The Allure of Commercial Debt: The Case of Zambia and Mozambique

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ABSTRACT

Public debt continues to plague many Least Developed Countries (LDCs). Despite debt relief that was given to highly indebted poor countries in 2005. Debt remains an important source of additional capital for a country's development needs, especially when government revenues are insufficient. Budget deficits and capital investment require debt to finance them, but importantly debt should be used wisely. Well utilised debt brings about significant results in provision of government services and leads to better lives for people. However, when mismanaged, debt tends to be inflationary, may lead to rising interest rates and the worst-case scenario would be a crisis in which the country fails to pay back debt.

The United Nations General Assembly in 2015, composed 17 goals known as Sustainable Development Goals (SDGs) whose aim were to reduce poverty and ensure a sustainable future for all by the year 2030. However, considerable dependence on external financing of LDCs to meet these goals remains a paradox; while debt is supposed to be a panacea and improve economic growth and social capital expenditure, it has dark sides of impeding LDCs from attaining the very goals they would want to achieve.

The common drive for increased public borrowing in LDCs' has been an infrastructural development agenda, to some extent poverty relief as well as emergency and disaster relief. In years past, LDCs mostly borrowed concessionally from multilateral and bilateral financiers like the World Bank, the International Monetary Fund (IMF) and donors. However, these funds were perceived to have stringent conditions and were thought of as limiting and deterring LDCs from achieving their ambitious structural programmes. In recent times therefore, starting around 2010, there has been a sharp shift to non-concessional borrowing with particular interest in loans from private commercial bond markets, with an allure that these loans have no rules or conditions.

Two countries in the low-income country's category - Zambia and Mozambique - fraught with low socio-economic development, low levels of GDP per capita, shortage of capital, low levels of productivity, high levels of poverty and vulnerability to economic shocks, present interesting cases of how they have dealt with their freedom to acquire external public debt from commercial markets.

Zambia's public debt has become a hot issue and a main concern for citizens and investors. Despite the huge external debt, the external debt ceiling was increased by over 100% to ZMW 160 billion in 2016. Further, Zambia escalated its domestic borrowings from government securities in 2016 to cover for shortfalls between expenditure and revenues because of low revenues collected. The budget deficit burgeoned, and capital investment has been non-stop, leading to an upswing in inflation and high interest rates. In 2017, the joint IMF/World Bank debt sustainability assessment (DSA) labelled Zambia at high risk of debt distress, following the soar in external debt and public debt servicing burdens.

Mozambique on the other hand, already announced that it could not service its US$2 billion Eurobond in 2016 and sought ways to restructure the debt instead. Negotiations with its creditors on the debt restructuring terms are still underway.

This default, coupled with the IMF's decision to halt its loan programme after discovering the hidden debt, led to Mozambique's debt distress. Ostensibly, there exists a relationship between exchange rates and external debt servicing costs. In this regard, the instability of currencies in most LDCs has increased the cost of external debt servicing.

What is interesting though, is that less than 15 years ago, both Zambia and Mozambique's debts were written off with the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) and they remained with minimal external debt. Despite these write-offs, the countries are back to experiencing high external debt burdens which have brushed off and are leading the countries to experiencing some fundamental economic and social difficulties. The challenges threaten to reverse gains already made in economic growth and poverty reduction and hinder future progress because larger proportions of resources mobilised are being allocated to debt servicing.

Zambia has issued three Eurobonds between 2012 and 2015 totalling US$3 billion. Presently, its total public debt levels have escalated to over US$19 billion, estimated at 76% of GDP, way above the IMFs recommended sustainability threshold. Total public debt owed by Mozambique to other countries rose from US$6.1 billion to US$15 billion between 2012 and 2018, which caused the debt-to GDP ratio to increase to a high of 130% in 2016. Mozambique, in that year, admitted to secretly issuing bonds worth more than US$ 1 billion back in 2013. Currently, its total external debt has risen to US$14 billion, and its debt-to-GDP ratio stands at 107%.

Seeing that debt is meant to be a solution to many challenges of LDCs other than the burden that it has become, this paper asks some pertinent questions that include (i) how and why did Zambia and Mozambique become highly indebted? (ii) what are the major drivers of the burgeoning debt, are there similar reasons or are there discrepancies? (iii) with Mozambique in default and undertaking restructuring, what lessons are there for Zambia and other LDCs?

The study analysed both quantitative and qualitative data. Desk analysis of the World Bank's International debt statistics, fiscal tables obtained from the Ministries of Finance and other secondary data within relevant scope were reviewd. Quantitative analyses also included extensive literature reviews of works previously undertaken on the countries.

The paper deliberated possible alternative debt refinancing remedies that could be used to avoid default within pursued sustainable development agenda. It analysed debt restructuring options that could be used in the undesirable event of a default.

Several options could be considered before the Eurobond maturity if the Zambian Government wants to avoid a default:

a) **Bond buyback**: A bond buyback allows the Zambian Government to pay for the principal at the current market value of the Eurobond which is only around US$500 million. To avoid default or refinancing the Eurobond, the Government could start buying back the Eurobond before redemption because of its lost value. But with no sufficient sources of financing for this option, the Government would need to raise funds for a buyback. Options for this are limited but include utilizing proceeds from the IMF bailout package or setting funds aside for the buy.

b) **Refinancing:** The Zambian Government can seek to change the terms of the 2022 Eurobond before maturity, including extension of the loan duration so that it does not have to be redeemed in September 2022. Revising the interest rates or changing the value of the bond are all variables that could be negotiated on. Using Lazard Freres, the Government needs to establish who holds the country's bonds and understand their priorities before entering any negotiations.

c) **Rolling over**: upon maturity in September 2022, the Government would aim to issue another Eurobond, with a total value of US$750 million betting on the possibility of finding new buyers for a new Eurobond. The money raised could be used to pay the holders of the current Eurobond. However, given the low credit rating and the current debt sustainability levels, it would be a challenge to find buyers of a new Eurobond at maturity. This is not an option that the Government should be considering. At worst, it is unfeasible; at best it is extremely expensive.

Furthermore, the paper imparts the international community with initiatives and recommendations in areas of LDC fiscal policy that could help address looming debt crises of LDCs and propose means to advance attainment of the SDGs.

a) Both the Zambian and Mozambican Governments require to find that critical balance between fiscal consolidation efforts and the need to overcome the deficit in infrastructure.

b) If Mozambique is to maximize the liquified natural gas resource boom and Zambia the copper boom, the authorities will have to manage macro-fiscal risks adequately.

