ZAMBIA:

PRIVATE SECTOR ASSESSMENT

Prepared for USAID Zambia

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May 24, 1997

Preface

The objective of this study was to identify mechanisms to facilitate and accelerate sustainable private sector growth in Zambia, and indicate which of these might require USAID assistance over the next five years. As part of this process, the consultant was to:

* provide a brief assessment of Zambia's macro-economic environment;

* identify the major constraints to private sector growth in Zambia, with special attention to human resources, cultural constraints, business practices, access to capital, regional and international competition, transaction costs, and infrastructure;

* review and discuss GRZ policies that assist or retard private sector growth, with specific attention to policies that inhibit investment or further development of the economy, such as licensing procedures, taxes, pricing policies, import/export controls, land tenure, or contract law;

* identify private sector activities that have the most potential for encouraging growth in investment, employment, and growth generally;

* determine if there is a role in macro-economic assistance, and advise on three or four other most promising areas for USAID assistance in private sector development, and identify requirements for further investigations to develop specific interventions, developing scopes of work for further studies;

* review the current HRDA and IESC assistance, to assess their relevance within the advised interventions and recommend ways to enhance these activities;

* describe other donor activities in areas identified for possible USAID assistance and determine whether there is duplication or conflict in USAID involvement; and

* comment on the cross-cutting themes of gender and Southern Africa Regional Linkages.

This study was undertaken between April 22, 1997 and May 24, 1997 in Lusaka, Zambia. Approximately 65 persons from the private sector, the public sector, and NGOs kindly provided in-depth interviews of the issues. In addition, over 100 persons provided short commentary on the private sector situation. Over 80 recent documents related to private sector growth in Zambia and with direct relevance to the country were reviewed. The list of persons interviewed and a bibliography are included as Annexes to this document.

The private sector is a complex animal, full of many surprises. The consultant would like in particular to thank Messrs. North, Thomas, Soroko, Hartenberger, Wolters, and Polhemus for their insightful comments and critique of how things are in Zambia. Ms. Gale, as director of this study, has her finger on the pulse of the private sector and provided both invaluable contacts and direction, often from her own forward thinking. All of those interviewed, from both private and public sector, deserve thanks not only for sharing their views, but for their ongoing commitment to the development of this nation.

Many discussed the issues with me but asked not to be specifically mentioned; I am also grateful to you. Drs. Wood and van Bastelaer and Mses. Voland and Brickell of the IRIS Center provided both logistics and substantive technical backup, which is crucial in a study of this nature, and Drs. Wood and Caldwell made substantive comments on the draft.

The consultant has consulted a wide variety of sources, but the final extrapolation into this report is her own responsibility. Any errors, omissions, or misstatements of fact are not intentional but are an inevitable part of data-gathering in developing nations, in particular during the planning periods of donors, and are regretted.

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I. Background and Introduction

Zambia is a landlocked country of 8.3 million inhabitants located in southern Africa. Its 750,000 square kilometers of high plateaus are cut by numerous rivers, including a border in the mighty Zambezi River. Recently it has been nicknamed the "hub of Southern Africa", referring to its eight neighbors: Zimbabwe, Botswana, Angola, Namibia, Zaire, Tanzania, Malawi, and Mozambique.

The land is rich, in both agricultural potential and in both minerals and gemstones, though some of the country is prone to drought. Zambia's low population density, though threatened in the medium term by its 3% population growth rate, means that much land is unoccupied, and there is great scope for investment in agriculture and agro-related businesses. Its abundant wildlife and beautiful scenery has opened the doors to growth in tourism. The known copper and cobalt reserves in the Copperbelt, long mined, are daily being expanded by new exploration and discoveries of both new copper/cobalt deposits and additional minerals such as gold and nickel. Zambian amethysts and tourmalines are being joined by high-quality emeralds in world markets.

While water is problematic in the drought-prone south, the rivers are an important source of both irrigation water, tourism potential, and hydro-electric power. There is good scope to follow on from the early example of the Kariba Dam, which since 1963 has provided sufficient hydropower for serving part of the domestic needs and for export.

Zambia was historically a transit area for many semi-nomadic peoples, although eventually seven major linguistic groups settled in these areas. In the early 1900s mining of copper began, and with it the establishment of the then-Northern Rhodesia as an urbanizing locale providing an export product for Britain. Southern Rhodesia (now Zimbabwe) supplied the food for the mining communities, which were generally discouraged from farming. However, there were benefits to being a major copper exporter, and at Independence in 1964 the country had a per-capita GDP similar to South Korea and Chile.

In 1964 the country embarked on a socialist developmental approach, to be funded by the copper revenues which formed 90% of foreign exchange earnings and 50% of GDP. A manufacturing sector which was highly protected was created from both copper revenues and debt. President Kaunda committed the nation to a public stance as a front-line state, and to a high degree of social services for his people, including subsidized food from a controlled agricultural sector. The up-side was the widespread education of the population, and a commitment to solid living standards regardless of race or tribal background. The down side of this approach was the disastrous developments in the economy, which ultimately pulled social services into the morass.

The first ten years were the best. Copper prices were reasonably high, donor inflows were as well in response to Zambia's role as a front-line state, and investments in coal, hydro-electricity, and manufacturing initially paid off. From 1964-1974, the economy grew at a respectable 2.4%. There were some signals however; agriculture was not growing as fast, despite the huge potential.

Particularly from 1975, when widespread nationalization of businesses occurred and copper prices fell, the nation careened into a seventeen year period of consistent declines in every single social and economic indicator. Some of this was undoubtedly due to the costs of the war to the south, which created the need for alternative transport links to be built and more defense spending, as well as lack of trade with what was a long-traditional food source.

But ultimately, the policies which supported a subsidized lifestyle for urban workers without requiring stringent performance from them in return came home to roost. Parastatal performance was never strong, and ultimately collapsed. Collapsing copper prices and huge increases in the import bills were not adjusted to by a tighter belt; the government simply borrowed to cover the shortfalls. When the plans didn't work well enough, manufacturing suffered. The economy declined at an average of 1.5% per year for the next ten years.

By 1985 things were getting rather desperate. The Zambian government had instituted price and exchange controls, tripled its debt, overvalued the currency, and cut capital investment to the point where the infrastructure was starting to collapse. By then two piecemeal attempts at IMF/World Bank structural adjustment programs had been set up, but the government continued to fall off the program, returning to the existing structure when political problems arose.

For the next seven years, Zambia and the donors danced intricately, and there were sincere attempts to start the economic adjustment program. However, in the end the country kept failing to keep to the strict diet of devaluation, monetary and fiscal control, and deregulation. Ultimately the result was the virtual collapse of the economy, lack of availability of even simple goods such as flour in urban areas, and continuation of decline in infrastructure, manufacturing, and agriculture. Even the mines, after many years without critical reinvestment, started to decline in their production performance.

By 1991 the Zambians had enough. Everyone could see that their standard of living was half of that at Independence. They elected the Movement for Multiparty Democracy, or MMD, in the first multiparty elections in many years. Unlike many re-emergences of multi-partyism in Africa, this group was made up of a large number of businesspeople. Thus the MMD manifesto read like a structural reformers' dream. The government, led by President Chiluba, rapidly put in place a program with the IMF and the World Bank, and by early 1992 things were moving at a rapid pace. A number of key reforms were set in place, including privatization; complete currency liberalization and opening of the foreign exchange regime; monetary controls; and other measures. (More details follow in the next section.)

The MMD government was re-elected in 1996, albeit after severe donor concerns about election legitimacy and other governance issues, and withdrawal of some balance of payments support that year. This second term for the President is marked by the lack of an opposition in sufficient numbers to prevent MMD from unilateral action, and most of the prominent economic reformists of the first term are noticeably absent from both the Cabinet and, in many cases, from MMD itself.

The donors, including USAID, have been staunch supporters of the economic liberalization program, which has been the fastest in Africa. Their approach in the early years of Chiluba's administration was to focus on those areas where government most needed to move, and provide a united stance and financial support to ensure movement in these areas. Examples include the closure of ZIMCO, the umbrella holding company for parastatals; cutting of all subsidies to parastatal bodies, including Zambia Airways; and privatization of ZCCM. On other issues, in particular governance concerns, and of late in the economic reform areas as well, donor voices are not so united or consistent on the key issues, and the Zambian government sometimes decides not to proceed according to their advice.

The next section discusses macro-economic performance of late, and the key issues considered by the private sector in the overall macro-economic environment.

II. Macro-economic and Ownership Situation

A. General Approach by the Zambian Government

Since the Chiluba government was elected in late 1991, it has pursued a standard structural adjustment program, punctuated by fits and starts associated with donor dissatisfaction (and balance of payments support hiccups) over some key political decisions. The overall approach has been to take the "strong medicine" by means of very rapid adjustment and stabilization package, to shift the overall economy from public involvement and direction to an open and private sector-driven stance.

The strong focus is on the IMF program, and most donor programs are linked to it. In 1992 Zambia embarked on an IMF rights accumulation program, from which Zambia graduated in 1995 to an Enhanced Structural Adjustment Facility, or ESAF. The mid-term review was approved in late February 1997, with waivers for adherence to six of the ten requirements made on December 1995 economic statistics. The December 1996 benchmarks, which were less rigidly reviewed, were all made except for one item. However, the March-end 1997 statistics showed a program that was off course again, and the IMF has made extremely strict requirements of the GRZ by the end of June in order to remain on track.

The macro-economic and economic structural achievements since 1991 are very impressive, and a review demonstrates the strength of the changes:

* Adaptation and (largely) adherence to a cash budget and a certain degree of budgetary discipline, resulting in strong reductions in inflation;

* complete restructuring of the tax system to create economic incentives for growth balanced with revenue for the government, along with creation of an independent Zambia Revenue Authority, and effective introduction of a VAT;

* conversion of the currency to full exchangability, and a market-determined exchange rate, along with an interbank foreign exchange (or foreign exchange (or forex)) market, stock exchange, and other financial sector liberalization;

* opening of trade: dropping of non-tariff barriers including quotas, bans, and most of the onerous licensing procedures; substantial lowering of tariffs and customs duties;

* debt rescheduling: renegotiations of commercial and Paris Club debt and debt buyback has eliminated arrears, which have also been cleared with the multilaterals; setup for access of overall debt writedowns under the HIPIC conditions is planned for 1998 or 1999;

* removal of price controls and interest rate controls;

* elimination of subsidies for parastatal operations and for food (with social safety net exceptions), and a highly successful privatization program which should have privatized over 70% of the economy by the end of 1998;

* passage of numerous Acts for privatization, financial sector, and company operations, modernizing the legal framework for business operations; and

* improvement of both organizational structures and government's capacity for monetary management and supervision of the financial sector, including the opening of a stock exchange and better bank reporting on arrears and capital adequacy.

