Zambia

key figures
- Land area, thousands of km² 753
- Population, thousands (2005) 11,668
- GDP per capita, $ PPP valuation (2005) 1,270
- Life expectancy (2000-2005) 37.4
- Illiteracy rate (2005) 17.8
A buoyant copper sector and strong growth in tourism and construction underpinned moderate growth in 2005. GDP growth of 4.5 per cent was, however, slower than expected, reflecting the drought experienced in many parts of the country, the high price of imported oil and fuel shortages, and a non-expansionary fiscal policy. Stable fuel supplies, better rainfall and continuing investment in mining are expected to boost growth to 5 and 5.5 per cent in 2006 and 2007 respectively. Achieving broad-based growth is a major challenge, since mining generates few spill-over effects for the rest of the economy, while about 70 per cent of the population still live below the poverty line.

In 2004, the authorities undertook a major fiscal consolidation effort and began reforms to improve public administration and expenditure management. This contributed to achievement of the Heavily Indebted Poor Countries (HIPC) Initiative completion point in April 2005 which triggered the cancellation of $3.9 billion of external debt. Restored donor confidence translated into larger flows of aid and an increase in the proportion provided in the form of direct budgetary support. Improved fundamentals, coupled with high world copper prices, led to a surge in capital inflows and foreign reserves and an appreciation of the kwacha. The main challenge in 2006 will be to ensure that funds generated by debt relief are dedicated to priority sectors.

The new National Development Plan for the period 2006-10 will form the basis of the authorities’ development agenda and poverty reduction programme. Reducing vulnerability to drought, improving resilience to terms of trade shocks and raising the employment-generation and poverty-reduction impact of growth are the main objectives of the plan. Great emphasis is placed on investment in rural infrastructure and labour intensive sectors.

The outcome of the 2006 presidential elections is not expected to change policy framework since

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**Figure 1 - Real GDP Growth and Per Capita GDP**  
($ PPP at current prices)

<table>
<thead>
<tr>
<th>Year</th>
<th>Real GDP Growth (%)</th>
<th>Per Capita GDP ($ PPP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>2</td>
<td>3500</td>
</tr>
<tr>
<td>1998</td>
<td>1</td>
<td>3000</td>
</tr>
<tr>
<td>1999</td>
<td>2</td>
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</tr>
<tr>
<td>2000</td>
<td>2</td>
<td>2000</td>
</tr>
<tr>
<td>2001</td>
<td>2</td>
<td>1500</td>
</tr>
<tr>
<td>2002</td>
<td>2</td>
<td>1000</td>
</tr>
<tr>
<td>2003</td>
<td>2</td>
<td>500</td>
</tr>
<tr>
<td>2004</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>2005(e)</td>
<td>3</td>
<td>3500</td>
</tr>
<tr>
<td>2006(p)</td>
<td>5</td>
<td>3000</td>
</tr>
<tr>
<td>2007(p)</td>
<td>5</td>
<td>2500</td>
</tr>
</tbody>
</table>

Source: IMF and Central Statistical Office data; estimates(e) and projections(p) based on authors’ calculations.
the opposition remains divided and has not yet announced what policy changes it would introduce. Nevertheless, the fight against corruption, President Mwanawasa’s battle-cry, has run out of steam as the Presidential Anti-Corruption Task Force has not managed to bring any successful case to court and efforts to prosecute former President Chiluba have reached a standstill.

**Recent Economic Developments**

The recovery in agricultural production registered over the last two years was brought to a sudden stop by the poor rainfall in the southern and western regions during the 2004/05 season. Although the planted area increased by one third (from 631,000 to 835,000 hectares), production of maize – the main staple food – stood at 866,187 tonnes – a 28 per cent reduction over the previous season. The Ministry of Agriculture has attributed the decline in output to the reduced harvests of small- and medium-sized farms. Taking into account the current levels of reserves, the maize deficit is estimated at 271,000 tonnes, in marked contrast to the surplus of 185,000 tonnes in the 2003/04 season. The government has allowed importation of up to 200,000 tonnes of maize and removed the 15 per cent duty on imports to improve their flow. Other crops were similarly affected, with the exception of more drought-resistant ones, such as cassava, which registered 18 per cent growth in volume, continuing the booming trend sparked by improved seed varieties. Wheat production increased considerably (by 65 per cent), as did rice, but these are minor crops in terms of volume. Better rains in the 2005/06 season and an increase in the area planted are expected to boost agriculture production and ensure a good performance for maize and cash crops in 2006-07.

Livestock and dairy products showed considerable dynamism in 2005. Better animal disease control and processing earned Zambian beef an “A” quality grade, which makes it suitable for export. Consumption of dairy products, a sector in which foreign investment has played a key role in expanding production and quality, is constantly increasing. Horticulture and floriculture, regarded as highly promising activities, suffered from the financial collapse of the largest player in the sector which had provided input credit to 7,000 farmers. The volume of fresh fruit and vegetables fell from about 8,500 tonnes in 2004 to 6,500 tonnes in 2005. The output of cut flowers in 2005 was estimated to be about 4,000 tonnes. The sub-sector remains small – the total turnover of all Zambian firms is about equivalent to that of the largest Kenyan exporter – and, because of the low volumes produced, exporters are paying substantially higher freight rates than in other African flower-producing countries. The Association of Export Growers forecasts that production should regain the 2004 level in two years thanks to new investment. In one recent transaction, for example, Chalimbana Fresh Produce, a subsidiary of the UK’s Plantation & General Investments Plc, acquired Agriflora’s vegetable production assets. Continuing its strong growth performance, tobacco production – mainly for export – reached 58,000 tonnes in 2005, up from 37,000 in 2004.

