A HUMAN-NEEDS BASED DEBT SUSTAINABILITY ANALYSIS: A CHALLENGE FOR ZAMBIA

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EXECUTIVE SUMMARY

In this report, Jubilee Zambia presents a proposal of a set of guides on the development of a human-needs based Debt Sustainability Analysis Framework (DSA.). This proposal is formulated with a view to stimulate dialogue at national and international levels on the need to develop a human-need based framework on Debt Sustainability Analysis for Zambia. Jubilee Zambia believes that a better and effective DSA framework is one that primarily promotes and upholds sustainable human development in poor countries such as Zambia.

In developing this proposal, Jubilee Zambia recognises that the country has made significant achievements in attaining the HIPC Completion Point in early 2005. On one hand, this process has resulted in appreciable debt relief, both from bilateral and multilateral creditors. But on the other hand, research has shown that the IMF's DSA approach upon which debt relief was delivered has serious limitations. Zambia faces numerous social and economic challenges, such as high poverty levels and the HIV/AIDS pandemic. In addition, the experiences of other countries such as Uganda and Gambia continue to show the vulnerability of poor countries to deeper external debt crisis.

In view of this, a broader approach is proposed to address some of the limitations inherent in the IMF's DSA. The proposed debt sustainability based on essential needs approach provides an opportunity for the Zambian Government to make concerted efforts at reducing the debt burden whilst providing for the country's pressing development needs, especially if the country is to make important strides towards attaining the Millennium Development Goals (MDGs).

This approach rests on promoting economic development, which will nurture long-term stability and prevent continued future indebtedness in the country. In addition, the Zambian government must exercise prudent and coordinated borrowing from the international community to ensure that resources are applied effectively. Contractions of loans for the sake of it must be avoided and the law empowering the Minister of Finance and National Planning to contract debt without Parliament's approval must be reformed.

The proposed human development approach involves the following steps:

1. **Determine the Resource Envelope** available to the Government, excluding grants. Experience has shown that grants tend to flow irregularly as disbursements are subject to delays and dependent upon adherence to certain conditionalities. Thus, inclusion of grants may overly estimate the actual size of the resource envelope available to Government.

2. **Costing the Human Development Expenditure** based on the simple assumption that resources available to HIPC governments must first be used for essential expenditures that are necessary to eradicate poverty and attain the MDGs.

3. **Determination of Net Revenue Available for All Other Expenditures** including recurrent expenditure, personal emoluments, external debt service, etc., is obtained by deducting the total human development expenditure (in Step 2) from total available revenue (in Step 1).

4. **Deduct External Debt Service Payments from Net Revenue** so that the remaining amount would then be used to assess a country's level of debt sustainability.

5. **Sustainability Indicators** with the basic rule that "when the projected flow of debt service exceeds the projected net revenue, a country is *unable* to service its external debt and the debt burden should be considered as *unsustainable*."

Finally, the proposal makes important recommendations that, when embraced by all stakeholders, can contribute to enabling the country to break away from the chains of the heavy debt burden.

- **National Government**: It is important for political leadership and executive to adopt and improve this alternative approach to debt sustainability in order to implement programmes that will promote the social and economic development for the people in Zambia

- **International Financial Institutions**: It is important for the International Monetary Fund and World Bank to include the issues raised in this alternative approach in view of the failures and limitations of their models of DSA approach.

- **International Community**: It is critical for the international community to support this alternative approach especially because of its serious link to MDGs and emphasis on sustainable development.

- **Jubilee-Zambia**: The campaign for a better and effective DSA approach that uplifts human needs must be intensified especially in view of the shortcomings of the HIPC initiative and the need importance of meeting the MDGs in Zambia.

LIST OF ACRONYMS AND ABBREVIATIONS

AfDB	African Development Bank
AIDS	Acquired Immune Deficiency Syndrome
CAFOD	Catholic Agency for Overseas Development
DSA	Debt Sustainability Analysis
EU	European Union
Eurodad	European Network on Debt and Development
G-7	Group of Seven Industrialised Countries
GDP	Gross Domestic Product
HDI	Human Development Index
HIPC	Heavily Indebted Poor Countries
HIV	Human Immune Virus
IDA	International Development Assistance
IFIs	International Financial Institutions
IMF	International Monetary Fund
MDGs	Millennium Development Goals
MoFNP	Ministry of Finance and National Planning
NEPAD	New Partnership for Africa's Development
NPV	Net Present Value
ODA	Official Development Assistance
PPG	Public and Publicly Guaranteed
PRGF	Poverty Reduction and Growth Facility
PRSPs	Poverty Reduction Strategy Papers
TB	Tuberculosis
SAPs	Structural Adjustment Programmes
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme

1.0 INTRODUCTION

Generally, countries borrow because their financing needs exceed their domestic resource envelope. Specifically, external financing may cover the gap between domestic saving and total investment as well as the gap between a country's national income and its total consumption. This is particularly important when there is a temporal decline in national output, often due to external shocks such as drought or deterioration in the terms of trade Therefore, if well invested, borrowing is expected to support steady economic growth and development. However, the accumulation of external debt should neither compromise the current as well as the future ability to repay debt nor the capacity of the citizenry to have a decent standard of living.

In Zambia, Government began to borrow heavily from the international community in the early 1970s in order to finance fiscal and current account deficits that had set in (Ndulo and Sakala, 1987). These twin deficits arose mainly from the need to finance subsidies and public infrastructure against a background of deterioration in domestic revenue and export earnings.[1] Persistent fiscal and current account deficits led to continued borrowing and the accumulation of a high debt burden, which by 2004 stood at approximately US$ 7.1 billion. The high debt burden has placed a severe constraint on the country's budget and capacity to improve the people's living standards through increased social sector expenditures, thereby threatening the possibility of attaining the Millennium Development Goals (MDGs).

Over the past few years, however, the Zambian economy recorded some notable progress. Between 2000 and 2004, real Gross Domestic Product (GDP) grew by an average of 4.6 percent. Notwithstanding this growth, this figure falls short of the 5.0 percent required to support the sustenance of Zambia's external debt (see Table 1). Furthermore, this figure is also below the NEPAD threshold of 8.0 percent GDP growth required to make noticeable in-roads into poverty as reflected by a fall in Zambia's ranking on the Human Development Index (HDI), from 153 in 2000 to 164 in 2003. Thus, in order to halve the poverty levels by 2015 in line with MDGs, it will require relatively high economic growth rates and more equitable distribution of resources to make a meaningful impact on improving the standard of living of Zambians.

Table 1: Selected Economic Indicators 2000–2004

Economic Indicators	2000	2001	2002	2003	2004
Real GDP growth (%)	3.6	4.9	3.3	5.1	5.0
Exports (% of GDP)	26.6	28.2	27.9	28.2	33.6
Imports (% of GDP)	40.7	44.6	42.0	41.6	40.9
Current Account excl. grants (% of GDP)	-19.2	-20.8	-17.3	-16.2	-11.9
Gov. revenue excl. grants (% of GDP)	19.4	19.2	17.9	17.9	18.4
Debt service (% of GDP)	-	3.9	3.3	4.5	6.9

In view of the high debt situation, multilateral and bilateral creditors recognised that most countries, including Zambia, had no capacity to repay the debt under existing support mechanisms. Therefore, in response to increased pressure from the civil society and the United Nations, the IMF and World Bank developed the Heavily Indebted Poor Country (HIPC) Initiative in 1996. This followed the failure of the Structural Adjustment Programme (SAP) to improve the developing countries' economies. Thus, the HIPC Initiative provided for coordinated action by the international community, mainly the multilateral organisations and creditor governments, to reduce the external debt burden of the most heavily indebted poor countries to sustainable levels.

At the core of the HIPC Initiative is the debt sustainability analysis (DSA), which is the analytical tool used to determine the amount of debt relief required to bring about long-term debt sustainability.

