Zambia

key figures

- Land area, thousands of km² — 753
- Population, thousands (2004) — 10 924
- GDP per capita, $ (2003) — 401
- Life expectancy (2000-2005) — 32.4
- Illiteracy rate (2004) — 18.6

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Zambia

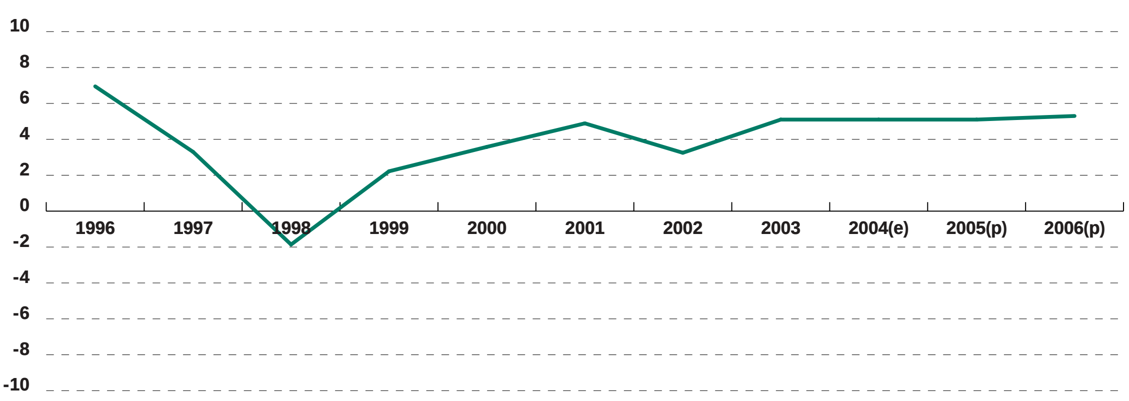
AGAINST A BACKDROP OF ECONOMIC decline in the preceding two decades, Zambia achieved its fifth consecutive year of solid growth, with GDP growing at 5.1 per cent in 2004, significantly above the target of 3.5 per cent, as a result of strong copper output and exceptionally good agricultural performance. Strong GDP growth is expected to continue over 2005-06, at about 5 per cent, on account of increasing mining production and continuous efforts to raise agricultural productivity. However, the economy has not diversified and therefore remains highly vulnerable to climatic and terms-of-trade shocks. Growth has not significantly reduced poverty, which still affects more than 70 per cent of the population.

Under pressure from a rising domestic debt and the prospect of missing the HIPC completion point – initially expected to be reached at the end of 2003 – the government embarked on a major fiscal consolidation effort in 2004. The fiscal adjustment is part of a broader reform agenda. Comprehensive strategies are being discussed between the government and the donors to improve the accountability of public expenditure management, the soundness of the financial system and the development of the private sector.

The next two years will test the sustainability of government policies and 2004's macroeconomic stability.

The challenge will be to sustain the authorities' new policy stance. In particular, budget discipline will be important to resist spending pressures in the run-up to elections in 2006 and ensure attainment of the HIPC completion point, which is now expected in the first half of 2005, and that funds are dedicated to priority sectors, including the hiring of staff in education and health. In parallel, the reforms contemplated will need to be accelerated.

Figure 1 - Real GDP Growth



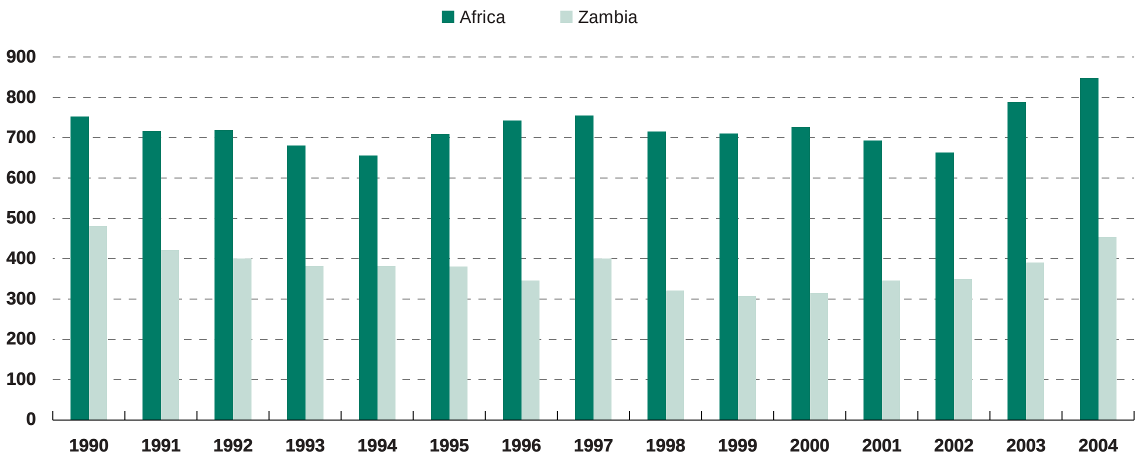
Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

Recent Economic Developments

Over the period 2000-03, growth averaged 4.2 per cent, driven by agriculture, mining activity, and a dynamic tourism sector. Strong agriculture and mining output, together with sizeable private investment, strengthened economic performance in 2004, bringing growth to an estimated 5.1 per cent.

After three years of scanty rains and drought forced the country to rely on external food aid, agriculture registered strong growth in 2002/03 and 2003/04.

Figure 2 - GDP Per Capita in Zambia and in Africa (current $)



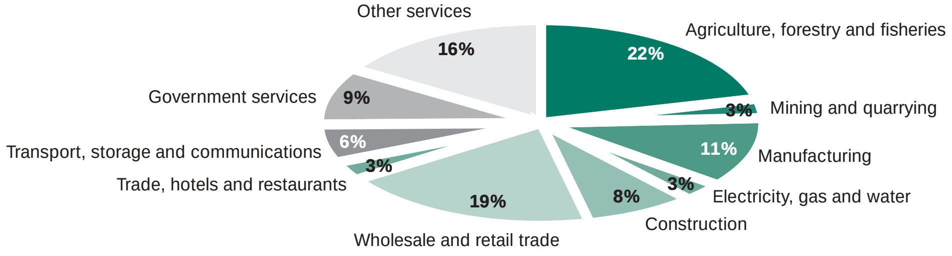
Source: IMF.

