AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

ZAMBIA

Driving Zambia's Transformation

The Reform of the Global Financial Architecture

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8NDP	Eighth National Development Plan
AfCFTA	Africa Continental Free Trade Area
ADF	Africa development Fund
AEO	Africa Economic Outlook
AFDB	African Development Bank
ARC	African Risk Capacity Group
BoZ	Bank of Zambia
CFR	Country Focus Report
CIF	Climate Investment Fund
CSR	Corporate Social Responsibility
DFI	Development Finance Institution
EU	European Union
FDI	Foreign Direct Investment
GCF	Green Climate Fund
GDP	Gross domestic product
GEF	Global Environmental Facility
GRZ	Government of the Republic of Zambia
HDI	Human Development Index
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
MDB	Multilateral Development Bank
NDP	National Development Plan
NPCC	National Policy on Climate Change
NPCIP	Nature People and Climate Investment Plan
NPL	Non-performing Loans
SDGs	Sustainable Development Goals
UNFCCC	United Nations Framework Convention on Climate Change
USA	United States of America
USD	United States Dollars
WBG	World Bank Group

EXECUTIVE SUMMARY

Macroeconomic performance and outlook

- There has been steady real GDP growth from 5.2% in 2022 to an estimated 5.8% in 2023, driven by activities in the wholesale and retail trade, agriculture, mining and quarrying sectors, and household and corporate consumption. Despite the relatively high real GDP growth outturn, inflationary pressures have persisted, at 10.9% in 2023, broadly unchanged from the 11.0% recorded in 2022. Inflation has mainly been driven by high prices of food, transport costs and pass-through effects of the exchange rate depreciation.
- Zambia has undertaken a raft of fiscal and other macroeconomic reforms to restore macroeconomic stability and debt sustainability under the International Monetary Fund (IMF)-supported Extended Credit Facility of US$ 1.3 billion. The country has made significant progress in debt restructuring and negotiations with creditors are nearing completion. In May 2024, private bondholders unanimously endorsed the country's debt restructuring programme, clearing one of the remaining major hurdles for completion of a very protracted restructuring process.
- The economy is projected to grow at 2.3% and 6.6% in 2024 and 2025 respectively, owing to recovery in the mining activities, underpinned by renewed investor confidence and high global copper prices, and continued strong performance in services and manufacturing sectors. Downside risks to the growth outlook include the drought which has affected agricultural production and electricity generation, fluctuating copper prices, slippages in reform programme execution and the impact of the invasion of Ukraine by the Russian Federation on fertiliser and fuel prices.

Zambia's structural transformation

- The Zambian economy is characterised by low productivity across economic sectors, reflected in correspondingly low level of structural transformation. Productivity gaps between various sectors of the economy have widened, further weakening prospects for improvement in structural transformation.
- There is a nexus between low economic growth and lack of economic diversification and underdeveloped structural transformation. Between 2015 and 2020, Zambia experienced slow economic growth and growing macroeconomic imbalances owing to a combination of endogenous and exogenous shocks.
- There are five major constraints to the realisation of structural transformation process in Zambia. These include weak and inconsistent policy implementation; lack of and mismatched skills; vulnerability to climate change; and financing constraints.
- Addressing the above constraints would open opportunities for accelerated structural transformation, reinforced by sound institutional quality; consistent implementation of industrial policy; human capital development to build skills; investment in science and technology; capital investments, especially in infrastructure such as transport and energy; and internal market competition.

- Zambia needs to sustainably increase mobilisation of domestic resources while advocating for reform of the international financial architecture, which has led to delays in completing the country's debt restructuring process. Reforms of the global financial architecture would unlock the necessary external financing for structural transformation within the broader ambit of the country's 8th National Development Plan, crucial for achievement of its Vision 2030 and the SDGs.

Structural transformation and reform of the international financial architecture

- There is an urgent need to reform the international financial architecture, specifically regarding developing an efficient debt restructuring process and sovereign credit metrics that could systemically improve economic conditions.

1

MACROECONOMIC PERFORMANCE AND OUTLOOK

INTRODUCTION

This Country Focus Report for Zambia analyses structural transformation in the economy of Zambia in recent years and the possible benefits from reforms of the international financial architecture. The report therefore first conducts a critical analysis of economic growth and prospects, after which it delves into providing an understanding of the progress and experience of Zambia's implementation of policies targeting structural transformation. The report is divided into three Chapters. Chapter 1 provides an analysis of the current macroeconomic conditions and the outlook in the medium term. Chapter 2 analyses the experience, outcomes of economic policies aimed at structural transformation, key drivers of structural transformation, main constraints and suggested remedial public policies. Chapter 3 analyses the financing requirements, the existing financing gap and the specific reforms of the international financial architecture that are critical to attaining significant structural transformation in the Zambian economy. It also contains the conclusion and key policy recommendations.

1.1 Macroeconomic performance and outlook

Zambia experienced a high average growth rate of 7% between 2004 and 2010, which laid a strong foundation for socio-economic transformation. However, this high growth was not sustained and dropped to an average of 4% during 2011–2023. Growth during 2004–2010 was mainly driven by high copper prices and expansion of wholesale, trade and service activities. The slow growth since 2011 was mainly due to the sharp decline in copper prices between 2011 and 2016 and the severe droughts in 2015–2016 and 2018–2019. These droughts decreased agricultural production and significantly constrained hydropower electricity generation, leading to severe electricity rationing which dampened activity in almost all economic sectors. Furthermore, the lower agricultural production sharply reduced the food stocks, driving up the prices of staple foods such as maize.

The economy is dominated by the services sector, which accounts for 58.2% of GDP, followed by the industrial sector with 36.6% (of which 12% from the mining sector), while agriculture and the non-mining activities contributed the remaining 5.2% of GDP. Since the scarring effects of COVID-19, the economy has recovered strongly, growing steadily at 5.2% in 2022 and 5.8% in 2023 (see Table 1). This growth has mainly been driven by expansion in the wholesale and retail trade, agriculture, mining and quarrying sectors, and household and corporate consumption. However, owing to the ongoing drought as from the last quarter of 2023 through 2024, agriculture and energy output have been severely constrained, with cascading adverse effect to the rest of the economy. The economy is projected to grow at 2.3% and 6.6% in 2024 and 2025 respectively, owing to the continued recovery in the mining, services and manufacturing sectors and to higher global copper prices.

1.2 Other recent macroeconomic and social development

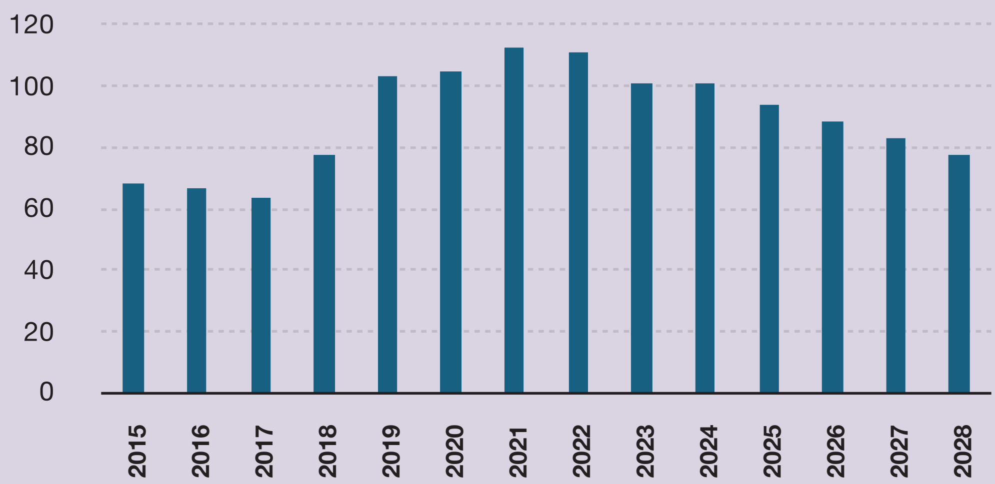
1.2.1 Inflation, monetary policy, and exchange rate

Inflation has been on a downward trend, from 22.1% in 2021 to 11% and 10.5% for 2022 and 2023 respectively. Inflationary trends were expected to continue decelerating at 8.8% and 7.3% for 2024 and 2025 respectively, but the current drought poses risk to the initial projection. The drought has caused heavy losses of maize produce and has severely curtailed cross-sectoral output, owing to low electricity generation. Zambia relies on hydro-sources for electricity generation for about 85% of the current output level. Inflation will persist well above the target band of 6-8%, mainly driven by a combination of food and fuel prices. This situation will be worsened by the depreciation of the kwacha. The kwacha depreciated relative to the US dollar by about 20% between March 2023 and March 2024. The Bank of Zambia (BoZ) has used the Monetary Policy Rate as a tool to control inflation, albeit with moderate success. The BoZ has successively raised the rates from 8.5% in November 2021 to 11.0% and 12.5% in November 2023 and February 2024 respectively. The BoZ has effectively employed a managed floating exchange rate regime to avoid severe deterioration of the value of the kwacha.

