Zambia

key figures

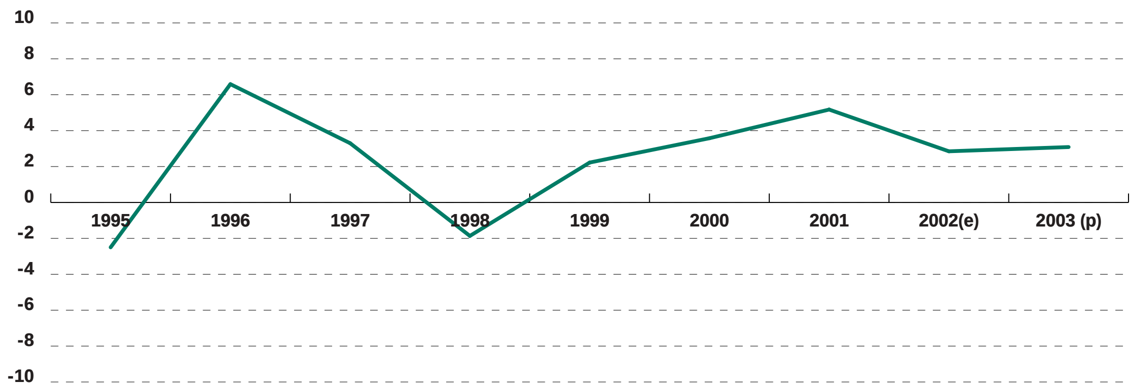
• Land area, thousands of km^2	753
• Population, thousands (2001)	10 649
• GDP per capita, $ (2001)	339
• Life expectancy (2000-2005)	42.2
• Illiteracy rate (2001)	21.1

Zambia

In 1991 Zambia started a radical reform path that transformed it from a centrally planned to a market economy. This dramatic change, which entailed privatising the initial close-to-80 per cent share of public economic activity and liberalising prices for most commodities, revived the economy and resulted in a good growth performance for the first half of the 1990s. Nevertheless, the government has not been very successful in diversifying the country's export base away from its heavy dependency on copper, or managing its expenditures more efficiently, whose funding still strongly rely on foreign assistance, or, and most importantly, reducing poverty. These shortcomings originate mainly from delays in the implementation of structural reforms. Economic performance improved significantly in 2001 — GDP grew by 5.2 per cent — thanks to the recent investments in the privatised copper sector. However important tests await the new government, elected in December 2001: the pull out of the Anglo-American Corporation (the major private shareholder in the largest mining

Improving economic governance and diversifying away from mining have become Zambian priorities

Figure 1 - Real GDP Growth



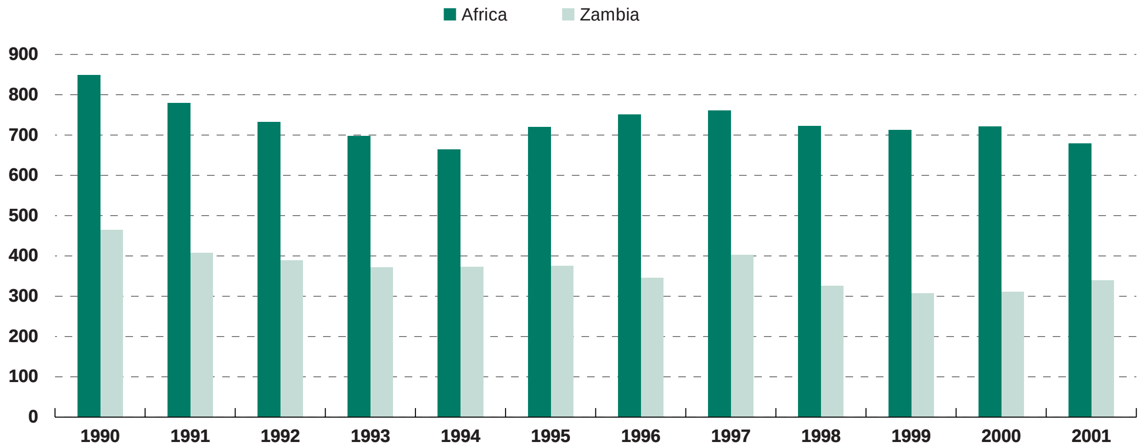
Source: Authors' estimates and predictions based on Central Statistical Office data.

company in the country) may result in severe economic disruption. Output of the main staple crop, maize, has been meagre, following the massive drought that hit the country in 2002, and its forecasts are not encouraging. Crucial foreign aid ever more depends on domestic good governance; the aids pandemic is not declining while its devastating effects have not yet fully materialised. Growth for 2002 and 2003 is therefore expected to be below target at about 2.8 and 3.1 per cent, respectively. The government medium-term strategy for growth and poverty reduction is outlined by the Poverty Reduction Strategy, issued in May 2002, which sets macroeconomic targets and policy actions in order to reduce poverty and promote the diversification away from mining. In support of Zambia's commitment to the economic programme, at the Consultative Donor meeting held in July 2002, the donor community pledged about $1.3 billion for 2003 and 2004.

Recent Economic Developments

Zambia's recent economic performance suffers from a mix of domestic and international unfavourable factors. On the domestic side, the government

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



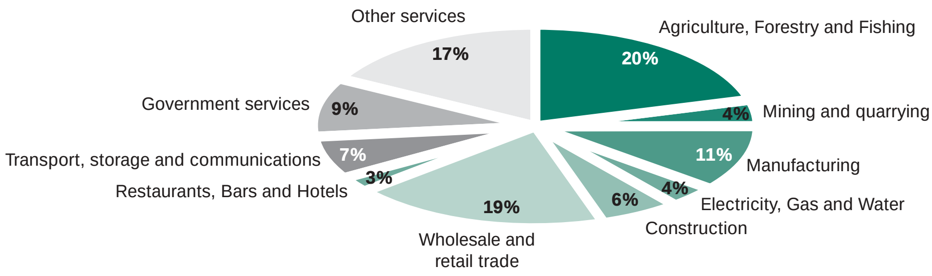
Source: Authors' estimates based on IMF.

