Brown Bag Dialogue Series

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Q3 | The Debt Issue

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Addressing Zimbabwe's Huge Debt Burden

The Head of Zimbabwe Aid Debt and Management Office (ZADMO) Andrew Bvumbe is optimistic of the steps that the Government is taking to address the huge and unsustainable debt burden saying that the country is keen to resolve the problem.

"The debt issue is a development challenge to Zimbabwe and without its resolution there shall be no access to development resources from the international financial institutions," he said.

He was speaking at a UNDP-organized Brown Bag Dialogue Event on "Leveraging on Debt Sustainability as a catalyst for sustainable development: the case of Zimbabwe". The event was held on 24 October 2012 at the UN complex in Harare, as part of the UNDP quarterly Brown Bag Dialogue Series, meant to provoke critical reflection on Zimbabwe's development challenges.

Zimbabwe's debt overhang is an impediment to the growth trajectory. By end-2011, invalidated external debt stock (including arrears) was estimated at US$10.7 billion, representing 113.5% of the country's Gross Domestic Product of which 67% is arrears. The bulk of the debt is owed to bilateral creditors amounting to US$3.3 billion (or 31% of total debt stock), followed by multilateral creditors at US$2.8 billion (26%), other debt at US$2.5 billion (23%) and private debt at US$2.1 billion (19%).

It was pointed out that the country needs $15 billion to cover the resource gap in the implementation of 2011-2015 Medium Term Plan and this cannot be achieved without a comprehensive debt relief. The possibility of using the country's mineral resources to settle the debt in the medium term must be accompanied by a debt relief mechanism. Therefore, the Government launched the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS) which

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From left to right - Andrew Bvumbe (ZADMO), Dr. Phineas Kadenge (University of Zimbabwe), Stan Nkhata (MEFMI) and Fanuel Bokosi (AFRODAD). (Photo UNDP)

has led to significant progress in dealing with the debt stock.

As a strategic policy response to the debt overhang, the country is considering a debt relief mechanism under the Heavily Indebted Poor Countries (HIPC) initiative and make use of fresh financing from international institutions and mineral wealth to achieve sustainable development in the context of ZAADDS.

The Strategy

The initiative is a hybrid debt resolution strategy which includes the adoption of the traditional debt resolution initiatives, combined with leveraging of the country's natural resources to achieve sustainable economic development. It entails the continuation of macro-economic stabilization programmes initiated in Short Term Emergency Recovery Programme (STERP 1) and (STERP 11) and buttressed by the Medium Term Plan for 2011-2015.

Approved by the cabinet in 2010, ZAADDS was developed against the background of Zimbabwe's unsustainable debt overhang and the country's lack of capacity to address the debt burden and attract new financing.

It is innovative, incisive and well articulated. It calls for the operationalization of a debt management office, undertaking a validation and reconciliation exercise of the external debt data-base.

The policy heralds a major shift as reflected in the re-engagement with creditors and the international community for the removal of sanctions as well as negotiating for arrears clearance, new financing and comprehensive debt relief and leveraging Zimbabwe's natural resources in pursuit of debt relief and development.

The formulation of the Accelerated Re-engagement Economic Programme (ZAREP) is seen as a significant milestone towards re-engagement with development partners and forms part of re-engagement in the context of the Staff Monitored programme (SMP) currently being negotiated with the IMF. Similar programs have been extended to the Republic of Congo, Togo, Sudan, Liberia and most recently, Myanmar.

"The clearance of arrears to the IFIs is important as this is the only way that Zimbabwe will be able to avail itself of any multilateral financial assistance and a comprehensive debt relief mechanism" states the ZAADDS policy document, noting that the Fund's Poverty Reduction and Growth Facility, which has been replaced by the Extended Credit Facility (ECF), amount to US $ 140 million.

Clearance of ECF arrears will unlock new financing arrangements from the IMF, within the context of a Fund supported financial arrangement, which will then be used to repay the bridging loan obtained from the cooperating partners. The ZAADDS policy brief is informed by the awareness of the need for implementing a series of reforms focusing on among others, strengthening public finance management; budget implementation and execution; review of national tax laws; effective aid coordination; debt management; privatization, restructuring and commercialization of state enterprises; and strengthening financial sector stability.

