

The Loan Contraction Process in Africa

Making loans work for the poor



The Case of Mozambique



AFRODAD AND CHRISTIAN AID

MAKING LOANS WORK FOR THE POOR IN MOZAMBIQUE

STUDY REPORT

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LIST OF ACRONYMS

AfDB	African Development Bank
AIDS	Acquired Immune Deficiency Syndrome
CAS	Country Assistance Strategy
CPRS	Country Portfolio Performance Review
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
HIV	Human Immunodeficiency Virus
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
KF	Kellogg Foundation
MAP	Multi-sector AIDS Programme (of UNAIDS)
MDG	Millennium Development Goal
NGO	Non Governmental Organization
NPV	Net Present Value
PAD	Project Appraisal Document
PCN	Project Concept Note
PGD	Program Document
PID	Project implementation Document
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
UN	United Nations
UNAIDS	Joint United Nations Programme on HIV/AIDS
WB	World Bank

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1 Introduction

1.1 Background to the Study

The existence of a debt crisis in Africa is now widely acknowledged. Unsustainable debt levels represent a major threat to Africa's long-term development efforts, making it imperative to find a real and sustainable solution to this crisis.

The high level of African countries indebtedness results from a range of factors, such as the deterioration of terms of trade, the rise of interest rates in the international market, as well as internal factor that include internal imbalances coupled with the high state budget deficit and inappropriate macroeconomic policy choices made immediately after independence.

If African countries have abided by the laws that were established to regulate external borrowing, they could have prevented the debt crisis currently facing them. Parliaments should therefore take a more active role in approving loans. Parliamentary involvement should also be extended to parliaments in the North to ensure that loans benefit the targeted beneficiaries and that appropriate returns are secured. Civil society organizations should also be involved in monitoring loans to ensure that financial resources are being appropriately used.

The rate of Mozambique's external debt has accelerated since the 1980's as a result of political factors associated with the civil war, the adoption of inappropriate macroeconomic policies and the cyclical natural disasters that have affected the country. This resulted in the failure to implement some macro projects where part of external financing was diverted towards disaster relief.

In 1996, when the Heavily Indebted Poor Countries (HIPC) initiative was launched, Mozambique was one of the African countries considered eligible by the Bretton Woods institutions due to the of the country's unsustainable external debt and high levels of poverty (about 70 percent of the total population living below the poverty line).¹ The decision point was reached in April 1998 as a result of sound macroeconomic performance. In April 2000, Mozambique was further eligible for the enhanced HIPC that allowed the country to receive additional debt forgiveness, underscoring recognition by the international community of the country's continued progress in implementing sound macroeconomic and structural policies, and of the overall quality of its Poverty Reduction Strategy Paper (PRSP).

Despite the positive impact of the HIPC initiative in terms of debt burden alleviation, external debt remains a serious threat to overall efforts towards poverty reduction and socioeconomic development as significant portion of the country's resources is still diverted to meeting debt-servicing obligations. Therefore, efforts still need to be made to ensure appropriate management of external debt by Government, including the establishment and enforcement of an appropriate legal and institutional framework. There is also a need for involvement of civil society and all stakeholders in debt monitoring to ensure that external debt contracting and the use of borrowed funds are in the best interest of the country's poverty reduction and development objectives, and that the debt is kept at sustainable levels.

2.0 General objective of the study

The overall objective of this study is to ensure that the loans taken by the poor countries are legitimate and serve the basic function of poverty reduction and development. This objective should primarily be achieved in the short, medium and long term planning of governments of the poor countries. By this objective the study intends to realign the support rendered by international financial institutions to poor countries with the basic needs of those countries.

2.1 Specific objectives of the study

- To challenge African Governments and international financial institutions to become more transparent, accountable and inclusive in the loan contraction and debt management process starting from 2004;
- To raise the awareness of anti-debt campaigners, civil society organizations and the general public in Southern and Eastern Africa and the UK in the course of 2004 on the need to monitor loan decisions and push for or use existing spaces for civil society participation in the loan contraction and debt management process; and
- To strengthen AFRODAD and Christian Aid partnership to continue collaborating to achieve their collective goals using their respective strengths and resources in advocacy and research.

2.2 Rationale for the study

The rationale of this study is premised on the understanding that the procurement, utilization and management of public loans and debts are a national and global issue and, therefore, should be seen to be transparent, accountable, participatory and inclusive. The processes of loan procurement and debt management require systematic planning to be sustainable. It is only when loans are legitimate that they become sustainable. Thus, by making loans sustainable, governments will have extra revenue to support their social services and goods for development and enhance their people's welfare and reduce poverty. This study is a framework on how the loan contraction process and debt management can be rationalized in this way.

2.3 Research Methodology

The study is based on documental research and interviews with key players on external debt issues. After analyzing the terms of reference and the study outline provided, a review of the key available documents and studies on debt issues in Mozambique was conducted. This allowed the preparation of questionnaires for the key players in the Ministry of Planning and Finance, the Central Bank, the Ministry of Education, the World Bank and IMF country offices, and civil society represented by the Debt Group.

The results of the interviews and the information gathered from the documents and the Internet were the main sources of information used in the production of this report.

The study has some limitations that result from the difficulty of access to some information sources. For instance, most of the detailed information regarding debt that would allow a better and more robust understanding of the debt crisis is not public and is held within the Ministry of Planning and Finance. The Ministry considers the information politically sensitive and, therefore, not to be disclosed. Available and public information includes mainly aggregate figures that are published in Government, IMF and World Bank reports.

