Competence, Integrity and Virtue

Zambia Institute of Chartered Accountants

Comments on the Annual Borrowing Plan for the 2025 Financial Year

ZICA

1.0 INTRODUCTION

i. The Zambia Institute of Chartered Accountants (ZICA) is a professional membership body whose function, among others, is to advise Government on matters of national and economic development. The Institute is also mandated to develop, promote and enforce internationally comparable practice standards in Zambia as well as protect and assist the public in all matters relating to the practice of accountancy. With this mandate in mind, our comments on the Annual Borrowing Plan have been made with full cognizance of our obligations as promulgated in the Accountants Act as well as our professional resolve to act in the public interest.

ii. We are privileged to be invited to make oral and written submissions to the Planning and Budgeting Committee on the consideration of the Annual Borrowing Plan for the 2025 Financial Year.

2.0 TOTAL BORROWING NEEDS FOR THE 2025 FINANCIAL YEAR

In 2025, the Government intends to spend K217.1 billion to be financed through tax and non-tax revenues, grants and debt. Revenue and grants are projected at K182.4 billion leaving a deficit of K34.7 billion. This will be financed through domestic and external borrowing of K15.4 billion and K19.3 billion, respectively.

The external borrowing of K19.3 billion relates to projected disbursements on already contracted loans, which were previously approved by the National Assembly, while domestic financing of K15.4 billion relates to new debt to be raised from the domestic market through issuances of Government securities in 2025.

We note that out of the total borrowing of K34.7 billion, only domestic financing requires approval of the National Assembly.

COMMENTS

We commend Government. This is a requirement of the Public Debt Management Act, 2022. The plan is part of the process that delivers enhanced debt transparency and accountability.

We note however, that whilst the maximum net domestic borrowing will be set at K15.4 billion, we note that such a limitation will be academic if not accompanied by policy to reverse the accumulation of domestic arrears. Should domestic arrears significantly increase, it would run counter to the policy objectives of managing the national debt burden. The accumulation of domestic arrears can have very detrimental impact on the economy, including;

1. ***Private Sector Liquidity: When government delay payments to suppliers and contractors, it strains the liquidity of businesses, particularly small and medium-sized enterprises (SMEs), potentially leading to cash flow problems and reduced capacity for investment and growth. In some instances, businesses have been forced to scale their operations down due to liquidity challenges presented by unpaid debts and tax refunds (including Value Added Tax).***

2. ***Credit Market Distortions: Accumulated arrears can distort credit markets by effectively crowding out private sector borrowing. Businesses may find it harder to obtain loans as financial institutions may become more cautious in lending, especially if they hold significant amounts of government debt.***

3. ***Economic Uncertainty: The accumulation of arrears can create uncertainty in the economy, affecting business confidence and investment decisions. This uncertainty can lead to delayed or reduced investment, slowing down economic growth.***
4. ***Public Service Delivery: Delays in payments can also affect public service delivery, especially if contractors halt work on public projects due to unpaid bills. This can have broader social and economic impacts, including on infrastructure development and public welfare. There are numerous examples of contractors stopping work due to failure of government to settle their invoices.***
5. ***Fiscal Sustainability: Persistent accumulation of arrears can raise concerns about fiscal sustainability, as it may indicate underlying issues with fiscal management and budgetary discipline. This can affect the government's credit rating and increase the cost of borrowing.***
6. ***Trust and Reputation: Accumulating arrears can damage the government's reputation and trustworthiness, making it more difficult to engage with suppliers and contractors in the future. It can also affect the government's ability to attract investment.***

3.0DOMESTIC DEBT

Gross Domestic Financing for the financial year 2025 is projected at K78.6 billion, out of which K15.4 billion will be Net Domestic Financing to finance the 2025 National Budget, with the remainder being used to refinance maturities falling due in 2025.

3.1 Methods of Raising Domestic Financing In 2025

Domestic financing will be raised through the issuance of Government securities in public auctions. The auctions will continue to be conducted by the Bank of Zambia in its capacity as Government's fiscal agent.

