

## Chapter One

# Background

### 1.1 The HIPC Initiative

The Heavily Indebted Poor Countries (HIPC) Initiative was first introduced in September 1996 as an official comprehensive framework to remedy the debt crisis of the world's poorest countries, hereafter referred to as HIPCs. In 2000, the initiative was enhanced to allow for deeper, faster and broader debt relief. This was done mainly in response to immense pressure that HIPC was not delivering adequate debt relief and there was mounting evidence that the initiative was failing to offer poor countries a robust exit from unsustainable debt.

In this paper we refer to enhanced HIPC interchangeably as HIPC II while the initial HIPC framework that lasted until 1999 is referred to as HIPC I.

Key features of HIPC I include<sup>1</sup>:

- Eligibility: A country must be an IDA-only borrower and must have a track record of implementing IMF/World Bank-led adjustment programmes.
- Debt Sustainability: 200-250 percent net present value (NPV) debt-exports-ratio and 20-25 percent of debt service-to exports ratio.
- Track Record: 3-years of IMF-World Bank-led adjustment programs for a country to reach the decision point and 3 more years for country to reach completion point.
- Completion Point: This is the point at which debt relief promised at decision point is finally delivered, if all conditionalities are met.

Under massive pressure calling for total debt cancellation, the IMF and World Bank decided to replace HIPC I by the enhanced HIPC (HIPC II) initiative in September 1999, but the initiative became operational only in 2000. Enhanced HIPC brought some improvements on HIPC I conditions. In addition to a country being eligible for borrowing from the IDA window of the World Bank, there is now need for the country to be also eligible to borrow from the IMF's Poverty Reduction and Growth Facility (PRGF), a replacement of the Enhanced Structural Adjustment Facility (ESAF). Also under the enhanced HIPC a recipient country starts receiving interim debt relief at the Decision Point while the remaining relief is delivered at the Completion Point, which is now floating<sup>2</sup>. In addition, a HIPC country is required to develop a Poverty Reduction Strategy Paper (PRSP), aimed at creating home ownership of economic and social programs in the country.

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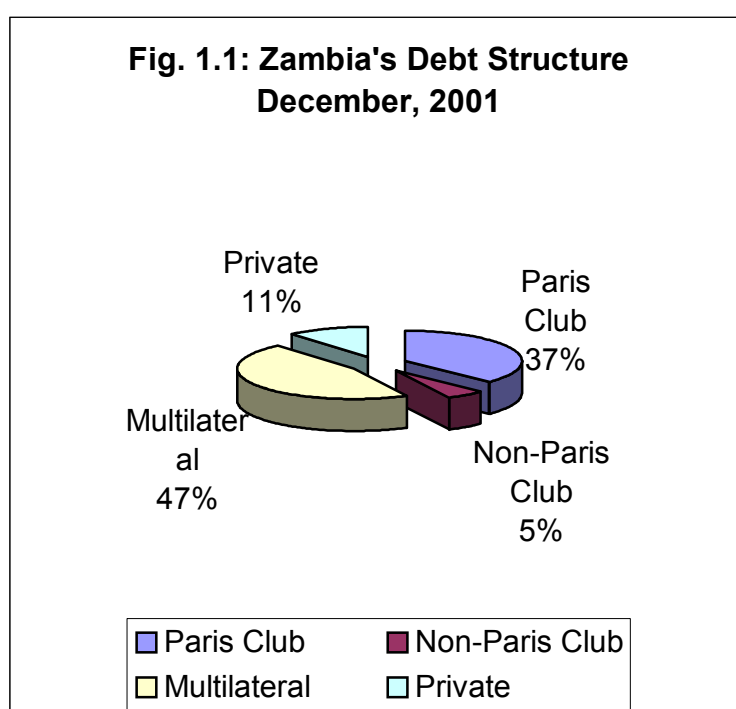
<sup>1</sup> For more details see *External Debt and the HIPC Debt Initiative*: Report of the Conference on the Ethical Dimensions of International Debt, Seton Hall University, and October 22-23, 1998.

<sup>2</sup> Floating Completion Point means that a country that has reached the Decision Point can reach the Completion Point at any time as long as it meets preset conditions.

## 1.2 Zambia's External Debt

As at end-December 2001, Zambia's external debt stock stood at US\$ 7.27 billion up from US\$ 6.31 billion, as at end-December 2002, due to the expansion in private sector debt which increased by 75.8 percent from US\$ 473.3 million in 2000 to US\$ 832.3 in 2001. The increase in private debt was largely due to increased borrowing by the new mine owners who increased their investment outlays. Government does not guarantee Zambia's private debt. However, increased private debt is a concern because it competes for national foreign reserves with government demands.

Debt owed by government increased by 9.5 percent from US\$5.84 billion as at end of 2000, to US\$6.44 billion as at the end of 2001. This increase was due to the non-receipt of debt relief under Cologne Terms from members of the Paris Club arising from the non-signing of agreed minute disbursement on old loans and the non-servicing of non-Paris Club debt.



In terms of external debt structure, in 2001 Zambia owed US\$3.346 billion to multilateral institutions (IMF, World Bank and others). This represented 47 % of the total external debt. Following the multilateral debt is the Paris-Club debt standing at US\$2.714 billion (37 %), Private debt US\$0.832 billion (11 %) and non- Paris club US\$ 0.378 billion (5%). All this information is illustrated graphically in Figure 1.1 above. Since the bulk of Zambia's external debt is owed to multilateral and bilateral creditors signifying the inability of the country to access commercial credit.

Zambia's debt crisis originates from the 1970s when the country started facing balance of payment problems mainly due to poor copper prices and high cost of

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Zambia's vital import, oil. These problems coupled with growing liberation struggles in the Southern African region contributed to the growing debt in the early 1980s<sup>3</sup>. Government's suspension of IMF programmes in 1987 worsened the debt crisis further because on resumption of relations arrears and penalties amounted to over US\$3 billion.

These factors have led to an ever-growing external debt that has not been accompanied by economic progress. External debt was about US\$3.2 billion in 1980 but grew to over US\$ 7 billion by the 1990s. Table 1.2 below indicates the structure of Zambia's debt in the last five years until 2001.

Table 1.1 below shows the different type of external debt as a percentage of the total stock. The table reveals that private debt as a percent of total debt increased steadily from 4 percent in 1998 to 11.4 percent of total debt in 2001. Also the table shows that multilateral debt reduced from 54.6 percent of external debt in 2000 to 46 percent of total debt in 2001 and that since 1999, multilateral debt has been higher than bilateral debt.

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<sup>3</sup> A study by JCTR and ACTSA (2000) estimate the Apartheid-caused debt for Zambia at US\$ 5.345 billion.

**Table 1.1**  
**Zambia's External Debt Stock (US \$ million), 1997 to 2001**

	1997	1998	1999	2000	2001	% Change 2000/2001
<b>Bilateral</b>	<b>3,296.90</b>	<b>3,477.80</b>	<b>2,676.40</b>	<b>2,390.20</b>	<b>3,091.76</b>	<b>26.4</b>
	<b>[48.8]</b>	<b>[50.2]</b>	<b>[41.1]</b>	<b>[37.9]</b>	<b>[42.5]</b>	
Of which						
Paris Club	2,816.5 (41.7)	2,998.5 (43.3)	2,405.0 (37.0)	2,131.40 (33.8)	2,713.85 (37.3)	27.3
Non-Paris Club	480.4 (7.1)	479.3 (6.9)	271.4 (4.2)	258.80 (4.1)	377.90 (5.2)	46.0
<b>Multilateral</b>	<b>3,152.4</b>	<b>3,172.70</b>	<b>3,375.1</b>	<b>3,446.82</b>	<b>3,346.04</b>	<b>-2.9</b>
	<b>[46.7]</b>	<b>[45.8]</b>	<b>[51.9]</b>	<b>[54.6]</b>	<b>[46.0]</b>	
Of which						
ADB/ADF	327.0 (4.8)	257.0 (3.7)	370.7 (4.9)	316.66 (5.0)	318.66 (4.4)	0.6
World Bank	1,450.2 (21.5)	1,547.6 (22.3)	1,668.3 (25.6)	1,736.43 (27.5)	1,837.06 (25.3)	5.8
IMF	1,205.5 (17.9)	1,205.2 (17.4)	1,219.2 (18.7)	1,245.40 (19.7)	992.00 (13.7)	-20.3
Others	169.7 (2.5)	162.9 (2.4)	166.9 (2.6)	148.33 (2.4)	198.32 (2.7)	33.7
<b>Total Govt. Debt</b>	<b>6,449.3</b>	<b>6,650.5</b>	<b>6,051.5</b>	<b>5,837.02</b>	<b>6,437.80</b>	<b>9.5</b>
	<b>[95.5]</b>	<b>[96.0]</b>	<b>[93.0]</b>	<b>[92.5]</b>	<b>[88.6]</b>	
Private Debt	303.3 (4.5)	278.2 (4.0)	455.9 (7.0)	473.49 (7.5)	832.3 (11.4)	75.8
<b>Total Debt</b>	<b>6,752.60</b>	<b>6,928.70</b>	<b>6,507.40</b>	<b>6,310.51</b>	<b>7,270.06</b>	<b>15.2</b>

**Source:** GRZ Economic Report, 2001

**Note:** The figures in bold and square brackets indicate the share of that type of debt as a percentage of total debt and the figures in curled brackets indicate the share of that sub-type of debt as a percentage of that type of debt

According to the Zambian government, the enhanced HIPC Initiative will reduce Zambia's external debt stock by US\$ 3.8 billion over a period of 20 years. This casts doubt whether Zambia's debt stock will ever be reduced significantly since government continues to contract new loans.