Given these limitations, particularly the lack of detailed and accurate data on bilateral and commercial bank debt, the study concentrates its analysis on the multilateral debt. This, in any case represents the largest part within the Mozambican debt structure and

is declining as the government gives privilege to multilateral and more favorable loans. Moreover, the detailed data, e.g. by loan or by sector, does not reflect debt restructuring.

3 Overview of the Country's Debt Crisis

3.1 Stock of Debt and Debt Indicators

As a result of debt relief, Mozambique is expected to receive assistance of US\$ 1.4 billion in NPV terms under the initiative involving debt relief of nearly US\$ 3 billion in nominal terms. This assistance is worth an estimated 70 percent of Mozambique's GDP. While traditional debt relief mechanisms were already expected to reduce the stock of Mozambique's debt by about one half, from US\$ 5 billion in NPV terms at the end of 1996 to US\$ 2.5 billion at the end of 1999, HIPC assistance will further reduce the debt stock to about US\$ 1 billion. This means that the overall result is to reduce the stock of debt by four fifths.

Mozambique was facing a rising burden of estimated debt service after the full application of traditional debt relief mechanisms. The effect of HIPC assistance has been to reverse this trend and turn it into a nominal decline in debt service actually paid, thus freeing resources for health and education spending. The size of this decline in relative terms is underlined by the fall in debt service paid in relation to exports. HIPC assistance also re-establishes normal relations with creditors - under which debt service due equals debt service paid - and removes a debt overhang which may have deterred domestic and foreign private sector investment.

Tables 3 and 4 provide data on Mozambique's debt levels and its projections until 2010. From the figures in the tables, it can be concluded that debt relief mechanisms will allow for a substantial reduction of both stock of debt and debt service. The NPV of debt to GDP ratio is estimated to fall from 27.7 percent in 2001 to 25.9 percent in 2004 and 24.1 percent in 2010. Debt service to revenue ratio will fall from 12.5 percent in 2002 to 9.0 percent in 2004, although in absolute terms the total debt service will be kept at an average of US\$ 55 million.

These figures indicate that, despite the significant amount of debt still serviced, total debt has been brought to relatively more sustainable levels as the result of various mechanisms of debt relief. However, this can't be seen as the end of debt crisis. Keeping debt at sustainable levels will depend on various factors, including government macroeconomic discipline in order to sustain economic growth and increase the level of revenues to stimulate domestic production and exports; the ability to tighten the regulations and conditions regarding new borrowing; and international willingness to assist the country in its efforts to fight against poverty by funding government programmes through grants.

3.2 Ministry and Sector Loans

In Mozambique only the Ministry of Planning and Finance signs loan agreements with international financial institutions on behalf of the country while the line Ministries play the role of implementing agencies.

The largest Government execution agencies of the main multilateral loans include the Central Bank, the Ministries of Planning and Finance, Agriculture, Water and Construction/Public Works, Education, Health, Transport and the Ministry of Industry and Trade, as indicated in Table 5.²

In general, these Ministries are considered key within the Government effort to foster sustainable economic growth and, at the same time, meet the population's basic human needs.

The distribution of loans indicates that the Economic Policy sector and the Finance sector consume a significant part of the external loans. This is justified by the deep macroeconomic and macro financial management institutions and systems reforms undertaken, mainly with IMF and World Bank assistance, as part of the transition from a centrally planned economy to a market oriented economy. On the second level in

Table 3 Net Present Value of External Debt, 2000-2010 (US\$ million)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	Actual	Estimated			Projected						
1 NPV of total debt	1 109.0	915.7	998.6	1 073.4	1 154.6	1 233.4	1 315.9	1 398.0	1 476.7	1 544.4	1 611.8
2 NPV of Outstanding debt											
3 Official bilateral and commercial	1 109.0	812.5	809.6	807.0	805.8	799.7	788.3	786.8	784.7	775.1	766.9
Paris Club											
Other official	661.9	349.5	331.7	317.1	304.1	290.8	277.2	273.8	270.0	265.3	260.5
Commercial	534.5	264.9	247.0	231.9	219.4	206.5	193.5	190.8	188.0	184.7	180.7
4 Multilateral	91.7	56.0	56.3	56.8	56.3	55.9	55.4	54.7	53.9	52.8	52.5
IDA	35.7	28.5	28.5	28.5	28.5	28.4	28.4	28.3	28.1	27.8	27.3
IMF	447.1	463.0	477.8	489.9	501.7	509.0	511.0	513.0	514.8	509.8	506.5
AfDB	268.3	280.4	292.8	304.8	316.6	328.3	340.1	352.4	364.9	369.1	367.9
Others	70.8	72.2	72.9	70.6	67.8	60.4	47.4	33.7	19.5	6.3	0.0
5 Nominal Stock of Total Debt	68.7	70.9	73.2	75.6	78.5	81.9	85.5	89.2	93.0	97.0	100.4
6 NPV of Debt to GDP Ratio (%)	39.2	39.0	38.9	38.8	38.8	38.4	38.0	37.4	37.4	37.3	38.2
	2 177.6	1 978.0	2 121.4	2 253.7	2 386.2	2 510.7	2 629.2	2 756.9	2 882.4	3 002.4	3 121.4
	-	27.7	28.0	27.0	25.9	25.4	25.0	24.6	24.0	23.3	22.5

Source: Mozambican Authorities; Bank and Fund Estimates (IMF and WB websites)

terms of volume of loan allocation, Table 6 shows that government loan allocation is done line with the overall poverty reduction strategy that establishes the need to attain sustainable economic growth led by the private sector. Furthermore, the strategy defines investments in agriculture, education and rural infrastructure as fundamental areas for poverty reduction.

