



# THE ROAD TO ZAMBIA'S 2020 SOVEREIGN DEBT DEFAULT

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By Margret Mbewe, Ignatius Masilokwa, Théodore Humann, Mbewe Kalikeka, Martin Kessler and Sylvia Mwamba<sup>1</sup>

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## 1 Introduction

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On 13<sup>th</sup> November 2020, Zambia became the first African country in the COVID-19 era to default on its Eurobond debt after missing a coupon payment of US\$42.5 million. Consequently, Fitch downgraded Zambia from a CC rating to Restricted Default, following Standard and Poor's (S&P), which had already reduced its equivalent rating to Selective Default ahead of the expiry of a 30-day grace period for the coupon payment. This came after the Government's admission that the country was already defaulting on its external obligations and would not be making debt service payments.

The Government has remained in default ever since, a fact reflected through significant reduction in its external debt service payments, and the corresponding accumulation of arrears. Subsequently, debt service was only maintained for institutions with preferred creditor status, i.e. international financial institutions and regional development banks, while arrears to its private and official bilateral creditors keep accumulating, with exceptions made for essential projects that still have undisbursed amounts. In 2020, Zambia serviced only half of its external debt while in 2021 and 2022 the country's external debt service was below target, underspending by 83.4% and 95.5%, respectively.<sup>2</sup>

Against this background, this paper recounts Zambia's economic administration choices leading up to the debt distress to draw learning from past experiences. The review starts with the first debt distress of the late 1990s to the early 2000s and its resolution through the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) processes. It then discusses Zambia's macroeconomic and fiscal landscape (Section 4) leading up to the debt distress, focusing in particular on the dramatic change in economic trends from 2015 onward, marking the era of significant debt accumulation for Zambia. In section 5, the authors describe the creditor composition and the factors behind the debt dynamics, including exchange rate depreciation, primary deficits and debt service costs. Section 6 highlights the declining quality of Public Financial Management as an important element, showing the consequences on the budget, especially in relation to resource allocations to social and economic sectors. Section 7 describes the default and Section 8 draws the conclusion. A subsequent paper will look at lessons learned from default times, providing suggestions to reform the "Common Framework", the G20-Paris Club mechanism for debt resolution.

**Following the default, the Government sought for external assistance to bring the country's debt back to sustainable levels and obtain the much-needed fiscal relief. Therefore, in 2020, the Government applied for the G20/Paris-Club Common Framework for Debt Treatment beyond the Debt Service Suspension Initiative (DSSI), thereafter, Common Framework, which included a formal request for debt restructuring to official creditors.**

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2. MOFNP 2021 Annual Economic Report

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## 2 Zambia's Economic Dynamism After the HIPC and MDRI Initiatives

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In the mid-2000s, Zambia witnessed a transformation in its financial situation when it became a beneficiary of debt relief programs, namely the MDRI and the HIPC initiatives. The two initiatives resulted in substantial reduction in Zambia's external debt, plummeting from a staggering US\$7.1 billion in 2004 to a mere US\$500 million by 2006. The debt relief alleviated the strain on Zambia's fiscal resources and resulted in an overall improved economic outlook.

Debt relief granted Zambia the crucial opportunity to kickstart its economic development and leverage its increased fiscal capability for targeted investments in vital sectors. In the mid-2000s, the nation also reaped the rewards of rising copper prices, resulting in a boom of the mining and quarrying industry whose contribution to GDP rose from about 10% in 2000 to 15% in 2010. In parallel, the agricultural and construction sectors also responded to the debt relief with robust growth. Therefore, through the freed up fiscal space and prudent fiscal management, while at the same time capitalizing on the surge in global commodity prices, Zambia effectively turned its economic situation around, consistently achieving GDP growth rates that averaged 6% between 2000 and 2010.

Generally during this period, the country experienced robust economic growth resulting in a stable macroeconomic landscape. The exchange rate remained fairly stable and averaged K4.2/US\$ between 2000 and 2010<sup>3</sup>. Additionally, there were notable enhancements in Zambia's international reserves, notably the months of import cover<sup>4</sup>, which increased to an average of 2.7 months during the 2005-2009 period, from 1.6 months in the 2000-2004 period. Inflation trended downwards to a single digit, averaging 8% in 2010 from about 30% in 2000<sup>5</sup>. Despite these achievements, credit conditions remained tight, with domestic lending rates averaging 28% during the period 2000 to 2010.

Therefore, to continue funding its development initiatives, the country turned to the commercial capital markets, the new source of development financing.

**Consequential to the impressive macroeconomic performance discussed above, in 2011 the World Bank reclassified Zambia's economic status from Low-Income to a Lower-Middle Income, a significant milestone for the country. This reclassification also altered Zambia's access to development finance, reducing its share of concessional funding<sup>6</sup>.**

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## 3 Post HIPC and MDRI Initiatives

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Following its economic reclassification in 2011, Zambia continued to consolidate the economic gains previously achieved and was ranked amongst the fastest growing economies in Sub-Saharan Africa. Between 2011 and 2014<sup>7</sup>, economic growth, though diminishing, still averaged high, around 6%. This growth record was on account of increased copper production, favourable food supply and

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3. Bank of Zambia Fortnightlies

4. Typically, this metric assesses the average number of months of imports that a country's central bank's international reserves can support.

