

DEBT CANCELLATION FOR POVERTY REDUCTION

Research Report on the Loan Contraction Process in
Zambia

by

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January 2003

JUBILEE- ZAMBIA

hosted by

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Executive Summary

A review of Zambia's external debt portfolio shows that Zambia has generally borrowed excessively and imprudently, and failed to manage debt effectively. This paper examines the legal framework regulating the loan contraction process in Zambia. It evaluates the extent to which Zambia's poor capacity for loan absorption can be attributed to the legal framework governing public external debt.

Generally the legal framework relating to public external debt is made up of national laws which authorise the Government to borrow and international practice and procedures which regulate the manner in which that power is exercised *vis a vis* foreign creditors. The basic relationship of borrower and lender is contained in a loan agreement, which creates a contractual relationship. The domestic laws that the country relies upon to negotiate loan agreements are scanty and vague, and not used effectively due to inexperience on the part of negotiating personnel. Sometimes there is a failure to comply with the law resulting in unauthorised persons contracting loans. In addition, international law is heavily biased in favour of the interests of creditors. As a result, the country does not benefit from the minimal protection that domestic laws have to offer.

The present system of borrowing lacks legitimacy because the process does not include consultation with the people or their representatives before loans are contracted, nor does it result in real benefit to the people. Rather it undermines the process of development.

Recommendations for reform focus on greater public involvement in the loan contraction process, a clear and detailed debt legal framework and enforcement of legal procedures. JCTR plans to use this report to support a general education campaign on debt law and to lobby Parliament. It is hoped that the JCTR campaign will encourage and ultimately feed into any Government sponsored reforms.

Introduction

A study conducted by Jubilee Zambia indicates that there is little understanding of the loan contraction process in Zambia. This paper looks at the legal framework governing the Government's power to borrow. It begins by setting out the context and the implications for development. The paper then elaborates the salient points of the various laws that facilitate and regulate borrowing. The final part of the paper examines the strengths and weaknesses of the loan contraction process and makes recommendations for both law reforms and action strategies.

Part One Background

1.1 Zambia's debt Problem

A country like Zambia has several sources of foreign funding. The first source is grants provided bilaterally or through multilateral institutions. This is the best source of revenue since it does not have to be repaid and it is usually tied to specific projects which can be monitored. However it must be noted that grants also come with certain conditionalities including demands for a commitment to borrow. A second source – official development assistance must be paid back even though it is usually provided on concessional terms. It also comes with all sorts of conditions that may be too rigid and inconsiderate of difficulties that the receiving country may face. The third source is commercial loans. Governments compete for funds on the open market, waiving their immunity, and agreeing to be treated like any other borrower.ⁱ Zambia has obtained funds from all three sources and is considered a highly indebted country.

Zambia's debt has been as high as \$7 billionⁱⁱ. It has come down recently due to debt relief in the form of debt cancellation programmes currently underway. Zambia's debt is especially large in per capita terms. It is owed mainly to the multilateral financial institutions – 54.8% to the International Monetary Fund, World Bank and its affiliates.ⁱⁱⁱ A sizeable amount – 38.5% is owed bilaterally to mostly Western countries. And a small proportion – 6.7% is owed to private commercial lenders.

Zambia's debt crisis originates from the late seventies when the country was forced to borrow in order to support public expenditure in the face of falling copper prices. Prior to this external borrowing was kept under control. The loan portfolio typically contained long term loans for investment in large development projects. Exchange rates were stable and annual debt service obligations were only 6% of export earnings.

However, rapid Zambianisation and the trend towards public ownership of the economy soon gobbled up most resources. The 1973 OPEC oil price hike initiated the downward spiral in Zambia's fortunes. While Zambia needed more money for oil and other imports, it was earning less foreign exchange despite increased production. This led to a sizeable balance of payments deficit. Over the next ten years debt service obligations became unmanageable. The increase in debt stock stifled economic growth. New borrowing was necessary to service existing debt and maintain imports at pre-1973 levels. Notably, approximately eighty loans were obtained between 1973 and 1982. World bank lending to Zambia increased from \$12m to \$55m per annum. Loans averaged shorter maturity periods and a substantial portion of them was obtained at floating interest rates. When interest rates went up in creditor Western countries due to domestic policies, debt service increased remarkably.

There were initial attempts to make debt more manageable through debt rescheduling programmes. Rescheduling of existing loans became necessary in order to offset the debt service ratio in the short term. But relief was short-lived as copper prices remained depressed and rescheduled debt attracted higher interest rates. The problem of indebtedness became entrenched as accumulating arrears compounded the already onerous external debt. Zambia underwent a structural adjustment programme, an enhanced structural adjustment programme, and a rights accumulation programme but they had little positive impact on the economy or the living standards of people, which continued to deteriorate. After two decades of adjustment the problem of debt has grown both in size and magnitude.

The table below illustrates the growth and magnitude of Zambia's debt:

Debt Trends 1970-2000 (US \$'000)

Year	Debt Stock	Debt per capita	Debt service due % of exports	Debt service paid % of exports*
1970	654.00	163.5	-	6
1975	1683.50	350.7	-	19
1980	3261.20	572.1	-	25
1985	4575.90	672.9	-	16
1990	7237.40	904.7	81	15
1994	6572.70	730.3	51	31
2000	6310.50#			

* Percentage of exports vis a vis debt service reduced as more aid is used to service debt.

Other figures unavailable.

The big leap in the size of debt stock between 1985 and 1990 is attributed to multiple factors including new borrowing for debt service, a build up of arrears, a fine of half a billion slapped on Zambia after suspending debt service, etc.

Source: Zambia Coalition on Debt and Development "The Zambian Debt Problem", Economics Association of Zambia, 1996, p.3 and Ministry of Finance Economic Report, 2001.

The latest debt management programme, the Highly Indebted Poor Countries Initiative (HIPC) hopes to achieve a substantial reduction in debt stock once Zambia reaches completion point. Some of the assistance under HIPC will be provided prior to completion point provided Zambia meets certain conditionalities some of which are as follows¹: The country is supposed to adopt and implement a Poverty Reduction Strategy Paper (PRSP) prepared through a participatory process. The budget allocations to education and teachers remuneration, health and HIV/AIDS must increase. Zambia must sell controlling shareholding in ZANACO and ZESCO and maintain an integrated financial management information system. Many people fear that HIPC will be another failure. Most people suspect that HIPC will not resolve the crisis because it is too little, too late.

1.2 Impact on Development

1.2.1 Theories of External Debt

The need for development is the major underlying reason why Zambia resorted to borrowing. Borrowing was intended to foster economic development. However due to all sorts of problems that occurred, borrowing resulted in very little development actually taking place. Theories related to debt may serve to explain why this is so.

There are many theories about public debt and this paper takes an eclectic approach choosing to focus on two opposing theories. The first, based on Keynes, supports the state's involvement as the engine of economic development. Therefore the State needs to borrow in order to finance development. Public debt is seen as an instrument of economic stabilisation. It is a source of additional expenditure, providing investment finance and thereby increasing demand and employment. The theory raised high expectations about the role that Government could play in job creation and income distribution. Presumably, the welfare State could use debt to provide the necessary social services that could not be provided by the private sector. Public debt could be managed simply by maintaining a feasible balance between borrowing and taxation.