What is notable is both the speed and pattern of the changes. Largely, most of the radical reforms -- cash budget, exchange rate decontrol, changes in legislation, and privatization with attendant pricing and subsidy removals -- occurred between 1992 and mid-1995. Since that time, there appears to have been a reluctance to press on for completion of the program. This is evidenced by slowdowns or turnarounds in the following areas:

* Privatization: though ZCCM is in negotiations, ZESCO will now not be privatized, nor will the media; there are doubts about ZNCB; ZAMTEL will be delayed by the dismissal of the regulatory board for financial mismanagement; Indeni Refinery has not even been mentioned, nor have the many areas identified within the current civil service functions for privatization;

* civil service reform: has not yet commenced, despite years of creating mission statements and detailed plans for Ministries. The government appears to be unwilling to renegotiate current retrenchment agreements, over-generous and unaffordable by any standard; there seems to be little willingness to discuss the implementation plan or the financing arrangements;

* fiscal reform: though the budget has been reallocated to cover larger amounts of social sector expenditure, it still appears that the budget and planning process is very weak, and that in particular the expenditure side is problematic. Tax collections are not up in real terms for some years, despite the ZRA efforts; it is widely believed that those who are politically connected can avoid paying. An IMF report on the fiscal processes was submitted to GRZ in November; they have yet to make this public, although the Finance Minister has reportedly agreed to accept a long-term IMF fiscal advisor. A World Bank report noted that "there has been a disturbing tendency for fiscal performance to go off track, especially in the early part of the year... it is clear that there are problems with the budget making process..."[1] and

* agriculture: the ASIP program continues to languish thorough a number of changes of Ministers and senior civil servants, along with an apparent unwillingness to remove government from fertilizer distribution or rural financial services despite its costly failures in these areas.

The variation in both performance and consequences are a hint of the sine wave pattern of adjustment and program adherence, and increasing donor willingness since 1995 to accept Zambia's tumbles off the political and economic reform ladder.

[1]Implementation Completion Report, Republic of Zambia Privatization and Industrial Reform Adjustment, and Second Privatization and strial Reform, December 1996, pp 8-9.

A World Bank implementation report on the Second TA, provided for macroeconomic reform work, states (p 12) " Overall the implementation experience tended to call into question the government's commitment to the objectives of the project... Although notable progress and improvements have been made in some areas of macroeconomic analysis, findings highlight continued weaknesses in: macroeconomic analysis, particularly in public investment programming and its linkage to the budget process; budgeting and revenue estimate and projections, particularly in accounting for donor funding; and financial management..." but then continues in a counter vein: " Despite the weak performance of this TA project, ... there is room for further capacity building in Zambia."

B. Fiscal and Monetary Issues

For the last year the system has been "waiting to exhale" with the privatization of ZCCM, carved into nine pieces which were internationally tendered and are in negotiations now, with a public target date for completion of June 30.[2]
1[3] The lack of sufficient planning for ZCCM cashflows and production measures has meant that as of the end of April, $81 million in external arrears and Kw 55 billion[4] ($42.6 million) internally were due to ZCCM creditors. In addition, copper production hit record lows during a period of internationally high prices, and ZCCM was also unable to pay its taxes.

The result of this situation has been a freeze up of virtually the entire economy. Tax collections are behind, both directly because of ZCCM and indirectly because suppliers have not been paid and thus cannot pay taxes due. The Bank of Zambia has recently negotiated loans to cover the cashflow problems, with Kw 33 billion in domestic funds on its own guarantee, and $125 million in offshore money secured by copper sales revenues (and thus implicitly by the privatization sales revenue for ZCCM). But until the ZCCM privatization is finalized, this is expected to continue to be a major problem in the economy.

On the tax side, there has been no perceptible increase in the real value of tax collections since ZRA was founded. In particular, VAT and PAYE are successful, while income tax avoidance is still a large issue. This may be predicated on some continual compliance issues, part of the culture of non-repayment which seems still pervasive (see business culture section.) One example cited is that 5,000 firms are registered to pay VAT, while only 2,000 have filed income tax returns. Under-invoicing of imports and cash sales to avoid VAT are often mentioned as issues for the ZRA. Some have suggested that a carefully-crafted tax amnesty could bring some long-hidden players into the arena.

Questions have been raised about the management of the cash budget. The private sector complains that the length of time to payment from the government has extended in many cases to over one year.

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negotiations have had their problems, perhaps partly due to the President's having named the chief negotiator without fully consulting the ZP
d. This is apparently still an issue.

4 The current market exchange rate of Kw 1290.$1 has been used for the purposes of this report.

The implication of this is that the budget is being increasingly overspent, but that the payments are not made for longer periods of time while revenues are coming more quickly. As a result of the payments issue, the government is considered to be a client of last resort, and companies are complaining about the payment delays. Members of the Transport Association have reported that the government requires them to provide transport services for some proportion of their trucks at sub-standard rates and accept the delayed payments, or problems such as exclusion from government tenders occur.

The 1997 budget was considered by many to be a "non-budget" due to the lack of many changes. In some ways, that was considered positive. The government presented targets of 5.5% GDP growth based on good weather and non-traditional export growth, and 15% inflation. The GRZ stated its expectations of a small budgetary surplus, along with a commitment to cutting down government domestic borrowing to put downward pressures on interest rates and open the credit market for the struggling private sector. This would be a switch around from years of government squeezing the private sector and using the domestic savings (39% according to Chan, 1996.) Expenditures are targeted to roads, agriculture, and social services; however, there is a worrying increase in administrative and non-targeted expenditure heads, which are much less transparent. Associated with the legal changes, the SEDO Act 1996 gives some useful tax incentives for the small-scale sector: a 5 year tax holiday, and tax exemptions to any firm renting industrial estates to the SMEs or for interest on loans to small firms.

Government first quarter 1997 budget performance was worrisome. There was a substantial deficit, which the government funded by borrowings from the central bank. These were sterilized by its purchase of foreign exchange funds for balance of payments outflows. In order to rebuild free reserves, which are now at about three weeks of import cover, the government will have to run a solid surplus for the rest of the year. This may prove difficult given the problems of ZCCM as discussed above. Otherwise, we can expect an inflationary jump and pressure on the exchange rate.

On the monetary side, there has been extremely tight management of the money supply over the last 18 months, along with increases in both the liquid assets requirements (currently 43%) and the capital assets requirement (currently Kw 2 billion). The Bank of Zambia has sought to mop up excess liquidity in the system by sales of Treasury bills and upward adjustment of the liquidity ratio. This seems to have been very effective. The Bank of Zambia is also closely monitoring the financial sector's health, and some retrenching is going on preparatory to any deepening.

C. Exchange Rates

The private sector monitors three areas in the macro-economy on a short-term basis: the IIE, or inflation rate, interest rate, and exchange rates. Most recognize the inter-relationship between them, and watch the exchange rate as the lead indicator. The exchange rate has been more or less flat for about 18 months, during a time when the dollar has appreciated against many currencies. Thus the real exchange rate is declining fast, most particularly against the rand but also against other major currencies.

The pressure on the exchange rate has so far been alleviated by three factors:

-- overseas borrowing and savings: businesses report that they are increasingly looking to overseas borrowings, which are lower-cost, in preference to expensive local currency debt. Such funds are being brought in, and donors are also providing such windows (the EIB, for example). The private sector then funds repayments from export revenues. Some also report bringing in savings held as dollars externally in, to support businesses during what many feel is the lull before growth picks up late this year or early next year.

-- cash transactions: observations indicated that as much as 40% of business activity could be outside the formal banking system, due to Zambia's having become a trading hub due to its open foreign exchange (or forex) regime. Tanzanians, Malawians, and Zimbabweans bring in goods and take out dollars. Trade to Zaire and the Great Lakes plus Angola takes out goods and brings in dollars. Some funds are sent outside through non-bank transactions to avoid repatriation to places such as RSA, where re-export of foreign exchange can be problematic.

-- central bank operations. The Bank of Zambia reports the rate is market-determined. However, commercial bankers have mentioned the decline of official foreign exchange reserves by $40 million in first quarter 1997, and informal pressure being brought to bear on ZCCM (for foreign exchange (or forex) sales rates to the local banks), as well as on bureaux. The mopping up of excess liquidity has also clearly ensured that there is less kwacha around to buy foreign exchange.

The private sector firms consulted advised that they are projecting budgets on a dollar rate of Kw 1500 to Kw 1800 exchange rate by year-end, drawing an expectations band of a 15% to 40% devaluation. This is consistent with recent experiences of the last three years, and strongly consistent with a real exchange rate which has declined by 9% against the dollar and by 23% against the rand since 1994.[5] Interestingly, the rate is expected to stay at this level for the next two to three years and possibly appreciate as mining investment comes into the Copperbelt.

D. Interest Rates

Interest rates have been falling since late 1996, with commercial bank interest rates lagging behind the Treasury bill rates and very sticky. Real interest rates are high enough, and funds short enough, so most firms are not borrowing. The banks and accounting firms state that this rigidity is largely due to commitments to pay high interest rates to savers on fixed deposits which will not be adjustable for some months. Others argue that collusion may be occurring; bank profits for this year will be something to watch. There is clear evidence that the Bank of Zambia is exerting moral suasion as well in this area, and that the offers of T bills at low interest rates is more attractive to banks than no return at all on their very high liquid assets requirement. It can be argued that the gap between the T-bill rate and the bank interest rate may reflect more that the banks have no other investment option for their liquid assets than it does what the real interest rate may be.

Interest rates are tied to fiscal performance. With the GRZ having run a deficit in first quarter 1997, market speculation is that interest rates will decline, and then increase later in the year to inflation plus 6% or more, once there is demand pressure from both public and private sector for funds. As

[5] Hill and McPherson note the need to focus on a stable real exchange rate over time as an absolute requirement of sustainable [w]th. See Bureaucrats in Business, World Bank, for further details.

the private sector is largely borrowing offshore, there is potential for incomplete sterilization of incoming dollar-based loans as imports by these firms. The Bank of Zambia has stated its intention to keep money supply growth low and mop up liquidity through sales of Treasury bills; this could also drive up interest rates. However, over the next three years, interest rates locally are expected to stabilize somewhere between 14-20%.

Interestingly, those firms which foresaw a kwacha shortfall and were able to do so have diversified either into trade or fast-turnaround processing (such as maize milling) in order to generate local cashflow for their other activities without the need to borrow.

E. Inflation

The GRZ target for inflation by year-end is 15% annualized, which Price Waterhouse, in its 1997 budget commentary, noted was the 1995 target as well. Inflation is falling after a serious blip in the first quarter; it is currently annualized at about 27% according to Finance Minister Penza. There is an expectations problem, because the private sector anticipates an inflation rate near that of last year or about 35%, to be driven largely by a devaluation about mid-year. Some anticipatory pricing seems to be occurring already. However, the medium-term view is that interest will fall into single digits over the next three years.

F. Privatization

The privatization of the 80% of the economy which was publicly owned in 1991 is the gem of the Zambian structural adjustment program. It is progressing faster than anyone's expectations. Of the 326 units over 204 are divested, and most of the rest are well under way. The process has been independent, transparent, very well-financed, and is considered the best-managed in Africa. The donor consortium has worked well in filling funding and technical gaps, and the extensive long-term TA has been effective in skills transfer under the leadership of an internationally-experienced Zambian Chief Executive. ZCCM negotiations are now under way, moving the chief assets of the government into private hands by the end of this year. The program looks largely on track to complete most activities by the end of 1998. Zambia's private sector players are largely pleased with the program and its progress.

There have been hiccups in the privatization process, notably in the lack of certain appropriate legal and regulatory structures which had to be developed. (In this way, ZPA has also been a driving force for overall liberalization, pushing for policy change faster than it otherwise might have occurred, so they could get the parastatals divested.) The hardest final privatizations will be Zamtel, ZESCO, and Indeni Refinery. Regulations and regulators are not in place, and may not be for a year at least; this will cause other countries in the region to precede Zambia in privatizing their utilities, and have the first choice of investors.