Mining and quarrying output increased by 5 per cent in the first two quarters of 2005 compared with the same period of 2004, mainly reflecting positive growth in stone quarrying and coal mining. Buoyant demand and record-high prices boosted investment and production in the copper sector, continuing the 2004 trend. However, copper production suffered from oil shortages, strikes at Konkola Copper Mine (KCM), the largest copper producer, and floods at Mopani Copper Mines (MCM), the second largest. Preliminary figures indicate that copper production increased by only 5 per cent in 2005 against 12 per cent in 2004. This contributed to the slowdown in the sector’s growth, from 13.9 per cent in 2004 to 2.8 per cent in 2005. Production shortfalls at the biggest mines are expected to be offset by reinvestment in the Copperbelt mines and new production from two mines opened in 2005. Kansanshi, owned by First Quantum Minerals (Canada), is expected to produce 91,000 tonnes, while Luanshya, owned by J&W Investments (Switzerland), set a target of 50,000 tonnes for 2005, and plans to expand it to 67,000 tonnes in 2006. Total copper production is expected to increase to about 600,000 tonnes in 2006.
The manufacturing sector, dominated by food, beverages and tobacco processing, grew by 3.7 per cent in 2005, somewhat less than in 2004. Its contribution to overall GDP remains modest and is highly dependent on the performance of the upstream agriculture sector.

In the construction sector, continuing investment in mining and donor-funded work in road rehabilitation supported double-digit growth of 19.9 per cent in 2005, about the same as in 2004. This has created employment opportunities for skilled artisans like bricklayers, blacksmiths, plumbers and electricians. Official figures underestimate the size of the sector since investment in private commercial and residential housing estates is mainly informal. The sector is polarised around a few large foreign contractors and many small
enterprises which lack financial and technical capacity and mainly work as subcontractors. Strong growth should continue in 2006 as new infrastructure rehabilitation and housing projects are expected to start.

Tourism recorded double-digit growth of 12.1 per cent in 2005 compared to 6.4 in 2004, thanks in part to the “Visit Zambia Campaign,” which marked the 150th anniversary of the first sighting of the Victoria Falls. The country’s four international airports – Lusaka, Livingstone, Mfuwe and Ndola – recorded an increase in international passenger arrivals. On a cumulative basis, international passenger arrivals in the year to November 2005 were 202 121, up by 7 per cent from 188 257 over the same period in 2004. The sector should become a sustainable source of growth as transport infrastructure improves, especially airports and park roads, and a newly streamlined regulatory framework enters into force.

Against a background of increasing investment in the mining, tourism and transport sectors, private gross capital formation was the main driver of growth in 2005 and is expected to continue to be so in 2006 and 2007. In parallel, copper exports will increase, although less rapidly than imports of capital goods, so that a slight deterioration in external demand is expected in 2006 and 2007.

Growth in private consumption appears to have slowed in 2005, due to the poor performance in the agricultural sector. Conversely, government consumption, which contracted in 2004 in the context of a restrictive budgetary stance, moderately increased in 2005 and is projected to average 15 per cent of GDP over the forecast period as the 2006 presidential and legislative elections approach and HIPC funds are channelled towards poverty reduction programmes. Public gross capital formation is also expected to increase reflecting donor funded investment in infrastructure.

### Table 1 - Demand Composition (percentage of GDP)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005(e)</th>
<th>2006(p)</th>
<th>2007(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross capital formation</td>
<td>14.6</td>
<td>22.0</td>
<td>25.6</td>
<td>25.1</td>
<td>24.4</td>
<td>24.9</td>
<td>25.9</td>
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<tr>
<td>Public</td>
<td>5.4</td>
<td>11.8</td>
<td>11.4</td>
<td>8.9</td>
<td>8.3</td>
<td>8.5</td>
<td>8.9</td>
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<tr>
<td>Private</td>
<td>9.2</td>
<td>10.2</td>
<td>14.2</td>
<td>16.2</td>
<td>16.2</td>
<td>16.4</td>
<td>16.9</td>
</tr>
<tr>
<td>Consumption</td>
<td>91.0</td>
<td>91.3</td>
<td>87.1</td>
<td>81.6</td>
<td>81.4</td>
<td>81.4</td>
<td>81.4</td>
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<tr>
<td>Public</td>
<td>17.5</td>
<td>11.9</td>
<td>14.6</td>
<td>14.5</td>
<td>14.7</td>
<td>15.0</td>
<td>15.0</td>
</tr>
<tr>
<td>Private</td>
<td>73.5</td>
<td>79.4</td>
<td>72.6</td>
<td>67.1</td>
<td>66.7</td>
<td>66.3</td>
<td>66.4</td>
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<tr>
<td>External sector</td>
<td>-5.5</td>
<td>-13.4</td>
<td>-12.7</td>
<td>-6.7</td>
<td>-5.9</td>
<td>-6.3</td>
<td>-7.2</td>
</tr>
<tr>
<td>Exports</td>
<td>33.4</td>
<td>28.6</td>
<td>28.9</td>
<td>34.2</td>
<td>30.4</td>
<td>28.1</td>
<td>25.5</td>
</tr>
<tr>
<td>Imports</td>
<td>-38.9</td>
<td>-42.0</td>
<td>-41.6</td>
<td>-40.9</td>
<td>-36.3</td>
<td>-34.4</td>
<td>-32.7</td>
</tr>
</tbody>
</table>

Source: IMF and Central Statistical Office data; estimates(e) and projections(p) based on authors’ calculations.

The overall budgetary stance, however, remained restrictive in 2005, and is expected to remain so in 2006 and 2007.

### Macroeconomic Policies

#### Fiscal Policy

At the end of 2005, the authorities finalised the fifth National Development Plan which succeeds the Transitional Development Plan in shaping governments priorities to sustain and broaden the economic gains achieved in the last four years. Rural infrastructure, agricultural development and measures to combat the HIV/AIDS pandemic constitute the core of the plan. Although growth is expected to be driven mainly by mining and construction, investment in rural infrastructure and support to labour-intensive sectors, such as agriculture and manufacturing, are seen as essential to increasing employment and reducing poverty.

