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ZAMBIA'S EXPERIENCE WITH HIPC

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Considerable discussion – *and considerable confusion* – has raged in recent months about Zambia's "reaching the HIPC completion point." When will this really happen? What will it mean? Will the people of Zambia benefit? What will be the long-term effects? Why have negotiations been secret? What difference will it make for future debts?

The Debt Project of the Jesuit Centre for Theological Reflection (JCTR) has closely followed this topic of HIPC, providing analysis and education for the advocacy efforts of our Jubilee-Zambia campaign. This current Policy Brief presents background information on HIPC, examines its strengths and weaknesses for Zambia, explains the "completion point" problems, and offers clear recommendations from Jubilee-Zambia for the way forward.

1. INTRODUCTION: FORMULATION AND PURPOSE OF THE HIPC INITIATIVE

The HIPC Initiative was first launched in 1996 by the International Monetary Fund (IMF) and the World Bank, with the aim of ensuring that no poor country faces a debt burden it cannot manage. The Initiative entails coordinated action by the international financial community, including multilateral organisations, (e.g., IMF and World Bank) and governments, to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. Following a comprehensive review of HIPC I in September 1999, a number of modifications were approved. HIPC II was designed to provide faster, deeper and broader debt relief and to strengthen the links among debt relief, poverty reduction and social policies.

Zambia accessed the Initiative in 2000, reaching the so-called "decision point." This occurred after a three-year track record of macro and structural reforms and sound policies as spelt out by the IMF and the World Bank. The process entailed the preparation of the Poverty Reduction Strategy Paper (PRSP), which was to act as a blueprint for national planning and development. Zambia was expected to reach the "completion point" by December 2003. For reasons to be noted later this was not the case. Therefore we are currently on a quest to reach that point by December 2004.

The HIPC Initiative is now eight years old. Jubilee-Zambia strongly feels that this period is long enough to subject the Initiative to critical analysis and subsequently arrive at some "justifiable" conclusions on its capacity or lack thereof to allow debt distressed countries like Zambia to "exit" their mountains of unsustainable debts.

More specifically, what has been Zambia's experience with the HIPC Initiative since the year 2000? The best way to effectively analyse the HIPC Initiative is to take a hard look at what it promised to deliver at its inception and its underlying assumptions and then judge it against what has actually taken place so far.

2. HIPC PROMISES FROM THE IMF FACT SHEETS

When HIPC was being designed for Zambia, several clear promises were made by the IMF as to what would happen in the implementation of the initiative. Has this in fact been the case?

- *To provide a permanent and "robust exit" from unsustainable debts.* Jubilee-Zambia's current position is that the debt of Zambia is still unsustainable. According to UK based Jubilee Research Foundation, Zambia's debts will continue to remain unsustainable until 2010 regardless of whether or not the country reaches the HIPC completion point. This is particularly true because of the reasons explained in the assumptions below. Zambia has also been grappling with a huge domestic debt caused by several factors but key among them is the government's quest to borrow internally in order to remain current with foreign debt service.

- *To reduce poverty levels by unlocking sufficient funds through debt relief for the implementation of the PRSP.* Official statistics show that in 2002 the national budget allocated K450 billion to the PRSP but only 24.5% of the designated amount was released. In 2003 the amount was reduced to K420 billion and out of that only 50% was released. In 2004 the amount has been pegged at K521.7 billion and, if the past is anything to go by, the government might release 75% of the amount allocated. This is a clear case of HIPC failing to deliver on its promise of "sufficient" funds. As a consequence, the country will desperately need "top-up relief" side by side with increased donor inflows in order to meet the challenges of economic and social development.

3. HIPC ASSUMPTIONS FROM THE DECISION POINT DOCUMENT FOR ZAMBIA

In order to have a successful HIPC process, certain assumptions were made in the original IMF document (2000) as to what would occur in the Zambian economy over the next few years. Have these assumptions been realistic?

- *Stimulation and maintenance of annual real economic growth of 5% between 2000 and 2009 that would then be used as a springboard for reducing poverty.* Zambia's experience with growth rates in recent years has not in fact reached the projected "5%" target. Given current global and domestic situations, it is unlikely that a major turnaround would occur. Thus this assumption is overly ambitious and out of tune with reality.

- *Steady increases in government revenues from $554 million in 1999 to $1,164 million in 2010.* This assumption ignores the implication of a shrinking formal sector employment level (retrenchments) upon which the tax base is anchored. This is true even with the increased "pay as you earn" (PAYE) taxes introduced in the 2004 Budget.

