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An Analysis of the Legal Framework for Public Debt Management in Zambia

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Acronyms

AG	Auditor General
BOZ	Bank of Zambia
CACs	Collective Agreement Clauses
COMESA	Common Market for Eastern and Southern Africa
DSA	Debt Sustainability Analysis
EMD	Economic Management Department
GDP	Gross Domestic Product
IDM	Investment and Debt Management Department
IMF	International Monetary Fund
LGAA	Loans and Guarantees (Authorisation) Act
MOF	Ministry of Finance
MTDS	Medium Term Debt Strategy
MTEF	Medium Term Expenditure Framework
OAG	Office of the Auditor General
PDM	Public Debt Management
PFM	Public Financial Management
SOEs	State Owned Enterprises
TSA	Treasury Single Account

Executive Summary

Zambia's current legal framework for public debt management is inadequate. The high level of external debt standing at US$11.2 billion and domestic debt at K80.2 billion due to fast pace of debt contraction; the resulting heightened risk of debt distress; and the weak implementation of the 2017-2019 Medium Term Debt Strategy (MTDS), raise questions on the adequacy of the laws that govern public debt management. Now more than ever, with Zambia quickly headed to its first bullet repayment on its Eurobond debt, the country needs to enhance its legal framework on Public Debt Management (PDM).

Before 2011, the country borrowed almost entirely from bilateral and multilateral lenders such as the World Bank; then the existing legal frameworks were appropriate With the ushering in of commercial borrowing, from 2012, and the growing complexity of the debt portfolio, there is need for a revision in the public debt laws to adapt them to the changing circumstances.

Zambia's legal framework for public debt management adopts an internationally recognised maze of laws, and draws authority from different levels including the supranational, regional and locally drafted laws. The Loans and Guarantees (Authorisation) Act (LGAA) as the main subsidiary legislation on debt, nonetheless, remains ineffectual on several requirements and procedures necessary to effect prudent debt management.

The mandate to borrow on behalf of the State is well elucidated in the Amended Constitution, the LGAA and the Public Financial Management (PFM) Act. But there is a discrepancy between the LGAA and the Constitution – which is the Supreme Law of the Land –, on who has the, final authority in debt contraction. Article 62 (2) (d) of the Constitution grants final authority of loan authorisation to the National Assembly. Nevertheless, Section 3 of the LGAA vests power in the Minister to "… raise loans from time to time, in the Republic and elsewhere, on behalf of the Government". The LGAA only provides for the National Assembly to broadly authorise debt ceilings. Clearly, this is not the spirit in which the Constitution was enacted and does not uphold the separation of powers in the contraction and approval of debt.

Additionally, the LGAA does not prescribe mechanisms of reviewing the terms and conditions of loans – including those of redemption – of loans, which are determined by the lenders. This is despite Section 7 of the LGAA providing that any loan raised under the Act should be raised in accordance with such conditions and upon such terms as the Minister shall, in respect of such loan, direct. Similar powers are given to the Minister under Part V of the LGAA for him or her to guarantee loans. Without a critical review of the terms and conditions of loans the financial implications of debt on the economy, are left to chance.

Also, according to the LGAA, Government loans can be obtained for any reason as there are no clearly stipulated purposes for which the country can take on debt. As matters stand, these pertinent aspects of debt management are inadequate in the LGAA and leave room for a lot of discretion for the responsible authorities.

Zambia's definition of "public debt" is narrow and needs to be clarified from a legal perspective, because this has varying policy implications for the types of public instruments and institutions that are governed by the requirements of the PDM legal framework.

The high debt ceilings in Zambia have quite evidently, neither instilled discipline in spending nor restrained debt at all, as the aims the debt ceilings are expected to achieve. But have instead allowed debt to grow in a short period. By December 2019, the Government accumulated an external debt of US$11.2 billion, K80.2 billion in domestic securities and K26.2billion in domestic arrears.

As another consideration, the legal framework does not compel debt managers to accomplish necessary policy activities for the management of public debt. The law does not provide for any clear objectives to be achieved in debt management neither does it provide for the undertaking of Debt Sustainability Analyses (DSA) to inform the borrowing strategy. Additionally, the publication of medium-term borrowing plans through a Medium-Term Strategy (MTDS), is also not provided for in the law. As such, the maiden MTDS was only published in 2017 despite Zambia having courted the commercial markets in 2012. Though considered as policy issues by some jurisdictions, the lack of binding provisions for the undertaking of these requirements within the law, remains one of the biggest reasons why they have not been implemented. Thus, exposing Zambia to high risk of debt distress through the ambitious borrowing plans.

Lastly, there are no provisions for sanctions on debt managers for mismanagement for not following procedure. Additionally, there are no requirements for audits, transparency and accountability, nor any penalties stipulated for abrogating the LGAA. Moreover, the absence of provisions for transparency and accountability of public debt, has entrenched mismanagement of the proceeds of debt especially that no penalties are stipulated for abrogating procedure. Cleary, the legal framework needs strengthening by harmonising various pieces of legislation and including provisions that will overcome emerging debt issues. This will not only help to bring about prudent public debt management in Zambia but will minimize the exposure to debt default risks and also bring about the desired economic development achieved through judicious debt utilisation.

Thus, the law should require that the Government undertake prudent debt management which is so critical for risk management given that debt default can lead to severe macroeconomic consequences. Actions which should be mandated include: parliamentary approval on debt contraction; established processes on debating the terms and conditions of the loans; Government's borrowing purposes; a clarified and widen scope of debt; improve monitoring and assessment of debt levels in line with the debt ceiling; and undertaking and implementing policy actions such as, debt objectives which help avoid risky debt structures and poorly crafted strategies, regular debt sustainability analysis (DSA) and drafting and implementing medium term debt strategies (MTDS) on a rolling basis through rationalised borrowing plans. This will work well in addition to having well-equipped human resources, coordinating institutions and the right organisational capabilities. The recommendations are further developed as follows:

1. Amend the Loans and Guarantees Authorisation Act to improve Zambia's primary legislation for effective PDM to be achieved

Zambia's primary PDM legal framework requires clear-cut separation of authority, at the minimum in loan authorisation. Parliament's role in the LGAA remains limited to approving the debt ceilings and the Money Bills even though the Constitution requires the National Assembly to approve all contracted debt. Therefore, the LGAA needs to include a provision requiring that final loan authorisation be passed by the National Assembly in line with the Constitution.

Within the law, all loan agreements should be negotiated under local laws and Jurisdiction. This will enhance redemption, conversion and or the consolidation of loans. Apart from only having the Sinking Fund as the means of redemption, whose presence in the law is not backed by a requirement of consistent periodic funding, the Sinking Fund provision should depending on the loan amount prescribe how often and when the funds should be credited and clear guidance given on the percentages required.

Further, the amendment of the LGAA should specify the purposes for which the borrowed monies could be used for. Examples of common borrowing purposes that could be specified in legislation include: to finance budget deficits; fill short-term cash gaps; refinance maturing debt; finance investment projects approved by the legislature; honour government payment obligations under outstanding guarantees; add to foreign currency reserves; support monetary policy objectives to for example drain excess liquidity from the domestic market and so forth.

2. Widen the definitive scope of the Government's debt to strengthen the definition of public debt in the legal design

The definition of "public debt" within the LGAA, should be aligned to the Public Finance Management Act No. 1 of 2018 which defines public debt as: financial, material, and other resources including guarantees acquired or borrowed by a public body in the interest of the Republic. This will broaden the current definition of public debt, which currently has varying implications on PDM.

Contingent liabilities to be covered in the Central Government borrowing should be explicitly stated and adjusted as per the advice of the World Bank and IMF. Those contingent debts not covered should be given clear constraints. Enhancements to the framework should be made by restricting amounts that the Government can guarantee. The law should clearly state which SOE's debt is part of the structure of public debt, which should be calculated, analysed, and reported alongside other public debts. Additionally, subnational borrowing should be governed or clearly restricted depending on the aim to be achieved.

3. Set the debt ceilings as a percentage of GDP to ensure that debt ceilings serve the purpose for which they are meant

Ceilings should be expressed as ratios of the gross domestic product to allow for debt to move in line with the performance of the economy, such that in harsh economic times borrowing may be curtailed and encouraged in robust economic times. More importantly, PDM regulation should be used to deter unwarranted borrowing by including monitoring safeguards in the Law which will help indicate when borrowing is going overboard. To supplement the system of monitoring, indicators of debt safety, such as debt ceilings and debt repayment must be included in the law. These indicators and limits can be divided by type of debt.

