



CENTRE FOR TRADE POLICY & DEVELOPMENT

HE WHO PAYS THE PIPER: ZAMBIA'S GROWING CHINA DEBT CRISIS



TREVOR SIMUMBA
MAY 2018

TABLE OF CONTENTS

1	EXECUTIVE SUMMARY	5
2	BACKGROUND AND RATIONALE	7
2.1	A Growing Crisis: Zambia's Debt Burden	7
2.2	Looking East: Chinese Investment in Africa	7
2.3	Under the Radar: Chinese Investment in Zambia	8
2.4	Project Design and Methodology	8
3.	CHINESE LOANS AND INVESTMENT IN AFRICA	10
3.1	Chinese Interest in Africa	10
3.2	The Scale of Chinese Investment and Lending in Africa	11
3.3	Critiques and Misconceptions: Aid and Investment	12
3.4	The Attractiveness of Chinese Investment	12
3.5	The Chinese Approach in Africa	13
4.	THE ZAMBIAN DEBT POSITION	15
5.	LIFTING THE LID: CHINESE INVESTMENT IN ZAMBIA	18
5.1	The Level of Borrowing from China	18
5.2	What is Borrowing from China Spent On?	22
5.3	The Terms and Structure of Chinese Lending	23
5.4	Do We Know Enough About Chinese Lending in Zambia?	25
6.	CONCLUSION: WHERE NEXT WITH CHINA?	25
	REFERENCES	27

ACKNOWLEDGMENTS

The Centre for Trade Policy and Development wish to thank the researcher Mr. Trevor Simumba for his courageous effort to carry out this challenging study for the time and valued contribution from the start to the end of the research process. We wish to extend our gratitude to all the key stakeholders who agreed to give information to the researcher and his assistant. The study would not have been successful without their cooperation. We would particularly like to extend a special thanks to His Excellency the Ambassador of China to Zambia Yang Youming for his insightful comments and support towards this research. We also extend the same gratitude to the Zambia Institute of Policy Analysis and Research (ZIPAR) and the World Bank Country Economist who provided very good guidance and information to the researcher.

We are indebted to all the people that spared time to share their views and comments on this subject. Due to the sensitivities of some of the issues covered, a good number of respondents elected to remain anonymous. While the researcher acknowledges all the data and information obtained from the various sources the author takes full responsibility for any errors and/or omissions contained in this Report. Its contents are the sole responsibility of the Researcher and can in no way be taken to reflect the views of CTPD or the Government of the Republic of Zambia. As an organization we will be taking up some of the key issues raised in this report for further analysis and advocacy for inclusive policies that will further enhance economic growth and development in Zambia.

Isaac Mwaipopo
Executive Director
Centre for Trade Policy and Development

1 EXECUTIVE SUMMARY

ZAMBIA'S DEBT BURDEN

In Zambia's past, debt has been a millstone which has held the country back. In recent years, public debt is once again rising at a significant pace. The external debt stock increased from US\$6.95 billion at end of the 2016 to US\$8.74 billion by December 2017, and domestic debt (excluding arrears) has risen from US\$3.47 billion to US\$4.64 billion over the same period. This comes despite recent evidence of fiscal consolidation, stable exchange rates and improving economic growth and this trend of rising debt is continuing: the IMF estimate that by the end of 2018 overall debt stock is expected to stand at 60% of GDP, up from 35.6% in 2014.

Zambia's debt burden is clearly rising, but what is perhaps most worrying is that servicing this debt is increasingly unsustainable. The 2017 World Bank and IMF debt sustainability analysis puts Zambia at a high risk of debt distress and increasing fiscal deficits (of particular concern given the Eurobond repayments due in 2022 and 2027), yet negotiations for an IMF bailout package have recently been suspended. Concerns therefore abound that this new and increasing pile of external debt is not being managed in a way that promotes the required fiscal sustainability, and there is thus a viable risk that this time not only will Zambia's debt crisis hold us back, but the level of debt relief and international help received in the past will not be forthcoming.

Chinese Investment in Zambia

As a key provider of external finance to Zambia, understanding how Chinese debt fits into this overall picture is crucial to allowing the Zambian government (GRZ) to adopt appropriate and effective policies aimed at easing Zambia's debt burden. Since the turn of the century China has become increasingly invested in many African states, largely the result of the establishment of the Forum on China-Africa Cooperation (FOCAC). Zambia is no different, and Chinese investment in the infrastructure, natural resources and energy sectors is substantial. Chinese financing and companies are responsible for the on-going construction of airports (such as the new terminal at Kenneth Kaunda International Airport and the new Copperbelt Airport); roads (including the new Lusaka-Ndola dual carriageway project); and rail links (including extensions to TAZARA). Such Chinese investment takes many forms, including (i) grants direct from the Chinese government; (ii) interest free loans from the Chinese government through the Commerce Ministry; (iii) concessional loans; and (iv) commercial loans. However, in Zambia the bulk of Chinese lending is through direct project finance loans with either fully commercial or concessionary terms.

The scale of this Chinese lending is significant: speaking in October 2017, the Chinese ambassador to Zambia said that over 600 Chinese enterprises are investing in Zambia and the total Chinese investment is close to US\$4 billion, making Zambia one of the top ten destinations in Africa for Chinese investment. 95% of all of Zambia's external debt from export and suppliers' credit sources comes from China, with debt from Chinese sources equalling approximately US\$2.3 billion (or 27% of Zambia's total external debt stock) in 2017. Additionally, in 2016 a staggering US\$1.7 billion – 50% of all new loans contracted that year – was lent by Chinese sources. More importantly, according to a statement issued by the Minister of Finance on 21 February 2018, it was stated that China is a natural first creditor and accounts for 28% of Zambia's debt.

Nonetheless, very little is known about the terms and structure of these loans, nor what value they bring to the Zambian economy. Much of this Chinese debt is relatively low-cost when compared

to other sources of finance (at least in terms of interest rates), therefore permitting significant investment into projects designed to promote economic growth and development. However, there is a severe lack of transparency over many key terms, including repayment, contracting obligations, project feasibility, value for money and loan security. This lack of transparency makes it impossible to have a clear account of the implications of this borrowing for the public finances.

Policy Recommendations and Conclusion

To deliver on the potential offered by this relationship between Zambia and China, it is time for a rethink and for reform. This report therefore makes three key policy recommendations, as follows:

1. **Chinese Debt Must be Renegotiated:** Zambia is at high risk of debt distress, and the Chinese ambassador has signalled that China might be open to supporting the GRZ to restructure its debt portfolio. Zambia must therefore take advantage of this and seek to renegotiate its Chinese debt.
2. **Greater Transparency is Required:** The terms and structure of Chinese loans to Zambia – and details about how they are secured – must be transparent. Not only will this help to allay market concerns on the basis that investors should be provided with the key commercial terms of Zambia’s debt portfolio (thus reducing uncertainty), but it will permit greater oversight of the projects the GRZ is promoting and will improve value for money. An important starting point will be for the GRZ to urgently commission and publish a full, independent audit of Zambia’s current debt position which makes clear exactly what the levels of debt are.
3. **Debt Oversight Systems Must be Strengthened:** The GRZ, and specifically the Ministry of Finance, needs to review and reform its ineffective debt management structure. At present there is no ‘challenge function’ either from the Ministry of Finance or from within the sectoral ministries. The GRZ must therefore revamp and revitalise its public finance management systems and align them with national planning. A first step would be to establish a database of projects and to ensure that this is aligned with the debt management systems.

This report concludes that Zambia is at somewhat of a cliff-edge in terms of the sustainability of its debt burden. Reforming and restructuring its debt with China is no silver bullet, however if Zambia is to avoid the fate experienced in the 1990s and early 2000s then it cannot maintain the status quo. Opening negotiations with China and revaluating its public finance management systems would be a sensible – and justified – first step.

2 BACKGROUND AND RATIONALE

2.1 A GROWING CRISIS: ZAMBIA'S DEBT BURDEN

In recent years, public debt in Zambia has been rising at an unsustainable pace. Largely driven by external borrowing and the impact of exchange rate depreciation, outstanding public and publicly guaranteed is rising sharply: recorded at 35.6% of GDP at the end of 2014, the IMF estimate that by the end of 2018 the debt stock is expected to stand at 60% of GDP (IMF, 2017). The national debt burden continues to increase, and during 2018 debt repayment (of both external and domestic debt) is expected to be ZMW 20.14 billion, or around 28.1% of expenditure (PwC, 2017a). This is a marked increase on recent years and total debt looks set to continue to grow in future years.

The challenges in tackling this debt cannot be overestimated. Zambia is due to make its first bullet payment of US\$750 million on Eurobond issues in 2022, and then a second payment in 2027 (PwC, 2017b). However, Zambia currently has no obvious means of affording these payments and the government's policy in tackling its debt burden is therefore subject to significant and continued public interest, scrutiny and debate. The role and impact of Chinese debt in Zambia is an important and topical issue, one which to date has received relatively little attention.

2.2 LOOKING EAST: CHINESE INVESTMENT IN AFRICA

China has emerged over the last decade as a key player in global trade, aid and debt provision to Africa, largely through the strategic partnership of the Forum on China-Africa Cooperation (FOCAC)¹. China's search for natural resources to satisfy the demands of its increasing economic growth and industrialisation led it to Africa, and this interest has given rise to relationships that appear, for the Chinese and African heads of state, to be mutually beneficial. As a result, trade and investment links between the fast-growing economic powerhouse of China and states in Africa have taken a leap forward since 2004, and Africa is increasingly turning not just to the West but eastwards to China for financing to help its economic development. This trend is continuing: for example, President Xi Jinping has recently continued a drive to strengthen relations with the continent, and China has committed a further US\$60 billion to African nations through the FOCAC². International lenders such as the World Bank are also in discussions with the Chinese about working together in Africa, and lending between Chinese banks and African states is commonplace. Consequently, and as will be discussed further in this report, debt levels between states in Africa and China are significant.

