

A Copper-Bottomed Crisis? The Impact of the Global Economic Meltdown on Zambia

Duncan Green, Oxfam GB, March 2009¹

Introduction: a country on the verge of progress

At the time of independence in 1964 Zambia was a middle-income country and appeared set to develop into a prosperous nation. However, the combination of a tumultuous world economy and fiscal mismanagement led to rapid economic decline, which continued unabated into the 1980s and 1990s. Average economic growth from 1990-1999 was the lowest in the region and unemployment and inflation soared, resulting in per capita incomes 50 per cent less in 1999 than they had been 25 years earlier.

Zambia is now one of the poorest countries in the world, ranked 163 out of 179 countries on the UN's Human Development Index (2008). 64 per cent of Zambians were estimated to live below the poverty line in 2006, down from 71 per cent in 1991. The majority of these people live in rural areas in households headed by women² and half the children under five in the country suffer from chronic malnutrition or stunting, a figure that has worsened rather than improved over the last 30 years³. HIV prevalence in Zambia is amongst the highest in the world – estimated at 14.3 per cent in 2007⁴. Healthcare remains under-resourced and ill health is compounded by the lack of access to clean water and sanitation. Access to primary education by contrast has markedly improved but the quality of the education received is far below what is needed for widespread poverty reduction and girls in particular do not perform well beyond primary school.

Of late, however, Zambia's fortunes seemed to be improving. From 2003-2008, the economy grew at an average of over 5 per cent, driven by a policy environment conducive to new foreign investment, strong macro-economic management and low(er) inflation, more than a decade of political stability, and a mining boom. One result was that in 2005 the majority of Zambia's foreign debt was wiped out, allowing the government to introduce free primary education and remove user fees for rural health facilities. Enrolment rates in primary schools, for both boys and girls, increased dramatically.

Overseas aid has also played an important role. In 2006, with support from donors, Zambia made health care free for all in rural areas, providing free anti-retroviral treatment for people with HIV. Today 149,000 people are receiving lifesaving ARV treatment, 50 times the number of people being treated in 2003. Because of improved health care, there has been a 50 per cent increase in people using health facilities and 40 per cent increase in essential medicines in rural areas.

Overall, the widely respected Economics Association of Zambia concluded: 'for the first time in 30 years, poverty had started to reduce, at least in urban areas.'⁵

But just as hope was returning that Zambia's fortunes were about to change for the better, the global economy has gone into meltdown. This paper explores the impact of the global crisis on Zambia and the initial response by government and others.

Impacts of the crisis

As in many low-income countries, the financial sector plays a less important role than in rich countries. Although largely foreign-owned, Zambia's banks were not caught up directly in the global financial crisis of mid-late 2008. As recently as October 2008, the Economist Intelligence Unit was predicting 2009 growth of 6 per cent. Now, however, the recession in the real global economy is having a serious impact and early optimism appears to be giving way to increasing alarm at what lies in store for Zambians over the next two-three years. By February 2009, the EIU had slashed its 2009 growth forecast to 1.6 per cent.⁶

Copper

In international trade, Zambia is a one-product economy. Copper accounts for some 70 per cent of its exports, so the sudden and precipitate collapse of copper prices by two thirds, from \$9,000 per tonne in July 2008 to \$2,900 by the end of the year, has been traumatic.

Jobs: As some relatively high cost mines have suddenly become unprofitable, the most immediate social impact has been the loss of some 5,000⁷ out of a total of some 30,000 mining⁸ jobs in the mining sector. That may sound relatively few, but formal sector jobs are scarce in Zambia, and by one estimate, each one supports another 20 jobs in services, suppliers and the wider informal economy.

Trade and Exchange Rate: If copper prices stay at their current level, exports will halve in 2009, to about \$1.6bn. In 2008, Zambia's trade account went from surplus of \$30m in June to -\$70m in November.⁹ Total exports for 2009 were predicted to fall by over a quarter, from \$4.8bn in 2008 to \$3.4bn in 2009¹⁰. In Zambia, the exchange rate tracks the copper price and the national currency, the kwacha, has depreciated from K3,200 to the dollar in June 2008 to about K5,500 in February 2009.

