# UK HOUSE OF COMMONS INTERNATIONAL DEVELOPMENT COMMITTEE INQUIRY ON DEBT AND DEVELOPMENT, JUNE 2022

*Submission by Westminster Foundation for Democracy*

1. Westminster Foundation for Democracy (WFD) is the UK public body dedicated to supporting democracy around the world. Operating directly in over 40 countries, WFD works with parliaments, political parties, and civil society groups as well as on elections to help make countries' political systems fairer and more inclusive, accountable and transparent. Recognising the strong linkages between sustainable debt management and democratic governance, WFD has taken initiatives to highlight the role of parliaments in oversight of public debt.
2. WFD is aware that current global debt volume is at a 50-year high and triple its 2008 level, leaving 60 percent of low- and middle-income developing countries 'highly debt vulnerable'. While debt may be taken on for good reasons—for example: in response to the pandemic, to invest in infrastructure projects or to help reach the Sustainable Development Goals—the social cost of unsustainable debt can be devastating, particularly for women and marginalized groups. In 2021, twenty-five of the world's most poverty-stricken countries spent more on debt service payments than on health, education and social protection combined.
3. WFD shares the International Development Committee (IDC)'s views that the Covid-19 pandemic has exacerbated economic problems in many countries, with the effects often particularly dramatic for heavily indebted countries. WFD took note of the IDC report on the secondary impacts of the pandemic (2021), which observed that, in some nations, routine healthcare had ground to a halt and that vulnerable economies risked failure under rising levels of national debt. High public debt also constraints the fiscal space of countries to invest in climate change resilience and the sustainable use of natural resources, e.g., conservation enforcement, which is the greatest challenge for the environmental rule of law according to UNEP's First Global Report on Environmental Rule of Law (2019). This undermines short- and long-term economic growth and thus the sustainability of debt itself. WFD shares the concern with regards to public debt as mentioned in the UK government's strategy for international development (2022).
4. WFD welcomes the IDC inquiry's ambition to cover, among others, the criteria used to determine eligibility for debt relief schemes, 'debt-for-nature' (conservation) swaps, and the role the UK Government could play in low-income debt relief – both through bilateral and multi-lateral initiatives. In response, WFD suggests that **national parliaments in partner countries can play a more active legislative and oversight role with regards to public debt management and debt transparency**, and that this can be a useful good governance consideration in debt relief schemes, including conservation swaps.
5. Successful conservation swaps require high-level political ownership by the debtor country—not just from government but across the political spectrum, as well as from NGOs and civil society—to ensure continuity, good governance and institutional arrangements, robust oversight, and an enabling regulatory environment. National parliaments are uniquely placed to build and deliver these. Through its international programming, WFD has aimed to demonstrate that public debt sustainability would be significantly bolstered by paying more attention to the governance and parliamentary oversight requirements aimed

at enhancing debt transparency and accountability. In parallel, WFD is strengthening parliaments to place themselves at the centre of national policy processes related to climate change through pilot Environmental Democracy programmes.

6. Over the past years, WFD has conducted research on, and has provided capacity building to select countries on the role of parliaments in public debt management, such as an initial research paper (2020) and four policy briefs (2022). It forms the basis for this submission to the IDC on how the UK's international development policies can be strengthened by including a **public debt accountability lens through an enhanced role for parliaments in oversight of public debt**. Hence, WFD suggests six arguments for parliamentary involvement in public debt management.

