



Financing the Economic Stabilization and Growth Programme (Zambia Plus) in the Shadow of the IMF

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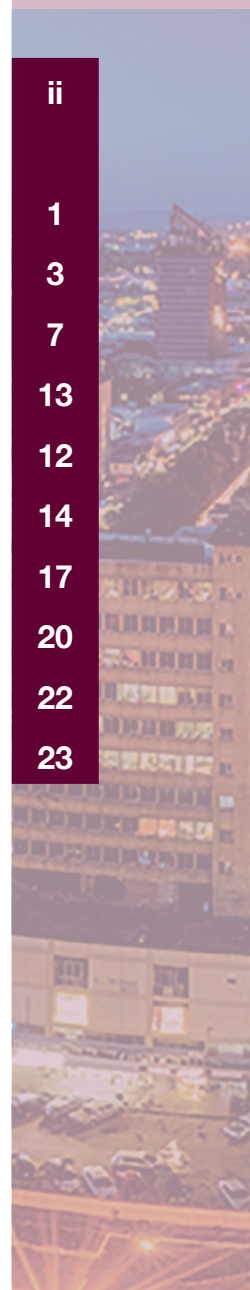
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Executive Summary

In February 2018, the IMF reaffirmed its August 2017 formal withdrawal from negotiations with Zambia over a package of financial support. The strong position to hold negotiations came in the IMF's Article IV Consultations report of 2017, which concluded that Zambia was at high risk of debt distress, and that whilst financial management and fiscal discipline were improving, the extent of the improvement was not sufficient to mitigate the growing public debt and fiscal deficit.

Whilst the IMF deal may be off the table for the time being, the many of problems that drove Zambia to engage the IMF most assuredly remain unresolved. Two to three years after the economic mini-crisis of 2015, Zambia continued to accrue sizable new debts, to utilize the proceeds poorly (to fund consumption spending) and to run persistent fiscal deficits – albeit a smaller and seemingly better managed deficit in 2017 compared to 2015 and 2016. These issues remain problematic despite the partial economic rebound, with high copper prices, good rains (leading to good harvests and more reliable power supply), and a stable Kwacha providing a strong platform for improvement. Nonetheless, fiscal performance is lagging behind and Zambia may be missing a window to re-establish prudent public financial management.

To this extent, ZIPAR asserts that IMF support to Zambia Plus is still absolutely critical. The support would secure US\$1.3 billion of interest-free financing, to buttress the balance of payments and create fiscal space of social and economic infrastructure development. This could continue to drive growth whilst enabling Zambia to resolve some of its not insignificant debt repayment challenges. The support would also increase the level of technical assistance from the IMF, allowing for more effective provision of early warning surveillance services such as the IMF's 2017 warning of high risks of debt distress given Zambia's fiscal path. Finally IMF supported programme would also improve the international community's confidence in Zambia, thus unlocking external resources from cooperating partners (donors) and investment partners.

Without IMF support, ZIPAR argues, the risk of debt distress will grow as Zambia is likely to see; (a) a continuation of excessive spending and mounting fiscal imbalances between revenue and expenditure; (b) continued mounting of the public debt as the Government attempts to sustain high spending appetite; (c) escalating risks of fiscal slippages and wastage given the expansionary fiscal environment; (d) further increases in the already high debt burden, with the possible emergence of external repayment imbalances; (e) rising pressure to raise domestic resources through a multiplicity of taxes and non-tax measures; and (f) ultimately, an intensification of social and economic hardships for the Zambian people, with the brunt of the deleterious effects falling disproportionately more on the poor and vulnerable members of society.

From the domestic spending profile, Zambia clearly needs external support to prioritize expenditures. The country in particular through Zambia Plus, has already undertaken commendable *prior actions* in pursue of better fiscal and economic governance – for example reducing subsidies and seeking to improve financial management. However, these actions alone are simply not enough to address the fundamental fiscal challenges, prevent the recurrent budget overspends against allocations or address the growing challenges and potential consequences of Chinese debt. Equally without further action the Government will not build domestic and international confidence about a credible fiscal strategy. Indeed, the persistent highly expansionary fiscal path that the country is on indicates continued debt growth or major revenue growth, which coupled with the high frequency of considerable fiscal slippages, is of concern and is arguably driving the rapid escalation of public debt.

The Government may be talking the talk on fiscal responsibility and fiscal fitness, but it is not walking the walk. The Zambian authorities need to take urgent action to satisfy domestic and international stakeholders, the IMF included, that they are addressing the challenges highlighted by observers around public debt, improving public financial management, enhancing spending priority setting, and curbing excessive and wasteful spending. Zambia needs the IMF to help cushion the difficult choices and provide the support to implement the prudent policies and reforms that are imperative during a time of slow real GDP growth and subdued revenue prospects.

The authorities face a clear choice: change course now and move Zambia back to a conservative fiscal policy and toward medium risks of debt distress, re-engage with the IMF, and ultimately bring Zambia back from the brink of economic malaise; or, continue with fiscal expansion and unsustainable debt accrual, to face the consequences of possible economic stagnation or even decline, deteriorating living standards and mounting socio-economic hardships.

1. A Protracted Negotiation between Zambia and the IMF

This policy paper was prompted by a protracted deliberation between the Zambian Government and the International Monetary Fund (IMF) regarding a Fund-supported economic programme. The Zambian authorities began contemplating an IMF “bailout package” in late 2015 in the wake of macroeconomic instabilities and growth slowdown that emerged during that year. The initial exploratory talks between the two parties in late 2015 and early 2016 were cordial. However, they were intermittently impeded because the build-up to the August 2016 general elections naturally gave rise to political uncertainties, taking attention away from talks of IMF support. Thus, for several months between late 2015 and 2017, the talks dragged on without a conclusion. By the close of 2017, the issue of an IMF deal was still in abeyance. In February 2018, the IMF announced that it had declined the second request from Zambia because the borrowing plans of the authorities were still too ambitious and threatened to further escalate the already heightened risk of debt distress. Discussions towards a Fund-supported programme were suspended, but the IMF left the door open to engage with Zambia through regular Article IV discussions and technical assistance (see Box 1.1). The Zambian Government did not offer any official statement reacting to the IMF position or specifying a counter-strategy to bring the discussions back on course.

The prolonged and inconclusive engagement naturally raised anxiety among various stakeholders locally and internationally. Some speculated that perhaps the negotiations had completely broken down and the Fund had permanently walked away from the table. With a number of other factors also at play – including the launch of the 2018 National Budget minus any IMF-financing component, the marked improvements in global copper prices in the second half of 2016 and in 2017, and the restoration of relative macroeconomic stability to the Zambian economy – other observers suggested that Zambia possibly did not need any IMF support.

This policy paper contributes to the public debate by bringing some clarity to some key emerging issues. Taking an empirical perspective, it assesses the relevance of IMF financing support to Zambia Plus, particularly in light of past macroeconomic stability (2015/2016) and unsatisfactory growth rebound in 2017. Furthermore, the paper reviews a few of the recent policy and structural reform efforts undertaken to improve Zambia’s economic governance. Given the impasse between the Zambian authorities and the IMF, we highlight the key outstanding or unresolved policy and structural reform issues. Finally, we offer policy reform options for improving Zambia’s prospects to return to prudent economic governance, rational resource allocation or prioritization, and effective spending on social protection, and economic and social infrastructure. We argue that prudent economic governance will in turn improve prospects for Zambia to secure IMF financial support once the engagement around the Fund bailout package resumes.



Box 1.1: Summary of 2016/2017 Engagements between the Zambian Government and the IMF

In November 2016, the Finance Minister sought and secured Cabinet approval to formally engage the Fund. On this basis, the fiscal authority began putting together a position to negotiate for financial support from the IMF. Zambia's negotiating position was expressed as the Economic Stabilization and Growth Programme (ESGP) 2017-2019, commonly called *Zambia Plus*, which was published in September 2017, 10 months after the Cabinet approval. From the onset, the "Plus" component of the *homegrown* programme was foreseen as the core element for attracting external development partners, including the IMF. But even as the ESGP was being drafted, the authorities continuously actively engaged the IMF regarding the financial support.

In the first half of 2017, the negotiations seemed very promising. Soon after the IMF mission to Zambia of 31st May to 10th June 2017, the Fund reported that it expected "to reach understandings in the coming weeks that would form the basis for presenting the authorities' request for an ECF arrangement and the report on the 2017 Article IV Consultation to the IMF Executive Board in August 2017" (IMF, 2017a). By the end of September, the Fund had still not made a decision. Despite this, the Zambian authorities remained optimistic about securing a positive decision from the Fund sooner or later. The 2018 Annual Budget Address delivered on 29th September 2017 stated that: "Government will continue to engage the Fund in October 2017 to set an agreeable macroeconomic framework that takes into account our spending and financing plans over the MTEF period and provides a platform to conclude an IMF Programme".

However, eleven days after the launch of the 2018 Budget Address, the IMF published its 2017 Article IV Consultation (IMF, 2017b). From this, the mood of the IMF had clearly changed compared to the June 2017 statement. The IMF Executive Directors acknowledged Zambia's progress where it had been made and expressed concerns where issues had arisen. They welcomed the improvement in Zambia's economic outlook and commended the launch of the ESGP and the Seventh National Development Plan (7NDP). Noting the significant challenges posed by domestic and external risks, they stressed the importance of containing recurrent spending, improving commitment controls, phasing out (fuel and electricity) subsidies, and strengthening public financial management, among other fiscal measures. They expressed particular concern at the pace of public debt increase, especially on external debt, contending that this had now put Zambia at high risk of debt distress. Therefore, even as the IMF was commending Zambia for having started with some noteworthy policy reforms and adjustments, it was no longer talking about "...presenting the authorities' request for an ECF arrangement... to the IMF Executive Board" as had been indicated in June 2017.

