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Malawi
Country Assistance Evaluation

November 14, 2000

Operations Evaluation Department

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Abbreviations and Acronyms

AIDS	Acquired Immune Deficiency Syndrome
BOP	Balance of Payments
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
EDDRP	Entrepreneurship Development and Drought Recovery Project
EEC	European Economic Commission
ESAF	Enhanced Structural Adjustment Facility
ESW	Economic and Sector Work
FRDP	Fiscal Restructuring and Deregulation Program
GDP	Gross Domestic Product
GNP	Gross National Product
GOM	Government of Malawi
HIPC	Highly Indebeted Poor Country
ICR	Implementation Completion Report
IFC	International Finance Corporation
IMF	International Monetary Fund
MDC	Malawi Development Corporation
MIM	Malawi Institute of Management
MIGA	Multilateral Investment Guarantee Agency
MIPA	Malawi Investment Promotion Agency
MASAF	Malawi Social Action Fund
MTEF	Medium-Term Expenditure Framework
NGO	Non-Governmental Organization
OED	Operations Evaluation Department
PAR	Performance Audit Report
PHN	Population, Health, and Nutrition
RBM	Reserve Bank of Malawi
SME	Small and Medium Enterprise
TA	Technical Assistance
UNDP	United Nations Development Program

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MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Malawi - Country Assistance Evaluation

Attached is a Country Assistance Evaluation on Malawi prepared by the Operations Evaluation Department. A draft of this evaluation was distributed to CODE in May 1998. This report is now being re-issued for the purpose of public disclosure.

By the early 1990's, despite having been "adjusting" for a decade, Malawi showed minimal progress in reducing poverty and food insecurity due to lack of real change in the production structure. Price controls and regulatory restrictions perpetuated a dualistic agriculture sector in which large estates produced export crops and smallholders subsistence maize. Industrial production was limited and inward-looking with private sector activity constrained by periodic macroeconomic instability, discouraging investment regulations, poor infrastructure, limited access to finance, and a poor competitive environment. GNP per capita was among the lowest in the world and close to half the population lacked access to basic health, education, and safe water facilities. With tobacco accounting for 60% of exports and rain-fed maize for 25% of GDP, the economy remained highly vulnerable to external shocks. The Bank's response in the early 1990's was an assistance strategy aimed at generating more sustainable and distributive growth through support to (i) maintain macroeconomic stability; (ii) stimulate private sector activity, especially diversification in agriculture and off-farm and export-processing activity; (iii) increase investment in human capital; and (iv) enhance institutional capacity.

Implementation of the strategy was affected by adverse external shocks, including severe droughts and changes in the terms of trade. Prior to 1994 the trade regime was improved and price and regulatory restrictions in non-agricultural sectors were removed. However, the government proved unwilling to address the adverse policy environment for smallholders. The post-1994 government showed a much stronger commitment to advancing all elements of the poverty reduction strategy. Among its first acts was to remove fees on primary education to boost enrollment rates. Since then, with Bank support, price and regulatory obstacles to agricultural production were removed, monetary management was strengthened, further improvements were made in the environment for production and exports, and expenditure on the social sectors was increased. However, due to external shocks and periodic fiscal indiscipline, macroeconomic stability was not sustained, resulting in crowding out of credit to the private sector and inflation. Bank assistance for infrastructure development had limited results, efficiency in the financial sector was not increased, the poor competitive environment was not improved, and most capacity-building measures had limited long-term impact.

Since 1995, there have been signs of progress in the right direction. An emerging smallholder shift in production harbors well for increased rural incomes and future food security. There are examples of export-processing firms prospering under the current environment.

Primary school enrollment increased by one million children. However, failure to achieve progress in the many key areas indicated above constrained the degree of supply response, with consequent inadequate progress in reducing poverty. To a significant extent, this was due to external shocks, which consumed substantial resources and set back the reform agenda. At the same time, the pre-1994 regime persisted with policies favoring elite groups and failed to implement key reforms in a timely manner. The post-1994 government showed much stronger commitment to the overall strategy and achieved significant progress. However, reforms in a number of key areas have yet to take place. In particular, failure to prioritize and consistently control public expenditure had a broad detrimental impact. Bank performance was overall satisfactory. The major interventions it supported were appropriate to Malawi's circumstances and consistent with the Bank's recommended poverty reduction strategy. In retrospect, however, excess reliance was placed in supply-oriented measures in agriculture before 1994 given the poor policy environment and on traditional capacity-building measures in the face of systemic weaknesses in the public sector. In addition, inadequate attention was paid to the short-term impacts of reforms and to institutional weaknesses in the financial and corporate sectors.

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1. Relevance of the Bank's Assistance to Malawi, 1991-1997

Background

1.1 At the end of the British colonial period, Malawi was left with a dualistic agricultural economy under which large expatriate-managed estates produced tea, tobacco, and cotton for export, while local smallholder farmers produced subsistence maize. A small commercial and industrial center in the southern region had been established, which included cement, bottling, tobacco-processing, and transport-related activities. The economy was characterized by surplus labor and periodic severe booms and busts, dictated by world prices of the cash-crops produced. Unlike its neighbors, Malawi had no known substantial mineral resources and its main assets were moderately fertile soils, good water resources, and a climate favorable to crop production. It lacked direct access to the sea, capital, technology, skilled labor and managerial capacity.

1.2 Following independence in 1964, development strategy under President-for-Life Hastings Banda aimed to achieve growth through estate-led agriculture, public investment in infrastructure, inward-looking oligopolistic industrial activity, and self-sufficiency in food production. This strategy, supported by the Bank at the time, yielded GDP growth rates of over 5% per year in the 1960's and 1970's. However, in the late 1970's, underlying weaknesses in the strategy became apparent when a decline in the terms of trade, drought, and a disruption of regional transport upset macroeconomic stability and caused GDP to contract. Widespread poverty, food insecurity, and high income inequality were also recognized as consequences of a development strategy that inhibited diversification and suppressed broad participation in growth. The government of Malawi responded with a broad Bank-supported adjustment program in the early 1980's to restore stability and diversify the production base. However, success in restoring stability and the on-set of favorable external conditions (i.e. improved tobacco prices) restored growth to over 4% a year between 1983 and 1985, and led to the postponement of more in-depth structural reforms.

1.3 In the late 1980's, another decline in the terms of trade and regional instability caused the fiscal and balance of payments positions to deteriorate once again and growth declined to less than 1% a year between 1986 and 1989 while GNP per capita contracted. A further round of Bank and IMF-supported adjustment measures in the late 1980's restored stability, restructured public and quasi-public firms, and reduced some price distortions, especially in the external and financial sectors. However, these efforts failed to address some of the critical factors inhibiting diversification and suppressing broad participation in growth. In particular, price controls and regulatory restrictions (e.g. the prohibition of smallholder production of cash crops) in the agriculture sector perpetuated the dualistic agricultural structure. Despite an improving trade regime, industrial production remained limited and inward-looking. A more robust private sector response was being deterred by discouraging (or in the case of non-ethnic groups, prohibitive) investment regulations, inadequate infrastructure, an inefficient and exclusive banking sector, and a poor competitive environment, arising from a few firms with close political ties dominating the corporate sector. The poor supply response meant that macroeconomic stability continued to be dependent on high levels of external support and subject to periodic disruption caused by external shocks.

1.4 By the early 1990's, Malawi was thus in the position of having been "adjusting" for close to a decade, but due to the lack of real structural change, showed minimal improvement in the lives of most Malawians. GNP per capita rose marginally, from $190 in 1980 to $200 in 1990 and in 1990, Malawi's GNP per capita was the sixth lowest in Africa and the ninth lowest in the world (down from 11th lowest in 1981). Life expectancy over the decade increased from 44 years in 1981 to only 45 years in 1991. Over half the population remained below the basic needs poverty line of $40 per year and income distribution was one of the most skewed in the world. Nearly 50% of the population lacked access to basic health, education, and safe water facilities and 60% were illiterate. Food security continued to be a major concern due to the dependence on rain-fed maize to meet the nutrition requirements of most Malawians.

Bank Assistance Objectives Since 1991

1.5 The Bank responded to these circumstances by evolving an assistance strategy that aimed to help accelerate progress on structural reforms and enhance investment in human capital to generate a more sustainable and distributive growth path. A smallholder-led growth strategy was supported, under which stimulating greater productivity and growth in smallholder agriculture would lead to higher rural incomes, which, in turn, would stimulate off-farm activities. As agriculture alone was unlikely to support higher incomes for all in the longer-term, an export-oriented industrial base was also to be established. The Bank's major contributions toward realization of these goals between 1991 and 1997 consisted of assistance to:[1]

1) Maintain macro-economic stability;

2) Stimulate market-driven private sector activity, first in smallholder agriculture and then in off-farm and industrial activities. To achieve this, intermediate objectives were to (i) rationalize the price environment; (ii) remove regulatory obstacles; (iii) improve the efficiency and reach of the financial sector; (iv) strengthen direct public technical assistance; (v) improve infrastructure; and (vi) privatize public corporations.

3) Increase human capital development and slow population growth by (i) re-orienting public expenditures in favor of the social services; (ii) improving public social service delivery; and (iii) promoting family planning.

4) Enhance institutional capacity in the country.