1. Part of FOCAC's remit is to hold forums which bring together the heads of states of China and of African states. The first FOCAC event was held in Beijing in 2000, and subsequently these events are organised every three years, with the most recent held in Johannesburg in 2015.
2. This was announced in 2015 by President Xi Jinping at the FOCAC meeting in Johannesburg. This is a significant increase from the pledge made at the first FOCAC meeting in 2006 when US\$5 billion was pledged, and from those made at the second and third FOCAC meetings in 2009 and 2012 when US\$10 billion and US\$20 billion respectively were pledged (Sun, 2015).

2.3 UNDER THE RADAR: CHINESE INVESTMENT IN ZAMBIA

Chinese domestic economic growth over the past two decades has clearly generated ripple effects in the global economy that cannot be ignored, and this includes in Zambia where China wields significant influence over the social, economic and political economy. Partly attracted by its natural resource wealth, Chinese investment in and lending to Zambia is significant and well-established. For example, the debate on Chinese involvement in Zambia dominated the 2006 general elections, and the country has subsequently seen numerous sponsored ‘fact-finding’ trips and exposure visits by Zambian chiefs, government officials, NGOs, ruling party cadres, and business people to China. It can be said that Zambia has also gone to substantial efforts to gain Chinese favour through a wide range of investment incentives and many large-scale infrastructure projects have been granted exclusively to Chinese state-owned enterprises (such projects ranging from roads, rail, airports, hospitals through to Special Economic Zones and large-scale mining licenses). Such projects are commonly financed through Chinese debt and lending, often through the Export-Import Bank of China (China Exim Bank) and the China Development Bank (CDB).

However, relatively little is known about just how far Chinese investment and lending in Zambia reaches, nor about how it impacts the Zambian economy. The opacity surrounding Zambia’s debt is partly the result of the large amount of Chinese project finance (estimated to be approximately US\$10 billion at present³) as such financing tends to be paid directly by the Chinese lender to Chinese contractors, without ever reaching Zambian government accounts. Whilst such financing and loans are eventually included in the government’s official debt figures, loans not yet disbursed are not added to the debt stock (Africa Confidential, 2017). Importantly, contingent liabilities related to sovereign guarantees issued against key loans to Zambian parastatals like ZESCO, Zambia Railways and TAZARA are also not clearly documented in the debt figures. Ultimately, whether such Chinese involvement has a positive impact on Zambia is a complex issue, but it is one which is particularly relevant given the increasing levels of Zambian debt.

2.4 PROJECT DESIGN AND METHODOLOGY

This report examines the issue in further detail by focusing on the fiscal policy implications, challenges and opportunities associated with Chinese debt in Zambia. It seeks to address the following five key questions:

1. How much has Zambia borrowed from China? What were the levels of borrowing in recent years, but also what do the borrowing trends over time look like?
2. How does this compare/relate to the overall fiscal position of the Zambian government? What implications does this raise?
3. What is known about the terms of this borrowing (including interest rates; forms of repayment e.g. in-kind vs. financial repayment; nature of conditions)?
4. What is known about what this borrowing has been used to invest in? How have decisions about where to invest been made?
5. What are the potential, broad, policy implications for the Zambian government?

3. This is based on the author’s own media research.

A two-phase methodology was used. The first phase consisted of detailed desk-based research, drawing on a range of published sources including: secondary literature; government, ministry and government agency publications/outputs and data; Bank of Zambia reports; World Bank reports; media reports and international data sets⁴. The second phase was comprised of targeted field stakeholder consultations and interviews with key respondents. These interviews were held with individuals who have a deep and high-level knowledge and understanding of both the Zambian debt situation and Chinese investment into the country. To respect the anonymity of these individuals, the interviews were (with the exception of an interview with the Chinese ambassador to Zambia) held off the record. Support for this project was provided by the Centre for Trade Policy and Development (CTPD) and the Zambia Institute for Policy Analysis and Research (ZIPAR).

The remainder of this report sets out its findings and is structured as follows:

- **Section 3:** This section provides a more in-depth analysis of China's investments in Africa and includes a review of how such investment is ordinarily structured. It also briefly compares Chinese investment with other means by which African states commonly receive support from the international community.
- **Section 4:** What follows is a summary of Zambia's current domestic and external debt position. Using government-provided data, it also highlights the significant dependence that Zambia has on external debt from China.
- **Section 5:** Drawing on information from the previous two sections, Section 5 examines and analyses the role of Chinese debt in Zambia and includes a review of key policy implications for the government.
- **Section 6:** This final section sets out the conclusions to the report and includes some policy recommendations for the government.

4. This included a review of (i) AidData; (ii) CARI Datasets; and (iii) the Brautigam-Hwang database. Taking these in turn: (i) China.aiddata.org is a collaborative online platform that seeks to make information about Chinese development finance flows to Africa more accessible and usable. AidData's methodology for Tracking Under-Reported Financial Flows (TUFF) to systematically collect open-source information about development finance flows from suppliers that do not publish their own project-level data. It uses TUFF methodology to track Chinese aid at the project level; (ii) China-Africa Research Initiative (CARI) of Johns Hopkins School of International Studies provides data on Chinese agricultural investments in Africa, Chinese loans to Africa, and Chinese FDI in Africa; and (iii) Brautigam and Hwang have developed a new database which provides data on Chinese loans to Africa, including scale of loans, their African recipients, and the sectors where borrowers are investing this finance

3. CHINESE LOANS AND INVESTMENT IN AFRICA

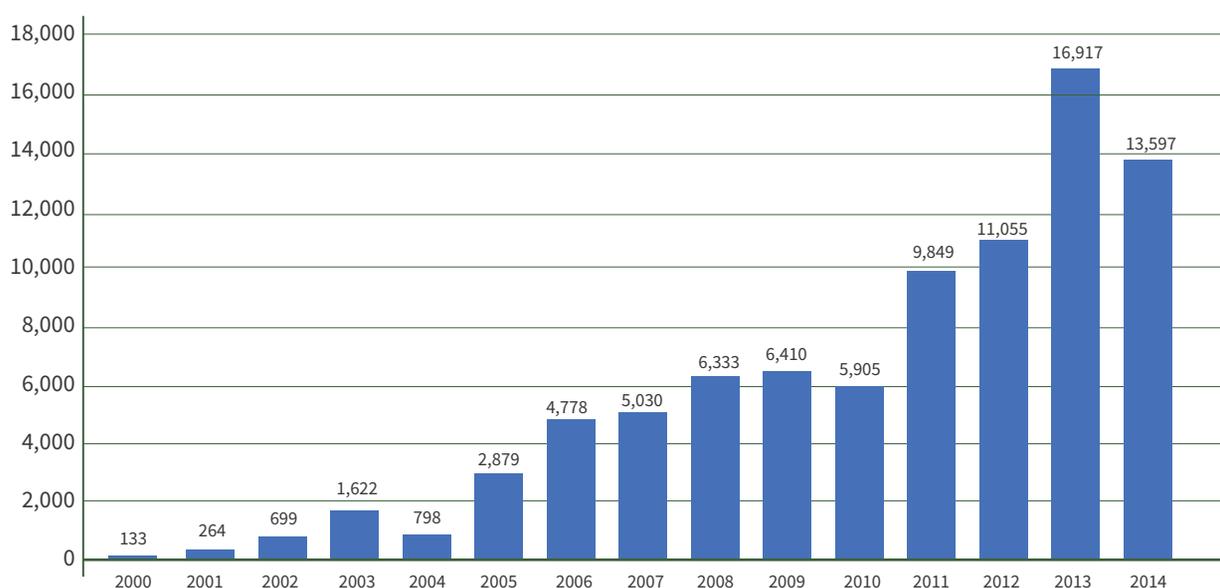
3.1 CHINESE INTEREST IN AFRICA

As noted in Section 2.2, Chinese investment in and financial support for African states is significant and has increased in recent years. This is in part due to demands for investment from many African states, but also because such investments have helped support and supply resources to fuel China's economic growth. However, it is important to understand that China's impact on Africa cannot be seen as a purely an economic phenomenon. From the Chinese perspective, the thrust towards investment in Africa reflects a mixture of narrowly defined economic impacts and broader geo-strategic concerns, including with regard to China's long-term energy and resource security. It also involves a complex assortment of public and private actors, sometimes acting independently, and sometimes in concert. Growing links between Africa and China thus reflect a combination of narrowly defined economic interests (for example, by way of direct trade links) and more broadly defined political factors, including the quest by some states in Africa to escape from pressures exerted by Western governments, international finance institutions and non-governmental organisations (NGOs) to promote more transparent and better governance. China is also often held up as a model of a state that has managed to transform its economy and alleviate poverty levels in a way that other states, including in Africa, can learn from.

3.2 THE SCALE OF CHINESE INVESTMENT AND LENDING IN AFRICA

The scale of Chinese lending to Africa is large and it is rising. The SAIS China-Africa Research Initiative Working Paper (Brautigam & Hwang, 2016) estimates that between 2000 and 2014 the China Exim Bank has provided nearly US\$59 billion in official, medium- to long-term finance to African governments and state-owned enterprises. The CDB has lent a further US\$13.7 billion to official African borrowers and their state-owned enterprises, while the Industrial and Commercial Bank of China (ICBC) has provided at least US\$3.3 billion. As depicted in Figure 1 below, there has clearly been a sharp rise in Chinese loans to Africa in recent years (Brautigam & Hwang, 2016).