### 1.2.1 The Structure of Bilateral External Debt

As indicated in table 1.1, Zambia owes both Paris and Non-Paris type of bilateral creditors. The four largest bilateral creditors as at the end of December 2001 were Japan (US\$705.8 million), Russia (US\$ 545.7 million), Germany (US\$ 483.2 million) and the United Kingdom (US\$ 359.9 million). These four largest creditors accounted for 77.2 percent of Paris club debt and 28.9 percent of total external debt. Apart from the four USA, France and Italy are also key Zambia's Paris club creditors with debt owed to each of them going over US\$ 100 million.

Whereas most of Zambia's bilateral debt is owed to Paris Club countries, debt owed to Non-Paris club is also significant (total non-Paris club debt stood at US\$378 million in 2001). As a percentage of total bilateral debt, Non-Paris club debt has been falling steadily since 1997 (see table 1.1). China and Kuwait are among the key Non-Paris club creditors with amounts owed in excess of US\$ 100 million.

Under the Paris Club arrangement, only the pre cut-off<sup>4</sup> debt is eligible for cancellation or/and rescheduling. Zambia's pre cut-off date is 1 January 1983<sup>5</sup>. This implies that only the debt incurred before that date qualify for relief given by various bilateral creditors. Debts after that date do not qualify. Table 1.2 below shows a detailed breakdown of Zambia's bilateral creditors as at December 2001.

**Table 1.2:  
Breakdown of Zambia's Bilateral Debt  
End-December 2001**

<i>Paris Club Creditors</i>			<i>Non-Paris Club Creditors</i>		
<i>Creditor Country</i>	<i>Amount US\$'000</i>	<i>% Of Total</i>	<i>Creditor Country</i>	<i>Amount US\$'000</i>	<i>% Of Total</i>
Japan	705,800.9	26.0	China	132,375.9	35.0
Russia	545,657.8	20.1	Kuwait	119,699.0	31.7
Germany	483,196.9	17.8	Iraq	62,834.9	16.6
U.K	359,900.3	13.3	Yugoslavia	26,769.0	7.1
USA	274,291.0	10.1	Romania	16,381.4	4.3
France	110,304.4	4.1	India	14,862.1	3.9
Italy	104,925.2	3.9	Bulgaria	4,979.9	1.3
Brazil	70,525.5	2.6			
Canada	49,474.0	1.8			
Austria	9,778.6	0.4			
<b>Total</b>	<b>2,713,854.6</b>	<b>100.0</b>	<b>Total</b>	<b>377,902.2</b>	<b>100.0</b>

Source: Situmbeko, L.C. and Musamba, C. (2002); MFNP

<sup>4</sup> The pre cut-off date is the date that Zambia first approached the Paris Club creditors for debt relief. Hence bilateral debt accrued after that date is not eligible for debt relief.

<sup>5</sup> The Zambian government could not give a specific amount of debt stock that could be attributed to the pre cut-off date.

### 1.3 Domestic Debt

Zambia's domestic debt has become increasingly important especially that domestic debt service will be higher than external debt service starting in 2001. Of profound concern regarding domestic debt is the fact that it crowds out the private sector and to a certain extent slows down economic progress. Moreover, a huge unpayable domestic debt is not eligible for cancellation under any existing debt relief mechanism.

It is therefore imperative that those focusing on the external debt of Zambia pay particular attention to the ever-increasing domestic debt. In order to fulfil its external obligations, government has to borrow domestically to service external debt thereby driving the domestic debt upwards. We can learn by noting that South Africa today does not face an external debt crisis but it has a problem with the huge domestic debt.

According to the GRZ 2001 Economic Report, Zambia's domestic debt at end of 2001 was K 3, 941.4 billion (about US\$1.0 billion). This is more than 10 percent of the external debt stock. The national budget for 2002 reveals that debt servicing on domestic debt will be higher than that on external debt. This could partly be attributed to HIPC and other relief mechanisms in place that have significantly reduced external debt service per year. According to the 2002 national budget, domestic debt service will cost K 443.9 billion (about US\$125 million) while external debt service was US\$137 million.

The structure of domestic debt is such that the bulk of the debt is owed to the central bank. Table 1.3 below shows the structure of Zambia's domestic Debt in 2000 and 2001. From the table we see that Bank of Zambia is the largest domestic creditor to government followed by the general public. Debt owed to the public is in the form of treasury bills and government bonds.

**Table 1.3**  
**Structure of Domestic Debt (K' billions)**

Creditor	Year		Percentage Increase (%)
	2000	2001	
Bank of Zambia	1,657.4 (49.9)	2,177.80 (55.3)	31.4
Financial Sector	264.3 (8.0)	239.2 (6.1)	-0.1
Transport and communication	43.2 (1.3)	46.8 (1.2)	0.1
General Public	1,437.9 (43.3)	1, 598.5 (40.6)	0.1
<b>Total</b>	<b>3,319.90</b>	<b>3,941.40</b>	<b>18.7</b>

**Source:** 2001 GRZ Economic Report and Author's own calculations. **Note:** figures in brackets indicate the proportion of each type of debt as a percentage of total debt

## Chapter Two

# Assumptions and Conditionalities

In order for a country to reach the HIPC completion point, creditors set certain pre-conditions (also agreed by recipient government) and if these are not met then qualification is delayed. Moreover, the amount of debt relief is determined after making certain economic assumptions. It is important to see whether the assumptions are realistic and whether the conditionality is easily attainable. In this chapter we look at specific conditionalities for Zambia to reach completion point and also evaluate the assumptions made in determining debt relief.

### 2.1 Conditionalities (Triggers)

In order to access debt relief under the enhanced HIPC framework the Zambian government is required to implement successfully conditionalities. Failure to do so results in non-delivery of debt relief.

According to the Decision Point document for Zambia (agreed in December 2000), the conditionalities (or triggers) that the country must meet before reaching the completion point include:

#### 1. *Macroeconomic and Structural reform*

- Maintenance of a stable macroeconomic environment as evidenced by satisfactory performance under a program supported by PRGF arrangement
- Implementation by the Ministry of Finance and National Planning (MFNP) of an integrated Financial Management Information System (IFMIS) on pilot basis for at least three ministries and a mid-term review of the pilot program.
- Implementation of the Medium-term Expenditure Framework prepared by MFNP and approved by the cabinet.
- Restructuring and issuance of international bidding documents for the sale of a majority (controlling) interest in the power company, ZESCO
- Issuance of international bidding documents for the sale of majority (controlling) interest in the Zambian National Commercial Bank

#### 2. *Poverty Reduction*

- The adoption of a PRSP to be prepared through a participatory process, and satisfactory progress with implementing and monitoring the PRSP for at least one year based on annual report.

#### 3. *Progress in Combating HIV/AIDS*

- Full staffing of secretariat to National HIV/AIDS/STD/TB Council
- Integrate HIV/AIDS awareness and prevention in pre-service and in-service programs for at least ten key ministries.

*4. Progress in Education Sector Reform as indicated by:*

- Increasing the share of education in discretionary budget from 18.5 percent in 1999 to at least 20.5 percent.
- Raising the starting compensation of teachers in rural areas above the poverty line for a household as defined by the Central Statistics Office (CSO).
- An action plan for increasing student retention in Northern, Luapula, Eastern, Northwestern and Western Provinces.

*5. Progress in Health Sector Reform as indicated by:*

- Implementation and scaling-up of an action plan for malaria.
- Procedures and mechanisms for the procurement of drugs re-organised to be fully transparent and efficient
- Timely release of complete, detailed annual health expenditure data.
- Actual cash releases to District Health Management Boards Shall be at least 80 percent of the amount budgeted.

According to the September 2002 IMF/World Bank HIPC Status Report, Zambia has made steady progress in meeting most of the conditionalities. Zambia completed the fourth review of the IMF's PRGF in May 2002 in line with which the authorities promised waivers for domestic arrears, net bank claims on the government, net domestic assets and gross international reserves. But for Zambia to reach the completion point probably in 2003, the PRGF program must remain on track, while progress should be made in divesting (privatising) controlling share in Zambia National Commercial Bank (ZNCB) and Zambia Electricity Supply Corporation (ZESCO). The IMF country representative recently alluded to the progress Zambia is making in meeting conditionalities on a televised Jubilee-Zambia programme on ZNBC in the last quarter of 2002.

Civil society (Jubilee-Zambia in particular) feels that all conditionalities stated above are generally except for the first one. It is generally argued that enhanced HIPC has meant a continuation of structural adjustment programs that registered very bad results in the country in the last decade.

Before the formulation of the Poverty Reduction Strategy Papers, it was argued strongly by the Fund and Bank officials that once the PRSP was in place, the conditionalities for enhanced HIPC would be dropped and in their place would be put the PRSP. This has not been done as is evidenced by the insistence by the Fund and the Bank that privatisation of the electricity company, ZESCO, and Zambia's only public owned commercial Bank, ZANACO. According to a recent report on privatisation in Zambia done by the World Bank, the key reason for privatisation is to stop government financing loss-making parastatals so as to keep them running. However, civil society is opposed to privatisation that would create more poverty mainly through job losses. It also argues that further privatisations should not occur before full and accountable financial and social audit of previous privations is done and made public.