The privatization revenues have been well below those originally anticipated, due to the state of the firms and their debt structures being far worse than initial indications. Initial estimates of up to $175 million in cash payments for non-mining assets have resulted in less than $50 million of actual divestiture payments. In the case of ZCCM, it is quite likely that most if not all of the revenues from the sales will be used for supplier payments and associated costs due to management collapse over the two years prior to the divestiture. Fortunately, the Zambians have recognized that this process is far less likely to be revenue-generating on the sales side than on subsequent taxes from companies which are now making money. The time has been short, but anecdotal evidence shows that this is clearly the case.

Investors seek consistency, and with regard to privatization this has of late become a concern. The President, in his speech to the Financial Times Investor Conference on May 14, reiterated his commitment to privatization, reminding the audience that "there are still no sacred cows." Regrettably, the next day in a radio interview he mentioned that the media would not be privatized. In the 1997 Budget Speech, ZESCO was reslotted for commercialization, removing it from the privatization tranching list.

G. The Official Debt Burden

Finally, in reviewing the overall economic framework one cannot lose sight of the debt scenario. Zambia currently owes over $6.3 billion. The composition of debt is rigid, with over half of it being non-reschedulable multilateral debt, and some non-Paris Club official debt which is difficult to be renegotiated. With the inevitable delays in such long-term investments, the cashflows will be insufficient and the economic growth too slow to meet the debt obligations. Zambia's debt-to-export ratio of 415% in 1995 is far above the 200% considered a maximum to avoid a severe insolvency problem; its ratio of debt service was 31% in late 1994 (and it had accumulated payment arrears as well); the usual standard of 25% to avoid severe liquidity constraints in the economy.

The crunch will come in about 2001, according to an extremely grim Annex to the World Bank growth projections report. At that time, government will default unless they become eligible for the HIPIC special multilateral debt writedowns in discussions in 1999. The government is aware that the donor requirements for eligibility will be IMF program-based, and will adhere to economic targets if they are rigidly defined. What is less clear is if the bilateral donors will make governance targets also a part of their support for Zambia to receive HIPIC relief. Meanwhile, a note of concern must be raised that the World Bank continues to lend very freely to the country while supporting a program which will cause bilateral taxpayers to take up the slack later. Its own report advises (Annex B pg 9):

" The debt situation of Zambia will remain unsustainable even if the Naples stock reduction option were implemented in 1999 and if the financing gap were filled with highly concessional resources in IDA-like terms from official bilateral creditors... There exists an urgent need to secure a larger proportion of future external financing on grant terms, which would prevent the rapid buildup of new debt. As regards the debt relief operation, **the existing instruments for such relief appear to be insufficient to improve the critical debt situation of Zambia.** " (Consultant's emphasis for last line.)

Zambia's debt is a non-issue for small and medium-sized firms, who concentrate much more on basic macro issues. It is a much hotter topic for mid-level and larger firms; they consult donors regularly on their stance, knowing how much Zambia relies on them for BOP and debt/investment support. Most expect that the donors will allow the writedown of debt, perceiving that otherwise, the economy will never fully recover.

To summarize, the private sector circumstances in terms of macro-economic stability are fair for the short-term, and very good for the medium term. The requirements are that the adjustment program stays on track to provide lower and stable interest rates, exchange rates, and inflation; donors support the program with grant funding; and debt relief occurs. Adherence to donor agreements and economic targets, fiscal and civil service reform, the ZCCM privatization, and improving the stability of the liberalization process will be key factors that the private sector and donors watch.

III. Government Policies and Private Sector Growth

One of the most impressive aspects of the economic liberalization program in Zambia has been improvements in the structures under which businesses operate. A number of pieces of key legislation have been passed, and the overall focus is changing from regulation to facilitation of private sector activities. The word *entrepreneur* is no longer one filled with negative connotations of exploitation and corruption. Rather, the official and often-mentioned approach is to "get government out of the business of business". These changes are impressive, and show every sign of being permanent. Zambia is undoubtedly one of the most liberal places in Africa to do business, and the word is getting around.

What is interesting about the liberalization process is that the rules of the game have been improved -- that is, the way in which individuals and organizations interact. Laws and policies have radically changed, and for the better. However, the institutions -- the civil service, business associations, political organizations, utilities, and others -- have not made the same alterations. In discussions with the private sector, they no longer talk about the rules which constrain them. Instead, they talk about how slow it is to get papers processed in the bureaucracy, how hard it is to find staff who have been appropriately trained within Zambian educational institutions, and why the phones don't work.

A. Business investment/licencing practices

Generally, this system has greatly improved. Business registration is simple and relatively inexpensive through the Registrar of Companies, and most feel that the 2.5% fee on paid up capital is not onerous. However, there are a number of licencing requirements within sectors. These reflect both the incomplete changeover from a highly regulated economy pre-1991, and a certain degree of protectionist behavior on the part of the existing firms. In addition, the rules are not uniformly applied, and this can create some difficulties. For example, there are a number of firms which have been historically operating in Zambia which do not have investment licenses, despite the fact that they have invested in the past, and may be considering new investment; investment licences are not required unless some specific benefit is sought for which an investment license is required.

The Investment Centre has been set up under the Investment Act (twice amended) as a one-stop shop for investment opportunities in Zambia. Since 1991, they have provided licenses worth $1.27 billion in investment pledges for the agriculture, manufacturing, transport, services, construction, financial institutions, fisheries, tourism, mining, engineering, health, and consultancy sectors. The Centre reports that approximately 42% of the promised investment has occurred or a value of $533 million, according to an ad-hoc survey; better data and some system of investment followup would be useful.

Originally, the Investment Act set up the Centre as a one-stop shop. However, the setup of the Centre did not facilitate this, since Ministries did not either empower the Centre to provide licenses which line Ministries provide, or transfer staff with this authority to work in the Centre. The result is what some have designated as "one window and many doors."

Investors spend a short period receiving an investment licence, after which they spend a number of months acquiring other items needed for running a business: work permits, land leases, tourism and food licenses, etc. Countries such as Malaysia have resolved this by assigning an Investment Facilitator to work with new investors, literally escorting them through the licensing maze. Zambia may use this model, or require secondment of decision-makers from line ministries into the Investment Centre. In any case, a review of the entire licensing structure, and revision to amalgamate the process into as few discrete licenses as possible, is very important at this time.

The GRZ is also struggling with the revenue generation vs. investor incentives issue,. On the incentives issue, many if not most of those which were originally provided in the 1991 Investment Act have subsequently been removed. This has been under the argument that investors look for stability and consistency of business structures, rather than incentives. While this is certainly true for mining, hydropower, and agriculture, it is less so for manufacturing and tourism, since other countries in the area have equal or better basics to offer in these areas. A comparative taxes and incentives paper done by the Investment Centre for the President's Forum in April 1997 showed clear advantages for investors in neighboring countries for manufacturing in particular. This is something to watch; an even playing field throughout the region is crucial, and Zambia will not wish to lose investors through a combination of inadequate incentives and a disabling trade regime (see later).

The other area for policy and structural change for the GRZ is where and how to house business regulation vs. business promotion. Currently there is the Ministry of Commerce, Trade and Industry, the Zambia Privatization Agency, the Investment Centre, and the Export Board, all handling various aspects of commercial regulation and promotion. Streamlining and very clear delineation of responsibilities in this regard is important to use the government's rare resources wisely, and to ensure that investors are equally clear about where to go for assistance.

At the lower end, firms often don't register in order to avoid tax, or because they see no benefit in business registration. A potential mechanism for improvement in this regard is to notify firms that they receive a five year tax holiday if they are small businesses. Government might also consider provision of vouchers for training (see Section VI), or structure SEDO to explicitly provide services to newly registered small firms.

B. Tax regimes

The tax regimes are much improved in most respects. The system for corporate tax is simple and very clear; see a table for this information in the Annex. The generic rate is 35%, but agriculture and non-traditional exports are taxed at 15%. Listing on the stock exchange allows a 5% cut in the taxation rate. Personal taxes are now made on the entire benefits package paid to employees rather than the base salary alone. This is doing a great deal to cut away the administrative costs firms bore of non-base benefits, since now a straight cash package is becoming the norm.

There are three areas where taxation is a problem. The first is in the VAT. It is high, unevenly applied (eg smaller traders, vendors, and those paying cash for some items avoid it), complex to administer, and has greatly increased the cost of goods, in particular for those firms which are relatively small. The cut to 17.5% as of July 1997 was greatly welcomed. Research on the impact of the VAT at the lower end of the business scale is badly needed in order to smooth its effects and improve compliance at that end.

Customs duties, while greatly improved, still have some classification problems. What are final products for some are inputs for others but are taxed at the higher rate; rubber was cited as an example by one manufacturer. In addition, the reintroduction of the 5% import declaration fee is problematic; the minimum import costs will now be 17.% VAT plus IDF of 5% plus minimum duty of 5%, or 27.5%. This is difficult to deal with when many neighboring countries allow tax-free import of all inputs. Manufacturers in particular have complained that they are disadvantaged in this regard.

Interviewees stated that bribery at the border stations is still common, as is under-invoicing, but that enforcement is weak in these areas.

As the tax structure improves and business sees the balancing of revenue generation and business environment enhancement by the GRZ, some changes are occurring. Some companies which have evaded taxes have expressed willingness to start paying taxes. However, they fear that if they commence, any audit would show non-payment of previous years and they would go bankrupt. On the other hand, many tax payers feel that those with political clout can and do evade tax payments. The honest ones then are increasingly pressured to pay, and arbitrary small mistakes found which cause them to have to pay fines. Thus, resolution of this problem will be tricky. A carefully crafted tax amnesty might be useful in bringing a number of new fish into the net.

Finally, taxes are paid when payers feel that they are getting returns from their money. With the roads in a terrible state, educational system and health system failing to perform to previous standards, and Ministry offices slow to respond, taxpayers feel less motivated to pay. A closer recognition of the connection between what earners pay and what they want delivered is an important part of capitalist democracies, and this has been slow to develop in Zambia.

C. Pricing and marketing policies

This problem is largely resolved, with pricing of both goods and services virtually completely deregulated. This is a strong and rapid change, due to GRZ commitment and the sale of the parastatal sector.

D. Land tenure

Land in Zambia is of two types; state land, and customary land. Only 6% of the land is alienated; the rest remains under customary control. All land is vested in the President, with others having the ability to lease for 99 years, renewable for another 99 years. Short-term land rights can be granted. Customary land has unlimited tenure, but may only be used by Zambian citizens under customary rights, unless converted to leasehold tenure.

The Land Act of September 1995 was a watershed act, providing for land to have value for the first time and to be sold without improvements. It allowed land to be sub-divided without permission of the government; set up faster mechanisms for survey/transfer; and designated ways of providing for leasing of customary land. It also allowed for common leasehold under which flats or units can be sold individually. However, there are still restrictions for acquisition of title, and the process often takes years, thus discouraging investors who need land access, especially if they wish to build. The land surveys are reported to be 8 years behind; new technologies might assist, or the contracting out of more private surveyors to help the process. A formal commitment on government's part to improve the title deed process and the land access will assuredly result in improvements in investment, both for investor purchase and also for use as collateral when borrowing for business development.

