Oxfam International Discussion Document

Oxfam International

www.oxfam.org

A Copper-Bottomed Crisis?

The Impact of the Global Economic Meltdown on Zambia

Duncan Green, **Oxfam GB**

December 2009

Based the author's interviews with a number of international donors, government officials, economists, and civil society organizations in Lusaka, this paper documents impacts on Zambia's trade and financial sectors as a result of the global economic crisis. It reflects on how the Zambian government has limited options to deal with the crisis and considers what the implications of this are to other institutions, both Zambian and international.

Introduction: A Country on the Brink of Progress[1]

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% less in 1999 than they had been 25 years earlier.

Zambia is now one of the poorest countries in the world, ranked 164 out of 182 countries on the UN's human development index (*Human Development Report* 2009). 59% of Zambians were estimated to live below the poverty line in 2006, down from 68% in 1996. The majority of these people live in rural areas in households headed by women[2] 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 thirty years.[3] HIV prevalence in Zambia is amongst the highest in the world – estimated at 14.3% in 2007.[4] 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.

---

[1] This paper is based on a visit by the author to Lusaka in February 2009, during which he interviewed a number of international donors, government officials, economists and civil society organizations. The original (March 2009) paper was updated with a series of phone interviews with Zambian-based experts in November 2009.

[2] Central Statistics Office (CSO) report, Nov 2007, p.22, http://www.zamstats.gov.zm/

[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

Of late, however, Zambia's fortunes seemed to be improving. From 2003-2008, the economy grew at an average of over 5%, driven by a policy environment conducive to new foreign investment, strong macro-economic management and low(er) inflation, 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. 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 went 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. However, contagion spread through other channels, notably trade and Zambia's heavy reliance on copper exports.

As recently as October 2008, the Economist Intelligence Unit was predicting 2009 growth of 6%. Since then, predictions for Zambia have largely followed the copper price, falling as the global crisis gripped the commodity markets and then rising as prices rebounded during 2009. The IMF is predicting 5.3% growth for 2009, which is itself considered conservative – the Central Statistical Office puts it at 6.3%.[6] This compares with 5.8% in 2008 and is well above the African average.

---

[5] Business Unusual: the Policy Implications for Zambia of the Global Economic Crisis, Economics Association of Zambia, January 2008, http://www.eaz.org.zm/downloads/

[6] CSO, The Monthly, Volume 80, November 2009

Copper

In international trade, Zambia is a one-product economy. Copper accounts for 70% to 80% 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, was traumatic. Equally unexpected has been the rebound, to $6,800 by December 2009. With the opening of what will be Africa's largest open cast copper mine at Lumwana in December 2008, mining output is expected to grow by 16% in 2009.[7] As a result, Zambia has got off relatively lightly from the global crisis.

Jobs**:** As some relatively high-cost mines suddenly became unprofitable, the most immediate social impact has been the loss of some 8,500 out of a total of some 30,000 mining[8] 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. With the rebound in mining, 1,500 of those jobs have now been regained.

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 a predicted $4.0bn in 2009. 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, before recovering to K4,600 by December 2009.

Tax**:** In terms of poverty, the most important aspect of copper mining is the extent to which it generates tax revenue that 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

---

[7] CSO, op. cit.

[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.

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 under-taxed sector and yet were, according to the Financial Times 'no harsher than standard rates worldwide'.[10] The new tax regime was expected to add an extra 9% 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.[11]

In January 2009, barely 9 months after their introduction, some of the key new tax measures were abolished as the downturn allowed the large, foreign owned copper companies to undertake what the Financial Times described as 'intense lobbying' of the government.[12] The government gave the following concessions to the companies:

- It scrapped the 'windfall tax', which fell due when copper prices exceeded $5,500 per tonne. 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% 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% of gross value, and a variable levy on profits. The

[10] Financial Times 27 January 2009

[11] Dr Situmbeko Musokotwane (Finance Minister), Budget Address, 30 January 2009

[12] Financial Times 27 January 2009

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 Zambia 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.'[13] 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!'[14]

By August 2009, the price of copper had already rebounded to the level where it would have triggered the windfall tax. According to a calculation by a locally based economist, just in the remaining 5 months of 2009, that would have generated approximately $50m in revenue, enough to expand the national health budget by 14%.

Since it is widely accepted that from the point of view of investor confidence, the only thing worse than changing the tax regime is changing it over and over again, there will be considerable resistance in the next few years to a third change (reintroducing the windfall tax), although it may become an issue in the 2011 elections.

Government Finances

Prior to the crisis, a combination of debt relief and increased mining taxes had already increased the 'fiscal space' available to the government by some 4% of GDP between 2004 and 2007. That means that the government potentially had up to an extra 4% of GDP to spend on schools, hospitals or infrastructure. Moreover, the government was anticipating a trebling in mining taxes to 4.6% of GDP in 2009, thanks to the windfall tax and other measures. With the reversal of the tax reforms, that has fallen to 1% of GDP in 2009 with no increase anticipated

---

[13] Author interview, February 2009

[14] Author interview, February 2009

before 2012. Zambia is giving away its most precious resource at bargain basement rates, starving the government of the resources it needs to improve social spending or invest in the wider economy.

Other factors have also hit government revenue. The depreciation of the Kwacha made imports more expensive and led to a slump in consumption of goods such as cars, hitting import tax revenues. The growing use of tax exemptions is also severely undermining the revenue base. Overall, Zambia's fiscal deficit will increase to 3% of GDP in 2009, compared with an initial projection of 1.8%, while the tax take has fallen from 19.2% of GDP in 2000 to a projected 15.0% in 2009, a worrying decline. Reversing this decline – removing exemptions, improving the collection of existing taxes, and eventually reintroducing a more sensible level of mining taxation, is seen by a range of donors, international institutions and economists as the main challenge facing the government in the medium term.

