a percentage of GDP would be reduced from an average of

8.7 percent in 1981-85 to about 6.3 percent in 1989, on the assumption that national savings would have to finance a larger share of investment (about 60 percent compared to 46 percent in 1981-85).

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as presented to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production, to increase exports and to promote self sufficiency in food. The primary objective will be to increase exports (including cotton, textiles, and tree crops) through agricultural pricing policies, and the provision of supporting services for export promotion and financing. Agricultural producer prices, which have been frequently adjusted in the past, normally will continue to be reviewed annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management training and extension service. Improved extension and research services for smallholders will also be provided, while the remaining subsidies on smallholder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of the decade, the alternative northern route, to the port of Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank and other donors, will reduce freight costs significantly, and will offer Malawi an alternative access to the sea, even when traditional routes through Mozambique can be reopened.

The Government will place additional emphasis on the health and education sectors, which are currently supported by sectoral lending programs of the World Bank.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports, and to promote efficient import substitution. Following the significant adjustment of the exchange rate which has already taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The authorities are committed to shortening delays in import payments during the program period and to improve the efficiency of the system of import authorization and exchange control. Finally, as the debt service ratio, although

progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants and external borrowing on concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the three-year period of the structural adjustment program.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. In particular, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.8 percent of GDP in 1986/87 and to 6.2 percent of GDP in 1987/88 and to about 5.5 percent of GDP in 1988/89. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC, whose position deteriorated significantly in 1985/86. Including receipts from the sale of the strategic grain reserve to Government, ADMARC will achieve an overall surplus of 2.1 percent of GDP in 1986/87 (see below). Excluding these receipts, its deficit will be reduced to 0.3 percent of GDP. Thereafter, ADMARC is expected to begin to show small surpluses. Assuming some increase in external financing of the Government, this fiscal position is sustainable. These objectives will be pursued also in the context of a stand-by arrangement with the Fund. The achievement of these targets will require careful review of the Government's expenditure which, together with realistic budgeting coupled with more effective control, should permit a modest expansion in development expenditure. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a comprehensive reform of the tax system with the objectives of simplification, greater equity, more rational indirect taxation and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget, in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity and infrastructural support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the

appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth and on improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that commercially oriented public enterprises should operate on an efficient and a profitable basis, so that they can contribute to the central government budget. To increase the efficiency of these enterprises, policies will aim at improving their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, regularizing financial flows between the enterprises and the Government and strengthening financial management. The scope for privatization will also be examined. The Government will adopt a strategy and timetable for the restructuring during 1986.

An urgent priority will be the restructuring of ADMARC. As a first step, during 1986/87, the Government will form a new holding company to take over ADMARC's nonmarketing-related investments. This company will divest six investments already identified and develop a strategy for the disposal of other assets. In addition, the Government has decided to acquire the strategic grain reserve and the silos in which it is stored. A fundamental review of ADMARC's marketing role is under way in consultation with the World Bank. The policy actions being considered include flexibility in the setting of producer and consumer prices so that each trading account is operated profitably; closure of markets which do not meet commercial criteria; introduction of differential pricing to minimize transportation costs; reduction in employment; and strengthening of corporate planning and management. These measures will facilitate private sector involvement in agricultural marketing. It is the intention that ADMARC achieve at least a breakeven financial position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private savings and an efficient allocation of capital. In the context of the program, the authorities will continue to explore the possibilities for moving toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector is being established under a World Bank financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of appropriate macroeconomic and structural policies will promote efficiency in the economy and stimulate production. Production of both traditional and nontraditional commodities for export is expected to benefit from these measures, in particular appropriate producer prices. Export performance should permit a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and achievement of GDP growth of 3.0-3.5 percent per annum during 1986-89. To achieve these objectives, gross inflows of grants and loans of about SDR 530-550 million over the period 1986-89 will be required. The World Bank is expected to contribute to the financing through SAL III and an anticipated SAL IV, of which SAL III and related cofinancing that has already been committed will amount to about SDR 95 million, while the Fund is expected to provide about SDR 17 million through the Structural Adjustment Facility (SAF). In 1986 gross capital inflows are expected to amount to about SDR 165 million, of which the World Bank is likely to contribute about SDR 95 million through SAL III and cofinancing, and the remainder is committed through concessional credits and grants from bilateral sources. The Fund is expected to provide SDR 7 million through a SAF loan. Also, the authorities have requested a 19-month stand-by arrangement with the Fund for an amount equivalent to SDR 24 million, from August 1986. In 1987 total loans and grants are estimated at SDR 135 million, which is expected to be met through additional disbursements under SAL III, including cofinancing, and possible additional support through SAL IV and anticipated concessional credits and grants which have been committed by bilateral donors. The second SAF loan is expected to amount to SDR 5 million. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations, and to maintain its relations with the Fund, at this stage in the context of a stand-by arrangement.

Malawi: Principal Elements of a Common Policy Framework

Targets

Real GDP growth	3.0-3.5 percent per annum in 1986-89
Increase in consumer prices	About 11.5 percent in 1986-87 and about 7 percent in 1988-89
External current account deficit	About 7-8 percent of GDP in 1986-87 to about 6.3 percent of GDP in 1988-89
Real import growth	About 3 percent per annum in 1986-89
Real export growth	About 3.5-4.0 percent per annum in 1986-89
Gross official reserves	At least 2 months of imports in 1986-89

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing aiming at promoting export crops and food self-sufficiency (continuous)

External sector

Flexibility in exchange rate management
Reduction in payment restrictions and more efficient foreign exchange allocation system (from 1986)
Restrained nonconcessional external borrowing (continuous)

Public sector

Central government deficit (excluding grants) 7.8 percent of GDP in 1986/87 to 5.5 percent of GDP in 1988/89
Institutional improvements in the Civil Service (from 1986/87)
Tax Reform (from 1986/87)
Increased programmatic approach to expenditures (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focusing on productive and export activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC restructuring: asset disposal (1986/87); breakeven in current operations (1987/88); review of marketing role (1988/89)

Monetary and financial sector

Real interest rates positive (continuous)
Financial schemes for export promotion and estate agriculture (from 1986)

Malawi: Summary and Timeframe for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89

Area	Objectives and policies	Actions	Phasing of implementation
1. Production, investment, and pricing			
a. Agricultural producer prices *	To ensure appropriate balance among food and export crops; and to enable profitable distribution and marketing.	Continue annual review of prices, in consultation with the World Bank, increasing the relative returns for selected export crops. Eliminate subsidization.	Major progress to be made through prices to be announced in September 1986. Annual reviews thereafter.
b. Export promotion and diversification *	To reduce export concentration in tobacco, tea, and sugar, while increasing total exports.	(i) Flexible exchange rate policy. (ii) Establish export financing facilities. (iii) Improve price incentives to smallholder farmers (see also section 1a).	Throughout the program period. Plans to be finalized during 1987/88. Implementation to start during 1986 review of agricultural prices.
c. Investment program *	Formulation of public investment program, paying due regard to financing and future recurrent cost implications.	Ensure consistency of each year's program with domestic and external budgetary resources.	Annual implementation within a three-year rolling framework; details to be established in consultation with the World Bank.
d. Retail prices *	Maintain liberal price regime.	No further action required.	
e. Fertilizer subsidies *	Full cost pricing of fertilizer sold to smallholders.	Eliminate subsidization.	Continue four-year phase out started in 1985/86 as agreed with World Bank and USAID.
f. Agricultural credit *	Provision of credit to estate agriculture.	Creation of a new facility within existing institutions	World Bank project approved in 1985 provides the basis for expanded activity in subsequent years if needed.
2. External policies			
a. Exchange rate	Flexible exchange rate policy.	Exchange rate adjustments at least to prevent any real effective appreciation.	Initial adjustment to be made in 1986; regular reviews thereafter.
b. External borrowing	To decrease the external debt service ratio.	Limit the use of nonconcessional borrowing.	Quantitative targets.
c. Exchange regime	To promote a more liberal and comprehensible system of foreign exchange allocation.	Improve efficiency in import - authorization and exchange controls through more active exchange rate policy.	To be implemented in parallel with 2(a).
3. Government			
a. Budget	Progressive reduction in the overall deficit.	Revenue measures equivalent to 2.0 percent of GDP; and expenditure restraints on wage bill and other recurrent and development components.	Budget introduced in March 1986, as supplemented by measures taken through August.
b. Expenditure control	To increase adherence to budgeted expenditure.	further measures to reach targets of 6.2 percent of GDP in 1987/88 and 5.5 percent in 1988/89. Quarterly targets on expenditure aggregates; introduce expenditure monitoring committee at highest level of the Civil Service.	Committee to start functioning in 1986/87.
c. Expenditure efficiency *	Institutional improvements in the civil service.	Review and implement as appropriate the recommendations of the Civil Service Commission.	Review to be completed in 1986.
d. Expenditure system *	Establish a system more conducive to tracking expenditure programs.	Implement a restructured budget.	Experimental presentation in 1986/87, with fuller implementation in subsequent years.
e. Tax reform *	Simplification; move toward expenditure taxation; reduce effective protection; increased revenue elasticity.	Review recommendations of World Bank study and implement appropriate measures.	Progress to be achieved during the program period.

(*) Asterisks show the policy actions which are formulated under IDA supported Structural Adjustment Operations.

4. Public enterprises

(a) Agricultural Development and Marketing Corporation (ADMARC) *

Return to financial viability; redefinition of its role and activities.

- (i) Crop trading accounts to be strengthened through better balance between purchase and selling prices; maize subsidy to be eliminated;
- (ii) Liquidity problems and recurrent cost to be addressed by Government's purchase of strategic grain reserve and silos;
- (iii) Divestment of development side of ADMARC's activities;
- (iv) Greater role for private sector in marketing.
(Major assistance from World Bank is envisaged.)

Producer and consumer prices adjusted in 1986. Full cost maize pricing by April 1987.

Transactions to be completed in 1986/87.

Sale of selected assets in 1986/87; establishment of self-liquidating investment subsidiary in 1986/87.

Throughout the program period.

(b) Public enterprises *

Ensure viability and operation without government transfer.

Review of structure and role of the major statutory bodies, to be conducted by the World Bank. All enterprises to be subject to income tax.

Study to be initiated in 1986/87, with possible reforms commencing in 1987/88 with effect from 1987/88.

(*) Asterisks show the policy actions which are formulated under IDA-supported Structural Adjustment Operations.

Malawi (concluded). Summary and Timeframe for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89

Areas	Objectives and policies	Actions	Phasing of implementation
5. <u>Money and credit policy</u>			
a. Credit policies	Monetary restraint and reduced bank claims on the public sector	Net domestic assets of the domestic banks to be reduced by contraction in claims on the Government and the statutory bodies in 1986/87.	Through fiscal year 1986/87. Continued restraint throughout the program period.
b. Financial intermediation	Promote greater financial intermediation; increase domestic saving; extend use of credit by private sector.	<ul style="list-style-type: none"> (i) Maintain positive real interest rates; (ii) ensure adherence to fiscal (including public enterprise) borrowing targets; (iii) Seek to liberalize interest rates. 	<p>Throughout the program period.</p> <p>Throughout the program period.</p> <p>Consider reduction in the number of borrowing and deposit rates set administratively.</p>

MALAWI

Structural Adjustment Facility Policy Framework Paper

KEY INDICATORS	Actual					Projected			
	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP (Growth Rate)	5.3%	3.0%	3.6%	3.3%	2.8%	3.1%	3.3%	3.5%	3.7%
GUY (Growth Rate)	-0.4%	4.8%	1.9%	3.6%	-1.7%	4.7%	3.4%	3.6%	4.7%
GUY/Capita (US\$)	-3.5%	1.6%	-1.3%	3.9%	-4.7%	1.5%	0.2%	0.4%	1.5%
Consumption/Capita (Growth Rate)	N.A.	-4.2%	4.8%	-0.6%	5.0%	-4.2%	0.2%	-0.8%	-1.3%
Debt Service (US\$)	112.7	101.7	78.6	116.7	114.4	122.2	120.8	122.4	112.8
Debt Service/XGS	33.0%	34.0%	28.0%	33.0%	38.0%	37.0%	33.0%	31.0%	26.0%
Debt Service/GDP	9.3%	9.0%	7.1%	11.0%	10.5%	11.0%	9.5%	8.6%	7.2%
Gross Investment/GDP	17.7%	21.5%	22.8%	13.9%	15.7%	17.0%	16.7%	17.4%	17.8%
- Public Investment/GDP	10.3%	8.4%	8.3%	8.5%	9.1%	10.0%	8.8%	8.3%	8.0%
- Private Investment/GDP	4.9%	6.2%	5.4%	4.0%	5.1%	5.0%	5.9%	7.1%	7.8%
- Stock Building/GDP	2.5%	6.9%	9.1%	1.4%	1.5%	2.0%	2.0%	2.0%	2.0%
Public/Private Investment (Ratio)	2.1	1.3	1.5	2.1	1.8	2.0	1.5	1.2	1.0
National Savings/GDP	6.9%	10.9%	11.0%	12.6%	6.6%	8.9%	9.1%	10.4%	12.4%
Public Savings/GDP	-1.0%	-1.3%	-0.2%	-0.7%	-1.0%	0.5%	1.0%	1.5%	2.0%
- Private Savings/GDP	7.9%	12.2%	11.2%	13.3%	7.6%	8.4%	8.1%	9.0%	9.7%
Domestic Savings/GDP	11.9%	15.1%	15.2%	16.6%	10.7%	14.3%	14.2%	15.2%	16.7%
Government Revenues/GDP ^{1/}	20.0%	19.7%	19.9%	20.9%	22.6%	23.4%	23.4%	23.4%	23.4%
Government Expenditures/GDP ^{1/}	35.6%	32.2%	30.1%	29.8%	33.2%	31.2%	29.6%	28.9%	28.9%
Deficit (-)/GDP ^{1/}	15.6%	12.5%	10.2%	8.9%	10.6%	7.8%	6.2%	5.5%	5.5%
Exports (Growth Rate)	-19.2%	-7.9%	4.0%	25.8%	2.7%	3.5%	3.7%	3.9%	4.0%
Exports/GDP	22.2%	20.5%	18.9%	26.0%	23.1%	24.8%	24.7%	23.8%	23.3%
Imports (Growth Rate)	-23.9%	-5.0%	1.5%	-12.0%	13.6%	3.0%	3.1%	3.2%	3.3%
Imports/GDP	28.4%	25.9%	25.3%	22.6%	26.9%	26.8%	26.3%	24.9%	23.4%
Current Account Deficit (US\$)	133.2	124.8	144.1	15.5	99.7	93.2	96.2	99.5	85.0
Current Account Deficit/GDP	10.8%	10.6%	11.8%	1.3%	9.1%	8.1%	7.6%	7.0%	5.4%

^{1/} Fiscal year runs from 1st of April to 31st of March; Data for 1981 refers to FY81/82, and so on.

