

# **DFID Malawi 2009/10 Poverty Reduction Budget Support: Options Appraisal Report**

**Final Version**

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\* Disclaimer: The views presented in this paper are those of the authors and do not necessarily represent the views of the UK Department for International Development

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## List of Acronyms

AfDB	African Development Bank
CABS	Common Approach to Budget Support
DAC	Development Assistance Committee
DAD	Debt and Aid Division
DFID	Department for International Development
EC	European Commission
ESF	Exogenous Shocks Facility
GDP	Gross Domestic Product
GoM	Government of Malawi
H&A	Harmonisation and Alignment
IDA	International Development Association
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
MCC	Millennium Challenge Corporation
MGDS	Malawi Growth and Development Strategy
MoF	Ministry of Finance
MoJ	Ministry of Justice
MoU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework
MPRS	Malawi Poverty Reduction Strategy
NAO	National Audit Office
NK	Norwegian Kroner
NWDP	National Water Development Plan
OECD	Organisation for Economic Co-operation and Development
PAF	Performance Assessment Framework
PEFA	Public Expenditure and Financial Accountability
PETS	Public Expenditure Tracking Survey
PFM	Public Financial Management
PFEM	Public Finance and Economic Management
PRBS	Poverty Reduction Budget Support
PRGF	Poverty Reduction Growth Facility
PRSC-2	Poverty Reduction Support Credit 2
SBS	Sector Budget Support
SPA	Strategic Partnership with Africa
SSA	sub-Saharan Africa
SWAp	Sector Wide Approach
TA	Technical Assistance
UA	Units of Account
USD	United States Dollars
p.a.	Per annum

## Executive summary

For DFID and several other donor agencies, General Budget Support (GBS) is a key modality for supporting Malawi's Growth and Development Strategy (MGDS). The Government-donor relationship built up around GBS has passed through several distinct phases. The original focus of attention was macroeconomic stabilisation. Attention subsequently shifted towards poverty reduction, public financial management and donor harmonisation and alignment, underpinned by a Common Approach to Budget Support (CABS) established in 2000/1. The programme suffered a major interruption in 2003/4 due to a breakdown in fiscal management, but has since become strongly embedded and systematically monitored through a rolling Performance Assessment Framework (PAF). The CABS programme now contributes approximately \$70m p.a. to the budget equivalent to 2.5% of Malawi's GDP (SPA, 2009). DFID is the largest single contributor and has been providing a predictable flow of resources through a succession of annual financing agreements.

This appraisal focuses on a decision by DFID to continue providing GBS in 2009/10, or to withdraw from the CABS programme and switch to alternative aid modalities, described in further detail in this report. The appraisal responds to new corporate guidance on economic appraisals which requires more quantification and analysis of alternative options for delivering aid. It is based on a review of relevant literature on GBS and Sector Budget Support (SBS), and consultations with DFID Malawi, CABS donors, GoM officials and the IMF held during 7 to 12 September 2009.

The decision to continue with GBS is complex for several reasons. GBS offers significant advantages over alternative modalities since it provides flexible resources and a strong platform for dialogue on budgetary and macroeconomic management issues. It offers potential for strengthening ownership of the reform programme, including the Public Finance and Expenditure Management (PFEM) Action Plan for which complementary technical assistance is being provided by CABS donors.

There are also risks. The budget process in Malawi suffers several weaknesses, diagnosed in successive Public Expenditure and Financial Accountability (PEFA) assessments, in particular a basic lack of credibility. Leakages in the general budget are a major concern, though there is a lack of reliable information to enable the extent of the problem to be gauged. CABS donors have on occasion been able to influence GoM spending decisions in line with the PAF, but attribution to the collective effort – and to DFID in particular - is inherently problematic. At the same time, well established sector based programmes and projects are in place that are well aligned with MGDS, able to absorb additional funds and therefore offer credible alternatives to GBS.

This report develops a pragmatic approach which focuses on the net costs and benefits of quitting GBS in favour of a set of defined alternatives, quantified in terms of expected impact on spending in priority areas of the MGDS – a proxy for 'pro poor spending'. For practical and methodological reasons it stops short of attempts to quantify effects on service delivery and economic growth or on institutional and political issues. In view of lack of key data the approach allows a range of plausible assumptions to be tested and accommodates alternative decision criteria. It highlights the key assumptions in the decision to use or not use budget support and reveals striking differences in the relative importance of different variables. The analysis also points to areas where more research and analysis would be useful to address the limited data base of information on Malawi's public expenditure and its

outcomes, and provides a framework for structuring more robust appraisals for a country such as Malawi.

The approach rests on five analytical elements as follows:

- Analysis of the GoM budget for 2009/10, distinguishing discretionary and non-discretionary expenditure in priority and non-priority areas of the MGDS.
- The influence which DFID might expect to exert, working with partners, on actual expenditure allocations in 2009/10, given past experience of significant departures from the budget and the ability of donors to exercise leverage.
- Potential influence on leakages in the GoM budget through progress under the PFM reform programme, as compared with leakages in donor managed programmes which provide additional oversight over narrower areas of expenditure.
- The effects of quitting GBS on GoM domestic borrowings and consequential knock-on effects on interest payments.
- Changes in transaction costs for donors and GoM if DFID were to switch to alternative modalities.

The results are gathered together in section 6 of the report. Continuing to provide GBS is found, on the basis of a conservative set of assumptions, to offer significant advantages compared with the alternatives. The expected result is higher overall spending on priority areas of the MGDS after taking account of leakages, transaction costs and interest payments on domestic borrowings. It should be noted that the underlying assumptions although considered plausible are not fully tested and would benefit from further validation. The finding rests critically on the degree of influence which DFID can expect to exert on the budget, evidence for which at present remains largely anecdotal.

In view of uncertainties inherent in the analysis we have explored the implications of applying an alternative decision making criterion: i.e. to select among alternative options on the basis of securing the least bad outcome ('mini-max'). Applying this approach supports the same conclusion. Continuing with GBS provides a more favourable balance of risks and benefits, in terms of spending on MGDS priorities, than the alternatives considered.

Finally, we identify potential advantages in redesigning the intervention as a multi-year programme of the type envisaged in the DAC joint evaluation framework, and built around a set of medium term strategic objectives. The impact of GBS would be enhanced significantly if CABS influence increased cumulatively over time. Beyond issues of public expenditure management, CABS might play a role in helping the government set a medium term macro economic framework that addresses Malawi's persistent foreign exchange shortages.

## 1. Introduction

1. This options appraisal for General Budget Support (GBS) in Malawi responds to DFID's new corporate guidance on economic appraisals, which requires greater quantification and analysis of alternative approaches to delivering aid. It is one part of a wider assessment that considers political, institutional, social, environmental and fiduciary questions. The options appraisal aims to strengthen the basis for decision-making about how DFID Malawi can maximise the effectiveness and impact of its development assistance.

2. The aim is to quantify, as far as possible, the costs and benefits of DFID continuing to provide GBS in Malawi compared with providing the same resources through other delivery channels. In view of significant data gaps, emphasis was given to consultation with Government and donor stakeholders in Malawi to estimate the scale of historical effects of GBS and to find evidence to inform a defensible analysis of the expected future net benefits from a continued GBS programme. In practice our analysis has had to rest heavily on a range of assumptions which, although plausible should ideally be researched more thoroughly than has been possible during the course of this brief review. The methodology is based on a review of relevant literature on GBS and consultations in Malawi between 7<sup>th</sup> and 12<sup>th</sup> September 2009.

3. The report is structured as follows. Section 2 provides brief contextual background for the appraisal. Section 3 describes the alternative options considered (i.e. the counterfactual positions). Section 4 discusses the appraisal methodology and the types of data and evidence used for the analysis. Section 5 sets out a 'base case' for comparison and describes the assumptions and judgements resulting from consultations with members of the Common Approach to Budget Support ('CABS') donor group. Section 6 reports the results of the options appraisal, provides sensitivity analysis and explores alternative decision criteria. Section 7 considers wider costs and benefits which are less amenable to quantification. Section 8 concludes with a discussion of lessons learnt and draws out recommendations for future work.



## 2. Context for the appraisal

4. The CABS donors have been providing GBS to Malawi through a harmonised programme since 1999. The group presently consists of DFID, the European Commission (EC), the Norwegian Embassy, the African Development Bank (AfDB) and the World Bank. The partnership with GoM is guided by a framework Memorandum of Understanding (MoU) agreed in September 2005 which sets out basic principles and commitments on each side. Key principles relate to alignment with Malawi's poverty reduction strategy, joint reviews and predictability of funding. Progress is assessed using a Performance Assessment Framework (PAF) comprising a jointly-agreed set of monitoring indicators. The main annual reviews fall in February-March prior to the budget, followed by a second review in August-September which focuses on the approved budget, public financial management (PFM) issues and preliminary assessments of performance during the previous year. Disbursements of GBS in 2008 amounted to \$72m, equivalent to over 2% of GDP and about 10% of GoM expenditure. Trends since 2004 are shown in Table 1.

**Table 1: Disbursements of GBS to Malawi**

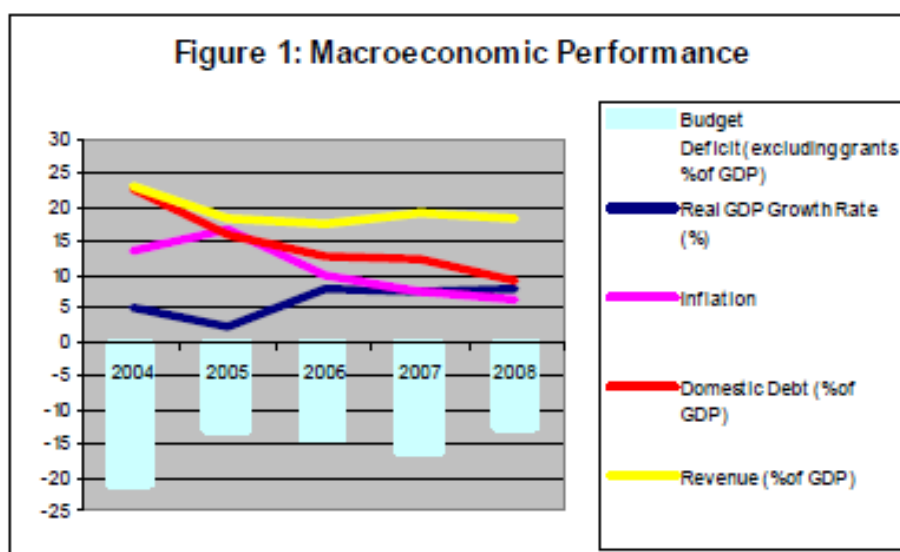
Survey year	2004	2005	2006	2007	2008
Disbursements of GBS – all donors (US\$ m)	67	93	110	58	72
of which DFID	17	19	36	36	40
CABS as % GDP	3.12	3.54	4.14	2.29	2.32
DFID as % of CABS	25	20	33	62	55

Source: SPA (2008)

### 2.1 Macroeconomic situation

5. Malawi is in the fourth year of implementing its second poverty reduction strategy, the MGDS, which covers the period from 2006 to 2011. Progress with implementation of the strategy is reviewed annually, most recently over August to October 2009. Assisted by relatively strong growth, poverty has declined to 40% in 2008 down from 52.4% in 2004/5<sup>1</sup>, against an MGDS target of 30-35% by 2011. Despite the global downturn the economy grew by 9.7 % in real terms in 2008, compared with 8.6 % in 2007 and 6.7% in 2006. The IMF estimates that growth will reach between 6 and 7% in 2009; slightly lower than projected by the authorities (7.9%) (IMF, 2009). Inflation and domestic debt have been on constant downward trends for the last 5 years, as shown in Figure 1; although domestic borrowing appears to have picked up during 2008/9.

<sup>1</sup> Government of Malawi National Statistics Office, Welfare Monitoring Survey 2008

**Figure 1: Macroeconomic Performance**

Source: AfDB (2009a)

6. So far Malawi has been relatively well insulated from the global financial crisis because of low integration with the world financial system and low levels of foreign investment. However falling prices for Malawi's main crops (tobacco, cotton, sugar and tea) are contributing to deterioration in Malawi's terms of trade and a shortage of foreign exchange. Malawi also receives around 4% of GDP in unrequited transfers from countries such as South Africa and could become more vulnerable to the downturn.<sup>2</sup> On the positive side substantial investment in uranium mining may begin to contribute increased exports this year.

## 2.2 Public Expenditure

7. The PEFA assessments for the period 2004/5 – 2006/7 show positive progress with PFM reforms but also point to major areas in need of attention. Linkages between the MGDS and the financial planning and budgeting systems have been weak, as has budget credibility. The 2008 PEFA assessment shows that funds are frequently reallocated between votes<sup>3</sup> within year, line ministries often fail to treat the budget as binding and significant unauthorised spending takes place. However, budget credibility at the aggregate level has improved recently, and the Government has implemented initiatives to strengthen the linkages between the MGDS and the budget (Tavakoli et al, 2009).

8. Weaknesses in payroll management have contributed to poor fiscal management. The payroll system suffers leakages connected with ghost workers, and unauthorized allowances, recruitments, promotions and wage increases. A personnel audit was carried out as a prior action for Poverty Reduction Support Credit 2 (PRSC-2) covering the whole public service. An underlying blockage is that the personnel and payroll systems lack transparency since they are not well integrated into the Integrated Financial Management Information System (IFMIS).

<sup>2</sup> IDA, April 24 2009, "Malawi: Second Poverty Reduction Support Credit"

<sup>3</sup> A vote is the administrative level at which Parliament appropriates the budget. For instance the Ministry of Finance is a vote in the government's budget.

9. There is a lack of meaningful parliamentary oversight and external accountability of the Executive. Very few ministries and departments are audited during the course of a year, largely due to limited human capacity. Reports submitted to Parliament suffer long delays, often of several years, and there is very limited follow up by the Auditor General and the Public Accounts Committee of Parliament.

10. A PFEM Action Plan is in place which aims to address many of these issues. The Action Plan is being supported by CABS donors, including the World Bank under the second PRSC, in collaboration with the IMF.

