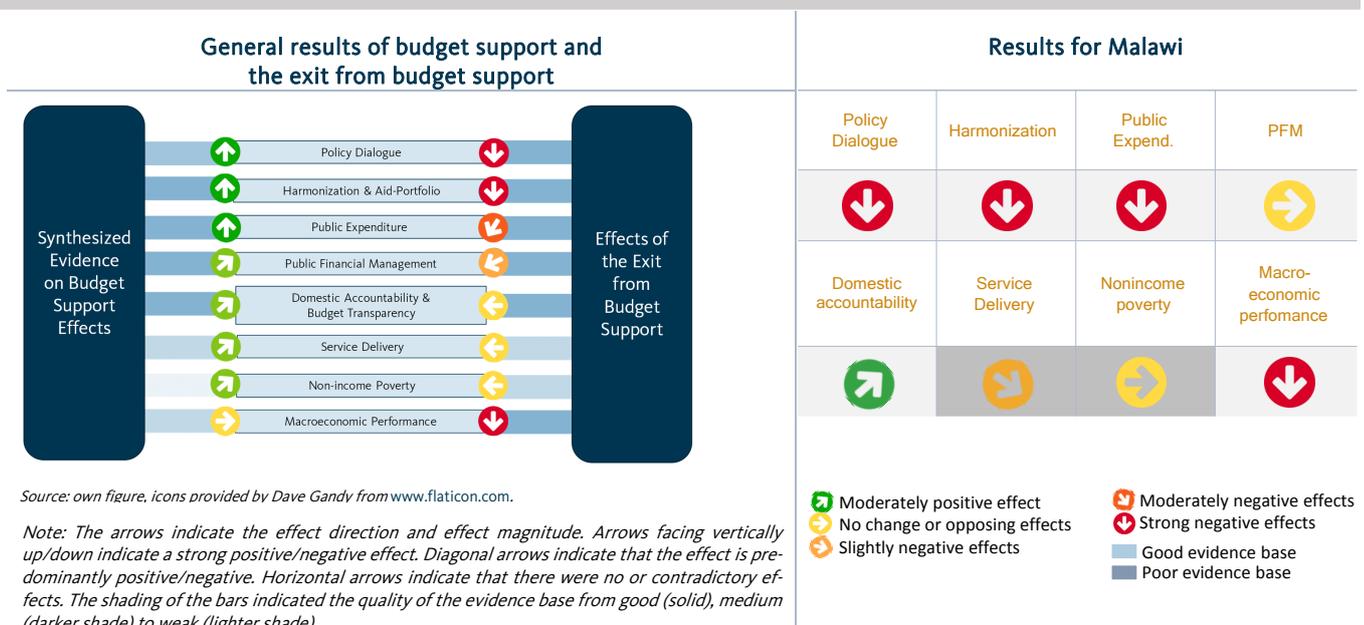


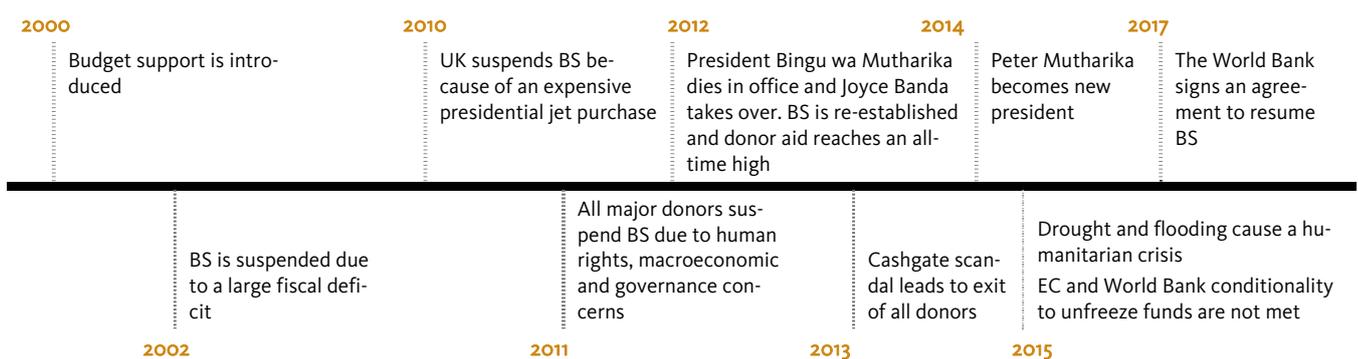
THE EFFECTS OF THE EXIT FROM BUDGET SUPPORT IN MALAWI

This 'country sheet' is a summary of findings on Malawi from the evaluation on the future of integrated policy-based development: lessons from the exit from general budget support (GBS). The larger evaluation analyses the exit from GBS in the country cases of Malawi, Rwanda, Uganda and Zambia, and compares the effects observed post-exit to effects during the budget support (BS) period examined in previous evaluations and lately corroborated in DEval's evaluation synthesis on the effectiveness of BS (Orth et al., 2017).

Evaluations across many countries during the GBS period found mostly positive effects (see figure below). These positive effects stand in contrast to the negative developments found after exit. The effects for Malawi are mostly negative too (see right part of figure below). Policy dialogue, harmonization, fragmentation, public expenditure and macroeconomic performance deteriorated after the exit. Domestic accountability and budget transparency and public financial management (PFM) are exceptions as they continued to improve after the exit.



Budget support (BS) was introduced in Malawi in 2000 and was suspended three times before the actual exit occurred in 2013, which was a reaction to macroeconomic and human rights concerns. The first suspension occurred in 2001/02 as the government's fiscal deficit exceeded the limit defined by the BS performance indicators. In 2010, the UK suspended part of its BS payments to protest against the purchase of a luxurious presidential jet for £8 million by the Malawian government. Germany