

**FIRST REPORT OF THE COMMITTEE ON ECONOMIC AFFAIRS AND LABOUR
FOR THE FOURTH SESSION OF THE TENTH NATIONAL ASSEMBLY
APPOINTED ON THURSDAY, 24TH SEPTEMBER 2009**

Consisting of:

Mr C W Kakoma, MP, (Chairperson); Mr G W Mpombo, MP; Mr J K Zulu, MP; Ms E M Imbwae, MP; Mr C Mulenga, MP; Mr F R Tembo, MP; Mr S Katuka, MP and Mr W C Simuusa, MP.

The Honourable Mr Speaker
National Assembly
Parliament Buildings
LUSAKA

Sir, following the guidance that your Committee should table the Report of the previous Committee for the Third Session of the Tenth National Assembly, your Committee studied in detail the Report of your previous Committee on Friday, 16th October, 2009, adopted the Report.

Your Committee Mr Speaker, Sir, have the honour to present the Report.

**C W Kakoma, MP
CHAIRPERSON**

**September 2009
LUSAKA**

REPORT OF THE COMMITTEE ON ECONOMIC AFFAIRS AND LABOUR FOR THE THIRD SESSION OF THE TENTH NATIONAL ASSEMBLY APPOINTED ON 21ST JANUARY 2009

Consisting of:

Mr C W Kakoma, MP, (Chairperson); Mr G Lubinda, MP; Mr D M Syakalima, MP; Ms E M Imbwae, MP; Mr C Mulenga, MP; Mr C L Milupi, MP; Dr K Kalumba, MP and Mr F R Tembo, MP.

The Honourable Mr Speaker
National Assembly
Parliament Buildings
LUSAKA

Sir,

Your Committee have the honour to present their Report for 2009.

Functions of the Committee

2. In addition to any other duties conferred upon them by the Hon. Mr Speaker, or any other order of the House, the functions of your Committee are as follows:

- a) to study, report and make recommendations to Government through the House on the mandate, management and operations of Government ministries, departments and/or agencies under their portfolio;
- b) to carry out detailed scrutiny of certain activities being undertaken by Government ministries, departments and/or agencies under their portfolio and make appropriate recommendations to the House for ultimate consideration by Government;
- c) to make, if considered necessary, recommendations to the Government on the need to review certain policies and/or certain existing legislation; and
- d) to consider any Bills that may be referred to them by the House.

Meetings of the Committee

3. Your Committee held fourteen meetings to consider submissions on the Impact of the Global Economic Crisis on Zambia's Economy and the operations and stability of financial markets in Zambia. Your Committee also considered the pricing of sugar in Zambia.

Format of the Report

4. Your Committee's report is divided into three parts. Part I outlines the impact of the global economic crisis while Part II highlights the pricing of sugar. Part III is the conclusion.

PART I

THE IMPACT OF THE GLOBAL ECONOMIC CRISIS ON ZAMBIA'S ECONOMY AND THE STABILITY AND OPERATIONS OF THE FINANCIAL MARKETS IN ZAMBIA.

5. From 2002, to the mid 2008, there had been a turn-around in Zambia's economic growth performance due to the effective implementation of good policies as well as a favourable world economic outlook. This was reflected in the positive growth rates in real GDP, low inflation, relative stability of the exchange rate and improved growth in the real sector. However, these positive economic gains were at the risk of being reversed due to the effect of the global financial crisis.

Your Committee resolved to study in detail the impact of the global economic crisis on Zambia's economy. Specifically, your Committee intended to achieve the following objectives:

- a) appreciate the operations and stability of the financial markets in Zambia;
- b) appreciate the impact of the economic downturn on the macroeconomic fundamentals;
- c) appreciate the impact of the economic downturn on the real sector of the economy;
- d) investigate strategies instituted by the Government to prevent, and mitigate the impact of the financial crisis in Zambia; and
- e) recommend to the Government measures to mitigate the impact of economic crisis.

In order to appreciate various views on the above subject, your Committee requested both written memoranda and oral submissions from the Ministries of Finance and National Planning (MoFNP); Commerce, Trade and Industry (MCTI); Labour and Social Security (MLSS); Energy and Water Development (MEWD); and Mines and Minerals Development (MMMD).

In addition, your Committee received submissions from the Bank of Zambia (BOZ); the Zambia Development Agency (ZDA); Zambia Revenue Authority (ZRA); Lusaka Stock Exchange (LuSE); National Council for Construction (NCC); Energy Regulation Board (ERB); Zambia Electricity Supply Corporation (Zesco); and the Zambia Tourism Board (ZTB).

Other witnesses were the Zambia Association of Chambers of Commerce and Industry (ZACCI); Zambia Association of Manufacturers (ZAM), the World Bank Group (WBG); Bankers Association of Zambia (BAZ); the Hotels and Catering Association of Zambia (HCAZ); Lafarge Zambia Limited; Copperbelt University (CBU); Caritas Zambia; Jesuit Centre for Theological Reflection (JCTR); and the Chamber of Mines of Zambia (CMZ).

The summary of their submissions is highlighted here below:

I). Balance of Payments Position

Your Committee were informed that as the global economic crisis unfolded during the fourth quarter of 2008, Zambia's exports fell by 24.6% to US \$909.8 million from the US \$1,206.7 million recorded in the third quarter. In the first quarter of 2009, export earnings declined by 27.1% to US \$663.3 million. Total export earnings thus declined by approximately 45% between the third quarter of 2008, and the first quarter of 2009, with

metal export earnings accounting for the bulk of this decline. This decline in earnings largely reflected declines in copper and cobalt prices rather than production, although cobalt production did decline sharply. However, Copper production rose from 141,734.4 metric tonnes in the third quarter of 2008, to 182,148.7 metric tonnes in the fourth quarter. In the first quarter of 2009, copper production fell to 167,185.4 metric tonnes, but this was still significantly higher than the 140,768 metric tonnes produced in the first quarter of 2008.

Copper prices on the London Metal Exchange declined from a monthly average of US\$ 7,610.4 per metric tonne in August 2008, to US\$ 3,065.6 per metric tonne in December 2008, before recovering to a monthly average of US\$ 3,749.8 per metric tonne at the end of March 2009 (Table 1 and 2). However, cobalt production fell from 1,235.5 metric tonnes in the third quarter of 2008, to 1,122.6 metric tonnes in the fourth quarter, and then posted a sharp drop to 586.9 metric tonnes in the first quarter of 2009.

