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IMPLEMENTATION COMPLETION REPORT

REPUBLIC OF MALAWI

THE SECOND FISCAL RESTRUCTURING AND DEREGULATION PROGRAM CREDIT (FRDP II) AND THE SECOND FISCAL RESTRUCTURING AND DEREGULATION PROGRAM TECHNICAL ASSISTANCE PROJECT (FRDP TA II), CREDITS NOS.: 31460, AND 31470

DECEMBER 21, 2000

Macroeconomics 1
Africa Region

CURRENCY EQUIVALENT
(As of December 2000)

Currency Unit	=	**Malawi Kwacha**
US$1.00	=	**MK 80**

FISCAL YEAR OF BORROWER

July 1 - June 30
(as of July 1998)

PRINCIPAL ABBREVIATIONS AND ACRONYMS USED

ADMARC	Agricultural Development and Marketing Corporation
CBM	Commercial Bank of Malawi
DSP	Divestiture Sequence Plan
ESAF	Enhanced Structural Adjustment Facility
ESCOM	Electricity Commission of Malawi
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IDA	International Development Association
MDC	Malawi Development Corporation
MK	Malawi Kwacha
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MPTC	Malawi Posts and Telecommunications Corporation
MTEF	Medium Term Expenditure Framework
NBM	National Bank of Malawi
NFRA	National Food Reserve Agency
OED	Operations Evaluation Department
TEP	Temporary Employment Permit

Vice President	=	Callisto Madavo
Director	=	Darius Mans
Sector Manager	=	Philippe Le Houerou
Task Manager	=	Sudhir Chitale

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Preface

1. This is the Implementation Completion Report (ICR) for the Second Fiscal Restructuring and Deregulation project in Malawi and the Second Fiscal Restructuring and Deregulation program Technical Assistance Project for which credits of SDR 65.7 million (US$ 90 million equivalent and SDR 1.5 million (US$ 2 million equivalent), respectively were approved on December 3, 1998 and made effective December 23, 1998. The project provided SDR 54.8 million to support adjustment policies; an initial tranche of SDR 43.8 (US$61.7 million equivalent) was disbursed on effectiveness and fully disbursed by December 1998. A second tranche of SDR 21.9 million was released in December 1999. The Technical Assistance project component of SDR 1.5 million is ongoing and the credit has therefore not been fully disbursed.

2. The ICR was prepared by David G. Greene, Consultant, and Sudhir Chitale , Senior Economist, and reviewed by Country Director. Preparation of this ICR was begun during the Bank's completion mission of April 2000. It is based on material in the project file. The borrower's comments are attached as Appendix.

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Evaluation Summary

Introduction

1. The Second Fiscal Restructuring and Deregulation Program Credit (FRDP II) sought to maintain the momentum of wide ranging reforms initiated by the Government of Malawi elected in May 1994, supported by FRDP I, approved in April 1996. FDRP I focused on expenditure prioritization through development and use of a medium term expenditure framework (MTEF), protection of budgetary outlays in priority sectors, civil service reform to streamline and increase the effectiveness of Government, continued deregulation of agricultural production and marketing, especially for tobacco and maize, tariff and tax reform to reduce protection and encourage exports, and privatization of state-owned enterprises. FRDP II continued along the same path. It aimed at improving and further institutionalizing the MTEF, accelerating civil service reform and Government restructuring. FRDP II also complemented FRDP I by increasing the focus on promotion of private sector led growth in the non-agriculture sector by accelerating privatization of the power and telecommunications sectors and improving the competitiveness and efficiency of the financial sector. The credit provided SDR 65.7 million (US$ 90 million equivalent) to for balance of payments and budget support. Simultaneously, a credit of SDR 1.3 million (US$ 2 million equivalent) was provided as a Second Fiscal Restructuring and Deregulation Program Technical Assistance Project.

Project Objectives

2. The overriding objective of FRDP II was to reinvigorate the Government's stabilization and adjustment program and create conditions for accelerated GDP growth and poverty reduction. The program supported by the credit assisted in (i) continuing government efforts to improve fiscal performance and achieve macroeconomic stability by reforming the structure of indirect taxes, further strengthening tax administration and improving expenditure prioritization, management and control and restructuring government functions and the civil service and (ii) encouraging growth of the private sector by further deregulation of agricultural markets and development of markets for land and labor, strengthening the financial market, accelerating privatization of government enterprises and functions and encouraging private sector participation in the development and improvement of infrastructure.

3. The first tranche, disbursed on effectiveness in December 1998, supported implementation of public expenditure management and civil service reforms, and initiation of private sector and infrastructure reforms. Implementation of policies in public expenditure management, civil service reforms and private sector development reforms against specified benchmarks was considered satisfactory and the second tranche, disbursed in December 1999 following a partial waiver of conditions relating to financial sector deregulation and outsourcing of government functions.

Implementation Experience and Results

4. Despite efforts by the Government, macroeconomic performance was less than satisfactory. About the time FRDP II was being prepared in late 1997 macroeconomic management went off track. Weakened fiscal discipline resulted in an increase in the deficit from 8% the previous year to 12 % of GDP in 1997/98 and to accelerating inflation, stagnation of private investment and a slowdown in GDP growth to below 4% per annum. In addition, in early 2000, the government identified public expenditure arrears. The Government has since put in place strengthened commitment control system to avoid the accumulation of arrears. On the whole, the Government has been making a strong effort to restore fiscal balance and reduce inflation, but the macroeconomic situation remains fragile.

5. Under FRDP II significant improvements continued to be made in the tax and tariff regime and in export incentives. The privatization program was administered competently and was accelerated and its coverage expanded. Some of the second order problems of the private sector, temporary employment permits and availability of land for industry were resolved. Positive steps were taken in improving the legal and institutional framework for private sector participation in the power and telecommunications sector, but progress in identifying potential foreign investors was limited. Slower progress seems to have been made in improving the financial sector regulatory framework and, here to, finding private investors has proven to be difficult. Institutionalization of the MTEF as a tool for prioritizing expenditures has been slow. However, recognition of its potential usefulness increased and the system has been improved and its use broadened. Shares of recurrent expenditures budgeted for pro-poor outlays, especially health and education, have been increased, but the gains have been eroded by inflation and increases in the client base. Progress of civil service reform has been marginal: although the number of Ministries has been reduced and 18 government services were outsourced, the size and functions of the civil service remained basically unchanged and the problem of salary compression were not resolved. Agricultural markets were liberalized, and under the FRDP II program the government attempted to put in place a workable maize price band system. In practice the maize price intervention has not worked. Moreover, the role of ADMARC in the sector has reduced and NFRA is being developed as an emergency relief organization. Consequently starting this year the practice of setting maize price band has been abandoned and the movement toward privatizing ADMARC seems to be losing its momentum.

6. The two FRDP programs supported actions that will have beneficial effects over the longer term, a new set of tools for setting budget priorities and managing expenditures are being institutionalized, privatization of state enterprises is proceeding at a reasonable pace and the regulatory frameworks for utilities and the financial sector are being strengthened.

Summary of Findings, Future Operations and Key Lessons Learned

7. Despite their shortcomings, performance of the Bank and Government and overall implementation of the project can be considered satisfactory. Implementation of the program supported by FRDP II presents a mixed, but on balance satisfactory picture and the reform effort is likely to be sustained. The first tranche of the credit was disbursed on effectiveness and the second tranche was disbursed in December 1999, after a partial waiver of conditions relating to outsourcing of government functions and preparation of a new regulatory framework for the financial sector.

8. It is clear that Malawi will require rapidly disbursing external assistance for some time to come, and that there is still a substantial agenda of policy issues to be undertaken. The issues is how to package policy conditions and amounts of assistance to maximize the degree and pace of implementation -- whether to continue along the lines of FRDP I and II, multi-sector, multi condition (omnibus) operations attached to US$ 100 million (or more) multi-tranched IDA credits, or to switch to smaller, more focused operations with all conditions fulfilled before loan approval. The former approach has the advantage of economizing on Bank staff and not requiring much analysis of the appropriateness of the package of conditions. However, large amounts of money riding on a single operation make it more difficult to withhold either board approval or tranche release. It also adds to the temptation to load the project with process conditions to make it look more rigorous. The latter approach requires more detailed consideration of the sequencing of reform and the conditionality should be attached to each operation and may require a broader spectrum of staff participation in preparation and supervision, especially if individual operations have sectoral focus.