reprogrammed parts of its BS in the same year in reaction to a deterioration of press freedom and minority rights. The latest suspension of 2011 was lifted after the surprising death of President Mutharika in 2012 and the election of the opposition party candidate, Joyce Banda, as new president (Molenaers et al., 2016). Budget support and aid in general reached a new high



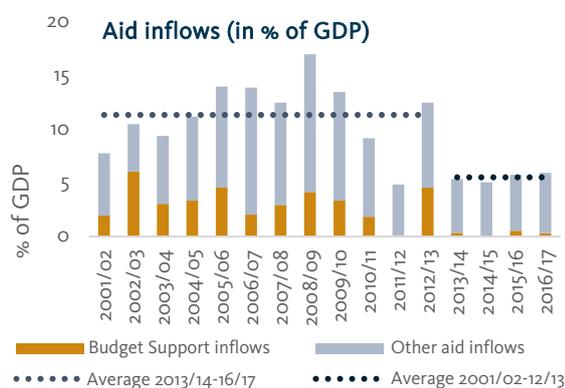
Source: own figure.

in that year, but came to a sudden halt with the Cashgate scandal (a large and systematic misappropriation of public funds). It not only exposed the profound deficiencies of Malawi's PFM system, but also shook donors' trust in their cooperation with Malawi. This determined Norway, the EC and the AfDB to suspend BS in the fall of 2013, the UK to withhold part of its sectoral BS (SBS) in the health sector, and Germany to postpone its negotiations with the Malawian government about reinstating budget support (Molenaers et al., 2016).

At the time of the exit, more than 15% of Malawi's budget was financed through GBS. Hence, it was evident that the suspension or withdrawal of BS would have massive negative repercussions on the Malawian economy. Malawi received almost USD 1 billion in GBS between 2000 and 2013, and USD 500 million in SBS. The largest shares came from the World Bank, EC and the UK.

In 2017, the World Bank re-launched GBS in Malawi after the IMF signalled their return to the country. The support is conditional to reforms in the agricultural and PFM sectors. It appears that bilateral donor BS is very unlikely to resume in the near future regardless of policy changes in Malawi, so that it will remain an option only for multilateral donors.

