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Impact of Usaid Funding Withdrawal on Malawi's Econom

Petrina Kaipa[1], Dr Kuselar Ramasamy[2]

[1]**Master Of Business Administration In Finance And International Business, DMI-ST. Eugene University**
[2]**Associate Professor, DMI-ST. Eugene University**

ABSTRACT

Since gaining independence, Malawi has largely depended on foreign aid to support its development efforts. For example, the United States Agency for International Development (USAID) has contributed up to 40% of the country's budget. However, in 2025, USAID announced it would withdraw its financial support. This study explores what this sudden aid cut means for Malawi's economy, society, and key sectors like health and education.

Using a combination of methods, including interviews with 72 government officials, service providers, and community members, along with data from various institutions and studies, the research paints a clear picture of the short-term impacts. The results show rising inflation, a weaker currency, and many jobs being lost, especially in sectors that relied heavily on donor funds. For example, in healthcare, critical services like HIV/AIDS treatment faced interruptions, with over 3,500 health workers losing their jobs and shortages of essential medicines. The education sector also suffered, with the suspension of school feeding programs and scholarships for vulnerable students.

At the household level, many families responded by eating less and selling assets, which worsened poverty. Overall, the study highlights that Malawi's heavy reliance on foreign aid has made its economy vulnerable and exposed weaknesses in governance.

To address these challenges, the study recommends boosting domestic revenue, diversifying development partnerships, improving transparency and accountability, and supporting community resilience efforts. This research adds to the ongoing conversation about aid dependence, offering practical policy ideas to help Malawi and similar countries build a more sustainable future.

Keywords

Poverty Alleviation

Social Protection Programs Household Livelihoods Cash Transfer Schemes Sustainable Development

1 Introduction Background of the Study

Foreign aid has played a pivotal role in financing Malawi's development since independence, accounting for an average of 40% of the national budget (World Bank, 2025). Among key development partners, the United States Agency for International Development (USAID) has been instrumental in supporting Malawi's health, education, agriculture, and governance sectors. Notably, USAID financed programs such as PEPFAR for HIV/AIDS treatment, school feeding initiatives, and health workforce recruitment.

Foreign aid remains a cornerstone of development financing for many low-income countries, particularly in Sub-Saharan Africa. Malawi, with its narrow industrial base and chronic fiscal deficits, has historically relied on donor support to fund essential sectors such as health, education, and agriculture. Foreign aid has enabled the government to deliver public services that would otherwise be underfunded due to limited domestic resources.

Among Malawi's key development partners, the United States Agency for International Development (USAID) has played a transformative role in supporting national development priorities. Since the 1960s, USAID has funded programs ranging from food security and maternal health to democratic governance and basic education. Notably, the President's Emergency Plan for AIDS Relief (PEPFAR) was a USAID-led initiative that supported over 700,000 Malawians living with HIV/AIDS, contributing significantly to reducing mortality and increasing treatment access.

However, in 2025, USAID suspended its financial support to Malawi, due to its new policies. This development created macroeconomic and social shocks, given Malawi's high dependency on donor inflows.

The cessation of USAID funding in Malawi is therefore not merely a fiscal event but a developmental turning point. It exposed the fragility of Malawi's economy and its overreliance on aid to sustain essential services. This study investigates these impacts comprehensively.

Significance of the Study

This study is significant in three main respects:

Academic Contribution**:** It adds to the body of knowledge on aid dependency by providing empirical evidence of the consequences of donor withdrawal in Malawi. The research contributes to the growing literature on aid volatility, dependency, and donor exit strategies. It offers a rare empirical case from Malawi, a country where aid remains a central pillar of development financing. By focusing on immediate post-withdrawal consequences, the study addresses a gap often overlooked in long-term impact studies.

Policy Relevance**:** The findings provide guidance for the Government of Malawi in designing sustainable financing mechanisms and resilience strategies. The findings can guide the Government of Malawi in crafting evidence-based fiscal and sectoral policies, especially in the health and education sectors. It also provides inputs into the ongoing dialogue around domestic resource mobilization and donor engagement under Vision 2063.

