Preface

The 2002 Monterrey Financing for Development Conference established a consensus among the international development community that 'sustainable foreign borrowing' will remain an important source of capital to finance private and public investment in developing and least developed countries for the foreseeable future.

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. On the other hand, civil society organizations 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.

Citizens' groups need to be allowed to scrutinize 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' organizations 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 citizens to hold their governments and creditor institutions to account.

This report indicates that post independence loan contraction and debt management process in Malawi was handicapped by lack of adequate legal instruments, institutional mechanisms, practices and policies which enable parliamentarians, together with civil society, to strengthen their oversight role. Parliamentarians often do not have the basic infrastructure (office, internet connection, research assistants) to conduct their oversight role in a meaningful manner. Capacity building from donors is usually channelled through the executive and the judiciary, but rarely goes to parliamentarians.It was exacerbated by the intransigence of the Muluzi regime that developed very antagonistic relations with the donor community mainly due to its extravagance on party programmers. The incompetence and sometimes lack of political will on the part of parliament to play its effective watchdog role has costed the country its development for decades.

The report bemoans the fact that despite the fact that Malawi is heavily donor dependent, it has been slow to come up with aid and debt policies to ensure effective use and delivery of development assistance that comes in form of loans or grants for various government projects and programmes. Corruption has riddled the financing system for some time and only served to set back development.

The report also urges the Malawian government and international financial institutions need to listen to the citizens and ensure that development policies are informed and shaped by their needs and perspectives through formal and informal democratic processes. 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.

Charles Mutasa

Executive Director

List of Abbreviations

ADB	African Development Bank
ADF	African Development Fund
BDEA	Arab Bank for Economic Development in Africa
BFCE	Banque De France
BFR	Banque de Francaise Du Comm. Exterieur
BOP	Balance of Payments
CABS	Common Approach to Budget Support
CAS	Country Assistance Strategy
CDC	Commonwealth Development Corporation
CIDA	Canadian International Development Agency
CISANET	Civil Society Agriculture Network
COF	Coface
CS-DRMS	Commonwealth Secretariat-Debt Recording and Management System
CSO	Civil Society Organisation
DAD	Debt and Aid Management Division
DAS	Development Assistance Strategy
DFID	Department for International Development
ECGD	Export Credit Guarantee Department
EIB	European Investment Bank
EIC	Export and Import Bank of China
ESF	Exogenous Shocks Facility
EU	European Union
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
GOAT	Government of Austria
GOBE	Government of Belgium
GOES	Government of Spain
GOFR	Government of France
GORS	Government of South Africa
HERM	Hermes
HIPC	Highly Indebted Poor Country Initiative
IBRD	International Bank for reconstruction and Development
IDA	International Development Association

IDC	Industrial Development Corporation of Africa
IFAD	International Fund for Agricultural Development
IFIs	International Financial Institutions
IMF	International Monetary Fund
IRLAD	Irrigation, Rural Livelihood Project
JOEC	Japanese Oversees Economic Co-Operation
KFAD	Kuwait Fund for Arab Economic Development
MAPCOI	Malawi Parliamentary Coalition on IFI
MC	Mitsui and Company
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MEGS	Malawi Economic Growth Strategy
MEPD	Ministry of Economic Planning and Development
MFI	Multilateral Financial Institution
MGDS	Malawi Growth and Development Strategy
MOF	Ministry of Finance
NDF	Nordic Development Fund
NGO	Non-Governmental Organisation
NPP	Nippon Electrical Company of Japan
NRDP	National Rural Development Programme
OPEC	OPEC Fund for International Development
PFMA	Public Finance Management Act
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Paper
RBM	Reserve Bank of Malawi
SAL	Structural Adjustment Loan
SAN	Sanlam Properties Limited
SAP	Structural Adjustment Programme
SBA	Stand-By Arrangement
SEB	Skandinaviska Enskilda Banken
SWAp	Sector Wide Approach
TNCs	Transnational Corporations
UN	United Nations
USAID	United States Agency for International Development

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1.0 Introduction

In recent years there have been increasing calls for more transparent, inclusive and governance processes, in particular in loan contraction, particularly with the International Financial Institutions (IFIs), as ultimately it is the people who get saddled with the national debts. Inclusiveness increases national ownership of programmes, and it is to achieve this that poverty reduction strategy papers (PRSPs) are drawn up through a consultative process involving government, civil society and donors.

To a large extent, the loan contraction process in many developing countries, including Malawi, has remained a closed shop open only to donors and a select few in government. Although parliament approves foreign loans in Malawi there is little debate on the real issues involved, including payment terms and there is no proper analysis of whether the loans incurred will serve the interests of the people. Part of the reason could be that the parliamentarians themselves are not familiar with the issues and hence just rubber stamp proposals without performing the due diligence required.

As a result, many loans that developing countries received failed to perform for a variety of reasons, which on the part of the recipient countries included poor choice of project to fund with borrowed resources, lack of accountability by the governments, corruption and misuse of funds, inadequate capacity to administer and monitor the loans as well as lack of project ownership by the beneficiaries. It is the responsibility of governments to negotiate beneficial and sustainable terms of repayment, and to account for the programme success. To achieve this, governments need to be transparent, inclusive, and accountable throughout the loan contraction and debt management process.

Donors also contributed to the failure of some projects by imposing conditionalities on loans that were not practical or which negated the benefits that may have been derived from the borrowed funds by setting their own priorities instead of following those of the borrowing countries and in some cases by providing inadequate funding.

Multilateral creditors, including the World Bank and IMF, play a dominant role in assessing the loan applications and the terms and conditions of repayment. To this extent, they are also accountable for the success of the projects and for ensuring that loan repayments do not stifle a country's ability to achieve the MDGs and the ability of governments to fulfill the social and economic rights of their citizens.

The purpose of the study was to examine the loan contraction and management process in Malawi and make recommendations on improving transparency, accountability and participation in the debt management process. What follows is an outline the legal and institutional frameworks regulating Malawi's borrowing practices and how these work in practice. The role of the IMF and World Bank and other major creditors/lenders' in the loan contraction process and their lending procedures are examined. The role of civil society in the loan contraction and monitoring process is also examined. Finally, there is an assessment of the extent to which Malawi, as beneficiary of the Multilateral Debt Relief Initiative (MDRI), is preparing itself to maximize the use of debt relief resources to achieve the Millennium Development Goals (MDGs).

1.1 Overview of Malawi's External Debt

In the period 1964 to 1978, Malawi borrowed extensively to support export-oriented estate agriculture using the "project approach". From 1978 the project approach was replaced by a program approach, which coincided with the introduction of the structural adjustment programme (SAP). The programme approach itself had two phases. The first fell under the broad-based economic stabilization programme, which ran until 1987. This was supported by structural adjustment loans (SALs). From 1988 to 1996, sectoral adjustment programmes were introduced and were supported by sector-specific adjustment Credits (SeACs).

Most of the loans contracted up to 1976 were on concessional terms. However from 1976 the debt terms (interest rate, average maturity, grace period, grant element) began to harden and reached their stiffest levels in 1979. But the terms **eased again after the introduction of the SAP**[1] as the bulk of the debt contracted at the time was from the IFIs - World Bank, African Development Bank and European Investment Bank[2]. (see Table 1)

[1] Malawi introduced its first macroeconomic stabilisation programme based on the IMF's stand-by arrangement (SBA) in October 1979 and the first World Bank-supported Structural Adjustment Programme (SAP) in June 1981.

[2] By 2005, 90% of the debt stock was owed to multilateral creditors. Credit to bilateral creditors accounted for almost 10%. Debt to commercial creditors is negligible (0.2%).