In line with the fiscal consolidation efforts undertaken in 2004, estimations for 2005 indicated that
Budgetary performance was broadly on track, thanks to the combined effect of reduced debt service following achievement of the HIPC completion point and lower government borrowing, which declined from 5.2 per cent of GDP in 2003 to an estimated 1.9 per cent in 2005. In addition, the government engaged in important efforts to limit public expenditure. For example, the wage bill was maintained below 8 per cent of GDP, while interest payments declined to 2.7 per cent of GDP in 2005 from 3.9 per cent in 2003. In parallel, budgetary allocations to social sectors were in line with the target. Expenditures on education amounted to 24 per cent of the budget and were mainly used for the recruitment of 8,000 teachers.

Government revenue was slightly lower than expected, owing to a temporary waiver of import duty and excise taxes on petroleum products to alleviate the impact of the fuel crisis. Nevertheless, thanks to increased donor support and careful control of expenditure, the overall budget deficit is estimated to have decreased to 2.3 per cent of GDP in 2005, from 2.8 per cent in 2004.

Zambia remains highly dependent on donors’ assistance which finances some 30 per cent of the government budget. The commitment to maintain fiscal discipline and improve budget execution (which is estimated to have increased to 70 per cent in 2005 from 40 per cent in 2004) has brought renewed credibility to the government. This has led to new donor pledges to increase aid volumes (complementing resources released by debt relief), improve their predictability and provide a greater proportion in the form of direct budgetary support.

The start of implementation of a new Public Expenditure Management and Financial Accounting system (PEMFA) last year is considered a cornerstone for improving expenditure oversight and strengthening budget execution. Encouraged by this reform, the number of donors providing budgetary support is expected to increase from five to seven in 2006, with total budgetary support expected to account for 28 per cent of grants by 2007, compared to 17 per cent in 2005.

The 2006 budget, entitled “From sacrifice to equitable wealth creation”, suggests that priority will be given to financing infrastructure rehabilitation (mainly through donors’ funds), education and health. Budget allocations to education and health are expected to rise respectively by 40 per cent to K1273 billion and by 20 per cent to K503 billion. At the same time, government will focus on a gradual decentralisation of government functions and resources to the district level and on tracking the effectiveness of public expenditures through public expenditures tracking surveys (PETS).

On the revenue side, in line with the Private Sector Development (PSP) Initiative, the government has introduced a series of tax incentives in an effort to attract new investment and consolidate existing ones. Overall, the government proposes a cut of pay-as-you-earn taxes, a reduction of the upper corporate tax rate for banks from 45 to 40 per cent, and the extension of tax incentives for copper and cobalt mining to that of all other base metals. The consequent loss of revenue is expected to be compensated by efforts to improve tax administration and collection and broaden the tax base by bringing the informal sector further into the tax net.

Continuing efforts to improve the quality and coherence of spending and enhance revenue collection, in tandem with higher and more predictable donor support, contribute to creating a window of opportunity for completing growth-enhancing reforms. At the same time, the government faces difficult trade-offs for 2006. Resources freed by debt cancellations – amounting to $127 million in 2006 – which should strengthen poverty-reduction spending, compete with other compelling short-term priorities, including voter registration, the general elections and the constitutional review process. Increases in spending, however, are expected to be more than compensated by higher donor support and a reduction of interest payments on public.

1. Budget support amounts to $101 million, $137.56 million, and $130.63 million in 2006, 2007, and 2008, respectively.
Zambia

Table 2 - Public Finances (percentage of GDP)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005(e)</th>
<th>2006(p)</th>
<th>2007(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue and grants*</td>
<td>24.9</td>
<td>26.1</td>
<td>25.0</td>
<td>23.9</td>
<td>23.5</td>
<td>24.0</td>
<td>23.7</td>
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<tr>
<td>Tax revenue</td>
<td>18.8</td>
<td>17.4</td>
<td>17.4</td>
<td>17.6</td>
<td>16.7</td>
<td>17.0</td>
<td>16.7</td>
</tr>
<tr>
<td>Grants</td>
<td>5.1</td>
<td>8.3</td>
<td>7.0</td>
<td>5.6</td>
<td>6.0</td>
<td>6.3</td>
<td>6.3</td>
</tr>
<tr>
<td>Total expenditure and net lending*</td>
<td>26.0</td>
<td>31.8</td>
<td>30.9</td>
<td>26.8</td>
<td>25.8</td>
<td>25.8</td>
<td>25.3</td>
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<tr>
<td>Current expenditure</td>
<td>18.4</td>
<td>19.4</td>
<td>19.5</td>
<td>18.0</td>
<td>17.6</td>
<td>17.3</td>
<td>16.4</td>
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<tr>
<td>Excluding interest</td>
<td>14.3</td>
<td>15.4</td>
<td>15.6</td>
<td>14.5</td>
<td>14.8</td>
<td>15.3</td>
<td>15.3</td>
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<tr>
<td>Wages and salaries</td>
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<td>8.0</td>
<td>8.4</td>
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<td>7.9</td>
<td>8.1</td>
<td>8.0</td>
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<td>Interest</td>
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<td>3.9</td>
<td>3.5</td>
<td>2.7</td>
<td>2.1</td>
<td>1.1</td>
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<td>Capital expenditure</td>
<td>7.6</td>
<td>11.8</td>
<td>11.4</td>
<td>8.8</td>
<td>8.2</td>
<td>8.5</td>
<td>8.8</td>
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<tr>
<td>Primary balance</td>
<td>3.1</td>
<td>-1.6</td>
<td>-2.1</td>
<td>0.6</td>
<td>0.4</td>
<td>0.3</td>
<td>-0.5</td>
</tr>
<tr>
<td>Overall balance</td>
<td>-1.0</td>
<td>-5.7</td>
<td>-6.0</td>
<td>-2.8</td>
<td>-2.3</td>
<td>-1.8</td>
<td>-1.6</td>
</tr>
</tbody>
</table>

a. Only major items are reported.
Source: Ministry of Finance and Economic Development and IMF data; estimates (e) and projections (p) based on authors' calculations.

debt. Overall, the budget deficit is expected to decline to 1.8 and 1.6 per cent of GDP in 2006 and 2007 respectively.

