Zambia

key figures

• Land area, thousands of km^2	753
• Population, thousands (2002)	10 698
• GDP per capita, $ (2002)	346
• Life expectancy (2000-2005)	32.4
• Illiteracy rate (2002)	20.2

Zambia

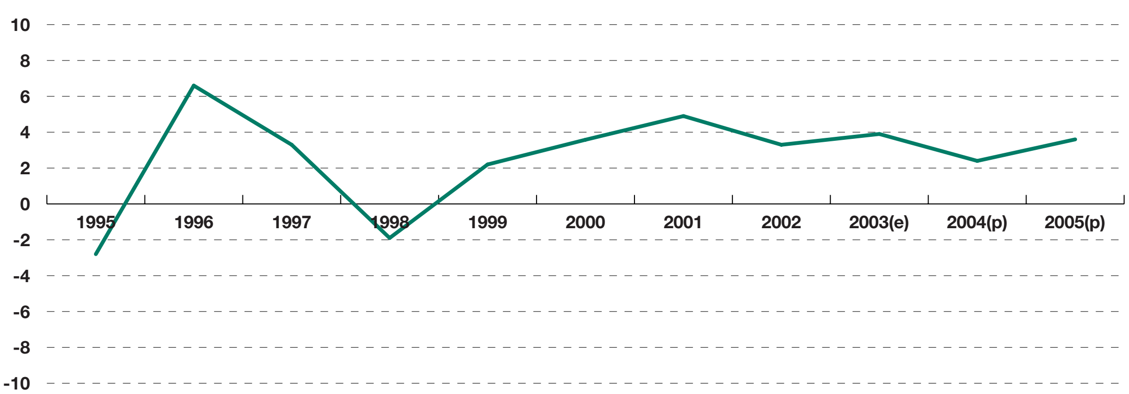
ZAMBIA EXPERIENCED A SIGNIFICANT ECONOMIC growth of 3.9 per cent in 2003. This performance relied mainly on external factors, such as favourable weather and high international metal prices, and does not seem to be based on internal policies or existent convincing development strategy. The government, particularly, has been unsuccessful on several fronts, which include: promoting a diversification of the country's export base away from its heavy dependency on copper; managing its expenditure — still strongly dependent on foreign assistance — more efficiently; and, most importantly, reducing poverty, which affects 73 per cent of the population. Slowing agricultural growth will reduce GDP growth to 2.4 per cent in 2004. However, new investment in the copper sector and in construction should result in a growth of 3.6 per cent in 2005. Despite this favourable short-term outlook, the absence of a comprehensive strategy of development will adversely affect the country's performance in the medium term.

A major obstacle to development in Zambia seems to be governance issues. While on the one hand, the Zambian president has embarked on an anticorruption crusade since his election in 2001, on the other the government continues to face the problem of accountability in its spending. Despite a commitment to increased social spending and the release of large amounts of donor financing following the launch of a Poverty Reduction Strategy Paper (PRSP) in 2002, disbursements in poverty reduction programmes have so far been limited and the quality of spending has been very poor. In 2003, the actual amounts disbursed in poverty reduction measures was only 3 per cent of total expenditures, less than half of the PRSP target. Only a tenth of the expenditures allocated for the roll out of the malaria programme were actually disbursed, crowded out by civil servants' emoluments and allowances that exceeded the programmed amount by 20 per cent, accounting for more than 30 per cent of total expenditures.

The positive performance and short-term outlook rely more on external conditions rather than on a long-term development strategy.

Overruns in personnel emoluments led to a suspension of IMF budget support in June 2003, preventing, in turn, the country from reaching the Highly Indebted Poor Countries (HIPC) completion point by December 2003. Rescheduled to end 2004, the achievement of this objective would entail the cancellation of $3.8 billion of foreign debt. The funds released are slated for poverty reduction measures. The achievement of this objective depends however on the ability of the

Figure 1 - **Real GDP Growth**



Source: Central Statistical Office data; projections based on authors' calculations.

government both to contain fiscal expenditures and to satisfactorily implement the PRSP. As highlighted by the expenditure restraints contained in the 2004 Budget, the government is concentrating its efforts on reaching the completion point. However, in the absence of institutionalised checks and balances, it remains highly uncertain whether the release of resources will be concretely disbursed in poverty reduction projects.

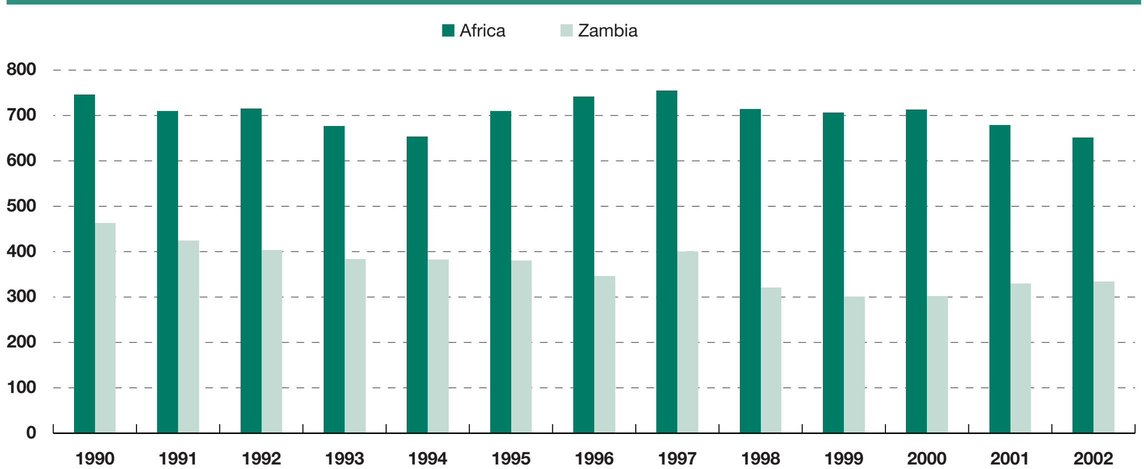
Recent Economic Developments

Owing to favourable dollar copper prices and a good maize harvest, growth averaged 3.9 per cent in 2003. This performance was also aided by strong growth in road and building construction. Economic performance seems, however, to come about more by default than by design, relying mainly on external conditions rather than on a long-term government development strategy. Growth in 2004 is projected to fall to 2.4 per cent, on account of modest growth in agriculture. Although re-investment in the mining sector and continued growth in construction — as a result of donor-funded road rehabilitation work — are expected to give a rise in growth of about 3.6 per cent in 2005, the absence of a concrete diversification strategy by the government will affect the country in the medium term.