4. Mandate policy actions that should be embedded in the law in line with advice from the IMF and World Bank for prudent PDM

Debt objectives should be embedded in the law. Zambia needs medium to long term objectives of PDM to be clearly articulated in the primary legal framework, which will guide implementation by debt managers, facilitate effective PDM and promote accountability. In particular, the Ministry of Finance should be responsible for preparation of the DSA at the technical level, with the results presented to Cabinet for consideration. The legal framework should also require the results to be laid in Parliament by the Minister of Finance, for consideration along with budget documents.

In line with this, the legal framework should explicitly provide for the preparation of the MTDS with the Minister of Finance requiring its preparation in a rolling fashion and in coordination with all other relevant departments and the medium-term expenditure framework. Moreover, the legal framework should explicitly provide for the MTDS to be approved by cabinet as is with the MTEF. As a policy document, the law will empower it and give it authority so that all public debt-related activities be carried out in compliance with it. Should non-compliance occur, legal consequences should be spelled out.

Borrowing plans should be anchored within the MTDS and prudent PDM objectives and rationalised as such. The legal framework should not only require the borrowing plans but should enforce restraint within the PDM objectives without which the borrowing plans may actually worsen PDM as has been the case in Zambia.

5. Provide adequate guidance on monitoring and assessment of loans, transparency and accountability as well as sanctions

A legal basis for auditors to take part in the management of public debt should be clearly provided for in the LGAA. While the PFM grants the Auditor General powers to audit public funds in general, the LGAA does not clearly give tasks and responsibilities of auditors. The Government should also move towards frequent publication of PDM information and data related to public debt. Civil Society Organisations's (CSOs) could be included to be distribution channels of the information on debt. Moreover, to secure effectiveness in the management of public debt, the law should regulate an enforcement mechanism by imposing disciplinary procedures but also civil or criminal sanctions for non-compliance of managers.

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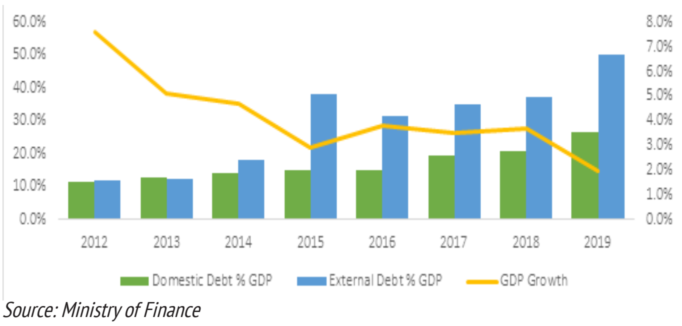
1. Introduction

In an attempt to diversify, industrialise and modernise its economy, Zambia still needs more capital and technology to facilitate economic growth, undertake structural transformation and improve human development to achieve a sustainable path of development. Capital raised from domestic revenues mobilised from within the economy, has been insufficient to undertake these aspirations. Thus, Zambia has borrowed additional resources to cover the difference between Government's revenues and expenditure over the years.

The gap between revenues raised and government spending has been widening over the years, inadvertently resulting in high fiscal deficits. For instance, the deficit outturn in 2018 was recorded at 7.6% of Gross Domestic Product (GDP), marginally higher than the 6.1% target. This trajectory continued in 2019, where the deficit was recorded at 8.2% of GDP on a cash basis against a set target of 6.5% of GDP . Elevated deficits have mainly been attributed to higher than programmed capital projects , entailing that extra debt was mainly obtained to undertake infrastructure projects.

Previously, Zambia relied on concessional external financing for infrastructure development and budget support. However, in 2011 when the country was reclassified to a lower middle-income category there was a significant reduction in concessional financing available to Zambia. The Government, therefore, resorted to non-concessional borrowing which is generally more expensive. As such, though external debt was as low as 12.1% of GDP in 2012, standing at US$3.1 billion and domestic debt was K15.1 billion representing 11.5% of GDP, these debt stock figures quickly escalated as shown in Figure 1. By end December 2019, external debt was US$11.2 and domestic debt at K80.2 billion growing by more than treble the amounts.

Figure 1: Public Debt Growth



Source: Ministry of Finance

Consequently, the International Monetary Fund (IMF) classified Zambia to be at high risk of debt distress in 2017 . Meaning that Zambia's capacity to pay back its debt was becoming questionable. This classification made investors, cooperating partners and the citizenry concerned. It has also led to the deterioration Zambia's credit rating .

While debt has been acquired to finance infrastructure projects, this has not been associated with an increase in economic growth but has instead become a burden on the economy. For instance, while expenditure on road infrastructure is expected to achieve future returns, the challenge is that a larger cohort of social and not economic roads have been finalised, thereby adversely impacting the growth prospects of the economy.

High debt servicing costs have crippled growth in the economy by forcing the Government to spend more on interest payments instead of on national development programmes. For illustration, in 2019, wages and salaries accounted for 38% of domestic revenues and debt servicing accounted for 46%. This means that only about 16% of the Government's revenues were left to fund other expenditure lines which drive the country's development, such as health, education, social protection and agriculture.

Escalated external debt servicing costs have further caused expenditure switches with the Government neglecting to pay its domestic obligations in favour of external commitments. Thus, accumulated domestic arrears stood at K26.2 billion by end December 2019 up from K20.3 billion in June 2019 and this excludes Value Added Tax (VAT) refund arrears. The continued accumulation of domestic arrears has in large part contributed to stifled private sector growth and reduced liquidity in the economy with economic growth in 2019 expected to be a record low of 2%.

1.1 Importance of a legal framework for prudent public debt management

Safeguarding a country from the ill effects of debt is undertaken through a process known as public debt management (PDM). PDM establishes and executes the strategy for the Government's debt, to raise the required amount of financing at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk . PDM can be undertaken through policy pronouncements. But to be effective, PDM should be undertaken within the confines of a robust legal framework . Several aspects of managing Zambia's public debt are provided for within Zambia's various pieces of legislation which were, however, enacted in times when Zambia was not exposed to external commercial debt markets.

Some argue that good debt management will not by itself guarantee against future debt crises, which are often beyond government control. Yet regulating debt management is important because it allows for the mitigation of the different kind of risks: market risks, budgetary risk, credibility and signaling risks, rollover risk, liquidity risk and reindexation risk that the government's liabilities portfolio faces. This is not only done through requiring insight from the past to be used for the future, but also through strategic plans, PDM helps guard against a country's financial vulnerability to external contagion and internal shocks. Because the Government's debt portfolio can be large and complex it may negatively impact firms and households and the entire economic environment of a country. For example, if a government borrows excessively from the domestic markets it results in a "crowding out" effect, meaning that there are fewer domestic resources for the private sector to invest . Similarly, if too much external debt is obtained the country may face large exchange and interest risks that may bulge the debt – risks that Zambia is currently facing . Other consequences may include the decline in international sovereign credit ratings.

Debt management is additionally important because it also aims at ensuring that debt servicing is undertaken in a wide range of circumstances including times of economic or financial market stress. Consequently, PDM should be hinged within the fiscal policy – taxation and spending policies - as well as the macroeconomic policy framework. In fact, even when macroeconomic indicators and debt to GDP ratios point towards economic prosperity, debt crises can still result. This is demonstrated by the Mexican crisis of 1994 and the Asian crises in the period 1995- 2000. This makes it even more necessary to monitor debt and all its aspects as regularly as resources allow. For debt management to be effective, there is need to harness the link in policies through the development of sound institutional structures and guidelines for reducing operational risk .

The centrality of a robust legal framework for PDM cannot be over-emphasised. While political and economic factors tend to influence debt policies and the quality of debt management practices, the legal framework should outline the rules and steps that establish ways through which decisions should be made regarding public debt . A good legal framework should help to promote discipline, accountability and transparency as well as safeguards debt managers from political influence, all of which are critical to achieving sustainable public debt. The PDM legal framework encompasses the legislation, legal norms and institutions that govern public sector debt.

1.2 Study Objectives

Given the manner in which the country has accumulated debt over the past few years, the heightened risk of debt distress and more importantly the bulging interest repayments the questions include: "what kind of provisions govern the management of debt or what is the current legal framework for PDM? Are there sufficient provisions within the law to guard against mismanagement and if not, what are these deficiencies? and finally what remedies could be explored to improve the legal framework for PDM in Zambia?

To answer these questions, the main objective of this study is to assess the adequacy of the legal framework for public debt management in Zambia. In particular, the study will specifically undertake the following:

- Understand how the PDM process is implemented in Zambia and its challenges;
- Evaluate the various pieces of legislation that guide PDM and analyse the effectiveness of Zambia's legal provisions on PDM; and
- Proffer solutions and remedies to improve the PDM process in Zambia.