## 2.2 Assumptions

Assumptions used in the Debt Sustainability Analysis (DSA) were largely macroeconomic. These assumptions are central in determining the amount of debt relief to be delivered to a country so as to reach 'sustainable' levels. Already a joint study by Jubilee-Zambia partners--CAFOD, Oxfam, Christian Aid and Eurodad--revealed that most of the assumptions in most HIPC countries were over ambitious. Perhaps that could explain why Uganda, a country that reached completion point under HIPC I, has gone three times below 'sustainable' levels after reaching completion point under HIPC II.

Below are the main macroeconomic assumptions made during the Debt Sustainability Analysis (DSA): These were the basis for determining Zambia's debt relief under HIPC.

- *Exports Growth:* Exports were projected to grow from US\$1.04 billion in 2000 to a staggering US\$ 4.158 billion by 2019. As a result of this projection of export growth, the ratio of the net present value of total debt to exports was projected to reduce from 172.6 percent in 2000 to less than the IMF sustainability threshold of 150 percent in 2001 and thereafter increasingly becoming reduced up to a low of 53.7 percent by 2019. In addition, the volume of exports was projected to grow at an average of 5.5 percent per year, from 1999 to 2019.
- *Economic Growth:* The economy was estimated to grow at 2.4 percent in 1999, 4.0 percent in 2000 and 5 percent thereafter. However, the sector source of this growth was not clearly indicated in the decision point document.
- *Government Revenue:* Government revenue was projected to grow at 17.6 percent of GDP in 1999 to 19 percent of GDP in 2010, yet at the same time total government revenue including grants were estimated to grow from US\$1.324 billion in 1999 to US\$ 2.908 billion in 2005 and up again to US\$ 3.986 billion in 2010.
- *Net Foreign Direct Investment:* Investments from abroad were projected to increase from US\$162.8 million in 1999 to US\$ 281.7 million in 2010. Projections here do not indicate which sectors would receive the increased investments, thereby making it difficult to deduce whether such type of investments would translate into growth for the economy.
- *Balance of Payment (BOP) Support:* External assistance was projected to come not in the form of loans but in grants. According to the Decision Point document, BOP grants are to rise from US\$60.5 million in 1999 up to US\$121 million in 2000 and up to US\$158.1 million in 2010 with an estimated annual average of US\$ 165.4 million in the next period, 2010-2019.

## What Do the Assumptions Imply?

Most of the assumptions mentioned above are overly simplistic and they fall far short of reflecting reality. No provision is made for any shocks such as drought and poor international commodity prices that have been perpetual problems in Zambia. There are a number of points that come out on each assumption that was used.

Firstly, the assumption that exports will grow from the current US\$1 billion to over US\$4 billion is unrealistic especially that copper, the main export commodity, faces uncertain and fluctuating international prices. With such an unrealistic projection of export growth, it is highly unlikely that the NPV of debt to exports ratio<sup>6</sup> will be lower than the sustainable thresholds, even after reaching completion point. Actually a recent IMF/World Bank status report on HIPC<sup>7</sup> reveals that Zambia after reaching completion point will still have an unsustainable external debt, mainly because of poor performance of the copper industry and the unanticipated pull-out of Anglo American Corporation. This shows that HIPC fails to deal, effectively and adequately, with external shocks that cause debt over-hang in a country like Zambia. The World Bank status report also shows that in the period 1970-1999 exports in Zambia grew, on average, at 0 percent per annum while average growth in 1990-1999 was a decline of -4.2 percent per annum. This history of export performance suggests that an average growth of exports of 7.1 percent per year between 2000 and 2017 is not attainable.

To illustrate further the fact that the projections especially of exports were overly ambitious here is a quotation from the recent World Bank HIPC status report:

The difference between projected export growth rates and actual outcomes reflect inherently high export volatility in HIPCs. These countries typically have a very narrow resource base which makes them vulnerable to volatility in international commodity prices... Firstly such fluctuations make it more difficult to project the likely path of key economic variables and hence to assess the prospects for long-term debt sustainability..... Secondly, since debt relief is calculated on the basis of sustainability ratios at a single point, volatility could mean that the level of fiscal revenue or exports at the reference point may be atypical and, hence, in case where the level is atypically high, the amount of debt relief may be insufficient to satisfy the objective of the HIPC Initiative.<sup>8</sup>

In addition, the use of exports as the main denominator in determining 'sustainability' and thus the amount of debt relief due is greatly flawed. Exports are not a good indicator of a country's ability to pay its debt especially in Zambia where government relies heavily on external assistance to service its debt. A country's

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<sup>6</sup> According to IMF and World Bank the sustainability ratio is 150 percent of net present value debts to exports.

<sup>7</sup> IMF and World Bank HIPC Status Report, September 2002.

<sup>8</sup> IMF and *World Bank HIPC Status Report*, September 2002, page 82.

ability to repay its debt must be looked at from a wider socio-economic situation, especially by taking into account poverty levels and deadly diseases such as HIV/AIDS.

Secondly, the assumption of a sustained economic growth of 5 percent per annum is indeed unrealistic, going by the performance of Zambia's economy in the last decade. In 2002, the economy grew only by 3 percent, down 1 percent from the projected 4 percent. Moreover, growth projections were made with the view that the copper industry would thrive again after re-capitalisation and change of ownership into private hands. This has already failed with the pull out of Anglo American Corporation and poor copper prices. Drought is still a major hindrance in recording growth in one of the key sectors, agriculture. Compared to an average growth of 2.48 percent in the last five years, it is highly unrealistic to project a sustained growth as high as 5 percent.

Thirdly, it is not uncommon in Zambia to find donors failing to fulfil their pledges, mostly on the pretext that government is failing to meet conditionalities. This is the same story with the pledged savings from HIPC relief. While some of the conditionalities are good, the failure by donors to meet pledged funding translates into certain programs not being implemented. The assumption that donors will now offer grants rather than loans must be a welcome development but the question is whether this is actually taking place. However, 2001 figures show that government borrowed US\$44 million as part of balance of payment support. This amount was higher than US\$ 31 million given as BOP grants to government in the same year. One point to note is that the amount of BOP loans in 2001 was significantly lower than the amount (US \$154 million) of loans obtained in the year 2000<sup>9</sup>. This indicates that the assumption in the Debt Sustainability Analysis that only grants would be offered was unrealistic.

Although in 2001, various creditors failed to fulfil their debt relief pledges in full, the picture has improved remarkably in 2002 where almost all pledges were met by the third quarter. An uncertain fluctuation in donor fulfilment of pledges, like in 2001, makes planning very difficult and in years of shortfalls, this hinders progress of poverty reduction efforts in the country.

### **2.3 Creditor Participation**

Since participation of all creditors, especially bilateral partners, is key to a country benefiting fully from the initiative, it is important to look at the willingness of creditors to participate in Zambia's debt relief process. For Zambia there is goodwill from most creditors to offer relief under the initiative. According to the same IMF/World Bank recent report, there has been financing assurances from creditors holding up to 97 percent of total debt. Among the creditors that have offered to provide interim relief are the African Development Bank (AFDB), IDA, IMF and the

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<sup>9</sup> Statistics obtained from *GRZ Economic Report 2001*.

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Paris Club. However, Bulgaria, China, India, Iraq, Romania and Saudi Arabia have not agreed to provide HIPC relief to Zambia.<sup>10</sup> Except for Saudi Arabia, Zambia owed the other five Creditors about US\$231 million in 2001. This represents 8.5 percent of total bilateral external debt.

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<sup>10</sup> IMF and World Bank Status Report, September 2002.

## Chapter Three

### Impact of HIPC II

Due to a huge increase in debt service that Zambia was to face beginning 2001 up until 2005, Zambia's qualification to the HIPC framework was received as a great relief on the country's already overburdened economy. But two years after reaching the Decision Point what is the impact on the ground? This is the question that this section tries to address with special reference to the impact on poverty reduction and debt service reduction. Participation issues with regard to spending of HIPC savings are addressed in the next section.

#### 3.1 Impact on Debt Service

Over the 5 year period, 1995-2000, Zambia on average paid about US\$150 million in debt service. However starting in 2001 debt service was supposed to be about US \$600 million per year for the next five years. This was as a result of arrears and penalties accumulated in the late 1980's when the Zambian government decided to stop servicing her debts. On resumption of good relations in 1990/91, the IMF offered loans to the Zambian government. Yet, the effect of these loans keeps resurfacing through high interest payments after some period. Thus Zambia's qualification to HIPC has had a dampening effect on the amount of debt servicing and as such the country will be able to overcome what is now commonly known as the "hump" or "balloon" effect.

Table 3.1 below shows the projected debt servicing amounts with and without HIPC initiative as indicated in the HIPC decision point document produced in 2000 by the IMF and World Bank.

Table 3.1 above illustrates that if Zambia fulfils all the conditionalities and donors fulfil their pledges fully, the IMF and World Bank project Zambia's debt service to be reduced by 53.5 percent per year on average in the 20 years under consideration. This if fulfilled would be indeed a substantial reduction in debt service obligations. However it is important to measure these projections with reality on the ground.

Without HIPC and traditional debt relief, average debt service per year for Zambia would have been US\$354.25 million and a total of US\$7.085 billion would have been transferred to creditors through debt service between 2000 and 2019. But after HIPC and traditional debt relief, Zambia's debt service is projected to be US\$137.7 million per year and US\$2.754 billion will be transferred to creditors through debt service.