[1] For instance, increased expenditures on subsidies such as those to the National Agricultural Marketing Board (NAMBOARD) contributed to widening of the budget deficit from 7.3 percent in 1978 to 29 percent of GDP in 1980 (Ndulo and Sakala, 1987).

However, the design of the DSA has failed to provide countries with a permanent exit from unsustainable debt due to, among other things, over-optimistic projections of exports and economic growth, failure to link debt relief to the attainment of the MDGs and failure to incorporate domestic debt into the analysis. In this regard, the paper is aimed at addressing these weaknesses by incorporating human development needs of the HIPCs.

The rest of the paper proceeds as follows. Section two gives an overview of the HIPC Initiative while section three presents some country experiences with the HIPC Initiative. In section four we present Zambia's HIPC experience while the proposed DSA is presented in section five. Section six gives recommendations and conclusions.

2.0 HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND THE DEBT SUSTAINABILITY ANALYSIS (DSA) FRAMEWORK

The HIPC Initiative is a comprehensive approach to debt reduction for heavily indebted poor countries pursuing IMF and World Bank supported adjustment and reform programmes (IMF and World Bank, 2005). The HIPC Initiative was launched in 1996 with the main objective of bringing external debt of poor countries to sustainable levels. The HIPC relief covered all public and publicly guaranteed (PPG) debt of the HIPCs, including debt owed to the international financial institutions (IFIs), governments and private lenders. The Group of Seven (G-7) and Paris Club creditors also pledged to cancel all concessional Official Development Assistance (ODA) debt, in addition to reducing non-concessional debt.

Although the HIPC Initiative was generally hailed as a breakthrough in relation to previous IMF/World Bank programmes, Catholic Agency for Overseas Development (CAFOD), United Nations and other organisations criticised it for not providing sufficient debt relief to the HIPCs. In addition, the Initiative was criticized for having limited country coverage and providing relief at a slow pace. Furthermore, countries that benefited under the Initiative were paying more on debt servicing than on public health and education. For example between 2000 and 2004, Zambia spent approximately 10.2 percent (IMF, 2005) of its GDP on debt service while expenditure on education and health was 3.0 and 2.0 percent, respectively.

Therefore, in September 1999, this Initiative was enhanced to take into account the weaknesses inherent in the original framework. The Enhanced HIPC framework was meant to provide a broader, deeper and faster debt relief than the original initiative, mainly through the following:

- A lowering of the Net Present Value (NPV) of debt to exports ratio to 150 percent (from the original 200-250 percent) considered appropriate for debt sustainability;
- Replacing the fixed three year period between the decision and completion points with floating completion point;
- Frontloading of interim debt relief from some creditors between decision and the completion point to maximise support of poverty reduction programmes;
- Linking the HIPC debt relief framework to the preparation of country-owned Poverty Reduction Strategy Papers (PRSPs) developed through a broad-based participatory process.

A country is eligible for debt relief when it:

- Is eligible for highly concessional assistance from the World Bank's International Development Association (IDA) and from the IMF's Poverty Reduction and Growth Facility (PRGF);
- Faces an unsustainable debt burden, even after traditional debt relief mechanisms have been applied; and
- Establishes a track record of reform and sound policies through IMF and World Bank supported programmes for a fixed three-year period.

Eligible countries are required to undertake a DSA in order to determine the amount of debt relief that a country needs to attain debt sustainability. Staffs of the IMF and World Bank together with officials of the debtor country prepare the DSA.

More recently, debt observers (e.g., CAFOD, Jubilee movements, among others) have argued that the outcome of the Enhanced HIPC Initiative has been inadequate in delivering long-term debt sustainability for the HIPCs mainly due to the following:

- Difficulty faced by HIPCs in adhering to the IMF's stringent conditionalities regarding implementation of macroeconomic and structural policies; and

- The inherent weakness in the DSA (does not take into account the human development needs).

Poor policy observance and slippages in key conditionalities have contributed to further delays in reaching both the decision and completion points. As a result, this has affected the flow of interim debt relief. For example, in the case of Cameroon, the Gambia and Guinea Bissau, the IMF and World Bank have attributed delayed graduation to completion points on problems experienced in implementing the PRSPs and meeting the PRGF targets, particularly on reduced public expenditure.

A critical concern of the DSA as applied has been that it lacks a robust theoretical justification (Gunter, 2001; Sachs, 2002, Jubilee Research 2003). More recently, even the IMF and the World Bank have acknowledged its limitations (UNCTAD, 2004). The criticisms of the DSA are mainly centred on the following:

(i) Failure to link debt relief to MDGs;
(ii) Failure to incorporate domestic debt into the DSA;
(iii) Over-optimistic export and growth projections.

(i) Failure to Link Debt Relief to MDGs

The DSA framework does not systematically link the amount of debt relief to the financing gap vis-à-vis the MDGs. The framework in assessing debt sustainability ignores the human development needs, such as high incidents of poverty, health service and education, etc. While it is expected that relief gained under the HIPC initiative may contribute to higher allocations to the social sectors, there is no mechanism to ensure that these additional funds are sufficient to cater for these primary needs.

(ii) Failure to Incorporate Domestic Debt into the DSA

In order for the HIPC Initiative to provide for overall debt sustainability of the poorest countries as a precondition for achieving sustainable growth and development, domestic debt, particularly domestic debt service ought to be included in the DSA (UNCTAD, 2004). Domestic debt service adds more to overall debt service and cuts into funds for social sector spending for poverty reduction. The Kenyan example highlights the gravity of omitting domestic debt from the HIPC Initiative. It is estimated that in Kenya's 1999/2000 budget, funds allocated to servicing the domestic debt of more than US$2.0 billion were more than double those allocated to servicing external debt (Rwegasira and Mwega, 2003). In Zambia, the Government, in the 2005 National Budget, has set aside K850.0 billion for domestic debt service, while K576.5 billion was budgeted for external debt (MoNFP, 2005).

(ii) Over-Optimistic Export and Growth Projections

Over-optimistic exports and growth projections tend to make a country's debt appear sustainable under the enhanced HIPC framework, but it masks the reality on the ground. Indeed it has been shown that some countries that qualified for debt relief after reaching the completion point have slid back into unsustainable debt because growth projections were over optimistic.

For example, it is estimated that the external debt for Uganda, which has attained the completion point status, remains unsustainable even after receiving debt relief. A study by Muwanga-Zake (2001) has shown that the unsustainability of debt was attributed to a decline in export revenues arising in part from the collapse of price of coffee its major commodity exports. This was further worsened by the increase in oil prices, ban on fish exports to the European Union and the fall in tourism revenue due to the civil conflict in tourist attraction areas.

From the above weaknesses, it has therefore been suggested that in computing debt ratios, the amount of expenditures needed to attain the MDGs be netted out from the base revenues such that the remaining amount can then be channelled to debt service after already providing for MDG requirements.

3.0 SELECTED COUNTRY EXPERIENCES WITH THE HIPC AND DSA FRAMEWORKS

To date there are 27 countries that have reached the decision point while 17 have attained completion point status and received irrevocable debt relief. After application of traditional debt relief mechanisms, post-HIPC completion point countries have experienced a reduction of two-thirds of the present value of the overall external debt stock of these countries (IMF and World Bank, 2004a). Furthermore, debt service-to-export ratios are said to have fallen from an average of 15.7 percent in 1998 to an average of 10 percent after 2002, freeing approximately US$ 1.3 billion in annual debt servicing savings (Dohia, 2004).

However, evidence shows that the HIPC Initiative, even after the completion point, has not provided countries with a permanent exit from excessive debt. Generally, debt ratios of some HIPC Initiative "graduates" have deteriorated and fallen back beyond the unsustainable thresholds as a result of declines in commodity prices, under-delivery of debt relief by some creditors, higher-than-expected new borrowings, and a decline in the discount rates used in the computation of the NPV of the debt stocks (IMF and World Bank, 2004a).

