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PERFORMANCE AUDIT REPORT

MALAWI

RAILWAYS RESTRUCTURING PROJECT
(CREDIT 2696-ML)

June 27, 2001

Sector and Thematic Evaluation Group
Operations Evaluation Department

Currency Equivalents
(Exchange Rate Effective February 2000)

Currency Unit: Malawi Kwacha (MK)
US1.0 = MK 46.79

Fiscal Year of Borrower
April 1 to March 31

Weight and Measures

1 foot (ft)	=	0.305 meters (m)
1 mile (mi)	=	1.609 kilometers (km)
1 square mile (mi^2)	=	2.5900 square kilometers (km^2)
1 ton (t)	=	0.907 metric tons (m tons)

Abbreviations and Acronyms

CFM	=	Portos e Caminhos de Ferro de Moçambique
DCA	=	Development Credit Agreement
GOM	=	Government of Malawi
IDA	=	International Development Association
ICR	=	Implementation Completion Report
LS	=	Lake Services Department
MK	=	Malawi Kwacha
MLS	=	Malawi Lake Services Limited
MOU	=	Memorandum of Understanding
MOTPW	=	Ministry of Transport and Public Works
MR	=	Malawi Railways
MR94	=	Malawi Railways (1994) Limited
MRL	=	Malawi Railways Limited
PA	=	Performance Agreement
PIC	=	Project Implementation Committee
PSOs	=	Public Service Obligations
RRP	=	Railways Restructuring Project
SAR	=	Staff Appraisal Report
TORs	=	Terms of Reference
UNCTAD	=	United Nations Conference on Trade and Development
USAID	=	United States Agency for International Development

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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

June 27, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Malawi Railways Restructuring Project (credit 2696-ML)

Attached is the Performance Audit Report (PAR) prepared by the Operations Evaluation Department on the above project, which was approved in FY95 and closed in FY00, 15 months after the original closing date. The original credit amount was for US$16.2 million and actual disbursement was US$6.7 million. The project was co-financed by USAID.

The primary objective of the project was to contribute to Malawi's economic growth through: (a) revitalizing the Nacala rail route; and (b) restructuring, commercialization, and eventual privatization of Malawi Railways (MR) and Malawi Lake Services (MLS), enabling them to operate more efficiently and without government subsidies. The project had two subsidiary objectives: (i) formulation and implementation of a transport policy aimed at promoting inter-modal and inter-route competition; and (ii) setting-up an institutional mechanism for close coordination among the entities managing the Nacala rail route, viz., Malawi Railways, the railways of Mozambique (CFM), and the Port of Nacala, to improve operations on the Nacala rail route.

The project was successfully implemented and achieved most of its key objectives. Malawi Railways was restructured and two new separate companies for railways and lake services were created. The Malawi Railways Limited (1994), MR(94), was created to manage the operation of railways under commercial terms, and was subsequently concessioned to the private sector. The Malawi Lake Service was also restructured, but its concessioning has not taken place yet.

The restructuring of the Malawi railways has increased the volume of traffic going through the Nacala route, albeit far short of SAR targets. In 1996, the first year of restructuring, international traffic increased by 20% but well below the SAR target. In 1999, still in the restructuring phase, the international traffic increased another 20%, but was less than half the SAR target. Similarly, the operating ratio (operating costs/operating revenues) slightly improved after restructuring, but was substantially below SAR projections.

Once railway operation was in the hands of cost-conscious private entrepreneurs, however, the performance of the railway system showed significant improvement. In 2000, the first year under private operation, the total rail freight traffic increased by 50%. The key to this improvement appears to be the new managerial cultural the concessionaire introduced, with its focus on motivating staff, cutting costs, and aggressive marketing to lure shippers back to the Nacala route for their international traffic.

Interviews and focus group meetings with major shippers conducted during the audit mission reveal that the strategy adopted by the private concessionaire appears to be improving the efficiency and effectiveness of the railway system. The major shippers in Malawi – tobacco exporters and freight forwarding companies among them – appear to be satisfied with the new private management of the railways. Among the more visible improvements they noted are improved service reliability and better communication between shippers and the railway company. These have allowed shippers to learn the status of their shipment more readily compared to the old system.

The PAR rates the outcome of the project *satisfactory,* institutional development substantial, and sustainability *likely.* The PAR further rates Bank and borrower performance *satisfactory*. These ratings are the same as the ICR ratings.

