

An Analysis of Public Debt Servicing in Zambia: Trends, Reforms and Challenges

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Abstract

The main goal of this paper is to discuss the dynamics of public debt servicing – both domestic and foreign – in Zambia, tracing the trends, reforms and challenges over the period from 1964 to 2015. The paper shows that the exceptional rise in public debt servicing obligations in Zambia over the period under review has been principally due to high domestic and foreign interest rates, frequent debt rescheduling at commercial rates, and capitalisation of non-liquidated service obligations at commercial rates. Also revealed in the paper is the fact that prior to 2005, Zambia experienced severe public debt servicing problems which eased after 2006 owing to debt relief initiatives and an economic rebound. Among the government debt service reforms discussed in the paper are structural adjustments in foreign exchange management, fiscal and monetary reforms, and aggressive engagement of traditional creditors. Primary among the identified challenges of public debt servicing in Zambia was the insistent economic crises that dogged the country during the study period. Notwithstanding the current public debt service sustainability and remarkable economic performance that characterise the country today, the paper found that the recent contraction of nonconcessional loans by the state poses a threat to debt service sustainability in future. Hence, the paper recommends, among other things, for aligning of public sector infrastructure spending with revenues to ensure budget sustainability, and to continue diversifying the economy to minimise the impact of external commodity price shocks on the economy.

KEY WORDS:

public debt servicing, economic growth, Zambia

Introduction

In theory, the debt overhang hypothesis asserts that public debt servicing depresses economic growth via a multiplier accelerator effect through various mechanisms: (1) it drives up domestic interest rates, thereby increasing the cost of borrowing, which then crowds out private sector investment; (2) it causes a net flow outwards of domestic resources (comprising of external grants, aid and foreign exchange resources) in the form of foreign public debt repayments; (3) it presents future tax uncertainty and a deterioration in domestic policies, which directly impact on real returns on investment; (4) it increases government participation in domestic capital and money markets, which can then lead to credit rationing; and (5) it increases the government's appetite to borrow so as to service its debts, among other reasons (Clements, Bhattacharya and Nguyen 2003; Krugman 1989; Metwally and Tamaschke 1994; Patenio and Tan-Cruz 2007; Sachs 1989).

However, the results of empirical research by Chowdhury (1994), Elbadawi, Benno, and Njuguna (1996); Fosu (1999), and Pattillo, Poirson and Ricci (2004), among others, reveal that there is no evidence supporting the negative linkage between public debt servicing and growth in studied countries. These contradictory results indicate that there are some systematic variations in the cost of public debt servicing across countries, varying also over time. Extending the discussion to Zambia will assist the country in its debt service management and in policy formulation, given the drive by state authorities to transform the country into a prosperous upper middle-income country by 2030.

Historically, the evolution of the Zambian public debt has been a result of sagging world copper prices in the mid-1970s until the late 1990s, which caused substantial decline in both economic growth rates and central government revenues from mineral taxation and exports (McCulloch, et al., 2000). The persistent rise in (i) budget deficits (see Appendix), (ii) domestic and international interest rates on debt, and (iii) rolling over of domestic public debt between 1975 and 1991 made Zambia one of the highly indebted poor countries in sub-Saharan Africa (Thurlow and Wobst 2006; McCulloch et al., 2000). The high public debt stocks (domestic and

foreign) translated into unsustainable public debt service obligations. Consequentially, the huge budget outlays towards public debt servicing in Zambia had been perceived as one of the hurdles to the country's economic growth process and also to poverty alleviation (Government of the Republic of Zambia "GRZ" 2008). Regrettably, the high domestic public debt service payments were not being transformed into productive uses by the recipients; thus, these allocations were an impediment to sustainable economic growth and development in Zambia (Bigsten and Kayizzi-Mugerwa 2000). Of much concern is the fact that between 2007 and 2014, national budget allocations for Zambia's domestic public debt servicing have consistently been rising relative to those allocated for new capital spending (Southern African Development Community "SADC" 2015).