### 3. Specification of alternatives

11. Based on discussions with DFID Malawi, three independent and mutually exclusive options are considered for the allocation of £25m of DFID assistance in 2009/10 as follows:

**Option 1** (Continuation of current rolling annual multi-donor GBS arrangement)

12. We take the base case ('Option 1') to be a one-year GBS operation, provided as part of the existing multi-donor arrangement in Malawi. We have also considered, as a variant on Option 1, a multiyear (i.e. three year) programme. An explicit medium term commitment could offer greater predictability, the opportunity to build a more harmonised approach to the PFEM Action Plan and potentially help address persistent difficulties with Malawi's macroeconomic framework as discussed further in Section 7.

**Option 2** (Switch to counterfactual scenario of additional support to the multi-donor health Sector Wide Approach (SWAp))

13. Option 2 is to provide equivalent resources via the Malawi health SWAp on the basis that the health sector can readily absorb additional funds. An attraction is that DFID funds could be less 'at risk' due to additional procurement oversight in the health programme. No significant gains in health policy are expected given that DFID is already an active partner.

**Option 3** (Switch to counterfactual scenario of continued DFID support for water and irrigation from Malawi country programme funds)

14. Option 3 is to provide additional resources for Malawi's National Water Development Plan (NWDP) via a Trust Fund arrangement with the World Bank. The Africa Catalytic Fund has already successfully channelled \$25m of DFID central funds, adding to resources provided by the World Bank and AfDB. This arrangement ends in December 2009. Under Option 3 DFID support would be maintained from DFID Malawi country programme funds.

15. Other options considered by the team but not selected for the full options appraisal are:

- Not providing the aid to Malawi. This would be equivalent to downsizing the DFID country programme in favour of reallocations to other countries. This was not considered to be a realistic prospect at the time of the study, given that a stable political and domestic policy environment is being maintained.
- Providing additional resources for the EC-led roads programme. Given the importance attached to the roads network in supporting growth, emphasis given by the EC to close results monitoring and the possibilities for delegated co-operation (potentially reducing transaction costs), this option offers some attraction for DFID but is considered less able to absorb further funding in the short run.
- To fund new (or extended) education projects. Common arrangements and SBS funding mechanisms are still being worked out, and there are limited immediate opportunities for disbursing funds on a significant scale.
- To provide additional resources to the energy sector, complementing resources available from the Millennium Challenge Corporation (MCC) and AfDB. There are however major unresolved questions concerning leadership in the sector and whether new coordination arrangements may need to be developed, which means this is a less viable option in the short run.

## 4. Methodology

16. The approach developed for the options appraisal draws principally upon three sets of analytical work: (i) the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC), EC frameworks for evaluating GBS and subsequent applications of the DAC Evaluation Framework;<sup>4</sup> (ii) DFID guidance on appraising budget support and a pilot options appraisal for GBS carried out by DFID Rwanda;<sup>5</sup> and (iii) recent evaluative reviews of SBS practices in sub-Saharan African.<sup>6</sup>

17. These analyses take different, though not incompatible, approaches to assessing channels of influence and setting counterfactuals for GBS (and SBS). The scope of the Rwanda options appraisal differs from the GBS evaluations and SBS review in that these latter studies are retrospective and do not attempt to quantify costs and benefits. The Rwanda appraisal is a forward looking analysis which attempts to compare estimated net benefits of GBS against an undefined 'proxy' alternative, based on various assumptions concerning channels of influence and valuation of costs and benefits. More detailed discussion of the 'standard' evaluation frameworks for GBS is included in Annex 1 and a critical review of the DFID Rwanda pilot appraisal is included in Annex 2.

18. The studies raise several issues and pointers for the present exercise in Malawi, as follows.

### 4.1 Lessons from previous studies

#### ***Coordinated donor decision-making and treatment of complementary capacity building***

19. The DAC GBS evaluation framework and Overseas Development Institute (ODI) SBS review, both treat budget support as a package of inputs consisting of: funds provided; technical assistance for capacity building linked to GBS/SBS; policy dialogue and related conditionality; and efforts by donors to improve harmonisation and alignment with recipient country systems and policies.

20. The approach followed in the Rwanda options appraisal is to 'factor out' PFM related capacity building elements of GBS on the basis that these would continue, and be equally effective, in the counterfactual situation. The Rwanda appraisal identifies, nevertheless, a set of critical spending decisions judged amenable to leverage by DFID and other donors through conditionality. The assumption is that influence would be lost if alternative aid modalities are chosen<sup>7</sup>. This assumption emerges as critical in determining the overall result of the options appraisal, with the largest benefit stream arising from the influence of donors on government spending allocations. A further important assumption is that DFID and other bilateral donors (though not multilaterals) are expected to act jointly in their decisions to continue or to quit GBS.

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<sup>4</sup> See Lawson and Booth (2004), IDD and Associates (2006), Lawson et al (2007), Caputo et al (2008).

<sup>5</sup> See DFID Rwanda (2009) prepared by D. Overfield, C. Selvetti and C. Collinson; DFID (2008); DFID (2009).

<sup>6</sup> See Williamson and Dom (2009), Ecorys (2008).

<sup>7</sup> For the Rwanda options appraisal SBS by all donors is assumed to be unaffected by the withdrawal from GBS. However, the expected influence of SBS on the Government of Rwanda's spending decisions is covered by the analysis.

21. In Malawi's case, a key issue is DFID's leadership role in the CABS group of donors, and the extent to which CABS is effective in encouraging progress against the PFEM Action Plan. Key issues relate to the budget process and macroeconomic framework as distinct from concerns over specific off-budget spending proposals as in Rwanda's case. In keeping with the DAC evaluation framework, and for pragmatic reasons, we have looked upon CABS influence as a synergistic combination of policy dialogue, other forms of encouragement and capacity building.

### ***Assessing medium and long-term institutional gains***

22. In keeping with the experience of the Rwanda appraisal we have not found it possible to quantify institutional changes in a meaningful way. In consequence the presumed channels of influence set out in the DAC GBS evaluation framework and in the SBS study framework are not fully captured. These comprise a 'flow of funds' effect and a series of institutional changes which produce (potentially) sustainable improvements in public expenditure policy, public finance management, domestic accountability, and service delivery systems (for SBS). The GBS framework in particular is designed to explore 'positive changes in the financing and institutional framework for public spending and the national budget/policy processes'. The factors are captured indirectly through a set of credible assumptions concerning CABS influence.

## **4.2 Analytical Framework**

23. The table below sets out the causal flow from inputs to impacts, for GBS and the two alternative options described, rooted in the cause-and-effect evaluation frameworks for GBS/SBS. We have developed an approach which addresses the overarching question 'does general budget support offer net benefits above and beyond alternative aid instruments?' in a simplified and transparent way. The focus is on the costs and benefits of switching modalities, as opposed to the absolute costs or benefits of providing GBS compared with not providing aid, at Level 3 of the framework. Casual tracks illustrating the channels of influence are shown in Annexes 8 to 10.

**Table 2: Levels of cause and effect**

<b>GBS</b>	<b>Health Sector Support</b>	<b>Water and Irrigation Programme</b>
<b><u>Level: 1 Inputs</u></b> -GBS funds -Conditionality -Policy dialogue -Technical Assistance (TA)/capacity building -Harmonisation and Alignment (H&A)	-SBS funds -Conditionality -Policy dialogue -TA/capacity building -H&A	-Programme funds -Conditionality -Policy dialogue -TA/capacity building -H&A
<b><u>Level 2: Consequences</u></b> -Programmable funds available to GoM -Policy dialogue on strategic issues -Focussed TA/capacity building - GBS related transaction costs	-Additional funding for health priorities -Dialogue on health policy -Focussed TA/capacity building -SBS related transaction costs	-Additional funding for water sector priorities -Dialogue on sector policy -Focussed TA/capacity building -Project related transaction costs
<b><u>Level 3: Outputs</u></b> -Public expenditure in priority areas -Fiscal discipline	-Health expenditure aligned with policy priorities	- Expenditure aligned with national Water

<b>GBS</b>	<b>Health Sector Support</b>	<b>Water and Irrigation Programme</b>
-Macroeconomic stability -PFM strengthened -Pro-poor policies -Intra government capacity -Domestic accountability strengthened	-Procurement efficiencies -Planning, budgeting & reporting -Service delivery system -Health services accountable, incentives	Development Plan -Procurement efficiencies -Planning, budgeting & reporting
<b><u>Level 4: Outcomes</u></b> -More, better quality, responsive public services due to PFM outcomes -Sector policies address market failures -Environment for growth and private investment	-More, better quality & responsive health services due to health policy and health system outcomes -Health policy addresses market failures	-Sustainable access to water supply and irrigation -Enabling environment for private sector development
<b><u>Level 5: Impacts</u></b> -Income/non-income poverty - Empowerment & social inclusion	-Income/non-income poverty -Empowerment & social inclusion	-Income/non-income poverty

Note: (1) Source: Author's own analysis.

### 4.3 Quantification challenges

24. We have developed a model which focuses down on outputs that are more easily quantified, implying lower emphasis on governance issues such as accountability and responsiveness. This choice is made for pragmatic reasons at the cost of the inherent shortcoming that qualitative issues, which are important factors in the choice of aid instrument, are not fully represented in the analysis. The left-hand column in the table below extracts the net benefit streams against which costs are compared in the model.

**Table 3: Costs and benefits at 'level 3'**

<b>Causal track / net benefit stream (Level 3)</b>	<b>Exogenous factors / variables requiring quantification</b>	<b>Data or proxy data requirements</b>	<b>Information sources</b>
GBS increases GoM allocations to priority areas	- Priority areas of spending identified -DFID/CABS influence on GoM allocations	- Composition of overall GoM budget - Effectiveness of policy dialogue	CABS Ministry of Finance (MoF) Budget data
Switching to health SWAp increases priority health spending	- GoM financing	-GoM health allocations -SWAP conditions	Health SWAp Budget data
Switching to water & irrigation programme increases priority infrastructure spending	- GoM financing	- GoM allocations - Project conditions	DFID, World Bank
Macroeconomic benefits of reduced domestic debt/ increased reserves	- Use of funds for Treasury management - Interest on domestic debt -DFID/CABS influence	- Domestic debt & reserve scenarios	WB/IMF MoF/Debt and Aid Division (DAD) CABS
Leakages reduce	-DFID/CABS influence on	- Actual leakages in e.g.	Public

<b>Causal track / net benefit stream (Level 3)</b>	<b>Exogenous factors / variables requiring quantification</b>	<b>Data or proxy data requirements</b>	<b>Information sources</b>
resources for priority spending	leakages via PFM reform -Effectiveness of SWAp oversight	payroll, procurement system - Leakages in sector programmes	Expenditure Tracking Survey (PETS) PEFA Audit reports National Audit Office (NAO) Health SWAp
Transaction costs	-Use of DFID resources	- Consultancy expenditures	DFID

Note: (1) Source: Author's own analysis.

25. The areas of quantification relate to:

- Implications of quitting GBS for domestic borrowings and consequential burden of higher interest costs on the budget.
- The proportion of GoM expenditure allocated to priority areas as reflected in the MGDS. We have analysed the budget in terms of the proportion over which GoM has immediate discretion, and explored the implications of alternative expenditure weightings within priority areas to enable DFID priorities to be reflected in the analysis.
- Expenditure 'leakages' in the overall budget (e.g. in the salary and procurement system) as compared with leakages in donor managed programmes.
- Transaction costs on donors and government in terms of staff time and resources.

26. In addition, we have drawn a distinction between causal tracks for which there is a reasonable evidence base (termed "Category A") from those where a higher degree of judgement has been necessary ("Category B").

#### **4.4 Service delivery and growth**

27. We have not quantified improved services or knock-on effects on economic growth. Simplifying assumptions are, firstly, that sector policies and institutions are unaffected by DFID switching resources from GBS into alternative programmes. Secondly, allocations within priority areas (e.g. health, education and infrastructure) have similar ultimate effects on economic growth at the margin. Full treatment of these issues falls beyond the scope of the present exercise and would require considerable further methodological development. Potential risks to Malawi's macroeconomic programme and implications for growth are discussed in Section 7.



## 5. Base case comparison

### 5.1 2009/10 budget

28. The model constructed for the options appraisal focuses on implications for public expenditure in priority areas. To provide a basis for comparison we have disaggregated the 2009/10 budget provided in the 2009 Financial Statement to distinguish non-discretionary spending (wages and salaries, interest payments, pension and gratuities, net lending, fertiliser subsidy, health SWAP expenditure and foreign financed development expenditure<sup>8</sup>) from discretionary areas of expenditure. It can be noted that the term 'non-discretionary' expenditure is conventionally limited to statutory items which are constitutionally protected. Our usage in the present report includes expenditures which are regarded as fixed in the short term and over which the Executive has very limited control for a variety of practical and political reasons.

29. A clear mapping of functional areas of the budget into MGDS priority areas cannot be immediately derived from the 2009 Financial Statement (or other available budget information) for several reasons. Firstly, MGDS expenditure is defined by GoM in terms of themes and priority areas that cut across different functional areas of the budget. Secondly, non-MGDS expenditure items (i.e. wage bill, statutory items and administration costs) includes activities which are recognised as fundamental to delivering MGDS outcomes. Thirdly, anecdotal evidence suggests that sectors have struggled to accurately link all planned activities and associated expenditure items to pre-determined MGDS codes and activities (Tavakoli et al, 2009).

30. GoM's estimate of the share of the overall budget going to the MGDS and hence to government priority areas (62% in 2009/10) should therefore be interpreted with caution. It is likely to contain an element of over estimation to the extent that some non priority expenditure items may be incorrectly included, and underestimation to the extent that a significant element of the wage bill and statutory expenditure required for the MGDS is excluded.

31. We have constructed estimates on the following basis. Firstly, that health and water/irrigation are considered priorities in the line with the MGDS. Secondly, that a proportion of the wage bill, discretionary recurrent expenditure and domestically financed development expenditure (50% under base case assumptions) is spent in other priority areas such as education, roads and agriculture. This yields a distribution of GoM spending in 2009/10, consistent with the 2009 Financial Statement, as shown in Table 4 below.

