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# ZAMBIA PRIVATE SECTOR ASSESSMENT

**FINAL REPORT**

*Bureau for Private Enterprise*
*U.S. Agency for International Development*

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| *Prepared for:* | *USAID/Zambia*<br>*Bureau for Africa, Office of Operations and New Initiatives* |
| *Prepared by:* | *Peter Boone, SRI International*<br>*Hakainde Hichilema, Coopers & Lybrand*<br>*Robert Rauth, The Services Group*<br>*Dennis Smyth, Coopers & Lybrand* |
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## ACRONYMS AND ABBREVIATIONS

| | |
|---|---|
| ASEAN | Association of Southeast Asian Nations |
| BCCI | Bank of Credit and Commerce International |
| BOZ | Bank of Zambia |
| CDC | Commonwealth Development Corporation |
| CIF | Cost, Insurance, Freight |
| DANIDA | Danish Aid Agency |
| DFA | Development Fund For Africa |
| EC | European Community |
| ERS | Export Retention Scheme |
| EXD | Export Declaration Customs Forms |
| FIAS | Foreign Investment Advisory Services |
| FINNIDA | Finnish Aid Agency |
| FSVC | Financial Service Volunteer Corps |
| FOB | Free on Board |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| GRZ | Government of the Republic of Zambia |
| GTZ | German Aid Agency |
| IATA | International Air Transport Association |
| IDA | International Development Association |
| IESC | International Executive Services Corps |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| INDECO | Industrial Development Corporation |
| IPR | Intellectual Property Rights |
| JICA | Japanese Donor Agency |
| JIC | Joint Industrial Council |
| MBO | Management Buy-Out |
| MER | Market Exchange Rate |
| MMD | Movement for Multiparty Democracy |
| MUB | Manufacturing-Under-Bond |
| NAC | National Air Charters |
| NGO | Non-governmental Organization |
| NORAD | Norwegian Aid Agency |
| NPWS | National Park and Wildlife Service |
| NYSE | New York Stock Exchange |
| ODA | Overseas Development Agency |
| OER | Official Exchange Rate |
| OGL | Open General Licensing |
| OPIC | Overseas Private Investment Corporation |
| PIRC | Privatization and Industrial Reform Adjustment |
| PTA | Preferential Trade Area |

| | |
|---|---|
| PTC | Post and Telecommunications Corporation |
| SADCC | Southern African Development Coordination Conference |
| SDR | Special Drawing Rights |
| SGS | Societe Generale de Surveillance |
| SIDA | Swedish Aid Agency |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organization |
| UNIP | United National Independent Party |
| USAID | United States Agency for International Development |
| ZACCI | Zambia Chamber of Commerce & Industry |
| ZCCM | Zambia Consolidated Copper Mines |
| ZEGA | Zambia Export Growers Association |
| ZEIL | Zambia Emerald Industries Ltd. |
| ZESCO | Zambia Electricity Supply Corporation |
| ZIMCO | Zambia Industrial and Mining Corporation |
| ZNCB | Zambia National Commercial Bank |
| ZNTB | Zambia National Tourist Board |
| ZPA | Zambia Privatisation Agency |
| ZSIC | Zambia State Insurance Company |
| ZTMB | Zambia Tourism Market Board |

## EXECUTIVE SUMMARY

In 1991, the people of Zambia inaugurated a new economic and political era when they voted into power the Movement for Multiparty Democracy (MMD). The MMD's platform has been based on the protection of human rights, democratic pluralism, good government, and the encouragement of private enterprise.

The Zambian economy still suffers from the effects of the longstanding distortions introduced during the Second Republic. Soon after independence, the UNIP regime sought to control the economy through nationalization, parastatal proliferation, trade and exchange restrictions, and price controls. Throughout the Second Republic the Zambian economy was characterized by its dependence on copper exports, the dominance of parastatals, and macroeconomic mismanagement.

There are four major constraints which remain from the Second Republic: (i) inflation; (ii) external debt; (iii) heavy reliance on copper; and (iv) the dominance of the parastatal sector. The impact of these limitations cannot be immediately removed from the economy, despite measures to remove these constraints.

The economic reforms planned by the MMD government focus on a short-term macroeconomic stabilization plan to control the budget deficit and inflation, and a long-term structural plan to reduce the size and inefficiencies of the public sector. The MMD government during its first year in office has introduced a bold set of stabilization and liberalization measures. Key elements of the program include:

- a series of exchange rate adjustments designed to discourage imports and make exporting more competitive;
- liberalization of the Investment Act and investment approval procedures, resulting in a significant amount of new investment, particularly in the agricultural sector;
- the announcement of a comprehensive new privatization program, including the approval of the 1992 Privatisation Act, and the establishment of the Zambia Privatisation Agency, and a list of companies to be privatized over the next year; and
- the decontrol of agricultural prices, opening the door to the private sector in the areas of marketing, milling and input distribution.

These liberalization measures notwithstanding, there are a number of constraints in the private investment climate which will need to be overcome if the private sector is to become the engine of growth envisioned by the Zambian government. The list of limitations to private sector growth in the current environment is quite extensive and includes:

- hyper-inflation;
- multiple exchange rates;

- high corporate taxes and import tariffs, particularly on imported inputs;
- restrictions on credit availability, especially on long term credit;
- outdated commercial, land, and labor laws;
- onerous importing procedures; and
- an investment incentive package, which although enhanced in 1991, is still uncompetitive by world or even regional standards, particularly for exporters.

The consultant team has drafted a set of policy and program recommendations aimed at improving the private sector enabling environment. It is the opinion of the team that unless serious new initiatives are undertaken to remove the key constraints to private sector growth, the private sector response to the Economic Recovery Program will not be as strong as anticipated by policymakers and the results could mean further stagnation and economic decline.

The principal short-term policy recommendations of the team are summarized below, followed by a set of program recommendations for USAID/Zambia (See Chapters VI and VII for more detailed recommendations):

**Short-term Policy Recommendations**

1. Reduce inflation -- the number one problem facing business -- by cutting government spending sharply and by allowing interest rates to become positive in real terms.

2. Institute legislation allowing for activities related to venture capital funds/merchant banks, mutual funds/unit trusts, and over-the-counter stock trading.

3. Remove all remaining controls on exchange rates so that rates can converge immediately into one market-determined exchange rate.

4. Reduce corporate income taxes and import duties dramatically, thus encouraging greater economic growth and substantially reducing tax evasion and under-reporting.

5. Abolish the capital registration tax and establish a 100 percent one-year investment allowance deduction on equipment and machinery.

6. Enhance incentives to foreign investors by increasing the allowable percentage of profit remittances from 75 percent to 100 percent.

7. In order to compete for export-oriented investment, it is recommended that the government of Zambia increase the tax

holiday for export industries to 10 years. To encourage existing investors, it is recommended a partial export regime be established.

8. Streamline the duty drawback scheme and develop and promote an effective Manufacturing-Under-Bond Scheme, based on paper control systems.

9. Expand and formalize the dialogue between the government, trade unions, and the private sector through the creation of a coordinating council.

**Program Options for USAID to Promote Private Sector Growth**

1. Zambia Export Development Project (ZED). This project option would focus on enhancing export procedures, policies, and incentives to support accelerated growth of non-traditional exports.

2 Private Sector Non-Project Assistance. Under this non-project intervention, USAID would provide balance of payments support to the GRZ through quick-disbursing foreign exchange injections in support of key policy reforms in the areas such as import duty reduction and foreign exchange liberalization.

3. Non-Bank Financial Mechanisms. A non-banking financial option is suggested as a means of providing long-term capital in an inflationary environment. The non-financial mechanism with the greatest chance of success is the establishment of a venture capital fund.

4. Post-Privatized and Export-Oriented Firm Assistance -- Champions. Under this project option, highly targeted technical assistance would be provided to a small number of relatively successful firms in the areas of production methods, quality control, pricing strategy, inventory control, and market brokerage assistance.

## ACKNOWLEDGEMENTS

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## I. INTRODUCTION

The objective of this report is to investigate the potential obstacles and opportunities to private sector growth and development in Zambia. The full range of legal, policy, regulatory and structural constraints have been examined and recommendations have been made to improve the private sector environment. Donor activity has also been examined to better allow USAID to prevent unnecessary duplication in its program strategy. The final chapter consists of a number of project and non-project options for USAID intervention.

This report has been prepared by Robert Rauth, The Services Group; Peter Boone, SRI International; Dennis Smyth, Coopers & Lybrand/USA; and Hakainde Hichilema, Coopers & Lybrand/Zambia. It is based upon a field mission to Zambia undertaken November 3-20, 1992. Given the short period of analysis and necessary reliance on secondary data, factual errors and information gaps are a possibility and are solely the responsibility of the team members. The opinions expressed in this report are those of the team members, and do not necessarily represent those of USAID or the U.S. Government.

## II. MACROECONOMIC SETTING

### A. The Legacy of the Previous Regime

In 1991 the people of Zambia inaugurated a new economic and political era when they voted into power the Movement for Multiparty Democracy (MMD). The MMD won by an overwhelming majority over the United National Independent Party (UNIP), which had ruled Zambia since independence. MMD's economic and political platform has been based on the protection of human rights, democratic pluralism, good governance, and the encouragement of private enterprise.

The Zambian economy still suffers from the effects of the longstanding distortions introduced during the Second Republic. Soon after independence the UNIP regime sought to control the economy through nationalization, parastatal proliferation, trade and exchange restrictions, and price controls. Throughout the tenure of the Second Republic, the Zambian economy was characterized by its dependence on the mining industry, the dominance of parastatals, and macroeconomic mismanagement.

One of the most striking features of the Zambian economy over the last twenty-seven years has been the **marked decline in the nation's wealth or capital stock**. By nearly all measures, the standard of living in Zambia today is less than half of what it was in 1964. Per capita income has fallen by 2 percent per year since independence. Gross domestic investment has dropped from 33 percent of GDP in 1964 to 12 percent in 1991. Gross domestic savings have also plummeted from 38 percent of GDP in 1964 to 12 percent in 1991. Foreign exchange reserves have also dwindled from US$7.6 billion in 1965 to a mere US$150 million today. Other national assets have also depreciated; it has been estimated that over the last few years the nation's road system has lost over US$400 million in value due to inadequate maintenance.

The copper industry has consistently been the mainstay of the Zambian economy, providing 90 percent of the country's export earnings in 1991. The public sector has also been dominant since the 1970s when the socialist government began nationalizing hundreds of existing private companies and creating parastatals. Heavy borrowing both to supplement falling copper earnings and to subsidize inefficient parastatals has left the country saddled with hyper-inflation and a massive debt burden. Overvalued exchange rates have also been a persistent problem, by stimulating imports and discouraging exports, and resulting in chronic shortages of foreign exchange in the official market.

Zambia's economic stagnation has affected **employment prospects**. The Zambian economy has been unable to generate a sufficient number of new jobs to keep pace with the country's annual population growth rate of 3.2 per cent. The economy has created only 100,000 new jobs in the formal sector since 1970, the Zambian population increased by 4 million during the same period.

Zambia's balance of payments has been strongly influenced by copper market fluctuations. While imports have remained fairly stable, export earnings have risen and fallen with the price of copper. In 1991 Zambia ran a merchandise trade surplus of US$133 million. Over the past four years the current account balance has improved steadily, shifting from a deficit of US$242 million in 1987 to a surplus of US$65 million in 1991.

Gross Domestic Product (GDP) growth has fluctuated with the shifts in the world copper market. High copper prices helped generate an annual GDP growth rate of 4 percent until the mid-1970s when reduced export earnings combined with the drag of inefficient parastatals and heavy debt burden precipitated a prolonged economic decline from the late 1970s until the mid-1980s. After a temporary 6 percent rise in GDP in 1988, the economy slid into a deep recession with three consecutive years of economic decline from 1989 to 1991 (see Table 2.1 below).

**Table 2.1**

**Real GDP Growth 1988-92**

| | 1988 | 1989 | 1990 | 1991 | 1992 (est.) |
|---|---|---|---|---|---|
| Real GDP growth | 6.3 | -1.0 | -0.5 | -1.8 | 2.0 |

Source: **Zambia Ministry of Finance**

There are four major constraints which still remain from the Second Republic: (i) inflation; (ii) external debt; (iii) heavy reliance on copper; and (iv) the dominance of the parastatal sector. The impact of these limitations cannot be immediately removed from the economy, even if measures to overcome these constraints are being undertaken immediately.

**Inflation** is a major constraint hanging over the Zambian economy. Over the 1989-91 period inflation averaged 120 percent. The main causes of inflation have been "demand-pull" factors associated with large public sector deficits, rapid monetary expansion and larger government and parastatal pay increases. There has also been the "cost-push" inflationary pressure stemming from the numerous depreciations of the exchange rate over the past few years.

Zambia's **external debt** outstanding is one of the highest in the world on a per capita basis. Total external debt outstanding stood at US$6.7 billion at the end of 1991, equivalent to about three times the Zambian GDP. Zambia's external debt represents US$838 per capita. After running into arrears in 1991, Zambia resumed repayments to the World Bank and has rescheduled debt owed to the International Monetary Fund (IMF) and several bilateral lenders. In December 1992, Zambia's donors are expected to provide further relief and rescheduling of official debt through the Paris Club and Consultative Group Meeting processes. Commercial debt buy-backs and debt-equity swaps are planned for 1993.

A third major constraint limiting the Zambian economy is its **heavy dependence on copper.** Copper accounts for about 90 percent of the country's export earnings, about 8 percent of GDP, and is an important source of government revenue. The problem is exacerbated by the fact that a sharp decline in copper output is forecast for the end of the decade and the world price forecasts are below present price levels of about US$1.05 per pound.

The fourth overhang on the economy is the **dominance of the parastatal sector.** While the sector accounts for about 80 percent of Zambia's gross fixed investment, it only contributes to about 50 percent of the economy's output. Despite the government's enormous investments in parastatals, these companies have yielded at best only marginal dividends; more often they have incurred chronic losses representing a major drain on the public finances in the form of direct subsidies, arrears on debts, or nonpayment of bills. The poor financial performance of the parastatal sector stems from a combination of factors including: deficient management; lax cost controls; overstaffing; lack of competition; and political patronage.

## B. Stabilization Program

The economic reforms planned by the MMD government focus on a short-term macroeconomic stabilization plan to control the budget deficit and inflation, and a long-term structural plan to reduce the size and inefficiencies of the public sector. The government's economic stabilization policies and plans are set out in "Economic and Financial Policy Framework 1992-1994" which was presented in March 1992. The government has set target GDP growth rates of 2 per cent in 1992, 3 per cent in 1993 and 4 percent 1994. To achieve this the government is depending on stable copper prices and recovery from the drought, as well as raising investment to 20 per cent of GDP by increasing public savings and directing resources to the private sector.

The Government of Zambia has initiated a series of tax reform measures designed to simplify the existing system and provide investment incentives. Recently adopted reforms include the establishment of three import tariffs categories of 15, 30 and 50 per cent (1991); the introduction of a uniform sales tax of 20 per cent for imported and domestically produced goods (1992); and a reduction of the corporate tax rate from 45 to 40 per cent (1992). Additional tariff revisions and corporate tax restructuring are planned for the 1993 budget.

The budget deficit averaged 12.4 per cent of GDP during the 1980s. The government's fiscal targets in the stabilization plan are to achieve a budget deficit (excluding grants) of no more than 2 percent of GDP in 1992, full balance in 1993, and a small surplus in 1994. The principal measures to achieve these goals are: (i) eliminating subsidies (maize, fertilizer, parastatal transfers and deficits); (ii) enhancing revenues by broadening the tax base and reducing loopholes; and (iii) civil service reduction.

Government spending in 1992 has been higher than projected, due to a large public sector pay increase in April, unforeseen government spending on drought relief, and continuing subsidies to loss-making parastatals. Zambia Airways is a parastatal which is acting as one of the largest drains on the public finances, presently sustaining financial losses of an estimated US$3 million per month. The overall budget deficit projection for 1992, including drought expenditures, is 2.4 percent of GDP (see Table 2.2 below).

The government also intends to utilize fiscal and monetary restraint as instruments to contain the hyper-inflation, which reached 95 per cent in 1991. Based on the inflation trends for the first ten months of 1992, **the IMF is projecting an annual inflation rate for 1992 of 170 percent,** compared with a target of 45 percent set by the government's stabilization plan.

The present inflationary pressures in Zambia stem from both cost-push and demand-pull factors. The principal demand-pull causes of inflation in Zambia are: (i) excessive central government borrowing from the banking system; (ii) rapid monetary expansion; and (iii) the high velocity of the circulation of money due to inflationary expectations and negative interest rates which together are inducing businesses and consumers to spend money as soon as it is earned. The primary cost-push factors fueling inflation in 1992 include: (i) higher import prices associated with the sharp nominal depreciation of the kwacha against the dollar; and (ii) higher maize prices resulting from the decontrol of maize product prices over the past year.

One of the government's stabilization plan objectives is to achieve positive real interest rates, thereby rationing credit to its most productive uses, and mobilizing additional savings. In September 1992, the Bank of Zambia liberalized financial markets and allowed commercial banks to set their own deposit and lending rates. Current short-term deposit rates are about 45 percent and short-term lending rates about 60 percent; therefore interest rates remain strongly negative in real terms.

Progress in achieving positive real interest rates and in lowering inflation has been weak due to lapses in fiscal and monetary control by the government. The target for broad money supply (M2) growth for 1992 was set at 25 percent. To date broad money supply growth in 1992 has been well above targets; the projected M2 growth rate for 1992 is about 100 percent. New adjusted targets for inflation and money supply growth for 1992 have been agreed upon with the IMF in July of 1992.

## Table 2.2

### Zambia Key Economic Indicators 1989-92

| | 1989 | 1990 | 1991 | 1992 (Est) |
|---|---|---|---|---|
| | | **(in percent change)** | | |
| Real GDP growth | -1.0 | -0.5 | -1.8 | 2.0 |
| Inflation rate | 158.0 | 105.0 | 95.0 | 170.0 |
| Real Exchange rate | 32.3 | -16.4 | -9.9 | -32.0 |
| Money supply (M2) | 65.3 | 45.8 | 98.1 | 100.0 |
| | | **(in percent of GDP)** | | |
| Budget deficit | -10.3 | -7.7 | -7.1 | -2.4 |
| | | **(in percent)** | | |
| Commercial bank lending rate | 35.0 | 40.0 | 46.0 | 60.0 |
| | | **(in US$ millions)** | | |
| Non-traditional exports | 70.0 | 113.0 | 84.0 | 60.0 |

Sources: Historical data for 1989-91; Zambia Ministry of Finance Projections for 1992; USAID Private Sector Assessment Team

Zambia plans to create a realistic exchange rate by aligning the official kwacha rate to the market rate by early 1993. This action, along with a streamlining of export-policy-related matters, should help to reduce trade imbalances and help the government meet its goal of increasing non-traditional exports by 10-15 percent a year during the 1990s.

The country's long-term growth strategy is to provide an environment conducive to private sector investment and to narrow the government's role to providing essential services such as infrastructure, human capital investment, social services and environmental protection. The success of the long-term plan will depend largely on the government's ability to reduce the dominant role of the public sector which owns, manages, or directs most industrial and commercial enterprises and accounts for over 50 percent of GDP.

## C. Public/Private Participation in the Economy

Zambia has a mixed economy, although parastatal firms account for about 80 percent of the investment in mining, manufacturing and agriculture. The low return on this investment is evident, however, from the fact that parastatals contribute to only about 50 percent of Zambia's GDP.

The largest parastatal is the Zambia Industrial and Mining Corporation (ZIMCO), a holding company which controls copper mines, oil pipelines, railroads, airways, insurance, retail and wholesale distribution, commercial banks, communications, and freight shipping. ZIMCO and its other parastatals are widely recognized as constraints on economic growth due to their monopoly control of markets, reliance on state subsidies, lack of technological innovation, corruption and political patronage. The government has announced plans to privatize many of ZIMCO subsidiaries over the next three years.

Nearly all of the large-scale mining activities in the country are state-owned enterprises. ZIMCO has a 60 percent shareholding in the largest mining company, Zambia Consolidated Copper Mines Limited (ZCCM). The dominance of the ZCCM in the economy is demonstrated from the fact that the parastatal accounts for 90 percent of Zambian foreign exchange earnings.

In the energy sector, ZIMCO controls the national oil pipeline through Tazama Pipelines. ZIMCO also controls the ownership of Zambia Electricity Supply Corporation (ZESCO) which enjoys a monopoly on electricity generation and supply. In transport and communications, ZIMCO owns Zambia Railways, Zambia Airways, Contract Haulage (the nation's largest trucking firm), United Bus Company, and the Post and Telecommunications Corporation (PTC).

ZIMCO's wholly-owned subsidiary, the Industrial Development Corporation (INDECO), has a majority shareholding position in more than 40 companies representing more than 60 percent of the value added in the manufacturing sector. The holding company also owns an insurance company, most of the country's larger hotels, agricultural and real estate ventures, a major bank, and a major chain of wholesale and retail stores.

The private sector accounts for about 50 percent of Zambia's GDP and is largely concentrated in services sector activities such as wholesale and retail trade, banking (13 commercial banks of which only one is a majority government owned), travel agencies, and insurance. The private sector is also prominent in agriculture, accounting for some 90 percent of the value added in that sector.

In the manufacturing sector, private companies currently account for 40 percent of the sector's value added. This percentage is projected to rise quickly over the next three years as virtually all of the parastatals in that sector are targeted for privatization. The informal sector is comprised of small and microenterprises and is entirely private.

## D. Privatization Program

President Chiluba and the MMD were elected to power on a platform which clearly stated the intention to promote privatization in Zambia in order to "optimize resource utilization, enhance the productivity and profitability of the private sector and assist in the reduction of the Government deficit."