The main issue is that the ability for HIPCs to substantially reduce poverty levels even in the presence of lower debt servicing continues to be limited. Projections by the IMF show that poverty-reducing expenditure is expected to increase, albeit modestly, from 6.4 percent in 1999 to 8.0 percent in 2006 for the 27 countries that have reached the decision point. It therefore comes as no surprise that a recent report by the UNDP (2004) states that many countries, including HIPC 'graduates', are projected to miss the MDGs.

A major challenge for HIPCs in the period between decision and completion points is the adherence to the stringent conditions of the IMF's PRGF. More than half of these countries have been off-track with the PRGF, mainly due to poor fiscal performance. This has been exacerbated by their inability to secure commitments of debt relief from non-Paris Club creditors and commercial creditors. Though the share of debt owed to commercial creditors is currently below 5.0 percent and has been reduced substantially, HIPCs continue to face creditor litigation for non-repayment of debt (Jubilee Research et al, 2003).

Below we present two selected country cases of the experience with the HIPC Initiative, showing how the DSA has failed to guarantee sufficient debt relief and provide enough savings for the HIPCs to attain the MDGs.

The Gambia: IMF's Stringent Conditionalities – the Long Mile to Debt Relief

Out of the three broad conditions to achieving debt relief at the completion point highlighted in section two, adherence to an IMF programme has been the most difficult for the HIPCs. An example of the delay this condition can cause is illustrated in the case of the small West African nation of The Gambia.

The Gambia is one of the poorest countries in the world ranking 155 on the UNDP Human Development Index (HDI) for 2002 (UNDP, 2004). With groundnuts as its main export and almost 70 percent relying on this industry for their livelihood, its economy and welfare of its people are highly vulnerable to adverse changes in the price of groundnuts.

By the end of 1999, The Gambia's external debt amounted to approximately US$ 452.0 million or US$ 258.0 million in NPV terms. This was equivalent to 59.0 percent of GDP and 217.0 percent of exports of goods and non-factor services (IMF, 2000). The Gambia reached the decision point in December 2000 and has been progressing very slowly towards completion point, when it is expected to receive relief of US$ 66.6 million in NPV terms. This has been mainly delayed by failure to stay on track with the IMF programme. Specifically, several difficulties have been experienced in the privatisation of Gambia Groundnut Corporation, a major player in the groundnut industry (see Box 1).

In the initial DSA undertaken in 2000, it was estimated that completion point would be attainable by December 2002. However, this target was not achieved as the IMF and The Gambian authorities failed to conclude negotiations for a new PRGF programme in February 2002. In July 2002, after satisfactory economic performance as reflected in robust real GDP growth and moderate inflation, as well as the country's renewed commitment to strengthen fiscal performance, the IMF and the Gambian authorities concluded negotiations for a new PRGF programme stretching to 2005. .

However, in 2002 adverse developments in the groundnut industry led to the decline in national output and a fall in export revenues in 2003. Consequently, the NPV debt-export ratio result (including the accumulation due to new borrowings) rose to 300.0 percent by end-2003, compared to the projection of 196.0 percent at decision point. In addition to this, various macroeconomic benchmarks were not achieved in 2003, particularly on the observance of fiscal and monetary benchmarks of the PRGF. As a result, The Gambia went off-track the IMF programme. This led to a reduction in both IMF and bilateral donor support[2]. Based on this development, the expected date of completion point was extended further to mid-2005 (Republic of The Gambia, 2005).

Box 1: The Case of Gambia Groundnut Corporation (GGC)

A prominent factor in the prolonged completion of the PRGF programme agreed in July 2002 has been the privatisation of GGC. GGC was first sold to the Swiss company Alimenta in 1993 but was subsequently renationalised in 1999 amid concerns over abuse of its monopoly status.

In 2001, Alimenta took The Gambian government to the international courts and forced the country to pay US$11.4 million damages for lost earnings and investment. Therefore in addition to the debt service it was already burdened with, The Gambian government had to clear this debt.

The Gambian government in 2001 approved the privatisation of GGC on the insistence of the IMF and World Bank. Originally, the target date of sale was December 2002, but due to various bottlenecks in the privatisation process GGC has not been placed on the market yet, contributing to the non-adherence to agreed structural policies.

The effect of withholding donor support had an adverse impact on the capacity of The Gambia to service its debt as well as finance social sector expenditures. With the decline in external support, there has been increased reliance on central bank borrowing, which ultimately placed upward pressure on inflation. The local currency, Dalasi, experienced a significant depreciation against the US dollar, compounding the decline in export earnings caused by the fall in the price of groundnuts. As regards poverty levels, The Gambia's position on the HDI has not improved significantly, and continues to be ranked as one of the poorest countries in the world (Table 2).

Currently, The Gambia is expected to attain completion point by 2005 at the earliest, which is tied to a number of performance triggers, such as the reduction in the fiscal deficit. However, these triggers have in the past undermined the country's ability to quickly exit from unsustainable debt.

Table 2: Selected Economic Indicators for The Gambia

	1999	2000	2001	2002	2003
Debt Service/Export %	11.8	15.4	18.5	7.8	9.8
Inflation (CPI)	1.7	0.2	8.1	13.0	17.6
Dalasi/US dollar % change 1\	5.1	28.9	13.7	38.1	32.3
Position on HDI	149	160	151	155	155

Sources: IMF (2004), UNDP (2004) and Central Statistics Department
1\ An increment means depreciation of the Dalasi

[2] Following the failure to complete the first review under the PRGF in 2003, the Paris Club withheld the second annual tranche covering the period 2003 to July 2004 (IMF, 2004b). Even the EU and other donors took similar stances.

The failure by the Gambia to exit from the high debt burden illustrates a combination of factors affecting many HIPCs such as the rigidity of the PRGF conditionalities and the IMF's overestimations in output and export growth rates.

Uganda: The Battle for an Elusive Exit from Unsustainable Debt

As is the case with many other HIPCs, the origins of the large debt stock in Uganda are related to the global economic shocks of the early and late 1970s and economic mismanagement including, inter alia, the command economic system where the state was actively, and often wrongly, involved in the running of the state enterprises. Like other developing countries, it also relied on concessional loans. However, what makes Uganda a unique case in the quest for external debt sustainability are the efforts made by the authorities to deal with the growing levels of external debt even before the establishment of the HIPC Initiative in 1996.

Beginning in 1991, the government implemented a comprehensive external debt reduction strategy that included Paris Club debt rescheduling and stock reduction options, commercial buy-backs, strict limits on non-concessional borrowing as well as general improvements in external debt management. Additionally, commitment to significantly reduce the stock of arrears was emphasised (Muwanga-Zake and Ndhaye, 2001). Combined with comprehensive macroeconomic programmes, this debt strategy contributed to the reduction of the debt service-to-export of goods and services ratio from 65.0 percent in 1991 to 20.4 percent in 1996/97 (IMF, 1998). It must be noted that one of the contributing factors to the reduced ratio may be attributed to the boom in coffee prices.

However, the reduction in the stock of external debt did not guarantee debt sustainability for Uganda. By end-1997, Uganda's external debt was unsustainable with the NPV of debt to exports of 243.0 percent. Hence, with the launch of the HIPC Initiative in 1996, the authorities embraced the framework and lobbied for the attainment of decision point in 1997 based on the justification that prior efforts had already been made and that Uganda had consistently implemented economic adjustment programmes since the early nineties. Uganda reached decision point in April 1997 and completion point a year later, making it the first country to be considered under the HIPC Initiative. At completion point it received debt relief of US$347.0 million or approximately 20.0 percent of its total external debt stock in NPV terms.

