Document of
The World Bank

Report No.: 37810

PROJECT PERFORMANCE ASSESSMENT REPORT

MALAWI

FIRST FISCAL RESTRUCTURING AND DEREGULATION PROGRAM (CREDIT 28530-MAI)

SECOND FISCAL RESTRUCTURING AND DEREGULATION PROGRAM (CREDIT 31460-MAI)

THIRD FISCAL RESTRUCTURING AND DEREGULATION PROGRAM (CREDIT 34520-MAI)

SECOND FISCAL RESTRUCTURING AND DEREGULATION PROGRAM-TA (CREDIT 31470-MAI)

THIRD FISCAL RESTRUCTURING AND DEREGULATION PROGRAM-TA (CREDIT 34510-MAI)

November 6, 2006

Country Evaluation and Regional Relations

IEG WORLD BANK
INDEPENDENT EVALUATION GROUP

Currency Equivalents (annual averages)

Currency Unit = Kwacha (MWK)

1996	US$1.00 = 15.31	2001	US$1.00 = 72.20
1997	US$1.00 = 16.44	2002	US$1.00 = 76.69
1998	US$1.00 = 31.07	2003	US$1.00 = 97.43
1999	US$1.00 = 44.09	2004	US$1.00 = 108.90
2000	US$1.00 = 59.54		

Abbreviations and Acronyms

ADMARC	Agricultural Development and Marketing Corporation
CBM	Commercial Bank of Malawi
CIDA	Canadian International Development Agency
DCA	Development Credit Agreement
DSP	Divestiture Sequence Plan
ESAF	Enhanced Structural Adjustment Facility
ESCOM	Electricity Supply Corporation of Malawi
FIMTAP	Financial Management, Transparency and Accountability Project
FRDP	Fiscal Restructuring and Deregulation Program
FY	fiscal year
GDP	gross domestic product
GOM	Government of Malawi
HIPC	heavily-indebted poor countries
ICR	implementation completion report
IDA	International Development Association
IDI	institutional development impact
IEG	Independent Evaluation Group
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
MACRA	Malawi Communication Regulatory Authority
MK	Malawi Kwacha
MOF	Ministry of Finance
MRA	Malawi Revenue Authority
MTEF	Medium Term Expenditure Framework
MTL	Malawi Telecommunications Limited
NFRA	National Food Reserve Agency
NSNS	National Safety Net Strategy
OECF	Overseas Economic Cooperation Fund
ORT	other recurrent transactions
ORTEX	oil importation company
PC	Privatization Commission
PE	public enterprises
PERMU	Parastatal Enterprise Reform and Monitoring Unit
PPAR	Project Performance Assessment Report
PRGF	Poverty Reduction and Growth Facility
PSD	private sector development
SDR	special drawing rights
SMP	staff monitored program
TA	technical assistance
TEP	Temporary Employment Permit
VAT	value added tax

Fiscal Year

Government: July 1 – June 30

Director-General, Evaluation	:	Mr. Vinod Thomas
Director, Independent Evaluation Group (World Bank)	:	Mr. Ajay Chhibber
Interim Manager, IEGCR	:	Ms. Lily L. Chu
Task Manager, IEGCR	:	Mr. Ismail Arslan

IEGWB Mission: Enhancing development effectiveness through excellence and independence in evaluation.

About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEG annually assesses about 25 percent of the Bank's lending operations. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons. The projects, topics, and analytical approaches selected for assessment support larger evaluation studies.

A Project Performance Assessment Report (PPAR) is based on a review of the Implementation Completion Report (a self-evaluation by the responsible Bank department) and fieldwork conducted by IEG. To prepare PPARs, IEG staff examine project files and other documents, interview operational staff, and in most cases visit the borrowing country for onsite discussions with project staff and beneficiaries. The PPAR thereby seeks to validate and augment the information provided in the ICR, as well as examine issues of special interest to broader IEG studies.

Each PPAR is subject to a peer review process and IEG management approval. Once cleared internally, the PPAR is reviewed by the responsible Bank department and amended as necessary. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the IEG Rating System

The time-tested evaluation methods used by IEG are suited to the broad range of the World Bank's work. The methods offer both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. IEG evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (more information is available on the IEG website: http://worldbank.org/IEG/eta-mainpage.html).

Relevance of Objectives: The extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). *Possible ratings:* High, Substantial, Modest, Negligible.

Efficacy: The extent to which the project's objectives were achieved, or expected to be achieved, taking into account their relative importance. *Possible ratings:* High, Substantial, Modest, Negligible.

Efficiency: The extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. *Possible ratings:* High, Substantial, Modest, Negligible. This rating is not generally applied to adjustment operations.

Sustainability: The resilience to risk of net benefits flows over time. *Possible ratings:* Highly Likely, Likely, Unlikely, Highly Unlikely, Not Evaluable.

Institutional Development Impact: The extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional Development Impact includes both intended and unintended effects of a project. *Possible ratings:* High, Substantial, Modest, Negligible.

Outcome: The extent to which the project's major relevant objectives were achieved, or are expected to be achieved, efficiently. *Possible ratings:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry and supported implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of the project). *Possible ratings:* Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower assumed ownership and responsibility to ensure quality of preparation and implementation, and complied with covenants and agreements, towards the achievement of development objectives and sustainability. Possible ratings: Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Contents

Principal Ratings .... **v**

Key Staff Responsible .... **vii**

Preface .... **ix**

Summary .... **xi**

Findings xiv

1. Country Context **1**

Macroeconomic Environment 2
Bank Program 6
Main Themes of the PPAR 6
Summary of Progress Across the Five Credits 8

2. Fiscal Restructuring and Deregulation Program I (FRDP I) **23**

Objectives and Design 23
Implementation Experience 23
Ratings 27

3. Fiscal Restructuring and Deregulation Program II (FRDP II) **29**

Objectives and Design 29
Implementation Experience 30
Ratings 32

4. Fiscal Restructuring and Deregulation Program III (FRDP III) **35**

Objectives and Design 35
Implementation Experience 36
Ratings 41

5. Fiscal Restructuring and Deregulation Program II TA (FRDP II TA) **45**

Objectives and Design 45
Implementation Experience 45
Ratings 46

6. Fiscal Restructuring and Deregulation Program III TA (FRDP III TA) **49**

Objectives and Design 49
Implementation Experience 49
Ratings 50

7. Findings and Lessons **53**

Findings......53
Lessons......54

Annex A: Public Expenditure Management/ Rationalization 55

Annex B: Privatization, Public Sector Management, and Utilities Reform 57

Annex C: Public Expenditure in the Social Sectors......61

Annex D: Tariff and Tax Policy Reform 63

Annex E: Agricultural Sector 65

Annex F: Financial Sector......67

Annex G: Reform Areas Addressed by the Five Projects Included in the PPAR.....69

Annex H: Basic Data Sheet 73

Annex I: List of People Met 83

Annex J: Comments from Co-financiers......87

Boxes

Box 2.1: Medium Term Expenditure Framework (MTEF) 24
Box 4.1: Integrated Financial Management Information System (IFMIS)......37
Box 4.2: The CIDA Textbook Project......39

Tables

Table 1.1: Key Macroeconomic Data 3
Table 1.2: Difference between Actual and Approved Expenditures 4
Table 1.3: Bank Strategy, 1996-2003 6
Table 1.4: Malawi Governance Research Indicators, 1996-2004...... 9
Table 1.5: Education and Health Expenditures as a Percent of GDP 12
Table 1.6: Sources of Revenue as a Percent of GDP...... 14
Table 1.7: Agriculture Sector Performance Indicators 17
Table 1.8: Maize Productivity, 1996-2004 17
Table 2.1: Selected Macroeconomic Variables, 1995-1999 24
Table 2.2: Health and Education Expenditures as a Percent of GDP, 1996/97-2004/05. 25
Table 3.1: Selected Macroeconomic Variables, 1996-2001 30
Table 4.1: Selected Macroeconomic Variables, 2000-2004 36

Figures

Figure 1.1: Real Treasury Bill Rates, 1996-2003 4
Figure 1.2: Private Investment as a Percent of GDP 4
Figure 1.3: Five Projects Included in the PPAR...... 6
Figure 1.4: Health Expenditures as a Percent of GDP...... 12
Figure 1.5: Education Expenditures as a Percent of GDP 12
Figure 1.6: Revenue as a Percent of GDP...... 14
Figure 4.1: Inflation Rate, 1994-2000...... 36
Figure 4.2: Fiscal Deficit, 1994-2000...... 36

Principal Ratings

	Africa Region	*IEG*	
	ICR*	***ES****	***PPAR***
First Fiscal Restructuring and Deregulation Program (Cr. 28530)			
Outcome	Satisfactory	Moderately Satisfactory	Unsatisfactory
Sustainability	Highly likely	Likely	Likely
Institutional Development Impact	High	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Unsatisfactory
Second Fiscal Restructuring and Deregulation Program (Cr. 31460)			
Outcome	Satisfactory	Moderately Satisfactory	Unsatisfactory
Sustainability	Likely	Likely	Likely
Institutional Development Impact	Not rated	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Unsatisfactory
Borrower Performance	Satisfactory	Satisfactory	Unsatisfactory
Third Fiscal Restructuring and Deregulation Program (Cr. 34520)			
Outcome	Unsatisfactory	Unsatisfactory	Highly Unsatisfactory
Sustainability	Unlikely	Unlikely	Unlikely
Institutional Development Impact	Modest	Modest	Negligible
Bank Performance	Satisfactory	Unsatisfactory	Highly Unsatisfactory
Borrower Performance	Unsatisfactory	Unsatisfactory	Highly Unsatisfactory
Second Fiscal Restructuring and Deregulation Program-TA (Cr. 31470)			
Outcome	Satisfactory	Satisfactory	Moderately Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Development Impact	Not rated	Substantial	Modest
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory
Third Fiscal Restructuring and Deregulation Program-TA (Cr. 34510)			
Outcome	Unsatisfactory	Unsatisfactory	Unsatisfactory
Sustainability	Likely	Likely	Unevaluable
Institutional Development Impact	Modest	Modest	Modest
Bank Performance	Unsatisfactory	Unsatisfactory	Unsatisfactory
Borrower Performance	Unsatisfactory	Unsatisfactory	Satisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible operational division of the Bank.
The Evaluation Summary (ES) is an intermediate IEG product that seeks to independently verify the findings of the ICR.

Key Staff Responsible

Project	*Task Manager/Leader*	*Sector Manager/ Sector Director*	*Country Director*
First Fiscal Restructuring and Deregulation Program (Cr. 28530)			
Appraisal	Hartwig Schafer	Ataman Aksoy	Barbara Kafka
Completion	Sudhir Chitale	Phillipe Le Houerou	Darius Mans
Second Fiscal Restructuring and Deregulation Program (Cr. 31460)			
Appraisal	Ahmad Ahsan	Ataman Aksoy	Barbara Kafka
Completion	Sudhir Chitale	Phillipe Le Houerou	Darius Mans
Third Fiscal Restructuring and Deregulation Program (Cr. 34520)			
Appraisal	Sudhir Chitale	Phillipe Le Houerou	Darius Mans
Completion	Antonio Nucifora	Phillipe Le Houerou	Hartwig Schafer
Second Fiscal Restructuring and Deregulation Program-TA (Cr. 34510)			
Appraisal	Ahmad Ahsan	Ataman Aksoy	Barbara Kafka
Completion	Sudhir Chitale	Phillipe Le Houerou	Darius Mans
Third Fiscal Restructuring and Deregulation Program-TA (Cr. 34510-M)			
Appraisal	Sudhir Chitale	Phillipe Le Houerou	Darius Mans
Completion	Yongmei Zhou	Helga Muller	Hartwig Schafer

Preface

This Project Performance Assessment Report (PPAR) covers the following operations:

Fiscal Restructuring and Deregulation Program (FRDP I, Credit 28530, P001648) for US$169.80 million equivalent, was approved on April 30, 1996. A first tranche of US$74.4 million equivalent was released upon effectiveness on May 24, 1996 and a second tranche of US$28.6 million equivalent was released on August 29, 1997, nine months later than envisioned. The project was co-financed by the Government of Germany with a grant of US$7.0 million equivalent, parallel financing was provided by the Government of Denmark with a grant of US$10.8 million equivalent and the Overseas Economic Cooperation Fund (OECF) (now Japan Bank of International Cooperation (JBIC) with a loan of US$50 million equivalent. Three supplemental IDA reflows amounting to US$10.2 million equivalent were also provided. The project closed in March 15, 2001, three years behind the original closing date (most of this delay was to complete technical assistance (TA) furnished under the project).

Second Fiscal Restructuring and Deregulation Program (FRDP II, Credit 31460, P045030) of US$176 million equivalent, was approved on December 3, 1998. A first tranche of US$60 million equivalent was released on December 07, 1998 and a second tranche of US$30 million equivalent was released on December 15, 1999, after a delay of 8 months. The project closed on June 30, 2001, one year later than planned.

Third Fiscal Restructuring and Deregulation Program (FRDP III, Credit 34520, P050294) for US$55.6 million equivalent, approved on December 21, 2000. Though originally planned as a US$80 million two-tranche operation, the project was later modified to include only one tranche (the original first tranche was increased from US$35 million to US$55.6 million) which was released on January 23, 2001. FRDP III closed on schedule on June 30, 2002.

FRDP II TA (Credit 31470, P056376) for US$2 million equivalent was approved on December 3, 1998 was completely disbursed, and closed on time, on June 30, 2001.

FRDP III TA (Credit 34510, P073832), for SDR 2.4 million (US$3 million equivalent) approved on December 21, 2000 had three components. The first one lagged 18 months behind the envisioned schedule. The actual total disbursement was US$2.2 million by the time the project was closed on June 30, 2004, seventeen months later than originally planned.

The PPAR is based on relevant Bank and Fund documents and on interviews with Bank and Fund staff. An Independent Evaluation Group (IEG) mission visited Malawi in July/August 2005 to discuss performance with federal and provincial officials who implemented the projects, representative of donors, and members of the Bank resident mission. Their cooperation and assistance in preparing the report is gratefully acknowledged.

Comments from the Bank's Regional Management have been incorporated into the report. Following standard IEG procedures, a copy of the draft report was sent to the Government of Malawi for their review and comments. No comments were received. Copies of the draft report were also sent to the co-financiers (Government of Germany, Government of Denmark, and Overseas Economic Cooperation Fund (OECF) (now Japan Bank of International Cooperation (JBIC) that co-financed the Fiscal Restructuring and Deregulation operation. Their comments have been incorporated to the final report. Comments from the Governments of Denmark and Germany are attached in Annex J.

This report was prepared by Mr. Elliott Hurwitz (Consultant), who assessed these projects in July/August 2005, under the supervision of Mr. Ismail Arslan (Task Manager). Ms. H. Joan Mongal and Ms. Agnes Santos provided administrative support.

Summary

1. This is a Project Performance Assessment Report (PPAR) on three International Development Association (IDA) adjustment credits and two complementary technical assistance credits to Malawi, and was prepared in support of the Malawi Country Assistance Evaluation (CAE). The Fiscal Restructuring and Deregulation Program (FRDP I) of US$169.80 million equivalent was approved in April 1996. The Second Fiscal Restructuring and Deregulation Program (FRDP II) of US$176 million equivalent was approved in December 1998 and the Third Fiscal Restructuring and Deregulation Program (FRDP III) of US$55.6 million equivalent was approved in December 2000. The FRDP II Technical Assistance project, of US$2 million equivalent, was approved in December 1998, and the FRDP III Technical Assistance project of US$3 million equivalent was approved in December 2000.

2. The FRDP I objectives were: (1) to assist with fiscal restructuring and public sector management, while protecting allocations to the social sectors; and (2) deregulate sectors of the economy, including smallholder agriculture, by removing market constraints and enhancing private sector development (including privatization). FRDP II and FRDP II TA continued along the same lines—improving public sector management and promoting private sector development. FRDP II continued the work of FRDP I in rationalizing government and civil service functions, promoting tax policy and civil service reform, and utility policy reform. FRDP III and FRDP III TA broadly continued the program by endeavoring to: (1) improve public sector management, and (2) promote private sector development; adding a third objective to create a safety net. The adjustment operations also required that the macroeconomic policy framework be consistent with the objectives of the program.

3. *The key objective of strengthening budgetary management and expenditure control was not met*. Institutions and practices intended to rationalize expenditures and foster stronger financial management—Medium Term Expenditure Framework, Integrated Financial Management Information System (IFMIS), Ministry of Finance project database, special review committees were ineffective, as were efforts to enhance budgetary transparency. In retrospect, these reforms were unsuccessful in large measure because of a lack of incentives: Government of Malawi (GOM) officials—at all levels—did not perceive an interest in implementing these reforms.

4. Privatization and deregulation of key sectors of the economy achieved some successes, *but ultimately had little effect on output or productivity due to remaining oligopolistic market structures and government involvement.* In the agricultural sector, some progress was achieved in deregulating markets and sale or liquidation of parastatal assets but these had little effect on production. From 1996 to 2004 ("the PPAR period"), agricultural productivity fell by 22 percent for maize and 54 percent for tobacco (the country's two most important crops). Malawi's agricultural productivity also lagged behind regional comparators. *Private sector growth was significantly hindered by macroeconomic turbulence.*

5. Privatization was successful in terms of the number of firms sold; however, many large enterprises remain in the public sector. Other private sector development

measures—intended to make Malawi more "investor friendly" and reduce transport costs—were implemented, but ultimately had little impact on investment. Domestic private investment fell over the PPAR period from 3.2 percent of gross domestic product (GDP) to 1.0 percent, and foreign direct investment (FDI) remained at a low level in absolute terms and was 2.4 percent of GDP in 2004. Reform progress was satisfactory in telecoms, but there was little advancement in the power sector.

6. The FRDP moved to increase allocation of funds to the social sectors, with positive results. During the PPAR period, spending on education (as a percent of GDP) rose modestly and that on health rose substantially. Achievement of other reforms in these sectors was mixed. Substantial progress was made under the FRDP in tariff and tax reform, and revenue as a percent of GDP rose. Extensive efforts were undertaken under FRDP II and FRDP III to reform the civil service, with modest success. However, Government attention to civil service reform continued after the FRDP III closure, and greater transparency in pay structure and a pay increase were implemented.

7. The FRDP contribution to financial sector restructuring was successful, as a mainly government-controlled banking sector was transformed by sale of the two largest banks to private interests; however, the government still wields considerable influence. Bank regulation and supervision are sound, and from available data the sector appears healthy. Despite this progress, interest rate spreads have not declined, and bank credit to the private sector remains low (5 percent of GDP in 2003), in large measure due to high real interest rates caused by large government demand for credit to finance its budget deficit. *Consequently, progress in the financial sector has contributed little to growth.*

8. Macroeconomic performance during the PPAR period was unsatisfactory, in part because of high and growing spending in excess of approved budgets. The effects of an unfavorable policy climate were compounded by droughts, floods, and other natural events, with negative impact on overall growth: from 1994 to 1998 real GDP growth averaged 4.2 percent, but from 1999-2003 growth dropped to 1.3 percent. Inflation was high and variable, averaging 26.2 percent (1996-2004) but reaching 37.6 percent in 1996 and 44.8 percent in 1999. Actual government spending consistently exceeded approved spending throughout the period—by increasing margins after 1999. To finance its deficit, the government sold substantial quantities of notes at high real interest rates; domestic debt rose from 3 percent of GDP in 1999 to 20 percent at end-2003, posing a substantial threat to economic stability. Many businesses found it more attractive to invest in notes than in their core businesses, and private investment fell during the PPAR period.

9. How could adjustment operations be initiated in such an environment? The FRDP I and II credits were approved during brief windows when the macroeconomic situation was temporarily stabilized, providing the Bank with a thin rationale to act. With FRDP III, pressure from the donor community to provide debt relief under the heavily-indebted poor country (HIPC) initiative helped push the Bank to lend, even though macroeconomic policies were clearly off-track. In retrospect, the unsatisfactory macroeconomic environment from 1998 to 2004 was such that policy-based lending should not have been considered.

10. Outcomes of FRDP I and FRDP II are rated unsatisfactory compared to implementation completion report (ICR) ratings of satisfactory and IEG ICR Review ratings of moderately satisfactory. Relevance of FRDP II was modest, as the Bank seemed not to have taken into account the implementation experience of the first credit and because project design was overly complex for a borrower at Malawi's stage of development. A key problem for both FRDP I and II was the unwillingness of authorities to undertake meaningful reform in key sectors—especially strengthening budgetary management—and the steadily deteriorating macroeconomic environment. Outcome of FRDP III was highly unsatisfactory. The credit was modestly relevant, and achieved little progress in expenditure management. IFMIS, in particular, detracted from the Bank's reputation, as considerable effort on the part of the Bank and the Government, and expenditure of US$2.3 million, produced virtually no results. Progress in other areas, in particular the sale of the Commercial Bank of Malawi (CBM) and an oil importation company (ORTEX), did not offset deficiencies.

11. Sustainability of FRDP I and FRDP II is rated likely. Sustainability of FRDP III is rated unlikely by both the PPAR and the ICR. Many of the modest benefits achieved in FRDP I and FRDP II are embedded in legislation, for example, tax policy reform, or gains in private sector development, where newly-private firms form an interest group that would strongly resist re-nationalization. However, the benefits achieved in FRDP III—especially in the accounting, audit, and procurement areas—while promising, are dependent on the continued pro-reform stance of the authorities. Institutional development impact of FRDP I and FRDP II is rated modest, and that of FRDP III as negligible.

12. Borrower performance for FRDP I and II is rated unsatisfactory, as the political and/or institutional impetus to accomplish the stated reforms was lacking. Borrower performance for FRDP III is rated highly unsatisfactory, as reform commitment continued to be lacking, and the macroeconomic climate became worse than during the earlier credits. Bank performance is rated satisfactory for FRDP I. Bank performance is rated unsatisfactory for FRDP II because the Bank pursued a nearly identical reform path when the experience had been poor in FRDP I—especially considering the lack of expenditure discipline and poor macroeconomic situation in 1997. Bank performance for FRDP III is rated highly unsatisfactory, considering the deficient quality at entry. The credit was initiated after a further period of poor reform and macroeconomic performance, the project was prepared hastily to facilitate Bank confirmation of HIPC eligibility, the credit delivered too few reforms for the size of the resource package, and its design as a one-tranche operation was ill-advised since follow-up to ensure reform implementation was difficult for the last operation in a series. The decision of the Bank to proceed with FRDP III and the size of the credit were heavily influenced by the desire of Bank management to help Malawi qualify for HIPC (although the Bank's room for maneuver was limited once the Fund had decided to proceed).

13. The main findings and lessons from these credits are:

Findings

- **The Bank was unrealistic in its assessment of GOM commitment:** The Bank was overly optimistic, with the degree of excessive optimism increasing from FRDP I through FRDP III. Government performance did not fully meet credit conditionality.

- **The FRDP projects were overly broad in scope:** The complexity of the FRDP credits severely taxed the country's limited capacity. Some issues, for example, agriculture, privatization, could have used more focused individual interventions.

- **Adjustment lending did not prove effective in improving the growth of agricultural output:** During the PPAR period agricultural output grew very slowly, did not become more diversified, and productivity fell, particularly after 2000.

- **The Bank did not provide valid advice on food security in 2000-2002:** The Bank and other donors endorsed a study recommending a 60,000 ton strategic reserve, based on "early warning indicators" that were to have provided six to nine months warning of shortages. But these indicators were flawed, and unfortunately these shortcomings, combined with government negligence, contributed to the severity of the famine

- **While the FRDP structural goals in the financial sector were largely realized, resulting benefits have been disappointing:** The banking sector has been largely privatized, and an adequate regulatory regime has been created. However, efficiency gains have not yet been achieved, and the sector contributes little to growth.

- **The HIPC eligibility requires that a country "have a track record of macroeconomic stability",** which Malawi clearly did not have when FRDP III was being prepared**.** In its eagerness to facilitate Malawi's HIPC eligibility, the Bank provided false comfort to the creditor community. Although it had limited room for maneuver once the Fund proceeded with HIPC, the Bank in effect confirmed Malawi's satisfactory track record and capacity to use assistance prudently, when in fact this had not been the case under FRDP I and II.