1.3 Methodology

To achieve these objectives, the study employed a mix of qualitative research approaches. Firstly, desk reviews of legal documents related to public debt management in Zambia were undertaken. Secondly, key informant interviews (KIIs) were conducted with various stakeholders directly or indirectly involved in the public debt management process. The two approaches are elaborated below:

(i). Desk Review: Various pieces of legislation governing public debt management in Zambia were analysed including the Zambian Constitution, the Loans and Guarantees Authorisation Act (LGAA), the Public Financial Management (PFM) Act and other acts used in the PDM process. The desk review also gathered and compared information with various PDM laws in other countries, this assessed whether Zambia's PDM laws have different requirements and what could be learnt and adopted from there.

(ii). Primary Data Collection: Questionnaires were administered to key informants which made it possible to interact with various stakeholders directly or indirectly involved in the PDM process. The key institutions targeted were: Ministry of Finance (MOF), covering the Investment and Debt Management (IDM) Department, Economic Management Department (EMD) and the Budget Office; Ministry of National Development Planning (MNDP); Bank of Zambia (BOZ); National Assembly; Lusaka Securities Exchange (LuSE); Securities Exchange Commission (SEC) and; the Auditor General.

The rest of the report is organised as follows: Section 2 gives an in-depth discussion of the current legal framework for public debt management in Zambia. Section 3 gives the legal framework design considerations and the conclusions and in Section 4 recommendations are provided.

2. Legal Framework for Public Debt Management in Zambia

Internationally, the PDM framework consists of a maze of laws at various levels, spanning supranational, national and sub-national legal frameworks and Zambia's legal framework aligns with the international frame as demonstrated in Textbox 1.

Text Box 1: Sources of the PDM Legal Framework

Supranational

• Treaties of SADC, COMESA and international bodies: Several Acts authorise the application of international law in Zambia including the: International Development Association, Cap. 361; Bretton Woods Agreements Act, Cap. 367; and International Finance Corporation, Cap. 368. These Acts enable Zambia to be a member of, and therefore eligible to borrow from the respective institutions.

The Constitution (Amendment) Act No. 2 of 2016 - Zambia

• Remains the primary source of the Law. It distributes political structures and powers, allocates fiscal powers including taxing authority and sets basic institutional arrangements including the authority to borrow and pay for debt related costs and expenses. It also sets the requirements for audit and reporting.

Primary Legislation

• Dedicated debt legislation - The Loans and Guarantee's (Authorisation) Act No. 13 of 1994, contains the prescribed public debt management laws, Government loan laws, treasury securities laws, and other prescriptions, which provide more specifically for mandates, institutional, and operational matters relating to public debt management;

• Public Financial Management (PFM) legislation - Includes budget laws, PFM or administration laws, and fiscal responsibility laws. The current operational PFM law in Zambia is the Public Finance Management Act No. 1 of 2018. Once enacted, the National Planning and Budgeting Bill of 2019 will establish the framework for budget preparation and execution, cash management, public debt, accounting, auditing, and reporting. Additionally, it will enshrine debt objectives in the primary legislation with the aim to build a culture of transparency and accountability. However, Zambia is currently basing its planning and budgeting decisions on the National Budgeting and Planning Policy approved by Cabinet in 2018. There are no dedicated fiscal responsibility laws in Zambia, they are nonetheless encompassed in the PFM Act; and

• Others - Include other relevant laws such as Central Bank laws, Public Procurement Laws etc... Central Bank laws typically provide for Government borrowing (if any) from Central Banks, and the Central Bank's role as fiscal agent to Government.

Secondary Legislation

• Regulations, rules and guidelines. For instance, those set by fiscal agents in governing the market for Government securities

• Rules, Circulars and Ministerial Orders. (e.g. Statutory Instrument (SI) 53 of 1998).

Adapted from Awadzi, A. E. (2015) Designing Legal Frameworks for Public Debt Management.

Zambia is also party to regional agreements. One regional PDM example is the requirement under the Fiscal Convergence Programme in the Common Market for Eastern and Southern Africa (COMESA), where the standard for government budget deficit (excluding grants) is set to 3% of GDP. Additionally, COMESA requires that "total debt as a ratio of GDP is reduced to sustainable levels" .This provision prescribes a regional constraint on public debt and overall fiscal policy by which Zambia should abide.

Majorly, the PDM legal framework is correspondingly embodied in other local levels of legislation. At the supreme level of the Constitution, Part XVI broadly guides PDM. Specific provisions are laid out in subsidiary legislation dedicated to PDM in various Acts of Parliament, while secondary legislation is contained in different sets of regulations, "ministerial orders" or statutory instruments and rules.

Standards and norms encompassed within the PDM legal framework should incorporate sound features which provide for: (i) the mandate to borrow and to issue new debt; (ii) the authority to conduct debt management activities (iii) the clarity over other substantive and procedural matters affecting public debt; and (iv) the stipulation of roles and responsibilities of various players . These guidelines are meant to strengthen the quality of PDM and reduce a country's vulnerability to structural domestic shocks and or financial external shocks.

In the sections below the report discusses these sound feature necessities, in light of Zambia's legal state of affairs.

2.1 The Mandate to Borrow and Issue New Debt

Zambia's PDM legal framework gives the authority to borrow both domestically and externally. The Constitution gives general broad provisions while specific provisions are given in the subsidiary legislation.

2.1.1 The Constitution (Amendment) Act No. 2 of 2016

The Constitution (Amendment) Act No. 2 of 2016, is the Supreme Law of the Republic of Zambia. According to Article 1, all laws, written law or customary law, must be consistent with it and any law which is inconsistent with its provisions is void to the extent of its inconsistency.

Within the Amended Constitution, there are established across-the-board public finance requirements including the authority to borrow and pay for debt related costs and expenses, the scope of debt, as well as other procedures. In accordance with Article 65 of Act No. 2 of 2016, the Government may, among other things, raise or guarantee a loan or grant on behalf of itself or other state organs, as well as undertake repayment of the loans by introducing in the National Assembly, the Money Bills.

Part XVI – covering Articles 198 - 212 of the Amended Constitution, stipulates the governance of public finances and the budget. Article (198) (c) lays down the guiding principle of sustainable borrowing to ensure inter-generation equity while Article 200 requires the establishment of a Consolidated Fund . The purposes of the fund include to be credited with all monies received in respect of a loan or grant approved and for the defraying of interest payments.

The powers to borrow and lend are stated in Article 207 Sub Article 1 (a) and (b) of the Amended Constitution. The Government may raise and/ or guarantee loans or grants on the State's behalf as well as on behalf of other State organs and other institutions. Article 207 Sub Article (2) provides that legislation enacted for borrowing and lending – the Loans and Guarantees Authorisation Act (LGAA) in this case – shall provide for the category, nature and other terms and conditions of a loan, grant or guarantee.

Further, the Constitution under Article 207 (2)(a), establishes a requirement that before a loan, grant or guarantee is executed, approval by the National Assembly is required. Loans to be contracted by the State and guarantees on loans contracted by State institutions or other institutions are to be submitted by Cabinet to the National Assembly for approval. Thus, assigning parliamentary oversight on the contraction of public debt by the Executive .

For a Constitution, the general PDM provisions are sufficient. However, specifications need to be further prescribed in subsidiary legislation for them to be effectively implemented.

2.1.2 The Loans and Guarantees (Authorisation) Act No. 13 of 1994

The Loans and Guarantees (Authorisation) Act No. 13 of 1994 is the primary legislation used for public debt in Zambia and it is the Act through which the broad pronouncements of the Constitution are to be prescribed . The act, in line with Article 207 (2) of the Constitution on borrowing and lending by the Government, authorises general borrowing, and grants power for the raising and granting of loans, guarantees and indemnities; specifies methods of raising loans; provides for the establishment of a sinking fund; and other supplemental debt related matters.

In Part II, particularly in Section 3, the Minister of Finance is empowered to borrow and raise loans on behalf of the Government as he may deem desirable and should not exceed at any one time the amount/ceiling he is authorised by the National Assembly. The methods by which a loan may be raised include, the issuing of bonds or stock, treasury bills or by agreement in writing. Further, Section 7 provides that any loan raised under this Act shall be raised in accordance with such conditions and terms as the Minister shall direct including the sum of money to be raised; source of the loan; interest rate payable; tax exemptions; and maturity limitation. The only other party recognised in the finalisation of the loan contraction process is Cabinet, of which the Minister of Finance is party to.

Discordance, however, arises on the final authorisation function on debt contraction between the LGAA whose final authority is Cabinet and the Amended Constitution which calls for debt to be approved by the National Assembly before contraction. Separation of roles and responsibilities and thus power, in the management of a country is a necessity and should be extended to public debt as well, to uphold unbiased decision-making and promote checks and balances in the management of debt.