The loans alignment with poverty reduction objectives reflects the fact that poverty reduction has for some time been the main objective of the Government. It also reflects the fact that most of the donors (both multilateral and bilateral) make their decision to lend on the basis of alignment of the loan purpose or project with the poverty reduction strategy developed by the government. From the 1980s, when the government started

Table 4 Debt Service Indicators 2001-2010 (US\$ million - estimates)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1.Total Debt Service	27.3	55.1	54.5	52.8	57.5	62.4	51.7	52.1	59.6	57.4
Multilateral	10.9	12.9	16.6	17.6	22.8	28.5	28.7	29.0	35.8	33.9
Official Bilateral	13.8	40.1	35.8	33.2	32.7	31.9	20.8	20.9	21.4	21.1
Commercial	2.5	2.1	2.1	2.1	2.1	2.1	2.2	2.2	2.5	2.4
2. Debt Service to Revenue Ratio (%)	7.2	12.5	10.5	9.0	8.8	8.7	7.5	7.7	8.2	7.8

Source: Mozambican Authorities; Bank and Fund Estimates (IMF and WB websites)

to borrow from multilateral donors, until the middle of the 1990s, there has not been a comprehensive poverty reduction strategy in place.

Table 3 Loans by Ministry (US\$ Million)

Ministry	Loan Amount
Central Bank	7150
Ministry of Agriculture	294.20
Ministry of Planning And Finance	528.90
Ministry of Water and Construction and Public Works	164.10
Ministry of Education	153.96
Ministry of Health	128.70
Ministry of Industry and Trade	90.00
Ministry of Mineral Resources and Energy	141.96
Ministry of Transport and Communications	96.00
Ministry of Tourism	48.60
Ministry of State Administration	59.20
Ministry of High Education Science and Technology	18.00
Ministry of Fisheries	18.60

Source: Computed by the author from World Bank/IMF/IFAD/KF and AfDB data

Table 4 Loans by Sector (US\$ Million)

Sector	Loan Amount
Economic Policy	697.30
Agriculture	298.80
Education	171.96
Energy	175.33
Environment	261.80
Finance	454.00
Fisheries	40.20
Health Nutrition and Population	183.70
Mining	40.26
Multi-sector	53.70
Oil and Gas	90.12
Private Sector Development	181.20
Social Protection	22.00
Telecommunications and Informatics	14.90
Transportation	425.70
Urban Development	59.20
Water Supply and Sanitation	145.30

Source: Computed by the author from World Bank/IMF/IFAD/KF/AfDB data

Table 5 Debt by Sector and Borrower (US\$ million)

Borrower	Loan Amount	Sector
CFM	170.0	Transportation
ANE	162.0	Transportation
TDM	4.5	Communication and Informatics
EDM	14.0	Energy
SASOL/ENH	79.0	Gas and Oil

Source: Computed by the author from World Bank/IMF/IFAD/KF/AfDB data

3.3 Debt by Economic Sector and Borrower Category

The Government of Mozambique is the main recipient of external loans and it exerts strict control on external borrowing. Few private and public companies that take external loans may only do so after getting government authorization.

There are limited loans by public companies in the Transportation sector (railways, ports and roads), Telecommunications and Informatics and Energy Sector (power supply and oil and Gas). The companies holding external loans are the Railways and Ports Company (CFM), the National Administration of Roads (ANE), the Telecommunications Company (TDM), the Electricity Company (EDM) and the Gas Company (SASOL/ENH). The loans held by these companies are shown in Table 7, below:

The companies that hold external debt are integrated into the key sector that follow the poverty reduction strategy objectives and are the sectors that have potential to contribute to fast economic growth.

3.4 Debt by Creditor and Purpose

Mozambique's main creditors define their purpose as assisting the country in its efforts to eradicate poverty. As earlier mentioned, the projects and programmes funded by various lenders fall under the main government objectives as stated in PRSP.

The IMF is the only creditor that concentrates all its loans on macroeconomic and financial management issues with the purpose of providing technical assistance to the government in order to improve its human resources and institutional capacity as well as define and implement sound macroeconomic and financial policies and programmes. The World Bank loans are more diversified and include purposes similar to those of the IMF, the building of national human capital through training and education, provision of basic social services and infrastructure, and generally supporting the implementation of the Government of Mozambique's development programme as outlined in the PRSP.

The purpose of the other creditors is also to assist the government in implementing its development programme as outlined in the Poverty Reduction Strategy, although with some of them concentrating in specific areas, for example IFAD loans are mainly concentrated in the agricultural sector.

3.5 Terms and Conditions of each Loan and Interest Rates

Neither terms and conditions nor interest rates for each individual loan are available as the Ministry of Planning and Finance and the Central Bank consider this information to be confidential.

However, available information indicates that most of the loans from multilateral donors are provided on favorable conditions in terms of credit maturity (up to 40 years), grace periods (up to ten years) and interest rates (ranging between 1 and 3 percent). The majority of multilateral loans are contracted to finance specific projects or programmes designed by government. However, most loans have some conditionalities attached to them namely:

- The loans must be used to fund projects and programmes in line with the Poverty Reduction Strategy (i.e. a positive conditionality);
- Procurement of goods, services and technical assistance should be limited to a certain group of countries, especially the creditor country or member states of the lending institution;
- The imposition of high profiles for bidding companies or consultants in procurement of goods, services and technical assistance that limits the participation of local companies and consultants; and

- Tying of grants to loans.

