**key figures**

- Land area, thousands of km\(^2\) 753
- Population, thousands (2006) 11,861
- GDP per capita, $ PPP valuation (2006) 1,167
- Life expectancy (2006) 38.8
- Illiteracy rate (2006) 32
Zambia
Zambias Gross Domestic Product (GDP) grew by an estimated 5.8 per cent in 2006, as a result of increased copper production, buoyant copper prices, an exceptionally good agricultural performance and a strong expansion in construction. GDP growth is expected to remain around 6 per cent in 2007 and 2008, as a result of increasing investment in mining and high demand for housing which should result in further expansion of construction. In tandem with a favourable economic performance, the macroeconomic fundamentals have improved in recent years. The government has achieved a major fiscal consolidation and undertaken public-sector reforms that triggered the cancellation of $3.9 billion of external debt in 2005. Restored donors’ confidence translated into larger inflows of aid, increasingly as direct budgetary support.

The sharp appreciation of the kwacha experienced in late 2005 and early 2006, coupled with the 2006 bumper harvest, eased inflationary pressure, which averaged 9 per cent - the first time in about 30 years that Zambia has achieved single-digit inflation.

Despite the broadly favourable assessment by the IMF of Zambia’s recent macroeconomic performance in the 2006 Poverty Reduction Growth Facility (PRGF) review, sustaining broad-based growth remains a major challenge. The economy is little diversified and therefore remains highly vulnerable to climatic and terms of trade shocks. Copper mines benefit from substantial favourable growth in 2006, boosted by copper production and good harvests, will be difficult to sustain and poverty remains persistent.
tax holidays and generate few spill-overs to the rest of the economy. The living conditions of the majority of the population are very unsatisfactory, with about 70 per cent of the population living below the poverty line.

The fact that ordinary Zambians are not feeling the benefits of the recent macroeconomic improvements clearly emerged at the September 2006 presidential and legislative elections. Although incumbent President Levy Mwanawasa enjoyed a fairly large margin of victory, the majority of Zambians, and in particular the urban electorate, voted against him, highlighting widespread discontent. The challenge for Mwanawasa’s second and final term will be to ensure that the economic benefits from the copper boom and debt relief will begin to have a favourable impact on ordinary citizens. Major efforts should be made to ensure that the mining sector makes a greater contribution to government revenues. In parallel, the authorities need to make substantial progress in improving the accountability of public expenditure management, and in implementing the decentralisation policy, financial-sector reform and private-sector development initiatives.

Expectations were raised with the approval in late 2006 of the Fifth National Development Plan (FNDP) for the period 2006-10 which details the government’s development agenda and poverty reduction programme. Rural infrastructure, agriculture and tourism development constitute the core of this ambitious plan, which, however, has a substantial financing gap. Therefore its implementation will depend on the magnitude of the scaling up of aid.

Recent Economic Developments

Over the period 2000-05, growth averaged 4.8 per cent, driven by agriculture, mining activity and construction. A bumper harvest and strong copper output together with sizeable investment, spurred by rising copper prices, strengthened economic performance in 2006, resulting in GDP growth of 5.8 per cent.

In 2006, agriculture registered a growth rate of 3.9 per cent. After a 2004/05 season of scant rains and drought that forced the country to rely on external food aid, agriculture registered strong growth in the 2005/06 season. Good climatic conditions resulted in a bumper harvest of maize, the main staple food, of 1.4 million tonnes compared to 800 000 tonnes in the 2004/05 season. Much of the maize was bought by the Food Reserve Agency (FRA) which purchased a total of 400 000 metric tonnes. The favourable response of small farmers reflects the surplus production and the attractive price offered compared with that of private traders. Nevertheless, the FRA has not been able to pay for its purchases and in December 2006 it still owed a large outstanding debt to farmers. This made it difficult for the farmers concerned to purchase inputs for the planting season. Partly to clear outstanding debts to farmers, the FRA exported 95 000 tonnes of maize to Zimbabwe and 5 000 tonnes to the Democratic Republic of Congo (DRC), worth $20 million. As a result, in part, of the continued ban on private-sector exports, maize prices have remained relatively low and stable, which is unusual for the last months of the year.

Figure 2 - GDP by Sector in 2005 (percentage)

Source: Authors’ estimates based on National Institute of Statistics data.

http://dx.doi.org/10.1787/818022131034
Scant rains characterised the starting of the 2006/07 season. In December 2006, the rainy season in Zambia had generally not yet begun outside the western parts of the country. Nevertheless, by February 2007 most of the country benefited from normal rains with the exception of southwestern Zambia where arid conditions persisted.

The commercialisation of production by subsistence and small-holder farmers 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. Therefore, although the National Agricultural Policy 2004-15 calls for promoting private-sector development in agriculture, the government remains heavily engaged in directly supporting small farmers. Through the Fertiliser Support Programme the authorities are providing subsidised fertilisers to small farmers, thought to number about 160,000, in the 2006/07 season. The subsidy, which has been increased from 50 per cent to 60 per cent in 2006 has been criticised by stakeholders for being excessively costly and hindering the emergence of an efficient fertiliser distribution system.

Non-traditional export (NTE) statistics indicate that there was a growth of about 25 per cent in 2006 over the previous year, recording earnings of more $650 million. The engineering products sector (copper rods, cables and wires); primary agriculture (cotton, coffee, tobacco and maize); and processed and refined foods (sugar, molasses and wheat flour) contributed to most of the growth. The main markets in 2006 were South Africa, the DRC, Malawi, Zimbabwe, the United Kingdom, the Netherlands, Switzerland, Portugal, Kenya and Germany.

