Owning the loan – poor countries and the MDGs

A Christian Aid and AFRODAD report on how national ownership of the loan process can help poor countries reach the Millennium Development Goals

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The African Forum and Network on Debt and Development (AFRODAD) is a civil society organisation born of a desire to see lasting solutions to Africa’s mounting debt problem, which has impacted negatively on the continent’s development process. AFRODAD works with and through its affiliates in ten African countries.

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Executive summary

Christian Aid and AFRODAD commissioned research in December 2003 to investigate the links between debt management, the build-up of new loans, and the most sustainable ways of financing the Millennium Development Goals (MDGs) in Malawi, Mozambique, Uganda, Tanzania and Zambia – all low-income and highly indebted countries. Together they face an estimated minimum shortfall of US$65bn, without which they will not reach the MDGs by the target date of 2015.

Since reaching their respective decision-points under the HIPC initiative, governments in these five countries have contracted US$4.4bn in new debts from the International Development Association (IDA), with another US$2bn in IDA loans in the pipeline for future projects. This debt stock is equivalent to the total amount they still need to repay all their creditors on their ‘reduced’ debt stocks between 2000 and 2015. In January 2004, their outstanding loans to the IMF totalled US$1.75bn, most of which have been agreed since 2000.

This report argues that the process by which aid-recipient countries agree to take on the terms and conditions of a loan needs to be opened up to scrutiny by citizen groups and their representatives in parliament and other formal democratic structures. This should help to avoid lending and borrowing mistakes, which in the past have led to the build-up of unsustainable debts that now have to be paid off at the cost of financing the MDGs.

The MDG targets, which differ from country to country, provide a useful political tool that allows citizens to hold their governments and creditor institutions to account for the design and impact of development projects and programmes, as well as their financing.

The research findings show that governments and international financial institutions often negotiate and sign loan agreements in a non-transparent and non-accountable way. In some cases the government may overrule their parliament’s objections to a loan, and often parliaments end up rubberstamping new lending agreements without being properly involved in the decision-making process.

Civil society organisations have played a very limited role at any stage of lending agreements. There is no formal legislation to involve them in the loan cycle, and they lack the resources and skills to research, advocate on and monitor government loans.

Recommendations

To African governments

1. Make transparent decisions about whether to finance development programme and projects through loans or grants, based on the nature of the project, the ability to repay the loan from the returns of the project, and future trade-offs with public investment needed to reach the MDGs.

2. Include citizens in the decision-making process through their formal representatives in parliament and official watchdog bodies, and through civil society organisations and networks that represent their different interests.

3. Enact legislation that will require the executive bodies responsible for dealing with external debt to make debt information accessible to the public.
4. Give parliament and other watchdog bodies a formal and substantive role in approving and monitoring all external loans.
5. Establish structures or processes outside parliament through which citizens can influence public loan decisions.
6. Set up official forums and processes through which citizens can debate and influence economic policy proposals to strengthen public ownership of economic reforms and promote their long-term sustainability.

To the UK government
1. Report to the UK parliament on the vote of UK executive directors in the World Bank and IMF on project and programme loans and grants.
2. Encourage G8 creditor countries to allow the IDA to disburse at least 40 per cent of its payments to HIPCs as grants that do not impose more or harmful conditions on borrowing countries.
3. Explore ways of making up the shortfall in future IDA financing as a result of reduced loan repayments – including larger replenishment amounts and cross-financing from more profitable World Bank lending instruments, such as loans to middle-income countries.

To international financial institutions
1. Write off with immediate effect all pre-decision-point debts owed by low-income countries where paying these debts is reducing the resources available to governments to cover the costs of reaching the MDGs.
2. Establish a transparent, fair and comprehensive international arbitration process on debt in the United Nations to allow all creditors and debtors (including non-HIPCs) to resolve the repayment of past and future debts created through loans that went to non-productive or failed projects and programmes, or were misappropriated by governments.
3. Provide a minimum of 40 per cent grant financing from IDA resources to all HIPCs in future, and increase the ratio for those countries that are most vulnerable to future debt payment problems. Ensure that such grants do not come with increased conditions.
4. Encourage national governments to make loan documents accessible to the public, drawing on the good practice of the World Bank, which publishes all loan programmes and projects on its website.
5. Encourage national governments to open up lending negotiations to watchdog institutions, including parliament and civil society, and to public consultation.
6. Respect domestic laws on future borrowing and repayment ceilings.
7. Provide government watchdog bodies and parliaments with financial and technical assistance to enable them to play an effective role in negotiating and monitoring external loans.
8. Stop requiring client countries to contribute counterpart funds for all loans and grants. This may cut off governments with small domestic revenues from much-needed future grants or credits.
9. Extend all future finance to low-income countries on IDA or better terms – including PRGF loans.
Introduction

At the 2000 United Nations Millennium Conference, all donor and aid-recipient governments agreed to tailor their future development policies and expenditure priorities to meet a set of development targets. These targets, called the Millennium Development Goals (MDGs), provide political and practical direction to international development institutions, governments and citizens in their collective fight to eradicate poverty.¹

<table>
<thead>
<tr>
<th>The Millennium Development Goals</th>
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</thead>
<tbody>
<tr>
<td>Eradicate extreme poverty and hunger</td>
</tr>
<tr>
<td>Achieve universal primary education</td>
</tr>
<tr>
<td>Promote gender equality and empower women</td>
</tr>
<tr>
<td>Reduce child mortality</td>
</tr>
<tr>
<td>Improve maternal health</td>
</tr>
<tr>
<td>Combat HIV/AIDS, malaria and other diseases</td>
</tr>
<tr>
<td>Ensure environmental sustainability</td>
</tr>
<tr>
<td>Develop a global partnership for development</td>
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</table>

Source: www.developmentgoals.org

Four factors will determine whether these goals are reached:

1. Western governments and the international financial institutions they control need to demonstrate a political commitment to provide aid and other resources in sufficient quantities to finance policies and investments that will contribute to the achievement of the MDGs. Using total aid provided and agreed aid targets as proxy indicators reveals a significant gap. Thus, between 2000 and 2002, total aid from the members of the Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) accounted for only 0.23 per cent of their Gross Domestic Product (GDP), compared with the target of 0.7 per cent. Though aid levels have started to rise again, even with the US$16bn increase in aid expected as a result of the Monterrey Agreements, aid levels are only likely to reach 0.26 per cent of DAC GDP by 2006.

2. Governments and development institutions need to listen to their citizens and ensure that development policies are informed and shaped by their needs and perspectives through formal and informal democratic processes.

3. Transparent and effective institutions, a supportive legal and regulatory framework and competent governance structures and processes are necessary to ensure development policies are implemented effectively.

4. Fundamental reforms to the international trade, investment and financial system are needed to support the structural changes necessary to promote pro-poor development strategies and to stem the tide of capital leaving low-income and developing countries, which is jeopardising their chances of using local savings and investments to finance the MDGs.

Christian Aid and AFRODAD commissioned research in December 2003 to investigate the links between debt management, the build-up of new loans, and the most sustainable ways of financing the MDGs in Malawi, Mozambique, Uganda, Tanzania and Zambia — all low-income and highly indebted countries. Together they face an estimated minimum shortfall of US$65bn, without which they will not reach the MDGs by 2015.²
Filling this finance gap is a minimum requirement to halve the number of citizens trapped in poverty by 2015, although it is equally important that governments use this money effectively. Given massive capital outflows, low commercial credit ratings, and a mere US$30bn in expected grants until 2015, the governments of Malawi, Mozambique, Uganda, Tanzania and Zambia will continue knocking at the door of the International Monetary Fund (IMF) and the International Development Association (IDA), which is the World Bank’s lending arm for low-income countries, for concessional loans.

Since their respective decision-points between mid-1998 and the end of 1999, when large amounts of their existing debts were reduced under the enhanced HIPC initiative, the five countries under discussion have contracted new debts from the IDA of US$4.4bn, with another US$2bn of IDA loans in the pipeline for future projects. This debt stock is equivalent to the total amount they still need to repay all their creditors on their ‘reduced’ debt stocks between 2000 and 2015. In January 2004 their outstanding loans to the IMF totalled US$1.75bn – most have been agreed since 2000, under the new Poverty Reduction and Growth Facility (PRGF).

