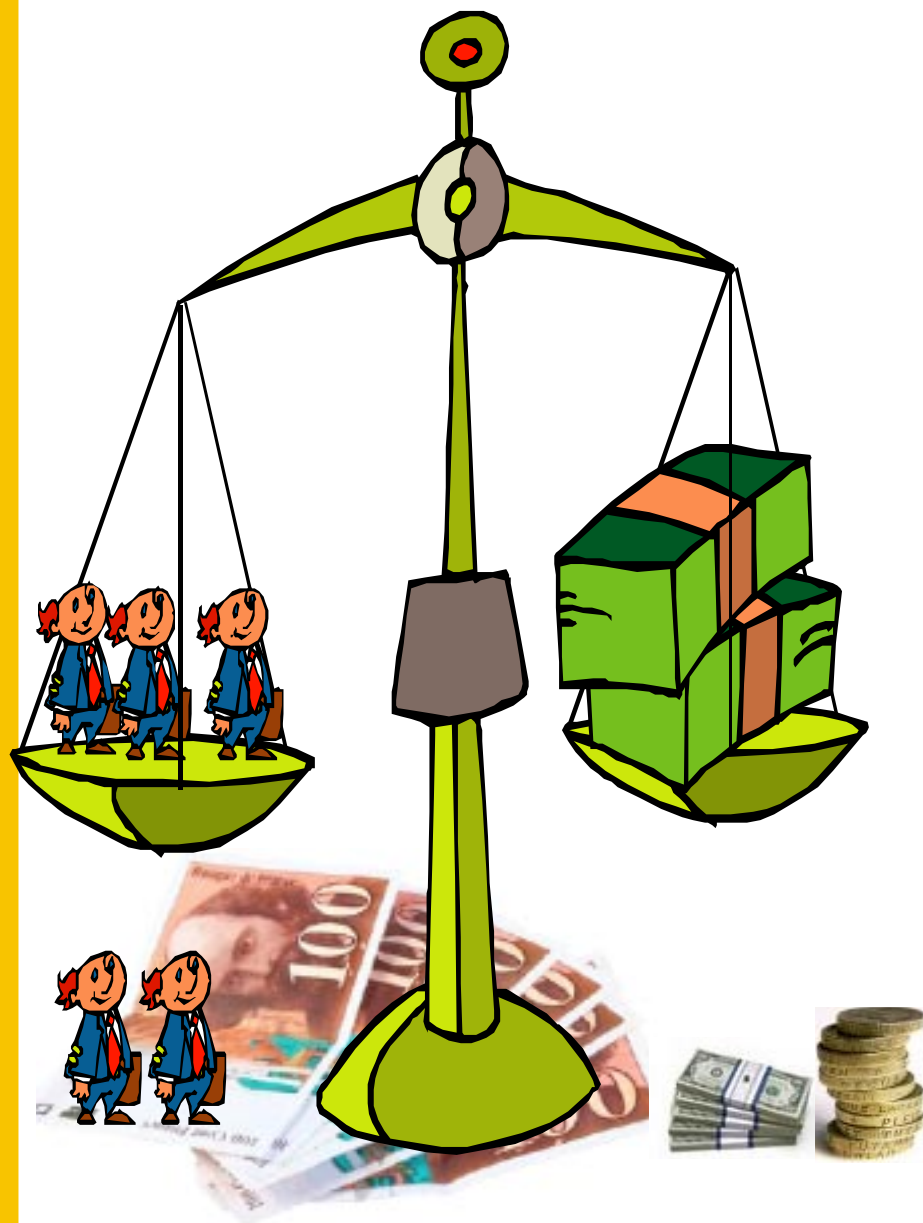


The Illegitimacy of External Debts



In the Case of
Malawi



African Forum and Network
on Debt and Development

The Illegitimacy of External Debt:

The Case Of Malawi

Final Report

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Abbreviations

ADB	African Development Bank
ADF	African Development Fund
ADMARC	Agricultural Development and Marketing Corporation
ASC	Agricultural Sector Adjustment Credit
ASH	Austrian Shilling
AUA	African Unit of Account
CBOs	Community Based Organisations
CPI	Corruption Perception Index
DEC	District Executive Committee
DEM	Deutschmark
ECU	European Currency Unit
EDDRP	Entrepreneurship Development and Drought Recovery Programme
EFF	Extended Fund Facility
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FFR	French Franc
FRDP	Fiscal Restructuring and Deregulation Programme
GBP	British Pound
GDP	Gross Domestic Product
GNP	Gross National Product
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
ITPAC	Industrial and Trade Policy Adjustment Credit
JPY	Japanese Yen
KD	Kuwait Fund
LIBOR	London Inter Bank Offered Rate
MASAF	Malawi Social Action Fund
NEPAD	New Partnership for Africa's Development
NGOs	Non-Governmental Organisations
NRDP	National Rural Development Programme

ODA	Official Development Assistance
PRGF	Poverty Reduction Growth Facility
PMC	Project Management Committee
PRSP	Poverty Reduction Strategy Paper
SAL	Structural Adjustment Loan
SAPs	Structural Adjustment Programmes
SAR	South African Rand
SDR	Special Drawing Right
UK	United Kingdom
UN	United Nations
US	United States
USAID	United States Agency for International Development
USD	United States Dollar

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Preface

At a basic level, the legitimacy of Africa's debts is highly questionable. Many of the loans, which are being re-paid now, were made during the Cold War to repressive regimes and corrupt leaders, who used the money to strengthen their rule or to line their own pockets. Africa was a hot battleground for the former USSR and the West, principally the United States. Both East and West furiously fought for the soul of the continent and disbursed billions of dollars in debt to any country that supported them, regardless of how brutal their leaders were or how bad their governments. Loans were made without attention to the viability of planned projects or to the capacity of the recipient country to make repayments. Very little of the money filtered its way down to the African people. Such irresponsible lending resulted in corrupt African leaders and governments grabbing as much money as possible to line their pockets, stash away in foreign bank accounts, invest in useless prestige projects, buy more arms and fortify their brutal security apparatuses which they then used to crush dissent, perpetuate themselves in power and create the conditions for the violent conflicts that today ravage the continent.

Demanding that the people of these nations and their new governments now pay for the corruption and mismanagement practiced by previous regimes is simply unjust. These debts are illegitimate, and should be cancelled outright!

Africa's debt burden and the zealous pursuit of repayments by international creditors have had severe repercussions in terms of the continent's human development. Forced cutbacks in basic social services have weakened health and education systems and undermined efforts to cope with the AIDS pandemic and the achievement of Millennium Development Goals (MDGs). Africa's children are suffering from malnutrition and are being denied the right to education by creditors who are determined to bleed Africa's economies dry. Meanwhile, the world's rich countries continue to ignore the huge debt that they owe to Africa, and to the global South more broadly, for centuries of plundering its human and natural resources. Then the question that still remains is "Who really owes whom?"

The growing calls from organizations in both the North and South for the complete cancellation of Africa's debt, without conditionality imposed by creditors and the need to redress the failed past and present debt relief initiatives imposed by the international community has prompted AFRODAD to undertake this research on Illegitimate Debt in Malawi

It is also a useful piece of work that draws on the failures by the creditor nations to acknowledge the share of their blame in contributing to this crisis. Despite the awareness raised by campaigners all over the world that debt is a result of an unjust financial system and that justice has to prevail in resolving the crisis, the rich and industrialized countries continue to dominate the decision making process at the global level rendering all other efforts by other development actors useless.

We hope this research will contribute positively to Malawi's current work.

We reiterate, as AFRODAD, the message that forcing the poor people of Africa to pay back illegitimate debts, which are now being used to oppress, kill and leave them with bloody legacies, is simply unjust.

Barbara Kalima-Phiri (Mrs.)
AFRODAD Coordinator/Director

Executive Summary

The illegitimacy of Malawi's foreign debt arises largely from the fact that the debt has been used to prop up despotic and corrupt regimes; from the adverse impact of the official foreign debt on economic and social development; the poor policy advice and poor project planning associated with this debt; the pressure from donors on Malawi to take up loans, especially for SAPs; the inability of the country to service its official foreign debt and the difficulties that it faces in servicing that debt.

Malawi has a comparatively high level of official foreign debt. As at the end of 2002, the sum of public and publicly guaranteed debt in Malawi stood at US\$2.7 billion, according to official statistics. Most (95.4 percent) of this debt was owed by the central government mainly to multilateral donors (85 percent), but also to bilateral (11 percent) and commercial (4 percent) creditors. The evolution of this debt shows that during the 1970s debt as a percentage of export earnings (called the debt ratio) exceeded 100 percent, but averaged less than 200 percent. Between 1975-79 and 1980-84 half decades, there was a marked increase in this ratio from 198.0 percent to 289.4 percent. This was followed by another rapid rise to 400.8 percent during 1985-89. However, since the latter half decade, the increase in the debt ratio has been slower, with the debt ratio averaging 478.0 percent during 1995-2001. As a percentage of gross domestic product (GDP), the pattern of growth of Malawi's public and publicly guaranteed debt has been similar (Table 8).

The country is also shouldering a relatively high debt burden. During the 1970s, the country's debt service as percentage of exports (the so-called debt service ratio) was modest and averaged less than 11 percent. The debt service ratio accelerated during 1980-84 and peaked at 32.4 percent during the subsequent half decade. Since then, it has declined, but it is still far higher than what it was during the 1970s. The pattern of growth of debt service as a percentage of GDP has been similar to that of the debt service ratio (Table 9).

The purpose of this study is to ascertain the illegitimacy of Malawi's official foreign debt, and to propose policy and institutional changes for resolving the problem of illegitimate debt. According to international civil society, foreign debt is illegitimate if it is against national law; it is unfair, improper or objectionable; or if it infringes on public policy. Illegitimate debt includes debts that cannot be serviced without causing harm to peoples or communities, debts incurred at usurious interest rates and debts that were not used for the intended purposes or were misappropriated.

Most of the official foreign debt of Malawi was incurred when the country was under the despotic rule of Banda. Creditors gave loans to prop up this oppressive regime and not to serve the interests of the people. In other words, this debt is odious. The loans from the IMF were not sanctioned by the nation through Parliament. Creditors continue to give loans to Malawi when they know fully well that the new regime is blatantly corrupt and wasteful in the use of resources. Again, most of the loans from the IMF are not sanctioned by Parliament.

All indicators of ability of a country to service its foreign debt point to the fact that Malawi's ability to service its foreign debt has worsened from around 1981 (Table 4). From 1960 to about 1980, the country enjoyed relative economic stability. Relative economic stability facilitated capital accumulation, which resulted in high rates of growth of the resources required for servicing foreign debt. Between 1981 and 2000, the average rate of growth of real GDP declined, implying that the resources for servicing foreign debt grew at a lower rate than the one achieved earlier.

The numerous debt reschedulings or postponements agreed to with the Paris and London Clubs since 1982 are symptomatic of the difficulties that Malawi has in servicing its official foreign debt. The same is true of the various debt forgiveness agreements and debt write-offs that the country has received from bilateral creditors, and the debt relief received under the second Highly Indebted Poor Countries Initiative (HIPC 2) from 2000.