9. The experience of this project tends to reinforce the lessons associated with FRDP I.

i. The project demonstrates once again the synergy between macroeconomic stabilization and structural reforms.

ii. Careful and extensive preparation, including a strong background of economic and sector work, extensive collaboration with government, consultation with stakeholders and coordination with other suppliers of external assistance and is a necessary but not sufficient condition for execution of complex adjustment

iii. Fiscal restructuring and civil service reform should begin with a fundamental reconsideration of the role of government undertaken at the political level. Restructuring of the government, the civil service and the budget must have political leadership and be based on decisions about the future role of the public sector.

iv. Protecting pro-poor fiscal outlays may prevent further deterioration of services but it cannot address deep-seated problems of equity, efficiency and quality of public health and education.

v. Issuance of policy statements, appointments of commissions or commissioning studies is not proxies for "ownership," especially when they precede stakeholder consultation or parliamentary consideration. Governments may begin to think carefully about their commitment only when definitive, irrevocable actions are imminent.

vi. The willingness of private domestic or foreign enterprises to invest in privatized state enterprises or functions in a small, poor country without an established record of good management, cannot be taken for granted, even with improvements in the legal and institutional framework.

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Main Report

Statement/Evaluation of Objectives

1. FRDP II was the second adjustment operation designed to support the process of policy reform initiated by the Government of Malawi that was democratically elected in May 1994. That Government, unlike its predecessor, was and remains committed to broad-based development and poverty reduction. The Government demonstrated this commitment early on with landmark decisions ending restrictions on smallholder production of burley tobacco (and other limitations on private agricultural trade) and eliminating primary school fees. The Government initiated monetary and fiscal policies designed to stabilize the economy, began reform of tariff and surtaxes, and improved export incentives. It also began the long process of streamlining government and reforming the civil service, prioritizing government expenditures to emphasize pro-poor programs such as primary education and health care, and privatizing state owned enterprises. The Government's program was supported by FRDP I of SDR 73.2 million, US$ 106.4 million equivalent, approved in June 1996, and an IMF ESAF arrangement.

2. The macroeconomic stabilization measures and structural reforms supported by FRDP I initially resulted in significant reduction of fiscal deficits and inflation. The economy responded well to falling inflation and deregulation of agricultural markets and GDP growth averaging 8% in 1995-97, about a third the result of recovery from the 1994 drought. Growth was broader based and more equitable than in the past with rapidly increasing smallholder production of burley tobacco, growing rural markets and emergence of a fledgling nontraditional exports. However, implementation of both the stabilization effort and structural reforms faltered in 1997. Failure of expenditure control led to a widening of the fiscal deficit and a resurgence of inflation. Structural reform also began to lag. There was little progress in restructuring of expenditures, civil service reform and privatization were slower than expected. Nevertheless, almost all the specific conditions for release of the second tranche were met and the program was completed, after a partial waiver of a few specific conditions, with disbursement of the second tranche in September 1997.

assistance component in FRDP I, the project is expected to close in March 2001). The credit provided SDR 65.7 million (US$ 90 million equivalent) for balance of payments and budget support. Simultaneously, a credit of SDR 1.3 million (US$ 2 million equivalent) was provided as a Second Fiscal Restructuring and Deregulation Program Technical Assistance Project. The credits were approved and made effective in December 1998 and the first tranche was disbursed immediately afterwards.

4. Both, FRDP I and II were prepared and implemented against the background of a difficult and complex political economy, where the forces for reforms were quite closely matched (and often outmatched) by forces against reforms. It was also based on home grown reforms prepared in the middle of a macroeconomic crisis. The policy dialogue on the FRDP II, some specific aspects of its design (e.g. fiscal reporting framework that it supported), and the money it provided all had important contribution in the maintaining the stability of economy. The credit helped to restore fiscal balances from the crisis of late 1997. It helped to avert another one that could have arisen due to large terms of trade loss in FY 1998-99 (close to 2% of GDP), and potential fiscal overruns from the closely contested election of FY 1999. Similarly, the quick disbursement by FRDP II in December, 1998 after the large terms of trade losses and the resulting 60% devaluation in the Kwacha in mid - 1998 helped to restore confidence.

5. The overriding objective of FRDP II was to reinvigorate the Government's stabilization and adjustment program and create conditions for accelerated GDP growth and poverty reduction. It was estimated that a GDP growth rate of 5%-6% p.a. would be needed to produce a decline in the poverty head count ratio from 43% to 38% of the population. This, in turn, would require raising private fixed investment from about 4% to 7% of GDP. Improvements in the targeting of public expenditures and government services would also contribute to reduction of poverty. The program supported by the credit was thus designed to (i) assist continuing government efforts to improve fiscal performance and achieve macroeconomic stability by reforming the structure of indirect taxes, further strengthening tax administration and improving expenditure prioritization, management and control; restructuring government functions and the civil service, and (ii) support policies to encourage growth of the private sector by deregulation and development of markets for land and labor, strengthening the financial market, accelerating privatization of government enterprises and functions and encouraging private sector participation in the development and improvement of infrastructure.

6. The adjustment component was made available in two tranches, the initial tranche of SDR 50.9 million (US$ 74.4 million) was disbursed on effectiveness, and the second, SDR 21 million (US$ 30 million) was disbursed in December 1999. The first tranche supported implementation of public expenditure management and civil service reforms, and initiation of private sector and infrastructure reforms. The second tranche followed implementation of policies in public expenditure management, civil service reforms and private sector development reforms against specified benchmarks. Of the 12 specific conditions

for release of the second tranche, 10 were fully met and a partial waiver was granted for the other two (relating to the regulatory framework for the financial sector and the outsourcing of some government functions).

7. The FRDP II Technical Assistance Project financed technical support, training and equipment to: (i) implement policy reforms, including the medium term expenditure framework, auditing and reviewing the development budget, reforming expenditure control procedures and systems, and implementing civil service reforms; (ii) 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 agriculture; and (iii) develop the agenda for the next round of macroeconomic and sectoral policy reforms through research into further constraints to growth. A separate Privatization Technical Assistance Project (US $ 10 million) provided assistance to implement the privatization program

Achievement of Objectives

8. Implementation of the program supported by FRDP II presents a mixed, but on balance satisfactory picture. Performance under FRDP I demonstrated the links between stabilization and growth, with stabilization being the key to promotion of investment and sustained growth. Unfortunately, macroeconomic stabilization proved to be the weak link in the chain of adjustment. During 1995-97, macroeconomic management improved, inflation subsided and this, coupled with structural reforms, led to recovery of GDP growth. However progress on macroeconomic stabilization proved difficult to sustain and about the time FRDP II was being prepared in late 1997 macroeconomic management went badly off track. Weakened fiscal discipline resulted in an increase in the deficit to 12 % of GDP in 1997/98 and to accelerating inflation and a slowdown in GDP growth to below 4% per annum partly as a result of high real interest rates and unstable effective exchange rates.

9. Despite increasingly tight budgetary controls and expenditure cuts, fiscal deficits have proved difficult to control and inflation continues to be a severe problem. On average, consumer prices rose by 40% per year over the last three years. Some of the fiscal pressures are due to high level of public sector borrowing especially by the statutory corporations. In addition, during 1999 and 2000, Malawi also faced external shocks such as the high oil prices, low tobacco prices, the political problems in Zimbabwe and the devaluation of the Rand. All these shocks led to a sharp devaluation in the Kwacha and have adversely affected the fiscal situation. In early 2000, an IMF mission requested by the Government also identified arrears on domestic public expenditures. Since then the Government has strengthened the implementation of the cash budget and the commitment control system to address the problems of expenditure control.