This increase in new borrowing is of direct concern to the citizens of the five countries under discussion for a number of reasons. Firstly, they have had very little, if any, involvement in the agreements for new loans, and will not get to oversee projects funded by the loans. Secondly, if future government resources are redirected to service unpayable debts, this will have knock-on effect on the government’s ability to provide basic services. This situation can be avoided if governments use loans prudently to finance productive investments that will generate the necessary economic growth and government revenue to pay back the loans. A country that is able to raise its GDP, which might be partially generated by loan-funded projects, and is able to expand high-value exports, for which it will realise hard-currency income, will have less difficulty in meeting its repayments. It is when large sums have been borrowed and used for unproductive projects, or to fund projects they were not intended for, or been stolen through corruption, that a country will find itself either unable to meet its debt commitments or doing so only at the expense of many of its people.

Malawi, Mozambique, Uganda, Tanzania and Zambia have small economies and they rely on a few primary commodities to obtain the bulk of their export earnings. They have faced highly volatile international prices and declining terms of trade. Despite the concessional nature of the IDA and IMF loans they are eligible for, they still face the risk of entering another cycle of unsustainable debt stocks and difficult negotiations with creditors for debt relief packages that still leave them with unpayable debts. Even World Bank researchers have admitted recently that ‘if the additional Official Development Assistance (ODA) flows envisioned in the light of MDGs are provided primarily even as concessional loans, the vast majority of countries... are likely to experience serious difficulties in repaying these loans in future’.6

This report argues that citizens’ groups need to be allowed to scrutinise the process by which aid-recipient countries agree to take on the terms and conditions of a loan. This should help to avoid lending and borrowing mistakes, which in the past have led to the build-up of unsustainable debt that now has to be paid off at the cost of financing the MDGs. Citizens’ organisations and the bodies that represent the interests of different groups of poor people in the formal democratic process need to be informed about the purpose of every project and programme financed by new loans, including the associated risks of the loan in the light of a country’s existing unpaid loans and economic indicators.

Public debate should inform the final decision of governments and creditors on the content of development projects and programmes, as well as the most appropriate form of finance. The MDG targets, which may differ from country to country, provide a useful political tool that allows

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citizens to hold their governments and creditor institutions to account for the financing, design and impact of development projects and programmes.

There is already a precedent for involving citizen groups in loan decisions. National poverty reduction strategies (PRS), which all low-income governments have to prepare if they want debt relief or new concessional loans from the World Bank and IMF, have to be developed in consultation with non-state organisations and the broader public. The World Bank and IMF introduced this requirement because they recognise that ‘national ownership’ is vital to the success of any development project or programme. The experience of this process so far, discussed on pages 22 – 24, provides some lessons on the difficulties, but also the opportunities, of increasing accountability and transparency in the loan-agreement process.

This report is divided into the following sections:
(i) an analysis of the options open to low-income countries to raise the money necessary to achieve the MDGs
(ii) an assessment of the merits and problems of concessional-loan and grants financing
(iii) an outline of debt-management capacity, loan-agreement processes and citizen participation in loan decisions in Malawi, Mozambique, Uganda, Tanzania and Zambia
(iv) recommendations to African governments, the UK government, international financial institutions and civil society organisations.

How will low-income countries raise the money for the MDGs?

Working out how much the MDGs will cost is the first step towards achieving them. Global cost estimates help to identify the large gap that exists between the resources available to developing countries and the resources needed to achieve the MDGs. These estimates provide the donor community and developing-country governments with guidelines as to how much extra development assistance is needed to meet the MDGs. They will also help civil-society groups in donor countries to monitor the aid-allocation decisions of their governments.

It is extremely difficult to estimate the real cost of meeting the MDGs, both at global and national level. Various development agencies have used different methods to estimate the cost of reaching either all the MDGs or one of the MDGs globally, or some of the MDGs in specific countries.7

All these methods, including those used by the New Economics Foundation cited in this report, suffer from limitations. They:
• rely on poor data
• tend to underestimate the impact of HIV/AIDS
• use average unit costs instead of marginal costs, which are a more accurate way to calculate the cost of providing services to remote communities
• exclude the costs of public investment necessary to address the root causes of poverty – such costs include social and economic infrastructure, high-level skills development and private-sector development. These costs are crucial to sustain any decline in poverty reduction after 2015
• ignore funding implications arising from complementarities between different goals – for example, they don’t account for how money spent on water and sanitation will affect health status and school drop-out rates, or to what extent the global partnership commitment to open up markets in developed countries will stimulate production in low-income countries.

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Despite these shortcomings, existing global and country-by-country calculations do give a crude indication of at least the minimum amount of finance needed to achieve the MDGs. World Bank researchers estimate that aid disbursements to all aid-recipient countries will need to double from existing commitments to between US$40bn and US$60bn a year until 2015 to help them halve income poverty and reach the other MDGs.\(^6\) Christian Aid and AFRODAD commissioned the New Economics Foundation and Jubilee Research to calculate the approximate cost of achieving the MDGs in five sub-Saharan African countries.\(^9\)

### Table 1. Financing the MDGs in Malawi, Mozambique, Tanzania, Uganda and Zambia

<table>
<thead>
<tr>
<th>Country</th>
<th>Total shortfall 2000-2015 (US$bn)(^1)</th>
<th>Est annual shortfall (US$m)</th>
<th>Minus est aid based on 2001 ODA flows (US$m)</th>
<th>Annual shortfall (%)</th>
<th>Minus 100% debt cancellation (US$m)</th>
<th>Est annual shortfall (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malawi</td>
<td>7.5</td>
<td>500</td>
<td>307</td>
<td>-39</td>
<td>600</td>
<td>-30</td>
</tr>
<tr>
<td>Mozambique</td>
<td>12.5</td>
<td>830</td>
<td>751</td>
<td>-10</td>
<td>600</td>
<td>-5</td>
</tr>
<tr>
<td>Tanzania</td>
<td>22.5</td>
<td>1.5</td>
<td>1033</td>
<td>-32</td>
<td>700</td>
<td>-24</td>
</tr>
<tr>
<td>Uganda</td>
<td>17.7</td>
<td>1.18</td>
<td>696</td>
<td>-42</td>
<td>1000</td>
<td>-36</td>
</tr>
<tr>
<td>Zambia(^2)</td>
<td>5</td>
<td>330</td>
<td>392</td>
<td>18</td>
<td>1500</td>
<td>150</td>
</tr>
</tbody>
</table>


**Notes:**

1. This shortfall is calculated by estimating the total amount of resources available for MDGs minus the estimates of approximate costs of achieving the MDGs. Resources available are calculated by projecting domestic revenues, minus remaining post-HIPC debt service (not including new loans), non-MDG essential spending, and required MDG spending, to arrive at the total financing gap.

2. The MDG finance gap calculations for Zambia show a surplus of external finances available for reaching the MDGs, even without debt cancellation. This shows up some of the shortcomings of current methods of calculating MDG financing shortfalls. For example, the impact of HIV/AIDS on overall economic growth and the cost of losing public sector employees have not been included. Expected earnings from copper exports are also very difficult to predict, given the volatility of international prices in this commodity.

The findings show that there are very different needs for external finance even among low-income countries. Hundred per cent cancellation of pre-decision point\(^5\) debts will assist all of the countries to lower their annual finance shortfalls. At present, the governments of Mozambique, Tanzania and Uganda are still paying back half of their pre-decision point debts, and the governments of Malawi and Zambia are paying back most of their pre-1999 debts.

There are three ways of filling the finance gap in low-income countries:

- increased domestic investment and savings
- plugging the holes through which domestic savings and investment leave the country
- external grants and loans.

**Domestic resources**

A country's own resources are usually by far the most important sources of finance to achieve sustainable increases in economic well-being and social development. Domestic resources are predominantly generated by domestic private-sector activity, such as building factories,
commercial agricultural production and selling services, as well as public investment in productive activity, such as building roads and railways. There are two main routes through which domestic resources can increase the well-being of a country and its people:

- increased economic activity in both the private and public sectors leading to a growth in wages and consumption
- the spending of tax revenues collected by the public administration.

Table 2 outlines the expected increase in economic growth in the five countries under discussion, which will determine investment and savings, and domestic revenue. It will fall far short of the amounts needed to achieve the 2015 MDGs, outlined in table 1 on page 7.