Source: Economic Report 1986, IMF and World Bank estimates.

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July 31, 1986

TO: Messrs. A.Choksi (CPD)
Katz (CPD)
Iseman (ESAVP)

This PFP represents a compromise among ourselves, the IMF and the Government. The matrix has not been cleared by the Government and the Table of Indicators has not been cleared by either the Government or the IMF, but they are consistent with the contents of the paper. Since the IMF hopes to present their Stand-by to the Board by the middle of next week your clearance as soon as possible would be appreciated.

Fred M. King

Fred King, EALSE

U-1200, ext. 6-9624

Attachment

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector in recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply. The large public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending operations of the Bank and by successive stand-by arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the smallholder agricultural sector. Key public sector institutions have

been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of structural adjustment has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: after encouraging signs in 1984, the external current account deficit rose to about 9.1 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 41 percent. The deficit on central government operations remains large. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is need for achieving growth in per capita income which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

For the coming three-year period, GDP growth is projected at 3.0-3.5 percent per year, which will permit an increase in real income per capita. To that end, the Government will seek to adjust the economy through incentives to the private sector and restructuring of the public

sector (as outlined in sections 3, 4, and 5 below) so as to achieve an improvement in the balance of payments. In this framework, the current account deficit would have to be reduced to a sustainable level, which on the basis of current information and outlook, would fall from about 7.8 percent of GDP in 1986-87 to about 6.3 percent of GDP by 1988 and 1989 while maintaining official reserves of at least two months of imports. The current account targets are based on projected export volume growth of about 3.5-4.0 percent per annum and import volume growth of about 3.0 percent per annum during 1986-89. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985, and is projected at 11.5 percent per year in 1986-87. To achieve a GDP growth rate of 3.0-3.5 percent and assuming moderate improvements in the use of capital, gross investment (including stock building) would have to be around 18 percent of GDP. The current account deficit (foreign savings) as a percentage of GDP would be reduced from an average of 8.7 percent in 1981-85 to about 6.3 percent in 1989, on the assumption that national savings would have to finance a larger share of investment (about 60 percent compared to 46 percent in 1981-85).

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as presented to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production, to increase exports and to promote self sufficiency in food. The primary objective will be to increase exports (including cotton, textiles, and

tree crops) through agricultural pricing policies, and the provision of supporting services for export promotion and financing. Agricultural producer prices, which have been frequently adjusted in the past, normally will continue to be reviewed annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management training and extension service. Improved extension and research services for smallholders will also be provided, while the remaining subsidies on smallholder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of the decade, the alternative northern route, to the port of Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank and other donors, will reduce freight costs significantly, and will offer Malawi an alternative access to the sea, even when traditional routes through Mozambique can be reopened.

The Government will place additional emphasis on the health and education sectors, which are currently supported by sectoral lending programs of the World Bank.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate

policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports, and to promote efficient import substitution. Following the significant adjustment of the exchange rate which has already taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The authorities are committed to shortening delays in import payments during the program period and to improve the efficiency of the system of import authorization and exchange control. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants and external borrowing on concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the three-year period of the structural adjustment program.

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In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. In particular, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.8 percent of GDP in 1986/87 and to 6.2 percent of GDP in 1987/88 and to about 5.5 percent of GDP in 1988/89. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC, whose position deteriorated significantly in 1985/86. Including receipts from the sale of the strategic grain reserve to Government,

ADMARC will achieve an overall surplus of 2.1 percent of GDP in 1986/87 (see below). Excluding these receipts, its deficit will be reduced to 0.3 percent of GDP. Thereafter, ADMARC is expected to begin to show small surpluses. Assuming some increase in external financing of the Government, this fiscal position is sustainable. These objectives will be pursued also in the context of a stand-by arrangement with the Fund. The achievement of these targets will require careful review of the Government's expenditure which, together with realistic budgeting coupled with more effective control, should permit a modest expansion in development expenditure. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a comprehensive reform of the tax system with the objectives of simplification, greater equity, more rational indirect taxation and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget, in line with a tax study in collaboration with the World Bank.

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Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private savings and an efficient allocation of capital. In the context of the program, the authorities will continue to explore the possibilities for moving toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector is being established under a World Bank financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of appropriate macroeconomic and structural policies will promote efficiency in the economy and stimulate production. Production of both traditional and nontraditional commodities for export is expected to benefit from these measures, in particular appropriate producer prices. Export performance should permit a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and achievement of GDP growth of 3.0-3.5 percent per annum during 1986-89. To achieve these objectives, gross inflows of grants and loans of about SDR 530-550 million over the period 1986-89 will be required. The World Bank is expected to contribute to the financing through SAL III and an anticipated SAL IV, of which SAL III and related cofinancing that has already been committed will amount to about SDR 95 million, while the Fund is expected to provide about SDR 17 million through the Structural Adjustment Facility (SAF). In 1986 gross capital inflows are expected to amount to about SDR 165 million, of which the World Bank is likely to contribute about SDR 95 million through SAL III and cofinancing, and the remainder is committed through concessional credits and grants from bilateral sources. The Fund is expected to provide SDR 7 million through a SAF loan. Also, the authorities have requested a 19-month stand-by arrangement with the Fund for an amount equivalent to SDR 24 million, from August 1986. In 1987 total loans and grants are estimated at SDR 135 million, which is expected to be met through additional disbursements under SAL III, including cofinancing, and possible additional support through SAL IV

and anticipated concessional credits and grants which have been committed by bilateral donors. The second SAF loan is expected to amount to SDR 5 million. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations, and to maintain its relations with the Fund, at this stage in the context of a stand-by arrangement.

Malawi: Principal Elements of a Common Policy Framework

Targets

Real GDP growth	3.0-3.5 percent per annum in 1986-89
Increase in consumer prices	About 11.5 percent in 1986-87 and about 7 percent in 1988-89
External current account deficit	About 7-8 percent of GDP in 1986-87 to about 6.3 percent of GDP in 1988-89
Real import growth	About 3 percent per annum in 1986-89
Real export growth	About 3.5-4.0 percent per annum in 1986-89
Gross official reserves	At least 2 months of imports in 1986-89

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing aiming at promoting export crops and food self-sufficiency (continuous)

External sector

Flexibility in exchange rate management
Reduction in payment restrictions and more efficient foreign exchange allocation system (from 1986)
Restrained nonconcessional external borrowing (continuous)

Public sector

Central government deficit (excluding grants) 7.8 percent of GDP in 1986/87 to 5.5 percent of GDP in 1988/89
Institutional improvements in the Civil Service (from 1986/87)
Tax Reform (from 1986/87)
Increased programmatic approach to expenditures (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focusing on productive and export activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC restructuring: asset disposal (1986/87); breakeven in current operations (1987/88); review of marketing role (1988/89)

Monetary and financial sector

Real interest rates positive (continuous)
Financial schemes for export promotion and estate agriculture (from 1986)

Malawi: Summary and Timeframe for Implementation of Policies Under Structural Adjustment Facility Arrangement, 1986/87-1988/89

	Objectives and policies	Actions	Phasing of implementation
1. Production, investment, and pricing			
a. Agricultural producer prices	To ensure appropriate balance among food and export crops; and to enable profitable distribution and marketing.	Continue annual review of prices, in consultation with the World Bank, increasing the relative returns for selected export crops.	Major progress to be made through prices to be announced in September 1986. Annual reviews thereafter.
b. Export promotion and diversification	To reduce export concentration in tobacco, tea, and sugar, while increasing total exports.	(i) Flexible exchange rate policy. (ii) Establish export financing facilities. (iii) Improve price incentives to smallholder farmers (see also section la).	Throughout the program period. Plans to be finalized during 1987/88. Implementation to start during 1986 review of agricultural prices.
c. Investment program	Formulation of public investment program, paying due regard to financing and future recurrent cost implications.	Ensure consistency of each year's program with domestic and external budgetary resources.	Annual implementation within a three-year rolling framework; details to be established in consultation with the World Bank.
d. Retail prices	Maintain liberal price regime.	No further action required.	
e. Fertilizer subsidies	Full cost pricing of fertilizer sold to smallholders.	Eliminate subsidization.	Continue four-year phase out started in 1985/86 as agreed with World Bank and USAID.
f. Agricultural credit	Provision of credit to estate agriculture.	Creation of a new facility within existing institutions	World Bank project approved in 1985 provides the basis for expanded activity in subsequent years if needed.
2. External policies			
a. Exchange rate	Flexible exchange rate policy.	Exchange rate adjustments at least to prevent any real effective appreciation.	Initial adjustment to be made in 1986; regular reviews thereafter.
b. External borrowing	To decrease the external debt service ratio.	Limit the use of nonconcessional borrowing.	Quantitative targets.
c. Exchange regime	To promote a more liberal and comprehensible system of foreign exchange allocation.	Improve efficiency in import - authorization and exchange controls through more active exchange rate policy.	To be implemented in parallel with 2(a).
3. Government			
a. Budget	Progressive reduction in the overall deficit.	Revenue measures equivalent to 2.0 percent of GDP; and expenditure restraints on wage bill and other recurrent and development components.	Budget introduced in March 1986, as supplemented by measures taken through August.
b. Expenditure control	To increase adherence to budgeted expenditure.	further measures to reach targets of 6.2 percent of GDP in 1987/88 and 5.5 percent in 1988/89. Quarterly targets on expenditure aggregates; introduce expenditure monitoring committee at highest level of the Civil Service.	Committee to start functioning in 1986/87.
c. Expenditure efficiency	Institutional improvements in the civil service.	Review and implement as appropriate the recommendations of the Civil Service Commission.	Review to be completed in 1986.
d. Expenditure system	Establish a system more conducive to tracking expenditure programs.	Implement a restructured budget.	Experimental presentation in 1986/87, with fuller implementation in subsequent years.
e. Tax reform	Simplification; move toward expenditure taxation; reduce effective protection; increased revenue elasticity.	Review recommendations of World Bank study and implement appropriate measures.	Progress to be achieved during the program period.

Public enterprises

(a) Agricultural Development and Marketing Corporation (ADMARC)

Return to financial viability; redefinition of its role and activities.

- (i) Crop trading accounts to be strengthened through better balance between purchase and selling prices; maize subsidy to be eliminated;
- (ii) Liquidity problems and recurrent cost to be addressed by Government's purchase of strategic grain reserve and silos;
- (iii) Divestment of development side of ADMARC's activities;
- (iv) Greater role for private sector in marketing.
(Major assistance from World Bank is envisaged.)

Producer and consumer prices adjusted in 1986. Full cost maize pricing by April 1987.

Transactions to be completed in 1986/87.

Sale of selected assets in 1986/87; establishment of self-liquidating investment subsidiary in 1986/87.

Throughout the program period.

(b) Public enterprises

Ensure viability and operation without government transfer.

Review of structure and role of the major statutory bodies, to be conducted by the World Bank. All enterprises to be subject to income tax.

Study to be initiated in 1986/87, with possible reforms commencing in 1987/88 with effect from 1987/88.