Table 1: Stock of external debt and terms and conditions

Table 1: Stock of external debt and terms and conditions											
Item	1970	1974	1975	1976	1979	1980	1981	1984	1986	1987	1989
Average Interest %	3.8	2.2	2.7	4.8	8.3	6.0	6.7	3.9	3.1	1.7	0.8
Average Maturity Years	29.2	40.4	32.5	24.9	18.4	23.5	29.9	38.2	27.0	42.8	39.4
Grace Period Years	6.0	8.5	7.0	6.5	4.6	5.9	6.8	8.4	7.7	9.2	9.9
Grant Element %	47.0	66.0	57.0	40.7	19.3	32.4	35.5	54.1	51.1	72.7	80.1
Outstanding Debt (US$m)	123	230	260	299	661	821	812	876	1,161	1,373	1,394

Source: Kaluwa et.al (1992)

Because most of the loans in the earlier period were for the productive sectors, they generated sufficient foreign exchange to cover repayment because of increased exports. Between 1970 and 1979, for instance, economic growth averaged 7.2% (Kaluwa et al 1992). As a result, debt repayment remained sustainable and Malawi was able to repay its debts. However, SAP reforms failed to generate broad based growth. For instance, the export sector did not perform as expected and failed to generate sufficient export revenue to service the debts. Consequently, the balance of payments (BOP) deteriorated and Malawi increasingly relied on external borrowing to balance its books, which in turn worsened the debt position. Between 1989 and 2005 Malawi's debt stock grew by over 80 percent, but slowed down to 16 percent between 2000 and 2005. (see Table 2)

Consequently, by 1999, Malawi's debt had reached unsustainable levels[3]. The failure to reach the completion point under HIPC since 2001 meant that the country continued to service its debt at unsustainable levels.

Table 2: Debt outstanding & debt service payments (US$m) since 2000

Creditor Category	2000	2001	2002	2003	2004	2005
Bilateral						
Disbursed Outstanding Debt	353.3	308.4	333.6	353.6	342.4	289.0
Principal Repayment	12.1	13.6	11.6	7.2	5.1	5.2
Interest Payments	5.6	4.7	4.0	2.3	1.6	1.4
Total Debt service	17.6	18.4	15.6	9.6	6.7	6.6
Commercial Bank						
Disbursed Outstanding Debt	10.4	7.4	7.6	7.4	6.5	4.4
Principal Repayment	1.8	1.6	1.0	1.1	1.5	1.3
Interest Payments	0.6	0.7	0.4	0.4	0.4	0.1
Total Debt service	2.5	2.2	1.4	1.5	1.9	1.4
Multilateral						
Disbursed Outstanding Debt	2,165.4	2,176.0	2,418.3	2,667.8	2,802.9	2,648.0
Principal Repayment	36.9	46.0	37.9	53.1	62.8	65.7
Interest Payments	15.1	19.6	16.6	18.8	21.1	20.0
Total Debt service	52.0	65.6	54.5	71.9	84.0	85.7
TOTAL						
Disbursed Outstanding Debt	**2,529.1**	**2,491.7**	**2,759.4**	**3,028.8**	**3,151.8**	**2,941.4**
Principal Repayment	**50.8**	**61.2**	**50.4**	**61.5**	**69.5**	**72.1**
Interest Payments	**21.3**	**25.0**	**21.1**	**21.5**	**23.2**	**21.5**
Total Debt service	**72.1**	**86.2**	**71.5**	**83.0**	**92.6**	**93.7**

Source: Ministry of Finance

[3] Using the three measures, namely ratio of the Present Value (PV) of debt to exports (267 percent compared to the sustainable threshold of 150 percent), the debt service ratio (19 percent compared to the sustainable threshold of 15 percent, and the ratio of the present value (PV) of debt to domestic revenue (472 percent compared to the acceptable threshold of 250 percent)

For example, between 2000 and 2005, external debt service grew at an annual average rate of 6 percent. By 2005, the external debt service stood at US$93.7 million, about 20 percent of GDP. In 2004 Malawi's external debt was 151% of GDP while public domestic debt was 23% of GDP. In 2003, debt service to exports was 24%.

1.2 Current External Loan Agreements

As of July 2006, Malawi was servicing 216 loan agreements. Annex 3 presents a complete list of the projects funded. The top five creditors by number of loans being serviced, were IDA with 82 loans, ADF 47, EIB 14, Japanese Overseas Economic Cooperation (JOEC) 10 and International Fund For Agricultural Development (IFAD) with 9 projects. The pattern for total debt repayments was IDA at US$52 million, the IMF US$24 million, JOEC US$13 million, ADF US$5 million and EIB US$4 million. Although the IMF does not have many loan agreements, it received a substantial amount of debt service from Malawi. Repayment rates were influenced by the grant element of each loan.

Table 3: Summary of debt being serviced as at July 2006

Creditor	# Loans	Terms and Conditions				Farthest Maturity Date	Estimated Annual Debt Service (US$)
		Average Grace period	Average Concessionality	Average Interest rate	Average Commitment		
IDA	82	10	66.87	0.75	0.55	15/10/2054	51,961,350.42
IMF	4	5	48.44	0.50	0.25	01/12/2015	24,053,297.87
JOEC	10	10	10.55	1.93	0.10	20/12/2026	12,588,514.25
ADF	47	10	75.72	0.75	0.50	01/09/2054	5,216,504.57
EIB	14	8	53.02	2.16	0.00	15/12/2031	4,023,528.24
CDC	1	5	7.44	9.25	0.00	20/06/2009	3,326,783.84
EIC	1	6	27.10	4.00	0.00	30/04/2016	1,876,407.94
GOAT	1	15	38.96	2.75	0.00	31/12/2022	1,766,106.32
IFAD	9	10	57.72	0.92	0.22	15/12/2045	1,592,824.63
ADB	1	5	0.00	10.50	0.50	01/07/2011	1,372,315.52
KFAD	3	5	43.88	2.33	0.00	15/09/2029	1,352,811.87
OPEC	4	6	46.19	1.00	0.00	15/08/2024	1,341,733.14
BDEA	4	6	45.23	2.25	0.00	01/04/2030	1,206,742.93
GOFR	6	12	31.14	2.50	0.00	30/06/2042	1,182,465.16
MC	2	10	0.00	6.60	0.00	31/10/2008	827,533.54
NPP	2	10	0.00	6.60	0.00	31/10/2008	299,905.21
SAN	1	1	41.16	1.00	0.00	30/11/2019	251,133.31
NDF	5	10	66.35	0.75	0.00	15/07/2039	221,798.83
IDC	2	10	20.91	3.00	0.00	31/10/2008	180,279.68
SEB	1	10	16.68	7.40	0.00	10/01/2010	144,818.47
ECGD	2	11	2.98	~	0.00	31/10/2008	140,789.15
HERM	2	10	0.00	6.90	0.00	31/10/2008	82,413.79
COF	2	10	14.00	5.46	0.00	28/02/2009	78,171.43
GORS	2	10	36.11	2.00	0.00	01/07/2008	62,854.84
GOES	1	0	0.00	0.25	0.00	30/06/2048	50,341.41
BFR	2	10	0.00	2.00	0.00	15/02/2008	12,907.15
BFCE	1	4	9.12	10.59	0.00	08/04/2007	8,127.94
IBRD	1	10	10.18	6.03	0.50	01/02/2007	3,244.45
GOBE	2	10	65.68	0.00	0.00	31/12/2030	31.2
TOTAL	215	8.2	28.8	3.5	0.1		115,225,737

~ = Variable rate daily

Thus, the ADF had the highest concessionality, roughly 76 percent of the loans. IDA and Nordic Development Fund (NDF) followed with 67 and 66 percent respectively. The average grant element for IMF loans was 48 percent while JOEC loans had the lowest grant element of only 11 percent. The bulk of the loans had low interest rates, some as low as 0.75%. Banque de France and ADB, at 10.59% and 10.50%, charged the highest interest rates. (See Table 3)

On average, Malawi's current external debt is on better terms and conditions than the loans contracted in the 1970s and 1980s. This is largely because the bulk of the loans are from IDA and other multilaterals with larger grant elements and lower interest rates. Apart from the monetary terms and conditions, each creditor and loan has other non-monetary terms. Common among them are those relating to internal capacity, proper financial accounting and management of project funds, implementation of agreed reform measures as well as conditions for effectiveness, disbursements and the procurement process.