**Monetary Policy**

The Bank of Zambia seeks to contain inflation by controlling money supply growth, increasingly through open-market operations. The policy target is to lower inflation to around 10 per cent in 2006 and to a single digit by 2007. To this end, the bank began tightening liquidity in mid-2004. As a result, the rate of growth of broad money fell from a high of 36.4 per cent in July 2004 to 10.8 per cent in September 2005. Inflationary pressures were also eased by the 27 per cent appreciation of the currency experienced in 2005, which offset to some extent the impact of fuel and food price increases. Thus, after increasing to 19.5 per cent in September 2005, inflation declined to 15.9 per cent by the end of the year – its lowest level in the past 10 years.

In November, the kwacha dropped below the K4 000 per US dollar level for the first time since January 2002 and settled at K3 255 per US dollar on 30 November 2005. The sudden appreciation of the currency largely reflects greater inflows of foreign exchange (gross international reserves amounted to 2.3 months cover of imports in November 2005, well above the stated objective of at least 1.3 months for the year), stemming from foreign investment, increased exports from mining, and large inflows of official development assistance which were heavily concentrated towards the end of the year. Following attainment of the HIPC completion point, the government’s demand for foreign currency has fallen, with a concomitant improvement in Zambia’s creditworthiness; in turn foreign investors’ demand for local Treasury bills has experienced a significant increase. Despite concerns over the loss of competitiveness of non-traditional exports, the Bank of Zambia did not intervene, relying instead on market forces to stabilise the currency through the broad-based, inter-bank foreign exchange trading system. In mid-December, the Energy Regulation Board reduced petroleum product prices by 11 per cent, while reduction in mealie meal prices took effect from January 2006. Against the background of improved economic fundamentals, expected increases in donor support and a projected increase in the output of copper at higher prices, the current value of the kwacha is expected to be sustainable. The strengthening of the currency, combined with lower pressure on food prices resulting from an improved harvest and the continuation of a slightly restrictive or neutral fiscal stance is expected to bring average inflation down to 14 per cent and 9.5 per cent in 2006 and 2007.

Increasing commercial banks’ credit to the private sector is another of the central bank’s objectives. To this end, the reduction of statutory reserve requirements, coupled with lower government borrowing, have freed up resources for private-sector lending, which expanded
by 40 per cent in 2004 and 35 per cent in 2005 as banks rebalanced their portfolios in response to reduced returns on foreign exchange activities. These positive developments notwithstanding, the private sector credit to GDP ratio is, at 6 per cent, amongst the lowest in sub-Saharan Africa. Moreover, structural constraints to lending experienced by the banks suggest that lending rates are likely to remain high at an average 35 per cent. In order to give a real boost to lending, banking regulations need to be strengthened through, among other things, a revision of the bankruptcy law and better contract enforcement.

**External Position**

Trade has emerged as a key policy area in 2005, with the concurrent launch of the Integrated Framework for Trade-related Technical Assistance to Least-developed Countries (IF) and Zambia’s election to chair the meetings of the 50 Least Developed Country (LDC) members of the World Trade Organisation (WTO). Thanks to the IF, the government will receive substantial and co-ordinated support for strengthening its capacity to deal with regional and multilateral trade issues, as well as to develop its export strategy. In this respect, the Minister of Trade and Industry has taken a strong position in preparation for the Hong Kong ministerial meeting and advocated larger financial commitments to provide aid for trade to the LDC group.

On the regional side, discussions continued on the establishment of the Common Market for Eastern and Southern Africa (COMESA) Customs Union, originally planned for 2005. Differences over desired common external tariff rates and slower than expected implementation of the Free Trade Area Agreement (eight of 19 members still maintain tariffs, albeit preferential ones, on imports originating from the other members) led to postponement of establishment of the Customs Union to a future date. Zambia is also participating in the Southern African Development Community (SADC), its major trading partner, and the latter’s Preferential Trade Agreement.

Although benefiting from a variety of preferential market access initiatives, including the EU Everything-But-Arms initiative (EBA) and the US African Growth and Opportunity Act (AGOA), the stringent rules of origin of these schemes, combined with serious domestic supply-side constraints, continue to hamper the realisation of their full export potential. Both initiatives have generated only negligible additional exports for Zambia compared to the pre-existing Generalised System of Preferences scheme. The benefits from the AGOA have been indirect, through increased cotton exports to South Africa, which then exports clothing to the US market.

Although OECD countries remain an important export market, accounting in 2004 for 43 per cent of total exports, regional trade has picked up in recent years, boosted by the dynamism and strong investment capacity of South Africa and implementation of the COMESA and SADC preferential trade agreements. As was said earlier, the SADC is now Zambia’s largest trading partner, accounting for 49 per cent of total exports in 2004 and 56 per cent of imports in 2004. South Africa is the single largest partner country, importing copper, electricity, tobacco, cotton and sugar and exporting to Zambia in return a wide range of capital and consumer goods.

Overall, external developments in 2005 continued to be favourable, boosted by continuing high copper prices, which partially offset the rise in the oil import bill. Although export growth was less spectacular than the 60 per cent increase registered in 2004 (copper and cobalt exports rose by 21 per cent in volume terms), total exports for 2005 are estimated to be more than $2 billion, an 18 per cent increase in current dollar terms over the previous year (in volume, copper and cobalt exports grew by 7 per cent). Copper exports still account for about two thirds of the total, although non-metal exports, mainly cash crops such as cotton, tobacco and vegetables, have expanded considerably in the recent past. As anticipated last year, horticulture and cut-flower exports have suffered from the collapse of Agriflora, the biggest vegetable and rose exporter.