Tax: In terms of poverty, the most important aspect of copper mining is the extent to which it generates tax revenue which the government can then use to fund health, education, infrastructure, social protection, and all Zambia's other pressing needs. The tragedy here is that after decades of mismanagement of the mining sector, in April 2008 the Zambian government had finally introduced a modern system of taxes and royalties that was expected to generate significant resources from a hitherto untaxed sector and yet were, according to the Financial Times 'no harsher than standard rates worldwide'¹¹. The new tax regime was expected to add an extra 9 per cent to the government's domestic revenue collection although due to implementation problems and the refusal of several mining companies to pay up, in its first year it raised only one third of this amount.¹²

In January 2009, barely nine months after its introduction, that system was abandoned as the downturn allowed the large, foreign owned copper companies to undertake what the Financial Times described as 'intense lobbying' of the government.¹³ The government gave the following concessions to the companies:

- It scrapped the 'windfall tax' which fell due when copper prices exceeded a certain level. In fact, prices had fallen below this level in October 2008, so no further tax was liable. However, companies were keen to get rid of the tax, arguing that it penalized high cost mines because it was levied on the overall value of copper produced, not on profits.
- The government allowed hedging income to be included as part of mining income for tax purposes. This is a serious setback as it is relatively easy to demonstrate a loss on hedging (and move any profits offshore), allowing companies to further minimise their tax payments.
- It allowed companies to write off 100 per cent of any investment against tax as depreciation in the year in which the expense occurs – well beyond the international norm, according to tax experts.

What is left is the standard corporate tax, a mineral royalty of 3 per cent of gross value, and a variable levy on profits. The government and mining companies argue that this is fairer, since

it does not penalize high cost companies, but in the words of one international aid official, 'the tax on profits is excellent in theory, but the Zambian Revenue Authority can never have the internal capacity to effectively force the mines to comply. These are massive mining companies with the best tax lawyers – they will run rings round them.'¹⁴ It is bread and butter work for international tax lawyers and accountants to minimise tax liabilities by minimising the paper profits of their employer. The sense of helplessness is palpable. As one senior government official ruefully remarked, 'those companies who didn't pay the windfall tax owe us – but when my son is sitting where I am sitting, we will still be asking them!'¹⁵

The copper slump is likely to have other longer term effects, for example in squeezing smaller companies, leading to their consolidation in the hands of the larger firms. Riskier investments such as exploration are also likely to be delayed, with knock-on effects in future years in terms of reduced output.

Finance

Although not directly involved in the collapse of confidence and wave of toxic debts affecting the global financial system, according to the Economics Association of Zambia, 'both banks and non-bank finance institutions have in the past few years drawn heavily on external sources for equity finance, debt finance, or in the case of banks, deposits to support their operation.'¹⁶ This inflow is now showing signs of drying up, with relatively prosperous Zambians and small enterprises reporting banks' growing reluctance to lend. According to the Bank of Zambia, capital flows suddenly dried up following the global collapse in October 2008, with foreign direct investment (FDI) falling from \$1,324m in 2007 to \$939m in 2008, and portfolio investment recording a \$6m outflow in 2008 compared to an inflow of \$42m in 2007.¹⁷ Both trends are likely to accelerate in 2009.

As the economy slows, non-performing loans look set to rise, further adding to the banks' level of risk aversion. Increased conservatism will mean credit is redirected away from small and medium enterprises, which generate large numbers of jobs and are critical to ensuring growth benefits poor people.

Other impacts

Tourism: Although the depreciation of the Kwacha should make tourism more attractive, the global slump in tourist travel, and the decline in the use of hotels and other services by the copper companies, is expected to lead to a 50 per cent fall in hotel bookings.¹⁸

Construction: Construction has been growing at an annual 17 per cent in recent years, creating many jobs for poor people. That is set to fall as mines reduce their investment, although aid and government-funded infrastructure projects should continue.

