SAIPAR | Government of Ireland International Development Programme


NUMBER 9, DECEMBER 2024

POLICY BRIEF

# ZAMBIA'S EXTERNAL PUBLIC DEBT STORY: FROM DEBT RELIEF TO DISTRESS TO RESTRUCTURING

CAESAR CHEELO JULY 2024

***"Hard times create strong men [and women], strong men [and women] create easy times, easy times create weak men [and women], and weak men [and women] create hard times." attributed to G. Michael Hopf***

## 1. INTROUDCTION

Zambia's external public debt management has seen a complex path of ups and downs, marked by remarkable milestones, challenges, and reforms. Following massive external debt accumulation in the 1970s and 1980s, the country secured substantial debt relief in the mid-2000s, experiencing a period of relative debt and fiscal stability, which was later following by another episode of debt accumulation and eventual distress; as a result, post-2020, Zambia has had to steadfastly pursue spirited debt restructuring efforts. This policy brief examines Zambia's external debt trajectory from the 1970s and 1980s, through the mid-2000s, to 2023, highlighting the key lessons and policy implications of the trajectory.

The rest of the brief is organized as follows: Section 2 highlights the key underlying contributors to Zambia's first debt rise in the 1970s and 1980s; Section 3, described the debt relief and debt stability record achieved during 2004–2011; Section 4 focuses on the economy's mounting debt levels and ensuing macroeconomic challenges over 2011–2021; Section 5 discusses in a bit more detail the debt restructuring efforts from 2021 to 2023; and Section 6 closes the brief with key lessons learned and policy implications.

## 2. FIRST DEBT RISE: 1970S AND 1980S

The mounting debt situation of the 1970s and 1980s, driven by economic mismanagement, external shocks, and structural vulnerabilities, posed far reaching critical challenges for Zambia, which linger on today. These challenges from the early years can be categorized into economic, social, and governance-related factors.

In terms of economic challenges, the Zambian economy's heavily reliance on copper mining and copper exports, which has historically accounted for most of the country's export revenues, is fundamental. During the mid-1970s, a significant decline in global copper prices severely reduced national income and hampered economic activity, leading to notable foreign exchange shortages, balance of payment imbalances, fiscal deficits and increased borrowing to sustain public spending (Seshamani, 1994). The decline in copper prices coincided with rising costs of imported goods which adversely affected Zambia's terms of trade, worsening it balance of payment and particularly balance of trade imbalances and increasing reliance on external debt (FONDAD, 1991). Moreover, the oil price shocks of the 1970s and rising global interest rates, particularly in the 1980s, inflated Zambia's external debt burden. Loans became increasingly more expensive, trapping the country in a cycle of borrowing and repayment difficulties (Seshamani, 1994).

Eventually, Zambia was forced to implement International Monetary Fund (IMF) and World Bank prescribed Structural Adjustment Programmes (SAPs), which imposed severe austerity measures. These included reducing public spending and subsidies, which exacerbated the mounting economic hardships faced by the country (Jesuit Centre for Theological Reflection, 1999).

In tandem with the economic challenges, social challenges escalated. Firstly, the economic crisis led to reduced government spending on essential services like education, healthcare and infrastructure, aggravating already poverty levels and inequality (Jesuit Centre for Theological Reflection, 1999). Declines in economic activity, particularly in the mining sector, resulted in widespread job losses, rising unemployment and limited income opportunities (Seshamani, 1994). The socio-economic hardships, coupled with the austerity measures of the time, sparked widespread public discontent and protests, in 1987 and 1989, against the government's inability to mitigate the crisis (University of Zambia, 2002).

A few key governance challenges thus emerged, including Weak Fiscal Discipline (Pangaea Holdings, 2021), widespread policy inconsistencies and policy failures (Seshamani, 1994), deepening dependency on external financing, particularly external borrowing (FONDAD, 1991). By the late 1980s, Zambia's debt crisis had become unsustainable, leading to chronic economic stagnation and widespread poverty. The situation necessitated the comprehensive debt relief efforts that were to come in subsequent decades.