Though this was the largest debt relief Uganda had ever experienced, its debt profile soon slid back into the unsustainable region. This highlighted severe weaknesses in the original HIPC Initiative, some of which remain to this day. A DSA undertaken in 1999 by the Uganda authorities indicated that the NPV of debt to exports ratio crossed the threshold of 200.0 percent (under the original HIPC Initiative) following a significant decline in export earnings and an increase in debt following new loans. It also revealed the danger of overlooking the impact of the domestic debt stock, showing that debt relief based on both external and domestic debt would have substantially reduced the debt-to-export ratio to sustainable levels (Muwanga-Zake and Ndhaye, 2001).

At end-June 1999, the NPV of Uganda's external debt stood at US$ 1.8 billion as opposed to the projection of US$ 1.6 billion computed at completion point. This translated into a debt-to-export ratio of almost 250.0 percent; 100.0 percentage points above the threshold of 150.0 percent under the Enhanced HIPC framework. Uganda was therefore considered under the Enhanced HIPC initiative and again reached completion point in May 2000, where it received relief of US$656.0 million in NPV terms.

After two HIPC completion points Uganda has still not made a permanent exit from the external debt crisis. This has been partly due to the several shocks experienced in its external sector. The significant drop in the price of coffee, its main export, has been the biggest problem. Over the period 2000 to 2001, the price fell by 64.3 percent (Jubilee Research et al, 2003). This shows how estimates of export earnings and GDP growth are often unrealistically made in the DSA.

A recent analysis indicates that Uganda's NPV of debt-to-exports ratio at end-June 2003 was 258 percent, almost 90.0 percentage points above the end–2001 projection (IMF and World Bank, 2004c). Perhaps the discrepancy would have been different if the DSA was efficient enough to capture the realities of Uganda's export sector, such as the ban slapped on fish exports to the European Union (EU), as well as the sensitivity of the NPV of debt to the changes in the discount rate.

Despite the various efforts that have been made, Uganda has been unable to successfully make a permanent exist from debt and attain a sustainable stock of debt. In fact, indications are that debt service may increase in the short-term. Debt service in 2006 is expected to be double that in 2002 (Table 3).

Table 3: Uganda – Debt Service, 1999-2006

	1999	2000	2001	2002	2003	2004	2005	2006
	Actual					DSA Projections		
Debt service (US$' mn)	98	103.3	60.6	56.3	60.6	93.0	99.1	112.2
Debt service/exports (%)	11.8	15.6	8.8	8.1	7.8	10.0	10.2	10.9
Debt service/govt revenue (%)	12.9	16.1	9.7	8.1	8.5	10.7	10.8	11.9
Debt service/GDP (%)	1.7	1.8	1.0	1.0	1.0	1.4	1.4	1.5

Sources: IMF and World Bank (2004c)

Besides the inherent flaws in the DSA criteria, new disbursements of loans and non-delivery of HIPC relief by some donors have contributed to difficulties faced by the Ugandan authorities in managing the external debt.

However, it must be recognised that the HIPC Initiative has increased social sector expenditure in Uganda due to increased net inflows. For instance, poverty-related spending increased from 18.0 percent in 1998/99 to more than 30.0 percent by 2002/03 (Jubilee Research, 2003). Notwithstanding this increase in poverty reducing spending, with a ranking of 147.0 on the HDI (2003), it shall certainly require much more social sector spending to uplift the general standard of living. Despite the net increase in resource flows to Uganda, the goal of attaining levels of external (and indeed domestic) debt that will allow Uganda to meet the MDGs remains rather distant.

The above country case studies provide ground upon which one can question the success of the HIPC DSA to provide a permanent solution to the debt problem in Africa.

4.0 THE DSA FOR ZAMBIA

Zambia's External Debt Profile

Zambia's total stock of external debt amounted to US$7.1 billion as at end 2004, representing an increase of 11.0 percent from US$6.3 billion in 2000 in nominal terms. The increase in debt stock arose mainly from new borrowings by the Zambian Government. In view of the country's development needs, this debt stock translates into high debt service payments even after the attainment of the completion point in April 2005. Between 2000 and 2004, debt service increased by 62.7 percent in nominal terms from US$139.1 million to US$373.2 million. The bulk of this amount (US$ 259.5 million) was paid to the IMF (Republic of Zambia, 2005; IMF and World Bank, 2005).

As at end 2004, US$3.8 billion (54.7 percent) was owed to the multilateral creditors (IMF, World Bank, AfDB, etc.) while US$2.7 billion (38.8 percent) and US$0.5 billion (6.5 percent) was owed to bilateral and commercial creditors, respectively (see Table 4). Looking ahead, the bulk of the outstanding external debt will be due to multilateral institutions.

Table 4: External Debt Stock (In US$ millions), 2000-2004

		2000	2001	2002	2003	2004	2004 % of total stock
Multilateral		**3,446.8**	**3,313.7**	**3,855.1**	**3,703.1**	**3,872.0**	54.7
	ADB/ADF	316.7	318.7	318.7	217.2	311.0	
	World Bank	1,736.4	1,837.1	2,491.0	2,294.4	2,359.0	
	IMF	1,245.4	948.2	965.9	1,065.1	890.0	
	Others	148.3	209.7	102.0	126.3	312.0	
Bilateral		**2,390.2**	**3,091.8**	**2,614.8**	**2,245.4**	**2,748.0**	38.8
	Paris Club	2,131.4	2,713.9	2,343.1	2,000.0	2,483.0	
	on-Paris Club	258.8	377.9	271.7	245.4	265.0	
Total Govt. Debt		**5,837.0**	**6,405.5**	**6,469.9**	**5,948.5**	**6,620.0**	
Private and Parastatal		473.5	717.5	670.4	546.6	460.0	6.5
Total External Debt		**6,310.5**	**7,123.0**	**7,140.3**	**6,495.1**	**7,080.0**	
Debt relief (Non-HIPC and HIPC)*			436.0	437	391	276	

Sources: MoFNP Economic Reports (2002, 2004)

Debt Sustainability Analysis for Zambia

In 2004, the IMF and the Zambian authorities conducted an updated DSA, based on a number of assumptions (see Box 2).

Box 2: Zambia: Key Macroeconomic Assumptions for the 2004 updated DSA

As a basis for a DSA in Zambia, the IMF (2005) made the following macroeconomic assumptions:

1.0 Increase in export receipts from US$1,850.0 million in 2004 to US$5,092.0 million by 2023;

2.0 Increase in government revenues (excluding grants), as a percentage of GDP, from 18.4 percent in 2004 to 20.0 percent in 2023;

3.0 Real GDP annual growth rate of 5.0 percent over the period 2004 to 2023.

Source: IMF (2005)

The updated DSA showed that by end-2003, the nominal stock of debt was US$7.1 billion and US$4.9 billion in NPV terms after traditional debt relief, translating into 112.8 percent of GDP or approximately 432.0 percent of exports. Following the completion point, the NPV of debt was expected to be US$2.1 billion, representing a reduction of 57.1 percent. In terms of the NPV of debt-to-export ratio, it was 184.4 percent compared with the threshold of 150.0 percent for end 2003 and 161.0 percent for end 1999.