Additionally, the process that is followed when contracting loans is not written down, hence there is no standard procedure to guide loan negotiators. For instance, for public external debt acquisition, a request for financing for a particular project will be submitted to MOF particularly the Investment and Debt Management Office (IDM). Then IDM will approach potential funders for the project, or the line Ministries can specify the funders. If the terms of financing are in line with the set benchmark at MOF, a draft agreement is prepared for the Attorney General's approval. The negotiated terms of the loan are presented to Cabinet for final approval and then executed by the Minister in Charge of Finance .

Clauses, terms and conditions are set by lenders and investors as can be seen with the external agreements, as well as the financial agreements of the Eurobonds and the domestic bonds bided competitively, thus the law should provide for external consultative debate and negotiation before approval. So that all financial implications are considered and renegotiated if need be, since, the financial instruments involved are offered and designed by international financial investors, which consequently have an informational advantage with respect to their potential risks and may have consequences at redemption (see Text Box 2).

According to the LGAA, the Sinking Fund is largely the vehicle through which loans raised for a period of more than 10 years are to be redeemed or paid off. It is from this fund that both interest and principal amounts are to be paid out. Despite this, the Act does not stipulate the percentages of the loan that are to be contributed to the fund or in what frequency. But clearly, the intent is for the Fund to be sufficiently serviced with funding that provides for redemption of loans, upon the expiry of the period of such loan, of not less than 75% of the principal.

Text Box 2: Implications of issuing loans in international markets

The issuance of government loans from international commercial markets mean that debt is issued under international law reducing the influence of national legal systems and hence the State's authority.

A bond's governing law plays a major role for debt restructurings, it predefines the contractual provisions for restructuring as well as the jurisdiction for potential litigations. A large majority of outstanding emerging market bonds issued in international markets are under New York law, with English law the second most common.

For the European Union (EU) countries public bonds have been predominantly issued under domestic laws. An important dimension where the governing law makes a difference is that it gives a sovereign broader scope to seek to alter the substantive terms of its sovereign debt contracts by changing relevant laws of the sovereign.

For instance, considering that Zambia is quickly nearing the repayment period for its first Eurobond of US$750 in 2022, and refinancing of the Eurobonds is being considered as one of the remedies to manage Zambia's public debt.

Zambia may have challenges in obtaining restructuring deals on its first two Eurobonds because the terms do not include Collective Action Clauses (CACs); a CAC is contract clause designed to mitigate collective action problems in debt restructurings. Including CACs in a bond contract helps prevent creditors from refusing to cooperate in restructuring processes. But since the third Eurobond does include CACs it may be easier to restructure it. This means that, the Government is at the mercy of the investors decisions with regards to restructuring the principal payments plans of the first two Eurobonds.

Source: Udaibir S et al (2012) Restructuring Sovereign Debt: Lessons from Recent History

Without the rider on the periodic funding, the Sinking Fund provision falls short of a distinct yardstick and creates room for non-compliance to it. Nonconformity to the requirements of the provision in the Act are observed with Zambia's current Sinking Fund.

Non-conformity to the requirements of the provision in the Act are observed with Zambia's current Sinking Fund. Firstly, it was only operationalised in 2016, despite the contraction of the Eurobonds in 2012. Secondly, while funds have been intermittently provided for the Sinking Fund in national Budgets these have not been actualised during such years. Lastly, the sufficiency of the funds provided for in the budgets has not been near that which is sufficient for the redemption of the Bonds. Based on existing Eurobond loans for instance, for the Fund to have served its purpose, the Government should have been setting aside at least US$ 75 million per year for principal repayment, and an additional US$ 40 million in interest into the Fund . But only K536 million was allocated in 2016 and another K100 million in 2018 and still these amounts were not actualised.

Additionally, lacking in the LGAA are the purposes for borrowing. The non-description of situations in which the Government can obtain borrowed funds has probably been one of the major reasons why borrowing has been undertaken to majorly finance budget deficits and not investments. Comparisons with the South African PFM Act show that within the Act are outlined the purposes for which borrowing can be undertaken and the importance of having this in the legal framework cannot be stressed enough.

According to South Africa's Public Finance Management Act No.1 of 1999 the Minister of Finance may borrow:

(a) To finance national budget deficits;
(b) To refinance maturing debt or a loan paid before the redemption date;
(c) To obtain foreign currency;
(d) To maintain credit balances on a bank account of the National Revenue Fund;
(e) To regulate internal monetary conditions should the necessity arise;
(f) Any other purpose approved by the National Assembly by special resolution.

Outlining the purposes of borrowing in such fashion make the task of auditing easier. Deviations are quickly pinpointed and those responsible of abrogating this can easily be brought to book.

2.1.3 Other Legislation

In Zambia, PDM is also regulated by other legislations that provide additional legal support to the primary legal framework (Text Box 3). One salient Act with significance to the PDM framework is the Public Finance Management (PFM) Act No.1 of 2018 which is discussed in this section. Of importance to note, in other jurisdictions for instance Kenya and South Africa , PFM Acts play a clear-cut fundamental role in the management of public debt. They are comprehensive, restrictive and all-encompassing to include directions on national planning and budgeting, loans and guarantees and other commitments, general treasury matters including the determination of disciplinary and criminal procedures on misconduct.

Text Box 3: Primary and Secondary Legislation Guiding Public Debt Acquisition in Zambia

- **The Loans and Guarantees (Authorisation) Act No. 13 of 1994**
- **The Public Finance Management Act No. 1 of 2018**
- **The Treasury Bills Act No. 161 of 1965**
- **The Bank of Zambia Act No. 43 of 1996**
- **Local Loans (Registered Stock and Securities) Act No. of 1994**
- **The Development Bond Act No. 13 of 1994**
- **The Loans and Guarantees (Maximum Amounts) Order No. 25 of 2014**
- **The Loans (Local Registered Stock) (No. 3 and No. 4) Regulations**
- **The Loans (Stock, Bonds and Treasury Bills) Regulations**
- **The Development Bond Regulations**

Adapted from Banda-Muleya. F. & Nalishebo. S. (2018) 'Reversing Zambia's High Risk of Debt Distress'

The Public Finance Management (PFM) Act No. 1 of 2018

The objective of this Act is to provide for oversight and accountability by detailing an institutional and regulatory framework for the management of public funds. The Act therefore, focuses on the use of public funds including debt after its contraction and hence its appropriation.

Part II, in particular Section 4 establishes the Treasury, with the Minister as its head, to make policy and decisions on the Government's behalf. The role of the Treasury is outlined in Section 5 where it is given responsibility to manage public debt; promote and coordinate the Government's national fiscal and macro-economic policy; receive, manage and disburse public funds; prepare, implement, and manage the national budget; manage the Consolidated Fund; provide good governance and control of public bodies and assets; and formulate and coordinate public investment policy; among others.

Efficiency, effectiveness, transparency and accountability in the generation of revenue of the Republic is a requirement provided in Part III Section 20 of the Act. According to Section 27, all repayments of monies borrowed by the Minister, interest payable and costs, charges and expenses of managing the debt shall be charged against the Consolidated Fund and this is in line with the Constitution.

The PFM Act in Zambia is limited to authorising the setup of institutions to manage and control PFM, and it also includes a section on financial misconduct which, however, only legislates on disciplinary procedures, but misconducts are not deemed to be criminal. The Act also grants the mandate for external audit to the Auditor General.

Secondary Legislation

Within Zambia's secondary legislation various guidelines are given for the enhancement of PDM. For instance, the Development Bond Regulations set a limit to the maximum holding of bonds and the incumbent amounts. However, while the setting of a specified ceiling is appreciated it presents some flaws. Specific bounds face the risk of becoming impractical when the country's economic growth performance is low. Besides, it is not clearly stated whether the country's ability to pay back is taken into consideration when coming up with these ceilings or not. It would have been more prudent if the ceiling figures were stipulated in line with the country's GDP.

2.1.4 Scope of Public Debt

Currently, there is no universally accepted definition of "public debt" and, various jurisdictions have different definitions of their public debt .

In the Zambian context, Article 208 of the Amended Constitution Act No. 2 of 2016, gives the scope of Public Debt. Sub Article (1) states "A public debt shall be a charge on the Consolidated Fund or other public fund" while Sub Article (2) defines public debt as "For the purpose of this Article, public debt includes the interest on debt, sinking fund payments in respect of the debt and the costs, charges and expenses incidental to the management of the debt." Whereas, the PFM Act No. 1 of 2018 defines Public debt as:" financial, material, and other resources including guarantees acquired or borrowed by a public body in the interest of the Republic".