As if to drive the point home about a stalled negotiation, on 30th November 2017, the Fund released a Transcript of IMF Press Briefing from Gerry Rice, which unequivocally stated that discussions were on hold:

"Where we are on Zambia is that discussions on a new arrangement were put on hold in August of this year after the authorities unveiled large borrowing plans that we believe threatened that sustainability. So during the Annual Meetings and during a follow-up set of meetings actually led by our Africa Department Director Abebe Selassie, who made a recent visit to Zambia, the authorities expressed their will for a speedy re-engagement with the Fund. Where we stand is that while progress has been made on several elements of a prospective program, the discussions will need to progress and provide greater clarity, including on fiscal policy commitments and credible borrowing plans consistent with debt sustainability. So we're just essentially waiting for further data and details on the government's external borrowing plans, and then we would field a staff visit to update the macro framework and discuss the way forward."

In February 2018, IMF Mission chief Boileau Loko issued a statement (in part) that "the latest borrowing plans provided by the authorities continue to compromise the country's debt sustainability and risk undermining its macroeconomic stability and, ultimately, living standards of its people. Against this background, future program discussions can only take place once the Zambian authorities implement credible measures that ensure debt contraction is consistent with a key program objective of stabilizing debt dynamics and putting them on a

declining trend in the medium term". This essentially signified that the IMF had declined the authorities' request and suspended discussions towards a Fund-supported economic programme until further notice.

2. Recapping the Potential Benefits of IMF Support to Zambia

Zambia's intermittent experience of macroeconomic instability and policy challenges in 2015 is now well documented in the literature on Zambia (BOZ, (n.d.) ; Cheelo, 2016 ; World Bank, 2016 ; Cheelo 2017 ; MOF, 2016 ; MOF, 2017). Much of this grey literature also explains how the exogenous shocks dissipated over 2016 and 2017, and how real GDP growth marginally rebounded from 2.9% in 2015 to 3.4% in 2016 and 3.1% in the first half of 2017.

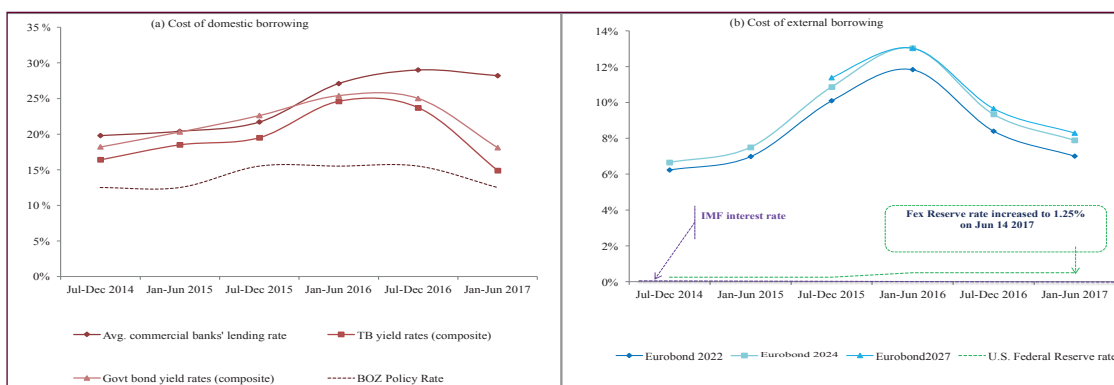
Within this medium-term macroeconomic context, in March of 2017, ZIPAR published a paper entitled: "Economic Distress and the Inevitability of an Economic Recovery Programme". The main messages of that paper are summarized in Box 2.1, with minor modifications. Approximately one year later, ZIPAR still stands firmly behind the key messages from March 2017. IMF financial support to Zambia Plus would be significant for the following main reasons:

- **Affordable finance:** IMF financing can be anticipated as a concessional zero-interest loan, which would be significantly more affordable than commercial borrowing from domestic and international markets. Domestically, even though yield rates on government securities fell to 18.1% (Government bond yield rate) and 14.9% (Treasury Bill yield rate) in the first half of 2017 from 25% and 23.7%, respectively, in the second half of 2016 (Figure 2.1, panel (a)), they remained rather high. Similarly, on the international scene, while Zambia's Eurobonds dropped from trading in the range of 11.8-13.0% during January to June 2016 to 7.0-8.3% over January to June 2017 (Figure 2.1, panel (b)), they were still relatively high, especially compared to the U.S. Federal Reserve rate, which was at 0.5% over most of the reference period. This simply emphasizes that a zero-rated IMF loan would be much cheaper than domestic and commercial international borrowing options.

Box 2.1: ZIPAR's March 2017 Statement in Summary:

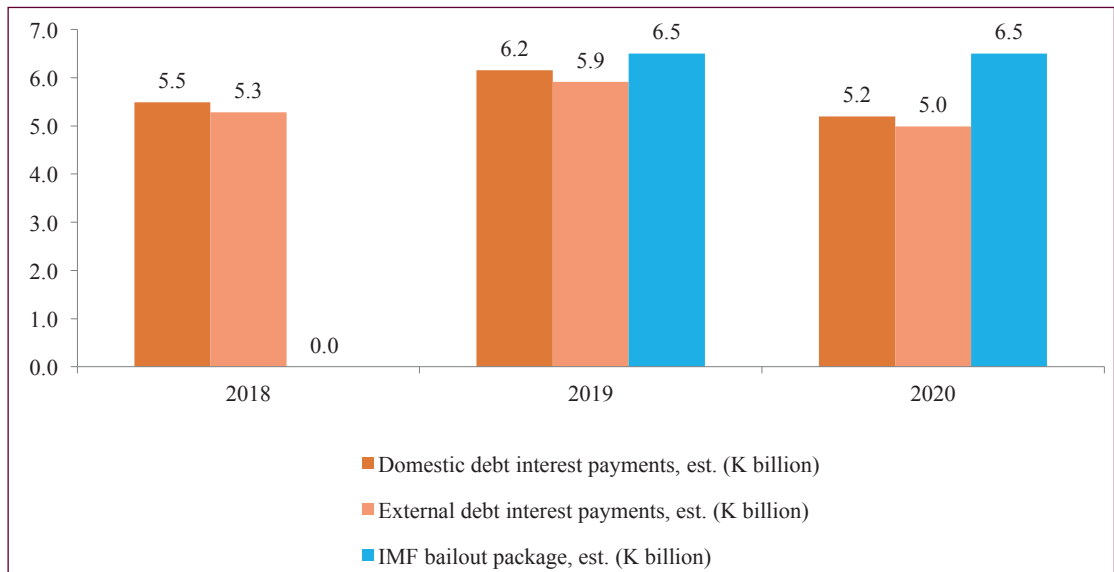
- The absence of Zambia Plus would do bigger and longer lasting damage to the lives of the poor than would the few challenges of the programme itself;
- Whilst copper prices were rising [and still are], lessons from history suggested that it would be unwise to pin Zambia's recovery or rebound to robust growth rates on such a volatile commodity as copper;
- Using commercial international markets as the primary source of sufficient affordable financing was not a realistic option for Zambia;
- Utilizing the US\$1.3 billion interest-free in the offing from the IMF in a reasonable way, for instance toward external debt servicing, would secure fiscal space for Zambia to maintain spending on priority social protection and infrastructure programmes, thus smoothing the robust growth recovery process; and
- In order to ensure that growth recovery stays on track and policies to support growth, reduce poverty and prudent fiscal governance are implemented on time, Zambia Plus would have to be underpinned by strong, rational and accountable institutions and policy-makers, backed by social and political restraints.

Figure 2.1: Borrowing costs



Source: Author's construction from BOZ, MOF and IMF data

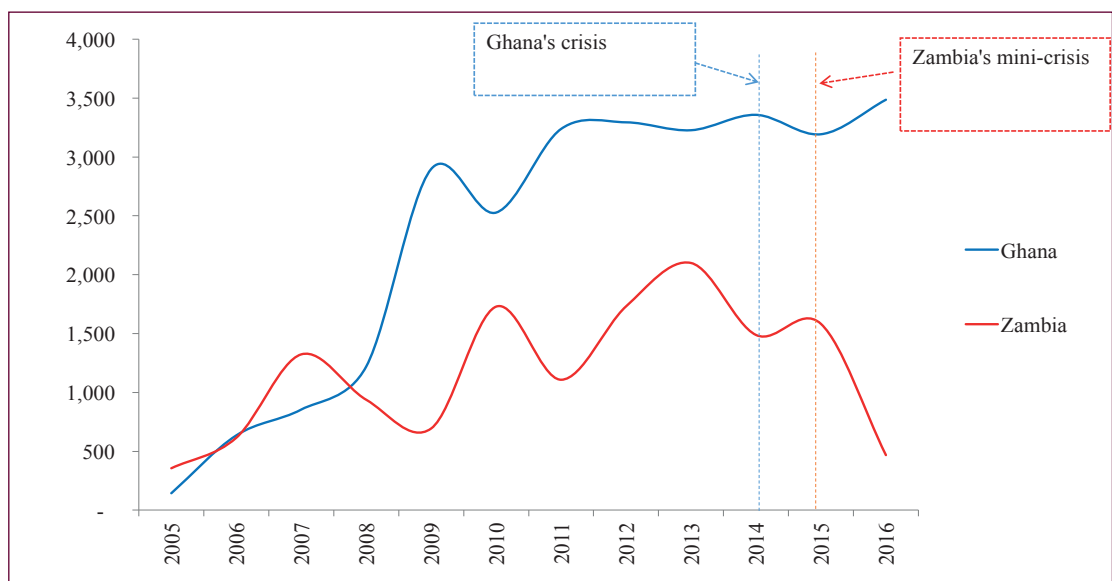
Figure 2.2: Borrowing costs



Source: Author's construction from BOZ, MOF and IMF data

- Sizable financing:** Zambia would be eligible to an IMF loan amounting to about US\$1.3 billion over a 2-3 year programme period. This would be a sizable amount. To put the amount into perspective, the Medium Term Expenditure Framework (MTEF) projects that total interest payments over 2018- 2020 will average 15.8% of total planned expenditure annually. The MTEF does not distinguish between domestic and external debt interest payments. However, assuming, for illustrative purposes only, that the same distribution of interest payments seen in 2017 (with 51% of total interest payments being on domestic debt and 49% being on external debt), then external debt payments would increase from K5.3 billion in 2018 to K5.9 billion in 2019 before falling to K5.0 billion in 2020. If Zambia were to secure the US\$1.3 billion package from the IMF, this would imply a Balance of Payments cash inflow equivalent of about K6.5 billion (US\$650 million) per year in 2019 and 2020. This would be significantly larger than the external debt service obligations in the two years, by 10% and 30%, respectively. Thus the availability of an interest-free loan from the IMF would allow the authorities to shift fiscal savings on external debt servicing equivalent to K5.9 billion in 2019 and K5.0 billion in 2020 to priority social protection and infrastructure expenditures.