Neo-classical economists on the other hand favour the rolling back of the State. Having observed the breakdown of monetary discipline in debtor States and the failure of debtor economies to sustain enough growth to keep pace with the demands of debt service, they see public external debt as a transfer of resources from one State to another. Debt denominated in foreign currency combined with a failure to apply loans to productive investment reduces the real income of the debtor. Their arguments are grounded in 19th Century public finance analyses that viewed public debt with suspicion.

Nineteenth Century financial analysts argued that political expediency invariably leads to the abuse of public debt and misuse of loan funds. Adam Smith for instance believed that using debt finance rather than taxes would eliminate the necessity to apply to the people for taxes to support the governments' agenda. And yet it would eventually result in the imposition of higher taxes to support debt service. He observed that once debt reached a certain level it could never be repaid. David Hume feared the impact of income concentrated in the hands of creditors who had no connection to the State. According to Hume such debt would inevitably destroy the nation.

1.2.2 Zambia's Debt History

Zambia gained independence at a time when Keynesian economics were popular. With a favourable attitude towards borrowing and the assumption that copper exports would support debt service, Zambia borrowed heavily for the provision of social services. The welfare state encouraged an attitude of fiscal laxity on the part of policy makers as the traditional stigma attached to fiscal deficits and growing public debt gave way to nonchalance. Traditional principles that a deficit is only justified if incurred for productive investments rather than current expenditures were insidiously abandoned in favour of fiscal policies that made full employment and expanded welfare programmes their predominant objectives.

The large debt burden that resulted has several implications for development. These must be seen in the context of attempts to manage the debt crisis in compliance with creditors requirements.

First, once Zambia became heavily indebted, it became necessary for creditors to demand the imposition of measures to facilitate debt repayment. Consequently, Zambia's creditors have had a major impact on Zambia's development policies. The country has been under various structural adjustment programmes since 1981. The first programme called for ceilings on money supply and credit, a reduction in the budget deficit, a public service wage freeze, and decontrol of the market. Zambia failed to comply with the stringent austerity measures due to civil strife attributable to unpopular curtailment of social services such as food subsidies, causing the Government to initiate various unilateral measures to resuscitate the economy – namely, the Interim National Development Plan (INDP) in 1987.

The INDP called for a reduction in luxury imports, use of foreign exchange as a strategic development resource and most importantly a ceiling on debt service payments. It was hoped that this would free resources for investment purposes. However, when the Government tried to introduce a New Economic Recovery Programme restricting imports, limiting debt service to 10% of export receipts and fixed exchange and interest rates, the multilateral and bilateral creditors refused to endorse the Programme, forcing Zambia to return to donor sponsored restructuring. In order for Zambia to become eligible to borrow, the country first went through a rights accumulation programme (RAP), under which donors made payment to the IMF on behalf of the country as it struggled to earn the rights to borrow. The programme negotiations were protracted and only finalised in 1991. The range of conditionalities to be met by Zambia included set benchmarks for achieving what was termed 'good governance'.

Good governance meant a return to multi-party politics, and a fundamental change of economic policy. The State was to withdraw from the economy through decontrol and liberalisation of the market, and privatisation of the public sector. The public service was to be reformed through restructuring of ministries and mass retrenchments. Government provision of social services such as education and health became liable to fees through cost recovery and cost sharing schemes. After the MMD Government came to power in 1991 these conditionalities were implemented to a large extent with the exception of the privatisation programme. The four-year national development plans were abandoned altogether. But despite all these reforms, the debt burden did not ease in any sustainable way over the next ten years.

1.2.3 Debt and Development/Poverty Reduction

The most obvious impact of the heavy debt burden is on the availability of resources for both investment in capital expenditure and provision of social services. Most people are extremely poor. According to the Poverty Reduction Strategy Paper 2002-2004^{iv} future plans and programmes face a large financing deficit that will have to be filled by external as well as domestic resources. The heavy debt burden has reduced resources for poverty reduction, significantly crowding out social expenditure.^v

From a legal point of view, public external debt has a disturbing effect. The Constitution spells out all those developmental rights and activities that it *cannot* promise because it lacks the necessary resources. Part IX of the Constitution of Zambia contains what are known as the Directive Principles of State Policy. The principles are intended to guide the Government as a whole in the development and implementation of national policies. They also guide the making, enactment and application of all laws. The Principles of State Policy are:

- a) The State shall be based on democratic principles.

- b) The State shall endeavour to create an economic environment that encourages individual initiative and self-reliance among the people and promotes private investment.
- c) The State shall endeavour to create conditions under which all citizens shall be able to secure adequate means of livelihood and opportunity to obtain employment.
- d) The State shall endeavour to provide clean and safe water, adequate medical and health facilities and decent shelter for all persons and take measures to constantly improve such facilities and amenities.
- e) The State shall endeavour to provide equal and adequate educational opportunities in all fields and at all levels for all.
- f) The State shall endeavour to provide to persons with disabilities, the aged and other disadvantaged persons such social benefits and amenities as are suitable to their needs and are just and equitable.
- g) The State shall take measures to promote the practice, enjoyment and development by any person of that person's culture, tradition, custom or language in so far as these are consistent with the Constitution.
- h) The State shall strive to provide a clean and healthy environment for all.
- i) The State shall promote sustenance, development and public awareness of the need to manage the land, air and water resources in a balanced and suitable manner for the present and future generation
- j) The State shall recognize the right of every person to fair labour practices and safe and healthy working conditions.

The principles are not *justiciable* – meaning that they are not by themselves legally enforceable in any court, tribunal or administrative institution. They are to be observed only in so far as State resources allow or where Cabinet determines that the general welfare of the public necessitates their application.

Consequently, under the Constitution, people are obliged to pay taxes; but those payments do not entitle them to development or basic resources. In fact the Constitution makes it clear that any activities related to meeting the needs of the people are subject to availability of resources. And yet the same Constitution makes debt repayment a direct debit on public revenue. Theoretically, since the country is bankrupt, this is tantamount to saying that the state will service all debt without even prior recourse to the people but it cannot be compelled to prioritise development.

Debt also has implications for the development of future generations. The process of debt rescheduling means that responsibility for debt servicing will be passed on to future generations, causing them to suffer undeserved deprivation that comes with indebtedness.

Future generations will be servicing debt long after the people who signed for the loans or who benefitted from the loans are gone. They will continue to be accountable for current policies and their repercussions. Furthermore donor support is of little help. Presently most aid is used to service debt rather than funding capital developments.

1.3 Debt Cancellation Campaign: Approaches and Theories

1.3.1 Jubilee Zambia

Theological instruments provide one approach to tackling the debt crisis. The idea of debt cancellation draws extensively from Christian principles and teachings. Theologians claim an inalienable and indestructible human dignity. Faith in God is linked to respect for the human person. The Church's position as reflected in its social teachings emphasises the inherent dignity of all human life. Human potential is realised in relationship to others, making it obligatory for everyone to pursue the common good and build a society that gives all people the opportunity to realise that potential.

