THE CASE OF THE EXOGENOUS SHOCKS FACILITY AND THE EXTENDED CREDIT FACILITY TO MALAWI AND THEIR EFFECTS ON THE POOR IN MALAWI

Report

By

ActionAid International in Malawi and Malawi Economic Justice Network

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i. List of Acronyms and Abbreviations

AAI	ActionAid International
AAL	Agricultural Adjustment Loans
AfDB	African Development Bank
BoP	Balance of Payment
CABS	Common Approach to Budget Support
CISANET	Civil Society Network on Agriculture
CSO	Civil Society Organization
CSQBE	Civil Society Coalition on Quality Basic Education
DAD	Department of Aid and Development
DFID	Department for International Development
ECAMA	Economics Association of Malawi
ECF	Extended Credit Facility
ESAF	Enhanced Structural Adjustment Facility
ESCOM	Electricity Supply Commission of Malawi
ESF	Exogenous Shocks Facility
EU	European Union
GEF	Global Environment Facility
HAC	High Access Component
HIPC	Heavily Indebted Poor Country
IFI	International Finance Institution
IHS	Integrated Household Survey
IMF	International Monetary Fund
LICs	Low Income Countries
LTD	Limited
MDRI	Multilateral Debt Relief Initiative
MEFP	Memorandum of Economic and Financial Policies
MEJN	Malawi Economic Justice Network
MERA	Malawi Energy Regulatory Authority
MGDS	Malawi Growth and Development Strategy
MHEN	Malawi Heath Equity Network
MoAFS	Ministry of Agriculture and Food Security
MEFP	Memorandum of Economic and Financial Policies
MoEPCD	Ministry of Economic Planning Development and Development
MoEST	Ministry of Education Science and Technology
MoHP	Ministry of Health and Population

MOU	Memorandum of Understanding
NSA	Non State Actors
PCC	Petroleum Control Commission
PEFA	Public expenditure Accountability Framework
PIN	Public Information Notice (PIN)
PRGF	Poverty Reduction and Growth Facility
PRGT	Poverty reduction and Growth Trust
PRSP	Poverty Reduction Strategy Paper
RBM	Reserve Bank of Malawi
RCF	Rapid Credit Facility
SAPS	Structural Adjustment Programmes
SCF	Standby Credit Facility
SDR	Special Drawing Rights
SP	Sulfadoxine-pyrimethine
USA	United States of America
USAID	United States Agency for International Development
WB	World Bank
WTO	World Trade Organization

FOREWORD

This study, jointly commissioned by Malawi Economic Justice Network and Actionaid International Malawi, was commissioned in 2010 as part of a multi-country study involving other countries like Pakistan, Kenya and Ghana with financial support from Rockerfeller Brothers Foundation. The study is a continuation of efforts by civil society to pursue evidence-based advocacy, in recognition that macro-economic policies determine the direction of poverty fight.

From history, we have been working closely as civil society in monitoring macro-economic policies and establishing their link with the capacity of government to deliver on service provision. We are building on the works on Poverty Reduction Strategy Papers and the impact of conditionalities set in the agreements between Malawi and the IMF on social service delivery. A good case example is the wage cap, a conditionality that crippled government from spending beyond a certain ***'agreed ratio'*** with IMF on overhead expenses. This in turn limited how much government could invest in the training and recruitment of teachers and nurses amidst growing concerns on the collapsing social service sectors in the early 2000s.

Pressure from civil society organizations resulted in IMF claiming that it was undergoing various reforms in order to remain relevant to the member states. In 2008, the global economic crisis created an opportunity for IMF to present itself once again as a relevant organization in management of global finance mechanism. The offer of bailout programmes to various countries was the key role that IMF took with reformed terms of engagement.

It is against this background that this study was commissioned to examine the programmes which IMF put on the offer; in this case the focus was on Malawi. After implementing a one year Exogenous Shock Facility, Malawi went ahead and signed a three year programme in 2010; the Extended Credit Facility which derailed in 2011.

The study examines the design of the programmes and their effectiveness against their terms, assesses the conditionalities to establish whether there is a change, and picks out a case of a trigger that did not work (the devaluation of the Kwacha) and its impact on poverty. This paper also identifies general policy recommendations that can be pursued in order to make macro-economic policies responsive to the needs of the people.

This report is useful for activists of social and economic justice, scholars, government, development partners, media and indeed the cross-section of the society.

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1.0 Executive Summary

This report is a critical analysis of how the International Monetary Fund's new wave of loans to Malawi, the Exogenous Shock Facility (ESF) and the Extended Credit Facility (ECF) fall short as long term and comprehensive solutions to cushion Malawi from the impacts of the 2008 Global Financial Crisis and other related exogenous shocks. The IMF credits were aimed at helping Malawi build up reserves of up to 3 months import cover which is the standard IMF requirement for LICs to meet its imports needs such as fuel, medicines and fertilizer. In generic terms, the aim of these credits is to expedite economic support so that Malawi does not slip back from the macro-economic milestones already achieved under the IMF guidance due to the impact of the external and unforeseen shocks.

The research however shows that the credits are not and will not be a panacea to solving Malawi's economic problems on a long-term basis without considering many other factors that are at the root of the country's economic crises including the Government's failure to manage its economy, for instance in moving beyond the agro-based economy to mining and other sectors as well as managing other non-financial issues that have triggered cancellation of aid to Malawi, such as good governance, rule of law and observance of human rights. Aid suspensions which often lead to acute economic problems in the country, as is the case currently, in the 2011/2012 Financial Year.

The study focuses on Malawi's experience of the initial IMF response to the global financial crisis, the loan and program extended under the Exogenous Shocks Facility (ESF, December 2008-December 2009) and also with the ongoing Extended Credit Facility (ECF) loan that supplanted it (2010-2012)[1]. Being the first beneficiary country of the IMF ESF in the world, Malawi received a credit of $77.1 million on December 3, 2008[2] but a joint staff review of progress on ESF was left incomplete because the Malawi government failed to stick to the set milestones and the review report was never presented to the IMF Board for approval. During the same period, Malawi faced more unexpected external shocks such as increases in fertilizer and fuel prices, which further widened the current account gap necessitating more financial support to meet increased cost of imports. And so instead of getting the full $77.1 million under the ESF, the programme was called off after Malawi had received $52 million only, and then moved into the ECF program running until now although Malawi is off track and negotiations to resume the programme between the IMF and the Malawi Government are going on.

The current ECF programme is a successor to the 2005-2008 Poverty Reduction and Growth Facility (PRGF) programme, and is scheduled to run until 2012, with total disbursements of $79.4 million (SDR 52.05 million). The first review of the ECF was done in February 2010 and indications then showed that Malawi was on track with the programme. However, the second review conducted in March 2011 both in Malawi and in Washington, showed that the review was unsuccessful because Malawi failed to meet the agreed programme targets,

[1] Times Reporter, IMF Okays govt to draw K1,6bn, The Daily Times News Paper, December 28, 2010 page 1
[2] Country Report No 09/16

mainly the failure to maintain foreign reserves that in turn led to the derailing of Malawi's growth trajectory[3]. The suspension of aid is one direct result, with most donors under the Common Approach to Budget Support (CABS) withholding direct budget support for the 2011/2012 Financial Year following on the stress signal from the IMF that Malawi was off track. Among the main agreed macro-economic conditions in the ECF that Malawi was judged to have fallen short on were the failure to liberalize the forex exchange regime by December 2011 and increased government domestic borrowing largely through the Reserve Bank of Malawi using the Ways and Means borrowing tool.

While the ESF was like a jumpstart to support Malawi's efforts to adjust to severe terms of trade shocks (2008-2009)[4]; the ECF's objectives were aimed at enhancing economic stabilization, maintaining internal economic equilibrium and helping sustain poverty reduction efforts by improving structures in the budget that promote safety nets for the ultra poor and build competitiveness of the business climate through expanding the capacity and quality of infrastructure, promoting investor access to finance, and reforming legal and regulatory frameworks governing financial supervision and the operation of other key economic activities[5]. In other words, the ECF carried the programme objectives of the ESF for a longer period.

In the short term measure especially in year one of the ECF framework (2009-2010 review period), the credit facilities seem to have responded to the cause in that they helped to build foreign reserves and allowed Malawi to meet its import needs. The IMF credit facilities also helped to signal to the CABS[6] donors to resume economic support to the government of Malawi to meet its budget support. However in the second phase of the ECF review period, 2010-11, in which the assessment indicated Malawi failing to stick to the ECF terms leading and being off track with the IMF, the situation on the ground shows worsening of economic problems in that Malawi continues to experience acute forex problems as exhibited in the persistent shortages of fuel and medicines in most hospitals and clinics The fact that the second ECF review conducted in March 2011 has been unsuccessful means that the Malawi government has failed to address the problems identified for which the ECF was developed and agreed upon. So far neither the Malawi government nor the IMF is coming up with any plausible solution(s) to resolve the problems. At least the IMF has provided the Malawi government with some possible solutions to end Malawi's perpetual economic woes. For instance the IMF has conducted some impact analysis of devaluing the local currency and liberalizing the forex regime with possible safety nets to sectors of Malawi's population that would be affected in the process. But decisions from the Malawi government to date are not backed up by any feasibility studies on the impact of not taking the policy advice from the IMF other than the position presented by the State President on Malawi's position not to devalue or liberalize the forex regime[7]. On the same point the Head of State has categorically

[3] Thom Kanje, World Bank withholds aid, The Daily Times, Tuesday 31 2011 page 1
[4] Malawi: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, November 3, 2008 page 1
[5] MEPF, January 26th, 2010
[6] The CABS group was formed in 1999 to provide harmonized general support to Malawi's Budget. The group is made up of the AfDB, UK, Germany, Norway, European Commission and the World Bank. The IMF and the UNDP participate as observers.
[7] Public Lecture by The State President, State House Lilongwe, July 20th, 2011

rejected the IMF advice and has said that he would never succumb to pressure from the IMF to devalue the kwacha because doing so would result in prices of commodities going up. He said,

> "…I have been admonishing the so called economists even the international community that if we devalue the Kwacha, people in the village will suffer. Those insisting that we should devalue the Kwacha are not wishing you people in the village well.I want those who are looking into issues of forex to have a principle to defend this country. Don't protect the IMF but protect the people. If it's difficult for you to do so, just tell me that you won't manage to help the people and resign. I will be happy to receive your resignation.'' [8]

On the ground however, cost of living is on the increase as the government has revised the cost of fuel by 12-13% at the pump to help raise money to meet the cost of fuel on the global market. The consequence of the fuel increase has been a resultant general price hike of up to 25% while people's earnings increased by 7% in the same period. Fuel shortages have had a knock-on effect on many socio-economic spheres such as an increase in imported foodstuffs, and a shortage of essential medicines in hospitals and clinics. It has also created a black market for fuel, with prices ranging from MK 500 ($3) per litre of petrol instead of the normal MK 300 ($1.50) per litre. The most affected sector of the Malawi population is the 60% of the people living under $2 per day who depend mostly on government services to meet their basic needs in health, education and agriculture. With the persistent fuel shortages, the Malawi government is failing to reach out to its citizens with medicines, teaching and learning materials especially in the remote rural areas. In many rural clinics, patients, other than children under five and pregnant women who are a priority for essential medical care, have to hire private vehicles to get to hospitals because the official hospital ambulances are often without fuel. Some observers say that probably it is time that Malawi considered opening up the energy sector which is controlled by Malawi Energy Regulatory Authority (MERA) and limited to a few traditional players who are now overwhelmed by the challenges of forex and outstanding bills to pay suppliers. The sector should be opened up to individuals and private companies that can bring fuel even in a context of lack of forex. This will in the short and medium term ease one of the biggest pressures that has reduced production and productivity in the country and is one of the biggest determinants in commodity pricing as well as transport costs.

On the other hand, the donor freeze on direct budgetary support which is often around 10% of the national budget which has influenced the government's decision to finance 100% recurrent costs in the Zero Deficit Budget (ZDB) introduced in the 2011/2012 financial year as a way to reduce donor dependency, has led the Malawi government to introduce new taxes which have reduced disposable finances of ordinary people even more.

Unfortunately, the new taxes introduced by the Malawi Revenue Authority[9] even on basic necessities such as table and kitchen salt, meat products including "offals" and house rentals,

[8] Madalitso Musa, Bingu adamant on devaluation, The Daily Times, Friday December 30, 2011, page 3

[9] Malawi Revenue Authority Customs and Excise Division, Public Notice NO: 4/2011, June 3 2011

which previously carried no taxes have the potential to compound the economic woes of poor people in the country.

Throughout the ECF programme especially in the second phase (2011-2012), the disagreements between, the Malawi government on one hand and the IMF and the CABS donors on the other regarding the failure by the Malawi government to control public expenditure and domestic borrowing has been the major bone of contention between the two sides. The Malawi Government has always argued that its domestic borrowing has been a result of delays by the CABS donors to release the pledged funding to meet recurrent costs and related public commitments. In other words the slow response to the IMF's signal by the CABS donors influences the Malawi Government to go against the ECF agreement to reduce domestic borrowing because government has to borrow to meet its recurrent costs in the wake that there are no funds for that. On the other hand, the IMF and the CABS donors accuse the Malawi government of succumbing to the pressure to spend outside the approved budget ceilings. A case in point is the procurement of the presidential jet at a time when the economic climate was not conducive for such a huge expenditure[10]. Most donors interviewed during the study also indicated that the borrowed money often does not reach the poor people on whose behalf the government borrows the money.

Whatever the case may be, if the failure by the Malawi government to control public expenditure including continued domestic borrowing not allowed under the ECF agreement is a result of uncontrollable pressure to spend to promote business as usual in government as claimed by the donor community, then the Malawi government shares greatly in the causes of the economic problems that the country is facing other than the external factors. But if the continued domestic borrowing and pressure to spend against the ECF agreement is a result of the government's desire to meet citizens' needs as outlined in the Malawi Growth and Development Strategy (MGDS) then the IMF ECF agreements need to be questioned because the conditionalities could be infringing on people's rights to access social amenities – i.e. maintaining macro-economic indicators at the expense of peoples' rights.

However, the state of affairs described above shows that the IMF credit facilities alone, the ESF and the ECF, fall short as responses to Malawi's economic problems unless other economic policies are brought into the equation. The ECF, just like most of the IMF's macro-economic policies, are narrow in that they are taken as a solution to all countries' economic problems without taking into consideration the local economic context which also contributes greatly to economic crises of LIC countries like Malawi. These macro-economic conditions are not negotiable even if it is said that Malawi negotiated with the IMF on the ECF terms. The experience of Malawi's relationship with the IMF in the new phase of credits raises familiar complaints even as the IMF asserts that the institution is reforming and becoming more democratic to embrace the needs of poor countries. The experience raises fundamental question as to whether the IMF-Malawi relationship is that of partners in development or of unequals; most likely the later would be true in this case.