Figure 2.3: FDI inflows (US\$ million)



Source: Author's construction from MOF (MTEF) and IMF data

- Technical assistance on macroeconomic management/governance:** conceived in Bretton
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Woods, United States, in July 1944, the IMF is governed by and accountable to the 189 countries that make up its membership, Zambia included. The 189 countries have given the Fund charge primarily to ensure the stability of the international monetary system and to look after all macroeconomic and financial sector issues that bear on global stability. A core responsibility of the Fund is *global surveillance*; that is to oversee the international monetary system and monitor the economic and financial policies of its 189 member countries. Because of this mandate, the IMF possesses almost unlimited access to the fiscal, financial and macroeconomic data records of all of its members. Using a pool of highly competent global experts, it is able to engage individual countries in Article IV Consultations and use the data and fact-finding missions to identify potential risks to stability. Against this, it recommends appropriate policy adjustments needed to sustain economic growth and promote financial and economic stability. This technical assistance or surveillance function is vital for the early detection of economic faltering and emerging distress, something that individual developing countries are often late to notice. With an IMF supported programme and closer working relations between the Fund and the Zambian authorities, Zambia would stand to benefit from credible early detection and counteraction strategies of economic distress.

- **Transparency and accountability mechanism:** because the IMF is mandated to pry into the financial and macroeconomic affairs of its members with a broader primary objective to impartially safeguard the function of the global financial and macroeconomic systems, it is able to candidly point out the potential policy and structural risks to stability of its members. With growing transparency in the way it pushes national authorities to see and be accountable for their policy actions the Fund is an effective external accountability mechanism. In some cases where national authorities might not be willing or able to share information openly with their citizens, the IMF surveillance function becomes an important avenue for sharing information, and fostering transparency and accountability. Of course, the IMF should not be taken as a panacea for or replacement of independent national transparency and accountability mechanisms through the Legislature, watchdog public institutions (like the Auditor General), civil society, the media and think tanks and research institutions. These require their own strengthening in order to serve an effective internal transparency and accountability function.
- **Signaling foreign investors and development partners:** it is well known that the international community generally looks to the opinions of the IMF regarding where to invest and where to provide some form of donor aid or development assistance. For example, in August 2017, the international credit rating agency S&P revised its rating of Zambia from negative to stable due to the economy's improved growth prospects and greater liquidity in the banking system. However, this was expressly premised on the Zambian authorities reaching agreement with the Fund on IMF financial support to the ESGP by the end of the year. Moreover, a short retrospective view shows that Ghana, which solicited IMF support in 2015 following severe macroeconomic hurdles in 2014, experienced a 4.9% decline in Foreign Direct Investment (FDI) inflows from US\$3.4 billion in 2014 to US\$3.2 billion in 2015 before the programme (Figure 2.3). But the situation saw a ready rebound in FDI inflow, to US\$3.5 billion (9.2% annual increase) only one year after Ghana agreed a financial support programme with the IMF. In contrast, partly because of the prolonged and inconclusive discussions between the IMF and the Zambian authorities, which started during the economic mini-crisis in later 2015, Zambia's FDI fortunes turned out differently from Ghana's. In the absence of an IMF supported programme, FDI inflows to Zambia declined by 70.4%, from US\$1.6 billion in 2015 to US\$469 million in 2016 (Figure 2.3). The presents or absence of an IMF supported economic programme seems to matter a great deal for foreign investment decisions.

For these reasons and possibly others, IMF support to the ESGP would be highly relevant and essential for Zambia even though, by end-2017, the economy had achieved some level of stabilization and growth recovery post the mini-crisis of 2015. Recognizing the necessity of IMF support, the authorities, in parallel with negotiating with the Fund, undertook some key *prior actions* – measures that a country agrees to take before the IMF's Executive Board approves financing or completes a review – towards cajoling the Fund. The ensuing section looks at some of the relatively successful policy and structural reform undertakings of the Zambian authorities during the period 2015-2017.

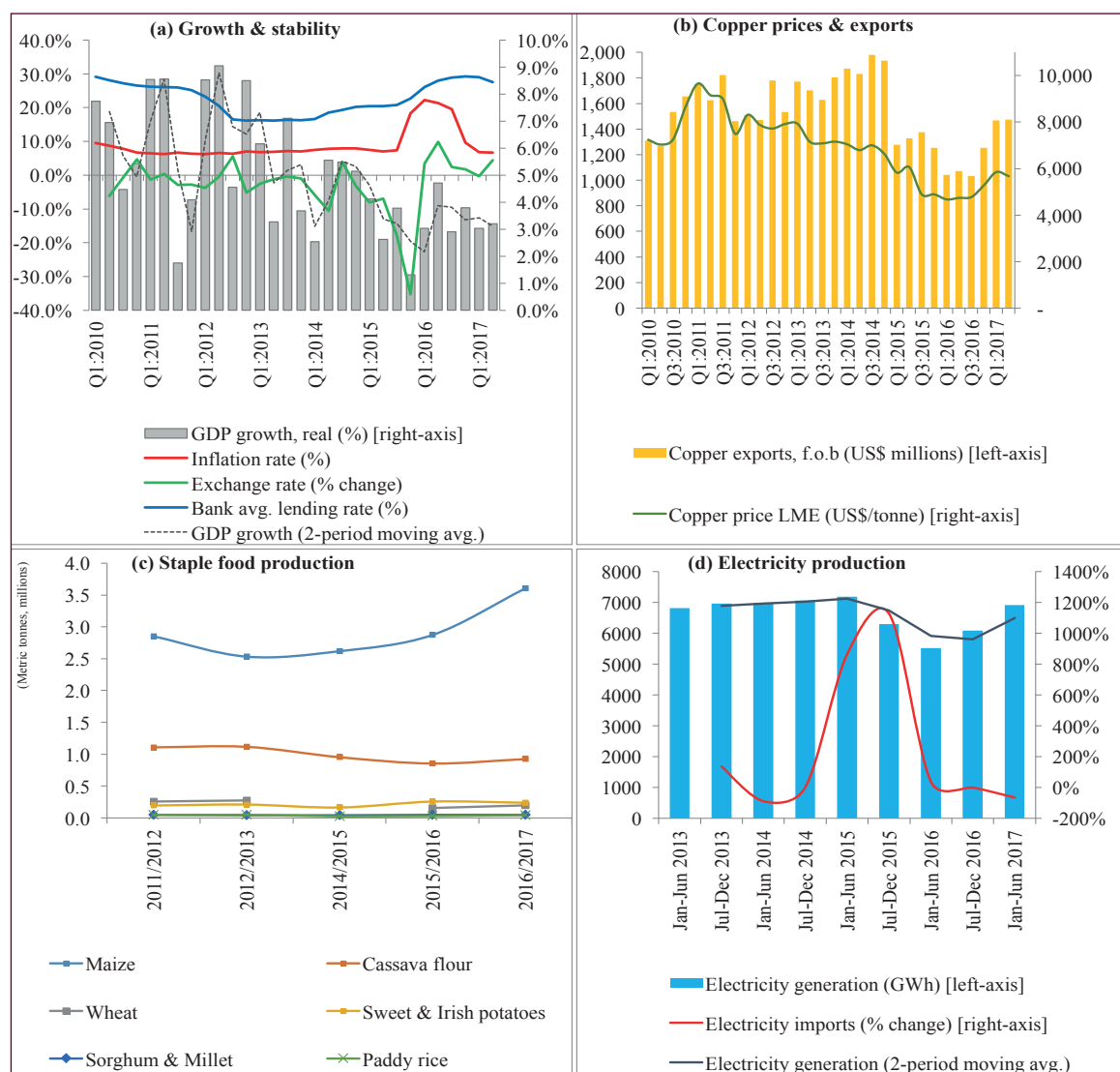


3. Zambia's Recent Policy and Structural Reform Efforts

Zambia's growth outlook in 2017 only improved marginally compared to the mini-crisis year of 2015 (Figure 3.1). Although, real GDP Growth was positive in the first half of the year, averaging 3.1%, it was relatively subdued compared to the same periods in 2015 and 2016 (3.4% and 3.9%, respectively) (Panel (a)). On the other hand, the stability outlook in 2017 improved markedly: the exchange rate and accompanying inflation volatilities that had set in in the third quarter of 2015 and carried through to the fourth quarter of 2016, dissipated in 2017. However, this resulted in considerably high nominal interest rates on commercial lending compared to the period leading up to the mini-crisis (Panel (a)).

Copper prices – which had been steadily declining since their peak level in the first quarter of 2011 – fell sharply in the first quarter of 2015, triggering a sharp decline in Zambia exports; but as prices rebounded in 2016 and 2017, so did the copper exports (Figure 3.1, Panel (b)). Staple food production in agriculture (Panel (c)) and electricity production (Panel (d)) were both on the upswing in 2017, underpinned by good rains in the 2016/2017 season.

Figure 3.1: Aggregate economic indicators, Zambia



Source: author's construction (various sources)

Some of the strong and commendable policy and structural reform efforts of the Government, which contributed to some of the above improvements in Figure 3.1 include the following:

Launch of 7NDP: In July 2017, the Government launched the 7NDP (Volume 1) as the developmental roadmap for Zambia over the next five years. A major concern that emerged towards the end of 2017 is that Volume 2 – the Implementation Plan – of the 7NDP was significantly delayed. The Implementation Plan was only launched in February 2018, implying that the first year of the 7NDP lapsed without an Implementation Plan. This bears high risks of possible implementation slippages and/or lags.