Realizing that parastatals are primary obstacles to economic growth and private sector development, the Zambian government has approved a privatization plan to divest the government of all holdings except public utilities and natural monopolies. Specifically targeted is ZIMCO, which manages 150 parastatals affecting every sector of the economy from copper mines to bakeries. Within five years 140 parastatals are to be sold, liquidated or contracted out to private management.

The Cabinet approved the privatization plan in March 1992 and a privatization bill was presented to Parliament in June. The resulting Privatization Act of 1992 established the **Zambia Privatisation Agency** (ZPA). The agency is composed of several ministry representatives and private sector leaders who will schedule enterprises for privatization, evaluate the proposals of potential buyers, and monitor the progress of privatization to prevent the creation of private monopolies. On November 12th, Mr. James Matale was made the new director of ZPA. The Overseas Development Agency (ODA) is currently funding an Adviser/Manager who reports to the director. The privatization program is controlled by the Ministry of Commerce, Trade and Industry.

As an additional incentive for the rapid movement of the Government of the Republic of Zambia's (GRZ) privatization plans, the World Bank Group, through its International Development Association (IDA), approved a US$200 million Privatization and Industrial Reform Adjustment Credit (PIRC) for Zambia on June 3rd, 1992. A parallel IDA technical assistance credit of US$10 million, to ensure that the adjustment program is properly implemented, was also approved. The adjustment credit, consisting of three tranches, is intended to continue the Economic Recovery Program supported by IDA through its March 1991 Economic Recovery

Credit, and to deepen the program in the three key areas of private sector development, privatization and parastatal reform.

The first PIRC tranche (US$100 million) was released in July 1992, following GRZ's compliance with PIRC conditions including enactment of the Privatization Act. The US$10 million technical assistance credit for privatization support activities such as valuation was also released to the ZPA. The second and third tranches of US$50 million each are contingent upon specific actions relating to privatization and industrial reform. With respect to privatization, the second tranche conditions state that the GRZ will have taken all steps necessary on its part for divestiture of an initial ten companies, and have offered for sale a second group of companies, including several sizeable companies. This tranche is expected to be released in January 1993.

With respect to privatization, third tranche conditions require that the GRZ will have achieved satisfactory progress on implementation of the privatization program, including taking all steps necessary on its part for privatization of a further ten companies, bringing the total to a level equivalent to about 10 percent turnover of companies to be privatized, and including implementation of an action plan to assist redundant staff. This will be followed by a review of the progress and achievements of the privatization program.

Zambia's privatization strategy is designed to replace inefficient parastatals with competitive, privately-owned enterprises. To this end the ZPA has adopted the following guidelines: (i) When possible. multi-location companies will be sold as units rather than wholes; (ii) the government will not allow new capital investment in companies to be divested; (iii) Zambian participation in the privatization process will be encouraged; (iv) a small stock exchange will be created; and (v) loss-making enterprises with little chance for turnaround will be allowed to close.

As of November 9, 1992, the ZPA had chosen 19 companies to divest through tender offer to ensure it will meet the PIRC second tranche condition of having an initial ten companies ready for sale (referred to by the ZPA as "Tranche One" companies) and "another group of companies" offered for sale by year-end 1992. The ZPA has issued tenders for all 19 companies, which have been valued and are ready for negotiation and sale. Two of the 19 companies will be sold to minority shareholders holding pre-emptive rights. To date, the ZPA has received over 300 pre-qualification applications from 196 investors (individuals and companies) interested in bidding for the 19 parastatal enterprises currently ready for sale. It has sold nearly 200 tender packages to date and has indicated through public announcements that tender packages for Tranche One companies will only be available from November 3rd to November 19th, after which the tender period for these companies will be considered closed.

Also in accordance with PIRC conditions, the ZPA expects to offer for sale a group of larger companies for sale by year-end. The ZPA has identified 34 companies for tender and notification will be given to the Cabinet by the end of November 1992. This meets the second tranche condition requiring "another group of companies" to be offered for sale by year-end 1992 and prepares the ZPA for meeting or exceeding the PIRC third tranche condition of "taking all steps necessary on its part for privatization of a further 10 businesses."

The five year divestiture program covers all ZIMCO subsidiaries excluding only some key utilities and industrial companies. Future legislation will restructure the remaining parastatals and ZCCM's copper mines. The three methods for sale planned by ZPA are: private sale through tender, including management buy-outs (MBOs); negotiated bid (generally with minority shareholders holding pre-emptive rights); and public offerings (by early 1993).

The progress described above is quite impressive considering the unsuccessful attempts by the previous government to put a privatization program in place. The IDA credits and technical assistance will help the GRZ through many of the obstacles faced by any country undertaking such an enormous privatization program. However, there are currently several constraints to privatization and private sector development in Zambia which must be addressed for the privatization program to succeed and for newly-emerging companies to survive in a post-privatization economy.

In addition to inflation, which is in some way connected with nearly every obstacle to private sector development, the biggest financial sector constraints to privatization and private sector development are:

- Lack of non-bank financing mechanisms such as an equity market, venture capital funds and mutual funds;
- Lack of liquidity for private sector working capital purposes;
- Absence of financial market depth, including sources of medium and long-term credit for private sector investment needs.

The ZPA has indicated that lack of financing, insufficient liquidity and inadequate capital market development could seriously hinder the privatization program unless additional donor assistance is made available in the form of investment funds and technical assistance to the ZPA. This technical assistance could include identification, valuation, and advertising of parastatal companies to be offered for sale. USAID is taking a lead role in providing technical assistance to the ZPA and will be providing long-term institutional level assistance in the form of a corporate finance advisor. Other donors, such as ODA and GTZ, are already providing some assistance while NORAD and UNDP have proposed assistance in some critical areas, including: the social impact of privatization, including the need to retrain workers made redundant following the privatization of their companies; review of tenders; and public relations assistance. However, the volume of privatizations planned, and the ambitious timetable to be followed, indicate that the scale of this assistance may be too small. IDA's US$10 million technical assistance credit will be used by ZPA to cover activities for which donor funds are not available.

The IMF is providing funding and technical assistance for the revision of the Banking Act and the Bank of Zambia Act. Several key proposed amendments to the Banking Act will attempt to address the need to make additional forms of credit available to the privatization process. These and other amendments to the banking legislation will be discussed later in this report, within the context of the need to remove bureaucratic or otherwise unnecessary impediments to private sector development in Zambia.

The Privatization Act contains plans to establish what is being referred to as a Privatization Trust Fund, whereby a certain percentage of shares from privatizations would be held in trust on behalf of Zambians who cannot afford to buy shares when parastatals are privatized. This fund would make it possible for the GRZ to reserve shares for the public and to make a gradual sale of the shares over a period of time. The World Bank has indicated that some donor assistance would be welcomed to help develop the Privatization Trust Fund and identify a private company to manage its portfolio.

The Privatization Trust Fund could be established with seed capital from a venture capital fund. Venture capital funds and similar mechanisms often involve a certain percentage of foreign investors, mainly due to the limited absorptive capacity of some local economies. However, these mechanisms would be available to Zambians participating in joint ventures and management buy-outs.

Discussion of several financial mechanisms needed to facilitate the privatization process is included in the chapter focussing on financial sector constraints to private sector development.

## III. FINANCIAL SECTOR CONSTRAINTS TO PRIVATE SECTOR DEVELOPMENT

### A. Banking Institutions

Commercial Banking. The commercial banking system in Zambia is more developed than those of several neighboring countries. The thirteen commercial banks operating in Zambia are predominantly private sector owned and the local presence of prominent international banks (ANZ Grindlays, Barclays, Standard Chartered and Citibank) is a reflection of their confidence in Zambia's economic potential. The largest commercial bank[1] in Zambia is the Zambia National Commercial Bank (ZNCB) which is wholly-owned by the GRZ.

Specialized Financial Institutions. While there are a relatively large number of commercial banks in Zambia, there is a **lack of** a sufficient number of **healthy and competitive specialized financial institutions** (savings banks, merchant banks, etc.) and contractual savings institutions (insurance companies, pension funds and provident funds). The recently established Co-op Bank will serve the cooperative movement. The three development banks, each currently experiencing financial difficulties, are: the Development Bank of Zambia, a traditional development bank; Lima Bank, an agricultural development bank; and the Export-Import Bank of Zambia, a trade finance development bank. Savings institutions include: the Zambia National Building Society; the Credit Union and Savings Association; and the National Savings and Credit Bank.

Contractual savings institutions include the Workmens' Compensation Fund, the Zambia National Provident Fund, the Zambia State Insurance Company (ZSIC) and several new private insurance companies (including Madison Insurance Company, ZCF Insurance Services Limited, Goldman Insurance Co., and Professional Insurance Corp. Ltd.) which opened in mid-1992 when the government monopoly on insurance was liberalized.

With the exception of the new insurance companies, all of the contractual savings institutions are government-owned and each has developed monopolies in its respective area of expertise. This lack of competition in the critical area of long-term savings mobilization and credit allocation has created a financial environment with **inadequate and inefficient financial intermediation capabilities.**

Export Finance. One area which highlights the credit crunch and lack of depth in the financial sector is export finance. The Export-Import Bank has little liquidity to offer exporters. Several

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1 The other commercial banks are: Barclays Bank of Zambia Ltd.; Standard Chartered Bank (Z) Ltd.; ANZ Grindlays Bank (Z) Ltd.; Citibank Zambia Ltd.; Meridien BIAO Bank Zambia Ltd.; African Commercial Bank Ltd; Indo-Zambia Bank; Union Bank Zambia Ltd.; Commerce Bank Ltd.; Finance Bank (Z) Ltd.; Manifold Bank Ltd.; and New Capital Bank Ltd. (formerly Capital Bank).

exporters indicated it is extremely bureaucratic and is not able to serve their needs. Export financing is also costly for businesses. Exporters indicated that although the basic letter of credit fee charged by most banks in Zambia is about 1.5 percent, additional fees and charges bring the total cost to as high as 3.5 percent. Finally, the processing of letters of credit is often delayed by what many consider to be unnecessary regulations and bureaucratic procedures.

Government Distortion of Financial Markets. Commercial banks and other financial institutions have not been able to fully serve the private sector's need for investment and working capital. The constraints identified in this chapter indicate that the financial sector, which has operated under varying levels of government involvement and interference for more than two decades, currently **lacks** the **depth, capacity and flexibility** to effectively mobilize savings and allocate credit to both the existing and post-privatization private sector.

Many of the constraints to private sector development identified in this chapter stem from the **public sector's** many years of **insatiable demand for available credit** and the resulting lack of growth of the private sector due to the limited availability of savings and investment capital. There has also been a legacy of negative real interest rates which has discouraged savings mobilization. Domination of the economy by the public sector has often also been accompanied by loose monetary and fiscal policies. In addition, there has been little encouragement made by the GRZ to deepen and broaden financial markets by expanding the types of financial instruments offered by existing financial institutions and introducing new financial mechanisms.

Recent liberalization of interest rates and foreign exchange controls, as well as the introduction of competition in the provision of financial services such as insurance, was applauded by the financial and business community as well as by the donor community. Following the release of the government's budget in 1992, donors were pleased with the budget's efforts to liberalize the economy, including plans to reduce the budget deficit and privatize parastatal companies. These and other liberalizations are currently in various stages of implementation. The effectiveness of these recent changes can only be measured once they have been fully and properly implemented. Description and status of these recent liberalizations will be included, when appropriate, in the discussion of the relevant constraints to private sector development.

## B. Impact of Inflation

It is clear in talking with business people that **inflation is the number one problem** they are encountering. Apart from acting as an implicit tax on liquid assets, the high rates of inflation have had a far-reaching impact on nearly every aspect of business operations. Of all the distortions present in the Zambian economy, inflation is the most adverse and its impact the most profound.

Although it would be impossible to list the myriad ways in which inflation affects businesses, it is worthwhile to note some of the ways in which inflation has transformed Zambia's business environment.[2]

- Inflation makes long-range planning impossible. High rates of inflation make long-term revenue and cost projections highly subjective. Depreciation expenses become meaningless in an environment where a new set of tires costs three times the original value of the truck. Offsetting allowances such as pensions, insurance, terminal benefits as well as depreciation lose all relevance after Zambia's recent monetary woes. In similar fashion, agricultural producers refuse to honor contracts with agro-processors as agreed prices become unattractive compared to the open market.

- Inflation has eliminated long-term capital availability. As will be described in greater detail later, Zambia's high inflation and negative interest rates have meant that there are virtually no deposits longer than 12 months in duration -- this void prevents commercial banks from offering any long-term capital financing. Overseas loans -- though theoretically available -- are avoided by all but export-oriented firms as producers and traders cannot raise their prices as fast as inflation.

- Inflation encourages firms to increase inventories and debt. Firms that can afford it are accumulating stock and maximizing their overdrafts. Numerous firms have noted that they are importing goods as their only safe hedge against inflation. Even one taxi driver is stocking petrol against fears of future price rises.

- Inflation prevents full capital repatriation. Because the government has only recently allowed foreign investment figures to be officially registered in hard currency terms, those who invested in Zambia in the past are limited to repatriating the original investment plus retained earnings. Given the severe decline in the kwacha over the years, this figure tends to represent only a small portion of the investment's real value.

- Inflation increases tax rates. Zambia has a progressive tax rate system on personal income but inflation has forced anyone making over US$500 a year into the highest tax bracket. In some countries, a system of indexing has been implemented to prevent relatively low wage earners from experiencing "bracket creep". At present, there is no plan to introduce indexing although a plan to shift the brackets upward has reportedly been formulated.

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[2] See Murray Sanderson's "How Inflation Affects Taxes" in Profit, September 1992.

Inflation Expectations. The years of high inflation have created inflation expectations of such proportions that government officials, banks, businesses and individuals have developed very short-term time horizons. The existence of hyper-inflation in recent years has distorted the behavior of public and private sector participants in the economy. This has created an environment where there is little planning beyond a short-term time horizon. This environment is not conducive to private sector development because banks have become limited in their ability and willingness to provide financing.

Negative Interest Rates: The interest rate liberalization in mid-September 1992 allowed commercial banks to determine their own maximum lending, savings and time deposit rates according to competitive forces, without government interference. Despite the recent removal of interest rate controls, **negative real interest rates prevail** in Zambia. For example, the treasury bill rate (traditionally a market-determined benchmark rate for lending in most economies) remains fixed by the Bank of Zambia at 47 percent. By forcing commercial banks to purchase treasury bills to satisfy liquidity reserve requirements and fixing the rate at a relatively low nominal rate (well below the inflation rate of 170 percent), the GRZ has created an artificial and low-cost market for its securities. This is an artificial and market-distorting method of holding government borrowing costs down.

When one considers the estimated annual inflation rate for 1992 of 150 percent, it becomes obvious that commercial bank lending and deposit rates are severely negative in real terms. Lending rates currently range from 57 to 63 percent (plus fees ranging from 2 to 5 percent) and are far below the inflation rate, resulting in negative real lending rates of approximately -110 percent. Deposit rates currently range from 38 to 49 percent (depending on the type and amount of deposit) and are even more negative than lending rates. Commercial banks are reluctant to raise lending rates to positive real levels (above the inflation rate) for fear of forcing their borrowers into default. Correspondingly, they are equally reluctant to raise deposit rates to positive real levels because of concerns about the resulting high cost of funds. Commercial banks have indicated they hope to gradually increase interest rates on loans and deposits to positive levels.

Outlook: When the business community and consumers are convinced that GRZ is serious about implementing the proper mixture of fiscal and monetary policy measures needed to bring the inflation rate down, they will be more willing to extend their time horizons. Fiscal measures called for by the business community include, among others: cuts in government expenditures; budget deficit reduction; simplified tax rates; and more efficient tax collection. Instead, the government has granted large wage increases to parastatal workers and moved relatively slowly in the implementation of proposed fiscal policy reforms. Monetary policies used in the GRZ's attempt to control inflation, and their impact on liquidity and private sector development, are described in the next section.

## C. Unbalanced Inflation Control Measures

Lack of a coordinated fiscal and monetary policy approach to controlling inflation has led to a relatively unsuccessful fight against inflation and rigid controls on commercial banks. The Bank of Zambia's (BoZ) imposition of high liquidity reserve requirements on commercial banks has created an environment where the public sector absorbs nearly all of the available liquidity in the economy, leaving very little for the private sector's working capital and investment needs. This **liquidity squeeze** is a major constraint to the development of a post-privatization private sector economy.

The money supply grew at twice the expected level during 1992, due mainly to the large amount of donor funds (over US$200 million) which flooded into the economy in response to the drought as well as large pay increases for parastatal workers. In an effort to reduce the level of inflation in Zambia, the government has been very rigid in the use of one monetary policy tool (commercial bank liquidity reserve requirement, which is commonly referred to as "reserve requirement") while moving slowly on the implementation of fiscal policy reforms.

Liquidity Reserve Requirements. The Ministry of Finance, through the Bank of Zambia, has placed an unusually high reliance on the reserve requirement to control money supply growth and reduce inflation. Specifically, there is currently a **66 percent reserve requirement** forced on commercial banks operating in Zambia. This means that 66 percent of each kwacha raised in the form of deposits or borrowings must be held at the Bank of Zambia as follows: a "core liquidity" ratio of 42.5 percent in the form of Zambian treasury bills (short-term government securities) and 23.5 percent in a minimum statutory reserve account on which no interest is paid. The amount which must be maintained at the BoZ in the form of treasury bills was actually increased recently from its already high levels; the previous treasury bill liquidity reserve requirement was 35 percent.

High reserve requirements and the related forced investments in **low-yielding government securities have discouraged efficient financial intermediation activities** on the part of banks in Zambia. By comparison, **banks in most countries are subject to reserve requirements** in the range of **3 to 5 percent**. Countries such as Sierra Leone and Zaire, which experimented with high reserve requirements for long periods of time, have eventually seen negative impacts on private sector development.

It is ironic that one result of the combination of unusually high reserve requirements and slow progress on fiscal reforms is the channeling of liquidity to the parastatal companies, whose low levels of productivity and printing press-financed wage increases have been identified as one of the main causes of high inflation. The entire financial system has been negatively affected by the **lack of central bank autonomy** from the Ministry of Finance. At present, the central bank is used more as a fiscal agent than traditional central bank. This has hindered its ability to develop a range of flexible and efficient money supply management tools.

Development of Monetary Policy Tools. Money markets are used to store and exchange excess liquidity which takes the form of short-term "money market" instruments. Examples of money market instruments include: interbank deposits (banks lend excess liquidity to each other); government securities; repurchase agreements; bankers' acceptances; certificates of deposit; and commercial paper. Money markets are therefore short-term securities markets and, when developed properly, provide a noninflationary way to finance government deficits. They also allow governments to implement monetary policy through open market operations (the purchase and sale of money market instruments from commercial banks to manage money supply growth) and provide a market-based reference point for setting other interest rates.[3]

The recent approval to create a secondary market in government securities will allow the Bank of Zambia to use a more direct tool of monetary policy management: buying and selling treasury bills to drain or add liquidity to the economy. Until quite recently, banks were only able to sell ("discount") treasury bills to the Bank of Zambia. This served to discourage the development of a secondary market in government securities.

Recent Positive Moves by the Bank of Zambia: Most central banks offer some sort of "discount window" facility so that banks with short-run liquidity problems (i.e., unexpected deposit outflows) can borrow reserves for limited periods.[4] The Bank of Zambia has **raised its lending rate** (for emergency liquidity needs of banks) **from 49 to 54 percent** and its discount rate for treasury bills to 52 percent (while holding the treasury bill rate at 47 percent) to discourage banks from developing an overdependence on the discount window and central bank borrowing as a source of liquidity. This move was also designed to force banks to do two things which will lead to the development of open market operations which are a more efficient monetary policy management tool. The intended results include:

- development of a secondary market in government securities;

- broadening the interbank market in Zambia to include banks other than Barclays, Standard Chartered, ANZ Grindlays and Citibank.

With inflation exceeding 100 percent, the high reserve requirement has served to create an artificial market in treasury bills (which pay negative real interest rates) and an artificial rate, rather than market-driven base rate against which commercial banks could set their interest rates. The development of these two types of money markets should eventually lead to the existence of a market-determined interest rate which can be used to accurately measure (interest rate will reflect level of liquidity) and manage (open market operations by BoZ) money supply growth.

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[3] World Bank's World Development Report 1989, page 108.

[4] Improving Monetary Management in Sub-Saharan Africa, James S. Duesenberry and Malcolm F. McPherson, page 189.

Now that a crude form of trading in government securities is about to begin, the GRZ should be willing to stop requiring banks to artificially support the treasury bill market through high reserve requirements. In most countries, investors buy government securities because they see them as a relatively risk-free investment and their level of attractiveness is a reflection of general investor confidence in the economy. The GRZ should therefore remain firm in its commitment to take the necessary fiscal and monetary policy measures to restore confidence in the economy. Voluntary purchases of government securities will rapidly develop as banks and non-bank financial institutions (mutual funds, etc.) seek liquid forms of investment with which to diversify their portfolios.

The development of a more efficient money supply management tool will enable the Bank of Zambia to lower the liquidity reserve requirement for banks considerably. This will free up a large amount of liquidity which can be put to productive use by financial institutions in the private sector.

## D. Lack of Long-Term Credit

The combination of the short-term time horizon which permeates current thinking in the economy and the "crowding out" of the private sector by the public sector credit demands has resulted in the **complete absence of long-term credit** for businesses' working and investment capital needs. The Development Bank of Zambia was designed to be a source of long-term financing but its poor financial condition, combined with the overall shortage of liquidity, has rendered it nearly helpless in meeting the long-term financing needs of the economy. The implication of not having access to long-term capital means that Zambia will continue to be saddled with outdated technology; it will therefore be difficult for Zambia to compete with competitor countries. In the short-term, Zambia can best address its capital requirements through the attraction of foreign investment and joint venture partners.