[10] Mabvuto Banda, UK Says Bingu's jet cost K3.4 BN, Weekend Nation, Saturday, May 28 2011 page 1

Caught in dilemma as to whether or not to implement the IMF austere conditionalities of devaluing the kwacha and liberalizing the foreign exchange regime after defaulting on the ECF terms, what Malawi needs most is to begin to address its economic challenges with a proper policy mix of trade, aid but also gradually developing an exit strategy to aid dependency, good monetary and public expenditure control. At the same time Malawi needs to address other non-economic issues that have led to its traditional donors freezing aid which the country needs still as it is developing an exit strategy to aid dependency. Malawi must normalize its relations with the donors and also move towards creating good neighborliness with surrounding countries which could also provide economic solutions for instance if the Malawi kwacha was allowed for inter currency usage in trade up to some depth in Mozambique, Zambia and Tanzania.

One point comes out loud and clear however: while the IMF and Malawi government are in the dilemma of resetting and adhering to macro-economic conditions, the welfare of the people, especially the poor, should inform the two entities on the best course of action to take so as not to worsen their already impoverished state. Hence the central thesis for this report is that much as the IMF's ESF and ECF programs seem to provide some solutions to Malawi's economic instability, the solutions are short-term and largely unresponsive to the needs of the poor. Malawi needs to develop long-lasting strategies to increase domestic resource mobilization such as tax reforms, addressing deficits in trade, budget financing, reducing overdependence on donor aid and diversifying its economy by moving to new sectors such as tourism and a well regulated mining sector.

Some of the main recommendations that the research brings forth are as follows:

- High level commitment from the Malawi leadership to address the root causes of trade deficits, budget deficits, public overexpenditure and general financial imprudence that push Malawi to seek more financing including loans.
- Develop strategies that would make Malawi's trade commodities competitive on the global market, for instance by adding value to fetch more money as opposed to the current trade in raw agricultural commodities
- Much as the IMF has come up with quick fix solutions to the impact of external shocks on Malawi's economy, real and long lasting solutions to Malawi's economy first and formost lie in the country's ability to generate its own revenue and reduce donor dependency which has austere conditionalities attached to the aid. One such way of revenue diversification for Malawi would be to promote the emerging mining sector. However the sector needs better policy and legislative framework as well as better contractual frameworks than is the current situation in which Malawi's license are fees are one of the lowest in the SADC region. More studies are needed both from the Malawi government and Civil Society on how best Malawi could diversify the tax base and on robust ways of domestic revenue generation.
- Civil Society needs to develop a well-thought-out debt monitoring plan for the current ECF. This could serve as a wake up call for government and IMF to know that their actions are being monitored.

- To involve the parliamentary committee on budget and finance to play its external oversight role on loan contraction and usage of the credits as a way to contract essential loans only that have long-lasting benefits to the country.

2.0 Research Findings

- Malawi was the first country to get a loan under the IMF's Exogenous Shocks Facility (since re-cast as the Rapid Credit Facility [RCF]), which was designed to help low income countries to cope with economic reversals not of their making. Malawi received $77million (December 2008-December 2009). After the lapse of that loan, Malawi got a more conventional three-year loan program worth $79.4 million under the Extended Credit Facility (formerly the Poverty Reduction & Growth Facility) for 2010-2012.

- The IMF claims that the ESF and its successor, the Rapid Credit Facility (RCF), provide faster, easier, and more appropriate loans for countries experiencing external shocks. Malawi elected to contract an ESF in response to factors including escalating fuel costs, which shot from $8 million per month in 2007 to over $20 million per month in February 2008, fertilizer price increases from $750/metric tonne to about $1,600, and the dwindling of foreign reserves for import cover from the normal 3 months to 0.8 months import cover, making it difficult for the country to meet its import needs.

- The IMF maintains that conditionalities attached to the emergency credit facilities are meant to narrowly address some of the root causes of Malawi's economic problems. The conditions applied to Malawi's ESF arrangement were more numerous and more similar to standard IMF programs than those applied to subsequent ESF programs. These conditionalities included tightening of fiscal and monetary policies, reduction in domestic government borrowing and improvements in public financial management by resisting spending pressures. These have had a negative impact on service delivery in LICs like Malawi; for instance reduced government borrowing by the Malawi government meant shrinking service provision to poor people especially in the areas of education and health.

- The review of the ESF arrangement (from December 2008 to December 2009) which was aborted and never presented to the IMF board for approval, showed that it was unsuccessful, owing both to fiscal overspending in the run-up to the May 2009 presidential and parliamentary elections that also led to bloated domestic borrowing, and the procurement of the $22.1 million presidential jet in 2009. Externally, Malawi faced severe terms of trade so much so that the ESF credit facility could not suffice as a response to this economic crisis without considering other economic factors needed to help address the problem.

- The signing of the ECF IMF programme, signalled to the rest of the donor community Malawi's willingness to stick to the IMF macro-economic reforms despite the termination of the ESF program. This move unlocked grants and financial aid from the rest of the donor community in the Common Approach to Budget Support (CABS) that had frozen financial aid to Malawi. This spells out the importance of the IMF programmes to Malawi – or at least the weight, and power, that donors continue to give to the IMF's conclusions.

- In contrast to the ESF, the Malawi government initially secured positive reviews from the IMF for its performance under the ECF, until March 2011 when the programme showed cracks and crumbling due to slippages by the Malawi government to stick to the terms for the ECF.

- Because of fairly successful performance of the first year of the ECF, the IMF granted a waiver to Malawi on some non observance performance conditionalities for the second tranche of the credit while keeping to the two major conditionalities, first on reduction of domestic borrowing and secondly pressuring Malawi to liberalize its foreign exchange controls to reflect the real exchange rate but these were not observed by the Malawi government and led to suspension of the ECF programme by March 2011.

- The scope of the IMF's role to help address economic shocks of Malawi is narrow in that the stress is on macro-economic parameters without taking into consideration of the micro-economic factors which have a very big impact on the macro-economic policies which in the end leads countries to falter on the terms of the IMF Programmes.

- Political decisions of the Malawi government leading to violation of the terms of the ECF have led the country to experience more economic hardships, such as renewed fuel and forex shortages which have in turn led to reduced service delivery in the social sectors such as health, cost of living escalating at the same time creating conducive climate for the proliferation of a parallel market, which is profiteering on people who seek their services as the government and the private are failing to provide. This also led to a decline of anticipated revenues in the 2011/12 fiscal year as grants were expected to fall by 26% to 17% of total revenue on account of aid cuts in the first half of the fiscal year. Domestic revenue is also expected to decline by up to 1.1% of GDP due to reduced production[11].

- The genuine involvement of non-state actors such as the parliamentary committee on budget and finance, the civil society and the private sector is conspicuously missing in current crisis of credit contraction in Malawi.

[11] NICO Asset Managers Limited Monthly Economic Report November 2011, www.nicoassetmanagers.com

3.0 Recommendations

Having identified some major findings cited above, the study concludes with the following recommendations;

3.1 To the Malawi Government and her finance institutions:

- First and formost, the Malawi government should make sure that the agreements they make with the IMF are realistic and attainable and that they are not sinister to wider Malawian society in the form of harsh conditionalities. Stopping government borrowing for instance, where and when such is essential in service provision to wider Malawian society, just to build foreign reserves to meet conditionalities of the IFIs does not make sense and is tantamount to denying citizens their right to enjoying basic human rights. Government should also pay attention when CSOs, private sector as well as the IFIs warn government to cut or curb unnecessary expenditures that are incurred using domestically borrowed resources.

- There is urgent need to come up with robust strategies and policies to boost and diversify domestic revenue collection with which to finance the national budget, one of which is to venture into the mining sector and being able to tax the sector properly without giving too many tax breaks or getting lost in buying of shares in the mining companies (as is the case with Paladin Energy (LTD) Uranium Mine in Karonga in which the Malawi government traded in its 15% share with tax breaks and in the process lost out on substantial potential revenue collection). This sector is currently contributing between 3 and 10% of Malawi's GDP. There are close to 144[12] mining companies in the country exploring or extracting minerals and yet the licence fees collected are so low and collection of other taxes is not robust. The government needs to improve its capacity in mining contract agreements; it also needs to improve the capacity of the Malawi Revenue Authority (MRA) to collect tax in the country. However the best policy mix to attain the elements mentioned would be best informed with independent studies that would draw lessons from nearby countries such as Zambia and Tanzania, and generate objective recommendations that the country could consider implementing as opposed to unilateral and untested political decisions on economic issues.

- The lessons from the global financial crisis, such as delays and cuts in donor aid to meet direct budget support (with suspension and delay being the main problem in Malawi at this point), should serve as a wake up call to the Malawi government to find lasting solutions to financing public expenditure as opposed to waiting for donor aid and borrowing from International Finance Institutions such as the IMF, which entails adverse conditionalities. Malawi should begin to develop an exist strategy to reduce donor dependency which still stands close to 40% of the national budget.

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[12] Source: Mineral Rights, Mineral and Mines Department, Ministry of Natural Resources, Energy and Environment-The number includes both actively mining companies and those doing exploration and prospecting

- The Malawi Government should find ways and means to address the perpetual budget deficits which often lead to external borrowing. One way to do this is to open up the budget formulation process for honest discussions with a wider group of stakeholders such as the civil society and the private sector to help come up with a budget that is reflective of the Malawi Growth and Development Strategy (MGDS) priorities so as to reduce unnecessary spending. The adoption of the Zero Deficit Budget (ZDB) Process by the government in the 2011/2012 fiscal year is one way to go. However, its implementation from the 2011/2012 fiscal year is rather premature and untimely since it it premised on having a good economic climate which is not the case right now in the country owing to the fact that revenue collection is dwindling as Malawi Revenue Authority (MRA) is failing to meet its targets and also that the shocks of the global finacial crisis are not over yet. At the same time, most traditional donors have withheld direct budget support which makes up close to 10% of revenue to the recurrent costs in the budget.

- Related to addressing budgetary constraints, the Malawi governmnet should also consider opening up the enegy sector to allow more private entities to complement government efforts to ensure availability of fuel supplies. Currently one of the biggest problems affecting productivity is lack of adequate and constant supplies of fuel in the country due to forex shortages. Lack of fuel which is the back bone of production in Malawi, has knock-off effects in the provision of other services such as delivery of medicines to hospitals and clinics in the country.

- The Malawi government needs to put in place mechanisms that would stimulate value addition to its raw materials. Currently, Malawi relies on trade in unprocessed agricultural commodities which do not fetch enough forex. Malawi needs to industrialize the agriculture sector and help address supply side constraints that make it difficult to add value to raw commodites from the sector.

- To help reduce trade deficits, in which Malawi's import volumes are exceeding export volumes, the Malawi government needs to examine its import list so that commodity payments that would assist in boosting production in the country would be prioritized in the wake of inadequate foreign reserves. For instance, fuel, fertilizer and related agricultural inputs, medical and medicinal products, educational materials are essential.

3.2 Parliamentary Committee on Finance and Budget

- There is need to build the capacity of committee members sitting on parliamentary committee on Budget and Finance to be able to make informed decisions about loan contraction in Malawi. Of late, we have seen the national assembly pass finance bills without taking time to understand the implications of the loans as well as terms set in the loan.

- Active participation of the Budget and Finance committee in loan contraction process in both the ESF and ECF is conspicuously missing. The National Assembly should throughly discuss, vet and approve such loans; this is conspicously missing in Malawi. Therefore there is a need for the Ministry of Finance or the Executive Arm of Government to genuinely involve the National Assembly to avoid the Minister of Finance mortgaging the nation with loans due to lack of consultation process.

3.3 To the International Monetary Fund (IMF)

- Much as the IMF has come up with quick fix solutions to the impact of external shocks, together with the WB, they must openly acknowledge their historic role that fuelled the current financial crises, including harsh terms of trade and impacts of liberalization that led to de-industrialization in many LICs[13] including Malawi from the early 1980s.

- IMF programs designed to help Malawi and other LIC countries adjust to external shocks must not have any negative conditionalities attached other than those that are geared at making the programme itself work. The IMF should limit itself to requiring the standard fiduciary principles of acountability and transparency associated with any loan. Exogenous shocks by their very nature cannot be predicted and do not originate within the country or government, and so conditions would be inappropriate[14]. For instance, LICs including Malawi, do not determine prices for their commodities at the international market; most LICs have weak or no Early Warning Systems to disasters and with the incomplete arrangements at the United Nations Framework Convetion on Climate Change (UNFCCC) and the Global Environment Fund (GEF) on how best to cushion climate change vulnerable countries, it would be difficult to determine how LICs would finance themselves in times of external shocks if IMF crisis response programs have many conditionalities.

- The Fund's advice to LICs should allow room for the countries to decide on the economic future of their country. In this regard, national governments should have be flexibility to allow a wider consultations with citizens, including members of civil society and the private sector before they agree anything with the IMF. For instance one solution proposed by the IMF to help reach internal and external economic equilibrium in Malawi is to see to it that government does not subsidize key parastals when they are in debt, but rather that the parastatals in question should adjust user fees as cost recovery mechanism or worse still that non-performing parastals be privatized. Of late, the water boards and the electricity company, the Electricity Supply Commission of Malawi (ESCOM), have increased user fees in response to the IMF's advice and with little consultation with the wider Malawian society. Much as this sounds logical, raising user fees further impoverishes people. The government should engage its citizenry in consultations about difficult decisions, and have the

[13] http://imf-ieo.org/eval/complete/eval_01102011.html

[14] Bank Information center, The IMF's Responses to exogenous shocks caused by the food and fuel crises, August 29 2008

space to implement those measures that will balance fiscal prudence and the general welfare.

3.4 Civil Society Organizations

- Malawian civil society played a crucial role in the campaign for cancellation of Malawi's foreign debt (1999-2006), which culminated in debt cancellation of close to $2 billion and brought the total debt stock down to $687 million by 2006. Now the debt stock, both foreign and domestic, is slowly increasing to $1 billion in each category. Already the IMF has sounded caution that Malawi is at medium risk in its debt sustainabilty capacity despite claims by the Malawi government that it is sustainable. The Malawi civil society should embark on citizen audits based on solid research on the debt situation and begin to advocate for publicly transparent and accountable government audits to avoid slipping back to the pre-debt cancellation period.

- With its expertise especially in demonstrating the human impact of IFI policies, CSOs can also conduct policy monitoring exercises or cost benefit analyses of contracting loans such as the ECF and provide alternatives to policy direction taken by the technicians. The ground is fertile currently for more of such research in the wake of the current IMF/Government stand off on the ECF.

