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Strengthening Alternative Ways of Development Financing: The Building-up and Management of Financial Funds for Local Development. First Experiences Gained from Swiss Debt-for-Development Funds

1. Introduction

As we all have observed, one of the major development problems of the last decade was the huge volume of external debt of different kind (e.g. ODA loans, officially guaranteed export credits, and private debt). The outstanding debt, the debt overhang, was of such magnitude that negative effects on the growth of the indebted countries' national economies could be observed, and a widespread near-default of sovereign debtors had ill financial repercussions on the Export Credit Agencies. The first two types of debt play a major role in the SILICs. Furthermore, one had to think about the rationale for debt conversion (so-called debt swaps), as opposed to unilateral write-offs (what Switzerland did for its outstanding ODA debt).

At the end of the eighties, more than 25 Swiss development NGOs and church-related organizations came together in order to form a coalition to carry out a national campaign on debt relief. Finally, after long debates on how to combine structural changes with the necessary short-term improvements in financial flows between the South and the North through a substantial debt reduction, the NGOs opted for the debt swap option, whereby domestic Debt-for-Development or Counterpart Funds (CPF) are created.

The Swiss NGO coalition thus launched a petition named "debt for development", requesting the Swiss Government to establish a "debt relief fund" of at least SFr 700 m in order to write off the (official and commercial) bilateral debt owed to Switzerland by the LICs. As "creative debt relief", the objective was to reduce the debt overhang of eligible countries and to establish counterpart funds which would finance development projects aimed particularly at alleviating poverty and generating new income at the local level.

In 1991, the year of Switzerland's 700th anniversary, the Swiss Administration worked out a bill establishing the "Swiss Debt Reduction Facility". This Facility tries to combine the interests of the NGOs engaged in development work, as well as those of the Government and of the business community, so as to improve the difficult financial standing of the Swiss Export Credit Agency (ERG), heavily subsidized by the Swiss Government.

In that same year, the Parliament established the "Debt Reduction Facility" with an endowment of SFr 500 m to finance its operations. Four types of operations were planned at bilateral and multilateral levels in order to support SILICs with on-going policy reforms with a view of assisting them in their efforts to obtain debt stock and debt service relief. These operations are:

- Buy-backs of "tail-ends" of officially guaranteed Swiss export credit debt. These tail-ends are held by private exporters at their own risk and are part of Paris Club debt negotiations. When the government has accomplished these buy-backs and transfers from the ERG, they will decide upon initiating bilateral debt relief negotiations.
- Buy-backs of commercial bank debt and contributions to the IDA Debt Reduction Facility
- Contributions to the clearing of arrears and, where appropriate, the financing of obligations towards the international financial institutions (IMF, WB, and regional development banks)
- Complementary measures: new money for balance of payments supports for debtor countries having followed a reasonable debt management policy

I will concentrate on the first type of operations, the only one where counterpart funds are a fundamental part of the policy. In general, the criteria for the countries' eligibility to benefit from the Swiss Debt Reduction Facility are:

- highly indebted low income countries, primarily LLDCs;
- countries with a Swiss ODA Program, having to restructure their debt in the Paris Club and which are engaged in a medium-term economic reform (Structural Adjustment Programs);
- countries having an acceptable governance situation and an adequate debt management policy.

By August 1994, nine bilateral debt conversion agreements were signed, involving a face value of approximately SFr 850 m of debt, thus generating close to SFr 155 m in local currency.

2. The concept of creative debt relief

Writing off the external debt does not necessarily provide the development partners with the tools to foster development in a broad sense, particularly not in strengthening the NGOs' capacity to contribute to the national development process. By writing off the external debt and by channelling the converted part through the so-called "Counterpart Fund" (CPF), the idea is not to do more of the same, but to allow domestic NGOs to create long-term financial instruments for projects and programs, thus enhancing their financial autonomy as well as their organizational and management capacities: this is the concept of this "new generation of debt swaps". The part of the local funds not directly used to finance projects can serve as capital base for intermediate financial instruments (e.g. revolving fund of an NGO or as a loan guarantee fund with a local development bank). Under the first generation of debt swaps, some of the big NGOs from the North undertook some debt swaps with high redemption rates to finance specific projects.