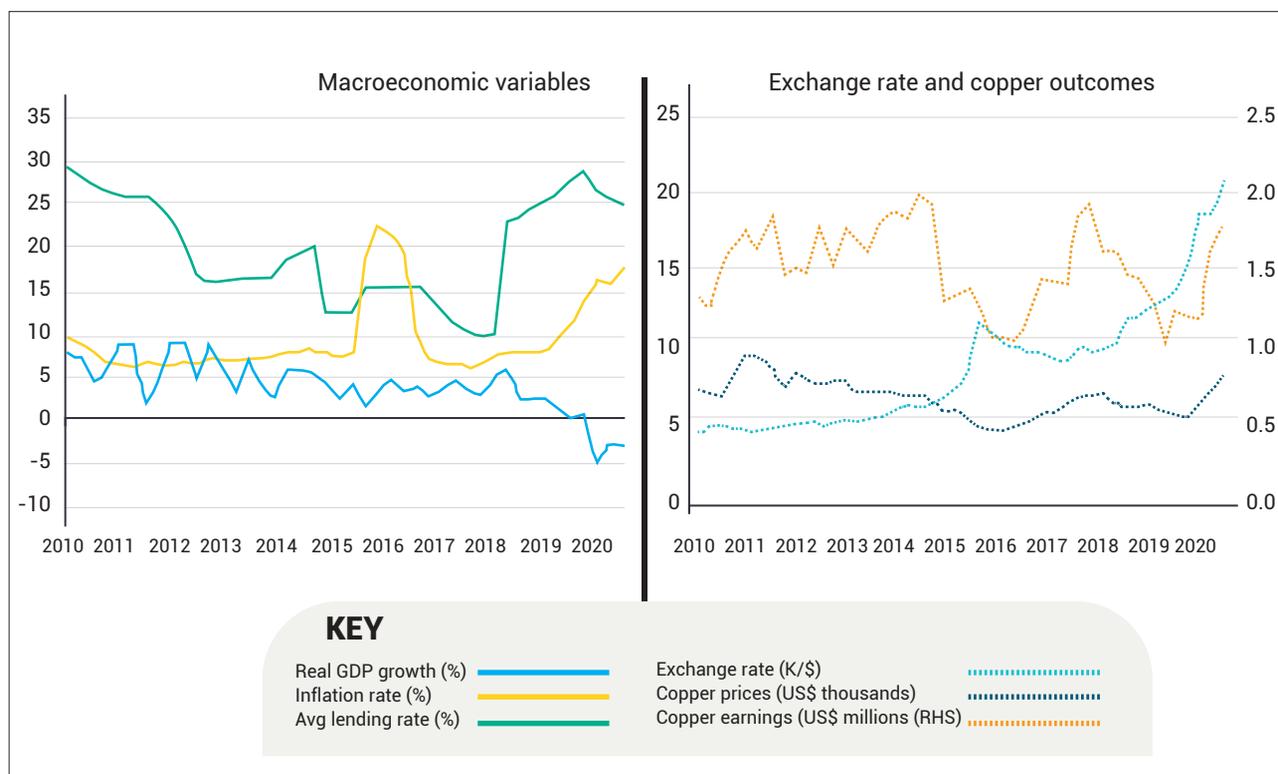
5. World Economic Outlook Database

6. World Bank (2013). Zambia Economic Brief

7. Bank of Zambia (2014). Fortnightlies

growth in transport and communications industry. Key economic indicators were well contained; with inflation consistently falling within the 6-8% target, declining average lending rates, a peak in copper prices and a relatively stable exchange rate fluctuating around K5.39/\$ as indicated in figure 1 below. This eventually culminated into a current account surplus averaging 3.5% of GDP (except for 2013) and ultimately improved reserves from 3 to 4.3 months of import cover<sup>8</sup>.

**Figure 1: Zambia's selected macroeconomic variables (2010-2020)**



**Sources:** Bank of Zambia and Zamstats

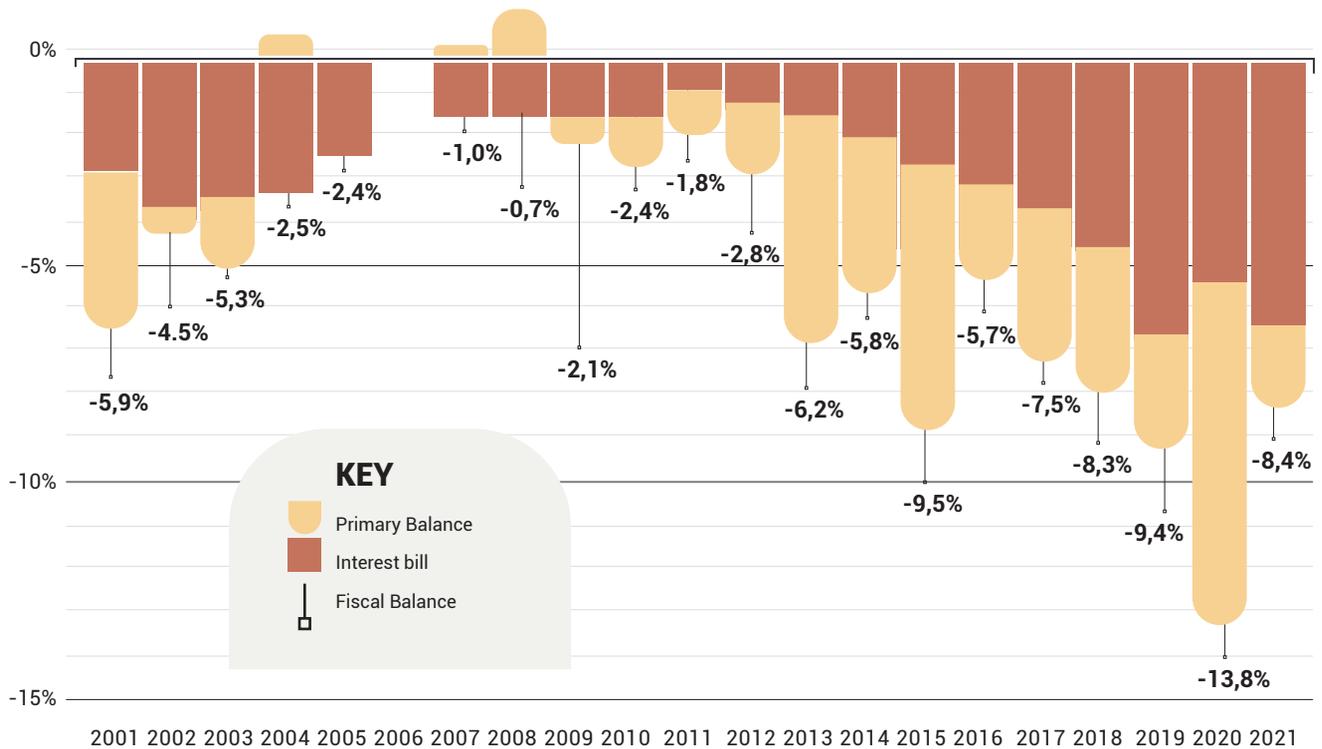
Following the change of Government in 2011, the Patriotic Front (PF) administration adopted an expansionary fiscal policy stance primarily focused on an ambitious infrastructural drive, with expenditure programs geared towards transport, information and communication technologies and energy sectors. While some infrastructure projects had significant socio-economic gains, others generated minimal benefits with negligible economic return, eventually yielding little positive spillovers to the economy<sup>9</sup>. Concurrently, there was an increase in public administrative spending including; raising the salaries of over 200,000 civil servants, establishment of 20 new district administrations, and expanding subsidies during the period (2011 – 2012).

Notwithstanding, the increase in public spending was not accompanied by an increase in revenues. For instance, from 2011 to 2014, revenues averaged around 17% of GDP while expenditures increased from 20 to 23% of GDP over the same period. As a result of this fiscal pattern, the fiscal deficit on a cash basis rose from 2.8% of GDP in 2012 to 5.2% in 2014.

8. Ibid

9. IMF. (2022). Country Report No. 22- Zambia

**Figure 2: Fiscal deficits and Primary balance (2001-2021), in % of GDP**



Source: IMF, World Economic Outlook

In 2015, Zambia experienced a drought which was a match in the powder barrel. The low precipitation experience resulted in lower agricultural output particularly for the more productive southern part of the country and subdued electricity output. Zambia's electricity sector is not only characterised by a higher concentration of hydropower but is also concentrated in the drought-prone Southern region, creating electricity supply constraints in drought times. This led to electricity rationing by the power utility company, ZESCO Limited, resulting in power outages of 8-12 hours per day. This adversely impacted industrial production, compelling the Zambian government to increase electricity imports and energy subsidies.

By the end of 2015, the macroeconomic landscape had significantly deteriorated. The rationing of electricity supply greatly affected mining operations while at the same time the global demand for copper reduced and, accordingly, the commodity price fell, adversely curtailing the country's export earnings by 35%. This eventually led to the Kwacha depreciating by over 40% and in tandem, inflation in the domestic economy increased to an average of 18.3%.<sup>10</sup> The large depreciation of the country's currency further reduced the country's ability to import essential goods. Zambia's recourse was to tighten its monetary policy stance.