Figure 1: China's Annual Committed Loans to African Countries, 2000-2014



3.3 CRITIQUES AND MISCONCEPTIONS: AID AND INVESTMENT

These increases in Chinese investment and provision of loan finance in Africa since 2000 are not free of criticism; ultimately, China is not supporting Africa’s development for ‘altruistic’ reasons. Its support has strings attached – though to a much lesser degree than that of the West – and such strings are mostly commercial. Chinese investments have been credited with helping to fuel economic growth and development in many states but concerns about inherent self-serving Chinese interests have also been raised. These concerns are often studded with accusations of a “neo-colonialist” Chinese attitude and Chinese investments are at times termed as “rogue-aid”. Negatives critiques of Chinese involvement are commonplace; for example, many Chinese investments are considered opaque and lacking transparency, and often Chinese investors are not required to adhere to minimum environmental or labour standards (as is the case with other Western investments). In addition, critics suggest that Chinese investors are often unfairly favoured by African governments through uncompetitive incentive schemes, and there is an argument that an influx of small traders and labour from China (an extension of Chinese investment) do not add substantial value to the local, host economy and in fact take away jobs from locals.

Furthermore, despite the high and increasing levels of Chinese involvement in many African states, Chinese loan finance and investment is a complex and murky subject and is often misunderstood. This is particularly due to lack of sufficient credible and cohesive data-sources and inadequate documentation of key developments and agreements between the Chinese and their African counterparts, but also because the “Chinese government encourages its agencies and commercial entities to closely mix and combine foreign aid, direct investment, service contracts, labour cooperation, foreign trade and export . . . to maximize feasibility and flexibility of Chinese projects to meet local realities in the recipient country (Sun, 2014)”. This means that the form in which China provides “aid” and “investment” to Africa is wide-ranging.

The largest deals between China and Africa tend to be government-to-government and involve infrastructure projects and natural resources (Wharton 2016), and the majority of loan finance from China to Africa originates with China’s official export credit agency, the China Exim Bank. However, the CDB and state-owned commercial banks (such as ICBC) are playing an increasingly visible role and the Chinese Ministry of Commerce and large Chinese state-owned companies also regularly provide zero interest rate foreign aid loans and supplier credits. In addition to direct loans from the Chinese government to African states (through China Aid), China therefore provides the following types of support and investment which can be considered “aid”:

- Export buyers’ credits (including preferential buyers’ credits);
- Official loans at commercial rates; and
- Strategic lines of credit to Chinese companies.⁵

5. This reflects the information from this project’s interview with the Chinese ambassador to Zambia who stated that China provides the following types of funding: (i) grants direct from the Chinese government (China Aid); (ii) interest free loans from the Chinese government through the Commerce Ministry under the FOCAC process; (iii) concessional loans (from China Exim Bank and CDB); and (iv) commercial loans (from China Exim Bank, CDB and ICBC).

Such a mix of practices add a further challenge to identifying what comprises Chinese “aid”. Another significant challenge is that there is a lack of consistency between various definitions of “aid”, which in turn makes comparisons challenging⁶. The term “aid” is often used interchangeably with “investment” when discussing Chinese involvement Africa, but the latter term is far wider in scope and includes a combination of various instruments such as interest-free loans, concessional loans and buyers’ credits. For example, between 2001 and 2012 the total amount of Chinese “aid” was US\$8.5 million according to the OECD definition⁷, but according to Rand Corporation estimates it totalled US\$670 million⁸. It is therefore crucial that any analysis of Chinese aid and investment in Africa acknowledges these complexities and challenges in order to capture the true scope of Chinese “aid”.

3.4 THE ATTRACTIVENESS OF CHINESE INVESTMENT

Whatever the complexities of Chinese “aid”, investment and lending, we should avoid falling into the trap of thinking that borrowing from the Chinese is in some way inherently bad. The following Section 3.5 discusses the nature of Chinese lending in some more detail, including some of the challenges and drawbacks. However, it is important to keep in mind the reasons Chinese lending is attractive and why it will, for the foreseeable future, play a major role in African governments’ public finances. Table 1 below provides a high-level ‘compare-and-contrast’ between the different options for finance available to African governments. Any government will have a mix of different forms of lending, however there are advantages to Chinese lending: it can be cheaper than many realistic alternatives, more easily accessible, and it can have fewer strings attached.

-
6. For example, the most widely accepted definition of Official Development Assistance (ODA) comes from the Organisation of Economic Cooperation and Development (OECD), of which China is not a member. China is therefore not required to follow the OECD’s guidelines and definitions, and based on OECD definitions most of China’s development finance falls under the “Other Financial Flows” (OFF) category, and not ODA. “Development finance” is perhaps a more appropriate term when referring to Chinese foreign aid.
 7. The OECD defines ODA as “those flows to recipient countries or territories which are provided by official agencies, and each transaction of which is administered with the promotion of the economic development and welfare of developing countries as its main objective and is concessional in character and conveys a grant element of at least 25% (calculated at a rate of discount of 10%) (OECD, 2017).”
 8. The Rand Corporation definition captures both direct foreign aid and government-sponsored investment activities.

Table 1: Borrowing Options Available for African Governments

FINANCING SOURCE	PROS	CONS
China (including Exim Bank and CDB)	<p>Cheap (Often LIBOR¹ + 1% or 2%)</p> <p>Fewer strings attached</p> <p>Longer repayment options and more flexibility.</p> <p>Not Conditional on governance / meeting international standard.</p>	<p>Certain conditions, including the requirement to employ Chinese labor and subcontract to Chinese companies.</p>
World Bank	<p>Development-oriented i.e. the primary motive is economic benefit of the recipient country.</p> <p>Cost depends on income or recipient country.</p>	<p>Strings attached, such a environmental assessments.</p> <p>Long-drawn processes.</p>
IMF	<p>Aimed at long-term development and prosperity</p> <p>Strong signs to wider market of credibility.</p>	<p>Stringent conditions linked to the loans</p> <p>Reputation issue and domestic political pressue against “going to the IMF”.</p>
Euro-bonds	<p>Funds available are large.</p> <p>No direct conditions, as applied to World Bank and IMF loans.</p>	<p>Expensive.</p> <p>If not managed well, could lead to large debt-problem.</p>

NOTE: This table presents pros and cons from the perspective of African governments. It is necessarily schematic and high-level

While there are reasons for Chinese lending to be considered attractive, it is also important to more critically understand the motivation of Chinese lenders and, linked to this, some of the potential risks. This is addressed in the next section.

3.5 THE CHINESE APPROACH IN AFRICA

There is a debate about how strategic Chinese investment in Africa: is it entirely strategic, or is it partly driven by short-term business interests? In 2006, China announced a strategic industrial plan toward Africa which envisaged the creation of five preferential trade and industrial zones for Chinese business entry in Zambia, Mauritius, Egypt, Nigeria, and possibly Tanzania. While such industrial zones are meant to foster growth in the host countries by establishing a manufacturing base, they are also a medium to encourage Chinese companies to invest in Africa by reducing operational costs⁹. Further research is required to understand what strategic interests these zones serve for China.¹⁰

However, it is clear that China’s engagement with Africa was initially carried out under the strategic objective of its “Going Global Strategy” which sought to create multinational companies, in particular in the infrastructure and extractive (oil, iron ore and timber) sectors. This dual, but related, focus on gaining access to natural resources and on infrastructure appears to remain the main driver behind Chinese lending.

9. See <https://www.saiia.org.za/occasional-papers/71-chinese-economic-and-trade-co-operation-zones-in-africa-the-case-of-mauritius/file> . Zambia could be a potential case study for further research on this topic.

10. CTPD is currently carrying out research on four such ‘Multifacility Economic Zones’ established in Zambia, two of which are owned by Chinese investors.

With many African states suffering from infrastructure challenges, infrastructure has remained a key focus of large loans from China to Africa at the state level. China has emerged as a significant financier of infrastructure projects across the region, with loans totalling approximately US\$5 billion per year for infrastructure in Africa in recent years (Dollar, 2016). And while the term “natural resources” has disappeared from China’s policy statements in the latest FOCAC meetings (replaced with language like “industrial capacity cooperation” and “strategic complementarity”) (Sun, 2015), as of 2015 the majority of African exports to China were still natural resources (Sun, 2015). It appears that gaining access to natural resources remains a key motivation of China, both at the state and sub-state level.

A review of the literature suggests two further common elements of how the Chinese lend to African countries which are worth noting:

- Much Chinese financial “aid” and investment creates an obligation for African countries to favour Chinese service providers for infrastructure construction and other contracts. For instance, “70% of infrastructure construction and other contracts are awarded to “approved”, mostly state-owned, Chinese companies and the rest handed to local firms, many of which are also in joint ventures with Chinese groups. Many [of these] projects have been undertaken with imported Chinese labour (Reality of Aid Network, 2010)”. Indeed, projects backed by concessional loans are mostly required to be executed by Chinese contractors, often selected through a non-competitive negotiation process (Dollar, 2016).
- China frequently provides low-interest loans to nations who rely on commodities, such as oil or mineral resources, as collateral. Such commodity-backed loans were previously a feature of European, American and Japanese assistance, but in recent years they have been dropped given the evidence that such aid reduces its effectiveness¹¹. The Chinese have, however, taken this model – often referred to as the “Angola model” – to scale (Sun, 2014; Dollar 2016), and approximately one-third of China’s loans to Africa are secured by commodities (Dollar, 2016). However, while some loans are backed by natural resources, “there is no consensus . . . even among Chinese analysts” on how many of the loans are secured, and how they will be repaid (Sun, 2015). Some loans are potentially unsecured (whereby there is a reliance on the investment creating sufficient GDP growth and revenue to finance repayment), and there is also evidence that some loans are secured by land rights.¹²

Having briefly assessed the nature and characteristics of Chinese lending to African governments, in Section 5 we turn to Chinese lending to Zambia in particular. Before doing so, Section 4 provides an overview of the current Zambian debt position.