- Civil Society needs to develop an effective monitoring plan starting with the current ECF. This could serve as a wake up call for government and IMF to know that their actions are being monitored.

4.0 Study Outputs

The study was expected to discuss the following elements:

1. Terms and conditions in the agreement between the IMF and the Malawi Government
2. Impacts of the terms whether negative or positive on provision of social services i.e. health, education and agriculture and how effective the ESF/ECF were, from the basis of the agreement;
3. Obligations of the Malawi Government as well as those of the IMF and if both parties met the obligations and if other donors responded in a timely way to the IMF's signal to support Malawi;

4. Recommendations that could be drawn on the Role of CSOs and Parliament in monitoring IMF and government agreements;

5. Policy recommendations to:
    a. Government
    b. IMF
    c. Civil Society Organizations
    d. Parliamentary Committee on Budget and Finance;

6. Any reforms needed for IMF in relation to its governance structure and functions and what prospects exist of it becoming a more valuable partner to low-income countries like Malawi;

7. The impact of the decision of the Malawi government to default on the IMF Conditionalities.

5.0 Research Methodology

This research was a product of both literature review and consultations with key informants. For literature review documents used were sourced from the IMF website: www.imf.org ; local newspapers; and also from the Malawian Ministry of Finance. The bibliography provides a list of the books and references used. Under consultations, the researcher talked to selected key informants from the Malawi Government, the development partners, private sector and the civil society. The findings were then analyzed and formed part of this research paper.

6.0 Challenges and Constraints Met

The Research was not without challenges and constraints. The major one was access to information and also accessing relevant public officials. However the major sources of information used in this research was the internet, especially the IMF website, which at times did not provide all information required. For instance the review report of ESF as well as the March 2011 ECF Review Report are not available. The problem of information access and availability was mitigated by meetings with key informants in which discussions were held with some key selected people whom the researcher thought would have such information.

Finally, due to the sensitivity of the research, there was a general unwillingness by interviewees to be quoted as source of information for the research, hence the list of the key people interviewed is not provided but is available. This was done to protect the sources from possible reprisals.

7.0 Introduction: The New wave of IMF Loans to Malawi, the ESF and the ECF

The impact of the 2008 global financial crisis, which was principally caused by failures in regulation in the United States, particularly in the banking and housing (mortgage) sectors, has given and legitimized the IMF's new role to save ailing economies of LIC countries such as Malawi. The IMF's Exogenous Shocks Facility made its first loans in response to the global financial and economic crisis at this point in time, Malawi being the first beneficiary.

The effects of the global financial crisis and its aftershocks have exhibited two major things namely:

- Firstly that the economic recession once again called into question the theory that the market would or can sort itself out without sustained governmental regulation.

- Secondly, the IMF is seen increasingly taking up new roles and influence in providing solutions to the impact of the global financial crisis either with policy advice or with financial support in the form of concessional loans. This is reminiscent of what happened in the third world foreign debt crisis of the 1980s, when the IMF came up with policies and financing mechanisms to support heavily indebted countries to come out of their economic crisis (albeit with dubious results).

It is estimated that close to $14.5 trillion or 33% of the value of the world's companies was wiped out as a result of the global economic crisis. The huge net losses threatened closure of industries, leading to job losses and general global economic slow-down. The impacts of the global financial crisis have been felt throughout the world. The global trading system was disturbed in that there was low consumer demand; financial aid flows from rich countries dried up or slowed down as most of the rich countries opted to deal with domestic problems. This reduced financing of both foreign direct investments and assistance for programmes like the Millennium Development Goals (MDGs), to which rich countries had pledged to provide up to 0.7% of their GDP.

For poorer countries, including Malawi, the drop in revenues from trade, foreign investment, and migrant remittances overseas strained national budgets and household incomes; many countries had budget deficits and were not able to meet social obligations of their citizens. This led to humanitarian crisis in terms of lack of health care, education services and also rising costs of food and non-food essentials such as fuel.

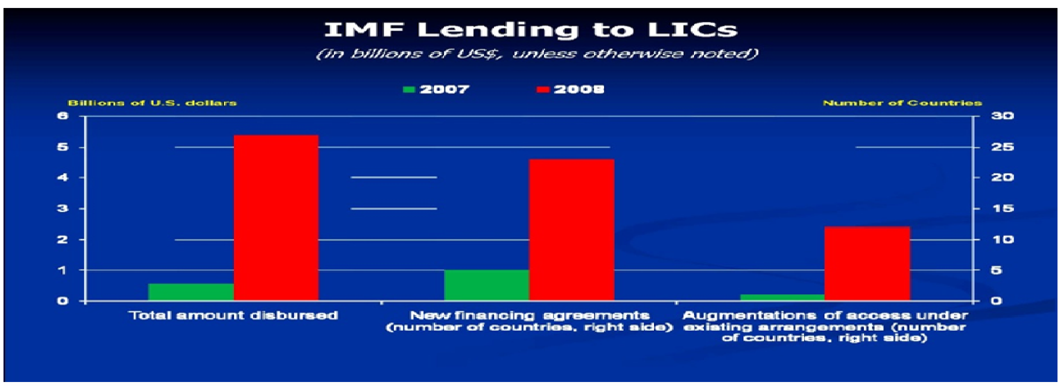
However what is important for this paper is not so much the impacts but rather the responses of both developed and developing countries to the economic crisis. There were varied solutions to correct the crisis and in trying to put the world economy back on a growth path. For instance, the US had no option but *to bailout* their ailing enterprises, especially the banks and the motor vehicle sectors, to avoid total collapse of the sectors and face unrest from their citizens resulting from job losses and repossession of mortgage assets such as housing. In the process the U.S. came up with a $14.5 trillion rescue package using tax-payers money to bail out the ailing sectors. This trend was later on emulated in the United Kingdom and other European countries where close to $2 trillion in subsidies and other rescue packages was given to the private sector.

On the other hand the IMF was entrusted by the G20 group of leading economies to come up with the crises solutions for developing countries. The whole purpose was to avoid scenarios where such countries would slip back from the IMF programmes due to the financial crisis. Although not technically and necessarily intended as solutions to the financial crisis, the IMF first implemented the ESF and the ECF facilities during the shocks of the financial crises and Malawi happens to be one of first beneficiary countries.

According to the IMF, the Exogenous Shocks credit facilities are short-term concessional loans, carrying zero per cent annual interest rate until 2011 and thereafter 0.25% with repayments made semiannually, beginning 5½ years ending 10 years after disbursement[15] and are funded and managed by the Poverty Reduction and Growth Trust (PRGT).

As Figure 2 below shows, by 2008, the amount of funds in the trust were $1.2 billion and increased to $4.0 billion by 2010 and are expected to rise to $17 billion (*with the increasing demand for credit from poor countries*) by 2014 with most of the contributions to the fund coming from the IMF's internal resources[16], including repayments from older concessional loans. This Trust Fund will become the new tool that the IMF uses to provide loans to LICs to deal with economic shocks and therefore become a new interest area for policy makers, especially civil society, to investigate the new role that the IMF is assuming in the midst of global economic challenges and its continued imposition of neo liberal economic policies resisted in the Debt Campaign in the last two decades.

Figure 1: IMF Lending until 2014:



Source: www.imf.org/extarnal

7.1 Background: Malawi's Economic and Development Vision and the need for donor support

Malawi is a landlocked country, situated in central Africa sharing borders with Mozambique in the Southeast, Tanzania in the Northeast and Zambia in the West. Having a total land area of 118,484 square kilometers of which one third is water (lakes and rivers) and 94,276 square kilometers of land, the country is home for 13.1 million people[17] making Malawi one of the most densely populated countries in Southern Africa.

Considered one of the ten poorest countries in the world by the United Nations Human Development Report (HDR), Malawi has a Human Development Index (HDI) of 0.388 meaning that close to 2/3 of people live below the poverty line of $1 per day. In terms of consumption of national resources, 20% of the richest people consume 46.3% of the resources while the poorest 20% consume only 6.3%. The 2006 Integrated Household Survey

[15] IMF, The Exogenous Shocks Facility-High Access Component (ESF-HAC), Fact Sheet March 2010 on www.imf.org/external page

[16] Financing the Fund's concessional Lending to Low-Income Countries, International Monetary Fund Fact Sheet on *www.imf.org/external* page

[17] National Statistics Office, Preliminary 2008 Population and House Census Report

(IHS) reports that rural and urban gini-coefficients of 0.37 and 0.52 respectively and 0.54 for the national, which among the worst in the world. Only 10% of the total work force is in formal employment and close to 85% employed in the agricultural sector, which is the most common economic activity, contributing between 35 to 39% of the National Gross Domestic Product (GDP) and shares up to 90% of Malawi's total exports. Malawi's GDP per capita keeps on falling from $210 in 1994 to $170 in 2008 despite the fact that Malawi's economic growth rate has been been averaging over 7% over the 2006 to 2009 period. Since 2009, Malawi's economic growth has been on the decline pegged at 6.6% in 2011 due to harsh economic conditions resulting from the 2008 global financial crises, unbalanced terms of trade epitomized by low tobacco sales in the 2011/2012 growing season and also dwindling aid flows which form substantial part of foreign reserves.

High on Malawi government's development agenda are two things; first is poverty reduction, to reduce the proportion of "ultra poor," which stands at 27.8% and bring forth prosperity and wealth for the people; and secondly, to turn Malawi from a consuming and importing country into a producing and exporting country[18]. In all this, Malawi's quest is to induce economic growth and usher in development at all levels however the biggest challenge for Malawi in achieving this is its weak and fragile economy susceptible to exogenous shocks and also characterized by heavy donor dependence. It is therefore understandable that the Malawi government would panic at any internal and external shocks that would disturb its economic and development agenda be it aid flows, trade imbalances, donor fatigue or withdrawal and any economic external shocks that would disturb its Balance of Payment. This also explains why Malawi would readily get loans like the ESF and ECF from the IMF to support its economic programmes and also why keeping good relations with its traditional donor who give up 40% of the National Budget for Development programmes and also 10% as direct budget support for recurrent costs is critical to the country. At the same time any external shock to Malawi has the potential to derail its economic and development agenda.

Despite having clear economic and development goals and good implementation strategies in place, the reality on the ground is that budget allocation and also expenditures often do not tally with the MGDS vision and programme. For instance, findings of the budget analysis of the 2009/2010 national budget by MEJN[19] reveals that budget expenditures decrease when MGDS targets demand that they increase. The cause of this is often lack of adequate financing to the budget coupled with mismanagement and weak fiscal policies.

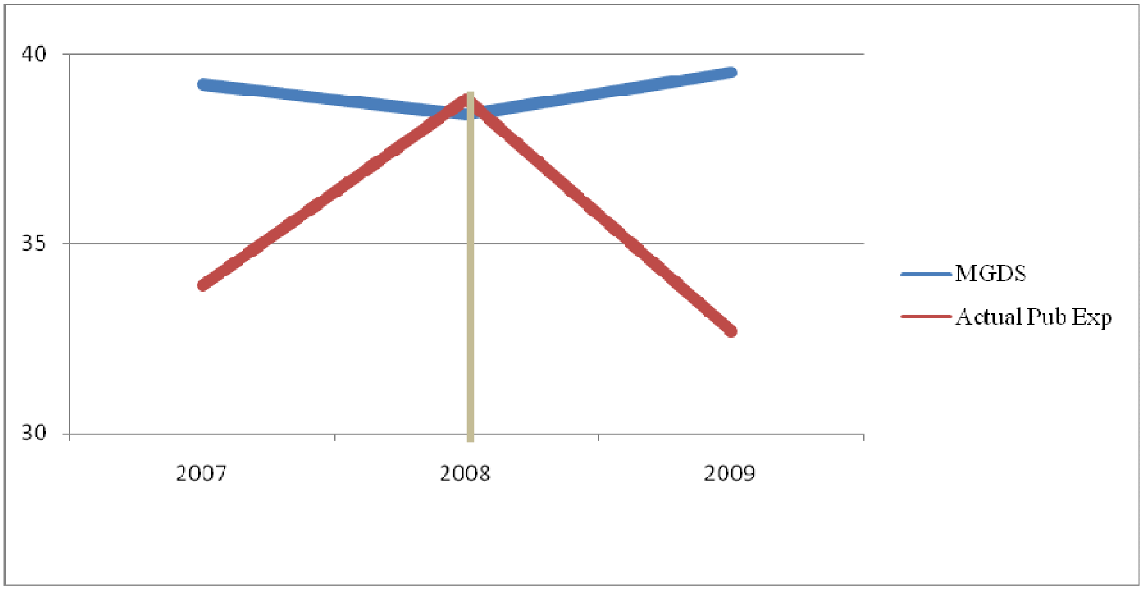
When MGDS projects a decrease, it makes it hard to determine whether expenditures are governed by the MGDS or not as Figure 3 below illustrates the situation described above. The Figure shows that annual budgetary expenditures have fluctuated from 33.9% of GDP in 2007/08 to 38.8% in 2008/09 then down to a projected 32.7% in the 2009/10 budget against MGDS targets of 39.2%, 38.4% and 39.5% respectively[20].

[18] Malawi's Economic and Development Agenda is well spelled out in the MGDS which has 9 priority areas and this also forms basis for achieving the MGDS.

[19] A network of Civil Society NGOs working on economic issues in Malawi

[20] Malawi Economic Justice Network, 2009/2010 Malawi National Budget Analysis, July 2009 p14

Figure 2: Misalignment of Budget to MGDS



Source: MEJN 2009/2010 Budget Analysis, July 2009

8.0 Malawi-IMF: Real Development Partners or relationship of unequals?

The recent relationship between Malawi and the IMF in the ESF and ECF programmes further raises the question as to whether the IMF and LICs like Malawi are real development partners or unequal partners where the IMF always holds the advantage, as the authority with the policy advice and power to save the LICs from their economic problems.

Malawi became a member of the IMF in 1965 on July 19; its quota is SDR 69.4 million (about $101.7million) and by 2008 its outstanding use of the IMF credit totaled SDR 54.4 million (about $79.8 million)[21]. Starting in the early 1980s, the IMF designed Structural Adjustment Programmes (SAPs) to help debt ridden countries like Malawi to continue servicing their debts by advising on budget cuts and other measures. Debt and SAPs gave the IMF the leverage to impose a package of orthodox "neo-liberal" economic policies which LIC countries like Malawi had little choice but to adopt and implement such as budget austerity, trade and investment liberalization, privatization, layoffs, export orientation – that laid the foundation for economic globalization to take root in most of the developing world.