privatisation strategy has been hesitant when dealing with some crucial sectors (particularly those considered strategic institutions): copper mining was privatised only in March 2000, and the energy, telecom, and financial sectors are still to be privatised. Inefficient and under-capitalised SOEs in these sectors have kept generating losses, which, together with the 2001 presidential elections and the Organisation of African Unity (OAU) summit's exceptional expenditures, created serious budget problems for the Zambian government. The external factors such as lower copper prices, the shrinking of foreign budget support, and regional tensions (Angola, Congo and recently Zimbabwe), have worsened the situation and further limited the government resources to stimulate economic growth, even if the external debt burden has been significantly reduced on account of the Heavily Indebted Poor Country (HIPC) initiative. In spite of good GDP growth in 1996 (which was over 6 per cent following a good harvest) growth in the rest of the 1990s was either negative or slightly positive. In contrast with this gloomy picture, real GDP grew by 5.2 per cent in 2001, owing mainly to an increase in the mining production fuelled by improved efficiency of the privatised mines. Unfortunately though, forecasts for 2002 and 2003 are not as favourable as hoped: in particular the pull out of Anglo-American Corporation and the massive drought that hit the country in 2002 have determined a 2002 GDP growth of 2.8 per cent. In 2003 growth is forecast at 3.1 per cent.

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 into export oriented agriculture, light manufacturing, small scale mining and tourism. In this light, diversification programmes and dialogue with support from the World Bank have commenced with a series of consultative workshops, particularly with the Copperbelt business community, which is largely dependent on the mining sector.

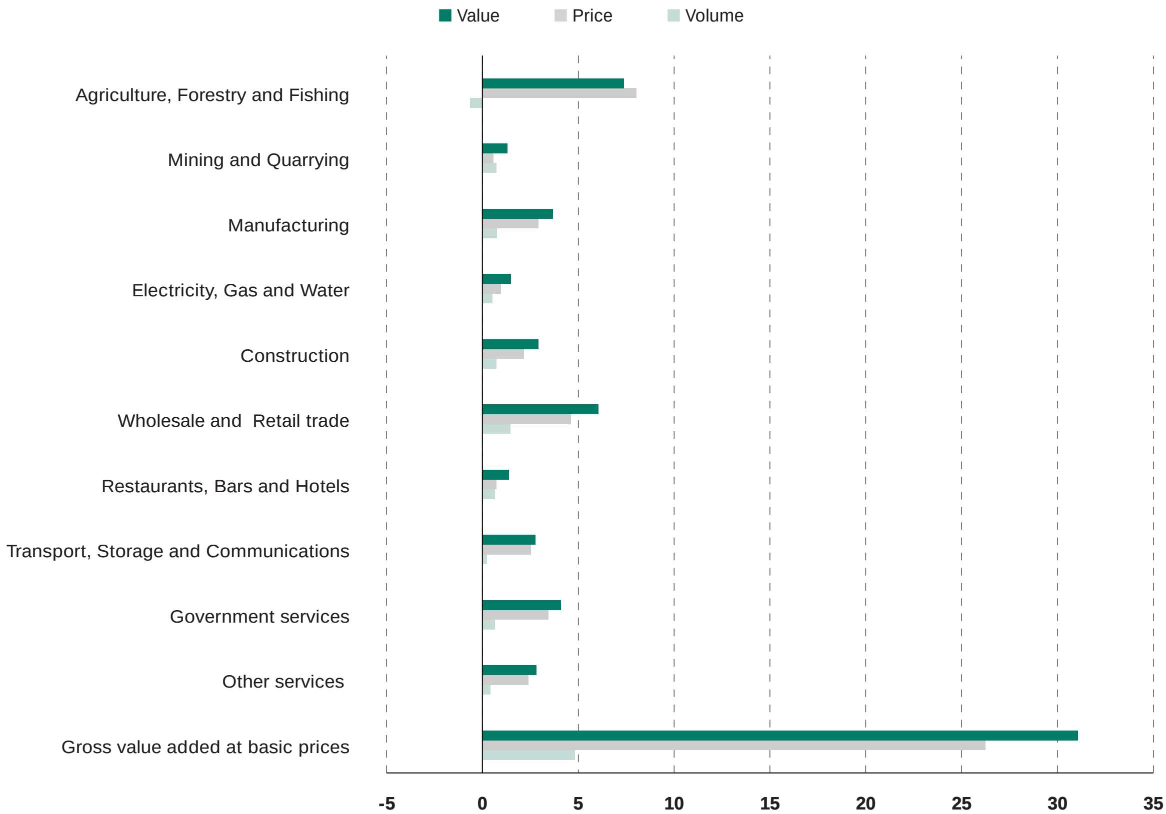
Zambia is well endowed with mineral resources and the country derives most of its foreign earnings from the export of minerals. The mining industry, which is dominated by copper and a few other minerals, namely, zinc, silver, gold and cobalt, has been the most important driving force of economic development in Zambia for over 70 years. However, owing to decreasing world prices in copper, poor investments in new and existing mines and unsupportive management practices, copper production has declined and its contribution to the sector on GDP has progressively diminished, from 19 per cent in 1992 to around 4 per cent since 1999. However, in 2001, the sector recorded a real growth of 14 per cent compared to a growth of only 0.1 per cent in 2000 and a decline of 24.8 per cent in 1999. The rebound of the mining sector was mainly due to a recovery in copper and cobalt production, arising from recapitalisation and investment activities, following privatisation of the mines in 2000. However,

Figure 3 - GDP by Sector in 2001



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

Figure 4 - Sectoral Contribution to GDP Growth in 2001



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

there are increasing uncertainties about the prospects of the mining sector, following the decision (January 2002) of the major shareholder in the largest mining company, the Konkola Copper Mines (KCM) to withdraw from the company and its exit in August 2002[1]. KCM's investment plans have been reduced and its output is estimated to contract. The outlook for production remains therefore uncertain, depending mainly on the performance of the smaller copper mining firms. The dominant position of copper mining in the economy has largely overshadowed the exploitation of other potential mineral resources,

1. The structural section provides a detailed illustration of the privatisation process and current situation of the mining companies.

particularly in the field of gemstone and industrial mineral, which offer great potential.