Launch of Zambia Plus: In September 2017, the Government launched the ESGP, Zambia's bold and decisive plan of action for restoring fiscal fitness and overall macroeconomic stability for sustained inclusive growth and development during 2017-2019. It specified a range of policy and structural reforms, which the Government would pursue towards fiscal fitness and broad macroeconomic stabilization. Apart from the unresolved policy and structural reform issues discussed in Section 4, key concerns can be pointed out regarding the macroeconomic (growth and fiscal) assumptions of the EGSP, which caused marked disparities between the Programme on the one hand and the Medium Term Expenditure Framework (MTEF) 2018-2020 and the 2018 National Budget on the other.

Removal of Fuel and Electricity Subsidies: The Government also took strong measures to phase out longstanding fuel and electricity subsidies, which were viewed as regressive by many including CUTS and ZIPAR (2017)¹ Cheelo and Haatonga-Masenke (2018)², PMRC (2017)³, and IMF (2017b). The anti-poor bias or regressive nature of the subsidies was part of the rationale for their removal. Firstly, the fuel subsidy was eliminated in October 2016 and then electricity subsidies were partially removed, through migrations towards cost-reflective electricity tariffs based on a 50% increase in tariffs in May 2017 and a further 25% upward revision in September 2017.

A quick look at Table 3.1 shows that the subsidies had grown substantially between 2013 and 2016, peaking at K4.9 billion or 9.4% of budget expenditure in 2016 against a target of 2.3% of the year's budget. In comparison – not in Table 3.1 – the outturn on Farmer Input Support Programme (FISP) was K1.9 billion or 3.7% of actual expenditure against a budget of K1 billion; whereas the combined outturn on Food Security Pack, Pension Fund, Social Cash Transfer, and Empowerment Funds (social protection proper programmes) was a mere K622 or 1.2%, a 57% underfunding compared to the combined budget target of K1.4 billion. In striking contrast, total outturn on the regressive fuel and electricity subsidies was an overrun of 320.5%. These subsidies clearly posed considerable strain on Zambia's fiscal resources.



Table 3.1: Government expenditure on fuel and electricity subsidies

		Fuel subsidy (incl. payment arrears)	ZESCO electricity subsidy	Subsidies, total	Subsidies (% of Total Govt. Expenditure)	Total Govt. Expenditure
2013	Target (K millions)	0	0	0	0.0%	31,685
	Prelim. Outturn (K millions)	1,610	0	1,610	4.8%	33,790
	Variance (%)	∞	∞	∞	n.a.	6.6%
2014	Target (K millions)	0	0	0	0.0%	41,049
	Prelim. Outturn (K millions)	307	0	307	0.8%	38,542
	Variance (%)	∞	∞	∞	n.a.	-6.1%
2015	Target (K millions)	0	0	0	0.0%	44,815
	Prelim. Outturn (K millions)	2,713	364	3,078	6.0%	51,685
	Variance (%)	∞	∞	∞	n.a.	15.3%
2016	Target (K millions)	1,156	0	1,156	2.3%	50,412
	Prelim. Outturn (K millions)	3,845	1,014	4,859	9.4%	51,827
	Variance (%)	232.8%	∞	320.5%	n.a.	2.8%
2017 (Jan- Jun)	Target (K millions)	350	370	720	2.4%	29,941
	Prelim. Outturn (K millions)	350	459	809	3.1%	26,388
	Variance (%)	0.0%	24.1%	12.4%	n.a.	-11.9%

Note:

∞ = Infinity, essentially meaning there was no budget target (or planned expenditure) against the outturn in question.

n.a. means the calculation is not applicable.

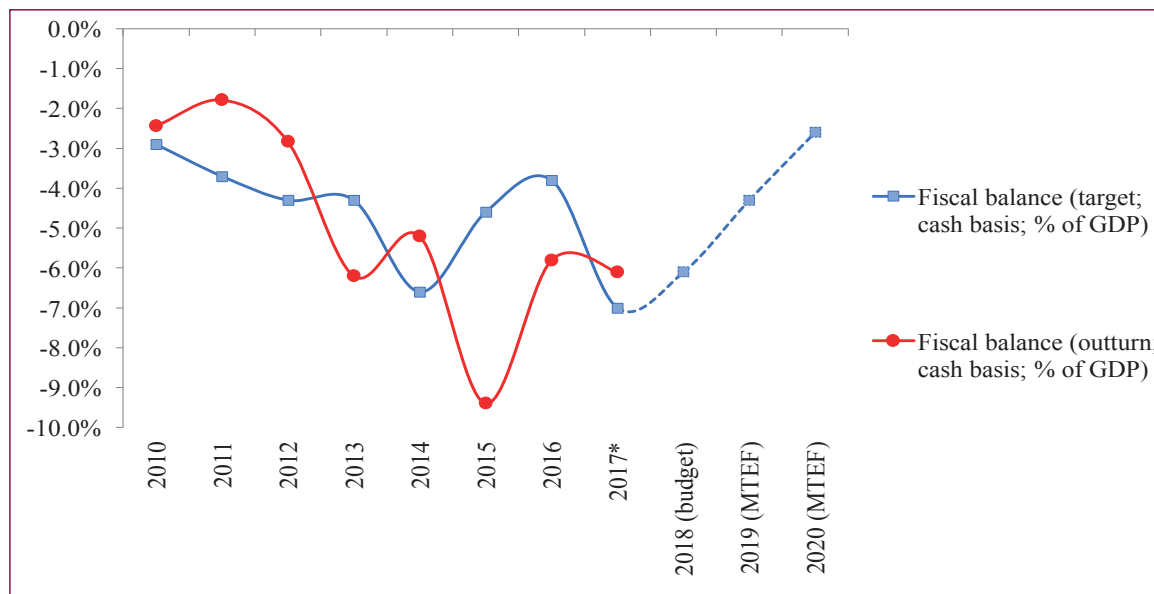
Variance was calculated as (Outturn – Target)/ Target*100; a positive implies that the Outturn > Target or expenditure above budget (or unplanned spending, overspending, budget overrun, excess expenditure, etc.).

Source: constructed from Annual Economic Reports (various) and 2017 Mid-Year Economic Review

The removal of the fuel subsidy in 2016 showed immediate results in the 2017 budget outturn, with the mid-year target to dismantle fuel payment arrears of K350 being perfectly met. On the other hand, despite the 50% upward revision in the first half of the year, electricity subsidies remained during the period, with a mid-year expenditure outturn (K459 million), which was 24.1% over the targeted expenditure. However, the 2018 Budget (both Yellow Book and Budget Address) does not have any allocations to fuel arrears or ZESCO subsidies or emergency (subsidized) power importation, presumably because the Governments expected to have had fully dismantled fuel and electricity subsidies by the end of 2017.

Fiscal Consolidation: The Zambia authorities also made significant progress with fiscal consolidation. The 2018 Budget Address⁴ reported that: “In line with the fiscal consolidation stance, expenditures are projected to be below target... Consequently, the deficit on a cash basis is expected to close the year at 6.8 percent of GDP” [p.7] and actually achieved a 6.1% of GDP preliminary outcome compared to the 7.0% that had been targeted. This was the first time in about two years that the authorities achieved a (cash-basis) budget deficit outcome that was better than what was targeted (Figure 3.2). The 2017 projected outturn figures are good news – they show a move toward fiscal discipline being restored and a move away from previous year’s buildup of significant arrears (unsettled public payments).

Figure 3.2: Fiscal balance (cash-basis) targets and outturns



Source: author's construction from Budget Speeches

In November 2016, the IMF (2016)⁵ estimated that the stock of arrears would increase by K10 billion by the end of that year, to about 9% of GDP. However, the 2018 Budget Address reports that the 2016 outturn on arrears was much worse than estimated by the IMF, although it was expected to improve markedly in 2017: “the stock of domestic arrears as at end June 2017 was K13.2 billion, from K19.1 billion in December 2016. The significant reduction in arrears is attributed to Government’s concerted effort to clear [the] arrears” [p.7]. The Government clearly set in motion a strategy for clearing the arrears (Table 3.2). However, as of the time of preparing this paper, it remained to be seen in 2018 and 2019 how well the authorities would keep to the plan. Nonetheless, giving them the benefit of the doubt, the measures committing the Government to dismantle the arrears were welcome.



Table 3.2: Budgetary allocations to dismantling arrears in 2017 and 2018, selected items*

	2017 (K)	2018 (K)	Total (2017-2018) (K)	Total (2017-2018) (% of Total: All Selected Items)
Zambia Police - Ministry of Home Affairs - HQ	-	50,000,000	50,000,000	0.9%
Ministry of Home Affairs - HQ	20,976,000	58,096,850	79,072,850	1.4%
Fuel arrears - Loans & Investments - MOF	500,000,000	-	500,000,000	8.9%
Dismantling of arrears - Loans and Investments - MOF	2,107,714,046	-	2,107,714,046	37.7%
MOF - HR & Admin. - Public Service Pension Fund Financing Gap	1,400,000,000	792,800,000	2,192,800,000	39.2%
MOF - Office of the Accountant General	38,659,768	50,700,000	89,359,768	1.6%
Ministry of Transport and Communication - HQ	1,050,000	50,910,000	51,960,000	0.9%
Ministry of Housing and Infrastructure - Capital Project Arrears + Goods & Services Arrears	2,217,736	80,445,240	82,662,976	1.5%
Ministry of Agriculture - FISP & FRA Arrears	-	441,000,000	441,000,000	7.9%
Total: All Selected Items	4,070,617,550	1,523,952,090	5,594,569,640	100.0%

*The selected items were chosen as those with an allocation equal to or greater than K50 million in either 2017 or 2018 or both.

Source: constructed from Yellow Book (2018)

During 2017-2018, planned items for Dismantling of Arrears under Loans and Investments in MOF and Public Service Pension Fund Financing Gap added by far the greatest amount of pressure to the overall accumulation of arrears. In 2016, Fuel arrears were also a notable challenge, which, as earlier indicated, was generally being resolved as of 2017. A new challenge emerging from 2017, however, was the accumulation of FISP and Food Reserve Agency (FRA) arrears, which required to be dismantled in 2018. Going forward, the Public Service Pension Fund Financing Gap and FISP & FRA arrears were two items to look out for as they would require the most attention in terms of systems strengthening and structural reforms.

