Assessing the Social and Economic Implications of Zambia's Debt Management Reforms

Final
Report

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EXECUTIVE SUMMARY

In response to escalating debt challenges, Zambia initiated a series of debt management reforms, supported by a 38-month Extended Credit Facility (ECF) from the IMF, valued at US$1.3 billion. This program, which began in August 2022, is scheduled to conclude in 2025. These reforms, focused on restoring fiscal stability, restructuring debt, and improving public financial management, have played a critical role in mitigating Zambia>s debt distress risks while also exerting several socio-economic impacts.

Key outcomes of the reforms include a reduction in the pace of external debt accumulation, which decreased from a growth rate of 20 percent in 2017 to about 4 percent in 2023. Despite this slowdown, the stock of external debt has continued to rise due to ongoing disbursements for essential infrastructure projects, highlighting the challenges in achieving sustainable debt levels in the medium term. Additionally, the reallocation of resources toward high-priority projects led to the cancellation or rescoping of US$2 billion in non-essential projects, enhancing fiscal space for social sector investments.

On the economic front, the reforms have yielded mixed results. The increased fiscal space has allowed for higher spending on education, health, and social protection, contributing to long-term poverty reduction efforts. However, the removal of subsidies and implementation of cost-reflective pricing models have increased the cost of living, disproportionately affecting vulnerable populations, including women and rural communities. This has exacerbated existing inequalities and heightened the financial burden on the most disadvantaged groups.

The reforms have also shifted the government>s borrowing focus from external to domestic sources, resulting in a rise in domestic debt. This shift, while necessary for reducing external debt vulnerabilities, has led to the crowding out of the private sector due to increased borrowing costs, posing a risk to leading a private sector led economy.

On the social front, the reforms have also yielded mixed results with some respondents indicating improvements in the provision of social services such as health, education and social protection. Whereas, the reforms have also induced a heightened cost of living, reduced employment opportunities, increased poverty among vulnerable groups and also caused several operational challenges for businesses.

Therefore, although Zambia's debt management reforms are crucial for stabilizing the economy, they have also introduced socio-economic challenges that require careful management to ensure that the benefits of fiscal stability do not come at the expense of social equity. The government, therefore, must continue to balance fiscal discipline with targeted social spending to protect vulnerable populations and promote inclusive growth.

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SECTION 1: INTRODUCTION

1.1 Context

In 2019, the International Monetary Fund (IMF) raised the issue of Zambia's debt unsustainability status asserting that it enunciated as back as 2017, alongside identifying Zambia as potentially at risk of debt distress, prompting a call for more prudent debt management within the country. In response, Zambia has embarked on a series of economic and debt management reforms since August 2022, supported by a 38-month IMF Extended Credit Facility (ECF) totalling US$1.3 billion. It is widely perceived in the developing world that IMF-supported programmes impose stringent conditionalities that can have detrimental socio-economic effects on people's livelihoods. In recent times, there has been increasing criticism from numerous developing countries regarding the "structural adjustment reforms" prescribed by the IMF in the mid-1990s, particularly their failure to promote sustainable development.

Against this background, this study sought to assess the social and economic implications of Zambia's recent debt management reforms. This analysis aims to illuminate the effectiveness of these reforms in addressing the challenges Zambia's challenges related to public debt and in enhancing the country's fiscal sustainability and growth prospects.

1.2 Background

The IMF promotes international financial stability by providing financial support to countries hit by crises, with the aim of creating breathing space as they implement policies that restore economic stability and growth.[1] These crises occur in the form of balance of payment challenges, when a country is unable to pay for essential imports or service its external debt, as is the Zambian case. Others present themselves in the form of financial crises stemming from illiquid or insolvent financial institutions and fiscal crises caused by excessive deficits and debt.[2]

Broadly, the IMF provides three kinds of concessional lending facilities to Low-Income Countries (LICs) that need an IMF support program. i) Extended Credit Facility (ECF), which is a sustained medium- to long-term engagement for countries with protracted balance of payments challenges; ii) the Standby Credit Facility (SCF), which provides financing for LICs with short-term balance of payments and adjustment needs caused by domestic or external shocks, or policy slippages, it can also be used on a precautionary basis during times of increased risk and uncertainty; iii) the Rapid Credit Facility (RCF), which is a rapid financial support often acting as a single up-front payout for countries facing urgent balance of payments needs.[3]

From the time of its independence in 1964, Zambia has benefited from thirteen (13) lending commitments from the International Monetary Fund (IMF) with the first stand-by agreement taking effect in 1973. So far, Zambia has so far had six (6) Standby Arrangements, six (6) Extended Credit Facilities and one (1) Structural Adjustment Facility Commitment.

Like many other developing countries, Zambia reached the completion point of the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) debt relief programs and qualified for US$ 6.6 billion sovereign debt relief in 2005.[4] Following the US$6.6 billion of (HIPC, Word Bank, IMF, and Paris Club) debt relief, Zambia's public sector

1. *https://www.imf.org/en/About/Factsheets/IMF-at-a-Glance#:~:text=The%20International%20Monetary%20Fund%20%28IMF%29%20works%20to%20achieve,to%20increase%20productivity%2C%20job%20creation%2C%20and%20economic%20well-being.*
2. *ibid*
3. *https://saipar.org/wp-content/uploads/2021/09/Inevitability-and-Necessity-of-an-IMF-Supported-Economic-Programme-for-Zambia.pdf*
4. *https://www.researchgate.net/publication/354116880_Sovereign_debt_and_growth_in_Zambia_determining_the_tipping_point*

debt declined to 25% of GDP in 2006 from 104% in 2005.[5] During the immediate period after debt relief (2007-2010), the country's growth in public debt was slow and steady as the government remained cautious on borrowing whilst running small fiscal deficits averaging 1.6% of GDP per year. Consequently, GDP growth was also increasing at a much faster pace (8.9%), causing the debt-to-GDP ratio to further decline to 18.9% in 2010.[6]

Post the 2005 debt relief initiative, Zambia's goal was to maintain responsible and sustainable borrowing. However, the various economic gains and the shift to an expansionary fiscal public policy through infrastructure development after 2010 facilitated the rapid accumulation of debt and shift from concessional to non-concessional sources of finance. Between 2012 and 2015, Zambia had raised US$3 billion from the issuance of Eurobonds. The country also took advantage of infrastructure borrowing opportunities, and its state-owned enterprises would also borrow directly from lenders with explicit guarantees. Furthermore, significant borrowing from lenders such as China was also noted, making China, Zambia's largest single creditor.

The onset of the Covid-19 pandemic in 2020 exacerbated the already deteriorated economic fundamentals mainly due to escalated public debt levels.[7] This further pushed the fiscal deficit to 11.7% of GDP in 2020 leading to escalated debt servicing, diminished debt carrying capacity and crowding out of the social sector.[8]

According to the country's 2023 Debt Sustainability Analysis (DSA), the present value of external debt service to revenue peaks at 61 percent in 2024, significantly above its 14 percent threshold. Similarly, the present value of external debt service to exports ratio peaks at 26 percent in 2024 and is projected to remain above its 10 percent threshold until 2029. The report also shows a significant breach of the present value of public debt to GDP, which remains above the recommended threshold of 35 percent throughout the projection period. As such, Zambia's solvency and liquidity indicators (debt sustainability indicators) all showed that the country was at risk of debt distress.

1.3 Contextual Analysis

Zambia's deteriorated fiscal space resulting from its unsustainable debt burden necessitated the call for the country to undertake economic and debt management reforms supported by the IMF which are necessary for addressing balance of payment challenges and fostering economic stability. The economic and debt management reforms are anchored by the objectives of Zambia's IMF supported program which are as follows:

a. Restoring sustainability through fiscal adjustment and debt restructuring.

b. Creating fiscal space for social spending to cushion the burden of adjustment; and

c. Strengthening governance and reducing corruption vulnerabilities, including by improving

d. public financial management.

e. Strengthening monetary policy and re-rebuilding external resilience, safeguarding financial stability.

However, the implementation of IMF reforms has in the past yielded a mix of positive and negative outcomes. Some positive outcomes have included restoring economic growth, promoting social spending, promoting financial stability, and curbing inflation. On the other hand, some negative

5. https://openknowledge.worldbank.org/server/api/core/bitstreams/af390be8-c811-5567-b6bb-0445c89c9113/content
6. ibid
7. https://www.uneca.org/sites/default/files/MGD/INFFSept2022/Zambia%20Debt%20-%20Maryann%20Lumba%20Nkunika-Lwandamina%20En.pdf
8. https://saipar.org/wp-content/uploads/2021/09/Inevitability-and-Necessity-of-an-IMF-Supported-Economic-Programme-for-Zambia.pdf

outcomes include crowding out private investment, limiting economic opportunities for individuals, constraining fiscal policy flexibility during, and posing potential risks to social safety net programs. However, proponents of IMF supported programs have argued that the current reform program is based on Zambia's home-grown reform agenda. Nonetheless, there remains a critical need to comprehensively understand what the specific social and economic effects of implementing these reforms are in the country's current context.

4. General Objective

A thorough examination of the impact of Zambia debt and economic management reforms on key sectors such as poverty reduction, employment, and income distribution in addition to access to healthcare, education, and the adequacy of social safety nets.

1.4 Specific Objectives

i. Examine the specific debt management reforms that Zambia has implemented.

ii. Assess how the social and economic implications of the debt management reforms and explore their potential impacts.

iii. Assess the socio-economic impacts if Zambia had sustained expansionary fiscal policies without implementing reforms.

iv. Identify the challenges, opportunities, and lessons learned from the debt restructuring process in terms of economic stability, and social inclusion.

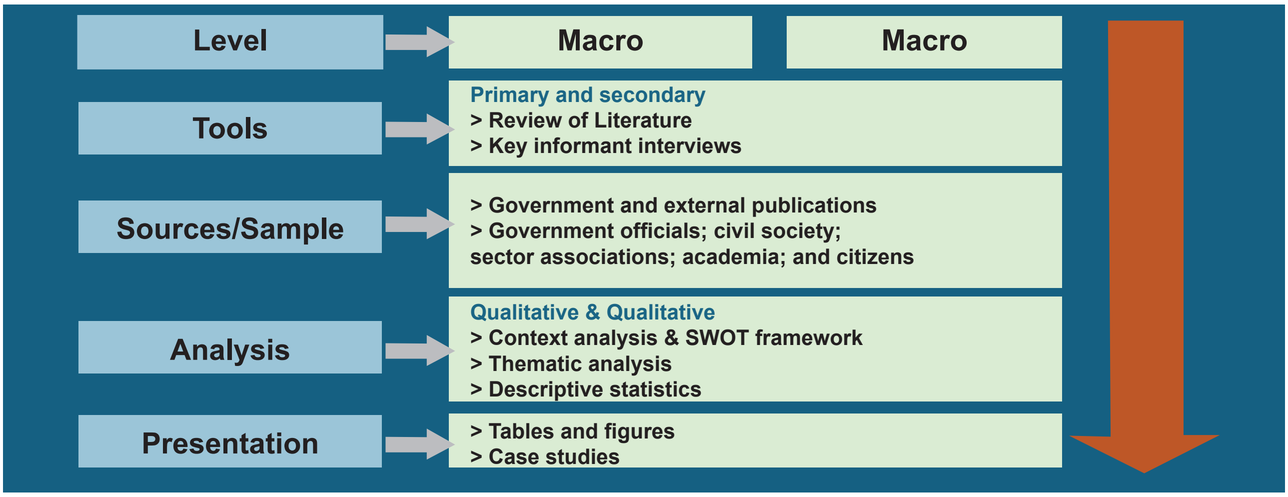
1.5 Limitation

The study was conducted during a period of severe drought, which impacted key sectors like energy and agriculture. The drought caused widespread load shedding, disrupting households, businesses, and essential services, while agricultural losses affected food availability and prices, adding economic strain. This introduced confounding factors that could influence findings on the social and economic impacts of debt management reforms. However, the debt management reforms span close to a three-year period which helps to mitigate this effect. This extended study period allows the analysis to account for variations over time, reducing the likelihood that drought-related challenges would significantly amplify or obscure the true effects of the debt management reforms.

