JCTR

Policy Brief

Promotion of Social Justice and Concern for the Poor

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Zambia's Public Debt Status post HIPC and MDR Initiatives

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1.0 Introduction

Concerns for public debt levels have continued to take centre stage in the last few years mainly in industrialized countries. The Euro zone is the latest to be engulfed in debt crisis following substantial increase in sovereign debt levels in a number of Euro zone countries such as Greece, Ireland, Spain, Portugal and Italy. There has consequently been a fear of contagion of the crisis to other countries including developing and emerging countries due to increased interconnectedness in the global financial system.

The recent developments in the European Union have strengthened calls for Public Debt Management reforms and increased domestic resource mobilization in developing countries such as Zambia. With most donor countries experiencing financial crisis, there is expected to be a significant reduction in budgetary transfers to developing countries thereby posing greater challenges to government debt management. The situation may be compounded by most aid recipient countries' inability to generate sufficient domestic resources to stabilize debt ratios that are likely to be worsened by the reduction in foreign aid and subsequent increased borrowing from the open market at higher interest rate.

It is therefore satisfying to note the progressive debt contraction and management clauses that have been included in the Zambian draft constitution under article 282 (Borrowing and Lending by Government) meant to enhance Parliamentary oversight on the executive with regard to fiscal external borrowing. These clauses must be supported by all well-meaning Zambians. Even though Zambia's debt position at the moment is said to be sustainable, it is important that the Government prioritizes debt management reforms to avoid another debt crisis especially in light of Europe's debt crisis. It should be noted that Public Debt Management is an indispensable component of successful macroeconomic management necessary for overall economic stability and sustainable economic development.

The Public Debt reforms that the Zambian Government embarked on in 2004 aimed at strengthening debt management capacities of various Government institutions engaged in debt management should be accelerated. Currently, the institutions and policies that governed debt contraction and management at the height of the country's debt crisis prior to HIPC and MDR debt cancellation initiatives still exist and if left unchecked may make debt management reforms ineffective. It is therefore the objective of this policy brief to analyze the status of Zambia's debt stock and provide policy options for the country in face of the volatile global economy.

2.0 Zambia's Debt Status post-HIPC

Debt cancellation for Zambia under the Highly Indebted Poor Countries (HIPC) and the Multilateral Debt Relief (MDR) initiatives reduced the country's external debt from US7.1 billion to US $0.9 billion (JCTR 2006 first quarter policy brief). Debt relief was not only experienced in form of debt stock reduction but in debt service amounts payable to creditors as well. This resulted in a lot of resources being freed for social sectors and other domestic needs. The country has however witnessed a steady increase in the level of public debt between 2006 and 2011. External debt as at 2010 stood at US $3.0 billion comprising US $1.3 billion public debt and US $1.7 billion private debt but publicly guaranteed debt (2010 Economic Report). 2011 preliminary data from Ministry of Finance reveals that public debt stood at US $1.9 billion as at end of 2011. Domestic Debt is approximately US $2 billion (10 trillion Kwacha).

Table 1. External Debt Stock - 2010

Type of External Debt	Amount in US $' Billion
Public	1.3 billion
Private	1.7 billion
Total External Debt	3.0 billion

Source: Economic Report, 2010

2.1 Public External Debt

Countries world over rely on external borrowing to finance their development agenda and Zambia is not an exception. Even industrialized countries like the United States borrow to finance their budget. It is therefore an acceptable practice for a country to externally borrow either bilaterally or multilaterally to supplement domestic resources for development; especially if resources are invested in projects that have a high economic return to enable the country repay the loan without necessarily overburdening people with taxes.

Zambia partially finances its budget from borrowed resources. In the recent past, the level of public external debt has steadily increased rising from US$ 972 million in 2006 to US $1.8 billion. This is quiet a sharp increase in debt levels in that the debt stock has literally doubled in five years. The increase in the public external debt stock has been attributed mainly to increased borrowing by Government to finance infrastructure projects such as roads and hydro power stations. The stock of public external debt is given in table two.