Good climatic conditions as well as timely delivery and distribution of inputs, resulted in a bumper harvest of maize, the main staple food, of 1.2 million tons compared to 0.6 million tons in 2001/02. Substantial production increases were also recorded in other crops, including wheat, sorghum, soya beans and groundnuts. With national needs of about 1 million tonnes, the overall food security of the population improved significantly, leaving 0.2 million tonnes of maize available for export. As demand from the neighbouring countries is strong, the Zambian authorities aim at making the country a leading regional maize exporter, mainly to import-dependent Zimbabwe, Angola and DRC. Export revenues are also benefiting from good cash crops, as the continued inflow of Zimbabwean farmers has translated into a boost in tobacco production, which grew by 86 per cent, reaching 37 million tons in 2003/04.

Despite substantial improvements in input delivery under the Fertiliser Support Programme (FSP), the agricultural performance of smallholders, who produce the bulk of agricultural output, remains vulnerable to rain patterns. Moreover, although 58 per cent of Zambia's total land is classified as having medium to high agricultural potential, only 14 per cent of it is currently under cultivation. The development of the sector is hampered by the lack of access to credit, infrastructural deficiencies, which translate into very high transport costs, and the absence of proper and consistent marketing channels.

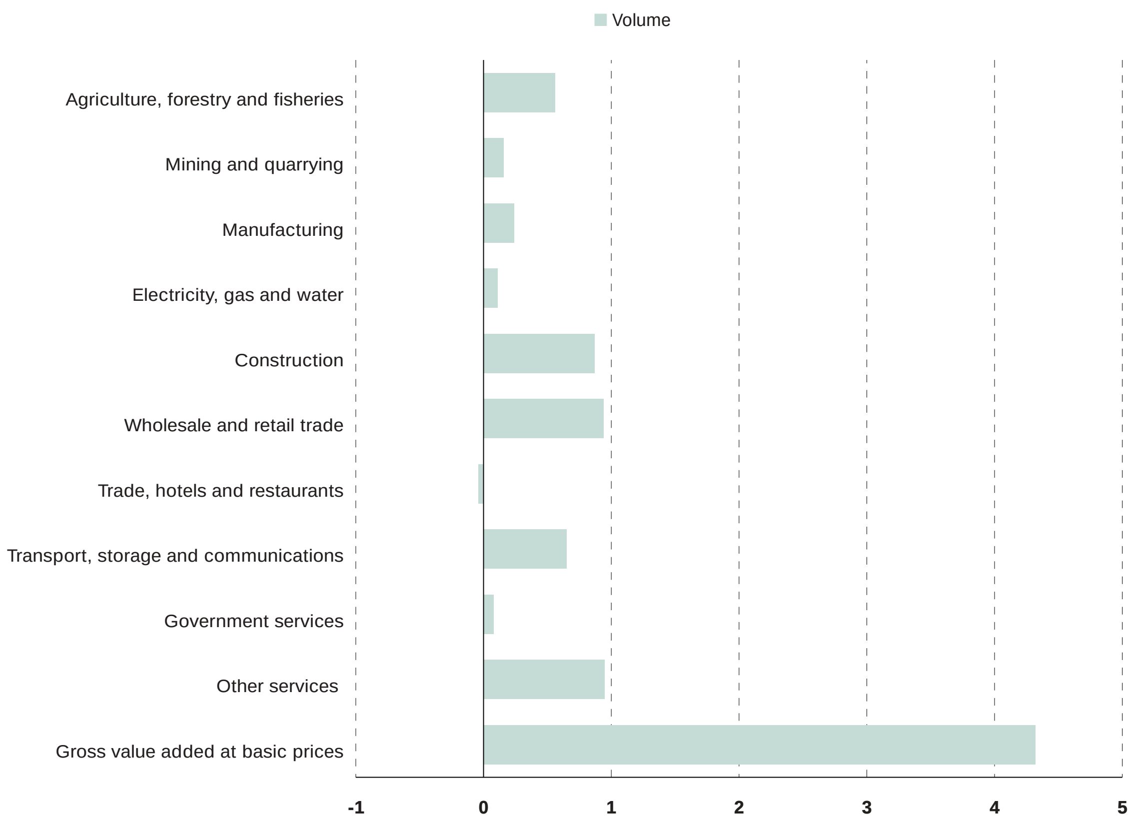
In an attempt to promote an efficient and sustainable agricultural sector, assuring food security and income generation, the government is following a two-pronged development policy. On the one hand, it prioritises the availability of inputs (irrigation, seeds, fertilisers) and extension services to small farmers; on the other, it supports the creation of outgrower schemes for commercial agriculture where smallholders grow crops "to order" for agribusiness in return for stable prices, inputs and training. This is outlined in the National Agricultural Policy for the period 2004-2015, which aims at increasing the agricultural contribution to GDP from the current level of 22 per cent to over 30 per cent by 2015. The policy also stresses the importance of developing linkages between smallholders and the agribusiness sector, through increased private sector participation in agricultural service delivery. In order to promote agricultural diversification and expand regional exports, major steps are also being taken in the promotion of livestock, through cattle restocking and animal diseases control, and fishery production – especially through the encouragement of aquaculture. Emphasis is also placed on the development of high-value products, such as spices (i.e. paprika), horticulture and floriculture. In the light of these efforts and of the good weather so

Figure 3 - GDP by Sector in 2003 (percentage)



Source: Authors' estimates based on Central Statistical Office data.

Figure 4 - Sectoral Contribution to GDP Growth in 2003 (percentage)



Source: Authors' estimates based on Central Statistical Office data.

far this year, Zambia is expected to have another sizeable harvest in the 2004/05 season.