Agriculture, fishery and forestry, which account for 20 per cent of Zambian GDP, shrunk by 2.6 per cent in 2001. Compared to many other Southern African countries, Zambia has relatively abundant land and water. Some of 58 per cent of Zambia's total land area is considered as medium to high potential for agricultural production, however, only 14 per cent of Zambia's total agricultural land is currently being cultivated. The unused potential and the sector's high dependence on seasonal rainfall lead to a highly variable performance and very often food security is not guaranteed. In the 2000/01 crop season, agriculture under performed owing to scanty rains in most parts of the country at the beginning of the season, followed by excess of rainfall in some areas, and prolonged dry spells in the southern regions. The national production of maize, which is the main food crop, decreased by about 30 per cent compared to the 1999/2000 crop season (from 1 053 000 to 802 000 metric tonnes). The situation deteriorated even further in the following crop season since drought in early 2002 led to a maize shortage of 635 000 metric tonnes. It is estimated that the 2001/02 crop production will only feed 6 million people out of a total population of more than 10 million. In May 2002, as a consequence of massive drought, the Zambian government declared a national disaster with regard to food insecurity and water shortage in the southern province and asked for urgent donor assistance. In order to cope with this emergency, the World Food Programme (WFP) and many donors became involved in food aid programs. However, owing to the government's reluctance on importing genetically modified grain, the WFP imports have been limited, leaving the bulk of import to government and the private sector.

There are two main categories of farmers in Zambian agriculture: small scale and medium-large scale. Small-scale farmers are mainly subsistence producers of maize, while medium-large scale farmers produce surplus maize and other cash crop, 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 the total land in Zambia falls under the customary land tenure system controlled and allocated by traditional authorities (village chiefs) which leads to inefficient land resources allocation and is an additional factor inhibiting the sector's growth potential. In the 1970s and 1980s, the government was highly interventionist in the agricultural sector, encouraging maize production, guaranteeing the purchase of maize at fixed prices from producers and subsidising its sale to urban consumers. Credit schemes for the purchase of fertilisers were implemented, however they failed owing to the very low rate of loan recovery. Moreover, on account of policy bias in favour of maize, infrastructure and service support to the agricultural sector discriminated against other equally rewarding activities in this sector. Since the Movement for Multiparty Democracy (MMD) came to power in 1991, it has been government policy to take steps to withdraw from the provision of agricultural inputs, to end the guaranteed maize purchases and consumer subsidies, and to privatise the mills. Against these goals and principally in response to the past poor performance of the agricultural sector, the Agricultural Sector Investment Programme (ASIP) was launched in January 1996. While the programme succeeded in promoting the diversification away from maize towards higher value added crops (i.e. cotton, tobacco, sugar, vegetables and flowers) and in the restructuring of the Ministry of Agriculture, failures were experienced in ensuring national and regional food security, and in promoting private sector involvement in commodity marketing and input supply. The main challenges faced by the sector include poor service delivery for small-scale farmers, marketing constraints in outlying areas as a result of poor infrastructure (notably feeder roads), a void in agricultural finance and credit, a weak regulatory framework, and poor accessibility and administration of land.

The new government, elected in December 2001, has set agriculture as the priority sector to promote Zambian economic growth and announced radical moves to tackle shortages, including contracting with large-scale farmers to produce maize under irrigation, construct dams, and provide fertilisers and pesticides to smallholders. Furthermore, the government intends to create a Crop Marketing Authority (CMA) that will be a buyer of last resort and which will maintain strategic reserves.

The manufacturing sector, which accounts for 11 per cent of GDP, registered a growth of 5.8 per cent in 2001. Besides the fabricated metal product sub-sectors, which registered a decline of 4 per cent in value added, all the sub-sectors of manufacturing recorded an increase. Food, beverages and tobacco, which are the largest manufacturing sub-sectors, grew by 5.1 per cent. This performance was due to the improved access of Zambian products to markets in the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and the EU following the signing of the SADC Trade Protocol and the coming of the Free Trade Area (FTA) in COMESA. In addition, textile and leather products, which represent the second biggest contributors to manufacturing, grew by 6.8 per cent, mainly owing to increased export demand for textile products such as cotton yarn and lint. Increased activity on the mines led to additional demand for basic metals. Despite these positive achievements, the development of the sector is constrained by a series of bottlenecks. These include a narrow export base, unfair competition arising from smuggling and export subsidies in some trading partner economies. Other constraints, which will be further discussed in the structural section, are lack of long-term capital, high cost of energy, and inadequate infrastructure.

The major contributors to the service sector are wholesale and retail trade, which accounts for 19 per cent of GDP. In 2001, wholesale and retail trade grew by 6.0 per cent. Tourism is also growing and its development is strongly encouraged by the authorities. The rapid growth of the sector is nevertheless constrained by several factors, such as inadequate infrastructure and marketing and Zambia's reputation of being a high cost destination (owing to expensive air transportation). Despite these shortcomings, the trend of tourist arrivals and investments has steadily increased in the last five years. In 2001, the solar eclipse, as well as the OAU Heads of State Summit accounted for much of the growth in both arrivals and earnings. Furthermore, the opening of the Sun International Hotels in Livingstone near the famous Victoria falls in 2001 also boosted the tourism sector. It is estimated that Restaurants, Bars and Hotels subsectors grew by 24 per cent in 2001 compared to 12 per cent in 2000.

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Gross capital formation	**13.1**	**17.6**	**18.6**	**20.0**	**20.7**	**20.4**
Public	9.1	10.6	9.9	11.6	12.3	12.1
Private	4.0	7.0	8.7	8.4	8.4	8.2
Consumption	**92.7**	**92.8**	**95.2**	**95.8**	**94.8**	**94.2**
Public	16.6	13.9	13.8	17.2	17.7	18.0
Private	76.6	78.9	81.3	78.6	77.1	76.2
External sector	**-5.8**	**-10.4**	**-13.8**	**-15.8**	**-15.5**	**-14.5**
Exports	37.0	26.9	26.9	29.2	29.1	28.7
Imports	-42.8	-37.3	-40.7	-45.0	-44.6	-43.2

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

In 2002 and 2003, private investments are estimated to decrease as a consequence of the uncertainty surrounding the future of the KCM mines, while public investment continue their growing trend according to the increase in capital expenditures envisaged in the budget and in the Poverty Reduction Strategy. Government consumption is also estimated to rise on account of the increase in agricultural spending.

Macroeconomic Policy

Fiscal and Monetary Policy

During the 1990s, the Zambian economy suffered from high inflation, budget and current accounts deficits and exchange rate volatility.