**Table 4: Allocation of 2009/10 budget**

US\$ million	Non discretionary	Discretionary	Total
Health	135	106	241
Water and irrigation	33	5	37
Other priority	748	264	1,012
Non priority	154	374	528
<b>Total</b>	<b>1,070</b>	<b>748</b>	<b>1,818</b>

Note: (1) Source: author's calculation based on the 2009/10 Financial Statement (MoF, 2009).

<sup>8</sup> This includes statutory expenditure that is readily identifiable from table 1 (fiscal framework) from the Financial Statement 2009/10 (MoF, 2009).

## 5.2 Effects of quitting GBS

### *Fungibility*

32. The immediate effect of DFID quitting GBS is to reduce the volume of flexible resources available to GoM to support the overall budget, and redirect these to designated priority areas. An important consideration is whether resources over which GoM has discretion would remain unaffected by this change or whether GoM would partially compensate for expenditure switching on DFID's part (i.e. through fungibility of the budget).

33. Two pieces of evidence are relevant in this context. The recent SBS review shows that in low income sub-Saharan Africa (SSA) countries donor finance provided at sector level is not significantly compensated by reallocations, especially in countries where sector support is aligned with government policy preferences and where virtual earmarking or additionality is applied. Similar experience is borne out in Malawi's case. During a key period of implementation of the health SWAp between 2002/3 and 2006/7 a planned increase in donor financing was not compensated by any significant reallocation away from health in the budget, leading to a clear overall increase in health spending<sup>9</sup>. Moreover unplanned, short term interruptions to donor financing for the SWAp have been compensated by GoM suggesting strong alignment of donor-government preferences. In view of this we have not assumed significant fungibility in the budget. The immediate impact on priority spending of DFID quitting GBS consists in this situation, of the combined effect of: (i) a proportionate reduction in overall spending from the withdrawal of GBS and (ii) an equivalent increase in spending in the health or water programmes.

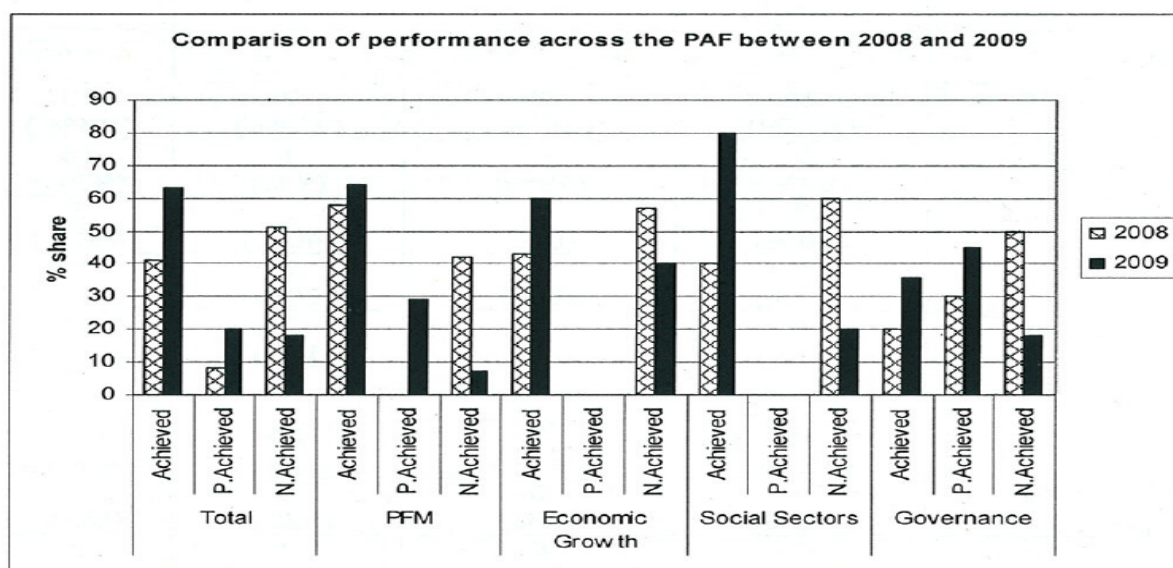
### *CABS influence*

34. A potential secondary effect of DFID quitting GBS is to diminish the influence of the CABS group. The group deploys a combination of dialogue, conditionality and technical assistance to encourage GoM to meet performance indicators in the PAF. The PAF includes specific targets to restrain within year reallocations among spending votes and maintain non-salary recurrent expenditures (PAF indicators 2 and 3).

35. There is evidence that GoM performance is improving; of 25 targets contained in the PAF, covering PFM, economic growth, social sectors and governance, 60 % were achieved at the time of 2009 CABS review, compared with 40 % in 2008, as shown in the Figure 2 below. Reallocations among budget heads in 2007/8 were 7.2%, exceeding the PAF target of 10% and improving on previous years' performance. However in 8 out of 20 votes considered in the assessments, variations still exceeded 10%. The fertiliser subsidy and Ministry of Transport and Public Works programme have stood out as areas of frequent over spending (by margins of 20% and 63 % respectively). By contrast the NAO and National Assembly Programme have consistently under spent. These are major concerns in view of the central accountability functions of these institutions.

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<sup>9</sup> MoF/DFID calculation of health SWAp discretionary expenditure.

**Figure 2: Trends in performance against PAF Targets (2008 – 2009)**

Note: (1) Source: CABS, March 2009 Aide Memoire (2009b).

36. Attributing change to the CABS group and to DFID in particular, is not straightforward because of other influencing factors such as the IMF programme and technical assistance provided for the PEFM Action Plan.

37. GBS in Malawi is perceived to have created a platform for GoM–donor dialogue which has positively influenced expenditure allocations. The GBS Evaluation for Malawi noted that the CABS group established a significant role in protecting priority spending during the period of extreme fiscal prudence in 2003/4, and created opportunities for cross Ministry dialogue amongst government officials. There is recent evidence suggesting that CABS has been influential in increasing domestic budget allocations for roads maintenance (in favour of new road building) and that PAF monitoring has been instrumental in introducing public financial management reforms including roll out of the IFMIS.

38. Interviews carried out under the present review suggest that CABS donors add weight to the IMF's current fiscal monitoring efforts by drawing in specific knowledge and expertise on developments in the wider economy, such as effects of the fertiliser programme, and that CABS and the IMF operate in a collaborative and influential way. Within CABS DFID is recognised as playing a particularly strong leadership role, and for having built relationships with MoF which provide high level engagement on GoM spending decisions.

39. This evidence is largely anecdotal and inherently difficult to quantify. A particular difficulty in assessing CABS influence over leakages is the lack of reliable baseline information. The payroll and public expenditure tracking surveys (PETS) point to salary leakages of the order of 3%, however interviews point to methodological difficulties including underestimation of absenteeism at service delivery level (MoEPD, 2009). Reliable information on leakages in the health SWAp is also lacking, although there is an expectation among donors that additional procurement oversight and audit is worthwhile.

40. We have relied on close consultations with CABS donors and other officials in Malawi to establish credible judgements, and taken a conservative approach to setting a base case for purposes of comparison. In the base case situation the effect of DFID quitting GBS is taken to reduce discretionary expenditure in priority areas (i.e. in favour of non priority areas) by a

modest 1%, and to increase leakages by 1% through marginally slower progress of the PFEM Action Plan. Leakages in donor managed programmes are taken as 5% compared with 10% across the budget as a whole. We have also considered a multi-year programme to allow for the possible effect of progressive influence over time to be explored<sup>10</sup>.

### ***Domestic borrowings***

41. An important consideration in switching to Options 2 or 3 is that unused balances held in accounts used for the health SWAp and water/irrigation programmes cannot be used for Treasury management purposes, by contrast with the central Treasury account used for GBS. The likely effect of quitting GBS would be to increase GoM domestic borrowings on approximately a one-to-one basis in order to maintain flexibility for short term cash flow management of the budget, producing an interest burden dependant on the rate of interest on short-term Treasury Bills.

42. It can be noted that interest payments are mainly an internal transfer within the economy and arguably should be excluded in the analysis. Higher interest costs nevertheless reduce resources available to GoM for poverty reducing expenditure, and could increase distortionary effects of taxation at the margin. A further concern is that higher domestic borrowings could crowd out private investment leading to lower growth, as discussed further in section 7.

### ***Transaction costs***

43. There are no major implications for DFID staffing, which would remain unaffected in the short run by a change in the balance of UK-Malawi programme. Experience shows that as budget support has scaled up, CABS reviews and related monitoring activities have become more intensive. In Option 1 DFID could expect to incur continued consultancy costs estimated at £40,000 p.a. On the GoM side, harmonisation under the programme has helped reduce demands on government time and effort. However it is not likely that this would be substantially affected if DFID withdrew. Nor are changes in transaction costs in the health and water/irrigation programmes expected. This is not to say that these programmes do not involve significant design and supervisions costs; rather that the incremental effect on transaction costs of DFID adding resources to existing programmes is unlikely to be significant. In the former case, DFID already contributes substantial resources and is active in donor-government dialogue. In the latter case, DFID resources would continue to be managed via the World Bank under delegated arrangements.

### ***Multiyear programme***

44. We have considered how the options appraisal would be affected if DFID were to move to a 3 year GBS programme, with re-specification of the counterfactuals to reflect a corresponding medium term commitment to health or to water/irrigation.

45. An advantage in moving from a single year to a rolling GBS arrangement is, in theory, that this would provide a more predictable flow of resources to the budget. However our discussions with partners revealed a high level of expectation that DFID will disburse GBS funds in 2009/10, and continue to do so, provided basic partnership conditions remain in

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<sup>10</sup> In the interests of simplicity the analysis implicitly values leakages on the basis that they reduce priority spending by an equivalent amount, although in practice leakages also occur in areas of non-priority spending. In this respect the approach used marginally overvalues benefits of reduced leakages.

place. In this situation moving to a more a formalised medium term commitment may produce little or no practical difference. It could however provide an opportunity to build coherence among CABS donors with varying disbursements plans (see Table 5), stronger links with the three year framework provided by the PAF and accompanying multi-year technical assistance programmes for public financial management. A three year GBS programme closely meshed with programmatic support for PFM reforms might offer greater potential for transformative change as envisaged in the DAC joint evaluation framework.

**Table 5: CABS indicative disbursement plans, in foreign currency**

CABS partner	2010/11	2011/12
Norway (Nk m)	70	70
EU (Euro m)	30.5	-
AfDB (UA m)	10	-
World Bank (\$m)	30	30
DFID (£m)	-	-

Note: (1) Source: AfDB (2009b).

46. We have explored whether advantages might be significant in quantitative terms through elaborations of the model to cover 2010/11 and 2011/12 and by allowing plausible extremes to be tested. At one end of the spectrum, the effect on the GoM budget over the three year horizon is taken to be neutral (i.e. as compared with a series of single year arrangements). This situation is realistic to the extent that Malawi does not have a credible MTEF which would be the natural mechanism for making use of additional commitment information for management purposes and, as noted above, DFID disbursements are already relatively predictable. At the opposite extreme, CABS influence is taken to be cumulative over time, on the basis that the GBS programme could in principle be supported by more programmatic forms of support for PFM reforms e.g. with linked short and medium term objectives. This is in keeping with the 2004 Malawi joint evaluation which found evidence that medium term expectations have been important in incentivising change. The evaluation recommended, for this and other reasons, that donors should move to GBS commitments extending well beyond a single year.

47. We have captured these extremes in the model by comparing a progressive increase in CABS influence (i.e. influence over allocations and leakages) to 3% over three years, with a one-off influence of 1% (i.e. as in the base case). In the absence of a credible Medium Term Expenditure Framework (MTEF) we have constructed a three year budget on the basis of GoM estimates in the 2009 Financial Statement and IMF expenditure forecasts. The presumption is that DFID would provide £75m disbursed in equal tranches in 2009/10, 2010/11 and 2011/12, either as GBS or - in the counterfactual situation - for the health SWAp or water/irrigation programme<sup>11</sup>.

<sup>11</sup> We have taken a three budget based on IMF forecasts of overall expenditure with a constant share going to priority and non-priority areas, as a more reliable basis for the analysis than the MTEF which is widely regarded among partners as lacking credibility.

## 6. Results

48. This section reports the main results of the options appraisal. The results relate to measurable effects on priority spending at level 3 of the analytical framework, that is to say the net effect of quitting GBS on the overall volume of resources going to priority areas of the poverty reduction strategy, expressed as a proportion of DFID expenditure<sup>12</sup>. We have provided DFID with a spreadsheet to allow alternatives to the base case, including expenditure weightings, to be tested. Since the model should be used to gauge orders of magnitude rather than provide point estimates, results are presented using a rating system as follows.

**Table 6: Impact ratings**

Rating	Net costs/benefits of quitting GBS as % DFID expenditure
Highly positive	>+25%
Moderately positive	+5 to 25%
Insignificant/neutral	-5 to +5%
Moderately negative	-5 to -25%
Highly negative	<-25%

Note: (1) Source: author's own analysis.

49. Switching to Option 2 or 3 is found to produce a small but significant net cost in terms of changes in priority spending, receiving a 'moderately negative' rating in the table below. GBS is therefore marginally preferred in the base case situation if no further considerations are taken into account. It should be noted that this is not a reflection of the absolute benefits of providing GBS; but the incremental gain from providing GBS over and above the best available alternatives. The expectation is that GBS would result in more resources going to priority areas of the MGDS in overall terms after allowing for transaction costs, leakages in the general budget and lower interest costs on domestic borrowings. Although we have not quantified the benefits of improved services, the expected consequences of continuing with GBS would be faster progress against MGDS objectives.

50. The breakdown of this overall result is given in Table 7. It shows the estimated changes in priority spending (i.e. across all priority areas of the MGDS) expected if DFID were to quit GBS. Thus, for example, quitting GBS in favour of the health SWAp produces a small (i.e. greater than 5% but less than 25%) decline in priority spending if all the different elements in the left hand column are taken into account. The same result emerges in the case of switching to water/irrigation. Looking at different elements in Table 7, the main positive effect of quitting GBS arises from the direct increase in health and water/irrigation spending (item 2a). This is offset by withdrawal of the contribution made by GBS to other priority areas (item 2b), and by loss of DFID influence through CABS (items 4 and 5a). Domestic financing and transaction costs (items 1 and 3) emerge as less significant elements. The advantages of routing funds through donor managed programmes (i.e. in terms of avoiding leakages in the GoM system) emerge as relatively limited in the base case situation (item 5b).