The shortage of liquidity for all banks in Zambia has limited their ability to provide even the traditional commercial bank service of offering short-term credit to the business community. The high level of inflation -- with few indications of a near-term reduction -- has reduced their willingness to commit their funds for any period beyond the short-term. In turn, the high level of inflation has dampened the willingness of businesses and individuals to commit their deposits for periods longer than a few months, thereby serving to further limit the ability of banks to offer medium and long-term credit. This environment, combined with the lack of alternative (non-bank) financial mechanisms, has left no room for the provision of long-term credit vital to the existence of a productive private sector.

Mexico, which had several years of high inflation during the 1980s, experimented with high reserve requirements and directed credit programs. The inflation rate was reduced when the government enacted firm fiscal policy measures and took other actions (i.e., proper valuation of foreign exchange rate) designed to restore confidence in the economy. The reduction in the inflation rate from approximately 150 percent in 1986 to approximately 20 percent in 1990 brought about a return of massive amounts of flight capital which had been driven abroad during the years of high inflation and an overvalued local currency. Part of the reason for the capital inflow was the Banco de Mexico's (central bank) reduction in its reserve requirement to less than 10 percent.

The combination of a lack of liquidity, state control of existing non-bank financial institutions and lack of competition has reduced the ability of "traditional" institutional investors (contractual savings institutions such as Zambia State Insurance Company, Zambia National Provident Fund, pension funds and Workmens' Compensation Fund) to play a critical role in mobilizing long-term debt and equity capital for the investment needs of the private sector.

The development of effective money markets in Zambia will provide the foundation for the development of capital markets needed to provide long-term debt and equity finance for the privatization process and the investment needs of the business community. However, in order to break through the inflation-induced paralysis of nearly all savers, investors and lenders in the Zambian economy, there is a need to "unfreeze" existing sources of debt and equity finance such as pension funds, provident funds, insurance companies and leasing companies.

There is also a need to develop and/or authorize new sources of debt and equity capital in the form of relevant financial mechanisms such as: venture capital funds; unit trusts/mutual funds; merchant banks; some form of stock exchange; and debt swaps with minimal inflationary impact. Capital market instruments such as these are necessary to provide the emerging Zambian private sector with the capital it will need to survive and contribute to economic growth.

The inability or unwillingness of existing financial institutions to offer, as well as invest in, many of money market and capital market financial instruments mentioned is the result of both the public sector's draining of nearly all liquidity from the system and outdated banking laws which do not recognize many of the financial instruments required in modern private sector economies. Since the reasons for the liquidity shortage have been discussed, the following section of this chapter will focus on legal ambiguities surrounding the introduction of new financial instruments and institutions.

## E. Legal Ambiguities Regarding Non-Bank Financial Mechanisms

Donors such as USAID and the World Bank (through the IFC) have a comparative advantage in the development of non-bank financial mechanisms,[5] especially venture capital funds,[6] mutual

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[5] Regional Financial Markets Guidebook, USAID, August 1991, Page III-46.

[6] Traditional **venture capitalists** provide seed, start-up, development and expansion financing in the form of equity capital or loans, with return linked to performance and with some measure of financial control. A venture capital "fund" is simply a pool of

funds[7] and capital market development. These are important means of supporting the development of private sector businesses.

The existing Banking Act was written in 1972 and is inappropriate in that it severely limits commercial banking activities and offers little guidance relating to non-bank financial institutions. The **legal ambiguities** surrounding the introduction of non-bank financial institutions and new financial instruments has stifled private sector development due to: (i) the limited methods available to generate long-term domestic and foreign investment in the private sector; and (ii) the lack of central bank authorization and guidelines to establish and develop non-bank financial institutions. This has hindered the creation of venture capital funds, mutual funds, merchant banks and other forms of financial intermediation.

Financial Institutions Act. The Banking Act is currently in the process of being rewritten, with IMF funding and technical assistance, to incorporate present day banking practices which are critical to the privatization process and private sector development in general. The new legislation would allow for the increase in the number of specialized financial institutions more suited to urban and rural credit needs. **The new Act would allow for the establishment of venture capital funds, mutual funds, merchant banks and other institutions designed to both mobilize and provide equity and risk capital to the private sector.**

Several amendments would remove outdated and inappropriate rules and regulations. For example, an existing regulation requiring commercial banks to open a branch in a rural area for every branch opened in an urban area, regardless of the low demand for commercial banking services in rural areas, is scheduled to be abolished. Another example of outdated regulations is the penalty for serious violations of certain banking regulations. Due to the many devaluations which have taken place since 1972, penalties stated in kwacha terms need to be adjusted; the current law indicates the penalty is about 15,000 kwacha (US$50) or five years in prison. Not surprisingly, most guilty parties prefer to pay the fine.

The new draft, to be renamed the Financial Institutions Act, is expected to be ready for review by the business, banking, and donor communities prior to its expected presentation to the Cabinet and Parliament early in the first quarter of 1993.

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investable resources raised by a venture capital company or companies. More than traditional mutual funds, venture capital funds target risky ventures with high upside potential.

7 A **mutual fund** (also known as a unit trust) is a company that makes investments on behalf of individuals and institutions who share common financial goals and objectives. The funds of these investors are pooled together and managed by a professional money manager. The pool of funds is used to assemble a portfolio of stocks, bonds and other financial instruments that have characteristics which are in line with the objectives (i.e., high income or high capital appreciation) of the mutual fund.

The draft being considered is the result of the incorporation of twelve or more pages of proposed amendments to the existing Act, designed to substantially improve the financial sector's ability to foster private sector growth. Apart from allowing for the introduction of certain non-bank financial institutions and eliminating outmoded regulations, the new draft would improve the ability of the Bank of Zambia to ensure the maintenance of a healthy, transparent financial sector with a high level of depositor confidence. The need to improve supervision of the banking system was underscored by the May 1991 suspension of operations of Capital Bank due to imprudent lending practices and the August 1991 closure of BCCI Zambia Ltd. (taken over by Union Bank Ltd.). The financial condition of many existing specialized financial institutions in Zambia (ZSIC, ZNBS and ZNPF) is weak and their service has been politely described as inefficient. Decisions will need to be made concerning whether these institutions will be able to survive competition from the private sector or will need to be restructured or closed. The new Act would also allow for the introduction of competition to several areas of financial services currently monopolized by state-owned financial institutions.

Bank of Zambia Act. The Bank of Zambia Act is being rewritten with funding and technical assistance from the IMF. The proposed amendments to the existing Bank of Zambia Act are designed to improve its autonomy and its authority to assume the proper roles of a central bank: supervision and regulation of financial institutions; effective management of monetary policy; and the facilitation of financial and private sector development. The draft is expected to be ready by year-end 1992 and will most likely be considered for approval during the first quarter of 1993. This Act is very important because it will give BoZ more responsibility for determining the activities in which banks may engage. This responsibility currently rests with the Finance Ministry's Registrar of Banks.

Many businesses and banks in Zambia have stated that the cloud of uncertainty over what types of banking activities are allowed, and what types are not, has stifled the development of flexible and innovative methods of financial intermediation. Even the informal sector -- which normally thrives when the formal sector it competes with is highly regulated, bureaucratic, and complicated -- is starved for credit. The passage of the Financial Institutions Act and the Bank of Zambia Act in 1993 should succeed in removing many of the obstacles to the creation of more innovative financial mechanisms and the more flexible use of existing financial mechanisms.

Until these Acts are approved and implemented, legal ambiguity and uncertainty will continue to paralyze efforts to provide long-term credit to the private sector. Once these Acts are in place, much work will need to be done to provide the legal and regulatory foundations in the form of guidelines for the introduction and operation of non-bank financial mechanisms such as **venture capital, mutual funds and merchant banking**. In addition to the plans of two investment companies to convert to merchant bank status, several commercial banks, including Barclays, plan to open merchant banking subsidiaries once this activity is authorized by the new banking law.

Privatization Act of 1992. A central bank official noted that, in his view, the Privatization Act of 1992 could be interpreted to allow for the use of several non-bank financial mechanisms - if it would facilitate the privatization process. He added that approval for activities not included in the existing Banking Act is required from the Finance Ministry's Registrar of Banks and the Bank of Zambia. He said the lack of information generally available to the private sector could be a reason why banks are not aware of, or are confused by, this possible interpretation of the Privatization Act. One investment company in Lusaka is essentially operating as a merchant bank in preparation for buying shares offered in upcoming privatizations. Most financial institutions in Zambia, however, are either not aware of this interpretation or believe the Privatization Act's authority to supersede all other Acts is as vague as the existing Banking Act's authority to allow for non-bank financial mechanisms. While some banks currently have leasing operations and are preparing to open merchant banking subsidiaries, they are waiting for more specific indications of authority to engage in non-bank financial activities.

Many observers feel that special **management buy-outs (MBOs)** and other schemes will be required in order to encourage Zambian equity participation in privatized firms. Special long-term financing instruments may be needed to provide equity and loan capital so that Zambians have an opportunity to participate in the ownership of these companies.

Debt Conversion Mechanisms. Debt-for-equity and debt-for-local currency swaps have been used at times in Zambia until recently, when the Bank of Zambia imposed a tax of 70 percent on the proceeds of debt swaps which increase the amount of local currency in circulation. It has also imposed a quantitative restriction on swaps by administratively determining a fixed amount of debt which can be converted each year. Although it is not unusual for central banks to set such limits, bankers in Zambia indicated they believed the ceiling set by the Bank of Zambia is unnecessarily low. This has reduced the swap activity dramatically and, since the use of debt swaps was removed from the Privatization Act of 1992, limited what would be a very productive and beneficial use of debt swaps: privatization of parastatals.

The Bank of Zambia now reviews debt swap proposals on a case-by-case basis and the process is so slow that it has greatly reduced the incentive for the use of debt swaps. The financial community is hoping that the Bank of Zambia will allow for the use of various types of debt swaps designed with little or no inflationary impact. This will hopefully be combined with successful efforts by the GRZ to control money supply growth and inflation with more effective monetary policy and fiscal policy management.

Constraints to Financial Market Development. The principal **constraints** to the development of a **money market** in Zambia are some of the same which were identified earlier in this chapter as constraints to private sector development: **severely negative real interest rates; excessive government interference in commercial banks' ability to mobilize and allocate credit; and years of unrestricted commercial bank borrowing from the Bank of Zambia**, thereby discouraging the development of more efficient and market-oriented methods of providing credit to the business community.

Commercial banks, of which there are many in Zambia, are normally the most active participants in the development of a money market. The low cost of borrowing from the Bank of Zambia only served to reduce the incentive for the development of a money market. Commercial banks became somewhat dependent on the this source of funding. The Bank of Zambia's recent decision to raise its lending and discount rates was designed to encourage banks to broaden the interbank market and develop a secondary market in government securities. This move signaled a shift to a more market-oriented policy, less government interference in commercial bank activities and the beginning of a money market. This is also expected to facilitate the move to positive real interest rates which will be market-driven instead of administratively determined.

Apart from inflation, the principal **constraint** to the development of a **capital market** in Zambia is the **legal ambiguity surrounding the existing banking rules and regulations**. As stated earlier, commercial banks have been reluctant to expand into capital market activities until they are clearly authorized by the proposed new banking legislation. Contractual savings institutions in Zambia have not been willing or able to take a lead role in capital market development due to the lack of competitive pressure and their poor financial condition.

## IV. POLICY ENVIRONMENT FOR PRIVATE SECTOR DEVELOPMENT

### A. Business Establishment and Licensing Procedures

The difficulties in establishing an enterprise in a country is often a strong signal of how open the country is to new investment. Zambia has made substantial strides in this direction with the creation of the Investment Centre. The implementation of the Investment Act has reduced the delays and red tape faced by new firms that qualify under the Act. In general, firms under the Investment Act receive approval from the Centre within the 30-day time period stipulated within the Law. However, contrary to the Centre's billing as a one-stop shop, other agencies are still responsible for allocating land, work permits, and tourism licenses.

Mining.[8] Because mining activities do not qualify under the Investment Act, new operations in this sector have a separate establishment process. The creation of a mining enterprise includes a series of stages. The first stage consists of obtaining a Prospecting License which costs K2,500 for semi-precious stones such as aquamarine and amethyst and K5,000 for precious stones (i.e. emeralds).[9] If prospecting is positive, the mining company is expected to undertake the surveying and mapping of the area which typically costs approximately K10,000 for a small mine. Upon completion of the survey/mapping exercise, the mining concern may apply for a Mining License, which costs K10,000 for semi-precious stones and K20,000 for precious stones. Should this stage prove successful, the mining firm will submit its financing plan and mining strategy in the hopes of obtaining a Mining Right. The Mining Right is necessary if the company is to obtain financing from a bank or other external source. Once operational, an annual license fee of K45,000 is required. While the entire process is not expensive in dollar terms, it is an expensive and cumbersome process for the many small-scale miners in Zambia. Consequently, the registration process for mining can be viewed as an additional push towards the informalization of the Zambian economy. An additional constraint to the mining industry is that Zambians are not allowed to become traders in gemstones unless they are lapidaries or hold mining/prospecting licenses. Only foreigners, lapidaries and those in possession of mining/prospecting licenses can buy, sell, or even hold gemstones legally.

Other Industries. The registration process appears to be less difficult for other industries. New manufacturing firms, for example, are issued a manufacturing license by the Investment Centre within two to three days. Food-processing operations are required to obtain health certification while tourism facilities need approval from the Zambia National Tourist Board (ZNTB). There have reportedly been some excessive delays with some projects still awaiting approval after

[8] See Theo Bull's September 1992 article on mining in Profit.

[9] There are reports, that at least under the previous government, that prospecting licenses for emeralds were only available to well-connected people. It could not be confirmed as to whether this remains the current practice.

nearly a year. There are also delays in obtaining title to land for agricultural purposes within the 30-day limit.

Capital Registration Tax. One of the principal disadvantages of the registration process is the 2.5 percent capital registration tax.[10] This tax -- for which there are no exemptions -- places a heavy burden on both new and existing companies which are financing expansions. Many other countries have eliminated this tax as it encourages undercapitalization, less sophisticated technology, and places a heavy tax burden on firms when they are least able to make a high cash payment. The Registrar of Companies, which is responsible for collecting this tax, has gone so far as to accuse firms of being overcapitalized. Given the higher capital needs of the mining and manufacturing sectors, this tax provides an unfair advantage to traders who generally have lower capital requirements. Not surprisingly, this tax is rarely paid by small traders and can be seen as another obstacle to the development of the formal private sector. The constraint posed by this tax is exacerbated by the fact that it is nearly impossible to access financing for investment at the present moment. As such, the capital registration tax hinders the upgrading of technology which lapsed far behind international standards under the past government.

## B. Business Taxation[11]

At present, the **high level of corporate income taxes and import tariffs pose the greatest constraint on business development** in Zambia. The high levels of taxes are not only a drag on economic growth but a strong inducement for tax evasion. The business community -- both formal and informal -- is remarkably open in discussing the need to evade taxes and tariffs in order to survive. The high levels of taxation have been argued as necessary to balance the budget. But many Zambians believe that they pay "developed country taxes" in return for "third world services". There is a perception that formal sector firms are bearing the brunt of the budgetary measures and that the government should emphasize expenditure reduction instead of tax increases.

The Income Tax and Sales Tax Act are the main legislation regarding taxes in Zambia. Other taxes include the mineral export tax, withholding tax, customs duties, and selective employment tax. The relevant tax rates are provided in Appendix A.

Company Tax. Corporate income tax is set at a flat 40 percent and there are reports that this will be reduced to 35 percent in the next budget. While this likely decrease in corporate taxes is to be applauded, it will not allow Zambian industries to compete effectively against the increasing level of imports coming from countries with larger economies-of-scale, more modern equipment,

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[10] Effective January 1991 this tax was reduced from its previous five percent figure.

[11] The fiscal incentives for investment and export activities are covered later in this chapter.

and more attractive policy environments. Experience in other countries demonstrates that there is a strong link between economic growth and tax levels; a corporate tax rate at even 35 percent will not allow Zambian industries to compete effectively.

Mining Taxes. There are two types of taxes imposed on mining related operations. The Mineral Tax is levied on revenue and is deductible from income for income tax purposes. Revenues from minerals other than copper are taxed at a rate of 20 percent, with gemstones and precious metals taxed at 15 and 10 percent respectively. The Mineral Tax is not imposed on copper because of the government dominance of that sub-sector. The second mining tax is the Mineral Export Tax which is levied at 13 percent of the value of all export minerals.[12] Unlike the Mineral Tax, the Mineral Export Tax is not deductible from corporate income tax liabilities and is paid by traders. In this manner, the corporate and mineral export taxes represent a clear case of double taxation, and when the withholding tax on dividends is included, triple taxation occurs. It should be noted that the Minerals Tax is particularly punitive in that it is based on gross revenue rather than gross profits, which means that taxes can be liable even if the firm is not profitable. As such, this tax is extremely difficult for new operations, which would typically have high start-up operating costs.

The high tax rates, plus the relatively high cost of production inhibits formal investment in the mining sector and encourages informal sector activities. In comparison, it is important to emphasize that a reduction in Chilean taxes stimulated mining and prospecting activity substantially; tax holidays for mining activity are becoming increasingly common in Latin American countries.

High Import Duties and Taxes. Despite recent rationalization of the tariff structure, Zambia's tariffs are prohibitively high and have actually increased for most industries. Although on paper it appears as though most imports are subject to tariffs between 15-50 percent, the effective duty is typically in the range of 50-100 percent when taking into consideration the import license levy, the uplifting factor and sales tax. The switch from FOB to CIF prices and the switch to the retention rate of exchange from the official rate of exchange on the valuation of imports has increased duties substantially without actually changing the tariff structure. The present system of calculating import tariffs is complex, and not transparent; it is surprising how many importers do not understand it. Zambia's high rate of tariffs on raw materials and components -- despite economic liberalization -- continues to be characteristic of an import-substitution economy. In that sense, Zambian manufacturers have the worst of both worlds, they are now forced to compete with imports while their tariff levels have been increased.

12 Theo Bull, in his September 1992 article in Profit states that the Minerals Export Tax is 5 percent while the Ministry of Commerce, Trade, and Industry Investment Guidelines uses the figure of 13 percent.

Sales Tax. The sales tax is a flat tax of 20 percent and is imposed on services as well as both imported and locally manufactured goods. This tax is expected to be replaced by a comprehensive value-added tax in the future.

Selective Employment Tax. The selective employment tax of 20 percent on emoluments paid to non-Zambian employees is also prohibitive. Since it is recognized that the country lacks certain specialized skills, the selective employment tax burden is both discriminatory and counterproductive. In contrast, many countries have established preferential personal tax rates for expatriates in the hopes that this will encourage foreign investment and transfer of technology.

Withholding Taxes. A 40 percent withholding tax is imposed on foreign dividends and is clearly uncompetitive with many other countries. Considering that dividends represent income that has already been taxed, the withholding tax is particularly punitive. Dividends on locally sourced income are charged at a lower rate of 15 percent.

Inflation and Taxation. It should be mentioned that inflation has had a major impact on taxation. Apart from being an implicit tax on liquid assets, inflation has also caused massive bracket creep -- and has resulted in the maximum tax now being imposed on annual salaries above US$500. Clearly this is not what officials had in mind when they created Zambia's "progressive" income tax regime. At present, there does not appear to be any movement toward the institution of indexing income, a practice which is used in some countries to eliminate bracket creep.

Inflation also has tremendous effect on corporate tax liabilities. As discussed in the previous chapter, depreciation and other deductible allowances required for planning purposes become irrelevant as these pre-set rates are eroded by inflation. As these deductible expenses diminish relative to nominal revenues, tax liabilities necessarily increase (not to mention the impact of being unable to afford new equipment in the longer-term time horizon). In addition, inflation also increases "paper profits" in that raw materials are purchased at relatively low cost when compared to the final sales price. Last-in first-out (LIFO) accounting could redress this problem to some degree but this accounting principle is not generally accepted in Zambia.

Investment Allowance. Apart from the three-year tax holiday given to new firms and expansions, it is worth noting that Zambia does not allow for an investment allowance deduction. In Namibia and South Africa, existing firms are allowed to depreciate 100 percent of the cost of the equipment in the first year. This has been an effective way of updating capital equipment and improving productivity levels. In Zambia's hyper-inflationary environment, this up-front deduction would also help to make depreciation expenses relevant again.

Lastly, it should be mentioned that there is discussion to establish a capital gains tax in Zambia. At present, there is only a 7.5 percent property transfer tax. A capital gains tax -- given the high rates of inflation in recent years -- would be unusually punitive.

## C. Exchange Rate Policies

Previous Exchange Rate Management. Exchange rate management in Zambia in the past has been characterized by fixed pegging of the kwacha to other currencies, significantly overvalued exchange rates, numerous sudden adjustments, multiple rate systems, and chronic shortages in the official markets.

The Zambian kwacha (K) was introduced in 1968. The kwacha was tied to the U.S. dollar until 1976, when it was devalued by 20 percent and pegged to the SDR. The kwacha remained fixed to the SDR until 1983 when it was pegged to a trade-weighted basket of currencies. Between 1983 and 1985 the kwacha was devalued by 20 percent in nominal effective terms. Despite the 20 percent devaluation, the currency remained grossly overvalued, trading on the parallel market at about one third of its official value.

In 1985 Zambia introduced a foreign exchange auction which resulted in a de facto nominal devaluation of 56 percent against the U.S. dollar. In a break with the IMF in 1987, the auction was abolished and replaced with a fixed pegging of the kwacha at K8=US$1. In 1988 the system was changed to pegging the kwacha to the SDR, at an initial rate of K13=SDR1, representing an effective nominal devaluation of 20 percent. In 1989 the kwacha rate was readjusted to K20=SDR1, bringing about a 38 percent nominal devaluation.

In 1990, a dual exchange rate system was introduced comprising the official exchange rate (OER) and the market exchange rate (MER). The OER was initially pegged at K25=US$1, while the MER was set at K40=US$1. The objective was to adjust the rates and achieve a market-clearing rate. A crawling peg system was introduced the same year in an attempt to merge the official exchange rate with the market rate. Complete unification was not successful, however.