Third World churches have applied this concept to the problem of debt in their teachings on liberation theology. In particular, they demand the application of a preferential option for the poor. This is a preference for solidarity with the poor and 'insignificant' justified by Christian charity. The preferential option necessitates that in every venture, we identify those at risk of being marginalized or deprived of some condition for a fully human existence and take measures to protect them prior to implementation of the venture. Thus the preferential option for the poor ensures that for Christians, the justice of all policies and programmes is measured by how they impact on the weakest members of society or those in most need.

The Jubilee year 2000 provided an opportunity for the church to campaign for debt cancellation. The tradition of Jubilee as set out in the bible relates to a time, which comes to pass every fifty years to cancel debts and free slaves. On September 23rd Pope John Paul II met with a Jubilee 2000 delegation and made a strong appeal to world leaders to resolve the crisis. He noted that there is a social mortgage on all private property. The law of profit cannot be applied to that which is essential for the fight against hunger, disease and poverty.^{vi}

Jubilee-Zambia has since 1998, been at the forefront of lobbying for debt cancellation for Zambia. Jubilee-Zambia has undertaken a number of projects, aimed at lobbying for debt cancellation. They have conducted nation-wide opinion polls to raise awareness of the debt campaign. They have lobbied for a debt mechanism to ensure that debt relief benefits the poor and that future borrowing is monitored by civil society. The campaign seeks to ensure that any debt relief goes towards poverty reduction. A debt petition circulated by Jubilee-Zambia collected 325,000 signatures. Jubilee Zambia has carried out research on the debt problem which shows the need for a continued focus on debt cancellation even as other measures are put into place to tighten the borrowing process and create mechanisms to ensure that the process is transparent and in compliance with the law.

1.3.2 Human Rights

Human rights theory provides another approach to debt cancellation. The human rights approach regards international instruments guaranteeing human rights as fundamental to any international relations. Therefore State contractual obligations must not lead to the violation of these fundamental rights. A country cannot uphold an agreement that violates the human rights of its people. And since human rights are enjoyed and enforced primarily through the domestic law of each particular country, it is the responsibility of the government of that country to prioritise the delivery of rights. As a part of the UN international system advocating the importance of human rights, international financial institutions such as the World Bank and the IMF also have a responsibility to uphold human rights. The argument in

a nutshell, being the fact that, human rights cannot be sacrificed in order to meet debt repayment.

In practice however, responses to the crisis have generally followed donor country expectations and ignored or denigrated the rights of people in indebted countries on the grounds that they are responsible for incurring the debts in the first place. Such an approach however fails to acknowledge the lack of legitimacy of many African governments at the time that debts were incurred, due to lack of democratic governance, accountability and transparency. It also fails to take into account the fact that many of the victims of debt are children who cannot be held legally accountable for the debt. And yet as already noted above, the various economic programmes instituted to make debt sustainable have avoided any substantial cancellation of debt. There has been little in the way of actual debt cancellation. Rather efforts are aimed at ensuring smooth debt service. Hence Jubilee Zambia's decision to continue to lobby for debt cancellation beyond the Jubilee year 2000.

Part Two: The Current Legal Framework

This part of the paper examines the extent to which Zambia's poor capacity for loan absorption can be attributed to the legal framework governing public external debt. It begins by setting out what maybe termed the ideal loan process to provide a basic standard against which the process in Zambia is measured.

The Legal Concept of Public External Debt

From a legal perspective, public external debt is a monetary obligation that a country incurs by procuring money from outside the country, normally in foreign currency.^{vii} Some loans are obtained directly by the Government, but others may be obtained by quasi-government institutions provided the Government guarantees repayment. The government of a debtor country assumes a legal obligation to pay back. In order to do so, the country has to raise revenue from taxes. Therefore the people are ultimately liable for the repayment of public debts regardless of whether they were aware of the debts or not. It is also legally irrelevant that the loan proceeds were misused and did not benefit the country.

2.1 The Ideal Process

The ideal process draws extensively from data and training materials provided by the United Nations Institute for Training and Research (UNITAR). On the basis of research conducted in a number of developing countries, UNITAR has consolidated its findings into training modules that deal with the legal aspects of existing debt management systems and recommend reforms.

According to UNITAR, since public debt has serious implications it is very important that it is incurred only in compliance with the law. The Constitution or an Act of Parliament must provide the authority to borrow. Normally Parliament is informed in order to ensure that the loans are used appropriately. Informing Parliament is also very important because it is one way of notifying the people through their representatives and it helps with the monitoring the loans.

When a government department or ministry requires financing, for instance in order to implement a project, the ministry will draw up a project proposal and then approach the department of government responsible for finance. Ideally, the loan contraction procedure

begins with the responsible department of government such as the Ministry of Finance holding preliminary talks with the lender's representatives. The authority to borrow and the procedure are incorporated in an already existing Act of Parliament. The loan agreement resulting from the negotiations is either submitted to a specialised body that reviews agreements and recommends them for further consideration by Parliament/ a parliamentary sub-committee or to Cabinet.

Only if a draft loan agreement is approved will the Minister of Finance be mandated to sign on behalf of the Government. Any other individual may sign only upon the written approval of the minister. This step must never be overlooked as it ensures that the debt process is centralised and easily monitored and managed. Copies of the agreement must be sent to the certain departments such as the Auditor-General, Central Bank or National Archives. Finally, the agreement should be entered in a public register that shows the parties to the agreement, the amount procured, the purpose for which it has been procured, the maturity period, and the purpose and beneficiaries of the loan. This serves to promote transparency in loan procurement.^{viii}

Once a loan is obtained, there must be an effective debt management system in place to monitor the use and repayment of the loan as well as maintain a database. The system must be operated by well- trained and effective negotiators even though most creditors tend to insist on the use of standard loan agreements. Since a loan agreement is contractual it ought to be negotiated by both parties. Negotiation of loans occurs at various points in the life of the loan particularly where the loan needs to be rescheduled.^{ix}

When a country is unable to meet its debt obligations it will normally seek relief from its creditors. The most popular forum for rescheduling is currently the Paris Club. These negotiations however produce no binding obligations. They result in an "Agreed Minute", which merely enables the country to obtain relief from individual creditors. These bilateral negotiations are what bind the parties.

Once loans are obtained they must be managed efficiently. Unless there is effective debt management, then at a certain point the expectation of increases in revenue to allow for the payment of interest and the principal becomes illusory causing governments to lose autonomy in financing their own programmes. The point at which the ratio of debt to revenue reaches an impasse depends on a host of factors some of which cannot be known at the time of borrowing. The measures used to identify this critical point are usually the ratio of external debt stock to exports or the gross national product, or the ratio of debt service to exports.^x

Some countries have attempted to avoid getting into too much debt by fixing borrowing ceilings through budgetary legislation. One approach is to introduce ratios between revenues and loans and pursuing a totally balanced budget at all times which cuts out the need for and authorisation to borrow. Another approach is to set a ratio between loans and total public investment countrywide over a given period of time. Both approaches seek to finance public expenditure from public revenues i.e taxes, but maintain a balance through increasing public revenues or cutting expenditure.^{xi}

2.2 The Authority to Borrow: Acts/Legal Provisions and Procedures

2.2.1 Loans and Guarantees (Authorisation) Act

In Zambia, there are a number of laws that work together to authorise and regulate public external borrowing. The Legal framework changed substantially in 1969 from what it was at Independence. It is very significant that the current law was enacted at around the time

when a referendum was held to usher in the One-Party State. The domination of UNIP and its government was clearly intended to extend to public borrowing. Law reforms had the effect of ousting Parliamentary control over the borrowing process and legalising undemocratic contraction and management of loans.