Your Committee were further informed that the overall Balance of Payments (B.o.P) deficit widened to US \$177.6 million in the fourth quarter of 2008, from a deficit of US \$ 120.6 million recorded the previous quarter. However, during the first quarter of 2009, the overall balance of payments deficit narrowed to US \$148.2 million, as imports fell quite sharply and the improved copper prices boosted metal export earnings. The fall in imports reflected reduced economic activities and pessimism in the economic outlook of the country explained by the unfolding recession. This was reflected in the decline in productive inputs such as petroleum products, chemical products, plastic and rubber products, iron and steel products, industrial boilers and equipment, electrical machinery and vehicles in the first quarter of 2009.

Table 1: Balance of Payments, 2008 Q1 – 2009 Q1 [US \$ millions, f.o.b]

	2008				2009
	Q1	Q2	Q3	Q4	Q1
Current Account	52.0	81.6	-653.0	-530.5	-227.8
Balance on goods	421.1	235.8	-183.9	-71.2	-10.4
Exports, f.o.b	1,318.6	1,441.8	1,206.7	909.8	663.3
Metal sector	1,147.2	1,216.2	925.6	711.7	524.2
Copper	1,035.5	1,126.1	856.2	666.4	513.4
Cobalt	111.7	90.1	69.4	45.3	10.7
Non-traditional	171.4	225.6	281.1	198.1	139.1
Imports, f.o.b	-913.2	-1,225.9	-1,416.3	-999.9	-688.6
Metal sector	-368.5	-407.0	-291.5	-313.5	-231.2
Non-metal sector	-544.7	-818.9	-1,124.8	-686.4	-457.4
Goods Procured in ports by carrier	6.9	6.8	13.5	10.2	7.3
Non-monetary Gold	8.8	13.0	12.2	8.6	7.6
Services (net)	-130.4	-153.5	-189.2	-145.1	-83.0
Services Receipts	69.4	80.8	75.6	71.3	72.0
Services Payments	-199.8	-234.2	-264.8	-216.3	-155.0
Income (net)	-198.2	-232.3	-247.5		
Income Receipts	-353.7	-347.4	-347.4	-350.0	-203.3
Income Payments	7.4	8.2	8.9	5.1	7.8

O/W: Income on Equity Payments	-336.3	-336.3	-336.3	-336.3	-192.0
Current Transfers (net)	115.0	346.8	67.5	35.7	68.9
Private	-7.4	265.2	-7.2	-11.7	-29.3
Official	122.4	81.4	74.7	47.4	98.2
Commodity, SWAP & Global Fund	18.9	51.7	36.8	42.6	18.5
Budget Grants	103.5	29.8	37.9	4.8	79.7
Capital and Financial Account	112.8	64.5	532.3	308.0	56.5
Capital Account	49.2	43.7	68.5	68.5	48.8
Capital Transfers	49.2	43.7	68.5	68.5	48.8
General Government	49.2	43.7	68.5	68.5	48.8
Project Assistance grants	49.2	43.7	68.5	68.5	48.8
Financial Account	63.5	20.8	463.7	239.5	7.7
Direct Investment	234.7	234.7	234.7	234.7	102.4
In reporting economy	234.7	234.7	234.7	234.7	102.4
Portfolio Investment	19.7	-18.6	23.7	-30.9	-171.5
Liabilities	19.7	-18.6	23.7	-30.9	-6.1
Other Investment	-190.8	-195.3	205.4	35.7	76.8
Assets	-278.4	-253.5	94.9	-35.1	39.2
Increase in NFA - banks(-)	80.4	29.7	111.1	-78.5	3.4
Other Short term Deposits	-358.8	-283.2	-16.2	43.2	35.9
Liabilities	87.6	58.2	110.5	70.8	37.5
Government	42.3	12.9	2.4	9.8	15.4
Disbursement of Loans	51.5	19.8	19.8	19.8	22.6
Project	19.8	19.8	19.8	19.8	11.8
Budget	31.8	0.0	0.0	0.0	11.0
Amortization of loans(-)	-9.2	-6.8	-17.3	-10.0	-7.0
Private Foreign Borrowing (net)	45.3	45.3	108.1	61.1	22.0
Errors and Omissions	0.0	0.0	0.0	45.0	23.2
Overall balance	164.8	146.1	-120.6	-177.6	-148.2
Financing of Overall balances	-164.8	-146.1	120.6	177.6	148.2

Table 2: Finished Copper and Cobalt Production, Q1 2007 – Q1 2009

	Copper		Cobalt	
	Production (mt)	Change (%)	Production (mt)	Change (%)
Q1 2007	114,912.7	0.6	906.5	-27.4
Q2	124,926.2	8.7	1,281.7	41.4
Q3	141,068.3	12.9	1,444.2	12.7
Q4	141,076.9	0.01	1,252.9	-13.2
2007 Total	521,984.1	5.0	4,885.4	0.3
Q1 2008	138,921.8	-1.5	1,144.5	-8.7
Q2	147,828.3	6.4	1,086.0	-5.1
Q3	141,734.4	-4.1	1,296.5	19.4

Q4	182,148.7	28.5	1,090.0	15.9
2008 Total	610,633.20	29.3	4,617.00	21.5
Q1 2009	167,185.4	-8.2	600.3	-44.9

II). Exchange Rate

Your Committee were informed that between the end of the third quarter of 2008, and the first quarter of 2009, the exchange rate of the Kwacha against major currencies depreciated significantly. Between September 2008, and March 2009, the Kwacha lost 39.8% against the US dollar to settle at a monthly average of K5, 568.43/US\$ while it fell by 6.0% against the UK pound to an average of K7, 931.57/£. Against the Euro and the South African Rand, the Kwacha lost 31.1% and 8.2% to averages of K7, 286.52/€ and K562.98/ZAR, respectively.