2.0 Loan Contraction - Legal and Institutional Framework

2.1 Legal Framework

The Malawi Constitution provides the overall legal framework for loan the contraction process. Section 180 of the Constitution stipulates that the government can only raise a loan under the authority of an Act of Parliament. Parliament may, in the Act authorizing the raising of a loan or by any other Act, appropriate the proceeds of the loan for specific purposes and authorize the payment of such proceeds out of the Consolidated Fund for such purposes. In terms of the Constitution therefore, Parliament has the power to authorize and ratify loan agreements. The Government prepares and presents a loan authorization bill, which has to be passed by Parliament and assented to by the President.

The Public Finance Management Act (No. 7 of 2003) outlines the authority and procedures to be followed in loan contraction. The Government may only borrow in accordance with this Act. Part VII Section 56 (1) states, "… the Minister [of Finance] is empowered to borrow by way of term loan within Malawi or elsewhere, as the National Assembly shall determine by an authorizing Act, not more than such sums of money as that Act authorizes. Furthermore, (2) prior to raising a loan the Minister shall first (a) ensure that it is in the public interest to do so; (b) ensure that it is fiscally responsible in accordance with section 12[4] ; (c) ensure that it is consistent with Government economic and fiscal policy; (d) satisfy himself that the Government has or is likely to have, on current projections, the financial ability to meet all the obligations under the loan including future loan payments; and (e) consult with the Attorney General and obtain in writing from the Attorney General, an opinion approving the legal aspects of the loan agreement".

Further, Section 56(4) provides for statutory debt service as follows: "all principal, interest and other money payable under a loan agreement shall be a charge on the public revenues of Malawi and on the Consolidated Fund or such other fund or account as the Minister determines, and shall be statutory expenditure payable at the times provided in the loan agreement."

With regard to external borrowing by any person, company or body corporate, organization or statutory body, Section 63 (1) of the Public Finance Management Act gives powers to the Minister of Finance to give, in writing, a guarantee or indemnity, but with prior approval of Cabinet and consistent with Section 12. When the Minister of Finance gives such a guarantee, s/he is merely required to report to the National Assembly. No Act of Parliament is required. However, the Act stipulates that the money the State pays under a guarantee or indemnity constitutes a debt due to the State from the person, company or body corporate, organization or statutory body and may be recoverable in any court.

There is no legal provision that requires the Government to consult civil society groups and project beneficiaries before borrowing from external sources. Even the principles of responsible fiscal management outlined in Section 12 of the Public Finance Management Act do not provide for consultations. Although the Act requires the Minister of Finance to ensure that the loan is "in the public interest", the Act does not specify how the Minister determines this. Ideally, one would expect the Minister to get the views of project beneficiaries whether the project would benefit them more than any other of the same magnitude. The Act is vague on this but a minister can use the provision to open up discussions on the loan with the public.

2.2 Roles of Relevant Public Institutions

Various public institutions are involved in the loan contraction process directly or indirectly. These include Parliament, Ministry of Finance, Reserve Bank, Offices of the Auditor General and Accountant General.

2.3 Ministry of Finance

The Ministry of Finance (MoF) is the sole institution mandated to borrow on behalf of the Government. The procedure is that line ministries and departments submit their project proposals to the Ministry of Economic Planning and Development (MEPD) for appraisal and subsequent inclusion under the Public Sector Investment Programme (PSIP).

[4] The Section specifies principles of responsible fiscal management

When a project has been included in the PSIP the MoF looks for funding for it. If locally generated revenue is not adequate to finance the project, MoF in collaboration with MEPD looks for external sources. When a creditor is identified and an agreement developed, MoF obtains legal opinion of the loan agreement from the Attorney General.

After that the MoF, with the assistance of the Ministry of Justice, prepares a Loan Authorisation Bill to seek Parliamentary approval. The President assents to the authorizing Act once Parliament has approved the Bill.

The Debt and Aid Management Division (DAD) in the Ministry of Finance, is mandated to manage all aspects of debt, including resource mobilisation, policy and technical analysis - debt sustainability analysis, loan financing proposal reviews, disbursement and debt service. DAD takes the lead in the loan contraction process and is always part of the Government negotiating team and works closely with MoJ in drafting loan authorization bills. DAD makes recommendations on best sources of finance and sustainable levels of borrowing and is currently leading the formulation of the Development Assistance Strategy, which aims to improve its role in aid coordination and effective donor management.

DAD collaborates with other players within and outside Ministry of Finance. It consults the Budget Division of MoF on issues related to loan agreement requirements for government contribution, budget allocations for debt service and other charges. DAD works closely with other bodies to monitor and ensure quality of processes. These include the Accountant General in making payments; the Auditor General in producing management accounts and audit reports and the Director of Public Procurement to procure goods and services.

DAD also works with the Reserve Bank's External Debt Service Section on technical analyses and debt disbursement and service. On debt service, the procedure is that DAD issues instructions to the External Debt Section of the RBM to effect payment for any Government loan at least one week before the payment due date. The sending of these instructions is triggered by either official reminders from the creditors or through frequent monitoring and reviews of obligations by DAD staff.

2.4 The Reserve Bank of Malawi

The Reserve Bank of Malawi (RBM) was established by an Act of Parliament to serve as the State's principal instrument for the control of money supply, currency and the institutions of finance. According to Section 43 of the Reserve Bank of Malawi Act (Cap. 44:02), when contracting any external loan, the Minister has to consult the Bank on the terms and conditions of such debt relating to interest, fees and maturity. In this case, the Bank acts as adviser to the Government in terms of Section 35 of the RBM Act.

The External Debt Section in the RBM works closely with the Debt and Aid Management Division of Ministry of Finance. The Section's debt management function is to monitor trends in external debt, both public and private, in terms of debt stock growth and service volume and to advise the Government on the best borrowing strategy to achieve sustainable debt levels. The Section ensures that records on each loan are properly kept and that the appropriate authorities undertake their obligations under the loan agreement. The Section also effects payment for all Government external loans.

2.5 Office of the Auditor General

The Auditor General (AG) has a crucial role in ensuring good governance and improved financial management in the loan contraction process. The role of the AG is to make public agents accountable for their actions. The AG depends on a well-functioning Public Accounts Committee, to achieve this.

The AG's office is established under Section 184 of the Constitution to audit and report on the public accounts of Malawi as prescribed by an Act of Parliament. According to Section 6(3) of the Public Audit Act (No. 6 of 2003), the Auditor General is mandated to audit and examine transactions, books and accounts, and other financial records associated with any project, programme, and other activities receiving funding from public moneys. The AG audits all institutions relying on taxpayers' money, and submits reports at least once a year to the President or the Speaker of National Assembly. Thus, the AG's Office is an independent institution, and the AG is accountable to the President and the National Assembly where he/she reports directly.

The AG does not have a direct link with the loan contraction process, apart from providing general oversight and enhancing financial accountability. The AG's annual report is presented to the National Assembly Committee for the Whole for debate. If the National Assembly finds issues in the report for further scrutiny, it refers them to its Public Accounts Committee. While members of the National Assembly only comment on reports by the AG, the Public Accounts Committee is mandated to examine and report on the transactions and financial statements of any institution that got funds/ money from the Consolidated Fund appropriated by the National Assembly.