"The country is at a critical juncture" explains Mr. Bvumbe, stressing the need for Zimbabwe to commit to a reform agenda.

Jonas Mashamba making a contribution to the discussion on debt sustainability. (Photo UNDP)

Why a Debt Overhang is Not Good for the Economy

In addition to affecting a country's credit rating and challenges associated with debt servicing it is evident that due to debt overhang, Zimbabwe has lost out on a number of funding opportunities from international creditors. This has forced a number of projects to be suspended or cancelled.

The debt overhang is impacting on implementation of development programmes, including the extension of the Kariba South Power Station (above). Photo: www.sxc.hu

Among these are the US $ 400 million package from China for the extension of the Kariba South Power Station; the US$15 billion per year WB's Infrastructure Recovery Asset Platform; the US$500 million Rapid Social Response Program; the US$500 million Micro Finance Enhancement facility; and the US$10 billion Infrastructure Crisis Facility.

"The non-resolution of the debt issue has become a major impediment to Zimbabwe's rapid economic recovery," notes the Minister of Finance, Mr. Tendai Biti, in a foreword to the Zimbabwe's Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS). The Minister argues that the resolution of the debt burden "will unlock fresh financing for critical infrastructure reconstruction projects and economic recovery programme that will significantly improve the quality of life of the ordinary Zimbabwean."

Therefore, the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAREP) is considered important for the re-engagement with the international financial institutions. Within this context, explains Mr. Mvumbe, the government has discussed broad framework, covering inter-alia, fiscal sustainability, expenditure management, and expenditure monitoring and wage policy. Addressing the structure of the budget is particularly important given that 70% of recurrent costs constitute public sector wages and related employment costs.

Dr. Phineas Kadenge of the University of Zimbabwe observes that Zimbabwe's debt overhang must be viewed within a historical context, and viewed through the prisms of humane and social needs. He posited that certain levels of debt are associated with good economic performance, while those for the period 1999 and beyond could be associated with the decline in economic performance that led to accumulation of arrears and penalties.

In his view, the country's heavy indebtedness originated from exogenous forces, such as persistent droughts. For instance In 1983, 1985 and 1992, the country experienced severe droughts which forced government to commit resources to drought mitigation measures thus further worsening the country's fiscal and debt position.

The economist Nguyuru Lipumba traces the surge in external debt in sub-Saharan Africa to the "Volcker" recession of the early 1980s and the collapse of commodity prices which affected terms of trade as partly to blame for the debt crisis that for decades, retarded growth and undermined poverty reduction in the region.

While Zimbabwe did not face this challenge in the 80s, today it is currently experiencing debt distress with the bulk of external debt in arrears with most of the external debt indicators exceeding thresholds for low-income countries with weak policy frameworks.

> *"The resolution of the debt burden will unlock fresh financing for critical infrastructure reconstruction projects and economic recovery programme that will significantly improve the quality of life of the ordinary Zimbabwean."*

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Perspectives on post 2015 MDGs in Zimbabwe.

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MDGs and Debt Sustainability

With only three years to the deadline set for the achievement of the Millennium Development Goals (MDGs), the linkages between MDGs and debt sustainability remains a pertinent issue. Reducing expenditure on the social sector is likely to affect the achievement of MDGs targets on education, health and environment, among others.

This has led to calls for what Dr. Kadenge describes as ring-fencing social sector spending and identifying quick impact projects to alleviate the suffering of the poor. "There's need to grow the cake for social sector spending" he noted. Echoing similar sentiments, Dr. FanuelBokosi of the African Forum and Network on Debt and Development (AFRODAD), advocated for debt affordability framework that includes "a human face."

UNDP Economics Advisor Mr. James Wakiaga in a recent paper observed that it's important for the developing countries to strike a balance between financing the MDGs and debt sustainability. Noting that most least developed countries (LDCs) have urgent and pressing development expenditures that make debt service a herculean task, Wakiaga said that debt financing of national development strategies will tend to increase the indebtedness of these countries.

"Analytical work on the utility of debt financing and debt sustainability frameworks as tools of harmonizing MDGs and debt sustainability within the context of limited fiscal space becomes critical," he stated, adding that most sub-Saharan countries are facing enormous challenges in sustaining their debt repayment obligations.