Table 2. Estimated GDP (1) and domestic revenue (2) (US$m) until 2015

<table>
<thead>
<tr>
<th></th>
<th>Malawi</th>
<th>Mozambique</th>
<th>Uganda</th>
<th>Tanzania</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1920</td>
<td>393</td>
<td>4737</td>
<td>625</td>
<td>7232</td>
</tr>
<tr>
<td>2010</td>
<td>2290</td>
<td>446</td>
<td>6486</td>
<td>921</td>
<td>9363</td>
</tr>
<tr>
<td>2015</td>
<td>3509</td>
<td>502</td>
<td>8886</td>
<td>1351</td>
<td>12306</td>
</tr>
</tbody>
</table>


Plugging the holes

Before turning to external sources to fill these shortfalls in the finances necessary to reach the MDGs, we believe that governments should first plug the holes through which capital (domestic savings and investments) is leaving their countries. These 'holes' include:

- profit remittances by foreign companies
- debt repayments
- patent and copyright fees charged by multinational corporations for using technology or medicines they have invented
- bio-piracy, whereby multinational corporations market and sell plant and animal products that have been used by local populations for generations
- the stealing of public funds by corrupt government officials
- the overseas savings of wealthy residents
- multinational corporations’ practice of setting the prices of goods traded between different branches of the same corporation at artificially low levels, which show up as lower corporate profits on their accounts, thus lowering the taxes governments are able to collect on their profits
- deteriorating terms of trade
- loss of export revenue as a result of protectionism and high subsidies in developed and developing countries
- loss of remittances due to the blockage on the free movement of people.

In many smaller developing countries, migrant citizens' remittances play a significant developmental role. World Bank reports have shown that relatively poor migrant workers in rich countries send more money home to developing countries than the combined total of government aid, private bank lending and IMF/World Bank assistance.

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**Owning the loan** – poor countries and the MDGs
Unless fundamental reforms take place in the international investment, trade and financial system, low-income countries in Africa will never be able to retain their savings and use them to reduce poverty. Agencies such as the UNDP, UNCTAD, the Millennium Commission and the World Bank should use their collective expertise to calculate the actual amount of money leaving the country and the costs incurred by poor people due to the existing international financial, trade and investment systems. Without fundamental reforms to these systems, which Christian Aid, AFRODAD and many other citizens’ organisations across the world are demanding, low-income countries will remain dependent on external aid.13

External resources

Countries can attract finance from outside their borders in the shape of development assistance (both grants and loans), private investment and private-sector loans (to both companies and government). We are mainly concerned with development assistance. This normally includes all grants and concessional loans (with at least a 25 per cent grant component) in cash or kind, made by a country's government or international financial institutions to governments of aid-recipient countries. Official government aid excludes ‘private aid’ in the form of donations by private foundations.

The costs and benefits to the recipient of external grants and loans depend on the level of concessionality (the financial cost of accepting the loan or grant), but will also vary between countries and through time. The level of concessionality will range between zero in the case of grant aid (monies not to be repaid) and a nominal interest rate in the case of aid loans, through to full market rates in the case of loans from foreign banks and other commercial institutions.

Figure 1. World Bank concessional lending

| The International Development Association (IDA) is the World Bank's biggest concessional lending window. It provides long-term loans at zero interest (albeit with a 0.75 per cent ‘service’ charge and a 0.5 per cent ‘commitment’ fee) to countries that have a per capita income of less than US$875 (in 2002) – currently 81 countries. |
| Standard IDA loans (or ‘credits’) have maturities of 40 years with a ten-year grace period on the principal amount. Since 1960, the IDA has lent US$135bn. The amount of IDA funds allocated to each country depends on how poor they are, and on a World Bank assessment of their policy environment (as measured by the Country Policy and Institutional Assessment). Government contributions from the richer member countries fund the IDA. |
| Source: http://www.worldbank.org |

The level of concessional aid available to a country depends on a number of factors. These include:
- donor perceptions of the effectiveness of aid to the recipient country
- the IMF's assessment of the recipient government's economic policies and financial transparency
- political pressure from interest groups in donor countries
- the health of the global economy.
In a return to common aid practices during the cold war years, donors' domestic and foreign policy objectives (for example, the fight against terrorism) are again becoming an important factor in determining which countries and what projects receive aid. The financial cost of reaching the MDGs has not yet become a key criterion for aid allocations across the donor community. The UK Department for International Development (DFID) is an exception – it allocates countries' bilateral grants according to country-based MDGs.

**Aid effectiveness**

Past experience has shown that development assistance is most effective in promoting human and economic development if it has the following characteristics:

- **poverty focused**: aid is less likely to be poverty focused if it is being used to meet other domestic or foreign-policy objectives

- **flexible and ‘owned’**: aid is likely to be more effective when recipients design their own development strategies

- **low transaction costs**: the drawbacks of burdensome donor engagement are well documented in terms of both the effectiveness of aid and the erosion of domestic ownership of the development process. In countries where donors judge the policy environment conducive, they have moved away from a small project-based approach to aid, to modes of donation that support separate sectors of an economy (for example, health or transport), and often entire budgets. In doing so, they are explicitly supporting national planning and expenditure priorities as evidenced through budget allocations. By coordinating their approaches around a common country-owned tool (such as the budget), donors have managed to significantly reduce the costs they impose on recipients

- **predictable**: donor finance in the past has too often been unpredictable and prone to policy reversal. In order to provide the stability of resources that poor countries need to invest in promoting growth and improved public services, donors have to commit to longer time frames

- **transparent delivery**: through more efficient institutions

- **sensitive to a government's absorption capacity**: takes account of whether the recipient government has the technical personnel to manage the projects and programmes funded by external aid and the effect of external aid flows on inflation and exchange rates.

**What mix of loans and grants?**

At the 2002 Monterrey Financing for Development Conference, the international development community agreed that sustainable foreign borrowing will remain an important source of capital to finance private and public investment in developing countries for the foreseeable future. This consensus followed an intense debate between the US administration and other DAC donors in 2001, in the period running up to the 13th replenishment of IDA funds. The US wanted to make its continued contribution to IDA conditional on at least half of all IDA disbursements being made as grants, not loans.

This suggestion, supported by many civil society organisations in the US, was strongly rejected by all other DAC donors. They had legitimate concerns about the US administration's requirement of strict performance benchmarks for such grants, which would bypass national poverty reduction strategies. They were also worried that the US administration was not prepared to disburse more money to IDA to make up for the loss of debt repayments if IDA starts to disburse fewer loans
and more grants. They finally reached agreement in 2002 that between 18 and 21 per cent of IDA transfers could be made in the form of grants to all countries that qualify for IDA assistance and up to 40 per cent for the poorest, debt-vulnerable or post-conflict countries.

In our judgement, all five countries under discussion should qualify for at least 40 per cent IDA grants, based on one or more of the above criteria. In 2002/03, however, grants made up 35 per cent of total IDA approvals to Malawi, 40 per cent to Mozambique, 56 per cent to Zamb, but only 18 and 13 per cent to Uganda and Tanzania respectively. Although these figures are partly influenced by the size of IDA grants for HIV/AIDS prevention and treatment, which only attract grant funding, they show that the World Bank can double the ratio of grant aid to loans to Uganda and Tanzania.

**Figure 2. Assessing the benefits and problems associated with loans and grants**

<table>
<thead>
<tr>
<th>IDA grants:</th>
<th>IDA concessional loans:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- reduce a low-income country’s exposure to the future risk of unsustainable debt, which can cause it to divert public resources away from reaching the 2015 MDGs</td>
<td>- stimulate a credit culture and fiduciary responsibility in low-income countries</td>
</tr>
<tr>
<td>- mean governments do not have to drain scarce revenues when they take hard currency loans, albeit concessional, for non-productive investments such as social services</td>
<td>- mean low-income countries can build up a track record, allowing them to participate in international capital markets in the longer term</td>
</tr>
<tr>
<td>- provide a permanent escape from the debt trap</td>
<td>- avoid a grants-only policy that would reduce the funds available to the IDA, which on average earns between 20 and 40 per cent of its income from debt repayments</td>
</tr>
<tr>
<td>- protect donors from the risk of future non-payment.</td>
<td>- avoid a culture of dependency that would result from a grants-only policy in developing countries</td>
</tr>
</tbody>
</table>

At their last meeting in Dubai in September 2003, HIPC finance ministers recommended that the decision to distribute IDA resources as loans or grants be reviewed on a case-by-case basis, depending on the finance gap that needs to be filled to reach the MDGs. They also called for debt sustainability to be measured by considering the ratio of debt service to the budget revenue, which should not exceed ten per cent.