Against this background, the aim of this study is to analyse the evolution of government debt servicing in Zambia since 1964 by highlighting debt service trends, reforms and challenges. The paper attempts to examine the heavy burden that government debt imposes on the country's development prospects. The rest of the paper is arranged as follows: Section 2 presents an overview of the Zambian economy; Section 3 discusses the trends in public debt service in Zambia; while Section 4 reviews the public debt service reforms in Zambia. Finally, Section 5 discusses the challenges facing public debt service management in Zambia and Section 6 concludes the paper.

Overview of the Zambian economy

Since the early 1900s, the Zambian economic performance has been largely concentrated in two economic sectors: mining (mostly copper) and agriculture (mostly maize and tobacco). While the mining sector is predominantly capital-intensive, using modern technology, the agricultural sector is principally labour-intensive, using traditional methods (United Nations 2016). According to the United Nations (2016), construction and transport industries have since 2010 also been characterised by capital-intensive production methods and their contribution to the country's economic growth has been on the rise. Generally, the economy of

Zambia is heavily dependent on copper mining, which accounts for over 70% of the country's total export earnings, but employing less than 2% of the population (Central Statistical Office "CSO" 2016). Unemployment and underemployment rates in Zambia stood at 7.9% and 10.2% as at end of 2015, with the highest proportions of people employed in the agriculture, forestry and fisheries industries (World Bank 2016).

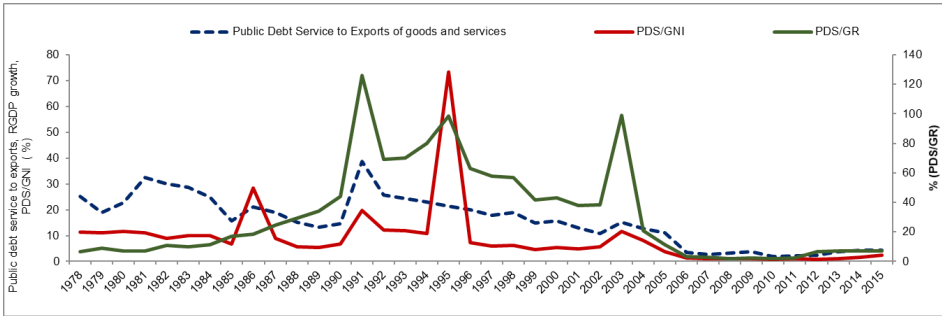
As of 2015, the Zambian economy was considered one of the fastest-growing economy in sub-Saharan Africa, characterised by robust economic growth rates averaging 6.9% between 2005 and 2015, driven mainly by unprecedented high commodity prices (GRZ 2017). With a per capita gross domestic product (GDP) of around US\$ 1,700 in 2015, Zambia is now a lower-middle-income country (World Bank 2016). However, a combination of declining world mineral prices, particularly of raw copper, and inadequate production and supply of industrial enablers such as electricity, lowered the economic growth rates of Zambia beginning 2015, which recorded a 2.9% growth rate relative to 7.6% in 2012 (GRZ 2017). Inflation in Zambia averaged 11.4% and 9.9% between the periods 2006-2009 and 2011-2015, respectively (GRZ 2017). Following the slump in world commodity prices by the end of 2014, the fiscal deficit of Zambia worsened, increasing from 2.4% of GDP in 2011 to 9.4% of GDP in 2015, thus necessitating increased public borrowing, both domestic and foreign, to fund expansionary fiscal policies (World Bank 2016).

Trends in public debt servicing in Zambia

The huge stock of government debt, public and publicly guaranteed, in Zambia since the 1970s brought about solemn implications for the country's debt servicing obligations and general economic performance as it directly affected credit creation, national gross savings, national gross investment, and central government gross revenue performances (Clements, Bhattacharya and Nguyen 2003). The active presence of the government in the domestic capital markets in the early 1990s, in addition to foreign borrowing, not only affected domestic interest rates and also crowded out investments, but also brought about severe tax reforms to

raise revenue for debt servicing (Clements, Bhattacharya and Nguyen 2003). According to Atique and Malik (2012) and Tasos (2014), a high public sector debt service obligation reduces the private sector incentive to invest, which leads to negative economic growth. Figure 1 indicates the trends in public debt service ratios in Zambia during the period from 1978 to 2015.