Table 2 presents a more detailed quantitative analysis of government fiscal policy. On the revenue side, its main features are: a quite balanced distribution of revenues across different sources — such as income taxes, domestic and international trade indirect taxes; a strong dependency on foreign support — grants represented around 30 per cent of total revenues in 1999 and have shrunk to around 25 per cent in 2000 and 23 per cent in 2001; and a reduction in non tax revenues, mainly due to a decline in privatisation receipts. It should be noted that, in 2001, tax revenues, especially direct taxes, but also trade taxes, have produced better than expected results due to sustained GDP growth. On the other hand, mineral royalties have diminished, on account of tax exemptions granted to the newly privatised mines. Additionally, general budget support grants, in contrast to specific project grants, have recorded a sharp reduction due to donors' concerns over Zambia non-compliance of some conditionalities regarding the implementation of structural reforms. In total, external programme assistance has declined from $539 in 1999 to $376 million in 2001.

On the expenditure side, most of the current expenditures are non-discretionary and linked to wages and salaries (6.8 per cent of GDP in 2001) and other recurrent government operations. Besides, given the past accumulation in the stock of domestic debt and high interest rates, the servicing of domestic debt has become a key issue. The stock of domestic payments arrears amounted to 2 per cent of GDP in 2001. Among the capital expenditures, the most important recent public investments have been in road maintenance and rehabilitation (27 per cent of total capital expenditures in 2001) in order to support the agriculture and tourism sectors.

The overall fiscal deficit for 2001 was about 8.1 per cent of GDP (exceeding the target of 7.4 per cent), mainly owing to overruns in capital and other expenditures in the last quarter of 2001 as a result of the presidential elections. The government has begun to implement some much needed expenses control mechanisms and to consolidate its diverse accounts in an attempt to eliminate various non-transparent and discretionary accounts and thus more tightly control its overall outlays.

A major development for the future is the implementation of the medium-term macroeconomic targets set in the 2002-04 Poverty Reduction Strategy Paper, issued in May 2002. Focusing on poverty reduction programmes (targeted at 2.2 per cent of GDP per year) and continuing its strong revenue effort, the medium-term fiscal strategy aims at narrowing the fiscal deficit to 6.4 per cent of GDP in 2004.

However, the massive maize purchase to avert food famine has put pressures on government finances. Moreover, the government's wage bill increased in 2002 following a large wage increase granted to public workers in November 2001, and, on account of the high inflation, it may continue to rise in 2003. The domestic interest bill has also grown compared to 2001 along with the increase in interest rates and the stock of government paper outstanding. In addition, revenue growth has been limited owing to pro-growth tax incentives (lower duty on diesel fuel, lower tax on electricity and reduced direct and indirect taxes) and donor's support is estimated to have been $15 million lower than the programme target of $160 million. The deficit in 2002 is therefore estimated at 8.9 per cent of GDP. A projected further increase in the wage bill and the potential additional costs of maize imports will lead to a fiscal deficit in 2003 of 9.4 per cent of GDP.

Zambian monetary policy primary objective is inflation reduction. Zambian consumers suffered high levels of inflation throughout the 1990s with the rate peaking at 188 per cent in 1993. This fell to an annual average of 26 per cent at the end of the decade reducing to 21.7 per cent in 2001. The Bank of Zambia (BoZ) main instrument is the control of monetary aggregates, and it operates within a fully convertible foreign exchange market. Although fully independent from the Treasury, in 2000 the BoZ needed to accommodate

Table 2 - Public Finances (percentage of GDP)

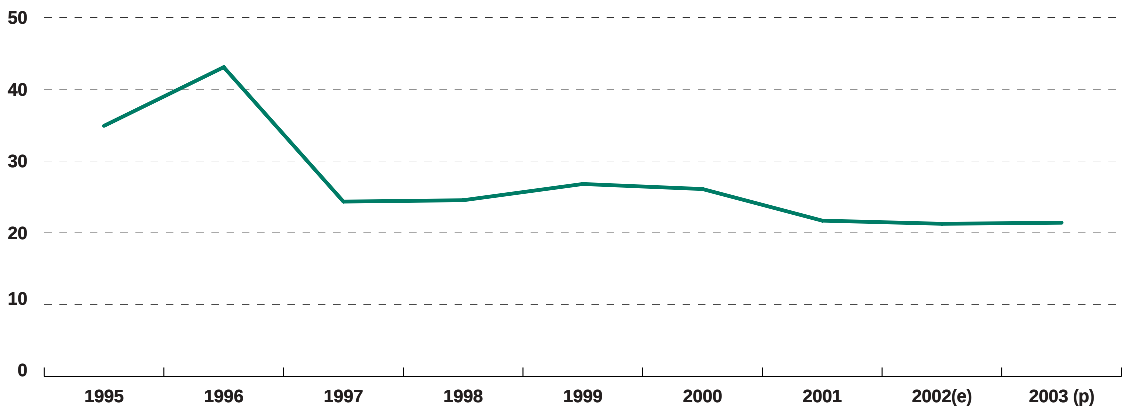
	1995	1999	2000	2001	2002(e)	2003(p)
Total revenue and grants[a]	**29.0**	**25.7**	**23.2**	**24.8**	**24.4**	**23.8**
Taxes	18.2	17.2	17.3	18.6	18.4	18.1
Grants	9.1	8.0	5.7	5.7	5.5	5.2
Total expenditure and net lending[a]	**33.4**	**29.7**	**31.0**	**32.9**	**33.3**	**33.1**
Current expenditure	24.2	16.8	16.1	20.2	20.9	20.9
Excluding interest	*15.6*	*12.3*	*12.1*	*16.2*	*16.7*	*16.9*
Wages and salaries	5.9	5.4	5.3	6.8	7.0	7.1
Interest on public debt	8.6	4.5	4.0	4.0	4.3	4.0
Capital expenditure	9.1	10.6	10.0	11.5	12.6	12.5
Primary balance	**4.3**	**0.5**	**-3.8**	**-4.1**	**-4.6**	**-5.4**
Overall balance	**-4.3**	**-4.0**	**-7.8**	**-8.1**	**-8.9**	**-9.4**

a: Only major items are reported.
Source: Authors' estimates and prospects based on Ministry of Finance and Economic Development and IMF.

the government borrowing requirements (emanating from debts service obligations, domestic expenditures, and government lending to its remaining loss-making enterprises) especially in a situation where foreign support had reduced, the balance of payment deteriorated, the kwacha depreciated sharply, and price of fuel, transport and other services increased. The resulting expansion of domestic credit, combined with cost-push factors exacerbated the pressure on domestic prices. In 2001, the central bank tightened its monetary policy by increasing statutory cash reserve requirements and by pursuing more aggressive open-market operations. This resulted in a sharp increase in interest rates (on 91-day treasury bills) from 34 per cent at the end of 2000 to about 45-50 per cent during the latter part of 2001, in a real appreciation of the kwacha against the US dollar, and in a reduction of the year end inflation to 18.7 per cent. Zambia recently found itself in a domestic debt trap where the domestic debt accumulated fast, interest rates were high, and government margins for reduction of expenditure were meagre. For the immediate future, the key challenge for macro policies in Zambia is the reduction of real interest rates without losing control of inflation. While the yield on 91-day Treasury bills declined to nearly 30 per cent at end-August 2002, commercial banks lending rates remained high.