Present Exchange Rate Management System. The current government's strategy is to maintain a competitive exchange rate based on market determination of value, with the intention of closing the gap between the official and market rates by 1993. To that end the MMD government introduced a 30 percent nominal devaluation of the official kwacha rate in January 1992. The government's plan is to gradually adjust the official rate downward to meet the market rate.

Presently there are four different exchange rates in Zambia, which is confusing for businesses and creates constant opportunities for arbitrage and rent seeking behavior. There are three officially recognized rates (official rate, bureaux de change rate, and the retention rate) and one unofficial rate which is not recognized by the government -- the informal market rate. The present gap between the official rate and the bureaux de change rate is 36 percent (see Table 4.1 below).

**Table 4.1**

**Exchange Rate Levels**

**(K per US$; November 1992)**

| Official Rate | Bureaux de Change Rate | Retention Rate | Informal market Rate |
|---|---|---|---|
| 227 | 305-315 | 310-330 | 365-370 |

Source: USAID Private Sector Assessment Team Data

The **official market** is currently supplied with foreign exchange through the Bank of Zambia by two sources: net copper proceeds and donor funds. The only licensed approved uses of the official rate are imports and official travel. Under the Open General Licensing (OGL) system importers must present pro forma invoices and inspection certificates to commercial banks to obtain foreign exchange. Currently about 90 percent of all imports and official travel are available through the OGL system as only a short list of negative items are not eligible for OGL imports. Currently about US$6.5 million per week is sold through the OGL system according to Bank of Zambia estimates.

The second window is the **bureaux de change** window which was created in October 1992. Under the bureaux system, licensed foreign exchange dealers are free to buy and sell foreign exchange at market prices. Licensing is very open to any legitimate applicant. There are still a number of restrictions placed on the buying of foreign exchange, however, including a limit of US$2,000 per purchase of foreign exchange, the requirement that purchasers of foreign exchange have their passports stamped with each purchase, and some restrictions about uses of foreign exchange. Unless these restrictions are lifted it is unlikely that the bureaux rates will completely merge with the informal market or retention market rates.

Under the **retention market**, up to 100 percent of foreign exchange earnings of non-traditional exporters may be sold to third parties or retained in retention accounts with commercial banks for up to six months. The retention market is also supplied with foreign exchange by inward remittances from NGOs, charitable organizations, and new direct foreign investment in Zambia. Since there are no quantitative limits on the amount of foreign exchange purchased in the retention market other than availability, foreign exchange sold in this market often fetches a premium over foreign exchange sold in smaller quantities in the bureaux market. Nonetheless, these funds must be utilized within six months or are remitted to the BoZ in exchange for their kwacha equivalent.

Because of the restrictions in both the bureaux and the retention markets, some business people and informal-sector traders prefer to buy their foreign exchange through the **informal market**, even though the foreign exchange purchased in that market is more expensive. As of November 1992, there was about an 18 percent gap between the bureaux rate and the infonnal market rate.

Foreign Exchange Controls and Access. Until 1992, there were chronic scarcities of foreign exchange in the official market, leading to shortages of spare parts, consumer products, and manufacturing inputs. Starting in 1992, however, under the more liberalized system and as a result of the increased inflows of donor funds, foreign exchange is no longer scarce in the official channels.

Despite the increased availability of foreign exchange and the movement towards market exchange rates, there are still a number of policy-induced restrictions to foreign exchange access. As mentioned above, the foreign exchange in the formal market is restricted to items licensed under the OGL system and official travel. In the bureaux market, there are limits on the amount of foreign exchange which can be purchased through the bureaux (e.g. US$2,000 limits, or US$5,000 with pro forma invoices, and passport stamping) which restrict access. The retention market has a number of bureaucratic formalities that deter small businesses and the informal market, and there is no assured availability in this market unless you are a non-traditional exporter.

In addition to these restrictions to foreign exchange, there are other regulation which limit foreign exchange access. For example, no overseas accounts are allowed for Zambians. Access to foreign exchange loans is difficult for those who are not exporters. For exporters, the BoZ generally approves overseas loans within one week. Under the 1991 Investment Act firms are allowed to remit only 75 percent of their after-tax profits,[13] which compares unfavorably with other countries. Most countries allow 100 percent remittances of profits and dividends to foreign investors. Non-traditional exporters in Zambia do obtain rapid approval (1-2 days) for their profit remittances, however.

Foreign investors who do not have an investment license under the 1991 Investment Act are subject to even more extreme limitations on the remittances of their profits. Under the Exchange Control Act, these investors are only allowed to remit up to 20 percent of their paid-up capital, or 50 percent of after-tax profits, whichever is less. Zambia's control on profit remittances compares poorly with other countries. Many countries now guarantee remittances of 100 percent after-tax profits.

Regarding the repatriation of capital from the proceeds of a sale or liquidation of a business, foreign investors are only allowed by BoZ to repatriate in foreign currency the original

[13] It is not clear to the study team how this restriction will be enforced in the present environment when foreign exchange is readily available in bureaux de change and the retention accounts. Nonetheless the restriction should be removed from the Law.

investment plus retained earnings -- not the full sales value including capital appreciation of the business. This restriction also compares poorly with many other countries which now allow foreign investors to repatriate 100 percent of the capital proceeds resulting from sales of their businesses.

An additional problem for foreign investors in Zambia is that the Bank of Zambia is still in arrears over the allocation of foreign exchange for past dividend remittances. One company interviewed mentioned this as a constraint deterring its parent company from undertaking additional investments in Zambia.

## D. Pricing Policies

Consumer Prices. In the past, the government intervened heavily in the pricing of consumer goods with an extensive list of items under price control until 1990 when most price controls were lifted except for fertilizer and maize. Prices on fertilizer and maize were liberalized in 1992. Private traders are now allowed to participate in all phases of maize and fertilizer marketing.

Despite the price decontrol, there is still strong parastatal influence on the prices for a number of manufactured items and utilities. Most of the large parastatals consult with government before making any major price increases. There are still a number of cross-subsidies in pricing by parastatals. Some government shops reportedly still sell goods at uniform prices irrespective of transport costs (panterritorial pricing).

Agricultural Prices. In January 1992, the new government cut the subsidies on maize roller meal and maize breakfast meal dramatically, resulting in price increases of 103 and 165 percent respectively. Further subsidy cuts were made three months later, and in so doing the government had completely eliminated the subsidies on breakfast meal and roller meal. Into-mill prices and consumer prices now vary by mill, reflecting cost differences. The combined effect of these policies should be increased efficiency and increased incentives to private producers, traders, and millers.

Despite the decontrol of maize prices, the Minister of Agriculture and the President severely criticized the millers for raising prices for a third time this year in June 1992. However the Minister for Agriculture emphasized that the government would not interfere in market forces. Subsequently some milling companies voluntarily reduced their prices.

## E. Import and Export Controls

Export Procedures. Documentation for exports has been eased significantly by the creation of the EXD form. The EXD form is the only document required for exports and copies go to Customs, the Bank of Zambia, and the Ministry of Commerce. This document requires only two signatures -- Customs and the Bank of Zambia -- and is generally processed within a few hours. Export licenses generally are assessed at three percent of value. The imposition of an export license fee is counter to trends in other countries where export levies are being removed in order to boost exports.

Containers used for exports can be sealed at the factory although many exporters continue to pack and seal containers at the private transit sheds operated by licensed brokers such as AMI and Manica. The practice of sealing containers at the factory is common in other countries and helps to accelerate processing as well as eliminate pilferage and damage of the goods. Customs requires that two officers witness the packing/sealing of the container; these officers are typically made available to the exporter within 24 hours. There is no extra charge for this on-site service but due to a lack of transport, the firm must often provide transportation to Customs agents.

Import Procedures. Pre-shipment inspection of imports is required for any shipment above US$5,000 in value. This inspection is undertaken by SGS (a private Swiss firm specializing in Customs matters) in the country of export. SGS ensures that the shipment is properly valued, counted, and described. This practice was instituted because of the high amount of over-invoicing that occurred before the commencement of liberalized foreign exchange access combined with the absence of any valuation or investigative branch within Zambian Customs. Slow SGS procedures have been cited as slowing import shipments, with delays of two to four weeks depending on the country of origin of the import shipment.

The forms required for importation depend to some degree on the source of foreign exchange being utilized. An Open General License (OGL) is used for no-funds accounts as long as the import is not one of the few items such as liquor, tobacco, and firearms on the negative list. Imports utilizing retention funds use a separate ERS (Export Retention Scheme) form. OGL licenses can be granted by commercial banks while licenses for imports using retention money are granted by Customs. These two variations of import licenses cost 10 percent of the import value and commonly take three days to obtain. Other documents required for imports include the SGS form, pro forma invoice, insurance certificate and a bond and border form for goods transported by truck. Duties and sales taxes (tax clearance certificate) must be paid before the importer can take possession. Customs claims that goods are typically cleared within 12 hours while most importers claim to take possession of their goods within a slower but still reasonably competitive 24-48 hours.

Import licenses are gradually being phased out in other countries. With the liberalization of foreign exchange, such controls become unnecessary except for record-keeping purposes. Consequently, Customs declarations are the only import documents necessary in a number of countries working to streamline import procedures and reduce the amount of documentation required.

Customs generally requires that imported goods and materials be cleared at one of the licensed, privately managed transit sheds in Zambia. The cost of this handling service (which does not represent any transportation expense) generally adds approximately 10-12 percent to the import value. This is an unusual practice and is another factor making Zambian manufacturers uncompetitive.

Customs can clear containers and other goods at the factory but only by special request. These "special deliveries" are cleared by Customs officers at the factory without any additional expense to the importer. Special deliveries, however, are usually restricted to perishables, highly sensitive machinery, and spare parts needed to resume production. Nonetheless, large exporters such as Swarp Spinning Mills and Serioes are given a greater level of flexibility and both their import and export shipments are usually cleared at the factory site. Officials at both companies stated that their competitiveness would be reduced if forced to import through the costly transit sheds.

Corruption. Zambian firms generally believe that Customs processes imports and exports in a reasonable amount of time. Complaints instead are more commonly directed to the increasing level of corruption amongst Customs officials. In particular, Zambian manufacturers accuse Customs officers of permitting widescale illegal importation of finished goods. These imports allegedly enter the country with little or no duty paid, and are thus at a comparative price advantage vis-a-vis goods produced in Zambia. Conversations with informal traders indicates that this is occurring to at least some degree.

Apart from the low pay and limited training of Customs officials, enforcement is made more difficult by lack of facilities, equipment, and transport. The Lusaka branch of Customs for example has only one calculator in its cashier's office and computerization of Customs has yet to occur.

## F. Labor Policy

Wage Settlements.[14] Prior to the establishment of the 1990 Industrial Relations Act, labor rates negotiated between unions and industrial associations were binding only upon the negotiating parties. Sections 86 and 89 of the 1990 Act, however, made these Joint Industrial Council (JIC) decisions binding on "every employer and employee in the industry" regardless of whether the employer is a member of the relevant association. Because the firms representing the associations on the JICs tend to be larger and more prosperous, JIC negotiated wage rates are often above the levels that can be afforded by smaller firms within the industry. Not surprisingly, a highly sophisticated, capital-intensive operation is more likely to have higher productivity levels than a smaller, more labor-intensive operation. This policy change has therefore had the following negative effects:

[14] See October 15, 1992 presentation by Beatrice N. Mwila at the Zambian Federation of Employers.

- Many firms have been unable to pay the negotiated rates and have been forced to make reductions in staffing levels. This wage floor prevents firms and workers from setting mutually beneficial agreements on labor.

- It is extremely difficult to establish productivity incentives on an industry-wide basis due to the varied processes utilized within each industry. This is unfortunate, as Zambian firms have found that productivity incentive schemes have been highly effective in motivating their employees.

Fringe Benefits. Because of Zambia's traditionally high tax rates and generally paternalistic policies, employers have historically paid low wages compensated with high levels of fringe benefits which until recently were not taxable. Employers are required to provide a housing allowance (25 percent of base salary though it often is set at 50 percent), a transportation allowance (often up to 25 percent of base salary), social security (five percent up to a maximum of K750 per month), funeral expenses, three months sick leave, and an annual one month leave. In addition, many employers provide lunch, medical care, uniforms, etc. Company managers report that fringe benefits range from 75-300 percent of base salary as compared to the 20-40 percent typically found in other developing countries. Nonetheless, it should be emphasized that even with the abnormally high benefits, Zambian labor costs remain very competitive.[15]

Moreover, the fringe benefits required -- maintaining houses, providing transport -- prove to be time-consuming from an administrative perspective. Company managers nearly unanimously supported raising labor rates by the equivalent they are now paying in fringe benefits. This would not only reduce their administrative headaches, but allow Zambian workers greater flexibility in determining their cash outlays.

Overall, there appears to be a trend toward greater reliance on casual laborers as they are entitled to lower wages, fewer benefits and no severance pay. In this manner, the artificially imposed labor and fringe benefit rates are serving to decrease formal employment and are likely to strengthen pressure for more capital-intensive processing, contrary to the government's objective of maximizing employment opportunities.

Termination. Employers report that it has become easier to terminate unproductive labor under the new government. Presently, management no longer needs approval to dismiss a worker -- all that is required is that the Labour Office must be contacted four days prior to termination. Unlike most countries where severance pay and dismissal payment schedules are quite similar, in Zambia the severance pay formula is much more generous. Statute 126 of the Employment Act states that workers with over ten years service are entitled to three months payment (at most recent salary levels) for each year served upon retirement or redundancy. Considering recent rates of inflation this payment can place a substantial burden on a firm. In contrast, the dismissal

[15] Although, as discussed later, productivity levels are lower than in some countries.

payment for fired workers is only two weeks salary per year of service. Most countries provide one month salary per year of service for either severance or dismissal payments.

Industrial Disputes. The Labour Industrial Relations Court is seen as an additional constraint by employers. Delays of up to two years are not uncommon and the court is viewed by employers as more favorable towards workers. This perceived bias is worsened by the fact that no appeal process is available. The Labour Commissioner has noted that delays have in the past been caused by a shortage of funds and judges and that the present administration is appointing additional judges and establishing permanent courts in both Ndola and Livingstone.

Work and Residency Permits. Reports vary regarding the difficulty in obtaining work and residency permits. Representatives from the Investment Centre note that when someone is investigated closely by Immigration delays average 2-3 months, though most investors do not receive such close scrutiny. Private sector officials claim that the process is more difficult when an employer needs to replace a departing expatriate. The general criticism is that the process is not transparent, criteria are not clear, and no guaranteed minimum level of expatriate personnel is specified in contrast to other countries embarking on liberalization programs.

## G. Property Rights

Legal Status.[16] Zambia's land policy was changed dramatically in 1975. Freehold land was changed to leasehold and land was deemed valueless under the Land (Conversion of Titles) Act. Leases are normally issued for periods of 99 years with the option to renew for a further 99 years. Most land is under the auspices of local chiefs and is known as reserve and trust lands. Traditional areas comprise 94 percent of all land in Zambia with only the remaining six percent being considered state land.

While a 99-year lease can provide adequate security to an investor, the absence of privately owned land means that it cannot always be used as collateral for loans (particularly tribal land), thus further hindering Zambian access to finance. Banks often accept only the structural improvements on the land as collateral which necessarily reduces the amount banks are willing to lend.

Commercial Farmers. For agricultural sector investments, there are numerous ways to obtain access to land for nominal sums.

- Reserve and trust lands require the approval of the local chief, who grants approval through local district councils. Upon approval, district authorities authorize a survey and demarcation of lands through the Ministry of Agriculture.

[16] See Commercial Farmers' Bureau Review of Agricultural Land Tenure and Legislation, December 11, 1991.

The Commissioner of Lands acts as a title-deed issuer upon receipt of the survey documents.

- Land under control of the District Councils requires application to local authorities as well as approval from the Commissioner of Lands.
- State land access is granted directly through the Commissioner of Lands.

Access to reserve and trust lands is slowest of the options as much of it remains unsurveyed; as a result of the shortage of survey teams, delays of up to one year are not uncommon for the formal allocation of virgin land. Because of the difficulties in developing virgin land, it is more common for investors to sub-let or purchase leases to already developed land.

Because it is seen as the property of the state, those gaining access to undeveloped land are required to develop the site to a minimum level within 18 months or loss the right to develop the property. Through this regulation, the government has effectively closed off one of the more attractive alternatives to reducing the bite of inflation -- the holding of land assets. In short, present land policy does not allow property holders to save, plan or utilize property as they see fit. This lack of flexibility and security of assets is a handicap to the entire economy. The fact that a country with Zambia's agricultural potential remains only eight percent cultivated seems to indicate that the land policies are at least partly to blame.[17]

Traditional Farmers. Small farmers in traditional areas generally prefer state land as it is considered more secure; traditional lands are secured solely through a verbal agreement with the local traditional authorities. Farmers in traditional areas face a number of land policy constraints. These include:

- insecurity of tenure. Although it is not common for chiefs to displace farmers on favor of others, this does sometimes occur;
- absence of title deeds to offer commercial banks as collateral;
- there is no guarantee that the farmers' children will inherit the land upon their death;
- cattle can be grazed anywhere except where crops are being raised. This "tragedy of the commons" leads to overstocking and land degradation.

These factors have led to strong demand from emergent commercial farmers for individual titles. At present, farmers lack the level of security needed to make the long-term improvements necessary to increase productivity.

Transfer of Land. The Land (Conversion of Titles) Act states that no sale or transfer of land may take place without the President's consent although this responsibility has been delegated to the Commissioner of Lands. Similarly, land cannot be allocated to non-Zambians unless approved

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[17] Although past agricultural price controls, lack of infrastructure and tsetse fly infestations are perhaps even stronger reasons.

in writing by the President. The Act also restricts the size of farms on Reserve and Trust Land to 250 ha. which is considered too small for "serious commercial farming" in a report prepared by the Commercial Farmers' Bureau (now known as the Zambian National Farmers' Union).

Unlike most countries, each of these transactions must be approved by the Commissioner of Lands and a minimum level of development of the property must have taken place for a transaction to occur.

Land -- whether urban, agricultural, or mining -- cannot easily be subdivided in Zambia. Apart from restricting property-holders from the right to utilize their asset as they best see fit, this clause has had negative repercussions on the development of housing, mining, and agriculture. With regard to urban housing, outdated colonial land use restrictions have been retained which has prevented an emerging middle class from obtaining property. The Lusaka City Council, for example, does not allow title ownership to a flat or maisonette unless it stands upon its own piece of ground.[18] From a non-residential perspective, the difficulty in subdividing land prevents miners and other investors from selling a portion of their property to finance further investment. This reduces Zambia's potential for both investment and job creation, and is particularly discriminatory against smaller, less capitalized entrepreneurs.

Security of Assets. Under the Land Acquisition Act the President has broad powers in expropriating property in the interest of the country. While nearly every country allows for the purchase of private property for public use through the principle of eminent domain, it appears as though this clause was abused under the past regime.

Land, companies, and shops have been expropriated periodically in Zambia, most recently in 1988, when nearly 200 businesses owned by the Asian community were seized. Despite this negative record, the business community in Zambia appears confident that their property is secure under the MMD government. Projects approved under the Investment Act are given strong protection against expropriation and clear guidelines have been established to ensure that if any property is nationalized that a fair market price will be paid.

Concern with security has therefore shifted from government expropriation to thefts and other crimes. The lack of security appears to have spread throughout the country and is a common complaint of people at all levels of the socio-economic ladder.

In similar fashion, small-scale mining operations have been particularly susceptible to wide-scale loss of assets after making significant mineral discoveries. One mining concern stated that after hitting an aquamarine vein, the mine was trespassed by 80 local villagers with picks and axes who made off with most of the find. Because of their remote locations, this is a recurrent problem for small-scale mining operations.

[18] See Theo Bull's October 1992 article in Profit.

Intellectual Property Rights. Zambia is signatory of the Paris Convention (April 1965) and the Berne Convention (January 1992). The Paris Convention establishes minimum standards and procedures for copyright protection. The Berne Convention provides minimum standards and mandates that foreigners receive the same protection as nationals with regard to patents and trademarks (national treatment). Zambian law protects patents for a period of 16 years from the date of publication of the patent.

The study team is of the view that Zambia's Intellectual Property Right (IPR) policies do not present a major constraint to foreign investment. Zambia's IPR regime compares favorably with its African neighbors. Table 4.2 below provides a cross-country comparison of IPR regimes of selected African countries.

## Table 4.2

## Cross-Country IPR Protection

## in Selected African Countries

| Country | Duration of Protection | Memberships P | Memberships B | Available Patent Protection 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|---|---|---|
| Zambia | 16a | x | x | x | x | x | x | x | x |
| Tanzania | 20b | x | | x | x | x | | | x |
| Kenya | 20b | x | | x | x | x | | | x |
| Botswana | 20b | | | x | x | x | x | x | x |
| Mauritius | 14b | x | | x | x | x | x | x | x |
| Zimbabwe | 20b | x | x | x | x | x | x | x | x |

Source: World Intellectual Property Organization

Notes:

| | | | |
|---|---|---|---|
| a | from publication date | 1 | Pharmaceuticals |
| b | from filing date | 2 | Food Products |
| | | 3 | Chemical Products |
| P | Paris Convention | 4 | Plant/Animal Varieties |
| B | Berne Convention | 5 | Surgical Procedures |
| | | 6 | Microorganisms |

## H. Legal System

Legal Uncertainty. One of the primary factors fostering an unstable investment environment is that many critical laws relating to business are due for revision. While it is critical that the government undertake necessary reforms and/or modifications to the Land, Labour, Banking, and Investment Acts, among others, passage of these acts will be necessary before Zambia can effectively broaden its appeal to both foreign and local investors. The primary obstacle to revising the legal foundation is the shortage of legal draftsmen. It is reported that **Zambia has only two legal draftsmen.** At least one donor agency has stated that its offer of technical assistance in this area has been ignored.