## 3. DEBT RELIEF AND STABILITY: 2004–2011

From the 1970s and 1980s, Zambia's public debt situation mounted markedly, peaking at 213% of GDP in 1991. This unsustainable debt burden severely constrained the country's fiscal capacity and economic prospects. However, in the mid-2000s, Zambia experienced a transformative period of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). These programmes reduced Zambia's external debt from approximately US$7.1 billion in 2004 (or 184% of GDP in 2003) to about US$500 million by 2006 (or 17% of GDP in 2005), significantly alleviating the fiscal pressures experiences during the era (Findevlab, 2023; Nkulukusa, 2024). The resulting fiscal space and reduced debt servicing costs allowed Zambia to achieve notable benefits in the areas of fiscal, macroeconomic, socio-economic, and economic governance performance. For instance, the sharp reduction in debt servicing obligations almost immediately enabled the Zambian government to redirect resources to development priorities such as expenditures on infrastructure projects (road networks, rural electrification, etc.). This significantly boosted connectivity and economic productivity. Moreover, with fewer financial constraints, Zambia was able to allocate a greater portion of its budget to essential sectors, particularly healthcare, and education, which had long been underfunded.

On the macroeconomic front, the country saw relative exchange rate stability, albeit a persistently depreciating Kwacha due to unaddressed underlaying structural imbalances. The Government's ability to avoid excessive borrowing to cover budget deficits also helped to tame inflation, which had been a chronic issue during the 1980s and 1990s. This macroeconomic stability reduced the cost of imports and promoted investment, among other tings (Hill and Martin, 2024).

On the socio-economic side, the debt relief facilitated increased spending on health and education. The Government expanded access to primary healthcare services and undertook major vaccination campaigns, reducing child mortality rates. In education, the removal of school fees for primary education increased enrolment significantly, particularly among children from poor households. The concurrent public investments in social protection programmes and efforts to create job opportunities through infrastructure projects was reductions in extreme poverty levels, albeit very gradually and with a rural-urban disparity whereby rural poverty remain persistently high.

The economic governance benefits of debt relief, including outcomes like improved fiscal discipline, budget transparency and accountability, and budge credibility increased the levels of donor and investor confidence. By 2010, this saw Zambia attracting significant amounts of Foreign Direct Investment (FDI) in its mining and agriculture sectors, which supported sustained economic growth.

The period between 2004 and 2011 was transformative for Zambia. Debt relief through the HIPC and MDRI initiatives significantly reduced the country's debt burden and provided the fiscal breathing room necessary to pursue developmental goals. With targeted investments in infrastructure, social services, and economic governance, Zambia demonstrated the potential of debt relief to drive economic stability, recovery and growth, social progress, and sustainable development.

## 4. RISING DEBT AND ECONOMIC CHALLENGES: 2011–2021

Over the decade between 2011 and 2021, Zambia's external debt once again escalated significantly, with the debt-to-GDP ratio surging from 20.8% in 2011 to over 118.6% by 2021, surpassing the Sub-Saharan Africa average (HKS, 2023; Nkulukusa, 2024). This rapid debt accumulation is associated with a decline in the real GDP growth rate from 7.6% in 2012 to a dismal 1.4% in 2019 (prior to COVID-19), below the Sub-Saharan Africa average of 2.7% in 2019 (World Bank, 2023). Given the mounting debt levels, debt service obligations increased from US$89 million in 2011 to over US$2 billion by 2022. Debt destress increased to the extent that, in November 2020, Zambia became the first African country to default on its external debt service obligations, missing a $42.5 million interest payment on a Eurobond. As would be expected, this severely constrained public resources which would have been for critical sectors like health, education and infrastructure development. As had happened in the 1970's and 1980s, history repeated itself, with the debt crisis leading to increased poverty, limited new job opportunities and income inequality (Findevlab, 2023; Hill and Martin, 2024; Nkulukusa, 2024).