The sharp depreciation of the local currency was as a result of increased risk aversion to emerging and developing economies' financial assets. In the Zambian case, this was reflected in reduced participation by foreign investors in domestic investment instruments, leading to significant foreign exchange outflows. In this regard, the supply of foreign exchange by foreign portfolio investors for the purchase of Kwacha denominated financial assets, such as Government securities and domestic company equities, had significantly declined. These outflows of foreign exchange, attributable to foreign investor activities exerted pressure on the exchange rate of the Kwacha against major foreign currencies, resulting in notable weakening of the local currency.

It was explained further, that the decline in copper prices and the resultant fall in the supply of foreign exchange to the market by the mining sector contributed to increased pressures on the exchange rate of the Kwacha against major currencies to depreciate leading to the overall deterioration in the balance of payments position. Amidst these developments, adverse expectations of a depreciating Kwacha produced increasingly speculative trading with an increase in dollarisation of domestic transactions and the panic buying of foreign exchange. These factors contributed to the increased volatility witnessed in the exchange rate.

III). Employment

Regarding employment levels, your Committee were informed that there was no comprehensive data available on the impact of the global financial crisis. However, preliminary data from the Ministry of Labour and Social Security suggested that the mining and tourism sectors lost 10,000 and 254 jobs respectively as a result of the crisis. The slowdown in the mining sector had a domino effect on the manufacturing and construction sectors, which supply goods and services to the mining sector. For the mining sector, which was Zambia's flagship industry and major income earner, the loss of 10,000 jobs meant that almost 60,000 people were affected based on the Jesuits Centre for Theological Reflection (JCTR) Basic Needs Basket for a family of six. In the Zambian culture where extended families were encouraged, 60,000 of the people affected was but a bare minimum.

IV). Inflation

On inflation, your Committee were informed that the impact of the global financial and economic crisis was likely to be transmitted, with a lag, through the exchange rate, as the

sharp depreciation in the exchange rate lead to higher prices of imported goods and services and also raised inflation expectations of business.

Overall annual inflation rose during the fourth quarter of 2008 from 13.2% in August, 2008 to 16.6% in December 2008 before falling to 13.1% in March 2009. These movements in overall inflation were largely driven by increases in food inflation. Annual food inflation rose from 16.3% in August 2008, to 20.5% in December 2008, before declining to 13.9% in March 2009. On the other hand, non-food inflation rose from 10.4% in August 2008, to 12.9% in December 2008, before declining marginally to 12.3% in March 2009.

It was further explained that during the second quarter of 2009, the downward inflation trend witnessed over the first quarter had been reversed with both food and non-food inflation trending upwards. This could partly be explained by the pass through effects of the depreciation in the exchange rate and the removal of subsidies on maize supplied by the Food Reserve Agency to millers. Inflation expectations were also adjusting upwards given the uncertainties in the prospects for the domestic economy as the global economic crisis unfolded. Overall inflation rose to 14.7% in May 2009, with food inflation rising to 16.1% and non-food inflation rising to 13.3%.

V). Interest Rates

Your Committee were informed that the global economic crisis had impacted on domestic interest rates mainly through its effects on the operations of the Government securities markets. This situation arose as a result of the withdrawal of foreign investors from participation in the Government bonds and Treasury bills which contributed to shortfalls in the advertised tenders for Government securities, pushing up interest rates.

Data from the Bank of Zambia indicated that after being relatively stable prior to September 2008, yield rates on Treasury Bills rose over the fourth quarter of 2008, and first quarter of 2009. Reflective of this trend was the 364-day Treasury bills which increased to 18.15% in March 2009, from 13.90% in August 2008. This was in response to the declining supply of funds to meet Government financing requirements through the securities market channel.

With the rise in the yield rate on Government securities, commercial banks had also adjusted their lending rates upwards with short-term and long-term lending rates reflecting the movements in Government Treasury bills and Government bonds. The foreign portfolio investors trading behaviour in the Government securities market had, therefore, not only adversely impacted on the Government securities yield rates, but also on domestic lending rates.

VI). Remittances from citizens abroad

Your Committee were informed that it was difficult to ascertain the impact of the global economic crisis on remittances because of limited data available. However, the adverse change in the inflow of remittances by Zambians working abroad as a result of the global financial crisis was unlikely to have a significant impact on the economy. This was because of the fact that migration out of Zambia was low. It was explained that there was need for more information and data on remittances.

VII). Capital Markets and the Stability of the Financial Sector

Your Committee were informed that Zambia's capital market had been adversely affected by the global economic crisis with the LuSE all share index falling by 54.7% between August, 2008, and March 2009, (excluding ZCCM-IH) and by 44.2%, when ZCCM-IH is included in the index. This dramatic drop in the LuSE all share index reflected the withdrawal of foreign portfolio investors from Zambia's equities as evidenced by the negative foreign portfolio inflows in the capital market. Share price declined in almost all the equities trading at the LuSE. Consequent to share price declines, LuSE's market capitalisation in Kwacha terms had declined by 27.9% to K19.4 billion in February, 2009, from K24.8 billion at end September, 2008.

Despite the decline in volumes transacted, turnover increased over the period. Between 2006 and 2007, foreign investor participation boosted the market from US\$7,961,764 and US\$12,524,927 respectively. In 2008, however, the net position was (US\$5,667,556). This meant that more foreigners sold their shares and exited the market at very low prices in order to salvage their investment.

Zambia's financial system, dominated by the banking system, remained fairly stable. This was largely due to banks being adequately capitalised and the fact that Zambian banks were not exposed to toxic assets unlike their western counterparts. The adequate capitalisation of the Zambian banks had been confirmed by the recent Financial Sector Assessment Programme that was undertaken jointly by the International Monetary Fund and the World Bank in November 2008. However, the adverse effects of the crisis in the mining sector had led to a rise in non-performing loans as firms and households lost contracts or employment and were unable to remain current on their loan repayments.

Your Committee were informed that the Bank of Zambia was aware of the risks posed to the financial sector by deteriorating corporate and household balance sheets and had stepped up its supervisory activities of the key financial sector institutions. In this regard, changes made in strengthening the regulatory framework for the financial sector in the recent past had strengthened the ability of the Bank of Zambia to meet any financial shocks. These changes included the following:

- a) increasing the capital base of commercial banks;
- b) improving the regulatory framework by incorporating non-bank financial institutions into supervisory ambit of the Central Bank;
- c) introducing risk based supervision; and
- d) adopting a more comprehensive plan for the financial sector through the implementation of the Financial Sector Development Plan (FSDP).

