SAIPAR blog

Inevitability and Necessity of an IMF-Supported Economic Programme for Zambia

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1. Is an IMF-supported economic programme inevitable for Zambia?

History has shown that, a considerable amount of mistrust of the International Monetary Fund (IMF) exists among some economic commentators and observers in Zambia and abroad. That said, an IMF programme is nonetheless absolutely and resoundingly necessary for Zambia. ***Given the country's current economic context, a Fund programme is inevitable***.

2. Why and in what ways is the IMF Inevitable for Zambia?

2.1 A quick three-point historic perspective

To understand the inevitability of an IMF programme for Zambia, we need to look at the country's recent economic history, particularly since 2011. The year 2011 is arguably a defining moment for Zambia's debt trajectory for at least three reasons:

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- The year 2011 was the last year of an IMF-supported programme in Zambia[i]. This means that throughout the period of the deep and painful economic, structural and public sector reforms, from the 1990s until Zambia stabilized in the late 1990s and established sustained real GDP growth after 2000 (reaching a peak real GDP growth rate of 10.3% in 2010), ***the IMF walked with Zambia throughout the journey***. Surprisingly, few analysts and observers, particularly the anti-IMF proponents, have ever bothered to check what role the IMF programme played in assisting Zambia to establish macroeconomic stability and sustained economic growth during this period. Local commentators tend to look for global examples where the IMF left countries better off than it found them, forgetting to check in their own backyard. Even though we cannot attribute all or even a big part of Zambia's successful turnaround of yesteryear to the IMF as that is an empirical issue, it is important to be open-minded and hold the possibility that the IMF was probably an unsung silent hero that effectively supported Zambia's economic recovery story of the 1990s and early to mid-2000s.

- In 2011, Zambia graduated from a low-income to lower middle-income country. Thus, the ***country could now borrow commercially internationally***; and in quick succession, issued three Eurobonds totaling US$3 billion between 2012 and 2015. The borrowing was supposedly mainly to finance infrastructure development, but huge questions remain today about where within the domestic economy the proceeds of these debts were actually utilized and what economic returns they have yielded. With coupon rates ranging from 5.375% for the 2012 Eurobond worth US$750 million to 8.97% for the 2015 US$1.25 billion issuance, the issue of establishing the economic returns of commercial debts becomes quite salient.

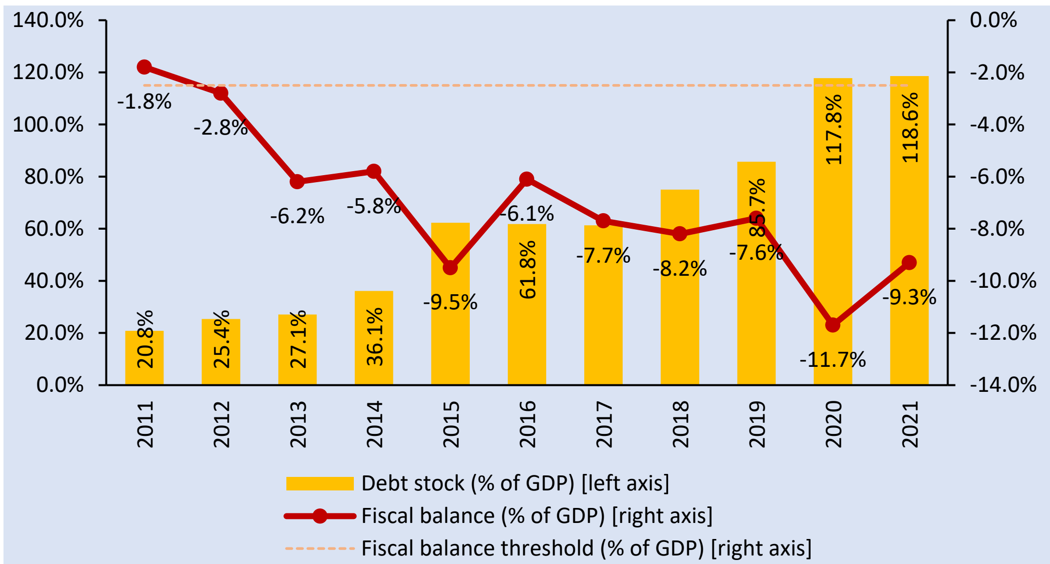
- In 2011, ***the spendthrift Patriotic Front (PF) political party took office in Government***. During the campaigns leading up to 2011, the PF had promised to "put more money in the pocket" for the poor and to drive an ambitious infrastructure-led development agenda. Essentially, a shift from a conservative fiscal policy stance to a persistent and often irrational and corruption-ridden expansionary fiscal policy position set Zambia on a path of excessive overspending and unrelenting borrowing, which ultimately became unsustainable.

