



In Further Pursuit of an IMF-Programme: Possible Pathways for Zambia and Lessons for Africa

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Abstract

Since 2015, Zambia's real GDP growth has declined markedly, its local currency has depreciated notably with episodes of serious volatility, and the risks of fiscal and debt distress have mounted. As the country searches for solutions, one viable international economic diplomacy instrument might be the IMF. Since its creation in 1945, the IMF has fostered global monetary cooperation, secured financial stability, international trade, high employment, sustainable economic growth and poverty reduction, mainly through: lending, surveillance and capacity building. Zambia has been pursuing an IMF-supported economic programme since about 2016, but with dismal success. In contrast, other economies like Ghana and Zimbabwe appear to be making headway. Key questions emerge from the foregoing: what does the evidence say about the relevance and significance of an IMF-supported programme for Zambia? Why has the country's recent quest for an IMF deal failed? Does Zambia have feasible pathways to an IMF deal? This paper tackles these issues using simply descriptive statistical analysis, stylized facts and a political economy lens. We highlight a number of specific pathways that Zambia could follow in further pursuit of an IMF-support programme.

Key words: Macroeconomic policy, political economy, International Monetary Fund (IMF)

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Executive Summary

Since 2015, Zambia's real GDP growth has declined markedly, its local currency has depreciated notably with episodes of serious volatility, and the risks of fiscal and debt distress have mounted and are now being heavily felt. As the country searches for solutions, one viable option might be an IMF-supported economic programme. The IMF fosters global monetary cooperation, secured financial stability, international trade, high employment, sustainable economic growth and poverty reduction, mainly through: lending, surveillance and capacity building. Zambia has been pursuing an IMF-supported programme since 2016, but with dismal success.

This paper compares five countries in sub-Saharan Africa: Angola, Ghana, Mozambique, Zambia and Zimbabwe and offers insights into how Zambia might find pathways back to the negotiating table with the IMF. The paper addresses key questions, including: what does the evidence say about the relevance and significance of an IMF-supported programme for Zambia? Why has the country's recent quest for an IMF deal failed? Does Zambia have feasible pathways to an IMF deal? Based on a simply descriptive statistical analysis, stylized facts and a political economy lens, the paper highlight some specific pathways that Zambia could follow in further pursuit of an IMF-support programme.

Why Zambia needs an IMF programme

Zambia's debt has reached unsustainable levels, a fact established by the IMF's Debt Sustainability Analysis of July 2019. Over the years, Zambia's external debt and debt servicing burdens have soared, putting the country at high risk of debt distress. Considering that the Eurobonds are the most expensive component of Zambia's external debt, IMF support presents an opportunity for sizable affordable refinancing. This could be structured as a form of balance of payment support (e.g., a Standby Credit Facility) to cover debt principle repayment obligations when the fall due and/or to redeem some of the Eurobonds now.

Since IMF financing usually comes in the form of concessional zero- or low-interest loans, redeeming the Eurobonds early would offer sizable debt service relief considering that interest payments on debt servicing (excluding amortization) swallowed 22% of total expenditure (excluding amortization) in the first half of 2019 compared to an interest payment target of 18% of total expenditure. And this happened even though disbursements to social spending were severely cut back.

IMF support would also bring in much-needed technical assistance on economic reform as well as an external impetus for mutual accountability and transparency.

Finally, an IMF deal would send the right signal to investors and other development partners that Zambia is re-establishing international credibility.

Key pathways for Zambia to return to the negotiating table with the IMF will require the authorities to understand and pre-empt the IMF's expectations of Zambia in terms of prior actions.

Expectations of the IMF

Broadly, prior to the reopening of negotiations between the two parties, the IMF will expect Zambia to take key prior actions in the following areas in order to show commitment restoring prudent financial management:

- Fiscal and debt management reforms that ensure pragmatic and credible fiscal and borrowing adjustments.
- Legal or legislative reforms that address gaps and weaknesses in key legal frameworks like the Loans and Guarantees Act, Public Procurement Act and Planning and Budgeting legislation.
- Institutional reforms to ensure the protection of social sector spending, to reorganize and improve the functioning of the agricultural sector, to enhance the business and investor climate, and to address the risks of corruption, financial misappropriation and other vices.

Recommendations

Zambia has passed up previous opportunities to demonstrate to the IMF that it is serious about implementing an IMF programme. Instead of halting new borrowing, debt has continued to grow. Where regulatory reforms were due to improve oversight of debt contraction and spending, these were delayed. Work carried out by key public institutions such as the Auditor General and the FIC has been ill-supported or ignored. And the Government has repeatedly made commitments to austerity and fiscal consolidation that it has failed to act on.

With growth projected to slow to 2% for the year, inflation having reached 8.9% in July and delayed disbursements of wages and social protection programmes escalating, the Zambian economy is increasingly feeling the impact of debt. This has only increased the need for IMF support to Zambia to rebalance the fiscal instability and put the economy on a sustainable debt course.

In summary, we would recommend the a number of prior – and immediate – actions to demonstrate the Government's commitment. The authorities will need to expedite fiscal consolidation, strengthen institutional oversight and improve internal commitment and capacity to debt management as possible pathways for Zambia towards an IMF financial and technical support programme:

- i. The Government must take more concerted prior actions to enhance fiscal and debt management and to undertake necessary fiscal adjustment. It must cap non-concessional borrowing and dismantle pipeline (committed but undisbursed) debt over the short-to-medium term in order to stabilise debt levels. Starting in the 2020 National Budget, Zambia must commit to implementing an extended and revised ESGP, along with a revised and legally

reinforced Medium-Term Debt Strategy.

- ii. The Government must finalize the long outstanding legislative reforms, particularly revising the Loans and Guarantees Act and Public Procurement Act, and enacting the Planning and Budgeting legislation.
- iii. The Government must strengthen institutional oversight over borrowing and overall fiscal management. The borrowing oversight will improve the effectiveness of future debt contraction, thus fostering a positive contribution of term financing to the country's economic and social development. Strengthening institutional oversight will require finalising the financial oversight reforms and insulating key public institutions that monitor, support and execute spending. It will also require comprehensive structural reforms to address ongoing business climate, investment climate, social sector and agricultural sector weaknesses. Strengthening all these institutions and structures will act as a key signal to the IMF that Zambia is serious about addressing the ongoing fiscal management weaknesses and the risks of corruption and other vices. This will also boost investor confidence, relieve pressure on the Kwacha and lower future refinancing costs.
- iv. The Government needs to demonstrate commitment to bringing debt to sustainable levels as well as improve its internal capacity to execute its proposed approach. It can do this by bringing in IMF technical assistance through a Staff Monitored Programme, and creating a strategic and measurable roadmap to reducing debt levels. Moreover, the Government can institute a comprehensive, routine, transparent system for public debt recording, monitoring and public reporting.

An IMF deal remains within Zambia's reach, and becomes increasingly necessary as households and firms continue to feel the day-to-day adverse impact of debt. However, securing the deal will take genuine commitment from the Government to demonstrate that it is committed to restoring fiscal fitness and sustainable debt over the medium-term. This requires prior fiscal and debt, legislative, structural and institution reform actions, starting with the 2020 budget. All these actions are beneficial in themselves as they will help restore public and investor confidence, to stabilise the exchange rate and through an eventual IMF deal, to reduce debt servicing costs over time. Ultimately, the recommended prior actions in terms of fiscal and debt, legislative institution and structural reforms will be the main precursor and pathway for Zambia to secure the crucial support of the IMF.