On the side of bilateral donors' the scenario is gradually being reversed as a significant number of these donors are moving from the project approach to budget support and pool funds, whereby donor funds are allocated directly to the government budget. The government then has the responsibility and authority to manage the funds although there are certain impositions aimed at ensuring transparency and good financial management. Ironically, the multilateral donors are still reluctant to join the budget support approach with other donors and they set their own parallel mechanisms that constitute a tremendous burden on the Government.

3.6 Current Debt Service Payments versus National Expenditure

The burden of external debt servicing has been reduced significantly as a result of debt relief, particularly after the HIPC initiative. In 2001, debt service represented only 0.6 percent of total expenditure. Although, in 2002, it increased to 1.13 percent, it dropped again in 2003 to 0.82 percent, as shown in Table 8. This compares favorably to 1999. Debt service continues to represent a significant drain on government resources.

As indicated in Table 4, debt service to public revenue represented 7.2 percent in 2001, 12.5 percent in 2002 and 10.5 percent in 2003. In addition, available data suggest that the amount of current debt service could be enough to dramatically increase expenditures in key social sectors such as education and health. Hanlon (2000) indicates that the cost of Mozambique's debt servicing could allow for more than 10 000 children to have access to education.

When analyzing these figures, one should take into account that in the coming years they will tend to rise not only because the Government continues to borrow to finance its expenditures, but also because some of the new loan that are currently in a grace period will start to be serviced, as will some of the recently restructured loans.

Table 6 Debt Servicing and Public Expenditures (Meticais billion)

	2001	2002	2003 (Projected)
Total Expenditure	24 579	28 460	29 524
	477		1 165
Interest on Public Debt	330	1 274	923
	147		242
✓ Domestic	1.94	952	3.94
✓ External	1.34		3.13
Debt service to public expenditures (%)	0.59	322	0.82
i. Domestic			
ii. External		4.47	
		3.34	
		1.13	

Source: IMF Country Paper No. 03/288

Another element of concern is the increase of domestic public debt. While efforts are being made to lessen external debt service, domestic debt service is rising, as illustrated in Table 6, The largest part of the domestic debt was incurred to pay for the restructuring of two large commercial banks that went into bankruptcy due to serious corruption.

4 The Legal Loan ContractiNG Process

4.1 Legal Provisions and Procedures

In Mozambique there is no legal provision dealing with debt issues in general, but only internal regulations within the Ministry of Planning and Finance and the Central Bank. It is clear from these regulations that the only entity authorized to contract external loans is the Government of Mozambique, represented by the Ministry of Planning and Finance and the Bank of Mozambique. An exception is for large public and private companies that are allowed to take loans, but only with Ministry and Central Bank approval and the company must be ready to present guarantees.

The lack of regulations has resulted in damage for the government in that companies that took external loans without guarantees went to bankruptcy and the Government had to bear the debt.

The absence of laws to regulate issues such as conditions precedent, representations and warranties, covenants, events of default, dispute resolution, provision for failed projects, etc. appears to be one of the weaknesses in debt management in Mozambique.

4.2 Borrowing Strategy and Negotiation

As earlier mentioned external borrowing is centralized and primarily the responsibility of the ministry of Planning and Finance, and the central Bank. There are also parameters to be followed when embarking in a loan process that include the obligation to align the loan objective to the government priorities, as expressed in the Poverty Reduction Strategy.

Another element of the borrowing strategy pursued by the government relates to the selection of creditors, whereby privilege is given to multilateral creditor institutions that offer low interest rates, and longer maturity and grace periods, over bilateral and commercial bank lenders that tend to be more expensive and less favorable. The government through the control mechanisms established in the Central Bank has followed this strategy strictly.

4.3 Institutional Relations

Debt management is the responsibility of the Ministry of Panning and Finance. Public or publicly guaranteed debt can only be contracted with approval of the Ministry. The Ministry maintains the database for multilateral debt, while the Bank of Mozambique maintains the database for bilateral debt. Coordination between the two agencies is good and efforts are being made to strengthen the capacity within the Ministry so that all monitoring of public debt can be united within the Ministry.

The ministry of Planning and Finance is responsible for monitoring and instituting appropriate management systems to ensure good returns from projects. The national Directorate of the Treasury deals directly with the country's external debt management issues. It also coordinates projects from external resources. Within the directorate, the Public Debt Area deals with and has executive functions on public debt issues. The directorate's main function is to communicate to the users of borrowed funds the rational use of the funds through regular revision of the project portfolio. The Inspeccao Geral de Financas is institutions charged with auditing and monitoring projects while the National Directorate of Public Accounting is responsible for monitoring the use of the funds at sectoral level.

4.3.1 Philosophy, Principles and Government Strategies

The underlying philosophy and principles on external loan resources are as follows:

- The credit request process is now centralised in the Ministry of Planning and

Finance. Most of the loans are for public projects. In 1998, Mozambique launched a Medium Term Expenditure Review Programme. The programme aims at allocate funds efficiently, and deals with medium-term integrated sectoral development plans. It defines policies, strategies and priorities that make it possible to assess the external financial resources required to finance projects. From this, it is possible to forecast the extent of indebtedness in the following years;

- In 1997, the Mozambique Government approved the legal instrument to approve expenditures. This is known as Lei do Enquadramento Orçamental . The instrument defines who approve the funds and how to increase the limit on borrowed funds;
- In 1997 the government also approved the classificadores orçamentais. These are codes that facilitate the organisation of information on revenues and expenditures at various levels and improve performance in public finance programming and monitoring, economic analysis and financial analysis.