Medium Term Debt Strategy: In September 2017, the authorities launched the Medium Term Debt Strategy 2017-2019, which would aim to reduce the risk of public debt distress, and also planned to revise the Loans and Guarantees (Authorization) Act in 2018. These measures together with the systems strengthening measures (IFMIS and Treasure Single Account) mentioned above could be expected to yield notable dividends in containing the accumulation of arrears or commitments and stemming the contraction of new debt.

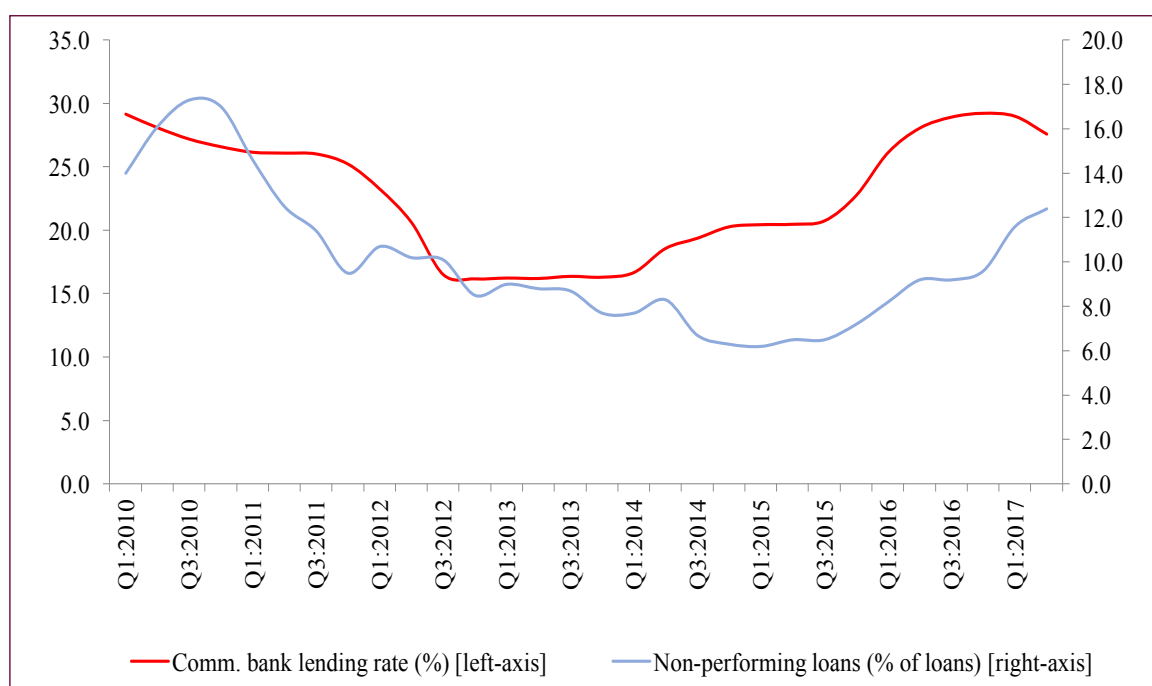
Monetary Policies and Reforms: The monetary authorities did well in undertaking carefully considered monetary policy adjustments over 2015-2017. After a considerably tight stance during part of 2015 and most of 2016, in 2017 BOZ commendably gradually unwound the quantitative and administrative measures it had applied to tighten the monetary conditions. The last measures to loosen the monetary conditions in 2017 were in November, and they included a lowering of the BOZ policy rate from 11% to 10.25% and the reduction of the statutory reserve ratio from 9.5% to 8.0%. The monetary authorities also launched the National Financial Sector Development Policy 2017 and National Financial Inclusion Strategy 2017-2022 in the same month. The IMF (2017b) also commended the central bank for taking steps towards implementing “the Financial Sector Assessment Programme (FSAP) recommendations, including taking steps to strengthen

supervision capacity and the crisis preparedness framework” [p.2].

Despite the favourable monetary policy stance, the commercial banks were relatively slow to respond in terms of lowering commercial lending interest rates. The banks generally justified this on the basis that the period of macroeconomic instability and resultant tight monetary conditions during the second half of 2015 and most of 2016, had, by 2017, caused them to hold increasingly larger proportions of non-performing loans. Non-performing loans increased from 6.5% of the total loan portfolio of banks in quarter two of 2015 to 12.4% in quarter two of 2017 (Figure 3.3). Of course, this was not the full story behind the high interest rates considering that average lending rates had already started rising in the first quarter of 2014, well before the instabilities of 2015 and during a period when the share of non-performing loans was on the decline. Nonetheless, this and other factors – such as high non-interest operating costs and signals of heightened domestic borrowing by the fiscal authorities in 2018 – limited the prospects for commercial banks to reduce interest rates.

Within its policy purview, this paper asserts that BOZ would do well to consider formulating and instituting financial regulations that have greater influence on the portfolio structures of commercial banks loans and advances. For instance, regulatory restrictions could be imposed in terms of thresholds on the share of commercial bank loans that can be lent to the Government through the purchase of securities. This would assist with enhancing the level of competitive lending to the private sector among banks.

Figure 3.3: Non-performing loans (% of total loans) and average lend rates



Source: author's construction from BOZ data in MPAF

On the other hand, as pointed out in the IMF's 2017 Article IV Consultation and expressed by other local and international observers, by the end of 2017, Zambia continued to face some serious outstanding or unresolved policy and structural reform issues, which hampered progress towards an agreed IMF supported economic programme. These are worth an analytical comment. The ensuing section therefore focuses on some of these issues.

Sections 2 and 3 set out the improving macroeconomic and fiscal climate in Zambia and can paint a positive picture. However despite the improving economy and the strides in economic governance highlighted in Section 3, observers including the IMF, have pointed out some serious outstanding policy and structural reform issues, which still confronted Zambia by the end of 2017. Some of these are summarized in Box 4.1 in headline format. Out of these headliners, the subsections in Section 4 select and elaborated on what we considered as the core or major issues – but in short Zambia still faces a significant challenges stemming from the reliance on debt to fund current spending, its ability to repay debt and slow progress with financial management reforms.

4.1 Philosophical Stance and Fiscal Prudence

Fiscal prudence stems from the economic philosophy of the political administration in Government. Zambia took on a highly expansionary fiscal path in 2012 when the Patriotic Front (PF) political party assumed office of the Government. The PF Manifesto 2011-2016 asserts that: “Under the MMD government, investment in infrastructure development has been limited and the pace of development slow. Part of this is due to an obsession with maintaining ‘tight money’ through fiscal and monetary policies. This has resulted in many parts of Zambia resembling ghost towns despite more than five years of record mineral prices and a production boom” [p.28]. The PF Manifesto thus inevitably locked the then new Government into a very ambitious infrastructure development programme (See, Annex 1), thus ushering in fiscal expansion. The real growth rate of the national budget rose from 2.1% per annum during 2002-2011 to 10.2% per year during 2012-2018 despite the severe hikes in inflation in 2015 and 2016 (see also Figure 4.1). On the other hand, real GDP growth averaged 7.5% per year over 2002-2012 compared to 4.5% per year over 2012-2018. Clearly, once the fiscal expansion “ubwato” (or boat) left the dock in 2012, it became difficult to bring it back and the policy stance persisted.

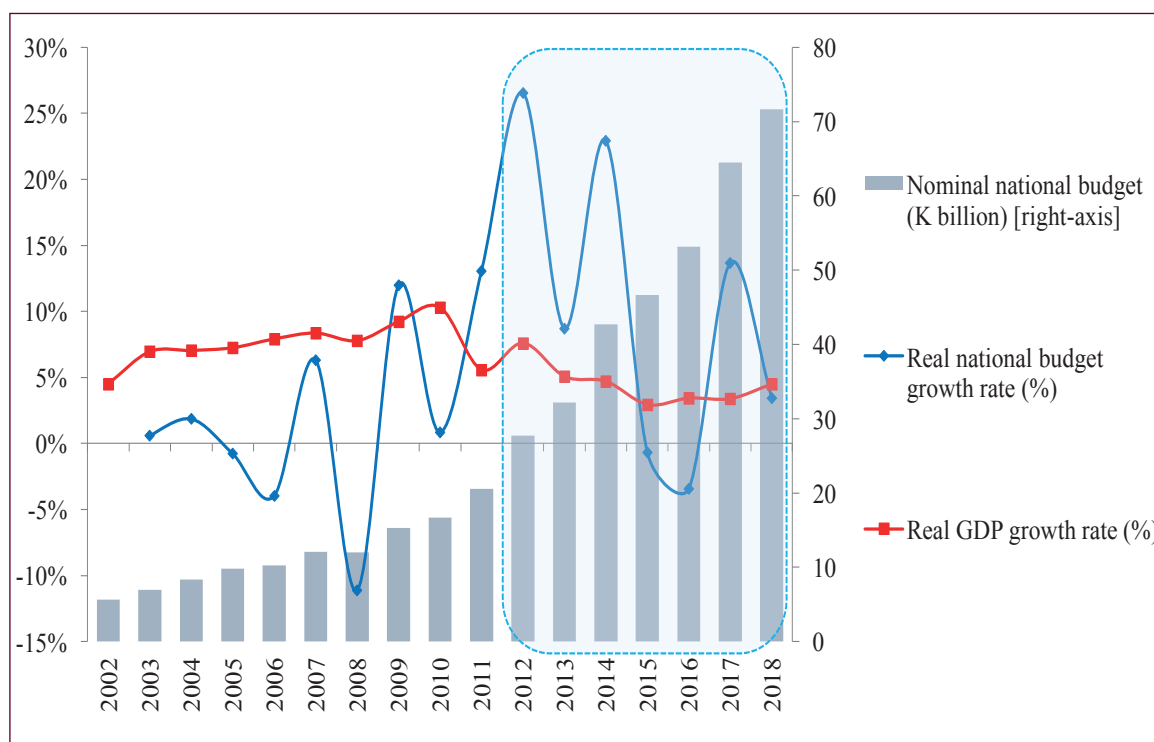
Granted, after the 2015 mini-crisis, the then Minister of Finance initiated efforts to restore fiscal fitness, including through encouraging high-level Cabinet buy-in into the fiscal consolidation agenda. This offered a glimmer of hope that the

