

E – BRIEFING 7

National Action Group Forum

29th August 2005

The IMF – Government of Malawi Agreement, 2005-2008

This **e-bulletin** summarises the IMF-GoM Agreement that has recently been concluded to assist businesses in understanding the implications for doing business in Malawi. For the full agreement see (<http://www.imf.org/external/np/loi/2005/mwi/071805.pdf>) or request from nag@globem.net. You are encouraged to access the whole agreement. While care has been taken to ensure the accuracy of the summary information in this e-briefing, readers should make their own independent assessment before taking decisions in relation to the content. In this briefing, direct quotes are shown in italics.

Summary

On August 5th, the IMF Board agreed to resume lending to Malawi, approving an initial disbursement of about \$7.9m. Six additional payments, of similar amounts will be made every six months, with the final payment to be disbursed in May 2008, provided that various conditions are met. The loan, which totals about \$55.8m, is part of the IMF's Poverty Reduction and Growth Facility (PRGF) and is available on highly concessionary terms with an annual interest rate of 0.5% to be repaid between 2010 and 2015.

Like other IMF loans, PRGF loans are always conditional upon recipient countries adhering to agreed reforms and limits on expenditure. All these reforms aim to stabilize the Malawi economy and many of these reforms will have a direct impact upon businesses.

Moreover, the resumption of lending by the IMF has enabled other donors in the CABS¹ group to provide direct budget support to the government as grants. In fact, the primary use of this external assistance will be repayment of domestic debt. Reducing stock of debt means that those who have been lending to the government will need to find alternative ways to get a return on their funds, including the commercial banks who have invested heavily in Treasury Bills. The result of this should be that interest rates start to fall for both borrowers and savers. Lower real interest rates should facilitate increased borrowing and investment by the private sector, though rates would probably have to fall further for a significant uptake. In the immediate term, this will provide some relief for current borrowers.

Why has the IMF agreed to resume lending now?

In July 2004, the Government of Malawi requested the IMF to monitor its performance without the incentive of immediate lending. This "staff monitored programme", which ran for the fiscal year 2004/05, was a chance for the Government to develop a positive track record leading to resumed lending from the IMF in due course.

In reviewing the staff monitored programme for 2004/5, the IMF stated that:

"Malawi's economic performance has improved since mid-2004 under the program monitored by Fund staff. After several years of economic deterioration, significant progress has been made in restoring macroeconomic stability, strengthening economic growth, and

¹ Common Approach to Budgetary Support, including the European Union and governments of the United Kingdom, Norway and Sweden, whilst the World Bank is currently developing a structural adjustment credit.

stabilizing the government's domestic debt. The government is committed to continued strong policy implementation, especially budget implementation, to consolidate these gains."

Main Points of the IMF – GoM Agreement

The main substance of the agreement is a statement by the government of the economic policies that it intends to follow. These are contained in the *Memorandum of Economic and Financial Policies*, 18th July 2005. The summary below covers the main points of the agreement and highlights those areas of most interest to businesses in Malawi.

Main Economic Objectives

The main economic objectives set by the program over the next three years are:

- To raise economic growth to near 6% a year, with an emphasis on rural incomes;
- To increase health services and educational opportunities;
- To reduce core inflation to the 5–8% range;
- To run a fiscal surplus to reduce the government's domestic debt to less than 15 % of GDP from over 24%; and
- To build international reserves to at least two months of imports.

Strategy for achieving the Objectives

The strategy for achieving the above objectives includes:

Good Governance

- Zero tolerance for corruption. *"Public officials and civil servants.....must be held accountable for their actions."*
- Financial governance, including public expenditure management, civil service wage and pension reforms, procurement and budget reforms. *"We [the Government] will continue to strengthen financial management in Malawi's remaining parastatals and complete the ongoing review of their governing boards."*
- *"Economic governance. The government needs to become more business friendly by making our institutions more efficient, providing better service to our citizens and foreign investors, ensuring that the tax burden is fair, and by reducing subsidies."*
- Political governance, including local government elections in 2005/6.

Macro environment

- More investment in roads, railways and bridges, streamline the operations of ESCOM (including clearing arrears to and from other government entities) and pursuit of regional power arrangements.
- Improved court system, including the introduction of a commercial court, streamlined business licensing and strengthened tax administration.
- Maintain a healthy banking system including: anti-money laundering and fraud protection; continuation of the rural credit scheme (MARDEF)

Fiscal Policy

- The overarching objective of fiscal policy is domestic debt reduction as servicing represented nearly 50% of tax collections.
- Objective to make tax policies and administration competitive and business friendly.
- Implement a civil service payroll census and wage bill cap as these are high relative to neighbouring countries.

Monetary and Exchange Policy

- *"Our medium-term exchange rate objective is to have the Kwacha fully market determined and build foreign exchange reserves, but at the same time recognize the*

importance to businesses of a predictable currency value. We will continue to smooth the exchange rate for seasonal fluctuations, but refrain from attempting to influence its underlying value. We recognise that the most important ingredient for exchange rate stability is sound economic policies.....”