3. The major components of a creative debt relief program

A creative debt relief operation, as implemented by the Swiss Facility, includes four central components:

- *A bilateral debt relief agreement:* The Swiss Government negotiates the debt relief, including the provision of local currency (the Counterpart Fund), with the debtor government. This agreement contains the rate of the debt conversion, the payment modalities, the sector(s) in which the capital should be invested, and the structure and composition of the body responsible for the management of the fund.
  The rate of the debt conversion is determined by both the value of the debt based on approximate secondary market prices and the actual cash flow relief obtained by the debt reduction. More arbitrary criteria are the quality of the public spending, from a development point of view, the debtor's budgetary constraints and the absorptive capacity for additional development projects by the debtor government and the domestic NGOs. In general, these conversion rates are rather low, on average around 20%, which would correspond approx. to the "tail-end" of the bilateral debt.
  The funds are deposited in a local commercial bank account, i.e. taken out of the budget in order to be protected against inflation and to have on-demand access. As a side effect, the local financial sector is thus supported.
- *The body responsible for the management of the CPF:* Generally, the NGO representatives of the CPF board or committee will come from the most representative national umbrella organizations or NGO networks. The contracting parties, i.e. the two governments, will, in most cases, also have a seat on the CPF committee.
  Within a short time after its formation, the CPF body has to establish rules and regulations for its functioning and for the allocation of the fund's resources. These include, among others, general investment and funding policy guidelines, funding application guidelines, project selection criteria, etc.
- *Projects and programs to be submitted for funding:* Within the priority sectors defined in the agreement – normally, at least one of the sectors should focus on rural development, small-scale industry, and natural resources management – the scope of projects and activities eligible for funding is defined broadly enough to allow all the interested NGOs and People's Organizations to file applications. An innovative field for its

impact is the strengthening of the organizations themselves by measures of organizational development, including the enhancement of their financial autonomy through endowments.
- *The development partnership:* A creative debt relief program should, in the best of cases, be part of a long-term relationship between NGOs in the South and private and/or public development agencies in the North. Only a relationship of long standing provides the necessary insight into the local conditions and sufficient knowledge of the strengths and weaknesses of specific organizations. Particularly in the preparatory phase, when the CPF is designed, a close co-operation and regular exchange of information between relevant NGO partners in the South and the North are of great importance. This includes as well an effective lobbying by the interested local NGOs with their respective governments.

4. The role of the Southern NGOs

Southern NGOs and their networks play a crucial role in designing and implementing the debt relief opertions with the respective debtor country. They can get involved at different stages:
- When designing the CPF policy: NGOs might be consulted by the Swiss NGO Coalition or the Swiss Development Agency for the policy of the management and the utilization of the fund. At the same time, they might advocate their interests with their own government.
- When an NGO network, or eventually individual NGOs, become members of the Fund's decision making or executive body (board, technical committees, monitoring sub-committees).
- When making use of the Fund: NGOs and People's Organizations file applications for funding with the CPF according to the guidelines of the Fund.
- During Monitoring and Evaluation: local service organizations or NGO consultants may be mandated by CPF's management to monitor or evaluate specific projects funded by a CPF.

5. The experiences gained until now with CPF: three examples

Within the CPF concept, there is a wide range of locally adapted and 'tailor-made' options for the management and use of the proceeds of debt conversion operations. The variety of options ranges from an NGO-managed capital fund to the budgetary support of the government. In all cases (except one), domestic NGOs participate in the funding decisions at committee level. All funds organize their own executive and monitoring structures and all projects must organize independent financial audits. Some of the experiences gained may be illustrated by the following examples:

Bolivia: a 'slim' management structure and a quick disbursement option

In Bolivia it was possible to rely on a relevant Swiss Development Co-operation (SDC) national program, a well established relationship with the government and a highly organized domestic NGO network having a good absorptive capacity. The Swiss NGOs' presence is specifically focused on regions and partners and cannot give a broad support. Bolivia's fund, the first one of the Facility, started to work about a year ago. There is no separation between the policy and the executive management levels. The fund has already approved 11 projects, programming about 90% of its resources. All the projects and programs are implemented by NGOs and private institutions. Two of these projects are designed as financial instruments, one of them being a revolving fund run by an NGO (FADES) specialized in this kind of operations. The fund is credited with SFr 5.8 m to support rural handicrafts and micro-enterprise production. The amount of one credit can fluctuate between US$ 3,000 and US$ 35,000; reimbursements should be made between 1 and 3 years, with an 8 – 12 percent interest rate, and the beneficiary must be able to provide collateral. In the sub-committee are represented: SDC, the NGO network, FADES, and the evaluator.