Figure 1: Public debt service growth trends in Zambia (1978-2015)



Source: SADC Statistical Year Book (2015); World Development Indicators (2016)

RGDP = Real Gross Domestic Product

GNI = Gross National Income

PDS = Total Public Debt Service

GR = Government Revenue

Public debt servicing trends in Zambia can be split into three phases: (i) 1980-2005, (ii) 2006-2015 and (iii) 2016 and beyond. While the first two phases are visible in Figure 1, the third phase gives a public debt servicing forecast for Zambia based on past and present trends in public sector borrowing and on the general economic performance of the country. In the first phase, 1980-2005, the debt service burden of Zambia was rising exponentially, reaching its worst peak between 1990 and 1996. During this phase, Figure 1 portrays a deteriorating debt service payment capacity of Zambia as signified by the persistent fall in public debt service-to-exports of goods and services ratio. As manifested in Figure 1, between 1991 and 1994, the ratios of public debt service-to-GNI, public debt service-to-exports of goods and services, and public debt service-to-revenue were at their worst in the country's history -- and so was economic performance (GRZ 2006b). While Figure 1 shows a lower public debt service-to-GNI and public debt service-to-export of goods and services ratios between 1987 and 1990, scheduled debt service was actually much higher (World Bank

2015). The government's policy of putting a ceiling on foreign public debt servicing contributed to the noticeable fall in the debt service ratios between 1987 and 1990 (World Bank 1993: 60).

During the period of 1985 to 1996, Zambia's average annual growth rate was 0.29% (World Bank 2012). The observable spikes in 1991, 1994 and 2003 in Figure 1 are a result of drastic shifts in political regimes (1991 and 2003) and of substantial economic and financial structural reforms (1991, 1994 and 2003). These years, 1991, 1994 and 2003, are associated with the lowest growth rates of the period, that is, -0.04%, -8.63%, and 3.3%, respectively (World Bank 2012).

Phase two, 2005-2015, is characterised with considerable reductions in public debt stock owing to the debt relief initiatives that started in 2000. As indicated in Figure 1, the period is associated with declining public debt servicing ratios. The reduction in public debt service burden after 2000, especially on foreign public debt, boosted public savings and investment prompting increased physical infrastructure and human capital development, which then led to an economic rebound beginning 2006 (Bigsten and Kayizzi-Mugerwa 2000). During this phase, economic growth and inflation averaged 6.9% and 10.6%, respectively, and the fiscal position of the country improved significantly (GRZ 2017).

Also depicted in Figure 1 is the new twist of public debt service ratios, which began trending upwards after 2012 due to renewed domestic and foreign public borrowing, debt roll-over and gradual deterioration in international copper prices (United Nations 2016). Consequentially, Zambia's risk of foreign public debt service distress, according to the IMF debt sustainability analysis, changed from low to moderate after 2012 (IMF 2015). Consequently, phase three provides a futuristic outlook of Zambia's public debt service burden, which is expected to be increasing with the level of the country's output by 2020 (IMF 2014a). As government indebtedness increases, possibilities are that Zambia's public debt service commitments after 2020 will be financed by distortionary means (like seigniorage), especially if existing gross national investments fail to yield meaningful returns (IMF 2014b). Moreover, although all of Zambia's public debt sustainability indicators are expected to remain below the IMF and World Bank applicable thresholds until 2020, the public debt

service-to-government revenue ratio is expected to exceed the 18% IMF/ International Development Association baseline threshold (IMF 2015). Table 1 and Table 2 provide a comparison of Zambia's foreign public debt service payments in the pre- and post-Highly Indebted Poor Countries (HIPC) periods.

Table 1: Public debt service payments of Zambia (Pre-HIPC era) (1990-1999)

	Foreign public debt (US\$ millions)	Foreign public debt service (US\$ millions)	Foreign public debt service/ Foreign public debt stock (%)
1990	7,237	647	8.9
1991	7,271	718	9.9
1992	6,971	678	9.7
1993	6,791	522	7.7
1994	6,583	541	8.2
1995	6,859	590	8.6
1996	7,181	453	6.3
1997	6,758	376	5.6
1998	6,862	315	4.6
1999	5,950	386	6.1

Sources: BOZ Annual Reports (various), IMF Country Reports (various) and Budget Speeches

Table 2: Public debt service payments of Zambia (Post-HIPC era) (2000-2015)