Imports continued to increase, both in dollar (20 per cent) and volume terms (9.4 per cent), mainly reflecting an increase in oil imports due to the temporary closure
Table 3 - **Current Account** (percentage of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>1997</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005(e)</th>
<th>2006(p)</th>
<th>2007(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade balance</td>
<td>-0.7</td>
<td>-7.6</td>
<td>-7.9</td>
<td>1.0</td>
<td>0.6</td>
<td>0.0</td>
<td>-1.0</td>
</tr>
<tr>
<td>Exports of goods (f.o.b.)</td>
<td>30.5</td>
<td>24.3</td>
<td>24.4</td>
<td>32.9</td>
<td>29.4</td>
<td>27.3</td>
<td>24.8</td>
</tr>
<tr>
<td>Imports of goods (f.o.b.)</td>
<td>-31.1</td>
<td>-31.9</td>
<td>-32.2</td>
<td>-31.9</td>
<td>-28.8</td>
<td>-27.3</td>
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<tr>
<td>Services</td>
<td>-4.8</td>
<td>-6.5</td>
<td>-5.5</td>
<td>-4.0</td>
<td>-4.0</td>
<td>-4.0</td>
<td>-4.0</td>
</tr>
<tr>
<td>Factor income</td>
<td>-5.2</td>
<td>-4.1</td>
<td>-3.4</td>
<td>-7.8</td>
<td>-7.8</td>
<td>-7.8</td>
<td>-7.8</td>
</tr>
<tr>
<td>Current transfers</td>
<td>4.7</td>
<td>2.0</td>
<td>-0.1</td>
<td>-0.5</td>
<td>-0.5</td>
<td>-0.5</td>
<td>-0.5</td>
</tr>
<tr>
<td><strong>Current account balance</strong></td>
<td>-6.1</td>
<td>-16.2</td>
<td>-16.9</td>
<td>-11.3</td>
<td>-11.3</td>
<td>-11.3</td>
<td>-11.3</td>
</tr>
</tbody>
</table>

Source: Bank of Zambia and IMF data; estimates (e) and projections (p) based on authors’ calculations

The trade balance is expected to slightly deteriorate in 2006 and 2007. Copper export volume should continue to grow strongly at about 8 per cent but lower international prices are expected to lead to a more moderate increase in value. Furthermore, imports will rise by an estimated 12 per cent, reflecting investment in mining and infrastructure rehabilitation-related expenditures. The prospects for non-metal exports are less clear cut. The sector is likely to suffer somewhat from the appreciation of the kwacha. Although a stronger currency could drive down the price of imported inputs, the net effect will also depend on the relative import content of the various sub-sectors.

Besides currency considerations, other obstacles remain to the expansion of non-metal exports and improvement of their international competitiveness. Horticulture and livestock have considerable potential but suffer from structural bottlenecks, especially the high cost of finance and transport and limited certification capacity, which keep production volumes low. Lack of compliance with sanitary and phytosanitary barriers still

![Graph of Stock of Total External Debt and Debt Service](image-url)
represents a major obstacle to expanding agricultural exports to the EU and US markets.

The combined effects of the phasing out of the EBA sugar protocol (2006-09) and the overall reform of the EU sugar regime (2006-15) are likely to have a significant impact on the agricultural sector. On the one hand, producers will face an important, although gradual, reduction in the EU raw sugar reference price, even though the EU guaranteed price will still be 50 per cent higher than the world price. On the other hand, while the price cut would negatively affect revenue from existing export quotas, the phasing out of the EBA sugar protocol, culminating in duty-free and quota free access from 2009, will open up opportunities to expand export volumes and broaden the range of products supplied.

At end-2004, Zambia’s debt stock was estimated at $7.1 billion. Of this, about 56 per cent was owed to multilateral creditors, 43 per cent to bilateral creditors and a small balance of 1 per cent to commercial creditors.

Achievement of the HIPC completion point in April 2005 triggered an external debt cancellation of $3.9 billion over a period extending to 2023. Out of the $3.9 billion, some Paris Club creditors have already committed themselves to cancelling the $1.4 billion of debt owed to them and to grant additional debt relief of $393 million.

Following the positive outcome of the review in December 2005, Zambia has also been granted multilateral debt relief. The IMF will provide 100 per cent debt relief on all debt incurred by Zambia before 1 January 2005 which is still outstanding. This relief amounts to $577 million. Additional debt relief is expected from the World Bank and the African Development Bank in 2006.

Given the above developments during 2005, the external debt stock will be reduced substantially in 2006, triggering lower external debt service payments and in turn providing more resources for poverty reduction priorities.

Structural Issues

Recent Developments

The promotion of the private sector and the reform of parastatal enterprises constitute, along with public sector reform, the pillars of the structural reform agenda, which gained momentum in 2004 under the threat of missing HIPC completion point triggers.

At the government’s request, the World Bank conducted an assessment of Zambia’s business regulations and overall investment climate in 2004. The assessment echoes the concerns of the private business sector regarding such issues as business registration, land acquisition, visa and work permits, taxation and labour legislation. The proposed new investment code has encountered strong resistance; especially because of fears that the generous incentives proposed to attract new investors could result in substantial loss of tax revenue. It was not implemented. Neither was the planned one-stop shop for new investment. Because of similar fears of revenue loss, approval of the Export Processing Zone is still pending.

Some progress was observed in 2005, mainly in the privatisation and commercialisation of large parastatals. The sale of a 49 per cent share of ZANACO, which was stalled in 2004 after negotiations with South Africa’s ABSA collapsed, seem to have reached a positive conclusion with the choice of the Netherlands’ Rabobank as preferred bidder. The choice reflected the AAA credit rating of this bank and its proven experience in providing finance to rural areas in developing countries. This was coherent with the government’s desire to maintain and strengthen the large rural network operated by ZANACO as an instrument to improve farmers’ access to credit. The transaction has been jeopardised, however, by an order from the Lusaka High Court to suspend negotiations following an application from a member of parliament whose own bid was unsuccessful.