To appreciate the advantages of the current legal and institutional framework for loan contraction in Malawi, it is important to note that until 2003, when the Public Finance Management Act and the Public Audit Act were passed, the 1994 Constitution and the Finance and Audit Act of 1962 provided the legal basis for the loan contraction in general and for the AG in particular. While the AG currently reports directly to Parliament, under the old legislation s\he had to prepare and submit Annual Reports to the Minister of Finance, who was responsible for passing them on to the Public Accounts Committee of Parliament.

The old arrangement was flawed as the AG also audited the MoF, which also funded them. As a result, the Executive could undermine the AG's oversight role by under-funding the department. Under the new arrangement, the independence of the AG has been further strengthened as its funding is determined by Parliament[5], while the new legislation also provides for independent staffing and compensation.

2.6 National Assembly

Parliament has two specific roles in the loan contraction process: to debate the Loan Authorisation Bills prepared by the Ministry of Finance in collaboration with the Ministry of Justice and to approve and legislate the raising of loans. In this role, Parliament can accept or reject the contraction of loans by approving or disapproving the Loan Authorisation Bills. The basis for disapproval can be twofold and may include unfavourable terms and conditions or loans that do not benefit the constituents represented by the parliamentarians.

Parliament's second role, through its Public Accounts Committee, is to debate the Auditor General's reports and take action against those found guilty of abusing or misappropriating funds. Although this function is carried out after the loan has been contracted and the money has been spent, indirectly, Parliament's insistence on improved financial management sends a message to the Executive on how future loans should be contracted and utilized. The manner in which Parliament has played the two roles is discussed below.

2.7 Implementation of the Legal Provisions

Apart from IMF credits, no loans are contracted without parliamentary approval. However, the extent to which the Minister sticks to some of the provisions of the Public Finance Management Act (No. 7 of 2003) is subject to debate. For instance, how does a minister determine that a specific loan is in the public interest? With minimal consultations before raising a loan, the Minister's judgment of what is in the public interest can be subjective. The Government has raised loans for some projects that were not viable. The Minister has also guaranteed loans of some parastatal, which then failed to generate the revenue to service those loans forcing the government to step in and pay. Although under Section 63(3) of the PFMA the government should recover the money from the parastals even through the courts, it has not used this route but has quietly paid off the loans.

Although the Minister is supposed to consult the Secretary to the Treasury for expert advice, the technical analysis that DAD makes on specific loans is often ignored due either to political expediency or failure to appreciate the issues raised relating to the terms and conditions of the loans. This leads to non-compliance with creditor procurement and disbursement rules, delays in preparation and submission of accounts and external audits as well as in the resolution of audit queries. The result of these delays is slow and poor implementation of projects and consequently higher commitment charges.

Traditionally the National Assembly has approved all bills authorizing Government to raise loans with little or no debate. This has led to laxity on the part of the Executive. Although the Minister is expected to prove to Parliament that the loan was to finance a project in the public interest, it is doubtful whether this was done. This may have been due to the limited extent to which the electorate can hold their MPs accountable during their 5-year term following the repeal of the Recall Provision in the Malawi Constitution in 1995.

[5]Parliament raised concern on low allocation to the AG's Office during this year's budget session

Thus 'rubber stamping' of loans continues even under the current 'perfect' parliamentary conditions where the opposition is in the majority and debate on economic issues is intense. Another possible explanation is that the MPs just do not understand the issues involved in loan contraction, which is worse as it allows projects that are otherwise not sound to be passed without due scrutiny.

2.8 Malawi's Record Of Debt Servicing

Malawi has a good record for servicing its external debt as the country follows the legislative provisions for external debt service to the letter [6]. However, the good performance on the external front appears to be at the expense of domestic debt service where Malawi is neither sticking to the borrowing limits nor servicing its debt on time[7]. This has led to the view that Malawi has more of a domestic debt problem than external debt. Domestic debt is closely linked to external debt. When Malawi's relations with the IMF soured due to the government's economic mismanagement, most donors responded by withholding their financial support. Consequently the Government resorted to domestic borrowing and ignored the legal borrowing limits resulting in the debt ballooning. To a large extent therefore, the rapid growth in total domestic debt stock since 2000 can also be blamed on the non-disbursement of budgetary support by donors as well as on increased Government spending.

Although the Government takes 'advice' from the BWIs not to contract expensive external loans, it ignores similar 'advice' from local experts in relation to domestic debt. There is therefore need to put in place mechanisms to ensure that the government keeps within the specified limits for domestic borrowing and spending.

The IMF supervises both the external and domestic debt using PRGF conditionalities and targets. On domestic debt the PRGF document requires the preparation of quarterly reports on the status of arrears and ceilings on central government's net domestic borrowing under the structural benchmarks and quantitative targets, respectively. However, the control mechanisms for domestic debt are in most cases ineffective and indirect as monitoring of the PRGF is on a quarterly basis when excessive borrowing has already been done. With external borrowing however, creditors immediately withhold funds when the government misses targets.

Although delays still occur in auditing, the Public Audit Act and the Public Finance Management Act have helped to speed up the process. The Public Finance Management Act stipulates that the Accountant General should prepare the financial statements for the fiscal year ending in June not later than October 31st. The AG should then examine them and provide a written report attached to the financial statements to the National Assembly expressing his opinion by December 31st. The financial statements, together with the report of the AG, are then passed on to the Public Accounts Committee.

Current AG reports are timely and often critical of ministries and government institutions that abuse or misappropriate resources. While prior to 2003 annual reports were only presented several years after the end of the fiscal year, making it difficult to follow up on cases, Controlling Officers now receive wake-up calls and follow-up investigations by Parliament's Public Accounts Committee are carried out while the trail is still hot. In the past, the effectiveness of the AG to enforce accountability was also frustrated by the absence of disciplinary action, follow-up investigations and prosecutions, but this is no longer the case.

2.9 Multilateral Financial Institutions and Donors In Loan Contraction

Malawi is heavily dependent on donors. About 60 percent of Government operations, 80 percent of the capital budget and 20 percent of the recurrent budget are supported by external loans and grants. Since the introduction of SAP, Government borrowing has been 'supervised' by the BWIs. Other donors, particularly the bilaterals, have taken their cue from the IMF, which has a signalling role, on whether they should provide financial assistance. If Malawi fails to meet IMF conditionalities, the major bilateral donors also suspend or withdraw their support.

The major donors include the UK's Department for International Development (DFID), United States agency for International Development (USAID), Canadian International Development Agency (CIDA), Japanese International Corporation Agency, German Technical Corporation (GTZ), and the governments of Norway, Sweden, Taiwan and China. Multilateral donors include the EU, World Bank, IMF, ADB and various UN Agencies.

[6] This is one of the reasons why Malawi could not qualify for the earlier HIPC Initiative.

[7] The Minister of Finance in his 2006/07 Budget Statement confessed: "For the first time, for a long long time, it has been possible to end the year with a sizeable repayment of domestic debt".

2.9.1 Donor support, processes and coordination

The role of donors and their impact on Malawi's loan contraction process varies depending on several factors. First, the interlocking nature of their operations in various sectors (Figure 1), affects the loan contraction and management process. In some cases, more than one donor supports different components of one project. In others one donor finances more than one project in several sectors or ministries.

Second, donors have their own interests and the involvement of government becomes tangential, especially when donor interests conflict with national interests, systems and procedures. Third, the types of support through, either grants or loans or both, also affect the process. Grants significantly reduce the need for loan financing, and ultimately debt stock and debt service. Availability of significant amounts of grants reduces the demand for loans, which increases the Government's flexibility in negotiating softer terms and conditions. Fourth, different donor procedures, terms and conditions, overstretch the government's capacity to negotiate effectively with them individually.