Reflecting favourable copper prices and increased investment in the sector, mining production grew by 15.7 per cent in 2004, regaining its prominence in the Zambian economy. Copper prices averaged $1.19 per pound during the third quarter of 2004 compared to $0.77 per pound in same period of 2003. In 2002, the performance of the mining sector was adversely affected by the withdrawal of Anglo American from the Konkola Copper Mines (KCM), which produces two thirds of Zambia's copper, and the continued closure of Roan Antelope Mining Corporation of Zambia (RAMCOZ). In 2003 and in the first half of 2004, the government started a comprehensive economic restructuring programme aimed at promoting private sector-led mining development. Copper production jumped by 21 per cent in the first six months of 2004, as a result of improvements in technology at First Quantum Minerals' Bwana Mkubwa mine and the rehabilitation of the RAMCOZ mine (re-named Luanshya), which was bought in June 2003 by J&W Investments of Switzerland. The acquisition of 51 per cent of KCM by Vedanta Resources in August 2004, the rehabilitation of the second largest producer, the Mopani Copper Mines, and the coming on stream of the Kansanshi and Lumwana mines in 2005 and 2006 suggest overall good prospects for the sector. Total production is expected to increase from 403 000 tonnes in 2004 to 500 000 tonnes in 2006.

Buoyant agriculture and mining supported manufacturing performance. In particular, food, beverages and tobacco agribusinesses stood out as the leading and rapidly growing sub-sectors. Textiles and leather fared relatively well too, mainly owing to improved investment in cotton ginneries, which in turn led to increased exports of cotton yarns to South Africa.

Despite such positive achievement, manufacturing remains constrained by a series of bottlenecks, including the high cost of credit, the high cost base (mainly due to Zambia's landlocked status), administrative barriers and unfavourable duties on inputs compared to the rest of the region, which reduce competitiveness *vis-à-vis* neighbouring countries. More generally, entrepreneurs and business associations lament the lack of an overall vision and of a long-term development strategy, which also translates into inadequate/outdated regulatory framework, including protracted delays in the approval of the new Investment Act.

To improve the dialogue with the private sector and strengthen the business climate, the authorities have taken major steps in 2004, including the adoption of a private sector development plan focused on trade capacity building, regulation, infrastructure development, and SME financing. This initiative, together with spillover effects from continued investment in mining and agriculture are expected to benefit private-sector activity in the medium term.

Restructuring of the mining sector and real estate developments, coupled with donor funded work in road rehabilitation, supported a booming construction sector, which grew by 5 per cent for the third year in a row. Donor-supported infrastructure projects and further investment in private commercial and residential housing estates are expected to ensure strong growth in the sector over 2005-06.

Tourism enjoyed strong growth in 2004 as a result of improved marketing and investment by the private sector, encouraged in turn by supportive measures, such as the recently established Tourism Development Credit Facility. Total arrivals at the Livingstone airport increased by 39 per cent to about 57 000 passengers. The number of tourists visiting the game parks increased by 9 per cent in 2004. However, the potential of the sector is not fully exploited owing to relatively poor

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Gross capital formation	**12.8**	**20.0**	**23.0**	**26.1**	**25.4**	**27.0**	**30.5**
Public	6.0	11.9	11.8	11.5	9.9	9.4	10.0
Private	6.8	8.2	11.1	14.7	15.5	17.6	20.5
Consumption	**93.4**	**95.6**	**90.4**	**84.8**	**82.4**	**86.7**	**86.8**
Public	18.3	12.8	13.0	14.6	12.9	13.0	13.7
Private	75.1	82.8	77.4	70.1	69.5	73.7	73.2
External sector	**-6.2**	**-15.7**	**-13.4**	**-10.9**	**-7.8**	**-13.8**	**-17.4**
Exports	34.0	29.0	28.6	31.0	34.3	30.3	27.4
Imports	-40.3	-44.6	42.0	41.9	-42.2	-44.1	-44.7

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

infrastructure in many national parks and cumbersome bureaucratic and regulatory requirements. In order to overcome these constraints, the authorities are designing a Tourism and Hospitality Bill, aiming at simplifying and rationalising the licensing framework in the sector, in line with international standards. Moreover, the donor community has launched a series of infrastructure development programmes in some tourist areas.

Against a background of increasing investment in the mining sector, private gross capital formation is expected to increase in 2005 and 2006. The associated increase in imports of capital goods will partially offset the growth of copper volume exports. Government consumption, which contracted sharply in 2004, following the restrictive stance of the Budget, is expected to increase moderately in 2005 and 2006, as poverty reduction spending increases and the 2006 presidential and legislative elections approach.

Macroeconomic Policies

Fiscal and Monetary Policy

Highly dependent on donors' assistance – which has financed some 30 per cent of the government budget – Zambia has anchored its macroeconomic policy on the Poverty Reduction Strategy Paper (PRSP) for 2002-2004 and the Transitional National Development Plan. However, frequent fiscal slippages experienced throughout 2003 – due mainly to overruns in public-sector wages and poor public expenditure management – undermined the authorities' ability to achieve the PRSP targets. Unsustainable government borrowing crowded out private-sector investment and reduced resources available for poverty reduction. As a result, the IMF suspended its budget support, and the country could not reach the completion point under the enhanced HIPC initiative, originally scheduled for 2003.

In 2004, the authorities engaged in a sharp fiscal adjustment in the framework of the new IMF Poverty Reduction Growth Facility approved in June 2004. The government implemented a painful and unpopular rationalisation of public employment, scaled back housing allowances, and froze public sector wages, reducing domestic borrowing from 5.1 per cent of GDP in 2003 to 2.1 per cent of GDP in 2004. The contraction in recurrent and interest expenditure more than offset the slight reduction in government revenue, mainly stemming from lower payments on profits and dividends by the financial sector. The overall budget deficit for 2004 is estimated at 3.9 per cent of GDP, compared to 6 per cent in 2003.

