

AFRICAN DEVELOPMENT BANK GROUP

**MALAWI: COMPLETION POINT DOCUMENT UNDER THE
ENHANCED HIPC INITIATIVE**

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LIST OF ACRONYMS AND ABBREVIATIONS

ACB	Anti-Corruption Bureau
ADB	African Development Bank
ADF	African Development Fund
APR	Annual Progress Report
BHA	Better Health for Africa
CPAR	Country Procurement Assessment Review
CPIA	Country Policy and Institutional Assessment
DTED	Department of Teacher Education and Development
EU	European Union
EDF/EIB	European Development Fund/European Investment Bank
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HCC	HIPC Consultative Committee
HIPCs	Heavily Indebted Poor Countries
HIPC-APP	HIPC Assessment and Action Plan
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
HRMIS	Human Resource Management Information System
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association of the World Bank
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IMF-SMP	IMF Staff-Monitored Program
IPTE	Initial Primary Teacher Education
JSAN	Joint Staff Advisory Note
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
M&E	Monitoring and Evaluation
MGDS	Malawi Growth and Development Strategy
MIE	Malawi Institute of Education
MIITEP	Malawi Integrated In-service Teacher Education Program
MPRSP	Malawi Poverty Reduction Strategy Paper
MSME	Micro, Small, and Medium-scale Enterprises
NGO	Non-governmental Organization
NPV	Net Present Value
NSNS	National Safety Net Strategy
ODPP	Office of the Director of Public Procurement
PAA	Public Audit Act
PBA	Performance-Based Allocation
PFMA	Public Finance Management Act
PPE	Pro-Poor Expenditure
PRGF	Poverty Reduction Growth Facility
RMC	Regional Member Country
SMP	Staff Monitored Program
SWAp	Sector-Wide Approach
TICPI	Transparency International Corruption Perception Index
TTCs	Teacher Training Colleges
TWC	Technical Working Committee
UA	Unit of Account

Debt Sustainability and its Sensitivity

The NPV of Malawi's external debt at-end 2005 is estimated at US\$ 1.9 billion. After full delivery of HIPC Initiative assistance committed at decision point, Malawi's external debt is reduced to US\$ 1.3 billion. With voluntary debt relief by bilateral creditors, the external debt is further reduced to US\$ 1.2 billion, equivalent to 229 percent of exports. Because of exogenous factors that fundamentally affected its economic circumstances, the Boards of IDA and the IMF approved a topping up assistance for Malawi to bring its NPV of debt to exports ratio down to 150 at completion point.

After enhanced HIPC (with topping-up), MDRI debt relief, and bilateral debt relief beyond HIPC, Malawi's external debt would be reduced from approximately US\$ 1.2 billion at-end 2005 to US\$ 180.1 million at-end 2006. With the reduction, all of Malawi's debt burden ratios would be below the HIPC thresholds.

The sensitivity of the long-term debt sustainability is examined under four scenarios: (i) borrowing on non-concessional terms; (ii) higher borrowings and lower export revenue; (iii) periodic droughts; and (iv) scaling up aid through loans rather than grants. The results show that Malawi's debt is vulnerable to exogenous shocks. Thus, prudent public expenditure management would be needed to sustain a strong economic growth after completion point.

Delivery Modality and Indicative Financing Arrangement

It is proposed that the Bank Group makes a commitment to provide Malawi with an irrevocable debt relief of US\$ 70.5 million in end 1999 NPV terms plus an additional assistance of US\$ 68.8 million in end-2005 NPV terms from December 2001 to July 2023. Twenty (20) percent of the debt relief would be financed from internal resources, 40 percent from the European Commission pledges and 40 percent from the HIPC Trust Fund.

Recommendations

The Boards of Executive Directors are invited to approve Malawi's qualification for HIPC assistance at completion point under the enhanced HIPC Initiative, and to approve for Malawi the proposed HIPC assistance of US\$ 70.5 million in end 1999 NPV terms and an additional assistance of US\$ 68.8 million in end-2005 NPV terms, from January 2001 to July 2023. It is also recommended that the Boards approve that Malawi qualifies for the MDRI.

MALAWI – COMPLETION POINT DOCUMENT UNDER THE ENHANCED HIPC INITIATIVE

I. INTRODUCTION

1.2. As you will recall, the Boards approved the completion point document for Malawi on 15 November 2006.¹ Following this approval, the Bank Group received some information from IDA in January 2007 that they had a legal question outstanding which could imply that the topping up assistance to Malawi would need to be revised at the margin. Within the context of this revision, based on some additional information from other creditors and an upward revision of the exchange rate between the US\$/NOK, the Bank Group reached an agreement with IDA and the HIPC Trust Fund to make the necessary adjustment for AfDB related debt relief. As a result, the Bank's estimates have been revised accordingly to take into account the NPV of topping up assistance which is now discounted to the date of the completion point instead of to the decision point date.²

1.3. IDA issued a corrigendum and the Bank Group is taking action to follow through. For the AfDB, the changes and adjustments required would imply providing Malawi with an irrevocable debt relief of approximately US\$ 139.31 million in NPV terms (US\$ 70.51 million in end-1999 NPV terms, and US\$ 68.80 in end-2005 terms), equivalent to US\$ 212.83 million in nominal terms as compared to US\$ 238.66 million in nominal terms initially reported, with effect from January 2001 to April 2024. It is therefore the value in nominal terms that changes for about US\$25.83 million. The NPV terms remains unchanged.

1.4. Against the background of these new developments, the Bank Group took action to prepare this corrigendum and make the necessary limited adjustments as recommended. The related few changes can be found in the following sections: (i) Delivery Modality and Indicative Financing Arrangement, and Recommendations, in the Executive Summary of the approved Boards Document; (ii) Section X on Proposed Debt Relief Delivery Modality; and (iii) Section XII on Recommendations, particularly items (ii) and (iii). In line with these changes, Chart 1 and Annexes 2 to 7 have been adjusted accordingly. The new Chart.1 and the revised Annexes can be found in this corrigendum for consideration along with the amendments presented below in greater detail.