The restructuring and concessioning of Malawi Railways confirms a number of OED lessons.

- Restructuring can make eventual privatization process more manageable, but significant performance improvement should not be expected in the interim.
- Substantial investment in the interim should be avoided if possible since prospective concessionaires do not always put commensurate values on these investments.
- It is important to separate the operation and downsizing functions during the restructuring exercise. The Malawi railway restructuring created two separate entities to manage the reorganized railway operation and to carry out the retrenchment of surplus staff and disposal of surplus assets.
- There is a need to keep an intense policy dialogue with the government to maintain the focus on the privatization agenda. The project's conditionality to make substantial disbursement conditional on progress on the privatization agenda turned out to be a useful instrument to keep the focus on privatization.
- Staff Retrenchment is a complex undertaking. It requires careful planning and rigorous economic and social assessment. An analysis on the distribution of costs and benefits should be included as part of cost-benefit analysis.
- Establishing an appropriate regulatory mechanism for the post-privatization period should not be overlooked.

Attachment

Contents

This report was prepared by Binyam Reja, who audited the project in December 2000 and reviewed by Asita de Silva and Laurie Effron. William Hurlbut edited, and Romayne Pereira provided administrative support.

Principal Ratings

	ICR*	OED**	PAR***
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Development	Substantial	Substantial	Substantial
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

Key Staff Responsible

	Task Manager	Division Chief	Country Director
Appraisal	Yash Pal Kedia	Jeffrey Racki	Katherine Marshall
Completion	Yash Pal Kedia	Yusupha B. Crookes	Barbara Kafka

* ICR-Implementation Completion Report. Ratings by the Region.
** ES-Evaluation Summary. OED ICR review rating.
*** PAR-Performance Audit Report. OED audit ratings

Preface

This is a Performance Audit Report (PAR) of the Malawi Railway Restructuring Project (Credit 2696 -MA).

The PAR was prepared by the Operations Evaluation Department (OED) based upon a review of the President's Reports, Staff Appraisal Reports (SARs), Implementation Completion Reports (ICRs), transcripts of Board proceedings, project correspondence files, Bank documents on other transport projects, and other Bank and non-Bank materials. In December 2000, an OED mission visited Malawi to discuss the project with relevant government officials, representatives from the private sector, beneficiaries, and professional and trade organizations. OED also discussed the projects with Bank staff in charge of the project at headquarters. The kind cooperation and invaluable assistance from all the people consulted are gratefully acknowledged.

The audit agrees with the ratings of the implementation completion report and OED's assessment of the ICR. The PAR adds value to the ICR by focusing on Malawi's experience with the concessioning and restructuring of the railways.

Following standard procedures, copies of the draft PAR were sent to the relevant government officials and agencies concerned as well as cofinanciers for their review and comments. No comments were received.

1. Introduction And Background

1.1 The Railway Restructuring Project (RRP) was prepared and approved during major political and economic changes in Malawi. After 30 years of authoritarian, single-party rule, a new government came to power under multi-party elections held in May 1994. The new government agreed with the World Bank and the International Monetary Fund on a Medium-Term Policy Framework for economic stabilization and structural reforms. The policy framework and the government's development strategy were anchored on poverty reduction through growth and targeted intervention to the poorest. A key strategy for achieving growth was unleashing the potential of the private sector.

1.2 Malawi's small, open economy is vulnerable to internal and external shocks. With a GDP per capita of US$220, it is one of the poorest country in the world. Its economy depends on limited export of primary products and a small domestic market. Agriculture is the mainstay of the economy, accounting for 30% of Gross Domestic Product (GDP), 90% of exports, and 85% of employment. Foreign trade is important and makes up 50% of GDP. But, recurrent droughts affect the export market and cause fluctuations in GDP growth.

1.3 As a landlocked country, Malawi depends on neighboring countries for access to the sea to facilitate its international trade traffic. This has made Malawi's transport cost very sensitive to the political situations and the performance of the transport system in neighboring countries. In particular, the lack of peace and stability in Mozambique in the past and the poor performance of that country's transport system have affected transport costs for Malawi transit traffic. During Mozambique's civil war in the 1980s, Malawi's international traffic shifted to Durban, South Africa, which is longer and more expensive than a fully functional Nacala route in Mozambique. The change in route increased Malawi's transport cost from 25% of F.O.B trade value in 1975 to 45% of F.O.B trade value in 1987, resulting in significant burden on the economy. The economic burden of high transport costs is estimated to be 4 to 6% of GDP. The current peace and stability in Mozambique has helped, but transport costs still remain high.