The authorities have set an end of the year inflation target of 13 and 8 per cent for 2002 and 2003 respectively. However, the shortfall in maize supply has put further pressure on prices and, in the first eight months of 2002,

Figure 5 - Inflation Rate



Source: IMF and Central Statistical Office data.

inflation averaged 22.7 per cent. Average inflation for 2003 is expected to remain around 21 per cent.

The foreign exchange market was characterised by excess demand for foreign exchange over 2002 in order to meet the cost of importing maize. These foreign currency demand pressures together with the effect of the uncertainties in the copper sector resulted in a steadily depreciating trend of the nominal value of the Kwacha-US dollar exchange rate (the year to August depreciation rate stood at 16 .7 per cent).

External Position

During 2000 and 2001, balance-of-payments developments were mixed. In 2000, the deficit of merchandise trade increased sensibly due to a larger increase in the import bill relative to export revenues. Imports of oil and oil products have been the main cause of concern given the rise in prices and the closure of the main domestic refinery. In addition, the re-capitalisation of the mines induced higher imports of expensive capital and intermediate goods. Metal exports performed well on account of rising copper prices and increased demand from East Asian economies, but non-traditional exports, such as tobacco, cotton yarn and lint, fresh flower and gas oil continued a decline that has lasted for some years. This is mainly attributed to stiff competition from other regional economies. The capital and financial accounts also declined reflecting reduced FDI inflows and project loans. This latter trend also severely affected the year 2001 which recorded a substantial shortfall in EU assistance. However, 2001 was also characterised by a strong export performance of copper, thanks to the privatisation of mines which resulted in a 27 per cent increase in copper export volumes; non-traditional exports recorded a growth of 13 per cent owing to a strong performance by horticulture and floriculture. The solar eclipse and the opening of the Sun International Hotels in Livingstone were partly responsible for the sharp increase in tourism earnings. This strong export performance was more than offset by a substantial increase in imports, particularly of equipment for the mining sector, resulting in a current account deficit of 20.6 per cent of GDP. Although the overall balance-of-payments deficit was broadly in line with the programme target, the targeted reserve build up was not reached owing to a substantial shortfall in external assistance. In 2002, imports of equipment for the mining sector are estimated to have decreased on account of less investment in the KCM mines, while maize imports have increased. On the other hand, exports of copper have slightly increased in 2002, as a result of the output of smaller mining firms. The year 2003 is likely to reproduce the same trend in import and export patterns, with copper exports slightly increasing, reflecting higher copper prices. Foreign direct investment is expected to grow by 14 per cent particularly in non-related copper sectors.

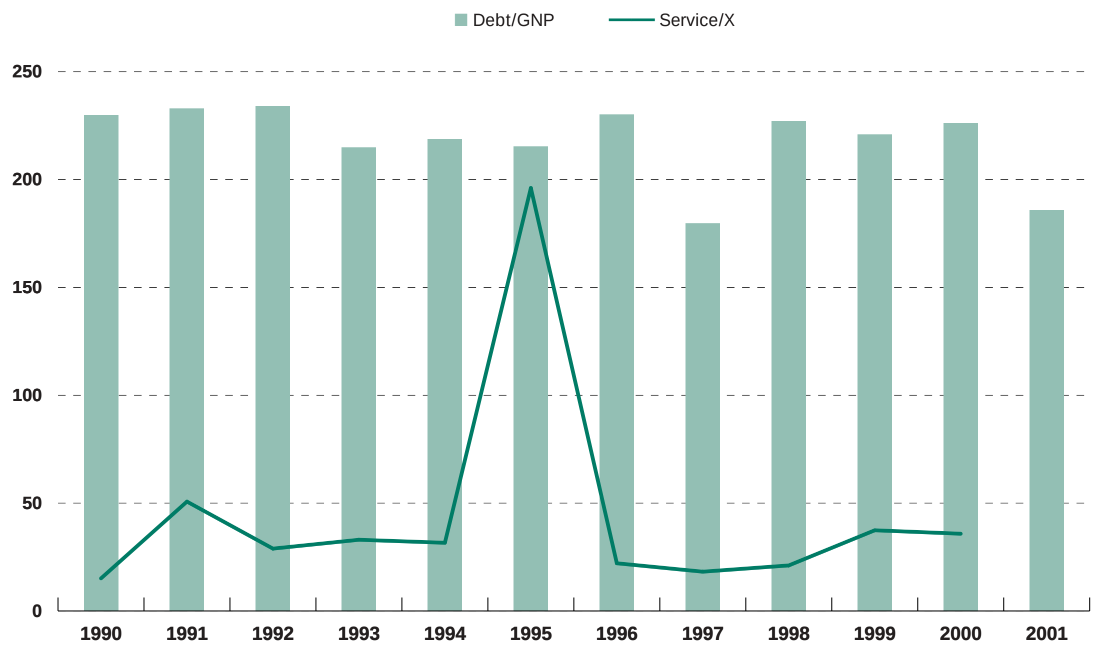
In late 2000, Zambia reached the decision point under the Enhanced Heavily Indebted Poor Country (HIPC) initiative. This is expected to help reducing the country's external debt commitments, standing at $6.3 billion at the end of 2000. The programme target for the debt relief in 2001 was of $292 million, however, owing to delays in agreeing on a Paris club rescheduling on Cologne terms, the total interim debt relief was about $278 million.