II. ASSESSMENT OF MALAWI'S REQUIREMENTS FOR REACHING COMPLETION POINT

2.1 In line with the enhanced HIPC framework arrangements at decision point, Malawi had to fulfill some conditions for reaching completion point. These include:

- (i) Preparation of a full PRSP and its satisfactory implementation for at least one year;
- (ii) Maintenance of a stable macroeconomic environment and satisfactory implementation of a PRGF-supported program; and
- (iii) Implementation of key structural and governance triggers to strengthen public expenditure management, improve the quality of education and health care, fight HIV/AIDS, strengthen land and credit markets, and create an effective safety net system.

This section assesses the progress in the implementation of these requirements.

¹ See Malawi – Completion Point Document Under the Enhanced HIPC Initiative (ADB/BD/WP/2006/107 – ADF/BD/WP/2006/124 of 16 October 2006), and Item 3.1 of the Summary of Decisions ADF/BD/SD/2006/628/Prov.1 of 22 December 2006.

² Reference the letter from IDA dated January 22, 2007 on the subject, which could be made available from the file upon request.

A. Preparation and Implementation of the Poverty Reduction Strategy

2.2 Malawi's first poverty Reduction Strategy Paper (PRSP) was prepared in 2001. It identified the key development challenges facing the country. Its implementation provided the basis for improving poverty outcomes in Malawi. The full PRSP – the Malawi Poverty Reduction Strategy (MPRS) – which was prepared by the government using a participatory process involving a wide range of stakeholders, was adopted in April 2002 with implementation covering 2002/03 – 2004/05. The MPRS was built around four main strategic pillars: (i) sustainable pro-poor growth; (ii) human capital development; (iii) improving the quality of life of the most vulnerable; and (iv) good governance and cross-cutting issues.

2.3 The MPRS committee was established to co-ordinate the monitoring and evaluation of the poverty reduction strategy. The first two Annual Progress Reports (APRs) indicated that progress in the implementation was limited. However, the third APR indicated that implementation had been broadly satisfactory with progress made in the MPRS priority areas of agriculture, education, health, public expenditure management, public sector reforms and corruption prevention. The government had started the preparation of a succession strategy even before the MPRS expired.

B. Maintenance of a Stable Macroeconomic Environment

2.4 The decision point in December 2000 coincided with the approval of a new PRGF arrangement. The performance of the economy under the former arrangement was very poor. There were fiscal slippages mainly due to bail-outs of public enterprises; interest rates increased very sharply as a result of high public borrowing; and there were over-run of wage bills and over-spending on current expenditures.

2.5 A new Government, elected in mid 2004, demonstrated a commitment to restore macroeconomic stability through a reduced domestic borrowing in 2004/05, and a general restoration of fiscal discipline. As a result, economic growth increased from 3 percent in 2002, to 3.9 percent in 2003 and 4.6 percent in 2004. In 2005, it decreased to 1.9 percent. Inflation was reduced from more than 20 percent in early 2002 to less than 10 percent at end 2003, but picked up to 11.2 percent in 2004 and 15.9 percent in 2005. Overall deficit declined from 12.9 percent of GDP in 2003/2004 to 3.5 percent of GDP in 2004/2005¹. Domestic debt was reduced from 24.8 percent of GDP in 2004 to below 20 percent in 2005/2006. The government's efforts were marred by a weak exchange rate forcing the government to peg the exchange rate. The pegging of the exchange rate led to an accumulation of private external payment arrears on delivered imports. The exchange rate was allowed to depreciate in early 2006, resulting in the clearance of the backlog at end July 2006.

2.6 Despite the challenges, Malawi met all the quantitative targets during the 18 months period from mid 2004 to-end 2005. The economy has been stable since mid-2004 under an IMF Staff Monitored Program (IMF-SMP), and under a PRGF-supported program. A new three year

¹ Malawi: IMF Country Report, 06/94/ , February 6, 2006; and Malawi: IMF Country Report, 06/155, January 2006.

PRGF was approved on August 5, 2005. The first review of the program which was completed in February 2006, gave Malawi a satisfactory performance rating through end of September 2005. The government remains committed to the restoration of macroeconomic stability and a reduction in domestic debt to 16 percent of GDP.

C. Implementation of Key Structural and Governance Triggers

2.7 ***Improving economic governance:*** The Malawian authorities have taken measures to improve efficiency in the utilization of public resources. The Finance and Audit Act was separated into two separate legislations, the Public Finance Management Act (PFMA) and the Public Audit Act (PAA) in order to strengthen the legal framework for public finance. To improve transparency in public finance, public expenditures are reported on quarterly basis. An Integrated Financial Management Information System (IFMIS) is currently in place in eight ministries and would be available in all ministries within two years. Authorities have also made progress in the preparation, execution and evaluation of public sector budgets.

2.8 The new Government has adopted a zero tolerance policy on corruption. Specific measures taken include: (i) an amendment of the Corruption Practices Act to widen the definition of corruption and provide protection for a whistleblower; (ii) the passing of a new Public Procurement act to create a new Office of the Director of Public Procurement (ODPP) for strengthening controls and safeguarding public procurement; (iii) the introduction of a new public payment system as part of IFMIS to keep track of government accounts in commercial banks; (iv) the strengthening of the capacity of the National Audit Office; and (v) undertaking a governance and corruption baseline survey through the Anti-Corruption Bureau (ACB). These measures have yielded some results with several investigations into the activities of high profile members of the Government, and arrests and convictions of some others.

2.9 ***Raising the quality of education:*** The Government of Malawi has taken steps to improve the quality of education. These include: (i) an increase in the sector's share of discretionary recurrent budget to 29 percent from 2001/02 to 2004/05, which exceeds the 23 percent threshold agreed to in the HIPC decision point document; (ii) re-allocating funding from boarding facilities toward teaching and learning materials; (iii) increasing enrollment in teacher training colleges; (iv) distributing donor-supplied primary textbooks directly from the supplier to the schools; and (v) increasing the number of properly trained teachers in primary schools (with donors' support). As a result of these measures, enrollment in primary level education has increased from 1.9 million to 3.2 million. The ratio of pupils per qualified teacher has declined from 123 in 2000 to 83 in 2005. As well, the number of pupils per permanent classroom has declined from 114 in 2000 to 99 in 2005 even though it is still very high.