**Debt data and debt transparency**

7. The first argument for parliamentary involvement in public debt management is that it serves as a catalyst to advocating for the timeliness, accuracy and comprehensiveness of information on public debt. Greater debt transparency can lead to better scrutiny of how the government is managing its public debt, which in turn can reduce debt-servicing costs for governments in the long run, benefits creditors, and makes it easier for citizens to hold governments accountable for how public resources are being utilized.
8. In many low-income developing countries (LIDC), information regarding debt is very limited, if available at all. The World Bank found that as of November 2021 nearly 40% of LIDCs have never published debt data or have not updated information in the past couple of years. Poor quality of data on public debt and weak public reporting practices are fuelled in part by weak standards in recording and reporting of debt, which impede debt transparency and effective oversight. The World Bank found that 46% of 70 LIDCs surveyed had weak capacity in recording and reporting of debt. Almost 60 percent of countries sampled did not meet requirements in debt recording, while 65% did not meet those for debt reporting and evaluation.
9. In many countries, one of the challenges associated with understanding public debt is often that the Ministry of Finance will only report central government, rather than whole-of-government debt. For instance, if a government is only reporting on central government debt, they are omitting the debt of State-Owned Enterprises (SOEs) and subnational governments, which are often significant drivers of public debt. If the debt figures that are being provided don't paint the full picture, it's difficult for parliamentarians to fully assess the fiscal risk and comprehend the fiscal space available for new programs.
10. MPs also require up-to-date information on the composition of government debt and its strategy for managing the debt. This allows parliament to scrutinize the government's treatment of sovereign debt portfolio risks, such as the ratio of external-to-internal debt; borrowing in foreign currency; and short-term debt, that can be subject to rollover risks. As parliament delegates the debt-management function to the executive branch, and as part of that delegated authority, the government should report to parliament on how it implements its debt management strategy.
11. According to the UNCTAD Principles of Responsible Lending and Borrowing, governments should put in place arrangements to ensure the proper approval and oversight of official borrowings and other forms of financing, including guarantees made by state-related entities. This requires a transparent process for obtaining financing and assuming sovereign debt obligations and liabilities.

**Legal framework on public debt management**

12. The second argument for parliamentary involvement in public debt management is that it serves to establish and implement a stronger legal framework that clearly defines procedures, responsibilities and accountabilities in managing, approving and overseeing public debt. This is emphasized in the UNCTAD Principles.
13. While most countries have a financial administration act, far fewer countries have specific public debt legislation in place. Depending on the political system, setting a legal framework for public debt management can be considered as one of parliament's key tasks, as it ensures that parliament provides strategic direction to borrowing decisions and specifies the roles and responsibilities for the institutions involved in debt management.
14. WFD has found that best practices in debt management legislation include these six elements:
    - ✓ The legal framework clearly sets out the authority to borrow.
    - ✓ The parliament retains the authority to scrutiny and ratify loan agreements.
    - ✓ The parliament is required to approve contingent liabilities.
    - ✓ The government is required to report to parliament annually on its debt management activities.
    - ✓ The government is required to draft and table in parliament a strategy that sets out the medium-term debt strategy.
    - ✓ An external auditor or the Supreme Audit Institution (SAI) provides annual audits of debt management activities.
15. One of these six elements is parliaments scrutinizing and ratifying loan agreements. In cases when a minister of finance signs a binding legal agreement with a foreign government but bypasses the loan valuation processes conducted by the debt management unit, parliamentarians cannot assume that due diligence has been done on loan agreements. Mozambique is a well-documented case where the political leadership contracted debts starting in 2013 and illegally bypassed parliament in concluding loan agreements, with huge ramifications for both the economic health of the country and the political reputation of those who negotiated these loans in secret. This underscores the reason why loans need to be publicly scrutinized, in line with the UNCTAD Principles.
16. Another of the above mentioned six elements for a debt management law is the question of parliamentary approval of or providing information on contingent liabilities to parliament. Contingent liabilities refer to obligations whose timing and magnitude depend on the occurrence of some uncertain future event outside the control of the government. Contingent liabilities include lines of credit, letters of credit and loan commitments. In that respect they are 'off-balance sheet' because they are not recognized as part of the debt until they are called. Contingent liabilities are only paid when an unexpected event occurs. While more than two-thirds (69%) of countries that have participated in a Public Expenditure and Financial Accountability (PEFA) assessment since 2016 (42 of 61) undertake annual approval of borrowing approved by either parliament or government, only 18 % (11 of 61) produce an annual report outlining all or most significant contingent liabilities. WFD is of the view that parliamentary approval of contingent liabilities, the publication by government of significant contingent liabilities, or both, helps to ensure that parliament and the public are aware of the contingent liabilities that are being taken on by the government. An interesting example is Fiji, where the Constitution prevents the government from providing a guarantee to an individual or body without the authorization of parliament and establishes a reporting mechanism back to parliament.