Under the current legal framework, the most important piece of legislation is the ***Loans and Guarantees (Authorisation) Act, Cap 366*** of the Laws of Zambia. This Act is primarily intended to give blanket authority to the Government to borrow. Once this authority is given, the loan contraction process tends to follow international principles and rules. There are a number of Acts that authorise the application of international law and multilateral financial institutions in Zambia. These are ***International Development Association, Cap. 361; Bretton Woods Agreements Act, Cap. 367; International Finance Corporation, Cap. 368***. These Acts enable Zambia to be a member of and therefore eligible to borrow from these institutions.

The key provisions of the ***Loans and Guarantees (Authorisation) Act*** are as follows:

- Loans maybe raised through the issue of bonds and stock, issue of treasury bills and by agreement in writing. The Minister determines the terms and conditions applicable. *This expectation is unrealistic in view of the fact that the Minister is expected to negotiate terms that are favourable to Zambia in circumstances where the lenders clearly have the upper hand.*
- Section 3 of the Act gives the Minister of Finance a general power to borrow both within and outside Zambia, as he may deem desirable. *This gives the Minister too much discretion to commit the country to dangerous levels of debt.* The ceiling on borrowing is contained in a statutory instrument authorised by resolution of the National Assembly. (Under Article 80 of the Constitution, a statutory instrument is to be published in the Gazette within 28 days *after* it is approved by Parliament). When the National Assembly is not sitting, the Minister is authorized in the public interest and with the approval of the President, under section 26, to vary the ceiling on borrowing to the extent necessary to raise an urgent loan or guarantee. *This creates another loophole. . External loans are not subjected to the scrutiny of Parliament before they are obtained nor is the Auditor-General supplied with all loan documentation.*The present borrowing ceiling was set under Cap 366, by statutory Instrument No. 53 of 1998, at a maximum of K20 trillion. This is the maximum allowed to be outstanding at any one time on loans raised from outside the Republic. In addition the Government can guarantee up to two hundred thousand, million, Kwacha. *It is uncertain whether these figures were determined on the basis of the country's ability to absorb and service such debt or simply to accommodate the existing debt obligations and their multiplication due to a failure to pay back or service them adequately. There is some concern that if twenty trillion Kwacha amounted to \$4 billion at the 1998 exchange rate, and the actual outstanding debt at the time was \$7 billion, then the ceiling is not properly defined and workable.*
- Loans for a period of not more than one year are payable into a special depository account but those for more than a year are payable into the general revenues of the Republic. *These are then difficult to monitor.* Loans raised for a specific purpose must be applied only to that purpose.
- All debt charges are paid out of the general revenues of the Republic and details included in the financial report to Parliament. *This report thus comes after the fact and serves little useful purpose.*

- Although a sinking fund maybe established in the public interest where a loan is obtained through the issue of bonds or stock, it is mandatory to establish a sinking fund for the redemption of not less than 75% of the loan only where bonds and stock issued in respect thereof exceed 10 years.^{xii} *Sinking funds are not used in practice. Officers queried at the Ministry of Finance were unaware of the provision or what it entails.*
- Under the Loans (Stock, Bonds and Treasury Bills) Regulations appended to the Act, in the case of any loan raised by the issue of stock and bonds the Bank of Zambia shall keep a register of each issue of stock and bonds. The holders of the stock and bonds are also registered. *It is uncertain whether this has been done.*
- Under Parts V and VI of the Act, the minister can guarantee or grant loans to persons and on such conditions as stated under the same provisions of the Act. For instance, upon the issue of a warrant by the President, the Minister can on written agreement and whatever conditions he deems fit, grant loans out of the general revenues of the Republic to any person or body specified in the warrant. *The Minister has wide and dangerous discretionary powers to lend out public resources.*
- Although loans contracted under prior Acts remain valid, all new loans must be raised under the **Loans and Guarantees (Authorisation) Act** or other written law enacted in future. This section rules out the use of a previous Act, which placed more stringent measures on Government including the passing of an Act of Parliament to authorise a public loan. (Namely, the **General Loan and Stock Act of 1931** detailed below)

Clearly, the **Loans and Guarantees (Authorisation) Act** does not provide adequate guidance with regard to the procedure to be followed by the Ministry of Finance in negotiating and monitoring loans. It should offer better protection from the risks of borrowing internationally.

2.2.2 Supporting Legislation

In addition to the **Loans and Guarantees (Authorisation) Act**, the Republic of Zambia can also obtain moneys from foreign sources through several means. The Government may issue treasury bills through the **Treasury Bills Act, Cap. 348**. It can also issue stock and bonds or execute loan agreements under a number of Acts both current and moribund. **The General Loans (Guarantee) Act** is a general guarantee by the Government that certain corporations will discharge their obligations under agreements made with governments, the World Bank, the Commonwealth Development Corporation and other bodies and organizations outside Zambia. Any sum required for fulfilling any guarantee may be paid out of the general revenues and assets of the Republic and a statement to that effect laid before Parliament at the end of the financial year of the corporation on whose behalf the payment was made. No loan guarantees may take priority over World Bank loans except in the case of specific exceptions stated in the Act.

Under the **General Loan and Stock Act, 1931, Cap. 350**, moneys may be obtained through the issue of debentures. This Act is *no longer used* but it offers much better protection to the Republic than **Cap 366**. Of special note are the following: *That an Act of Parliament is required to authorise borrowing; that there are ceilings on the life of a loan; and that a trustee administered sinking fund must be established.* **Cap 350** specifically provides that, a loan may be raised in any manner including the issue of a debenture or Zambian stock provided there is authorization to borrow for a specified purpose contained in an Act of Parliament.

Cap 350 may be compared to the ***Local Loans (Registered Stock and Securities) Act Cap. 353*** under which, loans must be Gazetted.

Debentures under the ***General Loan and Stock Act*** should be registered. A sinking fund authorised by the Act and funded through regular contributions from the general revenues and assets of the Republic shall be used to pay the loan, interest and costs of administering the fund. The sinking fund is to be administered by trustees and the costs of administration are to come out of the fund itself. Debentures are drawn for payment and paid on a specified date. Interest on the loan ceases on the date appointed for repayment of the loan whether payment of the principal is demanded or not. The date for redemption of stock should not exceed 60 years from the date of issue. If the sinking fund is insufficient to cover the principal moneys borrowed then only are they chargeable to the general revenues of the Republic. The following examples of statutory loans and guarantees under the General Loan and Stock Act, illustrate the range of ways in which Government borrowing can be supervised and monitored by Parliament. Thus in the first example, Government authority to obtain a loan is subject to providing Parliament with the details of the proposed project. And in the second, the issue of a Government guarantee is conditional upon the beneficiary reimbursing Government.

- ***The Loan Act, Cap. 351.*** This Act passed in 1931, empowered the government of the day to borrow the equivalent of K4.5m. The purposes of the loan specified under the Act include the construction of civil buildings, communications infrastructure and road and harbour development. A sinking fund was to be set up not later than 3 years after the date from which interest begins to run.
- ***Rhodesia Railways Loans Guarantee, Cap. 369*** – under which the Government could co-sign with the Government of Southern Rhodesia to guarantee a loan to Rhodesia Railways. The Zambian Government would guarantee the repayment of one half of the principal and interest on any loan and recover the money from Rhodesia Railways. Trustees were to handle the transactions involved.