- *Steady increases in export receipts from $841.7 million in 1999 to $2,348.1 million in 2010.* This assumption does not take into account the falling prices of primary commodities upon which Zambia's foreign earnings rely. There is no assurance that the current high copper prices on the world market will be maintained or that the government tax earnings from exports will be substantial.

- *Provide a stable macro and structural economic environment, which would act as an incentive to attract foreign direct investments.* While the macro policy environment may have improved in some relative terms (e.g., reduction in inflation rates), the structural reforms have continued to occasion social suffering on the poor. This has occurred through loss of jobs in the civil service (public sector reform programme) and due to privatisation, fees in schools and hospitals, and increase in taxes. The social suffering has a serious destabilising potential.

4. STRENGTHS AND BENEFITS OF THE HIPC INITIATIVE

Theoretically speaking, there are benefits that have come with the country's qualification to the HIPC framework. For instance, Zambia's debt figures on paper strongly suggest that there has been some modest debt relief delivered to the country during the last three years. According to the Government's *2002 Economic Report*, external debt was reduced to US$ 6.488 billion in 2002 from US$ 7.123 billion in 2001, representing a decline of 8.9%. This reduction was largely due to loan repayments and to debt relief coming under the HIPC Initiative. The total pledged debt relief under the HIPC package is $3.8 billion in nominal terms or $2.5 billion in Net Present Value (NPV) terms. The bulk of the assistance will be delivered to Zambia upon reaching the completion point. Were it not for the HIPC framework, Zambia would have been paying annual debt service in the range of

$500-$600 million. But due to the Initiative, the country's debt service payments have dramatically fallen and now vary between $120 million and $150 million per year.

Moreover, there has been a deliberate effort by Government to target the poor and hence to channel more budgetary resources to the social sectors. Relative to the pre-HIPC era, there has been a marked increase in health, education and social expenditures. Indeed, about 20.5% of the discretionary budget in 2003 was spent on the education sector, up from 18.5% in 1999.

It is true that there has been some gross abuse of HIPC resources in many parts of the country. This unfortunate situation is reflected in both the Auditor General's annual reports and in the findings of the recently "suspended" Independent HIPC Monitoring and Tracking Team. But it is also true that some debt relief resources have in many instances been used to rehabilitate boreholes, upgrade rural feeder roads, repair and paint schools and hospitals, procure hospital drugs, buy school desks, pay rural teachers hardship allowances, fund the National AIDS Council Secretariat, among many other things. This surely is a positive contribution to Zambia's development.

5. WEAKNESSES AND COSTS OF THE INITIATIVE

Prevalent extreme poverty is a critical problem facing both the government of Zambia and its cooperating development partners. At present, more than eight million Zambians out of a population of approximately ten million are living on less than a $1 per day and the majority of these are women and children – critically important potential for future development in the country. Therefore, evaluating the HIPC Initiative in the context of reaching the Millennium Development Goals (MDGs) becomes extremely important and imperative. Preliminary reports from both the Government of Zambia and the United Nations Development Programme (UNDP) clearly indicate that the MDG targets of eradicating extreme poverty, eradication of hunger and reducing maternal mortality ratio are highly unlikely to be reached by 2015. *Firstly*, this is because annual debt service payments are diverting money meant for the implementation of core pro-poor programmes. *Secondly* and more importantly, the full effects and cost of the HIV/AIDS pandemic in this country have not been adequately integrated into the social and economic analysis that should be guiding implementation of the HIPC Initiative.

Nearly one-fifth of the adult population aged 15-49 years is estimated to be infected with HIV. HIV/AIDS and other poverty-related factors such as malaria and malnutrition have drastically reduced life expectancy to 37 years in Zambia. The HIV/AIDS pandemic sharply reduces the productive labour force upon which future economic growth largely depends. This situation, if not arrested, will compromise Zambia's capacity to generate sufficient economic growth rates that are key in meeting creditor requirements and conditionalities.

Zambia's recently introduced health policy to provide antiretroviral drugs to HIV/AIDS patients in public hospitals and health centres needs support. But the cost of providing prevention and treatment programmes will act as a substantial drain on the government budget. How can we strike a balance between the genuine need to meet the necessary HIV/AIDS programmes on one hand and the statutory debt service obligations on the other? Can the two go together without the latter seriously undermining the former? Empirical evidence clearly demonstrates that debt service payments have been and continue to be a block to quality health care provision. This is one clear fact that debt relief programmes like HIPC have been ignoring for far too long in Zambia and elsewhere.