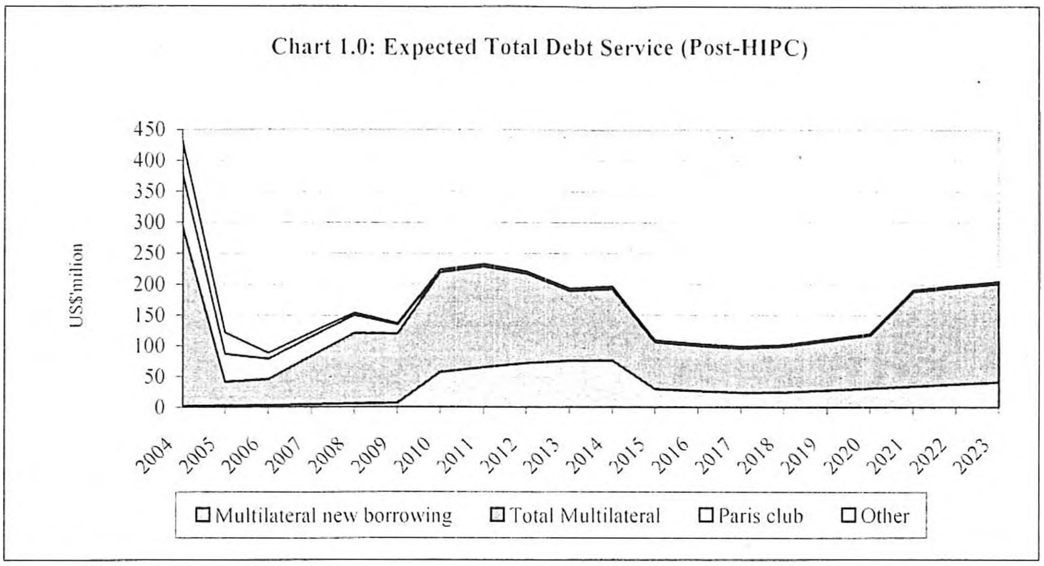
The higher than projected debt/exports ratio was attributed to an over-estimation in the export earnings and significant changes in the discount rates and exchange rates. Although the actual debt-exports ratio of 184.4 percent was higher, this figure would have been more by 28.4 percentage points (i.e. 212.8 percent), had it not been for interim debt relief received between the decision and completion points (Table 5).

Table 5: Change in NPV of Debt-to-Export Ratio from Decision Point to Completion Point (%)

	Anticipated change in the Ratio end-1999 to end-2003	Unanticipated Change in the end-2003 Ratio	Total Change in Ratio
End-1999 NPV of debt-to-exports ratio	150.0		150.0
End-2003 NPV of debt-to-exports ratio		161.0	
Factors contributing to the changes in ratios			
New Borrowing (2000-03)	74.5	-7.4	67.1
Export Growth (2000-03)	-63.5	34.5	-29.1
Changes in parameters		27.5	27.5
Of which			
Discount rates		19.8	19.8
Exchange rates		7.8	7.8
Changes in HIPC relief assumptions		-28.4	-28.4
Other factors		-2.8	-2.8
End-2003 NPV of debt-to-exports ratio	161.0	184.4	184.4

Sources: IMF and World Bank, 2005

Although Zambia attained the completion point and is expected to receive debt relief after Enhanced HIPC assistance, total external debt remains high, averaging US$ 2.4 billion in NPV terms over the post-HIPC period (2004-2023). Similarly, average total debt service is expected to remain high at US$135.6 million over this period. Out of this amount, 60.0 percent will be due to multilateral creditors. Further, beginning 2010, it is anticipated that debt service of additional borrowings from multilateral creditors will increase substantially from US$7.3 million in 2009 to US$76.3 million in 2014 as the hump in Chart 1.0 shows. This translates into an increase of over 900 percent for new borrowing as the country makes its final lap towards the achievement of MDGs by 2015 (IMF and World Bank, 2005). Although total debt service on new borrowing is expected to decline sharply to an average of US$31.0 million from 2015 to 2023, the impact on social expenditures will certainly be felt.



Limitations of the DSA for Zambia

Notwithstanding the above factors, the IMF framework shows that Zambia's external debt will be "sustainable" beyond the completion point, with all the parameters indicating a general decline even in the presence of severe shocks. However, this paper notes that the IMF framework has its own limitations as outlined below.

Failure to Link Debt Relief to MDGs: The IMF's DSA framework does not incorporate the impact of human development needs, such as high incidence of poverty compounded by the prevalence of HIV/AIDS, and therefore falls short of enabling Zambia to achieve the MDGs. It is argued that in order to overcome these socio-economic problems, Zambia will need to commit substantial financial resources in these areas (Jubilee Research et al., 2003). It must be noted that the main objective of debt relief is to muster financial resources needed to achieve the MDGs or costed poverty reduction programmes. Thus, any analysis of debt sustainability must be integrated into the broader set of human development objectives.

Failure to incorporate Domestic Debt into the DSA: Given that the DSA does not incorporate the effect of domestic debt, the sustainability projections are grossly underestimated. In Zambia, the size of the domestic debt is very high. Consequently, Government has had to divert substantial resources to servicing this debt. For instance, the Government in the 2005 National Budget has set aside K850.0 billion (US$169.4 million) for domestic debt service, compared with K900.0 billion (US$179.4 million) for Health and K870.0 billion (US$173.4 million) for Education (Republic of Zambia, 2005)[3]. Coupled with the impact of servicing external debt, Government's capacity to provide improved allocations to these social sectors remains severely curtailed.

Reliance on Export Earnings: The DSA takes export earnings as key determinant of Government's capacity to repay external debt. Consequently debt sustainability is anchored on performance of the external sector. Zambia, like other developing countries, depends on narrow export base, largely dominated by commodity products. Prices of such products often suffer from large swings on the international market, a factor that is outside the control of the HIPCs.

More recently in their DSA framework, the IMF and World Bank (2005) have recognised the impact of external shocks on exports and ultimately on the prospects of attaining a permanent exit from debt. Hence, in assessing Zambia's debt sustainability, sensitivity analysis indicated that even with a 20.0 percent reduction in the price of copper as well as lower non-traditional export volume growth, the external debt would be sustainable. However, exclusive reliance on exports criterion in the case for Zambia is reflected in the following limitations:

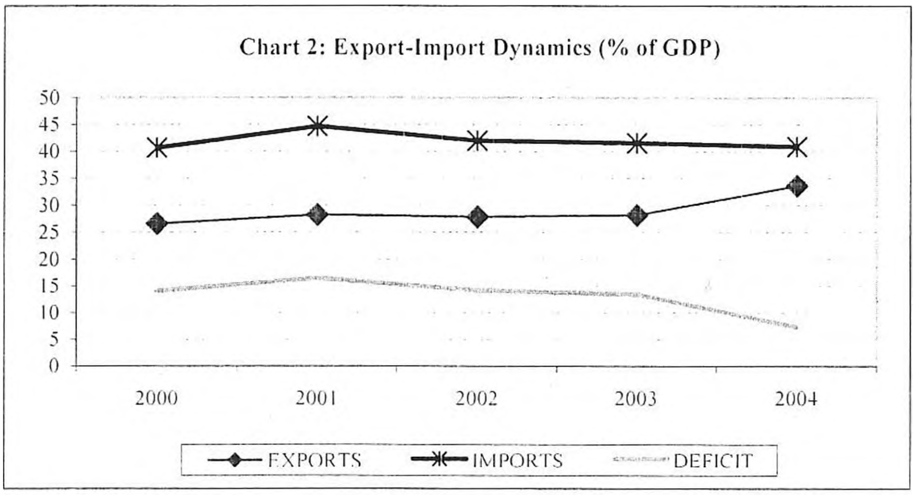
[3] Converted at the IMF programme exchange rate of K5,017.00/US$

- As a basis for calculating the debt sustainability without taking into account Zambia's poverty levels, investment in basic social needs, such as education, health and HIV/AIDS, is a fundamental omission. Thus, the IMF's analysis would only be feasible in a situation where debt service constitutes the only major Government expenditure. In Zambia, the use of export earnings as a measure of the Government's ability to repay external debt tends to exaggerate the true capacity of the Zambian economy, and is hence rather too simplistic.

- In Zambia, major foreign exchange earners are privately owned and enjoy enormous tax rebates. In view of this, the Government spends huge domestic resources to buy foreign exchange required for debt servicing, thereby undermining its capacity to adequately meet its social expenditure obligations. The situation is further compounded by the fact that Government also has to borrow domestically to pay for external debt service, due to untimely or non-delivery of anticipated foreign aid pledges and programme assistance.

- Over reliance on export revenues as a basis for calculating debt sustainability ratios also ignores the structural difficulties Third World countries face in international trade arrangements. Third World countries face restrictions in the expansion of their export sectors because of unfair trade practises by the developed countries, namely, imposition of quotas, subsidies on agriculture products, phytosanitary measures, etc. Furthermore, Third World countries have very little influence on the prices of commodities, thereby making them price-takers in international markets.