	Foreign public debt (US\$ millions)	Foreign public debt service (US\$ millions)	Foreign public debt service/ Foreign public debt stock (%)
2000	5,831	169	2.9
2001	5,771	158	2.7
2002	6,684	148	2.2
2003	5,286	151	2.9
2004	7,080	211	3.0
2005	4,528	302	6.7
2006	2,513	96	3.8
2007	1,189	121	10.2
2008	1,982	130	6.6
2009	3,638	137	3.8
2010	3,202	135	4.2
2011	3,544	139	3.9
2012	4,281	121	2.8
2013	5,318	101	1.9
2014	6,170	101	1.6
2015	7,805	109	1.4

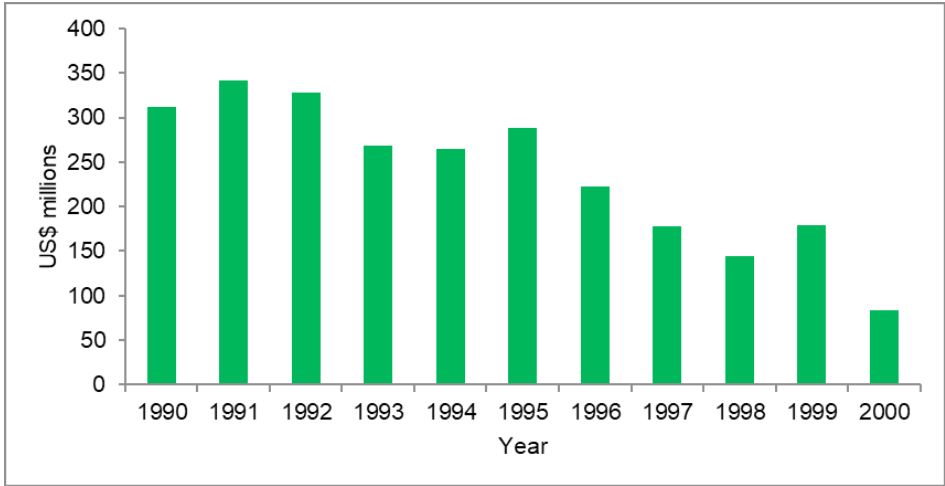
Sources: BOZ Annual Reports (various), IMF Country Reports (various) and Budget Speeches

From Table 1, it can be observed that in the pre-HIPC era, foreign public debt service payments were all above US\$300 million annually, an amount too high for a country already suffering from balance-of-payment challenges and incessant government revenue constraints (World Bank 2012). Despite being insignificantly proportional to total foreign debt stock, the foreign public debt service disbursements constituted a significant percentage of the overall government revenue (CSO 2005; World Bank 2012). A period high debt service ratio of 9.9% was recorded in 1991, when the country made a once-off payment of US\$300 million to the World Bank, thereby clearing all its debt service arrears to the institution, with the intention of normalising relations and also as a gesture of subscribing to the Bank's sponsored new economic reforms (Andersson, Bigsten and Persson 2000; World Bank 1993). On the contrary, foreign public debt service payments between 2000 and 2015 averaged US\$144 million annually, owing to the debt relief initiatives extended to Zambia by its creditors (World Bank 2015). In essence, it can be construed from Table 2 that the HIPC and Multilateral

Debt Relief (MDR) initiatives generated huge savings for Zambia through a reduction in foreign public debt servicing commitments.

Generally, prior to the debt relief in 2005, the average foreign debt-to-GDP ratio was 154%, meaning that the Zambian economy had no capacity to generate sufficient financial resources to pay back its foreign financial dues (African Development Bank "AfDB" 2010; Thurlow and Wobst 2006). The remarkable rise in public debt service burden in Zambia between 1987 and 2000 had been predominantly due to rising inflation, high domestic and foreign interest rates, not merely additional government borrowings (Dinh, Aduugna, and Myers 2002). Inflation in Zambia rose rapidly from the late 1980s reaching a peak of 186% in 1993, and averaging 97.6% between 1987 and 1993 (World Bank 2003). Domestic interest rates on both lending and government securities averaged 72.8% between 1990 and 2000, with a period peak of 143.5% in 1993 (Thurlow and Wobst 2006). Foreign interest rates on debt between 1987 and 2000 averaged 53.3% (World Bank 2003). Given the dwindling government revenues due to depressed copper prices and de-industrialisation, unredeemed public debt securities were recapitalised at the going high market interest rates, thus worsening the debt levels and repayment ability of the government. In terms of foreign debt service payments' composition, half of the money was going towards interest payments while the remaining small balance was channelled towards principal debt repayment (Copestake and Weston 2000). Figure 2 shows the trend in public debt interest payments in Zambia between 1990 and 2000.

