RESOLVING ZAMBIA'S SOVEREIGN DEBT PROBLEM: A HOME-GROWN SOLUTION OR AN IMF SUPPORTED PROGRAMME?

Background and Problem

The last five years have seen government making frantic efforts to clinch a 'bailout package' from the International Monetary Fund (IMF). Success in clinching the package has however been elusive. With the change of government in August 2021, there has been renewed effort by the new government to bring the IMF to the table for assistance. A few meetings have since been made with the Fund to chart the way forward with the country's debt problem. This has sent opinion-makers and critiques talking. Some critiques feel that the government is getting too close for comfort to the IMF, arguing that the newly found closeness between the government and the Fund reeks of a return to neo-liberal ideals which, apparently, wreaked havoc on the masses while the SAPs and HIPC initiative lasted. There has therefore been calls for home-grown solutions to the country's debt problem.

The Depth of Zambia's Debt Problem

The volume of Zambia's sovereign debt has increased several folds in the last ten years. Between 2016 and 2020, the debt stock almost doubled from US$11,0 billion to US$20.5 billion. Table 2 shows that the majority (70%) of this debt has been external debt, which has also doubled from $7.7 billion in 2016 to $14.3 billion in 2020. The speedy growth in debt stock has exerted a lot of pressure on the nation's treasury. Further, it led to downgrading of the country's credit rating and loss of investor confidence: Moody's rating downgraded the country's credit rating to junk status, making the country a high-risk investment destination.

Table 1: Type of Zambia's public debt

Type of debt	**2016**	**2017**	**2018**	**2019**	**2020**
External ($ billion)	7.7 (70%)	9.4 (66%)	11.4 (70%)	13.2 (70%)	14.3 (70%)
Domestic ($ billion)	3.3 (30%)	4.8 (34%)	4.9 (30%)	5.7 (30%)	6.2 (30%)
Total ($ billion)	**11.0**	**14.3**	**16.2**	**18.9**	**20.5**

Source: Ministry of Finance, 2020

Foreign Debt Pitting the Country

Of all external debt contracted so far, 46.5% is commercial, 29.9% is bilateral and 23.7% is multilateral. The fact that 70% of the total sovereign debt is foreign pits the country against the vagaries of the foreign exchange market and developments in the balance of payments. A depreciation of the local currency for instance entails an increase in debt obligations denominated in foreign currency. As a matter of fact, the increase in debt obligations payable every year in the last few years can be attributed partly to depreciation of the local currency.

Debt Sustainability Debate

Debate as to the sustainability of the country's sovereign debt started in the early parts of the last decade. While some opinion-makers argued that the country would soon be chocked with debt, government snubbed such arguments and re-assured the public that debt levels were within manageable and sustainable limits. The question of debt sustainability was however settled last year in 2020. Zambia become the first African country to default on its sovereign debt by failing to pay a coupon of $42.5 million on European issued bonds. While this default may not have been anticipated, looming problems on debt stress had already been acknowledged in the 2017 Debt Sustainability Analysis (DSA), and the 2019 Joint World Bank-IMF DSA actually concluded that Zambia's risk of external debt distress was high (IDA[1] and IMF, 2019).

International Monetary Fund Deal (IMF Deal)

The question of how to move out of the debt problem through a restructuring has now become a preoccupation of the Ministry of Finance. Based on the constant contacts that the Ministry of Finance has made with the IMF recently, it is obvious that the restructuring of debt will be done under an IMF supported program, and this has not been received well by some sections of society, some of whom have argued that a home-grown solution to the debt problem would be more favorable. Others have even argued that recent reports that the country's revenue authority has consistently outperformed its revenue collection targets is an indication that the country has enough capacity to deal with the debt problem using home-grown solutions.

Possible Solutions to the Debt Problem

There is no alternative solution to the debt problem other than restructuring. The country cannot repudiate the debt because the cost would be too high and would include being ostracised from the international financial markets. Sovereign debt restructuring is an exchange of outstanding sovereign debt instruments for new debt instruments or cash through a formal process (Nalishebo and Halwampa, 2015). Debt restructuring enables a sovereign state regain control over its sovereign debt by making the debt sustainable through reduction of interest payment, lengthening of repayment period or even cancelling of part or all of the debt.

How Must Zambia Restructure Her Debt?

Given the gravity of the debt situation, Zambia has no solution but to restructure its sovereign debt. But the question is, 'should the restructuring be done under a home-grown program or an IMF-supported program?' But before we provide an objective response to this question, it is important to have a clear understanding of what a home-grown solution would look like and compare it with an IMF supported solution.