Composition of Assistance

1.6 Between 1991 and 1997, a total of 16 projects that were closed during the period (having disbursed US$ 564 million) and a further 14 were approved and remain currently active (worth US$ 582 million in commitments). Among these projects were 4 adjustment operations (3 completed and one on-going) worth $434 million in balance of payments support. Of the $712 million in investment lending that was effective over the period, 41% went to infrastructure, 29% to the social sectors, and 20% to agriculture. Twelve formal ESW reports were produced between 1991 and 1996, covering infrastructure, agriculture, the financial sector, the social sectors, environmental protection, and public sector management. The Bank maintained a good relationship with both the pre-1994 government and the incumbent government and had an influential role in the policy development, especially after 1994. The

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[1] Explicit Bank objectives in 1992 were (a) comprehensive measures toward poverty alleviation (b) liberalization of the environment for the private sector (c) natural resource conservation and (d) macroeconomic stability (MOP/C-2396). In 1994, objectives were stated as (a) economic diversification and broad-based private sector participation (b) improvement of social indicators (c) environmentally sound policies and (d) capacity building (MOP/C-2624). The 1996 CAS defined Bank objectives as (a) maintenance of macroeconomic stability (b) stimulation of private sector initiative (c) promotion of population control and human resource development and (d) capacity building and decentralization. Current Bank objectives, stated in the 1998 CAS draft are (a) creating broad-based, labor-intensive growth (b) sustaining growth and protecting the poorest (c) improving public sector management and (d) strengthening policy dialogue and implementation.

Bank's leadership among the local donor community, particularly in terms of setting the policy agenda, is also acknowledged.

Relevance of the Bank's Objectives and Interventions

1.7 *Relevant goals and mostly relevant assistance interventions.* The development goals supported by the Bank between 1991 and 1997 were and remain consistent with the Bank's accumulated knowledge of sustainable poverty reduction and appropriate to Malawi's circumstances. Under the Bank-supported strategy, poverty reduction will occur in Malawi when there is dynamic productive activity according to the comparative advantage of the country, broad-based participation in this activity, higher consumption levels of basic social goods and services, and emergence of a sound local economic management capacity. Intermediate objectives and instruments identified by the Bank were broad and endeavored to addressed many of the identified constraints to achievement of these goals. A detailed description of Bank interventions supporting each major objective is attached as Annex A. In retrospect, however, there were some exceptions to the largely relevant assistance provided by the Bank between 1991 and 1997, as presented below.

1.8 *Poor results from supply-oriented meaures in an inconducive policy environment.* Prior to 1994, Bank financing for public research, extension, credit, and input-supply to stimulate diversification and growth in agriculture (designed between 1985 and 1993) did not induce any significant structural shifts because of price and regulatory restrictions that inhibited changes in smallholder production. Only after elimination of these constraints in 1994 were the desired shifts observed. Indeed, after removal of the fertilizer subsidy in 1994/95, it became apparent that production of some high-yield varieties promoted through extension efforts were not economically viable. Support to public agencies providing technical assistance (TA) to small and medium industries (SMIs) also did not have significant impact and several Bank-financed credit-lines targeted at smallholders and SMIs that were effective during the period became politically influenced and were used more as short-term income transfers than as catalysts for development in their target sectors. These supply-oriented efforts were costly (especially the training and visit system) and reflected a series of factors including, (i) Bank persistence with an outdated paradigm for agricultural development until the mid-1980's; (ii) inadequate integration of Bank investment lending with policy advice in the late 1980's; and (iii) adoption of next-best solutions given the intransigence by the Banda government in effecting policy changes in the early 1990's. In the event, despite effective implementation of several of these efforts, they had little impact on advancing key strategic objectives.

1.9 *Poor results from traditional technical assistance to public agencies where systemic weaknesses exist*. The Bank financed traditional technical assistance modalities (i.e. training, counterpart advisors, equipment) to build capacity in public agencies in nearly every project since 1991. However, even among those efforts that were implemented effectively, little significant long-term impact on capacity was achieved, mainly because they were overcome by systemic weaknesses that influenced performance in the public sector. These included poor individual incentives, lack of coordination among and within ministries, inappropriate organizational structures, and the inability of the public sector to attract, motivate, and retain high-caliber people. In the face of such systemic weaknesses, the Bank's efforts served more to temporarily relieve the symptoms rather than address the real causes of the problem.[2] In

[2] A departure from this approach to capacity-building was Bank assistance to establish the Malawi Institute of Management (MIM), which embodied a longer-term approach to capacity-building in terms of both: (i) its objective, which was to build a local knowledge-building and skills imparting mechanism; and (ii) the process used to create it, which involved MIM's independence from government interference and freedom to depart from standard civil service compensation guidelines to attract good people.

the absence of advances in civil service reforms that address these systemic issues, it is unlikely that continued dependence on traditional technical assistance efforts will result in real capacity building.

1.10 *Costs resulting from the absence of a safety net strategy during major policy reforms.* Other than a pilot public works component in the MASAF project, the Bank, correctly in OED's view, did not directly finance safety net transfers, given extensive government and other donors' safety net efforts (mainly aimed at food security). With hindsight, however, there were costs associated with the lack of Bank support to develop a coherent safety net *strategy* that identified vulnerable groups and cost-effective transfer mechanisms in the context of severe budget constraints and the need to avoid disincentive effects. Lack of a safety net strategy resulted in both (i) some measures undertaken by the government being uncoordinated and conflicting with the main poverty reduction effort; and (ii) short-term costs that helped strain political commitment (as discussed below). For example, some free food and input distribution programs became politically influenced, rapidly expanded beyond the initial target groups, and some continue to date despite questionable purpose and with consequent fiscal implications. One 1992 program, originally envisioned some 188,000 beneficiary farmers, while in the event, some 800,000 farmers (or 73% of smallholder households) were provided with free fertilizer and hybrid maize seed, and the free input program continues to date in certain areas. A Bank study of the free distribution system concluded that such efforts "put great pressure on available infrastructure, entail huge financial costs, and divert scarce resources from longer-term development programs". The free fertilizer programs also encouraged a shift toward some high-yield maize varieties, which turned out to be unviable in the liberalized environment. The need for a safety net strategy to be in place has been recognized by the Bank and is being addressed through a Social Safety Net Study.

1.11 *Strained political commitment in the absence of sensitivity to adverse short-term impacts*. Given the lack of a coherent safety net strategy in place in Malawi, Bank assistance in the 1990's inadequately anticipated and dealt with the adverse short-term impacts of the reforms it supported. This resulted in (i) immediate hardships; (ii) an adverse effect on production incentives in the short-term, and (iii) strained political commitment. As an example, conditions at the time the Bank/IMF advised the government to float the exchange rate did not favor smooth transition to market-determination and a sudden nominal depreciation of 200% in 1994 (51% in real terms) caused reportedly severe hardships.[3] Following this experience, the kwacha was allowed to appreciate in real terms since 1996, adversely affecting export incentives and despite a nominal depreciation of 20% in mid-1997, is still estimated to be overvalued. In 1995 and 1996, regional trade agreements combined with overall tariff reductions to allow regional finished goods to come in at lower tariffs than intermediate goods, making even potentially efficient local-market manufacturers uncompetitive. With Bank encouragement, this distortion was addressed in the 1997 budget, which removed tariffs on inputs for local-market manufacturers. However, the intervening period impacted adversely on local industries and gave rise to vocal criticism of the reform effort. The timing of the fertilizer subsidy removal was also politically costly, raised food security concerns, and remains a politically volatile issue. Unlike the authoritarian previous regime, which tolerated little dissension, the current elected government is likely to be more sensitive to the adverse short-term implications of reforms. Future Bank support for major policy reforms will therefore require (i) more knowledge-generation ESW that identifies both short and long-term consequences of reforms; (ii) timing and sequencing that minimizes adverse short-term impacts, and (iii) ensuring the presence of strategically targeted safety net transfers, where necessary.

[3] Conditions at the time of flotation in Feb, 1994 included: the presence of only two foreign exchange dealers and three major exporters, all of which were controlled by a single firm with close political ties; a period of high public expenditures and sharp liquidity expansion; lack of coherent monetary policy due to the political uncertainty; a low level of reserves; and highly seasonal flows of foreign exchange.

1.12 *Inadequate emphasis on the poor competitive environment.* The issue of a few large corporations dominating the manufacturing and service sectors and creating a poor competitive environment has been an issue since the mid-1980's. However, given the magnitude of the problem and its wide potential detrimental effect on advancing the overall strategy, it received inadequate emphasis in the agenda of the 1990's.[4] According to the Malawi Chamber of Commerce, three firms control up to 80% of the corporate sector in "asset ownership, market shares, and revenue." Two of these (ADMARC and MDC) are public corporations and the third, Press Corporation (owned by President Banda), is managed by a trust comprising Press and government appointees. Press dominates a range of local markets and is significantly horizontally and vertically integrated, while ADMARC's dominant position in urban and town retail maize sales helps crowd out small private traders. There are reports of active efforts by large firms to discourage new entrants and an effective anti-monopoly regime to discourage unfair practices is absent. These circumstances risk inhibiting wider participation in productive activity, a seemingly essential component of dynamic and broad-based growth. It is apparent that the pre-1994 government had a "taboo" on addressing the issue and at present, there is some uncertainty as to the impact of change along with perceived political risks associated with it. However, failure to address the issue risks raising problems that will have to be dealt with in the future: (i) *if* the poor competitive environment is a critical obstacle to a broader and more diversified production structure, then the overall poverty reduction strategy will not advance; (ii) dependence on a few inward-looking firms for a substantial proportion of GDP is a high-risk position; and (iii) following on the recent East Asian experience, the interlocking ownership between the main banks and the few dominant firms raises questions as to the exposure levels of the banks and the viability of projects undertaken by the firms.