Box 4.1 Summary of Outstanding Issues:

- a) **Philosophical Stance on Fiscal Prudence:** Weak fiscal prudence or the inability to take on a conservative (or prudent) fiscal policy stance that brings public expenditure under control stems from the economic ideology of the day;
- b) **Weak fiscal governance:** this refers to fiscal indiscipline and thus, frequent fiscal slippages showing up in terms of large spending variances, high unplanned spending, and wasteful spending and misappropriation;
- c) **Risk of debt distress:** this comes from a mounting debt overhang as a result of persistent non-conservative (or expansionary) fiscal policy;
- d) **Domestic revenue mobilization constraints:** this reflects significant limitations hindering or reducing the contribution of various components of the economy to fiscal revenue;
- e) **Policy inconsistencies:** this reflects the frequent or prolonged occurrence of both *policy reversals* (start-stop policy decisions) and *mismatches* between major policy sets (e.g. conservative monetary policy coupled with expansionary fiscal policy);
- f) **Half-hearted structural reforms:** committing to reforms that are then ignored or poorly executed during implementation; e.g., FISP e-voucher reforms, infrastructure (road) project reforms, land reforms, SOE reforms were agreed in planning documents like the Budget Address, ESGP and MTEF, but not well followed through during not implementation.
- g) **Half-hearted commitment to scaling up social protection:** (see, ZIPAR and UNICEF (2017) “Analytical Brief on Social Sector Budget 2018: a Mirage in the Social Sector budget”, *Policy Brief*, October);
- h) **Weak long-term structural transformation strategies:** Zambia’s current medium and long-term plans & strategies (ESGP & 7NDP), while commendable, do not offer much promise for fundamental structural transformation or economic restructuring.

Government's huge spending appetite might eventually be subdued. For instance, in November 2017, the Finance Minister's Ministerial Statement to the National Assembly announced that the main outstanding issue under discussion with the IMF – apart from the highly emphasized need to take measures to slow down on the pace of debt accumulation towards reducing Zambia's risk exposure to debt distress from high to low – was the serious need to scale up fiscal consolidation measures, particularly expenditure restraint. According to the Ministerial Statement the much needed expenditure restraint had been committed to and was being substantially dealt with at the level of Cabinet. Among other things: "... Cabinet, on November 6, 2017, discussed these [debt distress and expenditure restraint] issues and gave a clear policy direction. This included: (a) re-prioritizing projects by concentrating on on-going projects; (b) re-scoping projects to be implemented in stages to ensure fiscal sustainability. An example is the implementation of the Lusaka/Ndola Dual Carriageway which will be implemented in stages; in addition, cabinet resolved the following: (c) no commercial contracts that require debt financing should be signed without Treasury Authority; and (d) tender and legal approvals should not be given where the funds are not available" [pp.2-3].

Figure 4.1: National budget growth (%) and size (K million) and GDP growth (%)



Source: constructed from Budget Addresses (2002-2018) and IMF WEO database

While the Cabinet's decisions showed some level of political will to foster spending restraint, a few outstanding concerns regarding the prudence of fiscal management remained. An example is the commissioning of the Lusaka/Ndola Dual Carriageway project late in 2017, which was expected to ultimately cost US\$1.2 billion, or US\$3.75 million per km for the 320km stretch between the two cities. By any global standard or benchmark, this road project was considerably overpriced. Moreover, the project was commissioned minus a project appraisal, implying that its economic costs and returns were not well established *a priori*. The marked unresolved issues on such an expenditure-heavy project potentially weakened the credibility and believability of the Government's claim that it had renewed its commitments to fiscal restraint considering the rather lackluster attention to the project.

In the case of the Lusaka/Ndola Dual Carriageway, the authorities would do well to give a comprehensive Ministerial Statement to the National Assembly, fully explaining: (a) the status of the project appraisal; (b) the justification for the hefty price (US\$3.75 million per km for the 320km); (c) the exact amount out of the US\$1.2 billion that is concretely guaranteed or a debt commitment

by the Government; (d) the specific sources and terms of the project financing, including whether or not the physical assets (road and other infrastructure installation like fuel stations and hotels) were used as collateral for any portions of the term financing; and (e) more generally, the pre-contraction measures to be applied to all large or expenditure-heavy on-going projects and programmes before loans are taken out, towards rationalizing and fully justifying the loans.

Another issue for enhancing fiscal prudence, which remained outstanding by the end of 2017, was the revision of key pieces of legislation (namely: the Public Finance (Amendment) Act No. 15 of 2004; the Public Procurement (Amendment) No. 15 of 2011; and the Loans and Guarantees (Authorization) Act 1994), and the formulation of new Planning and Budgeting legislation. By the end of the year, none of these had been table before the Parliament for consideration. The authorities would do well to ensuring that the preparation and submission to Parliament of all four piece of legislation is expedited. These would form the main part of the legal framework for renewed legislative commitment to fiscal prudence, particularly if they incorporate substantive provisions for the establishment of explicit quantitative fiscal rules – i.e., long-lasting, legally binding, quantitative constraints or restrictions on budgetary aggregates such as revenues, expenditures, public debt, budget balance and so on, which are kept in force for periods of over five-year at a time – as an integral part of the legal framework. The fiscal rules would restrain both the Executive and the Legislature from amassing excessive powers and discretion to spend (Lienert and Fainboim, 2010; Schaechter et al, 2012; Baunsgaard et al, 2012).

However, these options and suggestions are likely to be followed through and sustained only if the authorities at the highest levels of the Government have a fundamental philosophical change of heart, opting to steer away from the current path of excessive spending in the face of dwindling resources.

4.2 Weak Fiscal Governance

Weak fiscal governance is generally thought to be significantly influenced by the fiscal policy stance prevailing in a country at a given time. In a persistently expansionary fiscal environment both inadvertent and deliberate fiscal indiscipline often emerges, usually manifesting itself in terms of frequent fiscal slippages. Both of these were evident in Zambia during 2016 and 2017.

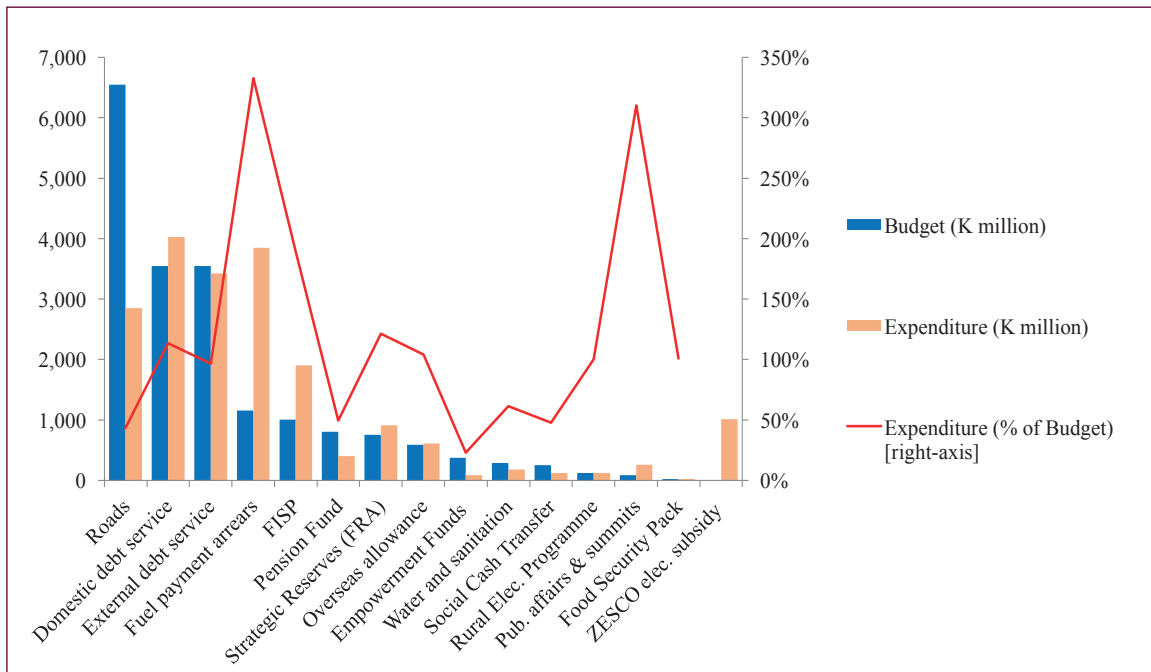
Generally, examples of “inadvertent” or accidental slippages might include large spending variances on certain budget items as the authorities attempt to offset expenditure shortfalls in certain areas by introducing spending deficits in budget lines that are perceived as relatively low priority.

In Zambia, signs of fiscal weakness were evident in both 2016 and 2017, albeit to different degrees. In 2016, the most dominant programme from a selection of 15 budget items was Roads which was allocated K6.6 billion but only saw an expenditure release of K2.9 billion or about 44% of the budget amount (Figure 4.2). In 2017, the Roads programme dropped to fourth place among the selected items (Figure 4.3), with a K2.4 billion budgetary allocation; however, the expenditure releases was K3.7 billion or 137% of the budget. In both years, the Government failed considerably to meet the outturns targeted in the budget.

Domestic and external debt interest payments (or debt service) were also significant in 2016 and 2017 in terms of magnitudes. In terms of expenditure release performance, they were generally above the amounts planned in the budget; except for external debt service in 2016, which was marginally (4%) below the respective budgeted amount.