10. Implementation of structural adjustment policies supported by FRDP II also presents a mixed picture. On the positive side, significant improvements

continued in the tax and tariff regime and in export incentives. The privatization program is being administered competently and is being accelerated and its coverage expanded. Some of the second order problems of the private sector, temporary employment permits and availability of land for industry have been resolved. Positive steps have been taken in improving the legal and institutional framework for private sector participation in the power and telecommunications sector, but progress in identifying potential foreign investors has been limited. Slower progress seems to have been made in improving the financial sector regulatory framework and, here to, finding private investors has proven to be difficult.

11. Progress in institutionalization of the MTEF as a tool for prioritizing expenditures has been slow, largely because of "ownership" issues and weaknesses in the underlying budgetary processes. However, recognition of its potential usefulness is increasing and the system has been improved and its use has been broadened. Shares of recurrent expenditures budgeted for pro-poor outlays, especially health and education, have been increased, but the gains have been eroded by inflation and increases in the client base. Progress of civil service reform has been marginal: although the number of Ministries has been reduced and 18 government services have been outsourced, but the size and functions of the civil service remain basically unchanged and the problem of salary compression has not been resolved. Agricultural markets have been liberalized, but movement toward changing the maize pricing regime and privatizing ADMARC seems to be losing its momentum.

12. The FRDP programs supported actions that will have beneficial effects over the longer term: a new set of tools for setting budget priorities and managing expenditures are being institutionalized, privatization of state enterprises is proceeding at a reasonable pace and the regulatory frameworks for utilities and the financial sector are being strengthened. On balance, the preliminary judgment is that, despite their shortcomings, performance of the Bank and Government and overall implementation of the project can be considered satisfactory.

Major Factors Affecting the Project

13. Malawi is extremely aid dependent. External assistance was equivalent to about 15.3% of GDP in FY 98/99 (net foreign borrowing, 8.9% and grants 6.4% of GDP) and financed 58% of the budget in that year (75% of the development budget). Delays in IDA disbursements, which account for about 30% total disbursements of official loans and grants, can have strong negative repercussions for meeting macroeconomic targets and carrying out vital programs. The critical role of external assistance was heightened in 1998 by a US$ 77 million (13.6%) decline in export earnings. The urgency of securing external assistance appears to have led to the Government agreeing to take actions it hadn't thoroughly considered and to the Bank to hasten development of the adjustment program, including process conditions in the policy mix and compromising on some less than satisfactory performance to ensure the flow of disbursements.

14. The government's technical and managerial capacity and institutional structure are quite modest and the scope and complexity of the FRDP II program proved to be beyond the Government's ability to implement it in the short time provided by the initial April 1999 target for disbursement of the second tranche.

15. An additional complication was the scheduled national election in May 1999, in which the incumbent government was reelected with a reduced parliamentary majority. This may have occupied the attention of key policymakers and accounted for the government's moving cautiously on more controversial policy actions.

Project Sustainability

16. Malawi will continue to need quick disbursing assistance for some time, and there are no indications that the Government has reconsidered its commitment to the types of reform supported by FRDP I and II and the program should be sustainable. Nevertheless, the Government has expressed concern about the pace of adjustment and whether Malawi is liberalizing faster than its neighbors and competitors, which, given its weak infrastructure and low level of industrialization, is putting it at a competitive disadvantage. The issue seems to be not whether reform will proceed but whether the pace and scope of reform and the lending instrument are appropriate and consistent with Malawi's capacity. Although some important actions continue to be taken in connection with the project, in many of these still represented initial or intermediate steps that required intense follow up activities and/or further action. It is clear that the reform agenda is too broad relative to implementation capacity and that the scope and sequencing of reform should be reconsidered.

17. The main threat to the sustainability of reform is the difficulty the Government is experiencing in maintaining macroeconomic stability. The macroeconomic situation remains fragile and inflation continues to be a problem. Larger than anticipated fiscal deficits, high rates of inflation and low GDP growth can erode the social and political support for reform.

Bank Performance

18. Bank performance in the preparation and supervision of the project was satisfactory. The reform package was formulated after consultations with stakeholders during preparation missions and discussions of the August 1998 Country Assistance Strategy. Analytical underpinning of the credit was provided by the IBRD study, "Accelerating Malawi's Growth" (September 1997). This study concluded that a wide range of policy initiatives was needed to promote high investment and growth including improved fiscal management, better prioritization of public expenditures to ensure adequate funding of social sector programs, improved land policies to encourage greater utilization of estate lands, improved infrastructure services, increased the supply of industrial sites and streamlined procedures for approval of employment of skilled expatriate workers.

Many of the policy issues identified by this study, were further analyzed in the consultant studies financed under the associated TA project. The status of these studies is indicated in paras. 43- 44.

19. The Bank used economic and sector work effectively, maintained a close and continuous dialogue with the Government, encouraged broad consultation with civil society and stakeholders and maintained close relations with the IMF. Lessons were drawn from the OED performance audit of the last completed adjustment credit, the Enterprise Development and Drought Recovery Program (Cr. 2396-MAI) approved in May 1992 and closed in March 1996. Unfortunately, the ICR for FRDP I, which might have revealed other relevant lessons, had not yet been not undertaken because the project had not yet closed. The Government requested such an assessment in its aide memoire commenting in the report of the FRDP II identification mission.

20. FRDP II also incorporated recommendations from the review of high impact adjustment lending and other OED reports (i) being grounded in a multi sector economic work "Accelerating Malawi's Growth" and other sector work; (ii) obtaining Government commitment and ownership (iii) arranging for broad consultations with civil society; and (iv) being well embedded in the country assistance strategy and supported by complementary credits in the areas of infrastructure investment and private sector development.

21. The Bank continued to overestimate the Government's ownership of and capacity to carry out the complex reform agenda. In addition, it did not sufficiently consider some regional implications of the reform agenda: unregulated informal trade with neighboring countries and the relative pace of adjustment of Malawi and its neighbors and its effects of competitiveness. Finally, the Bank also underestimated the difficulty of attracting foreign investors to privatized state enterprises and even attracting domestic private investors.

Borrower Performance

22. Given its technical and managerial limitations, the performance of the Borrower was satisfactory. FRDP II was based on detailed reform programs prepared by the Government and spelled out in its Letter of Development Policy. Government ownership of the program was publicly affirmed by the issuing of a White Paper (in November 1998). High-level attention was ensured by assigning the Cabinet Committee on the Economy responsibility for overseeing implementation of FRDP II as a key part of the overall economic reform program. The project incorporated several features to help ensure government ownership: significant actions were taken before board approval, including further improvements reforms in expenditure management, rationalizing Government functions and the civil service and strengthening the privatization program. However, government ownership of the adjustment programs the program may not be as strong as it appears. The Government seems consider its commitment seriously only when definitive, irrevocable actions are imminent.

Assessment of Outcome

Fiscal Restructuring

23. **Implementing the MTEF.** Both FRDP I and II supported the adoption and expanded utilization of a Medium Term Expenditure Framework as a tool for prioritizing Government outlays. However, the effort undertaken to institutionalize the MTEF and make it an integral part of the budgetary process has not yet completely succeeded. At the outset, establishment of the MTEF was discussed and agreed between the Bank and MOF technical staff. There was little or no participation by sector ministries or by higher levels of Government. As a result, MTEF was seen as a MOF/Bank initiative, not related to the work of the ministries. It was not fully integrated with the regular budgetary processes. After five years of gradual implementation, it has not yet evolved into the useful prioritization tool it was intended to be. However, there is increasing awareness of its potential value and progress is being made in improving and implementing the MTEF system (a condition of release of the second tranche). Moreover, FRDP II continued improvement of the MTEF by (i) including all ministries/activities in the MTEF; (ii) integrating the development budget process into the MTEF; (iii) bringing the salaries budget into the MTEF by considering staffing requirements linking the MTEF to the functional reviews of the ministries; and (iv) integrating the budget and MTEF cycles.

24. **Protecting Pro-poor Outlays** The MTEF prioritization exercise was incorporated in the 1998/99 budget and allocations for critical, non-wage current expenditures were increased: agriculture by 22% over previous year, health (24%), education (49%), and police services (23%). Expenditure on road maintenance was increased by over 100% and was expected to meet around 75% of road maintenance requirements. At the sub-sectoral level, projected real allocations for provision of teaching and learning materials in primary and secondary education, pharmaceuticals, preventive medicine programs, water and sanitation, and road maintenance were increased or maintained at 1997/98 levels. Non-essential expenditures in other sectors were identifies and reduced or eliminated. Satisfying a condition of release of the second tranche, quarterly expenditure monitoring targets were established and complied with.