Areas	Objectives and policies	Actions	Phasing of implementation
5. <u>Money and credit policy</u>			
a. Credit policies	Monetary restraint and reduced bank claims on the public sector	Net domestic assets of the domestic banks to be reduced by contraction in claims on the Government and the statutory bodies in 1986/87.	Through fiscal year 1986/87. Continued restraint throughout the program period.
b. Financial intermediation	Promote greater financial intermediation; increase domestic saving; extend use of credit by private sector.	<ul style="list-style-type: none"> (i) Maintain positive real interest rates; (ii) ensure adherence to fiscal (including public enterprise) borrowing targets; (iii) Seek to liberalize interest rates. 	<p>Throughout the program period.</p> <p>Throughout the program period.</p> <p>Consider reduction in the number of borrowing and deposit rates set administratively.</p>

MALAWI

Structural Adjustment Facility
Policy Framework Paper

KEY INDICATORS	Actual					Projected			
	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP (Growth Rate)	5.3%	3.0%	3.6%	3.3%	2.8%	3.1%	3.3%	3.5%	3.7%
GDY (Growth Rate)	-0.4%	4.8%	1.9%	3.6%	-1.7%	4.7%	3.4%	3.6%	4.7%
GDY/Capita (US\$)	-3.5%	1.6%	-1.3%	3.9%	-4.7%	1.5%	0.2%	0.4%	1.5%
Consumption/Capita (Growth Rate)	N.A.	-4.2%	4.8%	-0.6%	5.0%	-4.2%	0.2%	-0.8%	-1.3%
Debt Service (US\$)	112.7	101.7	78.6	116.7	114.4	122.2	120.8	122.4	112.8
Debt Service/XGS	33.0%	34.0%	28.0%	33.0%	38.0%	37.0%	33.0%	31.0%	26.0%
Debt Service/GDP	9.3%	9.0%	7.1%	11.0%	10.5%	11.0%	9.5%	8.6%	7.2%
Gross Investment/GDP	17.7%	21.5%	22.8%	13.9%	15.7%	17.0%	16.7%	17.4%	17.8%
- Public Investment/GDP	10.3%	8.4%	8.3%	8.5%	9.1%	10.0%	8.8%	8.3%	8.0%
- Private Investment/GDP	4.9%	6.2%	5.4%	4.0%	5.1%	5.0%	5.9%	7.1%	7.8%
- Stock Building/GDP	2.5%	6.9%	9.1%	1.4%	1.5%	2.0%	2.0%	2.0%	2.0%
Public/Private Investment (Ratio)	2.1	1.3	1.5	2.1	1.8	2.0	1.5	1.2	1.0
National Savings/GDP	6.9%	10.9%	11.0%	12.6%	6.6%	8.9%	9.1%	10.4%	12.4%
- Public Savings/GDP	-1.0%	-1.3%	-0.2%	-0.7%	-1.0%	0.5%	1.0%	1.5%	2.0%
- Private Savings/GDP	7.9%	12.2%	11.2%	13.3%	7.6%	8.4%	8.1%	9.0%	9.7%
Domestic Savings/GDP	11.9%	15.1%	15.2%	16.6%	10.7%	14.3%	14.2%	15.2%	16.7%
Government Revenues/GDP ^{1/}	20.0%	19.7%	19.9%	20.9%	22.6%	23.4%	23.4%	23.4%	23.4%
Government Expenditures/GDP ^{1/}	35.6%	32.2%	30.1%	29.8%	33.2%	31.2%	29.6%	28.9%	28.9%
Deficit (-)/GDP ^{1/}	15.6%	12.5%	10.2%	8.9%	10.6%	7.8%	6.2%	5.5%	5.5%
Exports (Growth Rate)	-19.2%	-7.9%	4.0%	25.8%	2.7%	3.5%	3.7%	3.9%	4.0%
Exports/GDP	22.2%	20.5%	18.9%	26.0%	23.1%	24.8%	24.7%	23.8%	23.3%
Imports (Growth Rate)	-23.9%	-5.0%	1.5%	-12.0%	13.6%	3.0%	3.1%	3.2%	3.3%
Imports/GDP	28.4%	25.9%	25.3%	22.6%	26.9%	26.8%	26.3%	24.9%	23.4%
Current Account Deficit (US\$)	133.2	124.8	144.1	15.5	99.7	93.2	96.2	99.5	85.0
Current Account Deficit/GDP	10.8%	10.6%	11.8%	1.3%	9.1%	8.1%	7.6%	7.0%	5.4%

^{1/} Fiscal year runs from 1st of April to 31st of March; Data for 1981 refers to FY81/82, and so on.

Source: Economic Report 1986, IMF and World Bank estimates.

[CH5-Lago-1]

OFFICE MEMORANDUM

cc: YH, LF, JK

→ B-10

DATE: July 15, 1986
TO: Distribution
FROM: Florent Agueh, Chief, EAISE
EXTENSION: 6-9620
SUBJECT: MALAWI - Policy Framework Paper (PFP)

fag.

The attached draft of the Policy Framework Paper for Malawi has been approved by the Malawi Government (except for a few very recent changes which are now being checked with them) by IMF staff and by my division staff. It reflects the results of extensive discussion between the Malawi Government and a recent IMF mission in which Bank staff participated and also takes into account the comments of a working level meeting of Bank staff held on May 29.

The objectives and policy measures outlined in the Paper are fully consistent with the program being supported through the Third Structural Adjustment loan. We have revised the projections made for the SAL to take account of recent developments and additional data as well as a range of views in the Fund and the Bank concerning the likely impact of policy change. The differences between the PFP and SAL projections are however relatively small (exports, for example, in the period 1986-89 are projected to grow at 3.5-4.0% per annum in the PFP compared with 4.5-5.0% per annum under the SAL, and GDP is projected to grow at 3.0-3.5% per annum in the PFP compared with 3.5-4.0% under the SAL) and well within the margin of error of such projections exercises.

Please could you let Ian Porter (X69632) know by COB, Thursday, July 17th, whether you have any additional comments on the Paper. It will then be forwarded to OPSC for review.

Distribution: Messrs. Jaycox, Isenman (EASVP); Kraske (o/r), Messenger, Greene (EAIDR); Christoffersen, Garg, Southworth (EAP); Choksi (CPD); Tuncer, Porter, King (o/r), Lago-Gallego (EAISE).

[CH5-Porter's (Mem15jul86)5]

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector in recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply. The large public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending operations of the Bank and by successive stand-by arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the smallholder agricultural sector. Key public sector institutions have

been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of a structural adjustment has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: after encouraging signs in 1984, the external current account deficit rose to about 9.1 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 41 percent. The deficit on central government operations remains large. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is need for achieving growth in per capita income which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

For the coming three-year period, GDP growth is projected at 3.0-3.5 percent per year, which will permit an increase in real income per capita. To that end, the Government will seek to adjust the economy through incentives to the private sector and restructuring of the public

sector (as outlined in sections 3, 4, and 5 below) so as to achieve an improvement in the balance of payments. In this framework, the current account deficit would have to be reduced to a sustainable level, which on the basis of current information and outlook, would fall from about 7.8 percent of GDP in 1986-87 to about 6.3 percent of GDP by 1988 and 1989 while maintaining official reserves of at least two months of imports. The current account targets assume that export volumes will grow by about 3.5-4.0 percent per annum and import volumes by about 3.0 percent per annum during 1986-89. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985, and is projected at 11.5 percent per year in 1986-87. To achieve a GDP growth rate of 3.0-3.5 percent and assuming moderate improvements in the use of capital, gross investment (including stock building) would have to be around 18 percent of GDP. Since the current account deficit (foreign savings) as a percentage of GDP would be reduced from an average of 8.7 percent in 1981-85 to about 6.6 percent in the next four years, national savings would have to finance a larger share of investment (about 60 percent compared to 46 percent in 1981-85). This would come about through increases in both public and private savings.

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as presented to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production, to increase exports and to promote self sufficiency in food. The primary objective will be to increase minor exports (such as cotton, groundnuts,

and rice) and nontraditional exports (such as textiles and tree crops, among others) through agricultural pricing policies, and the provision of supporting services for export promotion and financing. Agricultural producer prices, which have been frequently adjusted in the past, normally will continue to be reviewed annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management training and extension service. Improved extension and research services for smallholders will also be provided, while the remaining subsidies on smallholder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of the decade, the alternative northern route, to the port of Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank and other donors, will reduce freight costs significantly, and will offer Malawi an alternative access to the sea, even when traditional routes are open.

The Government will place additional emphasis on the health and education sectors, which are currently supported by sectoral lending programs of the World Bank.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports, and to promote efficient import substitution. Following the significant adjustment of the exchange rate which has already taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The authorities are committed to shortening delays in import payments during the program period and to improve the efficiency of the system of import authorization and exchange control. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants and external borrowing on concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the three-year period of the structural adjustment program.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. In particular, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.8 percent of GDP in 1986/87 and to 6.2 percent of GDP in 1987/88 and to about 5.5 percent of GDP in 1988/89. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC,

whose position deteriorated significantly in 1985/86. Including receipts from the sale of the strategic grain reserve to Government, ADMARC will achieve an overall surplus of 2.1 percent of GDP in 1986/87 (see below). Excluding these receipts, its deficit will be reduced to 0.3 percent of GDP. Thereafter, ADMARC is expected to begin to show small surpluses. Assuming some increase in external financing of the Government, this fiscal position is sustainable. These objectives will be pursued also in the context of a stand-by arrangement with the Fund. The achievement of these targets will require careful review of the Government's expenditure which, together with realistic budgeting coupled with more effective control, should permit a modest expansion in development expenditure. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a comprehensive reform of the tax system with the objectives of simplification, greater equity, more rational indirect taxation and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget, in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity and infrastructural support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth and on improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that commercially oriented public enterprises should operate on an efficient and a profitable basis, so that they can contribute to the central government budget. To increase the efficiency of these enterprises, policies will aim at improving their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, regularizing financial flows between the enterprises and the Government and strengthening financial management. The scope for privatization will also be examined. The Government will adopt a strategy and timetable for the restructuring during 1986.

An urgent priority will be the restructuring of ADMARC. As a first step, during 1986/87, the Government will form a new holding company to take over ADMARC's nonmarketing-related investments. This company will divest six investments already identified and develop a strategy for the disposal of other assets. In addition, the Government has decided to acquire the strategic grain reserve and the silos in which it is stored. A fundamental review of ADMARC's marketing role is under way in consultation with the World Bank. The policy actions being considered include flexibility in the setting of producer and consumer prices so that each trading account is operated profitably; closure of markets which do not meet commercial criteria; introduction of differential pricing to minimize transportation costs; reduction in employment; and strengthening of corporate planning and management. These measures will facilitate private sector involvement in agricultural marketing. It is the intention that ADMARC achieve at least a breakeven financial position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private savings and an efficient allocation of capital. In the context of the program, the authorities will continue to explore the possibilities for moving toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector is being established under a

World Bank financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of appropriate macroeconomic and structural policies will promote efficiency in the economy and stimulate production. Production of both traditional and nontraditional commodities for export is expected to benefit from these measures, in particular appropriate producer prices. Export performance should permit a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and achievement of GDP growth of 3.0-3.5 percent per annum during 1986-89. To achieve these objectives, gross inflows of grants and loans of about SDR 550-575 million over the period 1986-89 will be required. The likely contribution of the World Bank is about SDR 190 million through SAL III, SAL IV, ADMARC support and related cofinancing, and the Fund at about SDR 17 million through the Structural Adjustment Facility (SAF). In 1986 gross capital inflows are expected to amount to SDR 175 million, of which the World Bank will contribute about SDR 95 million through SAL III and cofinancing, and the Fund SDR 7 million through SAF loan. The authorities have requested a 19-month stand-by arrangement with the Fund for an amount equivalent to SDR 24 million, from August 1986. In 1987 total loans and grants are estimated at SDR 145 million, of which the World Bank is likely to contribute about SDR 55 million through SAL IV and ADMARC support and

related cofinancing and the Fund SDR 5 million through the SAF loan. The remainder of concessional loans and grants in both 1986 and 1987 has been committed by other donors and lenders in connection with investment projects and restructuring of ADMARC. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations, and to maintain its relations with the Fund, at this stage in the context of a stand-by arrangement.

Malawi: Principal Elements of a Common Policy Framework

Targets

Real GDP growth	3.0-3.5 percent per annum in 1986-89
Increase in consumer prices	About 11.5 percent in 1986-87 and about 7 percent in 1988-89
External current account deficit	About 7-8 percent of GDP in 1986-87 to about 6.3 percent of GDP in 1988-89
Real import growth	About 3 percent per annum in 1986-89
Real export growth	About 3.5-4.0 percent per annum in 1986-89
Gross official reserves	At least 2 months of imports in 1986-89
Gross investment (including stock building)	About 18 percent of GDP in 1986-89
National savings	About 11 percent of GDP in 1986-89

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing aiming at promoting export crops and food self-sufficiency (continuous)

External sector

Flexibility in exchange rate management
Reduction in payment restrictions and more efficient foreign exchange allocation system (from 1986)
Restrained nonconcessional external borrowing (continuous)

Public sector

Central government deficit (excluding grants) 7.8 percent of GDP in 1986/87 to 5.5 percent of GDP in 1988/89
Institutional improvements in the Civil Service (from 1986/87)
Tax Reform (from 1986/87)
Increased programmatic approach to expenditures (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focusing on productive and export activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC restructuring: asset disposal (1986/87); breakeven in current operations (1987/88); review of marketing role (1988/89)

Monetary and financial sector

Real interest rates positive (continuous)
Financial schemes for export promotion and estate agriculture (from 1986)

→ B-2d.

July 18, 1986

Ian Porter

Ian,

As we discussed yesterday, below are CPD's comments on the draft Malawi PFP to be incorporated before circulation to the OPSC. They are largely a matter of presentation, and are based on the OPSC's guidance and issues raised on other papers (which are embodied in the guidelines sent yesterday).
(draft)

1. In sections 1 and 2, there is much discussion of the financial and macroeconomic problems, but by comparison, only a few references to issues of incentives, institutional reform and basic development constraints. This might convey the impression that addressing the latter is not important for achieving the growth and development objectives of the policy framework. Some additional material on these problems, (e.g., managerial capacity) which are being addressed with Bank support, would restore this balance and give a context for some of the actions that are mentioned later in the text.

2. Numbers used in the text, especially when referring to the outer years of the Program, seem overly precise for the paper (even if they were important to clarify the discussions with the IMF and the government). You may wish to express the various ratios to GDP without decimal points, and/or qualify the relevant statements. (Indeed, the apparent discrepancy between the PFP projections and the SAL would not arise if the expected GDP growth rate were expressed as 3-4%, if all are agreeable to this.) A particular example is the discussion of the fiscal deficit (last para., p. 6), which as put does not convey the sense of flexibility that is supposed to be (we understand) an important element of these programs. While this can be handled in a number of ways, I would offer as a formulation for the last part of the sentence "...and to an average of 5 1/2 to 6 percent on a declining trend in 1987/88 - 1988/89", or simply "and to about 5 1/2 percent by the end of the program period".

