

The scale of debt restructuring needed for Zambia to make the debt sustainable under IMF rules

Zambian CSO Debt Alliance and Jubilee Debt Campaign UK, February 2022

1. Summary

The below calculations suggest that in order for Zambia to be assessed as at moderate risk of debt distress by the IMF following a debt restructuring, external private and bilateral creditors need to:

- Cancel all interest payments
- Cancel two-thirds of principal payments

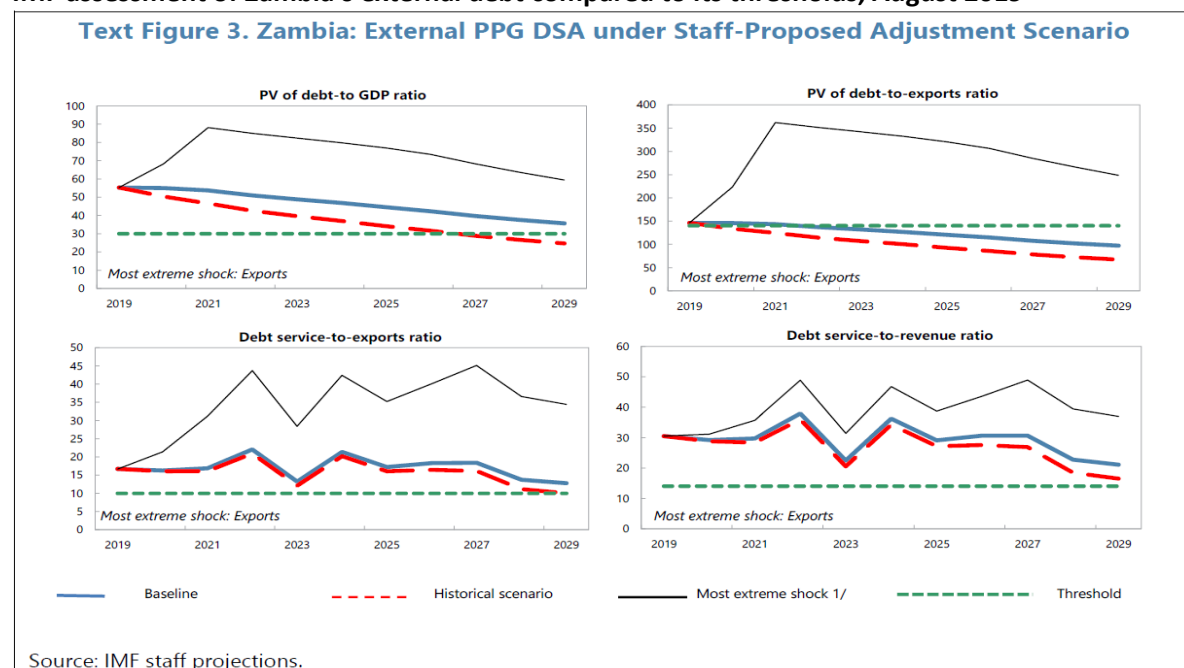
2. IMF thresholds for moderate risk of debt distress

Under the IMF Debt Sustainability Framework, to be assessed as at moderate risk of debt distress (rather than high) Zambia’s debt needs to be below all of the following thresholds:

- External debt service below 14% of government revenue
- External debt service below 10% of exports
- Present value of external debt stock below 140% of exports
- Present value of external debt stock below 30% of GDP¹

Of these, when the IMF last conducted a Debt Sustainability Analysis for Zambia in 2019, Zambia was above all four thresholds, but most above the threshold for external debt service as a percentage of government revenue (see Box from IMF report below). Therefore, this analysis will focus on the debt restructuring needed to get and keep debt service below 14% of government revenue.