2. Project Objectives And Relevance

2.1 The primary objective of the RRP, approved in FY, was to contribute to Malawi's economic growth by revitalizing the poorly run Nacala rail route. A fully functional Nacala rail route was expected to reduce the transport margin on overseas traffic and result in savings of US$25 to US$35 million in transport costs.

2.2 The project strategy to revitalize the Nacala route comprised:

(a) Restructuring, commercializing and eventual privatization of the Railways and Lake Services, enabling them to operate more efficiently and without depending on government subsidies
(b) Formulating and implementing a transport policy aimed at promoting inter-modal and inter-route competition

(c) Setting-up an institutional mechanism for close coordination among the entities managing the Nacala rail route: Malawi Railways, and the Mozambique Port and Railway Company CFM (N) for the Mozambique side railway link and Port of Nacala.

2.3 The project's objectives and strategy, which focused on market-based reforms and better coordination in the Nacala corridor, were relevant to the development objectives of the country and consistent with the Bank's sector strategy for railways. Since transport costs are a significant part of Malawi's GDP, reducing these costs can free up resources for productive investment and poverty reduction efforts. The project components were sufficiently designed to achieve the above objectives (see Box 1).

BOX 1. RAILWAY RESTRUCTURING PROJECT COMPONENTS

1) *Restructuring of Malawi Railways.* This component, to be implemented by Malawi Railways (MR), involved

- Incorporation of new railway and lake service companies to be called the Malawi Railways Limited (1994) (MR94), and the Malawi Lake Services (MLS) respectively
- Formalization of relationships between the newly incorporated companies and the government through performance contracts
- Retrenchment of surplus staff and disposal of surplus assets
- Eventual winding-up of MR.

2) *Railway Revitalization and Privatization.* This component, to be implemented by the newly incorporated MR(94), included

- Commercialization and eventual privatization of MR(94)
- Consultancy and advisory services to assist in developing privatization options for railways, preparing bidding documents, managing the bidding process, negotiations, and finalizing the privatization/concession agreement
- Rehabilitation of infrastructure and operating assets to enable MR(94) to improve its operating efficiency while awaiting privatization
- Setting up an institutional mechanism for effective coordination of the railways in Malawi and Mozambique.

3) *Lake Services revitalization and privatization.* This component, to be implemented by the newly incorporated MLS, was designed to assist in

- Commercialization and eventual privatization of MLS's core activities,
- Consultancy and advisory services to assist in developing privatization options for the lake services and ports, preparing bidding documents, managing the bidding process, negotiations, and finalizing the privatization/concession agreement
- Rehabilitation of the operating assets of MLS while awaiting privatization.

4) *Transport Policy.* This component, to be implemented by the Ministry of Transport, sought to provide assistance for

- Developing a transport policy that would provide a framework for efficient operations of the transport sector, and
- Enhancing the institutional capacity of the ministry for analyzing the performance of the transport sector and providing adequate response.

The Nacala Corridor

2.4 The Nacala corridor comprises three entities: Port of Nacala, railway link in Mozambique, and railway link in Malawi. At the start of this project, the Mozambique Ports and Railways Company (CFM) managed both the Port of Nacala and the Mozambique railway link, while Malawi Railways managed the Malawi railway link. The two separate institutional arrangements to manage the corridor create coordination problems between the three entities, and make the performance of one part of the system dependent on the performance of the other segments. For example, a functioning railway link in Malawi does not help with international traffic if the railway link in Mozambique continues to malfunction. Therefore improving all three segments of the corridor is essential if Malawi Railways is to improve its performance and regain its market of international traffic. The Bank recognized this early in project preparation and included in the project design an institutional mechanism to coordinate railway operation on both sides of the boarder in Malawi and Mozambique. The project made credit effectiveness dependent on two corridor-related actions: (i) MR94 and CFM signing an *Operations Agreement* to enable them to run trains on each other's railway system, (ii) MR94 and CFM setting up a *Joint Review Board* to sort out operational problems.