<sup>12</sup> We have deducted leakages and interest payments on domestic borrowings without any further adjustment. Strictly speaking these could affect both priority and non-priority spending and their significance in the analysis may therefore be marginally overestimated.

Summary of major assumptions used in Malawi Options Appraisal

This box brings together the main assumptions used in the options appraisal, distinguishing those that are fundamental throughout the analysis from those which are not pre-determined and are inserted as choice variables in the model. The appraisal would benefit from more research and analysis to address the limited data base of information on Malawi's public expenditure and its outcomes as discussed further in Section 7.

In the former category, the analysis assumes that:

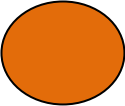
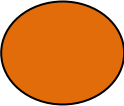
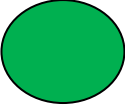
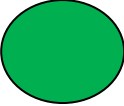
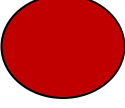
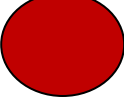
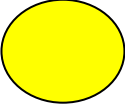
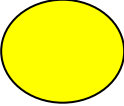
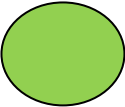
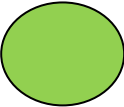
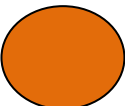
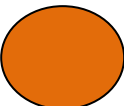
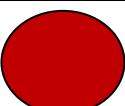
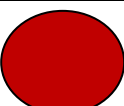


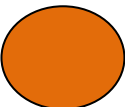
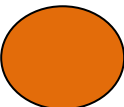
- Resources allocated through GBS may not be used fully for MGDS priorities
- All expenditures allocated through the Health SBS or through the Water & Sanitation Trust Fund would be used fully for MGDS priorities
- Transaction costs associated with existing earmarked alternatives are fixed. In consequence the marginal increase in transaction costs from allocating additional resources to these programmes is negligible
- Expenditures allocated to earmarked alternatives are subject to lower (or at least no greater) levels of leakage than resources going through GBS into the general budget.
- There are no significant differences in absorptive capacity between the three options and resources are fully disbursed

The main variables selected in the model relate to:

- The proportion of discretionary expenditure, in areas other than health and water/irrigation, allocated by GoM to MGDS priorities
- The influence exerted by CABS donors on the allocation of the budget to priority areas, and on leakages in the general budget
- The absolute levels of leakage in the health and water/irrigation programmes, including in the general budget
- Different weights which donors may wish attach to expenditures in health or water/irrigation, relative to expenditure in other MGDS priority areas (such as education or roads), reflecting their importance for poverty reduction and other related corporate objectives

51. It should be emphasised that these results rest heavily on judgements made in a few critical areas. If consideration is restricted to areas where quantitative evidence (e.g. budget data) is available (shown as 'Category A' in Table 7) the finding is reversed. Thus if 'Category B' estimates are excluded on grounds of limited anecdotal information (e.g. concerning CABS influence), Options 2 and 3 emerge as preferred over Option 1, receiving ratings of 'moderately positive'. The degree of influence of CABS is taken to be a modest 1% in the base case however. Our discussions with CABS donors focussed on a possible range of influence between zero and 5%. A brief summary of the main assumptions on which the analysis is based is shown in the textbox above.

**Table 7: Incremental benefits of quitting GBS as % of DFID expenditure**

	Health SWAP	Water programme	Comment	Reliability of estimate
<i>Category A</i> 1. Domestic financing cost			Interest cost of increased domestic borrowing based on real rate of interest on short terms TBs	<i>High</i> – based on actual interest rates
2a. Direct allocative effect of <u>increased</u> DFID spending in health/water			Reflects direct effect of increased DFID spending in priority areas	<i>Med/high</i> – based on known areas of spending
2b. Direct allocative effect of <u>withdrawal</u> of GBS			Reflects effect of withdrawing GBS on priority spending in overall GoM budget (excluding the relevant sector)	<i>Med/low</i> – based on estimated composition of budget
3. Transactions costs			Based on consultancy costs	<i>High</i> – based on known cost of consultancies and staffing plans
<b><i>Sub total</i></b>				<i>See text</i>
<i>Category B</i> 4. Indirect effect (Influence over budget allocation)			Reflects 1% reduction in allocations to priority allocations	<i>Low</i> – based on circumstantial evidence of CABS influence
5a. Reduced leakage in the general GoM budget			Reflects slower pace of PFM reform and 1% increase in leakages compared with Option 1	<i>Low</i> – no reliable information on overall leakages or CABS influence
5b. Reduced leakages in donor managed programme			Reflects lower leakages in donor managed programmes (5% compared with 10%)	<i>Low</i> – no reliable information on leakages in health SWAp
<b><i>Total</i></b>				<i>See text</i>

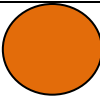
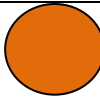


Note: (1) Source: author's own analysis; (2) Note: point estimates shown in Annex 4.

52. Results for a three year GBS programme are summarised in Table 8 below. This shows the incremental benefit of foregoing a multiyear GBS programme in favour of equivalent support for the health SWAp or water/irrigation programmes over three years, based on the parameters described in Section 5.2.5. The advantages of GBS compared with Options 2 and 3 are shown to increase significantly in circumstances where CABS influence (over allocations and leakages in the general budget) increases on a cumulative basis. The balance of advantage between the alternatives is otherwise similar to a single year



arrangement. The potential gain is significant since the influence of GBS is exerted over the entire budget, producing a scale effect which does not arise with Options 2 or 3 in view of their narrower scope. Any disadvantage of extending a commitment over a longer period (e.g. in the event performance difficulties or a fundamental breakdown in the partnership) are in principle capable of being mitigated with appropriate conditionality design, suggesting that the balance of advantage is in favour of moving to multi-year programme, in line with the recommendations of 2004 Joint Evaluation. This is potentially an important design feature which will be discussed in more detail later.

**Table 8: Incremental benefits of multi-year GBS programme**

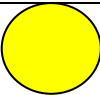
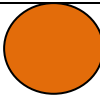
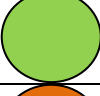
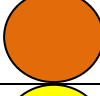
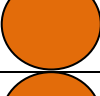
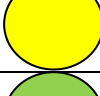
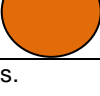

CABS influence over allocations and leakages in the general budget	Health SWAp	Water programme
CABS influence equals 1% in 2009/10 to 2011/12		
CABS influence equals 1% in 2009/10; 2% in 2010/11; 3% in 2011/12		

Note: (1) Source: author's own analysis.

## 6.1 Weightings

53. The influence of weightings on health and water/irrigation expenditure (i.e. relative to other spending priorities such as education) is shown in Table 9 below<sup>13</sup>. The effect of applying a 50% weighting to the health or water and irrigation is to place the alternatives on an equal footing to GBS. Our finding is that it would require a stronger weighting of the order of 100% to decisively shift the balance of the advantage to the favoured sector.

**Table 9: Incremental benefits of quitting GBS: effect of expenditure weightings**

Weighting	Health SWAp	Water programme
Health weighting: +50%		
Health weighting: +100%		
Water/irrigation weighting: + 50%		
Water/irrigation weighting: + 100%		

Note: (1) Source: author's own analysis.

<sup>13</sup> The weightings are equivalent applying shadow prices for health and water expenditure, reflecting DFID priorities, as opposed to actual changes in expenditure allocations.

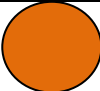
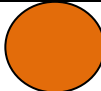
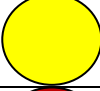
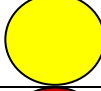


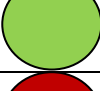
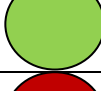
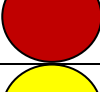
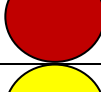
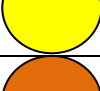
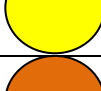
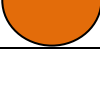
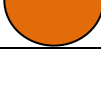
## 6.2 Sensitivity analysis

54. In view of uncertainties surrounding 'Category B' costs and benefits, the sensitivity of results to variations in underlying assumptions and judgements has particular importance for the options appraisal. We have recalculated the results given in Table 7 to reflect a variety of alternatives to base case assumptions, as shown in the left hand column of Table 10 below. The main conclusion is that results are sensitive to the degree of CABS influence over leakages in the general GoM budget. In the absence of any such influence (see line 4 in Table 10) Options 2 and 3 emerge as preferable to Option 1. More concrete evidence on the extent of leakages in the general GoM budget (relative to donor managed programmes) is needed to support a definitive conclusion on this however.

55. The sensitivity analysis shows that CABS influence on budgetary allocations (see lines 2 and 3 in Table 10) - although important - is marginally less critical than influence over leakages. If CABS influence here is taken to be zero (line 2), there would be little to choose between the options. If influence is taken to be greater than in the base case (i.e. 5% in the example shown) the case for continuing with GBS is strengthened further (line 3). Thus, within the range of variation considered, Options 2 and 3 are found to offer no clear advantages over Option 1.

56. The sensitivity analysis suggests that DFID's ability, working through CABS, to encourage development of elements of the budget process critical to controlling leakages (e.g. audit and accountability functions) could be especially important in exploiting the advantages of GBS and that better evidence on leakages is important for providing stronger basis for decision making. This is another potentially important design feature that will be discussed further in section 8.

**Table 10: Incremental benefits of quitting GBS: sensitivity analysis**

	Health SWAp	Water programme
1)Base case		
2)CABS influence on allocations = zero		
3)CABS influence on allocations = 5%		
4)CABS influence on leakage in general GoM budget = zero		
5)CABS influence on leakages in general GoM budget= 5%		
6)Leakage in donor programmes = zero		
7)Leakage in donor programmes = 10%		

Note: (1) Source: author's own analysis.

57. 'Break even' positions, i.e. circumstances in which Options 1, 2 and 3 score equally in terms of their impact on resources going to priority are as follows:

- A situation where DFID/CABS influence on allocations is close to zero, with other variables as in base case, or
- where a small (approximately 0.5%) influence is exerted by DFID/CABS on leakages in the general budget

58. As previously noted the extent of leakages in donor managed programmes is largely unknown. Our analysis shows however that Options 2 and 3 would score equally compared with Option 1 (i.e. 'break even') even in the unlikely extreme situation of donor managed programmes eliminating leakages altogether. Set against this however is the possibility that leakages in the general budget may in fact be greater than assumed in the base case which would strengthen the case for earmarked interventions.

59. In the break even situations described a decision to continue or quit GBS should therefore rest on wider effects, including institutional changes falling outside the scope of the present analysis. It can be noted that leakages in donor programmes and the GoM budget should be relatively amenable to quantification (e.g. though further work on PETS) as compared with CABS influence which is inherently more judgemental.

### 6.3 'Mini-max'

60. A highly simplified alternative approach to decision making under uncertainty is to select among alternatives on the basis of securing the least bad expected outcome: i.e. 'mini-max' criterion. It is of some interest to consider whether applying this criterion would support or undermine our main overall finding in favour of GBS.

61. The worst case scenario for GBS is represented by a combination of zero DFID/CABS influence on allocations and leakages in the general GoM budget, and elimination of leakages in donor managed programmes. By contrast the worst case scenario for Options 2 and 3 is a relatively high degree of CABS influence over allocation and leakages (5% in the example shown), and no further reduction in leakages in donor managed programmes. Running the model to reflect these different extremes shows that:

- In the worst case scenario for GBS switching to Options 2 or 3 produces net *benefits* exceeding roughly 30% of DFID's proposed £22m expenditure
- In the worst case scenario for the Health SWAp and water/irrigation alternatives, the effect of switching would be to generate a large net *cost* exceeding around 150% of DFID expenditure

62. The best strategy for avoiding the strongly disadvantageous worst case outcome in the latter of these two cases is therefore to continue with GBS - consistent with the conclusion of the preceding analysis.

## 7. Wider Implications

63. The analysis so far has concentrated on the effects of quitting GBS on GoM priority spending, in view of its direct relevance for achieving MGDS outcomes and the opportunities for quantification. This section briefly discusses wider implications for Malawi's macroeconomic programme and potential effects on growth, corresponding to Levels 4 and 5 of the analytical framework in section 3.

### 7.1 Domestic borrowings

64. A longstanding feature of Malawi's macroeconomic programme has been fiscal consolidation focussed on reducing domestic debt to create fiscal space for poverty reducing expenditures and to crowd in the private sector. Domestic borrowings have been dramatically reduced in the last 5 years (with the exception of a small rise in 2007/8 due to bank recapitalisation, and in 2008/9 due to higher than expected spending). Real interest rates are low (5% p.a.) and commercial bank lending to the private sector has remained buoyant partly in response to the decline in borrowings. A further discussion of trends in domestic borrowings, private investment and growth over the last 10 years in Malawi is presented in Annex 3.

65. In present circumstances the IMF considers that domestic borrowings are not crowding out private investment. However a withdrawal of GBS by DFID would be unhelpful at a time when GoM is experiencing difficulty in reducing borrowings in line with its current programme targets. Malawi completed its IMF sponsored PRGF in July 2008 and began a successor one year Exogenous Shocks Facility (ESF) in December 2008. Five out of six performance criteria for December 2008 were observed, with the exception of the borrowings target.

66. If DFID were to quit GBS, GoM borrowings could increase by up to 0.8% of GDP compared with a targeted reduction of 1.4% between 2007/08 and 2008/09 (IMF, 2009). Although not a major cause of concern at present, risks to the macroeconomic programme and growth could become significant if confidence among CABS donors was diminished and lead to a withdrawal of GBS on a larger scale.