The underlying philosophy and principles for debt repayments are that debts must be repaid according to the commitments in the loan agreement. Notwithstanding this principle, the following actions have been undertaken:

- The government approaches the bilateral creditors for the debt-relief request. If relief is not granted, it has to repay the debts;
- Mozambique is not servicing all its debts. Only concessional loans are being repaid. Debts incurred in the 1970s and 80s but where the creditors have not agreed to reschedule are also not being repaid. However, negotiations with the creditors to reschedule the loans are in progress;
- The Government of Mozambique negotiates with bilateral creditors at the Paris Club on the conditions for debt-rescheduling
- Creditors outside the Paris Club are advised by the International Financial System Rules to set conditions similar to those of the Paris Club, or risk not getting repaid by their debtors.

4.3.2 Procedures for Loan Procurement and Formal Appraisal Mechanisms

Under the Government's Five-year Economic Programme, sectors define their strategies and sectoral policies from which priority projects are identified. The next stage is for the various sectors, with the support of the Bank of Mozambique and the Ministry of Planning and Finance, to identify the external funding sources for their projects. Thereafter they submit formal requests to the Ministry of Planning and Finance to borrow externally.

A joint mission comprising of the Ministry of Planning and Finance, Bank of Mozambique and all the sectors involved in projects evaluate the requests to assess whether the project should be financed borrowed external funds. After making securing the external financial resource, the sectors apply for the registration of their projects in the Public Investment Plan for each three years, at the National Directorate of Planning and Budgeting.

In analyzing the external financial requests, the Bank of Mozambique seeks to determine whether the concessions under the loans match those it gets from the Paris Club.

The Ministry is the major link between the creditors, the Government and project implementers and is responsible for ensuring that budget provisions are adhered to. ³

4.3.3 Loan Cases

- The Rural Development Project and the Agricultural Rehabilitation Project were both drawn up and launched in the 1980s with funds from the World Bank. When the two projects were analyzed, it was found that they had been over-budgeted for. The Ministry of Planning and Finance discussed the issue with the Ministry of Agriculture, and the projects were redefined and the excess amounts allocated to them were reallocated to other projects;
- In the 1980s again, another project was drawn up in the cashew sector, financed by the African Development Bank. A thorough analysis of the project was carried out in 1992 and it was discovered that only 10 percent of the planned activities were being implemented. The project was re-assessed and some of its components allocated to other sectors.
- The third project, the Projecto de Citrinos de Timanguene, failed because of the war. As a consequence, its equipment and infrastructure were completely destroyed.

Monitoring of recently acquired debt has been good. The authorities have made a concerted effort to reconcile data on older debts with creditors and, with few exceptions, this process has now been completed. This data is maintained using the Commonwealth Secretariat database system CS-DRMS. The database is generally up to date and is regularly maintained by both the Ministry of Planning and Finance and the Central Bank. However, the system is not able to produce data directly in an analytic form. The Bank of Mozambique is in the process of establishing a computerized database to track external private sector debt (currently comprehensive information on stocks is monitored more closely). Flows related to private sector debt and its repayment are already relatively well monitored by the Bank of Mozambique.

The technical staff at both the Ministry of Planning and Finance and the bank of Mozambique are experienced and knowledgeable about debt issues and have carried out numerous debt-restructuring negotiations.

4.4 Institutional Checks and Balances

In Mozambique, the Administrative Court (playing the role of the Auditor General) and the Parliamentary Commission for Plan and Budget (i.e. the specialized Parliamentary body) are responsible for controlling public finance. However, there is no specific provision that allows these bodies to exert control or to participate in loan negotiation.

The Parliamentary Commission monitors debt only as part of the Government budget component as it has the ultimate responsibility to recommend the approval of the budget and the General Account to the Parliament. The Administrative Court only audits the General account before its approval by the Parliament.

It is clear from this framework that there is no balance between institutions as far as debt management is concerned. All responsibility and authority lies with the Government as only the Ministry of Planning and Finance and Central Bank have the authority to negotiate and manage loans, and the Council of Ministers ratifies all loan agreements.

5 The Role of Creditors

5.1 The IMF and World Bank Country Mission Teams

The IMF is highly centralized with most of the loan negotiation and contracting process being conducted by Washington based teams with very little role for the country mission. All background documents are prepared in Washington including the negotiation of the terms and conditions of the loans.

The country mission team is relatively small and its role is basically to:

- Liaise on a regular basis with the Government;
- Facilitate the work of headquarters missions when they travel to the field
- Liaise with other donors, whose coordination is done through various working groups; and
- Provide information to headquarters concerning macroeconomic and sociopolitical developments in the country.

One of the roles of the IMF Country representative is to establish dialogue with the civil society on issues related to the overall country economic growth and development programme, but not necessarily on issues regarding the loan contraction process. Very little is done in terms of civil society organizations and IMF links since the mission has a small team and the representative has been involved in other many responsibilities and tasks, including the coordination with other donors mentioned earlier.

Similarly, the World Bank Country mission, despite its larger capacity compared to the IMF mission, has little involvement in the loan negotiation and contraction process. The whole process is conducted from the headquarters, including the preparation of background documents, such as the country assessment and the Country Assistance Strategy (CAS). The Head of World Bank delegation that negotiates with Government normally comes from Washington.

However, this scenario seems to be in the process of changing as for the first time, in May 2003, the World Bank's Multi-Sector AIDS Programme (MAP) and the Public Sector Reform Project (PSRP) were signed in Mozambique, although the negotiations were conducted in Washington.

5.2 The Role of IMF and the World Bank in Loan Negotiation and Contraction

5.2.1 The IMF

When Mozambique approached the IMF for assistance the country was in a state of economic crisis. Its currency was weak; its international reserves depleted, economic activity stagnant or even falling, and bankruptcies increasing. Mozambique needed assistance to return the country's external payments position to health and to restore the conditions for sustainable economic growth.