1.2.2 Fiscal policy and dynamics of public debt:

The fiscal deficit marginally improved owing to higher mining sector revenue collections. The deficit was 6.6% in 2023 compared to 8.2% of GDP in 2022. In addition, there was an estimated current account deficit of 1.1% of GDP in 2023, compared to a surplus of 3.8% in 2022, on account of higher export volumes and prices against subdued imports of consumer goods. The high deficits are largely owing to recurring expenditure pressures, capital project financing and interest payments on external debt. Zambia's public debt increased from 63.4% of GDP in 2017 to 110.8% in 2023, mainly driven by massive borrowing for infrastructure development. The country's debt is currently deemed unsustainable based on solvency and liquidity parameters. The debt service-to-revenue ratio, the debt service-to-exports ratio, the Present Value (PV) of Public and Publicly Guaranteed (PPG) external debt-to-GDP, and the PV of PPG external debt-to-exports indicator breached the IMF's debt sustainability thresholds. It is commendable that the Government of the Republic of Zambia (GRZ) is currently undertaking a raft of macroeconomic and fiscal reforms under the IMF programme to manage the debt down to sustainable levels in the medium term.

Figure 1.1 -Zambia Debt-GDP 2015-2028



1.2.3 External position – external financial flows

The international reserves coverage was 3.4 months of imports in November 2023, as compared to 4.4 months at end 2022, which was on the account of the use of the Extended Credit Facility and the Special Drawing Rights (SDR) from the IMF. Zambia received SDR equivalent to USD 937.6 million from the IMF at the end of 2021, as well as project inflows and improved mining tax receipts. The mining sector is the largest contributor to the stock of foreign direct investments (FDI), at 59.4% in 2022.

Table 1: Key macroeconomic indicators

	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP growth	1.4	-2.8	6.2	5.2	5.8	2.3	6.6
Real GDP growth per capita	-1.6	-5.8	3.4	2.5	3.0	1.7	1.8
Inflation	9.2	15.7	22.1	11.0	10.9	9.3	7.0
Overall fiscal balance, including grants (% GDP)	-9.4	-13.8	-8.1	-8.2	-6.6	-5.2	-3.4
Primary balance (% GDP)	-2.5	-7.8	-2.1	-2.0	-0.2	0.9	1.9
Current account (% GDP)	0.6	12.0	11.9	3.8	-1.1	3.3	8.4
Total population (millions)	18.4	18.9	19.5	20.0	20.6		
Life expectancy at birth (Years)	62.8	62.4	61.2	61.8	63.0		

Source: Data from Domestic authorities; estimates (e) and prediction (p) based on authors' calculations

1.2.4 Social developments

According to the 2022 Household Survey, the incidence of poverty in Zambia is estimated at 60% of the population, compared to 54.4% in 2015. The incidence of poverty among females was 57%, which is 2% higher than that for males. Poverty levels remain highest in rural areas (78.8%) compared to urban areas (31.9%) owing to lower public investment. Inequality remains high (Gini coefficient of 0.507 in 2022, compared to 0.546 in 2015). The unemployment rate for men is 12%, and that for women is 13.6%. Unemployment among young people (15–24 years) remains high, estimated at 24.7% (2021) and is driven by lack of jobs, skills shortages and skills mismatches. According to the 2022 Statistical Update of Human Development Indices and Indicators, Zambia is classified in the medium human development category, with a Human Development Index (HDI) value of 0.588 in 2021, having improved from 0.401 in 1990. During the same period, there was an improvement in the following areas: life expectancy at birth increased from 49.2 to 63.5 years; mean years of schooling increased from 4.7 to 7.1 years, while expected years of schooling increased from 7.5 to 12.1 years. Although Zambia is above the average of 0.537 for countries in Sub-Saharan Africa, its HDI score remains below the average of 0.645 for countries in the medium human development group.

1.3. Economic outlook and risks

The economy is projected to grow at 2.3% and 6.6% in 2024 and 2025 respectively. The growth is underpinned by continued recovery in the mining, services and manufacturing sectors, and higher global copper prices. Inflation is projected to decelerate from 9.3% in 2024 to 7.0% in 2025, driven by food and fuel prices. The fiscal deficits are projected to decrease from 5.2% and 3.4% of GDP in 2024 and 2025 respectively, owing to the ongoing fiscal reforms. The current account balance is projected to improve from the negative of 1.1% in 2023 to 3.3 and 8.4% in 2024 and 2025 respectively, on account increased copper output.

Box 1: Impact of tighter international financial conditions (transmission channels)

The impact of the global financial conditions is mainly transmitted to Zambia through at least four different channels: (i) commodity prices; (ii) reduced investment; (iii) higher interest rates and impact on debt; and (iv) decline in urgently required aid for dealing with climate change emergencies. The tightening monetary conditions in advanced economies, which is highly correlated to low growth in those economies, have dampened the global demand for commodities. Specifically, the copper price declined and this perennially and adversely affects Zambia's balance of payments. The recent interest rate hike in the United States of America and the monetary tightening policies in the advanced economies have also resulted in an increase in debt servicing costs for Zambia with a depreciating kwacha currency, in addition to a decline in inflow of foreign direct investments (FDI). The worsening global financial conditions adversely impact the response to the urgent need for the aid that Zambia needs to deal with the impact of ongoing drought crisis.

Risks: There are six risks to the projected growth, namely geopolitical conflicts; subdued global growth; weakening copper price; exchange rate fluctuations; delayed implementation of policy reforms; and climate change. The invasion of Ukraine by the Russian Federation and the ongoing Israel-Palestine conflict may gravely impact global inflation and commodity prices, specifically grains and petroleum products. In the face of such price increases triggering inflationary pressure, the BoZ may further raise interest rates, as evidenced in the latest November 2023 increase of the monetary policy rate by 1%, from 10% to 11%. Invariably, the slowdown in global economic growth, together with contraction in a major economy like China poses the risk of dampened demand for copper. Thus, copper prices are projected to weaken in the medium term. Since copper is a major foreign exchange earner, this will negatively impact Zambia's growth projection. The kwacha depreciated by 23.27% in 2023. Coupled with the loss of earnings from copper, the depreciation in the kwacha may also lead to more inflationary pressure. The possibility of delayed implementation of policy reforms could heighten fiscal risk. Lastly, climate change risk, specifically drought stemming from erratic rain cycles could adversely impact Zambia's agriculture and power production, given the country's dependence on rain-fed agriculture and hydropower generation.

1.4. Policy options to foster high and resilient growth: supporting macroeconomic stability and economic transformation

The short-term and immediate policy measures is for the GRZ to increase social spending towards social protection of the vulnerable groups from hunger, but the enduring solution lies in increasing investment in irrigation and climate-smart agricultural practices to mitigate drought. Investments in the energy sector are also required to meet the anticipated increased energy requirements for ramping up mining output to augment foreign exchange earnings. Higher yields and productivity from the agricultural sector would help to contain food-driven inflation. Increased foreign exchange earnings are expected to lead to appreciation and stability of the kwacha against the US dollar, and it is commendable that Zambia is increasing efforts to promote its tourism sector and developing farm blocks to increase foreign exchange earnings.

There is also an urgent need for the Zambian government to accelerate structural transformation and economic diversification by adopting sound industrial policies and efficient tax administration to increase domestic resource mobilisation. In addition, Zambia's structural transformation could immensely benefit from reforms of the global tax system, which could reduce illicit financial outflows, thereby unlocking the needed external financing for structural transformation. The limited structural transformation in Zambia is typified by a disproportional reliance on the mining sector, specifically copper mining, which contributed 12.9% of GDP in 2022 and generates 70% of Zambia's total export revenues. The service sector contributed about 57% of GDP in 2022, while industry contributed 33.8% of GDP in the same year, albeit with a negligible manufacturing component of 8.1% of GDP. Construction, utilities, and industrial activities contribute about 10.9% (2022) of GDP. The agricultural sector's contribution to GDP shrank from 9.3% in 2012 to 3.3% in 2022, though the sector employs over 50% of the total labour force, which is composed of 58.5% males and 41.5% females. Low productivity is clearly illustrated by the widening productivity gaps between the various sectors of the economy. The current GRZ policy of an integrated approach to developing farm blocks is expected to lead to higher productivity in the agricultural sector. Lastly, the current IMF programme-linked Public Financial Management reforms being undertaken by the Zambia are expected to lead to both medium- and long-term economic growth and resilience.