Interestingly, land ownership is also a big problem for the urban compounds in Lusaka, where the land is often under one title and sub-dividing for individual purchase has been a nightmare. Access for widows to land seems a national problem according to the ILO livelihood survey.

E. Labor

Zambia has the advantage of some of the lowest labor rates in the region in terms of salary. Benefits structures which were mandatory and pumped up the cost of labor are being whittled away by changes in legislation. The formal sector employment has dropped substantially, and unions, despite their political connections, are waning in terms of influence. The last vestiges of the control are in the requirements for industry-wide wage negotiations, limits on paying piece rates for performance, and the Industrial Court, which is reputed never to find in favor of an employer.

Productivity is also a problem. The reasons why:

* AIDS. A recent WHO saliva sample showed that as much as 50% of the key age groups (20-40) tested HIV positive in urban areas. The rates are much lower in rural areas, 15% or so. The World Bank Poverty Assessment stated that "Sickness and death due to AIDS could derail any development prospects for Zambia." Middle managers seem to be one of the hardest-hit groups. Donors and the government have recognized and taken on this problem; more explicit workplace partnerships, and more open discussions of how to deal with the epidemic in terms of health services and intentional overstaffing, are crucial.

* Tying performance to productivity. Employers say that there are changes in the government approach to this area, and that firing a non-performer is much easier than in the past. However, it is still hard to pay piece rates, which means that a piece rate Zimbabwean cotton picker will gather 1.5 times as much cotton in a day as his fixed wage Zambian neighbor.

* Know-how. There are few systems to replace those Zambian middle managers who are dying of AIDS or going to Botswana to work for higher salaries.

An educational system emphasizing quality training, both for middle managers and for key blue collar skills such as carpentry and mechanics, will stand the government in good stead for the 21st century, and will win friends and money from the private sector.

* Outside help. There is still a problem with work permits, thus showing a lack of understanding of the underlying rationale. In a business, the owners want profit. If they hire an expatriate, the costs are very high. As soon as they find a Zambian national who can perform those tasks for that cost or less to equal level of quality, the firm owners will hire the Zambian. Therefore, expatriates are (with the exception of owner-operators or key executives in multi-nationals) temporary. The focus should be on demonstrating the competence and cost-effectiveness of Zambians to handle the jobs, not on forcing the firm to justify why they want to use an expatriate.

F. Legal system

The Zambian legal system is a hodge-podge of customary law, British common-law, Parliamentary-based legislation, and Constitutional law. There is a similar disparity in the administration of justice, with the Ministry of Legal Affairs, the Ministry of Home Affairs, the Anti-Corruption Commission, the Human Rights Commission, the Law Development Commission, the University of Zambia, the Institute for Advanced Legal Education, and the National Institute for Public Administration, the courts, and others all having roles to play.

Commercial legislation has been given a great boost over the last ten years. A large number of Acts have been rewritten in simple, clear, logical language. They have also been more carefully interwoven into the overall legal framework than in the past. The result is a commercial framework which is much improved, and needs only fine-tuning at this point.

Senior members of the system have advised that there have been a proliferation of organizations, but ineffective delivery of services to the people, resulting in the findings of the Human Rights Commission where numerous abuses were brought to light. There appears to be confusion over who is responsible for what, and the lack of appropriate systemic structure and clear administration slows down all processes, from legal drafting through court rulings. This result is particularly onerous for businesses, for whom time is money.

In interviews, the business community stated that the system takes too long, that there are too many delays, and that advocates and judges are insufficiently well-versed in the new legislation. The Arbitration Law is outdated, and there are too few alternatives to resolve disputes outside the courts. Court timing and arbitrary protocols mean that cases are often lost on technicalities rather than on their merits. The establishment of a commercial court and training of the judges and lawyers would greatly improve this situation, and in particular speed up the processing of legal transactions.

G. Promotion/identified key areas

The GRZ has successfully identified and targeted investment in the following areas:

* Mining, including exploration, small and large-scale mining of minerals and gemstones;
* Tourism, with emphasis on high-cost low-impact services;
* Agriculture and agro-processing;
* Hydropower, for the first time welcoming private sector involvement; and

* Manufacturing using local raw materials and exporting.

For the most part, investment in these areas is facilitated, and the proper policies are in place. The exceptions seem to be in the lack of a comprehensive National Parks Plan which is closely implemented; problems in the structure of trade and tax for certain manufactures; leakage and illegal smuggling of gemstones; and a swinging door policy on fertilizer distribution and rural credit. Resolving these policy gaps with full participation of the private sector will go a long way to promoting further private sector growth in these key areas.

H. The public-private sector dialogue

Austin Associates mention the weakness of the public-private sector dialogues in the southern African region.

In Zambia, there are a number of voices for the private sector. The Zambia Association of Chambers of Commerce and Industry with its attendant local chapters has become a more vocal group, especially as it begins to be legally mandated to participate with government in areas such as the Zambia Privatization Agency Board. The Zambia Association of Manufacturers and the Zambia Federation of Employers also participate in the discussions of policies and practices of government which affect their interest groups. Recently, provincial small business federations have begun to form and discuss issues with their local Members of Parliament. The Zambia National Farmers Union represents farming interests across the spectrum, and a new National Tourist Board is the voice of investors in that area.

There are three essential difficulties with the dialogues, which can be resolved smoothly if the GRZ and the private sector representative organizations make concerted efforts in this regard.

* Cooperation, not confrontation. Organizations do have their biases, but they also have legitimate concerns which need to be addressed. Conflict is the most common mechanism for relations between government and business, and it can never be productive in the long run. Name-calling in the newspaper, in particular any racially-oriented remarks or run-on complaints, is very unproductive and counter to Zambia's wonderful history as a rainbow of colors of people all working together. Work in negotiations technology says, "focus on the problem not the person."

* Make the case with facts and figures. Much of the argument made for change in Zambia at this time is based on evidence which is anecdotal or opinion-based. A careful and dispassionate analysis of the pro's and cons of any change in Zambian government law, policy, regulation, or practice should be made, and the winners maximized while losers are minimized. Each party should review alternatives and options carefully; joint brainstorming exercises must be encouraged.

* Meet often, and be persistent but calm about following up on joint action. There is a case to be made for mandatory monthly dinners between key members of the public and private sectors. Much of Zambian business is done at meals and cocktail parties (and some also say that reconciliation occurs at funerals.) It is much easier to work closely with people whom you see often, and who become friends, colleagues, or at worst persons whom one disagrees with but understands better.

I. Security issues

Investors mentioned security issues, particularly concerns regarding security of persons and property in rural areas. In urban zones, bars on windows and metal doors are a matter of course, and neighborhood watches and private security companies have arisen in response to the lack of capacity of the government to sufficiently minimize risk. In the ILO sustainable livelihood study, some persons mentioned resorting to thievery in order to survive. Thus, we may be able to expect some changes as the economy improves. As with other areas, making police more visible -- particularly in high crime areas -- and tracking and adjusting to crime patterns will help, as will a more streamlined and effectively administered criminal justice system. The public-private partnership is a key element of reducing this risk.

The next section discusses the most key issues to private sector investment and performance in Zambia. Infrastructure has been included in the next section despite the government's role in providing it, since the issues are so fundamental to national growth.

IV. Key Issues for Private Sector Growth

-- capital access -- equity and debt

-- human resource capabilities/gender

-- infrastructure

-- business practices

Interviewees said that margins are getting slimmer and quality better, as competition increases. Innovative services are being required of service industries; price, quality, and timing of delivery are much more important in goods than previously. There is a noticeable improvement in the non-pricing aspects of sales; service is faster, and the attitude to clients much more facilitating. Advertising is more common, although it is usually the larger firms which are advertising, since it is viewed as a “first-disposable” cost.

-- trade issues

-- transaction costs

-- "demonstration effect"

-- gender issues

-- regional integration and competition

V. Donor Involvement and USAID Assistance

A. Review of donors involvement in macroeconomic/private sector reforms[6]

Donors have been involved in Zambia's economic transition both in financing the setup of certain parastatals earlier in its history, and in supporting the liberalization process which began engagement in 1991. A table of current donor activities in Zambia, designated by program areas, is shown as an Annex to illustrate both the volume and the variety of services being provided for private sector growth enhancement. In addition, ZAM has published a 1997 Directory of Donor Programmes, Financial and Other Services to Business which may be very useful. The incomplete nature of the table reflects the circumstances of donor information flows and the fact that much of the activity is undergoing a planning review at the current time.

Canada is providing assistance largely to small projects. A proposal for a comprehensive private sector program was turned down by the GRZ last year due to its scope when compared to the resources anticipated.

Denmark has been focusing on vocational and informal training for entrepreneurs and others, in the area of private sector development.

The **European Union** is deeply involved in a variety of areas for private sector development, and undertook a study late last year to be used for this year's programming. Under its Export Development Program, it focuses on four sectors: tobacco, textiles, coffee, and horticulture. It works with the key organizations in each of these areas, providing a 50% pre-shipment credit facility, and technical assistance for the associations. Work with the Export Board will include technical assistance, funding for trade fairs and promotional materials. Under its trade and enterprise support facility, firms can access forex loan funds for feasibility studies, and later for investment. Small business marketing studies and microfinance is being supported. It is planning work in gemstone market strengthening, foreign investment promotion (mainly technology transfer) , and SME work in non-financial (eg business development) services and associated institution-building.

Finland currently is limited to participation in a micro-enterprise program in Luapula Province which has a micro-credit component. The project is converting to an agriculture focus consistent with ASIP. However, the micro-credit component is likely to be spun off and run separately, possibly by CMS. It has done an internal review of private sector enhancement options, and may invest by funding key people in business associations, or place a small component within existing projects. It may also partner with another collaborating donor on a private sector project.

Germany has a number of projects in the area of private sector enhancement. On the macro level, they are one of the co-financers of the macroeconomic assistance METAP 2. In private industry, they are providing advisory services to the Ministry of Commerce, Trade, and Industry in industry and (short-term) in trade, and to the ZPA on privatization and parastatal reform, along with ZACCI on policy and small business. They are co-financing the Zambia Venture Capital Fund, and providing funding for the Industrial Training Center along with other vocational training. A regional

[6] The author is indebted for much of this section to the summary notes from the Working Forum for the Private Sector donor group meetir d May 7, 1996.

project will provide chamber of commerce strengthening and act as a channel for support to key industries in areas such as trade fair participation. Another regional project is looking at cross-border trade. In addition, the Germans are working in water, forestry, agriculture, and natural resource management, including some private sector promotion within the sectoral projects.

The **IMF** is focusing its assistance very tightly to monetary and fiscal control, in particular to banking supervision and to budgetary reform with long-term advisors either in place or due to come soon. The Fund effects change by its performance indicators in order to continue to provide a structural adjustment facility for balance of payments support. Its influence is very broad, since most bilateral donors and the World Bank link their assistance to Fund approval.

Ireland has been working with the Investment Centre, and with industrial estate development for SMEs in Mazabuka, Lusaka, and with the YWCA. It is also working to increase the knowledge and understanding of SME activities and behavior via research and creation of a database.

Japan is working mainly on vocational training, though there are also some programs in energy alternatives, and poverty alleviation.