Cap. 350 however, paved the way for ***Cap 366*** by stating that nothing in it prohibits the raising of loans in the Republic upon terms and conditions specified in an Act authorizing the raising of such loans.

2.2.3 Constitutional and Statutory Controls on Borrowing

The authority to borrow is controlled and limited through a number of laws including the Constitution. Thus certain Acts provide mechanisms to monitor and control the power to borrow. However, such laws are either inadequate or ignored by the Minister of Finance because the regulatory mechanisms they create are weak and ineffectual. The key controlling mechanisms are as follows:

2.2.3.1. The Attorney General

Article 54 of the Constitution creates the office of Attorney General or principal legal adviser to the Government. His specific functions are to cause the drafting of and sign all Government bills to be presented to Parliament. To draw and peruse agreements, contracts, treaties, conventions and any other documents to which the Government is a party or has an interest. An agreement, contract, treaty, convention or other document in which the Government has an interest should not be concluded without the legal advice of the Attorney General unless the law provides otherwise. . *It must be noted that the Attorney General is*

an integral part of Government and therefore not well placed to give independent advice. His independence is further undermined by the fusion of the offices of Minister of Legal Affairs and Attorney General last year.

In order to be valid, all draft loan agreements should be approved by the Attorney General. In practice this was rarely done in the past, due to political expediency or because the Government was in a hurry to secure the loan on offer. The Ministry of Finance simply chose to ignore the Attorney General's office unless the creditors insisted that he be consulted. And yet the Attorney General serves to assist the Minister of Finance since the Attorney General has the necessary legal expertise to identify risky provisions in loan agreements.

2.2.3.2. The Auditor-General

Articles 121 and 122 set up the office of Auditor-General. He is the watchdog of the nation's finances and his office is set up in such a way as to ensure his independence as he performs his functions. Thus his appointment is ratified by Parliament, his salary is a direct debit on the general revenues and he cannot be removed from office without complying with lengthy constitutional requirements. *However it must be noted that the office itself is inadequately funded and dependent upon the Ministry of Finance for regular grants. All staff other than the Auditor-General are seconded by the Ministry of Finance. The office has also been hampered by a lack of cooperation on the part of the Ministry of Finance.* The functions of the Auditor-General are set out in an Act of Parliament - the **Public Audit Act, Cap. 378 of the Laws of Zambia**, which states that:

- The Auditor-General's function is to audit the accounts relating to the general revenues of the Republic. This includes auditing any expenditure charged by the Constitution or any other law on the general revenues and making a report thereon to the President within twelve months after each financial year. *In practice this Report is usually late, sometimes by as much as two or three years.*
- The duties of the Auditor-General are to audit the accounts of every statutory, corporation, public company, Government department and private institution that receives a public grant. The Auditor-General verifies whether the moneys received by the institution have been applied to their legitimate purpose. Where the President considers it desirable in the public interest he can request the Auditor-General to carry out a specific audit investigation. *It must be reiterated that audits and reporting to Parliament are not completed in accordance with the Constitutional time limits, thus hampering the ability of Parliament to act on any malfeasance.*
- The Auditor-General can carry out special and interim audits in order to circumvent financial loss or damage to Government due to serious financial irregularities. The report is submitted to the President for onward transmission to Parliament. *This may create unnecessary delay or editing of a report.* If the President delays the report then the Auditor-General should submit it to the Speaker of the National assembly.
- For purposes of the audit, the Auditor-General is entitled to full access to all accounting records. This includes records relating to Government contracts for the supply of goods and services. Obstructing the Auditor-General in his duties is a criminal offence. *And yet the Auditor-General's reports indicate that he does not have as much access in practice as he should by law.*

2.2.3.3. Parliament and Budgetary Controls

Parliament does not have direct control over the extent to which the nation can be exposed to external debt since such power is the prerogative of the Minister of Finance. Parliament's powers are exercised through more general budgetary controls. Parliament's committee of Ways and Means, which also doubles as the Committee of Supply and Demand examines the Government budget under various heads of expenditure and approves certain amounts to be spent under each head.

Such general controls in expenditure may help to limit Government expenditure of external loan proceeds begin with the President's good sense in authorising expenditure. According to **Article 115** of the Constitution, no money can be expended from the general revenues of the Republic unless the President issues a warrant; or the money is a direct charge by law; or it was raised by the department seeking to spend it. The President will issue a warrant if an Appropriation (budget) or Supplementary expenditure Act has been passed by Parliament, unless the expenditure is urgent, necessary to carry on the services of Government or continuing capital projects. In which case the President must immediately send a copy of the warrant to the Auditor-General. 'Urgent expenditure' must be legalized through a Supplementary Expenditure Bill. The Bill is presented to Parliament within four months or at its next sitting. *However since debt is a direct charge under the Constitution this protection does not apply to it.* Under **Article 120**, public debt (which includes interest, sinking fund charges, repayment or amortisation of debt and all expenditure connected to raising a loan) is a direct charge on the general revenues.

2.2.3.4. Public Reporting and the Public Accounts Committee of Parliament

The Public Accounts Committee is the Parliamentary institution mandated to scrutinise Government expenditure by verifying and commenting on the Auditor-General's report. The Committee's findings and recommendations for disciplinary action in the event of mismanagement of public resources are presented to Parliament as a whole and published. The Committee can request for any information other than ministerial files and minutes. It can also summon any controlling officers including the Minister of Finance to appear before it. *However its recommendations come after the fact and are generally ignored. The Government's 'action taken' reports invariably say nothing more than 'noted'.*

2.2.3.5. Ministry of Finance Internal Controls

The **Finance (Control and Management) Act, Cap.347 of the Laws of Zambia** regulates the way in which public revenues are expended. The Finance (Control and Management) Act regulates the management of public finances. Public moneys are defined under the Act to a) include all revenues and all moneys raised or received for purposes of or benefit of the Republic and b) to include all stamps, bonds, debentures and other securities raised or received by or on behalf of or for the benefit of the Republic. Clearly the Act covers loans. **The Finance Control and Management Act regulates public funds only from the expenditure point of view and is not very helpful when it comes to the loan contraction process. It is also not strong enough to handle financial abuse in a country in which corruption and abuse of office are rampant. It is not adequate for debt management in an economy where misuse of loan proceeds is endemic. Year after year the Auditor-General's reports contain cases of financial abuse of and yet little or no action is taken against perpetrators. There is a general acceptance of mismanagement as a regular occurrence, either due to ignorance or ineptitude, as the cases cited later in this paper illustrate.**

Specific provisions of the Act state as follows:

- The Minister of Finance is responsible for the control of all finances unless control is specifically assigned to any other Minister by law. He is assisted in his task by controlling officers acting under the supervision of the permanent secretary (PS) of the Ministry of Finance. The PS has to authorize the opening of accounts, making of deposits and use of public moneys. All use of public moneys must be in accordance with this Act or other written law.
- This includes advancing moneys to any person. Under the Act, such advance must be in the public interest. The moneys are refundable or chargeable against any head of expenditure but *should not be made in anticipation of an appropriation by the National Assembly*.
- Any public moneys that have been lost or misappropriated maybe charged against moneys appropriated by the National Assembly. *The PS has the power to write off deficiencies of public moneys and to abandon irrecoverable amounts of revenue, debts and overpayments*. And the Minister has absolute discretion to make donations from public stores to educational or charitable institution, welfare association or cooperative society. If the value of the donation exceeds K1m then the Minister needs the prior approval of Parliament.
- Under section 11 of the Act, if a loss of public moneys is due to the wilful default or neglect of duty by a public officer, he must explain the loss, and where the PS so directs make good on the loss. Failure to do so may lead legal action.
- The PS, unless precluded by law, also has access to all the books of account of any Ministry, Government department, agency or statutory corporation and can appoint any persons as internal auditors to examine such books.
- The Act reiterates what is in the Public Audit Act. Under the Act, the Auditor-General is authorized to have full access to and to audit the books of all statutory corporations in the absence of internal auditors. *Yet as noted earlier, the Auditor-General complains persistently about the lack of cooperation from controlling officers and their staff*.

2.2.3.6. Bank of Zambia Controls

The role of the Bank of Zambia in external debt management is not very clear, with the exception of balance of payments support provided by creditors. In general, the Bank is to receive and disburse Government money and keep account thereof under the ***Bank of Zambia Act, Cap. 360 of the Laws of Zambia***.

- The Bank is mandated under sections 4 and 48, to act as banker, economic adviser and fiscal agent to the Republic, and official depository of Government funds.
- Under section 50, the Bank shall on such terms and conditions as the Minister may determine issue and manage Government loans.
- It also acts as banker for financial institutions, foreign governments and international agencies. The Bank is to undertake and transact in the name of the Republic, responsibilities resulting from the participation of the Republic in inter-governmental organizations.
- There is some hierarchy in the relationship between the Bank and the Ministry of Finance. Under the Act, the Minister of Finance is empowered to give mandatory

directions to the Bank. This gives the Minister control over the Bank, which may be abused. The Act tries to prevent such abuse by stating that instructions must be in writing and issued only after consultations with the Governor of the Bank. *The Bank's role vis vis public debt should be clarified with Bank having more independent input in the debt management process.*

2.3 Loan Contraction Process in Zambia

Having evaluated the authority to borrow from the point of view of the ideal process, it is evident that the Zambian legal framework differs substantially from the ideal process referred to earlier. The same applies to the actual loan contraction process.

The External Resource Mobilisation (ERM) department of the Ministry of Finance is responsible for borrowing from external sources. It has three sections. The Bilateral and Multilateral Units are responsible for non-debt creating transactions. Borrowing is confined to a Debt Unit. The Unit is responsible for contracting and managing external loans. The process of contracting loans is not written down hence there is no standard procedure to guide loan negotiators.

Once the department of investments and debt management receives a request for funding from a line ministry, it approaches creditors likely to favour that particular type of project. If the creditors are agreeable to the project, they send a 'standard' draft loan agreement for review by the Ministry of Finance. It is very important at this time to assess the financial implications of the various clauses and conditions in the agreements in order to avoid committing the country to impossible demands. In practice not enough attention is given to the study of the draft loan agreement because of the assumption that it is not negotiable. It may not even be submitted to the Treasury Consul or the Attorney- General for their comments. And yet as a contractual agreement every part of the document ought to be negotiable to ensure true agreement and justify enforcement of obligations created.

Although the power to borrow is contained in domestic law, the actual transaction of borrowing is also governed by international law and practice. Thus while loan agreements may vary, they normally include the following, which are negotiated by the parties to the best of their ability:^{xiii} The importance of negotiating each and every part of the loan agreement is underlined by the arguments below.

- A preamble that includes definitions, the names of the parties and the purpose of the loan. Borrowers need to analyse the definitions of the key concepts carefully and appreciate their implications before agreeing to sign.
- A section on terms and conditions in the loan agreement spells out the borrower's financial obligations including the interest rate, commitment fees, legal and out of pocket expenses, penalties and amortisation. The interest rate is very hard to renegotiate once it is established and the penalties for late payment may be onerous. Creditors usually push for what they claim are standard terms in loan agreements. But it is very important to ensure that the country can comply with the terms and conditions in the agreement. The loan agreement must be seen as a contract and therefore subject to the rules of contract.
- The borrower must make certain representations of fact relating to the financial and legal status of the borrower. For instance that the legal requirements under the

national law have been complied with. It must also equate the ranking of new debt to any other existing unsecured indebtedness.

- A section under covenants and undertakings deals with promises by the borrower to perform or refrain from doing anything (such as changing domestic law) that would affect its financial condition and integrity. Covenants generally project into the future so the borrower must be careful not to unduly restrict its financial and operational activities. For instance it should not sign away its right to a defence in case of default as has been known to happen in the case of Zambia.
- A section on pre-conditions to disbursement sets forth a number of conditions which the borrower must meet before the loan is disbursed. These conditions may be excessive and irrelevant unduly delaying draw down on money that is already incurring commitment fees. They should be negotiated to a minimum.
- A section on default generally identifies events that give the lender the right to accelerate the maturity of the debt and terminate its commitment. These events must be few and clear – not subject to arbitrary determination by the creditor. For instance they should not include factors beyond the control of the borrower. In the case of technical default (violation of covenants) as opposed to blatant default, (non-payment) the borrower should ensure a reasonable grace period in which to effect compliance before penalties become applicable. Borrowers should also avoid cross-default clauses under which default on one loan triggers default on other loans.
- In case of disagreement or default, the loan agreement also contains the law that will determine any dispute. Currently the creditor determines the law that is applicable. (This position is due to a reversal of the traditional position under which, the law of the borrower State, was applicable in cases where the lender was not a nation State.) The applicable law and dispute resolution institution - whether international or in a creditor State - is heavily dominated by jurists from the North. For instance loan agreements generally include a waiver of sovereign immunity placing the borrower at the same level, as the creditor be it a bank or multilateral financing institution.

Zambia has generally performed very badly with regard to loan negotiation. Once the draft loan agreement is approved, having undergone minimal negotiation or examination of the contractual obligations, a signing ceremony will take place either locally or abroad. At this point access to the proceeds of the loan will be dependent on the fulfilment of certain pre-conditions such as setting up a project unit to implement the project, open bank accounts etc. The project accountant draws on the funds using a withdrawal application form. Un-disbursed funds remain in the custody of the creditor but are committed to the project. It may take years to fully disburse a loan. Not all monies may be disbursed due to failure to comply with conditionalities along the way. Yet commitment fees are due and payable throughout. Sometimes creditors cancel loans because disbursement has gone beyond the contracted period. All these obstacles carry financial costs in addition to fees and charges such as interest on disbursed funds.

The same problems also arise with regard to balance of payments support. Balance of payments support is provided by donors as new loans or grants. Where the Government fails to comply with conditionalities such as privatisation then promised support maybe withheld, throwing the budget into disarray. For instance under HIPC, Zambia is obliged to fund certain social sector needs as opposed to making debt payments. However it has been unable to raise the necessary resources.

