COUNTRY BACKGROUND PAPER:

ZAMBIA

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This report has been prepared by the Foundation for Research in Economics and Business Administration SNF-Oslo for the World Bank Regional Programme on Enterprise Development. The SNF RPED team is lead by Professor Finn R. Førsund, the rest of the team consisting of Nils-Henrik M. von der Fehr, Karl Ove Moene, Sverre A.C. Kittelsen, and Arne Torgersen. While this report is based on a number of sources, the World Bank Economic Report for Zambia CG Meeting (World Bank, March 1993) proved particularly useful, and we have borrowed extensively from that report.
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1. INTRODUCTION - HISTORICAL BACKGROUND

Zambia's formal economy before Independence in 1964 was dominated by the copper sector and heavily controlled by non-Zambians. All but a small number of Zambians with jobs in the mines or with the government were outside the formal economy, predominantly in subsistence agriculture. The first Zambian government was committed to using copper revenues to improve public services and to bring more Zambians into the formal sector. At the outset policies towards the private sector were liberal, but increasingly the policy shifted to a greater reliance on regulation and state ownership. By the early 1970s the formal sector was dominated by the large parastatal monopolies.

In the first period after Independence, Zambia experienced ten years of economic prosperity before the oil shocks and the copper-price decline of the 1970s exhibited a number of structural weaknesses of the economy. The dependence on copper export earnings, the weak manufacturing base, the neglect of agriculture and the openness of the economy ensured that the world recession was transmitted to all sectors of the economy and contributed to a decline in gross domestic product for almost ten consecutive years and took Zambia from a middle income country to a low income country (according to the World Bank classification).

The immediate response of the government to the decline in growth, and the 70 per cent deterioration in the terms of trade during the seventies, was to run down foreign reserves and increase international borrowing. Starting in the late seventies, and continuing during the eighties, a series of stabilization programmes to improve the macro-economic performance was introduced. However, none of these were comprehensive enough, and none were sustained, to prove successful in the longer run and during the ten year period 1975-1984 the economy was allowed to continue to backslide into a permanent situation of low growth, high inflation, trade balance deficits, and indebtedness. From 1985, Zambia took some drastic measures to overhaul its policy regimes, only to switch to major reversal of those policies in 1987. From 1989, far-reaching reforms have been instituted and the new government that
came into power in October 1991, has proclaimed a complete reorientation towards market-oriented economic policies, including deregulation and privatization. Even though the changes have been welcomed by most observers, so far there have been few signs of any economic recovery.

2. RECENT ECONOMIC PERFORMANCE AND POLICIES

Over the last ten years, economic development has been at a standstill, or, if anything, the economy has been in decline. Real Gross Domestic Product (GDP) was 5.6 percent higher in 1991 than in 1982, but measured per capita, there was a decline of 23.7 percent. Due to considerable improvement in the Zambian terms of trade during the period, caused by increasing copper prices, and increasing external assistance, incomes displayed a slightly less dismal performance: From 1982 to 1991, Gross National Income (GNI; which, in addition to GDP, includes terms of trades adjustments, as well as transfers and income from abroad) rose by 36 percent, although in per capita terms there was a decline of 1.8 percent. This continues a trend of declining living standards since about 1970 making Zambians considerably worse off today than at Independence in 1964. Since the mid-1970s the gains in social indicators have been partially reversed, and are now in decline. Whereas in the seventies and early eighties, Zambia used to outperform most of its peers, life expectancy, infant mortality, and school enrolment are now comparable to those of other low-income countries (WB 1993).

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1 Official statistics in Zambia are not reliable and there are often conflicts between different sources of economic data. While efforts have been made to improve official national accounts data, the problem of unreliability appears to continue (Seshamani, 1993).
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</tr>
</thead>
<tbody>
<tr>
<td>GNI</td>
<td>1658</td>
<td>1760</td>
<td>1750</td>
<td>1664</td>
<td>1645</td>
<td>1947</td>
<td>2167</td>
<td>1958</td>
<td>2193</td>
<td>2255</td>
</tr>
<tr>
<td>GNI per capita (Constant 1977 K)</td>
<td>274</td>
<td>281</td>
<td>259</td>
<td>247</td>
<td>235</td>
<td>268</td>
<td>287</td>
<td>250</td>
<td>270</td>
<td>269</td>
</tr>
<tr>
<td>Current Account Balance (Percentage of GDP)</td>
<td>-15.4</td>
<td>-6.0</td>
<td>-3.5</td>
<td>-21.0</td>
<td>-17.9</td>
<td>-7.7</td>
<td>-4.8</td>
<td>-2.3</td>
<td>-3.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Consumer Price Index (Low Income Urban, percent yearly change)</td>
<td>12.4</td>
<td>18.5</td>
<td>21.1</td>
<td>37.4</td>
<td>54.0</td>
<td>45.6</td>
<td>54.7</td>
<td>128.0</td>
<td>111.0</td>
<td>92.6</td>
</tr>
</tbody>
</table>

The current account has been in deficit for a long period, the deficit reaching a record level of 21 percent of GDP in 1985. From the mid-eighties, the performance of the external economy has improved, the current account deficit being turned to a small surplus in 1991. The main fluctuations in the current account balance has been due partly to changes in the world market copper price and partly to variations in debt service payments (section 2.4.). While Zambia used to have strong regulations on foreign exchange, and a policy of overvalued exchange rate, in recent years the country has moved to one of the most liberal foreign exchange regimes in Africa with an exchange rate that is based on market forces and appears to be balancing supply and demand.

Inflation has been in the double digits for many years, but has picked up considerable towards the end of the 1980s. The inflation rate peaked at 128 percent in 1989, but has remained around 100 percent per year since. The new government is committed to a low-inflation economic policy, but recent evidence shows no signs of a substantial fall in the inflation rate (Seshamani, 1993). The main reason for the poor performance seems to be a slack monetary policy.

2.1. Aggregate output and demand

The WB 1993 report sums up the growth performance of the Zambian economy in the following points:
Zambian had one of the worst economic growth rates in the world over the 1960-88 period.

Although growth was poor, Zambian investment ratios were among the highest in the world.

Factors particularly unfavourable for per capita growth included low initial human capital, very high government consumption, the world's highest fiscal deficits, and very high population growth.

Modest, but steady, GDP growth of on average 2.4 percent, was achieved during the first ten years after Independence, largely due to increasing copper export receipts and mainly taking the form of expansion of import-substituting manufacturing industries. After that, GDP growth largely stagnated, except for 1985 and 1988, years in which agriculture performed exceptionally well due to good rains. Over the 26-year period 1965-1991, average growth amounted to 1.1 percent, implying a total increase in output of around 33 percent. In per capita terms, GDP fell by more than 60 percent in that same period.

<table>
<thead>
<tr>
<th>Table 2: GDP Composition by Expenditure, 1965-1990</th>
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</thead>
<tbody>
<tr>
<td><strong>Source:</strong> WB 1993</td>
</tr>
<tr>
<td><strong>GDP</strong></td>
</tr>
<tr>
<td>100.0</td>
</tr>
<tr>
<td><strong>Investment</strong></td>
</tr>
<tr>
<td>25.3</td>
</tr>
<tr>
<td><strong>Consumption</strong></td>
</tr>
<tr>
<td>60.0</td>
</tr>
<tr>
<td><strong>Import</strong></td>
</tr>
<tr>
<td>34.7</td>
</tr>
<tr>
<td><strong>Export</strong></td>
</tr>
<tr>
<td>49.2</td>
</tr>
<tr>
<td><strong>Savings</strong></td>
</tr>
<tr>
<td>40.0</td>
</tr>
<tr>
<td><strong>Implied Foreign Savings (Investment - Savings)</strong></td>
</tr>
<tr>
<td>-14.7</td>
</tr>
</tbody>
</table>

Growth in the early period after Independence was fueled by a high level domestic investment, on average amounting to more than 20 percent of GDP, and reaching 40 percent in 1975. It appears that much of this investment did not result in output growth. The economic structure established during the earlier years after Independence proved to be vulnerable and too rigid to adapt to the changing economic environment. The decline of the copper export earnings after 1974 eroded
the country's capacity to import. The result was an economy-wide shortage of intermediate goods and spare parts which proved to be critically constraining to the manufacturing industries that had been built on the consumption of imports behind a wall of domestic protection. Indeed, Zambia achieved more growth per unit of investment during the 1975-1991 period than during the period from 1965 to 1974, when investment levels have mostly ranged between 10 and 15 percent of GDP. This suggests that the adjustment of sector policies in later years may have more than compensated for the lack of investment in terms of stimulating growth, particularly in the agricultural sector.