One major impact of the crisis on government finances was the IMF's decision to issue a new quota of 'special drawing rights' to its members. This global equivalent of 'quantitative easing' disproportionately benefited Zambia, since its SDR quota reflects the days after independence, when it accounted for a much larger proportion of Africa's economy. As a result, the government received a windfall of $630m from the SDR allocation, greatly improving its reserve position. One international aid official commented 'The IMF has transformed into Father Christmas overnight. It's surreal, mind boggling. Zambia was always held up as how to have an awful relationship with the IMF. In the press, the Fund is now the most popular institution around.'

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.'[15] 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 FDI falling from $1,324m in 2007 to $939m in 2008, and portfolio investment recording a $6m outflow in 2008 compared with an inflow of $42m in 2007.[16] Both trends looked likely to accelerate in 2009.

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, has led to a 15% fall in tourism income in 2009.[17]

Agriculture: New investments in the sugar sector, along with good rains producing a bumper maize harvest in 2009, helped agricultural output grow at a predicted 12% in 2009,[18] up from 1.9% in 2008. Opinions differ on whether the government's use of fertiliser subsidies contributed to this performance.

***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). The crisis has not led to a major change in aid budgets for Zambia.

---

[15] Business Unusual, op. cit.

[16] 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

[17] Government of Zambia, 2010 Budget Speech

[18] CSO, op. cit.

Possible Silver Linings: non traditional exports and fuel prices

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, although these are now rising again, along with other commodity prices.

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.'

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 official.[19] '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.' A conversation with one senior government official bears him out – his main concern over the currency depreciation was the escalating cost for Zambians who send their children overseas to university!

The government's record on social spending is indeed mixed. On the positive side, total health spending has almost doubled in the last 6 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. A corruption scandal in the health ministry also led several donors to suspend disbursements in 2009, although that

---

[19] Author interview, February 2009

seemed to have been resolved at the time of writing (December 2009).

The record on social protection (SP)is more disappointing. According to the civil society umbrella coalition, CSPR Zambia, a 'national social cash transfer scheme targeting the poorest 10% of Zambians would cost only 1.1% of the total government budget in 2009.'[20] But despite considerable donor interest and funding for a series of pilot projects, which donors now plan to scale up following positive evaluations, one previous Minister of Finance portrayed SP as little more than 'handouts to lazy people' and like other African governments, preferred the language of wealth creation to that of poverty reduction. According to the Economics Association of Zambia, this 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.[21]

Happily, the current Minister of Finance seems better disposed to the idea of social protection, and donors hope that the evidence from successful pilot programmes in a number of districts will help persuade the government into a change of course on SP.

However, 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 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

[20] CSPR Zambia, 2009 Post-Budget Analysis, February 2009

[21] Armando Barrientos, presentation at Enabling Growth and Promoting Equity in Global Recession, ODI seminar, London, February 2009, http://www.odi.org.uk/events/

more difficult option for low-income country governments than for rich ones.

In the eyes of government, at least, 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.'[22]

Conclusion

A combination of rebounding copper prices, bountiful rains, and prompt action by the international community through the issue of SDRs has meant that Zambia has got off lightly from the global crisis. Instead, the biggest casualty of the crisis has been the country's future. In the words of one locally-based economist:

'Two years ago, Zambia was expecting finally to get a bonanza from the mining tax. It had never previously had that revenue. What has changed is that that expectation has evaporated, but there haven't been any real cuts. It's much easier to lose something you've never had than to have it and then lose it. And the vast majority of the population never expected to see the benefit of that tax anyway.'

The evaporation of the windfall tax has pushed the country back to square one, setting back Zambia's hope of generating enough domestic resources to develop the country and its people while reducing its dependence on aid. In the words of Oxfam country director Ann Witteveen, 'this country was poised to take a huge step forwards and now that's been taken away. A lost opportunity is not as newsworthy as X million people losing their jobs, but it's still desperately sad.'

---

[22] Author interview, February 2009

This paper was written by Duncan Green.

For further information on the issues raised in this paper please e-mail advocacy@oxfaminternational.org.

The information in this publication is correct at the time of going to press.

www.oxfam.org

Oxfam International is a confederation of fourteen organizations working together in more than 100 countries to find lasting solutions to poverty and injustice: Oxfam America (www.oxfamamerica.org), Oxfam Australia (www.oxfam.org.au), Oxfam-in-Belgium (www.oxfamsol.be), Oxfam Canada (www.oxfam.ca), Oxfam France - Agir ici (www.oxfamfrance.org), Oxfam Germany (www.oxfam.de), Oxfam GB (www.oxfam.org.uk), Oxfam Hong Kong (www.oxfam.org.hk), Intermon Oxfam (www.intermonoxfam.org), Oxfam Ireland (www.oxfamireland.org), Oxfam Mexico (www.oxfammexico.org), Oxfam New Zealand (www.oxfam.org.nz), Oxfam Novib (www.oxfamnovib.nl), Oxfam Quebec (www.oxfam.qc.ca)

The following organizations are currently observer members of Oxfam International, working towards full affiliation:

Oxfam India (www.oxfamindia.org)
Oxfam Japan (www.oxfam.jp)

The following organization is linked to Oxfam International:

Oxfam International and Ucodep Campaign Office (Italy)
Email: ucodep-oi@oxfaminternational.org

Please write to any of the agencies for further information, or visit www.oxfam.org.
Email: advocacy@oxfaminternational.org