



Harnessing Zambia's external debt for development

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In recent times there has been debate on Zambia's steadily growing external debt. This comes in the wake of debt relief efforts of the Highly Indebted Poor Country (HIPC) and Multilateral Debt Relief (MDR) initiatives which saw a reduction of the country's debt stock from US\$ 7 billion in 2001 to US\$ 934 million in 2006. This freed up resources in terms of debt servicing and contributed to the growing fiscal space for Zambia to invest in key areas of the economy. It also contributed to optimism regarding economic development across the country and opened up more avenues to raise funds for development on international capital markets

The debut US\$ 750 million Eurobond issuance by Zambia alongside Namibia, Nigeria and Senegal, attest to the growing attractiveness of the African debt market and indeed a 'shot in the arm' for Zambia. Funds raised from the issuance of sovereign bonds can contribute to the development of critical infrastructure projects that have previously been constrained due to gap between investment needs and domestic resources plus foreign funding. It is therefore not surprising that a number of public agencies have expressed interest to issue sovereign bonds on the international capital market. For instance the Road Development Agency (RDA) intends to issue a US\$ 1.5 billion bond, Lusaka City Council intends to issue a US\$ 500 million bond, and ZESCO also intends to issue a US\$ 250 million bond. While Zambia's ability to guarantee repayment is considerably large at present, it is feared in most quarters of the economy that, if the borrowing is not done with caution it could make the country slip back into a debt trap.

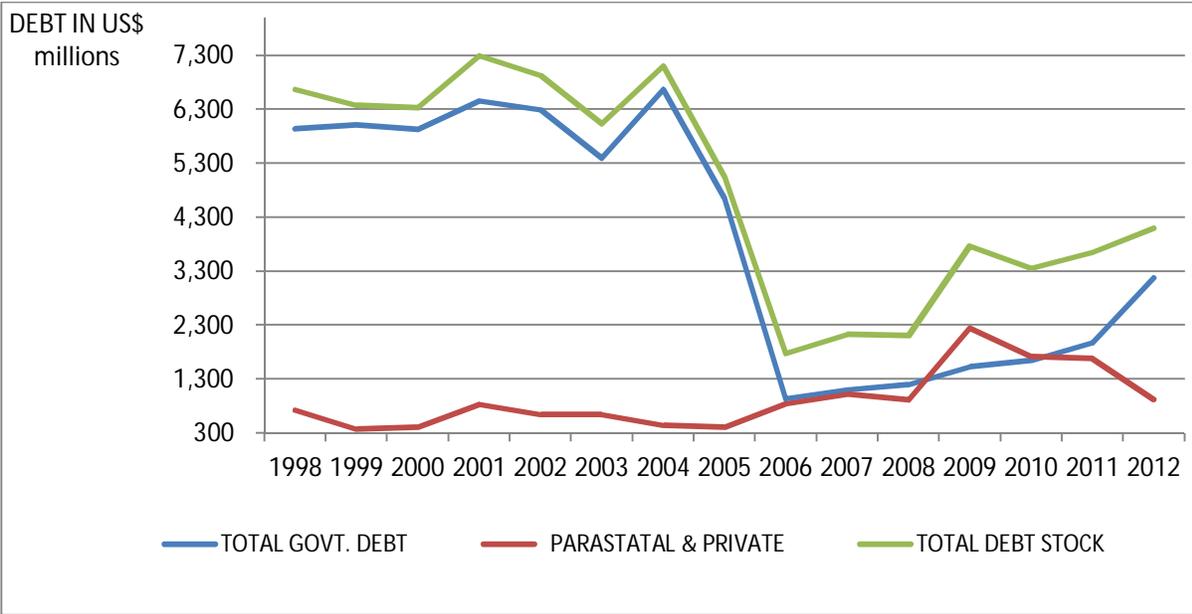
Zambia's Debt Trend

External debt has been rising in absolute terms from US\$ 934 million in 2006 to US\$ 3,179 million in 2012. This shows that within a period of six years, the debt has increased by US\$ 2,245 million in absolute terms representing a 240% increase.