Table 3 - Current Account (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Trade balance	-0.2	-4.8	-6.8	-9.8	-9.7	-8.8
Exports of goods (f.o.b.)	34.2	24.7	23.4	24.9	24.8	24.7
Imports of goods (f.o.b.)	-34.4	-29.4	-30.2	-34.7	-34.5	-33.5
Services	-5.6	-6.7	-6.9	-6.3		
Factor income	-7.0	-5.0	-4.5	-3.8		
Current transfers	8.6	-0.5	-0.6	-0.6		
Current account balance	**-4.2**	**-17.0**	**-18.8**	**-20.6**		

Source: Authors' estimates and predictions based on Bank of Zambia and IMF data.

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank.

In 2002 the interim debt relief under the enhanced HIPC initiative amounted to $266 million. Such interim debt relief together with the World Bank disbursement of $56 million allowed the BoZ to build up gross international reserves to $166 million at the end of June 2002, compared to the programme target of $159 million.

At completion point, which is targeted by 2003, Zambia's creditors would write off some $3.8 billion of debt in nominal terms. However, the reaching of the completion point is dependent upon sustained economic restructuring and the successful implementation of the Poverty Reduction Strategy Paper for at least one year.

Structural Issues

A broad based economic reform programme started in 1991, with the advent of the Movement for Multiparty Democracy (MMD) government which embraced donor-advised structural adjustment policies and promoted the transition from a centrally planned economy to a market based economy. Notable progress has been made in trade liberalisation, privatisation, deregulation of prices, and ending of foreign exchange control.

Privatisation was included in the MMD manifesto as a centrepiece of economic reform and it came about more as a practical way to recapitalise the State Owned Enterprises (SOEs) and to let them operate efficiently and viably. When the MMD government came into power, more than 80 per cent of the companies were state owned, ranging from mines, utilities, financial services to launderettes and bakeries. Generally, SOEs were characterised by undercapitalisation, over staffing and inefficiency which contributed to their inability to make profits and effectively rendered most of them unsustainable business ventures. They were also a drain on the limited government resources in terms of investment requirements and subsidies whilst achieving a negative return to government. Moreover, several members of SOE management were allegedly not accountable for commercial return but for political patronage and, therefore, privatisation was seen as an important way to remove all political interference in the running of SOEs.

A structured, finalised privatisation programme started in July 1992 with the enactment of the Privatisation Act of 1992, which gave the legal basis to the privatisation programme and attributed the Zambia Privatisation Agency (ZPA) the responsibility for all government privatisation issues. The divestiture process took place in different phases, starting from the privatisation of the small and medium enterprises, and then proceeding to the larger companies.

In order to encourage the citizens' participation in the privatisation programme, the Privatisation Act allowed the payment of the purchase price of privatised SOEs on deferred terms by Zambians. Furthermore, the Ministry of Finance established the Zambia Privatisation Trust Fund where some designated shares of privatised companies were held for future flotation to the Zambian public on the Lusaka Stock Exchange. Since the establishment of the Privatisation Trust Fund, seven companies have been offered for sale to the Zambian public. Most of the companies were sold through Management/Employee Buy-outs. However, another method of Zambian participation in privatisation used has been through the decision by government to sell non-core assets (such as parastatal residential houses) to Zambian sitting tenants. A total of 257 SOEs had been privatised as of 30th April 2002 out of a working portfolio of 280 SOEs. Of all the SOEs privatised, 65 per cent were sold to Zambian individuals, 29 per cent to foreigners while 6 per cent were wound up. Despite the substantial number of companies privatised so far, it should be taken into account that the largest companies in vital economic sectors such as utility, oil and financial sector are still state owned and the mines, which represent the greatest country's asset, were privatised only in 2000. Indeed, while most of the small and medium enterprises were privatised by the mid-1990s, the government dithered over the sale of the largest companies which became more unproductive, inefficient and over staffed, characterised by bad management, lack of investment and corruption. The substantial delay was due to vested interests in retaining the so-called strategic companies in the state's hands. This has been the case of copper mines, which were considered national treasures, and have been the object of profound disagreements within the government and mining circles with regard to their disposal. The need to sell mines, however, became increasingly acute from 1998, as they started to incur substantial losses and donors made their aid conditional on the mines' privatisation. In March 2000, a consortium led by the Anglo-South African mining firm, Anglo-American Corporation, bought the largest mining company, Konkola Copper Mines (KCM) which account for about two-third of the country's copper production. The acquisition took place when the KCM's asset value was much lower owing to the obsolescence of the plant and the slump in copper prices. In January 2002, after incurring substantial losses ($108 million in the two years until December 2001, while the acquisition price was $90 million), Anglo-American announced its decision to pull out from the mines. In August 2002, Anglo-American divested completely, agreeing to leave in place its management team, and providing a financing package of $105 million which covers virtually all of KCM's expected operating deficit for 2002/03. The government is committed to running the mines until a new strategic investor is found. In order to support the government's effort the World Bank and IMF have to broaden their external assistance.

Privatisation in Zambia produced mixed results. The process suffered from political interference and bad sequencing. Although placed quite easily, most small and medium enterprises encountered difficulties due to major bottlenecks such as lack of access to cheap finance for re-investment, poor management capabilities and stiff competition following the liberalisation of the market. In addition, manufacturing companies producing products for the mining industry (chemicals, rubber, and plastics) suffered from stagnating demand owing to the delayed privatisation process in the mining sector. Only companies acquired by foreign capital, such as in the sugar and cotton sector, managed to survive and expanded their production. Furthermore, the privatisation process encountered a number of obstacles. Many privatised companies were dismantled and ZPA did not have either the capacity to prevent or to monitor. Considerable employee terminal benefits, inherited from the previous government labour law, led to over staffed parastatals. In summary, although the privatisation in Zambia achieved the objective of reducing government budgetary costs arising from subsidies and capital expenditures, it did not really promote economic growth nor created a sound private sector.

The new government, elected in December 2001, has promised to complete the process, privatising utility parastatals, such as the Zambia telecommunication company (ZAMTEL) and the Zambia Electricity Supply Corporation (ZESCO). Moreover, the deregulation of petroleum prices and imports has been completed and there are plans to effectively privatise the oil sector refineries, such as the Tanzania-Zambia pipeline (Tazama), the Indeni oil refinery and the Zambia National Oil Company (ZNOC). In order to overcome the lack of transparency associated to certain deals, especially in mining, the authorities are more in favour of concession agreements (as agreed for Zambia Railways). However, the public reaction to these changes has been somewhat negative, as was demonstrated in 2002 when the unions and other NGOs staged a protest march against the sale of ZESCO, ZAMTEL and ZANACO (the Zambia National Commercial Bank). There also seems to be government level disagreement about the way forward with the privatisation process, which could also threaten the allocation of the HIPC funds from the IMF, should this process cease.