The fiscal measures freed up resources for poverty reduction spending, which doubled to 2.2 per cent of GDP in 2004, in line, for the first time, with the PRSP targets. In particular, the budget allocation for education met the target of 20.5 per cent of the total discretionary domestic budget. However, health spending was below its target, with poor reporting and limited absorption capacity at the district level. Formidable challenges still remain to improve transparency and the efficiency of budget execution, financial reporting, audits and procurements.

In order to improve efficiency, effectiveness and accountability in the management of public finance, the government, assisted by donors has designed a Public Expenditure Management and Financial Accountability (PEMFA) reform programme. The comprehensive programme, approved in June 2004, focuses on twelve areas of improvement, including budget preparation and execution, debt management, internal audit and control, and harmonisation of external aid. The programme for 2005 includes a pilot Integrated Financial Management Information System (IFMIS) in at least three ministries. PEMFA is part of a more ambitious Public Sector Reform Programme, launched at the end of 2003, which also encompasses civil service reform, and decentralisation of administration of resources to provinces and districts. However, progress in these two areas has been limited so far.

Based on the Medium Term Expenditure Framework (MTEF) for 2005-2007, the 2005 Budget calls for a further reduction in government domestic borrowing. To this end, the authorities would keep the wage bill below 8 per cent of GDP and curb non-priority expenditure. At the same time, they would increase priority expenditures on poverty reduction and track their implementation through quarterly budget execution reports, while settling domestic arrears, which in the past hindered the government's ability to execute investment projects. Sizeable outlays relating to the preparation of the 2006 legislative and presidential elections are also projected.

The moderate increase in current expenditures will be largely offset by a contraction in non-priority capital spending and higher revenue collection, stemming from the expiration of the temporary suspension of a 5 per cent import duty on petroleum products. The budget deficit is projected to fall to 1.8 per cent in 2005 and to increase slightly to 2.4 in 2006 as elections approach.

To finance the budget deficit, external programme assistance, mostly in the form of grants, is expected to increase substantially, limiting domestic borrowing to 1.5 per cent of GDP. To mobilise external support, the authorities will need to resist additional pressures to increase spending in this pre-election year, while improving public expenditure management, through PEMFA reform. The fiscal consolidation efforts, together with progress in major structural reforms, are expected to allow the country to reach completion point in the first half of 2005, thus triggering an external debt cancellation of $3.8 billion.

Inflation slowed in 2004, averaging 18.3 per cent, and well below the original target, despite the pass-through of higher world oil prices to consumers. The relative stability of the exchange rate of the kwacha and favourable food price developments helped contain inflation.

Table 2 - Public Finances (percentage of GDP)

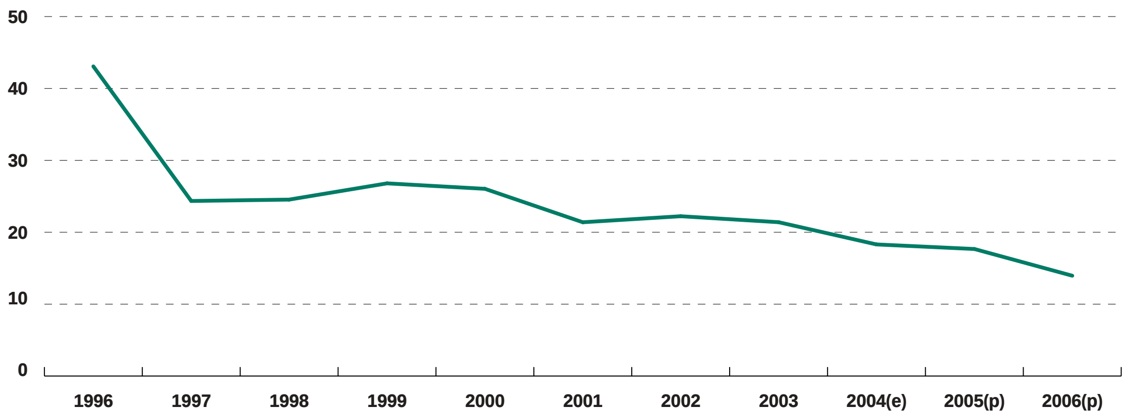
	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**26.8**	**24.8**	**26.1**	**25.1**	**22.7**	**24.5**	**24.7**
Tax revenue	19.0	18.6	17.4	17.5	16.8	17.3	17.4
Grants	6.1	5.7	8.3	7.0	5.2	6.6	6.7
Total expenditure and net lending[a]	**32.1**	**31.9**	**31.8**	**31.1**	**26.6**	**26.3**	**27.1**
Current expenditure	23.4	19.4	19.4	19.6	16.7	16.9	17.0
Excluding Interest	*18.6*	*16.9*	*15.4*	*15.7*	*13.8*	*14.1*	*14.9*
Wages and salaries	5.8	6.8	8.0	8.5	7.6	7.4	7.5
Interest	4.8	2.5	4.1	3.9	2.9	2.8	2.2
Capital expenditure	8.7	11.9	11.8	11.5	9.9	9.4	10.0
Primary balance	**-0.5**	**-4.5**	**-1.6**	**-2.1**	**-1.0**	**1.0**	**-0.2**
Overall balance	**-5.3**	**-7.0**	**-5.7**	**-6.0**	**-3.9**	**-1.8**	**-2.4**

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.

The central bank mopped up the excess liquidity that had arisen from the reduction in the statutory reserve requirement in October 2003. This last measure was aimed at freeing up resources for commercial lending; however, the sharp reduction in government borrowing coupled with persistent demand by the banking sector for government bonds put a downward pressure on treasury bill rates (from 32 per cent in November 2003 to 6 per cent in June 2004). The resulting negative real interest rates led the monetary authorities to soak up the excess liquidity, through open market operations. Interest rates on treasury bills went up to 17 per cent in November 2004, thus contributing to reducing inflation. Credit to the private sector increased by almost 40 per cent during the year through to September 2004, reflecting in part the incentive to switch to lower-cost domestic financing which prevailed during most of the year.