Most OECD DAC bilateral donors provide overseas development assistance in the form of grants to low-income countries – mostly because there could be another build-up of unsustainable debt in these countries.

In view of the finance gap faced by the five African countries under discussion and the likelihood that they may again enter a debt trap in the near future – a situation facing many low-income countries – we recommend that:
IMF loans to low-income countries are made on at least current IDA terms
at least 40 per cent of IDA disbursements to all HIPCs should be in the form of grants.
The decision of whether to distribute IDA further resources in the form of grants needs to be based on:
- a country-by-country analysis of vulnerability to future unsustainable debts
- accurate costing of resources needed to achieve the 2015 MDGs
- realistic estimates of future economic growth, government revenue and export growth,
taking into account long-term growth trends and volatile international commodities prices for their
primary export commodities
- all bilateral aid to HIPCs should be in the form of grants only.

Who decides on loans?

Christian Aid and AFRODAD commissioned research in Malawi, Mozambique, Uganda, Tanzania
and Zambia to find out:

- whether the borrowing process is transparent
- how governments and international financial institutions can be held accountable for their
  borrowing and lending decisions
- what role national watchdog institutions and civil society groups can and should play to
  ensure that lending and borrowing decisions are made in a transparent way, borrowing is
  sustainable, and public funds can be accounted for.

During the 1980s, African economies experienced poor returns on investment programmes, which
caused a shift in the donor community from project- to adjustment-focused aid. The latter was
meant to promote economic growth by requiring aid-recipient governments to undertake a series
of economic stabilisation and structural policy reforms. This practice continues today, through the
IMF’s Poverty Reduction Growth Facility (PRGF), and the World Bank’s Poverty Reduction Credit
(PRC). The latter is transferred as budgetary support to a country’s poverty reduction strategy
only once the government has instituted economic policy reforms, including privatisation, wage
freezes, or trade liberalisation, which are often required as part of HIPC or PRGF negotiations.19

The underlying assumption of the international financial institutions is that structural adjustment
loans will lead to economic policy reforms that, in turn, will stimulate changes in inflation, interest
rates and economic growth. However, experience has shown two sorts of outcomes. Firstly, in
countries where governments have more rigorously followed international financial institutions’
policy prescriptions, the predicted economic outcomes have fallen short of expectations.
Secondly, some governments have not been willing to follow the required prescriptions because
they did not want to incur the social and political cost of implementing reforms that would cause
different interest groups to challenge their hold on power. On the second issue, the World Bank
acknowledges that necessary political and economic reforms are far more likely to be followed
through and sustained if they are motivated or accompanied by incentives for governments
created through the formal democratic process. Although democracy is still a relatively new
phenomenon in most African countries, initiatives implemented through democratic institutions
are more likely to be successful.

There are a number of reasons why citizens and their representative bodies should be concerned
about new borrowing in low-income countries. Their governments are still trying to leave the debt
trap in which they have been caught since the early 1980s. In the past, programme and project
loans were made in hard currency, on a variety of terms. Many of them were used to fund projects that failed to achieve their full potential or never had the productive potential to repay the loan. Some were diverted to unintended uses and beneficiaries through corrupt practices. During the regimes of Sani Abacha and Mabuto Sese Seko in Nigeria and in the Democratic Republic of Congo, for example, corrupt state officials often diverted loans and grants to their personal bank accounts.

Figure 3. A failed loan to the cashew-nut industry in Tanzania

In the 1970s, the World Bank lent Tanzania US$45m to develop its cashew-nut industry, in part to build processing plants. But the Bank overestimated the market for cashew-nut exports and the business never really took off. Few of the plants were ever fully operational, and most now are completely dormant.

Much of the equipment was bought from Japan. Tanzania owes Japan more than it owes any other government – US$661m. Italy ranks third in its list of government creditors, at US$203m. Many of these debts are associated with the cashew-nut fiasco.

When Christian Aid visited World Bank officials in Tanzania to ask them about this, they made it clear that the cashew-nut debacle is ancient history as far as they are concerned. They have admitted their mistake and want everyone to move on. But this is not ancient history for Tanzania.20

Today, despite enhanced HIPC debt relief, the government of Tanzania is still paying off about half of its debt to the World Bank and some of its debts to the Japanese government.

During the 1980s and 1990s, commodity prices continued to fall; economic growth rates fell as resources for production and consumption declined; and the value of local currencies plummeted against the hard currencies in which the loans were denominated, sending the possibility of repaying the loans further out of reach.

These problems were compounded by the collapse of local industry, job and income losses, and cuts in public spending on basic social and other publicly provided services, caused by World Bank- and IMF-prescribed structural adjustment programmes. These programmes were introduced to reduce budget deficits and encourage economic growth. However, they have generally failed to reach even their limited objectives of increased economic growth through economic, institutional and structural reform.21

This was partly due to misallocation of programme aid and the ineptitude of African leaders and bureaucracies. But it was also caused by indiscriminate lending practices, which did not motivate governments to make the necessary reforms. Donors did not respect the governments' national development objectives, and implemented externally devised economic programmes. For example, during the 1970s and 1980s, the World Bank and IMF refused to support national development plans in Tanzania and Zambia that promoted self-reliant development.
After resuming relations with the international financial institutions in 1991, the Zambian government took out a series of loans from the World Bank for economic recovery, privatisation, investment promotion and social and economic adjustment, as part of an economic structural adjustment programme agreed with the Bank in 1991. An independent poverty assessment conducted in 1994 found that this programme has increased poverty in Zambia.22

The report found that three aspects of the programme actually harmed the poor:

(i) the removal of price controls and transport subsidies for maize, which squeezed the incomes of poor maize farmers in remote areas, while the large margins of private traders raised maize prices for poor urban consumers
(ii) the reduction of import taxes on rice reduced the income of poor rice farmers who had previously benefited from tariff protection
(iii) public expenditure on health and education decreased.

The structural adjustment IDA credits amounted to about US$755m between 1991 and 1994. In 2004, the government will be repaying these loans at about US$20m a year, given that it has not yet reached completion point23, and is therefore not eligible for full HIPC debt relief. In view of the failure of the structural adjustment programme to improve the welfare of the poorest households or to generate widespread economic returns, and given the steady decline of international copper prices over the past ten years (despite its current eight-year high), robbing the government of its main source of foreign exchange, Zambians cannot be expected to repay this loan at the cost of public investments needed to achieve the MDGs.

Even after the very limited HIPC debt-relief initiative, Uganda is still left with the same unsustainable level of debt repayment as before, and Zambia, which has not yet reached completion point, is still spending more on paying debts than on health and education. In addition to servicing their old debts, governments in these five countries have already taken out £4.4bn in concessional loans alone since reaching their decision-points for debt relief under the enhanced HIPC initiative. A new build-up of unsustainable loan repayments after 2010, when their grace periods start expiring, will compete with the limited domestic resources available for essential public investment needed to reach the MDGs.

| Table 3. Estimated debt interest repayment on new concessional and non-concessional borrowing (US$m) |
|---|---|---|---|---|
| Malawi | 5.6 | 15.1 | 34 | 7 | 30 |
| Mozambique | 8 | 36.5 | N/A | 14.3 | 59.5 |
| Tanzania | 15.5 | 64.2 | N/A | 24.6 | 132.4 |
| Uganda | 14 | 37 | 77 | 17 | 83 |
| Zambia | 25 | 93 | 74 | 45.4 | 84.6 |

Source: World Bank and IMF joint decision-point or completion-point documents.
Although the above figures are only based on estimates, they do indicate a trend towards increased borrowing in the next decade, which will lead to a doubling or even quadrupling of debt repayments after 2010. Government revenue and economic growth rates, however, are not expected to increase at similar levels (see table 2).