The process of monitoring loans begins once the loan agreement has been signed. One copy of the agreement, is kept by the Director of Investments and Loans. Copies are also sent to the Ministry of Legal affairs and Treasury Consul. The IT officers in the department

open a folder on the loan. The folder contains the creditor reference number, the date when the loan was signed, the date it takes effect, the period during which draw down should take place, amount and currency of loan, economic sector, repayment dates, interest and rate, penalties and applicability. All this information goes into a database used to manage debt. Once the loan becomes effective and disbursement begins, disbursement records are also maintained. The database is used to project debt service due for purposes of budgeting. Each year the budget indicates in *Kwacha* terms what amounts to the equivalent in dollars of debt service on a month, by month, basis. This figure is agreed with the IMF.

Part Three: Relevance of Framework (based on certain key experiences)

3.1 Case Studies

The rapid growth in Zambia's indebtedness over the past two decades can be attributed to the inadequacies of the debt legal framework. . With a weak loan contraction system in place it is easy to see why Zambia is facing a serious debt crisis. Both existing weaknesses in the law and a failure to adhere to the laws that do exist mean that Zambia lacks a sufficiently supportive and mandatory framework within which to effectively manage debt. Each year the Auditor-General's Annual Report identifies numerous instances of abuse of the loan contraction process to the detriment of the country as a whole. Examples drawn from the year 2000 Report include.^{xiv}

- **Onerous pre-disbursement conditions**

International Development Association (IDA) and European Investment Bank (EIB) loans

In 1994 the Zambian Government solicited loans from IDA and EIB to strengthen the capacity of the Ministry of Energy and Water Development. The loans were also intended to rehabilitate and strengthen the institutional capacity of TAZAMA pipelines, and improve the efficiency of product distribution. The implementation of the project was conditional upon the following: *Execution of a subsidiary agreement between the Government and TAZAMA; Implementation by Government of preliminary measures to reform the petroleum pricing mechanism to the satisfaction of the World Bank; Execution and fulfilment of the preconditions related to the EIB agreement; Government entering into an agreement satisfactory to the World Bank, with oil marketing companies to manage the refined product terminal.* In April 2000 IDA cancelled the balance of the credit for failure on the part of Government to meet legal covenants relating to the liberalisation of prices and importation of crude oil products. At the time of cancellation, the World Bank had only disbursed 20% of the loan amount of \$25m. The EIB loan, which was meant to supplement the IDA loan, was subsequently cancelled although \$17m of the \$20m had already been disbursed. Although the Auditor-General's report fails to spell out the financial and legal implications of cancellation and of leaving the project incomplete, these can be assumed to be substantial.

- **Poor management of guarantees**

IDA/PIRTA Credit for ZCCM Retrenchment and Retraining Programmes

In January 1999, the Government and IDA entered into a loan agreement of \$65m to finance the retrenchment and retraining of ZCCM employees. According to the agreement, ZCCM was to repay the loan in 10 annual instalments beginning three and a half years after the date of the agreement. ZCCM was to pay 9% interest per annum on disbursed amounts and three quarters of a percent commitment fees on the balance not yet disbursed. As of April 2000, \$34m had been disbursed but no

recoveries had been made from ZCCM to cover interest due or commitment fees *exposing Government to the risk of default* and its consequences.

- **Failure to take advantage of contractual obligations to minimise losses**

Contract between NEDBANK and the Ministry of Works and Supply

In April 2000, the Ministry of Works and Supply, *without authorisation from the Minister of Finance* as required by law, entered into a financing agreement amounting to \$3m for the supply of spare parts for road equipment by Prime Parts (Z) Ltd and Turn Pan (Z) Ltd. The repairs were to be completed by April 2001 but this was not done and *the Ministry did not claim liquidated damages from the company amounting to \$500 per day as provided for in the contract*. The loan was to be repaid by the Ministry of Works and Supply from its budgetary provisions. As of November 2001 the sum of \$3m principal and \$200,000 interest charges were due and payable to NEDBANK.

- **Unnecessary borrowing and poor monitoring**

Financing Agreement between Government and ABSA Bank South Africa for the supply of farming inputs to the Food Reserve Agency

In November 2000, the Government entered into a financing agreement amounting to over \$25m so as to enable Hyundai International Trading Corporation to supply various inputs for the 2001, farming season. The Government issued promissory notes under which it *irrevocably* undertook to pay in November 2001 over \$29m plus 2% interest upon presentation of the notes. As it turned out the financing agreement was unnecessary because the supplies were obtained too late and were in any event sourced locally. Individual suppliers had to be sourced to supply inputs and as of July 2001 it was unclear how much of the facility had been paid to the suppliers since the exercise was ongoing and a reconciliation statement had not been done.

3.2 Strengths

The following are the main strengths of the existing loan contraction framework:

- The process of borrowing is governed by an Act of Parliament.
- There are constitutional provisions regarding the review of all government contracts prior to execution, by the Attorney-General, which ought to ensure that loan agreements are not inimical to the interests of the State before they are signed.
- The Auditor-General has constitutional power to audit loans and report to Parliament.
- Only the minister of finance is authorised to sign loan agreements thus limiting the number of persons who can commit the nation to debt.
- The loan agreement is a contract and therefore subject to the normal rules of contract. Thus the agreement should not be made under the influence of mistake, illegal act, duress, undue influence, or misrepresentation. However this needs qualification. Freedom of contract is a two-edged sword. Since

Zambia has inexperienced negotiators, it should be wary of the dangers of the concept of freedom of contract. The principle assumes that parties negotiate as equals and are therefore bound by the agreed contract.

- The public Accounts Committee which is customarily, headed by a member of the opposition party oversees public accounts and has the power to summon the Minister of Finance and his officers to appear before it and account for their actions.

3.3 Weaknesses

The following are the main weaknesses of the current loan contraction process:

- The process does not fully comply with the law as set out in the Constitution and the **Loans and Guarantees (Authorisation) Act**, resulting in a failure to take advantage of protection offered by the law.
- Constitutional mechanisms to control borrowing have failed due to structural and procedural bottlenecks. On the part of the Auditor-General in particular, the submission of the financial report by the Ministry of Finance is not done in a timely fashion thus making it more difficult for the Auditor-General to prepare his report. In the past there was a tendency on the part of the Ministry of Finance to ignore both the Auditor-General's office and that of the Attorney General. The Auditor-General's reports were not taken seriously until recently. Parliament's Committee of Ways and Means, which approves the budget and the Public Accounts Committee, which reviews the Auditor-General's report were quite ineffectual in the past. The Members of Parliament on the Committee do not always have the skill to scrutinise the reports effectively. The Committee did deal with Government policy as a whole, only individual instances of abuse of office. And even then there was no follow up to ensure that culprits were disciplined.
- The process of borrowing is also far from transparent. The law is not complied with. Under the law only the Minister of Finance is authorised to sign a loan agreement. His authority can only be delegated to another person in writing. And yet this is not done and there are numerous cases where the Ministry of Finance only finds out about a loan when the creditors come knocking. The Ministry of Defence is particularly prone to this weakness. If the law was adhered to such loans should be treated as illegal and lacking in validity; they should not be honoured by the country. Presently the Government has been trying to compile a complete register of all public loans but has found it hard to do so because loan agreements are scattered in the different ministries.
- The law itself is too weak and vague. It does not provide for proper monitoring or transparency in the borrowing process particularly at the time a loan is negotiated and contracted. Furthermore the procedures are not written in some form of practice direction. Thus inexperienced officers have to muddle their way through the negotiating process. They may be too timid to press for better terms. In any case most lenders have their own lending agreements, which are not subject to much negotiation.
- The process does not require Parliament's involvement even though a loan once contracted binds the whole nation. The Minister of Finance enjoys too much power in terms of borrowing, spending and debt service. The

- mechanisms or offices created under the Constitution to act as a check on his powers are not consulted until the process of negotiating a loan is complete.
- Under the law, the proceeds of long-term loans are payable into the general revenues making them difficult to monitor. Additionally, balance of payments support is done through book entries and no actual resources enter the country. Thus the supporting country makes direct payment to the IMF or World Bank.
 - Poor accountability and poor debt management are evident from the failure to control the growth of debt.