In 1985, Malawi reluctantly agreed to its first imposed IMF structural adjustment programme, which focused on liberalizing its agricultural sector, the backbone of Malawi's economy, with Agricultural Adjustment Loans (AAL) to break government monopoly[22] in the sector as

[21] Press Release: IMF Executive Board Approves $55.9 million Three Year Arrangement for Malawi under the PRGF and additional Interim Assistance under the Enhanced HIPC Initiative, August 5 2008 on www.imf.org/external page

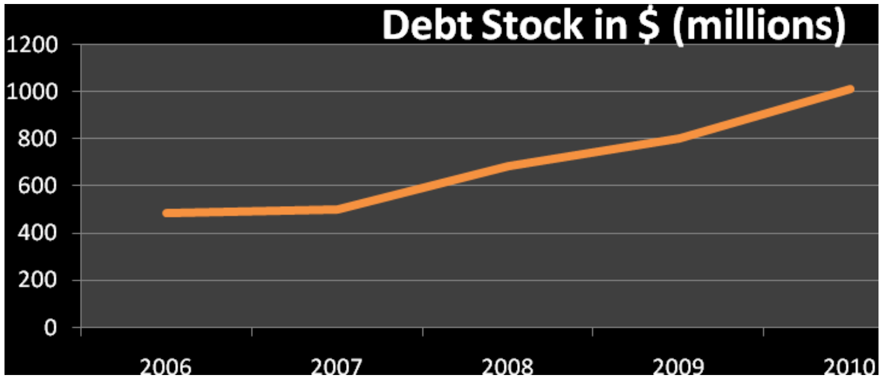
[22] See http://web.worldbank.org/WBSITE/EXTERNAL/EXTOED/EXTASSAGRISUBSAHAFR/0,,menuPK:4422655~pagePK:64829575~piPK:64829612~theSitePK:4422577,00.html

a pre-condition to aid Malawi's ailing economy. From then on Malawi has undergone a series of IMF programmes to help the country deal with its economic problems. From August 2005 to August 2008, Malawi underwent the Poverty Reduction and Growth Facility (PRGF) programmes; from December 2008 to December 2009 Malawi had an ESF programme with the IMF; and from 2010 to date an ECF programme, although it is currently off-track. In all these programmes Malawi has had very little room to negotiate the terms of the conditionalities other than to adopt them, which shows that Malawi and the IMF are not equal partners and that the IMF has an upper hand in the power relations between the two.

When the SAPs were questioned by the global civil society, especially the Jubilee 2000 Movement (led in Malawi by the Malawi Economic Justice Network [MEJN]) as being unjust, the IMF quickly transformed itself and moved to new policies called the Poverty Reduction and Growth Facility (PRGF), in which one of the principles encouraged was inclusive participation in national economic issues whereby civil society mostly but also the private sector were to work along with their national governments in developing national poverty reduction visions and programmes. These too were questioned in that they were not responsive enough to poverty reduction, in that they were IMF dictated and led and did not provide comprehensive response to the foreign debt crisis. Indeed, PRGF macroeconomic policies closely resembled those under SAPs, regardless of the positions advocated by participants in the consultations. In 2000 the IMF acquiesced to limited debt cancellation to allow poor countries to use monies intended for debt servicing for pro-poor sectors and improve service delivery especially in health, education and agriculture and food security. Malawi benefited from this in 2006 when her foreign debt stock was reduced from $2.8 billion to $487 million.

To achieve this, Malawi, had to undergo several stages of the PRGF until reaching the decision point, in 2006, when the foreign debt was finally cancelled. The process demanded close attention to conditionalities set by the IMF which included tight fiscal management, reduced civil service wage bill and reduced civil service size, liberalization, privatization of state owned entities, liberalization of foreign exchange controls and removal of subsidies and user fees where necessary. The debt cancellation was good news to Malawi in that millions of dollars were saved. Had that money been used prudently, it would have gone a long way to boost Malawi's economy and put the country on sound economic growth and development and also reduce further foreign debts contraction. However, Malawi's debt stock has increased steadily, as figure 1 below shows, to over $1 billion by 2010, up from about $487 million in 2006.

Figure 3: Foreign Debt Stock accumulation for Malawi after Debt Cancellation in 2006;



Source: MoF 2010 Mid-Year Review of the public external and domestic debt portfolio p2

There is a clear evidence that poor countries such as Malawi continue to borrow externally to help boost their economies and development programmes. After debt cancellation one would expect slowed borrowing but on the contrary it is on the increase showing that something is fundamentally wrong either in developing countries' economies in that they cannot generate their own money or at that the world economy is harsh to poor countries in that they are failing to compete with rich countries at the global level which in turn makes these countries start borrowing. Poor countries have also experienced an increase in domestic debt, mostly due to delays or cuts in donor aid which in some cases forces national governments to borrow domestically to finance recurrent costs.

9.0 The Triggers of the IMF ESF and ECF Credits to Malawi

The IMF states that the global recession led to a number of impacts which many LICs could not cope with: increased food and fuel prices, reduced financing to social sectors as a result of budgetary crises, reduced international aid flows and general low international financing.

In the case of Malawi, the country did not experience increased food prices because this was cushioned by local production of food, mostly maize.

9.1 Malawi's seeking of the ESF Credit from the IMF

According to the IMF, the ESF (now renamed the Rapid Credit Facility [RCF]) provides limited resources to respond to needs and has less conditionalities from IMF since this is meant to be a transitory process where policy implementation is constrained.[23] The beneficiaries for this facility are those LICs that are under the PRGF programme with the IMF and are experiencing external shocks or for those countries that have graduated from the PRGF. Malawi benefited under these criteria as it had had a PRGF until 2009 and had also come up with its *homegrown* poverty reduction strategy the MGDS, which serves as its PRSP.

[23] Ibid page 2

After a successful completion of its third PRGF (2005 to 2008) in which Malawi attained a relative degree of economic stability, efforts to sustain the economic targets achieved and to keep Malawi on a sound economic growth then pegged at 9.8 % per annum were soon shattered by external unforeseen shocks discussed already. Despite having improved its economic climate, Malawi once again sought financial assistance of $77.1 million under the ESF credit facility from the IMF in 2008 to help address external shocks such as increased fuel costs due to global fuel increase, increased prices for fertilizers for its agriculture subsidy programme, too low foreign reserves to cover imports for three months for the country.

In the Letter of Intent to the IMF board sent by the Malawi Government on November 13 2008, the Malawi Government requested for the high-access Exogenous Shocks Facility (ESF) to address the severe terms of trade shocks that the country was facing from increased costs of fertilizers and fuel in the 2007-2008 financial year.[24] The programme was expected to last from December 2008 and expire in December 2009 with a joint IMF-Malawi review of performance. The letter also indicates that Malawi's performance under the Fund's programme would serve as a signal to the rest of the donor community for domestic support and Malawi's determination to maintain macro-economic stability and build on the achievements of the recent successful PRGF program.[25]

In other words, a nod by the IMF to support Malawi with the ESF would not just provide Malawi with the much needed financial muscle but also signal to the rest of the donor community that Malawi was back on track with the IMF.

9.2 ESF Commitments by the Malawi Government

In the same Letter of Intent (December 3, 2008), the Malawi government committed itself to the following terms:

(a) To provide a consistent and coherent economic policy framework to underpin development objectives to respond to the terms of trade shock in the short to medium term basis.
(b) To focus on enhancing the sustainability of growth and development through policies that consolidate economic stability and reinforce resilience to shocks, including through rebuilding of international reserves; improve public finance management; and support private sector-led growth.[26]

Under the agreement the Malawi government tied itself to doing four major things:

1. To stick to the 2008/2009 Budget which the IMF had also approved; in other words to control public expenditure

2. To pursue monetary policy that would keep inflation moderate and converging towards the medium term goal of 5%. In the same vein also to build foreign reserves to help the country withstand external shocks

[24] Malawi: Letter of Intent to Mr Strauss-Kahn, Managing Director, International Monetary Fund, November 13 2008
[25] Ibid
[26] Ibid

3. To continue with public financial management (PFM) reforms with particular emphasis on budget monitoring and avoid domestic borrowing.

4. To liberalize exchange rates of the MK to the $ so as to give a true reflection of cost of the dollar to the MK as opposed to the repressed official rates that the Reserve Bank of Malawi uses

9.3 Outcomes of the ESF Credit

What the ESF programme managed to achieve in the short term perspective was to bring back confidence of the development partners in CABS arrangement to support Malawi, but it did not manage to entrench a genuine adaptation to the challenges presented by the global financial crisis. In the course of implementing the ESF, Malawi slipped on some of the agreed terms, which led to the cancellation of the programme as well as suspension of the balance of $25.1 million after having received $55 million. By end-June 2009, targets for the ESF program such as net domestic debt repayment to the Reserve Bank and the net domestic assets and net international reserves of the RBM were missed by wide margin. This was largely due to the loosening of fiscal and monetary policies during the run-up to the general and presidential elections held in May 2009[27]. Therefore a preliminary review of the programme by both the IMF and the Malawi government showed dismal implementation as the report states:

> Performance under the ESF arrangement was less successful. The initial disbursement under this arrangement helped Malawi weather the impact of shocks arising in 2008 from high international fuel and food prices, and also catalyzed additional donor support. However, important program slippages in the first half of 2009-especially in the public spending-led to much higher domestic borrowing than expected, and lower reserves accumulation. As a result these slippages, no program reviews were completed[28].

9.4 The ECF Credit to Malawi 2009-2012

After the cancellation of the ESF, Malawi requested an Extended Credit Facility (ECF) of $79.4 million for a period of three years (2009-12) which was approved by the IMF board on February 10, 2010 in its Press Release No 10/52[29].

The ECF in essence is another PRGF, except that its conditions, according to the IMF, are slightly improved with less conditionalities and the amount of money in question is more, for instance, $79.4 million in ECF as compared to $62.1 million under the 2008-2009 PRGF. However, these slight differences don't apply across the board – even the IMF doesn't pretend that the ECF really differs from PRGF. The re-naming was more to put it in harmony with the two new creations, Rapid Credit Facility and Standby Credit Facility.

The ECF facility was meant to support Malawi in its medium term reforms to address balance of payments (BoP) weaknesses and sustain growth and poverty reduction[30]. It was also meant

[27] Malawi: Staff Report for 2009 Article IV Consultation and Request for a Three Year Arrangement Under the Extended Credit Facility, IMF Country Report NO: 10/87, March 2010, page 4: www.imf.org
[28] CABS Review page 10
[29] IMF, IMF Executive Board Approves Three Year $79.4 million Extended Credit Facility Arrangement for Malawi, Washington D.C February 19, 2010 p 92

to facilitate the IMF's positive signal to domestic stakeholders and development partners of Malawi's continued adherence to macro-economic conditions and so motivate the development partners to continue with their financial support to the country in the form of direct budget support in the 2011/2012 national budget.

The ECF therefore has a specific objective which is to stabilize Malawi's macro-economics and especially to address the growing BoP problems by building external reserves to meet the country's import needs. And one expected consequence of having the ECF with the IMF was to give a possible positive signal to Malawi's development partners to resume financial aid to the national budget. In other words, Malawi needs to have a programme with the IMF in order for most of its traditional development partners under the CABS arrangement to disburse financial support to the government. It is for this reason that Malawi needs to be in good books with the IMF, even though the funds the IMF gives to Malawi are minimal compared to the CABS's funding. The political power the IMF has on the country in terms of aid flows is enormous and critical for the country's economic well being.

It is interesting to note that the IMF's assessment report on Malawi's eligibility to accrue the ECF credit facility as provided in the IMF Staff Report number EBS/10/ shows that the IMF acknowledged that Malawi's debt carrying capacity had not increased since the 2006 debt cancellation and that Malawi was at a medium term risk of external debt distress.[31] The IMF further reports that Malawi's economy was and would continue to be vulnerable because its exporting base is concentrated in few sectors, with its main export sector, agriculture, largely rain fed and susceptible to climatic changes. It also notes that the country suffers from low international reserves, leaving it vulnerable to external shocks such as increases in fuel price as happened in 2008. What was even more worrying for the IMF in the midst of all these challenges is the fact that Malawi was not moving fast enough with policy reforms to begin to address the challenges and find lasting solutions for external support. Nevertheless, the Board, on recommendation by the IMF Staff, approved Malawi to access 75% of its SDR quota under the ECF arrangement.

9.5 Malawi's Commitments to the ECF terms of agreement

According to the Letter of Intent to the IMF, signed by both the Reserve Bank Governor of Malawi, Dr Perks Ligoya and the Minister of Finance, then Hon Mr. Ken Kandodo, on behalf of the Malawi government, the Malawi Government committed itself to the following things to meet the conditions of the ECF:

a. To provide a consistent and coherent macro-economic policy framework to underpin Malawi's development objectives more especially to preserve macro-economic stability while enhancing growth and poverty reduction;
b. To move towards a market determined forex exchange rate by December 2011 and to rebuild international reserves;

[30] Malawi: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, January 26, 2010, www.imf.org

[31] Malawi: Staff Report for the 2009 Article IV Consultation and Request for a Three Year Arrangement Under the Extended Credit Facility-Debt Sustainability Analysis, February 10 2010, page 1, www.imf.org

c. To improve public financial management and monetary and fiscal transparency
d. To support a private sector led growth.[32]

9.6 The IMF ECF Terms to Malawi

To compliment the commitments of Malawi government to the ECF, the IMF came up with a package of macro-economic policies outlined below:

1. To liberalize the foreign exchange regime as well as depreciating the local currency. This also entailed having the RBM having minimal intervention in matters of forex control by allowing commercial banks and reputable forex bureaus to operate withous restraint in the sector;
2. To pursue prudent fiscal and monetary policies, as reflected in the fiscal year 2009/10 budget and through restrained monetary aggregate growth, to contain aggregate demand and inflation pressures and shift demand toward domestic output;
3. To create room in the budget for more social and pro-poor spending in line with the MGDS and improving the structure of the social safety net to protect poor households from shocks and policy adjustments, including exchange rate depreciation;
4. Improve public financial management, tax administration, and the efficiency and solvency of public utilities, and enhance the business climate by expanding the capacity and quality of infrastructure, promoting investor access to finance, and reforming legal and regulatory frameworks governing financial supervision and the operation of other key economic activities.