Within the LGAA, prescription of the scope of the Government's debt includes guarantees and indemnities of other State organs and institutions. But what is not clear is whether this extends to contingent liabilities for example, debts arising from the privatisation of State-Owned Enterprise's (SOEs) or funds used for solving problems of bankruptcy of credit institutions like Development Bank of Zambia and the Credit Guarantee Scheme, or the expenses for environmental remediation, etc.

Indeed, adding all SOE debts into public debt remains a controversial opinion because: (i) a State company should be responsible for its debts and the Government should not intervene in the repayment capacity of state companies, except in defaulted government-guaranteed debts; (ii) bankruptcy or default should not happen, especially if evaluation procedures are properly undertaken; (iii) some SOEs can operate efficiently and make positive contribution to the annual budget and the economy.

But poorly managed contingent liabilities have haunted countries. The Czech Republic in the 1990s faced a debt crisis despite economic indicators pointing towards economic growth, due in part to contingent liabilities that its Ministry of Finance was unaware of. Recently, three Mozambican SOE's namely Mozambique Tuna Company (Ematum), Proindicus and Mozambique Assets Management (MAM) defaulted on their US$2 billion dollars State guaranteed loans. The responsibility to pay the loans fell on the shoulders of the Mozambican State and taxpayers .

Contingent liabilities can thus balloon the country's public debt over time if there is no legal framework that caps or monitors them. Zambia could find itself in the same shoes as Mozambique, if laws that ensure appropriate recording and approval of contingent debt by the Ministry of Finance (MOF), are not put in place. Countries such as Ireland and Sweden present good examples in how to enhance the management of contingent liabilities. Ireland's PDM laws for instance require parliament's approval before the issuance of any contingent liabilities whereas Swedish law requires approval by the Minister of Finance before the issue of such debt.

The Act is also silent on whether subnational entities can undertake borrowing on their own behalf. For instance, India in 2011 had an alarming rate for its subnational debt recorded at 25% of its GDP because of this ambiguity. The absence of stipulated actions on such incidences lead to potential risks for public debt sustainability. Without which, it is difficult to know the true reflection of the country's total contingent and public debt alluded to in the 2013 Auditor General's report concerning Zambia's MOF. subnational borrowing should be governed or clearly restricted as in the case of South Africa unless otherwise allowed with a caveat, like is done in Jamaica, where the Financial Administration and Audit Act specifies that all public sector entities, through the ministries responsible for them, gain approval from the Ministry of Finance and National Planning before undertaking subnational borrowing.

Therefore, the amendment of the LGAA should take into consideration the inclusion of contingent liabilities and subnational borrowing as part of the scope of public debt.

2.1.5 Debt Ceilings

Contrary to the belief that debt ceilings are austere and restrictive, most governments actually use them to make borrowing easier. The larger an endorsed ceiling, the more debt a country can accrue. Statutory instrument (SI) 53 of 1998, introduced the debt ceiling at K20 billion (or K20 trillion at the time) until 2014 when it was raised to K35 billion within the Loans and Guarantees (Maximum Amounts) Order No. 25 of 2014. The ceiling was increased further to K60 billion in 2015 and by over 100% to K160 billion in 2016.

The Loans and Guarantees (Maximum Amounts) Order No. 27 of 2019 provides limits for the maximum amount of loans that can be contracted by the Minister raised both within and outside of the Republic. The maximum amount of external loans that can be raised outside the country and payable over a period of more than 1 year is K160 billion. The domestic maximum for loans raised within Zambia and payable over a period of not more than 1 year is K30 billion while that for debt payable over a period of more than 1 year is limited at K70 billion. The total contingent liability at any one time to persons resident outside Zambia is K50 billion; and to persons ordinarily resident in Zambia is K30 billion.

As things stand, Zambia has breached the debt ceilings thresholds provided for in the law. According to the state of the economy address presented by the Minister of Finance on 12th February 2020, external debt increased from US$ 10.23 billion in June 2019 to US$ 11.2 billion in December 2019. At the exchange rate of 12th February 2020 of K14.7 external debt amounted to K164 billion, K4 billion above the threshold. Likewise, domestic debt increased to K80.2 billion in 2019 K10 billion above the threshold. Domestic arrears stand at K26.2 billion which is within the threshold of K30 billion, but they exclude Value Added Tax (VAT) refunds which if added will surely surpass this set threshold. The question that begs an answer is what happens in this situation of breach? The law does not give sanctions or recourse for this kind of mismanagement neither does it provide cautionary measures to be followed in a situation where breach is imminent. Thus, this is another inadequacy that needs to be dealt with.

2.2 The Authority to Conduct Debt Management Activities

Good debt management practices should be tucked within the legal framework to ensure that the funds obtained from debt are used wisely. Debt management practices that can attain this include: well stipulated objectives of PDM, a debt management strategy informed through the conducting of debt sustainability analyses and annual borrowing plans .

This section discusses these requirements and makes a case for their inclusion in the Zambian legal framework.

2.2.1 Objectives of PDM in Zambia

To guide the conduct of debt managers, promote public debt accountability and facilitate effective PDM, Zambia needs medium to long term objectives of PDM to be clearly articulated in the primary legal framework, The main piece of legislation governing PDM – the LGAA – excludes clear objectives and neither are the objectives stipulated in any other piece of legislation. With clear debt management objectives missing, there is no facilitation for effective public debt audits to be undertaken on public debt neither can assessments on the viability of debt nor accountability checks be made on the part of debt managers.

As a remedy, Zambia's maiden Medium-Term Debt Management Strategy (MTDS) stated objectives for the period 2017 to 2019 were to meet Government's financing needs and payment obligations at the lowest possible cost, consistent with a prudent degree of risk. Consequentially, the Government was aiming to deepen the domestic debt market. Zambia was to embrace a gradual increase in domestic and concessional financing to achieve this debt objective. By altering the debt portfolio structure, the country was going to reduce associated exchange rate risks of large proportions of foreign currency denominated debt . However, this was not implemented and because it was not a part of the law, no one can be held accountable for not achieving lower costs and minimized risks.

2.2.2 Debt Sustainability Analyses

Debt sustainability analyses (DSAs) should be a part of the overall fiscal risk management framework and help to assess the sustainability of debt given macroeconomic and institutional variables. DSA's help identify and prudently manage fiscal risks from debt, and they provide guidance for sound debt management strategies . They have become a common feature in several jurisdictions even though they are strictly speaking not a core PFM function.

The lack of frequent undertakings of DSA may be part of the reason why Zambia has been unable to draft frequent debt strategies and it could also be because there is little or no capacity within the MOF to undertake these exercises. The first MTDS was devised after undertaking a DSA in early 2017. The DSA statistically and analytically informed the quantitative benchmarks or targets and initiatives for new borrowing in the medium term. It was through the DSA conducted by the IMF in 2017 that Zambia's risk of debt distress was elevated from medium to high implying that the probability of breaching the debt sustainability thresholds was high and a default on debt servicing was more than likely.

However, DSAs have not been frequently undertaken partly because they are not a requirement of the law and in part because the country still has to develop capability to conduct them. If Zambia had the capacity to undertake these DSAs annually, the risks of debt distress would have been pinpointed and dealt with quite quickly. Thus, providing a statutory basis for the undertaking of DSAs could help to formalize and entrench the practice. If this were to be provided for in the law, there would be need to clarify the responsibility for their preparation and approval and the periodic frequency of preparation, such as on an annual basis or on a mid-term basis, if domestic capacity makes this feasible.

2.2.3 Requirements for a Medium-Term Debt Management Strategy

An MTDS is important because it provides the policy framework in which managerial decisions about recurrent or programmable debts are to be facilitated, while this is done as part of the intermediary resolve to address debt challenges, the ultimate goal is efficient and effective debt management. A good MTDS is more or less a start off point that must be coupled with sound macroeconomic and regulatory policies that are essential for containing the welfare and output costs associated with external and financial shocks.

The MTDS may support secondary objectives such as development of the domestic debt market. Zambia faces a series of simultaneous development constraints that would make good use of the additional capital provided by debt to overcome these challenges but the absence of a strategic plan in form of an MTDS has led to an indeterminate kind of debt management.

Absence of the provision of an MTDS in the legal framework underestimates the fact that the Government manages a huge foreign exchange reserve portfolio, a fiscal position which is subject to real and monetary shocks. It also fails to appreciate the effects that a large exposure to contingent liabilities and the consequences of poorly managed balance sheets in the private sector can have on the whole economy. A well thought out MTDS should be considered within the broader context of the general factors and forces affecting the management of the Government's balance sheet. This would ensure prudent PDM policies irrespective of shocks within the domestic financial banking sector or from the global financial contagion. Lack of legal frameworks specifying the inclusion of an MTDS to be periodically established made Zambia only publish its first

MTDS in September 2017 after several underlying attempts. However, despite the excellent effort at an MTDS, the aims were abrogated sooner than anticipated. The strengths of the espoused domestic debt pillar were highly dependent on external factors while the risks were almost certain . If the performance of Government security auctions in the first half of 2018 was anything to go by, Government's expectation on domestic debt was too optimistic that they ended up raising less funds than anticipated from the domestic markets.