As a percentage of GDP, external debt increased from 9 % in 2006 to 15% in 2012. There was a slight dip in the parastatal and private sector external debt incurred between 2008 and 2009 but eventually rising in 2009. The debt reduced from US\$ 1,021million in 2007 to US\$ 909 million in 2008 and rose to US\$ 2,250 million. This is attributed to the global financial crisis that mainly affected the country's copper industry. During this period, copper prices fell from a peak of US\$ 8,400 per tonne to slightly below US\$ 3,000 per tonne on the international market. The crisis led to some major mines failing to borrow for investment in critical operations with some of them temporarily ceasing operations.

Like many countries world over, the rise in Zambia's debt is healthy as this is necessary to finance the development agenda. This increase is a combination of concessional borrowing and bond issuance to finance key infrastructure projects in the energy, transport and other sectors of the economy particularly in providing the necessary ingredients for the private sector to thrive. As long as the selected projects are carefully implemented, they have the potential to spur growth in all sectors of the economy and reduce poverty in the country. This being the case, the Zambian economy is likely to register record growth to enable it service its debt.

Zambia's external debt trend, 1998 to 2012



Source: Ministry of Finance and Bank of Zambia

Debt Sustainability Projections

According to the International Monetary Fund (IMF), Zambia's external debt is projected to rise slightly in the medium term, but is expected to decline gradually overtime. Under the baseline assumptions, the present value of external debt to GDP ratio is expected to reach 24 percent in 2015 and come down thereafter to about 16 percent by 2032. The World Bank and IMF debt sustainability framework provides for a 40 percent external debt to GDP threshold for Zambia's external debt if it is to remain sustainable in the long-run.

How can Zambia maintain sustainable debt levels?

Issuance of sovereign bonds does carry both risks and opportunities and as such there is need to pursue a debt portfolio that encompasses both concessional borrowing and bond issuance so as to hedge against risks inherent with international capital market exposure.

The size of the bond should be carefully considered based on the impact it will have on the external debt profile of the country. It is therefore necessary to always carry out a cost benefit analysis and carefully examine the impact of additional debt in the medium to long-term. In other words, borrowing should be on the basis of the needs of the country and ability to pay back taking into consideration the maturity of the bond to avoid roll over risks.

During the 2013 budget address to parliament, the Minister of Finance, Honorable Alexander Chikwanda assured the nation of Government's commitment to ensuring a sustainable debt for the current and future generations. To this effect he said, *"Sir, we remain mindful of our inescapable duty to never again burden future generations with unsustainable debts. In this regard, we will institutionalize a rigorous appraisal system for screening investment projects in order to ensure that borrowed funds are only applied to infrastructure projects that directly and demonstrably contribute to the nation's economic growth. We will also promote transparency by conducting regular debt sustainability analyses (Budget speech, 2103)".*

Building institutional capacity is fundamental to ensuring a sustainable debt. There is need to equip staff in the Ministry of Finance with appraisal skills to ensure projects that yield both social and economic returns to capital are carefully selected. This is particularly important because paying back the debt will be a challenge if the country gets this wrong, even with "sustainable" debt of less than 40% of GDP.

Similarly the capacity building of staff in the debt management departments should be enhanced to be able to carry out regular debt sustainability analysis that informs policy makers of the long term implications of additional debt.

The legal and policy framework on debt requires reviewing. The recently adopted article 282 clauses 2, 3 on parliamentary debt oversight during the just ended National Convention on the Draft Constitution is a welcome move towards harnessing the external debt. The article in clause (2), states that “Government shall not borrow, guarantee, or raise a loan on behalf of itself or any State organ or institution, authority or person except as authorized by or under an Act of Parliament; and Clause (3) states that the terms and conditions of the loan shall be laid before the National Assembly and shall not come into operation unless they have been approved by a simple majority of the National Assembly.” To ensure that the act on parliamentary oversight achieves its intended purpose, there is need to go a step further by including a clause explicit on the governance of the acquired bonds as relates to institutional support, monitoring and evaluation of the investment project selected.

Government should come up with specific time lines in the formulation and implementation of a new debt management policy. This is necessary to ensure that the country remains consistent with its broad objectives of debt sustainability and accelerating economic growth with increased borrowing.

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