Figure 2: Foreign public debt interest payments in Zambia (1990-2000)



Source: Bank of Zambia Annual Reports (various)

Figure 2 reveals that interest payments on foreign public debt were on average US\$300 million between 1990 and 1995 and constituted approximately 50% of the total debt service payments (World Bank 2003). Compared to the average annual central government revenues during the period 1990 to 2000, the foreign public debt service payments indicated in Figure 2 represent a high proportion of the country's budget expenditure (CSO 2005). From a historical point of view, Zambia's interest payments due on outstanding foreign public debt were on average US\$120 million annually between 1986 and 1991 (World Bank 1993: 60) and US\$237 between 1990 and 2000 (World Bank 2003). This means that the high world interest rates of the 1990s exacerbated the foreign debt service burden of Zambia by blowing up interests on outstanding foreign public debt, principal and arrears.

The foreign public debt service payment reduction visible in 1993 in Figure 2 was due to the Paris Club debt pardoning initiatives (BOZ 2002). According to the HIPC Report of 2000, Zambia spent approximately 20% of its GDP on foreign public debt service payments between 1990 and 2000, relative to 3% and 2% allocated to education and health sectors, respectively (BOZ 2002). This massive disparity in budget allocation between foreign public debt service payments and social sectors explains the direct effect

of huge foreign public debt repayments on economic development in Zambia between 1990 and 2000.

Historically, Zambia's debt service burden increased progressively in the early 1990s, before declining steadily after 1996. Whereas the downward trend in interest payments on debt after 1995 was an indication of severe economic crisis and revenue constraints, the drastic fall in the public debt payments noticeable in 2000 in Figure 2 was a result of massive debt relief from the Paris Club and Bretton Woods institutions (World Bank 2001). Following the debt relief and subsequent economic recovery, Table 1 assesses the foreign debt burden and debt sustainability of Zambia in the post debt-relief era -- the bigger the ratio, the higher the debt problem.

Table 3: Foreign debt sustainability ratios of Zambia (2005-2015)

Indicator	Foreign debt/GDP	Foreign debt/Exports	Foreign debt/ Government revenue	Foreign debt service/ Exports	Foreign debt service/ Government revenue
Indicative threshold	40%	150%	250%	20%	18%
2005	86.7	215.6	56.8	11.2	4.0
2006	43.4	56.7	46.8	3.5	3.2
2007	23.8	59.3	48.4	2.6	2.6
2008	21.2	58.2	41.2	3.2	2.1
2009	23.8	82.7	65.6	3.7	2.4
2010	20.4	57	57.7	2.9	1.8

Indicator	Foreign debt/GDP	Foreign debt/Exports	Foreign debt/ Government revenue	Foreign debt service/ Exports	Foreign debt service/ Government revenue
2011	24.3	48.1	49.1	2.1	2.2
2012	27.7	42.8	82.3	2.4	6.8
2013	26.9	56.7	94.3	3.4	7.1
2014	28.2	61.8	101.1	4.1	7.3
2015	38.7	54.2	97.6	3.8	6.9

Source: African Statistical Yearbook (various editions), Central Statistics Office (CSO) (various issues), Bank of Zambia Annual Reports (various years)

The foreign public debt relief initiatives extended to Zambia by its traditional creditors eliminated the country's public debt service distress by 2006, and both foreign debt to-GDP and foreign debt service-to-exports ratios fell to within baseline thresholds. The proportion of the country's export revenues committed to foreign debt service was reduced from 11.2% in 2005 to 1.9% in 2010, as shown in Table 3, thus widening Zambia's fiscal space. As revealed in Table 3, Zambia's debt sustainability ratios since 2006 fell to within indicative thresholds, meaning that the country could no longer qualify for additional debt relief under MDR initiative.