The most urgent issue for the Zambian economy is thus a further reduction of its dependency on copper and the encouragement of private sector investment in high value crops, light manufacturing, small-scale mining and tourism. However, as examined later, the development of the private sector is hindered by a series of bottlenecks in terms of limited access to long-term finance, high utility costs, poor infrastructure and high company taxes. Overcoming these constraints in the short term appears unlikely in light of the absence of an institutionalised dialogue between the government and private sector which is in turn partly due to the absence of a cohesive voice among private sector representatives *vis-à-vis* the authorities.

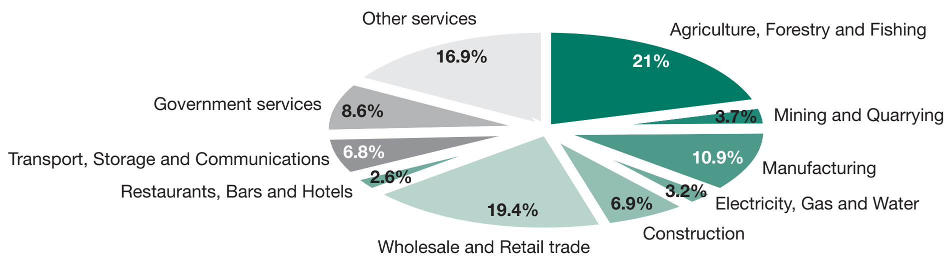
Accounting for about 21 per cent of GDP and absorbing 67 per cent of the labour force, Agriculture, Forestry and Fishery remain a cornerstone of the economy. After three seasons of scanty rains and drought that forced the country to rely on external food aid, the sector registered a growth of 5 per cent in 2003, compared to a decline of 1.7 in 2002. The national production of maize, which is the main food crop, almost doubled, reaching 1.2 million metric tonnes compared to 607 000 in the 2001/02 crop season. Substantial increases were also recorded in other crops, including wheat, sorghum, soya beans, and groundnuts. Following the favourable food production in the 2002/03 agricultural season, the country's food security situation has improved. According to official sources, the total food availability was estimated at 2.25 million metric tonnes of cereal equivalent against the national requirement of 1.8 million tonnes.

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



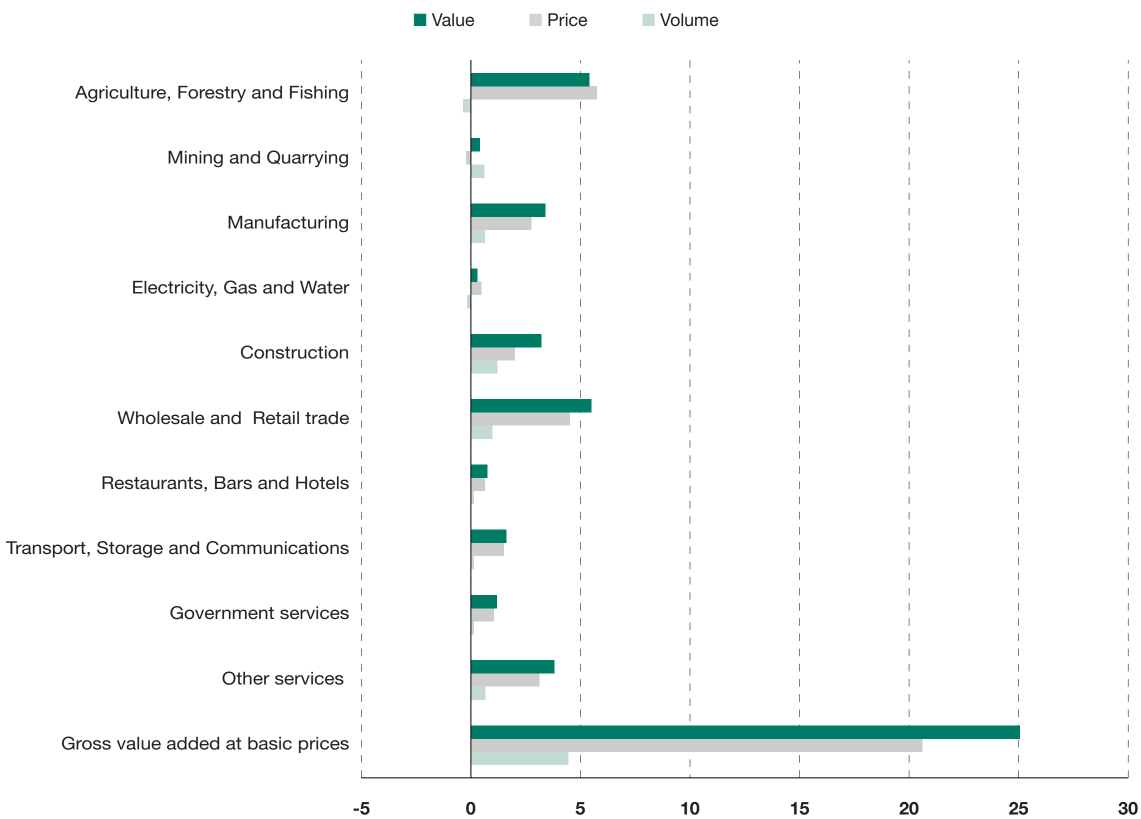
Source: IMF.

Figure 3 - **GDP by Sector in 2002**



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

Figure 4 - **Sectoral Contribution to GDP Growth in 2002**



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

This increase was mainly the result of improved weather conditions and government efforts to distribute inputs on time across the country. However, owing to poor irrigation systems, agricultural performance remains vulnerable to rain patterns and is threatened by lack of access to credit and infrastructural deficiencies, translating into very high transport costs, and lack of proper and consistent marketing channels. Weather conditions in the 2003/04 season are expected to be normal and agriculture is projected to grow by a more modest 3 per cent in 2004 and 2005.

While 58 per cent of Zambia's total land area is considered to have medium to high potential for agricultural production, only 14 per cent of total agricultural land is currently under cultivation.

Commercial farmers own most of the best agricultural land and they produce surplus maize and other cash crops, such as horticulture - the largest growth industry in the sector - cotton, sugar, and coffee for the local market and for export. More than 90 per cent of subsistence farming land in Zambia falls under the customary land tenure system controlled and allocated by traditional authorities (village chiefs) which leads to inefficient land resource allocation and is an additional factor inhibiting the sector's growth potential. Furthermore, high interest rates and limited credit facilities prevent new investment in the sector.