2.2 Fiscal and debt statistics: where we came from and where we are now

From the foregoing, it is important to understand just how bad are things in Zambia on the fiscal stability and debt sustainability fronts? As they say: "*pali debt, ba PF bana tifaka ku-wire*!"

- **Deepening fiscal deficits:** Fiscal deficit is the shortfall in Government's revenue compared to its spending. It reflects the Government's preference to live beyond its means, essentially comprising the main pressure point for borrowing. Zambia's fiscal deficit under the PF regime increased from 1.8% of GDP in 2011 (the level inherited from the predecessor Movement for Multiparty Democracy (MMD) Government) to a striking 11.7% of GDP in 2020 (Figure 1). Some might argue – possibly rightly so – that the exceedingly deep deficit in 2020 was mainly on account of the macroeconomic effects of the COVID-19 pandemic; however, even before COVID-19, Zambia's fiscal deficit was substantially deep at 7.8% of GDP per year on average over 2015-2019 (compared to a rule-of-thumb stable fiscal deficit threshold of 2.5% of GDP).

Figure 1: Fiscal and debt indicators, 2011-2021



Note: statistics for 2021 are projections

Source: constructed from IMF and MOF data

- **Mounting public debt stock**: with the underpinning spending pressures over the past 10 years and the unyielding borrowing behaviour, Zambia's stock of public and publicly guaranteed debt stock increased from 20.8% of GDP (or US$4.9 billion) in 2011 to 85.7% of GDP (US$20.4 billion) in 2019 and 117.8% of GDP (US$23.5 billion) in 2020 (Figure 1).

- **Increasingly precarious debt composition:** the changing composition of the debt stock as it mounted, eventually caused debt distress for Zambia. Focusing narrowly on the 2019 public debt stock of US$20.4[ii], precarious external and domestic debt positions are observed:
  - **(i)** Out of an external debt stock of US$11.1 billion in 2019, 49% was commercial debt, with Bondholders holding 27% of commercial debt and other private commercial creditors holding 22%; and
  - **(ii)** The bulk of the domestic debt stock of US$9.3 billion was commercial considering that it was mostly in terms of Government paper (Treasury bills and bonds) which

was generally issued at much higher interest rates (yield rates) than the lending interest rates of commercial banks.

- **Diminished debt carrying capacity and escalating debt service**: a joint World Bank-IMF Debt Sustainability Analysis (DSA)[iii] reveals that Zambia's debt-carrying capacity weakened with its foreign reserves' import coverage declining from 4.7 months in 2015 to 1.7 months in May 2019. All four external debt burden indicators breached their indicative thresholds, three of them by large margins and throughout the medium-term under the baseline scenario of the DSA. In 2019, 2020 and 2021, the single budget item of *debt service* was estimated at 46%, 51% and 70%[iv] of domestic revenue, respectively[v].

- **Crowding out of social sector spending:** under the weight of mounting debt stock and huge debt service burden, ***social spending had already collapsed well before COVID-19***. For instance, in 2017[vi], the allocation to debt service in the National Budget was 14% of the budget. During execution of the 2017 Budget, 109% of the debt service budgetary allocation was funded, implying a 9-percentage point overspend on debt service. On the other hand, selected social spending areas (Pensions Fund, Social Cash Transfer (SCT), Water and Sanitation, Economic Empowerment and Rural Electrification spending combined) were allocated 5.03% of the 2017 Budget, but received far less their allocation, at 64% of the combined allocation. This implies a 36-percentage points underspending on the budget. In fact, Water and Sanitation only received a paltry 8% of its targeted allocation in 2017.

3. Arguments for an IMF programme

3.1 Precursor observations! an argument for the IMF

Before presenting the core arguments on the necessity and inevitability of an IMF programme for Zambia, it must be stressed that given the current circumstances, the country must inevitably make significant fiscal adjustments, with or without an IMF programme. However, without a Fund programme, the required fiscal adjustments will be more painful and stressful than with a programme. The reasons behind this argument are presented further below in relation to some of the points on the inevitability of an IMF programme for Zambia.