Horticulture and floriculture have for long been regarded as highly promising NTE sectors. Since they are highly labour intensive, they are believed to be among the sectors for the government’s Poverty Reduction Programmes (PRPs) in agriculture. The two sectors in the NTE sector are almost 100 per cent export-focused. The floricultural sector employs nearly 4,000 people from 22 flower farms (mostly cut flowers) which are located within a 20 kilometre radius of the Lusaka International Airport. Zambia currently produces more than 60 varieties of cut flowers (roses). The Netherlands has been the biggest market for Zambia’s roses, accounting for more than 70 per cent of exports. Other important markets are the United Kingdom, Germany and South Africa. Before the collapse of one of the largest producers and exporters of fresh horticultural products, Zambia’s horticultural industry employed more than 16,000 people (mostly women) who worked at every stage in the chain of distribution. After the collapse, the company’s assets were bought by the second-biggest producer and another entrant. This at least restored some confidence among about 5,000 out-growers. The main markets for Zambia’s fresh vegetables are the United Kingdom, South Africa, Germany, the Netherlands, Australia, New Zealand, Norway and France.

These sectors are 100 per cent export-oriented and they experienced financial losses as a result of the appreciation of the kwacha against major currencies in the last few months of 2005. In order better to exploit the potential of the horticultural sector, much should be done to improve its domestic value chain as well. At present, fresh produce flows in the country are dominated by a fragmented, small-scale traditional marketing system, characterised by chaotic and insanitary markets with inadequate physical infrastructure. Ultimately, the current system is very poorly suited to linking farmers more closely with consumers to provide an increasingly reliable supply of quality produce. Improved market information and marketing extension is needed more actively to link farmers to wholesale markets. High freight costs arising from high and unstable fuel prices have rendered both sectors uncompetitive in global markets. The use of refrigerated trucks for the South African market has been a better option for the producers.

The honey export sector in Zambia is another important agro-food system experiencing emerging structural changes in regional and international markets. This sector affects the livelihoods of more than 12,000 beekeeper households (100,000 people) most of whom live in the North-Western Province. Honey constitutes 50 per cent of these farmers’ incomes and up to 70 per
Farmers in this area earn less than $0.50 per day and fall well below the international poverty line. Of the honey exported from Zambia, 95% is certified organic – Zambia currently exports about 700 metric tonnes of honey and 10 metric tonnes of beeswax each year and most of it is sold in the European Union. Zambia is a surplus producer of honey and could double both its exports and the number of beekeepers. However, infrastructural and other trade-related and supply chain issues must be addressed if this is to be achieved.

Copper production increased by 8% in 2006, mainly in response to buoyant world demand reflected in record high prices. Nevertheless, production, at about 492,000 tonnes was 4% per cent down from the original forecast as a result of operational problems experienced at the Konkola Copper Mine (KCM), the largest copper producer, and at the Mopani Copper Mines (MCM), the second largest. Production shortfalls at the biggest mines are expected to be offset by the opening of new mines in 2007 and 2008. Mopani Copper Mines launched the expansion of a smelter which is expected to become Africa’s largest, with total capacity of 850,000 tonnes of copper concentrate per year. A $200 million smelter, with a planned capacity of 150,000 tonnes per year is about to be built by China Non Ferrous Metals Group and will be completed by 2008. In 2007 and 2008 further expansion of copper production will also result from major investments undertaken by Equinox Resources in the Lumwana mine in the North-Western province.

Although there was a slowdown compared to the growth rate of 21.2% per cent in 2005, the construction sector registered growth of 9% per cent in 2006, driven by continuing investment in mining, donor-funded work in road rehabilitation and real estate developments. The increasing demand for cement led to investment of $170 million, which will increase production to over 900,000 tonnes within the next three years.

The tourism sector continued to record positive growth with an increase in investment and tourist arrivals. The number of tourists in 2006 increased by 3.1% per cent to 670,000 from 650,000 in 2005. Zambia contains 19 national parks and 34 game management areas, covering over 22.4 million hectares, and the largest waterfalls in the world. Much of the tourism in Zambia is concentrated around the Victoria Falls in Livingstone. The Zambian side of the falls has experienced a boom in tourist arrivals in recent years, as many Western airlines have stopped flying to the originally more developed Zimbabwean side and Western tour operators have pulled out of that country. The number of overseas tourists visiting Zambia almost doubled between 2003 and 2005, with the vast majority of those visitors spending some time at the falls. Despite these positive developments, the sector continues to face a number of challenges.

First, tourism infrastructure in Zambia is largely underdeveloped, including, telecommunications, transport, and accommodation facilities. Hotel room capacity remains very low although the supply has been growing steadily. Second, resources for the industry’s long-term development are inadequate. Although the Tourism Development Credit Facility (TDCF) was established by the government in 2003 to provide affordable credit to Zambians, the small size of the fund (at K5 billion per year) and the large number of applicants suggest that it is inadequate. Third, although tourism has been identified as a form of rural development, the interests of the local communities have not been fully incorporated into most business models. Fourth, there is inadequate environmental management. While the government and co-operating partners have started rehabilitating park roads and airports - the airport of Livingstone has been recently expanded and will soon be able to receive non-stop flights from Europe – more should be done to stimulate environmentally sustainable growth in the hospitality sector.

Three foreign-owned hotels are under construction close to the falls. South Africa’s Legacy Holdings Limited was awarded a Tourism Concession Agreement (TCA) by the Zambia Wildlife Authority (ZAWA) to establish a $260 million golf estate containing two hotels, an 18 hole golf course, marina and 450 chalets a little upstream of the Victoria Falls in Mosi-oa-Tunya National Park. The project, which was estimated to create 1,900 tourist bed spaces, would enable Zambia to compete favourably
with Zimbabwe. Livingstone now has slightly over 1,000 beds compared to 3,000 beds in Victoria Falls town on the Zimbabwean side of the Zambezi River. The project was estimated to bring in the country 150,000 tourists per year and make $170 million a year.

The 220-hectare project would, however, disturb flora and fauna in the heritage site, cut it in two, and disturb the elephant movement corridor, which is an essential part of their range. The project would also severely damage plans for the Kavango Zambezi (KAZA) Transfrontier Conservation Area, one of the most ambitious elephant conservation plans and shared by Zambia, Zimbabwe, Botswana and Namibia.