ACRONYMS

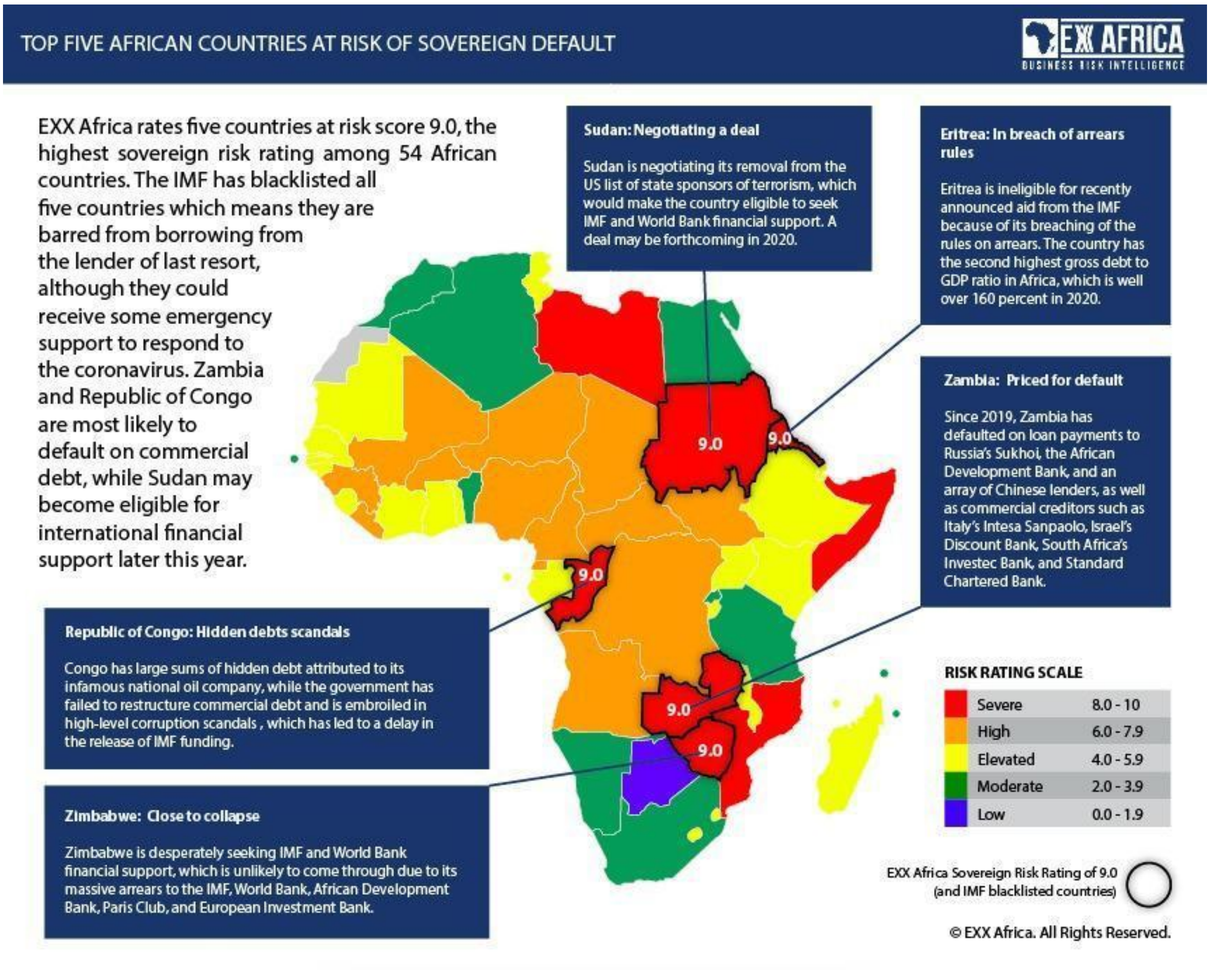
AFDB	African Development Bank
DSA	Debt Sustainability Analysis
CPIA	Country Policy and Institutional Assessment
GDP	Gross Domestic Product
GNI	Gross National Income
GRC	Governance Related Conditionalities
HIPC	Highly Indebted Poor Countries
IFIs	International Financial Institutions
IMF	International Monetary Fund
MDB	Multilateral Development Banks
MDRI	Multilateral Debt Relief Initiative
MTDS	Medium-Term Debt Management Strategy
LDCs	Least Developed Countries
SDGs	Sustainable Development Goals

1. INTRODUCTION

Public debt continues to plague many least developed countries (LDCs) in 2020, despite the debt relief given to heavily indebted poor countries (HIPC) starting from 1996. The HIPC initiative by the World Bank, the International Monetary Fund (IMF) and other multilateral, bilateral and commercial creditors[1], saw many LDC's forgiven of their external debts.

A decade down the line, risks of debt default for most of the African LDC's stand from elevated to severe. EXX Africa shows sovereign risk ratings of African countries in 2020 in Figure 1.1. In the wake of the Corona Virus Disease 19 (COVID-19) pandemic, public debt is on the verge of ravaging the economic gains made by many of these economies to the worst levels yet to be seen.

Figure 1-1: Public Debt Risk Rating and Risk Scores for African Countries, 2020



Source: https://exxafrica.com/

Two countries in the low-income country's category - Zambia and Mozambique - fraught with insufficient socio-economic development, low levels of Gross Domestic Product (GDP) per capita, shortage of capital, inadequate levels of productivity,

[1] https://www.worldbank.org/en/topic/debt/brief/hipc accessed on 15 May 2020.

high levels of poverty and vulnerability to economic shocks, present interesting cases of how they have dealt with their freedom to acquire external public debt from commercial markets, which demonstratively has come to haunt them.

Since 2019, Zambia has defaulted on several debt repayments[2] after contracting debt at a rather fast rate. Zambia's debt was recorded as the fourth fastest growing load in Africa with a percentage change of 271.3% between 2010 and 2016. On the other hand, Mozambique has the fourth highest debt to GDP ratio of 112% in Africa[3] and in May 2016 there were disclosures of "hidden debt," and by public disclosure the country has been in official debt default since February 2017[4].

Both Zambia's and Mozambique's debts were written off with the HIPC initiative and the Multilateral Debt Relief Initiative (MDRI) and remained with minimal external debt. Notwithstanding the write-offs, the two countries are experiencing high external debt burdens, relegating the gains of sustainable debt made during the HIPC initiative. So, while external debt levels were reduced, the root causes to the debt problem had not been adequately dealt with.

Inopportunely, the high debt levels driven by high fiscal deficits, are being experienced at a time when the countries are experiencing some fundamental economic and social difficulties, likely to be made even worse by COVID - 19. Zambia for instance, has had significant macroeconomic challenges reflected in low growth (2% of GDP in 2019), rising inflation and debt service obligations as well as low international reserves[5]. This was not different for Mozambique where growth was all time low of 1.9% of GDP in 2019 on account of the negative impacts of the cyclones and a fairly high fiscal deficit of 6.4% of GDP in the same year[6].

In addition, both these countries have faced increased risks derived from the changing composition of the public and publicly guaranteed debt. Zambia and Mozambique issued sovereign bonds in the international capital markets and have been contracting non-concessional debt from external private and public sources.

These economic and social challenges may be made worse by the COVID-19 health pandemic and threaten to reverse gains already made in economic growth and poverty reduction. Additionally, they may hinder future developmental progress because larger proportions of resources mobilised are being allocated to debt servicing. For instance, in 2020 both Zambia and Mozambique recorded contracted growth at 2.4% and 1.9% respectively.

Given that the United Nations General Assembly in 2015, composed 17 goals known as Sustainable Development Goals (SDGs) whose aim are to reduce poverty and ensure a sustainable future for all by the year 2030, the desired outcomes may be insurmountable. Without sufficient collection of domestic revenues and considerable dependence on external financing by these countries to meet these goals, Zambia and Mozambique are likely to face an uphill battle in achieving the SDG's.

[2] https://exxafrica.com/
[3] IMF (2018, March) Retrieved from https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf
[4] https://www.afdb.org/en/countries/southern-africa/mozambique/mozambique-economic-outlook
[5] The Bank of Zambia (2020) "The K10 Billion Stimulus Package – Frequently Asked Questions.
[6] https://www.afdb.org/en/countries/southern-africa/mozambique/mozambique-economic-outlook

The irony for both countries is that while debt is supposed to be a panacea and help improve economic growth and social capital expenditure, external commercial debt has revealed its dark sides working to impede Zambia and Mozambique's prospects of attaining the very goals they would want to achieve.

Remarkably, Zambia and Mozambique are not the only countries facing this fate. The World Bank shows that in two-quarters of HIPC countries, public debt as a percentage of GDP increased by at least 50%, in less than 10-years after these countries benefitted from debt relief[7]. But for the purposes of this paper, keen interest is taken in understanding what was behind the nonchalant approach to the effects of unsustainable debt in the two countries.

RESEARCH QUESTIONS

Seeing that debt is meant to be a solution to the many challenges of LDCs other than the burden that it has become, this paper asks some pertinent questions that include:

i. How and why did Zambia and Mozambique become highly indebted after debt relief?
ii. What are the major drivers of seeking external private debt as compared to traditional multilateral and bilateral debt, are there similar reasons or are there discrepancies?
iii. What are the likely impacts of high debt on the countries achieving the 17 goals in the SDGs? And what lessons for other LDCs?
iv. What debt refinancing options are there for LDC's borrowing from external private sources and what initiatives can the international community undertake to avoid a looming debt crisis in LDCs?

METHODOLOGY

The study employs a mix of quantitative and qualitative research approaches. Desk reviews of research works previously undertaken on the two countries and literature related to Zambia's and Mozambique's debt situations are undertaken. Analysis of the World Bank's International debt statistics and fiscal tables obtained from the Ministries of Finance and other secondary data within relevant scope are also undertaken to establish sources of the debt, quanta of debt, and current sustainability levels.

Triangulating this information, the paper establishes the likely impacts of debt on the two countries, the would-be solutions or debt restructuring options that could be used, and the lessons for other LDCs. Additionally, the paper imparts the international community with some initiatives and recommendations in areas of LDC fiscal policy that could help address looming debt crises of LDCs and propose means to advance attainment of the SDGs.