- The exports criterion is silent on the country's demand for imports, which exerts pressure on the available foreign exchange. This is particularly true for Zambia that is highly import-dependent in both consumption and production. For example, the increase in oil prices on the world market places a significant demand on the available foreign exchange. In fact, although the trade deficit has fallen to 7.3 percent of GDP in 2004 from an average of 13.2 percent between 2000 and 2003, it remained relatively high (see Chart 2).



Source: IMF, 2005 and authors' estimates

Table 6: Zambia: Social Indicators (1990 –2003)

Social Indicators	1990	2000	2003	MDG 2015
Illiteracy rate, Adult total (percent of people 15+)	34.0	32.8	-	
School enrolment, primary (percent net)	55.0	60.0	72	100
School enrolment, secondary (percent net)	21.4	30.9	-	
Life expectancy at birth, total (years)	47	50	-	
Mortality rate, infant (per 1,000 live births)	123.0	110.0	-	63
Access to safe water (percent of population)	52.0	64.01	-	71
Extreme Poverty incidence (%)	58.2	58.0	-	29.1
HDI Ranking	-	153	164	

Source: Zambia Analytical Report, Volume 10, CSO (2003), Zulu & Situmbeko (2004), Republic of Zambia, Second PRSP Report (2004)

In summary, the size of the debt stock, even after receipt of interim relief at decision point and additional relief at completion point, continues to be a source of worry to Zambia in the sense that it is an indicator of high debt service payments in the future in the absence of total debt cancellation. Although available data show that Zambia's external debt will be sustainable until 2023, it is important to note that sustainable debt does not guarantee sustainable development. Thus, even though debt projections show that it will be sustainable, the amount of debt service remains high and would entail reduced expenditures on the social sectors. Hence, poverty levels are likely to remain high despite the expected reduced debt stock. With poverty levels still high, Zambia also needs substantial increase in social spending if it is to attain the MDGs. In light of this, Zambia needs nothing less than a combination of total debt cancellation and increased timely aid in form of grants and not loans.

Legal and Institutional Framework of Debt Management

Another important aspect beyond DSA, which has been ignored, is debt management. This issue includes the legal and institutional framework for debt management and the need for professional capacity to manage debt (both domestic and external).

Although an Act of Parliament, Chapter 366 of the Laws of Zambia, regulates the legal and institutional framework for debt management in Zambia, there are a number of weaknesses in the provisions of this Act. Firstly, provisions of the debt contraction process and management at all levels under cap 366 are vested in the MoFNP. Under section 26, the Minister, with the approval from the President, is authorised to vary ceilings on borrowing to the extent necessary to raise urgent loans and guarantees[4] (Munalula, 2003). This clause is very subjective and is therefore subject to misapplication.

Secondly, external loans are not subjected to public scrutiny before they are obtained nor is the Attorney General supplied with all loan documentation. This is so despite the fact that the Attorney General, under Article 54 of the Constitution, is empowered to provide legal advice on any agreement, contract, treaty, convention or other document in which the Government has an interest before it is concluded.

Therefore, lack of involvement by the public and other interest groups such as the Parliament and civil society, both at contraction and monitoring levels does not conform to the basic tenets of governance, such as transparency and accountability. In fact, Munalula (2003) cites a number of cases based on the Auditor-General's Annual Report of 2000 of poor management of debt and argues that this is a symptom of the existence of inadequacies in the legal framework and institutional arrangements in the area of external debt management[5].

[4] The present ceiling for external borrowing is set to maximum of K20 trillion, by statutory instrument no. 53 of 1998.
[5] For detail see Munalula (2003).

The Need to Reform the DSA

In view of the inherent weaknesses of the DSA and the legal and institutional framework in Zambia, a reformed framework is needed, which could quickly provide resources to attain the MDGs by 2015. Such a framework should take into account the sustainability of debt whose primary focus would not only be provision of social services to the Zambian people, particularly the poor, but the accumulation of physical infrastructure as well. This is key in fostering sustained economic growth and development.

The proposed framework must therefore address the perceived weaknesses inherent in the current DSA framework. In essence, the proposed DSA framework should incorporate as much as possible social sector indicators to assure high probability of attaining the MDGs by 2015. Additionally, issues dealing with debt contraction and management, professional capacity to undertake prudent debt management and assessment, the role of civil society organisations and the private sector must also be taken into account in the whole process of DSA. Furthermore, the linkage of the HIPC Initiative to the domestic budget process and greater institutional framework must also be fully addressed.

5.0 A HUMAN DEVELOPMENT DSA FRAMEWORK FOR ZAMBIA

The achievement of sustainable debt levels in the face of high poverty levels and other pressing social issues such as the HIV/AIDS pandemic calls for a drastic approach to debt service. Thus, in Zambia, the case for a DSA that takes cognisance of these problems is justified. In view of this, the paper proposes a human development based DSA framework. The rationale for the proposed framework is premised on the inadequacy of the IMF DSA approach to deliver debt sustainability in the face of pressing human development needs. This framework is akin to an initiative advanced by the IMF and the World Bank (2004) with significant modifications as applied by CAFOD (1998), Eurodad (2001) and Bunte et al (2004) and Jubilee Research et al (2003).

Thus, under the human development DSA, expenditures on essential basic needs are considered as a priority while external debt service and other expenditures are considered thereafter. This is in contrast to the current DSA, which takes external debt service as a primary concern and other expenditures as a secondary consideration. It is therefore important to note that the proposed DSA will effectively replace the exports criterion with one that measures debt servicing with respect to human development needs.

The proposed human development approach involves the following steps.

1) Determine the Resource Envelope

Available resources to Government are all the revenues excluding grants. Although it would be tempting to include grants as an additional source of Government revenue, experience has shown that grants tend to flow irregularly as disbursements are subject to delays and dependent upon adherence to certain conditionalities. Thus, inclusion of grants may overly estimate the actual size of the resource envelope available to Government. For this reason, our analysis excludes grants from the available resource envelope. Hence, the available resource envelope will ordinarily be the sum of tax and non-tax revenues. This can be expressed as a percentage of GDP.

2) Costing the Human Development Expenditure

The human development approach is based on the simple assumption that resources available to HIPC governments must first be used for essential expenditures that are necessary to eradicate poverty. This covers expenditure on all social sectors (health, education, etc.), domestic debt service and basic infrastructure (roads, technology etc.). These expenses must be met from the resource envelope defined in Step 1. Estimating the social costs relies on the resource requirements necessary to attain MDGs.

3) Determination of Net Revenue Available for All Other Expenditures

Net revenue available for all other expenditures, including recurrent expenditure, personal emoluments, external debt service, etc. is obtained by deducting the total human development expenditure (in Step 2) from total available revenue (in Step 1). In a situation where net revenue is below zero, it would mean that a country is unable to adequately address its social needs by itself. Therefore, this would essentially suggest that debt service is unsustainable, warranting total debt cancellation and increased grant aid. If the amount is above zero, then one would proceed to assess external debt against net revenue.

4) Deduct External Debt Service Payments from Net Revenue

Once net revenue available for spending on other sectors has been determined, the next step involves deducting debt service payments and other expenditures on important but non-essential sectors. The remaining amount would then be used to assess a country's level of debt sustainability.