Norway will have consultations this month on funding in its key areas of mining, energy, tourism, and forestry. They expect to shift away from roads and into education, as part of the new World Bank multi-donor exercise. Norway has just signed new agreements to fund the Investment Centre in materials production, technical advice, and international promotion. It will also continue to support the registrar of companies with institutional strengthening. Work on small enterprise which has gone on in Kasama for some time will draw to a close, and the NGO will be finally capitalized and cut loose. Funds for specific privatization work are forthcoming, as is funding of training for ZESCO. They expect to link some key Norwegian firms with Zambian counterparts for technology transfer and to promote stronger relations.

Sweden core programming is going on now for a new cycle to start in 1998; it was delayed one year by the donor withdrawal of Balance of Payments support last year. There has been an overall reduction in SIDA funds worldwide, which will also affect Zambia. SIDA will be moving away from work in capacity building and in infrastructure. The main programs continuing are the joint macroeconomic support to the Ministry of Finance and Bank of Zambia; work on Kafue Lower for hydropower; health; education; and work on Zamseed in agriculture. In addition, the partnering of Swedish firms with Zambian companies for technology transfer and trade will continue, along with support to reform government procurement systems through the Tender Board. SIDA will assist in Medical Stores and Zambia Railways restructuring. Work is being considered in microfinance and in strengthening of the local chambers of commerce. There is an economic expansion in outlying areas program which provides training to entrepreneurs in rural areas.

UK has recently sponsored a very useful survey study of SMEs in Zambia. In addition, they are providing legal assistance to ZPA, co-funding for the Zambia Venture Capital Fund, money for CARE to establish its microfinance services, funds to VSO to provide volunteers for the private sector. New work areas anticipated are in export development, microfinance in the Copperbelt, and vocational training.

UNDP will invest in employment as a core objective with a focus on SMEs, value-added, women, downstream activities, viable employment generation schemes, and connected policy supports. UNDP is working largely through UNIDO and the ILO in some important work in the private sector. Having wound up a multi-pronged project which supported the ZPA, the Lusaka Stock Exchange, the Investment Center, and others, UNIDO is now developing a new program in the framework of its Alliance for Africa's Industrialization to put in place later this year. This involves assisting African governments to develop appropriate strategies, marketing Africa to the world, and strengthening the public-private dialogue. The focus area will be agribusiness, with technology transfer (particularly in rural areas), industrial connections to outgrower schemes, and industrial subcontracting links for SMEs will be options for activity. A design team for an $8.5 million program in Employment and Sustainable Livelihood, for which advance research has been done, will arrive shortly. Gender mainstreaming work in private sector support is also due for design shortly, along with ILO funding of microfinance.

The **World Bank** has emerged as the single largest funder of private sector activities, from legal reform through privatization to direct business financing. Under the recently negotiated Enterprise Credit, funds will be provided for matching grants for medium-size and larger businesses to acquire training or technical advice; actual financing of investment through a new government apex called Zambia Enterprise Finance to the banking system; and TA for financial sector supervision. Privatization of ZCCM and ZPA institutional costs will be borne through ERIPTA, along with institutional strengthening of the Ministry of Mines, and a small amount of further assistance for legal drafting and training of judges to the Ministry of Legal Affairs under both ERIPTA and FILMUP. The establishment of a mandatory social security scheme is being put in place with Bank assistance. A new adjustment credit is looking at trade, the budget, public service reform, and the macroeconomic management. A power rehabilitation loan will focus on the need for private sector investment following establishment of an effective and competent regulatory body for energy. The Bank is coordinating work on a multi-donor Roads Network Investment.

B. USAID program and commitments

USAID is currently designing a new strategic phase, to cover the years 1998-2002. Under this phase, it will continue to support its core competencies and investments, which are:

* Reduce the State's role in the provision of goods and services, including work in privatization, and management of privatized SOEs improved through business training and entrepreneurial support;

* Increasing the productive participation of rural enterprises and communities in the national economy, involving efficient product marketing associations, productive economic participation increasing rural investment; diversified and productive farm enterprise management practices;

* Increased use of practices that improve child and reproductive health, which involves HIV-AIDS prevention, family planning, decentralization of health services to the community level, upgrading of health worker skills and national planning and monitoring capacities at all levels, and support of public-private health partnerships; and

* A more sustainable multi-party democracy built, including improved citizen awareness of rights and responsibilities, independent journalism, improved public policy implementation. Work on the rule of law is being considered in a review taking place now.

Interested readers are referred to the USAID Mission for the strategy paper which is due to be completed and approved shortly.

C. Existing USAID private sector assistance: HRD, IESC, privatization

USAID private sector assistance since 1992 exists in five areas: privatization, advisory services for small business, training of Zambian managers in the USA, and domestic and international training programs for small businesses. The privatization program has been reviewed (Boone, 1995; Price Waterhouse, 1997.) Although it is too early to determine the overall macroeconomic effects of the privatization program, by world standards (and particularly by African standards) it has been rapid, honest, and successful. The USAID program as it stands will be completed in November 1997. Potential add-ons until privatization is finalized over the next two years is included in Section VI.

University training programs for Zambians overseas has been successful, but the benefits tend to accrue to a very small group of individuals. It is clear that the ATLAS program produces top achievers, and that in particular the women who are so-trained become role models. Retention of this program should be linked into the priority growth areas, and potentially limited to women participants, as they are in critically short supply in the management structures in Zambia.

The International Executive Service Corps(IESC)

IESC is a non-profit US organization which provides the services of (largely retired) American professionals as volunteer technical advisors to requesting businesses. The volunteers have actual substantive business experience in the field which they advise. The local business, depending on its capacity, will absorb some portion of the transport, lodging, and meals/incidentals costs of the volunteer and spouse, who travel together as part of the IESC agreement. (Overhead costs are borne by USAID directly.)

Since 1992, USAID has provided $2.7 million in grant financing to enable the provision of volunteers to over 100 firms as of 5/97. Services rendered by volunteers have been both firm-specific, as in the improvements of a bakery, and generic, as in legal services to the ZPA and to association-building for both ZACCI and the nascent provincial business associations. The work and approaches are hands-on and tailored to the needs of the requesting business. At this time, the British and Dutch governments have quite similar programs; the three do very occasionally pass on requests between each other, but there are no formal arrangements.

Previously the focus of the program was on newly privatized firms and small indigenous firms. In the last few months, the IESC program has been restructured to focus on tourism (as a privatizing sector generally), newly-private firms and in particular MBOs, women-owned firms, manufacturing, and agribusiness. Work is ongoing in plastics, bakeries, hotels, and citrus. Work is being considered in sausage-making, small private health clinics, and insurance. Firms in the 20-50 employee range can best use an IESC volunteer, both in terms of covering costs and also to be able to take advantage of external links with suppliers and buyers. The new IESC Director is expanding the reach so that that the volunteer can also advise 3-5 smaller firms in the same or closely-related type of business. This "piggy-backing" of volunteer work makes the overall cost less to the firms, and makes assistance available to those small firms which otherwise could not afford it.

The mechanism for provision of services involves a request from a firm; an assessment by the director in discussion with the small firm on issues and needs; design of a Terms of Reference and determination of the contribution of the firm to the volunteer costs; clearance of the TOR by USAID; recruitment of the volunteer by IESC in the USA and clearance/acceptance locally; refining of the TOR once the volunteer arrives, to ensure it is correct as he/she sees the situation on the ground; agreement with the requesting firm of the final TOR; and performance of the agreement, which is usually 1-3 months in total duration. Once completed, the volunteer evaluates the project, and this is discussed with the participant firm(s). Six months later, a post-project evaluation is carried out.

Firm contributions can be in kind (as in provision of a guest house as accommodation) or cash, but there will always be some form of contribution. The contribution is determined by the Director, looking at turnover, number of employees, actual and potential profitability, and other factors.

As a result of the Mission's participation in the New Partnerships Initiative, local managers with key skills are forming the Zambia Management Assistance Program. Under this initiative, a mentoring program for selected SME businesspeople will be put in place, with senior business executives volunteering to support their growth.

The IESC program has merit and is important to Zambia, but there are a few glitches to be ironed out. The improvements on firms are not tracked sufficiently to see how many firms take the advice they are paying for, and what results ensue. This is particularly important to see whether the experimental "piggyback" system is effective in delivery of services. In this regard, establishment and use of a database by IESC is very important. The system of determination of firm contribution seems not to be standard, and in lieu of a rigid formula some guidelines should be made, so firms themselves recognize that the approach is fair.

To this can be added or calculated the overhead costs of volunteer services; in the case of some larger firms, they may be able to absorb some of IESC's running costs as well.

The guidelines for firm assistance should be closely tied to and consistent with the overall USAID program, and areas such as private health services, agribusiness, women's firms, small business associations, and newly privatized firms should be actively sought and given preference. There should be very clear linkages (including shared office space) and joint clients with HRDA, something which is neither clear or documented by either project. The Mission may wish to establish some mechanism for ensuring that the Health and Ag offices are informed when volunteer TORs are presented which they may have some interest in; the officers in these sections may have additional valuable input to provide to the process. Finally, this program is very management-intensive, with the USAID project manager having to provide clearance on every TOR and volunteer. A more tightly structured grant would alleviate some of this burden.

Human Resources Development Activity (HRDA)

HRDA commenced operations in September 1991, with the objective of training Zambians in basic business operations. The project rightly recognized that in a socialist environment, most people had not been exposed to business operations and activities, and thus would need access to information about how competitive economies operate, and more particularly how individual small firms commence and develop. The project concentrates on training service delivery of small business management, marketing, and planning to small (ten employees or less) and medium-sized businesses, and has trained approximately 840 persons, largely owners, in the last 5 years, most of whom have been in the last three years. Participant businesses have averaged ten employees or less, and work in at least forty major manufacturing and service areas.

From 1991 through 1993, training was managed from within the USAID Mission by a personal services contractor who contracted training services out. In 1993, a cooperative agreement with Clark Atlanta University enabled design of a training curriculum, special training of local trainers for delivery of training services, and organization of training workshops. Training was provided in the areas of policy analysis and planning, business planning and basic finance, business contracting, production management, and export marketing strategies.

In 1995, a project review showed that a of a 45% sample of the 450 trainees through May 1995, ninety-nine percent said that they have used learned skills in their businesses. Between 53-87% had put the information directly to use in business plans, accounts, and production management, with good results. Over 75% reported increases in gross revenue, which was largely reinvested in the business. Seventy percent or more of the respondents found new markets, improved financial control, and/or improved the quality of their goods and services and attributed this change to the training program.

In 1996, as part of the transition phase to local implementation, discussions were held with graduates regarding small business associations, as it seemed obvious that the businesses did not have a network or collective voice. An IESC volunteer worked with HRDA graduates in the provinces, explaining the purpose and operation of small business associations. Mr. Solomon also discussed the importance of such organizations for business networking and discussed with graduates how such associations can be formed.

The result was that within one year, provincial business associations have been formed by the client group without assistance in all nine of Zambia's provinces. The associations have constitutions, democratically elected leadership, branch offices, have all registered, and charge fees of up to Kw 10,000 for joining and up to Kw 30,000 per year. The estimated membership is over 1,300 and rising quickly, while local Chambers of Commerce are largely in decline. Field reviews throughout 1996 in the provinces show both an exceptionally strong commitment and local ownership of the associations, and commencement of using them as a voice for government and a network to do business with each other.

An internal review of HRDA clients undertaken in late 1996 showed that on average, within one year the participants had increased their employee levels by an average of 3 persons. Businesses cutting staff were outnumbered by those hiring new staff 3-1. In a country where under- and unemployment are key issues, such results are heartening if not astonishing.