3. Implementation Experience And Project Achievements

3.1 The project was successfully implemented between 1995 and 2000 and achieved most of its key objectives. Malawi Railways was restructured and two new separate companies for railways and lake services were created. The Malawi Railways Limited (1994), MR(94), was created to manage the operation of railways under commercial terms, and was subsequently concessioned to the private sector. The Malawi Lake Service was created to manage lake services on commercial terms, but, unlike the railways, the MLS has not been concessioned to the private sector yet.

3.2 The restructuring of the Malawi railways has increased the volume of traffic going through the Nacala route, albeit far short of SAR targets. As shown in Table 1, in 1996, the first year of restructuring, international traffic increased by 20% but well below the SAR target. In 1999, still in the restructuring phase, the international traffic increased another 20%, but was less than half the SAR target. Similarly, the operating ratio (operating costs/operating revenues) slight improved after restructuring, but was lower than SAR projections.

3.3 Once the railways was in the hands of cost-conscious private entrepreneurs, however, the performance of railways showed dramatic improvement. In 2000, the first year under private operation, the total rail freight traffic increased by 50%.

Table 1: Changes in Railway Performance from Restructuring and Concessioning

	1994	1996		1999		2000	
		Restructuring Phase				Concessioning Phase	
	Base case	Target	Actual	Target	Actual	Target	Actual
International Traffic (in 000)	100	175	120	300	145	300	260
Domestic Traffic (in 000)	210	210	176	210	167	210	210
Total Traffic (in 000)	310	385	296	510	312	510	460
Operating Ratio (%)	138	110	116	94	110	NA	NA

3.4 The objective of the restructuring Malawi Lake Services was achieved, but the privatization program experienced long delays. It is now underway and is expected to be completed in the coming year. Traffic increase has been modes, but reduction in staff has reduced the amount of subsidy needed to operate the service.

3.5 The project achieved its objective of formulating and implementing the National Transport Policy. The policy sets the stage for the legal and regulatory frameworks for railways, inland waters, shipping, road traffic, transport, and civil aviation. A regulator responsible for enforcing the safety and environment-related requirements has been appointed.

3.6 The project did not achieve the objective of setting-up an institutional mechanism for close coordination among the entities managing the Nacala rail route, viz., Malawi Railways, the railways on the Mozambican side, and the Port of Nacala. A joint Review Board was set up, however. And its representative met regularly to discuss cross-border operational issues and established rules for non-stop running of train. But, both CFM and MR94 did not effectively use the rules. Since the same concessionaire was selected for the Mozambican side, the stage is set for efficient improvement of the Nacala Corridor.

4. Key Issues In Railway Reform

4.1 The Malawi railway reform program was one of the early efforts in Africa to concession railway operations to the private sector.[1] It is similar to reform efforts worldwide, but has some distinctions. Instead of pursuing concessioning at the outset of the reform initiatives, the Malawi railway reform was done in stages, which allowed restructuring to happen before concessioning was pursued.

4.2 This strategy was chosen for two reasons. First, the Bank and GOM felt that since privatization takes a long time, an intermediate measure is needed to improve the operational and financial performance of the railways in the short run, and to regain the railway's market share in the highly competitive transport industry. Second, it was believed that a restructured railway would be more attractive to prospective concessionaires, as most of the surplus staff and assets would have been retrenched and disposed. Private concessionaires, it was believed, would show more interest in a leaner and efficient railway company than they would in a bloated railway company with dilapidated assets.

Restructuring of Malawi Railways: The Creation of MR94

4.3 As part of the condition for credit effectiveness, the Government of Malawi established the Malawi Railways (1994) Limited (MR94) to operate the railways on commercial terms and under performance contract with the government. The government further agreed during negotiations that the new railway company, unlike its predecessor, would not be a statutory body so that MR94 would not be precluded from subsequent privatization. The old Malawi Railways (MR) was to remain for some time to manage the

1. The Cote d'Ivoire—Burkina Faso railway concessioning is the only one that preceded the Malawi railway reform. Since then, several others (Cameroon, Mozambique, among them) are in the process of being concessioned to the private sector.

retrenchment of staff and dispose of assets not transferred to the new company. Of the 3,600 staff in the old MR, only about 1200 were transferred to MR94, and less than 50% of the operating assets were transferred.