11. The OECD has worked over the years to understand the impacts of so-called ‘tied aid’, and subsequently led the efforts to bring together a consensus among the development community to untie aid, given evidence that tying aid reduces effectiveness by as much as a quarter (Anderlini, 2007). For more information on OECD work, please refer to the following:

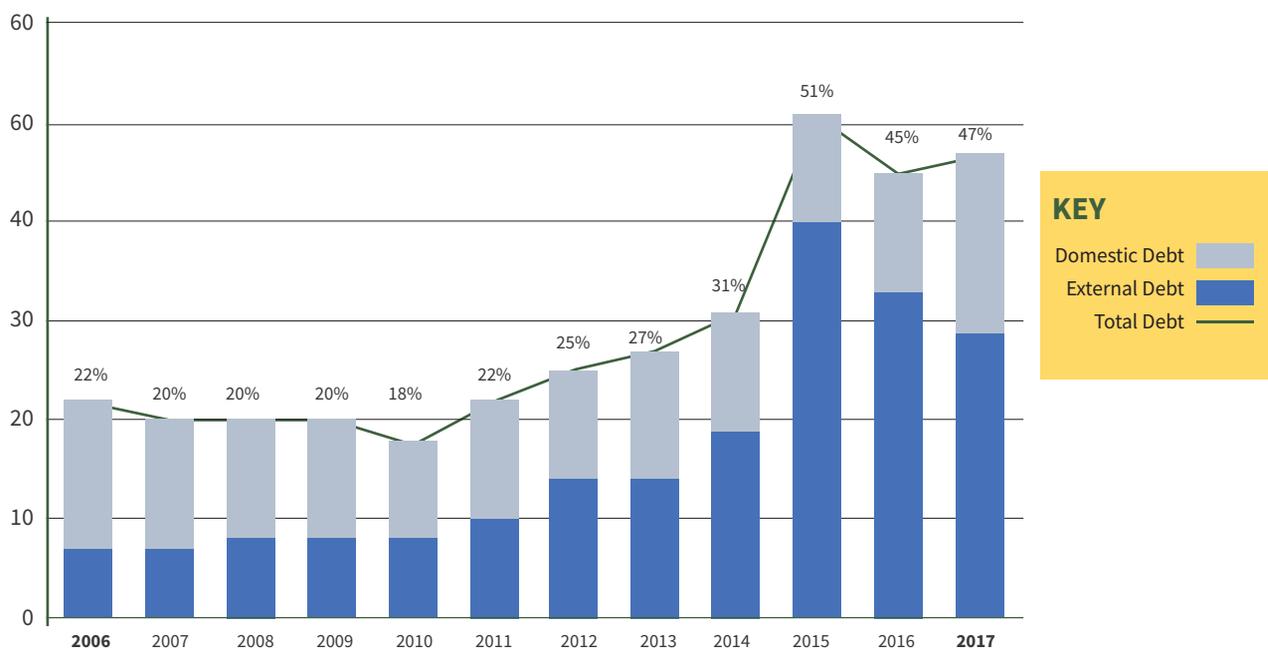
12. <http://www.oecd.org/development/untyingaidtherighttochoose.htm> There is evidence that this occurs in Zambia.

4. THE ZAMBIAN DEBT POSITION

“We cannot spend what we do not have. We cannot borrow beyond our ability to pay.”

This statement was made emphatically by the Minister of Finance during the 2017 budget presentation. However, the government of the republic of Zambia (GRZ) has found it increasingly difficult to live up to this promise. Zambia was one of the countries which was granted debt relief by the international community just over a decade ago. In Zambia’s past, debt has been a millstone which has held the country back: it held back growth by crowding out private sector activity; it stunned development by reducing the amount of money available for investment in health and education; and it made it harder for small and medium-sized enterprises (SMEs) to access finance to grow. The country now stands at the cusp of having to suffer an even worse repetition of these issues – “even worse” because it is not clear that the relief received in the past will be available again in the future.

As noted in Section 2.1 and depicted in Figure 2 below, Zambia’s debt burden continues to expand. Its external debt levels are rising and the ceiling on external borrowing was revised in February 2016 from K35 billion to K160 billion¹³. In 2011 when the Patriotic Front (PF) government took office, Zambia’s external debt stood at US\$3.5 billion (15% of GDP). Using the government’s own figures, external debt stock increased to US\$8.74 billion as at end-December 2017 from US\$6.95 billion at end of the 2016 (an increase of 25.8%). Domestic debt (excluding arrears) has also increased by 46.6% between end-December 2016 and end-December 2017. Below is a chart showing Zambia’s public debt to GDP ratio since 2006, as compiled by ZIPAR. The government’s preliminary figures for 2017 show that external debt in fact comprises 34% of GDP, higher than ZIPAR’s estimate of 29%.

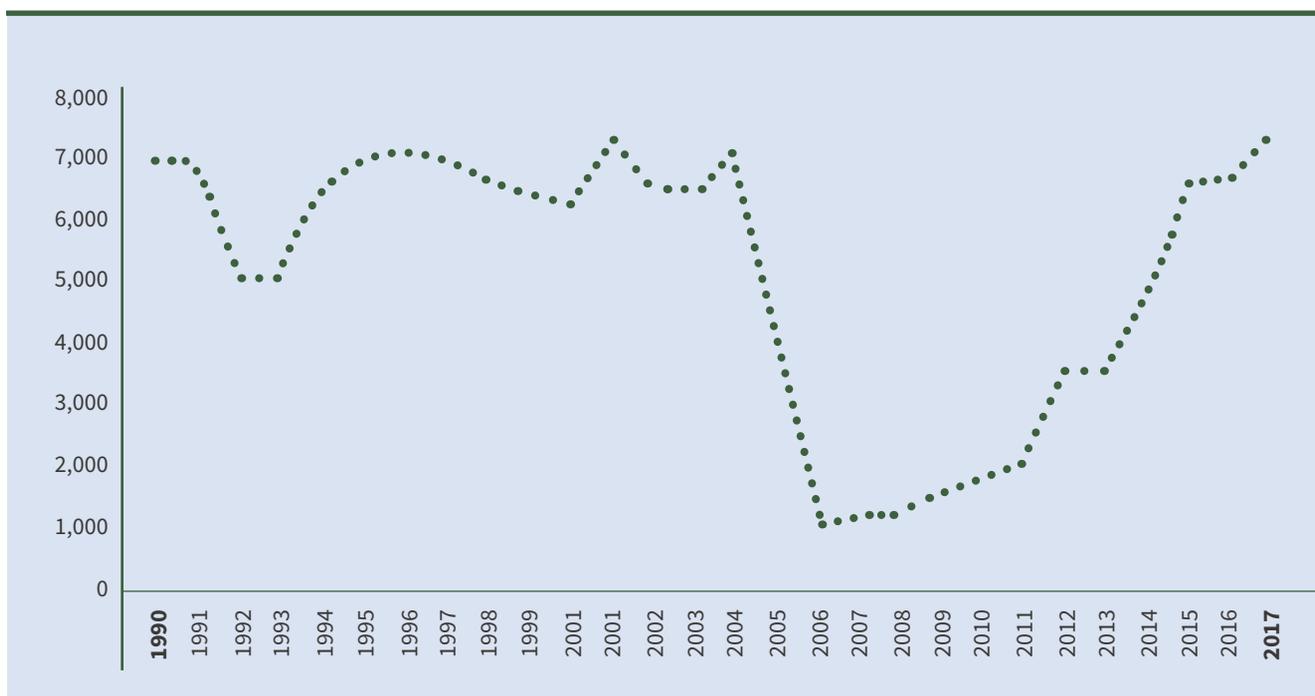


13. The debt ceiling was raised by virtue of an amendment to the Loans and Guarantees (Authorisation) Act, Chapter 366 of the Laws of Zambia. For government bonds, the Act caps debt at K40 billion and for treasury bills the cap is K30 billion (see Zambia Debt Management Strategy).

Figure 2: Zambia’s Public Debt to GDP Ratio (2006-2017)

However, the use of external debt as a tool for development must be done in a manner that maintains fiscal discipline and stability, as well as promoting economic growth to generate income to repay the debts. This is particularly the case in Zambia, because Zambian access to bilateral and multilateral concessional financing is now more restricted due to austerity measures in developed economies and the World Bank’s reclassification of Zambia as a lower middle-income country. This focus on borrowing to generate growth, and as a result increased government revenue, is not happening. Instead, the country continues to run large (and repeated) fiscal deficits, which in turn feeds more borrowing from non-concessional sources¹⁴. The warning lights are flashing brightly.

Figure 3 clearly reiterates the findings of Figure 2 above, showing that external Zambian debt grew sharply from 2012 onwards. But it also shows that Zambia risks going back to the bad old days of the 1990s and early 2000s when debt severely held the country back. Then, as shown in Figure 3 below for years 2005 and 2006 where debt stock dropped rapidly from over US\$7,000 million to nearly US\$1,000 million, the international community allowed Zambia debt relief. However, with concerns that the new pile of external debt is not being managed in a way that promotes the required fiscal sustainability (The World Bank, 2017), there is a risk that this time not only will Zambia’s debt crisis hold us back, but the level of debt relief and international help received in the past will not be forthcoming.