25. Even though there have been increases in budget allocations, per capita health spending has been eroded by inflation, leading to stagnation of per capita outlays since the mid 1990s and health outcome have worsened. The combination of malaria, respiratory infections, diarrhea and ailments associated with childbearing and childhood and a worsening HIV/AIDs epidemic have reduced life expectancy at birth to 44 years. Public sector primary health services have continued to deteriorate, partly because heavy loss of clinical staff and patients continue to bypass primary and secondary facilities, clogging tertiary hospitals. A fundamental reconsideration of the Government's health strategy is needed. This

should start with analysis of the burden of various diseases and the cost effectiveness of interventions. Decisions then have to be made about which interventions are handled most effectively in the public sector and which in the private sector. The staff requirements of the public health system, both numbers and levels of training should grow out of this analysis, and help reshape the health education. Similarly, although the share of education in the overall recurrent budget increased, per capita outlays have been eroded by increases in enrollment and inflation. In fact, the real value of primary education spending per student in 1997/98 prices declined from MK 608 in 1994/95 to MK 336 in 1997. Primary education outcomes are unsatisfactory: only 30% of students achieve standard 8 within the minimum number of years and only 10% of primary school students progress to secondary school. There is undoubtedly a need for a major increase in primary education outlays, but sector management and teacher allocations need to be addressed, as does the issue of user charges

26. **Improving Expenditure Control** The government agreed as a condition of release of the second tranche of FRDP II to improve expenditure monitoring and control. The supervision mission of March 1999 noted that Government expenditure controls appeared to have been tightened. Monitoring reports were being produced on a regular basis and being reviewed by the Cabinet Committee, which asked Ministries for to explain deviations for budgets and plans for corrective action. The Committee has been screening requests to extra-budgetary expenditures, accompanied by a clear identification of expenditures to be cut. In early 2000, an IMF mission requested by the Government identified arrears on domestic public expenditures which suggested some problems with the underlying commitment control system. Under the 10 point plan, as of July 1, 2000, the Government has put in place new rules to avoid accumulation of arrears. These rules require controlling officers in line ministries to maintain an up-to-date expenditure and commitment register. Ministries which do not submit the commitment and expenditure returns in time would not be funded. All ministries and departments now can plan their expenditures on the basis of a quarterly budget allocation provided by the MOF. The actual commitments however, are restricted to a monthly Credit Ceiling Authority (CCA), which is generally one third of the quarterly ceilings.

Promoting Development of Agricultural Markets

27. **Privatizing ADMARC** The FRDP programs have supported liberalization of the maize market, allowing private traders to take over the functions performed by ADMARC, which was to be privatized and commercialized. In fulfilling a condition of release of the second tranche of FRDP II, the Cabinet approved a privatization program for ADMARC that had been prepared by consultants. The program called for ADMARC's commercial and developmental functions to be separated and the company prepared for privatization. The profitable cotton and tobacco sections of ADMARC were to be separated off and privatized. Excess and unused facilities were to be sold and 40 sale points in favorable locations with a strong private trading presence were to be privatized. The remaining

unprofitable sale points, were to be turned over to the recently established National Food Reserve Agency (NFRA), until alternative social safety net measures could be developed. The new, slimmer ADMARC trading company would be privatized by about 2002. The National Food Reserve Agency was to be made the principal instrument for maize market interventions. These interventions were to take place on clearly established market-based rules using purchases and sales to keep the maize price within a band established relative to export and import parity prices.

28. The consultant's report indicated that despite evidence to the contrary, the majority of stakeholders still believed that ADMARC is critical in Malawi's agricultural marketing system because there is a lack of capacity in the private sector. During the last quarter of 1999, the Government was began consultations with representative stakeholders (consumers, smallholders and farmer associations) to tie down the details of provision of marketing services in remote rural areas. These consultations have not yet been completed. The proposal for privatizing ADMARC seems to be losing momentum and the Government now appears to be having second thoughts. To begin with, in most crops except maize, ADMARC is not as important as it was in the past, handling less than 10% of the crop. Even in maize ADMARC does not enjoy monopoly rights on buying of maize from small holders. Finally, it has not been easy find private sector buyers even for maize depots in the profitable markets. Consequently, ADMARC has proposed dividing its operations into commercial and "social" (200 unprofitable) units. It would then contract to run the "social" operations, compensated by Government. Government, as the sole shareholder in ADMARC, would receive the profits from commercial operations as a dividend. The development and the future of the social functions of the ADMARC is closely linked to the development of the NFRA as a strong emergency relief organization.

29. **Implementing the Maize Price Band** The FRDP II program called for the Government to update the maize price band semiannually, based on a formula that includes the import and export parity prices. The principle is that maize from Government stocks and imports would be sold at the ceiling price to contain excessive increases in consumer prices and purchased at the lower price band to support producer prices. Experiments with setting a maize price band have proved unsatisfactory. Government attempts to implement a maize price band have highlighted the lack of a suitable mechanism and institution for managing it. In practice, maize market interventions set a ceiling price that was too low and discouraged the supply of maize by deterring imports by private traders and taxing producers. Moreover, because large fraction of Malawi's population lives near its lightly policed borders, maize trade is virtually unregulated and there are likely to be large flows between countries, diminishing the effectiveness of country-specific interventions to stabilize prices. Appreciating these difficulties, since early this year, the Government has abandoned the practice of establishing the maize price band. As per the new institutional structure, supported by the Bank, the NFRA is being focussed on purely emergency relief operations in times

of draught. The rest of the maize marketing is being left to a combination of private sector and ADMARC.

30. **Reforming Land Policy** Land policy is a socially and politically charged issue and, not surprisingly, progress in development of a new land policy has been slow. A new policy framework is needed to provide and safeguard the development of a land market, protect the security of customary tenure by stopping arbitrary non-compensated transfer of customary land into leasehold tenure, provide a framework for managing conflicting claims on land between customary cultivation and leasehold, introduce procedures for charging and collecting estate rentals that progressively reflect the economic value of leasehold lands. In March 1996 the Government appointed a Presidential Commission of Inquiry to review of land problems and recommend principles for a land policy that would foster a more efficient, environmentally sustainable and equitable land tenure system. The Commission's report was issued in November 1999. The Policy Planning Unit of the Ministry of Land and Valuation is reviewing its recommendations to define the new land policy principles and identify institutional changes needed to ensure at secure land tenure arrangements and sound land lease procedures. These conclusions are due to be presented in mid-2000. The Bank seems to have discovered that land issues are too complex to be addressed effectively in an adjustment operation and there was no follow through in FRDP II.

Encouraging Development of Private Enterprises

31. **Privatizing State Owned Enterprises** The Government initiated the process of privatization of state owned enterprises in late 1994. The process was assisted by an IDF grant which ended in 1998, and a follow up US $10 million Technical Assistance Project approved in June 2000, is providing assistance to implement the privatization program. A Privatization Bill was approved by Parliament in spring of 1996, and detailed operational procedures for privatization were prepared drawing on international best practices. Implementation of privatization has been delegated to a Privatization Commission, which began work in 1997 and is orchestrating individual transactions.

32. Progress of privatization was closely monitored under FRDP I and considered satisfactory. The privatization program effort is being intensified under FRDP II. In August 1998, the Government approved a "Divestiture Sequence List" of 100 enterprises held by Government directly and indirectly through MDC and ADMARC. Until recently utilities and ADMARC's agricultural operations were not included in the privatization plan. Under FRDP II Government has agreed to offer for sale companies and banks owned by MRC, ADMARC and government and parts of ADMARC's agricultural markets, warehouses and trading facilities and these are included in the divestiture sequence list. As a condition of release of the second tranche, the government agreed to privatize 15 enterprises 1998/99. This condition was fulfilled as 17 enterprises were brought to the point of sale between July 1998 and October 1999

33. **Facilitating Temporary Employment Permits** As part of the FRDP II program the government decided to facilitate issuance of Temporary Employment Permits. A new policy was gazetted in October 1998 enabling investors to obtain TEPs easily. The new policy introduces "key posts", for which TEPs will be granted automatically, the number depending on the size of the investment. The outcome of applications would be communicated within 40 days. Permanent resident no longer need TEPs to work. Review of the issuance of TEPs indicates that the lag in approvals had been reduced.