Government bonds will continue to be issued at face value with market driven coupon rates while Treasury bills will continue to be issued at a discount at market yield rates. Additionally, Government securities will be issued in local currency through competitive and non-competitive bidding at single price allotment.

Domestic Debt Borrowing Instruments

Government bonds - will constitute both medium and long-term domestic debt instruments to be issued during the year. The tenors on offer will be 2-years, 3-years, 5-years, 7-years, 10- years and 15-years to be issued monthly with T+3 being the settlement date.

Treasury bills - will constitute short-term instruments with a maturity period of up to one year. Instruments on offer will include the 91-days, 180-days, 273-days and 364-days tenors to be issued fortnightly with settlement date being T+4.

COMMENTS

The projected increase in both domestic and external debt indicates a continuing expansionary fiscal stance. We have previously cautioned against increasing domestic borrowing which when combined with domestic arrears, presents significant risks to the economy, including:

1. ***Crowding Out:*** *When government increased borrowing from domestic markets, it may crowd out private sector borrowers, including businesses and individuals. Crowding out leads to reduced investment in the private sector, a situation that has been evident in the Zambian economy as investors have increasingly preferred to lend to government rather tha the private sector. There is a the limited pool of savings available for*

investment. We note that when the government borrows more, it absorbs a larger share of the available savings, leaving less for private business. The negative effects of crowding out can manifest in several ways:

- ***Higher Interest Rates:*** *As the government competes for the same pool of funds as the private sector, the increased demand for credit has driven up interest rates. Higher interest rates have made borrowing more expensive for the private sector, which has led to a decrease in private investment.*

- ***Limited Access to Capital:*** *With the government taking up a significant portion of the available credit, there has been capital available for private borrowers. This has particularly affected small and medium-sized enterprises (SMEs) and startups that have found it more difficult to obtain loans. The financial services posture towards small business and start-ups has been extremely risk averse leading to such businesses relying on donor driven start-up funding.*

- ***Reduced Economic Efficiency:*** *Government projects may not always be as efficient or profitable as private sector investments. In many instances, government has borrowed for recurring expenditure. If government borrowing diverts funds from more productive private investments, it can lead to a less efficient allocation of resources and potentially lower economic growth. Government borrowing primarily used for current consumption rather than capital expenditures, does not contribute to future productive capacity as private sector investments might.*

- ***Monetary Policy Implications:*** *The Bank of Zambia has responded to the inflationary pressures caused by high government borrowing by tightening monetary policy, may have further increased interest rates and exacerbated the crowding-out effect.*

2. ***Interest Rate Risk:*** *As the demand for credit by the government increases, it can put upward pressure on interest rates. Higher interest rates can increase the cost of borrowing for the government itself, as well as for the private sector, leading to higher debt servicing costs and reduced investment.*

3. ***Inflationary Pressures:*** *If the increased borrowing is not matched by an equivalent increase in domestic savings, it can lead to inflationary pressures. This is because the excess demand for funds may result in an increase in the money supply if the central bank monetises the debt.*

4. ***Debt Sustainability:*** *Excessive domestic borrowing will exacerbate concerns about debt sustainability, even bearing recent progress made with debt restructuring. This is more so with respect to Treasury bills, which are short-term and need to be rolled over frequently. This can will government fiscal health vulnerable to shifts in investor sentiment and market conditions.*

5. ***Financial Sector Stability:*** *A high concentration of government debt in the portfolios of domestic banks and financial institutions can pose risks to financial stability. If the government faces difficulties in servicing its debt, it can have a ripple effect on the financial sector. This was evident when there was suggestions that the financial services sector should impair government debt and instruments as required by International Accounting Standards. The mere suggestion caused significant stress on the financial services sector and threatened the stability of the banking system.*

6. ***Reduced Fiscal Space:*** *As domestic debt levels rise, government will have less fiscal space to respond to economic downturns or other emergencies.*

High debt servicing costs will limit the government's ability to implement counter-cyclical fiscal policies.