1 Introduction

Zambia has been vying for an IMF-supported economic programme since 2016. This quest was triggered by a significant economic decline in 2015. Initially, most observers viewed the economic downturn as a transient exogenous shock. However, the slump established itself as the new normal for the country. By early 2019, Zambia's real Gross Domestic Product (GDP) growth remained markedly subdued, its local currency had experienced persistently high depreciation with several episodes of notable volatility, and a number of other disquieting instabilities remained inherent. Notable among them, the country faced high risks of fiscal and debt distress.

While, to date, Zambia's three-year scurry for an IMF-supported programme has seen dismal success and remains in limbo, in contrast, others economies like Ghana and Zimbabwe appear to be making headway in securing IMF programmes. Ghana experienced a notable drop in economic performance in 2014. Less than a year later, in 2015, Ghana secured an IMF Extended Credit Facility (ECF). Similarly, in a bid to fix an ailing economy, the Zimbabwean authorities appointed a new Finance Minister in September 2018. The Minister immediately instituted a number of policy, legal, institutional and structural reform efforts, which showed such credibility that eight months later, in May 2019, the Managing Director of the IMF approved a Staff-Monitored Programme (SMP) for Zimbabwe, covering the period from May 2019 to March 2020.

A number of key questions naturally emerge from the foregoing: is an IMF-supported programme relevant and important for Zambia? Does Zambia have any feasible pathways to an IMF deal? This paper tackles these issues, using simple descriptive statistical analysis organized as stylized facts and viewed through a political economy lens. We unravel the economic, legal and political factors affecting Zambia's prospects to secure an IMF package.

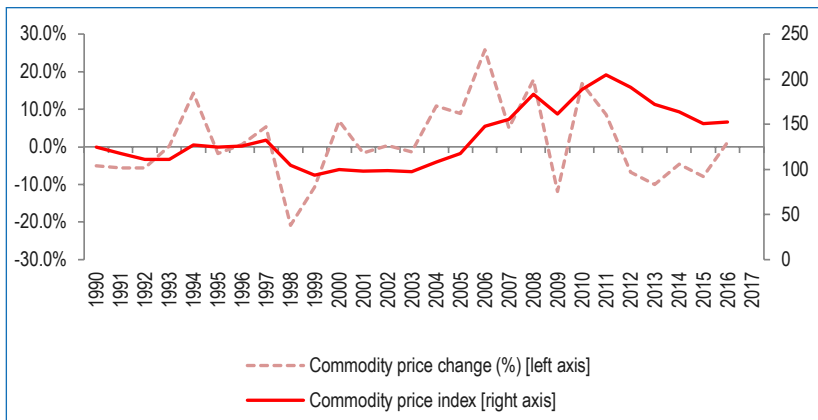
The rest of the paper is organized as follows: Section 2 presents evidence about a turning tide in a number of African comparator countries. Section 3 drills down into the case of Zambia, presenting country-specific evidence on the relevance and importance of an IMF-supported programme for the country. In Section 4, we explore some of the feasible pathways at Zambia's disposal towards an IMF deal. Section 5 offers our concluding remarks.

2 A Turn in the Tide in Africa...

With the dissipation of the 2004-2011 commodity price super-cycles (Figure 2.1), from round 2012, the tide started to turn for the worst in a number of African countries. Frequent episodes of instability and economic growth decline became manifest in many sub-Saharan African countries. Most of these countries clearly needed to take greater care in designing and implementing credible macroeconomic policies and reform programmes that could foster and lock in stability and foster sustained inclusive growth.

A descriptive statistical look at Zambia and four comparator countries – Angola, Mozambique, Ghana and Zimbabwe – over 2010-2018 (with projections to 2024 where data were available) is telling. It shows that economic malaise that arose were not unique to Zambia. However, among these comparator countries, Zambia was generally one of the worst two countries in terms of macroeconomic misfortunes. The subsections that follow present the evidence on the foregoing summary views.

Figure 2.1: Global commodity prices



Source: author's construction from UNCTAD database (UNCTADStat, 2019)

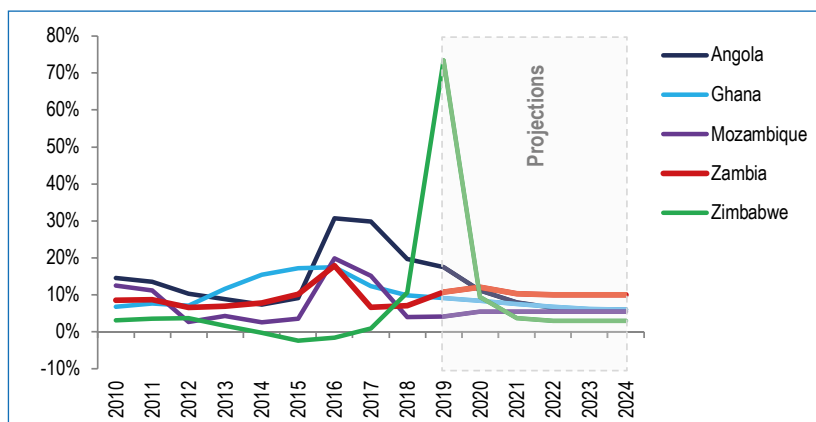
2.1 Macroeconomic instability

We drew on two measures of (in)stability, namely the inflation rate and exchange rate changes, to illustrate the recent happenings in the five comparator countries. The inflation rate was used as a proxy for commodity price stability while exchange rate changes captured the level of local currency stability.

Inflation rates rose sharply in 2013 for Ghana, and in 2015 for Angola, Mozambique and Zambia. In contrast, Zimbabwe's inflation rate followed

a very different trajectory, with an anticipated peak of 73% in 2019 (Figure 2.2). For the other four countries, the rates peaked in 2016, with Angola being the worst affected with an outcome of 31% in that year. Zambia's peak inflation rate was 18% (two percentage points below Mozambique). The IMF's projections suggest that Zambia's inflation, which had declined since the 2016 peak, will increase to 12% in 2020 and close the reference period at 10%, in breach of the country's targeted inflation range of 6-8%. From 2020-2024, all five comparator countries are anticipated to experience relative price stability, with Zambia expected to record the highest inflation rates in the group.

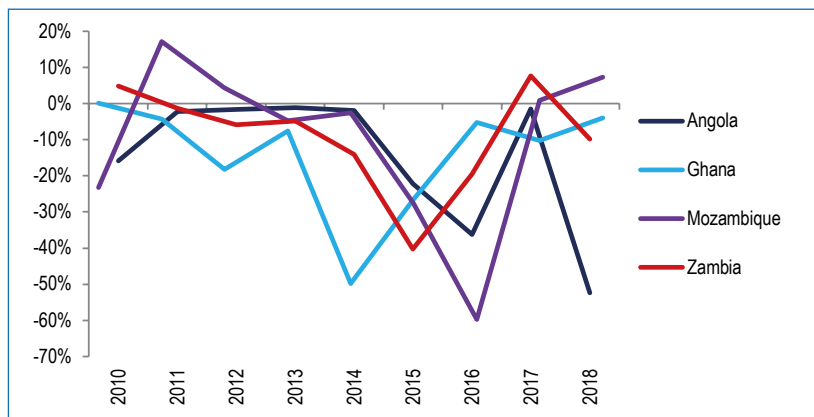
Figure 2.2: Inflation rates (annual % change)



Source: author's construction from WEO database (IMF, 2019)

Exchange rate movements in the comparator countries were quite volatile during the reference period (2010-2018), a reflection of dependency on a narrow range of primary export commodities that are susceptible to the vagaries of global commodity price fluctuations. Although Zambia's worst record of depreciation over the period, 40% in 2015, was not the worst outturn among the comparator countries, the country still closed 2018 with the second weakest local currency position, with a depreciation of 10% (Figure 2.3).