Tanzania: a medium-term CPF including the public sector, and a small absorptive capacity

In Tanzania there is a well established bilateral co-operation (presently supporting the structural adjustment process), a young, but not yet consolidated NGO community, and a government with big financial problems to fulfill its development commitments. Since other counterpart funds and other donors could be interested in the CPF policy, an independent legal structure was created: the "Public Trust Fund". It is the first time that NGOs can participate in this kind of funding structure. A small management committee has been established, and the fund will finance micro-projects (up to TSh 50 m) with disbursements (not yet started) having medium-term operational time periods. Twelve NGO projects have applied for the first round of project approvals, and it is possible that the government's share will be below 40 percent. This fund model has already raised the interest of other donors in Tanzania, since it allows an effective financing of micro-projects. For the first time, as well, the Government spends money on local NGO activities and is, thus, strengthening the policy dialogue between the Government and NGOs.

Philippines: a sizeable amount and a strong NGO community

The bilateral debt volume of the Philippines is one of the largest to be negotiated under this Facility. As a MIMIC, the Philippines possess a reasonable domestic financial sector. There is no long-term bilateral development co-operation between Switzerland and the Philippines and only a few Swiss NGOs run their own programs locally.

Nevertheless, the Philippines are busy with implementing an economic reform program, having signed an agreement with the IMF/WB. A strong and highly competent NGO community exists, embracing different tendencies. The Swiss NGO Coalition has the mandate to prepare the negotiations with the Philippine Government and the NGOs. Because of the selection criteria mentioned before, we believe that the Philippines can become a model for a capital fund, and negotiations and lobbying for this option have been undertaken. After long preparations and difficult negotiations, also on the Swiss side, this model seems to be maintained as the Swiss and the Philippine NGOs' proposal for the forthcoming negotiations. If the Philippine government agrees, the proceeds of the debt relief will be invested in a long-term capital fund. Interest earnings will be used as a project fund for productive agricultural and fisheries activities. Also, part of the capital can be disbursed yearly, and the operational life of the fund is expected to be about ten years. It will be a long-term additional financial instrument for the Philippines' NGO community.

6. What are the actual constraints

- Although Switzerland practices a cautious conversion policy, taking into account the monetary constraints of the debtor, the governments try to limit the costs of financing activities of domestic NGOs and opt, as a first priority, for public expenditures according to their own development priorities. In some cases "one-off" payments are not possible because of budgetary constraints and payments in two or three installments are negotiated.
- The transfer of the funds to a private bank account is almost the only non-negotiable position of the Swiss Government and a very new procedure for most governments. But only this procedure allows a quick access to the funds.
- NGO participation was also contested in some, if rare, cases, but Switzerland's firm position made the general policy to allow domestic NGOs to participate in the decision-making process and their submission of projects and programs for funding.
- The innovative character of the scheme can only have an impact if domestic NGOs are informed and briefed early enough about the policy of the Facility. This can only be done in an optimum way if the Swiss NGO Coalition or Swiss NGOs are fully engaged in the debtor country during the preparatory stage of the debt relief.

7. What is the actual potential

Besides the additional financing on the micro-level, which in some cases is substantial, and the financial restructuring on the macro-level, which is in most of the cases marginal, the potential is focussed on the following components:

- On policy level, the Facility establishes a dialogue within the domestic NGO-community and creates a forum where government and NGOs can discuss development problems and approaches.
- A second potential lies in the participation of umbrella NGOs in the designing and decision-making process; it strengthens their ownership of development programs and their know-how of financial instruments, increases their experience with monitoring and evaluating projects and makes future negotiations easier, where the investment in local financing instruments – with its own legal structure – are concerned.
- A third potential lies in the demonstration effect of successfully operating funds. Also outside the context of debt relief, the creation of Financial Funds is an alternative to traditional project-oriented financing.
- Finally, we are confident that the impact of the Swiss debt relief policy on the SILICs will be strengthened by similar facilities of other donors at the bilateral and multilateral levels.