Some donors are also less flexible than others, which makes it difficult to adopt new modes of aid delivery and other best practices. The impact of the various donors on the loan contraction and management process also depends on the modalities of providing financial support, whether through project or budget support. Budget support and other proposals for effective aid coordination and harmonization, including through basket funding, (as currently provided by DFID, EU,

World Bank, Governments of Norway and Sweden)[8] , are consistent with the Paris Declaration. However, given the difficulty of meeting their audit requirements when funds are mixed in a basket fund, donors such as the US and Japan are unlikely to join the group. These factors complicate aid/donor coordination and management and create additional work for overstretched government officials.

Apart from the BWIs, the role of other donors in the loan contraction process is indirect. Bilateral donors like USAID, DIFD and Norway, who provide grants, reduce the need for loan financing. Other donors such as UNDP also provide technical assistance and training in debt management, thereby improving capacity in debt and aid management. Donors such as the US.[9] and EU Governments, which make large contributions to the IFIs, also indirectly provide soft loan financing to Malawi. This reduces demand for expensive loan financing and gives the country some flexibility in dealing with other creditors.

2.9.2 The World Bank

The role of the World Bank in the loan contraction process is both proactive and reactive. In either case, the loan or financing portfolio of the Bank largely follows its three-year Country Assistance Strategy (CAS), which in turn, is based on Malawi's overall macro-economic policy framework instruments such as the Malawi Growth and Development Strategy (MGDS). In developing the CAS, the Bank works with Ministry of Finance to initially identify focus areas, which form the basis for the consultation with various stakeholders. Thereafter the Bank conducts consultative meetings on the CAS with civil society. The responses and reactions on the proposed areas of focus from these meetings are then fed back to the Government. Thereafter, the Bank and the Government come up with the final list of priority areas of focus in the CAS. As a business plan, the CAS also specifies levels of funding in these priority sectors. The Bank, however, bemoans poor participation by civil society at these meetings. For their part, civil society groups complain the lack of interest by the IFIs to involve them throughout the process[10] .

In the proactive case, the Bank initiates the process. The local WB staff identifies an area of intervention on the basis of the CAS. It then works with the relevant Government ministry to develop the project idea. When this is developed, the WB local office asks the Malawi Government to write to the Bank seeking assistance. Roughly 80% of the current World Bank project portfolio comprise of projects initiated by the Malawi Government. The WB would like the proportion to be even higher. Due to capacity constraints, it is inevitable for the WB local office to assist in putting things together for the Government to adopt. In some cases a combination of the two modes is used as the Government takes an idea to the WB local office, which in turn puts the idea in project concept format for the Government to carry forward.

[8]The African Development Bank is expected to join this group of donors shortly.

[9]The U.S. Government makes the single largest contribution of about 25% of resources to the World Bank

[10] Some civil society groups admit lack of seriousness on their part, citing examples when the Bank invited them to a meeting and most of them disappeared before the end of the meeting. Others cited monthly and quarterly IMF meetings, which began with large attendance from civil society but attendance faded away as time went by.

World Bank representatives in Malawi are prepared to open up the loan contraction process to democratic oversight in parliament and consultations with civil society throughout. They cited examples of instances when they had to ask for the involvement of civil society[11]. Apparently, this is done when the Bank is pressured or does not trust government on a specific issue. The country representatives emphasize the need for civil society to be proactive and organized, given that the Articles of Agreement of the World Bank stipulate working with the government.

The Bank does not expect to face any conflict about the terms and conditions of its loans largely because these are formulated and agreed upon by Ministers of Finance of various governments, including Malawi.

Because there is no scope to re-negotiate the standard terms and conditions, the Bank expects the Minister of Finance to 'internally' handle any conflicts that may occur.

According to the World Bank local office, civil society needs to be proactive in several ways to increase their participation in the loan contraction process. They need to prepare a register of their organisations to be given to the Bank for inclusion in future consultations and engagement. For its part, the Bank proposes to establish a position in the local office to act as focal person for civil society issues. Just like in Kenya, this will increase visibility, transparency, accountability and inclusiveness. The Bank also proposes to hold quarterly meetings with civil society. To avert future debt build-up, the Bank has adopted a policy of funding through grants until Malawi qualifies for full debt relief under HIPC. Thereafter, the Bank proposes to reduce its lending portfolio by more than 50 percent from US$110 million a year to US$50 million a year.

The Bank's current official lending procedure - involving identification, preparation, appraisal, negotiation, Board (approval), signing and effectiveness - is not necessarily different from that practiced during the SAP era of the 1980s and 1990s. Although the involvement of civil society groups in the World Bank-government relations was forced upon them in the new mechanism, especially with the advent of the Poverty Reduction Strategies, the "stages approach" of reaching an agreement still remains a monopoly of the World Bank and the Government to a large extent.

2.9.3 The International Monetary Fund (IMF)

The International Monetary Fund (IMF) does not lend for specific projects but primarily provides BOP support to enable countries to rebuild their reserves, stabilize their currencies, continue paying for imports and restore conditions for strong economic growth. The IMF uses several credit instruments and facilities, including the Poverty Reduction and Growth Facility (PRGF) and the Exogenous Shocks Facility (ESF) for low-income countries like Malawi at concessional interest rates.

IMF's PRGF-supported programmes are supposed to be framed around comprehensive, country-owned Poverty Reduction Strategy Papers (PRSPs), which in turn, are supposed to be prepared by governments with the active participation of civil society and other development partners. As such, the targets and policy conditions in a PRGF-supported programme are supposed to be drawn from the country's overall policy framework instruments, and the 'other' terms and conditions of IMF credits should vary in relation to what the specific government proposes to do and plans to achieve.

After a decade of poor relations between the government and the IMF due to Malawi's economic mismanagement, the IMF Executive Board approved a new PRGF arrangement for Malawi on August 5, 2005, for SDR 38.2 million (about US$56.8 million) to support the government's economic program for 2005-2007. Performance under the programme is reviewed quarterly. The role of the local IMF office in the current PRGF has been to facilitate and monitor. The local IMF office and IMF missions from Washington often consult civil society and other stakeholders, including bilateral and multilateral donors, when designing and implementing this arrangement. In addition, the IMF holds quarterly meetings with civil society to discuss its operations in Malawi.

An assessment of the current PRGF shows that Malawi has met all the performance and quantitative targets. The quarterly reviews indicate significant improvements in macroeconomic management. The quantitative targets of the PRGF relating to the external sector reveal the IMF's significant role in Malawi's loan contraction process and in averting future debt build-up. These targets include a zero limit to accumulation of external payments and limit on new non-concessional external debt[12] .

[11] A very recent and encouraging development in testimony of WB's willingness to engage civil society groups is that the Bank has invited and funded the attendance of one of the civil society groups to this year's WB and IMF Annual Meetings in Singapore.

[12]On domestic debt, these targets include ceiling on central government's net domestic borrowing. However, as noted earlier, these targets are in most cases ineffective and indirect due to the fact that monitoring of the PRGF is on a quarterly basis when excessive domestic borrowing has already been undertaken.

While the statutes provide for limits on the extent to which the government can borrow on the domestic market, apparently there are no such limits on external borrowing. In the absence of such limits and the absence of an official National Debt and Aid Policy, the IMF conditionalities and targets in the PRGF continue to provide some control mechanism. However, as observed above, these limits breed some 'crisis' on domestic debt.

2.9.4 Civil Society In The Loan Contraction Process

The involvement of civil society in Government processes started with SWAps and SIPs, which predate the PRSPs. However it became more visible during the preparation of the first PRSP. Civil society involvement in the subsequent policy processes was not as prominent or as visible.