Since his election in December 2001, President Mwanawasa made agriculture the priority sector for Zambian economic growth and announced radical moves to improve the land tenure system as well as to strengthen rural infrastructure and extension services. Although progress in setting up infrastructure and creating markets remains slow, in 2003 government policies have been successful in improving access to fertilisers and seeds. This was achieved through the introduction of a 50 per cent input subsidy under the Fertiliser Support Programme (FSP) to small-scale maize farmers. In addition, the government encouraged the planting of irrigated "winter" maize by commercial farmers by guaranteeing an agreed minimum price indexed to the US dollar. Another major factor that led to improved maize production in 2003 was the heightened participation of the private and non-governmental sectors in this crop through out-grower schemes and community projects, respectively. Interestingly, as a way to attract investment and encourage the development of commercial farming, the Zambian government has welcomed white Zimbabwean farmers into the country. The initial enthusiasm of the farmers to immigrate to Zambia however, has abated in the face of reluctance by the Zambian immigration authorities to issue permits for Zimbabwean labourers.

The mining and quarrying sector grew by an estimated 3.3 per cent in 2003 mainly on account of an increase in copper output, in a context of rising international metal prices. Growing demand in construction activities, especially in road construction and residential housing development led to a growth in other mining and quarrying sub-sectors of about 9 per cent in 2003, compared to a decline of 13.5 per cent the previous year.

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. In particular, in December 2003, 85 per cent of RAMCOZ was sold to J&W investments of Switzerland, while 51 per cent of KCM should be sold to Sterlite Industries of India in mid-2004. Another important company, First Quantum Minerals is expected to start large-scale production in the Kansanshi copper mine by the end of the year. These increasing investments in the sector suggest good overall prospects for the mining sector in 2004 and 2005.

The manufacturing sector, which accounts for 11 per cent of GDP, registered an estimated growth of 6.3 per cent in 2003, compared to 5.7 per cent in 2002. The growth in this sector was largely from the food, beverage and tobacco sub-sector, because of the rebound in agriculture and increased investment in food processing, coupled with the reduction of duties on inputs. The textile and leather sub-sector also recorded positive growth owing to improved investment in cotton ginneries, which in turn led to increased exports of lint cotton.

Despite these positive achievements, the development of the sector is constrained by a series of bottlenecks. These include a weak domestic market, a narrow export base, and unfair competition arising from smuggling from Zimbabwe.

Moreover, as examined later, the signing of several trade agreements since the 2000, both within the region and with the US and EU have proved so far to have limited impact on boosting manufacturing exports. This has highlighted the lack of competitiveness of the Zambian manufacturing sector owing to Zambia's high cost base (mainly due to its landlocked status) and poor co-ordination between producers and exporters.

Another major constraint to the development of the sector is insufficient access to affordable credit. Commercial lending is very expensive on account of the government's enormous borrowing requirements which crowd out the private sector. Commercial Banks hold around 70 per cent of Zambia's total Treasury Bill's issuance. Actual rates charged to investors are close to 45 per cent nominal. Even in real terms, these rates remain extremely high, at around 23 per cent per annum, reducing the incentives to invest in more risky manufacturing projects. The limited new investments are therefore undertaken by foreign companies, but these are also under pressure owing to high utility costs, inadequate infrastructure and difficulties in acquiring licences.

Tourism has registered an average growth of 5 per cent over the period 2001-2003. The opening of two luxury Sun International Hotels in Livingstone near the famous Victoria Falls in 2001 and the rehabilitation of Livingstone airport to increase air traffic from South Africa, contributed to boost tourist arrivals. The rapid growth of the sector is nevertheless constrained by inadequate infrastructure, poor marketing and by the proximity of Zimbabwe, whose current political economic turmoil discourages tourism in the Zambezi River.

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

	1995	2000	2001	2002	2003(e)	2004(p)	2005(p)
Gross capital formation	**13.1**	**18.6**	**20.0**	**23.0**	**22.6**	**23.1**	**24.9**
Public	9.1	9.9	11.6	14.0	13.2	12.9	13.3
Private	4.0	8.7	8.4	9.0	9.4	10.3	11.6
Consumption	**92.7**	**95.2**	**95.8**	**82.3**	**81.6**	**76.4**	**74.5**
Public	16.1	13.8	17.2	13.0	14.0	13.1	12.8
Private	76.6	81.3	78.6	69.4	67.6	63.3	61.7
External demand	**-5.8**	**-13.8**	**-15.8**	**-5.3**	**-4.2**	**0.5**	**0.6**
Exports	37.0	26.9	29.2	23.7	24.4	27.3	27.2
Imports	-42.8	-40.7	-45.0	-29.0	-28.6	-26.8	-26.6

Source: IMF and domestic authorities data; projections based on authors' calculations.

Against a background of increasing investment in the mining sector, private gross capital formation is expected to increase in 2004 and 2005. Increased copper volumes will then translate into increasing exports. Government overspending (largely caused by higher than budgeted pay rise for public sector workers) experienced in 2003 is expected to modestly contract, reflecting the restrictive stance of the 2004 budget to facilitate the resumption of donor funding and the achievement of the completion point.

Macroeconomic Policy

Fiscal and Monetary Policy

The Zambian government's economic policy objectives are anchored in the Poverty Reduction Strategy Paper issued in May 2002, whose overarching goal is poverty reduction through sustained economic growth and employment creation. In line with this goal, the government set a series of objectives for 2003, including reducing the budget deficit, reaching the completion point under the enhanced HIPC initiative, and raising poverty reduction expenditures to 2.2 per cent of GDP.

Despite the government's commitment to contain expenditures, overall budget deficits have reached 8.1 per cent of GDP in 2001 and 6.3 per cent in 2002. This was the result of persistent fiscal indiscipline and withholding of donor budgetary support — which constitutes the major component of budgeted revenues — in response to the government's deviation from policies and benchmark agreed with donors.

Although revenue collection was 2 per cent above target, thanks to improved collection of mineral royalties and higher collections in Pay As You Earn taxes, the overall budget deficit is estimated to have averaged 7.6 per cent of GDP. This was due to a higher than expected increase in civil service personnel emoluments — wage increases ranged from 35 per cent to 124.7 per cent against a projected 12.6 per cent — as well as increasing payment of housing allowances and financing of by-elections not foreseen in the budget. This led to current expenditures exceeding the programmed amount by 20 per cent.

Projected overruns on personal emoluments above the target of 8 per cent of GDP agreed with the Bretton Woods Institutions led to a suspension of International Monetary Fund budget support in June 2003. In turn, this prevented an agreement on a new IMF Poverty Reduction Growth Facility (PRGF). The successful implementation and monitoring of the PRGF was crucial to reach the HIPC completion point. This would have enabled the country to qualify for a $3.8 billion debt write off, out of the $6.5 billion it owes in foreign debt. The date for the achievement of the completion point, scheduled for December 2003, has therefore been postponed to the end of 2004.