**Table 3.1**  
**Projected Effect of Enhanced HIPC on Debt Servicing (US\$' Million)**

Year	Without Debt Relief	After Traditional <sup>11</sup> Relief	After HIPC Relief	Reduction Due to HIPC	% Reduction due to HIPC
2000	386	193	169	24	12.4
2001	606	436	158	278	63.8
2002	599	429	148	281	65.5
2003	588	434	151	283	65.2
2004	554	434	211	223	51.4
2005	501	434	202	232	53.5
2006	233	214	96	118	55.1
2007	262	241	121	120	49.8
2008	283	246	130	116	47.2
2009	294	257	137	120	46.7
2010	289	256	135	121	47.3
2011	295	267	139	128	47.9
2012	282	256	121	135	52.7
2013	270	245	101	144	58.8
2014	271	251	101	150	59.8
2015	286	267	109	158	59.2
2016	278	291	119	172	59.1
2017	267	306	127	179	58.5
2018	266	321	135	186	57.9
2019	275	338	144	194	57.4

**Source:** IMF-World Bank Decision Point Document 2000 and author's own calculations

A point worth noting is that in 2019 Zambia is expected to pay US\$144 million in debt service. At the current level of production such an amount will still be a huge burden on the economy and the people. On the other hand such a debt service amount would not be such a burden if indeed the economy grows as projected at 5 percent per annum over the period until 2019. Yet we have already demonstrated how impossible it is to achieve such a sustained growth since past performance is way below these projections.

Revised estimates of debt servicing (as revealed in the September 2002 World Bank/IMF HIPC Status Report) reductions as a result of HIPC differ remarkably from the figures shown above. This is due to the error associated with forecasting, so the actual amount of debt service may be equal to or below or above the projected amounts.

<sup>11</sup> Traditional debt relief refers to bilateral debt relief offered by the Paris and non-Paris club countries.

According to the 2001 Economic Report by government, in 2001, the external debt service payments for the year, 2001, without Paris Club and without enhanced HIPC relief, were going to amount to approximately US\$606 million. This amount came down substantially to US\$434 million after accessing debt relief from Paris Club at Naples Terms (i.e., 67 percent net present value reduction). As a result of enhanced HIPC relief, the debt service amount was further reduced from US\$434 million (i.e., after Paris Club reduction) to US\$160 million. Therefore the amount of reduction due to enhanced HIPC relief is US\$274 million, representing a 45.2 percent reduction in debt service without Paris Club relief. In addition, due to suspension of debt service to some Paris Club members, government actually paid a lower amount of US\$116.5 million in debt service during 2001.

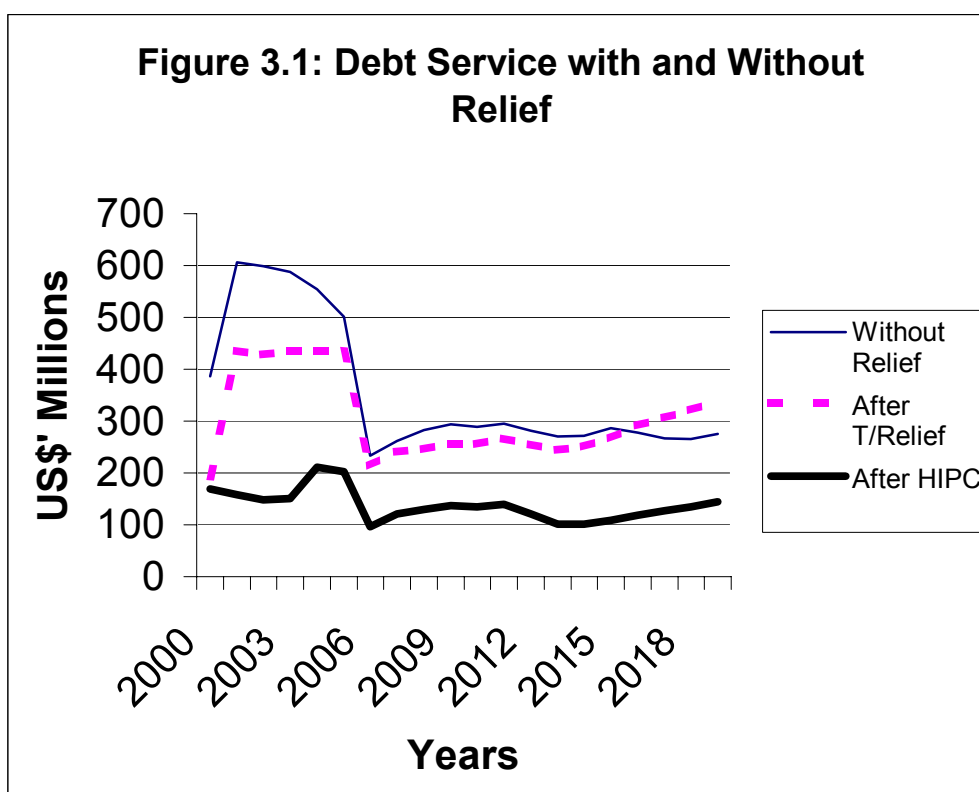


Figure 3.1 above shows the reduction of debt service as a result of traditional debt relief (T/Relief) and then the amount of debt relief after enhanced HIPC relief over the period 2000 up to 2019. The graph reveals that debt service with HIPC and traditional debt relief will be significantly lower. After 2016, debt rescheduled would fall due and this raises the curve for traditional debt relief above that of debt service without relief.

### 3.2 Debt stock Reductions

Under enhanced HIPC, Zambia’s debt stock will be reduced by a nominal amount of US\$ 3.8 billion over a period of 22 years beginning in January 2001. Thus debt stock

reduction will be done in accordance with the duration of loan repayment. For example, because IMF loans have a shorter duration of up to five years, debt owed to the IMF would be reduced over a five-year period. On the other hand, World Bank loans have a long repayment period, meaning that debt reduction may be spread over a very long period. It is quite difficult to know what Zambia's debt stock may be after reduction because during the same period of relief, government is procuring new loans that will add to the old debt stock.

The September 2002 HIPC status report <sup>12</sup> actually indicates that there is little if any reduction in debt stock during the interim period (i.e. period between decision and completion points). It is thus not possible to deduce the amount of debt stock that has been reduced due to HIPC relief. However it is possible that the debt stock may be reduced due to other traditional debt relief processes, especially under the Paris club arrangements.

An analysis of 2001 preliminary debt stock figures reveals that debt stock for Zambia actually increased from US\$6.31 billion in 2000 to US\$ 7.27 billion in 2001, representing a 15.2 percent increase. This is in spite of the country's qualification for interim relief under the enhanced HIPC framework. The increase is attributed to increased private debt, mainly contracted by the new mine owners.

### 3.3 Impact on Internal Debt

Zambia's internal debt is as important as the external debt to most policy makers and debt activists alike. As at end-December, 2001, Zambia's internal debt stood at K3, 941.4 billion. Compared to a domestic debt of K3, 319.9 billion in 2000, this represents an 18.7 percent increase. This is largely attributed to the increase in Bank of Zambia Kwacha and foreign bridging loan. The increase in the bridging loan was partially due to insufficient funding from the national budget for the HIPC Initiative and insufficient balance of payment support. Starting 2002, arrears on the internal debt will be higher than those on external debt, implying that the country may spend more on internal debt service than on external one. Although some people and organizations claim that this is because of relief under HIPC, that view must be looked at in the context of what lead to the domestic debt arrears overshooting those on external debt. Preliminary investigations at the Ministry of Finance reveal that the increase in domestic arrears was partly and perhaps largely caused by the inefficiency of enhanced HIPC relief delivery. In particular, during 2001, HIPC relief was delayed and so the Zambian government was forced to borrow domestically in order to service external debt.

These may have been the same resources later refunded into the HIPC relief. However the domestic debt problem had already been created. Economically speaking, the growth in domestic debt has a devastating effect on the growth prospects for the economy. Domestic borrowing by government crowds out private

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<sup>12</sup> IMF and World Bank HIPC Status Report, September 2002.

borrowing, thereby reducing the level of domestic private investments. Moreover, the IMF and World Bank encourage growth of the private sector but government borrowing is not a good incentive for private investment stimulation.

### 3.4 Pledged Versus Actual Debt Relief

In almost all instances, different creditors that have 'accepted' to participate in a country's debt relief process deliver debt relief following pledges. For Zambia in the last two years, 2001 and 2002, different creditors have pledged to participate in Zambia's HIPC process. Below is a breakdown of pledged and actual debt relief offered in the two-year period.

<i>Creditor</i>	<i>2001</i>		<i>2002*</i>	
	<i>Pledged</i>	<i>Actual</i>	<i>Pledged</i>	<i>Actual</i>
United Kingdom	8,468	8,468	8,162	4,080
France			5,159	3,408
U.S.A			2,919	-
Canada	1,563	1,563	2,274	1,195
Brazil			1,675	-
Austria			105	-
Japan			6,398	-
Russia			-	-
Germany			10,252	-
IDA	18,859	10,638	23,214	20,769
EDF			65,000	65,000
ADB	22,232	11,000	14,324	14,326
ADF			3,006	2,911
IMF			151,265	151,265
Various		71,529		
<b>Total Relief</b>	<b>201,122</b>	<b>103,198</b>	<b>293,753</b>	<b>262,954</b>

Source: GRZ HIPC Expenditure Review Report 2001 and Third Quarter Report 2002

\* Period covered up to September 2002.