In spite of the government's encouragement of the citizen's empowerment, the private sector participation in the economy has been undermined by weak macroeconomic stability and lack of an appropriate economic infrastructure. Specific problems include high inflation, erratic exchange-rate movements, steep interest charges and high import duties on fuel and other essential inputs which all make investment planning difficult with increased uncertainty and risk. In particular, the most important constraint to the development of a sound private sector is the cost of long term investment finance. Commercial lending is very expensive on account of the government's enormous borrowing requirements which crowd out the private sector's requirement. Commercial Banks hold around 70 per cent of Zambia's total Treasury Bill's issuance. Actual rates charged to investors are closer to 50 per cent nominal. Even in real terms, these rates remain extremely high, at around 20 per cent, per annum.

The various donor funded capital access schemes for the private sector had little impact and a succession of several state-owned development banks providing credit to small farmers have failed owing to low recoveries, political interference and poor management. This vacuum has determined that only individual entrepreneurs with sufficient collateral are able to borrow from private banks but high interest charges and stringent borrowing requirements still severely restrict small traders and farmers' access. In addition, production costs are very high due to elevated factor costs for energy (e.g. electricity), transport (e.g. fuel prices) and communications.

Another major constraint is represented by a private sector not cohesive and not organised into a single national framework. In order to build a common platform to voice private sector interests, a number of private sector intermediary organisations have been growing rapidly since the mid-1990s. The most established is the Zambia Association of Chamber for Commerce and Industry (ZACCI), Zambia Association of Manufacturers (ZAM), Zambia National Farmers Union (ZNFU), Zambia Chamber of Small and Medium Business Associations (ZCSMBA), and, Zambia Export Growers Associations (ZEGA), but most recent structures include the Private Sector Development Association and the Zambian chapter of the Southern African Enterprise Network. Intermediary associations provide training and advisory services, act as a conduit for developing business contact and sources of funding, and increasingly enter into dialogue with the government on policy related matters for their members. In addition, many governmental and non-governmental bodies are involved in the promotion of new areas of investment. The Zambia Investment Centre, in particular, is working on the New National Investment Plan which encourages private sector investment and identifies new investment opportunities in export oriented agriculture, light manufacturing, small scale mining and tourism.

Zambia has among the most liberal banking regulations in the region. The country has 16 commercial and retail banks. The major commercial bank in the country is the state owned Zambia National Commercial Bank (ZANACO) which is heavily indebted. The bank has branches in every district and its liquidation would determine the collapse of the entire system of payment. In December 2001, the Zambia Privatisation Agency advertised the sale of a 35 per cent stake of ZANACO, however there has been no expression of interest owing to the lack of majority control for the buyer and uncertainty about the status of the balance sheet. In response, in May 2002, the Cabinet has approved the sale of at least 51 per cent of government's share in the bank and the government cleaned up the balance sheet and issued a bond valued at K250 billion ($51 million) to recapitalise the bank.

As part of the government's economic reform programme aimed at developing the financial and capital market, the Lusaka Stock Exchange (LuSE) was established in February 1994, with preparatory technical assistance from the International Finance Corporation (IFC) and the World Bank in 1993. Currently, 11 companies are listed. Among those, seven have been offerings on the back of Zambia's privatisation programme, in which shares have been advertised to the Zambian public only. The Zambia Sugar Plc public offer, in late 1996, was the only exception in which shares were also offered to international investors, because the shares on offer were a combination of those warehoused by the Zambian Privatisation Trust Fund and those owned by the Commonwealth Development Corporation (CDC). Several incentives have been put in place to promote rapid development of the capital market in Zambia. These include the following: no exchange controls, no restrictions on shareholding levels, no restrictions on foreign ownership, no capital gains tax, and corporate income tax reduced to 30 per cent for companies listed on the LuSE.

Zambia' s population of about 10 million and a territory of 750 000 km^2 is served by a transport infrastructure consisting 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. Three of the major roads run parallel to the railways. Over the years, the state of the road infrastructure in the country has deteriorated as a result of lack of maintenance. 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 produce is also made very difficult and thus deepens poverty in rural areas, where 62 per cent of the population lives. Road repairs have been undertaken under the Road Sector Investment Programme (ROADSIP), which is a partnership between road users, the government, and donors to bring a core network of the road to maintainable conditions. The project started in 1998 and during the first three years of implementation substantial improvements to the paved road network have been achieved. 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. Also the rail network is in poor conditions and low maximum speeds are imposed on many sections of the network. However, the Railway industry is in transition, internal reorganisation and staff reduction have resulted in an improvement of Zambia Railways financial performance. Tenders have been published in 2001 for the privatisation of its operation under a concession agreement.

Political and Social Context

Zambia is one of the most politically stable countries in Southern Africa. The independent state of Zambia was created in 1964 and Dr Kenneth Kaunda of the

United National Independence Party (UNIP) was its first president. After two decades of the UNIP one-party rule, Zambia's returned to multi-party in the 1991 elections which resulted in the victory of the Movement for Multi-Party Democracy (MMD) and the election of President Frederick J.T. Chiluba, a former trade unionist. Although the newly liberalised political environment opened the way for comprehensive economic reforms and reversed the UNIP centrally planned trend, the Chiluba era (which lasted for a decade) has been highly characterised by allegations of corruption and political interference in the economic sectors (Zambia is ranked 75th — out of 91— on Transparency International Corruption Perception index). Zambia held presidential, parliamentary and local government elections on December 27, 2001 with both international and local monitoring. The new President is Levy Mwanawasa of the ruling party, who defeated lead opposition candidatae with a slim victory, 29 per cent to 27 per cent.

The new government has taken steps to fight corruption, strengthening the Anti-Corruption Commission, the Office of Auditor General and other relevant government institutions and improving the transparency and accountability in the management of public resources. Furthermore, a law against money laundering and related vices has been recently approved. In line with these measures, another important sign of the government's commitment to improve governance emerged in the President's speech of July 2002. On that occasion, President Mwanawasa highlighted a number of high profile corruption cases involving high ranking officials and political and business leaders, leading to the removal of all the officials involved.