3. The references to future commitments by the Bank are rather specific, while the situation with other donors could be brought out more clearly. What are the disbursements expected on the basis of existing commitments, and what would be needed to meet the remaining projected requirement.

4. The "guidelines" have a sample policy matrix and indicators table. You may be interested in the attached Burundi PFP, which has cleared all the hurdles. (The matrix and the table were added after the return of the mission.)

Jeff Katz

Attachment

cc: Messrs. Choksi, Huang



Office Memorandum

RECEIVED

JUN 25 1986 JUN 25 PM 5:25

Mr. Choksi
→ B-2d.
cc: YH(2)

TO: Mr. Agueh, IBRD

FROM: Grant B. Taplin GBT

SUBJECT: Malawi - Policy Framework Paper (PFP)

June 24, 1986

I attach a copy of the above-entitled document that has been discussed and agreed, ad referendum, between the recent Fund mission and the Malawian authorities. The authorities have requested me to submit it to the World Bank for review and clearance.

In the identification and exposition of major areas to be addressed, the discussions in Malawi and the draft benefited from the contributions of Messrs. Tuncer, Lago-Gallego, and Hall.

I believe that the draft reflects a narrowing of differences of views about the medium-term outlook, as the recent visit to Malawi provided the opportunity for assembling and assessing the latest available information. As a result, the real GDP growth rate is now projected at 3.0-3.5 percent during 1986-89, a range that is nearer to the target reviewed at the Consultative Group meeting in January 1986. Moreover, the underlying export volume projections are slightly higher than under earlier scenarios. I attach a printout of the medium-term balance of payments, to assist in the review of the PFP. This scenario will also form the basis for a proposed stand-by arrangement with the Fund.

We would like to present to the Executive Board of the Fund the new stand-by arrangement, the policy framework paper, and the request for a loan under the structural adjustment facility at the end of August or early in September 1986.

I would appreciate being informed when it has received approval by the OPSC, as required in Mr. Stern's memorandum on the subject.

Attachments

cc: Mr. Ouattara (without attachments)
 Mr. Gondwe " "
 Mr. Bhatia " "
 Mr. Beveridge " "
 Mr. Artus " "
 Mr. Basu " "

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighbouring countries through which Malawi's external trade traditionally has passed. Although the authorities have regarded the public sector as essential in promoting development, economic policy has been oriented toward the private sector in recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector.

During this period, only infrequent use was made of key price variables, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government deficits, fueled by expenditure, partly because some major infrastructural investments proved to be more costly than envisaged. The financial position of several public enterprises and the Press group (a major private corporation) also deteriorated sharply, a situation that was aggravated by intensification of price controls. The large public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in the debt service burden, together with unfavorable export developments, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took some adjustment measures in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program has been supported by three structural adjustment lending operations of the Bank and by successive stand-by arrangements with the Fund, followed, in September 1983, by an extended arrangement. Progress has been made in moderating the growth in domestic demand pressures through containing government expenditure and a significant increase in revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed

to the smallholder agricultural sector. Key public sector institutions have been reorganized and the Press group has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and a price liberalization program has been completed. The Government has also collaborated with the World Bank in formulating a more realistic public sector investment program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government considers that the program of a structural adjustment has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: the external current account deficit was about 9.1 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 41 percent. The deficit on central government operations remains large. The Agricultural Development and Marketing Corporation (ADMARC), the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is need for achieving growth in per capita income which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

The Government's objective for the coming three-year period will be to achieve a GDP growth rate of 3.0-3.5 percent per year during 1986-89, which will permit an increase in real income per capita. To that end,

the Government will seek to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in sections 3 and 4 below) so as to achieve an improvement in the balance of payments. In this framework, the current account deficit would have to be reduced to a sustainable level, which on the basis of current information and outlook, would be about 6.3 percent of GDP by 1988 and 1989 while maintaining official reserves of at least two months of imports. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985.

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as presented to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production, to increase exports and to promote self sufficiency in food. The primary objective will be to increase nontraditional exports (such as cotton, groundnuts, rice and wheat) through agricultural pricing policies, and the provision of supporting services for export promotion and financing. The Malawi Export Promotion Council will be strengthened. Agricultural producer prices, which have been frequently adjusted in the past, will continue to be reviewed at least annually, so as to achieve and maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management

training and extension service. Improved extension services for small-holders will also be provided, while the remaining subsidies on small-holder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of the decade, the alternative northern route, to the port of Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank and other donors, will reduce freight costs significantly, and will offer Malawi an alternative access to the sea, even when traditional routes are open.

The Government will also strengthen the health and education sectors, which are currently supported by sectoral lending programs of the World Bank.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports, and to promote efficient import substitution. Following the significant adjustment of the exchange rate which has already taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The authorities are committed to shortening delays in import payments during the program period and to improve the efficiency of the system of import authorization and exchange control. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year

period, the Government intends to rely almost entirely on grants and external borrowing on very concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the three-year period of the structural adjustment program.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce the deficit of the public sector. In particular, the overall deficit of the Central Government (excluding grants) will be reduced to no more than 7.8 percent of GDP in 1986/87 and to 6.2 percent of GDP in 1987/88 and to about 5.5 percent of GDP in 1988/89. The improvement in the financial performance of the rest of the public sector will be concentrated on ADMARC, whose position deteriorated significantly in 1985/86. Including receipts from the sale of the strategic grain reserve to Government, ADMARC will achieve an overall surplus of 2.1 percent of GDP in 1986/87 (see below). Excluding these receipts, its deficit will be reduced to 0.3 percent of GDP. Thereafter, ADMARC is expected to begin to show small surpluses. Assuming some increase in external financing of the Government, this fiscal position is sustainable. These objectives will be pursued also in the context of a stand-by arrangement with the Fund. The achievement of these targets will require careful review of the Government's expenditure which, together with realistic budgeting coupled with more effective control, should permit a modest expansion in

development expenditure. At the same time, the Government expects to improve the efficiency and managerial quality of its operations by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study, including the reorganization of some ministries. A revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a comprehensive reform of the tax system with the objectives of simplification, greater equity, more rational indirect taxation and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget, in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity, related marketing services, and infrastructural support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth, centered on exports and efficient import substitution, and on improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that commercially oriented public enterprises should operate on an efficient and a profitable basis, so that they can contribute to the central government budget. To increase the efficiency of these enterprises, policies will aim at improving their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, regularizing financial flows between the enterprises and the Government and strengthening financial management. The scope for privatization will also be examined. The Government will adopt a strategy and timetable for the review during 1986.

An urgent priority will be the restructuring of ADMARC. As a first step, during the fiscal year 1986/87, certain assets will be sold to the private sector and to the Government to unwind accumulated financial imbalances. This will be followed by a more fundamental review of its role (to be completed by 1987/88), tailoring its investment activities, and examining the potential for increased private sector activities in the marketing of certain crops. In the interim, the Government will pay close attention to ADMARC's financial position in setting appropriate agricultural prices, consumer prices, and its operating expenses, so as to achieve a sustainable breakeven position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private savings and an efficient allocation of capital. In the context of the program, the authorities will continue to explore the possibilities for moving toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. A specific financing facility for the estate agricultural sector is being established under a World Bank financed project, and preparations are under way for setting up an export financing arrangement. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of appropriate macroeconomic and structural policies will promote efficiency in the economy and stimulate production. Production of both traditional and nontraditional commodities for export is expected to benefit from these measures, in particular appropriate producer prices. Export performance should permit a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and achievement of GDP growth of 3.0-3.5 percent per annum during 1986-89. To achieve these objectives, gross inflows of grants and loans of about SDR 550-575 million over the period 1986-89 will be required. The likely contribution of the World Bank is about

SDR 190 million through SAL III, SAL IV, ADMARC support and related cofinancing, and the Fund at about SDR 17 million through the Structural Adjustment Facility (SAF). In 1986 gross capital inflows are expected to amount to SDR 175 million, of which the World Bank will contribute about SDR 95 million through SAL III and cofinancing, and the Fund SDR 7 million through SAF loan. In 1987 total loans and grants are estimated at SDR 145 million, of which the World Bank is likely to contribute about SDR 55 million through SAL IV and ADMARC support and related cofinancing and the Fund SDR 5 million through the SAF loan. The remainder of concessional loans and grants in both 1986 and 1987 has been committed by other donors and lenders in connection with investment projects and restructuring of ADMARC. Additional concessional capital inflows during the program period would facilitate increased investment and higher growth rates, in conformity with the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations, and to maintain its relations with the Fund, at this stage in the context of a stand-by arrangement.

Table 1. Malawi: Principal Elements of a Common Policy Framework

Real GDP	3.0-3.5 percent in 1986-89
Consumer prices	to about 7 percent in 1988-89
External current account deficit	about 6.3 percent of GDP in 1988-89

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing aiming at promoting export crops and food self-sufficiency (from 1986/87)

External sector

Flexibility in exchange rate management
Reduction in payment restrictions and more efficient foreign exchange allocation system (from 1986)
Restrained nonconcessional external borrowing (from 1986).

Public sector

Central government deficit (excluding grants) 7.8 percent of GDP in 1986/87 to 5.5 percent of GDP in 1988/89.
Institutional improvements in the Civil Service (from 1986/87)
Tax Reform (from 1986/87)
Increased programmatic approach to expenditures (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focusing on productive and export activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC restructuring: asset disposal (1986/87); breakeven in current operations (1987/88); review of marketing role (1988/89)

Monetary and financial

Real interest rates positive (continuous)
Financial schemes for export promotion and estate agriculture (from 1986)

OFFICE MEMORANDUM

Mr. Choksi

→ B-2c

DATE: June 4, 1986

TO: Mr. Ernest Stern, SVPOP

THRU: Mr. Edward V. K. Jaycox, Regional Vice President, ESA

FROM: Jochen Kraske, Director, EAI

EXTENSION: 74285

SUBJECT: MALAWI - Policy Framework Paper

1. Over the past six weeks, we have been involved in discussions with the IMF on the preparation of a PFP for Malawi. At one point, the divisional staffs had agreed on a draft paper, but this paper was not satisfactory to the other departments in the IMF. Further discussions have not been able to remove the differences of view between our staffs. We have had a working level review and were informed that it was agreed at a meeting with Mr. Erb and yourself that these issues should be raised with senior management at an early stage. We would like at this point to inform you of where we stand.

2. We and the IMF are in agreement on the general assessment of the problems being faced by Malawi and the direction of the policies that need to be adopted. Our differences lie more in the pace and size of policy reform needed to correct the imbalances in the Malawi economy, the likely strength of the response to the policy measures, and the levels of foreign resources that will be available to help this adjustment. We presented a scenario for the changes in the macroeconomic variables and the policy implementation needed to achieve these changes with the third SAL in December 1985. While we are making adjustments now in those numbers to reflect a slightly poorer than expected GDP growth in 1985 and recent data revisions, we have not seen anything to lead us to change our basic view that the Malawi economy can adopt reforms over the next two to three years that will lead to increased levels of export growth, rising per capita GDP and declining current account and budgetary deficits. We are projecting an average growth of GDP over the next three years (1986-1988) of about 3.5 percent per annum. By contrast, the IMF believes that achieving their fiscal and BOP targets will mean limiting economic growth to only 2.5 percent a year in this time frame. This is well below the population growth rate of 3.1 percent and below the average of 3.2 percent achieved over the last four years. The basic implication of the IMF figures is that the Government's Structural Adjustment Program being supported by the Bank will not be successful. We cannot support this view.

3. Some key areas of difference are clear already, others will become clear as both we and the IMF develop more fully our projections based on recent data and the findings of the IMF and World Bank missions now in the field. For example, our export growth rate projections are higher than the IMF's with especially significant differences in non-traditional exports. The IMF sees little scope for expanding these over the next three years, while we feel this is a key element of the

Malawi structural adjustment. We believe that increased prices for agricultural goods along with the export incentive package being adopted under SAL III will lead to significant increases in exports and increased diversification away from sugar, tea and tobacco.

4. Two potential areas of disagreement are projected fiscal deficits and foreign capital flows. We are not able to comment fully on the targeted fiscal deficit, as neither the Government nor the IMF has worked out the full implications for key recurrent and developmental expenditures. Until that is done, we are left with an uneasy feeling that overly rapid reduction of the budgetary deficit could damage medium term development prospects excessively. We believe that the IMF's figures underestimate likely capital flows, but we will need a few days to input recent data to verify this.

5. The attached table compares the key macroeconomic variables used by the Bank and the IMF in our most recent projections. It ignores differences in price forecasts, even though these are large, as this topic needs to be resolved at a different level between the two institutions.

6. We believe that more work needs to be done to resolve this difference before the PFP is ready for OPSC review and discussion with the Government. The IMF has been pushing for early review by the OPSC so they can discuss with the Government while a mission is currently in the field (they were asking to begin these discussions on June 4). We believe it is premature for an OPSC review and discussions with the Government, and that we should await the return on about June 16 of the IMF and Bank missions now in the field. Do you agree with our position?