Malawi's illegitimate debt should be cancelled for the following reasons:

- The moral argument that citizens of this poor country should not carry a debt burden resulting from debts acquired by despotic and corrupt governments that are not for their benefit.
- The fact that the country's illegitimate debt impinges on public policy, is unfair, improper or objectionable.
- The problem of moral hazard, which occurs when economic agents are insured against a risk and so are encouraged to engage in riskier behaviour. For example, the knowledge that the World Bank and the IMF can bail out the economy if it is in a crisis encourages creditors to extend loans they might otherwise consider too risky. Whether the government can repay or not, they know that they will recoup their investments. The moral hazard problem can be eliminated only if debts considered illegitimate are not subject to repayment and not included in bailouts.
- The argument of "force majeure", which is a principle of law that acknowledges that a significant change in the conditions of a contract may render it invalid. This can be applied to Malawi's debt crisis of the early 1980s which saw the dramatic rise in interest rates imposed world-wide by the U.S. government from the end of 1979 and the drop in export prices of developing countries.

In order to avert the recurrence of illegitimate debt, the Malawi Government should ensure that it is not burdened with new and onerous debt, support various proposals for international regulations, which would give it protection against creditors, and support the ruling that odious debts cannot be enforced. In addition, it should reject SAPs and adopt alternative development programmes and policies. In this regard, it should rely on grants and mobilize domestic financial resources through government savings to finance development before resorting to foreign loans, and mobilize and use social capital, wherever appropriate. On its part, Parliament should see to it that the government abides by national laws governing external borrowing. While civil society should support the search for and the implementation of alternatives to SAPs, and monitor government external borrowing and debt.

In conclusion, given the strong case for regarding Malawi's official foreign debt to be illegitimate, and taking into account the justifications for debt cancellation, Malawi can be used as a case study and as a guinea pig for dealing with creditors.

1 Introduction

1.1 The Doctrine of Illegitimate Debt

Foreign debt is illegitimate if it is against national law; it is unfair, improper or objectionable; or if it infringes upon public policy (Hanlon, 2002). Four categories of illegitimate debt have been identified. These categories are unacceptable loans, unacceptable conditions, inappropriate loans and inappropriate conditions (Hanlon, 2002). Unacceptable loans or conditions are those that are prima facie void because the loans involved clear misconduct by the lenders, violated the national laws of the debtors, or were grossly unfair. The relevant loans were given to corrupt officials and/or for bad projects or led to capital flight; whereas the relevant conditions were associated with policy demands that were against national policies. Inappropriate loans or conditions are those where the lenders failed to apply prudence and due diligence and gave loans that were inappropriate under prevailing circumstances. Examples include illegally (according to national laws) lending money at excessively high interest rates and loans for consumption purposes, and unsuitable policies that stand against national interests.

The Latin American Parliament has developed a legal foundation characterising four causes of illegitimate foreign debt. These are the origin of the debt (national criminal and civil laws need to justify whether there is forgery, fraud or irregularities involved); where the creditor increases interest rates unilaterally and in unlimited fashion; the Brady Plan Agreement, which forced governments of debtor countries to renegotiate debts with implicit and forced recognition of illegitimate debts, charging interest on interest; and co-opting of government negotiators who signed agreements then resigned to assume posts in private companies benefiting from the agreements (Frere, 2002).

In 2001 a meeting of debt campaigners convened by the Canadian Ecumenical Jubilee Initiative at the World Social Forum identified the following types of illegitimate debts:

- Debts that cannot be serviced without causing harm to peoples or communities;
- Odious debts contracted not for the needs of the people but to strengthen a despotic regime;
- Debts contracted for fraudulent purposes;
- Debts whose proceeds were stolen through corruption;
- Debts for projects that were never built or from loans that were not put to the use for which they were contracted;
- Debts incurred at usurious interest rates;
- Debts that have become unpayable as a result of creditors unilaterally raising interest rates; and
- Private loans converted to public debts under duress in order to bail out lenders.

To this list, we may add debts that have been paid in real terms where the countries are paying back not the original debt, but the debts they had to incur to pay back their debt. Debts that cannot be serviced without causing harm to peoples or communities are also referred to as immoral debts. Defined in this way, illegitimate debt includes odious debts, loans secured through corruption, usurious loans, and certain debts incurred under inappropriate structural adjustment conditions. According to McGill University legal scholars, there are three necessary conditions for a debt to be considered odious: (a) the debt

must not have received the consent of the nation; (b) the funds borrowed must have been contracted and spent in a manner that is contrary to the interests of the nation; and, (c) the creditor must be aware of these facts (Adams, 2002). It must be noted, however, that thus far there is no consistent odious debt jurisprudence. There are only precedents, which have been interpreted by some people as indications of the evolution of customary international law in this particular context.

According to Alexander Sacks, a legal expert who coined the doctrine of odious debt, if a dictator incurs debts not for the needs or interest of the state, but to strengthen his or her despotic regime, to repress the population that fights against it, or to colonise its territories with members of a dominant nationality, then these debts are odious to the indigenous population. These debts are not an obligation for the nation. They are the despotic regime's debts, personal debts of the power that has incurred them. When this power falls, those debts consequently fall with the fall of the power that incurred them (Sacks, 1927). Alexander further argued that if a government wished to invoke the doctrine of odious debt, it would be necessary to prove that the debt did not serve the public interest and that the creditors were aware of that fact. If the government in question proved this beyond reasonable doubt, the creditors would need to prove to the contrary and show that the funds were used for the benefit of the country.

The concept of odious debts, and hence illegitimate debts, has a long history. It first arose from the US capture of Cuba from Spain in 1898. Spain demanded that the US pay Cuba's debts and the US refused, on the grounds that the debts had been imposed on the people of Cuba without their consent and by force of arms. The US further argued that, in these circumstances, from the beginning the creditors took the risks of the investment. The concept of odious debt was upheld and formally entered international law in the 1923 judgment of US Chief Justice Taft in the case of *Great Britain vs. Costa Rica*. Two lawyers from the First National Bank of Chicago subsequently used the concept of odious debt in 1982 to warn their employers and other banks of the consequences of a change of sovereignty for loan agreements. In 1997, Njongonkulu Ndungane, Archbishop of Cape Town, used the same concept to make a case for writing off the debts of apartheid South Africa. And in December 2001, Argentinians took to the streets and demanded a suspension of the country's foreign debt, on the grounds that much of the debt got out of control during the 1976-1983 military dictatorship.

1.2 Objectives and Scope of the Study

The objectives of this study are to:

- To identify illegitimate debt and its key characteristics in the context of Malawi;
- To critically assess various national procedures for external borrowing in relation to Malawi's illegitimate debt;
- To trace the use and final destination of funds loaned for some key national projects before and after independence;
- To critically examine the process and period by which debt grew without legal, administrative and economic justification;
- To ascertain the performance of certain institutions and instruments of the state and their link to Malawi's illegitimate debt;
- To provide a basis for lobby, advocacy and dialogue with government and lenders/

donors on illegitimate debt issues; and

- To propose appropriate policy and institutional changes for resolving the problem of illegitimate debt and recommend mechanisms and strategies to avert the recurrence of illegitimate debt.

In pursuit of these objectives, the study elaborates on the concept of illegitimate debt and analyses and reviews information, perceptions and perspectives of the concept of illegitimate debt. The study also attempts to identify and quantify Malawi's illegitimate debt and explains its structure.

2 Background

Data on Malawi's official external debt during the colonial and early independence periods is sparse. From data that is available for the period from 1970, it appears that the country's external indebtedness increased rapidly at an average annual rate of 22.5 percent between 1962 and 1973 (Pryor, 1990). Several factors account for this development. Independent Malawi embarked on a development programme that required external resources, which were partly obtained by way of loans. Independence also meant that the government was now freer to borrow abroad, while as a member of multilateral financial institutions, the country became eligible for loans from there, in addition to bilateral and commercial sources.

Between 1977 and 1978, the external public debt of Malawi grew rapidly. The annual rates of growth of this debt were 50.1 percent in 1977 and 30.6 percent in 1978. This was a result of heavy borrowing in commercial markets to finance major investment projects by public enterprises. On account of central government borrowing, the debt grew rapidly again between 1979 and 1983, with the annual rate of growth averaging 33.0 percent, and between 1985 and 1986 when it grew at an average annual rate of 45.6 percent. Both public enterprises and the government took advantage of the favourable rating of the country by creditors to borrow heavily abroad. This borrowing contributed to the marked rise in foreign debt service obligations during the late 1970s and the early 1980s. It would appear that during this period official foreign debt grew without full economic justification and is therefore illegitimate.

The sharp rise in total external debt from the late 1970s and in particular in the early 1980s reflects a variety of other factors, which also contributed to the global and African debt crises of the same period. These factors included the quadrupling of the price of oil between 1973 and 1974 and the doubling of its price between 1979 and 1980. Malawi drew on the resources of the International Monetary Fund (IMF) during the first oil crisis. Later, Malawi also drew on the resources of the IMF under stand-by and compensatory financing arrangements, and contracted loans from the World Bank under structural adjustment programmes. During this period, Malawi also contracted loans from private or commercial sources. The period 1980-82, in particular, witnessed a sharp rise in credit from private sources and in credit contracted at floating rates. Credit from private sources consisted of suppliers' credit and commercial bank lending, with typical one-year maturities and three to five year repayment periods. The relevant loan contracts provided for flexible interest rates related to LIBOR. The rates of interest during 1980-82 were particularly high. Deflationary measures introduced by the Federal Reserve Bank of New York contributed to high rates of interest. On these grounds, the loans contracted by Malawi then can be considered to be illegitimate.

Unsatisfactory and declining levels of official financial inflows compounded the country's debt problem. In absolute terms, net disbursements of Official Development Assistance (ODA) rose in nominal terms throughout the 1970s, the 1980s and the early 1990s and peaked at US\$573 million in 1992. In per capita terms, they also peaked in 1992 at US\$64. However, in real terms, these disbursements declined from US\$169 million and US\$29 million in 1979 to US\$7 million and US\$0.65 million in 2000, respectively. Net inflows of public and private external capital also rose in nominal terms throughout the 1970s and peaked in 1980. Since then, they do not seem to have reached that level again. Like net ODA, they too did not increase in real terms. Thus, generally net inflows of external aid and credit did not provide adequate foreign exchange for servicing debt and meeting other commitments.

The share of ODA in the financing of gross domestic investment increased slightly from 39.4 percent in 1979 to 41.2 percent in 1982 (World Bank, 1985). Lack of data does not permit comparison with other periods. The grant element had, however, fallen over the same time period. Whereas it accounted for 97.0 percent of total net ODA in 1978/79, by 1981/82 it had declined to 73.6 percent.

The deterioration in the external debt position also reflected a worsening in the balance of payments since 1978, which in itself was mainly due to a sharp rise in transport costs following the replacement of short land routes to the sea through Mozambique by longer routes and due to deterioration in the terms of trade. Other contributory factors included a decline in the rate of economic growth after 1979 and currency devaluations.