### 7.2 Foreign reserves

67. The scheduled review of the ESF in June 2009 was held back, in part because of elections but also to provide an opportunity for GoM to reset its macroeconomic strategy to address Malawi's low level of foreign reserves. Reserves are currently inadequate to cover essential imports for more than a few weeks: 1.5 months of import cover in August against a target of 2.4 months (IMF, 2009). The situation is especially risky given that the current position already reflects the buttressing effect of a seasonal concentration of tobacco proceeds in April-September, prior to a seasonal rise in fertiliser imports expected in the last quarter of the year; and Malawi's structural vulnerabilities to external shocks.

68. An important issue for the options appraisal is whether quitting GBS and providing funds via alternative routes would worsen an already fragile position. In the short term, budget support disbursements of \$60 m in the second quarter of the 2009 calendar year, (primarily the World Bank and AfDB) have contributed to an increase in net reserves of \$55m (from \$75m in Q1 to \$130m in Q2 2009, on a calendar year basis). The expected reserve position in December 2009 is \$174m - around 5-6 weeks of import cover - assuming continued disbursements as shown in Annex 5.

69. Routing funds via the Health SWAp or as other project funds would contribute equally to Malawi's foreign exchange reserves in the short term, but carry an obligation to subsequently spend resources on project activities. By contrast providing resources as GBS gives the authorities discretion to absorb but not spend foreign aid to help build up reserves. The effect of DFID quitting GBS depends therefore on whether this discretion is exercised in practice by the authorities.

70. Room for manoeuvre is highly restricted under present policies. Malawi operates a highly regulated foreign exchange market and has, since 2006, been using its foreign reserves to help keep the Kwacha stable against the dollar and allow it to appreciate against other currencies. A combination of lack of flexibility in the exchange rate system, overvaluation of the currency by an estimated 15%, and worsening terms of trade is pushing the burden of adjustment on to reserves.

71. The effect of quitting GBS under present policies would therefore, in effect, be to remove a prop to an unsustainable exchange rate regime, rather than to diminish Malawi's reserves. To improve the position more fundamental action is needed to improve the workings of the foreign exchange market by providing greater flexibility (e.g. removing multiple currency practices) and to further consolidate net domestic debt. Options for doing so were under discussion with the IMF at the time of our review.

## **8. Design options and lessons for future**

### **8.1 Design issues and lessons for future**

72. This section draws together key design considerations for future budget support in Malawi emerging from our review, and lessons from our attempts to quantify the costs and benefits of providing GBS.

### **8.2 Design**

73. Two major design features emerge from the preceding analysis. Firstly, the importance of DFID influence in the model used, both on minimising leakages and on improving budget allocations, points to the need for GBS to be accompanied by strong and sustained dialogue on budget and PFM issues in order to have maximum impact on pro-poor spending. This dialogue should offer opportunities for DFID to influence the quality and quantity of public spending, and ensure a more pro-poor and efficient spending agenda, by reinforcing the role of the budget in decision making and building stronger opportunities for domestic accountability in the longer term. To achieve a strong level of dialogue, DFID needs to devote adequate staff resources to participate in CABS and related fora, including at a senior level. Confirmation that the wider context for GBS is conducive (e.g. that the Ministry of Finance and other Government stakeholders are receptive to engagement with donors around these issues) is subject, however, to further institutional and political appraisal in DFID. Secondly, the possibility of influence building up over time points to the benefits of a multiyear arrangement as discussed further below. This is a departure from DFID's approach of annual programmes since 2005.

74. Since long term impact is less likely to be achieved if capacity and ownership act as bottlenecks to policy implementation, the effectiveness of donor support for capacity building is important for the sustainability of the programme. Governance issues fall outside the scope of the present review, however experience suggests that focussing on building the capacity of accountability institutions in ways that enhance their independence and credibility (e.g. by engaging within the wider governance landscape) is critical (Hudson, et al, 2009).

75. There is also a potential tension between using conditionality to leverage short term spending decisions, and incentivising improvements in capacity and decision making over the longer term. Experience suggests that conditionality does little to strengthen ownership, but the dual motivation of supporting domestic accountability and ensuring that aid is well accounted for need not be in tension if donors make more use of domestic accountability systems as they strengthen. The design challenge is how to manage GBS in ways that ensure that accountability to donors does not overshadow improvements in domestic accountability (i.e. 'does no harm'). Moving towards a multi-year GBS programme which combines short-term budgetary management and longer-term governance objectives could be helpful in this respect.

### **8.3 Lessons for the future**

76. The analysis highlights key assumptions in the decision to use or not use budget support and reveals some striking differences in the relative importance of different variables. The approach also provides a basis for considering how a more robust options appraisal might be structured in future for a country such as Malawi, and what sort of data analysis this might imply. Our suggestions on areas for future investigation and analysis draw heavily on peer reviewer comments (Lawson, 2009) and fall into six areas as follows:

- Our treatment of transaction costs has necessarily been abbreviated and has not looked in detail at sector and project based alternatives to GBS. A fuller investigation of whether GBS involves a lower or higher level of transaction costs, in terms of design and supervision effort, than competing modalities would be desirable.
- As noted above, there are major information gaps concerning the proportion of spending that are subject to leakage or other major inefficiencies. A more thorough analysis possibly involving further work on PETS would provide a more robust basis for future decision making.
- By contrast to the Rwanda options appraisal the analysis is founded on a comparison between GBS and specific counterfactual interventions. However our treatment of counterfactuals involves a simplified assessment of implications for priority spending and it has not been possible to take account of intra sectoral allocation issues. This might be addressed through a more thorough appraisal of the alternatives.
- Given the limitations of the study we have not been able to accurately gauge how far GBS has reinforced the importance of the budget and associated decision-making processes in Malawi (i.e. looking beyond more narrowly drawn indicators in the PAF) and how this might alter in future with continued DFID participation in the CABS programme. Since reinforcement of the role of the budget in decision making is an important rationale for providing GBS, further investigation would be desirable.
- The options appraisal is based on the premise that fungibility in the GoM budget is insignificant. This is partly supported by evidence however the judgement is not a straightforward one. In view of the significance of fungibility in our calculations a more thorough investigation of how far competing modalities allow expenditure patterns to be determined by donors would add credibility to future analysis.
- We have not explored the value of changes in the quality or quantity of services. Future work might seek to address this through examination of whether there are particular areas of expenditure which have been strongly supported by GBS. This would need to be accompanied, ideally, by estimates of the marginal benefits of expenditures in different areas of the budget in terms of their contribution to poverty reduction and growth. Since this would involve significant additional research and analysis an alternative would be to draw comparisons with international or regional expenditure levels. The 2006 Public Expenditure Review points for example to significant areas of under expenditure in health (notably health worker salaries) while overall health allocations in Malawi are comparatively high by regional standards, suggesting the need for a relatively high degree of disaggregation in any such comparison.

77. Finally, interviews carried out during our review demonstrated a perception among donor partners and GoM that DFID will continue to provide GBS, as in previous years, regardless of the outcome of the options appraisal. The impact of DFID withdrawing GBS at a late stage itself is a significant issue. To add value to future decision making, analytical work could usefully commence at an earlier stage and ideally be carried out alongside a more thorough appraisal of alternative interventions.

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## Annex 1: Overview of Logical Frameworks for GBS

78. Key features of the OECD DAC evaluation framework relevant to the Malawi PRBS Options Appraisal are summarised below.

- The goal of providing GBS is seen in terms of three dimensions of poverty: income; non-income and empowerment/social inclusion. Framing poverty in a broad way places demands on the evaluation framework to explore institutional changes across a broad spectrum of policies and accountability issues.
- The influencing channels considered in the evaluation framework are complex but essentially boil down to two main types. The first type ('stream 1') is a 'flow of funds effect' which captures the influence of providing more resources to government in a form which is programmable in the budget. On the basis that institutional changes in the PFM system also occur (through 'stream 2'), the expected result is a combination of improved fiscal discipline (enhancing growth) and improved use of public resources for pro-poor service delivery (improving non income poverty) .
- The second type of influence ('stream 2') operates through improved domestic processes for policy making, budget formulation and execution. The logic is that improvements in these areas enable all resources available to government (i.e. including GBS) to be used more effectively.
- There is a strong presumption that synergistic interaction is intended between streams 1 and 2, giving GBS much of its distinctive character. An important though not exclusive driver in stream 2 is improved accountability to citizens – as opposed to donors – for spending decisions and for establishing a pro-poor policy environment. A further driver is external influence brought to bear by donors through conditionality or 'new' types of policy dialogue. The framework explicitly accommodates both endogenous and exogenous effects for stream 2.

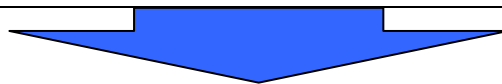
79. The evaluation framework therefore treats GBS as package of synergistic inputs consisting of:

- Funds provided;
- Technical assistance for capacity building linked to GBS;
- Various forms of policy dialogue including conditionality, and;
- Efforts to improve harmonisation among donors providing GBS and to align with national systems and policies.

80. The following table shows in diagrammatic form the OECD DAC Evaluation Framework for GBS. It is reproduced from Lawson et al (2004).

**Table 2: Summary of OECD-DAC Evaluation Framework for GBS****Level 1 - General Budget Support Inputs**

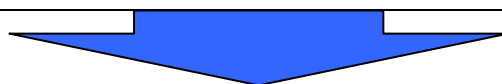
- GBS Funds
- Policy dialogue and related Conditionality
- TA/capacity building
- GBS aligned to government policies and systems and harmonised across donors

**Level 2 – The Immediate Effects – changed relationship between external assistance and the national budget/national policy process**

- More external resources for the government (additional funding)
- Proportion of external funds subject to national budget process increased (increased government control over external resources & increased fungibility of resources)
- Increased predictability of external funding for government
- Policy dialogue and conditions focused on strategic issues (rather than project issues)
- TA/capacity building established to improve PFM Processes and Pro-Poor Sector Policies:
- Donor activities more harmonised & external assistance more aligned with government policies and systems

**Level 3 - The Outputs – positive changes in the financing and institutional framework for public spending and public policy**

- Partner government is encouraged and empowered to strengthen PFM systems
- Partner government is encouraged and empowered to strengthen pro-poor policies and processes
- Allocative and Operational efficiency of public expenditure is enhanced
- Aggregate fiscal discipline and macroeconomic management are improved
- Intra-government incentives and capacities are strengthened
- Democratic accountability is enhanced

**Level 4 - The Outcomes – Government capacity to reduce poverty enhanced**

- More resources flowing to service delivery agencies
- Public services effectively delivered responsively and pro-poor
- More effective and accountable government improves administration of justice and respect for human rights, as well as general confidence of people in government
- Macroeconomic environment is favourable to private investment and growth:
- Regulation of private initiative works to ensure business confidence, equity, efficiency and sustainability
- Appropriate sector policies include public actions to address major market failures, including those arising from gender inequalities

**Level 5 - The Impact – poverty reduced**

- Income poverty reduction
- Non-income poverty reduction
- Empowerment and social inclusion of poor people

## Annex 2: Review of GBS Appraisal for Rwanda

81. The Rwanda economic appraisal applies the central notion that if donors switch from GBS to projects/programmes that bypass government systems, effects on poverty occur through five possible routes:
- Less-strongly harmonised systems, leading to higher transaction cost and fewer resources available for poverty reduction
  - Lower PFM/accountability performance, producing a similar effect
  - Less GoR accountability for priority sector spending & policies, leading to a combination of fewer resources for poverty reduction and lower growth
  - More donor influence over where donor (i.e. distinct from other government) funds are spent, meaning more resources for poverty reduction
  - More control over fiduciary risk, producing a similar effect.
82. With one important exception, and in contrast to the Evaluation Framework, the approach takes social, political and economic policies in Rwanda as fixed regardless of aid modality. The key exception is that GBS is assumed to alter the composition of government spending in favour of pro-poor areas by tilting the relative influence of pro-poor and non pro-poor domestic lobbies. Though not stated explicitly, the presumption is that influence is achieved through conditionality and threat of withdrawal, i.e. an exogenous influence tantamount to a 'bribe'.
83. The nature of services provided at point of delivery is also taken as fixed, simplifying the analysis considerably, though the share of 'pro-poor' services within the overall mix is amenable to influence as described.
84. TA/capacity building is excluded from the analysis on grounds that – although complementary to GBS – these can be pursued independently and are presumed to generate the same effect regardless of whether donors use - or avoid - government systems. The evaluation framework, by contrast, includes the possibility of flexible funding per se empowering government by giving greater control over resources, improving responsiveness to citizens through improved accountability and (though not explicitly stated) a degree of 'demand pull' for PFM reforms.
85. In brief, the Rwanda appraisal takes donor and government preferences as fundamentally unaligned, and treats GBS as an instrument for short term leverage rather than building ownership.

### *Quantification*

86. The Rwanda appraisal takes the following approach to quantification:
- *Cost of less harmonised systems:* treatment of this component is relatively straightforward. The approach is to estimate administration and consultancy fees associated with management of free standing programmes based on past experience, distinguishing fixed and variable costs. An arbitrary assumption is made concerning the number of programmes that would displace GBS, though in other respects the method is reasonably evidence based. In practice the scale of costs associated with less harmonisation is found to be relatively insignificant. For reasons

discussed, no consideration is given to alignment. Harmonisation among donor providing GBS is not discussed in detail.

- *Cost of reduced accountability:* the approach is to look at evidence of leakages from the budget based on audit findings, adjusting for the possibility of higher leakages from unaudited expenditure. Consequential risks for higher inflation and lower growth are also considered in some detail. A judgement is made that GBS limits leakages in a given proportion. The size of the effect is chosen somewhat arbitrarily, but since these costs have limited significance in the overall appraisal the assumptions made are not in the 'sensitive' category.
- *Lower pro poor spending:* it is assumed that in the absence of GBS non pro-poor lobbies gain the upper hand in budgetary decision making, leading to wastage on 'pet' schemes not included in the MTEF - though at a relatively advanced stage of identification, and posing a real threat to the integrity of the budget. Adjustments were made concerning the likely mix of public and private financing involved. The resultant cost was the single most important element of the options appraisal, dwarfing other considerations in the analysis. The approach is partly evidence based – but the most critical assumption of all (*viz* that that threat withdrawal of GBS is the only available solution, and that other forms of encouragement or influence have zero traction) is taken largely as an article of faith. Some further testing of the hypothesis might have helped strengthen the options analysis, given that the results of the appraisal rest heavily upon it.
- *Influence of freestanding programmes on public spending:* consideration is given to the possibility that free standing programmes influence the composition of overall public spending, though in practice the effect is neglected for lack of any clear evidence on the extent of fungibility in the budget. A small benefit is identified relating to reduced leakages in donor controlled programmes by comparison with those managed by the government - though again clear evidence for this was not found.