34. **Resolving Industrial Land issues.** Availability of serviced industrial land and ready-made factory shells has been deemed to be important for manufacturing growth. There is a perception among manufacturers that serviced industrial land is scarce, in the sense of being expensive or unavailable. There appears to be excess demand for factory space and factory shells, possibly because of preference of businessmen for rentals, given economic uncertainty. The authorities ration land allocations, encouraging investors to invest in land without necessarily using it for industrial plant. In the context of FRDP I the government undertook to provide more serviced industrial land so as to ease the shortage. Between April 1997 and March 1998 25 serviced industrial plots were offered in Lilongwe, and 12 in other locales. Between April 1998 and March 1999 120 plots were issued in Lilongwe and 10 in Mzuzu. However, the general issue of Government subsidization of enterprises through provision of land and factory shells has not yet been addressed.

35. **Improving Infrastructure** The reform agenda by was expanded under FRDP II to encompass measures to improve and expand infrastructure, particularly in the power and telecommunications sectors. There are only about 40,000 telephone lines in working order and 70,000 electricity customers. Government-owned Malawi Posts and Telecommunications Corporation (MPTC), has had chronic operational and financial problems, relies entirely on public sources of financing, and has little commercial autonomy. In the electric power sector, the main supplier, ESCOM, has had difficulties in providing reliable power services and faces serious financial difficulties. These problems have suggested a need for fundamental restructuring of these utilities, commercialization and/or privatization, and private sector entry and competition and FRDP II supported the implementation of actions leading to this.

36. Implementation of **telecommunications sector reform** is proceeding relatively well. As a condition of second tranche release, the Government approved a new Communications Policy and the Communications Act No. 41 of 1998 provides for opening all non-basic telecommunications services (mobile, data, Internet, paging) to private service providers. In fact, two cell phone operators (also a condition of release of the second tranche) and two Internet providers have entered the Malawian market. The Government is now in the process of splitting Posts and Telecommunications into separate businesses. This has, however, proved to be a difficult and time-consuming task because of the

absence of financial records. Advisers have been appointed to assist in securing a strategic partner for Malawi Telecom (also a condition of release of the second tranche).

37. Progress was made toward **power sector reform** under FRDP II. Actions were initiated to resolve ESCOM's financial problems and to encourage private investment in the power sector. As agreed under the FRDP II, an Electricity Act was enacted to establish an independent regulatory body, the Electricity Council, to license electricity producers (including ESCOM) on equal terms. A Power Sector Policy Statement clarifying licensing and tariff rate adjustment procedures was prepared, and on the basis of this, a new draft of the Electricity Act has been prepared. However, the new draft has not yet received cabinet approval. In the interim, the Government has taken steps to corporatize and commercialize ESCOM and establish its commercial and managerial autonomy. The Government has also initiated financial restructuring of ESCOM by converting a portion of its debt to Government to equity, raising electricity tariffs by 35% to help ensure ESCOM's financial viability. Although the reforms, identified in the FRDP II were implemented, further progress leading to privatization of ESCOM or a restoration of its financial viability has been slow. The strategy for privatization of ESCOM is still under discussion, but the emerging consensus at the technical levels seems to be to unbundle it into separate generation, transmission and distribution companies (all still owned by ESCOM), and start privatization with the distribution company. This approach, however has not gotten political approval. Similarly, there have been difficulties and delays in implementing the automatic tariff formula approved in May 2000, leading to liquidity problems in ESCOM and debt service arrears to the Government.

38. **Reforming the Financial Sector** The two dominant commercial banks, the National Bank of Malawi (NBM) and the Commercial Bank of Malawi (CBM), which account for more than 90% of all banking sector assets, are controlled by Government, ADMARC, the MDC and the quasi-private Press Corporation. The level of efficiency of the financial sector is low, as indicated by large interest rate spreads, the limited range of financial instruments, and high profit margins. Accordingly the Bank urged and Government agreed in FRDP II to review **financial sector regulation** to identify reforms to strengthen and unify regulatory framework and to issue guidelines for the privatization of the two main commercial banks (conditions of release of the second tranche). Progress in revising the regulatory guidelines for the financial sector has been slow, owing to longer than expected delays in the production of the consultants' reports. The interim reports were prepared in November 1999 and the final reports were expected by January 31, 2000. In the meanwhile the Reserve Bank of Malawi has set up an internal working group to review all the recommendations and prepare detailed proposals for reform. These proposals are expected to be prepared by early 2001.

39. Progress has also been slow in reducing the public sector's stake in CBM and NBM. The Government has decided to privatize the CBM by the strategic

partner approach. The Privatization Commission has appointed advisers but no qualified buyer has expressed an interest. In the case of NBM, the Government has permitted Press Holdings to increase its 48% shareholding to 51% by purchasing part of ADMARC's shares. IDA has recommended additional safeguards, including strict ceilings on connected or related lending of commercial banks.

40. **Studies Financed under FRDP II Technical Assistance** The objective of the technical assistance provided under FRDP II was to provide technical support, training and equipment to implement policy reforms, evaluate their impact on Malawi's economy, and develop the agenda for the next round of macroeconomic and policy reforms. A separate privatization Technical Assistance Project (US$ 10 million) provided assistance to implement the privatization program.

41. A **Power Sector Policy** study financed under the project recommended focusing the initial stages of reform on the distribution sector and maximizing private sector involvement in new generation and distribution facilities. The study served as background for a stakeholder meeting for preparation the Power Sector Policy Statement issued in June 1999. The consultant-prepared **Financial Sector Regulatory Review** of August 1999 provided an overview of the sector, outlined the key issues and recommended a package of macroeconomic, microeconomic, regulatory and institutional measures, including recommendations for restructuring and privatization of financial institutions. A study by consultants facilitated revision of **Temporary Employment Permit** Policy. It helped dispel the widespread perception that a large number of foreigners work on TEPs displacing Malawians. It also provided recommendations for streamlining the procedures for obtaining permits and for clarifying TEP status. It suggested making permits for key posts transferable and determined by nature of industry, and responding to all applications within45 days. A consultant study dated October 1999 reviewed supply and demand side constraints for **Access to Industrial Land/Infrastructure** based of a questionnaire survey and structured interviews and focusing on land, services and factory space. The survey found that the problem was not a shortage of space but shortage of government subsidized space. It found that prospective investors in light manufacturing were unwilling to build their own factory shells because of the combination of high cost, risk and lack of well-defined property rights. In addition, because of overlapping departmental responsibilities and cumbersome procedures made obtaining industrial sites was cumbersome and time consuming. It called for a comprehensive review of land legislation and regulations with the aim of reforming the legal and regulatory framework and increasing the supply of privately owned land.