As part of the ongoing restructuring of the financial sector and in accordance with the Financial Sector Development Plan approved in 2004, the
National Savings and Credit Bank (NSCB) and the Development Bank of Zambia (DBZ) submitted to the Bank of Zambia at the end of 2005 detailed plans for their incorporation under the Companies Act. The cabinet approved a repeal of some sections of these two non-bank financial institutions’ statutes which were in conflict with the Banking and Financial Services Act. In September 2005, IFAD approved a $14 million Rural Finance Programme, which includes a $2.15 million to recapitalise the NSCB and develop its capacity to provide rural banking services. In March 2005, DBZ signed a strategic partnership agreement with the Export-Import Bank of India, which had already injected $1.4 million into the bank’s capital base.

The process of commercialisation of the Zambia Electricity Supply Corporation (ZESCO) is underway, with the appointment of a new Board of Directors, dominated by private sector representatives. A performance review of the new governance structure is scheduled for mid-2006. Considerable investment has been secured, however, for expanding power-generation capacity. ZESCO has signed a memorandum of understanding with Farab International of Iran for building a 120 megawatt hydroelectric power plant on the Kafue River and with Sinohydro of China for an even bigger power plant at the Lower Kafue Gorge (600 megawatt).

The government is still pondering over the commercialisation strategy to adopt for ZAMTEL, the national telecommunication company, which owns the monopoly of fixed lines, the international telecommunication gateway and Cell-Z, one of Zambia’s three mobile operators. Following the acquisition of Telecel by South Africa’s MTN, competition for the rapidly expanding mobile market has heated up, with massive investment to expand network coverage to rural areas.

High expectations were also generated by the adoption by a public-private forum of a far-reaching Private Sector Development (PSD) Initiative, endorsed by government, the private sector and the donor community at the Livingstone Forum in 2004. Although a number of steps were taken to strengthen, for example, the capacity of private sector associations and establish a business forum to institutionalise public-private dialogue, overall implementation has been very weak. Similarly, the plan to regroup and rationalise the five agencies in charge of private sector development under a Zambia Development Agency has not advanced and is not likely to do so before a new cabinet is installed in 2006, notwithstanding the recent announcement by the Minister of Finance during his 2006 budget speech. On the positive side, most donors have signed a memorandum of understanding with the government along the lines identified by the PSD Initiative and formed a dedicated group chaired by a lead donor (the Netherlands). Some donors have gone further and provided some initial funding for this initiative.

In accordance with the National Agricultural Policy 2004-15, the government is committed to fostering private-sector development in agriculture, disengaging from direct intervention and limiting itself to the provision of public goods such as rural infrastructure, basic research, disease control and market information. Promoting market-oriented agriculture remains one of the most challenging policy priorities. Farmers lack access to inputs at affordable prices and credit more generally, and find it difficult to market their products. Agribusiness firms and buyers have set up out-grower schemes, often supported by NGOs and donors, to strengthen links with and assist their suppliers by, for example, guaranteeing sales at pre-determined prices and, in some cases, providing technical assistance, subsidised fertilisers, and extension services. These initiatives have been quite successful in the cotton and tobacco sectors, while problems of contract enforcement and side-selling to competing buyers have limited the development of similar schemes in horticulture.

Owing to persistent credit constraints, the government continues to provide subsidised fertilisers to small farmers through the annual Fertiliser Support Programme. The programme is however criticised by stakeholders for being excessively costly and hindering the emergence of a functioning fertiliser distribution system.
Transport Infrastructure

Zambia is a landlocked country, which shares borders with eight countries and therefore constitutes a potential regional hub with, notably, the north-south transport corridor, linking DRC with South Africa and Tanzania and improved transport links with Angola. However, the current network is not designed to take advantage of the strategic location of the country in the sub-region. In addition, internal connectivity is hampered by the presence of several water crossings, long distances and low population densities. Poor infrastructure entails high transport costs (estimated to account for 60-70 per cent of the cost of production of many goods), limits the development of markets, reduces mobility and exacerbates the consequences of food crises. Road accidents and associated deaths, injuries and property damage impose an additional heavy toll on the country and its people.

The transport network in Zambia includes all four modes of transportation: rail, road, civil aviation, and inland water transport. Historically, the physical transport infrastructure was developed to link Lusaka and the Copperbelt with the main north-south routes. Out of a total road network of 67 671 km, only 37 000 km are gazetted, of which 18 per cent are paved, 23 per cent are gravelled and 59 per cent are dirt roads. The bulk of the formal road network was constructed during the first decade after independence and, owing to the lack of adequate maintenance through to the mid-1990s, it has gradually deteriorated. In particular, the quality of paved roads has been severely affected by systematic overloading of trucks and poor drainage, resulting in widespread potholes. The quality and practicability of dirt roads is vulnerable to weather conditions, holding back the further development of commercial agriculture, which in fact remains concentrated around Lusaka.

Institutional and resource constraints combine to explain Zambia’s poor road maintenance track record. They include blurred responsibilities among road management agencies, a poor regulatory framework which negatively affects private contractors and limited and erratic budgetary transfers to the appropriate local authorities. A 15 per cent levy on fuel constitutes the chief source of financing of the Road Fund.

Rail and road mobilise about three-quarters of total goods trade, with approximately 2.2 million tonnes transported by road as compared to 400 000 tonnes by rail. In this context, improvement of road transport features prominently in the government’s strategy for enhancing economic growth. In order to provide a coherent policy framework to the transport sector, the government approved a transport policy in 2002 and launched a strategic plan for the period 2003-07.

Road infrastructure programmes initially focused on the rehabilitation of trunk and district roads linking Lusaka with Coppermines. The strategy has increasingly shifted towards rehabilitation of rural and feeder roads in order to facilitate access to markets for agricultural products and to tourist areas, as well as to completion of transport corridors to neighbouring countries. There are also plans to open new alternative railway routes to the sea and, notably, to such ports as Lobito Bay (Angola), Walvis Bay (Namibia), Beira and Nacala (Mozambique).

