TRANSITION FINANCE 2019

Zambia

As part of its transition finance work stream, and through its new "Assessing, Benchmarking and Counselling" (ABC) approach, the DAC/OECD is carrying out several country pilots in countries facing different transition challenges as they move through the development continuum. The Zambia country pilot looks particularly at the transition challenges faced by a country having moved from the low-income country (LIC) to the lower middle-income country (LMIC) category.

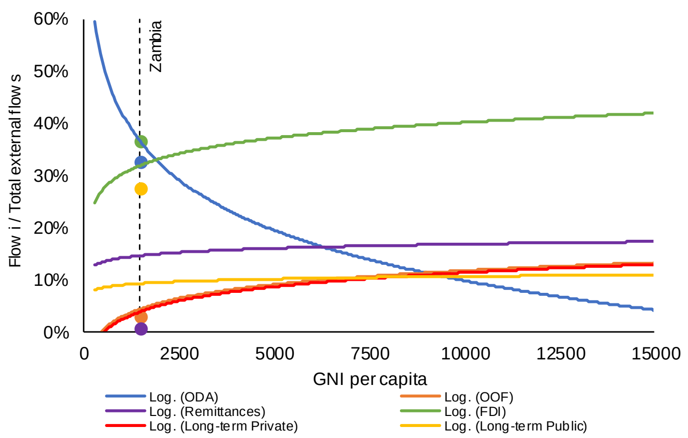
ASSESSING

Zambia transitioned from the low-income to the lower middle-income category in 2011 after years of robust growth in the early 2000s. However, Zambia still belongs to the group of least developed countries and its middle-income country status masks stubbornly high levels of economic and social vulnerabilities.

- Excessive reliance on copper, which presents more than 70% of exports, exposes the national economy to volatile commodity price movements.
- 57.5% of people in Zambia live below the poverty line. The ratio is 77% for rural areas.
- The Global Hunger Index of 2018 ranked Zambia as the fifth hungriest country in the world.

At the same time, Zambia is undergoing a challenging transition with regard to its financing mix. With the reclassification to LMIC status, Zambia gained access to a wider range of financing options including international debt capital markets. The Government issued a series of Eurobonds starting in 2012, which amounted to a total of around USD 3 billion or more than 40% of public external debt. Moreover, Chinese lending, especially in the form of export credit, plays a growing role in the country's financing landscape. In 2016, Chinese loans amounted to a quarter of Zambia's total external debt stock. Conversely, the share of concessional finance from DAC providers in the overall financing mix decreased, and the influence of DAC providers has declined accordingly.

Zambia's external financing mix is over-reliant on long-term public debt



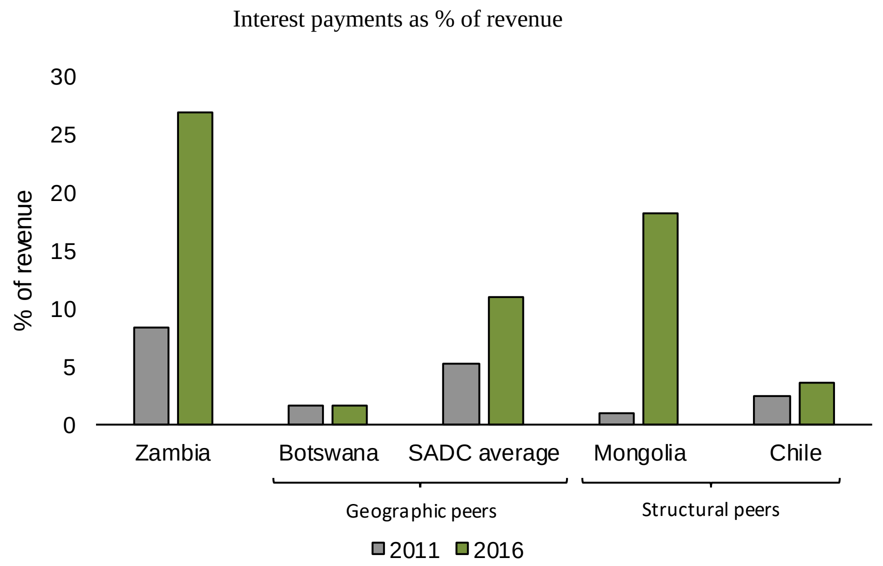
Note: The plotted lines represent predicted values at each GNI per capita level. The predicted values result from a logarithmic regression where the share of flow over total external flows is regressed on the logarithm of GNI per capita. The underlying values are average values for the years 2012-16.
Source: Creditor Reporting System, https://stats.oecd.org/Index.aspx?DataSetCode=crs1

BENCHMARKING

This has implications on the financing mix of the country. After having been one of the major beneficiaries of the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI) in the early 2000s, mounting debt levels again raise concerns around the government's ability to honour its repayment obligations.

- External borrowing is expected to reach 65% of GDP in 2017.
- Debt service is programmed to account for 42% of domestic revenue in 2019, diverting funds away from spending on social sectors.
- Although debt levels have increased across countries, the pace of the increase has been especially rapid in Zambia. Due to the high concentration of maturities and borrowing at variable interest rates, the implications on debt servicing costs has also been more severe.

The share of Zambia's revenue going to interest payments has substantially increased



Note: Data on other benchmarking countries more limited.
Source: World Bank, World Development Indicators, http://wdi.worldbank.org/tables

COUNSELLING

A strategy to accompany the country's transition should have two dimensions:

- ✓ **The Cooperative Approach:** Zambia needs to build resilience against possible transition setback through good governance and social safety nets. This involves setting up a better debt governance framework to monitor total public sector debt levels in a more transparent manner. To accompany and support these efforts, official providers can increase technical assistance on debt management, strengthening negotiation skills for new debt issuance but also for the restructuring of existing debt. Zambia can also benefit from targeted support for better public financial management systems, and the institutionalising of value-for-money analysis and implementation.

- ✓ **The Competitive Approach:** A stable and predictable regulatory and business environment is key to promoting a vibrant private sector and more economic diversification. This again can lead to more foreign and domestic investment but also more public revenues. In particular, there is scope to capture more value from the mining industry by developing upstream and downstream linkages. Development partners can provide valuable technical assistance and capacity building in this regard. Moreover, support for domestic resource mobilisation from the mining sector in the form of assistance in tax audits of mining companies has shown great results and needs to continue in the future.