Lessons

- **Incentives within the Bank can motivate unwise lending:** The desire to transfer resources and establish HIPC eligibility were important motivations to the initiation of FRDP III, to its size, and to its inappropriate design as a one-tranche credit.

- **The region's macroeconomic assessments need to have greater realism and consistency:** Analyses of the macroeconomic environment in the FRDP II and III project documents are unbalanced and lack realism and consistency. *Existence of a Fund program should not be a sufficient condition for the Bank to initiate adjustment lending.*

- **Policy-based lending in an unstable macroeconomic environment is unwise:** The turbulent macroeconomic performance from 1994 to 1998 should have alerted the Bank that further adjustment lending after FRDP I: (1) was not warranted; and (2) was unlikely to have a significant impact.

- **In promoting reform, the Bank needs to take account of the incentives that a program creates:** MTEF, IFMIS, and civil service reform were unsuccessful in large measure because GOM officials—at all levels—did not perceive that it was in their interest to implement these reforms.

- **The Bank should structure lending to Malawi with more earmarked, targeted aid, and tighter fiduciary controls:** To assure that funds are used in the manner intended, budgetary support should be subject to tighter fiduciary controls, and greater use should be made of earmarked assistance.

Vinod Thomas
Director-General
Evaluation

1. Country Context

1.1 Malawi is one of the world's poorest countries, with a per capita GDP of US$160 in 2004, a level that has essentially stagnated for a decade. Around 86 percent of Malawi's 11.2 million people live in rural areas, and agriculture is the main source of income for 80 percent of the population. Poverty in Malawi is widespread and severe; although data are poor, it is estimated that nearly 60 percent of Malawians live in poverty.[1] Additionally, in part as a legacy of the country's first 30 years of independence (1964-94) under a single party regime, the country's income distribution is extremely unequal, with a Gini ratio of 0.62.

1.2 Malawi's poor have larger households than the non-poor, and one-third of all poor households are headed by women. These households are more vulnerable because they have fewer adult workers, and women are less likely to find gainful employment than men. Finally, as of 2004 the AIDS pandemic had created around 500,000 orphans and foster children, who place heavy demands on poor households.

1.3 Malawi's human development indicators are poor compared to the rest of Africa. In 2004, an estimated 14 percent of people in the 15-49 age group were infected with HIV/AIDS, and life expectancy that year was just 38, having fallen in recent years mainly as a result of the AIDS pandemic. Infant mortality, maternal and child mortality, and stunting are also very high. Of the 174 countries in the 2004 United Nations Development Programme (UNDP) Human Development Index, Malawi ranked 165th. In addition, the country's limited human resources have been substantially eroded by the HIV/AIDS pandemic.

1.4 The country is divided into southern, central, and northern administrative regions, and 28 local administrative districts, with the southern region most densely populated and urbanized. Population growth of 2.1 percent (1997-03) places pressure on limited natural resources, notably agricultural land and Lake Malawi. Malawi's landlocked position, together with high transport costs and poor infrastructure both inside the country and in adjacent countries combine to place significant constraints on exports.

1.5 Malawi is highly vulnerable to climatic variability, particularly periodic droughts. There were three droughts during the period—1994, 2001-02, and 2004-05. During 2002, the country experienced a severe famine, and it was estimated that hundreds of people died. The situation was exacerbated by the country's sale of much of its grain reserve in 2001 after a bumper harvest in 2000.[2]

1.6 Malawi is extremely aid-dependent, with foreign assistance averaging US$435 million per year from 1994 to 2004, equivalent to 27 percent of GDP and over 40 percent of the government budget during that period. Donors dissatisfaction with government's overall reform progress has led, on occasion, to aid suspensions, such as when the European Union, two Nordic countries and the United Kingdom suspended budgetary support from late 2002 until early 2004. Denmark and the Netherlands

[1] According to the 1997/98 household survey.

[2] The Bank responded with the Emergency Drought Recovery Project, approved in November 2002.

subsequently terminated their programs in Malawi. However, these suspensions were partially offset by increased donations by other organizations, or by humanitarian assistance in response to emergency situations, and consequently the overall level of foreign assistance has been quite stable, averaging US$443 million from 1996 to 2003.[3] The 2001-2003 suspension of support was instrumental in the government's action in 2003 to pass a number of important laws laying a foundation for future progress in public expenditure management.[4]

1.7 Prior to 1994, Malawi's economy, especially the smallholder agricultural sector, was very highly regulated. The domestic market for manufacturing was small, and public investment developed a few large conglomerates—for example, the Malawi Development Corporation (MDC), Agricultural Development and Marketing Corporation (ADMARC), and the Press Corporation. These three firms historically dominated a wide range of businesses including agro-processing, consumer goods, banking, insurance, and other financial services.[5] In most other manufacturing subsectors, a few large firms dominated production.

1.8 In 1994 a new democratically-elected government came to power with the election of President Muluzi.[6] Its early policy actions displayed more concern to the needs of the poor. The reform strategy of the new administration was based on:

- Smallholder agriculture as the central element
- Reliance on the private sector and competitive markets
- Macroeconomic stability
- Reorientation of expenditure policy toward social services

1.9 In early 1995, prior to the inception of FRDP I, smallholder tobacco quotas and smallholder marketing restrictions were *de facto* lifted, resulting in income gains to participating farmers estimated at US$185 million (1995-97). Attempting to build on this achievement, FRDP I sought to improve land use efficiency, liberalize quotas and other market impediments, and improve input availability (see annex table E).

Macroeconomic Environment

1.10 Malawi's growth was slow in the 1980s, averaging around 1.4 percent per year. Economic performance improved in the early 1990s, and income grew rapidly in 1995-96 following the country's first multi-party elections (1994) and the liberalization of agricultural production and marketing and international trade introduced by the new government. But the average annual GDP growth per capita since 1996 has been just 0.7 percent. In addition, Malawi has experienced macroeconomic instability caused by

---

[3] Total foreign assistance ranged from a low of US$368 million (1997) to US$506 million (1996) during that interval.

[4] See chapter 6. These included the Public Finance Act, Public Audit Act, and Public Procurement Act.

[5] In 2001, these three firms accounted for around 26 percent of GDP. World Bank. 2004. *Malawi Country Economic Memorandum: Policies for Accelerating Growth*, p. 59.

[6] President Muluzi ruled the country throughout the period of the FRDP, until the election of President Mutharika in 2004.

large fiscal deficits leading to high inflation, as well as substantial volatility in the nominal value of the Malawian currency, and a long-term decline in its value (see table 1.1).

1.11 Macroeconomic performance during the PPAR period was unsatisfactory, in part because of high levels of spending in excess of approved budgets. Growth during the 1990s fluctuated sharply, and has worsened in recent years. From 1994 to 1998 real GDP growth averaged 4.2 percent, but from 1999-2003 growth dropped to 1.3 percent. Often affected by droughts, floods, and other natural events, the variation in annual growth was substantial: -10.2 percent in 1994, 16.7 percent in 1995, -4.2 percent in 2001, 3.9 percent in 2003, and 4.6 percent in 2004. Inflation was also high and variable over this period, averaging 26.2 percent (1996-2004) but reaching peaks of 37.6 percent in 1996 and 44.8 percent in 1999. As described below, actual spending exceeded approved spending by an increasing margin after 1999. To finance its deficit, the government sold substantial quantities of notes to the Reserve Bank of Malawi (RBM) and to commercial banks at high real interest rates, and domestic debt rose from 3 percent of GDP in 1999 to 20 percent at end-2003. This steep increase in domestic debt and interest payments—until conditions improved in late 2004—posed a substantial threat to economic stability. Many businesses found it more attractive and less risky to invest in these notes than to invest in their core businesses, and consequently private direct investment fell during the PPAR period, declining from 3.2 percent of GDP in 1996 to 1.0 percent of GDP in 2004.[7] Macroeconomic volatility posed substantial risks for Malawian businessmen and farmers, and depressed economic growth.

Table 1.1: Key Macroeconomic Data
(all data in percent unless otherwise noted)

	1994	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*
GNP/P (Atlas) $	136	156	164	166	168	170	169	157	158	162	160
Population (million)	9.1	9.2	9.4	9.7	9.9	10.1	10.3	10.5	10.7	11.0	11.2
Real GDP growth rate	-10.2	16.7	7.3	3.8	3.3	4.0	1.1	-4.2	1.8	3.9	4.6
Domestic saving/GDP	-3.0	-0.3	3.1	-0.7	7.5	-0.2	-2.8	-10.3	-5.7	-5.1	-3.6
Domestic Inv./GDP	29.1	17.4	12.3	11.6	13.5	14.7	13.6	13.9	10.4	11.2	11.1
Dom. Pvt. Inv/GDP	11.6	5.2	3.2	2.6	2.3	2.4	2.3	2.4	1.8	0.6	1.0
Foreign Dir. Inv/GDP	0.0	0.0	1.3	0.9	1.9	2.2	1.5	1.6	2.0	2.5	2.4
Agric. Prod/GDP	22.3	26.9	31.4	30.3	32.2	34.4	35.7	35.3	35.3	36.3	36.4
Mfg. Production/GDP	15.5	14.0	13.0	12.6	12.3	12.2	11.6	10.5	10.2	9.8	9.9
Exports GNFS, curr. $m.	350	424	521	569	574	493	446	481	471	439	532
Exports GNFS/GDP	29.6	29.7	21.4	22.5	32.4	27.5	26.2	28.5	25.1	27.9	24.3
Imports GNFS/GDP	61.7	47.0	29.9	35.3	38.4	42.5	38.5	39.8	43.2	41.2	44.6
Curr. Acct.Bal/GDP	-15.3	-1.4	-7.1	-11.9	-0.2	-8.2	-5.3	-6.8	-11.2	-7.6	-8.0
Exch. Rate (MK/$)	8.7	15.3	15.3	16.4	31.1	44.1	59.5	72.2	76.7	97.4	108.9
Real eff. exch. rate: index	115	100	138	153	112	112	113	116	115	90	84
Fiscal Revenue/GDP	16.1	17.9	15.5	14.8	18.1	17.2	18.4	17.2	20.7	23.5	23.6
Total G/GDP	44.2	31.8	22.7	23.8	29.1	29.6	32.8	31.9	39.7	43.3	42.9
Fiscal Bal.w/o grants/GDP	-28.1	-13.9	-7.2	-9.0	-11.0	-12.4	-14.4	-14.7	-19.0	-19.8	-19.3
Fiscal Bal. w/grants/GDP	-17.1	-5.8	-2.8	-5.6	-5.1	-5.6	-5.8	-7.9	-12.1	-7.3	-4.1
Av. Inflation rate (CPI)	34.7	83.3	37.6	9.2	29.8	44.8	29.5	22.7	14.8	9.6	11.5
Av. Treasury Bill Rate	27.7	46.3	30.8	18.3	33.0	42.9	39.5	42.4	41.8	39.3	28.6
Net ODA (current $)	471	435	492	344	435	447	446	404	377	518	477

Source: Government of Malawi, IMF, World Bank Development Data Platform.

[7] Domestic private investment as a percent of GDP; see table 1.1

1.12 A significant factor in Malawi's poor macroeconomic conditions was the consistent overshooting of expenditures above what had been budgeted. As shown in table 1.2, the deviation of actual expenditures compared to what had been approved in the budget averaged around 2.7 percent of GDP from 1994 to 2000, after which it increased dramatically.

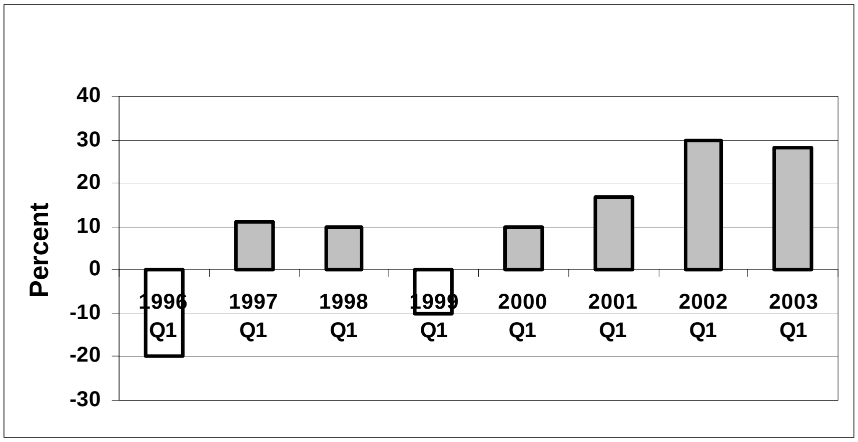
Table 1.2: Difference between Actual and Approved Expenditures
(Percent of GDP), 1994-2004

1994/95	*1995/96*	*1996/97*	*1997/98*	*1998/99*	*1999/00*	*2000/01*	*2001/02*	*2002/03*	*2003/04*
7.8	2.2	-0.8	2.2	2	3.1	2.3	5.6	8.3	14.8

Source: Durevall and Erlandsson, "Public Finance Management in Malawi," (Sida Economic Report), 2005, p. 9.

1.13 **Real Treasury Bill Rates and Private Investment:** Treasury Bills were the main source of domestic financing for Malawi's deficits, and figure 1.1 below shows real Treasury Bill rates over the FRDP period. The rising real rates after 1999 reflect the increasing deficit, and the volatility of the rates reflects the instability of the inflation rate.

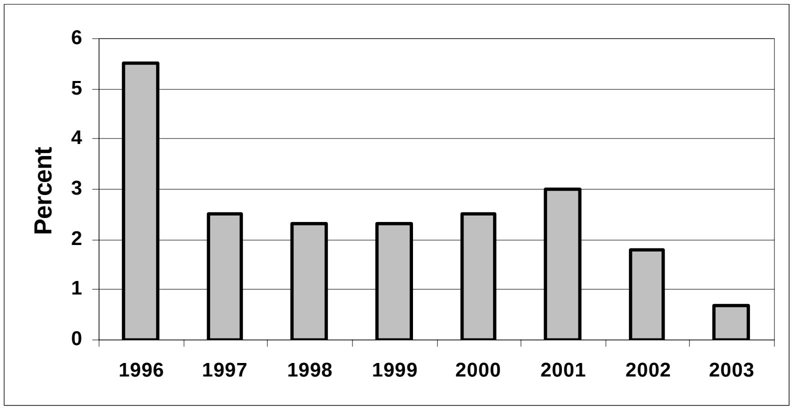
Figure 1.1: Real Treasury Bill Rates, 1996-2003



Source: Durevall and Erlandsson. "Public Finance Management Reform in Malawi." (Sida Economic Report), 2005, p. 10.

1.14 Private investment as a percent of GDP is shown in figure 1.2, and it can be seen that it declines from 5.5 percent in 1996 to under 1 percent in 2003. This reflects the well-known phenomenon of high real interest rates on government paper "crowding out" private investment, as investors and businessmen concentrate on the relatively greater returns and lower risk of investing in government paper.

Figure 1.2: Private Investment as a Percent of GDP



Source: Durevall and Erlandsson. "Public Finance Management Reform in Malawi." (Sida Economic Report), 2005, p. 11.

1.15 It is clear that the macroeconomic environment from 1996-2004 was unsatisfactory and was a significant obstacle to achievement of the objectives of the FRDP credits.

1.16 **Adjustment Lending in a Difficult Macroeconomic Environment**: As noted above, Malawi experienced a turbulent macroeconomic environment from 1996-2004. Real growth was much lower in the latter part of this period than in the former, and the fiscal balance deteriorated significantly—with an unsustainable build-up of domestic debt—until 2004. How were these three adjustment loans approved during this time? The FRDP I and II credits were approved during brief windows when the macroeconomic situation was temporarily stabilized, providing the Bank with a thin rationale to act. With FRDP III, pressures to provide HIPC debt relief impelled the Bank to lend, even though macroeconomic policies were clearly off-track. The unsatisfactory macroeconomic environment from 1996 to 2004 was such that policy-based lending should not have been considered.

1.17 In October 1995, the International Monetary Fund Enhanced Structural Adjustment Facility (IMF ESAF) program for SDR 45.8 million was approved by the Fund Board. It was intended to be a three-year program with annual tranches of approximately SDR 15.3 million. The first year's tranche was fully disbursed by end-1996. FRDP I went to the Bank's Board in March 1996, when Malawi's macroeconomic performance was undergoing rapid, but short-lived, improvement.

1.18 The second annual drawing under the ESAF program was authorized by Fund staff in December 1996 and the first half of the second tranche (or approximately SDR 8 million) was disbursed by April 30, 1997. However, the ESAF program began going off track in mid-1997 and was suspended by the Fund in November 1997. Malawi was then put under a Staff Monitored Program (SMP) from April to October 1998, during which its finances were monitored closely. Following successful implementation of the SMP, the balance of the second annual tranche of the ESAF was disbursed in October 1998. FRDP II was approved by the Bank's Board on December 3, 1998, and thus Bank management could certify that Malawi was back on track at that time.

1.19 Because the ESAF was originally a three-year program which would have been completed in October 1998, and only the second annual tranche had been disbursed by that date, the Fund extended the ESAF by one year, augmented the ESAF with an additional SDR 5.15 million, and approved the release of the third tranche (now SDR 20.4 million). These funds were fully disbursed in FY99.

1.20 The Fund's Poverty Reduction and Growth Facility (PRGF) program for SDR 45.1 million was approved on December 21, 2000, the same date the Bank approved FRDP III. Only an initial drawing of SDR 6.45 million was made at the time of Board approval. The PRGF program went off track even before the first review could be concluded in the first half of 2001. The first review was finally concluded in October 2003, with the release of another SDR 6.45 million, but the program was again off track before a second review could be concluded, and the PRGF was cancelled in late 2004.

Bank Program

1.21 The Bank's strategy in Malawi over the PPAR period converged on several key areas (see table 1.3): creating appropriate conditions for growth; achieving macroeconomic stability; improving human development; and strengthening capacity.

Table 1.3: Bank Strategy, 1996-2003

mid-1990s country assistance strategy	*late-1990s country assistance strategy*
Achieve macroeconomic stability.	Create conditions for broad-based, labor-intensive growth.
Improve population and human resource development.	Foster environmental sustainability and human development.
Stimulate private sector growth.	Improve public sector management and capacity.
Build capacity and stimulate decentralization.	Strengthen policy dialogue, implementation, and donor coordination.

Main Themes of the PPAR

1.22 IEG selected these five lending operations to evaluate key aspects of the Bank's stabilization, adjustment and technical assistance program to Malawi, and derive lessons for future operations. The five adjustment and TA operations comprise a continuous program of reform from 1996 to 2004 ("the PPAR period"). Their timing and size are shown in figure 1.3.

Figure 1.3: Five Projects Included in the PPAR

	Credit (millions of US$)		*Calendar Year*
PPAR Projects	***Approval***	***Closing***	***91 92 93 94 95 96 97 98 99 00 01 02 03 04***
FRDP I	November 1996	March 2001	$109
FRDP TA II	December 1998	June 2001	$2
FRDP II	December 1998	June 2000	$92
FRDP TA III	December 2000	June 2004	$3
FRDP III	December 2000	June 2002	$55

1.23 *Focus of the PPAR Projects*: The five projects reviewed by this PPAR focused on:

- Macroeconomic stabilization
- Improved expenditure management
- Civil service reform
- Increased allocations to, and improved performance of, the social sectors
- Tariff and tax policy reform
- Agriculture and financial sector reform

- Utility reform
- Private sector development

1.24 The specific reforms included within each of these areas are shown graphically in annex G.

1.25 *The country assistance strategy in the mid-1990s and FRDP I:* FRDP I addressed the first strategy goal of maintaining macroeconomic stability by providing budgetary assistance while supporting structural measures to enhance revenue, strengthen expenditure control, implement tariff and tax reforms, civil service reform, and privatization. Some of these areas were also being addressed by the ongoing Second Institutional Development Project (FY94) as well as analytic work, for example, the Pay and Employment Study (FY94).

1.26 FRDP I also addressed the second strategy goal, improving population and human resource development, by increasing the budgetary allocation to the health and education sectors, and within the sectors by placing greater emphasis on primary education and preventive health services. FRDP I tackled the third strategy goal of stimulating private sector growth by establishing a legal and institutional framework for advancing the privatization agenda, as well as by supporting actions to facilitate investment, obtain suitable land for businesses, and reducing other obstacles to business. Finally, FRDP I addressed the fourth strategy goal of building capacity by improving Customs' administrative capability, strengthening economic policy formulation, and developing a plan for strengthening tax administration.

1.27 *FRDP II and the country assistance strategy in the late 1990s:* FRDP II supported the first goal of this strategy, creating conditions for broad-based, labor-intensive growth, by attempting to foster the growth of the smallholder segment of the agricultural sector. It planned to do this by creating more scope for the private sector—small-scale trading and services in rural areas, and privatization of government trading and cropping activities. The credit also aimed to improve the business climate to foster labor-intensive manufacturing.

1.28 FRDP II linked an improved macroeconomic climate with maintenance of food security for the poor, and while FRDP II did not directly address environmental sustainability—the second strategy goal—the credit supported measures to enhance the flow of resources that benefit the poor—primary education, preventive health care, and "starter packs" of agricultural inputs to smallholder households.[8] Efforts to improve public sector management (strategy goal 3) included stronger budgetary procedures—including a Medium Term Expenditure Framework (MTEF)—and integration of the development budget with the recurrent budget.

1.29 *FRDP III and the country assistance strategy in the late 1990s:* FRDP III was prepared under the late 1990s strategy, and presented to the Board in November 2000, along with a progress report on the strategy. FRDP III contains a number of measures

[8] "Starter packs" consisted of improved maize seed to cover 0.1 hectare (20 kg), together with grain legume seed and chemical fertilizer.

intended to improve the environment for private business generally, including privatization (including banking and petroleum distribution) and telecom liberalization. However, the operation did not explicitly address the goal of broad-based, labor-intensive growth. Human development was addressed by requirements to maintain specified levels of expenditure for education and health, and by focusing on specific reforms within those sectors, while environmental sustainability was not directly addressed. Improved public sector management was taken up by a number of new institutions and procedures—for example, a screening procedure for new projects, greater transparency of expenditures, and creation of an independent Auditor-General—considerable reliance is placed on development of an Integrated Financial Management Information System (IFMIS).

Summary of Progress Across the Five Credits

1.30 During the period, progress was greatest in tariff and tax policy and in financial sector privatization. Macroeconomic performance actually deteriorated, and there was modest progress in civil service reform and negligible progress in expenditure management, agricultural policy, and private sector development.

1.31 **Public expenditure management/rationalization:** Improved budgetary management and expenditure control was a key focus of all five credits. The intent was to ensure more predictable budgetary execution while achieving better alignment of the recurrent and capital budgets.

1.32 To strengthen public expenditure management, an MTEF was introduced—FRDP I—to be followed by full integration of sector budgets under FRDP II. FRDP II also aimed at reducing the deviation of actual expenditures from planned. IFMIS would be introduced under FRDP III which would further strengthen budgetary controls and introduce efficiency gains. The two technical assistance credits were to provide complementary training to MOF staff charged with public financial management, as well as the monitoring unit in the Treasury.

1.33 The FRDP also supported measures to strengthen the institutions and procedures involved with public financial management, including monthly reports on fiscal performance to a Special Cabinet Committee on Budgetary Measures, the Finance and Audit Committee of Principal Secretaries, and the Controlling Officers and respective Ministers. It was envisioned that the Special Committee of the Cabinet would review and discuss in detail the reports and recommend steps to enforce expenditure control.

1.34 MTEF was introduced on a pilot basis in 1995 and then launched in May 1996, during pre-appraisal of FRDP I (see box 2.1). MTEF is a rolling 3-year budget plan that aims to better define Ministry goals and outputs, redefine programs on this basis, and allocate resources accordingly. MTEF figured prominently in reforms sponsored by FRDP II and III as well. MTEF was never satisfactorily implemented due to, inter alia, exaggerated growth forecasts; unrealistic ministerial budget requests; and the fact that donor support is not integrated with budget process. In retrospect, the MTEF was an over-response to Malawi's most urgent problem which was not medium-term planning, but rather reliable and transparent annual budgetary execution.