[7] https://blogs.worldbank.org/africacan/how-much-should-sub-saharan-african-countries-adjust-curb-increase-public-debt

2 HEAVILY INDEBTED! AGAIN!

In low income-countries, as the name entails, debt remains an important source of additional capital for these country's development needs. High budget deficits have shown that government revenues are insufficient to ordinarily meet budget needs. With their budget deficits hovering above 5% of GDP in the recent past, Zambia and Mozambique's debt financing needs have increased.

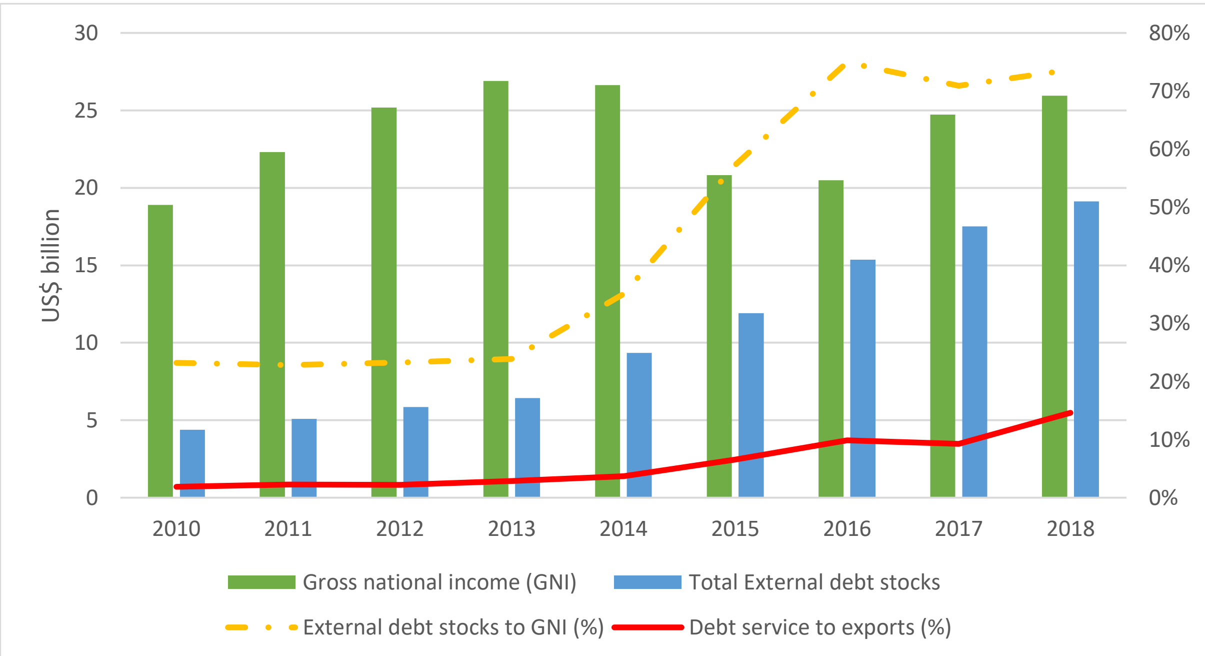
[redacted] ZAMBIA: PRICED FOR DEFAULT

Zambia targets to become a middle-income prosperous nation by 2030. In the country's attempt to diversify, industrialise and modernise its economy, Zambia needs a lot more capital and technology to facilitate economic growth, undertake structural transformation and improve human development to get on a path of economic development. Capital has not only come from the domestic revenues raised within the economy, but extra resources also had to be borrowed.

Several public investment programmes have been front loaded, with the belief that they could substantially raise economy-wide output and consumption and raise their own capital in the long run. Although these public investment programmes are good for the economy, they have not been without cost. Zambian public debt has increased at an alarming rate within a short space of time.

External public debt escalated from US$ 4.3 billion in 2010 to US$ 19.12 billion in 2018 as shown in Figure 2-1, standing at triple and exceeding the amount of US$ 6.3 billion forgiven during the HIPC era. The Zambian Government's efforts to reduce the country's infrastructure gap as well as bring down poverty and inequality resulted in large spending overruns and a substantial public sector wage bill from 2013. However, fiscal indiscipline played a cardinal role in burgeoning the debt.

Figure 2-1: Zambia's Public External Debt Statistics, 2010 - 2018



Source: International Debt Statistics, 2020, The World Bank

Between 2010 and 2013, external debt remained below 30% of Gross National Income (GNI). GNI was steadily increasing and the ratio of external debt stocks to both exports and GNI were well within the sustainable range of 23% and 55% respectively. Debt service as a percentage of exports was below 3% and going by all thresholds, the country was debt sustainable. However, from 2014, total external debt stocks begun to soar and steeply and with GNI not performing as well as previously. The ratio of external debt to GNI reached as high as 74.9% in 2016 though it subsided to 73.7% in 2018 which was still very high as shown in Figure 2-1.

The increases in external debt commenced when Zambia first courted the Eurobond commercial market in 2012. With a political regime change, the new Government adopted an expansionary fiscal stance that saw the external debt stock rise by 60.6% in a space of a year on account of the issuance of the first Eurobond amounting to US $750.0 million in 2012. Debt service payments increased tenfold from US $34.14 million in 2011 to US $326.3 million in 2012.

Urgency to overcome deficient capital investment ordinarily led to the fast-paced debt contraction to undertake extra infrastructural and capital investment. For instance, the first Eurobond in Zambia was dedicated to promoting infrastructure development (energy, roads, rail, health and education infrastructure)[8]. After exploring opportunities in commercial external markets, the composition of external debt changed with the proportion of commercial debt moving from nil to 28% in 2012.

Zambia's commercial debt quickly escalated to 42% and 52% as a proportion of external debt in 2014 and 2015 respectively when the country courted the markets again for bonds of US $1 million and US $1.25. Regardless, the country's external debt was still within sustainable levels, even though external debt from commercial markets increased to US $3 million after the 3rd issue of Eurobonds in July 2015.

But the country's situation was not helped when growth prospects turned in that year and GDP dipped, growing only by 2.9%, despite high growth rates in Zambia's GNI's from 2010 to 2015. Economic headwinds were faced through an upswing in inflation and high interest rates as well as a depreciated exchange rate. In that year. the country almost experienced a double-digit budget deficit mainly driven by non-stop capital investment which had called for increased debt.

In the absence of sufficient domestic revenues, which remained low and stagnant, fiscal deficits run in succession from that year. Total government expenditure consistently outstripped revenue collections by a margin wider than anticipated from 2015, leading the country to contract more debt. Additionally, the rapid nominal and real exchange rate depreciation in 2015 also had important knock-on effects on the collection of domestic revenue. Inadequate revenues and poor copper prices meant that Zambia had to accumulate more debt to shelter the low export and revenue earnings and cover an apolitical expansionary fiscal era which had to be financed by debt.

[8] Moody's Investor Service (2013) "International Sovereign Issuance in Africa

Zambia's approach to heavy capital expenditure did not abate despite lack of sufficient domestic resources. Pushing external borrowings to about 59% of GDP by the Governments estimates as at end of 2017, a territory so close to unsustainable external debt levels. In October of that year, the joint IMF/World bank debt sustainability assessment (DSA) issued a red flag that Zambia was at high risk of debt distress. Implying that the country was likely to breach the thresholds for debt and debt service indicators and, should the country continue on the same borrowing trajectory, Zambia would likely default on its debt service obligations.

Concerns raised by the IMF were mostly related to the aggregate borrowing plans of the Zambian Government. The key message from the IMF was, given the precarious situation of high debt thresholds the country was in; the Zambian Government needed to apply some brakes and could not continue on a borrowing trajection as before. Several actions had to be undertaken by the Zambian Government including: a slow down on the contraction of new debt - especially non-concessional loans, the government needed to strengthen its debt management capacity, and improve project appraisal and selection processes.[9]. Implementing these measures would help improve fiscal governance, which stood as the weakest link on the country policy and institutional assessment (CPIA) rating of Zambia.

Despite the warnings, Zambia's total external debt stock levels escalated to over US$19 billion, estimated at 73.7% of GDP in 2018, according to the World Bank. Zambia was by then at brink of default on several its obligations as the country was stressed with all debt indicators way above the recommended debt sustainability threshold levels for medium country performers.