Inflation is expected to average 18 per cent in 2005 and to fall to 14 per cent in 2006, supported by lower pressure on food prices, and tighter monetary and fiscal policy. While the central bank will continue to eliminate

Figure 5 - Annual Average Inflation Rate



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

remaining excess liquidity, fiscal restraint should allow bank credit to expand in line with GDP growth.

Following the establishment of a broad-based inter-bank foreign exchange trading system in July 2003, the volatility of the kwacha/dollar exchange rate diminished. The kwacha has remained stable to the dollar and even appreciated slightly. The overall stability of the currency also reflected favourable copper prices and the depreciation of the dollar.

External Position

Pursuant to the Common Market for Eastern and Southern Africa (COMESA) Free Trade Area Agreement, since 2000 Zambia has eliminated the tariffs on originating products from the other FTA members, and granted trade preferences to the COMESA states not in the FTA. The country is currently investigating the effects of the proposed COMESA Customs Union and the adoption of a common external tariff (CET). A major stumbling block to this end is Zambia's simultaneous membership in the Southern African Development Community (SADC), which is the main trade partner. The situation is further complicated by the forthcoming negotiation of the Economic Partnership Agreement (EPA) with the EU, which has to be done on a regional basis.

Zambia benefits from a variety of preferential market access initiatives, including the Generalised System of Preference (GSP), the EU Everything But Arms initiative and the US African Growth and Opportunity Act (AGOA). However, serious supply-side constraints, including the limited capacity of Zambian producers to meet quality and safety standards, as well as the lack of a clear government export strategy, have significantly hampered the realisation of their full potential. According to US import data, the impact of AGOA on Zambian exports has been insignificant. This comes as no surprise since most Zambian exports already benefited from duty-free status under the US GSP and, even before being AGOA eligible, Zambia was unable fully to exploit its GSP quota. Zambian producers have not been able to access the US market for agricultural produce since the required pest risk assessment has not yet been completed.

Reinforcing the overstretched human and institutional resources within the Zambian trade administration is of foremost importance. The inclusion in 2004 of Zambia in the Integrated Framework for trade-related technical assistance to LDCs (IF) represents an important opportunity to address weaknesses in the formulation of the trade strategy and the support of export industries.

External developments in 2004 were extremely favourable. The external current account deficit narrowed, reflecting the tighter fiscal stance and a sharp improvement in the terms of trade (despite higher oil prices). Total export earnings are estimated to have increased by 50 per cent in 2004, mainly because of higher copper and cobalt exports. Copper receipts increased by 66 per cent in the period January to September 2004 compared with the same period in 2003. Mineral products account for around 69 per cent of total exports, followed by agricultural products, including tobacco, cotton, sugar, vegetables and cut flowers. In 2004, non-mineral exports have increased by 26 per cent. The EU is the largest export market (50 per cent of the total), followed by the SADC (25 per cent). Exports to the EU include copper, sugar, cut flowers and vegetables. Zambia's exports to its neighbouring countries mostly consist of sugar, cotton yarn, copper ores and copper cables, as well as the 2004 maize surplus.

Imports recorded an increase of 32 per cent in 2004, owing to the high demand for capital goods by the mining sector. Imports from South Africa represent more than 50 per cent of total imports, which include mining equipment, chemicals, processed foods and consumer products.

The trade balance is expected to deteriorate in 2005 and 2006, as a surge in imports of capital goods for new investment expansion and further refurbishment of the mining sector is expected to offset large increases in copper volumes. Moreover, while remaining at a high level, world prices of copper are projected to decrease with respect to their 2004 peak. Non-traditional exports are expected to perform well in 2005-06. Tobacco exports are projected to expand thanks to the British American Tobacco export agreement with Malawi for an estimated $2 million. Sugar exports are also expanding, because of an EU decision to increase the existing 20 000 export quota by 7 125 tonnes. On the negative side, horticulture exports might suffer from the financial irregularities that led Agriflora, the biggest vegetable and rose exporter, to collapse in 2004. Textile and clothing exports might also rise since the government has successfully negotiated with SADC partner countries an increase in its duty-free textile and clothing export quota to the region, from $3 million to $9 million.

The stock of external debt, which stood at $7.12 billion in 2002 declined to $6.45 billion at the end of 2003. The decline was mainly attributable to the implementation of the Paris Club Agreement of September 2002, through which bilateral creditors provided debt relief of up to 90 per cent for the consolidated period from January 2001 to 31 March 2003. The reduction in debt stock was also due to debt repayment amounting to $113.1 million in 2003.