Outmoded Legal Foundation. The Companies Act forms the basis of Zambia's commercial law and it has remained largely unrevised since 1910 and is considered extremely difficult to administer fairly, even for knowledgeable and experienced judges. This problem is exacerbated by the fact that decisions of the courts are not published. There is no separate commercial court or small claims court, and judges require further training with regard to business-related law. Commercial disputes are said to be subject to excessive delays and poor implementation which naturally discourages parties from filing complaints.

The Competition Act is seen as giving overly discretionary powers to civil servants. The law allows officials to close down businesses that are "predatory", without giving any sufficient definition to the term. Like many other standing laws, the Competition Act is perceived by the business community as running counter to the liberalization and deregulatory focus of the new government.

## I. Investment/Export Incentives

Investment Act. The 1991 Investment Act represents a major step forward in Zambia's new recognition of the importance of private investment as the engine of growth in its economy. The Act represents a marked change from the 1986 Act, which accorded the government wide-ranging powers to regulate new investment, including reserving the right to take ownership shares in foreign investments.

The 1991 Act does not distinguish between expatriate and foreign investors, instead, foreign investment is considered to be any investment financed from overseas capital -- whether or not it is owned by a Zambian. The law provides assurances that private property will be respected, and expropriation is prohibited except when approved by an Act of Parliament (Section 40). In the event of expropriation, the law requires that full compensation be made at the market value of the property convertible at the prevailing rate of exchange for the currency when the investment was originally made.

The Act also provides measures for dispute resolution through an arbitration board. If no settlement is reached through the arbitration board within one month, the parties of the dispute refer it to the International Center for the Settlement of Investment Disputes or another institution for the settlement of disputes.

The Investment Act establishes the Investment Centre and Board which serves as a clearinghouse for the completion of all formalities required for the establishment of new enterprises. The investment license is the basic instrument for authorization of an investment under the law. An investment license is not required per se to make an investment, but is needed to benefit from the incentives provided by the law.

Investment licenses are to be issued within 30 days for all applications meeting the guidelines. During the first 11 months of 1992, the Investment Centre approved 400 investments, of which 290 companies have already obtained operating certificates. This is a dramatic increase in investments over the previous years. Most of the 400 investments approved have been in the agricultural sector. The average size of the new investments is relatively small by international standards, in the range of US$100-300,000. Some of the investments approved for licenses have been in the domestic services sector. This was surprising to the study team since it is not one of the five sectors listed in Section 31 as enterprises which qualify for incentive (see below).

Qualification for incentives is supposed to be limited to the following types of producers:

- Non-traditional export products or services;
- Agriculture (domestic and export);
- Tourism (with a minimum 25 percent net foreign exchange earnings);
- Import substitution (with significant local materials and utilization and net foreign exchange savings);
- Firms locating in rural areas.

If a company was already established before the Act was promulgated, that company may qualify for incentives if a new sub-unit of the company meets any of the above criteria as long as separate accounts can be maintained to segregate the new activities from the other units of the main enterprise. In spite of this clause many of the existing firms in Zambia would like to see the Act revised so that incentives to new investors would be more equal with incentives offered to existing investors.

The list of economic activities qualifying for incentives is fairly broad. The list excludes primarily commerce, trade, and other domestic market services. As mentioned above, however, some domestic services firms have managed to obtain incentive certificates which is not justified by the law. The incentive approval criteria for import substitution firms are quite general; the Investment Centre officials stated that they considered nearly all local manufacturing activities as net foreign exchange savers. The mining incentives are provided by separate legislation.

The basic incentives granted to qualifying industries (Section 32) comprise:

- duty and tax exemption on capital goods;
- dividend tax exemption for 7 years;
- profits tax holiday for 3 years, followed by a reduced rate (75 percent) for an additional 2 years;
- employment tax exemption for 7 years;
- foreign exchange retention accounts of 70 percent of gross foreign exchange earnings (this percentage has been increased to 100 percent by newer legislation).

Of these incentives, only the foreign exchange retention scheme is performance based; i.e. tied to the achievement of certain macroeconomic objectives. In the case of the foreign exchange retention, the objective is increasing export as measures by the export earnings of the enterprise.

The tax holiday of three years on corporate income tax is modest in comparison with investment incentives is many other countries, and is probably not sufficient to attract export-oriented manufacturers. In addition most non-traditional exporting firms and agricultural ventures make little if any profits in the first three years of operations so there is little, if any, extra incentive provided by the three year tax holiday.

Non-traditional exporters pay corporate taxes of 15 percent in Zambia, which is low by Zambian standards but not very low compared with countries like Togo, Kenya, Cameroon, Tunisia and other countries which offer 100 percent profits' tax holidays starting at ten years in duration for export industries. Cross-country research indicates that incentives are important attraction elements in the investment decision-making of export-oriented foreign direct investment.

In addition to the short tax holiday on corporate tax, the Act's other incentives for exporters are not very attractive by international standards. For example exporters must pay full duties on raw materials and intermediate goods. In addition exporters pay uplifting charges and sales taxes on imported inputs. The combined import taxes can range from 50 to 100 percent. This compares poorly to countries like Kenya, Togo, Cameroon and Tunisia where all inputs are duty-free for exporting firms. In Tanzania under the new Investment Code, all sales taxes and import duties manufacturing (for domestic production or export) have been removed. Gaining access to inputs at competitive prices is a prerequisite for competitive export manufacturing.

Another weakness in the Act is the clause (Section 41) which restricts remittances to 75 percent of a company's after-tax profits. Most countries do not restrict the remittances of profits, and attempts to do so often result in transfer pricing or other means of minimizing profits and transferring funds overseas. In addition, with the recent moves towards a market-based convertible currency market in Zambia, the need to restrict remittances disappears completely as firms will be free to purchase foreign exchange in the retention or bureaux markets. Restrictions in the Act could serve to deter new investors unfamiliar with Zambia.

There are currently some modifications being discussed which could serve to weaken the Act. These modifications could include a minimum investment of US$200,000 to qualify for a license. If this minimum investment cutoff were in effect it would effectively eliminate about half of the new investment coming into Zambia in 1992. Experience in Mauritius demonstrates that many of the large-scale exporting enterprises began operations on a very modest scale. A minimum investment level would thus punish labor-intensive industries, despite the fact that employment creation is one of Zambia's most pressing needs. There is also discussion of abolishing the tax holiday and eliminating duty-free imports of machinery. It is the opinion of the study team that these changes would make the Zambian investment much less attractive than its neighbors' regimes, and the potential negative impact of reversing previous investment liberalization should be carefully considered.

Other Export Programs. While the Investment Act allows for the duty-free importation of equipment and machinery, the drawback and manufacturing-under-bond (MUB) programs allow exporting firms the right to import raw materials and components duty-free. Neither the drawback nor the MUB programs are well-understood or well-known in Zambian manufacturing circles. It is unclear if this is due to Customs concern for potential loss of revenue, the extra work that it entails, or from general inertia.

MUB Program. The MUB program is the more attractive of the two regimes and it is utilized by companies such as Swarp Spinning Mills and Serioes. Firms that export qualify for MUB status by submitting an application to Customs which generally takes anywhere from six weeks to six months to approve.

In theory, each MUB firm is to have a bonded warehouse at the factory for storing materials that will eventually be utilized for export. This warehouse has a double-key lock which means that a Customs officer must be present at the time the materials are brought into the factory from the bonded warehouse. The double-key system is therefore a physical rather than paper control of the stock. In this way, it is the least sophisticated and least complex program for Customs to administer, but the most cumbersome system for the manufacturer. Because Customs does not have a full-time presence on-site, the manufacturer must contact and transport the official to the factory when needed. The bond required for the MUB firm is roughly equivalent to the duties that would be imposed were the imported materials sold on the local market. This is a more cumbersome system than is some countries with MUB programs which require only an annual, general bond.

In actual practice, Customs is more flexible in administering the MUB regime. This is to their credit, but these aspects should be formalized to allow all manufacturers to benefit. For example, rather than having a physically separate bonded warehouse, the entire Swarp Spinning Mills is considered an MUB. In this way, Customs officers need not be present each time Swarp needs to move inventory into the production process. For both Swarp and Serioes, Customs control of inventory is done primarily on an audited -- rather than physical control -- basis, although agents do inspect both facilities frequently. Unlike some MUB programs, Zambia's system does allow for sales to the local market, although for control purposes, the product is supposed to be differentiated from the one that is exported. In fact, this does not appear to be stringently followed.

Drawback Program. The drawback program is differentiated from the MUB regime in that the manufacturer pays the import tariffs on raw materials and components up-front. After the final product is exported, the duties on the raw materials utilized are remitted to the manufacturer. As in other countries with duty drawback programs, Zambia's system is **hampered by the extremely slow payment process** of Customs (delays of up to nine months have been reported). While a slow payment process in other countries is detrimental to cash flow, the several month delay typically experienced by Zambian firms is disastrous given the high inflation rate.

One of the reasons behind Customs' slow payment procedures is its requirement that notification be received from Customs in the country of destination before payment can be made. Not surprisingly, the notification to Zambian Customs is typically not high on the list of things to do in Customs offices abroad. Most other countries require less stringent export verification than Zambia. Because drawback programs are generally better suited to occasional exporters or a firm just beginning to re-orient towards external markets, the lack of efficiency poses a particularly harmful obstacle to encouraging the growth of non-traditional exports.

## V. PROSPECTS FOR GROWTH AND INVESTMENT

### A. Comparative Advantage Assessment

#### 1. Labor

Given Zambia's high un- and under-employment rates, there is no shortage of unskilled labor. Unskilled labor in the industrial sector earns a base pay generally between K6,000-11,000/month. When including the fringe benefits discussed under Labor Policy above, the inclusive monthly salary ranges from K8,000-25,000. Using a middle figure of K16,500 (and dividing by the 48 hour work week) this gives Zambia an inclusive hourly wage of approximately US$0.25/hour. Thus even with Zambia's high fringe benefits, hourly wage rates remain very competitive. This is **among the lowest wage rates in the world** as it is in the range with such low-cost countries as Indonesia, Kenya, and Madagascar. It is nearly a third of the prevailing wage rates in Mauritius.

Productivity levels in Zambia -- as reported by managers who have worked elsewhere in Africa -- are said to be equal or slightly less than those in the region. Swarp Spinning Mills, for example, found that despite the low wage rates, its unit cost of production is higher than that of mills in India, China, Taiwan, and Portugal. A textile consultant who studied Swarp found that **low labor productivity** was the firm's greatest constraint. In its expansion plans Swarp has therefore turned to more automated processing activities despite the low cost of labor. Low productivity levels overall are partially due to the lack of productivity incentives as discussed above under labor policy. Productivity has increased significantly where individual incentives have been implemented. In one leather-sewing operation, productivity has gone up by over 40 percent since piece-rate wages have been put into place while a consumer goods company has seen its productivity increase by 60 percent within a few months.

Low productivity rates are also a consequence of limited training and educational programs. The illiteracy rate was estimated at 27 percent in 1990 and less than 40 percent of higher education graduates have pursued studies in technical, scientific, medical, agricultural, or managerial fields. Artisans are also in short supply; technical schools and vocational colleges are lacking in Zambia and employers have expressed much desire for these types of facilities. The lack of economic opportunities has led up to 50 percent of the nation's university graduates to reside outside Zambia.

**Labor-management relations are tense.** The press has reported that at least 20 factory managers have been assaulted by their employees over the last few years. The Chairman of the Zambian Association of Manufacturers notes that the number is much higher, but managers have feared making these disturbances public. There were a wave of strikes in the first half of this year but they appear to have diminished in recent months after a number of firms were allowed to sack striking employees.

**AIDS** has complicated the labor picture in Zambia. The large number of funerals employees must attend has increased absenteeism rates and the unexpectedly high mortality rates and hyper-inflation have made employers' allowances for terminal benefits inadequate. AIDS has hit middle- and upper-management levels particularly hard and concerns are being expressed that managerial talent will become even more scarce. As a result, some firms have doubled the number of employees they place into their training programs.

### 2. Infrastructure

The Investment Centre assists qualifying firms in accelerating their utility hook-ups. Water and electricity have generally been reliable services in Zambia; in fact, Zambia has historically been a net exporter of energy. Access to water is typically the most simple to obtain and electricity connections are also fairly routine. **Electricity and water rates are competitive.** Medium-scale industrial electricity users pay an inclusive price of approximately US$0.02/kwh which is one of the cheapest electricity rates in the world, despite a recent increase of 400 percent. Within the region, Namibia is the only country known to have equivalent rates, most countries around the world have rates ranging between US$0.05-.10/kwh. Water and electricity cut-offs were rare before the onslaught of the drought and voltage fluctuation has not been problem.

There is a substantial waiting list for telephones and they can sometimes take up to one year to be put into place. Although businesses are supposed to receive priority, at least one engineering firm doubted that this is true. The Investment Centre claims that most of the new investors have had their phones installed within 2-3 months. Other sources have noted that PTC officials demand "supplementary charges" before installing telephone equipment.

The direct dialling system does not always work well and reports of dialling 20 times before getting through has been reported. Another manufacturer noted that it is nearly impossible to phone South Africa between the hours of 8:30 am to 3:30 pm. Quality of phone service appears to vary somewhat by location. Many more complaints were heard about quality of phone service in the Copperbelt than in Lusaka. A manufacturer in Ndola stated that it is easier to call London than Lusaka and that he sometimes goes for weeks without a telephone. As a result, most companies have additional private lines for senior management staff as a form of insurance should there be a breakdown with central systems.

**Telephone charges are very expensive and uncompetitive.**[19] A call to the United Kingdom costs US$5.50/minute, and when one includes sales tax the figure jumps to US$6.60/minute. This compares unfavorably with a number of other countries; calls from Mauritius and Kenya to the United Kingdom cost between US$1.60-1.69/minute. While the PTC has allowed for AT&T Direct Service to the United States, this new competition is restricted to those who are calling the United States and are able to bill an account there.

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[19] See September 1992 issue of Profit.

It is expected that the quality and cost of telecommunications service will be improved shortly. The Minister of Finance has stated that the Telecommunications component of the PTC will be privatized and that three firms have already expressed interest in taking over the operations. ZESCO -- the electric company -- is also a potential candidate for privatization.

### 3. Transportation

Air Freight. Zambia Airways has monthly expenditures of US$4 million versus revenues of only US$1 million; there are 2,000 employees for only six planes. This inefficiency is reflected in its higher prices. Given the nature of international air pricing agreements (IATA), the price of air freight that Zambia Airways -- and its subsidiary cargo operation National Air Charters (NAC) -- charges, is then followed by the other airlines serving Zambia such as British Air and UTA. Although slated for privatization, the government has continued to bail out the airline with the rationale that "it costs less to keep it going than it does to close it down."[20]

National Air Charters offers the only regularly scheduled, dedicated cargo plane and air freight capacity is sometimes a problem. The NAC operation will soon be operating three times a week. However, not all of its space is utilized by Zambian exporters as it also takes cargo from Zimbabwe and Kenya to Europe.[21]

**Air cargo prices** to Europe generally range between US$1.58-2.05/kilo which is **high compared to other fresh horticultural exporting countries**. Kenya's prices are presently at US$1.32/kilo to Europe and exporters there are claiming that that price is uncompetitive. Ghana and Gambia -- two countries which are also emerging as strong horticultural exporters to Europe -- have air freight rates of just US$0.80/kilo.

Part of the problem is high jet fuel prices. According to two sources, despite Zambia's recent 33 percent reduction in jet fuel prices to US$1.23/gallon, it is still more than 50 percent higher than the world price (US$0.85/gallon). This may reflect the fact that jet fuel suppliers such as AGIP, Mobil, and British Petroleum all source their jet fuel from the Indeni refinery at a fixed price. It is not clear how much of the price represents higher overhead costs such as the need to transport crude oil from the coast and how much represents parastatal inefficiency.

Nonetheless, jet fuel prices in the region are so uncompetitive that Zambia now has one of the cheapest jet fuel prices in the region. Considering that jet fuel regularly comprises 35 percent of air freight costs, this factor is significant. Despite the reduction in jet fuel prices, no corresponding reduction has been made in air cargo rates.

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[20] Dr. Mwanza at the November 13, 1992 ZACCI conference.

[21] The fact that Zambia Airways is sometimes not able to provide cargo space to Zambian exporters while simultaneously taking on cargo in neighboring countries could possibly be explained by a need for foreign exchange earnings.

The cost of air freight is the primary cost for horticultural exporters. A recent study in Kenya found that air freight can comprise as much as 50 percent of the CIF price. As a result of these uncompetitive rates, Zambia's once promising fresh horticultural exports sector has nearly disappeared; only the higher value floraculture exports can compete under the present cost structure. In an attempt to redress this situation, the Zambia Export Growers' Association (ZEGA) is trying to organize a lower priced charter. However, charter service proved unfeasible last year due to an absence of steady volume.

Sea Freight. Most containerized traffic is being transported through Dar-es-Salaam while an increasing amount of non-containerized traffic is being shipped through Beira, Durban, and Walvis Bay. Pilferage is a huge problem in Dar for non-containerized traffic and bribes must be paid to crane operators, Customs, weigh bridge attendants, and truckers etc. to move the shipments.

**Shipment of a 20 foot container from Zambia** (through Dar) to Europe costs approximately US$3,000, **nearly double what it costs from Dar or Mombasa.** If shipped through Durban, the all-in price increases to US$4,000. For the apparel industry, being landlocked adds anywhere from 5-15 percent to the CIF price; one apparel manufacturer says that Zambia's geographical position is its biggest disadvantage to increasing non-traditional exports. Another manufacturer notes that operating in Zambia increases his turn-around time to 16 weeks when ideally it should be only 4-5 weeks. This delay results from greater distances as well as excessively long import procedures (particularly SGS inspections in South Africa).

Road/Railway Traffic. Frustrations with the joint Zambian/Tanzanian Tazara Railway has meant that increasing amounts of traffic are now being handled by truckers. The trucking industry is primarily private, very open and extremely competitive. There are hundreds of trucking firms operating (many from Somalia and Tanzania) and Zambia has been much less restrictive in granting licenses than neighbors such as Zimbabwe and Namibia. As a result, Zambia is unusual in that the **cost of trucking is actually slightly less in price than rail shipments.** A 20 foot container transported by road from Dar costs US$1,650 while by rail it would cost US$200-300 more. It generally takes approximately 5-10 days for a shipment to reach Zambia from Dar by truck. In contrast, rail traffic can take anywhere from 1-4 weeks. The railway has suffered from poor maintenance, bad stock, and ineffective management. Consequently, breakdowns and derailings are fairly common. In addition, rail shipments are prone to heavy pilferage losses.

Road traffic is slowed by the fact that the border is open daily only from 6:00 am to 6:00 pm. For commercial traffic, the border is effectively open only from 8:00 am to 4:30 pm. Roads are in terrible shape within Zambia and this increases the cost of maintenance, delivery times, and fuel costs. Transportation between Lusaka and the Copperbelt is expensive and difficult. Fresh horticultural exports, therefore, have survived only near the Lusaka area.

### 4. Relative Importance of Basic Factors

Although it is impossible to quantify the various factors behind successful economic development, a number of generalizations can be made, in terms of both macro and micro issues. On a national level, the cost of labor remains a critical factor for many light industrial sectors such as apparel and footwear manufacturing. That is because labor costs are often 60 percent of local operating costs. Conversely, water and electricity comprise only a small percentage of total operating costs and, as such, the reliability is much more important than cost. As mentioned above, the cost of air freight is a critical issue for fresh agricultural exports.

For more capital-intensive activities the relative importance of the various factors of production differs dramatically. For these sectors, the educational level of the labor force, the cost of transportation, availability of local raw materials, and the cost of available infrastructure assume greater importance.

## B. Regional Market Opportunities

Zambia does not have a large internal market which could meet the requirements of large investments. However, its relative political peace in the middle of a region characterized by political instability could be exploited as a location for export oriented businesses to service some niche markets in the region. A good example of a product from which the country could generate reasonable export revenue within the regional market is Zambian timber. This product has proved to be quite popular in the region.

Zambia's membership of the Southern African Development Coordination Conference (SADCC) and the Preferential Trade Area (PTA) could provide additional competitive advantages to the country for exporting within the region. This advantage may, however, only apply to regional imports that are not sourced from the PTA member countries as these do not qualify for lower duties as provided for under the PTA trade agreement.

There are, however, a number of factors that reduce Zambia's competitiveness in the regional export market. These include:

- high cost of raw material imports arising from high customs duties and other taxes. These result in high and therefore uncompetitive export prices;
- high rate of inflation resulting in businesses thinking short-term resulting in low investment for export production;
- relatively poor quality of Zambian products;
- high freight charges;
- border difficulties -- particularly when transporters go to Zimbabwe and Mozambique;
- external policy constraints, in particular the difficulties Zimbabweans have in obtaining import licenses;

- slowness, poor reliability and general inefficiency of the transport modes servicing the country especially the railway network.

In addition to the above constraints, which limit the ability of the Zambian exporting firms to service the regional market, the size of the regional market itself is small. This is evidenced by, except for South Africa, the low GNP per capita of the countries that make up the region. In addition, the markets of countries south of Zambia are largely dominated by South African and Zimbabwean suppliers who tend to be more competitive on both cost and quality.

As a consequence of the political reforms in South Africa, Zambia may now be in an excellent position to negotiate a special bilateral trade agreement with South Africa which has already entered into an agreement with Zimbabwe.

## C. HIGH POTENTIAL SECTORS AND SUBSECTORS

### 1. Agriculture

Zambia has considerable agricultural potential, with about 9 million hectares of reasonable to good arable land. Despite its good potential, however, only about 20 percent of the arable land is currently utilized. The majority of the land currently under production is rainfed maize. Other significant crops include sorghum, cassava, millet, sunflower, groundnuts, cotton, tobacco, sugar cane, soybeans, and a variety of fruits and vegetable crops. Zambia also has a large cattle herd, mainly targeted for local consumption.