IMF assessment of Zambia’s external debt compared to its thresholds, August 2019²



If following a restructuring external debt service was planned to be at exactly 14% of government

¹ <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/39/Debt-Sustainability-Framework-for-Low-Income-Countries> and <https://www.imf.org/en/Publications/CR/Issues/2019/08/02/Zambia-2019-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-48558>

² <https://www.imf.org/-/media/Files/Publications/CR/2019/1ZMBEA2019002.ashx>

revenue, this would mean any small change could quickly push Zambia back to high risk of debt distress. Therefore, the restructuring should aim to reduce debt service to well below 14% of government revenue. For this analysis, we have aimed for 12%. This mirrors what the IMF has recently said for Chad, another country currently negotiating a debt restructuring under the G20 Common Framework. The IMF programme documents for its December 2021 loan to Chad say the debt restructuring needs to “bring the risk of debt distress to ‘moderate’”, and this means reducing the external debt service-to-revenue ratio below 12.3%, “to ensure there is some space to absorb shocks to revenues without a deterioration in the risk rating.”³

Since Zambia’s 2019 Debt Sustainability Analysis was completed by the IMF there has been a global pandemic and economic crisis, which has made Zambia’s debt situation even worse. For example, the IMF now expects Zambia’s GDP to be 10% less in 2022 than it expected in 2019, and government revenue 6% less.⁴

3. Working out resources available for repayment

The first step in this analysis is to work out the resources the Zambian government has available to it for paying the external bilateral and private debt.

To calculate how much will be 12% of government revenue, we have taken IMF projected GDP figures and government revenue as a % of GDP figures for Zambia from the World Economic Outlook. These only go from 2022 to 2026. We have therefore assumed GDP continues to grow at the same rate as in the IMF projections, and government revenue continues at the same rate as 2026, to produce figures until 2035. This shows 12% of Zambian government revenue is \$510 million in 2021, rising to over \$1 billion by 2035.

Multilateral debt payments are not included in the G20 Common Framework, and Zambia has remained current on making all multilateral debt payments. Therefore, these must be paid before any external bilateral and private debt payments. The World Bank International Debt Statistics database shows multilateral debt principal and interest payments on debt already contracted from 2021 to 2028. From 2028 on we assume these continue to steadily fall on the same pattern as before.

Zambia will also contract new external debt over this time period, particularly from multilateral lenders, even if it does not borrow more from private external lenders. It is difficult to know at what rate, what maturity this debt will have and what interest rate will be payable on it. Below we present some alternative scenarios, and what this means for the amount of debt private and bilateral creditors need to cancel.

Scenario 1. New external borrowing starting at \$600 million a year

Between 2017 and 2021 new external loans to the Zambian government averaged \$1.5 billion a year, of which \$290 million was from multilateral lenders, though none from the IMF.⁵

The Zambian budget presented in October 2021 proposed that ZMK47.9 billion (\$2.7 billion) of external borrowing would take place in the following financial year. This includes refinancing of debt

³ <https://www.imf.org/en/Publications/CR/Issues/2021/12/15/Chad-Request-for-a-Three-Year-Arrangement-under-the-Extended-Credit-Facility-Press-Release-511043>

⁴ The IMF April 2019 World Economic Outlook used in the DSA says Zambia’s GDP at 2010 prices would be KWA155 billion in 2022. The October 2021 World Economic Outlook says it will be KWA140 billion, in 2010 prices. The IMF April 2019 World Economic Outlook used in the DSA says Zambia’s government revenue would be \$4.8 billion in current prices by 2022. The October 2021 World Economic Outlook says it will be \$4.5 billion.

⁵ World Bank International Debt Statistics

coming due to be paid. However, in this analysis we assume all bilateral and private debt is restructured so none needs to be refinanced. The Zambian government also committed to not borrow from non-concessional sources other than for refinancing, but did not specify how much of the external borrowing would be refinancing and how much new borrowing.