Until 1970, the share of external debt held by bilateral donors was the single largest. The share held by financial markets was the second largest. The third and fourth were shares held by multilateral donors and private suppliers. From 1971 to 1978, the share held by multilateral donors was the second largest. But from 1979, it became the single largest and has been so since that time, followed by debt held by bilateral donors (Pryor, 1990).

The rest of the study is devoted to an explanation of why Malawi's official foreign debt is illegitimate and odious. The explanation takes into account the objectives and scope of the study as stated above, as well as the various dimensions of illegitimate debt. In particular, the examination considers who benefited from the debt, the quality of policy advice and project planning associated with the debt, the economic and social impact associated with the debt, the role of certain institutions and instruments of the state, national procedures for external borrowing, and the inability of the country to service debt and the difficulties that it is facing in servicing its official foreign debt. The analysis of illegitimate and odious debt is done in the following four chapters, which cover loans used to prop up repressive and corrupt regimes, loans associated with poor or wrong policy advice, loans for not rigorously scrutinised projects and inability to service the external debt. The breakdown does not follow Hanlon's scheme of unacceptable loans, unacceptable conditions, inappropriate loans and inappropriate conditions because Malawi's loans overlap these four categories.

3 Loans Used to Prop Up Repressive and Corrupt Regime

Malawi was a British Colony from 1891. The Colonial Office appointed a governor who ran the affairs of the country with the assistance of expatriate civil servants. However, effective control of the country remained with the Colonial Office. The country became independent of British rule in 1964, after a long period of nationalist struggle for independence that started soon after the Second World War. Most of its modern economic and political institutions are modeled on British institutions. It has a mixed economy and practises parliamentary democracy. Initially, independent Malawi was a multi-party state with a prime minister as head of government. In 1966, Malawi became a republic with a president as head of state and government. A little later, the country was declared a one-party state. In 1971 Banda became life-president, and remained so until 1994 when multi-party presidential and parliamentary elections were held. Within the colonial period, the country was a member of the Federation of Rhodesia and Nyasaland against the wishes of the majority African people from 1953 to 1963. During this period, the Federal Government ran some of the government functions, including economic affairs, from Salisbury, now Harare.

The creation of a one-party state with a life presidency effectively turned the regime into a dictatorial or despotic one. A number of factors facilitated Banda's acquisition of absolute power. First, Malawians believed that there was no other person in the land who could successfully lead them in the struggle against the federation and colonial rule. As a condition for accepting leadership of this struggle, Banda demanded and got absolute powers to run the Nyasaland (later Malawi) Congress Party, and, as a spillover, the government itself. Secondly, his success in breaking "their stupid federation" and winning independence for his people made him stand out as a saviour and a man of extraordinary ability who should not be questioned. Thirdly, whatever may be said about his despotic ways of ruling, Banda managed to get the support of the rural masses and consolidated his hold on the country through the Malawi Young Pioneers, Malawi Youth League, the Women's League, the police and the army. Fourthly, he had the support of donors who saw no alternative to him.

There was a lot of political dissent to his regime both within the country and abroad. He crushed this dissent ruthlessly through the youth wings of the Malawi Congress Party, the police and the army; and through excessive use of the preventive detention regulations under the Public Security Act of 1964, as well as traditional courts, which were allowed to try criminal cases. Some of the people who were detained died in prison. Malawians became so afraid that they learnt not to express their view on the regime in any form. Banda's intolerance of criticism extended even to officials of the party. The slightest sign of disloyalty on the part of these people was also ruthlessly suppressed.

Multilateral, bilateral and commercial creditors gave loans to Malawi to prop up the dictatorship. Three examples of major projects that were financed by donors for this purpose were the movement of the capital from Zomba to Lilongwe, the lakeshore road and the railway line that linked Malawi with the Mozambican port of Nacala. The British Government refused to finance these projects on the ground that the costs outweighed the benefits. Despite this assessment, the West German Government agreed to finance the lakeshore road, and the South African Government agreed to finance the movement of the capital and the new railway line to the Mozambique border. These donors supported the regime because in Banda they found a loyal ally in the East-West struggle and a moderate in the geopolitical struggles in Southern Africa. It is not known whether the dictator or members of the "inner circle" had any kickbacks from these projects.

How much of the country's total debt consists of loans that were given for the purpose of propping up Banda's regime is not known. According to Hanlon, one-fifth of all developing country debt consists of such loans (Hanlon, 1998). If we accept this assumption, the loans that were given to prop up Banda's regime amounted to US\$20 million as of 1964. By the time that the regime ended in 1994, the cumulative amount of loans given for this purpose was US\$400 million. This means that even though the regime committed gross human rights violations over a long period of time, the flow of funds continued. How much of those funds were lost through corruption, or were transferred to foreign banks, is not known. When the dictatorship fell in 1994, it was wrong to expect the democratically elected successors to repay those debts. Why should the victims of oppression be expected to pay the cost of their own torture and imprisonment? The creditors and not the borrowers should take responsibility for loans to dictators.

These loans should not be repaid also because they were associated with poor conditions and policies and because they did not benefit the people. Besides, these loans constitute odious debts as defined in international law, and therefore cannot be the responsibility of those that did not take them on and who suffered as a result of those loans. Strictly speaking, the debts did not receive the consent of the nation. The funds borrowed were contracted and used in a manner that is contrary to the interests of Malawi. The creditors were aware of all these facts. Furthermore, there is one other reason why these loans should not be repaid. This is the issue of moral hazard. Forcing repayment of these loans is tantamount to accepting to lend to corrupt and oppressive dictators. Creditors can understand that such loans are economically unwise and morally unacceptable only if debtors do not honour such debt.

The return to multiparty democracy in 1994 brought with it an apparent reduction in violations of civil liberties and human rights. But, lack of transparency and accountability in the way that the affairs of the state are managed and wastefulness in the use of public resources have increased. Furthermore, according to a number of surveys of businessmen, corruption cases and the media, corruption has become more pervasive, touching all aspects of life, in the public sector as well as in the private sector. There is a high level of corruption in public procurement, management of parastatals, management of government expenditure, provision of public services, among other activities. As measured by the Corruption Perception Index (CPI) released by Transparency International, the level of corruption in Malawi is actually rising (Table 1). In 2002, Malawi ranked 68th within a group of 102 countries worldwide. In addition to the CPI, public awareness of corruption in Malawi is high due to numerous high profile corruption cases reported over the past few years.

Table 1: Trends in the Malawi Corruption Perception Index

Year	CPI Score 10=Best, 1=Worst	Rank	Total Number of Countries
1999	4.1	45	85
2000	4.1	43	90
2001	3.2	61	91
2002	2.9	68	102

Source: World Bank, Malawi Country Memorandum Policies for Accelerating Growth, January 2003.

We shall briefly explain two examples of foreign loans whose proceeds were stolen through corruption. The first example is that of a theft reported in the "Daily Times" newspaper of 11th April 2000. According to the newspaper, this theft was uncovered by the government audit of 2000. The loan involved was granted by the European Union. The sum that

was stolen amounted to K650 million or 7.43 million Euros. The second example is the theft of US\$10 million, which the World Bank had lent to the Malawi Government for on - lending to small and medium scale enterprises through micro-finance institutions. This theft took place in the mid-1990s.

Corruption is deviant behaviour. Therefore, its causes are basically sociological, having to do with failure in upbringing. The recent rise in the level of corruption in Malawi is, however, due to weak governance. In 1995 Parliament passed a Corrupt Practices Act, which led to the establishment of the Anti-Corruption Bureau. The work of this body has been constrained by lack of a clear and comprehensive definition of corrupt practices and appropriate penalties, lack of power to prosecute corruption cases, lack of independence, an inadequate budget, limited numbers of staff, political interference and lack of political will to make its work effective. Other aspects of weak governance that account for the high level of corruption include complexity and use of discretion in the rules governing the business environment; e.g., vis-a-vis the taxes and incentives offered; and lack of transparency and accountability in the use of public money.

The high level of corruption in Malawi has increased the cost of doing business and affected the delivery of public services in general. Among other things, it has also adversely affected relations between Malawi and its creditors, who from time to time suspend disbursements of loans and aid. Suspensions of resource flows in turn adversely affect the effectiveness of foreign loans, and lead to massive deficit financing, with all that it implies in terms of inflation and high levels of domestic debt, which by the way is illegitimate because it is above the level permitted by law. Hence, the questions that were raised about the legitimacy of loans to the old regime can also be raised with respect to the new regime. Why should the country repay loans that were extended to a corrupt and wasteful regime, especially when creditors knew this fact?

The Ministry of Finance, the Ministry of Economic Planning and Development and the Reserve Bank of Malawi play a key role in acquiring stabilization and structural adjustment loans, which, on account of poor policy advice, and also poor policy design, constitute illegitimate loans. The Ministry of Finance plays a role because it has overall responsibility for financial matters in the government, the Ministry of Economic Planning and Development because it is responsible for economic development, and the Reserve Bank of Malawi because it is the custodian of government funds and has responsibility for maintaining a comprehensive database on public debt, processing debt servicing, as well as assisting the Treasury with debt management. These state institutions may suggest to the Bretton Woods Institutions the fields in which policy changes are required. But the IMF and the World Bank respond to suggestions on the basis of their own diagnosis. Often, they ignore the views of the state institutions.

Their views, rather than those of state institutions, dominate the negotiations for loans. The staff of the Bank and Fund draft the letters of intent and the framework papers, which describe the programmes that the country will implement supported by the resources of the Bank and the Fund. For these reasons, the state institutions see themselves as having no useful role to play in policy making. They see their role as being concerned with seeking loan money for supporting the budget and the balance of payments, and agreeing to reform proposals so that the country can secure debt relief. They do not see their role as being concerned with policy making. Civil society believes that the World Bank and the IMF control the process of securing foreign debt in order to foster their agenda, which is to open up the Malawian market to foreign goods, investment and consultants; and to promote capitalism.

The executive authority of the World Bank, the IMF and other donors over borrowing nations is illegal. According to general international law and international penal law, the SAPs and stabilization programmes, which they advocate, are illicit because these programmes and policies violate the basic rules of international laws. In particular, according to the UN Human Rights Commission, they violate human rights. Furthermore, SAPs and stabilization programmes constitute an illegitimate act because they are applied against the interests of borrowing nations. Asking for debt cancellation is thus a legitimate act and also a legal one since donors and the government have, in general, violated international law and, in some cases, domestic law.

4 Loans Associated With Poor Or Wrong Policy Advice

4.1 Stabilisation Loans

As indicated in a later section of this report, the economy of Malawi experienced rapid economic growth from the 1960s. The period of rapid economic growth came to a halt around 1979. At first, the country reacted to the factors that brought the period of rapid economic growth to an end by borrowing resources abroad. This led to a worsening in the debt profile and debt burden. Later, emphasis was placed on stabilisation of the economy through a series of short-term and medium-term IMF-supported stabilisation programmes. Short-term stabilisation programmes included a two-and-a half year stand-by arrangement concluded in August, 1979, for SDR 26.34 million, a two-year stand-by arrangement concluded in 1980, compensatory and contingency financing facilities, a one-year stand-by arrangement concluded in 1982, another one-year stand-by arrangement concluded in 1988, and yet another stand-by arrangement lasting less than one year concluded in 1994 (Table 2). These programmes aimed at restoring external equilibrium, reducing internal financial imbalances, promoting economic growth and reducing the rate of inflation. It was designed to pursue these objectives through the usual demand management measures and through measures for increasing exports. These measures did not achieve an improvement in the balance of payments, an increase in the rate of economic growth or a reduction in the rate of inflation on a sustained basis.