IMF loans are usually provided under an 'arrangement' which stipulates the conditions the country must meet in order to gain access to the loan. The Executive Board must approve all arrangements. Arrangements are based on economic programmes formulated by countries in consultation with the IMF, and presented to the Executive Board in a 'letter of intent'. Loans are then released in phased installments as the programme is carried out.

The IMF role in this process is to provide the country's authorities with advice on the economic policies that might be expected to address the problems most effectively. For the IMF to also provide financing, it must agree with the authorities on a programme of policies aimed at meeting specific, quantified goals regarding external

viability, monetary and financial stability, and sustainable growth. Details of the programme are spelled out in a 'letter of intent' from the government to the Managing Director of the IMF.

A programme supported by IMF financing is designed by the national authorities in close cooperation with IMF staff and is tailored to the special needs and circumstances of the country. This is considered essential for the program's effectiveness and for the government to win national support for the programme. Such support, or 'local ownership', of the programme is critical to its success.

5.2.2 The World Bank

The World Bank recognizes that many past assistance efforts, including some of its own, failed because the agenda was driven by donors rather than by the governments they were trying to assist. Under its current development policy, the Bank helps governments take the lead in preparing and implementing development strategies in the belief that programmes that are owned by the country, with widespread stakeholder support, have a greater chance of success.

In Mozambique the Bank uses the Poverty Reduction Strategy (PRS) approach, which involves widespread consultation and consensus building on how to boost development. Under this process, national poverty reduction strategies is prepared by the country, creating a framework for donors to better coordinate and align their programmes with national priorities. The government consults a wide cross section of local groups and combines this with an extensive analysis of the country's economic situation and poverty in the society. The government determines its own priorities from this process and produces targets for reducing poverty over a three to five year period. These are outlined in a Poverty Reduction Strategy Paper (PRSP). The Bank then aligns its assistance efforts with the country's own strategy.

The Bank's blueprint for its work with a country is based on a Country Assistance Strategy (CAS) that, in the case of Mozambique, is derived from the priorities contained in the country's PRSP. The CAS is produced in cooperation with the government and interested stakeholders. The preparation of the CAS may draw on analytical work conducted by the Bank or other parties on a wide range of economic and social sectors, such as health, education, agriculture, public expenditure and budgeting, fiscal management, or procurement, among others.

The role of the Bank in loan negotiations can be divided in six phases:

- 1 *THE IDENTIFICATION PHASE* The goals outlined in the CAS guide the priorities of the Bank's lending programme and are a useful source of information for interested stakeholders and businesses wishing to identify potential future areas of Bank lending. During the identification phase, World Bank teams work with the government to identify projects that can be funded as part of the agreed development objectives. Once a project has been identified, the Bank team creates a Project Concept Note (PCN) which is an internal document of four to five pages that outlines the basic elements of the project, its proposed objective, likely risks, alternative scenarios to conducting the project, and a likely timetable for the project approval process.
- 2 *THE PREPARATION PHASE:* This part of the process is driven by the recipient country that the Bank is working with and can take not more than three years, depending on the complexity of the project being proposed. The Bank plays a supporting role, offering analysis and advice where requested. During this period, the technical, institutional, economic, environmental and financial issues facing the project will be studied and addressed - including whether there are alternative methods for achieving the same objectives. An assessment is required of projects proposed for Bank financing to help ensure that they are

environmentally sound and sustainable (environmental assessment). The scope of the environmental assessment depends on the scope, scale and potential impact of the project.

- 3 *THE APPRAISAL PHASE:* The Bank is responsible for this part of the process. Bank staff reviews the work done during identification and preparation, often spending three to four weeks in the client country. They prepare for World Bank management either Project Appraisal Documents (investment projects) or Programme Documents (for adjustment operations) and the Financial Management team assesses the financial aspects of the project. The PID is updated during this phase. These documents are released to the public after the project is approved (see below).
- 4 *THE NEGOTIATION AND APPROVAL PHASE:* After Bank staff members have appraised the proposed project, the Bank and the country that is seeking to borrow the funds negotiate its final shape. Both sides come to an agreement on the terms and conditions of the loan. Then the Project Appraisal Document (PAD) or the Programme Document (PGD), along with the Memorandum of the President and legal documents are submitted to the Bank's Board of Executive Directors for approval. The appropriate documents are also submitted for final clearance by the borrowing government, which may involve ratification by a Council of Ministers or the country's legislature. Following approval by both parties, their representatives formally sign the loan agreement. Once this has occurred, the loan or credit is declared effective, or ready for disbursement, upon the relevant conditions being met, and the agreement is made available to the public.
- 5 *THE IMPLEMENTATION AND SUPERVISION PHASE:* The implementation of the project is the responsibility of the borrowing country, while the Bank is responsible for supervision. Once the loan is approved, the borrowing government, with technical assistance from the Bank, prepares the specifications and evaluates bids for the procurement of goods and services for the project. The World Bank reviews this activity to ensure that its procurement guidelines have been followed. If they have, the funds will be disbursed. The Bank's Financial Management Team maintains an oversight of the financial management of the project including periodically requiring audited financial statements.
- 6 *THE ROLE OF CIVIL SOCIETY:* The civil society which is represented by the Mozambique Debt Group (that include various non governmental organisations (NGOs) working in the area of debt) does not play any role in debt-financed-project design, loan negotiations and debt management as the Government has defined this as its own exclusive responsibility, although strangely it recognizes the role of the Debt Group in the fight for debt relief. Government has not been keen to share information regarding debt with civil society as this is considered sensitive and for exclusive use of Government and its partners.