Table 3.2 above shows amount of pledges and actual relief delivered by various creditors. In 2001, total amount of relief pledged was US\$201 million but only US\$103 million of the pledges were met. The fulfilment of pledges in 2002 has improved remarkably. By end of Third quarter 90 percent of the pledges had been met. It is expected by government that almost all the pledges in 2002 will be fulfilled.

Total pledges to date amount to US\$494.9 million of which US\$366.2 million<sup>13</sup> has been fulfilled, signifying a 73.99 percent of fulfilled pledges. At this point it is important to mention that pledges signify the amount of relief to be given and not actual cash. To illustrate this point, in 2002 K1 097 billion was received as debt relief between January and September, yet only K 103 billion has been realised as actual cash realised.

### 3.5 Social Sector Spending

The majority of Zambians today live in abject poverty (according to World Bank estimates, over 80 percent of Zambians live below a US dollar a day). High levels of deprivation and high prevalence of diseases like HIV/AIDS, TB and malaria have resulted in short life expectancy, which stands at 37 years, down from 50 years a decade ago. With almost one-third of primary school aged children and two thirds of secondary school aged children not in school, future literacy levels are threatened.

The social sectors<sup>14</sup> (health and education) are therefore key in reversing the current situation. Therefore, the success of HIPC should also be measured on how much is realized in terms of boosting expenditures to the social sectors. The main premise of HIPC has been that the countries involved would register sustained and significant growth that would help ease the burden of debt. Thus debt as a percentage of government revenue would reduce remarkably, thereby increasing revenue to be spent domestically. This coupled with increased debt relief would widen the resource envelope, making it easier for government to pursue poverty reduction strategies and other developmental priorities.

According to the Bank and the Fund, early indications are that relief under the HIPC initiative will help governments increase social spending. "Largely due to HIPC assistance, social expenditures in the enhanced HIPC decision point countries are projected to increase from US\$5.3 billion in 1999 to US\$7.6 billion in 2002, an average increase of over US\$ 830 million per year."<sup>15</sup>

Table 3.3 below shows projected social expenditures for Zambia from 1999 to 2005. Looking at the projected expenditure figures in this table and comparing to debt service projections in table 3.1 reveals that debt service, after traditional and enhanced HIPC relief, will remain below allocations to the social sectors, in the period 2001 up until 2005. However, debt service amounts per year will still be higher than allocations on health or education alone.

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<sup>13</sup> For Period-January,2001 to September, 2002.

<sup>14</sup> Apart from health and education other sub-sectors such as social safety nets are considered part of the social sector.

<sup>15</sup> Source: World Bank Report "Financial Impact of The HIPC Initiative, p-5.

**Table 3.3**  
**Projected Social Expenditures for Zambia**

Year	Social Expenditure (US \$' million)	Social Expenditure as a % of Government revenue	Social Expenditure as % of GDP
1999	166	30	5
2000	149	24	5
2001	205	30	6
2002	231	33	6
2003	261	34	6
2004	286	34	6
2005	313	34	6

Source: HIPC Country Document and IMF and WB staff Estimates.

Moving away from projections and focusing on actual expenditures, 2001 budget allocations reveal that health and education sectors were US\$24 million and US\$ 33 million respectively. However, actual debt service after total debt relief was US\$116 million, implying that debt service has continued being significantly higher than social expenditure in Zambia, even after the most favourable conditions under HIPC. Moreover, actual disbursements to social sectors would have been much lower because there has been a trend where budget allocations are not met in full.

Looking at HIPC saving allocations in the national budget, of K78.67 billion allocated to the health sector only K39.5 billion was actually disbursed in 2001. In the education sector, of the K60.38 billion allocated from expected HIPC funds only K36.7 billion was actually disbursed. Combining the two sector allocations, of total HIPC funds, 39.5 percent was to go to social sectors but only 31.3 percent was actually disbursed<sup>16</sup>. This shortfall in disbursement could in part be explained by the lack of fulfilment of pledges by donors. Yet, it also shows that government lacks proper criteria of prioritising towards poverty reduction. When a debtor defaults on debt service payments penalties are slapped, but when a donor defaults there are no negative sanctions imposed on the donor.

<sup>16</sup> For more details on the social sector spending see research report by Jubilee-Zambia (2002) “Where Does the Money Go? Servicing Debt versus Servicing People”. Lusaka

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## Chapter Four

# Governance

If Zambia serviced her external debt from domestic resources, HIPC savings from reduced debt servicing would have translated into more money to be targeted at empowering the majority poor Zambians. The reality however is that a large portion of debt service in Zambia comes from external assistance, and therefore no real cash would be realized via reduced debt servicing. This section analyses how HIPC savings in terms of grants from donors have been utilized by looking at the links with the PRSP and also the national budgeting process.

### 4.1 Budgeting Process

#### The HIPC Savings

There are two main sources of HIPC savings (actual funds). The first source is via creditors' (cooperating partners) direct contributions, and the second is through actual debt relief by way of write-offs.

For debt written off, a standing order for all debt servicing which attracts HIPC relief is issued to the Bank of Zambia. According to government procedure, on the repayment date the Bank of Zambia transfers 100% of the debt service from an account called Control 99 to another account, Control 63. Bank of Zambia then retains part of the loan eligible for HIPC relief and this is transferred to Control 49, which is a separate account at the central bank specifically earmarked for HIPC savings

As such, in some instances the process involves an accounting process without real cash exchanging hands.

#### HIPC Expenditure and Accounting Process

In order to track down expenditure of HIPC funds, HIPC funded and co-funded programs are identified and allocated a special identification code.

On a monthly basis, released resources from the HIPC account to line ministries are identified through a funding sheet showing HIPC programs to which funds have been applied. A monthly report is then submitted to the Accountant General by the Budget Office detailing sources, receipts and disbursements of HIPC resources.

HIPC expenditures are reported like any other government programs but using HIPC codes. Every month line ministry controlling officers submit a detailed report on all expenditures including expenditures from HIPC funds to the Accountant General. However, the responsibility that actual expenditures reported for HIPC programmes

are consistent with the approved amounts and activities lies totally with the controlling officer who normally is the Permanent Secretary.

Then the Accountant General prepares a monthly-consolidated report detailing HIPC receipts, disbursements and expenditures. The report is then passed on to the HIPC Expenditure Monitoring Team who is then supposed to publish quarterly reports for public scrutiny. This has been done in government-owned newspapers, but it still remains questionable whether members of the public understand clearly these reports.

Therefore in terms of HIPC resource flow there are three key phases as indicated below:

- i) Debt is cancelled and counterpart funds are transferred to control 49 for onward allocation to HIPC projects.
- ii) Disbursements of funds are made to beneficiary ministries
- iii) Utilisation of funds is done by the line ministries

#### 4.1.1 Allocations and Disbursements

A total of K351.9 billion was expected to be available as HIPC savings in the year 2001. During national budgeting process, chairpersons of government PRSP working groups were asked to identify priority areas on which this money was to be spent. No wider consultation was involved in identifying areas of greatest need. The following were the areas earmarked for the funds:

Sector/Sub-sector	Amount in Billion Kwacha	Amount as % of Total
1. Education	60.3	17.1
2. Health	57.0	16.2
3. HIV/AIDS	31.4	8.9
4. Water and sanitation	33.5	9.5
5. Social safety net and micro finance	30.2	8.6
6. Rural Development	124.4	35
7. Good Governance	10.0	2.8
8. Low Cost Housing	5.1	1.4
<b>Total</b>	<b>351.9</b>	<b>100</b>

Source: HIPC Resource Accounting Manual by Office of Accountant General MOFNP, 2001.

Table 4.1 shows that a large proportion i.e., 35 % of HIPC savings budgeted for were earmarked for rural development. In addition education and health also were allocated amounts in excess of 10 percent. However there could have been lack of prioritisation within the chosen sectors as evidenced by growing discontent among

some Members of Parliament, in the press, on how savings were actually utilized. It is important to mention that though these, amounts look big, in real terms they are insignificant, especially in light of rising costs.

According to Ministry of Finance and National Planning sources, of the K351 billion budgeted, only K186.5 billion was actually disbursed to the earmarked sub-sectors, leaving a budgeted balance of K165.3 billion in 2001. During 2001 a total of K384.875 billion was received from donors. The discrepancy between amounts received from donors and actual amounts disbursed to projects is as a result of late receipt of money from some donors. The balance was disbursed in 2002.

#### **4.1.2 Mechanism of Receiving and Disbursing HIPC Funds**

On the due date of debt servicing, the portion meant for HIPC relief is retained in an account at the Bank of Zambia. It is from this account that the funds are then disbursed to line ministries who in turn are required to spend the funds on the agreed upon areas in the budget.

The Budget and Economic Affairs Accounting Unit is responsible for releasing the funds to line ministries by the 5<sup>th</sup> day of every month. Before the funds are released to line ministries, each ministry is required to submit to Budget Office and Economic Affairs Unit a HIPC expenditure projection form.

After HIPC funds reach line ministries, the controlling officer is in charge of the process of disbursing the resources. According to the chairman of the steering committee for monitoring and evaluating the HIPC process, the provincial accountants are not involved in the whole process. Controlling officers in Ministries are then required to report on the status of projects on a monthly basis to the Accountant General.

#### **4.1.3 Auditing**

According to the HIPC manual, HIPC funds are supposed to be audited by both internal and external auditors. However the manual fails to state which external auditors would be involved and how they will be selected. So far, no internal audit reports were available at the time of this study, and no external auditors have been selected.