During the period, weaknesses in the policy and regulatory environment were widespread. In essence, Zambia's debt crisis was substantially compounded by deficiencies in the country's regulatory framework. Policies governing public financial management lacked coherence, resulting in ad hoc, unplanned and un-appraised borrowing to cover growing but unnecessary fiscal deficits. Debt ceilings, where they existed, were frequently breached, highlighting insufficient oversight and management mechanisms (IMF, 2021).

At the same time, growing governance challenges in the public sector, particularly allegations of widespread corruption, rent seeking and political interference in the operational affairs of public economic institutions, eroded public sector functioning, public confidence and donor trust. Major infrastructure projects, funded through external borrowing, were often marred by procurement irregularities, inflated costs, and substandard delivery (Transparency International, 2021). For instance, audits revealed significant mismanagement in road construction projects and energy sector investments.

The legislative framework governing debt management was also inadequate during the period, lacking provisions for comprehensive debt contraction, recording, monitoring, and reporting. This legislative weakness allowed the accumulation of opaque "hidden debts," as public guarantees for loans to state-owned enterprises (SOEs) went unrecorded (World Bank, 2022) and were only noticed when they were about to crystalize. Furthermore, planning and budgeting processes were fragmented, with limited alignment between national development plans and budgetary allocations.

Key public economic institutions, such as the Ministry of Finance and the Office of the Auditor-General, faced capacity and sometime mandate or jurisdictional constraints that hindered effective oversight of borrowing and expenditure. Limited technical expertise and inadequate staffing undermined the Ministry of Finance's ability to readily and credibly assess the economic feasibility and long-term sustainability of debt-financed projects (OECD, 2022).

Macroeconomic volatility, including persistent inflationary pressures and local currency depreciation, further exacerbated Zambia's debt challenges. Over the period, the Zambian Kwacha depreciated significantly against the US dollar, increasing the cost of servicing foreign-denominated debt (Hill and Martin, 2024). In addition, the structural business environment remained weak, characterized by excessive bureaucracy, unreliable energy supply, and high costs of doing business, all of which deterred private sector investment and compounded economic stagnation (World Bank, 2022).

Therefore, between 2011 and 2021, Zambia's rising debt burden reflected systemic weaknesses in economic governance, misalignments, inconsistencies and inadequacies in policy and regulatory frameworks, and constraints in institutional capacity. Addressing these structural deficiencies is critical for ensuring sustainable debt management and fostering long-term economic growth.

## 5. DEBT RESTRUCTURING EFFORTS: 2020–2023

Facing unsustainable debt levels and the November 2020 default on external debt servicing, Zambia embarked in an effort to seek and secure debt relief through engagements with the IMF and the G20 Common Framework in 2020. However, the restructuring process was protracted, highlighting weaknesses in the framework, such as delays and coordination challenges among diverse creditors (Hill and Martin, 2024; HKS, 2023).

By June 2023, Zambia had reached an agreement with official creditors under the G20 Common Framework, marking a significant step toward restoring debt sustainability (MoFNP, 2023). This agreement included maturity extensions, concessional interest rates, and nominal haircuts for bondholders, creating fiscal space for essential public investments (Nkulukusa, 2024).

The status of debt restructuring as of June 2024 was such that Zambia's external debt under restructuring consideration amounted to a total of US$13.4 billion, of which US$6.3 billion or 47% of the total was owed to bilateral creditors under the Official Creditor Committee (OCC) category, US$3.8 billion (28%) was owed to Bondholders, and US$3.3 billion (25%) was owed to other private creditors ((Nkulukusa, 2024). As of June, Agreements in Principle (AIPs) were reached for the full amounts under the OCC and Bondholder categories while an AIP was yet to be reached with Other Private Creditors; this implied that AIPs were reached on 75% of the total external public debt profile.