TAKING STOCK OF ZAMBIA'S STRUCTURAL TRANSFORMATION PROGRESS

2

KEY MESSAGE

Zambia has not experienced significant structural transformation, despite the existing economic policies articulated to diversify the economy. This outcome is in part due to serious financing constraints and low economic growth. It is important that Zambia sustainably adopt sound industrial policies, increased domestic resource mobilisation based on public-private partnerships and augmented by reform of the international architecture to unlock the necessary external financing for structural transformation. In the framework of Zambia's structural transformation, the role of FDI needs to be amplified in tandem with improvement in the domestic business environment.

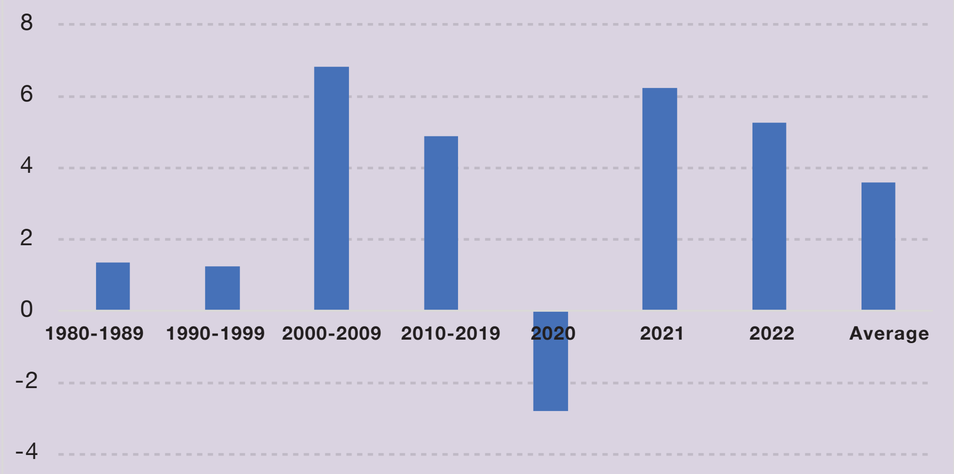
2.1. Taking stock of economic performance and transformation in Zambia

(a) Historical economic performance

As shown in Figure 2.1, Zambia predominantly experienced slow economic growth except for the 2000–2009 period, during which the economy grew at an exceptional 6.8% as compared to the average of 3.6% in 2010–2022 (AfDB Statistics Department, May 2024). Given the average population growth rate of 3%, even the 6.8% exceptional growth could not significantly impact structural transformation. The predominance of low growth is mainly explained by various endogenous and exogeneous shocks. The sharp decline in copper prices during 1980–1989, 1990–1999, 2011 and 2016, coupled with the severe droughts in 2015–2016 and 2018–2019 agricultural seasons are the main reasons. Severe electricity rationing followed and long periods of electricity load shedding dampened activity in almost all economic sectors. Further aggravating this situation is the high and unsustainable public debt, mostly stemming from borrowing for expenditure on infrastructure projects that are yet to yield positive returns. There is a nexus between Zambia's lack of economic diversification and limited structural transformation on the one hand, and low economic growth on the other. Between 2015 and 2020, Zambia experienced slow economic growth and macroeconomic challenges owing to the above-mentioned endogenous and exogenous shocks. The real GDP growth rate declined during the 1980–2022 period, averaging 3.6% as shown in Figure 1, largely owing to perennial drought, copper price fluctuations and the impact of COVID-19, which adversely impacted all economic sectors. Notably, in 2020, economic growth contracted by 2.8% owing to the impact of the COVID-19 pandemic and a deteriorating fiscal position caused by excessively high domestic and external debt. It is a positive development that some steady growth has been experienced since 2021 and 2022, when real GDP growth recovered to 6.2% and 5.2% respectively, driven by the agriculture, manufacturing, energy, wholesale and retail trade, and the ICT sectors. However, the mining output underwent a relative decline despite an uptick in global economic activity and commodity prices. Going forward, the economy is projected to grow by 4.3, 4.7, 4.7 and 5.2% in 2023, 2024, 2025 and 2026 respectively, but this growth must be sustainably supported by diversifying the economy and improving productivity across sectors. The growth projection is underpinned by the expected recovery in the mining, services and manufacturing sectors; higher global copper prices; and the market confidence associated with the ongoing fiscal consolidation measures. However, there are external risks to growth on account of fluctuating copper prices and the impact of Russia's invasion of Ukraine[1] on fertiliser, staple foods and fuel prices.

1 https://www.forbes.com/advisor/investing/rule-of-72/

Figure 2.1 Zambia Real GDP, by Decade (percent)



(b) Economic convergence

Zambia was classified as a low-middle-income economy in 2011 according to the World Bank Atlas Method. Currently, Zambia falls short of the Southern African Development Community (SADC) targets on inflation (5%); debts level (60%); ratio of budget deficit to GDP (3-1%); and current account (9%) targets required for regional economic convergence. Attainment and maintenance of the SADC economic convergence indicators are requisite for growth that can usher Zambia into a prosperous middle-income status. Essentially, the GRZ targets in Vision 2030 were to grow the economy at progressively higher rates from 6% from 2006 to 2010; 8% between 2011 and 2015; 9% between 2016 and 2020; and 10% between 2021 and 2030. However, owing to the deterioration of income per capita estimates recorded in 2021, the World Bank reclassified Zambia from lower middle-income to low-income status in 2023. The Zambian government remains committed to regaining the low-middle-income status through its medium-term economic strategy. It is also notable that the Zambian 8th National Development Plan clearly targets progress to a prosperous middle-income status. The pathway to this goal is a sustained average growth rate above 6% over a decade, given the high population growth rate of 3% per annum.

(c) Sustainable Development Goals (SDGs)

Zambia's progress in the attainment of the SDGs is mixed. Only 19% of the SDGs have been achieved or are on track, while 47% have had limited progress and 34% are deemed to be worsening according to the 2023 SDG Report. The major trend shows that quality of education; gender equality; decent work and economic growth; and climate action have moderately improved. However, affordable clean energy; zero hunger goal; industry, innovation and infrastructure; and partnerships for the SDG goals have stagnated. Poverty, peace, justice and strong institutions are shown to have deteriorated, which is corroborated by other measures related to the SDGs.

A more illustrative depiction of Zambia's progress towards achievement of the SDGs can be gleaned from the 2022 Household Survey, which shows the incidence of poverty around 60% of the population, as compared to 54.4% in 2015. The incidence of poverty among females was 57%, which is 2% higher than that for males. Poverty levels remain highest in rural areas (78.8%) compared to urban areas (31.9%) owing to lower public investment. Inequality remains high (Gini coefficient of 0.507 in 2022, compared to

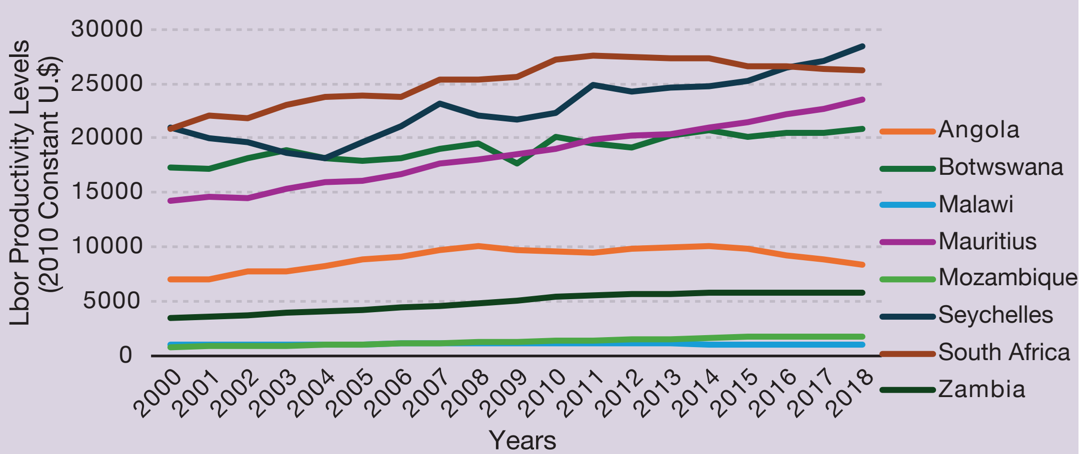
0.546 in 2015). Again, the 2022 Statistical Update of Human Development Indices and Indicators classified Zambia in the medium human development category, with an HDI value of 0.588. This marks an improvement from 0.401 in 1990. However, it is laudable that during the same period, Zambia attained progress in the following areas: life expectancy at birth increased from 49.2 to 63.5 years; mean years of schooling increased from 4.7 to 7.1 years; and expected years of schooling increased from 7.5 to 12.1 years. In comparative context, even though Zambia is above the average of 0.537 for countries in Sub-Saharan Africa, its HDI score remains below the average of 0.645 for countries in the medium human development group.