Medium-term programmes included an extended Fund arrangement of 1983, which addressed both economic instability and structural problems, an enhanced structural adjustment financing (ESAF) arrangement in 1988, an ESAF/PRGF (poverty reduction growth facility) arrangement in 1995, and a PRGF arrangement in 2000, all of which aimed at increasing the rate of economic growth, reducing the rate of inflation, improving the external financial position and reducing poverty. The measures for achieving these objectives included reducing monetary growth, achieving a balanced fiscal position, improving expenditure control, deepening structural reforms, strengthening governance and prioritising pro-poor expenditure. These longer-term programmes are best evaluated together with structural adjustment programmes, which they complemented and with which they shared common features. This is done later in the paper.

At this stage, suffice it to say that compared to the pre-adjustment period (1971-80) the data in Table 4 indicate that the external account position improved during the adjustment period (1981 to the present day). But, as indicated by budget deficits as percentage of GDP, internal financial imbalances increased during the adjustment period, implying that the expenditure control measures adopted were either not appropriate or not effective. Furthermore, the average rate of economic growth declined during the same period. None of the measures adopted aimed at expanding the stock of capital, which is a key determinant of economic growth in Malawi, or at improving total factor productivity, which is another important determinant of economic growth, or at increasing the number of years spent in school by the population, which is yet again an important determinant of economic growth.

Reducing monetary growth did not lead to a reduction in the rate of inflation. Meanwhile, the proportion of the population living below the national poverty line increased from 54 percent in 1991 to 65 percent in 1998 and 68 percent in 2003, implying that the policies were not effective in reducing poverty because they were not appropriate. As at the end of 2002, the amount outstanding on these longer-term loans was US\$69.8 million. The total debt owing to the IMF, including shorter-term debt, amounted to US\$92.8 million at the end of the same year. All this debt due to the IMF is illegitimate because it did not get

Table 2 Malawi: Stabilisation Loans from the International Monetary Fund

Type of Loan	Date Approved	Expiry Date	Amount Approved (SDR)	Amount Drawn (SDR)
Poverty Reduction Growth Facility (PRGF)	21/12/2000	20/12/2003	45.11	6.44
Enhanced Structural Adjustment Facility (ESAF)	18/10/1995	16/12/1999	50.96	40.96
Stand-by	16/11/1994	30/06/1995	15.00	12.73
ESAF	15/07/1988	31/05/1994	67.00	67.00
Stand-by	02/03/1988	30/05/1989	13.00	9.30
Extended Fund Facility (EFF)	19/09/1983	18/09/1986	81.00	57.00
Stand-by	06/08/1982	05/08/1983	22.00	22.00
Stand-by	09/05/1980	31/03/1982	49.90	40.00

Source : IMF Survey (various issues).

the consent of the nation through Parliament (no bills were brought before Parliament to authorise the government to borrow money from the IMF). It is also illegitimate because it did not benefit the nation. In other words, it is odious. Some of the debt consists of inappropriate loans for budget or balance of payments support or for drought relief. This is illegitimate to the extent that it represents consumption loans. Moreover, the conditions associated with IMF credits are either unacceptable or inappropriate as defined above. In addition, it would seem that Malawi is paying back debt in real terms, in the sense that it is paying back debt that it had to incur in order to pay back the original loan. A recent example of this is the US\$6.6 million Interim Assistance from the IMF to help Malawi make debt service payments on existing debts.

4.2 Structural Adjustment Loans

Between 1981 and 2002, Malawi received eleven structural adjustment loans from the International Development Association (IDA) of the World Bank, totalling \$661.0 million in value (Table 3). Other multilateral institutions co-financed some of the SAPs to the tune of \$121.2 million. And bilateral creditors loaned \$208.9 million for some of these programmes (Table 3). The debt due to the IDA alone that was outstanding as at the end of 2002 was estimated at US\$587.4 million. This excludes the SAL I loan, which was a hard loan. This loan is assumed to have been fully repaid to the World Bank. There were other debts owing to other creditors, the outstanding amount of which has not been estimated. The original loans only are shown in Table 3.

The data shown in Table 4 indicate that the various structural adjustment programmes succeeded in reducing external financial imbalances. But they failed to reduce internal financial imbalances and the rate of inflation, and to increase savings and investment rates, the rates of growth of real GDP and formal sector employment. A number of factors help to explain the generally unsatisfactory outcomes of SAPs. Some authors emphasize bad luck in the form of adverse terms of trade, disruptions to shorter trade routes

and a large refugee population in the country from the late 1980s to the early 1990s (Gulhati, 1989). But even if Malawi had experienced good luck, SAPs would not have been very successful because of poor policy design for which the donors are responsible. There was incompatibility among the policy objectives and lack of co-ordination among the policies. Another weakness is that the sequencing of economic reforms was not optimal. The country did not achieve macroeconomic stability before embarking on domestic financial sector reforms. The goods market was liberalised before financial and factor markets were liberalised, which was wrong sequencing. Foreign trade was also liberalised before liberalisation of the domestic financial sector, which was also wrong. Liberalisation of the capital account started before everything else, which again was not right sequencing (Chipeta, Mkandawire and Taye, 1999).

On account of unacceptable loans and poor policy design, SAPs can be said to be illegitimate. The acquisition of SAP loans was done according to law. These loans were also sanctioned by Parliament. But under one-party rule, Parliament merely rubber-stamped the actions of the executive branch of government and therefore did not exercise independent judgment. SAPs are definitely illegitimate because of poor policy advice associated with unacceptable and inappropriate conditions. These conditions included periodic adjustment of the exchange rate and interest rates, decontrol of industrial product prices, removal of fertiliser subsidy, and privatisation of state-owned enterprises, among others.

4.3 Agricultural Sector Adjustment Loans

In the agricultural sector, the principal objectives of structural adjustment programmes (SAPs) were to ensure appropriate price policy (Structural Adjustment Loan I or SAL I) and adequate incentives (Structural Adjustment Loan II or SAL II), expand the role of the private sector in the marketing of smallholder crops (Structural Adjustment Loan III or SAL III), increase efficiency and improve incomes of smallholders, increase efficiency of land use and protect the environment (Agricultural Sector Adjustment Credit or ASAC) and to complete removal of remaining pricing and marketing constraints on smallholder agriculture (Fiscal Restructuring and Deregulation Programme or FRDP I). The main policy measures implemented were rationalisation of and annual increases in smallholder producer prices; removal of fertilizer subsidies; reducing the role of the Agricultural Development and Marketing Corporation (ADMARC) in favour of private competition in marketing inputs and outputs; and allowing smallholder farmers to grow burley tobacco. Supporting macroeconomic policies stressed the control of inflation so as to shift the rural-urban terms of trade in favour of agriculture and the role of exchange-rate liberalization to remove the implicit tax on agricultural exports.

The yields of the main cash crops grown by smallholder farmers have not increased. The performance of the food sector under SAPs has also been unsatisfactory with no increase in yields of most food crops. This has increased the risks of food insecurity and necessitated food imports, which use up scarce foreign exchange. At the local level, the distribution of food imports is constrained by poor transport infrastructure and logistics. Hence, in addition to economic reforms, two interventions were required: policies that would increase productivity in the food sector, and direct intervention to lower transport and marketing costs (African Development Bank, 1995).

While the performance of smallholder agriculture cannot be attributed solely to SAPs (other factors included weather and the terms of trade), the fact that smallholder agriculture has not done well under SAPs suggests that SAP policies failed to arrest the impact of other factors on the sector. SAPs have addressed the price constraint, but not such non-price constraints as infrastructure and risk. Nor have they adequately addressed

such problems as inadequate producer incentives, unfavourable internal terms of trade and inadequate credit and extension services. Clearly, the agricultural development policies recommended by the World Bank under SAPs were unsatisfactory and for this reason the loans are illegitimate.

Table 3 Malawi: Structural Adjustment Loans 1981-2002

Name of Structural Adjustment Loan	Fiscal Year Approved	IDA Credit (US \$ million)	Co-financed by	Amount of Co-financing (US \$ million)
Structural Adjustment Loan I (SAL I)	1981	45.0		
SAL II	1984	55.0		
SAL III	1986	30.0	ADF	69.0
SAL III Supplement	1987	10.0	SJF USAID	30.0 15.0
Industrial and Trade Policy Adjustment Credit (ITPAC)	1988	79.0	Japan EU ADF USAID Germany Netherlands	25.0 15.0 17.2 35.2 10.2 3.9
Agricultural Sector Adjustment Credit (ASAC)	1990	79.0	UK Netherlands Germany	25.0 10.6 9.0
Entrepreneurship Development and Drought Recovery Programme (EDDRP)	1992	120.0	Japan ADF	70.0 20.0
EDDRP Supplement	1995	44.6		
Fiscal Restructuring and Deregulation Programme I (FRDP I)	1996	106.4		
FRDP II	1998	90.0		
FRDP II Technical Assistance	1998	2.0		

Source: World Bank (various documents).

5 Loans for Not Rigorously Scrutinised Projects

5.1 The National Rural Development Programme

From the late 1960s, the Malawi Government implemented comprehensive rural development projects in selected areas. These projects were management intensive and prohibitively expensive. So, by 1978, this approach had been replaced by a new National Rural Development Programme (NRDP) (Malawi Government, 1983). The NRDP aimed at a broader geographical coverage but focused more directly on support services for production, extension, marketing, credit, etc. The programme was divided into numerous rural development projects, each covering an ecologically homogeneous area. Increased productivity would be achieved by encouraging intensive rather than extensive farming practices in view of the scarcity of cultivable land. There were projects on farm mechanisation intended to break through the technology boundary. There were also projects to ensure that adequate soil conservation measures would be taken in order to minimise the damage caused by soil erosion (Malawi Government, 1987).

The failure of Malawi to develop smallholder agriculture, as explained already above, reflects inappropriate policies and an inappropriate policy environment, but only in part. This failure also reflects poor design of the NRDP and the individual projects that together constituted the programme. There were, for example, no projects to deal with the shortage of labour, especially at critical seasons of the agricultural cycle. There was a standard crop package that all areas had to adopt, irrespective of the suitability of natural conditions, whether the recommended food crops were used by the people there, and whether the people liked to grow them or not. The resource constraints of poor and women farmers were not taken into account. Improved food crop seeds that were recommended did not appeal to local farmers who considered them to be expensive to grow and difficult to store and process. The project appraisals exaggerated the expected rate of adoption of improved seeds, fertiliser and crop husbandry practices in order to show a high benefit/cost ratio and so win the support of donors. As if this was not enough, the government did not allocate enough resources to fund recurrent costs once the development of the projects was over. As we have stated above, yields of food and cash crops have not improved in Malawi, in spite of the NRDP. Food insecurity has increased. For these reasons, the loan costs of NRDP and its components funded by the ADB, IDA, ADF, IFAD, EU, USAID, UK and other creditors must be considered illegitimate and cancelled.