SECTION 2: METHODOLOGY

As depicted in the graphical representation below, the study adopts a mixed-methods approach, integrating both macro and micro-level analyses to comprehensively evaluate the socio-economic impacts of Zambia's debt management reforms.

Figure 1: Research Methodology Framework



2.1 Data Collection

Data was collected from a variety of sources to ensure a representative sample that includes key stakeholders across different sectors. Secondary data was gathered through a comprehensive desk review of pertinent published documentation and reports. Purposive sampling was used to select government officials from relevant ministries such as the Ministry of Finance and National Planning, the Ministry of Community Development and Social Services, as well as representatives from civil society organisations, sector associations, academia, and the general populace. The strategy ensures that the study captures a broad spectrum of insights related to the economic and social implications of debt management reforms.

Simultaneously, primary data was gathered through focus group discussions and interviews, supported by structured, closed-ended key informant questionnaires which were shared virtually. This approach aimed to capture qualitative insights, perspectives, and experiences of stakeholders regarding the impact of debt restructuring. Focus groups included residents of Chawama Compound, traders at Lusaka's City Market, members of the Zambia National Marketeers Credit Association (ZANAMACA), bus drivers at City Market, the Online Taxi Drivers' Association of Zambia, and mobile money agents and operators at Novare Pinnacle Mall in Kabulonga, Lusaka.

2.2 Presentation of Results

Research findings have been presented using a combination of tables, figures, and case studies. Tables and figures summarise quantitative data and trends, while focus group discussions delve into specific instances of how the reforms have impacted different sectors and communities. The multi-faceted presentation approach ensures that the research findings are accessible and comprehensible to a broad audience, including policymakers, scholars, and the public.

2.3 Ethical Considerations

Ethical considerations are paramount in this research. All data collection and analysis adhere to the highest standards of research ethics, including ensuring confidentiality and informed consent of all participants. The integrity of data collection processes was rigorously maintained to ensure that all findings are accurate and responsibly reported.

SECTION 3: PRESENTATION OF KEY FINDINGS

Zambia's debt management reforms, supported by the IMF and based on its Eighth National Development Plan, aim to restore debt sustainability and improve transparency. Key measures include suspending non-concessional borrowing, cancelling or rescuing certain loan-financed projects, and prioritising concessional and domestic financing. The government has restructured much of its external debt under the G20 framework, focusing on reducing the debt burden while excluding domestic debt to maintain financial stability. Legislative improvements have been made through the Public Debt Management Act, enhancing oversight and accountability. Zambia is also implementing austerity and revenue reforms, including tax adjustments and subsidy removals, to bolster fiscal resilience and support economic growth, with the goal of improving debt indicators and reducing debt distress.

3.1 Zambia's Debt Management Reforms

Prior to the approval of Zambia's IMF supported reform program, the country proposed several debt management reforms anchored on the Eighth National Development Plan (8NDP) with the aim of restoring debt sustainability and improving debt management and transparency. These reforms are also tied to the country's structural benchmarks and quantitative performance criteria and indicative targets based on the September 2022 IMF Staff Report.

a. Suspension on the Contraction of Non-Concessional Loans

Over the past decade, Zambia's creditor landscape has shifted from traditional multilateral and bilateral creditors to include a growing number of non-concessional creditors, such as Eurobond holders and other private entities. This evolution has led to more complex debt structures, higher interest rates, and increased exposure to market fluctuations (Essl et al., 2019). Recognizing these risks, the government suspended the contraction of non-concessional public external debt in December 2019, opting to focus exclusively on concessional loans and domestic borrowing to manage debt sustainability.

b. Cancellation and Rescoping of External Debt Financed Projects

Government had also been dealing with significant amounts of contracted but undisbursed loans. According to the Ministry of Finance and National Planning, the stock of contracted but undisbursed external debt stood at US$4.02 billion at the end of 2021. As such, in 2020, the Government began undertaking an exercise to cancel and scale down some loan financed projects to reduce the stock of contracted but undisbursed loans. This strategy aims to reduce the number of non-essential projects and adjust the scope of ongoing projects to align with current fiscal priorities and economic realities. By doing so, Zambia intends to redirect resources to critical areas that can stimulate economic growth, enhance fiscal sustainability, and ultimately reduce the likelihood of debt distress. The affected projects were then scheduled to be financed through general budget revenues in a phased manner. Furthermore, as part of the prior actions of the IMF extended credit facility, the Government has published the list of loan financed projects whose implementation is intended to continue (IMF, 2023).

c. Asset Liability Management Exercise and External Debt Restructuring

Zambia embarked on an Asset Liability Management exercise, prompting the government to pursue the Debt Service Suspension Initiative (DSSI)[9] initially for six months, later extended to 12 months. Subsequently, the government secured approval for debt restructuring under the

9. *https://www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statement%20on%20Zambia's%20Public%20Debt%20Management%20Strategy.pdf*

G20 Common Framework, aiming to restore debt sustainability. So far, significant progress in restructuring has been made. The country has so far restructured 77 percent of its external debt including US$6.3 billion official creditor debt and US$3.9 billion Eurobond debt. What remains is to finalise the restructuring of the over US$ 3 billion worth of private creditor debt (23 percent of the restructuring parameter). As Zambia makes progress in its debt restructuring process, it subsequently resumes servicing its debt obligations at the restructured terms.

d. Exclusion of Domestic Debt from the Restructuring Perimeter

With the rise in Zambia's domestic debt and also being at high risk of debt distress during the COVID-19 pandemic period, its restructuring perimeter would have included domestic debt. Although restructuring domestic debt may offer a way of limiting the external reputational consequences of external debt restructuring and perhaps avoiding loss of access to external debt markets, it may also have its own adverse effects. For instance, domestic banks and pension funds disproportionally hold domestic rather than external debt (IMF, 2021).

As a result, sovereign stress due to domestic debt restructuring can easily spread to other parts of the economy, with potentially serious adverse effects on financial stability and economic activity.[10] Therefore, domestic debt was excluded from Zambia's debt restructuring perimeter. However, as the Government restructures external debt, it has since prioritised domestic debt financing for budget support in line with the medium-term debt strategy (2023–2025) (Ministry of Finance and National Planning, 2023).

e. Strengthening Public Debt Management

One contributing factor to Zambia's indebtedness was the weak legal framework governing public debt management, specifically the Loans and Guarantees (Authorisation) Act of 1969. According to Muleya et al. (2020) some of the weaknesses of this Act included insufficient oversight and accountability mechanisms, inadequate provisions for transparent reporting, and a lack of comprehensive debt management strategies. Furthermore, the LGAA was inadequate for managing the complexity and fast pace of Zambia's debt contraction. There was also a discrepancy between the LGAA and the Constitution regarding who holds the final authority in debt contraction, leading to conflicts. The Act also lacked clear provisions for reviewing the terms and conditions of loans, which were mostly determined by lenders. Finally, the LGAA did not clearly stipulate the purposes for borrowing and its definition of "public debt" was too narrow, hence, lacking legal clarity.

Therefore, it was clear that the country needed to strengthen its legal framework for public debt management to guard against future episodes of indebtedness. As such, in 2022, the LGAA was repealed and replaced with a new law the Public Debt Management Act (PDMA) No.15 of 2022. The new law provides for significant improvements aimed at addressing the deficiencies of the LGAA by enhancing the transparency of public debt, reinforcing parliamentary oversight over loan acquisition, and formalising public debt management operations.[11]

f. Limit the Accumulation of External Arrears to Contractors

Zambia accumulated significant external arrears totalling US$563 million to external suppliers working on projects with non-disbursing loans. Additionally, the delay in adjusting fuel pump prices to cost-reflective rates until mid-December 2021 also led to fuel arrears reaching US$597 million, including US$169 million in late payment interest by the end of December 2021. These arrears worsened the existing debt situation, impacting the national budget (IMF,

10. https://www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statements%20-%20Debt%20Restructuring.pdf
11. https://www.uneca.org/sites/default/files/MGD/INFFSept2022/Zambia%20Debt%20-%20Maryann%20Lumba%20Nkunika-Lwandamina%20En.pdf

2022). To address this, the government imposed a limit on the accumulation of external arrears and planned to dismantle both fuel and external contractor arrears by 2031 through budget allocations, pending an audit's outcome.

However, in the third IMF review under the country's extended credit facility, it was noted that fuel arrears escalated to US$897 million by the end of 2023,[12] Government will carry out a liability management operation financed through a loan denominated in U.S. dollars from domestic banks to achieve net present value gains. Besides achieving this, the operation will also shift external liabilities to domestic foreign currency liabilities for the government, mitigating the external debt sustainability risks caused by the drought shock.[13]

g. Implementation of Austerity Measures

The implementation of austerity measures supported by IMF, through an extended credit facility have primarily focused on fiscal reforms aimed at increasing revenues through tax policy reforms and improved revenue administration, and elimination of subsidies on petroleum products. The current reform program emphasises indirect taxation as a key part of its broader fiscal consolidation strategy. This approach involves streamlining and broadening the Value Added Tax (VAT) base, which is a significant component of indirect taxes. Government has also introduced a mobile money levy to be charged on all mobile money transaction. Furthermore, unifying the Corporate Income Tax (CIT) rate to around 25-30 percent, limiting VAT exemptions on unprocessed foodstuffs to specific items that figure prominently in the food basket of the poor, raising excises on tobacco and alcoholic beverages, and levying duties on sugar-sweetened beverages, cement, coal, single-use plastics, fertilizers and pesticides.[14]

In trying to improve revenue administration, the government through the Zambia Revenue Authority (ZRA) aims to improve tax audits and compliance management, enhance the use of electronic fiscal reporting, and matching tax and customs data on a regular basis.[15] Other

12. *https://www.elibrary.imf.org/view/journals/002/2024/190/article-A002-en.xml*
13. *Ibid*
14. *According to Zambia's IMF Country Report No. 22/292.*
15. *ibid*

measures include the removal of subsidies on petroleum products through the restoration of the cost-plus pricing model for petroleum products and the migration towards cost-reflective electricity tariffs. The cost-plus pricing model has seen the monthly revision of the petroleum pump prices.

h. Focus on Achieving High Levels of Economic Growth

As Zambia strives to restore debt sustainability and mitigate medium-term debt distress, it is crucial to strengthen measures aimed at boosting and diversifying exports and stimulating economic growth. Higher economic growth enhances revenue mobilisation through increased tax receipts, thereby enhancing levels of economic activity and ultimately raising GDP. This improvement enables better debt servicing without increasing tax rates and positively impacts debt sustainability indicators such as the debt-to-GDP ratio, debt service-to-revenue ratio, debt service-to-exports ratio, and external debt-to-GDP ratio. Ultimately, this will bolster investor confidence, leading to more favourable borrowing terms and lower interest rates.

As a brief manner of conclusion, Zambia's debt management reforms, supported by the IMF, aim to restore fiscal stability and reduce debt distress. Key actions include suspending non-concessional loans, restructuring external debt, and strengthening debt oversight laws. Through focused resource allocation, austerity measures, and economic growth initiatives, Zambia is working to reduce its debt burden and establish a more sustainable fiscal path for the future.

SECTION 4: ECONOMIC IMPLICATIONS OF DEBT THE MANAGEMENT REFORMS

This section presents the findings on the economic implications of debt management reforms, based on a desk review that utilized secondary data, including economic reports, statistical analyses, and government policy documents.

a. Reduced Pace of External Debt Accumulation

Following the suspension of the contraction of non-concessional loans, Zambia has continued to borrow concessionally from multilateral creditors such as the IMF, World Bank and Africa Development Bank but is monitoring its borrowing pace through the indicative target on the present value of new external concessional borrowing. As a direct result of this the Government's borrowing pace has slowed down. This can be seen from the growth in public debt as shown in figure 2. The growth in public debt reduced from 20 percent in 2017 to about 4 percent in 2023. The government is scheduled to continue the implementation of this measure until public debt sustainability is restored in line with the medium-term debt strategy. Despite the slowdown in the pace of debt accumulation, the stock of external debt has continued to rise.