2.10 ***Improving the health system:*** The authorities have been pursuing reforms to improve the health system. A SWAp agreement signed in 2004 has resulted in an increase in resources allocated to the health sector. Malawi has been training and deploying over 3000 nurse technicians, over 60 medical assistants, and 20 radiography technicians. The average budget for drugs and medical supplies has been above the Better Health for Africa (BHA) standard. The first phase of the reform of the Central Medical Services has been completed. The Government, with the support of UK's DfID, has introduced a topping-up salaries program for health workers

in order to retain them in the public sector. The level of front-line staff, drugs, and other basic medical supplies has been increased, with the drug procurement and distribution system being reformed to improve efficiency.

2.11 *Fighting HIV/AIDS:* At decision point, the prevalence rate of HIV/AIDS for the working age population in Malawi was 16 percent, which was among the highest in Sub-Saharan Africa. The Government introduced measures to: (i) strengthen the institutional framework for fighting HIV/AIDS; (ii) scale-up preventive measures; and (iii) mitigate the impact of HIV. Progress has been made in the fight against HIV/AIDS with the latest HIV/AIDS monitoring report showing that HIV infection has stabilized in the past two years in Malawi. To date, Malawi has shown good progress in the fight against HIV/AIDS, and some results have already started showing. The latest HIV/AIDS monitoring report shows that HIV infection rates have stabilized in the past two years.

2.12 *Improving access to land and credit:* The Government of Malawi has drafted a legislation to ensure that more rural households have access to land and credit. A micro finance policy has been approved by cabinet and a monitoring system for all micro-finance institutions established. By December 2005, the number of people with access to micro-credit services had increased by 79 percent, exceeding a targeted 20 percent increase.

2.13 *Creating an effective safety net system:* In 1999 the Government of Malawi started work on developing an effective and affordable safety net system. With assistance from the World Bank, it developed a National Safety Net Strategy (NSNS) aimed at achieving the Government's objectives. Since then, there has been progress in the rationalization and prioritization of existing and new programs under the NSNS. A monitoring and evaluation (M&E) system of the NSNS has been established, and although there are still some challenges, several actions have been taken towards the creation of an effective and affordable safety net system.

D. Use of HIPC Initiative Interim Assistance

2.14 HIPC debt relief resources were to be used for poverty reduction activities and to supplement domestic resources earmarked for poverty reduction projects/programs. The savings from the interim HIPC assistance have been used very much in line with the criteria established at the decision point. Funds for such activities were protected, i.e. Protected Pro-poor Expenditures (PPEs), to ensure uninterrupted delivery of services. Furthermore, to ensure transparency and accountability, funding allocations and expenditures under the PPE are published on the Ministry of Finance website and in the press every quarter. The Government in consultation with stakeholders, especially civil society and parliament, plans to revise the list of activities categorized as PPE.

E. Overall Assessment

2.15 From the above review, it is concluded that Malawi has met all of the requirements that were specified at the decision point to monitor its progress in meeting the completion point conditions under the enhanced HIPC framework. For ease of reference, a copy of the relevant HIPC completion point document prepared by the Bretton Woods Institutions (BWI), including

key HIPC reforms and objectives for reaching the floating completion point, is attached as Annex 8.²

III. TOTAL DEBT STOCK AT DECISION AND COMPLETION POINTS

3.1 Annex 1 shows that after a review of the stock of debt at end 1999 against creditor statements, the estimate of Malawi's nominal stock of debt was reduced from US\$ 2.604 billion to US\$ 2.6 billion, and the NPV of debt after traditional debt relief reduced from US\$ 1.469 billion to US\$ 1.466 billion .

3.2 **Multilateral creditors:** The NPV of debt of multilateral creditors as of end 1999 was reduced from US\$ 1.0976 billion to US\$ 1.0939 billion. This includes a reduction in the NPV of debt of ADB Group from US\$ 162.0 million to US\$ 160.0 million.

3.3 **Bilateral and Commercial Creditors:** The estimate of NPV of debt owed to the Paris Club creditors increased from US\$ 294 million to US\$ 320 billion mainly due to the re-classification of EU loans administered by IDA, and the United Kingdom, which have been classified as commercial at decision point, are currently being treated as bilateral debt. Consequently, the estimate of NPV of debt owed to commercial creditors was reduced from about US\$ 43 million to US\$ 17 million. The NPV of debt owed to non-Paris Club creditors was reduced from US\$ 35.1 million to US\$ 34.7 million.

3.4 As a result of these changes, the total HIPC assistance in NPV terms has been revised upwards from US\$ 643 million to US\$ 646 million (See Annex 1).

IV. HIPC ASSISTANCE AT COMPLETION POINT

4.1 Table 1 shows creditor participation in the revised HIPC debt relief for Malawi. Debt relief from multilateral and bilateral creditors are respectively US\$ 482 million and US\$ 157 million in NPV terms at end 1999, accounting for 74.6 percent and 24.2 percent of the total debt relief. Debt relief from for commercial creditors is US\$ 8 million accounting for 1.2 percent of the total debt relief. The African Development Bank Group's share of the debt relief is US\$ 70.5 million in end 1999 NPV terms equivalent to 14.6 percent of the multilateral debt relief and 10.9 percent of the total debt relief.

4.2 **Interim Multilateral Assistance:** The total amount of interim assistance to Malawi by the Bretton Woods Institutions and the ADB Group at completion point amounts to US\$ 142.7 million in end 1999 NPV terms, broken down as follows: (i) World Bank/IDA: US\$ 100 million; (ii) ADB Group: US\$ 26 million; and (iii) IMF: US\$ 16.7 million. EU/EIB has provided interim debt relief on identified EDF and EIB loans.

² See: IMF/IDA, Malawi: Debt Relief at the Heavily Indebted Poor Countries (HIPC) Initiative Completion Point and Under the Multilateral Debt Relief Initiative (MDRI), August 11, 2006.

4.3 **Interim Bilateral and Commercial Creditors Assistance:** Paris Club creditors have provided interim assistance through a flow treatment under the Cologne terms agreed to in January 25, 2001, and all commercial creditors, but two, have provided HIPC debt relief comparable to that of the Paris Club.