### Observations

87. A number of observations and potential lessons can be drawn from the Rwanda appraisal:

- Of the five influencing tracks laid out, it is possible to establish - even on the basis of a qualified analysis – that one factor alone (i.e. preventing 'white elephant' spending) stands out as the main determinant. Other effects are found minimal by comparison - including growth effects - on the basis of course that the various assumptions used are 'about right' within broad orders of magnitude. It is unlikely that these key points would have been intuitively obvious at the outset, itself illustrating the value of the approach.
- It might have been useful to follow up with further 'robustness' checks on the most critical assumption – a lesson which might be taken up in the Malawi appraisal if time permits.
- The analysis was conservative in the sense that no endogenous channels of influence were considered for GBS i.e. the potential effects of complementary TC, capacity building and policy dialogue are factored out. Exogenous conditionality emerges as the overwhelming advantage of GBS compared with alternatives.

- Difficulty in establishing the extent of fungibility in the budget means that no advantage – in terms of influence over the composition of the budget - is attributed to freestanding programmes. The analysis gives no real clue to the significance of fungibility, but considerable elaboration of the methodology would have been required in order to shed light on this.
- The counterfactual is not specified in detail which makes it impossible, as a matter of principle, to pin down specific benefits to be gained from alternatives, as illustrated in the above example. Arguably this introduces a degree of bias in favour of whatever alternative is most closely specified in the analysis – in this case, GBS. The lesson for Malawi is closer specification of counterfactuals.

## Annex 3: Domestic borrowings and growth – long term trends in Malawi

88. Malawi has had a history of major swings in domestic debt financing and levels of private investment which provide some basis for judging potential impacts on growth of a major withdrawal of GBS. The key comparison is between the period from 1999 – 2003 when weak fiscal performance brought the country to the verge of crisis. The government ran a deficit of more than 7% GDP p.a. financed almost wholly by domestic borrowings. Domestic debt ballooned from 3% to 25% GDP and competition for funds, in Malawi's highly oligopolistic domestic financial market, drove short term real interest rates to between 20-40%. The led to a dramatic reduction in borrowings by farmers and business and a marked slowdown in growth. The economy rebounded after 2004 as GoM reduced domestic borrowings, assisted by resurgence in GBS flows. Interest rates fell dramatically and private investment resumed.

89. The table below provide an overview of how domestic borrowings, the cost of capital, levels of private investment and growth evolved over this period. To help normalise for weather fluctuations (which have a major impact on year on year growth Malawi) comparison can be drawn between average growth performance in the 6 year period before 2004, and the following 5 year period up to 2009. Comparing these two periods, it can be seen that an increase in average growth from 2% to 6.8% p.a., coincided with an increase in private investment from 3% GDP to nearly 9% GDP, and a fall in average net domestic borrowings from 5.5% GDP to almost zero. The step change increase in domestic borrowings in 2002 and 2003 led to a sharp rise in interest rates followed by an observable decline in private investment. The overall picture that emerges is that a decrease in domestic borrowings of 1 % of GDP may lead, as a broad rule of thumb, to a one-on-one increase in private investment (i.e. about 1% GDP) and one-on-one increase of growth rate (1% p.a.).

90. It should be noted that the comparison looks at a period of extreme crowding out and macro economic dislocation and therefore provides a 'worst case' indication of links between GoM borrowings, investment and growth.

**Table 11: Performance of GDP, private investment, interest rates and domestic borrowing, 1999-2009**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Av 1999 - 2004	Av 2005 - 2009
<b>GDP growth (% p.a.)</b>	4.0	1.1	-4.2	2.1	3.9	5.1	2.1	6.7	8.6	9.7	6.9	2.0	6.8
<b>Private investment (% GDP)</b>	4.5	3.7	3.6	2.6	1.7	1.8	2.7	2.8	11.7	18.2	NA	3.0	8.9
<b>Interest rates (short term TBs)</b>	40	39	42	42	39	28	24	23	13	11	13	38	16
<b>Domestic borrowings (% GDP)</b>	2.1	1.2	6.9	11.8	7.7	3	0.3	0.7	0.4	1.6	-1.5	5.5	0.3

Note: (1) Source: IMF, 2009; WB/RoM, 2006

## Annex 4: Incremental benefits of quitting GBS

Table 12: Incremental benefits of quitting GBS as % of DFID's proposed £22m expenditure using base case assumptions presented as point estimates

	Single year programme		Three year programme (in year 3)	
	Health SWAP	Water	Health SWAP	Water
<b>Category A</b>	-5%	-5%	-5%	-5%
1. Domestic financing cost				
2a .Direct allocative effect of increased DFID spending in health/water	+87%	+98%	+87%	+98%
2b . Direct allocative effect of withdrawal of GBS	-58%	-69%	-58%	-69%
3. Transactions costs	+0.2%	+0.2%	+0.2%	+0.2%
<b>Sub total</b>	+24%	+24%	+24%	+24%
<b>Category B</b>	-9%	-9%	-10%	-10%
4. Indirect effect (Influence over budget allocations)				
5a. Reduced leakages - GoM	-29%	-29%	-29%	-29%
5b. Reduced leakages -donor programmes	+5%	+5%	+5%	+5%
<b>TOTAL</b>	<b>-9%</b>	<b>-9%</b>	<b>-10%</b>	<b>-10%</b>

Note: (1) Source: Author's own analysis.

## Annex 5: Central Bank foreign exchange budget, 2009

TABLE 16: RESERVE BANK OF MALAWI: FOREIGN EXCHANGE BUDGET FOR 2009 (US\$ MILLIONS)

	Jan	Feb	Mar	QTR I	Apr	May	June	QTR II	Jul	Aug	Sep	QTR III	Oct	Nov	Dec	QTR IV	Annual
Actual Gross Reserves (beginning prd.)	236.17	164.31	113.47	236.17	75.20	97.32	105.82	75.20	130.11	156.81	130.11	215.64	191.33	163.31	215.64	236.17	236.17
<b>SOURCES OF FOREIGN EXCHANGE</b>	<b>6.60</b>	<b>14.62</b>	<b>29.38</b>	<b>50.60</b>	<b>55.70</b>	<b>125.11</b>	<b>161.73</b>	<b>242.54</b>	<b>91.93</b>	<b>90.61</b>	<b>240.19</b>	<b>8.90</b>	<b>3.00</b>	<b>59.70</b>	<b>71.60</b>	<b>704.93</b>	<b>704.93</b>
Purchases of Foreign Exchange	-	-	21.37	21.37	38.16	57.71	77.94	173.81	73.78	21.00	129.78	-	-	-	-	-	323.46
of which from ADBs	-	-	15.00	15.00	10.00	10.00	5.18	25.18	1.50	-	-	-	-	-	-	-	48.18
Non-ADB	-	-	6.37	6.37	28.16	47.71	72.76	148.63	72.28	21.00	128.28	-	-	-	-	-	275.28
Foreign Interest Earnings	0.06	0.05	0.00	0.11	0.02	0.00	-	0.02	-	0.10	0.20	0.10	0.10	0.10	0.10	0.20	0.63
Other Receipts	0.23	6.33	-	-	-	35.80	1.73	37.53	2.59	-	2.59	-	-	-	-	-	40.12
Privatization Receipts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Funds for SFRM	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Maize Proceeds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other	0.23	6.33	-	6.56	-	35.80	1.73	37.53	-	-	-	-	-	-	-	-	44.09
Balance of Payments Grants	-	-	-	-	-	23.87	36.64	60.50	-	42.61	58.75	5.90	-	31.80	37.70	156.95	156.95
European Development Fund (EDF)	-	-	-	-	-	1.11	1.11	1.11	-	16.14	35.51	51.65	-	-	-	52.76	52.76
ADB FERT SUBSIDY (starting 2008)	-	-	-	-	-	15.17	15.17	15.17	-	-	-	-	-	-	-	15.17	15.17
IDA (DPL) grant component	-	-	-	-	-	-	31.20	31.20	-	-	-	-	-	-	-	31.20	31.20
UK/Malawi Prog. Aid - DFID/Irish	-	-	-	-	-	7.59	7.59	7.59	-	-	-	-	-	31.80	31.80	39.39	39.39
Norwegian BOP/Debt Service Aid	-	-	-	-	-	-	5.44	5.44	-	-	-	5.90	-	-	-	5.90	11.34
Germany (KfW)	-	-	-	-	-	-	-	-	-	7.10	7.10	-	-	-	-	-	7.10
HIPC Debt Relief & IMF (MDRI)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Balance of Payments Loans (excl. IMF)	-	-	-	-	-	-	7.25	7.25	-	-	-	-	-	-	-	-	7.25
African Development Bank (AfDB)	-	-	-	-	-	-	7.25	7.25	-	-	-	-	-	-	-	-	7.25
African Development Fund (ADF)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
International Devt. Association (IDA)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
DPL	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Republic of China (ROC)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
International Monetary Fund (IMF)	-	-	-	-	-	-	-	-	-	15.30	15.30	-	-	10.60	10.60	25.90	25.90
PRGF/ESAF	-	-	-	-	-	-	-	-	-	15.30	15.30	-	-	10.60	10.60	25.90	25.90
SDR Allocations	-	-	-	-	-	-	-	-	-	81.00	-	-	-	-	-	-	81.00
Total Project Funds	6.31	8.24	8.01	22.56	17.52	7.73	38.17	63.42	15.56	11.60	33.57	2.90	2.90	17.20	23.00	142.56	142.56
of which: Misc. Project Funds	6.31	8.24	8.01	22.56	6.05	7.73	5.16	18.94	15.56	2.90	21.36	2.90	2.90	2.90	8.70	71.56	71.56
food aid	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Norwegian food aid	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
NAC funds	-	-	-	-	-	16.35	16.35	-	-	2.90	2.90	-	-	1.10	1.10	20.35	20.35
Health Swaps	-	-	-	11.47	-	16.66	28.13	-	3.51	5.80	9.31	-	-	13.20	13.20	50.64	50.64
EU Food Security/AfDB and Irish	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Bridge loan/Other loans swaps	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>USES OF FOREIGN EXCHANGE</b>	<b>77.71</b>	<b>65.24</b>	<b>68.29</b>	<b>211.24</b>	<b>34.54</b>	<b>117.20</b>	<b>127.09</b>	<b>288.83</b>	<b>105.63</b>	<b>117.00</b>	<b>183.41</b>	<b>33.21</b>	<b>31.02</b>	<b>48.52</b>	<b>112.75</b>	<b>766.22</b>	<b>766.22</b>
Sales of Foreign Exchange	63.74	61.64	46.49	171.87	30.85	104.96	121.23	257.04	89.35	20.82	121.97	25.52	26.42	31.32	63.26	634.14	634.14
Reserve Bank of Malawi Operations	6.34	0.29	5.54	12.17	1.00	3.47	5.28	9.75	10.93	6.28	17.21	-	-	6.28	6.28	45.41	45.41
<b>GOVT PAYMENTS</b>	<b>7.63</b>	<b>3.31</b>	<b>16.26</b>	<b>27.20</b>	<b>2.69</b>	<b>8.77</b>	<b>10.58</b>	<b>22.04</b>	<b>5.35</b>	<b>4.88</b>	<b>14.23</b>	<b>7.69</b>	<b>4.60</b>	<b>10.92</b>	<b>23.21</b>	<b>86.68</b>	<b>86.68</b>
1.0 Embassy Remittances	3.30	1.13	1.28	5.71	0.86	1.20	6.03	8.09	4.06	0.94	5.50	2.35	0.80	3.96	7.11	26.41	26.41
2.0 Old Maize	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3.0 Fertiliser	-	-	-	-	-	3.00	3.00	-	-	-	-	-	-	-	-	3.00	3.00
4.0 Other Govt Payments (incl. LCs)	1.62	1.80	14.89	18.31	1.41	4.44	2.83	8.68	1.14	3.00	7.14	3.00	3.00	3.00	9.00	43.13	43.13
Of which Govt Letters of Credit	0.67	0.04	0.13	0.84	0.16	0.35	0.85	1.36	0.01	-	0.01	-	-	-	-	2.21	2.21
Health SWAP & NAC Payments	-	-	-	-	-	0.06	0.02	0.08	-	1.50	3.00	1.50	1.50	1.50	4.50	7.58	7.58
Army comm facility repayments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other govt uncategoryed payment	0.95	1.76	14.76	17.47	1.25	4.03	1.96	7.24	1.13	1.50	4.13	1.50	1.50	1.50	4.50	33.34	33.34
5.0 Debt Service incl. HIPC	2.71	0.38	0.09	3.18	0.42	0.13	1.72	2.27	0.15	0.94	1.89	2.34	0.80	3.96	7.10	14.14	14.14
Principal (Central Gov.)	2.02	-	-	2.02	-	-	1.06	1.06	0.15	0.53	0.89	1.22	0.56	2.07	3.85	7.82	7.82
Interest (Central Gov.)	0.67	0.38	0.09	1.14	0.42	0.13	0.15	0.70	-	0.28	0.57	1.12	0.24	1.87	3.23	5.64	5.64
Other (penalty/commissions)	0.02	-	-	-	-	-	0.51	0.51	-	-	-	-	-	-	-	0.51	0.51
IMF	-	-	-	-	-	-	-	-	-	0.13	0.13	-	-	-	0.02	0.15	0.15
Principal	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest	-	-	-	-	-	-	-	-	-	0.13	0.13	-	-	-	0.02	0.15	0.15
Other (Parastatals debt Service via RBM)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Revaluation losses/profits	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>ESTIMATED GROSS RESERVES (eop)</b>	<b>165.05</b>	<b>113.69</b>	<b>74.57</b>	<b>74.57</b>	<b>96.36</b>	<b>105.23</b>	<b>120.46</b>	<b>130.46</b>	<b>116.41</b>	<b>215.64</b>	<b>215.64</b>	<b>191.33</b>	<b>163.31</b>	<b>174.49</b>	<b>174.49</b>	<b>174.49</b>	<b>174.49</b>
Errors & Omissions	- 0.74	- 0.22	0.63	0.63	0.96	0.59	- 0.35	- 0.35	- 1.25	-	-	-	-	-	-	-	-
<b>ACTUAL/TARGET GROSS RESERVES</b>	<b>164.31</b>	<b>113.47</b>	<b>75.20</b>	<b>75.20</b>	<b>97.32</b>	<b>105.82</b>	<b>120.11</b>	<b>130.11</b>	<b>115.16</b>	<b>215.64</b>	<b>215.64</b>	<b>191.33</b>	<b>163.31</b>	<b>174.49</b>	<b>174.49</b>	<b>174.49</b>	<b>174.49</b>
End-period MK/US\$ exchange rates	140.60	140.60	140.61	140.61	140.61	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60
Period average MK/US\$ exchange rates	140.58	140.60	140.61	140.61	140.61	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60	140.60