Figure 2: Percentage Growth in External Public Debt

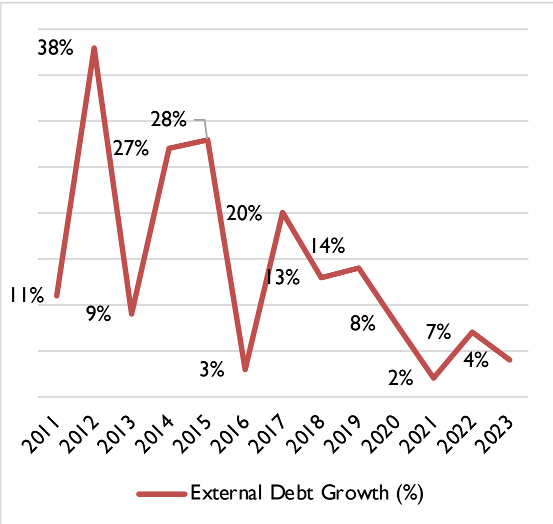
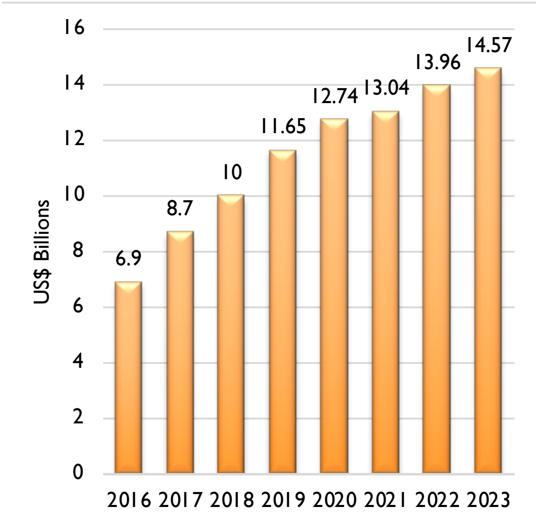


Figure 3: External Public Debt Stock



Source: Author's Computations using data from the Ministry of Finance and National Planning

As illustrated in Figure 3, since the government suspended the contraction of non-concessional external debt in 2019, the debt has increased from US$11.65 billion to US$14.57 billion in 2023, reflecting a 25 percent rise in the external debt stock. This increase is primarily due to continued disbursements from multilateral and some bilateral creditors to finance ongoing priority infrastructure projects (Ministry of Finance and National Planning, 2023).

b. Re-allocation of Resources Towards High-Priority Projects

Several non-priority external debt financed projects have been cancelled and rescoped amounting to US$1.1 billion and US$280 million, respectively (IMF, 2022) as presented in figure 4. Furthermore, according to Zambia's medium term budget plan (2022 - 2024), in 2022, additional non-priority loan financed projects were cancelled in line with the Government's capital expenditure programme. The entire exercise resulted in the cancellation of 12 projects.

Meanwhile, 6 projects were continued under financing from general Government revenues and 61 priority projects were to continue through concessional financing. This resulted in US$2 billion worth of savings equivalent to 48 percent of the total amount of loans. This was going to reduce total expenditure from 37.1 percent of GDP in 2022 to 35.5 percent of GDP by 2024, hence contributing to the country's fiscal consolidation (Ministry of Finance and National Planning, 2022).

Figure 4: Cancelled Non-Priority External Debt Financed Projects

	PROJECT NAME	LENDER	IMPLEMENTING AGENCY
1	Smart Zambia Phase III	Exim Bank of China	Cabinet Office (Smart Zambia Institute)
2	Medical Equipment Purchase	Lily-Peck International FZE	Ministry of Health
3	FTJ Luapula University	Industrial Commercial Bank of China	Ministry of Education
4	Supplies to Zambia Police	Paramount Limited	Ministry of Home Affairs and Internal Security
5	Rehab of Urban Roads Phase III	Exim Bank of China	Ministry of Housing, Infrastructure and Urban Development
6	Selected Township Roads on The Copperbelt	Exim Bank of China	Ministry of Housing, Infrastructure and Urban Development
7	Upgrading of 122 Kilometers Kawambwa-Mporoko Road	Exim Bank of China	Ministry of Housing, Infrastructure and Urban Development
8	Lusaka-Ndola Dual Carriage	Jiangxi Corporation	Ministry of Housing, Infrastructure and Urban Development
9	Digital Terrestrial Television Broadcasting Systems In Zambia Phase II and Phase II	Exim Bank of China	Ministry of Information and Media
10	Elbit $400m - Ashra Loan	Israel Discount Bank	Ministry of Defence
11	Elbit - Hermes Facility B	Israel Discount Bank	Ministry of Defence
12	Selected Urban Roads L400 In Lusaka	Exim Bank of China	Ministry of Housing, Infrastructure and Urban Development

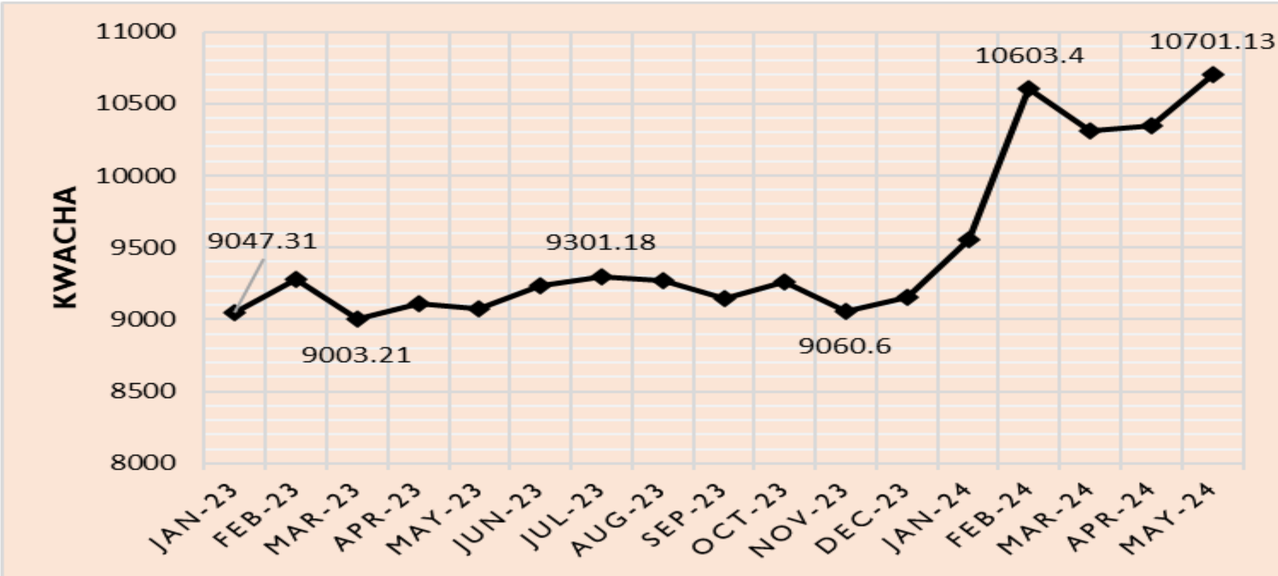
Source: Ministry of Finance and National Planning

Meanwhile, the continuing 61 priority projects through concessional financing indicates a strategic reallocation of resources towards high-impact, essential infrastructure and development projects necessary to foster public service delivery. However, the cancellation of certain projects entails a compromise in the quality of public service delivery, especially in rural areas where the need is greater.

c. Increased Cost of Living

According to the Jesuit Centre for Theological Reflection (JCTR), the Basic Needs and Nutrition Basket (BNNB),[16] reveals an increase in the cost of living for a family of five in Lusaka. The monthly cost rose by K1,653.82, from K9,047.31 in January 2023 to K10,701.13 by May 2024, as illustrated in Figure 5. This upward trend has been mirrored in other towns across Zambia, although the costs in these areas are generally lower than in Lusaka. Furthermore, the drought has also contributed by affecting over 8 million people, with approximately 6 million at risk of food insecurity, significantly impacting the country's most vulnerable populations.[17]

Figure 5: Cost of Living, Basic Needs and Nutrition Basket - Lusaka



Source: Author's construction using data from the Jesuit Centre for Theological Reflection (JCTR)

d. Enhanced Fiscal Space for Social Sector Spending

The cancellation of several non-priority projects coupled with Zambia's debt restructuring agreements characterised by extended maturities and reduced interest rates, have contributed to enhancing fiscal space. For instance, without debt restructuring, Zambia would have been required to pay US$6.3 billion between 2023 and 2031. However, with the restructuring agreement, payments to official creditors have been significantly reduced to US$750 million over the same period.[18] In the same vein, the agreement with bondholders reduces what Zambia will spend on servicing this debt from US$ 3.98 billion to US$3.05 billion, cancelling the unpaid interest of US$840 million. This further unlocks potential savings of US$840 million and creates an additional US$2.5 billion worth of cash flow during Zambia's IMF program. These measures have freed up resources for enhanced social sector spending as illustrated in figure 6.

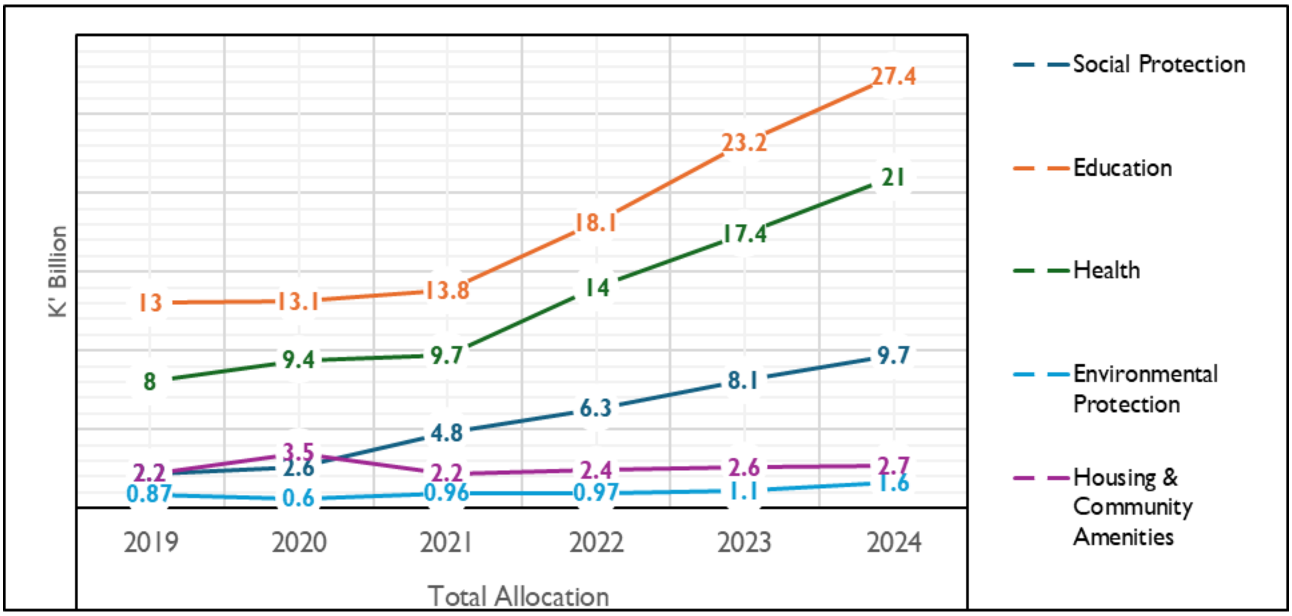
16. https://jctr.org.zm/jctr-thematic-areas/cost-of-living/bnnb/
17. https://www.unicef.org/zambia/press-releases/un-coordinator-el-ni%C3%B1o-and-unicef-regional-director-call-international-solidarity
18. https://www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statements%20-%20Debt%20Restructuring.pdf

The total budget allocations to education, health, social protection, environmental protection, and housing and community Amenities reflect a prioritisation of these sectors. The substantial increases in expenditure in these areas was necessary to address the immediate social and economic challenges in the country and improve overall quality of life for citizens. These increases in social sector spending have led to enhanced investments in programs such as the Social Cash Transfer, Home-Grown School Feeding, and the Food Security Pack which have seen expanded coverage and increased transfer amounts.