2.2 Zambia's structural transformation: drivers, bottlenecks and opportunities

(a) Trends in productivity

Zambian economy is characterised by limited structural transformation mainly owing to low productivity across sectors. Invariably, low productivity is also characterised by widening productivity gaps between the various sectors of the economy. Agriculture still employs well above 50% of the rural population, productivity remains low, and there have been no surplus resources to channel into industry. Ideally, higher productivity in the agricultural sector spurring industrial processing of the surplus output should be the precursor to the much-needed value-added activities that can create the large number of jobs needed in the economy – and the envisaged sectoral labour shifts. Yet not only the agriculture sector, but also the industrial and service sectors are dominated by informal activities. Framed within a regional context, Zambia ranks among the Southern African countries experiencing a comparatively low level of labour productivity (see Figure 2.2). Zambia, together with Malawi and Mozambique, have the lowest labour productivity levels. In 2018, the per capita GDP of Zambia stood at 5,743 US dollars, as compared to 20,872 U.S. dollars, and 26,200 U.S. dollars of Botswana and South Africa respectively (Dieppe et al., 2020). The success of the structural transformation process of Zambia therefore requires sectoral gains in productivity, which traditionally would be a function of an increase in physical capital, and a sustained upgrade in the technical skills of the labour force. In agriculture, this means increased investment in irrigation facilities, better seeds, inputs such as fertiliser, mechanisation and upgrade in the skills of farmers to realise productivity gains.

Figure 2.2: Labour productivity levels for selected Southern African countries, 2000–2018

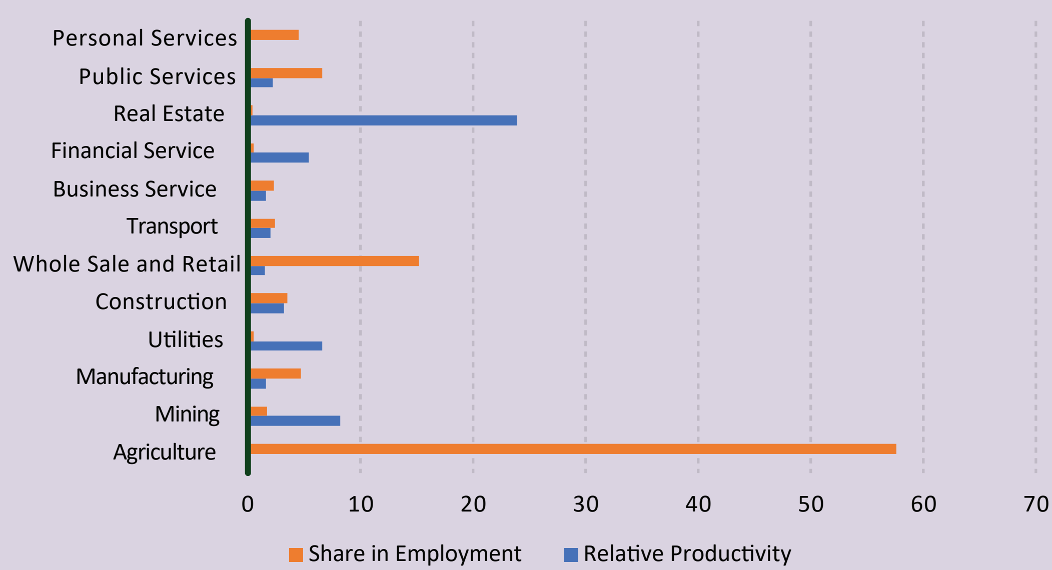


Source: Dieppe et al. (2020)

(b) Zambia's structural/economic transformation

In Zambia, more than half of the population lives in rural areas, with a majority employed in the agricultural sector. Effectively, about 57%, 15.2%, and 11.1% of the population are employed in the agriculture, wholesale and retail, and public and personal services sectors. The rest of the labour is distributed across other sectors such as transport, financial services, manufacturing, mining and construction. The structural change in the three decades shown in Figure 2.3 has been disjointed and negligible. Though negligible, the most notable change in real structural change requisite for economic development, is between 2000 and 2009. There is glaring evidence of stagnation in productivity in the period between 1991 and 2018.

Figure 2.3: Relative sectoral productivity and employment shares in Zambia 2018

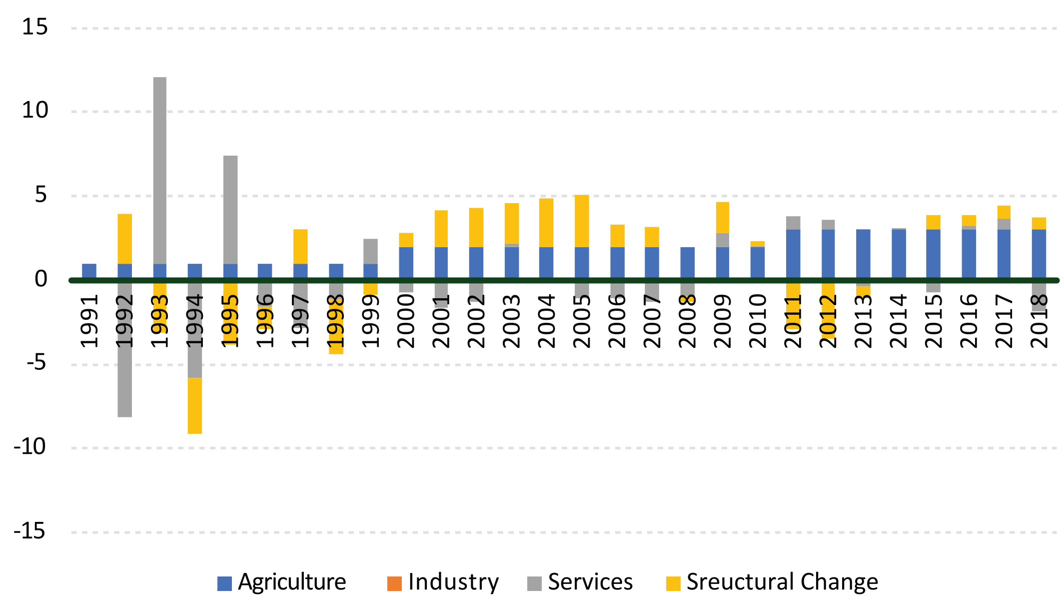


Source: Dieppe et al. (2020)

(c) Structural transformation – labour productivity

In terms of sectoral contributions to GDP, the service sector accounted for about 57% of GDP in 2022, while industry contributed 33.8% of GDP. However, the meagre contribution of the manufacturing sector to the industrial contribution to GDP stands at 8.1%. In the actual sense, the contribution of the manufacturing sector has deteriorated over the years, as evidenced by the reduction from 11% in 2012 to 8.1% in 2022. Construction, utilities, and other industrial activities mainly contributed to about 10.9% of GDP in 2022, slightly up from 9.8% in 2012. Also notable is the shrinking contribution of the agricultural sector to GDP. While there are a few large, highly productive commercial farms, the sector is dominated by subsistence-based smallholder farms with low productivity and limited value addition. Zambia's agriculture sector also remains highly susceptible to climate change shocks, as with the ongoing drought which has cause food insecurity and low hydropower generation, affecting all productive sectors. Low productivity, also characterised by widening productivity gaps between the various sectors of the economy, demonstrates the difficulty in realising the much-desired economic diversification and structural transformation. Figure 2.4 also shows the glaring productivity gaps.