Table 1. Creditor Participation in the Revised HIPC Assistance
(US\$ million)

Creditors	Completion Point Debt Relief (end-1999 NPV)	Percentage of Total Debt Relief from Multilateral Creditors (%)	Percentage of Total Debt Relief from all Creditors (%)
Bilateral Creditors	156.5		24.2
Multilateral Creditors	482.0	100.0	74.6
<i>ADB Bank Group</i>	70.5	14.6	10.9
<i>World Bank (IDA)</i>	333.3	69.2	51.6
<i>IMF</i>	30.3	6.3	4.7
<i>EU(EDF/EIB)</i>	27.4	5.7	4.2
<i>Other Multilaterals</i>	20.5	4.2	3.2
Commercial Creditors	7.7		1.2
Total HIPC Debt Relief	646.2		100.0

Sources: IMF/IDA, Malawi: Debt Relief at the Heavily Indebted Poor Countries (HIPC) Initiative Completion Point and Under the Multilateral Debt Relief Initiative (MDRI), August 11, 2006.

V. DEBT SUSTAINABILITY AFTER HIPC ASSISTANCE

5.1 Malawi's nominal stock of external debt at-end 2005 is estimated at US\$ 2.97 billion in nominal terms and 1.9 billion in NPV terms (See Table 2). Multilateral creditors are owed 88 percent of the total nominal debt stock. The IDA and the ADB Bank Group are Malawi's largest creditors accounting for 65 percent and 14 percent of total outstanding debt respectively. Malawi's external debt after full delivery of assistance under the HIPC Initiative at completion point is estimated at US\$ 1.3 billion in NPV terms, equivalent of 245 percent of exports. Voluntary debt relief by bilateral creditors after the HIPC debt relief would further reduce the external debt to US\$ 1.2 billion, equivalent to 229 percent of export. This NPV of debt to exports ratio exceeds the projected 169 percent ratio by 60 percentage points and the HIPC threshold of 150 percent by 79 percentage points.

5.2 The debt burden analysis shows that even after full delivery of HIPC assistance, and assuming reasonable export and GDP growth, Malawi's NPV of debt to exports ratio would still be above the HIPC threshold for more than a decade. Furthermore, Malawi's debt sustainability is highly vulnerable to exogenous shocks.

Table 2. Malawi: Nominal and Net Present Value of External Debt at Completion Point as of end 2005 (In millions of US dollars)

Creditor	Legal Situation		NPV of Debt	
	Nominal Debt	NPV of Debt	After Enhanced HIPC	After Additional Bilateral Assistance
Multilateral	2,626.0	1,607.8	1,168.6	1,168.6
<i>IBRD/IDA</i>	<i>1,933.4</i>	<i>1,171.9</i>	<i>835.6</i>	<i>835.6</i>
<i>IMF</i>	<i>75.2</i>	<i>41.3</i>	<i>43.3</i>	<i>43.3</i>
<i>African Development Bank Group</i>	<i>429.2</i>	<i>259.7</i>	<i>199.2</i>	<i>199.2</i>
<i>Other Multilaterals</i>	<i>188.2</i>	<i>134.9</i>	<i>90.5</i>	<i>90.5</i>
Paris Club Bilateral	300.0	274.2	83.7	0.0
Non-Paris Club Bilateral	40.9	35.0	19.9	19.9
Commercial	2.5	2.6	0.6	0.6
TOTAL	2,969.4	1,919.5	1,272.9	1,189.2

Source: IMF/IDA, Malawi: Debt Relief at the Heavily Indebted Poor Countries (HIPC) Initiative Completion Point and Under the Multilateral Debt Relief Initiative (MDRI), August 11, 2006.

VI. CONSIDERATION FOR ADDITIONAL ASSISTANCE

6.1 Under circumstances where a country suffers from exogenous factors resulting in the deterioration of its debt-burden indicators at completion point, the enhanced HIPC Initiative allows for additional debt relief (topping-up) at completion point.

6.2 **Drought:** In the 2004/2005 growing season, Malawi experienced a drought which affected farm produce and led to country wide food shortages. Malawi suffered a shortfall in the production of its staple food of about 1 million tones in 2005. The need for food imports affected Malawi's affected its current account balance and its external reserve position.

6.3 **Lower than Projected Export Receipts:** Volume of exports grew at an average of 8.5 percent over 2001-05 against an expected average growth of 5.4 percent. However, growth in commodity prices averaged about 0.5 percent against an expected growth of 2 percent, with the price of tobacco, the main export, falling by 13.6 percent between 2001 and 2004. The increase in Malawi's market share in the tobacco world market from 1.47 percent in 2000 to 2.41 percent in 2004 could not compensate for the decrease in prices, leading to a lower export revenue.

6.4 ***Fixed Interest Rates on Borrowed Capital:*** Declining market rate in the industrialized world have not affected Malawi's nominal debt burden because the interest rates on the external debt are fixed. Furthermore, declining interest rates in industrialized countries are often associated with a lower level of economic activity in industrialized countries which leads to a reduction in imports into industrialized and exports from developing countries. This results in a decline in external reserve position and heavier debt burden on developing countries.

6.5 ***Depreciation of the US Dollar against the SDR:*** The bulk of Malawi's debt, about 67 percent, is denominated in SDR while its main exports are denominated in US dollars. Consequently a depreciation of the US dollar against the SDR, and weaker commodity prices resulted in a deterioration of its balance of payments and a worsening of its external reserve position and debt burden.

6.6 ***Lower than Expected Concessionality of New Loans:*** At decision point, it was assumed that the grant element of new loans would be about 71 percent. However, the actual grant element for new loans over 2000-05 averaged 57 percent and this worsened Malawi's debt burden.

6.7 ***Increase in Import Prices, especially Oil Products:*** At decision point, the expected increase in import prices was projected at 0.7 percent each year over 2000-05. However, the actual increase was 6.7 percent, largely due to the sharp increase in petroleum prices. This together with weak export prices contributed to a large deterioration in Malawi's terms of trade of about 20 percent over 2000-05, with the deterioration expected to continue in the near future.

6.8 In view of the above analysis, Management concludes that the deterioration in Malawi's debt-burden indicators was primarily due to exogenous factors and therefore recommends contribution to an additional assistance (topping-up) of US\$ 411 million in NPV terms as at end 2005, to bring Malawi's NPV of debt to exports ratio after bilateral debt relief beyond HIPC assistance down from 229 percent at end 2005 to the 150 percent HIPC threshold. The Bank Group's share of the topping up is estimated at US\$ 68.8 million (16.7 percent); while that of IDA and IMF together is estimated at US\$ 304 million (74 percent).