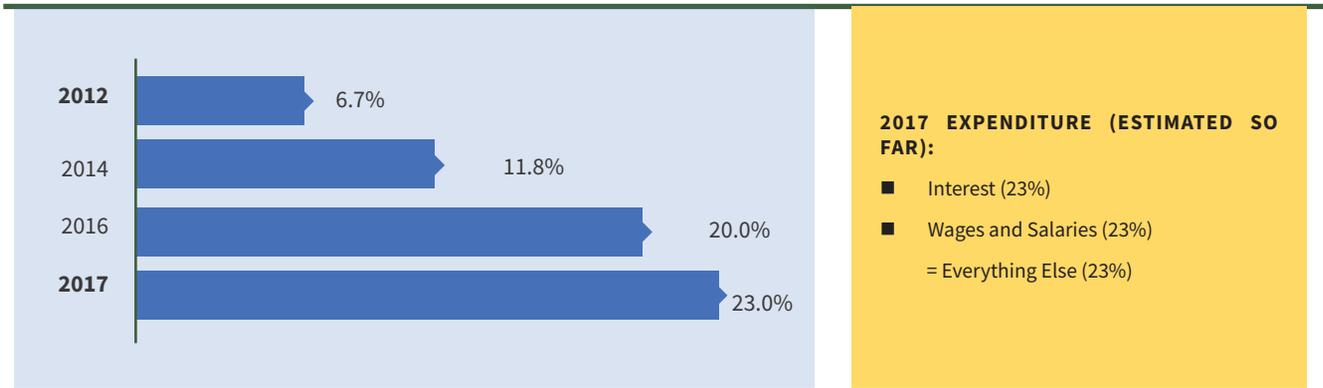
Source: The World Bank, 2017

Figure 3: Zambia’s Public Sector External Debt (US\$ millions)

In other words, Zambia’s rising debt has come at a significant cost and is challenging the economy’s sustainability. An example of this is the strain put on the government’s budget. As shown by Figure 4 below, rising debt put significant pressures on Zambia’s economy in 2017: after debt service costs (interest) and payment of public sector wages and salaries, only 23% of domestic revenue was available for allocation and spending elsewhere. The ever-increasing public wage bill – which

14. Non-concessional lending is typically provided at market rates (as opposed to concessional lending which is normally offered at lower than market rates). Zambia has issued three Eurobonds with a total value of US\$3 billion (these were issued in 2012, 2014 and 2015) and a US\$450 million syndicated loan was also raised in 2016, all at market rates (The World Bank, 2017)

accounted for 39% of the total expenditure in the first half of 2017, 5.6% higher than projected (ZIPAR, 2017a) – combined with high debt servicing costs and lower-than-planned domestic revenue are hampering Zambia’s ability to promote economic growth and spend on development. This is an example of how high levels of public indebtedness can impact on Zambia’s development progress.



Source: The World Bank 8th Zambia Economic Brief, background material from World Bank launch PowerPoint Presentation.

Figure 4: Interest Payments and 2017 Expenditure (% of Domestic Revenue)

Not only are debt levels rising at an unhealthy rate in Zambia, but the stakes are becoming more perilous. There are suggestions that Zambia’s debt is at a higher level than official figures suggest: for example, in a recent article in Bloomberg it was suggested that some lenders, including Nomura Holdings Inc., believe the Zambian state has not come completely clean on the level of its external debt (Hill & Mitimingi, 2018). In addition, former Minister of Finance Dr. Situmbeko Musokotwane (current UPND Chairman for Finance and Parliamentary Committee on Economic Affairs Chair) and former Vice President Dr. Nevers Mumba have also disputed the GRZ’s debt numbers and have outlined clearly that there is significant Chinese debt that has not been properly reported in the government economic reports and statements. Dr Situmbeko Musokotwane “has projected that Zambia will have a total debt of US\$24.46 billion by 2021 if the current borrowing trends by the PF government continues (Lusaka Times, 2018a).” The World Bank and IMF debt sustainability analysis conducted in 2017 puts Zambia at a high risk of debt distress and increasing fiscal deficits, and negotiations for the IMF bailout package have consequently been suspended. As the World Bank states:

“an unsustainable debt burden would impact on poverty reduction in Zambia. It would reduce not only public investment and income growth, but would also reduce fiscal space for social spending as the cost of servicing the debt increases. Less money would be available to finance the government’s national development plans. In the 1990s and early 2000s, high debt service costs directly reduced government budgetary allocations on health, education, and agriculture; and many social safety nets were eroded (The World Bank, 2017).”

A little over 10 years after a huge domestic debt relief effort, the rapid accumulation of debt has therefore once again put Zambia in the spotlight. As a key provider of external finance to Zambia, understanding how Chinese debt fits into this picture is crucial to allowing government to adopt appropriate and effective policies aimed at easing the Zambian debt burden.

Section 5 examines in further detail what form Chinese investment in Zambia takes and analyses the impact it has upon the Zambian economy.

5. LIFTING THE LID: CHINESE INVESTMENT IN ZAMBIA

With GRZ hungry for finance, it has had to look to a range of sources for borrowing. Chinese lending has started to play a growing role, but as noted in Section 2.3, the facts have too often been thin on the ground. In this Section 5, based on the secondary literature and drawing on the elite interviews conducted for this project, we set out information on the following:

- The level of borrowing in Zambia from China;
- What borrowing from China is spent on; and
- The terms and structure of Chinese lending to Zambia.

We seek to make clear where we rely only on official data, some of which has been cast into doubt.¹⁵ We also directly reference interviews conducted for this study, sometimes on the record and sometimes reported anonymously.

5.1 THE LEVEL OF BORROWING FROM CHINA

The overall level of borrowing from China is not clear. Indeed, the lack of clarity about exactly how much GRZ owes to Chinese lenders is highly problematic and needs to be urgently addressed. It appears to be one of the reasons for the breakdown of the negotiations for an IMF loan. The Chinese Embassy in Lusaka stresses the level of “investment” in Zambia stating that “there are more than 600 Chinese enterprises investing in Zambia and the total Chinese investment is close to US\$4 billion. Zambia has become one of the top ten destinations among all African countries for China¹⁶.” However, this does not represent lending to the GRZ. Indeed, in our interview for this project, the Chinese ambassador stated that the Chinese embassy in Lusaka does not have any direct role in or oversight of lending to the GRZ from China, including the lending from China Exim Bank on a commercial basis. Their role is limited to the Chinese Aid funding which is grant based and in facilitating political and commercial links between Zambia and China. On the Zambian government side, the new Finance Minister Margaret Mwanakatwe recently stated that: *“we are not contemplating any stock re-profiling but just the flows that fall due in the period of the repayments. China being a natural first creditor and accounting for 28% of our debt was a natural creditor to have a discussion with.”*

This paper returns to the point the Minister makes about discussing debt with the Chinese. However, at this stage the 28% figure is worth focusing on, and it would be helpful for the government to publish more information on how they arrived at this number for it is hard to reconcile with the official Zambian public data on borrowing from Chinese sources set out below. Indeed, in addition to the general difficulty of defining Chinese “aid” discussed in Section 3.3 above, there are several possible reasons that estimating overall levels of Chinese borrowing is hard:

- The first is that the Ministry of Finance may not even know about some borrowing undertaken

15. See for example Africa Confidential, 2018: https://www.africa-confidential.com/article/id/12290/Into_the_valley_of_debt

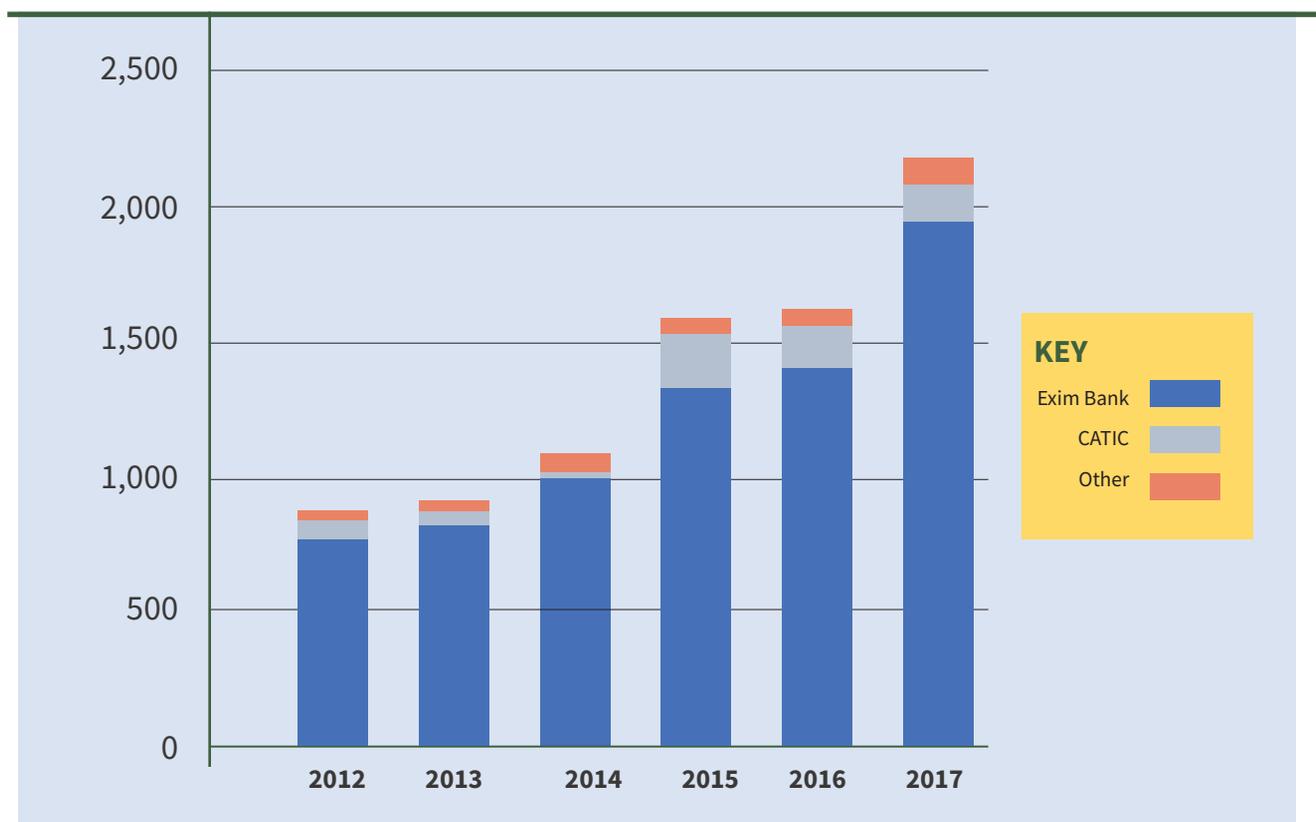
16. Ambassador Yang Youming’s Foreword on the Chinese National Day Special Edition by Zambia Daily Mail from Chinese Embassy in Zambia, 4 October 2017.

by other government ministries or parastatals. In private interviews for this study, it was reported that individual ministries have taken out loans from the Chinese which are backed by GRZ and which should count as sovereign debt, however the Ministry of Finance did not know about the borrowing.