The rise in expenditures, compounded with a shortfall in donor funding in 2003 — external budget support was originally set at 42 per cent of revenue — forced the government to increase domestic borrowing. This led to a growth in domestic debt of about 26.5 per cent: from K.4850 billion ($1.02 billion) at the end of 2002 to K.6270 billion ($1.31 billion) at the end of December 2003. In turn, domestic debt interest payments accounted for 10.6 per cent of total expenditures compared to a PRSP target of 4.5 per cent.

Overruns in current expenditures crowded out disbursements on some priority expenditure items, such as investment in roads and other infrastructures and poverty reduction programmes. Domestic capital expenditures accounted for only 7 per cent of total expenditures and were 50 per cent below target. Of these, expenditure on poverty reduction programmes was 76.5 per cent below target, amounting to less than 1 per cent of GDP. Underspending on poverty reduction programmes is a clear reflection of very weak political commitment, lack of monitoring mechanisms as well as capacity constraints at the local level. The failure to increase poverty reduction expenditure is another disappointment for the donor community, as the satisfactory implementation of the PRSP constitutes a major criterion of HIPC debt relief.

With the attainment of the HIPC completion point by the end of 2004, considered vital to the medium-term economic survival of the country, the government presented an "Austerity for Prosperity" budget in January 2004.

The budget puts emphasis on the accumulation of revenues, introducing two new personal tax bands at 35 and 40 per cent that is expected to increase the burden of taxation borne by the average middle-income earner in Zambia. This measure is highly controversial as it is likely to place more pressure on formal sector employees (only 450 000 individuals) and it fails to address the need to extend the tax base to the informal sector. Indeed, the budget also fails to contemplate measures to broaden the VAT base. Furthermore, the new tax increases are not expected to have a strong impact on budget revenue; against a background of already very high corporate and personal taxation, there is little scope to increase revenue further.

In terms of expenditure, the government committed to limit current expenditures and domestic borrowing requirements, while protecting priority social spending. Public sector wage rises have been frozen. However, the payment of the housing allowance for civil servants was set to continue in 2004. Despite these restrictive measures, overall budget deficits for 2004 and 2005 are expected to continue to be disappointing at 8.2 and 8.6 per cent of GDP respectively.

The principal focus of monetary policy in 2003 was to achieve an end of year inflation target of 8 per cent. The achievement of this objective was based on a broad money growth not exceeding 6.6 per cent. However, owing to slippages in fiscal policy, the inflation target was revised to 17.1 per cent and annual growth in

Table 2 - **Public Finances** (percentage of GDP)

	1995	2000	2001	2002	2003(e)	2004(p)	2005(p)
Total revenue and grants[a]	**29.0**	**23.2**	**24.8**	**26.2**	**23.6**	**22.2**	**21.7**
Tax revenue	18.2	17.3	18.6	17.5	16.4	15.4	15.1
Grants	9.1	5.7	5.7	8.3	6.8	6.4	6.2
Total expenditure and net lending[a]	**33.4**	**31.0**	**32.9**	**32.5**	**31.2**	**30.4**	**30.3**
Current expenditure	24.2	16.1	18.7	19.4	20.4	19.2	18.8
Excluding interest	*15.6*	*12.1*	*16.2*	*15.4*	*16.5*	*15.6*	*15.3*
Wages and salaries	5.9	5.3	6.8	8.0	8.8	8.1	7.7
Interest	8.6	4.0	2.5	4.1	3.8	3.6	3.5
Capital expenditure	9.1	10.0	11.9	11.8	11.2	10.9	11.2
Primary balance	**4.3**	**-3.8**	**-5.6**	**-2.3**	**-3.7**	**-4.6**	**-5.1**
Overall balance	**-4.3**	**-7.8**	**-8.1**	**-6.3**	**-7.6**	**-8.2**	**-8.6**

a: only major items are reported.
Source: Ministry of Finance and Economic Development and IMF data; projections based on authors' calculations.

money supply was adjusted consistently upwards to 16.9 per cent.

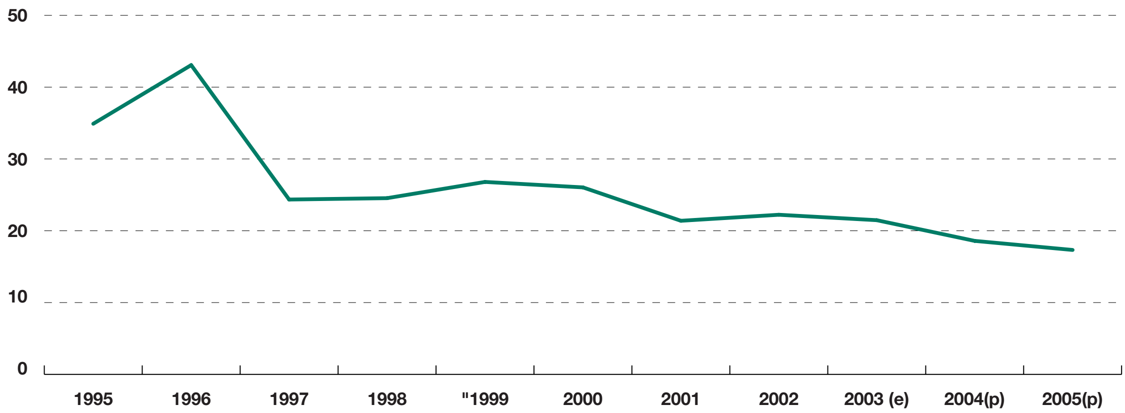
In addition, in order to stimulate private investment, the Bank of Zambia completed the conversion of kwacha statutory reserves on foreign currency deposits into US dollars to increase liquidity in the financial system and therefore allow for a reduction in interest rates. Further, the statutory reserve requirements ratio on both kwacha and foreign currency deposits was reduced from 17.5 per cent to 14 per cent. The reduction of the statutory reserve ratio was intended to release funds to commercial banks with a view to improving availability of funds in the banking system for lending to the real sectors, especially agriculture. However, despite this measure, and partly owing to the high inflation, lending rates remained high and unaffordable. The average lending base rate and the average lending rate fell only marginally to 38 and 45.6 per cent at the end of December 2003 from 38.8 per cent and 46.4 per cent at the end of September 2003 respectively.