### Table 4. New credits and loans\(^1\) (US$m)

<table>
<thead>
<tr>
<th></th>
<th>IDA credits</th>
<th>IDA grants</th>
<th>Debt owed to IMF January 2004(^2)</th>
<th>New PRGF(^3) loans since decision point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uganda</td>
<td>1600.24</td>
<td>127.12</td>
<td>231.92</td>
<td>168.5</td>
</tr>
<tr>
<td>Zambia</td>
<td>493.1</td>
<td>173.75</td>
<td>854.69</td>
<td>351.29</td>
</tr>
<tr>
<td>Tanzania</td>
<td>1198.92</td>
<td>77</td>
<td>435.20</td>
<td>228.65</td>
</tr>
<tr>
<td>Mozambique</td>
<td>955.47</td>
<td>152.6</td>
<td>208.17</td>
<td>116.54</td>
</tr>
<tr>
<td>Malawi</td>
<td>225.15</td>
<td>56</td>
<td>16.71</td>
<td>19</td>
</tr>
</tbody>
</table>

Notes:
1. These figures were calculated by adding project approvals cited in the IDA projects database since decision point in each country. Decision points were April 1998 for Uganda, the end of 1999 for Zambia, June 1999 for Tanzania, the end of 1998 for Mozambique, and the end of 1999 for Malawi. IMF figures were calculated from IMF country information on current loans and purchases outstanding in January 2004.
2. The US$ value of total debt was calculated at the 19 March 2004 rate of SDR1 = US$1.479.
3. These calculations are based on actual amounts disbursed on all PRGF loans since decision point.

### How are loans agreed?

To ensure that the borrowing and lending practices from the past are not repeated, citizen groups and democratic institutions that represent them need to participate in the design of development projects and programmes, monitor their means of financing, and have the opportunity to hold their governments and donor institutions to account for failed projects and programmes or inappropriate terms of finance. The borrowing process needs to become more transparent and accountable by giving formal democratic structures, such as parliament, watchdog institutions and citizen groups, a larger role in deciding on and monitoring loans. The system of checks and balances on the executive branch of government, which has primary responsibility to decide on and monitor loans, needs to be strengthened through legal reforms and increased capacity if it is to fulfil these functions.
<table>
<thead>
<tr>
<th>Legislation</th>
<th>Malawi</th>
<th>Mozambique</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>bank internal regulations</td>
<td>Guarantees and Grants Act (1974); Public</td>
<td>Accountability Act (2003); budget Act (2002); MFPED</td>
<td>General Loan and Stock Act (1931)</td>
<td></td>
</tr>
<tr>
<td>Line ministry request</td>
<td>Yes</td>
<td>Yes – or large public or private companies</td>
<td>Yes – plus donors and/or consultants</td>
<td>Yes – or ministry of finance</td>
<td></td>
</tr>
<tr>
<td>Lender appraisal of the project</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes – and by government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Drafting and reviewing of a bill</td>
<td>Ministry of justice; attorney general</td>
<td>Ministry of planning and finance</td>
<td>Line ministry; donor; consultants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parliamentary approval and enactment</td>
<td>Yes</td>
<td>No – by ministry of planning and finance</td>
<td>Yes</td>
<td>Yes – but sometimes retrospectively</td>
<td></td>
</tr>
<tr>
<td>Parliamentary approval</td>
<td>No – central bank only</td>
<td>No – inter-ministerial committee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Presidential approval</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual debt sustainability assessment</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public access to debt information</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Future borrowing</td>
<td>Only concessional</td>
<td>No limits</td>
<td>IDA terms only</td>
<td>Limits, can be lifted by the president</td>
<td></td>
</tr>
<tr>
<td>Commercial borrowing policy</td>
<td>Ceiling</td>
<td>Yes</td>
<td>Ceiling</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Cap on future debt repayment</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Evaluate new loans against existing loan portfolio</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Sufficient trained staff</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
</tbody>
</table>

All the countries, apart from Mozambique, have at least one statutory instrument that outlines legal procedures for entering into a loan agreement. However, a culture of bureaucratic confidentiality and mistrust of civil society in some countries is blocking public access to information on external debt. There are no legal provisions in any of the countries under discussion for public access to debt information, although the Tanzanian government does publish all loan documents.

**Figure 5. Specific features of the loan-agreement process**

- **Malawi**: The minister of finance is responsible for examining the feasibility of a project and the cabinet committee on the economy's mandate is to discuss loan and debt issues before they are tabled in parliament. Parliament is currently drafting a debt and aid management policy to support this process.
- **Mozambique**: There is no legal provision dealing directly with debt issues, which in the past caused the government to inherit the debt of companies that took external loans without guarantees and then went into bankruptcy. External borrowing is controlled by the central government. This has led to a high degree of efficiency and coordination between the ministry of planning and finance and the central bank.
- **Tanzania**: The constitution mentions neither the role of parliament nor that of civil society. External borrowing powers have been concentrated in the hands of the minister of finance. Within this limitation, the 2003 amendment to the 1974 Government Loans, Guarantees and Grants Act attempts to provide a strategy for more efficiency in external public borrowing and in loan negotiations. In addition, the ministry of finance is working on strengthening its debt-management skills.
- **Uganda**: The country's constitution clearly outlines the role of parliament in loan agreements. The president is responsible for keeping parliament informed about how debts are used and repaid. The 1995 constitution focuses on decentralisation. Theoretically any part of local government can contract a loan, but in practice donors and lenders prefer to deal with central agencies, and have shifted from project to general budget support.
- **Zambia**: The legal framework changed significantly in 1969, in line with attempts to institute a one party state, ousting parliament from its controlling role over the borrowing process. The key piece of legislation, the Loans and Guarantees (Authorisation) Act gives the minister of finance excessive discretionary powers to borrow both internally and externally, to raise the upper amount they can borrow or to guarantee loans for third parties.

**Checks and balances in the loan cycle**

**Parliament**

Parliament has a dual role in the obtaining and use of borrowed funds. This role is internal, as an arm of government, and external, as the representative of the people, who should be the ultimate beneficiaries of loans taken in their name. Parliament, as the representative of the people, therefore needs to be involved in the process of agreeing foreign loans and in monitoring their use.

In Uganda and Malawi every loan has to be approved by parliament. Ugandan constitutional provisions on transparency in debt management provide an example of best practice to other aid-recipient countries. It stipulates that parliament has to scrutinise each development proposal, whether financed through loans or grants, to determine whether their objectives meet the development and poverty eradication goals of the Poverty Eradication Action Plan. However,
parliamentarians and parliamentary committees do not have the time or skills to debate the terms and risks of loan packages (especially in relation to the overall level of public debt), propose alternative means of financing, or monitor the project or programme to be funded by the loan.

The government can also sway parliament to rubberstamp loans, even if this raises objections to loan-funded projects. The Ugandan government recently overruled parliamentary and broader civil society objections to a power-purchase agreement between the government and AES, a private US-based power company, to build a dam near the Bujagali Falls. The government took an IDA grant to guarantee future repayments of its debts to the private company that will build, own, operate and eventually transfer the project. Ugandans are concerned about the future environmental and social impact of the project. The government is currently in closed-door discussions with the World Bank for a further US$115m loan for a guarantee.26

In Mozambique and Zambia, parliamentary approval is not required for loans. Although the Mozambican parliamentary commission monitors public debt that is recorded in the central budget, many sectoral programme and project loans are not recorded in the budget. In both these countries, loan decisions are left in the hands of ministries of finance and central banks. These institutions cannot be expected to take a broader view of people-centred development.

Auditor general
There are offices of the auditor general in all the countries studied (in Mozambique it is called the administrative court). The function of the auditor general is to audit and report on the country’s public accounts. In Mozambique and Tanzania, there are no provisions for the auditor general to exercise any control over or participate in loan negotiations. The auditor general offices in all the countries under discussion are relatively effective given the financial constraints they face and the fact that they lack legal powers to prosecute public servants who misspend or steal public money. In Malawi, the auditor general is a presidential appointee and does not audit the accounts of the president, the army, the police or foreign embassies, which limits its independence.

Parliamentary Public Accounts Committee
All of the countries, except Mozambique, have a Parliamentary Public Accounts Committee (PAC), which is empowered by law to conduct an independent audit of all public spending. However, in Tanzania, the committee is under the sway of the ruling party, while in Zambia its recommendations usually come after the budget has been passed and are generally ignored. In Malawi, a member of the opposition chairs the PAC to ensure balance. In Uganda, the Local Government Finance Act gives local assemblies a similar role to the PAC at a local government level.