- The second is that some debt is difficult to categorise and there are different approaches: for instance, the Eurobonds are 100% sovereign debt and easy to account for but there is also a lot quasi-sovereign debt (for example, contracted by ZESCO) that is difficult to quantify.
- The third is that there is a lack of accounting for “pipeline debt” which may have been contracted previously, but has not yet been included in the official data¹⁷.

With these caveats about how the official data may be incomplete, it is nevertheless useful to look at the official reported data (as published by the Zambian Ministry of Finance) of borrowing from Chinese sources. Figure 5 shows that Zambia’s external debt from export and suppliers’ credit sources has been increasing since 2012; however, what is most notable is that around 95% of this comes from Chinese sources (either from the China Exim bank or from the China National Aero-Technology Import and Export Corporation (CATIC). In terms of overall levels of GRZ external debt stock, Table 2 shows that this has also been increasing rapidly from approximately US\$3.48 billion in 2012 to US\$8.7 billion in 2017, with debt from Chinese sources equalling approximately US\$2.3 billion (or 27%) in 2017.

Figure 5: Zambia’s Export and Suppliers’ Credit 2012 – 2017 (US\$ millions)



Source: Ministry of Finance Annual Economic Reports (2014 to 2017)

17. One private interviewee stated that “The debt update issued by the Ministry of Finance in February (2018) did not include pipeline debt, particularly the Chinese debt pipeline for 2018”.

	2012	2013	2014	2015	2016	2017
Total External Debt from Chinese Sources	831.09	862.67	1074.67	1660.32	1775.01	2332.82
Total Government External Debt ¹	3480.66	3512.93	4806.83	6704.37	6947.1	8738.95
Percentage Chinese ²	24%	25%	22%	25%	26%	27%

Sources: Ministry of Finance Annual Economic Reports (2014 to 2017)

FOOTNOTES

1. This figure includes all reported external government debt stock, comprising: (i) multilateral debt; (ii) bilateral debt; (iii) export and suppliers' credit; and (iv) commercial debt.
2. This includes export and suppliers' credit to China Exim Bank and CATIC, as well as commercial debt from the CDB.

A similar story of increasing Chinese debt is revealed by looking at the new loans contracted by GRZ, as detailed in Table 3 on next page. Although the figure has dipped in 2017, in 2016 a staggering US\$1.7 billion – 50% of all new loans contracted that year – was lent by Chinese sources (the CDB, China Exim Bank and ICBC). As indicated by the named borrower for each loan, the vast majority of these loans were for large-scale infrastructure projects.

TABLE 3
ON NEXT
PAGE



18. This figure includes all reported external government debt stock, comprising: (i) multilateral debt; (ii) bilateral debt; (iii) export and suppliers' credit; and (iv) commercial debt.

19. This includes export and suppliers' credit to China Exim Bank and CATIC, as well as commercial debt from the CDB.

Table 3: Chinese Loans Contracted by the Zambian Government 2014 - 2017

YEAR	BORROWER	LENDER	TOTAL (US\$)	% TOTAL NEW LOANS
2014	Kenneth Kaunda International Airport (1)	China Exim Bank	45,060,000.00	
	Kenneth Kaunda International Airport (2)	China Exim Bank	306,000,000.00	
	Kariba North Bank	China Exim Bank	54,000,000.00	
			405,060,000.00	26%
2015	Urban and Township Roads Project	CDB	418,000,000.00	
	Smart Zambia Phase I (ICT) Project	China Exim Bank	65,550,000.00	
			483,550,000.00	22%
2016	Mansa-Luwingu (M3) Amendment	CDB	29,500,000.00	
	Public Security Network III	CDB	178,500,000.00	
	Solar Powered Milling Plant	CDB	170,000,000.00	
	Lusaka-Kafue Bulk Water Supply	China Exim Bank	127,500,000.00	
	Ndola Airport	China Exim Bank	337,621,500.00	
	Phase II Urban Roads Lusaka	China Exim Bank	312,809,500.00	
	Nkana Water and Sanitation	ICBC	169,642,996.60	
	Chinsali General Hospital Project	ICBC	135,806,251.37	
	Housing Units Project	ICBC	274,612,768.07	
			1,735,993,016.04	50%
2017	Ndola Airport (15%)	ICBC	59,580,194.00	
	Communication Tower	China Exim Bank	280,764,601.55	
			340,344,795.55	19%

Sources: Ministry of Finance Annual Economic Reports (2014 to 2017)

While this data helps give a sense of the changes over time, it is important to emphasise again that stakeholders interviewed for this project were concerned about the reliability of these numbers. As one interviewee put it: “The lack of reporting and complexity of debt has caused a lot of the problems for the government.”

Another significant and worrying trend in recent years has been the GRZ’s ‘borrowing upon borrowing’. For example, four loans amounting to US\$170.5 million have been taken out by GRZ in 2017 and 2018 to pay for the 15% counterpart funding required by various Chinese implemented projects, namely: Star Times (US\$41 million); the Ndola Airport project (US\$59.5 million) ; Lusaka 400 Phase 2 roads (US\$36.2 million) and the Copperbelt Township roads (US\$33.8 million) (Lusaka Times, 2018b). Each of these loans was provided by ICBC. The effect of these loans is concerning, not least because such ‘borrowing on borrowing’ is further inflating the costs of principal loan repayments and interest servicing payments.

5.2 WHAT IS BORROWING FROM CHINA SPENT ON?

As Table 3 above shows, Chinese engagement in Zambia covers a range of sectors including the construction of various infrastructure projects including airports, roads, bridges, energy facilities and hospitals. In this project’s interview with Yang Youming, the Chinese ambassador to Zambia, he stressed this focus on infrastructure in particular, stating that China believes that Zambians need infrastructure first before the industrialisation process might begin: “you can’t put the cart before the horse”. He made the point that, after having invested heavily in infrastructure, China would now like to shift to investment into Zambian industry, and he highlighted several recent Chinese investments which illustrated this shift in focus. These include investments in the following:

- Marco Polo Tiles (valued at US\$50 million);
- Various fertiliser plants;
- Matero Industrial Park (by China Sinoma);
- A cement and building materials factory in Chongwe;
- The Lusaka East Pharmaceutical Company (valued at US\$40 million); and
- The China African Cotton Mill in Eastern Province.

However, the bulk of existing investment still appears to be focused on infrastructure. China’s expertise in transport infrastructure, combined with access to funding from Chinese state-owned banks, has certainly made it a key player in Zambia’s transport sector. In respect of road investment, as of April 2016 16 out of 23 contracts tendered for Link Zambia 8,000 had been contracted to Chinese companies, and Lusaka 400 is 85% financed by a China Exim Bank loan. The 321 km Lusaka-Ndola Dual carriageway is also being supported with US\$1.2 billion of Chinese investment (see Case Study 1 below for further details).²² Railway investment is also significant: for example, the Tanzania-Zambia Railway Authority (TAZARA) recently received four new locomotives and 18 wagons from a Chinese firm, and the 388 km Serenje to Eastern Province TAZARA rail link is being financed using US\$2.3 billion of Chinese money. Finally, Chinese finance is behind the design and construction of the new terminal at Kenneth Kaunda International Airport (KKIA) (see Case Study 2 below for more details), and the Copperbelt International Airport is being financed using US\$397 million of Chinese loans (African Aerospace, 2017).

20. Private interview.

21. See Ministry of Finance 2017 Annual Economic Report Table 7-5 ‘Loans Contracted in 2017’.

22. It should be noted that in our discussions with the Chinese embassy it was clarified that the Lusaka-Ndola dual carriageway is a public-private partnership (PPP) and the Chinese consortium implementing the project have obtained commercial funding from the CDB.

5.3 TERMS AND STRUCTURE OF CHINESE LENDING

As we saw in Section 3.5, Chinese assistance can come in a range of forms. It can be through grants made directly by the Chinese government, or it can be in the form of interest free loans which are made through the Ministry of Commerce in Beijing. However, the bulk of lending is through direct project finance loans with either fully commercial or concessionary terms. In this section we discuss some case studies of this form of lending in an attempt to shed more light on its terms and structure.

CASE STUDY 1:

THE LUSAKA-NDOLA DUAL CARRIAGEWAY PROJECT



During the ground-breaking ceremony for the Lusaka-Kapiri-Ndola dual carriageway project, the Chinese ambassador to Zambia recited an old Chinese proverb: “build your roads first if you want to get rich.” The Lusaka-Ndola dual carriageway project is an example of the Zambian government’s aim of achieving this goal by improving its infrastructure to promote economic growth and development, with the Minister of Finance stating that “the recently launched Lusaka-Ndola dual carriage way is one of the most critical economic roads”. The project is being constructed using Chinese financing.