**Given the weak fundamentals, the country only managed to record marginal economic growth with real GDP growing at 2.9 % and 3.4% in 2015 and 2016<sup>11</sup> respectively as shown in Figure 1 above.**

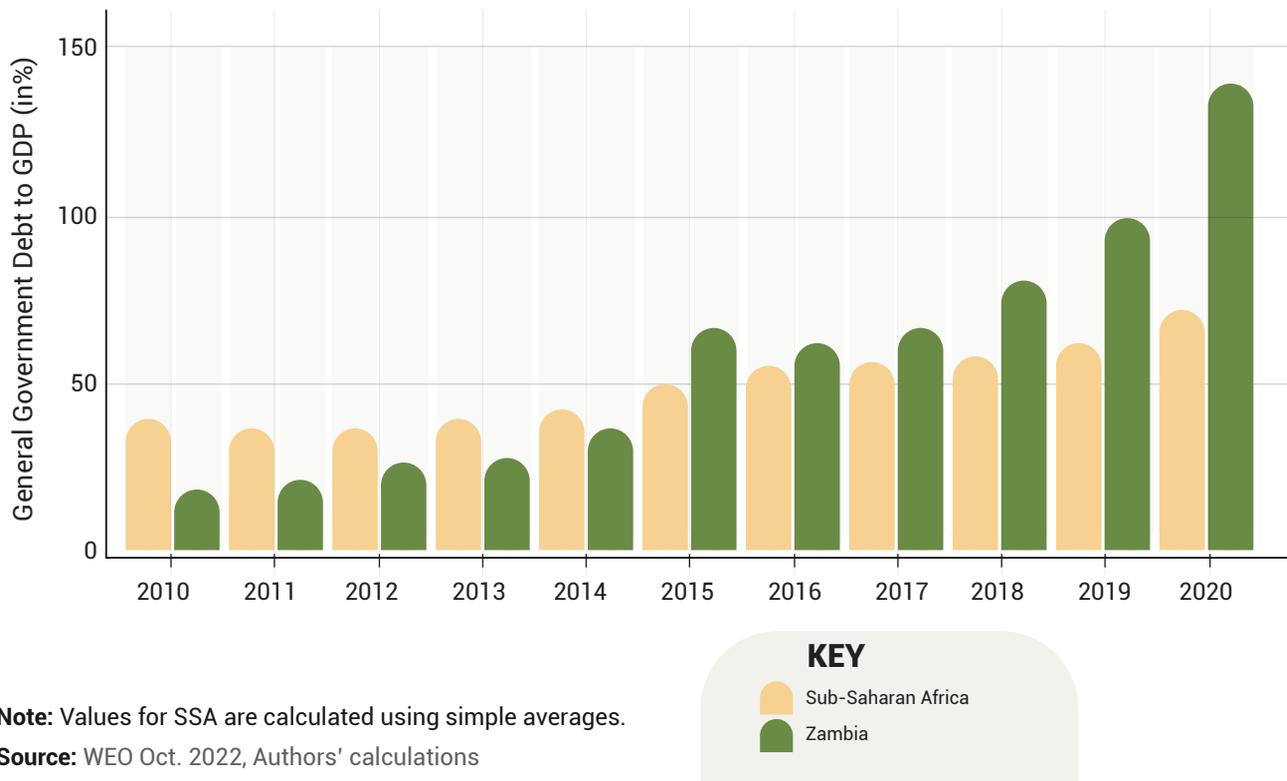
10. Zambia Statistical Agency Monthly Bulletins.  
11. Ibid

## 4 Towards another Debt Crisis

After spending most of 2010 decade with a credit rating of B, Zambia's economic outlook deteriorated in 2016, and the country was downgraded several times in 2018 to reach the CCC credit rating in 2019, just before the COVID-19 crisis.

Due to increased borrowing and the 2019 depreciation of the Kwacha, interest payments had also shot up to 6% of GDP in 2019 from 3.4% of GDP in 2016. Eventually, Zambia's stock of public debt reached unsustainable levels, doubling from 60.6% of GDP in 2016 to 120% in 2019.

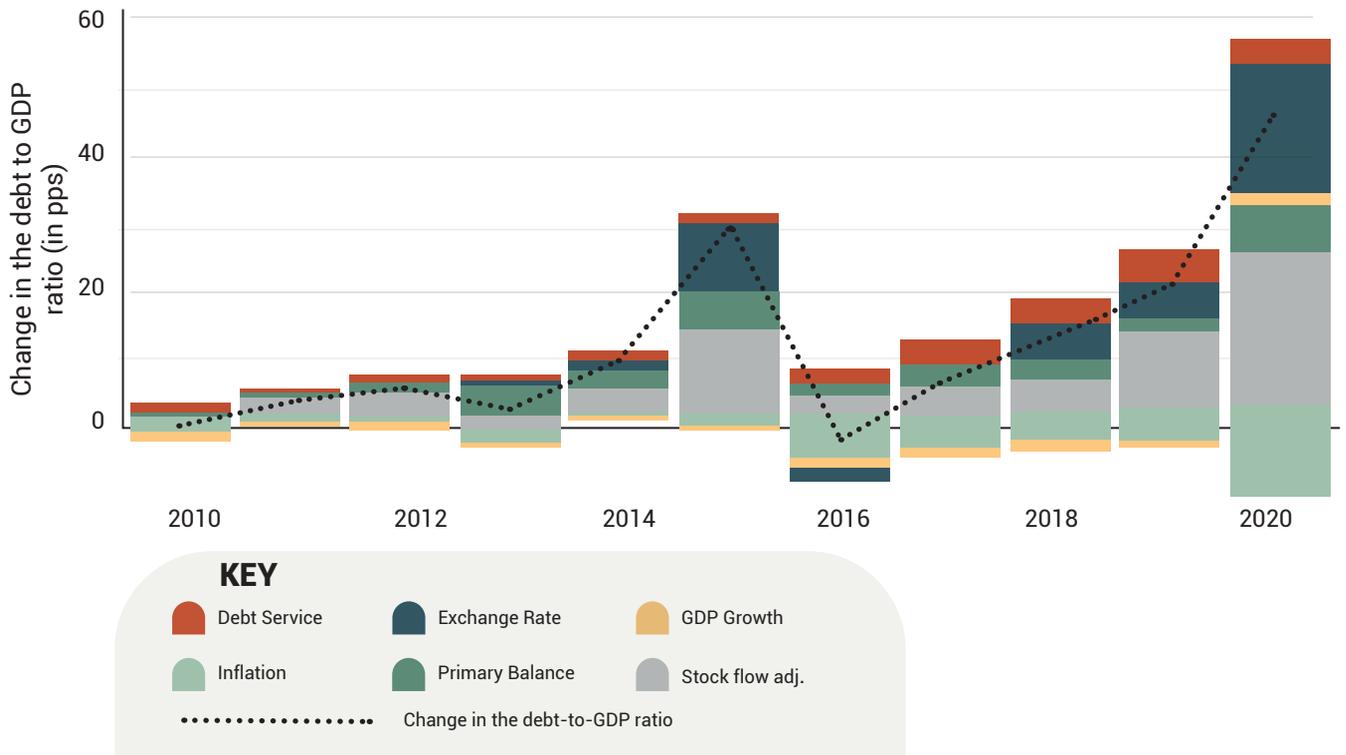
**Figure 3: The comparative evolution of general government debt in Zambia and SSA**



Notably, the July 2019 Debt Sustainability Analysis (DSA) by the IMF highlighted that Zambia's public debt was unsustainable and the risk of debt distress, high. Prior to that, the IMF's October 2017 DSA also painted Zambia's risk of debt distress as high, two years after its risk of external debt distress was assessed as moderate (May 2015). Weak country policy and institutional capacities, as well as weak fiscal adjustments hampered the country's growth potential. In 2019, Zambia's GDP growth was recorded at 1.4%, making the economy vulnerable to external and global shocks.