Cleared & cc: Choksi, Tidrick, CPD; Porter, EALSE; Greene, EAPDR
cc: Jansen (PBD); Michalopoulos, Roger (VPERS) Smith (FPAFS);
Iman (PPD); Shalizi, Edelman (CPD); Gulhati (ESAVP); Tuncer
(EALDR); Garg, Malik, (EAPSA) Agueh (o/r), Lago-Gallego
(o/r), Riley, Wolff (EALSE); Hall (EAFML)

FKing:mt [stern-pfp (MT-2.1)]

Comparison of World Bank and IMF Projections
1986-1988

	World Bank	IMF
GDP Growth (% per annum)	3.5	2.5
Exports Growth (% per annum)	4.4	2.8
Imports Growth (% per annum)	3.4	2.5
Current Account/GDP (%)	8.4	7.4
Budget Deficit/GDP	8.4	6.8
Debt Service Ratio	33.8	38.4
Capital Inflow	US\$585 million	SDR450 million

FKing:mt

[pfp-table (MT-2.1)]

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: June 2, 1986

TO: Files

FROM: Fred M. King, EAISE *FMK*

EXTENSION: 69624

SUBJECT: MALAWI - Policy Framework Paper

- June 16.*
1. A meeting was held on May 29, 1986 to discuss the draft PFP for Malawi. Attending were Messrs. Agueh, Choksi, Tidrick, Shalizi, Imam, Roger, Edelman, Wolff and King. The following decisions were reached at the meeting.
 2. A memorandum will be drafted and sent through the Regional Vice President to Mr. Stern explaining the differences between the Bank and the IMF on this PFP, and informing him that the IMF has requested Bank clearance by June 4 so the PFP can be discussed with the Government by an IMF mission in the field. These differences are particularly important for 1987 data, as it was expected that this PFP would be updated annually, and later years, which were more uncertain anyway, could be adjusted in the future. The division explained that we felt the IMF figures were too different from our SAL program to be acceptable. While the meeting felt that such a review was premature and should await the return of the IMF mission, it was agreed that we would ask Mr. Stern if he wanted an OPSC review now.
 3. It was agreed that the present PFP is lacking in specificity in a number of areas. Expansion is needed in the areas dealing with how the structure of the economy is expected to change, with more description of expectations of key variables such as savings, investment, the public and private mix, and exports. It was also agreed that more needs to be said on foreign capital inflows. Assumptions on these flows could account for some of the assumed differences in growth rates between us and the IMF.
 4. It was also agreed that more needs to be said on ADMARC, including the expected effects of the restructuring program on the fiscal deficit and when we expect increased private sector participation in marketing. It was agreed that unless we had very strong basis for our arguments, we should acquiesce to the IMF's fiscal targets.
 5. Other specific comments recommended expanding the description on page 7 of the public enterprises study, including actions underway or to be taken; expanding the discussion on the import and foreign exchange regime given on page 5; and adding to the table on page 10 the following topics: import regime; targets on imports, exports, reserve levels, and domestic savings.
 6. Finally, the division was reminded that it should look carefully at the effects of the recent oil price decrease on Government revenue and growth prospects.

Cleared & cc: Agueh, EAISE; Tidrick, CPD

cc: Choksi (CPD); Jansen (PBD); Michalopoulos, Roger (VPERS)
Smith (FPAFS); Iman (PPD); Shalizi, Edelman (CPD); Jaycox,
Gulhati (ESAVP); Kraske, Greene, Tuncer (EA1DR); Garg, Malik,
(EAPSA) Lago-Gallego, Riley, Wolff (EAISE); Hall (EAFML)

FKing:dj [memo/king (MT-2.1)]

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

→ B-2A.
N623

RECEIVED

1986 MAY 28 PM 12: 57

Date: May 28, 1986
To: Distribution
From: Fred M. King, EAISE *FKK*
Extension: 69624
Subject: Malawi: Policy Framework Paper

After discussions at the working level between the Bank and IMF staff working on Malawi, agreement was reached on a PFP on May 9, 1986. However, that draft was not acceptable to other departments in the IMF and a revised draft was sent to us on May 13 (attached). This was followed by a series of memoranda dealing with the differences between the Bank and IMF on this amended PFP (attached). A meeting was held on Friday, May 23, 1986, to try to identify and perhaps resolve the differences. Attending were Messrs./Mss. Hino, Taplin, Bell and Christensen of the IMF, and Agueh, Tidrick and King of the World Bank. It was agreed that the main areas of conflict are on projected growth rates of GDP and especially export growth rates. It is not clear what the policy implications of these differences are, although it is likely that they would imply an IMF program with expenditure targets lower than we would like. No other differences in policy recommendations were evident. An IMF mission is in the field now and it was agreed that they would work on refining their projections based on more recent data. Mr. Tuncer of the Bank would work with them in the field. The IMF asked that Bank and Fund staff reach agreement on projections in the field and that the Bank obtain OPSC clearance by early June so that the PFP can be discussed with the Government. We agreed to go ahead with a working party review, with the understanding that the IMF would consider the GDP and export growth rate issues still open until more work had been done in the field. We explained that we are not comfortable with a paper that projects growth over the next four years at less than the population growth rate and less than the average for the preceding four years. The region would appreciate advice from the working party on how to proceed from here. A meeting will be held Thursday at 2:00 p.m. in U-1250.

When?

Distribution

Messrs. Choksi (2), CPD; Jansen (2), PBD; Michalopoulos, Roger, ERS; Ms. Oakes-Smith, Finance

Cleared with and cc: Messrs. Tidrick, CPD; Agueh, EAISE

cc: Messrs. Gulhati, ESAVP; Kraske, Greene, Tuncer (o/r), EAIDR; Garg, Malik, EAPSA; Lago-Gallego (o/r), Riley, Wolff (o/r), EAISE; Hall, EAFML

FKing:mt

[imf-policy (MT-2.1)]

1. problems/projects
2. major issues in 3-4 crucial sectors
3. how structure expected to change
4. indicators of some key parameters
S/Y, I/Y, X/Y
or Pm. Prt/Pub.

OFFICE MEMORANDUM

Date: May 23, 1986

To: Mr. Grant Taplin, IMF

From: Florent Agueh, Chief, EALSE
Hay-

Extension: 69620

Subject: Malawi: Draft of Policy Framework Paper

1. I would like to respond to your memo of May 22 before you leave on your mission.

2. You correctly point out that there now seems to be a fundamental difference in our views on Malawi's growth prospects. This is unfortunate, as we believed this had been resolved with your PFP draft of May 9 to which we had agreed. I doubt that we can now resolve this issue at the working level and my understanding of the procedure is for us to pass this up to designated levels in our institutions to be resolved. I would disagree with your statement that the policies that are needed have not been specified. They are set out quite clearly in our SAL documents and we believe that policy package and the corresponding growth rates are still valid.

3. I am surprised at your request for updated projections while you are in the field. I believed that agreement had been reached between Mr. Tuncer and yourself and that these would be finalized next month after he and Mr. Lago-Gallego had returned from Malawi. I do not believe we can change this agreement now and produce something on such short notice. In any case, I do not expect there to be any major variations in the assumption on real values for GDP and export growth, aid flows, etc., from those given in the CEM.

4. As you know, Mr. Tuncer has left already and will participate in your mission according to his Terms of Reference. As you appreciate, he was expecting to use the May 9 PFP which reflects his input as the basis for discussions with the Government. Mr. Tuncer is in a position to speak for structural aspects and underlying policy. We expect Mr. Tuncer will come back and report and we will follow the established procedure to obtain clearance from the OPSC and our Board.

Cleared with and cc: Mr. Kraske, EA1DR
cc: Messrs./Mss. Jaycox, Gulhati, ESAVP; Dubey, Choksi, CPD; Garg, Malik, EAPSA; Tuncer, EA1DR; Hall, EAFML; Lago-Gallego (o/r), Riley, Wolff(o/r), EALSE; Bhatia, Bell, IMF

FKing:mt



Office Memorandum

MAY 22 1986

TO: Mr. Agueh, IBRD

FROM: Grant B. Taplin G.B.T.

SUBJECT: Malawi - Draft of Policy Framework Paper

May 22, 1986

I would like to respond to your memorandum of May 20, 1986 on the above-mentioned topic.

With respect to your paragraph 2, the issue is clearly identified. In response to your query, the Fund staff in preparing the draft of the PFP and for the stand-by negotiation has been working with a growth rate assumption of 2 percent per annum in 1986 and 1987, rising to 3.5 percent per annum in 1988 and 1989. This lower growth assumption in 1986 and 1987, compared to your target, is based largely on lower export growth and to some extent the impact of lower import growth derived from the current account target. The premises of the Bank's structural adjustment operation are well-known, and it may well be that "with proper policies" your target can be realized. However, those policies and implementing measures have not been specified. In the absence of such specification and on the basis of information currently available at headquarters, I remain doubtful that an average growth rate of 3.5 percent could be sustained. Nevertheless, the feasibility of 3.5 percent would also have to be considered in the light of present prospects for Malawi, which we hope to assemble and assess in the field. In any case, the growth rate for 1986 is already largely determined, because planting has already taken place and harvesting is underway. Thus, policies will have to be directed toward 1987 and beyond.

To advance the formulation of the policy framework, it will be essential to have the details on your revised balance of payments projections and underlying assumptions of policies which you believe will lead to the realization of your growth targets. It appears unlikely that these can be provided before our departure over the weekend. Thus, this material should be made available in time to be reviewed with the Bank staff during our stay in Malawi, and will, in addition to new information obtained in the field, serve to modify the projections in the PFP as appropriate. I trust that Mr. Tuncer will be prepared and authorized in this regard. If not, I would appreciate being advised before my departure (on May 23, 1986), which will permit me to bring this to management's attention.

Concerning the points raised in your paragraph 3, the reduction in the consolidated deficit (excluding grants) of the Central Government and ADMARC from 8.4 percent of GDP in 1985/86 to about 6 percent in 1986/87 is to be achieved by a reduction in the deficit of the Central Government (excluding payments to ADMARC) of 1.2 percent of GDP and a reduction of a similar size in ADMARC's deficit, excluding central government purchases of the strategic grain reserve and silos

(attachment). The proposed improvement in the position of the Central Government is consistent with the budget for 1986/87, while the improvement in ADMARC's account implies a small overall deficit in its operations excluding the above-mentioned government purchases. This latter improvement is expected to be achieved from a reduction in ADMARC's operating losses and the disposal of a number of assets to the private sector. An aspect of the work of the forthcoming mission will be to ensure that the recently issued budget is feasible, and, if not, to work out with the authorities the nature and magnitude of additional measures needed to achieve it.

With respect to paragraph 5, the foreign financing requirement is determined in part by export prospects and the expected availability of foreign capital. As you note elsewhere in the memorandum, the adoption of appropriate policies may lead to stronger GDP growth, mainly through higher export growth. But, it is not necessarily the case that higher GDP growth requires larger external financing. Again, the level of foreign resource requirements is an issue which should be reassessed in the light of information which will become available in the field.

I can accept fully the points made in paragraph 4, and the text should be amended to reflect these comments. Concerning paragraph 6, I would suggest an amendment which would describe this measure in terms of an increased role for the private sector as a continuing process, without specifying a target date.

For operational purposes, it is important that Mr. Tuncer, who will be joining the mission for the discussions related to the policy frame, be authorized to agree ad referendum on the policy framework paper for Bank management. I envisage those discussions to begin about June 4. I trust that appropriate authorization can be obtained within the Bank by that time.

Attachment

cc: Mr. Ouattara (on return)
Mr. Gondwe
Mr. Bhatia (on return)
Mr. Beveridge
Mr. Artus
Mr. Basu
Mr. Hino

Malawi: Consolidated (Selected) Public Sector Deficit

1985/86 - 1986/87

(In percent of GDP and millions of MK)

	1985/86		1986/87		Improvement 85/86 - 86/87	
	Percent of GDP	millions of MK	Percent of GDP	millions of MK	Percent of GDP	millions of MK
<u>I. Central Government Deficit</u>						
Overall deficit (-)	-8.4	-162.8	-7.7	-166.5	0.7	-3.7
of which lending and transfers to ADMARC	1.3	26.0	1.8	38.4	0.5	12.4
Deficit excluding transfers and lending to ADMARC	<u>7.1</u>	<u>-136.8</u>	<u>-5.9</u>	<u>-128.1</u>	<u>1.2</u>	<u>8.7</u>
<u>II. ADMARC Deficit</u>						
Overall deficit	-1.3	-25.2	2.9	62.0	4.2	36.8
less revenue from Government	--	--	-3.0	-64.4	-3.0	-64.4
ADMARC deficit excluding revenue from Government	<u>-1.3</u>	<u>-25.2</u>	<u>-0.1</u>	<u>-2.4</u>	<u>1.2</u>	<u>22.8</u>
<u>III. Consolidated deficit</u>						
Overall deficit	<u>-8.4</u>	<u>-162.0</u>	<u>-6.0</u>	<u>-130.5</u>	<u>2.4</u>	<u>31.5</u>

OFFICE MEMORANDUM

Date: May 20, 1986

To: Mr. Grant Taplin, IMF

From: Florent Agueh, Chief, ~~FALSE~~ *Agueh*

Extension: 69620

Subject: Malawi: Draft of Policy Framework Paper

1. We would like to offer you some comments on the recently revised Policy Framework Paper. As you know, we were in substantial agreement with the draft sent to us on May 9, 1986, but some of the changes that have been made subsequently give us some difficulty. These are discussed in the order that they appear in the paper.
2. On page 3, the growth rate target has been changed from an average of 3.5 percent to an end of period target of 3.5 percent. What are the assumed growth rates in 1986 and 1987 and the new period average? As you know, our structural adjustment operations are based on the premise that per capita growth will be positive through this period, and we still believe that with proper policies, the external assistance levels that we expect to be available, and continued emphasis on export growth, GDP growth, averaging 3.5 percent over these 3 years is realistic. (This is only slightly above the average of 3.2 percent for the past 4 years.)
3. On page 6, you have set a target of six percent for the consolidated deficit of Central Government and ADMARC and explain that this may involve the curtailment of some recurrent expenditures. We would appreciate an elaboration of this point. How much would recurrent expenditures be cut and in what areas do you see these cuts coming? This seems a very rapid reduction of this deficit, which I believe was 9 percent of GDP in 1984/85 and 8.4 percent in 1985/86, and we believe the policy implications of this need to be spelled out.
4. We would also like to make a few comments on other parts of the paper. On page 4, there is mention of "non-traditional exports (such as cotton, groundnuts, rice and wheat.)" We would call cotton, groundnuts and rice minor exports, but not non-traditional in the sense that a market for these crops already exists, with established buyers, etc. We would doubt that wheat would be profitable for export, but its production should be expanded as an import substituting crop. We would consider tree crops and textiles to be non-traditional exports with good possibilities. Also, on page 4, we would suggest that "Improved extension services for smallholders will also be provided..." should be amended to "Improved extension and research services..."
5. The projected inflows of grants and concessional financing on page 9 of SDR 425-475 million will, of course, need to be higher if higher growth targets are to be achieved. In the CEM we estimated US\$600 million,

but we will be revising this figure in the next few weeks as we enter in the recent data for 1984 and 1985 that we have just collected.