Figure 2.3: Exchange rates change (annual %)



Negative sign (-) depicts local currency depreciation

Zimbabwe excluded due to its currency collapse around 2002

Source: author's construction from UNCTAD database (UNCTADStat, 2019)

2.2 Growth and per capita growth performance

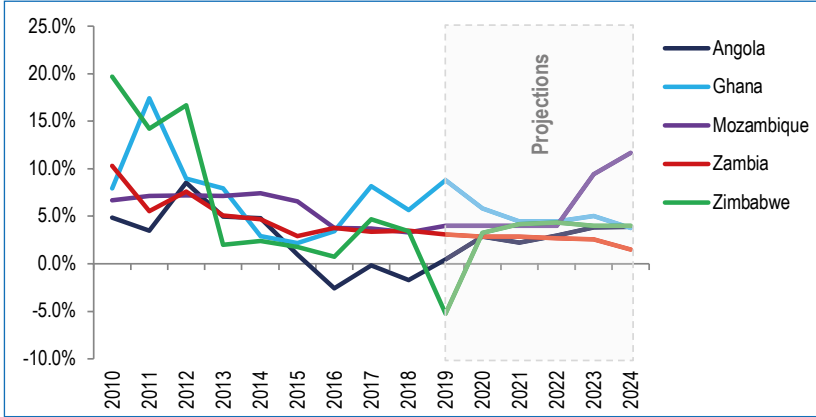
To elaborate the recent growth experiences in the five comparator countries, we utilized two measures of growth: the real GDP growth rate; and the Gross National Income (GNI) per capita level. The GNI per capita was as measured by the World Bank in its Atlas method¹. The reference period was 2010-2018, with projections for 2019-2024.

In terms of **real GDP growth** performance, at the start of the period, Zambia held the second highest growth rate, 10.3%, and was only surpassed by Zimbabwe with an impressive 19.7% growth rate (Figure 2.4). However, with all the economic woes that would emerge in the interim, Zambia's GDP growth rate would decline to 2.9%, the lowest showing in over a decade. The IMF predicts that Zambia's real growth will slow down to 2% by the close of 2019. And given the country's current economic trajectory, Zambia's growth rate is projected to decline further to a meagre 1.5% by 2024², relegating the country to worst growth performer in the group. On the other side of the spectrum, Mozambique is expected to close the period with an impressive growth rate of 11.7%. The other three (Angola, Ghana and Zimbabwe) will be expected to post growth in the range of 3.8-4.0%.

1 The Atlas method GNI is what the World Bank uses to classify countries by income group. For the current 2019 fiscal year: low-income economies are defined as those with a GNI per capita of \$995 or less; lower middle-income economies are those with a GNI per capita between \$996 and \$3,895; upper middle-income economies are those with a GNI per capita between \$3,896 and \$12,055; high-income economies are those with a GNI per capita of \$12,056 or more.

2 Latest estimates in IMF Article IV Consultations of July 2019.

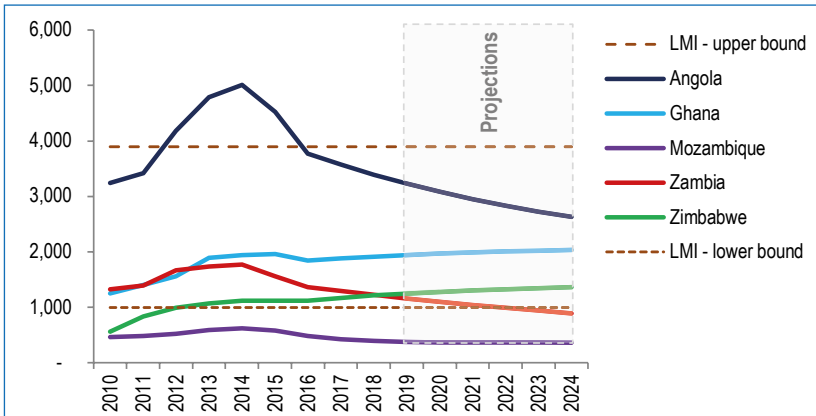
Figure 2.4: Real GDP growth rates (%)



Source: constructed from WEO database (IMF, 2019) and Article IV Consultations (IMF, 2019)

Consistent with the GDP growth story, Zambia’s **GNI per capita** performance, which had elevated the country to lower-middle income status in 2011, fell from a peak of US\$1,770 in 2014 to US\$1,170 in 2017 (Figure 2.5). At this rate, projections suggest the GNI per capita level will decline further to US\$938 by 2023, pushing Zambia back into lower income country status and taking it further away from its overarching Visions 2030 aspiration of becoming a prosperous middle-income country by 2030. From having the second highest per capita income among the comparator countries in 2010, by 2024, Zambia is projected to have the second worst performance of the group.

Figure 2.5: GNI per capita (US\$)



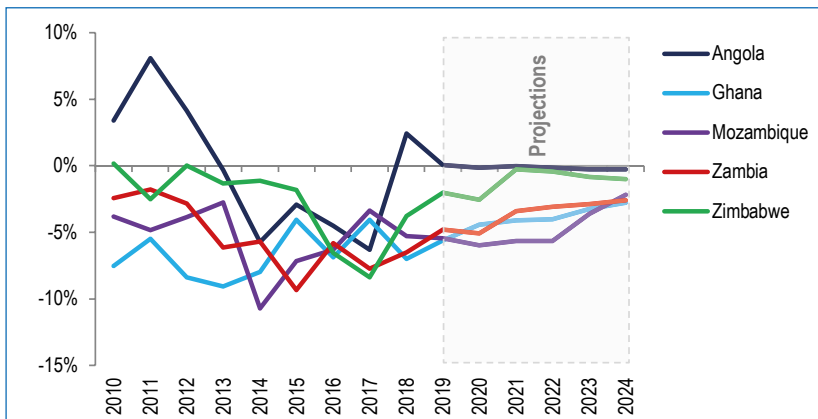
Source: constructed from WDI (World Bank, 2018)

2.3 Fiscal and public debt performance

To compare the fiscal and public debt performance of the comparator countries, we used statistical measures of fiscal balances (fiscal revenues less fiscal expenditures) and total public debt stocks, respectively. These were assessed over the period 2010-2018, with projections to 2024.

Regarding **fiscal balances** (on a cash basis), all the comparator countries – except for Angola – experienced varying magnitudes of persistent fiscal deficits throughout the reference period. Zambia's deepest deficit, at 9.3% of GDP in 2015, was the second worst outturn in the group, surpassed only by Mozambique's 11% of GDP deficit in 2014 (Figure 2.6). The IMF predicts that Zambia's fiscal cash balance will ease with time, reducing from a projected deficit of 4.8% of GDP in 2019 to 2.6% of GDP in 2024; ahead of only Ghana's 2.8% of GDP deficit. On a commitment basis, Zambia's fiscal balances are expected to be considerably worse, with expected deficits of 9% of GDP in 2019 and 5.6% of GDP by 2024.