Table 2. Trend in External Public Debt 2006 - 2011

Creditor	2006	2007	2008	2009	2010	2011*	% Change (2006 - 2010)
Multilateral	636.58	706.12	751.81	1,114.36	1,198.41	1,240.12	94.81
ADB/ADF	126.53	91.30	121.22	170.79	222.24	216.74	71.30
World Bank(IDA)	260.64	316.90	352.03	406.64	430.36	489.91	87.96
IMF	41.38	85.95	95.51	344.78	366.18	367.88	789.03
Others	208.03	211.97	183.05	192.15	179.63	167.29	(19.58)
Bilateral	278.05	286.78	293.16	293.21	298.57	283.19	1.87
Paris Club	204.85	212.55	218.29	219.08	224.56	212.65	3.81
Non-Paris Club	73.20	74.23	74.87	74.13	74.01	70.54	(3.63)
Suppliers Credit	57.14	111.75	143.58	136.95	269.18	466.69	716.75
Total Government Debt	971.77	1,104.65	1,188.55	1,544.52	1,766.16	1971.70	102.90
Total External Public Debt as % of GDP	11.12	9.20	10.55	11.14	10.95	10.73	

Source: Ministry of Finance submission to Parliamentary Committee on Economic Affairs; 2012
Asterisk (*) preliminary data

Worth noting from the above table and of great concern to JCTR is the exponential increase in debt from Suppliers' Credit which is non-concessional. Between 2006 and 2011, non-concessional loans increased more than twelve times the debt levels of 2006. Non-concessional loans attract higher interest rate than concessional loans and thus have a higher debt burden on the Zambian people. Unless these loans are invested in projects with a high economic return, the country will have a big challenge paying back the debt. Only IMF loans have increased at a higher rate than the supplier credit category but IMF loans are largely concessional.

2.2 Private External Debt

Private external debt forms a larger component of Zambia's total external debt; about 60 per cent. Private investors, mostly corporations borrow externally by way of issuing bonds or syndicated loans[1] and invest in various projects that contribute to the development of the economy and from which they repay the loans. It is not very clear how much private external loans the Zambian Government has guaranteed but below are some of the non concessional loans that Government guaranteed in the last two years.

Table 3. Non Concessional loans guaranteed by Government

Creditor	Purpose	Date Signed	Amount
European Investment Bank	Rehabilitate and upgrade two generating units at Kariba North Bank Station	5th October 2010	EUR 7,600,000
Development Bank of Southern Africa	Construction of the 360 MW Hydroelectric Power Plant as extension to the existing Kariba North Bank Power Station	10th September 2010	USD 105,000,000
Development Bank of Southern Africa	Construction and Rehabilitation of public roads in Zambia i.e. Kabompo-Chavuma,	22nd December 2010	USD 262,000,000
ZANACO	Construction of selected distribution lines and substations	27th July 2011	USD 80,000,000
Poly Technologies, INC	Lusaka City roads project	31st August 2011	RMB 258,800,000
Industrial & Commercial Bank of China Limited	Pensulo-Kasama & Pensulo-Msoro-Chipata 330kV power transmission line project	9th November 2011	USD 285,000,000

Source: Ministry of Finance submission to Parliamentary Committee on Economic Affairs; 2012

[1] A syndicated loan is a loan offered by a group of lenders called a syndicate (but managed by one lender) who work together to provide funds for a single borrower. The borrower could be a company or a government.

It is generally argued that private external borrowing does not make a country as vulnerable to external shocks as the public external debt does and thus not a major source of concern. This is because both private lenders and borrowers are said to be better equipped to assess the risk of their actions (lending and borrowing) and are therefore better placed to mitigate for risks. This view however has been discredited by several financial crises in the last ten years which hit countries with high private investment rates such as Thailand and Mexico. Therefore a larger share of private debt relative to public debt should not be interpreted as an indication of lower vulnerability. In fact it is often impossible to separate public from private liabilities and this is especially the case for private external debt that is publicly guaranteed.

Government should therefore be equally concerned about private external debt because it is as risk as public debt and has serious implications on the general economy and the welfare of the people in case of a sudden outflow of investment. The domestic currency severely depreciates in case of a sudden outflow of investment leaving a lot of people to suffer currency exchange losses and other adverse economic effects. A publicly guaranteed loan is also a drain on public resources in case the private borrower fails to repay. There is therefore urgent need for Government to publicly state the amount of private external debt that it has guaranteed in public interest.

2.3 Public Domestic Debt

Public domestic debt comprises of mainly marketable securities such as treasury bills and Government bonds. Treasury bills are short term loan instruments that Government uses to borrow from the public and matures after a period of between 91 days (3 months and 364 days (1 year). Government bonds on the other hand have a longer maturity period ranging between 2 and 15 years. These credit instruments are tradable before their maturity period meaning the initial buyer may sell the instrument to a third party before its maturity period. Government also borrows through issuance of non marketable securities such as the ten year bonds issued to Bank of Zambia. Other domestic public liabilities include domestic arrears to suppliers, pension arrears and awards and compensation.