Through the use of repurchase agreements and open market operations, the Bank of Zambia managed to increase its money supply by about 13.8 per cent with an inflation rate of 17.2 at the end of 2003, (the latter down from 26.7 per cent in December 2002). The decline of inflation towards the end of the year was also supported by a slowdown in food inflation, following the 2002/03 favourable crop harvest. On the contrary, annual non-food inflation rose in 2003, mainly due to an increase in petroleum product prices and the pass-through effects of the depreciation in the exchange rate of the Kwacha, particularly, against the South African Rand in the third and fourth quarters of 2003.

The 2004 budget set an end of the year inflation target of 15 per cent and indicated that interest rates should be in line with inflation by the end of 2004. While food inflation is expected to ease further in 2004, a recent announcement by the Energy Regulation Board to adjust retail prices of petroleum products upwards and risk of slippages in fiscal polices may contribute to building up inflationary pressures in the economy. Despite continued tight monetary policy, inflation is therefore expected to decrease only moderately to 18.6 per cent in 2004 and to 17.3 per cent in 2005. Real interest rates are expected, however, to remain high, owing to the need to attract investment into government securities in order to sustain the government's borrowing requirement.

In 2003, the performance of the kwacha against major trading currencies was mixed. While the kwacha depreciated by 33.7 per cent against the South African rand, it appreciated by 3.3 per cent against the dollar, from K4740 per US dollar in December 2002 to K4583.8 per US dollar in December 2003. The appreciation is attributable to a series of factors, including the introduction of a broad based inter-bank

Figure 5 - **Annual Average Inflation Rate**



Source: IMF and Central Statistical Office data.

foreign exchange system in July 2003, the favourable earnings from copper exports due to high copper prices and the weaknesses of the US dollar against major international currencies.

External Position

Since 2000, Zambia has entered into a number of trade agreements, including the Common Market for Eastern and Southern Africa (COMESA) Free Trade Area, and the Southern African Development Community (SADC) Trade Protocol. Moreover, it has been granted preferential access to the US African Growth and Opportunity Act (AGOA) arrangement, and the EU Everything but Arms initiative. The impact of these arrangements has been mixed, however, especially because Zambian exporters have not been able to take advantage of their provisions to the same extent as other partners in AGOA. The Zambian government has been criticised for its inactivity and lack of timeliness in implementing trade agreements. For example, extended delays in meeting the requirement for AGOA eligibility in 2001 resulted in lost business for some textile companies. Moreover, as highlighted in the manufacturing section, regional competition appears to have increased, affecting negatively local firms' domestic market sales. This is mainly due to the disadvantaged position of Zambian firms with regard to basic competitive factors, such as interest rates and utility and cement prices, compared to the other countries in the region.

More than 60 per cent of total imports come from South Africa, which supplies mining equipment, chemicals and processed foods. It should be noted, however, that imports from many neighbouring countries and especially Zimbabwe are underreported as much of the cross border trade, particularly in manufacturing, is unrecorded. Smuggling of manufacturing products from Zimbabwe appears to have intensified over the past two years, owing to the currency distortions in that country.

Total export earnings are estimated to have increased by 24 per cent because of increased metal exports, especially towards East Asian economies. Metal export earnings benefited mainly from the rise in international copper and cobalt prices as well as increased volumes. Further export earnings emanated from increased export volumes of cotton lint, tobacco and copper rods and cables. On the other hand, imports recorded an increase of 15.3 per cent in 2003 owing to increased import volumes of petroleum, building materials, and fertiliser.

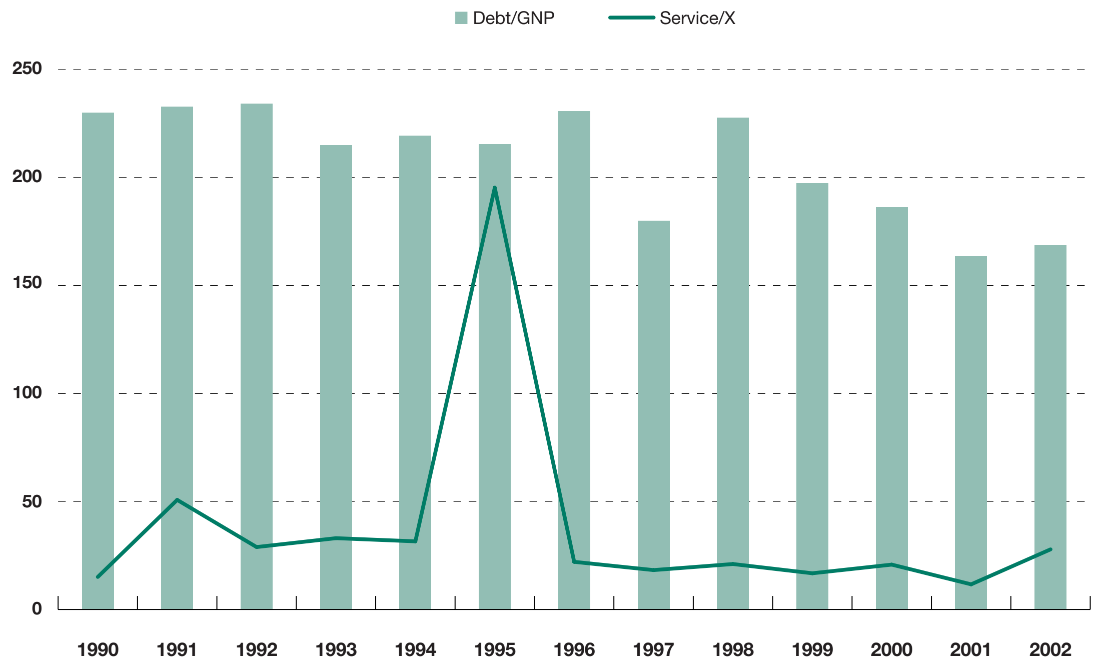
In 2004, the external position is expected to further improve on the back of increasing copper prices and expected increase in volumes due re-investment in the copper mines. The gains are expected to be even more pronounced in 2005, when KCM and RAMCOZ mines' rehabilitation is expected to bear fruit. The trade balance in 2004 and 2005 is expected therefore to average 1.8 and 1.7 per cent of GDP respectively.

Table 3 - **Current Account** (percentage of GDP)

	1995	2000	2001	2002	2003(e)	2004(p)	2005(p)
Trade balance	-0.2	-6.8	-9.8	-7.8	-6.6	-1.8	-1.7
Exports of goods (f.o.b.)	34.2	23.4	24.9	24.8	25.4	28.3	28.2
Imports of goods (f.o.b.)	-34.4	-30.2	-34.7	-32.6	-32.1	-30.1	-29.9
Services	-5.6	-6.9	-6.3	-6.6			
Factor income	-7.0	-4.5	-3.8	-4.2			
Current transfers	8.6	-0.6	-0.6	0.2			
Current account balance	**-4.2**	**-18.8**	**-20.6**	**-18.4**			

Source: Bank of Zambia and IMF data; projections based on authors' calculations.