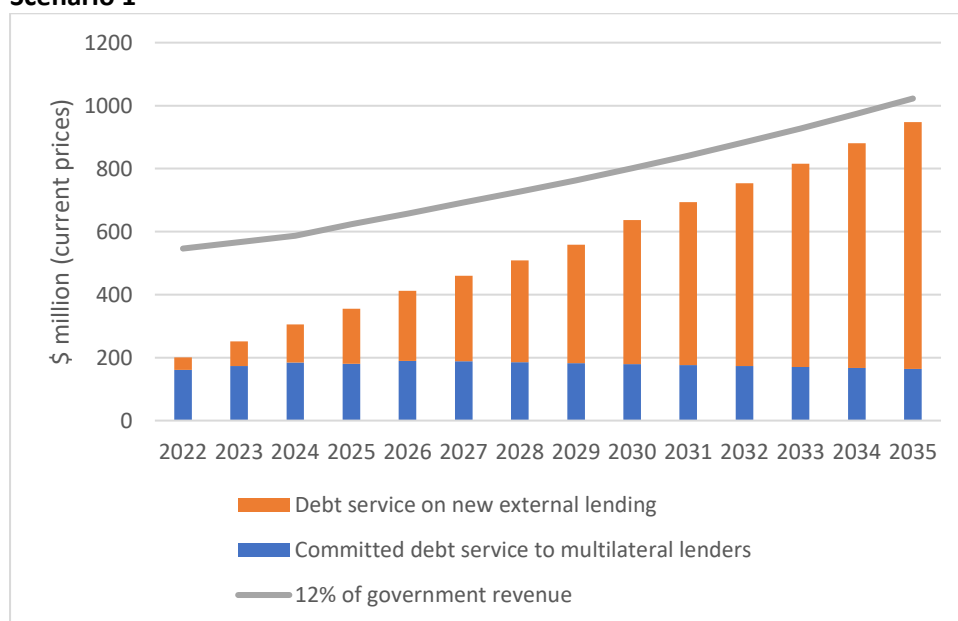
IMF staff have agreed in principle to lend \$1.4 billion over three years, \$466 million a year.⁶

For this first scenario we have therefore assumed that:

- New external lending to Zambia in 2022 is \$600 million, which is 40% of the yearly average for 2017-2021, a significant adjustment, based on \$466 million of IMF loans plus existing multilateral lending.⁷ We then predict it grows at the same rate as projected by the IMF for US\$ current GDP, 5%.
- That 5% of outstanding debt will be repaid every year (the average from 2017 to 2020 was 3%, but this seems unfeasibly low, and three Eurobonds are included within this which had no amortization over this period. Though in contrast to this, multilateral lending tends to come with longer maturities)
- The average interest rate on new debt is 1.5% from 2021 to 2023, then as IMF lending is replaced by other more expensive lenders, and global interest rates rise, it increases to 2% from 2025 to 2028 and 2.5% from 2030 to 2035. For interest rates to remain this low would require most of the new lending to be from lower interest multilateral and bilateral sources.

This produces the following analysis of the limit on debt service, and debt service that has or will be contracted:

Scenario 1



In total under this scenario between 2022 and 2035 there is space to make \$2.8 billion of debt payments on previously contracted external bilateral and private debt.

⁶ <https://www.imf.org/en/News/Articles/2021/12/06/pr21359-zambia-imf-staff-reaches-staff-level-agreement-on-ecf>

⁷ Multilateral loans, not including the IMF, averaged \$258 million a year between 2016 and 2020. For this scenario we have assumed this falls by 50%, to \$130 million a year.

As of end-2020, there is \$4 billion of external bilateral debt and \$5.7 billion of external private debt, according to the World Bank International Debt Statistics database. According to the Zambian government there is \$3.9 billion of external bilateral debt and \$5.9 billion of external private debt (not including interest areas).⁸ For the following calculations we assume the amount owed to private and bilateral external lenders is \$9.8 billion.

These figures do not include state owned enterprises, but state owned enterprise debt does not need to be included in a restructuring if it can be serviced by the state owned enterprise. If any of the \$3.5 billion of state owned enterprise debt does need to be taken on by the state, then more debt cancellation will be needed across bilateral and private creditors than in the calculation which follows.

The \$9.8 billion of principal owed to external bilateral and private creditors is far more than Zambia has the payment capacity to make while being at moderate risk of debt distress, never mind paying any interest. Therefore, our first conclusion is that all interest payments on external bilateral and private debt need to be cancelled. If any interest is to be paid following a restructuring, then more debt would need to be cancelled than in the calculation below.

Above we have calculated Zambia has space to make \$2.8 billion of debt payments on already contracted bilateral and private debt between 2021 and 2035. This means \$7 billion needs to be cancelled, with the remaining \$2.8 billion spread out for repayment over the next 14 years. This is a cancellation of 71% of the principal, over two-thirds.

How it is spread out is far beyond the scope of these calculations, as we do not know the already existing maturities of the debt and the preferences of lenders for being paid less but sooner or more but later. But this gives a sense of the scale of debt cancellation which is needed from Zambia's debt restructuring for Zambia to be classed as at moderate risk of debt distress by the IMF.