Furthermore, the Public Welfare Assistance Scheme (PWAS) and the Farmer Input Support Program (FISP) have been enhanced to benefit more small-scale farmers. Additionally, the government is now able to provide free education and also employ more education and health workers to enhance public service delivery. However, the relatively low and stable spending on environmental protection and housing and community amenities suggests that these areas may not be receiving the necessary attention from the Government, potentially posing risks to long-term development.

When these total allocations are expressed as a percentage of the annual budget, social protection, health and education expenditures show an upward trend as shown in figure 7. Social protection increases from 4 percent in 2021 to 5.4 percent in 2024, before a projected slight decline to 4.6 percent by 2026. Education spending equally peaks at 15.4 percent in 2024 but is projected to average around 15 percent by 2027.

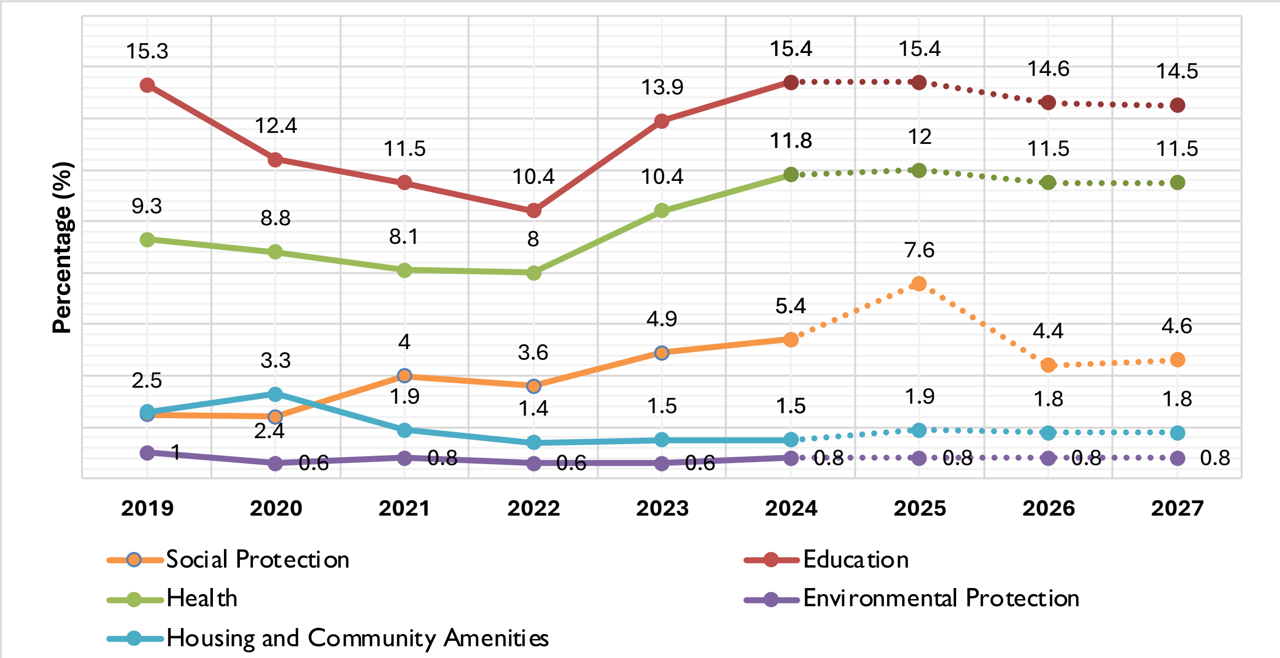
Figure 6: Total Sector Budget Allocations (K' Billions)



Source: Author's Computations using data from the Ministry of Finance and National Planning

Health spending also grows, reaching 11.8 percent in 2024, but is expected to slightly decrease to 11.5 percent by 2027. In contrast, expenditures on environmental protection and housing and community amenities remain low and stable, suggesting these areas may not be prioritised in the budget.

Figure 7: Projected Social Sector Spending (% of the Budget)



Source: Author's Computations using data from the Ministry of Finance and National Planning

Despite the initial increases in social protection, health, and education expenditures, projections indicate a slight decrease in allocations by 2027. This suggests that, in the medium term, budget allocations will still fall short of regional and global commitments, such as the Abuja Declaration on health spending and the Incheon Declaration and Framework for Action, which call for at least 15 percent of the budget to be allocated to health and education, respectively.

e. Increase in Domestic Debt and Its Crowding-Out Effect on the Private Sector

Despite the country's growing external debt, domestic debt has also been on the rise. Both Treasury Bills and Bonds have seen substantial increases in value over the period from 2016 to 2023 as illustrated in figure 8. The government has relied more heavily on long term securities (bonds) in recent years, to reduce the risks associated with frequent refinancing of short-term securities (treasury bills). This has coincided with the government's medium-term ambition of leaning more to domestic debt to close the financing gap. As such, the exemption of domestic debt from Zambia's debt restructuring perimeter has limited the domestic financial sectors' exposure to the adverse effects of restructuring. This is because a significant proportion of Zambia's domestic debt is in the form of Government securities mostly held by commercial banks and pension funds such as the National Pension Scheme Authority (NAPSA) (IMF, 2023).

Figure 8: Domestic Debt Composition, K' Billion

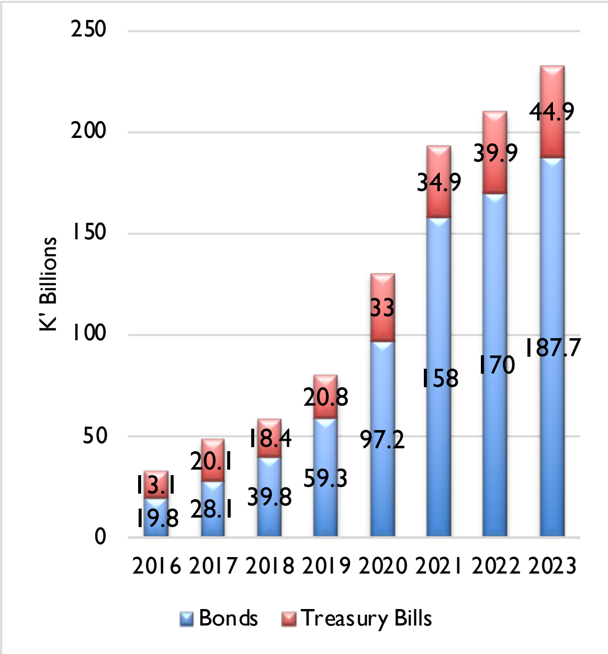
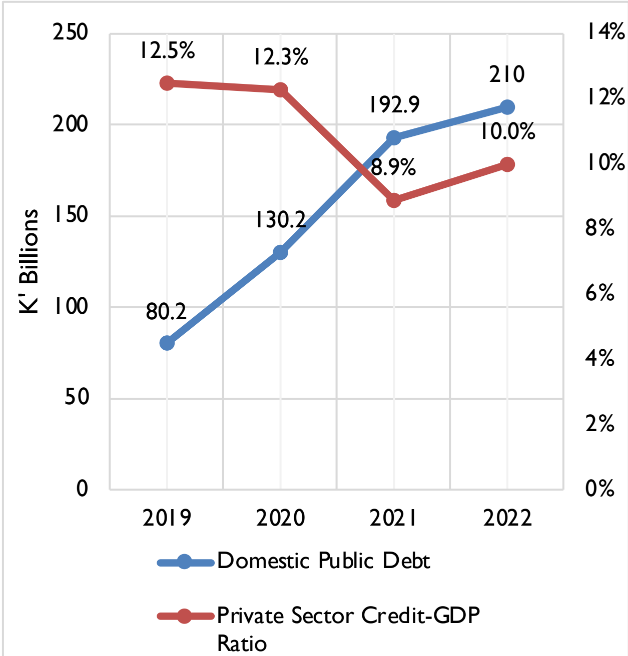


Figure 9: Domestic Debt and Private Sector Credit



Source: Author's Computation using data from Bank of Zambia

However, in trying to reduce its reliance on external financing due to risks such as exchange rate volatility that tend to balloon a country's debt burden, the government is gradually increasing the share of domestic debt in the country's annual financing needs.

This will be done by gradually growing the domestic market to move from the initial 70:30 of external and domestic financing, 55:45 in 2024 and 45:55 in 2025 respectively (MoFNP, 2023). Be that as it may, this shift has also been countered by the country's structural challenges. For instance, as at the end of July 2024, the Bank of Zambia had recorded major under subscriptions in both treasury bills and bonds this year.[19] The Bank only managed to raise K25.32 billion from a target of K41.9 billion, indicating almost 40 percent under subscriptions. This poses potential risks for budget support and refinancing maturing securities.

Furthermore, as government borrowing from the domestic market has increased significantly, rising from K80.2 billion in 2019 to K210 billion in 2022, loans from the financial sector to the private sector have declined as a percentage of GDP, dropping from 12.5 percent in 2019 to 10 percent in 2022, as shown in Figure 9. This trend suggests that the increase in public domestic borrowing may be crowding out the private sector, making it more challenging for businesses to access the credit needed for investment and expansion.

f. Partial Implementation of the Public Debt Management Act Amid Persistent Debt Sustainability Challenges

To strengthen public debt management, the Government has repealed and replaced the Loans and Guarantees (Authorisation) Act with the Public Debt Management Act. While not without its limitations, the new Act has made significant progress in enhancing transparency, parliamentary oversight, and accountability in public debt management. This is essential in reducing the likelihood of future debt crises which often have adverse socio-economic implications and usually demand expenditure cuts to critical social sectors, negatively affecting the provision of social services and safety nets. As such, economic woes are exacerbated,

19. https://www.boz.zm/bonds-tender-results.htm

inequalities deepened, and growth prospects crippled.

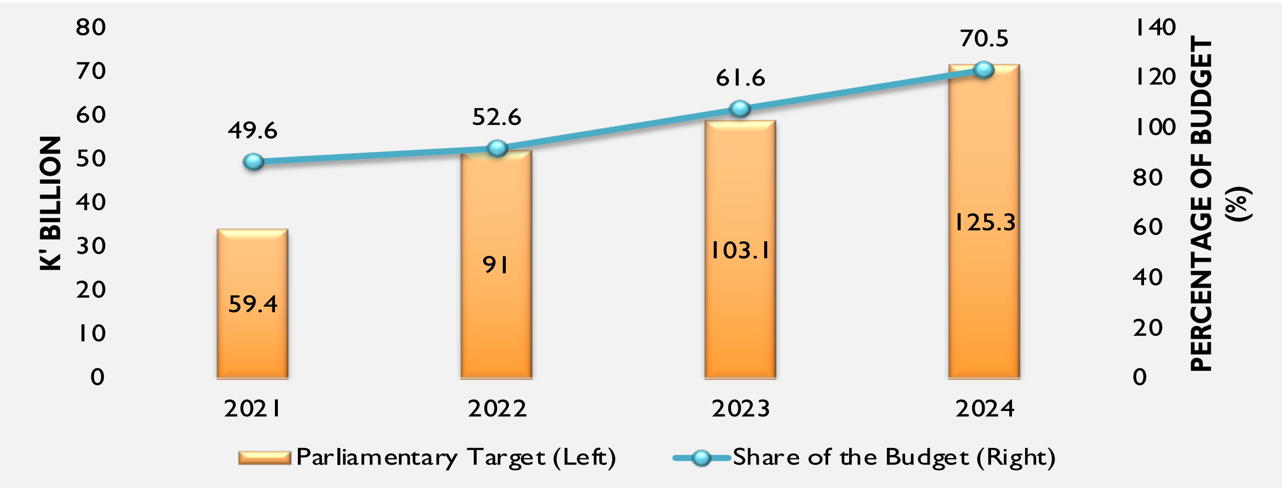
Although several provisions of the Act are currently being implemented, such as the presentation and publication of several publications such as the annual borrowing plans, medium term debt strategy, public debt reports and bulletins, and debt sustainability analyses. The Act is yet to be fully implemented pending the finalisation of its operationalisation guidelines. Furthermore, inadequate technical capacity and limited stakeholder consultations prevent Parliament from effectively fulfilling its oversight role. Members of Parliament find it challenging to understand the cash flows, projections, and quantitative parts of the annual borrowing plans and the Act itself (National Democratic Institute, 2023).