> As a result of a 13.19% increase in fuel prices by the Malawi Energy Regulatory Authority to meet costs of transporting it into Malawi, public transport costs shot up by between 10-20%, making it very difficult for people to travel especially as salaries and wages of workers did not increase. The rise in fuel costs has led to price increases for almost all consumer goods making it difficult for poor people

9.7 Outcomes of the ECF mid Term Review

A midterm review of the first year of the ECF (2009-2010) indicated that the program was more successful compared to the ESF in as far as keeping to the terms of agreement are concerned. On paper and in the short term, it assisted Malawi to correct its foreign reserve status from 0.5 months of import cover to 3.5 import cover months.[33] Adherence by the Malawi government to the conditions set in the ECF also prompted the IMF signal to CABS Donors to support Malawi's Budget and other related donor financed programmes.

[32] Malawi: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, January 26, 2010, www.imf.org
[33] Caroline Kandiero, Bank Sees pressure on foreign reserves, Business Times, The Daily Times, Wednesday 2 February 2011, page 1

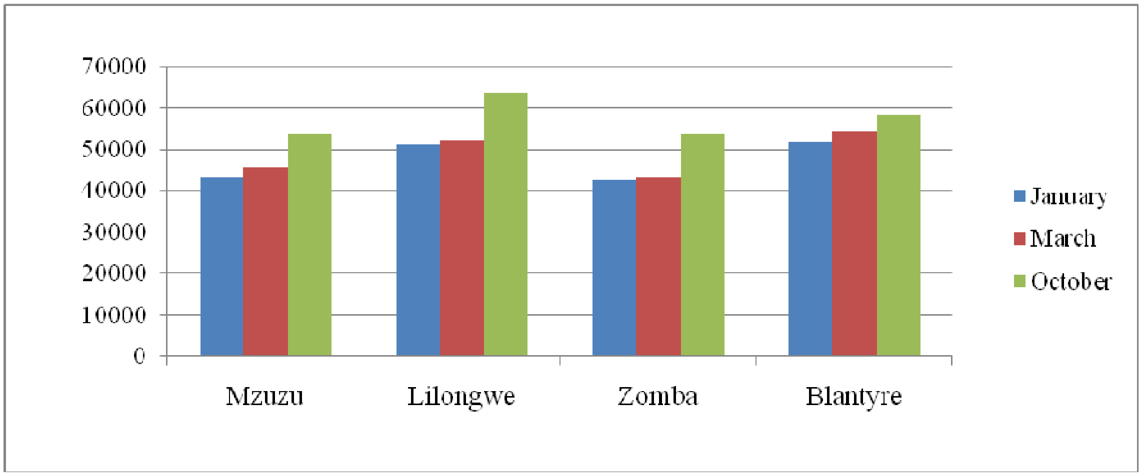
However, not much has changed positively in people's welfare and provision of commodities such as fuel remained elusive. For instance, in response to the global fuel increase, the Malawi Energy Regulatory Authority (MERA) increased prices for fuel at the pump twice in 2011 -- in January 2011 by between 12%-13.19% and again on November 8 2011 to MK380 (more than $2) per litre of petrol while diesel went up by 38.46 % from MK260 to MK360 per litre[34]. This caused a spiraling commodity price increase of up to 25% making it hard for a poor Malawian to access essential basic needs. For instance local transport from Lilongwe to Blantyre rose from MK 1,200 ($9) to MK1, 400 ($10) and the fare between Blantyre and Mzuzu, went up from MK 2,600 ($ 18) to MK 2,900 ($ 20)[35]. At the same time local city fares increased by 50% from MK100 to MK150 making it so difficult for people in the cities to travel as one resident from Blantyre puts it:

> At the moment, we are only concentrating on finding enough money for food and water. Otherwise, we have to walk 7 kilometres every day from our home in Blantyre's Ndirande Township to shops in the Limbe trading centre because paying for public transport would consume half of our income[36].

According a survey conducted by the Centre for Social Concern (CfSC) on cost of living in the four major cities of Blantyre, Lilongwe and Mzuzu, the report indicates that cost of living has gone up by 21% between January and October 2011, with the highest increase being between March and October. Figure 2 illustrates the details.

Figure 4: Cost of Living in Malawi's Major Cities (MK):

[34] Caroline Kandiero, The Year of Malawi's worst ever fuel crisis, The Business Times, December 27, 2011 page 7
[35] Caroline Kandiero, Bus Commuters refuse new fare, Business Times, The Daily Times, Thursday February 3, 2011 p 5
36 BLANTYRE, 19 December 2011 (IRIN), MALAWI: Urban poor hit by slew of price increases



Source: Centre for Social Concern

It is now clear that the achievements gained in the first year of the ECF were temporary, due to much higher imports than projected; large cumulative terms of trade declines, lower than expected budget support from donors, over-borrowing relative to the initial targets on the international scene, domestic debt exceeding initial fiscal targets and lack of exchange rate flexibility[37] which has been implemented piecemeal resulting in no tangible results in availability of forex or luring of forex out of the black market to the mainstream banking systems.

Malawi continues to suffer from external factors that pose threats to its economy, for instance besides the fuel increase, by the end of the season in 2011, tobacco sales showed serious decline and yet it is the main forex earner for the country. So far tobacco sales indicate that Malawi has fetched $293.1 million (down from the project $300 million year) compared to $416 million in the 2010 tobacco sales[38]. At the same time the annual fuel budget for Malawi has increased to $366 million from $180 million[39] in 2009. In other words, all tobacco sales, would not even equal to importing fuel in 2011/2012 financial year. And due to reduced donor grants resulting from freeze of financial aid from the CABS donors, public expenditure is projected to rise from 3.3% in 2011/2012 to 11.1%[40] in 2012/2013 unless the aid flows are resumed. This means increased borrowing by the Malawi government from the Reserve Bank of Malawi which would further jeopardize the ECF programme as this is one condition to observe by the Malawi Government. Clearly this shows that Malawi's economic problems cannot be rectified by just the ECF programme but by a correct policy mix that needs to tackle several issues at the same time.

9.8 Outcomes of the Second ECF Review, March 2011: Malawi is off Track!

A second review of the ECF conducted in March 2011 indicates that the ECF has not been successful despite modifications made to allow smooth implementation of the credit facility. Several targets have been missed, the major one being failure by the Malawi government and

37 Ibid page 10
38 Chikondi Chiyembekeza, The Year Tobacco Farmers Wept, The Nation Business, Saturday December 31, 2011, page 9
39 Dumbani Mzale, Disaster Looms As tobacco earnings equal fuel import bill, The Nation Business Review, Thursday, June 16 2011 page 1
40 www.nicoassetsmanagement.com

its economic institutions to address the forex liberalization dilemma and also depreciating the Kwacha by the agreed month of December 2011. The terms of agreement under the ECF programme were premised on Malawi's adherence to a path set and agreed with the IMF aimed at correcting the macro-economic conditions which were supposedly making it difficult for Malawi to correct its BoP and meet its import needs. The factor that the IMF most focused on was what they identified as Malawi's unrealistic and inflexible foreign exchange regime. The Malawi government knowingly committed itself to follow this and to see to it that by December 2011, the kwacha would have been floated against the dollar. Besides, the country was expected to have shown significant strides in adopting a more liberalized and flexible exchange regime by then. But the government, as confirmed by President Wa Mutharika himself in his many speeches, has categorically refused to devalue its local currency.

The government did eventually agree to a 10% devaluation in early August 2011 pegging the Kwacha to MK152 to $ from MK142 to $ from the last devaluation done in 2009. The expectations of the IMF were that the government would continue to devalue the local currency so as to gradually lure the forex on the parallel market to official channels. Very surprisingly however, instead of further continuing to depreciate the kwacha as agreed with the IMF, the Malawi government planned to revalue and appreciate the kwacha to MK140/MK142 when it was officially at current MK152 to the $.[41] This surprised the IMF and who remarked that "this proposal, if true, runs completely counter to the ECF (Extended Credit Facility) programme design."[42] In other words Malawi was deliberately and knowingly breaking the terms of the agreement of the ECF with the IMF. By the end of December 2011, the official exchange rate of the local currency to the $ was MK167[43] to $1 in the banks and up to MK230 or MK 250 on the parallel market.

10.0 Malawi Backs out of the ECF Conditionalities

10.1 Devaluing the currency would harm the poor

The major reason given by the Malawi government for not devaluing the kwacha is that poor people would be harmed it would also escalate the costs of imports like fuel, fertilizers and related inputs and would lead to inflationary tendencies. Malawi uses a managed exchange rate regime to make sure the kwacha to dollar exchange rate is controlled.

The RBM also plays a crucial role to control and manage forex in the country, which has not pleased the IMF; In Government letter of intent on the ECF, one condition was that the RBM would not meddle in forex issues but would let the commercial banks do that. However, President Mutharika has repeatedly admonished economists and the RBM not to listen to the IMF's advice to devalue the kwacha and liberalise the currency. He points out that the RBM and the country's economists must work to protect the people and not the IMF:

[41] Mabvuto Banda, Govt may peg kwacha at K140 to dollar, Weekend Nation, Saturday May 28 2011 page 1
[42] Ibid page 3
[43] Taonga Sabola & Dumbani Mzale, Kwacha falls at 10% against dollar, The Nation Tuesday 9 August 2011 page 1

> 'Those insisting that we should devalue the kwacha are not wishing you people in the village well. I want those who are looking into issues of forex to have a principle to defend this country. Don't protect the IMF but protect the people. If it's difficult for you to do so, just tell me that you won't manage to help the people and resign. I will be happy to receive your resignation.'[44]

If indeed the current cost of living was bearable for average Malawians and that government wanted to maintain the status quo, then government's reasoning makes sense; but unfortunately this is not the case at present as prices of commodities are skyrocketing. The cost of living for the ordinary person, as confirmed by the Centre for Social Concern (CfSC), even with the current repressed and controlled forex regime and also with an overvalued local currency, has increased tremendously as official inflation rates have risen to 8.1% in the urban areas and 7.7%[45] in the rural areas; many believe the true rates are in double digits based on the actual cost of commodities. By December 2011 many basic commodities including maize, the staple food and major determinant for calculating inflation in the country, had increased as the Table below shows:

Table 1: Price Rise of some basic food items between Jan and December 2011

Item	Price in January 2011(MK)	Price in December 2011
Maize 50 Kg Bag	1,600.00	3,000.00
Bread (loaf)	120.00	200.00
Beans	240.00/Kg	300.00/Kg
Usipa (dried fish)	1,100.00/Kg	1,800.00/Kg
Kitchen Salt	70.00/Kg	106.00/Kg
Sugar	165.00/Kg	200.00/Kg

Source: Adopted from Daily Times, December 31 2011 page: Exchange rate $1=MK167

Already government has revised the inflation upwards to 9%, GDP growth downwards from 6.9% to 6% and also a decline in grants from 26% to 17% of total revenue in the 2011/2012 financial year indicating an anticipated reduction in donor inflows. Public expenditure is set to increase from 3.3% GDP in 2011/2012 to 11.1% in 2012/2013 owing to more domestic borrowing to meet recurrent costs. This is all because of donor aid cuts, fuel shortages and low productivity of the private sector[46].

Much as it is true also to point out that no country has devalued its way to prosperity without complementary policy measures (policy mix) to be competitive, it is equally true to argue that no country can prosper and become competitive by having a repressed forex regime like Malawi has currently. This managed exchange rate has proved costly not only to importers and exporters in Malawi but also smallholder farmers in the tobacco sector. The problem is illustrated by the losses incurred by smallholder tobacco farmers in the past tobacco season. The farmers sold their tobacco in dollars equivalent to the Kwacha. Since they were paid through banks at a rate of MK152 to a dollar for most of the 2010/2011 tobacco season it

[44] Madalitso Musa, Bingu adamant on devaluation, The Daily Times, Friday December 30, 2011, page 3

[45] Monthly Economic Report November 2011: NICO Asset Management: www.nicoassetmanagement.com
[46] Ibid

means that they lost out in exchange transactions and now they would wake up to buy the same dollar at more than MK167 or more in the next growing season in the form of imports such as fertilizers and this would surely demotivate most of them to plant more tobacco. This means that the repressed exchange rate has not been advantageous to the farmers as in the process of the transfer of the dollar to kwacha the farmers went home with less money than if they had been paid using the correct forex regime.

Therefore the basis for the Malawi government's decisions not to stick to the ECF agreements on devaluing the kwacha and liberalizing the forex regime is more political than based on sound economic reasoning. Government's rigidity on the foreign exchange defeats traditional economics of supply and demand. But worse still the money that governments wants to protect to meet needs of the citizens is not trickling down to the poor person, especially now as most of it ends at the level of holding the government machinery together or paying recurrent costs and in the process essential services such as procurement and transporting medicines to people in the rural areas is affected as there is no fuel to run vehicle services.

In fact some critics have indicated that the more government delays devaluation of the kwacha, the steeper its inevitable devaluation will be, exonerating the IMF's advice in which it has insisted that devaluation is the only way to go to resolve the country's persistent forex shortages[47].

Unfortunately now, Malawi is caught in dilemma and there is no easy way out. The government has procrastinated for too long to bite the bullet and begin to address its economy. Over the decades, the kwacha has not been allowed to float gradually to the dollar to respond to changing economic trends in the country. In other words, government control over the kwacha has not been backed up by other policies that should have helped to improve production and exporting so that the overvalued kwacha could have benefited the country's economy. Now it is like an unstoppable train and the only viable approach is to allow the kwacha to devalue to some level, without harming the poor, but enough to rejuvenate the private sector and also to woo forex back into formal banking channels where it could be accessible. However when this devaluation does take place, prices will sky-rocket again as the value of the kwacha drops in forex terms. To protect the poor, safety net programmes will be necessary. The Malawi government needs to get prepared to mitigate such impacts.

Looking at the two sides of the problem, a middle path would seem more reasonable. This path would require an objective analysis of the pros and cons of devaluing or not devaluing the kwacha; unfortunately the Malawi government has not done such a study, while one conducted by the IMF has not been accepted by the Malawi government[48]. The government therefore needs to come up with a plausible and well researched cost benefit analysis on devaluation as well as not liberalizing the forex regime, and base its policy decisions on the findings and recommendations of the research.

[47] Simeon Maganga, Chilumpha warns of kwacha plunge...should govt delay devaluation..The Daily Times, December 27, 2011 page 1

[48] Reason given for not accepting the report is because the Malawi government reports that it was not consulted in the research let alone the development of the terms of reference as well as identification of the consultant to conduct the survey. It was all done by the IMF.

10.2 IMF: Liberalizing forex regime and floating the Kwacha is not negotiable

On the other hand, the IMF holds the view that the only way for Malawi to get out its perpetual economic crises is to liberalize the forex regime as agreed, which will result in a devaluation of the kwacha. This would in turn ease the pressure to access forex by the private sector and in the process production for export would be re-energized as opposed to now when this is hampered mostly due to lack of forex to procure raw materials and other inputs. Currently, banks cannot sell forex; there are long queues for forex from the private sector in the banks and small scale entrepreneurs are the worst hit by the problem. Most donors including the IMF strongly believe that there is a lot of forex in the country but it is in unofficial channels[49] and the only way to bring it into official ones is by devaluing the kwacha to the level it is selling against the dollar on the black market. The IMF and the development partners are of the view that if government could manage to make forex available in official channels of circulation, it would induce the private sector to start production and exporting thereby strengthening the economy because they would have access to the forex they need for imports.