Fig 2.4 Zambia: Aggregate labor productivity and structural change



Source: AfDB ECSTJune 2024

(d) Main economic policies implemented to foster economic transformation

Zambia has pursued the goal of economic diversification and structural transformation as a means of building an economically prosperous society since independence in 1964. The distinctive policy choices Zambia made can be identified as import substitution in the 1960s and market liberalisation policies in the late 1980s and 1990s, upon which the current economic principles have been anchored. Effectively, the GRZ has used its national development plans since 1966 to create implementation framework for achieving diversification and structural transformation. The first national development plan in 1966 made specific reference to diversifying the economy, albeit through an import substitution policy. The GRZ sought to reform the productive sectors by first taking over ownership in diverse sectors. This was done through the Mulungushi and Matero reforms of 1968 and 1969, which led to nationalisation of manufacturing industries, transport, service and utility companies.

From the 1970s to 1990, the Import Substitution Policy (ISP) seemed to yield deceptively positive results in terms of manufacturing value-added. At face value, the manufacturing value-added increased from about 5% in 1969 to around 27% in 1990. This was mainly due to ISP restricting imports without attention to the need for domestic competition within the industrial sector. Notably, the GRZ maintained resource allocations to state corporations despite inefficiencies. The ISP was followed by the new policy of market liberalisation in the 1990s and, owing to the lack of competition, the manufacturing value-added fell from 27% in 1990 to 11% in

1995, and wholesale and retail trade sector became dominant in the economy. The post market-liberalisation policies based on the open market approach, albeit with inefficiencies inherent in tariffs and bottlenecks to the implementation of administrative rules have endured, frustrating the process of economic diversification and structural transformation.

Despite the less-than-optimal outcomes of economic diversification and structural transformation policies pursued by the GRZ, all the national development plans (NDP) (from the first NDP 1966–1971 to the current 8th NDP 2022–2026) have included direct or indirect references to economic diversification and structural transformation as pathways to creating a prosperous nation. The 8th NDP targets economic transformation and job creation through leveraging the development of the agriculture, manufacturing, mining, and tourism sectors. Regarding pragmatic implementation, the NDP has included the development of energy, transport and logistics, water and other critical infrastructure, and skills development as the foundation for diversification and structural transformation. It would be pertinent to place productivity goals at the core of the planned interventions under the 8th NDP, to lay the foundation for meaningful structural transformation. Zambia's structural transformation can benefit immensely from some of the successful industrialisation experiences of East Asian countries polices, as summarised in Box 2 (Agola, N, 2016).

There is considerable opportunity for Zambia to benefit from its central geographical location. Zambia borders eight countries, with several trade corridors. As such, Zambia could immensely benefit from regional trade in processed goods, specifically agricultural commodities. It follows that FDI promotion could leverage this comparative advantage. In fact, the farm block initiative, with its integrated approach that include value addition activities, would be a useful framework for export-oriented production targeting the regional markets. Nevertheless, for optimal benefits, there would be a need for continued improvement of the business environment.

Box 2: Zambia – learning from successful experiences of industrialized East Asian countries (Japan, Korea, Singapore and China-Taiwan)

- Identification and state support to a few industrial sectors with optimal backward and forward linkages while ensuring there is intense domestic competition among players
- Making sustained investment in the supporting infrastructure such as transport, energy, and water
- Adopting industrial regulations that support infant industry growth with the framework of competition
- Development of industrial financing framework to spur technology import, and incentives to FDI
- Sustained human capital building with a focus on science and technology education-industry linkages.

Drivers to accelerate structural transformation By order of importance, first is the high quality of bureaucracy that is reflected in the competent formulation and consistent implementation of a raft of public policies that are consistent with sound industrial development. Again, it is worth noting the critical role of the state at the infant phase of industrial development, when the private sector is either underdeveloped or too risk-averse to undertake the requisite investments for industrial development. In this regard, it follows that the state public policy actions are a key primary driver of economic diversification and structural transformation. Connected to the state role is the pivotal role of education and skills development that is premised on science and technology, closely matched to industrial development. However, Zambia faces a critical challenge of skilling and creating jobs for its growing youthful population, which is currently at 10,049,19,1 of which only 3,615,507 persons are in the labour force, excluding 6,433,684. Generally, there is a problem of both lack of skills and skill mismatch.

Another driver of structural transformation is production technology imports required for value addition. However, given the diminishing outturn and value-added as a percentage of GDP from the manufacturing sector, and the dominance of exports of unprocessed commodities, there is a need for policies to improve the financing of critical industrial ventures, with optimal backward and forward linkages in the economy. Key infrastructure such as roads, railways and power plants are critical drivers of structural transformation and Zambia faces the challenge of inadequate infrastructure. While the country has continued to make strides towards improving the requisite key infrastructure for progress in structural transformation, there are challenges regarding the adequacy of the infrastructure. According to the Africa Infrastructure Development Index 2021 Report, Zambia was ranked 20th out of 54 countries. There is inadequate financing and the lack of human technical capacity to build and maintain the infrastructure is linked to the inadequacy. Nevertheless, Zambia's overall level of infrastructure development has gradually improved since 2010. In the energy sector, Zambia has an overdependence on hydropower sources (85% of its electricity needs), and there is a supply gap of 810 MW, which is worsened by the perennial droughts. Finally, markets serve as a critical driver in structural transformation, particularly given Zambia's advantageous geographical position for regional trade.

(f) Bottlenecks to fast-paced structural transformation

There are five major constraints to the realisation of structural transformation process in Zambia when compared to countries that have attained fast-paced structural transformation. These are inadequate public policy formulation and implementation; lack of and mismatches in skills; vulnerability to the vagaries of climate change; and financing constraints. Experience in countries of East Asia such as Japan, Singapore, Korea, China-Taiwan, and even Malaysia shows that these nations paid great attention to consistent industrial policy formulation and implementation, and science and technology-based education across a broad swathe of the population. The common causative denominator in the successful structural transformation and industrialisation of these countries is the well-formulated industrial policy, characterised by selectivity of industrial sectors, with optimal forward and backward linkages in the economy, and sustained implementation over the lengthy period required to realise the desired national outcomes.

In addition to the necessary industrial policy, the bureaucracy that drives the process must be highly efficient. As mentioned above, Zambia has been unsuccessful in formulating and implementing policies defined by ISP and market liberalisation models in the past six decades. That demonstrates the industrial policy constraint on structural transformation. Whereas Zambia could reap from its demographic dividends, the large youthful population that could form a large pool of labour for industrial take off sorely needs skill training. Therefore, Zambia faces the critical challenge of providing technical training and jobs for the burgeoning youthful population. In 2021, (for the 15 years and above) the potential working population was 10,049,191, of which 3,615,507 persons were in the labour force and 6,433,684 were outside it, indicating a pervasively high rate of youth unemployment. This is attributable to a mismatch in skills and lack of dynamic job creation. Again, only about 13% of those eligible for the labour market access have undergone formal technical and vocational education training.

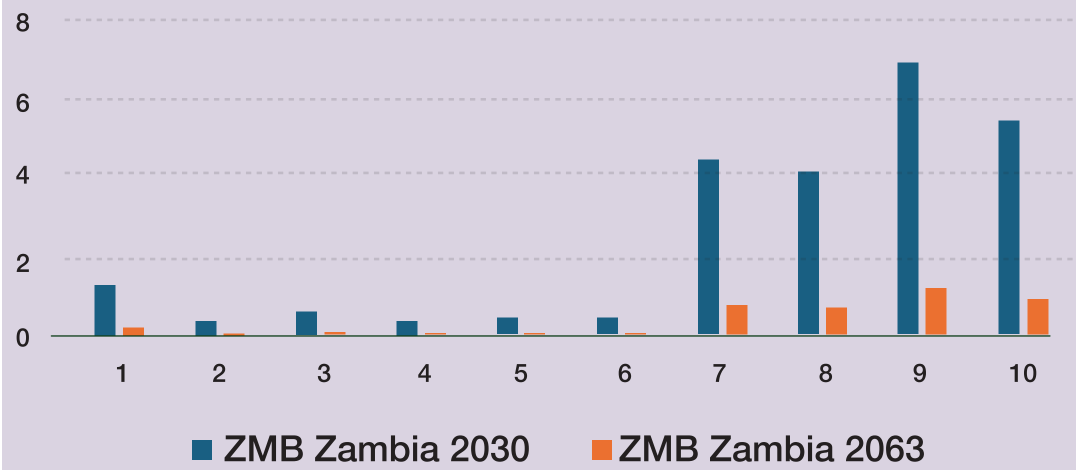
Zambia is also highly susceptible to perennial climate change events, specifically drought and floods, despite the adaptation and mitigation efforts of the GRZ. Between 2015 and 2019, droughts slowed down economic growth, mainly owing to low agricultural and electricity output. While the low agricultural output fuelled food inflation, it also negatively impacted all economic sectors owing to the lack of adequate power supply to run production operations. Currently, Zambia is facing a drought crisis that necessitated a policy response requiring long hours of load shedding. The effects of the power cuts and load shedding on industrial output has led to revision of the previous growth projections from 4.7% to 4.5%. Invariably, such low growth, against the backdrop of 3% per annum population growth, feeds into inequitable resource allocation and a general lack of inclusive development. The other critical constraint to structural transformation is the lack of financing needed to implement industrial and general economic and social development. The total annual financing needs for structural transformation by 2030 is estimated at USD 6.9 billion, while the financing gap is estimated at around USD 5.4 billion. This demonstrates the dire lack of financing (AfDB, ECST estimates).