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



Source: World Bank.

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 attributed mainly to the implementation of the Paris Club Agreed Minute of September 2002 through which Paris Club 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 due also to debt repayment amounting to $113.1 million in 2003.

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

As mentioned earlier, slippages in the economic programme with the IMF resulted in the failure to achieve the HIPC completion point scheduled for the end of 2003. The government has been placed on the Staff Monitored Program (SMP) to assess its progress towards macroeconomic stability. The government's commitment to IMF programmes is necessary to institute a new Poverty Reduction Growth Facility (PRGF). In this respect, the budget framework for 2004 was considered satisfactory for the IMF in order to proceed to a new PRGF arrangement. In turn, a satisfactory performance under PRGF program will allow the country to reach the completion point in December 2004, thereby accessing maximum debt relief amounting to $3.8 billion. The reaching of the completion point is also dependent upon the successful implementation of the Poverty Reduction Strategy Paper. The assessment of intermediary targets shows, however, that many programs envisaged by the PRSP, especially in the health and structural reforms have been implemented only partially.

Structural Issues

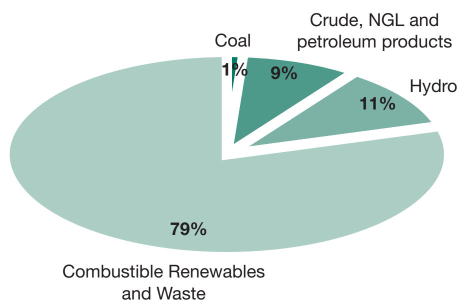
The 1990s were characterised by substantial trade liberalisation, privatisation, and deregulation of prices under donor-advised structural adjustment policies. The advent of President Mwanawasa in 2001 signalled a return to the doctrine of self-reliance. He adopted a more critical stance towards privatisation and in favour of a "Zambianisation" of the economy. As mentioned earlier, in spite of the government's encouragement of citizen empowerment, private sector participation in the economy is limited, undermined by weak macroeconomic stability, lack of dialogue with the government, critical infrastructure bottlenecks and high import duties on fuel and other essential inputs which all make investment planning difficult with increased uncertainty and risk.

A part from petroleum, which is wholly imported, Zambia has abundant energy sources, including fuel wood, hydropower, coal and renewables such as solar, wind and biogas.

As woodlands and forests cover about 66 per cent of the total land area, wood fuel in the form of firewood and charcoal is the principal source of energy in the country, accounting for 79 per cent of total energy supply. The second largest indigenous source of energy is hydropower, contributing 12 per cent to national energy supply. Most commercial energy needs are met from the country's hydroelectric stations, namely Kafue Gorge (900 MW), Victoria Falls (108 MW), owned and operated by the state-owned Zambia Electricity Supply Company (ZESCO) and Kariba North Bank[1] (600 MW), and other small hydro and diesel stations. The mining industry is the largest energy user, consuming about 70 per cent of total supply while industrial users account for 15 per cent.

The total installed electricity generating capacity in Zambia is 1780 MW, which represents only a quarter of the country's potential, estimated at 6000 MW. However, despite the availability of excess installed capacity, accessibility of electricity to the majority of the population remains low. About 21 per cent of the urban population has access to electricity and only

Figure 7 - **Structure of Domestic Energy Supply in 2001**



Source: International Energy Agency.

1. Owned by Kariba North Bank Company.

2 per cent have it in rural areas. In addition, power distribution suffers from technical and non-technical losses, associated to illegal connections that lead the distribution sector to operate at a huge loss.

Plans to rehabilitate the distribution infrastructure and increase accessibility to electricity by the majority of the population through liberalisation of the sector and privatisation of the generation and distribution functions were already contained in the National Energy Policy formulated in 1994. Over the past ten years, however, there has been no progress in this direction. ZESCO is still vertically integrated, holding the monopoly of generation, transmission and distribution.

In 2002, the Energy Regulation Board proposed a programme to restructure the industry through the unbundling of the generation, transmission and distribution functions, placing them under private management. Privatisation of ZESCO also became one of the objectives set in agreement with the IMF in order to reach the HIPC completion point. However, in April 2003, the government announced that ZESCO would be commercialised, leaving aside the proposal of unbundling the company. The road map towards commercialisation will involve the appointment of a board of directors independent from government interference and the implementation of a broader energy policy framework. Performance under this new arrangement will be reviewed at the evaluation point of the HIPC objectives, scheduled for June 2004. Another government priority is to unlock the country's huge hydropower potential, by attracting foreign investment. This makes the need to restructure the industry and eventually unbundle generation from transmission and distribution pressing.

In terms of increased access to electricity, at the end of 2003 the parliament discussed the creation of a Rural Electrification Authority in charge of developing and implementing rural electrification master plans for the systematic electrification of rural areas. The functions of the authority will include: developing mechanisms for the operation of a grid extension network for rural electrification as well as applying a smart subsidy for capital costs on projects designed to supply energy in rural areas. The rural electrification programme also contemplates the use of solar technology that has been applied so far only in pilot projects, with encouraging results.

Petroleum is fully imported through the 1704 km Tazama pipeline, jointly owned by Zambia and Tanzania, which transports crude oil from Dar es Salaam to Nodla and the Indeni refinery. Until 1999, petroleum imports were handled by the Zambian National Oil Company (ZNOC). In 2002, ZNOC was liquidated and the government proceeded with the liberalisation of oil procurement. The marketing and distribution of petroleum products is undertaken by privately owned oil marketing companies that have been licensed to import and retail petroleum products, as well as purchase refined products from the Indeni refinery. Zambia's retail petroleum prices remain, however, among the highest in the region owing to high transport costs, the weak domestic currency as well as the incapacity of the Indeni refinery to guarantee supply.

A structured, finalised privatisation programme was launched in July 1992 with the enactment of the Privatisation Act of 1992, which set out the legal basis of the privatisation programme and attributed responsibility for all government privatisation issues to the Zambia Privatisation Agency (ZPA). The divestiture programme envisaged different phases, starting from privatisation of small and medium enterprises, and then proceeding to the larger companies. A total of 259 State Owned Enterprises (SOEs) had been privatised as of 31 December 2003 out of a working portfolio of 283 SOEs. While there has been progress in privatising SOEs, the largest companies in vital economic sectors such as utilities, oil and finance are still state owned.