VII. DEBT RELIEF UNDER THE MULTILATERAL DEBT RELIEF INITIATIVE (MDRI)

7.1 Upon approval of completion point debt relief under the enhanced HIPC Initiative, Malawi would qualify for further debt relief from the African Development Fund (ADF) under the MDRI. With the approval of the topping-up, the total debt relief under MDRI amounts to US\$ 1.47 billion in nominal terms spread over 50 years, with the Bank Group's portion being US\$ 253 million.³

³ The MDRI debt relief provided by IDA and ADF are netted out from the IDA and ADF allocations. See MDRI Implementation Modalities. Ref.: ADF/BD/WP/2006/31 dated 5 April 2006. Topping-up of HIPC assistance would lead to a reduction in MDRI debt relief provided by IDA, IMF, and ADF.

VIII. BANK GROUP INVOLVEMENT IN THE POVERTY REDUCTION STRATEGY

8.1 The African Development Bank Group's involvement in Malawi from 2002 to 2006 is in consonance with the strategic orientation of the Malawi Poverty Reduction Strategy Paper (MPRSP), its successor the Malawi Growth and Development Strategy (MGDS), the Vision 2020, and the Millennium Development Goals. Under ADF-IX the Bank Group supported the government's efforts to reduce poverty using a three-pronged strategy, namely: (i) increasing economic growth; (ii) building the capacity of public institutions to be responsive to the needs of the poor; and (iii) reducing the vulnerability of the poor. The implementation of the 2002-2004 Country Strategy Paper (CSP) under ADF-IX translated into some UA 21.34 million operations mainly in (i) Road Rehabilitation and Upgrading in Karonga and Chitipa Districts, (ii) Lake Malawi Artisanal Fisheries Development Project; (iii) a project preparation study on Land Reform and Sustainable Rural Livelihood; and (iv) Humanitarian Emergency Assistance for Drought Affected Communities. But most importantly, The Bank's support for Good Governance and Policy Reforms of about UA120 million significantly contributed to improve Malawi's Country Policy and Institutional Assessment (CPIA).

8.2 The Bank Group's strategy under ADF-X revolves around interventions in two broad areas: (i) rural infrastructure development; and (ii) human capital and institutional capacity development. The implementation of the 2005-2009 CSP under ADF-X has translated into the following operations; (i) Rural Health Project IV (UA 15 million); (ii) Support for Secondary Education (Education V) (UA 15 million); (iii) Irrigation and Conservation Development (UA 15 million); and (iv) Small Holder Crop Production and Marketing Project (UA 15 million).

IX. DEBT SUSTAINABILITY OUTLOOK

9.1 The results of the debt sustainability analysis are presented in Table 3. After enhanced HIPC assistance (including the topping-up), bilateral debt relief, and MDRI, Malawi's debt burden indicators are expected to remain below the HIPC threshold throughout the project period of 2005-2025.⁴

- (i) the NPV of total debt would be reduced from about US\$ 1.3 billion in 2005 to US\$ 180 million in 2006, average about US\$ 612 million per annum from 2005-2015, and about US\$ 1.5 billion per annum from 2016 to 2025;
- (ii) the NPV of debt to exports ratio would drop from 229 percent in 2005 to 32 percent in 2006, average about 59 percent per annum from 2005-2015, and about 98 percent per annum from 2016-2025;

⁴ IMF/IDA, Malawi: Debt Relief at the Heavily Indebted Poor Countries (HIPC) Initiative Completion Point and Under the Multilateral Debt Relief Initiative (MDRI), August 11, 2006.

- (iii) the NPV of debt to GDP ratio would decrease from 57 percent in 2005 to 8 percent in 2006, average about 14.5 percent per annum from 2005-2015, and about 26 percent per annum from 2016-2025;
- (iv) the NPV of debt to revenue ratio would decline from 244 percent in 2005 to 33 percent in 2006, average about 61 percent per annum from 2005-2015, and about 108 percent per annum from 2016-2025; and
- (v) average annual debt service to exports ratio would decline from 7.2 percent in 2006 to about 2.2 percent in 2015, average about 2 percent from 2005 to 2025, and about 2.2 percent from 2016-2025.

Table 3. Results of the Debt Sustainability Analysis: Debt Burden Indicators

	HIPC Threshold	2005	2006	2015	2025	Average	
						2005 - 2015	2016 - 2025
NPV of Total Debt (millions of US\$)		1271.6	180.1	841.4	2194.0	612.2	1540.8
NPV of debt to exports ratio (%)	150%	229%	32%	83.9%	103.2%	59%	98.2%
NPV of debt to GDP ratio (%)	40%	57%	8%	20.8%	28.1%	14.5%	25.7%
NPV of debt to revenue ratio (%)	250%	244%	33%	87.8%	118.5%	60.7%	108.4%
Debt service to exports ratio (%)	20%	--	7.2%	2.2%	2.7%	2%	2.2%

Sensitivity Analysis

9.2 The long-term sustainability of Malawi's debt is assessed under the following four scenarios: (i) Borrowing on less than full concessional terms; (ii) Higher borrowings and lower export revenue; (iii) Failure to protect the economy from periodic droughts; and (iv) Scaling up aid through loans rather than grants to meet the MDGs.

9.3 **Borrowing on less than full concessional terms.** Under this scenario, with a grant element of 45 percent rather than the actual grant element of 57 percent from loans obtained from 2000-2005, Malawi's debt indicators would still remain below the HIPC thresholds throughout the project period. However, by the end of the project period, its NPV of debt to exports ratio would be above 117 percent and its debt service to exports ratio above 7 percent.

9.4 **Higher borrowings and lower export revenue:** This assumes that: (i) the Government supplements the aid levels with higher borrowings similar to the levels within the period 2000-2005; (ii) that the structural reforms are not successful; and (iii) that global prospects of tobacco prices are poor. Under this, there would be a steep increase in Malawi's NPV of debt to exports ratio exceeding the HIPC threshold in 2019 and reaching 196 percent at the end of the project period. Debt service to exports would also rise to 5 percent by 2025.