**Parliamentary oversight on public debt management**

17. The third argument for parliamentary involvement in public debt management is that it strengthens oversight over government policies and spending. This includes shaping oversight of public debt throughout the different stages of the budget cycle— formulation, approval, execution and audit/oversight. In many countries, the hype around the budget process is usually related to a long list of new government programs and infrastructure that voters will benefit from; and debt and debt management are rarely serious considerations.
18. WFD is of the view that, when it comes to oversight over public debt management, parliament has a significant role to play in all four stages of the budget cycle. Although the formulation stage is generally viewed as the purview of the executive branch, parliament has a significant role to play in the oversight of public debt during the formulation phase as well.
19. In many countries, the formulation stage of the budget is usually characterized by pressure on the Minister of Finance from his or her cabinet colleagues to maximize the departmental budget ceilings. Debt is not as exciting and often takes a back seat. Incorporating a discussion in parliament during the formulation phase about the "hard budget constraints", which are in part informed by the public debt situation (as well as macroeconomic forecasts), can help to temper expectations ahead of the tabling of the annual budget. That is why the pre-budget statement and medium-term economic framework, which is the government's rolling expenditure plan that sets out medium-term expenditure priorities and hard budget constraints, need to be debated in parliament, as happened for instance in Kenya.
20. The Budget Policy Statement (BPS) and the Medium-Term Debt Strategy (MTDS) were tabled in the National Assembly of Kenya in February 2020. Reports from the Budget and Appropriations Committee (BAC) and the Parliamentary Budget Officer (PBO) relating to scrutiny of the 2020 Budget Policy Statement (BPS) and MTDS highlighted how parliament can raise matters of concern around public debt. Issues raised by the BAC in its report included the Pro-Domestic Borrowing Strategy, the Debt Service to Revenue Ratio, Coverage of Public Debt and Debt Guarantees and Debt Transparency.
21. Furthermore, by monitoring the government's mid-year financial review, parliaments can also exercise influence during the execution phase of the budget. A deterioration in macro-economic assumptions underlying the approved budget, revenue shortfalls and other factors may signal higher than predicted debt accumulation. This may precipitate the need for the government to pivot on its approved budget in order to address the aforementioned change in circumstances. Given parliaments' role in controlling the public purse, parliaments need to be apprised of such fiscal risks in real time, as opposed to seeing it for the first time in the public accounts.
22. Finally, the ex-post audit/oversight phase tends to be the conventional phase in which many parliaments, particularly those employing the Westminster parliamentary system, exert a strong oversight role relative to other phases.
23. The Public Accounts Committee (PAC) in Zimbabwe is an example of effective ex-post oversight. Based on the work of the Auditor General of Zimbabwe, the PAC in 2019 helped to determine the extent to which the government was meeting its own debt transparency requirements (reporting on public debt and guarantees), respecting the borrowing limits set by parliament, and whether the government was following the law related to parliamentary approval of guarantees and loan agreements. This case underscores the value-add of a

dedicated ex-post oversight committee (or in some cases a budget and finance committee) can have on monitoring public debt and public debt management. It highlights the importance of the role of the Supreme Audit Institution in auditing the government's debt management capacity, including whether it is in compliance with existing debt management legislation.

**Debt oversight in emergency contexts**

24. The fourth argument for parliamentary involvement in public debt management is that it serves to protect the national interest in emergency contexts. When states accumulate high levels of public debt as a result of emergency response efforts, their long-term fiscal sustainability can be jeopardized, and policy options constrained. From natural disasters to the COVID-19 pandemic, different emergencies will require different responses, but by understanding the processes and procedures by which parliaments can consider public debt in emergency contexts, parliamentarians can be better prepared to defend the public interest when the going gets tough.
25. While emergencies may see the delegation of legislative powers to the executive branch on a time-limited basis, parliament can take proactive steps to ensure a strong legislative framework guides government action in an emergency context. Escape clauses for fiscal and debt rules, contingency funds and other sources of emergency assistance are important elements for parliamentarians to understand before a crisis hits.