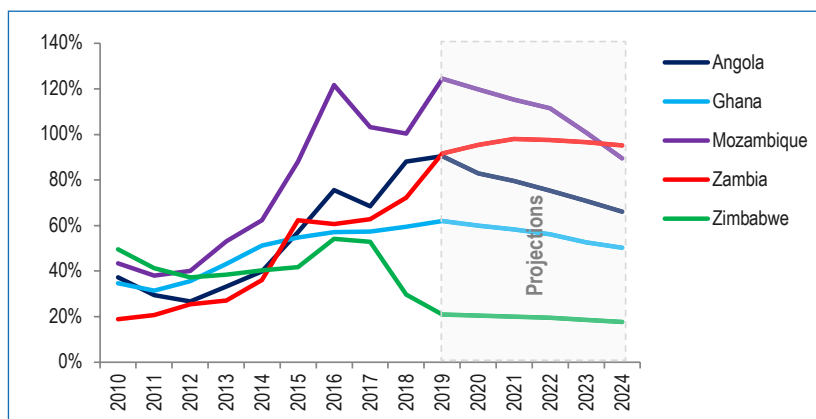
Figure 2.6: Fiscal balance, overall (% of GDP)



Source: constructed from *Fiscal Monitor Reports* (IMF, 2019) and *Article IV Consultations* (IMF, 2019)

The mounting **public debt** levels across the comparator countries over the reference period are unsettling. In the group of five, Zambia appears to have had the largest borrowing appetite during the period. From having the lowest public debt stock in the group, at 18.9% of GDP, Zambia's indebtedness soared to 72.4% of GDP in 2018 (Figure 2.7). It is projected to jump to 92% of GDP in 2019. By 2024, the country's debt stock will stand at 95% of GDP, posting the largest projected debt overhang among the comparators, surpassing even Mozambique's projected debt stock of 89% of GDP.

Figure 2.7: Total public debt (% of GDP)



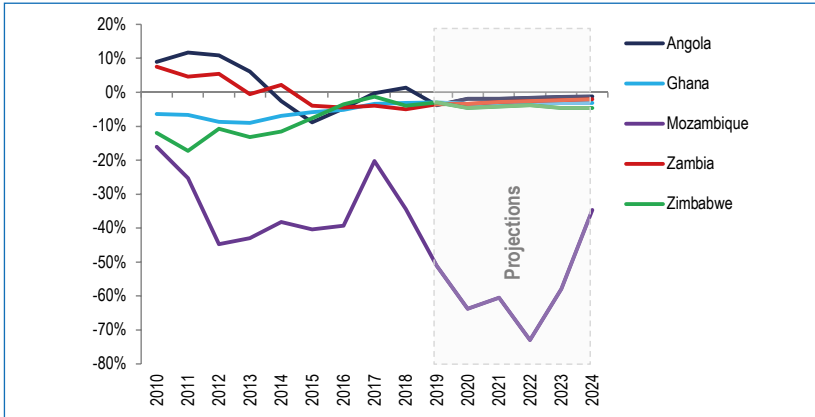
Source: constructed from WEO database (IMF, 2019)

2.4 External economy performance

On the external front, the current account balances in the Balance of Payments (BOP) and inward flows of Foreign Direct Investment (FDI) are two simple intuitive measures that capture the external health of an economy. We compared these two measures in turn across the five comparator countries, over the period 2010-2018, with projections to 2024 in the case of the current account balances.

Between 2010 and 2018, Zambia's **current account balance** saw mixed fortunes that were generally better than most of the other countries in the group of five. The country opened the period in 2010 with a current account surplus of 7.5% of GDP, which was below only that of Angola with a surplus of 9.0% of GDP (Figure 2.8). With the 2015 economic slump, Zambia's current account began to experience deficits that continuously deteriorated to the country's worst position over the period, 5.0% of GDP in 2018; this was the second worst posting in the group, after Mozambique's deficit of 34% of GDP. The IMF projects that Zambia will have rebounded somewhat by 2024, with a deficit of 2.0% of GDP, closing the period in second position overall behind Angola; the balancing being most likely propped up by anticipated favourable copper export performance. Mozambique was by far the worst performer in terms of the current account balance, with a deficit that would deteriorate from 16% of GDP in 2010 to a massive 73% of GDP in 2022 and an end-period level of 35% of GDP in 2024.

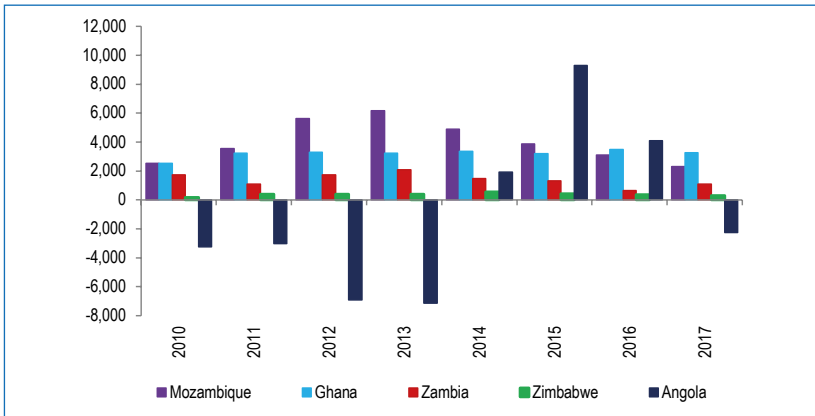
Figure 2.8: Current account balances (% of GDP)



Source: constructed from WEO database (IMF, 2019)

FDI inward flows typically signify the level of confidence of foreign investors in a given investment jurisdiction or economy. Over the period 2010-2017, Zambia was the average or median country in the group in terms of FDI inflows. In 2010, inflows to Zambia amounted to US\$1.7 billion compared to US\$2.5 billion each into Mozambique and Ghana, US\$165.9 million in Zimbabwe and capital flight or FDI flow reversal of US\$3.2 billion for Angola (Figure 2.9).

Figure 2.9: FDI inward flows (US\$ millions)



Source: constructed from UNCTAD database (UNCTADStat, 2019)

Zambia’s inward FDI increased to a period peak of US\$2.1 billion in 2013 before plummeting to US\$662.9 million in 2016 (an election year and the year after the 2015 downturn). By the close of the period in 2017, FDI

inflows had rebounded somewhat to US\$1.1 billion. Mozambique and Ghana were both well ahead of Zambia in attracting inward FDI flows throughout the period. Angola fared badly in the initial years (2010-2013) with persistent FDI inward flow reversals that signified massive capital flight, then a return to positive inward flows during 2014-2016, and finally a reversal again in 2017. Angola therefore experienced the most erratic or volatile record of FDI inward flows over the period. Zimbabwe's inward flows were positive but significantly subdued throughout.

Ultimately, as earlier alluded to, the tide has turned for the worst in the five African comparator countries. Although the episodes of commodity price instability are expected to dissipate going forward, currency fluctuations seem set to remain as a notable worry. Real GDP growth is mostly expected to remain subdued going forward, particularly for Zambia. Per capita incomes are expected to decline, remain flat or only increase marginally, curtailing the ambitions of the comparator countries to improve their income standings. While Zambia's fiscal balance is expected to improve somewhat, on a commitment basis, the deficit will remain quite deep and the marginal improvements will be too late, leaving a huge debt overhang for Zambia. The external economies will be somewhat favourable, but not sufficient to make a significant difference to Zambia's stability and growth fundamentals.

The five countries will do well to redouble their efforts in formulating reliable policies and reform programmes and in effectively implementing them. Policy and structural reforms will play a cardinal role in fostering stability and spurring sustained inclusive growth. For Zambia in particular, the macroeconomic conditions have deteriorated sharply. As the IMF indicated in July (IMF, 2019), the outlook for Zambia is clouded by the (ongoing drought and) heightened debt vulnerability. The country remains significantly exposed to high risk of external and public debt distress, and urgently needs to formulate key reforms and make a firm commitment to implementing them.

3 Relevance and Importance of an IMF Programme for Zambia

Earlier (in Section 1) we briefly explained how Ghana pursued and secured an IMF ECF in 2015, only a year after it experienced a notable economic decline. We also explained how Zimbabwe initiated extensive policy, legal and structural reforms after September 2018 to turn around its ailing economy and secured an IMF SMP only eight months later, in May 2019.