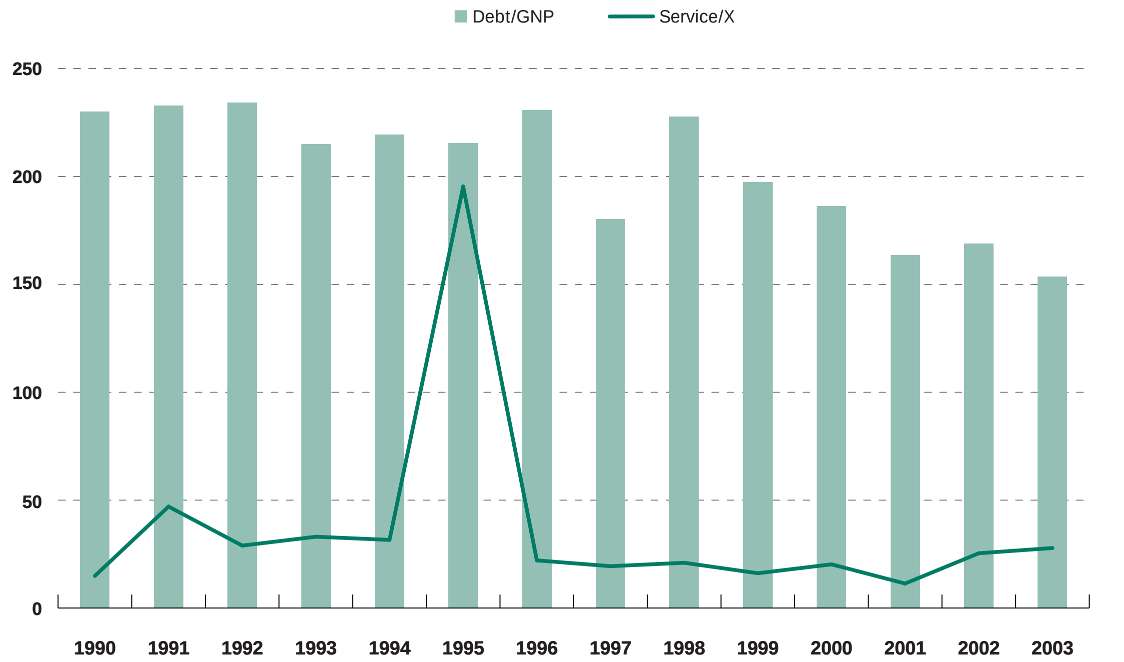
Table 3 - Current Account (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-1.8	-10.1	-7.8	-6.3	-2.6	-8.0	-11.2
Exports of goods (f.o.b.)	30.4	24.3	24.8	25.9	30.0	26.2	23.5
Imports of goods (f.o.b.)	-32.3	-34.5	-32.6	-32.2	-32.6	-34.3	-34.7
Services	-7.6	-6.3	-6.6	-5.5			
Factor income	-6.4	-4.0	-4.2	-3.4			
Current transfers	-0.1	0.3	2.1	0.7			
Current account balance	**-16.0**	**-20.1**	**-16.6**	**-14.4**			

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

The external debt increased to $6.8 billion in 2004, owing to positive flows on existing and new loans minus amortisation payments. A total of $129 million was spent on foreign debt service during the year. In the framework of the HIPC Initiative, total debt relief from bilateral and multilateral creditors amounted to $360 million for the year. As of end-2004, good progress was made towards meeting the triggers for the HIPC Initiative completion point, thereby accessing debt relief amounting to $3.8 billion. Zambia is expected to reach the completion point in the first half of 2005, provided that performance under the PRGF-supported programme, approved in June 2004 remains

Figure 6 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports)



Source: World Bank.

strong and implementation of poverty reduction strategy is satisfactory.

Of the total external debt stock, the government accounted for 92 per cent, while private sector and parastatals accounted for the remaining share; 57 per cent was owed to multilateral institutions, while bilateral creditor debt represented 35 per cent.

Structural Issues

In 2004, the government moved forward with its structural reform agenda. This included HIPC Initiative completion point triggers: soliciting bids for privatisation of the Zambia National Commercial Bank (ZANACO), progress in the commercialisation of the Zambia Electricity Supply Corporation (ZESCO), and the restructuring of the non-bank financial institutions (NBFI), as part of a broader reform of the financial sector.

A bid for the sale of 49 per cent share of ZANACO, the largest commercial bank of Zambia, was launched by the Zambian Privatisation Agency (ZPA) in 2004, but Barclays' acquisition of ABSA (Amalgamated Banks of South Africa), the highest bidder, stalled the negotiations. Therefore, ZPA is currently negotiating with the second retained bidder, the African International Finance Holdings.

Progress has also been made in the commercialisation of ZESCO, through the appointment of a governing board, dominated by private sector representatives. A new article of association is expected to be approved shortly to ensure that there is no interference from the government, and a new energy bill under preparation is expected to be finalised by June 2005. The overall process of reform of the energy sector also included the establishment of the rural electrification authority (created in May 2004) and the rehabilitation of infrastructure.

The government is considering a commercialisation strategy for ZAMTEL, the national telecommunications company, which owns the monopoly of land lines, the international gateway and is the proprietor of mobile operator Cell-Z. A major issue concerning ZAMTEL, is its profitability. Almost 70 per cent of its revenue comes from control of the heavily congested international gateway connection, which is a more expensive way of providing international lines than satellites. So far, security reasons have led the government to stick to this option. However, the authorities are currently finalising a policy review and indications are that the report may recommend the reduction of the current high fees charged for an international gateway licence ($15 million) and open the system further.

In the mining sector, a major development was the sale of 51 per cent of the Konkola Copper Mines (KCM) to the Indian company Vedanta. Before this acquisition, the company had engaged in deep restructuring of operations, leading to a sharp fall in productions costs and expanded output, and leading to $60 million profits during the first six months of operations.

As part of a broader reform process aiming at exploiting synergies and reducing duplication, ZPA will be merged with four other agencies in charge of private sector development to create the Zambia Development Agency. These parastatals include the Zambia Investment Centre (ZIC), the Small Enterprise Development Agency (SEDA), Zambia Export Processing Zone Authority (ZEPZA) and the Export Board of Zambia (EZB). The legal structure of the new development centre still needs to be clarified; while ZPA's governing board is mainly composed of private sector representatives and directly reports to Parliament, the ZIC's board is mainly composed of government officials and reports to the Ministry of Commerce, Trade and Industry.

Since 2002, the government has embarked on an assessment of the financial sector, with technical assistance from the IFIs. The exercise culminated in the formulation of a Financial Sector Development Plan in June 2004, based on a wide consultation process. The Plan identified the reform of the legal and regulatory framework and the rationalisation of state-owned NBFIs as major steps towards strengthening the soundness of the sector. An amended Bank and Finance Services Act should reinforce the independence of the BoZ and its oversight role. The Plan also foresees the introduction by end-2005 of legislation for micro-finance institutions and a new Development Financing Act, replacing the Development Bank of Zambia Act. The latter would imply a renewed role for the NBFIs in providing development finance, in particular for the Development Bank of Zambia (DBZ).