Rainfall has been erratic over the last decade as demonstrated by the droughts of 1982-84, 1986-87, 1989-90, and 1991-92. Average annual rainfall ranges between 700-1300 mm per annum. The range of climatic and topographic conditions means that a wide variety of crops can be grown. There are three main seasons: a cool and dry period from April to August, hot and dry from August to November, and warm and wet from November to April.

The underdevelopment of Zambian agricultural sector predates independence. During the period of the Central African Federation, agricultural production was discouraged in Zambia (then Northern Rhodesia) so it could concentrate on mineral production and consume the agricultural surplus from Zimbabwe (then Southern Rhodesia).

After independence, the government of Zambia followed a strongly interventionist strategy in managing the sector, including nationalization, establishment of parastatals, regulated markets, price controls, and subsidies. The price controls and subsidies on maize and fertilizer, the system of uniform national pricing, and the cooperatives' monopoly on maize marketing all served as major disincentives to production and optimal land utilization, while encouraging consumption and nurturing a bloated and inefficient structure of agricultural cooperatives.

Over the past three years, the government has taken important steps to remove itself from intervention in agricultural markets. The government has eliminated almost all subsidies and price controls on maize and fertilizer, and abolished official monopolies on maize marketing and milling. These actions should encourage greater production and should allow private traders to bring about a competitive and efficient maize and fertilizer marketing and distribution system.

Despite the present serious drought situation, the agricultural sector is attracting considerable new investor interest, particularly from entrepreneurs from South Africa and Zimbabwe. About half of the 400 new investments approved by the Zambian Investment Centre in 1992 have been in the agricultural sector. The main types of new agricultural investments approved include: (i) cereals production (maize, wheat, rice); (ii) food processing (vegetable oils, flour, biscuits, fast foods, etc.); (iii) livestock ranching; (iv) fruit and vegetable production (including manufacturing of fruit juices); and (v) horticulture products for exports (mainly roses and other flowers).

The main attractions of the Zambian agricultural sector for farmers from Zimbabwe and South Africa include: (i) the availability of arable land in Zambia on a long-term lease basis; (ii) the recently enacted suppression of price controls which offers new opportunities for profitable ventures; (iii) the 1991 Investment Act which offers a package of incentives and streamlined approval procedures for foreign investors; (iv) political changes in both South Africa and Zimbabwe which are putting increased pressures on existing farmers to divide or re-distribute their land.

Under the Investment Act all new agricultural investors are entitled to the common set of incentives. Additional incentives available to agricultural producers include a ten percent investment tax allowance, and a corporate income tax of 15 percent compared with the standard 40 percent.

In the months ahead, the privatization process will also offer new opportunities to private investors. One of the parastatals targeted for privatization is the Zambia Agricultural Development Limited. All state-owned ranches and farms are also slated for privatization. In addition the government plans on privatizing the INDECO maize mills. Private sector traders will also find new opportunities in maize and fertilizer hauling and marketing.

### 2. Mining

Mining has long been the backbone of Zambian industry and the country's principal export earner. Mining accounts for eight percent of GDP and 90 percent of export earnings. Copper alone counts for more than 80 percent of export earnings and copper and its by-products (cobalt) account for more than 90 percent of metal production. The copper/cobalt operations are run by Zambia Consolidated Copper Mines (ZCCM) which is 60 percent government-owned with Anglo-American holding 27 percent of ownership and Roan Selection Trust the remaining 7 percent.

In spite of Zambia's potentially tremendous mineral reserves and mining's traditionally dominant role in the economy, new investment in this sector has been disappointing in recent years.

Because there is often a 15-25 year lag between prospecting and actual mining, the mining sector will experience a stagnation phase over the medium-term.[22] For example, production levels that averaged 700,000 tons/year have now dropped to approximately 400,000 tons annually. Within five years, production is expected to decline rapidly to about 200,000 tons per year. As a result, the Minister of Mines has announced that the government's mining plan will require US$2 billion in investment. About US$1.5 billion of this would be to rehabilitate existing mines and develop new ones, while US$450 million would go to exploration and US$50 million to the promotion of small-scale gemstone mining.[23]

If the large-scale mining sector is privatized and/or opened for competition, and current tax levels reduced, levels of investment necessary for the sustainability of the sector could be attained. As pointed out in the Business Taxation section, Zambia's mining taxes are clearly uncompetitive. The high tax rates, plus the relatively high cost of production inhibits large-scale formal investment in the mining sector and encourages small-scale informal sector activities. When combined with the higher costs of production, (US$0.40-.50/pound for copper mining in Peru and Chile compared to US$1.00/pound in Zambia), Zambia's environment for new mining activity is much less promising than it would appear at first glance. In comparison, it is important to emphasize that a reduction in Chilean taxes stimulated mining and prospecting activity substantially; tax holidays for mining activity are becoming increasingly common in Latin American countries.[24]

Unofficial small-scale mining exports have been estimated to reach as high as US$200 million per year. There are 330 holders of prospecting and mining licenses and approximately 20 small-scale mines have reasonably steady operations.[25] The major gemstone is emeralds but there are also large reserves of less precious gemstones like aquamarine and amethyst. The high taxes, cumbersome regulatory procedures, and gemstone marketing board virtually ensured that this sub-sector remained part of the informal sector. While the monopsony of ZEIL has been ended, Zambians (unless they hold mining/prospecting licenses or are lapidaries) are still not allowed to trade gemstones. This regulation, combined with high taxes and cumbersome registration procedures will likely keep this sub-sector as the most attractive of all the informal sector

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[22] In addition to the substantial time lag necessary, studies in Canada and Australia note that an investor commonly spends between US$40-150 million to have a 90 percent probability of making an economic discovery. Once found, a medium-sized metal mine could be expected to require a capital investment of over US$35 million.

[23] See Economist Intelligence Unit Country Profile 1992-93.

[24] Of course, any new investment in mining would have positive repercussions on mining service industries.

[25] See Theo Bull's two-part series on small-scale mining in Profit, August and September 1992.

activities. Without radical policy changes, the high value-to-weight, hard to trace nature of gemstones make it extremely difficult to formalize.

### 3. Manufacturing

The manufacturing sector accounts for 20 percent of GDP and is the second largest formal sector employer after mining. Zambia's manufacturing sector has long been import-substitution oriented with protection provided by high import tariffs and shortages of foreign exchange. Over 60 percent of inputs in the manufacturing sector are imported, ranging from a high of 90 percent for Dunlop Zambia to a low of 25 percent for food processing, beverages, and tobacco industries. Much of the manufacturing sector includes inefficient parastatals slated for the auction block. Principal manufacturing industries include textiles, pulp and paper products, food and beverages, and tobacco. There are only a few export-oriented firms.

In the wake of import liberalization, the manufacturing sector has been hard hit by a number of factors. Manufacturers in other countries benefit from more attractive policy regimes, economies of scale, more modern technology, and more efficient management and labor forces. Furthermore, it appears as though many of the newly imported finished goods are not paying full customs duties thus giving them an additional cost advantage. Capacity in 1991 was estimated at only 35 percent and this year it is expected to drop by another 10 percent.

Given Zambia's small and relatively poor population, many of the manufacturing firms in the country can be expected to fail in the in the face of highly competitive imports. Consequently, manufacturing firms that survive can be expected to fall within a few categories:

- firms utilizing local raw materials. As such agro-, wood- and mineral-processing activities should have some comparative advantages as shown by the success of Swarp Spinning Mills and Zamefa (copper rod and wire manufacturers). In each of these sub-sectors, substantial cost savings can often be gained by processing near the raw material source.

- labor-intensive operations. Although Zambia's landlocked geographical position will prevent sub-sectors such as apparel, footwear, and sewn sporting goods from playing a lead role in the economy, the country's low labor costs and absence of apparel quotas should allow it to attract more investment in these sub-sectors given the proper policy environment.

- high value-to-weight niche items. While air freight is presently not competitive in either cost or reliability, high value, low weight items could be successful. Togo for example has been able to attract investment in niche items such as wig-making and natural cosmetics, while Mauritius has generated employment in model shipbuilding.

- with a deregulated telecommunications sector, Zambia could also attract investment in the fast-growing informatics sector. Zimbabwean firms have already begun doing offshore data processing for a number of British companies and city councils. Because the information in this industry is carried by satellite or air freight, Zambia's landlocked position becomes irrelevant.

This list is not all-inclusive but meant to provide an idea of the types of activities becoming prominent in other developing countries. Certainly a number of local firms will survive and prosper through serving the local market, particularly mine-related activities and bulkier consumer goods. But even in these sectors, greater competition will be encountered; depending on what eventually happens to ZCCM, the close supplier relationships built on proximity and parastatal bonds could even be reduced.

## 4. Tourism

Zambia's potential for tourism is significant, but largely underdeveloped. The principal attractions are Victoria Falls, and an extensive national park system with abundant wildlife and remote wilderness. There are 19 national parks and 32 game management areas which include 23 million hectares of land reserved for wildlife. Within a short distance from Lusaka there is the Lilayi Game Lodge with a game reserve, or the Lechwe Lodge and game reserve.

Tourism revenues for 1991 and 1992 are depressed with some of the main hotels heading into losses for both years. According to the Chairman of the Hotel Association of Zambia, the main causes of the downturn in tourism receipts have been: the recession in the industrialized countries; the reports of cholera; the drought reports; security concerns; and increased poaching of elephants which has dramatically reduced their population, particularly in Luangwa.

Travel industry investors in Zambia also are of the opinion that Zambia Tourism Marketing Board (ZTMB) promotion efforts must be more organized and efficient. ZTMB has very limited promotional material. Even when they do produce good quality promotional material such as the Zambia Travel and Holiday Guide, ZTMB produces very few copies for distribution.

The National Parks and Wildlife Service (NPWS) funds are also seriously inadequate to maintain their parks and protect wild game from poachers. Recognizing its inability to protect the wildlife at the Kasanka National Park from poachers, in 1990 the Director of NPWS signed a ten-year lease with a private company -- Kasanka Trust Company. The lease gives Kasanka Trust Company the authority to manage the national park and develop it for tourism in partnership with the local community.

The Kasanka experiment has been highly successful. Several mammal populations that were almost extinct two years ago have been restored. The puku population, which was almost non-existent two years ago has had its population at the Kasanka Part restored to a level of 1500. The Kasanka Park also shelters rare mammal species such as the blue monkey and the sitatunga.

Kasanka also boasts an elaborate network of roads, bridges, pontoons, an airfield and accommodation for both local and international visitors at three sites.

The NPWS is so pleased with the results from this experiment that it is now considering leasing some of its other smaller national parks to private companies. Some of the best candidates for private investor leasing are NGOs that are seriously interested in wildlife preservation. Many of these NGOs such as the Nature Conservancy are also interested in debt-for-nature swaps, whereby Zambian debt would be traded for Zambian land which would be set aside as conservancy land.

Tourism enterprises with at least 25 percent of their gross earnings in foreign exchange qualify for the common set of incentives in under the Investment Act. Additional benefits to tourism enterprises under the Act include priority allocation of land, and priority in the provision of infrastructure such as water, power, and telecommunications.

There are a number of state-owned hotels and parks in Zambia which are likely to be privatized representing potentially profitable ventures. The parastatal National Hotels Development Corporation is currently the owner of the nation's largest hotels including the Intercontinental and the Pamodzi in Lusaka. These hotels are slated for either total or partial privatization. In addition the government has stated its willingness to lease individual national parks to private operators, as mentioned above. Foreign bidders are particularly encouraged to invest in the upgrading of tourism facilities near Victoria Falls and Livingstone Falls.

## VI. POLICY RECOMMENDATIONS TO ENCOURAGE PRIVATE SECTOR DEVELOPMENT

Despite the staggering pace of liberalization in macro-economic policy undertaken over the past few years, the overall policy environment for private sector operations remains restrictive. The Zambian economic policy framework has had three primary adverse effects: (i) it does not allow existing firms to compete on either a national or international basis; (ii) it has resulted in the creation of a large informal sector economy; (iii) it has created a culture that views prevailing economic rules and institutions as increasingly irrelevant to the day-to-day realities of operating in the existing environment.

### A. Financial Sector

The number one problem facing businesses in Zambia is hyperinflation. It has eliminated long-term capital, makes long-range planning impossible, and increases tax rates, to name just a few of its affects. In order to contain inflation to manageable levels, the government should cut spending sharply and allow interest rates to become positive in real terms.

Given the current high levels of inflation, it is difficult to make recommendations concerning increasing the availability of finance. At the present rates of inflation, any new financing activity is most likely to occur through the creation of non-bank, equity-based financial mechanisms such as direct foreign investment, debt-equity swaps, venture capital funds/merchant banks, mutual funds/unit trusts, and over-the-counter stock trading. Because each of these mechanisms are related to equity -- rather than loans -- they can function within the current inflationary environment. However, at the present time, there is no legal foundation for the undertaking of these activities. Therefore, it is recommended that the government institute legislation allowing for activities related to venture capital funds/merchant banks, mutual funds/unit trusts, and over-the-counter stock trading. The development of these activities is particularly critical to the successful take-off of the privatization program.

### B. Business Establishment Procedures

The primary constraint with regard to business establishment procedures is the levying of the 2.5 percent capital registration fee. Capital registration taxes are increasingly being viewed as anachronisms as they act as a barrier to new investment. In fact, many countries only charge a nominal stamp duty for corporate registration. This tax places a particularly heavy burden on the two industries for which Zambia has the greatest potential -- mining and agro-processing. This is because these two sectors are relatively capital-intensive. A corporate registration tax also unfairly penalizes productive activities relative to trading activities which require less capital. For these reasons, it is recommended that the capital registration tax be abolished.

## C. Business Taxation

At present, the high level of corporate income taxes and import tariffs pose the greatest constraint on business development in Zambia. Corporate income tax is set at a flat 40 percent and there are reports that this will be reduced to 35 percent in the next budget. While this likely decrease in corporate taxes is to be applauded, it will not allow Zambian industries to compete effectively against the increasing level of imports coming from countries with larger economies-of-scale, more modern equipment, and more attractive policy environments. Consequently, it is recommended that Zambia institute a flat corporate and personal income tax of 15 percent. A decrease in tax rates does not necessarily entail a drop in government revenue. Experience in Chile, Mexico, Colombia, Pakistan, India, and Indonesia demonstrates that government revenues can actually increase under lower, fairer tax systems. This is because it stimulates economic activity and reduces the incentive for tax evasion.

The corporate mining taxes which are based on gross revenue rather than gross profits are similarly prohibitive to private investment. It is important to point out that a reduction in Chilean taxes stimulated mining and prospecting activity substantially and tax holidays for mining activity are becoming increasingly common in Latin American countries. In order to stimulate investment and job creation in one of Zambia's highest potential sectors, it is recommended that non-copper mining activities also be taxed at a flat 15 percent income tax rate. As such, the Minerals Tax and the Minerals Export Tax should be abolished.

Despite recent rationalization of the tariff structure, Zambia's tariffs on raw materials and intermediate goods are prohibitively high and have actually increased for most companies. In fact, tariff levels are more characteristic of those found in import-substitution economies. Although on paper it appears as though most imports are subject to tariffs between 15-50 percent, the effective duty is typically in the range of 50-100 percent when taking into consideration the import license levy, the uplifting factor and sales tax. The switch from FOB to CIF prices and the switch to the retention rate of exchange from the official rate of exchange on the valuation of imports has increased duties substantially without actually changing the tariff structure. The present system of calculating import tariffs is complex, and not transparent. It is therefore strongly recommended that raw materials, components, and equipment should have import duty levels of five percent for manufacturers producing for the local market. This action would allow industries in Zambia to compete, without the government having to return to the failed policies of protectionism.

Apart from the three-year tax holiday given to new firms and expansions, it is worth noting that Zambia does not allow for an investment allowance deduction. In Namibia and South Africa, existing firms are allowed to depreciate 100 percent of the cost of the equipment in the first year. This has been an effective way of updating capital equipment and improving productivity levels. In Zambia's hyper-inflationary environment, this up-front deduction would also help to make depreciation expenses relevant again. It is recommended that industries be given a 100 percent, one year deduction on machinery and equipment purchases.

## D. Exchange Rate Policies

The multi-rate exchange system is confusing for businesses and encourages arbitrage and other non-productive activities. The government has stated that it intends to merge the various exchange rates. It is recommended that the government remove the remaining foreign exchange controls and allow the rates to merge on a market-determined basis such as the bureaux de change market, as soon as possible.

Exchange rate policies are already more competitive than many of Zambia's neighbors and the 100 percent retention scheme has been warmly welcomed by the business community. Nonetheless, some distortions and restrictions in the foreign exchange policy framework survive and the modification of these policies would have a significant impact. The Bureaux de Change is working well but its effectiveness has been limited by the documentary requirements and the US$2,000 limit (US$5,000 if in possession of a pro-forma invoice). These amounts remain too small for most importers to use and many fear the passport stamp necessary when utilizing the Bureaux. As such, it is recommended that the US$2,000 limit be abolished and that documentation for the transaction remain anonymous, as it now is in most countries. Activity to this point in the Bureaux has demonstrated that there is a large amount of foreign exchange present in Zambia, and that current exchange rates have actually strengthened against hard currencies.

With regard to retention accounts, two severe constraints remain. First, there is a six-month maximum limit on retention accounts. This is unfortunate, as possession of a retention account is one of the few ways in which a firm can legally protect itself from inflation without tying money up in less liquid assets. Equally problematic is that small exporters in possession of retention accounts often need a longer period of time to accumulate foreign exchange for equipment purchases. In this way, the six month limit impedes the modernizing of Zambia's exporters. Instead of the current situation, it is recommended that exporters be allowed to possess either overseas accounts or foreign currency accounts in Zambia. An alternative -- though less attractive -- recommendation is to end the time limit on retention accounts.

## E. Import and Export Controls

Besides the high tariff rates described above, the aspect of Customs which requires most immediate attention is the unusual requirement that imported goods and materials must be cleared at one of the licensed, privately managed transit sheds in Zambia. The cost of this handling service -- which does not represent any transportation cost -- generally adds approximately 10-12 percent to the import value. Customs has been flexible in allowing exporters to be exempted from this procedure, but it is still required for smaller exporters and those producing for the local market. This requirement is therefore yet another hidden cost to Zambian industries. It would be preferable if Customs charged a flat fee for on-site inspection to those requesting this service. This would provide revenue to Customs while simultaneously reducing handling fees to Zambian importers.

With the liberalization of foreign exchange controls, the need for import and export licenses is no longer necessary and adds to the cost of doing business in Zambia. Other countries that have undergone similar liberalization efforts have shifted to utilizing Customs forms as a means of record-keeping and have found this practice to be sufficient. It is therefore recommended that the requirement for obtaining import and export licenses (even through commercial banks) be ended. At minimum, it is recommended that export licenses be abolished as they are a disincentive to the government's objective of encouraging non-traditional exports.

### F. Labor Policy

Zambia is far behind many countries in the implementation of a reasonable labor policy. The present policy is inflexible, and has become more so -- in some ways -- since 1990. The first constraint concerns the binding of Joint Industrial Council (JIC) on all firms within the industry regardless of whether the employer is a member of the relevant association. Smaller, less sophisticated businesses are often unable to pay the wage scales agreed to by the larger, more prosperous association members. In addition, Council settlements have not been amenable to the establishment of productivity incentives which -- by nature -- benefit both employer and employee. For these reasons, it is recommended that firms which are not members of associations be exempt from the JIC settlements. Moreover, it is recommended that parallel agreements be allowed between employers and employees which would include productivity incentives so long as a minimum wage level be guaranteed.

A second issue concerning labor policy is the paternalistic system of fringe benefits currently under practice. Many of the fringe benefits required -- maintaining houses and providing transport for example -- are administrative headaches for the employer while simultaneously limiting worker flexibility in determining their own cash outlays. Consequently, it is recommended that employees and employers have the right to mutually decide whether to continue or end this practice on an individual firm basis in exchange for the cash equivalent of the fringe benefits.

### G. Property Rights

The question of land status is always highly controversial and politically charged. In Zambia, the law as it currently stands does not permit freehold possession of land and treats land as a valueless commodity. This topic is too complex for a short study such as this one, but it is clear that the government will have to continue progress in changing land status in Zambia. Work should begin to assess the value of state land with the objective that land allocated in the future be sold -- or at minimum leased -- at some value approaching market prices. Once this change has taken place, any rationale for the 18 month "use or lose" concept will be terminated, and land can begin to play the savings and security role it plays in other market-oriented economies. In the meantime, it is recommended that privately held leases for property be allowed to be subdivided freely, with the state role being simply as a registrar of the transfer. This modification to present policy will help to spur investment and job creation in the mining, agricultural, and residential housing sectors and will be particularly beneficial to smaller, less liquid entrepreneurs who lack access to traditional finance mechanisms.

## H. Investment/Export Incentives

There is presently much discussion of revising the recently enacted Investment Act. As with any document, the Investment Act has strengths and weaknesses. The Act itself has been more broadly interpreted than necessary, which has rightly created a backlash from existing firms who are not privy to the same incentives. The Zambian business community has thus interpreted the law as being unfair to existing companies. In fact, the weakness of the law is that its incentives are not are not performance-based. It is much preferable if the incentives are directed toward desirable objectives such as exports generated or jobs created.

At present, export and import industries are treated equally which is non-sensical; clearly the foreign exchange benefits generated by exporters is more important to the country than low value-added import-substitution industries. Under the Act, industrial firms receive a three-year tax holiday, followed by reduced corporate tax rates. While this incentive is attractive compared to the non-Investment Act environment, it is still uncompetitive with the ten-year holidays becoming standard for export-oriented firms in the region. Therefore, it is recommended that firms exporting greater than 80 percent of their production be granted a ten-year tax holiday. Although it is rightfully argued that tax holidays are ineffective attracting industries producing for local consumption, surveys have shown that they are quite important in attracting export-oriented firms. Others oppose tax holidays on the basis that there should be a unified corporate tax rate. However, nearly every country now offers tax incentives for exporters and refusing to do so is unrealistic and limits Zambia's potential for economic growth.