The unsustainable debt relates to both short-term/ long-term debt, internal/ external and public/private debt, and only the magnitude differs. It is therefore incumbent upon developing countries to ensure that the level of indebtedness is consistent with achieving MDGs. The domestic debt equally constitutes a burden since the service obligations will compete and "crowd out" investments to achieve the MDGs.

Giving the example of Uganda, he demonstrated that the inadequacy of the debt-relief and the pressures on limited fiscal space had exacerbated the debt-distress even for LDCs countries that have benefitted from Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI) mechanisms. One of the challenges is coming up with a comprehensive solution on the best methodology for calculating debt sustainability, stated Wakiaga.

Highlighting the need to secure fiscal space to finance development expenditures, Mr. Wakiaga posited that expanding fiscal expenditures as a way of addressing the MDGs must holistically take into account long-term sustainability and ability to mobilize additional resources through concrete policies. Quoting Bernhard Gunter he said: "The additional fiscal space for the MDG investments must not be created through debt financing either external or domestic and this should be matched with anticipated debt –relief for the HIPC countries"

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Policy Shot in the Arm for MDGs Achievement

The Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS), if properly implemented, will go a long way in contributing towards the achievement of the Millennium Development Goals (MDGs) and poverty reduction in the country, experts say.

By reducing interest and principal payments, debt relief can open up fiscal space for spending on development programs, including MDGs programmes. In addition, debt relief can open the way for additional borrowing to generate resources for these programmes.

"The conditionality associated with debt relief can encourage reforms which may if appropriately designed generate benefits for growth and poverty reduction," remarks the University of Zimbabwe economist Dr. Phineas Kadenge. The economist explains that using the new-found space created by debt relief offers the best hope for rapidly increasing expenditures on MDGs programmes.

Policy Implementation framework

- Strengthening of debt management through the establishment and operationalization of a debt management office in the Ministry of Finance
- External debt data-base validation and reconciliation with all the creditors
- Negotiating a comprehensive arrears clearance and debt relief programme , including critical new financing
- Re-engagement with the international community on the normalisation of relations and the removal of sanctions
- Leveraging Zimbabwe's natural resources in pursuit of economic development

Between a Rock and a Hard Place

In resolving the debt crisis, there will be winners and losers, asserts Dr. Fanuel Bokosi of AFRODAD summing up the dilemma facing Zimbabwe as it grapples with the problem of the debt overhang. Arguing that default is not a preferred civil society option, he is also skeptical of the Heavily Indebted Poor Countries approach saying it imposes enormous moral hazards on beneficiary countries.

Under the HIPC mechanism, debt service payments on eligible debts are cancelled or rescheduled while countries that reach the HIPC Completion Point automatically qualify for debt relief under the Multilateral Debt Relief Initiative (MDRI), by which significant stocks of debt are written off. This leads to significant debt service savings and improvement in foreign external position. Being on a HIPC programme sends positive signals to development partners and investors on re-engagement and improved credit worthiness due to low debt levels arising from debt cancellation.

But critics say that the HIPC's approach—which comes with conditionalities —is premised on sustainability and other hypothetical assumptions. So what next?

In a presentation entitled "Leveraging on Debt Sustainability for Sustainable Development" Mr. Stan Nkhata, of MEFMI Secretariat listed three other options namely, the sovereign debt default mechanism involving a stay of debt service payments by the debtor; mortgaging revenues from mineral resources that entails linking revenues from mineral resources to future debt service payments; and the NGOs alternative approach or the so-called Fair and Transparent Arbitration Process (FTAP).

The default option propagated by civil society groups is seen as providing temporary relief to the debtor. However, as experience from several countries has shown, this initiative does not solve the debt situation as the default option involves a stay of debt service payments by the debtor. This is compounded by the continuation of arrears and the risk of debt being sold to vulture funds, which is costly.

Mortgage mineral resources is equally not viable because in the case of Zimbabwe, these resources are not enough to resolve the country's debt situation. Furthermore, royalties to government from the proceeds of mineral resources are not significant.

Equally, the Fair and Transparent Arbitration Process (FTAP) has its flaws. The criteria of using the legitimacy (odious) of debt for verifying creditor claims could lead to disagreements while shutting the arbitration processes to assessment of reasons for insolvency may attract the moral hazard in debt contraction by the borrowers, argues Mr. Nkhata. At the same time, the approach is silent on the likely direct and indirect consequences of formally declaring insolvency. Furthermore, the stay of debt repayments, now and in the future, as well as the failure to illustrate the amount of debt relief and debt sustainability gains relative to other initiatives is not clarified. FTAP is not clear on the sources of financing this approach.