As usual to the IMF, this is a panacea and the best medicine to turn around Malawi and put the country back on sound economic growth and development. Currently, negotiations between the IMF technical team and the Malawi government are underway to bring Malawi on track with the ECF and the major bone of contention is the forex regime flexibility which Malawi is so reluctant to adopt despite committing itself in the ECF Programme agreement.

Much as there might be some merit in the advice of the IMF to Malawi, there is need to do thorough poverty and social impact analysis prior to imposing this on the Malawi government. Just as it is true that the managed exchange control regime in the country has failed to address the forex problem, devaluation of the kwacha without subsequent support mechanisms such as increased production for export has the potential to fan inflationary tendencies in the country and indeed be harmful to poor people as prices of basic commodities would increase.

Too often, IMF programmes lack a qualitative impact assessment of the policies recommended. There is need to take into account also micro-economic issues that are so critical in deciding on the right course of economic direction. The IMF's expertise could surely be useful to the government, but the Fund needs to improve its modus operandi by being more inclusive and sensitive to country needs. The IMF needs to be aware that Malawi's economic problems would be resolved by sound macro-economic policies (whether or not they are the ones the IMF prescribes) only if parallel measures are taken to resolve the other pressing problems, from governance to civil liberties, that have a bearing on the country's well-being.

Therefore whatever arguments for or against liberalizing the forex exchange controls and floating the kwacha might be, it is the local Malawian who is bearing the brunt of the policy failure from both the IMF for imposing policies that are not feasible for a fragile economy

[49] Henry Mchazame, Kwachas'winners and loser, Business Analysis, The Daily Times, Wednesday June 15 2011 page 2

like Malawi, and the Malawi government for its unsound economic and non-economic decisions to manage the country. The hardships are being felt much more in the urban and peri-urban areas where survival is much more dependent on having fluid cash as opposed to the rural areas where the people depend on homegrown food such as maize which is still in abundance.

> *Because of the Agricultural Subsidy in 2009/2010, FEWSNET reported that Malawi's cereal availability remained stable with adequate national stocks of about 217,000 metric tonnes in the ADMARC and strategic grain reserves at the end of December 2010. Then, maize was being sold at an average of MK33/KG thereby stabilizing maize prices and competition amongst private maize traders. And so failure to provide fertilizer subsidy in the 2011/2012 would likely jeopardize the country's positive food security status.*

While the possible liberalization of the forex regime might mean more forex available as donors start bringing in some, and people start going to banks again to spend their dollars, it will take some time to sort out the shortages, reopen businesses, import intermediate goods for production and get people back to work. As a way forward Malawi needs a good policy mix to bail the country out of its economic crises which should comprise robust domestic revenue collection, trade facilitation to promote value addition and not just trade in raw agricultural materials like tobacco. Important also is the need tocreating good relationships with the country's development partners, because Malawi needs the development partners in the short and medium terms as it develops an exit strategy from donor dependency.

11.0 Impact of the Malawi Government decision to back out on the ECF Agreement

11.1 Reduced budget to the Farm Input Subsidy Programme (FISP)

One of the biggest problems that Malawi has had over the years has been food insecurity in terms of availability and affordability, especially of maize[50]. Maize is the staple food for most Malawians and economically, it is the major determinant factor in calculating Malawi's inflation rate[51]. Bumper maize yields push down the inflation index, while poor harvests encourage inflation. Even though the global economic crisis did not affect prices of domestically-grown maize in the country, prices of imported supplementary foodstuffs went up due to the increased cost of transportation but also reduced production from the countries of origin.

[50] K Owusu & F Ng'ambi, Structural Damage: The Causes and Consequences of the 2001-2002 Hunger Crisis in Malawi, World Development Movement, United Kingdom, 2002

[51] Maize alone has 54% share in factors used to determine inflation rate in Malawi by the National Statistic Office

In a bid to improve food security status at the household level mostly, the Malawi government introduced an agricultural subsidy in the form of fertilizers and seeds financed by the national budget with support from Common Approach to Budget Support (CABS) donors under the Fertiliser and Inputs Subsidy Programme (FISP). With the increase of global prices of fertilizers from $750/metric tonne to $1,600/Metric tonne in the 2008/09[52] fiscal year, the Malawi government found itself looking for additional funding to finance its commitment to provide subsidized fertilizers for its citizens. The IMF ESF and ECF assisted greatly to bring back the CABS donors to support the FISP. Since the 2007/2008 growing season, many donors have been supporting the Malawi government to subsidize fertilizers with MK19 billion ($130 million).

Now that Malawi is off-track with the ECF programme, the government will not have adequate forex from its development partners through aid to meet the needs of the FISP, so there is a danger that Malawi would easily slip back to the state of food insecurity. Due to budgetary constraints largely, Government has reduced the number of beneficiaries from 1.6 million in the 2010/2011 growing season to 1.4 million in the 2011/2012 growing season. So far only three major development partners - the aid agencies of the UK, Norway, and Ireland -have shown interest to contribute to the tune of MK7.7 billion out of the MK17.4 billion FISP budget. There are also reliable sources that indicate that should Malawi remain off track with the ECF, the three development partners might create parallel structures to provide the fertilizers and farm inputs directly to the beneficiaries as an emergency measure. Much as this sounds plausible to do, it throws out the Paris Principles on Aid Effectiveness that emphasize that governments should take the lead role in utilization of development aid.

Florence Gusito from Nyenga village is one of the people deemed ineligible to receive fertilizer and seed subsidies this year due to shortages of fertilizers as a result of donor aid cut to the FISP programme and she cannot buy from the markets because she is too poor to afford it. This means she likely won't have enough food next year.

Worse still there are serious concerns that the fertilizer that has already been procured might not reach the intended beneficiaries on time, mostly due to transporters struggling to deliver it to market points owing to diesel shortages[53]. By October 25 2011, only 25% out of the budgeted 140,000 tonnes of the fertilizer consignment had been delivered and it is doubtful if the remaining fertilizer was able to reach farmers in time for the growing season by the end of the year.

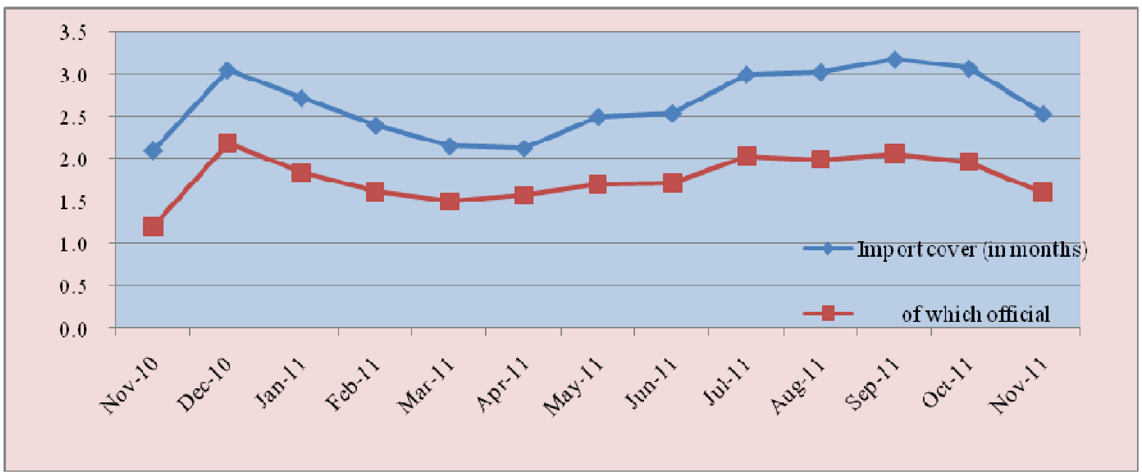
[52] 2010/2011 Budget Speech delivered by Hon Ken Kandodo, Minister of Finance, 2010/2011 National Budget, Lilongwe May 28th 2010 p14

[53] Caroline Kandiero & Thom Kanje, Input Subsidy in jeopardy, The Daily Times, Friday October 20, 2011 page5

11.2 Continued Persistent Low Foreign Reserves and low Imports month cover

Malawi continues to face acute forex shortages due to two factors: 1) reduced aid flows as a result of the development partners suspending assistance in response to the negative signal from the IMF; 2) low tobacco revenues in the 2010/2011 growing season despite having sold more tobacco than most previous years, due in part to the inflexible exchange regime which has diverted forex to the black market. There has not been a significant change in forex availability since the 2007/2008 financial year and there seems to be no tangible solution in the wake of standoff between the IMF and the Malawi government on the forex regime. Between November 2010 and November 2011, the highest accessible forex reserve levels Malawi ever attained was an amount sufficient to cover 2.2 months of imports in December 2010 and the lowest level was 1.0 month of import cover in March 2011 when Malawi went off track on the ECF programme as Figure 4 below shows (indicated in the lower graph). This means that officially Malawi has not had adequate forex with which to meet its import needs including fuel and other essential commodities such as medicines.

Figure 6: Gross official and accessible reserves November 2010-2011



Source: Reserve Bank of Malawi

What is worrisome about the foreign reserve problem is the fact there are a lot of conflicting messages to the public on the truth of how the country is performing. The *Nyasa Times* sees this as "a direct admission that fiscal systems in the country don't have adequate forex amounts despite data from the central bank showing recommended months of import cover". This comes in after the RBM governor indicated that Malawi has $429 million, equivalent to 3.29 months import cover, while at the same time claiming that Malawi needs $200 million to save it from total collapse[54]. Being a net importer of finished consumer goods such as medicines and related medical needs, agricultural inputs, machinery, vehicles and even educational materials and farm inputs, the low foreign reserves mean that Malawi cannot

[54] Gawo Sande Reserve Bank churns out conflicting stands, Nyasa Times, November 11, 2011

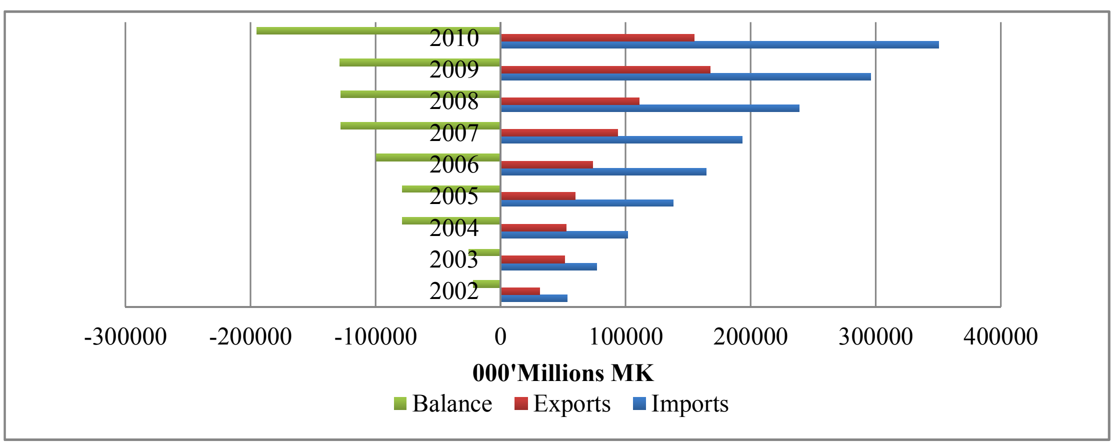
source its essential and required commodities, thereby endangering service delivery in the country. This is most likely the reason why Malawi opted to go for the IMF support tools to help rebuild its foreign reserve stocks in the short to medium term and also help unlock donor support following the aid freeze in the 2007/2008 financial year.

In the lean period of forex in the country, the Reserve Bank of Malawi (RBM) introduced a rationing policy on purchase of forex. Any purchases of forex for holiday and personal use were limited to $5,000 and only up to $50,000 for business purposes, with strict adherence to detailed documentation presented to the Reserve Bank of Malawi. This stifled doing business in Malawi and also led to withholding of goods including fuel by international suppliers, resulting in chronic shortages of fuel in the country.

The situation of low foreign reserves is a persistent problem for Malawi; it is directly linked to exports and imports. Mainly exporting raw agricultural products and failing to diversify its production base, while its volumes of imports are on the increase due to increased consumption demand of imported goods, Malawi is likely to have a persistent negative current account balance unless a deliberate policy to boost industrialization of other sectors such as mining supplements trade in agriculture products.

Figure 7 below, showing trade balances from 2002 to 2010, helps to illustrate the problem of Malawi's low reserves and it shows that while export volumes have been increasing since 2002, the import volumes have increased much more than the exports, thereby creating the negative trade balance which in turn contributes to the low foreign reserves.

Figure 7: Import, exports and trade deficit 2002-2009:



Source: Comtrade.com & www.nicoassetmanagement.com

11.3 Service Delivery on the decline

The social sectors are the ones that have felt the most pinch of dwindling services, for instance delivery of medicines, teaching and learning materials to schools. This is a direct result of the shortages of both fuel and forex with which to procure the essential drugs. When the CABS donors were providing budget direct support to the Malawi government there were still shortages of drugs and other essential services but it has worsened in the last two years in the country due to a combination of pulling out of support and failure to have adequate reserves to meet the country's import needs. The story provided in **Case Study 1** below illustrates how the combination of lack of forex, fuel shortages and reduced budget support has led to a collapse of medical services resulting in people failing to access essential drugs or critical patients failing to go to referral hospitals because there is no fuel for ambulances.

Figure 8: Services of under five and pregnant women are a priority over all other medical services now

Only essential services such as under fives and pregnant women (as reflected in Figure 8) are given priority now; all other patients have, for instance, are likey to walk or hire private vehicles if they want to access referral medical care.

That many Malawians are unable to access medical services at this point in time because of the IMF –Government standoff, is an infringement of human rights as stipulated in the Malawi Constitution which guarantees the right to good health and states that:

> '…The State shall take all necessary measures for the realization of the right to development. Such measures shall include, amongst other things, equality of opportunity for all in their access to basic resources, education, health services, food, shelter, employment and infrastructure.'[55]

Case Study 1: Lack of Forex and Fuel Shortages affecting health services delivery

Samuel Kathumba is a clinical officer at one of the clinics fifty kilometres out of the Lilongwe City. He is in charge of seven other centres while he is stationed at the main centre. He is also in charge of an ambulance that services all the six centres. On average, the clinic receives close to 200 outpatients per day and it also has facilities for admissions for maternity as well as other patients. It is also a centre for ARV administration and, according to Samuel, there are over 1,200 registered HIV patients. Samuel has been a medical staffer for close to a decade and he indicated that he has enjoyed it until the last two years when he is becoming despondent by the dwindling medical services resulting from lack of essential medicines. Samuel reported that a few times he has had to inform his patients, after making diagnosis and prescribing the required treatment that the clinic did not have the prescribed medicines and so the patients had to go and procure the medicines from pharmacies or shopping centres or go to another clinics or any other referral hospital.