During debt restructuring negotiations, a significant contention emerged between the OCC and Bondholders due to differing interpretations of "Comparability of Treatment". The OCC's agreement with Zambia entailed substantial maturity extensions and reduced interest rates without nominal haircuts, aiming to alleviate the country's debt burden over an extended period (Ministry of Finance and National Planning, 2023). In contrast, bondholders proposed a 16% nominal haircut alongside shorter maturity extensions, seeking a more immediate adjustment to the debt's face value (Moneyweb, 2023). This divergence led to delays and strained negotiations, as each creditor group perceived the other's terms as disproportionately favorable. The lack of a universally accepted framework for applying Comparability of Treatment under the G20 Common Framework remains a critical challenge, underscoring the need for standardized guidelines to align creditor expectations and streamline future debt restructurings.

While Zambia's debt restructuring efforts marked a crucial step toward addressing its unsustainable debt burden, the far-reaching impacts of the crisis continued to linger on and to constrain the country's economic recovery by the close of 2023. Despite the APIs under the G20 Common Framework and nominal fiscal relief, several challenges are expected to persist, threatening Zambia's macroeconomic stability and growth as well as its socio-economic progress and structural transformation towards sustainable development.

From a fiscal perspective, debt service obligations, although reduced, are poised to still consum a significant share of public revenues, limiting the government's capacity to address developmental priorities. The fiscal deficit remain a concern, as revenue generation struggle to match the scale of expenditure needs, particularly in critical sectors such as health, education, and infrastructure. Inflationary pressures have mounted in recent times, driven by structural weaknesses and external factors such as global commodity price volatility. This continues to undermine the purchasing power of ordinary Zambians.

Furthermore, on the macroeconomic front, achieving sustained stability and growth has continued to prove elusive. While restructuring has created short-term fiscal space, it did not address underlying vulnerabilities such as dependency on copper exports and exposure to exogenous shocks. The Zambian Kwacha continues to experience persistent periodic depreciations, exacerbating the cost of foreign-denominated debt servicing and adversely affecting the terms of trade. The downside risks of sluggish real GDP growth rate coupled with high unemployment, especially among the youth reflects the limited impact of debt restructuring, so far, on overall economic resilience and growth.

Zambia's socio-economic challenges from the 2011-2021 period remain stark. Poverty rates, which had climbed significantly during the debt crisis, have shown little sign of abatement. Reduced public investment in social services during the pre-restructuring years has left a legacy of weakened healthcare and education systems. Efforts to address youth unemployment and gender disparities remain inadequate, contributing to social disquiet and inequality.

Sectoral weaknesses, particularly in agriculture, manufacturing, and energy, continue hampering Zambia's economic diversification efforts. Energy shortages and unreliable infrastructure remain as a notable deterrent to investment as the agriculture sector, despite its vast potential, suffers from inadequate financing, market linkages, commercialization, climate-smart transformation and resilience. The anticipated benefits of debt restructuring to these sectors have been slow to materialize, prolonging the historic structural imbalances in the economy.

Structural and business environment issues also remain persistently problematic. High costs of doing business, bureaucratic inefficiencies, and regulatory unpredictability continue to deter both domestic and foreign investment. The structural inertia not only restricted economic transformation but also impeded the private sector's ability to generate employment and drive growth.

## 6. CONCLUSION, LESSONS LEARNED AND POLICY IMPLICATIONS

In closing, Zambia's debt management journey underscores the necessity for comprehensive debt management strategies, transparent creditor coordination, and robust economic policies to achieve debt and macroeconomic stability, and sustainable development. Looking beyond 2023, the forgoing debt management and attendant challenges recounted in this policy brief highlight the need for sustained social and economic reform efforts to complement debt restructuring efforts. Addressing fiscal inefficiencies, enhancing macroeconomic stability, strengthening institutional governance, and tackling structural barriers will be critical for Zambia to break the cycle of debt dependency and foster inclusive and sustainable economic development. Without concerted efforts to resolve these deep-seated issues, the spectre of another debt crisis is likely to remain looming large, undermining the potential benefits of restructuring achievements.