The DBZ will be recapitalised, with private resources accounting for at least 75 per cent. As a first step, in September 2004, the Export-Import Bank of India increased the bank's capital by 35 per cent (injecting $1.4 million), and a new board of directors was being appointed. The International Fund for Agricultural Development (IFAD) has committed a $2.15 million contribution to strengthen the role of the National Savings and Credit Bank as a provider of rural finance. In the absence of an agreement over a viable business plan, no rescue strategy exists for the Zambia National Building Society, whose operations were reduced and are monitored by the BoZ.

Recent evaluations of the business climate in Zambia highlight a weak legal and regulatory framework, including protracted delays in the approval of crucial pieces of legislation, and poor contract enforcement. Poor transport infrastructure – only 45 per cent of the core road network is in good condition – also increases the cost of doing business in this land-locked country and limits market access. The difficult access and high cost of long-term finance, as well as stringent collateral requirements, are also often reported as major concerns by the business community. The private sector acknowledges, however, that poor managerial capabilities may constitute a bigger problem.

The private sector has also expressed concerns about the continuing lack of government vision, as reflected by recent conflicting signals on investment legislation. On the one hand, the President has formed a council of international advisors on investment and business climate (the Zambia International Business Advisory Council, ZIBAC); on the other, he is pushing for legislation reserving some sectors of the economy to indigenous business. The absence of a clear private-sector development policy has resulted in a piecemeal government approach to remove bottlenecks and promote growth. A long standing issue is the poor dialogue between the government and private sector. Field interviews suggest a lack of mutual understanding with respect to their relative roles and responsibilities in addressing such constraints. This also reflects the proliferation, polarisation and lack of cohesion among business associations.

In an effort to formulate a better strategy and improve the quality of the dialogue, representatives of the government, donors and the business community gathered in June 2004 for the Private Sector Development (PSD) Forum in Livingstone. The 280 Participants to the Livingstone Forum adopted a comprehensive action plan that is being translated into a concrete strategy and projects to be financed with donor support. This ambitious initiative, however, will require further efforts from donors to co-ordinate their

Innovative formulas to provide regular financing to farmers: The Zambia Agribusiness Fund and the ZACA Warehouse Receipt Financing

In order to foster linkages between small-scale producers and commercial agribusiness, USAID has launched the **Zambia Agribusiness Technical Assistance Centre**. Addressed, in particular, to farmers who produce all-year-round crops, the centre provides technical assistance and supervises an investment fund that extends credit lines to farmers to buy irrigation equipment. Big commercial agribusinesses buy the crops (at a price net of the cost of the loan) and pay back the loan to the fund. Highly successful, this pre-financing export facility extends credits in US dollars, applying an interest rate averaging 8-10 per cent, compared to that in local currency of 35-40 per cent, and presents the advantage of ensuring the predictability of funds and repayment. The $1 million fund has benefited about 3 000 small-scale honey, horticultural and diary producers and it is already self-sustaining. The next step envisaged would be to convert credits into equities.

Another successful initiative implemented by USAID in 2002 in collaboration with the Zambian Agricultural Commodity Agency (ZACA) is a **warehouse receipts financing** programme. The farmers who benefit from a loan deliver the commodities to be stored in a bonded and insured warehouse; and the warehouse operator issues warehouse receipts. The receipts are warrants of the loan. Once the bank or the credit company has the warehouse receipts in its hands, it advances to the borrower a specified percentage of the value of the commodity stored. The amount it lends is primarily based on the acceptability and the ease of control of the collateral. Beneficiaries have accessed more than $700 000 in bank encashable warehouse receipts against their commodities stored in ZACA certified warehouses. To encourage and support local banks, the USAID-funded Development Credit Authority provides a 40 per cent guarantee to the loan. Problems may arise when local banks do not recognise receipts as documents of title. In this respect, ZACA has requested an amendment to the 1994 Agriculture Credits Act. In the medium term, the objective is to encourage the creation of farmers' associations to pool their demand for credit, minimise transaction costs and allow for mutual responsibility. The ultimate aim would be to complement the warehouse-receipt financing mechanism with hedging tools, developing a commodity stock market in Lusaka.

In parallel, USAID and other donors are financing local NGOs or technical assistance business associations, such as the Zambia Chamber of Small and Medium Business Associations in charge of providing business development services, to create market linkages between farmers, agribusiness and urban consumers, and ensure training in business skills.

projects, from the private sector to unify its views, and from the government to ensure a coherent approach.

In the key, mostly informal, SME sector, the bottlenecks mentioned above are exacerbated. Addressing their specific needs is complicated by the absence of a clear picture of the sector: no census of it has been undertaken, and the 1996 official SME definition, based on turnover or invested capital, is outdated by the high inflation environment. Observations suggest that SMEs are concentrated in trade and light manufacturing, including food, textile and clothing and timber. They find access to credit difficult and small businesses bemoan the lack of information about existing financing facilities. The absence of a central repository of information on customers credit conduct contributes to a bad repayment culture that in turn leads banks to require stringent collateral (equivalent to two to three times the value of the loan).

Donors and government agencies have embarked on a series of initiatives to improve access to finance for local companies. Since 2000, the World Bank, the European Investment Bank and Propaco have launched a third-party credit lines facility. In the World Bank sponsored programme, project-specific funds are disbursed by an Apex unit, managed by the BoZ, to selected commercial banks which are left with the responsibility of screening applications from firms and assuming part or all of the credit risk. These credits inject foreign-currency liquidity into the system at preferential rates. In turn, banks are able to offer foreign-currency-denominated loans at more attractive conditions (the interest rate differential ranging between 27 and 35 basis points). Although widely successful in expanding private-sector access to finance (disbursements in excess of $46 million have been made to more than 200 companies), this initiative has mainly benefited the larger and more formal companies. In fact, SMEs, which often lack financial statements and formal guarantees were generally unable to access these credit lines.