4.4 The restructuring allowed operations and downsizing of the railways to be carried out by two separate entities, with appropriate expertise and mandate. Operations were to be done by the newly formed MR94, and while retrenchment of surplus staff and disposal of surplus assets were to be carried out by the old MR. This arrangement proved useful because it allowed MR94 to commence operation with a clean slate, with "new" staff and assets and without having to deal with the more difficult issues of retrenching of surplus staff and disposing of surplus assets. These responsibilities were left to the old MR, which was unburdened in its activities by concerns about operational issues.

Outcome of the Restructuring Effort

4.5 The restructuring effort made the subsequent privatization of MR94 more manageable than it would have been if MR remained in the same position with surplus staff and assets. While this is an important achievement in and of itself, it had limited effect on improving the efficiency of the railway system in the interim. With only 145,000 tons of international freight traffic going through the Nacala route in 1999, the restructuring was able to achieve only about 50% of the targeted improvement from restructuring (see Table 1 in chapter 3).

4.6 A number of exogenous factors limited the achievement of MR94 targets, including the poor performance of the railway line on the Mozambican side, and heavy rains in 1996 that caused damage on the rail tracks. However, the inability of MR94 to increase its market share attests to the fact that reforms within a public sector framework – such as restructuring state-owned enterprises – have limited effect on improving the performance of those enterprises. MR94 was not able to reorient itself into a customer-oriented operator, capable of winning shippers' confidence to use the Nacala rail route over other alternatives. Instead, shippers perceived that MR94 was no different from its predecessor, and continued to use the more expensive, but efficient, Durban route. As it turns out, shippers value efficiency more than simple cost reduction, and regaining customer confidence requires significant changes on the part of the railways.

4.7 As part of the restructuring effort, performance contracts were signed between the government and MR94 to provide the latter with operational autonomy and make it accountable for results; at the same time, the government was expected to finance the operating deficits for the loss-making passenger services as part of public service obligation (PSOs). But, the contract was soon violated when the government failed to provide the agreed financial support for the PSO. MR94 was forced to cross-subsidize passenger services from its profitable freight operation. But this left it with insufficient funds to maintain the railway system, which was a violation of the performance contract agreement that MR94 will allocate adequate resources for maintenance.

Concessioning of Malawi Railways: From MR94 to CEAR

4.8 As was envisioned during project preparation, the second stage in the railway reform process was the privatization of Malawi Railways. In 1995, shortly after the commencement of MR94, the government officially adopted a policy to privatize MR94. And in 1996, after some initial delays, it engaged an international consultant to provide advisory services for the privatization. The initial delays in procuring the advisory services indicated a wavering of commitment by the government on the privatization plan and risked its derailment. But, this was quickly remedied because the project had a mid-term review condition that made major project investment dependant on satisfactory progress on the privatization agenda.

4.9 The Privatization Commission, a government entity in charge of privatizing state-owned enterprises in Malawi, managed the privatization process of MR94. Following the consultant report, the Commission decided that MR94 should be privatized by way of a long-term concession. In 1998, the Commission put MR94 out for a bid and received three bids in response. A consortium comprising CFM and SDCN were chosen as the preferred bidder. CFM is the Mozambique Ports and Railway Company and SDCN is a group made up of international investors and an American-based Railroad Development Corporation (RDC).

4.10 After a lengthy negotiation, a concession agreement was signed in November 1999 between the government and the Central and East African Railways Company Limited (CEAR), the locally registered company owned by the consortium. CEAR took over the operations of MR94 on December 1, 1999, for an initial period of 20 years.

4.11 Under the Concession Agreement, the government retains ownership of railway rights of way and all the land and buildings directly associated with the railway. The concessionaire, however, purchased from the government the rolling stock needed to run the railways. Rolling stock, land, and buildings not required for railway operation are being sold or leased out by the government.

4.12 The long-term concession arrangement puts all commercial risks with the private concessionaire. It makes CEAR fully responsible for operating, managing and financing the railway system, and reduces the government's role to enforcing safety regulations and monitoring the Concession Agreement between the private sector and the government.

4.13 Under the Concession Agreement, CEAR is required to continue providing passenger services to the public at government-subsidized prices. The government has, however, reneged on this agreement and has not provided the agreed subsidy to the concessionaire. However, a study conducted by the Privatization Commission has concluded passenger services under the current private operating procedures are profitable. [2]

2. Implementation Completion Report, Malawi Railways Restructuring Project, Borrower Comments, p. 14.

Results of the Concessioning

4.14 Traffic on the Nacala route has increased by 50% in the first full year of CEAR's operation. The key to this improvement appears to be the new managerial cultural the concessionaire introduced, with its focus on motivating staff, cutting costs, and aggressive marketing to lure shippers back to the Nacala route for their international traffic.