1.35 Efforts to install and pilot IFMIS (box 4.1) began during the Second Institutional Development Project and continued through FRDP III and the Financial Management, Transparency and Accountability Project (FIMTAP). Of US$6.3 million allocated, US$2.3 million has been spent with little result. Efforts to pilot IFMIS in five ministries were unsuccessful, and alternative software is being sought. Progress was made in accounting and audit reform, which, although under-resourced, provides some level of checks and reviews for expenditures. See annex A for detailed presentation of conditions and achievement.

1.36 *The critical objective of improving budgetary management, transparency, and expenditure control was not met.* While official budgets were prepared, they were routinely circumvented via “unexpected expenditures” and “extraordinary” Ministerial requests. Institutions and practices intended to rationalize expenditures and foster stronger financial management (MTEF, IFMIS, MOF project database, special review committees) were ineffective, as were efforts to enhance the transparency of the budgetary process. Actual spending exceeded approved spending by 2-3 percent of GDP from 1997/98 to 2000/01, but the gap increased rapidly to nearly 6 percent of GDP in 2001/02, 8 percent in 2002/03, and nearly 15 percent in 2003/04. A December 2004 Fund Report characterized the budgetary process as “extremely weak, with outturns frequently differing from the original budget by substantial margins.”[9] Annex A presents a detailed enumeration of conditions in this area and the degree to which they were fulfilled.

1.37 Efforts to strengthen auditing and accounting were more effective, although the institutions created are new and untested (see discussion of auditing, accounting, and procurement reform in chapter 4 under FRDP III).

1.38 *Quality of Governance:* One way to view Malawi’s progress in improving public sector management over the PPAR period is to examine the assessment of governance on the Bank Governance and Anti-corruption website. During the PPAR period, Malawi improved slightly in two of the six dimensions assessed—Voice and Accountability, and Control of Corruption—but worsened in the other four. As shown in table 1.4, the gain in the two categories averaged 0.12 while the decline in the other four averaged 0.20. Government Effectiveness and Regulatory Quality worsened over the period.

Table 1.4: Malawi Governance Research Indicators, 1996-2004

	1996	*1998*	*2000*	*2002*	*2004*
Voice & Accountability	-0.43	-0.10	-0.28	-0.56	-0.50
Political Stability	0.10	0.12	0.11	0.16	-0.33
Government Effectiveness	-0.69	-0.54	-0.65	-0.63	-0.81
Regulatory Quality	-0.43	0.10	-0.10	-0.39	-0.57
Rule of Law	-0.20	-0.51	-0.46	-0.44	-0.29
Control of Corruption	-0.99	-0.50	-0.21	-0.85	-0.83
Estimates range from -2.5 to + 2.5					

Source: Bank Governance and Anti-Corruption Website, July 2005.

[9] IMF. “Malawi: Ex Post Assessment of Longer-Term Program Engagement.” December 2004, p. 15.

1.39 **Civil Service Reform**: Problems in civil service included understaffing in key areas (nurses, teachers, police) and excess staffing in others. Low pay, poor training, and inadequate linkage between performance and career path led to low morale. Analytical work behind the reforms was done in the 1994 Pay and Employment Study.

1.40 The 1995 civil service census determined that there were around 120,000 workers. From 1993 to 2000, 22,000 additional teachers were hired, and 20,000 temporary workers in other fields were retrenched (a condition of FRDP I). However, many of the new teachers were inadequately trained, and the concurrent introduction of free primary education meant that the student/teacher ratio declined only from 68 to 61.

1.41 Extensive efforts were undertaken under FRDP I and FRDP II to reform the Civil Service. In 1997 and 1998, a functional review of Ministries was conducted, consisting of a series of reviews of individual ministries by 4-5 person teams. Each report for each ministry/department was then submitted to the Cabinet Committee on Civil Service Reform for approval before the implementation of recommendations. In most cases, recommendations related to rearranging or streamlining divisions within a ministry or department but did not propose retrenchment.

1.42 Major tax-free "allowances," such as free housing, were consolidated into base pay. After the closing of FRDP III in April 2004 the number of Ministries was reduced from 30 to 19; by August 2005, the number had climbed back to 24. The GOM established a Human Resources Management Information System which, in 2005, was used to process payroll and will gradually be expanded to include other functions. This system has successfully been utilized to identify a limited number of duplicate salaries paid to the same person.

1.43 Civil service salaries were (and remain) low, averaging around one-fourth to one third of comparable employment in other sectors. Under FRDP III TA, a Medium Term Pay Policy study was conducted, which led to a 26 percent general salary increase in October 2004 (after a long period without any increases), additional consolidation of allowances, and the extant 75 grades reduced to 18. These efforts have led to modest improvements in the Civil Service System, with some progress in identifying and eliminating duplicate salary payments and unauthorized allowances. Also, whereas pay was formerly provided for leave days accrued but not taken, that practice has been eliminated.[10]

1.44 While progress is being made in reforming the Civil Service (continuing under FIMTAP), substantial problems remain. The Government has been unable to explain the paradox of a civil service that has a high vacancy rate but a wage bill that appears to be too high considering the large number of unfilled positions. The vacancy rate is particularly high for those with professional skills (42 percent in 2003), in part because of

---

[10] The calculus was that even though the pay increase would have a negative effect on the fiscal situation, it would be partially offset by the savings in eliminating "ghost workers" and other reforms. It was also presumed that any benefit from improved public services would be worthwhile, and that the government could make up for a net deficit by reprogramming other funds.

the AIDS pandemic. The Government is currently discussing with donors a scheme whereby the salaries of those in the health sector with critical skills would be "topped up." Pay and morale remain low, although there was an expectation that there would be another pay increase in October 2005.

1.45 **Greater Emphasis on the Social Sectors:** Prior to the FRDP, primary education was made free in 1994, which increased enrollment from around 2 million to 3 million in one year. However, this action exacerbated the shortage of classrooms and qualified teachers. The ratio of all teachers to pupils increased from 1:84 in 1991/92 and 1:78 in 1992/93 to 1:108 in 1994/95, with many of the new teachers ill-trained.[11]

1.46 The FRDP credits endeavored to increase spending on the social sectors, and each of the FRDP credits used a different measure to assure that sufficient resources were allocated to the education and health sectors, which complicates assessment:

- FRDP I — Education and health sector "shares of total recurrent expenditure"
- FRDP II — Education and health sector "shares of other recurrent transactions"
- FRDP III — Education and health sector "shares of discretionary recurrent expenditure"

Measured in this way, the performance of the FRDP credits in raising the proportion of government spending on the social sectors was mixed, and during the PPAR period spending in the health sector was flat and that in the education sector declined.[12]

1.47 However, a more meaningful way to assess expenditures is to measure the proportion of health and education expenditure as a percent of GDP. Figures 1.4 and 1.5 and table 1.5 show the proportion of GDP spent on health and education. As shown, health expenditures rose substantially—nearly 150 percent over the 8-year period—while education spending rose more gradually, rising 20.5 percent. Looked at in this way, the FRDP credits were successful in stimulating a greater flow of resources into these sectors.

1.48 Little attention was paid in the three credits to the quality of education or health services. FRDP I monitoring indicators addressed the quality of both health and education, but there is little evidence that they were followed during supervision. And FRDP III conditionality included an increase in the number of teachers trained (see para. 1.50).

1.49 The FRDP was intended both to increase the allocation of funds to the social sectors and also to reallocate funds within those sectors to increase the benefits flowing to the poor. In the case of FRDP II and III, the latter was represented by the plan to increase expenditure on primary education (vice secondary education), and preventive heath care.

---

[11] World Bank. "Cost, Financing and School Effectiveness of Education in Malawi: A Future of Limited Choices and Endless Opportunities." 2004, p. 35.

[12] These were not meaningful measures due to the large increase in interest payments as a percent of recurrent expenditures.

There was also a desire to increase funding to improve retention of key front-line workers (for example, nurses, teachers).

Figure 1.4: Health Expenditures as a Percent of GDP

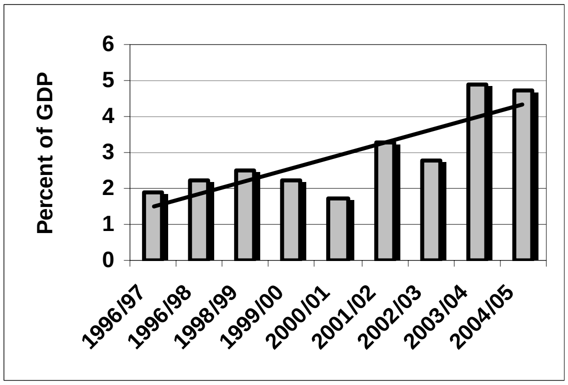


Figure 1.5: Education Expenditures as a Percent of GDP

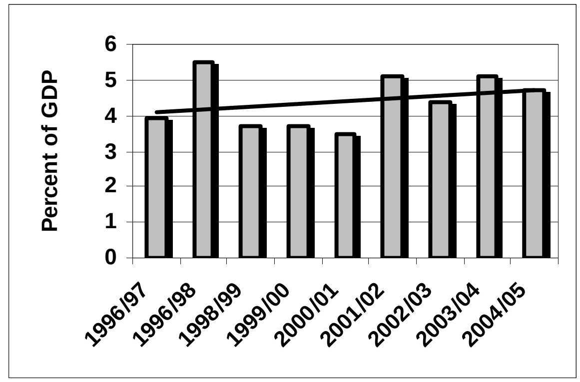


Table 1.5: Education and Health Expenditures as a Percent of GDP

	1996/97	*1997/98*	*1998/99*	*1999/00*	*2000/01*	*2001/02*	*2002/03*	*2003/04*	*2004/05*
Education	3.9	5.5	3.7	3.7	3.5	5.1	4.4	5.1	4.7
Recurrent	3.5	4.7	2.5	2.8	2.3	3.9	3.7	4	3.5
Development	0.4	0.8	1.2	0.9	1.2	1.2	0.7	1.1	1.2
Health	1.9	2.2	2.5	2.2	1.7	3.3	2.8	4.9	4.7
Recurrent	1.7	1.9	1.1	1.6	1.6	2.3	2.2	1.9	2.1
Development	0.2	0.3	1.4	0.6	0.1	1	0.6	2.9	2.6
Total	5.8	7.7	6.2	5.8	5.2	8.3	7.2	10	9.4

Source: 2001 PER and Bank documents.

1.50 Non-financial goals in the social sectors were partially met. The FRDP III goal of enrolling 6,000 individuals in teacher training annually was not met; the annual level of individuals enrolled was around 3,000 from 2001/02 to 2003/04. The proportion of nominally qualified teachers rose from 58 percent in 1995 (after the influx of new students) to 88 percent in 2004. However, the number of pupils per teacher rose from 61 in 1994/95 to 63 in 1999 and 72 in 2004. Donor-supplied textbooks were delivered as required directly from suppliers to schools, bypassing the Ministry of Education, and the ratio of textbooks rose from 0.04 textbooks per pupil in 1993/94 to 0.67 textbooks per pupil in 2004.[13] (Additional detail is provided in annex C.)

1.51 **Tariff and Tax Policy Reform**: Progress in this area was substantial. Under the FRDP credits, tariffs were significantly reduced, and Malawi currently has a substantially open trade regime. The country met all the conditions in this area, and has maintained rates at a low level. The average trade-weighted level of tariffs was reduced from 19 percent in 1996 to 14 percent in 1999. In the 1998/99 budget, the maximum tariff on consumer goods was reduced from 35 percent to 30 percent, with tariffs on selected

[13] FRDP III specified that textbooks were to be delivered from suppliers directly to schools, bypassing intermediaries and opportunities for theft. This effort, financed by the Canadian International Development Agency (CIDA), was successful.

intermediate goods, raw materials, and capital goods reduced from 10 percent to 5 percent. In April 1998, all taxes on exports were eliminated.

1.52 The current maximum tariff is 25 percent, with an average rate of 10 percent on intermediate goods and 0-5 percent on raw materials. Malawian officials expressed the view that the Bank did not have a "coordinated program" for tariff reduction, that is, did not take into sufficient account the rates of Malawi's neighbors, and that in some cases Malawi was disadvantaged by its unilateral tariff reductions. Officials also believe that tariff reductions hastened the decline of Malawi's industrial sector, "neglecting the supply side" so that Malawi was not ready to face foreign competition. However, data show that Malawi's tariff regime is comparable to that of its neighbors; its average tariff (2001) was 13.6 percent, compared to Zambia and Mozambique, which had average tariffs of 13.4 and 13.6 percent respectively, while South Africa's average tariff was 6.4 percent.[14] The decline in the industrial sector was due to other factors, including macroeconomic instability, real effective exchange rate appreciation, and an inhospitable tax and incentive regime.[15]

1.53 During the PPAR period, exports were essentially flat, averaging around 26.2 percent of GDP (see data in table 1.1). The 2003 Bank trade study concluded that the country's trade performance had not been hindered by its trade regime, but that macroeconomic—especially exchange rate—instability, internal and external transport costs, and a narrow export base was hindering realization of the gains from trade.[16]

1.54 *Tax Reform:* Revenue as a percent of GDP rose modestly from 1996/97 to 2001/02, and then more rapidly in 2002/03 and 2003/04. As shown in table 1.6 and figure 1.6, revenue rose from 15.5 percent in 1996/97 to 16.8 percent in 2001/02, and then reached 22.7 percent in 2003/04. Although the government was not entirely successful in raising user fees to cover the marginal cost of providing services, non-tax revenue doubled, as a percent of GDP, from 1996/97 to 2001/02.

1.55 To counter the drop in revenue from the reduction in tariffs, in 1996 the Government modified the value added tax (VAT) structure on goods and services to a 4-tier system. For example, a rate of 20 percent was applied to hotel and restaurant services, as well as for some intermediate and final goods. A zero rate was maintained for the agricultural, food processing, and pharmaceutical sectors in the interest of equity and poverty alleviation. Thus, as shown in table 1.6, VAT revenue rose modestly, as tariff revenue declined.[17]

[14] World Bank. "Malawi: Integrated Framework, Diagnostic Trade Integration Study." 2003, p. 25 and 26.

[15] 2004 CEM, p. 64. For example, there is a tax on turnover, whether or not a firm is profitable, and incentives available to firms are complex, non-transparent, and highly discretionary.

[16] World Bank. "Malawi: Integrated Framework, Diagnostic Trade Integration Study." 2003, p. v and vi.

[17] The most important factors in improved revenue performance from 1994 to 2001 were reforms in tax policy and improvements in the institutional structure in this area—principally MRA. From 2002 to 2004, however, the motivation for the GOM to increase revenue was the increased budget deficits and pressing need for funds to pay interest on domestic debt.

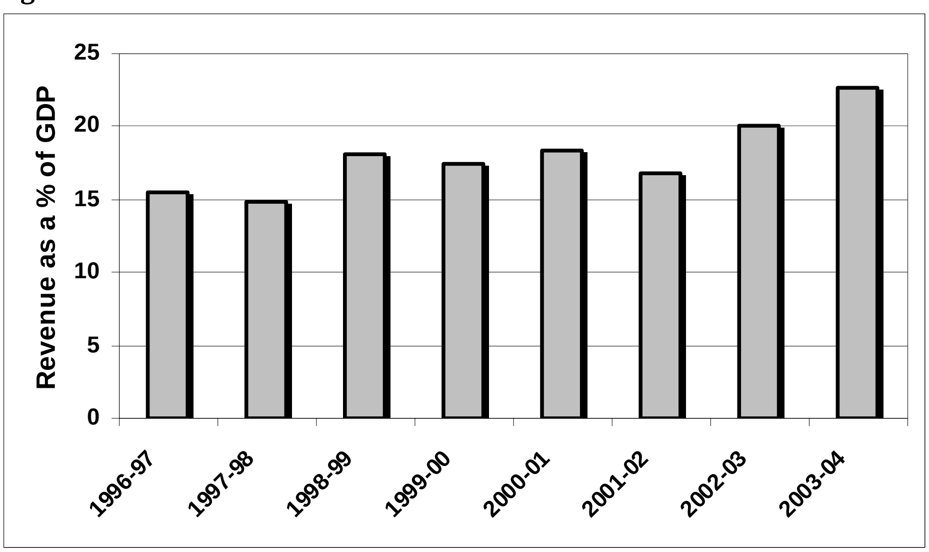
1.56 It should be noted that the most important factors in revenue performance during the years 1994 to 2001 were reforms in tax policy and improvements in the institutional structure in this area—principally the Malawi Revenue Authority (MRA). From 2002 to 2004, however, the motivation for the GOM to increase revenue was more tangible: increased budget deficits, and the steeply increasing need for funds to pay interest on domestic debt.

Table 1.6: Sources of Revenue as a Percent of GDP

	1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*	*2001-02*	*2002-03*	*2003-04*
Revenue	15.5	14.8	18.1	17.4	18.3	16.8	20.7	22.7
Tax Revenue	14.6	13.8	15.4	15.8	16.9	14.9	17.7	20.3
Direct taxes	6.4	6.0	7.2	7.3	7.7	6.9	7.9	8.7
Individual	2.2	2.7	3.2	3.4	3.4	3.1	3.7	4.4
Corporate	3.5	2.5	3.0	2.8	2.8	2.2	2.4	2.5
Withholding	0.7	0.8	1.0	1.0	1.6	1.7	1.8	1.8
Indirect taxes	8.6	8.1	8.6	8.9	9.7	8.3	8.0	9.2
Dom. taxes on goods	5.1	5.1	6.0	6.4	7.2	6.5	8.0	9.2
Surtax (VAT)	4.3	4.4	5.3	5.7	5.4	4.8	6.0	6.5
Excise	0.8	0.7	0.6	0.7	1.8	1.7	2.0	2.7
Taxes on int'l trade	3.5	3.0	2.6	2.4	2.1	1.8	2.0	2.8
Misc. duties	0.0	0.0	0.0	0.0	0.5	0	0.2	0.1
Collection of arrears	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Tax refunds	-0.4	-0.4	-0.4	-0.5	-0.4	-0.3	-0.4	-0.5
Tax adjustment	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
Non-tax revenue	0.9	1.0	2.7	1.6	1.4	1.8	3.1	3.2

Sources: IMF Article IV Review. August 2002, table 7; IMF Country Report on Malawi. August 2005, table 2c.

Figure 1.6: Revenue as a Percent of GDP



Sources: IMF Article IV Review. August 2002, Table 7; IMF Country Report on Malawi. August 2005, table 2c.

1.57 *Malawi Revenue Authority:* In 2000, with the support of FRDP III the tax collection service was restructured, and MRA was established as a self-financing, private sector-oriented parastatal organization, with a Board of Directors consisting of both public and private sector members. MRA consists of the following units:

- Customs and Excise
- Income Tax
- Tax Audit and Investigations
- Information Technology
- Policy, Planning and Research
- Finance and Administration
- Board Secretary/Chief legal counsel

1.58 MRA received technical assistance from the Fund (an advisor for one year), the U.S. Treasury, and the Department for International Development (DFID). The revenue service was modernized and training provided to customs and other officials. Training was provided in planning, administration, and implementation of the VAT and surtaxes. Assistance was also afforded in the implementation of new incentive structures for staff, and human resource management. The latter included work on the agency's organizational structure, job grading system, remuneration structures, and policies and performance appraisal systems. Also, coverage of the VAT was expanded, and revenue collection was partially automated. Officials expressed the view that while the Bank took part in the creation of MRA, it did not follow through and provide sufficient assistance in its restructuring and modernization.

1.59 MRA is funded by the retention of 2.5 percent of the amount that it collects (4 percent for collections above the budgeted amounts), and so the agency has an incentive to be aggressive in collections. Until recently, that resulted in agents making repeat visits to their "best taxpayers," but as a result of complaints the incentive system was expanded to take into account "new taxpayers" that were identified by agents. Malawi has a high revenue/GDP ratio, 23.5 percent in 2003, for a country in its income category.

1.60 Despite the achievement of tax reform and the success of MRA in raising revenue, the tax system in Malawi is viewed as complex and discretionary. Further, tax refunds are not sufficiently quick or reliable, and hence the system overall is viewed as a barrier to private business activity.[18]

1.61 **Agriculture sector reform**: In December 1994 the GOM adopted an agricultural sector strategy to help transform the sector from a subsistence/dualistic structure (over-dependent on maize and tobacco) to a more diversified and viable one that also functions as a catalyst for growth in the non-farm sector. The main objective of the GOM strategy was to attain broad-based sustainable agricultural growth of at least 3 percent per year, which they intended to achieve by removing the most binding constraints to the integration of smallholders into the mainstream of development (access to land, cash crops, inputs, and markets). Thus, the strategy also comprised a shift from an emphasis on production by large estates to that by smallholders.

[18] World Bank. 2004 Country Economic Memorandum, p. 10.

1.62 In early 1995, prior to the inception of FRDP I, as part of its change in agricultural strategy the GOM de facto lifted smallholder tobacco quotas and smallholder marketing restrictions, which resulted in an income gain to participating farmers estimated at US$185 million (1995-97) and the growth of the smallholder sector. Attempting to build on this achievement, FRDP I sought to benefit smallholders by improving land use efficiency, liberalizing production quotas and surrogate prices and reducing regulatory restrictions to increase input availability. Additionally, recognizing that high transport costs were a key constraint to Malawi's agricultural sector, FRDP I included measures to improve competition and efficiency in transport. FRDP II sought to increase the maize price band which—as part of the operation of the Strategic Grain Reserve—had also sought to limit price fluctuations.[19]

1.63 Finally, supported by the FRDP credits, the GOM pursued land policy reform. In 1996, the Government established a Presidential Commission on Land Policy aimed at promoting equitable access to land, security of titles, and improved land administration procedures for estate owners, smallholders, traditional authorities, and local government.

1.64 There were some successes in the liberalization of agricultural policies: a National Land Policy was issued in 2002, formal quotas on smallholder tobacco deliveries to the auction floor were abolished; and producer prices, marketing, and sales were liberalized (with the significant exception of maize). However, as shown in table 1.7 during the PPAR period agricultural output grew very slowly, and productivity fell, particularly after 2000.[20] During the PPAR period land use efficiency and land market development improved only modestly.

1.65 The reforms supported by the FRDPs did little to address the key supply-side risks faced by farmers, including macroeconomic volatility and costly and unreliable transport services. The policy package was also not successful in creating food security for the population, including large numbers of smallholder farmers who become net buyers of food when food production declines. Also, abrupt policy reversals and frequent interference in the importation and sales of maize and chemical fertilizers affected both the reliability of maize supplies to urban and rural households as well as the timely availability of fertilizer. Finally, there were serious problems in the marketing arrangements for tobacco.

1.66 As an indicator of the poor performance of Malawi's agricultural sector over the PPAR period, maize productivity—a predominant factor in Malawi's rural economy—is low in relation to regional and other comparators, and is falling (see table 1.8). Malawi achieves just 61–84 percent of the yields realized in neighboring countries. Worse, Malawi's maize yields have been declining over the past decade, while those in neighboring countries have either been flat or rising.

[19] The maize price band had been established to set a price ceiling that would limit increases in consumer prices and a floor that would support producer prices. The band was supported by means of the wholesaling operations by ADMARC on behalf of the Strategic Grain Reserve.

[20] The first row of table 1.7 reflects official figures showing an average growth of around 6 percent in 1996-2003 agricultural value added, however, there is some doubt as to their validity. For example, Bank data for 1995 to 1998 reflect growth of agricultural production of 7.6 percent annually compared to government figures of 14.7 percent per annum.