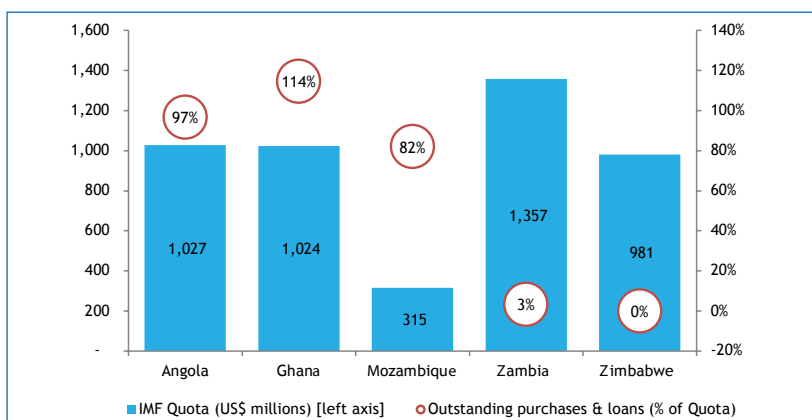
What we did not explain is that Angola and Mozambique have also been recent beneficiaries of the IMF so that out of the five, Zambia is the only country pursuing an IMF programme that has not secured one over the current period of economic downturn.

3.1 Financial positions with the IMF: Five comparator countries

For the five comparator countries – Angola, Ghana, Mozambique, Zambia and Zimbabwe – the following statuses with the IMF hold (see also, Figure 3.1).

Angola: as of 31 May 2019, the country held a Special Drawing Rights (SDR³)-quota of equivalent of US\$1.027 billion at the IMF. From its quota, a total of US\$992 million (or 96.1%) had been approved and stood as outstanding purchases and loans to Angola under a three-year Extended Fund Facility (EFF) IMF programme from 7 December 2018 to 6 December 2021.

Figure 3.1: IMF programme status



Source: constructed from <https://www.imf.org/external/np>

Ghana: as of 31 May 2019, Ghana held an SDR-quota of equivalent of US\$1.024 billion at the IMF. The country's total outstanding purchases and loans against its quota were US\$1.17 billion (114.4% of the quota) under an Extended Credit Facility (ECF) IMF programme, agreed on 3 April 2015 and expired on 29 March 2019. Ghana therefore presents a case of a country that was able to attract IMF financial support above and beyond its quote limit by 14.4%.

Mozambique: as at 31 May 2019, Mozambique's IMF SDR-quota was equivalent of US\$315 million and the country's outstanding purchases

3 Exchange rate: US\$1.39 = SDR1.00

and loans against this quote amounted to US\$258 million (81.9%), under three IMF programmes, a Rapid Credit Facility (RCF), an Exogenous Shocks Facility (ESF) and the latest programme, a Standby Credit Facility (SCF) approved on 19 April 2019 to support the aftermath of the Cyclone Idai disaster of 2019.

Zambia: as of 31 May 2019, Zambia held an SDR-quota of equivalent of US\$1.375 billion at the IMF, the largest quota in the group. The country's total outstanding purchases and loans against its quota were US\$45 million (3.3% of the quota) against the ECF programme that expired back in June 2011. Zambia has been bidding for a new IMF programme since December 2016 when the Cabinet gave the Minister of Finance Authority to seek Fund support (Cheelo, 2018).

Zimbabwe: as of 31 May 2019, Zimbabwe held an SDR-quota of equivalent of US\$981 million at the IMF. The country had no outstanding purchases and loans against its quota since the expiry of its last ECF programme in October 2000. However, after a change in political administration, in September 2018, Zimbabwe initiated a new bid to secure a new IMF programme. The IMF approved a Staff-Monitored Programme (SMP), for the period of May 2019 to March 2020, designed to dispense advice without the accompaniment of any loans.

As aforementioned, out of the five comparator countries, Zambia is the only one whose bid for IMF support has remained in abeyance despite the country having started its campaign way back in 2016. Clearly, the country has been overlooking or neglecting something critical in its attempts to lay the groundwork for negotiations with the IMF.

But, would an IMF programme really be useful for Zambia? Would it offer benefits that make a meaningful difference to the country's macroeconomic performance and economic fortunes in general? Or would an IMF programme simply entail, as some have argued, saddling the country with a larger debt burden and escalating the ongoing debt stress and other instabilities.

3.2 Relevance and significance of an IMF programme for Zambia

Based on several studies since 2016, ZIPAR has frequently reiterated that IMF support would be critical for Zambia, both for the cheaper sizable financing it promises and the customized technical support that comes with the money. Cheelo (2018) lists and elaborates on five key points regarding the benefits of an IMF programme, which remain relevant today. These are summarized below with a few minor modifications:

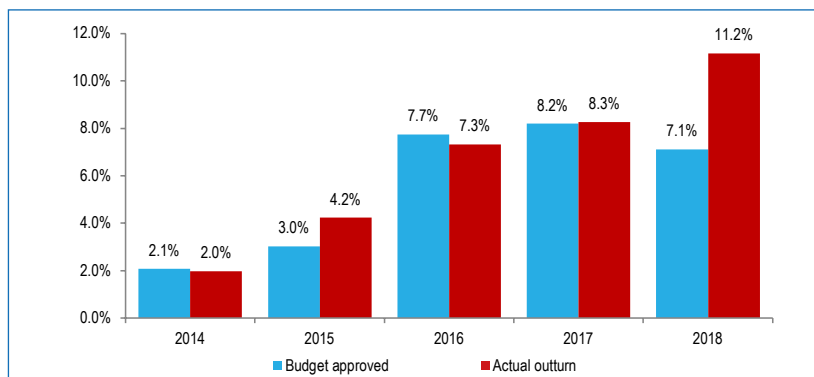
Sizable financing: to bring the size of IMF financing into perspective, we compare it with the requirements for settling the principal amounts of the first Eurobond issued by Zambia. Recall that Zambia's IMF quota as at 31

May 2019 was US\$1.375 billion. Deducting the total outstanding purchases and loans of US\$45 million the eligible quota is US\$1.312 billion. Assuming Zambia could secure 100% of this amount under a Standby Credit Facility⁴ to pay off the Eurobonds as they fall due in 2022 and 2024, the country would be able to cover the full amount (100%) of the first Eurobond of US\$750 million in 2022 and a further 56% (or US\$562 million) of the US\$1.0 billion Eurobond falling due in 2024. Essentially, the US\$1.312 billion, secured under a standby arrangement, would cover 75% of the US\$1.750 billion for 2022 and 2024. If we further assume that, like Ghana, Zambia could secure 114% of its uncommitted or undrawn quota, the equivalent amount (US\$ 1.496 billion) would cover 85% of Zambian financing requirements for the first two Eurobonds. This is not a trivial or dismissible amount of money, particularly for a country facing significant fiscal constraints.

Affordable finance: IMF financing is expected to be in the form of concessional zero- or low-interest loans. Overall, interest payments on external debt are exerting growing pressure on Zambia's National Budget. In 2014, planned (or budget approved) external debt interest payments were 2.1% of domestically financed expenditure and the actual expenditure was slightly slower than planned at 2.0% of domestically financed expenditure (Figure 3.2). As of 2018, the external debt burden had escalated such that the planned amount was equivalent to 7.1% of domestically financed expenditure. Worse still, the 2018 actual outturn in interest expenditure on external debt came to 11.2% of domestically financed expenditure. In the first half of 2019, interest payments on debt servicing (excluding amortization) swallowed 22% of total expenditure (excluding amortization) compared to an interest payment target of 18% of total expenditure. Considering that the Eurobonds are the most expensive component of Zambia's external debt, replacing the Eurobonds with IMF loans under the aforementioned standby facility, would alleviate a big part of the growing debt service burden.