VIII). Monetary Policy and the Global Financial and Economic Crisis

Your Committee were informed that the broad monetary policy response to the global financial and economic crisis was addressing the challenges presented in the foreign exchange market with sharp increases in exchange rate volatility as well as to meet the increased demand for both foreign exchange and Kwacha liquidity. During the fourth quarter of 2008, the Bank of Zambia effectively rebalanced its monetary policy instruments by placing greater weight on foreign exchange sales to the market to dampen down volatility in the exchange rate and address the increased demand in the foreign exchange market. In the fourth quarter of 2008, the Bank of Zambia made net sales of US \$127.6

million to the market, whilst in the first quarter of 2009, net sales increased to US \$ 208.5 million.

The Bank of Zambia, in March 2009, issued directives to commercial banks in which lending to off-shore institutions or placing of funds with them by local banks or providing other sources of Kwacha funding was restricted to over a year. Contravening the directives was deemed to be an unsafe and unsound banking practice. The measures were aimed at strengthening the regulatory framework governing the financial and capital markets, in light of the global challenges. Despite these measures, the Bank of Zambia continued to monitor the developments in the financial sector.

IX). Impact of the Global Economic Crisis on the Real Sector

a) Mining

Your Committee were informed that the effects of the crisis had progressively spread beyond the financial sector to hurt the real sector. Zambia experienced the effects of the crisis on the real sector towards the end of 2008, which worsened towards the beginning of 2009. The mining sector was at the centre of the impact and this was explained through its linkages with other sectors such as manufacturing and construction.

Your Committee were further informed that Konkola Copper Mines (KCM) Plc and Mopani Copper Mines (MCM) Plc had downsized their output and, therefore, capacity, citing rising operational costs due to the falling copper price on the international market. Worse still, some notable mines had since closed, including Chambishi Metals, Bwana Mkubwa Mines, and Nkana Smelter, whilst Luanshya Copper Mines was placed under care and maintenance. This had resulted in severe job losses in the mining sector. It was estimated that about 10,000 jobs had so far been lost in the mining sector as a result of the global financial crisis.

b) Agriculture

Your Committee were informed that the agricultural sector in, 2008, performed unsatisfactorily and generally contracted by 4 percent. The impact of the financial crisis on the agricultural sector had been mainly through fluctuations in the exchange rate. The excessive depreciation of the Kwacha led to an increase in the prices of inputs and significantly exposed farmers who had incurred foreign currency denominated debts.

In addition, the global financial slowdown also dampened the demand for floricultural exports in Europe while that of horticultural exports remained fairly stable. It was anticipated that owing to the favourable weather patterns in the 2008/2009 season, crop and food production were likely to be well-above average and, as such, food inflation should remain fairly stable.

c) Construction

Your Committee were informed that the construction sector was adversely affected as was usually the case when economic activity slowed down. However, proposed spending on infrastructure announced in the 2009 budget was expected to cushion the impact. Lafarge, which was the major stakeholder in the construction sector, had been affected by the economic slow down through reduced demand for cement.

The reduction in the demand for cement would be an even bigger challenge for Lafarge Company because it recently commissioned a new plant, which was partly funded through debt financing. The depreciation of the local currency had adversely impacted on the company. Historically, 85% of the turnover was in local currency, yet a significant portion of the expenses remain in foreign currency. The single biggest cost element in foreign currency was coal, which was mostly sourced from Zimbabwe. Gypsum, bauxite and spare parts were other inputs which were purchased in foreign currency. Historically, gypsum had been supplied from Chambishi Metals Plc which had suspended operations. This had prompted the importation of the raw material.

d) Manufacturing

Your Committee were informed that the effect of the crisis on manufacturing in Zambia had been twofold:

Firstly, due to the depreciation of the Kwacha, Zambia's exports had become competitive. This was the case with non-traditional exports (NTEs).

Secondly, the depreciation of the Kwacha had made it expensive for local manufacturers to invest in new machinery. This was because Zambia imports most of its manufacturing equipment, and these were costly as a result of the depreciation of the Kwacha. Thus, most manufacturers had been forced to postpone their expansion programmes.

It was explained that the impact on the importers outweighed the benefits that accrued to the exporters because the export base in Zambia was narrow. Further, it was explained that the manufacturing sector was experiencing high costs of repayment for loans that were denominated in foreign currency. This situation had placed these companies at high risk of going under as they could not meet their obligations.

Apart from reduced orders, manufacturers complained of unreasonable requests by the mines for discounts on their products as well as delaying in payments for their supplies. Apart from reduced demand from the mines, consumer demand for products had significantly gone down as well. The retrenchments in the mining sector and other industries had negatively impacted on consumer spending due to reduced disposable incomes.

e) Tourism

Your Committee were informed that the other sector that was adversely affected was tourism. Regrettably, there was inadequate statistics to demonstrate the impact. The industry had recently seen its better days and was flourishing steadily for two reasons. First, the success in the mining sector and the general stable economic outlook stimulated much interest in foreign nationals to visit Zambia. Second, the country seemed to have benefited significantly from Zimbabwe's political and economic turmoil. Whereas, in the past Zimbabwe received more tourists than Zambia, the situation changed after the year 2000 post land policy institutionalisation era.

In order to accommodate the influx of tourists, several lodges and hotels had sprung up predominately in Livingstone and Lusaka and recently in Solwezi and surrounding areas. In terms of accommodation in guest houses, lodges and hotels, occupancy rates were nearly 100 percent which led to employment creation and increased foreign exchange earnings.

However, with the financial crisis being experienced by developed countries, the situation changed. The sector recorded employment loses and it was estimated that accommodation occupancy declined by about 20 percent.

f) Energy

Your Committee were informed that the impact of the crisis on the energy sector was divided into the electricity and petroleum sub-sectors.