42. **A study of the manufacturing sector** was included in the TA component of the operation to review sector response to adjustment programs and trade liberalization. The issues to be addressed include (i) whether there has been de-industrialization, (ii) has there been switching from competitive to noncompetitive

sectors, (iii) which sectors have contracted and which expanded (iv) what can be done to improve performance, (e) whether the country has benefited from trade agreements. The main issues defined above were addressed in a study carried out by the Bank as a part of its non-lending services and additional work is being carried out under the ongoing Privatization and Utility reform Project. Consequently this study was dropped and the resources reallocated to other aspects of the TA program. In addition, consultancy services assisted the contracting out process and provided software and training to support the MTEF. Finally, US$ 500,000 was allocated for training

43. **Key Lessons Learned**

i. The project demonstrates once again the synergy between macroeconomic stabilization and structural reforms that was apparent in FRDP I. Reaping the full benefits of structural reform depends heavily on fiscal discipline avoidance of inflationary pressures.

ii. Careful and extensive preparation, including a strong background of economic and sector work, extensive collaboration with government, consultation with stakeholders and coordination with other suppliers of external assistance and is a necessary but not sufficient condition for execution of complex adjustment

iii. Fiscal restructuring and civil service reform should begin with a fundamental reconsideration of the role of government undertaken at the political level. Restructuring of the government, the civil service and the budget must have political leadership and be based on decisions about the future role of the public sector.

iv. Protecting pro-poor fiscal outlays may prevent further deterioration of services but it cannot address deep-seated problems of equity, efficiency and quality of public health and education. This is probably best done in sector specific operations, not in omnibus operations such as FRDP.

v. It is easy to overestimate government ownership of programs when their conditions involve processes. Issuance of policy statements, appointments of commissions or commissioning studies is not proxies for "ownership," especially when they precede stakeholder consultation or parliamentary consideration. Governments may begin to think carefully about their commitment only when definitive, irrevocable actions are imminent.

vi. The willingness of private domestic or foreign enterprises to invest in privatized state enterprises or functions in a small, poor country without an established record of good management, cannot be

taken for granted, even with improvements in the legal and institutional framework.

Future Operation

44. Malawi will require rapidly disbursing external assistance for some time to come, and there is still a substantial agenda of policy reforms to be undertaken. The issue is how to package policy conditions with amounts of assistance to maximize the degree and pace of implementation. In other words, whether to continue along the lines of FRDP I and II, tranched, multi-sector, multi condition (omnibus) operations attached to US$ 100 million (or more) multi-tranched IDA credits, or to switch to smaller, more focused operations with all conditions fulfilled before loan approval. The former approach has the advantage of economizing on Bank staff and not requiring much analysis of the appropriateness of the package of conditions. However, large amounts of money riding on a single operation make it more difficult to withhold either board approval or tranche release. It also adds to the temptation to load the project with process conditions to make it look more rigorous. The latter approach requires more detailed consideration of the sequencing of reform and the conditionality should be attached to each operation. It may require a broader spectrum of staff participation in preparation and supervision, especially if individual operations have sectoral focus.

Telegrams: FINANCE, Lilongwe
Telephone: Lilongwe 789 355
Telex: 44407
FAX: 789 173
E-mail: finance@finance.malawi.net

MINISTRY OF FINANCE
P.O. BOX 30049
LILONGWE 3
MALAWI

Ref No: 32/1/6

18th December, 2000

The Executive Director
African Department
World Bank
Washington D.C. 20431
United States of America

Dear Sir

COMPLETION REPORT: MALAWI FISCAL RESTRUCTURING AND DEREGULATION PROGRAMME (FRDP)

I wish to acknowledge receipt of the Fiscal Restructuring and Deregulation Programme (FRDP) completion report submitted for our comments. At the time we received the report, Government was also in the process of evaluating the impact of the two FRDP credits on the Malawi economy. The completion report did, therefore, contribute to the evaluation of the credits. We, however, had some comments on the completion report itself.

The implementation performance of both FRDP I and FRDP II credits was generally satisfactory. As indicated in the report, except for activities relating to civil service reform, commercialisation and privatisation of ADMARC, telecommunications privatisation, and the separation of the Finance and Audit Act into two separate Acts on Finance and on Audit, all activities supported by the credits were finalised in good time.

The good performance of the economy during the period 1995-1998 was a result of the reforms supported by the two credits. Of course, certain other factors could also have contributed to this performance. In particular, the Civil Service Reform helped to detect overlaps between ministries, which prompted a reduction in the number of ministries from 27 to 19. However, streamlining of the service has yet to take place and consultancy work on the rationalisation of the Civil Service is expected to be completed by April 2001.

In the agricultural sector, reforms have necessitated tremendous change in the characteristics of production systems as well as in input and output markets. Competition now flourishes more than was previously the case when markets were of a monopolistic and monopsonostic nature. There also has been an increase in total agricultural output of both food and cash crops. On the other hand, however, reforms in the agricultural sector have meant an increase in the cost of production and thereby negatively affecting the smallholder farmer. Also, lack of proper training for smallholder farmers in tobacco production has compromised qualify leading to lower prices of the crop.

Privatisation has led to increased Malawian participation in all sectors and ownership de-concentration in listed companies. Further, it has promoted Malawian participation in rare sectors like formal manufacturing sector and promoted partnerships and share-ownership.

The most far-reaching innovation in the tax system was the introduction of the Malawi Revenue Authority, which among other things, was to strengthen tax administration, expand the tax base and allow Government to increase revenue. In expenditures, the Medium Term Expenditure Framework (MTFF) was introduced to improve allocations to higher priority programs.

Reforms in the financial sector resulted, among other things, on the size of the Treasury bill stock growing from less than 0.1 percent of gross domestic product (GDP) to 9 percent of GDP by 1998. The liberalisation of the financial sector has resulted in increased number of banks and hence competition within the financial sector. However, the improvement of regulatory and promotional services by the Reserve Bank of Malawi is necessary, as identified by the Bank funded consultancy on the Regulatory Framework for the Financial Sector.

The introduction of free primary education in 1994 has led to enrolment increases by nearly a million. Community-driven projects have helped organise and enhance community– demanded projects in school-building, water supply, health clinics, roads and irrigation. The Poverty Monitoring System (PMS) has helped to measure changes in the welfare of the people through regular household surveys. Inflation has, however, eroded the gains in the poverty reduction area while macroeconomic

stability has remained elusive. On the other hand, the HIV/AIDS pandemic continues to take away Malawi's productive labour force and to raise the number of orphans in the country.

In addition to implementation problems highlighted in the completion report, lessons from the FRDP II have also shown the need for simpler design of programmes and less cross conditionalities if the objectives of the programmes are to be attained. The timing of targets should be reviewed with a view to limiting benchmarks to those within the control of the authorities and not the legislature. The short and long-term benchmarks should also be clearly designated and a balance needs to be achieved in accessing the importance of attaining each one of them.

Procurement delays also contributed extensively to the slippage of programmes under FRDP II. For instance, the process to appoint a consultant took nine months. This was a result of the requirement for a "no objection" to come from Washington despite the presence of a procurement expert within the Malawi World Bank Field Office. It also took some time for the Malawi Government and the World Bank to agree on key issues in the programmes. This took up time originally budgeted for such consultations.

In most cases of non-compliance, the problem has been largely in the design of the programmes, with ownership lying in the bureaucrats and not the people to benefit from the reforms. The paper exercises have therefore suffered from lack of consultation and participation by the wider community in Malawi. For the successor credits to be successful, Government will need to increase its consultations with key stakeholders including the members of the civil society.

Despite a series of earlier adjustment operations, there remains a backlog of policy constraints which the Government is committed to removing rapidly. To this end, the Government will continue with the pursuit of prudent financial policies and additional efforts to deepen structural reforms geared at creating an environment conductive to private sector development, promotion of domestic savings and investment, acceleration of production and export diversification, further development of human resources, and improvement in physical

infrastructure. The Government will, therefore, continue with measures to further liberalise agricultural production and marketing arrangements; restructure Government establishments and the civil service to improve efficiency and effectiveness in providing public goods and services, improve public expenditure management, continue with the privatisation programme, and implement further tax and tariff reforms, among other measures.

We trust that you will find our comments useful. But should you need further clarifications, please do not hesitate to contact us.

Finally, we wish to thank the Bank for the continued support it gives to the Malawi Government.

Yours sincerely

R.P. Dzanjalimodzi
SECRETARY TO THE TREASURY

Cc: Mr David G. Greene
Consultant World Bank
Washington D.C.