More so, the debt and financial crises in Zambia's major creditor economies, and the subsequent implementation of austerity measures by these countries, contributed to the reduction in new debt flows to Zambia, leading to marginal decrease in foreign public debt-to-GDP ratio in 2010, as revealed in Table 3. Nonetheless, faced with little room to pursue counter cyclical interventions, Zambia diversified its foreign sources of finance by issuing Eurobonds in 2011 (Zambia Institute for Policy Analysis and Research "ZIPAR" 2015). In 2012, the government of Zambia

issued 10-year US\$750 million worth of Eurobonds, and collectively, the amount increased to US\$1.75 billion by 2015, bringing the total foreign debt to US\$6.3 billion at the end of August 2015 (United Nations Economic Commission for Africa “UNECA” 2016; ZIPAR 2015). The Eurobond funds were to fund expansionary infrastructure development and rehabilitation, mostly road and rail networks, energy generation, and transmission and central government hospitals (Ministry of Finance and National Planning “MOFNP” 2013). The issuance of these Eurobonds contributed to the rise in foreign public debt-to-GDP and foreign debt-to-government revenue ratios after 2013.

With a foreign public debt to GDP ratio of 38.7% in 2015, as indicated in Table 3, relative to the 40% indicative threshold of the IMF/World Bank; and a combination of (1) the Zambian Kwacha depreciation against major trading currencies, (2) emergence of current account deficits in 2015, and (3) reduced export earnings caused by the decline in commodity prices and low manufacturing production capacity; the country's chances of experiencing debt repayment problems in future are on the rise. Between 2006 and 2014 Zambia had been recording current account surpluses (GRZ 2017). These adverse developments in the Zambian economy require the government to continuously seek external balance-of-payment support and to implement appropriate longer-term budgetary measures to ensure public debt service payments sustainability in future.

Furthermore, Table 3 also shows that although the Zambia's foreign debt service to government revenue ratio is within the IMF sustainability range, it is actually on the rise. With the maturing of Eurobonds and newly contracted nonconcessionary loans, the country's foreign debt service costs are likely to double by 2020 (IMF 2016). Also, the rising international interest rates on debt are expected to aggravate the debt repayment challenges of the country in the foreseeable future (World Bank 2015).

Public debt servicing reforms in Zambia

The high government debt in Zambia – both domestic and foreign – prior to the debt reliefs, directly implied massive debt service obligations for the country. Zambia's exceptionally high government debt service costs emanated from soaring domestic and foreign interest rates, poor performance of the domestic economy, frequent debt rescheduling at commercial rates by creditors, and the capitalisation of non-liquidated service obligations at commercial rates (Andersson, Bigsten and Persson 2000). By the late 1970s, Zambia was already in a serious foreign debt service trap, which prompted the government to undertake debt service reforms. In 1973, 1976, and 1978, the government negotiated a series of contractual agreements with the International Monetary fund, the World Bank and the Paris Club with the intention of easing public debt payments and enhancing economic performance (World Bank 1993). However, these agreements failed to serve the purpose because of transitory terms-of-trade respites and rising poverty levels (Andersson, Bigsten and Persson 2000).

Between 1980 and 1986, the government of Zambia re-negotiated for a more orchestrated and coordinated foreign public debt servicing package with its traditional creditors, mostly the Bretton Woods institutions and the Paris Club (World Bank 1993: 59). However, in 1981, for instance, an Extended Fund Facility, which had been negotiated with the IMF, broke down and was replaced by a new set of debt rescheduling agreements beginning in 1983, particularly with the Paris Club and the London Club commercial banks (GRZ 2006a).

Upon realising that the adopted reforms were not reducing the debt servicing obligation of the country and that the foreign payments were drawing substantially on scarce financial resources that otherwise could be used to advance national developmental programmes, the Zambian government revised its financial, structural, and economic reforms. Consequently, in 1987, the country adopted regulatory policies as evidenced by the implementation of a 10% ceiling on foreign public debt payments in a move meant to tame resource outflow (Bigsten and Kayizzi-Mugerwa 2000). Even though the country's economic performance partially improved and stabilised, this 10% foreign public debt servicing

restriction policy caused Zambia to be isolated economically as most creditors substantially reduced the flow of foreign aid and other forms of support to the country (Organisation for Economic Co-operation and Development 2011).