In 1997, a two year cooperative agreement was let through ZACCI for the services of HRDA to be provided under its umbrella, following a 1995 survey by GTZ which stated that the only sustainable umbrella association with the requisite administrative capacity was ZACCI. The target for the two year period is 20 training courses per year, reaching 4,500 persons, with a particular focus on rural businesses. The cost per workshop is about $6,000, of which a quarter is covered by the trainees in fees. The management expects to exceed this number of trainings, and will provide trainings in social safety net and other services funded by other donors. HRDA subcontracts the trainers, who are largely from the Copperbelt University.

Under this arrangement, provincial business associations are responsible for setting up the training courses. Once they have located 25 enrollees and collected Kw 30,000 of the 50,000 fee, they contact the HRDA office to arrange a training program. The provincial small business associations arrange the local site, all logistics, and collection of the remainder of the registration fee within two months after the course is completed.

A meeting in March 1997 with three representatives from each of the provinces learned that training setup was ready from HRDA; within the month, every single province was ready for training programs, and many are well over-subscribed. The next step is clearly linkages between them, and formation of a national small business association which is member-driven in terms of services and activities. The businesses have already identified their chief problems as credit; physical facilities; and stationery/communications, in that order, and want to use the associations and training to work on these problems.

A recent report on best practices by the Inter-American Development Bank states that the programs specialize in business development services; reach more than 500 clients, focus on businesses with 10 or less employees, charges a fee for services, and serves clients in a specific sector. Keys to sustainability involve helping to form local business networks, providing technical assistance/training, and no provision of credit with the services (instead faciliatating links to other organizations which do this).

By every single standard of success, the HRDA project is outstanding in its performance.

The project should be expanded and certain areas added to it, particularly an internal monitoring system, direct links to IESC following training completion, funding for Internet access to share business ideas and create new markets domestically, and the establishment and facilitation of member-driven national small business association. The project should be set up as a stand-alone project, with a supervising board made up of provincial representatives. HRDA should be delinked from ZACCI, which currently has a large number of donors involved with it and is having management difficulties as a result. Linkages to the CLUSA activity under the Agriculture office, and to private sector promotion in the health services areas, are natural and should be encouraged. Please refer to Section VI for further details on this area.

The next section discusses donor investment options for private sector enhancement. They are rank-ordered, and the four requested by USAID to be further developed have been discussed in more detail. Others are provided for general consideration by all donors.

VI. Recommended Areas for Private Sector Growth Enhancement

A. Overall Commentary

*" Western aid, and the conditions under which it is given, must focus on the extent to which the reforming countries promote the growth of the nascent private sector... as we learn that macro-economic adjustment does not guarantee economic success, that multi-party democracy is not enough for political success, we begin to focus on the **institutions** through which economic and political activity are carried out and mediated...*" Klitgaard, p 44

Zambia has made a great deal of progress in the past six years, and the US assistance has been an important part of that process. In order to continue to contribute actively, what is proposed is four options for assistance to strengthen the institutions which reinforce growth in any country, and the rules of the economic game. The areas of trade relations, commercial law and practice, privatization, and small business representation deserve the most attention, and are deemed both by the consultant and those interviewed as being the most contributory to deepening and broadening economic growth in Zambia. Two of these build on strong programs already in operation, and two of them are new areas for USAID. Two areas involve ongoing partnership with the Regional Center for Southern Africa Mission. All four reinforce and provide synergy for both Agency and Mission programs and other donor activities.

Privatization work can continue, to complete the larger firm divestitures, get government out of production, and establish a mortgage market to encourage long-overdue national savings. It will also start the process of moving government into its true core competencies, and away from distorting markets and sub-optimal public investment.

The cost of being the first one on the block to open an economy can be severe. Zambia has found itself exposed, with neither solid regional/bilateral trade agreements nor the domestic capability to protect its own industries from unfair competition, particularly from Zimbabwe and South Africa. The creation of a level playing field, with innovative mechanisms involving the private sector intimately in the agreement and enforcement processes, can both strengthen the economy and provide crucial ongoing mechanisms for public-private sector dialogue and interaction.

Though Zambia has dramatically improved its legal framework for business, there are glitches in the physical operation of the courts and the administration of justice. Time is money, and assurance that the legal institutions function effectively, impartially, and rapidly in support of commercial activities is crucial. More effective systems of administration and better-trained players can both reinforce the power of law and the capacity of businesses to function in the global marketplace.

Finally, broadening the base of economic growth and ensuring that the poverty-stricken rural areas benefit by emergent formal sector businesses is crucial. In Zambia, the emergent National Small Business Association, with over 1300 member businesses in nationwide provincial associations in just over one year, provides a unique opportunity for training and advisory services, advocacy, and linkage to credit opportunities.

Information on training activities from 1996 alone demonstrated a 20% overall increase in number of employees in one year. Bringing more of these businesses into the formal sector and forging linkages between them, larger businesses, and government can commence the re-engagement process currently lacking in the economic structure.

Before going into the details on the four recommended areas, a comment on the appropriateness of macro-economic assistance is provided as required by the Terms of Reference. On the macro-economic advisory side, the GRZ has closed out its long-term technical assistance services from expatriates in the areas of budgets, loan servicing, and macroeconomics. The current senior technocrats have advised that they would prefer not to have such assistance at this time. This is consistent with a rising view throughout the government that such advisory services are not desirable, due to a) potential for leakages of information pre-emptorily to outsiders -- particularly donors; b) problems with creation of dependency on consultants; c) lack of sufficient results in counterpart programs, and d) the government' s own uncertainties associated with an incomplete civil service reform.

It can be observed that particular weaknesses in macroeconomic management and in strategic planning can only be handled by a combination of long-term advisors paired with a program to provide PhD level overseas training to a set of committed Zambians, followed by their return and one year handover. After this, the key must be to pay these newly-trained economists sufficient amounts to retain them within government. Failing this, the Zambian government should look towards recruiting Zambian economists internationally for their national financial and planning management, and paying them accordingly.

In this regard, the Bank of Zambia may be considered a model, with the retention of the international economist and Zambian national Dr. Mwansa as Governor/ The BoZ has a solid ongoing training program with an external MS in economics from Aberdeen University run through the Bank training center, and a salary package which ensures recruitment and retention of the highest caliber of professionals. It has accepted long-term assistance from the IMF in bank supervision, and continues to use expatriate advisors fully and sparingly.

The four areas of assistance recommended to enhance private sector growth and broadening of participation are listed below:

B. Privatization

Background

The privatization program has continued to be successful by all accounts, and is on target for a completion in late 1998 or early 1999. The international consultants have largely completed both transactions work and the transfer of skills into the ZPA Zambian staff. The Chief Executive advises that, between funding from the World Bank and ongoing GTZ consultants, there is no need for further assistance in ongoing standard transactions. At this point, four activities remain to be wrapped up, for which USAID can consider further assistance through early 1999:

a) Housing and mortgage finance. This is a source of savings in many countries, and the traditional provision of housing by employers has robbed Zambians of this opportunity. There have not until very recently been any mechanisms for long-term finance; nor have salary structures and interest rates been consistent with mortgages on existing housing prices. (The Zambia National Building Society, a parastatal, has been non-operational for some time in this area, becoming a real estate investment operation instead.) Ironically, the political pledges to provide homes to sitting tenants at very substantial discounts, while favoring one set of the population at the expense of the rest, has opened a door for mortgage opportunities. The first private building society has been established, and has made 25 mortgages to date on a five year repayment schedule, at interest of 45% adjustable.

The parastatal-based housing stock is made up of houses ranging from one room shacks to mansions, with the vast majority simple worker housing. There are approximately 12,000 houses outside the mining units, and 44,000 in the mines. The rough estimated value of the non-mining housing is $40 million, and $600 million for the mining housing. Disposal of this housing stock is an integral part of the privatization process, and is helping the mortgage market to be established.

Within ZPA, the housing stock team is evaluating the stock (which had never before been listed, titled, or valued) and determining, for current and previous deals, exactly what housing belongs to whom. For non-mining units (the mines and housing are still in negotiations) the team locates the houses, arranges for each to have title, acquires a list of tenants, and sets up sales to tenants. Since there are apartment buildings, ZPA has also become involved in setting up the first-ever common ownership associations, with the associated teething problems. The team is currently up to date with housing associated with recent parastatals sold, but have a backlog of firms previously sold which should be completed by the end of 1998.

Once housing is designated, the ZPA team is developing a unique system for disposal of medium and low-value homes (high-end homes are easily sold for cash). First, since there has never been an appropriate pricing mechanism due to lack of mortgage finance, they are pricing based on extrapolating market rental payment values for that and similar units. Then, the conditions of sale involve a down payment of 30-35% of the rental cost-based price. The remainder due is converted to dollar-equivalents, and payments are scheduled for payment of the kwacha equivalent of the dollar payment at a 10% interest rate over five years. Because the time is short, the interest payments are always positive, enabling a double-cap system to be arranged. Each quarter, the payments are adjusted by up to 25% for any devaluation of the currency, and then the entire loan is rescheduled and lengthened accordingly, up to a minimum of payment of interest only. In this way, the dollar basis of the loan is preserved, without creating an undue pressure to increase the payments. The system works because of the large down payment, short period of the mortgage, and implicit expectation that the inflation rates will stay below 100% and decline.

The ZPA will tender out the collection and management of these housing mortgages to a financial institution for some percentage of the total mortgages. Ultimately, the mortgages can be bundled and sold to a financial institution, adding another financial vehicle to the stock exchange. Funds received from housing payments might have a variety of extremely valuable uses, from forming a pool for additional private sector mortgage financing to investments in housing areas, where power and water services are poor to non-existent. As the kwacha stabilizes, the market will move to variable-rate mortgages, and this market will further develop.

b) Telecommunications. A recent very senior investment advisor commented that modern telecommunications is the sine qua non for international market participation. Zambia's telephone systems have been mentioned in the President's Forum on Enhancing Zambia's Investment Climate as "poorly maintained and could be made considerably more effective. Its current state is responsible for the loss of more than one investment project..."

Currently, USAID's regional center has been providing assistance in the areas of telecommunications regulation and Zamtel privatization. The assistance has been less than successful, due to a combination of difficulties with consultant performance and regulator internal problems. The GRZ recently dismissed the Board and executive of the Communications Authority, citing financial irregularities. Establishment of a new Board will take time, and setup and establishment of appropriate regulations will necessarily follow. Regrettably, as Dr. Luders, former Minister for the Economy in Chile during its successful privatization period noted in his speech to the Zambia Investor Forum on May 15, no reputable investor, either public or private, will involve itself in this relatively small telecommunications market until there is evidence of both established regulations and a reasonable degree of competence and stability in the regulating body. Therefore, assistance in this area will be required for the next 18 months to two years, both on the regulatory side and to keep Zamtel from collapsing until it can be divested.

C) Other key privatizations. Generally, as in the ZCCM case, larger firm privatizations are handled by specialist teams. These teams are interim short-term consultants who are specialists in that field, who have been involved in specific privatizations of that nature worldwide. They commonly work with privatization agencies on the market evaluation and bid documents, pre-qualification, evaluation of bids, and negotiations. Areas which may require this assistance if the President adheres to his recently reiterated "no sacred cows" privatization stance include ZESCO, if ZPA recommendations on unbundling are accepted by the Cabinet; ZNPF if the issues of Social Security/pension privatization is determined; Medical Stores Ltd; and Indeni Oil.