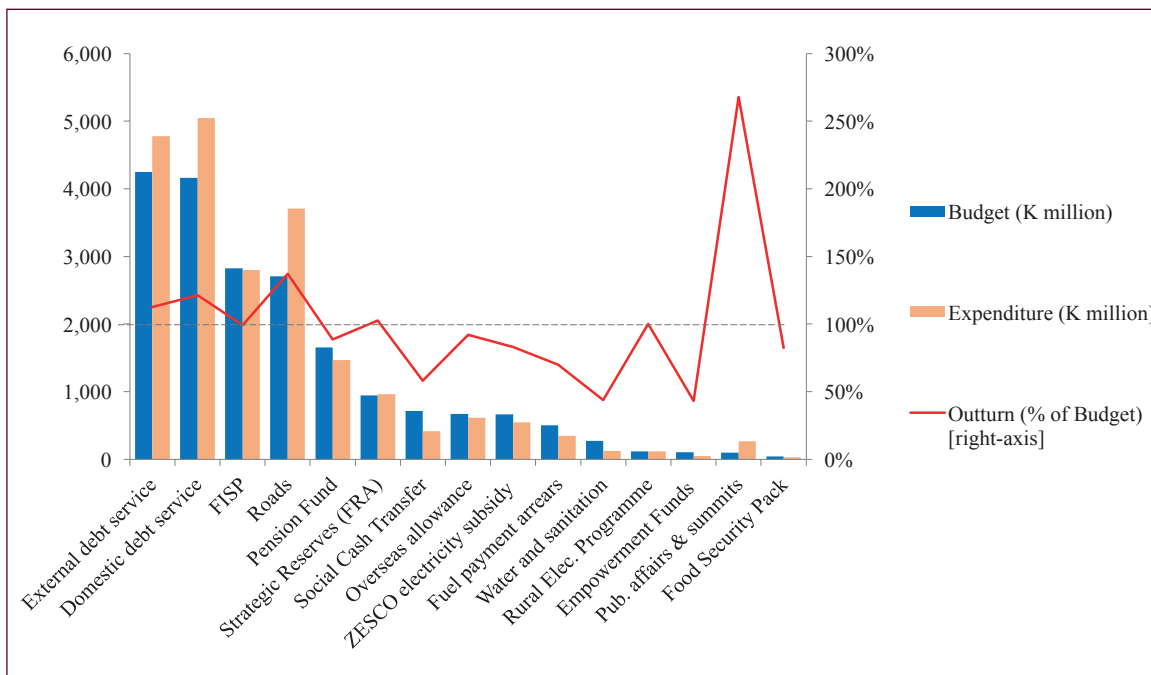
The Farmer Input Support Programme (FISP) was the fifth largest item in 2016, and saw an expenditure release of K1.9 billion, which was 190% of the budgeted amount (Figure 4.2). In 2017, this programme’ rose to third place in terms of budget size among the selected items and although its allocation was almost at parity with the expenditure release, the year’s expenditure, at K2.8 billion, was K900 million more than in 2016 (Figures 4.2 and 4.3).

Figure 4.2: Fiscal performance on selected items, 2016



Source: Constructed from 2016 Annual Economic Report

Figure 4.3: Fiscal performance on selected items, 2017



Source: Constructed from 2017 Fiscal Tables

The relatively smaller selected items generally experienced varying levels of underfunding relative to the budget; the only exceptions to this were five or six cases where the releases were marginally higher than budgets or at parity with the budget; and the case of Public Affairs and Summit meetings, which received releases of 310% and 268% of their respective 2016 and 2017 budget allocations. Ultimately, even though the overall cash-basis fiscal deficit outturn in 2017 was very close to the planned deficit (6.8% of GDP outturn against 7.0% of GDP target) particularly compared to 2016 (5.8% of GDP outturn against a 3.8% target) (recall, Figure 3.2), the devil in the

details of the budget execution reveals worrying expenditure deviations from the budget in both years (the controversial 2017 Fire Tender story in Box 4.2, is another case in point of worrying budget variation). This failure to broadly keep to programmatic budgets is symptomatic of weak fiscal discipline.

Box 4.2: Fire Tender Story of 2017 Illustrates Disparity between Planned Budget Spending and Spending Outturns

The now infamous controversial decision by the Government to purchase 42 Fire Tender at a unit cost of US\$1.0 million each is a case in point of weak fiscal discipline. Fire Tenders (or fire trucks) are planned and budgeted for as part of Programme 5054 Fire Safety and Services in the annual Estimates of Revenue and Expenditure (National Budget). The Fire Safety and Services programme are found under Head 29/06: Ministry of Local Government or under Head 20/06: Loans and Investments. Any planned and budgeted purchase of Fire Tenders shows up in these places in the Budget. A look at the budgets for 2012 to 2017 shows that Zambia's largest budgetary allocation to Fire Safety and Services was in 2014, at K21.1 million (equivalent to US\$3.4 million at the exchange rate of K6.18 per US\$ at the time). In 2016 and 2017, K7.1 million (US\$750,000) and K12.6 million (US\$1.3 million) was allocated to Fire Safety and Services (Table 4.1):

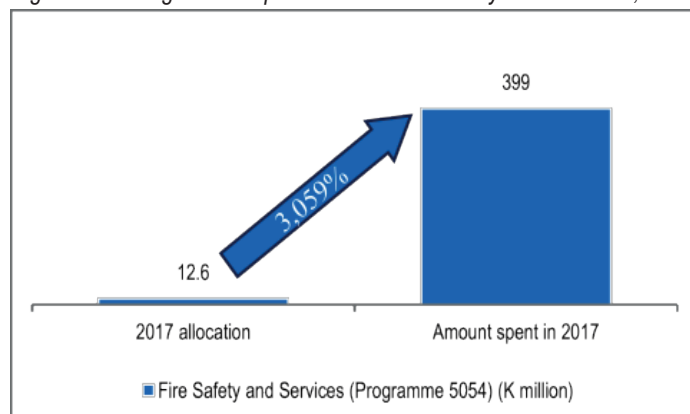
Table 4.1: Budget to Fire Safety and Services

	2012	2013	2014	2015	2016	2017
Fire Safety and Services (Programme 5054) (K million)	6.2	11.0	21.1	13.1	7.1	12.6
Fire Safety and Services (Programme 5054) (\$ million)	1.2	2.0	3.4	1.5	0.75	1.3
Exchange rate (annual average, nominal) [BOZ]	5.14	5.38	6.18	8.64	9.50	9.5

Source: constructed from Yellow Books (various)

Naturally, when it came to light that the Government had purchase 42 Fire Tenders at US\$1.0 million apiece, raking up a total bill of US\$42 million (K399 million) (Figure 4.4), the ensuing public outcry was very loud. This outlay was off-budget or an unplanned expenditure; it represented a 3,059% variance from the amount budgeted for Fire Safety and Services. Moreover, in June 2017, the Executive issued Statutory Instrument No.44 of 2017, which designated the town councils of 48 districts across the country as fire authorities for the districts. Considering that SIs are not vetted or overseen by the National Assembly, they tend to give the Executive greater discretion to change laws without checks and balances. SI no.44 of 2017 therefore raises concerns that the Executive used it to establish new fire authorities simply as a way to absorb unnecessary Fire Tenders that it had made up its mind to purchase. To date, no record exists that any fire incidence and risk audits or other project appraisals were ever done to inform SI no.44 on the establishment of new fire authorities or the purchase of the fire trucks. The National Assembly has also never exercised its oversight function to demand a comprehensive and conclusive report on the issue of the Fire Tenders. The Fire Tender slippage thus remains as yet another example of a symptom emanating from a deep-seeded core problem to do with a weak and nonchalant fiscal governance environment.

Figure 4.4: Budget and expenditure on Fire Safety and Services, 2017



Source: constructed from Yellow Book 2017

4.3 High Risk of Debt Distress

By the end of 2017, the outstanding issues regarding Zambia's high exposure to the risk of debt distress were well documented in the grey literature (ZIPAR, 2017⁹; IMF, 2017b; Nalishambo and Banda-Muleya, 2017¹⁰; World Bank, 2017¹¹). ZIPAR (2017) had described the mounting debt burden as the "elephant in the room". The public debt overhang rose very quickly as a result of persistent expansionary fiscal policy (discussed in Section 4.1). The stock of public debt rose from 18.9% of GDP in 2010 to a peak of 61.4% in 2016 before it declined marginally to a projected level 55.6% in 2017. This rapid accumulation became one of the most alarming elements of Zambia's fiscal profile.

In February 2018, the IMF officially expressed further concern at the pace at which Zambia's public debt had increased, putting the country at high risk of debt distress. The Fund continued to urge the Zambian authorities to tone down its ambitious borrowing plans and instead "implement credible measures that ensure debt contraction is consistent with a key program objective of stabilizing debt dynamics and putting them on a declining trend in the medium term".

One key aspect of Zambia's growing public debt has to do with how its proceeds are used. Debt is not per se a bad thing – countries borrow to support strategic investments and drive growth. However, notable concern have arisen that Zambia is not focusing its debt finances strategically; the debt is repeatedly used to finance recurrent expenditures or so-called Government consumption. This non-productive spending is exacerbating Zambia's debt problem and links to the issues revealed in section 4.2. Weak fiscal processes and poor financial and debt management are fueling decisions to borrow more in order to sustain the high recurrent expenditures. Unchecked – by an IMF supported economic programme for instance – the unrelenting borrowing spree is likely to lead Zambia to even higher risks of debt distress than what the IMF pointed to in August 2017 and again in February 2018.

One significant debt component, which is given surprisingly little direct attention, is Chinese debt. The economic downturn of 2015 and the spending pressure during 2016 appear to have been catalytic in encouraging the Zambian authorities to borrow heavily from easier-going, few-questions-asked and more accessible non-traditional development partner funds, particularly from China. The number and monetary value of Chinese loans contracted by the Government jumped markedly from 2015 to 2016:

- Whereas the total number of Government contracted loans increased by 117% from 12 loans in 2015 to 26 loans in 2016, Chinese loans rose by 350% from two in 2015 to nine in 2016;
- As the total value of new Government loans rose by 39% (from US\$2.2 billion in 2015 to US\$3.1 billion in 2016) in nominal terms, new loans from China increased by a staggering 259 percent (from US\$484 million in 2015 to US\$1.6 billion in 2016).
- By end-2016, Chinese loans stood at 35 percent of total contracted loans in that year compared to 17 percent in 2015.

Overall, China's debt stock stood at over US\$1.6 billion in 2016, having grown by 12% in nominal terms from the 2015 amount. The Chinese debt was nearly a quarter (23%) of Zambia's total external debt stock in 2016. Some observers argue that the true size of China's debt to Zambia is not known and might be higher and growing more rapidly than the records officially show.