Table 3. Trend in Domestic Public Debt (2006 – 2011), K' Billion

Debt Category	Dec. 2006	Dec. 2007	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011
Domestic Debt Stock	7,720.84	8,279.08	8,494.64	10,340.96	10,867.36	14,028.70
Domestic Debt as % of GDP	20.02	17.92	15.49	16.00	13.99	14.93

Source: Ministry of Finance

Even though domestic debt stock remains relatively low at 14% of GDP at the end of 2011, the increase in the stock between 2006 and 2011 of 82 per cent is exponential and worrying. The increase is largely attributed to deficit financing by the Central Government through the issuance of securities which formed 93% of the total domestic debt stock in 2011.

It is worth noting that domestic debt is less problematic than external debt in that it is owed in domestic currency and thus does not increase with the depreciation of the local currency as in the case of external debt. However, domestic debt increases with reduction in inflation and this is true in the case of Zambia where inflation has been on the decline for the period under review from double digit to single digit. Government therefore has to find a way of stabilizing the domestic debt levels.

With the economy growing fast, it should be expected that the share of the budget being financed from borrowed resources would reduce. The irony however is that at the time the economy has been growing very fast with sectors like the mining and agriculture making significant foot prints on the GDP, tax revenue has not proportionally increased thereby resulting in increased borrowing. Government needs to reverse this trend by mobilizing more tax revenues from the growing economy.

3 External Debt Service

Due to debt cancellation experienced by Zambia in 2006, debt service amounts reduced substantially. Public external debt service payment reduced for example from US$126.86 million in 2005 to US$65.14 million in 2006. Debt service payments have since stabilized and thus the country has continued to benefit from the fiscal space that debt cancellation has created. The table below shows debt service payments for the period under review.

Table.4 Public External Debt Service between 2005 and 2011 (US$' Million)

	2005	2006	2007	2008	2009	2010	2011
Principal	100.31	48.14	47.16	41.44	42.17	29.79	20.45
Interest	29.56	17.07	13.35	19.31	11.48	8.72	13.69
Total	129.86	65.21	60.51	60.75	53.65	38.52	34.14
External Debt Service as % of Total Budget	4.45	2.66	1.83	1.86	1.54	1.11	0.85

Source: Ministry of Finance

The reduction in debt service payment is partly due to the fact that recently acquired loans are still enjoying the ten years grace period during which repayments are not due. As soon as the grace period expires, debt service repayment on new loans will become due and the total repayable amounts are likely to increase in the long run. Service repayment therefore could become a serious burden in few years time when the loans being contracted matures and every caution must be taken in contracting new debts.

4 Debt Sustainability

Having endured a debt overhang for over a decade before debt was cancelled in 2006, it has been a concern of the Jesuit Centre for Theological Reflection and many other well-meaning stakeholders that the country avoids getting into another debt trap. The question therefore has been whether Zambia's debt level is sustainable or not. The concept of debt sustainability is very important because if public debt growth is left unchecked relative to the country's income, government would have to constantly increase taxes and reduce spending on goods and services which will adversely affect the ordinary people. The country went through this before debt cancellation and the results are apparent and fresh in many people's minds. Government could hardly provide social services such as health care and education services because the priority was debt servicing. The question of debt sustainability is therefore important to assessing the country's capacity to borrow and repay new loans.

The IMF and World Bank have jointly developed a Debt Sustainability Framework that enables countries and donors in mobilizing finances for low-income countries' development needs, while reducing the chances of an excessive build-up of debt in the future. The framework guides borrowing countries to match their financing needs with their current and future repayment ability. It also guides creditors to lend money to countries on terms that ensure development and debt sustainability for the recipient

country. Debt sustainability framework therefore suggests that indicators of debt sustainability (Debt to GDP ratio, Debt to Export earnings ratio or Debt to Government revenues ratio) should not increase for ever but should be kept below minimum thresholds for the country's debt to remain sustainable.