The United Nations Educational, Scientific and Educational Organisation (UNESCO) warned that such an initiative could lead to the removal of the falls from its list of World Heritage Sites. The project has faced much criticism and opposition from environmentalists, Livingstone residents and generally the majority of Zambians who argue that the massive development within the Victoria Falls would lead to such deregistration. Opposition has also been expressed by the Zimbabwean authorities who claim that their counterparts have not consulted them on the issue – the Victoria Falls frontier covers Zambia, Zimbabwe and extends to Botswana. The Environmental Council of Zambia (ECZ) accepted the construction of the two hotels but rejected the building of the golf course and the 450 chalets. It rejected much of Legacy Holdings’ environmental impact assessment (EIA) for the project and offered an alternative site for development.

Legacy Holdings appealed against the ruling to the government through the Ministry of Tourism, Environment and Natural Resources but the government upheld the ECZ’s decision. Legacy Holdings is therefore contemplating the option offered by the ECZ to build on the northern part of the Maramba river.

The authorities intend to formulate a National Tourism Development Master Plan, strengthen the overall public sector tourism policy framework and promote local private sector participation.

Private gross capital formation was a major driver of growth in 2006, especially in mining and construction and is expected to continue to show rapid growth in 2007 and 2008. The growth of investment will also result in increased imports of capital goods. Copper exports are expected to continue to increase when the new production facilities come on stream in 2007 and 2008.

Growth in private consumption appears to have risen in 2006, thanks in part to exceptionally good

Table 1 - Demand Composition (percentage of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>1998</th>
<th>2005</th>
<th>2006(e)</th>
<th>2007(p)</th>
<th>2008(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross capital formation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public</td>
<td>16.4</td>
<td>23.0</td>
<td>7.3</td>
<td>12.3</td>
<td>10.2</td>
</tr>
<tr>
<td>Private</td>
<td>8.0</td>
<td>7.0</td>
<td>-10.2</td>
<td>13.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Consumption</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public</td>
<td>93.9</td>
<td>79.9</td>
<td>7.8</td>
<td>6.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Private</td>
<td>15.8</td>
<td>13.7</td>
<td>-10.2</td>
<td>13.0</td>
<td>5.0</td>
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<tr>
<td>External sector</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>78.1</td>
<td>66.2</td>
<td>8.4</td>
<td>5.4</td>
<td>4.3</td>
</tr>
<tr>
<td>Imports</td>
<td>-10.3</td>
<td>-2.8</td>
<td>-10.5</td>
<td>9.5</td>
<td>5.6</td>
</tr>
</tbody>
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Source: IMF and Central Statistical Office data; estimates (e) and projections (p) based on authors’ calculations.

http://dx.doi.org/10.1787/767456416336
agricultural performance. The rate of growth of government consumption accelerated in 2006 in the run-up to the presidential and legislative elections. Conversely, domestically-financed public capital expenditure contracted to compensate and to accommodate the revenue shortfall stemming from the impact of the currency appreciation on trade, taxes and grants. Thus, the overall budgetary stance remained prudent.

**Macroeconomic Policies**

**Fiscal Policy**

The FNDP for the period 2006-10, was approved in December 2006. The growth strategy includes supporting rural development, especially in the agricultural sector, encouraging stronger links between agriculture and manufacturing through agro-processing, and stimulating stronger growth in tourism. The broad macroeconomic objectives of the plan are detailed in the Medium Term Expenditure Framework 2007-09 which projects GDP growth of at least 6 per cent in 2007 and 2008, while reducing annual inflation to no more than 5 per cent, and increasing spending under the budget on PRPs by at least 0.5 of a percentage point of GDP a year.

The preparation of the plan involved greater consultation among the stakeholders and is more comprehensive compared with the previous PRPs. Nevertheless, the policy measures required to achieve the expected targets, e.g. to improve rural growth, are not clearly defined, and the plan has an aggregate financing gap of about $1.5 billion. This implies an increase in the annual requirement for the FNDP from $550 million to $800 million. The Ministry of Finance intends to rely on increased foreign aid and domestic borrowing to cover the gap. This may pose a challenge to the efforts of limiting domestic borrowing to 1 per cent of GDP in 2007, and 0.5 per cent of GDP in 2008 and 2009.

In 2006, the stance of fiscal policy remained prudent in line with the fiscal consolidation efforts undertaken in the past two years. Estimates for 2006 indicate that budgetary performance was broadly on track, thanks to the combined effect of reduced debt service following achievement of the Heavily Indebted Poor Countries (HIPC) completion point and lower government borrowing, which declined from 5.2 per cent of GDP in 2003 to an estimated 1.8 per cent in 2006. Overall, budget execution was less successful than in 2005, affected by the re-direction of spending to preparations for the elections and the limited absorption capacity of some sectors, such as health and education. Poor execution also reflected the carry-over of unspent balances from previous years.

The kwacha appreciation in late 2005 resulted in a net shortfall in anticipated revenue and grants of 2.5 per cent of GDP in 2006 as a consequence of the reduced kwacha value of donor budget support and of the value added tax (VAT) on imports and customs duty. Nevertheless, the shortfall in revenue was more than offset by the reduction in capital expenditures (by 2.7 per cent compared to the amount budgeted) and the overall deficit is estimated at 2.5 per cent of GDP, compared to the 2.6 per cent originally budgeted.

Zambia is highly dependent on donor assistance, which finances some 30 per cent of the government budget. The fiscal discipline achieved in the recent past has earned the government renewed credibility which 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. Budgetary support is expected to account for 22 per cent of grants in 2007, and 25 per cent in 2008, compared to 15 per cent in 2006.