The emergence of the COVID-19 pandemic that hit the country in 2020, was just the straw that broke the camel's back as the economy was already at its weakest pre-Covid, growing at 1.4% in 2019. Therefore, the effect of the COVID-19 pandemic added further momentum to the already ailing economy as the growth reached the lowest point in 2020, at -2.8%, Zambia's first recession since 1998. The deterioration in the key macroeconomic variables in 2020 culminated in Zambia's external debt service default, with the fiscal deficit increasing to 14.5% in 2020 compared to 9.4% in 2015.

**Figure 4: Zambia's Debt Decomposition**



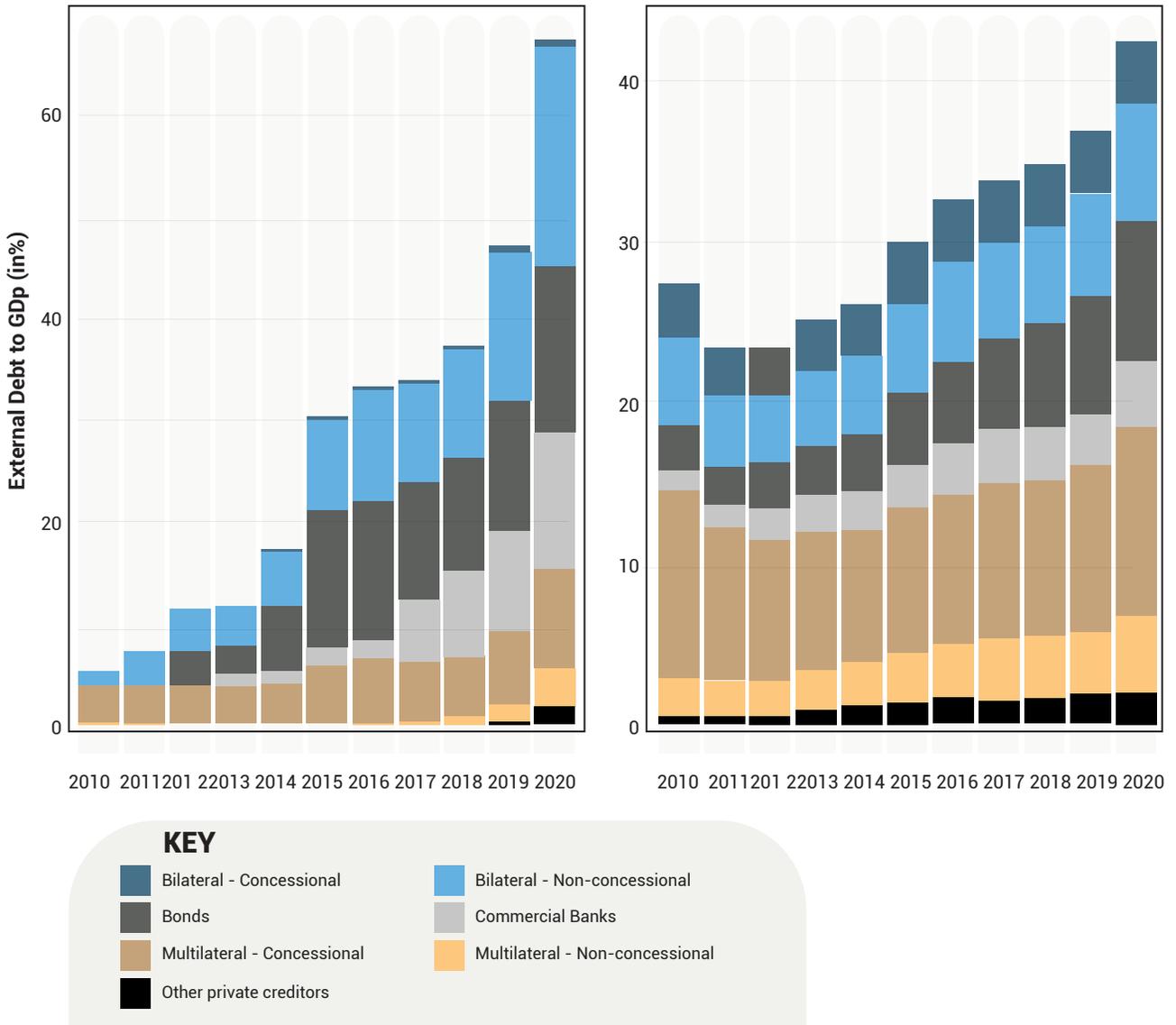
**Sources:** FDL calculations based on the 2022 international Debt Statistics, the April 2023 World Economic Outlook and International Financial Statistics. Notes: Change in the general Government gross debt, in percentage points of GDP

## 5 Credit Profile

### 5.1 External Debt

As mentioned earlier, the stock of Zambia's public external debt increased from US\$1.96 billion representing 18.9% of GDP in 2011 to US\$12.7 billion in 2020 representing over 540% increase. The rise in the external debt stock and the disaggregation to show the changes in the profile of creditors over the referenced period are illustrated in Figure 5 below. The share of bilateral concessional debt remained significant in the rest of SSA, but close to in existent in the case of Zambia. Notably, for Zambia, the Paris Club members had largely switched to grants, while the other bilateral creditors were lending at non-concessional rates.