11.4 Dwindling of household Incomes

Another vulnerable sector to the forex shortage problem is the people engaged in small and medium entrepreneurs, like Tobias Chilimampunga, whose story is given in **Case Study 2.**

Case Study 2: An experience of impact of Forex Shortages in Malawi

Figure 9: Tobias Chilimampunga in his holding shed for fish

Tobias Chilimampunga comes from TA Milili, Lilongwe. In 2001, he lost his job as administrative clerk in the Ministry of Agriculture and Food Security following a civil service restructuring programme designed by IMF. For two years, Tobias could not find a formal job and he resorted to street vending to raise some money to meet family needs especially to pay for school fees for his three sons. He was lucky then that he had some capital from the redundancy package paid to him after being laid off from the civil service. However, the money did not take him far as he had invested some into constructing a small house in Likuni, one of the townships in Lilongwe City.

In 2006, influenced by a colleague who was a cross border trader plying his trade between Malawi and Tanzania, Tobias decided also to venture into cross border trade to make more profits. Tobias started buying electronic products from Tanzania and selling them in Malawi. At times he would also venture into hardware materials. From the business, Tobias was able to take home money at least MK 80,000 as profit from a good trip. His capital was about MK300, 000 (about $ 2,000).

Having opened an account with the New Building Society in 2005, Tobias has been able to access forex from the bank for his business until in 2009 when he started experiencing problems to access forex easily. He was informed that a $5,000 limit had been put on procuring of forex per trip. According to Tobias, things started getting worse in the latter half of 2010 when it became extremely difficult to access forex from his bank. He lamented in the vernacular and said, "zimatheka kuti mwina ndagula kale ticket ya bus, koma ku bank forex kulibe. Ndimatha kusintha ticket yija katatu podikilira ma dola koma sizimatheka ndiye timangopita pa Hyper Store kugula mpa mtengo wodula kwambiri mwini $1 kulipira MK240 mmalo mwa MK167 ku Bank. Komanso tikasintha ndalama zimenezi akumatilanda pa maborder chifukwa choti timakhala tilibe mapepala ake"(At times, while having already procured a bus ticket, I find myself changing my travel plans several times because the bank cannot sell me the dollars on time. As a result I resort to buying the forex at the parralle market at the Hyperstore in Lilongwe at MK240 to $1 as opposed to MK167 at the Bank. And oftentimes forex procured at the Black Market is confiscated at the borders by Immigration officers as we are required to procure the forex from the banks.")

Tobias soon realized that his business was not doing well, mostly because he was having difficulties accessing forex and this meant reduced trips to Tanzania; buying forex on the black market made his goods expensive and he started realizing fewer profits. Fewer profits meant less money in his house and therefore not being able to meet his family's needs. As a result, Tobias changed his trade from a cross border trader to a fish vendor commuting between Salima and Lilongwe.

Tobias' experience with shortage and inaccessibility of forex is very common amongst those engaged in informal economy especially the cross border traders and the small and medium entrepreneurs (SME). Most of the SMEs procure their raw materials from cross border traders who get the products from neighboring countries to import into Malawi, and lack of forex makes it difficult for the SME to produce goods for the market. Reduced profits means reduced household incomes and this contributes to poverty levels in the country.

The problem of forex shortage for many poor Malawians is not just a financial issue or problem; for them it is a human rights problem as their economic rights are being violated by the government in that it is failing to come up with a long lasting solution to solve the problem. It is disturbing people's socio-economic welfare and their livelihoods. Even after getting the IMF credit facilities (abeit partial), the ESF and ECF, there is still acute shortage of forex in Malawi.

As illustrated in the story above, the small-scale entrepreneurs find it difficult to access forex from official banks to procure trade goods as well as raw materials for production thereby affecting household economies. Firstly, the amount of forex they can apply for is up to $5,000 maximum at one time, but for them to access it they have to wait for a long time. Unfortunately, business for this sector depends on frequency and speedy supply of the commodities and the longer they wait at the banks, the less they sell and the less money they make for their families. But if they chose to procure the forex on the parallel market, it is often expensive and their goods cannot be competitive. As a conclusion to the forex problem and external reserves build up, Malawi's low international reserves as well as lack of forex at the domestic level indicates an underlying chronic and intensified imbalance in the foreign exchange market which Malawi must resolve if it is to continue realizing the economic growth it has been registering recently, otherwise the country risks a down trend in economic growth.

11.5 Failure to address the Fuel Crisis

Due to the unavailability of forex, Malawi has had a fuel supply problem since 2009 which began as a minor problem but to date has become the worst fuel shortage crisis experienced since Malawi attained its independence from Britain in 1964[58] and as things unfold, the problem is there for a long time unless a long term solution is developed. The ESF and also the ECF were partly aimed at addressing fuel shortage but stalling of the ECF means no immediate solution is in sight.

The fuel crisis in Malawi is caused first and foremost because the country does not have the forex to procure the commodity; secondly because Malawi does not have reservoirs to store fuel supply to be used in times of scarcity; instead fuel is consumed as it comes into the country and any interruptions leads to its scarcity. And thirdly, the energy sector is dominated by a few registered players as the sector is controlled by MERA and the PCC which bars private players who may have the required resources to be able to supply fuel consistently in the country and help to resolve the crisis. Probably it is time that the Malawi government flexed rules and laws in the sector to allow more players to participate in the fuel procurement. Renewed availability of fuel in the country could go a long way to resolve some of the problems the country is facing.

Figure 10: Long fuel queue at Area 18 Filling Station in Lilongwe

[58] Simeon Maganga, Chilumpha warns of kwacha plunge, The Daily Times, Tuesday 27, December 2011, page 1

With conflicts in the Middle East, the cost of procuring fuel has increased and any external shock of supply of fuel would raise the price of fuel; Malawi has no control over such circumstances. Therefore there is the need to liberalize the sector to benefit the consumer. Currently the annual bill of fuel for Malawi has jumped from $180 million to $366 million and as reports indicate that close to 3,000 second-hand vehicles are brought into Malawi on monthly basis, the consumption of fuel will keep going up thereby further increasing fuel needs in the country. The scarcity of fuel in the country has led to the creation of a black market for fuel which has turned out to be a racket between workers at filling stations and illicit traders who charge exorbitant prices ranging from MK 500 ($3) per litre of petrol instead of the normal MK 300 ($1.50) per litre and in the process these people are profiteering from fellow Malawians' suffering. Malawi's fuel remains the most expensive in Southern Africa irrespective of its scarcity, and for people to get it from the black market makes the fuel even more expensive. Details in Table 2 below illustrate this fact. What makes the fuel that expensive besides global market fuel increases is government levies that comprise close to 50 % of the total fuel cost and yet the beneficial impact of the levies, one of which is to stabilize fuel prices, are not seen. The levies include Energy Regulatory Levy, Road Levy, Malawi Bureau of Standards levy, Safety Net Levy, Rural Electrification Levy and Price stabilization levy.

Table 2: Comparative costs of fuel at the pump in Malawi to some Southern African Countries

	Country	Approximate cost at the Pump($)
1	Malawi	2.30
2	Mozambique	1.70
3	Zambia	1.66
4	Tanzania	1.65
5	Zimbabwe	1.32
6	South Africa	1.01

11.6 Failure to signal to CABS donors to support the national budget

Although the IMF had provided the credit facilities and signaled to CABS donors to support Malawi's budget, the reality on the ground indicates that donors, particularly DFID and EU, have not been responsive enough and have used the failure of the ECF programme with Malawi as the major reason to withhold financial aid to Malawi. Unfortunately, the donors who are less reliant on the IMF like the Norwegian Government have been slow in coming forth to provide budget support to the government. This in turn has harmed the lives of poor people in that government has failed to meet its obligation in service provision. A positive signal to the CABS donors is critical because if Malawi does not have an economic programme with the IMF and also if the IMF does not approve Malawi's proposed budget, the CABS donors will not support Malawi's budget thereby affecting government planning.

The government has responded to this cut in donor aid by borrowing money from domestic banks to meet its budget demands, thus increasing domestic debt precipitously.

The failure of the second review of the ECF in March 2011 has already sent negative signals to the CABS donors that not all is well between the IMF and the Malawi government. And the fact that the IMF has not approved the 2011/2012 budget compounds the problem in that the CABS donors remain unwilling to offer budget support unless Malawi has a running programme with the IMF. For instance, some of the CABS donors such as the EU, DFID, WB, and Germany, have already indicated unwillingness to provide new support to the MK307 billion ($46 billion) 2011/2012 proposed budget[59]. On the government side, Malawi's poor governance record has further pushed most of the CABS donors to withhold their aid to Malawi since one of the pillars in the CABS budget support to Malawi is respect for and promotion of human rights and good governance.

Even though the IMF might think that it is punishing the Malawi government for failing to observe terms of the ECF, the measures of both the IMF and the Malawi government have negative consequences on the lives of the poor people.

11.7 Domestic borrowing and public expenditure on increase.

One of the ECF's conditions requires that the Malawi government reduce domestic borrowing and control public expenditure by sticking to the approved budget expenditures and not to allow any budget overruns. However, the 2009/2010 and the 2010/2011 public expenditures show budget overruns above 25%, like in the Ministry of Agriculture and Food Security. It would be important to find out if the budget outruns and increased public expenditure is a sign of the needs that the government has to meet in service delivery or if it comes from the fact that the government cannot manage public expenditures adequately. Due to the ongoing standoff with the IMF on the ECF and cuts in grants and direct budget support by CABS donors, there are projections that public expenditure in the next few years would increase from 3.3% of GDP in 2011/12 to 11.1% in 2012/13 as a result of government domestic borrowing recurrent costs that were financed by direct budget from CABS donors and also by grants and foreign aid.

CABS donors on hand are concerned with Malawi's public expenditure, citing the procurement of the presidential jet at a cost of $22 million[60] and jet's soaring running costs which are draining Malawi of vital resources needed most for service delivery in the country. This is tantamount to using scarce public resources for luxury items at a time when the economic conditions would logically prohibit such an expenditure. However, Government has pledged that should the budget execution fall short of domestic repayment targets, the government is committed to protecting social spending and make sure that repayments for the jet's $22 million loan remains under 1% of the GDP[61]. In times like these when luxurious expenditures are prioritised against social expenditures, donors and the IMF could be

[59] Thom Kanje, World Bank withholds aid, The Daily Times, Tuesday, May 31 2011 page 1
[60] Mabvuto Banda, UK says Bingu's Jet cost K3.4bn, K1.4bn more than what govt revealed officials tight-lipped on running costs, Weekend Nation, Saturday May 28 2011 page 1
[61] IMF, Staff Report for the 2009 Article IV Consultation and Request for a Three Year Arrangement under the Extended Credit Facility, February 4 2010

exonerated for attacking the Malawi government over its failure to control public expenditure and often supplementing it with domestic borrowing when funds are not available to meet such costs.

On the other hand, the IMF and the CABS donors should reconsider their position that some government borrowing, for instance where the government has to meet services related to meeting the MGDS targets in education, health and agriculture, is in contravention of the macro-economic policies available to government. This would unnecessarily be restricting government from providing for its people. Malawi needs to invest and expand in education, health and agriculture to meet the needs of the 60% of the population that is impoverished. When resources are not coming forth from donors, the Malawi government should be allowed to borrow for such services. And therefore, the IMF and the CABS donors need to allow government policy space to decide what is best for its people without abusing the space for inclusion of extravagant expenditure of course.

12.0 Have the IMF Credit Facilities achieved their objectives?

Even though the IMF and the Malawi Government entered into the ESF and ECF agreements to address Malawi's economic problems, the loans to Malawi have created more problems for the country than the good it was purported to bring forth. While the credit facilities have not been implemented in full, it may also be argued that the credits may have exacerbated the economic challenges that Malawi has had to deal with due to withholding of aid by bilateral donors resulting from lack of an IMF signal, the ECF having derailed from the track . In short the ESF and ECF have not met their objectives.

Looking back to 2008 (when Malawi got the IMF ESF credit) to date, one could report that in the short to medium term perspective, the ESF and the ECF managed to address the foreign reserve problem temporarily but the conditions that triggered the credits and the positive impact anticipated from the credits are far from being realized; instead life for an average Malawian is worsening by the day. The Malawi government was seen trying hard to address its economic problems and sticking to the agreements in the credit facilities, but the cost of observing the terms of the credits prevented positive change to people's lives on the ground as they still experienced fuel shortages, rise in commodity prices and scarcity of medicines in clinics.

12.1 New Taxes to beef up lost revenues

In a bid to make up for the lost revenue in frozen grants and aid cuts and frustrated by donor politics in the 2011/2012 fiscal year, the Malawi government through the MRA has introduced austerity measures such as new taxes and VAT charges. The new tax measures are seen as "milking a thin cow", in other words taxing people that are already paying huge taxes. On a more subtle note, some of the new tax measures introduced (which were later reversed due to pressure from civil society) targeting poor people's survival areas such as salt and meat products (especially offals) were in fact detrimental and impact negatively on the lives of poor people who already do not consume enough calories for a health and active life. That the taxes also target education and educational institutions[62] will further hinder access to education in the country as this would make education materials more expensive besides going against the very objectives of the MGDS and the MDGs, one of which is to promote access to education for all. At the centre of the new tax regime is the fact the IMF as early as 2009 advised the Malawi government to raise utility fees on water and electricity as a way to widen revenue collection.

Besides the tax payments, Malawians also have to bear other non-tax measures for instance on fuel, road licenses, and road penalties - all in a bid to raise revenue. For instance, the Malawi Police which was once a dormant player in revenue collection, is apparently being given targets on how much to collect from road fines. For instance there are revelations that the police were given orders to collect up to MK250 million[63] (about $1.3 million) within eight months from road fines but most of the fees charged by the police are not gazetted. This also is creating room for corruption from both the police and the road users as some of the road fine collections do not find their way into the national coffers.