1.13 *More explicit recognition of the central role of agro-processing.* The Bank-supported strategy emphasized inducing smallholder agricultural diversification and growth as the immediate objective that would catalyze growth in the rest of the economy and generating an industrial base as the medium-term objective. However, it is apparent that greater diversification, value addition, and growth in agriculture will be driven by the presence of appropriate markets. The shift in smallholder production after liberalization from maize toward burley production was because the market for burley tobacco existed. Agro-processing that uses local agricultural produce and labor for export is a clear link between the short-term and long-term growth objectives. Examples of successful export-oriented tomato processing or cut-flowers illustrate the potential role that a thriving export-oriented agro-industrial base can have in catalyzing further diversification and growth in agriculture that supply-side efforts or the small local market are unlikely to have. The success of the smallholder-led growth strategy may thus be partly dependent, even in the near-term, on the emergence of an agro-processing base with access to world markets. The implication is that measures to induce an agro-processing base such as enticing foreign investors and increasing access to serviced industrial sites and industrial finance required equal near-term priority. In this respect the roles of IFC and MIGA in Malawi, which has been very limited in the past, warranted greater emphasis.

[4] Bank activities in this area consisted of assistance to negotiate agreement on the management of Press between the old and new governments in 1994/5 and since 1996 support for the early stages of a privatization program. The Bank is presently discussing restructuring of the large corporations with the government, including divestiture of holdings in banks and the mature holdings of ADMARC and MDC. The issue of Press expects to be addressed as the dialogue deepens.

2. Efficacy of the Bank's Assistance

Key Events Affecting Achievement of Objectives

2.1 *External shocks and major political change.* In 1992 and again in 1994, Malawi suffered two severe droughts. These droughts, along with losses of about $100 million from adverse changes in the terms of trade in 1992, are estimated to have depressed GDP in Malawi by as much as 30% of one year's GDP between 1992 and 1994. In 1992, the international community suspended all non-humanitarian aid to Malawi in an effort to pressure President Banda to address human rights issues. In 1993 a national referendum resulted in elections in May, 1994, which ended thirty years of one party rule. The incoming government asserted its commitment to sustainable poverty reduction and among its early acts was the abolishment of fees for primary education. The end of the civil war in neighboring Mozambique in 1992 resulted in the re-opening of shorter land-routes to the sea and a diminished inflow of refugees. Donor funding recommenced in the fall of 1993 was fully restored by 1995. The emergence of the widespread AIDS epidemic also appears to be placing a severe burden on the healthcare system, reducing life-expectancy ratios, taking a toll on capacity in the public and private sectors, and increasingly threatening overall development progress.

Table 2.1: Effectiveness of Macroeconomic Policies, 1990 - 1996

Indicator	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
Fiscal balance/GDP (after grants)	-4.0	-3.2	-9.7	-6.4	-13.6	-6.6	-4.8
Current account balance/GDP (aft. grants)	-3.5	-8.8	-12.1	-11.1	-9.3	-5.1	-4.0
Foreign reserves (months of imports GS)	2.6	2.3	0.7	0.9	0.7	1.9	4.1
Gross domestic savings/GDP	9.7	12.4	0.1	-4.2	-2.4	2.1	10.8
Real effective ER change (pos. = apprec.)	-0.7	3.5	-7.9	1.9	-29.1	-13.4	38.1
Total tax revenue/GDP	17.1	16.7	17.0	14.3	18.2	16.7	15.9
Consumer price inflation (change, p. av.)	11.9	12.6	22.7	19.6	34.7	83.4	36.3
M2/GDP	18.9	19.7	20.8	22.3	23.7	18.5	17.2
Credit to the government/GDP	4.6	2.9	10.7	10.5	12.0	4.8	3.3
Credit to the private sector/GDP	10.2	10.9	13.3	8.8	10.8	5.6	4.2

Achievement of Objectives

2.2 Inability to maintain macroeconomic stability in the face of major external shocks and fiscal indiscipline. Despite four sequential balance of payment loans and overall commitment by both the pre-1994 and the incumbent governments to maintain stabilization targets, a major departure from targets established in the Policy Framework Papers was witnessed between 1992 and 1995 (Table 2.1). The main reason behind this was that Bank and government efforts were overwhelmed by a series of external shocks, especially drought, but also terms of trade changes, an influx of refugees, and suspension of non-humanitarian donor aid. The experience underscored the fragility of the economy and the need for structural change: reliance on a single crop (tobacco) for 60% of exports and on rain-fed maize for over 25% of GDP is not a sustainable position. This adverse impact of external conditions was exacerbated, however, by the government's failure to rationalize public expenditures and by politically-driven fiscal and monetary indiscipline. Despite implementation of some expenditure management measures endorsed by the Bank, public expenditures remained unprioritized and over-extended. There was also a breakdown in fiscal and monetary discipline during the 1994 elections and the present fiscal crisis (which has caused the IMF to suspend the ESAF agreement), is partly attributed to upcoming elections next year. On the positive side, sound monetary management has been maintained since 1994 and reforms on the revenue side helped maintain tax revenue to GDP at a stable level. However, the inability to maintain macroeconomic stability during the mid-1990's resulted in crowding out of credit to the private sector and high inflation, both of which contributed to a very unfavorable investment environment and hampered the expected supply response.

2.3 *Significant progress in rationalizing the price environment.* Building on progress made under the Banda government in the late 1980's and early 1990's, price reforms were accelerated in the mid-1990's. The Bank played an instrumental role in moving this agenda forward and each of the price rationalization measures contained in the adjustment loans were implemented. By 1996, most price controls had been removed, import/export licenses eliminated, quantitative import restrictions replaced with tariffs, and tariff rates consolidated and reduced. Most significantly, in 1993 and 1994, prices were liberalized for all smallholder crops (except maize, which was allowed to float within a band) and during the 1995/96 growing season, the government completely removed the fertilizer subsidy. These measures resulted in smallholder diversification away from maize, mainly toward burley tobacco, but also to other food crops. In February, 1994, with Bank/IMF advice, the kwacha was floated and present central bank intervention into the market is guided by reserve targets agreed with the IMF. A range of incentives to encourage exports are in place, and Malawi's preferential access to markets in the European Union, southern African region, and the United States also support export-oriented activity. These efforts have helped Malawi develop a price environment favoring market allocation of resources, diversification in agriculture, and export-oriented production.

Table 2.2: Progress in the Banking Sector, 1990 - 1996

Indicator	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
Liquid assets/deposits (liquidity ratio)	44.5	31.8	39.4	48.8	52.7	62.3	70.6
Loans/deposits	67.6	72.0	81.8	53.0	55.2	39.0	31.2
Treasury bill holdings/deposits	3.2	2.7	7.4	16.1	14.8	34.1	41.3
Bank spread	8.9	7.5	5.5	7.8	6.0	10.1	19.0
Real deposit rate	0.2	-0.1	-6.2	2.2	-9.7	-46.1	-10.0
Credit to the private sector/GDP	10.2	10.9	13.3	8.8	10.8	5.6	4.2

Achievement of Objectives

2.4 *Inadequate progress in the financial sector due to institutional constraints*. Bank interventions helped improve supervisory capacity over the banking system and ease entry into it, which resulted in the entry of two new banks. Despite these achievements, however, there was no significant improvement in the performance of the sector. Between 1992 and 1996, the loan to deposit ratio in the banking system declined from 81% to 31%; credit to the private sector declined from 13% of GDP to 4.2%; and in 1996, there remained a 19% spread between deposit and lending rates (Table 2.2). Part of the problem was macroeconomic instability, which resulted in (a) heavy government borrowing that crowded out credit to the private sector; (b) high inflation, which discouraged long-term lending; and (c) negative real deposit rates, which suppressed domestic resource mobilization. At the same time key institutional changes in the sector were not addressed. The two main banks hold 90% of banking sector assets and they in turn, are owned by the three largest firms in the corporate sector. This concentrated and interlocking ownership in the banking and corporate sectors inhibits competition in both sectors and questions exposure levels of the banks. Meanwhile, Bank-supported rural credit-lines did not have significant long-term impact in the financial sector. While credit-lines were generally disbursed to their intended recipients, several of them became politically influenced, which affected repayment rates, or they were unable to increase the ability of the intermediaries to sustain such lending. The result has been continued lack of long-term lending, high real interest rates, and stringent borrowing requirements that serve to exclude most Malawians from access to investment capital.

2.5 *Good progress in removing regulatory obstacles.* Building on initial progress made in the late 1980's, measures in two Bank adjustment loans, along with advice during supervision missions helped consolidate and advance the process of removing regulatory obstacles to investment and production. Along with price liberalization, the removal of official quotas and restrictions on agricultural output was a critical step in enabling a shift in smallholder agricultural production. Other progress included the elimination of industrial licensing, easier business registration, and removal of restrictions on expatriate capital movements. The Malawi Investment Promotion Agency (MIPA) was established in 1992 and presently provides a one-stop service to guide potential investors through remaining obstacles. A 1996 survey revealed that private firms perceive regulatory obstacles to starting a business as a relatively lesser problem than other factors. However, continuing problems include the uncooperative attitude of the bureaucracy, cumbersome land leasing procedures, and impediments to expatriate employment, each of which are identified as negatively affecting foreign investment decisions, in particular.