Better accountability and improved governance are the key donor conditions for scaling up direct budget support. Thus, further increases in aid are subject to the successful implementation of the Public Expenditure Management and Financial Accounting system (PEMFA) launched in 2005, which is considered key to improving expenditure oversight and strengthening budget execution. Nevertheless, progress in implementation has been slow. A key milestone of the PEMFA, the piloting of the Integrated Financial
Management Information System (IFMIS), has incurred delays, partly because of a change in ownership of the local firm originally selected to install the IFMIS. A Spanish provider was then selected in November 2006. In addition, effective implementation of the PEMFA suffers from lack of progress in the decentralisation process and in public service management, the other fundamental pillars of the public-sector reform programme. Much effort is needed to improve the accountability of public spending, particularly as regards the use of the proceeds from debt relief for poverty reduction programmes. In order to improve accountability, a matrix of indicators (Performance Assessment Matrix) has been put in place for review by the government and its development partners every six months.

The government’s aid policy and strategy will be approved in 2007, which should help to ensure that Zambia has an appropriate framework for taking the lead in managing and coordinating external assistance. The aid policy is strikingly tough on technical assistance whose modalities in the past threatened local ownership and wants to make it genuinely demand-driven. In response to the new aid policy, donors are preparing a Joint Assistance Strategy for Zambia (JASZ) which reflects a new trend in aid architecture with the development partners focusing their support on a limited number of sectors. The JASZ will be aligned both on the FNDP and the aid policy.

In 2007 and 2008 the government will continue its efforts to cut non-priority expenditures and improve the quality and coherence of spending. Authorities have committed themselves to channelling significant resources towards spending on health and education. Spending on the former (including sizeable investment outlays) is expected to increase to 12.7 per cent and 13 per cent of the budget in 2007 and 2008 respectively, up from 10.7 per cent in 2006. Spending on education is expected to reach 16.8 per cent and 17.3 per cent of the budget in 2007 and 2008 respectively. The challenge will be to improve service delivery at the local level, and increase local authorities’ absorption capacity by achieving concrete progress in the decentralisation process.

In order to consolidate the fiscal objectives in the medium term, the authorities recognise the need to generate more revenue (which declined from 19 per cent of GDP in the early 2000s to 16.4 per cent by 2006). Nevertheless, the 2007 budget will be affected by the outcome of the September elections which revealed a strong sentiment for lower taxes. Indeed, pay-as-you-earn taxes contribute far more to total tax revenue than do corporate taxes. One priority of the government in 2007 will be to increase tax revenue from the mining sector, which benefits from substantial tax concessions. The main goals would be to raise mineral royalties to 2.5 per cent from the 0.6 per cent which the mines currently pay. It has been estimated that if the tax

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<th>Table 2 - Public Finances (percentage of GDP)</th>
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<tbody>
<tr>
<td>1998</td>
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<tr>
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</tr>
<tr>
<td>Total revenue and grants</td>
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<tr>
<td>Tax revenue</td>
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<tr>
<td>Grants</td>
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<tr>
<td>Total expenditure and net lending</td>
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<tr>
<td>Current expenditure</td>
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<tr>
<td>Excluding interest</td>
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<tr>
<td>Wages and salaries</td>
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<tr>
<td>Interest</td>
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<tr>
<td>Capital expenditure</td>
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<tr>
<td>Primary balance</td>
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<tr>
<td>Overall balance</td>
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</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.

http://dx.doi.org/10.1787/263510621318
regime were the same as in Chile, the Zambian government would receive an extra $800 million in revenue annually (12.5 per cent of current tax revenue). However, renegotiations of existing mining agreements are very difficult and subject to the willingness of the individual mining companies to modify the terms. It will therefore take some time to reach a solution. Nevertheless, it will be important to change the tax provisions in new mining contracts. In the short term, the government will try to improve tax administration and collection and broaden the tax base by bringing the informal sector further into the tax net to compensate for a reduction in income taxes. Overall, the budget deficit is expected to decline to 2 per cent and 1.8 per cent of GDP in 2007 and 2008 respectively.

**Monetary Policy**

The Bank of Zambia intends to reduce inflation further to the 5 per cent target set in the FNDP by controlling money supply growth, increasingly through open-market operations. Inflation fell sharply in 2006 aided by a bumper harvest — food prices account for about 50 per cent of the consumer price index (CPI). Inflationary pressures were also reduced by the 27 per cent appreciation of the currency experienced in late 2005 and early 2006 which offset to some extent the impact of fuel price increases. Average inflation for 2006 is estimated at about 8.5 per cent, compared with 18 per cent in 2005 and represents the lowest level in the past 30 years. Inflation is expected to average 8.6 per cent and 7.8 per cent in 2007 and 2008 respectively. The emerging inflationary pressures in food prices are expected to be contained by the high inventories and to be offset by lower world oil prices. Possible risks to this positive outlook may, however, stem from increased private consumption, lower than normal rainfall, and possible fiscal policy slippages.

The appreciation of the kwacha continued at a moderate pace in the first half of 2006, and mainly reflected greater inflows of foreign exchange stemming from foreign investment, increased exports from mining, and large inflows of official development assistance. In September 2006, the kwacha weakened against the dollar, depreciating by 5.1 per cent as a result of capital outflows prompted by the uncertainty surrounding the elections and a wider global emerging markets sell-off. In the last quarter of the year, the foreign exchange market was characterised by a general depreciation of the kwacha against major currencies with intermittent volatility. In order to moderate the volatility and maintain stability in the value of the kwacha, the Bank of Zambia intervened by purchasing and selling foreign exchange in the market. Nevertheless, despite periods of depreciation, the kwacha appreciated by almost 20 per cent in 2006, to average K 3 755 to the US dollar.

Against the background of increased donor support, which is expected to be disbursed during the first nine months of the year, and a projected increase in the output of copper, the current value of the kwacha is expected to be sustainable. The Bank of Zambia will continue to maintain a flexible exchange regime, intervening with open market operations to smooth out undesirable fluctuations. International reserves are adequate, having increased to cover 3 months of imports.