D) Privatizing key areas of the civil service. ZPA has undertaken a study to determine which areas of the public service can be effectively placed in the private sector, and a number of fruitful options have been presented by the consultants. This is a crossover area between civil service reform and privatization, but -- pending Cabinet approval and donor agreement -- it could be the work that kickstarts the downsizing of the civil service.

Management/Mechanisms

The most appropriate mechanisms appear to be:

-- the securing of the housing long-term consultant through end 1998 in order to ensure skills transfer and the processing is complete.
-- continuance (with more intensive management oversight from the RCSA) of the regional telecommunications assistance from Price Waterhouse for both regulation and privatization preparations through the end of 1999. USAID Zambia should consider co-financing some of this, so as to take fuller ownership of the process and management.
-- financing of a pool of specialist short-term technical assistance for key privatizations, to be drawn upon as needed by ZPA through mid-1999.
-- provision of one long-term advisor with specific skills in this area and some short-term technical assistance for the government department privatizations for a period of up to mid-1999.

The packaging of all but the telecoms assistance can be done in either one overall tender, or in a local grant agreement to the ZPA, which can then administer the process. Costing will emerge as part of the design process. The design TOR can be found in Annex B.

Internal Synergy

Completion of the overall privatization program supports the USAID agency goal of broad-based economic growth, through the objective of strengthened markets.

Privatization of Medical Stores, and of any of the health or health-related services in government, serves the Mission's Health strategic objective. Privatization of any agricultural or ag-related services within the civil service, and the privatization of both the lodges and agribusiness parastatals, serves the Agriculture strategic objective. Divestiture of activities within government, stripping it down to key essential functions, serves the democratic governance objective.

External Synergy

Completion of the privatization program strongly serves economic liberalization and the emergence of a private-sector driven economy from one which was 80% stat-owned six years ago. Donor partners are GTZ, ODA, Norad, and the World Bank. GTZ will continue with a long-term program advisor and support for related social safety net services. ODA will continue support for legal advisory services to ZPA. Norad will continue team support for certain specific transactions, and is expected through its assistance to the Investment Centre to continue the process of parastatal international marketing which USAID has financed. The World Bank is expected to finance any additional needs not funded by other donors, including completion of the ZCCM privatization process.

Indicators

a) housing units divested; sale of at least one bundled mortgage package
b) issuance of internationally acceptable regulations for Zambia's telecommunications sector; tender of Zamtel
c) all possible completed for divestiture of any special firm;
d) percentage of budgetary expenditure transferred from public to private provision of services.

<u>C. Industrial courts and legal training; links to legislative reforms</u>

Background

Zambia's court system has just become independent of the Ministry for Legal Affairs, under legislation passed in late 1994 which is still being implemented. The courts consist of a Chief Justice who presides over the Supreme Court, with subsequent tiers in the High Court, magistrates' courts, and an industrial court which handles labor issues. Over 400 local courts only preside over customary law cases.

In discussions, the Minister and Permanent Secretary for Legal Affairs said
that the legal framework, in particular that for business, has greatly improved over the last ten years, but still needs fine-tuning. In this regard, the publishing of the Laws of Zambia and their expected availability on CD-ROM shortly, along with expected similar documentation of case law, is a great

improvement. Training of legal drafters has been very solid, and resulted in much simpler, more logical legal framework. Regrettably, they have all left for work in neighboring countries with better conditions, putting pressure on the few remaining drafters to cut back research and count on memory, a dangerous practice.

The separation and establishment of autonomy of the courts is an important change, and in particular the requirement that the Judicial Services Commission must recommend judges for appointment before they can be so appointed by the President. One problem is that a large number of justices have died recently. Over 20 new justices will be proposed in the next session of Parliament for confirmation, and they range across the political spectrum. Salaries and benefits have been increased, but procurement of transport remains a problem; the Lusaka Court Presiding Judge walks to her court every day.

Existing problems include poor government investigative and prosecutorial capacity, as lawyers cannot be retained due to better private practice options; inadequate physical structures for court operations; a shortage of prison capacity; poorly-qualified magistrates; severe congestion of the Lusaka courts, and inability to set up a consistent system of circuit courts in the provinces; and the overall administration process, including court administration and separation of responsibilities among the various players on the legal scene. Both the Minister and Permanent Secretary explicitly mentioned the long delays in having cases heard, and the high costs they know are borne by the private sector as a result.

Private sector interviewees stated that while the law itself is much better, actual administration of law is a nightmare. Delays of up to five years for a court decision are not unusual, and this causes severe difficulties in terms of contract adherence and enforcement. Arbitration is not a feasible option due to antiquated legislation and lack of an operating structure. Businesses cited problems locating competent legal counsel; dealing in particular with international contracts, labor issues, and bad debts; dockets and files being “lost” by the court clerks; and dealing with myriad arbitrary court rules, which result in cases being lost due to procedural rules rather than considered decisions by the justices. Experiences with judges themselves are mixed; the view is largely that lack of information rather than incompetence or corruption is the substantive problem, although integrity was a question in a few minds. On the lawyer side, LAZ is viewed as not doing a sufficiently good job of ensuring self-policing amongst the legal profession; senior lawyers are not regular participants; and it has taken on a strongly political slant, possibly at the cost of emphasizing technical excellence.

The Minister mentioned that there has been discussion about division of the courts into civil, criminal, family, and commercial sections. The division would allow specific development of both practicing lawyers, magistrates, and justices in these specialist areas, and improvement of cashflow and overall administration. The chief justice is considering this option seriously. Private sector interviewees unanimously cited a special commercial court as crucial for a better business environment.

Management/Mechanisms

The support of commercial court operations would require as a pre-requisite that the Chief Justice decide to divide the courts as listed above (and it may also require an Act of Parliament; the 1994 Act will need to be reviewed to ensure it fits existing legislation). Once this has been determined, the set up of the commercial courts and strengthening of commercial legal services can occur. This results package could be broken down into the following activities:

-- establishment of the commercial court administrative systems; this will require a long-term advisor and funds for short-term technical assistance as needed.
-- training of justices. Only two of the judges sent to the UK for training under World Bank's FILMUP project chose specializations in commercial law. Both the Minister and businesses mentioned the importance of the previous USIS-sponsored assistance providing US justices to work with their Zambian colleagues. Contact and exchange programs can be arranged both in Lusaka and elsewhere with another court system, law faculty, or combination. Training upgrades for judges can be established and met by providing training programs in key areas of commercial legislation (both in Zambia and elsewhere) in the Institute for Advanced Legal Education (IALE) in Lusaka. Establishment of a system of extra-judiciary arbitration, possibly alternative dispute resolution, could be done now starting with those trained under the Privatization Support Project in negotiation skills as a base group.

-- training of lawyers. The government is currently rewriting the Legal Practitioners Act, and appears very amenable to requiring lawyers to upgrade their skills and understanding of legislation by mandatory course-hours each year. (In the absence of this, the LAZ could make the same requirement, as does the Zambia Association of Accountants.) This is similar to legal and accountancy requirements in many countries. The IALE, which is being housed in a new building courtesy of World Bank funds, can be structured to provide this service. In addition, the commercial court may require additional certification in commercial law in order for lawyers to appear before it, and the certification can ensure a better quality of case presentations, and more assurances to the business community that their legal practitioners are well-qualified. One or two long-term advisors and/or a partnering arrangement with an external law faculty can establish this and institutionalize it locally. Strengthening of the LAZ could also contribute to the process of self-policing of the profession.

-- improvement in access to basic commercial information. IALE can provide basic courses for accountants and businesses in common areas such as contract law, establishing a partnership or corporation, how to hire a lawyer and what to expect from them, how the courts work, and special seminars on key legislation. A small pay-access library for commercial transactions, including Internet access and standardized formats for the most common legal documents, would open the door for businesses to access such information. The project could also place the Commercial Laws of Zambia on ZAMNET through ZAMLII, making them universally available to the public in the absence of copies at the Government Printers.

-- fine-tuning commercial legislation. In particular, the Arbitration Act is long overdue for change. It is strongly advised that the Zambian legal drafters be offered packages sufficient to encourage them to return, with an agreement with GRZ that these positions be permanently special-graded to allow payments of such remuneration permanently. The project can then sliding-fund the positions over a five year period.

All of this assistance is appropriately packaged together in a Request for Application, which would expect responses from non-profit legal associations and law faculties. Depending on the determination of the Mission, this could become a component or partner project to a rule-of-law initiative under the democratic governance strategic objective.

Internal Synergy

The synergy of this proposed project is exceptionally strong with the democratic governance strategic objective of the Mission. Systems in which the performance of the judiciary is bolstered, the law itself made more understandable and transparent to the public, and speed of the courts improved, along with alternatives to court resolution of disputes provided, make the rule of law effective for everyone, not just the private sector.

The Mission's Health initiative requires rewriting of legislation in order to allow for private sector participation in the provision of health services. This should and can be accomplished under this project in the legal drafting section.

Agriculture will benefit from both strengthened capacity of the courts to deal with contractual matters and debt issues. Decentralization of such skills can benefit village-based enterprises and peasant farmers participating in outgrower schemes, particularly if the improvement in access to commercial legislation information work involves courses to provide basic training as an outreach activity.

External Synergy

Such a program will clearly contribute to balancing of powers by supporting a more independent and competent judiciary. For the overall economy, as Klitgaard notes, "institutionalization may occur through... having a judiciary which rapidly, impartially and fairly examines private sector claims, (including those) for changes in government contracts and regulations."

The World Bank assistance completes in 1999, and existing and future activities are limited to provision of one external drafter, drafting of certain specific legislation, building of the IALE premises, very limited generic training of judges, and publication of the Laws of Zambia and court decisions on paper and CD-ROM. This program neatly dovetails and builds on the FILMUP work.

Indicators

-- speed at which the average case is dispatched
-- numbers of actions handled by arbitration, and speed of settlement
-- key acts amended as needed
-- numbers of persons accessing Internet /commercial library sites

<u>D. Trade policy and practices</u>

Background

Until the early 1990s, Zambia had a trade regime typical of many protectionist states: high tariffs and customs duties, non-tariff barriers, foreign exchange controls, and a great deal of paperwork for importation or exportation of any goods or services. Since 1992 the government has, as part of the overall liberalization process, dismantled many of the barriers to trade, and has shifted from being highly restrictive to having one of the most open economies in the region.

Tariff rates are now on a 5-15-25% system, and many goods such as capital equipment for certain industries come in duty-free. Though the 5% import tax has been reintroduced, VAT has been cut to 17.5% so the net increase is 2.5%. Paperwork has been greatly simplified, and the foreign exchange is unrestricted.

While Zambia has liberalized rapidly, its neighbors have not followed suit. Others (notably Zimbabwe and South Africa, which have long histories of protectionism) have continued to subsidize exports (in some cases explicitly), maintain forex restrictions, use non-tariff barriers such as food quality controls which are arbitrarily applied, and in some cases place unexpected punitive tariffs or quotas on Zambian exports. This creates an uneven playing field, encouraging both multinational and regional manufacturers to move production to more protected countries. Unfortunately, Zambia's membership in COMESA, SADC, and WTO has not yet helped resolve these issues, and its numerous bilateral trade agreements are in most cases outdated. Neither the legislation nor practices are in place to enforce abuses. Zambia suffers as a result from being the first in the neighborhood to liberalize. As one businessman put it, "It's Zambian business against the rest of the world, with us in shorts and them in body armor -- and sofar, they are winning."