Therefore, even with enhanced debt management, Zambia is still far from achieving its fiscal rules as enshrined in the Public Debt Management Act and its debt sustainability thresholds. According to Zambia's Debt Sustainability Analysis (2023), the present value of external debt service to revenue peaks at 61 percent in 2024, significantly above its 14 percent threshold. Similarly, the present value of external debt service to exports ratio peaks at 26 percent in 2024 and is projected to remain above its 10 percent threshold until 2029. The report also shows a significant breach of the present value of public debt to GDP ratio, which remains above the recommended threshold of 35 percent.

g. Positive Revenue Performance

The various tax policy reforms and efforts to improve revenue administration have contributed to a positive performance of revenues. According to the Zambia Revenue Authority (ZRA), the country's reliance on domestic revenues has grown over the past four years as can be seen from the increase in both the target set by parliament and revenue as a share of the budget. Over the past five years, the country's revenue target has grown by an average of 19.4 percent. Notably, in 2022, the target saw an exceptional increase of 53.3 percent in the revenue target as illustrated in figure 11.

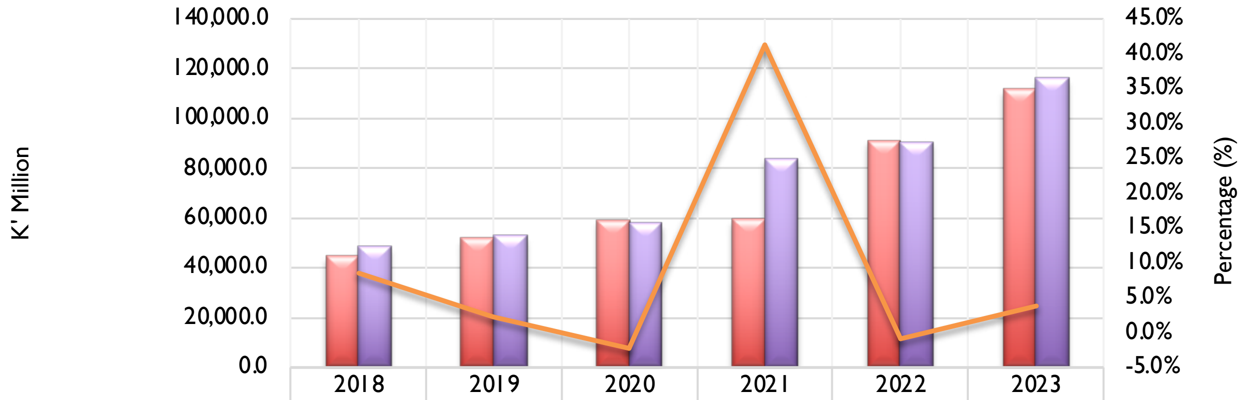
Figure 10: Domestic Revenue Performance



Source: Author's Computation using data from Zambia Revenue Authority

Over the same period, revenue performance has averaged 9.8 percent above the target. However, this average is influenced by an outlier in 2021 underpinned by over collection of taxes especially from the mining sector due to buoyant copper prices. Otherwise, without the 2021 performance, the average revenue achievement is approximately 2 percent above target.

Table 11: Performance of Domestic Revenue Target vs Out-turn



	2018	2019	2020	2021	2022	2023
Revenue Target	44,667.5	51,844.2	59,037.5	59,369.2	91,035.0	111,643.3
Revenue Out-Turn	48,459.4	52,968.6	57,665.1	83,915.2	90,345.9	116,055.3
% Variance	8.5%	2.2%	-2.3%	41.3%	-0.8%	3.8%

Revenue Target Revenue Out-Turn % Variance

Source: Author's Computation using data from Zambia Revenue Authority

The government's policy is to raise tax revenue to over 21 percent of GDP in the medium term from the current average of 18.1 percent. However, factors such as widespread informality, low compliance rates, fraud and tax evasion, limited access to and use of third-party data, and an inaccurate taxpayer register have contributed to challenges in achieving this goal.[20]

20. *This is according to a presentation made by the ZRA Commissioner General during the 2023 quarter three and budget review meeting.*

SECTION 5: SOCIAL IMPLICATIONS OF THE DEBT MANAGEMENT REFORMS

To gain a comprehensive understanding of the social implications of Zambia's debt management reforms, data was collected using two primary methods: an online questionnaire and focus group discussions. The online questionnaire was circulated and received 158 responses. This provided quantitative data from a broader demographic, allowing for a broader analysis of the impacts of the reforms on various segments of the population.

Meanwhile, the focus group discussions were conducted with residents of Chawama Compound, traders at Lusaka's City Market and members of Zambia National Marketeers Credit Association (ZANAMACA), Bus drivers at City Market, Online taxi drivers' association of Zambia, mobile money agents and operators at Kabulonga's Novare Pinnacle mall in Lusaka.

The demographic profile of the respondents to the online questionnaire shows a majority representation from the 25–34 age group, with 75 respondents, followed by those in the 35 – 44 and 18 – 24 age ranges, comprising 39 and 15 respondents respectively as illustrated in figure 12. In term gender disaggregation, figure 13 shows that there was a higher proportion of male respondents at 70 percent compared to females' 30 percent.

Figure 12: Age Profile

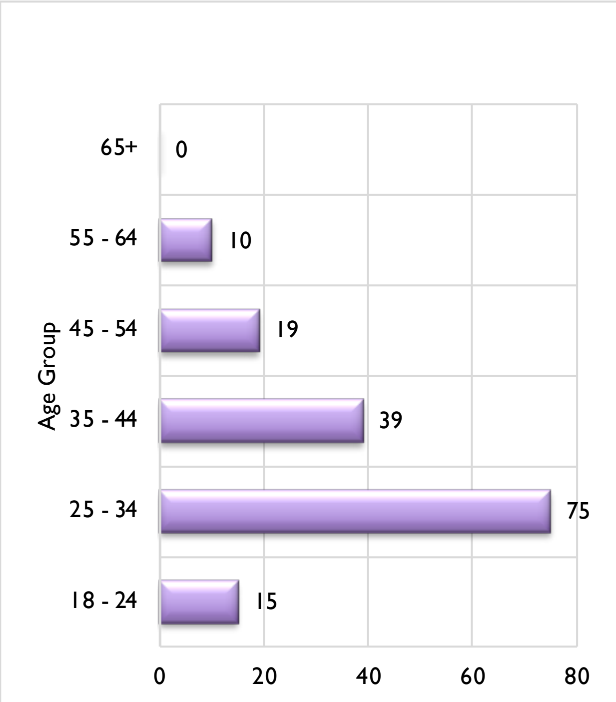


Figure 13: Gender Profile

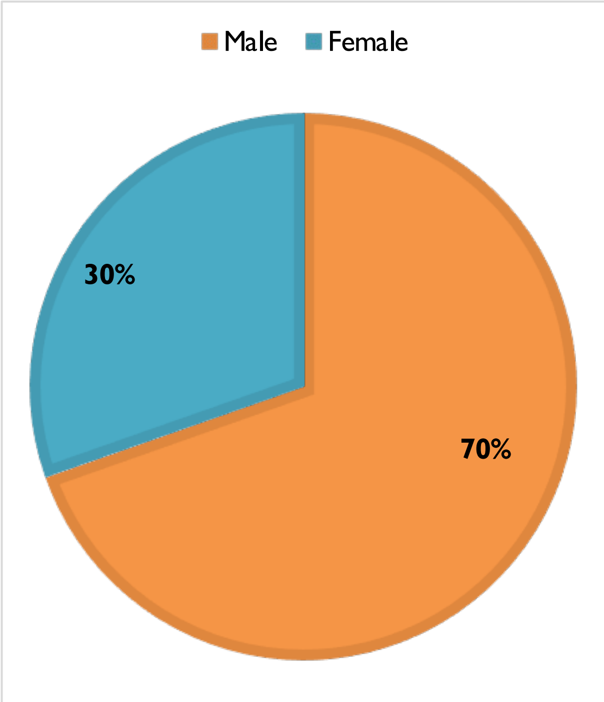


Figure 14: Geographical Location

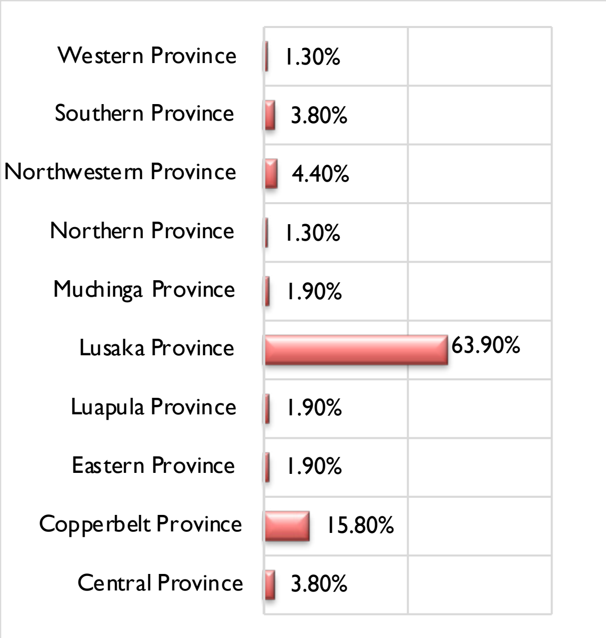


Figure 15: Economic Activity

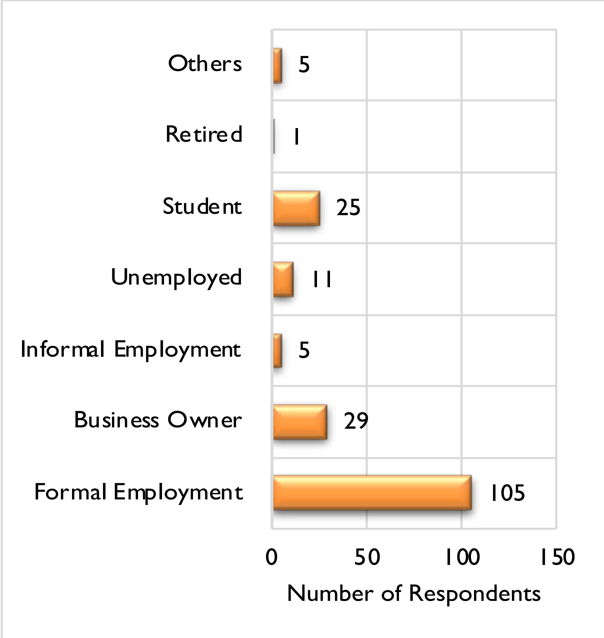


Figure 14 shows that geographically, most respondents are from Lusaka Province (63.9%), with Copperbelt Province accounting for 15.8% of the respondents, while other provinces such as Central, Southern, and Northwestern are less represented. In terms of economic activity, most respondents are engaged in formal employment (105), followed by business owners (29), and students (25). In terms of economic activity of the respondents, figure 14 shows that a smaller number are involved in informal employment (5) or are unemployed (11). The summary of this demographic profile confirms the diverse perspectives captured. This diversity enables a broader understanding of the social and economic issues impacting different segments of the population.