The present value reduction of the debt is likely to be significantly higher than 71%, as interest has been cancelled, and possible maturity extensions on what remains to be paid.

Scenario 2: IMF loan programme of \$466 million a year for three years

If the IMF loan programme is confirmed, then we know both the planned disbursements of \$466 million a year, and when the repayments will be made. This therefore allows us to calculate a second scenario which more explicitly includes the IMF programme. The IMF loan will be through its Extended Credit Facility (ECF) at 0% interest and repayments take place between 5.5 and 10 years after they are given.

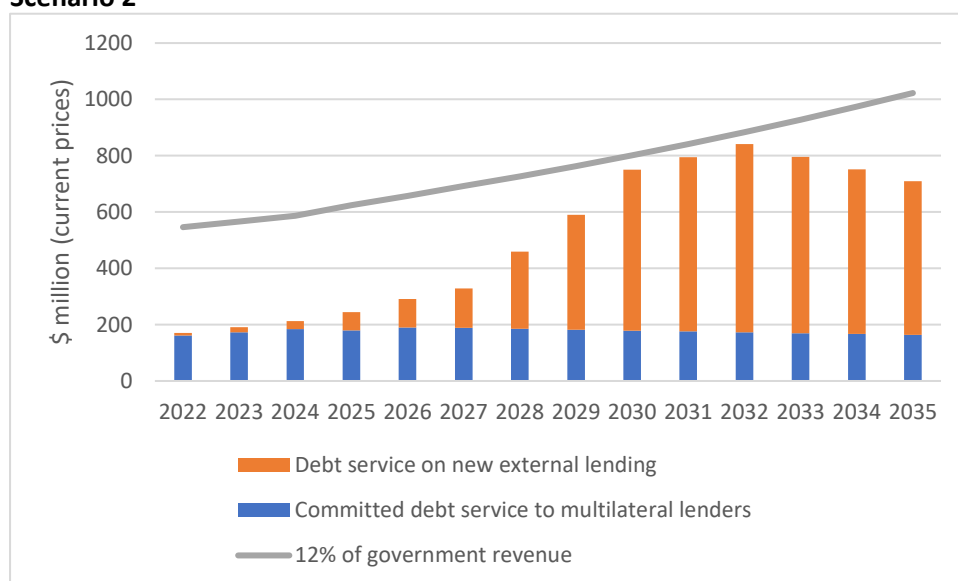
In this scenario we assume:

- the IMF lends Zambia \$466 million a year for three years from 2022 to 2024, at 0% interest. Repayments of ECF loans take place between 5.5 and 10 years after they are given.
- Other multilateral lending is \$130 million a year from 2022, increasing by 5% a year, at 2% interest, rising to 3% interest from 2030 as global interest rates rise
- Other external lending begins again in 2025 at \$300 million a year, increasing by 5% a year, at an average interest rate of 4% a year, rising to 5% interest from 2030. For this to be the case such loans would primarily be bilateral, but may in time include private loans.

This produces the following analysis of the limit on debt service and debt service that has or will be contracted:

⁸ https://www.mof.gov.zm/?wpfb_dl=378

Scenario 2



Overall, across this period the total amount of debt payments under the threshold is \$10.6 billion, and the total amount of payments on old multilateral loans and new lending is \$7.1 billion, which leaves \$3.5 billion for paying the existing private and bilateral debt. This is a slightly more than scenario 1, and would imply a debt cancellation of 64%, as well as no interest being paid.

6. Private creditors have already factored in significant debt cancellation

Through the prices Zambia’s Eurobonds have been bought and sold at, we can see that private creditors have already factored in significant debt cancellation for Zambia. Prior to the Covid pandemic the Eurobond maturing in 2024 was being bought and sold at less than 70% of the face value (and the same pattern is true of the other two Eurobonds).

When Covid hit the price fell to less than 30%. This implies a 70% debt cancellation for those selling at that price, and those who bought at that price will make a profit, not including interest payments, even if there is a 70% debt cancellation. By Spring 2021 the bond was still trading at less than 50% of face value. Since the election of the new government the price has risen significantly on expectation of a restructuring which favours private creditors, but there is no reason that expectation should be met. And the bond is still trading at 75% of its face value.

Private creditors have been expecting a significant debt cancellation for three years, and many of those who own the Eurobonds now bought them at well below the face value.