The Difference Between a Home-grown Solution and an IMF-supported Solution

We use the example of Greece to distinguish between a home-grown solution and an IMF supported solutions. One thing we ought to note is that a sovereign debt crisis occurs when a sovereign state fails to meet its debt obligations as they fall due. It is a problem of limited resources. Solutions therefore lie in being able to raise additional finances to meet the debt obligations. In the absence of debt cancellation, this can be achieved by using different strategies such as by growing the economy (this does not work in the short run); reducing the coupon rate, which reduces the amount of interest payable at a point in time; or lengthening the repayment period to give a country more time to mobilise resources. It can also be achieved by implementing expenditure cuts to free some financial resources for debt servicing or rolling-over the loan. In the case of a roll-over, the Government would issue another Eurobond upon maturity in 2022 with a total value of US$750 million and use the money raised from the issue to pay the holders of the current US$750 worth Eurobond. The actual strategy employed to deal with the debt can involve various combinations of the measures explained above and can be done under the support of an IMF program or a home-grown program.

[1] International Development Association

Experiential Example on Debt Structuring Solution

In essence, there is no major difference between an IMF supported restructuring programme and a home-grown solution except for the conditions which are usually imposed by the IMF. For illustration purposes, we use the case of Greece, where a home-grown solution was employed before an EU-IMF Consolidation Package. The main ingredients of the two strategies are highlighted in Table 2.

Faced with a growing debt crisis, Greece designed and implemented home-grown consolidation package in 2010. However, the success of the home-grown package was short-lived and not enough to restore markets' confidence (Kouretas and Vlamis, 2010). This forced the Greek government to negotiate for an EU-IMF consolidated package.

Home-Grown and EU-IMF Consolidated Package

It should be clear from Table 2 that the there is no major difference between the hone-grown solution and the EU-IMF solutions. Both packages were essentially austerity packages aimed at freeing-up resources through expenditure cuts as well as raising additional resources through increase of tax on selected activities and commodities. What the EU-IMF package did differently was to intensify on expenditure cuts and implement further increase in selected taxes.

Table 2: Home-grown and EU-IMF Consolidation Package

	Home-grown Response	**EU-IMF Consolidation Package**
	Measures on the Revenue Side	
1	Measures to reduce tax evasion and improve tax collection.	Raising of value-added tax bands by between 4.5% and 21%.
2	Reduction of social contribution evasion.	Increase in indirect taxes of gasoline, tobacco and alcohol along with higher electricity charge
3	A special levy on profitable companies.	An increase of property taxes, taxes on luxury goods and on offshore companies and real estate.
4	Acceleration of EU receipts for the public investment programme	Introduction of a "green tax"
5	Increase on several types of indirect taxes.	
	Measures on the Expenditure Side	

1	A 10% cut in general government expenditure on salary allowances	Reduction on total salary payments to employees of the public sector
2	A recruitment freeze in the public sector for 2010	A freeze on state pensions
3	Implementation of a 5:1 retirement/ recruitment ratio for public sector employees from 2011 onwards	Cutting public sector works by 5% and education spending by €0.2bn.
4	Reduction in the budget item linked to social security and pension funds by 10%	A 3-year freeze in wages and pensions
5	Other relevant measures to reduce government expenditures in most public services	Cut backs in central government operational costs.

Source: Kouretas and Vlamis, 2010

Weighing the Two Solutions

It should be clear from the experience of Greece that a home-grown solution has no essential difference with an IMF supported package. They both seek to free-up resources for debt servicing by instituting expenditure cuts, raising additional finances through, inter alia, selected tax increases. But the question people wish to ask is 'if there is no difference in principle' then why bother which one to implement? Specifically, why should we opt for an IMF supported programme?

In determining which restructuring package to implement, the most important thing to consider is the likelihood that the extant problem will be resolved as well as the legitimacy and costs associated with implementing a selected strategy. Below is a brief description of each of these elements.

- **Legitimacy**: this entails general confidence among the public that a government's power to make binding decisions for the society are justified and appropriate (Dahl, 1998). Legitimacy entails convincing the public and other stakeholders to buy into a policy.
- **Cost**: these costs include social and economic costs of pursuing a given alternative solution to the debt problem. Social costs may include reduction of social sector spending while economic costs could include slowdown in economic activities, loss of access to financial markets as a result of deteriorating credit rating.
- **Political feasibility**: this entails general acceptability of the programme by various stakeholders including politicians, the general population, and cooperating partners.
- **Technical feasibility**: this is the knowhow of designing and implementing a selected strategy.