At present, none of the committees are formally involved in scrutinising proposed loan packages or monitoring the implementation of loan projects that are not funded through the central budget.

Anti-Corruption Bureau
In Malawi, the Anti-Corruption Bureau (ACB) operates as a government department mandated by the Corrupt Practices Act (1995) to deal with cases of corruption, including those involving public loans and grants. Donors and the government jointly fund the bureau. It acts in conjunction with the director of public prosecutions, but is perceived as being more effective in handling cases of petty corruption than major, top-level cases. Civil society is regarded as a key partner of the ACB, particularly in terms of reporting cases of corruption.
The effectiveness of formal watchdog institutions

Table 6. Watchdog institutions

<table>
<thead>
<tr>
<th></th>
<th>Malawi</th>
<th>Mozambique</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor general</td>
<td>Not effective</td>
<td>Not effective</td>
<td>Not effective</td>
<td>Not effective</td>
<td>Not effective</td>
</tr>
<tr>
<td>PAC (parliament)</td>
<td>Effective</td>
<td>Does not exist</td>
<td>Not effective</td>
<td>Effective</td>
<td>Not effective</td>
</tr>
<tr>
<td>Anti-Corruption Bureau</td>
<td>Effective</td>
<td>Does not exist</td>
<td>Does not exist</td>
<td>Does not exist</td>
<td>Does not exist</td>
</tr>
</tbody>
</table>

This table shows at a glance the extent to which citizens could be protected from poor or corrupt loan deals or management if existing watchdog institutions were to become involved in the loan-agreement process. The criteria used to judge effectiveness are the power a body holds, its level of independence, and its level of financial and operational capacity.27 Some watchdog bodies have a legal role to oversee loans contracted by government. However, a number of these institutions are under-funded, under-staffed, or are not sufficiently independent from the executive. Moreover, although the constitution assigns them an important role in monitoring public finances, they do not use this power to monitor public loans sufficiently.

The World Bank in the loan cycle

The World Bank can either propose a project to the government of a host country or it can consider a proposal from the government. Following the initial approach from either side, the process leading to the agreement of a loan or credit goes through five phases:

1. **The identification phase**, in which a World Bank team works with the government to identify projects that can be funded as part of the agreed development objectives in the country assistance strategy (CAS), and creates a project concept note (PCN) outlining the project decided upon.

2. **The preparation phase** is driven by the borrowing country. The World Bank has a supporting role, offering analysis and advice where requested.

3. **The appraisal phase** is the responsibility of the World Bank, which reviews the work done during identification and preparation, often spending three to four weeks in the borrowing country.

4. **The negotiation and approval phase** involves both sides coming to an agreement on the terms and conditions of the loan. World Bank staff submit the appropriate documents to the Bank’s board of executive directors and the borrowing government for approval.

5. **The implementation and supervision phase**, in which the implementation of the project is the responsibility of the borrowing country, while the Bank is responsible for supervision, maintaining an oversight of the financial management of the project, including periodically requiring audited financial statements.

Under its current development policy, the World Bank claims to help governments take the lead in preparing and implementing development strategies in the belief that programmes that are country-owned, with widespread stakeholder support, have a greater chance of success.
According to this new rhetoric, the World Bank and its client governments are equal partners. However, the World Bank carries far more weight than it is willing to admit in public, considering the financial resources it commands and the dependency of low-income countries on it as a ‘lender of last resort’.

The relationship between the World Bank, client governments and their citizens is complex. In Uganda, for example, the World Bank and the government agreed to build a hydropower dam near the Bujagali Falls, despite opposition from parliament and environmental groups who were concerned about the social displacement and environmental destruction the project would cause. In Mozambique during the early 1990s, the World Bank insisted that the government reduce tariffs on cashew-nut exports, despite opposition from the government, the cashew-nut processing industry and trade unions. The World Bank country representative believed that trade liberalisation would bring better prices to peasant cashew-nut farmers. Only after 10,000 cashew-nut processing job losses did the World Bank agree to let the government raise tariffs on exports again.

In Malawi, the World Bank and other donors have been calling on the government to speed up the privatisation of the Agricultural Development and Marketing Corporation (ADMARC), instead of encouraging the government to open up this decision to public debate and national consultation with everyone who would be affected by the policy. These examples are a far cry from the World Bank’s stated commitment to ‘national ownership’ of policies.

The World Bank, through its policy advice and financial presence, wields significant influence over the political decisions of governments in low-income countries. It should therefore take responsibility for its policy advice and the projects it funds. It should encourage and respect local checks and balances (through watchdog institutions, domestic laws and public debate) on its country-level activities.

The IMF has a powerful influence on the economic policies and budget decisions of governments – IMF staff members often sit in ministries of finance. The IMF’s decision to lend to a country or not, based on its judgement of how well the government has implemented its prescribed economic reforms, ‘signals’ to all other international creditors and donors whether or not to give aid to a government.

Christian Aid and AFRODAD call upon bilateral donors and other creditors to stop giving the IMF this gatekeeper role. It should instead become an equal partner in a forum of donors, aid-recipient governments and citizens, which will develop and evaluate economic policies based on their impact on poverty. The IMF should only lend to countries that face problems paying their loan balance in the short-term, without imposing potentially harmful economic reform conditions on the loan. Where the government and international financial institutions do discuss economic policies, these discussions, and accompanying policy decisions and loans, should be subject to public debate and comply with domestic borrowing laws.

**Civil society participation in loan agreements**

Civil society organisations can participate in all aspects of public lending, from formulating development strategies, programmes and projects, to monitoring the impact of development programmes and overall public lending. They can do so by:

- carrying out research and advocacy during the loan proposal and agreement
- monitoring development projects and programmes, including how they’re financed.
Research and advocacy

The space open to civil society organisations in the loan-monitoring and agreement processes depends on the broader political context and their own ability to respond to potential opportunities. In the loan-agreement processes described on pages 15 – 17, there is no formal legislation that allows for civil society participation.

Nevertheless, there are more opportunities for participation in some countries than in others. In Uganda, for example, the Public Finance and Accountability Act stipulates that information on the use of borrowed funds should be made available to the public. However, the Uganda Debt Network has found that local government officials are suspicious of civil society organisations and are often unwilling to give them such information.

Since 2002, the Malawi Economic Justice Network has used the political space created by the PRS process to review and comment upon the national budget at the time of its presentation to parliament. The Malawi PRS also stipulates that: ‘Civil society must be involved in arriving at “agreements” for the HIPC initiative.’ But civil society has been only marginally involved in monitoring HIPC agreements, partly due to a lack of the necessary people and skills.

In Zambia, the Civil Society for Poverty Reduction (CPRS) has used the budget speech as an opportunity to make a series of recommendations to the government on borrowing prudently and responsibly, including putting a ceiling on the amount it borrows each year. These recommendations were based on in-depth research into the loan-agreement process in Zambia. Thousands of citizens have also taken to the streets; first at the end of the Kenneth Kaunda regime to protest against the rise in basic food prices as a result of World Bank policies, and recently to protest against the privatisation of state-owned banks and copper mines.

In all the countries under discussion, the PRS process has been the first loan-financed programme to be formally opened up to civil society participation, on the insistence of the World Bank and IMF. Given that they had to prepare PRSPs in order to qualify for HIPC debt relief, most of the relevant governments saw this merely as a means of accessing debt relief funds, and not as an integral part of the development process itself. Their lack of political commitment or previous experience of consultative policy-making, together with the inability of citizen groups to use the opportunity to make a meaningful impact on national development policy, meant there were huge limitations in the way national PRSs were formulated.29

Weak local civil society is a particular concern in Tanzania, Malawi and Mozambique. In these countries, civil society organisation staff members do not have the required technical skills, experience or resources to monitor external loans and grants or are too loyal to the ruling party to challenge government decisions; and the organisations’ formal influence is limited by the legal framework and political context.30

The World Bank and most governments view the role of citizens in the PRS process as strictly limited to non-economic decisions. Yet, in recent years, both the World Bank and IMF have emphasised that ‘national ownership’ is crucial for the success of all loan- and grant-funded development projects. Facilitating public consultations and the integration of informed citizens into the loan-agreement process will turn their claims into reality, and give the projects and programmes they are financing a greater chance of success.