5) Sustainability Indicators

Under the human development based approach, external debt sustainability entails that total debt service would be covered by domestically generated revenue. Therefore, external debt sustainability would entail that the amount obtained in Step 4 be above zero. More generally, the following basic rule should apply:

- **Basic Rule:** When the projected flow of debt service exceeds the projected net revenue, a country is **unable** to service its external debt and the debt burden should be considered as **unsustainable.**

AN APPLICATION TO ZAMBIA

In assessing external debt sustainability the approach proposed above is adapted and applied to the Zambian situation. Two scenarios are presented below. The first scenario is based on the programmed dataset of parameters in the Medium Term Expenditure Framework (MTEF) for Zambia in line with the IMF's PRGF, which was agreed upon with the Zambian authorities. The second scenario is based on costings consistent with MDGs estimates. Table 7 gives the estimates of the assessments. It must be noted that the estimates provided hereunder are for the medium term and are for illustrative purposes. For longer-term analysis of the debt sustainability, more research would be required, particularly on the cost estimates of social sector expenditures required to attain the MDGs.

Factors outside Government's control (e.g., drastic changes in the international prices of oil and copper and other shocks such as drought), must be taken into account when undertaking the DSA. Including such factors in the analysis would strengthen the proposed approach in that these might impair Government's capacity to raise sufficient revenue to meet expenditure on social sectors. Without undermining the importance of these factors, this study has however not endeavoured to estimate the impact these shocks due to data limitations.

For example, in times of drought (as has been the situation during the 2003/4 agricultural season), the Zambian Government would have to commit additional resources to provide food relief to affected segments of the country's population. When this happens, Government's ability to service external debt would inevitably be affected. Therefore, the flexibility of the poverty based DSA approach is that it allows Government to make the necessary expenditure adjustments by taking into account the occurrence of such shocks. Future research could also endeavour to highlight the effect of these shocks on Government's expenditure requirements.

Table 7: Human Development Based Debt Sustainability Indicators (Percent of GDP)

	2004	2005	2006	2007	Aver. 2005-7
(a) Revenue excluding Grants	18.4	18.4	19.6	19.6	19.2
MTEF BASED ESTIMATES					
(b) Total Essential Needs Expenditure	10.4	10.4	11.3	12.3	11.3
Social Expenditure	*5.3*	*6.0*	*6.8*	*7.7*	6.8
Domestic Debt Service	*2.9*	*2.7*	*2.2*	*1.9*	2.3
Capital Expenditure[1]	*2.3*	*1.7*	*2.3*	*2.7*	2.2
External Shocks	-	-	-	-	-
(c) Revenue Available for Other Expenditures [(a) – (b)]	8.0	8.0	8.3	7.3	7.9
(d) External Debt Service	8.7	1.7	1.3	1.6	1.5
(e) Sustainability Indicators [(c) – (d)]	**-0.7**	**6.3**	**7.0**	**5.7**	6.3
HUMAN DEVELOPMENT BASED ESTIMATES					
(f) Total Essential Needs Expenditure	22.6	20.7	22.7	22.9	22.1
Social Expenditure	*10.9*	*10.9*	*10.9*	*10.9*	10.9
Domestic Debt Service	*2.9*	*2.7*	*2.2*	*1.9*	2.3
Capital Expenditure[2]	*8.9*	*7.1*	*9.6*	*10.1*	8.9
External Shocks	-	-	-	-	-
(g) Revenue Available for Other Expenditures [(a) – (f)]	-4.2	-2.3	-3.1	-3.2	-2.9
(h) External Debt Service	8.7	1.7	1.3	1.6	1.5
(i) Sustainability Indicators [(f) – (h)]	**-12.9**	**-4.0**	**-4.4**	**-4.9**	-4.4

Source: IMF (2005), Jubilee Research et al (2003), Authors' estimates
Notes:
1\ Domestically financed as given in the MTEF
2\ Assumes total programmed capital expenditure is fully financed by domestic revenues

STEP 1: Determine the Resource Envelope

The estimates for the resource envelope in the baseline are based on the MTEF projections. In the MTEF, Government estimates that domestic revenue would average 19.2 percent of GDP between 2005 through to 2007. This projection is based on historical performance of the tax collection system and expectations about the economy's growth.

STEP 2: Costing the Human Development Expenditure

In this study, we present two scenarios which are contrasted against each other, namely, the base line scenario based on the MTEF estimates and the Human Development based on the MDGs costings as provided by Jubilee Research (2003).

In March 2005, the IMF recognised Government's commitment to increasing spending on social priority poverty reducing programmes. They stated that, in order to make significant inroads in poverty reduction, Government needed to increase expenditure in these areas by 1.6 percentage points of GDP during the MTEF period.

In evaluating the impact of the MTEF expenditure requirements on external debt sustainability, this study argues that poverty-reducing programmes include social expenditure (health, education, water and sanitation), infrastructure development and domestic debt service. However, given the absence of reliable data on expenditures on water and sanitation, social sector expenditure is restricted to that of health and education. Therefore, collectively, expenditure on the social sector, infrastructure (capital) and domestic debt service has been considered an estimate of essential needs for the country. However, these areas are not by any means exhaustive.

Table 7 shows that under the baseline scenario, average essential expenditure over the period 2005-7 is estimated at 11.3 percent of GDP. Out of this amount, 6.8 percent is for social expenditure and the domestic debt service and capital expenditure are estimated at 2.3 and 2.2 percent of GDP, respectively.

The total social expenditure is assumed to increase by 1.6 percentage points of GDP, consistent with the IMF's projections (IMF, 2005). Similarly, domestic debt service and capital expenditure estimates are assumed to be consistent with the projections given in the MTEF. It must be noted that the amount budgeted for capital expenditure is based on domestically financed component of capital expenditure. The rationale for focussing on the domestic component is that the external component of capital expenditure is not entirely restrained by the domestic resource envelope.

Applying the human development methodology, total essential expenditure is estimated at an average of 22.1 percent of GDP. Out of this amount, 10.9 percent is for social expenditure while 2.3 and 8.9 percent are for domestic debt service and capital expenditure, respectively.

In estimating the expenditures required to attain the MDGs, Jubilee Research (2003) calculated that in 2004, Zambia would need US$590.0 million which translates into 10.9 percent of GDP. Using this as a base, this study assumes that total social spending required will at least grow proportionately with the growth in nominal GDP over the reference period. Domestic debt service is assumed to be the same as that in the baseline. This is in line with Government's commitment to reduce outstanding domestic debt. In order for the country to achieve sustainable levels of economic development necessary to guarantee an adequate revenue base, investment in physical capital (e.g., roads) will have to be increased. Given that foreign financing of capital expenditure is often irregular and tied to conditionalities and donors' priority areas, thus compromising the levels of investment and growth. Thus, this study argues that an increased allocation to capital expenditure is necessary. Consequently, capital expenditure is assumed to cover the total programmed expenditure, i.e. both domestic and foreign financed, which essentially is the required level of capital expenditure for the country in a given period.

STEP 3: Determination of Net Revenue Available for All Other Expenditures

The average net revenue available under the baseline scenario is 7.9 percent of GDP, while for the human development based scenario it is -2.9 percent of GDP. This means that the domestic resource envelope is insufficient to support the costed human development needs spending.

STEP 4: Deduct External Debt Service Payments from Net Revenue

In both scenarios, the amount of external debt service is 1.5 percent of GDP on average. Therefore, this figure is deducted from the net revenue of 7.9 percent and -2.9 percent obtained under the MTEF scenario and the human development based approach, respectively.

STEP 5: Sustainability Indicators

Estimates of the sustainability indicators show that when the MTEF based scenario is applied to assess external debt sustainability, Zambia would be able to service its external debt. However, this will be at the expense of improved resource allocation to the social sector and higher investment in physical capital. On the other hand, when an increase in social spending and investment are factored in, the estimates show that Zambia would slide into an unsustainable debt situation. Therefore, applying the basic rule, Zambia is *unable* to service its external debt from the remaining resources after providing for a larger resource envelope for human development needs. Hence, its external debt should be deemed *unsustainable*.

Much as the proposed approach appears to be simplistic in nature, it illustrates that there is need to take into account the country specific essential social and economic needs in order to achieve long-term debt sustainability and attain the MDGs. In view of this, Zambia needs unconditional total debt cancellation and increased grant aid in order for it to attain the projected improvements in the social sector and increase the likelihood of attaining the MDGs.