A trade survey and study just completed by Mr. O'Brien for GTZ illustrates some of the issues. Manufacturers and producers generally view export, in particular to the region, as a vital part of their investment and growth strategy. The domestic market is small and has shrunk due to the rigor of the adjustment process.

The areas in which Zambia has a natural advantage: agriculture, mining, and tourism -- lend themselves very well to exporting to other countries in the region. In addition, the high cost of local capital compared to foreign exchange encourages firms to borrow internationally, and then export to fund the debt payments in lieu of an uncertain exchange rate for local currency.

The business community cited a number of concerns about trade, including trade-restricting agreements among independent firms, arbitrary home-country sourcing of materials by multinationals or regional firms, the lack of capacity to deal with smuggling and unfair trading, theft in transport, lack of market information, and non-tariff barriers. They remain skeptical of Zambia participating in free trade areas in the region, and feel that key negotiations are crucial but are dubious of a good outcome for new trade agreements with Zimbabwe and South Africa. There is concern, particularly in local firms, with a SADC agreement, but they do feel that a clear schedule for trade liberalization within SADC should be negotiated as soon as possible, in very precise terms.

The O'Brien study recommended a number of areas for action within Zambia, which form some of the core of this potential project:

* Proper classification of imports for tariff purposes, and a general revision of the tax structure to ensure that importers face the same playing field as producers
* tighter control of smuggling, under-invoicing, and other measures for tax avoidance
* introduction of legislation for anti-dumping and countervailing duties, along with clear explanations of mechanisms to employ when appropriate to trigger these
* ongoing assessment of trade regimes with trading partners, to ensure the situation is balanced and fair to Zambia

Trade policy is considered to be an area where the Ministry of Commerce, Trade and Industry has and can develop influence and competence. The Deputy Director for International Trade is Ms. Bridgette Chilala, who is assisted by four economists including Lillian Bwalya and Ms. D.N. Tembo (three positions are vacant). She mentioned that after Zambia liberalized, the competition became fierce, and in some cases unfair. Most of the private sector does not understand the conditions of the WTO or many of the other trade agreements, nor do her colleagues in other ministries who need to be clear on the meaning and implications. The government needs assistance in the following areas:

* determine how to set up antidumping and countervailing duties, and what should trigger them, and how to carry them out
* update all trade legislation
* facilitate training in trade negotiations. In this regard, the work with ZPA negotiators was noted. These might, with a bit of additional work, provide a strong base of consultant negotiators for the GRZ to use in trade negotiations
* create awareness of the new intellectual property rights agreement and its application, and changes accordingly in Zambian legislation
* work with the Bureau of Standards on phytosanitary conditions for exporters
* training in how to improve market access to other countries
* preparation and involvement on COMESA implementation

The Zambia Association of Manufacturers in particular has also reinforced the need for work in this area.

Management/Mechanisms

The support of trade initiatives would require, at minimum, concurrence of the Ministry of Commerce, Trade, and Industry and its collaborating ministries, and in particular the ZRA. As the Permanent Secretary has expressed a preference for interim technical assistance, any long-term advisors would need to be housed elsewhere. The private sector should be an ongoing and natural partner for this project; ZAM is probably the best home for it at the current time, subject to GRZ agreement on this.

Suggested areas for project implementation:

-- rewriting of all legislation in trade and related areas to make agreements consistent.

-- training in trade analysis for Zambian economists/consultants as well as for Ministry staff. In this way, the Ministry can hire people domestically for analysis of trade agreements, thus “privatizing” the initial analysis, which can then be reviewed by the Ministry for setup of negotiations or action.

-- negotiations skills training for negotiators (possibly starting with those whom ZPA has used), Ministry staff, and others as appropriate. This creates a second pool of outside negotiators to assist the Ministry.

-- an education campaign for the private sector on the nature of the agreements, mechanisms for dealing with unfair trade situations, and vehicles for dialogue with government on trade issues.

-- review of the tax regime to determine any difficulties or inconsistencies, and correct them wherever possible.

This project can be tendered to one firm as a combination of one long-term advisor and a set of combined local and international short-term technical assistance.

Internal Synergy

Trade improvements will facilitate, in particular, export of agricultural products, supporting the Agriculture strategic objective. In addition, such an investment would link very naturally to the RCSA work on cross-border trade.

External Synergy

GTZ has commenced this work but does not expect to continue it in an intensive form. Work ongoing with the Investment Centre, macroeconomic advisory services via METAP, and with the Export Board, as well as with the various export sector organizations, would benefit from such an activity.

Indicators

-- legislation passed with improved trade provisions
-- % of trade taking place with countries whose trade agreements with Zambia are deemed “fair” by private sector associations

E. Expansion of services/assistance to small businesses

Background

"Most Zambian businesses don't understand what are the real issues they are facing." A donor

In Zambia, many of the small and medium-sized firms have collapsed during the last six years of economic liberalization. Part of it was structural inadequacies, and part was lack of sufficient information, market access, or credit to do business. While this paper does not recommend a credit program for a variety of reasons (including the crowding of other donors into this area), it is apparent that Zambians want and need better understanding of basic business skills. At all levels, firms have mentioned lack of book-keeping and record skills, ability to produce competent business plans, lack of marketing capacity, and inability to generally manage a business using competitive principles. This is the saddest legacy of the previous regime, and it needs to change rapidly if Zambian business is to grow.

Of particular interest is the fact that small firms have the greatest potential to expand employment, which is a key issue in Zambia. In addition, the highest levels of poverty are in rural areas, but they are also the locales for new growth of small firms, especially in areas where there are outgrower schemes or other mechanisms for cash income. Very few services are being offered to this group, which is very small in Africa generally, and is often called the "missing middle" in the literature.

HRDA and IESC have been described in detail above, and their potential defined. What seems appropriate at this time is to pool their talents together in a comprehensive program of small business development assistance which is rural-based and demand-driven.

Management/Mechanisms

Assistance to this group could consist of the following:

-- careful facilitation of a national small business association, with limited but key assistance to the provincial associations on their request

-- ongoing training in business management areas as per the existing HRDA pattern

-- identification of common technical areas for two potential types of assistance:

-- IESC volunteers

-- a voucher system, whereby all small businesses receive a voucher worth say Kw 50,000 which can be redeemed for some portion of a technical training course by any of a set of pre-qualified private training firms. The small business owner then pays the rest of the training fee, and chooses which firm he wants for his training. This is modeled on a successful program in Venezuela, which is demand-driven and low-management after the initial setup.

-- facilitation of linkages for credit assistance. One option might be to start the lending process by providing joint agreed guarantees as per microfinance models. Citibank might, for example, agree to secure a loan with the assets of not only the loanee but three of his/her colleagues who believe that a) their colleague will be successful, having reviewed the plan with them, and b) they will be next in line for a group-secured loan.

The best mechanism for this is likely to be two contracts; one for IESC, and one as a host country contract to a board made up of the provincial small business associations, which includes periodic international technical assistance on a demand basis. Thought should be given to delinking the HRDA project from ZACCI, and placing contractual commitments for collaboration in both the IESC and HRDA agreements.

Internal Synergy

Facilitation of small business activities provides benefits to both the agriculture strategic objective and, where the businesses are health product related, to the health strategic objective. There are natural links between the CARE and CLUSA work in agriculture and the management training/association work proposed here. Development of a national small business association serves the governance objective.

External Synergy

Work which most donors are doing in this area is limited to ZACCI and to microfinance services, or to very limited physical locations. This project can set standards for training and enable more widespread coverage in rural areas. The materials and approach could be shared with other donors, and their clients encouraged to participate in provincial small business associations.

Indicators

-- numbers of persons participating in provincial small business associations
-- increase of income, turnover, and number of employees for trainee businesses after receiving training and/or technical support

F. Other Options for Donor Assistance

In preliminary discussions of USAID assistance, the following areas were deemed to be less crucial for this donor. However, they emerged in discussions with both the private sector and government, and others may find them useful to consider.

5. Microfinance, and associated financial sector reforms. A number of donors have mentioned their interest in and commitment to microfinance. This is important, perhaps crucial given the collapse of rural farming financial institutions, banks curtailing their exposure in agriculture due to drought and other risks, and the expressed need of rural SMEs for credit services. However, it will require a good deal of care in coordination to ensure that such a program does not go wrong. Key issues: sources of wholesale finance for microfinancial services; lack of existing organizations which could or will become self-sustaining; disagreements over the minimalist or package of services approaches; a culture of non-repayment and political loan forgiveness; marginalization of women as borrowers; existing programs which are not charging market interest rates or focusing on full financial self-sufficiency. It will be crucial to connect financial services with non-financial services (eg business training and market access) to reinforce the potential for success. Work on the legislation (which is inadequate) could also be incorporated into the commercial legal reform project as proposed above.

6. Establishment of the apprentice scheme to increase technical skills. The private sector is particularly keen on this. Legislation already exists and could easily be implemented. The private sector funded a pre-feasibility study, which Devcorps completed. The cost is about $3 million, and ZAM mentioned that after three years the private sector would self-finance the scheme. This is worth a close look, perhaps in the context of the World Bank overall review of education; one key item to consider is that apprentice schemes traditionally exclude women, and this will have to be accounted for in the setup of any such scheme.

7. Senior economic advisory services for Cabinet and MPs. As the Malawi Cabinet has mentioned, "no one has trained us for this job of structural adjustment." Zambian Ministers have mentioned that economies in transition become very complex, and few Ministers or MPs are professional economists. Therefore, sub-optimal decisions may be made at the political level because of insufficient information about the economic consequences. Very carefully packaged short inputs, probably from key persons at Ministerial level in the emerging nations of Southeast Asia, for example, could facilitate better understanding of the adjustment process and clearer rationales for economic decision-making.

8. Revamping of business registration and licencing procedures, both for small businesses and changing/reversing the Investment Centre approach, to use a facilitator for all processing systems and receive the investment licence at the end, once everything else is done. The Investment Centre argues that there are too many license requirements, and most are unnecessary. The Centre might garner goodwill by granting investment licenses to many larger firms operating for years in Zambia which currently do not have them. This would a system and pattern of license acquisition, since apparently this is currently not the case. The small business registration system will require legal review and discussions. Norad might well take this up as part of their Investment Centre project, starting now.

9. Development of small livestock markets. This is both a store of value and direct income source for women in rural areas. Meat demand is rising. In lieu of broiler factories, there might be value to extension in chickens and other small livestock, especially near towns. This work needs to be done in the context of ASIP and donor work in agriculture.

10. Establishment of a medium-term employment strategy and setup of inter-Ministerial coordination accordingly. There is a crucial need for a national approach which deals with sustainable livelihood issues, as the ILO demonstrated in its recent study. Improvement of labor legislation and practices, and the encouraging self-monitoring of trade and other skills groups, will be vital as the economy makes the shift from public to private operations.

11. Development of an urban development/mortgage market/mortgage financing. Work on this is commencing within the ZPA, but the financial market is not yet deep enough to make this work. Institutionalizing the process will be crucial to promotion of home ownership and implicitly to national savings systems. Provision of serviced plots has long been under discussion, but little has been done.