**Gendered effects of public debt in emergency contexts**

26. Because emergency contexts and responses thereto can both produce different outcomes for men and women, WFD is of the view that the relationship between gender-based analysis and parliamentary oversight of public debt in emergency contexts requires specific attention. In some instances, the effects of an emergency may disproportionately impact women. In others, even where the negative consequences of the emergency appear to be roughly equal in their impacts, the recovery measures may be slower to support women. UN Women found, for example, that "women and girls are disproportionately impacted by disasters and threats, including climate change. Due to gender-specific barriers and inequalities, women experience higher loss of lives and livelihoods during disasters and a longer recovery time".
27. WFD beliefs that any fiscal rules or targets designed to limit debt accumulation beyond a certain level need to be accompanied by a solid gender-responsive budgeting methodology that assesses whether the spending that is taking place within the limits defined by the fiscal rule or target is benefiting women and other vulnerable population groups.

**Oversight of State-Owned Enterprises (SOEs)**

28. The fifth argument for parliamentary involvement in public debt management is that it serves to unearth the risks of State-Owned Enterprises (SOEs) becoming a major cause of debt accumulation and debt crises. What underlies SOE debt however is often the poor state of SOE governance, patronage appointments to boards of directors, weak internal controls and a limited accountability framework. Where the central government is underwriting SOE debt, these issues are all the more serious.
29. While SOEs often require specialized oversight, parliamentary oversight committees are generally overstretched and have a limited capacity and little time in most low-income and

middle-income countries. Because of the nature of audit reports, focused mostly on compliance, PACs are often backlogged on central government and local government accounts. They lack the capacity and time to oversee SOEs as well. Many East African and South Asian countries, for instance, have dedicated SOE oversight committees, which operate separately from the PAC. It is vital that these committees move beyond compliance to examine poorly performing SOEs and examine the guarantees made to these SOEs.

### Enabling Environments for successful Nature-for-Debt Swaps

30. The sixth argument for the involvement of parliaments in public debt management is that their engagement is critical to deliver many of the requirements of successful conservation swaps. In the first place, these schemes require high-level political ownership across the political spectrum. This is needed to ensure continuity in both their negotiation and implementation phases. They also require ownership from civil society and local communities, as conservation and related climate adaptation activities require the active participation of local communities. National parliaments are uniquely placed, as the institutions representing the people, to build cross-party consensus on conservation swaps, and provide an avenue for the voices to NGOs and civil society to be part of the policy debate, including as regards the legal form of the locally established institution to manage the debt-for-environment swaps away from political interference, e.g. government agencies, trust funds, public foundations, and associations. Conservation swaps also require good governance and oversight, as well as an enabling regulatory environment to maximise buy-in from creditors and leverage additional funding from the private sector, including their alignment with relevant national development plans and relevant international commitments e.g., with the Nationally Determined Contributions (NDCs) under the United Nations Framework Convention on Climate Change (UNFCCC) and with the National Biodiversity Strategies and Action Plans (NBSAPs) under the Convention on Biological Diversity (CBD). Properly resourced national parliaments can exert scrutiny over swaps implementation as well as over their consistency with national conservation priorities.

### Conclusion

31. As the UNCTAD Principles clearly articulate, because the taxpayers of a country will ultimately be responsible for the repayment of the sovereign’s debt, their representatives in the legislature should ideally be involved in the decisions about whether and how to incur the debt, and on the features of conservation swaps. This may take the form of legislatively specified debt ceilings, borrowing objectives, and incentives for leveraging private investments to complement the swaps, legislative oversight of government finances, the ability to conduct post-disbursement audits of specific transactions, or any other kind of legislative intervention.
32. **WFD believes that the above six arguments for parliamentary involvement in public debt management should lead to the UK and others making parliamentary oversight on public debt management one of the criteria for their debt relief schemes. Strengthening the governance and domestic accountability in debt relief schemes will contribute to prudent debt management and more sustainable economies.**
33. As there is increased awareness and engagement with parliaments globally on oversight of public debt management, WFD is rolling out targeted support to parliaments in public debt

management through pilot assessments, tailor-made learning and knowledge building, and parliamentary assistance programmes. WFD is currently working with the parliaments of – for instance - Sri Lanka and the Maldives on enhanced oversight on debt. WFD has launched an e-course on parliaments and public debt and continues to partner with the National Democratic Institute for International Affairs (NDI) and the United Nations Conference on Trade and Development (UNCTAD) in research and knowledge building on this topic.