The governance structure of the sector has also been reformed. With a view to clarifying the management and financing of the core network, three road agencies, namely, the National Road Development Agency (NRDA), the National Road Fund Agency (NRFA), and the Road Transport and Safety Agency (RTSA), have been created and became operational in 2005. Under the new configuration, NRDA is responsible for planning, procurement, supervision and monitoring the whole road network and for centralising functions which were previously split up between various line ministries. Similarly, the NRFA co-ordinates all resources for the road sector, including government and donor funding and user charges. Accordingly, the fuel levy for routine maintenance is now channelled directly to the NRFA, avoiding the slippage and erratic fund flows caused by its previous inclusion in the overall government budget. The RTSA is responsible for transport licensing, traffic safety and axle load control.
In tandem with institutional reforms, substantial donor support has been granted to the Road Sector Investment Programme (ROADSIP I) since 1997. During the implementation of its first phase, completed in 2003, progress was made in rehabilitating urban, trunk, main and district roads, while the rehabilitation of feeder roads fell far short of the target, largely because of erratic government funding and the inadequate capacity of local authorities to execute rehabilitation works. The government is currently undertaking the second phase of the programme. The 10-year ROADSIP II (2004-2013), which represents spending totalling $1.6 billion, has four main objectives: to bring the core road network (40 113 km of which over half are classified as trunk, main and district roads and the remainder as feeder, urban and parks roads) into serviceable condition; to strengthen the technical and managerial capacity of the new road authorities; to create employment opportunities in the road sector; to improve road safety and environmental management in the road sector through the establishment of procedures and guidelines.

Against a background of progressive phasing-out of donor support for road maintenance and expansion – it is expected to end altogether in 2013, the government is preparing a financial strategy to generate adequate revenues for the NRFA through the adjustment of the fuel levy and the introduction of additional user charges.

In addition, the authorities are working on ways to attract private sector participation in road construction through public-private partnerships (PPP). So far, private sector interest has been weak, discouraged by an inadequate regulatory framework. In early 2005, a process was begun to establish a policy with clear guidelines for investors, to review and strengthen the legal framework, and to increase the capacity of both public and private players in managing and administering PPPs in transport infrastructure, drawing on the successful experience of neighbouring South Africa and Tanzania.

In parallel, the National Council for Construction is promoting certification for contractors and an action plan to strengthen the local road construction industry. The introduction of toll roads is considered a long-term option since such a step would need to comply with the SADC stipulation that an alternative road be provided free of charge.

The railway network is in very poor condition as a result of inadequate investment and weak management. The network consists of Zambia Railways Limited (ZRL) and the Tanzania-Zambia Railway system (TAZARA). ZRL has a 1 266 km single track network which runs from the border with Zimbabwe at Livingstone to the border with DRC, with branch lines to the Copperbelt. The 20-year concession to manage ZRL, granted in 2003 to New Limpopo Bridge Projects Investments (NLPI) and Spoornet, highlights significant problems related to the inadequacy of the regulatory framework. In particular, experts suggest that the level of investment stipulated in the agreement is too low for a railway line of this magnitude, while only 65 per cent of the concession fees owed to the government have been paid by the concessionaires, who cite a change in circumstances. Despite a reduction in the number of derailments from 400 per year to 200 (the regionally accepted level is 20), the level of maintenance remains very poor and rail volumes declined by 7 per cent in one year, with most of this decline reflecting a shift to road transport.

TAZARA, which was built by the Chinese in 1975 and is owned jointly by the Tanzanian and Zambian governments, is 1 800 km long and represents the main route for exporting copper cathodes via the port of Dar es Salaam. In recent years, copper has increasingly been channelled through the ports of Beira and Durban, reducing volumes transported on the TAZARA line. This decline has pressured Zambia and Tanzania to search for a foreign investor, although an outstanding $10 million debt to the Chinese government could discourage perspective investors. According to the Zambia Privatisation Agency, in mid-2005, the Chinese government expressed interest in participating as an investor if the company were to be privatised. However, progress on this front is not expected until late 2006.
Meanwhile, the government is seeking to develop alternative and shorter routes for copper to reach the sea. Private sector participation in the form of build, operate and transfer (BOT) projects is envisaged for railways linking the mining hubs in the Copperbelt to the Angolan port of Lobito and the Mozambican port of Nacala. Similar arrangements are being considered for linking Livingstone and Walvis Bay in Namibia for tourism purposes.

Zambia has one inland port at Mpulungu on Lake Tanganyika, which serves the three neighbouring countries of Tanzania, DRC and Burundi. Mpulungu Harbour Management Limited (MHML) was granted a concession to run the harbour in September 2000 and is currently handling 70 000 tonnes of cargo per year. Severe problems of interconnection with other modes of transportation greatly reduce opportunities for expanding capacity, however. Air transport has improved significantly in recent years. Airport infrastructure consists of four major airports (Lusaka, Ndola, Livingstone and Mfuwe), all operated by the National Airports Corporation, and 140 aerodromes or air strips. Its quality has suffered, however, from poor maintenance. Investment projects are underway to expand and modernise Lusaka and Livingstone airports and there are plans to grant concessions for all airports except Lusaka to private companies. Many airfields are used in remote areas for the distribution of food and medicines but are often in a very poor state of repair, which prevents their being used for commercial purposes.

**Political and Social Context**

Zambia’s political situation has been stable since the Movement for Multiparty Democracy (MMD) came to power in 1991. The MMD has promoted a transition from the centrally planned economy which had been in place since independence in 1964 to a market-oriented one. The first MMD government, led by President Frederick Chiluba, launched comprehensive economic reforms but was accused of widespread corruption and political interference in economic activity. In 2001, after a failed attempt to change the constitution to allow a third mandate for the president, the chosen MMD candidate, Levy Patrick Mwanawasa, won a closely contested election and put the fight against corruption at the heart of his political programme. The opposition contested the election results vigorously but peacefully.