Table 1.7: Agriculture Sector Performance Indicators

		1996	1997	1998	1999	2000	2001	2002	2003
Ag. GDP Growth (factor cost)		25.5	-0.05	2.73	11.2	5.67	-8.5	2.8	9.2
Ag. Share of GDP (percent)		35	33.7	33.5	35.4	36.5	34	37	38
Exports (US$ million)		483	530	528	447	406	427	421	441
of which:	Tobacco	300	346	321	215	241	236	284	291
	Tea, sugar, coffee	71	78	101	71	81	97	81	109
Imports (US$ million)		624	783	579	674	563	585	727	792
of which:	Maize (US$ mt)	28	16	41	0	0	9		
	Maize ('000 mt)	83	55	325	31	9	54	193	
	Fertilizers ($ mt)	22	57	50	50	50	275	193	
	Fertilizers ('000t)	58	245	154	110	55	225	228	228
Consumer food prices									
Total (2000=100)					77	100	118	136	144
Urban						100	130	153	160
Rural						100	115	133	140
Food Consumption (Cal/cap/day)		2,086	2,039	2,112	2,148	2,150	2,160	2,155	
Production ('000 mt)		***95/96***	***96/97***	***97/98***	***98/99***	***99/00***	***00/01***	***01/02***	***02/03***
	Maize	1,793	1,226	1,772	2,479	2,501	1,713	1,557	1,983
	Tobacco (sales)	142	158	134	134	160	125	138	117
	Sugar	186	175	190	170	200	190	190	210
	Coffee	4.8	4.6	3.8	3.5	3.8	4.3	3.6	3.9
	Tea	34.2	37.2	44.1	40.4	48.2	44.7	36.8	39.2
Productivity:									
Maize (mt/ha.)		1.44	0.99	1.37	1.81	1.74	1.1	1.05	1.28
Tobacco (all varieties)		12.4	13.8	10.9	7.3	8.3	7.2	5.7	5.7

*estimate
Sources: IMF, Food and Agricultural Organization (FAO) Stat, National Statistics Office (NSO), Ministry of Agriculture (MoA) and mission estimates.

Table 1.8: Maize Productivity, 1996-2004
Malawi and Selected Countries (mt\ha)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Malawi	1.4	1.0	1.4	1.8	1.7	1.1	1.0	1.3	1.1
Kenya	1.5	1.5	1.7	1.5	1.4	1.7	1.5	1.6	1.3
Mozambique	0.9	0.9	0.9	1.1	0.9	0.8	1.0	1.0	1.0
Tanzania	1.6	1.2	1.3	1.4	1.5	1.7	1.7	1.6	1.8
Zambia	2.1	1.5	1.3	1.4	1.5	1.5	1.4	1.5	1.5
China	5.2	4.4	5.3	4.9	4.6	4.7	4.9	4.8	5.2
Mexico	2.2	2.4	2.3	2.5	2.5	2.6	2.7	2.5	2.5

Source: FAO Stat.

1.67 Successful measures taken under the FRDP credits to improve competition and efficiency in the transport sector—including concessioning of the railway and liberalization of freight rates—have so far had little impact as more fundamental barriers (for example, lack of sufficient revenue to upgrade or maintain the railroad track-bed) continued to keep rates high.

1.68 **Financial Sector:** The FRDP credits were instrumental in reducing the government's role in the financial sector and improving the regulatory framework.[21] In 1996, majority state-owned banks controlled 100 percent of the sector's assets, and the two dominant banks, National Bank and the Commercial Bank of Malawi (CBM)—both majority state-owned—controlled 73 percent of the sector's assets. FRDP II recognized that private investment was inhibited, inter alia, by the continued dominance of public or semi-public parastatals in the financial sector. Prior to FRDP II, the government sold 12 percent of the shares of the CBM, and as part of the conditionality of the credit committed to begin the process of privatizing CBM and National Bank. FRDP III emphasized completing financial sector privatization as part of the Interim Poverty Reduction Strategy Paper (I-PRSP), and provided conditions requiring completion of a new regulatory framework and sale of CBM. By 2005, 97.6 percent of the sector's assets were privately-owned, and the two largest banks controlled 60.2 percent of the sector's assets.[22] Three banks, with a combined market share of 24.6 percent (2005), either entered the market for the first time or changed ownership, and these new entrants sparked competition during the time of the PPAR, for example, with respect to branch location and convenience of automatic teller machines (ATMs). It should be noted, however, that while the government has largely been removed from the sector as a majority owner, it continues to wield influence as a minority owner[23] and through strong ties with National Bank, the nation's largest.

1.69 However, *credit to the private sector fell over the PPAR period and remains very low*—around 7.7 percent of GDP in 2003. Spreads between saving and lending rates actually increased during the time of the PPAR, so the impact of the structural changes in the sector was limited.[24] "Crowding out," as discussed in para. 1.14, almost certainly played a major role in limiting benefits. And the lack of impact of the financial sector measures reinforces the established guidance that it is inadvisable to undertake financial sector reforms in a turbulent macroeconomic environment.

1.70 *Regulatory Framework:* Under FRDP II a study was completed on a regulatory framework, but the framework was not implemented as called for in the conditionality.[25] In terms of a regulatory framework, the Reserve Bank of Malawi (RBM) has established a satisfactory regime for a country at its income level. Banking supervisors assure that banks stay at or near Basel levels for all key indicators: maximum concentration for one borrower, 25 percent; capital adequacy ratio for core capital, 6 percent and for total capital, 10 percent (all banks in Malawi are currently in substantial compliance with these

[21] During FRDP II, a study was completed on a regulatory framework for the financial sector, but the framework itself was not implemented as called for in the conditionality, necessitating a partial waiver for disbursement of the second tranche. (The regulatory framework was implemented during and after FRDP III.)

[22] Additional information on the structure of the banking sector is in annex F.

[23] For example, in 2004 the government owned 20 percent of National Bank, 8 percent of Stanbic, and 12 percent of NBS.

[24] Gross domestic savings in Malawi were very low, averaging 4 percent from 1994-2001, compared to 16.6 percent in sub-Saharan Africa. 2004 CEM, p. 3.

[25] This necessitated a partial waiver for second tranche disbursement. The regulatory framework was implemented during and after FRDP III.

ratios). Banks in Malawi submit profit and loss, income, and balance sheets to RBM monthly; a more comprehensive set of data, including the percent of non-performing loans, is provided to regulators quarterly. On-site supervision staff is located in Blantyre, and each bank is visited at least annually and more frequently if irregularities are detected. The banking supervision staff numbers around 30 professionals, and has relatively little turnover in the Malawi context. Bank supervision staff indicated their gratitude for technical assistance provided by the Fund.

1.71 **Privatization and Private Sector Development**: In general, FRDP I focused on the development of the legal and institutional framework for privatization, FRDP II focused on privatization of major commercial public enterprises (PEs), and FRDP III included a component for privatization, including of commercial banks, as well as support for monitoring PE finances through the Parastatal Enterprise Reform and Monitoring Unit (PERMU), established in the Ministry of Finance in 2000.[26]

1.72 *Privatization*: Public Enterprises accounted for around 20 percent of GDP at the start of the privatization program, and had a significant influence on the formal economy because of the oligopolistic market structure and interlocking relationships between them.[27] The Public Enterprises (Privatization) Act was enacted in April 1996, and a Divestiture Sequence Plan (DSP) consisting of a list of 100 PEs (later expanded to 165, many of which were apparently subsidiaries of the original 100) approved by the Cabinet Committee on the Economy in August 1997. This list deliberately targeted privatization of smaller firms first, and left many large firms—such as utilities, telecom, Air Malawi, and others—to be divested later.[28]

1.73 The Privatization Commission (PC) was established in 1996 to implement the above plan, and the DSP was the document from which the Privatization Commission derived its authority to privatize a particular enterprise. The PC includes representatives of government, each political party, the Malawi Congress of Trade Unions, and of the business community. The PC reports to the Minister of Privatization, who has concurrently been either the Vice President or President of the country; the Secretariat of the PC, headed by an Executive Director, is responsible for implementation of the privatization program.

1.74 In terms of the *number of firms sold*, the privatization program was largely successful.[29] As of December 1999, 35 out of the original 100 PEs on the DSP had been privatized, and by August 2005, 65 of the 100 firms on the list had been privatized (of which 10 had been owned by ADMARC). The privatization program was assisted by the World Bank Privatization and Utility Reform Project (PURP), a US$10 million effort approved in June 2000.

1.75 The Commercial Bank of Malawi and the National Bank of Malawi were sold in 2003. Other divestitures include: Auction Holdings Ltd, Chemicals and Marketing Ltd,

[26] However, the effectiveness of PERMU in this task might be questioned. In August 2005, its total staff was three.

[27] The influence of the parastatals gradually weakened during the PPAR period owing to new entry and market liberalization.

[28] Exceptions were that the National Bank of Malawi and the Commercial Bank of Malawi were divested.

[29] Data on the comparative size of the firms privatized vs. those still in public hands were not available.

ORTEX, Dwangwa Sugar Corporation (DSC), Malawi Dairy Industries, Malawi Telecom, and National Insurance Co. Ltd.

1.76 *However, numerous large firms and entities remain to be sold*: Lilongwe and Blantyre Water Boards, Malawi Development Corporation, Malawi Rural Finance Corporation, Electricity Supply Corporation of Malawi (ESCOM) Distribution, ESCOM Generation, Tourism Development and Investment Corporation, Malawi Housing Corporation, Malawi Savings Bank, and most importantly, ADMARC (see below). While repeated efforts have been made to sell Air Malawi, poor market conditions and other factors have thus far prevented its divestiture. While 65 of the original list of 100 firms have been sold, it seems likely that the proportion of the assets of state-owned firms that have been sold is well below the proportion of firms that have been sold.

1.77 *ADMARC:* ADMARC figures prominently in privatization planning from a number of perspectives. The impetus to sell the firm arose from its inhibiting effect on private activity in agricultural markets, as well as its high cost to the budget; the firm incurred deficits of 1.6 percent of GDP in 1998/99 and 1.9 percent in 2000/01. [30] The 1998 Fund ESAF contained conditionality that ADMARC be prepared for privatization by April 1999, and then sold between 1999 and 2003.

1.78 FRDP II envisioned that ADMARC would be prepared for commercialization and privatization, but the conditions fall short of calling for its sale. FRDP III, however, did not carry forward actions supporting privatization, or even further divestiture of profitable ADMARC activities, as it was judged more important to avoid creating obstacles to HIPC eligibility. Finally, the 2002 Poverty Reduction Strategy Paper (PRSP) states:

> "In terms of specific parastatals, Government will continue to implement the action plan for privatization and commercialization of ADMARC. Firstly, all ADMARC subsidiaries will be privatized or liquidated. Government will also identify excess marketing and infrastructure for valuation and auction. Further, cotton ginning operations will be transferred to a separate company. Government will then repeal or amend the ADMARC Act and incorporate ADMARC as a limited company in preparation for its privatization...."[31]

1.79 However, the Government had substantial doubts about privatization of ADMARC, driven in part by understandable public concern about the adequacy of strategic food reserves, as well as agricultural marketing and the supply of inputs in rural areas. Consequently, the Government, with the support of donors, settled on a policy of divesting ADMARC's profitable subsidiaries, and transferring responsibility for food security to National Food Reserve Agency (NFRA), which had been created in 1999 to manage the strategic grain reserve and act solely as a disaster and emergency relief agency—as opposed to intervening in markets to "stabilize" prices.[32] And in 2003, the Government repealed the ADMARC Act and incorporated ADMARC as a limited liability company.

---

[30] Data on ADMARC losses from FRDP III. Internal World Bank document.

[31] Malawi Poverty Reduction Strategy Paper and Joint Staff Assessment. 2002, p. 81.

[32] *De facto,* NFRA did not take full charge of food security until around 2004. It was during ADMARC's *de facto* control of the National Food Reserve that at least 60,000 MT of grain was found missing from the reserve.

1.80 As described in detail in para. 4.18, upon assuming responsibility for managing the strategic grain reserve, NFRA continued to intervene in maize markets. Advised by donors to retain a reserve of 60,000 tons,[33] without proper authorization the agency sold off the entire grain reserve prior to the severe drought of 2001-02. Unfortunately, the flaws in the advice provided to the government—along with the unauthorized sale—contributed to the severity of the famine.

1.81 By August 2005, all non-core ADMARC firms had been divested; privatized firms which were wholly or partially owned by ADMARC include: David Whitehead and Sons, Shire Bus Line, Finance Corporation of Malawi Ltd, Sugar Corporation of Malawi, Grain & Milling Company Ltd, Cold Storage Company Ltd, National Bank of Malawi, and the Malawi Tea Factory Company Ltd.

1.82 *Private Sector Development*: As noted above, doing business in Malawi was difficult due to the constraints of poor infrastructure, high transport costs, the oligopolistic structure of many sectors, and macroeconomic turbulence. The regulatory and bureaucratic burden was also heavy; the Bank's Doing Business indicators ranked the country 96th of 156 countries in the overall ease of doing business. Relatively better rankings were listed for hiring and firing, ranked 41st and protecting investors (62), while dealing with licenses (110) and paying taxes (138) were relatively worse (see annex table B3).

1.83 Most measures stipulated by the FRDP credits were implemented, and modest progress was made:

- Establishment of Investment Promotion Agency which partially streamlined investment procedures and made the country more "investment friendly."
- Successful privatization of 65 firms on an agreed list of 100 (later expanded to 165). However, the remaining firms are large and difficult to sell, including Air Malawi and ESCOM.
- Resolution of the problem of Temporary Employment Permits which hindered foreign investors.
- Progress in making available industrial land to investors.

1.84 However, successful measures taken under the FRDP credits to improve competition and efficiency in the transport sector—including concessioning of the railway and liberalization of freight rates—had little impact as more fundamental barriers continued to keep rates high. These include:

- Deficiencies in the nearest port, Nacala, Mozambique, include poor security, an inefficient port authority, and few shipping lines that call on a regular basis. The result is that much Malawian cargo goes through Durban or Maputo at greater expense.
- The volume of imports into Malawi is much greater than that of exports, so many trucks bringing goods in must return empty.

[33] As discussed in para. 4.19, this advice was based on faulty premises.

- High internal transport rates are due to the poor condition of the roads, remaining restrictions on the activity of foreign operators, and high transport taxes.

1.85 Despite the modest success in private sector development, little real impact has been felt. The level of investment—both from domestic and foreign sources—was low. Gross domestic investment, which was 22.8 percent of GDP in 1983, declined to 15.2 percent in 1993, 12.5 percent in 2002, and 8.1 percent in 2003. Foreign direct investment was US$3 million in 1983, US$8 million in 1993, and US$6 million in 2002 (all figures are less than 0.5 percent of GDP). And budgetary subsidies and other transfers comprised 3.8 percent of GDP in 1998/99, 2.9 percent in 1999/00, 5.5 percent in 2000/01, 4.2 percent in 2001/02, 4.8 percent in 2002/03, and 4.1 percent in 2003/04.[34]

1.86 *Utilities Reform:* With support from FRDP II and III, progress has been satisfactory in the telecom area, but there has been little movement in the power sector. The Malawi Communications Regulatory Authority (MACRA) was established in 1999, and its organization and function conform to international practice. MACRA's Director General is appointed for a fixed term, and the agency has its own independent source of revenue from licensing and other user charges. The agency has the technical competence to monitor spectrum utilization in and around the country, and it has a legal staff as well. MACRA, however, is weak in its capacity to perform economic analyses of the telecom sector, and has also had difficulty in enforcing its decisions, especially against the incumbent (Malawi Telecommunications Limited (MTL)).

1.87 The government "shopped" MTL, the incumbent fixed-line operator, more than five years, before the sale was finally completed in January 2006. In the meantime, two wireless operators have been licensed and are currently operating. While the FRDP III benchmark for fixed line subscribers has been exceeded, Malawi's teledensity remains very low—80,000 fixed line phones for a population of 12,000,000. Fixed line service is especially lacking in rural areas, and the condition of the equipment is poor and waiting time for an installation is unacceptably long. A further problem is the limited lack of policy-making capacity in the Ministry of Telecom and Information.

1.88 However, the number of mobile phones increased from 5,000 in 1995, to 24,000 in 1999, and 200,000 in 2005.[35] There is also one government-owned television and radio station, and 15 privately-owned radio stations licensed by MACRA. While there are 12 Internet Service providers, there is currently no broadband service available. While substantial progress has been made in the telecom sector, Malawi has not yet reached the level of "subsequent actions" envisioned in FRDP III. These include the sale of MTL in 2001 and preparing for full liberalization of all telecom services by removing all entry restrictions on long distance and international voice telephony by 2003.

---

[34] IMF. "Malawi: Selected Issues and Statistical Appendix." December 2004, p. 54.

[35] While this growth is impressive, Malawi's wireless penetration rate is still below regional averages.

2. Fiscal Restructuring and Deregulation Program I (FRDP I)

Objectives and Design

2.1 This operation (FRDP I) was intended to assist Malawi to attain its economic objectives focused on two broad policy areas:

- Fiscal restructuring, to prioritize, protect, and, where necessary, expand inter-sectoral and intra-sectoral allocations to the social sectors (particularly emphasizing primary-level services) on a sustainable basis while staying within the overall fiscal framework now being monitored under the IMF's ESAF program. The operation supported development of an MTEF, comprehensive civil service reform, and tax and tariff reform.
- Deregulation, which was expected to consolidate structural measures initiated by the GOM under previous adjustment operations. These included complete removal of remaining pricing and marketing constraints on smallholder agriculture, and removal of the binding constraints to broad-based private sector entry and development.

2.2 Of course, the Development Credit Agreement (DCA) also required that the macroeconomic policy framework be consistent with the objectives of the program. The credit was structured such that an initial tranche of US$74.4 million equivalent would be disbursed upon effectiveness based on policy actions already taken, with a second tranche of US$30 million equivalent intended to disburse around six months later, after the completion of designated civil service reforms.

2.3 Quality at entry was inadequate. On the positive side, the actions supported by the credit, if effectively implemented, had a good chance of creating significant benefits. However, the credit was overly broad in scope, considering the capacity of the Borrower: FRDP I contained 42 conditions across five sectors. A more targeted instrument in, for example, private sector development, or the agricultural sector, would probably have had a greater chance of success. In terms of Borrower commitment, the Bank was overly optimistic. While some officials were supportive of the credit, many others—at all levels—did not perceive that it was in their interest to implement these reforms. And while formal monitoring indicators were developed, there is little evidence that they were used to assess progress. In particular, there were only 2 indicators cited in the social sectors—infant mortality and maternal mortality—with none in education other than expenditures.

Implementation Experience

2.4 *Macroeconomic Environment:* Macroeconomic conditions were unsettled during FRDP I (table 2.1). As noted above, real GDP growth was relatively strong compared with later periods: 7.3 percent in 1996 and 3.8 percent in 1997. However, inflation was high and variable: 37.6 percent in 1996 and 9.2 percent in 1997. The current account balance was -7.1 percent in 1996, -11.9 percent in 1997, and -0.2 percent in 1998, and the nominal exchange rate also fluctuated significantly. Although the macroeconomic situation worsened during the subsequent operations that are the subject of this PPAR, the unsettled 1996-98 macroeconomic situation was not helpful to the realization of the credit objectives.

Table 2.1: Selected Macroeconomic Variables, 1995-1999

	1995	*1996*	*1997*	*1998*	*1999*
		FRDP I			
Real GDP growth rate	16.7	**7.3**	**3.8**	3.3	4.0
Av. Inflation rate (CPI)	83.3	**37.6**	**9.2**	29.8	44.8
Av. Treasury Bill Rate	46.3	**30.8**	**18.3**	33.0	42.9
Curr. Acct. Bal/GDP	-1.4	**-7.1**	**-11.9**	-0.2	-8.2
Real eff. exch. rate: index	100	**138**	**1513**	112	112
Fiscal Revenue/GDP	17.9	**15.5**	**14.8**	18.1	17.2
Fiscal Bal. w/o grants/GDP	-13.9	**-7.2**	**-9.0**	-11.0	-12.4
Fiscal Bal. w/grants/GDP	-5.8	**-2.8**	**-5.6**	-5.1	-5.6

Source: Government of Malawi, IMF, World Bank Development Data Platform.

2.5 *Public Expenditure Management/ Rationalization*: The objective in this area was to improve the budgetary allocation process and ensure the consistency of recurrent and capital budget with resource availability and development priorities. A number of process steps were successfully completed before credit approval, including implementation of a cash budget, roll out of MTEF in five pilot agencies, and announcement of sectoral envelopes and expenditure targets for critical categories in social sectors in the FY96/97 Budget Circular. *However, progress after these initial steps was negligible*. The implementation of MTEF, seen as a critical step in gaining greater control over the budget, did not advance and contributed little to budgetary discipline (see box 2.1). The prevailing practice was that while an official budget was prepared, it was routinely circumvented and exceeded by political intervention—"unexpected expenditures," or "extraordinary" requests by Ministers.[36] Actual spending exceeded approved spending by 2-3 percent of GDP during FRDP I.[37]

Box 2.1: Medium Term Expenditure Framework (MTEF)

MTEF was a critical tool that the Bank envisioned as a means of ensuring more accurate budgetary allocations, as well as greater transparency and consistency of the recurrent and capital budget with (1) resource availability, and (2) development priorities. MTEF is a rolling 3-year budget plan that aims to better define Ministry goals and outputs, redefine programs on this basis, and allocate resources accordingly.

MTEF was a key aspect of public expenditure reform across the whole FRDP. It was envisioned that MTEF would be introduced under FRDP I, and that sector budgets would then be fully integrated with MTEF under FRDP II. Thus, under FRDP II the deviation of actual expenditure from that which was budgeted would be reduced.

MTEF was introduced on a pilot basis in 1995 and then launched in May 1996, during pre-appraisal of FRDP I. *MTEF has not been satisfactorily implemented and has not served its intended purpose* due to, inter alia: exaggerated growth forecasts; politicization of budget requests (ministries ignore MTEF and exaggerate resource requests); the fact that donor support is not integrated with the budget process. While some agencies prepare 3-year plans, these are largely pro-forma and are routinely ignored when higher priority requirements arise.

Source: Interviews with Government of Malawi Officials and project documents.

---

[36] DFID. "The Budget as Theater—The Formal and Informal Makings of the Budget Process in Malawi." July 2004.

[37] Durevall and Erlandsson. "Public Finance Management in Malawi." Sida Economic Report. December 2004, p. 9.

2.6 *Expanding Allocations to the Social Sectors*: As noted in para. 1.46, FRDP I did not meet the stipulated minimum budgetary shares for either the health or education sectors. However, assessing health and education expenditures as a percent of GDP is a more meaningful measure of resource allocation. As shown in table 2.2, health expenditures rose substantially—nearly 150 percent over the 8-year period—while education spending rose more gradually, rising 20.5 percent.

Table 2.2: Health and Education Expenditures as a Percent of GDP, 1996/97-2004/05

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Education	3.9	5.5	3.7	3.7	3.5	5.1	4.4	5.1	4.7
Health	1.9	2.2	2.5	2.2	1.7	3.3	2.8	4.9	4.7

Source: 2001 PER, Annex 1; Bank documents.

2.7 *Civil Service Reform:* Problems in the civil service included understaffing in key areas (nurses, teachers, and police) and excess staffing in other areas. Low pay, poor training, and inadequate linkage between performance and career path led to low morale. Further, the wage bill had nearly doubled between FY1988/89 and FY1993/94 when it reached 44 percent of total Government recurrent expenditures.[38]

2.8 FRDP I was part of a process of civil service reform that continues until the present. Under the credit, a census of civil service workers determined that there were 120,000 workers, and 20,000 non-permanent civil servants were retrenched. In 1997 and 1998, a functional review of Ministries was conducted, which resulted in only minor progress. While it had been expected that a comprehensive Civil Service Reform Action Plan would be prepared and implementation begun around six months after project inception (November 1996), this was not completed under FRDP I and the second tranche of US$30 million equivalent was disbursed nine months late in August 1997, with *a waiver issued for non-performance of civil service conditions.*

2.9 *Tariff and Tax Policy Reform:* Malawi made significant progress in this area under FRDP I. Tariff rates were reduced across the board—with trade-weighted tariff rate reduced from 19 percent to 14 percent—and by April 1998, all export taxes had been eliminated. Additional detail on achievement of conditions is presented in annex D.

2.10 *Agricultural Policy:* FRDP I conditionality focused on taking initial steps to achieve reform in five areas: (i) development of a comprehensive land policy to improve the efficiency of land use; (ii) removing quotas based on land title status to increase smallholder productivity; (iii) stimulating greater producer price flexibility to encourage greater efficiency and diversification; (iv) improve input availability by liberalizing regulatory restrictions; and (v) improve competition and efficiency in transport. An enumeration of conditions in this area and their fulfillment is presented in annex E.