4.15 Interviews and focus group meetings with major shippers conducted during the audit mission reveal that the strategy adopted by CEAR appears to be improving the efficiency and effectiveness of the railway system. The major shippers in Malawi – tobacco exporters and freight forwarding companies among them – appear to be satisfied with the new private management of the railways. Among the more visible improvements they noted are improved service reliability and better communication between shippers and the railway company. These have allowed shippers to learn the status of their shipment more readily compared to the old system.

4.16 Despite these improvements, a substantial amount of international traffic still goes through other more expensive routes, notably through Durban, which suggests that the Nacala route is far from becoming the natural outlet for Malawi's international traffic. The main reason for this, according to local observers, is that the railway link on the Mozambique's side continues to be in poor physical condition and poorly managed by CFM. However, this is expected to change soon, as the same concessionaire has taken over the Mozambique side of the railway and the Port of Nacala, putting the management of the entire Nacala corridor under one management. This is expected to avoid delays at border crossing, and use wagons and locomotive more effectively.

4.17 However, there are more fundamental reasons that have prevented the Nacala route from increasing its market share of Malawi's international traffic: the lack of investment to improve the rail infrastructure (especially on Mozambique side) and the continued superiority of the road transport system. These are highlighted below.

Few Investments from the Private Sector

4.18 The poor physical condition of the Mozambique railway link in the Nacala route is not expected to change soon, as the investment for improving it has not been secured from the new concessionaire or from any other sources. In particular, 77 kilometers of rail track inside Mozambique is in need of rehabilitation and has been a major source of delays on the route. While major investment may not be warranted because of the low-level traffic on this section of the route, fo the Nacala route to be fully functional, this rail link needs to be rehabilitated. But this is not likely to happen anytime soon, which would further delay improvements expected on the Nacala route and keep it from becoming the natural outlet for Malawi's international traffic.

Competition from Road Transport

4.19 The Malawi railway system faces stiff competition from Malawi's vibrant road transport sector. The substantial efforts to revitalize the Malawi railway system through restructuring and concessioning have had limited impact on making the railways more competitive with road transport and regaining its market share for international traffic. The reasons for this are twofold: the strong customer preference for road transport and the sub-optimal pricing for all modes of transport. The road transport system is the preferred option for many shippers. It provides door-to-door service and better reliability, while the railway is too cumbersome and bureaucratic for most small shippers.

4.20 The pricing in the transport sector in Malawi, as in many other countries, puts the railways at a competitive disadvantage with the road transport sector. Truckers use the road network without having to pay the full cost of using it, while the railways have to pay the full cost of operating rail service. In addition, there is no adequate controlling mechanism to prevent truckers from overloading. A recently instituted road fund attempts to make truckers pay the cost of using roads, but the fees are insufficient and overloading has not been curtailed. Hence, without an optimal pricing system for all transport modes and controlling the overloading by truckers, the railways will continue to be at a competitive disadvantage.

4.21 Changes in regional trading patterns have also made road transport the preferred choice. Since the democratic changes in South Africa, most of Malawi's imports for consumer goods have been coming from South Africa by road, further decreasing the traffic demand for the railways.

Staff Retrenchment

4.22 The existence of a large surplus staff is often the cause poor financial and operational performance in railways. Therefore, an important element of railway reform and moving to a more efficient and market-oriented railway operation system often entails retrenching surplus staff. But staff retrenchment is a difficult and complex undertaking with strong political and social dimensions. The Malawi experience was no less difficult and complex. Of the 3,600 railway staff at the start of the project, 2,400 were retrenched during the restructuring phase, and a further 600 were retrenched during the concessioning phase.

4.23 The process of retrenching the surplus staff was difficult and caused many labor disputes between the retrenched staff and the government. In some cases, the dispute involved the Bank, where the retrenched staff complained to the Bank that they were not receiving adequate compensation and that the expected benefits were not forthcoming. In a letter to World Bank President, the retrenched staff, calling themselves, Railways Retrenched Association, complained that the retrenched workers "have reached the poverty line" and "appealed for assistance" from the President.[3] The Bank responses to this letter noted that the World Bank "did not make specific recommendations regarding retrenchment package to Malawi Railways or Malawi Government" and advised the Association to "approach the government" and "make the maximum use of the counseling and retraining facilities offered under the project."