Other donors' initiatives more specifically targeted on SMEs have been encouraging (see box on previous page), revealing the existence of a pent-up demand for financial services emanating from small-sized businesses usually not serviced by commercial banks and outside of the micro-finance reach. Well-designed programmes show the possibility for local banks to move towards the lower end of the market when they are reassured by guarantees from donors and the development of credit-referencing bureaux. Furthermore, these initiatives are encouraging micro-finance institutions (MFIs) to extend credit lines to individual firms. The scale of these schemes remains, however, small owing to the limited capital base of MFIs, their dependence on donor financing and current regulations that place severe requirements for registering as micro-finance institutions.

Political and Social Context

The Zambian political situation has been relatively stable. In 1991, Frederick JT Chiluba's Movement for Multiparty Democracy came to power, promoting transition from the centrally planned economy that had been in place since independence in 1964. The newly liberalised political environment opened the way for comprehensive economic reforms; however, there were allegations of corruption and political interference in economic sectors. In 2001, Chiluba was succeeded by Levy Patrick Mwanawasa of the ruling party in a slim election result that was contested by the opposition.

President Mwanawasa has made the fight against corruption his centrepiece, receiving strong support from the donor community. The former administration was made accountable for theft of public resources in a trial which started in the last quarter of 2003. However, the trial lost momentum in 2004, owing in part to the lack of co-ordination between the courts, the Anti-Corruption Commission, and a special Task Force created by the President to investigate cases of corruption. This situation has created discontent; some civil society organisations have complained that corruption is fought on a selective basis – little is done to combat the widespread petty corruption of junior officials – and that the current legislation does not allow access to public documents for press investigations.

A strong independent press and civil society organisations are closely following the government's constitutional review process aimed at rebalancing powers away from the presidency, introducing an absolute majority clause for presidential elections and increasing freedom of information. Recent statements from the President suggest, however, that the new constitution will not be adopted until after the 2006 elections, causing further division amongst the civil society, opposition politicians and the government.

The PRSP for the years 2002 to 2004 aimed at reducing the poverty rate to 65 per cent of the population in 2004 (its 1996 level) from 78 per cent in 1998 and at achieving strong sustained economic growth. During the period of January 2002-June 2003, progress was disappointing, according to the PRSP intermediate assessment, owing to the government's failure to disburse all the resources allocated for poverty reduction (only 25 and 50 per cent of the amounts allocated in 2002 and 2003 were actually disbursed), and poor co-ordination between district development plans and the national PRSP. However, the draft progress report covering the period June 2003-January 2005 shows improvements. Allocations to poverty related programmes increased and reached the target of 2.2 per cent of GDP in the 2004 fiscal year; but implementation problems remain in some areas, notably in the health sector which suffers from limited absorptive capacity at district level and an increasing brain drain – there are only 700 doctors left in the country, and more than 2 000 nurses have left for the United Kingdom over recent years. The 2003 review of the 2001-06 National Health Strategic Plan highlighted the need to improve the monitoring system, raise public health expenditures from the current 10 per cent of discretionary budget to 15 per cent, and create a task force of human resources to counteract the retention problems in rural areas.

Malaria and respiratory infections remain the main causes of death, and there has been no improvement over the past two years according to health indicators. Conversely, the under-five mortality rate has decreased (to 168 per 1000 compared to 194 in 1996) thanks to a rise in the full immunisation coverage for children under one year of age. However, despite an increase in supervised deliveries by almost 50 per cent between 1999 and 2002, the maternal mortality rate was still high, at 729 per 100 000 in 2002.

According to the 2002 Zambia Demographic Health Survey, 16 per cent of the population aged 15-49 is HIV positive. The infection rate is substantially higher among women (18 per cent) than men (13 per cent). Morbidity and mortality due to HIV/AIDS have continued to escalate, overwhelming the health care service – it is estimated that about 70 per cent of medical hospitalisation admissions are related to them.

In September 2004, Zambia declared HIV/AIDS a national emergency. Through a number of initiatives, including Global Fund-supported programmes, and the Zambia National Response to AIDS, the government has scaled up the health sector's response, increasing the number of Voluntary Counseling and Testing (VCT) programmes, improving management of opportunistic infections, and strengthening the national laboratory capacity. Ahead of the government's target, 13 500 people were already receiving anti-retroviral drugs (ARVs) at the end of 2004, paying a cost-sharing fee of 40 000 kwacha ($8), and the authorities announced their intention to extend provision to 100 000 people – half of the 200 000 currently in need of treatment – by 2005. Concerns have been raised about the equity of the treatment as the majority of people that benefit are in Lusaka. This is attributable to the general lack of information on the availability of services in the rest of the country. Furthermore, a major barrier to the wider access of ARVs is the cost-sharing policy. Exemptions exist in principle for the most vulnerable, but these are rarely applied.

The draft HIV/AIDS policy currently under formulation is considering offering free treatment for those accessing treatment in low-cost care services. In order to scale up the HIV/AIDS treatment programme, the policy will also focus on promoting routine health testing and counselling in ante-neonatal and sexually transmitted disease (STD) clinics. Substantial efforts will be made to train health professionals in ARVs delivery.

In the education sector, the abolition of fees for government primary schools in 2002 has resulted in an increase in enrolment in primary education, from 70.5 per cent in 2001 to 76.5 per cent in 2003. Primary completion rates have also improved from 65.3 per cent in 2001 to 72.9 in 2003. Secondary education, however, suffered major problems in 2003. Budgetary expenditure overruns led to the suspension of the PRGF, and the Ministry of Education's payroll was frozen, leaving about 10 000 new teachers unemployed, and leading to a steep increase in the pupil/teacher ratio. This in turn has led many teachers to arbitrarily set ceilings for enrolment along with requests for monetary or non-monetary contributions (such as school uniforms).

The overall picture of the education sector has improved over the past year. Domestic allocations to the sector have increased – the 2004 benchmark for the HIPC completion point, set at 20.5 per cent of domestic discretionary budget, was met. The 2005 budget foresees substantial hiring of teachers, while outstanding severance benefits are expected to be paid to 7 000 teachers no longer in service, allowing a similar number to be hired.