Table 2-1: Public External Debt Stock by source in Million US$, Zambia, 2010 - 2018

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Multilateral	**924**	**966**	**1,077**	**1,183**	**1,212**	**1,295**	**1,408**	**1,621**	**1,813**
World Bank (IDA)	430	492	565	632	667	698	760	894	1,003
Others	494	474	512	551	545	597	648	727	810
Use of IMF Credit	1,117	1,137	1,126	1,110	1,011	907	813	794	715
Bilateral	**334**	**810**	**1,197**	**1,229**	**1,424**	**1,847**	**2,310**	**2,602**	**2,872**
Export & Suppliers' Credit	**794**	**1,518**	**763**	**1,057**	**2,566**	**3,645**	**6,586**	**6,902**	**7,748**
Others	794	1,518	763	1,057	2,566	3,645	6,586	6,902	7,748
Commercial Debt	**33**	**108**	**835**	**1,063**	**2,258**	**3,441**	**3,436**	**4,657**	**5,302**
Eurobond	0	0	750	750	1,750	3,000	3,000	3,000	3,000
Others	33	108	85	313	508	441	436	1,657	2,302
Official Creditors[10]	1,257	1,776	2,274	2,412	2,635	3,142	3,718	4,223	4,685
Public & Publicly Guaranteed Debt[11]	827	1,625	1,598	2,120	4,824	7,086	10,022	11,559	13,050
Total Govt. External Debt Stock	**2,085**	**3,401**	**3,872**	**4,531**	**7,459**	**10,227**	**13,740**	**15,782**	**17,735**
Total with IMF credit	**3,202**	**4,538**	**4,998**	**5,642**	**8,470**	**11,134**	**14,553**	**16,575**	**18,449**

Source: Constructed from International Debt Statistics, 2020, The World Bank

Notably, from 2010 to 2013, the larger proportion of Zambia's external debt was concessional from multilateral creditors including the World Bank, the African Development Bank (AFDB) and the IMF. The proportion of concessional debt was

[9] IMF (2017) *Zambia: 2017 Article IV Consultation.* Washington, DC: International Monetary Fund.
[10] Credit from Multilateral and Bilateral sources.
[11] Credit from official creditors and comm1q1ercial debt.

larger than half the external debt and as a result debt servicing for the country was not as painful as these loans have little or no interest rates.

From 2014, commercial debt became the principal financing mechanism of external debt. Aside the issuance of the Eurobonds in 2012, 2014 and 2015, the importance of other sources such as export and supplier guarantee and the increase in the Chinese debt footprint has played a significant role in driving the share of commercial debt. With less concessional and more commercial debt, interest costs increased tremendously.

[redacted] HOW DID ZAMBIA GET THERE?

Zambia's burgeoned public external debt is a hot issue and a main concern for citizens and investors. Nonetheless, the factors behind Zambia's debt increase vary and span economic, legal and political reasons. Additionally, trouble has been in the choice of investment which has been a setback, with no balance between social and economic investment and without considering prudent costs or projects with the highest rates of return.

2.2.1 ECONOMIC PUSH

Reclassification of Zambia as a lower middle-income country in 2011 subsequently reduced the country's access to traditional concessional borrowing from multilateral and bilateral partners. As a consequence, the Zambian Government expanded its sources of external financing into the international capital markets with commercial borrowing taking a prominent share.

With Zambia vulnerable to changes in copper commodity prices, the high degree of instability in the copper price during 2014 - 2015 paused a threat to the country's economic prospects. The mono economic structure of depending on copper export earnings at approximately 70% of all exports meant that in that period of low copper prices there are less foreign exchange earnings. External debt became a panacea to obtain forex and undertake foreign payments.

2.2.2 INSTITUTIONAL AND LEGAL INADEQUACIES

Primarily, inadequate institutional and legal frameworks to manage the debt landscape played a key role. Zambia's debt institutional management framework deviates from internationally accepted best practices and the absence of the provision of a medium-term debt management strategy (MTDS) in the legal framework underestimates the fact that the Government manages a huge foreign exchange reserve portfolio, which is subject to real and monetary shocks.

The absence of laws to prescribe instruments that should be used to manage and handle public debt risks such as the MTDS made it relatively easy to contract external debt, as there was no robust debt management strategy to have quantified, in detail, the costs and risks of alternative debt strategies and provide a better understanding of debt opportunities and challenges ahead.

2.2.3 EXPANSIONARY FISCAL POLICY

Zambia's fiscal policy took an expansionary trajectory with the change of Government in September 2011. Since that time fiscal policy has been largely and directly intertwined with politics. With the new government bent on undertaking redistribution across individuals, regions and generations: the core of political conflict was introduced into the country's fiscal policy and fertilised the ground for an expansionary capital expenditure programme. Nonetheless, during the period domestic revenues were insufficient for the aspirations and the Government resorted to massive external borrowing to finance arguably unsustainable expenditure[12].

2.2.4 INFRASTRUCTURE DEVELOPMENT PROGRAMMES

Lack of infrastructure has remained a major challenge for least developed countries growth, economic diversification, and human development. Critical areas for Zambia's infrastructure development include investment in health, education, water and sanitation, power generation capacity through upgrading and construction of new generation facilities as well as alternative energy sources, improving and expanding the rail network and constructing additional inter-provincial and inter-district roads to open up the country through the Link Zambia 8000 project. Moreover, the housing shortage in Zambia is estimated at 1.5 million housing units, and to clear the backlog,110,000 units will need to be constructed per year for the next ten years.

To change the transport infrastructure outlook, Zambia has been implementing the Link Zambia 8000 project, seeking to transform the country from land-locked to land-linked. The project involves paving 8,201 km of road at an estimated cost of $5.6 billion. However, the project has not come cheap and has required the Zambian Government to expand collection of tolls on major roads to fund road maintenance and broaden financing options for road infrastructure development. Among such projects, the Pave Zambia 2000 program, aimed at rehabilitation of 2000 km of urban roads and the L400 project, constructing or rehabilitating 400 km of Lusaka urban roads at a cost of $348 million[13].

While debt contraction was undertaken at much higher levels in former years a comparison between 2017 and 2020 shows that there has clearly been a reduction in debt contraction in Zambia.

Table 2-2: Loans Contracted by the Zambian Government in 2017 and 2020

Lending Institution	Loan Description	Loan Amount (US$)	Lending Institution	Loan Description	Loan Amount (US$)
Standard Chartered Bank	Placement Agreement	134,000,000			
IDA	Eastern-Southern Higher Education	8,700,000	IDA	Africa CDC Regional Investment	94,918,540.20

[12] Banda-Muleya & Nalishebo (2018) "Reversing Zambia's High Risk of Debt Distress" - ZIPAR
[13] https://www.trade.gov/country-commercial-guides/zambia-infrastructure-development

IDA	Mining Environment Improvement	47,800,000	IDA	Girls Education and Women's Empowerment Project	148,869,199.94
IDA	Agribusiness and Trade Project	29,200,000	IDA	Irrigation Development and Support Project (IDSP)	30,000,000.00
Startimes	Terrestial Television System (15%)	41,000,000.00	IDA	Zambia COVID-19 Emergency Response and Health Systems	20,100,000.00
IFAD	Enhanced Agribusiness Programme	15,500,000.00	African Development Bank	Nacala Road Corridor Phase IV Supplementary Financing	12,623,588.84
Citi Bank UK Branch	Safe City Project	78,600,000.00	African Development Bank	Capacity Enhancement Project	11,540,248.06
INDU Com Bank Chin	Ndola Airport (15%)	59,580,194.00	African Development Bank	Sustainable Livestock Enhancement and Management project	10,818,982.55
EXIM KOREA	Public Safety Information System	41,532,000.00			
EXIM INDIA	Traffic Decongestion Project	245,740,000.00			
EXIM CHINA	Communication Tower	280,764,601.55			
Israel Discount Bank	Defence Project	400,000,000.00			
UBA	Supply and Delivery of 80,000 Mt of Fertiliser	84,784,497.00			
Investec Bank	Maina Soko Hospital Upgrade	165,406,758.60			
Bank HAPOLIM B.M	Defence Project	55,636,397.00			
Standard Chartered Bank	Lusaka Traffic Decongestion 15%	44,900,000.00			
BADEA	Cancer Treatment Centre	10,000,000.00			
Israel Discount Bank	Defence Project	7,705,000.00			
Total		**1,750,849,448.15**			**328,870,559.59**

Source: Constructed from International Debt Statistics, 2020, The World Bank

In 2017, the Zambian Government contracted eighteen (18) new loans amounting to US$1.75 billion compared to twenty-six (26) loans amounting to US$ 3.09 billion in 2016. The loans contracted in the year were used to support the development of key sectors such as health, education, transport, infrastructure, agriculture, security and information and communication technology as shown in Table 2-2[14].