As part of the anti-corruption crusade, high profile members of the former administration, including Chiluba himself, were accused and put on trial in 2003. Despite two years of investigations, no one accused by the Anti-Corruption Task Force has been successfully convicted by any court yet.

Two major events polarised the political scene in 2005: the constitutional review process and the run-up to the 2006 elections. Many civil society organisations and opposition parties want to seize the opportunity of the constitutional review to amend the electoral law, replacing the current first-past-the-post system with one based on an absolute majority. The new text, which also includes changes to the executive powers of the president, was presented to parliament in December. Recent statements from the president suggest, however, that a new constitution will not be adopted until after the 2006 elections, causing further divisions between civil society, opposition politicians and the government.

Besides the thorny issue of who will run against the incumbent president, the forthcoming election is likely to entail huge costs, related to voter registration and the need to campaign throughout a large and sparsely populated territory. Fearing that these costs could reduce budget allocations to poverty-reduction programmes and to improve transparency of the electoral process, various donor countries are considering funding the elections.

According to the latest living conditions survey for 2002-03, 67 per cent of the Zambian population is classified as poor and lives below the poverty line income of K92 185. This result implies that 46 per cent of the population live in extreme poverty since their income is not sufficient to meet the cost of the minimum
food basket, while 21 per cent, while being able to afford the food basket, still fall short of being able to acquire other non-food basic necessities. In August 2005, the cost of food alone for a family of six in Lusaka was estimated at K513 590, while that of a fully representative consumption basket stood at K1 358 990. It should be noted that the basket does not include other essentials such as transport, health and fuel. The incidence of poverty is particularly high in Northern Province (81 per cent of the population), followed by Northwestern (72 per cent), Eastern (71 per cent) and Luapula provinces (70 per cent). The lowest rate of poverty was observed in Lusaka and Copperbelt provinces (57 and 58 per cent, respectively).

Over the past two years, the health sector recorded a moderate improvement in key basic health care delivery indicators and a general decrease in the incidence of major diseases such as malaria, non-pneumonial respiratory infections and diarrhea. The drug situation generally improved with 0.79 kits per 1 000 patients opened in 2004, compared to 0.73 kits opened per 1 000 patients in 2003. In addition, immunisation coverage of children under one year old improved from 74 per cent in 2003 to 77 per cent in 2004. Nevertheless, health care delivery continues to be constrained by lack of human, material and financial resources. Allocations to the health sector declined from 8.1 per cent in 2004 to 6 per cent in 2005, although, according to the Medium Term Expenditure Framework, they are supposed to increase to 6.5 per cent in 2006. Absorption capacity at district level remains limited, the brain drain of nurses and doctors is increasing and many international NGOs compete with the public sector, offering health workers more attractive remuneration packages. According to recent estimates, there is one doctor for every 14 000 people, compared to one for 7 000 in 1984. Regional discrepancies are huge, with one doctor per 145 780 people in Luapula province, compared with one doctor per 6 660 people in Lusaka. In order to retain health workers, the government has appointed a task force to design selective incentives for personnel in remote rural areas and other sensitive locations. Health workers have been extremely hard hit, however, by the HIV/AIDS pandemic.

With an official prevalence rate of 16 per cent, in 2004, Zambia declared HIV/AIDS a national emergency and, in June 2005, the government removed the cost-sharing fee of K40 000 ($8), granting free provision of anti-retroviral (ARV) therapy. As of December 2005, about 40 000 people were receiving ARV drugs, compared to about 15 000 one year earlier. The major obstacle to improving ARV provision is lack of specialised health staff. On the prevention side, thanks to the activity of the National AIDS Council (NAC), a broad-based corporate body charged with co-ordinating a multi-sectoral, national response to HIV/AIDS, substantial progress has been made in scaling up national response through mass prevention campaigns and in increasing the number of Voluntary Counselling and Testing Centers. In addition, the Global Fund and other bilateral initiatives are channeling resources towards fighting the disease. Nevertheless, NAC considers that co-ordination with partner institutions is poor, arguing that they often set up new structures in the form of international NGOs instead of reinforcing the capacities of existing public institutions. Strengthening the role of NAC in the centralisation, co-ordination, and monitoring of HIV response is among the main priorities of the 5th National Development Plan.

After having reached 15.9 per cent of the total national budget – the 2004 benchmark for the HIPC completion point – total budget releases to education decreased to 12.5 per cent in 2005, although the figure should rise to 16.3 per cent in 2006. Over the past year, the education sector attracted significant support from donors through a sector-wide approach, which was of particular benefit to basic education at district level. The major programmes implemented dealt with expansion of school facilities, curriculum development, provision

2. The basket uses the prices of essential food and non-food items to estimate the cost of living for a family of six in Lusaka, Livingstone, Kabwe Ndola, Luanshya and Kitwe. It only highlights essential products such as mealie meal, kapenta, green vegetables, cooking oil, and milk, as well as non-food essentials such as housing water, energy and soap.
of education materials, provision of bursaries for vulnerable children and orphans, improvement of equity and gender balance and the provision of HIV/AIDS prevention education. These measures, coupled with the abolition of fees for government primary schools in 2002 and the impact of the government’s post-pregnancy re-admission policy, had a positive impact on school enrolment. The gross enrolment level at basic school rose by 5.4 percentage points, from 87.7 per cent in 2003 to 93.1 per cent in 2004, while the high school enrolment level increased from 13.9 to 16.5 per cent. In spite of these improvements, the sector continues to suffer from a dramatic shortage of teachers – as budgetary constraints hamper the recruitment of additional personnel – and a very uneven distribution of teacher to pupils across the country. In some remote areas, the ratio is as high as 1:400, while, in Lusaka, it is only 1:20. In order to retain teachers, especially in rural areas, government provides rural hardship and housing allowances to deserving teachers serving in rural areas.