There has been little civil society involvement in the loan contraction process. This is not because civil society has not been proactive but more because the government has not seen it fit to include them. In initiatives, such as the PRSP, where the government and the IFIs wanted them to participate, it solicited their involvement and the door was open to whosoever wanted to participate. Civil society participation was not linked to their capacity as in some cases donors and the government provided capacity building for relevant CSO officials.

The question therefore, in relation to the loan contraction process and to development in general, is whether the Government and World Bank recognise that civil society can be a viable partner. When they recognize this, civil society involvement in any government process will become natural. The Ministry of Trade and Private Sector Development is a case in point as it involves the private sector on a routine basis in assessing the critical issues involving regional and multilateral organizations such as COMESA and the WTO.

CSOs claim that (i) GoM and IFIs hold the consultations after decisions have already been made, (ii) government and World Bank officials fear that involvement of civil society would slow down processes and (iii) most of the consultations are at the overall policy framework level and not project or programme levels and therefore of less interest to them.

3.0 A Case Study of a Loan Contraction Process The IRLAD Project

The Irrigation, Rural Livelihoods and Agricultural Development (IRLAD) Project is a case study to illustrate a typical loan contraction process in Malawi. IRLAD was chosen because of its poverty focus and because it is a long-term project. It is also a World Bank supported project. The case illustrates the reactive mode of project identification and assess the willingness of the Government and the WB to involve other stakeholders.

Project Description and Details

IRLAD Project is intended to (a) increase agricultural productivity and net incomes of poor rural households; and (b) strengthen the Government's institutional capacity for long-term irrigation development.

The project has four major components - Irrigation Rehabilitation and Development; Farmer Services and Livelihoods Fund; Institutional Development; and Project Coordination, Monitoring and Evaluation. Beneficiaries include smallholder farmers, Ministry of Agriculture and Bunda College of Agriculture, Natural Resources College.

The total cost of the project is US$48 million, with US$40 million representing IDA's grant contribution and US$8 million representing loan financing by the IFAD. The terms and conditions of the loan include a 10-year grace period after the first disbursement, repayment period of 30 years in 60 semi-annual instalments, and service charge at the rate of 0.75 percent on the principal amount of the loan outstanding. The completion date is December 31, 2011. The concessionality rate computed from the terms and conditions is 65.0 percent.

3.1 The Loan Contraction Process

3.2 Mixed Genesis

The project illustrates both the reactive and proactive modes of the World Bank's loan contraction process. First, until 2004 when the Government came up with the Malawi Economic Growth Strategy (MEGS), the World Bank had not been a major donor in the agricultural sector for some time but MEGS specified the agriculture sector as one of the growth sectors. Responding to the MEGS, the Bank approached the Government to find out what the key issues were in the agriculture sector. Thus WB reacted to the identification of the agriculture sector as a growth sector but was proactive by approaching the Government.

Based on the justification that the proposed irrigation project would involve several small-scale irrigation dams - as opposed to its large dam projects that failed globally - the World Bank accepted to work with the Government. Consequently, an appraisal team was fielded to work with the government team in designing the project and determining its feasibility and sustainability. Given capacity limitations in agricultural projects, the Bank recommended to the government the involvement of the Food and Agricultural Organization (FAO) to assist in the design of the project. The appraisal team then held consultations with relevant stakeholders including beneficiaries, at the design stage and with communities in the selected sites.

IFAD, which was already involved in several small projects in the agricultural sector, requested to participate in the IRLAD project. Again, this represents a combination of both the reactive and proactive modes on IFAD's part. IFAD was reactive because the government had already designed the project with the World Bank, and proactive because it requested to co-finance the project. Finally, consistent with its recent shift of funding from loans to grants, the World Bank participation in the project is through a grant while that of IFAD is entirely through a loan.

3.3 Negotiations and Involvement of Other Stakeholders

The Government team, comprising of officials from line ministries led by the Ministry of Finance negotiated the loan agreement. The negotiations centred on issues like conditions for effectiveness, disbursements schedules and the procurement process because the other terms and conditions were similar to those of WB. No civil society representatives were included. Even the Civil Society Agriculture Network (CISANET), which has been working in the agriculture sector, was not invited. .

As expected, Parliament was not involved in the loan contraction process until the IFAD Irrigation, Rural Livelihood and Agricultural Development Project Loan Authorization and Ratification Bill, 2006 was tabled in the National Assembly. Parliament passed the Bill on April 19, 2006 and the President assented to the Act on May 2, 2006. It is noteworthy that while the authorization bills contain the official terms and conditions, they do not include those on effectiveness, disbursements and the procurement process yet these are the very issues the Malawi Government team concentrated on in their negotiations with the Bank.

This was one of the few loan authorization bills that attracted some debate when it was tabled in parliament, but perhaps for the wrong reasons. Members of the House raised concerns regarding the geographical distribution and location of the irrigation dams. The concerns were however motivated by self-interest by MPs who were simply complaining because their constituencies were not included in the project.

3.4 Project Selection Criteria

There were no public protests or conflicts about the loan, except the debate on the Authorisation bill in the National Assembly. According to the government, the selection of the project sites in the eleven districts of was based on several factors. First, with limited resources, the project could not cover all the districts in Malawi. Second, the project sites were determined by availability of water. Finally, given that other donors, including the European Union, were already funding micro-irrigation projects in some districts, the selection of the districts under the IRLAD projects focused on the districts that were not covered by any donor.

Lessons Learnt

The case study above has important lessons on Malawi's loan contraction process. These include that civil society organisations should focus their involvement at the consultative stage when the potential donors consult project beneficiaries on the project, and not at the negotiating stages as these are left to the government. That there is need to build the capacity of parliamentarians to enable them to debate loan contraction issues outside the narrow and partisan context of their constituencies, but rather on broader lines of whether the loans are sustainable and will benefit the people. Given the size of the grant element of the project, it may also be necessary to assess whether the loan component covered by IFAD could not have been more sustainably covered using local resources, and thus avoid incurring a foreign debt.

4.0 Malawi as a MDRI Beneficiary

Without debt relief, Malawi will continue to service its current debt stock well into the 2050s. This constitutes a heavy drain of resources on the economy given an annual debt service estimate of over US$100 million (Table 4). This underscores the importance of debt relief and the need for the authorities to speedy reach the HIPC completion point.

The Multilateral Debt Relief Initiative (MDRI) provides for 100 percent relief on eligible debt from IMF, IDA and ADF to a group of low-income countries that have reached the completion point under the enhanced HIPC Initiative, and those with per capita income below US$380 and outstanding debt to the Fund at end-2004. The initiative is intended to help these countries advance toward the achievement of their MDGs by 2015.

4.1 Bumpy Road to HIPC Completion Point

The Boards of Directors of the IMF and the World Bank approved Malawi's eligibility for debt relief under the Enhanced HIPC on December 21, 2000. Malawi was initially expected to reach the HIPC floating Completion Point on December 31, 2003 after meeting the conditions agreed with the IMF, including maintenance of sound macroeconomic stability, satisfactory implementation of a three-year PRGF-supported program, successful implementation of the PRSP for one year, good governance, and the attainment of other structural criteria in the health, education and HIV/AIDS sectors.

The IMF Board approved a three-year loan under the PRGF for Malawi amounting to SDR 45.11 million (US$ 58 million) in December 2000. The loan was to be released in seven equal semi-annual tranches of SDR 6.44 million (US$ 8 million). The first tranche was released on approval. However the successful completion of the first review could not be achieved to warrant release of another tranche up until 2003. Major concerns of the IMF and other donors included increasing economic mismanagement coupled with lack of political will to reform. The Government failed to meet budget fiscal targets under the PRGF, resulting in huge monetary policy slippages.