2.3. Zambia's structural transformation agenda and the international financial architecture

Zambia's 8th NDP articulates the country's commitments to undertake measures to foster structural change that could lead to the realisation of a prosperous middle-income economy. The key plank in the strategy to realise such structural transformation is the sustained development of the agricultural, manufacturing, mining and the tourism sectors, while ensuring that both the hard and soft supporting infrastructure is adequate. The key infrastructure areas that require urgent upgrading are energy, transport and logistics, general productive and supportive technology, including information and communications technology, water systems and human technical capacity building (8th NDP 2022-2026). Notably, there is a huge financing need of about USD 6.9 billion up to 2030, and even most dire is the financing gap of USD 5.4 billion. To finance its structural transformation, Zambia needs a concerted effort to mobilise funds from the private sector, MDBs and traditional bilateral

donors. Private sector financing requires a massive improvement in the business environment to attract FDI to diverse sectors of the economy beyond the mining sector, which has traditionally been the main beneficiary of FDI inflows.

Figure 2.5 : Zambia Structural Transformation: Annual Financing Gap ($ Billions USD)



Source: AfDB ECST June 2024

As a percentage of GDP, FDI inflows to Zambia have dwindled from 7.5% in 2013 to negative 1.6 in 2021 (BoZ, 2024). While there has been a wide variation in FDI per year, the average FDI in the last decade (2013–2022) is a paltry 3.16%. There is a need to attract increased and sustained FDI to diverse sectors of the economy over more than a decade to spur structural change. The other potential source of funding is capital markets, even though the small size of the market and the limited trading are impediments. Currently, just over 20 companies are publicly listed on the Lusaka Securities Exchange; therefore, there is an urgent need for massive reforms and outreach to the public to encourage participation in capital markets. The MDBs have a major role to play in financing the structural transformation process, both through concessional financing and by de-risking the financial instruments necessary for mobilising private sector funding. Concessional financing is the suitable type of external source of financing Zambia needs given the current high level of debt risk.

2.4. Concluding remarks and policy recommendations

The role of the GRZ is pivotal to the structural transformation of the country. It is commendable that the Zambian authorities are currently implementing a raft of fiscal reforms under the IMF programme to restore macroeconomic stability in the medium term and to spur growth in diverse sectors of the economy, including agriculture and energy. Specifically, the agricultural and energy sectors are critical for the restoration of the steady economic growth required for structural change. Agricultural value chain development remains a key anchor of Zambia's industrial development effort, a major source of domestic revenue mobilisation through exports to the regional markets and a platform for creating quality jobs. The role of the GRZ is even more important in terms of interventions required in the many instances of market failure. For example, the GRZ must promote the development of key sectors with high chances of forward and backward linkages to contribute to inclusive growth both in the rural and urban centres. While selecting key sectors, the GRZ will need to foster domestic competition to ensure the competitiveness of its exports in regional markets under the framework of the Africa Continental Free Trade Area (AfCFTA) and other regional trade arrangements to which Zambia is a signatory.

The private sector remains a key driver to the process of structural transformation, specifically in terms of the financing, technology imports, innovations and job creation necessary for inclusive economic growth. The optimal performance of this role hinges on government policies for creation of a conducive business environment. Likewise, there is need for policies to incentivise FDI flows into the country that extend well beyond the mining sector. Equally necessary is a larger catalytic role on the part of MDBs to increase investments in the private sector. This is specifically because of the competitive advantage of MDBs in mobilising highly concessional financing and the use of de-risking financial instruments to leverage more private sector financing. Specifically, the role of MDBs is even more important for infrastructure financing Zambia needs to narrow the current infrastructure gap. Given Zambia's current high debt situation, the financing of infrastructure projects will have to rely heavily on public-private partnerships (PPPs). The MDBs will play a critical role in mobilising and catalysing private sector participation.

Box 3: Structural change: concepts and methodologies

Structural transformation refers to an evolutionary qualitative transformation of economic systems. Such change is usually accompanied by systemic technological progress and organizational changes. As conceptualized by Schumpeter (1939), technology, knowledge and institutions are the critical building blocks that lead to structural change in an economy. A pragmatic approach requires adoption of the input-output model to achieving structural transformation.

3

FINANCING STRUCTURAL TRANSFORMATION IN ZAMBIA: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

KEY MESSAGES

Structural transformation requires sustained domestic financial resource mobilisation and external sources of financing working in tandem. There is an urgent need to strengthen the domestic resource mobilisation capabilities while also reforming the international financial architecture, specifically regarding having an efficient debt restructuring process, sovereign credit metrics, global tax governance and a global financial system that supports financial resilience in emerging economies, with liquidity support during crises and shocks.

3.1 Introduction

Given Zambia's current debt distress situation and the huge gap in the financing needed to accelerate structural transformation and more generally to secure the financing required to deliver on the SDGs and climate action, both domestic and external resource mobilisation are urgently needed. This is all the more so given the heightened vulnerability of Zambia to climate change events, as evidenced by the ongoing drought crisis which the GRZ has declared as an emergency and which requires USD 900 million in 2024 alone, to address immediate needs. The protracted debt restructuring process under the G20 Common Framework has not lent itself well to addressing the urgent financing needs of Zambia. It would therefore be pertinent to highlight and discuss some of the weaknesses of the international financial architecture, which therefore requires urgent reforms, and what positive impact such reforms could have on the ongoing debt distress situation, combined with the lack of financing for SDGs and emergency climate change events that the country faces.

Invariably, Zambia's debt restructuring experience has put to the test the touted efficacy of the G20 Common Framework in debt restructuring. The Zambian debt restructuring negotiations have, disappointingly, taken longer than the speedy process that was initially promised when the G20 Common Framework was conceived. When the country was classified as being under high debt distress in 2017, the MDBs stopped providing non-concessionary funding to Zambia. Moreover, the role of the credit rating agencies has been questioned, specifically in regard to overvaluing sovereign risks, leading to escalation of the crisis. In essence, the Zambian debt restructuring experience and the role of credit rating agencies during the selective defaults in 2021 have validated the urgent need for reforms and transformation of the global financial architecture. In addition, there is a need to increase the efficacy of efforts towards domestic resource mobilisation, together with climate financing interventions. Therefore, the next sections of this chapter will analyse the efforts aimed at domestic resource mobilisation, external resource mobilisation and climate financing opportunities, together with the constraints placed on these by the existing international financial architecture. It will then suggest possible reforms of the current international financial system that could benefit Zambia's structural transformation.