Initially proposed as a PPP, it is understood that the 321km Lusaka-Ndola Dual Carriageway project is being financed with a loan of US\$1.2 billion to the Chinese-led PPP consortium from the China Exim Bank. As with the construction of the new terminal at KKIA, the dual carriageway is being constructed by the Chinese company China Jiangxi. Whilst nearly 3,000 jobs are expected to be created by the project over its four-year construction period, it is another example of funds being funnelled into Zambia from China but going directly to Chinese owned and operated companies – in this case China Jiangxi – instead of to the government or directly to Zambian firms. It remains to be seen how local Zambian companies and individuals will be sub-contracted by China Jiangxi to work on the project.

Not only is the size of this Chinese loan tremendous, but its terms remain opaque. For example, it is understood that the GRZ have provided a US\$1.2 billion sovereign guarantee for this project, but the exact terms of this security are unknown. Furthermore, there are significant questions surrounding the value for money afforded by this project: at the time requests for proposals were being taken in January 2016, the Road Development Agency stated that the economic internal rate of return for the carriageway would be approximately 29%; however, latterly in a Ministerial Statement to Parliament the Minister of Infrastructure and Housing noted that this rate of return had fallen to 15%.

Ultimately, the opacity surrounding the financing of the Lusaka-Ndola project mean that it is difficult to ascertain the true impact it will have on Zambia’s debt burden

CASE STUDY 2:

KENNETH KAUNDA INTERNATIONAL AIRPORT



Over the past few years export credit financing in China has increased significantly. Most Chinese “aid” – and concessional export credits in particular – comes in the form of foreign infrastructure, energy and natural resource projects that are contracted out to and then implemented by Chinese companies. As a result, the disbursement method used is almost always direct payment of the Chinese supplier, with the host government receiving little or none of the incoming funds. An example of a project structured in this way is the new terminal building at Kenneth Kaunda International Airport in Lusaka.

Construction of the new international terminal at KKIA is regarded as “one of the key strategies in developing Zambia as a transport hub in the southern African sub-region”, and it is hoped that it will help to create jobs, promote tourism, aid transportation of goods and people whilst contributing to greater revenue generation (Ministry of Works and Supply, 2016). The government of Zambia engaged the China Jiangxi Corporation for International and Technical Co-operation Zambia Limited (China Jiangxi) to construct the new international airport infrastructure, with construction getting underway on 1 April 2015. China Jiangxi was also given the responsibility of designing the new airport facilities which include the presidential pavilion, new passenger terminal, commercial complex, airport shopping mall, office park, new warehousing facilities and the rehabilitation and conversion of the existing terminal into a new one to cater for domestic flights.

This project is undoubtedly creating employment for Zambians: as of the end of January 2018, the total number of Zambians employed on the project was 1,200. However, the financial commitment – and the project’s contribution to Zambia’s debt position – is tremendous. The Minister of Housing and Infrastructure Development, Mr. Ronald Chitotela, recently confirmed that the total cost for the design and construction of the new airport facilities is US\$360 million (this is comprised of loans from the China Exim Bank in the form of suppliers’ and export credit, the first loan being for US\$306 million and the second for US\$54 million). As of March 2018, US\$250 million, including a US\$25 million advance payment, has been disbursed and spent (Ministerial Statement, 2018). The facility has a maturity period of 20 years, an interest rate of 2% per annum, a 0.25% per annum management fee and a 0.25% per annum commitment fee (Ministerial Statement, 2018).

These case studies highlight several important points. The first important (and positive) point is the low interest rates which are available from Chinese sources of lending. For example, the interest rate on the KKIA financing is 2% (or 2.5% once commitment and management fees are included). This is significantly lower than the rate available through commercial lending, including Zambia’s Eurobonds²³. This suggests that GRZ is able to finance large-scale infrastructure projects

in Zambia – each with the aim of boosting economic growth and human development – at a scale that might not be possible if it was reliant solely on commercial debt.

However, the case studies also demonstrate some negative aspects of Chinese financing. The second point regards the lack of transparency which makes it impossible to have a clear account of the implications of this borrowing for the public finances. For example, not knowing what the repayment terms are for the Lusaka-Ndola dual carriageway makes it impossible to ascertain the implications for future repayments. How does GRZ intend to service its debt repayment obligations, and does it have the ability to do so? Furthermore, this lack of transparency means very little is known about how these loans are secured: in the past loans were often linked to the copper price (a similar model to the ‘Angola model’ commodity-backed loans discussed in Section 3.5 above), but this is no longer commonplace. Instead, it is understood that the GRZ might issue sovereign guarantees (as is the case with the Lusaka-Ndola project discussed in Case Study 1 above), and that loans are increasingly secured by prime government land and buildings. Nevertheless, there is no certainty over what the structure, terms and scale of the security offered is.

A third point is whether Chinese financing is providing Zambia with the best value for money for its investments. For example, the funding model where payments are made direct from the Chinese lender to a Chinese contractor who will deliver the work may have some advantages in terms of ability to deliver the project – for instance, when interviewed for this project the Chinese ambassador expressed faith in the Chinese system generating effective project management. As an example, he stated that China’s own success in moving from a net borrower to a net lender has led to its effective project management and appraisal systems which in turn ensure viable economic returns to investments made through loans. But this funding model also raises questions about competitiveness, how much the infrastructural investments are generating jobs (and knowledge transfer) in the Zambian economy, or returns for Zambian firms. Engineering Institute of Zambia (EIZ) vice president for finance and administration Abel Ng’andu estimates that the GRZ awards more than 80% to 90% per cent of government construction works to foreign contractors and not local firms (Rose, 2017), and this claim has been corroborated by the former Minister of National Planning, Lucky Mulusa, who stated at a joint Zambia China Forum that “over 10 years from 2011 to 2021, Zambia is envisaged to spend about US\$20 billion of which 83% will be undertaken by Chinese companies (Lusaka Times, 2017).” Overall, it is difficult to ascertain whether these projects are providing true value for money for Zambia, and the near-50% drop in the economic rate of return for the Lusaka-Ndola dual carriageway (as discussed in Case Study 1 above) is a case in point.

5.4 DO WE KNOW ENOUGH ABOUT CHINESE LENDING IN ZAMBIA?

This Section 5 has ultimately shown that investment in Zambia is significant and it has been increasing over recent years. Nearly all of Zambia’s debt from external export and suppliers’ credit sources comes from China, and Chinese lending comprises over a quarter of Zambia’s total external debt stock. Much of this Chinese debt is relatively low-cost when compared to other sources of finance, therefore permitting significant investment into projects designed to promote economic growth and development. Nonetheless, whilst the physical projects that these investments are financing might be visible to many Zambians (for example, the new road, rail and air links that are being constructed), it is still the case that very little is known about the precise terms – and therefore the cost to the Zambian economy – that these loans carry.

23. For example, Zambia’s most recent Eurobond issue in 2015 had a coupon rate of 8.97%.

6. CONCLUSION: WHERE NEXT WITH CHINA?

A continued focus by the GRZ on infrastructure investment supported by Chinese finance has the potential to be a “win-win” situation for both China and Zambia. However, in order for both to benefit and to ensure the best value for money, reforms are required: Zambia’s debt position is unsustainable, and a reform of the terms and structure Chinese debt could go a long way towards relieving the burden.

China is an important partner for Zambia, but the GRZ must ensure that relationships with China (and Chinese entities) work to promote enhanced domestic private sector development, industrialisation and trade in the sub-region. Zambia’s project development and public investment systems must be strengthened, as should its debt management systems. It is therefore critical that the GRZ conducts detailed project appraisals and feasibility studies of all Chinese-funded projects to ensure value for money, and the Ministry of National Planning must be supported to ensure that they have the capacity to monitor and evaluate the implementation of the National Development Plan. Ultimately, Zambia’s overall public finance management systems must be aligned with national planning and they must be made more transparent.

However, the responsibility does not lie solely with the GRZ. There is an important role to be played by civil society organisations alongside that played by the GRZ, and these organisations must continue to raise the issue and inform debate. A good example is the work being undertaken by AFRODAD²⁴, and in particular its development of an African Borrowing Charter which ultimately seeks to ensure that public debt in African states is sustainable.²⁵ The conversation must not be permitted to wane.

Zambia and China have had relations for more than 50 years, but to deliver on the potential offered by this relationship it is time for a rethink and for reform. This report therefore concludes with three key policy recommendations, as follows:

1. **Chinese Debt Must be Renegotiated:** Zambia is at high risk of debt distress, and China is restructuring its debts across Africa. The Chinese ambassador has signalled that China might be open to supporting the GRZ to restructure its debt portfolio in Zambia, and Zambia must therefore take advantage of this and seek to renegotiate its Chinese debt. This might involve a process of refinancing or it might instead focus on addressing concerns about how the debt is contracted. Regardless, the key is ensuring that Zambia is in a position to service its debt (both Chinese and otherwise). Chinese support in reaching this position should be encouraged.
2. **Greater Transparency is Required:** The terms and structure of Chinese loans to Zambia – and details about how they are secured – must be transparent. Not only will this help to allay market concerns on the basis that investors should be provided with the key commercial terms of

24. The African Forum and Network on Debt and Development (AFRODAD) is “a regional platform and organisation for lobbying and advocating for debt cancellation and addressing other debt related issues in Africa.” See www.afrodad.org/

25. The African Borrowing Charter is in draft form, however it “aims to sustainably balance public debt levels with the necessity to accelerate inclusive development and enhance public service delivery in Africa” and “to contribute to improvements in the transparency of the political, institutional and administrative processes used; and the accountability of the State actors involved in; the contraction and management of public debt, the issuance of public guarantees, the selection and implementation of debt financed projects and the formulation and execution of overall fiscal policy, within the context of strengthened legal frameworks and the rule of law.”