2.11 Regarding the first area, a Presidential Commission was appointed in 1996 to review land policy—as required by FRDP I—however, the commission issued a report only in late 1999, and a policy was issued only in 2002 as an outcome of the Agricultural

[38] "Malawi Civil Service Pay and Employment Study." World Bank. 1994, p. vi.

Support Services Project (a pilot project in negotiated land redistribution). During the PPAR period, land use efficiency and land market development improved only modestly.

2.12 Although the initial steps regarding tobacco quotas identified in FRDP I were achieved, it was only in 2002 that smallholder tobacco delivery quotas were formally abolished (though informal quotas are reportedly still in place), and consequently the benefits were limited.

2.13 Virtually all agricultural producer prices were liberalized and export controls removed prior to FRDP I, except for maize. In the latter case, price interventions by ADMARC and the NFRA continued (and are still in force). In accordance with FRDP II conditionality, the maize price band was widened as an intermediate step in liberalizing its price. NFRA had its Trust Deed amended to limit the agency to food security, as opposed to intervening in markets to foster price stability as it had previously done.

2.14 The FRDP I requirement to remove regulatory restrictions so as to improve input availability was met, but did not have much effect as inputs were readily available by the time the new policies took hold. FRDP I removed restrictions on imports of used trucks and spare parts, and removed controls on prices of domestic road transport (however, other regulations continued to restrict the movement of regional transport operators throughout the country). The FRDP I measures were the first of a number of steps taken throughout the PPAR period—in conjunction with complementary investment projects[39]—to make transport more efficient; overall progress was modest, however, as more fundamental transport barriers continued to keep rates high (see para. 1.84).

2.15 *Overall Agricultural Trends*: During the PPAR period, output grew very slowly. In particular, production of maize—the country's key food crop—fluctuated considerably but was essentially flat. Tobacco and sugar production were down during most of the period, but rose in 2004. Critically, however, productivity fell during the PPAR period, by 22 percent for maize and 54 percent for tobacco.

2.16 Agricultural performance was weak because of a decline in yields, low profitability, and withdrawal into low value crops. The weak performance is explained by the highly risky environment faced by farmers engaging in production and accessing markets for inputs and outputs. This high risk environment results first from macroeconomic volatility and costly and unreliable transport services.

2.17 *Privatization and Private Sector Development*: A sound Public Enterprises Act was passed in April 1996, and a competently-managed Privatization Commission established. Most other measures stipulated by the FRDP credits in this area were also implemented:

- Establishment of Investment Promotion Agency which partially streamlined investment procedures.
- Establishment of an Export Processing Zone.

[39] Railways Restructuring Project (FY95) and Roads Maintenance & Rehabilitation Project (FY99).

- Sale of an agreed list of 20 firms held by ADMARC and the Malawi Development Corporation (MDC).
- Resolution of the problem of Temporary Employment Permits which hindered foreign investors.
- Privatization of the oil importation company (ORTEX).
- Progress in making available industrial land to investors.

Ratings

2.18 *Relevance:* On balance, overall relevance was *modest*. On the positive side, most areas addressed by the credit were those that dealt with significant development barriers that remain relevant today. In particular, the efforts to strengthen budgetary management, implement agricultural reforms, and improve the environment for private business—if they had worked—could well have improved the country's economic performance and reduced poverty. The expenditure minima for the health and education sectors were highly relevant to the welfare of the poor, and the two-tranche design was appropriate to follow up on the implementation of reforms.

2.19 Detracting from relevance was the overly complex project design—particularly in the area of strengthening budgetary management—and with too many sectors and too many difficult conditions considering the country's capacity. In the agricultural area, the credit conditions—while seemingly practical—in actuality had little impact on production (as shown by the data on agricultural production).

2.20 *Efficacy:* Efficacy was modest overall. In the critically important area of strengthening budgetary management, progress was negligible. In the end, all of the systems, protocols, and rules that the Bank provided or advocated were overridden by politically-motivated actions. The MTEF, of which so much was expected, was simply ignored or made into a pro-forma exercise. The budget minima for the social sectors were only modestly successful in providing more resources in these areas.

2.21 Efficacy in the area of Civil Service reform was modest. While a census was completed and a limited retrenchment undertaken, development of a comprehensive reform plan proved difficult and necessitated a waiver. Achievements in the area of tariff and tax reform were substantial, with a good foundation laid for the subsequent establishment of the Malawi Revenue Authority.

2.22 Nearly all agricultural conditions were fulfilled, but with little impact on output or productivity. Privatization under FRDP I was substantial, with a sound institutional foundation being laid, and a reasonable start to the privatization process. In the area of improving the environment for private business and facilitating investment, progress was substantial and was built upon by subsequent credits. Yet, the poor macroeconomic climate, and Malawi's relative unattractiveness as an investment destination, combined to overwhelm the progress and the level of FDI remained at a low level (between 0.9 percent and 1.9 percent of GDP 1996-98; annex A).

2.23 *Outcome:* Outcome was unsatisfactory, compared to satisfactory in the ICR and moderately satisfactory in the IEG ICR Review. The most important factor was the inability to make progress in budgetary management, but the uncertain macroeconomic environment—in part caused by weak budgetary management—provided an inhospitable climate for reforms to have a substantial impact. Efficacy in most other areas was modest, as well. With the benefit of time, the PPAR could see clearly that reform progress was limited and the macroeconomic climate was unsatisfactory.

2.24 *Sustainability:* Sustainability is likely, compared to highly likely in the ICR and likely in the IEG ICR Review. With the exception of the education and health expenditure minima, the benefits created by the credit are likely to continue. Tariff and tax policy reform continued through the PPAR period, and are embodied in statute. Privatization achievements will endure, as backtracking would be difficult and controversial—especially among donors. And the other gains in private sector development, which have remained in place since FRDP I and have the support of the business community, are unlikely to be reversed. Recent political developments are also positive for the continued flow of benefits from reforms implemented under FRDP I.

2.25 *Institutional Development Impact:* IDI was modest, compared to high in the ICR and modest in the IEG ICR Review. There was little gain in the key areas of budgetary management and civil service reform. On the other hand, gains in the tax and tariff area and in privatization contributed to a positive IDI outcome.

2.26 *Bank and Borrower Performance:* Bank performance was satisfactory, the same as in the ICR and in the IEG ICR Review. Analytical work in support of FRDP I was strong.[40] While the credit was quite demanding for a borrower with limited capacity, overall it was relevant, it addressed important development barriers, and was responsive to the needs of the Borrower. The macroeconomic situation was relatively better than it was for the later credits.

2.27 Borrower performance was unsatisfactory, compared to satisfactory in both the ICR and the IEG ICR Review. Most critically, the Government did not fulfill its commitments on budget management. In the area of Civil Service Reform, the Borrower was also deficient. The continued maintenance of an interlocking group of state-owned and parastatal firms in key sectors also served to keep out new entrants, keep margins high, and penalize the poor.

[40] Agricultural Sector Memorandum (1994), background papers on manufacturing and transport sectors (1993), Budget Management Review (1995), and Malawi Poverty Profile (1995).

3. Fiscal Restructuring and Deregulation Program II (FRDP II)

Objectives and Design

3.1 The stated objectives of FRDP II were to support policy reforms to accelerate economic growth and poverty reduction, and provide technical assistance to help implement policy reforms. The adjustment credit aimed to maintain the momentum of policy reforms launched by the Government of Malawi since 1994 by improving public expenditure management and promoting private sector development. The credit aimed to meet increased balance of payments financing requirements that Malawi faced due to a sharp fall in export earnings, and to implement policy reforms by maintaining economic stability and mitigating the transitional costs of adjustment.

3.2 FRDP II was accompanied by a companion TA credit, FRDP II TA, in the amount of US$2 million (discussed in chapter 5). The adjustment credit consisted of two tranches, the first of US$61.7 million equivalent disbursed upon approval, and a second tranche of US$28.3 million equivalent disbursed after achievement of specified reforms (expected after four months, but in actuality released after 12 months).

3.3 The reforms supported by FRDP II continued many of the thrusts begun in FRDP I, and included:

- Improving the quality and management of public expenditures
    - Sustaining increased expenditures in the social sectors
- Rationalizing government and civil service functions
- Tax policy and financial sector reforms
- Private sector development
    - Privatization, including a program for the commercialization and privatization of ADMARC
    - Facilitating Temporary Employment Permits for skilled expatriate workers
- Utility policy reforms
- Maize price and marketing reforms—reducing government interventions in the maize market

3.4 Quality at entry was inadequate. The Bank was unrealistic in attempting to improve the quality and management of public expenditures in much the same manner as FRDP I—when in reality little progress had been made. In terms of Borrower commitment, it is difficult to understand how the Bank could have worked for two years with officials at various levels, struggled to achieve progress, and then initiated a new operation that continued on essentially the same course. As in FRDP I, the credit was overly broad in scope, spanning five sectors, but with just 16 conditions. Monitoring and evaluation improved somewhat, with “intermediate progress benchmarks” for each area specified in the conditionality matrix. Most of these were appropriate, except in expenditure management, where they were too vague to be workable. No indicators were included for the social sectors except sector expenditure levels. Implementation of the reform program was monitored by the Cabinet Committee on the Economy, an ineffective arrangement. As described below, the macroeconomic environment was worse than that which prevailed at the start of FRDP I. Considering the lack of progress under FRDP I and the turbulent macroeconomic environment, the initiation of FRDP II suggests that the Bank was more concerned with the transfer of resources than with the results achieved.

Implementation Experience

3.5 *Macroeconomic Environment*: It is useful to review the macroeconomic environment before the approval of FRDP II (table 3.1 below). Although the macroeconomic environment had been unsettled from 1995-1997, imbalances were starting to be reduced. The fiscal deficit (before grants) fell from 28 percent in 1994/95, to 14 percent in 1995/96, and 7 percent in 1996/97. Inflation declined, interest rates fell, and the exchange rate was relatively stable. But in the second half of 1997, macroeconomic performance deteriorated, mainly due to the loss of adequate expenditure discipline. A higher wage bill than budgeted, excessive travel-related expenditures and a shortfall in income tax collections pushed the 1997/98 fiscal deficit to 12 percent of GDP. Inflation tripled (1998 over 1997), interest rates rose rapidly, and foreign exchange reserves fell to 2.1 months of imports. Poor rainfall in 1997 also led to a decline of 23 percent in maize production. Malawi also faced adverse changes in the terms of trade, as tobacco prices fell and the South African Rand was devalued. In 1995-97—the period preceding FRDP II—GDP growth averaged 9.3 percent per year, whereas in 1998-2000 it averaged 2.8 percent. Inflation was volatile and averaged 43.4 percent from 1995-97, falling to 34.7 percent during the credit, while the real effective exchange rate was steady.

Table 3.1: Selected Macroeconomic Variables, 1996-2001

	1996	*1997*	*1998*	*1999*	*2000*	*2001*
				FRDP II		
Real GDP growth rate	7.3	3.8	3.3	4.0	1.1	-4.2
Av. Inflation rate (CPI)	37.6	9.2	29.8	44.8	29.5	22.7
Av. Treasury Bill Rate	30.8	18.3	33.0	42.9	39.5	42.4
Curr. Acct. Bal/GDP	-7.1	-11.9	-0.2	-8.2	-5.3	-6.8
Real eff. exch. rate: index	138	153	112	112	113	116
Fiscal Revenue/GDP	15.5	14.8	18.1	17.2	18.4	17.2
Fiscal Bal. w/o grants/GDP	-7.2	-9.0	-11.0	-12.4	-14.4	-14.7
Fiscal Bal. w/grants/GDP	-2.8	-5.6	-5.1	-5.6	-5.8	-7.9

Source: Government of Malawi, IMF, World Bank Development Data Platform.

3.6 Malawi had received a disbursement under the Fund ESAF in April 1997, but the program began to go off-track in mid-1997 and in November the program was suspended. Malawi was put under a staff-monitored program (SMP) from April 1998, to November 1998, during which its finances were monitored closely. Following successful implementation of the SMP, the balance of the second annual tranche of the ESAF was disbursed in October 1998. FRDP II was approved by the Bank's Board on December 3, 1998, and thus during this brief window it could be considered that Malawi was "back on track." The FRDP II internal Bank document presents a dismal picture of the Malawian economy at the inception of the credit, yet it strongly implies that the satisfactory medium term macroeconomic framework in Malawi were positive indicators for an adjustment lending. The unsatisfactory macroeconomic environment from 1998 to 2004 was such that policy-based lending should not have been considered, and the Bank should have made its own assessment of the macroeconomic environment rather than depending on the existence of a Fund program.

3.7 *Improving the Quality and Management of Public Expenditures*: The credit supported measures to strengthen budget discipline, reduce the primary deficit, and lower inflation. These measures included: more systematic use of the MTEF; enhanced and more frequent expenditure monitoring; and stronger expenditure control procedures. More intensive examination of investment projects made a modest improvement in the budgetary process. In accordance with FRDP II conditionality, agencies were required to convene a committee led by a senior official in order to approve new investment projects. This procedure slowed, but did not stop, approvals of new projects that were not in the original approved budget.

3.8 However the fiscal deficit (without grants) increased from 9.0 percent in 1997 to 12.4 percent in 1999, the opposite of what FRDP II had intended, inflation remained high, and consequently the measures taken were not successful.

3.9 Efforts to *sustain increased expenditure levels in the social sectors* were mixed. The levels stated in the Letter of Development Policy were probably not achieved; the credit required that the 1997/98 share of Other Recurrent Transactions (ORT), be 8.9 percent for education and 12.1 percent for health; 1998/99 share of ORT, 13.2 percent for education, and 14.9 percent for health. Data were not available on ORT, however, as shown in table 2.2 above, examining recurrent expenditures as a proportion of all expenditures shows that while the higher level of health expenditures was broadly sustained, education expenditures fell.

3.10 The modest progress in *rationalizing government and civil service reform* started during FRDP I slowed during FRDP II. An intended salary study was not completed (a Medium Term Pay Policy study was conducted later under FRDP III TA). Little progress was made in rationalizing, outsourcing, or eliminating functions identified in reviews conducted under FRDP I, or in redeploying individuals where that was determined to be more efficient, and as a result a partial waiver was granted in this area to permit disbursement of the second tranche.

3.11 Progress continued in *tax policy reform*, with the average tariff level declining from 19 percent in 1996 to 14 percent in 1998/99, and the top rates on consumer goods reduced from 35 percent to 30 percent and on intermediate and capital goods to 5 percent. A tax reform study, implemented with FRDP II TA funds, was completed during FRDP III and resulted in the wider imposition of a surtax (VAT). However, as noted earlier, the fixed-level turnover tax affected profitable firms in the same manner as those making losses, and many incentives for investors and exporters were complex, non transparent, and highly discretionary.

3.12 In the *financial sector*, a study was completed on a regulatory framework, but the framework itself was not implemented as called for in the conditionality, necessitating a partial waiver for the disbursement of the second tranche. (The regulatory framework was implemented during and after FRDP III).

3.13 In the *private sector development*, a privatization and commercialization plan for ADMARC was developed, and 18 firms identified in the Divestiture Sequence Plan (DSP) were brought to the point of sale.[41] However, only 1 of the 18 firms (Fincom) was owned by ADMARC—less progress than envisioned under the credit. During FRDP II, the Government began to rethink the privatization of ADMARC, despite commitments to do so (annex table B1).

3.14 In addition, progress was made on streamlining procedures to obtain a Temporary Employment Permit (TEP), which permitted expatriates to work in the country. This progress provided a foundation for further advancement in this area over the next five years.

3.15 In *utility policy reform*, progress was made in establishing a legal and institutional framework for the telecom and power sectors. A Telecommunications Policy was promulgated in August 1998, with enabling regulations issued in December of that year. Malawi Posts and Telecommunications was split into separate entities (with both entities receiving technical assistance from the Bank), and the Malawi Communication Regulatory Authority—MACRA—was established in 1999. The agency has been the beneficiary of considerable TA,[42] and MACRA appears to have reached a satisfactory level of competence. Its director is appointed to a fixed term, and it is independently funded by fee income. At the start of FRDP II, there were approximately 40,000 fixed-line telephones in the country, and the goal of the credit was to increase this number to 60,000. In August 2005, the number of fixed-line telephones was 80,000, but in addition there were two mobile carriers with 200,000 phones. MACRA has also licensed 14 private radio stations and 19 Internet Service Providers. However, the condition of the fixed line system remains poor.

3.16 While the Electricity Act of 1998 permitted the establishment of an independent regulatory agency and entry of private firms into the sector, little progress has been made to date in either of these areas.

3.17 *Maize Price and Marketing Reforms*: The goal of this activity was to reduce government interventions in the maize market. This largely failed, even though the National Food Reserve Agency (NFRA) had its Trust Deed amended to limit the agency to food security, as opposed to intervening in markets to foster price stability as it had previously done.

Ratings

3.18 *Relevance:* Overall relevance was modest. On the positive side, utility policy reforms addressed valid development barriers, and the emphasis on sustaining expenditure levels in the social sectors addressed the nation's widespread poverty. Reducing government interventions in the maize market was sensible, as was rationalizing government and civil service functions.

[41] By December 1999, 35 out of 100 PEs on the DSP had been privatized.

[42] From Danida, USAID, and the South African Regulatory Authority.

3.19 However, detracting from relevance was the lack of realism the Bank displayed in once again tackling the strengthening of budget discipline in approximately the same manner as in FRDP I. Having made little or no progress on improving expenditure management in FRDP I, it is puzzling why the Bank would go forward on the same track without pausing to assess why advancement had been so difficult. Also, the lack of expenditure discipline displayed by the GOM in the second half of 1997 should have alerted the Bank that: (i) the approach taken in this area seemed to have yielded no framework, rules, or procedures that could withstand a change of political desires; and (ii) the GOM's lack of a consistent or responsible macroeconomic policy had the potential to undermine hard-won progress on structural reforms—which is what actually happened. And despite the lack of significant progress in most sectors addressed by the overly-broad FRDP I, FRDP II continued the same "broad front" approach with 16 conditions across the same five sectors.

3.20 *Efficacy:* Efficacy was modest overall. High and volatile inflation, and the steadily rising deficit—which was financed by domestic borrowing—undermined structural achievement. The key effort to strengthen budget discipline was unsatisfactory, as was the attempt to advance civil service reform and increase allocations to the social sectors. Privatization progress was reasonable, but divestiture did not yet extend to larger firms such as utilities or the financial sector, nor did privatization touch ADMARC as yet (except for one subsidiary). And good achievement in the telecom sector was offset by a lack of progress in the power sector.

3.21 *Outcome:* Outcome was unsatisfactory, compared to satisfactory in the ICR and moderately satisfactory in the IEG ICR Review. The credit was only modestly relevant, achieved little or no progress in the key area of expenditure management, and only modest progress in most other areas. Good progress in the telecom sector and reasonable advancement in privatization—without so far tackling the most difficult cases—did not offset the deficiencies noted. With the benefit of time, it is evident how little reform progress was made, and how turbulent the macroeconomic environment was.

3.22 *Sustainability:* For the modest benefits achieved, sustainability is considered likely, the same as in the ICR and IEG ICR Review. Tax policy reforms are embedded in legislation, do not face opposition, and seem likely to endure. Progress in PSD is likely to be sustained; the firms brought to the point of sale have been sold, and seem unlikely to be renationalized. Some of the state-owned firms divested were liquidated, or closed their doors soon after state support was withdrawn. And those newly-private firms that are viable form a growing interest group that would strongly oppose re-nationalization. And the progress on TEPs has yielded real, if modest, benefits, with little reason to believe that the government would backtrack. The establishment of the telecom regulatory agency and its gradual increase in capacity is a real benefit that seems unlikely to be reversed. Advancement in the telecom sector—particularly the rapid growth in wireless—has produced broad benefits that have a wide constituency. Finally, Malawi's heavy dependency on donors makes it considerably less likely that it would backtrack on reforms.

3.23 *Institutional Development Impact:* IDI was modest, the same as in the IEG ICR Review. (IDI was not rated in the ICR.) On the positive side, a growing number of firms were privatized; the basis of a regulatory regime set up in the telecom sector; and tariffs reduced. On the other hand, the most important goal of the credit, building capacity in managing public expenditures was not achieved.

3.24 *Bank and Borrower Performance:* Bank performance was rated unsatisfactory, compared to satisfactory in both the ICR and the IEG ICR Review. The design of the project was deficient: the Bank largely pursued a similar path to that of FRDP I, when the weaknesses of that approach should have been evident. By 1998, the Bank should have understood that an overly complex design, with too many sectors and conditions, was not suitable for a country with Malawi's capacity. Also, the lack of expenditure discipline displayed by the GOM in the second half of 1997 should have alerted the Bank that the approach taken seemed to have yielded no procedures that could withstand a political decision to overspend, and that the GOM's lack of a responsible macroeconomic policy could undermine progress on structural reforms.

3.25 Borrower performance was unsatisfactory, compared to satisfactory in both the ICR and the IEG ICR Review. Most critically, the Government did not fulfill its commitments on budget management or expenditures in the social sectors. In the area of civil service reform and expenditure rationalization, the Borrower also failed to make adequate progress.

4. Fiscal Restructuring and Deregulation Program III (FRDP III)

Objectives and Design

4.1 The project had three broad objectives, first to improve public sector management; secondly to promote private sector development, and lastly to create safety nets.

4.2 The objectives were based on existing experience and analytical work.[43] The project was a one-tranche operation, approved in December 2000, with US$55.6 million equivalent disbursed soon after effectiveness. FRDP III was complemented by a TA loan of US$3 million to support implementation of policy actions taken under the credit (see chapter 6).

4.3 Quality at entry was poor. FRDP III's design as a one-tranche operation was ill-advised in the context of Malawi's modest progress on earlier reforms—especially in the critical area of strengthening budgetary management and improving fiscal performance—since follow-up to ensure reform implementation was difficult for the last operation in a series. Also, FRDP III was prepared too hastily; the Bank should have taken greater account of the lack of Borrower commitment and the slowing of reform momentum. A multi-tranche operation would have been more suitable in terms of assuring the implementation of reforms, but would have taken longer to identify (which was of concern to the Bank because of the role of FRDP III in HIPC eligibility as explained in the next paragraph).

4.4 FRDP III was also over-dimensioned, in effect providing too much money for too few reforms. The original amount suggested for a single-tranche operation was US$35 million, but at the request of the authorities this was raised to US$55 million to cover NFRA recapitalization.[44] A credit in the amount of US$55.6 million was disproportionate to the FRDP III reform package, and was also inconsistent with the uncertain commitment the country had thus far shown to the FRDP. However, Bank management believed that a larger loan would be more appropriate in conjunction with its efforts with the Fund to establish the country's HIPC eligibility, and thus US$20 million was added to the credit, indicating that HIPC was also a motivating factor in the initiation of the credit.[45]

[43] Public Expenditure Review, 2001; study of options for a Safety Net Strategy; privatization experience in earlier adjustment projects and in preparation of Privatization and Utility Reform Project.

[44] In the event, FRDP III funds were not used to recapitalize NFRA and the GOM authorized new borrowing by NFRA at non-concessional rates, which led to a subsequent bailout of the agency amounting to 0.6 percent of GDP.

[45] It should be noted, however, that the Bank had limited room for maneuver concerning HIPC once the Fund made a decision to go ahead.

Implementation Experience

4.5 *Macroeconomic Framework:* FRDP III was initiated in a poor macroeconomic environment (table 4.1); Malawi's fiscal deficit (without grants) was 14.4 percent in 2000, 3.4 percentage points higher than 1998 and double the level of 1996 (figure 4.2). The high and variable rate of inflation in the period prior to FRDP III presented an obstacle to private business (figure 4.1). GDP growth in 2000 was 1.1 percent, down from 4.0 percent in 1999. The nominal exchange rate was MK59.5/$, down from MK44.1/$ the preceding year and MK15.3/$ in 1996. An FRDP III internal Bank document statement proved to be misleading when it stated that the diversification of GDP showed an increase in the share of manufacturing due to improved macroeconomic situation during the 1990s when most of the data presented support the conclusion that the macroeconomic environment at credit inception was poor.