Practical Impact: Communities and civil society organizations may use the insights to develop adaptive mechanisms in the face of external funding volatility. For civil society organizations, NGOs, and development partners, the study offers insights into the vulnerabilities of externally funded programs. Communities affected by donor withdrawal can also use these findings to advocate for local resilience-building strategies, such as local health financing and community-led school support.

Objectives of the Study

Main Objective

To examine the economic consequences of the cessation of USAID funding in Malawi. Specific Objectives

1. To assess the macroeconomic effects (inflation, currency depreciation, employment).
2. To evaluate the impact of funding withdrawal on the health sector.
3. To analyze the consequences for the education sector.
4. To determine the effects on household welfare and community resilience.
5. To propose policy measures to mitigate the impacts of donor withdrawal.

Scope of the Study

The study focuses on the economic consequences of USAID's funding withdrawal in Malawi, with emphasis on the health and education sectors and the macro-economic and household impacts. The most immediate window of aid cessation impacts. Both primary data (from respondents across government, NGOs, health/education workers, and communities) and secondary data (official reports, IMF and World Bank publications, and academic studies) were used.

2 Literature Review

Theoretical Frameworks

Aid Volatility and Fiscal Instability

Aid volatility refers to fluctuations in the volume and timing of external financial assistance. Research indicates that unstable aid inflows can lead to macroeconomic instability, fiscal mismanagement, and vulnerability to external shocks **(**Bulíř & Lane, 2002). Governments expecting continuous funding may overspend during peak aid periods**,** leaving insufficient buffers when aid declines. Heller (2005) further emphasizes that abrupt reductions in aid often force governments into domestic borrowing or emergency expenditure cuts, exacerbating inflation and fiscal deficits.

The aid dependency theory argues that prolonged foreign aid can weaken domestic resource mobilization and create structural economic imbalances (Moyo, 2009). According to this view, sustained aid inflows reduce the incentives for governments to collect taxes and invest in domestic production, thereby perpetuating underdevelopment. The theory also suggests that aid volatility disrupts public planning and service delivery.

In Malawi, this theory is particularly relevant. Over the past 30 years, the country has repeatedly experienced donor suspensions (e.g. Cashgate in 2013) that disrupted budget execution and policy implementation, reinforcing the notion that overreliance on aid creates fiscal fragility.

Critics of the theory argue that the problem is not aid itself, but how it is managed. Proponents of this counter-view believe that well-coordinated and transparent aid can complement domestic efforts and strengthen capacity over time (Burnside & Dollar, 2000).

Aid Dependency and Economic Development

The dependency theory posits that excessive reliance on external assistance can undermine domestic revenue mobilization and long-term economic development (Moyo, 2009). In Malawi, overreliance on USAID and similar donors has historically weakened policy reform incentives**,** leaving critical sectors vulnerable to donor decisions (IMF, 2001).

Public finance theory provides a framework for understanding how governments raise and allocate resources. In aid-dependent countries, foreign aid becomes a quasi-public revenue stream, subject to political and administrative control. The withdrawal of donor funds, therefore, functions like a sudden revenue shock, with similar consequences as a fall in tax revenue or export earnings.

According to this theory, effective public financial management (PFM) systems are essential for mitigating the impact of such shocks. In the absence of strong PFM systems, donor withdrawal may lead to fiscal deficits, spending cuts, and social unrest (Foster & Mijumbi, 2020).

Long-Term Fiscal Implications of Aid Withdrawal

Empirical studies suggest that permanent reductions in foreign aid produce sustained negative effects on public investment, human capital development, and tax collection capacity (Combes et al., 2016). Temporary shocks, while disruptive, tend to be more manageable if governments can deploy adaptive fiscal strategies.

Sustainable development theory emphasizes long-term development that meets present needs without compromising future generations. From this perspective, heavy reliance on external aid violates the principles of sustainability, as it fosters dependency rather than resilience.