3.4 Recommendations

The large number of weaknesses are attributed to local experiences showing that Zambia has generally borrowed imprudently and failed to manage debt effectively. Past mistakes have been compounded by other factors to result in an unsustainable debt burden. In that sense it can be said that there are problems with the way in which the concept of debt was applied which are still pertinent to date. There was a failure to appreciate the long-term consequences of debt resulting in a cavalier attitude towards borrowing. There were also problems with the process of negotiating for loans. Consequently there is little visible benefit today from the numerous loans contracted. And there are still serious weaknesses with their monitoring and servicing. In short, Zambia has for a long time now, lacked the legal capacity to manage debt. That capacity must be created within the domestic law as a matter of urgency, even though international borrowing procedures, and international customary law practices must be taken into account in any such framework. It is therefore recommended as follows:

3.4.1 Content of Law and Loans

- The Constitution or an Act of Parliament must provide the authority to borrow. The law on debt should be consolidated into one Act. Both international and domestic loan principles must be spelt out. Terms of reference or guidelines to negotiating loans should be in the statute itself, at the very least, as regulations. This is important in order to ensure transparency and enforcement. Some of the provisions under the Act should be:
 - Clear criteria and conditions under which, loans can be contracted by public officers.
 - A limit on sources of loans and interest rates applicable to public borrowing.
 - A time limit on the life of loans and charging of interest.
 - A ceiling on Government borrowing in any financial year and on the total outstanding debt.
 - Debt service mechanisms such as mandatory establishment of sinking funds, that ensure Government's ability to service debt without jeopardising domestic obligations to social needs and development.
 - Debt service should not be a direct debit on general revenues.
 - Loans and their terms and conditions must be publicised in the Gazette and national newspapers before the contract is signed.

- Only loans with a grant element of 95% should be contracted.
- A ceiling on debt service of 5% of Government revenues preferably sourced from exports NOT new loans.
- The Auditor-General should report directly to Parliament – to a Public Accounts Committee constituted on the basis of suitable expertise - and not through the President.
- Failure to comply with the law should be criminalized.

3.4.2 Oversight Framework

- It is important to create a specialised body such as a Debt Commission or National Trust to oversee and monitor the borrowing process. The Commission or Trust can provide information to the public and also coordinate a better working relationship between the various key players – Ministry of Finance, Auditor-General, Parliament Civil Society and the Attorney-General.
- The Government should include the issue of a Debt Commission or Trust in the proposals to revise the Constitution.
- Provided the authority to borrow and the procedure are incorporated in an already existing Act of Parliament, draft loan agreements should be submitted to the specialised body for review and recommendation to Parliament/ a parliamentary sub-committee.
- Only if the draft loan agreement is approved will the Minister of Finance be mandated to sign on behalf of the Government. Any other individual may sign only upon the written approval of the minister.
- Copies of the agreement must be kept by the Debt Commission or Trust, and sent to certain departments such as the Auditor general, central bank or national archives.
- The Auditor-General must report directly to Parliament and to the Debt Commission or Trust. Copies of his reports should also go to the police and the DPP for their action where necessary.
- Finally, the agreement should be entered in a public register that shows the parties to the agreement, the amount procured, the purpose for which it has been procured, the maturity period, and the beneficiaries of the loan.

3.4.3 Loan Contraction Process and Management/ Monitoring

- Parliament must be informed in order to ensure that loans are used appropriately.
- There must be increased transparency in the debt contraction and management process. Clear rules of procedure and publicity governing foreign loans must be followed.
- The system of loan contraction must be operated by well- trained and effective negotiators. Negotiators need to analyse the definitions of the key concepts carefully and appreciate their implications before agreeing to their inclusion.
- It is very important to ensure that the country can comply with the terms and conditions in the agreement. The loan agreement must be seen as a contract

- and therefore subject to the rules of contract. Representations of fact relating to the financial and legal status of the Government must be made only with the full agreement of the Attorney- General and the Auditor-General
- The events that give the lender the right to accelerate the maturity of the debt and terminate its commitment must be few and clear – not subject to arbitrary determination by the creditor. In the case of technical default (violation of covenants) as opposed to blatant default, (non-payment) the Government should ensure a reasonable grace period in which to effect compliance before penalties can become applicable. It should also avoid cross-default clauses under which default on one loan triggers default on all other loans.
 - The law to determine any dispute should be that of a neutral arbiter if possible.
 - Once a loan is obtained, there must be an effective debt management system in place to monitor the use and repayment of the loan as well as maintain a database. The database should be shared with other institutions that can participate in the monitoring process such as the Auditor-General.
 - All persons involved in debt management and monitoring need to receive adequate training as part of an overall capacity building programme.

3.4.4 Public Educational Campaign

- The public or beneficiaries of loans should determine the need to borrow and monitor the loan. In order to do this, they need to be fully informed. There is need for a nation-wide educational campaign on public debt and its consequences to enable people to participate in and control the process. The campaign should take place at various levels, namely schools, places of employment, legislative bodies, public service, law enforcement, mass media and rural constituencies.

ⁱ UNITAR Module 3, The National Borrowing process.pp12-13.

ⁱⁱ All \$ figures refer to US currency.

ⁱⁱⁱMinistry of Finance Economic Report 2001. A more comprehensive analysis of the problem is contained in a JSD thesis written by Dr Munalula and entitled “The Legitimacy of Sovereign Debt” Notre Dame, 2001.

^{iv} Ministry of Finance and National Planning, p.125

^v PRSP 2002-2004, p.28.

^{vi} <http://www.2000usa.org/campaign/pope.htm>.

^{vii} See UNITAR Module 2.

^{viii} UNITAR module 3, The National Borrowing Process, pp.36-44

^{ix} ^{ix} UNITAR module 3, The National Borrowing Process, pp.43-46.

^x UNITAR Module 3, The National Borrowing process. pp13 -14

^{xi} UNITAR Module 3, The National Borrowing process. pp13-14.

^{xii} A sinking fund is set up to service a loan. Thus regular payments are made into the fund to cover interest and principal as well as other administrative costs related to the loan or maintenance of the fund that may arise.

The money to service the loan comes from the general revenues only where the fund falls short. This enables better monitoring of the debt service process as well as the use to which a particular loan was put.

^{xiii} UNITAR module 3, The National Borrowing Process, pp.46-50.

^{xiv} Report of the Auditor-General on the Accounts for Financial year Ended 31st December 2000.