9.5 ***Failure to protect the economy from periodic droughts:*** This assumes the occurrence of drought every 5 years, starting in 2010, which will affect production (including exports), external reserves, and the maintenance of low inflation. Under this, Malawi's NPV of debt to exports ratio would remain below the HIPC threshold throughout the projection period.

9.6 ***Scaling up aid through loans rather than grants to meet the MDGs:*** This assumes that aid to Malawi increased from 21.5 percent of GDP to 26.5 percent of GDP over 2011-2025, with the composition of aid between loans and grants remaining the same as that of recent year. New borrowings rise to 6.8 percent of GDP, and export growth is 0.5 percent higher than the baseline growth. Under this, the NPV of debt to exports ratio would rise to 157 percent at the end of the project period which is higher than the HIPC threshold. This clearly indicates that Malawi would need to rely on grant financing for faster progress towards achieving the MDGs.

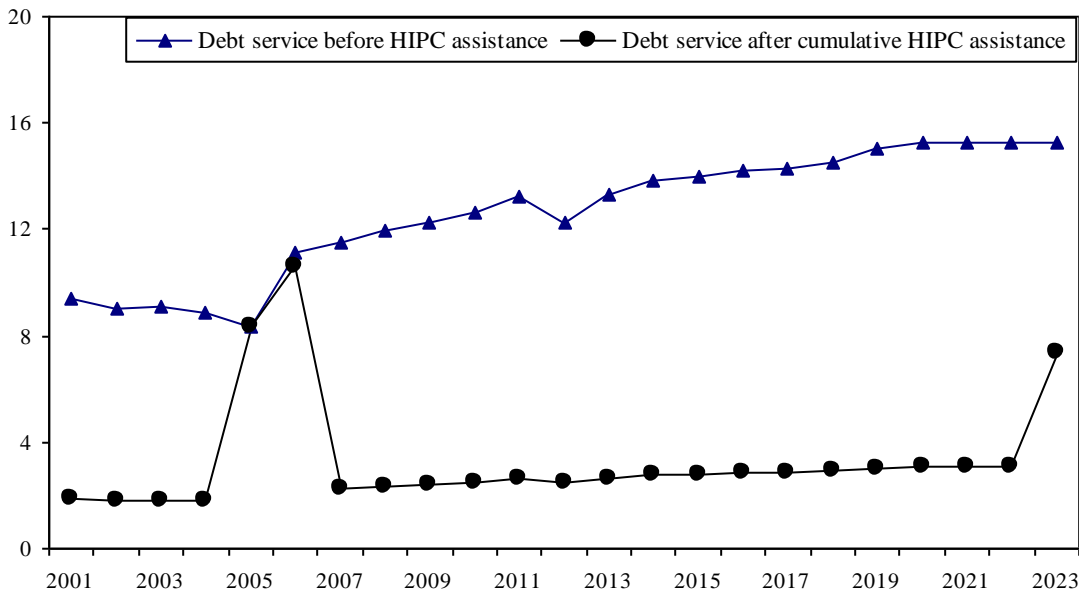
9.7 The sensitivity analysis shows that Malawi's debt is vulnerable to exogenous shocks. As a result, the government would need prudent public expenditure management and continued structural reforms to sustain a strong economic growth after completion point, and avoid a deterioration of its debt burden indicators.

X. PROPOSED DEBT RELIEF DELIVERY MODALITY

10.1 The debt relief assistance to Malawi aims at smoothing the profile of Malawi's debt service to its bilateral and multilateral creditors. In reaching its completion point, it is proposed that the Bank Group makes a commitment to provide Malawi with an irrevocable debt relief of approximately US\$ 139.31 million in NPV terms (US\$ 70.51 million in end-1999 NPV terms and US\$ 68.80 in end-2005 terms), equivalent to US\$ 212.83 million in nominal terms, with effect from January 2001, as per the debt relief schedule given in Annexes 2, 3, and 4. The breakdown of the debt relief into principal and charges is presented in Annex 5 and the structure of the relief in terms of currency presented in Annex 6.

10.2 The debt relief assistance would relieve Malawi of up to 80 percent of its debt-service obligation to the Bank each year until July 2023, when the total debt relief would have been delivered. Malawi's debt service profile with the Bank Group before and after the HIPC assistance is provided in Annex 7. The impact of the debt relief on Malawi's debt service profile is illustrated in Chart 1 below.

Chart 1. Impact of Debt Relief on Malawi’s Bank Group Debt Service Profile
(in US\$ millions)



10.3 The provision of debt relief, as described, is consistent with the rules and regulations of the African Development Bank and the African Development Fund.

Legal Aspects of Debt Relief Operations

10.4 Under the enhanced HIPC framework, debt relief for Malawi is to be provided in accordance with the terms described in the preceding paragraphs. These terms will be implemented by:

- (i) A Revised Debt Relief Agreement between the Bank Group and the Government of Malawi;
- (ii) A Contribution Agreement between the Bank Group and IDA; and
- (iii) A HIPC Trust Fund Grant Agreement between the Bank Group, the International Development Association (IDA), and the Government of Malawi.

XI. INDICATIVE FINANCING ARRANGEMENTS

11.1 The debt relief by the Bank Group would be financed as shown in Table 4 below.

Table 4. Indicative Financing Arrangements

(US\$ million, in NPV terms)

Sources of Financing	Total Contribution	Percent of the Total (%)
Internal Resources	27.86	20
European Commission Pledge	55.72	40
HIPC Trust Fund	55.72	40
TOTAL	139.3	100

XII. RECOMMENDATIONS

12.1 The Boards of Directors are invited to:

- (i) Take note of the justification for Malawi's qualification for HIPC assistance at its completion point under the enhanced HIPC Initiative;
- (ii) Approve the completion point proposal for Malawi as well as the proposed HIPC assistance US\$ 70.51 million in end-1999 NPV terms or US\$ 105.89 million in nominal terms, according to the financing arrangements presented in XI;
- (iii) Approve an additional assistance (topping-up) of US\$ 68.80 million in end-2005 NPV terms, or US\$ 106.94 million in nominal terms, under the Initiative to lower Malawi's NPV of debt to exports ratio to 150 percent.; and
- (iv) Approve Malawi's qualification for the MDRI.