Price Zambia's \$1 billion Eurobond maturing in 2024 has been trading at⁹



7. The IMF's role in the debt restructuring

The IMF has a policy of not lending into unsustainable debt situations unless a debt restructuring takes place during the IMF programme, or grants or low interest loans are provided in such a way as to make the debt sustainable. As explained in one recent IMF paper: "The Fund may only lend if debt is assessed to be sustainable in the medium term under the GRA¹⁰ and PRGT¹¹. If debt is not sustainable, the Fund is precluded from lending unless the member takes steps to restore debt sustainability, including through either debt restructuring or the provision of concessional financing."¹²

The IMF has this policy because otherwise, if it lends into unsustainable debt situations:

- Pressure will be put on a country to make further cuts in spending and increase taxes in order to reduce the debt. This is often self-defeating because the damage done to the economy reduces the revenue with which to pay the debt, while negatively impacting the meeting of basic needs and human rights.
- IMF programmes will be much less likely to restore balance of payments and macroeconomic stability if there is not a restructuring.
- IMF resources will effectively be used to pay off previous lenders, incentivizing them to continue to act recklessly in the future.
- The IMF may itself need to offer debt relief in the future to restore debt sustainability, which means member governments of the IMF have to pay for the debt crisis, rather than the original lenders.

⁹ Business Insider https://markets.businessinsider.com/bonds/sambia-republikdl-bonds_201424_regs-bond-2024-xs1056386714

¹⁰ General Resources Account – one of two sets of countries at the IMF. See Section 3.

¹¹ Poverty Reduction and Growth Trust – the other of two sets of countries at the IMF. See Section 3.

¹² IMF. (2019). 2018 REVIEW OF PROGRAM DESIGN AND CONDITIONALITY. May 2019. <https://www.imf.org/~media/Files/Publications/PP/2019/PPEA2019012.ashx>

This means that the IMF requires a debt restructuring which makes the debt sustainable before it is able to lend to countries with an unsustainable debt. However, this also means that creditors can hold up an IMF loan programme by refusing to agree a necessary debt restructuring. The IMF therefore has a further policy, known as the lending into arrears policy. This allows the IMF to lend to a government if it is in default to private or bilateral creditors, so long as the government is negotiating in good faith with those creditors.

The IMF's spokesperson Gerry Rice said in November 2021 "Zambia's debt is unsustainable. Therefore, the IMF would need sufficient funding assurances from creditors before an agreement on an extended credit facility could be made."¹³

This is the first step of the process – private and bilateral creditors need to accept a debt restructuring which makes the debt sustainable before the IMF can lend. However, the IMF should make clear the second step of the process. If creditors refuse to accept such a debt restructuring, the IMF can lend to Zambia, so long as Zambia goes into and remains in default on the private and bilateral creditors who refuse to accept the restructuring.

The G20 should do the same in regards to the Common Framework for Debt Treatments, which Zambia has applied for. Under the Common Framework, G20 governments have offered to restructure debt so that it is sustainable, so long as private creditors agree to take part in the restructuring. If private creditors refuse to take part in the restructuring, the G20 should offer to provide the necessary debt cancellation on bilateral debt as long as Zambia goes into and remains in default on private creditors until they accept the restructuring.

The IMF recently emphasised the importance of the lending into arrears policy, and generally support for defaulting on recalcitrant creditors, as part of the tools needed to make creditors accept debt restructurings under the Common Framework. In a blog post on 2 December IMF Managing Director, Kristalina Georgieva, and Director of the Strategy, Policy and Review Department, Ceyla Pazarbasioglu, said *"the Common Framework should clarify further how the comparability of treatment will be effectively enforced, including as needed through implementation of the IMF arrears policies, so as to give greater comfort to creditors and debtors."*¹⁴ The IMF was effectively saying that countries need to go into arrears – default – on creditors who refuse to accept a Common Framework restructuring, as the means to get those creditors to agree.

Political and financial support to Zambia to maintain defaulting on private creditors is the way to make those private creditors accept the necessary debt restructuring.

¹³ <https://www.africanews.com/2021/11/05/zambia-no-time-frame-on-imf-talks/>

¹⁴ <https://blogs.imf.org/2021/12/02/the-g20-common-framework-for-debt-treatments-must-be-stepped-up/>