**Figure 5: Breakdown of external general Government debt in Zambia (LHS) and SSA (RHS)**



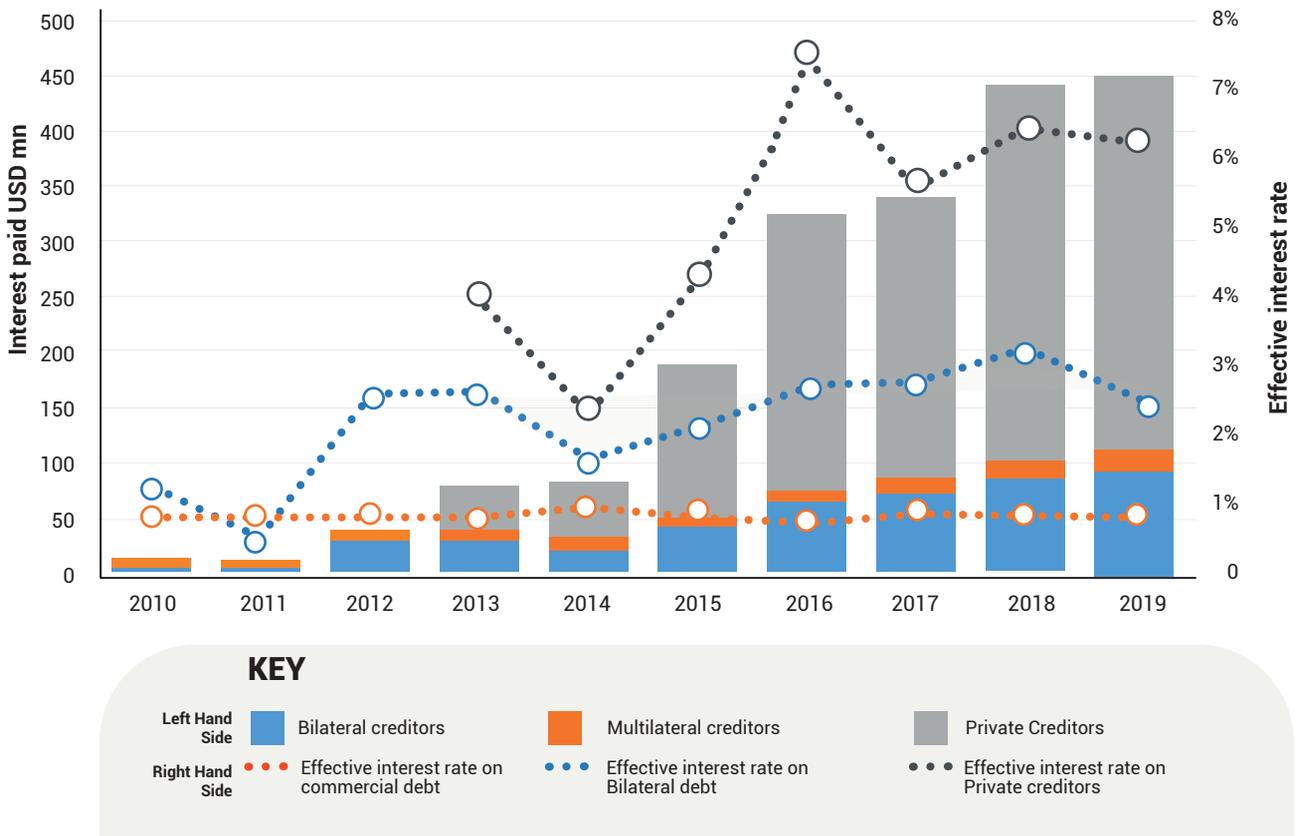
**Source:** IDS 2022, Authors' calculations

**Note:** Values for SSA are calculated using simple averages. Differences in definitions and data availability between IDS and other sources on debt can result in differences in debt ratios.

**The Figure also elicits comparison between Zambia's debt dynamics with Sub-Saharan Africa (SSA)'s average, on two notable features as follows:**

- 1. First, the rate of increase.** The rate of increase in debt was much higher for Zambia than the average for SSA. In Zambia, external debt rose from under 5% in 2010 to 65% of GDP in 2020 while the SSA average increased from 27% in 2010 to about 43% of GDP in 2020; and
- 2. Second, the debt composition.** For Zambia, debt to multilateral institutions, as a share of GDP, only grew slightly, increasing from about 2% to 10% between 2010 and 2020, but as a share of external debt, it shrank.

**Figure 6: External Debt Interest Payments (in Millions)**



**Source:** International Debt Statistics 2023

**Note:** Interest payments (in bars) are in USD millions on the left-hand side, and rates (lines with markers) denote effective interest rates (interest/debt stock) for each category.

### 5.1.1 Multilateral Debt

Before 2015, multilateral loans averaged 44% of total external debt, the largest component of the country's external debt stock. The IMF, World Bank i.e. International Development Association (IDA) and the African Development Bank were the major sources of multilateral loans. These loans took the form of budget support, project and program loans on concessional terms. For most of these multilateral loans, interest rates averaged 0.75%, with grace periods of up to 10 years and maturity of over 40 years, mostly directed towards education, health, agriculture and infrastructure, water and sanitation and energy sectors. Despite the share of multilateral loans to external debt diminishing between 2010 and 2021, IDA loans to Zambia increased in absolute terms. Records from the Ministry of Finance and National Planning (MoFNP) show that multilateral loans accounted for about 64% of total external public debt stock in 2011 before dwindling to about 15% by the end of 2021.

### 5.1.2 Bilateral Debt

Besides multilateral loans, Zambia also borrowed from bilateral sources. These loans were mostly concessional with maturity periods of up-to 40 years. For Zambia, the main sources of bilateral loans were the traditional Paris and non-Paris Club members. The non-Paris Club sources accounted for a greater share with the largest non-Paris Club lender to Zambia being China. Other non-Paris Club lenders included Iraq, India and Saudi Arabia. From 2011 to 2021, total bilateral debt averaged 32% of external debt.

Notably, bilateral external debt comprised of “export and supplier’s credit”, which specifically denote financing with the specific purpose of facilitating the purchase of goods and services from the creditor country. Chinese companies dominated this financing window. This financing source became increasingly prominent in the recent past increasing from US\$448 million in 2011 to over US\$4 billion in 2021<sup>12</sup>, averaging 26% of the external debt portfolio over the reference period and becoming the second largest source of total external debt (after commercial debt). The Exim Bank of China (which offers loans on partial concessional terms)<sup>13</sup> and CATIC were the major creditors under this category. EXIM Bank of China loans totalled nearly US\$3 billion in 2020 (approximately, 24% of the total external loans). Over time, bilateral loans were primarily acquired to finance the construction and completion of infrastructure projects<sup>14</sup>.

### 5.1.3 Eurobonds/Commercial debt

The Government issued three Eurobonds in 2012, 2014, and 2015, amounting to US\$750 million, US\$1.0 billion, and US\$1.25 billion, respectively. Table 1 shows the structure of the Eurobonds.

The rapid issuance of the Eurobonds increased the proportion of external commercial debt to 45.3% in 2015 from 28.7% in 2012. By 2019, commercial debt accounted for 50.3% of the total external debt. This significantly altered the public debt architecture, making commercial debt a crucial sources of development finance.

**Table 1: Structure of Zambia's Eurobonds**

	1 <sup>st</sup> Eurobond	2 <sup>nd</sup> Eurobond	3 <sup>rd</sup> Eurobond
Amount (US\$ million)	750	1,000	1,250
Year of Maturity	2022	2024	2025-2027
Payment Structure	Bullet	Bullet	Back-end amortising in 3 installments
Coupon rate	5.375%	8.5%	8.97%
Coupon amount per year (US\$ million)	40	85	112
Issue date	13 Sept 2012	14 April 2014	23 July 2015
Tenor	10 Years	10 Years	11 years (average)
Sovereign rating on issue date	B+(S&P); B+(Fitch)	B+(S&P); B(Fitch); B1 Moody's)	B(S&P); B(Fitch); B1(Moody's)

**Source:** National Assembly

12. MOFNP (2015 & 2021) Annual Economic Reports

13. Arve Ofstad. (2019). Zambia's looming Debt Crisis.

14. Brautigam. (2022). China and Zambia: Creating a Sovereign Debt Crisis for a detailed analysis of China's role in debt accumulation).