The poverty situation in Zambia has dramatically worsened in parallel with the poor economic performance of the country in the last thirty years (per capita income in 2000 was about 60 per cent of its level in late 1960s). According to the 1998 Living Conditions Monitoring survey in Zambia, around 73 per cent of Zambians are classified as poor[2] (compared to 69.7 per cent in 1991). The majority of people suffer from weak purchasing power, homelessness, and insufficient access to basic necessities such as education, health, food and clean water. In the 1990s, the HIV/AIDS pandemic has worsened the poverty situation. Poverty is more prevalent in rural areas compared to urban (83 per cent and 56 per cent respectively) but it has risen faster in urban areas lately due to failing industries and rising unemployment. Most of the rural poor are small scale farmers followed by medium scale farmers and rural poverty is largely attributed to poorly functioning markets for agricultural output and to low agricultural productivity because of poor utilisation of agricultural inputs and inadequate irrigation systems. Therefore, farmers are highly vulnerable to the weather for their crops, as patently demonstrated by the drought that hit the country in 2002 that, as mentioned earlier, determined a food shortage of 635 000 tonnes and exposed 2.3 million people to the risk of starvation.

Interventions to promote a self sustaining agricultural sector and ensure increased household income and food security are envisaged in the Joint government – donor Poverty Reduction Strategy Paper. Completed in early 2002, the Poverty Reduction Strategy Paper for the years 2002 – 2004 focuses on measures to reduce the poverty rate to 65 per cent of the population in 2004 (its level of 1996)[3] and achieve strong sustained economic growth. Although agriculture is a priority, the document sets out goals and policy actions in other vital economic sectors, such as: industry, mining and tourism. Important objectives are set also to promote equitable and efficient health and education services in the country. The strategy is budgeted at $1.2 billion over 2002-04. It is estimated that the external financing requirement will amount to 1 125 million over 2002-04, of which the expected HIPC resources amount to about $773 million.

2. The Central Statistical Office determines the household poverty line as the amount of monthly income required to purchase basic foods to meet the minimum caloric requirement for a family of six people.

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

Zambia is one of the hardest hit countries in the worldwide HIV/AIDS pandemic, with a national average of 21 per cent in the 15-45 age group. The percentage of HIV sero-prevalence is 29 per cent in urban areas (mainly Lusaka and the Copperbelt) and 14 per cent in rural settings. Mobility is one of the determining factors of the spread of HIV/AIDS. After urban areas, prevalence of HIV/AIDS is highest among the major transport routes. It is estimated that Zambian life expectancy has fallen from 51 years in 1990 to 41.4 in 2000; and the rate of population growth has declined from 3.5 per cent (in the 1980s) to about 2.9 per cent in 2000. This is largely due to the effects of AIDS. Also AIDS related diseases have become prominent; tubercolosis related cases have risen and other diseases continue to have a negative impact on the health status, including malaria, diarrhea and respiratory tract infections. Although recent surveys suggest that the HIV prevalence has stabilised and has even been reduced among young people in urban areas, the high incidence of HIV/AIDS constitutes a serious restriction for development efforts. Moreover, the general health status of Zambia's population has worsened over the past two decades**.** The infant mortality rate is 109 per 1 000 births and the maternal mortality rate is 649 per 100 000 births, one of the highest in Africa. In 1992, the Government began taking a decentralised approach to health services with the goal of providing "Zambians with equity of access to cost-effective, quality health care as close to the family as possible." Zambia's decentralisation of health services marked a radical departure from past approaches, often excessively centralised. The Sector Wide Approach (SWAp) works by moving responsibility for essential service functions to the district level to make services more responsive to local needs and accountable users. In 1993, the introduction of user fees, theoretically refundable to those in extreme poverty, has generated much needed new revenue, but has also driven many away from the health service because of lack of funds. Furthermore, despite the Ministry of Health's accomplishments to date, much remains to be done before all Zambians have access to quality health care. There are problems of poor physical infrastructure and equipment, poor participation, and inadequate resource allocation. Health care spending accounted for 1.9 per cent of GDP in 2001. However, the government was intending to increase health spending to 3 per cent for 2002. In the framework of the PRSP, and according to the newly launched National HIV/AIDS/STD/TB Strategic framework (2001-03), public health priorities have been identified. These include: improving service delivery of basic health package, rehabilitating infrastructure, and investing substantially in HIV/AIDS awareness campaign. 7.9 per cent of the PRSP budget has been allocated to implement the above mentioned priorities.

The Zambian education system has seriously deteriorated over the last thirty years as a result of economic decline, lack of resources and institutional inefficiencies. Moreover, the introduction of fees for government primary schools in the 1990s determined further drops in attendance. According to the 1998 Living Conditions Monitoring Survey in Zambia, the net primary enrolment rate is at 66.4 per cent. However, attendance rates are much lower in rural areas and it is estimated that among those that enter Grade 1, only about two-thirds complete school through Grade 7. The school attendance rates of girls is generally lower than that of boys, and, in rural areas, is much lower. At secondary level, the net attendance rate is about 25 per cent (38 and 15 per cent in urban and rural areas, respectively. According to the Zambia Poverty Reduction Strategy, the secondary school level has suffered from a lack of programmes of expansion, rehabilitation, educational material support, and curriculum review. As a consequence, the quality of teaching and learning has been severely affected. Currently, less than 50 per cent of primary school leavers are absorbed by secondary schools. Very few students graduating from secondary schools find places in tertiary institutions due to a severely limited number of institutions. The stagnation of school enrolment is on account of a number of long-standing problems including inadequate numbers of schools and long distances between homes and school facilities. School infrastructure has also deteriorated. Furniture, textbooks and learning materials in most schools are in very short supply or non-existent. Zambia's HIV/AIDS crisis further undermines the educational system by significantly increasing teacher absences and causing dramatic increases in the number of school-age orphans. The policy for the education sector was laid down in 1996. The Basic Education Sub-Sector Investment Programme (BESSIP) is the main instrument for implementing that policy. Targets include 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 will be extended to secondary school and an equity programme is envisaged that will bring the abolition of fees at basic level. Other measures include development of guidelines for cost sharing for levels other than basic education. In line with the PRSP objectives, the government is committed to devote more resources to the sector. According to the Ministry of Finance and Economic Development, the government spent 3 per cent of GDP in 2001 on education, compared to 2.5 in 2000.