Despite improved macroeconomic fundamentals, lending rates remain high at about 30 per cent mainly because of structural constraints on lending experienced by the banking sector. Competition is very low and mainly focused on services. In addition, there is general lack of confidence in sustained low inflation over the medium term. 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. The government, through the Bank of Zambia, has approved the establishment of the Credit Reference Bureau (CRB) which is being pioneered by the Bankers’ Association of Zambia (BAZ). The CRB was scheduled to begin operations in early 2007. The bureau is aimed at providing lenders in the financial sector with factual information on clients upon which they can make decisions on whether to lend or not. Banks and other financial institutions will be required to submit information about their clients to make it possible to distinguish between good and defaulting borrowers. According to the BAZ, the credit culture has been improving as a result of declining interest rates. The Bank of Zambia believes that the licensing of the CRB will help reduce the cost of doing
business and stimulate economic growth through increased private sector borrowing. Also of significance is the introduction of Point of Sale (PoS) and debit cards.

**External Position**

Zambia benefits from a variety of preferential market access initiatives, including the European Union (EU) Everything-But-Arms initiative (EBA) and the US African Growth and Opportunity Act (AGOA). Nevertheless, the stringent rules of origin of these schemes, combined with serious domestic supply-side constraints, have so far led to disappointing results. Both initiatives have generated only negligible additional exports for Zambia compared with 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.

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. Switzerland is the main OECD export destination although this is due to the fact that it is a trans-shipment point for other destinations. The third largest destination of exports is China (7.3 per cent) which is a major purchaser of Zambian copper.

Overall, external developments in 2006 continued to be favourable, boosted by continuing high copper prices and investment in the sector. In volume, copper and cobalt exports grew by 15 per cent in 2006. Copper exports still account for about two thirds of the total, although non-metal exports, mainly cash crops such as cotton, tobacco, flowers and horticultural products, have expanded considerably in the recent past. Although the sudden strengthening of the currency since November 2005 reduced the kwacha value of agricultural exports by 30 per cent, production increased thanks to abundant rainfall in 2006. Imports continued to increase, by 10 per cent in real terms, reflecting sustained demand for capital goods generated by foreign investment and refurbishment in the mining sector and the appreciation of the kwacha. Overall, the trade balance is estimated to have improved substantially, reaching 6.2 per cent of GDP in 2006.

<table>
<thead>
<tr>
<th>Table 3 - Current Account (percentage of GDP)</th>
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<tbody>
<tr>
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<tr>
<td>Trade balance</td>
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<tr>
<td>Exports of goods (f.o.b.)</td>
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<tr>
<td>Imports of goods (f.o.b.)</td>
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<tr>
<td>Services</td>
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<tr>
<td>Factor income</td>
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<tr>
<td>Current transfers</td>
</tr>
<tr>
<td>Current account balance</td>
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Source: Bank of Zambia and IMF data; estimates (e) and projections (p) based on authors’ calculations

The trade balance is expected to deteriorate slightly in 2007 and 2008. Copper export volume should continue to grow strongly at about 10 per cent but lower international prices are expected to lead to a more moderate increase in value. Major obstacles remain to the expansion of non-metal exports which will require 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 represents a major obstacle to expanding agricultural exports to the EU and US markets.

Zambia’s external debt fell significantly from over $7 billion in December 2003 to less than $1 billion in October 2006 after the attainment of the HIPC
completion point in 2005 and consequently qualification for debt relief under the Multilateral Debt Relief Initiative (MDRI). Most multilateral co-operating partners have cancelled 100 per cent of Zambia’s debt. The government intends to spend a total of K1 98.7 billion from the MDRI savings in 2007 to scale up expenditures linked to poverty reduction such as agriculture, water and sanitation, training and infrastructure. As mentioned earlier, the challenge would be to assure that monitoring mechanisms for the use of those savings are in place.

**Structural Issues**

**Recent Developments**

The momentum of Zambia’s structural reform programme exhibited during the HIPC completion period slackened in 2006. Political and financial priorities dictated by the presidential and legislative elections and Zambia’s success in receiving full debt relief probably contributed to the slowdown. Thus, promotion of the private sector, the reform of parastatal enterprises and public-sector reform, especially decentralisation, took a back seat for a good half of the year.

Three major state enterprises are currently under negotiation leading to privatisation or commercialisation: Zambia Electricity Supply Corporation (ZESCO); Zambia National Commercial Bank (Zanaco); and Zambia Telecommunication (ZAMTEL). At the end of 2006 the sale of 49 per cent of Zanaco to Rabobank was still awaiting signature by the Attorney General. The closure of the deal was delayed during the election period as the government feared the opposition’s possible politically-inspired claims about possible job losses or branch closures. Such threats would have been unfounded: Rabobank’s business plan for Zambia aims to expand the number of branches, possibly by 20.

ZAMTEL, the national telecommunication company, which owns the monopoly of fixed lines, the international telecommunication gateway and Telecommunications.
Z, one of Zambia’s three mobile operators, will be commercialised but no date has been set. Vested interests associated with its monopolistic status are a key constraint on progress. The government is still pondering the commercialisation strategy but hopes to improve the regulatory framework to address barriers to entry so as to enhance competition in the sector.

Problems in commercialising the Zambia Electricity Supply Corporation (ZESCO) continue. While progress was made in the appointment of a new board of directors dominated by private-sector representatives, there are questions about the independence of the board. The chief executive was appointed by the President of the Republic of Zambia and the board by the Minister of Energy and Water Development. Plans are underway to change this so that the board selects the chief executive. Zambia has great potential to become a major exporter within the Southern African Power Pool but ZESCO is experiencing financial problems, foresees a capacity shortfall in two to three years and is generally under-performing. The private sector (e.g. mobile companies) resort to their own generators rather than wait for ZESCO to expand its network.