It is important to mention that the capacity of the civil society in Mozambique is also relatively weak and, therefore, it has not enough ability and power to pressure the government into allowing its participation in debt management issues. This participation could facilitate its monitoring role.

Despite this negative scenario, both the World Bank and the IMF recognize the important role that NGOs play as advocates for policy change and institutional reforms, as well as in meeting development challenges. They consider that NGOs often operate in close contact with the poor in remote areas and are in the best position to help identify the most pressing concerns and needs and to recommend solutions.

As part of the World Bank and IMF commitment to forging a more participatory development strategy, they liaise with NGOs to increase the consultative process with civil society, particularly in areas of economic development, poverty alleviation, gender

issues and the environment. Working together with the Bank and IMF, NGOs have helped introduce participatory approaches, strengthened transparency and accountability at the grassroots level, improved efficiency of service delivery, ensured better targeting of projects to the poor and piloted innovations.

In conclusion, the participation of civil society is viewed indirectly in the process of designing macro strategies and programmes and not at the level of specific loan or project management.

6 International Issues and Internal Debt Management

6.1 Millennium Development Goals and Debt

At the United Nations Millennium Summit in September 2000 world leaders placed development at the heart of the global agenda by adopting the Millennium Development Goals (MDGs), which set clear targets for reducing poverty, hunger, disease, illiteracy, environmental degradation, and discrimination against women by 2015. The origin of the Millennium Development Goals (MDGs) is to be found in the United Nations' Millennium Declaration that was adopted on 8 September 2000 by all of the 189 member states (147 of which were represented by their heads of State or Government). These goals were set for the year 2015 with reference to the international situation prevalent in 1990.

Upon undertaking to eradicate poverty, government leaders around the world clearly stated that for the first time in the history of humanity it was possible to achieve such a goal using the resources, knowledge and technologies now available to humankind. The Declaration contains numerous commitments to enhance the future of humanity in the new century. The United Nations Secretariat subsequently drafted a list of eight objectives, each with a set of targets and specific indicators. The first objective is to halve the proportion of the world's people living in extreme poverty and suffering from hunger. The full list of MDGs is:

- 1) Eradicate extreme poverty and hunger
- 2) Achieve universal primary education
- 3) Promote gender equality and empower women
- 4) Reduce child mortality
- 5) Improve maternal health
- 6) Combat HIV/AIDS, malaria and other diseases
- 7) Ensure environmental sustainability
- 8) Develop a global partnership for development

With the global commitment to reduce poverty by 50% by 2015, it has become an overarching objective for both national and international stakeholders to include millennium development goals various global or national strategies.

The pattern of sector distribution of loans in Mozambique indicate to a large extent the potential for the loans to contribute towards the achievement of development goals since the majority of the projects they fund are based upon the Poverty Reduction Strategy that falls squarely in line with the MDGs.

On the development of global partnerships for development, goal 8, it can be argued that World Bank Group supports the overall development objective and strategy of the Government. Most new operations under the CAS focus on increasing those economic opportunities that are likely to have the maximum impact in reducing poverty in Mozambique. However, some of the Bank's practices may harm the MDG in Mozambique. For example the fact that the Bank, despite its efforts to work in coordination with other donors, has the tendency to establish its own mechanisms of assistance delivery while other donors tend to work in coordination using common mechanisms. The restrictions imposed, for example, on teacher's salary benchmarks could jeopardise the goal of universal education for all as it may cause teachers to drop out of the profession.

The IMF also has a crucial role to play in the achievement of MDGs in Mozambique, although some of the macroeconomic policy measures it prescribes are likely to harm

the efforts made to achieve these goals. For example, the IMF is predicting declining aid flows, despite rising donor support and evidence that more aid can be productively absorbed. The negative impact of this inflexibility and conservatism is compounded by the continued role of the IMF as the gatekeeper for donor aid and debt relief.

In order to play a positive role, the Fund needs to show greater flexibility in its economic targets, demonstrating a longer-term focus on poverty reduction and analyzing the trade offs this entails for short-term economic policy.

6.2 The Human Rights Approach and the Debt Question

A rights based approach to development is a conceptual framework for the process of human development that is normatively based on international human rights standards and operationally directed to promoting and protecting human rights.

Essentially, a rights based approach integrates the norms, standards and principles of the international human rights system into the plans, policies and processes of development. The principles include equality and equity, accountability, empowerment and participation. A rights based approach to development includes the following elements:

- Accountability;
- Empowerment;
- Participation; and
- Non-discrimination and attention to vulnerable groups.

6.2.1 Accountability

Rights based approaches focus on raising levels of accountability in the development process by identifying claim holders (and their entitlements) and the corresponding duty holders (and their obligations). In this regard, they look both at the positive obligations of duty holders (to protect, promote and provide) and at their negative obligations (to abstain from violations). They take into account the duties of the full range of relevant actors, including individuals, states, local organisations and authorities, private companies, aid donors and international institutions.

Such approaches also provide for the development of adequate laws, policies, institutions, administrative procedures and practices, and mechanisms of redress and accountability that can deliver on entitlements, respond to denial and violations, and ensure accountability. They call for the translation of universal standards into locally determined benchmarks for measuring progress and enhancing accountability.

For all human rights, states must have both the political will and the means to ensure their realization, and they must put in place the necessary legislative, administrative, and institutional mechanisms to achieve that aim.

While primary responsibility under the human rights system lies with individual states, the international community is also duty bound to provide effective international cooperation, inter alia in response to shortages of resources and capacities in developing countries.