5.2 The Malawi Social Action Fund

This is a rapid disbursement project with the following objectives:

- i) to provide additional resources to create village level assets that will be directly beneficial to the poor through investments in primary education, peripheral health services and safe water;
- ii) to promote a new approach to rural development by involving communities in project preparation and implementation, while encouraging government agencies, NGOs and private institutions to assist communities when needed;
- iii) to support a district level programme of labour-intensive construction to be targeted at the poorest districts as a safety net operation; and
- iv) to strengthen poverty monitoring and assessment.

The project has gone through two phases (MASAF I from 1996 to 1998 and costing US\$56 million of IDA loan money, and MASAF II from 1998 to 2002 and costing US\$66

million in IDA loan money). The third phase (MASAF III) started in 2003. It will cost US\$32 million in loan money and US\$26.5 million in grant money from IDA. The total loan is thus US\$154 million. The first two phases had two main components; namely, a community sub-project where local communities chose projects for implementation in their areas and had these appraised by the district executive committee (DEC), leaving actual implementation to a project management committee (PMC); and a public works programme run by district commissioners, with localities selected on the basis of the degree of food insecurity, pay levels set below market daily rates, employment offered only to one member per family, and taking into account gender balance. MASAF III will retain only the first component. The other components will be concerned with capacity building and social support for vulnerable and the disadvantaged groups.

Neither MASAF nor the individual local projects are subject to rigorous project appraisal using net present value or internal rate of return methods. One wonders therefore whether MASAF is consistent with national development objectives and priorities and whether the money is used for a beneficial cause. Assets have certainly been created, but some are not in a good condition, although they are being used. Communities provide bricks, sand and their time. They do not take part in the actual construction, which is done by contractors. Hence, they are not acquiring the skills that they need for maintaining these assets. It is not surprising that they do not accept full responsibility for maintenance. Government itself is failing to finance recurrent costs of schools and clinics, so that the assets are not used effectively.

Traditional self-help spirit is being undermined by a new form of community development, which is largely commercialized. The modest funding of the public works programme and the decision to spread the benefits to as many families as possible meant that beneficiaries did not receive enough money to escape from poverty under MASAF I. Under MASAF III, the provision of social support through NGOs and CBOs is tantamount to commercialisation of social security, which for centuries has been provided locally through social capital. Besides, as is the case with contractors that build schools, clinics and bridges, most of the benefits will go to the organizations that will be serving the vulnerable and disadvantaged groups. For these reasons, the US\$154 million loan from IDA must be considered illegitimate and cancelled.

The IDA loan must be considered illegitimate for a number of other reasons. One is that the contracts have been awarded fraudulently to politicians belonging to the ruling party. Members of other parties have been denied contracts. In several cases, the contractors have not completed the projects, but they have been paid the money due to them.

6 Inability to Service the External Debt

6.1 Introduction

Ability to repay debt or debt servicing capacity is determined by three main factors. The first is the rate at which the debtor country is generating resources for servicing debt; in other words, the rate at which gross domestic product is increasing. The second is the rate at which claims of government on that output through tax and non-tax revenue are rising. (For debt owed by the private sector, the relevant variable is the rate at which profit is rising). The third factor is the rate at which receipts from abroad in the form of export earnings, grants and loans are rising. Since these factors are governed by a country's policy environment, which must rank as another factor that influences debt servicing capacity, we shall start our analysis with a brief review of Malawi's policy stance.

6.2 The Pre-SAP Period of Controls and the SAP Period of Liberalisation

The independent government of Malawi inherited an economy that was subject to controls, covering product prices, interest rates, imports, exports, entry into various economic activities, which it extended. Adoption of price controls arose from government's wish to influence the pattern of industrial development through policies on industrial licensing, import licensing, indirect taxes and duties, tax incentives and allowances, exchange control, minimum price controls on smallholder agricultural products and maximum price controls on manufactured goods. Most imported and locally manufactured goods were subject to some kind of formal or informal price control. Formal price controls applied to a set of key products like cement, fertilisers and sugar; as well as to products that formed the bulk of the basket for low-income groups. Owing to the large number of industrial products subject to price controls, delays between receipt of applications for price increases and approval adversely affected the financial position of business firms. Similar delays characterised the granting of tariff increases to public enterprises.

The pre-SAP period of controls ended in 1980, although controls as such were not dismantled immediately. The data in Table 4 show that the pre-SAP was a period of relative economic stability, with low rates of inflation, low interest rates, high rates of savings and investment, and high rates of economic growth and employment expansion. During this period, Malawi had no difficulty servicing its foreign debt. The period of stability and high rates of economic growth ended around 1979 as the balance of payments worsened and the country suffered from a serious drought and deterioration in the external terms of trade. In most respects, the post-1980 SAP period has been the reverse of the pre-SAP period, generating debate about the legitimacy of Malawi's foreign debt.

6.3 Structure and Growth of the Economy

The structure of the economy of Malawi in 1960 was typical of a very low-income country. Agriculture accounted for about 45 percent of GDP, whereas manufacturing accounted for 4.5 percent. Industry as a whole accounted for 8.8 percent and services for 24 percent (Malawi Government, 1965). Over 90 percent of the country's labour force was engaged in agriculture. By 1979, some structural transformation had occurred, as the share of agriculture in GDP declined to about 32 percent, while the shares of manufacturing, industry as a whole and services increased to about 12 percent, 20 percent and 45 percent, respectively. Since then, there has been virtual stagnation in the shares of agriculture, industry and services in GDP. The share of manufacturing increased at first, but later declined.

Table 4 Malawi: Selected Pre-SAP and SAP Period Macroeconomic Indicators

Indicators	Pre-SAP (1971-80) Period	SAP(1981-2000) Period
Rate of Growth of Real GDP (% Per Annum)	6.1	3.0
Rate of Growth of Formal Sector Employment (% Per Annum)	7.1	3.6
Gross Domestic Savings/GDP(%)	13.0	7.7
Gross Domestic Investment/GDP(%)	26.2	16.6
Commercial Bank Prime Lending Rate(%)	9.8	25.4
Rate of Inflation	9.5	24.4
Current Account Deficit of the Balance of Payments/GDP(%)	13.1	9.4
Broad Money/GDP(%)	16.8	17.2
Exchange Rate (Malawi Kwacha Per US Dollar)	0.8	13.1
Budget Deficit Excluding Grants/GDP (%)	-7.3	-10.2
Budget Deficit Including Grants/GDP (%)	-5.3	-5.7

Sources: Malawi Government, Economic Report (various issues); Reserve Bank of Malawi, Financial and Economic Review (various issues) and World Bank, World Development Report (various issues).

How Malawi's national income grew between 1960 and 2002 is summarised in Table 5. The data in Table 5 are shown by half decade in order to control for short-term influences. During the first half decade, real gross domestic product (GDP) grew at an average annual rate of 4.6 percent. During the three succeeding decades, real GDP grew more rapidly at an average annual rate close to or above 6 percent. What these high rates of growth imply is that the country's ability to service foreign debt rose during these periods. With the exception of the 1995-2000 period. Subsequently Malawi achieved lower rates of economic growth, averaging one-third during 1980-84, about one-half during 1985-89 and about one-tenth during 1990-94, of the average rate of economic growth attained between 1965 and 1979 (Table 5). These lower rates of growth have reduced the ability of the country to service its foreign debt, casting doubt on its legitimacy.

In per capita terms, real GDP on average grew at a rate close to 2.0 percent during the first decade. During the three succeeding half decades, real per capita GDP grew at an average annual rate above 2.0 percent and reached MK173.70 in 1979. This record is remarkable in comparison with the achievements of the colonial period and the less satisfactory performance of its neighbours, especially Mozambique, Zambia and Tanzania, and with the Malawi's own performance between 1980 and 1994 (Table 5). During the next three decades, the average rate of growth of real per capita GDP was negative, but it was positive between 1995 and 2000 (since then it was negative again until 2003).

Table 5 Malawi: Half-decadal Rates of Growth of Real Gross Domestic Product and Real Per Capita GDP

Halfdecade	Average Annual Rate of Growth of Real GDP %	Average Annual Rate of Growth of Real Per Capita GDP %
1960-1964	4.6	1.9
1965-1969	5.8	2.2
1970-1974	6.4	3.1
1975-1979	5.8	3.2
1980-1984	2.1	-1.3
1985-1989	2.6	-0.6
1990-1994	0.6	-1.4
1995-2000	5.8	3.8

Source: Malawi Government, Economic Report (various issues) and IMF, International Financial Statistics Yearbook 1990.

7 Information Collection

Information collected from official sources in Malawi indicates that, as at the end of 2002, the total of public and publicly guaranteed debt stood at US\$2.7 billion. Of this amount, 95.4 percent was owed by the central government to bilateral, multilateral and commercial creditors; 2.9 percent was owed by the Reserve Bank of Malawi to the IMF; and 1.7 percent was owed by public enterprises to bilateral, multilateral and commercial creditors.

The information shown in Table 6 gives a breakdown of bilateral loans by creditor, loan currency, the amount outstanding as at the end of 2002, average repayment period and the interest rate. The total amount outstanding as at the end of 2002 was US\$331.3 million. The Japanese Bank for International Investment was the single largest bilateral creditor, followed by the Export Import Bank of China, which was a distant second. Other important bilateral creditors were the Credit National of France, the Kuwait Fund and the Intern. Bk Fuer Aussehandel AG of Austria. These bilateral loans were contracted in nine different currencies, so the country must repay them in several major currencies, which is a burden in itself. The average repayment period ranges from 9 years to 21 years and the rate of interest form 1.9 percent to 8.5 percent. These rates of interest are hardly usurious. Thus, on the basis of the level of interest rates, these loans cannot be said to be illegitimate.

Table 6 Malawi Government Bilateral Loans as at the End of 2002

Creditor	Loan Currency	Absolute Amount Outstanding (US\$ millions)	Amount Outstanding as Percentage of Total	Average Repayment Period (Years)	Interest Rate (Percent)
Export Credit Guaranteed and Development	GBP	0.7	0.2	9.0	4.0
South African Government	SAR	1.9	0.6	12.0	4.5
International Development Corporation (South Africa)	SAR	0.7	0.2	9.0	3.0
Japanese Bank for International Investment	JPY	220.2	66.5	20.0	1.9
Credit National	FFR	27.1	8.1	14.0	2.5
NEC Corporation	JPY	1.6	0.5	9.0	6.6
Mitsui & Co.	JPY	4.5	1.4	9.0	6.6
COFACE	FFR	0.4	0.1	9.0	5.9
Banque de France	EURO	0.2	0.1	9.0	7.1
Hermes Kreditversicherungs	DEM	0.4	0.1	9.0	6.9
Intern. Bk Fuer Aussehandel AG	ASH	20.9	6.3	19.0	2.8
Kuwait Fund	KD	23.1	7.0	21.0	2.8
Export Import Bank of China	USD	29.7	9.0	13.0	4.0

Source: Reserve Bank of Malawi.