Regarding the electricity sub-sector, your Committee were informed that the sector was made up of five licensed companies, namely: ZESCO Ltd, the vertically integrated Company that was involved in generation, transmission, distribution and supply of power; the Copperbelt Energy Corporation Plc (CEC), a transmission company that buys all its power from ZESCO for onward sale to the mines on the Copperbelt and to the frontier mine in Congo DR; and Lunsemfwa Hydro Power Company (LHPC), an independent generation company that sells all its power to ZESCO except for two small mines it supplies in Kabwe. In addition, two new companies were recently licensed, namely, Zengamina Hydro Power Company (ZHPC), a mini hydro company situated in North-Western Province commissioned in 2007, and North-Western Energy Company Ltd (NEC), a distribution company also in North-Western Province which began operations in October, 2008.

In terms of the impact of the economic crisis on the electricity sector, your Committee were informed that the major impact was the rising costs caused by inflation, depreciating Kwacha and rising interest rates. This was further worsened by declining sales. The other challenge was the large number of miners who were laid off on the Copperbelt. Most of these miners were ZESCO customers, and it was anticipated that they would begin defaulting on their electricity bills.

It was explained that being the major player in the electricity sector, ZESCO's operational and financial performance had cascading effects on the industry as a whole affecting both its power suppliers like Lunsemfwa and its power off-takers like CEC. One big challenge the industry was facing was that ZESCO was grossly undercapitalized.

Concerning the Petroleum sub-sector, your Committee were informed that the petroleum products played a pivotal role in most industrial and mining processes in Zambia. Currently, Zambia procures all her petroleum product requirements from the international markets. The Government, through its agent, TAZAMA, was responsible for the importation of the petroleum feedstock, having taken over this responsibility from Total Outré Mer in July 2007. In December 2007, the Government entered into a long term supply arrangement with the Independent Petroleum Group (IPG) of Kuwait for the supply of up to 1.44 million tonnes of petroleum feedstock over a two year period. This contract was still in effect.

On the impact of the crisis, your Committee were informed that although the world prices for petroleum had fallen from a \$140 per barrel in mid 2008 to less than \$50 per barrel in early 2008, the procurement, transportation and processing costs of Petroleum feedstock had gone up as a result of depreciation of the Zambian Kwacha against major foreign currencies. There had also been a drop in the demand for petroleum products on the market.

X). Government Strategies to Mitigate the Impact of the Global Economic Crisis

Your Committee were informed that there was an emerging consensus internationally on some of the critical measures that small open economies like Zambia needed to take, if they were not only to weather the global economic crisis, but also to prosper after the crisis.

The following are the measures:

- a) maintaining macroeconomic stability;
- b) increasing or consolidating public and private sector investment in infrastructure that builds the long term productive capacity of the economy and helps to diversify the economic base;
- c) improving the business climate by lowering the cost of doing business; and
- d) harnessing regional markets as an alternative source of demand for exports as well as source of supply for goods and services, including energy.

In this regard, your Committee were informed that the response by the Government to the current global financial and economic crisis, reflected in the 2009 Budget Speech, was consistent with this emerging consensus. The thrust of the Budget was to focus on long term investment that leads to the diversification of Zambia's economy.

CONCERNS BY STAKEHOLDERS

6. The following were some of the concerns raised by the stakeholders regarding the impact of the global economic crisis:

a) Implementation

Most of the witnesses who appeared before your Committee affirmed that though the global economic crisis had adversely impacted the economy, some of the problems posed by the crisis were not new to Zambia. The country had been experiencing these problems before and the crisis had only compounded the situation. In this respect, stakeholders were concerned that despite numerous representations during the INDABA and the Zambia International Business Advisory Council (ZIBAC) meeting on issues affecting the economy, implementation had been a challenge. The issue of diversifying the economy was one such recommendation that had been raised in various fora but had not received the necessary attention. It was hoped that the global economic crisis would force the Government to begin implementing various recommendations.

b) High Cost of doing Business

A concern was raised regarding the high cost of doing business in Zambia. This problem was attributed to the high transport and telecommunication costs, poor infrastructure, high taxes, poor tax structure and cumbersome licensing procedures.

c) High Lending Rates

Another concern was raised that the cost of borrowing in Zambia was generally high. It was highlighted that the operational monetary policy instrument in Zambia was money supply and not interest rate. However, the lending rates were still very high despite Governments efforts to arrest the problem through such initiatives as the reduction of the

Reserve Requirement Ratio and Moral Suasion. It was evident that the economy was not responding to money supply as an instrument of managing interest rates. They viewed this problem as requiring a policy change from concentrating on money supply to targeting interest rates. They observed that some countries in Africa, including some developed countries, targeted interest rates in order to reduce it to acceptable levels.

d) Capital Flight

It was explained that currently Zambia had one of the most liberal financial markets in the region. This exerted pressure on foreign exchange reserves and encouraged speculation thereby threatening the stability of the Kwacha. This, in turn, posed a challenge in planning and implementing business projects. If adequate measures were put in place, the impact of the global economic crisis was not going to be as severe as it had been on Zambia's economy. It was the view of the stakeholders that income earned in Zambia should be banked in the country. This would make available the much needed foreign exchange for loans and to stabilise the exchange rate.

e) Dollarisation of the economy

The global financial crisis led to certain sections of the business community preferring to quote their prices in dollars. They were using the dollar to hedge themselves against the unstable exchange rate. This was not good for the economy because it encouraged speculation and further led to the depreciation of the Kwacha. In addition, this practice only benefited a small group of people.

f) Multifacility Economic Zones (MFEZ)

There was a general consensus among the stakeholders that the MFEZ, if properly implemented, would spur economic development. However, there were concerns about the suitability of the location for these Zones. Specifically, it was viewed that the MFEZ should be located in economically depressed areas such as Kabwe, Ndola and the rural areas. They argued that, if implemented, the move would decongest the urban areas and open the rural areas for development. Further, the US\$500,000 requirement to invest in the MFEZ was prohibitive for most of the local companies. It was, therefore, unlikely that the MFEZ was going to benefit the local people. Other stakeholders appealed for joint ventures between local and foreign investors. They argued that incentives provided for under the MFEZ, which were so generous, would only benefit foreigners, who would later relocate after recovering their investment.

g) Infrastructural Development

Several witnesses lamented the poor and inadequate road and railway infrastructure. They avowed that most of the areas in Zambia were inaccessible due to poor transport infrastructure making it difficult to attract development to those areas. They argued further that roads were being over burdened by heavy trucks carrying heavy industrial equipment and copper concentrates thereby causing destruction. The aviation industry was also viewed to be performing poorly with inadequate infrastructure at the Lusaka International Airport. They argued that with its central location, Zambia should have positioned itself as the communication hub of the region.