While the share of consumption in GDP was around 60 percent in the 1960s, it has gradually increased, particularly after the halt in the growth rate. Consumption levels have consistently stayed above 80 percent since the mid-seventies, reflecting both the fall in investment and the government's lack of response to the decline in output. The result has been a low level of savings and a considerable increase in foreign debt.

2.2. Sectoral composition of GDP and manufacturing

In the years following Independence, earnings from mineral exports were relatively buoyant, due to rising copper prices, and they were supplemented by external financing to meet the import requirements for capital and intermediate goods, which helped to sustain a rapid expansion of the manufacturing sector. During this period, GDP in manufacturing and construction grew at 10 and 9 percent per annum, respectively. By 1975, the manufacturing sector's share in total GDP increased from 6 to 17 percent, while the construction sector's share was doubled to 10 percent. Agriculture was growing less rapidly and its share in GDP fell slightly from just over 14 percent in 1965 to 13 percent by 1975.
Table 2: GDP Composition by Sector, 1965-1990
Source: WB 1993

<table>
<thead>
<tr>
<th></th>
<th>1965</th>
<th>1975</th>
<th>1985</th>
<th>1990</th>
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</thead>
<tbody>
<tr>
<td>GDP</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>14.2</td>
<td>13.1</td>
<td>13.1</td>
<td>16.8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6.3</td>
<td>16.8</td>
<td>22.9</td>
<td>31.6</td>
</tr>
<tr>
<td>Mining</td>
<td>40.1</td>
<td>13.6</td>
<td>15.6</td>
<td>10.5</td>
</tr>
<tr>
<td>Construction</td>
<td>5.4</td>
<td>9.5</td>
<td>2.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Services</td>
<td>31.9</td>
<td>44.6</td>
<td>44.9</td>
<td>37.9</td>
</tr>
<tr>
<td>Other</td>
<td>2.0</td>
<td>2.4</td>
<td>1.0</td>
<td>1.0</td>
</tr>
</tbody>
</table>

By the early 1970s, the mining sector was beginning to contribute less to the economy as copper prices started to decline from their high of over $2.00 per pound in 1966 to less than $1.00 in 1974. At the same time, production was constrained by the flooding of a major mine in 1970 and by increasingly difficult mining conditions. The sharp drop in copper prices, and consequent loss of export earnings, initiated a long period of economic stagnation. Contraction of demand, as well as excess capacity in manufacturing, resulted in weak demand for new and replacement investments. Consequently, the construction sector was considerably reduced while the manufacturing sector grew at a very moderate rate. By the mid-1980s capacity utilization is reported to have been less than 60 percent across the manufacturing sector, with some subsectors, such as wood and wood products and paper and paper products, at as low as 30 and 35 percent respectively (Ndulu, 1990). Very low investment rates over a long period has resulted in a capital structure with little useful economic life.

Although real agricultural growth average only 2.2 percent between 1965 and 1991, the growth rate reached 7 percent during 1983-90, indicating the sector's capacity and potential for higher growth. The fact that the high growth rate in the late 1980s occurred at a time when the sector's terms of trade were deteriorating (mainly reflecting the Government's determination to keep food prices low in the face of increased inflation) can be explained by two factors: First, despite worsening terms of trade, agriculture still offered relatively better investment opportunities to domestic investors than for example manufacturing which was facing severe shortages of raw
materials and spare parts as a result of foreign exchange constraints. Fertilizers, the only operating expenditure requiring foreign exchange, was made readily available through preferential foreign exchange allocations by the Government and donor community support programs. Second, the significance of smallholder production in agriculture makes the sector less sensitive to price incentives than to non-price factors. Despite this improved performance, however, Zambian agricultural growth remains fragile because of its dependence on weather conditions, the extreme dependence on crops in general and maize in particular, the high degree of subsistence production (accounting for more than 50 percent of total output), and the extremely narrow export base (basically consisting of small quantities of tobacco, cotton, coffee, and beef). The fact that irrigation is almost non-existent and most crops are rain fed explains the disastrous contractions in agricultural output following the four droughts between 1974 and 1991.

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</thead>
<tbody>
<tr>
<td>GDP Total</td>
<td>2.4</td>
<td>0.4</td>
<td>3.2</td>
<td>-1.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Agriculture</td>
<td>2.5</td>
<td>0.5</td>
<td>8.3</td>
<td>-2.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>10.1</td>
<td>1.4</td>
<td>2.0</td>
<td>-1.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Mining</td>
<td>-3.7</td>
<td>-1.4</td>
<td>-4.8</td>
<td>-2.9</td>
<td>-2.5</td>
</tr>
<tr>
<td>Construction</td>
<td>8.6</td>
<td>-7.5</td>
<td>-3.1</td>
<td>-1.2</td>
<td>-2.6</td>
</tr>
</tbody>
</table>

Most of Zambia's public and private industries other than the copper mines were established prior to the mid 1970s. Between 1965 and 1975, the Zambian government established nearly 80 parastatal companies either through new investment or acquisitions of existing private companies. Nearly half of these companies were in the manufacturing sector, almost a third were in the retail/wholesale, finance and other services sub-sectors, and the remaining were in the transport, agriculture, and energy sectors. The Government took majority shares in over 95 percent of these companies, and most of the major ones were entirely government owned. Nearly all parastatal companies had to rely on imported machinery and equipment, and over 80 percent of them had to maintain their production by the use of imported intermediate goods. By
1975, the parastatals accounted for over 50 percent of the output from the manufacturing and transport sectors. They dominated service industries such as the insurance and wholesale/retail businesses as well as production and distribution of energy.

The growth of domestic manufacturing was stimulated by protectionist trade policies. By allowing for higher prices for domestic producers through tariff and non-tariff protection, a strong incentive for the growth of import substitution industries and a severe bias against exports was created. During much of the 1970s, the nominal rate of protection for all goods was estimated to be 34 percent while the effective rate of protection amounted to 160 percent (WB 1984). The structure of tariff rates implied higher protection for domestic consumer goods industries, lesser protection for intermediate goods industries, and minimum protection for capital goods industries. The incentives contributed to the development of an industrial structure based on domestic market orientation, high dependency on capital-intensive and import-intensive industries, and a dominance of public sector (parastatal) enterprises.

During the earlier years of Zambia's industrialization, consumer goods industries such as food processing grew by over 100 percent from 1965-1970; similarly the textile and wearing apparel industries grew by 13 percent per year between 1965 and 1974. Industries naturally protected by high transport costs and dependent on the requirements of the mines, such as basic metal and metal products, also expanded rapidly - by 12 percent per year during 1965-1974. The most significant subsector expansion with an annual growth of over 30 percent occurred in chemicals and chemical products. This basically relates to the government investment in industrial chemicals - the creation of a large government-owned fertilizer factory with a view to substituting for fertilizer imports.

The nature of the early expansion reflects both supply and demand conditions. On the demand side, national income was rising thanks to the increasing revenue from copper exports, and consumer demand for goods and services was strong. Further, the public sector was expanding fast, creating markets for domestically produced
goods and services. More importantly, the closure of the southern transport route created a surge in demand for domestic substitutes for manufactured imports. On the supply side, exports of mining products performed well, and therefore the imports of capital and intermediate goods were readily available and at a low price due to the over-valuation of the Kwacha. During most of the early period of 1965 to 1974, Government economic policy was relatively liberal while the public sector was expanding at a fast pace. Following the formal adoption of the one-party state in 1972, however, attempts to suppress the private sector became more deliberate.

From the peak around the mid-seventies, a number of industries began to contract and have continued doing so up until now. While the average increase in manufacturing output was 20 percent between 1975 and 1991, wood and wood products fell by 27 percent, metals and metal products by 23 percent, and chemicals by 22.5 percent. The only sectors with considerable growth were textiles and minerals. The latter sector, however, although doubling in size between 1975 and 1991, still accounts for a small share of manufacturing output. Textiles, growing by 400 percent between 1970 and 1985, have experienced more difficult times lately (among other reasons, because of cheap second-hand imports) and output fell by 15 percent from 1985 to 1991.
Apart from the parastatal companies, most Zambian manufacturing enterprises are small. Of the 1013 firms in the food, textiles, wood and metal product industries, 636 had less than 20 employees, only 98 had more than 100 employees while 16 firms employed more than 1000 workers. The size distribution is particularly skewed in the wood and wood products industry, in which more than three quarters of the firms employ less than 20 workers. The small size of enterprises is an indication of the low degree of efficiency in much of manufacturing. On the other hand, the prevailing size distribution suggests the importance of economic reforms that benefits small-scale business.