Table 4.1: Selected Macroeconomic Variables, 2000-2004

	2000	*2001*	*2002*	*2003*	*2004*
			FRDP III		
Real GDP growth rate	1.1	**-4.2**	**1.8**	**3.9**	4.6
Av. Inflation rate (CPI)	29.5	**22.7**	**14.8**	**9.6**	11.5
Av. Treasury Bill Rate	39.5	**42.4**	**41.8**	**39.3**	28.6
Curr. Acct. Bal/GDP	-5.3	**-6.8**	**-11.2**	**-7.6**	-8.0
Real eff. exch. rate: index	113	**116**	**115**	**90**	84
Fiscal Revenue/GDP	18.4	**17.2**	**20.7**	**23.5**	23.6
Fiscal Bal. w/o grants/GDP	-14.4	**-14.7**	**-19.0**	**-19.8**	-19.3
Fiscal Bal. w/grants/GDP	-5.8	**-7.9**	**-12.1**	**-7.3**	-4.1

Source: Government of Malawi, IMF, World Bank Development Data Platform.

Figure 4.1: Inflation Rate, 1994-2000

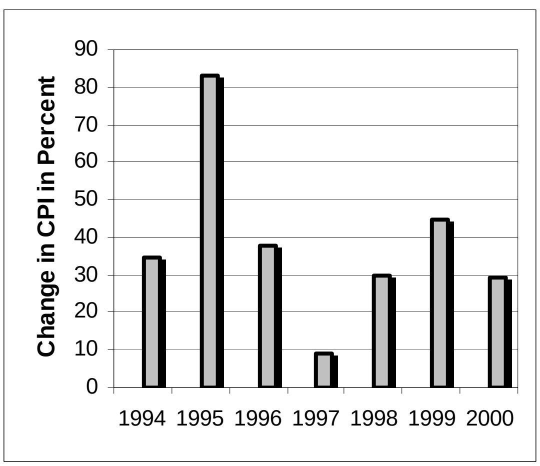
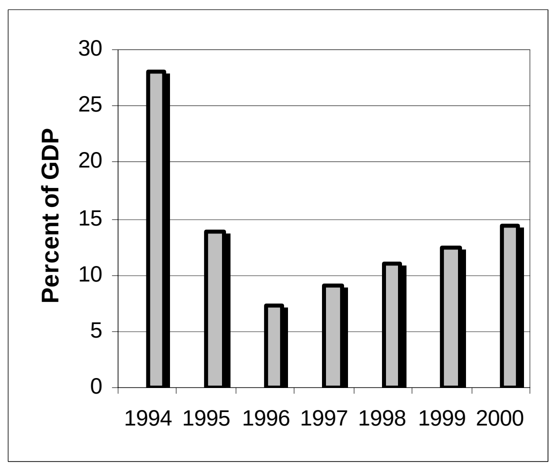


Figure 4.2: Fiscal Deficit, 1994-2000



Source: Government of Malawi, Bank Data Platform.

4.6 FRDP III was approved on December 21, 2000, the same date the Fund approved a PRGF program. An FRDP III internal Bank document strongly implies that the existence of a Fund program was sufficient to indicate a satisfactory macroeconomic environment. The PRGF went off track even before the first review could be concluded in the first half of 2001, and the review was finally concluded in October 2003; the PGRF was later canceled in 2004.

4.7 During FRDP III, the fiscal deficit continued to worsen, increasing domestic borrowing requirements and keeping interest rates high. The fiscal deficit, without grants, was 14.4 percent of GDP in 2000, 14.7 percent in 2001, 19.0 percent in 2002, 19.8 percent in 2003, and 19.3 percent in 2004. GDP growth from 2001 to 2003 averaged 0.5 percent per year.

4.8 *Improve Public Sector Management:* Efforts to strengthen budgetary formulation and execution continued but met with little more success than was achieved in the earlier FRDP credits. Unrealistic and politically-driven practices continued to dominate the budget process. Efforts under FRDP III to make budget data more transparent were largely unsuccessful; budget data were published and put on the internet once, when the credit disbursed, but the practice was not continued. The organization created to monitor the finances of parastatals, the Parastatal Enterprise Reform and Monitoring Unit (PERMU), achieved little impact. The finances of large parastatals were not made public, as the credit required, and in August 2005, the total staff of PERMU consisted of three individuals. A mechanism was established by which any proposed new projects were to be screened by a specifically-created committee chaired by a senior official of the Ministry of Finance. This was honored in form, but had little impact on which projects went forward.

Box 4.1: Integrated Financial Management Information System (IFMIS)

IFMIS is an automated system to strengthen financial control and management of public funds by providing timely and accurate budgeting and financial information across government.

Efforts to install and pilot IFMIS in Malawi began in 1995 under the Second Institutional Development Project. Procured using standard Bank procurement procedures, a contractor was selected who installed the system at five pilot sites. However, significant problems were encountered using the system, the first contractor was eventually terminated, and a new vendor engaged to resolve the issues that emerged with the first supplier. However, the 2nd vendor did not have sufficient knowledge of public financial accounting, and was not able to resolve the issues. Given the length of time this had taken, there had been five GOM project managers and three Accountants General, so considerable institutional memory was lost.

A peer review of project implementation was undertaken to identify outstanding issues and lessons learned, and develop a strategy to enable successful implementation. It is envisioned that, in the installation of a new system, significant business process re-engineering will take place. GOM officials have examined software in use by other African governments, and are proceeding with plans to purchase this proven software and scrap IFMIS altogether.

Efforts to implement IFMIS had begun in 1995 and continued for ten years through FRDP III and FIMTAP. Of US$6.3 million allocated for the project, US$2.3 million has been spent with little result.

Source: Interviews with Government of Malawi Officials and Project Documents.

4.9 Part of the effort to increase transparency was the development of IFMIS, the Integrated Financial Management Information System.[46] This was to have been an automated system to provide timely and accurate budgeting and financial information across government. IFMIS was a disaster, did not work, and consumed 10 years of Bank and government effort and US$2.3 million with virtually no benefit (see box 4.1).

[46] IFMIS was funded by the Second Institutional Development Project, but its implementation was an FRDP III condition.

4.10 However, several initiatives were launched during FRDP III which are currently producing benefits and have promise to achieve more:

- *Procurement reform*: Efforts in this area seem to be moderately successful. The Public Procurement Act established the Director of Public Procurement to supervise public procurement, which was decentralized to line ministries—a radical departure from earlier practice in which procurement was centralized. This was just beginning to work efficiently in August 2005, and promises to reduce the opportunities for corruption
- *Audit reform:* Under the FRDP III TA project, the legal and institutional framework was created to help ensure that public funds are used efficiently and for the intended purpose (see chapter 5). The Auditor General reviews the accounts of government ministries and other units (subject to resource limitations)—a salutary process. While the institutional arrangement is not ideal and additional resources would be helpful, the prospect of an outside audit of ministry accounts is likely to have a positive effect in reducing variance from agreed budgets and corrupt practices. The Auditor General also reviews the terms of references of contracted audits, tracks outputs of these, and the management response.
- The Office of the *Accountant General*, although also under-resourced, works to ensure that public accounting is performed properly, that is, that payments are accounted for, and that funds are being spent for the purpose intended. The reports of the Accountant General on each Ministry are sent to the Controller for that Ministry, and the consolidated reports are sent to the Parliament.

4.11 In addition, *tax administration* was improved. In 2000, tax collection was restructured, the Malawi Revenue Authority (MRA) was established, and the agency received technical assistance from the Fund and from the U.S. Treasury, as well as from the Bank. The revenue service was modernized and training provided to customs officials and others, coverage of the VAT was expanded, and revenue collection was partially automated.

4.12 MRA retains 2.5 percent of the amount that it collects (4 percent for collections above the budgeted amounts), so the agency has an incentive to be aggressive in collections. Until recently, that resulted in agents making repeat visits to their "best taxpayers," but as a result of complaints the incentive system was expanded to take into account "new taxpayers" that were identified by agents. Malawi's revenue/GDP ratio went from 18.4 percent in 2000 to 17.2 percent in 2001, 20.7 percent in 2002, 23.5 percent in 2003, and 23.6 percent in 2004.[47]

4.13 In the *social sectors*, FRDP III stipulated that discretionary recurrent expenditures on education be at least 23 percent of all such budgetary expenditures, with health expenditures required to be at least 13 percent. These levels were achieved, and FRDP III continued the record of the earlier credits of increasing expenditures in these sectors over what they would otherwise have been (as discussed earlier, the increased

[47] As noted in annex D, the most important factors in revenue performance during the years 1994 to 2001 were tax policy reforms and improved institutional structure—principally MRA. From 2002 to 2004, however, the motivation for the GOM to increase revenue was increased budget deficits, and the rapidly increasing need for funds to pay interest on domestic debt.

spending was more pronounced when measured as a percent of GDP). However, while spending increased, the impact was unclear. As noted in para. 1.50, FRDP III also required that primary-level textbooks be delivered directly from suppliers to schools, bypassing the Ministry of Education and reducing the opportunity for theft. This effort, financed by CIDA and described in Box 4.2, was successful, and resulted in a substantial increase in the availability of textbooks. Finally, an FRDP III condition that 6,000 individuals be enrolled in teacher training annually was not met: around 2,850 teachers graduated in 2001/02, 3,150 in 2002/03, and 3,000 in 2003/04.

Box 4.2: The CIDA Textbook Project

In previous efforts to supply teaching materials to Malawi, much of the material provided to the Ministry of Education did not reach schools, and some items were found for sale in local markets. In 2001, the Canadian agency CIDA sent an inventory form directly to every school in the country, and based on the responses, ordered 11.4 million books and teacher's guides tailored to the needs of each of the country's 4,363 schools. Since many schools did not have roofs or were outdoors, the agency packaged the books for shipment directly to each school in 12,300 secure, waterproof steel cabinets. Deliveries began in late 2001 and were completed the following year. In large measure due to this program, the ratio of books to pupils rose from 0.04 books per pupil in 1993/94 to 0.67 books per pupil by 2004. The total cost of the project was US$7.5 million.

Source: CIDA Website.

4.14 *Private Sector Development:* The most important accomplishment of FRDP III in this area was the sale of the Commercial Bank of Malawi to a strategic investor in 2003. This achievement was a major element in the transition of the financial sector from 100 percent state ownership in 1996 to 97.6 percent private ownership in 2005. Despite the change of ownership, however, there is little evidence of greater efficiency—such as reduced spreads between lending and deposit rates. The bank regulatory framework developed consistently during the PPAR period, and the established regime is satisfactory and is an impressive achievement for a country at Malawi's income level.

4.15 Another important achievement was the legal separation of Malawi Posts and Telecommunications into two corporate entities. After several unsuccessful attempts, Malawi Telecom was finally sold in January 2006, more than three years after FRDP III closed. The telecom sector has been further liberalized by licensing of two wireless operators, and leaving open the possibility of licensing others.[48] The country has 200,000 wireless phones as of August 2005, as well as 80,000 fixed wire phones. The telecom sector regulator—MACRA—was established in 1999, and its organization and function seem to conform to international practice.

4.16 Petroleum imports were liberalized, and the parastatal that was previously the sole importer (ORTEX) was sold. The buyer was a group of private importers—perhaps not an optimal solution—but one that is understandable given the size of the Malawian market. The outcome seems to have been positive, with a much wider availability of outlets.

[48] Although a third wireless operator has been licensed for several years, it has not started operations, and the government is considering its policy options.

4.17 *Social Safety Nets:* The goals of FRDP III in this area were to: (1) design a National Safety Nets Strategy (NSNS); (2) design a targeting scheme for the formerly universal "starter pack" system; and (3) recast the NFRA with a clear mandate as a strategic grain reserve involved in relief and disaster activities, and not as a market stabilizer.

4.18 In accordance with FRDP II and III conditionality, the government established NFRA to manage the strategic grain reserve, rather than use it for price stabilization operations. However, NFRA did not take full operational charge of food security until 2004, and de facto, ADMARC continued to operate the grain reserve for several years, including the unauthorized sales in 2000-2001. Following its establishment, NFRA continued the price stabilization function formerly exercised by ADMARC, and raised its stock to 167,000 tons. The context in which this was done was the severe drought that afflicted Malawi in 2000-2002.[49] In 2000, the government was advised by donors, including the Fund and the Bank (which was the lead advisor on food security), to reduce its existing maize stocks from 167,000 tons to 60,000 tons, which donors advised was "the safest immediate option."[50] The government followed this advice, but in the event, NFRA—without proper authorization—sold its entire reserve, and by early 2002 the country faced its most severe famine in 50 years without any reserve. The government and donors have since focused on the emergency provision of food to those most in need, a subsidy on maize, and the continued operation of the starter pack system as a universal program.

4.19 Donor advice to reduce the Malawian food reserve was flawed. While if the 60,000 tons had been available the famine would have been less severe, in the context of an output decline of nearly a half-million tons the reserve still would not have been adequate. As noted by the IMF Factsheet, the recommended reserve level was based on the efficacy of "early warning indicators" which were to have warned of a shortfall six to nine months in advance. However, these indicators were based on flawed agricultural data and assumptions as to warning time, and did not serve their intended function. Further, the government was not aware of the shortfall even after it began, and began to investigate the adequacy of food supplies only after being alerted by reports from NGOs in February 2002. Finally, the logistical difficulty of moving large quantities of maize into Malawi was underestimated. Unfortunately, these shortcomings, combined with the negligence of the government, contributed to the severity of the famine.

4.20 The NSNS was prepared and adopted by the government, but little has so far been done regarding implementation. While it was the intention of FRDP III to restructure the starter pack program (see next paragraph) and integrate it with other elements of the NSNS, this has not yet been achieved. In the context of the famine, it is perhaps understandable that the government has not yet acted to change a system which, although inefficient, ensures that affordable food is available.

---

[49] Maize production in 2001/02 was 1.55mt compared to normal annual consumption of 2.0 mt, a shortfall of nearly half a million tons.

[50] The Bank and other donors endorsed the study that provided this advice: ADE. "Malawi: Inception Technical Assistance to the NFRA" August 2000, commissioned by the GOM and paid for by EC-RESAL. See IMF. "Malawi – The Food Crises, Strategic Grain Reserve" and the IMF. "Factsheet" July 2002, and RESAL/MTLconsult. "Technical Note N07: NFRA—Can A Strategic Grain Reserve Be Justified in Malawi?" April 2000. EC-RESAL studied food security across a number of countries, and ADE and MTLconsult were firms that worked under contract to the EC.

4.21 The donor-sponsored “starter pack” program was introduced in 1998 because many smallholders could not afford the production inputs necessary to increase food crop yields, a donor sponsored “starter pack” program was introduced in 1998. The starter pack involved free distribution of a package of fertilizers and hybrid maize and legume seeds for 0.1 ha. per household to about 3.0 million farm households in an effort to demonstrate and jump start the uptake of more productive agricultural technologies. In the two years of the program’s existence, maize production reached levels not achieved before or since.

4.22 Despite its initial success, the program was replaced in 2000/2001 with a less ambitious (and less costly) “Targeted Inputs Program” (TIP), whose scope, components and costs were gradually increased until, by 2004, it had regained the size and cost of the starter pack program, but with a key difference: TIP was no longer introducing the more productive hybrid maize technology. Rather, lower cost open-pollinated varieties were distributed, which did not have the yield potential to contribute to net farm incomes that hybrid lines could offer. Although it is traditionally opposed to such subsidies on account of their distorting effects, the IMF approved this one.

4.23 NFRA was created in 1999 to manage the strategic grain reserve and act as a disaster and emergency relief agency. While NFRA had responsibility for managing emergency reserves, ADMARC owned the physical facilities and for several years was the de facto manager. Under FRDP III, NFRA’s Trust Deed was amended to restrict it solely to disaster and relief operations, rather than price stabilization (NFRA did not adhere to these requirements). It should be noted that while the FRDP III credit was increased by US$20 million ostensibly to recapitalize NFRA, the funds were not used for that purpose, and in 2001/02 the government borrowed at non-concessional rates to bail out the agency (the amount was equal to 0.6 percent of GDP).

Ratings

4.24 *Relevance:* Overall relevance was negligible. On the positive side, FRDP III was less complex than the earlier two credits. It continued efforts in roughly the same areas as the earlier FRDP credits, but using different approaches. The emphasis in the area of budgetary management moved to fiscal transparency, implementation of IFMIS, and the creation of institutions (auditing, accounting, PERMU) that could monitor expenditures. Privatization avoided ADMARC and focused on just a few large firms, rather than setting a goal in terms of numbers of firms privatized. And the safety net strategy—attempting to target the starter pack program, and restructure NFRA—was aimed at better reaching the poor and preventing or mitigating humanitarian disasters.

4.25 Less positive was the Bank’s decision to proceed with another adjustment operation in a country that had demonstrated over a long period that it had great difficulty implementing reforms and maintaining a satisfactory macroeconomic framework. Given that the Borrower’s commitment to following through on reform had been shown to be weak, the use of a single-tranche operation was unwise. Moreover, FRDP III was over-dimensioned for the program of reforms it encompassed, in effect providing too much money for too few reforms. An unspoken objective in the approval of FRDP III was the Bank’s desire to confirm Malawi’s eligibility for HIPC debt relief.

4.26 *Efficacy:* Efficacy was modest. FRDP III introduced a number of measures and institutions intended to better manage the budgetary process, either by direct intervention, or indirectly by tighter monitoring or greater transparency. The screening committees to review projects had little impact. Measures to enhance transparency did not work; agencies did not make results public, and parastatal finances remained opaque. IFMIS was a disaster. Fiscal deficits continued to rise, and interest to service domestic debt became a major line item in the budget. Efforts to divest Malawi Telecom were unsuccessful (thus far), and while an NSNS was developed, starter packs remain untargeted, and little real progress was made in this area—still sensitive after the recent drought.

4.27 On the other hand, as noted in para. 4.10, auditing, accounting, and procurement reforms—although nascent—are having a positive effect, and have the potential to generate significant benefits. Privatization was modestly successful, with the sale of the CBM and ORTEX, and separation of Malawi Posts and Telecommunications into two entities. And NFRA was restructured, recapitalized (at non-concessional rates), and is now fully in charge of strategic grain reserves (but with little analytical or planning capacity or guidance).

4.28 *Outcome:* Outcome was highly unsatisfactory, compared to unsatisfactory in the ICR and the IEG ICR Review. The credit was modestly relevant, and achieved little in the critical area of expenditure management, where performance continued to deteriorate. IFMIS, in particular, detracted from the Bank's reputation. Progress in other areas, in particular the sale of CBM and ORTEX, did not offset the deficiencies noted. Finally, the credit size was disproportionate to the reforms stipulated, and the macroeconomic environment was poor prior to credit inception as well as during implementation.

4.29 *Sustainability:* Sustainability is, on balance, unlikely, the same as in the ICR and the IEG ICR Review. While the privatizations and the institutional change in Posts and Telecom are likely to endure, the resilience of the reforms in accounting, audit, and procurement is dependent on the continued pro-reform stance of political decision-makers. NFRA's competence has yet to be tested, and its willingness and ability to stay out of markets except in emergencies has also not yet seen a test. While Malawi is highly-dependent on donor support, and will see pressure not to backtrack, the nature of these benefits makes them vulnerable to policy shifts.

4.30 *Institutional Development Impact:* IDI was negligible, compared to modest in the ICR and the IEG ICR Review. On the positive side, the gains in the Malawi Revenue Authority and the implementation of a competent bank supervision regime were noteworthy, as were the privatization of CBM and ORTEX.

4.31 However, much more important was the continued inability to strengthen budgetary management. The failure of IFMIS was important, and the continued state ownership of Malawi Telecom and the lack of a real NSNS or targeting method for starter packs considerably outweigh the positive elements.

4.32 *Bank and Borrower Performance:* Bank performance was highly unsatisfactory, compared to satisfactory in the ICR and unsatisfactory in the IEG ICR Review. The design of FRDP III as a one-tranche operation was ill-advised in the context of Malawi's modest progress on earlier reforms—especially in strengthening budgetary management and improving fiscal performance.

4.33 The increase in the size of the credit by US$20 million was unwarranted. While the government stated that the funds would be used to recapitalize NFRA, the additional funding was spent by the government on other things and NFRA ultimately had to be bailed out at a much higher cost. By approving a credit of this size, the Bank sent a signal to donors that Malawi was HIPC-eligible, a message that was unwarranted given the reality of the situation.

4.34 Borrower performance was highly unsatisfactory, compared to unsatisfactory in the ICR and the IEG ICR Review. The Borrower did not maintain a satisfactory macroeconomic environment; indeed the fiscal deficit climbed to nearly 20 percent of GDP during the credit. The additional US$20 million was not used for NFRA recapitalization, which imposed substantial additional costs on the country. And once the credit had disbursed, many follow-up actions ("subsequent actions" in the conditionality matrix) were either not done or failed to achieve their intended effect, in part due to lackluster government commitment.

5. Fiscal Restructuring and Deregulation Program II TA (FRDP II TA)

Objectives and Design

5.1 FRDP II TA was designed in conjunction with the FRDP II adjustment project, and was approved by the Board at the same time. Its three objectives were to: (1) implement policy measures under the Government's reform program supported by the FRDP II adjustment credit, including providing consultancy support, training and hardware for implementing the MTEF, auditing and reviewing the development budget, reforming expenditure control procedures and systems, and implementing civil service reforms; (2) evaluate the impact of structural reforms on Malawi's economy, in particular by examining the effects of liberalizing trade and exchange rate policy on manufacturing, and liberalizing agriculture production and trade on the agriculture sector; and (3) develop the agenda for the next round of macroeconomic and sectoral policy reforms through research into further constraints to growth.

5.2 Quality at entry was adequate. Most of the studies, training, software, and consultancy services financed under FRDP II TA addressed important development barriers consistent with the Bank and government strategy. In particular, the household survey supported by the credit permitted a more accurate assessment of poverty. And the project design was adequate for its implementation.

Implementation Experience

5.3 As noted, the credit supported a household survey, the first done in Malawi. This effort collected benchmark data on poverty, human development, the adequacy of infrastructure, and government effectiveness. Subsequently, a poverty monitoring system (not funded by FRDP II TA) was launched to measure changes in the welfare of the people through regular household surveys).

5.4 FRDP II TA also provided consultancy services that assisted the process of contracting out government functions. While the consultancy services were satisfactorily provided, the process of contracting out government functions was not successful (see chapter 3). The project also provided training and software to support implementation of the MTEF, which has also been unsuccessful thus far in strengthening budgetary management.

5.5 Studies financed under FRDP II TA included:

- **Power Sector Study:** Served as background for stakeholder meeting prior to Power Sector Policy Statement issued in June 1999. However, little progress has subsequently been made toward power sector reform. In recent efforts to push forward sectoral reform, the original study was found to be still valid as a basis for the formulation of the government's current power sector legislative and policy initiative.

- **Financial Sector Regulatory Review:** Reviewed key issues and presented guidelines for restructuring and privatization of financial institutions. Study proved useful in subsequent privatization of CBM and development of regulatory regime.

- **Study of Temporary Employment Permits** (TEP): Helped dispel widespread belief that a large number of foreigners working on TEPs were displacing Malawians, and provided recommendations for streamlining TEP process. Study proved useful in subsequent progress made in this area.

- **Study of Access to Industrial Land and Infrastructure:** Study found that investors were unwilling to build their own facilities due to high cost, risk, and lack of well-defined property rights. In addition, complex procedures made purchasing industrial sites from private individuals difficult. Little progress was made with regard to privately-owned sites, but government began program to make its own land available.

5.6 These studies contributed to Bank dialogue with the government in all but the power sector, and hence assisted in furthering reform. However, a study on the effect of trade and exchange rate liberalization on the manufacturing sector was dropped from FRDP II TA and conducted separately by the Bank.

Ratings

5.7 *Relevance:* FRDP II TA was substantially relevant. The efforts the credit supported addressed significant development barriers that remain relevant today. The substantive areas covered by the credit are important aspects of the Bank strategy for Malawi and the country's own priorities, and the design was satisfactory to achieve the credit goals.