With President Mwanawasa's arrival in power, there has been a change in policy regarding privatisation of the largest SOEs. Contrary to the plan envisaged by the 1992 privatisation programme, the government has chosen to commercialise the telecommunications, energy and insurance parastatals. However, it is committed to completing the privatisation of the Zambian National Commercial Bank (ZANACO) as its sale is part of the objectives set in agreement with the IMF to reach the HIPC completion point. In this respect, major negotiations took place in early 2004 between the government and the two interested bidders for the 49 per cent of ZANACO, namely: the Amalgamated Bank of South Africa (ABSA) and Africa International Financial Holding (a consortium of HSBC, the European Investment Bank, the International Finance Corporation, Netherlands Development Finance Organisation, and the National Bank of Malawi). The government will retain a 25 per cent stake in ZANACO and 26 per cent will be sold to Zambians through the Zambia Privatisation Trust Fund, for future floatation.

In the mining sector, after a delayed and problematic privatisation of the Konkola Copper Mines (KCM) in 2000, which ended with the withdrawal of the investor, Anglo American, from the mine, there were new developments in 2003. In particular, negotiations with the Indian Sterlite Industries for the acquisition of KCM took place throughout the year and are expected to conclude in mid-2004, while 85 per cent of RAMCOZ mine has been bought by the Swiss Firm J&W Investments.

In the transport sector, a major development in 2003 has been the concession of Zambia Railways Limited to a consortium comprising New Limpopo Bridge Project Investments and Spoornet from Israel and South Africa, respectively. The concession will run for a period of 20 years.

Transport infrastructures in Zambia consist of a road network of 37 000 km of primary, secondary and tertiary roads, a rail network of approximately 1 700 km, one international and three regional airports. Over the years, the road sub-sector has taken the largest share of the cargo haulage business, which has resulted in increased pressure on the roads from heavy goods' vehicles. This, coupled with poor road maintenance, has contributed to the rapid deterioration of the road network. The main problems have been institutional and financial, which relate to inadequate and erratic flow of funding and lack of clearly defined responsibilities among road management actors.

The poor state of rural feeder roads inhibits mobility and accessibility. As a result, access to farm inputs and marketing of farm products is also made very difficult and thus deepens poverty in rural areas, where 62 per cent of the population lives. Moreover, owing to inefficiencies in the transportation network, transport costs account for about 60 to 70 per cent of the cost of production for many goods, fuelling goods' prices and undermining the competitiveness of Zambian exports.

Road repairs have been undertaken under the Road Sector Investment Programme (ROADSIP), which is a partnership between road users, the government and donors. The project started in 1998 and during the first three years of implementation substantial improvements to the paved road network have been achieved. In particular, the percentage of paved roads in good condition rose from 20 per cent in 1995 to 44 per cent in 1999. Under the 2002-04 Poverty Reduction Strategy Paper, ROADSIP II has been launched in order to continue with the objective set in the first phase.

The rail network comprises the Zambia railways, running from the Zimbabwean border in the south to the Congolese border, and the Tanzania Zambia Railways (TAZARA), jointly owned by Zambia and Tanzania, which links the former to the port of Dar es Salaam. As mentioned earlier, in July 2003 Zambian Railways was given in a 20-year concession to New Limpopo Bridge Project Investments and Spoornet. Through greater investment in the company, the consortium aims at reversing the sharp decline in passenger transport and boosting freight volumes.

Over the past years, increasing inefficiency of TAZARA's service delivery has led to a decline in trade through Dar es Salaam to the advantage of the ports of Durban, and Beira, in South Africa and Mozambique, respectively. This reduction in market share has put pressure on the *parastatals* and in 2003 the government approved private sector participation in running TAZARA. The study of options for private sector participation is expected to commence in 2004.

Political and Social Context

Zambian political history has been relatively stable compared to many other states in sub-Saharan Africa. However, the stability masks deep running problems. In 1991, the Movement for Multiparty Democracy, led by Mr Chiluba, came to power, promoting the transition from a centrally-planned economy, in place since independence in 1964, to a market-led economy. Although the newly liberalised political environment opened the way for comprehensive economic reforms, the Chiluba era (which lasted for a decade) was highly characterised by allegations of corruption and political interference in economic sectors.

In December 2001, Zambia held presidential, parliamentary and local government elections. Despite the fact that EU monitors judged the procedure to be neither free nor fair, Mr Levy Mwanawasa of the ruling party was appointed president with a slim victory: 29 per cent to 27 per cent.

In response, opposition leaders launched a challenge in the Supreme Court in early 2002. The case is expected to last for some time however, probably even beyond the next presidential election, scheduled for 2006. The outcome of the trial is thus likely to be undermined.

After winning a number of by-elections in 2003, the ruling party has secured a parliamentary majority for the first time since the 2001 elections. Moreover during 2003, in an attempt to reinforce his position and divide the opposition, the president appointed members of opposition political parties to his government. However, this move has been seen as way to reach out to the opposition and has caused a lot of acrimony between the ruling party and the opposition.

Since his appointment, Mr Mwananwasa has embarked upon an anti-corruption crusade. A number of high profile former government ministers were charged with corruption and abuse of public office, including the former president, Chiluba. The parliament lifted Chiluba's immunity in July 2002 and he was charged with 59 counts of theft and diversion of state funds. The trial started in the last quarter of 2003.

Despite the zero tolerance initiative against corruption, President Mwananwasa is criticised for having made extensive use of patronage to consolidate his position following the disputed election victory and he shows no intention of reforming the patronage system. Furthermore, corruption of public officials and misuse of public funds continue to be widespread in the country, as suggested by the severe problems encountered in executing budgets allotted to development purposes, which naturally inspires suspicion of malfeasance. Zambia was ranked 92th — out of 133 — on Transparency International's Corruption Perception Index in 2003.

A clear and relatively reliable picture of poverty in Zambia is provided by the results of the Demographic and Health Survey (ZDHS) of 2000/01. Geographically, there is a clear degree of polarisation between the urbanised areas going on the "rail line" from north to south in the centre of the country, and the vast predominantly rural areas at the north, east and west of the country. The division is reflected, for instance, in terms of literacy levels, child mortality rates, life expectancy, access to safe water, electricity, sanitation, and quality of housing. Education and health facilities in rural, remote areas are severely understaffed and there are no incentives for medical or paramedical staff to move there. In the western province, for example, there is one medical doctor for over 30 000 people.