The matrix below shows the feasibility of each of the two strategies based on legitimacy, cost, political feasibility and technical feasibility.

Table 3: Feasibility Matrix

	Home-grown Package	**IMF-supported Package**
Legitimacy	High level of legitimacy. Enjoys support from local population.	Low level of legitimacy in the general population which views the IMF as a champion of capitalism.
Costs	Government can try to minimise the social and economic costs through careful selection of interventions.	Government has little discretion to minimise the social and economic costs. Conditions have to be adhered to.
	Prone to the time inconsistency problem.	Conditionalities can be negotiated to minimise social economic costs.
Political feasibility	Enjoys a lot of political support from the population.	Very law political support from the population which sees the IMF as a champion of dismal neo-liberal ideals.
	Enjoys limited support from cooperating partners due to poor governance record	Cooperating partners may find the IMF more credible.
Technical feasibility	Local technocrats may have to rely on hired consultants to negotiate a reasonable restructuring package.	Very high level of technical expertise to negotiate complex restructuring packages.
	Prone to the time inconsistency problem.	Plans are credible and less prone to time inconsistency problem

Where to Now?

From the feasibility matrix above, it is clear that a home-grown package scores highly on the scale of legitimacy as opposed to the IMF which is viewed as a champion of neo-liberal ideals which, a few years ago, wreaked havoc on people's social and economic welfare as the country battled to resolve its debt and economic problems under the HIPC initiative and the Structural Adjustment programme.

Time Inconsistency Problem

In terms of social and economic costs, a home-grown solution is flexible enough to minimise social economic costs. But the flexibility renders it less credible and prone to the time inconsistency problem. The time inconsistency problem exists when a stabilisation policy, which should ensure permanently sustainable growth, is sometimes subordinated by the state to short-term aims, which later require painful re-adjustments (Reľovský, 2004). For example, in an election year, the government in power can suspend selected necessary austerity measures to improve its approval rating, but at the expense of long-term stabilisation of the economy. On the other hand, the conditionalities associated with an IMF package, as experienced by the country under the Structural Adjustment Programme (SAP), are known to exact high social economic costs. The austerity measures that come with an IMF package are associated with, inter alia, expenditure cuts, wage freezes, employment freeze, and privatisation of public assets. However, the conditionalities can be negotiated to bring about a win-win situation. They are not cast in stone. For example, during the implementation of the HIPC initiative, Zambia was expected to privatise the power utility company. However, this condition was later waived and efforts to commercialise the utility company were implemented instead (ADB[2], 2005).

Political Perception on Debt Solutions

Comparing the political feasibility of the two options, it is clear from the feasibility matrix that both options are equally matched. While a home-grown solution enjoys a lot of political support from the population, cooperating partners may find it less credible and therefore be sceptical about it. On the other hand, an IMF-supported package enjoys a lot of political support from cooperating partners on account of the credibility of the IMF. But the local population has tended to be hostile to IMF supported packages. This is on account of their bad experience with austerity measures under the infamous SAPs and the HIPC initiatives. Nevertheless, an IMF package would be more endearing to bondholders due to the confidence it brings in the market.

Technical feasibility is one of the most important conditions in obtaining a favourable restructuring package. Due to the complexity of the composition of bondholders, negotiating a package which will be supported by majority of the bondholders is quite a complex thing. The IMF enjoys a lot of capital because it has dealt with similar issues a lot of times. Even if the country were to hire a consultant to negotiate a restructuring deal, the results would not be as favourable as would be results negotiated by the IMF.

Conclusion and Recommendation

The essence of a home-grown and IMF-supported bailout package is the same. Both packages seek to restore debt sustainability by exacting measures to either reduce expenditure and free-up some resources for debt servicing or increase selected taxes to raise finances for debt servicing or both. There is, however, a difference in the possibility that each of them will succeed in restoring debt sustainability. The difference lies in qualities such as legitimacy, costs, political feasibility, and technical feasibility. In terms of costs and political feasibility, an IMF package competes favourably with a home-grown solution. However, the IMF has a high score on the metric of technical feasibility. Based on this, the following are the recommendations:

[2] African Development Bank

- An IMF-supported restructuring should be prioritised due to its immunity from the time inconsistency problem.
- Conditionalities associated with the IMF package should be negotiated in such a way as to minimise the social economic costs.
- Political support for the IMF-package should be galvanised from the public to minimise political backlash.

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