"Would it not be more strategic to first secure international consensus on the alternative approach?" poses the policy analyst.

While the Zimbabwe Accelerated Arrears Clearance Debt and Development Strategy (ZAADDS), offers a good framework, experts have called for other measures to complement ZAADDS including reduction of the multilateral debt service burden through bilateral grants and increasing the concessionality of new borrowing. Others include improving debt and reserve management.

Enhancing coordination with donors, and lobbying for long term multilateral debt reduction is also necessary. "In fact, a Multilateral Debt Fund (MDF) should be established, with contributions used to service debt" writes Dr. Kadenge.

Gold mining in Mazowe. Mortgaging revenues from mineral resources is possible but these resources are not enough to resolve the country's debt situation. (Photo: Joachim Carlos Viera)

MDGs and Debt Sustainability

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Inevitably, there are linkages between debt sustainability and achievement of the MDGs from a perspective of economic stability and growth, since the latter is predicated on sound debt management. Debt distress create conditions for "crowding out " of private sector, deny investment on health, education and social protection programmes that are important for MDG achievement.

Acknowledging that achievement of MDGs is dependent on adequate funding and strong policies to support growth, the economist gave the example of the IMF proposed operational framework for debt sustainability which established that continuous policy and institutional reforms could productively utilize additional resources for MDGs.

"The UNDP perspective lies in emphasizing on better and effective use of aid flows to build the capacity of countries to initiate and sustain the reforms," he asserted.

MDGs and Fiscal Space

Meanwhile, Mr. Udo Etukudo, a UNDP Economic Advisor argues that securing adequate financing to achieve national MDGs and poverty reduction targets is by far the biggest operational challenge facing most African economies today. The economist working to support the Ministry of Economic Planning and Investment Promotion cites the critical issue of "fiscal space" saying this is strongly linked to fiscal sustainability and the ability of Governments to fully finance their MDG and poverty reduction agendas.

According to the African Development Bank, fiscal space is "the identified set of concrete policy actions for enhancing domestic resource mobilization, and the reforms necessary to secure the enabling governance, institutional and economic policy environment for these policy actions to be effective."

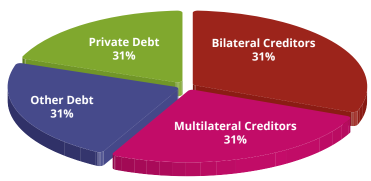
Stressing that achieving fiscal space for MDG attainment will be possible only through efficiency improvements in the way national budgets are executed, combined with a more proactive re-deployment of domestic resources towards public investment in key poverty reducing and development-enhancing activities, he states: "The implications are that fiscal space considerations must have a long-term horizon and that scaled-up public investments should create additional productive capacity in the economy, so as to yield positive human development returns."

In addition there's need to focus on domestic resource mobilization which is extremely critical not simply for financing MDG achievement in Africa, but also for putting in place the right incentives to stimulate the investment climate for domestic business activity, pro-poor growth and infrastructure development. It's necessary therefore to strengthen the legal framework on domestic legislation governing business start-ups, economic participation by domestic agents, employment legislation regarding hiring and firing, minimum wage legislation, economic legislation covering investment, market-based competition, legal protection, etc.

Furthermore, African economies need to return to the basics and fulfil the three basic tenets of economics: namely the protection of property and human rights; an economic environment guided by market based competition; and the provision of appropriate incentives to economic agents.

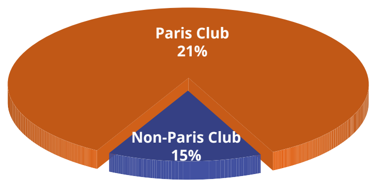
"These basic tenets constitute the major foundation for building an enabling business environment in which economic growth and development is sustainable, and poverty reduction can be successfully achieved."

Zimbabwe Debts at a Glance



Overview of Zimbabwe's Debt

Source: IMF



Bilateral Debt by Creditor

Source: Ministry of Finance

Brown Bag **Dialogue Series**

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