Changes in aid portfolio, policy dialogue and harmonization



Since the exit from GBS in 2013, the level of donor support to the Government of Malawi (GoM) declined compared to the GBS period (2000–13). The figure to the left shows that the total amount of aid received by the GoM after the exit is significantly lower than it used to be between 2005 and 2010. However, the overall ODA support to Malawi declined only very moderately, and in 2016 reached levels similar to those before the exit. This demonstrates that the donors' portfolio is predominantly off-budget because ODA remains high but is no longer registered as inflow.

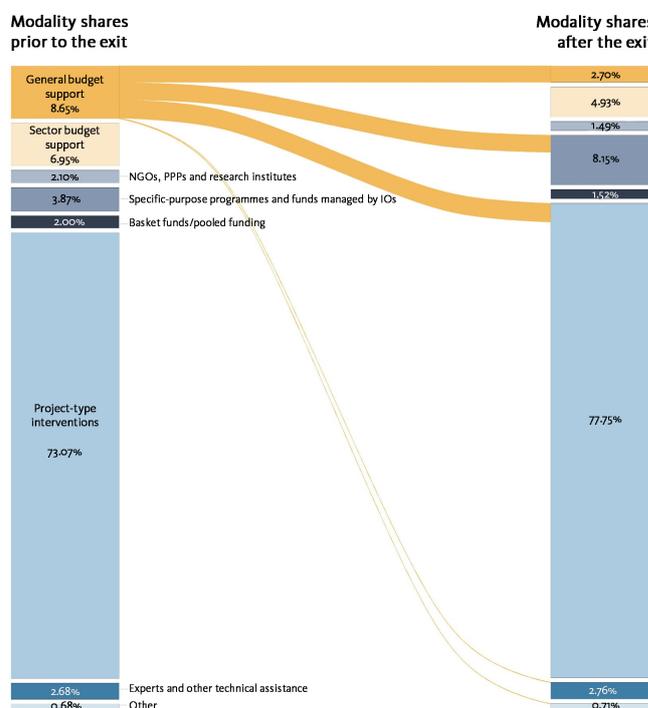
The aid portfolio became more fragmented after the exit and harmonization decreased consequently. The donors' portfolio ap-

pears more fragmented, because with the exit from budget support, mostly off-budget project support gained in importance and only in some sectors pooled funding. Sector-wide approaches are still in place in the health and education sectors but have disappeared in others.

Such an individualized approach generally impedes harmonization and ownership. Even in the assessment of the possible return to budget support, fragmentation was visible. In 2015, the EC and World Bank together developed a policy matrix, based on which both organizations evaluated the possibility of a return to budget support. One year later, the two donors shifted to different performance matrices, with the World Bank returning to GBS. Pooling arrangements, such as basket funding or SBS, were introduced after the exit in the health and education sectors in an effort to compensate for the lack of service delivery and to maintain harmonization among donors.

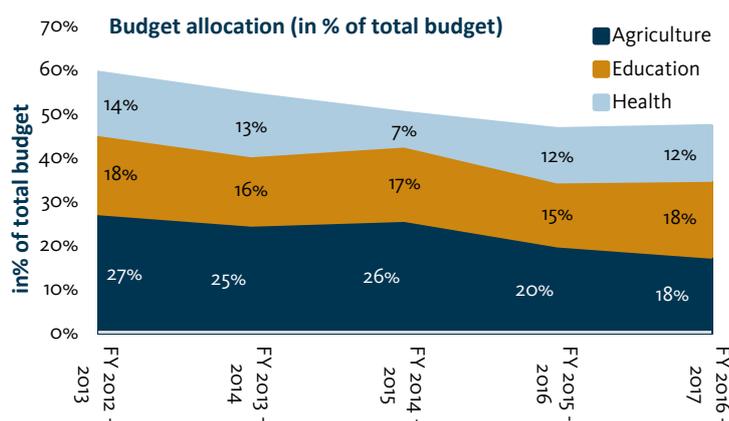
With the exit from budget support, the dialogue structure in Malawi collapsed and was only partially re-established in 2015. The quality of the re-established dialogue has never reached that of the dialogue under budget support. In 2013, going hand in hand with the exit from budget support, the high-level policy dialogue stopped. The dialogue on PFM continued after a short break due to internal and external pressure. The Cashgate scandal had demonstrated the need to reform the PFM system, which created internal reform pressure. The reform pressure was amplified by the constant push for dialogue from the donors. The quality of discussions on PFM decreased compared to budget support times according to statements from donors and partners. It appears that the lack of high-level dialogue caused this decline in quality. The dialogue in sector working groups that still exist in some sectors was not sufficient to compensate the dialogue loss at a higher political level.