## Allocations of the Eurobonds

The first two Eurobonds were accompanied by a detailed plan of how they would be spent. However, the third Eurobond had no such plan, although statements were made after it was issued that it would be used for infrastructure, and some areas were highlighted in the media by the then Deputy Minister of Finance.<sup>15</sup>

The first Eurobond worth US\$750 million was largely used for infrastructure projects mainly targeting the transport sector. A scrutiny of the beneficiary institutions shows that the largest recipient of these resources was the power utility, ZESCO, accounting for 34% of total funds

Like the first Eurobond, significant proportions (over 60%) of the second Eurobond were earmarked for infrastructure projects, as shown in Table 2.

The third Eurobond followed a similar pattern with a significant portion dedicated to infrastructure projects. However, some information on the expenditure of this Eurobond was inaccessible as over 30% of the funds were not allocated to any specific projects. Nonetheless, the media reported significant allocations toward roads and administration.

**Table 2: Summary of Proposed Usage of the 3 Eurobonds in Zambia**

Eurobond I (US\$ million)		Eurobond II (US\$ million)		Eurobond III (US\$ million)	
ZESCO Limited–Power Distribution	69	Budget Support	250.3	Not specified	410
ZESCO Kafue Hydro Power Station	186	Ministry of Transport, Works, Supply and Communications	236.4	Roads	400
Development Bank of Zambia–On Lending	20	NRFA	218.8	Administration	268
RDA–Pave Zambia Project	65	Ministry of Education, Science and Vocational Training	171.9	Health, Education and Youth	111
Ministry of Health – Hospital Modernization	29	TAZARA	40	Air and Maritime Transport	40
NRFA – Kitwe – Chingola Dual Carriage Way	100	FRA	28.1	Agriculture	21
NRFA – Refinancing on Formula One Road Project	145	ZNBS	22.3		
Zambia Railways Limited – Rehabilitation	120	NATSAVE	17.2		
Discount Premium	14.6	IZB	15.2		
Transaction Costs	1.4				
<b>Total (US\$ Million)</b>	<b>750</b>		<b>1,000</b>		<b>1,250</b>

**Source:** Towards 2022 - Options for paying back Zambia's Eurobond Debt - ZIPAR Working Paper No. 37 December 2019

15. <https://www.lusakatimes.com/2015/07/24/zambia-successfully-issues-us1-25-billion-eurobond/>

Anecdotal evidence indicates glaring inefficiencies in the use of the resources from Eurobonds. Despite having plans for the utilisation of the Eurobonds, the actual implementation of the plans turned out to be a big challenge. For instance, Zambia Railways Limited experienced inflated contracts that did not match the goods supplied. Further, the Company incurred losses despite funds for rehabilitation being channelled toward the institution. On the other hand, ZESCO made little progress in the rehabilitation of the distribution networks, and part of the funds were returned to the Bank of Zambia (BOZ)<sup>16</sup>. At the same time, the Development Bank of Zambia (DBZ) had no lending framework despite funds being disbursed to the institution. The Ministry of Health recorded irregularities with contractors and missing documentation, while the Road Development Agency reported severe abnormalities, including delayed payment of contractors and poor workmanship.

## 5.2 Domestic Debt

In addition to external debt, the Government turned to domestic borrowing to finance its rapidly growing fiscal deficits. As of 2017, domestic borrowing was reported to include only Treasury Bills and Bonds (excluding arrears and awards and compensation). Therefore, 2016 onwards, the Government turned to domestic markets, increasing the size of T-bills and the size and frequency of auctions for Government Bonds from quarterly to every two months.

Between 2015 and 2021, the holders of Government securities included banks, non-bank financial institutions (NBFIs) and the Bank of Zambia, including non-resident holders. Commercial banks, followed by non-banks, dominated holdings of Treasury Bills. On the other hand, until 2018, the largest share of Government bonds was held by NBFIs, followed by commercial banks. NBFIs includes institutional investors such as pension funds, who invest in securities to meet long-term obligations<sup>17</sup>. Post 2018, the Bank of Zambia became the second largest holder of Government bonds in the domestic market, as it attempted to mitigate roll over risks in 2019, as well as to implement COVID-response purchases of bonds under the Secondary Market Bond Purchase Programme (SMBPP)<sup>18</sup> in 2020. In 2021 and 2022, domestic debt continued to grow, mainly due to financing needs for the budget deficits.

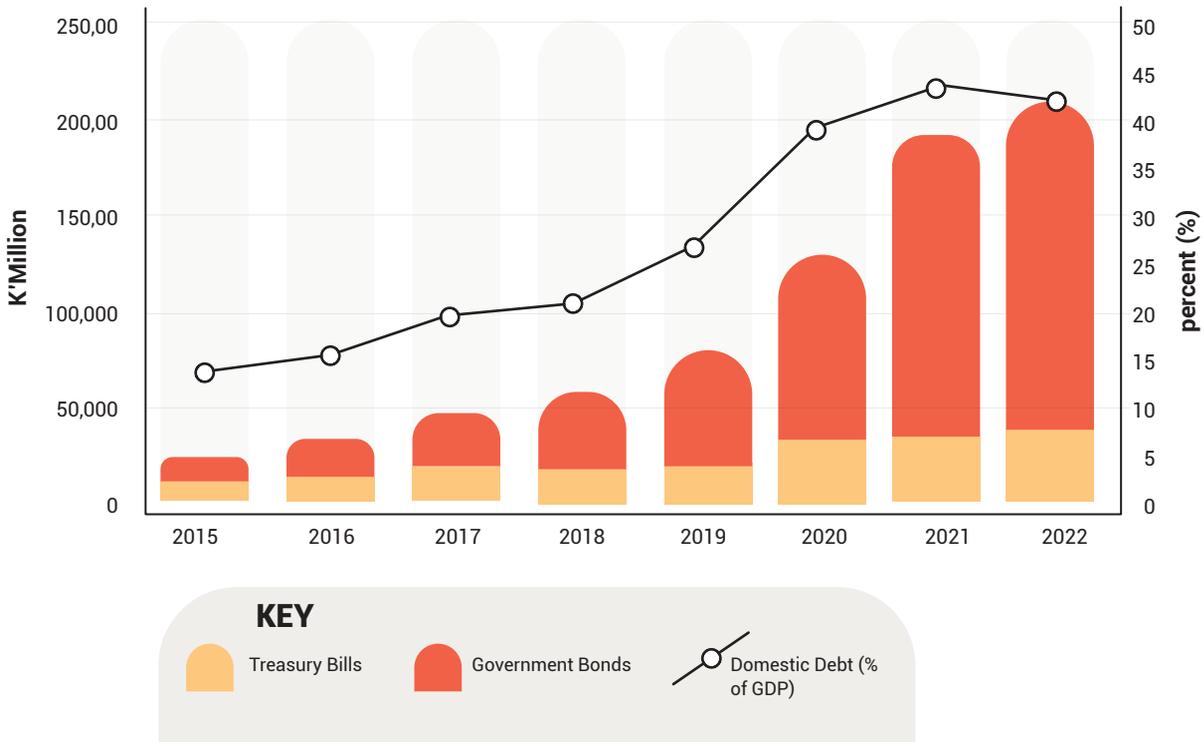
**Domestic debt increased fivefold, in nominal terms, from K24 billion in 2015 (13% of GDP) to K130 billion in 2020 (39% of GDP), as shown in Figure 7. The rapid increase in the stock of domestic debt was a result of the Government's shrinking access to foreign financing from the international capital markets since 2016.**