[14] (Ministry of Finance, 2018)

Though purported that the loans were for infrastructure development, a large share of the loans were utilised in other means including US $463 million in defence projects and US $297 million utilised in expenses for budgetary support. To a large extent therefore, concerns about the loan utilisation were raised as some loans were being channelled into non-productive sectors with little or no capacity to generate returns.

Three years down the line, with the stark realities of the burgeoned debt, the Zambian Government in 2020 reduced the number of loans contracted to seven (7). Additionally, loans were obtained from concessional sources amounting to US $328.87 million compared to US $1.4 billion contracted in 2019[15]. The loans were contracted largely to finance the completion of on-going infrastructure projects, response interventions to infectious diseases such as the COVID-19 Pandemic and support to sustainable livestock development as shown in Table 2-2.

These combined factors put together have left Zambia in debt distress. In November 2020, the country skipped its scheduled Eurobond coupon payment of US$ 42.5 and similarly missed a $56.1 million coupon on its Eurobond maturing in 2027. Zambia was the first country to default on its debt obligations during the COVID era.

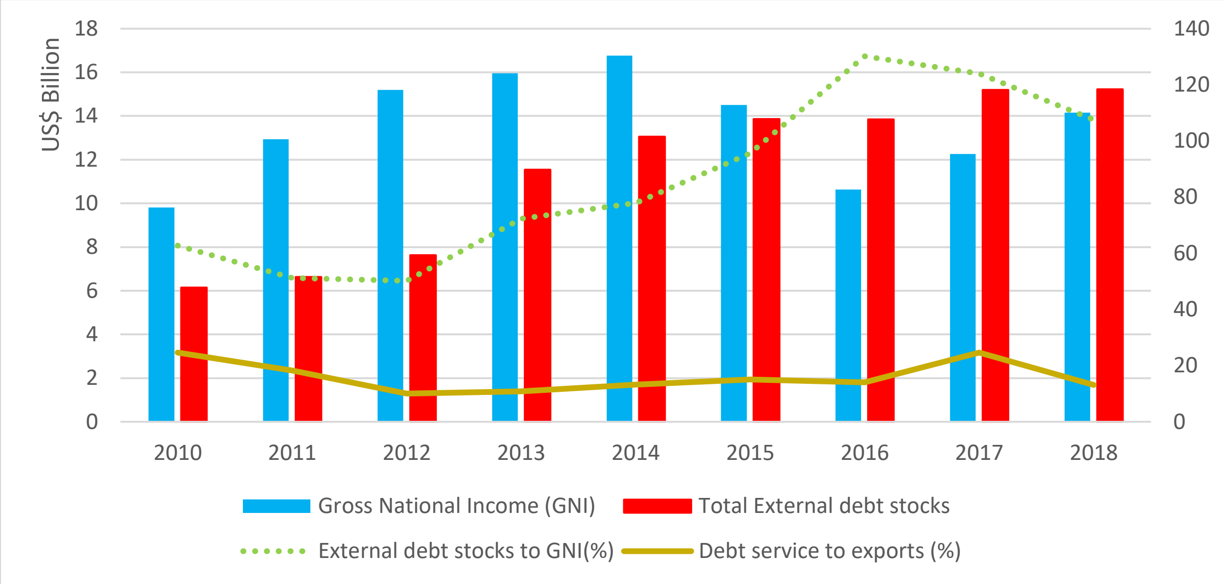
[redacted] MOZAMBIQUE: IN DEFAULT

Like Zambia, Mozambique received debt relief under the HIPC initiative albeit in 1999. Mozambique's national economy depends on a small number of primary products for exports whose markets are volatile to product substitution. Additionally, the country is highly import dependent and this makes the country vulnerable when exposed to international financial markets. Likewise, indebtedness results from the dynamic of import dependence and consolidates it. Especially that the value of exports contracted in recent years, due to the fall in commodity prices of primary products.

Mozambican public debt grew quite exponentially driven by more difficult to negotiate, more expensive and shorter-term commercial debt. The bulk of the debt was used for weaponry and other large scale investment projects whose returns were not immediate and could not generate capacity to service the debt in the short or medium term.

[15] (Ministry of Finance, 2021)

Figure 2-2: Mozambique's Public External Debt Statistics, 2010 - 2018



Source: Constructed from International Debt Statistics, 2020, The World Bank

Mozambique's total external debt grew from US$ 6.1 billion in 2010 to $15.2 billion in 2018, according to the World Bank's international debt statistics. Peculiar to Mozambique was that this debt was larger than its GNI in 2018 and increased by a near to 30% jump in two years.

The period from 2010 to 2015 saw an increase in the Debt to GNI ratio. Though the ratio dissipated in 2011 to 51.2% from 62% in 2010 due to a fast growth in the GNI, the ratio quickly increased to 72.3% in 2013 and 95.6% of GNI in 2015 and fast breached the debt to GDP threshold set by SADC of 60%. As shown in the figure below, the debt to GNI ratio rose from 62% in 2010 to about 107.6% in 2015.

M,During the period under review, the country guaranteed controversial loans contracted in 2013 and 2014 by state owned enterprises (SOEs). Proindicus obtained US$ 622 million, Mozambique Asset Management got US$ 535 million and the Ministry of the Interior or Empresa Macambicana de Atum contracted US$ 221 million), all on commercial terms. Loan contraction was secretly undertaken without the knowledge of parliament despite Article 179 of the Mozambican Constitution requiring that the legislature be consulted on sovereign debt guarantees.

Additionally, through investment banks Credit Suisse and VTB Capital, loan participation notes worth US$ 850 million akin to an unlisted bond were organised for Ematum for the purpose of acquiring tuna fish fleet, maritime security and other supplies. Twenty-four (24) trawlers, three patrollers and three interceptors which were designed to be armed with 20mm cannon and 12.7mm machine gun were also to be purchased[16]. The tuna bonds concept had been a pretext for defense expenditure. Loan channels prescribed by the laws were not followed

[16] Bokosi F.K and Chikova Rangarirai (2017) Bond Issuance and the Current Debt Crisis in Mozambique. AFRODAD

despite the Government guaranteeing the debts on behalf of the state-owned enterprises.

Table 2-3: Mozambique: Debt, Public and Publicly Guaranteed Percent of GDP, 2014 - 2018

	2013	2014	2015	2016	2017	2018
Public Sector debt	**53.1**	**64.3**	**87.4**	**126.9**	**106.6**	**110.0**
Public sector external debt (incl. guarantees)	**47.0**	**58.1**	**76.6**	**104.3**	**87.4**	**92.4**
A. Bank of Mozambique - IMF	1.1	1.1	1.8	2.0	1.3	1.1
B. General Government	36.3	47.5	63.6	89.4	72.8	75.0
Multilateral creditors excluding IMF	21.1	19.9	26.2	35.9	29.5	30.0
Bilateral creditors	15.2	19.9	28.6	39.0	32.3	33.1
Paris Club	2.6	3.1	4.7	7.1	7.1	8.1
Banks	0	3.0	3.0	6.9	5.1	5.0
Ematum/Mozam Eurobond	0	3.0	3.0	6.9	5.1	5.0
Others public sector ENH (LNG project)	0	4.6	5.7	7.6	5.9	7.0
C. Government guaranteed external debt		9.5	11.2	11.2	8.3	8.1
Ematum	9.5	2.1	2.5	0.0	0.0	0.0
Proindicus	5.3	3.8	4.5	5.7	4.2	4.1
MAM	3.9	3.2	3.9	5.1	3.8	3.7
Other guarantees	0.0	0.4	0.4	0.4	0.3	0.2
D. External Arrears	0.3	0.0	0.0	1.7	5.0	8.2

Source: Adapted from Mozambique Joint World Bank IMF Debt Sustainability Analysis, 2020

External debt owed by Mozambique to other countries rose from US $6.1 billion to US$15.2 billion between 2010 and 2015, which caused the debt service to exports ratio to increase way above the 5% threshold set for developing countries. The ratio was as high as 24.7% in 2010 but subsided to 10% in 2012.