Monitoring

Civil society organisations often have wide contact networks in communities because of the services they provide to households and their advocacy activities. This allows them to monitor the effect of loan-funded programmes and projects, as well as the funds freed up as a result of debt-
relief initiatives, on poverty. In Malawi, the Malawi Economic Justice Network has started monitoring budget expenditure and its effect. However, the government still deviates from its budget spending commitments and has passed supplementary budgets without consulting parliament or civil society groups.

Jubilee 2000 helped Uganda become the first beneficiary of debt relief under the HIPC initiative. Subsequently, the Uganda Debt Network has developed the ability of communities to monitor the use of the Poverty Action Fund (funds redirected from debt repayments and put aside for poverty reduction spending), using a community-based monitoring and evaluation system.

In Tanzania, the government has set up a debt-relief account to fund education, healthcare, water, infrastructure and agriculture. The account is audited and monitored every two months by a joint committee comprising donors, creditors, government officials, non-governmental organisations, the business community, the media and members of parliament. The government regularly informs public about how these funds are being used to reduce poverty.

**How can citizens become involved in loan-funded projects and programmes?**

The three loan-funded projects and programmes discussed below illustrate the opportunities and challenges for citizen participation in all phases of the World Bank loan cycle.

1. **Tanzania Social Action Fund**

The World Bank and the government set up the Tanzania Social Action Fund (TASAF) in 2000 to buffer communities from the potentially negative social impact of the structural economic reforms the government was implementing under a World Bank-led structural adjustment programme. It is a rapid-disbursement grant-giving fund to respond to requests by or on behalf of rural and urban communities for local development projects, ranging from digging and maintaining boreholes to setting up community centres. Its main objective is to increase the ability of communities to prioritise, implement and manage sustainable development initiatives. So far, 534 projects have been completed and 690 are in progress, providing about 70,000 jobs (just under half for women). Projects have included improving school, health and community facilities, and constructing roads, hospitals and schools.

The TASAF is financed by a US$60m concessionary IDA credit, approved in August 2000. The government had to pay a US$0.45m service charge, as well as a US$0.3m commitment fee for the loan. This interest-free loan will cost the government US$1.5m a year from 2010 for the next 40 years.

Although approved by parliament, the supposed beneficiaries of the loan were not consulted during the loan's preparation, appraisal or negotiation and approval phases. And there was no meaningful public debate inside or outside parliament on the need for and terms of finance for the many projects that the loan would fund. Organisations already helping communities were bypassed to set up entirely new and expensive government-run structures.

Civil society organisations, parliament and other watchdog institutions can now monitor the impact of the loan. They can see whether it has led to a sufficient increase in productive economic activity to allow the government to raise the domestic revenue required to pay back US$1.5m a year until the loan matures. If the loan is unsustainable and compromises the future public investments needed to reach the MDGs, the IDA should agree to cancel future repayments.
2. Zambian Enterprise Development Fund
In 1997, the ministry of finance and national planning approached the World Bank with a proposal developed by the ministry of trade and industry. The Zambian government wanted to complement ongoing economic reforms in Zambia with a fund to kick-start the Zambian manufacturing and export sectors. The loan was disbursed through a number of financial institutions (Anglo Leasing, Barclays Bank Zambia, Cavmont Merchant Bank, First Alliance Bank and Indo Zambia Bank) as a multipurpose investment facility to private enterprises that needed foreign-currency denominated loans to help them pay for imported parts used in export products, or to expand their export-production base. It also included a small matching grant scheme to help export enterprises.

The government and private enterprises, through the Zambia Association of Manufacturers and the Zambia Associated Chambers of Commerce and Industry, participated in negotiations and helped design the project with the World Bank. A technical committee, consisting of government and private-sector associations, was set up to evaluate and select technical and financial proposals for the multipurpose investment facility. This is an example of good practice, where beneficiaries were involved in the project's design and financial decisions. However, parliament did not approve the loan and was not involved in any stage of the loan negotiation. Therefore, there was no independent assessment of whether the Zambian government would be able to repay the loan in ten years' time, or of the project's wider economic and social implications.

Initially, most banks were reluctant to participate in disbursing the multipurpose investment facility funds, citing the non-risk-sharing element, the poor-quality applications received, and general manufacturing and economic decline as major stumbling blocks. They were also concerned about the requirement to provide matching funds, which led to a low take-up of grants.

Because the US$45m IDA credit was taken out before Zambia reached decision-point under the HIPC initiative at the end of 1999, it is included in the calculations of Zambia's overall debt stock eligible for debt relief. Even so, under the terms of the enhanced HIPC initiative, the government will still need to pay back about half of this loan from 2007 onwards for the next 40 years, assuming it has reached completion point by then. This will cost the government about US$5m a year in public revenues. The government also paid US$0.34m in service charges and US$0.22m in commitment fees to the World Bank when they signed the loan contract.

According to a recent World Bank assessment, this loan was successful in developing the production capacity of Zambian export firms. If so, this should provide the government with sufficient income from domestic corporate taxes by 2007 to repay the outstanding amount without compromising essential public investments for reaching the MDGs. Civil society organisations, parliament and other watchdog institutions should monitor whether economic conditions in Zambia, which have deteriorated in the past few years, will allow for this expenditure from 2007 onwards.

3. Poverty-reduction support credit in Uganda
The Ugandan government has borrowed three poverty-reduction support credits from the IDA since reaching its HIPC completion point. These credits were approved in three instalments of US$150m since 2001. They are intended to tackle the priorities identified in the Uganda Poverty Eradication Action Plan (PEAP), submitted to the World Bank as a PRSP to allow Uganda to qualify for HIPC debt relief and future loans. The Ugandan government will start repaying the first instalments of its credit in 2011, the second in 2012 and the third in 2013. By 2013, it will pay US$11.2m a year from public resources to service these credits. It has also paid a US$3.4m service charge and a US$2.3m commitment fee on these loans.
The limitations of the PRS process, which is now required of every low-income country that wants concessional loans, have been extensively documented.31 However, in Uganda, the PRS process offers civil society, parliament and other watchdog institutions valuable lessons on advocacy and how to monitor future loan processes. Civil society groups and local communities have gained a lot of experience and skill in policy formulation and monitoring the impact of government spending under the PEAP. They can use these skills to assess the future need for poverty-reduction finance, the terms of such finance – loans or grants – and the nature and impact of the project to be financed at all stages of the lending process.

Conclusions

Our research shows that governments and international financial institutions often negotiate and sign loan agreements in a non-transparent way. Citizens and watchdog bodies are not able to hold them accountable for the new loans they negotiate. Parliaments often end up rubberstamping new lending decisions, or if they have objections, as in the case of the hydropower project in Uganda, are overruled by the government. Apart from the PRSs funded by IDA credits, civil society organisations play no role in the loan cycle of any other IDA-project or PRGF-programme loans. This is partly due to the absence of formal space in the loan cycle, but also to civil society organisations' lack of the necessary resources and skills.

Recommendations

To African governments

1. Make transparent decisions about whether to finance development programmes and projects through loans or grants, based on the nature of the project, the ability to repay the loan from the returns of the project, and future trade-offs with the public investment needed to reach the MDGs.

2. Include citizens in the decision-making process through their formal representatives in parliament and official watchdog bodies, and through civil society organisations and networks that represent their different interests.

3. Enact legislation that will require the executive bodies responsible for dealing with external debt to make debt information accessible to the public.

4. Give parliament and other watchdog bodies a formal and substantive role in approving and monitoring all external loans.

5. Establish structures or processes outside parliament through which citizens can influence public loan decisions.

6. Set up official forums and processes through which citizens can debate and influence economic policy proposals to strengthen public ownership of economic reforms and promote their long-term sustainability.

To the UK government

1. Report to the UK parliament on the vote of UK executive directors in the World Bank and IMF on project and programme loans and grants.

2. Encourage G8 creditor countries to allow the IDA to disburse at least 40 per cent of its payments to HIPC for grants that do not impose more or harmful conditions on borrowing countries.

3. Explore ways of making up the shortfall in future IDA financing as a result of reduced loan repayments – including larger replenishment amounts and cross-financing from more profitable World Bank lending instruments, such as loans to middle-income countries.
To international financial institutions

1. Write off with immediate effect all pre-decision-point debts owed by low-income countries where paying these debts is reducing the resources available to governments to cover the costs of reaching the MDGs.