3.1.1 Internal financing of structural transformation and constraints

3.2 Domestic resource mobilisation

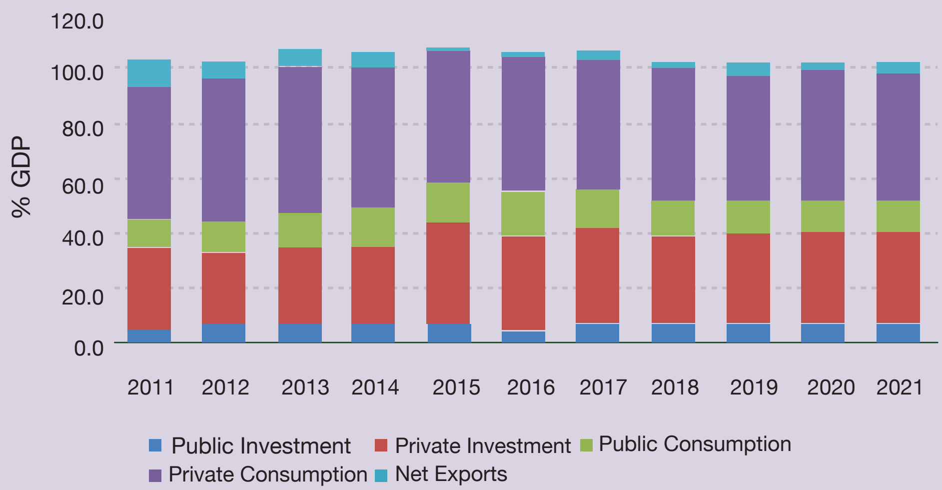
The GRZ is currently pursuing a well-defined fiscal policy objective for 2022–2024, with the key goal of attaining fiscal consolidation. The pathway to this goal is the use of a combination of efficient domestic resource mobilisation and expenditure rationalisation, according to the GRZ Medium Term Budget Plan 2022–2024. In terms of expenditure, the GRZ has prioritised human and social development, therefore social protection programmes for vulnerable population segments feature prominently. In the medium-term budget, the total revenues, together with grants, are projected to average 22.1% of GDP. Through reduction and rationalisation of public expenditure, the GRZ targets a reduction of its fiscal deficits from 6.7%, 6.3% and 5.2% in 2022, 2023 and 2024 respectively.

The GRZ target for domestic revenue mobilisation is 21.2% of GDP to be able to finance education, health, infrastructure and other sectors critical for structural transformation. Therefore, the GRZ has sustained efforts to improve domestic resource mobilisation. During the 2020–2022 period, revenue and grants accounted for 22.2% of GDP, which is well above the continental average of 16%. The share of total revenue and grants to GDP increased from 20.6% in 2020 to 21.6% in 2022, mainly attributable to favourable copper prices and enhanced mechanisms for revenue collection. A breakdown shows that tax revenues accounted for 16.9% of total revenues, non-tax revenues contributed 4.8%, while grants made up 0.5% (GRZ White Paper, January 2022). In 2023, domestic revenues accounted for 20.9% of GDP (tax revenues accounting for 17.6%, while non-tax revenues were at 3.3%). The respective share of GDP percentage projections for 2024, 2025 and 2026 are 21.0% (tax revenues 17.7%); 21.5% (tax revenues 18.2%); and 21.9% (18.6% tax revenues). Non-tax revenues are projected to remain constant at 3.3% during the 2024–2026 period. The GRZ has taken strategic measures to mobilise domestic resources through expansion of the revenue base, tax policy changes and tax administration efficacy measures. The tax administration efficacy measures include the use of an electronic invoicing system to eliminate malpractice. The GRZ has also committed to completing the integration of government agencies and services into the use of the Integrated Financial Management Information System. In addition, the GRZ is streamlining the granting of tax incentives to the critical players in the economy. Lastly, the GRZ could also leverage global climate finance sources by stimulating the growth of the domestic climate finance market as part of the preparedness to absorb global climate finance inflows. In tandem with such effort, the GRZ could strengthen capacity-building in its institutions to ensure that they can effectively implement and monitor environmental and social safeguards across all sectors of the economy.

3.2.1. Private capital for structural transformation

Given the debt distress, the 8thNDP plans to promote financing mechanisms leveraging resources from the private sector, but without implications for the GRZ balance sheet. As such, the 8th NDP clearly states the intention through policies to mobilise funds from non-traditional sources such as pension funds, capital markets, green bonds, PPPs and impact investments to fund its structural transformation agenda. Figure 3.1 shows that the largest contributions to GDP are from private investments and private consumption, as compared to public investment and public consumption. During the 2015–2022 period, the average value of capital investments as a percentage of GDP was 34.92%, and the lowest value 26.98%, which is slightly above the global average. Nevertheless, within the Zambian context of huge infrastructure gap, there is a need for rationalised and sustained capital investments. Since the last quarter of 2021, the GRZ has prioritised administrative reforms for ease of doing business, to incentivise investors in key sectors such as energy, mining, agriculture and transport. In this regard, the Public-Private Partnership (Amendment) Act of 2021 is a step forward to having a functional PPP framework in the country. There is a need for further development of sector-specific PPP guidelines and a supportive ecosystem, in addition to establishing a feasibility study fund to enhance the creation of a robust pipeline of feasible and bankable PPP projects. The creation of the Public-Private Dialogue Forum in April 2022 by the GRZ is also notable progress, given that the President of Zambian presides over this forum, which is tasked chiefly with eliciting the private sector's active participation in shaping public policy on private sector issues. Further to this positive development is the initiative on Private Sector Development Reform Programme, whose main mandate is to formulate legislation and institutional reforms targeting key aspects of doing business in Zambia.

Figure 3.1 : Contributions to the GDP from demand side (2010-2010)



Source: Africa Development Bank, Statistics Department

3.3. External financing of structural transformation, constraints and the need for reforming the international financing architecture

Given the huge financing gap for structural transformation that Zambia faces, access to external financing remains a compelling argument. This is even more so owing to the low savings rate in the country. For instance, in 2021 Zambia's savings rate was a mere 2.59% of GDP. In addition, the ongoing debt distress context limits the access to external sources of financing, the only viable option being the resort to concessional financing sources. According to the Zambian authorities and IMF estimates and projections, the concessional funding expected from the African Development Bank Group between 2024–2027 amounts to USD 750 million, while between 2002–2028, the World Gank Group's planned financing will provide USD 1.701 billion. Lastly, through the Extended Credit Facility, the IMF is expected to disburse USD 1.315 billion to the GRZ. Zambia needs these financial resources to accelerate its structural transformation.

3.3.1. Rise of debt as an important source of development finance in Zambia

Zambia has been in debt distress since 2017 and the main driver of public debt was the massive borrowing for infrastructure development in 2015–2019. The total PPG debt increased from 63.4% of GDP in 2017 to 110.8% in 2023. The fiscal deficits averaged 9.6% of GDP during the 2017–2020 period owing to an expansive fiscal policy. However, because of fiscal consolidation, the gap has gradually narrowed since 2021. The deficits rose from 7.0% of GDP in 2017 to 13.8% in 2020, then declined to 8.1, 8.7% and 6.6% of GDP in 2021, 2022, and 2023 respectively. Debt servicing takes up about 30% of the foreign exchange earnings, leaving less fiscal space for the development spending required for structural transformation.

Zambia's total public sector debt as at end of September 2023 was USD 26.3 billion, of which central government external debt was USD 14.3 billion. Guaranteed and non-guaranteed state-owned enterprise external loans amounted to USD 1.5 billion and USD 500 million respectively. Domestic debt amounted to USD 10.6 billion. The stock of private sector external debt as at end second quarter of 2023 was USD 8.5 billion. Total arrears as at end third quarter of 2023 stood at USD 10.4 billion, of which public sector external arrears were USD 6.2 billion and domestic arrears were USD 4.3 billion. The bulk of the external debt is held by Eurobond holders in the amount of USD 3.0 billion; other commercial lenders hold USD 3 billion (41.5%); followed by bilateral creditors, amounting to USD 4 billion (27.6%); partly concessional and non-concessional, multilateral institutions, USD 3.5 billion (25.2%); and plurilateral lenders debt in the amount of USD 500 million (5.6%) during the second and third quarters of 2023.

Zambia's external debt is exposed to refinancing, interest rate and exchange rate risks. Notably, the public sector debt service projections have an 80.85% fixed interest rate debt, while variable interest rate debt is 19.15%. Domestic debt projections account for 58.11% of the total fixed rate debt. Exchange risk is because as at end third quarter of 2023, 59.76% of public sector debt stock was denominated in foreign currency.

In the debt restructuring efforts, Zambia has cleared the IMF programme benchmarks set for transparency, disclosure and debt management institutional performance and setting of rules. The Public Debt Management Act 2022 provides for the raising of loans and grants; the issuing of guarantees; the approval of loans by the National Assembly; the issuing of loans by or on behalf of the Government; the establishment of sinking funds; and the establishment of the Debt Management Office and provision for its functions, which ensure transparency in debt management. In terms of disclosure, the Act requires the quarterly publication of the debts statistical bulletin, which the GRZ currently implements. To ensure that the country does not return to unsustainable debt levels, the GRZ has developed a Medium-Term Debt Management Strategy for 2023–2025. For external debt, the focus will be on the use of concessional financial sources and other low-cost sources, mainly targeted for use on projects with high socio-economic returns. For domestic debt, the GRZ will ensure that the issuance of government securities is primarily from the domestic market. On 22 June 2023, the Zambian authorities reached an agreement with the Official Creditor Committee on a debt treatment that is in line with IMF programme parameters and agreed on an MoU in October 2023. In parallel, on 28 May 2024, the bondholder voted in favour of the debt restructuring deal, thus bringing the debt restructuring effort towards an imminent closure and a possible return to a path of debt sustainability.