Zambia has its own definition of absolute poverty (about $0.50 per day) and of moderate poverty (about $0.78 per day). According to these definitions, absolute poverty has remained stable throughout the 1990s in Zambia, but overall poverty has increased, from 69.7 per cent of the population in 1991 to 72.9 per cent in 1998 (83.1 per cent in rural areas, and 89 per cent in the western province, compared to 56 per cent in urban areas). The poor households in the areas where maize is the prevailing food crop are also subject to recurrent food security breakdowns. Underweight prevalence for children under five years of age is 28.1 per cent, compared to 22.5 per cent in Uganda and 25.4 per cent in Malawi.

Interventions to promote poverty reduction were included in the joint government-donor Poverty Reduction Strategy Paper. Owing to lack of government will and political uncertainties, the preparation of the PRSP underwent long delays and was completed only in early 2002. 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)[2] and at achieving strong sustained economic growth. Although agriculture was the priority, the document set out goals and policy actions in other areas such as industry, mining, tourism, health and education.

However, the intermediate assessment of the progress achieved by the implementation of the PRSP reveals disappointing results. According to poverty monitoring surveys conducted by local civil society groups, poverty levels have not shown signs of decline despite more than one year of implementing the PRSP by the government. Food insecurity continues to characterise some remote areas owing to inadequate access to farm implements, inputs, credit and markets, which in turn are due to the poor road infrastructure and inadequate extension services. Furthermore, as examined later, the education sector continues to be constrained by inadequate staffing, insufficient teaching material, HIV/Aids, and poor infrastructures. No notable progress has been made towards the provision of safe and clean water and sanitation facilities. Even in industry, tourism, and mining the survey revealed that no notable strategies identified by the PRSP were implemented. The only sector that seemed to have recorded positive developments was the health sector, particularly in certain sites such as rehabilitation of health centres, decentralisation and autonomy in the form of Traditional Birth Attendants (TBAs) and Community Health Workers, as well as a modest improvement in staffing levels. However, the sector continues to suffer from the high cost of health services as well as inadequate bed spaces.

There may be several explanations for the limited progress of the PRSP measures. The major explanation lies in the government's failure to disburse all the resources earmarked for poverty reduction. As mentioned earlier, only a paltry 25 per cent of the total amount earmarked for poverty reduction programmes during the 2002 and 2003 fiscal years was actually disbursed. Other related reasons include the low level of knowledge and understanding of the PRSP at district levels leading to a lack of linkages between district development plans and the national PRSP. In addition, the government is criticised for not providing adequate information on PRSP implementation to the beneficiaries of the poverty reduction programmes.

The ZDHS showed that 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). There are some indications that the HIV infection rate for young adults is decreasing as the proportion found to be HIV positive increases from 5 per cent among 15-19 year olds to 25 per cent of 30-34 year olds, before falling to 17 per cent of 45-49 year olds. The most worrisome finding from the ZDHS is that almost 50 per cent of the women in the 15-49 age bracket in urban areas are infected with HIV. Mobility is one of the determining factors of the spread of HIV/Aids. After urban areas, prevalence of HIV/Aids is highest along the major transport routes. The 2001-02 ZDHS shows the association of HIV with high adult mortality. Lusaka, Copperbelt and Southern provinces appear to have both the highest adult mortality levels and they are also associated with high HIV levels. The adult mortality levels in these areas are 60 per cent higher than in the northern and north-western provinces, with the average mortality rate about 14.6 per 1 000 in the 15-49 age group.

Although government and donor communities have designed programmes and allocated substantial resources to fight the disease, specific policy responses have been delayed or only partially implemented. This is attributable to the low absorptive capacity of the districts and hospitals and to the brain drain that affects the sector. The country is left with 700 doctors and more than 2 000 nurses have left the country to go to the United Kingdom over the past year. In the framework

2. Rural poverty is to be reduced from 83 per cent to 75 per cent and urban poverty from 56 to 50 per cent.

of the Global Fund supported programmes, the government committed itselfto provide antiretroviral drugs to 10 000 people per year and announced its intention to extend provision to 100 000 people in 2005. However, in 2003, only 3 000 people had access to antiretroviral treatment, which was offered only in two country hospitals. The slow uptake is mainly explained by the high cost of hospitalisation associated with antiretroviral treatment. This amounts to K500 000 ($105) per day, corresponding to the monthly salary of a public servant. Another important constraint is the lack of trained people able to provide the treatment.

In terms of other health indicators, the 2001/02 health survey indicated a deterioration of the under-five mortality rate from 162 per 1 000 in 2000 to 168 per 1 000 in 2002, while malaria incidence also seems to have increased from 80 per cent in 2000 to 110 per 1 000 in 2003.

Health policy is based on the five-year National Health Strategic Plan, launched in 2001. One of the main features of the organisational and institutional restructuring of the public health system was decentralisation from the central to the district levels. While some district hospitals have been rehabilitated under the PRSP, erratic drug supply and difficult physical access to health centres continue to pose serious challenges. In addition, the existence of health user fees continues to impede access for the very poor.

Government health expenditures accounted for 2 per cent of GDP in 2002. The 2002 budget execution report reveals some interesting figures: out of K5 billion ($1.05million) allocated for the malaria programme only K500 million ($105 000) was disbursed; and only 25 per cent of the resources allocated for the rehabilitation of hospitals was spent. This, while K1 billion ($ 211000) was budgeted for aircraft purchases, the total disbursement was K3 billion ($631 000).

Following the abolition of fees for government primary schools in 2002, enrolment in primary education increased 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. Despite this progress, barriers to improved education persist. Examination fees remain a big hindrance to progression beyond grade 7.

Moreover, secondary education suffered major problems in 2003. Following the overrun in expenditures in 2003 that led to the suspension of the PRGF, 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 education sector policy was laid down in 1996. The Basic Education Sub-Sector Investment Programme (BESSIP) is the main instrument for implementing that policy. Targets included improved school infrastructure, sufficient textbooks and resources, more and better-educated teachers, expanded access for girls, and improved health and nutrition. Under the PRSP, the BESSIP programme would have been extended to secondary schools. According to the PRSP monitoring carried out by a civil society group, most schools continue to suffer from erratic supplies of learning material. Furthermore, little has been done to improve district infrastructure, and no improvements have been reported in health and sanitation at school. Zambia's HIV/Aids crisis further undermines the educational system by significantly increasing teacher absences and attrition rates and causing dramatic increases in the number of school-age orphans. According to the Ministry of Finance and Economic Development, the government spent 3 per cent of GDP in 2002 and 2003 on education, which is below the benchmark for the HIPC completion point. It requires that 20.5 per cent of the domestic discretionary budget go towards education.