6. Finally, on page 10, you set a target for ADMARC "diminishing to a residual marketing role" by 1988/89. This is too early a target, as we do not yet know how quickly the private sector can respond to increased marketing opportunities.

Cleared with and cc: Mr. Greene, EAIDR
cc: Messrs./Mss. Bhatia, Bell, IMF; Gulhati, ESAVP; Choksi, CPD; Garg,
Malik, EAPSA; Hall, EAFML; Lago-Gallego (o/r), Riley, Wolff, EAISE

FKing:mt



Office Memorandum

1/15

TO: Mr. Agueh, IBRD

May 13, 1986

FROM: Edwin L. Bornemann

ELB

SUBJECT: Malawi: Draft of Policy Framework Paper and of Part of Briefing Paper

Further to Mr. Bhatia's memorandum of May 9, I attach a copy of the draft of a Policy Framework Paper for Malawi, edited to reflect changes stemming from the comments of interested departments in the Fund (Attachment I). I would appreciate receiving any comments on these changes that you might have (by noon Friday, May 16, directly to Mr. Taplin, ext. 8730), otherwise it will be assumed that they are acceptable.

I also attach for your review and clearance a draft section on SAF matters to be incorporated in the briefing paper (Attachment II). Would you kindly provide your comments at your earliest convenience, as we are working with the goal of sending the briefing paper to management before the close of business May 16.

Attachments

cc: Mr. Ouattara (on return)
Mr. Gondwe (on return)
Mr. Bhatia (on return)
Mr. Beveridge
Mr. Artus (on return)
Mr. Basu (on return)

DRAFT 05/09/86

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have recognized an essential role for the public sector in promoting development, economic policy has been oriented toward the private sector in the recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector. Only infrequent use was made of changes in key

price variables, such as agricultural producer prices, the exchange rate, and interest rates, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government/expenditure, particularly on major infrastructural investment for the building of a new capital city. The financial position of several public enterprises and a major nominally private corporation (Press Holdings)^{also} deteriorated sharply, a situation that was aggravated by intensification of price controls. The large ~~XXXXXX~~ ^{public sector} deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase together with unfavorable export developments, in debt service burden, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took ^{some} adjustment measures already in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program was supported by three structural adjustment lending operations of the Bank and by successive stand-by arrangements with the Fund, which were followed, in September 1983, by an extended arrangement. Progress has been made ⁱⁿ moderating the growth in domestic pressures emanating demand/through containing government expenditure and a significant increase in ^{revenue.} taxes. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the small-holder agricultural sector. Key public sector institutions have been

reorganized and Press Holdings has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and retail prices almost completely liberalized. The Government has also collaborated with the World Bank in formulating a more realistic public investment sector program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the given the continuing imbalances considers program of economic problems, the Government acknowledges that the structural adjustment program has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: the external current account deficit was about 10 per cent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 43 per cent. The deficit on central government transactions remains too large. ADMARC, the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural

nature. At the same time, there is a need for achieving growth in per capita income (SDR 125 in 1985), which had barely risen since 1981.

These problems require concerted action on structural and macroeconomic policies.

The Government's objectives for the coming three-year period will be to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in sections 3 and 4 below) so as to achieve an improvement in the balance of payments which will permit real GDP growth to average at least 3.5 percent a year. In this framework, the current account deficit would have to be reduced to

(*)

7.0 and 1989
about 6.5 percent of GDP by 1988/while maintaining official reserves of
at least two months of imports. Over the three-year period, inflation
is expected to decline by about half from 15 percent in 1985.

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy
for the next three years and the longer term, as set out to the Consul-
tative Group meeting of January 1986, will continue to place strong
emphasis on the development and diversification of production and
exports. The primary objective will be to increase nontraditional
exports (such as cotton, groundnuts, rice, and wheat) through agricul-
tural pricing and exchange rate policies, and through the provision of
supporting services for export promotion and financing. The Malawi
Export Promotion Council will be strengthened. Agricultural prices will
continue to be reviewed frequently, so as to restore, if needed, and to
maintain an appropriate balance among the various export and domestic
food crops, mainly by raising the relative prices of commodities that
have export potential. Agricultural production will also benefit from
measures to improve the estate sector's access to new credit facilities
to finance their investment, and setting up an estate management
training and extension service. Improved extension services for
smallholders will also be provided, while the remaining subsidies on
smallholder fertilizer will be removed by 1989. Domestic production
will be encouraged by the continuation of a liberal pricing system.

??
tree crops
+ textiles

Any
import
HP

+ research

An appropriate infrastructure is a key element to development.
Particular importance is attached to the road network. It is expected
that, by the end of 1989, the alternative Northern route, to the port of

7
Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank, will reduce freight cost significantly, and will offer Malawi an alternative access to the sea, even when traditional routes are open.

The Government will also strengthen the health and education sector, which is currently supported by sectoral lending programs of the World Bank, which plays a catalytic role in attracting additional finance.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports and promote efficient import substitution. After a significant adjustment of the exchange rate has taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The pursuit of a realistic exchange rate policy should also permit a more liberal and transparent system of import authorization and exchange control. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants or external borrowing on very concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the ^{three-year} ^{of} ~~the~~ period supported by the Structural Adjustment Program.

SAY MORE?

P-5122?

For the remainder of the program period, small decline in this consolidated deficit is expected to reflect an improvement in ADMARC's profitability. Assuming some increase in external financing of the Government, this fiscal position is sustainable.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce progressively the overall fiscal deficit/(excluding grants) to no more than 8 percent of GDP in 1986/87 and to 6 percent of GDP by 1988/89. These objectives will be pursued/in the context of a stand-by arrangement with the careful review of the Government's expenditure. This may lead to Fund. This will require/the curtailment of some recurrent expenditure together with items, and realistic budgeting coupled with more effective control, so as to permit a modest level of expansion in development expenditure. The Government expects to be able to prevent a deterioration in its services by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study. For example, the Government has approached the World Bank for technical assistance to reorganize three ministries. A fundamental revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a thorough overhaul of the tax system with the objectives of simplification, greater equity, more rational indirect taxation, and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity, related marketing services, and infrastructural

8-4-9.0
5/1/85

?

support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth, centered on exports and efficient import substitution, and on an improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that all commercially oriented public enterprises should operate on a profitable basis, so that they can contribute to the central government budget. To improve the efficiency of these enterprises, policies will aim at liberalizing their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, and regularizing financial flows between the enterprises and the Government. The scope for privatization will also be examined. A blueprint for the review will be completed before the end of 1986, at which time a timetable will be established for implementing the policies.

An urgent priority will be the rehabilitation of ADMARC, the principal marketing agency for smallholder crops. As a first step, during the fiscal year 1986/87, certain assets will be sold to the private

sector to unwind accumulated financial imbalances. This will be followed by a more fundamental review of its role (to be completed by 1987/88), tailoring its investment activities, and eventually diminishing its marketing operations to a residual position relative to the private sector. In the interim, the Government will pay close attention to ADMARC's financial position in setting appropriate agricultural consumer prices, prices, and its operating expenses, so as to achieve a sustainable breakeven position in 1987/88.

too optimistic?

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private saving and an efficient allocation of capital. In the context of ^{the program,} ~~a stand-by arrangement with the Fund,~~ progressive moves will be made toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. Specific financing facilities for export promotion and the estate agricultural sector are being established under the Government's structural adjustment program supported by World Bank finance. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

What?

7. Financing requirement

During the three-year program, it is expected that the implementation of macroeconomic and structural policies, including exchange rate action and the setting of appropriate producer prices, will promote

7. Structural adjustment facility (SAF) loan

The authorities are expected to request a loan under the Structural Adjustment Facility amounting to SDR 7.4 million in 1986 (20 percent of quota) and SDR 5 million in each of the two following years. The attached draft of a Policy Framework Paper (PFP) has been worked out jointly by the Fund and Bank staff and is currently in the process of being cleared by the Operations Policy Subcommittee of the Bank. The Fund staff intends to present the PFP and the request for access to the SAF to the Board at the same time as the discussions of the Article IV consultation and the new stand-by arrangement, provisionally scheduled for the second half of August. It is envisaged that the PFP will be discussed in the Bank Board at an earlier date.

During the joint mission, the Fund staff will focus attention on the exchange system including the exchange rate, balance of payments, fiscal, and monetary issues. Both the Fund and Bank staff will be involved in the discussions of ADMARC, while the Bank staff will concentrate on issues relating to the public sector investment program, measures to strengthen the estate sector, the Malawi Export Promotion Council, the transportation sector, institutional reform of the civil service, and restructuring of public enterprises.

The first annual program will reflect elements of the new stand-by arrangement. The benchmarks will comprise the performance criteria as well as a timetable for the ADMARC rehabilitation and the tax reform. The Fund staff will be guided by the briefing paper to avoid inconsistencies between the stand-by arrangement and the three-year structural program.

OFFICE MEMORANDUM

Date: May 23, 1986
To: Mr. Grant Taplin, IMF
From: Florent Agueh, Chief, EALSE
Extension: 69620
Subject: Malawi: Draft of Policy Framework Paper

1. I would like to respond to your memo of May 22 before you leave on your mission.

2. You correctly point out that there now seems to be a fundamental difference in our views on Malawi's growth prospects. This is unfortunate, as we believed this had been resolved with your PFP draft of May 9 to which we had agreed. I doubt that we can now resolve this issue at the working level and my understanding of the procedure is for us to pass this up to designated levels in our institutions to be resolved. I would disagree with your statement that the policies that are needed have not been specified. They are set out quite clearly in our SAL documents and we believe that policy package and the corresponding growth rates are still valid.

3. I am surprised at your request for updated projections while you are in the field. I believed that agreement had been reached between Mr. Tuncer and yourself and that these would be finalized next month after he and Mr. Lago-Gallego had returned from Malawi. I do not believe we can change this agreement now and produce something on such short notice. In any case, I do not expect there to be any major variations in the assumption on real values for GDP and export growth, aid flows, etc., from those given in the CEM.

4. As you know, Mr. Tuncer has left already and will participate in your mission according to his Terms of Reference. As you appreciate, he was expecting to use the May 9 PFP which reflects his input as the basis for discussions with the Government. Mr. Tuncer is in a position to speak for structural aspects and underlying policy. We expect Mr. Tuncer will come back and report and we will follow the established procedure to obtain clearance from the OPSC and our Board.

Cleared with and cc: Mr. Kraske, EAIDR

cc: Messrs./Mss. Jaycox, Gulhati, ESAVP; Dubey, Choksi, CPD; Garg, Malik, EAPSA; Tuncer, EAIDR; Hall, EAFML; Lago-Gallego (o/r), Riley, Wolff(o/r), EALSE; Bhatia, Bell, IMF

FKing:mt



Office Memorandum

MAY 22 1986

TO: Mr. Agueh, IBRD

FROM: Grant B. Taplin G.B.T.

SUBJECT: Malawi - Draft of Policy Framework Paper

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Mr. Gondwe
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1985/86 - 1986/87

(In percent of GDP and millions of MK)

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OFFICE MEMORANDUM

→ B-2d

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To: Mr. Grant Taplin, IMF
From: Florent Agueh, Chief, FALSE
Extension: 69620
Subject: Malawi: Draft of Policy Framework Paper

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3. On page 6, you have set a target of six percent for the consolidated deficit of Central Government and ADMARC and explain that this may involve the curtailment of some recurrent expenditures. We would appreciate an elaboration of this point. How much would recurrent expenditures be cut and in what areas do you see these cuts coming? This seems a very rapid reduction of this deficit, which I believe was 9 percent of GDP in 1984/85 and 8.4 percent in 1985/86, and we believe the policy implications of this need to be spelled out.

4. We would also like to make a few comments on other parts of the paper. On page 4, there is mention of "non-traditional exports (such as cotton, groundnuts, rice and wheat.)" We would call cotton, groundnuts and rice minor exports, but not non-traditional in the sense that a market for these crops already exists, with established buyers, etc. We would doubt that wheat would be profitable for export, but its production should be expanded as an import substituting crop. We would consider tree crops and textiles to be non-traditional exports with good possibilities. Also, on page 4, we would suggest that "Improved extension services for smallholders will also be provided..." should be amended to "Improved extension and research services..."

5. The projected inflows of grants and concessional financing on page 9 of SDR 425-475 million will, of course, need to be higher if higher growth targets are to be achieved. In the CEM we estimated US\$600 million,

but we will be revising this figure in the next few weeks as we enter in the recent data for 1984 and 1985 that we have just collected.

6. Finally, on page 10, you set a target for ADMARC "diminishing to a residual marketing role" by 1988/89. This is too early a target, as we do not yet know how quickly the private sector can respond to increased marketing opportunities.

Cleared with and cc: Mr. Greene, EA1DR

cc: Messrs./Mss. Bhatia, Bell, IMF; Gulhati, ESAVP; Choksi, CPD; Garg, Malik, EAPSA; Hall, EAFML; Lago-Gallego (o/r), Riley, Wolff, EALSE

FKing:mt

OFFICE MEMORANDUM

Mr. Choksi
→ B-20.