The partial debt relief under HIPC, though *necessary* for some short-term development, is certainly not *sufficient* for long-term sustainable development. And it has come to Zambia with serious social and economic costs. For instance, more and more Zambians continue to lose their jobs through donor dictated structural policies of privatisation. Retrenchments that have not been integrated into adequate retirement packages have been fuelling poverty and the accompanying effects of unconventional coping strategies. Moreover, the country has been stripped of many national assets through a reckless privatisation programme that was not adequately monitored for its economic and social effects on the people. In a bid to cure economic problems (e.g., debts) and social ills (e.g., poverty), HIPC has instead been reinforcing the problems it was meant to cure.

6. EXAMPLES OF OTHER HIPC COUNTRIES

It is important in our evaluation of the implementation of the HIPC Initiative in Zambia to look at lessons that can be drawn from other HIPC countries. The case of Uganda, which has often been used by the IMF and the World Bank as a role model and success story of the HIPC Initiative, needs a careful re-examination. Uganda has slid into debt unsustainability three times after reaching the completion point. This has largely been due to falling coffee prices at the international markets. Fresh evidence from that country shows that Uganda is now paying more in debt service than before accessing the HIPC Initiative. The same can be said of Mozambique and Tanzania, though their total debt stocks were slashed downwards. Recent graduates of the HIPC Initiative, Ethiopia and Mali, are going to require top-up debt relief in order to bring their debt thresholds to "sustainable levels." This is a clear indication that completing the HIPC programme does not in itself guarantee debt sustainability.

The conclusion to be drawn from these lessons is obvious: *HIPC is not an effective panacea to poor countries' debt problems nor is it an equitable substitute for total debt cancellation.* This means that HIPC can not and should not be relied upon to deal with the complex nature of the debt problems in Zambia. There is therefore need to redesign the formula and make it respond to our social and economic needs. For Zambia and indeed many debt-distressed countries, *full debt cancellation* must urgently be granted as a basis for meeting the many development challenges in these countries. This is the foundation for Jubilee-Zambia's position and the policy recommendations that we make.

7. MISSED "COMPLETION POINT: ROUND ONE

As earlier noted, Zambia was supposed to have reached the HIPC completion point by December 2003 but this did not take place. The country went off track with IMF and World Bank economic programmes during 2003 due to various factors. Key among the factors was the delay in privatising the national commercial bank (ZANACO), coupled with a budget overrun closely linked to the salary increments awarded to the civil servants. Zambia was then put under an extended Staff Monitored Programme (SMP) as a pre-condition for working out a new Poverty Reduction and Growth Facility (PRGF) with the IMF by June 2004.

To pave the way for reaching the HIPC completion point by December 2004, Zambia needed to satisfactorily implement the PRSP, complete a six-month track record under the new PRGF, and attain the few remaining HIPC triggers. Key triggers included: maintain a stable macroeconomic environment, prepare and implement a Medium Term Expenditure Framework (MTEF), implement an Integrated Financial Management Information System (IFIMIS), issue international bidding documents for the sale of the majority (controlling) interest in the Zambia National Commercial Bank (ZANACO) and the Zambia Electricity Supply Corporation (ZESCO). Others are a reduction in the level of domestic borrowing supported by tax measures to raise the GDP/revenue ratio in 2004 and the curtailment of public expenditure largely through structural reforms.

8. MISSED COMPLETION POINT: ROUND TWO?

On 14 June 2004, a meeting of the Executive Board of the IMF in Washington DC approved a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for Zambia. The new Facility is accompanied by loan pledges from the IMF worth US$ 320.4 million to support the government's economic programme into June 2007. Moreover, the European Union has pledged a grant of Euro 10 million to be accessed by July 2004 and a further Euro 100 million over the next three years.

Under the programme, non-priority expenditures, including wages, will be contained and plans for rightsizing and pay reform of the civil service will be expedited to support effective delivery of public services. The PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5-year grace period on principal payments. It is hoped that the new PRGF arrangement will signal to other donors to begin to release their cash flows (both loans and grants) to Zambia. This should then provide more funds for development programmes in the country, especially under the PRSP.

But there still remains some serious confusion about when exactly Zambia will reach this elusive HIPC completion point. The IMF has raised the technical issue that the PRGF that goes into effect on 01 July 2004 must run for six months and then be evaluated before the completion point, with its attendant benefits, can be reached. But the evaluation will take at least two to three months. So are we to understand that the completion point has again been missed, pushed back now to sometime during the first quarter of 2005? And what effect will this have on the planning for the 2005 Budget – which surely can be expected to be once again heavily dependent on external funding from donors?