Manufacturing industries are mainly concentrated in the two main industrial centres; Lusaka - the capital - and the Copper Belt. In the four sectors food, textiles, wood products, and metal products, more than 50 percent of all firms are currently based in these two areas. The concentration is particularly high for textiles and metal products, with 64 percent and 70 percent of all firms respectively, concentrated in Lusaka and the Copper Belt. In addition to the two main centres, Livingstone (in the
far south) is important for textiles and wood products, hosting respectively 11 percent and 6 percent of all firms in the sector.

2.3. Government Finance

The economic decline and the reduction in copper revenues after 1975 sharply reduced the Government's ability to supply public services, especially after access to the international capital markets was curtailed in the early eighties. Government's revenue position deteriorated further when donors became more and more reluctant to supply Zambia with support after repeated non-compliance with agreed adjustment programs. Government expenditure has generally been marked by large outlays on subsidies for industrial ventures (incl. Zambia Airways) and on defence, and concentration in the capital sphere rather than for recurrent operating facilities.

| Table 8: Government Expenditure, Million Kwacha - Constant 1984 Prices |
|------------------------|------------------------|------------------------|
|                        | Percent | Percent | Percent |
| Core Sectors           |          |          |          |
| Agriculture            | 579.2    | 39.0     | 340.2    | 31.6     | 354.3    | 36.5     |
| Health                 | 117.3    | 7.9      | 76.8     | 7.1      | 63.7     | 6.6      |
| Education              | 112.9    | 7.6      | 77.8     | 7.2      | 90.7     | 9.4      |
| Transport/Communications| 249.5    | 16.8     | 131.2    | 12.2     | 141.5    | 14.6     |
| Energy                 |          |          |          |          |          |          |
| Other Sectors          | 905.9    | 61.0     | 736.8    | 66.4     | 615.7    | 63.5     |
| TOTAL                  | 1,485.0  | 100.0    | 1,077    | 100.0    | 970.0    | 100.0 |

The supply of social services, in particular health care and education, has deteriorated under the pressure of the general decline in government revenue. In addition, the health and education sectors, traditional "donor sectors", were especially hard hit by donor cutbacks. Consequently, government expenditures fell by 30 percent in real terms between 1984-91 (WB 1992). Education saw its share of the budget shrink from almost 17 percent in 1984 to less than 9 percent in 1990. The decline was especially
evident in primary education, which received an ever shrinking share of the education budget in the 1980s. The lack of funds for recurrent operation has resulted in a rundown of education and health facilities (students per book ratios are up to 20:1).

Government's expenditure on health has kept pace during overall budgetary decline, and still compares favourably to many low-income countries. However, due to the concentration on tertiary care (in 1990, the University Teaching Hospital accounted for more than 20 percent of total Government health expenditures), the produced outcome, measured by various health indicators, is not much different from those of peer countries.

As in the health and education sectors, focus on new capital investments, rather than rehabilitation and maintenance, has been characterizing public expenditures on infrastructure. Consequently, much of the existing infrastructure is seriously run-down and generally poorly utilized. Infrastructure expenditure places a heavy burden on the Government; in 1991, the transport sector imposed a financial burden of about USD 100 million, or 12 percent of total revenues, in the form of grants, overdrafts, and short-term loans. Zambia Airways (ZA), the national airline, is in a critical financial condition. After a process of considerable cost cutting, which did not succeed in curbing losses, the Government has recently, in effect, cut subsidies and required ZA to operate within its own financial limits. The railways continue to show considerable losses, being outperformed by the, mostly private and largely competitive, trucking industry. However, the road network, while fairly extensive, is in poor condition. The international trunk routes have been kept in acceptable condition, largely with donor funds, but the domestic network is generally of poor quality and sometimes impassable, especially in rural areas and during the rainy season.

In order reduce the budget deficit, the Government has reduced subsidies to various sectors, including agriculture. The Zambia privatization programme is also ambitious. The Privatization Act was passed by Parliament in June 1992 and set up a quasi-autonomous Privatization Agency with mandate to privatize all of the 150 commercially oriented parastatals, including the mining company ZCCM, within ten years. By
measures introduced in the 1992 budget, the tax base was broadened, mainly through the introduction of taxes on previously un-taxed fringe benefits, such as subsidized housing and company cars, and the overall tax rate was lowered.

The corporate tax system in Zambia now involves a general corporate income tax of 40 percent, reduced to 15 percent for farmers and non-traditional exporters and with a one-seventh tax relief for rural enterprises. In addition, mineral income is subject to a Mineral Tax, deductible against income for income tax purposes and ranging from 10 to 20 percent on revenues depending on the type of mineral, as well as a Mineral Export Tax, a 13 percent levy on the value of exported minerals. For expatriate employees, with the exception of persons employed in agriculture, employers are required to pay an employee tax of 20 percent. Company losses may be carried forward indefinitely, but can only be deducted from income from the same source. Buildings can be depreciated over a period of ten years while the depreciation period for plants, machinery, and commercial vehicles, is four years.

Capital gains are not taxed, but there is a 10 percent tax on interest in excess of 20,000 Kwacha. There is a uniform sales tax of 20 percent, which, however, only covers the formal sector. The tariff band for imported goods are fifteen, thirty and fifty percent, with a few exceptions such as food and fertilizers (zero) and some luxury goods which are taxed at 100 percent of import value. The personal income tax ranges from 15 to 35 percent.

The July 1991 Investment Act introduced substantial investment incentives for specific investors, mainly relating to production leading to foreign exchange earnings and business located in rural areas. The benefits include exemptions from customs duties and sales tax on investment goods, exemptions from corporate income tax on up to five years and on dividends for seven years, and increased access to remittance abroad of dividends and profits in foreign currency. Critics, including the Chambers of Commerce, have complained about the differential treatment of new and old investments, giving new investors and advantage over existing enterprises.
2.4. Balance of Payments

Zambia experienced a considerable worsening overall external balance over the period 1970-1990. Terms of trade declines, resulting from oil price shocks and a sharp decline in copper prices, adversely affected the current account. This was compounded by a decline in copper output from the late 1970s onward. In addition, Zambia resisted a reduction in imports when the value of exports fell. Consequently, a huge debt stock accumulated as the country borrowed to finance its current account deficits.

Table 9: Summary Balance of Payments, 1970-1990 (USD Million)

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</thead>
<tbody>
<tr>
<td>Exports (net of factor services)</td>
<td>959</td>
<td>868</td>
<td>1608</td>
<td>911</td>
<td>1342</td>
</tr>
<tr>
<td>Imports (net of factor services)</td>
<td>658</td>
<td>1345</td>
<td>1765</td>
<td>936</td>
<td>1369</td>
</tr>
<tr>
<td>Resource Balance</td>
<td>301</td>
<td>-477</td>
<td>-157</td>
<td>-25</td>
<td>-27</td>
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<tr>
<td>Factor Services</td>
<td>-47</td>
<td>117</td>
<td>-205</td>
<td>-308</td>
<td>-332</td>
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<tr>
<td>Net Transfers</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-36</td>
<td>-43</td>
</tr>
<tr>
<td>Current Account Balance (w/o grants)</td>
<td>107</td>
<td>-726</td>
<td>-538</td>
<td>-369</td>
<td>-402</td>
</tr>
</tbody>
</table>

Over the period 1970-1990, Zambia's current account was in deficit for all but three years (1973, 1974, and 1979). The deficit average USD 315 million, or 11 percent of GDP, and reached its highest levels in 1980-82 at 16 percent of GDP, and again in 1985-1986 at almost 20 percent. Up to 1981, performance on the trade account dominated movements in the current account as the services account remained a relatively constant share of output. With the exception of 1975, when copper prices fell considerably, and 1981-82, when there was a world-wide recession, the trade account was consistently in surplus. In contrast, the service account was in deficit over the same period, mainly due to (i) Zambia's landlocked location which results in high transport costs (generally adding more than 20 percent to import costs), (ii) the dominance of a technologically advanced export (copper) which requires significant use of skilled labour from overseas, and, since the early 1980s, (iii) high interest payments on external debt. Since 1981, however, the relative stability of the two sub-accounts has been reversed; the trade surplus has been relatively stable, increasing
slightly as a share of GDP, while the services deficit first worsened and then improved slightly as a share of GDP. Movements in the service account are now dominating the overall current account balance, in part due to Zambia's erratic debt service behaviour (WB 1993).