RECEIVED

1986 MAY 21 AM 11:19

Date: May 20, 1986

To: Mr. Grant Taplin, IMF

From: Florent Agueh, Chief, FALSE
Agueh

Extension: 69620

Subject: Malawi: Draft of Policy Framework Paper

1. We would like to offer you some comments on the recently revised Policy Framework Paper. As you know, we were in substantial agreement with the draft sent to us on May 9, 1986, but some of the changes that have been made subsequently give us some difficulty. These are discussed in the order that they appear in the paper.
2. On page 3, the growth rate target has been changed from an average of 3.5 percent to an end of period target of 3.5 percent. What are the assumed growth rates in 1986 and 1987 and the new period average? As you know, our structural adjustment operations are based on the premise that per capita growth will be positive through this period, and we still believe that with proper policies, the external assistance levels that we expect to be available, and continued emphasis on export growth, GDP growth, averaging 3.5 percent over these 3 years is realistic. (This is only slightly above the average of 3.2 percent for the past 4 years.)
3. On page 6, you have set a target of six percent for the consolidated deficit of Central Government and ADMARC and explain that this may involve the curtailment of some recurrent expenditures. We would appreciate an elaboration of this point. How much would recurrent expenditures be cut and in what areas do you see these cuts coming? This seems a very rapid reduction of this deficit, which I believe was 9 percent of GDP in 1984/85 and 8.4 percent in 1985/86, and we believe the policy implications of this need to be spelled out.
4. We would also like to make a few comments on other parts of the paper. On page 4, there is mention of "non-traditional exports (such as cotton, groundnuts, rice and wheat.)" We would call cotton, groundnuts and rice minor exports, but not non-traditional in the sense that a market for these crops already exists, with established buyers, etc. We would doubt that wheat would be profitable for export, but its production should be expanded as an import substituting crop. We would consider tree crops and textiles to be non-traditional exports with good possibilities. Also, on page 4, we would suggest that "Improved extension services for smallholders will also be provided..." should be amended to "Improved extension and research services..."
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but we will be revising this figure in the next few weeks as we enter in the recent data for 1984 and 1985 that we have just collected.

6. Finally, on page 10, you set a target for ADMARC "diminishing to a residual marketing role" by 1988/89. This is too early a target, as we do not yet know how quickly the private sector can respond to increased marketing opportunities.

Cleared with and cc: Mr. Greene, EAIDR

cc: Messrs./Mss. Bhatia, Bell, IMF; Gulhati, ESAVP; Choksi, CPD; Garg, Malik, EAPSA; Hall, EAFML; Lago-Gallego (o/r), Riley, Wolff, EALSE

FKing:mt



Office Memorandum

TO: Mr. Agueh, IBRD

May 13, 1986

FROM: Edwin L. Bornemann *ELB.*

SUBJECT: Malawi: Draft of Policy Framework Paper and of Part of Briefing Paper

Further to Mr. Bhatia's memorandum of May 9, I attach a copy of the draft of a Policy Framework Paper for Malawi, edited to reflect changes stemming from the comments of interested departments in the Fund (Attachment I). I would appreciate receiving any comments on these changes that you might have (by noon Friday, May 16, directly to Mr. Taplin, ext. 8730), otherwise it will be assumed that they are acceptable.

I also attach for your review and clearance a draft section on SAF matters to be incorporated in the briefing paper (Attachment II). Would you kindly provide your comments at your earliest convenience, as we are working with the goal of sending the briefing paper to management before the close of business May 16.

Attachments

cc: Mr. Ouattara (on return)
Mr. Gondwe (on return)
Mr. Bhatia (on return)
Mr. Beveridge
Mr. Artus (on return)
Mr. Basu (on return)

DRAFT 05/09/86

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have recognized an essential role for the public sector in promoting development, economic policy has been oriented toward the private sector in the recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector. Only infrequent use was made of changes in key

price variables, such as agricultural producer prices, the exchange rate, and interest rates, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government/expenditure, particularly on major infrastructural investment for the building of a new capital city. The financial position of several public enterprises and a major nominally private corporation (Press Holdings)^{also}/deteriorated sharply, a situation that was aggravated by intensification of price controls. The large ~~XXXXX~~ public sector deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase together with unfavorable export developments, in debt service burden, placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took^{some}/adjustment measures already in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program was supported by three structural adjustment lending operations of the Bank and by successive stand-by arrangements with the Fund, which were followed, in September 1983, by an extended arrangement. Progress has been madeⁱⁿ/moderating the growth in domestic pressures emanating demand/through containing government expenditure and a significant increase in ~~taxes~~ revenue. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the small-holder agricultural sector. Key public sector institutions have been

reorganized and Press Holdings has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and retail prices almost completely liberalized. The Government has also collaborated with the World Bank in formulating a more realistic public investment sector program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, given the continuing imbalances, the Government acknowledges that the structural adjustment program has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: the external current account deficit was about 10 per cent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 43 per cent. The deficit on central government transactions remains too large. ADMARC, the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural

~~nature.~~ At the same time, there is a need for achieving growth in per capita income (SDR 125 in 1985), which had barely risen since 1981.

These problems require concerted action on structural and macroeconomic policies.

The Government's objectives for the coming three-year period will be to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in sections 3 and 4 below) so as to achieve an improvement in the balance of payments which will permit real GDP growth to ~~average~~ rise to at least 3.5 percent a year in 1988-89. In this framework, the current account deficit would have to be reduced to

7.0 and 1989
about 6.5 percent of GDP by 1988/while maintaining official reserves of
at least two months of imports. Over the three-year period, inflation
is expected to decline by about half from 15 percent in 1985.

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy
for the next three years and the longer term, as set out to the Consul-
tative Group meeting of January 1986, will continue to place strong
emphasis on the development and diversification of production and
exports. The primary objective will be to increase nontraditional
exports (such as cotton, groundnuts, rice, and wheat) through agricul-
tural pricing and exchange rate policies, and through the provision of
supporting services for export promotion and financing. The Malawi
Export Promotion Council will be strengthened. Agricultural prices will
continue to be reviewed frequently, so as to restore, if needed, and to
maintain an appropriate balance among the various export and domestic
food crops, mainly by raising the relative prices of commodities that
have export potential. Agricultural production will also benefit from
measures to improve the estate sector's access to new credit facilities
to finance their investment, and setting up an estate management
training and extension service. Improved extension services for
smallholders will also be provided, while the remaining subsidies on
smallholder fertilizer will be removed by 1989. Domestic production
will be encouraged by the continuation of a liberal pricing system.

??
+ tree crops
+ textiles

which have been frequently adjusted
in the past
achieve producer

+ research

An appropriate infrastructure is a key element to development.
Particular importance is attached to the road network. It is expected
that, by the end of 1989, the alternative Northern route, to the port of

7
Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank, will reduce freight cost significantly, and will offer Malawi an alternative access to the sea, even when traditional routes are open.

The Government will also strengthen the health and education sector, which is currently supported by sectoral lending programs of the World Bank, which plays a catalytic role in attracting additional finance.

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PSIR?

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports and promote efficient import substitution. After a significant adjustment of the exchange rate has taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The pursuit of a realistic exchange rate policy should also permit a more liberal and transparent system of import authorization and exchange control. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants or external borrowing on very concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the ^{three-year} period ^{of} supported-by/the Structural Adjustment Program.

SAY MORE?

For the remainder of the program period, small decline in this consolidated deficit is expected to reflect an improvement in ADMARC's profitability. Assuming some increase in external financing of the Government, this fiscal position is sustainable

- 6 -

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce ^{the consolidated} progressively of the Central Government and ADMARC ⁶ ~~the overall-fiscal~~ deficit/(excluding grants) to no more than 8 percent of GDP in 1986/87 and to 6 percent of GDP by 1988/89. These objectives also will be pursued/in the context of a stand-by arrangement with the careful review of the Government's expenditure. This may lead to Fund. This will require/the curtailment of some recurrent expenditure together with items, and realistic budgeting coupled with more effective control, so as to permit a modest level of expansion in development expenditure. The Government expects to be able to prevent a deterioration in its services by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study. For example, the Government has approached the World Bank for technical assistance to reorganize three ministries. A fundamental revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a thorough overhaul of the tax system with the objectives of simplification; greater equity, more rational indirect taxation, and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity, related marketing services, and infrastructural

8.4 - 9.0 - 84/85
8.4 - 85/86

?

support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth, centered on exports and efficient import substitution, and on an improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that all commercially oriented public enterprises should operate on a profitable basis, so that they can contribute to the central government budget. To improve the efficiency of these enterprises, policies will aim at liberalizing their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, and regularizing financial flows between the enterprises and the Government. The scope for privatization will also be examined. A blueprint for the review will be completed before the end of 1986, at which time a timetable will be established for implementing the policies.

An urgent priority will be the rehabilitation of ADMARC, the principal marketing agency for smallholder crops. As a first step, during the fiscal year 1986/87, certain assets will be sold to the private

sector to unwind accumulated financial imbalances. This will be followed by a more fundamental review of its role (to be completed by 1987/88), tailoring its investment activities, and eventually diminishing its marketing operations to a residual position relative to the private sector. In the interim, the Government will pay close attention to ADMARC's financial position in setting appropriate agricultural consumer prices, prices, and its operating expenses, so as to achieve a sustainable breakeven position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private saving and an efficient allocation of capital. In the context of ~~a stand-by arrangement with the Fund~~, progressive moves will be made toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. Specific financing facilities for export promotion and the estate agricultural sector are being established under the Government's structural adjustment program supported by World Bank finance. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of macroeconomic and structural policies, including exchange rate action and the setting of appropriate producer prices, will promote

efficiency in the economy and stimulate production. Exports of both traditional and nontraditional commodities are expected to benefit from these measures, permitting a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and GDP growth of 3.5 percent per annum by 1988. Under present assumptions, this scenario will necessitate inflows of grants and concessional loans of about SDR 425-475 million over the three-year period. The likely contribution of the World Bank is about SDR 190 million through SAL III, SAL IV, ADMARC support and related cofinancing, and the Fund at about ~~least~~ SDR 17 million through the Structural Adjustment Facility (SAF).

We need to compare.

~~To raise GDP growth to an average of 3.5 percent during 1986-88 would require an increase in concessional capital inflows over current estimates, possibly of the order of SDR 15 million annually.~~ In 1986, concessional loans and grants are expected to amount to SDR 175 million, of which the World Bank will contribute about SDR 95 million through

SAL III and cofinancing, and the Fund SDR 7 million through the SAF. Additional concessional capital inflows during the program period would loan. ~~In addition, a new stand-by arrangement with the Fund will permit-- facilitate larger volumes of imports and higher growth rates, in conformity with drawings of SDR 7 million in 1986.~~

the growth targets reviewed by the recent Consultative Group meeting.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations. In continuing its relations with the Fund, Malawi expects to be able to reduce progressively its outstanding use of Fund resources, while continuing close consultation, initially in the context of a stand-by arrangement.

Table 1. Malawi: Principal Elements of a Common Policy Framework

What about 86-87

GDP growth	by	in 1988-89
Consumer prices	about 3.5 percent	1986-88
External current account deficit	about 7 percent	in 1988 1988-89
	about 6.5 percent	in 1988 1988-89
	7.0	

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing continues to restore balance among crops (1986/87)

External sector

Flexibility in exchange rate management
Improvement of foreign exchange allocation system (from 1986/87)
Restrained external nonconcessional borrowing (from 1986/87 continuous)

Public sector

Consolidated and ADMARC
/Central government/~~overall~~ deficit (excluding grants) 6 percent of GDP
in 1988/89
Institutional improvements in the Civil Service (from 1986/87)
Tax reform (from 1986/87)
Expenditure system reoriented (from 1986/87)
Public sector investment program (PSIP) restrained by resources,
focussing on productive activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC rehabilitation: asset disposal (1986/87); diminishing to a
residual marketing role (1988/89); breakeven in current operations
(1987/88). ?

Monetary and financial

Real interest rates positive (continuous)
Interest rate liberalization (from 1986/87)
Financing for export promotion and estate agriculture (from 1986/87)

7. Structural adjustment facility (SAF) loan

The authorities are expected to request a loan under the Structural Adjustment Facility amounting to SDR 7.4 million in 1986 (20 percent of quota) and SDR 5 million in each of the two following years. The attached draft of a Policy Framework Paper (PFP) has been worked out jointly by the Fund and Bank staff and is currently in the process of being cleared by the Operations Policy Subcommittee of the Bank. The Fund staff intends to present the PFP and the request for access to the SAF to the Board at the same time as the discussions of the Article IV consultation and the new stand-by arrangement, provisionally scheduled for the second half of August. It is envisaged that the PFP will be discussed in the Bank Board at an earlier date.

During the joint mission, the Fund staff will focus attention on the exchange system including the exchange rate, balance of payments, fiscal, and monetary issues. Both the Fund and Bank staff will be involved in the discussions of ADMARC, while the Bank staff will concentrate on issues relating to the public sector investment program, measures to strengthen the estate sector, the Malawi Export Promotion Council, the transportation sector, institutional reform of the civil service, and restructuring of public enterprises.

The first annual program will reflect elements of the new stand-by arrangement. The benchmarks will comprise the performance criteria as well as a timetable for the ADMARC rehabilitation and the tax reform. The Fund staff will be guided by the briefing paper to avoid inconsistencies between the stand-by arrangement and the three-year structural program.