2.6 *Limited effectiveness of infrastructure assistance.* Bank projects helped develop an alternate trade route through Tanzania when the Mozambican borders were closed, increase the national availability of water and expand the distribution network in Lilongwe, and commence the privatization of Malawi Railways. More recently, the MASAF experience appears to be an effective means of creating basic social and economic infrastructure in rural areas. However, the private sector continues to identify deficient transport, telecommunications, water supply, and power as major obstacles to investment and operation of businesses. Infrastructure in rural areas also continues to be deficient, helping inhibit a greater response of the rural poor to economic signals. Bank-supported measures to improve access to industrial serviced sites were not effective and lack of access to them is identified as a critical obstacle to greater direct foreign investment by MIPA. Five of the eight Bank-financed infrastructure operations effective between 1991 and 1996 had unsatisfactory outcomes or are considered to be at risk (72% of disbursements in closed projects were unsatisfactory and 89% of commitments in on-going projects are at risk). None of the closed projects were considered likely to be sustainable. While physical components tended to be completed satisfactorily, projects suffered from poor financing and cost-recovery mechanisms, inconsistent policy directions, managerial problems, procurement problems, or failed to serve their target beneficiaries (i.e. the Urban I project). Evaluations underscored the need to plan development infrastructure projects in the context of available recurrent funds and to involve the private sector and beneficiary communities in the provision and maintenance of infrastructure.

2.7 *Some impact in the social sectors.* With full government commitment to progress in the social sectors, good progress was made in increasing social expenditures and budgetary targets established as conditions in two Bank adjustment loans were exceeded. Bank projects helped expand the primary school network as well as health facilities in some rural areas and as indicated above, the MASAF experience appears to an effective means of creating basic rural social and economic infrastructure. With persistent Bank support, the post-1994 government reversed the pro-natalist stance of the Banda government and began to support family planning. Rehabilitation of boreholes in rural areas helped increase access to safe water and was found to have consequent health benefits as well as reduce the time spent collecting water (especially during droughts), freeing up time for more productive activities. A promising Bank-supported initiative was the establishment of a Poverty Monitoring Unit in the Ministry of Economic Planning, which should in due course enable better feedback from interventions to improve the quality, reach, and consumption of public social services in Malawi.

2.8 *However, extensive problems remain.* The ensuing task of translating increased public social expenditures into sustained improvements in the quality and reach of basic social service delivery has proved more difficult. Most of the increase in expenditure was absorbed by increased civil service salaries and increased employment of teachers. None of the completed Bank-financed projects were considered likely to be sustainable, due mainly to their vulnerability to proper fiscal management and the availability of institutional capacity. In the health sector, Bank projects were found to have had an impact in specific local areas but less so on the health system as a whole. The health system, meanwhile, was overwhelmed by factors such as drought, the influx of Mozambican refugees, and the widespread AIDS epidemic. Most recent estimates indicate that half the population still does not have access to basic health or safe water (Table 4). In the education sector, Malawi's experience revealed the need to focus on quality and demand for basic social services and not only on capacity expansion. Despite extensive early efforts by the Bank and other donors to physically expand the primary education network, enrollment rates increased significantly only *after* the elimination of fees in 1994. Since 1996, indications of increasing repetition and drop-out rates are likely due to declining service quality and as well as the persistence of other factors affecting demand for primary education. For example, when adjusted for teacher quality, the pupil/teacher ratio deteriorated from 71:1 in 1992 to 131:1 in 1995. Factors such as clothes to wear, mother's education level, demand for domestic and agricultural labor, and the social value placed on education have in the past suppressed the demand for primary education. Secondary school enrollment rates also remain very low (around 4%), impeding greater returns to primary education.

2.9 *Constraints on women remain a particular concern*. Although a number of Bank-supported projects in the 1990's directly or indirectly aimed at improving the status of women, a range of constraints continue to suppress women's incomes, health and educational status, and their potential response to economic signals.[5] About 30% of rural households are headed by women (including defacto heads) and these households tend to cultivate smaller farms and have lower access to productive assets, basic social services, and public extension and credit services. Bank projects helped reduce some these constraints, but the impact has so far been confined to a relatively small proportion of women. Factors impeding progress include the traditionally lower status of women, less powerful roles adopted, and indequate education levels. Poor rural infrastructure also remains a central factor behind the inadequate status of women. Lack of access to safe water, power, and rural transport force women to spend substantial amounts of time collecting and hauling water (one study indicated that some women spend 50% of their time collecting water), gathering and hauling firewood, and hauling goods to and from market places. Time studies indicate that a combination of farming, household activities, and participation in the labor force (at the same proportion as men) raise women's workdays to 12 hours compared to a 6 hour workday for men. In such a situation, little time is left to access basic social services or engage in the entrepreneurial pursuits required for a more robust supply response.

2.10 *Limited achievement in building capacity due to systemic weaknesses.* Some progress was made in building economic management capacity, particularly in terms of helping internalize a sound policy framework within the new government after 1994. Bank support also helped establish the Malawi Institute of Management (MIM), which is recognized for the quality of its services around the region. Although it is not yet financially self-sufficient, the establishment of MIM offers the opportunity to reduce external training costs and expand the opportunity for management training to more Malawians. However Malawi's "lack of institutional capacity" is consistently reported to be behind the failure of projects and considered a major obstacle to more rapid progress toward development goals. Traditional TA to government agencies in the form of training and temporary foreign consultants has been plagued by poorly performing expatriate consultants, high turnover among local counterparts, and poor

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[5] Bank-supported objectives included increasing women's access to health services, water supply, agricultural extension services, credit, and girls access to education at all levels. The FY91 sector study, *Women and Development in Malawi: Constraints and Actions* served as the basis for components in projects aimed at assisting women (e.g. the Education, PHN, ASAC, Fisheries, Agric services, Water supply and MASAF projects). The government has also recognized and addressed the need to improve conditions facing women through a range of programs. The Commission on Women in Development (WID) was established to develop a relevant policy framework and coordinate WID programs.

relationships between counterparts. As an example, a National Health Plan prepared by expatriate consultants under a Bank project was rejected by the Ministry of Health (MOH) and an alternate Plan of acceptable quality was prepared by the MOH instead. However, when staff involved in the exercise shortly left the MOH, the capacity and sense of ownership created by the experience dissipated. As discussed above, given the limited success of efforts to date, a longer-term and more relevant approach to capacity building seems necessary. Meanwhile, difficulties in securing expatriate employment visas appear to inhibit a source of knowledge transfer through the private sector.

Overall Outcome: Toward Broader and More Sustainable Growth and Poverty Reduction?

2.11 *Signs of progress in the right direction.* Since 1995, there have been some signs of a shift in production patterns, caused mainly by improvements in the price environment and removal of restrictions on production. Among smallholders, there was a shift away from maize toward burley tobacco and other food crops and greater productivity per hectare resulting from this diversification. This led to an large inflow of disposable income into rural areas, with consequent implications for off-farm activities. The shift augurs well for future food security in Malawi (with food energy production increasing from 10 million kilocalories in 1995/6 to a record 11.6 million in 1997/8) and the eventual release of resources presently required for direct food security interventions. In 1995 and 1996, manufactured exports grew by over 11 percent per year and there are examples of prospering firms in agro-processing exports as well as the demise of inefficient import substitution firms (i.e. in the textile sector). An example of a firm prospering under the current environment and the process this creates is a manufacturer of hot chili sauce, Nali Limited. The firm uses locally grown tomatoes and chilies in a labor-intensive process for export to regional countries and Europe. The high margins afforded enables the firm to overcome costs imposed by poor infrastructure and Malawi's land-locked position; the use of agricultural raw materials creates markets for non-traditional agricultural products; the firm's competitiveness in world markets offers strong growth potential; and its labor-intensive process generates urban employment opportunities.[6] These signs indicate that, although limited, the response that is taking place is in the right direction.

2.12 *However, an inadequate degree of response.* The failure to advance many of the objectives established in the assistance strategy of the 1990's resulted in an inadequate degree of supply response, which remains a key obstacle to more rapid progress in reducing poverty. The extent of smallholder diversification has not yet helped reduce the vulnerability of the economy caused by dependence on tobacco for over 60% of exports. Poor rural infrastructure and the lack of accessible markets for non-traditional agricultural produce remain among the key constraints to further diversification in agriculture. Private sector investment averaged 4% of GDP between 1992 and 1996 and direct foreign investment continues to be negligible. Factors behind the insufficient private sector response include the impact of droughts, inconsistent macroeconomic policy, the inability to induce greater efficiency in the banking sector, crowding out of private finance by heavy government borrowing, a poor competitive environment, and the adverse transitory impacts of reforms. The inability to generate supportive infrastructure - especially that targeted at industries through improved access to fully-serviced sites - is also a key factor behind the limited response and is considered a *critical* factor behind the reluctance of foreign investors to enter the country by MIPA. A clear priority for current Bank assistance is to help capitalize on the early momentum by eliminating these obstacles to further diversification in agriculture and expanded agro-processing activity in a timely manner.

6 Other examples of identified non-traditional products grown as inputs for export-processing include a range of fresh fruits and vegetables, paprika, guar bean, essential oils, and bee honey.