USAID’s withdrawal exposes the fragility of Malawi’s development architecture, which has relied on temporary external support for core services like healthcare. This aligns with arguments by Sachs (2015), who calls for blending aid with domestic capacity-building and institutional reform.

Aid Effectiveness, Governance, and Corruption Governance and Aid Outcomes

Effective aid utilization depends on governance quality. Transparency International (2024) scored Malawi 34/100, indicating high corruption and weak oversight**.** Poor governance undermines aid effectiveness, particularly in sectors like health and education, where accountability for fund allocation is critical (World Bank, 2023).

The relationship between foreign aid and economic growth has been widely debated in development economics, with empirical evidence producing mixed results.

A seminal study by Burnside and Dollar (2000) argued that aid contributes positively to economic growth, but only in countries with sound fiscal, monetary, and trade policies. Their cross-country regression found that when good governance is present, aid is growth-enhancing. However, in countries with weak institutions, aid may have little to no positive impact.

In contrast, Rajan and Subramanian (2008) challenged the effectiveness of aid, finding no robust evidence that aid inflows systematically lead to higher economic growth. They argue that aid may displace productive investments, create rent-seeking behavior, and encourage inefficiencies in resource allocation.

More recent studies such as Galiani et al. (2017) found that the effectiveness of aid depends heavily on its stability, targeting, and sectoral allocation. Short-term aid boosts consumption and output, while long-term development aid contributes to capital formation and infrastructure development.

In the African context, countries like Rwanda, Ethiopia, and Ghana have experienced aid- supported growth, particularly when aid was aligned with national development plans. For example, Kharas (2014) documented that in Rwanda, foreign aid contributed over 10% of GDP growth during the early 2010s, particularly in infrastructure and health.

However, aid also has risks. Some studies have found that large aid inflows can lead to macroeconomic distortions, including inflationary pressures and exchange rate appreciation, a phenomenon known as Dutch Disease. This was evidenced in Nigeria, where large donor inflows led to a decline in non-oil exports (Olofin & Olusola, 2013).

Overall, the empirical literature indicates that foreign aid can enhance economic growth under the right conditions, particularly where governance is strong, aid is predictable, and absorptive capacity is high.

Foreign Aid on Fiscal Sustainability

Critiques of tied aid note that requiring recipients to purchase goods from donor countries can inflate costs and reduce local economic efficiency (OECD, 2020). In Malawi, this may have limited the ability of health and education programs to procure essential resources efficiently, increasing vulnerability to funding shocks.

Fiscal sustainability refers to a government's ability to meet its long-term expenditure obligations without resorting to excessive borrowing or macroeconomic instability. Foreign aid can support fiscal sustainability by closing budget deficits, financing capital projects, and reducing borrowing needs. However, aid can also create risks if it leads to dependency or substitutes for domestic revenue generation.

According to Gupta et al. (2004), aid has both positive and negative implications for fiscal behavior. On the positive side, aid can help reduce deficits and fund critical investments. On the negative side, aid can reduce domestic tax effort, especially when governments rely heavily on external financing rather than strengthening tax administration.

In sub-Saharan Africa, Foster and Mijumbi (2020) found that sustained aid helped countries like Uganda maintain fiscal balance, but only when aid was channeled through national systems. Conversely, where aid was fragmented or off-budget, it complicated fiscal planning and led to inefficiencies.

A study by IMF (2013) in low-income countries observed that volatile aid flows can worsen fiscal management, forcing governments to adjust spending mid-year, accumulate arrears, or increase domestic borrowing. This undermines budget credibility and macroeconomic stability.

In the context of Malawi, Chirwa and Zakeyo (2017) found that while foreign aid helped finance key expenditures, it also contributed to fiscal fragility due to its unpredictability. During periods of donor withdrawal, such as after the Cashgate scandal in 2013, the government struggled to maintain essential services without donor budget support.

Empirical literature agrees that foreign aid has the potential to improve fiscal sustainability, but only when it is predictable, well-integrated into public financial management systems, and complementary to domestic revenue mobilization efforts.