Shares of aid modalities before and after the exit



Source: own figure, based on OECD Creditor Reporting System

Public expenditure



Source: own figure, based on GoM data

The exit from budget support caused a decline in public expenditure. The budget allocations for health, education and agriculture declined in absolute terms (measured in percentage of GDP) and their relative share in the total budget also declined. This means these sectors were over-proportionally affected by the budget support exit.

The decline after the exit stands in contrast to the increase during the GBS period, which several sources confirmed. The evaluation synthesis found that budget support had a positive effect on the composition of social public expenditure. Evidence for Malawi shows that social sector expenditure increased during the BS era, but at the same time temporary BS

suspensions did not seem to trigger adjustments in public expenditure (Claussen et al., 2006).

Public finance management

The exit from budget support created momentum for PFM reform in Malawi due to external pressure. The exit from budget support had such a strong financial impact on Malawi and once it was realized that donors would not return if things remained the same, PFM reforms were addressed. The IMF and the World Bank integrated PFM reforms into the prior actions of their credit lines so that the GoM was eager to reform the area to regain external financial support. The Cashgate scandal was at first certainly a setback for PFM reforms in Malawi, but it also highlighted the necessity to improve PFM. An increased number of budget and audit reports after the exit, and reform progress regarding bank reconciliation are indicators for the PFM reform dynamics.

During the GBS period, the instrument triggered some important changes and the literature has found positive effects of BS on PFM in Malawi. During the GBS period the financial management information system was rolled out further. Moreover, laws and regulations regarding public finance and budget management were introduced. The Cashgate scandal has shown that it was possible, despite these systems and laws, to channel funds past the IFMIS system and unveil systemic weaknesses.

Domestic accountability

Since the exit, domestic accountability has been robust in Malawi due to external and internal pressure. The effect is caused, at least partly, by the exit from budget support. The prospect of a donor return and domestic incentive stemming from pressure of civil society organizations (CSOs) to improve budget transparency and domestic accountability led to improvements in (domestic) accountability. The internal pressure is, however, mostly the consequence of the Cashgate scandal, and the exit from budget support was, at most, an additional proof for the gravity of the situation. Budget information is now provided more regularly and of better quality. In mid-2017 plans to strengthen the role of the auditor general moved forward, which demonstrates the reform progress. The domestic accountability institutions continue to conduct budget scrutiny and provide policy recommendations, yet it remains controversial how big their actual influence is.

The evaluation synthesis has shown a positive effect of BS on domestic accountability in Malawi. Donors have been particularly active in working on domestic accountability and transparency systems during the GBS period (Claussen et al., 2006).

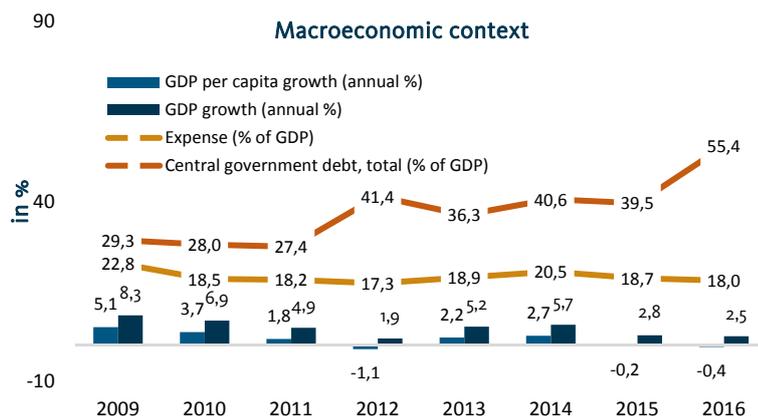
The policy dialogue structures provided a new entry-point to address accountability with partners and improved the collaboration between institutions in Malawi. The regular information exchange of the Ministry of Finance (MoFEPD) with sector ministries and the National Statistical Office was established and helped to create political space for CSOs and the media to participate and address issues of political and financial accountability.