The Investment Act is uncompetitive in two other major provisions. The first is that the Act does not allow for the duty-free importation of raw materials and components (only equipment is allowed duty-free access). Considering that some non-traditional export industries such as apparel often have import contents as high as 60 percent, the absence of this incentive makes Zambia uncompetitive to the sub-sector where its labor rate is most important. It is thus recommended that exporting firms be granted duty-free importation of raw materials and components.

The 75 percent remittance on profits is uncompetitive for all industries, particularly for export-oriented industries; as such, it is recommended that a 100 percent profit remittance be allowed for all firms with foreign investment, regardless of whether or not the firm has qualified for incentives under the Investment Act. In addition, all firms with foreign investment, regardless of whether they are in possession of an investment license, should be allowed to repatriate in foreign exchange the net proceeds from the sale or liquidation of the business.

It is also important that incentives be created for partial exporters as most existing firms will not be able to become primarily export-oriented. Zambia already offers duty drawback and manufacturing-under-bond (MUB) provisions but these remain either ineffective or unformalized. The drawback program has become nearly irrelevant due to slow payback procedures. Consequently, it is recommended that the drawback payment procedure begin when the goods are sealed and transported and not when Zambian Customs receives notification from Customs in the country of destination. Nevertheless, with current levels of inflation even this delay will effectively minimize the drawback payment.

As such, the MUB program is much more attractive in that no up-front cash payment for duties is required; instead, the manufacturer purchases a bond roughly equivalent to the duties payable should the imported raw materials be sold on the local market. As presently configured, MUB firms are to feature on-site bonded warehouses with a double-key lock system. This antiquated form of physical control is being phased out in other parts of the world and it is recommended that Zambian Customs shift from a physical control system to a paper control system for MUB operations. Similarly, further simplification to the MUB system should be made by requiring an annual general bond rather than the current bond per shipment. To further stimulate existing firms to re-orient towards external markets, it is recommended that those exporting under 80 percent of their production receive a proportional decrease in their taxable profits. For example, a manufacturer exporting 40 percent of production would have be taxable only on 60 percent of profits. This mechanism has been successful in Mauritius and is more straightforward and simple to administer than many partial export regimes.

There has also been much discussion regarding future changes to taxation in Zambia and the need to unify rates. While the eventual unification of tax and tariff rates at low levels is a sound goal, the creation of high unified rates is counterproductive to stimulating economic growth and the attraction of foreign investment. It is therefore strongly encouraged that the government not end the duty-free importation of equipment and machinery. Similarly, the termination of the tax holiday for any investments will reduce Zambia's attractiveness and send a negative signal to the international business community.

Lastly, although the private sector believes it enjoys a good relationship with the government and has open access to senior level officials, the private sector would like to formalize its dialogue with both government and trade union officials through the creation of a business/government/trade union coordinating council. Private sector officials believe that this tri-partite council would open communications and allow grievances to be ironed out before they become too serious. At the present time, it is apparent that the level of trust required between the three groups for private sector development does not exist. Closer cooperation between the three groups -- as has occurred in East Asia as well as Mauritius -- can help breakdown these divisions. Therefore it is recommended that a tripartite coordinating council be established.

* * *

The passage and implementation of any of the above incentives would be a significant improvement to the Zambian business environment. The passage and implementation of all or most of the recommendations would represent a fundamental change to the economic environment and enable a tremendous boost to private sector development. These changes would, in effect, broaden the liberalization effort by giving attention to the presently neglected supply-side of the equation. It should be emphasized that while some of the above recommendations are controversial, the policy framework proposed above basically mirrors the type of changes currently taking place in other African nations and reflect the scale of changes made earlier in Asia and Latin America.

## VII. OTHER DONOR ACTIVITY TO SUPPORT PRIVATE SECTOR DEVELOPMENT

Since the MMD Government assumed power after free elections, there has been a significant increase in donor community support for private sector development. Donor aid has sometimes been uncoordinated and has resulted in a certain amount of duplication and reduced benefits to the recipient country. In view of this, the project team has investigated other donor activities in order to prevent duplication and provide information targeting potential USAID assistance to private sector development.

Currently, there are a number of donors providing various forms of assistance to private sector development in Zambia. In the paragraphs below, the key activities of each of the donors is examined.

World Bank. The World Bank has to this point taken a coordinating role in the support of Zambia's structural adjustment program. The main thrust of Bank support has been in the areas of:

- balance of payment support;
- market liberalization;
- civil service reform;
- privatization and parastatal reform;
- private sector development;
- drought relief.

A credit facility of US$200 million has been extended to Zambia in support of these activities. The first tranche of this credit facility was US$100 million, and disbursement was made July 1992. Subsequent disbursements are dependent, however, on the Zambian Government's compliance to the conditions specified in the agreement. Key among these is progress in the divestiture of the first group of parastatal companies. Discussions with the World Bank representative revealed that the second tranche is expected to be disbursed in January 1993.

The World Bank is also expected to provide additional support in the following areas:

- study on establishing unit trusts;
- review of the 1991 Investment Act;
- assessing the potential for the privatization of some of the public utilities;
- liaison of donor activities.

The Bank is also considering providing technical support to the Government for legal reform. In addition to the above, direct IDA assistance is envisaged and is likely to include provision for a Debt Reduction Facility. The IDA has also committed approximately US$1 million to the Investment Centre.

UNDP. It is envisaged that UNDP's support will be concentrated in the areas of privatization, stock market development, institutional development of the Investment Centre and legal drafting assistance. Through UNIDO, UNDP's contribution to the support of the Investment Centre will include provision of experts for short-term assignments, project identification and evaluation. Other areas of support include short-term training courses in project promotion, market assessment and contract negotiation.

NORAD. NORAD is funding three privatization studies utilizing Norwegian consultants as part of its support to the Zambia Privatisation Agency (ZPA). These studies cover Chilanga Cement, ZAFFICO and Zambezi Sawmills. The agency is also providing institutional development support to the Zambia Bureau of Standards.

A study has been carried out and further support is likely to be provided in the form of implementation of recommendations made in the report. Another study aimed at providing institutional support to the Registrar of Companies is due to commence in early December this year. NORAD is also funding a number of studies in the small industries sector. It is likely that this assistance will focus on the provision of credit after specific needs have been identified through the studies.

In terms of support to long-term financial institutions development, NORAD funded a study which assessed the potential of establishing a mutual fund. The decision regarding whether NORAD would fund the mutual fund has yet to have been made by the Norwegian Government.

ODA. An Advisor/Manager position at ZPA is currently funded by ODA as part of its support to the privatization program.

JICA. This Japanese Government donor agency has provided about US$27 million to manufacturing businesses for importation of raw materials. Other forms of assistance are for balance of payment support and technical assistance to the Zambian Government.

EC. The EC is funding a US$14 million, three-year program for promoting non-traditional agricultural exports. The beneficiaries of this program are growers of tobacco, cotton, coffee, flower and horticultural products. About 60 percent of this budget is for providing credit facilities to producers and the rest is for short-term technical assistance in areas such as storage and packaging, and administration of the program.

The EC has also funded a study on the social impact of privatization, particularly as regards relocation and re-training of redundant employees. In addition, this donor is providing rural credit under a smallholder project in the North Western Province and for a rice project in Kasama.

DANIDA. Some time back, the Danish financed a study reviewing Zambia's business laws and the Investment Code. Since then, little or no significant support in private sector development has been provided by DANIDA.

FINNIDA. As part of its support to private sector development, FINNIDA assisted in transforming the Western Province Cooperative Union into a private company. Currently, support is provided to the Luapula Rural Development Programme with a view towards establishing a transport company. In addition, FINNIDA has a credit program covering small-scale forest industries which is being administered through the Development Bank of Zambia. As part of its future programs, FINNIDA is considering providing assistance to private printing businesses.

GTZ. This German aid organization is providing assistance in the form of financing short-term experts to carry out operational analysis of about 13 parastatals to be privatized. GTZ is also likely to employ local experts in specialized fields to support the current private sector development efforts.

Irish Aid Irish Aid is committed to the funding of the Director General of the Investment Centre for a period of 48 person-months. Additional short-term assistance is estimated at 20 person-weeks.

Italian Commodity Aid. The Italian Government has announced commodity grant aid to the Zambian Government. This aid, valued at about US$12.5 million, is to benefit both public and private Zambian companies who wish to import Italian produced commodities and services. Beneficiary sectors include agriculture, manufacturing, transport, construction, mining and telecommunications.

SIDA. The Swedish aid agency has developed a highly successful firm level assistance program. This program is primarily oriented towards the creation of business relationships between Swedish and Zambian firms.

# VIII. PROGRAM OPTIONS TO ENHANCE PRIVATE SECTOR GROWTH

Four potential private sector related program options have been suggested to USAID by the study team. They include: (i) Zambia Export Policy Development Project (ZED); (ii) Post-Privatized and Export-Oriented Firm Assistance (Champions); (iii) Non-Bank Financial Mechanisms; and (iv) Private Sector Non-Project Assistance. In compiling these, the team has strived to formulate options that will have maximum impact. The comparative strengths and weaknesses of private sector related projects elsewhere have been taken into consideration, as well as other donor activity already occurring in Zambia. Each of the options have been designed to be highly complementary to USAID's privatization project. The four options are also complementary with each other, and could be combined in various configurations to maximize their effectiveness.

In addition to benefitting post-privatized firms, the options would also assist export-oriented firms. This is critical, as the bulk of the growth in private sector development can be expected to come from external markets. An export-orientation is also necessary to attract foreign investors to Zambia who would not typically be interested in Zambia's small internal market. This aspect is particularly important because foreign investors often bring their own financing, thus bypassing one of the greatest constraints to private sector development in Zambia. In fact, in countries as diverse as Mexico and Mauritius, non-traditional export sectors experienced significant inflows of foreign investment during periods of high inflation. Similarly, locally-owned export-oriented firms are much more likely to qualify for overseas loans. As a result, two of the options, Zambia Export Policy Development (ZED) as well as Private Sector Non-Project Assistance (NPA), have been designed to enhance the policy environment -- particularly for export-oriented firms.

Because the business environment remains highly constrained, the team strongly believes that the two policy related options deserve the highest priority. Until the policy environment is improved, the potential for venture capital or other financial related projects would necessarily be limited to some extent. USAID has had a great deal of success with both these policy approaches in other countries.

One of the strong attractions of the NPA option is that it is an inherently simple and straightforward process. Two of the three targeted policy reforms would likely require only a ministerial circular to put in place. While this would be a costly option, it is easy to administer and would allow for fast disbursement. USAID can make an important improvement in the business climate with the NPA and it would allow the government to enact a policy that it knows is necessary, but unable to carry out for fear of negative budgetary and/or foreign exchange reserve impact.

The ZED project, meanwhile, is designed to allow USAID to assist not only with the formulation of policy, but also with the more difficult -- though equally critical -- aspect of the implementation of policy. In this manner, the ZED and NPA projects are very complementary, and could be combined so as to maximize USAID's leverage with the Zambian Government.

The Non-Bank Financial Mechanisms option is -- next to attracting foreign investment -- the best means to provide long-term capital in an inflationary environment. It is recommended that the non-bank financial mechanism for the best chance of success is venture capital. This is because venture capitalists are high-risk investors who are more willing to take a chance on new untested environments such as Zambia. However, a venture capital fund would benefit tremendously from an improved policy environment. The justification for this option may be less than for the other options in that substantial progress has already been made in this area without substantial donor assistance. Already two investment firms are basically operating as merchant banks, with the intention of investing in venture capital funds, despite the legal ambiguities surrounding this form of activity in Zambia. In addition, major commercial banks such as Barclay's and Standard Chartered are gearing up to establish merchant banks as soon as the revised Banking Act is passed.

The fourth option -- entitled Champions -- is the preferred option if USAID is not confident it can have a substantial impact on policy, either because of Government unwillingness to enact recommended reforms or because of conflicting donor opinions. Champions addresses this problem in that it has been shown to be successful even when the policy environment is constrained. Firm-level assistance projects such as Champions have proved to have the "biggest bank for the buck" of private sector projects in Latin America, but given the nature of its assistance, it is directed at a small number of already relatively successful firms. In this way, its impact is less broad than policy enhancement. In Kenya, the KEDS project has combined a Champions-style component with a ZED-like component.

Lastly, it should be mentioned that none of the four options are directly oriented at informal sector firms, although they could benefit through backward linkages with formal sector firms. Instead, the policy options formulated have been designed to extend some of the advantages of operating within the informal sector to formal sector firms. For example, informal sector firms are subject to lower taxes, easier business establishment and registration procedures, and less stringent labor policy controls. Moreover, two of the common disadvantages of being an informal sector enterprise -- poor access to finance and legal grievance resolution -- can hardly be viewed as more problematic for informal sector firms. The liberalization of the formal sector environment thus will not only spur the economy, but will also encourage informal firms to join the formal sector.

## A. Zambia Export Policy Development Project (ZED)

### 1. General Description

The Government of Zambia's New Economic Recovery Program places a great deal of emphasis on the expansion of non-traditional exports. The recovery program sets an ambitious target of expanding non-traditional exports by 10-15 percent per annum. The centerpiece of the government's strategy is the maintenance of an exchange rate policy that provides sufficient profit opportunities for efficient exporters.

Another key element in its strategy is the 100 percent foreign exchange retention account incentive for non-traditional exporters. Allowing export firms to retain sufficient foreign exchange to meet their import or foreign payment requirements has been a very useful incentive according to exporters interviewed. Non-traditional exporters are also given a lower corporate tax rate -- 15 percent compared with 40 percent for other companies. Exporters' customs forms (EXD) have also been simplified.

Some of the export incentives are still not competitive with neighboring countries, however. As mentioned previously in this report, the tax holiday of three years on corporate income tax is modest in comparison with investment incentives is many other countries, and is probably not sufficient to attract export-oriented manufacturers.

In addition to the short tax holiday on corporate income tax, the Investment Act's other incentives for exporters are not very attractive by international standards. For example, exporters must pay full duties on raw materials and intermediate goods. In addition exporters not operating under the drawback or MUB programs pay uplifting charges and sales taxes on imported inputs. The combined effective import taxes can range from 50 to 100 percent. This compares poorly with countries like Kenya, Togo, Cameroon and Tunisia where all inputs are duty free. Gaining access to inputs at competitive prices is a prerequisite for competitive export manufacturing.

In addition to the above mentioned measures, the government has stated its intentions of making the duty drawback and the MUB schemes more effective. Currently these schemes are not widely publicized or particularly well formulated and only a few companies benefit from them.

The Export Board of Zambia was established by the Export Development Act of 1985 to create an institutional framework to promote non-traditional exports. The Board's Council comprises members of the government and representatives of exporting associations. The Board's Council is supposed to recommend policies to the government of Zambia for the encouragement of non-traditional exports of goods and services as well as recommend trade agreements which will benefit Zambian non-traditional exporters. Currently the Council is dissolved and the Board has been ineffective over the last two years in implementing new measures to assist exporters. Exporters reported receiving little assistance from the Board regarding market intelligence or information on foreign markets. In similar fashion, the Zambia Ex-Im Bank is supposed to provide pre-shipment export financing based on confirmed letters of credit. Most exporters interviewed did not receive any credit from this bank.

Despite the efforts taken by government to date to encourage non-traditional exporters, there are still a number of areas in which more complete policy reforms and incentives are required in order for non-traditional exports to expand by 10-15 per year as targeted in the government's plan. The key areas in which additional policy reforms are needed are as follows:

- Liberalization of the trade regime so that exporters have access to inputs at internationally competitive prices -- export oriented firms would be granted duty-free imports of raw materials and components;

- Reductions or eliminations on import and export license fees and simplification or elimination of the licensing process;

- Export incentives would be enhanced and implemented for export manufacturers and partial exporters;

- Streamlining the duty drawback system to make it more effective including starting payments when goods are sealed;

- Developing and promoting the MUB scheme based on a paper control system;

- Streamlining customs importation procedures.

The overall objective of the ZED project would be to expand non-traditional exports through improvement in the export incentive framework and through a streamlining of import and export procedures. In addition, the ZED project could be used to help provide external market information. Some of the main themes of the project are to liberalize trade so that Zambians have access to inputs at internationally competitive prices, and to encourage exports through more competitive incentives streamlined and importing and exporting procedures.

## 2. Feasibility Criteria

The program would fulfill the USAID Development Fund for Africa (DFA) Strategic Objective One criteria for feasibility which calls for private sector-led initiatives to help increase efficiency and growth in African economies.

The project faces implementation risks. There is a risk that the short-term falls in import duties could be larger than USAID budget transfers, resulting in budget shortfalls. There is also a risk that the government might reverse policy reform measures at a later date. However, the government was elected on a platform of economic liberalization and is showing few signs of reversal to date.

Financial. The project would require both short- and long-term technical assistance would be required in the areas of: (i) trade reform policy; (ii) export development policy; and (iii) customs procedures reform. Cost-effectiveness would be determined by the magnitude of the policy reform impact on non-traditional exports.

Management/Operations. USAID/Zambia has personnel familiar with trade policy reform, and export development strategies. One long-term advisor would coordinate the ZED project. Short-term expertise will be needed in the areas of export policy incentives, trade policy reform, customs procedures, etc. It is recommended that a firm or consortium of firms be utilized to provide specialized assistance under this project. With this type of structure, the project should not pose too great a management burden on USAID staff.

Comparative Advantage. USAID has solid experience in supporting export development projects of this nature and has recently undertaken similar projects in other countries in Africa. Similar projects have been recently undertaken by USAID in Kenya, Cape Verde, Egypt, Tunisia, and Burundi, among other countries. Policy enhancement programs of this nature have been highly successful in a number of Caribbean and Central American countries where USAID has helped lay the foundation for strong private sector development. USAID has been one of the most successful bilateral donors in encouraging countries to undertake export-oriented policy reforms.

Complementarity. This project would complement and reinforce the other main USAID/Zambia private sector initiative -- the Privatization Support Project. ZED would also specifically complement the EC's firm-level assistance to exporters of non-traditional agricultural exporters.

Monitoring/Evaluation. The ZED project would be monitored like other policy reform projects. Key policy reform and timetables would be laid out in a policy reform matrix. Indicators of project performance would include: (i) reductions in import duties on raw materials and intermediate inputs; (ii) the introduction of competitive, performance-based incentives for export manufacturing; (iii) streamlined importing and exporting procedures; (iv) growth rate for non-traditional exports.

## B. Post-Privatized and Export-Oriented Fi[illegible]e -- "Champions"

### 1. General Description

USAID experience in Latin America and the Caribbean has shown that enterprise-level technical assistance and brokerage services to a limited number of producers is the most effective type of trade and investment project.[26] One advantage of this approach is that it is policy neutral. In a sense, the project can succeed whether or not the policy environment is positive. In fact, this approach has been found to be the most appropriate for increasing exports and job creation in constrained policy environments.

This approach assumes that there are major constraints placed on local producers and investors that can only be overcome by highly targeted technical assistance in production and marketing. Assistance is directed at firms which have a number of the ingredients necessary for success but require further expertise in technical aspects such as production methods, quality control, pricing strategy, inventory control, or market brokerage assistance. The assistance should be hands-on and firm-specific, rather than general marketing or feasibility studies.

This approach encourages the targeting of opportunities which can yield the greatest export and/or job creation per USAID dollar. Extensive, on-going assistance should be aimed at a few firms -- such as ten firms per year of the program. The process for selecting firms for assistance should be based on two factors. One, how much assistance would be required to enable the firm to export successfully (the less the better). Two, whether the firm is willing to share any portion of the technical assistance costs. The latter is crucial as it demonstrates the firm's commitment to the program and will encourage the firm to take the assistance more seriously. As the object of the project would be to increase jobs and exports, as well as turnaround privatized firms, assistance should be eligible to any private firms in Zambia (firms that are not yet in existence should be excluded as they offer no track record to measure accurately their potential). However, if necessary, eligibility could be limited to firms with 51 percent Zambian ownership.

### 2. Feasibility Criteria

This project, if properly designed and implemented, would fulfill all of the USAID CPSP criteria for feasibility.

Financial. The project would require on-going short-term consultants with industry-specific expertise. However, because of the relatively small number of firms that would be assisted, this is a fairly low-cost alternative. Cost effectiveness is an important element of this option as the intensive assistance to the small number of firms should yield positive results for relatively little funding. Moreover, USAID's leverage is increased by concentrating services on potential

[26] "Promoting Trade and Investment in Constrained Environments: AID's Experience in Latin America and the Caribbean," Louis Berger International, November 1989.

winners who can become role models for other enterprises and whose own employees may subsequently begin their own ventures.

Management/Operations. It is believed that a new institution need not be created to manage this project. One long-term advisor should be able to coordinate the assistance and could be situated within a broad-based organization such as ZACCI. USAID has much experience with this type of project elsewhere in the world, and attracting appropriate personnel should not be a problem. Given the specialized nature of the assistance required, it is recommended that a large firm or consortium be utilized that can easily access experts from a wide range of industries. (Organizations such as Macro/IRD, Kurt Salmon Associates, or IESC, can typically provide experts in a wide range of fields.) With this type of structure, this project would not pose too great a burden on USAID staff.

Comparative Advantage. USAID has successfully undertaken projects of this nature in a number of countries. This approach would help firms in Zambia to reorient their operations regardless of whether further policy reforms are successful or not. This is critical at this juncture, as it is unclear how much farther policy reforms will go over the next few years.