It was unlikely that Government would increase domestic borrowing to the desired proportion of 60% within the debt portfolio as purported in the MTDS period, especially that external debt remained the most viable option for financing the deficit . Additionally, it was also on the horizon at the mid-point implementation of the strategy in 2018, that Zambia was unlikely to access more concessional and semi-concessional external financing as compared to the more available yet expensive commercial debt because of the reclassification to a lower middle-income country.Thus, with unmitigated risks to the adopted pillars and strategies, the maiden MTDS was not meant to be. Silently, the Government abandoned the strategy they themselves had mapped out. Showing that even if an MTDS was to be adopted, on its own it lacks the power to be effective in Zambia because it is not mandated in the PDM laws.

2.2.4 Annual Borrowing Plans

Ideally, the legal framework should also mandate the preparation by debt managers of annual borrowing plans to help with implementation of the MTDS over a given fiscal year. Although, like the MTDS, approval by the legislature is typically not required . Borrowing plans should work to predictably achieve the objectives of PDM.

While the Zambian Government has had annual borrowing plans, they have been declared ambitious by the IMF. In 2017 and 2018, the IMF reiterated a few times that: "[the] borrowing plans provided by the Zambian Government continued to compromise the country's debt sustainability and risked undermining the country's macroeconomic stability and, ultimately, living standards of its people". In tandem with these warnings, Zambia's debt stock grew by 21.6% and 16.2%, respectively, in 2017 and 2018, showing that the country was unwilling or unable to adjust its borrowing plans despite the need for austerity during the period . This shows that without the objectives of reduced cost and risk, borrowing plans may actually jeopardise the aims of PDM.

2.3 Clarity over Substantive and Procedural Matters Affecting Public Debt

As stated earlier, the norms for the legal framework guiding PDM should be all encompassing of details that directly affect debt.

2.3.1 Procedural Matters on Auditing and Evaluation of Debt

Within the current legislation, procedural matters of debt contraction on auditing and evaluation, or use and pay-out of debt are not illuminated. The legal framework does not give guidance on when, and for what debt should be obtained, neither does it provide adequate guidance on the procedure to be followed by the Minister of Finance in negotiating and monitoring loans.

The Constitution in Part XVI, Article 211 calls for the mandatory reporting and auditing of public debt contraction. While the audit of programs and projects that use loans from public debt has been provided for in the PFM Act, there is no provision in the LGAA to specifically stipulate the tasks and responsibilities of auditors in the management of public debt .. Moreover, the lack of external accountability to the public, through legal means, implies that though there are aims to be achieved concerning public debt in each year's budget (Head 99 of the yellow book), there is no one to ensure accountability as to whether the Government did achieve those aims. Moreover, the Government does set debt objectives at least for domestic financing in the annual budget but without an evaluation of its commitments in relation to its macroeconomic objectives concerning public debt, it makes these aims less credible.

For instance, the 2007 national budget address set a macroeconomic objective of limiting domestic debt to 1.2% of GDP in that year. The 2008 national budget address reported an achievement of 0.95% of GDP in terms of domestic debt for the year 2007. In the recent past this accountability has not been demonstrated and as such though the Government intended to limit its domestic debt to 1.2% of GDP in 2017 the national budget address did not illustrate how this would be achieved and it was not stated whether the Government had met this target in the 2018 budget address.

2.3.2 Transparency, Accountability and Reporting

The Constitution also mandates mandatory reporting, therefore the LGAA should also explicitly require debt managers to maintain records of all debt liabilities and exposures including contingent liabilities to facilitate reporting by the Minister of Finance not only to the National Assembly but also for the information of the general public. Mandatory reporting is critical as seen in the case of Germany in Text Box 4, as it allows for a review of: the previous year's financing of the budget deficit; the composition of debt; the results of the debt management strategies; outlook for the medium term; any commitment fees; and penalties paid on any undisbursed amounts of any loan. When such reporting requirements are not made mandatory there is no accountability on the part of debt managers and no resolve to ensure that the right decisions on PDM are made.

The law does not also give guidance on what kind of information should be availed to the public through an MOF bulletin or in monthly reports. Therefore, important information on public debt, such as stock and flows of debt, local administration debts, contingent debts, and the use and repayment of all kinds of public debt, is not mentioned in published documents. Reduced transparency on public debt could be part of the reasons why Zambia's debt has burgeoned. The absence of public oversight may have served to reduce the effectiveness of the management of public debt and relegated the mechanism that could have been used as a trigger for early warning signs.

Text Box 4 : Germany's transparent PDM Framework

Germany's Federal Government Debt Management Act authorises the transfer of tasks related to debt management to the Federal Ministry of Finance, who in turn is authorised to set up the Finance Agency which is the central service provider for Germany's borrowing and debt management. The clarity of the legal status and functions of the Finance Agency in the legal framework is admirable at is shines light on the Minister's responsibility to ensure that the appropriate skills, processes, and systems are in place to manage risks related to debt management.

The legal framework also clarifies that approvals from the German Bundestag, which is the Parliament, are required for loan contraction and calls for regular reports on debt management issues to budget experts from the Parliament. These clear legal underpinnings are essential to achieve accountability in debt management.

Federal borrowing methods are specified in the Act along with the terms and conditions of the securities issued. Securities with an original term of more than 1 year may contain rescheduling clauses which provide debt restructuring measures such as the reduction of interest rates, the change in maturity, the reduction or change in the method of calculating; reducing the principal; and changing the currency of the notes or the place of payment; to name a few. The addition of debt restructuring measures in the legislation is creditable as it aids Government avoid defaulting of payment, and by putting the creditors in charge of making the decision, provides investor confidence and shows commitment to paying back the debt.

Additionally, the absence of openly published debt numbers, allows for the calculation of own likely debt ratios by international entities and foreign investors. Those with interest may calculate data on public debt in their own ways, causing inconsistency of Zambia's public debt information and raising alarms that might also be used by credit rating agencies. Thus, having transparent numbers work to the Government's own advantage when such information is released in good time.

2.3.3 Sanctions for non-compliance

Sanctions for non-compliance with any of the requirements, by debt managers, are not stipulated in the law. While disciplinary procedures have now been included in the PFM Act of 2018, a complete lack of criminal penalties is fertile ground for defiance to follow any provisions of the law, allows for the abuse of power by debt managers and may reduce the likelihood of implementing the law. Enforcement mechanisms (often including reporting and sanctions) should be stipulated by the legal framework. Sanctions for non-compliance of managers could be personal or institutional, and civil or criminal. Civil sanctions for the violation of the law may "include court action to recover payments received under any noncompliant debt transaction while criminal sanctions may involve fines and prison terms.

3. Legal Framework Design Considerations

With the burgeoned public debt stock in Zambia, the need for prudent PDM has become very critical. The existing legal frameworks for PDM in Zambia were appropriate for a time when the country borrowed almost entirely from bilateral and multilateral lenders such as the World Bank, and as a result, have served their purpose. The ushering in of commercial borrowing since 2012, the hardly implemented 2017 – 2019 MTDS and the surpassing of the debt ceiling in 2019 call for updating of the legal framework to mandate certain actions and adapt to changed circumstances.

A robust legal framework is therefore essential to undertake prudent PDM. For the law to ensure effective debt management, it should be all-encompassing and include provisions that will enhance the current framework for debt management. With a robust framework in place, PDM will help achieve sustainable Government debt through the undertaking of essential steps in debt management and ultimately the promotion of transparency, discipline and accountability. Within the current legislation, some key provisions necessary for the management of public debt are deficient.

Firstly, there are several matters that should be considered for amendment and or inclusions within the LGAA and include the following.

Final approval for debt contraction. The LGAA lacks provisions in respect of the separation of powers in the contraction and approval of debt. To this effect there is a disparity between the Constitution (Amendment) Act No. 2 of 2016 and the Loans and Guarantees (Authorisation) Act No. 13 of 1994 on who has the final authority to approve loans before contraction. According to the former, Parliament should have the final stamp, but subsidiary law grants the Minister of Finance through Cabinet this responsibility instead. The National Assembly's role remains limited to approving the debt ceilings and the Money Bills even though the Constitution requires the National Assembly to approve all contracted debt. Thus, approval of debt contraction has eluded members of the legislature, because the provision has not been prescribed in the LGAA.