h) Austerity Measures

There was a concern that the Government had not taken austerity measures in order to save resources as a response to the global economic crisis. There was need for the government to introduce cost saving measures in the public sector to cut on wastage of public resources during depressed economic times. Some of the measures proposed were cutting down the size of the Government structure and making it relevant to the country's economic development needs.

i) Increase in electricity tariffs

The proposal to increase the electricity tariffs in the midst of the global economic crisis was a source of concern among many stakeholders. They argued that the move would impact adversely on the consumers. They were also against Zesco's emphasis on increasing tariffs without restructuring its cost structure. They argued that increasing the tariffs would only be used to meeting labour costs such as high salaries for management and a bloated work-force.

j) Licensing of Hotels and Lodges

Your Committee were informed that the functions of the Zambia Tourism Board had been streamlined to marketing only. Licensing of hotels and lodges, which was previously the preserve of the board, was moved to the Ministry of Tourism, Environment and Natural Resources. Regrettably, the Ministry had not been exercising this responsibility and this was of concern to many stakeholders. It was highlighted that most of the hotels and lodges were operating without licenses, thereby discouraging tourists who take up insurance before they travel. To obtain such insurance policies, an individual was required to show proof that they would stay in a licensed hotel or lodge. In addition, investors were also being discouraged because financiers required a licence as proof of business.

k) Zambia's Aviation Industry

Several witnesses were concerned about the media reports that aeroplanes registered in Zambia had been declared unsafe by the International Aviation Authority. This was giving a negative impression on Zambia as a tourism destination and, consequently, hurting the tourism sector.

l) Access to Banking Services

Your Committee were informed that competition in the financial sector was increasing and that it was robust and well managed. A concern was, however, raised that despite these positive developments, the majority of Zambians had limited access to banking services.

COMMITTEE'S OBSERVATIONS AND RECOMMENDATIONS

7. After careful consideration of submissions from various stakeholders, your Committee wish to make the following observations and recommendations:

i) Observations

Your Committee wish to make the following observations:

- a) the global economic crisis exposed challenges of Zambia's over dependency on the mining sector;
- b) dollarisation was taking place in Zambia, despite the Central Bank's appeal that all businesses should quote prices in Kwacha;
- c) most of the shares are held by foreign investors and, therefore, their sudden withdrawal of investment from the capital market has serious repercussions on investment and the economy in general;
- d) Zambia has one of the most liberal financial markets in the region. This encourages capital flight through wholesome externalisation of sales revenue thereby exerting pressure on foreign exchange reserves. It also encourages speculation which threatens the stability of the Kwacha;
- e) the business licensing procedure is cumbersome making Zambia an unattractive investment destination;
- f) despite representations to the Bank of Zambia by various stakeholders, including your Committee on Economic Affairs and Labour, for them to reduce the cost of borrowing, the interest rates are still very high. Your Committee are aware that the Bank of Zambia had been using money supply as the operational monetary policy instrument and that the same has not been effective;
- g) the decision to locate the MFEZ in Lusaka and Kitwe will concentrate development in the urban areas at the expense of the rural and other economically depressed areas. Further, your Committee envisage low participation by the local companies in the MFEZ because the US\$500,000 requirement to invest in the MFEZ is too high;
- h) the bulk of Zambia's export are still primary products;
- i) there is poor infrastructure in the transport sector;
- j) there is a serious problem of non-availability of employment data at the Central Statistical Office (CSO). In addition, in preparing the National Budget, the Ministry of Finance and National Planning does not include employment indicators to constitute economic targets in the National Budget as is the case with GDP and inflation; and
- k) ZESCO, which is a major player in the energy sector, is in-efficient and undercapitalised due to poor management and a bloated management structure.

ii) Recommendations

In view of the above observations, your Committee wish to make the following recommendations:

- a) the Government should diversify the economy to include other sectors such as agriculture, tourism and manufacturing. A well diversified export base would ensure a sustainable foreign currency inflow that would help to stabilise the Kwacha against major currencies. In line with this, efforts should be made to explore regional markets since Zambia's domestic market is relatively small. Furthermore, your Committee urge the Government to promote diversification from mining copper and cobalt to exploration of other minerals such as oil, uranium, industrial and precious metals;
- b) the Ministry of Finance and National Planning should issue a statutory instrument compelling all business players to quote their prices in Kwacha;
- c) the Government should promote the participation of local investors on the capital market. In addition, your Committee recommend that parastatals should be privatised

- through public floatation of shares. This will ensure that the economy remains resilient during depressed economic times;
- d) the Bank of Zambia should come up with a regulatory framework to curb the externalisation of all the earnings by investors;
 - e) the Zambia Development Agency (ZDA) should streamline the business licensing procedure so as to reduce the cost of doing business;
 - f) the Bank of Zambia should come up with workable measures to reduce lending rates, such as targeting interest rates, since the use of money supply as an operational policy instrument has not been effective;
 - g) the MFEZ should be located in economically depressed areas, such as rural areas, so as to open them for economic development. Further, the Government should encourage joint ventures between local and foreign investors operating in the MFEZ. Furthermore, the financial requirement for the local investors to participate in the MFEZ should be reduced to a reasonable amount;
 - h) the Government should put in place policies that will encourage value addition. This will not only enhance Zambia's export volume but also increase the value of exports and increase job opportunities;
 - i) the Government should embark on a robust infrastructural development which should include construction of roads, railway transport and turn the Lusaka, Ndola and Livingstone International Airports to world class airports, and turn Zambia into the communication hub of the region;
 - j) there is need for the Ministry of Finance and National Planning, through the Central Statistical Office (CSO), to improve data collection in general and, in particular, data on employment. In addition, in preparing the National Budget, the Ministry should include employment as an economic target; and
 - k) ZESCO must be restructured by unbundling it into generation, supply and distribution components to run as separate entities. Unbundling ZESCO will make it more efficient and responsive to the current challenges in the sector. This will address the inefficiency that exists in ZESCO. Your Committee also recommend a wage freeze on management salaries and allowances for ZESCO.