Table 2.3: Production Changes in Malawi, 1990-1996

Indicator	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
GDP Growth Rate	8.8	6.2	-10.0	15.2	-12.9	13.5	12.2
Private sector GDFI/GDP	8.6	8.8	6.7	2.6	1.8	3.2	6.1
Manufacturing/GDP	13.6	13.0	14.6	11.8	13.7	13.4	11.5
Merchandise exports/GDP	22.8	21.8	21.4	16.0	29.1	28.0	19.8
Growth rates (index)							
Small scale agriculture	-3.4	14.2	-37.4	84.8	-33.4	33.9	39.8
Burley production	4.6	17.2	32.3	4.0	-30.9	42.2	16.3
Total manufacturing	11.3	3.0	3.0	-10.5	3.2	6.3	-5.6
Food, beverage, and tobacco	7.4	-9.0	3.5	3.3	-6.5	4.2	1.8
Footwear, clothing, and textiles	16.4	43.9	-8.3	-21.1	-15.9	-19.5	-8.2
Manufactured exports	29.9	3.2	-7.5	-1.9	-2.6	12.2	11.9

2.13 *Continued poor living standards.* As a result of the inadequate degree of structural change, the more sustainable and distributive growth path envisioned has yet be realized and there has consequently been no visible improvements in the lives of most Malawians. GNP per capita in Malawi declined from US$230 in 1991 to US$180 in 1996 (the decline due largely to the impact of the drought). Life expectancy at birth dropped from 45 years in 1991 to 43 years in 1997 and is well below life expectancy of 47 years in Mozambique, 51 years in Tanzania, and 57 years in Zimbabwe. In 1997, Malawi's GNP per capita was the fifth lowest in the world, down from ninth lowest in 1990 and it ranked 161st out of the 175 countries in UNDP's Human Development Index.

Efficacy of the Bank's Instruments

2.14 *Lower results from investment projects, given broad underlying constraints.* Of the 16 completed operations since 1991, 69% had satisfactory outcomes, 63% were likely to be sustainable, and 26% had substantial institutional development impact (ratings by disbursed amount; Annex Table 4). The outcome ratings are somewhat below Malawi's overall portfolio performance since 1967 (78% satisfactory) and Bank-wide outcomes since 1991 (78% satisfactory), although above the performance of Africa region projects since 1991 (66% satisfactory). The 3 adjustment loans had relatively high ratings of 77% satisfactory and 100% sustainable. Investment operations saw lower results with 57% having satisfactory outcomes and only 15% likely to be sustainable. These figures are well below the performance of the adjustment loans as well as the below the performance of all investment loans to Malawi since 1967 (73% satisfactory and 32% likely) and Bank-wide averages for investment loans since 1991 (77% satisfactory and 58% likely). Among the components of the completed investment loans, none of the 5 credit lines and only 7% of TA components were considered to be fully effective (Table 2.5). At present, 6 of the 15 active investment projects are considered to be at risk or potentially at risk (58% of the committed amount). Completed investment projects achieved relatively less success and low sustainability ratings mainly because of underlying constraints such as weak administrative capacity, the weak fiscal position, or inconsistent or non-existent policy directions. The result was that while policy advice and policy lending were relatively effective, investment lending had much more limited impact on moving the assistance strategy objectives forward.

Table 2.4: Effectiveness of Instruments in 16 Completed Projects

COMPONENT	Number of occurrences	Percent fully effective	Percent partly effective	Percent not effective
Credit Line	5	0%	40%	60%
Physical Construction	10	50%	50%	0%
Technical Assistance	14	7%	64%	29%
BOP Support	3	67%	33%	0%

2.1 *Satisfactory past Bank and Borrower project performance.* Both Bank and Borrower performance in closed lending operations was satisfactory, although weaknesses were apparent in Bank appraisals of agriculture and infrastructure operations and Borrower implementation of infrastructure projects. Bank performance averaged 82% satisfactory in project identification, and 78% satisfactory in project supervision, but only 62% satisfactory in appraisal. The lower appraisal ratings reflected (i) the neglect of the policy environment and real needs of beneficiaries in appraising pre-1994 agriculture operations; and (ii) overly optimistic assessments of fiscal and institutional constraints in designing infrastructure operations. Borrower performance ratings were higher than Bank-wide norms, with 83% of projects having satisfactory Borrower preparation, 75% satisfactory implementation, and 72% satisfactory compliance. The weakest area of past Borrower performance was in implementing infrastructure projects in the pre-1994 period. Ex-post evaluations considered none of the five projects in the sector to have been implemented satisfactorily, mainly because of weak commitment illustrated through lack of counterpart funds, inconsistent policy directions, and the failure to appoint key project management staff in a timely manner.

2.2 *Economic and sector work.* Several economic and sector reports that were produced between 1992 and 1996 were estimated to have had a significant impact on policy directions in Malawi, including the Agricultural Sector Memorandum and the Environmental Policy Study. However, there appears to have been a knowledge gap in certain areas (that seems to persist) that diminished both the relevance and effectiveness of Bank assistance. In particular, there was inadequate knowledge on (i) what the critical constraints to advancing the broad-based growth and poverty reduction strategy were; and (ii) what both the short and long-term impacts of major reforms were likely to be. As a result, Bank lending was spread rather thinly across and within sectors, activities were occasionally irrelevant (especially pre-1994), and a series of adverse short-term impacts caused widespread public criticism of the reform effort that helped strain government commitment to the remaining reform agenda. In addition, while the Bank's ESW on Malawi was much appreciated by Bank users, other donors, and individuals in the government, it was designed mainly to support the lending program and had limited dissemination and direct impact on advancing strategic goals in Malawi. Individuals in the private sector, NGOs, and parts of the government complain that although they are often interviewed by Bank teams preparing reports, they rarely see the end products.

2.3 *Policy advice and donor coordination.* The Bank's role as a policy advisor was strong throughout the 1990's and close cooperation with the post-1994 government did much to help set the policy agenda during the transition period as well as help internalize sound economic policies among key government leaders. However, among the private sector, press, and general public there seems fairly widespread skepticism of the "intentions" of the Bank in Malawi. The Bank is suspected of dictating terms to the government and not acting in the best interest of Malawians. There is a clear need for wider dissemination of the Bank's objectives, strategies, and limitations to stakeholders in the country, which would also help in consensus-building on the pace and direction of reforms. Among the donors, the IMF and the Bank worked closely in developing the macroeconomic agenda, while most of the other key donors deferred to the Bank's lead in helping the government establish a relevant policy agenda. The most strained Bank relationship in the past was probably with the European Economic Commission, where the two donors disagreed on some aspects of agricultural policy and in designing social sector interventions. Weekly meetings of the heads of missions organized by UNDP helped rationalize some activities of the major donors. However, the extent of large and small donors in the country along with limited government capacity and the lack of clear policies in some sectors inhibited better monitoring, specialization, and coordination of donor activities. IFC and MIGA's roles have been lower than would be desired in a country where the price environment has been largely rationalized and among the main tasks is to enhance direct foreign investment.

2.4 *Debt position.* The government's commitment to reducing its external debt burden has been strong and resulted in favorable debt management results in recent years. Although Malawi is a severely indebted poor country, its debt has been confined largely to multilateral creditors on highly concessional terms and assuming favorable external conditions, it is projected to manage its debt burden without external assistance.[7] At the end of 1996, the net present value of Malawi's debt stock was 294% of exports and this was reduced to 271% by end 1997. Projections that assume export growth of 7.4%, bring the ratio down to below 200% in 2002, which makes Malawi ineligible for HIPC status. The debt service to exports ratio ranged between 18% and 25% between 1991 and 1996 and in 1997 was 14.7%, below the 20% point which is considered unsustainable. Given Malawi's likely ineligibility for debt relief under the HIPC initiative, there is acknowledgment among staff in the Bank, IMF, and government that to some extent, Malawi is being penalized for its good performance in debt management in the past.

Efficiency of the Bank's Assistance

2.5 *Efficiency.* Efficiency indicators of Bank activities in Malawi since 1991 do not reveal any major deviations from Bank standards. Between FY91 and FY96, the average completion cost per project in Malawi was 2.5 staff years, slightly higher than the Bank-wide average of 2.4 staff years and the Africa Region average of 2.2 years. The average cost in staff weeks per formal ESW report was 40 staff weeks, which was below the Africa Region average of 52.7 staff weeks and the Bank-wide average of 62.6 staff weeks per formal ESW report. The total dollar cost of Bank activities in Malawi between FY95 and FY97 (including actual supervision costs) was 6% above the budget norm for Malawi for the period (scaled back from the FY97 norm established by DEC). This compares favorably with results in several neighboring countries: Kenya's actual outlays over the norm was 19%; Zambia's was 19%; and Tanzania's was 11%.

[7] Between 1991 and 1996, debt to multilateral creditors ranged between 73% and 80% of total debt stocks (EDT), with the Bank's share ranging from 53% to 58%. Restrained non-concessional borrowing in recent years raised the proportion of concessional debt outstanding from 74% of the total in 1991 to 93% in 1996. Although, in 1996, several public corporations were unable to meet their debt service obligations due to cash flow problems, their relative share of total debt is small. In 1996, 93% of total external debt outstanding was held by the central government, 6% by the central bank and 1% by statutory corporations.