| Table 10: Exports of Principal Commodities, 1970-1990 (USD Million) |
|---------------------------------|-----------------|----------------|----------------|----------------|----------------|
| Copper                          | 954.3           | 954            | 1277.8         | 624.4          | 1055.0         |
| Zinc                            | 15.4            | 36.8           | 24.8           | 16.9           | 15.2           |
| Lead                            | 6.9             | 6.1            | 8.2            | 2.4            | 0.0            |
| Cobalt                          | 88              | 22.0           | 110.9          | 7.6            | 88.0           |
| Tobacco                         | 4.1             | 7.1            | 3.4            | 0.7            | 4.3            |
| Maize                           | 0.0             | 0.7            | 0.0            | 0.0            | 0.0            |
| Electricity                     | 0.0             | 0.4            | 0.0            | 7.6            | 15.7           |
| Other                           | 0.0             | 10.3           | 40.3           | 44.3           | 63.9           |
| TOTAL Exports                   | 994.5           | 1037.4         | 1465.5         | 704.4          | 1242.2         |

Memo:
- Copper Volume ('000 MT)
  - 1970: 684
  - 1976: 641
  - 1980: 681
  - 1985: 475
  - 1990: 441
- Copper Price (USD/MT)
  - 1970: 1413
  - 1976: 1401
  - 1980: 2182
  - 1985: 1417
  - 1990: 2662
- Copper Price (Constant 1990 USD/MT)
  - 1970: 5634
  - 1976: 3057
  - 1980: 3032
  - 1985: 2066
  - 1990: 2662
- Non-Traditional Exports, % of total
  - 1970: 1.0
  - 1976: 1.8
  - 1980: 3.0
  - 1985: 7.5
  - 1990: 6.8

Zambia's export receipts have long been dominated by metal exports. While export concentration has fallen slightly since the early 1970s, it remains high by any standard, indicating that export diversification efforts have not been successful. Copper exports accounted for 85 percent of total export earnings in 1990, down from 96 percent in 1970. If one includes other minerals as well, the share in total export earnings were 93 percent 1990 (compared to 99 percent in 1970), the difference mainly due to cobalt exports.

The reduction in export earnings, due to the sharp decline in copper prices from the mid-1970s, has been exacerbated by reduced copper output over the period. From 1970 to 1990 the volume production was down by 33.5 percent, mainly due to the facts that existing mineral deposits had become less accessible at greater depths and that the ratio of overburden to ore ratios had increased in the open-pit. Also,
insufficient reinvestment in spare parts and routine maintenance, partly due to the lower after-tax profitability of ZCCM and the inadequate foreign exchange allocations, have contributed to the lower efficiency and output. In recent years, copper prices have improved somewhat while output has continued to fall.

Non-traditional exports seem to have suffered from official neglect because of the early dominance of copper exports. An over-valued exchange rate and fixed agricultural producer prices contributed to low export volumes, and consequently non-traditional exports remained a low and relatively constant share of total exports. After 1983, when the exchange-rate policy was significantly changed, with a relaxation of the foreign exchange constraint and export licensing and bringing the exchange rate more in line with underlying market conditions, the performance of non-traditional exports improved. Between 1988 and 1991, non-traditional exports grew at an average annual rate of 15.2 percent. The fastest growing exports over the period were processed food and primary agricultural commodities.

| Table 11: Distribution of Imports by End User Category |
|-------------------|---|---|---|---|---|
| Consumer Goods    | 33.9 | 21.7 | 20.5 | 17.6 | 21.1 |
| Food Products     | 8.1  | 5.0  | 5.1  | -    | -    |
| Other Non-Food    | 12.9 | 8.9  | 7.8  | -    | -    |
| Durable           | 12.6 | 7.8  | 7.6  | -    | -    |
| Intermediate Goods| 44.2 | 56.0 | 53.5 | 58.4 | 35.2 |
| Capital Goods     | 22.0 | 22.3 | 25.0 | 24.0 | 43.7 |
| Total Imports     | 100.0| 100.0| 100.0| 100.0| 100.0|
| Total Imports in USD Million | 1318.6 | 1497.1 | 1232.7 | 685.7 | 653.1 |
| Total Imports as percent of GDP | 59.8 | 60.4 | 48.8 | 26.5 | 24.0 |

Zambia's production structure has been highly dependent on imported inputs. This was a direct consequence of the tariff regime introduced after Independence to support import-substituting industrialization which was biased in favour of capital and intermediate imports. While Zambia started out with a much higher import-GDP ratio in the early 1970s, this fell sharply after the copper price bust in 1975, and despite
some increase in the ratio between 1979-1981, as copper prices picked up. Zambia has consistently had a lower import-GDP ratio than the rest of Africa since the mid-1970s. Because the exchange rate did not adjust to clear the market for imports, much of the compression was achieved through import licensing and administered foreign exchange allocation systems. The decrease in imports came mostly at the expense of consumer goods. However, imports of intermediate inputs and capital goods also fell significantly.

Increasing donor inflows in support of the economic reform program contributed to an upturn in import levels after 1988. Imports of consumer goods have recovered since 1990, due basically to exogenous factors such as the growth in maize imports (especially during the 1991-92 drought) and the increases in oil prices. Imports of capital goods have fluctuated in recent years, but the overall trend is a substantial increase, suggesting that producers quickly took advantage of the increased availability of foreign exchange to rehabilitate plant and equipment (see below). Imports of intermediate inputs have fallen over the recent period, possibly because of the overall fall in production.

The current account deficit was mainly financed by external debt. The stock of external debt doubled between 1970 and 1975 to USD 1.26 billion, and continued to increase until 1987, when it levelled off. The 1991 external debt totalled USD 7.19 billion, eleven times the amount in 1970, and Zambia's debt stock is now larger than other low-income countries using almost any criterion (WB 1993). After 1974, the government also drew down on reserves which fell to 1.2 months of imports by 1980. Foreign direct investment was never an important source of finance. Arrears began to be significant as early as 1975, but grew sharply after 1985 as macroeconomic imbalances worsened. Gradually external assistance in the form of grants became more important as a source of finance and Zambia's dept service burden in terms of actual cash payments is currently not very severe, reflecting generous rescheduling and increasingly soft terms of recent borrowing. However, Zambian commercial debt is currently trading at about 10 cents to the dollar in the secondary market, indicating that the financial markets have little confidence in Zambia's ability to service its debt.
Instead of allowing the exchange rate to adjust to market clearing levels, trade policy over most of the past twenty years has been characterized by the extensive use of import licensing and foreign exchange controls in response to fluctuations in copper price earnings. In the face of declining terms of trade and accelerating domestic inflation, the Kwacha was increasingly overvalued. Comprehensive reforms in exchange rate determination, foreign exchange allocation (including a weekly foreign exchange auction system), and the tariff regime, were undertaken in the mid-eighties. However, by 1987 reforms had stalled and many of the policies were reversed; a fixed exchange rate system was introduced and the Kwacha was revalued. The degree of exchange rate revaluation reached a peak in 1988, before policy reforms were renewed in 1989.

Under the latest reforms, the Kwacha is still not freely convertible, but importers have access to foreign exchange from three sources; the Open General Licensing (OGL), export retention, and the so-called "no-funds" scheme, or parallel market. Initially, OGL, under which foreign exchange can be purchased at the official rate, covered essential imports, such as ZCCM's import requirements, debt service, fertilizers and crude oil imports, but the system has gradually been liberalized and coverage is now about 95 percent of base-period imports. The process of obtaining a qualification for the OGL, although progressively streamlined, is still both expensive and time-consuming, and delays between an applicant's initial deposit of Kwacha and the actual receipt of foreign exchange takes from a couple of weeks up to six months.