Table 1: Summary of Assessments

A	Achievement of Objectives	Substantial	Partial	Negligible	Not Applicable
	Macroeconomics policies		✓		
	Sector Policies		✓		
	Sector Policies				✓
	Financial Objectives		✓		
	Institutional Development				✓
	Physical Objectives				✓
	Poverty Reduction		✓		
	Gender Issues				✓
	Other Social Objectives				✓
	Environmental Objectives				✓
	Public Sector Management		✓		
	Private Sector Development		✓		
	Other				✓
B	Project Sustainability	Likely ✓	Unlikely	Uncertain	
C	Bank Performance	Highly Satisfactory	Satisfactory	Deficient	
	Identification		✓		
	Preparation Assistance		✓		
	Appraisal		✓		
	Supervision		✓		
D	Borrower Performance				
	Preparation		✓		
	Implementation		✓		
	Covenant Compliance		✓		
	Operation		✓		
E	Assessment of Outcome	Highly Satisfactory	Satisfactory ✓	Unsatisfactory	Highly unsatisfactory

Table 2: Related Bank Credits

Loan/credit title	Purpose	Year of approval	Status
Preceding operations			
1. Fiscal Restructuring and Deregulation Program (FRDP)	Structural adjustment, macroeconomic stabilization, Medium Term Expenditure Framework, agricultural marketing liberalization, comprehensive civil service reform	1996	Fully disbursed, except for technical assistance component
Following operations			
1. Third Fiscal Restructuring and Deregulation Program (FRDP III)	Structural adjustment, auditing and procurement reform, Telecoms privatization, banking and agricultural marketing privatization	Expected for 2000	Not yet appraised
2. Privatization and Utility Reform Project.	Assistance for the privatization elements of the FRDP II, particularly Telecoms, the airline	June 2000	Effective

Table 3: Project Timetable

Steps in Project Cycle	Date Planned	Date Actual/Latest Estimate
Identification (Executive Project Summary)	Oct. 4, 1997	Oct. 4, 1997
Preparation	June 28, 1998	June 28, 1998
Appraisal	March 1998	March 1998
Negotiations	Oct. 13, 1998	Oct. 13, 1998
Letter of Development/Sector Policy (if applicable)	N/A	Sept. 24, 1998
Board Presentation	Dec. 3, 1998	Dec. 3, 1998
Signing	Dec. 4, 1998	Dec. 4, 1998
Effectiveness	Dec. 7, 1998	Dec. 7, 1998
First Tranche Release (if applicable)	Dec. 23, 1998	Dec. 23, 1998
Midterm review (if applicable)	N/A	N/A
Second (and Third) Tranche Release (if applicable)	Dec. 28, 1999	Dec. 28, 1999
Project Completion	June 30, 2000	June 30, 2001
Loan Closing	June 30, 2000	June 30, 2001

Table 4: Credit Disbursements: Cumulative Estimated and Actual (*US$ thousands*)

	FY99	FY00
Appraisal estimate	60,000	30,000
Actual	61,678	30,136
Actual as % of estimate	103%	100%
Date of final disbursement		Jan. 5, 2000

Table 5: Key Indicators for Implementation

	Area	Progress on Indicators For the First Tranche	Progress on Indicators for the Second Tranche
A.	**Fiscal management**		
1	Fiscal	Fiscal situation improved in 1998/99, primary deficit brought down to .3% of GDP.	Primary deficit was maintained at low level in 1999/2000
2	Expenditure rationalization	MTEF used to prioritize expenditures in 1998/99. The share of expenditures on goods and services was increased.	Expenditure prioritization continued in 1999/2000. The Government also maintained the share of expenditures on critical items such as teaching and learning materials, pharmaceutical services, road maintenance and water development, pharmaceutical services, road maintenance and water development. The Government strengthened expenditure control in the year 2000 by introducing the commitment control system.
3	Tariffs	Tariffs were reduced from 19% in 1996 to 14% in 1998/99	Tariff reform continued with further rationalization of Tariffs.
4	Rationalization of Government Functions	Completed functional reviews of eight Ministries.	30 agencies and functions were to be privatized. Only 18 achieved. Partial waiver was granted.
B	**Structural Reforms**		
1	ADMARC		Prepared a privatization and commercialization plan for ADMARC
2	Privatization	Identified a number of public enterprises as candidates for privatization along a divestiture Sequence Plan(DSP)	Of the 24 firms identified in the DSP, 18 have been brought to the point of sale involving 8969 employees.
3	Communication		Enacted a liberal communications legislation. Appointed advisors to advise on privatization of MTL, and licensed two cellular operators.
4	Electricity	Amended the Electricity Act and enacted legislation to implement the electricity bill. Established the Electricity Council to regulate the sector.	Clarified the licensing and tariff adjustment procedures. In the year 2000, however tariff adjustments have lagged behind and ESCOM has financial difficulties.
5	Financial Sector	Carried out a review of the financial sector Issued guidelines for the privatization of two Banks.	An information memorandum to obtain the strategic partner in CBM was published. The sale not concluded due to lack of investor interest. Government also sold a portion of its ADMARC holdings in the NBM. Sufficient progress was, however, not made on issuing extend RBM supervision to both banking and non banking institutions. ***Partial waiver was obtained.***

Table 6: Malawi - Key Macroeconomic Indicators

	Actual 1996	1997	1998	1999	Est. 2000
GDP growth (constant, percent)	7.3	3.8	2.0	4.0	3.2
CPI (end-of-period, %)	6.7	15.2	53.1	28.2	23.5
Treasury bill rate	30.8	18.3	33.0	42.9	
Exchange rate (MK/$, End of period)	15.3	21.2	43.9	46.4	64.1
Money and quasi money growth (%)	38.8	2.2	55.7	33.6	30.0
Percent of GDP					
Gross domestic investment	11.6	12.2	13.3	14.8	15.9
Gross domestic savings	3.0	0.9	6.0	3.1	3.1
Gross national savings	0.4	-1.5	1.9	1.4	3.8
Current account balance (% of GDP)					
Excluding grants	-11.2	-12.5	-16.8	-17.0	-15.5
Including grants	-7.2	-9.2	-7.8	-8.3	-7.9
Gross International reserves (months of imports)	3.0	2.6	4.0	4.1	3.5
Fiscal balance (percent of GDP)					
Excluding grants	-13.6	-13.3	-10.7	-11.1	-9.9
Including grants	-8.8	-9.5	-2.3	-4.0	-2.8
Primary balance	0.8	-2.3	-0.8	-0.5	0.0
Debt/GDP ratio	95	101.3	132	143	145
Debt service / Exports	16.9	14.7	19.3	19.7	20.7

Table 7: Studies Included in Project

Study	Purpose as defined at appraisal/redefined	Status	Impact of study
Power Sector Policy	Background for preparation of Power Sector Policy and stakeholder meeting on power policy	Being implemented. Consultative meeting held in June 1999.	Recommendation that initial stages of reform focus on distribution sector and maximizing private investment in new generation and distribution
Financial Sector Regulatory Review	Background for revision of financial sector regulatory framework	Issues Paper submitted	Provided overview of sector, outlined key issues and recommendations for restructuring and privatizing financial institutions
Government of Malawi Consultancy on Contracting Out	Update progress of contracting out program	Progress report – November 1999	Reviews status of program and suggests draft agreement format for contracts and local purchase orders
Government of Malawi Consultancy on Contracting Out Continuation	Same as above	Being implemented	
Budgeting Program for Activity Costing and Prioritization (1999/00 Budget)	Assistance including software and training for activity costing related to MTEF	Proposal submitted April 1999	
Employment Permit Policy	Review recent revisions in TEP policies and recommends improvements	Draft submitted –July 1999	Recommends improvements and clarification of "key posts" and simplification of approval processes
Manufacturing Sector Study	Review response of manufacturing sector to liberalization program, including extent of de-industrialization shifts of more competitive activities, including exports, impact of trade agreements and cross border initiatives	Proposal submitted July 1998	
Access to Industrial Land/Infrastructure	Survey end users to identify demand and supply side constraints on land, services and factory shells.	Completed October 1999	Should lead to reconsideration of policy of subsidized government provision of factory shells as the major source of industrial buildings.

Table 8A: Project Costs

Item	Appraisal estimate (US$ million)			Actual/latest estimates (US$ million)		
	Local costs	Foreign costs	Total	Local costs	Foreign costs	Total
1. Staff Costs including travel	-	0.5	0.5	-	0.5	0.5
Total	-	0.5	0.5	-	0.5	0.5

Table 8B: Project Financing[1]

Item	Appraisal estimate (US$ million)			Actual/latest estimates (US$ million)		
	Local costs	Foreign costs	Total	Local costs	Foreign costs	Total
IBRD/IDA	-	-	90	-	-	91.8
Co financing Institutions	-	-	0	-	-	0
Other External Sources	-	-	0	-	-	0
Domestic Contributions	-	-	0	-	-	0
Total			90			91.8

[1] Note that this excludes the FRDP II TA project.