Table 4.2: Public External Debt Stock, 2014-2016 (US \$ Million)

	2014	2015	2016	% Change (2015-2016)
(a) Multilateral	1,511.37	1,503.97	1,560.48	4%
World Bank (IDA)	666.12	695.79	747.51	7%
ADB/ADF	328.59	351.86	376.5	7%
IMF	331.44	256.82	182.09	-29%
Others	185.22	199.5	254.38	28%
(b) Bilateral	407.09	450	458.69	2%
Paris Club	137.24	195.32	219.92	13%
Non-Paris Club	269.85	254.68	238.77	-6%
(c) Export & Suppliers' Credit	1,073.69	1,598.85	1,621.58	1%
Export Import Bank of China	976.71	1,313.35	1398.59	6%
Catic	33.28	210.66	150.46	-29%
Others	63.7	74.84	70.17	-6%
(d) Commercial Debt	1,814.68	3,151.55	3,305.96	5%
China Development Bank	64.68	136.31	225.96	66%
Eurobond	1,750.00	3,000.00	3,000.00	0%
Others	15.25	80	424.6	431%
(e) Total Government External Debt	4,806.83	6,704.37	6,946.71	4%
(f) Total Chinese debt	1,041.39	1,449.66	1,624.55	12%
Total Chinese debt (% of total debt)	22%	22%	23%	

Source: constructed from Annual Economic Report 2016

Four things are not clear about Chinese debt:

- What is the formal or structured debt contraction process for Chinese loans and why is this process not officially published in Zambia and placed in the public domain for scrutiny for its reliability and consistency with Zambia's laws?
- How are the projects financed by Chinese loans selected and appraised for value-for-money (fair pricing), feasibility, economic viability or rates of return, environmental impact and so on? Why are the project appraisals attached to Chinese debt shrouded in secrecy?
- What transactional benefits does Chinese financing offer to the Zambian economy considering that the bulk of it goes through Chinese financial intermediaries to largely Chinese contractors and other goods and services suppliers?
- What is the "fine-print" in the Chinese loan agreements, which should be disclosed to the Zambian public, e.g., which of the physical assets (roads, airports, electric power plants, etc.) being financed by Chinese loans are currently or designated to be collateralized and under what terms?

These issues as well as the rapid growth of Chinese debt within Zambia's overall debt stock are among the main factors that have most observers considerably worried. Indeed, it is therefore no surprise that the IMF's earlier-mentioned (February 2018) statement argued that Zambia's latest borrowing plans were too ambitious and continued to compromise the country's debt sustainability, posing risks that could undermine Zambia's macroeconomic stability and ultimately, the living standards of the people. In part, the borrowing plans were ambitious because the authorities had their sights on Chinese term financing.

Conclusions and Recommendations for Prudent Economic Governance

This paper assessed whether IMF support to the ESGP is still relevant 2-3 years after the economic mini-crisis of 2015. It reviewed some of the recent policy and structural reform efforts done by the Zambian authorities to improve economic governance. It then highlighted some key outstanding policy reform issues that should be addressed in order to break the deadlock between the authorities and the IMF, and secure the bailout package.

The main messages of this paper are threefold:

Firstly, despite the IMF talks stalling, the problems that drove them, particularly the growing debt and weak fiscal management, remain. Economic improvements have masked the magnitude and deep-rooted nature of these problems, but fundamentally Zambia's fiscal position remains a challenge and the risks behind the persistent debt accumulation are arguably getting worse. This paper argues that the optimal solution for Zambia to tackle these challenges remains an IMF-supported economic programme. IMF support would imply sizable (US\$1.3 billion) interest-free financial support as well as close technical assistance and early warning surveillance services (such as the 2017 alarm bell that Zambia had fallen into high risk of debt distress). An IMF deal would also improve international confidence in Zambia and unlock external investment and donor resources. These issues are salient for a small open economy like Zambia and the main consequences of Zambia's on-going inability to secure the support will include: a continuation of fiscal slippages, mounting debts, possible emerging external imbalances, raising taxes and non-tax efforts to collect revenues, and ultimately an escalation of social and economic hardships for the Zambian people. These hardships will fall disproportionately more on the poor and vulnerable members of society.

Secondly, even though the Zambian authorities have already taken commendable prior actions for improving fiscal and economic governance, including through Zambia Plus, the actions are simply not sufficient to build confidence. In particular the persistent highly expansionary fiscal path that the country is on, the high frequency of marked fiscal slippages, and the rapid escalation of public debt are major concerns. The strong high-level stewardship, social and political restraint, and strong institutional backing and rational policy-making that ZIPAR called for in March 2017 is still wanting 12 months on. Excessive spending and borrowing remain relentlessly high.

Finally, the power to change its fate and improve prospects for greater support to its economic programme rests with Zambia. We conclude by offering some simple but fundamental policy reform options for improving Zambia's prospects to return to prudent economic governance, rational resource allocation or prioritization, and effective spending on social protection, and economic and social infrastructure:

- i. The Executive should recognize that, despite the recent marginal economic upturn, the Zambian economy remains fragile and at the whim of external factors. The good rains and rising global copper prices are hiding the potential perils of high indebtedness. The Executive should reaffirm its resolve to proactively enforce fiscal discipline and severely restrict further debt growth. Ultimately, **Zambia needs to move back toward a state of "medium risk of debt distress"**. Taking the prior actions for fiscal consolidation now, will enable Zambia to better manage the impacts of any downturns or slowdown going forward.
- ii. To support fiscal consolidation **the Executive should consider fostering fundamental political and social changes to the current economic philosophy**, nudging Zambia to move away from a path of fiscal expansion. The Executive should – in word and in deed – deliberately coach the country to tone down on the large spending appetites through consistent and sustained policy actions, including by scaling down and slowing down on the ambitious short-term

and medium-term programmes and projects particularly in infrastructure development, prioritizing only those that will deliver growth.

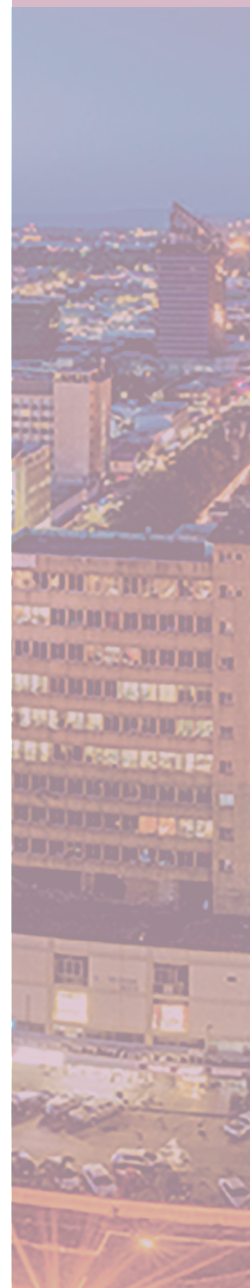
- iii. **The Executive must muster the will for and commitment to fiscal discipline.** The Government must regain budget credibility by formulating coherent short- and medium-term expenditure frameworks that it is able to stick to. These plans should recognize the economic value of spending and prioritize spending that supports growth – including effective support to reduce poverty. Sticking to budgets will be more than just meeting aggregate fiscal deficit targets, but also respecting programmatic allocations and thus reducing the wide expenditure variances seen in the recent past.
- iv. **As part of this Government should introduce explicit quantitative fiscal rules,** developed in consultation with local institutions like ZIPAR; that is, long-lasting, legally binding, quantitative constraints or restrictions on budgetary aggregates (particularly on expenditures and expenditure variations, public debt, budget balances and so on). The rules should be designed to be sustained for periods of over five-year per cycle. They should be established through a Statutory Instrument as an integral part of the legal framework. This will help to restrain both the Executive and the Legislature from excessive discretion in spending, budgetary deviations and rapid debt accumulation.
- v. While other debt strategies have been extensively suggested elsewhere including by ZIPAR, the issues surrounding Chinese debt are not well understood. **The authorities should undertake in-depth and comprehensive studies to explore and understand the size, nature and short, medium and long-term implications of the mounting Chinese debt.** The findings of these studies should be widely publicly disseminated for transparency and accountability, and in order to build national consensus and ownership over the issues.

Given the empirical perspective of this paper, we believe that these measures on prudent economic governance, among many others suggested by various authors, will help to restore Zambia's fiscal and economic fitness, improving prospects to secure IMF financial support once talk resume towards the stalled bailout package.

Annex 1: Infrastructure Development from the PF Manifesto 2011-2016

According to the Manifesto, in order to redress the situation of poor and deteriorating infrastructure up to 2011, the PF Government would focus on the following infrastructure projects (taken word-for-word from the Manifesto pp.28=29): :

- Rehabilitate and upgrade the existing road network including feeder roads in all districts to prescribed standards;
- Construct additional inter-provincial and inter-district roads to open up the country to facilitate accelerated development;
- Replace existing pontoons with bridges in order to promote social and economic activities in districts;
- Establish road maintenance camps on major roads throughout the country;
- Construct ring roads around major cities to decongest the central business districts;
- Promote employment creation through the use of labour intensive technologies and the use of local resources;
- Ensure the viability of existing railway lines, particularly ZR and Tazara, through monitoring and negotiation with suitable management concessions and partnerships.
- Construct or extend the rail network to areas of economic activities through public-private partnership;
- Provide incentives to railway operators in order to promote re-investment in the existing railway infrastructure thereby encouraging the use of railway transport;
- Promote public-private partnership in the aviation industry;
- Construct and upgrade airports and airstrips in districts;
- Rehabilitate and upgrade existing harbours and canals;
- Establish district works departments to manage maintenance of public infrastructure;
- Review the telecommunications regulatory framework;
- Establish micro credit financing for small scale Zambian contractors, and to ensure that there are compensatory measures in place to level the playing field between foreign contractors, especially those who are receiving financing and other subsidies from their countries of origin;
- Review the curriculum in Trades Colleges to provide skills relevant to infrastructure development;
- Review the Road Development Agency Act and the National Roads Fund Agency Act in order to achieve the above.



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(Endnotes)

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