**MALAWI: Nominal and Net Present Value of External Debt at Decision Point
as of end December 1999** (In millions of US dollars)

Creditor	Nominal Debt Stock		NPV of Debt after Rescheduling	
	At Decision Point	Revised at Completion Point	At Decision Point	Revised at Completion Point
Multilateral	2,187.1	2,174.5	1,097.6	1,093.9
<i>World Bank/IDA</i>	<i>1,603.0</i>	<i>1,601.4</i>	<i>756.7</i>	<i>756.4</i>
<i>IMF</i>	<i>87.6</i>	<i>87.6</i>	<i>68.8</i>	<i>68.8</i>
<i>African Development Bank Group</i>	<i>321.7</i>	<i>323.9</i>	<i>162.0</i>	<i>160.0</i>
<i>EU/EIB</i>	<i>95.5</i>	<i>88.6</i>	<i>65.5</i>	<i>62.2</i>
<i>Other Multilaterals</i>	<i>79.3</i>	<i>73.0</i>	<i>44.6</i>	<i>46.5</i>
Paris Club Bilateral	337.8	366.4	293.8	320.5
Non-Paris Club Bilateral	43.4	43.4	35.1	34.7
Commercial	36.0	16.2	42.8	17.3
TOTAL	2,604.3	2,600.5	1,469.3	1,466.4
TOTAL HIPC ASSISTANCE			643.0	646.0

Source: IMF/IDA, Malawi: Debt Relief at the Heavily Indebted Poor Countries (HIPC) Initiative Completion Point and Under the Multilateral Debt Relief Initiative (MDRI), August 11, 2006.

AFRICAN DEVELOPMENT BANK

HIPC Debt Relief Schedule

(in US\$ millions)

MALAWI

Completion Point Date :
30 August 2006

CALENDAR YEAR	TOTAL ADB	ADB PERCENT IN THE TOTAL	TOTAL (ADB/ADF)
2001	3.483144	46.4	7.500471
2002	2.884373	40.0	7.219489
2003	2.719805	37.4	7.279661
2004	2.148057	30.3	7.094150
2005	0	0	0
2006	0	0	0.552229
2007	1.907752	20.7	9.229120
2008	1.815845	18.9	9.612324
2009	1.721901	17.5	9.828069
2010	1.628975	16.1	10.125166
2011	1.542912	14.5	10.634652
2012	-	0	9.820082
2013	-	0	10.673400
2014	-	0	11.066871
2015	-	0	11.219243
2016	-	0	11.371553
2017	-	0	11.436524
2018	-	0	11.633564
2019	-	0	12.018673
2020	-	0	12.211844
2021	-	0	12.240120
2022	-	0	12.214272
2023	-	0	7.847551
	19.852765	9.3	212.829028

Summary

Total Nominal Relief	US\$ 212.829028 mn
<i>of which</i>	
ADB	US\$ 19.852765 mn
ADF	US\$ 192.976264 mn
Total NPV Relief	US\$ 139.309230 mn
<i>of which</i>	
In 1999 NPV	US\$ 70.508209 mn
In 2005 NPV	US\$ 68.801021 mn
Duration	23 years

AFRICAN DEVELOPMENT FUND
HIPC Debt Relief Schedule
(in US\$ millions)

MALAWI

Completion Point Date:
30 August 2006

CALENDAR YEAR	TOTAL ADF	ADF PERCENT IN THE TOTAL	TOTAL (ADB/ADF)
2001	4.017328	53.6	7.500471
2002	4.335116	60.0	7.219489
2003	4.559856	62.6	7.279661
2004	4.946093	69.7	7.094150
2005	0	0	0
2006	0.552229	100	0.552229
2007	7.321368	79.3	9.229120
2008	7.796479	81.1	9.612324
2009	8.106168	82.5	9.828069
2010	8.496190	83.9	10.125166
2011	9.091739	85.5	10.634652
2012	9.820082	100	9.820082
2013	10.673400	100	10.673400
2014	11.066871	100	11.066871
2015	11.219243	100	11.219243
2016	11.371553	100	11.371553
2017	11.436524	100	11.436524
2018	11.633564	100	11.633564
2019	12.018673	100	12.018673
2020	12.211844	100	12.211844
2021	12.240120	100	12.240120
2022	12.214272	100	12.214272
2023	7.847551	100	7.847551
	192.976264	90.7	212.829028

Summary

Total Nominal Relief	US\$ 212.829028 mn
<i>of which</i>	
ADB	US\$ 19.852765 mn
ADF	US\$ 192.976264 mn
Total NPV Relief	US\$ 139.309230 mn
<i>of which</i>	
In 1999 NPV	US\$ 70.508209 mn
In 2005 NPV	US\$ 68.801021 mn
Duration	23 years

AFRICAN DEVELOPMENT BANK GROUP
Revised HIPC Debt Relief Schedule
(in US\$ millions)

MALAWI

Calendar Year	Debt Relief at Decision point**	Topping Up Assistance	Total Debt Relief
2001- 2004*	29.093771	0	29.093771
2005	0	0	0
2006	0.222030	0.330199	0.552229
2007	7.280840	1.948280	9.229120
2008	7.506243	2.106081	9.612324
2009	7.578679	2.249391	9.828069
2010	7.801232	2.323933	10.125166
2011	8.249239	2.385413	10.634652
2012	7.623557	2.196525	9.820082
2013	7.940995	2.732405	10.673400
2014	8.492543	2.574329	11.066871
2015	8.439518	2.779725	11.219243
2016	5.659856	5.711697	11.371553
2017	0	11.436524	11.436524
2018	0	11.633564	11.633564
2019	0	12.018673	12.018673
2020	0	12.211844	12.211844
2021	0	12.240120	12.240120
2022	0	12.214272	12.214272
Jan. – July 2023	0	7.847551	7.847551
TOTAL	105.888503	106.940526	212.829028

* Cumulative of the total debt relief provided during the interim period

** Debt relief committed at decision point has been revised

AFRICAN DEVELOPMENT BANK GROUP
Debt Relief in Terms of Principal and Charges
(in US\$ millions)