Overall, Zambia's public external debt story experience offers several critical lessons for debt reform and effective debt management; some of these include:

- Strong Public Institutions: Establishing and maintaining strong public institutions insulated from political and other interference is essential for effective debt management. Independent and well-resourced institutions ensure transparency, accountability, and the technical rigor needed to align borrowing decisions with long-term fiscal and economic objectives, reducing the risk of debt mismanagement.
- Sustainable Borrowing: Prudent borrowing practices and effective public debt management, underpinned by strong institutions and credible legal, policy and regulatory frameworks, are essential for preventing the mounting of debt to unsustainable level.
- Diversified Economy: Fostering transition to a diversified economy reduces reliance on external debt financing and enhances resilience to shocks, thus limiting the chances of public debt growing to unsustainable levels.
- Improved International Debt Frameworks: The global debt architecture requires reforms to enhance coordination and efficiency in restructuring processes. Standardized guidelines and mechanisms should be developed to align creditor expectations and reduce negotiation bottlenecks. Additionally, increased transparency in debt data and creditor engagements, alongside clear enforcement mechanisms for agreed terms, can strengthen trust among stakeholders and accelerate resolutions.
- Enhanced G20 Common Framework: the G20 Common Framework, in particular, needs to be reviewed and enhanced to address delays in debt restructuring and ensure equitable treatment among creditors. Issues related to "Comparability of Treatment", which have led to disputes, particularly concerning the inclusion of local-currency debt and the roles of various creditors, must be resolved from a systemic perspective. Expanding the Framework's applicability to include high- and middle-income countries vulnerable to debt crises could also ensure a more inclusive, effective and equitable global debt governance system.
- Tenacity and Steadfastness: Persistent engagement in debt restructuring negotiations is crucial, as demonstrated by Zambia's prolonged efforts to secure agreements balanced across diverse creditors.
- Political Savviness: Effectively bringing key creditors like China on board requires diplomatic acumen and strategic negotiation. Bilateral donors and official creditors not directly sitting on the OCC can support debt restructuring processes by facilitating dialogue, offering technical assistance, and providing bridge financing to stabilize economies during negotiations.

## REFERENCES

AP News (2023) 'Debt-plagued Zambia reaches deal with China, other nations to rework $6.3B in loans'. Available at: *https://apnews.com/article/zambia-debt-restructuring-deal-china-a0d14e7af986e2f873555685cedb86b3.*

CGDev (2023) 'Zambia case study: Sovereign debt restructuring under G20 Common Framework'. Available at: https://www.cgdev.org/sites/default/files/zambia-case-study-sovereign-debt-restructuring-under-g20-common-framework.pdf.

Findevlab (2023) 'The road to Zambia's 2020 sovereign debt default'. Available at: *https://findevlab.org/wp-content/uploads/2023/12/The-Road-to-Zambias-2020-Sovereign-Debt-Default-vf.pdf.*

FONDAD (1991) Background to the African Debt Crisis. Available at: *https://fondad.org/uploaded/African%20Debt%20Revisited/African%20Debt%20Revisited-Chapter%20I.pdf.*

Hill, M. and Martin, E. (2024) 'Why the G-20 Common Framework for Debt Relief isn't helping poor nations'. Bloomberg. Available at: *https://www.bloomberg.com.*

HKS (2023) 'Zambia case study: Sovereign debt restructuring'. Available at: *https://www.hks.harvard.edu/centers/mrcbg/publications/zambia-case-study-sovereign-debt-restructuring-under-g20-common.*

IMF (2021) Zambia: Article IV Consultation and Request for an Extended Credit Facility Arrangement. Available at: *https://www.imf.org/en/Publications/CR/Issues/2021/11/10/Zambia-2021-Article-IV-Consultation-Request-for-an-Extended-Credit-Facility-Arrangement-468389.*

IMF (2023a) 'Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative'. International Monetary Fund (IMF), February. Available at: *https://www.imf.org/en/About/Factsheets/Sheets/2023/Debt-relief-under-the-heavily-indebted-poor-countries-initiative-HIPC#:~:text=The%20IMF%20and%20World%20Bank,faces%20an%20unmanageable%20debt%20burden.*