In 1990, the Zambian government implemented a policy which set a limit on foreign public borrowing, in addition to adopting IMF-supported structural adjustment measures. These IMF measures came as a result of Zambia's arrears in servicing its debts to the institution. To resume foreign public debt servicing, particularly to the IMF, the country subscribed to the IMF's "rights accumulation programme" initiative, which stipulated clearance of outstanding foreign debt arrears (IMF 2001). The period between 1995 and 1999 was characterised by somewhat firm adherence to the Enhanced Structural Adjustment Facility and the foreign public debt servicing conditions set out by the World Bank and the IMF (World Bank 2002).

The domestic public debt service reforms in Zambia comprised major shifts in fiscal and monetary policies along with structural and institutional reforms. The prime objective of these policy shifts was to reduce government expenditures and mobilise more financial resources to service both domestic and foreign debts (GRZ 2006b; Chileshe and Kafula 2015). Following the abrupt depreciation of the exchange rate due to reduced export earnings caused by the waning in commodity prices, and the subsequent economic decline, the government in 1987 disregarded the foreign exchange auction system and revalued its local currency (Bank of Zambia "BOZ" 2012, Chirwa and Odhiambo 2016).

In response to the high domestic public service costs in the late 1980s and early 1990s, the government turned to seigniorage and instituted the Public Service Reform Programme, which resulted in the restructuring of state enterprises. During the period 1988 and 1993, for instance, the average annual inflation of Zambia was 143%, with a peak of 186% recorded in 1993 (World Bank 2003).

In 1993, the government adopted a cash budget system in which cash was released to line ministries only if adequate funds were available in the government's main bank accounts to meet the required payments; and

the government also began to redeem its local debt with the assistance of an increased proportion of concessional foreign borrowing (World Bank 1993; GRZ 2006c). In 2014, the government reintroduced the cash budget system in which government ministries and arms' expenditure were supposed to be limited to the disbursed funds (GRZ 2013).

Challenges facing public debt servicing in Zambia

Public debt servicing challenges being experienced by the government of Zambia are rooted in economic and financial policy choices, global financial developments, and scanty foreign direct investment inflows since 1964 (World Bank 2000). According to the African Forum and Network on Debt and Development (AFRODAD) (2011), primary among the challenges of public debt servicing in Zambia is the insistent economic crisis that dogged the country from the 1970s until the late 1990s. The other fundamental cause of Zambia's increasing inability to service its public debts was the narrowness of the economy's production base, which constrained the revenue base of the central government (IMF 2005: 9). As a result, the government would divert a substantial proportion of received aid to build foreign currency reserves for payment of foreign arrears (IMF 2007: 2).

Although there has been sound improvement in macroeconomic policies and credible public debt servicing management strategies in Zambia since 2000, there still is need for greater diversification of the economy, expansion of the export base, and improvement in government project appraisals in order to maintain public debt stocks and government service payments within sustainable ranges, especially in the face of rising nonconcessional public borrowing commencing 2012 and also of the possibilities of external financial and economic shocks (IMF 2016).

The high nominal interest rates experienced between 1987 and 1996 made repayment of domestic public debt very difficult in the late 1980s and early 1990s (GRZ 2006c). These high rates of interest caused structural

imbalances as the interest cost of outstanding domestic public debt exceeded primary fiscal surpluses (BOZ 2002). As a result, after 1994, the government was unable to meet the financing of both maturing domestic debt and the interest due on the securities (GRZ 2006a). Moreover, the servicing of local-currency denominated public debt was adversely affected by both the government's limited capacity to tax and the small size of the country's tax base (MOFNP 2004). This, in addition to ineffective tax collection strategies, loss-making state-owned enterprises, and massive capital outflows, are among the reasons that assist in explaining the evolution of public debt and subsequent debt repayment difficulties during the period prior to 1999 (IMF 2000).