3.3.2. Benefits from reforms to the international financial architecture to Zambia

Zambia could benefit from the proposed reforms of the international financial architecture, specifically in three of the four main proposed areas of reforms (Wafa et al., 2024). These are the debt resolution process; the creation of a global financial system that supports financial resilience in emerging economies with liquidity support during crises and shocks; and reform of the global taxation system.

In debt resolution, Zambia chose the debt restructuring process under the G20 Common Framework, which supposedly was to be speedy. Instead, the process has taken over three years. Therefore, far from the set coordination ideals of the G20 Framework, Zambia experienced a nearly three-year delay in the restructuring resolution of its external debt. This is despite the Zambian authorities having shown full commitment towards debt restructuring since August 2021, in addition to fully engaging all creditors, and implementing front-loaded fiscal consolidation measures and sector reforms. Other notable measures include enactment of the 2022 Public Debt Management Act to ensure transparency and to strengthen parliamentary oversight of loan contraction; legalising public debt management operations by clarifying the roles of the Debt Management Office; and making mandatory the production of key debt-related reports such as debt sustainability analysis and a medium-term debt strategy. In addition, Zambia is implementing fiscal consolidation measures and economic sector reforms.

Zambia's experience has been a test case for other African countries facing debt distress given the protracted and unexpected sequence of actions. Notably, the G20 Common Framework was designed to coordinate debt relief offered by public and private lenders with predetermined debt treatment standards across all creditors. In principle, the framework is designed to ensure a well-coordinated and broad participation of creditors with fair or comparable burden-sharing for countries with unsustainable public debt, liquidity crises and debt vulnerability. The prolonged debt distress, together with the external shocks and slower economic growth which exacerbated poverty, generally impeded Zambia's progress toward the attainment of the SDGs. Accordingly, reform of the international financial architecture would obviate similar experiences in other indebted countries.

Zambia could also benefit from the proposed call for reform of the global financial architecture to create a financial safety net for emerging markets during shocks and crises by strengthening their liquidity during such difficult times. Under the current global financial architecture, upon a sovereign debt default event, the macroeconomic conditions in emerging countries such as Zambia are more likely than not to worsen with negative credit ratings. Credit ratings are a major aspect of the international financial architecture, though the industry is heavily concentrated. The impact of sovereign credit ratings issued by credit rating agencies negatively impacts a country's access to international financing and can trigger a domestic financial crisis. However, it is confounding that while the sovereign rating reports of credit rating agencies have a considerable impact on countries, the business is a global monopoly of a few firms whose methodologies are also far from transparent. This opacity and monopoly call for reform.

Zambia chose a selective default position on its repayment of $42.5 million and $56.1 million Eurobond coupons in December 2020 and 2021. This was based on the pressure for equal treatment of all creditors, which compelled the GRZ to choose the path of a deliberate default on the USD 42.5 million and USD 56.1 million Eurobond coupon payments that were due on 13 November 2020 and 30 January 2021 respectively, marking two default events. The immediate consequence of the notification of the selective default was the downgrading of the credit rating for Zambia from CC to Restricted Default by both Fitch and S&P Global Ratings. The immediate consequence was that Zambian bonds dropped to half their face value after the default announcement, which posed a systemic threat to the Zambian economy via the banking system. This is because government bonds provide 30% of the income of the Zambian banking sector (BoZ); thus, the announcement adversely affected banking sector balance sheets. There was therefore an urgent need to provide liquidity to Zambia at that time to avoid the two default events and the accompanying negative implication of further sinking the Zambian economy into a spiral of worsening economic conditions. Such liquidity financing was simply not available for Zambia, and it is therefore evident that reform of the international financial architecture to allow for availing the necessary liquidity financing during a sovereign liquidity crisis would be invaluable and lead to avoidance of a spiral into economic meltdown. In addition, sovereign credit rating reforms could prevent emerging countries such as Zambia from falling into a spiral of macroeconomic instability.

Lastly, Zambia could benefit from the call for reforms of the global taxation system aimed at strengthening the rule and norms of corporate taxation. As a strategic mineral resource-rich country, Zambia must prevent tax evasion practices in the mining sector. Notably, Zambia's illicit financial flows as a percentage of total trade is 11.8% (Brookings Institute, 2020). This presents financial loss that could be prevented through a strengthened global taxation system.

3.4. Financing climate action in Zambia

For Zambia to meet its nationally determined contributions targets, it must investment about USD 35 billion up to 2030. Zambia's private finance gap stands at about USD 2.9 billion annually. All these are predominantly expected to be mobilised through new climate finance mechanisms such as the Green Climate Fund (GCF) and other climate-related bilateral, multilateral and domestic financing, including the private sector (United Nations Framework Convention on Climate Change). Owing to scarcity of financial resources, a careful selection of projects should be adopted, with green growth finance mobilised in tandem through innovative financing mechanisms. Zambia is highly susceptible to the negative impact of perennial droughts and floods and the upfront private financing required to adapt to droughts and floods is roughly equivalent to 13.1% and 4.4% of GDP respectively. Zambia is among the top eight countries in Africa with the greatest potential for upfront investment required.

The environment for private sector financing of climate action in Zambia, including green bonds and other financial instruments such carbon credits, is still in its infancy with the legal and regulatory framework, product information and awareness-raising, human and technical capacity issues yet to be fully addressed. It will take time to develop a mature and fully supportive ecosystem for green financing. Currently, the private sector provides negligible climate finance in the form of corporate social responsibility. The great potential of private sector investments in climate action lies mostly in clean renewable energy projects. It is commendable that the Development Bank of Zambia was accredited by the GCF to receive and submit proposals on behalf of green projects developers, to be financed by the GCF. Essentially, a great opportunity for unlocking climate action financing in Zambia is premised on crowding in private sector investments. MDBs can play a critical role in assisting Zambia to crowd-in private sector financing for climate action through both their convening and coordination power and the de-risking of financial instruments. The de-risking factor is critical for making climate action financing concessional. MDBs can also a pivotal role of mainstreaming climate action financing through the various projects they implement in Zambia. The call for reforms of the international financial architecture favouring climate debt financing could help Zambia to secure more resources for climate action. Such reforms could unlock climate debt-related financial instruments such as debt-for-climate swaps. Zambia could benefit from climate-debt swaps based on the unique position of having about 60% of its land mass covered by forests.

3.5. Concluding remarks and policy recommendations

While domestic resource mobilisation remains critical to financing Zambia's structural transformation and addressing climate action needs, it is important to aptly understand its role, mainly as catalytic to private sector financing. Essentially, domestic resource mobilisation is critical, but it is not sufficient to meet the financing need for structural transformation. External sources of financing, whether through MDBs, bilateral donors, international financial markets, or general FDI, are indispensable for financing the structural transformation of Zambia. This view is mainly premised on the dialectical relationship between efficacy in domestic resource mobilisation and the sovereign capacity to sustainably attract foreign capital inflows. There must be full recognition of the inadequacies of the existing international financial architecture to allow optimal flows of capital and financial resources in a responsive manner, to address urgent needs in countries such as Zambia, which had two selective default events in 2020 and 2021. Zambia would have benefited immensely from an international financial architecture that could address its liquidity needs and help it avoid a spiral into a series of macroeconomic problems. It is commendable that the ongoing comprehensive public finance management and macroeconomic reforms being undertaken by Zambia under the IMF programme place Zambia in a position of preparedness to benefit from such reforms.

The first policy recommendation for Zambia is to stay the course of reforms to restore macroeconomic stability to increase the capacity for sustainable domestic resource mobilisation. Closely linked to domestic resource mobilisation efforts should be efforts to improve the ease of doing business in the country as a pathway to unlocking more international financial flows, to address the financing needs for structural transformation and climate action. This is based on the aforementioned dialectical relationship between domestic resource mobilisation and sovereign ability to attract international capital inflows.

Secondly, the Zambian authorities should emphasise and highlight their frustratingly long experience with the debt restructuring process as a compelling test case requiring urgent reform of the international financial architecture.

Lastly, the Zambian authorities should continue implementing polices directed at improving the ease of doing business to attract more international capital inflows.

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