In absolute terms, multilateral loans totaled USD 2,270.9 million at the end of 2002. The breakdown of this sum is shown in Table 7. The main multilateral creditors are the International Development Association (IDA) of the World Bank and the African Development Fund (ADF) of the African Development Bank (ADB). Loans from both institutions have long repayment periods. Moreover, interest rates on them are very low. However, these loans must be serviced, irrespective of the ability of the country to do so. Like bilateral loans, multilateral loans are also contracted in several currencies implying that repayment must be made in a number of major currencies, which is burdensome.

Table 7 : Malawi Government Multilateral Loans as at the End of 2002

Creditor	Loan Currency	Amount Outstanding (USD millions)	Amount Outstanding as Percentage of Total	Average Repayment Period (Years)	Interest Rate Percent
International Development Association	USD	1,781.5	78.5	33.0	0.8
World Bank	USD	7.5	0.3	15.0	7.5
African Development Bank	AUA	19.2	0.9	14.0	9.0
African Development Fund	AUA	319.8	14.1	40.0	0.8
European Investment Bank	ECU/EURO	2.8	0.1	10.0	5.5
European Development Fund	ECU/EURO	73.0	3.2	18.0	1.7
UNDP	USD	0.3	0.0	14.0	5.0
OPEC Fund	USD	2.8	0.1	13.0	1.6
International Fund for Agricultural Development	SDR	52.1	2.3	40.0	1.0
Nordic Development Fund	SDR	7.9	0.4	30.0	0.8
BADEA	USD	4.1	0.2	13.0	3.0

Source: Reserve Bank of Malawi.

Central government commercial credit was also contracted in a variety of currencies. Most of it, 89.0 percent, is owed to De Organismos, Instituto De Credit Oficial. It carries an interest rate of 0.25 percent, which hardly qualifies this credit as illegitimate, with an average repayment period of 10 years. The rest carry interest rates ranging from 5.8 percent to 9.4 percent, with average repayment periods ranging from 4 to 10 years. The interest rates are not usurious and, hence, the credits are not illegitimate on this basis.

Public enterprises also owe money to bilateral, multilateral and commercial creditors. The one bilateral loan outstanding at the end of 2002 was owed to the Commonwealth Development Corporation. Most of the multilateral loans were owed to the European Investment Bank, whereas most of the commercial loans were owed to the International Development Corporation of South Africa. The bilateral loan carried an interest rate of 9.3 percent, with a repayment period of 10 years. Interest rates on multilateral loans ranged from 2.9 percent to 10.0 percent, with average repayment periods of 4 and 15 years. While on commercial loans, on one loan the interest rate was 7.4 percent, and on the other loan it was variable. Average repayment periods ranged from 7 to 10 years. None of the applicable interest rates were usurious. On this basis alone, therefore, these loans cannot be considered to be illegitimate.

8 Socio-Economic Impact of the Foreign Loans

8.1 Selected Indicators of the Debt Burden

According to the new criteria put forward by the World Bank, Malawi is a heavily indebted poor country. Annual data on the total external debt of Malawi are available on a continuous basis only from 1973. Prior to that year, the data are discontinuous. This weakness in the data aside, in the 1970s the total external debt of Malawi was modest (Table 8). Before the end of the decade, the total external debt rose and quadrupled between 1970-74 and 1980-84 (Table 8). During subsequent half-decades, the total external debt of the country grew at a slower rate, doubling between 1980-84 and 1990-94 and nearly tripling between 1980-84 and 1995-2001 (Table 8). In per capita terms, total external debt more than tripled between 1970-74 and 1980-84, but less than doubled between 1980-84 and 1995-2001 (Table 8).

An alternative method of ascertaining the magnitude of total external debt is to consider the so-called debt ratio (total outstanding debt as a proportion of export earnings). For Malawi the debt ratio is shown by half-decade in Table 8. The data in that table indicate that the debt ratio did not change much during the 1970s. Subsequently, it rose fairly rapidly, doubling between 1975-79 and 1985-89. From 1985-89 the increase in the debt ratio has once again been modest. As a percentage of gross domestic product (GDP), the pattern of growth of total external debt has been similar (Table 8).

Table 8: Malawi: Selected External Debt Indicators

Indicator	1970-74	1975-79	1980-84	1985-89	1990-94	1995-2001
Total External Debt (US\$ million)	215.75	450.90	859.08	1,266.20	1,749.20	2,453.40
Total External Debt Per Capita (US\$ million)	43.59	80.45	132.83	167.58	197.26	237.21
Total External Debt/Export Earnings %	183.5	198.0	289.4	400.8	440.2	478.0
Total External Debt/GDP %	35.3	57.2	70.8	100.3	100.0	144.7

Sources: World Bank, World Debt Tables, World Development Indicators and African Development Indicators (various issues) and International Monetary Fund, International Financial Statistics (various issues).

Insofar as not all external debt is repayable in one year, comparing total external debt with a single year's export of goods and services or gross domestic product is not a very useful measure of the burden of external debt. Debt service as percentage of export of goods and services avoids this problem. As shown in Table 9, Malawi's debt service ratio in the 1970s was moderate. It accelerated in the early 1980s and has since remained high, indicating that a significant proportion of export receipts has been used to repay principal and pay interest on external debt. The debt service ratio should have been higher but for debt relief received since 1982. Recent forecasts indicate that the debt service ratio will rise above the average for the 1995-2001 period. Debt service as a percentage of GDP is another useful concept that shows the claims that are made on a country's domestic output by external debt service obligations. The trend in this ratio has

been similar to the trend in the debt service ratio. The trend in interest payments on external debt as a percentage of GDP has also been similar to the trend in the debt service ratio (Table 9).

Table 9: Malawi: Selected Indicators of Debt Burden

Indicator	1970-74	1975-79	1980-84	1985-89	1990-94	1995-2001
Debt Service/Exports %	10.4	9.3	20.0	32.4	22.5	16.2
Debt Service/GDP %	1.6	2.2	4.3	7.4	5.2	4.3
Interest Payments/GDP %	1.4	1.6	3.2	3.6	3.8	4.8
Official Exchange Rate Kwacha/US\$	0.83	0.86	1.14	2.25	4.44	36.27

Sources: Malawi Government, Economic Report (various issues), World Bank, African Development Indicators (various issues) and International Monetary Fund, International Financial Statistics (various issues).

The burden of the total external debt on the government budget has been onerous, especially after 1979. For example, of the total debt service payments made in the 1981/82 fiscal year, 65.0 percent were on account of the external debt (Malawi Government, 1984). As a percentage of total government recurrent expenditure, external debt service payments were 25.8 percent in 1981/82, lower during 1982/83-1983/84, but accelerated and peaked at 38.3 percent in 1986/87. The increase in external debt service payments contributed to the rise in the overall budget deficit, the size of which increased markedly between 1979/80 and 1981/82. During the initial period of debt relief, the budget deficit was smaller during each fiscal year, but rose sharply after the initial debt relief in 1985/86 and peaked in 1986/87. To finance these deficits, government has had to borrow abroad, thus further increasing external debt, and at home, mainly from the banking system. Borrowing from commercial and other banks has led to an increase in interest rates and to crowding out of the private sector from the financial market, while borrowing from the central bank has had an expansionary impact on aggregate demand and fuelled inflationary and balance of payments pressures.

Another indicator of the burden of external debt is movement in the exchange rate. An appreciation of the exchange rate makes it cheaper to buy foreign exchange, hence it reduces the burden of servicing external debt. On the other hand, a depreciation of the exchange rate makes it dearer to buy foreign exchange, thus increasing the burden of servicing external debt. The data in Table 9 indicate that the Malawi Kwacha depreciated gradually between 1970-74 and 1985-89. Subsequently, it depreciated more rapidly, especially during 1995-2001. In other words, the burden in local currency terms of servicing external debt on account of movements in the exchange rate increased slowly during the former and rapidly during the latter period.

Yet another way of assessing the external debt burden is by considering the structure of the debt and the terms of external borrowing. The data in Table 10 indicate that most of Malawi's official foreign debt is long-term and concessional, and, therefore, imposes less of a burden than short-term debt. Over time long-term debt has tended to rise in relation to short-term debt. Like short-term debt, use of IMF credit as a proportion of total external

debt has declined. The data in Table 10 also indicate that exports are a comparatively small and stable proportion of gross domestic product. Imports too have not shown a strong upward trend, being constrained by limited availability of foreign exchange for which they compete with external debt servicing.

Like Swaziland, Tanzania and Zambia, the International Monetary Fund classified Malawi as an official borrower (International Monetary Fund, 1988). That is, the country obtained at least two-thirds of its external long-term credits from official sources during 1978-82. The proportion of its long-term credits from official sources during 1980-82 was actually less than two-thirds. Later, however, it rose far above two-thirds. Long-term credits at floating interest rates as percentage of total long-term credits have increased since 1970-72. In contrast, long-term credits from private sources as a proportion of total long-term credits have declined since 1970-72. The terms of external borrowing have improved since 1970 with respect to average percentage interest rate and average maturity, but not with regard to average grace period and the proportion of loans with variable interest.

Table 10: Malawi: Structure of Total Official External Debt

Type of Debt	1970-74	1975-79	1980-84	1985-89	1990-94	1995-2001
Long-Term Debt/Total External Debt %	N/A	84.8	91.4	94.2	97.2	97.8
Concessional Debt/Total External Debt %	N/A	N/A	41.0	61.4	79.8	89.7
Use of IMF Credit/Total External Debt %	N/A	N/A	10.8	9.2	5.6	4.0
Exports/GDP %	24.4	26.6	24.8	23.0	23.4	26.6
Imports/GDP %	35.8	39.4	30.6	30.6	40.0	38.7

Sources: World Bank, World Development Report (various issues) and World Development Indicators (various issues), and International Monetary Fund, International Financial Statistics (various issues).

8.2 Official External Debt and Development

The “growth-with-debt” literature provides a framework for determining debt capacity and optimal foreign borrowing (MacDonald, 1982). The paradigm used for this purpose contains two parts. The first of these is a growth model in which domestic real output is assumed to depend on factors of production, such as capital, labour, and imported inputs, and on total factor productivity. For simplicity, one can make domestic output a function only of domestic capital stock. Real national income is the difference between real output and interest payments on foreign debt. A change in real national income will thus be determined by changes in the marginal product of capital, in the stock of foreign debt and in the rate of interest on foreign debt.

The second part of the paradigm is a savings model. Total savings is the sum of private savings, government savings and foreign savings. Private savings is specified as a function of disposable income through the average propensity to save. Disposable income itself depends on the average tax rate. Thus, the average propensity to save, the average tax rate and the level of private income all determine the level of private savings. If

government were to increase the average tax rate in order to finance foreign debt servicing, the result would be to lower the level of private savings. Government savings is the fiscal balance, that is revenues (which in this model comprise only income tax revenues) minus expenditures on goods and services. An increase in government expenditures to finance foreign debt servicing would tend to lower government savings. Finally, foreign savings is equal to the current account balance (net foreign borrowing).