MALAWI

Year	ADB			ADF			Bank Group		
	Principal	Charges	Total	Principal	Charges	Total	Principal	Charges	Total
2001-2004	9.302285	1.933094	11.235379	11.818155	6.040237	17.858392	21.120440	7.973331	29.093771
2005	-	-	-	-	-	-	-	-	-
2006	-	-	-	0.195842	0.356387	0.552229	0.195842	0.356387	0.552229
2007	1.428374	0.479378	1.907752	4.848028	2.473340	7.321368	6.276402	2.952718	9.229120
2008	1.427090	0.388755	1.815845	5.352933	2.443546	7.796479	6.780023	2.832301	9.612324
2009	1.425637	0.296264	1.721901	5.709397	2.396771	8.106168	7.135034	2.693035	9.828069
2010	1.424039	0.204936	1.628975	6.142796	2.353395	8.496190	7.566835	2.558331	10.125166
2011	1.421574	0.121339	1.542912	6.784579	2.307160	9.091739	8.206153	2.428499	10.634652
2012	-	-	-	7.558387	2.261695	9.820082	7.558387	2.261695	9.820082
2013	-	-	-	8.475803	2.197597	10.673400	8.475803	2.197597	10.673400
2014	-	-	-	8.934099	2.132772	11.066871	8.934099	2.132772	11.066871
2015	-	-	-	9.153846	2.065396	11.219243	9.153846	2.065396	11.219243
2016	-	-	-	9.370858	2.000695	11.371553	9.370858	2.000695	11.371553
2017	-	-	-	9.511422	1.925102	11.436524	9.511422	1.925102	11.436524
2018	-	-	-	9.779658	1.853907	11.633564	9.779658	1.853907	11.633564
2019	-	-	-	10.238577	1.780097	12.018673	10.238577	1.780097	12.018673
2020	-	-	-	10.504369	1.707475	12.211844	10.504369	1.707475	12.211844
2021	-	-	-	10.615800	1.624320	12.240120	10.615800	1.624320	12.240120
2022	-	-	-	10.669132	1.545140	12.214272	10.669132	1.545140	12.214272
2023	-	-	-	6.916686	0.930865	7.847551	6.916686	0.930865	7.847551
Total	16.428999	3.423766	19.852765	152.580367	40.395896	192.976264	169.009366	43.819662	212.829028

AFRICAN DEVELOPMENT BANK GROUP
Structure of HIPC debt Relief in Terms of Currency

Institution	Currency	Amount (US\$ million)	Percent in the group (%)	Percent in the total (%)
ADF	CAD	0.549472	0.3	0.3
	CHF	9.058585	4.7	4.3
	DKK	1.054323	0.5	0.5
	EUR*	40.969676	21.2	19.3
	GBP	9.711226	5.0	4.6
	JPY	36.388073	18.9	17.1
	NOK	3.335271	1.7	1.6
	SEK	0.241219	0.1	0.1
	USD	91.668420	47.5	43.1
Sub-total-1		192.976264	100	90.7
ADB	EUR	14.051317	70.8	6.6
	JPY	2.641428	13.3	1.2
	USD	1.256310	6.3	0.6
	CHF	0.019621	0.1	0.0
	DKK	-	0.0	0.0
	GBP	1.884089	9.5	0.9
Sub-total-2		19.852765	100	9.3
TOTAL		212.829028	--	100

* Cumulative of all Euro area currencies

AFRICAN DEVELOPMENT BANK GROUP

Malawi : Debt Service Profile

(In US\$ million)

Year	Before Debt Relief			Debt Relief			After Debt Relief		
	ADB	ADF	Total	ADB	ADF	Total	ADB	ADF	Total
2001	4.35	5.02	9.38	3.48	4.02	7.50	0.87	1.00	1.88
2002	3.61	5.42	9.02	2.88	4.34	7.22	0.72	1.08	1.80
2003	3.40	5.70	9.10	2.72	4.56	7.28	0.68	1.14	1.82
2004	2.69	6.18	8.87	2.15	4.95	7.09	0.54	1.24	1.77
2005	2.04	6.27	8.32	-	-	-	2.04	6.27	8.32
2006	2.43	8.69	11.12	-	0.55	0.55	2.43	8.13	10.56
2007	2.34	9.15	11.49	1.91	7.32	9.23	0.43	1.83	2.26
2008	2.23	9.74	11.97	1.82	7.80	9.61	0.41	1.95	2.36
2009	2.12	10.13	12.24	1.72	8.11	9.83	0.39	2.02	2.42
2010	2.00	10.62	12.62	1.63	8.50	10.13	0.38	2.12	2.50
2011	1.90	11.36	13.26	1.54	9.09	10.63	0.36	2.27	2.63
2012	-	12.27	12.27	-	9.82	9.82	-	2.45	2.45
2013	-	13.34	13.34	-	10.67	10.67	-	2.66	2.66
2014	-	13.83	13.83	-	11.07	11.07	-	2.76	2.76
2015	-	14.02	14.02	-	11.22	11.22	-	2.80	2.80
2016	-	14.21	14.21	-	11.37	11.37	-	2.84	2.84
2017	-	14.30	14.30	-	11.44	11.44	-	2.86	2.86
2018	-	14.54	14.54	-	11.63	11.63	-	2.91	2.91
2019	-	15.02	15.02	-	12.02	12.02	-	3.00	3.00
2020	-	15.26	15.26	-	12.21	12.21	-	3.05	3.05
2021	-	15.30	15.30	-	12.24	12.24	-	3.06	3.06
2022	-	15.27	15.27	-	12.21	12.21	-	3.05	3.05
2023	-	15.25	15.25	-	7.85	7.85	-	7.40	7.40
Total	29.11	260.90	290.01	19.85	192.98	212.83	9.26	67.92	77.18

Note: The debt service obligations, after the debt relief in year 2006 up to year 2024, are stable due to the HIPC debt service reduction, which is about 80 percent per year. The debt relief assistance significantly affects the country's debt service obligations. For example, in 2015 the debt service obligations fall from about US\$ 14.02 million to about US\$2.80 million. After year 2023, Malawi will assume full payment of its debt service falling due.

IMF/ World Bank HIPC Document for MALAWI

<http://www.imf.org/external/pubs/ft/scr/2006/cr06420.pdf>