The way Mozambique's debt is managed suggests that there is limited level of accountability which is expressed in lack of involvement of civil society in debt management and lack of accessibility of information by the public.

6.2.2 Empowerment

Rights based approaches also give preference to strategies for empowerment over charitable responses. They focus on beneficiaries as the owners of rights and the directors of development, and emphasize the human person as the centre of the

development process (directly, through their advocates and through organisations of civil society).

The goal is to give people the power, capacities, capabilities and access needed to change their own lives, improve their own communities and influence their own destinies.

The principle of empowerment is still lacking in the whole debt question, as is the case with accountability.

6.2.3 Participation

Rights based approaches require a high degree of participation, including from communities, civil society, minorities, indigenous peoples, women and others. Loan procurement and debt repayment affect the daily lives of people yet most African governments deny them the chance to know about them. Citizens must be well informed about debt issues and repayment problems that affect their education, health and social services. According to the UN Declaration on the Right to Development, such participation must be “active, free and meaningful”; mere formal or “ceremonial” contacts with beneficiaries are not sufficient.

Rights based approaches give due attention to issues of accessibility, including access to development processes, institutions, information and redress or complaints mechanisms. This also means situating development project mechanisms in proximity to partners and beneficiaries. Such approaches necessarily opt for process based development methodologies and techniques, rather than externally conceived ‘quick fixes’ and imported technical models. People should through civic organizations and their parliaments contribute to loan procurement and external debt issues.

6.2.4 Non-discrimination and attention to vulnerable groups

The human rights imperative of such approaches means that particular attention is given to discrimination, equality, equity and vulnerable groups. These groups include women, minorities, indigenous peoples and prisoners, but there is no universal checklist of who is most vulnerable in any given context. Rather, rights based approaches require that the question ‘who is vulnerable here and now?’ be answered locally. Development data need to be disaggregated as far as possible, by race, religion, ethnicity, language, sex and other categories of human rights concern.

An important aspect of rights based approaches is the incorporation of express safeguards in development instruments to protect against threats to the rights and wellbeing of prisoners, minorities, migrants and other, often domestically marginalized, groups. Huge external debt service by government is done at the expense of providing health, education and social welfare to its people. Furthermore, all development decisions, policies and initiatives, while seeking to empower local participants, are also expressly required to guard against simply reinforcing existing power imbalances between, for example, women and men, landowners and peasants, and workers and employers. Women and children are the most affected by huge national debt service more than men. The introduction of social safety nets resonates with the rights to a reasonable standard of living, food, housing, health protection, education and social security.

In a nutshell, one can argue that the way debt is managed and the lack of an appropriate monitoring system that allows for accountability, and the lack of participation suggest that debt in Mozambique is far from aligning with the human rights approach to development.

Conclusions and Recommendations

Despite the efforts made to relieve Mozambique's debt, it continues representing a significant burden to the country's economy and its population as it diverts resources that could be used to meet human basic needs.

The study concludes that, in terms of loan allocation to ministries and sectors, it is in line with the country's development priorities, including the Poverty Reduction Strategy and the Millennium Development Goals. On paper, it can be concluded that Mozambique is on the right track seeking appropriate mechanisms for making loans work for the poor, but the practical part of this is yet to be seen.

The study reveals that the creditor institutions are heavily centralized, leaving little active decision making power to local missions, while these missions are perceived as assumed to be having the greatest potential to represent the recipient country's interests because they liaise on a day to day basis with the Government and they have good knowledge of the civil society. This area needs redress.

The issue of loan negotiation, contraction and debt management needs attention. The lack of legal instruments, the lack of clarity regarding the role of various institutions in debt management and monitoring, the absence of clear and established borrowing and debt management strategies and the lack of participation of civil society by civil society jeopardize the chances of making loans work for the poor. It is therefore essential that NGOs and governments both work towards more and better public and political-level understanding of development efforts. This will require a wide range of complementary activities, some of which are best undertaken by NGOs, and others by government agencies. NGOs and governments both need to work towards more and better public and political-level understanding of loan procurement and debt repayment efforts. This will require a wide range of complementary activities, some of which are best undertaken by NGOs, and others by government agencies.

The study also concludes that little attention has been paid to the domestic debt, in comparison to external debt issues. But, in practice, domestic debt is becoming a serious issue as it is growing and unfortunately the largest portion has been used to cover the costs of corruption and mismanagement.

7. Recommendations

Based on the findings of this study it is recommended that:

- The activities of creditors be more decentralized in order to be much closer to the ultimate beneficiaries of the loans and allow for involvement of the civil society and other actors in the whole debt process;
- A legal instrument that regulates all issues related with the loan cycle; that is negotiation, contraction, monitoring and disputes resolutions, repayment as well as enforcement mechanisms be established;
- Civil society should be engaged in all the processes around the debt issue to allow for responses that fully comply with the human rights based approach and this should be established by law;
- A formal and sound debt management strategy be established that allows for better control of debt resource flows and ensures that the citizens and particularly the poor, participate in the debate of debt issues.
- Creditor institutions should avoid imposing macroeconomic policy measures that prevent the smooth flow of resources towards the achievement of the Millennium Development Goals.

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Other Sources of Information

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- Central Bank
- Ministry of Planning and Finance - Department of Debt Management
- IMF Country Mission
- World Bank Country Mission

¹ Poverty headcount index measured as consumption per capita - Poverty Assessment Report, 1998.

² These data do not consider the amounts deducted from debt relief and includes only the major multilateral donors.

³ According to the budgetary rules, the Ministry of Planning and Finance has to submit a report on use of borrowed funds to the Government and then to the Parliament.