4 "The IMF Standby Credit Facility (SCF) provides financial assistance to low-income countries (LICs) with short-term balance of payments needs. ... The SCF supports LICs that have reached broadly sustainable macroeconomic positions, but may experience episodic, short-term financing and adjustment needs" (IMF, 2019). In the case of Zambia, the expected Eurobond bullet payments due in 2022 and 2024 could constitute such a financing need.

Figure 3.2: External debt interest payments (% of domestically financed expenditure)

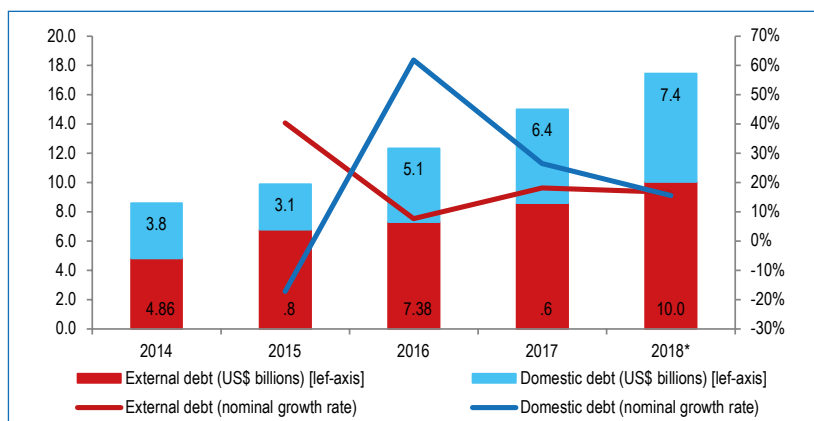


Source: Author's construction from MOF Fiscal Tables

Technical assistance on macroeconomic management and governance:

The IMF is a global authority in the surveillance of the multilateral financial system and offers technical assistance to territories where their health might be faltering or at risk of instability. For Zambia, the IMF has consistently offered vital early warning insights about the growing risks of debt distress. In 2016, the IMF warned about possible fiscal and borrowing slippages in the build up to the presidential and general elections. In that year, the country's external debt increased by 7.7% (in nominal US\$ terms) and domestic debt by 61.9%; so that the annual average public debt increase was 24.8% (Figure 3.3).

Figure 3.3: Public debt (US\$ million) and nominal growth in public debt (%)



Source: constructed from MOF Annual Reports (various)

In 2017 and 2018, the IMF reiterated a few times that: “[the] borrowing plans provided by the authorities continue to compromise the country’s debt sustainability and risk undermining its macroeconomic stability and, ultimately, living standards of its people”. In tandem with these warnings, Zambia’s debt stock grew by 21.6% and 16.2%, respectively, in 2017 and 2018, showing that the country was unwilling or unable to adjust its borrowing plans despite the need for austerity during the period. By 2018, Zambia’s domestic debt stood at around US\$7.4 billion and its external debt was around US\$10.0 billion, implying a total public debt stock of US\$17.4 billion, including arrears (but excluding arrears on VAT refund payments). At the end of 2018, in the absence of a Fund-supported programme, the IMF could not provide specialist technical assistance and only offered arms-length advice. The country remained at high risk of debt distress.

Transparency and accountability mechanism: An IMF financial support programme to Zambia would come with conditionalities such as: requirements for strict quantitative fiscal and monetary targets and adjustment, which Zambia would have to adhere to; insistence on transparency and accountability (good governance) in economic management; and (with the new face of the IMF) requirements for protection of social spending. The programme would therefore serve as an effective external accountability mechanism. In circumstances where the country struggles to stick to national plans or programmes – for instance, where Zambia’s performance in implementing the Economic Stabilization and Growth Programme (ESGP) was weak (Banda-Muleya, et al., 2019) – an IMF programme would have been useful for compelling adherence. Similarly, the external impetus of an IMF programme would force good governance by reinforcing the work of independent or semi-autonomous national transparency and accountability institutions such as the Legislature, watchdog public institutions (like the Auditor General and Financial Intelligence Centre (FIC)), civil society, the media and think tanks and research institutions. Granted, these require additional strengthening for them to foster transparency and accountability more effectively.

Signal to foreign investors and development partners: it is no secret that the international community generally takes the IMF’s opinions very seriously when considering where to invest and where to provide development aid. Even the international credit rating agencies look to the IMF for opinions about macroeconomic and financial soundness. For instance, Zambia experienced at least three credit rating downgrades in 2018, and two so far in 2019 (Moody’s in May⁵

5 In May 2019, downgraded the Government of Zambia’s long-term issuer ratings to Caa2 from Caa1 and changed the outlook to negative from stable.

and Fitch in June⁶). In all cases part of the rationale for the downgrades was that in the absence of an IMF financial support programme, it seemed likely that Zambia's macroeconomic conditions would continue to deteriorate and its exposure to debt and import payments distresses would only worsen. By failing to secure an IMF programme, Zambia forfeited the opportunity to build international confidence, including opening doors to funding from other multilaterals such as the World Bank and the African Development Bank (AfDB).

4 Is All Lost for Zambia to Clinch an IMF Deal? Feasible Pathways

Considering Zambia's limited progress towards an IMF financial support programme and the Fund's recent hardliner stance to not hold any discussions towards a programme, is all lost for the country? Are we out of the running for an IMF programme for the foreseeable future? The simple answer to these questions is, no. The country still has options to pursue a number of opportune prior actions, which will win the IMF over and soften the Fund's hardliner position. However, Zambia has thus far not taken these actions⁷ in line with the expectations of the IMF.

This raises the question: what does the IMF expect of Zambia? What prior action would the Fund look for in deciding whether or not to negotiate a support package for reform and economic recovery programme? The IMF has provided indicative answers in the 2019 Article IV Consultation Country report for Zambia (IMF, 2019). Within this, the "Directors noted the importance of ongoing and future technical assistance in enhancing the authorities' capacity", a latent indication of the Fund's willingness to offer assistance. Moreover, the Directors "cautioned that there is a narrow window for tackling fiscal challenges in an orderly and planned manner". Implicit in this statement is the fact that the window for Zambia to negotiate an IMF deal is also narrow. The extracts in Box 4.1 provide indications of the key insights from the IMF on the prior actions it would expect.

From Box 4.1 it is quite apparent that among the key expectations of the IMF are the following prior actions, which Zambia should take in order to make a compelling case of commitment to fiscal adjustment and to negotiating an IMF-supported recovery programme:

6 In June 2019, Fitch Ratings downgraded Zambia's long-term foreign-currency issuer default rating (IDR) to 'CCC' from 'B-'.
7

Prior actions is part of IMF terminology, describing measures that a country agrees to take before the IMF's Executive Board approves financing or completes a review. It reflects those measures that a country will voluntarily take as proof of seriousness about enhancing economic management.

Box 4.1: Extract from IMF Executive Board Assessment

Directors ... cautioned that there is a narrow window for tackling fiscal challenges in an orderly and planned manner. This would require a large front-loaded and sustained fiscal adjustment centered on stronger control and prioritization of public investment projects and postponing the contracting of new non-concessional debt, accompanied by enhanced revenue mobilization and the scaling back of exemptions and tax expenditures, while reducing domestic expenditure arrears. Directors stressed that the adjustment strategy should aim to minimize drag on growth and contain the impact on priority social spending. Some Directors also urged the authorities to carefully consider the benefits and disadvantages of shifting from a value-added tax to a sales tax.