TOUR OF LIVINGSTONE

8. Your Committee under took tours to various tourist attractions and lodges in Livingstone. These places included Limbo Lodge, River Club, Water Front and the international airport. They also visited the National Heritage Commission. In addition, your Committee held discussions with the Livingstone Tourism Association and the Association of Tour Operators and Owners of Lodges. The objective of the tours was to ascertain what was happening on the ground regarding the impact of the global economic crisis on the tourism sector.

OBSERVATIONS AND RECOMMENDATIONS

9. Arising from the tours, your Committee wish to make the following observations and recommendations:

i) Observations

Your Committee wish to make the following observations:

- a) the road infrastructure in Livingstone is generally poor, making it unattractive for investment and tourists;
- b) the cost of jet A1 fuel is still high despite the removal of taxes and this discourages planes from landing and refuelling in Zambia. This is attributed to perceived monopoly behaviour by some players on the market ;
- c) the Zambia Tourism Board is poorly funded and, as such, is unable to effectively market tourism in Zambia; and
- d) the visa fees are prohibitive and, as such, foreign tourists are not willing to visit Zambia. In addition, the system where foreign tourists are required to pay visa fees each time they temporarily cross from Zambia to neighbouring countries is discouraging.

ii) Recommendations

Arising from the above observations, your Committee make the following recommendations:

- a) the Government should embark on a robust programme of constructing and rehabilitating of roads in the tourist capital so as to attract investment and tourists;
- b) the Government should increase the budget allocation to the Zambia Tourism Board (ZTB) for tourism marketing. The amount required by the Zambia Tourism Board to effectively implement their marketing strategy is K15 billion;
- c) the pricing of the jet A1 fuel must be reviewed and impediments of monopoly tendencies in the supply chain must be ironed out; and
- d) in view of the expected influx of tourists during the World Cup 2010 in South Africa, the Government should reduce visa fees paid by foreign tourists. Multiple visa entry should also be considered for tourists wishing to temporarily visit other tourist places in neighboring countries.

LUSAKA STOCK EXCHANGE (LUSE)

10. Your Committee undertook a tour to the Lusaka Stock Exchange (LuSE). The objective of the tour was to avail Members a chance to see the economic activities at the Lusaka Stock Exchange in the light of the global economic crisis.

It was explained that at the Lusaka Stock Exchange, the global economic problem was manifested through exiting of foreign investors from the bond and equities markets, falling prices of securities and an actual reduction in the quantum of trade, volumes and turnover. As developed markets collapsed, foreign investors on the LuSE sold their holdings in order to cover their positions back home.

The price movements had resulted in reduced market capitalization and, therefore, the values of shares held by investors. The events in the world economy were reflected through the participation of and trend behaviour of foreign investors in the Zambian market.

OBSERVATIONS AND RECOMMENDATIONS

11. Arising from the tour, your Committee wish to make the following observations and recommendations:

i) Observations

Your Committee make the following observations:

- a) the legal framework covering capital market activities in Zambia was not all encompassing. The market was quickly changing while legislation was lagging behind. For example, there is no legislation covering the Central Securities Depository. The absence of this law is a source of apprehension by international investors and erodes market confidence;
- b) the level of participation by the local people on the Lusaka Stock Exchange is still low; and
- c) the number of companies listed on the stock market is still small.

ii) Recommendations

In view of the above observations, your Committee make the following recommendations:

- a) the Government should bring to Parliament for amendment the *Securities and Exchange Act* to bring it in line with international best practices. The law, if amended, will provide for the regulation of the Central Securities Depositories (CSD) and enhance market efficiency, reduce the risks attached to transactions in securities by eliminating manual processes and establishing electronic clearing and settlement;
- b) campaign strategies to attract more people to participate on the Lusaka Stock Exchange must be scaled up; and
- c) the Government should privatize all parastatal companies through public floatation of shares on the Lusaka Stock Exchange. Further, mining companies should also be compelled to participate on the LuSE. Currently, there are eight quoted mining companies and listing these would increase the number of companies listed on the stock market and increase the visibility of LuSE on the world market as these companies are international companies. In addition, listing the mining companies would offer an opportunity for Zambians to have a stake in the running of the affairs of these companies.

PART II

THE PRICING OF SUGAR

12. There were various representations through the media that the price of sugar manufactured in Zambia was fetching more cheaply in the regional markets than was the case locally. In order to verify these assertions, your Committee resolved to undertake a study on the pricing of sugar in Zambia.

The objectives of the study were to:

- a) ascertain the pricing of sugar on the local market;
- b) ascertain the pricing of sugar in the regional markets; and
- c) make recommendations to the Government on the pricing of sugar in Zambia.

In order to appreciate the subject, your Committee requested both written memoranda and oral submissions from the Zambia Business Forum (ZBF), the Zambia Association of Chambers of Commerce and Industry (ZACCI), Kafue Sugar and the Zambia Sugar PLC.

The following is a summary of their submissions:

I). Local Market Pricing

Your Committee were informed that the local market was the mainstay of the sugar industry and the pricing was driven by the cost of production. The local market sugar price model provided rural and urban consumers with food security through available, accessible, affordable and good quality sugar, and it sustained a viable sugar industry by providing a reasonable return to stakeholders in the sugar value chain. Stakeholders include small scale sugar cane growers, packaging manufacturers, transporters, banks, distributors, agents, retailers and industrial sugar users such as bakers, confectioners and brewers.

It was explained that a delivered national price ensured that the price of sugar was stable and similar across the nation. The price of sugar included packaging and distribution costs which accounted for almost a quarter of the price. In addition, domestically consumed sugar attracted Value Added Tax (VAT) which increased the price of sugar by 16 percent.

It was further explained that sugar cane growing and processing required huge capital investments and that the sugar industry was a high fixed cost business. Furthermore, Zambia was a high cost economy such that small producers had costs which were in the region of 30% above those of Zambia Sugar. The price of sugar reflected the country's high local costs, compared to the region, including wages, electricity, cane payments, fuel, transport services and social costs, which had been increasing each year. The operations of both cane growing and sugar processing were to some extent financed by bank borrowing. The cost of borrowing in Zambia was very high, compared to what was obtaining in the region.