Mozambique, in 2016, admitted to guaranteeing issued bonds secretly, bonds worth more than US$ 2 billion back in 2013. The external debt to GDP ratio immediately soared to 104.3 % from 76.6% of GDP. As at 2018, the total external debt to GDP stood at 92.4% after parliament declined to back the loans that were guaranteed without their knowledge. For a low performer country by the CPIA, like Mozambique, a debt to GDP ratio of above 60% signals a debt crisis and resulted in Mozambique being declared in debt distress.

Two years after the unveiling of the hidden debts, the Mozambican debt portfolio remained dominated by multilateral and bilateral loans as shown by the joint DSA of the World Bank and the IMF[17]. However, the trend towards issuance and guaranteeing of commercial loans upsurged, impacting on the composition and structure of the country's external debt stock and affected the sustainability of the debt and the general social and economic development of the country.

Despite the low share of sovereign bonds in the government's portfolio the increase in commercial debt, affected the country as the trend was in contrast with Mozambique's borrowing strategy and negotiation which states that multilateral loans should be prioritized over bilateral ones. The increase in the share of bilateral loans was attributed to the suspension of loans by the World Bank and IMF which resulted in bilateral loans increasing by 17% between 2010 and 2014.

[17] International Development Association and IMF (June 2019)

Mozambique already announced that it could not service its US$2 billion Eurobond in 2016 and sought ways to restructure the debt instead. This default, coupled with the IMF's decision to halt its loan programme after discovering the hidden debt, led to Mozambique's debt distress. Since part of the loans were diverted, the fishing companies made losses resulting in them failing to repay.

Mozambique is restructuring a Eurobond it sold in March 2016 and on which it has $727 million outstanding. That bond was the result of a restructuring of an $850 million facility, issued by state-run tuna-fishing company Ematum in 2013. Those notes - dubbed "tuna bonds" - were supposed to finance a tuna fleet and fishing infrastructure, but much of the cash was later designated for maritime security and reallocated to the defence budget.

The tuna notes were restructured in spring 2016 into an English-law sovereign Eurobond maturing in 2023. Within weeks Mozambique's hidden lending emerged, international lenders pulled out and Maputo faced another default which the government is trying to cure in the latest restructuring. As part of the overhaul, Mozambique proposes to issue $900 million of new, amortizing sovereign bonds maturing in 2031. The bonds come with an interest rate of 5% up to September 2023 and 9% thereafter until maturity. The proposal also includes up to $40 million in cash payments.

Mozambique's debt remains in distress in 2020. Future borrowings and government guarantee's reflect state participation in the sizable liquified natural gas (LNG) development[18]. According to the joint taskforce, debt is deemed sustainable in a forward-looking sense. The authorities are pursuing a strategy to bring public debt to moderate risk of distress levels. The stock of public and publicly guarantee debt, including domestic debt, reached about 110.5% of GDP at end-2018 while external debt stood at 92.4% of GDP.

The stock of arrears on public and publicly guaranteed external debt reached about US$1.2 billion at end-2018. The authorities are in good-faith discussions with private creditors to restructure Mozambique's Eurobond and previously hidden loans. The agreements being negotiated with creditors are designed to protect the interests of the country if future developments call into question the legality of the contracting of the loans or the issuance of the government guarantees.

[redacted] WHAT CAUSED MOZAMBIQUE'S DEFAULT?

Mozambique has been in debt distress with debt-to-GDP projected to surge in 2021 due to the balance sheet effect of currency depreciation and falling GDP resulting from the impacts of COVID-19. However, the effects of natural disasters, insurgencies, lack of debt management and transparency, have all be crucial in the absence of debt sustainability.

2.4.1 ROLE OF NATURAL DISASTERS AND INSURGENCIES

Mozambique is the 3rd amenable country to natural disasters in sub–Saharan Africa (World Risk Index, 2016) on account of the country's geographic location and

[18] Joint World Bank and IMF Debt Sustainability Analysis (April 2020)

topography. Natural disasters have been associated with a marked slowdown in the country's growth, even though they have been found to broadly have a muted impact on the fiscal balance. Effects will nonetheless occur with lags (associated with revenue or reconstruction) and tend to be obscured by expenditure switching and are often offset by external budget support. The relatively high vulnerability of Mozambique to hydro-meteorological disasters resulted in a cumulative economic loss of 16 percent of GDP over the period 1990-2016[19].

Additionally, Mozambique has been dealing with growing insurgencies and military expenditure. The off-budget military spending that had been revealed in 2016 had been part of a series of secret government loans from 2013 on. The loans were provided to three companies, Ematum, Mozambique Asset Management (MAM) and Proindicus, all of which are partly owned by the Servico de Informaçãos e Segurança do Estado (SISE), Mozambique's security services.

Of these off-budget sums, $500 million had reportedly been earmarked for patrol aircraft, boats and radars. Another $200 million was to pay commissions for individuals facilitating those deals. The $500 million alone would more than double Mozambique's military expenditure between 2013 and 2016. More so, since a jihadist insurgency emerged in Cabo Delgado province in October 2017, with more than 3000 civilians killed and 700,000 internally displaced, there continues to be pressure to deal with the challenge.

2.4.2 LIMITED CONTROL ON SOES

As previously mentioned SOEs' debt and their guarantees by the Government were at the heart of the 2016 debt crisis, showing that a lack of clear procedure on credit operations within SOEs remains key to addressing debt vulnerabilities. In recent years though, the Mozambiquan government has made significant progress in fiscal and debt management, and arrears clearance[20].

Primary and secondary legislation was passed on debt and guarantees management, for SOEs and public investment management. More recently, the Government has been working towards credit risk assessment methodologies to better support financial operations by SOEs and a manual to guide macro-fiscal projections was approved. In addition, the government continues to prepare financial risk statements in line with the budget cycle.

2.4.3 REAL EXCHANGE DEPRECIATION

Ostensibly, there exists a relationship between exchange rates and external debt servicing costs. In particular, the share of foreign-currency-denominated debt has increased by 12 percentage points since 2013 and representing in 2018, 36% of GDP in most SSA countries. This exposes some SSA countries to the risk of a

[19] https://www.elibrary.imf.org/view/journals/002/2018/066/article-A005-en.xml

[20] https://reliefweb.int/sites/reliefweb.int/files/resources/Mozambique-Economic-Update-Setting-the-Stage-for-Recovery.pdf

sudden stop of capital outflows generally observed in Emerging Markets economies[21].

The Mozambique Metical has been on a depreciation trajectory while the economy has not been growing at the anticipated levels. Thus, debt levels are projected to grow to 120% of GDP in 2020 largely reflecting the depreciation of the metical/USD nominal exchange rate and contraction in GDP. After falling steadily to 108% of GDP in 2019 from 127% of GDP in 2016 the debt ratios are anticipated to rise mainly on account of borrowing related to the participation of the Government in LNG projects and the subsequent rise in external debt from 89% in 2019 to 103% of GDP in 2020.

External and total public debt are projected at around 94% and 111% of GDP in 2020, respectively. Debt service levels remain substantially high. Initial projections indicate that external and public debt service to-revenue ratios could reached 13% and 48%, respectively, by the end of 2020.

Following progress in resolving the MOZAM bond default, the authorities are seeking to challenge the Proindicus undisclosed loan, seeking cancelation of the related debt and compensation for damages and losses. The authorities concluded negotiations with bondholders on the US$ 727 million MOZAM 2023 in 2019, resulting in a swap to a US$ 900 million bond. Under the agreement, the maturity was extended from 2023 to 2031, while the annual coupon rate was reduced from 10.5% to 5% until 2023 and 9% from 2023 onwards.

2.4.4 INFRASTRUCTURE GAPS

Mozambique still faces critical infrastructure challenges. Conceivably, the most conspicuous lies in the transport sector. Transport corridors are mostly functional in providing regional connectivity. Connection to mining and key production centers to ports as available but Mozambique's connectivity among urban and economic clusters is quite limited, lacking linkages that connect parallel corridors to each other. Apart from the recently finalised north-south National Road N1, the country has no (or has very limited) connection among the several west-east corridors and developing full connectivity would require sustained and enormous investments over decades, with the likely participation of the private sector and non-traditional financiers.

Additionally, rural population accessibility to domestic (and eventually international) markets is an enormous challenge, and lags behind what is observed in the region. Finally, maintaining the rapidly expanding road and rail network is an enormous hurdle to overcome, institutionally and financially, as the size of the network seems to overshadow the capacity of the country to provide funds for its maintenance.