5.8 *Efficacy:* Efficacy was substantial. Although the project was small in terms of funding, it delivered timely advice, materials, and equipment in support of important reforms the government was attempting to implement. In particular, the country's first household survey collected benchmark data on poverty, human development, and other important areas. Efficacy was reduced in instances where support was provided but where little progress was made, for example, consultancy services to assist in contracting out government functions; training and software for MTEF. However, in a majority of areas, the assistance was useful and contributed to a positive outcome.

5.9 *Outcome:* FRDP II TA is assessed as moderately satisfactory, as compared to satisfactory in both the ICR and IEG ICR Review. The rating is lower because some portion of the project effort was expended in areas that did not progress, and consequently FRDP II TA efforts in those areas made relatively less contribution to the advancement of reform.

5.10 *Sustainability:* Sustainability is rated as likely. The advice and techniques generated are likely to continue to produce benefits. The studies have proved durable, and the household data provided benchmarks for future analyses.

5.11 *Institutional Development Impact:* IDI was modest since some of the support it provided did not result in any discernible improvement in the functioning of the beneficiary institutions. This rating is compared to substantial in the IEG ICR Review, and is lower for the same reasons cited under outcome. (IDI was not rated in the ICR.)

5.12 *Bank and Borrower Performance:* For FRDP II TA, Bank and Borrower performance are both rated as satisfactory, the same as in the ICR and the IEG ICR Review. Overall, the support provided was timely and appropriate to the reform program being undertaken. The quality of the technical assistance was good, according to beneficiaries, and there were no shortcomings relating to procurement.

6. Fiscal Restructuring and Deregulation Program III TA (FRDP III TA)

Objectives and Design

6.1 FRDP III TA was designed in conjunction with the FRDP III project, and was approved by the Board at the same time as the adjustment project. FRDP III TA focused on three major areas of support: (1) public financial management (US$0.4 million); (2) public procurement reform (US$2.4 million); and (3) studies in support of reforms (US$0.2 million).

6.2 Quality at entry was poor. While the project addressed areas of evident need, and was consistent with Bank strategy for the country, the design was ambiguous. There was a divergence between the project components (stated in the previous paragraph), the performance indicators, and the project objectives, as stated in the DCA, which were: (i) assist in implementing policy measures under the program; (ii) assist in evaluating program impact; and (iii) develop the agenda for the next macroeconomic and sectoral policy reform.

Implementation Experience

6.3 Under FRDP III TA, the legal and institutional framework was created to help ensure that public funds are used efficiently and for the intended purpose; however this was accomplished 1-2 years later than originally envisioned.[51] These laws included the Public Finance Act (2003), which separated the financial management and auditing functions, and held ministry Controllers responsible for proper financial management. The Public Audit Act (2003) placed responsibility for audits with the Auditor General, who commissioned and/or reviewed audits of public agencies. The Public Audit Act is considered to be in line with international best practice. The Public Procurement Act (2003) established the Director of Public Procurement to supervise public procurement, which was decentralized to line ministries—a radical departure from earlier practice, in which procurement was centralized. *The development of the legal and institutional framework in these areas proved valuable as a basis for later reforms.*

6.4 FRDP III TA also provided assistance to the agencies charged with implementation in these areas. Thus, for example, assistance was provided to the Supreme Audit Institution to recommend appropriate audit methods, prepare audit manuals, and develop other materials. Training was also provided to MOF staff in relevant disciplines (for example, financial economics, computer science, debt management).

6.5 The largest component of FRDP III TA was that dealing with public procurement reform. The new law requires adoption of decentralized, more transparent procedures that promise to reduce fraud and corruption. The law also provided for a professional procurement unit. In addition to assistance in formulating the new law, support was

[51] The delay in establishment of the legal framework also caused delays in related training under the project.

provided to the establishment of the Procurement Authority, including training, technical advice, and equipment. Steps have been taken to establish these institutions and put these practices into place, they are currently beginning to produce benefits and appear to have a good chance to exercise a positive influence on public financial management in the future.

6.6 In addition, both the MOF and the National Audit Office (NAO) benefited from institutional strengthening and from the purchase of equipment under the credit. Finally, FRDP III TA funded a number of studies intended to facilitate reform, including:

- Tax Reform
- Energy and Power Policy
- Costing for Poverty Reduction Strategy Paper
- Food Availability and Accessibility Assessment

Overall, these studies were useful to the government in the design of reforms.

Ratings

6.7 *Relevance:* FRDP III TA was modestly relevant. On the positive side, the efforts the credit supported addressed significant development barriers that remain relevant today. The substantive areas covered by the credit were important aspects of the Bank strategy for Malawi and the country's own priorities, with the legislative framework envisioned in the project important as a foundation for later progress. However, as stated in para. 6.2, the project design was inconsistent, with a mismatch between the objectives and the components. The activities undertaken under FRDP III TA were much more narrowly focused than what was envisioned in the project documents.

6.8 *Efficacy:* Efficacy was modest, considering the broad objectives as stated in the Loan Agreement. Although FRDP III TA delivered useful advice, materials, and legislative drafts in support of reform, it fell far short of fulfilling its stated objectives.

6.9 *Outcome:* FRDP III TA is assessed as unsatisfactory, the same as the ICR and the IEG ICR Review. While the legislative framework that the project put into place was, at the time of the PPAR mission, beginning to produce benefits, the credit's achievements fell far short of its objectives.

6.10 *Sustainability:* Sustainability is rated as unevaluable, compared to likely in the ICR and ICR Review. While the legal and institutional framework created has produced benefits, and the advice and techniques provided are being utilized by staff in routine work, the continued flow of benefits from achievements under this credit is dependent on the political will of the government—which is unpredictable in the Malawian context.

6.11 *Institutional Development Impact:* IDI was modest for FRDP III TA, the same as the ICR and the IEG ICR Review. The project put into place a substantial legal and institutional framework that, with the benefit of several years' development, serves as a solid foundation for strengthening public financial management. However, the project was much more narrowly focused than intended.

6.12 *Bank and Borrower Performance:* For FRDP III TA, Bank performance was unsatisfactory, the same as in the ICR and IEG ICR Review. Borrower performance was rated as satisfactory, compared to unsatisfactory in the ICR and IEG ICR Review. In this case, with the benefit of additional time to judge the results of the assistance, Borrower implementation of accounting, audit, and other reforms was judged to be better than it was viewed immediately after project completion.

7. Findings and Lessons

Findings

- **The Bank was unrealistic in its assessment of GOM commitment:** The Bank was overly optimistic, with the degree of excessive optimism increasing from FRDP I through FRDP III. Government behavior, in many cases agreeing to policies or conditions and then pursuing other courses, should have alerted the Bank and should have been more accurately reported.

- **The FRDP projects were overly broad in scope:** The complexity of the FRDP credits severely taxed the country's limited capacity. For example, the 42 FRDP I conditions spanning five sectors were considerably beyond GOM capacity.[52] Some issues, for example, agriculture, privatization, could have used more focused individual interventions.

- **Adjustment lending did not prove effective in improving the growth of agricultural output:** During the PPAR period agricultural output grew very slowly, did not become more diversified, and productivity fell, particularly after 2000. Also during this period, land use efficiency and land market development improved only modestly. The Bank needs to refocus on lessons learned from investment lending, and modify or scale up as appropriate. For example, large poverty impacts are potentially achievable through provision of services in research and extension, rural finance, and marketing.

- **The Bank did not provide valid advice on food security in 2000-2002:** The Bank and other donors endorsed a study recommending a 60,000 ton strategic reserve, based on the efficacy of "early warning indicators" that were to have provided six to nine months warning of shortages. But these indicators were based on inaccurate agricultural data, and other assumptions on the logistics of food importation were also inaccurate. Unfortunately, these shortcomings, combined with government negligence, contributed to the severity of the famine.

- **While the FRDP structural goals in the financial sector have been largely realized, resulting benefits have been disappointing**: The banking sector has been largely privatized, and an adequate regulatory regime has been created. However, efficiency gains have not yet been achieved, and the sector contributes little to growth. The continued influence of government, crowding out from excessive government borrowing, the highly-concentrated structure of the sector, and poor macroeconomic policy have combined to limit the benefits.

[52] FRDP I sectors included Expenditure Rationalization, Civil Service Reform, Tax and Tariff Reform, Agricultural Policy Reform, and Private Sector Development. FRDP II was somewhat more modest with 16 conditions spanning five sectors, but still exceeded government capacity. FRDP III was somewhat more modest in covering just three sectors (Public Sector Management, Private Sector Development, and Safety Nets), but still required completion of 32 discrete actions.

- **The HIPC eligibility requires that a country "have a track record of macroeconomic stability",** which Malawi clearly did not have when FRDP III was being prepared**.** In its eagerness to facilitate Malawi's HIPC eligibility, the Bank provided false comfort to the donor community. Although the Bank had limited room for maneuver once the Fund decided to go ahead with HIPC, the Bank in effect confirmed that Malawi had established a satisfactory track record and the capacity to use assistance prudently, when in fact this had not been the case under FRDP I and II.

Lessons

- **Incentives within the Bank can motivate unwise lending:** The desire to transfer resources and establish HIPC eligibility were important motivations to the initiation of FRDP III. Despite the poor macroeconomic climate and lack of reform progress under the previous credits, FRDP III was enlarged by US$20 million (over the originally-conceived amount) and hastily structured as a one-tranche loan mainly to facilitate establishment of HIPC eligibility. Further, the operation was over-dimensioned for the scope of its policy package.

- **The region's macroeconomic assessments need to have greater realism and consistency:** The analyses of the macroeconomic environment in the FRDP II and III project documents are unbalanced and lack realism and consistency. *The existence of a Fund program should not be a sufficient condition for the Bank to initiate adjustment lending.*

- **Policy-based lending in an unstable macroeconomic environment is unwise:** The Malawian experience of turbulent macroeconomic performance from 1994 to 1998, with on-again, off-again Fund programs should have alerted the Bank that further adjustment lending after FRDP I: (1) was not warranted; and (2) was unlikely to have a significant impact due to the negative effect of macroeconomic turbulence on the efficacy of structural reform.

- **In promoting reform, the Bank needs to take account of the incentives that a program creates:** MTEF, IFMIS, and civil service reform were unsuccessful in large measure because GOM officials—at all levels—did not perceive that it was in their interest to implement these reforms. While an official budget was prepared, it was routinely circumvented and exceeded by political intervention. Ten years of effort on MTEF and US$2.3 million of expenditure on IFMIS have produced virtually no results.

- **The Bank should structure lending to Malawi with more earmarked, targeted aid, and tighter fiduciary controls:** To assure that funds are used in the manner intended, budgetary support should be subject to tighter fiduciary controls. Also, greater use should be made of earmarked assistance, including that which is delivered directly from suppliers to users, such as the successful CIDA textbook program (box 4.2).

Annex A: Public Expenditure Management/ Rationalization

FRDP Program—Public Expenditure Management/ Rationalization

Credit	Key objectives	Realization	Comment
FRDP I	1. Implement cash budget. 2. Complete MTEF pilot plan for 4 agencies, obtain cabinet approval. 3. Conduct review of Development Budget. 4. Announce sectoral envelopes for social sectors for 96/97 budget.	1. Completed. 2. Completed. 3. Completed. 4. Completed.	1. Items 1-3 were completed but had little impact. 4. Expenditure targets in the social sectors were generally met.
FRDP II	1. Maintain expenditure monitoring and control procedures. 2. Reduce deviations of expenditures from budgeted amounts. 3. Implement MTEF plan to prioritize expenditures.	1. Procedures were maintained in form, but little real change occurred. 2. Not achieved. Deviation of actual expenditures from budgeted rose gradually after 1995 until it increased dramatically in 2001 and after. 3. Prioritization was achieved in form, but little real change occurred.	
FRDP III	1. Increased allocations in 2000/2001 budget for education, health, agriculture, road maintenance, community development, and gender development. 2. Increase budget share for primary education. 3. Reduce budget share for secondary school. 4. Increase cost recovery in tertiary education. 5. Increase budget allocation for drugs. 6. Cost recovery for government services. 7. Establish detailed project database in MOF, restrict new projects to high priority sectors, establish special project review committees. 8. Transparency: Regularly post budgetary outcomes. 9. Establishment of commitment register and quarterly credit ceiling system (intended to work with IFMIS). 10. Create new parastatal monitoring agency; financial reports on parastatals to be made public. 11. Auditing reform: Create fully independent Auditor-General, with adequate staffing. Raise audit coverage of agencies to 75 percent in 2002.	1. Met (see annex C). 2. “ “ 3. “ “ 4. Not met (see annex C) 5. Met. 6. Generally not met; see annex D. 7. Intended rationalization of investment projects did not occur; MOF database not used; committees were ineffective. 8. Budgetary outcome posted once (prior to Board) but not since. 9. Commitment register is maintained pro-forma, with unreliable data. Credit ceiling does not effectively restrain agency funding. IFMIS is inoperative. 10. Monitoring agency (PERMU) is weak; staff as of 8/05 was 3 professionals. Financial statements not made public. 11. Under FRDP III TA, legal and institutional framework for audit reform was established. By 8/05, considerable progress had been made and audit function was assessed as having positive effect on budgetary discipline. Agency coverage was 60 percent in 2005 vs. expected 75 percent in 2002. Office of the Accountant General was also created, which is having a positive effect on assurance that public funds are being used for the intended purpose.	

Credit	Key objectives	Realization	Comment
	12. Procurement reform: Put into place legal framework for new procurement authority to facilitate transparent procurement.	12. Public Procurement Act (2003) established Director of Public Procurement to supervise this function. Public procurement was decentralized to line ministries, in contrast to earlier practice. By 8/05, institutional foundation was in place, regulations had been issued, and reform promised to reduce opportunities for corruption.	

Annex B: Privatization, Public Sector Management, and Utilities Reform

Table B1: FRDP Program - Privatization and Private Sector Development

Credit	Key objectives	Realization	Comment
FRDP I	1. Submit privatization legislation	1. Public Enterprises Act was passed in April 1996.	
	2. Develop privatization policy, implementation unit	2. Policy was developed and the Privatization Commission established.	
	3. Select state-owned enterprises (SOEs) for privatization or liquidation	3. Divestiture Sequence Plan (DSP) consisting of a list of 100 PEs was approved by the Cabinet Committee on the Economy in August 1997. The list was later expanded to 165.	3. The DSP deliberately focused initial privatization efforts on smaller firms.
	4. Develop plan to ease investment approval	4. A plan was developed which established a foundation for further progress.	4. During the PPAR period, good progress was made in simplifying the investment approval process.
	5. Identify and rezone land suitable for new industry	5. Progress was made in identifying government-owned land that might be used by investors. However, the acquisition of privately-owned land by foreign persons remained a very complex act.	
	6. Repeal business licensing laws discriminating on ethnic grounds	6. The laws were repealed, however, in 2004 annual business license fees were set at US$97 for citizens and US$970 for non-citizens, undermining the intent of the reform.	
FRDP II	1. Prepare privatization and commercialization program for ADMARC. Based on this, Government to decide on privatization of specific ADMARC assets.	1. Privatization Plan was prepared including ADMARC and other firms. 18 of the first 24 firms on the DSP were brought to the point of sale by the close of FRDP II. Only one firm owned by ADMARC, Fincom, was sold during FRDP II. However, six additional non-core ADMARC firms were privatized as of August 2005, of which 3 were the subject of FINMAG conditionality.	1. During FRDP II, Government developed significant doubts about privatizing ADMARC, and eventually decided to divest only its non-core assets.
	2. Sell 30-40 ADMARC markets and depots by 6/00	2. Not done.	
	3. Widen maize price band.	3. The maize price band was widened as an intermediate step in liberalizing its price. The National Food Reserve Agency (NFRA) had its Trust Deed amended to limit the agency to food security, as opposed to intervening in markets to foster price stability as it had previously done.	3. The Trust Deed was modified as required, but NFRA continued to intervene in markets to stabilize prices just as ADMARC had done earlier.
	4. Streamline Temporary Employment Permits (TEP) for expatriates.	4. A new policy was adopted in 1999 making it easier to obtain TEPs, partially easing the problem.	4. Progress on TEPs continued throughout the PPAR period; by 2004, employment permits were no longer a problem.

Credit	Key objectives	Realization	Comment
	5. Separate Post and Telecom into separate entities	5. Completed under FRDP III.	
	6. Establish independent telecom regulator	6. MACRA established in 1999.	6. By 2005, agency appears to have reached satisfactory level of competence.
	7. Secure strategic partner for Malawi Telecom Limited (MTL)	7. Government completed the privatization of MTL in early 2006, more than five years after FRDP III closed.	
	8. Increase no. of fixed line phones from 40,000 to 60,000 by 2001.	8. Number of fixed line phones was 80,000 as of 2005—still a very low number. However, there were also 200,000 mobile phones as of that date.	
	9. Clarify power sector licensing and tariff procedures to attract investor.	9. Conditions met but no real progress achieved.	
FRDP III	1. Malawi Post and Telecom split into two entities.	1. Successfully achieved.	1. Both entities received technical assistance from the Bank.
	2. Liberalization of internet service.	2. Successfully achieved. In August, 2005, there were 19 licensed internet service providers (ISPs) of which 9 were operational.	
	3. Telecom Policy Statement liberalizing basic telephone and cellular service.	3. Telecom Policy Statement issued August 1998, with enabling regulations following in December 1998.	
	4. Published request for expressions of interest in Malawi Telecom Limited (MTL).	4. Successfully published.	
	5. Liberalize import of petroleum.	5. Monopsonist importer split into regulatory body and importing body (ORTEX). ORTEX was privatized in 2002.	

Table B2: FRDP Program - Civil Service Reform

Credit	Key objectives	Realization	Comment
FRDP I	1. Complete Civil Service Census	1. Civil Service Census was carried out 10/95 under Second Institutional Development Project.	1. The census determined that there were around 120,000 workers.
	2. Retrench 20,000 non-permanent civil servants	2. 20,000 were retrenched.	2. Those retrenched were mainly unskilled workers such as messengers and cleaners.
	3. Implementation of agreed Action Plan for comprehensive Civil Service reform.	3. Implementation of Action Plan was started.	3. Although some actions were taken, little real progress resulted.
FRDP II	1. 30 government functions to be abolished or outsourced by 4/99.	1. Not met; 18 government services were outsourced, and a partial waiver granted.	
	2. Implement redeployment/ retrenchment in line with benchmarks.	2. Although benchmarks were reached, little real change resulted.	
FRDP III			

Table B3: Doing Business Indicators

Malawi Rank Among 156 countries surveyed

Overall Ease of Doing Business	**96**	Starting a Business	70
Protecting Investors	62	Paying Taxes	138
Hiring and Firing	41	Registering Property	83
Enforcing Contracts	56	Closing a Business	120
Dealing with licenses	110	Trading Across Borders	114
Getting Credit	85		

Source: Bank Doing Business Website. February 2006.

Annex C: Public Expenditure in the Social Sectors

Annex Table C1: FRDP Program - Education

Credit	Key objectives	Realization	Comment
FRDP I	Within the MTEF framework, the education share of total recurrent expenditure was targeted to be 22 percent in 1995/96, 25 percent in 1996/97, and 24 percent in both 1997/98 and 1998/99.	Not met. The actual education share of recurrent expenditure was 16 percent in 1995/96, 19 percent in 1996/97, 21 percent in 1997/98 and 14 percent in 1998/99.	As discussed below, each credit used a different variable to measure resources flowing to the sector. During the PPAR period, education sector share of total recurrent expenditure fell.
FRDP II	1997/98 share of ORT, 8.9 percent for education; 1998/99 share of ORT, 13.2 percent for education.	Probably not met. Education share of recurrent budget fell from 21 percent to 14 percent during those two years.	
FRDP III	1. Share of education in discretionary recurrent expenditures at least 23 percent 2. Achieve yearly enrollment of 6,000 students for teacher training. 3. Share of primary education to be 5.4 percent of other recurrent expenditures in 2000/01. 4. Textbooks to be delivered directly from supplier to school 5. Reduce budgetary allocation for boarding schools from 16 percent of recurrent expenditures to 9 percent. 6. Eliminate subsidy for boarding in secondary schools.	1. Essentially met: share was 21.0 percent in 2000/01, 29.1 percent in 2001/02, and 29.1 percent in 2002/03 (data from FRDP III ICR). 2. Not met. Around 2,850 teachers graduated in 2001/02, 3,150 in 2002/03, and 3,000 in 2003/04. 3. Met. Primary share was 7.3 percent in 2001/02, and 6.5 percent in 2002/03. 4. Met. Nearly all pupils have textbooks. 5. Not met. 6. Not met.	

Source: Data on education expenditures as a percent of recurrent expenditure are from the 2001 *Malawi Public Expenditures: Issues and Options.* Annex 1. Additional information from FRDP III internal document.

Annex Table C2: FRDP Program - Health

Credit	Key objectives	Realization	Comment
FRDP I	Health share of total recurrent expenditure 12 percent in 1995/96, 16 percent in 1996/97, 14 percent in 1997/98, and 15 percent in 1998/99*	Not met	
FRDP II	Health overall ORT 12.1 percent in 1997/98, and 14.9 percent in 1998/99.	Probably not met, as recurrent expenditures on education as a percent of total expenditures fell substantially over this period.	
FRDP III	1. Maintain the share of health in the discretionary recurrent budget at 13 percent. 2. Annually recruit, train, and deploy at least 200 nurse technicians, 50 new medical assistants, and 20 new radiography technicians.	1. Met. Health expenditures as a share of discretionary recurrent expenditures were 12.1 percent in 2000/01, 15.2 percent in 2001/02, and 18.5 percent in 2002/03. 2. Met. Students enrolled for nurse training were 435 in both 2001/02 and 2002/03; in medical assistant training, 100 in 2001/02 and 175 in 2002/03; and in radiography technician training, 20 in both 2001/02 and 2002/03.	

Annex D: Tariff and Tax Policy Reform

FRDP Program - Tariff and Tax Policy Reform

Credit	Key objectives	Realization	Comment
FRDP I	1. Engage pre-shipment inspection firm. 2. Complete TOR for MRA feasibility study 3. Approve expansion of surtax, complete analysis for reduction of maximum tariffs from 25 percent to 15 percent. 4. Extend duty drawback refund from 75 percent to 100 percent 5. Expand bonded factory provision.	1. Completed 2. Completed 3. Completed 4. Completed 5. Completed	1. Action succeeded in expanding revenue collections.
FRDP II	1. Reduce top tariff rate from 35 percent to 30 percent, and tariffs on intermediate and capital goods to 5 percent.	1. Completed	1. By 2005, maximum tariff was 25 percent
FRDP III	1. Create fully functional MRA. 2. Establish user fees covering costs for many services (for example, passports, vehicle licenses, police reports).	1. MRA created in 2000. 2. Some user fees were increased, but many still do not cover the marginal cost of providing the service.	

Sources: Interviews with GOM officials, FRDP III internal document.

Annex E: Agricultural Sector

FRDP Program - Agricultural Sector

Credit	Key objectives	Realization	Comment
FRDP I	1. Develop comprehensive land policy to improve land use efficiency and develop market.	1. Not realized under FRDP I, but policy issued in 2002 as an outcome of the Agricultural Support Services Project (a pilot project in negotiated land redistribution). During the PPAR period, land use efficiency and land market development improved only modestly.	1. While a Presidential Commission of Inquiry was appointed in 1996 to undertake a broad review of land policy, progress occurred much later.
	2. Raise smallholder productivity and income by removing quotas based on land title status.	2. Not fully realized under FRDP I. Restrictions were removed on crop production linked to title status. However, it was not until 2002 when smallholder tobacco delivery quotas to the auction floors were formally abolished (though informal quotas are reportedly still in force); liberalization of producer prices and delicensing of marketing and sales has been maintained, with the exception of maize, where price interventions (via ADMARC and the NFRA) and periodic trade restrictions continue in force.	2. As discussed above, productivity has fallen during the PPAR period.
	3. Encourage efficient smallholder production and diversification through appropriate producer prices.	3. Prices were liberalized (with the exception of maize), but with little effect on efficiency or aggregate production.	
	4. Improve input availability by removing regulatory restrictions.	4. Regulatory restrictions were liberalized but flawed GOM policies have restricted input availability.	
	5. Improve competition and efficiency in transport sector.	5. While Malawi Railways has been concessioned and there has been improvement in highway transportation, the impact on transport costs has been modest.	5. Most improvement occurred under IDA investment projects, reinforced by FRDP conditionality.
FRDP II	Widen maize price band.	Realized; the maize price band was first widened, and then formally abolished as the NFRA took over national stockpile management responsibilities from ADMARC.	