... Directors emphasized that strong actions would be needed to reduce debt-related vulnerabilities and called for continued efforts to enhance debt management and transparency. They urged the authorities to address weaknesses in procurement and in project selection and management to ensure prioritization and greater investment efficiency. They also stressed that stronger procedures are needed to ensure that budget execution reflects the authorities' fiscal goals...

Directors ... commended BOZ's actions to implement the recommendations of the 2017 FSAP... They also recommended continuing to address nonperforming loans.

... They emphasized that achieving inclusive growth and reducing poverty will require a steady focus on improving the investment climate, promoting productivity and human capital, and addressing the risk of corruption. They advised the authorities to develop proactive strategies to respond to the drought and climate-related risks and to promote well-functioning support programs in the agricultural sector to enhance resilience.

- (i) **Tackling fiscal management challenges:** the IMF expects Zambia to tackling fiscal challenges through:
- Re-establishing an orderly and planned approach (not the current ad hoc manner) to fiscal governance. Operationally, this should include the formulation of coherent policies and reform programmes and the systematic and firm commitment to implementing these instruments. Revisiting the ESGP, updating it and extending it to the period 2020-2022 would be a useful starting point.
 - Instituting stronger controls, including from a legislative reform perspective (by finalizing the revisions of the Public Procurement Act and Loans and Guarantees Act, and enacting the Planning and Budgeting legislation).
 - Establishing a prioritization mechanism for public investment projects (e.g., legally reinforced insistence on prior project appraisals, feasibility studies and environmental impact assessments for all prospective public investment projects before these projects are commissioned).

- Establishing measures for postponing the contraction of new non-concessional debt (e.g., by revisiting the Debt Management Strategy and giving it legal backing through the issuance of a Debt Management Statutory Instrument (SI), pending the finalization of the Loans and Guarantees, and Planning and Budgeting legal reforms).

(ii) *Enhancing revenue mobilization:* overall, the options that the IMF has in mind for enhancing revenue mobilization are not immediately clear, given the recent escalation of tax and non-tax revenue collection points on the one side and the subdued growth Zambia is experiencing on the other hand. Some hints from the Fund include: (a) scaling back on exemptions; (b) reducing tax expenditure; and (c) reducing domestic expenditure arrears. As already indicated, the feasibility of taking these as prior action comes into question considering the severe nature of the financing challenges Zambia is currently facing. This could be one prior action that the authorities could negotiate to “soft peddle”. However, a comprehensive and conclusive evidence-based position on the costs and benefits of switch from VAT to sales taxes should be an important prior action to take.

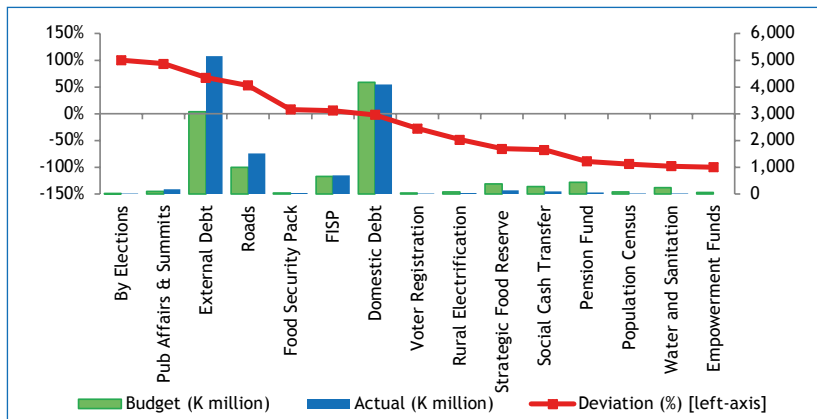
(iii) *Minimizing the drag on growth:* directly, little can be done by way of establishing robust growth stimulus programmes or interventions for the private sector, particularly given the ongoing fiscal constraints. However, fostering great public investment efficiency through enhanced procurement and management (including through tracking indicators like the Incremental Capital-Output ratio) could help to minimize the drag on growth. Between 2011 and 2014, real GDP growth was 5.7% per year on average and the National Budget’s real growth over the same period was a massive 17.8%. The massive increases in planned and actual government spending were not well appraised and thus did not foster sustained growth. As earlier noted, in 2015, Zambia’s growth declined, and a new trajectory was established with the growth rate averaging 3.6% annually during 2015-2019⁸. Thus during this period, total planned expenditure in the budget slowed down markedly to 5.0% per year, suggesting a willingness and ability by Zambia to make some fiscal adjustments. However, as argued earlier, the high level of borrowing persisted and was coupled with inadequate adjustment. Moreover, the quality of public spending, particularly public investment project expenditure remained weak and problematic.

8 Growth and Consumer Price Index (CPI) statistics used to estimate growth in 2019 were projections.

- (iv) Establishing sound debt management and transparency:** the 2016 Constitution provides that: “The National Assembly shall oversee the performance of Executive functions by... (d) approving public debt before it is contracted” and the Public Financial Management Act 2018 makes it illegal to seek approvals retroactively. Jointly, these two provisions imply that all unplanned debts that Zambia took on in 2018 and so far in 2019, which were not part of the Appropriation Bill that the National Assembly had sight of were probably illegal. Similar, international best practices such as the undertaking of project appraisals, feasibility studies, environmental impact assessments, etc. prior to the inception of any project, were not typically done, thus erode debt quality and transparency. Therefore, the key prior actions required here would include:
- Establishing a short-term legal framework (SI) to reinforce a revised and updated Debt Management Policy and Strategy, pending the finalization of the revision of the Loans and Guarantees Act and establishment of the Planning and Budgeting legislation; and
 - Instituting a credible, comprehensive and transparent public debt recording, monitoring, reporting and information sharing system, which offers more detail than simply headline public debt statistics. This should include summaries of the debt terms and conditions (loan interest rates, payment structures, grace periods and tenure, etc. as well as loan appraisal summary (with purpose and rationale, earmarking or ring-fencing mechanisms, utilization modalities, etc.). This would allow for critical public scrutiny, particularly by oversight institutions like the National Assembly and by independent key local and international experts.
- (v) Addressing procurement and project selection weaknesses:** as already highlighted, this would dually require prior actions in terms of: (a) finalizing the Public Procurement Act; and (b) establishing public procurement mechanism (e.g., legally reinforced insistence on prior project appraisals, feasibility studies and environmental impact assessments), which should mandatorily apply to all prospective public projects.
- (vi) Ensuring the budget execution reflects fiscal goals:** a straightforward but politically unpopular prior action for this would be to establish legally binding fiscal rules (legally prescribed quantitative limit on the fiscal deficit, expenditure, borrowing, etc.) through the issuance of an SI.

- (vii) Improving the investment climate and promoting productivity:** the prior action here would include regaining momentum on evidence-based doing business and competitiveness reforms. The evidence that informs these reforms would come from the likes of the Investor Perception Surveys (BOZ), Enterprise Surveys (World Bank), Doing Business framework (World Bank), Global Competitiveness Reports (World Economic Forum), etc.
- (viii) Human capital development:** the short-term prior action would be in terms of enhancing protection of social sector spending line-items in the Budget to avoid the deterioration in financing of social sector budget items that was seen in the first half of 2019 (Figure 4.1) for instance. Over the medium term, a key action would be to conduct routine or at least frequent periodic quality of public expenditure (QPE) reviews in the social sectors, which aim to detect and correct qualitative and quantitative fiscal performance slippages.