- *“We intend to move forward toward an independent central bank as part of a SADC wide initiative.”*

Other Policies

- Trade preferences will be a focus of attention, in light of their erosion.
- Remain committed to a liberal trade regime and *“to favor lower tariff scenarios.”*
- *“Our medium-term agriculture policies will be based on market principles. To this end, the government will continue to improve the functioning of markets, including removing practices (through legislation) that restrict free competition in produce, food and input markets.”*
- *“We have revised our privatisation divestiture plan. We believe that privatisation of some of our remaining state enterprises will bolster their efficiency, improve services, and potentially provide revenue to the government. After a temporary delay to reassure Malawians that the sale of state enterprises has many advantages and that resources will not be wasted, we are ready to proceed with this program.”*

Economic Program for Fiscal Year 2005/06

Arrears – (note - this is a “performance criteria”, so it must be completed to ensure continued IMF disbursements on schedule.)

- *“Our strategy for arrears will involve several steps that are outlined in the paper submitted to Cabinet for approval.*
 - ***Identify all domestic arrears.*** *Under the direction of the Accountant General, we have developed a list of arrears as of end-June 2004, including MK 8.5 billion incurred by ministries and MK 2.2 billion stemming from court cases and other claims. This goes beyond the audit conducted in 2004 that covered only a sample of ministries and was hampered by data collection problems. Ministries will be expected to resolve any delayed payments since end-June 2004 through their own budgets.*
 - ***Verify all claims.*** *A claim on government will be considered valid only if backed up by a contract signed by a government officer or invoice, and proof that the goods or services were provided.*
 - ***Centralize arrears processing.*** *Ministries have sent claims, with supporting documents, to a technical team appointed by the Minister of Finance under the Accountant General.*
 - ***Prioritization.*** *The special team will organize the certified claims according to a priority ranking established by the Cabinet. Special attention will be given to claims with penalty clauses, individuals (pension or salary arrears), and small firms.*
 - ***Settlement.*** *The means of settling our domestic arrears will depend on the amount of certified arrears and any offsetting factors such as unpaid taxes. As the remaining arrears exceed the 2005/06 budget provision of MK 2 billion, we have developed a settlement plan consistent with available resources. Clearance of some of these arrears could involve payment in government securities and be phased over time.*
 - ***New arrears.*** *Efforts are being made to avoid new arrears by improving financial management and adhering to the existing commitment control system. To the extent that arrears do emerge, for example through administrative delays, they will be cleared quickly using the spending ministry’s resources. Our new program of monitoring each ministry’s accounting departments on a regular basis should*

reduce the chances of unfunded commitments that can lead to arrears or payment delays.”

Tax policy and Administration:

- Reviewing the organisation of MRA, improve staff training and computerize operations. *“Our objective is to provide good service to our private sector, for example refunding VAT claims promptly and enforcing tax regulations consistently. As an important first step, we have decided to classify VAT refunds as statutory expenditures and eliminate the practice of granting VAT exemptions on government purchases.”*

Monetary and Exchange Rate Policies:

- Focus on reducing inflation and let exchange value of the Kwacha be market guided
- Conduct an analysis of commercial bank balance sheets
- Remain committed to a lower Liquidity Reserve Requirement to reduce operating costs of banks making room for reduced lending rates and better rates on deposits.
- Aim to reduce or eliminate the foreign currency surrender requirement.

Medium-term structural reforms

Business environment

- Strengthen the business environment by introducing a commercial court, streamlining business licensing, and strengthening tax administration.
- Investment in public physical infrastructure—roads, railroads and bridges.
- Negotiations towards entering the COMESA Customs Union in 2007 and the SADC FTA in 2008.

About this E-briefing and the National Action Group Forum

This e-briefing is intended to act as a means to feedback information to businesses and to organisations that work with the Private Sector about the National Action Group Forum and issues of importance to the development of the business community.

The National Action Group is a Forum for the discussion and **resolution** of issues that impact on the performance of the Private Sector in Malawi

The National Action Group Forum brings together the three main stakeholder groups who are interested in developing the Private Sector - that is Government, Businesses and Development Partners, with input from Civil Society where appropriate.

- **Government** is represented by the Ministers of Finance, Trade and Private Sector Development, Agriculture, and Economic Planning and Development. There are high-level representatives from the Reserve Bank and from key public sector organisations, such as the Privatisation Commission and ESCOM.
- **Private Sector** is represented by chief executives of leading companies, MCCI, NASFAM and key Sub-sector/Industry Associations.
- **Development Partners** that are active in private sector development are represented by the Heads of Mission and their Private Sector Specialists

For More Information

NAG Secretariat Private Sector Focal Point: Jason Agar/John McGrath (nag@globemw.net)

Tel. 01 675 520 / 672 933 / 672 830 **Tel/Fax:** 01 673 022 / 674 560

NAG Secretariat Government Focal Point: MEPD Charles Kambauwa 01 788888 / 788404

MTPSD Vincent Nkhoma 01 770244

NAG Secretariat Development Partner Focal Point: Rob Rudy, 01 773180/ 08 202428