The privatisation of Maamba Collieries Limited has been approved. The government has mandated Zambia Consolidated Copper Mines - Investments Holdings (ZCCM-IH) to take over the operations but, because of a large debt owed to Invotec this is still pending. A strategic investor has been offered 30 per cent of the Ndola Lime Company (brick and cement) monopoly but a precondition is a large recapitalisation (at least $20 million). There has been no progress on the privatisation of the Indeni Oil Refinery, which is currently running at half capacity and requires fresh capital investment to increase production. So far the plan to attract new capital from a third equity partner (the government and the French oil company Total would dilute their shareholdings to 35 per cent each to attract new investors) has not received any expression of interest.

Some elements of the Financial Sector Development Plan are moving forward. The Bank of Zambia’s ability to supervise bank and non-bank financial institutions has been strengthened and capacity is being built up to move to a fully risk-based approach in 2007. In January 2006 the regulations governing microfinance institutions came into force. There has been slow progress with financially troubled non-bank financial institutions. So far only two investors have taken up equity in the Development Bank of Zambia (DBZ) in which the government will retain a 25 per cent stake. The $2.15 million committed by the International Fund for Agricultural Development (IFAD) in 2005 to recapitalise the National Savings and Credit Bank (NSCB) has not yet been received. The institution is thus exploring new funding sources as it desperately needs to resolve unreconciled balances.

Efforts in 2006 to create a more business-friendly environment are shown by agreement on the Private Sector Development (PSD) Action Plan and the adoption of the Zambian Development Agency (ZDA) Act in May 2006, which involves the merger of five agencies in charge of private-sector development. The Action Plan Working Groups – on immigration; administrative barriers; tourism; and public-private partnerships (PPPs) – were approved by the cabinet and the more contentious land reform issue is awaiting approval. A draft legal framework for PPPs is being prepared in collaboration with the South African Development Community (SADC) for February 2007. Success has been registered in a short period in the administrative barriers group where thanks to computerisation and the greater independence of patents and licensing offices in certain provinces, the number of days to register a company fell in November 2006 to five from nine.

While most stakeholders seem optimistic about the PSD Action Plan some business representatives criticise it for being too donor-driven and are concerned about the sustainability of the reforms once donor funding has ended. Four donors support the PSD Action Plan through a Joint Financing Agreement ($10 million basket fund for three years) signed in April 2006 with the subsequent release of funds in June. A total of nine donors have signed the memorandum of understanding. The US Millennium
Challenge Account will also allocate $22 million to the PSD action plan in 2007 and 2008 placing special focus on immigration, administrative barriers and PPPs. In fact, private-sector participation in the PSD initiative through the Zambia Business Forum (ZBF) has been quite strong. ZBF has five representatives on the steering committee and two on the implementation committee, including the Chair.

Despite some delays caused by the election, difficulties in deciding who will pay retrenchment costs and government concerns about the liabilities of the five agencies to be merged into the Zambian Development Agency (ZDA), this new agency should be operational in 2007. It is urgent that the ZDA become fully operational since as long as it is not no other institution can follow up on investment matters. It also remains to be seen how independent the ZDA will be since civil servants will sit on the Board.

Decentralisation is the least developed pillar of Zambia’s public-sector reform, which dates back to 1993. The Decentralisation Implementation Plan (DIP) was adopted in February 2006 but is not being implemented and government and stakeholders have yet to agree on how to finance it. A memorandum of understanding has been signed with donors and a consensus on the costing and modality – a Decentralisation Trust Fund – should be reached in early 2007. The DIP addresses both fiscal and sectoral devolution in public health, water, and education, where fiscal devolution is clearly the biggest challenge. In the past, local councils have been heavily under-funded and in an ad hoc manner - Zambia’s local councils are among the least funded in Africa at about 2 per cent of the national budget compared to an average of 15 per cent. They have no constitutional right to generate revenue and have severely limited capacity. The government is still undecided where the Department of Decentralisation should be housed. There are proposals to bring it closer to central government, for example in the Cabinet Office. However, it seems that many stakeholders prefer that the Ministry of Local Government and Housing oversee the implementation of the policy and house the secretariat.

Access to Drinking Water and Sanitation

Zambia has vast water resources in the form of rivers, streams, lakes, and groundwater. However, a pattern of declining rainfall over the years has had a significant adverse impact on rain-fed agriculture. The National Water Policy of 1994, the National Environmental Support Programme, 1994, and the Water Resources Master Plan, 1995-2015, have outlined strategies and comprehensive action plans to develop the water sector to realise its potential for Zambia’s social and economic development.

Improving access to drinking water and sanitation, and combating pollution of both surface and groundwater are dealt with through other institutional frameworks. The national budget continues to reflect low government priority in funding the Water and Sanitation Sector, (WSS) shifting most of the burden to local authorities. In the Poverty Reduction Strategy Paper (PRSP) implemented between 2002 and 2004 only 3.5 percent of the budget was allocated to the water sector of which only 32 per cent of the allocation to Rural Water and Sanitation (RWSS) was actually spent.

The National Water Policy of 1994 is based on principles of separation of water resources management, under the responsibility of the Ministry of Energy and Water Development (MEWD), from WSS service delivery under the Ministry of Local Government and Housing (MLG); separation of regulatory and executive functions; devolution of authority to local authorities and private enterprise; and eventually achieving full cost recovery for WSS through user fees.