Office Memorandum

MAY 12 1986

TO: Mr. Agueh, IBRD

FROM: Rattan J. Bhatia *RJB*

SUBJECT: Malawi - Draft of Policy Framework Paper

May 9, 1986

Please find attached a redraft of a Policy Framework Paper (PFP) for Malawi. As you will observe, it is a joint product which incorporates the extensive comments of Messrs. Tuncer and Lago-Gallego, as well as some of your observations with respect to the draft of the briefing paper for the forthcoming Article IV consultation discussions and negotiation of a stand-by arrangement. The PFP is based on the medium-term scenario transmitted to you for comments on March 27, subsequently modified to accommodate a larger volume growth of imports in 1986 and 1987 (now targeted at 2.5 percent and 2.0 percent, respectively) and to be specific with respect to a gross reserve target of at least two months of imports through 1991.

The draft PFP is being circulated today to interested departments in the Fund for clearance; they are being requested to respond by the close of business Tuesday, May 13, 1986. The intention is to submit the mission's briefing paper, with the draft PFP, to the Fund management on May 15, with the expectation of management's response a day or two before the mission's departure on Friday evening May 23. I trust that this time schedule will permit you to obtain the appropriate clearance in the Bank, so that our joint work on Malawi can proceed within the envisaged time frame.

It would also be useful if you could provide me with an indication of the Bank's work program, including, if possible, the schedule for presentation of the PFP to the Bank Board.

Attachment

cc: Mr. Ouattara (without attachment)
Mr. Gondwe (without attachment)
Mr. Artus (without attachment)
Mr. Basu (without attachment)
Mr. Tuncer (IBRD)

Malawi - Policy Framework Paper for a Loan Under the Structural
Adjustment Facility from August 1986-July 1989

1. Introduction

Malawi is a predominantly agricultural economy, with virtually no developed mineral resources. Its exports are concentrated in tobacco, tea, and sugar, which are subject to large price fluctuations in world markets. Its landlocked position has made it particularly vulnerable to the repeated disruptions that have occurred in the transport network of the neighboring countries through which Malawi's external trade traditionally has passed. Although the authorities have recognized an essential role for the public sector in promoting development, economic policy has been oriented toward the private sector in the recognition of the importance of market forces. This, together with a focus on agricultural production, especially for export, allowed Malawi to achieve an impressive growth record from independence through much of the 1970s.

After 1978, a combination of exogenous and policy-related factors reduced the pace of growth and increased inflationary pressures. Disruptions to the external transport network became progressively more serious, culminating in the complete closure of rail links to the sea in 1984. The terms of trade worsened as the worldwide recession deepened, and the debt service burden increased as interest rates in world financial markets reached historically high levels and the dollar appreciated. Agricultural production was retarded by droughts in 1980 and 1981, and, in addition, by the erosion of incentives for smallholder production and by financial and managerial difficulties in the export-oriented estate sector. Only infrequent use was made of changes in key

price variables, such as agricultural producer prices, the exchange rate, and interest rates, and prices of most industrial products and services were subject to formal or informal controls. Domestic demand pressure was intensified by rapidly rising government expenditure, particularly on major infrastructural investment for the building of a new capital city. The financial position of several public enterprises and a major nominally private corporation (Press Holdings) deteriorated sharply, a situation that was aggravated by intensification of price controls. The large fiscal deficits were financed, in part, through large nonconcessional external borrowing. The consequent sharp increase in debt service burden placed severe pressure on the balance of payments and contributed to the rundown of external reserves. Although the Government took adjustment measures already in the early 1980s, it became necessary to seek debt rescheduling from the banks and official creditors in 1982 and 1983.

To address these problems in a coordinated fashion, the Government formulated a structural adjustment program in consultation with the Bank and the Fund. This program was supported by three structural adjustment lending operations of the Bank and by successive stand-by arrangements with the Fund, which were followed, in September 1983, by an extended arrangement. Progress has been made moderating the growth in domestic demand through containing government expenditure and a significant increase in taxes. The external borrowing has been almost entirely on concessional terms, and the authorities have pursued a more active exchange rate policy. Price incentives have been directed to the small-holder agricultural sector. Key public sector institutions have been

reorganized and Press Holdings has been successfully restructured. In addition, subsidies have been reduced, surcharges and fees adjusted more frequently, and retail prices almost completely liberalized. The Government has also collaborated with the World Bank in formulating a more realistic public investment sector program than in the past.

2. Current problems and medium-term objectives

Although considerable progress has been achieved in addressing the economic problems, the Government acknowledges that the structural adjustment program has to be continued. Malawi has not completed the adjustment of the external balance to a level which can be sustained in the medium term: the external current account deficit was about 10 percent of GDP in 1985, external reserves had fallen to a few weeks of imports by the end of the year, and the debt service ratio was 43 percent. ADMARC, the principal marketing agency for smallholder crops, is experiencing substantial financial difficulties of a structural nature. At the same time, there is a need for achieving growth in per capita income (SDR 125 in 1985), which had barely risen since 1981. These problems require concerted action on structural and macroeconomic policies.

The Government's objectives for the coming three-year period will be to adjust the economy through incentives to the private sector and restructuring of the public sector (as outlined in sections 3 and 4 below) so as to achieve an improvement in the balance of payments which will permit real GDP growth to average at least 3.5 percent a year. In this framework, the current account deficit would have to be reduced to

about 6.5 percent of GDP by 1988 while maintaining official reserves of at least two months of imports. Over the three-year period, inflation is expected to decline by about half from 15 percent in 1985.

3. Promotion of production in the private sector

The Government's macroeconomic and structural adjustment strategy for the next three years and the longer term, as set out to the Consultative Group meeting of January 1986, will continue to place strong emphasis on the development and diversification of production and exports. The primary objective will be to increase nontraditional exports (such as cotton, groundnuts, rice, and wheat) through agricultural pricing and exchange rate policies, and through the provision of supporting services for export promotion and financing. The Malawi Export Promotion Council will be strengthened. Agricultural prices will continue to be reviewed frequently, so as to restore, if needed, and to maintain an appropriate balance among the various export and domestic food crops, mainly by raising the relative prices of commodities that have export potential. Agricultural production will also benefit from measures to improve the estate sector's access to new credit facilities to finance their investment, and setting up an estate management training and extension service. Improved extension services for smallholders will also be provided, while the remaining subsidies on smallholder fertilizer will be removed by 1989. Domestic production will be encouraged by the continuation of a liberal pricing system.

An appropriate infrastructure is a key element to development. Particular importance is attached to the road network. It is expected that, by the end of 1989, the alternative Northern route, to the port of

Dar-es-Salaam, Tanzania, will be fully functional. The completion of this project, which is supported by the World Bank, will reduce freight cost significantly, and will offer Malawi an alternative access to the sea, even when traditional routes are open.

The Government will also strengthen the health and education sector, which is currently supported by sectoral lending programs of the World Bank, which plays a catalytic role in attracting additional finance.

4. External sector policies

In recent years, Malawi has pursued a flexible exchange rate policy. The Government will continue to manage the rate so as to stimulate the diversification and growth of exports and promote efficient import substitution. After a significant adjustment of the exchange rate has taken place in 1986, the aim of exchange rate policy will be to preserve competitiveness relative to its major trading partners and competitors. The pursuit of a realistic exchange rate policy should also permit a more liberal and transparent system of import authorization and exchange control. Finally, as the debt service ratio, although progressively declining, is estimated to remain high throughout the three-year period, the Government intends to rely almost entirely on grants or external borrowing on very concessional terms to finance the external current account deficit. In view of the outcome of the Consultative Group meeting in January 1986, the Government is confident that this strategy is realistic. It does not intend to seek new debt rescheduling arrangements during the period supported by the Structural Adjustment Program.

5. Policies in the public sector

In order to contain domestic demand pressures while promoting private sector activity, it will be necessary to reduce progressively the overall fiscal deficit (excluding grants) to no more than 8 percent of GDP in 1986/87 and to 6 percent of GDP by 1988/89. These objectives will be pursued in the context of a stand-by arrangement with the Fund. This will require the curtailment of some recurrent expenditure items, and realistic budgeting coupled with more effective control, so as to permit a modest level of expansion in development expenditure. The Government expects to be able to prevent a deterioration in its services by continuing the implementation of major institutional improvements in the civil service stemming from a recent extensive study. For example, the Government has approached the World Bank for technical assistance to reorganize three ministries. A fundamental revision of the system of budgeting and controlling of expenditure will also improve the effectiveness of government expenditure; this will be phased in over a number of years following an experimental presentation in the 1986/87 budget. The Government is also envisaging a thorough overhaul of the tax system with the objectives of simplification, greater equity, more rational indirect taxation, and improved allocative efficiency. Initial steps in this direction have begun in the 1986/87 budget in line with a tax study in collaboration with the World Bank.

Public investment will continue to be guided by the rolling three-year public sector investment program (the present program covers the period 1986/87 to 1988/89), with increasing emphasis on investment in productive activity, related marketing services, and infrastructural

support. The Government will be guided by both external and domestic resource availability, but will also pay due regard to future debt service and current expenditure obligations which will result. While the immediate investment cost is much easier to estimate than related future expenditure, the appropriateness of investment projects must be kept under continuous review. Investment projects will be evaluated against their contribution to economic growth, centered on exports and efficient import substitution, and on an improvement in the transportation situation, which is particularly vulnerable in the case of Malawi.

The public enterprise sector will be the subject of a comprehensive review and restructuring exercise to be completed during the three-year program period. The managerial problems in that sector will also be tackled. As elaborated within the current World Bank-supported structural adjustment program, it is the intention that all commercially oriented public enterprises should operate on a profitable basis, so that they can contribute to the central government budget. To improve the efficiency of these enterprises, policies will aim at liberalizing their pricing policies, coordinating their investment strategies with the national priorities defined by the public sector investment program, and regularizing financial flows between the enterprises and the Government. The scope for privatization will also be examined. A blueprint for the review will be completed before the end of 1986, at which time a timetable will be established for implementing the policies.

An urgent priority will be the rehabilitation of ADMARC, the principal marketing agency for smallholder crops. As a first step, during the fiscal year 1986/87, certain assets will be sold to the private

sector to unwind accumulated financial imbalances. This will be followed by a more fundamental review of its role (to be completed by 1987/88), tailoring its investment activities, and eventually diminishing its marketing operations to a residual position relative to the private sector. In the interim, the Government will pay close attention to ADMARC's financial position in setting appropriate agricultural prices and its operating expenses, so as to achieve a sustainable breakeven position in 1987/88.

6. Monetary and financial system

Financial intermediation has an important role to play in promoting economic development. The authorities intend to keep interest rates positive in real terms to encourage private saving and an efficient allocation of capital. In the context of a stand-by arrangement with the Fund, progressive moves will be made toward greater interest rate flexibility. By following prudent policies for the Central Government and public enterprises, there will be greater scope for satisfying private sector credit requirements. Specific financing facilities for export promotion and the estate agricultural sector are being established under the Government's structural adjustment program supported by World Bank finance. Appropriate steps are expected to be taken during fiscal 1986/87, with a timetable to be established for implementation during the following two years.

7. Financing requirement

During the three-year program, it is expected that the implementation of macroeconomic and structural policies, including exchange rate action and the setting of appropriate producer prices, will promote

efficiency in the economy and stimulate production. Exports of both traditional and nontraditional commodities are expected to benefit from these measures, permitting a decline in the external current account deficit by about 3 percentage points of GDP during the three-year period and GDP growth of 3.5 percent per annum by 1988. Under present assumptions, this scenario will necessitate inflows of grants and concessional loans of about SDR 425-475 million over the three-year period. The likely contribution of the World Bank is about SDR 190 million through SAL III, SAL IV, ADMARC support and related cofinancing, and the Fund at least SDR 17 million through the Structural Adjustment Facility (SAF). To raise GDP growth to an average of 3.5 percent during 1986-88 would require an increase in concessional capital inflows over current estimates, possibly of the order of SDR 15 million annually. In 1986, concessional loans and grants are expected to amount to SDR 175 million, of which the World Bank will contribute about SDR 95 million through SAL III and cofinancing, and the Fund SDR 7 million through the SAF loan. In addition, a new stand-by arrangement with the Fund will permit drawings of SDR 7 million in 1986.

A Consultative Group for Malawi first met in January 1986 to mobilize donor support. Malawi expects to continue to use this forum, stressing the need for concessional assistance and balance of payments support. Malawi hopes to continue to avail itself of the World Bank's resources, including structural adjustment operations. In continuing its relations with the Fund, Malawi expects to be able to reduce progressively its outstanding use of Fund resources, while continuing close consultation, initially in the context of a stand-by arrangement.

Table 1. Malawi: Principal Elements of a Common Policy Framework

GDP growth	about 3.5 percent 1986-88
Consumer prices	about 7 percent in 1988
External current account deficit	about 6.5 percent in 1988

Promotion of production in the private sector

Export promotion and diversification (continuous)
Liberal price regime to be maintained
Agricultural pricing continues to restore balance among crops (1986/87)

External sector

Flexibility in exchange rate management
Improvement of foreign exchange allocation system (from 1986/87)
Restrained external nonconcessional borrowing (from 1986/87 continuous)

Public sector

Central government overall deficit (excluding grants) 6 percent of GDP in 1988/89
Institutional improvements in the Civil Service (from 1986/87)
Tax reform (from 1986/87)
Expenditure system reoriented (from 1986/87)
Public sector investment program (PSIP) restrained by resources, focussing on productive activity (continuous)
Fertilizer subsidy removal (1989)
Public enterprises reassessed and restructured (1988/89)
ADMARC rehabilitation: asset disposal (1986/87); diminishing to a residual marketing role (1988/89); breakeven in current operations (1987/88).

Monetary and financial

Real interest rates positive (continuous)
Interest rate liberalization (from 1986/87)
Financing for export promotion and estate agriculture (from 1986/87)