3. Conclusions and Implications for Bank Operations

Conclusion

3.1 *Trying to do the right things, but with limited results.* The major objectives and interventions supported by the Bank since 1991 were appropriate to Malawi's circumstances and consistent with the Bank's recommended poverty reduction strategy. Smallholder production shifts and micro-level success stories in manufactured exports are signs of the relevant supply response that is a central part of the strategy. However, failure to advance many key strategic objectives limited the structural response and resulted in minimal visible improvement in the lives of most Malawians. To a significant extent, this was due to adverse external shocks that consumed substantial resources and set back the reform agenda. However, the pre-1994 government showed poor commitment to structural reforms and while the present government showed much stronger commitment, it procrastinated in implementing some reforms. Weak fiscal management, in particular, had a wide negative impact on advancing the strategy. On the part of the Bank, failure to confront some underlying factors such as systemic weaknesses in the civil service, institutional constraints in the financial and corporate sectors, or the poor policy environment before 1994 undermined the effectiveness of its assistance. Limited attention to the short-term impacts of reforms in the mid-1990's contributed to hesitancy in implementing some remaining reforms. In retrospect, the Bank had the most impact through policy advice, adjustment lending, and ESW. Investment operations had less impact on advancing key strategic objectives because of fiscal limitations, strained capacity, and undeveloped policy frameworks. Experience suggests that another round of external shocks, a continued suppressed supply response, or the protracted absence of visible improvements in the lives of Malawians can strain the resources and political commitment needed to advance the strategy, underscoring the need to accelerate real progress toward strategic goals.

3.2 *Current CAS.* Many lessons of the Bank's experience in Malawi since 1991 are reflected in the current draft CAS. The CAS proposes to help develop strategies across a broad range of sectors and restrict lending in sectors where finance is not the key constraint at present or supported by other donors. The approach reflects past Bank success with policy advice and ESW; the fact that the path toward achieving sustainable poverty reduction in Malawi requires progress across a broad front; the Bank's particular responsibilities in Malawi as the dominant external donor and an influential policy advisor; and the persistence of broad constraints that undermine the effectiveness of investment lending. Among the priority issues identified, are the need to accelerate real structural change, address the interlocking ownership problem, develop a safety net strategy, improve quality in education, and stimulate growth in the non-farm sector. More attention might be paid to addressing systemic weaknesses in the civil service that have broad implications for advancing the poverty reduction strategy (as does fiscal management, which *is* identified as a priority) and to developing a more focused infrastructure development strategy. A clearer strategy to address problems in the corporate and financial sectors and to stimulate agro-industry - including an enhanced role for MIGA and IFC - is also warranted. The political difficulty of remaining reforms (partly driven by uncertainty as to the immediate impact of some of them) should also be fully reflected in the CAS. An increase in knowledge-generating ESW in the upcoming CAS period should help: (i) isolate key constraints to an increased supply response and identify solutions to address them; (ii) elucidate short and long-term costs and benefits of reforms to reduce the political risk involved; (iii) help ensure that reforms are timed and sequenced adequately; and (iv) help identify vulnerable groups and ensure that appropriate safety net mechanisms are in place, when necessary. The FY97 Growth Options Study is a sound move in this direction, although this can be built on by closer assessments of the lower-level objectives being pursued (e.g. options in the financial sector, land reform, competitive environment).

Implications for Bank Operations

- *Recognition of short-term government concerns in the assistance strategy.* Unlike the authoritarian previous regime, which tolerated little dissension, the current elected government is likely to be more sensitive to the adverse short-term implications of reforms. Effective Bank support for major policy reforms will require: (i) focused knowledge-generation ESW that identifies both short and long-term consequences of reforms; (ii) timing and sequencing that minimizes adverse short-term impacts, and (iii) ensuring the presence of (strategically) targeted safety net transfers, when necessary.

- *The poor record in capacity building implies the need for a reassessment of strategies and instruments.* Traditional TA operations to help build capacity had limited long-term impact because of systemic weaknesses that influence performance in the public sector, such as poor individual incentives, lack of coordination among and within ministries, inappropriate organizational structures, and the inability of the public sector to attract, motivate, and retain high-caliber people. Advancement of civil service reforms that address these systemic issues is required if real capacity building is to be achieved.

- *Limited results in infrastructure development suggest the need for more strategically focused Bank assistance.* Limited success of Bank infrastructure development assistance supports a case for focusing Bank assistance on strategic infrastructure targets. Rural infrastructure development and the establishment of a policy and administrative environment that enables potential investors to access serviced industrial land emerge as candidates for intensified assistance to most immediately support a production response.

- *Expenditure rationalization remains a central concern.* Although consistently addressed by the Bank since 1991, persistence of weak fiscal management had a wide detrimental effect, including crowding out credit to the private sector, reducing the long-term impact of investments in infrastructure and the social sectors, and impeding investment in a range of priority activities. As recognized by the Bank, with limited scope for increasing revenues, intensified efforts to identify and eliminate non-priority expenditures and formulate a coherent expenditure policy are essential.

- *More effective investment lending will depend on advances in fiscal management, real progress in capacity building, and clear government policy directions.* Lower results of Bank investment operations in advancing strategic goals reflected the persistence of underlying constraints such as the unavailability of recurrent funds, erratic government commitment or government interference, and weak administrative capacity. The implication is that more effective investment lending will require improved fiscal management, real progress in capacity building, and well-established policy directions in each sector.

- *The impact of the poor competitive environment in deterring broad-based investment remains a key concern.* Although an issue since the mid-1980's, the problem of a poor competitive environment arising from a few firms dominating the domestic market has not yet been resolved. While the solution is likely to be difficult, failure to address the issue risks yielding further difficulties and inhibit the desired investment response. An effective anti-monopoly regime is not present.

- *Renewed strategy in the financial sector*. Bank support in the financial sector did not yield the desired results and finance costs remain high, long-term finance is negligible, and formal credit for small farmers and businesses remains scarce. A key unresolved issue is the interlocking ownership between the main banks and corporations, which discourages competition in both the banking sector and industry.

- *Supporting supply-oriented direct public assistance activities must be well-grounded.* In agriculture, extensive efforts at providing extension and agricultural inputs to increase productivity and diversification before 1994 saw limited results and only after production and marketing restrictions were removed were significant production shifts observed. Further efforts at direct intervention into production decisions must be well-grounded in a thorough assessment of the wider environment, identification of key real constraints, and elucidation of market failures being compensated for.

- *More overt recognition of the pivotal role of an export-oriented agro-processing base in the smallholder-led strategy.* The shift in smallholder production after liberalization from maize toward burley production was because the market for burley tobacco existed. Further diversification and growth in smallholder production is likely to also depend on the presence of appropriate markets for non-traditional produce. Micro-level stories suggest that one source of these markets is an agro-processing base with access to world markets. The implication is that measures to induce an agro-processing base such as enticing foreign investors and increasing access to fully-serviced industrial sites and investment finance require equal near-term priority. The role of IFC and MIGA in advancing this objective, which has been very limited in the past, should be enhanced.

- *An emphasis on service quality as well as on factors affecting demand for basic social services is necessary to ensure sustained improvement in coverage.* In Malawi's experience, increased expenditure on primary education supported a rapid increase in enrollments after elimination of fees, but at the cost of supporting quality improvements. Declining quality along with other factors affecting the demand for primary education appear to be causing some of these initial gains to erode. Relevant monitorable intermediate indicators in social sector interventions are also essential to enable proper assessment of the progress being achieved.

Annexes

Annex A: Bank Assistance and Choice of Instruments, 1991-1996

Macroeconomic stability.

To help maintain macroeconomic stability, the Bank provided conditional balance of payments support through four adjustment loans and technical assistance to strengthen tax and customs administration, expand the tax base, strengthen the central bank's monetary management and supervisory capacity over the banking sector, introduce cash budgeting, reducing the size of the civil service, and preparing a Medium Term Expenditure Framework in pilot ministries. Stabilization objectives were also embedded in all policy discussions with the government and targets established in bi-annual Policy Framework Papers. In addition, in 1992, when all bilateral donors suspended non-humanitarian aid, the Bank was the only donor to maintain balance of payments support. The FY92 EDDRP loan and a supplement in FY94 financed imports of maize to alleviate the adverse impact of successive droughts on the macroeconomic position.

Stimulation of Market-Driven Private Sector Activity

To generate a private supply response, Bank assistance aimed to (i) rationalize the price incentive environment to support market allocation of resources through adjustment conditionality intended to further reduce the tariff regime, eliminate the fertilizer subsidy, ensure the presence of appropriate export incentives, ensure a competitive exchange rate, promote market-based interest rates, and liberalize price and marketing restrictions in agriculture; (ii) remove regulatory obstacles through conditionality in two adjustment loans aimed at reducing restrictions on investment, easing the investment approval process, eliminating licensing, and streamlining land-leasing procedures; (iii) increase efficiency and reach in the financial sector through agreements under the adjustment loans supporting prudent banking supervision standards and easier entry into the banking system as well as through five completed and two on-going credit-line operations with components to strengthen the financial intermediaries involved; (iv) strengthen public technical assistance through five investment operations aimed at agricultural extension and provision of inputs and support for strengthening public agencies providing TA to SMIs; (v) improve infrastructure through eight investment operations in the transport, power, and water supply sectors (valued at US$274 million) as well as two other operations supporting the establishment of fully-serviced industrial sites to relieve the infrastructure constraint on investment; and (vi) privatize public corporations through the FY96 FRDP, which supported the early stages of a privatization program.