Following the 1994 Water Policy, the 1997 Water Supply and Sanitation Act, established an independent water regulator, the National Water Supply and Sanitation Council (NWASCO), and delegated to local authorities responsibility to provide water and sanitation in their respective areas. Consequently 50 out of 72 local authorities have established nine commercial water utilities (CUs) in urban areas, which are expected in the long term to be commercially viable. CUs are responsible for service provision to 86 per cent of the urban population; the remaining areas are serviced
either by 22 local authorities (13 per cent) or private providers (1 per cent). Commercialisation has been crucial to sustaining improvement in service delivery. Over the years, the CUs have made considerable achievements in extending water supply coverage (from 58 per cent in 2004/05 to 73 per cent in 2005/06), thanks to the support of the Devolution Trust Fund (DTF). The fund is a basket of co-operating partners’ funds which aims at assisting the providers to extend the provision of services to the peri-urban poor (see box). In addition, six out of nine commercial utilities had reached operational cost coverage by the end of 2006. However, this is adversely affected by the non-payment of services by government institutions. Infrastructure funding, in particular in sanitation\(^1\), is another major concern and risks jeopardising the current gains in the urban water sector. Besides support from the German government in Southern province and North-Western province, the African Development Bank in Central Province, the World Bank in Lusaka, and the Danish International Development Agency (DANIDA) in Western Province, there is no other significant infrastructure financing in the sector in spite of the very dilapidated infrastructure and escalating population in urban areas.

According to the latest Central Statistical office statistics, Zambia has 62 per cent coverage for drinking water supply (37 per cent rural and 86 per cent urban), and 27 per cent sanitation coverage (13 per cent rural and 41 per cent urban)\(^2\).

The institutional framework for rural WSS, adopted by the government in 2004, provides a strong basis and key principles for effective management of services, built on devolved authority for RWSS to the local authorities and communities and the WASHE (Water, Sanitation and Health Education) concept to promote sanitation as well as environmental health and the promotion of community management to ensure service sustainability. Despite all these strategies, the rural sector remains largely neglected, in terms of government financing. An attempt to redress this neglect has been made with the development in 2005 of the National Rural Water Supply and Sanitation Programme (NRWSSP), which is the Millennium Development

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**A Trust Fund to improve service provision in peri-urban areas**

The Devolution Trust Fund, instituted under the NWASCO, has been financing projects on a pilot scale for CUs to improve water supply since 2003. Funds are provided to CUs to extend their services to the peri-urban poor. A total of about 120 000 people in low-income areas have since benefited in terms of safe and adequate water supply. During the pilot phase, detailed procedures and guidelines were developed to make DTF operations more transparent and accountable. The establishment of the DTF as a basket fund targeting peri-urban and low-cost areas has been lauded as the most significant initiative the government has taken to extend water supply and sanitation services to these areas. Consequently a number of co-operating partners have made financial commitments to support the government achieve this objective. As at end 2006, about EUR8.8 million had been mobilised by the DTF from the Kreditanstalt für Wiederaufbau (KfW), DANIDA, and the European Union (EU) for financing implementation of WSS projects. In the future, there are plans to broaden the DTF mandate to water treatment investment. Nevertheless, the DTF’s scope is limited in that it is not linked to the decentralisation process.

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\(^1\) The lack of investment in sewerage infrastructure resulted in a reduced sanitation coverage in 2005/06, at about 32 per cent compared to 34 per cent in 2004/05

\(^2\) According to the more accurate statistics from the baseline data for the peri-urban areas, the national water supply coverage for urban and peri-urban areas stands at 67 per cent, leaving 33 per cent without access to clean, potable water.
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Goals (MDG) roadmap for RWSS in Zambia. Unfortunately the budget for the NRWSSP and the water sector included in the FNDP, is still very low, at about half the $148 million dollars required for the implementation of the first phase (2006-10). Nevertheless, the NRWSS represents a positive move towards a sector-wide approach (SWAp) which should help to create a strong constituency advocating increased funding for the sector; improve co-ordination and monitoring of sector resources; and help the adoption of policies that favour financial viability and output targeting of the sector. The NRWSSP includes implementation of the WASHE concept through several Area Based Projects (ABP) assisted by different co-operating partners. At present, three ABP are going to be supported by DANIDA ($18 million), the African Development Bank ($25 million) and the Dutch Co-operation Ministry ($18 million) for the next five years. The funds are expected to be channeled directly by the ministry of finance to the local authorities in charge of RWSS planning. To ensure a successful implementation of the NRWSS it will be necessary to move ahead with the decentralisation process to strengthen the institutional and financial capacity within local authorities.

Political Context and Human Resources Development

Presidential and legislative elections were held in September 2006, and were declared free and fair by international observers. President Levy Mwanawasa’s ruling Movement of Multi-party Democracy (MMD) retained a large majority in Parliament (81 seats), won 43 per cent of the vote, mainly from rural areas, but incurred heavy losses in urban areas to the Patriotic Front (PF) (804 000 votes). Despite a large parliamentary majority, the MMD faces strong opposition in Parliament from the PF which took over key urban district councils (Lusaka and Copperbelt). The increasing popularity of the PF and its leader, Michael Sata, as well as the creation of new political parties such as the United Liberal Party (ULP), have contributed to a more active political debate in Zambia.

President Mwanawasa’s government seems to have heard the warning message from urban areas, where half the population live and is placing renewed emphasis on welfare and employment creation. Sata’s proposals inter alia to expel foreign investors appealed to many Lusaka-based small and medium enterprises that are seeing few benefits from the government’s PSD initiative. Others wanted to register their discontent with the MMD’s perceived failure to bring the fruits of growth to the people and with worsening unemployment.

Transparency International’s 2006 Corruption Perception Index places Zambia in 111th place out of a list of 163 with a score of 2.6 (where zero equals highly corrupt). After three years of investigations and no successful prosecutions, the Anti-Corruption Task Force mandate was scheduled to end in December 2006. Zambia’s widespread petty corruption requires urgent attention. Responsible institutions such as the Anti-Corruption Commission, the Office of the Auditor General (OAG), the police, and the Drug Enforcement Commission are gaining in strength and authority. A draft National Corruption Prevention Strategy was prepared in 2006 and an increase in staff in the OAG from 100 officers to 439 enables representation in most districts. However, they are all insufficiently independent from the executive and their inadequate budgets limit the number of investigations than can be undertaken. If successful, the OAG campaign to build domestic demand for accountability and public awareness of its role, functions and recommendations could increase pressure on the government to respond more swiftly to the Auditor General’s recommendations.