12.2 Loan to be serviced with the IMF

The ESF ($77.1million, only $52m was disbursed before its termination) and ECF ($79.4 million) are concessional loans from the IMF and not grants; as such every Malawian would bear the cost of servicing the credits in the next decade. Unfortunately, there have not been long term benefits from the loan that would make Malawians happy to service this debt for in the next few years. The credit facilities have added to Malawi's public debt stock, which currently takes up 6.4%[64] of total public expenditure. It would be interesting in the long run to assess the benefits of these credits against the cost of repayment; however looking at the impacts of the credits this far, the benefits might not outweigh the cost of servicing the debts.

And so the question that the credits beg is whether Malawi really needed them and if at all there were other alternatives that the Malawi government could have used to address the country's economic problems. Should Malawi not have been more concerned with pleasing her bilateral donors under the CABS who provide much more resources to the budget than the $79.4 m in the IMF ECF to Malawi? As discussed earlier on the alternative to these credits for Malawi is to look at her domestic economic policies on public expenditure reduction, foreign exchange regime, tax regime and revenue collection systems, and diversification of the economic base including mining and value addition to agricultural products to improve competitiveness at the global market.

13.0 Participation of Non State Actors (NSA) in the ESF/ECF Loan Contraction

[62] Malawi Revenue Authority, New measures for customs and excise (tariffs) order for 2011/2012 Financial Year, section D 1 (c)
[63] Simeon Maganga, Traffic Fines not Gazetted, The Daily Times, Thursday June 2 2011
[64] Malawi Economic Justice Network, Bearing Our Fiscal Burden, A deeper look into the 2011/2012 Malawi Budget, June 2011 page 33

What is conspicuously missing in the arrangements of the IMF Crises Solutions with the Malawi government is the involvement of non state actors - civil society organizations, private sector, and faith based organizations - neither is the parliamentary committee on budget and finance of Malawi's National Assembly effectively involved or consulted for approval. These credits were not discussed with the wider Malawian citizenry. Loan contraction requires the involvement of more stakeholders other than just the government and the creditor institution. The history of the Third World Debt Crisis, out of many reasons, highlighted that one major reason for the crisis was the fact that the then creditors and national governments gave too much powers to the ministers of finance to contract loans without the national assemblies and civil society to discuss the necessity of such loans and what long term benefits would be accrued from the loans. Of late, Malawi has seen its National Assembly passing financial bills without much ado meaning that the national assembly did not bother to discuss the pros and cons of the loans and how the Malawi government would service such loans.

Civil society has a comparative advantage of conducting evidence based research on impact of economic policies since they are in touch with local people. The Budget and Finance committee are charged with external oversight mechanisms which they can use to question economic policies of government including loan contraction. In ECF/ESF both are conspicuously missing in the contraction processes

This was also the case with the IMF crises solutions to Malawi; most of the people learnt of these arrangements from the media. The IMF often, if not always, negotiates the loans only with the Ministry of Finance; unfortunately the Ministry of Finance does not even send the loan contraction proposal to the national assembly or the Committee on Finance and Budget to discuss and provide other views. The only time that the IMF has met and discussed the ESF and ECF with non state actors was in February 2011 at the introduction of the new IMF Resident Representative. The Malawi government has never even discussed the loans with members of civil society either and with the strained relationship between CSOs and government, it is unlikely that such meetings will take place in the foreseeable future.

It is critical that members of CSOs and the private sector such as the Economic Association of Malawi (ECAMA) are involved in the loan contraction process so that they can provide alternative views to loan contraction. The NSA also can help set accountability mechanisms for the Malawi government and also help the Malawi government to deal with certain donor tendencies which on its own the government could not manage. NSA have been known for their ability to generate evidence through research on the impact of donor conditionalities as well as the impacts of failure by the government to provide services. At the onset of the ESF and ECF, the NSA should have started to monitor the impacts of the credit facilities. Now that the ECF is off track and has become the major source of Malawi's economic crises, the NSA should have been coming forth with alternatives on how best the matter should be resolved and also to provide information on how the credits have been used to date, and where necessary to blow the whistle and demand explanations from both government and the IMF on the long term impact of these loans on Malawi's economy more especially on meeting service delivery to poor marginalized people who are suffering due to the endless wrangle now between the government and the IMF.

The National Assembly on the other hand is charged with oversight mechanism and with its powers provided in the Parliamentary Standing Orders can summon government to provide explanation on what the national assembly deems a problem in terms of implementation of economic issues[65]. Unfortunately due to lack of capacity as well as resources, the national Assembly fails to play this role. In this vein, the Malawi National Assembly should take deliberate measures to help build the capacity of the committee so that it is facilitated to play a vital role to economic issues in the country.

15.0 Has anything changed between the PRGF, the ESF and ECF?

As indicated earlier on in the document, the major objective of the IMF's ESF/RCF credit is to enable LICs adjust to impacts of external shocks and help to address or correct the external shocks in the shortest time possible. Created in 1995 and approved on 23 November 2005 by the IMF Executive Board under the PRGF Trust, the tool was only put to use in 2008 to support LICs as they struggled to adjust to the impacts of the global financial crisis. Malawi was the first beneficiary country. Together with the ECF and the Standby Credit Facility (SCF), the ESF became part of the Poverty Reduction Growth Trust tools aimed at providing rapid support to LICs facing external shocks and in need of rapid financial credits to address their problems.

The ESF assumed all terms of the PRGF facility such as low interest rates of 0.25% per annum, short repayment period of up to 10 years and semi-annual or quarterly repayment intervals. LICs accessing the ESF could be those already under PRGF arrangement or those not under the PRGF but showing interest to be under one and also ready to develop a PRSP that would create a roadmap on how the country would address matters of poverty reduction and pro-poor spending. The LICs were also expected to refrain from domestic borrowing, a factor that according to the IMF retards build up of foreign reserves resulting from high interest repayment rates compared to foreign debt servicing whose interest rates are often concessional but accessing such loans is not easy due to stringent qualification measures.

As such therefore, terms and conditionalities of the ESF are not very different from those of the PRGF; probably the only difference being that the PRGF is applied to countries that are already under the IMF programmes while the ESF could be applied to any LIC, under PRGF or not in as long as the LIC is facing external shocks that are affecting the economy and is need financial support from IMF to address the problems. The IMF claims that the conditionalities attached to the ESF/RCF are flexible and streamlined so that access to the credit is faster, responsive to country needs and provides more resources than in the PRGF.

The IMF also makes a key structural conditionality the public sector resource management and accountability as a way to achieve economic stability in LICs since it helps to instill fiscal discipline, public control and public expenditure. At the same time the IMF plays the

[65] Standing Orders, Section 154, sub 1 (a) and (b), Page 56

gate keeper role to trigger donor support to national budgets under both the ECF (formerly PRGF) and the RCF (formerly ESF).

Much as the IMF claims that the conditionalities have improved under the PRGF/ECF arrangements and with the ESF/RCF in that they are now more accessible, comprehensive and streamlined; and geared specifically to immediate problems, not much has changed in reality. According to a study by Eurodad[66] conducted in 10 low income countries, the IMF is pushing for contractionary growth while most of the rich countries are opting for Keynesian approaches with expansionary policies to combat the impacts of the financial crisis. The report further indicates that the IMF is advising LICs to freeze wage bills, cut wages, reduce budget deficits to less than 5% of GDP, reduce social spending, and pass on fuel and food prices increases to the citizens as taxes, and stay current with debt servicing schedules especially on domestic debts[67]. This is what Malawi was called upon to observe in ESF and ECF even though Malawi has to date not put into practice all conditionalities one of which has been to flex its foreign exchange regime.

Eurodad's position which is supported by the Bank Information Center (BIC) in their letter of August 29 2008 to the IMF Board, *"The IMF responses to exogenous shocks caused by the food and fuel prices crises"* both Eurodad and the BIC have criticized the IMF for perpetuating conditionalities in the ESF and connecting the conditionalities to the ESF when the ESF and PRGF are meant to cushion countries hit by external unexpected shocks. This is also the case in Malawi in which the IMF has linked adherence to the ECF terms as condition for CABS support to the budget and unfortunately the CABS donors have bought the idea in its totality so much so that no CABS donor can think out of the IMF box. The letter reads

> '…The ESF's high access component should not be attached to any policy conditionality in its recent modifications other than the normal fiduciary standards, and should focus on providing rapid, short term and concessional cash transfers to address the immediate macroeconomic impacts of external shocks[68].'

Even if the IMF claims to be flexible with conditionalities in ESF and the ECF; the fact that many LICs like Malawi have undergone a long history of IMF programmes including the harsh ones under the SAPs, means the claims do not hold water in that these countries have already been systematically aligned to IMF policies including the so called home grown poverty reduction strategies, like the MGDS in Malawi, the LICS have already embraced and internalized the Bretton Woods Institutions' conditionalities and the macro-economic policies. This has made advising government very difficult because what they have come to claim as home grown is in fact a regurgitation of the IMF conditionalities internalized over

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[66] Nuria, Molina Gallant, Bail-out or Blow-out: IMF Policy advice and conditions for low income countries at a time of crisis, Eurodad 2009. Conducted in Armenia, the DRC, Cote d Ivoire, Ethiopia, Republic of Kyrgyz, Malawi, Mongolia, Sao Tome, Senegal and Tajikistan,

[67] Ibid page 6

[68] Bank Information Center, *The IMF's response to exogenous shocks caused by the food and fuel price crises*, August 29 2008 (signed by ActionAid International; Oxfam International; Africa Network on Debt and Development; bank Information center USA; European network on Debt and development; New Rules for Global Finance Coalition USA; and Bretton Woods Project UK)

time. As such the ESF and the ECF are operating in an environment that is already conditioned and governed by the IMF/WB conditionalities. There is nothing “home grown” in either MGDS I or II since they are a product of experiences under the PRSP crystallized as home grown[69]. Malawi, just like any other LIC falling under the PRGF and related IMF programmes, has sharply limited fiscal and policy space to decide how to pace, craft and implement its development strategy outside the IMF programme. It is the rope that poor countries have tied around themselves for accepting to be under the IMF programmes and for having the IMF as the approving agent for national budgets and the key to unlocking donor support.

16.0 Conclusion

The ESF and ECF have to some extent brought some positive results to Malawi in the short term basis as they have helped to build foreign reserves and also helped to meet rising costs of fuel and fertilizers. But they have also brought some negative consequences that Malawi will have to live with for instance the cost of servicing the loans themselves. As medium to long term solutions, both the ESF and ECF are far from addressing problems that led to Malawi seeking IMF support. In the short term they may have buoyed Malawi’s economy, but every Malawian is aware that the country is facing acute shortage of fuel and forex problems. The Malawi government, even having received full ECF funds in the first year and support from the CABS group, is not able to give Malawians plausible reasons as to why fuel was in short supply and forex not available in 2010. This entails that the ESF and ECF are not a panacea to solve Malawi’s economic crises; this is indicative that there is something fundamentally amiss with Malawi’s economy that cannot be sorted out by having IMF programmes as the sole response to the problems.

In the current economic hardships of LICs like Malawi, the IMF and the World Bank should accept that most of the problems that LICS are experiencing today termed as external shocks are in part due to the impact of the IFI’s long term policy blunders that have left many countries reduced to producers of raw commodities dating way back to the 1980s. The IMF should not have rushed to craft solutions before correcting the problems that make the LICS perpetually vulnerable to external shocks because the solutions do not really take into account the root causes of LICs’ problems.

Malawi and other LIC governments too have a share of their own responsibility for implementing unsound political economies within their countries. National governments are at times irresponsibly extravagant and do not want to reduce public expenditure to match the revenue base. Often times it is the politically motivated expenditures that LIC governments fail to cut instead of financing basic needs to improve the lives of the most vulnerable in their countries. A case in point is the procurement of the presidential jet in Malawi at a time when it was not right to make such an expenditure but since Malawi was chairing the African Union, the procurement took on a political character and became a justifiable expense, with

[69] Francis Ng’ambi, Continuity or Change: A critique of the WB/IMF Economic Programmes and their impact on women and children: The Case of Malawi and Mozambique, OSISA, South Africa 2009

the IMF becoming partially complicit by agreeing to ensure that repayment for the loan for the jet does not reduce social spending. Nowhere did the IMF categorically indicate that it disapproved the procurement of the jet like some of the CABS donors did.

The Malawi government is failing to develop robust policies that could begin to shift the country from being a net importer to an exporting country able to compete in the global market, even though this is the goal driving the entire MGDS I and II. There is no long term investment strategy or political will to drive industrialization in the country as most of the policies revolve around the same sectors. The new tax regime, besides adversely impacting on poor people, has not targeted new areas, for instance the mining sector which to date has close to 144 licensed mining companies exploring or actively mining in the country. Many MNC enjoy unlimited tax breaks and tax havens in the name of FDI but in the process revenue is lost.

Malawi also has to endeavor to address its political governance style, including foreign relations with its neighbors, which would in turn help to address some of its economic woes. Most of the CABS donors besides responding to the IMF stress signal, are particularly concerned with internal governance and levels of unnecessary public expenditures and these have led to cuts in donor aid which has resulted in many consequent economic hardships to the poor.

Finally but not least, it will only be when Malawi is able to generate its own revenues, either from taxes or trade that it would be able to finance its national expenditure and have a real fiscal policy to determine the development agenda for the country. Unless this is done, Malawi will forever depend on donor aid, which does not come without conditionalities, or contract loans and credits such as the ESF and ECF which in turn lead to increased debt stocks creating future economic problems.

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18.0 Appendix 1: List of people Interviewed

(*Most of the people refused to be quoted or to have their names appear in the final report and so the list of peoplehas been removed but available from the MEJN Executive Director on justifiable request – such names can only be provided to a third party on approval by the indivual interviewed).*

	Name	Organization/Ministry	Location
1.		Reserve Bank of Malawi	Lilongwe
2.		Reserve Bank of Malawi	Lilongwe
3.		IMF Country Office	Lilongwe
4.		ECAMA	Lilongwe
5.		GIZ Malawi	Lilongwe
6.		Royal Norwegian Embassy	Lilongwe
7.		Delegation of the European Union	Lilongwe
8.		World Bank	Lilongwe
9.		African Development Bank	Lilongwe
10.		US Embassy	Lilongwe
11.		Chancellor College	Zomba
12.		Malawi Economic Justice Network	Lilongwe
13.		Malawi Economic Justice Network	Lilongwe
14.		Norwegian Church Aid	Pretoria
15.		Ministry of Finance	Lilongwe
16.		Ministry of Finance	Lilongwe
17.		Ministry of Finance	Lilongwe
18.		Ministry of Finance	Lilongwe
19.		Central Medical Stores	Lilongwe
20.		Chileka Clinic	Namitete
21.		Alliance One	Lilongwe
22.		Business man	Lilongwe
23.		Business man	Lilongwe