Figure 15: Awareness of Reforms

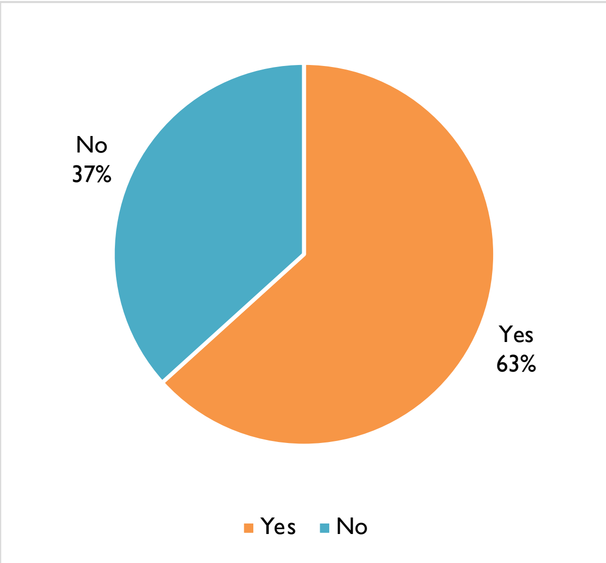
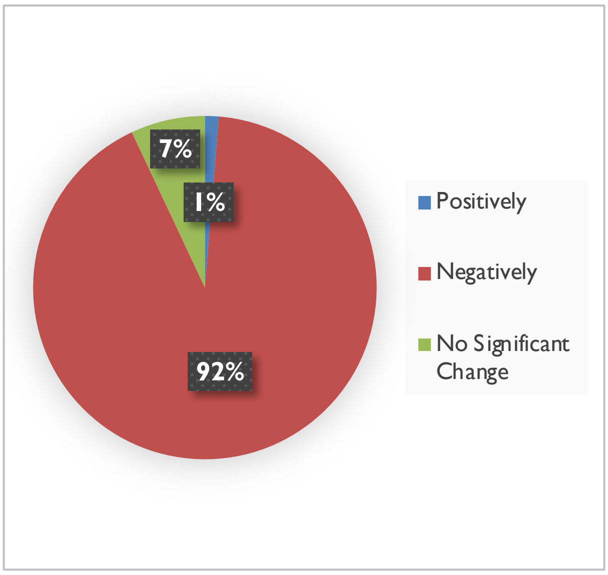


Figure 16: Effect on Livelihoods



In terms of awareness, figure 16, suggests that 63.2 percent of the respondents are aware about Zambia's debt management reforms with 36.8 percent not having an idea of these reforms. This shows that most respondents are aware of the debt management reforms. An overwhelming 91 percent of respondents indicated that the reforms have negatively impacted their livelihoods, with only 8 percent seeing no significant changes, and a mere 1.4 percent reporting positive effects.

The following where the key issues highlighted by respondents:

i. Improvements in Access to Healthcare and Education

Respondents reported improvements in access to healthcare access especially in urban areas particularly through the National Health Insurance Management Authority (NHIMA), even though challenges like shortage of medicines in public hospitals and the high cost of accessing essential services were frequently noted in some areas. Other respondents also noted the positive impact of free education as there were mentions of increased access to government education including scholarships and bursaries. This has eased the financial burden on many families and students. Additionally, the recruitment of more teachers has also gone a long way in reducing the pupil-teacher ratios which have previously been very high. However, issues of overcrowding in classrooms and long distances to schools remains predominant challenge especially in rural areas.

ii. Increased Cost of Living

One of the main implications noted by the respondents is the rise in the cost of living particularly the rising prices of goods and services, higher and unpredictable prices of fuel, increased utility costs and transportation, which have led to significant financial strain on households. This has impacted their ability to meet basic needs such as food and shelter. According to one member of a focus group formed at City Market in Lusaka, who is a mother of three and also widow noted:

In recent months, I have faced significant challenges in making ends meet due to the rising cost of living. I am struggling to afford even necessities like mealie meal to feed my children. I have also been unable to send them to college or university because the cost of everything has increased. My business has also slowed down, as my customers are also affected by the high cost of living and are finding it difficult to make purchases. If my father hadn't left me a house, I do not know where I would have been living with my children"

After interacting with a focus group formed in Chawama compound in Lusaka, several participants indicated that: "The cost of living keeps increasing and this had made it difficult for them to sustain themselves and their families. They stated that even basic commodities such as a "pamela" (a common term for a small portion of mealie meal packages in a small plastic bag) have had their prices go up. It is very difficult to survive especially for single headed households by women. Some of them work in industries located in the outskirts of Lusaka, but with the increase in transport fares, it is difficult to balance between feeding the family at home and paying for transportation to work. Some have even tried to start small businesses, but there is a general feeling that there is no money in the economy and as a result, making sales is often challenging"

iii. Reduced Employment Opportunities and Household Income

Respondents reported reduced employment opportunities and decreased household incomes as a result of the challenging economic environment. This has affected both formal employees and informal business owners in urban areas, making it harder for them to sustain their livelihoods. Some respondents observed that although the government has employed a number of education, health and defence workers, there are still a number of people, especially youths who are still unemployed.

Furthermore, the challenging economic conditions, such as increased fuel prices and erratic supply of electricity have also led to the loss of nonessential jobs, especially in industries where a number of people hold informal jobs. However, some respondents noted that there have been some positive developments in community infrastructure, such as the construction of new schools and health centres, employment opportunities and the formation of cooperatives created through government programs linked to the constituency development fund.

Respondents from a focus group in Chawama Compound emphasized the increasing difficulty in finding jobs. Many people who once worked in industries have been laid off, primarily due to the rising cost of production, but also largely because of the ongoing electricity crisis in the country. This has significantly reduced household incomes as people are no longer earning, making it challenging to provide for families. Additionally, children who have completed secondary school are also struggling to find employment. As a result, many are turning to drug abuse and illicit activities, commonly referred to as "junkies" in the community.

iv. Increased Poverty Levels among Vulnerable Groups

A significant portion of respondents (36.8 percent) reported knowing a beneficiary of a social protection program. They highlighted that vulnerable groups, especially women, children, and the elderly, are experiencing increased poverty and food insecurity, with limited access to social safety nets such as Social Cash Transfer (SCT) program, Home-Grown School Feeding, the Food Security Pack (FSP) and the Farmer Input Support Program (FISP). Some respondents acknowledged improvements in social safety nets, including the SCT program aimed at supporting the elderly and low-income families, and empowerment initiatives under the Constituency Development Fund (CDF) which are important for women and youth empowerment. Others also noted that the skills development scholarships provided under CDF are also helping some youths although the provided opportunities are limited. However, despite the increase in transfer amounts for programs such as SCT, the main concern was the delays experienced in disbursements in some areas and challenges in the targeting of beneficiaries.

v. Operational Challenges for Business Owners, Operators and Trader

Responses from those who own businesses indicate that 28.1 percent, provide services such as salons, barbershops, and transport services. Additionally, 18.8 percent are involved in retail businesses, while 7.8 percent operate in financial services, such as mobile money, or own market stands.

Business owners and operators continue to face rising operational costs due to high fuel and electricity prices, depreciation of the kwacha and reduced money supply. The situation has been exacerbated by the current drought which has caused severe load shedding in the country. Therefore, to keep their business going, some informal businesses such as barbershops, saloons and printing shops have had to either work extra hours or utilize alternative energy sources such as electric generators which tend to be very costly to operate. One member of a focus group formed at City Market in Lusaka who runs a barber shop noted:

“My business has really been affected by a lot of things, especially load shedding. If you check around town center, there is no shop or mall with electricity, we don’t even know when electricity will be restored. The biggest challenge is that even if we have to use generators, the cost of fuel is very high. It will be unsustainable to run my business. Due to this, I haven’t even been able to pay rent for my shop this month.”

Transport operators such as bus drivers and online taxi drivers also noted that the increase in fuel has adversely affected their operations making it difficult for them to meet their cashing targets. One respondent from a focus group of online taxi drivers who is also a yango driver in Lusaka remarked:

"The high fuel prices have had a negative impact on us drivers. One of the biggest challenges is that even when the government adjusts fuel prices at the end of the month, Yango does not increase ride prices to account for the rising fuel costs or the required float for us to get rides. Additionally, vehicle owners do not adjust our targets when fuel prices increase. For example, regardless of whether fuel prices go up or down, my weekly cashing target remains K2,000. However, when fuel prices rise, I sometimes only make around K1,800, making it difficult to meet my cashing target and cover my personal expenses. At times, I even have to use part of my salary to reach the cashing target."

The harsh economic environment usually does not favor traders and owners of small businesses as they may lack access to affordable finance. A respondent from a focus group of traders at City Market in Lusaka, who is also a member of the ZANAMACA noted:

“Traders often experience challenges in accessing credit to expand and sustain their business, with high interest rates and unavailability of cheaper loans. As a result, many traders do not have a fallback plan when their businesses face challenges, like now when the economic environment has made businesses very slow.”

Lastly, some of the austerity measures implemented by Government include the introduction of a mobile money levy. A focus group of mobile money operators and agents at Kabulonga’a Novare Pinnacle mall noted:

“The introduction of the mobile levy has significantly increased withdrawal charges, which has, in turn, reduced our commission rates. For example, before the levy was introduced, I would earn K100 from a K20,000 transaction, but now I only make about K50 from the same transaction. If this trend continues, our commissions will remain low, making it difficult to meet our financial needs, especially with business being slow and no money in circulation."

In summary, the responses from the focus group discussions and the virtual questionnaire highlight Zambia’s socio-economic landscape which has been shaped by both positive reforms and significant challenges. While improvements in healthcare access, free education, and infrastructure have provided tangible benefits, issues such as rising living costs, reduced employment opportunities, and operational difficulties for business owners remain prevalent. Vulnerable groups, including women, children, and the elderly, continue to experience increased poverty levels, with social protection programs struggling to meet demand in some areas.

SECTION 6: IMPLICATIONS OF SUSTAINING EXPANSIONARY FISCAL POLICIES WITHOUT REFORMS

As a point of departure, it suffices to have a bird's eye view of what this chapter looks at. This chapter is cognisant of the historical considerations at play. In recent years, Zambia has grappled with the consequences of sustained expansionary fiscal policies, raising critical questions about the long-term impacts of such approaches in the absence of essential structural reforms. The reliance on increased government spending and borrowing, while initially aimed at stimulating economic growth and addressing pressing social needs, has often led to detrimental outcomes, including deteriorating fiscal space and a burgeoning debt crisis.

Without strategic reforms, the implications of these policies extend far beyond mere fiscal imbalances; they encompass social unrest, inflationary pressures, and a stifled private sector, ultimately hindering Zambia's potential for sustainable development. This analysis will explore the multifaceted consequences of maintaining expansionary fiscal policies without implementing necessary reforms, highlighting the resulting economic and social challenges that threaten the nation's stability and growth prospects. By examining these dynamics, we aim to underscore the urgent need for comprehensive reforms to establish a resilient fiscal framework capable of supporting long-term development and alleviating poverty in Zambia. The following are points of consideration highlighted in this chapter:

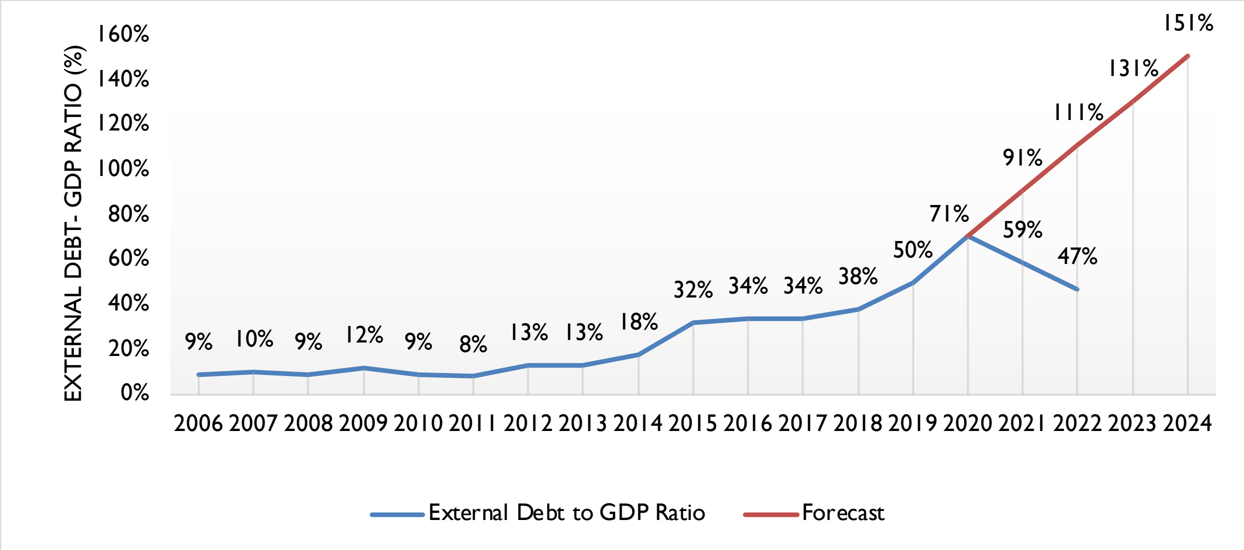
a. Deteriorating Fiscal Space and Reduced Social Sector Spending

Had Zambia continued without implementing reforms, the implications for its sovereign debt and fiscal space could have been severe. The country's expansionary fiscal policies would have resulted in increased borrowing. Furthermore, the absence of a robust debt management legal framework and accompanying strategies would have exacerbated the already existing debt burden through the continued accumulation of non-concessional loans and arrears, leading to a higher external debt-to-GDP ratio.