The lack of a consistent and principled political leadership led to an ineffective and dysfunctional Parliament as President Muluzi's party, continued to control a parliamentary majority in both the first and second multiparty elections in 1994 and 1999. As a result, there were massive fiscal policy slippages and other governance concerns such as corruption and mismanagement of public resources. The prosecution of several high-profile corruption cases (APEX, SECUCOM, the Petroleum Control Commission cases) had stalled during the period. Senior officials in parastatals such as the Malawi Telecommunications Limited were implicated in corruption in 2001 and in 2002 other senior Government officials were implicated on allegations of selling maize from the strategic grain reserve in 2000/01 to politically-connected people at below-market prices.

The first review was completed in October 2003, and SDR 6.44 million (US$9.2 million) was disbursed. The first review was completed following waivers of non-observance of performance criteria by the IMF, including ceiling on stock of reserve money, net domestic financing of Central Government, commencement of full operations of a unit to monitor parastatals, and compilation of monthly reviews summarizing commitment levels and arrears. Thus, between 2000 and 2003, Malawi had SDR 32.23 million in undrawn balance with the IMF under the PRGF.

The Completion Point was not reached as scheduled mainly because of performance and policy slippages by the previous administration on the Poverty Reduction and Growth Facility (PRGF). It was envisaged that the Completion Point would be reached by end of December 2004 but recurring performance and policy slippages led to the suspension of the PRGF programme in April 2004.

The general election in May 2004 brought a U-turn to economic mismanagement under President Bakili Muluzi. The newly elected President Bingu wa Mutharika, adopted a policy of zero tolerance to corruption. His insistence on the rule of law set the stage for a new era of sound governance and prudent economic policies that won back the support of donors. To re-establish a track record of macroeconomic stability, the new administration had to be on the IMF Staff Monitored Programme (SMP) from July 2004 to June 2005. The Government successfully implemented the SMP, and the IMF Executive Board approved Malawi's new PRGF arrangement in August 2005.

Allegedly based on his zero-tolerance stance on corruption, President Mutharika left the United Democratic Front (UDF) party in early 2005 and formed the Democratic Progressive Party (DPP). The DPP government does not have a formal majority in parliament, but relies on opposition parties and independent members for support. This development resulted in a totally different chemistry in parliamentary representation by political parties, with the opposition in the majority. The result has been a totally different Parliament with intensive scrutiny of all issues brought before it, thereby increasing transparency and accountability by the Executive.

4.2 Malawi Finally Reaches HIPC Completion Point

Malawi finally reached the completion point after the IMF and the IDA agreed on August 30 and August 31, 2006 respectively that sufficient progress had been made to reach the completion point under the Enhanced HIPC Initiative. The agreement with the IMF followed the successful completion of the second review of Malawi's economic performance under the PRGF.

Malawi made good progress to reach HIPC Completion Point. All the quarterly reviews under the PRGF showed significant improvements in macroeconomic management, and the country met all the performance and quantitative targets under the PRGF. The Government was able to satisfy the IMF and the World Bank on all but two "triggers" for reaching the Completion Point. Both triggers were in the education sector. One was for Malawi to achieve a yearly enrolment of 6000 students for teacher training. The failure to achieve this was due to lack of capacity in the teacher training colleges themselves. The second trigger was that the share of the education budget would at least average 30 percent of the overall national budget. The failure to achieve this was justified by huge expenditures related to the food crisis. Thus, the IMF waived the two triggers, thereby successfully completing the Second Review of the PRGF, which in turn determined the Completion Point, and triggered Malawi's beneficiary status under MDRI.

The current administration's fiscal discipline in domestic borrowing contributed significantly to Malawi's progress in reaching the Completion Point. The Government also took steps to improve governance and fight official corruption.

4.3 Use of HIPC and MDRI Resources

Debt relief under the enhanced HIPC Initiative from all of Malawi's creditors amounts to US$646 million in net present value (NPV) terms as of the decision point plus a topping-up of this assistance equivalent to US$411 million in NPV[13] terms[14] as of the completion point. This corresponds to approximately US$1.6 billion in nominal terms . Debt savings under MDRI (World Bank's IDA, IMF and ADB) amounts to US$1.4 billion. Thus, as a result of reaching the HIPC Completion Point, Malawi expects to receive the equivalent of US$3.1 billion in total nominal debt relief under HIPC Initiative and the MDRI on principal as well as interest payment. Average Annual debt service savings are expected to increase from US$39 million between 2001 and 2005 to about US$110 million between 2006 and 2025. Thus, scaled-up resources as a result of reaching the HIPC Completion Point amount to an annual average increase of about US$70 million. Malawi's annual debt service payments on outstanding debt are expected to average US$5 million between 2006 and 2025.

While implementation of MDRI was immediate after reaching the HIPC Completion Point, debt relief from other creditors was not. The Government had to engage in a process of effecting debt relief with these creditors, including correspondences and meetings.

The Malawi Growth and Development Strategy - representing Malawi's second-generation Poverty Reduction Strategy (PRS) - provides the overall framework for effective use of the resources. The 2006/07 budget took into account the expected debt relief savings and specified the priority areas for funding. These include agriculture, rural development, infrastructure and energy.

Moreover, the country reached the HIPC Completion Point through prudent economic management under IMF's surveillance, and it is hoped that the current administration shall follow the same path. Further, Malawi continues to implement reforms to strengthen public financial management to reduce the diversion of public resources to non-priority sectors. At the center of these reforms is the rollout of the Integrated Financial Management Information System (IFMIS) across all ministries.

[13] The NPV of debt refers to the discounted sum of all future debt service obligations (interest and principal)

[14] Nominal value refers to the actual dollar value of debt service forgiven over a period of time

The dominance of the opposition in Parliament has resulted in more intense scrutiny of public resource allocation and spending. This has increased transparency and accountability by the Executive. The Government's policy of 'zero-tolerance' of on corruption is beginning to bear results and several prominent cases are now before courts of law. All these factors point towards more effective use of MDRI resources.

On the downside, although Malawi has a good legal and institutional framework to check public resource mismanagement it often lacks the political will to enforce them. Very few people who misappropriated public funds have been punished[15] . Moreover, in the financial management information system that Malawi has adopted only the treasury and 'chequemaker' modules are operational. To close other loopholes of abuse of public resources, it is imperative that the budget and procurement modules of the system also become operational.

[15]Every year the Public Accounts Committee of the National Assembly summons controlling officers to account for misappropriation of public resources. However, no real punishment is meted to those who are proved to have deliberately misappropriated public resources. In addition, Malawi has been without an Auditor General for over four months

5.0 Malawi's Human Rights Obligations and MDG Status

Malawi is a signatory to the Millennium Declaration that commits countries to an expanded vision of development, promotes human development as key to sustaining social and economic progress and recognizes the importance of creating global partnerships. The Declaration has eight[16] goals and 18 targets to be achieved by the year 2015.

Malawi has attempted to achieve the MDGs within its PRSP's Economic Growth Strategy and the Growth and Development Strategy, which have provided the overall policy framework for poverty reduction. In 2003, Malawi produced its first report on progress towards the MDGs, which highlighted the shortfalls in poverty reduction and in advancing human development. The 2004 Malawi Demographic and Household Survey and Malawi's second Integrated Household Survey provides data to update the 2003 Progress Report.

Recent assessments indicate that Malawi is well placed to achieve three of the MDGs by 2015, provided additional resources are made available. These include gender equality (Goal 3), minimizing child mortality (Goal 4) and reducing HIV infections and AIDS-related deaths (Goal 6). While good progress has been made in achieving gender equality in primary school enrolment and in reducing gender disparity in youth literacy, more needs to be done to reduce the gender gap in higher education and to increase women's participation in the workforce and in positions of authority.

Some progress has been made in reducing child morbidity and mortality since 1990. With additional resources, the goal can be achieved. Malawi appears to have halted and begun to reverse the spread of HIV/AIDS, and has also started to reverse the incidence of malaria, by increasing the proportion of the population using effective malaria prevention.