Processes for contracting loans are not transcribed. While the mandate for borrowing is clearly given to the Minister responsible for Finance within the LGAA, there is no standard procedure to guide debt managers and loan negotiators. As matters stand, the determination of terms and conditions while required to be set by the Minister of Finance, are almost always dictated to Zambia by the lenders with little or no room for negotiation. Other pertinent aspects of debt management that require revisiting include channels to review the terms and conditions of loans so that financial implications of the loans are clearly understood by all, and procedures for redemption, conversion or consolidation of debt which are currently missing in the legislation and leave room for a lot of discretion for the responsible authorities.

Borrowing purposes are not legally mandated. The lack of specification of the reasons for which debt can be obtained means the country has no safeguards on borrowing and leaves room for exposure to contract debt for wrong or misguided reasons. By implication it is up to the Minister to dictate what debt will be used for.

Therefore, with these issues in mind, the Government needs to amend the LGAA that guides public debt management in Zambia so that all management and procedural details are catered for to attain effective debt management.

Zambia's definition of "public debt" is narrow and needs to be clarified from a legal perspective, because this has varying policy implications for the types of public instruments and institutions that are governed by the requirements of the PDM legal framework. From a debt management perspective, the IMF and the World Bank recommend that the scope of public debt should encompass the main financial obligations over which the central government exercises control. This is to ensure that effective constraints, risk analysis and reporting requirements apply to all public entities, to the extent feasible, even though the central Government may not be liable for the debts of the entire public sector.

The higher debt ceilings in Zambia have quite evidently, neither instilled discipline in spending nor restrained debt at all but has instead allowed debt to grow in a short period. The Government has instead accumulated an external debt of US$11.2 billion, K80.2 billion in securities and K26.2billion in domestic arrears.

Another consideration is that **the PDM legal framework in Zambia lacks actions necessary to compel the implementation of policy matters.** In Zambia important policy actions such as the setting of objectives, undertaking of DSAs, the periodic or rolling preparation of the MTDS and annual borrowing plans to feed into the budget, are of a policy nature and not mandated by the PDM laws. This leaves room for debt to be contracted for wrong or misguided reasons and exposes the country to the risks that come with borrowing internationally. While attempts have been made at undertaking these activities, the direction established to be followed within these documents has been forsaken and the annual borrowing plans do not speak to the objectives set in the policy documents.

Clear debt management objectives to give a general policy direction are missing in the pieces of legislation which make implementation on the part of debt managers haywire, monitoring, evaluation and assessment almost near impossible, and public auditing inadmissible. Because there is no guidance on the procedures of debt management including requirements for DSA, MTDS regarding when, and for what debt should be obtained, debt has served budget support and to a larger extent road infrastructure projects.

Lastly, **there are no provisions for sanctions on debt managers for mismanagement** for not following procedure. Additionally, there are no requirements for audits, transparency and accountability, nor any penalties stipulated for abrogating the LGAA. This makes it difficult to put on the right track those responsible for debt management and help stakeholders audit, assess and measure the effectiveness of the debt, policies the management and their implementation.

Undeniably, procedural clarification is essential for auditors who should be responsible for examining and certifying data of all kinds of public debt and debt indicators. This should include them clarifying the purpose of debt, evaluating the effectiveness of the proceeds of debt, examining debt repayment, and defining the security and sustainability of public debt. However, this is currently not available in the legal framework. Additionally, Information disclosure and data transparency on public debt remain imperative for restoring confidence in the development priorities of Zambia.

4. Recommendations

To ensure that the legal framework takes account of missing provisions and can address the different concerns, the proposed improvements to Zambia's legal framework design include:

1. Amend the Loans and Guarantees Authorisation Act to improve Zambia's primary legislation for effective PDM to be achieved.

Zambia's primary PDM legal framework requires clear-cut separation of authority, at the minimum in loan authorisation. Parliament's role in the LGAA remains limited to approving the debt ceilings and the Money Bills even though the Constitution requires the National Assembly to approve all contracted debt. Therefore, the LGAA needs to include a provision requiring that final loan authorisation be passed by the National Assembly in line with the Constitution.

Once the LGAA provides for step by step procedures on the requirement that final loan authorisation be passed by the National Assembly, it can facilitate for a requirement that terms and conditions of loans are debated in Parliament. Lessons can be learnt from South Africa where terms and conditions set out in financial agreements are debated in Parliament and analysed before the country is committed to any debt. This protects South Africa from financial agreements that may not be economically beneficial.

In addition, the amended LGAA should also make it a requirement that the Treasury Counsel or the Attorney General should be involved in the actual negotiations of debt contracts and not just to give comments. Making it mandatory for local legal personnel to be involved in the negotiations will allow for loan agreements to be agreed upon under terms and conditions that ensure true agreement with the requirements of the loan and justify enforcement of the obligations created as they will be in line with local laws and jurisdictions.

Within the law, all loan agreements should be negotiated under local laws and Jurisdiction. This will enhance redemption, conversion and or the consolidation of loans. Agreements should include CACs as the use of CACs has become the norm under European Law. The presence of CACs in the loan agreement can facilitate creditor-debtor negotiations in a restructuring situation, since they reduce the hurdle of having to achieve unanimity on a restructuring agreement (via the majority restructuring clause) and can limit the potential threat of litigation from "holdout" creditors.

Apart from only having the Sinking Fund as the means of redemption, whose presence in the law is not backed by a requirement of consistent periodic funding, the Sinking Fund provision should prescribe how often and when the funds should be credited and clear guidance given on the percentages required.

Further, the amendment of the LGAA should specify the purposes for which the borrowed monies could be used for. Examples of common borrowing purposes that could be specified in legislation include: to finance budget deficits; fill short-term cash gaps; refinance maturing debt; finance investment projects approved by the legislature; honour government payment obligations under outstanding guarantees; add to foreign currency reserves; support monetary policy objectives to for example drain excess liquidity from the domestic market and so forth.

Tabulating the reasons for which debt can be obtained safeguard against borrowing for speculative investments and borrowing to finance expenditures that have not been included in the annual budget or approved by the legislature. Such actions have been observed in several cases and has rendered the legislative process ineffective here in Zambia. In learning from this, the LGAA will require to state the purposes for which loans may be raised. This would act as a buffering tool to ensure debt is only contracted for practical and viable reasons and eliminate any risks of deviation.

2. Widen the definitive scope of the Government's debt to strengthen the definition of public debt the legal design.

The definition of "public debt" within the LGAA, should be aligned to the Public Finance Management Act No. 1 of 2018 which defines public debt as: financial, material, and other resources including guarantees acquired or borrowed by a public body in the interest of the Republic. This will broaden the current definition of public debt, which currently has varying implications on PDM such as inadequate coverage, leading to concerns of inaccurate and inconsistent public debt numbers.

Contingent liabilities to be covered in the Central Government borrowing should be explicitly stated. Those contingent debts not covered should be given clear constraints. Enhancements to the framework should be made by restricting amounts that the Government can guarantee. Objective criteria should be used to evaluate national government entities or local governments in their eligibility for national government debt guarantee – with those already highly indebted barred from obtaining more debt.

Optionally, it would be prudent to state whether SOE's debt is part of the structure of public debt, and should nonetheless be calculated, analysed, and reported alongside other public debts. Moreover, it should also be stipulated within the PDM law on whether debts arising from the privatisation of the SOEs, those solving the problem of bankruptcy of credit institutions, and expenses for environmental remediation and recovering from natural disasters would be considered as public debts because of their high potential risks for national financial security.

Additionally, subnational borrowing should be governed or clearly restricted in like manner as public sector entities, through the Ministry of Local Government, gaining approval from the Ministry of Finance and National Development Planning before undertaking subnational borrowing. This is a very good practice that will allow for proper documentation of debt and ensure that debt records accurately reflect the country's total debt.

3. Set the debt ceilings as a percentage of GDP to ensure that debt ceilings serve the purpose for which they are meant.

Ceilings expressed as ratio's allow for debt to move in line with the performance of the economy, such that in harsh economic times borrowing may be curtailed and encouraged in robust economic times. Subsequently, secondary legislation or guidelines could be used to set the nominal figures for the year according to the analysis and forecasting undertaken beforehand. This is to consider that macroeconomic fundamentals change with time but also allows to be in line with best practice regulations that require that debt plans be published at least annually.

More importantly, PDM regulation should be used to deter unwarranted borrowing with monitoring safeguards included to indicate when borrowing is going overboard. To supplement the system of monitoring, indicators of debt safety, such as debt ceilings and debt repayment must be included in the law. These indicators and limits can be divided by type of debt and presented in both nominal values and in percentage. In addition, it is important to provide reasonable limits. If they are too low, they can hinder the government in implementing necessary reactions during a crisis because the adjustment or approval of new regulations takes a lot of time. In contrast, if the limit is set at too high a level, they are ineffective.