The HIPC completion point has been described by IMF and World Bank officials as a "floating completion point." This certainly seems to be true in Zambia's case. But whether its *floating* character may mean that many Zambians *drown* in the process is surely a serious economic and ethical issue to raise!

9. JUBILEE-ZAMBIA'S POSITION

The HIPC framework as a basis for dealing with our unsustainable debts is weak both in process and content. Its premise and foundations are extremely shaky and questionable -- hence highly unsuitable for tackling the debt crisis in our country. Zambia's very low score on human development indices means that we simply cannot continue to divert our meagre resources to servicing external debts if the dream of realising the MDGs is to be met by 2015.

Under such deplorable social and economic circumstances, Jubilee-Zambia finds it ethically unacceptable to continue sending out as high as $120 million to $150 million per year as debt service obligations. The opportunity cost of annual debt service payments are the social services that have been consistently denied sufficient budgetary resources for ameliorating the immense suffering in the nation.

In light of the above, Jubilee-Zambia strongly endorses the proposal of the UNDP's 2003 *Human Development Report* that debt sustainability and subsequently debt service capacity should be assessed relative to the country's needs for achieving the PRSP and MDG goals and targets.

Jubilee-Zambia is aware of the fact that the IMF and the World Bank during their 2004 Spring Meetings have attempted to broaden debt sustainability through a new policy instrument -- the "Country Policy and Institutional Assessment" (CPIA). The CPIA incorporates within its overall assessment external shocks hitting a particular economy and government's capacity to raise domestic revenues. The IMF and World Bank then conduct a joint assessment of a given country based upon performance relative to twenty criteria grouped into four categories: (1) Economic management; (2) Structural policies; (3) Policies for social inclusion; and (4) Public sector management and institutions. On the basis of these criteria, a country is assessed on whether or not it can achieve debt sustainability. The Bank and the Fund also rate the quality of governance of each country government's performance in managing its collection (i.e., portfolio) of grants and loans by, among other things, disbursing funds and procuring goods and services that are essential to a project/operation in a timely manner. If a government has poor performance on such CPIA measures, the World Bank and the IMF can diminish (even cut off) their assistance to the government.

But one important point needs to be noted in an evaluation of the newly proposed CPIA process. A high CPIA score may not in fact correlate with high, sustained poverty reduction, or even with broad economic growth. Rather, the score largely reflects the extent to which a government embraces "neo-liberal" economic policies (e.g., liberalisation, privatisation, fiscal austerity, etc). One question clearly jumps off the page: *Will these measures improve the lives of the poor in Zambia*?

Jubilee-Zambia, while cautiously welcoming new initiatives for debt sustainability, wishes to make it very clear that the CPIA needs to go along with full debt cancellation. This needs to be accompanied by a significant reduction in conditionalities from above (economic and trade liberalisation), and clear national and international loan contraction processes that render themselves open to public involvement and scrutiny through parliaments and credible civil society organisations. *The economy and policies in general have to be reoriented to serve human needs of the debtors rather than profit needs of the creditors.*

In conclusion, Jubilee-Zambia demands for an immediate and unconditional total debt cancellation as a platform for effective and equitable poverty eradication in Zambia. We repeat our strong position that debt is not just an economic issue but an ethical and moral issue as well.

9. THE WAY FORWARD FOR POLICY

The Debt Project of the JCTR believes that this critical review of Zambia's experience with the HIPC Initiative has strong policy implications. Our hosting of the Jubilee-Zambia campaign encourages us to make the following calls:

- We call upon creditor countries to implement measures for cancelling debt that are far more radical than allowed under the enhanced HIPC, including cancellation of 100% of the clearly unpayable debts owed by Zambia to the IMF and the World Bank.

- We call for deeper, more realistic and more equitable debt relief that takes into account the current social, political and economic conditions of our country, especially the HIV/AIDS pandemic.

- We call for debt sustainability analysis in Zambia to be broadened and based on a country's specific financial needs to reach the MDGs and successfully implement the PRSP.

- We call for debt relief/cancellation measures to be seen not simply as economic assistance to the debtor countries but as a moral obligation to the poor people.

- We call for constitutional arrangements to oblige that the loan contraction process be opened up to public scrutiny through the involvement of Parliament.

- We call for greater respect of Zambia's national sovereignty in resolving our debt crisis, by not imposing harsh economic programmes as conditionalities for debt relief.

- We call for continued national and international campaigning by Jubilee movements that stand for effective and equitable debt cancellation for poverty eradication.

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