Access to foreign exchange has increased by the introduction of an export retention scheme in 1984. Initially, the scheme enabled non-traditional exporters to retain 50 percent of their gross foreign exchange earnings, provided the retention was used for their import requirements within 21 days. Eventually both the interval and the retention rate have been increased, and after the move to a 100 percent retention rate in February 1992, the amount of transactions under the scheme now amounts to about half that of OGL. Imports using retention funds require much of the OGL documentation as well as a tax clearance certificate, although the entire process does not take more than 4-7 days. The advantage of the no-funds market, reflected in a
less favourable exchange rate, is that no documentation is required and the importer does not have to pay a license fee. In late 1992, a Bureaux de Change System permitted open buying and selling for almost all legal purposes with a transaction limit of USD 3000. There is currently no significant black market premium in Zambia.

Although trade liberalization has been considerable over the recent years, import regulations continue, import taxes accounting for 30.8 percent of government revenue in 1991 (WB 1993). Zambia's tariff regime is complex due to various levels and taxes, as well as both general and user-specific exemptions. Applicable duties and levies of imports are; (i) Custom Duties (mostly ranging between 30-50 percent on value of imports, but with a substantial fraction being exempt from duty); (ii) Import Sales Tax (20 percent on all dutiable items, with the tax base being 120 percent of import value), and (iii) Import License Fee (10 percent on the value of imports through OGL or retention markets).

2.5. Banking and Finance

Zambia has a well developed financial sector, especially by the standards of most other countries in the region. Whereas most other Southern African states experience problems associated with lack of competition, Zambia has twelve commercial banks operating in an environment which is well supported by a wide array of additional non-bank financial institutions. The Bank of Zambia, established in 1964, oversees the banking sector and determines - in conjunction with the Ministry of Finance - Zambia's monetary policy. The central bank is governed by its own Act. However, the financial system is not particularly sophisticated, nor well developed. For example, it has no inter-bank market, money markets are only very limited, and recent events, notably the high inflation rates, have shortened the time horizon of banks and limited the types of lending activities which banks are willing to undertake.

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2 This section is based directly on WB 1993.
The commercial banking sector consists of three distinct groups of banks. The first includes the long established banks: Standard Chartered Bank, Barclays Bank, Grindlays Bank (all of which are majority foreign owned and have a long history of operations in Zambia), and (the 100 percent Government-owned) Zambia National Commercial Bank (ZNCB) established in 1969. With the exception of Grindlays, these are the largest commercial banks, and they dominate the sector, although their relative position has been reduced by the entry, during the 1980s, of the remaining eight new banks. The second group, which also tends to have international connections, include Citibank, Meridien, and Union Bank (from 1991, the latter is owned by local interests). The third group includes five relatively small indigenous banks; Indo-Zambia Bank, African Commercial Bank, Finance Bank, New Capital Bank, and Manifold Investment Bank. The new entrants to the sector have been attracted by the high return on average assets (ranging from 1.2 percent to 10.5 percent in 1989) and on equity (from 18 to 85 percent). In addition, the unregulated nature of banking entry by the Bank of Zambia, as well as the low capitalization requirements under the Banking Act, have permitted easy access for new-comers. The commercial banking sector is engaged in a wide variety of activities. In addition to normal commercial banking concerns, these include several loan syndications, the issue of bonds through subsidiary companies, the operation of foreign-exchange markets, and trading in Treasury Bills.

In addition to the twelve commercial banks, there are also two specialized banks, several leasing companies, and a wide array of other institutions. The Zambia Export and Import Bank (Exim Bank) is a rather small institution dealing with pre- and post-shipment credit for exporters and likely to be closed soon due to poor performance. The Equator Bank provides a range of merchant banking services and external lines of credit. The leasing companies tend to be subsidiaries of the major banks, while the smaller banks provide leasing services in conjunction with their normal lending activities. Leasing business has tended to develop as a separate activity because it is covered under the Commercial Act, rather than under the Banking Act or the Financial Institutions Act.
The non-banking institutions include The Zambia National Building Society (ZNBS) which provides mortgage finance, funded by the issue of various types of shares, the acceptance of deposits and the issue of mortgage bonds. The National Savings and Credit Bank (NSCB) operates like a post office savings bank, but is also involved in small amounts of lending. The Lima Bank is an agricultural bank. The Development Bank of Zambia (DBZ), which invests in equity and long-term loans, is an institution with which the World Bank and several other donors have had a long association. The Small Industries Development Organization (SiDO) provides finance and related services to the small-scale industrial sector in conjunction with the Village Industries Development Organization (VIS). The latter is a non-governmental organization providing similar services to an even smaller scale clientele. The Small Enterprise Promotion (SEP) also provides financial services to small-scale business.

The insurance sector was until recently completely monopolized by the Zambia State Insurance Corporation (ZSIC) and its sister company Zambia National State Insurance Brokers (ZNIB). New entry is now permitted in the insurance sector, but the parastatals still dominate, particularly in the reinsurance market. It is compulsory for private sector employers and employees to contribute to the Zambia National Provident Fund (ZNPF). For exporters, ZSIC offers cargo insurance from warehouse to warehouse. However, no insurance exists for the exporters who wants to extend credit for their overseas purchasers.

While the commercial banking sector is reasonably well developed, rural financial services are small and poorly developed and credit and savings services are not easily accessible to the majority of smallhold farmers, as well as small industrial firms. Distortions in financial markets (interest rate controls and subsidies), and institutional and management weakness among government-owned rural financial programmes, have circumscribed the provision of financial services in rural areas. The fact that commodity production programmes supported by farm credit have experienced considerable expansion, suggests that access to credit by smallholders is critical to investments and the adoption of new technologies.
The development of the financial sector has been impeded by the severe strains resulting from the adjustment process over the latter part of the early 1980s and into the 1990s. Although there are no ceilings on bank lending to the private sector, the government has used liquid asset requirements to limit growth in credit. Under these restrictions, in an environment of excess liquidity and, until recently, ceiling on the bank lending rate, the banks have focused on short-term lending to prime customers. In addition, the non-banking financial institutions (such as the Development Bank of Zambia), which have traditionally been long-term lenders in the economy, have had to deal with client exposure to foreign exchange risk in a period when the Kwacha has been depreciating at a very rapid rate. As a result, virtually no long-term lending is currently being undertaken. The only money markets are in Treasury Bills, and, despite the recent moves towards privatization, markets in equity instruments are also not well developed.

2.6. Labour Force and Employment

Zambia had a population of 7.8 million according to the 1990 census, and increase of 2.1 million from the 1980 census. Population growth rates have increased from 2.7 percent in 1960 to 3.2 percent in the 1980s. The acceleration in population growth has increased the dependency ratio, the ratio of people outside economically active age groups divided by the number in these groups. The dependency ratio is presently 1.06 in Zambia, up from 0.91 in 1960. Adding to the population pressure was the rapid rate of urbanization, increasing the urban share from 23 percent in 1960 to 42 percent in 1990, among the highest in sub-Saharan Africa.

Although population growth has increased the size of the labour force, falling education standards have contributed to a considerable part of the labour force lacking formal and technical skills. Furthermore, the spread of the AIDS epidemic threatens to eliminate part of the most productive people from the labour force; in one study, HIV infection among people with 10-14 years of education was shown to be three times as high as among people with less than 4 years of education (Ainsworth and Over).
The access to skilled labour is also hampered by the fact that the employment by expatriates is generally discouraged by restrictions on entry visas and work permits.

The informal sector has grown relative to the formal sector during the 1980s. In 1980, formal sector employment was almost 24 percent of the labour force, but this declined to under 10 percent by 1990. This development reflects the complete standstill in formal-sector employment growth, and the consequent lack of employment opportunities for labour-market entrants. During the last ten years, formal sector employment has been virtually constant in agriculture, mining, manufacturing, and transport, while construction experienced a decrease of 40 percent from 1980 to 1991. The only formal sector industry actually increasing employment, was services. The informal sector is primarily a rural phenomenon. In 1986, 85 percent of informal employment was located in the rural areas, compared to only 35 percent of formal sector employment (CSO 1992). Informal sector income distribution is more skewed than the formal sector one (PIC 1991).