Zambia's debt portfolio (thus reducing uncertainty), but it will permit greater oversight of the projects the GRZ is promoting and will improve value for money. In particular, there should be greater transparency of the procurement of Chinese infrastructure funding, the selection of construction firms and subcontractors (whether Zambian or Chinese) and the project design. Feasibility studies and repayment assessments must be conducted for each project, and these must be made public. An important starting point will be for the GRZ to urgently commission and publish a full, independent audit of Zambia's current debt position (both internal and external) which makes clear exactly what the levels of debt – and their repayment terms – are. The fact that, at present, non-disbursed but contracted debt is excluded from the GRZ's official figures on its external debt stock must also be addressed and rectified.

3. **Debt Oversight Systems Must be Strengthened:** The GRZ, and specifically the Ministry of Finance, needs to review and reform its ineffective debt management structure. At present, Ministries are responsible for planning and implementing their own sectoral investments with guidance from the National Development Plan, the Medium-Term Expenditure Framework and the annual budget. However, there is no 'challenge function' either from the Ministry of Finance or from within the sectoral ministries²⁶. The debt management system has also been offline for over three years. The GRZ must therefore revamp and revitalise its public finance management systems and align them with national planning. A first step – which would both support and be supported by the greater transparency suggested by Recommendation 2 above – would be to establish a database of projects (detailing their project cycles) and to ensure that this is aligned with the debt management systems. Such a system was beneficial in Colombia, and it could be replicated in Zambia.

Zambia is at somewhat of a cliff-edge in terms of the sustainability of its debt burden. Reforming and restructuring its debt with China is no silver bullet, however if Zambia is to avoid the fate experienced in the 1990s and early 2000s then it cannot maintain the status quo. Opening negotiations with China and revaluating its public finance management systems would be a sensible – and justified – first step.

26. See Le, Rogaland & Palale (2014).

REFERENCES

Africa Confidential. 2017. Stumbling Into a Debt Crisis. 15 December. [Online]. Available: https://www.africa-confidential.com/article-preview/id/12196/Stumbling_into_a_debt_crisis

Africa Confidential. 2018. Into the Valley of Debt. 6 April. [Online]. Available: https://www.africa-confidential.com/article/id/12290/Into_the_valley_of_debt

African Aerospace. 2017. New Copperbelt Airport Set to Shine. [Online]. Available: www.africanaerospace.aero/new-copperbelt-airport-set-to-shine.html

AidData. 2018. AidData: China's Global Development Footprint. [Online]. Available: <http://aiddata.org/china>

Anderlini, J. 2007. China insists on 'tied aid' in Africa. *Financial Times*, 25 June.

Brautigam, D. 2011. Chinese Development Aid in Africa: What, where, why, and how much? Wordpress. [Online]. Available: <http://www.deborahbrautigam.files.wordpress.com/2013/04/2011-brautigam-chinese-aid-in-africa.pdf>

Brautigam, D. & Hwang, J. 2016. Eastern Promises: New Data on Chinese Loans in Africa, 2000-2014. Working Paper No. 2016/4. China-Africa Research Initiative, School of Advanced International Studies, Johns Hopkins University, Washington, DC. [Online]. Available:

<https://static1.squarespace.com/static/5652847de4b033f56d2bdc29/t/58ac91ede6f2e1f64a20d11a/1487704559189/eastern+promises+v4.pdf>

China-Africa Research Initiative (CARI). 2018. Johns Hopkins University, Washington DC. [Online]. Available: <http://www.sais-cari.org/>

Davis, M. et al. 2008. How China delivers development assistance to Africa. Department of International Development, Beijing. [Online]. Available: <http://www.collection.europarchive.org/tna/20080305120132/http://dfid.gov.uk/pubs/files/china-dev-africa.pdf>

Dollar, D. 2016. China's Engagement with Africa: From Natural Resources to Human Resources. Brookings, John L. Thornton China Center. [Online]. Available: <http://www.brookings.edu/wp-content/uploads/2016/07/Chinas-Engagement-with-Africa-David-Dollar-July-2016.pdf>

Hill, M. & Mitimingi, T.C. 2018. Zambia's 'Unknown' Debts Face Scrutiny After Mozambique Scandal. *Bloomberg*. 6 April. [Online]. Available: <https://www.bloomberg.com/news/articles/2018-04-06/zambia-s-unknown-debts-face-scrutiny-after-mozambique-scandal>

IMF. 2017. IMF Country Report No. 17/237. October. [Online]. Available: <https://www.imf.org/~media/Files/Publications/CR/2017/cr17327.ashx>

Le, T.M., Rogaland, G. & Palale, P. 2014. Zambia: Rebuilding a Broken Public Investment Management System. Available: <https://openknowledge.worldbank.org/handle/10986/21052>

Lusaka Times. 2017. 83% of Projects Are Done By Chinese Companies. 8 September. [Online]. Available: <https://www.lusakatimes.com/2017/09/08/83-percent-projects-done-chinese-companies-mulusa/>

Lusaka Times. 2018a. Zambia's Total Debt Will Swell to Over US\$24 billion in Three Years - Musokotwane. 23 February. [Online]. Available: <https://www.lusakatimes.com/2018/02/23/zambias-total-debt-will-swell-us24-billion-three-years-musokotwane/>

Lusaka Times. 2018b. The Decisions of Cabinet at its 3rd Sitting on Monday 19th February, 2018. 22 February. [Online]. Available:

<https://www.lusakatimes.com/2018/02/22/decisions-cabinet-3rd-sitting-monday-19th-february-2018/>

Lusaka Times. 2018c. Cabinet Approves Funding Exceeding 200 million U.S Dollars for the L400 Project. 21 February. [Online]. Available: <https://www.lusakatimes.com/2018/02/21/cabinet-approves-funding-exceeding-200-million-u-s-dollars-l400-project/>

Ministerial Statement. 2018. Financial and Economic Aspects of the New Kenneth Kaunda International Airport. [Online]. Available:

http://www.parliament.gov.zm/sites/default/files/images/publication_docs/MINISTERIAL%20STATEMENTS%20BY%20THE%20MINISTER%20OF%20HOUSING%20AND%20INFRASTRUCTURE.pdf

Ministry of Finance. 2014 – 2017. Annual Economic Reports. [Online]. Available: <http://www.mof.gov.zm/index.php/economicdata/viewcategory/59-annual-economic-reports>

Ministry of Works and Supply. 2016. Ministerial Statement on Progress Made on the Construction Projects at Kenneth Kaunda International Airport. [Online]. Available: www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statement%20by%20the%20Minister%20of%20Works%20and%20Supply%20-%20on%20progress%20made%20on%20the%20construction%20projects%20at%20Kenneth%20Kaunda%20International%20Airport.pdf

OECD. 2017. Official development assistance – definition and coverage. OECD Home. [Online]. Available:

<http://www.oecd.org/dac/stats/officialdevelopmentassistancedefinitionandcoverage.htm>

PwC. 2017a. 2018 Budget Highlights: Zambia. [Online]. Available: <https://home.kpmg.com/content/dam/kpmg/xx/pdf/2017/11/tnf-zambia-nov29-2017.pdf>

PwC. 2017b. Reform to Perform: Zambia's 2018 National Budget. [Online]. Available: <https://www.pwc.com/zm/en/assets/pdf/zambia-budget-2018.pdf>

Reality of Aid Network. 2010. South-South Development Co-operation: A Challenge to the Aid

System? (Quezon City, Phillipines: Ibon Foundation, Inc.).

Rose, M. 2017. Govt spending up to 90% of construction money on foreign firms – Ng’andu. The Mast. 22 December. [Online]. Available: <https://www.themastonline.com/2017/12/22/govt-spending-up-to-90-of-construction-money-on-foreign-firms-ngandu/>

Sun, Y. 2014. China’s Aid to Africa: Monster or Messiah? The Brookings Institution (Op. Ed.). [Online]. Available: <https://www.brookings.edu/opinions/chinas-aid-to-africa-monster-or-messiah/>

Sun, Y. 2015. Xi and the 6th Forum on China-Africa Cooperation: Major commitments, but with questions. [Online]. Available: <http://www.brookings.edu/blog/africa-in-focus/2015/12/07/xi-and-the-6th-forum-on-china-africa-cooperation-major-commitments-but-with-questions/>

The World Bank. 2017. Zambia Economic Brief: How Zambia Can Borrow Without Sorrow. [Online]. Available:

<http://documents.worldbank.org/curated/en/782221512459934813/pdf/WP-P157243-PUBLIC-WorldBankthZambiaEconomicBriefDecemberFinalWEB.pdf>

The World Bank. 8th Zambia Economic Brief. Background material from World Bank launch. PowerPoint Presentation.

Zambia starts work on China-funded ‘mega road’ project. Available: <https://www.out-law.com/en/articles/2017/september/zambia-starts-work-on-china-funded-mega-road-project/>

ZIPAR. 2017a. 2017 Mid-Year Budget Review Rewriting the Fiscal Narrative. Presentation by Shebo Nalishebo,

ZIPAR. 2017b. Scaling the Eurodebt Wall. Working Paper No. 27.

ZIPAR. 2017c. Why Zambia Wants an IMF Bailout Package. Presentation by Ceaser Cheelo.

ZIPAR. 2018. Zambia’s Public Debt Portfolio: What CSOs Should be Advocating For. Presentation by Florence Banda Muleya.

HE WHO PAYS THE PIPER: ZAMBIA'S GROWING CHINA DEBT CRISIS

The Executive Director
Centre for Trade Policy and Development
P.O. Box 50882
Lusaka - Zambia

Plot 123, Kudu Road, Kabulonga
Tel: +260 211 264 409
[www:ctpd.org.zm](http://www.ctpd.org.zm)
Centre for trade policy & development
@CTPDZambia