Source: Reserve Bank of Malawi, 2009



## Annex 6: List of people met

<b>Name</b>	<b>Position</b>	<b>Organisation</b>
Manu Manthri	Economic Adviser	DFID Malawi
Dr. Jason Lane	Team Leader - Human Development	DFID Malawi
Christopher Maulidi Phiri	Deputy Programme Manager, Growth, Agriculture and Social Protection	DFID Malawi
Gwen Hines	Head of Office	DFID Malawi
David Woolnough	Team Leader - Growth	DFID Malawi
Charlotte Duncan	Team Leader - Governance	DFID Malawi
Chance Mwabutwa	Development Economist Economic and Public Affairs	Delegation of the European Commission to the Republic of Malawi
A.Maitland Macfarlan	Resident Representative	IMF Malawi
Dr. Florian Lang	Macro-Economic Advisory Services	GTZ
Samson Kwalingana	Research Assistant	World Bank
Young Kim	Senior Economist	World Bank
Maitland MacFarlan	Resident Representative	IMF
Fenwick Kamanga	Governance Adviser	AfDB
Martha Phiri	Economist	AfDB
Britt Hilde Kjolas	First Secretary Country Economist	Royal Norwegian Embassy
Francis Haiya	Head of Audit	Roads Fund Administration
Alex Makhwatha	Head of Finance	Roads Fund Administration
Heatherwick Njati	Deputy Budget Director	Ministry of Finance
Gerald Manthalu	Economist	Planning Division, Ministry of Health
Bryn Welham	Value for money and budget adviser	Ministry of Finance

## Annex 7: Summary of matters arising during fieldwork mission and proposed ODI actions

Ref.	Summary of Comment	Origin of Comment	Potential Implications for Scope of Work	Proposed Response/Action by ODI
1.	The selected 'counterfactuals' may not in fact be the most probable alternatives to General Budget Support, especially if the proposed 'switch' from GBS is immediate and the funds planned for GBS allocation in FY 09/10 must be absorbed entirely and exclusively by the specified alternative. Notwithstanding concerns about absorption of in-year increases to the health SWAp, the two counterfactual options should be: (i) programme support to the health SWAp following the modality for existing funds, and (ii) project support to the water sector through the existing WB/ADB project mechanisms.	DFID Malawi	Substitution in the options appraisal model of projectised water sector support for additional funding to Malawi Unpaved Roads Project (MURP).	We will revise the options analysis and supporting model to incorporate the health SWAp and financing for the Malawi water/irrigation programme as counterfactuals.
2.	Rigorous categorisation and calculation of priority versus non-priority areas of spending would be necessary to improve the robustness of the cost-benefit analysis in the options appraisal.	ODI	<p>Accurate modelling and estimation of the expected influence of GBS on the allocation of government spending to priority versus non-priority areas requires definition of what constitutes priority spending and then as detailed mapping of those priorities to administrative, economic and functional/programme breakdowns of the budget (and to MGDS 'themes' and 'priority areas').</p> <p>There are significant data limitations, covering three areas: (i) the programme classification of the budget was developed for the first time in FY 09/10 so there is no historical time series; (ii) there is no clear mapping of the</p>	<p>In view of the difficulty of mapping priority spending into the functional classification of the budget, we propose to treat preventive primary-level health services (including health SWAp expenditures) and water/irrigation expenditures (as guided by the National Water Development Plan) as a 'proxy' for priority areas of spending in those two sectors.</p> <p>It would be very time-consuming to undertake detailed data work from first principles in order to construct a robust intra-sectoral breakdown of priority/non-priority spending. Given the difficulties in estimating empirically the present and historical influence of GBS on GoM spending allocations and the absence of an</p>

Ref.	Summary of Comment	Origin of Comment	Potential Implications for Scope of Work	Proposed Response/Action by ODI
			functional/programme classification to a detailed administrative breakdown; and (iii) there are no reliable analyses of how historical budget data maps to MGDS themes/priorities or to the MGDS costing.	agreed definition/classification of 'priority' expenditure, it does not seem worthwhile investing substantial staff time to calculate specific estimates of priority/non-priority spending.  We do not envisage/recommend a more detailed disaggregation of the budget to further refine estimates of priority and discretionary spending since this is unlikely to be fruitful and would not shed light on a potentially more important area of uncertainty viz: CABS influence on key parameters.
3.	Rigorous categorisation and calculation of discretionary versus non-discretionary areas of spending would be necessary to improve the robustness of the cost-benefit analysis in the options appraisal.	ODI	For the appraisal time period of one year, some basic assumptions can be made from international experience about what constitutes discretionary/non-discretionary spending. Thus, salaries, debt interest and foreign-financed spending capital and non-discretionary in the short term, whereas operations & maintenance and domestic capital spending are discretionary. However, beyond these basic principles, there are specific items in the GoM budget which are categorised as statutory expenditure and others which are de facto non-discretionary for reasons of political economy. It is more difficult to estimate those items without detailed quantitative and qualitative research.  A further challenge is the mapping of discretionary/non-discretionary to priority/non-priority items, which would require quite extensive work to produce a comprehensive and reliable analysis.	We propose to carry out some further analysis of salaries, interest costs and foreign financed expenditure (by broadly defined sector), to be treated as non-discretionary items in order that traction in the models focuses on particular parts of budget. However, we do not propose to attempt a full mapping between the two breakdowns, beyond a simple reliance on the mapping of programme/sub-programmes to broad economic categories in the 2009/10 budget.  We do not envisage/recommend a more detailed disaggregation of the budget to further refine estimates of priority and discretionary spending since this is unlikely to be fruitful and would not shed light on a potentially more important area of uncertainty viz: CABS influence on key parameters.
4.	The scale of budgetary (re)allocations	DFID	Any matching funds requirement would need	In view of expected absorptive constraints,

Ref.	Summary of Comment	Origin of Comment	Potential Implications for Scope of Work	Proposed Response/Action by ODI
	implied by the matching funds requirement for switching to the health SWAp or roads project are unrealistic given the short-term limitations to GoM discretion and the absorptive capacity of the MURP.		to be adjusted in the model to reflect discretion/absorptive capacity or otherwise spread over a longer time period.	especially within the limited timescale of the current Malawi financial year, we propose to abandon attempts to analyse the effects of GoM matching spending on grounds that rapid switching of GoM spending on a significant scale is unrealistic.
5.	Despite the emphasis on modelling and estimating the quantifiable effects of general budget support, especially on spending allocations to priority areas, it is likely that rigorous quantification will not be possible against most presumed cause-and-effect relationships. It will be equally important therefore to focus on non-quantifiable costs and benefits, and to supplement the formal modelling of effects with a more qualitative assessment of the consequences of a switch from GBS.	ODI; Andrew Lawson	The report produced for the economic analysis component of the options appraisal should strike an appropriate balance between monetisation of cost/benefits streams and more qualitative description.	The report will include a discussion of the influence of CABS on the PAF, budget allocations and leakages, and will comment on the coverage and quality of relevant data. For the purpose of modelling, we will test the effect of a plausible range of 'what if' assumptions and report results in terms of broad orders of magnitude, directions of change and 'break even' positions - as distinct from providing actual values.  However, the impact on domestic interest payments will be quantified in more precise terms.
6.	The model only addresses transactions costs for donors. It excludes effects on GoM transactions costs by assuming the three selected options to imply identical levels of transactions costs. That may not be accurate.	CABS donors	The model would need to be altered to allow for differences in GoM transactions costs. Estimating the scale of those effects would require further consultation of with CABS donors and possibly with government.	We will include a brief, though limited, discussion of how alternative options may influence transaction costs for GoM drawing on but limited by existing documentation.
7.	Current modelling of DFID transaction costs in terms of staff time understates the importance of that variable and also assumes the absence of supply-side constraints. In practice, DFID staff inputs are more influential than is implied by the reduction in full employment costs by switching modalities. However, those inputs cannot be readily scaled up	DFID Malawi	The transactions costs dimension related to DFID staff time would need to be weighted to strengthen its influence in the model. However, the question of weighting is also a broader methodological issue for model and selective treatment of specific variables would not be advisable. Judgements will also be required about the weighting to be applied to	We propose to investigate the feasibility of introducing a simple weighting system for the various effects before determining a course of action.  We use consultancy fee rates as a proxy for DFID staff time.

Ref.	Summary of Comment	Origin of Comment	Potential Implications for Scope of Work	Proposed Response/Action by ODI
	because of limits on administration costs as a proportion of DFID programme spending.		each variable. Cost estimates for changes in DFID staff inputs as a consequence of switching between options should be calculated using consultancy fee rates.	
8.	It will be helpful to have a version of the model which allows substitution of different options (or counterfactuals) and adjustment of the different choice variations/parameters (incl. weightings attached to different effects). In that way, DFID Malawi could use the model to inform programming discussions and to consider the merits of alternative uses of country programme funds beyond the GBS appraisal.	DFID Malawi	It is likely that the model will allow substitution of the options to be appraised, although it will be constrained to single mutually-exclusive alternatives. It will not be capable of dealing with composite counterfactuals comprising a mixture of interventions within the same funding allocation. The spreadsheets will be set up so that all 'choice variables' can be altered.  Some attempt could be made to introduce the assignment of different weighting to the cause-and-effect relationships, but it would only be a simple mechanism based on an additional set of choice variables (i.e. user judgements on variable weighting).	The model will be provided in user-friendly form to allow DFID Malawi/CABS to test out the consequences of different judgements. This could include options for attaching different weights to different broad areas of expenditure. (See below 33).
9.	The model only presents single-year effects of the possible switch from budget support, but many of the presumed benefits of GBS are expected to accrue over the medium/long-term time period. Could those dynamic effects be modelled?	DFID Malawi	A multi-year version of the model could be developed, but it would complicate the analysis and would need to make assumptions about future rounds of DFID support (to GBS or alternatives) and to the lagged effects on behaviour of other CABS donors. A judgement will be required about whether the quantification of costs/benefits is sufficiently robust to warrant the investment of time in development of a dynamic model.	Developing a multi-year version of the model risks adding additional complexity without actually adding additional insight, and is not recommended for the study at this stage.
10.	Two tracks do not seem to be explored in detail in the current version of the model (or in fact in the Rwanda appraisal): (i)	Andrew Lawson	The stronger incorporation and modelling of domestic borrowing for budget financing purposes could be introduced into the model	We will attempt best estimates – going beyond the scope of the model – of the impact of changes in domestic borrowing on private

Ref.	Summary of Comment	Origin of Comment	Potential Implications for Scope of Work	Proposed Response/Action by ODI
	contribution of budget support to reduced costs of budget financing, esp. if predictable and if disbursed early in financial year; and (ii) effects of GBS on private sector confidence and likely consequences for FDI and private investment if GBS were discontinued. These effects could be developed further.		and evidence on likely effects drawn from previous episodes of delayed disbursement or withdrawal. Modelling the effects on private sector confidence would be more complicated and more qualitative. It would take the analysis 'beyond the dotted line' by addressing outcomes/impacts rather than just 'induced outputs'. Questions of attribution would become more complicated.	investment and economic growth in Malawi, based on available data from the IMF/ W-Bank / ADB reports. We will include a brief assessment of the impact of alternative options in terms of impact on Malawi's foreign reserves in the context of the IMF programme.
11.	This type of analysis could be used more broadly by the DFID country team to inform discussions and decision-making on the portfolio of projects/programmes. Allied to lessons and analysis which are specific to Malawi, more general points could usefully be captured for feeding into DFID corporate thinking on budget support appraisal.	DFID Malawi; Chris Collinson	As a complementary piece to the options appraisal, there is clear scope to prepare annexes on lesson learning specific to Malawi and on more general issues.	We could provide a section on broader lessons learnt from this (type of) analysis, including discussion of treatment of counterfactuals, issues surrounding integration of institutional and political analysis in a comprehensive 'options analysis', and use of the approach as a tool for identifying and exploring key assumptions (helping think through issues) when selecting among aid instruments.
12.	It would be useful to include a 'no aid' option in the analysis to reflect a scenario in which DFID might discontinue GBS and reduce the Malawi programme by the same amount (i.e. not reallocate the GBS provision to other instruments).	DFID Malawi	Fundamental redesign/development of the model would be needed, including an assessment of the appropriate size of the DFID Malawi programme. That would be tantamount to asking what the marginal costs/benefits of each £1 of GBS are.	It will not be feasible to address this issue fully for the current appraisal exercise. However, some limited discussion will be included in the report.
13.	Particular emphasis in the draft model is placed on the extent of leakages and the contribution of GBS to reducing them. However it is very difficult to measure 'leakages' and previous efforts in 2008 by DFID Malawi were unsuccessful. Estimation of those effects as part of the options appraisal may not be a realistic	CABS donors	Judgement is required about whether to include in the model and the formal estimation analysis those factors which cannot be quantified with reasonable confidence or certainty (given the informational and data constraints in Malawi). A large amount of data intensive work would be required to assess the existing and historical levels of operational	In the absence of robust data, strong caveats will be included in the report and discussion will cover the types of data which would be required to strengthen the analysis. Rather than omit this variable from the model we propose to include along with it cautionary notes and guidance on the types of evidence that should support any estimation by DFID.