The participation of women in the informal sector is high; more than 50 percent of informal employment consists of women, whereas women constituted approximately 15 percent of the formal work force. Women predominantly occupy the lower-paying jobs in the informal sector, especially in subsistence farming. The share of women in the total labour force has risen slightly over the 1980s, reaching 29 percent in 1990. Although the general women labour participation rate is considerable, women meet a number of obstacles which prevent them from participating on equal footing with men. Although primary school attendance is almost equal among men and women, the attrition rate in the final years of primary schools, and the high failure rate of women in the entry exam for secondary school, reduce the female participation rate in
secondary education. Domestic pressure and lack of finance seem to be among the main causes, but some 2 percent of the women are expelled from school each year on the grounds of pregnancy. Labour legislation intended to protect women from hard and dangerous labour, such as mines, or night work, had the effect of excluding women from various areas of employment. The Employment of Women, Young Persons and Children (Amendment) Act of 1991, removes the latter provisions and allows the women freedom to work in any industry. In the informal trading sector women have difficulties obtaining selling licenses, and leasehold to farmland is also more difficult to obtain for women than for men.

<table>
<thead>
<tr>
<th>Table 13: Number of Employees in the Formal Sector, Thousands, 1980-91</th>
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<tr>
<td>Source: WB 1993</td>
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<tr>
<td>Agriculture, Forestry and Fishing</td>
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<tr>
<td>Mining and Quarrying</td>
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<td>Manufacturing</td>
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<td>Construction</td>
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<tr>
<td>Transport and Communication</td>
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<td>Services</td>
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<td>TOTAL</td>
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After Independence, and continuing into the 1980s, enrolments in both primary and secondary schools increased considerably. In addition, a policy on technical and vocational training was adopted in the late 1960s and followed through in the following years, with formal pre-service and in-service training at crafts, technician and technological levels in a network of technical institutions. The rapid numerical expansion of the education system has not been maintained since 1985, and the gross enrolment ratio in primary schools has fallen since then. Parallel to this development, there has been a strong decline in learning materials, such as books, and new investment in physical infrastructure and/or rehabilitation of existing infrastructure; in 1991, salaries and allowances accounted for 97 percent of the allocation for primary education and 65 percent of that for secondary (a further 25 percent of the secondary allocation covered boarding costs). Many of the programs
on vocational training have been discontinued, and there is currently no formal apprentice system in Zambia.

The new Government is giving priority to education in general, and primary education in particular. Starting in 1991, Government has increased the budgetary allocation to education, and plan to continue to increase it further, to about 15 percent of the total Government budget by 1995.

2.7. Income and Wages

As showed in table 1, living standards of the average Zambian has been in decline for a long period. The decline in per capita income has pushed more and more people below the poverty line, and by 1991, 67 percent of the population live in poverty (58 in extreme poverty), as compared to an estimated 60 percent in 1974-75 (WB 1993). The current poverty level is well above that of Sub-Saharan Africa, where 47 percent were considered poor (30 percent extremely poor).³ Poverty is in general considerably higher in rural areas than in urban areas, with small-scale farmers constituting the bulk of the poor. However, the increase in poverty over the last 15 years has been much larger for urban than for rural households. This, together with the fact that the decline in incomes has been strongest for the higher-paid, implies that income inequalities narrowed over the 1974-1991 period.

After a modest increase in the late 1960s, real wages have been falling sharply since 1975. In 1991, average real earnings were reduced to 30 percent of the 1975 level. The fall has been particularly long in the manufacturing sector, dropping by 75 percent from 1975 to 1991. Due to the very high inflation rate in later years, the fall has continued, at an accelerated speed. Despite the steep decline in formal sector earnings, compensation of employees as a share in national income rose from 57 percent in 1975 to 63 percent in 1991. This was partly due to the fact that

³ The figures for Sub-Saharan Africa refer to 1985 (WB 1990).
employment grew faster than income and partly because the informal sector, which has higher wages on average because it includes most farmers, grew faster than the formal sector.

Table 14: Average annual Real Earnings by Sector, Indices 1975 = 100

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</thead>
<tbody>
<tr>
<td>Agriculture, Forestry and Fishing</td>
<td>90</td>
<td>139</td>
<td>100</td>
<td>111</td>
<td>118</td>
<td>136</td>
<td>48</td>
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<tr>
<td>Fishing</td>
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<tr>
<td>Mining and Quarrying</td>
<td>110</td>
<td>126</td>
<td>100</td>
<td>71</td>
<td>63</td>
<td>36</td>
<td>34</td>
<td>22</td>
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<tr>
<td>Manufacturing</td>
<td>100</td>
<td>111</td>
<td>100</td>
<td>78</td>
<td>72</td>
<td>37</td>
<td>25</td>
<td>23</td>
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<tr>
<td>Constructions</td>
<td>84</td>
<td>119</td>
<td>100</td>
<td>78</td>
<td></td>
<td></td>
<td>46</td>
<td>30</td>
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<tr>
<td>Transport and Communications</td>
<td>75</td>
<td>102</td>
<td>100</td>
<td>69</td>
<td></td>
<td></td>
<td>26</td>
<td>30</td>
</tr>
<tr>
<td>Services</td>
<td>99</td>
<td>103</td>
<td>100</td>
<td>76</td>
<td>73</td>
<td>40</td>
<td>26</td>
<td>20</td>
</tr>
<tr>
<td>Total</td>
<td>97</td>
<td>111</td>
<td>100</td>
<td>77</td>
<td>73</td>
<td>44</td>
<td>30</td>
<td>21</td>
</tr>
</tbody>
</table>

Minimum wages are not in effect in Zambia. The Minimum Wages and Conditions of Employment Act lets the Ministry of Labour set minimum wages. However, due to the fact that minimum wages have not been indexed with inflation, the act is not effective. Unionized employees, which constitute the majority of workers in the formal sector, work under collective agreements which are negotiated either directly between the employer and the employees or between an employer's organization and an industry-specific union. The Industrial Relations Act regulates the relationship between the trade unions and employers organization. The Act also sets up the Industrial Relations Court which has exclusive jurisdiction over disputes between employers and employees. Disputes not involving unionized workers are settled by the Labour Office and the Ministry of Labour.

For formal-sector employees, a number of social security benefits exist which protects them from the consequences of old age and illness. The Ministry of Labour and Social Security has the overall coordination, and a variety of implementing agents exists. Although, at present, the coverage of the programs is limited to the formal sector, plans exist to extend coverage of pension schemes to the self-employed. Implementation of the various schemes is weak, and enforcement of entitlements is
limited. This holds especially for women; although women are entitled to inherit 20 percent of their husband's estate, in general they have little possibility to appropriate benefits related to the death of a husband, most often because of "property grabbing" by relatives of the deceased.

2.8. Prices and Inflation

After a long period over various measures of price control, price limits have been eliminated and the Prices and Incomes Commission abolished. The inflationary environment and the substantial relative price changes among commodities cast doubt on the use of the Zambian price index. Furthermore, since the price index is based on the Laspeyres formula, increases in cost of living is generally overstated by use of the index.

| Source: WB 1993 |
| Low Income Urban, All Items | 100.0 | 39.5 | 100.0 | 793.5 | 1674.4 | 3224.9 |
| Food, Beverages and Tobacco | 68.0 | 39.1 | 100.0 | 792.6 | 1666.3 | 3182.3 |
| Clothing, Footwear and Accessories | 9.9 | 46.9 | 100.0 | 846.7 | 1839.0 | 3078.8 |
| Rent, Fuel and Lighting | 10.6 | 48.9 | 100.0 | 384.4 | 841.2 | 2780.5 |
| Furniture and Household Goods | 4.4 | 25.7 | 100.0 | 979.1 | 1911.2 | 3739.6 |
| Other Goods and Services | 7.1 | 39.3 | 100.0 | 835.9 | 1915.2 | 5584.6 |
| High Income Urban, All Items | 100.0 | 42.4 | 100.0 | 847.0 | 1695.2 | 3366.1 |
| Food, Beverages and Tobacco | 36.0 | 37.1 | 100.0 | 961.7 | 1912.2 | 3620.4 |
| Clothing, Footwear and Accessories | 8.8 | 45.4 | 100.0 | 778.5 | 1636.7 | 3236.7 |
| Rent, Fuel and Lighting | 19.5 | 56.9 | 100.0 | 246.8 | 369.6 | 1031.3 |
| Furniture and Household Goods | 7.9 | 31.7 | 100.0 | 1033.9 | 1929.1 | 3809.5 |
| Medical Care and Health Services | 1.5 | 53.5 | 100.0 | 783.6 | 1612.0 | 2946.2 |
| Transport and Communications | 13.7 | 44.7 | 100.0 | 834.2 | 1728.3 | 3972.8 |
| Recreation, Entertainment and Education | 6.3 | 47.0 | 100.0 | 752.6 | 1484.3 | 2913.4 |
| Other Goods and Services | 5.3 | 39.5 | 100.0 | 853.2 | 1972.2 | 3595.3 |

The inflation rate increased considerably in the late 1980s, after the start of the process of continuous devaluation of the Kwacha, and is currently running at around 200 percent. Price increases have been particularly high for necessities such as food, clothing and household goods. Government supplied services, such as health and education, as well as regulated services, such as housing and electricity, have tended
to lag behind the rest. However, following the changes in government policy, with emphasis on deregulation and the lifting of price controls, these commodities have been subject to large price increases lately.