As a further precursor, it is important to correctly attribute the fiscal adjustment to their rightful sources of impetus. That is, a number of key fiscal adjustments have been variously recommended for restoring fiscal stability, including the following: **(a)** dismantling fuel and electricity subsidies; **(b)** reforming the Farmer Input Supply Programme (FISP) particularly fertilizer supply leakages and beneficiary targeting challenges; **(c)** addressing arrear payments to Government supplies of goods and services; **(d)** addressing VAT refunds to the mining houses in Zambia; **(e)** addressing the mounting public sector wage bill; and **(f)** protecting social sector spending during fiscal adjustment.

But who has recommended the above-listed adjustments? Anecdotally, several observers tend to attribute most of these fiscal adjustment requirements wholesome to the IMF. It is argued that fiscal adjustments are synonymous with the Fund's conditionalities on compulsory austerity or fiscal consolidation. Indeed, some commentators go so far as to claim that the IMF recommends fiscal consolidation to the extent of also forcing countries to constrain or reduce their social sector spending. This usually stems from the adverse experiences of most Sub-Saharan African countries who undertook the IMF and World Bank's Structural Adjustment Programmes (SAPs) of the 1990s and 2000s.

However, these attributions are erroneous based on the propagation of misinformation and can be quite misleading. For instance, in the IMF Articles of Agreement, the protection of social spending on critical and well-targeted programmes in the social sector is described as important for protecting vulnerable groups from adverse shocks. That is, ***these days, the IMF is explicitly highly supportive of protecting social sector spending during the process of fiscal consolidation***. It is therefore simply not true that an IMF programme, as part of its conditionalities, will forcibly require Zambia to reduce spending on social sectors; quite the opposite actually.

Similarly, other required fiscal adjustment, which have often been labeled as IMF conditionalities, are actually prior actions that professionals, policy-makers (even those from the previous PF Government) and other observers in Zambia and internationally generally view as necessary changes, with or without an IMF programme. For instance, the reform of the FISP is long overdue, not necessarily in terms of reducing the size of the programme's budgetary allocation but in terms of eliminating the corruption-related leakages such as fertilizer supply overpricing and addressing the illicit misallocation of resources to non-beneficiaries to the detriment of intended beneficiaries.

3.2 The core of why an IMF programme is necessary and inevitable

Finally, we turn our attention to the core issue: what are some of the key points regarding an IMF-supported economic programme, which make it both necessary and inevitable for Zambia?

- **IMF loan terms and conditions**: the terms and conditions of IMF loans are generally much more favourable than any commercial debt, including any debt rearrangements (such as Bond refinancing). The IMF uses the following three concessional lending facilities to provide support to low-income countries (LICs) like Zambia[vii]:

(i) Extended Credit Facility (ECF): Sustained medium- to long-term engagement in case of protracted balance of payments problems.

(ii) Standby Credit Facility (SCF): Financing for LICs with actual or potential short-term balance of payments and adjustment needs caused by domestic or external shocks, or policy slippages – can also be used on a precautionary basis during times of increased risk and uncertainty.

(iii) Rapid Credit Facility (RCF): Rapid financial support as a single up-front payout for low-income countries facing urgent balance of payments needs – possible repeated disbursements over a (limited) period in case of recurring or ongoing balance of payments needs.

All three lending facilities are concessional, i.e., while they have different maturities and grace periods, they are all currently interest free. Financing under the ECF and SCF carries a zero-interest rate at least through June 2021, with a grace period of 5½ years and 4 years, respectively, and a final maturity of 10 years and 8 years, respectively. The grace period and final maturity for RCF repayments are the same as for the ECF, i.e., 5½ years and 10 years, respectively. Through an IMF programme, Zambia would be able to replace expensive commercial loans (bearing coupon rates in the region of 5.36-8.97%) for cheaper (zero interest rate) moneys; the debt service savings would create significant fiscal space.

- **An IMF programme would unlock new money**: Zambia is eligible to a quota of approximately US$1.3 billion in new concessional loan money. This would be over and above the COVID-19 related SDR937.6 million (approximately US$1.3 billion) that was released to Zambia recently (in early September 2021). Any commercial debt rearrangement (e.g., refinancing of the US$750 million Eurobonds falling due in 2022) would not introduce any new money. It would simply rearrange the existing stock. This would not offer much extra Balance of Payment (BOP) support or fiscal space, especially compared to financing under an IMF programme.