According to the United Nations Conference on Trade and Development (UNCTAD) (2012), the collapse of the world commodity market beginning the mid-1970s, especially of unprocessed copper, compelled the Zambian government to over rely on foreign and domestic public borrowings in a bid to uphold high levels of government spending. The undiversified Zambian economy caused the country's revenue sources to remain susceptible to external shocks, especially highly volatile world commodity prices (IMF 2010). Generally, during the period between 1987 and 1999, increased foreign public debt servicing costs offset overall improvements in export performance (IMF 2000). As a result, central government revenues continued to be subdued, falling below recurrent expenditures and foreign public debt servicing obligations (IMF 2009a, 2009b). Thus, foreign debt servicing problems in Zambia were mainly influenced by high and volatile world interest rates and weakening in the country's terms of trade. More fundamentally, foreign public debt servicing difficulties and currency mayhem in Zambia since 1987 led to sharp increases in defaults and the emergence of non-performing loans in the financial sector (World Bank 2000). The rescheduling of foreign public debt payments by creditors through the so-called Paris Club arrangements proved not to be a solution to the servicing obligations of the country, as evidenced by the persistent presence of servicing challenges prior to 2005 (BOZ 2010). In conclusion, most of the discussed debt service challenges disappeared after 2006 following massive debt relief and tremendous economic recovery.

Conclusion

This paper has discussed the public debt service dynamics in Zambia, from 1964 to 2015. In the discussions, it was highlighted that the dynamics in world commodity prices, particularly of copper, have predominantly determined the trends, reforms and challenges in public debt service in Zambia over the period under review. The paper identified three distinct episodes of public debt servicing in Zambia: (1) 1980 to 2005; (2) 2006 to 2015; and (3) 2016 and beyond. In the first episode, the country was facing high debt servicing costs emanating from both huge non-concessionary debts and high interest rates. In the second episode, the debt service costs of Zambia decreased radically following the HIPC and MDR debt relief initiatives and also owing to high economic growth rates. The third phase provided an overview of Zambia's future debt service sustainability. In this third phase, the paper revealed that, if the government fails to expand its revenue base by diversifying the economy, the country is likely to face liquidity and solvency challenges. Among the discussed debt-service reforms, there were exchange rate policy changes, economic structural adjustment policies, and active engagement of the international creditor community through contractual agreements. The paper further revealed that the country's major debt service challenges emanated from, among other things, a narrow government revenue base, high and volatile interest rates, and exceptionally high government debt stocks. Going forward, the paper recommends that the government of Zambia (1) embarks on stringent austerity measures that limit both domestic and foreign public borrowing, so as to curb the accumulation of high interest payments on public debt; and (2) improves its fiscal position, by aligning public sector infrastructural spending with revenues to ensure budgetary sustainability; and (3) continues with the diversification of the economy so as to minimise the impact of external shocks, particularly in terms of rampant fluctuations in world commodity prices.

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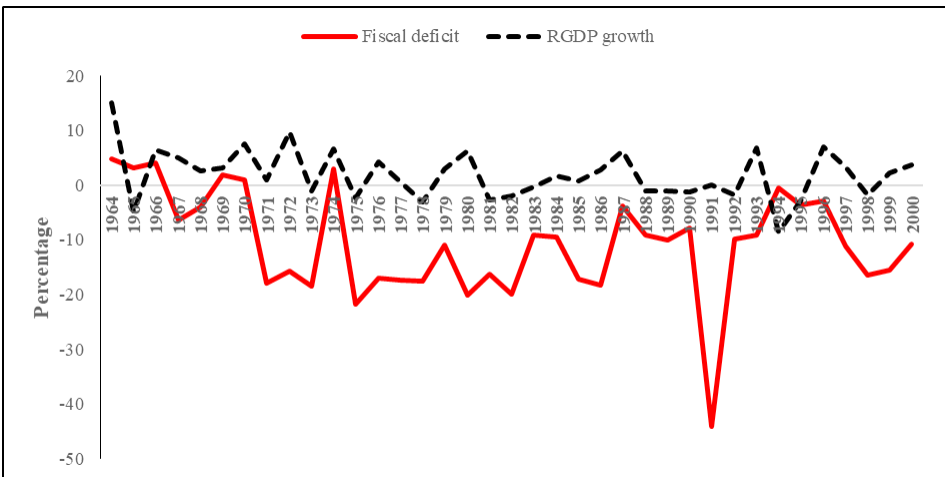
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APPENDIX

Fiscal deficit and real GDP growth in Zambia (1964-2000)



Source: World Bank 2003

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