Even though Mozambique spent an annual average of about $664 million on infrastructure during the late 2000s, equivalent to about 10% of its GDP and a relatively high share compared with other African countries, the expenditure is still

[21] https://blogs.worldbank.org/africacan/how-much-should-sub-saharan-african-countries-adjust-curb-increase-public-debt

only about half of the share of the estimated needs required. Around two-thirds of total infrastructure spending is investment. Transport absorbs the largest share of that spending and water, information and communication technology (ICT) and power represents similar level of spending. The public sector (through taxes and user fees) and official development assistance are the largest source of investment, followed distantly by private funds.

Assessing spending needs against existing spending and potential efficiency gains leaves an annual funding gap of $822 million per year, or 12.5% of GDP, most of it associated with water and sanitation and power. Mozambique will likely need more than a decade to reach the illustrative infrastructure targets. Under business-as-usual assumptions for spending and efficiency, it would take over 50 years for the country to reach these goals. Yet with a combination of increased financing, improved efficiency, and cost-reducing innovations, it should be possible to reduce that time to 20 years[22].

3 ALLURE OF COMMERCIAL DEBT MARKETS

Demand for external credit in countries such as Zambia and Mozambique have arisen on account of challenges spanning graduation from obtaining concessional loans, lack of institutional and legal frameworks to manage debt but also a response to problems such as natural disasters, insurgencies and poverty. As has been shown for both Zambia and Mozambique the infrastructural development agenda has been a common drive for increased public borrowing. To some extents this has been fuelled by a programme to relieve poverty as well as ensure emergency and disaster relief.

While in years past, Zambia and Mozambique mostly borrowed concessionally from multilateral and bilateral financiers like the World Bank, the International Monetary Fund (IMF) and donors. Recent times have shown that starting around 2010, there has been a sharp shift to non-concessional borrowing with preference of bilateral loans and loans from private commercial bond markets to concessional loans, with an allure that these loans are much easier to navigate. More so the vast and ever-changing development needs create an overwhelming demand for external credit and since development is primarily funded by through external credit, the traditional sources of supply remain difficult to access or can only provide insufficient sums.

[redacted] STRINGENT CONDITIONS IN INTERNATIONAL FINANCIAL INSTITUTION

International Financial Institutions (IFIs) such as multilateral development banks (MDBs) provide governments with loans and grants for alternative uses. In exchange for the finance, the borrowing governments commit to implement reforms such as sectoral adjustment and institution-building programmes as well as to undertake public investments in human and physical capital.

[22] https://ppiaf.org/documents/3152/download

In their operations with low-income developing countries, MDBs provide loans on concessional terms that are effectively a blend of loans and grants[23]. Fundamental to the workability of the multilateral systems are governments commitment to the policy reforms and changes in government practices embodied in MDB conditionality and their monitoring and enforcement measures.

Proponents of the multilateral system such as Rodrik[24] among others, have argued that, because borrowers are also shareholders of the MDBs, the conditionality and monitoring imposed by MDBs is more politically palatable compared with the alternatives of their being imposed by another sovereign government or by private financial institutions. MDBs therefore have important advantages relative to private financial institutions and bilateral donors in the design and monitoring of reform conditions for financing in developing countries and transition economies.

Unlike access to commercial financial markets which can resort to a combination of higher risk premia, greater collateral and shorter duration agreements to address the risk of non-compliance[25], none of these alternatives are available to MDBs who bear striking resemblance to micro financing institutions.

For the IMF especially, IFI conditionalities have been viewed as a screening device which enable the creditor to discriminate between debtor countries willing to use IMF resources to invest and repay their debts and countries which are not willing[26]. The expansion of IFI conditionalities is a logical extension of their "mission-creep", expressed for instance in the widening agenda of IMF's Surveillance and Article IV consultations[27]. Nonetheless, IFIs have no alternative to conditionalities to overcome borrower incentives that lead to commitment failure and or debt rescheduling[28].

Kapur and Webb[29] in their study of governance related conditionalities (GRC) in the World Bank and IMF found a new enthusiasm on legislative and institution-building efforts on borrowers to increase accountability, transparency, the rule of law, and participation. The increased conditionalities have led to the search for new debt sources.

For instance, Zambia has been seeking to access a US $1.3 billion facility from the IMF since 2016 and the Bretton Woods Institution has consistently demanded reduced borrowing in a time when Zambia was in a hurry to undertake

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[23] Buiter W. amd Fries S (2002) What Should the Multilateral Development Banks Do? Annual World Bank Conference on Development Economics

[24] D. Rodrik (1995), "Why is there Multilateral Lending", *Annual Bank Conference on Development Economics 1995*, pp. 167-205.

[25] Kapur D. and Webb R. (2000) Governance-Related Conditionalities of the International Financial Institutions. Center for international Development – Harvard University

[26] Marchesi S and Thomas JP (1999). IMF conditionality as a Screening Device. *The Economic Journal*, vol. 109, March.

[27] IMF (1999). Summary and Timetable of macroeconomic and Structural Adjustment Policies. IMF *Policy Framework Papers*. Washington DC. December.

[28] Fafchamps M. (1996). Sovereign Debt, Structural Adjustment and Conditionality. Journal of Development Economics, 50(2): 313–335, August

[29] Kapur D. and Webb R. (2000) Governance-Related Conditionalities of the International Financial Institutions. Center for international Development – Harvard University

infrastructure projects. Zambia has thus failed to obtain the facility, yet it has desperately needed to undertake its developmental projects but has managed in the same period managed to obtain $2.25 billion with relative ease. Thus, will the absence of the response to Zambia's need, Zambia turned to different lenders and or the commercial markets.

AMENABLE BILATERAL CREDITORS

For both Mozambique and Zambia, China has become the single most important creditor in the past decade. China's relative increase in the share of Mozambique and Zambia's debt has in turn been accompanied by subdued borrowings from Paris Club lending with a reduction in composition from 15% in 2005 to only less than 3% in 2018. China has stepped in to help construct and several large infrastructure projects such as paving roadways and constructing hydroelectric projects.

Nonetheless, China's unmatched capacity to finance largescale infrastructure projects are not without risk which include new forms of dependency especially with unclear terms and conditions of the debt and familiar dangers of over-borrowing especially that there is clearly an absence of adequate rules and procedures for restructuring privately held sovereign bonds.

ACCESSIBLE INTERNATIONAL CAPITAL MARKETS

Zambia and Mozambique both courted the international commercial debt markets to obtain total commercial sovereign debt of $ 3 billion and $ 2 million respectively. Given their incredible growth rates of above 5% before contracting the debt, the respectable credit ratings The recent surge of sovereign bond issuances by African countries has clearly been driven by the absence of conditionalities and the sometimes-misguided policy adjustments but the commercial markets do encourage debt management practices and sound macroeconomic policies which positively influence access to affordable international credit markets by improving perceptions of a country's credit worthiness. The Mozambiquan SOEs found it relatively easy to obtain the loans without the consent of their Parliament.

While the changing composition of Africa's debt structure presents new opportunities for development, risks and challenges vis a vis debt sustainability and governance of future debt crises are presented. Private loans come with much higher and more volatile interest rates. For instance, Zambia's 2014 bond issuance was priced at 8.6% compared to interest of 5.3% on its inaugural bond issuance in 2012.

The spiking levels and servicing costs of sovereign debt present prospects of defaults and debt restructurings. Defaults on private debt carry much stronger penalties that defaults on concessional debt. Costs of litigation, loss of access to affordable international credit, recalcitrant creditors and coordination challenges that tend to delay and escalate the costs of the debt.

Easy access to commercial debt markets – even though costlier and riskier, have had a heavy hand to this fast-paced debt contraction. Invertedly, aided by weak fiscal and debt management systems that allowed for a lack of debt transparency to flourish. To top this LDCs but importantly debt should be used wisely. The irony is that public debt seems to be the panacea to these economic ills as

4 DEBT REFINANCING OPTIONS

Well utilised debt brings about significant results in provision of government services and leads to better lives for people. However, when mismanaged, debt tends to be inflationary, may lead to rising interest rates and the worst-case scenario would be a crisis in which the country fails to pay back debt. Eminently, no clear strategy exists for Zambia to redeem its first Eurobond due on 20th September 2022.