Increased Investment in Human Capital

To promote greater investment in human capital, Bank assistance aimed to (i) re-orient public expenditure toward the social sectors through conditions in two adjustment loans; and (ii) improve the provision of basic social services through five investment loans. An effort to build the capacity to monitor poverty reduction was also supported. The investment loans supported capacity expansion in the provision of primary education and basic health services. Expansion in water supply coverage was supported through infrastructure operations. The FY96 MASAF program introduced community-based construction of basic social and economic infrastructure in rural areas. ESW on the social sectors included the FY91 study on Women and Development, the FY92 Population Sector Study, and the FY96 Human Resources and Poverty Profile.

Enhanced Institutional Capacity

Since 1991, 28 of the 31 Bank projects contained technical assistance components to help build institutional capacity. The two institutional development projects aimed to set up the Malawi Institute of Management and strengthen capacity in the Ministry of Finance. The FRDP supported a civil service reform effort, initially focused on reducing the size of the civil service and in the medium-term in increasing the efficiency and effectiveness of public service delivery. The FY92 Local Government Development project aimed to enhance financial and administrative capacity in the local government system. The bulk of Bank assistance for institutional development aimed at strengthening project-related Ministries and agencies to build capacity in the target sectors.

Annex B: Annex Tables

Annex Table 1: Comparative GNP Per Capita Growth

Percentage change	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*Average*
Madagascar	-8.7%	9.5%	4.3%	-4.2%	0.0%	4.3%	0.9%
Mozambique	0.0%	-11.1%	12.5%	0.0%	-11.1%	12.5%	0.5%
Malawi	**15.0%**	**-8.7%**	**14.3%**	**-29.2%**	**0.0%**	**5.9%**	**-0.4%**
Zambia	-11.1%	-5.0%	2.6%	-2.6%	5.3%	7.5%	-0.5%
Uganda	-25.7%	-23.1%	-5.0%	0.0%	26.3%	20.8%	-1.1%
Kenya	-7.9%	-2.9%	-20.6%	0.0%	3.7%	17.9%	-1.6%
Zimbabwe	-4.2%	-16.2%	-5.3%	0.0%	0.0%	14.8%	-1.8%
Tanzania	6.7%	-6.3%	-6.7%	-7.1%	0.0%	0.0%	-2.2%
SUB-SAHARAN AFRICA	-4.0%	3.2%	-3.5%	-3.4%	0.5%	2.6%	-0.8%
excluding South Africa	-8.5%	0.8%	-8.2%	-8.8%	-0.3%	6.1%	-3.2%
excl. S.Africa & Nigeria	-10.0%	0.1%	-7.6%	-9.0%	0.7%	5.4%	-3.4%
ALL AFRICA	-4.9%	2.6%	-3.7%	-1.3%	0.9%	4.2%	-0.3%

Annex Table 2: Access to Basic Social Service Delivery

(Percent of households)	*1992*	*1995*
Access to safe drinking water (1 km): National	47	48.4
Access to adequate sanitation (within 50 meters incl. pit latrines)	72	72
Access to primary school (5 km)	NA	96.2
Net enrollment rate (6-13 yrs)	60	83.1
Repetition rate (Grade 1)	NA	47.3
Pupils/teacher (quality adjusted)	78	131
Pupils/classroom	116	130
Access to health facility (5km)	NA	42.9

Annex Table 3: Sector Breakdown of Lending Assistance, 1991-1997

	Projects approved before 1991 (incl. 1991)			Projects approved after 1991			All projects effective between 1991 and 1997		
Sector	*Number of projects*	*Committed amount $m*	*Share of total*	*Number of projects*	*Committed amount $m*	*Share of total*	*Number of projects*	*Committed amount $m*	*Share of total*
Agriculture	5	130	30%	4	87	12%	9	217	19%
Education	2	64	15%	1	23	3%	3	86	7%
Electric Pwr & Engy.	1	47	11%	1	55	8%	2	102	9%
Finance	-	-	-	1	32	4%	1	32	3%
Industry	1	87	20%	-	-	-	1	87	8%
Multisector	-	-	-	2	277	38%	2	277	24%
Popultn, Hlth & Nutn	1	11	3%	1	56	8%	2	67	6%
Public Sector Mgmt.	1	11	3%	1	23	3%	2	34	3%
SOC PROTECTION, etc.	-	-	-	1	56	8%	1	56	5%
Transportation	2	42	10%	1	16	2%	3	58	5%
Urban Development	1	15	4%	1	24	3%	2	39	3%
Water Supply & Santn	1	20	5%	1	79	11%	2	99	9%
Grand Total	15	427	100%	15	727	100%	30	1,154	100%

Note: Amounts are commitments and do not reflect cancellations in completed projects Annex Table 4.

Annex Table 4: Ratings of completed projects

	Number of projects	*Value 1996 $m*	*Satisfactory Outcome*	*Likely Sustainability*	*Substantial ID*
Projects completed in Malawi since 1991 *of which:*	16	649	69%	63%	26%
Adjustment loans	3	371	77%	100%	27%
Non-adjustment loans	13	278	57%	15%	25%
All completed projects in Malawi (since 1967) *of which:*	54	1684	78%	52%	24%
Adjustment loans	7	632	87%	77%	21%
Non-adjustment loans	47	1052	73%	32%	26%
Africa Region projects completed since 1991 *of which:*	402	15,730	66%	35%	24%
Adjustment loans	72	6,872	70%	47%	25%
Non-adjustment loans	330	8,858	62%	23%	23%
Bankwide projects completed since 1991 *of which:*	1,228	101,451	78%	60%	38%
Adjustment loans	181	29,707	80%	64%	41%
Non-adjustment loans	1,047	71,744	77%	58%	36%

Note: Ratings by disbursed amount

Annex Table 5. Formal Economic and Sector Work on Malawi, 1991-1996

Report date	Title	Report number	Report Type	Sector
8/01/1991	Women and development in Malawi: constraints and actions	8612	SR	Social
2/19/92	Malawi - Financial policies for sustainable growth	9009	SR	Financial
3/1/92	Malawi - Economic report on environmental policy	9888	ER	Environment
5/29/92	Malawi - Population sector study	8513	SR	Social
8/1/92	Malawi - Transport sector review: selected issues	9908	SR	Transport
3/1/93	Malawi - Public sector management review: selected issues	9643	SR	Public sector management
12/29/93	Towards a national environmental action plan for Malawi: emerging issues	12678	SR	Environment
6/8/94	Malawi - Rural financial markets: strategic options for economic development	11773	ER	Financial
12/6/94	Malawi - Civil service pay and employment study	13071	SR	Public sector management
3/8/95	Malawi - Agricultural sector memorandum: strategy options in the 1990's	12805	SR	Agriculture
3/19/96	Malawi - Country assistance strategy	15494	CAS	All
3/19/96	Malawi - Human resources and poverty: profile and priorities for action	15437	SR	Social

Annex Table 6: Cost of Formal Economic and Sector Reports (SWs per Report)

	FY91	*FY92*	*FY93*	*FY94*	*FY95*	*FY96*	*Average FY91-FY96*
IBRD/IDA	56.5	52.3	61.6	75.3	66.7	63.3	62.6
Africa Region	46.3	42.1	50.6	57.2	56.1	63.7	52.7
Ghana	54.7	49.7	82.1	12.7	141.9	---	68.2
Kenya	41	73.7	88.4	210.5	---	---	103.4
Malawi	55.3	65.9	55.7	2.8	52.3	8.2	40.0
Tanzania	64.3	93.7	---	75.2	93.9	77.1	80.8
Uganda	83.9	71.8	55.4	44	48.5	7.5	51.9
Zambia	41.1	85.2	24.3	31.4	48.2	110.3	56.8

Annex Table 7. Average Completion Cost Per Project (SYs)

	FY91	*FY92*	*FY93*	*FY94*	*FY95*	*FY96*	*Average FY91-FY96*
IBRD/IDA	2.5	2.3	2.2	2.5	2.3	2.3	2.4
Africa Region	2.5	2.1	1.9	1.9	2.4	2.5	2.2
Kenya	3.5	2.5	1.3	3.3	1.6	2.8	2.5
Malawi	2.3	2.6	3.4	2.1	2.1	2.1	2.4
Tanzania	2.3	2.3	1.9	1.4	1.4	3.4	2.1
Uganda	2.4	1.9	2.3	2.8	1.6	2.3	2.2
Zambia	2.2	1.6	1.9	1.2	3.4	1.9	2.0

Note: Costs include pre-appraisal to board approval and do not include supervision costs and project review costs. (PBD)