- **IMF provides a very strong signal to the international community, unlocking pockets of finance and international goodwill**: The following examples emphasize this simple but powerful point:

(i) The G20 Common Framework of Official Creditors succeeded in establishing a moratorium, which covered part of Zambia's official debt for a period. This moratorium was possible because the IMF and World Bank weighed in and guided the establishment and implementation of the Common Framework.

(ii) Despite Zambia having hired financial advisors Lazard Frères and legal advisor White & Case, refinancing talks with Eurobond holder stalled in 2020, with the Bondholder citing, among other things, the agreement of a Fund deal between Zambia and the IMF as a pre-condition for negotiating with creditors. In other words, the Eurobond creditors suspended negotiations on debt restructuring until Zambia secures an IMF deal. In addition, when Zambia defaulted on its Eurobond debt service payments in late 2020, it is a widely held secret that the IMF stepped in to keep the creditors at bay, convincing them to holt the international arbitration process of recalling the principal amounts on all three Eurobonds totaling US$3 billion.

(iii) Multilateral and bilateral partners are on record that their future development finance to Zambian will depend on both good standing with them individually and on good standing with the IMF. This is especially important for securing budget support from various development partners, something that will not be granted without an IMF deal.

- **IMF is a highly competent technical assistant and strategic accountability partner**: the expertise of the IMF in economic management, governance, fiscal and debt rebalancing, macroeconomic stabilization, etc. will offer crucial support to Zambia going forward, given the recent history of significant economic mismanagement and weakening of economic institutions. For instance, on debt data integrity and reliability, it is well documented that the World Bank-IMF and Zambian authorities had serious disparities on debt numbers and therefore, on the understanding of the prospects for putting Zambia on a path of debt sustainability. Due to disputed numbers, some local economic commentators are still in denial today about Zambia's debt distress and unsustainability; IMF numbers are an effective counterbalance to these skewed arguments. ***An IMF programme thus presents important opportunities for realism in setting the debt records straight, transparency and mutual accountability, and technical assistant towards establishing fiscal and debt discipline***.

4. In closing…

Ultimately, an IMF programme is not meant as a panacea for Zambia's economic problem; however, it is a necessary element, among many others, for economic recovery. Economic recovery is not about finding sets of mutually exclusive policy options; it is about formulating and implementing a sequence of coherent complementary home-grown & external policies & programs. Of course, Zambia should not go to the IMF negotiating table with eyes closed or with a weak and poorly thought-out negotiating position. The country has experienced a lot, has learned a lot, including about its own self-destructive tendencies, and now has every opportunity to establish a strong strategic negotiating position and secure a reasonable deal, also riding on the domestic and international goodwill and strong political will. ***The right ingredients are in place for Zambia to move forward with an IMF-supported programme; the authorities must move forward with this and do so with haste***.

Reference and Notes

1[i] Zambia's last Fund programme was an Extended Credit Facility (ECF) – formerly Poverty Reduction and Growth Facility (PRGF)which was approved on 4th June, 2008 and expired on 29th June, 2011 having drawn down the full allocation of SDR 220.1 million
(https://www.imf.org/external/np/fin/tad/exfin2.aspx?memberkey1=1080&date1key=2021-08-31)

[ii] World Bank (2021) "International Debt Statistics 2021". Washington, DC: World Bank

[iii] World Bank and IMF (2019) "Zambia - Joint World Bank-IMF Debt Sustainability Analysis". World Bank, Washington, DC. © World Bank; and International Monetary Fund (IMF).
https://openknowledge.worldbank.org/handle/10986/32572

[iv] The 2021 projection assumes a scenario that reflects the outcome had the debt servicing suspension due to the default of November 2020 not happened.

[v] Nkulukusa, F. (2021) "Zambia's Public Financial Management", Presentation to the Political Party Training on Advocacy for Prudent Debt Management; Protea Chisamba Hotel, Chisamba, March

[vi] Statistics in the ensuing text were computed from the MOF Fiscal Tables for 2017 and the MOF 2017 Annual Economic Report.

[vii] https://www.imf.org/en/About/Factsheets/IMF-Support-for-Low-Income-Countries