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	aim. (n.b. Since CABS donors partly justify their GBS programmes on this premise, it will be a point of interest beyond DFID.)		inefficiency and resource misuse, and to estimate rigorously the contribution which GBS may have made to any reductions as a result of dialogue, conditions, technical assistance and capacity building.	
14.	Estimating the influence of the GBS package on spending allocations by the Government of Malawi is an important input requirement for the model. However, there are difficulties of evidence, measurement and attribution with this 'choice variable'. Rather than attempting to assess historical influence and to estimate future influence across the budget, it may be more feasible and more appropriate to measure influence based on achievement/non-achievement of PAF conditions which address spending allocations.	CABS donors	Judgement is required about whether to include in the model and the formal estimation analysis those factors which cannot be quantified with reasonable confidence or certainty (given the informational and data constraints in Malawi).	In the absence of robust data, strong caveats will be included in the report and discussion will cover the types of data which would be required to strengthen the analysis. Rather than omit this variable from the model we propose to include along with it cautionary notes and guidance on the types of evidence that should support any estimation by DFID.
15.	Notwithstanding the focus in the model on GBS/CABS influence upon GoM spending allocations and the centrality of that factor as a justification for GBS, there is limited evidence that the effect is significant. What evidence does exist is largely qualitative and anecdotal. That calls into question the attempts at quantification in the model (as opposed to treatment of the 'influence on spending' factor in more qualitative terms).	CABS donors	See above (14)	See above (14)
16.	The logic model for GBS presented diagrammatically includes the effects of	CABS donors	Quantitative assessment of the effects of GBS inputs upon pro-poor policies and in turn upon	Since these effects relate to Levels 4 and 5 of the framework and present problems of

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	the GBS package on pro-poor policies, but the spreadsheet model omits estimation or quantification of these effects. This factor is an important part of the justification for GBS and should not be excluded from the appraisal analysis of costs/benefits of switching from GBS.		economic growth would require a more sophisticated model than is feasible within the parameters of this work.	attribution, we propose not to attempt quantification in the model, but rather to discuss the issue in the narrative report sections.
17.	There are harmonisation benefits arising from DFID GBS which would be lost if DFID were to switch modalities. The CABS group is quite small and the influence of DFID within it is instrumental. CABS influence on GoM would diminish disproportionately if DFID withdrew and the harmonisation of donor efforts might also be reduced. Costs such as these should be captured in the model.	CABS donors	Benefits such as the strategic role of DFID cannot readily be captured in the existing quantitative model. The costs to donor harmonisation and collective influencing of GoM would require a different sort of metric than the one used for the existing version of the model.	It is proposed that these costs/benefits should be addressed as part of the narrative report on un-quantified effects.
18.	DFID plays a strategic role within the CABS group and its withdrawal from budget support might make it difficult for other donors to continue providing budget support. Those consequential, second-round effects are not addressed in the model.	CABS donors; DFID Malawi	There would be two options for modelling purposes: either (i) it could be assumed that certain donors withdrew their GBS inputs simultaneously with DFID; or (ii) a multi-year scenario could be modelling in which certain other donors withdrew in the following year (i.e. a lagged effect).	In the interests of simplicity, it is assumed that – given the prior assumption of a stable policy environment – other donors would not quit GBS in response to a withdrawal by DFID. From discussions with CABS donors it was not possible to establish a clear or definitive position on their response to a DFID withdrawal without further modelling of the exogenous shocks which might have precipitated the DFID withdrawal.
19.	Both the Rwanda appraisal and the Malawi analysis emphasise as primary factors the influence of GBS donors on improvements in PFM systems and in allocative efficiency. However, neither of these effects has been demonstrated	Andrew Lawson	Removing these factors from the model would leave only a residual coverage factors in the core appraisal analysis and would offer diminished distinction between the standard DFID GBS appraisals and the strengthened appraisal approach now being promoted by	Since all CABS donors (incl. DFID) do in practice cite these factors as key justifications for approval of their budget support programmes, it is useful to include a presumption that the beneficial effects may be quantified and to invite users of the model to



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	empirically by the various evaluations of GBS. They should not be given exclusive or disproportionate attention in the Malawi appraisal.		DFID.	input their own estimates of costs/benefits across the options (with evidence explicitly referenced). That approach has the merit of revealing hidden assumptions and eliciting evidence in support of the asserted influence.
20.	The greatest benefit of the appraisal should be the identification of important variables which, if maximised, would be expected to enhance the impact of GBS. The result might be a set of recommended design modifications focused on issues of predictability and transparency.	Andrew Lawson	This aspect could be addressed through a supplementary section or annex in the report and would be likely to add value to the scope of work.	We propose to include a section in the report on potential design modifications to GBS in Malawi. It would be informed by the analysis from Rwanda, although it may not push as far as the basic multi-criteria analysis applied in that case.
21.	The appraisal report should offer some discussion or commentary on the confidence level associated with the findings against each causal track. It may be expected that the 'results' for transactions costs, domestic financing and private investment will be more robust than those for other effects.	Andrew Lawson	It is a logical modification to the scope of work.	It will be covered as part of the narrative report sections.
22.	One area not addressed by the draft analysis is that of domestic accountability. Measures of openness or extent of published fiscal information (e.g. PEFA PI-10) could serve as a proxy.	Andrew Lawson	It may be too ambitious to address this type of qualitative and non-financial issue separately in the economic appraisal.	It could be covered by institutional appraisal, and referenced in the narrative sections of the economic appraisal. Discussion will be included as part of the lessons learnt.
23.	Absorptive capacity is a particular issue since there may be practical constraints to switching between GBS and sector instruments. For the Rwanda appraisal, a simplifying assumption was made that 'surplus' funds would be used to support development of the absorptive capacity of	DFID Malawi; Chris Collinson		Discussion will be included as part of the lessons learnt.

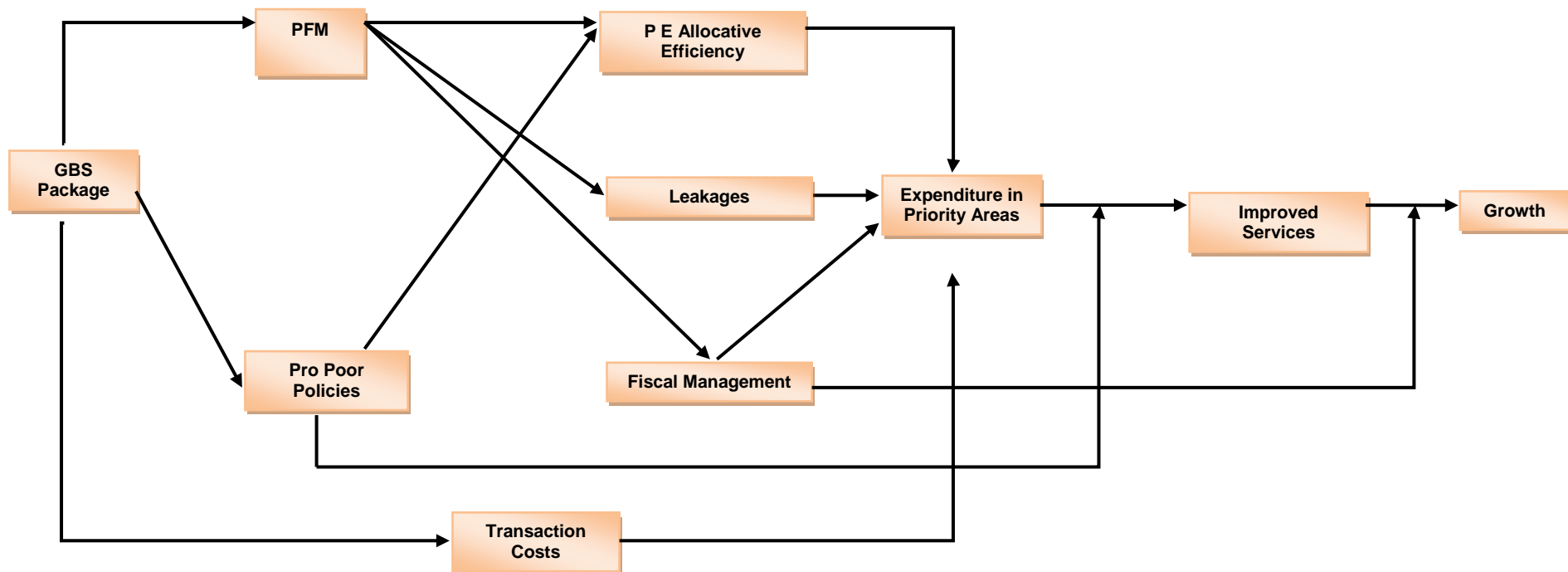
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	the sector. It is not clear in the Malawi analysis how the issue is dealt with.			
24.	The selection of options for the appraisal neglects governance type-interventions, which are important but which do not fit readily into the framework of mutually-exclusive counterfactuals. It would be unfortunate if the model established a bias against such interventions.	DFID Malawi	It was a necessarily simplification to select three mutually-exclusive options, each of which could absorb £22m in entirety in a single-year period. However, governance-type interventions could fall under some of the non-financial GBS inputs such as dialogue, technical assistance and capacity building.	Discussion will be included as part of the lessons learnt.
25.	The model does not attempt to estimate effects on outcomes or impacts arising from a discontinuation of GBS. All DFID assistance has to justify itself against contribution to poverty reduction and/or economic development so it is not clear why the GBS appraisal should stop short of estimating those effects.	DFID Malawi	It would be too complicated to address this issue as part of the current appraisal.	Discussion will be included as part of the lessons learnt.
26.	The big challenge for this work will be the communication of findings to DFID top management. It may be unwise to include specific monetary values in the appraisal report unless they are supported by robust methodology and data/evidence. A possible alternative approach would be to devise a format which showed the direction and relative scale of effect without actually offering quantification.	Chris Collinson; Duncan Overfield; DFID Malawi		
27.	By focusing only on those effects which can be quantified, the analysis risks being partial and incomplete. It will be important to say something about the non-quantifiable benefits and costs of	Chris Collinson; DFID Malawi		

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	switching from GBS. Some of the most interesting costs/benefits are likely to be those which cannot readily be measured.			
28.	The analysis avoids attention to political economy issues and to the differences between formal and informal policy processes and budgeting processes. The options appraisal should not be a purely technocratic assessment of technocratic issues.	DFID Malawi		Discussion will be included as part of the lessons learnt.
29.	It is not realistic to assume, as the model does, that all appraised options will have a corresponding effect on poverty reduction. Not all expenditure will be equally pro-poor.	DFID Malawi		Discussion will be included as part of the lessons learnt.
30.	The analysis does not address the question of why and whether GBS should be set at £22m (or £25m).	DFID Malawi		Discussion will be included as part of the lessons learnt.
31.	It would be helpful to include in the appraisal more explicit references to the evidence used to estimate each of the choice variables and to provide a commentary on the assessed robustness of that evidence.	DFID Malawi		
32.	If possible, it would be a valuable advance on the Rwanda appraisal to use some form of Multi-Criteria Analysis to incorporate effects which cannot readily be estimated and modelled through monetary values.	Chris Collinson		Discussion will be included as part of the lessons learnt.
33.	Not all effects should be assigned equal	DFID Malawi		

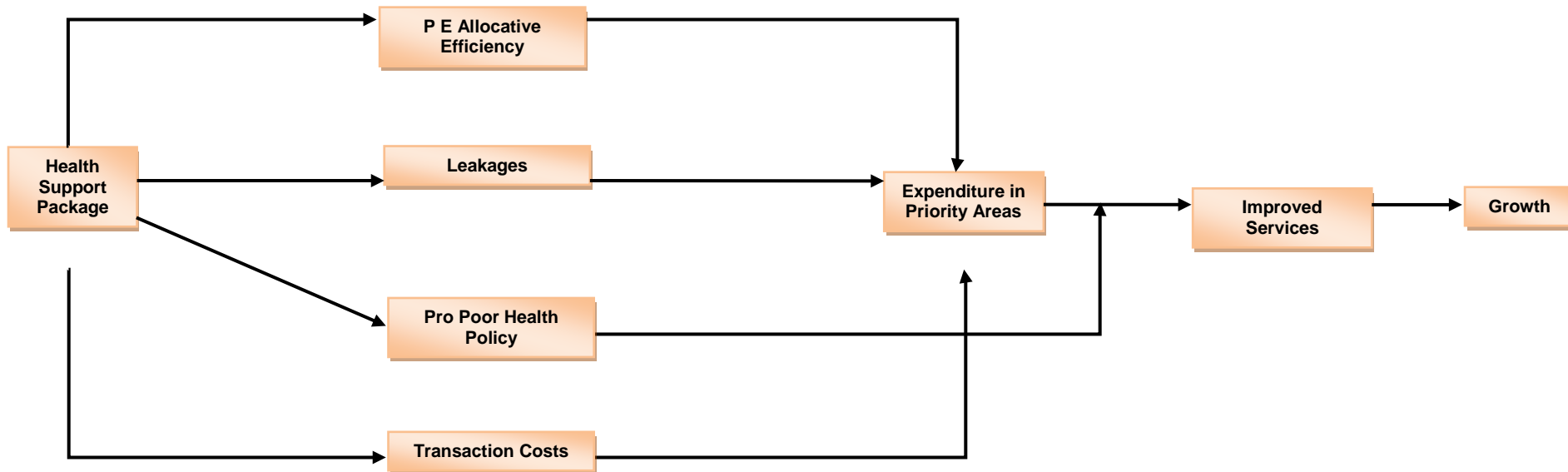
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	weighting in the model. The methodology should permit differential weighting which would allow DFID adjust the relative emphasis it places upon each variable.			

## Annex 8: Stylised Cost-Benefit Effects of Quitting GBS



## Annex 9: Stylised Cost-Benefit Effects of Switching to Health Support Package



## Annex 10: Stylised Cost-Benefit Effects of Switching to a Water Project