2. Establish a transparent, fair and comprehensive international arbitration process on debt in the United Nations to allow all creditors and debtors (including non-HIPCs) to resolve the repayment of past and future debts created through loans that went to non-productive or failed projects and programmes, or were misappropriated by governments.

3. Provide a minimum of 40 per cent grant financing from IDA resources to all HIPCs in future and increase the ratio for those countries that are most vulnerable to future debt distress problems. Ensure that such grants do not come with increased conditions.

4. Encourage national governments to make loan documents accessible to the public, drawing on the good practice of the World Bank, which publishes all loan programmes and projects on its website.

5. Encourage national governments to open up lending negotiations to watchdog institutions, including parliament and civil society, and to public consultation.

6. Respect domestic laws on future borrowing and repayment ceilings.

7. Provide government watchdog bodies and parliaments with financial and technical assistance to enable them to play an effective role in negotiating and monitoring external loans.

8. Stop requiring client countries to contribute counterpart funds for all loans and grants. This may cut off governments with small domestic revenues from much-needed future grants or credits.

9. Extend all future finance to low-income countries on IDA or better terms, including PRGF loans.32
Endnotes

1 The MDG approach has been criticised for a number of shortcomings. It tends to simplify poverty and development; was mainly developed by rich countries; relies on narrow indicators; and may distort national priorities. According to the UNDP, these concerns point to what could go wrong if the goals are taken out of context and seen as ends in themselves rather than as a benchmarks of progress towards eradicating human poverty. Rather, the MDGs should be determined by national development strategies and the target date, 2015, should not be seen as the end of the road. They are intended to mobilise and challenge all stakeholders to identify new actions and resources necessary to reach these goals.


3 World Bank estimates from the decision-point documents of the five countries.

4 Creditor countries decided at the 1999 G8 meeting in Cologne to give more debt relief to Heavily Indebted Poor Countries than under the terms of the 1996 HIPC initiative, in which creditor countries agreed to forgive some of the debts owed to them by their debtors.


7 For a summary of the methods used and their limitations see Antoine Heuty, Overview of MDG costing methodologies.


9 The UNDP has already done country calculations in Tanzania, Uganda and Malawi, but these suffered from some shortcomings. By their own admission, the New Economics Foundation estimates also face limitations. They had to rely on weak data, did not factor in external shocks, and did not develop an approach to estimate the complementarities between goals. But they did arrive at slightly higher figures than the UNDP costings by estimating higher capital costs and calculating estimated state expenditure. The World Bank and Millennium Commission are also in the process of developing country-level costings for reaching the MDGs.

10 The point at which donors decide that a government qualifies for HIPC debt relief. The calculations of how much debt relief to grant a government is based on the total stock of debt accumulated at decision point.

11 In 1992, Africa’s debt stock stood at US$300bn. For every dollar given in official development aid, three US dollars went back to rich countries in debt service payments. In 2003, US$19 of debt was repaid for each person in Africa – the same amount as was received in aid, Breaking Point: A Christian Aid briefing on the G8 Africa Action Plan, June 2003.

12 For a full conceptual explanation of this expanded notion of capital flight, see Yash Tandon, The role of FDI in Africa’s Human Development, paper commissioned by UNCTAD, 2000, unpublished.

13 Trade for Life, published by Christian Aid in 2001, gives a detailed analysis of the changes that need to take place in the international trading system for it to benefit low-income and developing countries.


15 Domestic priorities such as tying aid to the procurement of goods and services provided by the donor country, or foreign policy objectives such as stemming immigration or protecting business interests overseas.


17 A recent OECD survey of recipient countries showed a marked degree of frustration in recipient administrations for cumbersome donor procedures and reporting requirements, and dealing with donor aid that 'lacks fit with national priorities'. http://www.oecd.org/dataoecd/26/27/1958543.pdf (Phillip Amis and Lara Green, International Development Department School of Public Policy, Birmingham).

18 Where the rule of law is upheld, governance structures are reasonably democratic, macroeconomic policy is sound, and efforts to combat corruption are in place.
19 Jubilee Zambia has criticised the HIPC initiative, noting that it was misdirected, giving priority to debt servicing over meeting the needs of the poor, represented a continuation of the structural adjustment model which has not worked for Zambia, and is doomed to failure because its projections of factors such as future export earnings are unrealistic.


23 The point at which donors who have signed up to the HIPC initiative stop taking some of the debt repayments a government owes them. This point is reached only after the government has produced a poverty reduction strategy, implemented it for at least three years, and has fulfilled conditions set out by donors at decision point (see footnote 10) such as privatisation of state-owned enterprises, and so on.

24 In Uganda, despite a constitutional provision that local assemblies be involved in loan decisions, local officials are not keen to share information on loans and other finances with the public. Basil Kandyomunda, Making loans work for the poor in Uganda, AFRODAD Research Report, March 2004, unpublished.

25 This summary is based on information contained in five research reports commissioned by AFRODAD in March 2004. The reports are: N Khembo, Making Loans Work For the Poor in Malawi; G Dava, Making Loans Work for the Poor in Mozambique; B Kaiza, Making Loans Work for the Poor in Tanzania; S Muyakwa, Making Loans Work for the Poor in Zambia; and B Kandyomunda, Making Loans Work for the Poor in Uganda.

26 See Basil Kandyomunda, Making loans work for the poor in Uganda, a research paper presented to AFRODAD, March 2004.

27 This assessment is based on information contained in the five research reports commissioned by AFRODAD. See footnote 25.

28 We use the term ‘civil society’ to refer to all social life between the household and the state. This could include micro, small, medium and large enterprises: professional associations, trade unions, faith organisations, community-based organisations, environmental, development and research bodies, traditional leader associations, producer associations, and academia.


31 First, many of those living in poverty or their representatives in civil society and parliament were excluded from the consultation process; second, governments only showed selective willingness to consider civil society recommendations for policy priorities; finally the outcome of the exercise was predetermined by the macro-economic and structural-reform policies set by the IMF in its conditions for lending under the Poverty Reduction and Growth Facility. These policies aim to restore and maintain macro-economic stability and open up previously closed economies, without any assessment of the impact such changes will have on human development and poverty reduction.

32 PRGF loans carry a 0.5 per cent interest rate and have to be paid back within ten years, with a grace period of between three and five years.
## Glossary

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACB</td>
<td>Anti-Corruption Bureau</td>
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<tr>
<td>ADMARC</td>
<td>Agricultural Development and Marketing Corporation</td>
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<td>BOND</td>
<td>British Overseas NGOs for Development</td>
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<td>CAS</td>
<td>country assistance strategy</td>
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<tr>
<td>CRPS</td>
<td>Civil Society for Poverty Reduction: a network of civil society organisations established to influence the Zambian government’s poverty reduction strategy.</td>
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<tr>
<td>DAC</td>
<td>Development Assistance Committee: the Organisation for Economic Development and Cooperation’s development arm.</td>
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<tr>
<td>DFID</td>
<td>the UK Department for International Development</td>
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<td>HIPC</td>
<td>Heavily Indebted Poor Country</td>
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<tr>
<td>IDA</td>
<td>International Development Association: this association is part of the World Bank group. Its primary function is to make loans and grants to least-developed countries.</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<td>MDGs</td>
<td>Millennium Development Goals</td>
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<td>NEF</td>
<td>New Economics Foundation</td>
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<tr>
<td>NPRS</td>
<td>national poverty reduction strategies</td>
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<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<td>PAC</td>
<td>Parliamentary Public Accounts Committee</td>
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<td>PCN</td>
<td>project concept note</td>
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<td>PEAP</td>
<td>Uganda’s Poverty Eradication Action Plan</td>
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<tr>
<td>PRC</td>
<td>(World Bank) Poverty Reduction Credit</td>
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<tr>
<td>PRGF</td>
<td>(IMF) Poverty Reduction Growth Facility</td>
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<tr>
<td>PRS</td>
<td>poverty reduction strategy</td>
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<td>PRSP</td>
<td>Poverty Reduction Strategy Paper</td>
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<tr>
<td>TASAF</td>
<td>Tanzania Social Action Fund</td>
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<tr>
<td>TNC</td>
<td>Transnational Corporation</td>
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<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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