Prospects for achieving the rest of the MDGs by 2015, however, appear bleak. Malawi is unlikely to meet Goal One as little progress has been made in reducing poverty and ultra-poverty over the past decade. It is also not likely to achieve Goal Two as only 60 percent of children who start primary school actually complete a full course. Goal Five is also going to be elusive as maternal mortality actually increased between 1992 and 2000, and then recently begun to reduce, but the rate of reduction is not rapid enough to meet the MDG goal by 2015.

There are mixed signals on progress in ensuring environmental sustainability (Goal 7). On the one hand deforestation is rising at an alarming rate as more people use solid fuels, while on the positive side an increasing proportion of the population now has access to safe drinking water and improved sanitation.

Without debt relief it would have been impossible to meet the MDG targets, but with relief the targets will become more realistic although they will still be difficult to achieve and sustain given the country's low level of development. It will therefore be important to ensure that the resources coming through HIPC and MDRI be used with prudence and that any conditionalities attached to the use of debt relief resources take into consideration the MDG priorities.

5.1 Democratising Loan Contraction

Malawi's loan contraction process has not evolved in line with the democratic changes taking place in the country as it remains a monopoly of the Government, BWIs and donors. Neither civil society groups nor the project beneficiaries are involved although experiences in the development of SWAps, MPRS, MEGS and MDGs show the value of involving all relevant stakeholders.

Civil society's peripheral role in the loan contraction process shows that the government does not appreciate the value of inclusiveness and the need to involve the stakeholders and in the process to increase ownership, quality and efficiency. However, there are positive signs of increased engagement of civil society, by the IMF and the Bank which should be encouraged.

5.2 Can Malawi Do Away with External Loans?

Judging from the eight core MDGs, Malawi's development needs are too huge to do without external resources. Ideally, the country's import needs should be covered by its exports of goods and services as this would minimise external assistance.

[16] 1. Reduce extreme poverty and hunger; 2. Achieve universal primary education; 3. Promote gender equality and empowerment of women; 4. Minimize child mortality; 5. Improve maternal health; 6. Combat HIV/AIDS, malaria and other; 7. Ensure environmental sustainability; and 8. Organize a global partnership for development.

But prospects of rapid growth are minimal given the weak demand for its major export commodities, cotton and tea. There will therefore be continued need for external assistance to complement internal resources. The form these resources will take - whether grant or loan - will however determine the level of debt sustainability that can be maintained in the long term.

6.0 Making Loans Work for Malawi's Development

Three of the five principles of PRSPs also apply for loan effectiveness. The effectiveness of a loan depends on how the project is developed and how the loan is structured. Just like a PRSP, a loan-funded project can be effective if it is

1. Country driven and owned - broad based participation from formulation to monitoring
2. Results-oriented; and
3. Partnership oriented - active and coordinated participation of all development partners

Regardless of the source of finance of the project or programme, it is only when the beneficiaries realize the need and prioritise it that a project addressing that need becomes effective. Top-down development projects have failed. What is needed is bottom-up development planning. As a first step, decentralized government is more likely to be amenable to participation. Bureaucracy associated with central government makes beneficiary involvement costly and time consuming.

6.1 Best Practices in External Borrowing

The three principles of PRSP cited above and indeed the Paris Declaration on aid effectiveness provide a good basis for a best practice. The Declaration says that national strategies, owned by the country, should provide the road map for development, and that development partners should seek to align their funding to these strategies in the most effective and efficient ways possible. Bringing this to a project level, development needs articulated by the community, should be the basis for the development of projects for funding. The projects would need to be raised at district level and only projects in the district development plans should be funded. Taking this to the national level, external borrowing should only fund projects in the public sector investment programme (PSIP). The PSIP in turn should contain projects that originated from the district development plans.

The first step in loan contraction therefore should not be the development of a project concept, but should be the collective identification of development needs. Contracting a loan should be the last step in the process of addressing the development need. To solve the collectively identified problem, the development of the funding strategy (in this case the loan contract) should also be done collectively.

6.2 Core Pillars of Best Practices

- Loans should be contracted only to finance development with a have a human face. Development has a human face when the beneficiaries identify themselves with the development process as a solution to their problems.
- All investments and financing strategies must undertake careful cost-benefit analysis. The CBA on productive sectors projects should focus on rate of return to ensure that project contributes towards future debt payment obligations through increased export earnings or saved foreign exchange.
- Wider and substantive consultations are required to provide adequate information for decision-making by government and the IFIs, especially at the level of loan contraction. Selective consultations with relevant stakeholders are essential to provide a basis for choice and to engender ownership and partnership. Stakeholders who require capacity should be assisted so that they can contribute meaningfully to the development discourse, including debt issues.

6.3 Principles of the Best Practice

- Governments should only resort to external borrowing after they fail to get grants and given the country's level of development, external loans should be on concessional terms.
- Non-concessional borrowing should only be resorted for productive projects. Even then, careful and objective cost benefit analysis of the project and source of financing should be carried out involving all stakeholders.

7.0 Conclusion and Recommendations

A major finding of the study is that the concessionality of loans is not adequate to avert future debt crisis. Since 1981, Malawi contracted concessional debt from multilateral creditors but by 1999 its debt had become unsustainable. It is therefore recommended that some external borrowing limit be imposed on the basis of export revenues. Unless a project shows very high rate of return and is capable of generating enough foreign exchange over its loan period, it should not be financed once the limit is reached.

Consultations and collective responsibility within Government should be improved. Currently, Ministry of Finance, with some little help from Ministry of Justice, does everything on loan contraction. Even within the Ministry of Finance, there is little communication between Budget Finance, Economic Affairs and Debt and Aid. Further, the link between Ministries of Finance and Economic Planning and Development and the Reserve Bank of Malawi on loan contraction process is informal. The relationship should be formalized.

- It is recommended that a Loan Contraction Technical Committee be established comprising the Heads of Departments from Treasury and the Accountant General, Ministry of Justice, Ministry of Economic Planning and the Reserve Bank of Malawi. The proposed committee should finalise the draft National Debt and Aid Policy. DAD should act as the secretariat of the committee but this committee should be responsible for debt sustainability analyses and policy advice to high-level decision-makers.
- The World Bank and IMF were advocates of civil society involvement in development processes. While 'pushing' for civil society participation in Government development processes like SWAps, SIPs and PRSPs, they have not 'pulled' in civil society participation in their strategy and loan contraction process with the same zeal. It is therefore recommended that, apart from their establishing of positions for civil society liaison officers, they should make a deliberate effort to build their capacity as well involve the willing civil society organisations from an early stage in their processes.
- Donors must recognise the Government's limited capacity and respond by harmonising their procedures on loan contraction. This could be done through basket funding where donors co-coordinate their financial support under a Common Approach to Budgetary Support.
- Although civil society organizations in Malawi are not well developed, this does not justify their being sidelined in national debates. There is therefore a need to build the capacity of CSOs in community mobilisation for development planning and financing. The experience of PRSP development shows that the civil society can be brought to a level where they can engage government, donors and MPs in a constructive manner.
- CSOs should build their capacity to advise the National Assembly on issues relating to loan contraction. CSOs have not actively worked with Parliament to provide input into the loan Authorisation bills debates. By lobbying MPS from an informed position, civil society organisations would force the government to consult more widely before presenting the bills to Parliament. The critical analysis of the bills by the CSOs would help some of the less knowledgeable MPs to participate more meaningfully in the debates.
- Parliament should continue to authorise the raising of loans. However before a bill is presented before the Committee of the Whole, a specialized Parliamentary Committee should scrutinize. Further, the committee should demand the inclusion of all relevant terms and conditions, which are normally not included in such bills.

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Annex 1:

List of people interviewed

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