There is some debate on which debt ratio (relative to GDP, exports, and government revenues) is the most appropriate measure of debt sustainability. Different debt ratios may provide different signals on whether debt is sustainable or not. There are pros and cons to the use of each indicator but most of them are useful in some dimension. The most widely used ratio is Debt to GDP ratio, the one we will work with in this paper. A rising debt-GDP ratio is interpreted as a signal of over borrowing; warning of debt defaults if strong fiscal corrections are not adopted in time. The generally accepted minimum debt to GDP ratio especially for developing countries is 40 per cent. With a public debt to GDP ratio of less than 15% for Zambia, both Government and cooperating partners believe the country's ability to repay external debt is sound. For instance, according to the Debt Sustainability Analysis carried out in 2007 by Government; the country's debt is sustainable over the period 2007 to 2023. The analysis adds that debt will remain sustainable even with the additional borrowing of US$1 billion non concessional and US$1 billion concessional loans within during the same period (Ministry of Finance submission to Parliamentary Committee on Economic Affairs; 2012)

One limitation with the traditional Bretton Wood debt sustainability analysis as it is conducted in developing countries is that the analysis is generally confined to external borrowing because public debt in these countries is largely identified with external debt sovereign borrowing. The suggested identity between public debt and external debt does not always hold because of the growing importance of public domestic and private external debt. Private external debt in Zambia for instance is higher than public external debt but it is not incorporated in the debt sustainability analysis framework. Thus public debt (domestic and external) and private external debt sustainability needs to be addressed as two separate, though inter-related issues. Ignoring external private debt may over state the country's ability to repay external debts and thus make the country vulnerable to external shocks. Some of these private external debts are public in nature as they are publicly guaranteed and should therefore be included in the debt sustainability analysis.

5 JCTR's Position on Debt Status

JCTR believes that debt cancellation and the subsequent sustainable debt levels that Zambia has experienced are no license for continued indiscriminate borrowing but an incentive to Government to speed up loan contraction and management reforms in

order to avoid another debt crisis. The loan contraction process still lacks transparency, accountability and participation as it has remained the preserve of the executive with limited Parliamentary oversight. The laws and policies that governed loan contraction and management prior to debt cancellation in 2006 still exists and the indiscriminate borrowing game has continued even under the new Patriotic Front Government. Within six months of being in Government the new administration has borrowed not less than US$300 million. Below is the table of some of the loans contracted under the new Government.

Table 5. Newly contracted Public Loans

Source	Currency		Date	Purpose
	US Dollar	Euros		
European Investment Bank		80,000,000	12th Dec 2010	Rehabilitation of Great East Road
China	10,000,000		12th Dec 2011	Poverty reduction projects yet to be identified
African Development Bank	63,000,000		10th Jan 2012	Nkana water sewerage
Saudi Development Bank	12,000,000		2nd May 2012	Kalabo-Sikongo Road
World Bank	50,000,000		8th May 2012	Improving the country's livestock
European Investment Bank	30,000,000		17th May 2012	Kafue-Livingstone Power Transmission
African Development Bank	100,000,000		28th May 2012	Upgrade Luangwa-Nyimba Road
African Development Bank	35,000,000		25th June 2012	Development of the Itezhi Tezhi Power Project
French Government	68,850,931		5th July 2012	Rehabilitation of Great East Road
Total	**368,850,931**	**80,000,000**		

Source: JCTR Debt data base; created from media reports

The new Government must conduct a debt audit to ascertain how much public debt the previous Government contracted and for what purpose it was contracted. It must also uphold the loan contraction and management clauses provided for in the draft constitution meant to enhance Parliament's oversight role. The loans that are being contracted must be subjected to Parliamentary oversight and their use verified and approved. Contracting and managing debt resources cannot continue to be business as usual. Government cannot be borrowing money for projects that are yet to be identified. Recently the PF Government borrowed US$ 10 million from China for poverty reduction projects yet to be identified. If not borrowed for a specific project, money can end up being used on something else which has no relevance to meeting the needs of the people.

6 Recommendations

As a way of achieving a long term effective public debt management and sustainability, JCTR proposes the following policy recommendations.

- Government should borrow more of concessional loans than non concessional loans which attract higher interest rates and subsequently has a higher debt burden on tax payers

- Government should rigorously review the Public Management reforms that were embarked on by the previous regime; including debt management reforms

- Government should contract debts with low fixed interest rates in order to avoid payment of higher interest rate that accrues due to upward fluctuation in the interest rate.

- Government should maintain a sound market for Government securities (both primary and secondary markets) to be able to continue rolling over public domestic debt and avoid liquidity risk. In light of the huge domestic debt; Government needs an efficiently working bond market in order to roll over debt that matures by selling new securities

- Government should sustain economic growth to enable the country repay the loans. A country's indebtedness reduces with increase in economic growth as long as the rate at which debt is growing remains lower than the country's economic growth rate.

- Government should delay the issuance of sovereign bonds meant to raise US$ 700 million on the international market until the global financial environments and interest rates stabilizes.

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