2.9 Business Law and Regulations

To be able to commence a business, several licenses are required; a manufactures license, a foreign-exchange license, an import/export license, and, for distributors, a trading license. For foreign investors there are several additional licenses; an investment license, and investment permit, as well as an incentive permit. Most of the licenses have to be renewed at regular intervals, and the licenses are obtained from different institutions. With the introduction of the Investment Act of 1991, the process is considerably simplified with the Investment Centre functioning as a one-stop-shop, assisting with the procedure of applying for licenses.

Zambia has very complicated land laws, which tend to be an important obstacle to the efficient use of land. In Zambia there are three types of land; State, Reserve, and Trust land. The State land comprises eight percent of the total land, nearly all of which is surveyed. Only a negligible part of the rest of land is surveyed, and there is a large backlog in surveying. 100 year leases can be issued for surveyed land, while the length of the title deed for un-surveyed land varies between five and fourteen years. Obtaining a leasehold is generally both costly and time consuming. There are two different rents; one for urban land and one for the rest. Generally rents are low and, since they do not take into account neither the location and quality, nor the availability of infrastructure and utilities, rents are not reflecting the economic returns on the land. The leasehold of developed land may be sold, but not that for undeveloped land. The latter restriction reflects the view that land as such has no value. It has the unfortunate implication that un-developed land cannot be mortgaged.

3. CONCLUDING REMARKS ON FURTHER WORK.
Political independence in Zambia did not liberate the country from its economic dependence on copper. This has changed little since 1964 and the economy is still a victim of the prevailing conditions internationally for the mining industry. When copper prices were high, as in the first decade after Independence, Zambia enjoyed one of the highest growth rates in Sub-Saharan Africa. These golden years of relative prosperity, however, were followed by crisis caused by the international recessions in 1970s and 1980s. With employment, foreign exchange and governmental revenues all tied closely to the copper industry, it is easy to understand that the Zambian economic decline in the 1980 became extreme even in a Sub-Saharan context.

Zambia has in various ways tried to restructure and diversify the economy. A policy for import substitution, followed in several years after the 1968 Mulungushi Reforms, failed to reduce the dependence of copper. Instead, Zambia obtained an oversized sheltered industry that now produces below capacity. Zambia also tried to expand the agricultural sector via the Operation Food Programme. Mechanized state farms failed, however, to provide incentives for sufficient agricultural growth.

The dependence on minerals has continued as before and with the low copper prices during the 1980s, the country has accumulated a foreign debt so high that it threatens to retard all economic progress. All this is particularly troublesome as the copper mines cannot be operated with a surplus more than for another twenty years.

Thus, Zambia no doubt needs to restructure her economy to obtain more diversification. A major challenge to our research project is therefore to provide policy makers with a better knowledge base to undertake structural changes and to provide incentives for a more balanced growth.

Firstly, it is an important first step to utilize the micro data base established by the survey to give a more accurate description of the present firm and plant structures both between and within industries. More precise knowledge in this area may be necessary to grasp the real problems and to find possible solutions of the Zambian industry. Secondly, the data base should be used to obtain a better theoretical and
empirical understanding of the obstacles to growth and a diversified development in Zambia. We have some preliminary ideas on how the data set can be used and we conclude by a brief review of some of these ideas and the problems in that connection.

(i) The relevance of a production function approach. It is our belief that utilisation of the survey data within a production function setting can provide policy relevant information directly. In addition, the production function approach that we have in mind is a useful first step towards a more comprehensive study of more specific theories.

In a production function context technical efficiency of a firm is defined as the relative ability to produce outputs from a given bundle of inputs. The distribution of efficiency over the four industries covered by the questionnaire can serve as a guide for industrial policy to improve the general level of efficiency. The efficiency structure signals where to start to achieve greatest improvements in performance.

The distribution of scale efficiency will shed light on whether industrialisation is most successful at the smaller or larger end of the scale. Preconceived ideas about efficient scale abound, but the Zambian reality is what matters. The distribution of allocation efficiency will shed light on whether firms are starved of real capital, or not, with important immediate consequences for industrial policy. The fact that Zambia has had low economic growth even with relatively high investment rates, gives a clear indication of misallocation of resources. Yet it remains to be identified where and why the problems arise.

Most empirical work on production relationships in less developed countries (LDCs) have been done on a sectoral level. However, the problems of industries in LDCs like technical inefficiency, scale inefficiency and allocative inefficiency have to be analysed on a firm level basis. As we have seen the most striking economic problems of Zambia are macro economic imbalances with roots in a badly functioning micro
The establishment of micro survey data is therefore necessary to be able to start to address the problems mentioned above.

(ii) Noisy data and production functions.
The standard variables in a micro based production function are output, capital, labour, energy and raw materials. The survey will provide information on these variables. Three measures on output can be derived:

- Total sales
- Value added
- Quantities of 5 main products.

Total sales will be the standard variable. Value added may not be possible to deduce perfectly if answers are incomplete. Figures on quantities can be most helpful in industries with a concentrated range of products.

Information on capital is often a problem, and not only in LDCs. The survey tries to establish three measures.

- Book values
- Replacement or market values
- Horsepower.

In inflationary economies like that of Zambia book values can be far off "true" capital stocks. Replacement or market values should perform better, but may be difficult to get hold of. Horsepower is a classical proxy for capital stock.

The extent and coverage of industrial and employment census data seem good. Information on labour should therefore be as satisfactorily as in industrialised countries, and will be expressed both in numbers, wages and total wage bill. We will in addition get information on composition according to skills, education and turnover. Information on energy is provided on a cost basis. This also holds for raw materials. However, for the latter we will also have additional information on quantities matching the information on products.
It should be recognized that estimating production relations on the micro level using data described above is somewhat removed from the engineering realities on the shop floor. However, this problem is not specific for the data set to be established in Zambia, and estimating production functions on a micro level has received increased interest in economic journals over the last decade.

A general criticism of studies of industry in LDCs is that the data quality is too poor. But this is exactly why a special survey is so important. Yet we must face the prospect of the answers being far from satisfactorily. But even in this case all is not lost, especially if we can get information on the structure of incomplete information. As Tybout has recently emphasized it may be possible “to make noisy data sing” by following special procedures in estimating production technologies in LDCs (see Tybout 1993).

(iii) Some specific comparisons.

With respect to firm organization it is of some interest to distinguish between formal and informal activities and private and public ownership. In the informal sector the property rights are incomplete partly due to insufficient legal protection. This may imply higher costs of contract enforcement. A small amount of public policing of informal sector activities, however, also means less effective regulation and extended rights to the owners.

By operating in informal settings small enterprises may therefore on the one hand be more flexible than similar firms in a more formal settings. On the other hand informal firms may also face higher transaction costs and tighter rationing of for instance imported inputs, credit and so on. The production function approach allows us to test for such theories. We may also be able to find out which type of firms that faces most severe bottlenecks in input and output markets.

To a large extent the formal sector in Zambia consists of public companies. Yet there may still be controversies over where the line should be drawn between formal and informal activities. The distinction must to some extent be based on pragmatic criteria.
Given a workable distinction, however, we can easily test for the impact of both ownership and organization.

After Independence there were several attempts to undertake a "Zambianization" of the economy by replacing white workers by blacks, or simply to follow a policy of more equal opportunities. This was basically done by establishing parastatals and expanding the public sector. In this connection it may be interesting to address to what extent the public sector consists of surplus labour employed by the government to induce loyalty to the regime. Comparisons of productivities and excess capacities may provide answers.

Not all parastatals operate under the same regulations from the government. By a systematic comparisons of different designs of regulation one may obtain a picture of which types of regulation that performs the better. One may also ask whether successful deregulation is possible without privatization.