Annex F: Financial Sector

Annex Table F1: FRDP Program - Financial Sector

Credit	Key objectives	Realization	Comment
FRDP I	None		
FRDP II	Complete financial sector review, identify needed reforms; issue guidelines for privatization of two largest banks.	Review completed outlining key financial sector issues, and guidelines for restructuring and privatizing institutions. However, insufficient progress was made in implementation of the framework, and a partial waiver was granted.	Financial sector review financed by FRDP III TA.
FRDP III	Complete by early 2001 a new comprehensive regulatory framework; conclude sale of CBM.	CBM was sold in 2003 to a strategic foreign investor; however, at the same time, the second largest bank, National Bank, was sold (51 percent) to Press Corporation, a local conglomerate with close government ties.	Press Trust exercised its "right of first refusal" to buy National Bank.

Annex Table F2: Malawi Banking Sector, 1996-2004

	1996	1998	2000	2002	2004
Number of commercial banks	10	10	9	11	12
o/w government-owned*	7	7	6	6	1

*majority government-owned
Source: NRB data.

Annex Table F3: Market Shares of Malawi Commercial Banks, 2005

Bank	Market share (percent of assets)
National Bank	43.0
Stanbic (ex-CBM)	17.2
First Merchant	9.6
NBS	8.1
Finance Bank	5.8
7 others	14.4

Source: NRB data.

Annex Table F4: Interest Rate Spreads, 1996-2003

1996	1997	1998	1999	2000	2001	2002	2003
19.0	18.0	18.6	20.4	19.9	21.3	22.5	23.8

Source: 2005 WDI.

Annex Table F5: Real Interest Rates, 1996-2003 (in percent)

Year	1996	1997	1998	1999	2000	2001	2002	2003
Real interest rate	-8.5	19.0	9.8	8.0	21.6	22.6	30.8	33.9

Source: 2005 WDI.

Annex G: Reform Areas Addressed by the Five Projects Included in the PPAR

Area/component	FRDP I	FRDP II	FRDP TA II	FRDP III	FRDP TA III
Macroeconomics	Macroeconomic policy framework consistent with the objectives of the program	Primary deficit reduced from 4-5 percent to a balance			According to the Development Credit Agreement (DCA), the credit objective was to "assist in implementing policy measures under the Program."
		Domestic financing of deficits ended		Fiscal deficits (after grants) from 4.6 percent of GDP (2000/01) to 1.1 percent (2001/02) through stronger tax collections	
		Domestic debt stocks sharply reduced			
		Lower inflation to low teens by 1999 and under 10 percent by 2000		12-month inflation to 10 percent by end-2001	
		Lower interest rates to high teens by late 1999			
		Increase private fixed investment to 7-8 percent*			
		GDP growth rates of 5-6 percent			
Expenditure Management/ Rationalization	Improve expenditure control	Implement expenditure targets		Budgetary outcomes published on web with delay of no more than six months	Analysis of development budget priorities, including donors
	Improve budgetary allocation process and ensure consistency of recurrent and capital budget with resource availability and development priorities	Maintain expenditure monitoring and control procedures		By end-2000, Integrated Financial Management System (IFMIS) introduced in key ministries	Action Plan for introducing IFMIS
		Reduce deviation of expenditures from budgeted amounts		Finances of five largest parastatals published on web with delay no longer than six months	
		Implement MTEF plan to prioritize expenditures		New system to authorize parastatal borrowing implemented	
		Increase delivery of high priority outputs and services based on benchmarks		Legislation to separate financial management and auditing functions	Advise on splitting audit and finance act
		Improve budgetary planning and implementation		Create independent and functional Auditor-General's office	Review of existing audit methods and materials
				New legal framework for procurement; functional authority and transparent process	Prepare new procurement code; assist in establishment/ implementation of new procurement authority

Area/component	FRDP I	FRDP II	FRDP TA II	FRDP III	FRDP TA III
					Design procurement policies and regulations; automate system
					Comprehensive review of Supreme Audit Institution
					Strengthen Accountant General
		Sector programs fully integrated with MTEF			
Civil Service Reform	Restructure civil service	30 government functions abolished or outsourced by 4/99			According to the DCA, the credit objective was to “assist in implementing policy measures under the Program.”
		Implement redeployment or reduction of civil servants according to established benchmarks			
Public Sector Management					
Education				Education share of discretionary budget at least 23 percent.	According to the DCA, the credit objective was to “assist in implementing policy measures under the Program.”
				Health share of discretionary budget at least 13 percent.	
				Yearly enrollment of 6,000 students in teacher training.	
				Donor-supplied primary textbooks delivered directly from supplier to school.	
				Eliminate subsidy for secondary boarding schools.	
				Further expand cost recovery in tertiary schools; protect poor students; contract out catering	
Health				Recruit and deploy designated numbers of staff annually.	According to the DCA, the credit objective was to “assist in implementing policy measures under the Program.”
				Implement reform of Central Medical Stores.	
Rationalization of development projects				Establish mechanism for project screening by MinFin	According to the DCA, the credit objective was to “assist in implementing policy measures under the Program.”

Area/component	FRDP I	FRDP II	FRDP TA II	FRDP III	FRDP TA III
				Continue rationalization of development budget	
Tariff and Tax Policy Reform	Rationalize tariff and surtax and improve tax administration	Reduce tariffs on final goods from 35 percent to 30 percent		Further improve MRA operations through training.	According to the DCA, the credit objective was to "assist in implementing policy measures under the Program."
	Improve administration of export promotion	Reduce tariffs on selected other goods from 10 percent to 5 percent			
		In FY99, reduce top tariff rate from 35 percent to 30 percent and capital goods rate to 5 percent			
Agricultural Policies	Develop comprehensive land policy to improve land use efficiency and develop market	Widen maize price band			According to the DCA, the credit objective was to "assist in implementing policy measures under the Program."
	Raise smallholder productivity and income by removing quotas based on land title status				
	Encourage efficient smallholder production and diversification through appropriate producer prices				
	Improve input availability by removing regulatory restrictions				
	Improve competition and efficiency in transport sector				
Private Sector Development Policies	Improve operational and financial efficiency of the sector and support broad-based PSD	Extend privatization program to include utilities and financial sector	Study to facilitate Temporary Employment Permits.	Petroleum supply study carried out to explore privatization options	According to the DCA, the credit objective was to "assist in implementing policy measures under the Program."
	Liberalize investment regulations and increase private sector competition	By mid-99, bring to the point of sale agreed list of 15 to 20 firms	Study of access to industrial land and infrastructure	Privatize ORTEX by 5/02	
		Prepare privatization and commercialization plan for ADMARC	Manufacturing sector study: competitiveness, sub-sectoral growth		
		Streamline Temporary Employment Permit policy			
Financial Sector		Complete study on regulatory framework (3/99) and issue new framework (7/99)	Financial Sector Regulatory Review; guidelines for restructuring and privatization of financial insts.	Complete (early 2001) comprehensive regulatory framework	According to the DCA, the credit objective was to "assist in implementing policy measures under the Program."

Area/component	FRDP I	FRDP II	FRDP TA II	FRDP III	FRDP TA III
		Issue specific guidelines on privatization of two main commercial banks		Conclude sale of CBM	
		Implement new framework			
		Privatize two main banks			
		Reduce spread between saving and lending rates			
		Expand stock exchange			
Utility Reform		Establish independent telecom reg. authority	Power Sector Study.	Issue Information Memorandum for sale of Malawi Telecoms	According to the DCA, the credit objective was to "assist in implementing policy measures under the Program."
		Secure strategic partner for Malawi telecom		Full liberalization of cellular service by 2003	
		Amend law and gazette regulations to clarify tariff adjustment		Full liberalization of all telecom services by 2005	

*FRDP II Matrix presents private fixed investment target of 7 percent in one place and 8 percent in another.

Annex H: Basic Data Sheet

FISCAL RESTRUCTURING AND DEREGULATION PROGRAM (FRDP I) - CREDIT 28530

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	102.00	169.80	100
Total project cost	102.00	169.80	100
Cofinancing			
Germany	7	7.0	
Denmark		10.8	
OECF		50.0	
Cancellation	n/a	n/a	n/a

Project Dates

	Original	*Actual*
Departure of Appraisal Mission	Nov. 15, 1995	Nov. 15, 1995
Board approval	April 30, 1996	April 30, 1996
Signing	May 15, 1996	May 15, 1996
Effectiveness	May 24, 1996	May 24, 1996
Closing date	March 31, 1998	March 15, 2001

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N^o Staff weeks	*US$('000)*
Preappraisal	54.1	193.3
Appraisal	32.8	125.7
Negotiations	3.4	10.6
Supervision	71.0	287.4
Other	8	25.0
Total		

Mission Data

	Date (month/year)	*No. of persons*	*Staff days in field*	*Specializations represented*	*Performance rating*	*Rating trend*	*Types of problems*
Identification/ Preparation	April 1995	10	17				
Appraisal	Nov. 1995	10	20				
	Feb. 1996	10	18				
Supervision	May 1996	1	2				
	Sept. 1996	1	6				
	Dec. 1996	1	1				
	Oct. 1997	1	2				
	Feb. 1998	2	4				
	June 1998	2	4				
	March 1999	2	6				
Completion	March 2000	2	6				

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	***Credit no.***	***Amount (US$ million)***	***Board date***
Second Fiscal Restructuring and Deregulation Program (FRDP II)	31460	92	Dec. 3, 1998
Second Fiscal Restructuring and Deregulation Program Technical Assistance Project (FRDP II TA)	31470	2	Dec. 3, 1998
Third Fiscal Restructuring and Deregulation Project (FRDP III)	34520	56.02	Dec. 21, 2000
Third Fiscal Restructuring and Deregulation Technical Assistance Project (FRDP TA III)	34510	2.19	Dec. 21, 2000

SECOND FISCAL RESTRUCTURING AND DEREGULATION PROGRAM (FRDP II) - CREDIT 31460

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	n/a	n/a	n/a
Total project cost	90	92	100.02
Cancellation	n/a	n/a	n/a

Project Dates

	Original	*Actual*
Identification	Oct. 4, 1997	Oct. 4, 1997
Appraisal	March 1998	March 1998
Board approval	Dec. 3, 1998	Dec. 3, 1998
Signing	Dec. 4, 1998	Dec. 4, 1998
Effectiveness	Dec. 7, 1998	Dec. 7, 1998
Closing date	June 30, 2000	June 30, 2000

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N° Staff weeks	*US$('000)*
Preappraisal	80.8	440.3
Appraisal	48.6	149.3
Negotiations	20.1	37.2
Supervision	24.8	81.3
Other	8	25.0
Total	182.3	732.8

Mission Data

	Date (month/year)	*No. of persons*	*Staff days in field*	*Specializations represented a/*	*Performance rating*	*Rating trend*	*Types of problems*
Identification/ Preparation	Oct. 1997 Nov. 1997	4 4	18 19				
Appraisal	Feb. 1998 June 1998	5 10	20 17				
Supervision	March 1999	6	18				
Completion		1	18				

a/ Key to Specialized staff skills: Country Economist, Economist, Agricultural Economist, Resident Representative, PSD Specialist, OECF Representative

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS			
Operation	*Credit no.*	*Amount (US$ million)*	*Board date*
Third Fiscal Restructuring and Deregulation Project (FRDP III)	34520	56.02	Dec. 21, 2000
Third Fiscal Restructuring and Deregulation Technical Assistance Project (FRDP TA III)	34510	2.19	Dec. 21, 2000

SECOND FISCAL RESTRUCTURING AND DEREGULATION PROGRAM TECHNICAL ASSISTANCE PROJECT (FRDP TA II) - CREDIT 31470

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	2.0	2.01	100
Total project cost	2.0	2.01	100
Cancellation	n/a	n/a	n/a

Project Dates

	Original	*Actual*
Identification	Oct. 4, 1997	Oct. 4, 1997
Appraisal	March 1998	March 1998
Board approval	Dec. 3, 1998	Dec. 3, 1998
Signing	Dec. 4, 1998	Dec. 4, 1998
Effectiveness		March 19, 1999
Closing date	June 30, 2001	June 30, 2001

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N° Staff weeks	*US$('000)*
Preappraisal	80.8	440.3
Appraisal	48.6	149.3
Negotiations	20.1	37.2
Supervision	24.8	81.3
Other	8	25.0
Total		

The TA operation was identified, appraised and negotiated along with the FRDP II Adjustment Credit. All staff time for identification/preparation and appraisal/negotiation were combined inputs for both operations.

Mission Data

	Date (month/year)	*No. of persons*	*Staff days in field*	*Specializations represented a/*	*Performance rating*	*Rating trend*	*Types of problems*
Identification/ Preparation	Oct. 1997	4	18				
	Nov. 1997	4	19				
Appraisal	Feb. 1998	5	20				
	June 1998	10	17				
Supervision	March 1999	6	18				
Completion		1	18				

a/ Key to Specialized staff skills: Country Economist, Economist, Agricultural Economist, Resident Representative, PSD Specialist, OECF Representative

The TA operation was identified, appraised and negotiated along with the FRDP II Adjustment Credit. All staff time for identification/preparation and appraisal/negotiation were combined inputs for both operations.

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	***Credit no.***	***Amount (US$ million)***	***Board date***
Third Fiscal Restructuring and Deregulation Project (FRDP III)	34520	56.02	Dec. 21, 2000
Third Fiscal Restructuring and Deregulation Technical Assistance Project (FRDP TA III)	34510	2.19	Dec. 21, 2000

THIRD FISCAL RESTRUCTURING AND DEREGULATION PROGRAM (FRDP III) - CREDIT 34520

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	55.6	56.02	101
Total project cost	55.6	56.02	101
Cancellation	n/a	n/a	n/a

Project Dates

	Original	*Actual*
Identification		
Appraisal	Oct. 19, 2000	Oct. 19, 2000
Board approval	Dec. 21, 2000	Dec. 21, 2000
Signing		
Effectiveness	Jan. 23, 2001	Jan.23, 2001
Closing date	June 30, 2002	June 30, 2002

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N° Staff weeks	*US$('000)*
Preappraisal	61.9	237.4
Appraisal/Negotiation	34.3	117.4
Supervision		
Other	8	25.0
Total	104.3	379.8

Mission Data

	Date (month/year)	No. of persons	Specializations represented	Performance rating	Rating trend	Types of problems
Identification/ Preparation	Oct. 14, 1999 to Oct.19, 2000	23	1 Sector Manager 9 Economists 2 FMS 1 Health Specialist 1Agriculture Specialist 4 Consultants 2 RAs 2 ACS			
Appraisal/ Negotiation	Aug. 28, 2000 to Dec. 21, 2000	14	7 Economists 2 Agricultural Specialists 1 Procurement Specialist 1 Financial Specialist 1 RA 1 Consultant 1 ACS			
Supervision	No supervision (single tranche operation)					
Completion	Nov. 1, 2002 to March 31, 2003	5	2 Economists 1 Consultant 1 RA 1 ACS			

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	Credit no.	Amount (US$ million)	Board date

THIRD FISCAL RESTRUCTURING AND DEREGULATION PROGRAM TECHNICAL ASSISTANCE PROJECT (FRDP TA III) - CREDIT 34510

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	3.0	2.19	65
Total project cost	3.0	2.19	65
Cancellation	n/a	n/a	n/a

Project Dates

	Original	*Actual*
Identification		
Appraisal	Sept. 20, 1999	Sept. 20, 1999
Board approval	Dec. 21, 2000	Dec. 21, 2000
Signing	Jan. 11, 2001	Jan. 11, 2001
Effectiveness	April 11, 2001	Jan. 23, 2001
Closing date	Jan. 31, 2003	June 30, 2004

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N° Staff weeks	*US$('000)*
Preappraisal	61.9	237.4
Appraisal/Negotiation	34.3	117.4
Supervision	10	396.0
Other	3	15.0
Total	107.2	665.88

The TA operation was identified, appraised and negotiated along with the FRDP III Adjustment Credit. All staff time for identification/preparation and appraisal/negotiation were combined inputs for both operations.

Mission Data

	Date (month/year)	No. of persons	Specializations represented	Performance rating	
				Implementation Progress	Development Objective
Identification/ Preparation	Oct. 14, 1999 to Oct.19, 2000	23	1 Sector Manager 9 Economists 2 FMS 1 Health Specialist 1 Agriculture Specialist 4 Consultants 2 RAs 2 ACS		
Appraisal/ Negotiation	Aug. 28, 2000 to Dec. 21, 2000	14	7 Economists 2 Agricultural Specialists 1 Procurement Specialist 1 Financial Specialist 1 RA 1 Consultant 1 ACS		
Supervision	Oct. 4, 2001	3	2 Procurement Specialist 1 Sr. Operations Officer	S	U
	June 25, 2003	1	1 Public Sector Management	S	S
	Sept. 26, 2003	1	1 Team Leader	S	S
	Feb. 27, 2004	3	1 Team Leader 1 Consultant 1 Team Member	S	S
Completion	Nov. 14, 2004	1	1 Senior Economist	U	U

The TA operation was identified, appraised and negotiated along with the FRDP III Adjustment Credit. All staff time for identification/preparation and appraisal/negotiation were combined inputs for both operations.

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	Credit no.	Amount (US$ million)	Board date

Annex I: List of People Met

Government and Former Government Officials

Office of the President and Cabinet
Mr. Joseph Jeziman Matope, Principal Secretary

Ministry of Trade and Private Sector Development
Mr. Harrison J.K. Marshall, Acting Director of Trade
Ms. Alice Makhambera, Project Manager

Ministry of Transport and Public Works
Mr. Francis B. Chinsinga, Principal Secretary
Mr. C. Kilmanungirance, Director of Roads
Mr. J.B.M. Plirer, Principal Planning Officer

Privatization Commission
Mr. Maziko Sauti-Phiri, Executive Director
Mr. Sam Kakhobew, Chairman
Mr. Shadreck J. Ulema, Economist

Ministry of Commerce and Industry
Mr. Clement Phangaphanga, Principal Industrial Development Officer

Malawi Investment Promotion Agency
Mr. J. R. Kaphweleza Banda, Acting General Manager/Chief Executive
Mr. Alick C. E. Sukasuka, Acting Deputy General Manager
Mr. Pilira Patience Kalombola, Investment Promotion Executive

Ministry of Finance
Mr. Patrick Kabambe, Acting Secretary to the Treasury
Mr. McCallum M. M. Sibande, Director, Aid and Debt
Ms. Dorothy Banda, Director of Budget
Mr. Patrick Zimpita, Director, Tax Policy Division
Mr. Inopa Soko, Former Debt and Aid Director
Mr. Z. Chikhosi, Former Director of Budget

Ministry of Finance, Office of Public Enterprise Reform Monitoring Unit
Mr. Nerbert Nyirenda, Director
Mr. EEJS Kamanga, Deputy Secretary

Ministry of Economic Planning and Development
Mr. Patrick Kamwendo, Principal Secretary
Mr. Ben Botolo, Director of Planning

Ministry of Health
Dr. Hetherwick Ntaba, Minister
Dr. W.O.O. Sangala, Principal Secretary

Malawi Social Action Fund
Mr. Sam Kakhobew, Executive Director

Reserve Bank of Malawi

Mr. Victor Mbewe, Governor
Mr. Wilson T. Banda, General Manager, Economic Services
Mr. Tobias S. Chinkhwangwa, Director, Bank Supervision
Mr. Tom Malikebu, Principal Examiner, Policies and Regulations
Mr. Ellias Ngalande, former Governor, and former Secretary to the Treasury

Office of Public Procurement

Mr. B.S.M. Mangulama, Director
Mr. Joseph C.K. Mhango, Deputy Director

Malawi Communications Regulatory Authority (MACRA)

Mr. Evans J. Namanja, General Director

Malawi Confederation of Chambers of Commerce and Industry

Chancellor Kaferapanjira, Chief Executive
Mr. Sadwick Mtonakulta, Economist

Accountant General

Mr. J. Cham'dimba, Deputy Accountant General

Department of Human Resource Management

Mr. Dickson Chunga, Director of Human Resources Management
Mr. Mitchum Galega, Director of Human Resource Planning and Development
Mr. Joe Kuhrangwe, Director of Policy Research

Ministry of Transport

Mr. F. Chinsinga, Principal Secretary
Mr. C. Kilmangirance, Director of Roads
Mr. J.B.M. Phia, Principal Planning Officer

Development Partners

Mr. Thomas Baunsgaard, Resident Representative, IMF
Ms. Mary Lewellen, Acting Director, USAID
Mr. Roger Wilson, Director, DFID
Mr. Andrew Tench, Team Leader, EU Capacity Building Programme

World Bank Staff (Malawi)

Mr. Sudhir Chitale, Lead Economist, Southern Africa PREM
Ms. Elizabeth White, Senior Results Management Specialist,
Mr. Stanley Hiwa, Acting Country Manager
Mrs. Makhambera, FIMTAP Project Manager
Mr. Khwima Nthara, Economist
Mr. Zeria N. Banda, Communications Associate
Mr. Ross Worthington, FIMTAP TTL

World Bank Staff (HQ)

Mr. Hartwig Schafer, Country Director (and former FRDP I TM)
Mr. Ataman Aksoy, Division Chief, FRDP II
Ms. Barbara Kafka, former Country Director
Mr. Ahmad Ahsan, TM of FRDP II and FRDP II TA
Mr. Darius Mans, former Country Director
Mr. Gene Tidrick, former Lead Economist

Annex J: Comments from Co-financiers

Comments Received from the Government of Denmark
E-mail dated July 18, 2006

Dear Kyle Peters,

We have studied the PPAR with great interest. The report's findings and lessons provide valuable insights, which will benefit us in our future programming. Unrealistic initial assessment of the recipient governments' capacity and committtment is a common weakness among donors. It is more rare that the degree of optimism increases from one phase to another or from FRDP1 to FRDP 3 as it seems to have been the case here. The Bank's desire to-establish HIPC eligibility with the one-trache FRDP3 loan could have been analysed and documented in more detail in the PPAR.

Regards,

Peter 0. Jonsson
Head of Section
Department for Africa
Danish Ministry of Foreign Affairs
Direct tel. + 33 92 03 75
Fax + 33 92 09 64

Comments Received from the Government of Germany
E-mail dated July 26, 2006

Dear Kyle,

Thank you very much for sending us the a.m. report (PPAR) for comment.

As you know, Germany (via Financial Cooperation by KfW) has only participated in the First Fiscal Restructuring and Deregulation Program (FRDP I) in the amount of EUR 5,11 million (equivalent to USD 7 million). Therefore we did not follow closely the next programs. Therefore our regional manager informed me, that he cannot make any substantial additional comment to the PPAR.

We based our ex-post evaluation report on the draft of the ICR of FRDP I and rated our programme as all together sufficient (report dated 08 January 2001). This evaluation report was still written under the auspices of the operational department as our ex post evaluation department was not fully operational at that time. Therefore the rating is very general and we did not translate it into an English summary.

Under lessons learned the report mentions the by far too complex approach of the program, expecting too much as well from the Malawi government as from the donors. (This is already mentioned in para. 2.19 p. 27 of the PPAR.)

The operation department had sent a letter commenting the draft ICR in July 2000 which may be helpful, I have attached it to this mail for your information.

So, all together we do not have a specific comment that is worth being attached to the PPAR, but have sent you our feedback in time.

Best regards,

Ulrich Jahn
Principal Project Manager
Evaluation Department Financial Cooperation
KfW Development Bank

Tel. +49 69 7431-2764
Fax +49 69 7431-4515
e-mail: Ulrich.Jahn@kfw.de www.kfw.de