Aid: In recent years, Zambia has reduced its dependence on aid (although the quality of statistics is so poor that there are serious disagreements over how much aid the country actually receives). It may be necessary to reverse that with a substantial and immediate aid boost, perhaps drawing on the 'vulnerability fund' for the poorest countries proposed by World Bank president Robert Zoellick¹⁹, or an accelerated disbursement of agreed aid budgets. However, international aid officials in Lusaka are currently sceptical that this will occur on the scale needed to make a real difference.²⁰

Possible silver linings: non traditional exports, food, and fuel prices

Rapid currency depreciation will make Zambia's exports more competitive on world markets, but problems with quality, infrastructure, and recession in Europe and the US are likely to limit the possibilities of diversification away from copper into those markets. There is, however, substantial scope to turn Zambia into the regional breadbasket with appropriate agricultural investments, filling the void left by the collapsing Zimbabwean economy. Another positive impact of the global slowdown has been the decline in fuel prices. However, food prices in Zambia appear to some extent de-linked from the world economy – they did not rise as fast as in other countries during 2008, and at the time of this report, were not falling back in line

with world prices, perhaps because their fall was masked by seasonal factors (February is just before the harvest, when prices are at their peak).

How has the government of Zambia responded?

Both civil society and international institutions in Lusaka are concerned at an apparent lack of urgency in the government's response. In the words of Oxfam's Henry Malumo 'our government is living one day at a time. They don't want to sit down and talk with anyone – they are very defensive.'

In his budget speech on 30 January, Minister of Finance Dr Situmbeko Musokotwane predicted 5 per cent growth for 2009, something even his own officials expect will be revised downwards by mid-2009. The EIU's prediction of 1.2 per cent is at the low end of estimates – other economists in Lusaka predict 3-4 per cent.

The sluggish response appears to be part of a wider problem. 'The government doesn't have a major commitment to reducing poverty' says one senior aid official²¹. 'If you look at the spending side, all the increase has been urban – that's a political decision because that's where the next election will be won or lost. The rural poor can be taken for granted.'

The government's record on social spending is indeed mixed. On the positive side, total health spending has almost doubled in the last six years, mainly in donor funds for TB, malaria and HIV programmes. That progress is now likely to come under threat as donor funds are squeezed and domestic revenue dries up. As recession-hit private households switch from private to public services, demand is also likely to increase.

The record on social protection, however is more disappointing. According to the civil society umbrella coalition CSPR Zambia, a 'national social cash-transfer scheme targeting the poorest 10 per cent of Zambians would cost only 1.1 per cent of the total government budget in 2009'.²² But despite considerable donor interest and funding for a series of pilot projects, this is unlikely to happen as long as the Ministry of Finance in particular sees SP as little more than 'handouts to lazy people' and like other African governments, prefers the language of wealth creation to that of poverty reduction. According to the Economics Association of Zambia, this has led to a 'significant reluctance in the Zambian government to extend social transfer programmes in the form of cash, in-kind benefits, bursaries, school feeding, or health care costs. Over recent years, annual budgets have been ad-hoc, planning has been erratic, the level of technical dialogue has fallen, and expenditures have fallen significantly.' Past neglect matters in the current slowdown, because experience in other countries shows that it is far more feasible to scale up existing SP programmes than to introduce new ones from scratch in the middle of a crisis.²³

Even if the government wanted to act, its room for manoeuvre is highly limited because of its financial constraints, the problem of obtaining significant increases in aid, and the difficulties that Zambia, like many low-income countries, faces in raising domestic resources by issuing its own Treasury bills and other paper. So-called 'countercyclical financing' is a much more difficult option for low-income country governments than for rich ones.