4.24 The Bank played an inadequate role in ensuring that the staff retrenchment process was fair and transparent, and failed to provide the needed leadership or resources to make the retrenchment process less painful to all parties involved. The compensation package was to be financed from the project as part of co-financing from USAID. However, USAID cancelled its component, and financed it through another USAID project, which probably prevented the Bank from providing the needed leadership to ensure fairness and transparency in the retrenchment process[4]. The Bank did not evaluate ex-ante or ex-post the economic and social impacts of the retrenchment component. A retrenchment of this size – approximately 3,000 people were retrenched – should have been carried out with more careful planning and rigorous evaluation and monitoring.

Regulatory Environment

4.25 The post-privatization regulatory mechanism is essential for the success of a concessioning program. It ensures that the public interest of privatization is served, while protecting the private concessionaire from arbitrary government behavior and political interference. The need to have such a regulatory mechanism is widely recognized in railway reforms, but seems to have been missed in Malawi. An appropriate regulatory mechanism was not put in place to monitor and enforce the contractual agreement between the concessionaire and the government, and to enforce safety regulation. Regulation of fares, however, is not needed in Malawi because of the intense competition from the road transport that minimizes the monopoly power the railways would otherwise have.

4.26 The only regulatory mechanism put in place was a one-man regulator sitting in the Ministry of Transport. The audit mission's assessment of this arrangement is that it is grossly inadequate.[5] The regulator does not have the capacity or resources to monitor the contractual agreement between the concessionaire and the government, and to ensure the adherence of safety rules by the railway operator. The communication between the railway concessionaire and the regulator is poor. The regulator does not collect data on the performance of the railways and monitor safety compliance. Railway accidents, for example, are not systematically reported to the regulator, and appropriate investigation is not carried out to determine the cause of the accident. Instead, when railway accidents

3. Letter from Malawi Railways Retrenched Association dated 12 July 1995, and addressed to Mr. James Wolfensohn, President of World Bank.

4. When the project was approved in 1994, the Bank had no policy to finance staff retrenchment.

5. Based on the audit mission's interview session with the railway regulator.

occur, the regulator often is not informed by the operator, but hears of the accident through the media with the rest of the population[6].

5. Project Ratings

Outcome

5.1 The PAR rates the outcome of the project satisfactory. The assessment is based on three criteria: relevance, efficacy, and efficiency of the project

Relevance: The project objective to improve the Nacala route for Malawi's international transit was relevant for Malawi's development strategy at the time of project appraisal and today. The Nacala route is the shortest route and, with improved management, could be the most efficient route for Malawi's import and export transit. The strategy followed to restructure and concession the Malawi Railways was consistent with the Bank's sector strategy for improving the performance of railway operations. Some of the investment components later proved irrelevant once the concessioning program was substantially advanced. But, this was consistent with the Malawi Privatization Commission strategy limiting large investments on enterprises for which privatization has begun.

Efficacy: The restructuring and concessioning of the railways were satisfactorily implemented and contributed to improved railway performance. While traffic targets on the Nacala route have not been fully met, achievements since the private concessionaire took over railway operations are encouraging. The recent takeover by the same concessionaire of the Mozambique side of the railway link and the port of Nacala is also expected to further improve the performance of the entire Nacala route.

Efficiency: The ICR estimates that the ex post ERR was 78% versus 91% estimated at appraisal. The reduction is largely due to the reduced traffic projections and reduced benefits accruing. However, the ERR is still high because the cost of the project has been substantially reduced (due to cancellation of some of the investment components) and most of the benefits accrue from the privatization of Malawi Railways, instead from the investment.

Institutional Development

5.2 The concessioning of the railway to the private sector substantially altered the institutional framework within which the railway is operated and financed. From its monolithic and bloated structure, Malawi Railways has been changed to a trimmed, market-oriented operation. On this account, the PAR rates institutional development impact as substantial.

5.3 The project, however, fell short of establishing an adequate regulatory mechanism to monitor the contractual agreement between the government and the concessionaire, to enforce safety regulations. The current one-man regulator is grossly inadequate to carry out these important regulatory and monitoring functions in the post-privatization period.