Table 9: Economic Costs and Benefits

Benefits

The large development agenda facing Malawi needs many years of economic reform effort. FRDP II reinvigorated the government's stabilization and adjustment program and laid the basis for an acceleration in growth and poverty reduction. The program supported by the credit assisted in (i) improving fiscal performance and reforming the structure of indirect taxes, further strengthening tax administration and improving expenditure prioritization, management and control and restructuring government functions and the civil service and (ii) encouraging growth of the private sector by further deregulation of agricultural markets and development of markets for land and labor, strengthening the financial market, accelerating privatization of government enterprises and functions and encouraging private sector participation in the development and improvement of infrastructure.

The financing provided by the credit of SDR 65.7 million (US$ 90 million equivalent) was a crucial element of the overall financing requirements in support of the balance of payments and the budget. The parallel TA credit of SDR 1.3 million (US$ 2 million equivalent) was also crucial in carrying out the studies which laid the basis for new legislation in electricity, financial sector, civil service reform and privatization of government functions.

Costs

The adverse impact of the tariff adjustments in the FRDP II on the manufacturing sector was not as serious as anticipated at the time of appraisal. A study of the manufacturing sector done in 1999 by the bank indicated that the number of small and medium firms had increased during the course of the FRDP II period. Similarly the impact of privatizing selected Government functions on employment was also not as serious as anticipated at appraisal. Most of the workers who were laid affected were able to find jobs in the privatized service or other employment. FRDP II also did not have any adverse impact on the poor. Although some of the tariff adjustments in the electricity sector may have hurt the poor the expenditure shifts in the budget towards health and education more than compensated for this. In addition a successful implementation of the parallel Malawi Social action fund operation helped by creating employment amongst the very poor.

Table 10 -- Status of Legal Covenants

Agreement	Section	Covenant Type	Description of covenant	Comments
C3147	III.3.01	5	Carrying out Project in accordance with the implementation of the Program.	In compliance
C3147	III.3.02	3	Procurement of goods and consultants in line with Bank guidelines	In compliance
C3147	III.3.03	9	Reporting to the Association not later than 6 months after the Closing Date a plan for the sustainability of Program activities.	In compliance

Covenants types:
1. Accounts/audits
2. Financial performance/revenue generation from Beneficiaries
3...Flow and utilization of project funds
4. Counterpart funding
5. Management aspects of the project or executing policy/regulatory/institutional agency
6. Environmental covenants
7. Involuntary resettlement
8. Indigenous people
9. Monitoring, review, and reporting
10. Project implementation not covered by categories 1-9
11. Sectoral or cross-sectoral budgetary or other resource allocation
12. Sectoral or cross-sectoral action
13. Other

8. Present Status

C covenant complied with
CD complied with after delay
CP complied with partially
NC not complied with

A Satisfactory Compliance
B Procurement followed Bank procedures and guidelines

Table 11: Compliance with Operational Manual Statements

Statement number and title	Describe and comment on lack of compliance
1. (none)	(none)

Table 12: Bank Resources: Staff Inputs

Stage of project cycle	Planned		Revised		Actual	
	Weeks	US$	Weeks	US$	Weeks	US$
Preparation to Appraisal	N/A	N/A	N/A	N/A	80.8	440.3
Appraisal	N/A	N/A	N/A	N/A	48.6	149.3
Negotiations through Board approval	N/A	N/A	N/A	N/A	20.1	37.2
Supervision	N/A	N/A	N/A	N/A	24.8	81.3
Completion	N/A	N/A	N/A	N/A	8	25.0
Total	N/A	N/A	N/A	N/A	182.3	732.8

Table 13: Bank Resources: Missions

Stage of project cycle	Month/ Year	No. of Persons	Days in Field	Specialization[1]	Performance Rating[2]		Types of Problems[3]
					Implem. Status	Developm. objectives	
Through Appraisal	Oct. '97	4	18		-	-	-
	Nov. '97	4	19				
Appraisal through Board approval	Feb. '98	5	20				
	June '98		17				
Supervision	March '99	6	18				
Completion		1	18				
Total							

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

MAP SECTION

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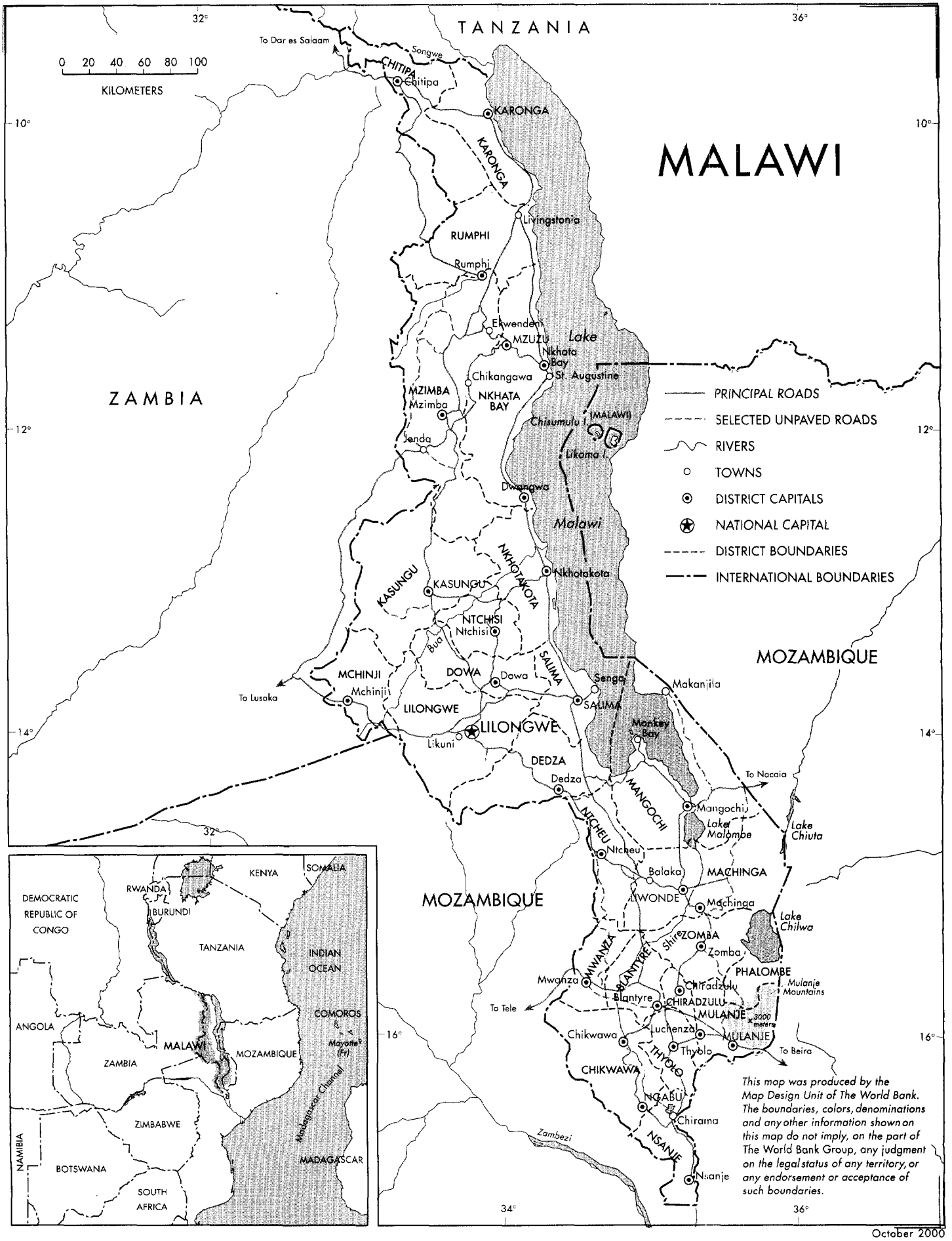

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