In the eyes of government, one potential source of revenue remains the 'emerging markets'. Even though China and the Middle East oil producers have themselves been hit by the global slump, one senior government official believes 'the Chinese are still hovering on the horizon; the sheikhs are there looking for investment opportunities; there are a few people in Russia – these are the people we want to attract by investing in infrastructure and offering incentives.'²⁴

Conclusion

It is very hard to see with any certainty what lies in store for Zambia as the global recession deepens. Interviews found both optimists and pessimists. The optimists argue that poor people in Zambia are largely isolated from the global economy – just as they did not share in the benefits of the boom, so they will largely be immune from the impact of the bust. To them, talk of a 'crisis' seems very 'northern' – most Zambians are already living in what northerners would see as a permanently critical condition. The pessimists see darker clouds on the

horizon, as the global crisis leaches into Zambians' lives through multiple channels including employment, taxation, and aid. Over recent months, the voices of gloom seem to have grown stronger, while the Panglossians are looking out of touch. The Bank of Zambia struck a particularly sombre note in March 2009 when it warned 'a collapse in incomes reduces peoples' capability to meet their basic social and human needs such as food, health, shelter, and education. The likely consequence over time is social upheaval.'²⁵

What is clear though, is that Zambia has only limited options. But the words of one aid donor, 'Zambia cannot do anything but hope for the best – its fate will be determined beyond its borders' seem excessively defeatist. Governments and other actors always have options. The problem is that the current government has yet to wake up to the potential seriousness of the situation, and has already made huge and unnecessary concessions to the mining companies that will hobble its ability to cope with the downturn.

It is therefore likely to fall to other institutions, both Zambian and international, to introduce a greater sense of urgency. Civil society organizations, academics, media, and international donors, in alliance with those politicians and civil servants who appreciate the need for action, must all play a role. This should include monitoring and responding rapidly to the multi-faceted impact on poor people generated by falling copper prices, declining tax revenues, and the global slowdown. There is a compelling case for reintroducing a proper system of mining taxation, so that Zambians all benefit when, as expected, mineral prices start to rise again.

Notes

- ¹ This paper is based on a visit by the author to Lusaka, during which he interviewed a number of international donors, government officials, economists, and civil society organizations. This will shortly be supplemented with field research in the copper belt.
- ² [Central Statistics Office](#) (CSO) report, November 2007, p.22
- ³ Living Conditions Monitoring Survey (2003), Central Statistics Office of Zambia.
- ⁴ Data from the 2007 Demographic and Health Survey as reported in the CSO Bulletin, May 2008, p.16
- ⁵ '[Business Unusual](#): the Policy Implications for Zambia of the Global Economic Crisis', Economics Association of Zambia, January 2008
- ⁶ EIU Zambia Monthly Report February 2009
- ⁷ Zambia Daily Mail 25 February 2009
- ⁸ 2004 estimate, from Alisdair Fraser and John Lungu, For Whom the Wind Falls: Winners and Losers from the Privatization of Zambia's Copper Mines, 2007
- ⁹ Business Unusual, op. cit.
- ¹⁰ EIU Zambia Monthly Report February 2009
- ¹¹ Financial Times 27 January 2009
- ¹² Dr Situmbeko Musokotwane (Finance Minister), Budget Address, 30 January 2009
- ¹³ Financial Times 27 January 2009
- ¹⁴ Author interview, February 2009
- ¹⁵ Author interview, February 2009
- ¹⁶ Business Unusual, op. cit.
- ¹⁷ Bank of Zambia, the Emergence of the Global Economic Crisis and its Impact to Social Economic Development of Zambia, Paper presented to the ZCTU top leadership workshop, March 2009
- ¹⁸ Business Unusual, op. cit.
- ¹⁹
- <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22049582~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>
- ²⁰ author interview, February 2009
- ²¹ author interview, February 2009
- ²² CSPR Zambia, 2009 Post-Budget Analysis, February 2009
- ²³ Armando Barrientos, presentation at Enabling Growth and Promoting Equity in Global Recession, [ODI seminar](#), London, February 2009
- ²⁴ Author interview, February 2009
- ²⁵ Bank of Zambia, op cit

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