Complementarity. UNIDO, SIDA and USAID (through IESC) have all had highly successful enterprise assistance programs in Zambia. The SIDA program, however, is primarily oriented towards creating business relationships between Swedish and Zambian firms. UNIDO's assistance appears to have been directed towards the development of the leather industry. The EC's program is to be focused on providing assistance solely to horticultural firms. The Champions approach is differentiated in that will be aimed at increasing non-traditional exports and in helping to turnaround post-privatized firms.

Monitoring/Evaluation. This project would be extremely easy to monitor and evaluate. Success of the assistance could be measured by increases in the number of jobs, exports, investment, and capacity usage. Secondary measures would include the number of spin-off firms created, new markets and products, as well as transfer of technology.

## C. Non-Bank Financial Mechanisms

### 1. General Description

The existence of high inflation makes it difficult to plan any financial sector program options. However, the option in most demand by the GRZ and the private sector community in Zambia is the introduction of non-bank financial mechanisms such as venture capital funds, mutual funds, merchant banks and some form of securities exchange (formal stock market or over-the-counter network), all of which are needed to provide equity finance to existing and privatized companies.

While all of these mechanisms are important components of privatization and private sector development, it is recommended that USAID focus its efforts on venture capital financing. Therefore, in order to provide a firm foundation for the increased availability of investment capital for privatization and private sector development in Zambia, USAID should take the lead role in the development of a legal and regulatory framework for the creation of venture capital companies and venture capital funds. USAID assistance could also involve coordinating with the World Bank plans to assist in the design and development of the proposed Privatization Trust Fund, since it may require venture capital financing.

<u>Assessment of suitability and viability of non-bank financial mechanisms.</u> The World Bank is preparing to commence a feasibility study relating to the viability of a mutual fund and a venture capital fund. The Bank has indicated its willingness to work with USAID and other interested donors on similar studies and other needed technical assistance. USAID assistance would initially involve coordination with the World Bank and other donors interested in funding feasibility studies in order to determine progress to date as well as plans to assess the viability of the introduction of venture capital funds, mutual funds, merchant banks and a securities exchange in Zambia. The assessments would include a determination of: the liquidity required for each mechanism; market demand; identification of possible professional fund managers, securities brokers and joint venture partners.

The GRZ and many key private sector participants, including prominent international banks and local financial institutions, have expressed strong interest in the development of these mechanisms. Therefore, once the viability of the introduction of these mechanisms has been affirmed (following positive feasibility studies by the World Bank and other interested donors), an assessment should be made as to whether the new Financial Institutions Act and other local legislation provides an adequate foundation for the introduction of these mechanisms. Lessons learned from other African countries attempting the introduction of similar non-bank financial mechanisms should also be considered.

<u>Timing and Sequencing Considerations.</u> The assessment of the suitability and existing legal foundation of these mechanisms will help to determine the timing of their introduction and appropriate sequencing. For example, the level of investor and donor interest in investing in venture capital and mutual funds will obviously influence the type of securities exchange (i.e., over-the-counter or formal stock exchange) required.

Recommended USAID Legal and Regulatory Foundation Assistance for Venture Capital. The GRZ, with World Bank guidance, has identified the need for the following financial mechanisms: Privatization Trust Fund; mutual funds; venture capital funds; and capital market development. Specifically relating to venture capital funds, the GRZ has identified the need to consider the following tasks:

- Recommend an institutional arrangement for establishing and managing venture capital funds;
- Identify sources of venture capital funds;
- Design guidelines on how venture capital funds are to be managed;
- Assess the feasibility of establishing venture capital companies or using existing financial institutions as the place where the funds are held and managed;
- Identify existing institutions that could act as managers of venture capital funds;
- Revise existing laws and define principles that will govern the operation of venture capital funds in Zambia.

The Importance of Developing Merchant Banking Skills. Several commercial banks in Zambia are planning to open merchant banking subsidiaries once new banking legislation authorizes the formation of merchant banking[27] operations. Some investment companies are also planning to begin merchant banking operations once the new banking legislation is in place. Discussions with commercial banks and investment companies has revealed their plans to use their merchant banking operations to participate in privatizations and venture capital and mutual fund activities, as well as the trading of money market instruments (i.e., treasury bills) and capital market instruments (equity shares) in a secondary market with other banks.

USAID could take a lead role in assessing the need for training assistance and other guidance (preparation of manuals, etc.) for the individuals the new merchant banks will hire as brokers. Since the Bank of Zambia has indicated the need for the training of its bank examiners in merchant banking activities (and other non-bank financial activities expected to be permitted in the new Financial Institutions Act), USAID could expand this technical assistance to include the training of Bank of Zambia examiners and an assessment of computer equipment needs.

## 2. Feasibility Criteria

The Non-Bank Financial Mechanisms Project would fulfill USAID CPSP criteria for feasibility. It is important that the activity be coordinated with other donors and that USAID involvement, once commenced, is consistent and closely coordinated with GRZ. Feasibility criteria are discussed below:

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[27] Merchant banks are similar to investment banks. They take equity positions in, and make loans to, private sector companies. They are often connected in some way with venture capital funds as investors or managers.

Financial This project would require short-term consultancies of approximately six-person months and at least one long-term position to perform the tasks recommended above. Such a project could be tailored to fit within USAID's financial resources, and then grow as warranted by results of feasibility studies and other assessments.

Management/Operations. Technical assistance can include the use of individuals from: IESC; FSVC (USAID-funded Financial Service Volunteer Corps); U.S. and Zambian consulting firms specializing in capital market development; regional (Botswana, Zimbabwe, etc.) or international (NYSE, NASDAQ, London) securities exchanges. It could also involve close coordination with the IFC, which, like USAID, is experienced in venture capital, mutual fund and capital market formation.

Comparative Advantage. The United States has a strong comparative advantage in the development of non-bank financial mechanisms. There is an enormous supply of capable, experienced individuals and institutions from which to choose a technical assistance team. USAID has provided feasibility study assistance for the creation of such venture capital funds as OPIC's Africa Growth Fund and, more recently, the ASEAN Growth Fund.

Complementarity. This project would firmly reinforce USAID's commitment to the GRZ's privatization efforts and to the removal of constraints to private sector development. This would clearly complement the work of USAID as well as the World Bank and other donors (UNDP, CDC and NORAD). Officials from CDC have already expressed strong interest in co-financing such a project with USAID. The key element of the project would be efforts to ensure that these mechanisms would be developed on firm and proven legal and regulatory foundations. Their successful implementation will substantially increase the amount of long-term credit available to private sector businesses.

Monitoring/Evaluation. The project would be relatively easy to monitor in terms of evaluating its impact. Some indicators would include: the amount of funds raised by these mechanisms; the actual demand from investors; the ability of these mechanisms to provide credit to, and otherwise facilitate, the privatization process and post-privatization private sector development; number of defaults; and percentage of loans repaid.

## D. Private Sector Non-Project Assistance

### 1. General Description

The Government of Zambia embarked on an ambitious new economic liberalization in 1992. The main components of the liberalization program include: (i) introduction of a more competitive exchange rate; (ii) decontrol of interest rates; (iii) privatization of parastatals; (iv) liberalization of the Investment Act and a streamlining of procedures; (v) the elimination of principal subsidies; and (vi) civil service reform.

These bold policy reform measures notwithstanding, there are still a number of areas in which more complete policy reforms are required in order for the private sector to become the engine of growth as the Government intends. The key areas in which additional highly targeted policy reforms are needed are as follows (one or more of the following reforms would be selected as conditionality for program assistance):

- Reduction in import tariffs so that producers have access to inputs at internationally competitive prices. The government would like to introduce such a reform but feels it does not have the budgetary resources to lower duties without additional support. The reduction in import duties is easy to implement -- it only requires a Ministerial Circular;

- Improving investment incentives including granting the right to remit 100 percent of after-tax profits, and introducing more competitive, performance-based incentives to exporting firms;

- Loosening controls on the bureaux de change by removing any limits on the amount of foreign exchange purchased from the bureaux and eliminating the stamping of passports procedure at the bureaux;

- Creation of a business/government/trade union coordinating council.

Reform in the key policy areas noted above would serve as a pre-condition for USAID/Zambia cash disbursements in the program. A policy matrix would be designed in consultation with GRZ during PAIP design. The policy matrix would include objectives, program targets, performance indicators, and a timetable for implementation. The program would be fast disbursing and divided into two tranches, with the first tranche scheduled for disbursement by about June 1993. The second tranche would be scheduled for release in FY 94 after satisfactory fulfillment of specified conditions.

USAID dollar disbursements would made through the Bank of Zambia. The Bank of Zambia would sell the dollars to the bureaux de change at the prevailing bureaux market rate at the time of disbursement. Dollars from each disbursement would be sold by the Bank of Zambia over an extended period of time to avoid any major disruptions in the narrow foreign exchange market.

Selling dollars to the bureaux would add depth to this new market, and encourage additional funds to flow into this market-based trading system.

The overall objective of the program would be to broaden market liberalization in the Zambian economy and activate major private sector development. The main themes of the program are to liberalize trade so that Zambian businesses have access to inputs at internationally competitive prices, consolidate establishment of market-based exchange rates, direct encouragement of exports through more competitive performance-based incentives, and establishment of a forum for private sector/government consultation process on key policy reform issues. In addition the program will add new depth to the market-based bureaux de change system. The program is innovative in that USAID would be the first donor to provide balance of payments support through the new bureaux system.

## 2. Feasibility Criteria

The program would fulfill the USAID Development Fund for Africa (DFA) Strategic Objective One criteria for feasibility which calls for private sector-led initiatives to help increase efficiency and growth in African economies. The program would also address the Mission's program goal of broadening economic and political pluralism, particularly through the establishment of the private sector/government forum.

The project faces implementation risks. There is a risk that the short-term falls in import duties could be larger than USAID budget transfers, resulting in budget shortfalls. The total US$ amount of import duties is budgeted at US$87 million for 1992. Of this total the amount of import duty revenue from raw materials and components is substantially less, although Customs does not have a breakdown by type of import. There is also a risk that the government might reverse policy reform measures at a later date. However, the government was elected on a platform of economic liberalization and is showing few signs of reversal to date.

Financial. In order to be an effective additional catalyst for bold policy reform of the magnitude envisioned, the program would require total disbursements of approximately US$15-20 million. In addition to the cash disbursements, short-term technical assistance would be required in the areas of (i) trade reform policy; (ii) investment policy incentives (iii) streamlining of bureaux regulations and formalities; and (iv) monitoring of bureaux de change market development.

Management/Operations. USAID/Zambia has personnel familiar with private sector development, trade policy reform, and foreign exchange liberalization. It is likely that short-term expertise will be needed to complement USAID expertise in these areas and in investment policy liberalization. The project would be very easy to manage since it essentially involves reaching one-time agreements with the government on one or two easy to monitor policy changes.

Comparative Advantage. USAID has solid experience in supporting non-project assistance programs of this nature, particularly in Africa. Similar policy assistance programs of this nature have been undertaken by USAID already in Zambia, Cameroon, Uganda, Ghana, and Rwanda among other countries. USAID has been one of the most successful bilateral donors in encouraging countries to undertake market-oriented policy reforms through non-project assistance.

<u>Complementarity</u>. The program would generally reinforce the other main USAID/Zambia private sector initiative -- the Privatization Support Project. The program would complement the World Bank's Privatization and Industrial Reform Project which is a broad privatization and regulatory reform project. The program would also supplement FIAS (World Bank) initiatives to revise the Investment Act. Since all of the reform measures targeted in the PSRP are new initiatives the program would not be supporting reforms already planned.

<u>Monitoring/Evaluation</u>. The program would be straightforward to monitor since the key policy reform and timetables would be laid out in a policy reform matrix. Indicators of program performance might include: (i) reductions in import duties on raw materials and intermediate inputs; (ii) the introduction of competitive, performance-based incentives for export manufacturing; (iii) the maintenance of an unrestricted, market-based foreign exchange trading system in the bureaux de change; and (iv) local industry performance in terms of sales, employment, investment, capacity utilization, and exports.

## E. COORDINATING COUNCIL

Although the private sector believes it enjoys a good relationship with the government and has open access to senior level officials, the private sector would like to formalize its dialogue with both government and trade union officials through the creation of a business/government/trade union coordinating council. Private sector officials believe that this tri-partite council would open communications and allow grievances to be ironed out before they become too serious.

Given the team's conversations with public and private sector representatives, it is evident that periodic meetings between the three groups could prove mutually beneficial. At the present time, it is apparent that the level of trust required for private sector development does not exist. Closer cooperation between the three groups -- as has occurred in East Asia as well as Mauritius -- can help breakdown these divisions.

This option is not considered as a potential program, but it is viewed as a low-cost alternative that could be combined with any of the four above options. USAID's involvement could range between making the creation and implementation of the council a condition for future support to actually providing funding for the periodic renting of conference facilities and occasional outside speakers.

## ANNEX A

## CURRENT BUSINESS TAXES

| Tax | | Rate |
|---|---|---|
| Export of non-traditional products (non-copper exports) | | 15% |
| Export of goods manufactured from domestically produced agricultural raw materials | | 0% |
| Farming | | 15% |
| Rural manufacturing (for the first 5 years) | | 30% |
| Manufacturing | | 40% |
| Banking | - first K10,000,000 | 40% |
| | - excess | 45% |
| Other | | 40% |
| Withholding tax on dividends | - resident companies | 15% |
| | - non-resident companies | 20% |
| | - first 5 years of farming profits | 0% |
| Management fees | | 30% |
| Selective employment tax | | 20% |
| Estate duty | | 6 - 12% |
| Sales tax | | 20% |
| Property transfer tax (on land and shares) | | 7.5% |
| Mineral Tax | | |
| | - non-copper | 20% |
| | - gemstones | 15% |
| | - other precious metals | 10% |

| | |
|---|---|
| Mineral Export Tax | 13% |
| Customs duty | 15 - 50+% (1) |
| Registration fee | K2,000 |
| Annual fee | K2,000 |
| Education levy - maximum | K75,000 |
| Taxation of trusts | 35% |

Note (1)

Although most items attract customs duty of between 15% and 50%, there are however others which attract higher rates of duty. Examples include beer and cigarettes currently charged at 100%. It is also true that with a 50% base rate, the effective duty paid by businesses is actually higher due to the compounding effect of the method of calculating duty.

It should be noted that in some cases, the tax rates shown in this Appendix are different from those applicable to companies that enjoy tax incentives provided for under the 1991 Investment Act.

## ANNEX B

## DEDUCTIONS ON CAPITAL EXPENDITURE

| Asset | Rates % | Notes |
|---|---|---|
| Industrial buildings | | (1) |
| . investment | 10 | (2) |
| . initial | 10 | (3) |
| . wear and tear | 5 | (4) |
| Commercial buildings | | |
| . investment | - | |
| . initial | - | |
| . wear and tear | 2 | (4) |
| Low cost housing | | |
| . investment | - | |
| . initial | - | |
| . wear and tear | 10 | (4) |
| Implements, machinery and plant (including commercial vehicles) | | |
| . investment | - | |
| . initial | - | |
| . wear and tear | 25 | (4) |
| Implements, machinery plant (used exclusively in farming) | | |
| . investment | - | |
| . initial | - | |
| . wear and tear | 50 | (4) |
| New or unused implements, machinery plant (excluding motor vehicles) for use in manufacturing process | | |
| . investment | 20 | |
| . initial | - | |
| . wear and tear | 25 | (4) |
| Non commercial vehicles | | |
| . investment | - | |
| . initial | - | |
| . wear and tear | 20 | (4) |

Notes to summary of deductions for capital expenditure.

1. In addition to the buildings associated with undertakings and trades that are normally regarded as industrial, the following are also classed as industrial:-

   (i) buildings first constructed as hotels after 1 April 1966 or extensions to such buildings which are certified as conforming to Government standards;

   (ii) accommodation for staff the cost of which does not exceed K20,000 for each housing unit;

   (iii) buildings for the welfare of employees engaged in undertakings or trades classsed as industrial;

   (iv) transport undertakings.

2. On the cost of construction of building used for manufacturing. Allowed in the charge year in which the building, addtion or alteration thereto is brought into use.

3. Allowed in the charge year in which the building is brought into use by the person incurring the construction cost or cost of additions or alterations thereto.

4. Calculated on cost on a straight line basis.

## ANNEX C

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ANNEX D

LIST OF INTERVIEWEES

## I. Zambian Government and Parastatals

H.F. Mojula
Director of Foreign Operations and Budget
Bank of Zambia

Neville Grant
Director of Bank Supervision
Bank of Zambia

Suya B. Mtonga-Chidumayo
Senior Economist
Research Department
Bank of Zambia

Lana Kinley
Adviser/Manager
Zambia Privatisation Agency

Mazinba Wilson Kapembwa
Investment Promotions Manager
Investment Centre

Nkonkanya Weston Simon
Investment Promotions Officer
Investment Centre

J.M. Mwamlima
Manager, Trade Information Services
Export Board of Zambia

James Groat
Chief Executive
Metal Fabricators of Zambia (ZAMEFA)

Mike Merrett
Managing Director
Mpongwe Development Company Ltd.

Mr. Gaston Y. Nkhoma
Assistant Station Manager
National Air Charters

Willie Banda
Commercial Engineer
ZESCO

B. M. Mwiiga
Assistant Controller
Department of Customs and Excise

## II. Private Sector

Dev K. Babbar
Director
Zambian Association of Manufacturers

Kushal C. Parakh
Financial Director
Galaun Holdings Ltd.

Mark Gibson
Cavmont Investment Company Ltd.

Michael M. McNie
Executive Director
Barclays Bank of Zambia Limited

Obed N. J. Muchima
Corporate Director
Barclays Bank of Zambia Limited

Nicholas Brentnall
Chairman of Zambian Bankers' Association
Managing Director of Barclays Bank of Zambia Limited

Charles H. Sichangwa
Deputy Managing Director
Meridien BIAO Bank Zambia Ltd.

Luke C. Mbewe
Managing Director
Meridien Management Services Limited
Meridien Leasing Limited

Lawrence S. Sikutwa
Managing Director & CEO
Madison Insurance Company Zambia Limited

Bill Fyfe
Manager, Marketing and Operations
Madison Insurance Company Zambia Limited

Raymond Chilembo
Manager
Citibank Zambia, Ltd.

Passwell Shapi
Manager
Citibank Zambia, Ltd.

Chris Spyron
Kembe Estates Ltd.

S.M. O'Donnell
Managing Director
ERZ Holdings Ltd.

Bal Raj Capur
Chief Executive
Match Corporation Ltd.

Peter Koutschebey
Executive Director
AMI (Z) Ltd.

Mr. Banda
British Petroleum

Mr. Pulino
UTA Airlines

Raj Mahesh
Ram Consulting Engineers

Elijiah Kacenje
General Manager
Foundry & Engineering Ltd.

Eugene Appel
Managing Director
Perway Industries Zambia Ltd.

Derek Law Crawford
Director
Towel Textiles Ltd.

L. Chipanta
Managing Director
Mweka Marketing Ltd.

Iain Bannatyne
Managing Director
Chloride Zambia Limited

G.H. Ngwira
Operations/Technical Manager
Dukon Limited

Michael Grummitt
General Manager
African Wire Ropes Ltd.

Sharad Nayee
Chairman
Kitwe Chamber of Commerce and Industry

Peter Canterbury
Chairman
Ndola Chamber of Commerce and Industry

Derek J. D. Broome
General Manager
Mukuba Hotel
Ndola

Management Team
Lyons, Brooke Bond

Ramesh J. Patel
Managing Director
Swarp Spinning Mills Ltd.

J.H. Dhody
Managing Director
Serioes

Hiri Bodalia
Managing Director
Shamrack Limited

Pat Puta
Managing Director
Copper Harvest Foods Ltd.

Murray Sanderson
Executive Chairman
Lutnda Limited

Howard Gatchell
General Manager
Vitretex Paints Ltd.

Frank Ferguson
Group General Manager
Star Commercial Ltd.

Campell Wilson
Owner
Discount Centre Blacksmiths

Patrick Phiri
Tailor

Stephen Nyirenda
Furniture Maker

James Chowa
Owner/Trader
Remise Enterprise

Zambia Confederation of Industries and Chambers of Commerce:

David Frost, Chairman
Theo Bull, Chairman of Subcommittee on Investment & Privatization
Bernard Chisanga, Chief Executive
Francis S. Mphepo
Patrick K. Chiwenda

John Hudson
Executive Director
Zambia National Farmers' Union

P.S. Chiumya
Director
Monica Chiumya Memorial Clinic
Tiwechi Investments Ltd.
Nachera Enterprises Ltd.

Doris Harlaar
Private Consultant

L. Gray Cowan
Senior Associate
Samuels International

## III. Diplomatic/Donor Community

Ambassador Gordon Streeb
U.S. Ambassador to Zambia

Michael R. Arietti
Deputy Chief of Mission
U.S. Embassy

Fred E. Winch
Mission Director
USAID

Val R. Mahan
General Development Officer
USAID

Dave Straley
Program Development Officer
USAID

John Wiebler
Program Officer USAID

Eric Daffern
World Bank Principal Energy/Industry Specialist
Task Manager
IDA Privatization and Industrial Reform Adjustment Credit

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Betty Wilkinson
VITA Program Manager
Zambia Village Industry Service (VIS)

Ernest Mtamboh
Investment Officer for Zambia
Commonwealth Development Corporation

Dominique McAdams
Deputy Residential Resresentative
United Nations Development Programme

Jim Billings
United Nations Development Programme

Malcolm F. McPherson
HIID Advisor to Ministry of Finance

Helge J. Svendsen
Senior Program Officer
Industrial & Commercial Sector
NORAD

E. Gunnar Ring
Rural Development Adviser
European Community

Mark Pearson
Technical Assistant
European Community
(adviser to Zambian Office of the President - Economic Affairs Division)

A. C. Daka
Secretary for Technical Cooperation
JICA

## IV. Pre-Zambia Interviews

Xiaofang Shen
Investment Policy Officer
Foreign Investment Advisory Service

Neil Billig
Office of Operations and New Initiatives
USAID

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