Combining the two paradigms yields the basic propositions associated with the growth-with-debt literature, which are:

- That a country can increase its growth of real national income by foreign borrowing as long as the marginal product of capital exceeds the cost of foreign borrowing. Within this simple model, the optimal level of foreign borrowing would be up to the point where the marginal product of capital is equal the interest rate applicable to foreign borrowing.
- That an increase in private savings through an increase in the average propensity to save would raise the growth rate.
- That an increase in the fiscal deficit, brought about either by a decline in tax revenues or an increase in government expenditures, would have an adverse effect on growth.
- That a rise in the foreign interest rate would lower the growth rate, as would a decline in external financing.

Trends in investment, savings and economic growth in Malawi appear to be correlated with trends in the external debt burden. The investment rate was relatively low during 1960-64, averaging 9.8 percent per year. This period coincided with the transition from colonial rule to independence in 1964 and from the Federation of Rhodesia to breakup of the federation in 1963. The uncertainty associated with the political and economic transition may have discouraged investment, despite the relatively low debt burden. From the 1965-69 period the rate of investment was higher and peaked during 1975-79, when it averaged 30.7 percent per year, but thereafter it declined, in part due to the rise in the external debt burden. The initial rise in the rate of investment made possible an increase in the amount of capital per worker; whereas the subsequent decline in the rate of investment led to a decrease in the amount of capital per worker. Our calculation of the index of physical capital per worker indicates that the amount of physical capital per worker declined from about 1980.

The growth of savings has also passed through distinct phases since 1960. During the 1960s (the first phase), national savings were negligible in Malawi and foreign savings financed virtually all capital expenditure. Between 1967 and 1969, for example, gross national savings financed only 8 percent of total investment (World Bank, 1985). The 1970s ushered in a new period when gross national savings grew fairly rapidly, averaging 11.2 percent of GDP during 1970-74 and 13.0 percent during 1975-79. As national savings increased, the share of foreign financing in total investment fell from 92 percent in 1967 to 50 percent in 1979 (Malawi Government, 1983). During the 1980s (the third phase), this trend was reversed, as gross national savings as percentage of GDP declined to 10.0 percent during 1980-84 and to 7.4 percent during 1985-89, partly due to the external debt burden. It remained at about the same rate during the 1990s, averaging 7.5% between 1994 and 1999. These trends in savings probably paralleled those that occurred in the Sub-Saharan African region as a whole. According to the 1987 World Development Report, saving in Sub-Saharan Africa as a percentage of GDP was 23.0

percent in 1980. By 1983, it had declined to 13.6 percent, and was estimated at 13.8 percent in 1986 (World Bank, 1987). The 2000s ushered in yet another phase when gross national savings declined further, averaging 6.4% between 2000 and 2003.

During the 1970s, which was a period of relatively low external debt burden, real gross national product (GNP) grew rapidly at an average annual rate of 5.4 percent. During the 1980s and early 1990s, there was considerable slowdown in the rate of growth of real GNP. This was a period when the external debt burden weighed most heavily on Malawi. During the next seven years, when there was a reduction in the relative burden of the external debt, real GNP grew rapidly once again, averaging 6.3 percent per annum. Trends in the growth of real per capita GNP followed the same pattern as that of trends in the growth of real GNP.

The decline in the rate of economic growth has been associated with a decline in per capita income. According to data reported in the World Development Report, Malawi's GNP per capita appears to have risen during the 1970s and peaked at US\$210 in 1983. Thereafter, it decreased, reaching US\$160 in 1987. It rose again, reaching the previous peak of US\$210 in 1992 and a higher peak of US\$220 in 1997. Since then per capita GNP has fallen continuously and now stands at about US\$160.

The decline in the rate of economic growth has also been associated with an increase in the level of poverty. There are no time series data on the proportion of the population living on less than the international poverty line of US\$1 per day. Available estimates of the number of poor people rely on national poverty lines, but only from the early 1990s. Using a national poverty line, the proportion of poor people in the population was estimated as 54 percent in 1990-91. For the same year, the poverty gap, which is a measure of the depth of poverty, was estimated at 4 percent, implying that to bring these poor people above the poverty line would require K140 million (World Bank, 1990). In 1998, the poor represented 65.3 percent of the population. In this year, about 28.7 percent of the entire population was living in extreme poverty. The poverty gap was estimated to be 0.282; while the square of the poverty gap, which is a measure of the severity of poverty, was estimated to be 0.157 (National Statistical Office, 2002). By 2003, poverty head counts had grown to about 68 percent (The Nation, 16 September 2003).

Concerning changes in government recurrent and total expenditure (recurrent and development) on education and health as percentage of GDP, there has been a steady increase in the relative shares of recurrent expenditure on education and health since 1970-74, but that the absolute levels of these shares remain comparatively low. Similarly, there has been a steady increase in the shares of total government expenditure on those services. However, these shares are also comparatively low.

As measured by net enrolment ratios, primary school enrolment showed little improvement between 1965 and 1990, rising from 44 percent to 50 percent. After the introduction of free primary education in the mid-1990s, net primary school enrolment has doubled. Secondary school education is not free. Following a policy decision to increase the number of secondary school places, net enrolment has increased there too, from 4 percent in 1990 to 25 percent in 2000. But there has been no increase in enrolment in higher education since 1990, which remains at 1 percent. The increase in primary and secondary school enrolments has not been matched with a commensurate expansion in resources. As a result, classroom accommodation is inadequate, with many primary school pupils having to learn under trees. Secondary schools have resorted to shifts, which puts an extra burden on teachers. Boarding accommodation in secondary schools is also inadequate. This has led to the expansion of day schooling. Pupil teacher ratios have

increased in both primary and secondary education, resulting in inefficiency in teaching. In addition, there is inadequate provision of learning materials. Despite the decline in the quality of education, the adult literacy rate has continued to increase, from 25 percent in 1977 to 52 percent in 1990 and 61 percent in 2001. However, the illiteracy rate of 41 percent is still unacceptably high. The pass rate at junior secondary level appears to have increased. The pass rate at primary school level has shown no improvement since the 1970s. At senior secondary level, the pass rate fell drastically during the second half of the 1990s. Subsequently, the pass rate has increased, but it is still far below the pass rates achieved earlier.

Health has experienced a similar fate. The increase in budgetary allocation to the sector has not been adequate to cater for a rapidly increasing number of patients. This has resulted in increasing numbers of in-patients per government hospital bed, declining availability of drugs and other materials, and inadequate numbers of doctors in relation to the size of the population. The delivery of medical services in government hospitals and clinics has certainly become inefficient. This has contributed to the increase in the death rate and therefore the decline in life expectancy from 43 in 1987 to 38 in 2001. The major cause of the decline in life expectancy, though, is AIDS. Infant mortality rate, which was 104 per 1,000 live births in 1977, declined to 83 in 1987, but rose to 117 in 1998. The corresponding under-five mortality rates were 203 in 1977, 148 in 1987 and 210 in 1998. Thus, both infant and under five mortality rates have increased recently. Furthermore, they are also comparatively high. The maternal mortality rate has also increased recently.

The fertility rate declined only slightly between 1992 and 2000, from 6.7 to 6.3, according to data contained in various issues of World Development Indicators and Demographic and Health Surveys conducted by the National Statistical Office. Between the same time periods, the percentage of children vaccinated decreased from 81.8 percent to 70.1 percent, the percentage of wasted (low weight for height) children increased from 5.4 percent to 5.5 percent, the percentage of stunted (low height for age) children increased from 48.7 percent to 49.0 percent, but the percentage of those with low weight for age decreased from 27.2 percent to 25.4 percent.

Budgetary allocations to other social sectors have also not been enough in real terms. According to the World Development Indicators, the percentage of urban population with access to safe drinking water declined between 1990 and the mid-1990s, while that of the rural population increased. Official data also confirm a deterioration in urban housing conditions in Malawi.

From time to time, Malawi as a nation suffers from food insecurity, a situation where the country is unable to produce enough food. For example, during the 1997/98 crop-growing season, the country did not produce enough food and had a maize shortage of 53,942 tonnes (Malawi Government 1999). The 1998/99 and 1999/2000 crop seasons experienced bumper maize harvests (Malawi Government 2000 and 2001). During the two succeeding seasons, however, maize production was inadequate. At the household level, Malawi has become chronically food insecure as many households are unable to produce or purchase enough food to meet their subsistence requirements. Food insecurity at this level also varies annually and seasonally. For example, whereas 8.0 percent of farm families were without food of their own during 1997/98, in the following season the percentage was down to 2.3 percent (Malawi Government 1999). Household food insecurity is felt most between October and April when food stocks have run out.

9 Renegotiations of Debt With Paris and London Clubs

9.1 Debt Moratorium

Malawi has experienced difficulties in servicing its foreign debt on many occasions. But the country has never been insolvent. And at no time has it declared that it will not pay back at all or declared debt moratorium. Nor has it ever declared foreign debt illegal on grounds of inability to repay it. The government is committed to meeting its international financial obligations. But it is doing so at great cost to its citizens in terms of foregone public services.

9.2 Debt Rescheduling

The balance of payments problem of the early 1980s was so serious that Malawi had no choice but to seek debt rescheduling. In 1982 and 1983, the country reached agreement with the Paris Club of official creditors to reschedule external debt service payments. Altogether, payment of US\$54 million was postponed over a two-year period. The debt rescheduling during the succeeding three years affected much smaller sums. In 1987, some external debt service payments were again postponed. These payments amounted to nearly US\$23 million. The following year the Paris Club agreed to reschedule 100 percent of both principal and interest falling due between April 1988 and May 1989 as well as arrears due between August 1987 and March 1988. This exercise was limited to loans contracted before January 1982. On previously rescheduled debt, only repayment of principal was rescheduled. The total sum affected was nearly US\$47 million. Other reschedulings involving smaller sums in US dollar terms were concluded in 1984, 1985, 1986, 1989, 1996, 1997, 1998 and 1999. In Malawi Kwacha terms, these reschedulings amounted to K813.9 million.

The point worth stressing is that debts rescheduled through the Paris Club in 1982 and 1983 were neither cancelled nor reduced. They were merely postponed, and, since interest was charged on the postponed payment, the problem was actually compounded and resurfaced after the end of the period to which the postponement applied in 1984. According to criteria developed by the Latin American Parliament, charging interest on interest, as the Paris Club did in respect of Malawi, qualifies the debt as illegitimate.

Under the 1988 agreement, both principal and interest on some debt were postponed; the grace period was extended to 10 years, while the repayment period was lengthened to 20 years. To the extent that rescheduling was in each case followed by pledges of financial support from bilateral and multilateral donors, the rescheduling exercises played a useful role in ensuring the continued flow of financial resources into the country and in preventing a deterioration in Malawi's international financial relations. As a precondition for debt rescheduling in 1988, Malawi had to enter into a standby arrangement with the International Monetary Fund (IMF). Having agreed with the Paris Club to debt rescheduling, the country's hands were tied to the extent that it was not allowed to contract commercial loans or to obtain bilateral loans on terms more favourable than those contained in the Paris Club agreement.