16. Republic of Zambia. (2013). Auditor General's Report - [https://www.ago.gov.zm/?wpfb\\_dl=145](https://www.ago.gov.zm/?wpfb_dl=145)

17. Ministry of Finance. (2015). Economic Report.

18. Ministry of Finance. (2020). Economic Report. The Secondary Market Bond Purchase Programme (SMBPP) was introduced in June 2020 by the Bank of Zambia to mitigate the impact of the COVID-19 pandemic on the financial sector and the economy. The programme entailed BoZ purchasing Government securities on the secondary market in order to inject liquidity into the financial system to support the stability of the financial sector and economy at large.

**Figure 7: Zambia's Domestic debt**



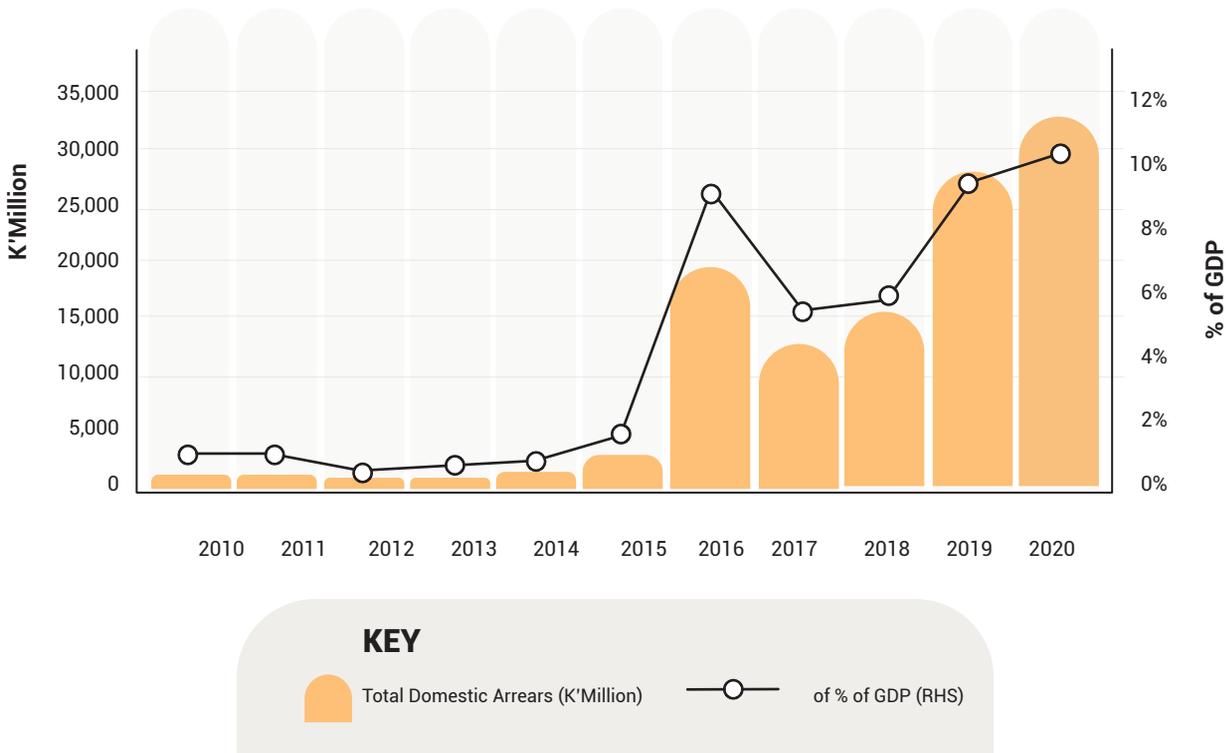
**Source:** Author's construction using data from Ministry of Finance and Bank of Zambia

### 5.3 Domestic Arrears

In parallel with the rise in domestic and external debt, the Zambian Government accumulated domestic arrears. The constitutive elements of the Government arrears included guarantees, compensations and awards, VAT refunds and pension arrears. Despite attempts to put arrears under control in 2017-2018, their amount went back up in 2019, peaking at 10% of GDP in 2020. The large increase in domestic arrears was on account of an increase in the supply of goods and services to the government; delayed payments to already commissioned road contractors; electricity imports and fuel procurements.

**Between 2010 and 2014, domestic arrears averaged 0.72% of GDP, increasing only moderately by an average of 33.1%. However, there was a spike in arrears after 2015, increasing by over 500% and reaching K18.8 billion (8% of GDP) in 2016 as shown in Figure 8 below.**

**Figure 8: Zambia's Domestic Arrears**



Source: Author's construction using data from Ministry of Finance and Bank of Zambia

Between the period 2016 and 2020, the bulk of these arrears remained VAT refunds and road contractors. The rise in arrears over the years was attributed to fiscal challenges due to higher expenditure relative to revenues. This higher expenditure resulted from higher debt service obligations, overruns on subsidies, COVID-19 mitigation related expenditure and variabilities in the macroeconomic environment, key among them being the currency depreciation and slower growth). Over time, these unpaid arrears resulted in service providers facing liquidity and solvency challenges as capital is held up by the Government.

## 6 The consequences of increased indebtedness

### 6.1 Rising debt in the context of deterioration in debt management

The switch to more expensive commercial loans amidst sluggish economic growth and weak Public Financial Management (PFM) frameworks all combined to initiate a fiscal and debt crisis. The weak legislature such as the Loans and Guarantees Authorisation Act of 1969 (Text Box 1) was fit for the bilateral and multilateral loans, but with the ushering of commercial, the debt portfolio became more complex and the legislation got outdated.<sup>19</sup> Further, other pieces of legislation in the PFM space were also inadequate.