Efforts have been made towards instituting a redemption strategy but by just every measure, economic fundamentals in Zambia are fragile. Inflation has breached 20%. Growth is ailing and revenues have not been as buoyant as expected. Further, the depreciated Kwacha is not helping matters as the instability of currency in Zambia has increased the cost of external debt servicing by making it prohibitively more expensive to service foreign-currency denominated loans, which include the Eurobonds.

Mozambique on the other hand appears to have navigated its debt restructuring landscape with a payment extension to 2033 and a reduction in the interest rates. Thus, lessons for Zambia as it is sliding closer and closer to a sovereign debt repayment date can be learnt. While two main options for paying back the Eurobonds have been proffered to include setting up a Sinking Fund to redeem the bonds when they are due as well as refinancing, there are other options that the Zambian Government could pursue.

[redacted]BOND BUY-BACK

The Zambian Government could undertake the option of a bond buy-back known as the process of repurchasing own debt by a debtor at a price lower than the original price. The option reduces both the interest cost and the outstanding balance. Using an agent such as the Bank of Zambia or Lazard Freres, the Zambian Government would buy-back the inaugural Eurobond in the secondary market before its redemption date of September 2022. Whereas if the Zambian Government chose to redeem the Eurobond in September 2022, it would have to find the full US $750 million the option of buyback would allow purchase at the current market value of the Eurobond which is currently estimated around US$500 million.

The option to buy-back the Eurobond before redemption would rule out higher taxes and cuts in non-debt service spending as a funding option. And it would almost certainly rule out borrowing from elsewhere too, because there is no time for the Government to take the fiscal actions needed to bolster investor confidence and bring down the likely interest costs to a reasonable level. The Zambian Government could either utilise part of the funds expected from the IMF facility, or start to utilise funds saved and brought in more gradually and buying bonds as and when extra funds come in. Initially, the buyback price would likely comprise a premium above the market price to entice investors to sell. Of course, once it became clear that the Government, or its agents, were buying the Eurobond, its price would increase.

Given that the current market price is building in a high possibility of a default; buybacks would signal that default was much less probable. So, although this is likely to prove to be a cheaper option than waiting till September 2022 and paying the full price, the gains would not be as great as implied by the gap between the current market price and the face value of the Eurobond unless undertaken secretly.

Buying back the Eurobond is far from a comprehensive solution to debt sustainability but appears to be the best course of action for a government that has no alternative.

REFINANCING THE EUROBOND

Under refinancing, the Zambian Government would seek to change the terms of the 2022 Eurobond, including crucially extending its duration so that it does not have to be paid off in September 2022. Refinancing would require negotiating with the current holders of the Eurobond. The practical terms of renegotiation would dependon the relevant clauses in the bondholder agreements. The bondholders may be permitted to form a committee to represent their interests with the issuer, so-called bondholder committees. Investors will be more inclined to renegotiate the terms if they think the alternative is a default – under which scenario they will not get any money back or will get a partial refund after a lengthy legal battle.

In Mozambique, a deal to refinance the Eurobonds was made with a committee made up of 50% of bondholders and approved by 75% of bondholders. In the case of Zambia, the bondholders may have competing demands depending on when and for what price they purchased the Eurobonds. If most of the original bonds have been offloaded on to the secondary market, which means those holding them bought them for below their original value, the return on their investment, if they were to receive the full repayment value, would therefore be much higher than the current interest rate of 5.375%. Given this option, investors could therefore be open to refinancing the Eurobond if it would reduce the risk of default while guaranteeing a positive return on investment.

The Government has three variables to negotiate with: the coupon rate (5.375%), the tenor (10 years) and the value of the bond ($750m). A palatable refinancing deal for the Government would amend all three variables to relieve pressure on its finances, whilst still offering investors a positive rate of return. It would also be necessary to agree a new redemption date.

For the refinancing or debt restructuring options to be triggered, there would be need to look at the legal fine lines of the bond agreements. To minimise opposition to the refinancing option and ensure a credible process, bondholders would have to be communicated to first, rather than them hearing about it in the media as was the case with the alleged “Turkey refinancing option”. The Ministry of Finance, in response to the Turkey refinancing news, have hinted towards talking to bondholders first. This will reassure the bondholders who are presently seemingly nervous about their investments in the Zambian Eurobond market. Bondholders are usually sceptical of a refinancing proposal made by the issuer unilaterally.

[redacted] ROLLING OVER THE EUROBOND

"Rolling over" is the practice of "carrying over" a loan, wherein the borrower pays the lender an additional fee in order to extend the loan's due date. Rolling over is similar to refinancing but refinancing has a slightly different connotation – it involves taking out a loan before maturity with either better terms and/or extended payback period. Under the roll-over option, the Government would aim to issue another Eurobond upon maturity in September 2022 with a total value of US$750 million and use the money raised from the issue to pay the holders of the current Eurobond.

Fundamentally, the Zambian Government might not be able to find buyers of a new Eurobond at maturity. Mainly because Zambia's credit rating has been cut substantially by all the credit rating agencies since 2012. The downgrades preclude some investment funds from buying a new bond because they are prevented by their rules from holding bonds that have low ratings; and it will deter other investors. Additionally, it is likely to be a very expensive option for Zambia. Those investors that are prepared to purchase a new Eurobond will want a much higher yield. The 2022 bond pays a coupon of 5.375%. By comparison, the current yield on the same bond is around 17%. A new bond might not have to have a coupon rate as high as 17% because its longer maturity would mean that investors could believe the risk of default was lower.

But the coupon that would have to be paid by any new Eurobond would have to be significantly higher than 5.375% because the Government's fiscal position is very much weaker than in 2012. Debt servicing costs would therefore increase significantly, which would mean either higher taxes or a further cut in other government spending. Even if the Zambian authorities took decisive action to rein in fiscal policy, and so regained some investor confidence, the rolling-over option would always be vulnerable to factors outside their control that might, by 2022, make investors more wary of buying Zambian debt. At the moment, therefore, this is not an option that the Government should be considering. At worst, it is unfeasible; at best it is extremely expensive.

5 CONCLUSIONS AND RECOMMENDATIONS

The paper finds that the main factors behind Zambia's debt increase vary and span economic, legal, and political reasons including the graduation to a lower middle-income country, absence of legal and institutional frameworks and an expansionary political regime that did not ensure the best choice of investment which has been a setback. With no balance between social and economic investment and without considering prudent costs or projects with the highest rates of return the debt which should have been self-repaying has shown its dark sides.

Similarly, the Mozambican public debt grew quite exponentially driven by more difficult to negotiate, more expensive and shorter-term commercial debt. Since the bulk of the debt was used for weaponry and other large scale investment projects whose returns were not immediate, the debt could not generate its returns and capacity to service the debt in the short or medium term eluded the country.

After its default Mozambique has gone ahead to renegotiate new terms for some of the defaulted loans and the lessons lie in the solutions for Zambia and other LDC's. Key is that different options exist and while others are more expensive, Zambia has a basket of proposals from which to work which could help the country avoid default on the principal debt payment. The choices include bond buy-back, restructuring or refinancing the debt as was the case with Mozambique or rolling the debt over.

Nonetheless, the fiscal landscape for both countries remain with high uncertainty, while transparency and accountability have been improving with efforts towards semblance of legal debt frameworks, both Governments require to find that critical balance between fiscal consolidation efforts and the need to overcome the deficit in infrastructure. Fiscal consolidation could resume to generate the necessary fiscal space to implement COVID-19 recovery measures. But infrastructure development should not be relegated.

Thus, improvement in the fiscal balance can be driven by strengthened tax administration, including through increased tax collection on services, income, and goods. But with sight to broadening the tax base, collecting some revenues from the greenfield investments while controlling wage bill growth and improving spending efficiency. Further progress in improving debt and fiscal risk management, combined with debt restructuring, would help reduce debt vulnerabilities and enhance debt sustainability. Achieving this fiscal consolidation will require continued strengthening of medium-term fiscal planning and a framework for managing the future inflow of resources.

If Mozambique is to maximize the LNG resource boom and Zambia the copper boom, the authorities will have to manage macro-fiscal risks adequately. Both countries require medium-term fiscal frameworks that are anchored in appropriate fiscal targets and establishing well-designed stabilisation funds to manage resource revenue in the future. Complemented by medium-term debt strategies underpinned by sustainable debt objectives. Finally, the implementation of the new regulatory framework for managing public investment should also contribute to fiscal stability, as investment projects are increasingly selected based on social and economic impact.