Aid and Poverty Reduction

While foreign aid is often justified for poverty alleviation, empirical studies indicate that aid effectiveness is contingent on institutional capacity**.** Well-governed systems tend to achieve more sustainable outcomes, whereas aid-dependent economies face risks of stagnation or reversal of development gains when funding is interrupted (Taylor & Francis, 2019).

3 Main Content/Discussion

The data have been analyzed in line with the study's objectives: macroeconomic impacts, health sector effects, education sector effects, and household/community responses. Quantitative data are presented first, followed by qualitative insights, and then a synthesis with existing literature. The aim is to show patterns, trends, and personal experiences of those directly affected, in order to give a holistic picture of the consequences of donor aid suspension.

Response Rate

Out of 80 questionnaires distributed, 72 were successfully completed and returned, representing a 90% response rate**.**

Demographic Characteristics of Respondents

To better understand the diversity and perspectives of those who responded to the study, key demographic characteristics such as gender, age, location, and employment category were considered. These variables provide insight into how different groups may have been differently affected by the withdrawal of USAID support in Malawi.

Gender Distribution

Out of the 72 respondents:

- 42% were male (30 respondents)
- 58% were female (42 respondents)

This gender distribution indicates a relatively balanced representation, with a slightly higher number of female participants. The overrepresentation of female respondents, particularly among community members and health workers, reflects the gender dynamics within sectors heavily impacted by the USAID withdrawal, such as health and education, where women often make up the majority of the workforce and service users.

Gender differences also emerged in the way the impact was experienced and reported. For instance, female respondents were more likely to highlight issues related to maternal health, school feeding programs, and household food insecurity, reflecting their roles both as caregivers and frontline service providers. Male respondents tended to focus more on employment-related impacts and macroeconomic concerns.

Age Distribution

The age distribution of respondents was as follows:

- 18–29 years: 14 respondents (19%)
- 30–44 years: 28 respondents (39%)
- 45–59 years: 20 respondents (28%)
- 60 years and above: 10 respondents (14%)

The largest age group was between 30 and 44 years, representing nearly 40% of the sample. This age group included many professionals in the health and education sectors, as well as economically active community members. Their responses often reflected both personal and professional insights into the consequences of donor aid suspension.

Younger respondents (18–29) including early-career teachers, junior health staff, and unemployed youth, often emphasized the loss of training opportunities, youth programs, and job prospects that were previously supported by USAID-funded initiatives.

Older respondents (45+) brought a historical perspective, comparing current hardships with previous aid fluctuations and economic shocks, and many expressed deep concerns about the sustainability of community programs without donor assistance.

Economic Impacts

Inflation and Currency Depreciation

- Primary data: 78% reported significant commodity price increases; 65% linked this to kwacha depreciation.
- Secondary data: Inflation rose from 22% (Dec 2024) to 28% (June 2025); kwacha depreciated by 12% (IMF, 2024).

Perception of Price Changes (% of Respondents)

- Increased significantly: 78%
- Increased slightly: 12%
- No change: 6%
- Decreased: 4%

Employment and Household Income

Secondary data confirms that over 3,500 health workers lost employment due to USAID’s suspension of health programs (USAID, 2023).

Health Sector Impacts

Drug Availability and Service Delivery

- HIV/AIDS treatment programs – 64%
- Malaria and TB programs – 22%
- Maternal and child health – 14%

Secondary data aligns: USAID’s PEPFAR program supported over 700,000 HIV patients (USAID, 2025).

4.3.2 Health Workforce

- 58% of health workers reported staff reductions.
- Confirmed by literature (Chirwa & Zakeyo, 2020) showing massive layoffs in donor- funded sectors.

Education Sector Impacts Programs and Access

Household and Community Impacts Poverty and Coping Mechanisms

- Reduced food consumption – 45%
- Borrowed money – 28%
- Sold household assets – 18%
- Other coping strategies – 9%

Secondary data: World Bank (2025) estimates that 435,000 Malawians could fall into extreme poverty by 2030 due to aid suspension.