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6. During the audit mission visit in December 2000, the regulator still did not have a functioning phone line.

Sustainability

5.4 The PAR rates the sustainability of the project as likely on account of the improvement of the performance of the railways through the concessioning. The concessioning of the railways itself is likely to be sustained. There is enough political commitment to continue with the private provision of railway services, and it is unlikely that the government will reverse this policy.

Bank Performance

5.5 The PAR rates Bank performance as satisfactory. The Bank provided useful advice for the restructuring and concessioning of the railways, and created a good working environment with the government. The Bank's decision to cancel some of the investment components when it was clear that the private concessionaire would take over was a sound judgment and saved the government of Malawi some money.

5.6 The Bank, however, could have done better in three key areas: providing leadership in staff retrenchment process, carrying out a thorough economic and social assessment of staff retrenchment, and supporting the establishment of a stronger regulatory mechanism.

Borrower Performance

5.7 The PAR rates the borrower performance as satisfactory. The government satisfactorily met most of the project conditionalities and showed support for the privatization process. The Privatization Commission efficiently managed the concessioning process.

6. Lessons Learned

6.1 Railway reform in Malawi was one of the early efforts in Africa to restructure and concession railway operations to the private sector. The experience provides some useful lessons:

- Restructuring can make eventual privatization process more manageable, but significant performance improvement should not be expected in the interim.
- Substantial investment in the interim should be avoided if possible since prospective concessionaires do not always put commensurate values on these investments.
- It is important to separate the operation and downsizing functions during the restructuring exercise. The Malawi railway restructuring created two separate entities to manage the reorganized railway operation and to carry out the retrenchment of surplus staff and disposal of surplus assets.
- There is a need to keep an intense policy dialogue with the government to maintain the focus on the privatization agenda. The project's conditionality to make substantial disbursement conditional on progress on the privatization agenda turned out to be a useful instrument to keep the focus on privatization.
- Staff Retrenchment is a complex undertaking. It requires careful planning and rigorous economic and social assessment. An analysis on the distribution of costs and benefits should be included as part of cost-benefit analysis.
- Establishing appropriate regulatory mechanism for the post-privatization period should not be overlooked.

Annex A: Basic Data Sheet

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

	Appraisal estimate	*Actual or current estimate*
Total project costs	29	9.3
Loan amount	16.16	6.7
Cofinancing	11.98	2.2
Date physical components completed	12/31/1998	3/31/2000
Economic rate of return	91%	78%
	-	-

Staff Inputs (staff weeks)

Stage of project cycle	*Actual*	
	Weeks	*US$*
Identification/Preparation	10.7	25.0
Appraisal/Negotiation	39.9	99.7
Supervision	8.9	224.8
ICR	9.5	11.4
Total	141	360.9

Mission Data

Stage of project cycle	*Month/year*	*No. of persons*	*Staff days in field*	*Specializationed staff skills represented*	*Performance rating Impplementation Status*	*Performance rating Development Objectives*	*Types of problems*
Identification/Preparation							
Dec-93		4		SER,TE,RR,DRR			
Appraisal/Negotiation		10		SRE,PE,SPS,TS(2)			
Apr-94				TEC,TE,FA,PO,RS			
Supervision							
Apr-95		4		PSDS,TEC,PO,SRE	HS	HS	
Oct-95		2		SRE,FA	S	S	
Feb-96		3		SRE,FA,EC	S	S	
Jul-96		2		SER,EC	S	S	
Apr-97		4		SER,PE,EC,IPO	S	S	
Jan-98		1		SER	S	S	
Jul-98		2		SER,PTS	S	S	
Mar-99		2		SER,FMS	S	S	
ICR							
Sep-99		3		SRE,IPO,EC	S	S	

SRE: Senior Railway Engineer; TE: Transport Engineer; RR: Resident Representative; DRR: Deputy Resident Representative; PE: Port Engineer; SPS: Senior Procurement Specialist; TS: Transport Specialist; TEC: Transport Economist; PO: Project Officer; FA: Financial Analyst; RA: Railway Specialist; PSDS: Private Sector Development Specialist; EC: Economist; PE: Principal Economist; IPO: Infrastructure Program Officer; PTS: Principal Transport Specialist; PO: Project Officer; FMS: Financial Management Specialist.