Figure 4.1: Fiscal performance (selected items), January-June 2019



Source: Author's construction from MOF Fiscal Tables

- (ix) Addressing the risk of corruption:** this will require prior actions to: strengthen watchdog and law enforcement institutions (Auditor General's Office, Financial Intelligence Centre (FIC), Drug Enforcement Commission (DEC), Anti-Corruption Commission (ACC), Immigration Department, Zambia Police, etc.); legally insulating them from undue political and other influences; and enhance the efficiency and effectiveness to do a professional job in line with their legal mandates. According independence and protection to such institutions can be a strong showing of commitment to addressing the risk of corruption and other vices.

(x) **Establishing well-functioning support programmes in agriculture:** among others, an important prior action would be the structural reform of the Farmer Input Support Programme (FISP), particularly ensuring to establish a clear set of programme objectives, rationalize the programme's ambition, and conclusively sort out the persistent targeting challenges.

In view of the foregoing, the main prior actions that could put Zambia back on a path to the negotiating table with the IMF are summarized below:

- **Fiscal and debt management reforms** that ensure pragmatic and credible fiscal and borrowing adjustments.
- **Legal reforms** that address gaps and weaknesses in key legal frameworks like the Loans and Guarantees Act, Public Procurement Act and Planning and Budgeting legislation.
- **Institutional and structural reforms** to ensure the protection of social sector spending, to reorganize and improve the functioning of the agricultural sector, to enhance the business and investor climate, and to improve oversight and enforcement capabilities for addressing the risks of corruption, financial malpractice and other vices.

Recognizing the ongoing gaps and weaknesses in formulating and implementing the key fiscal, debt, legislative, structural and institutional reforms, and thus committing to taking the prior actions will be critical for wooing and cajoling the IMF back to the negotiating table. These prior actions (and presumably many others) are feasible pathways for Zambia to ultimately clinch an IMF financial and technical support package. They will require critical thinking to formulate reliable policies, strategies and reforms. More importantly, they will need political will and stamina to see the prior actions through.

On the other hand, a failure to pursue the feasible pathways or undertake the so-called prior actions will cost the country dearly in terms of a forfeited IMF deal. All the would-be benefits of IMF support will be missed.

5 Conclusion and Recommendations

We have observed that after the macroeconomic instability and downturn of 2015, Zambia continued to face economic challenges and decided to pursue an IMF-supported economic programme in 2016, but without success. With growth projected to slow to 2% for the year, inflation having reached 8.9% in July and delayed disbursements of wages and social protection programmes escalating, the Zambian economy is increasingly feeling the impact of debt. This has only increased the need for IMF support to Zambia to rebalance the fiscal instability and put the economy on a sustainable debt course.

We therefore asked key questions such as: is an IMF-supported programme relevant and significant for Zambia? Why have the country's recent requests for IMF support failed? Does Zambia have any feasible pathways left for securing an IMF deal? We have tackled these questions, basing our analysis on simply intuitive descriptive statistics, stylized facts and a political economy lens. We have highlighted a number of specific pathways that Zambia could follow in further pursuit of an IMF-support programme.

In summary, we recommend the following prior – and immediate – actions to expedite fiscal consolidation, strengthen institutional oversight and improve internal commitment and capacity to debt management as possible pathways for Zambia towards an IMF financial and technical support programme:

5.1 Enhance fiscal management and expedite fiscal consolidation

The Government must take more concerted efforts to reduce Zambia's deficit over the short-to-medium term in order to stabilise debt levels and improve investor confidence, as well as demonstrate commitment to the IMF:

- i) Starting with the 2020 Budget, the Government should shift its expansionary fiscal policy stance on public administration and non-priority capital expenditures – for instance, by reducing spending on administrative infrastructure (e.g. new districts), creation of new ministries and new ministerial positions (including the reintroduction of deputy ministers), creation of new commissions, etc. – and take a more rational and conservative expenditure stance, including reducing capital spending through cancelling some infrastructure projects and only taking on debt for priority investments. The IMF has recommended reducing the deficit to 3.4% of GDP: budgeting for this would be an important first step in demonstrating commitment to reducing debt levels.

- ii) Ahead of the expiration of the ESGP at the end of 2019, the fiscal authorities should begin the process of revising and extending the programme – including specific targets where necessary for accountability. Zambia Plus should be maintained as the main set of policies, strategies and reform efforts for the further rationalization of public expenditure, for undertaking other necessary fiscal adjustments and for enhancing the quality of fiscal and economic management.
- iii) Over the medium term, the Government needs to recognise IMF's repeated concerns that Zambia's borrowing plans over the years have been too ambitious. The fiscal authorities should revise the Medium-Term Debt Strategy (MTDS), which is anchored to Zambia Plus, ensuring to rationalize the country's current borrowing plans and possibly reinforcing the strategy through a Debt Management SI that legally forces restraint.
- iv) Throughout this process of fiscal consolidation, the Government should re-evaluate its performance in terms of commitment to social sector spending, particularly social protection expenditure, and make fiscal adjustments accordingly, to ensure protected financing to these areas. Unlike the IMF of yesteryears, the present-day IMF is committed to protecting social spending and can also provide support to this end. Other important institutional reforms will be in the areas of improving the investment and business climate and addressing the risk of corruption and similar vices.

5.2 Strengthen institutional oversight

The Government must strengthen institutional oversight over borrowing to improve the effectiveness of contracting future debt to contribute to the country's economic and social development. Strengthening this oversight also acts as a signal to the IMF, as the Fund needs to be assured that any support to Zambia will be effective in promoting the country's long-term development.

- v) The fiscal authorities should finalize the work on the remaining pieces of legislation which will improve the manner in which new debt is contracted and spent – namely, the Loads and Guarantees Act, the Public Procurement Act, and the Planning and Budgeting Bill – and submit them to Parliament at the earliest opportunity.
- vi) The Government should strengthen and insulate key public institutions, particularly the watchdogs (Auditor General and FIC), the thinkers or policy advisors (think tanks, academia, etc.), the doers (implementing agencies like ERB, IDC, PACRA, ZDA, ZRA, etc.) and apex policy-makers (MOF, MNDP, Cabinet Office, BOZ, etc.), ensuring that they are sufficiently empowered and resourced to act professionally without undue external influences.

5.3 Demonstrate commitment and capacity

Government needs to demonstrate commitment to establishing debt sustainability levels and prudent fiscal management as well as internal capacity to execute the planned measures.

- vii) The fiscal authorities should consider enrolling to an IMF Staff Monitored Programme (SMP), as an informal agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic programme. This will reinforce the establishment of fiscal discipline – for example, through technical support concerning savings on expenditure and raise revenue sustainably; build trust between the authorities and the Fund; and pave the road to an IMF deal.
- viii) The Government should build capacity and skills in effective negotiation in key public institutions, particularly in MOF and MNDP, for both internal and external negotiations.
- ix) High level Government decisions such as those taken in the Special Cabinet Meeting of May 27, 2019 should be evidence-based and firmly rooted in existing policy stances and economic paradigms, to avoid undermining the professional work of the apex institutions and inadvertently weakening these institutions. Furthermore, these statements should be followed through with concrete implementation plans and actions.

An IMF deal remains within Zambia's reach, but it will take genuine commitment from Government to demonstrate that it is committed to restoring manageable debt levels in the medium-term and maintaining them in the long-term. This requires immediate action to expedite fiscal consolidation to reduce the budget deficit; strengthen institutional oversight to ensure productive use of lending; combined with longer term commitment and capacity to execute debt management plans. All these actions are beneficial in themselves as they will help restore investor confidence, stabilise the exchange rate and reduce debt servicing costs over time. Moreover, they will demonstrate the necessary commitment to sustainable debt management that is the precursor for the critical support the IMF can offer as Zambia – and her citizens – face the consequences of unsustainable debt.

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