19. See <https://www.africaportal.org/publications/analysis-legal-framework-public-debt-management-zambia/>

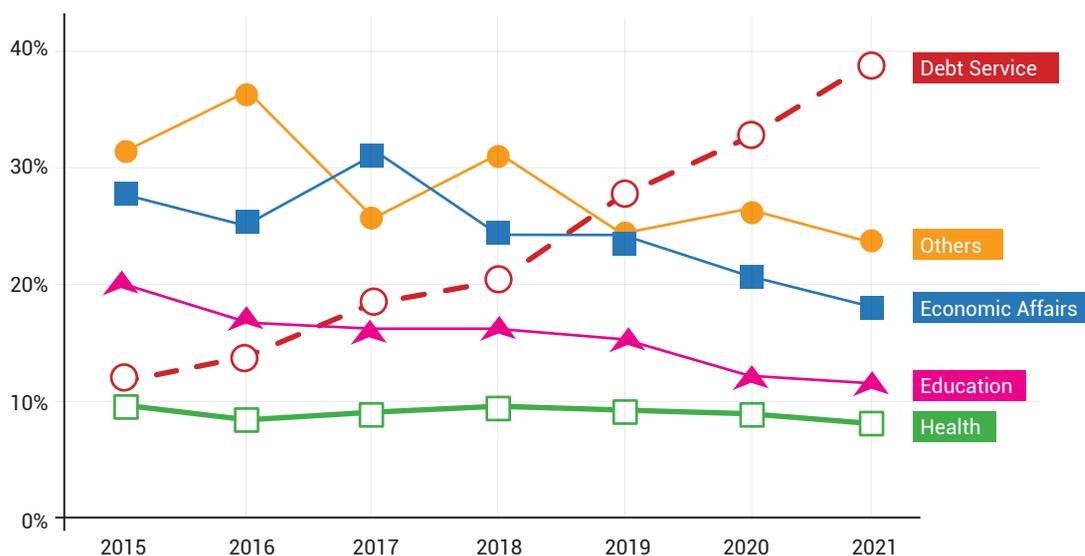
### Box 1: Recent reforms in debt management

Weak policy and legislative frameworks created a conducive environment for a debt crisis. Despite many Acts and regulations surrounding the contraction, usage, and management of public debt, the institutional and legal frameworks still need to be improved. Prior to the enactment of the Public Debt Management (PDM) Act (2022), the Constitution and Loans and Guarantees Authorisation Act (LGAA) were the two key pieces of legislature guiding the management of debt. However, the weaknesses and inconsistencies in these two pieces of legislation were observed, particularly the lack of clarity on the final authority for debt contraction, ultimately undermining the governance systems for debt management. The PDM Act 2022 responds to these weaknesses by providing for stronger parliamentary oversight over debt contraction and provision for debt limits. These are some of the many reforms being pursued in an effort to return Zambia towards debt sustainability.

## 6.2 Rising debt service

The Government's fiscal challenges slowly began to manifest, evidenced by the massive external debt stock that came with huge debt servicing costs which rose from 10% in 2014 to over 30% in 2020 as a share of expenditure. As a result, non-discretionary spending (debt service costs and civil service wage bill) took-up over 90% of domestic revenues by 2019, leaving very little fiscal space for critical sectors such as social spending. Additionally, debt repayment as a share of general public services in the Budget rose from 44% in 2015 to 77% in 2020. On the other hand, allocations towards Economic Affairs, Education, Health, Defense, Public Order and Safety as well as Recreation, Culture and Religion declined over the same period as shown in Figure 9. This left the country with little resources to invest in growth enhancing productive sectors of the economy. High debt levels also put immense pressure on the domestic financial markets, potentially crowding out private investment through stubbornly high lending rates

Figure 9: Expenditure by Functional Allocation and Debt Service, in % of total expenditure



Source: Annual Budget Speeches

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## 7 Towards default

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The Eurobonds that Zambia acquired over time posed repayment risks due to their repayment structures. The 2022 and 2024 Eurobonds had bullet repayment structures, making the country's debt unsustainable in the medium term.

On the bilateral side, Zambia applied for the Debt Service Suspension Initiative in 2020, but its official creditors also requested that the government would suspend coupon payments to private creditors as a condition. Indeed, as default was seen as inevitable, and as debt was highly opaque, any debt suspended by bilateral creditors would have just gone to pay bondholders.

**Even before reaching maturity on the first Eurobond, Zambia was already expending on interest payments every 6 months, and with little or no foreign reserves and no sinking fund, the country defaulted on a coupon payment of US\$42.5 million in 2020.**

Consequently, it defaulted on all three bonds. Bonds were accelerated and the result of this was interest payments accumulation until the country finds an agreement with its creditors.<sup>20</sup> Applying to the Common Framework was the only solution, but was it a good one? Zambia only reached an agreement with its official creditors in June 2023, and is still negotiating with private creditors.

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## 8 Conclusion and Possible Pathway for Zambia

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This paper recounted Zambia's first debt distress and associated debt relief initiatives undertaken in the early 2000s in efforts to return to sustainable debt levels. It also analysed the country's macroeconomic and fiscal landscape after the HIPC distress, which gave impetus to Zambia's reclassification to lower-middle income status from low-income status. Additionally, the paper discussed Zambia's economic situation in the run up to its second debt distress, whilst providing a breakdown of the changing creditor composition and analysing the implications of rising debt on the economy. Finally, it offered a narrative of the country's 2020 debt default.

Zambia's second debt distress occurred barely two decades after facing its first. Lessons from the HIPC period had not been internalized and led to a series of policy mistakes. Analysing these events is therefore valuable for economic policy implications in order to avoid repeating the mistakes of the past, again.

The report shows that Zambia's shocks experienced between 2012 and 2015 put the country's fiscal balance in a precarious situation. Due to limited concessional funding as a result of its reclassification, Zambia had to borrow funds from the international market at expensive rates in order to finance its development agenda.

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20. Kalikeka et.al (2019). Towards 2022-Options for paying back Zambia's Eurobond

The result of this runaway debt was that Government budgets were increasingly diverted towards debt service. By 2019, debt service became the largest spending category, accounting for more than 30% of expenditure. This surpassed economic affair spending and represented more than three times the allocation towards education and health. During the same period, the government's reliance on domestic sources of finance, such as government bonds and treasury bills, increased. The report also notes that despite being eligible to access funds, caution on its non-concessional borrowing was not taken and interest costs accumulated very fast internationally. Notwithstanding, despite the 2-3 years of restrictive fiscal policy afterwards, the pressure of interest payments was high and this created a strain on the fiscus which was exacerbated by the decline in copper prices. Further, the abandonment of fiscal policy efforts in 2019 made it difficult for the country to drive growth and stability in the domestic economy.

Adding to the existing challenges, the COVID-19 shock led to a further decline in exports and revenues. This left the government with no choice but to default on its external obligations. As a result, in February 2021, Zambia formally applied to the G-20 Common Framework. This launched a long and painful process towards the country's debt restructuring, including a change in political leadership, lengthy discussions with the IMF over a country programme, and even more complex negotiations with public and private creditors, which are still ongoing.

These transitions limit concessional finance and open the door to large flows of non-concessional finance. Under these conditions, a large exogenous shock like the one in 2015 was almost impossible to manage and led to dynamics that were difficult to control.

Finally, it is worth mentioning that this paper is a precursor for a follow-up analysis that will provide a deep dive into the country's debt default and restructuring process. These economic occurrences, as well as their socio and macroeconomic implications, will be discussed at length therein.

**What are the lessons of the past decade and a half? The main lesson is to exercise caution. Bonds are expensive sources of funding and require a clear and justified narrative for financial and economic returns. Lenders, both bilateral and multilateral, should also exercise more care, especially during transitions from low to middle-income economies.**



**Contact**

**Finance for Development Lab**

[communications@findevlab.org](mailto:communications@findevlab.org)

[www.findevlab.org](http://www.findevlab.org)