6.0 CONCLUSIONS AND RECOMMENDATIONS

It must be recognised that Zambia has made significant achievements in attaining the HIPC Completion point. This process has resulted in appreciable debt relief, both from bilateral and multilateral creditors. However, the study has shown that the IMF's DSA approach upon which debt relief was delivered has serious limitations. Zambia faces numerous social and economic challenges, such as crippling poverty levels, HIV/AIDS pandemic among others. Therefore, in order to reverse this situation, the country requires a significant amount of resources. It was expected that after debt relief, Zambia would be in a position to make significant savings for channelling into addressing these ills. However, in its present form, the IMF's DSA would be ineffective in providing for human development needs.

In view of this, a broader approach is proposed to address some of the limitations inherent in the IMF's DSA. The proposed debt sustainability based on essential needs approach provides an opportunity for the Zambian Government to make concerted efforts at reducing the debt burden whilst providing for the country's pressing development needs.

Estimates derived using the proposed framework show that Zambia's external debt remains burdensome, even after debt relief. It must be recognised that not all problems would be solved even under the poverty based DSA unless there is full cooperation between the Zambian Government, citizens, creditors and indeed full participation of the Civil Society Organisations and other interest groups on how this would operate.

But more central to the success of this approach rests on promoting economic development, which will nurture long-term stability and prevent continued country's future indebtedness. This calls for responsible policy-making aimed at promoting growth, diversification and trade. In addition, the Zambian government must exercise prudent and coordinated borrowing from the international community to ensure that resources are applied effectively. Contractions of loans for the sake of it must be avoided and the law empowering the Minister of Finance to contract debt without Parliament's approval must be reformed. Parliament should be given sufficient oversight powers to ensure that loan contraction falls within the confines of the country's development agenda.

Against this background, the study makes the following recommendations to enable the country break away from the chains of the heavy debt burden.

1. The Government and the IMF/World Bank must revisit the current DSA to link it to the MDGs, in order to secure sufficient resources for social sector and capital expenditures. Hence, Government should make expenditure on essential needs as a priority above external debt service. Therefore, external debt service must not compromise expenditure on domestic social sector needs.

2. In light of the above, Government should endeavour to strengthen expertise in costing the essential needs for longer term planning in order to assess the resources required to attain the MDGs. This will form a basis for the success of the proposed human development based DSA approach and provide a platform for unconditional debt cancellation upon negotiations. Accordingly, creditors are called upon to heed the call for debt cancellation and increased grant aid flows.

3. In order to be able to deliver these objectives, Government must, as a matter of priority, build capacity in debt sustainability analysis and management. Further, Government must develop a deliberate mechanism to retain professional staff.

4. The Government should create and maintain a clear database on all loans, grants and other forms of finances to avoid servicing debts that are no longer on its books.

5. Where feasible, Government should begin to move away from loans to grants as an innovative and efficient way of raising financing for the county's development needs.

6. In order to ensure long-term economic growth and debt sustainability, Government must put policies aimed at diversifying the economy. This will ensure a deeper and broader resource base and reduce the need for external debt borrowing.

7. The IMF/World Bank on their part should refrain from placing their debt service demands before domestic social sector needs.

8. To ensure that resources freed from additional debt relief are effectively utilised and accounted for, Government should reinstitute a HIPC Monitoring Team accountable to National Assembly. The composition of the team shall draw membership from various stakeholders such as Government, civil society, private sector and the Church. This will ensure transparency and promote good governance.

9. The National Assembly must sanction the contraction of new debt on specified terms based on Government's development needs. The Government must by statute publish the details of such debt in the national press and fully explain how it would be used. Thus will enable the public to monitor and ensure that Government is accountable for the use of resources.

10. In engaging creditors, the civil society should continue to impress upon the industrialised countries to dismantle trade barriers to facilitate fair trade.

11. Jubilee Zambia and other civil society organisations should continue civic awareness campaigns on debt issues, vis-à-vis reasons and procedures for debt contraction, use and impact on living standards of the people. In addition, the civil society must also continue to lobby creditors for total unconditional debt cancellation to enable the country meet its major development challenges.

12. In as much as civil society advocate for total cancellation of debt, the Zambian Government on its part should devise policies that would stimulate diversification of the export sector and the economy in general. This is expected to increase export earnings to levels beyond the country's import requirements, which would in turn reduce its dependence on foreign borrowing.

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Appendix

Table 1A: Essential Needs Expenditure Indicators for Sustainable debt

	In billions Of Kwacha, unless otherwise stated	1999	2000	2001	2002	2003	2004	Average
1.0	Total Revenue (excl. Grants)	1324.0	1953.0	2509.0	2909.0	3680.0	4750.0	2854.2
2.0	Essential Needs Expenditure	615.8	602.8	945.0	1444.9	1800.9	2110.4	1253.3
2.1	*O/w Total Social Expenditure*	456.5	463.5	739.6	994.9	1237.9	1364.8	876.2
2.2	*Domestic debt Service*	159.3	139.3	205.4	450.0	563.0	745.6	377.1
3.0	Capital Expenditure	124.0	228.0	494.0	417.0	507.0	584.6	392.4
4.0	Total Revenue less Social Expenditure	867.5	1489.5	1769.4	1914.1	2442.1	3385.0	1977.9
5.0	Total Revenue less Essential Needs Expenditure	708.2	1350.2	1564.0	1464.1	1879.1	2639.4	1600.8
6.0	Revenue available for other expenditures (5 minus 3)	584.2	1122.2	1070.0	1047.1	1372.1	2054.9	1208.4
7.0	External Debt Service	358.0	861.8	1511.8	1817.6	2191.3	2242.8	1497.2
8.0	MDG Spending[1]	-	1676.8	2002.4	2424.8	2732.0	2815.5	2330.3

1/Jubliee estimates

Source: IMF (Various), MoFNP, (2003,2004), Jubilee (2003) and Authors estimates

Table 2A: Debt Service and Debt Stock for Zambia 2004 – 2023

Year	TDS plus	Multi	Multilateral new borrowing	Multilateral	Paris club	Other	Total Debt Service	Debt stock
2004	429.9	290.3	2.2	292.5	85.6	51.8	429.9	4986.1
2005	118.6	35.5	3.4	38.9	44.8	34.9	118.6	2092.8
2006	86.3	39.1	3.5	42.6	33.5	9.2	85.3	2157.7
2007	116.7	73	5.5	78.5	31.3	6.9	116.7	2185.9
2008	147.7	107.7	6.5	114.2	29	4.5	147.7	2173.2
2009	129.5	105	7.3	112.3	15.1	2.2	129.6	2169.4
2010	166.2	104.3	57.5	161.8	2.3	2.1	166.2	2134.9
2011	167.9	98.5	65	163.5	2.3	2.1	167.9	2103.5
2012	149.4	73.1	71.9	145	2.3	2	149.3	2093.5
2013	117.7	37.8	75.7	113.5	2.3	2	117.8	2117.2
2014	120.5	39.9	76.3	116.2	2.3	1.9	120.4	2140.2
2015	79	45.9	30.2	76.1	2.3	0.6	79	2206.7
2016	76.5	46.7	26.9	73.6	2.3	0.6	76.5	2279.8
2017	75	48.1	24.1	72.2	2.3	0.6	75.1	2358.5
2018	77.6	50.2	24.5	74.7	2.3	0.6	77.6	2439.2
2019	83.2	52.2	28.1	80.3	2.3	0.6	83.2	2518.9
2020	88.8	55.3	31.1	86.4	2.3	0	88.7	2597.6
2021	156.6	119.4	34.3	153.7	2.8	0.1	156.6	2613
2022	160.9	119.8	37.7	157.5	3.4	0.1	161	2626.1
2023	163.7	119	41.1	160.1	3.5	0.1	163.7	2638.3

Source IMF (2005)

2005-06

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