Debts due to multilateral institutions follow the principle that their claims cannot be waived or rearranged. This principle needs challenging. In the case of Malawi, these claims, most of which are owed to the World Bank and IMF, represent more than 75 percent of the total external liabilities of Malawi. Creditors should bear the risk of loans like debtors. Thus, like bilateral donors, multilateral donors should be asked to convert loans into grants or make them more concessional, and permit repayment in local currency.

The London Club of commercial creditors first agreed to reschedule external debt service payments amounting to US\$ 57 million over a two-year period, 1982 to 1984. Later, the London Club agreed to reschedule repayment of principal on all commercial debt, but not the payment of interest. The second rescheduling followed the same principle. As neither principal nor interest was reduced, there was no debt relief as such. However, the spread was extended. A four-year grace period was introduced and repayment was spread over eight years.

9.3 Debt Relief

Malawi has received little by way of debt relief. Under the 1988 Paris Club agreement, both principal and interest on some of the debt was waived. However, there are no data on this initiative. Between 1995 and 2002, some bilateral donors granted debt relief amounting to K954.9 million.

9.4 Debt Forgiveness and Write-Offs

From time to time, Malawi has also received debt forgiveness from bilateral donors, resulting in debt write-offs. But, as is the case with debt relief, there are no comprehensive data on how much has been forgiven and written-off. The ADB and the ADF wrote off debts totalling K298.9 million in 2000.

9.5 Heavily Indebted Poor Countries (HIPC) Initiative

At the time of the HIPC 1 initiative, Malawi was repaying debt below or around the permissible level of 20-25 percent of its export earnings, so it did not qualify. Under HIPC 2, the permissible debt-service ratio has been reduced to 15 percent. So Malawi has now qualified for debt relief under the HIPC initiative. This initiative does not reduce the debt stock, however.

The main focus of this initiative is on meeting debt obligations, rather than debt relief. The World Bank and the IMF do not address the issue of unjust and odious debts through this initiative. SAPs and ESAFs are imposed by the World Bank and the IMF who neglect the poverty consequences of their programmes: job losses, loss of buying power, diminished access to education and health services, etc. The countries adopting these programmes still need too much earnings and new loans to service their debts (Kupens, 2000), thus further raising the question of legitimacy of foreign debt.

9.6 Poverty Reduction Strategy Paper (PRSP)

As a condition for accessing HIPC funds, the Malawi Government prepared a Poverty Reduction Strategy Paper in consultation with other stakeholders at the beginning of the new millennium. The consultation with civil society was inadequate and at times acrimonious. The paper was completed and adopted in 2002. The main goal of the Malawi PRSP is to achieve sustainable poverty reduction through empowerment of the poor. The PRSP sees the poor as active participants in economic development. It has been built around four groups of activities and policies, which together form the framework for poverty reduction. Known as pillars, these groups are:

- a) Sustainable Pro-Poor Growth – economically empowering the poor by ensuring access to credit and markets, skills development and employment generation.
- b) Human Capital Development- ensuring that the poor have the health status and education to lift themselves out of poverty.
- c) Improving the Quality of Life for the Most Vulnerable- providing sustainable safety nets for those who are unable to benefit from the first two pillars.

d) Good Governance – ensuring that public and civil society institutions and systems protect and benefit the poor.

In addition, there are four issues that cut across the four pillars: HIV/AIDS, gender, environment, and science and technology (Malawi Government, 2002).

The PRSP aims at a growth rate of 2.1 percent. This is believed to be too low for the purpose of reducing poverty. In the recent past, Malawi has aimed at achieving a growth rate of around 4 percent, but this too is not sufficient for the purpose of reducing poverty. The required higher growth rates of 6 percent or more will need higher levels of investment and a large measure of economic stability. But even these will not be enough to reduce poverty should the pattern of distribution of income deteriorate.

Another weakness of the PRSP is that those responsible for it were not given room by the World Bank and the IMF to come up with credible policies for reducing the rate of inflation, interest rates and for stabilizing the exchange rate. The Bretton Woods institutions categorically stated that they were responsible for the country's macroeconomic policies.

Under the PRSP Malawi is to get US\$50 million in debt relief annually for 20 years. It is this money that will be used on various programmes for reducing poverty. But the country does not get a reduction in its debt stock as such. Thus, the legitimacy of its foreign debt will remain an issue.

10 Conclusions and Recommendations

Malawi keeps information on foreign debt through the Debt Management Unit in the Ministry of Finance and similar units at the Reserve Bank of Malawi and the Ministry of Economic Planning and Development. This information is for official consumption. It is neither published nor disseminated to stakeholders in the country. Given the interest of civil society organisations, creditors, UN agencies, researchers and the government in the problems of foreign debt, there would seem to be a case for publishing and disseminating detailed material on foreign debt on a regular basis. The government itself appears to be willing to share this information with stakeholders. At present, however, this information is available only upon request, which may take a long time to honour. Aggregative information by creditor is available on the total value of the loans, the total amount outstanding, the interest rate and the average repayment period in years. But information on the purpose of the loans, current payment status and achievement of intended purpose is not available. Furthermore, information on debt relief does not distinguish between agreements to reschedule, agreements to service part of the debt only, which is the debt relief, and agreements to forgive and write-off debt. All these are referred to as debt relief, which is not helpful. There is an urgent need to refine the information on foreign debt.

Although the Malawi Government is servicing the country's official foreign debt, it is doing so at great opportunity cost to the nation in terms of foregone national income, as a result of which the level of poverty is rising. The country is also foregoing expenditure on education, health and agriculture, which has resulted in a reduction in the quality of education services and outcomes, an increase in mortality rates and in food insecurity. To the extent that Malawi cannot service its debt without causing harm to its peoples, the debt is illegitimate and it should be cancelled.

Although some official loans are procured from creditors according to national law and are sanctioned by the people through Parliament, other loans are not and are therefore illicit. We have in mind here most of the loans from the IMF in particular. Like other loans, IMF loans should be subject to approval by Parliament. All past loans are odious and therefore illegitimate because they were given by creditors to prop up a despotic regime that oppressed its own people. Current loans are also odious and illegitimate because they are given to a regime that is blatantly corrupt and wasteful in its use of resources.

Creditors, particularly multilateral institutions, have exerted undue pressure on the country to take up loans for liberalising the economy and for structural adjustment and reforms. The country took up these loans not because it believed in liberalisation and structural adjustment, but because it was short of cash. These loans and conditions are prima facie void and hence illegitimate not because they involved misconduct on the part of the lenders or necessarily violated the national laws of Malawi, but largely because they were grossly unfair, involving poor policy advice, and their effects were economically and socially damaging. Other loans were grossly unfair because they were associated with improperly designed projects and programmes. Malawi should support various proposals for international regulations, such as insurance schemes, arbitration panels involving both creditors and debtors and an international insolvency system, which would allow Malawi the same protection against creditors that local governments have in many countries. Malawi should also support the ruling that odious debts cannot be enforced.

Furthermore, the Malawi Government should take action to effect:

- Rejection of SAPs;
- Restoration in their place of genuine, equitable and sustainable development poli-

cies respectful of human needs, and based on popular participation. This means promoting the tenets of the Arusha Charter on Alternatives to SAPs, the Abuja Treaty and the African Alternative Framework;

- Establishment of sincere dialogue with its civil society organisations;
- Mobilisation of domestic financial resources through internal savings to finance development before resorting to foreign loans;
- Greater cohesion with other developing countries in negotiations with international institutions, such as the World Bank, IMF, EU, etc.; and
- Adherence to the requirement that all loans are sanctioned by Parliament.

Northern creditors should take action to effect:

- Funding of a development plan formulated by Malawi, which will replace liberalisation and structural reform programmes forced upon the country by donors; and
- Democratisation of the functioning of the IMF and the World Bank;

Civil society organisations should take action to:

- Support the search for, and the implementation of, alternatives to SAPs;
- Campaign for the democratisation of the functioning of the IMF and the World Bank;
- Strengthen solidarity with civil society organisations in other countries;
- Call for the publication and dissemination of data and information on Malawi's external loans; and
- Monitor government external borrowing and debt.

On its part, the UN should call upon the IMF, the World Bank and other donors to stop imposing on Malawi liberalisation and structural reform programmes containing policies that do not help to achieve the country's development objectives.

Malawi keeps information on foreign debt through the Debt Management Unit in the Ministry of Finance and similar units at the Reserve Bank of Malawi and the Ministry of Economic Planning and Development. This information is for official consumption. It is neither published nor disseminated to stakeholders in the country. Given the interest of civil society organisations, creditors, UN agencies, researchers and the government in the problems of foreign debt, there would seem to be a case for publishing and disseminating detailed material on foreign debt on a regular basis. The government itself appears to be willing to share this information with stakeholders. At present, however, this information is available only upon request, which may take a long time to honour. Aggregative information by creditor is available on the total value of the loans, the total amount outstanding, the interest rate and the average repayment period in years. But information on the purpose of the loans, current payment status and achievement of intended purpose is not available. Furthermore, information on debt relief does not distinguish between agreements to reschedule, agreements to service part of the debt only, which is the debt relief, and agreements to forgive and write-off debt. All these are referred to as debt relief, which is not helpful. There is an urgent need to refine the information on foreign debt.

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AFRODAD Profile

AFRODAD is a civil society organisation born of the desire to see lasting solutions to Africa's mounting debt problem which has impacted negatively on the continent's development process.

Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous African Society.

Mission

To secure policies that will redress the African Debt Crisis based on human rights value system.

Goals/ Objectives

- ✿ To mobilise African civil society to actively engage in issues of debt and development with their governments and with creditor governments and institutions.
- ✿ To secure the adoption of policies and measures by African governments and their creditors for the appropriate, efficient and effective use of loan resources to avoid worsening the debt crisis now and in the future.
- ✿ To create sustainable policy coalitions in African countries to deal with debt and related issues.
- ✿ To undertake research that will assist policy makers during policy formulation around debt and development issues.
- ✿ To facilitate dialogue between civil society organisations and governments on issues related to debt in Africa and elsewhere.

Afrodad's work is centered on the following programmes:

Research and Policy Analysis

This enables AFRODAD to gain deeper understanding of the underlying issues of the debt problem, contributory institutional mechanisms, and the responsibility of stakeholders (creditors and debtor institutions and beneficiaries).

Information and Communications

Based on research findings, information is packaged for different audiences for use in education, advocacy and lobbying, and policy formulation towards debt sustainable solutions.

Lobby and Advocacy

AFRODAD works in collaboration with other networks from within Africa and beyond in promoting the ongoing global campaign for sustainable debt. Policy change is the primary focus at national, sub-regional, regional and international levels on issues of debt and economic justice.

Civil society capacity building

AFRODAD facilitates the building of debt groups/ coalitions by NGOs, CSOs and individuals in Africa to discuss development, with debt as the central issue. The aim of this programme is geared to increase AFRODAD's capacity to perform its role as a Forum and Network.