4. Mandate policy actions that should be embedded in the law in line with advice from the IMF and World Bank for prudent PDM.

Debt objectives should be embedded in the law. Zambia needs medium to long term objectives of PDM to be clearly articulated in the primary legal framework, which will guide implementation by debt managers, facilitate effective PDM and promote accountability.

In particular, the Ministry of Finance should be responsible for preparation of the DSA at the technical level, with the results presented to Cabinet for consideration. The legal framework should also require the results to be laid in Parliament by the Minister of Finance, for consideration along with the budget documents. At an operational level, the Economic Management Department at the Ministry of Finance should have primary responsibility for the DSA given its macro-economic implications so that it works hand in hand with the Medium-Term Expenditure Framework in close coordination with the debt management team.

Additionally, taking a leaf from Kenya's PFM Act, there should be requirements on BOZ to guarantee that domestic financial markets are stable before Government securities are floated to avoid the crowding our effect and ensure liquidity in the economy. Assessing the effects of Government borrowing on the private sector whenever raising Government securities should be made mandatory and could be achieved through requiring the undertaking of annual DSA's in the law. The results of the analysis would help with the formation of strategies that would protect economic growth in the domestic economy. In line with this, the legal framework should explicitly provide for the preparation of the MTDS with the Minister of Finance requiring its preparation by EMD in consultation with IDM in a rolling fashion and in coordination with all other relevant departments and the MTEF. Moreover, the legal framework should explicitly provide for the MTDS to be approved by cabinet as is with the MTEF. As a policy document, the law will empower it and give it authority so that all public debt-related activities be carried out in compliance with it. Should non-compliance occur, legal consequences should be spelled out.

The Government also needs to recognise the IMF's repeated concerns that Zambia's borrowing plans over the years have been too ambitious. Going forward, the plans should be anchored within the MTDS and prudent PDM objectives and rationalised as such. The legal framework should not only require the borrowing plans but should enforce restraint within the PDM objectives without which the borrowing plans may actually worsen PDM as has been the case in Zambia.

5. Provide adequate guidance on monitoring and assessment of loans, transparency and accountability as well as sanctions.

A legal basis for auditors to take part in the management of public debt should be clearly provided for in the LGAA. While the PFM grants the Auditor General powers to audit public funds in general, the LGAA does not clearly give tasks and responsibilities of auditors. Given the different demands in the management of the different kinds of debt and the different loan users, the audit of public debt should be conducted regularly and annually.

Once debt objectives and borrowing purposes are set as part of the law, they will enable the office of the auditor general to examine whether these objectives and purposes have been met. This will also be important and feed into devising effective follow-up mechanisms for parliament. With clear procedures spelt out, audit findings and recommendations from the OAG could then be actually implemented to reduce wastage and indebtedness.

The Government should move towards frequent publication of PDM information and data related to public debt. The law should encourage openness on explaining the borrowing plans, what exactly will they achieve, the sources of the debt, the uses of the debt and what they will be spent on, how much interest will be paid on the debt and how often and when the principle will fall due. Data on local administration debts, contingent debts, the use and repayment of all kinds of public debt could also be included. Even though some information on debt is available on the MOF and Boz websites it is usually data in its rawest form which can be very difficult for the public to interpret. The provision of this information in the public domain through various means of publicising information on public debt will ensure transparency on public debt and strengthen the effectiveness of PDM.

Civil Society Organisations's (CSOs) could be included to be distribution channels of the information on debt. In this regard, the laws could clearly outline how the CSOs can be used as a stakeholder in disseminating information on behalf of Government. Currently, there is no legal basis or provision for the participation of the citizens or CSOs and hence allow for transparency and accountability. Currently, CSO participation remains very much limited.

Mandatory reporting by the Minister of Finance to Parliament should be embraced within the law to hold the Executive accountable for its actions, spending and polices. This oversight will work as a measure to ensure that Zambia's debt is sustainable but most importantly that it is being used for the right reasons. For this to be effectively achieved, an exhaustive report covering the debt portfolio, repayment of funds, fund appropriation, project levels of completion, achievement of MTDS, etc. will have to be presented to Parliament at least annually.

Moreover, to secure effectiveness in the management of public debt, the law should regulate an enforcement mechanism by imposing disciplinary procedures but also civil or criminal sanctions for non-compliance of managers. imposing sanctions for non-compliance of managers. The sanctions could work to recover payments received under any non-compliant debt transaction or related to fines and other punishment forms that would be imposed for individual or agencies.

Endnote

1. Ministerial Statement on the State of the Economy by Hon Dr. Bwalya K.E Ngandu, (12th Feb 2020) Ministry of Finance
2. Ministry of Finance. 2018. Annual Economic Report.
3. Debt distress is when a country is already experiencing difficulties in servicing its debt, as evidenced, for example, by the existence of arrears, ongoing or impending debt restructuring, or indications of a high probability of a future debt distress event (e.g., debt and debt service indicators show large near-term breaches or significant or sustained breach of thresholds).
4. Moody's, Standard and Poor's and Fitch have downgraded Zambia credit rating with a negative citing increasing and liquidity pressure that were impairing the Government ability to service the debt in the medium term.
5. Ministerial Statement on the State of the Economy by Hon Dr. Bwalya K.E Ngandu, (12th Feb 2020) Ministry of Finance
6. The International Monetary Fund and The World Bank, 2014. Revised Guidelines for Public Debt Management. Washington, D.C, IMF and the World Bank.
7. Awadzi, A. E. (2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
8. Market risks involve changes in the exchange rate, interest rates, commodity prices, as well as their volatility; budgetary risks refer to the eventual economic contingencies that alter the budget and the primary balance; credibility risk refers to loosing reputation dependent on the signals the government sends; rollover risk is associated with refinancing an obligation once the term has expired; and re-indexation risk is related to the need to index a paper, for example to neutralize the inflation tax.
9. Blanchard, O. & Johnson, D. R., 2013. Macroeconomics. Sixth Edition ed. s.l.:Pearson Education.
10. See Kalikeka. M., Nalishebo. S., and Banda-Muleya. F. (2019) Towards 2022: Options for Paying Back Zambia's Eurobond Debt. ZIPAR
11. Cassard, M. & Landau, D.F (1997) Sovereign Debt: Managing the Risks. Washington, D.C, IMF
12. The World Bank, 2007. Managing Public Debt from Diagnostics to Implementation, Washington: World Bank.
13. Awadzi, A. E. (2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal b Department Working Paper No. 15/147.
14. Awadzi, A. E. (2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
15. Bhatia, J. R., Zhang, J., & Kiptoo, K. C. (2011). Facilitating Multilateral Fiscal Surveillance in Monetary Union Context with Focus on COMESA Region.
16. Awadzi, A. E. (2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
17. The Consolidated Fund is commonly known as "Control 99".
18. The wording in this provision of law makes the approval by the National Assembly mandatory before the loan, grant or guarantee is executed.
19. The Act is yet to be amended even though the Constitution was amended almost four years ago.
20. Key Informant Interviews with Ministry of Finance
21. African Forum and Network on Debt and Development. (2013). Making Loans Work for the Poor in Zambia: Study Report Harare: AFRODAD.
22. ZIPAR (2019). Nurturing the Seeds of Growth: Analysis of the 2020 Budget.
23. Few argue this is not feasible as this money set aside could be used to fund other public service provision requirements. However, this is a requirement of the law. If it is not deemed a fit-for-purpose solution, then the law requires a change. So that there are no excuses for not following the law.
24. Ministry of Finance Fiscal Tables 2016-2018
25. https://kenyalaw.org/kl/fileadmin/pdfdownloads/bills/2015/PublicFinanceManagement_Amendment__Bill2015.pdf
26. https://www.treasury.gov.za/legislation/PFMA/act.pdf
27. (Awadzi, 2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
28. Fauvet (2017) https://www.iol.co.za/news/africa/mozambique-audit-into-hidden-debts-shows-at-least-713m-missing-9967606.
29. (Awadzi, 2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
30. Ministry of Finance. (2017). Zambia's Debt Management Strategy. Lusaka.
31. (Awadzi, 2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
32. Banda-Muleya. F. & Nalishebo. S. (2018) Reversing Zambia's High Risk of Debt Distress ZIPAR
33. Ibid.
34. (Awadzi, 2015) Designing Legal Frameworks for Public Debt Management. International Monetary Fund Legal Department Working Paper No. 15/147.
35. Cheelo. C & Mungomba.N (2019) In Further Pursuit of an IMF – Programme ZIPAR http://zipar.org.zm/research/our-publications/working-papers/121-possible-pathways-for-zambia-to-imf/file.
36. Key Informant interview with representatives of the Office of the Auditor General.

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