Service delivery and non-income poverty

The evidence gathered in interviews suggests that service delivery deteriorated after the exit from GBS and had negative repercussions on the amount and quality of services delivered in the health and education sectors. The pupil-teacher ratio increased from 61 in 2010 to 66 in 2015, which implies a worsening of service delivery in the education sector. Other data on service delivery in the social sector after the exit is not available. **The decline in social sector funding and service delivery had so far no measureable impact on non-income poverty in Malawi as trends in the health and education sectors continued.** Hence, the evidence before and after the exit from GBS allows no reliable conclusion regarding the causal effect of BS on non-income poverty and service delivery.

Macroeconomic performance

The national budget was financed up to 15% by GBS. Therefore, the exit hit the country's economy particularly hard and macroeconomic indicators deteriorated afterwards. **To replace the GBS funds, the country increased its fiscal deficits and raised**



Source: World Development Indicators

the debt level. The level of central government debt increased from around 40% of GDP to over 50% of GDP in the same period. The exit from GBS led to the build-up of debt (especially domestic debt) and increasing debt service cost. **The annual domestic borrowing increased from -0.2% (in 2012/13) of GDP to 5.9% of GDP in the year of the exit (2013/14).** Consequently, the share of tax revenue required to cover debt service costs increased from 13–15% during the GBS period to 20–25% after the exit, which led to a deterioration of an already tight fiscal situation.

Interestingly the short-term repercussions on the GDP growth were less pronounced than in the other

countries. The GDP growth rate was slightly above the sub-Saharan growth average in the years of and after the exit; however, in per capita terms, GDP growth remained low and was even negative in 2015 and 2016. The large fiscal deficit pushed the GoM into high domestic borrowing, which typically has adverse effects for the exchange rate and inflation, and crowds out private borrowing.

Due to the very large share of BS in the country's budget, it is very likely that the omission of BS contributed to the macroeconomic instabilities. The findings from evaluations during GBS support this claim.

The literature found positive effects of BS on the macroeconomic performance in Malawi prior to the exit. The improvements were attributed to a combination of budget support, IMF programmes and the political commitment of the GoM to achieve macroeconomic stability. Although it is difficult to accurately assess how the macroeconomic performance would have developed if BS was still in place, it seems that in the case of Malawi the importance of BS for the budget was simply too large to not cause economic destabilization after the exit.

Based on

Orth, M., Birsan, M. and Gotz, G. (2018), *The Future of Integrated Policy-Based Development Cooperation. Lessons from the Exit from General Budget Support in Malawi, Rwanda, Uganda and Zambia*, German Institute for Development Evaluation (DEval), Bonn.

Further sources

Claussen, J. et al. (2006), *Evaluation of General Budget Support, Malawi Country Report*, IDD, Birmingham.

Molenaers, N. et al. (2016), *Dataset Budget Support Suspensions (DBSS) 1999–2014*, University of Antwerp, Institute of Development Policy and Management, Antwerp.

Orth, M. et al. (2017), *What We Know about the Effectiveness of Budget Support*. Evaluation Synthesis, German Institute for Development Evaluation (DEval), Bonn.

The German Institute for Development Evaluation (DEval) is mandated by the German Federal Ministry for Economic Cooperation and Development (BMZ) to independently analyse and assess German development interventions. Evaluation reports contribute to the transparency of development results and provide policy-makers with evidence and lessons learned, based on which they can shape and improve their development policies.