### **4.2 Monitoring and Evaluation**

In order for the HIPC resources to be tracked and offer proper accountability especially in the wake of rampant allegations of corrupt tendencies by government officials, there is need for an accountable and transparent system that is broad based.

According to government, the Central Statistical Office with other 'co-opted' members is supposed to obtain HIPC transaction information, which should be used as a basis for monitoring and evaluating the impact of HIPC savings on poverty reduction.

In addition, government constituted a HIPC Expenditure Monitoring Team comprising the following organizations:

➤ Zambia Institute of Certified Accountants (ZICA)	2	representatives
➤ Zambia Institute of Marketing (ZIM)	2	"
➤ Zambia Association of Public Finance and Auditing	2	"
➤ Institute of Purchasing and Supplies	2	"
➤ Economic Association of Zambia (EAZ)	2	"
➤ NGOs	3	"

The monitoring group then reports to the Minister of Finance and National Planning and the Secretary to the Treasury also in the same ministry.

A ZICA representative currently chairs the committee. Discussions with the current chair revealed that the committee conducted some visits in certain districts of Central Province and according to him some projects such as feeder road projects were done in a satisfactory manner. He however revealed that in certain areas money was not properly utilized and certain projects were not done properly. Asked whether allocations to the provinces will replace the constituency development allocation, he could not give any answer to that.

This committee has not been meeting very regularly. Besides, almost all members are in full time employment and thus they have very limited time. Funding to the committee has been very poor, limiting the ability of the committee to conduct its business efficiently and on time.

### **4.3 Inadequacies of the Accounting Mechanism**

#### **4.3.1 Lack of Priorities**

The targeting of HIPC funds is done with very little input from the local people. From year to year the government budget allocation system has been criticized as lacking prioritisation towards poverty reduction. The sectors earmarked for HIPC funds seem to be in line with the PRSP. However there is no clear-cut prioritisation of saying which sector or project comes first within the earmarked ones, especially when disbursements are lower than allocations.

#### **4.3.2 Lack of Broad Participation**

Participation in allocating resources and also monitoring projects is left to government ministries, which many times fail to disclose the type of projects they

are undertaking. If the HIPC mechanism is to be a success, there is need for wider participation of Members of Parliament, CSOs and other interested parties, right from budgeting down through to monitoring and evaluation.

#### **4.3.3 Lack of Full Information Disclosure**

Government reports detailing HIPC funds received and disbursed only show allocations to particular line ministries without giving detailed information on what projects are being undertaken with the funds. Also, progress made in various HIPC funded projects is not reported. Moreover, the impact of the HIPC funded projects in improving poor people's living conditions is not mentioned in any of the reports.

#### **4.3.4 Monitoring Group**

The composition of the monitoring group lacks a broad enough representation. The group needed to be mixed, including government and civil society organizations. Moreover for the group's findings to be respected, the report must be presented to another authority like the Parliament in order to provide checks and balances. Members of the team need to develop relevant capacities and competencies for effective monitoring and evaluation of programs.

## Chapter Five

### Case Studies

This section gives two case studies on the performance of projects funded from the HIPC resources. Due to time and financial limitations in this research study, the findings of this section are mainly based on a report by the HIPC Expenditure Monitoring Team and discussions with various people.

It is important to mention that information on progress made by HIPC-funded projects is not well reported, despite the government assurances that the controlling officers (permanent secretaries) would be responsible for the task. The only source of information on projects is normally by contacting various ministries responsible. An exception is the report prepared by the HIPC Expenditure Monitoring Team on the HIPC funded projects in Central province. Presently the group is covering Lusaka province and it is hoped that the work will expand to cover all provinces and ministries.

For this reason the case studies below are focused on Central Province with a bit of additional information from other provinces.

#### 5.1 Road and Bridge Rehabilitation

In 2001, a total of K3 billion was allocated to the Central Province Roads Department for the repair of roads and bridges. In addition the District Administrator's office was allocated K100 million to be used for labour-based rehabilitation.

Among the roads and bridges done are the following:

- Kabwe-Ngabwe-Mukubwe Road
- Munkonchi and Adjoining Roads
- Mkushi river bridge
- Serenje Road networks
- Munte Bridge (Serenje)

Regarding some of the projects, tenders were floated to external contractors while some feeder roads were done by the roads department. The following sub-sections give a detailed description of selected works

##### 5.1.1 Kabwe-Ngabwe-Mukushi Road

The Kabwe-Ngabwe-Mukubwe road is a very important road. It is about 140 kilometres long and passes through two farms, Vwalika and Dar farms. It also links

Chiefs Ngabwe, Mukubwe and Chipepo. In terms of provinces, the road links three provinces- Central, Copperbelt and Northwestern provinces.

Rehabilitation works using HIPC funds included:

- Light grading -65 kilometres
- Heavy grading –65 kilometres
- Spot gravelling –10 kilometres

To do the repairs, International Engineering Trade of Ndola was contracted for the road works commencing in January 2002 at a total cost of ZMK1.2 billion.

A physical inspection of the works by the HIPC Expenditure Monitoring Team accompanied by the Chief Roads Inspector revealed that:

1. On the overall the road is in better condition than before the rehabilitation works. However, in certain portions the quality of work was very poor. For instance, a ten-kilometre stretch from Kakoma Metal pipe culvert is bordered by marshlands but was only roughly graded. Due to poor workmanship, the contractor was made to re-do the first 25 kilometres 3 times
2. The initial contract expected to last for 3 months has been extended for 3 times.
3. Despite the inefficiencies by the contractor, the government has maintained the same company mainly because, according to the HIPC Team, this particular contractor has political connections.
4. There was/is good supervision by the site engineer
5. Regarding benefits of the rehabilitation works on this road, there has been improved accessibility to surrounding communities. Various local people confirmed this. In addition business activities have been enhanced such that livestock and crops can now easily be brought to markets.

### **5.1.2 Mkushi River Bridge**

Repair of this Bridge cost a total of K98 million. A private contractor was hired to do the repair works but the quality of work was poor. As a result the Contractor was asked to re-do the repairs.

Moreover, even after undertaking the second repairs and the bridge being passable, the HIPC Expenditure Monitoring Team in their report remark that the repairs were still done very poorly. The team also observes that the work done was inadequate when compared to the bill of quantities and cost. Surprisingly, the contractor's work was fully certified by the Road Engineers and full payment made. At the time of the visit by the monitoring group, a copy of the inspection report was missing. The team further observed that the costing for the project were arbitrary and not checked for accuracy and reasonableness.

This raises concern that perhaps the engineers who certified the work as fully done when there is still a lot of work to be done connived with the contractor. It is also important for the authorising officer to check for accuracy of costing.

## **5.2 Education (Central Province)**

The education sector received HIPC funds directly from the Ministry of Education in Lusaka. The funds were used to buy desks, tables, benches, textbooks, and mattresses for the whole Central province. Mumbwa high school received money for well drilling by a contractor but the work was not properly done such that the wells were without water. Other two institutions that received HIPC funds directly from Ministry Headquarters are Nkrumah Teachers Training College and Serenje Secondary School.

The key constraint identified was that HIPC funds did not include a component to cover for transportation costs of items bought. Therefore, the Ministry of Education had difficulties in distributing items bought to intended places. Also, the tendering procedures were found to be too slow such that in certain instances quoted prices were overtaken by inflation.

To have a better insight of how HIPC funds were used in the education sector, we look specifically at how HIPC proceeds to Serenje Technical School were used

### **5.2.1 Serenje Technical High School**

The school was granted K325 million HIPC funds to rehabilitate teacher's houses on an on-going programme. In addition the school was given K121 million for rehabilitation of dormitories. Of the K121 million additional amount, K71 million were HIPC funds.

In addition to rehabilitation of teachers' houses, the K325 million was also used for water supply/sewer system repair. All the sewer and water pipes had to be exhumed and replaced with new ones. Other major works undertaken included:

- Painting all teachers' houses and cooks' compound
- Replacing defective electrical fittings
- Rectifying defective plumbing works
- Replacing damaged and leaking roofing asbestos sheets

In addition to the repair works, the school received 333 new mattresses, 25 dining tables and 50 benches.

Accountability for the money was assured through strict adherence to guidelines that stipulated the need to opening separate accounts and clearly stated tender procedures to be followed by the constituted project board.

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## 5.3 Financial Accountability

### 5.3.1 Roads Department

The HIPC Expenditure Monitoring Team found that the Roads Department spent a substantial amount (K153 million) on repair of their graders. This was done because some of the rehabilitation works were done in-house by the department. Justification for in-house jobs was that in certain instances the reserve price was too low to attract private contractors. But the monitoring team was prompted to remark that private sector works were by far better. Besides, pumping money into repairs ties money up, such that very little is spent on actual work at the end of the process.

The monitoring team also observed lack of proper control in fuel purchasing and utilisation. A total of K444.1 million was used on fuel purchases alone. According to the monitoring team, tracking fuel usage is very difficult, especially in trying to find out how HIPC funds were used. This was mainly due to lack of records.

In addition, some individuals borrowed some HIPC funds contrary to HIPC guidelines. Most of this money was usually reimbursed within three months. The only disadvantage is that this ties monies to be used immediately.

Regarding tendering procedures, some contracts in Serenje and Mumbwa were awarded to individuals and not to corporate entities and no records were kept. This made it difficult to determine whether tender procedures were actually followed.

### 5.3.2 Ministry of Education

The funding to the HIPC activities in this ministry for the province was effected directly from the headquarters in Lusaka to the accounts of the Provincial Education Officer (PEO). There are no records or any documentation reflecting any of this funding with the provincial accounting and controlling officer (PACO).