The drafting of a new constitution faces continued delays because of weak political will and lack of funding, with much focus on the high cost of the referendum – the last step in the process. Zambians are unlikely to have their long-awaited constitution before the end of the current government in 2011. However, President Mwanawasa in his last term of office may be more favourably disposed towards speeding up the process with support from donors. Civil society is also planning a remobilisation of the population for 2009. But Zambians may be hesitant about taking to the streets.
again after the government clampdown on the 2002 demonstrations.

With the strong economic performance experienced since 1999, the incidence of poverty has declined, but remains high. According to Zambia’s 2004 census 67 per cent of Zambians live below the national poverty line, earning less than K111 747 per month. The World Bank’s 2006 Poverty and Vulnerability Analysis finds there is a continuing fall in life expectancy; a deteriorating stock of human capital; rising malnutrition and ill-health; and continuing high levels of poverty. The World Bank reports that headcount poverty rates range from 62 per cent in rural areas, 40 per cent of whom live in deep poverty, to 45 per cent in urban areas (28 per cent in deep poverty), compared to an average of 70 per cent in 1991. There is a higher incidence of poverty in the Northern province (75 per cent), Luapula (67 per cent) and North-Western province (61 per cent) than in Lusaka and Southern provinces (47 per cent each).

As demonstrated in the elections, the government is under growing pressure to invest in social welfare and employment creation. Efforts in 2006 through statutory instruments 56 and 57 to establish a minimum wage in Zambia at K500 000 per month for the lowest category of worker are a significant improvement on the previous minimum monthly pay - even if domestic workers are excluded – but not sufficient to cover the monthly cost of basic needs in the country. The Basic Needs Basket for a family of six living in Lusaka in October 2006 was K1 422 950 per month to cover essential food (K463 450) and non-food items.

Performance in the health sector has improved only marginally since the adoption of the Millennium Development Goals. Indeed some basic health indicators worsened between 1992 and 2002. The maternal mortality rate increased from 649 deaths per 100 000 live births in 1996 to 729 deaths per 100 000 live births in 2002. Among children under five 47 per cent are stunted and 28 per cent underweight. The HIV/AIDS pandemic; a shortage of health care workers resulting in part from the brain drain; the poor state of health facilities; insufficient drugs and medical supplies; and high poverty levels all contribute to poor health outcomes. The government’s Basic Health Care Package covers 10 priority areas: free or cost-sharing health services in some areas including, inter alia, child health and nutrition; integrated reproductive health; HIV/AIDS, tuberculosis, sexually-transmitted infections, and malaria; human resources; infrastructure; and equipment. Some improvements in the supply of essential medicines have been registered: health centre stocks improved from 73 per cent in 2002 to 76 per cent in 2004. The FNDP implementation will place emphasis on constructing first level hospitals in the 19 districts which do not already have them.

Zambia is entering its third decade of double-digit HIV/AIDS prevalence, officially at 16 per cent, in 2004. Significant advances have been made by government, co-operating partners, civil society and the private sector in addressing Zambia’s HIV/AIDS epidemic through the National AIDS Council (NAC). However, Zambia has not managed to achieve the overall decrease in prevalence of HIV hoped for in the NAC goal for 2005 (reduction from 19 per cent to 15 per cent in the number of adults aged 15-49 who are infected with HIV). The national target set in 2006 is to reduce infection to below 10 per cent by 2010. About one million Zambians are infected with HIV and 200 000 require anti-retroviral treatment; and the epidemic is estimated to have created over a million AIDS orphans. The lack of human resources to support implementation is a crisis in itself and contributes significantly to the lower coverage of services in Zambia. Local authorities with only limited resources cannot provide a meaningful range of services.

Access to treatment and testing is improving. As of December 2006, about 90 000 people were receiving ARV drugs, compared to about 40 000 a year earlier. The major obstacle to improving ARV provision is a lack of specialised health staff. The number of Voluntary Counselling and Testing Centres reached 500 in 2006 and testing has increased from 9 per cent to 13 per cent. By January 2006, the number of Prevention of Mother to Child Transmission (PMTCT) health facilities had almost doubled to 265 from 136 a year earlier extending coverage to all nine provinces. But there is a worrying
trend. Despite broad public awareness – in 2005 94 per cent of men and 91 per cent of women knew that HIV/AIDS could be avoided – condom use has dropped, as have their distribution and availability in both urban and rural areas.

In respect of the MDGs, Zambia is most likely to succeed in the field of education. Marked success has been recorded for Grades 1-9 since the introduction of free primary education. Enrolment in Grades 1-7 and Grades 8-9 has increased by about 9 per cent annually since 2000. Net enrolment ratios increased from 68.1 per cent in 2000 to 79.4 per cent in 2004, thanks mostly to the significant increase in the number of community schools. However, the gender goal is lagging somewhat with a gross enrolment rate for girls of 86.4 per cent in 2004 compared to 93.2 per cent for boys and completion rates of 65.8 per cent and 78.3 per cent for girls and boys respectively. Despite this progress and the introduction of free primary education for grades 1-7, the poorest families still struggle to provide schooling for their children. Approximately 15 per cent of Zambian children do not get even the most basic training in literacy through primary education. Accessibility to secondary education remains very limited with a net enrolment ratio in grades 10-12 of only 18.6 per cent. The indirect costs of education in Lusaka, which include school uniforms, books and supplies, greatly exceed the direct costs that must be paid to schools in terms of user, Parent-Teacher Association or project fees. Further commitment and expansion of the Ministry of Education’s bursary programme; school health and nutrition programmes; a campaign in support of the girl child, and allowing pregnant pupils to return to school would all be steps in the right direction. The FNDP foresees significant investment in education over the next four years by allocating over 17 per cent of the budget in an effort to address the numerous remaining challenges, especially the quality of education, retention rates, new school buildings and school books.