The results from an exponential smoothing forecast, as shown in Figure 17, indicate that the country's external debt-to-GDP ratio was projected to continue its upward trajectory, increasing from 71 percent in 2020 to 91 percent in 2021, and further accelerating to exceed 150 percent by 2024. Similarly, the results suggest that the share of debt servicing in tax revenue and the annual budget would have significantly increased as shown by an exponential smoothing forecast in figures 18 and 19. The projected increase in the debt service to tax revenue ratio would have implied that the country borrows to both finance its budget and to fulfil its debt service obligations.

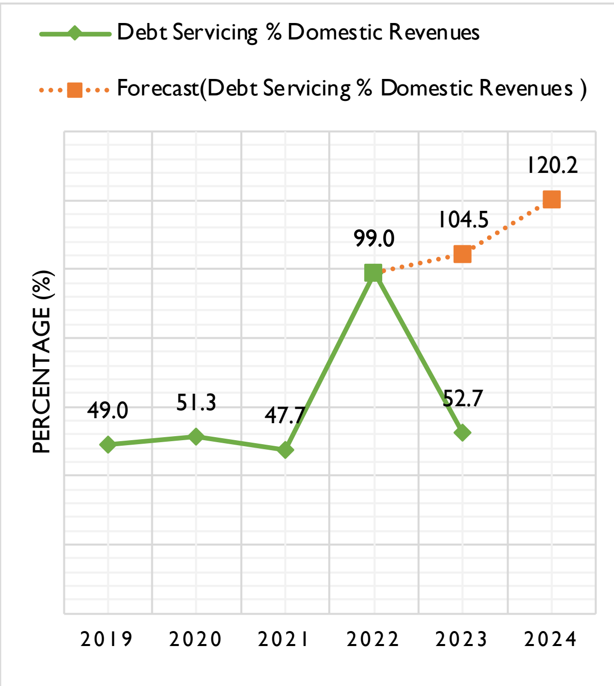
Meanwhile, the increase in the debt service to budget ratio would have meant debt servicing crowding out spending on other sectors. This would have further widened the fiscal deficit and reduced public investment in essential services such as health care, education, and social protection. The reduction in social spending can exacerbate poverty levels – which already remain elevated as shown in figure 20.

Figure 17: Forecasted Growth in External Debt-to-GDP Ratio



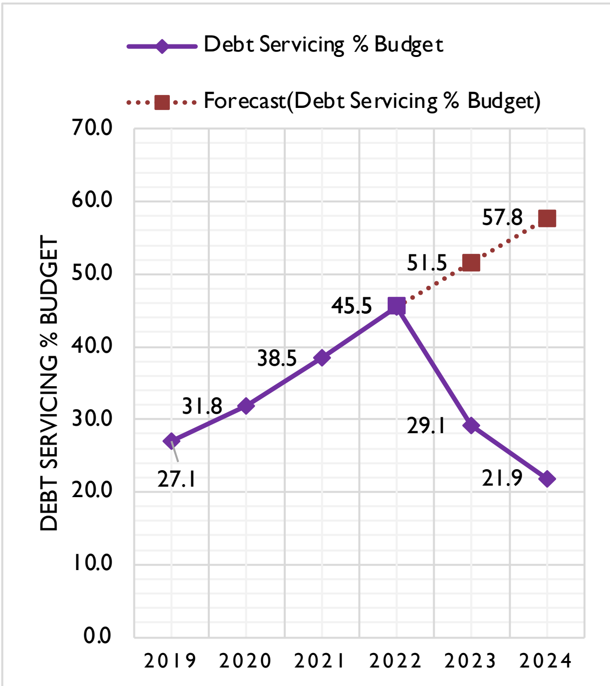
Source: Author's Computation using Exponential Smoothing Forecasting Method with data from the Ministry of Finance and National Planning.

Figure 18: Forecasted Growth in Debt Servicing to Revenues Ratio



Source: Author's Computation using Exponential Smoothing Forecasting Method with data from the Ministry of Finance and National Planning.

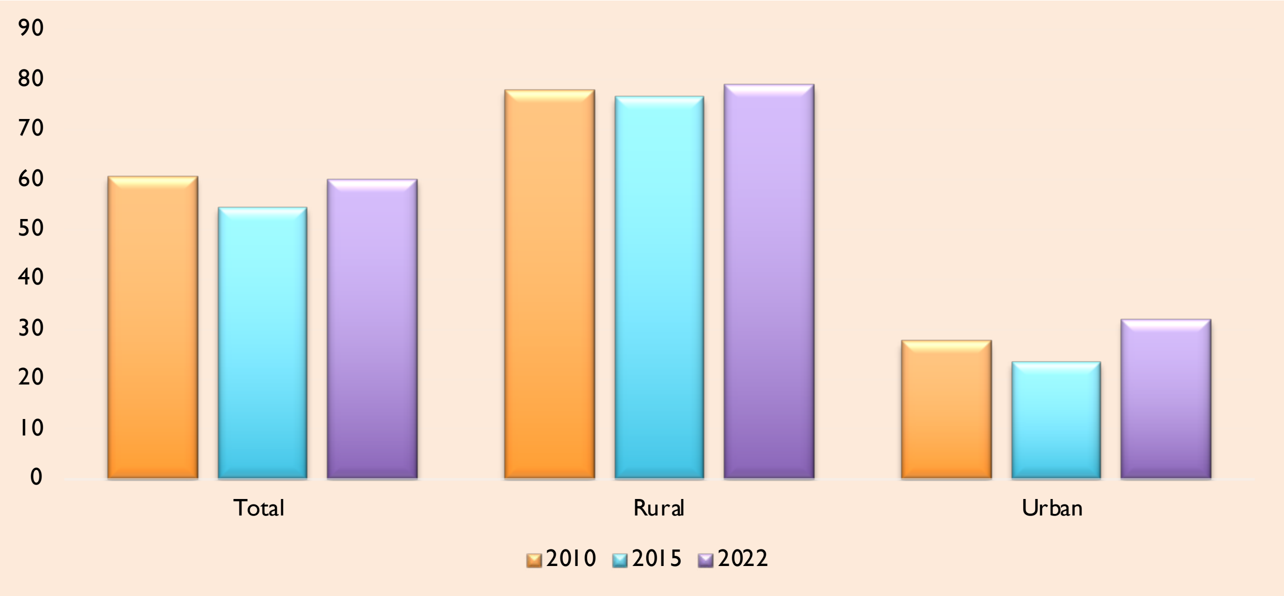
Figure 19: Forecasted Growth in Debt Servicing to Budget Ratio



Source: Author's Computation using Exponential Smoothing Forecasting Method with data from the Ministry of Finance and National Planning

According to Figure 20, the 2023 Poverty Assessment shows that by 2022, 60 percent of the people were living in poverty, with 78.8 percent living in rural areas compared to 31.9 percent in urban areas. [21] In the worst cases, these conditions can lead to increased social unrest and political instability, as the populace grapples with falling living standards and reduced economic opportunities.

Figure 20: Poverty Trends (percent) by Residence, 2010-2022



Source: ZAMSTAT

b. Deepening Sovereign Debt Crisis and Credit Rating Downgrades

Unchecked government spending and borrowing would likely exacerbate the already precarious debt levels, potentially leading to further downgrades in sovereign credit ratings by major agencies such as Moody's and Fitch. Such downgrades can result in elevated borrowing costs and restricted access to global capital markets, as illustrated when Fitch Ratings reaffirmed Zambia's Long-Term Foreign-Currency Issuer Default Rating at 'restricted default' in December 2023 following unresolved debt servicing issues since 2020. [22] Continued fiscal expansion without reform could have precipitated even steeper downgrades, exacerbating the fiscal crisis.

c. Currency Depreciation and Worsening Trade Balances

Sustained fiscal expansion without corresponding reforms could lead to significant depreciation of the Zambian Kwacha. As Zambia is a net importer, a depreciating currency would increase the cost of imports and escalate the expense of servicing foreign loans, both of which would adversely affect the trade balance. Additionally, a weaker currency could drive up the prices of imported goods, further fuelling domestic inflation. In a feedback loop, this depreciation and inflation can discourage foreign investment, as investors seek more stable and profitable environments, thereby further reducing the influx of foreign currency needed to bolster Zambia's reserves.

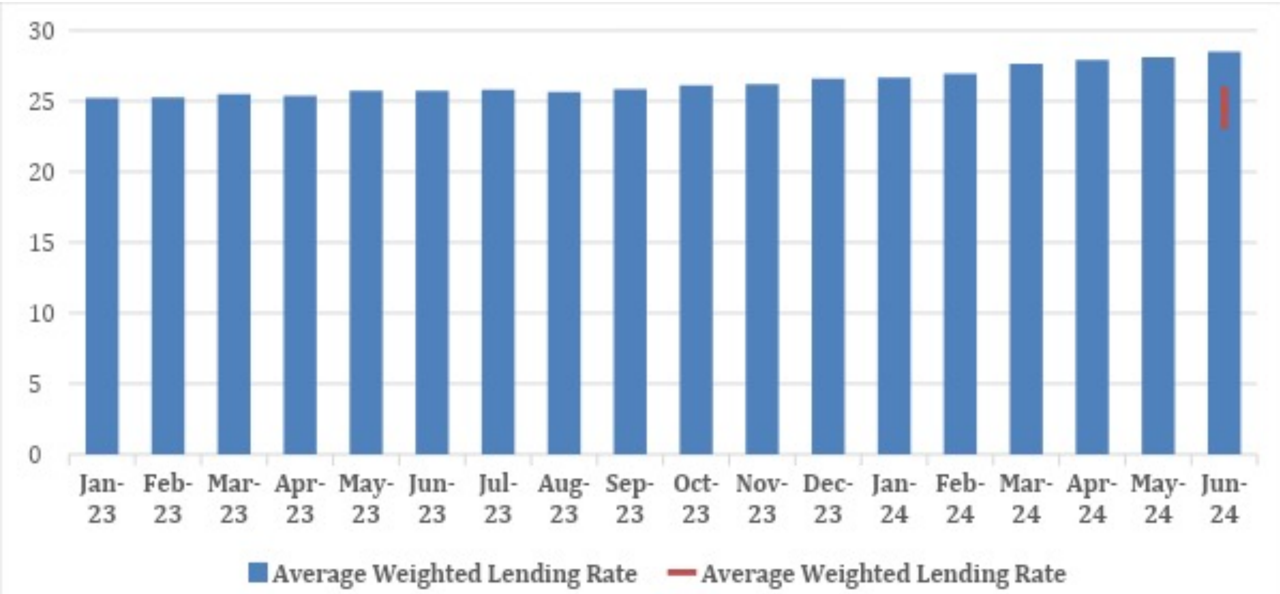
21. *file:///C:/Users/muled/Downloads/Highlights-of-the-2022-Poverty-Assessment-in-Zambia-2023%20(2).pdf*

22. *https://www.fitchratings.com/research/sovereigns/fitch-affirms-zambia-ltfc-idr-at-rd-upgrades-ltlc-idr-to-ccc-04-12-2023*

d. Crowding Out of Private Sector Investment

Persistent government borrowing domestically would crowd out the private sector by absorbing a significant amount of available financial capital, which in turn would drive up interest rates. As illustrated in Figure 14, throughout 2023, the average weighted lending rates (retail) exhibited a consistent upward trend. Starting at 25.23 percent in January, these rates progressively rose, reaching 28.52 percent by June 2024. The increase in lending rates makes borrowing more expensive for private enterprises, thereby restricting their ability to finance expansions, make capital improvements, or invest in innovation. This crowding-out effect is particularly detrimental in developing economies like Zambia, where private sector investment is crucial for economic diversification and job creation. Sectors such as agriculture, mining, and infrastructure development, which are vital for Zambia's long-term economic stability and growth, are most likely to be affected.