## 5.4 Other Findings

The case of utilisation of HIPC funds in Central Province clearly reveals that there was no involvement of the local people in the allocation and monitoring of projects. With the active involvement of local communities, there would have been less of the HIPC resources misapplied.

Another case of gross abuse of HIPC funds was in North Western province. According to a CCJP Co-ordinator in Solwezi, the first allocation of HIPC funds was not publicised. Civil society was not even given an opportunity to know which projects were being done with HIPC assistance.

The result was gross misuse of HIPC funds. Roads meant for rehabilitation were either poorly done or not done at all. Moreover, junior executive officers in

government bought expensive cars and built houses, raising suspicion whether or not income used in these purchases was within their income-bounds.

It is even alleged that when a Deputy Minister of Finance was visiting Solwezi, he was taken on a tour of roads rehabilitated using HIPC funds. At one point the Deputy Minister asked the Provincial Permanent Secretary when they were to reach the rehabilitated roads. To the disbelief of the Minister, the PS told the Minister that they were actually driving on one of the roads rehabilitated. Definitely the road was still in a deplorable state!

According to CCJP in Solwezi, the PS of North Western agreed that funds were misused and corrective measures were promised. To this date CCJP has not heard of any of the culprits taken to court or punished in other ways. The only action taken seems to be some administrative transfers of those believed to have been involved in the saga.

Subsequent releases to the province have been well publicised, though there is still limited information on projects done.

## Chapter Six

# Conclusions and Recommendations

In conclusion, the question on whether HIPC is working should be looked at in the context of the ability of the initiative to give a country permanent exit from debt overhang and at the same time offer the preconditions for economic and social prosperity. In Zambia's case it is clear that even after completion point HIPC will not provide the country a robust exit from "unsustainable" debt. The key reason for this is that enhanced HIPC has failed to tackle the key causes of debt overhang. Debt cancellation, even total cancellation, is not enough to prevent the country from further debt crises because of serious inadequacies in the international relations particularly of international trade. However debt cancellation is central in releasing resources that would then be earmarked for poverty reduction programmes.

### 6.1 HIPC and Debt

On the basis of this review of the performance of HIPC II in Zambia since 2000 and the projected performance of the economy in the next 20 years, there is strong evidence suggesting that HIPC II will not result in a robust exit from unsustainable debt. Debt service obligations will remain high, even after receiving full "HIPC treatment."

Moreover, as long as government continues to contract "new" loans without careful analysis of the impact of and how repayment of such loans, external debt stock will remain unsustainable. This will continue to block genuine economic development for a long time to come in Zambia.

In conclusion, HIPC II will not offer a robust exit to Zambia from the unsustainable external debt mainly because the initiative is based on unrealistic economic assumptions such as sustained growth in exports and economic growth. The HIPC initiative was designed primarily to benefit the creditors.

### Recommendations

Based on this finding, we recommend that:

#### To Creditors

Creditors should accept that the enhanced HIPC framework is not meeting the debtor countries' needs. To register that 5 out of the 26 countries will have unsustainable debt after reaching completion point and that several HIPCs will be paying more on debt service than before the HIPC process in a short period of 2 years is enough evidence that the initiative is failing.

Creditors must also take responsibility that HIPCs meet their Millennium Goals as set by the United Nations. As a first step towards this, debt relief initiatives should be

based on broader criteria such as the prevailing social economic situation. The IMF and World Bank should stop using narrow economic variables specially exports and government revenue as the only determinants of debt relief to be delivered. More emphasis should be on social indicators, such as disease prevalence, illiteracy levels and perhaps use a broad based index such as the UN Human Development Index (HDI).

As long as creditors fail to meet 100 percent of pledges on time, there will be financial gaps that result in certain key programmes being delayed or not implemented at all. Therefore cooperating partners are urged to be more sincere and fulfil their part as promised. This will go a long way in assisting the situation.

#### To Government

In order to prevent new debt problems, government should start borrowing prudently. It is sad to see that government has no clear policy on external debt including contraction of new loans. The revelation that government can borrow up to 20 trillion Kwacha in a single year thus doubling Zambia's debt in such a short period is no good borrowing guideline. Therefore government should have a long-term policy on both external and internal debt contraction. And at a regular time period, government should set the meaningful limit on how much should be contracted as new debt and to which needy areas. If not already being done, there should be a thorough analysis on how the government intends to repay the debt, clearly indicating their assumptions. In fact Parliament should be the key government vehicle through which these issues should be addressed.

Concerning information disclosure, government has provided information on HIPC funds received and disbursed to line ministries. However there has been lack of information on the nature of the projects undertaken. In this regard government should therefore release information pertaining to:

- i) HIPC amounts received
- ii) Who received the amounts
- iii) Where the money is coming from
- iv) How the money was used, meaning outlining the projects undertaken
- v) Highlight impact on poverty and how much progress has been made on the projects.
- vi) For resources utilized at district or provincial offices, government must be obliged to publish amounts received before even projects start and the type of projects the money is for. This will help the local people to get information and participate at that level.

## To Civil Society

Civil society must not to lose track of the key purpose of a debt cancellation campaign. The truth of the matter is that HIPC is failing not only in Zambia but also in many other countries. The initiative fails to address the key causes of debt such as unfair trade practices and subsidies in western markets. The failure of Enhanced HIPC should instead add more impetus to calls for total debt cancellation. For this reason, civil society must continue calling for total debt cancellation.

Civil society should also take centre stage in campaigning for new guidelines on external debt. There is need for a call for a debt policy, which would have both short term and long-term objectives. This will help the nation chart a new direction in terms of debt management.

Calls for reparations for the illegitimate debts, debts caused by resistance to apartheid in South Africa, must be enhanced. A strong campaign should be built around the case for reparations. South African civil society has made steady progress on this issue. It now remains for Zambian civil society here to work in solidarity with their colleagues in RSA.

## 6.2 HIPC and Debt Service

Even with HIPC, Zambia is expected to continue service debts. These payments are still comparatively higher than the budgetary amounts allocated to the social sectors. HIPC in its current form and content does not guarantee debt sustainability as evidenced by the hard-to-fill gap that debt service payments leave in the annual national budget. Despite our high debts and low exports earnings due to poor terms of trade, Zambia has been making huge financial transfers to the creditor community in order to remain "credit worthy" on the international money market.

New loans contracted at concessional rates have continued to add weight to the already heavy debt burden in the country. High levels of debt and the subsequent debt service payments limit government's ability to mobilise domestic financial resources needed for investments. A government burdened with debt is forced to invest less in economic infrastructure and to a greater extent, cut social spending, and possibly narrowing its potential tax base.

### **Recommendations**

Based on this point, we recommend that:

Government must not make any debt service payments until major social concerns in the national budget have been fully met. This is important in order for Zambia to seriously tackle the prevailing social problems especially in the health and education sectors. Government has been failing to meet its social obligations because debt service diverts resources away from these needy areas.

### 6.3 HIPC and Debt Relief

HIPC does not provide enough resources to generate the deep debt reductions that Zambia needs to solve the social and economic problems. Under the current HIPC package for Zambia, the debt relief resources are not adequate to contribute significantly to the social and economic development needs of the Zambian people.

Therefore increased debt relief to Zambia is the most immediate and efficient way to mobilise resources for development. Unless debt is resolved by way of full cancellation and accompanied by a set of implementable conditions such as responsible borrowing by our government and responsible lending by our creditors, the country will continue lagging behind all development initiatives. With significant debt relief, as opposed to hopes of investments and broadened tax, which are long-term goals, our government can plan into the future with more certainty.

### 6.4 HIPC and Conditionalities (Triggers)

The social triggers (conditionalities) are in principle good for poverty reduction. Increasing expenditure in the social sectors is certainly a good thing. But the trigger regarding privatisation of Zambia National Commercial Bank (ZANACO) and Zambia Electricity Supply Corporation (ZESCO) has raised a lot of concern among civil society, mainly due to job losses associated with private companies in Zambia.

#### **Recommendation**

This calls for great caution by government when considering privatisation of the remaining parastatals. We recommend that government should renegotiate the triggers by striking out the aspect of privatisation as conditionality for accessing debt relief. Just as PRSP must be de-linked from debt relief, privatisation must be de-linked from debt relief.

Civil society resistance to privatisation of the remaining parastatals should, however, not be misconstrued as a passport to government to continue abusing these parastatals for political programmes. There is need to stop financial haemorrhage in the parastatals. Certainly parastatals must not be allowed to drain government resources because they are loss making. In order to stop government from interfering in the running of these parastatals it is recommended that government should become a minority shareholder by selling part of its shares to Zambians.

### 6.5 Management of Debt Relief Resources

The report reveals that there has been consistent reporting on allocations, amounts received and actual disbursements to different ministries. However, there has been a serious lack of information on how much progress is being made in the various HIPC-funded projects. This is definitely a major concern amidst several allegations of

abuse of resources. Failure by government to provide progress reports on HIPC-Funded projects limits the ability of the citizens to participate in this process.

### **a) Planning and Prioritisation**

The report reveals that HIPC-funds though meagre have been spread thinly across too many sectors. This has led to lack of real impact on people's lives on national level.

#### **Recommendations**

Based on this point, we recommend that:

For HIPC-funds to have impact that will be felt nationally there is need to prioritise so that only a few sectors benefit. Prioritisation of HIPC-funds will lead to easy tracking of impact on poverty reduction. This will create more confidence among donors/creditors.