Policy and Recommendations from Respondents Thematic Analysis of Qualitative Responses

- Governance Concerns**:** Respondents cited corruption and poor accountability**.**
- Dependency Critique: Highlighted Malawi’s vulnerability to donor shocks.
- Community Resilience: Mentioned informal savings groups (village banks) as safety nets.

Synthesis with Literature

- Findings align with Moyo (2009) on aid dependency risks.
- Governance concerns confirm Kangoye (2013)’s analysis of aid unpredictability.
- Policy suggestions mirror Dreher et al. (2011) who advocate for aid diversification.

4. Findings

The cessation of USAID funding has led to:

- Macroeconomic instability (inflation, currency depreciation, job losses).
- Severe disruption of health services (drug shortages, HIV/AIDS treatment gaps).
- Educational setbacks (school feeding and scholarships suspended).
- Increased household poverty, with communities relying on coping strategies.

5. Conclusions and Recommendations

Based on these findings, the study draws the following conclusions:

High Aid Dependency is a Development Risk: The cessation of USAID funding exposed Malawi's vulnerability to aid shocks, confirming arguments in the literature that aid dependency undermines economic resilience (Moyo, 2009). Malawi's reliance on external donors such as USAID created a false sense of security in key sectors. The sudden aid suspension revealed that essential services such as health and education lack domestic resilience. Dependency on external funding without sufficient domestic capacity increases the risk of service interruption and policy failure.

Macroeconomic Stability is Fragile: The suspension contributed to inflationary pressures and exchange rate depreciation, reflecting the heavy reliance of Malawi's fiscal and monetary framework on external financing. The withdrawal caused inflation, unemployment, and currency devaluation, indicating that Malawi's macroeconomic fundamentals are not yet insulated from external shocks. The crisis also revealed the lack of buffer mechanisms to manage fiscal emergencies.

Social Sectors are Overexposed: Health and education services, heavily dependent on USAID, experienced severe disruptions, threatening human development indicators and reversing progress in areas such as HIV/AIDS control and primary education. Critical programs in health and education, which support human development and poverty reduction, are too dependent on foreign aid. Their disruption can lead to rapid deterioration in development outcomes, as observed in this study.

The economic burden has been felt most acutely by vulnerable households and communities. Aid shocks, when not mitigated by social protection policies, exacerbate inequality and deepen poverty. Households Bear the Brunt: The burden of adjustment fell disproportionately on households, particularly the poor, as donor withdrawals translated into rising poverty, food insecurity, and loss of social safety nets.

Governance and Sustainability Challenges Persist: Weak accountability systems and overreliance on external partners highlight the need for structural reforms in domestic resource mobilization, fiscal governance, and donor relations. Poor governance and financial mismanagement played a role in undermining donor confidence. Without transparent, accountable, and efficient public financial management, future donor engagement and domestic resource generation will remain constrained.

Recommendations

Based on the conclusions, the following recommendations are proposed:

5.3.1 Policy-Level Recommendations

Strengthen Domestic Resource Mobilization:

The Government of Malawi should broaden the tax base, improve efficiency in tax collection, and curb illicit financial flows to reduce overdependence on donor financing. The Malawi Revenue Authority (MRA) should expand the tax base through digitization, informal sector inclusion, and curbing tax evasion. Reducing reliance on donor funds starts with improving domestic revenue collection and expenditure prioritization.

Macroeconomic Stabilization Measures: Monetary authorities should adopt inflation-targeting frameworks, strengthen foreign exchange reserves, and prioritize fiscal discipline to reduce volatility caused by external shocks. The Ministry of Finance should establish mechanisms for fiscal discipline and buffer funds to mitigate external shocks. This includes better debt management and transparent budgeting.

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- If you like, I can help you generate a full references list including the books and older literature you used (e.g. Moyo, Burnside & Dollar, etc.), with proper page numbers.