(iv) Industrial environment and business climate.
It is of great interest to establish the range and form of the efficiency distributions mentioned above. Explanations of why there are distributions, however, may be of even greater value. In the search for such explanations additional information from the survey on, for example, technology, entry barriers, financial markets used by the firm, ownership structure, ethnic background of the owner, quality of infrastructure, etc. can be used to explore more specific influences.

It is our opinion that the significance of these industrial organization variables is best accounted for after we have established a better description of the distribution of firms, productivities and plant sizes. Such two-stage analyses of efficiency should yield valuable policy information on what course to follow in connection with deregulation, privatisation and other measures to improve the Zambian industry performance.

(v) Spillover effects and clusters.
Both old and new growth theories focus on positive spillover effects between interlinked industries and firms. Both learning by doing, imitation and market complementarities are important. Some theories emphasize the potential positive role of clusters. The case of Zambia, where the most important economic activities cluster around mining, demonstrates clearly that a cluster is not enough in itself. Mining has to few both backward and forward linkages to generate positive spillovers. The production function approach may, however, be used to identify other small clusters and their linkages.

(vi) Wages and efficiency.
Which type of firms; formal-informal, public-private, pay higher wages? Are wage differentials related to differentials in productivity? Again the production function approach can help in explaining whether higher profits in some firms may stem from lower wages or higher productivity. This is important to be able to distinguish between efficiency and distribution.

There have also been attempts in Zambia to narrow earlier pay differentials based on race. A better understanding of wage premiums in different sectors and types of firms may indicate to what extent labour markets are competitive or not. The fact that there exist a wage premium to public sector workers and that the female participation rate is particularly low in the public sector, may indicate some sort of labour market segmentation. Yet we do not know the causes and significance of these wage gaps and to what extent they are harmful to efficiency or not.

The questionnaire can also provide information on the role of local unions and of collective bargaining. In contrast to other Sub-African countries Zambia has a relatively large urban working class where the union movement has a long tradition both among European workers and African workers. The unions have mostly confined their time to union specific issues. Yet they played an active role in the fight for a multi-party system.

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It is interesting to explore how wages are determined in different industries and how rents are divided among stakeholders in different types of firms? Does the presence of unions narrow pay differentials among insiders. Do the wage gaps between insiders and outsiders widen? Answers to such questions may be important for industrial policy and for policies to reduce poverty.

Under some circumstances pay compression by unions may induce structural change by the elimination of the least efficient plants and by lowering the entry costs of new more efficient plants. To what extent does the role of Zambian unions fit to this model that has been rather successful in a Scandinavian context. More generally one may wish to know how union policies in Zambia affect growth and attempts to diversify production.

(v) Regulation and extralegal activities.

Extensive regulations and controls offer wide opportunities for corruption and favouritism on the one hand and smuggling, rule bending and inappropriate activities on the other. To obtain exact information on these matters is of course impossible. However, it would help to give the information obtained from the questionnaire on licensing, extra taxes and quotas a systematic treatment and relate the information to the basic productivity distributions. One basic question to pursue would be to what extent bribes and extralegal payment function any different from an ordinary tax system. According to some theories bribes constitute an additional drag on growth and structural change.

Another interesting feature is the career paths of public servants. Are positions in the public sector early in the career used as a basis for private sector business operations later on. Are political and bureaucratic positions used to allocate rents to own private firms? Such behaviour is harmful to growth and development. Even anecdotal evidence on these matters, from the conversations in connection with the interview, would be important for a better understanding of this type of rent dissipation.
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Andersson, P.-Å. (1993): "Labour Market Structure in a Controlled Economy. The case of Zambia", Doctoral dissertation, Economic studies 37, Department of Economics, University of Gothenburg. The dissertation analyses the segmentation of the Zambian labour market. Initially, in the post-colonial era, there was segmentation into a formal and mainly state-owned urban sector characterised by high living standards, and an informal and private agricultural rural sector. This model is seen by the author as conducive to regime loyalty. As external economic shocks set in a second aspect of dualism developed in a growing informal urban sector. Based on 1985 survey data, an econometric model is estimated that shows the presence of large wage premiums in the formal and public sectors. The final chapter estimates labour supply curves and finds that the income variable is significant for women, while the wealth variable is important for men.


Economist Intelligence Unit (1992): "Zambia — Country Profile 1992-93. Annual survey of political and economic background", London. The survey provides descriptive background information on political, economic and social conditions in Zambia as of July 1992. Reasonably up to date statistics are provided on many subjects and from different sources. Short chapters cover politics, demography, macroeconomic subjects and selected industries, as well as foreign trade, trade regulations and international relations generally. The style is journalistic, with an orientation towards foreign business interests.
This provides an update to the Economist Intelligence Unit (1992), with the latest available statistics on vital subjects, combined with a presentation of recent events and developments in politics and the economy.

This report presents the view of GRZ on progress in the Economic Recovery Programme, giving an overview of recent and ongoing reforms and concluding with requests for external financing.

The Dutch Disease model is used to analyse the impact of copper prices on sectoral performance, but finds this model lacking in its description of public sector response. Using two computable general equilibrium models for Zambia, adjustment policies that emphasise domestic austerity are found to be most likely to increase output, but at the same time likely to reduce real wages and favour profit earners, thus potentially enduring political conflict.

This study gives an overview of the macroeconomic setting, production structure and business environment, and reviews the institutions and donor organisations' policies. It reports the main problems to be inflation, lack of market mechanisms and unpredictable policy environment. The recommendation to NORAD is primarily to support the restructuring programme and making other projects dependent on the continuance of the programme.

This research paper seeks to analyse the effects of adjustment programmes imposed by international financial institutions, notably the IMF. A theoretical part contrasts the views of neo-
classical and structuralist economic schools. Chapter III reviews earlier cross-country comparisons and in depth case studies. The last two chapters present the evidence from the Zambian experience. Among the conclusions are that more pronounced structural policies rather than demand contraction would have been required to diversify the economy, although the effects of the adjustment programmes are difficult to separate from adverse external shocks.

This report for NORAD reviews the environment for small and medium scale enterprises (SME's), concentrating in its recommendations on the restructuring of the Small Industries Development Organisation (SIDO) and the decentralisation of financial and support services.

This report gives general background information on economic and social trends and more specific information on trends in development assistance. The main content is a comprehensive table of external assistance projects.

The report asks what set of policies can lead the industrial sector in the direction of a larger role in meeting demand and generating export revenues while using domestic resources efficiently. It attempts to answer by reviewing past policies and performance and by suggesting appropriate directions for policy reform. Past policies have intervened to limit competition, reducing the role of market mechanisms and expanding the role of public investment. This has lead to low capacity utilisation, declining productivity, increasing costs and bias in trade incentives. The final chapters propose a strategy for industrial development and policy reform, suggesting increased reliance on market mechanisms, a more uniform incentive structure across sectors, selective promotion of a limited number of new industrial activities, greater attention to linkages between industry and agriculture and a balance between public and private investment.
The report analyses the development prospects for the various sectors of the economy in response to the 1983 economic reforms. It describes these reforms as aimed at reducing price distortions and strengthening incentives for diversification, and proceeds to a detailed analysis of the prospects for growth in the medium term.

This audit report gives a detailed account of the use of a major World Bank loan aimed at assisting the development of the industrial and agricultural sectors of the economy. While it deems the project on balance to be considered a success since the enterprises financed by the loan performed well, the creation of jobs and foreign exchange was disappointing.

This audit report evaluates the World Bank loan designed to reform the foreign exchange system through an auction system and various other measures to improve import and export incentives. While initial implementation was satisfactory, the reforms were later abandoned for political reasons. This contributed to the failure of the project. The report summarises several lessons and recommendations.

This report reviews public expenditure, analysing the macroeconomic setting, allocation by functional groups and expenditure issues within key economic sectors and parastatal investment programmes. It recommends increased budgetary restraint and focusing on core expenditure areas.

This report reviews economic developments in major fields such as living standards, output and investment, balance of payments and income distribution and social services, discusses current
policy issues and evaluates prospects in the medium and long term. It emphasises the need to contain inflation and discusses the merits of a market based exchange rate, privatisation and deregulation. It reports projections of economic growth at over 5 % per year for the next decade if economic policy continues to improve through increased capacity utilisation. In the longer term the challenges are supposed to be to develop Zambia's human capital, to deal with the debt burden, to increase the rate of domestic investment, and to reduce the rate of population growth.
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