Diversion of HIPC funds to other causes has been reported in the press. This is so mainly because the funds are allocated through the main budget where government is at liberty to switch expenditures. It is therefore recommended that though the HIPC amounts appear in the national budget as revenue, the actual prioritisation and allocation of the funds must be done outside of the budget process to allow for broader participation in setting priorities.

### **b) Information Disclosure**

Money released to provinces is not publicised, thereby making it difficult for the local people to know and participate in monitoring government implementation of HIPC funds. Government has been publicising expenditure figures in national papers but this information is not detailed enough for people to be properly informed about these resources.

#### **Recommendations**

On the basis of this lack of information, we recommended that:

The controlling officers (Permanent Secretaries) in various ministries/provinces should not only give a financial report monthly on how much HIPC funds have been spent but they should indicate progress being made on various HIPC-funded projects in their respective ministries. As a result, the financial report from the Auditor General's Office should be accompanied by a projects' progress report on a quarterly basis.

In order to enhance local people's participation in monitoring government usage of HIPC funds, it is recommended that when money is received at provinces/districts it should be publicised and a breakdown of projects to be undertaken given. At that level quarterly reports on projects could also be made available. A broad-based

monitoring committee at the provincial/district level would be most welcome. Such a committee could include government, civil society and donor representatives.

### **a) HIPC Expenditure Monitoring and Auditing**

Based on the findings in this study, it is concluded that HIPC expenditure monitoring is very weak and auditing has not yet been done, at least at the time of conducting this study. The HIPC Expenditure Monitoring Team, though “independent” does not have the capacity to monitor expenditures that go to the whole country. At the time of this study, the team had only produced a report for Central Province. This means that 8 more provinces are yet to be covered. The group though comprising very competent people, it is too small to monitor expenditures that go to literally the whole nation.

Moreover, the team is only monitoring the expenditure of HIPC funds but there is also need to monitor the impact of HIPC-funded projects on the lives of the poor people. This is the essence of debt relief, to ease the suffering of the majority poor.

So far there has been neither an internal nor an external audit of the HIPC-funded projects.

We therefore recommend that:

### **Recommendations**

On the basis of this finding it is recommended that government adopts a debt mechanism proposed by Jubilee-Zambia. This will ensure broad based participation in allocation of HIPC resources, monitoring implementation of HIPC-funded projects and monitoring the impact of the same projects on reducing poverty. The mechanism involves establishing a broad-based committee comprising representatives from government ministries, parliament and civil society, with donors as observers. The prime responsibility of this committee would be to allocate HIPC-funds in a transparent manner, by so doing ensuring prioritisation towards poverty reduction. The committee would also be charged with monitoring all aspects of the projects. The second aspect of the mechanism is a social fund where HIPC-savings are deposited.

In the interim period before establishment of the Debt Mechanism, government should focus on funding the HIPC Expenditure Monitoring Team adequately thereby so that all provinces could be covered soon. The team should involve other people to help it monitor effectively. Reports by the team should be made public (especially through the press) so that the general public could appreciate the contribution of HIPC-funds. It is also recommended that an audit should be undertaken soon, either by the office of the Auditor General or by a Private auditing firm. This should be done immediately in order to clarify the extent of abuse of HIPC-funds by various government officials.

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Since the ability for Zambia to receive further debt relief depends on the proper usage of the HIPC resources released, it is important that audits are done annually in order to give a fuller picture of the usage or misuse of the funds.

## **Conclusion**

HIPC in its present form and content is not a solution to Zambia's external debt problem:

- 1) In structure, it leaves us with unsustainable debt because it is based on unrealistic and simple macroeconomic aggregates of exports and government revenues
- 2) In orientation, it is still too tightly tied to macroeconomic reforms like privatisation that have not yet been adequately evaluated
- 3) In practice, it is inadequate for poverty eradication and has been badly and in some instances fraudulently managed
- 4) In ethics, it is faulty, because it neglects to take into consideration that
  - a) Much of Zambia's external debt is illegitimate and
  - b) Debt servicing continues to hurt the poor the most

For these reasons, Jubilee-Zambia continues to call for total debt cancellation, with proper mechanisms to assure transparent spending of resources and no new debt contraction without open procedures

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**Appendix A**

<b>Name</b>	<b>Persons Interviewed</b>		<b>Position</b>
	<b>Organisation</b>		
Mr. Jack Jones Zulu	Jubilee-Zambia		Policy Analyst
Mr. Nabanda	CCJP-Solwezi		Co-ordinator
Mr. Steve Mbewe	MFNP (ERM)		Acting Director
Ms. Nancy Simango	MFNP	(Accountant	Senior accountant
Ms. Charity Musamba	General's Office) Jubilee-Zambia		Co-ordinator
Dr. Mark Ellyne	IMF		Resident Representative
Mr. C. Mulendema	Independent	HIPC	Chairman
Mr. Victor Simulyampondo	Monitoring Team	Jubilee-Monze	Committee Member

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## Appendix B

<b>Progress on the Implementation of HIPC Triggers</b>	
<b>HIPC Triggers</b>	<b>Status or Comments at end-December 2002</b>
<p><b>Poverty Reduction</b> The adoption of a PRSP with implementation and monitoring for at least one year</p>	PRSP was approved by Cabinet and subsequently endorsed by the IMF and World Bank in May 2002 and was officially launched in July 2002.
<p><b>Progress in Combating HIV/AIDS</b> Full staffing of secretariat for National HIV/AIDS/TB Council</p> <p>Integration of HIV/AIDS awareness and prevention programmes of at least 10 key ministries</p>	<p>All positions filled</p> <p>Awareness and prevention programmes integrated in pre-services and in-service training in the ministries</p>
<p><b>Progress in Education Sector Reform</b> Increasing the share of education in the domestic discretionary budget from 18.5 % in 1999 to at least 20.5 %</p> <p>Raising the starting compensation of teachers in rural areas</p> <p>Formulation of an action plan for increasing student retention</p>	<p>The share of education in the domestic discretionary budget rose to 20.8 % from 18.5 % in 1999</p> <p>80 % salary increase to primary school teachers raising average salary (pre-tax). A salary related rural hardship allowance of 20 % of basic pay in place</p> <p>A strategic plan in place</p>
<p><b>Progress in the Health Sector Reforms</b> Implementation and scaling-up of an action plan for malaria</p> <p>Procedures and mechanisms for the procurement of drugs reorganised to be fully transparent and efficient</p> <p>Timely release of complete detailed annual health expenditure data</p> <p>Actual cash released to District Health Management Boards (DHMB) to be at least 80 % of amount budgeted</p>	<p>Implementation of themes begun</p> <p>Roles of various actors reviewed and a procurement procedures manual prepared</p> <p>Annual and quarterly reports prepared</p> <p>Average percent of actual over budgeted Figures of GRZ grants to DHMB increased from 66 % to 84 % in 2002</p>
<p><b>Macroeconomic and Structural Reforms</b> Maintenance of a stable macroeconomic environment</p> <p>Implementation of an Integrated Financial Management Information System (IFMIS) on a pilot basis</p> <p>Implementation of a Medium Term Expenditure Framework (MTEF) prepared by MOFNP and approved by Cabinet</p> <p>Restructuring and issuance of international bidding documents for the sale of a majority (controlling) interest in ZESCO</p>	<p>PRGF on track</p> <p>IFMIS project team constituted, and short-term consultant contracted.</p> <p>As a basis of introducing an MTEF in 2004, a Budget Framework Paper was prepared in 2003</p> <p>15 expressions of interest were received and detailed terms of reference for engaging transaction advisors were submitted to the World Bank without objection in 2002.</p>

<p>Restructuring and issuance of international bidding documents for the sale of a majority (controlling) interest in the Zambia National Commercial Bank (ZANACO)</p>	<p>The ZPA advertised the sell of 51 percent GRZ shares on 18 May 2002</p>
<p><b>Improvement of Poverty Database and Monitoring Capacity</b>  Annual reports on poverty and social conditions prepared and disseminated by the Living Conditions Monitoring Unit of the CSO.</p> <p>Establishment/formalisation of the Strategic Operational Unit Under MOFNP</p>	<p>An annual Poverty Review Conference was held in March 2002 and fieldwork for the Living Conditions Monitoring Survey (LCMS) started on 16 November 2002.</p> <p>Planning and Economic Management Department and SOPS established in MOFNP</p>
<p><b>Other</b>  Satisfactory financing assurances from Zambia's external creditors</p> <p>Concurrence of the Boards of the World Bank and the IMF with the joint staff's assessment that the PRSP provides a sound basis for Bank and Fund concessional assistance</p>	<p>As per 2002 Consultative Group Meeting financing assurances were made</p> <p>The World Bank and IMF have endorsed the PRSP.</p>

Source: 2002 GRZ Economic Report by MOFNP.

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**Appendix C**

<b>Selected Economic Indicators in 2001 and 2002</b>		
<b>ITEM</b>	<b>2001</b>	<b>2002</b>
Real GDP ( 1994 prices) (K' billion)	2,622.5	2,701.9
Real GDP Growth (%)	4.9	3.0
Exports (US\$' million)	887	920
Imports (US\$' million)	1,253	1,157
External Debt Stock (US\$' billion)	7.123	6.488
External Debt Service (US\$' million)	116.5	137
Internal Debt Stock (K' billion)	4,139.3	4,249.1
Internal Debt Service (K' billion)	-	443.9

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Source: GRZ Economic Report 2002 by MOFNP