Annex Table 8. List of Projects Effective between 1991 and 1996

L/C	*FY*	*Proj. Name*	*Sector*	*Lending Type*	*Com mit. Loan $m*	*Utilized*	*Effectiveness*	*Status*	*Latest DO Rating*	*Latest IP Rating*	*Outcome*	*SUST*	*ID*
C1528	1985	URBAN I	Urban Development	INV	15.0	72%	1985-1993	Completed			Satisfactory	Uncertain	Modest
C1549	1985	AGRI RES.	Agriculture	INV	23.8	99%	1985-1993	Completed			Satisfactory	Uncertain	Modest
C1626	1986	EXT. PLANNING	Agriculture	INV	11.6	96%	1986-1993	Completed			Unsatisfactory	Uncertain	Modest
L2646	1986	IND. & AGRIC. CR.	Agriculture	INV	7.8	77%	1986-1993	Completed			Satisfactory	Likely	Modest
C1742	1987	LILONGWE WATER (WTR II)	Water Supply & Santn	INV	20.0	99%	1987-1993	Completed			Satisfactory	Uncertain	Substantial
C1768	1987	SECOND FAMILY HEALTH	Popultn, Hlth & Nutn	INV	11.0	100%	1987-1993	Completed			Satisfactory	Uncertain	Negligible
C1767	1987	EDUCATION SECTOR CRE	Education	INV	27.0	98%	1987-1994	Completed			Satisfactory	Uncertain	Modest
C1920	1988	IND/TRADE ADJUSTMENT	Industry	ADJ	87.1	100%	1988-1991	Completed			Satisfactory	Likely	Substantial
C1879	1988	TRANSPORT I	Transportation	INV	13.4	94%	1988-1994	Completed			Unsatisfactory	Uncertain	Modest
C1851	1988	AGRICULTURE CREDIT	Agriculture	INV	5.9	100%	1988-1995	Completed			Unsatisfactory	Unlikely	Negligible
C1966	1989	AGRI.MARKETING & EST	Agriculture	INV	18.3	100%	1989-1996	Completed			Satisfactory	Likely	Modest
C2121	1990	AGRIC SECTOR	Agriculture	ADJ	70.0	100%	1990-1992	Completed			Unsatisfactory	Likely	Modest
C2069	1990	INFRASTRUCTURE I	Transportation	INV	28.8	100%	1990-1995	Completed			Unsatisfactory	Uncertain	Substantial
C1990	1989	ENERGY I	Electric Pwr & Engy.	INV	46.7	100%	1990-1996	Completed			Unsatisfactory	Unlikely	Modest
C2036	1989	INSTIT.DEV.	Public Sector Mgmt.	INV	11.3	99%	1990-1996	Completed			Satisfactory	Likely	Substantial
C2083	1990	EDUC.SEC.II	Education	INV	36.9		1990-	Active	S	S			
C2220	1991	PHN SECTOR CREDIT	Popultn, Hlth & Nutn	INV	55.5		1991-	Active	S	S	(AT RISK)		
C2221	1991	FINANCIAL & ENTERPRI	Finance	INV	32		1991-	Active	S	S			
C2225	1991	FISHERIES DEV.	Agriculture	INV	8.8		1991-	Active	S	S			
C2379	1992	LOCAL GOVT.	Urban Development	INV	24		1992-	Active	S	S	(AT RISK)		
C2396	1992	ENTREPRENEUR DEV & D	Multisector	ADJ	174.9	100%	1992-1996	Completed			Satisfactory	Likely	Modest
C2386	1992	POWER V	Electric Pwr & Engy.	INV	55		1993-	Active	U	S	(AT RISK)		
C2513	1993	Rural Finl Svcs	Agriculture	INV	25		1994-	Active	S	S	(AT RISK)		
C2514	1993	AGRIC SERVICES	Agriculture	INV	45.8		1994-	Active	S	S	(AT RISK)		
C2624	1994	INSTIT.DEV.II	Public Sector Mgmt.	INV	22.6		1994-	Active	S	S			
C2696	1995	MALAWI RAILWAYS REST	Transportation	INV	16.2		1995-	Active	S	S			
C2753	1995	NAT WATER DEV	Water Supply & Santn	INV	79.2		1996-	Active	U	U	(AT RISK)		
C2810	1996	PRIMARY EDUCATION EM	Education	INV	22.5		1996-	Active	S	S			
C2853	1996	FISCAL RESTR&DERE	Multisector	ADJ	102		1996-	Active	S	S			
C2856	1996	SOCIAL ACTION FUND	SOC PROTECTION, etc.	INV	56		1996-	Active	HS	S			

Annex Table 9. Performance Ratings of Projects Completed since 1991

	No of projects	Disbursed Amount (1996$m)	Share of total net loan value	Percent SAT (by no.)	**Percent SAT (by Amount)**	Percent Sust.	Percent Sub ID	Percent Sat. Bank identif.	Percent Sat. Bank appraisal	Percent Sat. Bank supervision	Percent w/Sat. Borrower preparation	Percent Sat. Borrower implem.	Percent Sat. Borrower compliance
Ratings of Completed Projects, by Sector													
Agriculture	6	165	25%	50%	**37%**	68%	0%	49%	21%	41%	41%	87%	68%
Education	1	32	5%	100%	**100%**	0%	0%	100%	100%	100%	100%	100%	0%
Electric Power & Other Energy	1	53	8%	0%	**0%**	0%	0%	100%	0%	100%	100%	0%	0%
Industry	1	102	16%	100%	**100%**	100%	100%	100%	100%	100%	100%	100%	100%
Multisector	1	186	29%	100%	**100%**	100%	0%	100%	100%	100%	100%	100%	100%
Population, Health & Nutrition	1	13	2%	100%	**100%**	0%	0%	100%	100%	100%	100%	100%	0%
Public Sector Management	1	13	2%	100%	**100%**	100%	100%	100%	100%	100%	100%	100%	100%
Transportation	2	47	7%	0%	**0%**	0%	69%	31%	0%	31%	100%	0%	69%
Urban Development	1	15	2%	100%	**100%**	0%	0%	100%	0%	0%	0%	0%	0%
Water Supply & Sanitation	1	24	4%	100%	**100%**	0%	100%	100%	100%	100%	100%	0%	100%
Total	16	649	100%	63%	**69%**	63%	26%	82%	62%	78%	83%	75%	72%
Ratings of Completed Projects, by Objective													
Broad policy reforms	3	371	57%	67%	**77%**	100%	27%	77%	77%	77%	77%	100%	100%
Direct public support for productive activity	2	46	7%	50%	**69%**	0%	0%	100%	0%	69%	69%	69%	0%
Economic management capacity	1	13	2%	100%	**100%**	100%	100%	100%	100%	100%	100%	100%	100%
Financial intermediation	3	35	5%	67%	**81%**	81%	0%	100%	100%	100%	100%	81%	81%
Provision of basic social services	2	45	7%	100%	**100%**	0%	0%	100%	100%	100%	100%	100%	0%
Provision of economic infrastructure and services	5	139	21%	40%	**28%**	0%	40%	77%	17%	66%	89%	0%	40%
Total	16	649	100%	63%	**69%**	63%	26%	82%	62%	78%	83%	75%	72%

Annex Table 10. QAG Ratings for On-Going Projects

Project Name	*At Risk*	*Board Date*	*Closing Date*	*IP*	*DO*	*IPPblmSince*	*DOPblm Since*	*Effctv Delays*	*Compl Covnts*	*Mgmt Perfm*	*Count Funds*	*Proc Prog*	*Fin Perfm*	*Env Reset*	*Slow Disb*	*Ext Consec Prob*	*Risky Cntry*	*Risky Substr*
AGRIC SERVICES	**POTENTIAL**	6/15/93	9/30/99	S	S			0	0	1	0	0	0	0	1	0	1	0
EDUC.SEC.II	NONRISKY	12/21/89	6/30/98	S	S			0	0	0	0	0	0	0	0	0	1	0
ENV. MANAGEMENT	NONRISKY	6/20/97	12/31/02	S	S			0	0	0	0	0	0	0	0	0	1	0
FINANCIAL & ENTERPRI	NONRISKY	3/26/91	6/30/98	S	S			0	0	1	0	0	0	0	0	0	1	0
FISCAL RESTR&DERE	NONRISKY	4/30/96	3/16/99	S	S			0	0	0	0	0	0	0	1	0	1	0
FISHERIES DEV.	NONRISKY	4/2/91	6/30/99	S	S			0	0	0	0	0	0	0	1	0	1	0
INSTIT.DEV.II	NONRISKY	6/9/94	6/30/00	S	S			0	0	0	0	0	0	0	1	0	1	0
LOCAL GOVT.	**ACTUAL**	6/4/92	12/31/99	S	U		3/9/98	0	0	0	0	0	1	0	1	0	1	1
MALAWI RAILWAYS REST	NONRISKY	3/28/95	12/31/98	S	S			0	0	0	0	1	0	0	0	0	1	0
NAT WATER DEV	**ACTUAL**	6/28/95	6/30/03	U	U	11/7/96	6/17/97	1	0	1	1	1	0	0	0	0	1	1
PHN SECTOR CREDIT	**POTENTIAL**	3/26/91	6/30/99	S	S			0	0	0	0	0	0	0	1	1	1	0
POWER V	**ACTUAL**	6/17/92	6/30/98	U	U	10/30/97	7/3/96	0	1	0	1	0	1	0	1	1	1	1
PRIMARY EDUCATION EM	NONRISKY	1/25/96	6/30/99	S	S			0	0	0	0	0	0	0	0	0	1	0
Rural Finl Svcs	**POTENTIAL**	6/15/93	12/31/98	S	S			0	0	0	0	0	0	0	1	1	1	1
SECONDARY ED PROJECT	NONRISKY	3/24/98	6/30/03					0	0	0	0	0	0	0	0	0	1	0
SOCIAL ACTION FUND	NONRISKY	5/9/96	12/31/01	S	HS			0	0	0	0	0	0	0	0	0	1	0

Note: Ratings as of April 30, 1998