Abstracts

Die große Auslandsverschuldung vieler armer Länder, die das Wachstum in vielen Fällen negativ beeinflußte, hat NGOs und die Entwicklungszusammenarbeit in der Schweiz zum Nachdenken über Schuldenumwandlung gebracht. Als Folge einer Petition einer Koalition Schweizer NGOs an die Schweizer Regierung wurde ein Entlastungsfonds eingerichtet. Sein Ziel bestand in der Verringerung des Schuldenüberhangs berechtigter Länder durch die Einrichtung eines Counterpart-Fonds, welcher Entwicklungsprojekte, besonders zur Beseitigung von Armut und zur Einkommensschaffung auf lokaler Ebene, finanzieren sollte. Das Funktionieren dieses Konzeptes einer kreativen Schuldenerleichterung wird an den Beispielen von Bolivien, Tanzania und den Philippinen demonstriert. Die Vorteile der Schuldenumwandlung werden in die Schaffung eines Dialogforums mit den lokalen NGOs und den NGOs mit der Regierung, in der Teilnahme Dach-NGOs am Projektentwurf und am Entscheidungsprozeß und am Entstehen eines Demonstrationseffekts gesehen.

The large external indebtedness of many poor countries which had negative effects on the growth performance in many cases induced a thinking about the rationale for debt conversion among Swiss NGOs and development co-operation. As a consequence of a petition by a coalition of Swiss NGOs to the Swiss government resulted in the establishment of a debt relief fund. The objective was to reduce the debt overhang of eligible countries and to establish counterpart funds which would finance development projects particularly aimed at alleviating poverty and generating new income at the local level. The working of the concept of creative debt relief is illustrated by the examples of Bolivia, Tanzania, and the Philippines. The advantages of debt conversion are seen in the establishment of a dialogue forum with local NGOs and between NGOs and government; the participation of umbrella NGOs in the designing and decision-making processes; and the creation of a demonstration effect.

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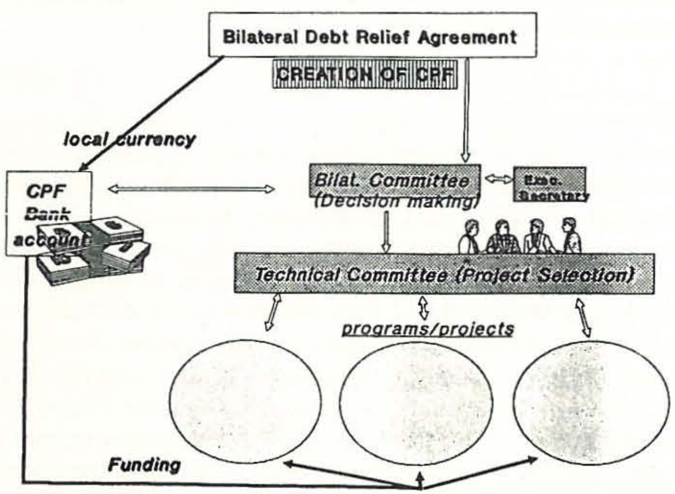

Table: Typical counterpart fund structure

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Democracy, Decentralized Government, and NGOs in Indian Rural Development

Introduction

Rural development in India is currently in a state of some confusion. The policies of economic liberalization, i.e. 'the New Economic Policies' (NEP) have been laid over a development scene that was already broad in its range of strategies and in which an extremely varied range of institutional actors play different roles in development, both complementary and competing. At international, national, and sub-national levels, many voices reflecting often quite different development discourses are now asserting a right to influence the course of development within the country. Yet the new directions in development and economic policy that have begun to emerge, are often serving only to complicate the issues involved and to provide misleading signals to the various institutions and actors involved in development planning and implementation at the local level. This paper is an attempt to reassess the role of local institutions in rural development with a view to aiding both the ultimate effectiveness of their involvement as well as the development of better aid policies by external organizations that wish to promote a pro-poor rural development through the local institutions.

From the institutional perspective two themes are currently prominent in discussions of rural development in India, each involving a different group of local institutional actors. The first is an argument for more effective, more accountable and more participatory local government. Here the institutional actors are Panchayati Raj institutions (PRI), that is institutions of local government operating at village cluster, Development Block, and District levels.

The second theme rests more upon the argument for a reduction in the state's involvement in development, i.e. a return to the market. Local Indian NGOs[2] figure in this discourse both for reasons of their ability to cushion

1 Senior Researcher at the Centre for Development Research, Copenhagen. An earlier version of this paper was presented at the International Conference on New Directions in Aid Policy for Rural Development, Vienna, October 13 – 15, 1994. A considerable debt is owed to Lars Engberg-Pedersen, Researcher at the Centre, with whom I have co-operated closely in recent work on democracy and decentralization in development.

2 Unless otherwise stated, NGOs are used in the article to refer to Indian NGOs involved in development work, usually at the local level.