7. ***Currency Risk:*** *Although borrowing in domestic currency reduces the risk of currency mismatches, it does not eliminate the possibility of currency risk entirely. If investors expect devaluation or depreciation, they may demand higher interest rates to compensate for the risk, which can exacerbate the cost of borrowing. The recent pressure on the value of the Kwacha is a risk and may see investors seeking significantly higher interest rates.*

8. ***Resource Allocation:*** *Heavy reliance on domestic borrowing can distort resource allocation, directing financial resources towards government consumption or inefficient projects rather than productive investments that could enhance long-term economic growth.*

9. ***Capital Market Development:*** *While government borrowing can initially help develop domestic capital markets by providing a benchmark yield curve and increasing market liquidity, over-reliance on domestic borrowing can hinder the development of diverse financial instruments and market participants. This is evident in the low liquidity of the Lusaka Stock Exchange with most capital allocated to government securities rather than shares.*

The net increase in debt stock should be carefully managed to ensure that it does not lead to unsustainable debt levels. The assumption made in the debt plan, such as full subscriptions at government securities auctions, may not materialize as expected. Changes in investor sentiment, global economic conditions, and domestic economic performance can all impact the actual outcomes of borrowing operations. This should be borne in mind

4.0 EXTERNAL DEBT

Government has not planned for contraction of any new loans from external sources in 2025. Therefore, external financing will be entirely met through drawdowns on already contracted external loans.

4.1 Projected Disbursements on Existing Loans

The Government projects to drawdown US $697.4 million from already contracted external loans and the Extended Credit Facility from the IMF. These funds will be utilised for the continued implementation of ongoing projects in various sectors of the economy, as well as general budget support.

Table 2: Projected Disbursements on the IMF ECF and Other Existing External Loans

Description	2025 Projected Disbursements (US $)
IMF Extended Credit Facility (Budget support)	187,955,612.78
Drawdown on already contracted loans	509,474,770.95[1]
Total	**697,430,383.73**

COMMENTS

We welcome the concessional loans. They will have lower interest rates, longer grace periods, and extended repayment periods. Despite their favourable terms, concessional loans can still pose several risks to the economy, including:

1. ***Debt Sustainability:*** *Even with concessional terms, there is a risk that the government may once again accumulate debt to levels that are not sustainable, especially if the loans are not used for projects that generate economic growth or sufficient revenue to repay the debt. We are gratified to note that the proposed disbursements are to projects that should generate significant economic growth.*

2. ***Dependency:*** *Relying heavily on concessional loans can create a dependency on external financing. This can be problematic if the availability of such loans diminishes due to changes in the policies of donor countries or international financial institutions. We note the looming elections in the United States which might have an impact on that country's posture towards both direct aid and the multilateral financial institutions.*

3. ***Repayment Obligations:*** *While concessional loans have more favourable terms, they still represent a future obligation that the government must meet. Failure to do so will lead to debt distress and damage the country's creditworthiness.*

4. ***Fiscal Space:*** *The need to eventually service concessional loans will reduce the fiscal space available for other government expenditures, such as social programs or infrastructure investment.*

5. ***Moral Hazard:*** *The favourable terms of concessional loans might lead to moral hazard, where government is less incentivized to manage borrowed funds prudently because the cost of borrowing is artificially low.*

It is crucial for government to manage concessional loans prudently, ensuring that borrowed funds are invested in projects that will generate economic growth and enhance the country's ability to repay its debts.

5.0 CONCLUSION

The 2025 Annual Borrowing Plan (ABP) addresses the requirement for the Government to bridge the financing gap in the 2025 National Budget. In addition, publication of the ABP demonstrates Government's commitment to enhance transparency and accountability in the contraction of public debt.

We believe that the added scrutiny should ultimately result in improved debt management by the Government.