IMF (2023b) 'World Economic Outlook Database: October 2023 Edition'. International Monetary Fund (IMF), October. Available at: *https://www.imf.org/en/Publications/WEO/weo-database/2023/October.*

Jesuit Centre for Theological Reflection (1999) Zambia: A Case Study of Economic Reform and the Impact on the Poor. Available at: *https://repository.jctr.org.zm/bitstream/handle/20.500.14274/113/ECONOMIC%20REFORM%20AND%20IMPACT%20ON%20THE%20POOR%20%282%29.pdf?sequence=1.*

JCTR (2002) 'Report on the Jubilee Zambia Debt Campaign Opinion poll 2002'. Jesuit Centre for Theological Reflection, Lusaka.

Mbewe, M., Humann, T., Kalikeka, M., Masilokwa, I., Kessler, M. and Mwamba, S. (2023) 'The Road to Zambia's 2020 Default'. Finance for Development Lab (FDL) and Zambian Institute for Policy Analysis and Research (ZIPAR), December.

Ministry of Finance and National Planning (2023) 'Zambia reaches agreement with official creditors on debt treatment under the G20 Common Framework'. Available at: *https://www.mofnp.gov.zm/?p=7444.*

MoFNP (2023) 'Ministry of Finance and National Planning: Zambia debt restructuring milestones'. Available at: *https://www.mofnp.gov.zm/?p=7444.*

Moneyweb (2023) 'Zambia's bondholders to soon get comparability question answered'. Available at: *https://www.moneyweb.co.za/news/africa/zambias-bondholders-to-soon-get-comparability-question-answered/.*

Nkulukusa, F. (2024) 'Understanding Zambia's debt restructuring'. Secretary to the Treasury, Ministry of Finance and National Planning.

OECD (2022) Strengthening Institutional Capacity for Debt Management in Sub-Saharan Africa. Paris: OECD Publishing.

Pangaea Holdings (2021) A [very] Short Take on Zambia's Debt Crisis: Analysing the Scales of Fiscal Policies and Debt Dynamics. Available at: *https://pangaeaholdings.co.zm/a-very-short-take-on-zambias-debt-crisis-analysing-the-scales-of-fiscal-policies-and-debt-dynamics/.*

PwC (2023) 'Turning a New Leaf: The Latest on Zambia's Debt Restructuring Journey'. Available at: *https://www.zambiamonitor.com/pwc-report-reveals-progress-in-zambias-debt-restructuring-admits-domestic-arrears-remain-a-challenge/ (Accessed: 4 December 2024).*

Seshamani, V. (1994) 'The Economic Policies of Zambia in the 1980s: Towards Structural Transformation with a Human Focus?', in Seshamani, V. (ed.) The Economic Policies of Zambia in the 1980s. London: Palgrave Macmillan, pp. 123–145.

The Diplomat (2023) 'China and Zambia: A New Chapter Beyond Debt?'. Available at: *https://thediplomat.com/2023/09/china-and-zambia-a-new-chapter-beyond-debt/.*

Transparency International (2021) Zambia Corruption Perceptions Index 2021. Available at: *https://www.transparency.org/en/cpi/2021.*

University of Zambia (2002) External Debt and Economic Growth in Zambia: An Empirical Investigation. Available at: *https://dspace.unza.zm/handle/123456789/306.*

World Bank (2022) Zambia Economic Brief: Seizing the Opportunity for Debt Transparency. Washington, DC: World Bank. Available at: *https://www.worldbank.org/en/country/zambia/publication/zambia-economic-brief-2022*

World Bank (2023) 'GDP Growth (Annual %) - Zambia'. Available at:*https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=ZM*.

World Bank WDI (2023) 'World Development Indicators'. Available at: *https://databank.worldbank.org/source/world-development-indicators#.*

**For further information contact:**
Tel: +260 761327702
Email: marja.hinfelaar@saipar.org
Address: SAIPAR, 32a District Road, Lusaka