II). Export Market Pricing

Your Committee were informed that the DRC export price of household sugar from Nakambala was approximately US\$530 per ton ex-mill, equivalent to K3 million per ton. After transport and import taxes, the sugar landed in Lubumbashi at approximately US\$866 per ton. In most cases, after all local charges and margins were included, this sugar was retailed in the region of US\$920 per ton or K5, 200 per kg.

The Great Lakes Region export price of sugar from Nakambala was approximately US\$500 per ton ex-mill. After transport and import taxes, the sugar lands in Kigali at approximately US\$1, 153 per ton and was retailed in the region of US\$1, 200 per ton or K6, 840 per kg.

EU raw sugar prices paid to Zambia on a delivered basis range from Euro 497 to Euro 523 per ton, equivalent to a net price of about US\$600 to US\$630 per ton or an ex-factory price of K3, 600 per kg. This was a favourable price considering that exports attracted duty draw back.

Your Committee were informed that considerable benefits accrued to Zambia through considerable foreign exchange earnings and enhanced employment opportunities arising from growing sugar cane and processing it for export. Recently, Zambia Sugar received enquiries from Zimbabwe to purchase raw sugar at very competitive prices. This had been made possible because the sugar industry in Zambia had been managed in a sustainable manner in contrast to that of Zimbabwe.

III). World Market Pricing

Your Committee were informed that the world market price of sugar did not reflect the cost of production of sugar. The market for sugar only represented about 10% of world production and was essentially a dump market utilised by producers without access to preferential markets and who had a production surplus.

IV). Tour of Zambia Sugar Company

Your Committee undertook a tour to Zambia Sugar so as to appreciate the processes involved in the manufacture of sugar. In understanding the manufacturing process, Members were expected to appreciate the discrepancies, if any, in the pricing of sugar. The tour also availed the Members the opportunity to see the various social activities that the company was undertaking.

Your Committee were informed that Zambia Sugar was the largest sugar producer in Zambia based at Nakambala Estate in Mazabuka District. The Nakambala Estate had around 14 600 hectares. In addition, there was a massive residential infrastructure made up of 11 townships with around 3 000 housing units, five schools, a hospital and four clinics, and a population estimated at over 30 000.

The company grew sugar cane at Nakambala Estate, with approximately 44% of the cane being supplied by out-growers. Approximately a third of the sugar produced was sold on the local market for both industrial and domestic consumption and the balance was shared between the regional markets and the European Union under the Everything-But-Arms (EBA) regime.

Your Committee were informed that the company also manufactured a range of sugar based specialty products. Molasses, a by-product of the sugar milling operation, was also sold mainly as stock-feed into both local and regional markets. The company was considering the possibility of ethanol production and electricity generation. The company was the largest single agricultural entity in Zambia. Together with out-growers, Zambia Sugar employed in excess of 15,000 people around the country.

a) Nakambala Expansion Project

Your Committee toured the recently completed major expansion project which had increased the factory capacity to 450 000 tonnes of sugar per annum and cane area, by an

additional 10 500 hectares by the company and out-growers.

The agriculture expansion infrastructure was complete with a formidable infrastructure of dams, 32 kilometers of canals and pipelines, pump stations, road works and power reticulation. All expansion areas had been planted to centre pivot irrigation systems.

b) Corporate Social Responsibility (CSR)

Your Committee were informed that the strategic intent of Zambia Sugar was that the company should be appreciated in the communities where it operated. The company had a proactive and sustainable CSR programme that was acknowledged country wide. The CSR programme empowered the community by providing infrastructure and sustainable capacity building to enhance and improve access to education, medical and sporting services. The company's investment in the CSR over the years was in several billions of Kwacha.

On-going projects were in the form of direct assistance such as the sponsorship of major sporting events and major cultural and traditional ceremonies, donations to the disabled, the upgrading of facilities at district hospitals, police stations, orphanages, government and mission schools, sports and social clubs, the local radio station, drainage works in high density and disease prone compounds and assisting in maintaining some of the municipal roads.

Zambia Sugar was the backbone of the Mazabuka economy through the massive cane payments to out-growers such as Kaleya Smallholders. The revenues received by the out-growers drove the economic activity of Mazabuka district and had a positive economic influence in Southern Province.

c) Findings from the tour

Arising from their meetings with various stakeholders in the sugar industry and the subsequent tour of Zambia Sugar Plc, the following are the findings of your Committee:

- i) the local market was the mainstay of the sugar industry in Zambia and that the export was a residual market. They, therefore, appreciated the company's initiative to take advantage of the export market in order to earn foreign exchange and maximize capacity utilisation, thereby creating employment;
- ii) the price of sugar in Zambia was generally high because of the high cost of doing business. This was mainly as a result of high telecommunication and transport costs, high taxes, poor infrastructure and high cost of finance; and
- iii) there is no evidence to show that sugar produced in Zambia is cheaper in the regional markets than it is locally.

OBSERVATIONS AND RECOMMENDATIONS

13. Arising from the interaction with the witnesses on the pricing of sugar and the subsequent tour of the Zambia Sugar PLC, your Committee wish to make the following observations and recommendations:

i) Observations

Your Committee make the following observations:

- a) some remote places in Zambia are not accessing sugar;
- b) the price of sugar is generally high because Zambia is a high cost destination; and
- c) there is limited access to reasonable financing for small to medium sugar cane farmers.

ii) Recommendations

In view of the above observations, your Committee make the following recommendations:

- a. Zambia sugar should ensure that sugar is distributed to all places;
- b. the Government should work out measures to begin to reduce the cost of doing business in Zambia so that sugar can be affordable; and
- c. the Government, through the Central Bank, should ensure that small to medium sugar cane growers have access to credit for them to increase output.

CONCLUSION

14. Your Committee, Sir, concluded their deliberations within their terms of reference. They had invited a number of stakeholders from whom they gathered valuable information on the topical issues.

Your Committee are grateful to the stakeholders who appeared before them and acknowledge their full co-operation and support. Your Committee wish to record their indebtedness and gratitude to you, Mr Speaker, for affording them the opportunity to serve on this important Committee. They also thank the office of the Clerk of the National Assembly for the services rendered during the year.

They are hopeful that the observations and recommendations contained in this report will go a long way in improving matters relating to the economy of Zambia.

**C W Kakoma, MP
CHAIRPERSON**

**August, 2009
LUSAKA**