Figure 21: Average Weighted Lending Rate, 2023-2024



Source: Author's construction using data from Bank of Zambia

Therefore, had Zambia opted to continue with its expansionary fiscal policies without implementing structural reforms, the country might have faced a deepened economic crisis characterised by a vicious cycle of rising debt, inflation, and socio-economic decline. Such a scenario would likely have constrained public investment and hindered private sector growth, further entrenching poverty. Thus, the implemented reforms are crucial not just for stabilising the fiscal and economic framework, but also for setting the foundation for economic recovery.

SECTION 7: CHALLENGES AND OPPORTUNITIES FROM THE DEBT RESTRUCTURING PROCESS IN TERMS OF ECONOMIC STABILITY, AND SOCIAL INCLUSION

3.4.1 Introduction

This chapter or section examines the intricate challenges and opportunities arising from Zambia's debt restructuring process, particularly in the context of economic stability and social inclusion. While the G20 Common Framework offers a potential path toward improved debt sustainability, Zambia has encountered significant obstacles, including prolonged negotiations and a complex debt portfolio that complicates restructuring efforts. These challenges have led to economic instability, characterised by credit rating downgrades and a depreciating Kwacha, which have undermined investor confidence and fuelled inflation. The adverse effects of these economic conditions are felt most acutely by vulnerable populations, particularly women, who struggle with rising living costs and limited employment opportunities. However, the ongoing debt restructuring process also presents opportunities to create fiscal space for increased investment in essential social programs. By exploring these dynamics, this paper aims to provide a comprehensive understanding of how Zambia can effectively navigate its debt challenges while promoting social inclusion and fostering long-term economic stability..

a. Challenges in the Debt Restructuring Process

Despite the G20 Common Frameworks' debt restructuring process giving hope for Zambia's restored debt sustainability and reduced risk of debt distress, negotiations under this process have extended to over three years. Some of the major challenges that have hampered the finalisation of this process include the infancy of the common framework in facilitating debt restructuring; Zambia's huge and heterogenous debt portfolio which has made restructuring negotiations a complex process; and lack of clarity on the comparability of treatment principle (Mumba & Mumba, 2023). Although 77 percent of the country's debt has so far been restructured, the country is still yet to finalise agreements with the commercial non-bonded creditors. The delay in finalising this process has had significant ramifications on economic stability and social inclusion in Zambia.

b. Economic Stability and Social Inclusion

The delay in finalising Zambia's debt restructuring process had kept the country in a state of default on its long-term external debt until recently. This situation led to downgrades by major international credit rating agencies such as Fitch Ratings, Moody's, and Standard & Poor's (S&P) Global Ratings. These downgrades significantly eroded investor confidence, creating a high-risk environment that had deterred the inflow of foreign direct investment (Mumba & Mumba, 2023). The reduced inflow of capital had further strained the supply of foreign currency, exacerbating the depreciation of the Kwacha, in turn, increasing the cost of imports and eroding consumer's purchasing power (Bank of Zambia, 2024).

The delayed debt restructuring process has contributed to the depreciation of the Kwacha, having a direct impact on the cost of essential imports, such as fuel and agricultural inputs, thereby contributing to a rise in inflation. As the cost of importation rises, the prices of goods and services increase in tandem. Additionally, the country's current economic reform program supported by the IMF has fiscal measures and prior actions aimed at promoting fiscal consolidation. Some of these measures, including the migration to cost-reflective electricity tariffs, the removal of subsidies on petroleum products, and the restoration of the cost-plus pricing model for petroleum products with a shortened pricing cycle from 60 to 30 days, have contributed to a rise in the cost of living mostly affecting the poor and vulnerable. As much as these effects are felt by all Zambians, evidence suggests that women have less capacity to absorb economic shocks compared to their male counterparts. (Action Aid, 2023; United Nations, 2020 & Sabarwal et al., 2010). Furthermore, Ngonga (2023, p. 1) highlights that:

The brunt of the impact of the high cost of living is borne by the poorest and most marginalised in Zambia. It must be noted that more than half of the Zambian population live under the poverty line and the majority of this demographic is women. In addition, official information from the 2021 Labour Force Survey by the Zambia Statistics Agency shows that unemployment is higher among women than men with 60.5 percent males employed at national level compared to only 39.5 percent of females. The survey also reported that males had a higher monthly income than females in all the different sectors. This therefore highlights that women stand to be impacted more than men by the high cost of living due to their limited capacity to earn decent income to afford basic needs and services. The high cost of living is therefore a driver of gender inequality.

Zambia's debt management reforms also include efforts to enhance revenue generation with an emphasis on indirect taxation as a key part of its broader fiscal consolidation strategy. This approach involves streamlining and broadening the Value Added Tax (VAT) base, which is a significant component of indirect taxes. However, according to Silva et al. (2019), indirect taxes are typically considered regressive, as they consume a larger proportion of income from lower-income earners than from higher-income groups. Since VAT is applied uniformly across goods and services, the financial burden disproportionately falls on the poor, who allocate a higher share of their income to consumption (Harris et al., 2018). Additionally, since a significant portion of those living below the poverty line in Zambia are women, such tax reforms tend to disproportionately impact them, exacerbating existing gender inequalities.

In addition, the shift towards increased domestic borrowing by the government, resulting from restricted access to external financing, has raised borrowing costs and crowded out the private sector. This disproportionately affects women who make the majority of those engaged in informal businesses, by limiting their access to and cost of credit, reducing employment opportunities, and increasing household financial challenges. As a result, women's ability to grow their businesses, find stable jobs, and contribute to their families is diminished, further exacerbating gender inequalities and hindering social inclusion in Zambia.

In terms of opportunities, the progress made so far in the debt restructuring process including the specific reforms has some opportunities in the long run for greater social inclusion by creating fiscal space that allows the government to increase spending on essential social sectors. This can already be seen from the investments in programs such as the Social Cash Transfer, Home-Grown School Feeding, and the Food Security Pack which have seen expanded coverage and increased transfer amounts. Additionally, the Public Welfare Assistance Scheme (PWAS) and the Farmer Input Support Program (FISP) have been enhanced to benefit more small-scale farmers. These measures are essential for reducing poverty and promoting social inclusion particularly among vulnerable groups such as women, children, and rural populations.

SECTION 8: CONCLUSION AND RECOMMENDATIONS

8.1 Conclusion

Zambia's debt management reforms, grounded in the Eighth National Development Plan and supported by the IMF, aim to restore debt sustainability and enhance debt management and transparency. However, these reforms have brought various socio-economic implications. On one hand, they promise to restore fiscal discipline through responsible borrowing, the reforms strengthen Zambia's debt-carrying capacity, improve fiscal sustainability, and enhance international credibility—critical for attracting much-needed investments and grants. This is crucial for fostering economic growth and creating opportunities for increased investments in both the social and economic sectors. Meanwhile, on the other hand, these reforms have also intensified social inequalities, by rising living costs disproportionately impact women.

Furthermore, they have also contributed to a rise in the cost of borrowing which has made it more difficult for Micro, Small, and Medium Enterprises (MSMEs) to access credit, limiting their growth potential. Additionally, the socio-economic implications have been worsened by the severe drought, by exposing over 6 million Zambia to food insecurity. This may compromise the government's current efforts to enhance social safety nets. Therefore, while the long-term benefits of these reforms may contribute to a more resilient economy, the short-term socio-economic challenges must be adequately addressed to ensure that the most vulnerable populations are protected during the transition.

8.2 Recommendations

Based on the findings outlined in part 3 of this report, the following recommendations are proposed:

a. Incorporating Gender Perspectives in IMF Programming

The IMF should significantly strengthen the integration of a gender perspective in the design and implementation of its policies and programs. This would ensure that the unique gendered impacts of reform programs are adequately addressed, enabling more equitable outcomes. This will allow the IMF to effectively address the specific challenges faced by women and other marginalised groups, thereby contributing to more inclusive and sustainable economic development.

b. Finalising Operational Guidelines for the Public Debt Management Act

Government should work towards finalising the operational guidelines of the Public Debt Management Act to aid the full implementation of the Act. This will ensure that the provisions of the Act are effectively enforced, leading to improved oversight, transparency, and accountability in debt management. Completing these guidelines is crucial for optimising the Act's potential to stabilise Zambia's fiscal environment, and ultimately support the country's economic recovery.

c. Enhancing the Administration of Direct Taxation and Progressivity in Zambia's Fiscal Reforms

The focus of Zambia's fiscal measures in its reform program should shift away from relying heavily on indirect taxation. Instead, greater emphasis should be placed on enhancing the administration of direct taxes such as wealth taxes and improving the progressivity of the entire tax system. This approach would ensure that the tax burden is distributed more equitably, reducing the disproportionate impact on lower-income households.

d. Balancing Fiscal Reforms with Social Inclusion

It will be necessary for the government to review reforms such as cost-reflective electricity tariffs, the removal of petroleum subsidies, and the cost-plus pricing model to ensure that they not only support fiscal consolidation but also promote social inclusion. This review should carefully consider the impact on vulnerable populations and implement mitigating strategies, such as targeted subsidies. This can help balance economic efficiency with equity and support the government in creating a more inclusive economy and reduce the risk of exacerbating poverty and inequality.

e. Prioritising Domestic Resource Mobilisation and Plugging Revenue Leakages

The government should prioritise enhancing Domestic Resource Mobilization (DRM) and plugging revenue leakages through illicit financial flows rather than over-relying on raising revenues through domestic borrowing. The results are two-fold, firstly, this can significantly protect the private sector by ensuring access to affordable credit. Secondly, doing so will ensure the government adequately invests in the social sector while also making significant strides in the economic sector. This approach will help balance fiscal responsibility while also building resilience.

f. Addressing the Rising Cost of Living

In addressing the cost of living, the government should focus on efficiently targeting cash transfers to support vulnerable populations, particularly considering the removal of fuel subsidies and the implementation of cost-reflective energy tariffs. Additionally, the government should work on strengthening and stabilising the Kwacha through sound monetary policies and controlling inflation by managing money supply and reducing excessive borrowing. A stronger Kwacha will help preserve and potentially increase disposable incomes, allowing households to better cope with rising costs, thereby reducing the financial burden on families.

g. Focusing on Stimulating Economic Growth

Fostering economic growth is crucial for establishing the capacity necessary for sustainable debt servicing in the wake of Zambia's debt restructuring. In line with the Eighth National Development Plan (8NDP), this growth should be fuelled by industrialization, with a focus on adding value in key sectors like agriculture, mining, manufacturing, and tourism, which have significant local forward and backward linkages. The approach should also emphasise boosting private sector involvement and investment, diversifying the economy, and expanding exports beyond traditional sectors and markets will be key for stabilising the Kwacha and enhancing the fight against poverty. Growing the economy will also deal with the high levels of unemployment by creating employment opportunities in the targeted key sectors.

h. Improving Access to Affordable Finance for SME's and Informal Businesses

The government should consider creating mechanisms that provide affordable and accessible capital to SMEs and informal businesses. This can be achieved by enhancing financial inclusion initiatives and partnering with financial institutions to offer low-interest loans, grants, and financial literacy programs. These efforts will enable SMEs and informal businesses to thrive and withstand shocks caused by the debt management reforms and the drought induced electricity crisis.

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